

FX Update: Greece, Oil and Easy Money

So what has happened after yesterday's Eurozone greenlight to the second programme for Greece

- Our economics team highlighted the two "positive" announcements from Brussels - announcement of a deal between private creditors and Greece on the latter's sovereign debt restructuring, and the approval for Greece's second bailout package worth EUR130b. So now the bailout includes significant additional efforts from both private and official sector creditors (PSI and OSI) and enhanced surveillance to reduce Greece's debt-to-GDP ratio to 120.5% by 2020 – via (1) official sector additional lowering of the interest rates on the bilateral loans to Greece and central banks bond channeling profits to Greece (OSI financing amount to EUR130bn until 2014); (2) private sector sees nominal "haircut" (a reduction in the amount of debt to be repaid to creditors) amounting to 53.5% was agreed (higher than 50% expected) and Greece launches a bond exchange, whereby the bondholders will receive new bonds with the interest rates of up to 2% until 2014; 3% between 2015-2020 and 4.3% thereafter.
- The euro saw a knee jerk upside move yesterday following the EU announcement (details of which we laid out by the Maybank Economics team today), with the EUR/USD rising close to 0.8% and high of 1.3293. Since then it has remained largely range bound between 1.3293 and 1.3220, in part due to the fact that it could have been priced in somewhat. As usual, the general view now is that there may be implementation risks and challenges in terms of the bailout but a disorderly fiasco on 20 Mar is now close to zero, if this agreement leads to eventual disbursement sometime in Mar.
- Overall, recent developments represent a major progress towards further stabilising the region's economies and financial markets and resolving the prolonged crisis. The Greek bailouts, ECB's policy actions since late 2011 that included cuts in the benchmark interest rate and banks' reserve ratios, purchases of sovereign bonds in the secondary markets, and "backdoor QE" via the massive long-term refinancing operations (LTRO), has stabilised financial conditions by narrowing key spreads, and avoiding a severe liquidity/funding crunch.

What to look out for until mid-June 2012

Eurozone event risks

- The implementations and challenges now include ratification by member states to allow for the provision by the EFSF (European Financial Stability Facility) of the necessary financing and to make "fiscal rule" constitutionally and legally binding, targeted by end-Mar 2012. The EU Council meeting on 1-2 March will review the combined lending capacity of the EFSF and ESM (European Stability Mechanism). The next Eurogroup meeting on 12 Mar will assess the implementation by the Greek government of all prior actions and examine the next steps to be taken and launch this second programme for Greece. In our view, this second bailout will probably delay the Greece debt repayment issue until 2014.
- During that time, austerity measures will likely see continued social unrest in Greece as it crimps on economic growth, the ability to repay debt and at the same time political uncertainty after Greece's April elections which adds to the implementation risks. On top of all this, investors would look for resolve towards a new "fiscal compact" to address and enhance fiscal discipline and governance which were lacking and contributed to the crisis. On top of this, over the next few months till end 2H-2012, there are key elections in eurozone that may create a bit of surprises before we end mid-year with the end of the bank recapitalization process.

Key Dates to Watch Out For

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|----------------------------|------------------------------------------------------------------------------------------|
| 22-Feb-12 | Launch of PSI debt exchange offer - Term Sheet Sent |
| 27-Feb-12 | German & Estonia Parliaments Votes on Bailout Funding |
| 28-Feb-12 | Finnish Parliament Votes on Bailout Funding |
| 29-Feb-12 | 2nd ECB LTRO |
| 01-Mar-12 | Dutch Parliament Votes on Bailout Funding |
| 1-2 Mar 2012 | EU Council Summit in Brussels |
| 04-Mar-12 | Russian Presidential Election |
| 08-Mar-12 | Debt Swap Offer Closes |
| 08-Mar-12 | ECB Announces Rates |
| 11-Mar-12 | Debt Swap Offer Completed |
| 12-Mar-12 | Switzerland - Referendum |
| Mid to End Mar 2012 | IMF Executive Board meets to decide on release of funds and EU/IMF releases Funds |
| 14-Mar-12 | FOMC Rate Decision |
| 18-Mar-12 | Germany President Election (Indirect) |
| 20-Mar-12 | Greece EUR 14.5bn bond repayment due |

| | |
|-------------------|-----------------------------------------------------------------------------------------|
| 25-Mar-12 | Hong Kong Chief Executive (Indirect) |
| April | Greece General Elections |
| 20-22 Apr 2012 | 2012 Spring Meetings of the IMF and the World Bank Group |
| 22-Apr-12 | First Round, French Presidential Election |
| 06-May-12 | Second Round, French Presidential Election (if needed) |
| 10 & 17 June 2012 | France Legislative First and Second Round (10 and 17 June) |
| 30-Jun-12 | Iceland Presidential Election |
| 31-Jun-12 | Deadline for Core Capital Ratio 9% for Banks , EU Banks to meet EUR115bn capital target |

Oil Risks – Differing Asian Currencies Reactions Differ

- The WTI and OPEC crude oil prices have risen by around 16% (current: 119.20) and 13% (current: 105.80) respectively since the end of 2011. Recent developments out of Iran and uncertainty in the Middle-East with possible cutbacks in Iranian oil supply, and a worsening of the situation may have adverse effects on oil prices going forward. We are increasingly concerned about the impact this will have on Asian inflation outlook this year especially when the labour market in some Asian countries, i.e. Singapore, remains quite tight. This remains a concern despite expectations that global growth may slow down. Typically, Asian economies in the region adopt inflation targeting regimes and tend to be wary of imported inflation.
- Our reduced form estimates of Asian currencies against OPEC oil prices (controlled for other factors) over the past 7 years found that rising oil prices tend to lead to appreciating Asian currencies as policy makers possibly react to dampen some of the expected imported inflationary pressures and concerns of oil price-pass throughs into goods and services. Interestingly, our results support the view that some countries such as Philippines, which has a higher imported oil dependence, typically sees a 0.4% appreciation in the USD/PHP for every 1% increase in oil prices. SGD and MYR tend to rise by around 0.3% whilst IDR (which has fuel subsidies) has a lower elasticity at 0.16%. The latter (IDR), tends behave as such due to the domestic fuel subsidies. Today's newswire report that the Indonesian President signaled the need to raise fuel prices and give assistance to the poor to offset the increase, could possibly reflect the expectation of higher oil prices by Asian governments in 2012 (as they try to limit fiscal costs). We will continue to monitor the situation in the Middle East and Iran, the possible impact on Asian inflation outlook and its impact on FX policies in the region.

Impact of Oil Prices on selected ASEAN Currencies

| <i>Currency</i> | <i>Impact of 1% increase in OPEC Oil Prices to Currency</i> |
|-----------------|-------------------------------------------------------------|
| USD/MYR | -0.25% |
| USD/SGD | -0.25% |
| USD/IDR | -0.16% |
| USDTHB | -0.01% |
| USD/PHP | -0.35% |

- Going forward, we still think eurozone headline news-driven volatility will drive currency markets as the periphery solvency issue remains one of the biggest destabilizing force that is still unresolved. Market participants will continually assess the success of the "ring-fencing Greece" exercise, where the funds will come from, how the debt will be repaid and whether it can be repaid, on top of concerns of "periphery contagion". It will only dissipate with positive economic growth and eventual erosion of markets risk aversion on the periphery economies. That will take many more years.
- ***In the next few months, key event dates out of Eurozone will be relevant for short term trading, but other destabilizing issues such rising oil prices (i.e. political uncertainty rather than demand factors) and the "after effects" of continued easy money from ECB, BOE, BOJ and remnants of Fed earlier actions will become more important. The latter leading to the possibility of higher capital inflows into Asia in the later part of 2012 and the former will possibly have an impact on Asian currency trends. Their inter-play against a backdrop of possible economic recovery in the second half of this year may be the main drivers for Asian currencies in 2012.***
- ***We currently maintain our forecast that the euro will end 1Q 2012 at around 1.3050 given the positive effects from the end Feb LTRO and some weakness on the back of expected volatility in Mar. Thereafter, we think the euro should strengthen back towards 1.32 levels by end 2Q 2012, as uncertainty tapers off out of eurozone with limited event risks in 2Q (except for surprises out of French Presidential Elections or an oil price shock triggered by the Iran situation).***

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