FX Viewpoint

Friday, December 01, 2017

FX forecast refresh

- Despite firmer US yields on the front end (and supportive yield differential dynamics), the broad dollar continued to decay in November. This may well persist into December (essentially the end of the year) as markets refrain from trading on major macro themes and remain defensively positioned, resulting in a lack of a coherent broad dollar view. As stated previously, rate differential dynamics (both on the long end as well as the short end) have been relegated in recent weeks with investors instead focusing on a **simpler heuristic of bouncing dollar prospects off the nominal levels of the 10y UST yield for example**.

- At this juncture, the **December FOMC** is expected to be uneventful with an expected third rate hike for the year but crucially, markets will scrutinize the accompanying quarterly projections and dot plots for additional cues.

- If the broad dollar does indeed lose directionality in the coming weeks, expect price action instead to be reactive to **idiosyncratic** headlines affecting each specific currency pair. On this front, expect some resilience in the European (and GBP) complex. However, investors may also continue to remain wary of carry (within G10 as well as in Asia), with the cyclicals underperforming all though November. **As such, remain conscious of further polarization within G10 space with short-end riskies continuing to pit an expected firmer profile for the EUR against the antipodeans for example.**

A tentative stab at divining 2018

- Going into 2018, the theme of global central bank policy convergence (a construct that failed to gain lasting traction in 2017) may continue to mature. This view is premised on the expectation of sustained macroeconomic growth prospects and firming inflation (and inflation expectation) dynamics, prompting a more activist reaction from global central banks (G10 as well as EM).

- In this scenario, expect attention to be diverted away from the Fed (which effectively would be mid-cycle in terms of its intended rate hike trajectory), resulting in increased appetite towards the other major currencies (at the expense of the dollar). A caveat to this view is if the Fed surprises on the upside in terms of its rate hike trajectory during 2018, in which case, heightened volatility would be expected to ensue.

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Asia is in no hurry

- Within Asia, the net portfolio inflow environment has demonstrated improvements in recent weeks (note also a supportive risk appetite environment) but a North-South divide remains apparent at this juncture. Note however that from a structural perspective implied net inflows committed to Asian focused funds have continued to deteriorate in 2H 17 with little immediate signs of a sharp revival just yet. This latter development we think may continue to constrain excessive outperformance for the regional currencies.

- Asian central banks meanwhile remain guarded and have been quick to dispel and discourage excessive expectations of implied hawkishness (the **Bank of Korea** being the most recent example). In our view, regional central banks will continue to tread cautiously in steering the markets to a neutral posture from a somewhat accommodative/neutral stance.

- Squaring the pace of economic activity with inflation pressures and the real interest rate environment across Asia, we feel that only the **RBI** and the **PBOC** potentially may continue to be viewed as firmly entrenched in a neutral/slightly hawkish mode. Elsewhere in Asia, we see little urgency for the other Asian central banks to incite hawkishness in the near term.

- One exception may be **BNM**, where depressed real interest rates may be slightly incongruent to the supportive macro environment. Akin to the BOK, a probable course of action for the Malaysian central bank may be a hike in 1Q 18 but likely to be heavily tempered by “one-and-done” and “data-dependent” language.

Renminbi complex

- Apart from short term liquidity considerations, expect little discretionary or structural impetus from the **CFETS RMB Index** or the USD-CNY mid-points into the end of the year. As noted previously, stability remains the operative word at this juncture, and our house view remains for a stable CNY NEER into 2018. As a result, expect the USD-CNY and USD-CNH rate to continue to reflect fluctuations in the basket’s constituent currencies (not least the USD).

SGD prospects

- The SGD has continued to retain sufficient traction in terms of overall valuation (aided partially) by broad dollar weakness in recent weeks. As stated elsewhere, we will continue to monitor any (upside drift) in the upper tolerance level for the **SGD NEER** in the coming weeks/months. On balance, expect the SGD to underperform the EUR and GBP into December, with SGD holding a slight advantage (on a spot basis) over the AUD, NZD, and CAD.

Revised central tendency forecasts (as at 01 Dec 17)

01-Dec-17	Spot	Dec-17	Mar-18	Jun-18	Sep-18
USD-JPY	112.54	112.80	113.33	114.33	115.33
EUR-USD	1.1906	1.2020	1.2044	1.2178	1.2311
GBP-USD	1.3531	1.3530	1.3632	1.3729	1.3826
AUD-USD	0.7562	0.7515	0.7492	0.7619	0.7746
NZD-USD	0.6829	0.6800	0.6777	0.6917	0.7057
USD-CAD	1.2878	1.2945	1.3017	1.2767	1.2517
USD-CHF	0.9838	0.9800	0.9826	0.9752	0.9679
USD-SGD	1.3481	1.3450	1.3402	1.3364	1.3326
USD-CNY	6.6153	6.5515	6.5495	6.5256	6.5018
USD-THB	32.688	32.50	33.36	32.76	32.15
USD-IDR	13543	13550	13574	13498	13421
USD-MYR	4.0910	4.0500	4.0386	4.0192	3.9999
USD-KRW	1087.77	1085.00	1073.33	1068.33	1063.33
USD-TWD	30.012	29.950	29.800	29.650	29.500
USD-HKD	7.8107	7.8100	7.8155	7.8209	7.8264
USD-PHP	50.309	50.20	49.90	49.75	49.60
USD-INR	64.46	64.15	64.16	63.74	63.33
EUR-JPY	133.99	135.59	136.50	139.23	141.99
EUR-GBP	0.8799	0.8884	0.8835	0.8870	0.8905
EUR-CHF	1.1713	1.1780	1.1834	1.1876	1.1916
EUR-SGD	1.6050	1.6167	1.6142	1.6274	1.6405
GBP-SGD	1.8241	1.8198	1.8270	1.8347	1.8423
AUD-SGD	1.0194	1.0108	1.0041	1.0182	1.0321
NZD-SGD	0.9206	0.9146	0.9082	0.9243	0.9403
CHF-SGD	1.3703	1.3724	1.3640	1.3703	1.3768
JPY-SG	1.1979	1.1924	1.1825	1.1689	1.1554
SGD-MYR	3.0346	3.0112	3.0133	3.0075	3.0017
SGD-CNY	4.9071	4.8710	4.8869	4.8830	4.8792

Source: OCBC Bank

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