

FX Insight

Six Charts For 2017

(An Extension of Our [FX Outlook 2017 - PPP - Of Political Uncertainty; Policy Changes; Rising Price Pressures](#))

Higher Growth, Rising Inflation, Higher Yields, Higher Dollar...

We see USD strength on the back of improved US medium term growth, positive productivity outlook, expansionary fiscal infrastructure package, changes in the regulatory environment and tax reforms (i.e. lower taxes) under the Trump administration.

Policy Divergence To Drive EUR, JPY Lower

Widening yield differentials to accentuate EUR and JPY's role as key funding currencies as ECB and BOJ are the only key central banks committed to ease in 2017.

Rise of the Commodities To Lend Buffer To Some

Stronger US growth trajectory, expansionary fiscal plans around the world that accompany fresh infrastructure projects suggest rise in demand for commodities. AUD, NZD, CAD, RUB and MYR stand to benefit from their upswing.

Which Asian Economy Will Fare Better With Trump as President?

We examine the openness of the ASEAN economies and their ability to withstand any protectionist measures that could be put in place by the Trump administration. Singapore remains the most vulnerable to any protectionist/anti-globalization measures as reflected by openness of its economy. The least vulnerable economies are Indonesia and Philippines, due to their large domestic economy.

USDJPY, USDMYR Highly Sensitive To UST Yields.

Our analysis shows that amongst the USD/Asian FX, USDJPY, USDMYR and USDSGD are highly sensitive to changes in UST yields. In addition, we observed that most USD/Asian FX react more to changes in longer-end UST yields (i.e. 10Y), as compared to shorter-end UST yields (i.e. 2Y). With markets expecting higher inflation and thus more room for Fed to raise rates, we expect UST yields to stay firm, and this is expected to exert further upside pressure on USDJPY, USDMYR and USDSGD.

Political Stresses in Europe May Pressure EUR

The 5Y European CDS Itraxx index (as a proxy for political risk) shows an inverse relationship with the EUR/USD. In particular during the Italian Referendum in Dec, UK's referendum on EU membership in Jun and European banking stresses in Feb, the 5Y CDS soared while EUR came under pressure. We expect to see potential pick-up in European CDS around those election periods in 2017 and potentially, the EUR to come under temporary downside pressure.

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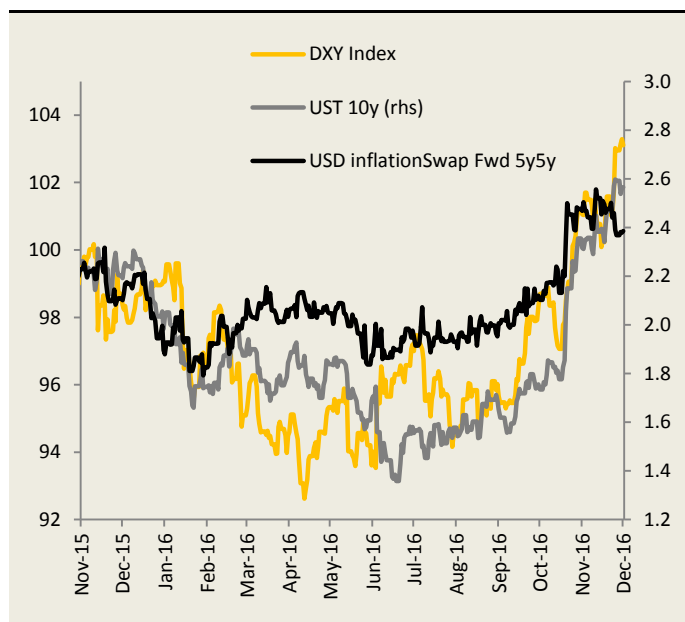
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6 Links You Need to Know

Chart 1: Higher growth, rising inflation, higher yields, higher Dollar...

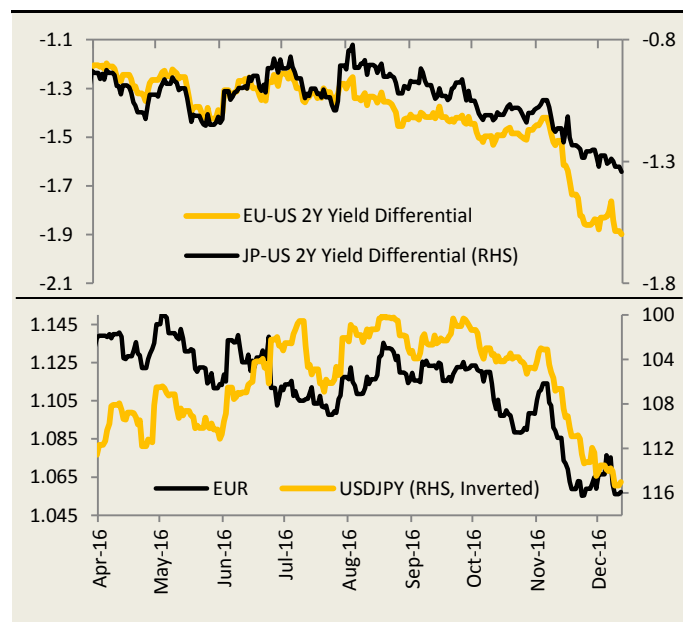
Look Out For More USD Strength...



Source: Bloomberg, Maybank FX Research

Chart 2: Widening Monetary Policy Divergence To Drive EUR and JPY Lower

EUR and JPY should weaken more against the USD



Source: Maybank FX Research, Bloomberg, CEIC

USD Strength To Persist into 2017

We see USD strength on the back of expectations of an improved US medium term growth. Positive productivity outlook on the back of expectations of a targeted fiscal infrastructure package, changes in the regulatory environment and tax reforms (i.e. lower taxes) under the Trump administration could lend support to the greenback.

Fiscal boosts could lead to concerns of faster inflationary pressures and as such affect the Fed rate hike trajectory. In other words, there will still be some policy uncertainty for the most part of 2017. In 1H 2017, we expect on average a steepening of the UST curve with the back end rising faster than the front end (higher nominal rates).

Rising growth, fiscal boosts, higher yields should lead to broad USD strength as we move into the new year, notwithstanding potential lags in fiscal policy loosening and immigration curbs, residual slack in labour market and disinflationary impact of higher US yields and a stronger dollar that could temper the Fed hawks.

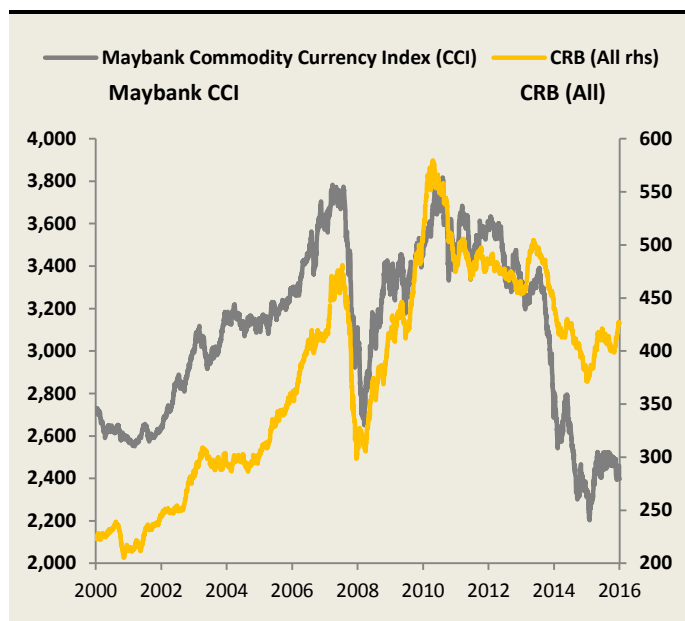
Fed Hikes As ECB and BOJ Retain Easing Mode

While the Fed raises its target rate one year after its first rate move, ECB extended its quantitative easing program from Mar 2017 to the end of the year. BOJ also reiterate its commitment to continue increase its balance sheet until Japan reaches its 2% inflation target. Policy divergence (of US vs. EU and Japan) has never been so clear and that could solidify EUR and JPY's role as key funding currencies for 2017.

Recent FOMC statement saw an adjustment to its dots plot projection higher to 3 hikes in 2017 (vs. 2 hikes in 2017). This suggests there is room for UST yields to rise further and drive monetary policy divergence between the Fed and those on monetary easing bias (in particular the ECB and BoJ) further, which is expected to lend further support for the USD vs. EUR and JPY.

Chart 3: Rise of the Commodities To Lend Buffer To Some

Commodity prices have bottomed and their rebound shall lift the AUD, NZD, RUB, CAD and MYR



Source: Maybank FX Research, Bloomberg

Note: The Maybank Commodity Currency Index comprise of equally weighted commodity-linked currencies based against the USD including AUD, NZD, MYR, RUB, CAD.

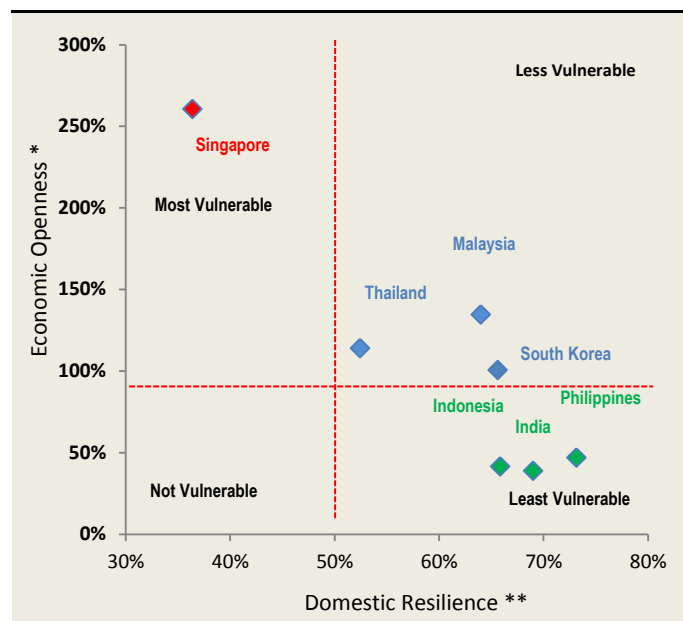
The Commodity Boost

The downtrend of commodity prices is nearing the end as investors priced in the bulk of the various supply glut and overcapacity issues. Prices are likely to react to any pick-up in demand next and as we move into a world of more fiscal stimulus out of the US and China, greater infrastructure needs from One Belt One Road, expect risks to commodity prices to be to the upside. That should lend AUD, NZD, MYR, RUB and CAD a fair buffers as they are highly sensitive to these price movements.

This chart shows how the various commodity currencies (which are depicted by the equally-weighted Commodity Currency Index line) have a reasonably strong correlation with commodity prices (Commodity Research Bureau (CRB) index). Currencies tend to overshoot and the rebound could be substantial when it comes.

Chart 4: Which Asian Economy Will Weather Trump Better?

India, Indonesia and Philippines most resilient, Singapore most vulnerable...



Note: * Proxied by Total Trade as % of GDP

** Proxied by Private Consumption as % of GDP

Source: Bloomberg, CEIC, Maybank FX Research

How will Asia fare with Trump as US President?

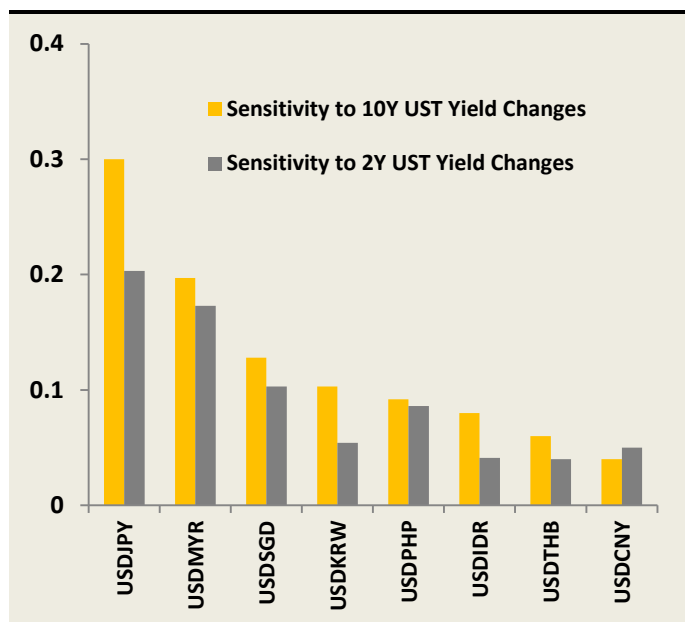
Much has been made about the protectionist bent of the incoming Trump administration. The flames of concern were fanned by the intention of the incoming Trump administration to repudiate the TPP and the threat of a trade war with China.

We examine the openness of the ASEAN economies and their ability to withstand any protectionist measures that could be put in place by the Trump administration. Our grid shows that Singapore remains the most vulnerable to any protectionist/anti-globalization measures as reflected by openness of its economy. Moreover, its private consumption as percent of GDP is the smallest among the ASEAN peers, which increases its vulnerability. The least vulnerable economies are Indonesia and Philippines, due to their large domestic economy. India stands out to us especially because of its sizeable domestic economy and higher yielding bonds, notwithstanding the recent growth-crimping demonetization efforts.

On relative value basis, we see opportunity to long INR, IDR and PHP against the SGD.

Chart 5: USDJPY, USDMYR Highly Sensitive to UST Yields

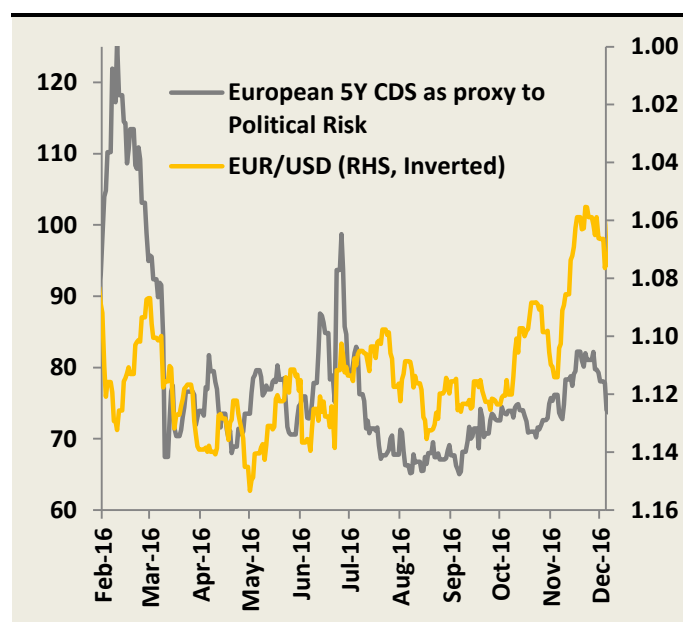
Higher UST Yields, Higher USD/Asia FX



Source: Maybank FX Research Estimates, Bloomberg

Chart 6: Political Stresses in Europe May Pressure EUR

Inverse Relationship between European 5Y CDS and EUR/USD



Source: Bloomberg, Maybank FX Research

Which Asian FX Are More Sensitive to UST Yields?

In anticipation of President-elect Trump's policies - expansionary fiscal policies (tax cuts, infrastructure spending) and trade protectionism measures, the past few weeks have seen markets re-price their expectation for US nominal rates higher.

In the above chart, we look at the betas of USD/Asia FX to daily changes in UST yields over the past 1 year, using OLS regression. And our analysis shows that amongst the USD/Asian FX, USDJPY, USDMYR and USDSGD are highly sensitive to changes in UST yields. In addition, we observed that most USD/Asian FX react more to changes in longer-end UST yields (i.e. 10Y), as compared to shorter-end UST yields (i.e. 2Y). With markets expecting higher inflation and thus more room for Fed to raise rates, we expect UST yields to stay firm, and this is expected to exert further upside pressure on USDJPY, USDMYR and USDSGD.

That said we caution that markets risk getting ahead of themselves as expectations have yet to materialize. Data and policy disappointment (i.e. slower pace of pick-up in inflation and/or Fed not as hawkish as expected) could see rates softening, and result in subsequent pullback in USD/Asia FX.

EUR Not Immune to Political Contagion

Europe is facing a very crowded election calendar in 2017 with scheduled Presidential elections for Netherlands in Mar, French Presidential elections in Apr-May, German Federal election in Aug-Oct. Potentially in Italy, an election could be called as early as in Feb-Mar. There are also other political risk events such as Italy Constitution court decision on electoral laws in Jan as well as UK's trigger of Article 50 by end Mar (which could potentially be delayed).

While our base case is for no Euro-area break-up, we caution for the risk of political contagion as Far-Right parties in Europe are expected to take the opportunity to stoke anti-EU sentiment, and this could lead to political stresses (expressed via opinion polls and CDS index) and undermine the future of the Euro-club. We expect heightened political stresses around those risk event dates to see higher level of FX volatility and this is likely to exert temporary downside pressure on the EUR in the lead-up.

The 5Y European CDS Itraxx index (as a proxy for political risk) shows an inverse relationship with the EUR/USD. In particular during the Italian Referendum in Dec, UK's referendum on EU membership in Jun and European banking stresses in Feb, the 5Y CDS soared while EUR came under pressure. We expect to see potential pick-up in European CDS around those election periods in 2017 and potentially, the EUR to come under temporary downside pressure.

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