Mizuho Chart Speak: EM Asia FX

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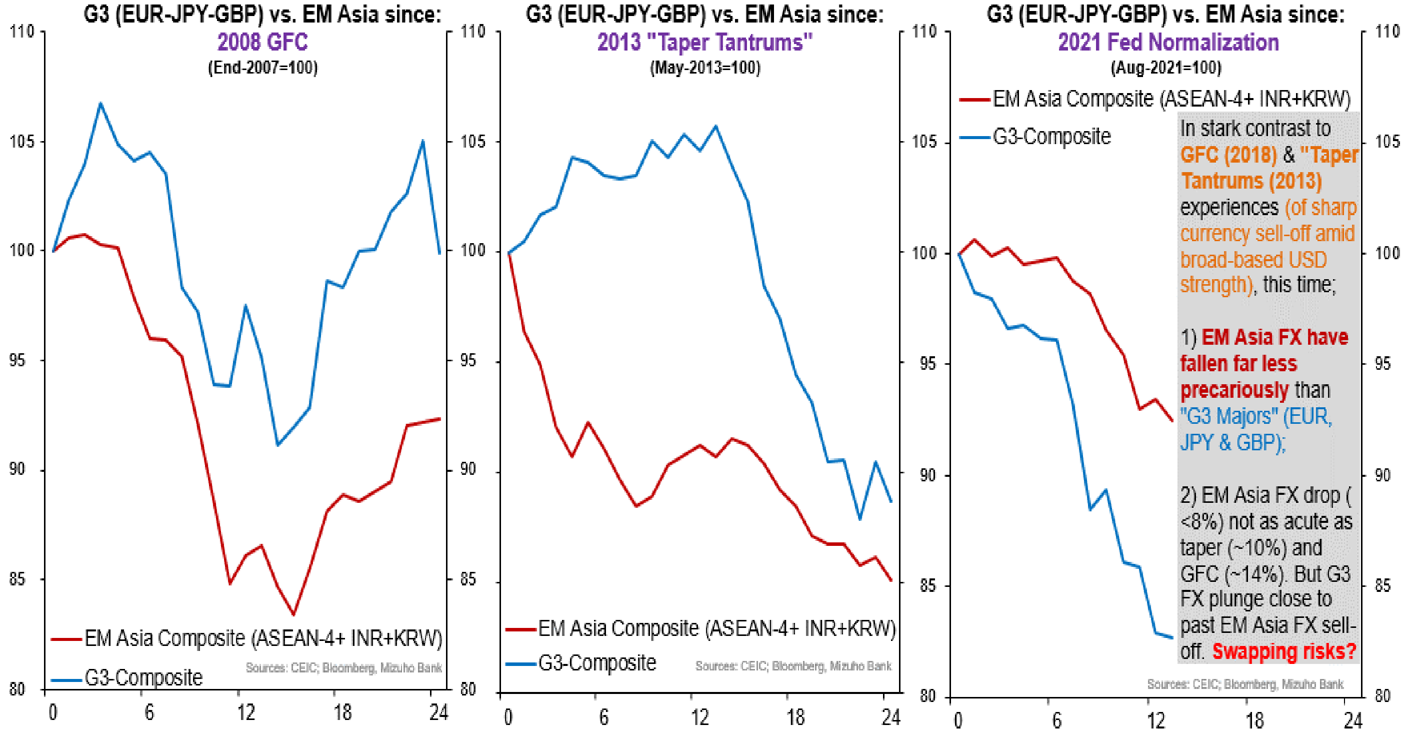
EM Asia FX (Part 1): Peculiar, Not Different



"You must unlearn what you have learnt" **– Master Yoda, Star Wars**

In a Nutshell: The **aberration of EM Asia FX performing relatively better** (falling less sharply) **than Majors/G3** (EUR-JPY-GBP) *into this cycle of sweeping USD strength* (from "risk off and a hawkish Fed) is **not to be mistaken for absolution from inherent EM Asia FX risks**. Instead, **peculiar G3 under-performance** *amid post-COVID snags, geo-politics, war, and policy divergence,* **conspiring with flattered and fleeting EM Asia FX resilience** (on fading relative inflation buffer) must be recognized as overstate EM Asia FX resilience. Especially **given the likelihood that "peak USD" may not relinquish dominance smoothly or swiftly**; given greater uncertainty and more economic pernicious risks elsewhere. So, ***further downside EM Asia FX risks cannot be carelessly dismissed*** **on** "this time, it is different" refrain.

Peculiar (FX Dynamics) …

A *bullish USD accompanying the Fed's aggressive tightening* amid *wider "risk off"* is **a familiar FX market experience**. Yet, ***this episode*** **of sweeping USD strength** is distinctly **peculiar**. And **glaringly so given EM Asia FX depreciation** that is **uncharacteristically less severe than the precarious drop in the G3 FX**.

This **relative G3 underperformance vis-à-vis EM Asia** is *completely at odds with historical precedence* of **EM** (Asia) economies, typically vulnerable to a far greater degree of capital flight, **suffering greater FX pressures** (see Charts) during periods of financial market turbulence (2008 GFC) and/or the Fed's normalization/tightening cycle (2013 'taper tantrums').

Alongside the **far more acute G3 FX plunge** this time (in sharp contrast to more measured EM Asia FX drop) that's *reminiscent of the degree of past EM Asia FX devastation* **begs the question of whether, G3 and EM Asia have swapped FX souls**. And **if so, why**.

… Not (this time, it is) Different

These questions merit careful scrutiny. Because sensational provocation aside, such a conjecture potentially **challenges received wisdom**, and **tested assumptions**, **about global FX dynamics into a potentially turbulent Fed tightening cycle**. And so, it is perhaps best to be **cautious** in reviewing the evidence, and **not cavalier in invoking that notorious refrain**, "*this time, it is different*". Not the least because of the inadvertent propensity to be dismissive of familiar risks/threats and looming crises.

All considered, the nuanced conclusion is that this **aberration of EM Asia FX out-performance relative to G3** (EUR-JPY-GBP) **should not be mistaken for absolution of inherent EM Asia FX risks**. Upshot being:

1) EM Asia's Overstated Relative Resilience: The **severe COVID distortions and disruptions** leading to **uncharacteristically higher DM inflation than in EM** (Asia) **explain** both the **relative out-performance** this time and comparatively greater resilience (vs. past crises) of EM Asia FX; **on account of more attractive real returns**. ***But*** as EM Asia's inflation catches up, these **relative advantages are poised to quickly fade**. Especially as a **hawkish Fed inflicting pain via rates** and **USD** threatens amplify EM Asia currency pressures down the road. And this may be **independent of other Majors continuing to underperform** (i.e. not just about swapping risks).

2) Majors May Endure Prolonged Pain: Fact is, **more acute policy trade-offs and stagflation risks** due to far more proximate impact of the Ukraine war for Europe and Brexit related wage/inflation woes for the UK mean that policy (real rate) divergences may be sticky one way or another. And that means a **rebound in the Majors elude for longer than** has been the case **in previous Fed tightening cycles**.

3) "Higher for Longer" USD: *Consequently*, **peak USD may not precede peak Fed rates as promptly** as it has in past cycles when economic cycles across the Atlantic have been more synchronized. The "*higher for longer*" **message on rates out of Jackson Hole may resonate with the USD**. Admittedly, greater two-way volatility may be expected for bets on the transition from peak rates-to-pivot bets. But that does not distract from "King USD" prolonging drag and entrenching more downside risks.

Master Yoda is right that we "*must unlearn*" received wisdom on relative G3 and EM Asia FX performance during stress. Crucially, to recognize that **peculiar G3 under-performance** *amid post-COVID snags, geo-politics, war, and policy divergence*, **conspiring with flattered and fleeting EM Asia FX resilience** (on fading relative inflation buffer) overstate EM Asia FX. And that is critical to avoid complacency about enduring (even if not immediately evident) risks from **"higher for longer" peak USD**.