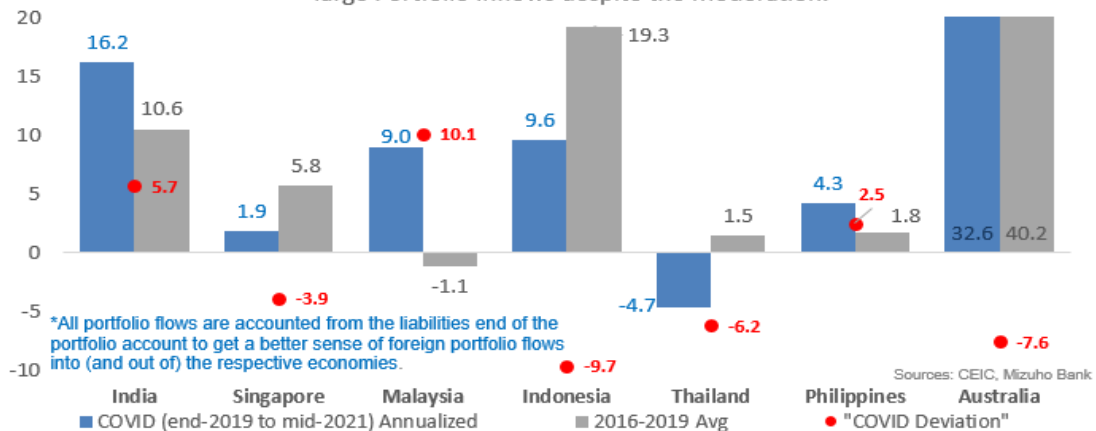


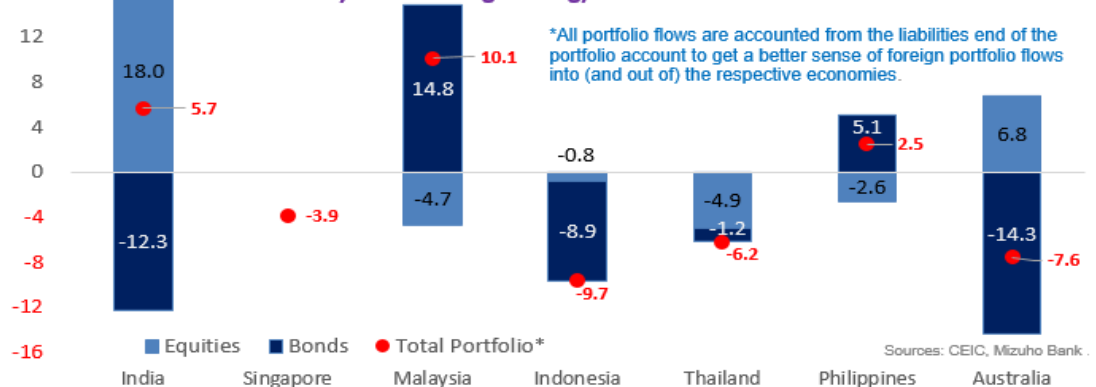
EM Asia FX - Deciphering Portfolio Flow & FX Linkages

Foreign Portfolio Flows (US\$ bn): India, Malaysia & Philippines have witnessed marked step-up in Portfolio Inflows since 2020; while Indonesia has relatively large Portfolio Inflows despite the Moderation.



Change in Portfolio Flows (Annualized; COVID vs. 2016-19 Avg; US\$bn):

Exceptionally Large Pick-up In Equity Inflows for India & Bond Inflows for Malaysia and Philippines Counsel Caution Amid **Potential for Capital Flow Volatility from Fed Tightening/Other Headline Risks.**

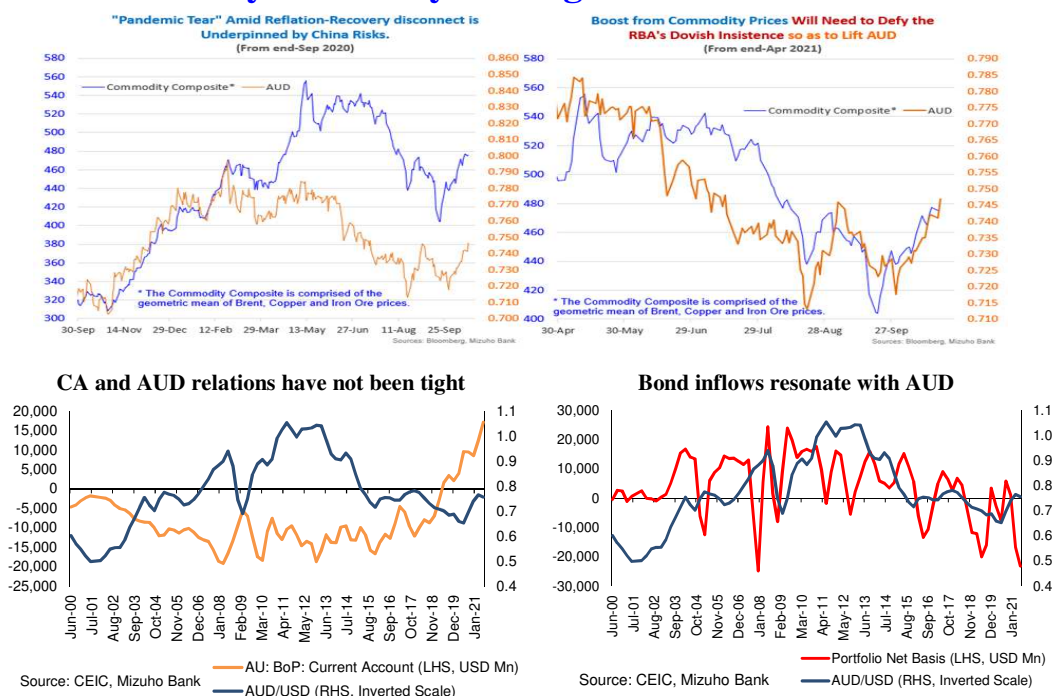


As inflation starts to rise sharply, threatening to erode real returns, and the Fed looks set to not only wind down QE in H1 2022, but most likely hike rates in H2 2022, the **risk of capital flow volatility will re-emerge**. And insofar that COVID prompted exceptional portfolio inflows in the region (at least partly fuelled by the unprecedented deluge of cheap liquidity from global central banks), the **risks of asymmetrically quick capitulation should not be dismissed** lightly. **Hastened taper and rate hikes amid high inflation, all while COVID “variant” risks linger only heighten uncertainty and exacerbate potential for volatility.** To this end, understanding recent shifts and flux in portfolio and overall FX flows provides serves as a useful basis of gauging risks of negative turns. The broad-brush (albeit incomplete) view is that *India is vulnerable to sharp reversals of equity inflows* has heightened, while *bond flow reversals pose potential vulnerabilities to Malaysia and the Philippines*. *Thailand, at the other extreme, may prove resilient having been stress-tested by exceptional COVID outflows.*

Executive Summary

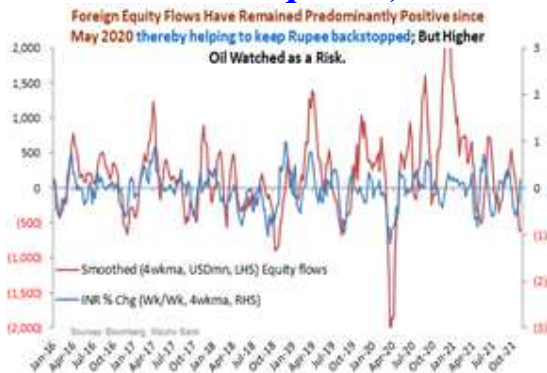
- **AUD:** **AUD is not immune to portfolio flows, but AUD-portfolio flow linkages may not always be evident or consistent directionally.** Reasons for this are **commodity cycles and portfolio flows** are **not always in sync**. That said, all else equal, the **baggage of “carry”** in the context of **real resource sector investment cycles** and **monetary policy response**, appears more consistent with **greater AUD sensitivities to bond rather than equity flows**.
- **SGD:** As counter-intuitive as it may sound (given deep, liquidity markets and open capital accounts), **getting a reliable pulse of SGD tendencies from equity or bond flows is fraught with a litany of structural challenges**. To be sure, **SGD is not insensitive to equity and bond flows; at least indirectly via other regional currencies, in the case of inflows into the region**.
- **INR:** **Rupee has quite clearly turned partial to equity flows** during COVID; as the staggering surge, quintupling to be precise, in COVID equity inflows vis-à-vis 2016-19 average has hijacked the portfolio flows narrative. But even larger FDI flows may dampen the impact of equity flows if the two are not aligned. And **rising Oil prices**, which threaten to reinstate a Current Account deficit, **could challenge rupee boost from equity inflows**.
- **MYR:** **Portfolio flows unmistakably sway MYR**, with **bond flows exhibiting a greater degree of influence** given larger magnitudes. But equally, MYR is a multi-faceted currency entailing close SGD linkages, oil/commodity boost and a strong current account surplus; resulting in **episodes of muted impulse transmission** from portfolio flows.
- **THB:** Rather than stand-alone impetus from either equity or bond flows, **combined portfolio flows tend to explain short-term THB moves with greater complementarity; although far from completely or comprehensively**.
- **IDR:** Not unlike the THB, the **rupiah takes cues from both equity and bond flows, but sensitivities appear to be appreciably more attuned to bond market flows** that tend to be more **significantly more pronounced**; and *key to financing the Current Account deficit* (by portfolio flows). In turn, naturally **accentuating IDR sensitivities**.
- **VND:** **Sensitivities to equities and bond flows can be considered highly negligible** in its current state of financial sector development, given the **lack of liquidity in capital markets and still budding foreign participation levels**.
- **MMK:** **Sensitivities to equities and bonds can certainly be considered non-existent and negligible**, simply because of the absolute infancy of its financial system; a decade old managed float system running in parallel with unofficial exchange rates, alongside a 5-year old stock market. Politics and institutional factors take centre stage in the influence of the MMK.

AUD: Commodity-Monetary Linkages

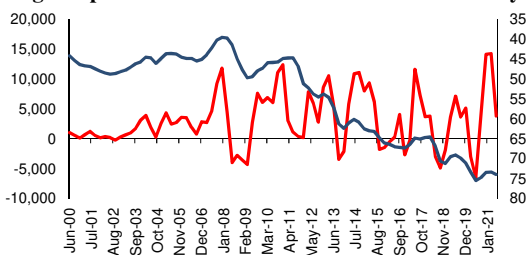


- Overview:** AUD is not immune to portfolio flows, but AUD-portfolio flow linkages may not always be evident or consistent directionally. Reasons being, commodity cycles and portfolio flows are not always in sync (an commodities are undoubtedly a very proximate and profound driver of AUD). That said, all else equal, the baggage of “carry (trades)” in the context of real resource sector investment cycles and monetary policy response, appears more consistent with greater AUD sensitivities to bond rather than equity flows.
- Commodities:** The elephant in the room is that AUD response and sensitivities are arguably the most sensitive to commodity prices. So much so that anticipated C/A, portfolio flows, FDI and even “carry trade” impulses derived from projected monetary policy response are often just backed out of commodity prices and fed into AUD.
- Current Account:** To some extent, that is reflected in AUD and C/A correlations not always being convincingly tight. COVID-induced surge in C/A to a surplus of ~\$47bn (annualized) is staggering compared to average 2016-19 deficit of \$24.9b; and yet that massive upswing in C/A has not shown up convincingly as AUD boost. Although the bigger issue may be some AUD-commodities decoupling; potentially on dovish RBA divergence.
- FDI:** It is worth noting that strong FDI inflows of ~\$43.7bn pre-COVID (despite declining to \$12.3bn annualized during COVID) function as key AUD support/anchor against portfolio outflows (COVID: -\$39.6bn; 2016-19: -\$13.8bn).
- Portfolio Flows:** And a key distinction is that portfolio outflows are typically composed of bond inflows (2016-19: \$11.0bn; COVID: \$2.7bn) and equity outflows (2016-19: \$24.8bn; COVID: -\$39.6bn); the latter outsize the former. And on the whole, bond inflows appear to have more resonance with AUD shifts.
- Commodity-Investment-Monetary Links:** Possibly as bond inflows are positively correlated to commodity prices insofar that positive terms of trade and investment multipliers prompt policy tightening, higher yields and resultant yield-seeking inflows boosting AUD. Whether these links are re-established post-COVID remains to be seen.

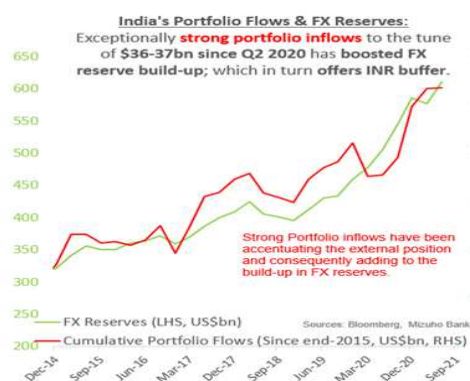
INR: Partial to Equities, But Wary of Oil



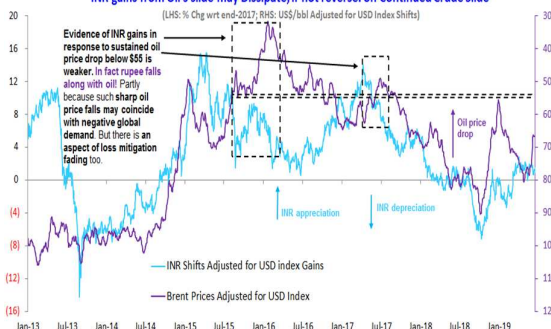
Tighter portfolio flows & INR relations seen recently



Source: CEIC, Mizuho Bank

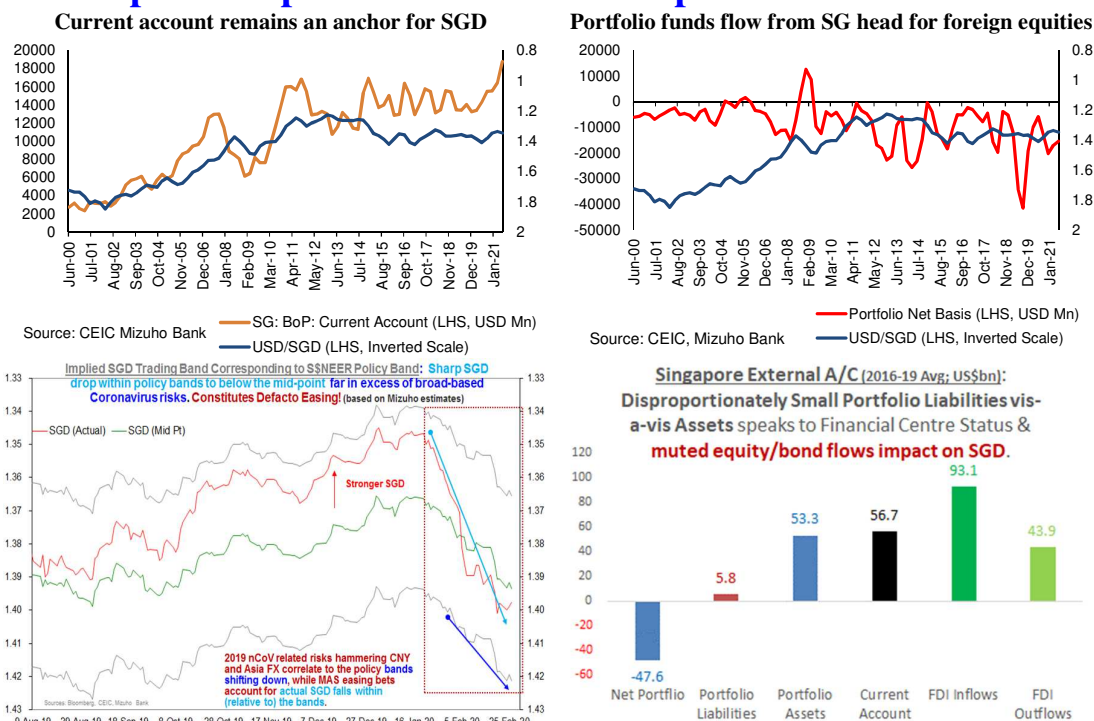


A Key Observation is that Rupee Tends to be Less Responsive to Oil's Slide below \$55; so INR gains from Oil's slide may Dissipate, if not reverse, on Continued Crude Slide



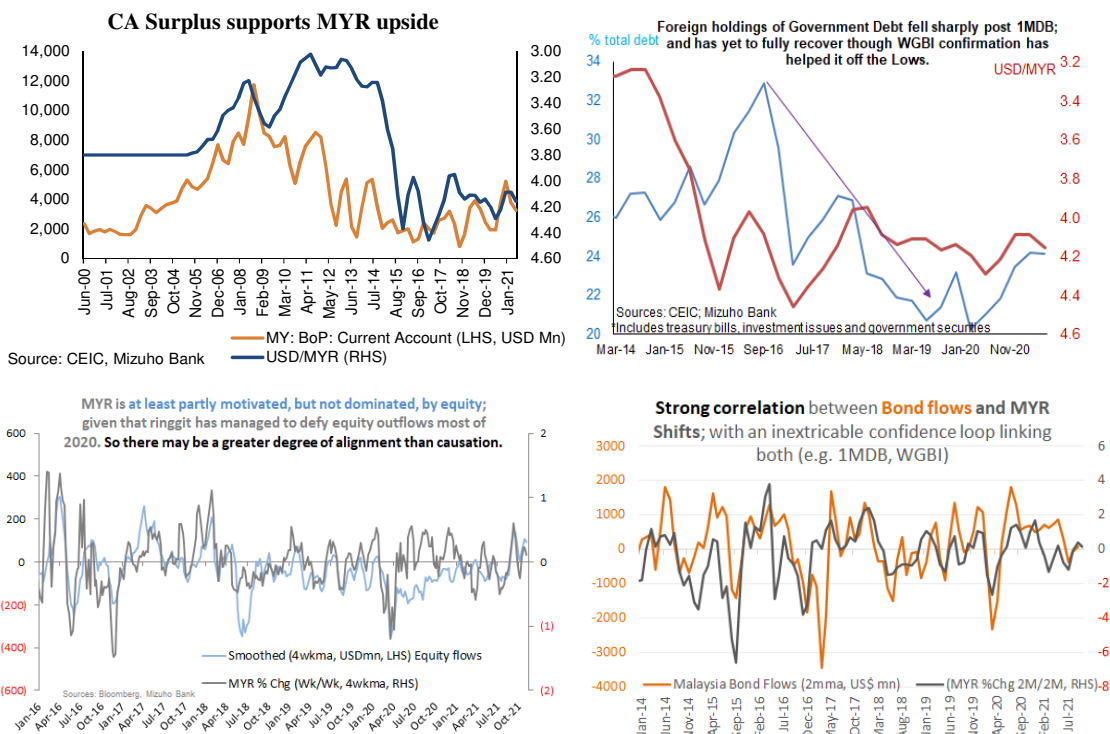
- Overview:** Rupee has quite clearly turned partial to equity flows during COVID; as the staggering surge, quintupling to be precise, in COVID equity inflows vis-à-vis 2016-19 average has hijacked the portfolio flows narrative. But even larger FDI flows may dampen the impact of equity flows if the two are not aligned. And rising Oil prices, which threaten to reinstate a Current Account deficit, could challenge rupee boost from equity inflows.
- Portfolio Flows:** Equity inflows have exploded to an annualized \$22.4bn during COVID from being largely balanced pre-COVID (2016-19); in fact, bond inflows were slightly larger at \$6.1bn compared to the \$4.4bn equity inflows. And so, the correlation between equity inflows and rupee (strength) appears to have tightened.
- FX Reserves:** And this is despite the fact the RBI's efforts to build up FX reserves (largely thanks to strong portfolio inflows) equity inflows), which all else equal, ought to have dampened the pass-through from equity/portfolio inflows to rupee appreciation. And on the flip side, may buffer rupee from pressures from outflows.
- FDI:** Speaking of buffer, India's strong FDI inflows also add to buffer in the rupee, but with a clear bias to a supportive rupee. COVID has also accentuated FDI inflows from \$34.1bn pre-COVID to an annualized \$45.2bn. While this underpins longer-run rupee and equity inflow dynamics, it dampens the correlation of the ebbs and flows.
- Oil:** And rising Oil prices, insofar that it does not immediately trigger equity outflows from India, is a source of weakening correlation between equity inflows and rupee; given the well-established negative correlation between oil and rupee.

SGD: Depth Dampens Portfolio Flow Impact



- Overview:** As counter-intuitive as it may sound (given deep, liquidity markets and open capital accounts), **getting a reliable pulse of SGD tendencies from equity or bond flows is fraught with a litany of structural challenges.** To be sure, **SGD is not insensitive to equity and bond flows; at least indirectly via other regional currencies, in the case of inflows into the region.**
- Capital Market Factors:** First, as a regional, if not a global, financial centre, **portfolio outflows from asset managers based in Singapore is misleadingly suggestive of SGD weakness;** which more often than not prove unfounded. A factor **exacerbated by its SWFs.**
- Portfolio Flows:** This is reflected in **Portfolio “Liabilities”** (associated with foreign flows into local financial assets) being **disproportionately smaller than Portfolio “Assets”** flows originating from Singapore heading for foreign equities/bonds. Notably, portfolio liability flows are dwarfed by the Current Account as well as FDI; suggesting “organic” equity and bond flows are overshadowed.
- Current Account:** In addition, and exceptionally large Current Account surplus also acts as a fundamental currency anchor and buffer against equity and bond flows impact on the SGD (in the absence of wider global/regional trends in the foreign exchange markets).
- MAS FX-based Policy:** **Crucially,** the MAS’ S\$NEER-based policy (guiding the trade-weighted SGD within trended policy bands), means that **policy buffers/parameters** will have a tendency to **subdue flows-based volatility and impulses in the SGD;** (unless this entails a sympathetic rise in equity/bond inflows across the region that lifts all regional/trade-basket currencies.) Even fundamental valuation effects are smoothed into the currency via the defacto monetary policy of “modest and gradual” S\$NEER appreciation.
- FDI:** What’s more, Singapore’s **coincident role as a regional headquarters (RHQ)** for global firms/MNCs also means hugely outsized FDI inflows. This tends to, on the whole, correspond to SGD strength. But more often than not **tends to overstate SGD impact.** Nevertheless, FDI impact (via real channels) could drown out the portfolio (equities and bond) effects.

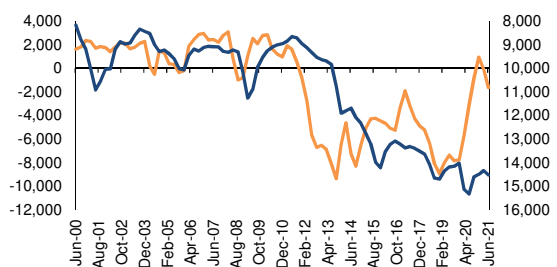
MYR: Bond Bias



- Overview:** Portfolio flows unmistakably sway MYR, with bond flows exhibiting a greater degree of influence given larger magnitudes. But equally, MYR is a multi-faceted currency entailing close SGD linkages, oil/commodity boost and a strong current account surplus; resulting in episodes of muted impulse transmission from portfolio flows.
- Portfolio Flows:** Staggeringly large bond inflows during COVID, of an annualized \$12.8bn are masked by even heavier equity outflows of annualized \$17.3bn. Both bond inflows and countervailing equity outflows have surged during COVID; but not proportionally as bond inflows have exploded almost 6.5X vs. equity outflows multiplying “just” 3.7X. So net portfolio outflows of \$4.5bn understates combined portfolio flows impact, but is also misleading smaller than pre-COVID (2016-19) outflows of \$6.7bn.
- Current Account:** Large C/A surpluses (annualized \$13.9bn over COVID and \$9.2bn for 2016-19) will buffer MYR downside, thereby dampening equity outflow impact; but may amplify scope for MYR upside from structural increase in foreign bond holdings (from sustained bond inflows). Therefore, barring major bond inflow reversals on political risks, the C/A structure should bias MYR to be more sensitive to bond flows.
- Bond Flows:** And bond flows are particularly important as there may be potential for strong structural catch-up following; i) confirmation of inclusion in WGBI (by MSCI, which earlier raised concerns), and; ii) recovery from massive bond outflows after the 1MDB scandal (~\$11.6bn outflows from MGS 2017-18). Especially given that these triggers had at that time triggered compounded (self-reinforcing) drag on MYR.
- FDI:** By comparison, FDI inflows of an annualized \$1.4bn may be drowned out by the C/A.
- Oil:** Although surging Oil making its mark on C/A may have a larger positive multiplier impact on MYR as the positives are not purely from C/A but also fiscal revenue boost filtering down to growth – all of which should prop up the MYR.

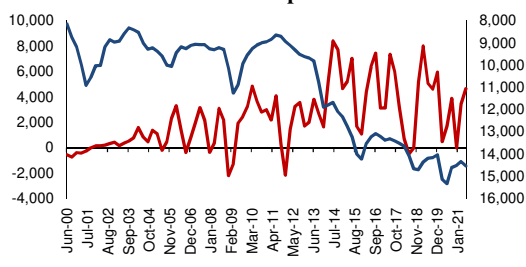
IDR: Bonded but Not Bound

C/A remains an indirect driver of bond and IDR flows



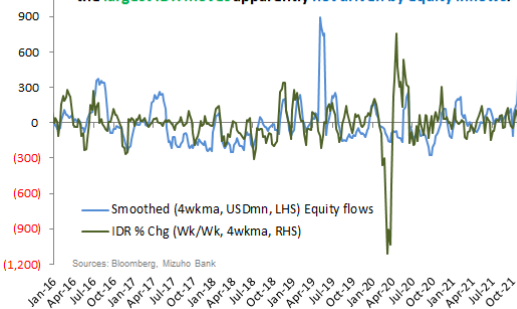
Source: CEIC, Mizuho Bank
 — ID: BoP: Current Account (LHS, USD Mn)
 — USD/IDR (RHS, Inverted Scale)

Bond inflows have dampened due to Covid



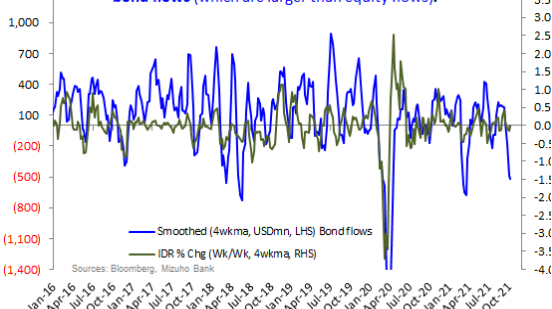
Source: CEIC, Mizuho bank
 — Portfolio Net Basis (LHS, USD Mn)
 — USD/IDR (RHS, Inverted Scale)

IDR has some degree of correlation with equities; with some of the largest IDR moves apparently not driven by equity inflows.



Sources: Bloomberg, Mizuho Bank

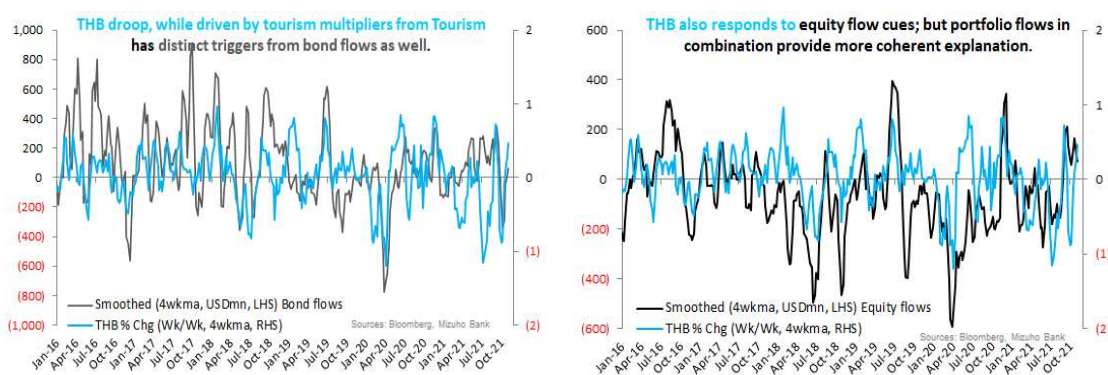
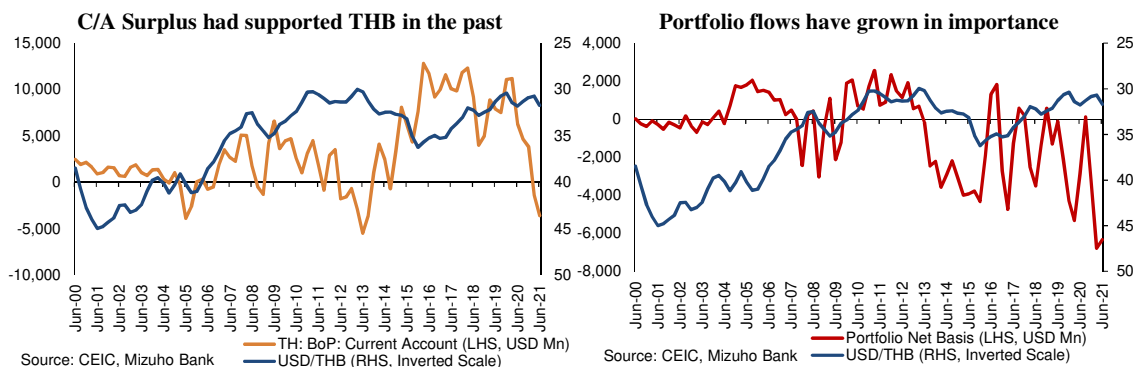
IDR appears to have greater sensitivity/co-movement with bond flows (which are larger than equity flows).



Sources: Bloomberg, Mizuho Bank

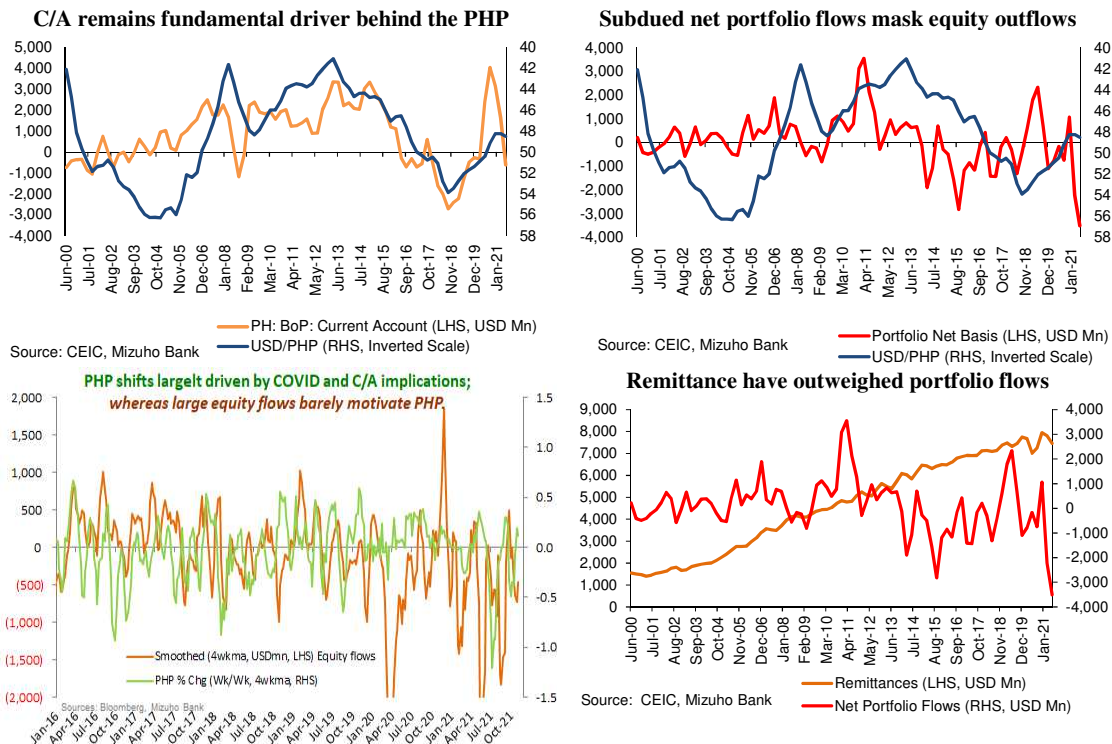
- Overview:** Not unlike the THB, the **rupiah takes cues from both equity and bond flows, but sensitivities appear to be appreciably more attuned to bond market flows** that tend to be more **significantly more pronounced**; and *key to partly financing the Current Account (C/A) deficit*. In turn, naturally **accentuating IDR sensitivities**.
- Portfolio Flows:** In Indonesia's case, **COVID had dampened bond inflows**, while it exacerbated equity outflows vis-à-vis pre-COVID trends. Nonetheless, bond inflows at ~\$11.8bn per annum, comfortably offsetting a sharply lower, annualized \$5.2bn C/A deficit during COVID (2020 to mid-2021). So, COVID accentuating the ability of **bond flows to more than finance the C/A deficit, exerts significant sway on IDR**. And **equity flows being smaller and typically negative, play more of a supporting role**.
- FDI:** That said, **portfolio flows do not rule the roost**; not unchallenged. Instead, FDI inflows, which used to be ~85% of bond inflows pre-COVID, now standing at 134% (185%) of bond (net portfolio) flows acts as a check on excessive volatility from bond and equity inflows. Admittedly, the volatility from bond flows could become more accentuated if trends in portfolio and FDI flows revert to pre-COVID; but that remains to be seen.
- Current Account:** And even then, if Indonesia's C/A were to widen considerably again from \$5.2bn annualized COVID trend) back to ~\$23.5bn pre-COVID (2016-19) average, this can increase volatility around bond inflows and IDR correlation.
- Commodity:** Especially if commodity prices add to the noise in IDR moves. Typically, higher coal and wider non-oil commodities tend to be positive for rupiah from a terms of trade impact. But this need not always correlate to bond flows insofar that global inflation induces bond yield volatility and attendant choppiness of bond market flows.

THB: Significant Sensitivities to Portfolio Flows



- Overview:** Rather than stand-alone impetus from either equity or bond flows, **combined portfolio flows tend to explain short-term THB moves with greater complementarity; although far from completely or comprehensively.** A reversion of C/A strength on the restoration of tourism may dampen portfolio flows influence.
- Portfolio Flows:** To be sure, **portfolio flows are not insignificant** for Thailand, and combined activity from inward and outward portfolio flows have amounted to a sizable amount of around a fifth of Thailand's typically large Current Account (C/A) surplus pre-COVID. And since **COVID, portfolio (asset and liability) flows have swelled in relative terms to almost twice (1.9X) the now eroded C/A.** And this arguably **accentuates sensitivity of the THB to equity and bond flows for now.**
- Current Account:** But that said, **restoration of the Current Account strength driven by the resumption of tourism later into 2022 may have a more pronounced effect on the THB – possibly in excess of, and sometimes diluting the effects of, equity and bond market flows – especially if cautious sentiments amid Fed normalization (in 2022) dampen or perhaps even undermine portfolio inflows.**
- Politics:** Simmering **political risks** could also be **reflected in the currency to a larger extent and for longer than in equity/bond flows**, where opportunistic bottom-pickers may return first; especially if encouraged by the added allure of a weak currency. In other words, if political risks resurface, there may **be periods of diluted correlation, if not outright de-coupling, between the currency and equity/bond inflows** as well.
- At the margin, bond flows** however, by virtue of the greater quantum involved, **appear to have greater sway over the THB.** But this is neither unchallenged nor unwavering.

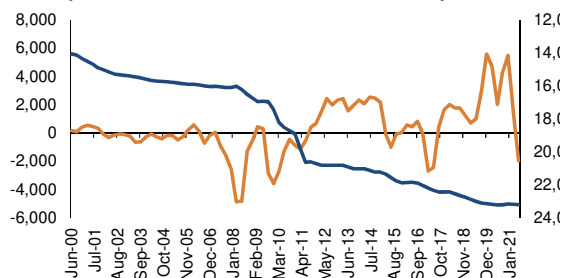
PHP: Dampened Portfolio Impact on Peso



- Overview:** Ostensibly, **portfolio flows** may be contributing to more noise than any discernible, reliable and consistent **information on the peso**. Instead, the evidence stacks up for **Current Account drivers**, led by resilient *OFW remittances*, and FDI anchor to water down the ripples from equity and bond flows impact on the currency.
- Portfolio Flows:** Notably, from being mostly subdued (\$727mn of outflows for 2016-19), net portfolio outflows have swelled to an annualized \$3.5bn over COVID (2020 through mid-2021). This was predominantly equity outflows surging. While bond flows were also up considerably, net flows were subdued by fairly even pick-up in inflows and outflows.
- Current Account:** But the associated drag on PHP was offset by a **markedly positive C/A shift** for the corresponding period to an **annualized surplus of \$6.6bn** (from an average deficit of \$3.8bn during 2016-19). This \$10bn positive C/A swing drowns out sensitivity to equity and bond flows.
- OFW Remittances:** The C/A offset may be framed in the perspective of OFW remittances (that are caught in the C/A); whereby an average of \$2.8bn of remittances a month – translating into \$33-34bn in 2020 – easily leans against the equity outflows.
- Oil & Higher Inflation:** Heading into a period of higher oil and inflation could result in downward pressures on PHP and attendant outflows in equities and bonds. But this would be a coincidence; whereas in terms of the causation, it may be more a case of higher oil alongside inflation and consequent downside in PHP may be the dog that wags the tail of equities and bond outflows.

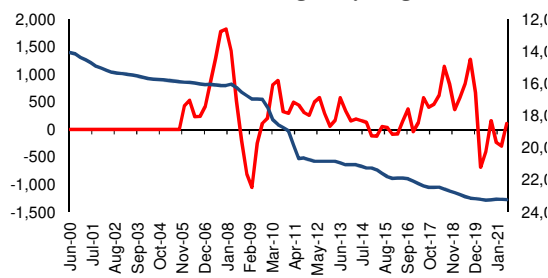
VND: Reserved Reaction

Healthy current account flows not reflected by the VND



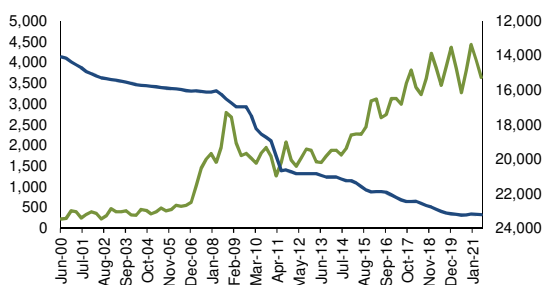
Source: CEIC, Mizuho Bank
 — VN: BoP: Current Account (LHS, USD Mr)
 — USD/VND (RHS, Inverted Scale)

Portfolio flows are smaller given young markets



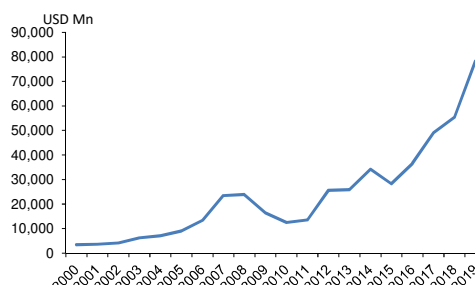
Source: CEIC, Mizuho Bank
 — Portfolio Net Basis (LHS, USD Mn)
 — USD/VND (RHS, Inverted Scale)

Vietnam remains an attractive FDI destination



Source: CEIC, Mizuho Bank
 — FDI Net (LHS, USD Mn)
 — USD/VND (RHS, Inverted Scale)

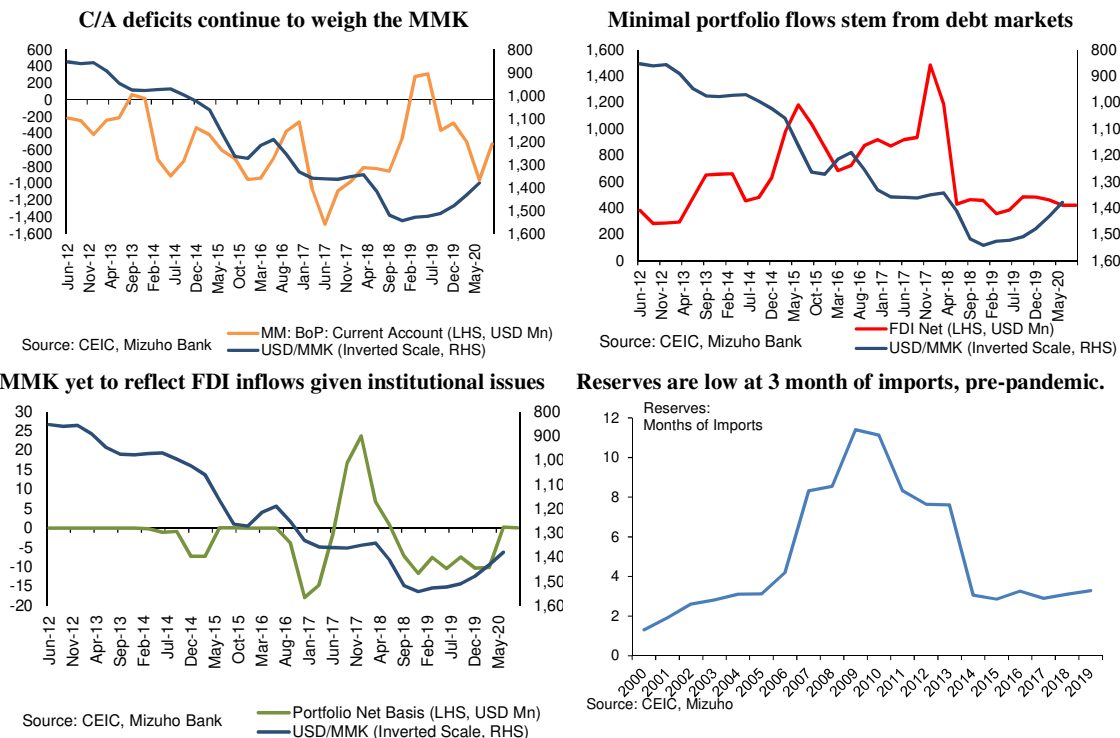
Reserves accumulation has accelerated since 2012



Source: CEIC, Mizuho Bank

- Overview:** In the case of the VND, **FX sensitivities** to equities and bond flows can be considered highly negligible in its current state of financial sector development, given the **lack of liquidity in capital markets and still budding foreign participation levels**.
- Capital Market Factors:** These insensitivities points to the lack of a deep and robust capital markets while capital flows remain fairly constrained. Equity markets in Vietnam have grown to almost 100% of GDP since its establishment in 2000 while bond markets which began in 2009 are around half the size of stock markets. However, this size masks the **underlying low levels of foreign activity** with foreign individual investors accounting for 1% of total individual accounts while foreign institutions fare better to make up about a quarter of total institution accounts.
- Portfolio Flows:** That said, in term of value, institutions' participation in markets may not be very significant given that their participation in government bonds stand at only 1% which underpins the **muted reaction function of the VND to portfolio flows** as illustrated in the (top right) chart above and the low levels of net portfolio flows at less than USD 2 billion. The range of products in debt markets is also limited as tenures above 10 years were only introduced after 2011.
- Current Account:** While the **current account surplus and flows of foreign direct investment** should in most cases be supportive of the Vietnamese dong, it has **instead likely led to foreign exchange reserves accumulation** which will serve future needs of maintaining macroeconomic stability ensuring healthy import cover ratios.
- State Bank of Vietnam:** Under the **continued observations by US treasury**, the **VND has displayed greater flexibility around the managed float** and this will serve to increase the FX sensitivities to real goods and investments flow into the medium term. However, FX sensitivities to capital markets will most likely continue to lag behind, especially bond markets will require the development of more products and a deeper secondary market as primary holders of corporate bonds are found to hold till maturity.
- FDI:** On balance, as Vietnam's economy grows with continued FDI flows which in turn enables greater current account surplus, reserves accumulation will likely continue albeit at moderate pace, in view of the US scrutiny. It is worth noting that in the long run, reserves accumulation will enhance the capability of the SBV to manage fluctuations in future, thereby capping the extent of sensitivities even as financial markets develop, in some aspects similar to the case of Singapore.

MMK: Largely Politically Sensitive



- Overview:** In Myanmar, **MMK sensitivities to equities and bonds can certainly be considered non-existent and negligible**, simply because of the absolute infancy of its financial system; a decade old managed float system running in parallel with unofficial exchange rates, alongside a 5 year old stock market.
- FX/Capital Market Factors:** It was only in 2012 when the Central Bank of Myanmar adopted a managed float system comprising daily foreign exchange auctions and abolishing the previous peg of the MMK to the IMF Special Drawing Right. In 2018, a trading band of +/- 0.8% was removed to allow for greater market led fluctuations. This underscores the infancy of establishing a basic financial system before even mentioning equity and debt markets developments.
- Portfolio Flows:** With the current grand total of 7 companies listed on the Yangon Stock Exchange, **under-developed and unattractive** will not be an understatement. The lumpy portfolio flows (top right chart) belong to the debt markets for Treasury bonds taking largely in the primary markets with players such as private and state-owned banks, foreign banks with branches in Myanmar and securities companies. That said, the secondary bond market remains illiquid alongside lacklustre offering with bonds of only up to the longest tenure of 5 years.
- Current Account:** To compound on financial sector worries, **persistent current account deficits have weighed on the MMK**. However, even for brief period of current surplus, the MMK was subject to speculative pressures, on top of persistent fiscal deficits. The establishment of transparent payment systems and invoicing in local currency for trade will allow the MMK to better reflect underlying fundamentals, though the latter is in turn dependent on MMK stability.
- Central Bank of Myanmar:** With just above USD 7bn of reserves (pre-Coup) and demand for USD elevated under the current turmoil, the central bank will have their hands tied as imports continue to outpace exports as evidenced by the need to suspend import of passenger vehicles to conserve foreign exchange. Abstracting from the political situation, the MMK will also be subject to headwinds from the Fed's tapering as its movement from be determined by key economic fundamentals such as FDI and potential economic growth.
- FDI:** The flows of FDI into Myanmar had been relatively resilient pre-coup and pre-pandemic encouraged by relaxation of rules such as allowing foreign lenders to own over 35% of local banks on top of favourable young demographics. The resolution of Myanmar political issues will be key to secure certainty required to attract FDI into the country

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