

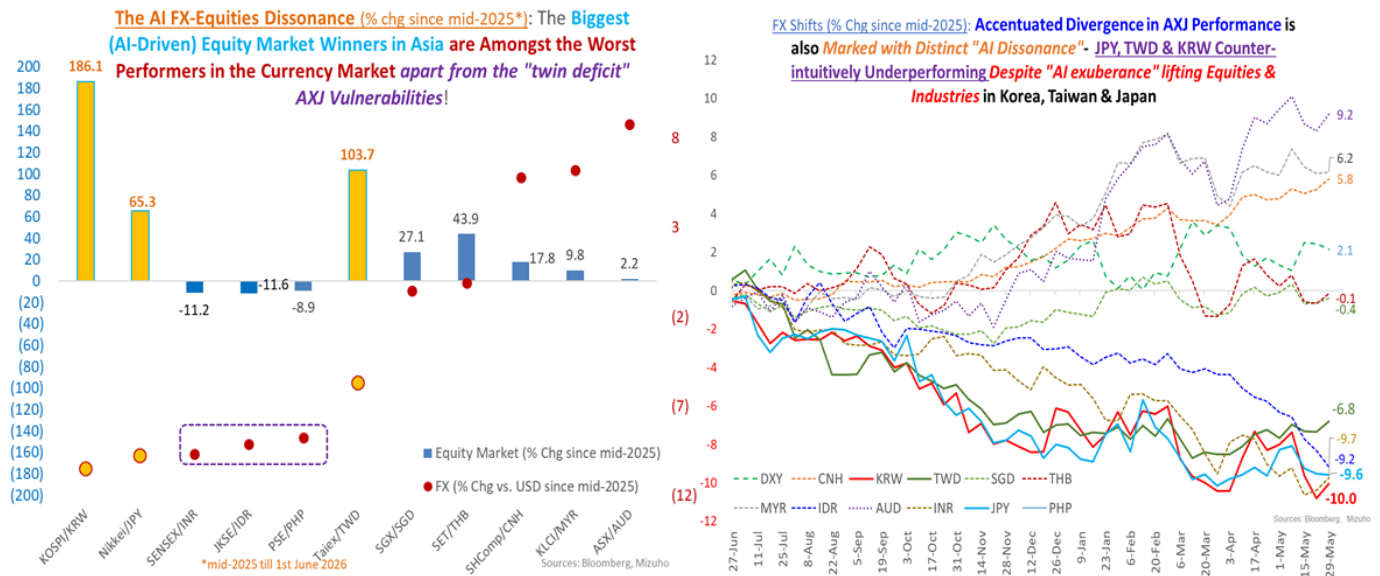
Dealing with the (Devil in the Details of) AI Equity-FX dissonance

“There is nothing more stimulating than a case when everything goes against you” – Sherlock Holmes

In a Nutshell:

- **Despite strong AI-driven equity gains in North Asia, KRW, JPY, and TWD have underperformed** in FX markets since mid-2025, diverging from the bullish equity narrative.
- Key factors for this **glaring equity-FX dissonance** include; i) **net foreign equity outflows** (notably from Korea and Taiwan); ii) **constrained current account dynamics** (Japan), as well as **political-fiscal risks** taking precedence.
- This has notably overwhelmed more hawkish policy expectations that ought to have supported respective currencies.
- **Crucially**, the US’ **"Pay America" capital extraction** has inflicted disproportionate pain on KRW, JPY and TWD.
- What’s more, **supply-side shocks from the US/Israel-Iran crisis**, particularly the "Hormuz crisis," are hurting KRW, JPY and TWD given disproportionate energy reliance as well as risks of industrial input disruptions.
- Point being, the drivers of this **equity-FX dissonance** are **evolving, uneven** across, and **asymmetric** (with non-linear trajectory and impeded reversion).
- All said, **as the conspiracy of geo-economic risks remain unresolved**, the stage is set for the stage for **extended equity-FX dissonance** and **entrenched AXJ divergence**.





- The **macro narrative of North Asia’s out-performance on bullish AI theme, being in pole position to exploit the AI capex build-out of “hyper-scalers”, has failed to express itself in FX markets.**
- In fact, **KRW, JPY** and **TWD** have **distinctly under-performed** the Asia FX space (since mid-2025) despite the obvious AI exuberance in equities.
- Notably, **similar under-performance elsewhere** in AXJ has been **attributable to significant headlines risks.**
- Specifically **geo-political stress confronting rupee** (hurt by exceptional and unexpected US trade antagonism) and **fiscal dominance/governance risks for the rupiah.**
- Whereas the **glaring underperformance in KRW, TWD** alongside the **JPY** sits in **in stark contrast to** corresponding, **exuberant surge in Kospi, Taix & Nikkei.**
- Admittedly, **recent episodes* of stumbles in tech stocks and the March “risk off” on Iran** on AI “shakedown” may, albeit only partly, explain pockets of sell-off** (in JPY, KRW & TWD).
- **But this falls far short of convincingly accounting for the sustained – in fact, even more accentuated – divergence between equities and respective currencies.**
- Afterall, the mainly **“hardware” exposure of North Asia’s AI exposures are predominantly still well-positioned to exploit robust capex by hyper-scalers.**
- And the upshot is that there is **no one-size-fits-all macro/thematic drivers for counter-intuitive currency weakness** (at glaring odds with corresponding equity markets).
- Instead, **AI Equities-FX dissonance is driven by a time-varying confluence of factors – peculiar to each currency – as follow:**

1. Net Foreign Investment flows

- One of which is net foreign equity outflows, **despite (and in defiance of) the AI-driven surge** on the bourses.
- This is **glaringly the case with Korea and, to a lesser extent, Taiwan – partly explaining corresponding pressures on KRW and TWD.**

- **But clearly not so for Japan given the languishing JPY, despite the surge of net foreign inflows into Japanese equities.**

Figure 1: Net Foreign Equity Flows

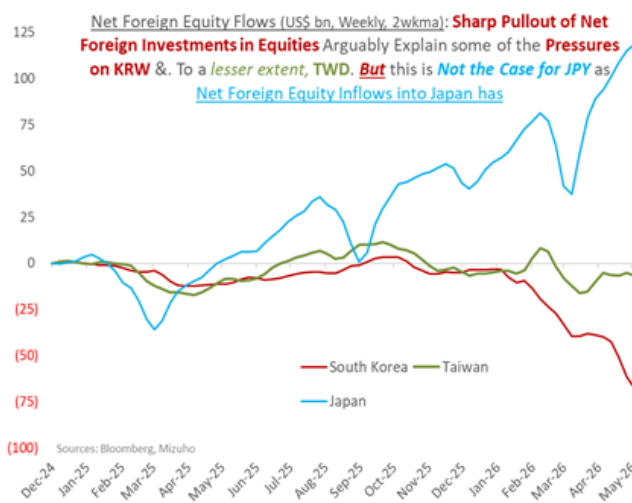
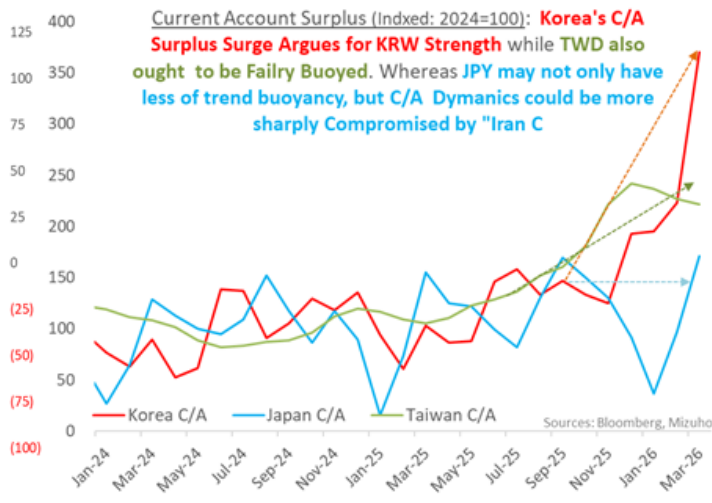


Figure 2: Current Account Dynamics



2. Nuances of Current Account (C/A) Shift:

- Notably, shifts in Current Account trend dynamics – at least partly driven by AI capex build-out – ostensibly account for some of the marginal FX shifts.
- But even here, it is highly imperfect, if not confounding. For one, the script is flipped with KRW and TWD weakness defying buoyancy suggested by C/A dynamics.
- Whereas JPY weakness despite net foreign equity inflows may partly squares with underlying soft spots in the C/A dynamics (outright drag from net goods and services trade deficit).

3. Policy Expectations & Political-Fiscal Risks:

- The projection*** for relatively more hawkish BoJ and BoK policy rates into mid-2026 (of at least 2 hikes) vis-à-vis the Fed's single (25bp) hike expectations, ought to lift – and not depress – JPY and KRW.
- Even the CBC has hinted at tightening bias, albeit refraining from overt allusions to imminent hikes, which ought to be consistent with some degree of TWD backstop.
- Nonetheless, offsetting, if not overwhelming, confluence of (geo-)political and fiscal risks may be the more dominant force exerting FX pressures – as appears to be especially the case for JPY.

Figure 3: Net Foreign Equity Flows

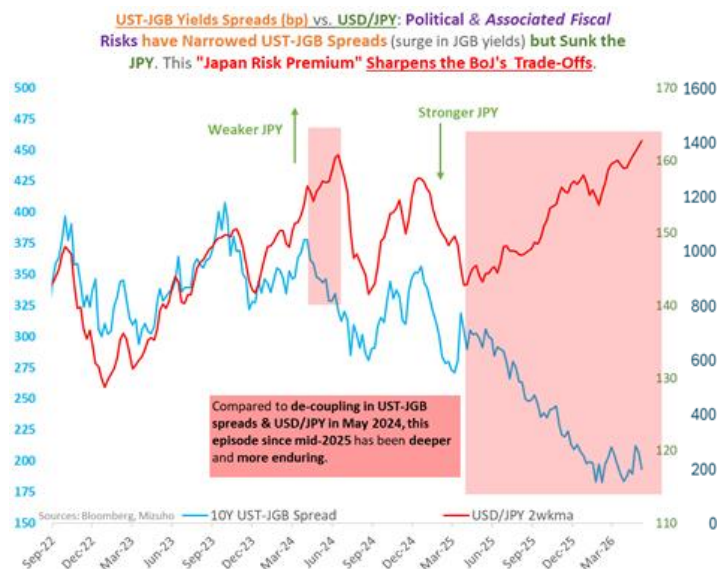
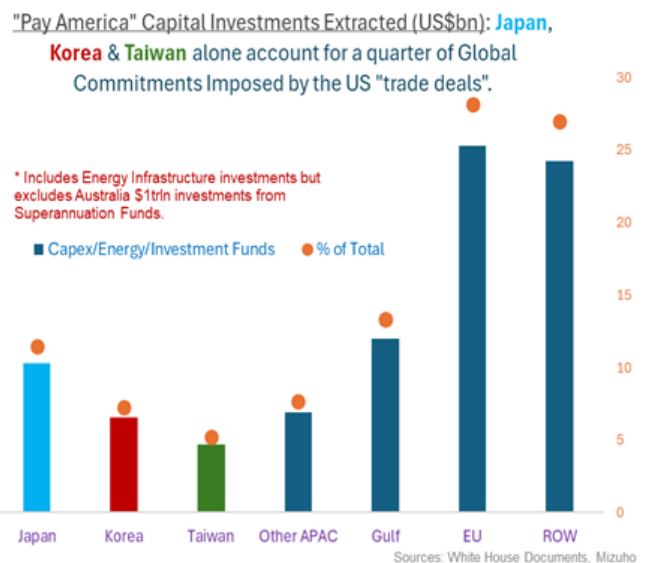


Figure 4: "Pay America" Capital Investments Extractions by the US



4. "Pay America" Capex Extraction:

- A **pin-pointed source of geo-economic stress** hurting KRW, JPY and TWD despite the "AI boost" is the **"Pay America" extraction of capital** (investments) demand by the US (of these key trade partners/allies).
- With Japan on the hook for \$550bn, Korea for \$350bn and Taiwan for at least \$250bn – purportedly within Trump's term – the **anticipated capital outflows** (expressed via FX market tools/behaviour[^]) is **inevitably showing up in exchange rates**.
- And this **extraordinary geoeconomic force** may be **overwhelming** (and confounding received wisdom associated with) the more conventional FX cogs.

5. US/Israel-Iran War Crisis

- What's more, the **supply-side shocks** induced by the "Hormuz crisis" and **amplified by industrial multipliers** may be disproportionately hurting KRW, JPY and TWD.
- Especially given *reliance on Persian energy* as well as *passage of wider industrial inputs* impacted, which imposes **cost pressures**, and **threatens to disrupt future production**.
- To be sure, this (FX pressures) **could easily reverse if Iran risks are alleviated**.
- *But amid the significant prevailing uncertainty potential for downside remains pronounced, and attendant FX drag is hard to avert.*

- The **factors** listed for the glaring **FX-Equity dissonance** are **not exhaustive**. And could **continue to evolve**.
- Crucially, these factors **do not apply evenly across** the JPY, KRW and TWD, and perhaps not even consistently.
- Hence, the **response function of these currencies will vary with shifting headline risks**., setting the stage for extended equity-FX dissonance and entrenched AXJ divergence.
- Moreover, *AI remains a rather asymmetric risk* for KRW, TWD and JY, which warns of *non-linear trajectories* with potentially *impeded reversion*.

- For one, the **“AI boost” may not only continue to elude for the associated currencies**, *if a positive turn in industrial multipliers is not realized*.
- What’s more, it **presents an additional layer of downside risk** *if the present euphoria gives way to overshooting (in equities) concerns*.

* The episodes – mostly in early-2026 (mostly pre-Iran) pertain to; *i) circular demand* (earlier) and; *ii) existential threats to certain (aspects of) industry*.

** Since April though markets have not only recovered from “Iran crisis” fears, but surged on AI rallies seemingly unfettered by Iran risks/”Hormuz crisis”.

*** Using market implied policy rate projection (as sourced from Bloomberg) alongside forecast polls.

^ Including Taiwan’s significant unhedged insurance outflows and reported hoarding of exports USD and Japanese/Korean banks buying USD (to prepare to fund capex into US).

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