Asia FX Outlook 2022: Gravitational pulls and sentiment swings

Despite our bullish dollar view for next year, the managed Chinese yuan should lend some stability to Asian emerging market currencies. Any depreciation in the yuan will likely require some easing in energy prices in China, while the likes of the Korean won and Taiwan dollar appear quite vulnerable to the rise in global inflation and tightening cycles

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The Asian FX pack is a heterogeneous one, and the outlook for 2022 requires consideration of a number of competing themes. At the heart of all this, is dollar strength. But China's yuan also acts as a local source of gravitational attraction, and China's managed currency stability is lending some stability to other currencies in the region, dampening the dollar's influence to some extent. That could change, but it will probably require commodity prices to moderate for China to soften its protective stance. The last thing China wants to do with growth already challenged, is to undermine consumer spending power by importing inflation through a weaker CNY.

Covid and the reopening of economies is also still a live topic in Asia, which despite a 'good' pandemic in 2020, suffered in 2021 due to a dismal vaccination rollout. This will be particularly relevant for the region's main tourist hotspots and their associated currencies, but also to Australia, which has spent much of 2021 in lockdown.

And for the high beta currencies such as the region's main "proxy-currency" the KRW, global inflation, central bank tightening, and in turn, risk sentiment and equity performance will provide an additional source of volatility (TWD, too, is exposed to such sentiment swings). This will need to be factored against rate increases locally, with a number of economies likely joining Korea in lift-off next year (Indonesia, India, and possibly the Philippines).

Additional risk factors that could exacerbate volatility include the ongoing restructuring of China's property development sector, which faces some big bond maturities next year, not just coupon payments. Also, we are likely to see current accounts, which in many cases improved measurably during the pandemic, begin to deteriorate as domestic demand recovers. And after being given the benefit of the doubt in 2020 and 2021, 2022 may be a year of reckoning for the ratings agencies given bloated fiscal deficits and the persistence of some unorthodox monetary policies.

USD/CNY: Currency stability amidst policy upheaval

	Spot	Year ahead bias	4Q21	1Q22	2Q22	3Q22	4Q22
USD/CNY	6.38	Mildly Bullish ↗	6.40	6.56	6.60	6.70	6.80

- **Macro picture:** Though China has largely recovered from Covid, it continues a strict lockdown policy in the event that cases are found. While lockdowns remain sporadic, the government has focused more on policies aimed at restructuring the economy for a higher quality of growth in the longer run. A large number of policies are being implemented at the same time, which complicates the short-term impact on the economy. We expect that many of these policies will remain effective over the year-end and so there is likely to be some further drag on activity in 2022. This is an inevitable process. But the result will be more balanced growth in time with an emphasis on ESG compared to just speedy but unsustainable debt-fuelled growth.
- **PBoC policy:** The central bank is not going to change policy interest rates or the Required Reserve Ratio in 2021. There is little room for monetary policy change. The complication of the mixed policy effects on the economy implies that doing nothing is probably the best option for monetary policy. Even with that in mind, the central bank will adjust liquidity when the system needs fine tuning. If there were another Evergrande moment, the People's Bank of China would likely release liquidity into the money market to avoid spikes in interest rates that could lead to market contagion. Conversely, if the market allows, there should be some absorption of liquidity to keep the interest rate spread against the dollar as stable as possible.
- **Capital flows:** China opened up investment channels for foreign investors in 2021. The pace has been quite fast compared to 2020. This opening up will continue in 2022 as the economy needs to transform in order to open up the capital account even more. The process will be slow. But as 2022 is expected to be a year of recovery for the global economy, more channels are likely to be opened which should see more capital inflows. These flows will support the yuan. However, as the Federal Reserve is going to hike in 2022 and there will be no interest rate action from the PBoC, the yuan will still largely be driven by depreciation forces. It is just that the speed of the depreciation will not be particularly fast.

USD/INR: At risk if the hot money turns cold

	Spot	Year ahead bias	4Q21	1Q22	2Q22	3Q22	4Q22
USD/INR	74.40	Mildly Bullish	74.00	74.50	74.70	76.00	76.80

- **Macro picture:** Following what was a fairly 'bad' pandemic in early 2021, India has emerged with daily Covid case numbers under control and a steadily rising vaccination rate for its population, suggesting a more stable 2022. The ongoing reopening of the economy is leading to stronger domestic economic growth – evidenced by a rising service sector PMI already in strong expansion territory. Manufacturing output growth is also recovering well, though like elsewhere, this is tempered by some supply constraints and rising prices. Current inflation spikes are concentrated in seasonal foods and should pass but inflation will end the year pushing into the top half of the Reserve Bank of India's 2-6% target range and high energy prices could further worsen India's current account and fiscal balance in 2022.
- **RBI policy:** The last RBI meeting on 8 October kept the policy repo rate at 4.00%, the reverse repo rate at 3.35% and the cash reserve ratio at 4.00%. Despite the improving growth backdrop and rising inflation, the RBI gave little indication that it is about to move to tighten its policy stance, saying at that meeting that it would maintain "the accommodative stance as long as necessary...while ensuring that inflation remains within the target going forward". That said, the economy has sufficiently improved such that we anticipate some reduction in accommodation beginning 1Q22, with the repo rate ending 2022 50bp higher at 4.50%.
- **Capital flows:** The Indian rupee has lost about 1.8% versus the US dollar year-to-date in 2021, though it has been a relative outperformer compared to other Asian peers. We put this outperformance down to a strong pipeline of IPOs and portfolio inflows which has offset the stronger dollar backdrop. Some have suggested that the successful IPOs of companies like Zomato in 2021 will open the floodgates to an even stronger pipeline next year, which would provide further INR support. But with the Fed possibly tightening as early as next year, the equity and IPO environment is likely to be much more challenged and we see the INR losing ground and rising to 76.80 by end-2022.

USD/IDR: Bank Indonesia to keep IDR volatility low

	Spot	Year ahead bias	4Q21	1Q22	2Q22	3Q22	4Q22
USD/IDR	14213.00	Mildly Bullish	14220.00	14486.00	14783.00	14436.00	14313.00

- **Macro picture:** Growth momentum hit a snag in 3Q as the authorities were forced to tighten restrictions due to the spread of the Covid-19 Delta variant. New daily infections have flattened more recently, allowing restrictions to be relaxed and growth momentum appears to have returned. Export growth has been robust, and we expect this sector to be a key driver of the overall recovery. Manufacturing rebounded sharply with recent PMI reports showing a substantial pickup in overall activity. Growth is expected to pick up further in the coming quarters as long as the pandemic remains subdued. Efforts to accelerate the vaccination rollout remain very important given that only 29% of the population is fully vaccinated.
- **BI policy:** Bank Indonesia (BI) has kept policy rates untouched in 2021 and will likely retain this accommodative stance well into next year. BI Governor Perry Warjiyo has supported a “pro-growth” stance suggesting that he will keep rates stable until late 2022. Meanwhile, BI has also pledged to maintain its presence in the spot market to maintain its currency and bond stability objectives. With inflation below the central bank target, we expect BI to keep rates at 3.50% well into next year and will only consider adjusting rates when the Fed begins its rate hike cycle.
- **Risk sentiment:** The Indonesian rupiah has been relatively stable in recent months helped by the sustained presence in markets by the monetary authorities as well as robust exports leading to a hefty widening of the trade surplus. Foreign investors have yet to return to the bond market with foreign bond ownership still in a downtrend. However, we do expect the trade surplus to remain in place in the near term, we also expect some volatility ahead for the IDR, especially as we edge closer to the Fed lift off next year. This development, alongside a dovish Bank Indonesia, suggests at least some modest depreciation for the IDR as we head into 2022.

USD/KRW: Facing weakness even as BoK hikes

	Spot	Year ahead bias	4Q21	1Q22	2Q22	3Q22	4Q22
USD/KRW	1180.00	Bullish	1180.00	1190.00	1220.00	1240.00	1215.00

- **Macro picture:** Korea is set to achieve GDP growth of just under 4% in 2021. This is slower growth than we expected, especially as South Korea has had a relatively moderate pandemic in terms of its direct impact on the economy. Softer than expected 3Q21 GDP growth of just 0.3% illustrates, however, how indirect supply constraints are weighing on growth and we anticipate growth moderating to just 2.6% in 2022. Like many other economies, South Korean inflation has spiked higher on base effects – reaching 3.2% in October and will likely not peak until the November figures are released, though it should ease back towards the mid-to-high 2's in 2022 depending on how persistent current energy price inflation is.
- **BoK policy:** The Bank of Korea was one of the first central banks in Asia to raise policy rates, which currently stand at 0.75% (7-day repo rate). We do not think this is the end for hikes this year. We see a further 25bp before year-end and more in 2022, with policy rates ending the year at 1.25% and expectations for a further 25bp of hikes in 2023. The BoK has demonstrated that it does not need to wait for the Fed to move and is also motivated to tighten by high household debt ratios, and a frothy housing market.
- **Risk sentiment:** Although it has a solid economy, strong external balance, rising domestic rates and is a key beneficiary of rising semiconductor prices, helping to lift the terms of trade, the Korean won was one of the region's worst performing currencies in 2021, acting as a proxy currency for ebbing risk sentiment as the USD rallied. It is hard to come up with a convincing reason why things should be any different in 2022. The risk environment may be even more challenged in the face of rates actually starting to go up in the UK and some other G-7 economies, and we see KRW pushing above the 1200 level by 2Q22 before slowly recovering in 2023.

USD/PHP: Opening up could bring renewed currency weakness

	Spot	Year ahead bias	4Q21	1Q22	2Q22	3Q22	4Q22
USD/PHP	50.32	Bullish	50.85	51.21	51.36	51.23	51.11

- **Macro picture:** Philippine economic activity has been in stop-start mode throughout most of 2021 as the authorities resorted to sweeping lockdowns to tamp down episodes of surging Covid-19 cases. As a result, the recovery effort has lost some momentum and we expect only a modest pickup in economic activity as vaccination rates remain relatively low, at 28% of the total population. A strong rebound in 3Q GDP growth however suggests that economic activity can expand despite lockdowns, although overall momentum may still be capped until the country achieves "full" vaccination by mid-2022.
- **BSP policy:** Bangko Sentral ng Pilipinas (BSP) has retained its accommodative stance despite above-target inflation in 2021. BSP Governor Benjamin Diokno vowed to keep rates unchanged "for as long as necessary" to aid the economic recovery, opting to look past supply-side driven inflation. But we do expect BSP to adjust policy rates by 2Q 2022 ahead of the projected Fed lift-off next year.
- **Risk sentiment:** A surprise rebound in GDP boosted overall sentiment towards the Philippines. Foreign investors have returned to support the Philippine equity market on prospects for faster growth. However, the faster reopening of the economy has led to surging imports, which in turn has caused the trade deficit to widen and the current account to revert to deficit. With growth expected to pick up in the coming quarters, we expect the current account deficit to widen further, resulting in a weakening bias for the Philippine peso in the coming months.

USD/SGD: NEER appreciation path could steepen in 2022

	Spot	Year ahead bias	4Q21	1Q22	2Q22	3Q22	4Q22
USD/SGD	1.35	Neutral	1.35	1.32	1.34	1.33	1.32

- **Macro picture:** Singapore's economy returned to pre-pandemic levels of GDP in early 2021 and the recovery has gained momentum despite tightened restrictions in 3Q. Retail sales outside automobiles are robust and the export sector should benefit from the strong global demand for electronics. The authorities have shifted their focus from growth to rising inflation, with price pressures representing the primary potential dampener to an otherwise robust recovery.
- **MAS policy:** The Monetary Authority of Singapore tightened its stance at least a quarter ahead of expectations, viewing the recovery to be well in-hand. The Singapore dollar's nominal effective exchange rate (NEER) is now slightly appreciating which should see it outperform many of its Asian peers. The MAS may very well increase the pace of NEER appreciation in 2022 given relatively hawkish commentary of late. The central bank has highlighted the threat of inflation, and with the overall economic outlook improving, we could see a more aggressive adjustment of policy in the coming months should inflation prove to be more persistent.
- **Risk sentiment:** Core inflation, the price indicator monitored by the MAS, has accelerated recently as supply chain bottlenecks force commodity prices higher. Accelerating inflation will be the key threat to growth in the near term although the export sector stands to benefit from sustained global demand. A possible downturn in China's growth prospects may also dent momentum in terms of the export outlook.

USD/TWD: Under pressure from capital flows

	Spot	Year ahead bias	4Q21	1Q22	2Q22	3Q22	4Q22
USD/TWD	27.79	Bullish	27.90	28.20	28.40	28.80	29.20

- **Macro picture:** Taiwan will keep its comparative advantage in manufacturing advanced semiconductor chips in 2022. At the same time, production bottlenecks will become more obvious in terms of yearly growth. Consumption will not increase until Taiwan's borders are reopened, and the timing of this is uncertain. Production and exports of semiconductors could again be offset by growth in imports of equipment to build factories for the future production of semiconductor as in late 2021. The main risk is still the relationship with Mainland China. The risk of a military event is small, but it is nonetheless a tail risk. Taipei could change its tone and try to re-establish unofficial communication channels but otherwise this deadlock will remain in 2022.
- **CBC policy:** The central bank is well known for its lack of policy activity. The policy rate is currently at 1.125% The last time rates were cut was in the first quarter of 2020. Even though Covid case numbers have started to pick up again, the central bank does not look likely to change the policy rate. Compared to many other central banks, including the US Federal Reserve, the Central Bank of the Republic of China has kept policy very steady since 2015, and we believe that this lack of policy action will not change in 2022, with the policy rate staying flat at 1.125%.
- **Capital flows:** The unchanging policy rate from the central bank provides a stable backdrop for capital flows. Capital inflows to Taiwan's asset markets are usually directed at the semiconductor industry. But the current chip shortage has challenged foreign portfolio inflows. The semiconductor shortage will continue in 2022 and Taiwan is responding by building more plants to cater for this. Consequently, we should continue to see inflows into Taiwan. But the overall trend of Taiwan's dollar will still likely be dominated by the strong US dollar and looming US rate hikes in contrast to Taiwan's monetary policy stasis.

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