

## FX Insight

# US Pivot and Event Risk at Play

### Rate Cuts Could Still Be a Possibility for 2023

For most part of this year, the Federal Reserve officials have repeatedly pledged to remain firmly committed to take inflation down to the medium-term target of 2%. While more officials have started to become cautious of the accumulative effect of the aggressive rate hikes undertaken thus far, all officials refrained from signaling an outright monetary policy pivot (to rate cuts). Our most conservative projection for US inflation suggests headline CPI could land around 3% by the end of the year, above the 2% target. However, a look into history suggests that Fed is still more sensitive to labour market deterioration rather than inflation. As such, rate cuts in 2H 2023 are still a possibility.

### Not All Rate Cuts Bring USD Weakness, But Our Base Case Expects So

We investigated the rate cut cycles since the turn of the century for the impact of rate cuts. **The first finding is that not all rate easing cycle bring about significant USD weakness.** USD strengthened substantially in 2001 as the US economic cycle seems to have troughed already by the first cut and started to rebound ahead of the rest of the world. In 2007, USD weakened more as other central banks continued to tighten after Fed cuts. That could hint of mild USD weakness for 2H 2023 should ECB and BoE continue to hike after Fed pauses/cuts. When Fed eased in 2019, global growth slowed gradually along with the US. USD saw mild weakness. In this cycle, our base case assumes growth to slow gradually, potentially cushioned a tad by a delayed China recovery. USD could thus weaken. **Second major finding, SGD, MYR, THB, IDR have performed well after Fed started easing in 2007 and 2019. Third, Gold strengthened when the Fed cuts, yields fall and USD weaken. So gold could still remain a preferred play.** In a black swan event, gold could also continue to outperform. So the environment in a late cycle continues to favour gold, especially as tightened credit conditions result in stresses in the financial markets that could erupt into crises. We developed a market sentiment index to monitor signs of market stresses.

The exception is if the US economy were to rebound faster than expected and ahead of the RoW, the USD strength would negate the boost that the decline in the real yield brings to gold.

### US Debt Ceiling and Default - A Risk We Cannot Ignore

We have assigned a 60% probability of the debt ceiling to be raised and default avoided and make this our base case given that we think neither the Republicans or Democrats would want to risk being blamed for the ensuring fallout that can come from a default. X-date has just been revised to 5 Jun and we anticipate that it could fall anytime between Jun-Oct. However, the longer the government stays afloat without a deal, the higher the volatility is likely to be for markets due to a rising uncertainty.

In the event there is a default, the DXY has historically shown to be more subdued. This time around, it is difficult to say that necessarily DXY strength would come off because market focus may be towards the Fed rate path. If the debt ceiling is raised and default avoided (even whether a deal is done at the eleventh hour), sentiment may improve and the risk-sensitive currencies including the MYR, THB, PHP and IDR may get a lift. SGD may also see some strengthening.

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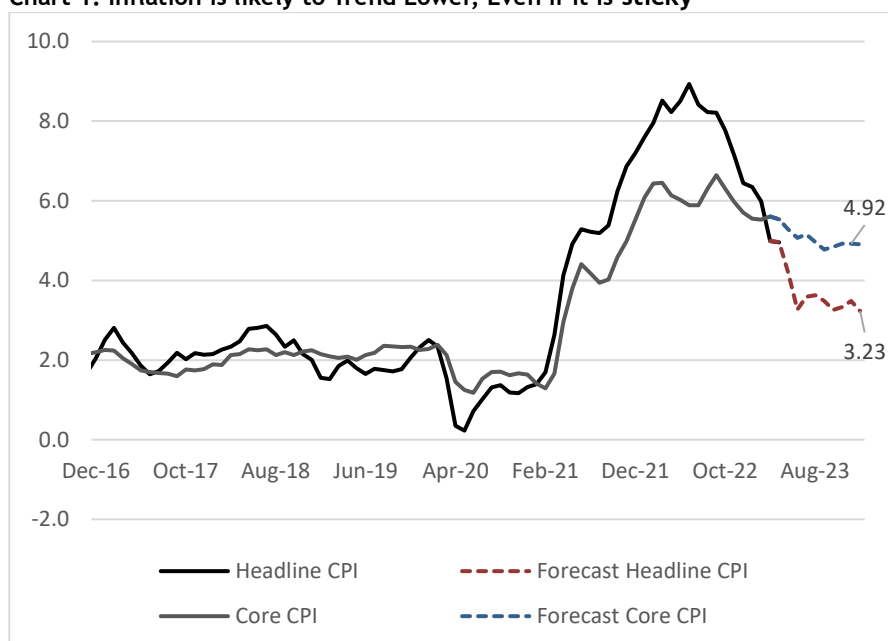
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## When the Fed Cuts...

For most part of this year, the Federal Reserve officials have preferred to err on the side of caution with repeated pledges to remain firmly committed to take inflation down to the medium-term target of 2%. While more officials have started to become cautious of the accumulative effect of the aggressive rate hikes undertaken thus far, all officials refrained from signaling an outright monetary policy pivot (to rate cuts). In order to have a proper assessment on whether the Fed could cut, we thought it is best to assess by first making a most conservative projection of US inflation.

It is perhaps conservative to assume that inflation could remain sticky but we are also aware of a high base present in the 2H 2022. As such, we took the 6-month moving average of the month-on-month momentum for both headline US CPI and US Core CPI to project inflation for 2H of 2023. Headline US CPI is found to potentially drift towards 3.2% while core CPI could hover under the 5%-level in the second half of the year assuming there is little disinflation from Apr.

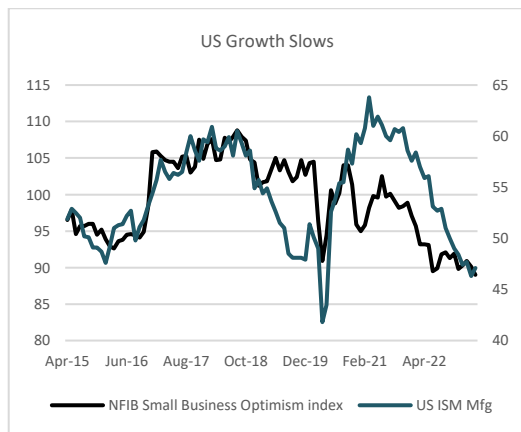
**Chart 1: Inflation is likely to Trend Lower, Even if it is sticky**



Source: Macrobond, BEA, Maybank FX Research & Strategy Estimates

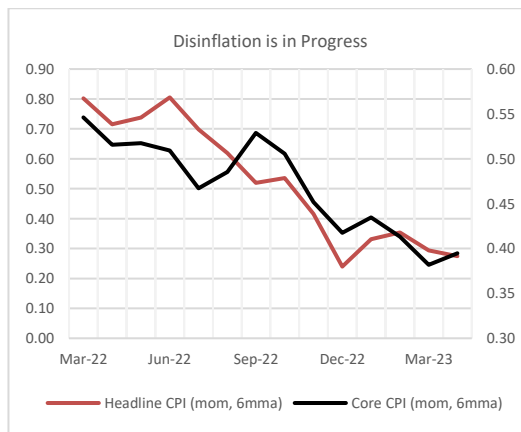
However, growth in the US has slowed based on certain leading indicators and on top of that, disinflation has been in progress with small businesses least optimistic in a decade based on NFIB data while ISM Manufacturing also continues to contract. Correspondingly, risks are skewed to the downside for inflation metrics, albeit elevated.

**Chart 2: Business Optimism Slumps**



Source: Macrobond, National Fed of Ind. Business

**Chart 3: Disinflation is In Progress**

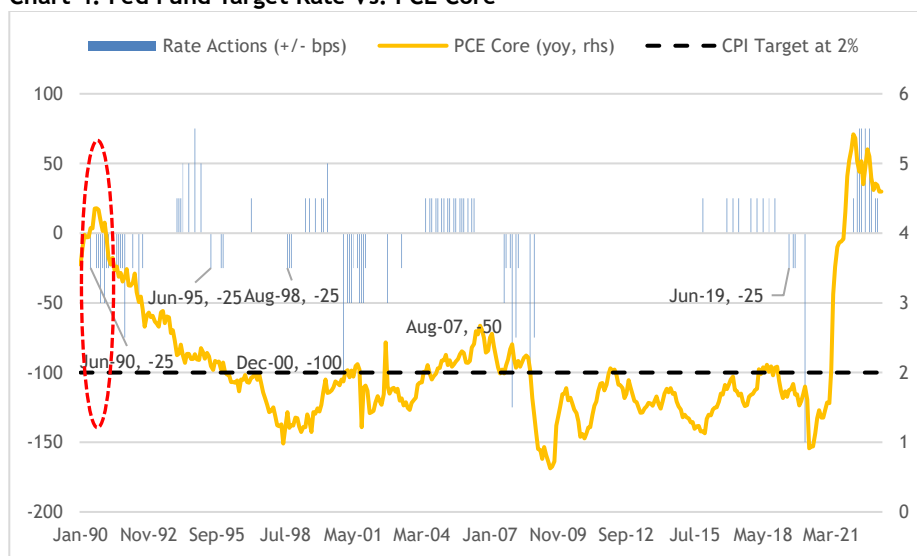


Source: BEA, Maybank FX Research & Strategy

## Has the Fed Ever Cut Policy Rate When PCE Core Was Above 2%?

At one point, right after the last FOMC meeting, markets priced in between 3-4 rate cuts (25bps each) through Jan 2024 based on the Fed Fund Futures. That expectations have since pared but rate cuts are still a possibility in 2023. Assuming that inflation is really sticky and the progress of disinflation hits a bump, our inflation projections for the next half of the year into 2024 could be well above the 2% inflation target. But, should labour market conditions deteriorate considerably, the Fed could inevitably be compelled to cut. We looked into the past to see if the Fed has ever lowered policy rates in spite of elevated price pressure. There weren't many instances due to the fact that inflation was well anchored for much of the past three decades. However, back in 1990, the Fed did cut the target rate even as inflation was trending higher.

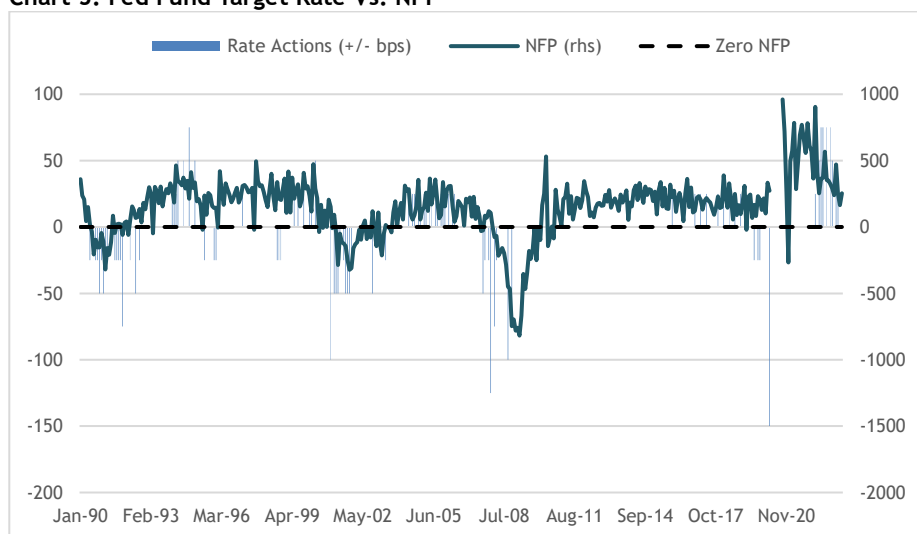
**Chart 4: Fed Fund Target Rate Vs. PCE Core**



Source: Bloomberg, BEA, Maybank FX Research & Strategy

This is due to the fact that labour market was deteriorating significantly then. NFP slipped quickly into negative. Labour market metrics are thus, still better predictors of rate cuts. We also note that Fed tends to pause when NFP drifts into the region of 0-200K and cuts, when the NFP trends into negative.

**Chart 5: Fed Fund Target Rate Vs. NFP**



Note: Data in the pandemic months of 2020 were left out in order to better display the full NFP historical data.

Source: Bloomberg, BLS, Maybank FX Research & Strategy

We looked into the rate cut cycles since the turn of the century for the impact of rate cuts on FX, Treasury yields and gold prices in 1-week, 1- month, 3-month and 6-month period. There were three easing cycles and they start from 2001, 2007 and 2019.

Table 1: When the Fed Starts to Cut Rates...

2001																			
	FFTR	DXY	EUR	GBP	AUD	NZD	CAD	SGD	MYR	THB	PHP	IDR	KRW	JPY	CNY	SPX	UST 10Y	UST 2Y	Gold
1Wk	--	0.84	-0.87	-0.95	0.21	0.36	-0.06	0.19	0.00	1.44	-2.25	-0.02	1.90	-2.14	0.01	1.37	8.50	-20.30	-0.56
1Mth	--	1.22	-1.36	-1.66	-1.64	0.27	-0.09	-0.02	0.00	3.50	1.65	-0.44	1.53	-1.04	0.01	7.03	17.10	-30.70	-0.19
3Mth	--	8.04	-7.62	-5.58	-14.81	-11.02	-5.54	-4.31	0.00	-3.06	1.35	-8.94	-5.46	-9.78	0.00	-10.71	6.20	-64.90	-5.09
6Mth	-275.00	10.00	-10.79	-5.81	-8.96	-8.73	-1.40	-4.71	0.00	-3.37	-4.75	-16.61	-1.90	-8.27	0.02	-4.59	49.70	-62.00	0.59
2007																			
	FFTR	DXY	EUR	GBP	AUD	NZD	CAD	SGD	MYR	THB	PHP	IDR	KRW	JPY	CNY	SPX	UST 10Y	UST 2Y	Gold
1Wk	--	-1.50	1.59	1.38	4.14	5.66	2.53	1.09	1.74	0.31	2.31	2.64	1.13	0.23	0.17	2.78	16.22	-2.51	1.76
1Mth	--	-2.01	2.46	2.29	6.95	6.44	5.44	3.43	3.42	1.59	4.91	3.13	1.30	-1.34	0.00	4.37	8.62	-9.24	5.14
3Mth	--	-2.87	4.05	1.13	3.26	8.26	1.02	4.43	4.95	6.47	13.12	0.38	-0.01	1.63	2.05	-0.59	-23.20	-75.87	10.72
6Mth	-225.00	-9.59	12.75	1.95	13.62	15.79	4.38	9.95	10.46	2.13	12.17	1.76	-5.29	14.39	6.06	-10.91	-93.99	-244.02	38.57
2019																			
	FFTR	DXY	EUR	GBP	AUD	NZD	CAD	SGD	MYR	THB	PHP	IDR	KRW	JPY	CNY	SPX	UST 10Y	UST 2Y	Gold
1Wk	--	-0.43	0.39	0.16	-1.62	-1.33	-0.97	-0.79	-1.61	0.21	-2.37	-1.86	-2.59	2.01	-2.02	-4.36	-35.57	-26.29	3.04
1Mth	--	0.47	-0.88	0.24	-2.10	-4.57	-1.03	-1.23	-2.15	0.52	-2.49	-1.27	-2.27	1.95	-3.64	-2.94	-56.35	-32.59	6.76
3Mth	--	-0.29	-0.49	5.85	-0.49	-3.98	0.75	0.62	-1.44	1.88	-0.65	0.04	1.12	-0.34	-2.60	0.87	-21.60	-20.24	4.31
6Mth	-75.00	-0.20	-1.17	7.58	-0.58	-0.09	0.08	1.43	1.49	0.75	-0.01	3.02	0.99	-0.62	-0.28	9.37	-37.41	-35.12	9.83

Note: All currency performance (except the DXY index) is taken as a % change against the USD within the time frame indicated. Price changes are taken from a day before the Fed eases for the first time in that cycle. For UST 10y and 2y yields, impacts were measured by taking the difference in bps. Also note that MYR was still pegged to the USD in 2001.

Source: Bloomberg, Maybank FX Research & Strategy

The first finding is that **not all rate easing cycle bring about significant USD weakness**. In fact, the 2001 rate cut saw significant USD strength that lasted for at least 6 months. During the period, AUD weakened substantially (-15% vs. USD) within three months, alongside equities (S&P 500) and IDR was sold off severely as well. EUR was under pressure. That was a period of clear risk-off that spurred USD strength. Much of the world was well into a cyclical downturn (marked by the blue line for OECD countries) but OECD Business Confidence Index (BCI) was already pointing to a rebound for the US (grey line). That contrast strengthened the USD. UST 10y yield rose while UST 2y fell, a reflection of improving economic prospect. Gold did not gain much.

Chart 6: Business Confidence Index for OECD, USA and DXY index



Note: The amplitude-adjusted OECD Composite Leading indicator typically normally precedes turning points of business cycles with a 6-9 month lead.

Source: OECD, Bloomberg, Maybank FX Research & Strategy

In 2007, the DXY index weakened almost 10% in the six months from the first rate cut in Sep 2007. AUD, EUR, NZD strengthened substantially as their respective central banks remained on a tightening cycle. Notably, S&P 500 was down and gold was up, six months on. Similarly, we may be able to expect EUR to potentially retain some resilience should Fed start to cut earlier than expected and ECB continues to hike in 2H 2023. Back to the 2007 cycle, gold was up as yields fell, boosted all the more by the USD weakness. During the same period, most Asian FX (except for KRW) gained.

The easing cycle which started in Jul 2019 saw only slightly softer USD as US growth weakened alongside global growth. The magnitude of rate cuts could also be small during the six months. The slowdown was relatively shallow for the US and thus we saw S&P recovering by the end of six months. Even so, gold was also up significantly as UST yields declined substantially. The notable FX winners were Asians - SGD, MYR, THB, KRW, IDR by the end of six months.

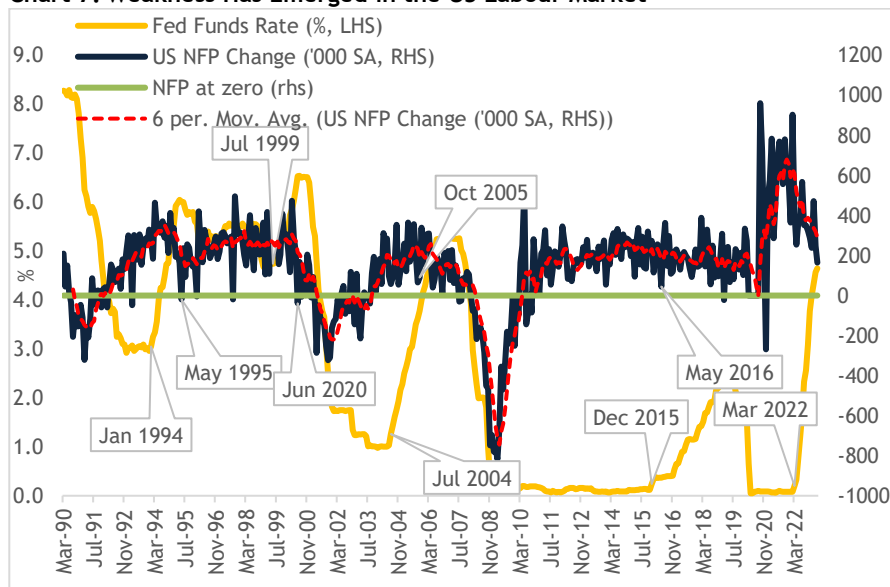
At present, we are arguably already in a global economic slowdown, based on the OECD Business Confidence index (chart 6). That has been supporting the USD on dips and to some extent gold prices. With labour market gradually easing and inflation still elevated, there could be some consolidation for the USD as the Fed reaches peak terminal rate and potentially provide a hawkish pause. **We cannot rule out a knee-jerk pullback in the greenback should Fed pauses in Jun as markets have started to price in a hike in Jun to some extent.** Fed Fund Futures already imply almost 50% probability of a rate hike as of 25 May. **Thereafter, the USD could settle into range-trades.**

If anything, risks could be skewed to the downside for the USD in the next six months, as ECB seems to have more runway in its rate tightening cycle and could hike their policy rates for possibly another 50bps more based on OIS. However, the threat of inflation may possibly keep the USD supported on dips before the Fed executes the first rate cut upon labour market deterioration.

#### When the Fed Cuts This Time...

A global slowdown has already begun. There could be a chance that when the Fed begins its easing cycle, the US economy as well as the rest of the world could be closer to the bottom of their respective economic cycles, and China's recovery pick-up could provide some buffer.

Chart 7: Weakness Has Emerged in the US Labour Market

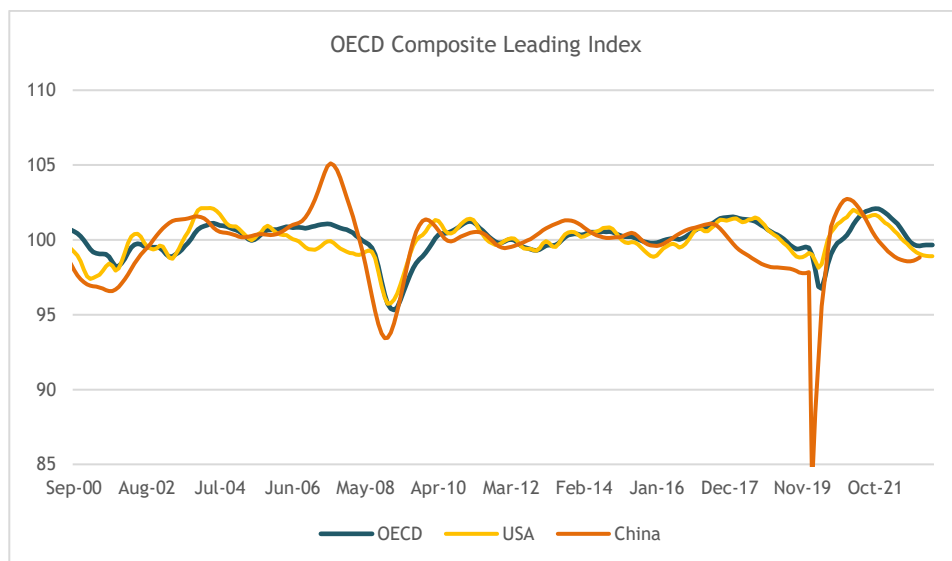


Source: Maybank FX Research & Strategy

There are signs of softening in the US labour market already but resilience in the services sector could help to enable soft landings. A mild slowdown for the US thus, remains our base case. Should the Fed cut policy rates in an environment of gradual global slowdown, **the USD could weaken modestly.** The UST yields would fall from current elevated levels. **The potential for the USD and UST yields to come off in**

such a macro environment could provide a boost to gold. We think this could liken the 2019 episode where gold and S&P 500 could rise at the same time while UST yields fall.

**Chart 8: China is at the cusp of recovery, gradual as it could be**



Source: Bloomberg, Maybank FX Research & Strategy

Should China growth start to pick up, we could be in a sanguine environment that is constructive for cyclical currencies such as AUD, NZD and KRW. We prefer to remain patient and accumulate on dips as these currencies are also sensitive to UST volatility that could still continue for a while yet and China's recovery could take some time. Based on history, Asian FX such as SGD, MYR, THB and IDR are more consistent performers in an environment of gradual global growth slowdown (2019, 2007) and UST yields were on a decline. We should remain positive on these currencies when Fed starts to pivot to a cut. In the present conditions, IDR could continue to outperform with its positive carry over the USD. Currencies such as MYR that has been under pressure due to the negative carry can spring back.

**In conclusion**, we think that USD could continue to consolidate within the next few months as Fed policy rates crest with a hawkish stance. However, balance of risks to the greenback could remain to the downside as there could potentially be other central banks such as the ECB and BoE that could continue to hike. EUR may outperform for a while, similar to what we have seen when Fed first cut rates in 2007. Into the first Fed cut that could happen in the next six months, we assume that the global slowdown could still be gradual with a slight chance of a buffer from China's recovery. **SGD, MYR, THB, IDR** have performed well in such environment in 2007, 2019. AUD, NZD and KRW could also be lifted this time, conditional on China's cyclical recovery.

#### JPY and Gold Still a Good Hedge

We do not rule out the potential for a black swan event occurring since credit conditions have been tightening and unforeseen stresses/accidents could erupt in the financial markets. In such an event, UST yields may drop more sharply, gold and JPY could outperform amid flight to safe havens. As such, **gold and JPY could remain good hedges** in late cycles. We further explore a tool in the next section to monitor market sentiment.

#### Sentiment Index

##### Methodology

The sentiment index model aims to capture the overall market sentiment by incorporating the daily changes in the USD (US Dollar) Index, US Treasury 2-Year Yield, US Treasury 10-Year Yield, and the absolute level of the VIX (Volatility Index).

To construct the sentiment index, we calculate the daily percentage changes for the USD Index, 2-Year Yield, and 10-Year Yield. These changes represent the relative movements in these variables from one day to the next. For the VIX, we use the absolute level as it provides a measure of market volatility.



The sentiment index is constructed by summing the daily changes in USD, 2-Year Yield, and 10-Year Yield, along with the absolute level of the VIX for each day. This provides a single measure that represents the overall market sentiment. The sentiment index is plotted over time to visualize its trend and fluctuations. This plot helps in understanding the changes in market sentiment over the specified period.

The higher the value of the index, the greater the level of fear (bearishness) in the market, the lower the value of the index, the greater the level of greed (bullishness) in the market.

### Observations

Against a backdrop of the US debt ceiling, uncertainty surrounding the Federal Reserve's future moves and signs of economic weakness from China, we note that the sentiment index suggests today that sentiment is still in a fairly moderate region i.e. neither too bullish nor too bearish. We would think that there is ample room for sentiment to further deteriorate, given that there are several issues that could severely heighten market volatility. We note that the previous periods of peak-bearishness occurred during the Global Financial Crisis (2008 to 2009) and the global Covid-19 pandemic (2020).

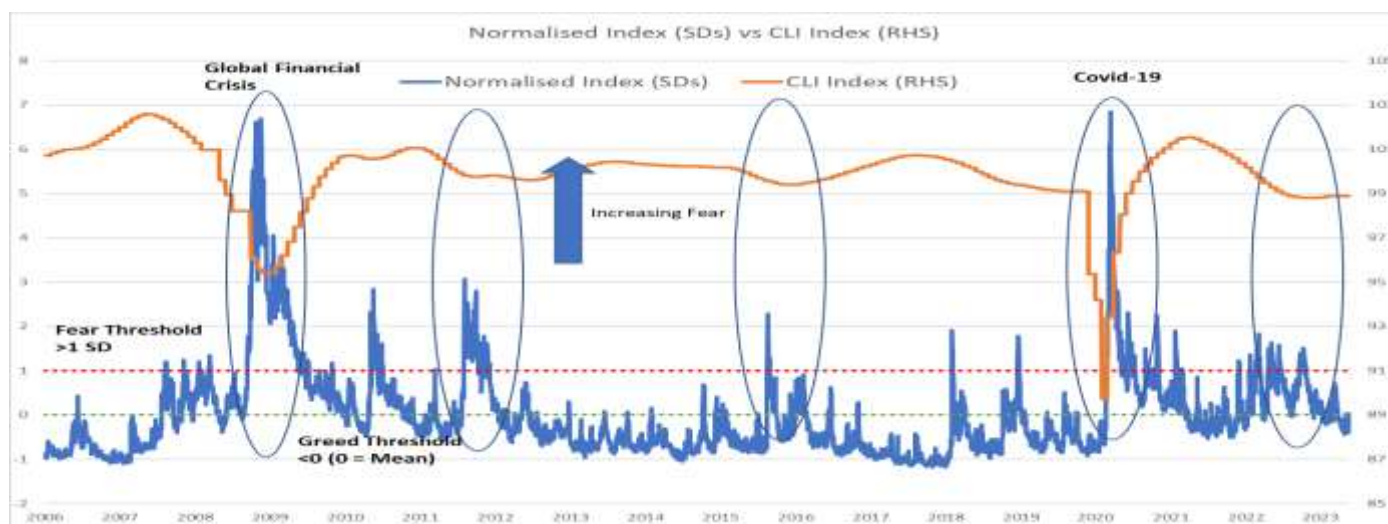
We note that periods of heightened fear based on the sentiment index often coincide with turning points in the business cycle as shown by the G-20 composite leading index (CLI). **We think that the sentiment index could thus be used as an indicator to predict when there might be a turning point in the business cycle, given that the sentiment index is generated daily and the leading index is released monthly.**

We also suggest that in times of lower fear, safe-havens could be relatively cheap, and it may be worth increasing allocations to traditional safe-havens such as gold, JPY, CHF or the USD/USTs in case of a turn in sentiment. Greed rarely goes more than one standard deviation beyond the mean, and this could perhaps be a reasonable reference threshold to begin looking for buying opportunities.

### Limitations

While the sentiment index model provides a framework for capturing market sentiment using the daily changes in the USD Index, US Treasury yields, and the absolute level of the VIX, it is important to acknowledge its limitations and consider potential improvements. We are cognizant that more variables could be selected, variables could be better selected or that the model could be extended by incorporating various time-series analysis techniques to account for the dynamic nature of market sentiment. Overall, the sentiment index model is a starting point for capturing market sentiment, but further refinement and enhancements are necessary to improve its predictive power and reliability in capturing the complex dynamics of market sentiment.

**Chart 9: Sentiment Index Chart vs G-20 CLI Index (RHS)**



Source: Maybank FX Research & Strategy Estimates, OECD, Bloomberg

May 25, 2023

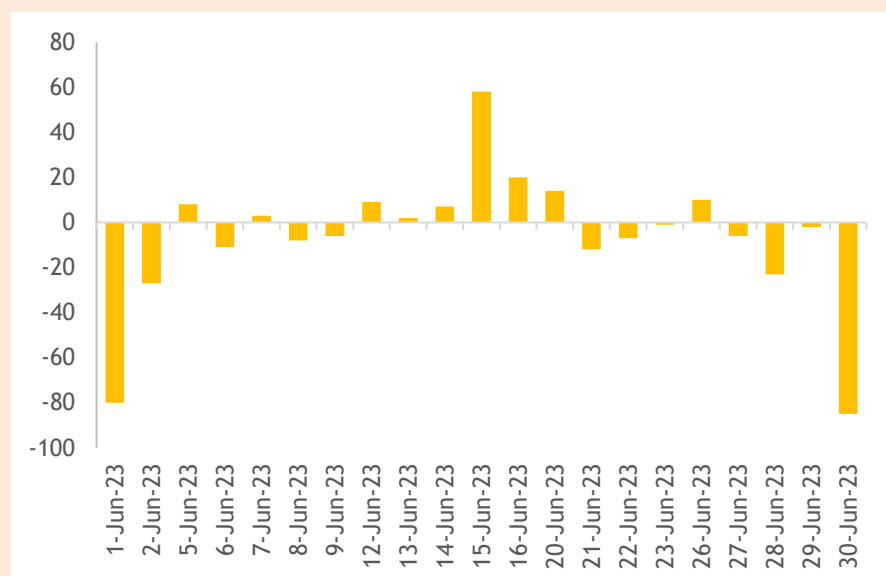
## Event Risk Alert: Debt Ceiling Threat Persists

While the hawkish Fed re-pricing continues to be a dominant market driver, there is an event risk we cannot ignore - US debt ceiling impasse, with the White House, Democrats and Republicans being unable to reach an agreement. The clock is ticking with Treasury Secretary Janet Yellen having warned that her “assessment is that the odds of reaching June 15 while being able to pay” all of the bills is “quite low”. Both sides have some major differences to iron out and the stand still is already causing anxiety in markets. In this piece, we therefore explore the outcomes that could occur and the impact on the FX markets.

### How Long Does the US Government Really have?

The so called “X-date” or day when the US government actually starts defaulting is constantly changing based on how the Treasury’s cash, expenditure and revenue position evolves. According to Bipartisan Policy Center (BPC), the so-called “X-date” can risk now falling any time between the 2 June and 13 June. At this point, there are two key metrics that we are monitoring to observe the likelihood on when the “X-date” would fall. These are the treasury operating cash balance and available borrowing capacity left under the extraordinary measures. The treasury operating cash balance stands at \$49.47bn as of 24 May whilst the available borrowing capacity under the extraordinary measures stood at about \$88bn as of 10 May. To put these numbers into context, the treasury is to estimated have a net \$80bn due in expenditure on 1 June whilst they have net \$27bn due on the 2 June. This shows they are cutting it extremely thin as soon as they hit 5 June. However, it is important to note that the net expenditures and revenue due are clearly just estimations and that it is difficult to tell with certainty how much it would really turn out to be. Treasury Secretary Janet Yellen has warned that the “X-date” can fall as early as (newly revised) 5 June and before 15 June.

**Chart 1: Estimated Net Expenditure and Revenue from 1 June - 30 June, \$bn**



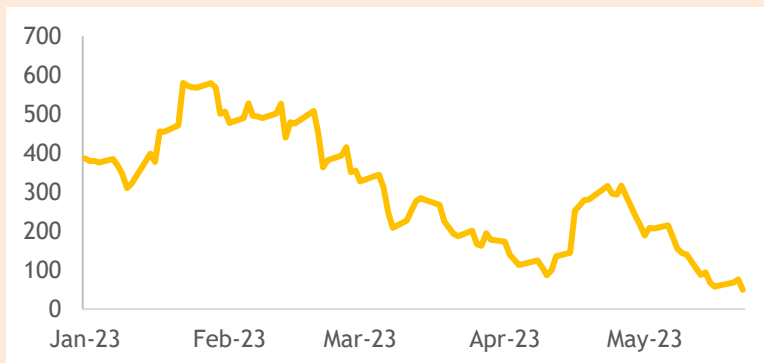
Source: Bipartisan Policy Center (BPC)

The 15 June itself marks an important point because \$80bn of revenue from quarterly tax receipts come in which can help keep the US government afloat for longer. Later, the US government would gain an additionally \$145.5bn in borrowing power on the 30 June through suspending investments in the CSRDF and PSRHB. However, by that point, we would only know that the US government can stay possibly afloat into July. However, getting this far in the year does not help the situation any more given that we have a congressional recess in August. This could create logistical challenges for the congressmen to hammer out a deal and given the dynamic nature of the US government’s cash position, the risk of default can rise. If the US government cash position remains sufficient pass August, then they would be able to receive one more quarterly tax payment on the 15 September. However, this may only keep them going until October and that marks a month where there is unlikely to be much substantial revenue, which could mean that would be the final point for a default to happen.

Ultimately, the timeline actually suggests that the longer the government stays afloat, the higher the volatility is likely to be for markets given there would be even more heightened uncertainty.



Chart 2: Treasury Cash Balance, \$bn



Source: Bloomberg, Maybank FX Research & Strategy

Table 1: Timeline of Key Dates

Date	Event
19 Jan	US government hits debt ceiling of \$31.4tn and exercises “extraordinary” measures to prevent binding of the ceiling
18 April	Federal income tax filing return deadline
1 - 14 June	Treasury is dangerously at a point of running out of cash and hence the “X-date” could occur sometime within this period
15 June	Quarterly tax payments are due which can provide an inflow of cash for the US government to keep government afloat longer
30 June	Treasury Department able to extract \$140bn in borrowing power from a key Federal retirement fund to keep them going into July
31 July	Federal Government can risk running a deficit by this date, which makes the default a possibility at around this point
August	Congress in recess
15 Sept	Another quarterly tax payment is due and can keep the US government afloat if they still do not default by this point
October	No substantial revenue coming in this month putting the US government in a very likely position of default if they last this far into the year
June - October	“X-date” can therefore possibly fall at any point during these months as highlighted by the purple coloured section of this timeline

Source: Various Websites, Maybank FX Research

## What are the key disparities between the two sides?

Table 2

Republicans' Demands	Democrats' Reactions
<b>Energy and mining permitting reforms:</b> Republicans would like to make it easier to launch new energy projects in the US but they would like a focus fossil fuels	Democrats are open to making energy permitting easier although they would want the focus instead to be on renewable energy
<b>Rescinding unused Covid-19 funds:</b> Republicans would like \$30bn of unutilized funds to be clawed back to create savings	President Biden has indicated that he would be agreeable to that
<b>Work requirements for Medicaid:</b> Republicans would like there to be a requirement for able-bodied adults with no children to work or train for work in order to stay on Medicaid	The White House has rejected this proposal
<b>Change current work requirements for food stamps:</b> Republicans have proposed to raise the work retirement age window for people enrolled in the Supplemental Nutrition Assistance Program (SNAP) from 50 to 55	Biden has only stated that whilst he rejected the Medicaid requirements, it is "possible there could be a few others" he could support "but not anything of any consequence"
<b>2024 Federal budget baseline number lower than 2023:</b> Republicans have requested for this	Democrats have rejected this and it has led to breakdown of talks a few times
<b>Spending caps to last for 10 years:</b> Republicans have demanded for it but they look like they can compromise for a shorter period	Democrats do not want spending caps to last longer than two years and so far the agreement looks to be getting closer to that

*Note: The demands would constantly be changing depending on how the negotiations evolve*

## What are the likely scenarios?

At this point, with a credit outlook downgrade from Fitch having already occurred, we are left with three scenarios happening.

The first scenario is that a default occurs. Given that we are now later in the year and with the risk of an "X-date" potentially being near, we are assigning a level of probability of this happening at 20%. Even in this default scenario, the US is likely still make good on its payments later once the ceiling is raised although full credit rating downgrade by the rating agencies could happen.

The second scenario is that a rating agency engages in a full credit downgrade for US debt but at the same time, the US government manages to avoid a default. We have assigned a 20% chance of this happening simply because of the urgency now for congress to get a deal and raise the debt ceiling as the "X-date" could be drawing dangerously close.

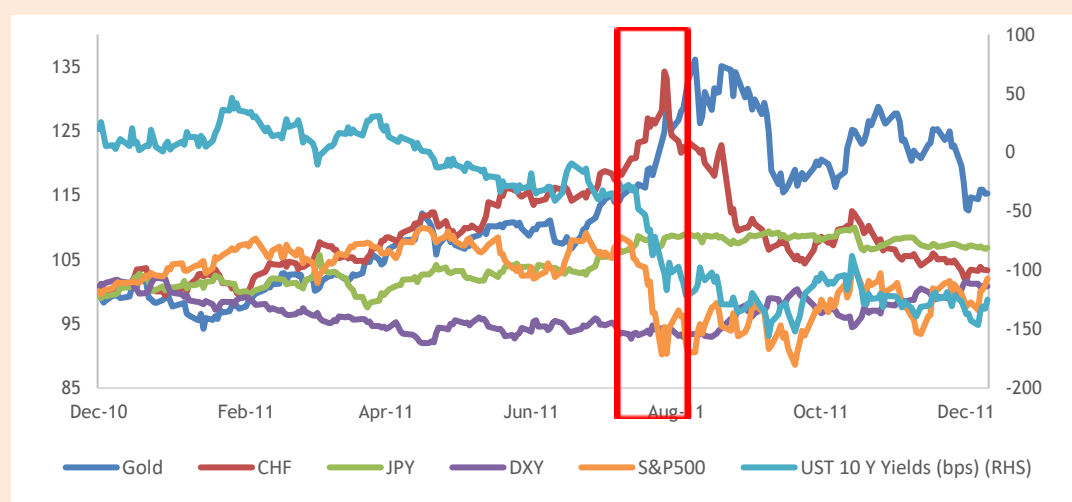
Our third scenario is for the debt ceiling to be raised and default is avoided. We have assigned a 60% probability of this happening and make this our base case given that we think neither the Republicans or Democrats would want to risk being blamed for the ensuring fallout that can come from a default.

### How did asset classes behave in past episodes? And what does this imply about how they would behave now?

When examining how some key assets performed when a credit downgrade occurred during the last two episodes, we generally found that the major traditional safe havens of JPY, CHF and UST 10 y performed well. However, for gold, it was mixed as it did well in 2011 whilst it actually came down in 2013. The S&P500 weakened on both occasions. The DXY was more subdued on both occasions compared to other periods when the VIX was high.

However, as we have seen, these asset classes are behaving very differently this time around when there is a rating outlook downgrade for US debt to negative by Fitch this time around. Gold, JPY, CHF and UST 10 y have actually been seeing a selling off. The DXY in contrast has seen strengthening. This would run contrary to logic but this could be that a lot of market focus may be on the Fed rate path and the possibility of additional hikes. Furthermore, elements of market could be seeing that a default represents a short-term liquidity crisis rather than an effective collapse in the government's financial position. The US government would still make good on its debt but delay payment on the shorter tenors. For that matter, a lot of the anxiety on the debt ceiling appears to be concentrated in the short-term UST where 1M yields have substantially climbed.

**Chart 3: Performance of “safe havens” and key assets during 2011 debt ceiling crisis**

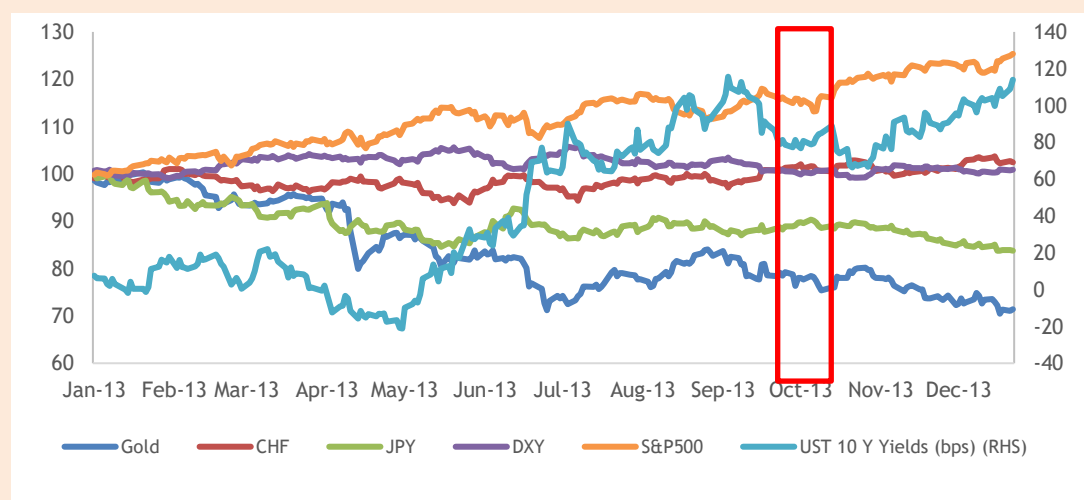


Source: Bloomberg, Maybank FX Research & Strategy

Note:

1. Red box highlights when S&P Downgrades US Credit Rating from AAA to AA+ in Aug 2011
2. All assets are indexed to a start date on 13 Dec 2010 except for UST 10 Y Yields which represent a direct change in bps

**Chart 4: Performance of “safe havens” and key assets during 2013 debt ceiling crisis**



Source: Bloomberg, Maybank FX Research & Strategy

Note:

1. Red box highlights when Fitch Placed the US under a “Rating Watch Negative”
2. All assets are indexed to a start date on 2 Jan 2013 except for UST 10 Y Yields which represent a direct change in bps

### How are EM ASEAN currencies going to fare?

In the event, there is a default, the DXY has historically shown to be more subdued. However, this time around, it is difficult to say that necessarily DXY strength would come off because market focus may be towards the Fed rate path. Therefore, a coming off of DXY strength (if any for that matter) would be more limited. Consequently, this would mean MYR, THB, PHP, IDR and SGD may not be able to get as much of a relief either.

However, if the debt ceiling is raised and default avoided (even whether a deal is done at the eleventh hour), sentiment may improve and the risk-sensitive currencies including the MYR, THB, PHP and IDR may get a lift. SGD may also see some strengthening.

#### Summary Table:

No.	Scenario	Implication on the FX	Probability
1	US enters into a default	<ul style="list-style-type: none"> <li>The DXY has historically been more subdued when such an event occurs but this time around market focus may be towards the Fed rate path. Therefore, a coming off of DXY strength (if any for that matter) would be more limited.</li> <li>Consequently, this would mean MYR, THB, PHP, IDR and SGD may not be able to get as much of a relief either.</li> </ul>	<p>20% likelihood</p> <p>We see it as less likely that the US would default on any of its debt obligations as neither Democrats or Republicans would want to blame for the ensuing fallout</p>
2	Credit rating downgrade but debt ceiling is raised and default avoided	<ul style="list-style-type: none"> <li>Sentiment may improve as deal gets through anyway (even amid the credit rating downgrade) and the risk-sensitive currencies including the MYR, THB, PHP and IDR may get a lift. SGD may also see some strengthening.</li> </ul>	<p>20% likelihood</p> <p>We see this as less likely to happen given the urgency now for congress to get a deal and raise the debt ceiling as the "X-date" could be drawing dangerously close</p>
3	Debt Ceiling is raised (even if it occurs at the 11 <sup>th</sup> hour) and any sort of default is avoided  (Our base case scenario)	<ul style="list-style-type: none"> <li>Sentiment may improve as deal gets through and the risk-sensitive currencies including the MYR, THB, PHP and IDR may get a lift. SGD may also see some strengthening.</li> </ul>	<p>60% likelihood</p> <p>This looks likely to happen given that history has shown the US government eventually successfully raises the debt ceiling even if it happens at the 11<sup>th</sup> hour and also neither Republicans or Democrats would want to be blamed about the ensuing fallout that comes from a default</p>

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