Mizuho Chart Speak: EM Asia FX

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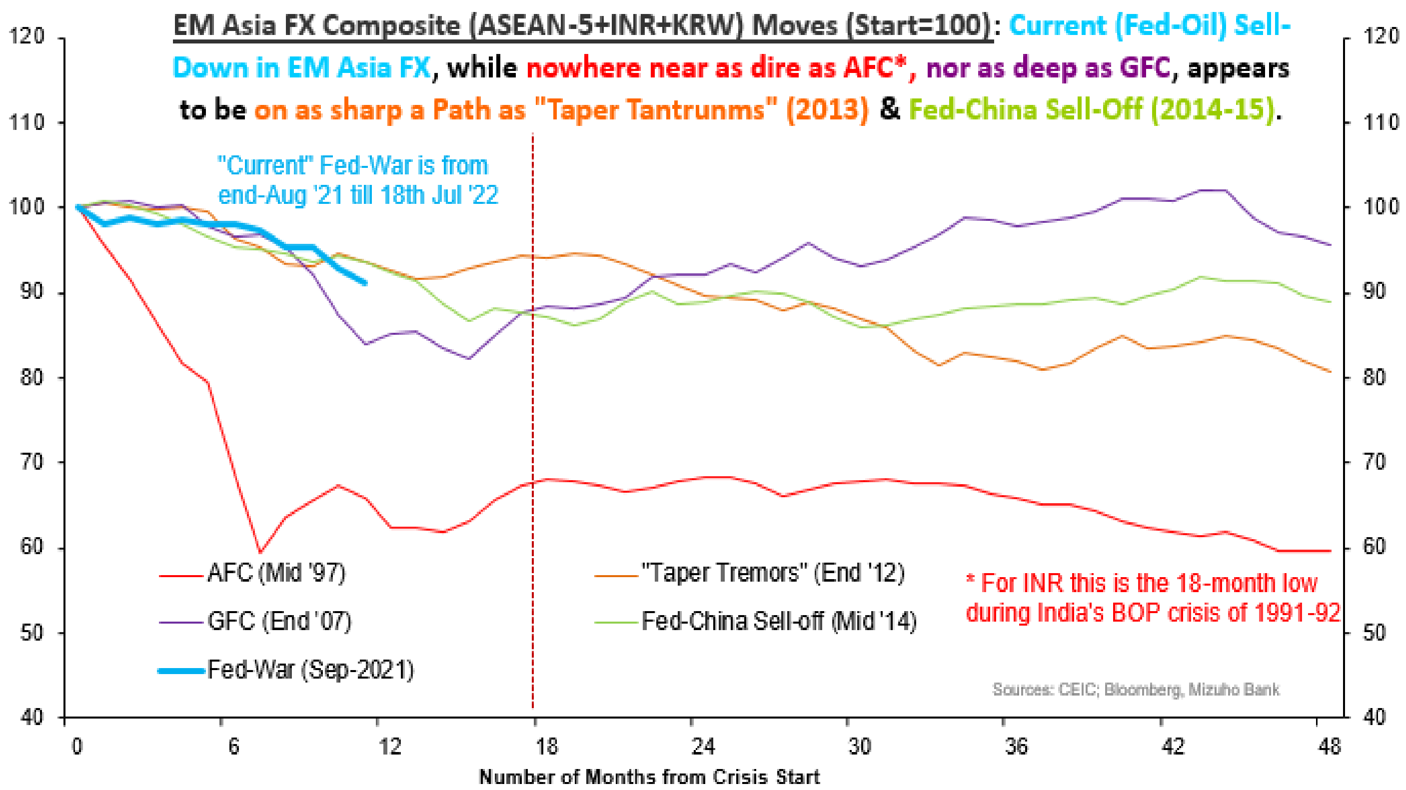
EM Asia FX Risks (Part 1): Overblown, But Not Obviated



"Great, kid, don't get cocky" **– Han Solo, Star Wars**

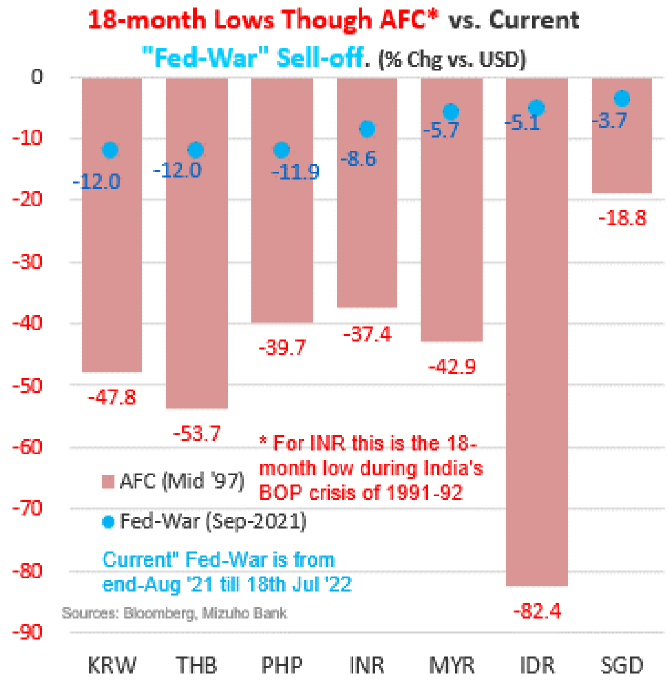
In a Nutshell: **Panic about an impending financial crisis**, and **attendant collapse in EM Asia FX** is **arguably overblown**. Fact is, the **speed and depth of EM Asia FX sell-off is nowhere in the vicinity of the 1997-98 AFC**, and is in fact *also not a severe as the 2008-09 GFC experience*. **But** that said, the **threat of persistent FX turbulence is not obviated** either. As Han Solo put it with flair, "*Great*…" so far, but given the obvious risks ahead "*don't get cocky*".

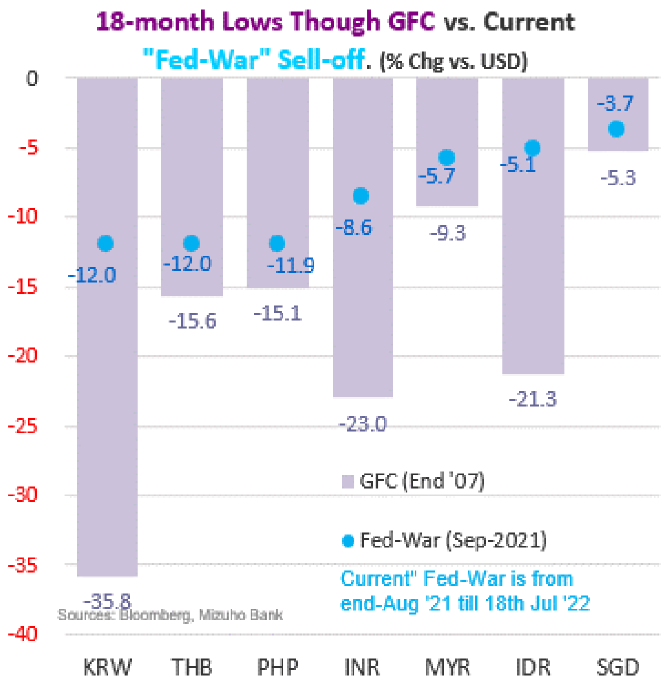
Not only are there **echoes of the financial turbulence endured during the 2013-14 "taper tantrums" and 2014-15 "Fed-China sell-off"**, but **mounting risks associated with a brutally hawkish Fed** and *consequent threat of a hard-landing* **suggest** that **FX market pressures** may remain **persistent** and **potentially turn more profound**. Especially *if currency sell-off* and *capital outflow risks* feed off and *aggravate one another;* as **recession risks** overtake and/or **"cash burn" concerns** with regards to FX reserves (more in Part 2 to follow) begin to take over. Notably, **counter-intuitive, relative resilience in IDR, INR** and to a lesser extent MYR are **arguably temporal, and certainly tentative in nature**. Thus **catch-down risks** ahead are worth keeping an eye out for.

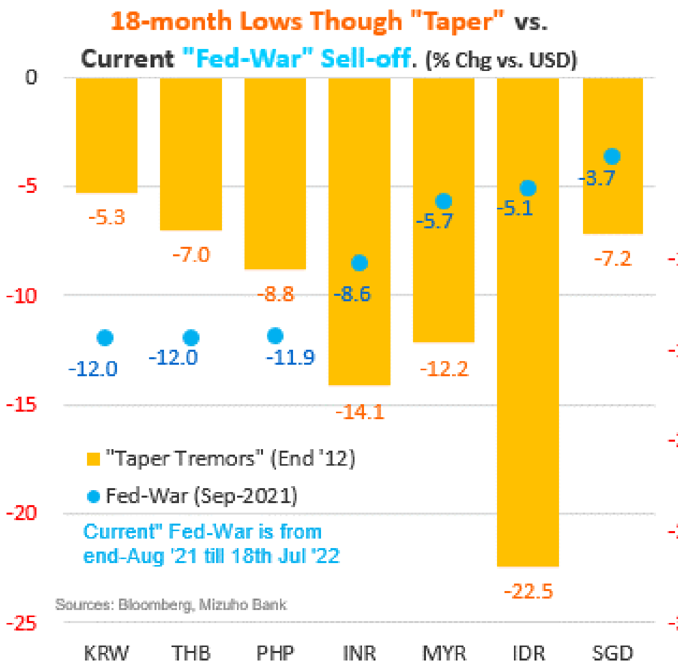
Risk of FX Crisis Overblown: To be fair, **panic about EM Asia FX plunge**, to unprecedented (INR, PHP) or multi-year (KRW, THB, MYR) lows**, heralding an imminent FX crisis is overblown**.

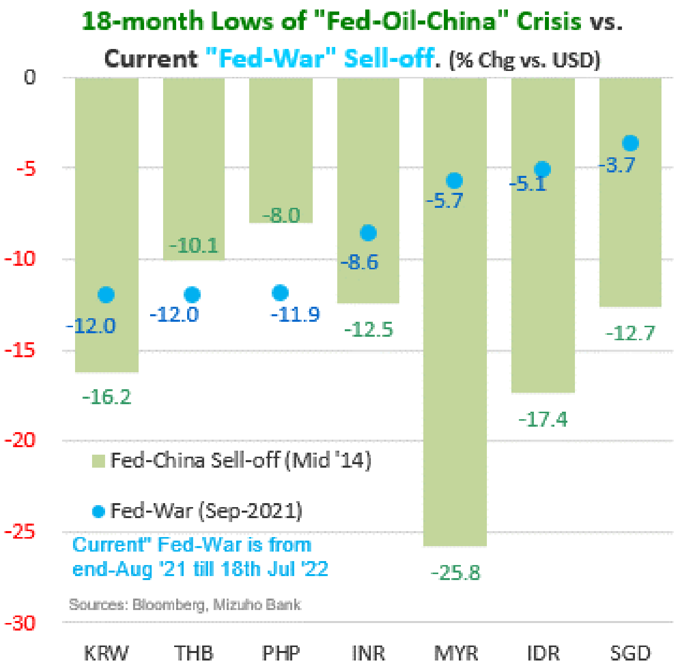
Point being, **soft starting points for EM Asia FX overstate the sell-off**; *when gauged by snapshots of current levels* to which EM Asia have dropped to. Whereas, the **depth and speed of EM Asia FX sell-off are far from crisis-type tailspin** (See Chart above). Certainly **nowhere near as dire as the 1997-98** Asia Financial Crisis (**AFC**), and *as of now*, **shallower than the 2008-09** Global Financial Crisis (**GFC**).

Admittedly there are echoes of the so-called "taper tantrums" of 2013-14 as well as the rolling 2014-15 financial shocks – from Fed's normalization, Oil's plunge and "China crisis". Nevertheless, **EM Asia FX market are arguably not staring down the barrel of an imminent FX crisis**. Certainly **nothing as devastating as the AFC of 1997-98** (for ASEAN and Korea) **or the BOP Crisis that struck India** (early-90's), which resulted in 40-80% loss in currency values across EM Asia FX (with the exception of SGD). And for the time being, not as severe as the GFC in 2008-09 either (See Bar Charts below).









But Threat of On-Going Turbulence Not Obviated: **But**, while risks of a full-blown EM Asia FX meltdown may be overblown, **the threat of significant FX turbulence** is **not obviated**. Not by a long shot. **Especially**

as an increasingly hawkish Fed – that poses a double whammy of more brutal rate hikes and quicker USD liquidity drainage – **accentuates capital outflow risks and attendant currency market turbulence**.

What's more, **sharply rising inflation in EM Asia** set to catch-up with, and potentially overtake, US inflation **may exacerbate capital outflow, and associated currency outflow risks** insofar that EM Asia's real rate differentials with US are further compromised. And the **juxtaposition of stagflation/recession threats** in the midst of brutal Fed rate hikes may **aggravate capital outflows-currency sell-off loops**.

FX Risks May Persist, Perhaps Eclipse: In fact, **whilst** the current EM Asia FX sell-off is **far from AFC-type crisis**, it is **no reason for complacency**. The **parallels with turbulence encountered during** "Taper Tremors" and "Fed-China Sell-off" (See Title Chart again) episodes **suggest that FX risks may persist for another 6-12 months** – consistent with the risk outlook ahead.

Crucially, the **sell-off this time may imaginably eclipse the 2013-14** ("Taper Tremors") **and 2014-15** (Fed-China) **experience**; and quite easily **if a brutal Fed fails to avert a "hard-landing"**. Lurching *from Fed-inflicted policy pain to Fed-induced economic gloom* threaten to **accentuate "twin deficit" stress** and **amplify "risk off" capital flight**. In which case, the **confluence of currency pressures** and **risks of reflexivity** may conspire to *flirt with, and exceed, the depths and scale of GFC losses* in EM Asia FX.

Differences, Not Defiance: Admittedly, the **nature of EM Asia FX sell-off this time differs somewhat** from past experiences *in scale, speed and dispersion across various currencies* (See Bar Charts above). **But** the evidence suggests there is **no defiance** of **significant, perhaps sweeping, EM Asia headwinds** from strong dollar tides amid a hawkish Fed or capital capitulation from amid "risk off"/recession fears.

Counter-intuitive Resilience & Catch-Down Risks: That said, **KRW, THB and PHP are notably at the bottom of the pile** while two of the worst-performing during "taper tantrums", the Indonesian rupiah (**IDR**) and Indian rupee (**INR**), are **counter-intuitively holding up far better**. **As is** the **MYR**, for now.

These **differences are attributable to** several factors such as:

i) *commodity buffer* and *uncharacteristically lower inflation for* **IDR**;

ii) *significantly larger FX reserves* (more than doubled from 2013) buffering **INR**, and;

iii) *Oil revenue* offset helping cushion the **MYR**.

But **relative resilience may be temporal** insofar the IDR' commodity buffers are fading as recession risks creep (similarly for MYR) up while its low inflation backstop is on borrowed time as fiscal strains challenge subsides. And **INR's FX reserve cushion** is being **quickly eroded by mounting "cash burn" risks** (watch this space for Part 2 of this report where we will cover this in detail).

Warrants Caution: The upshot is that **while fears of an impending FX crisis is overblown**, the **threat of persistent FX turbulence**, possibly leading to greater depreciation pressures, is **not obviated**. And **given the risks ahead**, the EM Asia FX space **warrants** due scrutiny and **caution**.