


Global Forex Outlook from an Asian Perspective

Alicia Garcia Herrero
Chief Economist Asia Pacific

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DIVERGENCE: IS IT REAL?**
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FOR STRONG APPRECIATION**
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AFTER ALL**



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GLOBAL MONETARY POLICY DIVERGENCE: IS IT REAL?

Central banks make divergent sounds

Hawkish



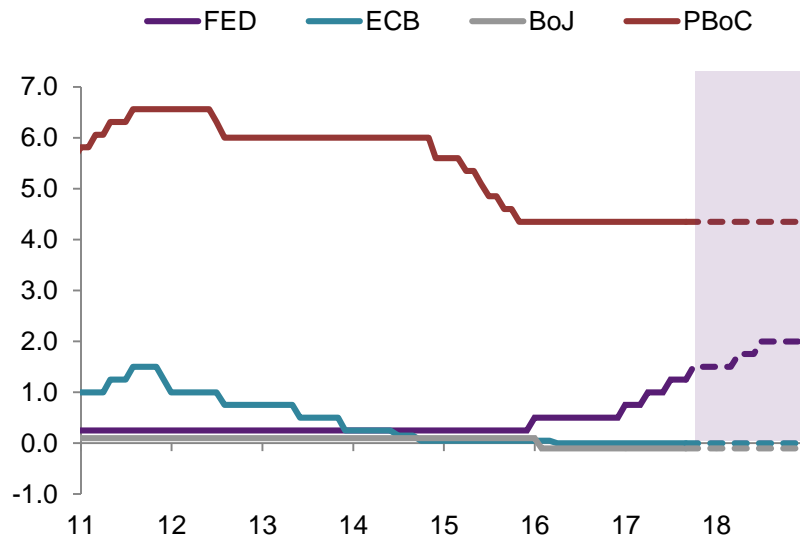
Dovish



Image Source: Mises Institute, ECB, Bank of Japan, Bullion Star, PicQuery

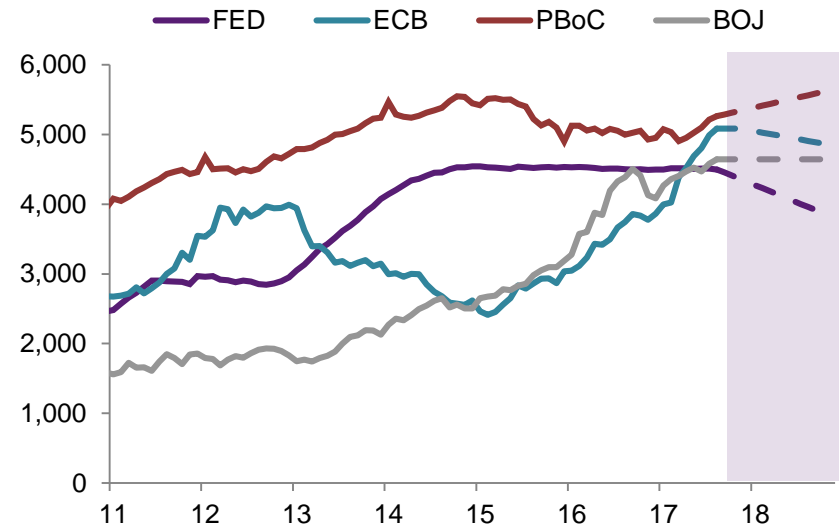
Both in terms of policy rates and balance sheets

Policy Rate (%)



Source: Natixis, Bloomberg

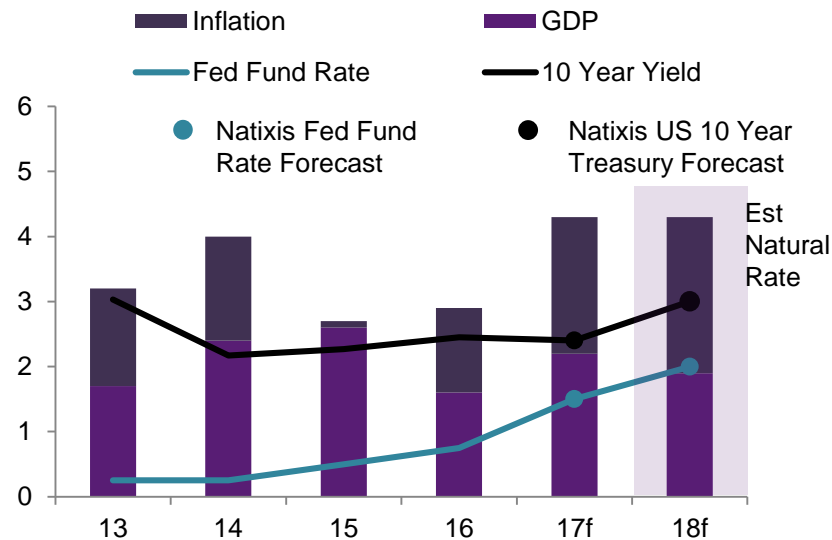
Central Bank Balance Sheet (USD bn)



Source: Natixis, Bloomberg

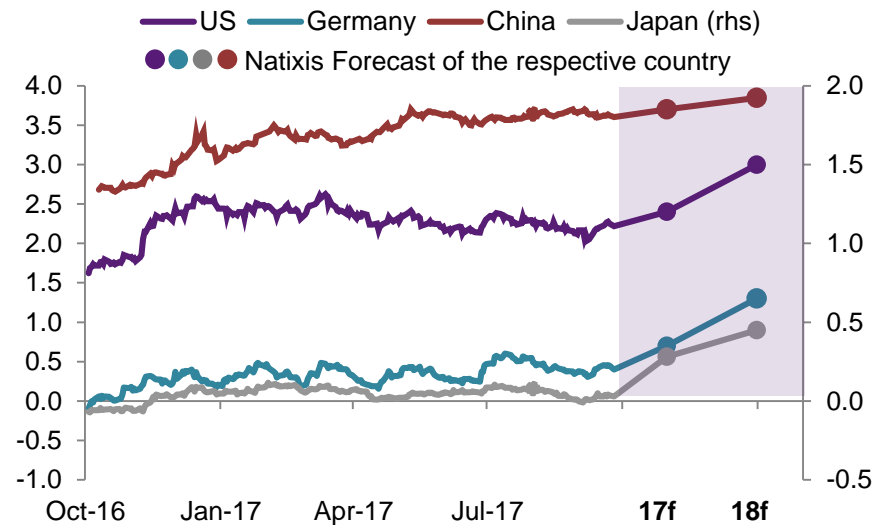
But can divergence last?. Very unlikely Low rate environment not to last either

Short and long term interest rates: Level of natural rate



Source: Natixis, Bloomberg

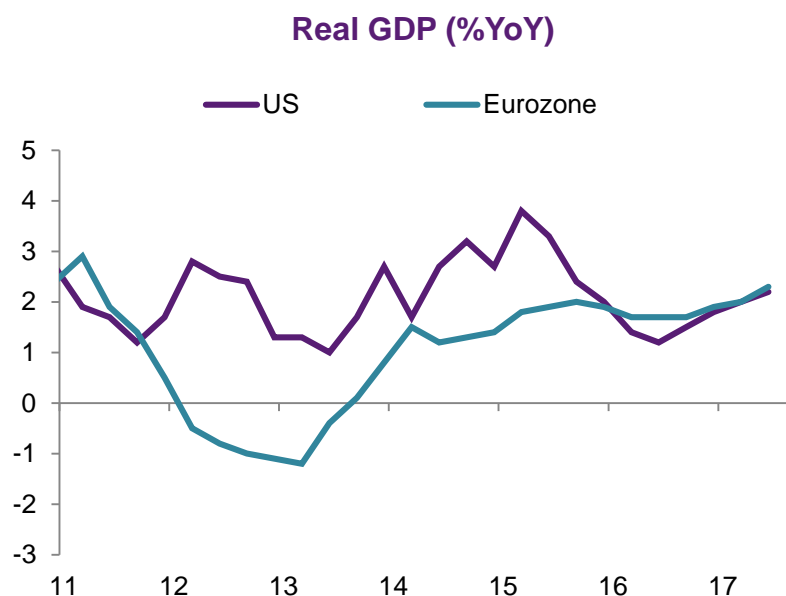
10 Year Government Bond Yield (%)



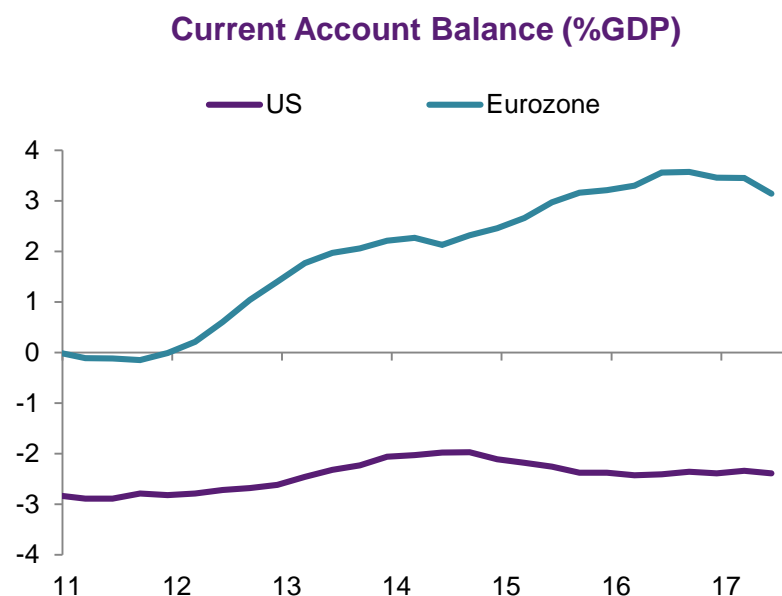
Source: Natixis, Bloomberg

Reasons for USD to remain weak against Euro

- Growth divergence shrinking (Eurozone growth today and US)
- Eurozone keeping an increasingly large current account surplus, in contract to US
- FED monetary policy normalization more discounted than that of the ECB



Source: Natixis, Bloomberg



Source: Natixis, Bloomberg

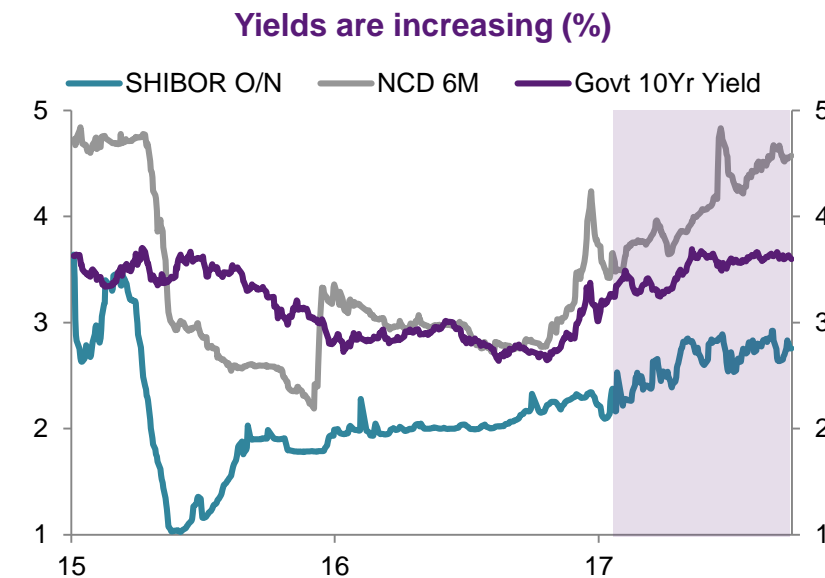


2

WHAT ABOUT THE RMB?
NOT SET FOR STRONG
APPRECIATION

PBoC not alone, even with capital controls

- PBoC will be pushed to follow the FED but capital controls to mitigate the pressure
- Still interest rates will need to creep up to avoid capital outflows and renewed pressure on RMB



Source: Natixis, WIND

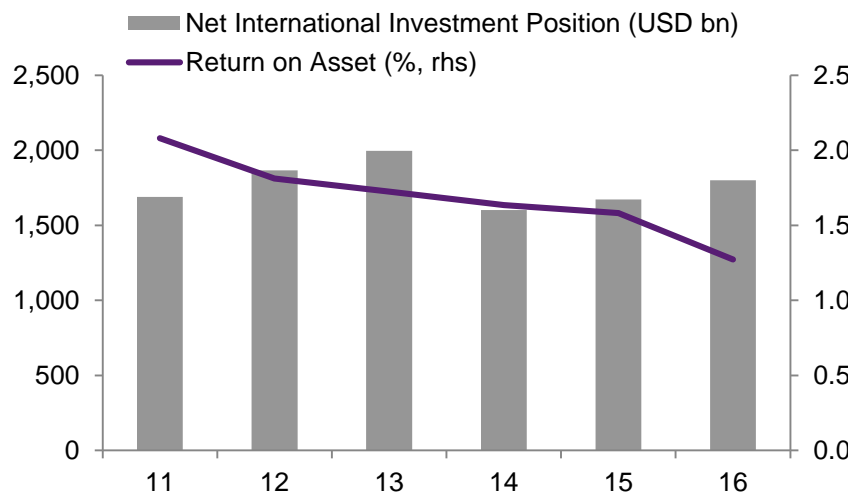


Source: Natixis, Bloomberg

Some reasons for a moderate downward pressure on RMB

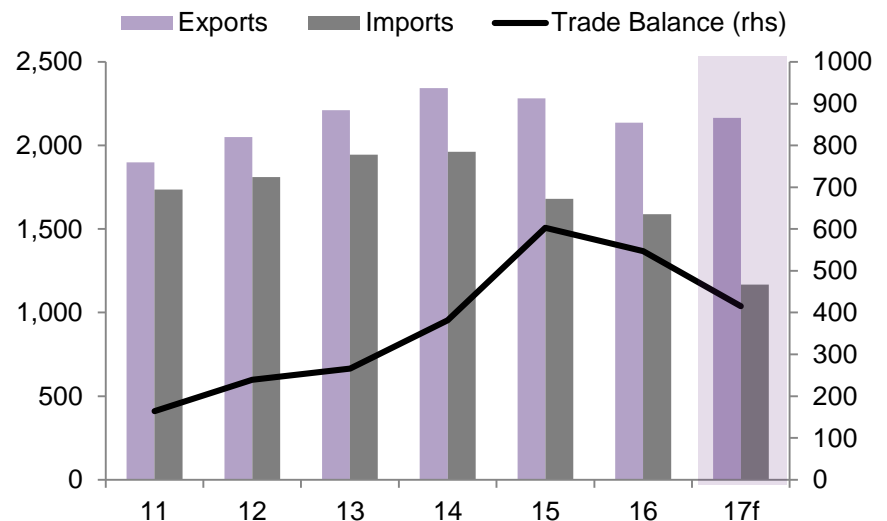
- Portfolio diversification a must given China huge (imposed) home bias
- Low return on assets pushing capital away
- Fear of appreciation due to competitiveness

China's Investment and Return on Asset



Source: Natixis, Bloomberg, CEIC
N.B. ROA estimated from Shanghai Composite Index

China Trade (USD bn)



Source: Natixis, Bloomberg

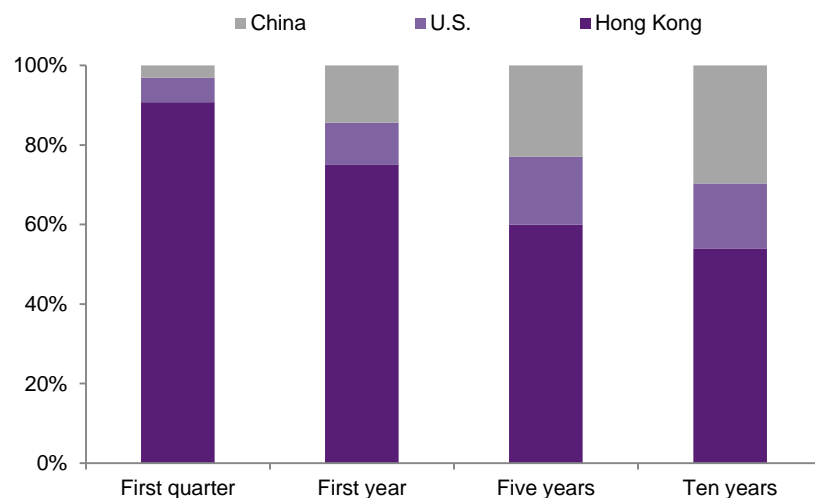


AND THE HKD? NOT
SO DULL AFTER ALL

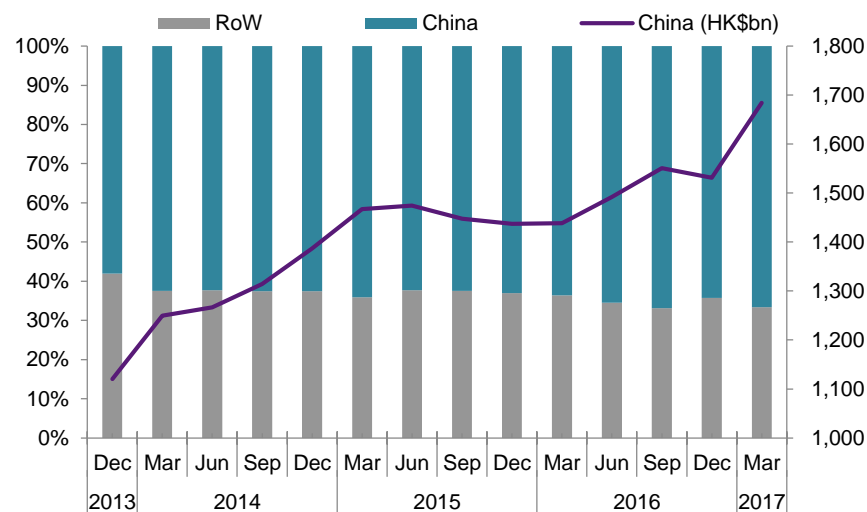
Squeezed between the FED and the Chinese economy

HKD economy increasingly linked to China, even financially while pegged to the USD

Forecast error variance decomposition of Hong Kong CPI



Cross - border lending (% of total)

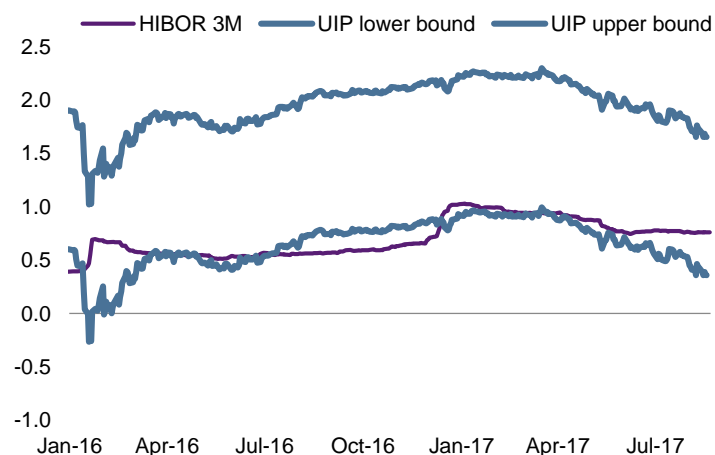


Sources : HKMA, Natixis
*Total loans for use overseas

Can a solution be found without breaking the system?

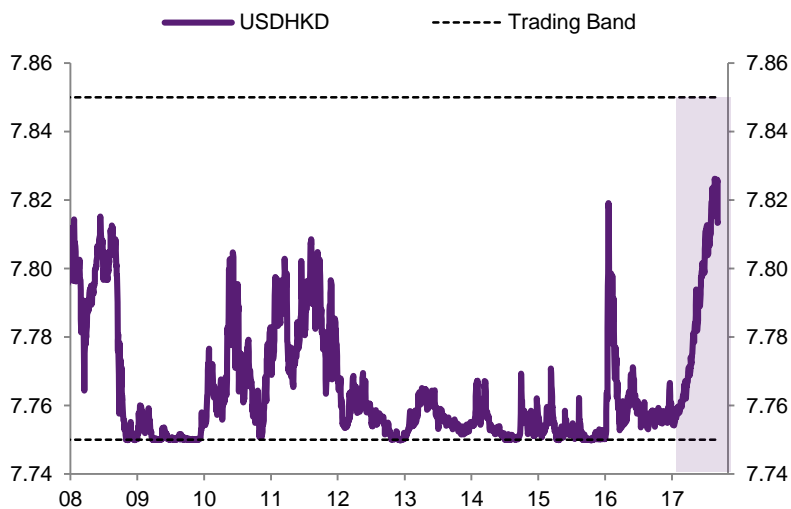
- Currency board key for the credibility of HKD exchange rate regime
- Credibility more important than competitiveness for a financial centre so keeping currency board is essential
- So how to gain some flexibility?: Introducing one more currency in the basket
- RMB not ready yet why not the euro?: Uncorrelated to USD and second most important reserve currency

The Credibility Band of USDHKD



Source: Natixis, Bloomberg

USDHKD



Source: Natixis, Bloomberg

All in all

- **Expect higher interest rates globally**
- **But not necessarily a stronger USD any time soon, at least against the euro**
- **Do not expect a very strong RMB either**
- **Beware of the dull HKD.**
 - **Its institutional setup has some cracks but it can be fixed with some imagination**

Projection

Money Markets

Official Rates / Eonia, Euribor & Libors		12/31/15	12/30/16	09/07/17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
FED		0.50	0.75	1.25	1.50	1.75	2.00	2.00	2.00	2.00
	3M Libor \$	0.61	1.00	1.32	1.60	1.85	2.10	2.10	2.10	2.10
	Forward				1.32	1.39	1.44	1.48	1.53	1.59
BCE		0.05	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.25
	3M Euribor	-0.13	-0.32	-0.33	-0.30	-0.27	-0.25	-0.22	-0.08	0.15
	Forward				-0.33	-0.33	-0.32	-0.31	-0.28	-0.25
BOE	Eonia	-0.13	-0.33	-0.36	-0.35	-0.33	-0.32	-0.30	-0.16	0.07
		0.50	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50
	3M Libor £	0.59	0.37	0.28	0.40	0.55	0.57	0.57	0.57	0.57
BOJ	Forward				0.29	0.34	0.39	0.43	0.46	0.50
		0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
	3M Libor ¥	0.08	-0.05	-0.03	0.00	0.00	0.02	0.02	0.02	0.02
SNB	Forward				0.06	0.06	0.05	0.05	0.05	0.05
		-0.75	-0.75	-0.75	-0.75	-0.75	-0.50	-0.50	-0.25	0.00
	3M Libor CHF	-0.76	-0.73	-0.73	-0.75	-0.75	-0.50	-0.50	-0.25	-0.25
	Forward				-0.73	-0.74	-0.74	-0.72	-0.69	-0.65

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