Carry Reconsidered

APAC FX Carry After the Yen Unwind: Where the Drawdown Profiles Actually Differ

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Abstract

The August 2024 yen carry unwind taught a lesson that markets have half forgotten, that carry is a short volatility trade wearing the costume of a yield strategy. With the BOJ now normalizing toward a 0.75 to 1.0% policy rate by mid 2026, the funding leg of the classic Asian carry trade is repricing structurally rather than cyclically. This paper argues that APAC carry is not G10 carry and cannot be modeled as such. We disaggregate the EM Asia high yielders, Indonesian rupiah and Indian rupee, from the lower yielding but chronically fragile Malaysian ringgit and Thai baht, and show that their drawdown profiles, risk off betas, and reserve buffers diverge sharply. Central bank divergence, BOJ tightening, PBoC easing, Fed cutting, MAS appreciating the S NEER, is manufacturing both the volatility that punishes naive carry and the dispersion that rewards a disciplined, buffer aware framework. We propose a practical positioning approach anchored on carry to drawdown ratios rather than headline yield.

1. The Costume and the Body: Why Carry Is Short Volatility

Carry trades earn a positive expected return in calm conditions and surrender it violently in stress. This is not a market imperfection to be arbitraged away but a risk premium being paid for a real service, absorbing the tail. The trade is long a high yielding currency, short a low yielding funder, and the carry (the interest differential) accrues in a straight line while the spot leg accumulates convexity risk that only shows up when correlations snap to one. The August 2024 episode was the cleanest demonstration in a decade. When the BOJ delivered a 15 basis point hike and signaled more, USD/JPY fell from roughly 161 to 142 inside three weeks, the Nikkei printed its largest single day loss since 1987, and a cascade of margin calls forced deleveraging across completely unrelated positions. The yen was the funder for a book far larger than the yen leg itself, and unwinding the funder is what transmitted the shock.

The relevant statistic for any carry strategy is therefore not the annualized yield pickup but the ratio of that pickup to the expected maximum drawdown in a stress window. A currency offering 5% carry that loses 12% in a 20 day risk off event has a materially worse profile than one offering 3% carry that loses 4%, even though the first screens richer. This is the analytical lens we apply to APAC for the remainder of the paper. Headline yield is the costume. Drawdown behavior is the body underneath.

> **Our view:** The yen unwind was not a one off. It was a preview of the funding leg repricing that is now structural. Position sizing that ignores drawdown to carry ratios will be repeatedly and predictably stopped out through 2026.

2. The Funding Leg Repriced: BOJ Normalization as a Regime Change

For two decades the yen was the world's reliable funder because Japanese policy rates were pinned near zero and the direction of travel was, at most, sideways. That anchor has been pulled. The BOJ is normalizing, with the policy rate heading toward 0.75 to 1.0% by mid 2026 and the 10 year JGB yield trading above 2.3%, its highest since 1998. Shunto wage settlements around 5.5% have given the Bank confidence that the inflation of the last three years is demand led rather than purely imported, and FY2026 inflation near 1.6% keeps the normalization path live. PM Sanae Takaichi's expansionary fiscal stance complicates the picture by adding demand, but it does not reverse the monetary direction. The funder is becoming a currency with a real, rising yield of its own.

This matters for Asian carry in two distinct ways. First, the mechanical yield pickup of borrowing yen to buy Asian high yielders compresses as the front end of the JGB curve lifts. Second, and more importantly, the yen's behavior in risk off is changing. A funder that is expected to appreciate in stress (because rate differentials are narrowing and repatriation flows accelerate) makes every carry book built on it more fragile, since the unwind of the funder amplifies the spot loss on the asset leg. The yen is reacquiring its safe haven reflex precisely as it stops being cheap to short.

> **Our view:** We do not think the yen carry trade is dead, but its risk adjusted return has structurally halved. Books that treat JPY funding as a free option on Asian yield are mispricing a funder that now bites back in exactly the moments the asset leg is falling.

3. Divergence as the Engine: Four Central Banks, Four Directions

The defining macro feature of 2026 is that the major APAC monetary authorities are moving in genuinely different directions at the same time. The BOJ is tightening. The PBoC is easing into persistent deflation under a policy stance it calls moderately loose, with China's 2026 growth around 4.4 to 4.5%, exports fading, and a property overhang that keeps domestic demand soft. The Fed is cutting. And the MAS continues its gradual appreciation of the Singapore dollar nominal effective exchange rate, a policy of currency strength rather than an interest rate at all. This is not the synchronized tightening or synchronized easing that flattens cross asset dispersion. It is a fan of divergent paths, and divergence is the raw material of both FX volatility and carry opportunity.

Divergence cuts both ways. It widens the realized differentials that carry harvests, but it also raises the volatility that carry pays out in stress. The naive response is to chase the widest differential. The disciplined response is to ask which differentials are backed by reserve buffers, current account resilience, and a central bank credible enough that the currency does not gap when global risk appetite turns. That question separates the APAC high yielders from one another far more than their headline rates do.

> **Our view:** Divergence is bullish for carry dispersion strategies and bearish for carry index strategies. Owning a basket of Asian high yielders as a bloc is a bet on correlation staying low. It will not, and the bloc trades will be the ones that unwind together.

4. APAC Carry Is Not G10 Carry

The academic and sell side literature on carry is overwhelmingly built on G10 currencies, deep, freely floating, with liquid forward markets and central banks that do not intervene in size. EM Asia violates most of those assumptions. Several of the relevant currencies are managed, lightly or heavily. Forward points embed capital control premia and onshore, offshore basis. Reserve adequacy, not just the interest differential, determines whether a currency holds in stress. And the thinness of the EM Asia carry literature means that most practitioners import G10 intuitions that do not transfer.

The most consequential difference is the shape of the return distribution. G10 carry has moderate negative skew. EM Asia carry has fatter left tails and, crucially, highly heterogeneous tails across currencies that screen similarly on yield. A managed currency with a large reserve buffer can look identical to a fragile one on a carry to yield screen and behave completely differently when the tide goes out. The 1997 to 1998 Asian crisis is the ancestral memory here, and while balance sheets are vastly stronger today, the reflex of policymakers to defend and then capitulate remains a live tail that G10 models simply do not contain.

4.1 The reserve buffer as the real yield

We argue that the economically meaningful carry in EM Asia is the interest differential net of the option value of the reserve buffer that protects it. Indonesia and India carry high nominal differentials but also hold substantial reserves and run policy frameworks credible enough to smooth, not eliminate, drawdowns. Malaysia and Thailand carry lower differentials and, in Thailand's case in particular, sit on weaker cyclical fundamentals that thin the buffer precisely when it is needed. Two currencies with the same headline carry can have opposite risk adjusted profiles once the buffer is priced.

5. Where the Drawdown Profiles Actually Differ: IDR and INR versus MYR and THB

This is the analytical core of the paper. We separate four currencies into two pairs by drawdown behavior rather than by yield. The Indonesian rupiah and Indian rupee are the high yielders backed by structural growth stories, India at roughly 6.5% growth and the fastest major economy, domestic demand driven, recently upgraded by S&P to BBB from BBB minus, and Indonesia at roughly 5.0% with nickel downstreaming, EV battery investment, and strong FDI into 270 million consumers. The Malaysian ringgit and Thai baht are the lower yielders with more cyclical and, for Thailand, more fragile underpinnings. Malaysia is a semiconductor packaging beneficiary but carries China oversupply risk. Thailand is the regional laggard at 1.8 to 2.5% growth, weighed by high household debt, a difficult auto transition, weak Chinese tourism, and a March 2026 election that adds political risk premium.

Currency	Approx carry (1Y differential vs JPY funder)	2026 growth backdrop	Reserve adequacy	Est. 20 day risk off drawdown	Carry to drawdown
INR	5.0 to 5.5%	~6.5%, fastest major economy	Adequate, RBI smoothing	4 to 6%	High
IDR	5.0 to 6.0%	~5.0%, FDI and downstreaming	Strong, BI defends actively	6 to 9%	Medium to high
MYR	2.5 to 3.0%	Chip packaging, oversupply risk	Moderate	5 to 7%	Medium
THB	1.5 to 2.0%	1.8 to 2.5%, regional laggard	Adequate but cyclically strained	6 to 10%	Low

Figures are Darmine estimates for illustration of relative profiles, not point forecasts. Carry differentials are approximate 1Y forward implied against a yen funder repricing toward 0.75 to 1.0%. Drawdown estimates are conditional on a global risk off window comparable to the intensity of August 2024, scaled to each currency's historical beta.

5.1 The high yielders: paid to hold, not just to wait

INR stands out because its drawdown is shallow relative to its carry. The growth story is domestic, insulating it from the trade channel that punishes export led currencies in a global slowdown, and the RBI has demonstrated a willingness and capacity to smooth volatility without pretending to peg. A 36% effective US tariff and an India EU trade deal frame a currency whose fundamentals do not depend on the external cycle turning favorable. The carry to drawdown ratio is the best in our set. IDR offers a higher nominal differential but a deeper tail, because commodity linkages and portfolio flow sensitivity widen its risk off drawdown. Bank Indonesia's active defense narrows but does not eliminate that tail. IDR is a hold with respect for sizing, INR is a hold with conviction.

5.2 The lower yielders: less cushion when it turns

MYR pays less and its fundamentals are hostage to the semiconductor cycle and Chinese oversupply, a two sided risk that can compress the currency when the chip cycle or China surprises to the downside. THB is the clearest underweight. Its carry is the thinnest in the set, and its drawdown is among the deepest because the cyclical backdrop, household debt near record levels, weak tourism recovery, and election uncertainty, thins the buffer at exactly the wrong time. A carry to drawdown screen ranks THB last even though a naive yield screen would place it above where its risk deserves.

> **Our view:** The ranking that matters is INR, then IDR, then MYR, then THB, and it is close to the inverse of what a headline yield screen produces for the bottom two. We would fund a long INR carry position by shorting THB exposure rather than by shorting yen, capturing both the differential and the drawdown asymmetry within Asia.

6. Risk Off Behavior and the Correlation Trap

The single most dangerous assumption in Asian carry is that the constituents diversify each other. In calm markets their pairwise correlations are moderate and a basket looks smoother than any single leg. In stress the correlations converge toward one, the basket's realized volatility jumps, and the diversification that justified the position sizing evaporates at the worst moment. This is the correlation trap, and it is the mechanism by which carry books that looked prudent on a Sharpe basis blow through their stop losses. The August 2024 unwind propagated through exactly this channel, positions with no fundamental link to the yen were sold because they were funded by it and because de risking is indiscriminate.

The practical implication is that stress correlations, not average correlations, must drive sizing. We assume that in a risk off window the four currencies in our set behave as a single factor with idiosyncratic loadings, and that the idiosyncratic component is where the buffer differential shows up. INR's lower loading on the common risk off factor is the empirical expression of its domestic demand insulation. THB's high loading is the expression of its cyclical fragility. A book sized to average correlations is implicitly short the very tail that carry is paid to bear.

> **Our view:** Size every APAC carry book to its stress correlation, which we treat as near one across the high yielders, and hold the reserve buffer differential as the only reliable source of relative resilience when the factor turns. The diversification you see in calm markets is a loan the market will call.

7. Where MAS and the SGD Fit: Carry's Quiet Anchor

Singapore sits outside the carry high yield conversation and is more useful for it. The MAS runs monetary policy through the S NEER rather than an interest rate, currently on a path of gradual appreciation, with core inflation contained in a 1.0 to 2.0% band and 2026 growth forecast upgraded by MTI to 2.0 to 4.0% after a strong 2025 in which the economy grew 5.0% and Q4 manufacturing rose 18.8%. For a carry investor the SGD is not a yield source but a low volatility, appreciating anchor, a currency whose policy framework explicitly dampens the moves that carry fears. In a diversified APAC book the SGD leg is the ballast, not the engine.

This is why we treat Singapore as the quality defensive overweight across the Darmine series and extend that here to the FX overlay. When the correlation trap springs on the high yielders, an appreciating S NEER provides a domestic funding and hedging leg that does the opposite of what the high yielders do, without relying on the yen, whose safe haven reflex is now entangled with the funding leg itself.

> **Our view:** The cleanest APAC carry structure in 2026 is long INR for the paid resilience, funded partly within Asia by short THB, with an SGD ballast leg to dampen book volatility, rather than a yen funded basket of everything that yields.

8. A Practical Positioning Framework

We reduce the analysis to a repeatable framework. First, rank candidate currencies by carry to expected drawdown, not by headline yield. Second, price the reserve buffer as part of the real carry, treating a credible, well provisioned central bank as a discount on the drawdown term. Third, size to stress correlation rather than average correlation, assuming the high yielders converge to a single factor in risk off. Fourth, prefer intra Asia funding legs (short the fragile low yielder) over yen funding where the differential permits, capturing drawdown asymmetry rather than importing the funder's own tail. Fifth, hold an appreciating, low volatility anchor such as the SGD as ballast. Sixth, define the reassessment catalysts in advance so that positions are exited on thesis change rather than on price alone.

- Rank by carry to drawdown, not yield. THB screens rich on yield and poor on this measure.
- Price the reserve buffer as real carry. INR and IDR earn a discount on their drawdown term that MYR and THB do not.
- Size to stress correlation near one across the high yielders, not to calm market diversification.
- Fund within Asia where possible, short THB to long INR, to capture drawdown asymmetry instead of importing the yen's safe haven tail.
- Anchor the book with an appreciating S NEER SGD leg as volatility ballast.
- Pre commit exit catalysts: a BOJ acceleration past 1.0%, a disorderly PBoC devaluation, a Thai election shock, or a Fed pause.

> **Our view:** Carry in APAC is a dispersion trade, not an index trade. The edge is in choosing which drawdown you are paid to bear, and in refusing to be paid too little for the deep ones.

Portfolio Positioning Summary

Overweight: Long INR carry as the highest carry to drawdown profile in APAC, backed by ~6.5% domestic demand led growth, an S&P upgrade to BBB, and RBI smoothing that keeps risk off drawdowns shallow. Constructive on IDR with disciplined sizing, high nominal differential, strong FDI and reserves, but a deeper commodity and flow linked tail. Overweight SGD as a low volatility appreciating anchor (gradual S NEER appreciation, MTI 2026 growth 2.0 to 4.0%) that provides book ballast without importing the yen's safe haven reflex.

Market weight: MYR as a semiconductor packaging beneficiary with genuine two sided China oversupply risk; a moderate carry to drawdown that does not justify overweight but does not warrant short. Selective Japanese financials benefit from BOJ normalization and a steeper JGB curve, but JPY as a carry funder is now a market weight at best given its reacquired safe haven behavior.

Underweight: THB as the clearest underweight, thinnest carry in the set against the deepest cyclical drawdown, high household debt, weak Chinese tourism, a difficult auto transition, and March 2026 election risk. Underweight naive yen funded Asian carry baskets that rely on calm market diversification, since stress correlations converge to one and the funder now bites back. Underweight China domestic demand exposure feeding into regional FX beta.

Key catalysts to reassess: Reassess if the BOJ accelerates past a 1.0% policy rate faster than mid 2026 guidance implies (compresses carry and lifts the funder), if the PBoC allows a disorderly CNY devaluation into deflation (regional FX contagion), if the Fed pauses its cutting cycle (broad USD strength that pressures all EM Asia carry), if the March 2026 Thai election delivers a shock, or if realized stress correlations among the high yielders diverge from our near one assumption.

Conclusion

The yen carry unwind of 2024 was not an anomaly to be filed away but a demonstration of what carry has always been, a short volatility position that pays steadily and loses suddenly. The BOJ's normalization has structurally repriced the funding leg, turning the yen from a costless funder into a currency that appreciates in exactly the stress windows that punish the asset leg. Against that backdrop, treating APAC carry with imported G10 intuitions is a category error. The reserve buffer, the growth model, and the stress correlation matter more than the headline differential.

Our central claim is that the drawdown profiles of the Asian high yielders diverge far more than their yields, and that this divergence is the opportunity. INR offers paid resilience, IDR offers higher carry for a deeper but defended tail, MYR offers thin compensation for cyclical risk, and THB offers the least carry for the most drawdown. The disciplined structure for 2026 funds resilience within Asia, anchors on an appreciating S NEER, and sizes to the correlation the market will actually deliver in stress rather than the one it advertises in calm. Carry reconsidered is carry chosen, not carry collected.

Sources and Further Reading

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