

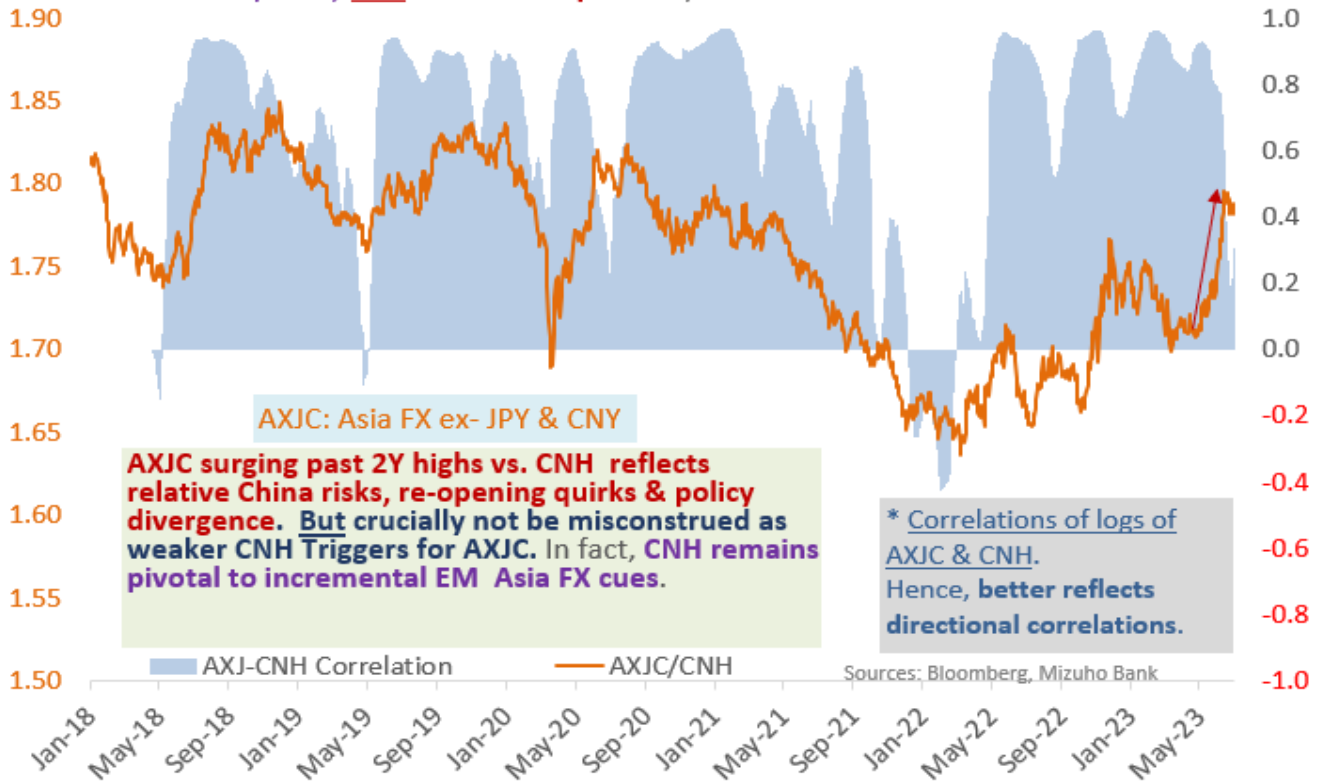
# Mizuho Chart Speak: CNH & AXJ

Economics & Strategy | Asia ex-Japan

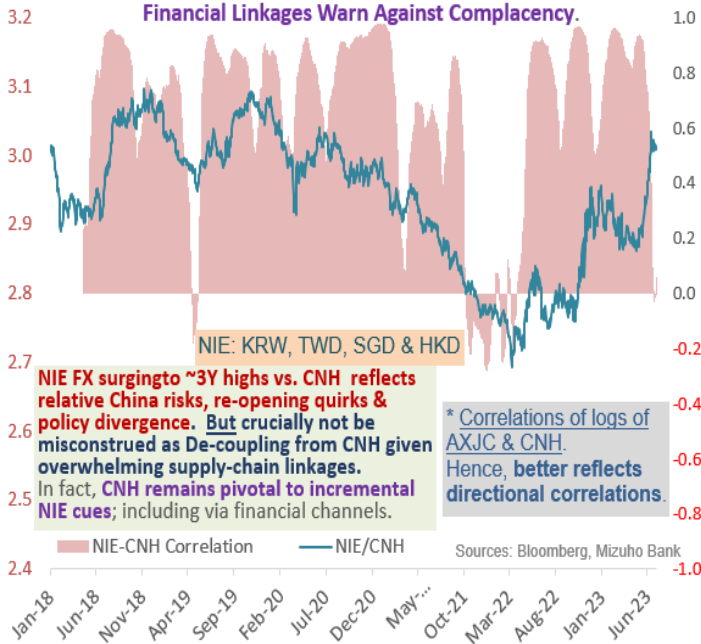
3 July, 2023 | Vishnu Varathan | Head, Economics & Strategy

## EM Asia FX: Remembering Renminbi Correlations

**Sharp Surge in AXJC vs. CNH** Corresponds to *Temporary & Partial Dampener, Not Durable Departure, From CNY Correlations.*

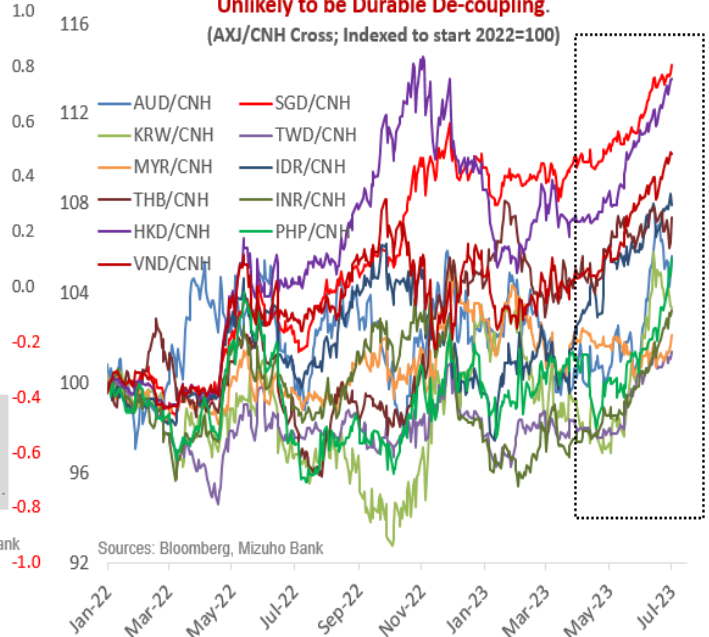


**Out-performance of, and diminished Correlations with, NIE Currencies (vs CNH) Even Sharper. But Exceptional Trade & Financial Linkages Warn Against Complacency.**



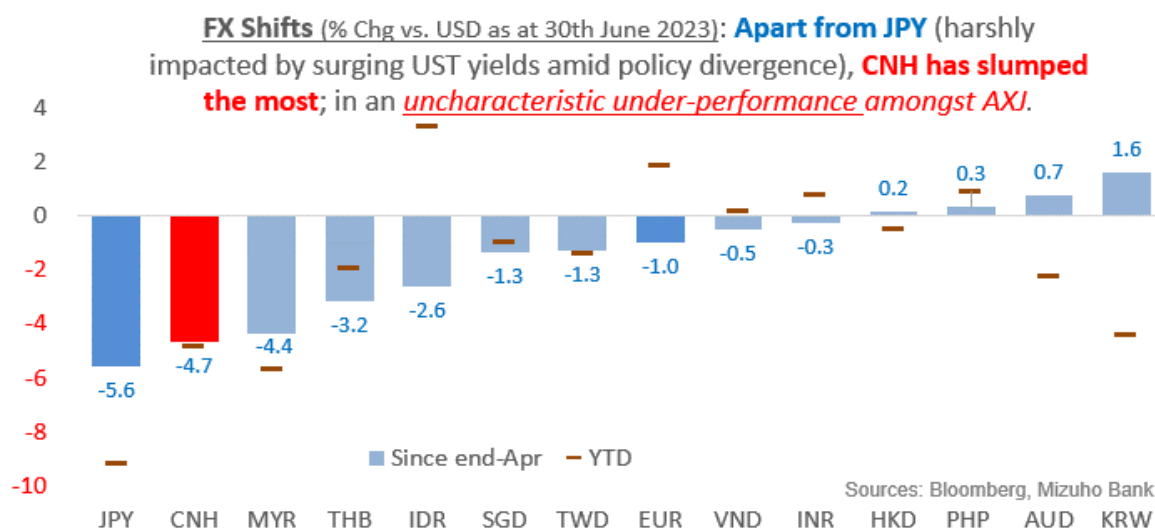
**Strong out-performance of other EM Asia FX (AXJ) vs. CNH; except for MYR (muted ahead of state elections).**

**Unlikely to be Durable De-coupling. (AXJ/CNH Cross; Indexed to start 2022=100)**



*“Don’t underestimate the Force.” – Darth Vader, Star Wars (Ep. IV): A New Hope*

- Recent **CNH under-performance** is **remarkable**. Obviously, **for its depth**; being 4-5% down vs. USD *since mid-May*. **But arguably, more for its dampened effect on EM Asia FX** as a whole; which is *fairly visible in the sharp upswing in AXJ/CNH* (consistent with AXJ out-performing CNH).
- Put another way, the **sway of CNH sell-off on other Asia FX** (as well as AUD) have been **far more muted** than historically high (positive) correlations would have otherwise suggested.
- Why is this poignant? For three reasons. First, the **positive correlation between CNH moves and Asia FX** (including AUD) has been to the order of *some 68%* since 2018. That's to say, even accounting for the 2018-19 US-China “trade war” **AXJ correlations with CNH** have been **significant**.
- Second, and even more importantly, this **elevated correlation** has been **consistent**. Fact is, **periods of diminished correlation have been brief, usually entailing CNH out-performance amid volatility**, and, above all, **promptly restored to the “usual” patterns of heightened co-movement**.
- Finally, *with over 70% sensitivity of proportional AXJ shifts vis-à-vis CNH* (even on an aggregated basis), what this means is that **CNH shifts have material, identifiable impact on AXJ**.
- And so, it is hard not to flag caution that **markets will do well remembering CNH correlations**, and **attendant drag forces from episodes CNH forces**, when assessing risks for other AXJ.
- Admittedly, **one-off/cyclical China-specific triggers** (e.g. counter-intuitively, but compelling drag from re-opening), **structural/geo-political pressures** and **policy divergence** undermining CNH may account for relative AXJ out-performance vis-à-vis CNH.
- Nonetheless, **inextricable and enlarged supply-chain and investment linkages** between China and the rest of Asia, dwarfing almost all other bi-lateral commercial linkages Asia has with other regions, **underpin the intertwined fates of the CNH and other EM Asia currencies**.
- Broader point being, the **buffer that EM Asia FX have against drag from CNY pressures** is likely **temporary and partial dampener, not a durable departure from entrenched positive correlation**.
- What's more, any **weakening in correlations** between CNH and other AXJ currencies have been **brief**, and **crucially, the reasserted CNH impact on other AXJ has been significant**.
- Simply put, it is **reckless to assume the same degree of buffer on further bouts of CNH pressures**. *In fact, it is too presumptuous to even have confidence that current AXJ out-performance against CNH will be retained* if risks sentiments sour. **AXJ catch-down risks as such remain a clear and present danger** in the absence of offsetting “risk on” and/or USD slump.
- The upshot? If **CNH soft spots show further signs of stress**, accentuated by greater pressures for capital outflows, it will lay bare **dangers of more generalized and sympathetic AXJ sell-off**.
- **Darth Vader's counsel to “not underestimate the force” resonates with not allowing measured AXJ cushion to breed complacency about immunity**. After all, the **“force” is strong with the CNH**.



Note: The AXJ notation as used here expressly excludes CNH, for ease (and accuracy) of comparison with Asia ex-Japan currencies; (such as INR, KRW, TWD, HKD, SGD, MYR, IDR, THB, PHP, VND and AUD).

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