Navigating Asian currencies amid the trade turmoil

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The ongoing US-China trade war shows no signs of a near-term resolution. Against this backdrop, Asian economies and currencies have come under pressure. But there are differentiations to be made.

US-China trade tensions have persisted for more than a year. On several occasions, there were hopes that the two countries were working towards a resolution, but the prospects of a trade agreement have so far failed to materialize. The likely outcomes are as unpredictable as the actors involved, thus we prefer to assess and manage the risks that accompany protracted tensions and determine suitable currency strategies under such an uncertain environment.

Clearly, trade tensions have taken their toll on the global economy. Global manufacturing PMIs have declined into contractionary territory. Services PMI, which have held up so far, have also started to moderate. Global and Asian growth is under threat even as policy support – both monetary and fiscal - remains strong. This comes as we approach the tail end of the 11-year old business cycle, so caution is warranted.

IMPLICATIONS FOR ASIA

The rest of Asia, alongside China, will inevitably suffer the economic drag from protracted trade tensions, but there are differentiations to be made. By export orientation and percentage share of exports to Hong Kong and China, North Asian economies show greater economic sensitivity compared to South Asians.

Since the beginning of the trade tensions almost 2 years ago, North Asian economies have lost greater global export share compared to their South Asian counterparts – see Fig 1. This suggests that supply chain linkages and geographical proximity of North Asian economies leaves their currencies more vulnerable to a persistent trade war as compared to South Asian currencies.

This is corroborated by the foreign exchange sensitivity analysis, which shows that, North Asian currencies demonstrate greater sensitivity to changes in the Renminbi (RMB) – see Fig 2. This is important since Chinese authorities have made clear recently that a weaker RMB will front the suite of countermeasures in place in response to additional tariffs. The correlations are also logical, since North Asian economies have a higher share of their GDP exposed to China's final demand, as compared to South Asians, which have lower fundamental linkages to the Chinese economy.

SILENT BENEFICIARIES

Over a longer-term horizon, the trade war has led to a permanent reconfiguration of supply chains in Asia. Supply chain diversification is ongoing, and South East Asia is primed to benefit. Labour costs in South East Asia are now lower than in China, and several of the key manufacturing centres in South East Asia have seen their competitiveness rankings and ease of business improve vis-à-vis China over the past decade.

Data released show Vietnam, Malaysia, Indonesia and Singapore have registered strong year-to-date foreign direct investment flows despite slowing growth. Anecdotally, these economies have scored landmark investments from high profile multinational corporations amid heightened uncertainty surrounding China as a production base, affirming the viability of South East Asia's manufacturing bases as suitable alternatives.

In the above context there is a compelling case to be made for South Asian currencies - the likes of the Indian Rupee, Indonesian Rupiah, Philippine Peso and Malaysian Ringgit - to outperform the North Asian currencies – Chinese Yuan, Taiwan Dollar and South Korean Won - in the near and medium term regardless of how trade tensions evolve. The Singapore Fixed Income team thus favours such relative trades within our fixed income portfolios.

Fig. 1. Sensitivity of Asian economies to the trade war[1]

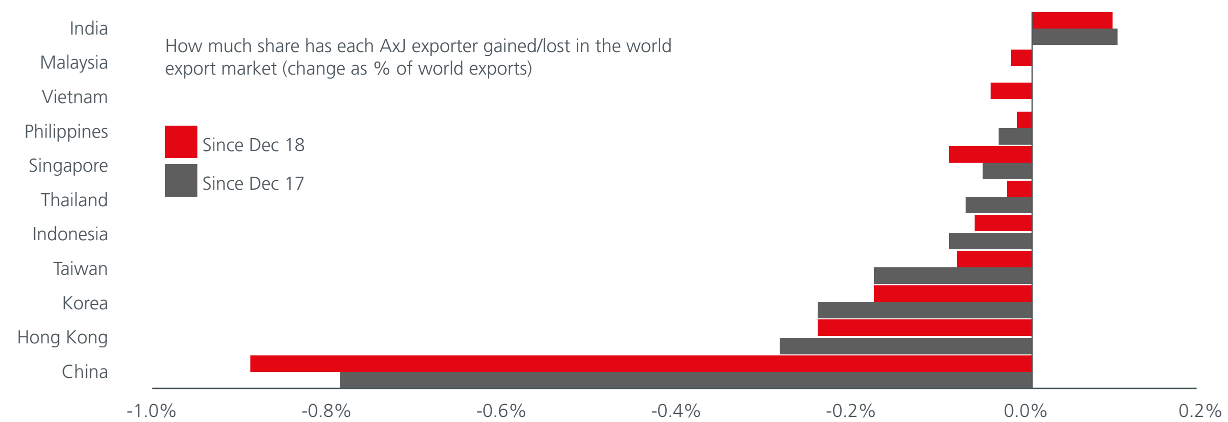
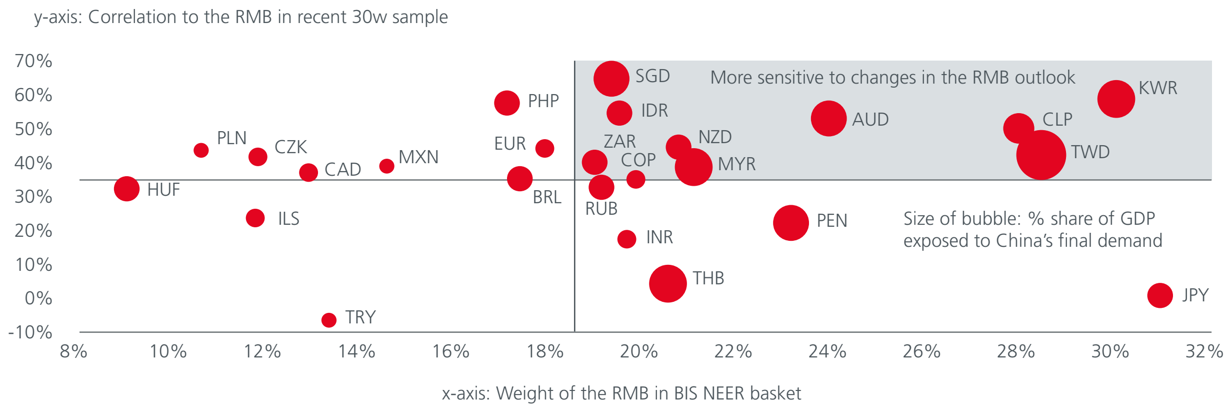


Fig. 2. Sensitivity of Asian currencies to the Renminbi[2]



Sources: [1]Haver, Morgan Stanley Research, Calculation note: We calculate world export share on 6M trailing sum basis to capture changes at the margin. Data as of April 2019 [2]BIS, OECD, TIVA, HSBC

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