Asia FX: Positing 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 outrights.

• 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 70th
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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• Most currencies have tracked equity markets tightly in this rebound. Based on simple level correlations between FX and local stocks (Charts 11-16), INR, THB and KRW are trading fair to equities, IDR has overshot and now looks rich versus the JCI, as does PHP, slightly. TWD still looks cheap versus local stocks.
• Regressions of FX against key financial variables suggest IDR and KRW now look rich to underlying asset market drivers (Chart 17). Indeed, both may soon encounter official bids, with IDR trading near the bottom of the 13300-13700 range identified by BI as fair value. PHP, SGD, TWD and CNY are within 1% of fitted fair value based on our regression. INR, MYR and THB could be considered cheap on this metric. We have been constructive on INR, had turned neutral on the THB, but have believed there are idiosyncratic reasons why MYR should remain cheap (political risk premium, reserve rebuilding, limited policy space).
Offshore-onshore implied yield spreads (Chart 1 and 2)
-4%
-3%
-2%
-1%
0%
1%
2%
3%
4%
3m NDF-Onshore Forward Implied Yield Spread
Offshore too negative
Offshore too positive
2010
-6.0%
-5.0%
-4.0%
-3.0%
-2.0%
-1.0%
0.0%
1.0%
2.0%
CNY
THB
Source: Bloomberg Finance LP
INR
2011
2012
2013
2014
2015
Offshore-Onshore Spread (%)
1Y Percentile (%) (RHS)
100
10

20
30
40
50
60
70
80
90
0
TWD KRW IDR
PHP MYR

Retracement since CNY deval (Chart 3)
-15%
-13%
-11%
-9%
-7%
-5%
-3%
-1%
1%
3%
Difference versus 10-August (day before CNY devaluation)
0%
-2%
-5%
Current
Max Drawdown
-2%
-1%
-1% 0%
2%
1%
MYR TWD CNY
INR SGD THB
ATM Vol curve (Chart 4 and 5)
10
11
5
6
7
8
9
Jan-15
-5.00
-4.00
-3.00
-2.00
-1.00
0.00
1.00
2.00
3.00
Apr-15
Jul-15
Vol Slope (ranked by 1Y percentile)
Current
1Y Percentile
Oct-15
Percentile --> 0 means vol
slope flattest or most
inverted over past year

MYR IDR SGD TWD THB CNH INR KRW PHP CNY
Source: Bloomberg Finance LP
0.00
0.20
0.40
0.60
0.80
1.00
1.20
Average Asia 1M ATM Vols
Average Asia 1Y ATM Vols
PHP
IDR KRW

Risk reversals (Chart 6-8)
3.5%
Average Offshore-Onshore 3M NDF Yield Spread
Average 3M Risk Reversal, RHS
2.5%
1.5%
0.5%
-0.5%
-1.5%
Sep-14
Nov-14
Jan-15 Mar-15 May-15
Jul-15
Sep-15
1.20
1.40
1.60
1.80
2.00
2.20
2.40
2.60
2.80
4.5
3.5
4
2.5
3
1.5
2
0.5
1
0
IDR MYR CNY THB CNH TWD PHP SGD INR KRW
3M Risk Reversal (ranked by 1Y percentile)
3M Risk Reversal
1Y Percentile, RHS
100
10
20
30
40
50
60
70
80
90
0
0.5
1.0
1.5

2.0
2.5
3.0
3.5
4.0
4.5
5.0
Average Asia 1M 25D Risk Reversal
Average Asia 1Y 25D Risk Reversal
Jan-15
Apr-15
Source: Bloomberg Finance LP
Jul-15
Oct-15

Equity flows (Chart 9-10)
KRW
-8
-7
-6
-5
-4
-3
-2
-1
0
1
0.4
TWD
0.3
THB
0.2
INR
0.2
0.0
-1.3
-2.6
-3.1
Q3 (July-Sep)
Oct MTD
-6.9
-2.6
-1.2
PHP
IDR
0.2
Source: Bloomberg Finance LP

Local stock market levels (Chart 11-16)
5600
JCI Index
USD/IDR, RHS
5200
4800
4400
12,200
12,700
13,200
13,700
14,200
14,700
4000
Jan-15
Apr-15
Jul-15
Oct-15
24500
25500
26500
27500
28500
29500
Jan-15
8,200
Apr-15
SENSEX
USD/INR, RHS
61
62
63
64
65
66
67
68
Jul-15
Oct-15
PCOMP Index
USD/PHP, RHS
7,800
7,400
7,000
6,600
Jan-15
Apr-15
Source: Bloomberg Finance LP
Jul-15
Oct-15
44

44
45
45
46
46
47
47
48

10,000
7,000
7,500
8,000
8,500
9,000
9,500
Jan-15
1,650
SET
USD/THB, RHS
1,550
Apr-15
Jul-15
TWSE
USD/TWD, RHS
30
31
31
32
32
33
33
34
34
Oct-15
1,450
1,350
32
33
34
35
36
37
38
1,250
Jan-15
2,200
Apr-15
Jul-15
Oct-15
KOSPI
USD/KRW, RHS
2,100
2,000
1,900
1,050
1,070
1,090
1,110
1,130

1,150
1,170
1,190
1,210
1,230
1,800
Jan-15
Apr-15
Source: Bloomberg Finance LP
Jul-15
Oct-15

Regression based fair value (Chart 17)
-4%
-3%
-2%
-1%
0%
1%
2%
3%
Rich/Cheap (+/-)
Percentage deviation of current spot from fitted value based on a 3-year regression of the currency against local equities, local 10Y bonds, S&P, 10Y USTs, USD TWI, Oil and Sovereign CDS (where available)
IDR KRW PHP TWD CNY SGD INR MYR THB
Source: Bloomberg Finance LP