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Rising USD & Inflation Tide

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- **USD**: **'USD Smile' mechanics inflection from left- to right-side (USD rising on improving economic condition)** is being underpinned by impending taper and hardening rate hike bets advanced to mid-2022. **Volatile, uneven USD ascendancy** though amid commodity boost.

- **Majors**: Whereas, the **ECB's propensity to signal normalization to lag the Fed alongside option to supplement fading PEPP with extended APP** could dampen EUR. Even more stark Fed-BoJ policy divergence amid climbing UST yields likely to suppress JPY.

- **Oil/Gold**: **Oil's surge is fuelling inflation concerns**, spilling over as **stagflation worries.** But surge to $90-100 may be **alleviated as power crunch eases; contained as supply response (OPEC+, Shale) hit** further out. **Gold** to be **restrained by rising real rates** though.

- **AXJ***: A **rising USD, backed up resurgent UST yields** against a backdrop of **rising energy/commodities** suggests **compromised EM Asia FX**; at least up till broader recovery in H2 2022. **Oil**'s surge, consequent **C/A rebalancing**, **fiscal/debt overhang** and **tourism resumption to re-order AXJ**.

- **CNY**: Unabated **surge in CNY NEER** to 2018 highs reflects C/A boost from "pandemic demand" and suspended outbound Chinese tourism. But as these fade, **sustained CNY out-performance is less likely**. Nonetheless, **CNY stability tilted to buoyancy** is favoured **heading into the 20th NPC** in Nov 2022.

- **China regulatory, property sector risks however loom menacingly**. **KRW though may be more sensitive than CNY** despite boost from chips and BoK with rate hikes.

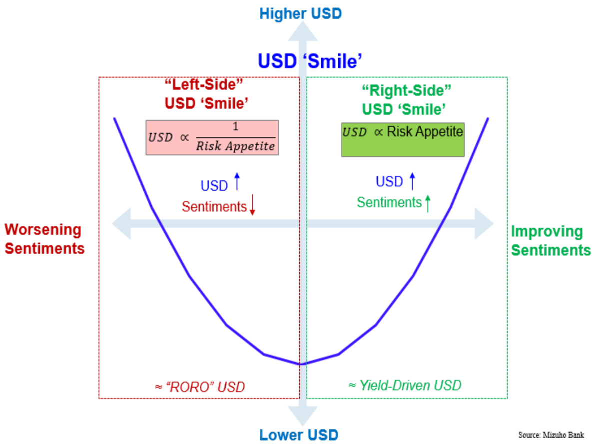
- **AUD** is set to be lifted by the **commodity tide rising to meet investment up-cycle; despite increasingly glaring RBA resistance to** (and divergence from growing global) **rate hikes dampening upside**. In contrast, **MAS' "ahead of the curve" slight slope reinstatement** will provide **limited boost to trade-weighted SGD given a rich S$NEER** and gradual slope.

- **Oil's ascendancy will instigate re-ordering in EM Asia FX**, with **INR and PHP most vulnerable**, although **IDR's usual vulnerability may be alleviated by coal exports**. While relegated for the time being, **THB may be set for out-performance** late-2022 **as and when the tourism multiplier** kicks in; especially if it coincides with returning Chinese tourists

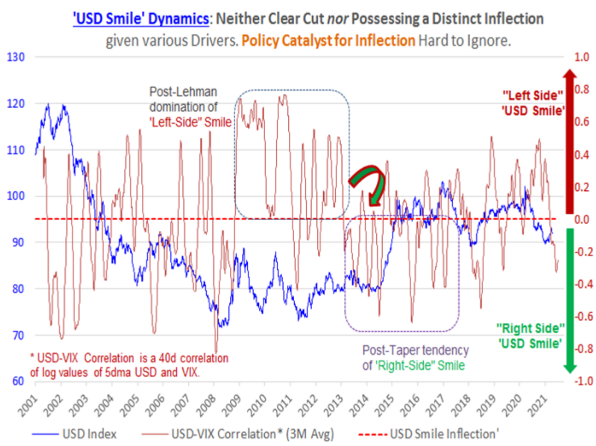
Currency Forecast Ranges

FX Forecasts	Dec 21	Mar 22	Jun 22	Sep 22	Dec 22
USD/JPY	109 - 115 (113)	111 - 116 (114)	111 - 116 (115)	111 - 117 (116)	112 - 118 (117)
EUR/USD	1.14 - 1.18 (1.15)	1.13 - 1.18 (1.14)	1.12 - 1.17 (1.13)	1.12 - 1.17 (1.13)	1.11 - 1.16 (1.13)
USD/CNY	6.24 - 6.83 (6.50)	6.35 - 6.80 (6.60)	6.26 - 6.75 (6.42)	6.18 - 6.63 (6.38)	6.13 - 6.58 (6.33)
USD/INR	74.0 - 80.1 (76.8)	72.7 - 77.8 (75.8)	72.4 - 76.3 (74.8)	71.1 - 76.9 (74.5)	70.3 - 76.0 (73.6)
USD/KRW	1150 - 1240 (1190)	1160 - 1250 (1200)	1150 - 1260 (1200)	1130 - 1230 (1178)	1100 - 1190 (1150)
USD/SGD	1.32 - 1.40 (1.36)	1.34 - 1.41 (1.37)	1.32 - 1.42 (1.35)	1.30 - 1.39 (1.34)	1.29 - 1.37 (1.33)
USD/IDR	13840 - 14920 (14200)	13980 - 15130 (14400)	14020 - 15300 (14450)	13890 - 15090 (14350)	13790 - 14990 (14250)
USD/MYR	3.91 - 4.34 (4.15)	4.02 - 4.40 (4.18)	3.91 - 4.30 (4.16)	3.97 - 4.30 (4.16)	3.93 - 4.24 (4.10)
USD/PHP	49.5 - 53.4 (51.2)	49.5 - 53.1 (51.5)	49.4 - 53.2 (51.6)	48.9 - 52.8 (51.2)	48.4 - 52.1 (50.5)
USD/THB	33.2 - 35.3 (33.9)	33.1 - 35.5 (34.0)	32.0 - 35.0 (33.8)	31.1 - 34.1 (33.0)	31.1 - 33.0 (32.0)
USD/VND	22600 - 23200 (22850)	22700 - 23200 (23000)	22800 - 23500 (23100)	22800 - 23300 (22950)	22700 - 23100 (22850)
AUD/USD	0.703 - 0.780 (0.750)	0.696 - 0.789 (0.730)	0.692 - 0.780 (0.746)	0.732 - 0.816 (0.772)	0.743 - 0.815 (0.778)

<u>Global FX: “Right” Inflection</u>



Source: Mizuho Bank



We stick with our conjecture that the **USD will by and large function in the right-half of the ‘USD Smile’**, consistent with the taper experience of 2013-14 (See Box 1 for a recap of ‘USD Smile’). What this means is that ***improving global growth outlook will more likely than not correspond to a stronger USD;*** at least through mid-2022 as **this is assumed to be correlated to, and therefore conflated with, the Fed’s propensity to tighten**. This is however a *prognostication of USD-mechanics,* specifically positive correlation, vis-à-vis sentiments, and *not a pronouncement of unfettered USD resurgence*. Instead, USD may be rendered bumpy by three (at least partly intertwined) factors.

<u>First</u>, is the **idea of unambiguously stronger US economic relative to its peers being challenged**. Largely (albeit not solely) **due to** the conspiracy of political brinksmanship and one-upmanship introducing **episodic dampening of US fiscal stimulus boost to growth**; which may be **distilled as**

"air pockets" for the USD. Second, **higher energy/commodity** prices **dampening USD** strength (given the antagonistic relationship) at the margin, although not dominating USD dynamics per se. Finally, the **interaction between higher inflation and yields driven by policy normalization bets**, *resulting in volatile two-way swings in real yields*. Which in turn is **likely to instigate two-way USD swings in sympathy with real yields** (barring "risk off" when USD thrives amid lower yields).

In concert, the stage is set for **USD to stumble into a volatile phase of consolidation with upside bias in the near-term** amid the cacophony of inflation risks, taper (and growing bets on 2022 rate hikes sooner) and decelerating recovery momentum. This may also be **highly uneven**, with *USD strength asserting more sharply against high-inflation, "twin deficits" EM currencies, whereas commodity currencies may retain traction*. **H1 2022**, could see **USD retaining the upper hand as mid-2022 rate hike bets** (taking over from taper) **supplant inflation** headwinds. But **broadening global recovery and convergence with Fed** may see **USD relent; conceding ground in H2 2022**.

We see this spanning over three phases, in terms of triggers

i) **Q4 2021**: **Heightened volatility in a generally elevated USD** as conflicting FX forces are juxtaposed. Inflation eroding real UST yields (thereby undermining USD) will inspire flashes of USD dips, but defer to Fed's hawkish bets (taper in November and rate hikes by mid-2022) and UST yields 2022. The inflation-policy cat-and-mouse not only ups volatility, but may also sharpen FX differentiation by high energy import dependence; and the corresponding inflation and "twin deficit" risks.

ii) **H1-2022: Firm, but peaking USD**. While taper boost to the USD finds follow-through from bets mounting on rate hikes brought forward to mid- from late-2022 (if not 2023) on one hand, broadening global recovery and peaking inflation may backstop EM FX. More so if China start to stabilize the economy ahead of the 20th Party Congress in November 2022 that will mark President Xi's consolidation of power.

iii) **H2 2022**: **Measured USD concessions**. With a greater degree of policy convergence with the Fed and widening global recovery helped by re-opening in EM Asia, USD could start to concede more ground generally; and gradually. China risks remain the curve ball.

EUR: The ECB's ability to infuse a dovish slant into the "taper" of PEPP speaks to the undertones of dovish bias in policy that is ostensibly consistent with an ECB that is inclined to follow, not front-run, the Fed on normalization proper. With the question of whether extended APP at least partly substitutes for PEPP fade still hanging, EUR bulls – that otherwise may be looking to exploit growth pick-up, inflation overshoot and the Current Account surplus – may remain relegated for now. We therefore see EUR inclined to be subdued below 1.15 rather than boldly breaking past 1.20 on a sustained basis.

JPY: Rising UST yields, more in sympathy with (rather than at odds with) inflation expectations is likely to keep USD/JPY fairly well-buoyed, with 110-116 ranges near-term likely being lifted to 112-118. Will JPY still retain its safe-haven status? Likely. That means bouts of "risk off" may trigger sudden and sharp USD/JKPY pullback testing lower limits below 110. But equally, JPY will not be the uncontested safe-haven. So that means the upside tendency of USD/JPY amid lagging recovery and undershooting inflation will suppress JPY more markedly. The Kishida Administration, while agitating on tax, is however unlikely to inspire USD/JPY turnaround given the weaker growth inferences.

Box 1: Spotting the 'USD Smile" Inflection

As **USD reaction to market sentiments gets harder to predict**, the elephant in the room is **whether 'USD Smile' mechanics is on the cusp of inflecting from "Left-Side"**, that is, ***rising*** (falling) ***on "bad news"*** ("good news"), **to 'Right-Side",** which corresponds to USD rising in tandem with improving sentiments. Trouble is, **determining an inflection is challenged** by **fluid** shifts between the two halves, **rather than being strictly confined to just one side of the 'USD Smile'**. Nonetheless, the **'USD Smile' is useful as a framework for determining the dominant influence** on USD; **between safe-haven "RORO"** ("risk on-risk off") moves, where USD moves inversely with yields, and **yield-driven USD-UST yield sympathy**.

'USD Smile' Paradigm: To be sure, the **'USD Smile'** proposition is a useful and more holistic framework to think about **wider mechanics of USD** as it **encompasses aspects of, but is not limited to**, "RORO" ("risk on-risk off") as well as yield-driven USD moves; two diametrically opposed mechanics (see "RORO"-Yield Spread Schematic overleaf). **"RORO" USD** moves are **premised on safe-haven** properties of the USD, which means a **stronger (weaker) USD corresponds to worsening (improving) sentiments**; and likely **lower (higher) UST yields**. This **is the exact opposite of yield-driven USD mechanics** whereby higher (lower) yield, alongside improving (deteriorating) sentiments, result in a stronger (weaker) USD. In reconciling the two mechanics, **'USD Smile' proposes a U-shaped USD reaction function**, with the **left half corresponding to "RORO"-like USD strength based on safe-have features** while the while the right-side of the 'USD Smile' squares with USD strength on rising yields in the context of improving sentiments/economic prospects

Pinning Down 'USD Smile': **Figuring out at which point of the 'USD Smile' curve current FX markets are functioning** is **useful** in anticipating FX market reactions to headline events and economic outcomes. But empirical evidence suggests that the 'USD Smile' is **not a rigid rule for the USD**, **but** rather a **fluid framework within which USD can operate** with a degree of discretion, **depending on circumstances**.

Ambidextrous & Ambiguous 'USD Smile' Realities: Specifically, correlations between USD moves and changes in risk sentiments (using S&P500 volatility index, VIX as a proxy) reveal that historically the **USD is far more ambidextrous**, **shifting quite easily between the "Left-Side" and the "Right-Side"** of the 'USD Smile' than a static application of the 'USD Smile' framework might lead one to believe. Moreover, and **more pertinently**, that the **'USD Smile' mechanics is currently more ambiguous** in, with **correlations suggesting no strong bias one way or another** (between "RORO" and yield-driven moves).

This is understandable given that on one hand an **exceptionally accommodative Fed**, with an unprecedented easing bias and paradigm shift to allow the economy to "run hot" alongside **lingering uncertainty amid virus-vaccine tensions suggest "RORO" type of USD mechanics** (**"Left-Side" of 'USD Smile'**) will dominate. Whereas on the other, **reflation** in the context of the **US leading the way out in global economic recovery** (helped by its vaccine rollout gains and fiscal stimulus) may predispose FX markets to **tilt the balance to yield-driven USD moves** (**"Right-Side of 'USD Smile'**). In turn, this suggests that how UST yields evolve in the context of the vaccine rollout and exceptional US fiscal stimulus ($1.9trln in COVID relief with US$3trln in infrastructure planned) and the Fed's reaction function to corresponding economic outcomes.

Fed Policy a Key Catalyst for 'USD Smile' Inflection: On that note, **rising UST yields**, especially if reinforced by rising real yields, is **arguably a key motivation for 'USD Smile' dynamics to shift to the "Right Side"**. But only inconclusively so. Instead, **experience suggests that Fed policy shift** *(e.g. 2013 "taper)* **shift tends to be a more decisive** catalyst **in entrenching a shift from "Left-Side" to "Right-Side" of 'USD Smile'**. With the **Fed bent on batting away suggestions of foreseeable normalization**, an **emphatic 'USD Smile' inflection eludes**. Meanwhile, amid **opposing factors favouring "Left-Side"** (Fed bias, uncertainty, etc.) **and "Right-Side"** (rising UST yields, US leading the recovery, etc.), **'USD Smile' dynamics are more likely to oscillate more easily between the two halves**.

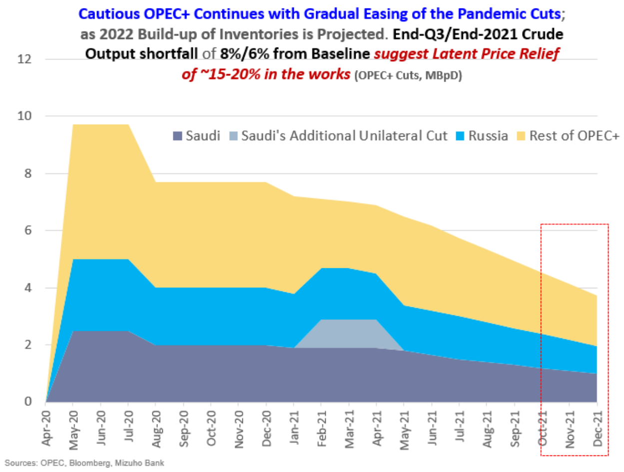
Oil: Crude Assumption of Stagflation Risks

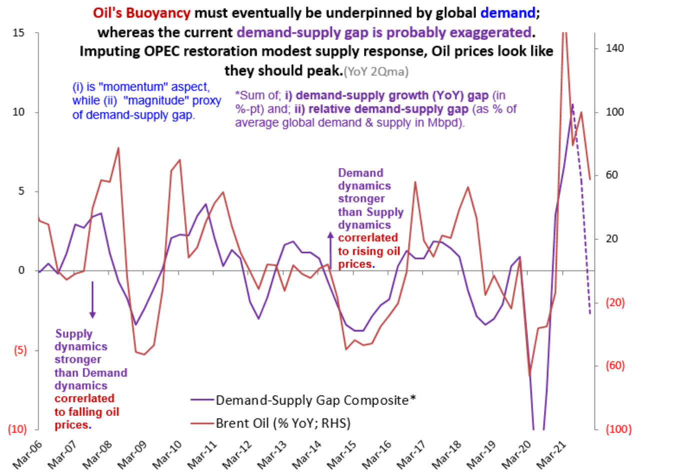
	Q3 2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	Q4 2022
Brent Oil	$64 - $81	$76 - $98	$78 - $94	$72 - $92	$70 - $87	$72 - $86
	$78.5	$88	$86	$82	$78	$79

Brent price surge past US$85/bbl is arguably **asserting stagflation fears** in some camps and undeniably **gaining policy prominence**; ***albeit as a tail risk rather than the overarching threat to monetary policy***. Accordingly, **oil's near-term bullish impulses**, exacerbated by the power crunch, **may relent to more stable consolidation that shrugs off crude assumptions of stagflation** risks.

And there are two key reasons why. First, *policy-dependent demand recovery*, which ought to regulate unbridled crude price (and related inflation) surge. **Insofar that demand is boosted by policy stimulus** *premised on "transitory" price pressures,* **policy response to excessive Oil upswing and attendant inflationary risks will arguably quell the most extreme Oil bulls**. Admittedly, post-pandemic (pent-up) demand resumption amid the current power crunch may dampen and delay demand-side price-cooling signals, but this mechanism is not broken altogether.

Second, *suppressed supply primed to respond* to resurgent crude. The most glaring of which is **OPEC+ supply cut** standing at nearly 8MBpD as at end-Q3; set to gradually decline to ~6MBpD by end-2021. This phased restoration **reveals part of the supply squeeze in price being self-inflicted, and set to fade**. ***Potentially sooner*** as pressure from US, India and other stakeholders could prompt output ramp-up sooner to alleviate the immediate crunch. Crucially, **non-OPEC+ response encouraged by these elevated prices** – led by Shale – alongside ***potential for drawdown on strategic reserves***.





As the current power crunch fades into end-2021, the **bigger picture is supply-demand re-balancing as supply response alongside smoother demand recovery tame the unbridled surge in crude prices**; consistent with some re-building of **crude inventories into 2022**. So, even after accounting for some upside testing triple digit Oil, we expect prices to mostly settle into the wider $70-$90 range.

Gold: Tug of War

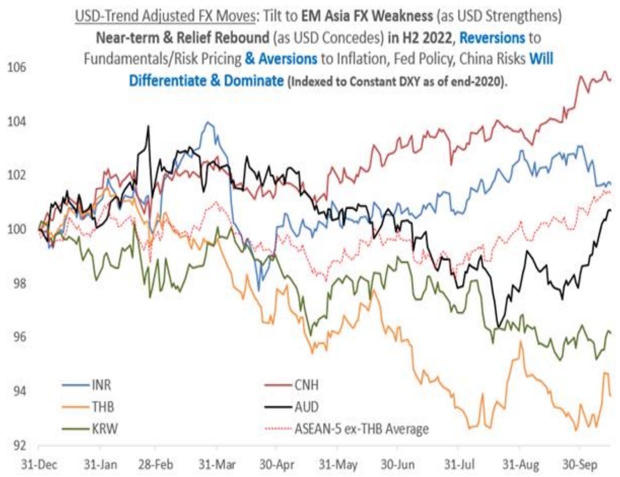
	Q3 2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	Q4 2022
Gold	$1690 - $1834	$1620 - $1885	$1565 - $1785	$1620 - $1790	$1660 - $1765	$1660 - $1790
	$1757	$1745	$1685	$1730	$1695	$1740

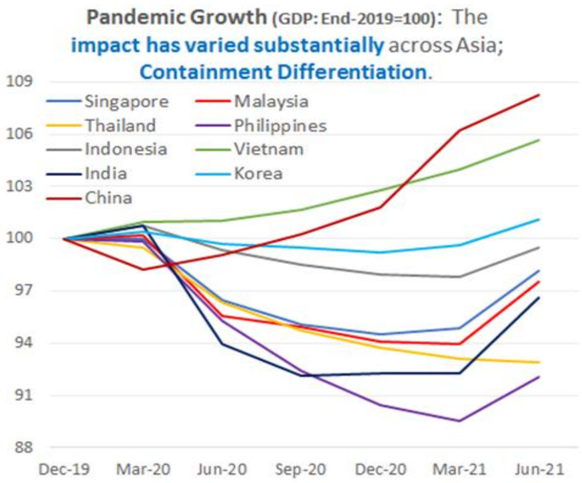
Gold's role as a hedge against inflation, ***subject to real rates not rising,*** and a safe haven play **remains intact although noticeably peaked** from its heady run up to breach $2000 in Q3 2020. The main catalyst that is **dampening the shiny yellow metal now** is that **global policy-makers are all primed for normalization/rates hikes**; which typically don't augur well for Gold, that is a zero-yielding asset.

In particular, with **taper transitioning to rate hike bets**, the **pressures on Gold could be somewhat more acute**; as the **decline in Gold's demand as a (USD) debasement hedge is accentuated by rising real rates** (as UST yields rise in anticipation of further normalization, alongside USD strength that is antagonistic to Gold price). Industrial demand may mitigate, but not fully offset. In which case, $1,600 support may be tested late-2021/early-2022 on the downside at the most volatile period (corresponding to the more hawkish market inflections), which may trigger portfolio reallocation out of gold.

But further out Gold may retain a good degree of traction; as gold entails no default risk. Moreover, safe haven diversification properties alongside flush global money supply (given the Fed is unlikely to abruptly or brutally engage in quantitative tightening) also lend to buoyancy in Gold. Especially if geo-political tensions ratchet higher amid economic uncertainties around high global debt.

Asia FX: Reversions & Aversions





As sweeping as the effects of Fed taper/rate hikes may be on FX markets transmitted via a broad USD trend, **attributing EM Asia FX wobbles exclusively to US policy shifts with a broad-brush** is way **too simplistic**. What's more, it **loses critical nuance that** is likely bound to **differentiate sharply**.

To be clear, **easy gains in EM Asia FX from Q2 2020 to early-2021**, due to a then receding USD tide, is now **supplanted by bumpier FX path**;

i) ***dominated in late-2021 and H1 2022 by USD traction ahead of impending US normalization*** (which is led by "taper" and rapidly inherited by rate hikes) that leaves EM Asia FX on a weaker footing through late-2021 and early-2022;

ii) ***before some moderation in USD strength in H2 2022*** driven by EM Asia central banks' economic/policy convergence with the Fed, which in turn sees varying degrees of recovery in EM Asia FX in the later part of 2022.

But that said, **EM Asia FX undulations and sharp differentiation must be appreciated for reversions to** pre-COVID **activity**, attendant **Current Account** (C/A) implications, binding **fiscal constraints** and ***perhaps risk premium***; but subject to **aversions** about **stagflation risks** instigated by cost-push reflation exacerbated supply-kinks, colliding with **US policy normalization** and **looming China risks that are hard to predict and/or quantify**.

The upshot is that **EM Asia FX risk sensitivities remain dynamic** in a rapidly evolving environment pulled between optimism about demand recovery and nerves about stagflation fears amid rising geo-political risks. Consequently, **frequent re-ordering of EM Asia FX performance** may be **par for the course**; including, but not limited to, the following dimensions.

C/A reversion *and more*: One of the most profound, albeit perverse, external economic impact that COVID had was **severe import compression led by Oil price collapse**, that had flipped regional C/A deficit economies (such as India, Philippines and Indonesia) into a surplus. As such, the **subsequent reversion of Current Account** patterns **led by Oil/energy price rebound on steroids** could claw back currency boost/buffer for INR, PHP and IDR. In particular, INR and PHP may be most prone to the antagonistic relation to oil prices; having very little buffer. Whereas, **Indonesia may have more buffer this time as soaring coal prices amid China demand** (benefitting from China-Australia tensions) helps to blunt the dent from Oil. On the flip side, Malaysia

Tourism/Travel reversion: Insofar that a clearer path of COVID will open the door for the **resumption tourism, EM Asia could be set for a more resounding boost for economic activity, C/A and correspondingly the currency**. And Thailand/**THB is the stand-out in terms of potential for out-performing** on a reversion to pre-COVID tourist arrivals and activity given its region-topping tourism multipliers (with GDP share of tourism ~22%). Philippines and Indonesia also show appreciable sensitivities, but may be overruled by wider Oil and C/A effects.

Fiscal Framework Reversion: The **fiscal largesse to engage the "rescue" necessitated by the devastation of COVID shifting back to rectitude**, especially as global vaccination rates rise and economies exit from pressing COVID exigencies, means that countries with deeper fiscal deficits and weak revenue recovery could be subject to some vulnerabilities. In the list of the "usual suspects", Indonesia's tax reforms have pre-empted this pitfall for now as has Malaysia's oil-related revenues. Whereas, at the margin, Thailand's fiscal stretch may be a hold-back for THB initially.

Twin Deficit Aversion: These may lead up to re-emergence of twin deficit" risks, which the **THB could be temporarily** (perhaps till H2 2022) **be subject to**; at least until tourism revenues start to recover and Thailand reverts to its usual C/A surplus. But **India, Philippines may be the most exposed as "taper" start to take aim at "twin deficit" vulnerabilities**; whereas IDR manages to skirt this "twin deficit" label (that hammered it in 2013), saved by the positive terms of trade boosting its C/A.

Stag-/In-flation Aversion: **Stagflation risks blown up by surging oil/energy prices** will also pose headwinds to economies/currencies as erosion of real returns **threaten to amplify capital outflows from taper-induced risk re-pricing** (which will entail a reversion to higher risk premiums) that is expected. For now, **INR and PHP are, in the headlines, arguably most exposed to inflation risks** given the high import dependence of energy alongside limited fiscal buffers. IDR though cushioned for now, may come under pressure if markets take a dim view of inflation being transferred by fiscal/quasi-state mechanics (subsidies by state or State Oil firm, Pertamina).

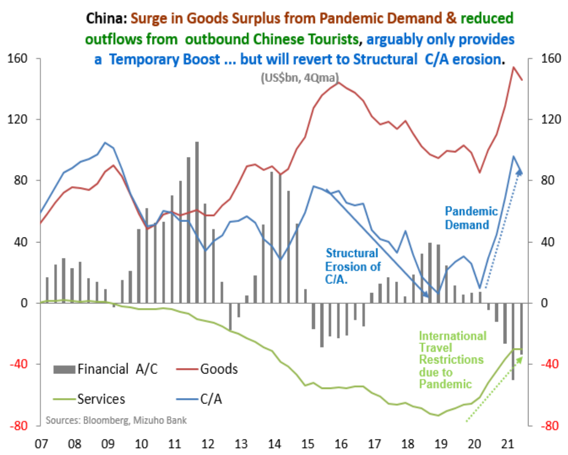
China Risk Aversion: This a **wide array of risks from the rash of China policy shifts/tightening** is definitely worth special mention, and deserves close attention. Most prominently, China may inadvertently impose on EM Asia FX via **shock transmission via credit market channels** (e.g. from widening property sector default, which while addressed in dribs and drabs is yet to be comprehensively resolved) **or tightening regulations that impact dent the real economy as well**; a risk accentuated by a sharper deceleration in Q3 GDP. Meanwhile, the **power crunch is a near-term dampener on Q4 2021 activity**, while the **COVID-Zero strategy of keeping borders closed may drag regional travel/tourism likely till mid-2022**. These risks though should subside starting Q2 as Beijing is likely to stabilize its economy ahead of the 20th Party Congress in November.

And so, the **aggregation and distribution of these risks remains consistent with broad-based EM Asia under-performance into H1 2022**, but gel with the story of **measured EM Asia traction in H2 2022**. That said the worst-case iteration of China risks could easily plunge EM Asia FX by an additional 5-10% of downside in H1 and delay even a partial recovery out later in 2022.

CNY: Ironic, But Not Inexplicable, Out-performance

	Q3 2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	Q4 2022
Policy rate^	3.85%	3.85%	3.85%	3.85%	3.85%	3.85%
USD/CNY*	6.42-6.58	6.24 - 6.83	6.35 - 6.80	6.26 - 6.75	6.18 - 6.633	6.13 - 6.58
	6.57	6.50	6.60	6.42	6.38	6.33

Note: Values in black are historical whereas those in blue represent forecasts. * Point forecast is for end-period. Ranges are only indicative. ^ The 1-yr Loan Prime rate is expected to be adjusted in small 5-10bps calibrations to 3.80%



Despite jarring headlines about tech sector regulatory storms, the **clamp-down on property sector credit and cash-flows**, and wider net of policy and/or regulatory diruptions under the banner of *"common prosperity" casting a shadow* now colliding with a **binding power crunch imposing an adverse supply-side shock** to the economy, the CNH remains as the stand out performer in the EM Asia FX space. And by quite a bit. But this **CNY outperformance, while ironic, is not inexplicable**.

It quite simply **boils down to intent and ability**.

Intent: For our purposes, this entails the PBoC's inclinations in guiding the CNY. And to that end, both **operational execution and strategic policy goals are not at odds with a firm CNY**. On the former, it is notable that the PBoC has only gently and intermittently leaned against the sustained appreciation in CNY fixing. Crucially, with regards to strategic policy objectives a **firmer CNY is desirable in containing rising global cost-push pressures** (led by energy) as well as to **transition to** Beijing's **"dual circulation" strategy** – on account of both *shifting to domestic consumption reliance* (at the margin) and *acquiring resources and know-how* to simultaneously secure and scale value chains.

Ability: Perhaps this is best framed as **fundamental propensity to appreciate**. Since the last edition of this report, a key fundamental boost that is tipping CNY towards more strength is the **sharply improved Current Account (C/A)** that benefits from **"pandemic demand" boosting goods balance**, but **crucially from closed borders** that have staunched massive net outbound tourism. This *"retained tourism dollars" is significant*, constituting *some 1.8%-2.2% of GDP* in recent years. What's more, **relatively lower consumer inflation in China** (averaging 0.6% Q1-Q3 2021 compared to. ~4% for corresponding US CPI), *on a PPP-basis,* also **supports the fundamental case for a stronger CNY**.

But these **fundamental propellers of sustained and significant CNY out-performance may subside heading into 2022** *as "pandemic demand" normalizes* and China joins other nations in *easing border/travel restrictions that revives outbound tourism*. **Although** Beijing is likely to enact a guarded re-opening of borders rather than throw open the floodgates of out-bound tourism; thereby **tempering subsequent currency impact CNY**.

Crucially as, ***Beijing will avoid currency instability ahead of, or during, the 20th National Party Congress in November 2022***. And so, it appears that **while the trade-weighted CNY is expected to peak**, a stable CNY exchange rate vis-à-vis the Greenback will be desired, with a bias to some CNY strength as a conveyor od sound policies and a healthy economy. This should also coincide with China relaxing its rash of "common prosperity" reforms/regulatory tightening measures that have exacerbated the slowdown in China's economic momentum (predating and independent of the power crunch).

In concert, all of these square with **increased CNY sensitivity to bouts of USD strength given a rich CNY NEER** (arguably diminishing buffer, assuming Beijing does not want excessive trade-weighted CNY strength). And so, a stronger USD bias amid taper/rate hike bets could lift USD/CNY through 6.50 to 6.60-6.80 into Q1 2022 before peaking and easing gently to 6.30-6.40 levels in H2.

AUD: Easing Pressures?

	Q3 2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	Q4 2022
Policy Rate (%)	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%
AUD/USD	0.71-0.759	0.720-0.760	0.731-0.790	0.742-0.800	0.748-0.790	0.743-0.780
	0.723	0.744	0.778	0.767	0.772	0.778

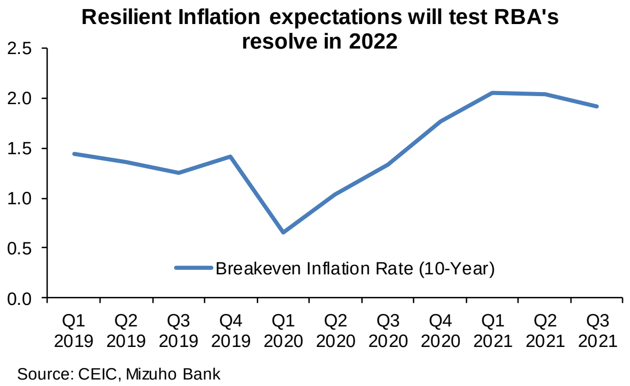
Note: Values in black are historical whereas those in blue represent forecasts. * Point forecast is for end-period. Ranges are only indicative.

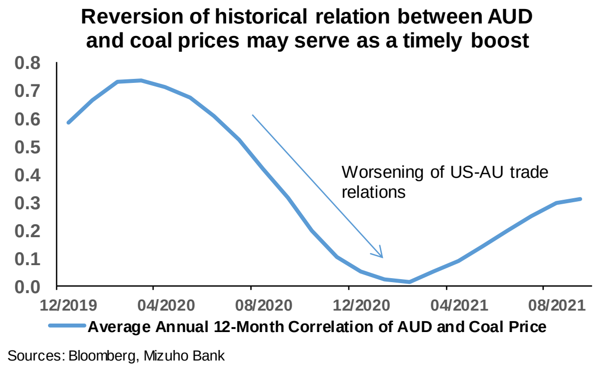
Since the mid-Q2 2021, the US and Australia's souring relations with China spilling into a stalling of their trade channels. Both factors will continue to drive AUD movements though their directions may no longer be synchronous as the latter may reverse a little to give a boost to the AUD. What's more recovering **investment cycle is likely to underpin the commodity boost to AUD and diminish AUD underperformance; contingent on RBA-FED divergence dissipating into late 2022**.

The RBA's guidance that rate hike conditions will not be met till 2024 may come under pressure in the coming quarters. This **apparent divergence with an impending US Fed tapering may result in a subsequent strengthening of the USD**. In addition, higher UST yields on the back of inflationary fears would compound and erode the AUD and subject it to bouts of volatility. Alongside these pressures, the **creep up of 10-year break even inflation rates in Australia indicating a rise in inflation expectations will test the RBA's seemingly resolute stance**.

In addition, domestic economic conditions in Australia may be **weighed down by Chinese property development woes if prolonged weak sentiments develop into structurally lower construction**

investment in China. The subsequent knock-on effects of a step down in exports to China could engender second round multiplier effects within Australia pulling back economic activity recovery.





On the flip side, the **underpinning concerns of inflationary pressures are higher commodity prices**, which could provide a fillip to the AUD. Admittedly, the pass-through of commodities price changes onto the AUD has weakened with the rise of trade tensions between China and Australia. However, the **power crunch may tip** the pragmatic Chinese calculus at the margin and perhaps provide the opportunity for a **reversion of this historical correlation, allowing some AUD gains to be realised sooner rather than later.**

The reopening optimism could also continue to shine for the AUD boosting the tourism sector with spillovers to services such as education and housing. The boost will likely dim over time as more countries open up, eroding Australia's relative advantage.

All said, we expect the gains for the AUD over 2022 to be relatively modest with these multiple strands of countervailing forces.

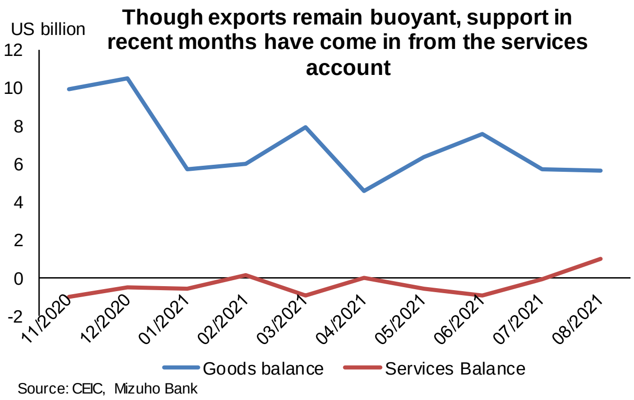
KRW: Restrained Weakness

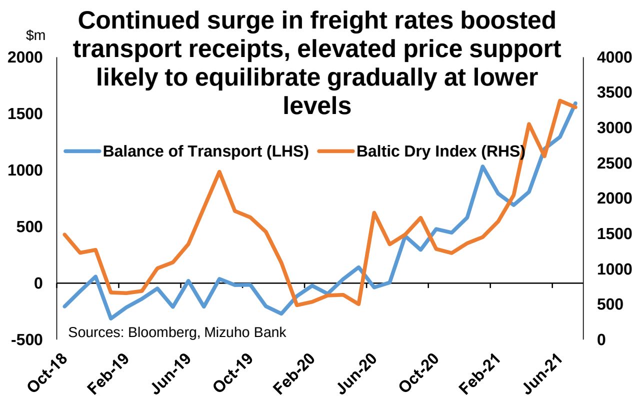
	Q3 2021	Q4 2022	Q1 2022	Q2 2022	Q3 2022	Q4 2022
Policy Rate (%)	0.75%	1.00%	1.25%	1.50%	1.50%	1.50%
USD/KRW	1129-1189	1150 - 1240	1160 - 1250	1150 - 1260	1130 - 1230	1100 - 1190
	1184	1190	1200	1200	1178	1150

Note: Values in black are historical whereas those in blue represent forecasts. * Point forecast is for end-period. Ranges are only indicative.

Further weakness in the Korean Won in Q4 is likely but extent of weakness likely to be capped. **The prospects of an early Fed tapering will continue to pose headwinds.** However, with headline CPI in September continuing to exceed both expectations and their target as well as turning broad-based, the BoK has reiterated their commitment to further policy rate calibration contingent on the growth recovery persisting.

With inflationary pressures building, the extent of negative interest rates worsens, exacerbating the skewed inefficient resources allocation across sectors by having very low hurdles to risk taking ventures. The concern was also emphasized by Governor Lee in his Oct press conference. Going forward with inflation projected to rise, the **BoK will remain focused on raising policy rates, just to keep real rates constant, much less to calibrate accordingly to suit the activity recovery momentum.** The base case (~65% odds) of a 25bp hike at next meeting (on 25th Nov) is consistent with BoK stance.





Fundamentally, current account surplus remains healthy at US$7.5 billion with exports value reaching all-time highs with robust shipments of semiconductors and computers. With global semiconductor market expected to continue double digit growth in 2022 especially that in the memory category, this will favour resilience in South Korea's technology conglomerates and the country's goods balance.

Some support in recent months has come from an **improvement in the services trade balance but the lift might be transitory**. In particular, the balance of transport has turn positive since July 2020 alongside rising freight rates. This should continue to buttress the current account till late H1 2022 before shipping supply chain issues normalize.

Possible **spill-overs of Evergrande crisis** through investment multipliers and wealth effects into a hard landing of China's real economy **remain tail risk** at this juncture. Domestic risks could stem from the possible slew of measures slated to cool the nation's property market. On the other hand, with a high vaccination rate, a well-executed reopening towards the end of 2021 could see KRW perform relative to regional peers.

SGD: No Tempting Bulls

	Q3 2021	Q4 2022	Q1 2022	Q2 2022	Q3 2022	Q4 2022
Policy Rate (%)	**Slight S$NEER Slope Reinstatement (0.5% p.a.)**		**Status Quo**		**Slight Increase S$NEER Slope (1.0% p.a.)**	
USD/SGD	1.338-1.369	1.32 - 1.40	1.34 - 1.41	1.32 - 1.42	1.30 - 1.38	1.29 - 1.37
	1.358	1.36	1.37	1.35	1.33	1.33

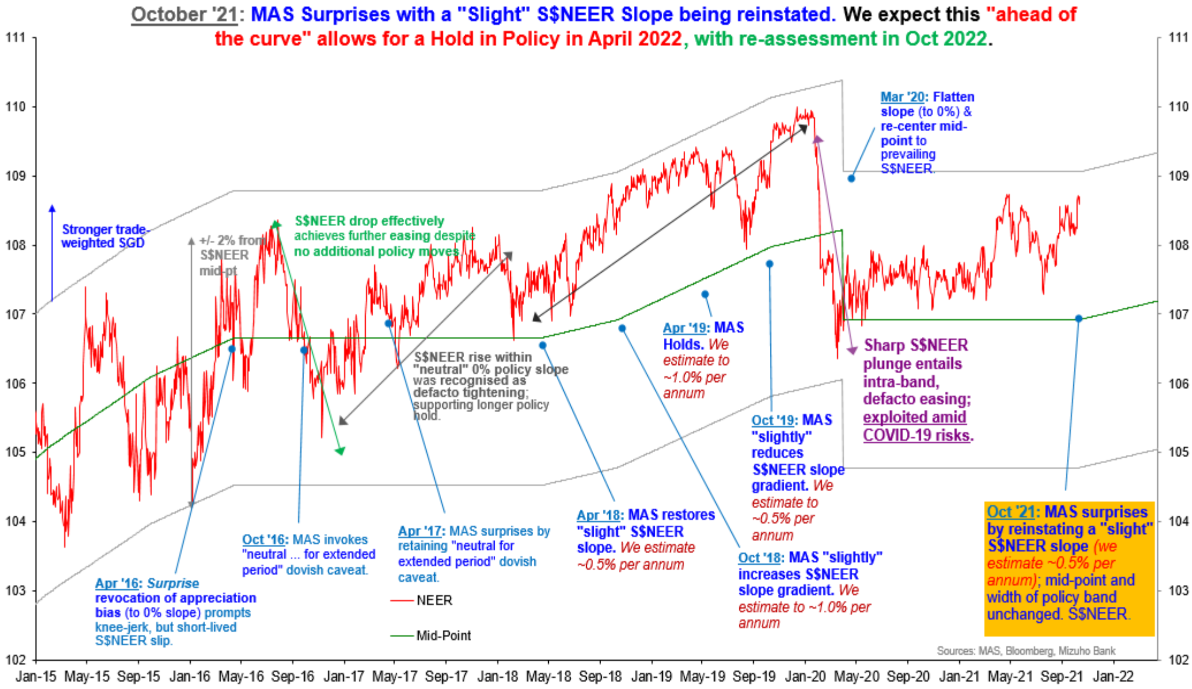
Note: Values in black are historical whereas those in blue represent forecasts. * Point forecast is for end-period. Ranges are only indicative.

The **temptation to conflate MAS tightening with pronounced SGD appreciation bias is understandable, but inherently flawed**; especially this time around. Point being, the MAS's **"ahead of the curve" calibrated reinstatement of S$NEER appreciation slope** (~0.5% per annum) at the October policy meeting was admittedly somewhat of the hawkish surprise. But the move falls short of critical pre-conditions to catalyse a marked bullish SGD shift. In fact, it is not even **poised to be hugely consequential to SGD trajectory**. For three good reasons.

For one, **upside potential** under current policy parameters is **mostly already exhausted by a rather rich S$NEER**. Fact is, a "rich S$NEER", at the strong half (if not top quartile) of the policy band for a while now essentially negates scope for the trade-weighted SGD to out-perform by appreciating within the current policy band parameters. So in other words, no "alpha" gains for the S$NEER.

Second, a **finely calibrated S$NEER** slope essentially only allows for **very controlled and measured increments in policy headroom for the S$NEER to appreciate**. Put another way, assuming a 0.5% per annum appreciation bias from a "slight" S$NEER slope, **only provides 0.2%-0.3% of headroom for the trade-weighted SGD to appreciate in the next 6 months before the next MAS meeting**.

Speaking of which, the third point is that insofar that the October meeting tightening was an "ahead of the curve" move to pre-emptively check emerging (rather than emphatic) wage-price spiral risks amid rising cost-push and dissipating labour slack, the **MAS** is **likely to pause in April 2022**.



In turn, this means the **in-built hawkish restraints** of **rich S$NEER with limited headroom** in concert with **linear and very incremental S$NEER ceiling lift** will be a **binding constraint at least through late-2022**, induce only a very modest S$NEER appreciation bias, if that.

Instead, all else equal, slightly accentuated appreciation bias - albeit uneven across various currencies - for the SGD will dominate. **Whereas USD trends and China risks may be the more prominent determinants of the larger shifts and turning points**.

In particular, **large shifts in USD trend**, which in turn determines USD/SGD levels corresponding to (presumed) +/-2% S$NEER policy, **remains a critical determinant of USD/SGD** shifts. And at the margin, **China risks will probably pose the most material** (intra-band) downside risks to S$NEER; hence **unexpected upside risks to USD/SGD**.

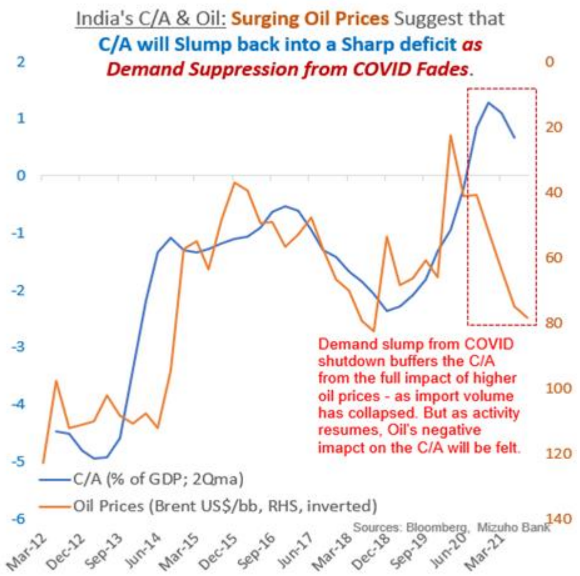
And this ought to be **consistent with USD/SGD tipped for bounces or outright upside risks in late-2021 into Q1 2022**, with **volatile, two-way peaking into mid-2022**. A case for **stronger SGD being reinstated in H2 2022** builds into Q3 as prospects for another MAS tightening move coincides with pick-up in EM Asia recovery/policy convergence with Fed.

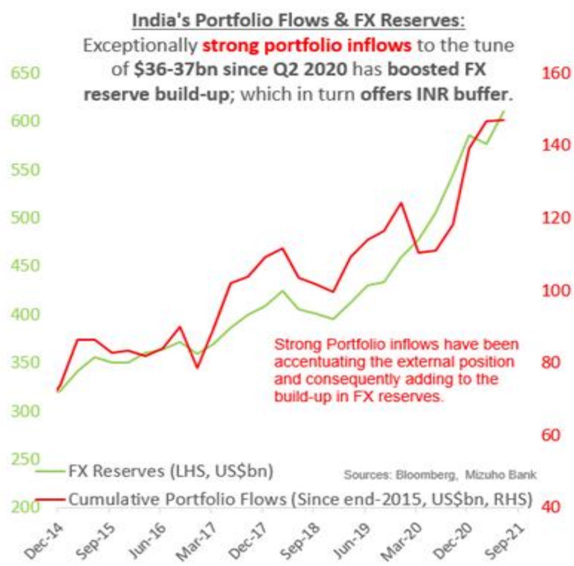
INR: (Fading) Borrowed Out-performance

	Q3 2021	Q4 2022	Q1 2022	Q2 2022	Q3 2022	Q4 2022
Policy Rate (%)	4.00%	4.00%	4.25%	4.50%	4.50%	4.50%
USD/INR	72.92-74.96	73.4 – 80.1	72.2 – 77.8	72.4 - 76.8	71.1 – 76.9	70.3 – 76.0
	74.24	76.8	75.8	74.8	74.5	73.6

Note: Values in black are historical whereas those in blue represent forecasts. * Point forecast is for end-period. Ranges are only indicative.

The **rupee while arguably endowed with relatively more inherent buffer due to a confluence of cyclical fortunes and structural factors**, is **nevertheless poised for some degree headwinds and accompanying volatility** as dark clouds of *high oil prices* conspire with the global cost-push pipeline feeding through to harden *Fed "taper"/policy shifts* risks. In short, ***while*** it is ***not conscripted to languish in taper trenches***, **borrowed out-performance may have to concede a fade**.





To address the elephant in the room, **our base case is for a far more resilient rupee through "taper 2.0"**; presumably taking off before end-2021. In other words, we **neither expect a bad iteration of "tantrums"** (nothing close to the 2013 "taper tantrums" episode) **nor for the rupee to be as devastated to the point of the "fragile five" status** in 2013 even in the event of worse-than-expected turbulence.

That said, the **fairly aggressive climb in Oil prices** (now at $85/bbl for crude compared to below $52 at the start of the year) will **inevitably pose a fairly strong headwind**. For one, Oil prices are consistent with India's C/A sliding back to 2-3% deficit (from a short-lived foray into a surplus in 2020). This **C/A "flip" from surplus to deficit** conspiring with higher oil prices denting capability to build-up FX reserves **while simultaneously eroding real return from Indian assets** potentially has ***both a catalyst and amplifier*** effect in terms of **relegating the rupee as an under-performer** in coming quarters.

What's more, the often cited, **spectacular FX reserve build-up** to ~$640bn (vs. $290bn pre-taper in 2013) has to a large extent also been **accentuated by exceptionally strong portfolio inflows** apart from the fortuitous but fleeting C/A surplus since COVID (largely thanks to the collapse in Oil, other commodities and import compression). **If taper/wider Fed tightening were to reverse the lighter-footed portfolio/capital flows**, then **in cahoots with higher** Oil, this could **underpin** the case for this year's **borrowed out-performance fizzling further** (having already started s of late-Q3).

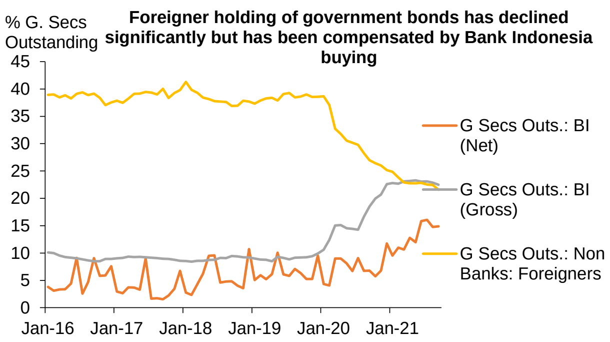
What's more, with **relief from inflation likely to prove short-lived and shallow**, the RBI's dilemma could also **accentuate headaches for the rupee**. Admittedly, oil prices are not quite as high as they were in 2013 (over $100), **FX reserve buffers** are a lot more comforting, **COVID** is very **well-contained** and **India's allure as an alternative to** (a plethora of) **China risks** looming large admittedly offer the silver linings for rupee. But it is just that. ***Silver linings that avert worst-case outcomes. Not silver bullets that offer unqualified immunity***.

With that being the backdrop, **rupee downside pressures may be accentuated** in coming months as a conspiracy of a **dominant USD** and **resurgent oil** prices alongside India's **sticky and elevated inflation** intensify INR pressures. In which case, **USD/INR could as such test north of 76** before setting sights on 78-80 regions under far more extreme "tail risk" outcomes. H2 2022 though should provide relief as global inflationary pressures and oil prices peak; allowing for sub-75 INR to resume.

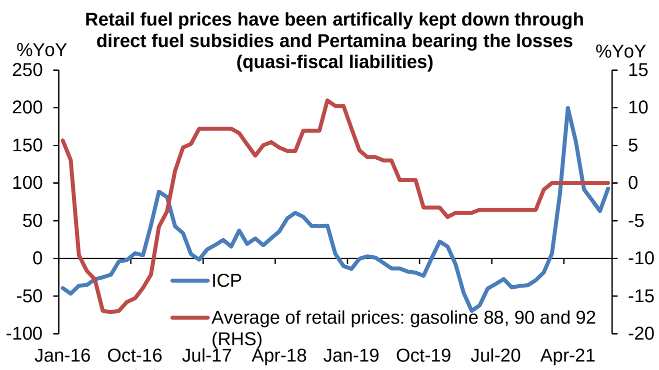
IDR: Latent Risks

	Q3 2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	Q4 2022
Policy Rate (%)	3.50%	3.50%	3.50%	3.50%	3.75%	4.00%
USD/IDR	14182-14568	13840-14920	13980-15130	14020-15300	13890-15090	13790-14990
	14313	14200	14400	14450	14350	14250

Note: Values in black are historical whereas those in blue represent forecasts. * Point forecast is for end-period. Ranges are only indicative.



Source: CEIC; Mizuho Bank



Source: CEIC; Mizuho Bank

USD/IDR has been resilient through Q2 and Q3 2021, and indeed appreciated versus USD, which is testament to Bank Indonesia's carefully calibrated policy settings even during the peak of covid infections in June/July, strong balance of payments (and basic balance) position given resilient FDI and portfolio inflows as well as frisky dollar sentiment ahead of the US Fed tapering announcement in September.

Looking ahead, **the risks to IDR stability cannot be ignored although a repeat of the 2013 taper tantrum is unlikely** given that the first (FX reserves, stronger domestic intervention, reduced exposure to global risk sentiment) and second (bi-lateral and multi-lateral swap agreements) lines of defence have since been significantly strengthened.

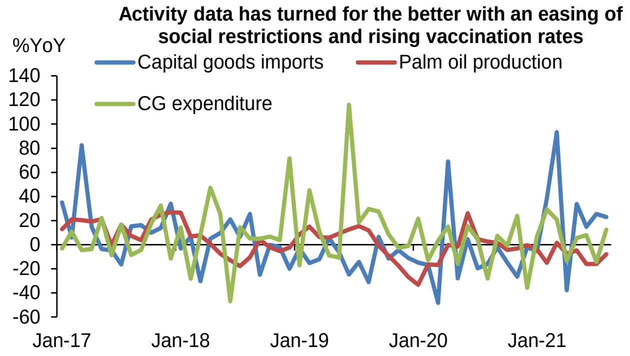
The main risk this time around is associated with debt monetisation from BI's direct financing of the fiscal deficit by buying bonds in the primary market. Market participants have so far remained fairly sanguine about these risks but as BI's (gross & net after accounting for OMO's) ownership of government bonds increases, **an exit policy from direct bond buying to a more market-based mechanism will be crucial to put in place.** **A timeline that is de-coupled**, to some extent, **from the economic recovery would also have some merit** especially as the global market liquidity conditions tighten and the pricing of financial instruments, including government bonds, is directly impacted.

Furthermore, **maintaining inflationary pressures, which have so far been artificially suppressed by subsidies on energy, will be crucial as BI unwinds its bond buying policy given the rise in global oil prices** will either cause a widening of government liabilities (directly on the fiscal deficit or 'below the line' through transfers of losses onto Pertamina's books) or a direct inflationary hit (albeit one-off) from higher retail fuel prices. **These risks will exacerbate already existent 'twin deficit' risks from the fiscal and current account deficit.**

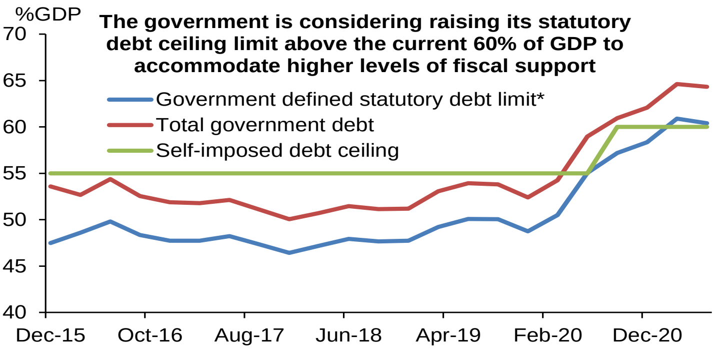
MYR: In a better place

	Q3 2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	Q4 2022
Policy Rate (%)	1.75%	1.75%	1.75%	2.00%	2.25%	2.50%
USD/MYR	4.13-4.25	3.91-4.34	4.02-4.40	3.91-4.30	3.97-4.30	3.93-4.24
	4.19	4.15	4.18	4.16	4.16	4.10

Note: Values in black are historical whereas those in blue represent forecasts. * Point forecast is for end-period. Ranges are only indicative.



Source: CEIC; Mizuho Bank



Note: *The governments' definition includes MGS, MGII and Islamic T-bills.For the latter, we do not the exact breakdown and proxy it with total T-bills. Data is quarterly; % GDP is a 4 quarter rolling sum figure. Source: CEIC; Mizuho Bank

The risks for MYR have abated significantly since the start of the year. The pandemic situation, while some ways away from returning to 'normal', **is markedly improved from the periods of frequent lockdowns (known as a Movement Control Order)**. With over 90% of the population vaccinated, the prospects around inter-state travel have opened up while intra-state activities have resumed with more regularity. This has given various aspects of economic growth a boost ranging from private consumption to exports as more factories resume normal working hours. More fundamentally, however, the tailwinds from higher commodity prices as well as electronics export support will keep the Malaysian economy in good stead for the rest of 2021.

Even near-term political uncertainty has been quelled with the newly appointed PM Ismail Sabri Yaakob extending an olive branch to all political parties within the UMNO coalition as well as to the Opposition. That said, political risks have not been put to bed as underscored by the collapse in Melaka's state legislature stemming from UMNO infighting.

Moreover, **ahead of the Budget 2022 announcement on 29 October, the fiscal situation will come back into the spotlight.** The government has already highlighted that it plans to raise the debt ceiling from 60% of GDP to 65% to allow for the allocation of greater fiscal space to handling the health crisis. Hence, most associated depreciation pressures on the MYR may already be priced in; although a knee-jerk upward spike in USD/MYR cannot be ruled out.

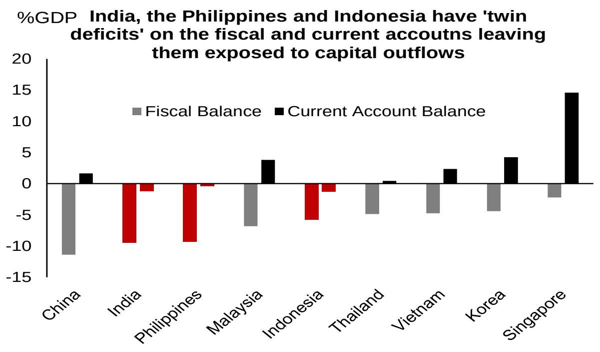
Heading into the 2022, the challenges around the normalisation of fiscal and monetary policy will become more pertinent. Bank Negara Malaysia may not be in hurry to raise interest rates with the inflation backdrop still relatively benign but it will cognisant of being perceived as 'behind the curve' especially with the US Fed decisively on a tightening path. Similarly, beyond debt ceiling risks, the government will benefit from a greater focus on boosting sustainable medium-term revenue sources and optimising the expenditure profile. All of these are future pressure points for MYR.

PHP: Pandemic, Policies and Politics Point to Further Depreciation

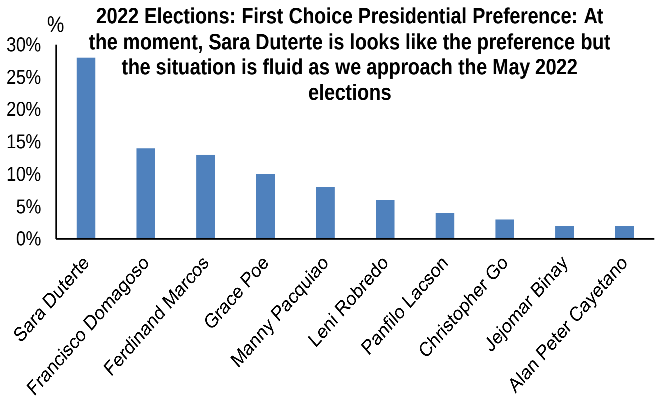
	Q3 2021	Q4 2022	Q1 2022	Q2 2022	Q3 2022	Q4 2022
Policy Rate (%)	2.00%	2.00%	2.25%	2.25%	2.50%	2.75%
USD/PHP	47.6 - 51.0	49.5-53.4	49.5-53.1	49.4-53.2	48.9-52.8	48.4-52.1
	51.0	51.2	51.5	51.6	51.2	50.5

Note: Values in black are historical whereas those in blue represent forecasts. * Point forecast is for end-period. Ranges are only indicative.

The USD/PHP will experience upward pressure in the coming quarters reflecting continued concerns around the pandemic, political situation and a mix of policies likely exacerbating 'twin deficit' concerns. On the pandemic, vaccination hurdles are apparent with less than 25% of the population fully vaccinated. Using average daily vaccination rates of the September at around 337k, this pace will still fall short of the authority's year-end target of 77 million vaccination persons and its year-end target of vaccinating 60% of the population. Admittedly, this has been reflective of the underperformance of the PHP as USD/PHP highs of 51.0 in Q3 2021.



Notes: Fiscal deficit is based on the fiscal year for India, Singapore & Thailand; Vietnam, China fiscal deficit is net lending/borrowing, IMF April 2021 WEO
All forecasts are IMF WEO April 2021.



Source: Pulse Asia; Survey conducted from June 7-16 2021

This will have knock-on effects on the economic recovery and in turn their worsening the 'twin deficit' concerns. The fiscal deficits for this year and the next are already large 9.3% of GDP and 7.5% of GDP, respectively. Moreover, additional pressures could build if the recovery threatens tax revenue collections. **On the external front, still elevated uncertainty around the economic recovery prospects may dampen hurt FDI prospects leaving the economy more reliant on volatile portfolio inflows to fund the current account deficit**; which given the 'stop-start' nature of economic activity will likely remain in a deficit on account of weak export growth but also from poorer price effects on the imports of oil.

In all this, Bangko Sentral ng Pilipinas (BSP) will have its hands tied. It raised its 2021 headline inflation forecast to 4.4% at its September meeting, indicating that inflation will remain above its 2-4% target range for the remaining months of 2021. Sticky food costs, elevated fuel and utility prices will continue be thorns for the BSP in terms for maintaining accommodative policy to aid the economic recovery.

The risk, however, is with the impending US Fed taper agenda, BSP is perceived as falling behind the curve adding to more PHP depreciation pressure. These pressures we expect will push BSP to begin the process of accommodation withdrawal in Q1 2022. That said, the hiking cycle this time around will likely be less aggressive than in the past given the fragile nature of the recovery as well as impending political uncertainty.

Ahead of the May 2022 Presidential elections, the race is looking open-ended with few top contenders including Sara Duterte, Leni Robredo and Manny Pacquiao. Politics related headlines could translate into some volatility for the peso.

Beyond the pandemic, however, the medium-term fundamentals for the economy remain sound with the authorities focussed on introducing tax reforms via CREATE which should bear fruit to expand fiscal space and allow for more infrastructure spending.

THB: Potential for a 2022 turnaround

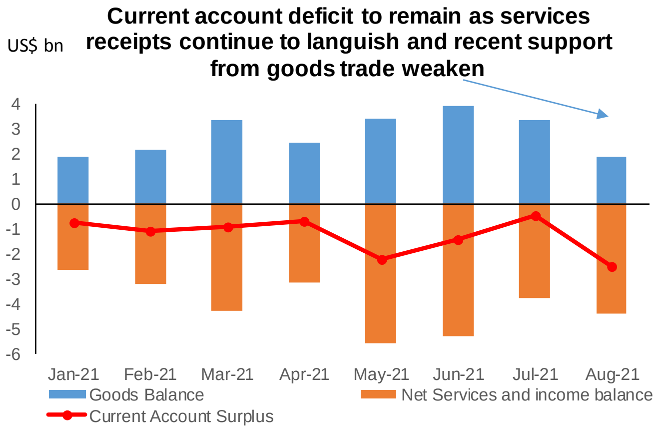
	Q3 2021	Q4 2022	Q1 2022	Q2 2022	Q3 2022	Q4 2022
Policy Rate (%)	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%
USD/THB	32.0 - 34.0	33.2 - 35.3	33.1 – 35.5	32.0 - 35.0	31.1 - 34.1	31.1 - 33.0
	33.8	33.9	34.0	33.8	33.0	32.0

Note: Values in black are historical whereas those in blue represent forecasts. * Point forecast is for end-period. Ranges are only indicative.

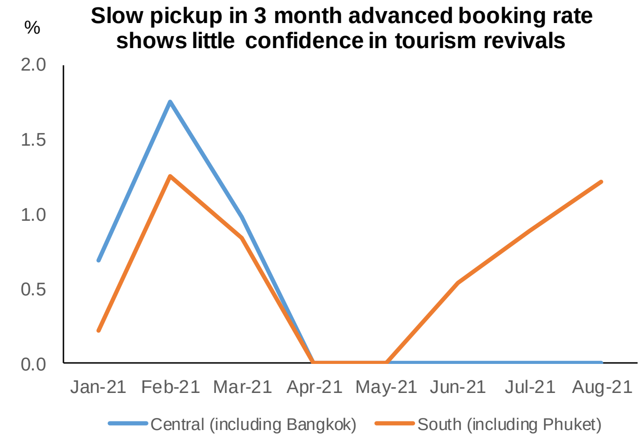
We see near-term pressure on THB persisting from the presence of twin deficits (*See Mizuho Chart Speak: EM Asia FX, 30 Sept) but expect this depreciation pressure to fade, and in fact led to some THB outperformance in H2 2022 as global and subsequently domestic tourism prospects show material signs of revival.

For Q4 2021 and Q1 2022, we expect THB depreciation pressures to persist. With goods & services export growth momentum weak, the current account deficit will likely persist. Even with the Phuket Sandbox and 'Samui Plus' tourist attractions launched in July, international visitors stood at around 15k persons in August, short of the authorities' ambitious one million target of tourist arrivals for Phuket and well below the 10 million visitors in 2019.

That said, Bangkok reopened to tourism on 15 Oct and is closely being watched as a bellwether of the country's reopening strategy. Moreover, as **Thailand is slated to remove quarantine for fully vaccinated air travellers from five low risk countries in November, signaling and confidence effects should not be ignored in the coming quarters.** The recovery of tourism revenue in H2 2022 may feature a **sharp turnaround on both fronts of price and volume with** greater pricing power in terms of average room rates (which remain some 60% below Dec-2019 levels) likely to kick in after occupancy rates reach sustainable levels.



Sources: BoT, Mizuho Bank



Sources: BoT, Mizuho Bank

With the THB losing over 10% in value versus the USD since the start of the year, the worst performing currency in EM Asia, this signalling effect could be the much needed pull factor required to boost THB prospects. More importantly, a highly **anticipated China reopening** in H2 2022 could fuel optimism around Thailand's tourism sector prospects (the Chinese accounted for >30% of total 2019 tourist arrivals). As such, we think, **THB will move to being the region's outperformer in H2 2022**, especially given the sharp underperformance in 2021.

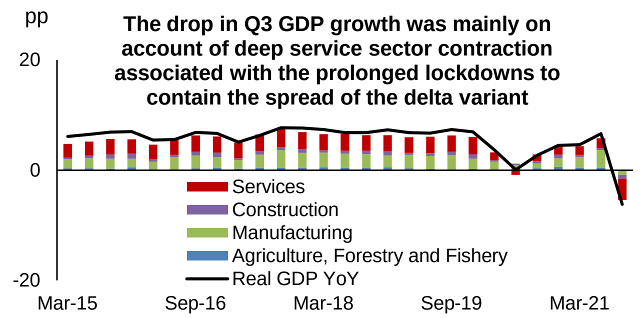
Notwithstanding, near-term THB weakness will prevent the Bank of Thailand (BOT) from starting the process of monetary policy normalisation in H1 2022, as we expect for most other ASEAN peers. As THB firms versus the USD, **considered and calibrated** policy rate increases will likely be undertaken by BOT. On balance, BOT will cognisant of risks around premature policy normalisation as the growth outlook remains weak but will also seek to prevent a spiral of THB weakness from additional rate cuts to a point of testing macroeconomic stability especially with the US Fed's impending normalisation.

A background but pertinent risk will continue to be political uncertainty. These risks predate the pandemic, when street protests calling for PM Prayuth's resignation, changes to the constitution and monarchy began in earnest. Given that none of these requests have been met and political flare-ups are common from time-to-time, THB will be subject to volatility from the various potential political manoeuvres.

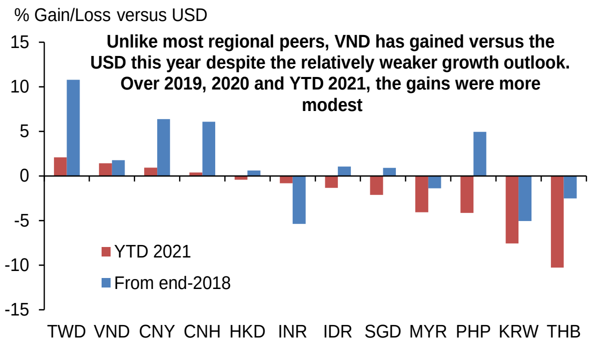
VND: Bucking the trend for now

	Q3 2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	Q4 2022
Policy Rate (%)	4.00%	4.00%	4.00%	4.00%	4.25%	4.50%
USD/VND	22761-23073	22600-23200	22700-23200	22800-23500	22800-23300	22700-23100
	22761	22850	23000	23100	22950	22850

Note: Values in black are historical whereas those in blue represent forecasts. * Point forecast is for end-period. Ranges are only indicative.



Note: We calculate YoY growth based on the revised VNDbn based figures.
For Q4, we use YoY and share from the previous base. Source: CEIC; Mizuho Bank



Source: Bloomberg; Mizuho Bank

VND strength versus the USD has been puzzling considering that economic growth was hard hit by the lockdowns imposed to curb the spread of the delta variant. Since the start of 2021, VND has gained versus USD compared to peers, which have lost significant value versus USD. **The 6.2% YoY contraction in Q3 did not deter this trend even as the details suggested a hit to domestic demand.** The services sector, namely the wholesale and retail sectors along with the restaurant and hospitality businesses, was the main culprit of the growth decline while manufacturing output was also hit consistent with factory closures in larger industrial parks.

We attribute the remarkably stable official USD/VND rate over the recent months to a few reasons. First, **although the Vietnamese economy is reeling from the spread of the delta variant, it still benefits from a perception of resilience**, similar to PHP and THB in 2020. We see an increasingly likelihood of that there will be some 'catch-up' depreciation in the coming months as market participants realise the depth of the COVID impact. Second, **Vietnam's external position is still relatively solid compared to regional peers.** Even though the current account deficit has narrowed since last year and the deficit in Q2 was larger than is seasonally recorded, the balance of payments remained in a comfortable surplus providing some buffer. In addition, FDI inflows, albeit reduced, have not stalled pointing to underlying confidence in the economy.

Third, **expectations around a near V-shape recovery could also be contributing to the optimism**. Vietnam's deep integration into global supply chains implies that electronics exports could bounce back following an easing of social restrictions; a similar response is expected from the services sector. Finally, **pressures from the US Treasury to maintain the VND and reduce pressure on the US-Vietnam bi-lateral trade deficit could be motivating SBV to keep the VND/USD rate close to current levels** without allowing it to appreciate further, as implied by the market rate (the average of the buy/sell spot quoted by VietCom Bank).

Box 2: MMK: In a Lurch

Pronounced MMK Depreciation Since The Coup

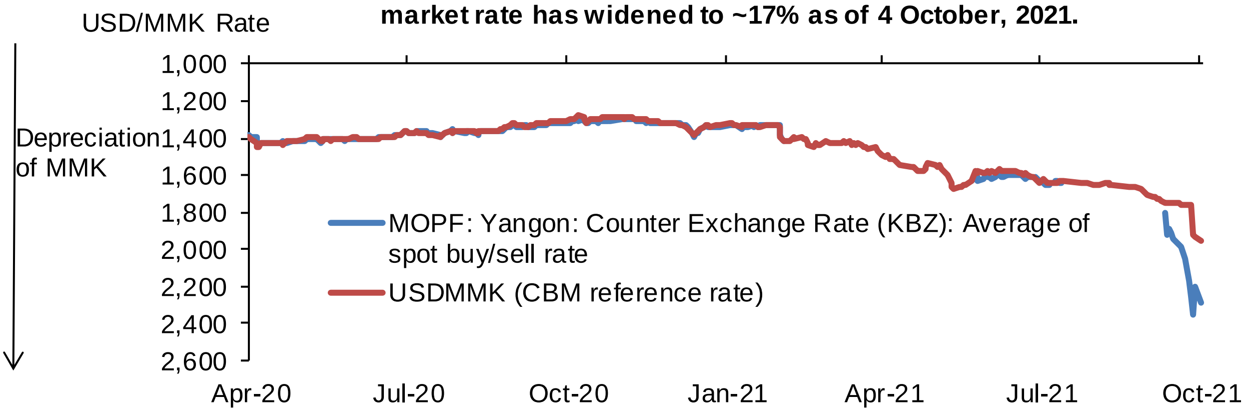
Since the coup in early February this year, **Myanmar's political and economic situation has been fragile.** Increasing political opacity and sanctions levied on military personnel and state associated owned enterprises have made **the business environment increasingly hostile to foreign investors**. Moreover, **domestic political protests and social unrest have exacerbated the pandemic situation**. Covid-19 infections, particularly with the spread of the delta variant, have remained elevated with the vaccination program woefully hampered by supply shortages and distribution hurdles.

As a result, most activity data point to a sharp decline from domestic car sales to mobility, along with export and import growth. The most obvious fallout of this entire situation has been the sharp depreciation of the currency. We had initially pegged that the USD/MMK rate would depreciate a further 5-10% from mid-August levels (see *Mizuho Flash: 17 August 2021: Myanmar: Risks Re-visited & Reinforced*) but in fact it has depreciated anywhere between 18-20%. The reasons are clear, also including banking sector limits on transactions as well as a physical shortage of US dollars onshore, made worse by substantially reduced exports receipts and FDI inflows. What's worrying is that even such a sharp fall may in reality be understated by the fact that the central bank (CBM) has some degree of buffer against extreme currency move – subject to foreign exchange reserves.

Still Volatile With Depreciation Pressures To Persist

Unfortunately, the current state of affairs implies that depreciation pressures could be sustained for some time yet. The 'market rate' of USD/MMK, assumed by us to be the average of the buy/sell spot quoted at the Yangon exchange, **suggests a ~17% gap between the official USD/MMK rate provided by CBM**, as of 4 October. On this date, the **market USD/MMK rate was 2285 versus the official rate of 1949**.

Despite the sharp depreciation of the MMK using the official CBM rate, the 'market rate' suggests an even sharper move. The gap between the official and market rate has widened to ~17% as of 4 October, 2021.



Source: CEIC; Mizuho Bank. Notes: The Yangon Counter exchange rate is from the Central Statistical Organization. There some gaps in the dataset likely reflecting a closure of the exchange rate and/or difficulty obtaining data.

Admittedly, this gap is volatile (changing on a day-to-day basis) but it does not abstract from the fact that the depreciation pressures on the MMK are persistent and if anything, building given the political fault lines are clear. Furthermore, **global market liquidity conditions** from the impending taper of asset purchases by the US Federal Reserves and generally tighter monetary policy from some economies **will put additional pressure on the MMK**. As such, **additional 15%-20% depreciation in MMK over the next 3-6 months from current levels cannot be ruled out.**

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