FX Viewpoint

Monday, October 02, 2017

FX forecast refresh – Still crunching?

- Our September Outlook entitled "Crunch Time?" proved particularly apt in light of the subsequent unfolding of global market events in the ensuing weeks. With global core long-end yields bottoming (and led by UST yields) a week and a half before the FOMC in September, the eventual outcome of the Fed meeting and Yellen's subsequent comments deepened a tilt in interest rate differentials favoring the USD at the expense of its G10 as well as Asian counterparts.

Evolving relative central bank dynamics

- Note that the latest updraft in global yields has also driven by complicity by key central banks, with the RBA discernibly more upbeat (in its meeting statement and meeting minutes), an earlier than expected rate hike by the Bank of Canada, and a hawkish hold by the BOE.

- Aggregated global inflation readings meanwhile are stabilizing but in our view, do not portend looming inflation risks (note the most recent surprise rate cut by Bank Indonesia) in the coming months. On this front, note that the RBA and the Bank of Canada have been on hand to dissuade excessively hawkish expectations.

- Meanwhile, we think the Fed is still not the only game in town and as noted previously, given the Fed's relative confidence of its prognosis in September, other major global central banks may also hasten their exit from dovishness, further entrench themselves in neutrality, or venture into hawkish territory in the coming months. **In this scenario, shifting relative central bank dynamics may eventually whittle away at a USD endeavoring to strengthen, as has been the case in the year to date**.

- Structurally, global central banks (of late, ECB, BOC, and RBNZ) may continue to wrestle with the impact of exchange rate movements on their policy reaction functions. However, we note that these policy banks remain interest rate targeters (more accurately, actually inflation targeters utilizing interest rates as intermediate policy instruments) and barring acute volatility on the FX front, should not detract materially from their policy intentions, which, since the summer, has been a tilt away from outright dovishness towards neutrality. **Again, evolving relative central bank dynamics between the Fed and its G10 counterparts we think will continue to be a staple into 4Q 17**.

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Strategy
Tel: 6530-4887

Emmanuel Ng
+65 6530 4073
ngcyemmanuel@ocbc.com

Back to the drawing board

- Thus, October promises to be eventful at the very least with the commencement of the **Fed taper** and the potential taper announcement (failing which, the EUR may be expected to experience some disappointment) by the **ECB** in the pipeline. In the interim, investors we think will continue to undergo a re-assessment of sorts (with respect to their expected return functions) in view of the recent volatility in global FX and interest rates**.**

- Note that this has been evidenced by global EM equities stuttering into the 2nd half of September, implied and actual inflows into Asia demonstrating a very discernible deterioration in recent weeks, and USD-Asia tilting higher from its year-to-date slumber. The inherent risk therefore is that with the risk appetite and net inflow environment less conducive, the delta of Asian FX may potentially begin to outpace that of the majors with respect to any further strengthening of the broad dollar. **Overall, this may keep deter excessive positive sentiment (continuing to sideline the cyclicals and EM/Asia) while benefitting the USD**.

Structural break?

- After the bottoming out in September, the question then is that will the dollar finally achieve escape velocity and turn the corner by strengthening into 4Q 17 after its year-to-date slide? We think this will have to be predicated by a sustained breach of key technical levels across a range of asset prices (including the DXY, 10y UST and bund yields, and even curvature characteristics of the US curve). **In the interim, note that our aggregate interest rate differential index continues to indicate a tailwind for the broad dollar in the near term.**

- As we step into October, the USD may retain the upper hand against the EUR (political and ECB uncertainty), AUD, CAD, and JPY (still sufficiently dovish BOJ plus political uncertainty), while markets may fade undue outperformance by the GBP (Brexit overhang) and the NZD (political uncertainty, sufficiently dovish RBNZ). In essence, in the current environment, markets may respond asymmetrically to any negative headlines from the other majors.

SGD Outlook

- On the SGD front, the NEER has continued to persist in the upper half of its perceived fluctuation band, although excessive SGD outperformance remains in check. Going ahead, we expect the MAS to retain a neutral stance at its October MPS (Monetary Policy Statement), leaving the SGD responding to its basket constituents in the interim.

Revised central tendency forecasts

	Spot	Dec-17	Mar-18	Jun-18	Sep-18
USD-JPY	112.84	114.40	115.60	116.80	118.00
EUR-USD	1.1775	1.1585	1.1490	1.1395	1.1300
GBP-USD	1.3372	1.3150	1.3033	1.2917	1.2800
AUD-USD	0.7829	0.7700	0.7633	0.7567	0.7500
NZD-USD	0.7199	0.7100	0.7067	0.7033	0.7000
USD-CAD	1.249	1.2715	1.2827	1.2938	1.3050
USD-CHF	0.9704	0.9775	0.9840	0.9905	0.9970
USD-SGD	1.3608	1.3720	1.3797	1.3873	1.3950
USD-CNY	6.6528	6.6570	6.6904	6.7241	6.7578
USD-THB	33.392	33.70	33.90	34.10	34.30
USD-IDR	13529	13600	13650	13700	13750
USD-MYR	4.2312	4.2700	4.2910	4.3120	4.3330
USD-KRW	1146	1160	1170	1180	1190
USD-TWD	30.392	30.600	30.767	30.933	31.100
USD-HKD	7.8115	7.8142	7.8195	7.8247	7.8300
USD-PHP	51.03	51.35	51.50	51.65	51.80
USD-INR	65.28	65.80	66.15	66.50	66.85
EUR-JPY	132.87	132.53	132.82	133.09	133.34
EUR-GBP	0.8806	0.8810	0.8816	0.8822	0.8828
EUR-CHF	1.1426	1.1324	1.1306	1.1287	1.1266
EUR-SGD	1.6023	1.5895	1.5852	1.5809	1.5764
GBP-SGD	1.8197	1.8042	1.7982	1.7920	1.7856
AUD-SGD	1.0654	1.0564	1.0531	1.0497	1.0463
NZD-SGD	0.9796	0.9741	0.9750	0.9758	0.9765
CHF-SGD	1.4023	1.4036	1.4021	1.4006	1.3992
JPY-SGD	1.2060	1.1993	1.1935	1.1878	1.1822
SGD-MYR	3.1093	3.1122	3.1102	3.1081	3.1061

Source: OCBC Bank

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