AXJ FX Outlook – October 2024

MIZUHO

Economics & Strategy | Asia ex-Japan

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Asia ex-Japan FX & Rates Outlook

October 2024: **Stumbling Up & Bouncing Down**

Heightened Uncertainty & Complex Dynamics: Against a backdrop of heightened uncertainty characterized by complex and delicate policy shifts, complicated by fraught geo-economic landscape and confused by dynamic cyclical-structural post-pandemic shifts in policy transmission/economic dynamics, the global macro landscape is rendered much harder to read.

Fed Rate Cut Impact Distorted: So even as the Fed cuts rates from elevated levels, relief (for AXJ and for EM Asia rates) may not be evident or even.

FX Stumbling Up: Accordingly, it may well be that AXJ end up stumbling up. The oxymoron not only reflecting the bumpy course to traction, but also the distortions inherited from the pandemic, which diminish effective gains and restrain full reversion.

Rates Bouncing Lower: EM Asia rates could also be “bouncing lower” as lower US and EM Asia rates are challenged by risk and term premium bouncing higher from exceptionally suppressed levels.

Stumbling Up & Bouncing Down

- **Asia FX:** The Fed' easing cycle notwithstanding, AXJ will likely still face a rather bumpy, if not turbulent, transition to more sustained traction. Especially in the context of relative US exceptionalism limiting Fed cut relief/boost, while China-related risks remain as a potential drag on AXJ. Some bias for high-yielders to under-perform on distinct steepening of the UST curve.

- **CNY**: Stability remains the centre-piece for the PBoC, as large appreciation or depreciation from current ranges are not desired. To be sure, deep quasi-capital controls and the PBoC's CNY fixing backed by deep FX reserves help to entrench the CNY's "low-beta" credentials. But geo-politics should not be discounted as a source of volatility.

- **HKD:** The Fed's aggressive rates and recent HK equities rally boosted the HKD spot towards 7.76 level, while momentum has been slowing amid uncertainties over China stimulus delivery.

- **INR**: The RBI preference for rupee stability coupled with a more cautious RBI, fiscal consolidation and ramped up (record) FX reserves will help to dampen (albeit not fully deflect) volatility to the downside. Whereas rupee upside scope (on USD declines) is diminished as a trade-off for FX reserve and rupee competitiveness (for "Make in India").

- **KRW**: BoK rate cuts even at a cautious pace imply KRW gains on Fed easing may quickly cede ground. Index inclusion flows aid KRW recovery though peaking semiconductor cycle may act as dampener.

- **TWD**: The peaking semi-conductor cycle and intensifying equity outflow kept the TWD upside limited. The political risk premium is set to escalate ahead of the US elections.

- **SGD**: With the inherited, stark SGD outperformance from an unprecedented tightening (via three rounds of significant S$NEER step appreciation) proving to be excessive, MAS easing (via measured step deprecation) is a distinct risk. This entails attendant dampening SGD.

- **IDR**: Measured pace of cuts with IDR stability concerns in mind could provide some support; but fiscal undercurrents remain amid a lack of track record for the new administration, while wider current account deficit on little upside to commodity prices likely to cast an overhang over IDR.

- **MYR**: Remains in a good position for further outperformance on reduced political risk premium, semiconductor tailwinds and supportive household consumption. BNM's prolonged hold ought to provide further support even if the currency is subject to volatility on CNH risks.

- **PHP**: Faster pace of cuts by BSP relative to regional peers, alongside slow-to-consolidate fiscal deficit compounding "twin deficit vulnerabilities" should mean regional underperformance.

- **THB**: Outperformance subjected to bouts of heightened volatility amid nascent fiscal risks and elusive structural reforms. Bulls increasingly restrained by calls for BoT easing and NPL concerns.

- **VND**: Strong economic performance does not resolve risks of diminished FX reserves and elevated NPLs. Episodes of VND vulnerability and asymmetric performance to persist.

- **AUD:** With China growth worries weighing, commodities wane in their ability to backstop the AUD. That said. RBA normalisation pace will lag the Fed's and support AUD bulls.

Currency Forecast

FX Forecasts	Sep 24	Dec 24	Mar 25	Jun 25	Sep 25	Dec 25
USD/CNY	7.00 - 7.28	6.92 - 7.52	6.94 - 7.45	6.91 - 7.30	6.82 - 7.21	6.82 - 7.23
	7.02	7.20	7.16	7.08	7.03	7.05
USD/HKD	7.76 - 7.82	7.76 - 7.80	7.75 - 7.79	7.75 - 7.79	7.75 - 7.79	7.76 - 7.80
	7.773	7.77	7.76	7.76	7.75	7.76
USD/INR	83.3 - 84.0	82.7 - 86.8	82.3 - 85.8	80.9 - 84.8	81.1 - 84.5	80.4 - 83.9
	83.8	84.1	83.3	82.5	82.8	82.4
USD/KRW	1303 - 1391	1240 - 1420	1250 - 1390	1240 - 1390	1230 - 1340	1230 - 1340
	1314	1350	1320	1290	1280	1285
USD/SGD	1.278 - 1.359	1.272-1.350	1.270-1.337	1.279-1.327	1.268-1.331	1.27-1.332
	1.285	1.320	1.305	1.300	1.290	1.293
USD/TWD	31.5 - 32.9	30.2 - 33.1	30.3 - 32.9	30.0 - 32.2	29.6 - 31.8	29.8 - 32.0
	31.7	32.1	31.3	30.9	30.5	30.8
USD/IDR	15070 - 16400	14980 - 16030	14710 - 15750	14790 - 15580	14180 - 15390	14330 - 15550
	15140	15400	15050	14980	14650	14800
USD/MYR	4.09 - 4.72	4.09 - 4.45	3.91 - 4.28	3.85 - 4.25	3.78 - 4.07	3.84 - 4.09
	4.12	4.24	4.08	4.02	3.94	3.97
USD/PHP	55.4 - 58.9	55.2 - 59.3	54.1 - 59.0	53.5 - 57.1	53.0 - 56.3	53.0 - 56.1
	56.0	57.0	56.2	55.0	54.2	54.8
USD/THB	33.2 - 35.9	30.9 - 34.6	31.8 - 34.8	32.1 - 34.3	31.2 - 33.4	31.2 - 33.4
	34.2	33.6	33.4	33.0	32.1	32.1
USD/VND	24540 - 25457	24700 - 25600	24700 - 25200	24200 - 24900	24100 - 24700	24200 - 24800
	24568	25100	24800	24470	24300	24400
AUD/USD	0.635 - 0.694	0.657 - 0.703	0.656 - 0.698	0.652 - 0.72	0.671 - 0.719	0.676 - 0.721
	0.691	0.664	0.673	0.686	0.706	0.701

Note: For FX forecasts, level in parentheses pertains to period end forecasts; and the period’s range precedes this.

Asia Ex-Japan (AXJ) FX: Deferential & Differentiated

Fig 1a. Headline Induced FX Volatility

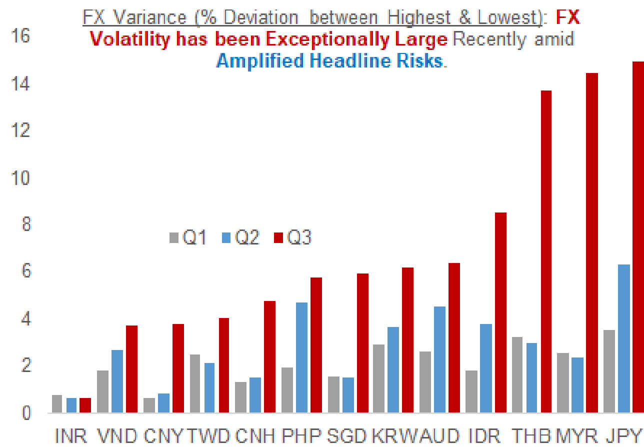


Fig 1b. Vulnerable to JPY Squeeze

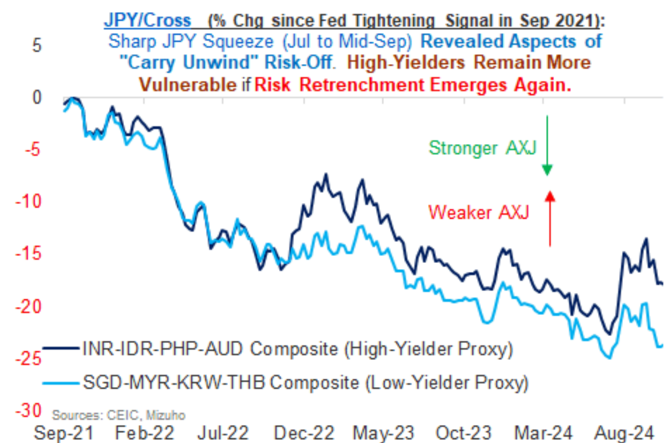


Fig 1c. AXJ Sensitivities to CNY Vary

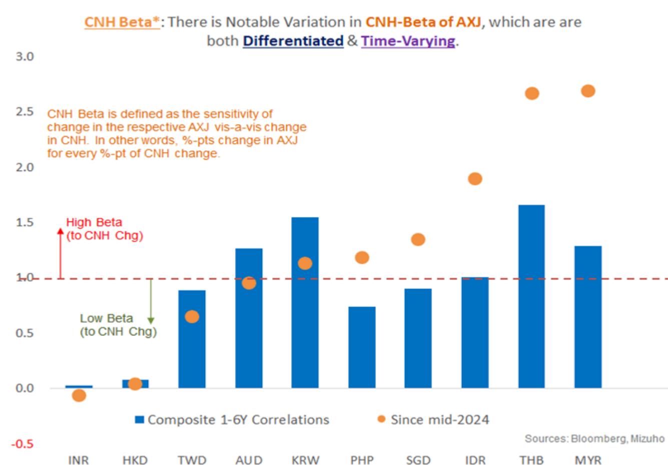
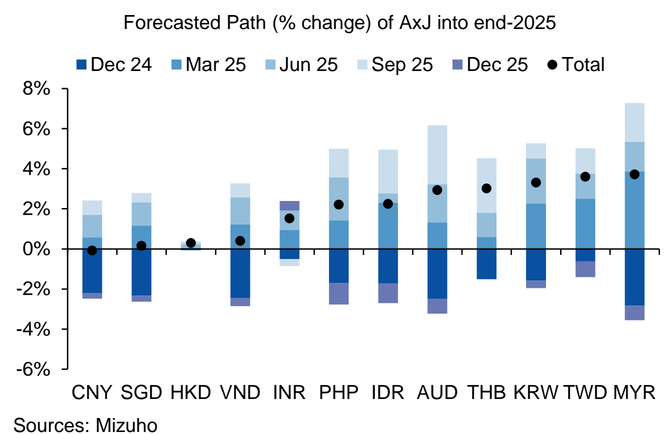


Fig 1d. Forecasted Path of AxJ into end-2025



FX

- Headline Rollercoaster: To be sure, **AXJ** have been **hijacked by heightened volatility** since mid-2024 caught up **in a rollercoaster of headline triggers**. The **resultant turbulence in AXJ** is derived **from** a confluence of; i) **rapidly shifting policy sands** unleashing *exceptionally whippy USD swings* alongside wild *JPY gyrations;* ii) the manic-depressive swings in risk sentiments due to **uncertainty overhanging China stimulus** and; iii) **on-going geo-political conflicts**.

- US Elections: All of these though have been ***complicated***, and perhaps *at times temporarily relegated,* ***by*** **US elections risks**. Notably, as **resurgent Trump 2.0 risks** with the attendant uncertainty cast on trade and geo-politics. The consequent gyrations in the USD have **upended abets on a linear "Fed pivot" decay** that was earlier (too simplistically) **priced into the Greenback**.

- Rolling Risks & Shifting Sensitivities: More importantly, the **unremitting cascade of risks** (sometimes conspiring, and at others, competing) result in *fluctuating sensitivities* resulting *highly differentiated,* but hard-to-predict outcomes across AJX. More so, as markets shift from presumed risks to "announcement effects" of initial statement by the President-elect to the details of actual policies rolled out into early-2025.

- Fed Pivots & Punctuations: Tempered **Fed pivot expectations** that have turned ***from an exclamation*** (of outsized and rapid rate cut expectations) ***to a comma*** (dialling back the pace of cuts) has abruptly **inflected the USD back up**, thereby **knocking back AXJ**. While the end-game (into H2 2025) of Fed rate cuts is for the USD to mellow, thereby lifting AXJ via confidence about exports demand (tilted towards exports-driven AXJ), interim uncertainty (entailing recession risks) could weigh on AXJ. Especially as Fed rate reductions in real terms is less pronounced due to exceptional inflation relative inflation shifts and comparative rate cuts by AXJ central banks. AXJ upside will be a punctuated and fairly fleetingly precarious affair.

- China Stimulus Factor: Meanwhile, details of the China stimulus may set-off **proxy gains in AXJ, depending on the degree** to which Beijing pulls the stops and pulls out the big guns. Moreover, the manner in which stimulus is directed, determining the demand manifestations (e.g. tech exports, commodities, consumption/tourism, outward investments etc.) will determine the (**differentiated**) CNY-beta of AXJ. That's to say, the propensity and amplitude of AXJ reactions to China stimulus (and CNY response) remains highly fluid.

- JPY Jolts: Notably, insofar as JPY swings could be especially volatile given the diametrically opposed policy stance of the BoJ (vs. Fed and other global central banks) as well as the JPY's exceptionally low starting point could also have varying impact across AXJ. On the whole, and avoiding extreme outcomes, positive JPY-AXJ correlations are tilted in favour of THB, SGD and MYR. But should the JPY squeeze be extreme enough to trigger "carry unwind" then correlations may flip (to negative), whereby sharp JPY gains could hurt high-yielders (INR, IDR, AUD, etc) the most.

- Upshot: Looking through all of these **highly-dynamic and unpredictable factors**, the **bigger picture is for AXJ to gain some traction into H2 2025**. ***But*** this will **necessarily** be **a very bumpy course** further obfuscated by highly different post-pandemic starting points (see Box 1).

- Differentiated outcomes: Looking across AXJ, and adjusting for various risks, MYR *remains in a relatively good position* as it benefits from a confluence of fiscal consolidation, relative monetary policy stability and inwards investments. Also of note is that the *THB also looks alluring insofar that tourism channels may be inspired* by China stimulus and JPY gains. Meanwhile a **steepening UST yield curve** could, **on a relative basis, disadvantage higher-yielders**. Moreover, barring a major upheaval to global trade, the **semiconductor/electronics cycle** remaining poised ought to favour KRW and TWD.

Rates

- Selectively Softer?: All else equal, the **global rate cut cycle underway**, which ought to be *reflected in EM Asia centra banks rate cuts* as well (albeit somewhat more measured), **ought to bias outcomes to softer yields in EM Asia**. *However,* the **depth of decline in yields may be selective** and somewhat **subdued** depending on the degree of coincident risk re-pricing aid wider global trade, geo-political and policy risks.

- Wider Premiums: To a large degree, **wider risk premiums** remain a **significant threat that undermines the outlook for appreciably softer yields**. Especially *in the context of the exceptional compression in AXJ-UST spreads in the post-pandemic Fed rate hike cycle.* Chances are, **risk-adjusted returns coming back into favour** (supplanting the rater indiscriminate chase for all-in returns), is likely to widen credit spreads. Especially catalyzed by a steeper UST yield curve, which not only induces corresponding term premium, but also accentuate risk pricing.

Fig 1e. rm Premium to Disadvantage High-Yielders

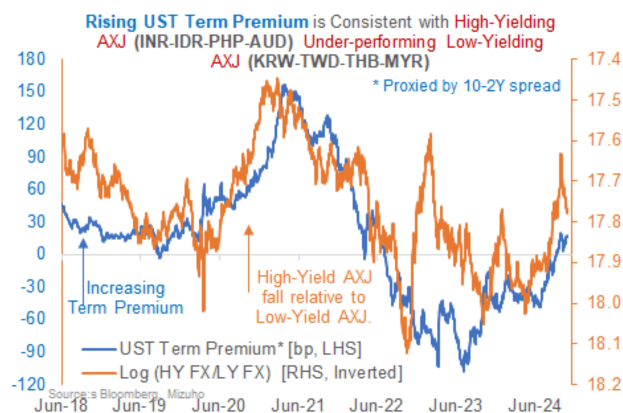
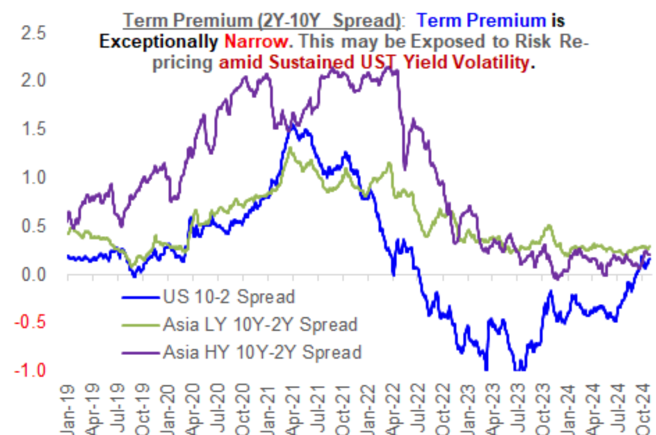
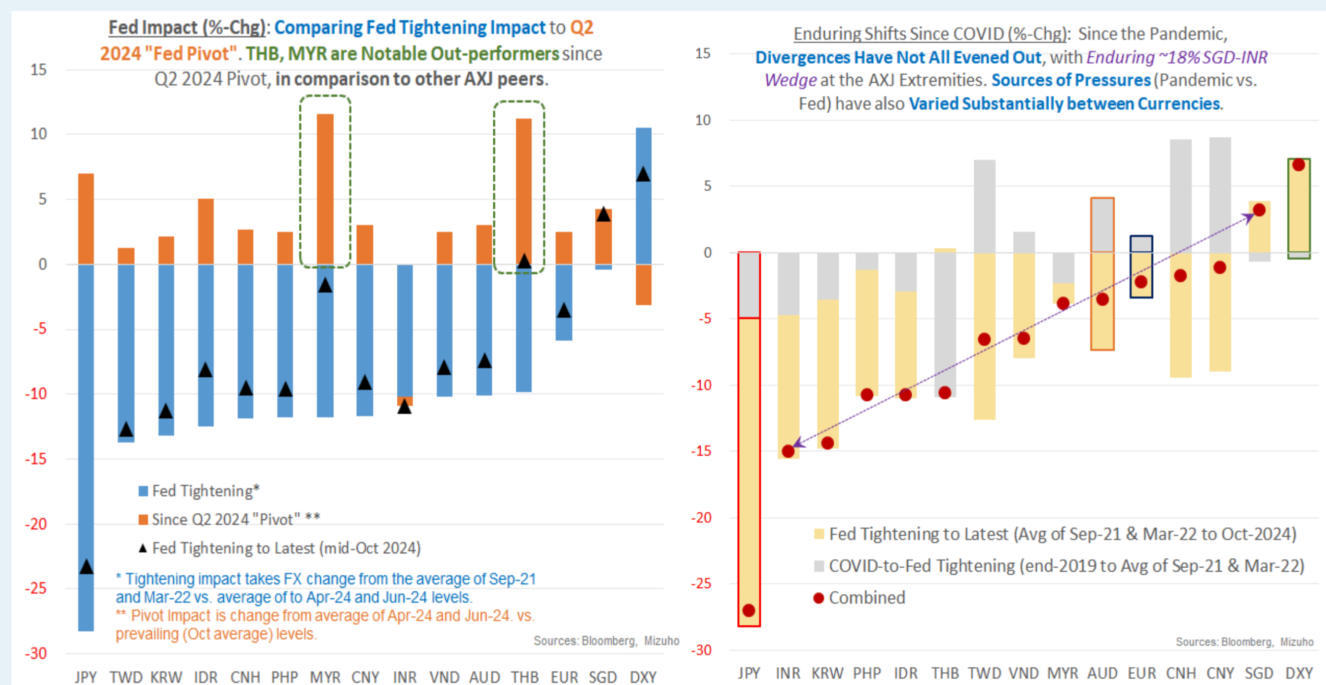


Figure 1f. Term Premium to Widen



Box 1: FX: (The Challenge of) Shifting FX Sands

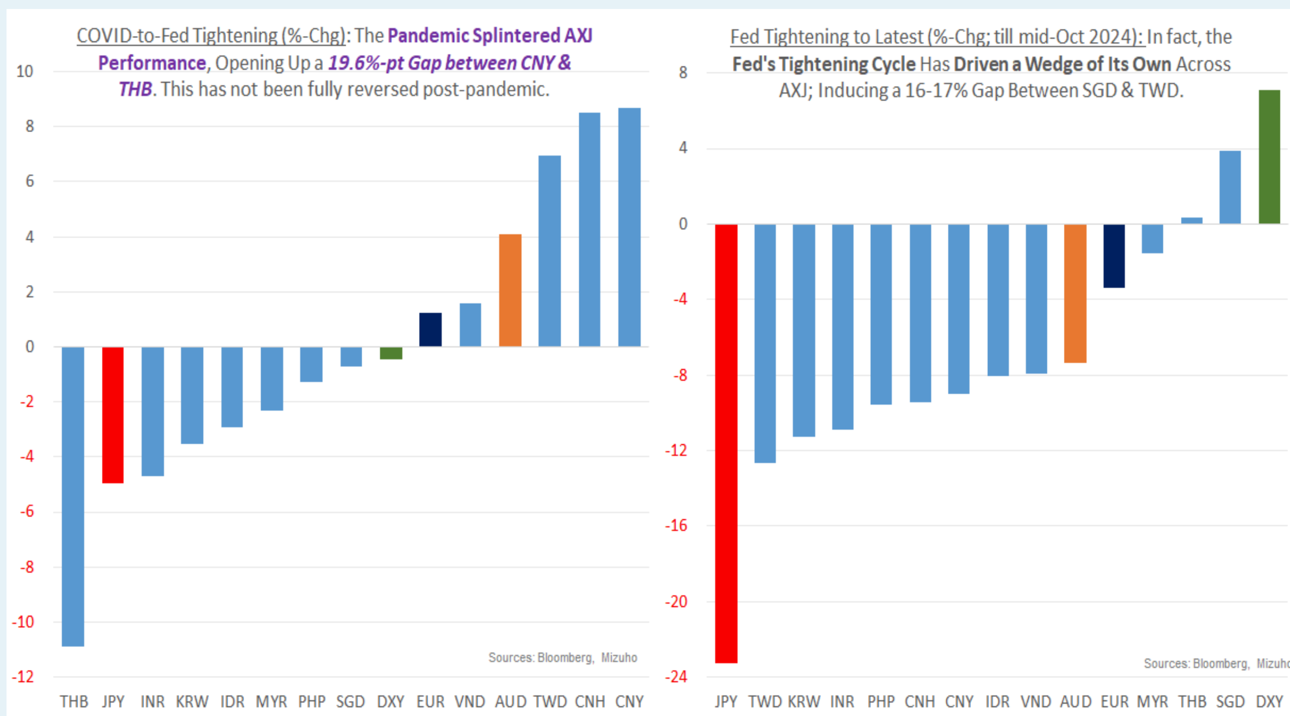


In a Nutshell

- A **bumpy course for AXJ**, with rapidly shifting volatility, **rather than a smooth upward trend on "pivot USD",** looks to be par for the course.
- It's the USD: For one, pockets of perkiness in the US economy inducing swings in Fed cut expectations, suggest USD volatility frustrating hopes for unambiguous AXJ grind higher.
- It's the Elections: What's more, with US elections, the risks are tilted to a stronger USD, compromising AXJ. And more acutely so, with Trump 2.0 outcomes.
- It's the Sensitivities: Crucially, **AXJ beta** (to periods of USD decline) are **highly differentiated** and **time-varying**. So, a re-ordering of performance depending on the drivers of risks is notable.
- It's Complicated (by post-pandemic distortions): Finally, **inherited post-pandemic distortions**, with the *distinction between cyclical-structural shifts blurred,* shroud AXJ outcomes.

- It is **tempting to suggest a distinct shift into bearish USD territory** *accompanying the Fed pivot* (into a Fed rate cut cycle) **supportive of AXJ** buoyancy, if **not ascendancy**.
- Admittedly, to some extent, the recent (since Q2) bounce in AXJ squares with this hypothesis.
- Nonetheless, it would be **careless, *if not outright cavalier*, to suggest linear (positive) projections in AXJ** based on simplistic dovish Fed (and corresponding bearish USD) views.
- Instead, **AXJ look set to endure** *heightened interim volatility on Fed shifts,* with *more profound downside risks from US elections,* before turning around on a *bumpy path to recovery further out.*
- First one, the **Fed's rate cut path expectations remain exceptionally fluid, and the USD significantly volatile**; with recent upside volatility as pockets of economic resilience temper views of the Fed's dovish intent. This in turn translates into *far more pronounced two-way USD volatility* than might be otherwise assumed a very bumpy path in any case.
- Second, **US elections risks** entailing strong **USD impulses could easily** (albeit temporarily) derail Fed pivot bets, supplanting bearish USD trend with *haven-driven USD demand resulting in AXJ turbulence.*

- Third, even **if (presumably bullish) USD shocks from US elections fade**, ***eventually deferring to a softer USD from Fed pivot,* positive AXJ response could vary substantially**.
- This is evident in ***differentiated*** and ***time-varying*** the **"beta" of the various AXJ currencies to USD decline**. Highlighting the differentiation is the fact that THB and MYR have by far outperformed in the initial USD pivot on Fed rate cut bets since Q2 2024.
- But what's problematic is that the ***time-varying (unstable) beta shrouds visibility on sustained sensitivities***. Especially as other **competing factors** such as *China stimulus, US-China trade antagonism* and *domestic political risk premium* evolve and interact.
- Finally, *unprecedented post-pandemic distortions* compounded by an *aggressive Fed cycle* challenge the ability to gauge prospects and potential for AXJ.
- Highly differentiated starting points inherited from pandemic shifts alongside the juxtaposition of cyclical and structural shifts **distorts AXJ response sensitivities**. Consequently, **measures of "reversion"** pegged to levels just before the Fed kicked off policy normalization may be **biased, if not flawed**. Hence, through the Fed rate cut cycle, **reactions across various AXJ are set to be very differentiated**, with *varying degrees of incomplete reversion.*



CNY: Beware the Bull Trap

	Q3 2024	Q4 2024	Q1 2025	Q2 2025	Q3 2025	Q4 2025
Policy Rate (%)	1.5	1.3	1.1	1.0	1.0	1.0
USD/CNY	7.00-7.28	6.92-7.52	6.94-7.45	6.91-7.30	6.82-7.21	6.82-7.23
	7.02	7.20	7.16	7.08	7.03	7.05
GDP (% YoY)	4.6	4.5	4.0	4.3	4.5	4.5
CPI (% YoY)	0.5	0.8	1.0	0.6	0.8	1.4

Note: Values in black are historical whereas those in blue represent forecasts. * Point forecast is for end-period. Ranges are only indicative.

Fig 2a. CNY unconvincing traction

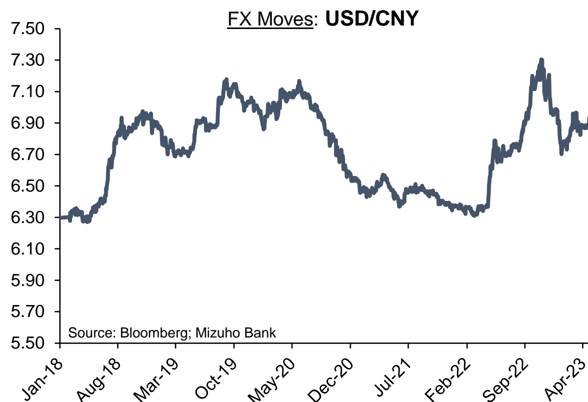


Fig 2b. Continued deflationary pressure onshore

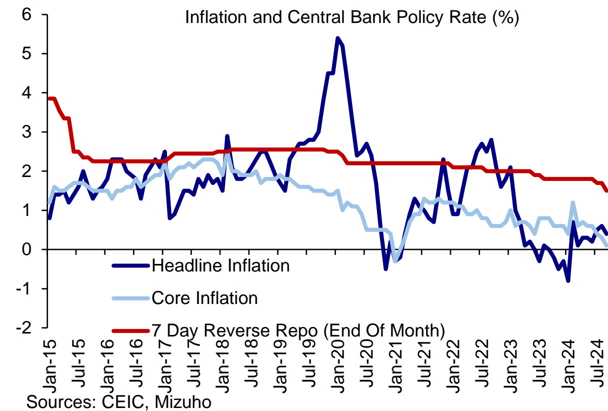


Fig 2c. Real rate drag limit near term upside

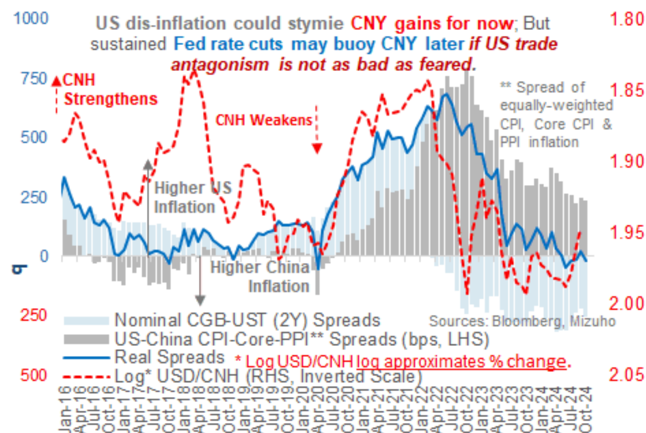
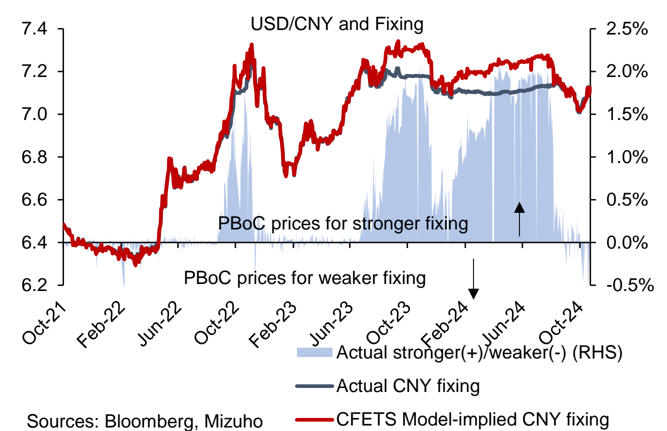


Fig 2d. PBoC priced for a stronger fixing in the past



FX

- Stimulus Need Not Soup-Up CNY: Admittedly, concerted efforts to unleash three arrows-type stimulus ought to buoy CNY. But **fiscal stimulus** alone is **not guaranteed to soup-up CNY gains**. Not on a sustained basis in any case. In fact, a **CNY bull trap is the bigger risk near-term** in the *context of front-loaded CNY gains* confronted by a conspiracy of *geo-political threats* and *risk of Beijing's stimulus falling short.*

- Expectations Gap: For one, it is **unclear whether intended fiscal stimulus will reinstall China's two major growth drivers** – *local government spending/investment* and *property demand.* Admittedly, **chronic domestic demand drag may be alleviated**. ***But,*** **for self-sustaining economic "lift-off" the size of the fiscal stimulus package must overcome expectations gap**.

- The Stimulus Tensions: And even if Beijing pulls off appreciable growth fillip for 2025, attendant **CNY boost may be compromised by stimulus tensions**. Specifically, *between growth optimism lifting CNY* and *policy easing* (monetary and fiscal) often *associated with currency drag.* Specifically, if economic optimism from the stimulus (driving CNY gains) is overtaken by headwinds to the RMB from incremental shifts in Fed-PBoC rate spread that is disadvantageous to the RMB. More so, if /or fiscal drag that is expected.

- Low(er) Beta: In any case, **CNY is a lower beta currency**, inherently relatively more subdued. Whereas bullish China stimulus FX bets may be better expressed via higher-beta AUD (on commodity amplification) and/or KRW (tech bets).

- PBoC Dampener & C/A-Reserves Backing: Notably, the **PBoC's daily CNY fixing** in the context of partial capital controls and limited (+/-2%) trading band guidance underpins CNH stability and its low-beta nature. Especially backed by a **solid surfeit of the Current Account** (~$53bn/quarter, 4Qma) and **deep FX reserves buffer of ~$3.3trln** the **PBoC's ability to dampen CNH volatility is underpinned**.

- But Financial Outflows the "Swing" Factor: But the **ability to stabilize the RMB is asymmetric**, as **threat of financial outflows may overwhelm** Current Account surplus. So, Beijing's stimulus is a decisive RMB stabilizing factor only insofar that it restores confidence sufficiently to staunch destabilizing financial outflows.

- US/Geo-Political Risks Can Overwhelm: To this end, the overhang of **geo-political risks**, led by US trade and diplomatic antagonism, remains a key bugbear that may **overwhelm any CNY buoyancy from stimulus**.

- Stability is the Sweet Spot (for the PBoC): For the PBoC, **relative CNY stability remains the sweet spot** between financial risks with strategic objectives. Especially as *J-curve benefits of a weaker currency* are *diminished by the move up the technological value-chain.* In fact, the **pugilistic geo-political backdrop further dis-incentivized even the appearance of mercantilist currency weakness**. Achieving this desired stability though can prove exceptionally challenging amid geo-political turbulence and global policy shifts.

- CNY Outlook: And so, USD/CNY after a smart pullback to test the 7-handle in immediate aftermath of China stimulus cheer, is likely to be bumped up towards 7.20 as US elections/geo-political risks overtake. The path back to ~7.05 into H2 20205 will probably be punctuated by heightened two-way risks. Meanwhile, sub-7 will be limited by PBoC stabilization, while upside risks beyond 7.30 are mitigated barring geo-political blowout.

Rates

- Softer Rates amid PBoC Stimulus: **Softer front-end rates** in line with the PBoC's assurances of stimulus – both by lower rates and flush liquidity – **looks to be the most likely direction of travel**. ***Although*** limited by fiscal expansion. What's more, emphatic efforts to tackle deflation risks will probably buoy long-end yields.

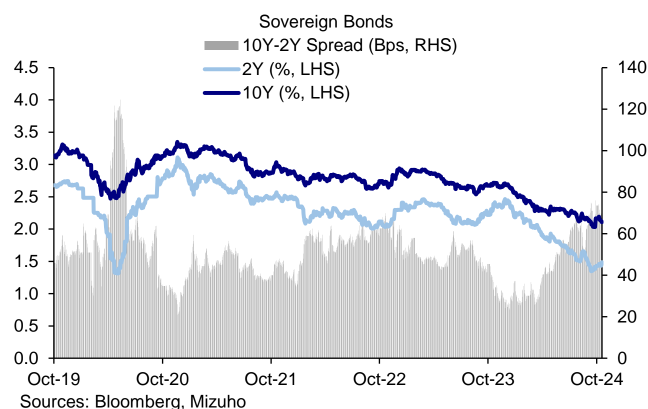
- Issuances to Add to Long-end Buoyancy: More so as additional CGB and local government bond issuances mop up liquidity. Especially with MoF hinting at sizable issuances, which may exceed recent issuance size.

- But PBoC Likely to More than Offset Issuances: Nonetheless, another rate cut of 20bp (7D reverse repo rate, 1.3% eop) and ~50bp RRR cut of 50bp in 4Q24 should temper long-end yield ascendancy from issuances.

- Yields: On balance, any rise in long-end CGB yields is expect be capped (10Y CGB yield in the range of 2.2-2.3% looks like a sustainable equilibrium). This reflects the conflict between stimulus (that ought to lower front-end yields via rate cuts) and wider fiscal deficit/enlarged public borrowing.

- Curve: A **mildly steeper curve seems to be par for the stimulus course**. This as **front-end rates may move lower** as banks cut their deposit rates, but the **long-end is propped up by reflationary policies**.

Fig 2e. PBoC averts unwanted flattening



Sources: Bloomberg, Mizuho

Figure 2f. Decline in M1 bodes ill for economic activity

Sources: CEIC, Mizuho

HKD: Bolstered by equity inflow

	Q3 2024	Q4 2024	Q1 2025	Q2 2025	Q3 2025	Q4 2025
USD/HKD	7.76-7.82	7.76-7.80	7.75-7.79	7.75-7.79	7.75-7.79	7.76-7.80
	7.773	7.77	7.76	7.76	7.75	7.76
GDP (% YoY)	2.9	3.1	1.9	2.9	3.0	3.0
CPI (% YoY)	2.5	2.1	2.3	2.9	2.5	2.3

Note: Values in black are historical whereas those in blue represent forecasts. * Point forecast is for end-period. Ranges are only indicative.

Fig 3a. HKD strengthened as Fed cut rates

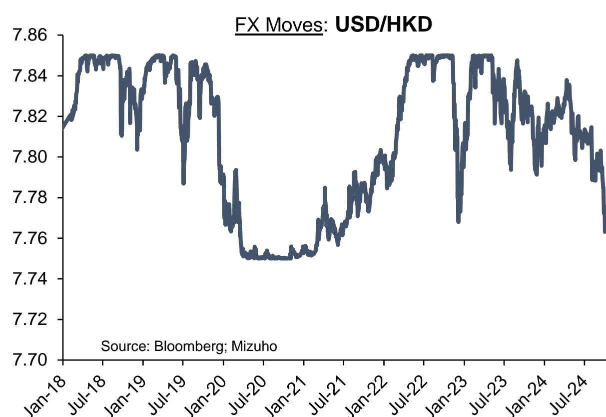


Fig 3b. Subdued underlying inflation

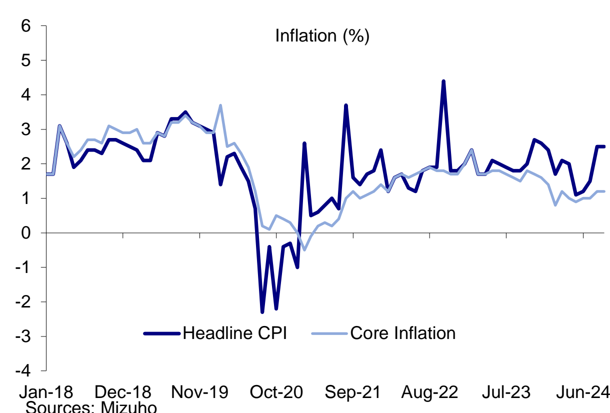


Fig 3c. HSI soared on China stimulus hopes

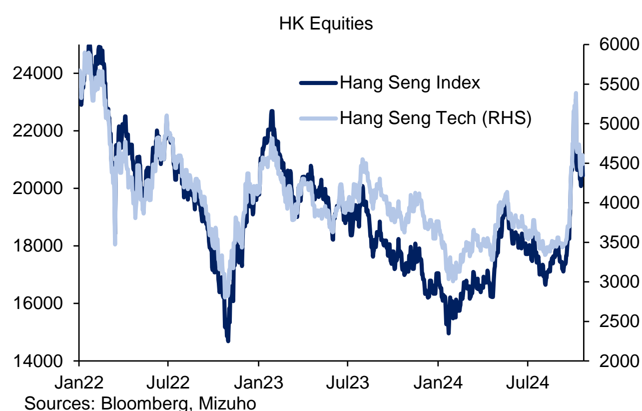
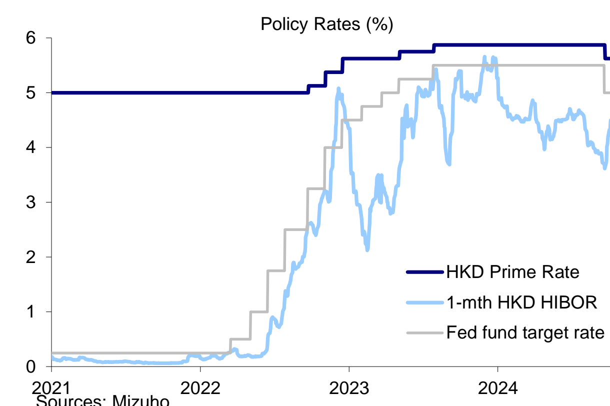


Fig 3d. HK banks cut prime rate after Fed's cut



FX

- Stronger HKD: HKD spot strengthened to below 7.77 level for the first time since December 2022 following the Fed's aggressive 50bps rate cut and a HK equities rally. In addition to the tailwind from the USD decline, a surprising 25bps prime rate cut by HK banks and the China's stimulus policy pivot boosted HK equities and encouraged capital inflow to HKD market. The largest company debut in 3 years also revived IPO market sentiment, bringing back HKD demand.

- Weak domestic growth momentum: Improving net exports kept robust GDP growth in Q2, but the cross-border consumption and lacklustre inbound tourism recovery amid the HKD strength dampened domestic consumption. The lingering property downturn and struggling stock markets caused negative wealth effect on consumption. The budget deficits constrained government expenditures due to sliding land premium.

- Underlying inflation remained low: Headline CPI eased to 2.2%YoY on moderating food prices gains. Netting out the effects of government measures, underlying inflation remained subdued around 1%YoY. Rising rentals amid talent inflow could fuel inflationary pressure.

- Minor stimulus measures: The HK annual policy address revealed more property supportive measures, setting maximum loan-to-value ratio at 70% for all homes. Taxes on spirits with an import price above HKD

200 will be lowered to 10% from 100% to support tourism and catering. The investment migration program is broadened, covering property investments valued at HKD 50mn or above.

- USD-HKD peg: We expect the USD-HKD peg to remain intact as the Linked Exchange Rate System best fits small and external-end economies like Hong Kong. By preserving HKD stability against USD with over 40 years history, the system serves as a foundation for the international financial centre. While the change of US president may raise market discussion on the peg stability, unwinding HKD exposures in the financial market will incur significant costs, resulting in a status quo of the peg.

- Equity inflow as a key: HKD spot remains robust around 7.77 level given capital inflow but may soften to the mid-point of HKD trading band if equity rally loses momentum. Mainland China investors are keen to buy HK equities due to A-H shares premium. The Stock Connect channel recorded significant southbound inflow over past few days. If bullish sentiment sustained, IPO demand could pick up, bringing extra demand for the HKD.

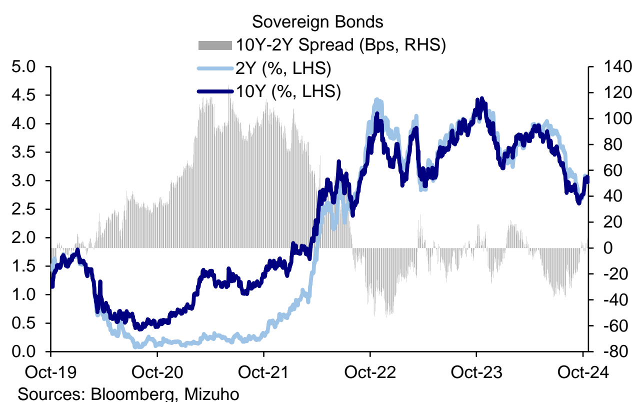
Rates

- Tighter HKD liquidity: The HK stock market rally led to HKD liquidity tightening. The Hang Seng Index daily trading volume surged from around HKD 100bn to a record high of HKD 620bn on 8th October, indicating stronger HKD liquidity demand for settlement. Together with low HKMA aggregate balance, HK banks tapped on discount window facility more often since mid-September. The Silver Bond issuances subscription also soaked up HKD liquidity in early October. However, overnight HKD HIBOR eased back somewhat as both HK stock markets and trading volume retreated. Separately, The HKMA cut counter-cyclical capital buffer (CCyB) to 0.5% from 1%, unleashing more room for loan lending to support corporate.

- Surprising HK prime rate cut: Although HK banks lagged behind in the Fed rate hike cycle, leading HK banks surprisingly cut the prime rate by 25bps after the Fed's bold 50bps rate cut. The rate decision suggested that HK banks' motivation to stabilize property market and lending out excessive liquidity given the subdued loan-to-deposit ratio. Indeed, HK banks reported credit impaired losses in their commercial real estate (CRE) loans to HK clients. Despite the narrowing spread between prime rate and HIBOR funding costs, a stabilizing property market could benefit banks' credit portfolios.

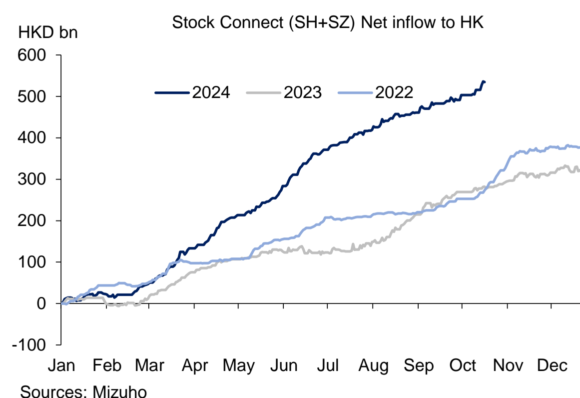
- USD-HKD rate convergence: The recent HK equities rally bolstered HKD rates, while the sustainability of higher HKD rates will depend on the HKD loan demand driven by recovery of property market and economic outlook. If the China stimulus rally sustained, it could shore up confidence on HK financial markets and bolstered IPO listing in HK stock markets due to improvement in equites valuations. Of course, more Fed's aggressive rate cuts could bring a USD-HKD rate convergence sooner. A Fed's crisis rate cut could narrow USD-HKD rate gap immediately, given the examples of the Covid Outbreak in 2020 and Global Financial Crisis in 2008, but this is not our base scenario.

Fig 3e. HKGB term premium tracked on UST



Sources: Bloomberg, Mizuho

Figure 3f. Strong Stock Connect inflow



Sources: Mizuho

INR: Dampening Volatility

	Q3 2024	Q4 2024	Q1 2025	Q2 2025	Q3 2025	Q4 2025
Policy Rate (%)	6.50	6.25	5.75	5.50	5.25	5.25
USD/INR	83.3-84.0	82.7-86.8	82.3-85.8	80.9-84.8	81.1-84.5	80.4-83.9
	83.8	84.1	83.3	82.5	82.8	82.4
GDP (% YoY)	6.5	6.9	6.7	6.3	6.1	5.5
CPI (% YoY)	4.3	5.7	5.4	5.8	4.2	4.5

Note: Values in black are historical whereas those in blue represent forecasts. * Point forecast is for end-period. Ranges are only indicative.

Fig 4a. Uncharacteristically Low Volatility

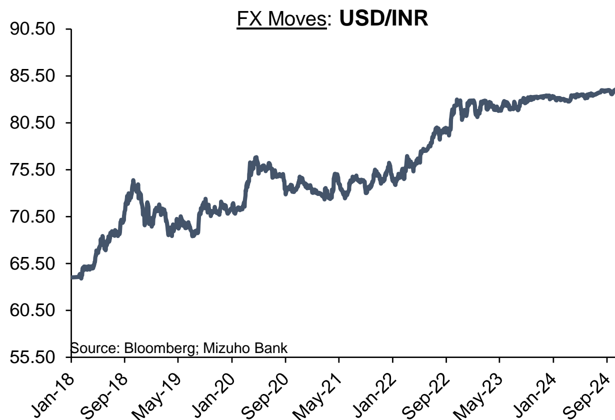


Fig 4b. India's Core Inflation is Better Contained

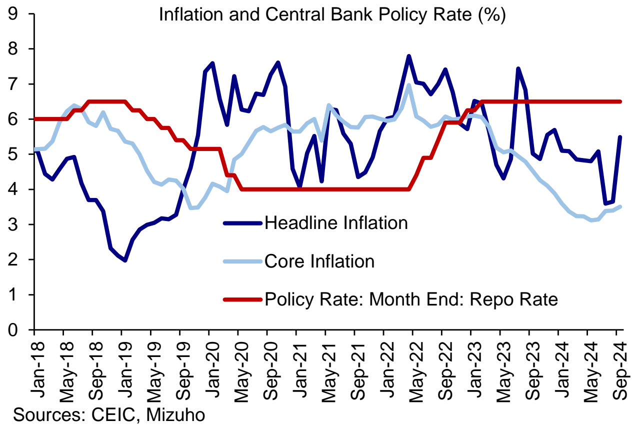


Fig 4c. Fiscal Consolidation Trajectory Encouraging

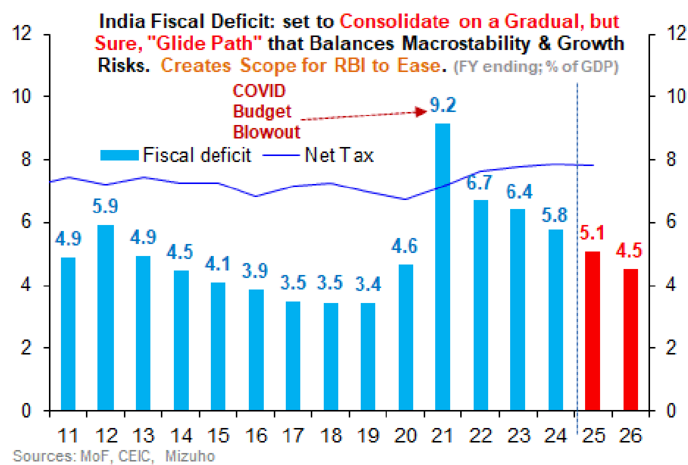
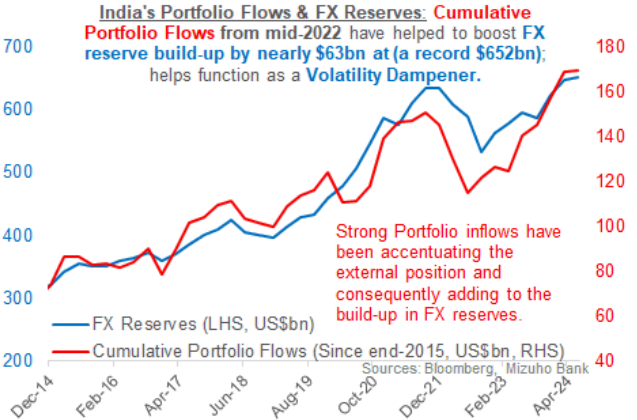


Fig 4d. Solid Build-Up of FX Reserves a Buffer



FX

- Lower- Beta, but on the Back Foot: The **Indian rupee**, **backed by** the desire for, and buffer of, **high FX reserves is expected to be uncharacteristically lower beta**. This ability to *better weather two-way volatility* however from much softer valuations. So, **remaining in its back foot** (considering the Rupee's under-performance since the pandemic) is the **implicit upfront price for rupee shock dampener**.

- CNY Hedge: An additional source of resilience for the rupee is also the fact that the **rupee may be the preferred anti-CNY hedge** within the AXJ, if not EM, space. Not just due to its **inherently low correlation with CNY**, but also because *India's strategic geo-political positioning against China enhances its allure* as a CNY hedge.

- (Relatively) Brighter Spot: Moreover, looking past cyclical moderation, the prospects of **higher growth potential** with its critical mass and demographic advantages **adds to the investment case**. In turn *backing the rupee through Current Account deficits.*

- Lower Inflation: What's more, with *inflation averaging appreciably lower* than has been the case in the past, **real returns are at the margin also more constructive** for rupee.

- “Twin Deficit” Overhang: *Nonetheless,* the **“twin deficit” handicap** for the rupee is **not convincingly shrugged off**. Hence the underlying risk of rupee drag **stifles the potential for emphatic rupee appreciation**.

- Reserves & Reserved: Finally, *on dollar downtrend the RBI has a preference to accumulate FX reserves* **purposefully forgoing “low-hanging” rupee appreciation**. But this is the **necessary trade-off to enjoy relatively enhanced rupee stability** *on USD uptrend.* This means rupee moves may be **more reserved either way on broader AXJ trends**. Furthermore, this stability and relatively subdued valuations dovetail with “Make in India” ambitions.

- INR Outlook: Expect that the USD/INR will likely be buoyed into US elections, attempting to dampen upside (rupee weakness) below 86 into early 2025. But rupee should gain ground to 82-83 into late-2025 as the USD mellows broadly.

Rates

- Central Bank: The **RBI has been remarkably patient with exercising scope to ease**, *forgoing an opening in October.* But easing is a matter of time. And sooner rather than later, given the reasonably solid inflation anchor and fading growth momentum.

- Policy Rate: With real rate trending at historically high levels and the Fed leading with a 50bp cut in Sep, the **RBI ought to have clear scope for 100-150bp of cuts in coming quarters**. More so, with fiscal consolidation making good progress.

- Yields: RBI cuts alongside falling global yields ought to induce some softening in GOI yields at well. But this is likely to be uneven (across the curve) and somewhat dampened.

- Curve: With a steepening bias in the UST yield curve, this steepening is likely to rub off on to the GOI curve, *albeit less dramatically* given that earlier flattening was not as pronounced. Nonetheless, **relative risk-adjusted re-pricing suggests some steepening will be hard to avoid**.

- Wider spreads: What’s more, with Fed rate cuts and a steeper UST yield curve comes a shift in focus from all in returns (that helped compressed GOI- UST spreads) to risk-adjusted returns, which will reinstate **wider (and more normal) risk/credit spreads**.

Fig 4e. Some Downside in Yields Expected

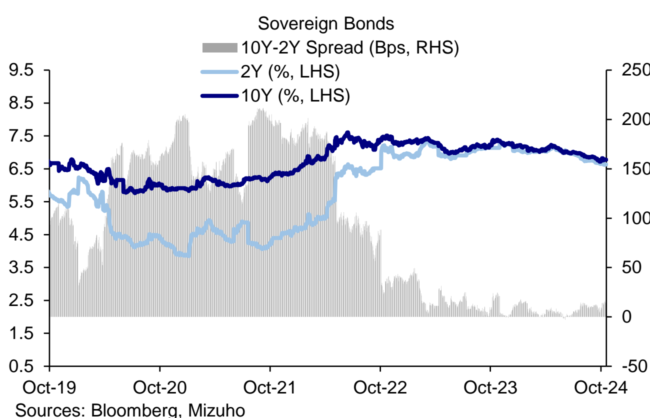
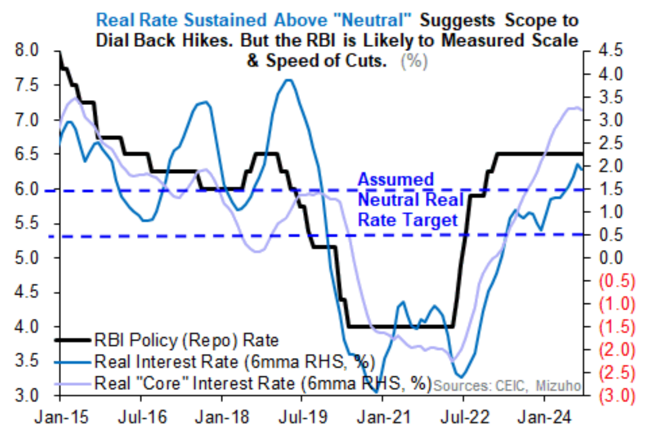


Figure 4f. Scope for RBI to Cut Yet to be Exploited



KRW: Cautious Starts and Ends

	Q3 2024	Q4 2024	Q1 2025	Q2 2025	Q3 2025	Q4 2025
Policy Rate (%)	3.50%	3.25%	3.00%	3.00%	3.00%	3.00%
USD/KRW	1303-1391	1240-1420	1250-1390	1240-1390	1230-1340	1230-1340
	1314	1350	1320	1290	1280	1285
GDP (% YoY)	1.5	2.2	1.6	2.5	2.4	2.4
CPI (% YoY)	2.1	2.1	1.9	2.2	2.4	2.0

Note: Values in black are historical whereas those in blue represent forecasts. * Point forecast is for end-period. Ranges are only indicative.

Fig 5a. KRW appreciation has been moderate

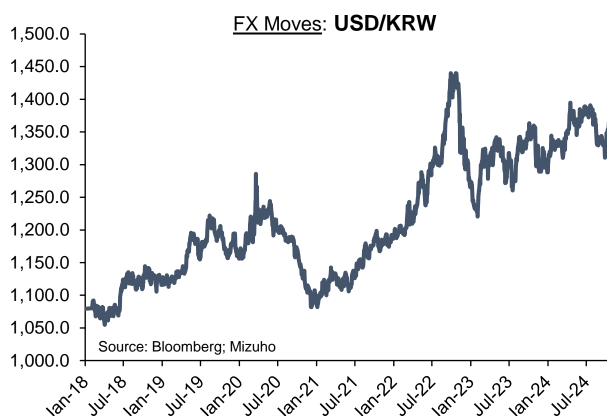


Fig 5b. Headline inflation decline aid BoK easing

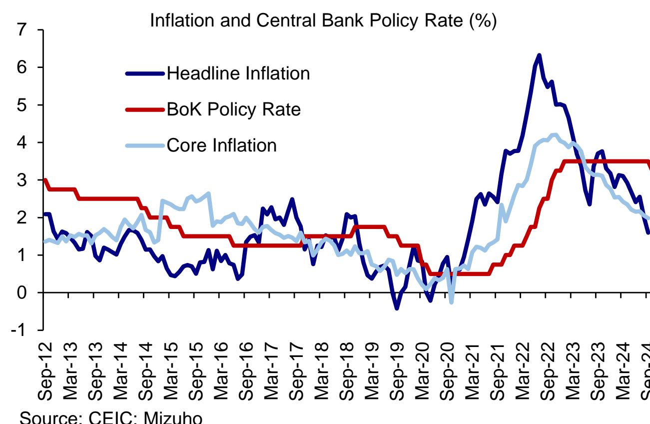


Fig 5c. Foreign holdings of KGBs have grown

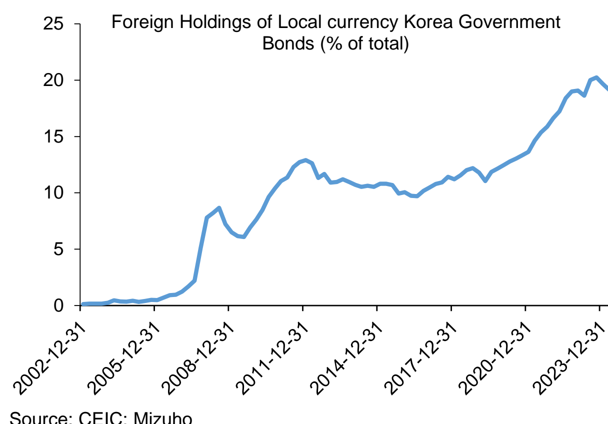
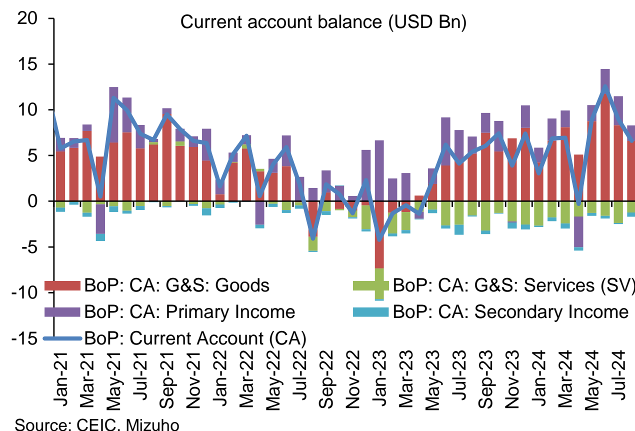


Fig 5d. Current account surplus return



FX

- KRW Hamstrung on many fronts: USD/KRW remains buoyant off 1300, **still far from recovering to pre-Covid levels of below 1200.** Even amid a backdrop of a softer USD backed by Fed policy easing, KRW performance has not been stellar as a constructive semiconductor backdrop was overwhelmed by risk off sentiments and BoK's easing. This situation is likely to continue to persist**.**

- Uneven Growth, Unfulfilled Tailwinds: Growth upside unable to provide KRW boost via rates in part due to underlying unevenness. Trade was supportive on strong external demand for semiconductors as demand for AI chips, computer, servers, and electronics rose. Domestic engines of growth remain soft as private consumption contracted.

- Inflation Relief Not Translating to KRW boost: Significant progress has been made to tackle inflationary pressures as a large share of items in the CPI basket have reverted to their pre-Covid inflation rates and headline inflation for September at 1.6% is now below the BoK's target. Despite higher headline real rates, sticky core inflation inflation and BoK's rate cut diminish KRW allure.

- Constructive Current Account Peaks: Surplus position has returned on semiconductor recovery. That said, these surpluses may have peaked and the strength of support is expected to turn milder in 2025 as the growth of semiconductor and electronics demand stabilise.

- Dented By Risk-off Sell-off: Tech related equities sell-off engendered risk off weakness for the KRW. Nonetheless, bond inflows remain strong and aggregate foreign flows are likely to remain a mild positive for the KRW in the months ahead especially on Korea's inclusion onto the FTSE WGBI.

- Fiscal consolidation lags: Internally, another impediment to KRW recovery is the lag of fiscal consolidation as 2023 dire industrial performance hit corporate tax revenue collection this year and the official deficit target of 3.6% of GDP is a risk of a slight miss.

- Outlook: KRW performance **expected to remain in the middle of the EM-Asia pack** as it remains hamstrung on multiple fronts. Risks off episodes from Fed easing often see KRW weakness on equity outflows. Even "risk on" periods from US soft landing may also see mild KRW gains as it often alludes to possibility of BoK easing as well. This backs the case for USD/KRW to remain buoyed off 1300 with occasional tests on Fed pivot weakness into early 2025. In turn, USD/KRW below 1300 may only materialise in mid-2025 as the BoK grapples with neutral rates. USD/KRW to remain backstopped above 1200 as semiconductor cycle runs its last legs in late 2025.

Rates

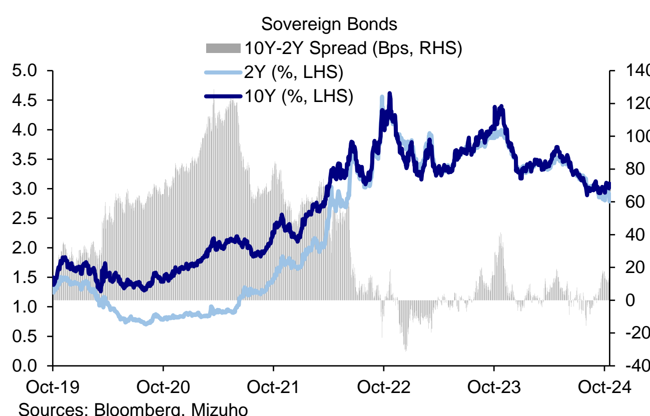
- Central Bank: Looking ahead, after October's hawkish cut, the **BoK is expected to continue cautious easing in 2025** with dependence on the housing prices and debt. Specifically, BoK is expected to **stand pat in November** as they lean on the need to assess the impact of the initial cut especially with Governor Rhee expressing that 5 out of 6 members see the rates being maintained for the next three months. In Q1 2025, we **expect another 25bp rate cut.** The trajectory beyond is highly uncertain as lagged effects of earlier easing may support for the real estate market.

- Risks: We have factored in the risks of a resurgence in housing debt amid continue rise in housing rise in early 2025 which dampens prospects of further easing by the BoK.

- Yields: Front end yields subjected to downside risks on speculative bets for BoK easing. Across tenors, gradual decline in yields on Korea's inclusion into FTSE's WGBI which was announced this month though its effective inclusion will only take place in November 2025. Furthermore, **the inclusion will be phased in over a one-year period** which points to **staggered inflows** though the announcement impact is likely to see some frontloaded demand. Korea will eventually take up a 2.2% weighting in the index with a **market value of US$691bn**.

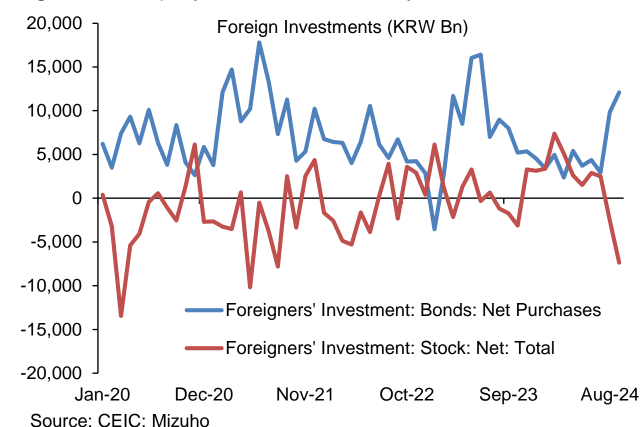
- Curve: A steepening of the KGB yield curve is to be expected given that the term premium is now utterly compressed, longer term issues **from demographics and associated expenditures and higher interest payments remain a key bugbear pushing up longer term yields.**

Fig 5e. Term Premium is severely compressed



Sources: Bloomberg, Mizuho

Figure 5f. Equity outflows offset by inflows into bonds



Source: CEIC; Mizuho

TWD: Doubled Edged Tech Sword

	Q3 2024	Q4 2024	Q1 2025	Q2 2025	Q3 2025	Q4 2025
Policy Rate (%)	2.000	2.000	2.000	1.875	1.750	1.750
USD/TWD	31.5-32.9	30.2-33.1	30.3-32.9	30.0-32.2	29.6-31.8	29.8-32.0
	31.7	32.1	31.3	30.9	30.5	30.8
GDP (% YoY)	3.4	2.9	2.7	3.2	3.2	3.0
CPI (% YoY)	2.2	2.3	2.0	1.9	2.0	1.8

Note: Values in black are historical whereas those in blue represent forecasts. * Point forecast is for end-period. Ranges are only indicative.

Fig 6a. TWD recovery remains impaired

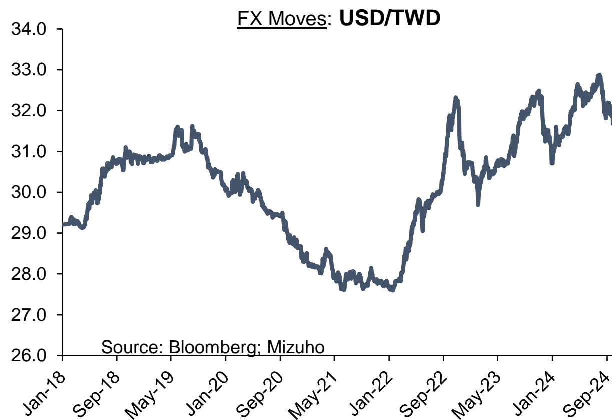


Fig 6b. Inflation remains very sticky

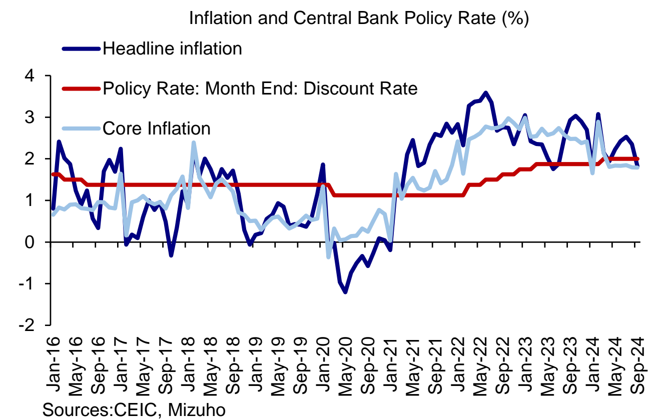


Fig 6c. Semiconductor inventory restocking continues

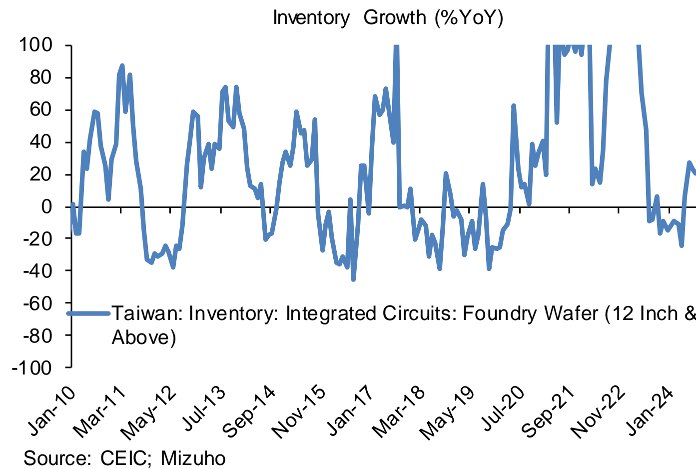
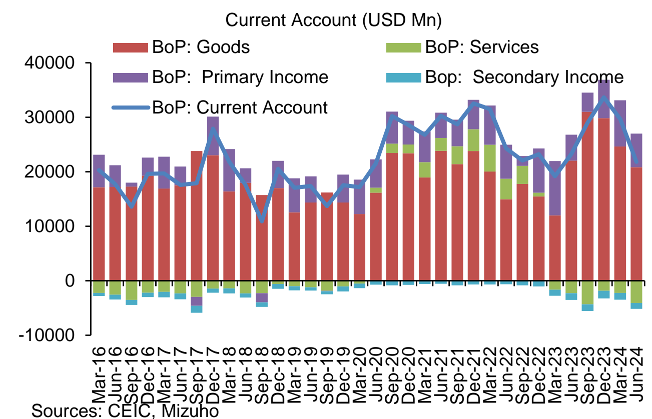


Fig 6d. Current account surplus



FX

- TWD's Choppy Recovery: TWD reversed its appreciation in September after hitting 31.5, falling back to 32 level amid the USD rebound. The intensifying capital outflow pressure and FX conversion from dividend payouts also led to a pullback in the TWD. Outflow pressure remain unlikely to abate in the near term and a moderating semiconductor cycle to imply a choppy recovery to persist.

- Necessitated CBC intervention: Amid choppy trading sessions, the CBC stepped in to smooth out FX market movements, reducing FX reserves by USD 1.1bn in September.

- Political Risk Premium into End-2024: Cross straits tensions remain a bugbear and while military drills are unlikely to translate to tangible conflict action, economic punishments via trade remain a possibility to wield although damage to be muted given the interdependence on high tech goods. Furthermore, **Trump 2.0 remains a key risk** with threats of defence withdrawals and payments being touted. In turn, there is substantial susceptibility to outsized TWD weakening.

- Marginal Fade of Growth Positives: As semiconductor cycle attempts to find a peak and consolidate, growth is expected to moderate in the coming quarters though given the tight labour markets, private consumption is likely to hold up. Macro allure of TWD to fade.

- Diminished Real Rates: Amid still resilient growth, core inflation may prove stickier than envisaged. Headline dis-inflation continues to be bumpy as natural disasters hit and ensuing effects on food supply chains take a couple of months to fade. In turn, the diminished real rates dampen the TWD.

- Less Supportive Current Account: Lower goods exports revenue and higher import expenditure led to smaller goods surplus in recent months. Meanwhile, stronger resident departures led to higher import expenditures on transport causing a wider services deficit. A smaller current account surplus in the months ahead is also expected to provide less support to TWD recovery.

- Financial Outflows Moderate, Risks Retained: Equity outflows have also set back the TWD as the sharp Q3 sell-off saw strong foreign outflow and this amounted to nearly US$14bn YTD, with only outflows out of Chinese equities being higher. The sell-off continued in October albeit with some moderation and outflow may moderate further, a reversal to inflows may be found wanting.

- Outlook: TWD is expected to enter a range trading, with risk skewed towards downside, as the US-TW rate spread widening provided support for the USD/TWD. Despite resilient Taiwan stock markets, the intensifying equity outflow pressure due to outbound investments could dampen the TWD outlook. The increasing geopolitical tensions related to US elections will fuel TWD volatility.

Rates

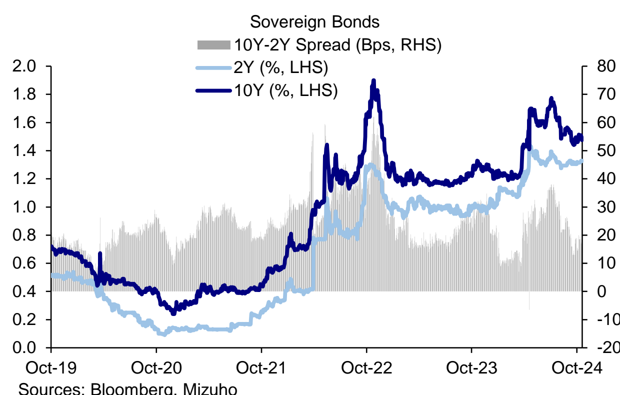
- Central Bank: We expected the **CBC to only cut rates in Q2 2025** on sight of discernible progress in housing debt and price stability. This is likely to coincide with the last legs of the semi-conductor cycle which will imply lower growth support from external demand. That said, these steps will be **highly calibrated** given that a lack of deterioration of labour market conditions pointing to higher long run inflation rates and aid the paradigm of higher neutral rates espoused by Governor Yang.

- Risks: The **near term risk may in fact be a rate hike** by the CBC especially if growth continues to hold up and housing prices rise further. While macroprudential measures have been implemented to curb real estate lending, quantity and quality-based assessment approach (via LTVs and RRR) to financial stability may have to be supported further by a direct increase in the cost of borrowing.

- Yields: Short end yields are likely to be backstopped by the CBC's policy stance in the near term and remain elevated especially if property prices head higher.

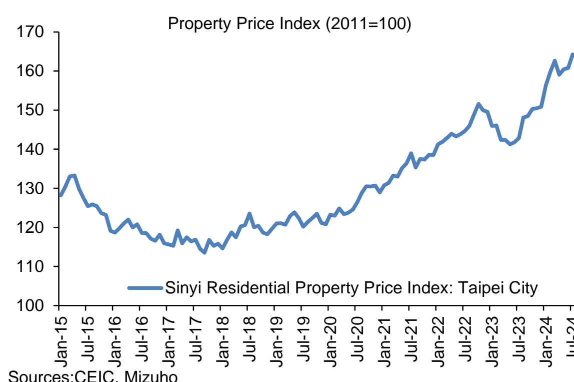
- Curve: While a flatish curve remains the base case, room for further narrowing in spreads remains limited, barring a yield curve inversion from a further rate hike. That said, steepening is also elusive without a rate cut as longer end yields are rather elevated and upside largely depend on longer end UST yield influences.

Fig 6e. Yields to remain elevated in near term



Sources: Bloomberg, Mizuho

Figure 6f. Escalating property price a key CBC worry



Sources:CEIC, Mizuho

SGD: Fading Outperformance

	Q3 2024	Q4 2024	Q1 2025	Q2 2025	Q3 2025	Q4 2025
S$NEER Slope	2.0%	2.0%	2.0%	2.0%	1.5%	1.5%
S$NEER Mid-pt	Hold	Hold	Hold	-65bp	Hold	Hold
USD/SGD	1.278-1.359	1.272-1.350	1.270-1.337	1.279-1.327	1.268-1.331	1.27-1.332
	1.285	1.320	1.305	1.300	1.290	1.293
GDP (% YoY)	4.1	2.2	2.3	2.4	2.3	2.1
CPI (% YoY)	2.2	2.3	2.4	2.4	2.5	2.3

Note: Values in black are historical whereas those in blue represent forecasts. * Point forecast is for end-period. Ranges are only indicative.

Fig 7a. SGD has been an outperformer

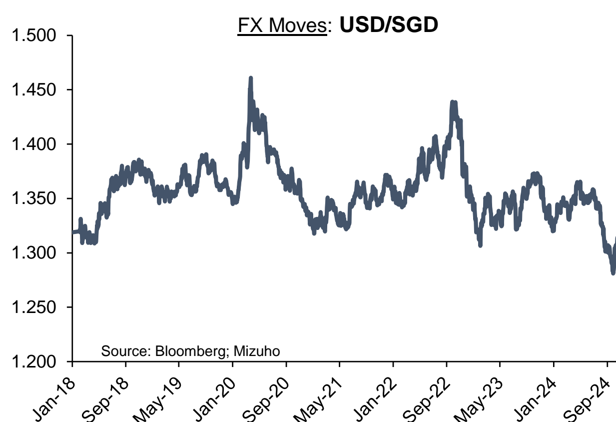


Fig 7b. MAS Core Inflation to head to 2% in H1

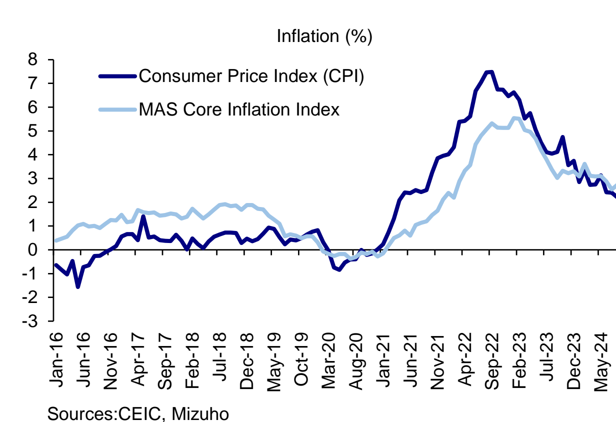


Fig 7c. Exceptional S$NEER Surge

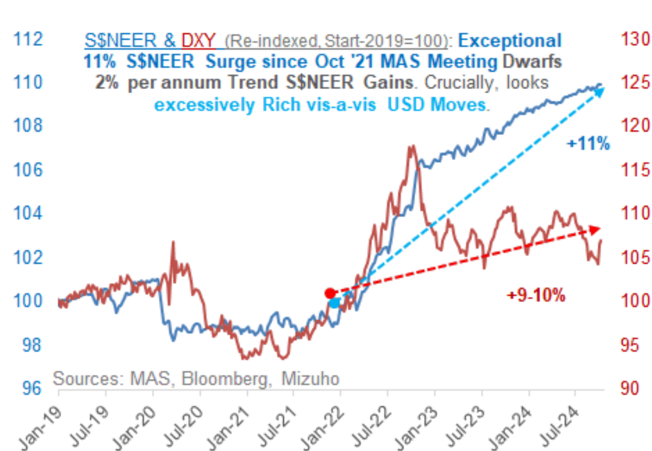
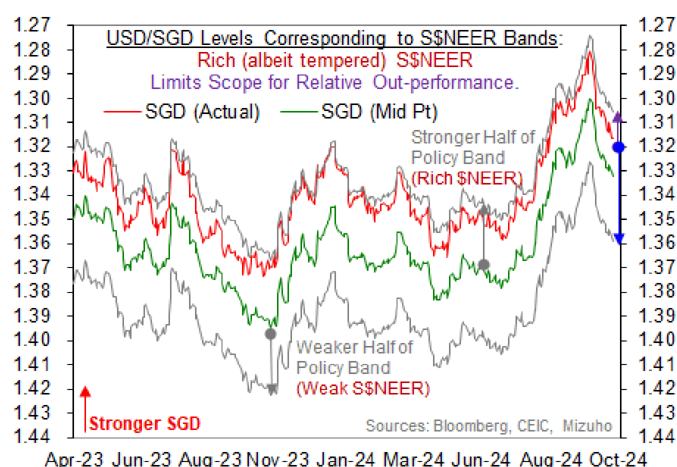


Fig 7d. S$NEER Rich Within the Band



FX

- Stretched Outperformance: The **SGD as a standout performer over the Fed hike cycle** and beyond is **no surprise** given the conspiracy of current account and capital inflows alongside exceptional and unprecedented MAS tightening. This position now **looks stretched**, *especially as the global easing cycle kicks in.*

- Set to Fade: But as the Fed cut cycle kicks **relative SGD outperformance is set to fade** on more than one count. And a key part of that may be some degree of unwind in MAS tightening that indirectly (via trade-weighted effects) mellows the SGD.

- Moderating S$NEER Levels: First and foremost, the likelihood of the MAS set to ease. And notably, via means of **moderating S$NEER levels** rather than just tempering the pace of S$NEER appreciation. In other words, *a measured depreciation of the S$NEER* **to compensate for the aggressive three-in-a-row step appreciation** (upfront appreciation of the trade-weighted SGD).

- Intra-band Limitation: Second, even if the MAS reassesses that a step depreciation is unnecessary, a **rich S$NEER** at the strong end of the S$NEER bands leaves **less scope for outperformance**.

- S$NEER Slope Reduction: More so, ***if the MAS reduces the S$NEER slope***, which is turn could **rein in the S$NEER** as the policy appreciation trajectory of the trade-weighted $NEER is accordingly trimmed.

- Binding Basket: More so, if larger-than-expected downside risk via key trade-basket components such as the CNY or EUR play out. Point being, given enlarged geo-political risks to China, and Europe, some residual S$NEER drag on the SGD is a factor to watch for.

- Impeded Wealth Inflows: What's more, the **unusually enlarged financial inflows**, notably from China, into Singapore's wealth hub **could moderate/normalize**. And with the risk of a **more distinct near-term pullback** amid tightening of China outflows in the context of geo-economic and CNY stability risks. In turn, the additional support for SGD could erode, facilitating a controlled correction.

- SGD Outlook: On the whole, we expect that the MAS hold in October will help to prop up the S$NEER for now, with downside in SGD stemming more from USD strength and downside CNY risks near-term. But into H1 2025, with step depreciation policy move a district likelihood, a 50-80bp downside adjustment (to scale in excessive out-performance) in the S$NEER corresponding reflected in the SGD must be considered.

Rates

- Central Bank: Whilst the MAS held steady (in Oct) citing appropriate stance amid a balance of risks, the sense is that **risks to growth are tilting to the downside** as inflation recede durably. Policy easing is as such a matter of time, especially as the current setting (level of S$NEER) is deemed to be too restrictive.

- Price-Taker: Strictly speaking, **MAS easing ought not to have direct impact on rates** as the **MAS**, by virtue of its FX-based (S$NEER) monetary policy tool choice, **is a price taker of global (mostly US) rates**.

- Yields (following USTs Lower): As such, it is **expected that SG yields will go lower**, *if* we are right about *UST yields heading lower beyond the US election bump.*

- Curve: Moreover, **SGS yield curve is also set to steepen** in tandem with a steeper UST yield curve.

- Narrower Discount: The co-movement US rates notwithstanding, it is notable that the undershoot of (discount in) SGS yields vis-à-vis UST yields appears excessive. As such, it is likely to moderate. Not just due to reversion of trends, but also as the pace of wealth inflows normalize and policy easing turns USD/SGD forwards less negative. The latter being compensated by a move higher in SG rates.

Fig 7e. Price-Taker of Global Yields, Tracking USTs

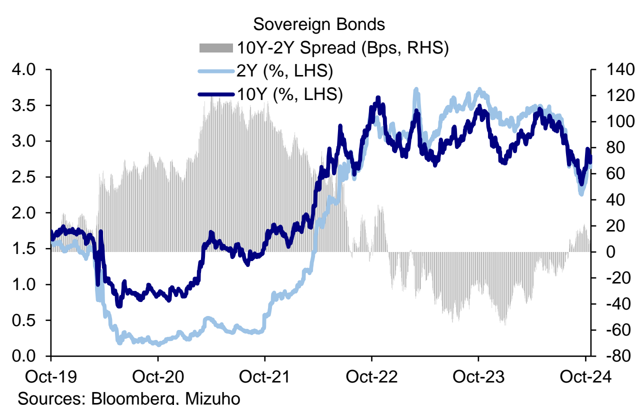
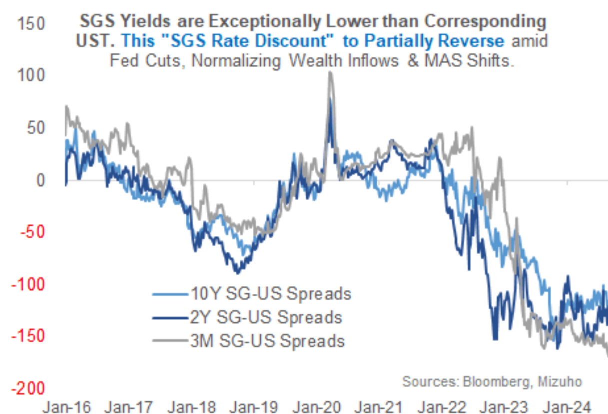


Figure 7d. But Excessive Discount Could Diminish



IDR: Rupiah Reigns

	Q3 2024	Q4 2024	Q1 2025	Q2 2025	Q3 2025	Q4 2025
Policy Rate (%)	6.00%	5.50%	5.00%	4.75%	4.75%	4.75%
USD/IDR	15070-16400	14980-16030	14710-15750	14790-15580	14180-15390	14330-15550
	15140	15400	15050	14980	14650	14800
GDP (% YoY)	4.9%	5.1%	5.0%	4.9%	5.2%	5.4%
CPI (% YoY)	2.0%	2.3%	3.1%	3.3%	3.2%	3.1%

Note: Values in black are historical whereas those in blue represent forecasts. * Point forecast is for end-period. Ranges are only indicative.

Fig 8a. Fed-induced IDR volatility

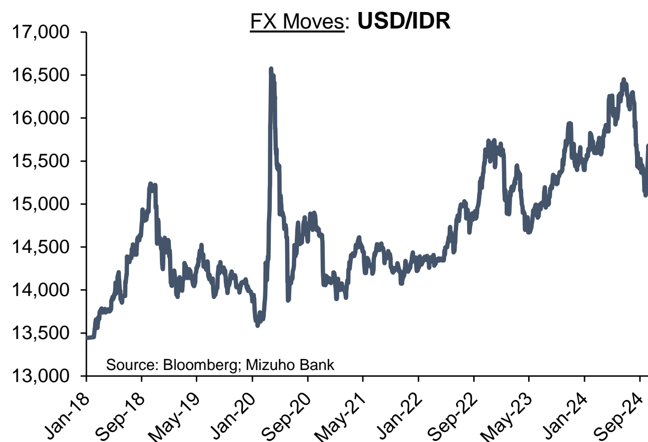
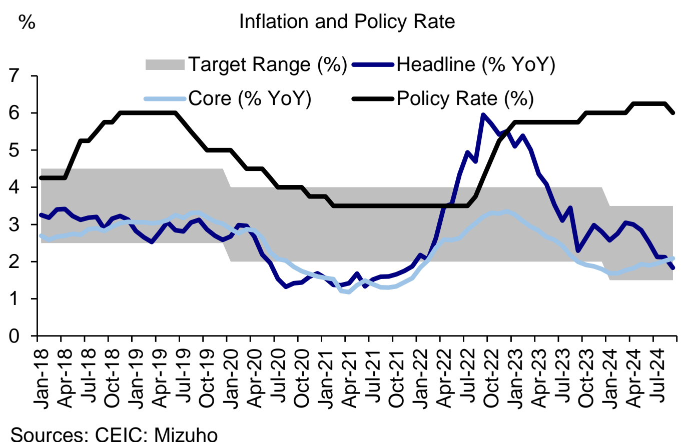
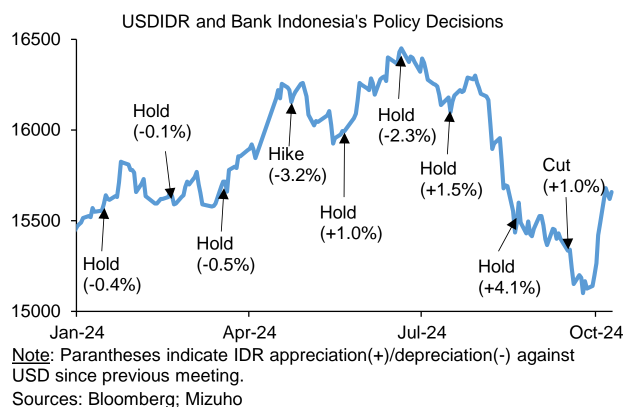


Fig 8b. Inflation has remained stable



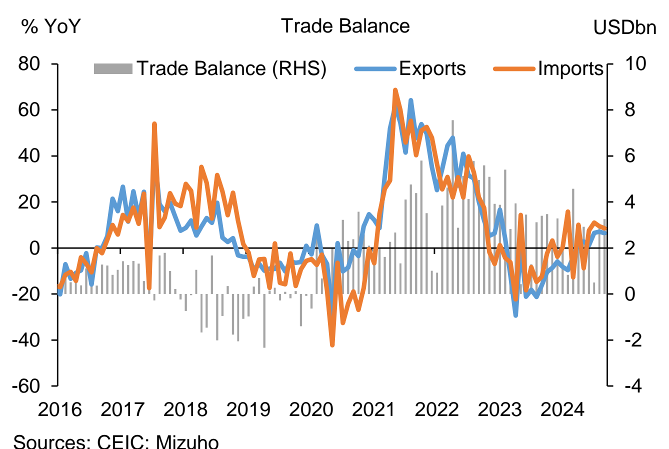
Sources: CEIC; Mizuho

Figure 8c. BI's concerned over rupiah stability



Note: Parantheses indicate IDR appreciation(+)/depreciation(-) against USD since previous meeting.
Sources: Bloomberg; Mizuho

Fig 8d. Smaller average trade surplus in recent months



Sources: CEIC: Mizuho

FX

- Fed-induced FX volatility: As a higher-beta currency, it is perhaps unsurprising that IDR has seen higher volatility amid the adjustments in Fed rate cut expectations since September. After appreciating about 2.1% against the greenback in September, IDR pared back its gains amid USD reversion as expectations of aggressive Fed rate cuts moderated. The IDR has weakened ~2.8% since end-September. Notwithstanding Fed-induced FX volatility, domestic factors (including fiscal undercurrents, growing twin deficit vulnerabilities and subdued growth upside relative to regional peers) play a part too.

- Fiscal overhang: Fiscal risks still present downside volatility risks as fears linger surrounding President Prabowo's comments earlier in the year on scrapping debt ceiling, even as the 2025 state budget draft (approved on 17 September) is targeted a fiscal deficit at 2.53%, which is below the 3% ceiling. Afterall, limited track record for the new President means that Prabowo would likely need to prove his commitment towards fiscal consolidation in action. Tellingly, IDR saw a mild ~0.2% rally after reports on 15 October that Finance Minister Indrawati (who is widely credited for consolidating Indonesia's fiscal balance) was asked to stay on in the new administration.

- Modest Growth Support: Growth remains supported and should be reflected in Q3 GDP print. Domestic consumption still appears healthy, with retail sales accelerating in the first two months of Q3, even if consumer sentiment edged slightly lower. Meanwhile, ongoing infrastructure push would support government spending and investments. But some risks on external front on smaller trade surplus in Q3.

- Stable Inflation: Inflation printed at 1.8% YoY for the month of September, the third consecutive print in the lower-half of BI's 2.5±1% target range. Inflation looks to remain stable for the rest of the year, but upside risks are present next year as Budget 2025 hinted at reduction in subsidies on fuel and electricity, in addition to possible demand-led inflation on greater infrastructure spending.

- Widening Current Account Deficit: Risks are tilted towards a wider current account deficit in Q3 from Q2 (-0.9% of GDP) on smaller trade surplus in Q3 and limited upside to commodity prices; services deficit may remain wide as outbound tourism spending has been growing at faster pace than incoming tourism receipts for the past two quarters.

- Supportive Financial Flows: Flows have been supportive, in particular equity flows. YTD equity flows (as at end-Sep) stand at USD3.2bn, in contrast to an outflow of USD309mn for the same period last year, while YTD bond inflows (USD2.7bn) falls short of last year's flows (at USD3.9b).

- IDR Outlook: Heightened volatility continued to be expected given IDR's higher beta to broad USD moves. But appreciating bias for IDR should still be retained insofar as "risk-off" is not sparked off, as the scope for cuts by the Fed is arguably larger than BI. Notably, current under-pricing of a cut at FOMC meeting could mean that IDR could be better supported in November. A breach of 16,000 (provided the Fed indeed cut rates) appears unlikely.

Rates

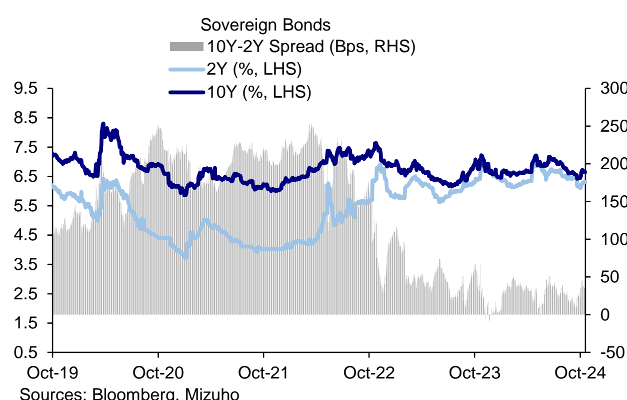
- Staggered Easing: After kicking off the easing cycle with a 25bps cut in August, BI stood pat in September, citing rupiah stability concerns. The decision was in-line our expectations, as we had previously argued that BI's easing cycle would likely be staggered – i.e. cutting during episodes of IDR strength and pause on IDR-volatility. Growth ought to afford space for such an approach, while inflation remains managed. For November meeting, there remains a case for BI to cut should IDR pare back October losses.

- Risks to Slower Easing: Risks are tilted towards Bank Indonesia easing slower than expected amid USD volatility, especially with US elections (and attendant USD volatility) in the coming months.

- Yields: 2Y yields have edged down to ~6.3% from ~6.4% before the September cut, while 10Y yields have moved higher from 6.5% in September to ~6.7%.

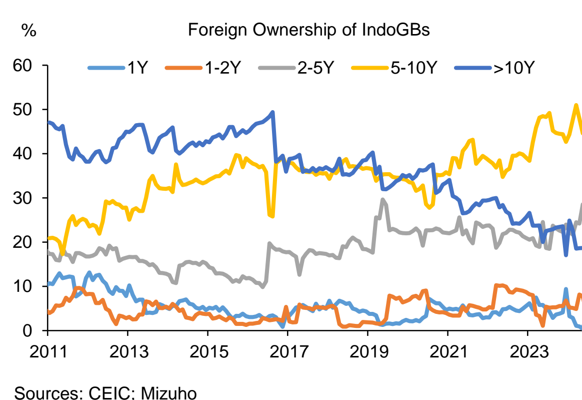
- Curve: Steepening bias to curve, as supply on longer end looks to be ample based on upcoming auction schedule, and as fiscal programmes likely necessitate more long-term borrowings.

Fig 8e. Yields lower following BI's Aug cut



Sources: Bloomberg, Mizuho

Fig 8f. Lower holdings of long-end IndoGBs



Sources: CEIC; Mizuho

MYR: Stability Anchor

	Q3 2024	Q4 2024	Q1 2025	Q2 2025	Q3 2025	Q4 2025
Policy Rate (%)	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
USD/MYR	4.09 – 4.72	4.09 – 4.45	3.91 – 4.28	3.85 – 4.25	3.78 – 4.07	3.84 – 4.09
	4.12	4.24	4.08	4.02	3.94	3.97
GDP (% YoY)	5.3% (A)	4.4%	5.6%	4.3%	4.5%	5.4%
CPI (% YoY)	2.0%	2.1%	2.0%	1.9%	2.1%	2.1%

Note: Values in black are historical whereas those in blue represent forecasts. * Point forecast is for end-period. Ranges are only indicative.

Fig 9a. MYR's still a regional outperformer

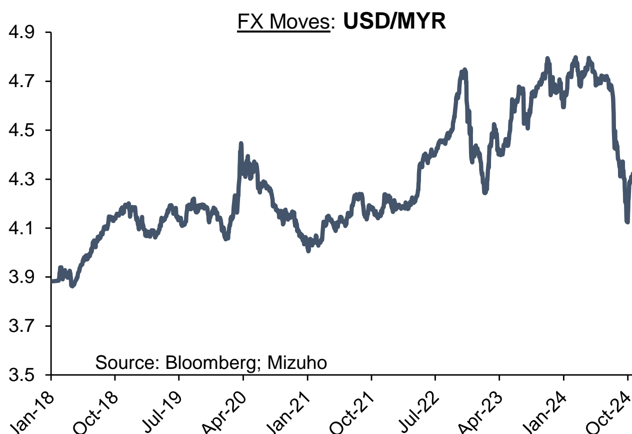


Fig 9b. Inflation remains stable

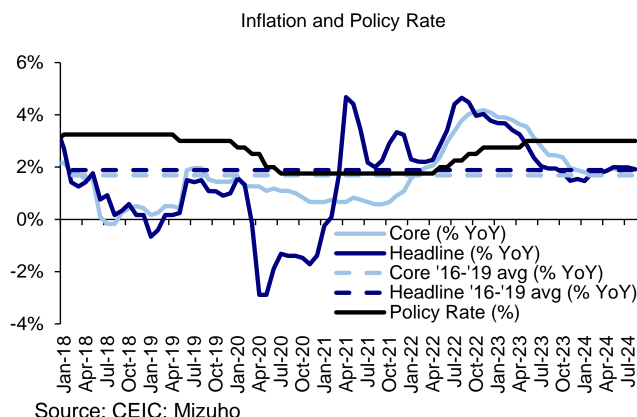
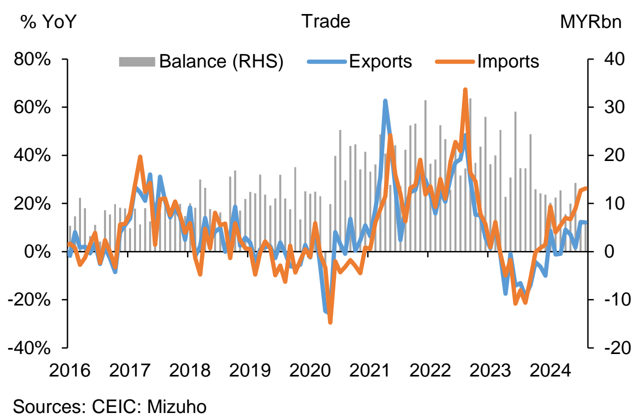
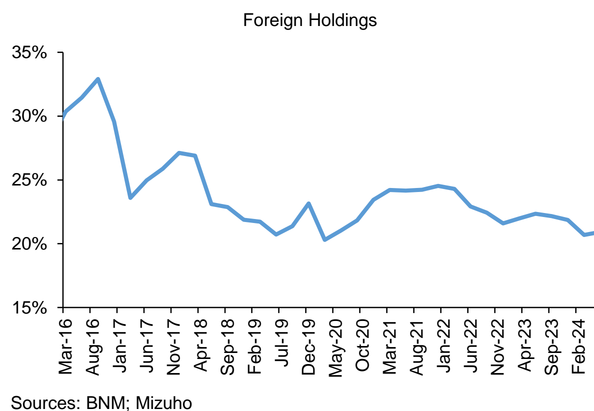


Fig 9c. Trade Balance Remains Supportive



Sources: CEIC: Mizuho

Fig 9d. Foreign holdings stable but lower compared to 2016-2019



FX

- FX Outperformer: Notwithstanding the recent sell-off, MYR remains an outperformer relative to regional peers amid robust growth, managed inflation and BNM anchoring stability with a prolonged hold.

- Fiscal direction is encouraging, but may miss target: Some risks of fiscal slippages in achieving 4.3% fiscal deficit this year as YTD revenues are 1.6% lower YoY lower despite successful roll out of services tax increase in Q1'24 and higher median wages for YA2023, while expenditures are 1.9% higher despite implementation of diesel subsidy rationalisation. Budget 2025 continues to demonstrate commitment on fiscal consolidation by targeting a fiscal deficit of 3.8%, but risks of missing revenue target as personnel income tax likely underperform median wage growth on distribution effects. Notwithstanding this, slippage is not expected to be outsized given scope expansion for sales and services tax and likely higher corporate tax revenue amid surging KLCI YTD.

- Resilient Growth: Q3's Advance GDP print affirmed the resiliency of Malaysia's manufacturing, services and construction sector, as the country remains well-positioned to benefit from manufacturing tailwinds, supportive

household consumption and continued FDI inflows into the country amid fading political uncertainty. Cost-of-living measures targeted at the poor, labour market reforms (e.g. minimum wage increases, tax incentive to increase participation rate), continued infrastructure push revealed in Budget 2025 would continue to support growth.

- Stable Inflation, Notwithstanding Upside Risks: Inflation remains stable and hovering around historical averages, despite increases in services tax, and hikes in water tariffs earlier on in the year. Upside risks on the expansion of scope from sales and services tax (details await), RON95 subsidy rationalisation (which is scheduled to be rolled out in mid-2025) as well as pass-through to services from higher wages.

- Current Account: Q2 current account balance (0.6% of GDP) was pulled lower on higher primary income outflows and smaller goods surplus. Value of imports increasing faster compared to value of exports in the July and August could mean a further narrowing of current account surplus in Q3.

- Financial Flows: Net portfolio outflow in September, with net bond outflows of USD155bn offsetting the net equity inflow of USD110mn. Nonetheless, on a YTD basis, there was net equity inflow of USD806mn and net bonds inflows of USD2.6bn, in contrast to a net equity outflow of USD442mn and net bond inflows of USD3.4bn for the equivalent period in 2023.

- MYR Outlook: MYR still has a greater relative upside potential on reduced political risk premium, semiconductor upcycle, supportive household consumption, and positive developments on the fiscal front. Expect USD/MYR to be backstop at around 4.40 levels.

Rates

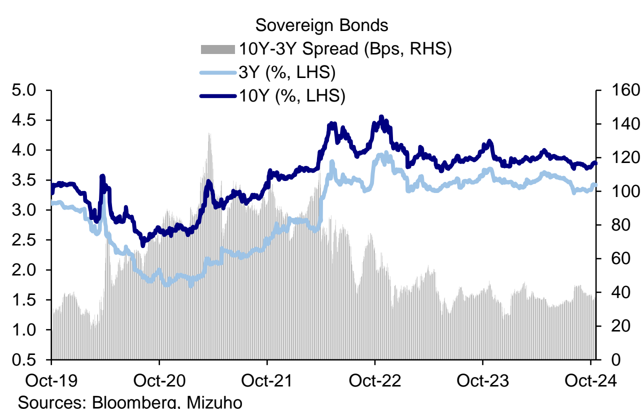
- BNM's Steady Hands: Prolonged hold amid supportive growth and managed inflation. Lower cumulative hikes (relative to Fed and regional peers) in this cycle should set a higher bar for cuts.

- Risks: Risks are tilted to a 25bps cut in late 2025 or even 2026 should domestic consumption shows signs of cracks and electronics cycle tailwinds fade. Notably, resilient domestic consumption is on the back of massive EPF withdrawals; and may not be that sustainable in the long-term. Moreover, after the stellar AI-led semiconductor surge, there could be moderation in quarters ahead.

- Stable Yields: Yields (3Y: ~3.4%; 10Y: ~3.7%) and term spreads (~37bps) have been rather stable and should remain so with BNM anchoring rates.

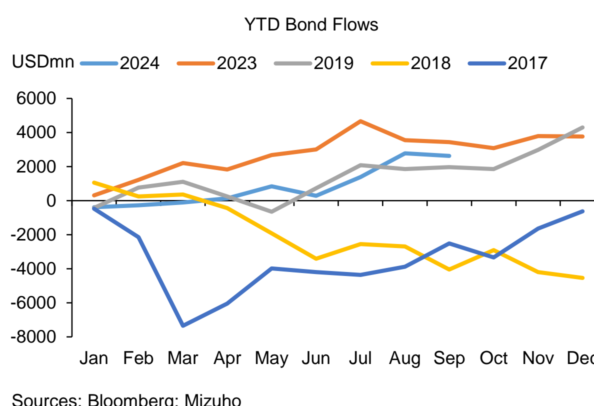
- Curve: Supply dynamics lend a steepening bias to the curve. In mitigating refinancing risk and narrowing pricing spread across maturities, issuance of short-term papers (<1Y) is expected to be reduced from 18.4% in 2023 to 11.2% of total gross borrowing in 2024; while composition of medium (3-7Y) and longer-term (10Y and above) instruments are estimated to increase to 37.9% and 50.9% respectively (prev: 37.3% and 44.3%).

Fig 9e. Yields stable amid BNM's continued hold



Sources: Bloomberg, Mizuho

Figure 9f. YTD Bond Flows Supportive



Sources: Bloomberg; Mizuho

PHP: Growth Risks

	Q3 2024	Q4 2024	Q1 2025	Q2 2025	Q3 2025	Q4 2025
Policy Rate (%)	6.25%	5.75%	5.25%	4.50%	4.25%	3.75%
USD/PHP	55.4 - 58.9	55.2 - 59.3	54.1 - 59.0	53.5 - 57.1	53.0 - 56.3	53.0 - 56.1
	56.0	57.0	56.2	55.0	54.2	54.8
GDP (% YoY)	6.1%	5.8%	5.7%	6.8%	5.6%	5.4%
CPI (% YoY)	3.2%	2.7%	2.9%	3.3%	3.2%	3.3%

Note: Values in black are historical whereas those in blue represent forecasts. * Point forecast is for end-period. Ranges are only indicative.

Fig 10a. PHP appreciation has been moderate

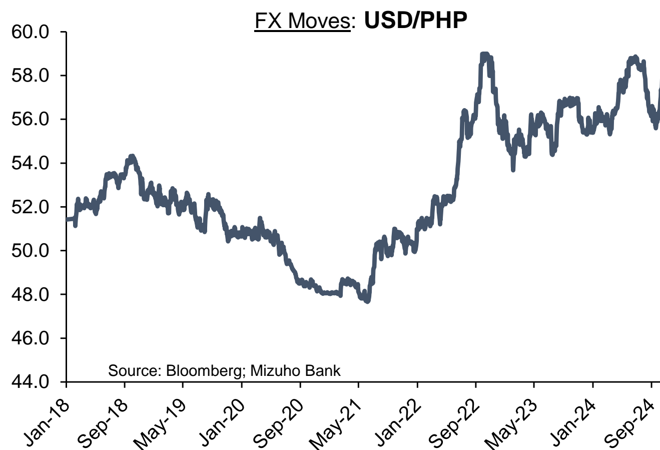
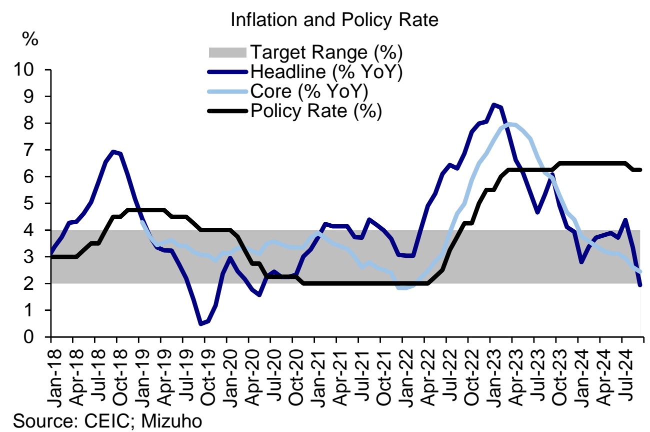
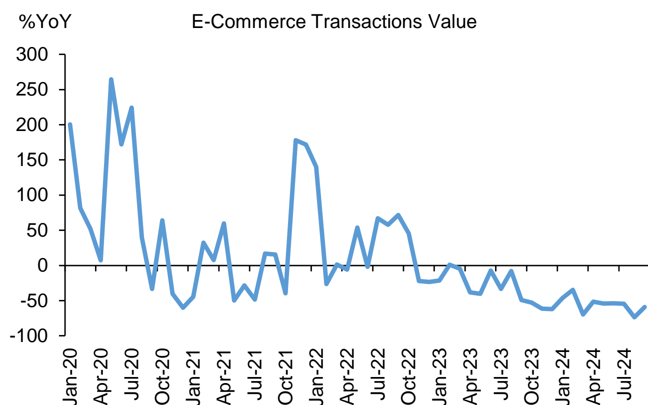


Fig 10b. Recent sharp moderation in inflation



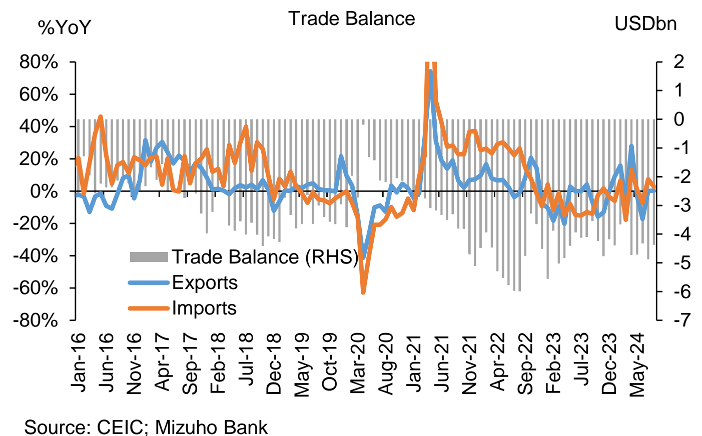
Source: CEIC; Mizuho

Fig 10c. Spending power appears weak



Sources: CEIC; Mizuho

Fig 10d. Exports in part offset by higher imports



Source: CEIC; Mizuho Bank

FX

- Soft on Dovish BSP: In September, PHP underperformed regional currencies, only appreciating about 0.2% against the greenback (regional average: ~1.7%). The underperformance could be attributed to BSP's dovish signalling with the cut in reserve requirement ratio, following the 25bps cut in August which kicked-off the easing cycle in the region and proceeded with a second cut in October. Continued dovish signalling, with dis-inflation progress providing room to ease has seen the PHP weakening about ~3.1% since end-September.

- Fiscal Risks Abound: Appears on track for 2024 towards a fiscal deficit target of 5.6% this year (2023: 6.2%). Revenues YTD (as at end-August) are 15.9% higher compared to a year ago while expenditures YTD are 11.3% higher. But fiscal risks accentuated on Budget 2025, which targets a fiscal deficit of 5.3% of GDP, as this estimate is derived from actual disbursement being lower than the budget. Full disbursement of budget could mean a fiscal deficit to the tune of 6%. The budget was approved by the lower house on 25 September, but is still pending approval from the upper house (likely by mid-December).

- Domestic Growth Risks: Domestic consumption remains a key risk to monitor and could potentially see another print of QoQ contraction in Q3 GDP release. Notably, e-commerce transaction value in Q3 was ~63%

lower compared to a year ago (Q2: -53% YoY) and only about ~50% 2019 levels for the same period. Nonetheless, external sector could be better supported on increased electronics exports and continued recovery in tourism.

- Inflation-in-check: Sharp moderation in September to 1.9%, undershooting BSP's 2-4% target band, on the back of moderation in food inflation. Unlikely return of tariffs on key food (e.g. rice) as BSP looks to ease should keep inflationary pressures in check.

- Current Account: Q3 current account deficit could narrow slightly from Q2 (-4.6% of GDP) on slightly better trade balances while remittances in July remained stable.

- Financial Flows: Philippines saw USD1.8bn bond outflows in August as BSP kicked-off its easing cycle, bringing YTD inflow to USD507mn**,** in contrast to USD2.5bn of inflows for the same period last year. Bond outflows could continue as BSP looks to ease further. Nonetheless, equity flows remain supported, seeing USD346m of inflows in Sep.

- PHP Outlook: Dovish inclinations by BSP would mean little room for outperformance for the PHP, especially amid "twin-deficit vulnerabilities" and mounting domestic growth risks. Could plausibly see breach of 59 handle.

Rates

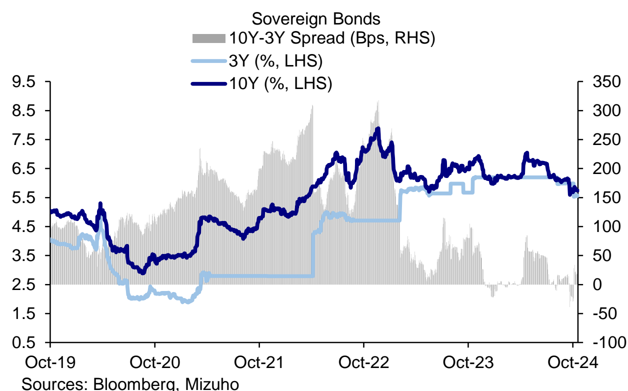
- Central Bank: BSP embarked on its second 25bps on 16 Oct. As we have argued, BSP looks set to cut at the fastest rate in the region as they have both the room and reason to cut. BSP has hiked rates by 425bps – the largest cumulative hikes among regional peers and policy rates at 6.00% remains much higher than 2016-2019 average nominal policy rate of 3.64%. Meanwhile, cracks in domestic consumption should mean an easing bias for BSP.

- Risks: Two-way risks on upside risks to inflation and faltering domestic consumption. In addition, volatile FX movements may come into the picture insofar as it could feed to inflation via the import channel.

- Yields: Yields have been trending lower since August cut, with 3Y and 10Y trading at ~5.6% and 5.8%, compared to 5.9% and 6.1% in August.

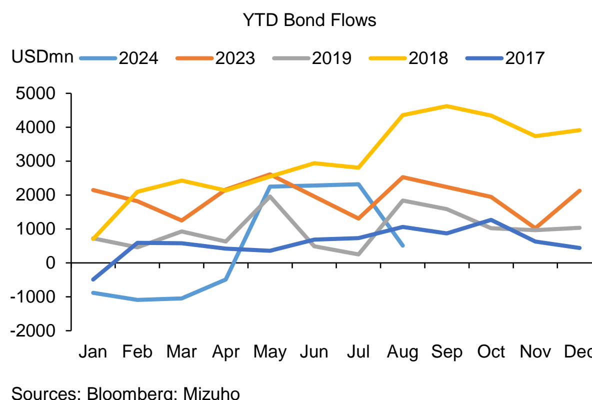
- Curve: BSP cuts should pull front-end yields lower to a greater extent than longer-end. In addition, much larger growth of long-term debt (>10Y) could lend a further steepening bias to the curve. Compared to 2023, issuances of >10Y Treasury bonds are 31.5% higher in 2024. This contrasts to 10% increase in the 2Y-5Y tenors and a decrease of 19.6% for the 5-10Y tenors. Belly of curve could be better supported (i.e. lower yields) on lower issuance amount.

Fig 10e. The term premium is compressed



Sources: Bloomberg, Mizuho

Figure 10f. Outflows in Aug following BSP's cut



Sources: Bloomberg; Mizuho

THB: Anchoring the Rocky Recovery

	Q3 2024	Q4 2024	Q1 2025	Q2 2025	Q3 2025	Q4 2025
Policy Rate (%)	2.50%	2.25%	2.00%	1.75%	1.75%	1.75%
USD/THB	33.2 - 35.9	30.9 - 34.6	31.8 - 34.8	32.1 - 34.3	31.2 - 33.4	31.2 - 33.4
	34.2	33.6	33.4	33.0	32.1	32.1
GDP (% YoY)	2.7%	4.0%	3.2%	2.8%	2.9%	2.0%
CPI (% YoY)	0.6%	1.4%	1.7%	1.6%	1.7%	1.5%

Note: Values in black are historical whereas those in blue represent forecasts. * Point forecast is for end-period. Ranges are only indicative.

Fig 11a. THB saw strong appreciation

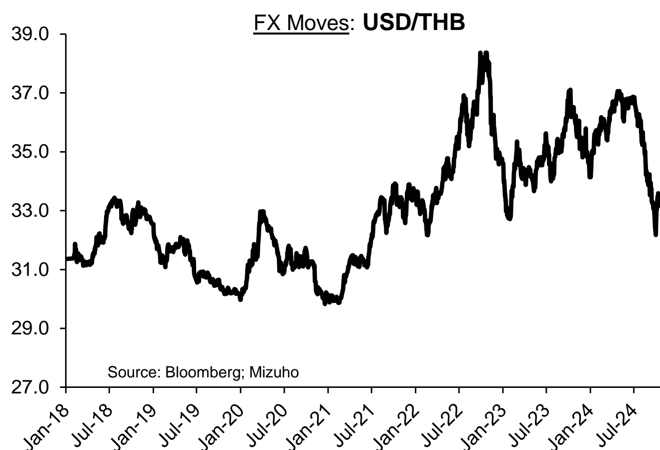


Fig 11b. BoT continued to keep rates on hold

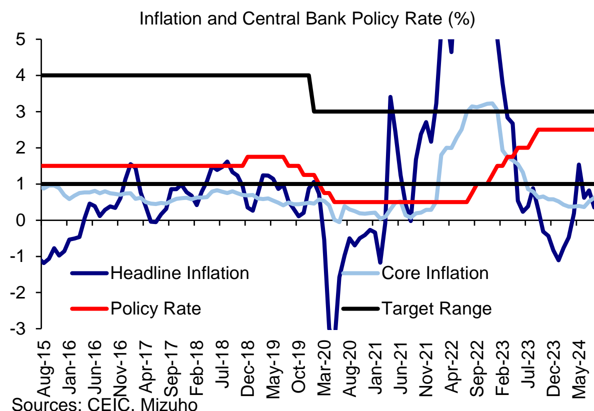
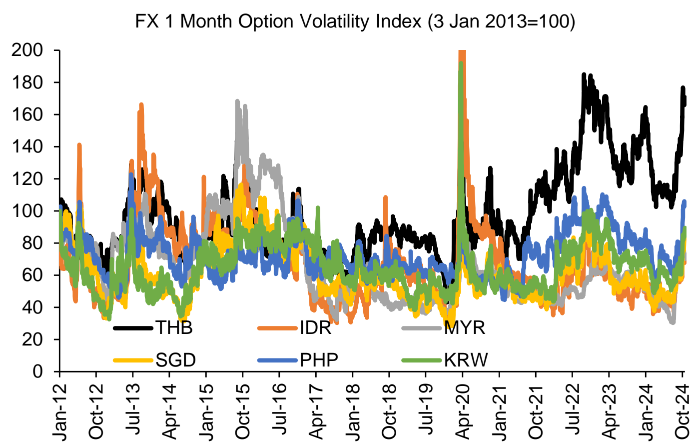
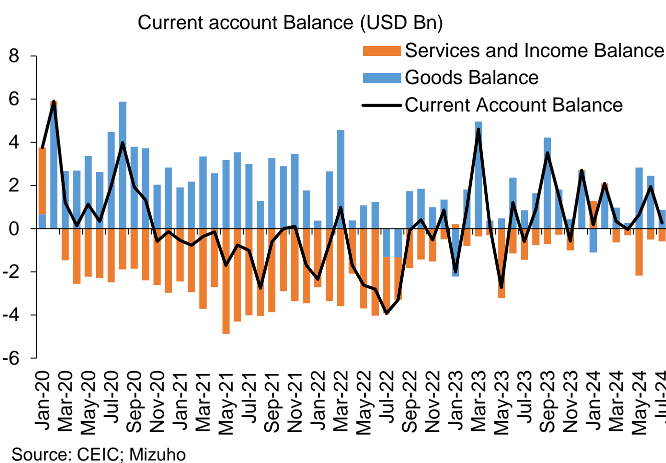


Fig 11c. High beta nature a threat to recent gains



Source: Bloomberg; Mizuho

Fig 11d. Current account surplus returns



Source: CEIC; Mizuho

FX

- Volatile Reversal to Outperform: THB has underperformed regional peers for much of 2024 but that has reversed in a swift manner in recent months, in part due to JPY and China spillovers. YTD, it has now outperformed most regional EM-Asia peers. Nonetheless, THB having the highest beta in the region also imply volatility is a key risk as volatility remains accentuated above its own historical trends and significantly above peers.

- Political Risk Premium Abates: New PM Paetongtarn represents a likely period of stability which has given impetuous for THB recovery. That said, fiscal woes are not entirely resolved.

- Fiscal Risk Premium Notable: Specifically, enlarged budget deficits were still approved even as tweaks to the country's digital wallet plan remains very much welcomed. That said, the digital wallet may be retained in the form of a phase 2 implementation in 2025 with exact details yet to be revealed. Consequently, a stealthy creep up in public debt ratio remain closely watched and may worry THB bulls.

- Uneven sluggish growth recovery: Growth is expected to pick up in Q4 on handout boosted consumption while the manufacturing sector continues a path of modest uneven recovery. Cyclical growth induced boost to THB prone to fade as structural weakness to persist.

- Inflation not a call for easing: Inflation is expected to rise up in a bumpy manner alongside various modification of diesel subsidies and Brent Crude price fluctuations. Underlying core inflation to stay near historical trends.

- Current Account Surplus Anchor Recovery: Thailand's current account balance is back to healthy surplus alongside strong arrivals recovery and higher occupancy and room rates. Tourism receipts remain a stable source of inflows which underpin the THB recovery.

- Financial flows a temporal positive: Strong foreign net inflows into equities and bonds in Q3 on expectations of Fed easing also served to boost the THB. These inflows may also have been aided by the government's efforts to boost local equity markets via the Vayupak Fund which is sold to both public and institutions with 10-year terms and include minimum return guarantee and cap on maximum gain rate.

- Outlook: On balance, **THB's relative near-term allure** is retained on comparatively more prolonged hold relative to ASEAN peers such as PHP and IDR though its marginal attraction is diminished by its heightened volatility especially for those seeking stability. Expected overall buoyancy above 33 level against the USD heading into the US elections and recent China and JPY tailwinds fade even though year end tourism seasonality may aid THB. Structural risks of fiscal deficit and rising public debt imply that THB bulls ought to remain cautious in the medium term.

Rates

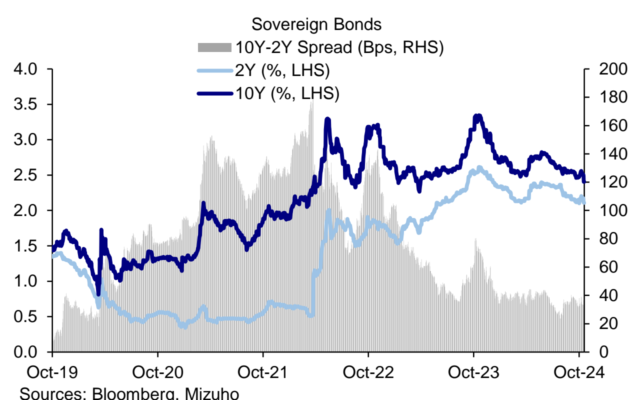
- Central Bank: After the recent 25bps cut on grounds of alleviating debt burden and slowing credit growth, we expect prospects of further **easing to only materialise in late Q1 2025 with a 25bp cut** on expectations of softer growth, worsening credit conditions and rising NPLs. That said, we expect **room for easing to remain limited** to 50bps considering risk of THB depreciate and the fact that the current stance being characterised as neutral. Late Q3 2025 is towards the end of Governor Sethaput's term and prospects of easing may rise materially as well as central bank independence may be tested.

- Risks: The near-term risk is earlier than expected easing. Some dovish inklings have begun to surface in their **last policy statement which flagged worries of tightening financial conditions** among SMEs and households and worsening credit quality which in turn feedback into real economic linkages and activity.

- Yields: In terms of government bond yields, 2Y yields appear to have stabilised above 2.1% in September after the steep declines in July and August driven by USTs. Going forward, amid inevitable differential to UST yield movement, we expect front end yields to remain elevated and relatively backstopped by the BoT's prolong policy hold.

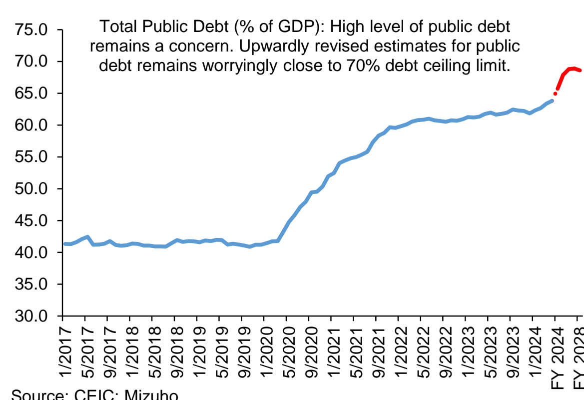
- Curve: The yield curve is very flat with the 10Y-2Y spread of government bonds at less than 40bps while the historical differential from 2015-19 stood at 84bps. Given **historically low spread** and the BoT's rate hold, a **further steepening of the yield curve is on the cards** especially as longer-term public debt ratio remains on course to rise.

Fig 11e. Short end yields anchored by BoT stance



Sources: Bloomberg, Mizuho

Figure 11f. Public debt remains on an upward trend



Source: CEIC; Mizuho

VND: Not Getting Carried Away

	Q3 2024	Q4 2024	Q1 2025	Q2 2025	Q3 2025	Q4 2025
Policy Rate (%)	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%
USD/VND	24540-25457	24700-25600	24700-25200	24200-24900	24100-24700	24200-24800
	24568	25100	24800	24470	24300	24400
GDP (% YoY)	7.4	6.9	5.2	5.3	6.1	6.3
CPI (% YoY)	3.5	3.0	2.8	3.3	3.5	3.6

Note: Values in black are historical whereas those in blue represent forecasts. * Point forecast is for end-period. Ranges are only indicative.

Fig 12a. VND depreciation seen in late Oct

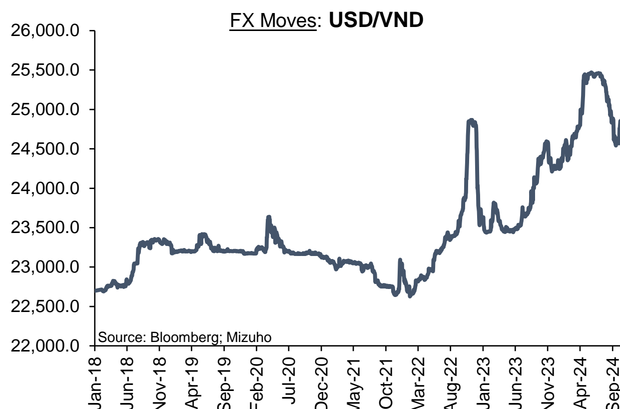
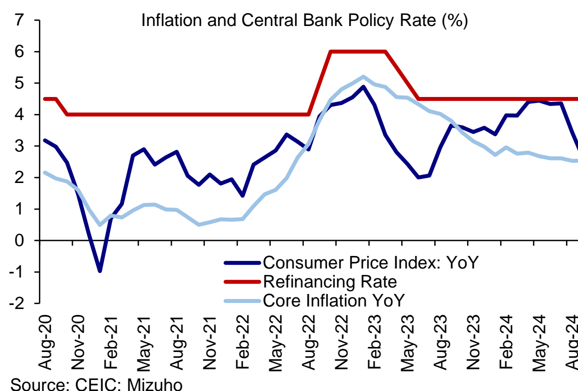
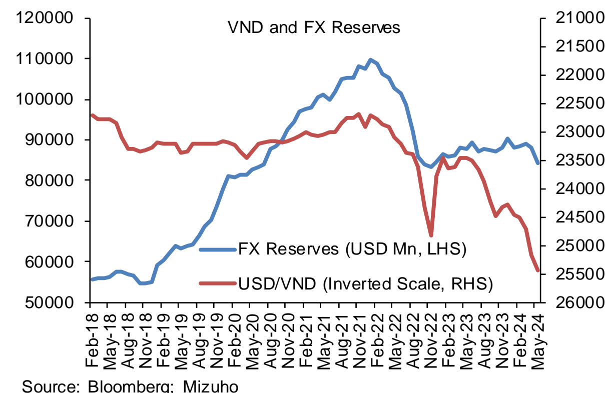


Fig 12b. SBV to continue to hold rates



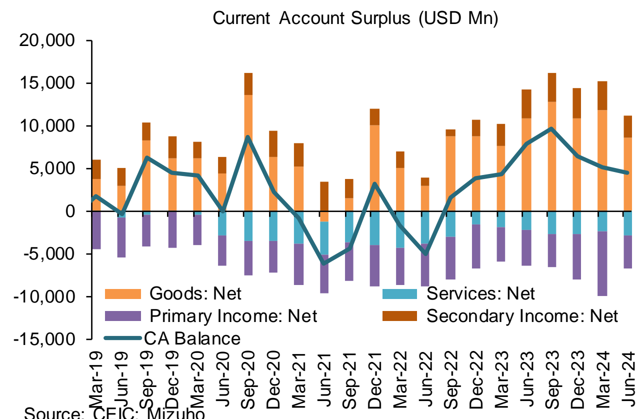
Source: CEIC; Mizuho

Fig 12c. FX reserves expended to defend VND



Source: Bloomberg; Mizuho

Fig 12d. Current account surplus returns



Source: CEIC; Mizuho

FX

- Desired Stability Becomes Sporadic: VND managed to endure through a period of sharp depreciation pressures in June as USD/VND tested the upper limits of the SBV's +/- 5% trading band. VND has made moderate gains in recent months amid a softer USD environment. That said, early October depreciation on US NFP outperformance is a reminder that FX stability is not to be taken for granted even if broader macro prospects remain firm.

- Political Risks Watched: Communist Party Chief To Lam has given up his presidency role in October to General Luong Cuong and this has been viewed as a positive sign of power sharing. On-going graft push which has seen the fall of many high-profile leaders to continue. Overall FDI orientation undisturbed though ensuing bureaucratic lags may dim FDI and associated VND allure.

- Slow Public Investment: Revenue collections (as a % of GDP) have proceeded at a pace similar to previous years though the faster pace of growth this year have led to higher collections. With expenditures being dragged by slow disbursement on development investments, budget surplus is higher for H1 2024.

- Stellar Growth Unable to Backstop VND: GDP growth has been excellent thus far with Q3 GDP at 7.4% YoY as both manufacturing and services sector saw strong growth with the manufacturing and services sector output expanding 11.4% and 7.5%YoY respectively. The **services growth was broad based** ranging from

wholesale, retail sales and motor vehicles to finance and banking services. On aggregate, 2024 GDP growth is now forecast to post around 7%.

- Dis-Inflation A Mere Statistical Relief: Lower petrol prices guided headline inflation lower alongside sharper decline in rice prices on relief from India's export restriction easing. Nonetheless, volatile global oil prices and lagged impact from supply destruction of agricultural sector from Typhoon Yagi coming through imply that headline dis-inflation ahead remain bumpy as most of the decline in Q4 is on favourable base effects.

- Current Account: H1 current account surplus stood at US$9.7bn as net goods surplus outweighed a wider services deficit and a growing primary income outflow (-US$11.6bn). The latter reflects the substantial FDI inflows into the country and these FDI invested operations remit profits back to their parent companies. The surplus position is likely to be retained for H2 2024 as well.

- Financial flows: Net foreign outflows from equities continued in Q3 although the magnitudes have moderated significantly with September's US$93m outflow much smaller than the US$582m of outflows in May.

- Outlook: The VND's path to recovery remains a moderate one with stability being the key focus of the authorities. Given substantial deterioration of FX reserves in May, the need for FX reserves accumulation is becoming more apparent especially amid volatile energy prices. Consequently, even in periods of weak USD environments, the VND is expected to lag regional peers. Similarly, in mild episode of USD strength, the SBV is likely to maintain FX stability to anchor confidence. Episode of outsized volatility on USD strength to be expected given low FX cover ratio. Near term buoyancy above 25000 to retained.

Rates

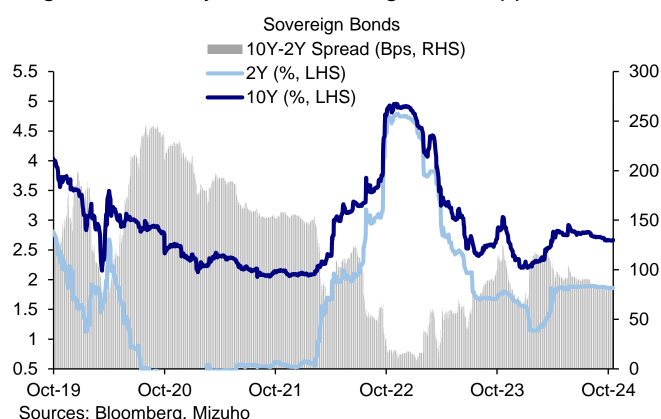
- Central Bank: We see an **extended hold at the current refinancing rate** as the SBV's policy rate is 50bps above its Covid lows indicating their continued support of growth amid real estate restructuring and corporate bond woes. There is little case for further easing given growth outturns thus far and the trade-off on VND stability. Yet, the fragility of property and banking sector amid elevated NPLs restrains the SBV from hiking to bolster the VND.

- Risks: A **smaller FX reserve buffer while not alarming remains at risk of dwindling further** should they be utilised in another episode of VND depreciation should UST yields surge and the Fed keep rates too high for too long. In turn, a forced hike is not entirely off the table, even if remote.

- Yields: The temptation is to call for higher front end yields relative to historical norms, though ongoing banking and property woes severely restrict the near-term increase in 1-year yields.

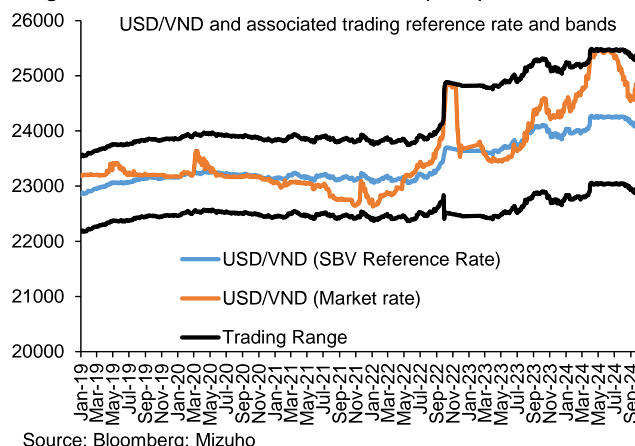
- Curve: The call is for further steepening led by higher long end yields as these 10Y yields hovering around 2.6% remain extremely low for their current stage of economic development. The low rate support growth but exacerbate concerns of resources being allocated to low productivity sectors.

Fig 12e. Lower yields need for growth support



Sources: Bloomberg, Mizuho

Figure12f. VND vulnerable to sharp depreciation



Source: Bloomberg; Mizuho

AUD: Asynchronous

	Q3 2024	Q4 2024	Q1 2025	Q2 2025	Q3 2025	Q4 2025
Policy Rate (%)	4.35%	4.35%	4.35%	4.10%	3.85%	3.60%
USD/AUD	0.635-0.694	0.657-0.703	0.656-0.698	0.652-0.72	0.671-0.719	0.676-0.721
	0.691	0.664	0.673	0.686	0.706	0.701
GDP (% YoY)	0.9	0.9	0.9	0.9	1.3	1.3
CPI (% YoY)	2.8	3.0	2.8	2.4	3.0	2.7

Note: Values in black are historical whereas those in blue represent forecasts. * Point forecast is for end-period. Ranges are only indicative.

Fig 13a. AUD rally faded even as RBA stood pat

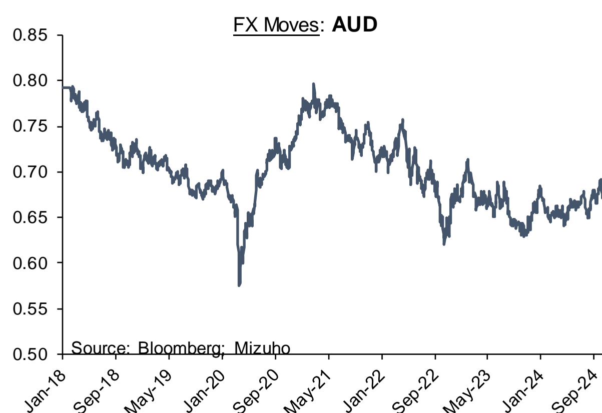


Fig 13b. RBA's less restrictive rate hike prolong hold

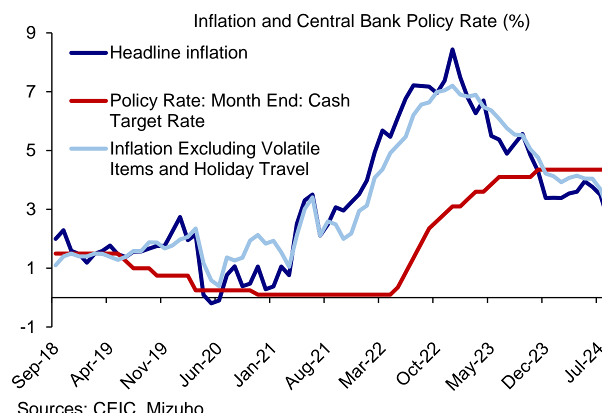


Fig 13c. Trade with China recovered

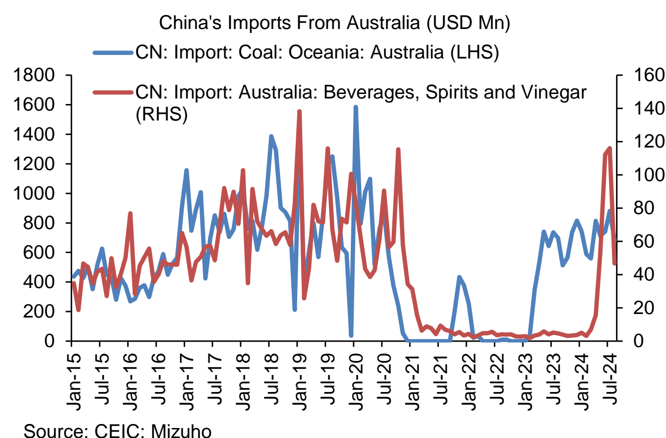
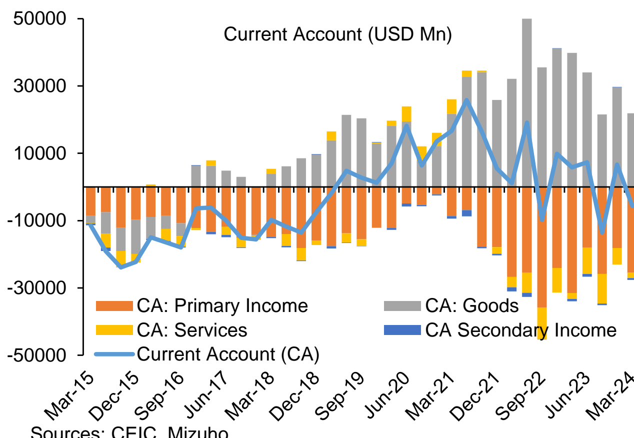


Fig 13d. Current account sank into deficit



FX

- Fading Rallies, Firming Backstop: AUD has seen a volatile ride above 69 cents before plunging back towards 67 cents. This underscores the point that RBA's rate hold remains subservient to wider swings of UST yields as markets grapple with the trajectory of Fed rate cuts. That said, RBA's prolonged hold may allow for firmer consolidation of the AUD though rallies have to await on more signs of real economic boost in China from recent stimulus announcements, though a looser fiscal path domestically and weaker external accounts also may prove to be impediments.

- Smaller political risk premium: A thawing of trade relations with China as reflected by Chinese Premier Li's visit in June has boosted industries such as coal, iron ore and wine.

- Expansionary fiscal stance to restrain AUD: After two consecutive years of surplus, **2024-25 budget is estimated to be expansionary**, incurring a deficit amounting to 1% of GDP. Spending growth will outstrip revenue on the back of tax cuts and a ramp up on spending on measures such as cost of living measures, Future Made in Australia program alongside green technology related incentives. In turn, the lack of fiscal consolidation may impede AUD recovery.

- Weaker growth cedes doubt into RBA hold: Private consumption growth remains tepid, with its contributions to GDP growth softening. In turn, government consumption has been the main driver while net exports provide occasional support as commodity demand weaken. The below trend growth is expected to persist as household savings ratio is still significantly below pre-Covid levels.

- Though Inflation necessitates elevated rates: Inflation's dip into target range is a construct of electricity rebate. Headline dis-inflation remains slow as rental inflation remains sticky. Limits to immigration (effective in 2025) is unlikely to cause rentals to decline but serves to restrain rental inflation amid subdued building approvals.

- Current Account's Tentative Recovery Prospects: Current account surplus slipped into a deficit position in H1 as falling goods offset a drop in services deficit. The services deficit narrowing is no real comfort given that it is significantly larger than pre-Covid levels as higher freight costs and residents' travel sending abroad weighed. Recent recovery in iron ore remain tentative and hinges on China's property sector.

- Outlook: AUD recovery remains highly bumpy and clouded. External demand may recover on global policy easing though a sustained China recovery may be subject to fit and starts and as such a **durable** lift above 67 cents may only prevail in Q1. Aside from the volatile Fed trajectory, the RBA's policy stance will be repeatedly questioned on both ends as they repeat not ruling anything in or out. Nonetheless, near term RBA tendency to hold imply relative allure against those who may be looking to ease such as PHP, INR and the IDR. That said, with markets pricing in only about a 5% chance of a rate cut in Q4, the risk remains on the downside for AUD should the job market wobble and the bar to hike is a high one given its lack of discussion at the latest RBA meeting.

Rates

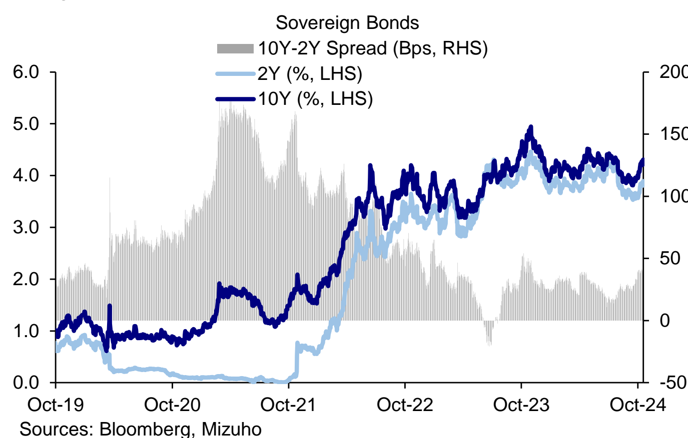
- Central Bank: The RBA is likely only to ease in mid-2025 to allow for further disinflation progress. The question for the RBA's base case is the treatment of various cost of living measures such as the statistical jump up of headline inflation in 2025 on expiry of measures such as the electricity rebates. It is not clear if a further calibrated form of these measures will be retained and persist for the next few years which then argues for only a partial exclusion of these rebates within the policy calculus. Furthermore, sight of prolonged economic weakness even without a downturn may become increasingly uncomfortable for the RBA.

- Risks: Given dire productivity growth performance in the past and sticky services inflation, stagflation remains a key risk for the RBA which entrenches their rate hold.

- Yields: Consequently, shorter end rates are likely to **remain elevated** with buoyancy sustained above 3.5% into the end of the year for 3Y ACGBs.

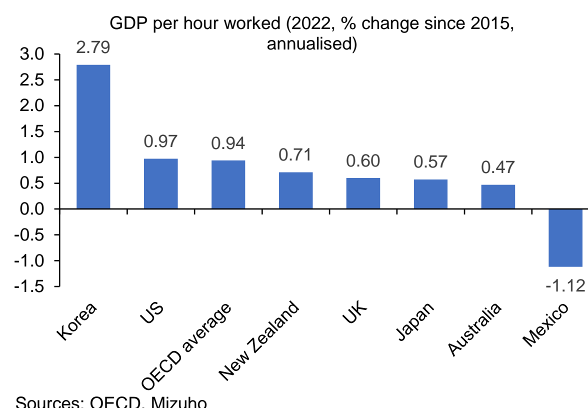
- Curve: In the near term, **there is room for some modest flattening before steepening on rate cuts**. Longer end yields may be subject to downward pressure as continued below trend growth impart worries of lower long run potential growth. That said, steepening of the curve still expected on rate cuts in 2025 on the front end while the longer end yield buoyed by sight of rising gross debt.

Fig 13e. Yields remain elevated



Sources: Bloomberg, Mizuho

Figure 13f. Lagged productivity growth



Sources: OECD, Mizuho

Global FX Assumptions: A Bumpy Ride with a Boisterous USD to a "Soft Landing"

	Q3 2024	Q4 2024	Q1 2025	Q2 2025	Q3 2025	Q4 2025
DXY	100.8	103.8	103.6	101.2	98.8	98.5
	100.2-106.1	99.5-106.5	99.2-105.5	98.2-104.5	97.8-102.5	96.0-100.5
Brent Crude (US$/brrl)	71.8	73.5	68.5	64.5	61.5	63.5
	68.6-88.0	68.5-82.5	63.5-78.8	60.5-72.5	57.5-69.6	58.5-70.5
Fed	4.75%-5.00%	4.25-4.50%	3.50-3.75%	3.00-3.25%	2.50-2.75%	2.25-2.50%
ECB	3.50%	3.00%	2.00%	2.00%	2.00%	2.00%
BoJ	0.25%	0.25%	0.35%	0.35%	0.35%	0.50%

The USD Backdrop

1) USD Set for a Soft Landing: As probabilities go, it is more likely that the **USD** (not necessarily the US economy) **will *eventually* have a soft-landing** (into mid-/late-2025). Which is to say, the **Greenback will capitulate, but not crash**. Notably, as relative US exceptionalism underscoring Fed cuts matched by other Major central banks, suggests that the USD is poised for ***more of a cushioned decline*** on more complex "USD Smile" dynamics ***rather than an uncontrolled downward spiral*** (in coming months) tied to Fed rate cuts/expectations. Crucially, the **depth of decline is likely to be far more limited**, stopping well *short of a "full reversion" to pre-Fed normalization low-/sub-90 DXY index levels.*

2) But on a Bumpy Path: And even then, the **path to a softer USD** may be **exceptionally bumpy** *with bullish detours likely into early-2025.* For one, it is **not a linear path to ubiquitously softer US data**. So, episodes of data out-run/upside surprise could easily invoke patches of USD rebound. Crucially, **US elections** and the **accompanying geo-political risks** may also be biased to a stronger USD. At least until the dust settles. Finally, initial, and sufficiently **acute US recessions risk could also ironically trigger USD strength** *via haven demand channels* (before USD soften on rate cuts and bottoming).

3) Elections & Affectations (of Strong USD): The **US elections** are **too close to call**. But the **uncertainty** itself may entail **heightened binary risks**. And the **tendency is for US election uncertainty to perversely underpin the USD**. To be sure, there is no clear directional correlation between US Presidential elections and the Greenback. But **global misgivings about the USD** will probably **compel the in-coming President** (regardless of Party and policies) **to (re-)assert commitment to a "strong USD" policy** on. And **Trump's chest-thumping about a "strong USD"** in the event of his second Presidency **speaks to that**. And so, inclination for bouts of USD strength into (and around) the elections is arguably reinforced.

Box 2 - Trump 2.0 Risk:

To be clear, US elections are too close to call once the margin of error is accounted for. Polls remain woefully unreliable and voter turnout is critical. Notably, Trump 2.0 is a distinct risk.

The economic (US exceptionalism) and geo-political (US antagonism) of Trump 2.0 could, at least temporarily, invoke Trum 1.0 type of market dynamics comprising USD strength corresponding to sharply higher long-end yields. What's worth noting is that despite the binary risk, a Harris victory should not be erroneously conflated with diametrically opposed outcomes (of soft USD and sharply lower yields).

At the very least, it is important to note that neither Republican nor Democrat outcomes will absolve a dire fiscal trajectory associated with a distinct steepening bias, if not outright (momentary) jump in long-end yields.

4) "USD Smile" Decline: But talk (even from a President), however, is cheap. And **mere verbal support does not translate into enduring (USD) elevation**. Instead, the **Fed's direction of policy travel** (down in rates) **corresponds to a gently softer USD tracing the path down the "USD Smile"**. Heading into mid-/late-2025. Specifically, with **diminished recession risks coinciding with lower rates**. And conditional on heightened

geopolitical risks dissipating. In addition, better prospects of global demand recovery into 2025 could also help with a softer USD juxtaposed against "risk on".

5) Atypical Fed Cycle USD: But that said, the depth of USD decline ought to be tempered. For one, it is remarkable, as it is pertinent, that the **USD's trajectory is atypical(ly resilient) for late-cycle Fed pivot**. This extraordinary resilience could in fact reveal a higher USD equilibrium into the rate cut cycle.

6) Less Compelling Fiat Alternatives: Not the least because the **fiat alternatives to the Greenback are structurally less compelling** *compared to previous cycles.* This partly explains exceptional support in Gold (that has defied elevated real rates), cryptocurrencies and other real assets. The upshot though is that in relative fiat terms, the Greenback could appear stronger relative to the past through Fed cuts. More so, as geo-politics tilts the scale to the advantage of the Greenback.

7) No Real Divergence: What's more, ***in real rate terms*****, enduring and profound policy divergence**, *corresponding with a sharp and sustained USD drop,* is unlikely. Point being, the US is unlikely to go it alone with large and fast rate cuts, checking nominal divergence. And US dis-inflation is not particularly vulnerable to falling significantly short. Especially given superior domestic buffer to energy shocks (from geo-politics) in Europe and Japan. Again, this checks the extent of USD pullback.

8) Geopolitics & the "Heads I Win, Tails You Lose" Syndrome: Crucially, **interim risks of bullish USD outbursts** could be **triggered by geo-political flares**. These are tilted in favour of USD, and *across a spectrum of outcomes* at that.
    a. **Military conflict**: Point being, an escalation of conflict could lift USD on haven demand and US war industry advantage on one hand. But on the other, a de-escalation, on US terms that transfers remnant conflict risks to Europe, will also undermine EUR (by default underpinning USD).
    b. **Trade Antagonism**: On the trade front too, direct assaults on Chinese exports carry significant risks of collateral damage to EUR (via supply chains/demand) and MXN (investments) over and above more direct hit on CNH and AXJ (via deep trade, investment and financial channels).

Fed: We expect the Fed to temper the pace of cuts for the rest of 2024 (to 25bp each in Nov and Dec), after the outsized 50bp cut in September argues for moderation as data come out mixed. But with increasing strains on household/consumer cash-flows conspiring with further deterioration in the job market, the Fed is inclined to hasten to cut. Hence, a sharper rate cut trajectory in H1 to add up to a cumulative 8-10 cuts by mid-2025 is our base case. This is however likely to underpin a deeper global rate cut cycle, and not overshoot it.

ECB: With a higher degree of economic uncertainty and geo-political exposures, the ECB needs to be more watchful of fragile confidence. As such we expect that the ECB will have to engage in deeper cuts heading into 2025 as economic weakness and vulnerabilities are exacerbated by the threat of trade conflicts.

BoJ: The BoJ is probably committed to setting course for rates to go towards 1.00%. But over a much longer horizon and highly conditional on economic strengths materializing. This includes sustained wage gains. But with a faster pace of Fed rate cut cycle, the BoJ will be hemmed in by the threat of adverse income/balance sheet impact from sudden and sharp appreciation. This is why further BoJ hikes are contingent on USD/JPY stability and Nikkei buoyancy. Neither of which is solid enough to inspire confidence.

Oil – Bearish Inclinations Despite Geo-political Incitement Risks: Whilst the risk of geo-political flares to Oil prices remain, these are likely to be temporary blips (that are addressed by supply response from elsewhere) that will not overwhelm a softening trend. On the whole, we expect that global crude prices will ease back to $62-70 into 2025 as demand softens amid (lagged) policy and trade uncertainties.

What's more, Saudi's notable shift from price support (presumably posturing for $80-100 barrel) to market share, further aligns supply dynamics with subdued oil prices. OPEC is expected to ease curbs and if Saudi relaxes further to roll back its "voluntary cuts" (to output) Oil prices may drift even lower. Admittedly, "live" threat of disrupted Iranian production cannot be ignored. But this is more of a temporary ~$10-15/barrel shock than it is a sustained surge to $100. Especially as OPEC spare capacity elsewhere is on hand to offset the Iranian disruption. Barring a blockade of the Straits of Hormuz, which may take Brent past $120, we expect Brent to ease back below $70 as supply-demand imbalances further ease amid more tentative demand conditions.

Rates: Softer, But Steeper

Lower Rates: The big picture view is for **global rates to go considerably lower**, and ***fairly rapidly*** as **global policy makers catch-down** in an effort to avert worse case outcomes from the lagged effects of tightening.

Global Rate Cuts to Gather Pace: Fragile underlying demand conditions alongside lingering geo-political risks make the case for more emphatic rate cuts. The US Fed will set the stage for global rates to decline.

Steeper Curve: But **lower rates** will also be **accompanied by a steeper yield curve**. With yield curve inversion shrugged off in Q3, the 10-2Y spread for the *UST curve may be set to widen to 50-100bp* into 2025 on a confluence of factors.

Fed Cycle: The first is that restoration of term premium and a "normal" upward sloping yield curve is expected in a Fed cut cycle. This as the policy sensitive 2Y yields fall more than the long-end.
Elections: What's more the alignment of US elections, entailing *fiscal risks and/trade tensions,* also feeds into the narrative of a steeper yield curve.

Geo-politics: Finally geo-politics in all its glory, with greater upside inflation risks from de-globalization, associated security costs, unwelcome "conflict deficits" and USD debasement risks, have the propensity to feature as structural term premium.

Wider (Risk) Premium: ***Associated with a steeper UST yield curve*** and Fed rate cuts is a **wider risk premium**. This, as the allure of "all-in" returns is challenged by risk-adjusted re-pricing. Pressures from fiscal deficits and trade disruptions only exacerbate these dynamics.

Macro Research, Asia ex-Japan

Vishnu Varathan
Managing Director, Head of Macro Research
Vishnu.varathan@sg.mizuho-sc.com

Tan Boon Heng
Vice President, Macro Strategist
boonheng.tan@sg.mizuho-sc.com

Serena Zhou
Director, Senior China Economist
serena.zhou@hk.mizuho-sc.com

Tan Jing Yi
Associate, Macro Strategist
jingyi.tan@sg.mizuho-sc.com

Ken Cheung
Director, FX Strategy
Ken.Cheung@hk.mizuho-sc.com

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