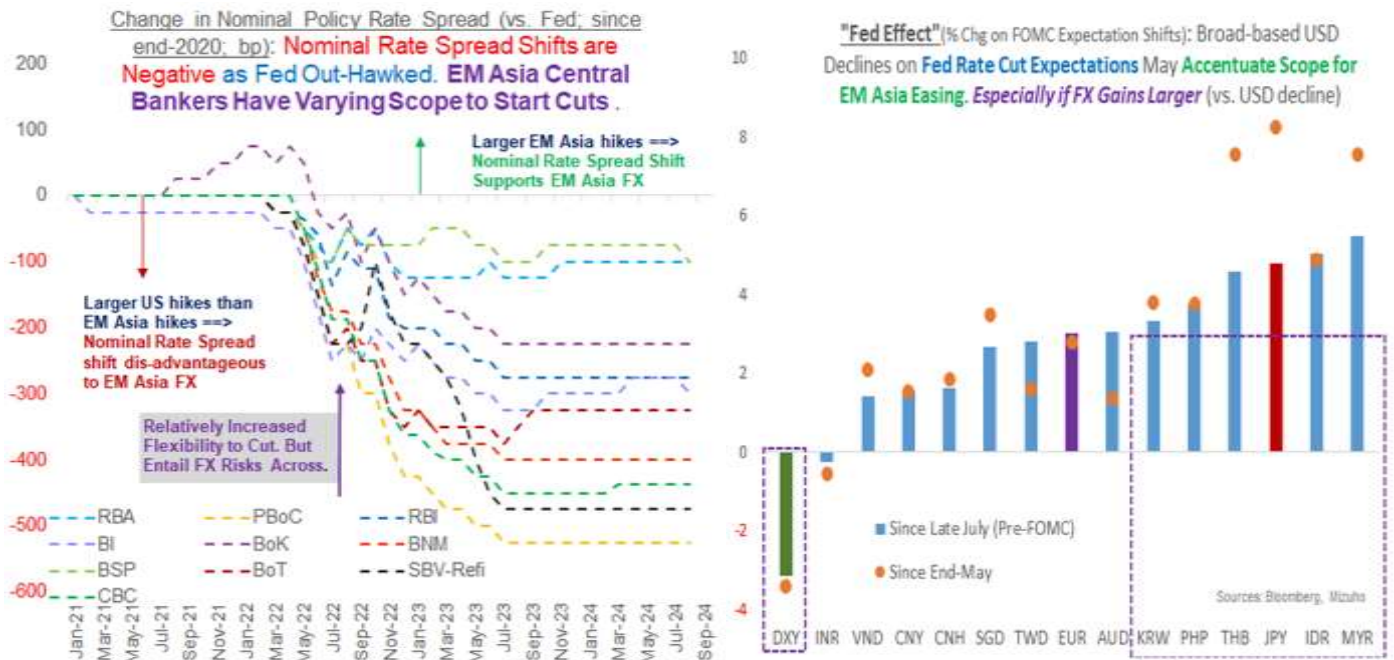


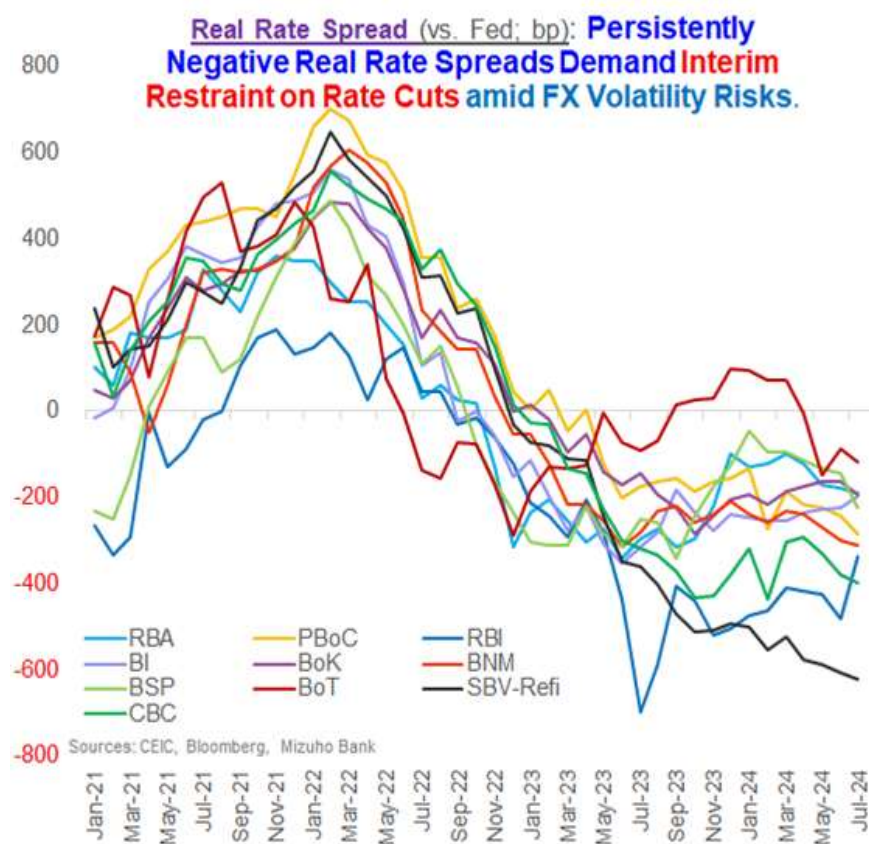
## Can EM Asia Start Cutting Rates Now?

*“Everyone has a plan until they get punched in the face^” - Mike Tyson*



- **Acute dovish shifts\* in Fed expectations, book-ended by a sharp and anticipatory drop in UST yields and USD, is suggests scope for EM Asia central banks to start cutting.**
- **But** only cautiously and tentatively as nascent **rate cut plans** must **necessarily be responsive to any flux in market conditions** and **ready for any remedial interim suspension**.
- In other words, to piggy-back on the Fed’s dovish tilt to start easing in Asia is admittedly a **fine plan. But just be prepared to be “punched in the face”**.
- Notably, dependent on **three key dimensions of uncertainty/volatility** that loom large.
- **Policy Expectations:** The **first** is **scope for abrupt, sometimes exaggerated, shifts in Fed expectations**.
- Especially as **in-coming US data are prone to be patchy and bumpy**, spanning the entire spectrum **across resilience to relief to (overdone) recession fears**.
- **Associated Risk Sentiments:** **Second** is **mercurial risk sentiments that accompany** any shifts in policy expectations.
- Specifically, whether Fed cuts bets inspire **“risk on” from pivot cheer/relief** or inflict **“risk off” from recession fears**.
- **Volatility & Unpredictability:** **Finally, consequent but harder-to-predict UST yield and USD volatility** prone to **fickle UST-USD correlations**.
- Trouble is, **out-sized post-NFP drop in UST yields** (plunging 30-40bp) **and USD** (tumbling >3%) **set USD and UST yields up for exaggerated reactions to any Fed expectation shifts**.
- That’s to say, current conducive (soft USD and low UST yields) conditions may be overdone and so may overstate scope for corresponding EM Asia rate cuts.

- What’s more, a *far higher tendency for USD-UST (positive) correlations to not only de-couple, but flip, depending on the vagaries of risk sentiments.*
- The upshot being, **heightened threat of market turbulence** f **mean that macro-FX-stability risks** will (at least initially) **confront, and hence constrain, scope for EM Asia central banks to ease.**
- And some more than others. Even as the BoT, Bank Indonesia and the BoK have cautiously stayed on hold, the **BSP’s rate cut last week was deftly executed, seizing on Fed rate cuts.**
- To be clear, the **BSP’s cut did not solely hinge on Fed expectations shift.** Instead, the **BSP had the benefit of ample economic justification** as well.
- Nonetheless, *negative real rate spreads for in EM Asia* (vs. Fed/US) *heighten associated FX depreciation risks* if EM Asia rate cuts are wrong-footed by adverse risk sentiments *amid Fed-related volatility and uncertainty.*
- Even more so given US election-related USD uncertainty. And so, markets may ultimately **favour restraint on EM Asia rate cuts heading into Q4 2024.**



^ Purportedly Mike Tyson said “punched in the mouth”, but same difference, we reckon. And someone punched in the mouth is probably not going to argue he was not punched in the face!

\* From expecting 2-3 rate cuts in July (and fewer than 2 in May), markets now expect around 5 rate cuts by the Jan 2025 FOMC (although moderating from over 6 rate cuts at the climax of overdone recession fears).

Fed Shifts (till 21-22 Aug 2024)	DXY	CNH	CNY	KRW	TWD	SGD	THB	MYR	IDR	INR	VND	AUD	PHP	EUR	JPY	2y UST (bp)	10Y UST (bp)
Since Late July (Pre-FOMC)	-3.1	1.6	1.6	3.3	2.8	2.7	4.6	5.5	5.0	-0.2	1.4	3.1	3.7	3.0	4.8	-40.1	-31.1
Since Shooting (13th July)	-2.9	2.0	1.7	3.0	1.9	2.7	5.4	6.7	4.1	-0.5	2.0	-0.6	3.5	2.2	8.6	-51.4	-37.9
Since end-May	-3.8	1.8	1.5	2.8	1.6	3.5	7.5	7.5	4.9	-0.6	2.1	1.4	3.3	2.8	8.2	-93.6	-69.5

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