# Scotia Asian FX Update

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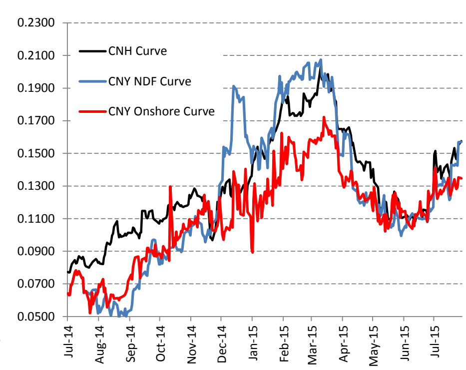
## CHINA PMI WEAKER WITH DISAPPOINTING UNDERLYING DETAILS

• Sub-indices on China PMI weaker, but still suggest support for trade surplus expansion.
• We continue to prefer USD/RMB curve steepeners as the way to play a bearish view, as spot renminbi is unlikely to move.
• RBI seen holding on policy, at least until new MPC structure is confirmed.
• Bank of Thailand to hold  on rates after government let's  it preference for a weaker currency to be known.


Source: EMED, Scotia FX Strategy




Source: Bloomberg, Scotia FX Strategy

USDCNY • China released its NBS July manufacturing PMI over the weekend, with the index dropping to flat at 50.0 vs. the expected decline to 50.1 (from 50.2 previously).  The underlying details show weakness in most categories, with output contracting by –0.5 (worst since January), and new orders down –0.2 (second consecutive monthly contraction).  With all the negative implications contained in the PMI, the CNY-supportive dynamic implied by the differential between the import and export orders sub-indices continued. Though new export orders contracted by –0.3 and imports by –0.2, the trends favouring weaker import dynamics over weaker exports remained, which should continue to imply a trend expansion in the trade surplus (see chart).

The rest of the week will be more quiet for Chinese data (the NBS non-manufacturing PMI registered a minor  increase to 53.9 in July), ahead of the July trade and price data to be released on Saturday and Sunday respectively.

Spot trading and the fixing continue to hold extremely stable, as macro-financial stability continues to be the main focus for Chinese policy makers.  However, our view on the NDF curve continues to pay off as the 2s12s steepen to a new multi-month high. We continue to foresee weak Chinese data and risk aversion pushing a further steepening in the curve. The CNH curve is showing the same propensity, tethered to the onshore curve, however the onshore curve still remains more stable, despite steepening in the same manner (see chart).

Despite the weakness in onshore yields, and the likelihood that they are managed lower by the PBoC, we still think curve steepening is likely as bets on renminbi depreciation increase. Should we see a move to widen the trading band, this could increase the pressure on points, though without a refinement to the daily fixing mechanism, it is less likely that we see any significant move in spot. Until then we feel that hedging flow on the perception of depreciation risk, heightened by the broad move higher in USD/Asia since late-June as well as outright speculator USDRMB buying interest will continue to pressure points.  Thus  in our view this is the best way to play weaker CNY risk, hence our suggestion to be long 2s12s two weeks back.

India - The RBI is scheduled to meet on policy tomorrow, with the market highly skewed towards the expectation for no cut in rates. We are in line with this, until we get greater clarity on the government's proposed monetary policy council structure (inherently a potentially dovish development).  PMI indicators will also be on tap for later this week. USDINR has been pressured higher  over the past few sessions, but remains an outperformer relative to the rest of Asia, as the RBI is likely enhancing market stability as foreign net outflows persist (mainly in the fixed income market).

Malaysia - While protests in Malaysia calling for the resignation of PM Najib have remained fairly quiet (with some arrests over the weekend), MYR is likely to continue  to underperform on the heightened political risk premium being priced in for the country. The June trade data will be released this week, with both exports and imports expected to continue to contract, though the monthly trade surplus is expected to hold around MYR 5.5bn. Foreign reserves data (to be released on the 7th), will show the degree to which the central bank continues to provide liquidity to the market as reserves utilization was extremely high as USDMYR traded to and through the 3.80 level. The reserves data may gain increasing importance to the market as a signal of nervousness from policy makers, however Malaysia maintains a high buffer yet, and external risks are low.

Korea - June balance of payments hit a monthly seasonal and absolute record high at $12.2bn, backed by a similar new record in the goods trade balance at $13.2bn. Net portfolio flows continue to be unconstructive, however in recent months driven more by domestic buying of foreign equities, rather than foreign selling of Korean equities, and is more than offset by the significant expansion in the trade surplus. This will keep the central bank focused on ensuring the expanding trade surplus does not cause competition threats for KRW vs. JPY, though KRW weakness has driven the exchange rate back to levels of earlier this year vs. the yen.

We feel that USDKRW has entered a consolidation mode, after a very rapid move that has pushed the pair to our end of year target. We still like it higher but feel that buying on dips towards 1140 through 1160 represents better value for longs, so long as the move is not predicated on a USD/Asia suppressive factor such as the failure of the Fed to hike in September.

Taiwan - Weakness in TWD has been long time coming and the past 1.5 weeks have seen significant action on this front as TWD has underperformed the region (since July 22nd). This week we see the release of CPI and WPI data, as well as the trade data for July. The latter will be more relevant as TWD weakness in our view is the preferred lever of action for monetary policy, with further weakness in TWD still required to help achieve balance in the external accounts.

Indonesia - CPI data today, as well as GDP data later this week will be important as the former will be watched in order to predict easing timing from the central bank, while the latter may increase political pressure on President Widodo, who has thus far disappointed high hopes from the market. Growth is expected to continue to decelerate, which will pressure BI to act in the coming months once inflation dynamics improve. We remain IDR bears and continue to target 1400 by year end in USDIDR.

Thailand - Inflation today is expected to show a fairly stable read at –1% on headline and 0.9% on core Y/Y respectively. This leads us to the BoT meeting on Wednesday. We would suggest that the central bank should still be biased for lower rates, however the government has let its preference be known (likely in consultation with monetary policy makers) that monetary conditions may best be eased via weakness in THB. USDTHB has breached the 35.00 level, and may be in line for consolidation as the move has been rapid over the past month. However we continue to like the pair higher and target 35.50 by year end.

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