

Easing Inflation Supportive of INR

- India's CPI inflation eases to 4.59% yoy in December from 6.93% the previous month, returning to the RBI's 4%±2% medium-term target range
- The RBI's open market operations have pushed up front-end government bond yields but still keep far-end yields in check, flattening the yield curve substantially
- We maintain our short USD/INR position as the high-yielding rupee is expected to shine in the first half this year amid the nation's solid growth prospect and benign inflation outlook that tend to yield higher real returns going forward

Asia Overview - Most EM Asian currencies rallied versus the dollar during Tuesday's Asian session. The SGD gained about 0.6%, while the JPY advanced 0.5% amid a dip in the 10Y UST yield.

The CNY and CNH rallied 0.3% and 0.5% respectively. USD/CNH will likely trade in a range of 6.40-6.50 with downside risks. China has told financial institutions to limit efforts to seek financing in the offshore market to slow capital inflows into the mainland, aimed at balancing cross-border flows and easing appreciation pressure on the yuan in our view. China's credit growth moderated in December as the central bank seeks to normalize monetary policy, with aggregate financing falling to CNY 1.72tn in December from CNY 2.13tn the month before. Katherine Tai, nominee for US Trade Representative, said on Tuesday that the incoming Biden administration will work with Congress and foreign allies to make sure that it contends with the challenges of China. The KRW dropped around 0.3%. USD/KRW is expected to slide towards the 1,080 level. South Korea will decide on 16 January whether to adjust distancing rules. The TWD pared all of its early gains and closed flat on Tuesday. USD/TWD is expected to trade between 28.0 and 28.2 in the near term.

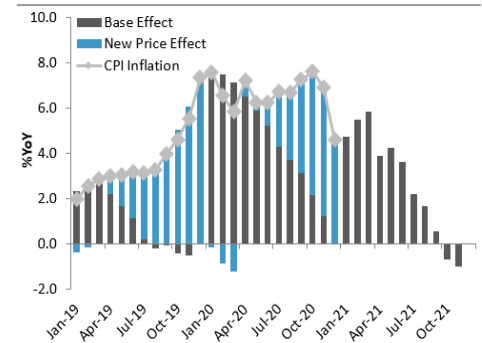
The INR gained 0.2%. USD/INR is likely to head for the 73.0 support level. The IDR edged down, with USD/IDR likely to trade towards 14,000. The BI extended the relaxation of credit card payment rules in response to the Covid-19 pandemic. The Indonesian central bank said on Tuesday it will ensure the rupiah's stability by intervening in the spot and domestic NDF markets through brokers or intervening directly in interbank market. The MYR declined 0.1%. USD/MYR will likely head for the psychological 4.00 support level. Prime Minister Muhyiddin Yassin said in a televised address on Tuesday that Malaysia won't hold elections or by-elections during the period of emergency, while all parliament and state assemblies will be suspended. Foreign holdings of Malaysian government and corporate bonds and bills rose 1.6% mom to MYR 223bn in December, with ownership of government bonds increasing 1.9% on month to MYR 202.1bn. The PHP gained 0.1%. USD/PHP is expected to consolidate around the 48.0 level at this stage. BSP Governor Benjamin Diokno told the Reuters Next conference on Tuesday that the worst is over for the pandemic-hit Philippine economy and a "remarkable rebound" is expected this year, adding that the current accommodative monetary stance is sufficient for a revival in economic growth. The THB inched up. USD/THB will likely fluctuate around the 30.0 level. The BoT said on Tuesday that Thailand's headline inflation is forecast to return to its 1-3% target range by mid-2021 after missing the mark last year.

Regional equity indices diverged on Tuesday. China's SHCOMP index rallied 2.18% amid USD 616.8mn of equity inflows, while India's NIFTY50 index increased 0.54%. South Korea's KOSPI index slipped 0.71% with foreign investors offloading a net USD 642.0mn of Korean shares. In the meantime, Taiwan's TWSE index declined 0.36% as global funds reduced their holdings in local main board shares by USD 227.8mn on Tuesday. Malaysia's KLCI index ended 0.32% lower. However, Thailand's SET index and Indonesia's JCI index closed up 0.22% and 0.20% respectively.

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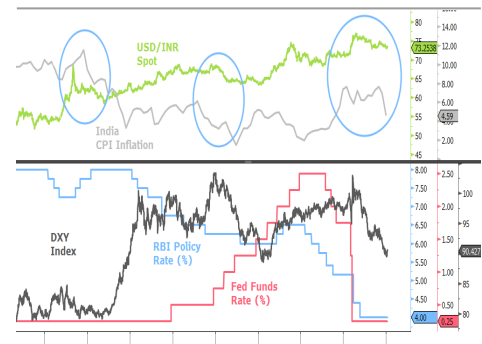
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India CPI Inflation Benign inflation outlook



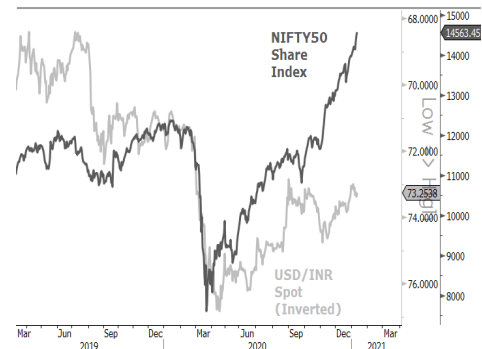
Source: Bloomberg & Scotiabank FICC Strategy

USD/INR vs. India CPI Inflation Rupee tends to advance when inflation eases



Source: Bloomberg & Scotiabank FICC Strategy

USD/INR vs. NIFTY50 Share Index Booming share prices suggest a stronger rupee



Source: Bloomberg & Scotiabank FICC Strategy

India • India's CPI inflation eased to 4.59% yoy in December from 6.93% the previous month, returning to the RBI's 4%±2% medium-term target range while paving the way for the RBI to resume monetary easing next month (5 February). Earlier, the National Statistical Office (NSO) said on 7 January that the Indian economy is estimated to contract 7.7% in FY2020-21 before expanding in FY2021-22.

India's ongoing economic recovery will fuel more equity portfolio inflows in the coming weeks, while softening inflation may revive foreign interest in rupee-denominated bonds. Foreign portfolio investors purchased a net USD 18.62bn and USD 202mn of Indian equities and bonds respectively in the period from 1 November to 11 January.

The RBI's open market operations (OMOs) have pushed up front-end government bond yields but still keep far-end yields in check, flattening the yield curve substantially in the past sessions. The Indian central bank announced in a statement dated 8 January that it will drain rupee liquidity through INR 2tn of 14-day reverse repos on Friday. In addition, it will buy INR 100bn of government bonds and sell an equivalent amount of Treasury bills through Operation Twist on Thursday.

In the months ahead, external liquidity will remain accommodative, adding fuel to EM Asia's currency carry trade for higher returns. The INR will rally and advance further once the market finally digests the Fed's tapering talk that rattled the market last week. Overnight, some Fed officials were seeking to ease market concerns over an earlier-than-expected tapering. Moreover, Fed Chairman Jerome Powell will likely manage to calm and pacify the market when he speaks in Princeton Economics Webinar at 1:30am SGT on Friday (15 January).

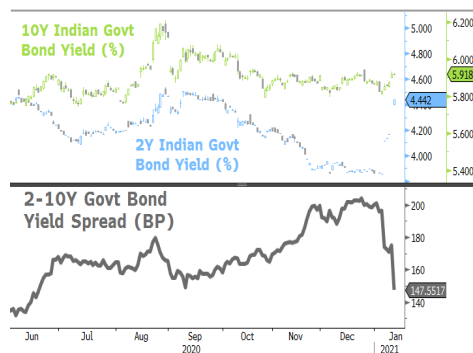
- *St. Louis Fed President James Bullard said on Tuesday that it's premature to discuss reducing the amount of monetary-policy support for the US economy while the pandemic is still raging.*
- *Boston Fed President Eric Rosengren said on Tuesday that the US central bank will keep short-term rates low until inflation achieves 2% on a sustained basis, and continue to purchase longer-term assets until the economic growth is on a stronger footing.*
- *Kansas City Fed President Esther George, considered one of the most hawkish officials at the US central bank, said on Tuesday that policymakers won't react if inflation "tips above 2%."*
- *On 8 January, Fed Vice Chairman Richard Clarida said that he expects the US central bank to maintain the pace of its asset purchases through the rest of 2021.*

In addition, India will kick start one of the world's largest coronavirus inoculation campaigns on 16 January, which is expected to improve and sustain a risk-friendly mood in local market in the months ahead.

We will keep a close eye on India's increasing non-performing assets that may slow and halt the INR's potential appreciation at the late stages. The RBI warned in its semiannual Financial Stability Report published Monday that an expected doubling of bad loans and soaring financial markets threaten the nation's financial stability, saying that the non-performing asset ratio is forecast to rise to 13.5% by the end of September 2021 from 7.5% a year ago.

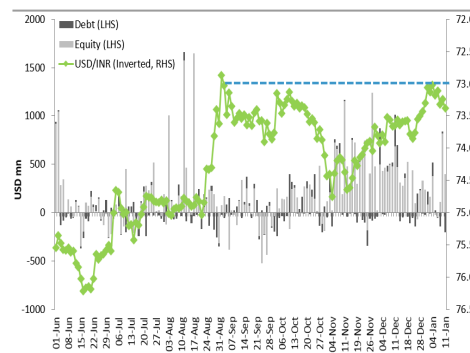
We maintain our short USD/INR position with a new target of 72.0 and a trailing stop of 74.0, as the high-yielding rupee is expected to shine in the first half this year amid the nation's solid growth prospect and benign inflation outlook that tend to yield higher real returns going forward.

Indian Government Bond Yields: 2-10Y Yield
RBI OMOs flatten government bond yields



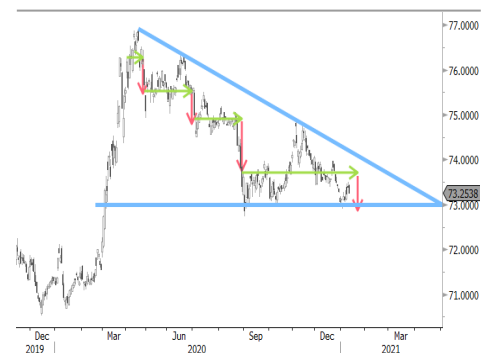
Source: Bloomberg & Scotiabank FICC Strategy

USD/INR vs. India Cross-border Portfolio Flows
Strong equity inflows to boost the HY rupee



Source: Bloomberg & Scotiabank FICC Strategy

USD/INR Spot
The rupee set to rally through the 73 level



Source: Bloomberg & Scotiabank FICC Strategy

TODAY'S CALENDAR

Time (HKT)	Economy	Type	Release	Period	Consensus	Actual	Last	Significance
07:00	KR	JOB	Unemployment Rate SA	Dec	4.1%		4.1%	med
11:00	KR	MONEY	Money Supply L SA MoM	Nov			0.6%	med
11:00	KR	MONEY	Money Supply M2 SA MoM	Nov			1.1%	med

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