Asia FI & FX Strategy Watch

Double Trouble- Tariffs to weigh on Asia FX

Retaliatory tariffs add pressure to Asia FX

The much-anticipated Liberation Day of announced tariff policies by the Trump administration is worse than our expected baseline for Asia – See note: Global Watch: Let's get ready to rumble 31 March 2025. China would see its topline tariff on its exports to the US rise to 54%, following the announcement of a supplementary 34% reciprocal tariff.

Asian countries are especially targeted because of their high trade balance surpluses with the United States. Of the 56 countries listed for reciprocal tariffs, 20 are in the Asia/Oceania geography – see Exhibit 1. Additionally, Singapore is listed for 10% universal tariffs along with Türkiye, the UK and Chile. A simple average of the proposed tariffs on Asia shows 33%, which underestimates a higher GDP adjusted calculation for China.

The bottom line is that this would weigh on Asian currencies more than their EM peers. This is also very evident on the EUR/Asia FX crosses, given the EU's 20% tariff baseline was closer to market expectations than for Asia.

Where from here? Watching USD/CNY & central banks

The next natural focus will be on potential retaliation, especially from China. The previous pattern of behavior suggests China may announce its counter measures on April 9th, when the US Liberation Day tariffs come into effect.

More immediately, the PBoC has allowed a higher USD/CNY daily fixing, suggesting a calibrated escalation and modest depreciation. China's FX strategy so far is to allow for a trade-weighted CNY depreciation by partly shadowing USD weakness and not adding to FX volatility with aggressive bilateral CNY weakness against the USD.

Other Asian central banks are likely to follow suit with FX smoothing of volatility, similar to how they reacted when President Trump won the election in November, forewarning tariff escalation.

Strategy implications: USD gives way to EUR crosses

Thus far, USD price action is unimpressive with the USD DXY index touching fresh lows for the year. The absence of safe-haven USD buying is helping Asia FX weather the negative consequences of the tariffs.

Nonetheless, it is important to keep an eye on the risks and evaluate the impact from a relative perspective. We maintain Asia FX would underperform relative to peers. In this context, CNY represents a funding currency and Asia FX will underperform relative to EUR. An alternative consideration would be long AUD, short CNY – see Liquid Insight: Retaliation after reciprocity: buy AUD/CNH 03 April 2025 .

We maintain that SGD is vulnerable, despite escaping the worst of the tariffs, due to its highly open economy – see EM Alpha: SGD - Shocking stuff. Enter dual digital 17 March.

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GEM FI & FX Strategy
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Glossary of terms

PBoC – People's Bank of China

CFETS – China Foreign Exchange Trading System

NEER – Nominal Effective Exchange Rate

For a complete list of our open trade recommendations, as well as our trade recommendations closed over the last 12 months, see: Global Emerging Markets Weekly: US exceptional downturn 20 March 2025

Timestamp: 03 April 2025 02:58AM EDT

The Kitchen Sink Sinks in

At face value, the reaction of Asian currencies to the latest salvo of US tariffs appears modest, despite the worse than expected announcement. The THB is leading the depreciation with a measured 80bps loss against USD at the time of writing.

By contrast, SGD is flat against USD, following an initial sell-off, helped by its better correlation to EUR relative to other peers. The likelihood is that Asian central banks would stabilize their currencies, to calm volatility in what is already an uncertain trade environment.

USD/CNY fixing initiates depreciation.

More notable was the daily PBoC USD/CNY fixing at 7.1889, which represents a calibrated depreciation against the previous day's fixing of 7.1793. This is helping to push the CNY trade-weighted CFETS index lower, consistent with strategy of allowing for a trade-weighted depreciation and shadowing of USD weakness this year.

However, the PBoC would need to tread carefully with depreciation. The onshore spot CNY is trading 1.5% on the weak-side of its +/- 2% daily trading band. As it approaches the limit of band weakness, liquidity may need to be tightened to maintain the integrity of the trading band. Tightening liquidity at this juncture would be inopportune, as the economy needs greater monetary accommodation to support growth and rising bond issuance.

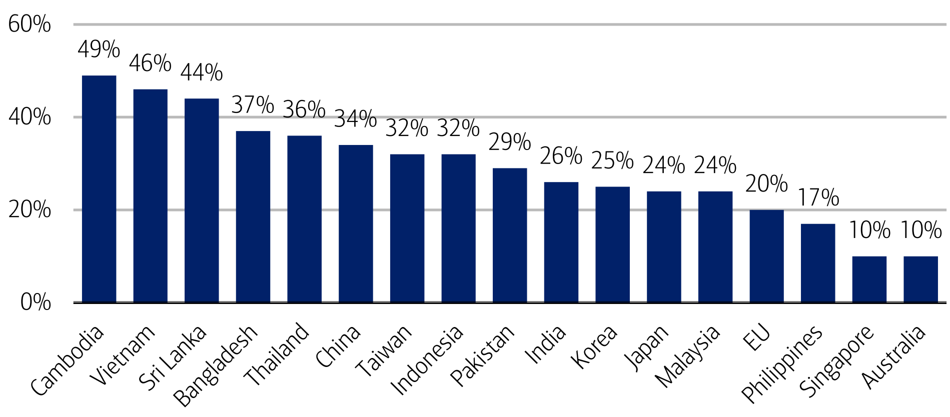
We maintain 2Q-end target of 7.50 USD/CNY, with an expectation of stabilization and modest appreciation, ultimately premised on trade negotiations taking place. However, there are upside USD/CNY risks in the event China and global growth takes a turn for the worse and China counter-stimulus does not materialize meaningfully.

China rates – FX dependent

China government bond (CGB) yields rallied 3-6bp in a bull-flattening fashion given the tariff rise was much larger than market anticipated and posed significant downside risk to growth outlook.

The future path of rates is largely contingent on the PBoC's reaction function. If the central bank continues to make FX stability as priority, then the room for cutting rates or easing funding condition could be limited in the near-term. On the other hand, if the PBoC starts putting greater focus on supporting sentiment and turns more dovish, yields would likely decline further, in our view.

Exhibit 1: Announced US reciprocal tariffs against key Asian countries and EU
Asia is especially exposed to the reciprocal tariffs relative to its EM peers and the EU



Source: BofA Global Research

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North Asia – KRW and TWD: No reprieve for friends

In North Asia, we expect TWD and KRW to continue their recent period of underperformance as these economies are more exposed to global trade than their EM peers. We continue to expect downward pressure on TWD and KRW NEER and HKD funding to loosen on the back off sell-off in Chinese equities.

Taiwan to be slapped with 32% in US tariffs

Taiwan's export to the US is heavily skewed towards advance electronic products and electronical components tied to the AI supply-chain. The announcement of 32% tariff on Taiwanese goods did include a clause where "semiconductors" are excluded.

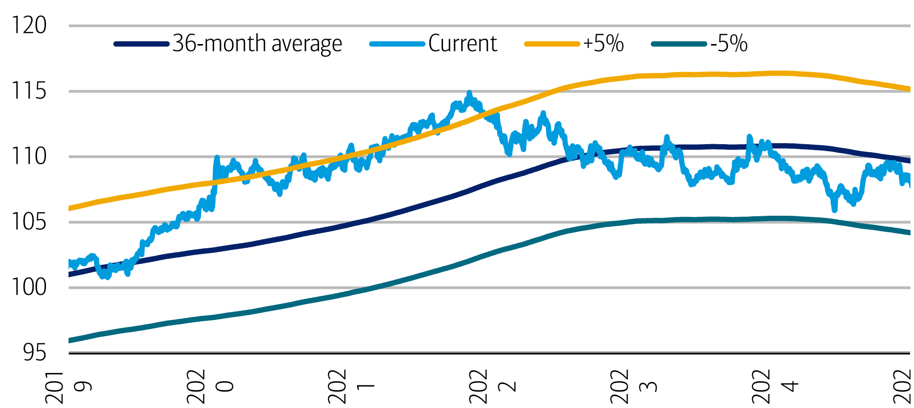
We will have to wait for the US administration's definition of what qualifies as "semiconductors" and how widespread this exclusion be on Taiwan's overall exports to the US.

The first-order impact of universal tariffs would be further sell-off in the NASDAQ, resulting in additional equity outflow and USDTWD to remain bid as foreign equity investors exit the local market. However, with the TWD NEER approaching closed to the weak-side (2.3% above) of the CBC's TWD NEER band, there may be increased official sector pushback against significant TWD depreciation.

We expect USDTWD to gradually move higher and TWD NEER to push lower within the CBC NEER band.

Exhibit 2: CBC valuation band for TWD NEER

Net equity outflows have resulted in TWD NEER to sell-off versus peer currencies



Source: Bloomberg

BofA GLOBAL RESEARCH

Korea is awaiting the outcome of the impeachment of the President, limiting scope for policy making

The US administration slapped 25% tariff on all Korean goods despite the US and Korea having a free trade agreement in which almost all goods (outside a few agricultural items) can enter each other's markets are tariff-free.

Korea is particularly vulnerable to the current trade war given the political uncertainty. The verdict to President Yoon's impeachment trail is set to be delivered on April 4th. According to Polymarket, the tail-risk of the charges of impeachment failing has risen to 25%-30% and the reinstatement of President Yoon may cause political paralysis that can further reduce investor and consumer confidence.

The KRW NEER has returned to the lows of Oct-2022 and we expect further KRW underperformance versus EM peers as Asia remains the epicenter in the current round of trade war. We expect heavy official sector intervention to keep USDKRW below 1,475.

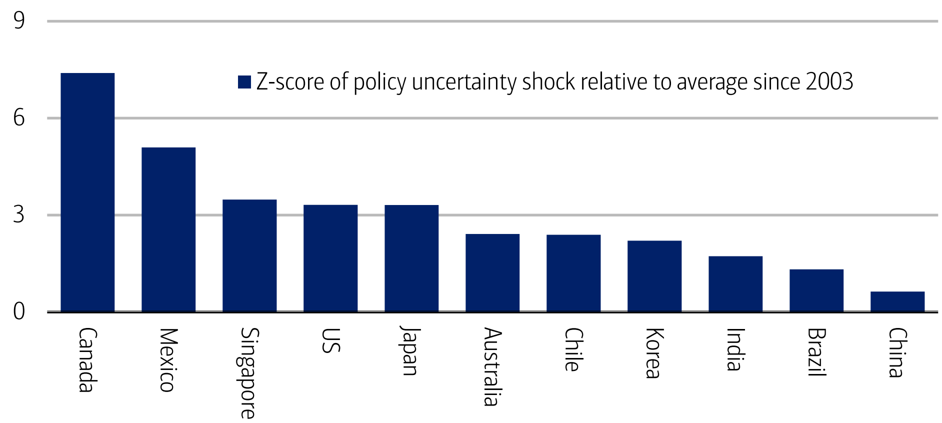
Korea swap rates rallied by about 5bp across the curve and reached new ytd lows. Our economists estimated that the sharp rise in US tariffs from 0% to 25% on Korea exports could have a direct impact of 0.4ppt to Korea's GDP.

The recently proposed KRW10tn supplementary budget by the government seems insufficient to mitigate the growth impact from tariffs. While more fiscal support might be delivered later this year, the BoK could face more urgency to cut rates and support sentiment in the near-term. We stay received for 3y KRW NDIRS (entry: 2.85%, spot: 2.5%, target: 2.45%, stop: 3.08%). Risk to the trade is delayed BoK cuts due to concerns on FX market volatility.

Hong Kong funding to further loosen as Chinese stocks sell-off

The imposition of 54% tariff on Chinese goods has sent Hong Kong-listed shares plummeting and our economist expect this increase in tariff would push China's 2025 growth from 4.5%., down towards 4%. The sell-off in Hong Kong-listed equities would reduce equity leverage and turnover. These would bias HIBOR lower, widening HK-US interest rate differentials and push spot USDHKD higher in the band. We continue to like receiving front-end HKD points.

Exhibit 3: Singapore shows the third highest uncertainty over policy.
The distance of current economic policy uncertainty indices away from their long-term average in standard deviation terms



Source: BofA Global Research, Macrobond, policyuncertainty.com   BofA GLOBAL RESEARCH

ASEAN/India – MYR, THB and SGD most exposed

Within ASEAN, MYR and THB would be most exposed to these tariffs due to larger net exports to US, higher tariff rates imposed and large exposure to global trade as proportion of GDP. Singapore's tariff rate was lower, but SGD policy is highly exposed to global trade cycle which could continue to weigh on SGD NEER – see Exhibit 3.

Weaker FDI flows over medium-term

Over medium-term, universal tariffs could negatively impact the investments into ASEAN region due to relocation from China. Indonesia, Malaysia, and to a lesser extent, Thailand have benefitted from this trend over the last few years and could see weaker FDI trends going ahead.

Some relief from USD beta and lower US rates

The immediate reaction to tariffs has resulted in a weaker USD against G10 FX and lower US rates. If market continues to price more Fed rate-cuts due to the negative growth impact of tariffs, it could provide some relief to countries which had seen high extent of USD demand and have accumulated large USD deposits over the last few years, including Indonesia, Malaysia, and Philippines.

Stronger EUR could also provide an offsetting support to bi-lateral exchange rates for high-beta currencies, including THB, MYR and to a lesser extent to the others. That may ease valuation concerns on INR, THB and MYR to some extent and reduce investor interest to positions for higher bi-lateral USD rates.

Reserves buffer to stabilize near-term pressure

FX reaction would also depend on central bank reaction functions and market perception of reserves adequacy. Most central banks have adequate reserves and have shown willingness to utilize them during such times. India, Indonesia, and Malaysia do have some an overhang of past interventions in the form of large short forward positions which could be a constraining factor over time. While central banks wish to maintain large negative forward positions to sterilize the intervention, market might see it as a negative signal in the form of future demand for USDs.

Rates – India, Thailand and Singapore with most room to rally

As downside risks to growth intensify, we see rates moving lower in most of ASEAN and India. Many central banks have cut rates over the past few months and markets have priced further easing over this year. Considering the market uncertainty and concerns about downside risks to growth, we see scope for markets to bring forward rate-cuts which could trigger further demand for duration.

India, Thailand, and Philippines bonds stand to benefit on that front as inflation has declined and growth is already soft. Singapore would benefit from higher correlation to US rates. Malaysia rates have been in a tight range for quite some time due to neutral monetary policy bias and strong growth. Domestic demand for Malaysian bonds remains strong and any signs of weaker activity could result in sharper rally and flattening of the curve. Indonesia's high real rates make it attractive as well, but cuts could be delayed until FX volatility declines.

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