
- The Fed is in no rush to lower its benchmark interest rates again next month amid persistently rallying core PCE inflation; Meanwhile, the US central bank is likely to re-expand its balance sheet to ensure the EFFR remaining in the target range
- The Trump administration is considering ways to restrict US capital flows into China according to Bloomberg, spurring risk aversion across the markets
- Early this week, risk-off sentiment could weigh on EM Asian currencies including the yuan; After that, EM Asian currencies are likely to rally in the run-up to the October 29-30 FOMC meeting, particularly if the US and China make a concrete progress or reach a deal at the Washington talks set for 10-11 October

Asia Overview - EM Asian currencies were mixed versus the dollar during Friday's Asian session. The SGD closed almost flat, while the JPY dipped somewhat despite a 1.2 bp decline in the 10Y UST yield.

The CNY gained slightly but the CNH weakened 0.2%. EM Asian currencies including the yuan could face downward pressure early this week. Chinese Vice Minister of Commerce Wang Shouwen said in Beijing Sunday that Vice Premier Liu He will lead the negotiating team to the US after a week-long holiday that ends 7 October. The PBOC said in its Q3 monetary policy implementation report that it will keep prudent monetary policy with an appropriate balance between easing and tightening, strengthen counter-cyclical adjustments and noticeably bring down real interest rates with market-based reforms. The KRW declined 0.1%. USD/KRW is likely to consolidate around 1,200 for now, following a broader market tone. North Korean Ambassador to the United Nations Kim Song said Saturday he is "positive" about a possible resumption of US-North Korea denuclearization talks. Bank of Korea Governor Lee Ju-yeol told reporters on Friday evening that "It will be tough to achieve the 2.2% growth projection," which may hint at an October rate cut in our view. The TWD was little changed amid equity inflows. USD/TWD is likely to fluctuate around 31.0 for now, susceptible to the US-China relations. Taiwan will likely approve TWD 700-800bn in applications from Taiwanese companies to invest back in the island this year.

The INR rose about 0.5%. USD/INR will likely decline further towards 70 in the coming weeks. Meanwhile, we keep a close eye on oil prices and US-China trade negotiations. Reuters reported on Friday that India is looking to ease foreign investment limits in government bonds in order to get its securities included in global bond indexes in the next two years. India’s Finance Minister Nirmala Sitharaman on Saturday mandated the CPSEs to pay outstanding dues to dealers and vendors by 15 October, with the aim of mitigating liquidity crunch. The IDR edged up. USD/IDR will likely rally through 14,200 at the moment. The MYR advanced 0.2%, with USD/MYR trading between 4.15 and 4.20 for now. FTSE Russell said Friday it will keep Malaysia on a watchlist for exclusion from its WGBI and provide further updates after the interim review in March 2020. The PHP increased 0.5%. USD/PHP is likely to head for 51.8. BSP Governor Benjamin Diokno said on Friday that the central bank will look at inflation, GDP, and global growth when it decides next on policy rate. The THB edged down. USD/THB is likely to stay above 30.5 this week.

Most regional equity indices resided in the red on Friday. China’s SHCOMP index rallied 0.11% amid USD 44.7mn of equity inflows, while India’s NIFTY50 index slid 0.51%. South Korea’s KOSPI index dropped 1.19% with foreign investors offloading a net USD 40.5mn of Korean shares. In the meantime, Taiwan’s TWSE index slipped 0.39% although global funds added to their holdings in local main board shares by USD 72.1mn on Friday. Malaysia’s KLCI index and Indonesia’s JCI index closed down 0.56% and 0.54% respectively. Thailand’s SET index ended 0.43% higher despite USD 58.3mn of equity outflows.
EM Asia • In the month of October, the Fed is in no rush to lower its benchmark interest rates again amid persistently rallying core PCE inflation. However, the US central bank will likely announce plans to re-expand its balance sheet through a bond purchase agreement as early as November.

We saw stronger demand for the 14-day cash loans than overnight liquidity from US primary dealers.

- On 27 September, the New York Fed awarded USD 22.7bn in cash loans to primary dealers via its overnight repo operation, while allotting USD 49.0bn through a 14-day term repo operation.
- On 26 September, the 14-day term repo operation was oversubscribed, attracting USD 72.8bn in bids even after the maximum size of the offering was doubled to USD 60bn by the New York Fed. Conversely, the overnight repo operation received just USD 50.1bn of bids, around half the USD 100bn maximum offering.

It suggests the longer-term cash loans could better calm US money markets and bring interest rates within its intended range. On top of the New York Fed’s overnight and term repo operations, the balance sheet expansion could help raise the reserve balances and excess reserves of US depository institutions, solving the dollar liquidity problem fundamentally and ensuring the effective fed funds rate (EFFR) remaining within the target range. As we mentioned earlier on 15 August, the Fed may need to grow its balance sheet sooner rather than later.

- On 23 September, New York Fed President John Williams said that it is “important that we examine these recent market dynamics and their implications for the liquidity needs in relation to the overall amount of reserves held at the Federal Reserve.”
- On 18 September, Fed Chairman Jerome Powell said that “It is certainly possible that we will need to resume the organic growth of the balance sheet earlier than we thought.”

The expansion would weigh on the dollar in general (Chart 4-5). If the Fed starts to re-purchase US Treasury bills/bonds at a monthly pace of USD 50bn for six months starting from either November 2019 or January 2020, the DXY Index will likely test the 90 mark, ceteris paribus. Therefore, EM Asian currencies are expected to rally amid accommodative external liquidity chasing regional assets, particularly if the US and China make a concrete progress or reach a deal as we expected at the Washington trade talks set for 10-11 October.

Excess Reserves (YoY, bn) vs. DXY Index (Inverted)
The Fed re-expanding its balance sheet starting from November 2019

Excess Reserves (YoY, bn) vs. DXY Index (Inverted)
The Fed re-expanding its balance sheet starting from January 2020

Source: Bloomberg, St. Louis Fed & Scotiabank FICC Strategy

Early this week, however, risk-off sentiment could briefly weigh on EM Asian currencies including the yuan.

American political media Politico reported last Friday that the Trump administration is considering expanding its! trade fight against China by targeting Beijing’s ties with the Wall Street and American investors, citing two people familiar with internal discussions.

- On Friday, Bloomberg reported that Trump administration officials are discussing ways to limit US investors’ portfolio flows into China, including 1) delisting Chinese companies from US stock exchanges; 2) limiting Americans’ exposure to the Chinese market through government pension funds and; 3) examining how the US could put limits on the Chinese companies included in stock indexes managed by US firms.
- On the same day, Bloomberg reported that executives from the biggest US financial firms are meeting with top regulators including PBoC Governor Yi Gang, Vice Finance Minister Liao Min and CSRC Vice Chairman Fang Xinghai at the Ritz-Carlton hotel in Beijing on Friday.
- Earlier on 24 September, Chinese Foreign Minister Wang Yi said that China will continue efforts to open up its economy, during a speech to US business executives on the sidelines of the United Nations General Assembly.

The report spurred risk aversion across the markets during last Friday’s New York session. In order to soothe investors, US Treasury Department spokeswoman Monica Crowley said in an emailed statement on Saturday that “The administration is not contemplating blocking Chinese companies from listing shares on US stock exchanges at this time,” but he didn’t address or rule out option 2 and 3.

It could be a negotiating tactic from the White House aimed at ratcheting up the pressure on China ahead of the upcoming meeting due next week. In addition, Bloomberg said in the abovementioned article that some advocates saw “the fact the discussions were being leaked as an effort by doves inside the White House to kill the effort by stirring up opposition.”
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