

Asia FX Brief (May'21)

4 May, 2021

Of Inflections & Infections

Vishnu Varathan
Head, Economics & Strategy
vishnu.varathan@mizuho-cb.com

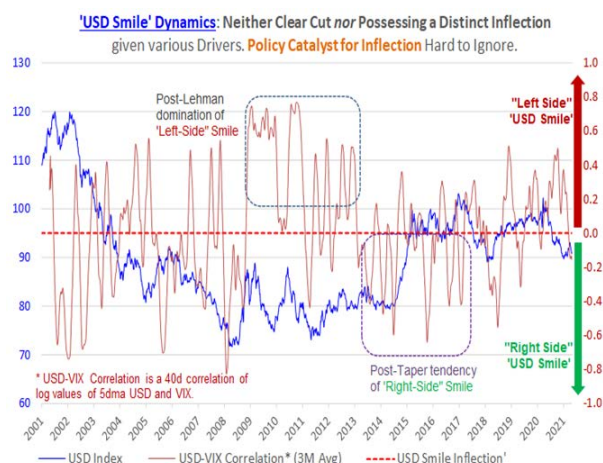
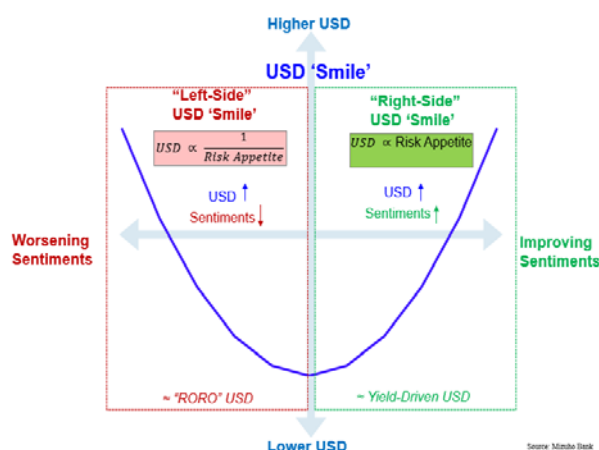
Lavanya Venkateswaran
Market Economist
lavanya.venkateswaran@mizuho-cb.com

- **USD: ‘USD Smile’ mechanics inflection from the left- to right-side (USD rising on improving economic condition)** is a serious proposition amid US economic and vaccine outperformance from exceptional fiscal boost. But **held back Fed doves for now**.
- **Majors:** Meanwhile, **Europe’s renewed infections replicated in many parts of EM/Asia amplifies US divergences**. But **policy differentials** between Fed’s “running hot” allowance and the **ECB’s single-mandate** amid reflation **provides interim EUR buoyancy; especially on vaccine boost**. But **JPY may be more inclined to softening amid rising UST yields**.
- **Oil/Commodities:** **Oil has had its inflection**, seen **consolidating** with a touch of upside bias **~\$60-78 as OPEC+’s gradual idle capacity restoration offsets demand recovery**. **Industrial metals** though are **extending H2 2020 inflection on bumper infra-reflation**.
- **AXJ*:** Mixed USD mechanics/ twitchy UST yields pick-up amid Fed accommodation underpin tensions between yield-seeking interest boosting high-yielders while **low-yielders remains more sensitive to UST yield shifts**. But **high-yielder buffer is on borrowed time**.
- **CNY: (Relative) Stability remains the name of the game**, and with the trade-weighted CNY (NEER) already materially higher back to pre-“trade war” levels, **further CNY gains could be rendered more measured**; especially as C/A dynamics turn less accretive.
- In turn, **restraints on degree/speed of CNY appreciation** into 2021 could **indirectly act to check the degree of gains in other AXJ**. Later into 2021 and in early-2022, lower-beta AXJ may track CNY gains better than higher-yielders, which may be more volatile.
- **AUD is well-placed to ride the commodity cycle; especially if RBA taper defines a policy inflection**. In contrast, **MAS inflection** via *calibrated S\$NEER slope restoration* will have **limited trade-weighted SGD impact** given a rich S\$NEER.
- **MYR set for a gentle boost**, but not a major fillip, from buoyant Oil. Whereas consistently more expensive **Oil may dent INR, IDR and PHP**; especially from delayed COVID recovery, **although near-term high-yielder attraction offsets**. THB waiting for tourism multiplier for a stronger rebound, but may collide with “taper”.

Currency Forecast Ranges

FX Forecasts	Jun 21	Sep 21	Dec 21	Mar 22	Jun 22
USD/JPY	98 - 105 (109)	98 - 105 (110)	100 - 107 (111)	100 - 108 (112)	102 - 111 (112)
EUR/USD	1.16 - 1.22 (1.19)	1.16 - 1.22 (1.17)	1.15 - 1.19 (1.17)	1.15 - 1.20 (1.16)	1.14 - 1.19 (1.15)
USD/CNY	6.21 - 6.76 (6.44)	6.29 - 6.70 (6.52)	6.26 - 6.64 (6.46)	6.13 - 6.51 (6.33)	6.37 - 6.79 (6.58)
USD/INR	73.0 - 79.4 (76.2)	72.2 - 77.3 (75.3)	71.8 - 76.5 (74.2)	69.5 - 75.0 (72.8)	73.3 - 79.3 (76.8)
USD/KRW	1040 - 1130 (1080)	1070 - 1150 (1115)	1040 - 1100 (1070)	1000 - 1070 (1040)	1150 - 1240 (1200)
USD/SGD	1.28 - 1.35 (1.31)	1.29 - 1.37 (1.32)	1.28 - 1.35 (1.31)	1.27 - 1.33 (1.30)	1.31 - 1.38 (1.35)
USD/IDR	14320 - 15500 (14750)	14320 - 15500 (14750)	14020 - 15190 (14350)	13750 - 14900 (14200)	14480 - 15740 (14960)
USD/MYR	3.80 - 4.22 (4.04)	3.98 - 4.24 (4.13)	3.96 - 4.24 (4.08)	3.85 - 4.14 (4.02)	4.01 - 4.36 (4.19)
USD/PHP	46.3 - 50.3 (48.2)	46.9 - 50.1 (48.8)	46.8 - 49.8 (48.3)	46.0 - 49.4 (48.0)	46.9 - 50.6 (49.0)
USD/THB	29.8 - 31.4 (31.3)	30.4 - 32.6 (31.2)	29.4 - 31.5 (30.6)	28.4 - 31.0 (30.2)	30.9 - 32.7 (31.8)
USD/VND	22400 - 23600 (23030)	22500 - 23500 (23090)	22600 - 23500 (23060)	22400 - 23400 (23020)	22600 - 23700 (23200)
AUD/USD	0.750 - 0.832 (0.800)	0.751 - 0.852 (0.788)	0.742 - 0.836 (0.800)	0.768 - 0.853 (0.810)	0.743 - 0.815 (0.778)

Global FX: Pondering 'USD Smile' Inflection



Two aspects of uncertainty are shroud the USD outlook. The first, and arguably the deeper puzzle, which is **whether the USD is operating on the left-half or right-half of the 'USD Smile'**. To be sure, this is not academic hair-splitting, but a **critical determinant of whether continued improvement in global economic conditions result in a softer USD corresponding to "left-side" 'USD Smile' dynamics (that was the case for 2020 and most of 2021) or a stronger USD, suggesting an inflection to the right-side of the 'USD Smile'**. For details on 'USD Smile' dynamics/inflection, refer to Box 1.

And the other, which is not unrelated to ‘USD Smile’ dynamics, is **how the Fed’s untested policy framework of “flexible average inflation targeting” will interact with an unprecedented scale of fiscal blast of some \$6trln and counting** (\$1.9trln of COVID relief, \$2.2trln of infrastructure⁴ and \$1.8trln of healthcare/education family support) to impact on the multiple mechanisms of rates, balance of payments and growth before being **distilled down to USD dynamics**.

Clarity is far from first rate. In fact, the **USD framework remains defined by ambiguity**. But on balance, our base case projection is for a **mellow USD bias for most of 2021, punctuated with spasms of volatility**, which is likely to be triggered by sharp rise in (real) UST yields and/or “risk off” from negative headlines pertaining to the pandemic and/or geo-politics. But **as the likelihood of “taper” starts drawing closer heading into 2022, a stronger USD may emerge more durably**.

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

- i) **Q2-Q3 2021: Heightened volatility** in USD moves will mostly be a by-product of markets grappling with the divergence between solid (and widening) US out-performance against a still accommodative Fed. And the car chase scenes between inflation expectations and UST yields 2022. Bu the Fed is mostly likely to have a grip on (dovish) policy expectations, and so USD will **on the whole remain fairly soft**.
- ii) **Q3-Q4 2021**: This may be the **so-called final push for USD bears** (before “taper”) as the **vaccination catch-up (with US) by the rest of the world**, including in the EM space, alongside a more solid and broad-based growth recovery could lend to “risk on” that **coincides with a softer USD**.
- iii) **H1 2022**: A “Dot Plot” that starts acknowledging inflation overshoot, incrementally bringing forward rate hike prospects to mid-2023 (or earlier), could cast the **spotlight on “taper” getting on the agenda for 2022**, given it is slated to be “well before” rate hikes. And insofar that this **sends UST yields higher** (and the UST curve steeper), triggering capital flows out of EM, **reinforcing the feedback loop to a stronger USD**.

Upshot: **Mild softening in the USD**, albeit **subject to bouts of volatility**, remains on the **agenda into H2-2021** as a dovish Fed overrules reflation bets that may lift the USD; especially amid sizable US advantage and lead in the global recovery story. While some catch up by the rest of the world may indeed give way to “risk on” USD capitulation in 2021, **2022 sets that stage for some reversal by means of USD strength insofar that “taper” risks become harder to ignore** amid sustained cost-push and exceptional fiscal stimulus igniting with the abundance of monetary stimulus.

EUR: The contrast between a single mandate **ECB being nudged along by reflation amid emergence out of COVID** into H2 perhaps squares with more EUR traction. But the path will be bumpy with two-way moves as subsequent COVID waves create headwinds to a smooth recovery. And to be sure, the ECB will not be thrilled by excessive EUR upside and will lean against excesses; but the policy constraints could make it hard to reverse this trend total. But relief from upward EUR pressures may come through in the form of Fed getting poised for “taper” into 2022.

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 108-112**; although volatility spill-over from yields and risk sentiments will keep revisits to 105 in play from time to time on short-lived UST yield capitulation.

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-haven features 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.

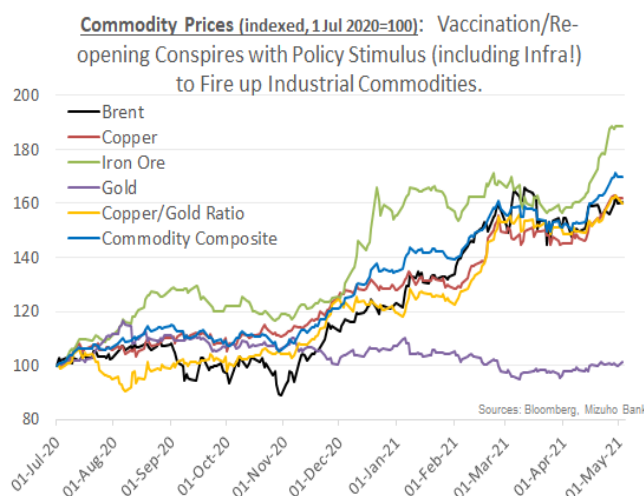
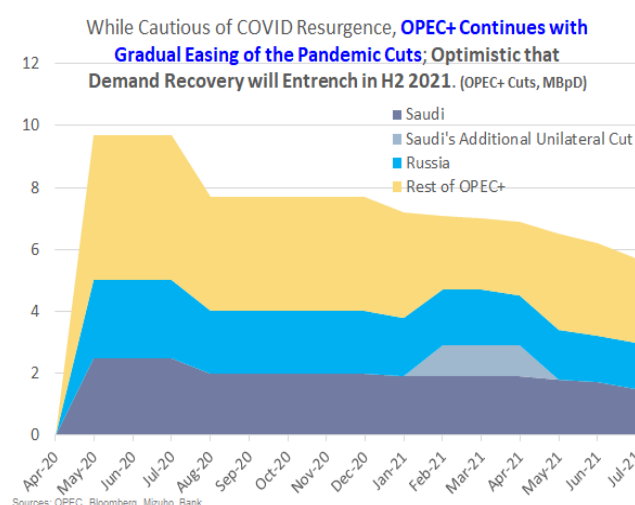
Fed Policy a Key Catalyst for 'USD Smile' Inflection: On that note, rising UST yields, especially if reinforced by rising real yields, is arguably a key motivation for 'USD Smile' dynamics to shift to the "Right Side". But only inconclusively so. Instead, experience suggests that Fed policy shift (e.g. 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 & Commodities: Reflation-Fuelled Boom

USD/barrel	Q2 21	Q3 21	Q4 21	Q1 22	Q2 22
Brent oil prices	\$68 (\$62-\$73)	\$65 (\$60-\$74)	\$74 (\$63-\$82)	\$73 (\$62-\$79)	\$67 (\$62-\$75)

Resounding evidence of reflation-fuelled commodity boom is difficult to deny given the run-up in commodity prices across energy and industrial metals. The **confluence of global vaccine rollout**, despite being at rather variable speed across economies, and the **containment learning curve helping to avert the harshest of restrictions/lockdowns** (even in the event of subsequent COVID outbreaks) is **underpins the demand recovery story** critical to providing a **boost to commodities**. And to be sure, this **fillip is not confined to a restoration of to pre-COVID levels** *such as* in the case of *oil*, but to **well beyond to 2011 highs for copper and iron ore**.

And this **is amplified by the unprecedented policy stimulus**, in particular accentuated by fiscal boost to infrastructure capacity expansion plans; *led by Biden's \$2.2trln US infrastructure* proposal. And in this context, **prospects for construction activity to resume as vaccination rollout widens** feeds into **multiplier effects of industrial metal prices** (projected from pipeline demand). And this is revealed in the **striking out-performance of industrial metals**, far ahead of precious metals – with Copper-to-Gold ratios surging – as well as energy.



To some extent, the fading need for prolonged QE as reflation takes hold dims the compelling allure of Gold; revealing a measured degree of antagonism between industrial and precious metals.

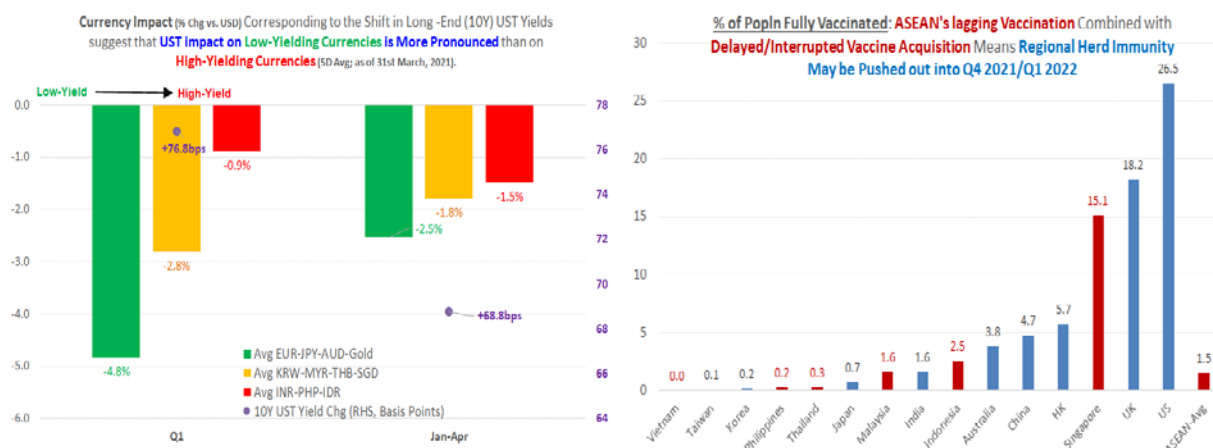
Whereas, as for **Oil** (and Energy), **wider dependence on global travel**, which is currently foiled by COVID mutations/resurgence and spots of setbacks to vaccine rollout, **conspiring with deliberately and painfully idled OPEC+ capacity** means that Oil's ascend is more likely to be checked from the current levels above \$60. As OPEC+ projects surplus inventory to be drawn down in H2 2021, the **phased restoration of OPEC+ production is likely to dampen Oil's beta to demand recovery**. As such, we expect that **Brent crude is likely to consolidate mostly in the \$60-75 range**, as the OPEC+ **retain not only idle capacity to ramp-up production, but also has a desire to do so** given pressures to make up for lost revenues (from output volume constraints imposed) amid fiscal strains exacerbated by COVID. As such, we think surges above \$85 likely to be short-lived; at least until a more coordinated demand pick-up across AEs, China and India start to come through (into 2022-2023?).

Asia FX: Divergence & Differentiation

'USD Smile' curve variability necessarily entails **higher downside volatility** as well as a **greater degree of differentiation within EM Asia FX**; which have been factored into H1 forecasts. At least

until markets get a grip on the **transmission** from the Fed's **flexible average inflation target** (which anchors low end yields exceptionally well) to **long-end yields**, EM Asia FX may be subject to **volatility**, vulnerable to episodes of USD strength.

Differentiation within EM Asia FX may then be coloured by **differences in vaccine rollout, exposures to higher energy/commodity/food prices** and supply-chain positioning in tis uneven global demand recovery. Typically, an **unexpectedly stronger USD from 'USD Smile' inflection will tend to impact "twin deficit" and higher-yielding EM Asia FX more adversely**; but subject to the lags between UST yield transmission and yield-seeking we outlined in an earlier piece ([Mizuho Chart Speak - EM Asia Risks: Beware High-Yield Spill-over from UST Upheaval, 12th March 2021](#)).



With **COVID relief** being patchy and tentative in Asia, the **ability of EM Asia FX to make the most of a softening bias in the USD has been suppressed**. What complicates the picture is that **FX paths are not just purely functions of COVID management and vaccinations lags** however. Instead, the **draw of yield-seeking behaviour** means that **the tensions between lingering risks and in-coming relief has been obfuscated by the overlay of greed**.

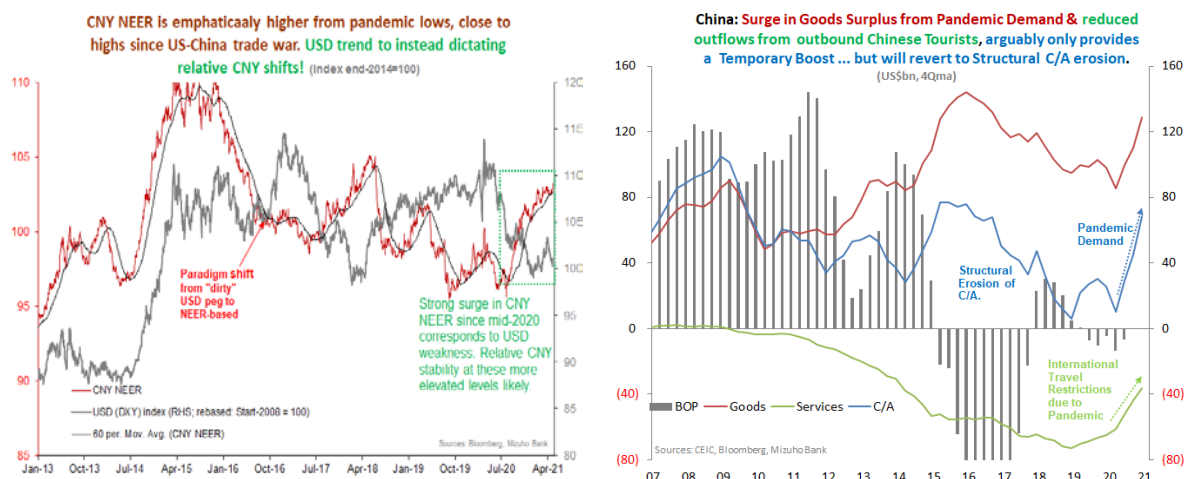
And so, there has been a **curious case of high-yielding EM Asia currencies having withstood rising UST yields better than their lower yielding counterparts**. This is however representative of yield-seeking behaviour allowing for pressures from higher UST yields to be absorbed by a relatively large cushion on returns; whereas (record) low yields in EM Asia space are highly sensitive as “no arbitrage” conditions kick in much faster. **But this has limits**. And **further (and sustained) rise in UST yields will probably increase the risks of abrupt risk re-pricing**. The timing of which may be **hastened by increasing lags in vaccinations and/or re-emergence of outbreaks**.

Reflation becoming more entrenched also means that vulnerability to risk re-pricing is most acute for “twin deficit” currencies most susceptible to cost-push pressures cutting into disposable income and profit margins. And so, in concert, volatility in INR, IDR and PHP May be higher near-term before some stabilization at stronger levels in late 2021; although H1 2022 may spell renewed sell-off risks if Fed taper comes into view.

CNY: Steady as She Goes

	Q1 2021	Q2 2021	Q3 2021	Q4 2021	Q1 2022	Q2 2022
Policy rate^	3.85%	3.85%	3.85%	3.85%	3.85%	3.85%
USD/CNY*	6.42-6.58	6.21 - 6.76	6.29 - 6.70	6.26 - 6.64	6.13 - 6.51	6.37 - 6.79
	6.57	6.44	6.52	6.46	6.33	6.58

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%



China's "dual circulation" policy in its broader context will further diminish the case for mercantilist exchange rate policies insofar that it;

- i) de-emphasizes lopsided exports dependency with a coincident focus on domestic demand;
- ii) moves manufacturing up the value chain, where *price competitiveness is reduced*, and;
- iii) requires acquisition of critical technology and know-how, which will in turn benefit from some degree of currency strength.

But while this will create a greater degree of policy comfort with a stronger CNY, it is **not to be mistaken for a desire for significant CNY appreciation** from this point. Instead, it merely lends support for a stable CNY with measured allowance for CNY appreciation on a trade-weighted basis.

Moreover, some shift in fundamentals to be expected also align with checking, rather than accentuating, CNY strength. First, a reversion to pre-COVID trade patterns amid deflation could start to erode China's goods surplus as higher commodity/energy import prices conspire with a pullback on "pandemic demand" to which China was nimble in catering to. What's more, *resumption of travel could also reinstate significant outflow of Chinese tourist spending*, which has temporarily been diverted onshore. In concert, this spells a **reversion back to China's Current Account erosion**.

Above all, **US-China tensions set to re-emerge more prominently as COVID** fades from the headlines could also dampen CNY allure. Especially if the timing coincides with re-emergence of USD strength from "taper" catalyst in 2022 (?).

Finally, suggestions that China's lead in (monetary) policy normalisation will drive CNY materially higher miss the wider point that China's closed capital account diminishes the impact from monetary policy divergences. Instead, what's **more pertinent are concerns of default risks from targeted tightening in parts of the credit channels**. And these are likely to at the very least check the pace of CNY appreciation.

In concert, we expect that the CNY will consolidate at slightly stronger levels in H2; potentially testing below 6.30 levels; but is unlikely to sustain an emphatic downward trend. And in H1 2022, USD squeeze above 6.80 is a risk that may not be discounted.

AUD: Between Bellwether & “Whether Bull”

	Q1 2021	Q2 2021	Q3 2021	Q4 2022	Q1 2022	Q2 2022
Policy Rate (%)	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%
AUD/USD	0.75-0.80	0.750-0.832	0.751-0.852	0.742-0.836	0.768-0.853	0.743-0.815
	0.76	0.800	0.788	0.800	0.810	0.778

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

AUD bulls have three reasons to get somewhat revved up, but could still struggle to

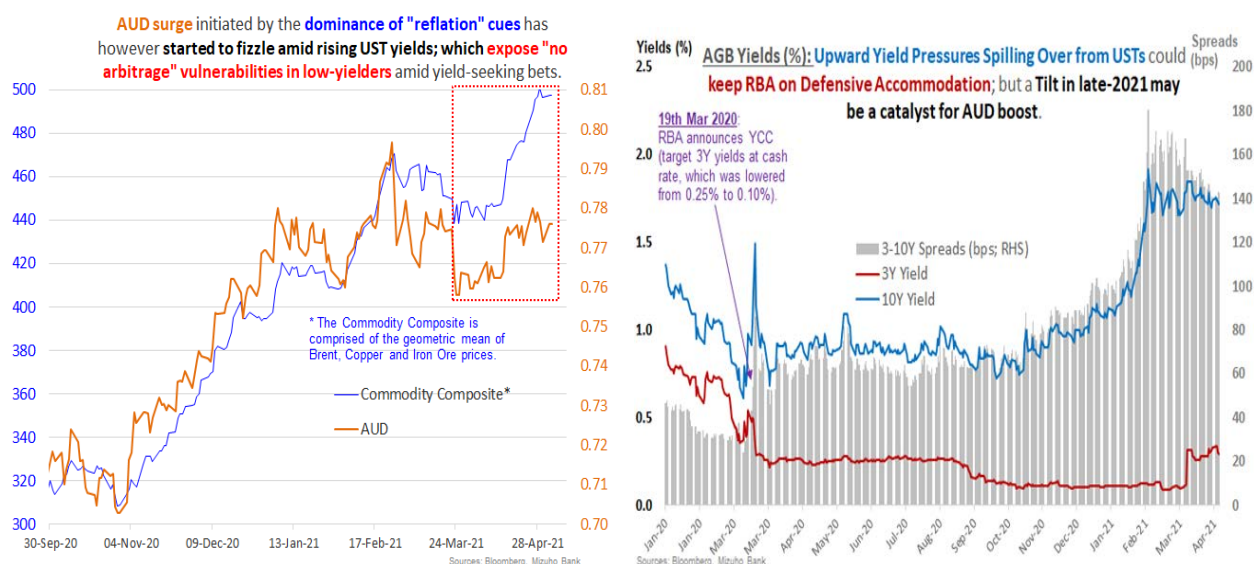
First, the RBA is increasingly tilting to a more neutral stance; expressly acknowledging better than expected economic and employment outcomes.

Accordingly, despite erring in the side of growth support/job market healing, the RBA is likely poised for reducing rather than ramping up policy stimulus. In particular, if the **second tranche of A\$100 of QE is wound up in Sep 2021, as scheduled, and further complemented by reduced YCC, AUD could be set for a fillip**. More so as Asia catches up US and UK on vaccination (in late 2021).

Finally, **global construction resumption** against a backdrop of US mega-infrastructure is also likely to **lift Australian output from mining flow-through**, further accentuated by **positive terms of trade effects**. In short the AUD appears to be the model for reflation lift.

But that said, we expect AUD upside bias to be punctuated by China risks and US divergence. Especially as a good part of reflation. Lost to AUD appears to have come through.

Specifically, AUD could still be vulnerable to;



- bouts of pick upon UST yields, which simultaneously erode AUD vis-a-vis USD and may trigger more QE-type response from the RBA;
- FOMC taper resulting in USD squeeze and a corresponding rush out of USD;
- lingering COVID risks, which can sent negative ripples via commodity prices.

So while **AUD may be a great bellwether of global economic recovery, whether bulls can materially extend and maintain ground will depend on the shape of Australia's COVID**

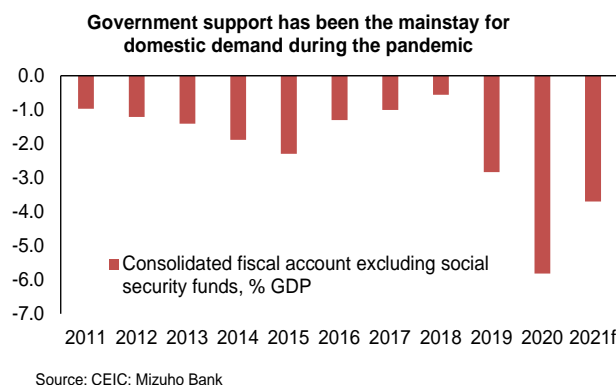
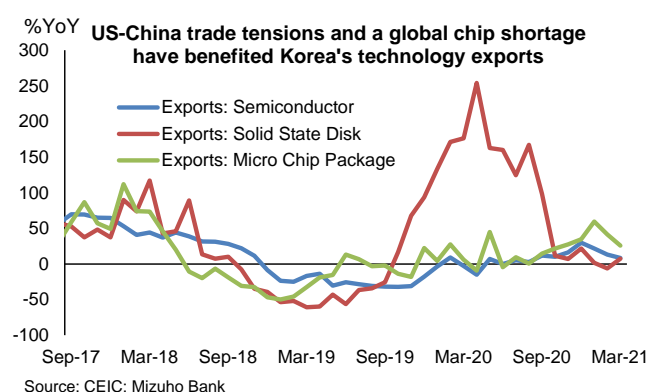
recovery, commodities and the Fed's propensity to "taper". We **expect a bumpy path up for AUD in 2021 although gains are likely to be checked** (and reined in) in H1 2022 as prospects of taper grow.

But that said, we expect a fairly higher floor for AUD compared to 2020.

KRW: Broadly Resilient

	Q1 2021	Q2 2021	Q3 2021	Q4 2022	Q1 2022	Q2 2022
Policy Rate (%)	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%
USD/KRW	1145-1080	1040 - 1130	1070 - 1150	1040 - 1100	1000 - 1070	1150 - 1240
	1134	1080	1115	1070	1040	1200

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



KRW will remain fairly resilient through H1 2021. Although new waves of COVID-19 have regularly impacted Korea, large scale lockdowns have been avoided and **accommodative fiscal and monetary policies have been effective in providing support to the most impacted parts of the economy**. This has resulted in growth not contracting as sharply as regional peers in 2020 and picking up decently in Q1 2021.

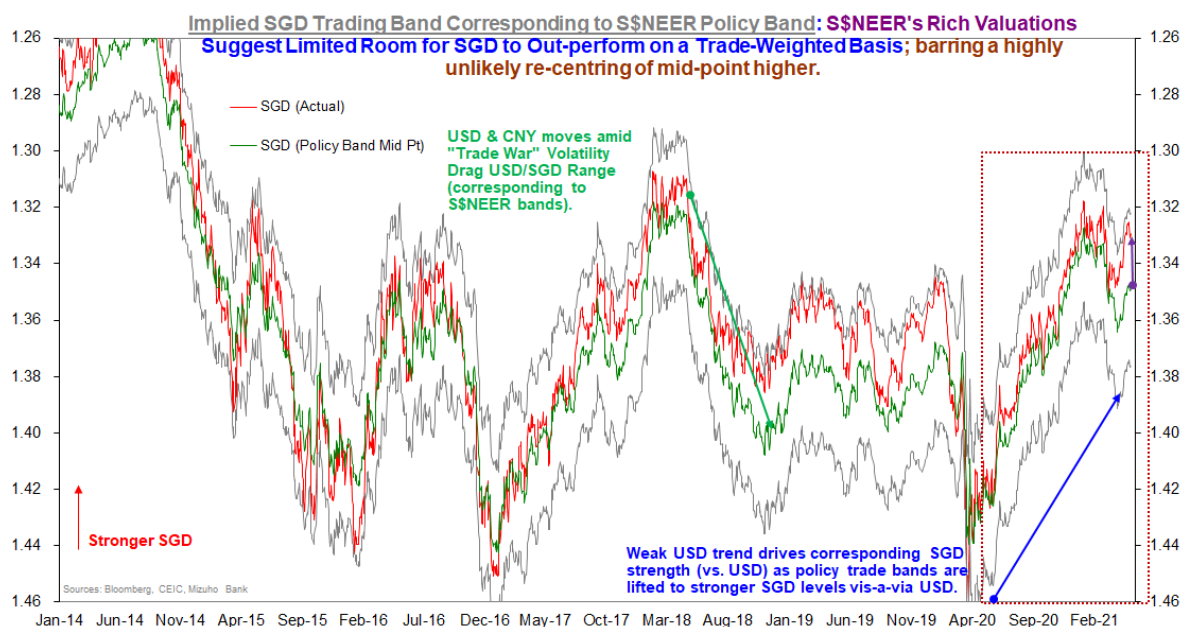
Furthermore, **export growth has remained strong despite uncertain external demand conditions given Korea's technology goods advantage**. This advantage could be sharpened with President Biden maintaining pressure on China and giving Korea the chance to benefit from substitution effects.

That said, with a softer USD in Q2 and Korea making progress on its vaccination drive, **we expect the KRW to remain broadly resilient**. More fundamentally, even when the USD shifts to the stronger side, Korea's export advantage as well as the strong policy support to growth will keep KRW from depreciating sharply. Bank of Korea, for its part, will likely smooth sharp and abrupt moves in KRW in either direction, but maintain its market anchored integrity.

SGD: Nearly Rich & Certainly Policy-Constrained

	Q1 2021	Q2 2021	Q3 2021	Q4 2022	Q1 2022	Q2 2022
Policy Rate (%)	Status Quo		Status Quo		Slight S\$NEER Slope Reinstatement	
USD/SGD	1.32-1.35	1.28 - 1.35	1.29 - 1.37	1.28 - 1.35	1.27 - 1.33	1.31 - 1.38
	1.35	1.31	1.32	1.31	1.30	1.35

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



Since the MAS meeting (on 14th Apr), SGD has strengthened substantially from ~1.34 USD/SGD levels to mid-1.32 (at the point of writing); up some 1.2% since MAS meeting and up 1.4% for April, though this is still fractionally down (-0.3%) year-to-date.

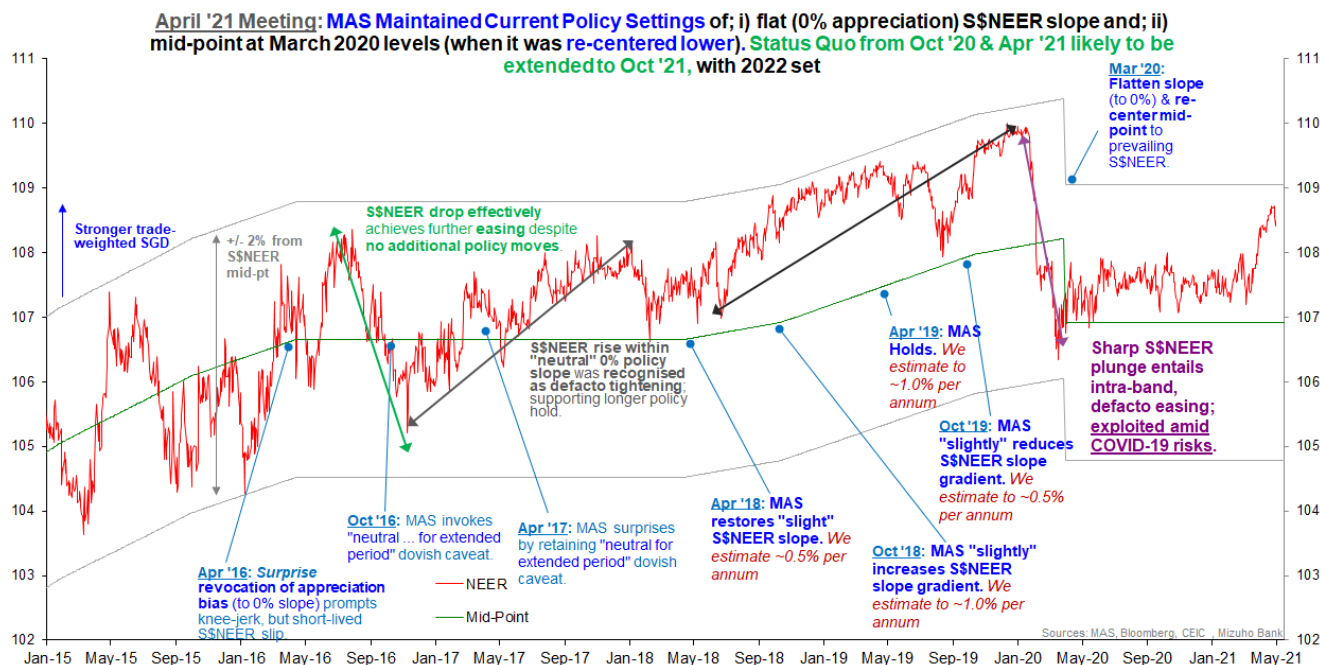
It is easy to attribute this to an **ostensibly less dovish MAS**, which notably **dropped** the “*for some time*” duration **guidance** to its **dovish stance** that “*policy accommodation remains appropriate*”. But the **confluence of two factors** means that this should not be mistaken for unbridled SGD strength from anticipated S\$NEER policy tightening.

The first condition is that of a **rather rich S\$NEER** evident for anyone who observes the S\$NEER's relative position within the policy bands. And notably, the **S\$NEER**, and correspondingly the trade-weighted SGD, is **approaching the boundaries of its (policy) upper limit**.

What's more, the S\$NEER is **not just richly valued but has risen significantly to around 150-170bps above the policy-mid-point from 40-80bps premium earlier in Q1 2021** (over and above the +120bps pre-MAS positioning). And this is **pushing the envelope on the upper limit of the (presumed) +/-200bps policy leeway for the S\$NEER**. Which is to say that this defacto tightening within the policy bands already more than accounts for a less dovish stance.

Whereas the MAS' next move, while most likely a tightening, is set to be calibrated restoration of a “slight” appreciation of the S\$NEER policy slope rather than a brutal step appreciated. In which case, the second condition, **even if the MAS moves to tighten earlier than expected, the policy headroom S\$NEER will not be immediately increased**. Instead it may be a very gradual appreciation bias of some 0.50% per annum that increases the upper limit of the S\$NEER by 50bps over a year.

Which is to say, the **30-50bps upside constraint of S\$NEER will be as binding as it is calibrated**. That is to say, **SGD out-performance will, on a trade-weighted basis, be rather limited**; to 30-50bps as indicated by relative positioning within S\$NEER policy bands. Or practically speaking, the **SGD is most likely to be driven by the broader USD trend**; with the specifics of its performance hinging on EUR, CNY and MYR, which tend to be the largest component of its trade basket. In addition, some degree of JPY sympathy from its quasi safe-haven status also factors into SGD performance. Thus, the overarching point is that **while SGD may out-perform on instances of “risk off”**, on a sustained basis, the room for SGD out-performance is severely curtailed by the rich S\$NEER.



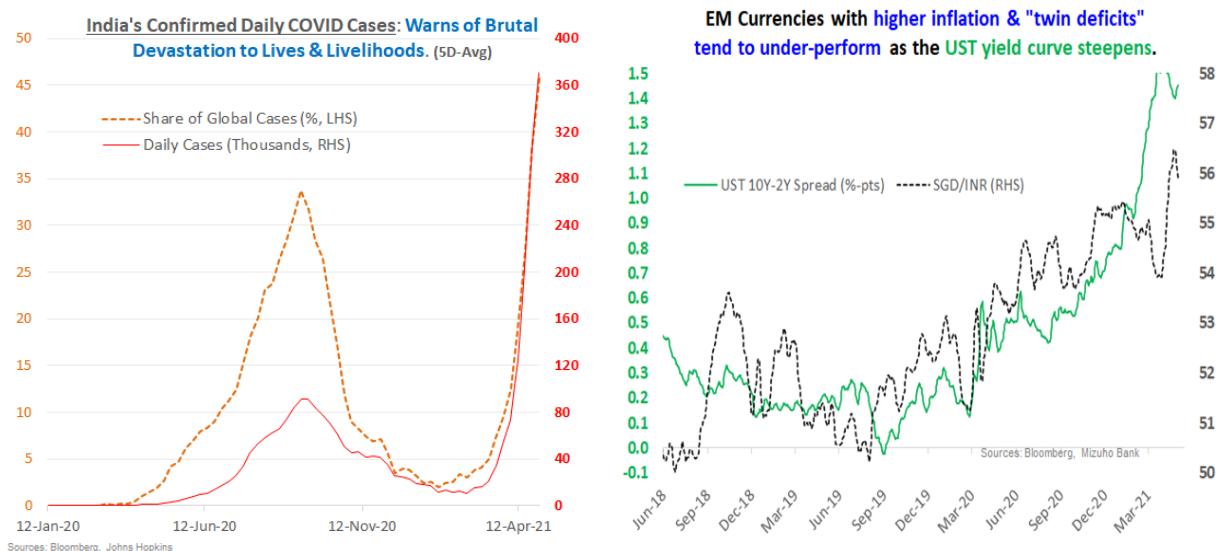
Meanwhile, measured USD weakness in 2021 could see USD/SGD test 1.31 support. But volatility rather than unabated weakness may overtake USD dynamics. And with this we expect **bumpy-two way price action towards a slightly softer USD/SGD this year**; but with distinct **non-negligible risks of USD/SGD squeeze on US-China risks coupled with “taper” prospects in 2022**.

INR: COVID Consternation

	Q1 2021	Q2 2021	Q3 2021	Q4 2022	Q1 2022	Q2 2022
Policy Rate (%)	4.00%	3.75%	3.75%	3.75%	3.75%	3.75%
USD/INR	72.28-73.79	73.0 - 79.4	72.2 - 77.3	71.8 - 76.5	69.5 - 75.0	73.3 - 79.3
	73.39	76.2	75.3	74.2	72.8	76.8

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

The **rupee is poised for more complex reactions function, with a propensity to under-perform, amid COVID consternation** (see Box 2); though admittedly, reserve building earlier and the hunt for yields amid bets on COVID re-emergence makes for a more unpredictable dynamic.



To be sure, our **base case is for rupee underperformance premised on the deadly wave of COVID** sweeping through India is arguably a simplistic reflex; but in its my it **coincides with wider current account and inflation shifts that may underscore at least a diluted version of this conjecture.**

Right off the bat, rupee dent projected from the devastating second wave is subject to the tensions between nearer-term economic recovery delayed and confidence that a strong come-back is however not derailed. The nuance here though is that the longer the delay, the less likely that a rebound in growth subsequently will prove to be a major boost for the rupee. So time is of the essence in pricing in rupee rebound inspired by growth.

For one, a **considerably delayed recovery is at higher risk of facing headwinds from less accommodative US policies** that may be accompanied by higher long-end US rates. In the worst case in fact, **rupee may sell off acutely if “taper tantrum”-type market disruption unfold.** What’s more rising commodity/energy prices also start to erode the Current Account along with corporate profit margins and disposable household income.

This **could also accentuate upside risks to inflation**, or at the very least keep it **sticky near the upper end of the RBI’s inflation target**; not only **constraining the RBI’s policy options/recourse** to support growth but **more worryingly upping the risks of destabilizing capital outflows** as real returns get slammed.

What’s worrying is that **in a more adverse iteration, this could have a negative feedback loop with the rupee.** Especially given the strains fiscal position accentuates twin deficit risks amid banking weakness and fragile growth multipliers impaired by disproportionately affected informal sector (grey economy). For more details on COVID risks to India, please refer to Box 2 below.

Admittedly the RBI’s strategic reserve building during protracted USD weakness May last year serves as a welcome buffer, limiting extreme rupee risks (to the negative side). Nonetheless, this does not negate risks of rupee testing 76-78 on episodes of slide in Q2 2020 and or in H1 2022.

Box 2: India's Devastating "Second Wave"

Misdiagnosis & Disproportional Devastation: India's devastating second wave of COVID is a tragedy born out of overconfident mis-diagnosis that vaccine rollout can supplant containment efforts ahead of herd immunity, compounded by the pre-existing pitfall of a false choice between containment and economic relief. The perceived dilemma is understandable but self-defeating; as lapses in containment that stress hospital capacity, will inadvertently inflict the malady of disproportional pain cascading from accompanying economic seizures. To be sure, India's daily cases spiking to over 400K, dwarfing the worst (sub-100K) of its Sep 2020 first wave and *accounting for over 40% of all global cases*, is first and foremost a human tragedy devastating lives and livelihoods like never before.

Vigilance Non-Negotiable: Beyond which, it is a cautionary tale against premature vaccine euphoria, and a round denunciation of complacency about containment on account of vaccine rollout. Fact is, *vaccine rollout simply does not absolve the need for vigilance on containment*. While India's violent COVID resurgence is the shrillest reminder that "flattening the COVID curve" is a burdensome journey, not a destination with bragging rights, the lesson is a global one.

More Dire On-the-Ground Realities: Especially as reported cases, likely, understate on-the-ground horrors of COVID. Inherent data shortcomings mean that real-time/complete vaccination data in contrast to cases/deaths subject to reporting lags and detection lapses (capacity constraints/asymptomatic cases).

Guarding Against Tipping Points: What's more, metrics such as infection and death rates are not to be misunderstood as static risks. Fact is, these are conditional outcomes highly dependent on on-going containment efforts (impeding contagion) and healthcare capacity (hospital beds, health care workers, medical equipment/treatment); with adverse feedback loops between them. So, averting a sharp deterioration to the "tipping point" that results in disproportionately large human and economic devastation is the unequivocal policy priority.

Economic Setback: With pockets of lockdown necessitated, and the healthcare crisis hijacking a nascent and fragile economic recovery, the unavoidable conclusion is that India's economic recovery will be at least delayed, if not diminished; *even after accounting for less brutal lockdown compared to last year*. We have accordingly downgraded CY2021 growth outlook to 6.8-7.8% (from ~10%) in a cyclical response to COVID resurgence; cognisant of wider dangers from accentuated unevenness of recovery, with inequalities inadvertently exacerbated.

"Grey" & Banking Pain Amplifiers: In which case, the far greater threat is that of "scarring" from disproportional adverse impact on the grey economy, in turn undermining growth multipliers. Reports on the plight of informal/daily-rated workers amid lost livelihoods casts a shadow (both supply- and demand-side) on the post-COVID snap back narrative. Moreover, prolonged retardation and restraint in the recovery amplifying balance sheet stress (both corporate and public sector) challenge the desire for investment pick-up to lead the way out of the pandemic. The is an unwelcome headwind to banking sector already saddled with non-performing assets and capital impairments pre-COVID.

Circular Maladies: In worse case iterations of lingering pandemic drag, the circularity of growth, banking sector impediments, fiscal constraints and credit ratings risks is the bugbear. Admittedly, the half-full take is that rating agencies remain optimistic about prospects for India's post-COVID rebound that is "delayed, nor derailed". But on the flip side, "stickier" growth downgrades may evoke negative credit ratings action given growth-fiscal feedback loops, and in the context of negative outlook by two of the three major ratings agencies (Fitch and Moody's). Making for more precarious circular risks is India's fringe ('BBB-/'Baa3') investment grade rating. Near-term, these risks may manifest as INR wobbles, until COVID containment is established more convincingly. Effective and lasting containment of COVID until herd immunity is attained is this a pre-condition for India to avoid a negative spiral of growth-banking-fiscal-ratings risks. The severity of the malady at hand does not afford any mis-diagnosis and/or policy mis-steps.

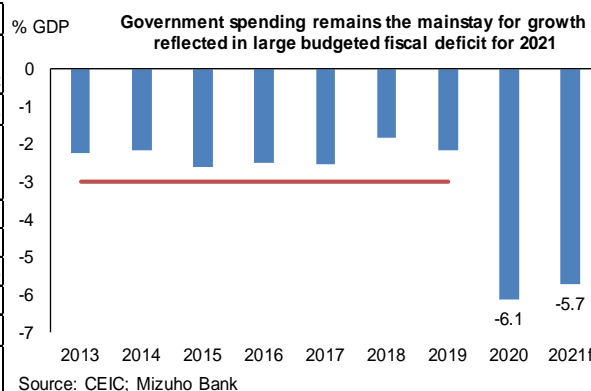
IDR: Vulnerabilities persist

	Q1 2021	Q2 2021	Q3 2021	Q4 2022	Q1 2022	Q2 2022
Policy Rate (%)	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%
USD/IDR	13895-14498	14320 - 15500	14320 - 15500	14020 - 15190	13750 - 14900	14480 - 15740
	14480	14750	14750	14350	14200	14960

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

Indonesia: Vaccination doses received versus total expected				
Country	Vaccination brand	Doses received so far	Total doses expected	% of target
Indonesia (As of 18 April)	Sinovac	59.5mn	140mn	42.5
	AstraZeneca	Only 20mn expected to arrive in 2021; 30mn in 2022	50mn	N/A
	Novavax Inc	N/A	50mn	N/A
	Indigenous Merah Putih	N/A	57.6mn	N/A
	AstraZeneca (with COVAX)	16mn	54mn	29.6
	Pfizer-BioNTech	N/A	50mn	N/A
	Total	75.5mn	441mn	17.1

Source: Cabinet Secretariat of the Republic of Indonesia, The Diplomat, Jakarta Globe, Jakarta Post, Mizuho Bank.
Note: The shipments from Sinovac include raw material equivalent of completed doses.



USD/IDR will be volatile in the coming quarters reflecting not just USD trends but also domestic vulnerabilities; both of these factors, we expect, will lead to some underperformance of the currency relative to peers. The softness in USD in Q2 may not be off much help to IDR given that the domestic situation looks vulnerable. Further out into Q4 and 2021, as the domestic situation stabilises, we expect IDR to regain some foothold.

Domestically, **the pandemic situation remains a cause for concern**. Although the government has instituted social restrictions in regions most impacted by COVID-19, the spread of the virus continues and may intensify during the Lebaran period (despite an intra-country travel ban). The government, as such, **has come to heavily rely on the vaccination drive** to bring the pandemic under control. However, so far only 17% of procured vaccinations have been received by Indonesia; while on paper, the government has signed deals to procure enough vaccines for ~80% of the population, it is unlikely that the supply of these vaccinations will come in on time, delaying the vaccination drive. Furthermore, challenges with respect to distributing the vaccinations across the archipelago cannot be understated.

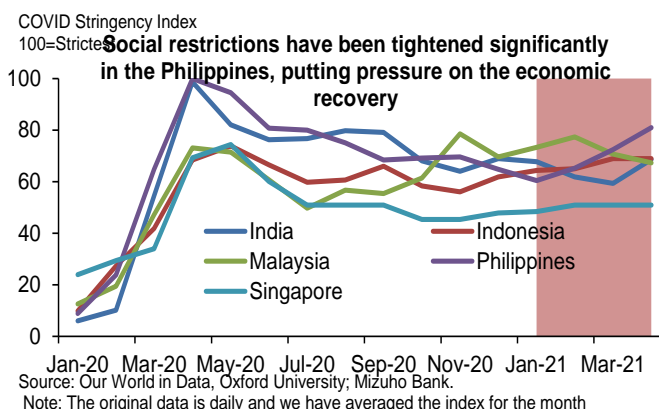
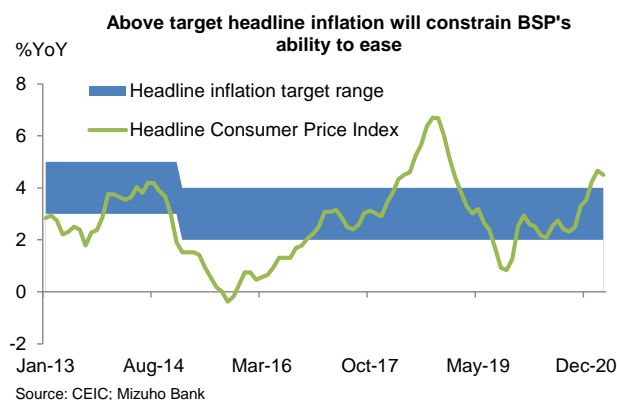
Others concerns around the IDR are from potential legislation changes. The government is planning to amend the central bank bill to include into BI's mandate growth as well as employment, along with inflation. The inclusion of these criterion **raise concerns around BI's credibility as well as its independence**, which can sorely be undermined by mixing multiple, often conflicting priorities, to the central banks' mandate.

Flare-ups in USD/IDR on these concerns cannot be ruled out. These can be **exacerbated by debt monetisation concerns** given that BI is still buying a large portion of government debt in the primary market to finance the fiscal deficit. And importantly, **fiscal policy remains the main engine of growth** with the fiscal deficits for 2021 and 2022 expected to be large.

PHP: Some underperformance to be expected

	Q1 2021	Q2 2021	Q3 2021	Q4 2022	Q1 2022	Q2 2022
Policy Rate (%)	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%
USD/PHP	47.4-48.8	46.3 - 50.3	46.9 - 50.1	46.8 - 49.8	46.0 - 49.4	46.9 - 50.6
	48.5	48.2	48.8	48.3	48.0	49.0

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



USD/PHP has been relatively range bound between 48-48.6 since the start of 2021. **Rising headline inflation to above the upper band of the BSP's 2-4% inflation target range**, constraints the BSP's easing bias. It cut the policy rate by 100bp in 2020 and funded some part of the government's fiscal deficit, in a measured and rule-based manner. However, **the persistent rise in headline inflation since September 2020 has tied the BSP's hands in terms of further imminent rate cuts**. Although higher inflation is being driven by supply-side factors, i.e. the price of pork and chicken; the persistent increase in these prices into 2021 risks setting into motion second round price increases at a time of higher unemployment and falling wage growth.

The need for the government to support growth has, therefore, increased. Unfortunately, the government has struggled to meet its expenditure targets and fell short of its 2020 fiscal deficit target by almost 2% of GDP. While this means that there is more money that can be spent in 2021, some of the main bottlenecks to expediting spending, including administrative hurdles have not been resolved.

Furthermore, **the Philippines COVID-19 case load, rising social restrictions and a slow vaccination drive will compound the headwinds to growth**, making the economic recovery pencilled in for this year fragile and inconsistent. As such, we expect **USD/PHP will underperform regional peers in the coming quarters**.

MYR: Resilient after political risks have diminished

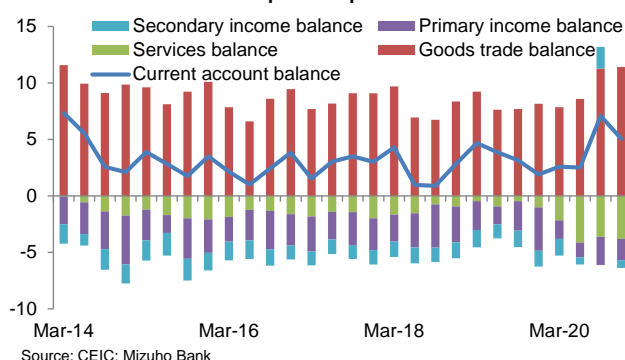
	Q1 2021	Q2 2021	Q3 2021	Q4 2022	Q1 2022	Q2 2022
Policy Rate (%)	1.75%	1.75%	1.75%	1.75%	1.75%	1.75%
USD/MYR	3.99-4.15	3.80 - 4.22	3.98 - 4.24	3.96 - 4.24	3.85 - 4.14	4.01 - 4.36
	4.15	4.04	4.13	4.08	4.02	4.19

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

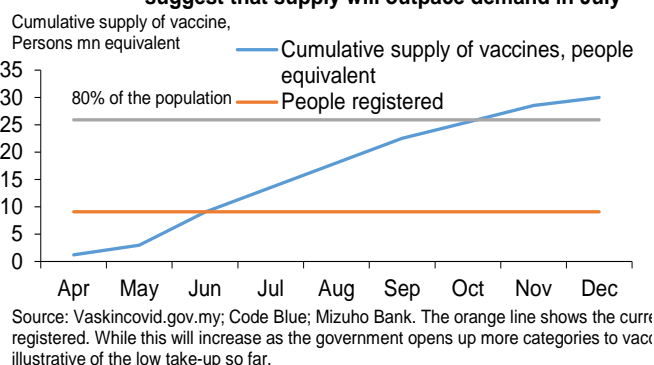
MYR's general weakness in Q1 2021 was marked by a few domestic factors, apart from USD strength alone. For one, **Malaysia's COVID-19 situation became more precarious through January and February forcing the government to impose stringent Movement Control Orders**. Second, **the political situation remained uncertain** as the government could not convincingly show a Parliamentary majority and a state of emergency was imposed on 12 January. The emergency is

expected to be lifted once a small group advising the King deems that the pandemic situation is under control – most expect the Emergency to last at least until September 2021.

Malaysia's current account surplus jumped driven by import compression



Malaysia: The current level of vaccine registrations suggest that supply will outpace demand in July



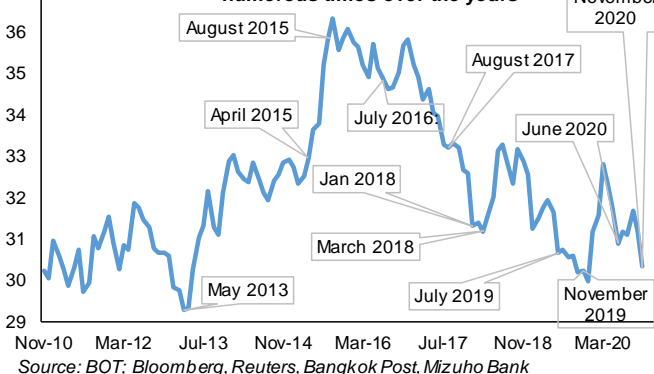
For the rest of the year, however, MYR is better placed than most other Asian EM currencies, in our view. The state of emergency is a blessing in disguise, as we see it, removing near-term political uncertainty and offering a steady hand to see through the surge in COVID-19 cases. Risks from FTSE Russell removing Malaysia from the WGBI have tided over; FTSE Russell confirmed Malaysia's inclusion by removing it from the 'watchlist'. The vaccination drive is well supported as the government has, on paper, procured enough vaccinations to cover the entire population; that said, delays cannot be ruled out given global vaccine supply and distribution challenges. Malaysia also faces a unique problem in that vaccination supplies will exceed demand by July, if registrations are not increased. Finally, as the global recovery gains traction, the rise in commodity (In particular, oil prices) will bolster the economic recovery especially in H2.

THB: A Change in Fortunes

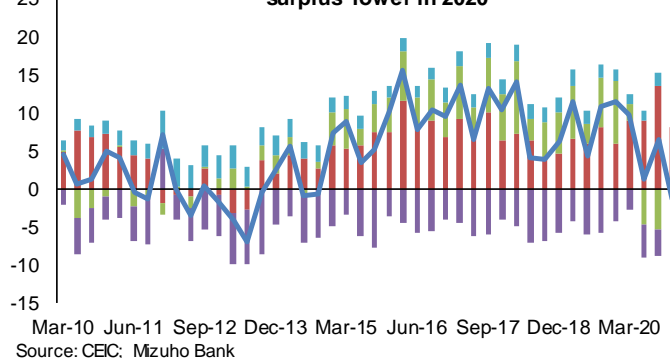
	Q1 2021	Q2 2021	Q3 2021	Q4 2022	Q1 2022	Q2 2022
Policy Rate (%)	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%
USD/THB	29.9-31.2	29.8 - 31.4	30.4 - 32.6	29.4 - 31.5	28.4 - 31.0	30.9 - 32.7
	31.2	31.3	31.2	30.6	30.2	31.8

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

USDTHB BOT has announced measures to curb THB strength numerous times over the years



USDbn A slump in tourist arrivals drove the current account surplus lower in 2020



THB's change in fortune in 2021 has been fortuitous for the BOT, which struggled with THB appreciation through 2020 and even announced numerous measures to alleviate the appreciation

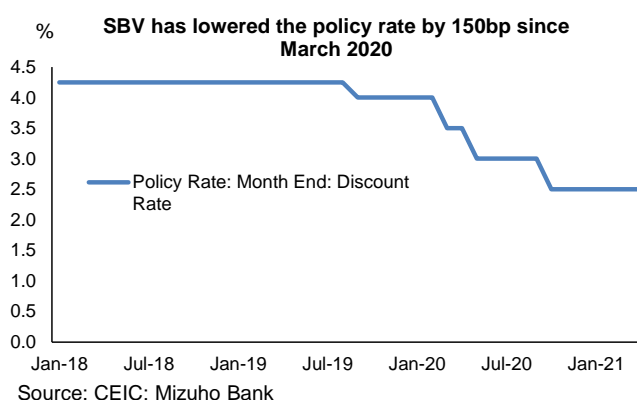
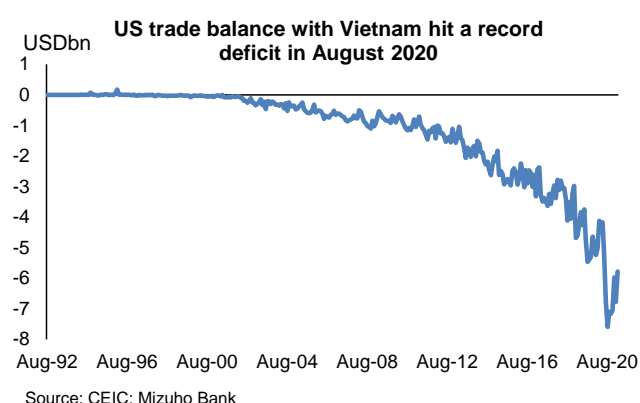
pressure, as it diverged significantly from the weak fundamentals of the economy. THB weakness, while driven by the US dollar trend to some extent, is also a function of market participants realising that Thailand's economic struggle will continue until much of the world is vaccinated and tourism channels resume.

Notwithstanding some bouts of downward movement in USD/THB, we broadly expect the depreciation pressure on THB to be sustained for a few reasons. First, although street protests have reduced on account renewed waves of COVID-19 infections, **the political situation remains precarious as the reality is that none of the changes demanded by protestors have been met:** namely, with regard to changes to laws around the Monarchy, the constitution and the resignation of the current PM; Second, **the current account position has shifted from a surplus to a deficit as the lack of tourism** has dried up services export growth, alleviating some appreciation pressures on the currency; Third, **Thailand's growth revival prospects are not driven by domestic factors alone but by the resuscitation of tourism and tourism-related sectors**, which will require more countries globally to make progress on vaccinations. **Lastly, Thailand's vaccination drive has left many wanting for more.** The government is heavily reliant on AstraZeneca (which is facing a number of production issues) and only recently has been shopping from other vaccine producers, making the timeline for the procurement of additional jabs uncertain and stretching out Thailand's path to herd immunity.

VND: No more a manipulator

	Q1 2021	Q2 2021	Q3 2021	Q4 2021	Q1 2022	Q2 2022
Policy Rate (%)	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%
USD/VND	22953-23164	22400 - 23600	22500 - 23500	22600 - 23500	22400 - 23400	22600 - 23700
	23071	23030	23090	23060	23020	23200

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



The Trump administration, as parting gift, in its final bi-annual currency report designated **Vietnam a currency manipulator** stating that it undervalued its currency by 4.7% in 2019. **Under Janet Yellen, the Treasury has taken a less confrontational approach and refrained from using this tag.** Despite this, **the underlying pressure on Vietnamese authorities with respect to VND has sustained.** The underlying issues of US' persistent and still wide trade deficit with Vietnam (albeit, narrowing from the record in August in 2020) needs to be addressed by looking at more fundamental reasons as well as the structure of the trading relationship.

Although Vietnam did outperform regional peers in 2020 by successfully containing COVID-19 outbreaks through rapid and effective contact tracing and targeted lockdowns, **it is behind the curve on its vaccination drive. This could weigh on the recovery and the currency in H2 2021 and 2022.**

Important Information

This publication has been prepared by Mizuho Bank, Ltd. ("Mizuho") and represents the views of the author. It has not been prepared by an independent research department and it has not been prepared in accordance with legal requirements in any country or jurisdiction designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research. MHBK provides this information for free. Please request for cancellation of subscription if you do not want to receive free-of-charge information from MHBK.

Disclaimer

Unless otherwise stated, all views or opinions herein are solely those of the author(s) as of the date of this publication and are not to be relied upon as authoritative or taken in substitution for the exercise of judgement by any recipient, and are subject to change without notice.

This publication has been prepared by Mizuho solely from publicly available information. Information contained herein and the data underlying it have been obtained from, or based upon, sources believed by us to be reliable, but no assurance can be given that the information, data or any computations based thereon are accurate or complete. This publication provides general background information only. It is information in summary form and does not purport to be complete. This publication has been prepared for information purposes only and is not intended by Mizuho or its affiliates to constitute investment, legal, accounting, tax or other advice of any kind and all recipients of this publication are advised to contact independent advisors in order to evaluate the publication, including, without limitation, the suitability of any security, commodity, futures contract or instrument or related derivative (hereinafter, a "financial instrument"), product or strategy herein described. This publication is not intended to be relied upon as advice to investors or potential investors and does not take into account investment objectives, financial situation or needs of any particular investor. It is not intended for persons who are Retail Clients within the meaning of the United Kingdom's Financial Conduct Authority rules nor for persons who are restricted in accordance with US, Japanese, Singapore or any other applicable securities laws.

This publication has been prepared for information purposes only and is not intended by Mizuho to market any financial instrument, product or service or serve as a recommendation to take or refrain from taking any particular course of action or participate in any trading or other strategy. This publication is not an offer to buy or sell or a solicitation of any offer to buy or sell any security or any of the assets, businesses or undertakings described herein, or any other financial instrument, nor is it an offer to participate in any trading or other strategy, nor a disclosure document under applicable laws, rules, regulations or guidelines. Nothing contained herein is in any way intended by Mizuho or its affiliates to offer, solicit and/or market any financial instrument, product or service, or to act as any inducement to enter into any contract or commitment whatsoever. Neither the author, Mizuho nor any affiliate accepts any liability whatsoever with respect to the use of this publication or its contents or for any errors or omissions herein.

Mizuho and its affiliates, connected companies, employees or clients may take the other side of any order by you, enter into transactions contrary to any recommendations contained herein or have positions or make markets or act as principal or agent in transactions in any securities mentioned herein or derivative transactions relating thereto or perform or seek financial or advisory services for the issuers of those securities or financial instruments.

All of the information contained in this publication is subject to further modification without prior notice and any and all opinions, forecasts, projections or forward-looking statements contained herein shall not be relied upon as facts nor relied upon as any indication of future results. Opinions stated in this publication are subject to change without notice. Future results may materially vary from such opinions, forecasts, projections or forward-looking statements. The information contained in this publication may not be current due to, among other things, changes in the financial markets or economic environment. Mizuho has no obligation to update any information contained in this publication. Past performance is not indicative of future performance.

This is a strictly privileged and confidential publication. This publication contains information addressed only to a specific individual and is not intended for distribution to, or use by, any person other than the named addressee or any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation. Save with Mizuho's prior written consent, you may not disclose, divulge, reproduce or furnish any information contained herein to any other party. Please notify the sender immediately if you have mistakenly received this publication.

Singapore: Mizuho is licensed as a bank under the Banking Act (Chapter 19) of Singapore, and is regulated by the Monetary Authority of Singapore.

Japan: Mizuho is authorised and regulated by the Financial Services Agency of Japan.

United Kingdom / European Economic Area: In the UK, Mizuho is authorised by the Prudential Regulation Authority and subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of MHBK's regulation by the Prudential Regulation Authority are available upon request. This publication may also be distributed by Mizuho International plc ("MHI"). MHI is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

United States: This publication is not a "research report" as defined in Commodity Futures Trading Commission ("CFTC") Regulations 1.71 and 23.605. The content of publications distributed by Mizuho Securities USA Inc. ("MSUSA") is the responsibility of MSUSA. The content of publications distributed directly to US customers by Mizuho is the responsibility of Mizuho. US investors must effect any order for a security that is the subject of this report through MSUSA.

© 2014 Mizuho Bank Ltd.