



Theme #8: Balti not faulty, China yet finer

2013 saw Asian FX fracture into a North and South complex. Relative sensitivity to the yen, the EM debt bubble, and the developed world equity/growth cycle all served to discriminate the two intra-regional groups at different points during the year. Ultimately, the North emerged fairly unscathed, while the South cheapened significantly. Indeed, much of South Asia FX still faces a host of challenges from political instability (THB), offshore debt holding overhang and weak commodity prices (MYR, IDR). However we refrain here from adding to shorts against most of this group, given a mix of large valuation adjustments, expensive carry, and/or improving policy responses that is shifting the risk-reward. We concentrate instead on currencies like INR where fundamentals have improved sufficiently to go long, and on SGD, where persistent overvaluation and exposure to a broadening in USD strength out to low-yielders favors a short bias. In North Asia, we stay short USD/CNH, but are mindful of the large build up in positioning. We favor a short JPY/KRW position to express our positive view on Korean fundamentals.

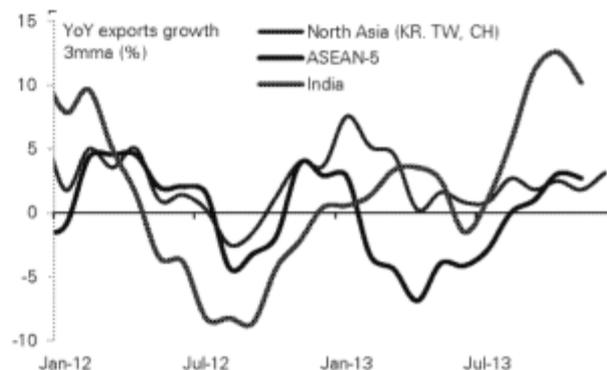
The rupee has had a makeover

After spending three years as one of the world's worst performing currencies, the rupee should fare better in 2014 for three main reasons. First, India has seen large improvement in her external balances. The trade deficit, which is the only driver of the CAD, has almost halved from its peak. While gold import compression has driven most of the trade improvement and could face slippage, exports and services have also been bright spots. Second, even as India's portfolio flow dependence is falling, both debt and equity flows could see positive swings. After aggressive debt outflows between May-Nov 2013, offshore holdings have fallen to "core" levels; indeed, foreigners returned as buyers in December. With large unallocated limits, a more positive duration view, and the possibility of index inclusion and/or Euroclearability, India could attract money. The key swing factor for equities will be general elections in May. To be sure, this is a binary event; but hopes of a pro-growth stable coalition could boost inflows in the run-up to elections. Third, RBI's swap activities have been a success adding to reserves. Concerns about oil USD demand appear exaggerated, and its return to the market in November did not raise volatility. Majority of their obligations to buy USD ahead of imminent swap repayments have been met. We are long a 6M USD/INR 62 put with an RKO at 57.

SGD no longer king

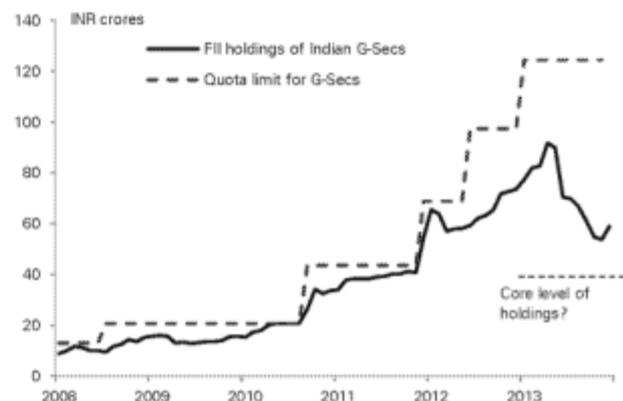
We have seen a long USD/SGD view as a good 'long-haul' trade to play for USD strength and US yield repricing. However, the lesson from 2013 was that USD/SGD took its cues more from the USD/G10 TWI than its USD/Asia peers which often behaved

Indian exports have been a bright spot in Asia



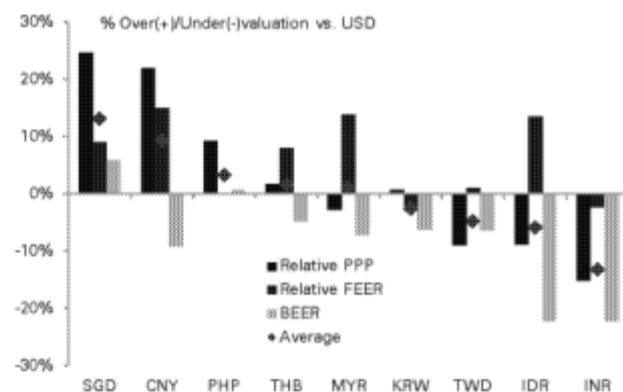
Source: Deutsche Bank, Bloomberg Finance LP

The outlook for debt flows is asymmetric in India



Source: Deutsche Bank, CDSL, SEBI

Broad consensus on SGD's overvaluation



Source: Deutsche Bank, Bloomberg Finance LLP, CEIC