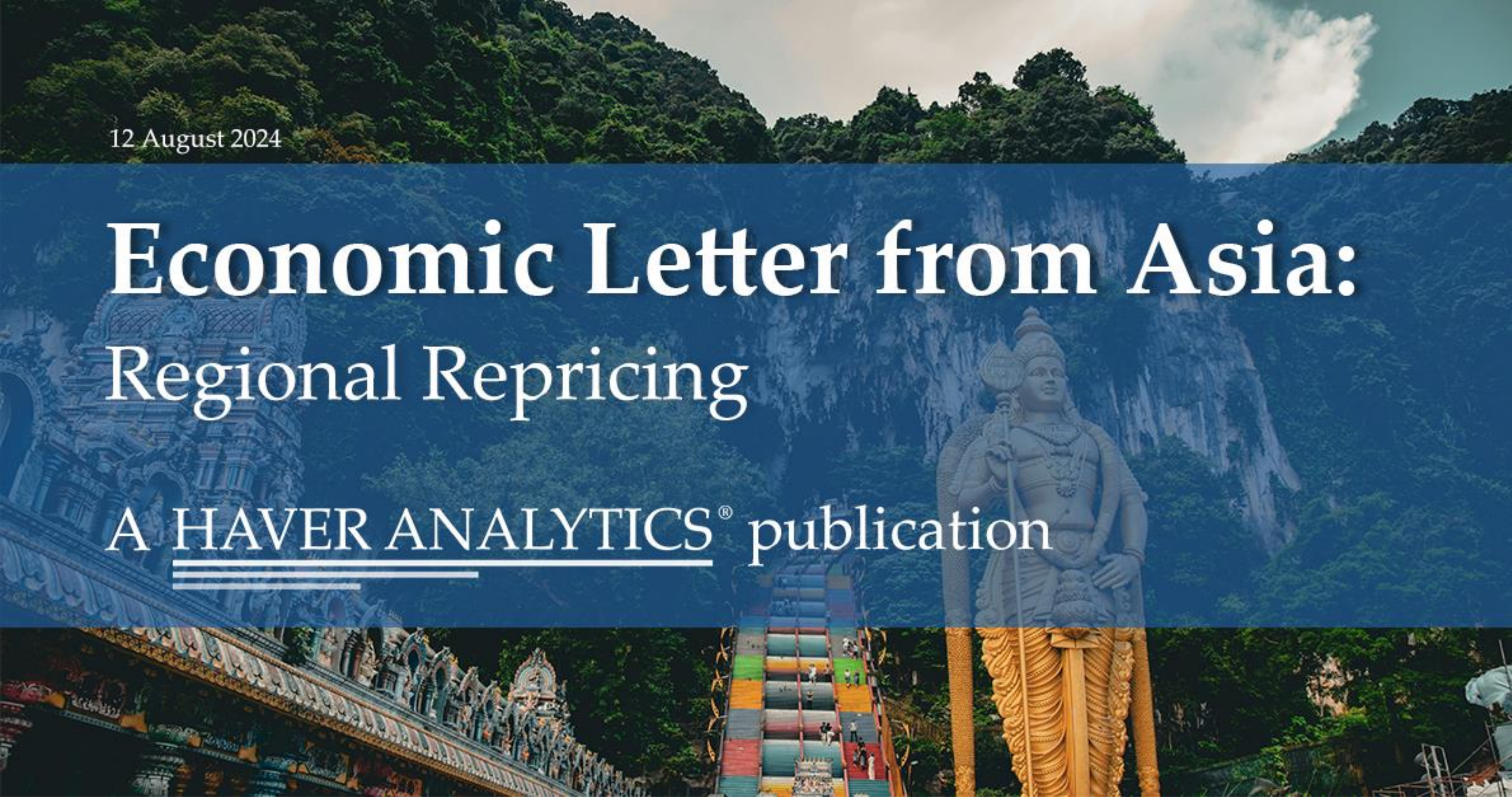


Link to article online: https://haverproducts.com/economic-letter-from-asia/
Written by Tian Yong Woon

Regional Repricing

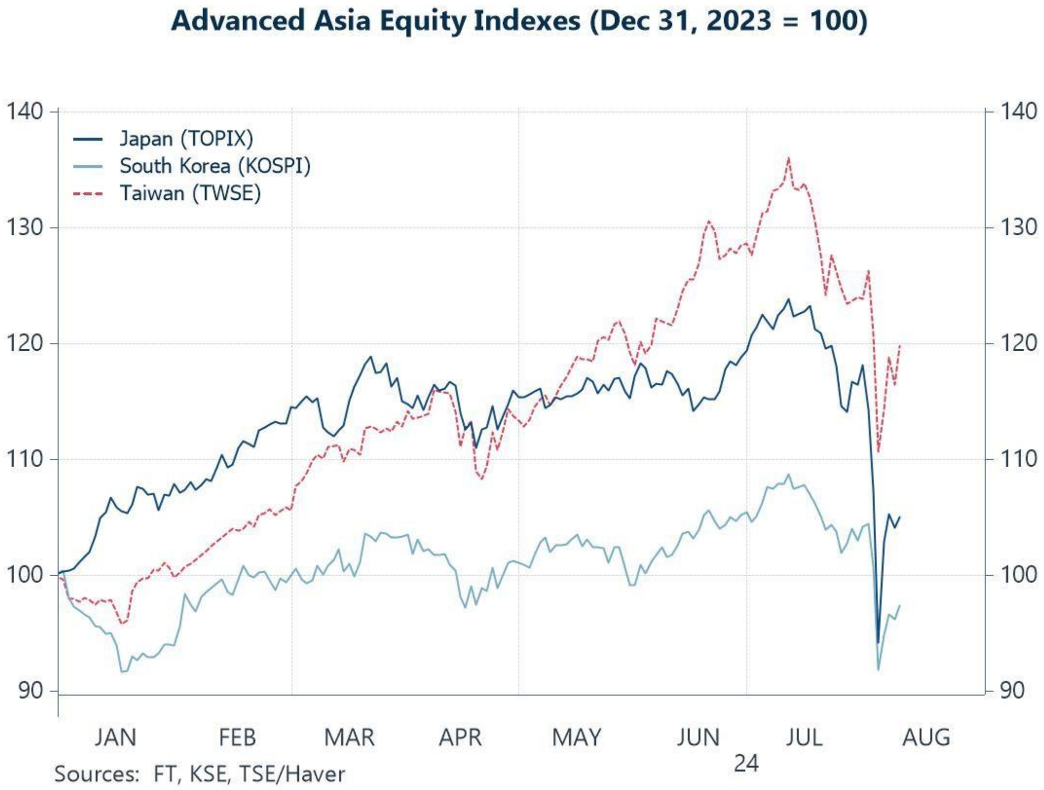
In this week's newsletter, we delve into recent developments in Asian financial markets. These developments follow the recent spike in volatility triggered by the Bank of Japan's (BoJ) July decision and the disappointing July US jobs report. Although some calm has returned to Asian markets, a repricing of assets seems to be underway, as investors reassess investment themes and the economic prospects for Asian economies. Most importantly, the carry trade themes are now shifting. Traditionally cheap funding currencies, such as the yen, are becoming more expensive as interest rates rise. Meanwhile, higher-yielding currencies, like the US dollar, are facing the prospect of reduced yields. Additionally, the technology theme is being reassessed, as evidenced by the significant selling in semiconductor-heavy equity indices for Taiwan and South Korea.

Beyond equity markets, we explore shifts in the relative currency performance of Asian economies. Notably, the Malaysian ringgit has shown a standout performance, with the rupiah having strengthened as well. We then examine the economy-specific factors driving these currency changes, including economic prospects and government measures. Overall, the interplay between global tech demand, monetary policy, and earnings is likely to continue shaping investor preferences in the near term. Investors will need to stay attentive to the key drivers of these themes, including inflation, geopolitical pressures, supply chain issues, and trade frictions.

Asian equities

Echoing broader global developments, Asian equity markets have faced turbulence in recent weeks, initially triggered by volatility in Japan following the Bank of Japan's (BoJ) hawkish July policy decision, and further exacerbated by a disappointing US labour market report for July. Although some stability has returned, volatility remains elevated. Overall, Asian equities initially dropped more than 10% since late July, recovering about half of those losses last week. Delving deeper, the sell-offs were more severe in specific economies and sectors, particularly within semiconductor-heavy indices in South Korea and Taiwan (see Chart 1). This trend reflects a broader reassessment by investors who now question whether semiconductor valuations have become overstretched after a prolonged rally.

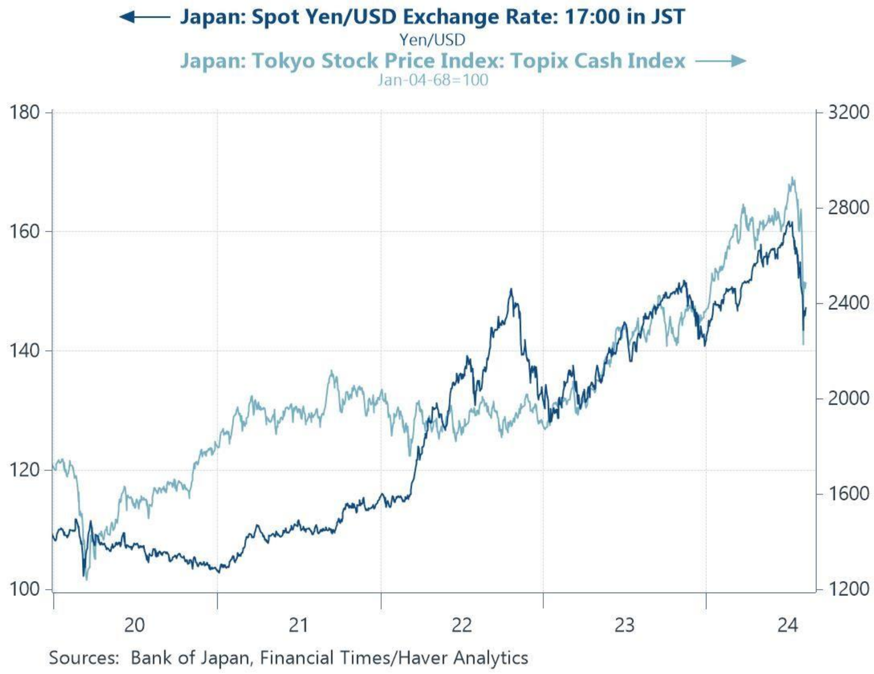
Chart 1: Advanced Asia equity indexes



More on Japan

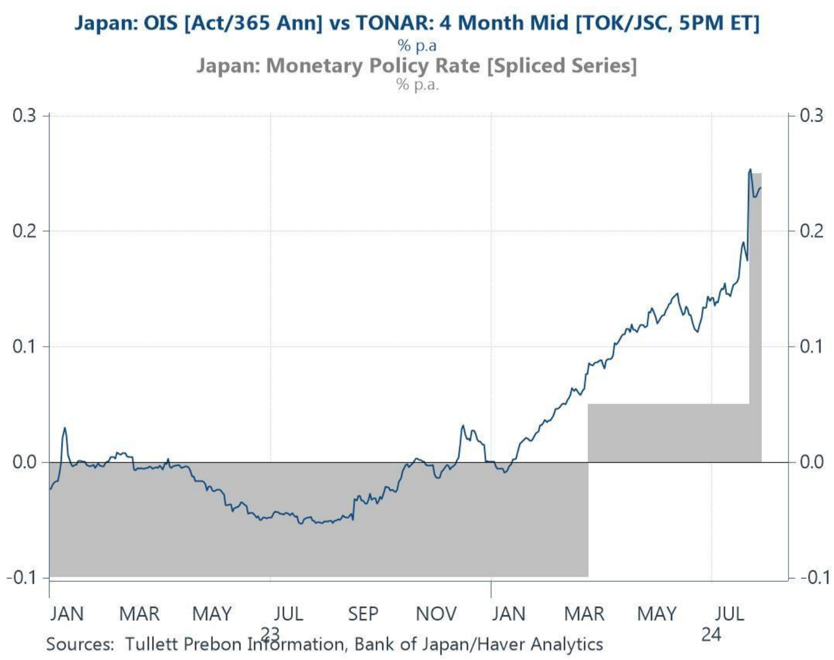
Next, we turn our attention to Japan, particularly in light of the BoJ July monetary policy decision, which attracted significant scrutiny. Among Asian equity markets, Japan presents a particularly interesting case. The initial equity sell-offs were largely driven by domestic factors, especially the BoJ's hawkish stance in July. This led to a significant reversal in the yen's previous weakness, while Japanese equities experienced substantial declines. However, recent comments from Deputy Governor Uchida downplaying the likelihood of further tightening by the BoJ, have helped stabilize the market. As a result, equities have rebounded strongly (see Chart 2), partly due to bargain hunters capitalizing on lower valuations. Meanwhile, the yen has ceded some of its recent gains, with the USD/JPY currency pair now trading above the 145 level.

Chart 2: Japanese equities and the yen



Regardless, Japanese markets now seemingly remain in a digestion phase, with the BoJ's summary of opinions from its July meeting, released late last week offering additional insights. Firstly, the summary revealed an estimation of Japan's neutral rate at 1%. This figure may provide investors with clues about how much further the BoJ might need to raise its policy rate to achieve a neutral stance. Additionally, the summary highlighted reasons for dissent against the BoJ's July hike. Namely, a board member cited a lack of data confirming sustainable growth in Japan's economy, a view which is shared by some Japan economists. Overall, market expectations for the BoJ's prospective actions for the rest of the year appear to have stabilized, as illustrated in Chart 3.

Chart 3: BoJ policy rate and Japan 4-month OIS vs. TONAR



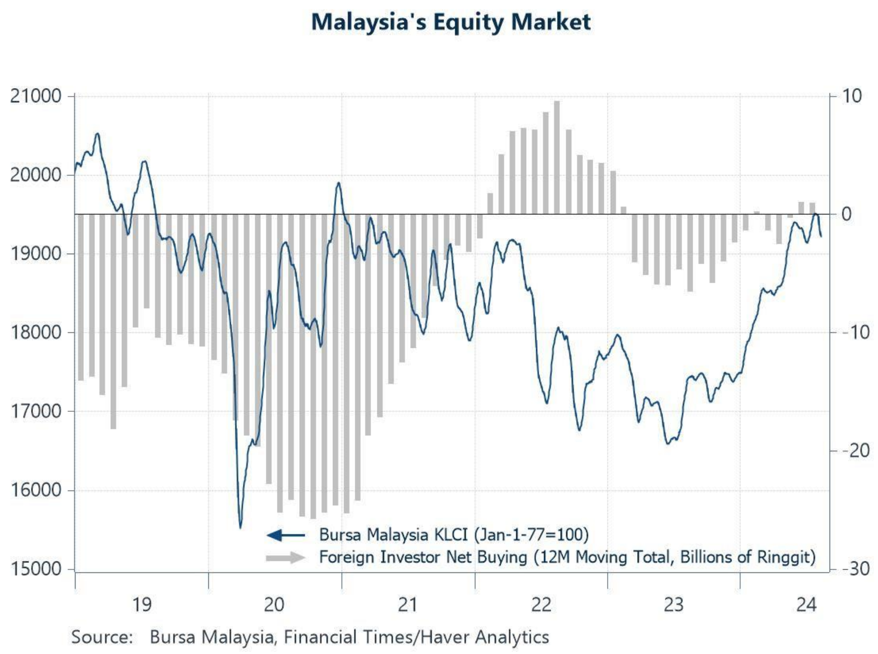
Asian currencies

Looking beyond Japan, recent developments in the Asia's FX markets reveal a marked shift in the relative performance of regional currencies, as depicted in Chart 4. The Malaysian ringgit, which struggled with prolonged weakness last year, has emerged as the top-performing currency in Asia this year. This is largely due to improved investor perceptions and recent positive economic data. The Indonesian rupiah has also strengthened recently, benefiting from a weaker dollar and improved perceptions of its economic stability. We will delve deeper into the specific drivers behind these changes for Malaysia and Indonesia in the following sections. Turning to other Asian currencies, both the Indian rupee and the Chinese yuan have demonstrated ongoing resilience, remaining relatively stable against the dollar year-to-date.

Chart 4: Year-to-date Asian FX performance

Next we explore the drivers behind the recent rebound of the Malaysian ringgit. As noted earlier, investor perceptions of Malaysia have improved, and this is due to a combination of strong economic data and recent government measures. A clear indicator of this shift is the recent positive turn in net foreign flows into Malaysian equities, as shown in Chart 5. Economically, Malaysia exceeded expectations with real GDP growth accelerating to 5.8% y/y in Q2, continuing its recent momentum. Moreover, unlike many of its Asian peers, Malaysia's economic growth has been heavily driven by private consumption. This arguably offers a more stable foundation compared to economies that have relied primarily on exports (e.g., Japan, South Korea), which are more vulnerable to shifts in global demand. Also, government actions likely bolstered the ringgit's recent outperformance. Specifically, efforts to encourage state-linked firms to repatriate and convert their earnings into ringgit may have supported the currency. Additionally, the government's initiation of subsidy rationalization measures, starting with diesel, could have eased investor concerns about fiscal sustainability.

Chart 5: Malaysia's equity market



Lastly, let's delve into the rupiah. Much like Malaysia, Indonesia's economic fundamentals have been an implicit support for its currency. Specifically, Indonesia's real GDP growth has been sustained stably around 5% in past quarters, even in Q2 (see Chart 6), largely driven by robust private consumption. However, investor concerns persist about Indonesia's debt levels. This is particularly due to previous reports about President-elect Prabowo's plans. To fund spending promises aimed at bringing GDP growth to 8%, Prabowo reportedly intends to allow Indonesia's debt-to-GDP ratio to reach to 50%. Additionally, Prabowo's team is considering removing the 3% cap on the fiscal deficit, a move that could further heighten concerns about fiscal discipline. The pace and scope of Prabowo's spending plans will become clearer once he takes office in October. The specifics of these plans will likely impact the rupiah, Indonesian government bonds, and the country's overall credit rating.

Chart 6: Indonesia real GDP growth and debt-to-GDP

About the author

Haver Analytics is pleased to bring [Tian Yong Woon's] commentaries on the state of the global economy to its clients.

Tian Yong joined Haver Analytics as an Economist in 2023. Previously, Tian Yong worked as an Economist with Deutsche Bank, covering Emerging Asian economies while also writing on thematic issues within the broader Asia region. Prior to his work with Deutsche Bank, he worked as an Economic Analyst with the International Monetary Fund, where he contributed to Article IV consultations with Singapore and Malaysia, and to the regular surveillance of financial stability issues in the Asia Pacific region. Tian Yong holds a Master of Science in Quantitative Finance from the Singapore Management University, and a Bachelor of Science in Banking and Finance from the University of London.

Data featured in this commentary:

Chart 1: Advanced Asia equity indexes
Series 1: index(S158TPX@INTDAILY,20231231=100)
S158TPX@INTDAILY [Japan: Tokyo Stock Price Index: Topix Cash Index (Jan-04-68=100)]
Series 2: index(S542CEX@INTDAILY,20231231=100)
S542CEX@INTDAILY [Korea: Stock Price Index: KOSPI (Jan-4-80=100)]
Series 3: index(S528TWN@INTDAILY,20231231=100)
S528TWN@INTDAILY [Taiwan Stock Exchange Capitalization Weighted Index (1966=100)]

Chart 2: Japanese equities and the yen
Series 1: X158JBB@INTDAILY
X158JBB@INTDAILY [Japan: Spot Yen/USD Exchange Rate: 17:00 in JST (Yen/USD)]
Series 2: S158TPX@INTDAILY
S158TPX@INTDAILY [Japan: Tokyo Stock Price Index: Topix Cash Index (Jan-04-68=100)]

Chart 3: BoJ policy rate and Japan 4-month OIS vs. TONAR
Series 1: MJPUU4M@INTDAILY
MJPUU4M@INTDAILY [Japan: OIS [Act/365 Ann] vs TONAR: 4 Month Mid [TOK/JSC, 5PM ET] (% p.a)]
Series 2: R158TAR@INTDAILY
R158TAR@INTDAILY [Japan: Monetary Policy Rate [Spliced Series] (% p.a.)]

Chart 4: Year-to-date Asian FX performance
Series 1: ((((((((((index(XUSJPSB@INTDAILY,20231231=100) + index(XUSTHSB@INTDAILY,20231231
XUSJPSB@INTDAILY [JPY Per USD Spot Mid Exchange Rate at 7 AM ET (JPY/USD)]
XUSTHSB@INTDAILY [THB Per USD Spot Mid Exchange Rate at 7 AM ET (THB/USD)]
XUSTWSB@INTDAILY [TWD Per USD Spot Mid Exchange Rate at 7 AM ET (TWD/USD)]
XUSKRSB@INTDAILY [KRW Per USD Spot Mid Exchange Rate at 7 AM ET (KRW/USD)]
XUSMYSB@INTDAILY [MYR Per USD Spot Mid Exchange Rate at 7 AM ET (MYR/USD)]
XUSIDSB@INTDAILY [IDR Per USD Spot Mid Exchange Rate at 7 AM ET (IDR/USD)]
XUSVNSB@INTDAILY [VND Per USD Spot Mid Exchange
Series 2: index(XUSMYSB@INTDAILY,20231231=100)
XUSMYSB@INTDAILY [MYR Per USD Spot Mid Exchange Rate at 7 AM ET (MYR/USD)]
Series 3: index(XUSIDSB@INTDAILY,20231231=100)
XUSIDSB@INTDAILY [IDR Per USD Spot Mid Exchange Rate at 7 AM ET (IDR/USD)]

Chart 5: Malaysia's equity market
Series 1: movt(S548KLS@INTDAILY,12)
S548KLS@INTDAILY [Malaysia: Stock Price Index: FTSE Bursa Malaysia KLCI (Jan-1-77=100)]
Series 2: movt(((N548FK22@EMERGEPR + N548FK12@EMERGEPR) - (N548FK24@EMERGEPR + N548FK14@EME

N548FK22@EMERGEPR   [Malaysia: Trading Participation: Foreign Retail: Buy Value (NSA, Mil.Ringit)]
N548FK12@EMERGEPR   [Malaysia: Trade Participation: Foreign Institutional: Buy Value(NSA, Mil.Ringit)]
N548FK24@EMERGEPR   [Malaysia: Trading Participation: Foreign Retail: Sell Value (NSA, Mil.Ringit)]
N548FK14@EMERGEPR   [Malaysia: Trade Participation: Foreign Institutional: Sell Value(NSA,Mil.Ringit)]

Chart 6: Indonesia real GDP growth and debt-to-GDP
Series 1: Q536NGDT@EMERGEPR
Q536NGDT@EMERGEPR   [Indonesia: Year-on-Year Growth of Quarterly Real GDP (NSA, % Chg)]
Series 2: N536FGMG@EMERGEPR
N536FGMG@EMERGEPR   [Indonesia: Central Government Debt as a Percent of Moving Total GDP (%)]

For more info on our databases please email sales@haver.com.