

Currency-risk Capital Requirements on Bond ETFs

- Taiwan's FSC plans to impose extra currency-risk capital charge of 6.1% on the bond ETFs
- It will prompt Taiwan's life insurers to raise their hedging ratios, imposing downward pressure on USD/TWD DF and NDF points in the months ahead
- We also keep a close watch on the US-China trade talks as a concrete progress could sustain renewed equity inflows and then prop up the TWD with USD/TWD DF and NDF points falling at a faster pace and with a flattening trend

Asia Overview - EM Asian currencies were mixed versus the dollar during Tuesday's Asian session. The SGD edged down, while the JPY fell 0.3% amid a 9 bp surge in the 10Y UST yield.

The CNY and CNH rallied slightly. The dollar/yuan is likely to break below the 7.1 level, remaining susceptible to the US-China trade talks. China's CPI rose 2.8% yoy in August, unchanged from the previous month's rate. Meanwhile, the nation's PPI deflation deepened last month, signaling a worsening economic slowdown. The KRW pared its early gains and dipped somewhat. USD/KRW is likely to consolidate and then slide further towards 1,180. North Korea fired two short-range projectiles into its eastern seas in the early morning on Tuesday, shortly after saying it will be willing to resume denuclearization talks with the US in late September. The TWD rallied 0.1% amid equity inflows. USD/TWD is likely to fall below 31.2.

India's onshore FX markets will reopen Wednesday after a public holiday. USD/INR is likely to head for 70 on hopes for portfolio inflows in the medium term. The RBI is working on putting in place a formal mechanism to assess the adequacy of its forex reserves. India's finance minister Nirmala Sitharaman said on Tuesday that the government will soon come out with decisions for the realty sector. The IDR declined 0.1%. However, USD/IDR could test the 14,000 level before long. Indonesia's trade minister Enggartiaso Lukita said in a statement on Monday evening that global trade tensions could derail the RCEP agreement if a deal is not struck by November. The MYR gained 0.2%. USD/MYR will likely reach 4.15 and then head for 4.10. The PHP declined 0.2% Tuesday, with USD/PHP likely to fluctuate around 52.0 for now. Philippines reported a wider trade deficit of USD 3.39bn in July, although exports rose a higher-than-expected 3.5% yoy. The THB inched up. USD/THB will trade in a range of 30.5-31.0, with risks of breaching the lower bound. Thailand's finance minister Uttama Savanayana told reporters after the weekly Cabinet meeting that the value-added tax rate will be kept at 7% for the fiscal-year starting 1 October.

Most regional equity indices resided in the red on Tuesday. China's SHCOMP index slid 0.12% despite USD 334.3mn of equity inflows. However, South Korea's KOSPI index advanced 0.62%. In the meantime, Taiwan's TWSE index dropped 0.44% although global funds added to their holdings in local main board shares by USD 72.8mn on Tuesday. Malaysia's KLCI index and Thailand's SET index closed down 0.54% and 0.32% respectively. Indonesia's JCI index ended 0.17% higher in spite of USD 13.2mn of equity outflows.

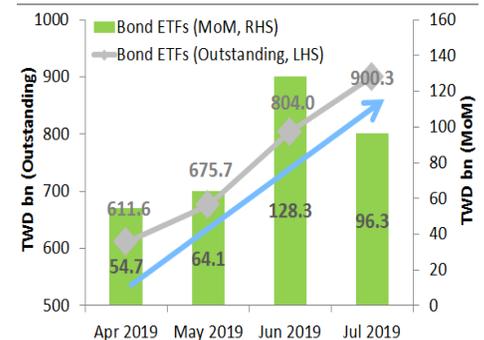
Taiwan • It was widely reported that Taiwan's financial regulator, the Financial Supervisory Commission (FSC), plans to impose an extra currency-risk capital charge of 6.1% on the bond ETFs denominated in the TWD but tracking foreign assets such as US corporate bonds.

In our view, the move is aimed at curbing Taiwanese life insurers' heavy positions in the bond ETFs that surged to TWD 900.3bn as at end-July, accounting for 96% of the total. The existing rules allow local lifers to allocate up to 10% of their total capital of TWD 25.5tn (i.e. TWD 2.55tn) in ETF products, suggesting there is still room for them to buy more bond ETFs.

FOLLOW US ON TWITTER @SCOTIABANKFX

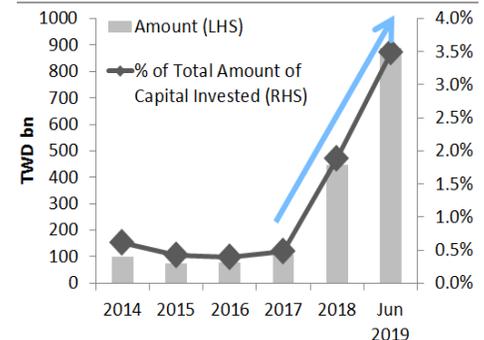
Qi Gao
 FX Strategist (Asia)
 +65 6305 8396
 qi.gao@scotiabank.com

Taiwanese Life Insurance Industry Investment Portfolio: Bond ETFs



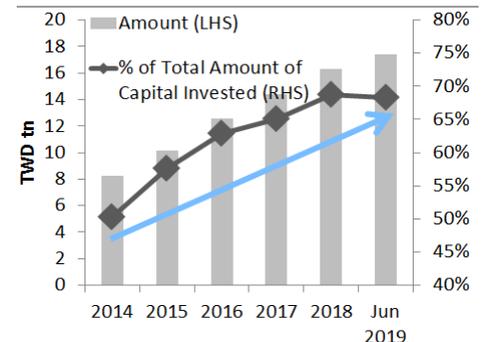
Source: FSC Taiwan & Scotiabank FICC Strategy

Taiwanese Life Insurance Industry Investment Portfolio: Securitized Products & Other



Source: Taiwan Insurance Institute & Scotiabank FICC Strategy

Taiwanese Life Insurance Industry Investment Portfolio: Foreign Investments



Source: Taiwan Insurance Institute & Scotiabank FICC Strategy

As the total amount of debt with yields below zero is now standing at around USD 15.3tn around the world, despite recent rises in the bond yields, Taiwan's life insurers are expected to keep purchasing bond ETFs for higher returns. **In the meantime, the planned extra capital requirements for currency risk will prompt local lifers to raise their hedging ratios, which will impose downward pressure on USD/TWD DF and NDF points in the months ahead.**

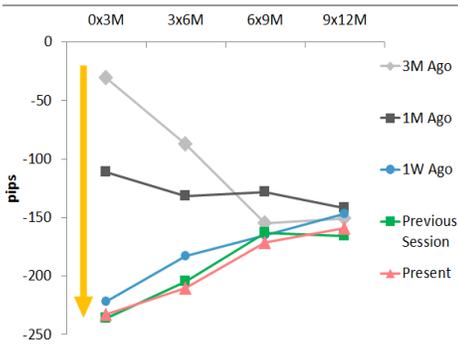
In our view, risk-on sentiment is likely to continue during the rest of September on hopes for the US-China Washington talks achieving a breakthrough.

- *South China Morning Post* reported late Tuesday that "China is expected to agree to buy more American agricultural products in hopes of a better trade deal with the US as the two nations prepare for a meeting between their top negotiators next month."
- A source familiar with the situation told the HK-based newspaper that working-level officials were discussing the text of a deal on the basis of a draft the two sides negotiated in April and the text would be reviewed when Chinese Vice-Premier Liu He met US Trade Representative Robert Lighthizer and Treasury Secretary Steven Mnuchin in Washington in early October.
- According to the report, China could also offer more market access, better protection for intellectual property and to cut excess industrial capacity, but would be more reluctant to compromise on subsidies, industrial policy and reform of state-owned enterprises.
- China's FX regulator, the State Administration of Foreign Exchange (SAFE), said in a statement on Tuesday afternoon that the nation removes investment quota limit for QFII and RQFII to further open up its financial market.

We also keep a close watch on the US-China trade talks as a concrete progress could sustain the renewed equity inflows throughout the remainder of the month, and then prop up the TWD with USD/TWD DF and NDF points falling at a faster pace and with a flattening trend.

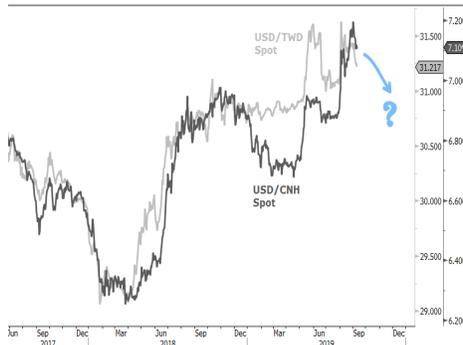
We would like to sell USD/TWD at 31.2 now, with a target of 31.0 and a stop of 31.3.

USD/TWD NDF Curve



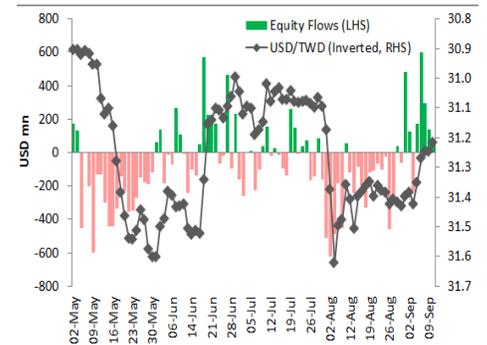
Source: Bloomberg & Scotiabank FICC Strategy

USD/TWD vs USD/CNH



Source: Bloomberg, TWSE & Scotiabank FICC Strategy

USD/TWD vs. Taiwan Equity Portfolio Flows (+, Inflows)



Source: Bloomberg, TWSE & Scotiabank FICC Strategy

TODAY'S CALENDAR

Time (HKT)	Economy	Type	Release	Period	Consensus	Actual	Last	Significance
07:00	KR	JOB	Unemployment Rate SA	Aug	4.0%		4.0%	med-high
08:30	AU	DATA	Westpac Consumer Confidence	Sep			100.0	med
12:00	MY	DATA	Industrial Production YoY	Jul	3.1%		3.9%	med-high

CONTACTS - GLOBAL FX STRATEGY

Shaun Osborne
 Chief FX Strategist
 T +1 416 945 4538
shaun.osborne@scotiabank.com

Qi Gao, FRM
 FX Strategist (Asia)
 T +65 6305 8396
qi.gao@scotiabank.com

Juan Manuel Herrera
 FX Strategist (G10)
 T +1 416 866 6781
juanmanuel.herrera@scotiabank.com

IMPORTANT NOTICE and DISCLAIMER:

This report is prepared by Scotiabank as a resource for clients of Scotiabank for information and discussion purposes only. This report should be considered a marketing communication and has not been prepared by a member of the research department of Scotiabank, it is solely for the use of sophisticated institutional investors, and this report does not constitute investment advice or any personal recommendation to invest in a financial instrument or "investment research" as defined by the UK Prudential Regulation Authority or UK Financial Conduct Authority. This document has not been prepared in accordance with EU legal requirements designed to promote the independence of investment research and the information contained in this publication is not subject to any prohibition in the EU on dealing ahead of the dissemination of investment research. Opinions, estimates and projections contained herein are our own as of the date hereof and are subject to change without notice. The information and opinions contained herein have been compiled or arrived at from publically available sources believed reliable but no representation or warranty, express or implied, is made as to their accuracy or completeness and neither the information nor the forecast shall be taken as a representation for which Scotiabank or any of its employees incur any responsibility. Neither Scotiabank nor its representatives accept any liability whatsoever for any loss arising from any use of this report or its contents. This report is not, and is not constructed as, an offer to sell or solicitation of any offer to buy any financial instruments and has no regard to the specific investment objectives, financial situation or particular needs of any recipient. It is not intended to provide legal, tax, accounting or other advice. Scotiabank and/or its respective officers, directors or employees may from time to time take positions in the products mentioned herein as principal or agent. Directors, officers or employees of Scotiabank may serve as directors of corporations referred to herein. Scotiabank may have acted as financial advisor and/or underwriter for certain of the corporations mentioned herein and may have received and may receive remuneration for same. This report may include forward-looking statements about the objectives and strategies of Scotiabank. Such forward-looking statements are inherently subject to uncertainties beyond the control of Scotiabank including but not limited to economic and financial conditions globally, regulatory development in Canada and elsewhere, technological developments and competition. The reader is cautioned that the member's actual performance could differ materially from such forward-looking statements. Past performance or simulated past performance is not a reliable indicator of future results. Forecasts are not a reliable indicator of future performance. You should note that the manner in which you implement any of strategies set out in this report may expose you to significant risk and you should carefully consider your ability to bear such risks through consultation with your legal, accounting and other advisors. Information in this report regarding services and products of Scotiabank is applicable only in jurisdictions where such services and products may lawfully be offered for sale and is void where prohibited by law. If you access this report from outside of Canada, you are responsible for compliance with local, national and international laws. Not all products and services are available across Canada or in all countries. All Scotiabank products and services are subject to the terms of applicable agreements. This report and all information, opinions and conclusions contained in it are protected by copyright. This report may not be reproduced in whole or in part, or referred to in any manner whatsoever nor may the information, opinions and conclusions contained in it be referred to without in each case the prior express consent of Scotiabank. Scotiabank is a Canadian chartered bank.

If you are affected by MIFID II, you must advise us in writing at trade.supervision@scotiabank.com.

™ Trademark of The Bank of Nova Scotia. Used under license, where applicable. Scotiabank, together with "Global Banking and Markets", is a marketing name for the global corporate and investment banking and capital markets businesses of The Bank of Nova Scotia and certain of its affiliates in the countries where they operate, including, Scotia Capital Inc. and Scotia Capital (USA) Inc., Scotiabank Europe plc, Scotiabank (Ireland) Limited - all members of the Scotia-bank Group and authorized users of the mark. The Bank of Nova Scotia is incorporated in Canada with limited liability. Scotia Capital Inc. is a member of the Canadian Investor Protection Fund. Scotia Capital (USA) Inc. is a broker-dealer registered with the SEC and is a member of FINRA, NYSE, NFA and SIPC. The Bank of Nova Scotia is authorized and regulated by the Office of the Superintendent of Financial Institutions in Canada. The Bank of Nova Scotia is authorized by the Prudential Regulation Authority and subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of The Bank of Nova Scotia's regulation by the Prudential Regulation Authority are available from us on request. Scotiabank Europe plc is authorized by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

To unsubscribe from receiving further Commercial Electronic Messages click this link: www.unsubscribe.gbm.scotiabank.com.