



RMB devaluation and ongoing weakness in China's economy has also again energized the debate about whether the peg is suitable for the Hong Kong monetary and financial system. We however, remain of the view that the peg will stay in place for foreseeable future, and that re-pegging HKD to a basket of currencies, such as Singapore's FX system, or to the RMB are not viable options for the foreseeable future.

India

India remains an EM adjustment role model with big strides in C/A improvement, reserve accumulation, and real rates. RBI has kept the door open to further easing. FDI trends are constructive. INR should be comparatively less exposed to China contagion. The main risks come from domestic disappointments, should there be 'under-delivery' on anticipated reforms and/or poor performance in state elections, given offshore positioning in the asset markets remains large.

Indonesia

A stubborn current account deficit, large foreign liabilities and limited policy space leave the IDR biased towards more weakness. Arguably, Bank Indonesia is already running a relatively tight policy, resisting the temptation to cut rates in the face of slower growth, but the appetite to raise rates from here will be more questionable. With recent drawdowns in reserves raising the question of adequacy again, policymakers appear to be broadening their tool-kit: USD deposit mobilization from banks, macroprudential measures mandating use of IDR, and reductions in domestic individuals' outflow limits. We think IDR will continue to slip lower in the weeks ahead.

Korea

We think the KRW has more room to weaken in response to the shifts in Chinese FX policy, given the high beta to the RMB and related competitiveness concerns. The poor domestic outlook in Korea should also bias policymakers to more actively seek a weaker currency and looser monetary conditions. Over the past few months, the authorities have been actively introducing policies to recycle the current account surplus. For example, the National Pension Service (NPS) has announced that it will accelerate overseas investments, amounting to an additional \$32bn of outflows by the end of 2016. YTD capital outflows have been around \$52bn, compared with a current account surplus of \$61bn. More aggressive recycling of the surplus could thus help tip Korea's balance of payments towards deficit. Given our house view that the Fed will likely raise rates this year, portfolio outflows could accelerate putting more upside pressure on USD/KRW. It is worth noting that during the last Fed hike cycle (2004-2006), Korea experienced \$17.3bn of equity outflows.

Malaysia

We are negative on the MYR, and long short-dated USD forwards with a near-term spot target of 4.50. First, we continue to be concerned about the risk of outflows from the bond maturities ahead. Second, we believe official participation skews the risk-reward towards USD longs. The central bank appears to have stepped away from its defense of the currency in August, with Governor Zeti stating that they are now looking to rebuild reserves. Indeed, reserve holdings have risen slightly since then. We thus expect the currency to be supported on dips. Third, an environment in which the Fed too is worried about Chinese and EM growth risks cannot be constructive for commodity prices, to which Malaysia remains vulnerable. Fourth, politics remains increasingly noisy with opposing domestic protest rallies and international investigations. The main source of caution comes from the fact that the MYR does appear undervalued on a few valuation models (BEER, PPP) and very stretched when compared to related financial asset prices. Illiquidity adds to the risk of gappy price action in spot both down and up. Policy space from reserves or rate hikes we think remains constrained, but the main risk of official support could come from large-scale repatriation of government-linked overseas assets.

Philippines

Except for the beta to US Treasury moves, there seems less to be worried about in the peso markets for now. The inflation trajectory is very well behaved, with core at 1.6%, and headline at 0.6%, well inside of the central bank's target zone. Philippines has less to worry about in terms of capital outflows compared with its peers. And its external accounts remain healthy as before, on the back of remittance and BoP flows, though export growth has been disappointing like in rest of the region. We have been worried about the overvaluation of the currency, but the flow dynamics are supportive. Potential idiosyncratic sources of risk, though likely only next year, for peso assets could be if the El Nino conditions turn particularly adverse, or if the Presidential elections were to throw up a market unfriendly surprise.