

## FX Insight

# Assessing FX Scenarios In Late Cycle Phase

### Positioning for the End of the Tightening Cycle

Since Mar 2022, the Fed has raised the Fed Fund target rate by 500bps from 0-0.25% to 5.0-5.25%. This has been the most aggressive tightening cycle that the Fed has seen in recent history in order to bring inflation under control. Well, inflation metrics have started to soften. Our house view looks for a final rate hike this week and while the Fed may still want to sound vigilant on inflation, our economics team reckons any further hike is too excessive. Given that we are closing in on the peak of hiking cycle, we want to look back into history and have a sense of how different asset classes and Asian currencies tend to behave around the peak of each rate hike cycle. This exercise would illuminate the kind of price action to expect for the next 3-6 months.

### ASEAN FX + RMB Trajectories In Different Scenarios

Taking into context the global developments, we examined the performance of ASEAN currencies and the CNY under various scenarios. In the base case scenario, we expect the US and global economy to hit a soft landing with US growth positive but more likely below 1.0% and the Fed to cut rates by about 200bps as US inflation would also cool to around 2.5%. This would concurrently also guide UST yields lower into the end of 2024. China's growth recovery at the same time would also start picking up more discernibly from the end of the year onwards with moderate rate of growth to follow. In this context and taking together both a best case and worst case scenario, we calculated the range of Dollar - Asian currency pairs that include USDMYR (2023: 4.30 - 4.70 and 2024: 3.70 - 5.00), USDSGD (2023: 1.30 - 1.38 and 2024: 1.25 - 1.45), USDIDR (2023: 14,800 - 15,500 and 2024: 13,000 - 16,500), USDTHB (2023: 32.00 - 35.80 and 2024: 30.00 - 37.00), USDPHP (2023: 54.30 - 55.50 and 2024: 50.00 - 58.00) and USDCNY (2023: 6.96 - 7.40 and 2024: 6.42 - 7.80).

### Analysts

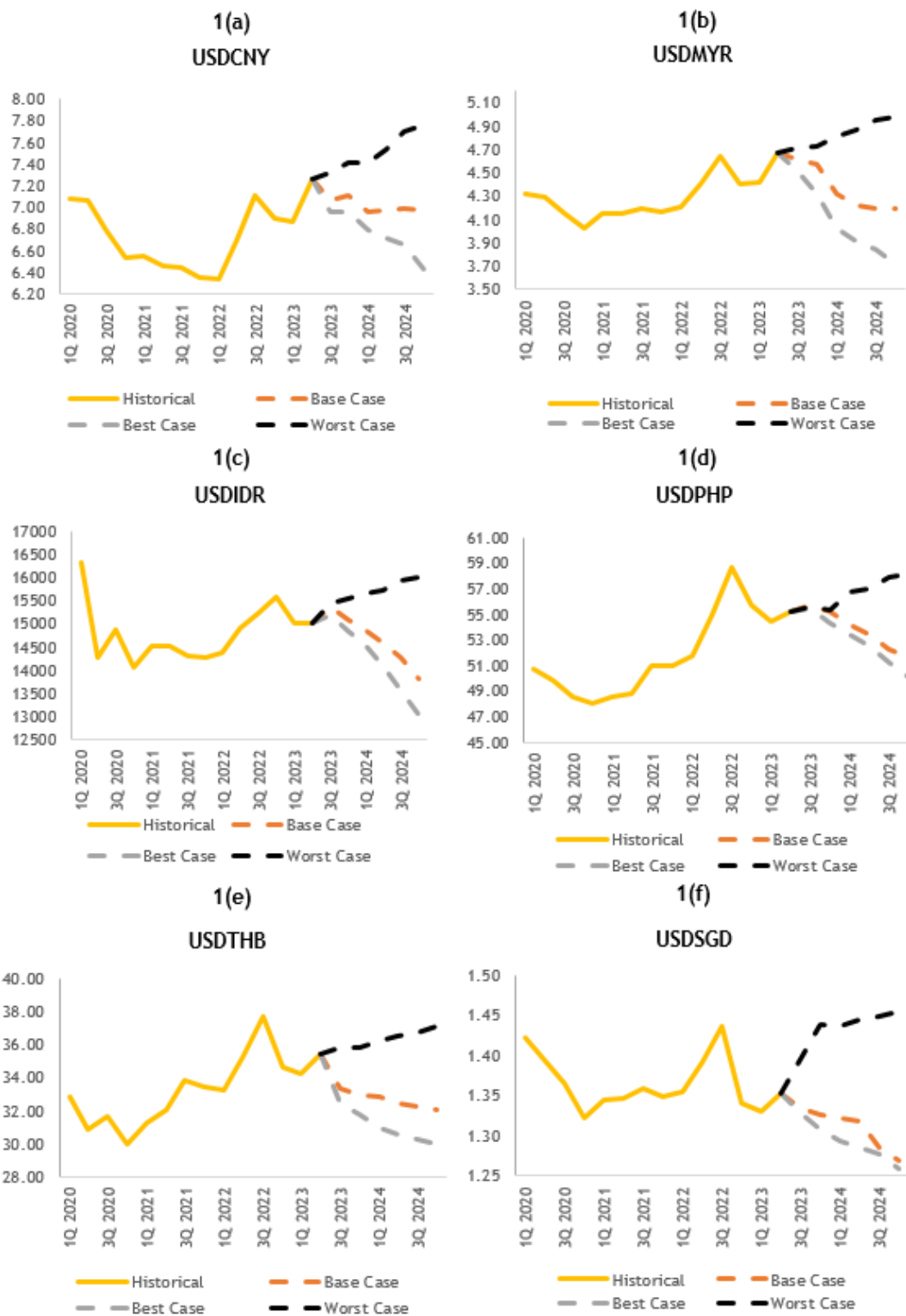
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Chart 1: Performance of Currencies Under Various Scenarios



Source: Bloomberg, Maybank FX Research &amp; Strategy

## Positioning for the End of Fed Rate Hikes...

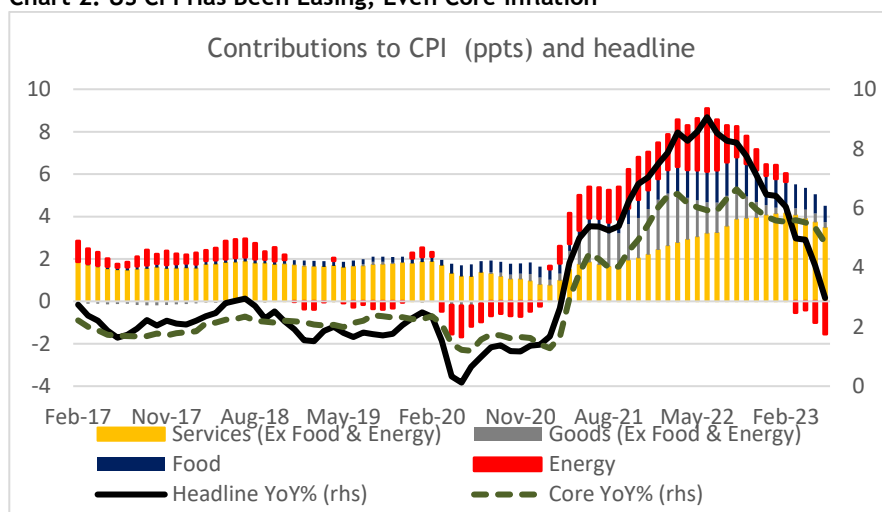
Since Mar 2022, the Fed has raised the Fed Fund target rate by 500bps from 0-0.25% to 5.0-5.25%. This has been the most aggressive tightening cycle that the Fed has seen in recent history in order to bring inflation under control. Well, inflation metrics have started to soften. The impact of the accumulative rate hikes had been broad on the financial markets and has been the most significant driver in the past several months. Our house view looks for a final rate hike this week and while the Fed may still want to sound vigilant on inflation, our economist reckons any further hike is too excessive. Given that we are closing in on the peak of hiking cycle, we want to look back into history and have a sense of how different asset classes and Asian currencies tend to behave around the peak of each rate hike cycle. This exercise would illuminate the kind of price action to expect for the next 3-6 months.

In the second part of the report, we used our fast tracking augmented fair value model to determine the possible paths of ASEAN +China FX based on the best, worst and base case scenarios.

### Positioning for the End of Fed Rate Hikes

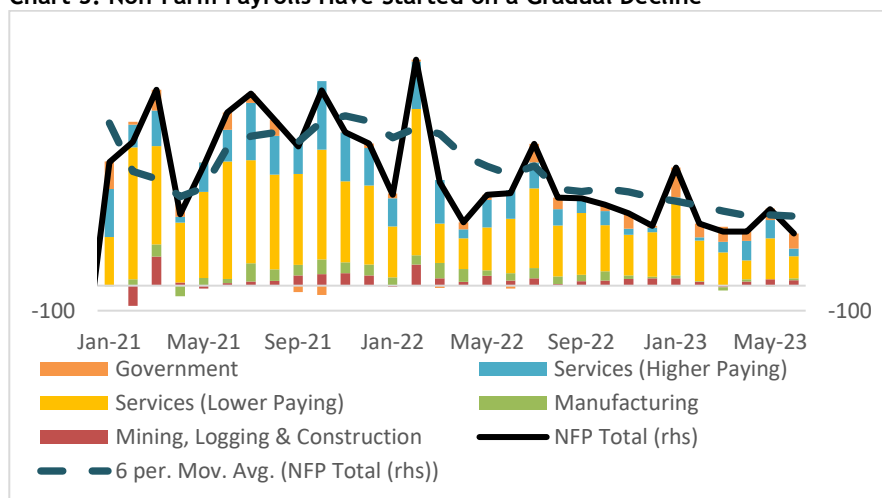
The whole purpose of tightening monetary policy is for the Fed to dampen demand and ease price pressure. On that front, the Fed seems to be finding success as inflation eases discernibly. Even the stickier services subcomponent had also started to soften. Meanwhile, the US labour market conditions are easing and non-farm payrolls have been on a downtrend but lower paying services hires still make the bulk of monthly hires.

Chart 2: US CPI Has Been Easing, Even Core Inflation



Source: Bureau of Labor Statistics, Bloomberg

Chart 3: Non-Farm Payrolls Have Started on a Gradual Decline

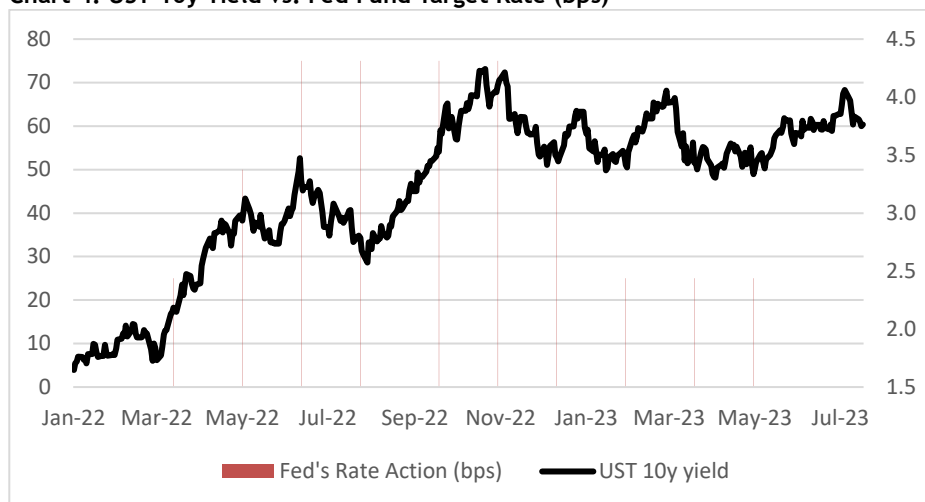


Source: Bureau of Labor Statistics, Bloomberg

At this point, even as the probability of a US recession is significant at 67% (based on term spreads), the current data does not suggest that a severe downturn is ahead of us. We thus continue to assume that the US economy is on a mild downturn (aka soft landing) and our base case also assumes that growth in most parts of the world to be in a soft patch for next year with a mild recovery in China to cushion. The resilience of the US economy also suggests that rate cuts are likely to occur only in 2024.

The first asset class we want to look at is US treasuries and we want to look into the 10y since it is the benchmark. UST 10y yield rose in tandem with the rate hikes and started to plateau once Fed started to ease off the pace of rate hikes from 75bps to 50bps. However, for the most part of this year, UST 10y yield managed to maintain elevation thus far.

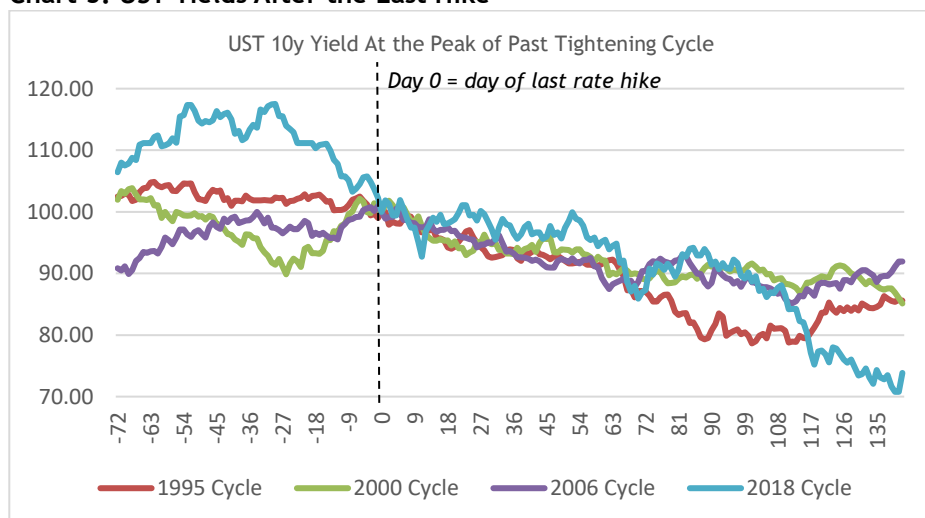
Chart 4: UST 10y Yield vs. Fed Fund Target Rate (bps)



Source: Bloomberg, Maybank FX Research & Strategy

A look back in history revealed that at some point, beyond the last hike, naturally UST yields will start to fall.

Chart 5: UST Yields After the Last Hike



Note: Day 0 denotes the day that the Fed hiked for the last time in each cycle. Horizontal axis is the days before the last hike and after. Price on Day 0 is indexed to 100.

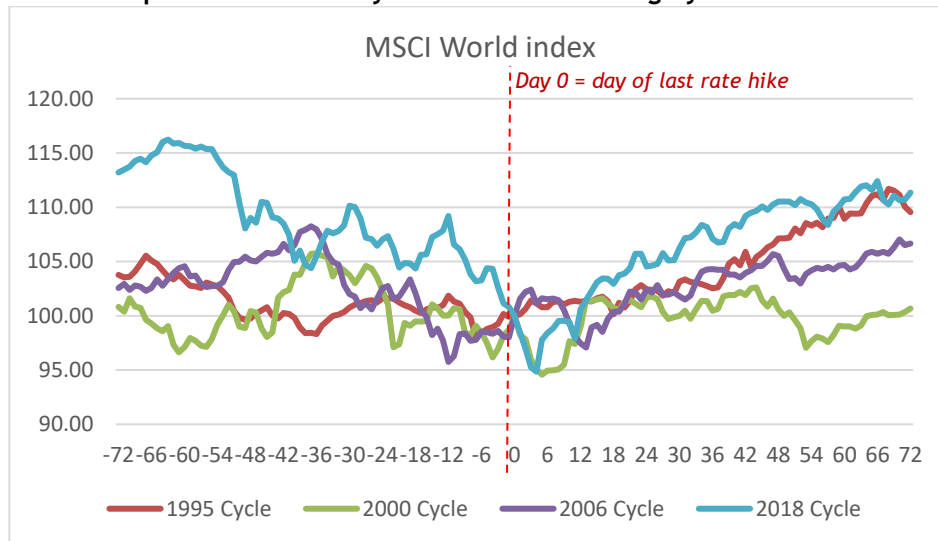
Source: Bloomberg, Maybank FX Research & Strategy

This fall in UST yields could also be due to risk aversion arising from concerns on growth. **Regardless, JPY could be the key beneficiary for a pullback in UST yields.**

Equities tend to rebound after the Fed is done with the hiking cycle. **This should**

be positive for risk-sensitive AUD, CAD and KRW.

**Chart 6: Equities tend to Rally After Fed Ends Hiking Cycle**

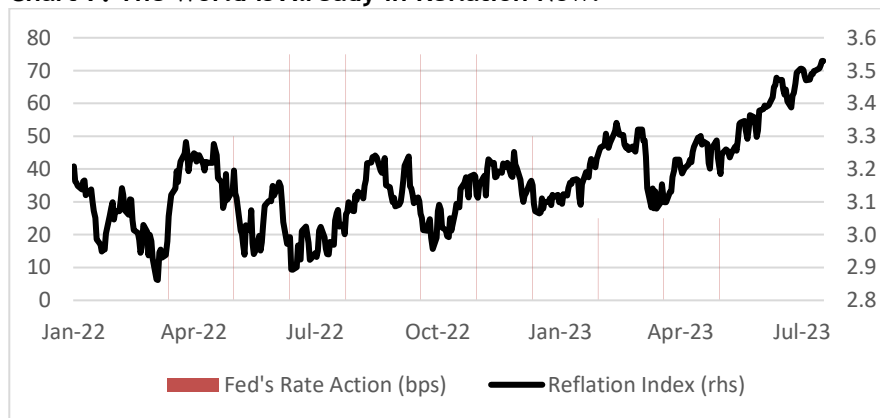


Note: Day 0 denotes the day that the Fed hiked for the last time in each cycle. Horizontal axis is the days before the last hike and after. Price on Day 0 is indexed to 100.

Source: Bloomberg, MSCI, Maybank FX Research & Strategy

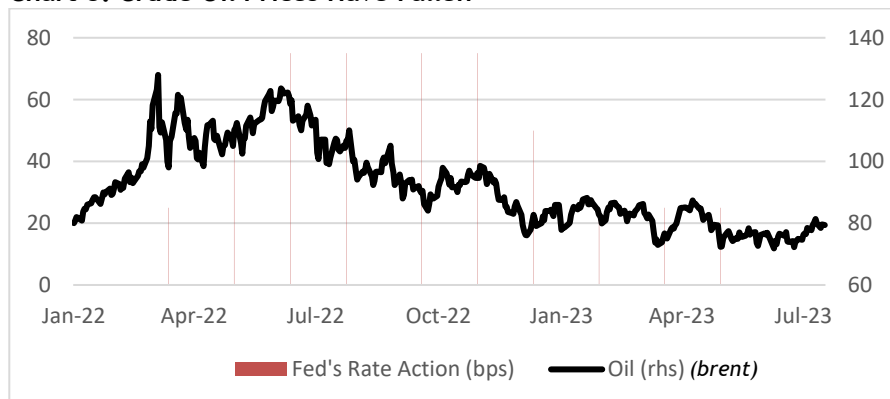
A look at the reflationary indicator - taking the MSCI World index/ FTSE Russell World Government Bond Index ratio as a proxy revealed that the reflationary process might have kick-started for a while now, potentially due to the excitement over the possibilities of AI and the potential for fresh chip demand.

**Chart 7: The World is Already in Reflation Now?**



Source: Bloomberg, Maybank FX Research & Strategy

**Chart 8: Crude Oil Prices Have Fallen**

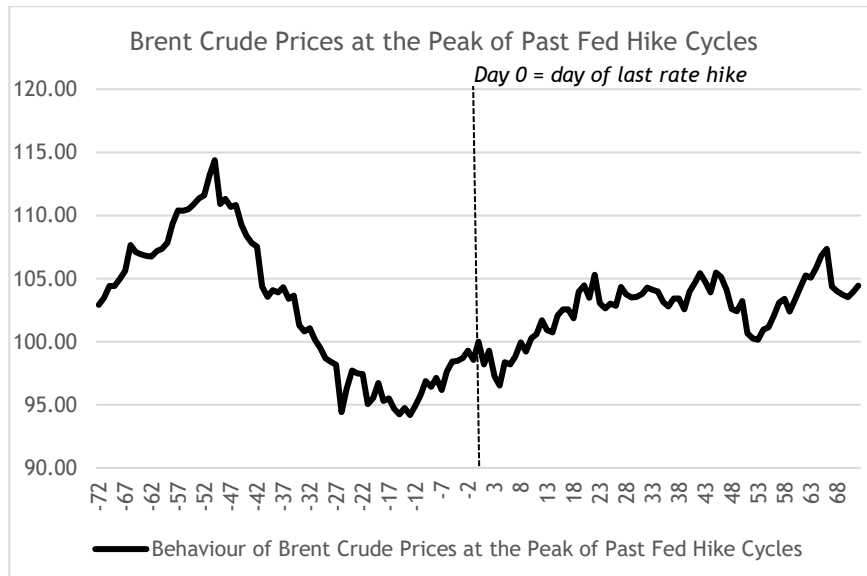


Source: Bloomberg, Maybank FX Research & Strategy

Oil prices has fallen and apart from the easing energy supply after the energy crisis that the world experienced in 2022, slowing growth had also played a part in the

decline of crude oil prices. The production cuts announced by major crude oil producers (Saudi Arabia, etc) have served to keep the crude oil prices stable and little recovery is seen.

**Chart 9: Brent Crude Prices See Some Climb After Last Hike**

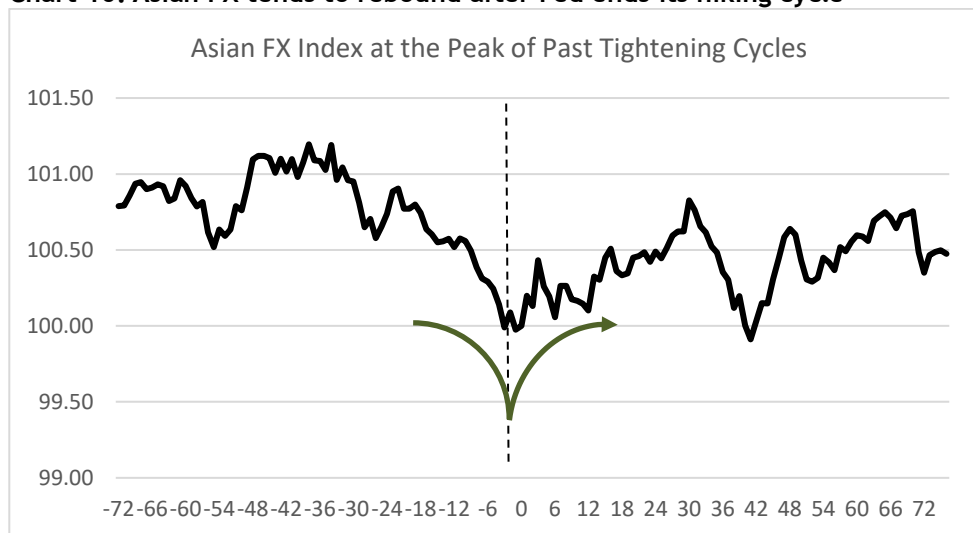


Note: Prices of Brent crude are indexed with price on last hike taken to be 100. We took into account four rate hike cycles (1995, 2000, 2006, 2018).

Sources: Bloomberg, Maybank FX Research & Strategy

History suggests that even in periods without war, oil prices do tend to fall as Fed continues to tighten monetary policy and only get some support after Fed stops hiking. This could be positive for oil-related currencies such as MYR and CAD.

**Chart 10: Asian FX tends to rebound after Fed ends its hiking cycle**



Note: Asian FX Index is an equally weighted index that consists of JPY, SGD, MYR, THB, IDR, INR, KRW, CNY against the USD.

Source: Bloomberg, Maybank FX Research & Strategy

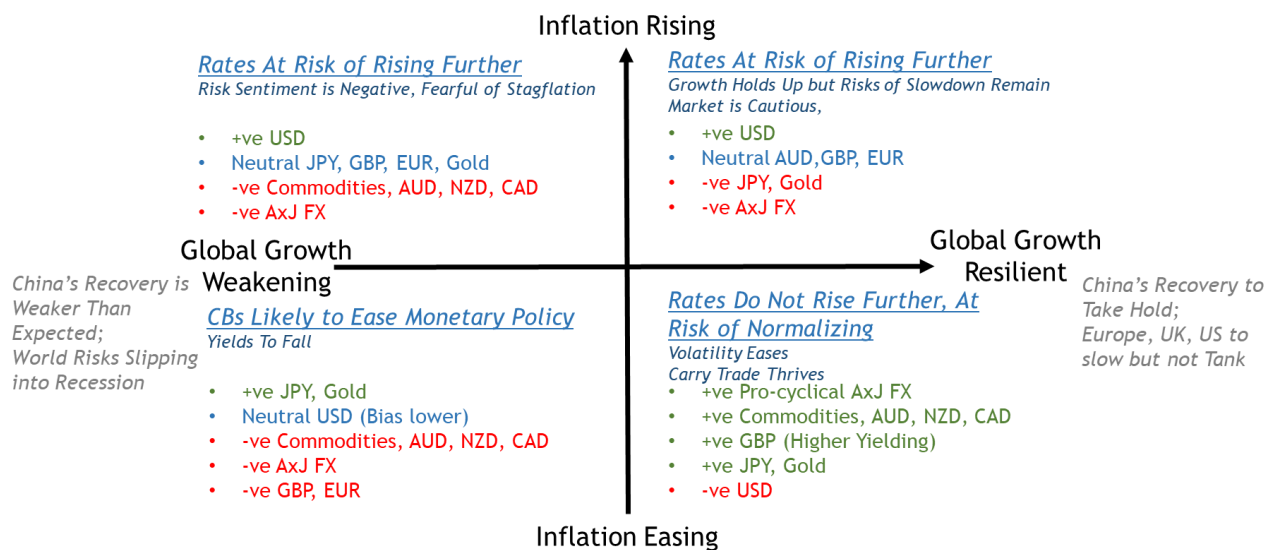
Asian currencies will start to strengthen as they have done in the past as the threat of further policy tightening on the global economy will start to fade, volatility will start to ease and carry trade will come into vogue once again. This is clear in chart 10 but it is also apparent that Asian currencies as a whole would not be able to make a full reversal amid lingering concerns on the global growth outlook that would naturally weigh on pro-cyclical Asian FX.

However, the above scenarios did not take into account the potential boost that China's recovery could bring. At this point, we prefer to be cautiously optimistic and expect China's recovery to only bring mild boost to the world. The China recovery effect may only emerge as early as 4Q 2023 or in 2024.

At this point of the report, what we have seen thus far is (a) our assumption that the world will witness a moderate slowdown (aka a soft landing), potentially cushioned by China's gradual recovery eventually albeit later. The end of the Fed hiking cycle could bring about equity rally (+ve for risk sensitive AUD, KRW, CAD), fall in UST yields (+JPY), rise in oil prices (+ve for CAD, MYR). Asian FX as a whole should see some support.

That said, we are also cognizant of the potential for the environment to shift. As such, we like to use a grid to guide us on our trading strategies according to the shifts in the environment taking into consideration only the balance of risks between inflation and growth dynamics.

**Chart 11: How to Trade the Constantly Shifting Environment?**



*Note: This chart should be taken with the context of the current interest rate environment (as of 21 Jul 2023) - that the Fed, BoE, ECB have hiked extensively.*

We build our forecasts on a scenario of a soft-landing and arguably, we see that happening in bottom right quadrant where inflation eases, global growth slows but not tank. That is a negative USD environment where US slows in line with the rest of the world. Pro-cyclical, risk-sensitive currencies will thrive well in an environment of stable yields. A gradual China recovery would be modestly positive for commodity-linked CAD, AUD and NZD. Gold could also benefit as real yields fall.

In the upper left quadrant, we envisage an environment of inflation trending back higher, potentially due to the wage price spirals. However, growth has started to slow more discernibly. Central banks (possibly including the Fed) would also be forced to raise rates and the possibility of a stagflation becomes more threatening. That would be negative for AUD, NZD, CAD and AxJ FX.

The upper right quadrant describes an environment where growth in the US and most parts of the world is resilient. Inflation remains elevated. There is the threat of further policy tightening and that is negative for the JPY and gold. A lack of clarity on the policy trajectory (especially in the Developed world) could keep the Asian FX on the backfoot. USD could be positive against the Asian FX and to a smaller extent, G10 FX.

The lower left quadrant is one that describes a more severe slowdown where China struggles to keep its recovery momentum. Fed is likely to cut and USD is likely to soften but growth concerns could keep the greenback supported on dips. We could potentially see USD strengthening back up should Asian currencies start to fall due to weak growth in the region. The fall in commodities will also affect AUD, NZD, CAD.

The above quadrants sum up broad trading strategies as the macro-environment shifts based on inflation and growth dynamics

In the next section, we use our augmented fast tracking model to guide and determine FX trajectories, specifically ASEAN + China using our base case, best case and worst case scenarios.

### Analyzing Where Currencies Would Head Under Various Scenarios

Taking into context the global developments, we try to examine the performance of ASEAN currencies and the CNY under various scenarios. We will look at a base, best and worst case scenarios. In the base case scenario, we expect the US and global economy to hit a soft landing with US growth positive but more likely below 1.0%. and the Fed to cut rates by about 200bps as US inflation would also cool to around 2.5%. This would concurrently also guide UST yields lower into the end of 2024 with the 10y yield by that point at 2.5%. China's growth recovery at the same time would also start picking up more discernibly from the end of the year onwards with moderate rate of growth to follow.

Meanwhile, the best case scenario would involve one of a goldilocks economy. For those less familiar, a goldilocks US economy would be one where growth is neither too slow or too fast and inflation is low. In such a scenario, US growth could be at a respectable 1.5% whilst inflation may drop below the target of 2.0%. The Fed could also engage in rate cuts of 200bps or more to bring down the rates from current elevated levels. Consequently, yields could ease from high levels and the 10y yield could be at 2.0% by end 2024. China's recovery would pick - up and growth may be much stronger than in the base case scenario, significantly outperforming the rest of the world.

In the worst case scenario, we would be expecting a situation of a recession but inflation reaccelerates to elevated levels. The US economy registers negative growth whilst the Fed continues to keep raising rates, possibly by another 200bps to tackle the high inflation numbers. UST yields as a result could keep rising to 7.00%, which levels last seen in the 80s/90s. China's economy keeps struggling showing no signs of any recovery and deflation takes hold with the central bank engaging in further rate cuts.

### Methodology

Our fast tracking model regression were run in OLS with USD - Asian currencies and explanatory variables such as reflation (MSCI World Index/FTSE World Government Bond Index), current account differential between the US and respective Asian country and real 10y yield differential between UST and the respective Asian country sovereign bond. We then augmented the regression for the respective currency pairs with additional relevant variables as follows:

1. For the USDMYR, augmented by both including a variable each for Brent prices and USDCNY.
2. For the USDIDR, augmented by including a variable each for crude palm oil prices and Brent prices.
3. For the USDTHB, augmented by including a variable each for USDCNY, DXY and gold prices.
4. For the USDSGD, augmented by including a variable each for USDCNY, DXY and USDMYR.
5. For the USDCNY, augmented by including a variable for DXY.



We incorporated the following key assumptions to create our forecasts

**Table 1: Key Scenarios and Assumptions**

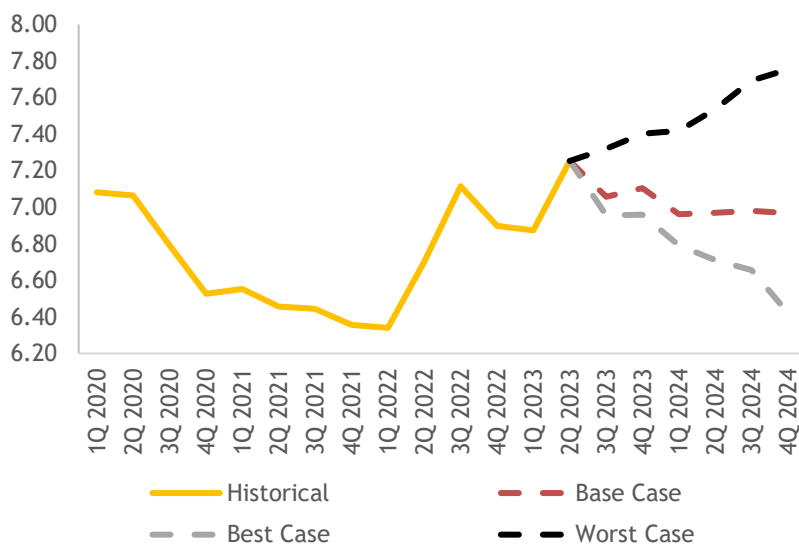
Year/Variable	Base Case		Best Case		Worst Case	
	2023	2024	2023	2024	2023	2024
DXY	103	98	98	85	110	130
UST 10 Y Yields	3.0%	2.5%	3.0%	2.0%	4.0%	7.0%
MSCI World Index	3150	3300	3250	3500	2900	2600
FTSE World Government Bond Index	1000	1200	1000	1200	950	800
Brent (US\$)	85	90	90	100	60	55

Source: Maybank Investment Bank Macro team inputs, Maybank FX Research & Strategy assumptions

The results of our model estimations provides guidance to possible range of scenarios that could emerge over the next 6-18 months. We currently do not include a high probability for the worse case scenario materialising over the next year so the skewness in the charts for the FX forecasts reflects this.

#### USDCNY

**Chart 12: Performance of USDCNY Under Different Scenarios**

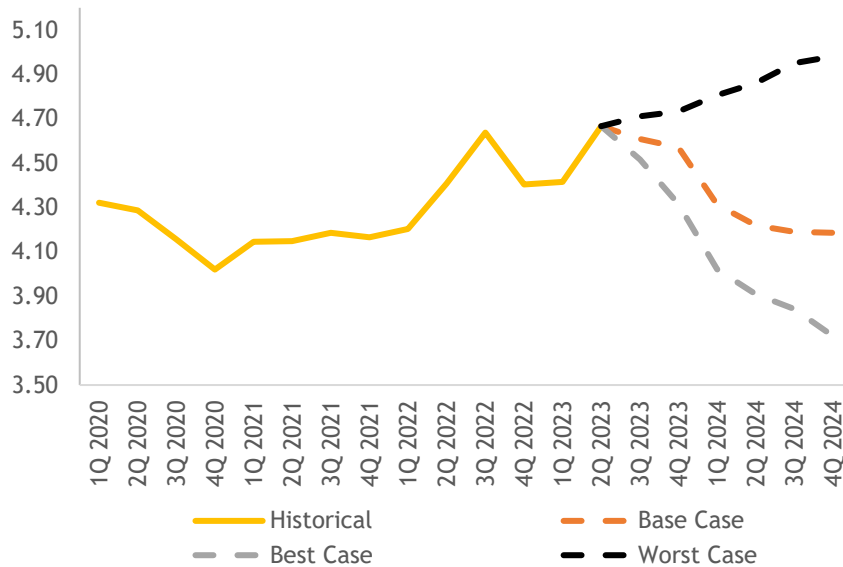


Source: Bloomberg, Maybank FX Research & Strategy

There is about a 14% difference between the USDCNY in the best case and worst case scenario. In the best case, the USDCNY would head back down towards 6.96 by end 2023 and 6.42 by end 2024 which are levels not seen since 2021. However, in the worst case scenario, the USDCNY would reach 7.40 at end 2023 and close to 7.80 by end 2024, which itself would be the highest level since 2005 - around the time when the currency was pegged to the USD. Our base case expectation is for the USDCNY to end 2023 at about 7.10 and 2024 at around 6.97.

## USDMYR

Chart 13: Performance of USDMYR Under Different Scenarios

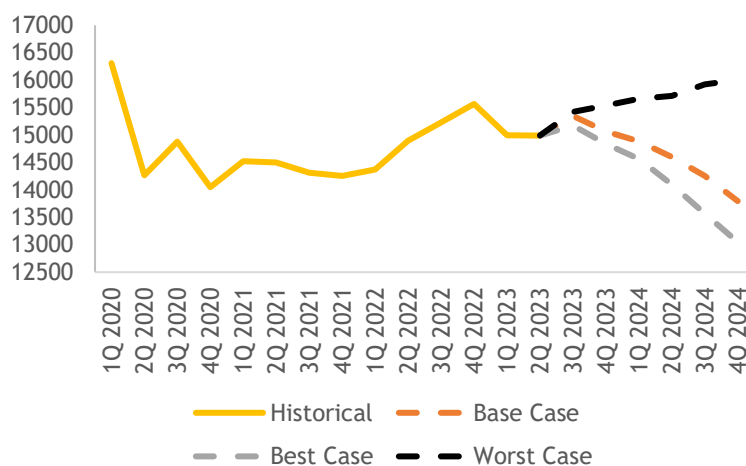


Source: Bloomberg, Maybank FX Research & Strategy

For the case of the USDMYR, the worst case scenario would witness the currency hitting around 4.70 at end 2023 and close to 5.00 by end 2024. This would come on the back of Malaysian inflation also rising like it does for its US counterpart and the economy also seeing a recession. BNM may raise rates in order to tackle the high inflation but they may still be a laggard to the US amid concerns of the state of the local economy. In our best case scenario, with strong China growth and the US economy holding up, Malaysia's growth would also similarly be strong. Inflation also eases and maintains at manageable levels. BNM may not move as they see that interest rates are at normalized levels but rate differentials with the US should widen as the Fed cuts rates. The USDMYR should hit around 4.30 at end 2023 and close to 3.70 by end 2024 in this case. Meanwhile, the base case would see the currency pair end 2023 at around 4.57 and 2024 at around 4.20. In this situation, Malaysia would still see positive growth amid a recovery in China (though less strongly than the best case) and inflation also eases. BNM may not move the rates as they may see at normalized levels again but with Fed rate cuts, the rate differential would widen benefiting the MYR.

## USDIDR

Chart 14: Performance of USDIDR Under Different Scenarios

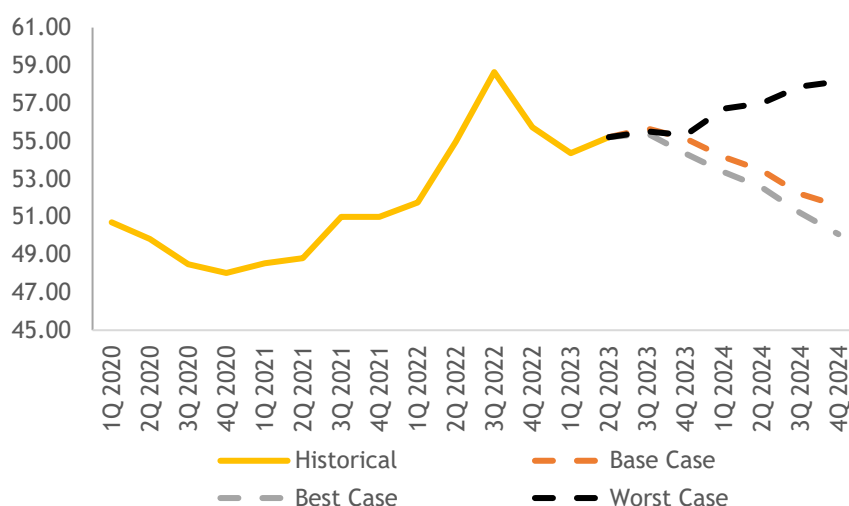


Source: Bloomberg, Maybank FX Research & Strategy

With regards to the USDIDR, we see a bigger disparity between the base case and worst case rather than with the best case. Our reasoning behind this is that sentiment in the base case we believe is likely to be rather strong and that further upside even in a best case would be more limited given there are not so much more significant factors that can boost the currency. In the base case, we already see that manageable levels of inflation is likely to position Bank Indonesia (BI) to be among the first to cut that would make the high yielding IGBs appealing and give support to the currency. Furthermore, Indonesia resiliently maintaining a trade surplus and strong fiscal discipline also gives a boost to the currency. The USDIDR may hit close to 15,000 by end 2023 and 13,800 by end 2024 in this scenario. The best case scenario would not be too different from the base case except that a weaker DXY as the global economy being strong would lead the USDIDR lower towards about 14,800 by end 2023 and 13,000 by end 2024. In the worst case scenario, the IDR would perform a lot more poorly given that if the Fed keeps hiking rates, market players would be quick to unwind positions in the high yielders such as the IGBs, weighing on the IDR. Furthermore, if rising global inflation feeds into Indonesia's inflation too, then BI could feel the pressure to raise rates too, which in turn could lead to some further unwinding in existing positions in IGBs. The USDIDR in this scenario would be at about 15,500 by end 2023 and 16,500 by end 2024.

## USDPHP

Chart 15: Performance of USDPHP Under Different Scenarios

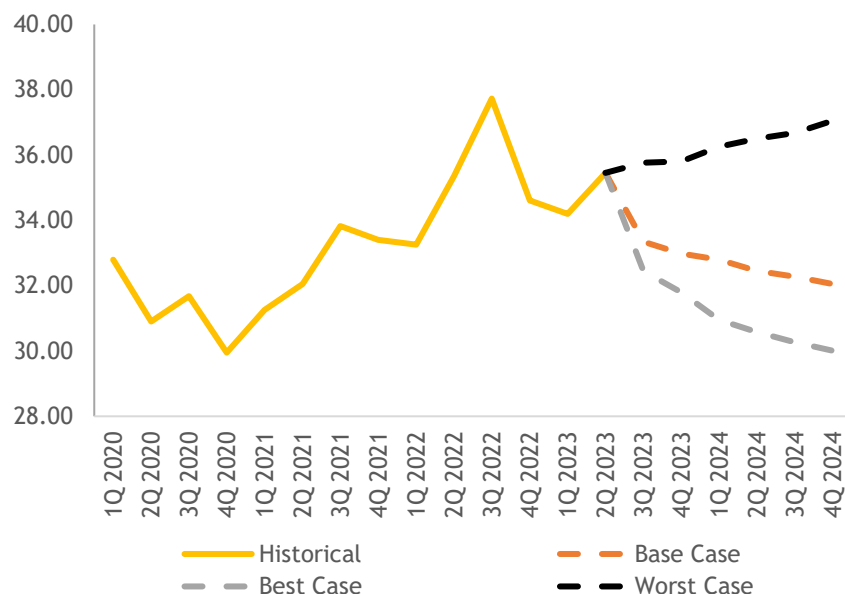


Source: Bloomberg, Maybank FX Research & Strategy

We also do not expect a significant difference in the PHP's performance between the base case and best case. In the base case, the PHP would benefit from USD strength coming off and US rates falling too. However, the twin deficit condition would limit the extent to which the PHP would strengthen with the USDPHP hitting around 55.00 by end 2023 and 51.50 by end 2024. In the best case scenario, the twin deficit would still persist and the PHP would only see some additional strengthening from the USD being weaker than in the base case scenario. We see it finishing 2023 at about 54.30 and 2024 at close to 50.00. In the worst case scenario, the PHP's twin deficit would work heavily against it as investors would attempt to aggressively unwind positions in EM currencies with such characteristics. The USDPHP would therefore rise to about 55.50 at end 2023 and 58.00 by end 2024.

## USDTHB

Chart16: Performance of USDTHB Under Different Scenarios

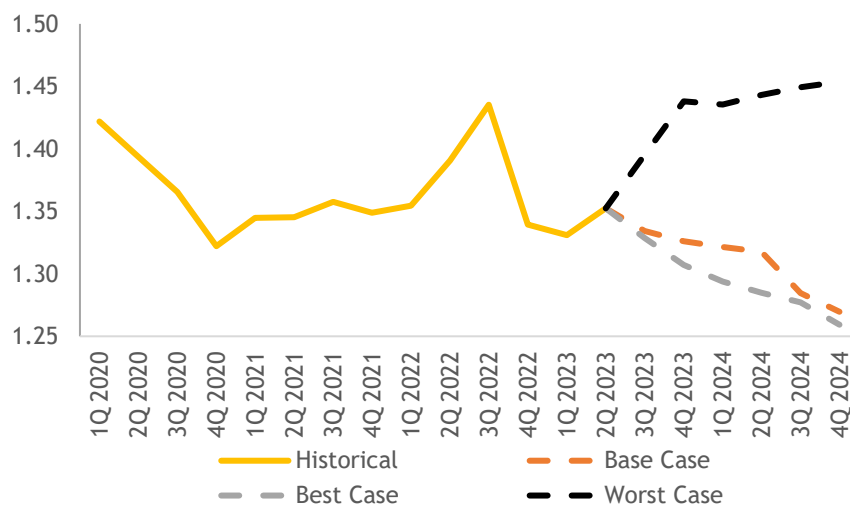


Source: Bloomberg, Maybank FX Research & Strategy

The USDTHB can see some quite disparity in performance depending on the scenario. In our base case, with a recovery in China becoming more discernible towards year end, we expect the increase of Chinese tourists coming into Thailand to turn the current account into a surplus and give support to the currency. This should bring the USDTHB to around 33.00 at end 2023 and 32.00 by end 2024. However, in the best case scenario, stronger Chinese economic growth would lead to more Chinese tourists travelling overseas and widening the Thai current account surplus, further boosting the currency and likely pushing it to hit close to 32.00 at end 2023 and 30.00 by the end of 2024. In contrast, the worst case scenario would result in a lot of downside for the THB. Under that situation, given China's economy continues to struggle, there may not be a large influx of Chinese tourists into Thailand. This may keep Thailand's current account in deficit and weigh on the THB, resulting in the current ending 2023 at 35.80 and 2024 at about 37.00.

## USDUSD:

Chart 17: Performance of USDUSD Under Different Scenarios



Source: Bloomberg, Maybank FX Research & Strategy

The USDUSD would face more upside in the worst case scenario where the greenback would strengthen and weigh on the SGD given its high weightage in the Jul 24, 2023

SGDNEER. However, given the SGD's resilience during times of stress, the pair may only hit about 1.38 at end 2023 and 1.45 by end 2024. That would also be around the highest level that the USDSGD has been at in the last decade. In the base case, China's continued recovery and the coming off of DXY strength amid stronger global growth should lead the USDSGD to around 1.33 at end 2023 and 1.27 by end 2024. In the best case, stronger China economic recovery and global growth (lead the DXY even weaker) should guide the USDSGD to about 1.30 at end 2023 and to around 1.25 by end 2024.

**Significant Weakness in Worst Case Scenario Whilst More Pronounced Upside only in MYR, THB and CNY in Best Case Scenario**

As can be seen, all the currencies can see quite substantial downside in the worst scenario (low probability) which is of little surprise given continued Fed rate hikes and weak global growth have tendency to heavily hurt the EM or Asia currencies. Meanwhile, the upside may only be stronger in the best case scenarios for currencies that are heavily tied to China's growth story which are namely the MYR, THB and obviously the CNY. As for the IDR, it tends to be more impacted from a US rates perspective and hence, the US growth story but given there is likely to already be very strong optimism in the base case, we do not expect the optimism can be so much stronger in the best case. The PHP may not strengthen so much more in the best case scenario vs the base case given that the twin deficit would persist in both scenario and limit the currency's strengthening.

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