



#### Asia FX: Positioning on positioning

The sharp rebound in Asian currencies in recent days can trace its roots to three drivers: 1) market re-pricing of the Fed after the weak NFP; 2) a more benign view of CNY ahead of the SDR review, and given better China reserves data, and stronger fixings; 3) stretched long USD/Asia positioning. In this note, we take stock of a range of positioning metrics to gauge how far the unwind has run.

- Long USD/Asia NDF positioning has largely been cleaned out. The average 3M NDF-onshore forward implied yield spread in Asia has fallen sharply. The spread is now near negative extremes that have held since the 2011 EM sell-off (Chart 1). This suggests offshore investors have rapidly unwound long USD asset hedges or speculative positions. For five pairs (MYR, PHP, IDR, KRW, TWD) the offshore-onshore yield spread is at or near the lowest level over the past year (Chart 2). The front ends of the USD/MYR and TWD NDF curves are trading below spot.
- KRW and IDR are now trading stronger than pre-CNY deval levels (Chart 3). PHP and THB have retraced all their losses since the China deval. MYR stands out as still trading 5% weaker versus then.
- On average, ATM vol curves remain very flat (Chart 4) although this masks intraregional divergence. Vol curves are still inverted in MYR, IDR, TWD, and SGD (Chart 5). In MYR and IDR this captures very high realized volatility, with gamma still valuable given sharp moves in both directions. For TWD, this is likely a reflection of the unwind of structured supply in the front end, while for SGD this could capture the premium on the MAS event. Other vol curves have been normalizing, namely the CNY and CNH curves as the market is increasingly convinced of the "stable-until-SDR-review" thesis, and is encouraged by official rhetoric, USD supply, and lower fixings. The scope for further vol normalization appears greater than in outright.
- Risk reversals have begun to retrace lower, but remain relatively elevated versus lighter NDF positioning (Chart 6). Even after today's move lower in riskies, the majority of 3M riskies remain above the 70<sup>th</sup> percentile of the past year (Chart 7). Front-end risk reversals have come off much more than the back end (Chart 8), suggesting the market continues to seek protection for the more medium term.
- Currencies appear to have priced in the end of equity outflows for now (Chart 9). Recall that equity outflows were a much bigger driver of Asian FX weakness over the summer than bond outflows (this was a 'growth tantrum' more than a 'taper tantrum'). The relationship between average FX returns and equity inflows for the six markets that report daily data (KRW, TWD, INR, IDR, THB, PHP) has been exceptionally tight for years. The 3m rolling sum of equity flows had reached cyclical lows by end-September. The recent surge in currencies suggests the FX market is now pricing equity flows to flatten out. Indeed, October has seen small inflows across markets (Chart 10). Whether Asian FX gains can extend will depend on whether equity inflows return in size.

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