Morgan Stanley

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FX Pulse

CHF and JPY Stay in Demand

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Putting the USD correction into perspective. We remain convinced the USD remains in a secular bull market with Asian debt and overcapacity unleashing USD-supportive flows. However, the weak US May NFP report has raised questions about the economy. As long as these uncertainties persist, low DM bond yields will allow EM capital flows to recover somewhat. This is not the first time we have seen the USD correct within its upward trend, but voices have once again become louder, declaring that the USD has topped out. Those statements have proved repeatedly wrong, and we believe this time is no different.

Guided by US labor. Nonetheless, this leaves the question of how long the current USD correction might last. The US labor market will provide the answer. The latest NFP slowdown, along with steady wage growth, could be a sign of labor market tightness, suggesting the Fed will prepare markets for higher rates and put the USD back on its rallying track later this summer. However, a cyclical slowdown of the US economy is another potential reason for labor market weakness. In this case, falling global bond yields could spark another valuation rally of risky assets keeping higher-yielding FX supported for longer.

CHF and JPY rally decouples from risk. Despite US equity markets trading near historical highs and EM shares rebounding sharply, the JPY and CHF have rallied as real yield differentials have turned in favor of these currencies. We project the JPY and CHF staying in demand with the CHF profiting as well from concerns related to Brexit.

PLN remains a sell. We take a deep dive into PLN, and think it should underperform EM with carry comparably low and given domestic and external risks on the agenda. We think any moves in EUR/PLN to 4.25 represent a buying opportunity, and we continue to prefer HUF over PLN. Attractive PLN valuations vs. the EUR may be a source of support later in the year, but not yet.

Click here to search for our research by currency

Exhibit 1: Current Trade Portfolio

Closed Trades			
Short AUD/USD	Closed at 0.7375 on 6-Jun-16		
Long USD/KRW	Closed at 1158 on 8-Jun-16		
Long USD/RUB	Closed at 64.00 on 8-Jun-16		
Long USD/CAD	Closed at 1.2750 on 7-Jun-16		
Long USD/SGD	Closed at 1.3528 on 9-Jun-16		
Long USD/MXN	Closed at 18.2481 on 9-Jun-16		
Short GBP/USD	Close at WMR on 10-Jun-16		
Active Orders	**Entry**	**Stop**	**Target**
Short CAD/JPY	85.10	85.50	70.00
Long BRL/MXN	5.37	5.20	6.00
Short SGD/IDR 3M FWD	9930	10100	9580
Limit Orders	**Entry**	**Stop**	**Target**
Sell USD/JPY	***108.60***	***112.00***	***98.00***

Source: Strategic FX Portfolio Trade Recommendations for more details. Changes in stops/targets in bold italics

FX Overview

Hans Redeker , Charles Rubenfeld

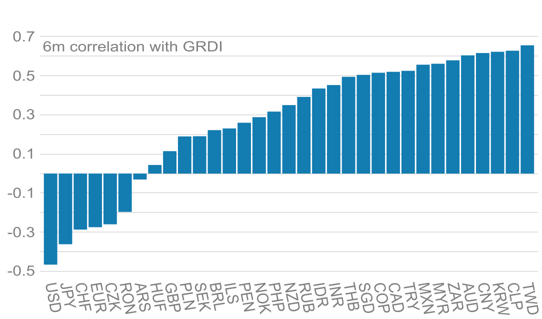
The post-NFP world looks less rosy for the USD as markets try to digest the reason for slower US job growth. If job growth is slowing not because of demand, but because of reduced supply, wages should rise, driving the next leg higher in USD. However, slowing investment and declining corporate profitability may link the slowing labor market to a renewed widening of the US output gap, opening more USD downside potential. Whatever the outcome, it would work in favor of the JPY, CHF and to a lesser degree the EUR. The higher US wage scenario suggesting higher US rates will not bode well for risk appetite. The alternative outcome – the reopening its output gap launching another deflationary impulse into the global economy – would lead to an increase of real yields in Japan and Switzerland, pushing the JPY and CHF higher.

Zero-return assets and the booming JPY and CHF

We have entered a world of low returns which will have implications on the evolution of currencies and asset markets. The most important takeaway is that the performance of low-yielding surplus currencies, whose yield curves are in negative territory, will become asymmetrically correlated with the risk outlook. So far, the JPY, CHF and to a lesser degree the EUR were moving in reverse to risk appetite, both higher and lower (**Exhibit 2**). The new environment suggests these currencies will rally when risk appetite is getting hit, but will stay bid even when risk does rally. The reason for this new relationship is found in the cause of the current risk rally: valuation adjusting to a new benchmark of zero-returns , as opposed to better earnings and an implicitly improving growth outlook (**Exhibit 3**). This is an important differentiation to make and it prevents us from concluding that the current risk rally is sustainable.

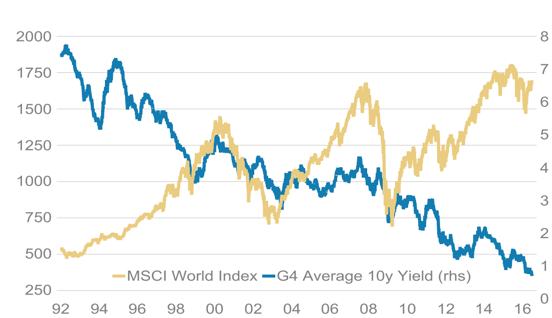
For many countries, lower nominal yields globally suggest lower real yields allowing asset prices to break higher on valuation reasons. However, where bond yields are already low or, worse, have entered negative yield territory, a further decline of yields will be difficult to engineer even if central banks become more accommodative. Here, the risk is that real yield differentials push currencies higher even if local deflationary pressures require the help of a lower FX valuation. The JPY, CHF, and to lesser degree, the EUR, fall into this category. There, where real yield differentials may push currencies higher without the support for real growth, productivity or investment return differentials, we use the term 'deflationary currency appreciation'. The BoJ, SNB and ECB may not like this outcome, but there is very little that can be done to avoid this scenario.

Exhibit 2: Risk Correlation of Selected Currencies



Source: Macrobond, Bloomberg, Morgan Stanley Research

Exhibit 3: DM Bond Yields Decline Pushing Equity Valuations Higher



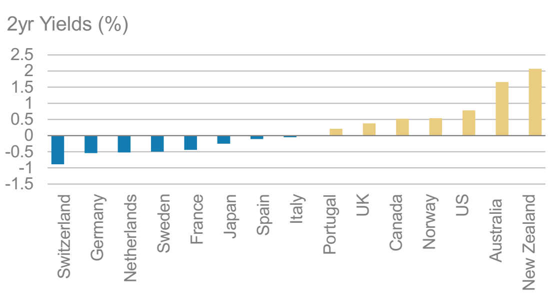
Source: Macrobond, Bloomberg, Morgan Stanley Research

The BIS claims that the too-accommodative monetary policy over recent decades has prevented failed-investment losses from being recognized. Ergo, the necessary reallocation of resources into higher yielding assets required to keep economies productive has slowed down, pushing total asset returns lower. By now, USD 10.4trn of sovereign bonds is negatively yielding, but when bonds enter negatively yielding territory, the elasticity for bond yields to fall further will decline. When there is a reduced elasticity for bond yields to the downside, real rates and yields remain sticky, pushing real yield differentials in favor of the currency running the highest deflation risks. Currency appreciation may even increase its deflation risks, creating an additional source of instability.

Low nominal yields lay foundation for rising real yields

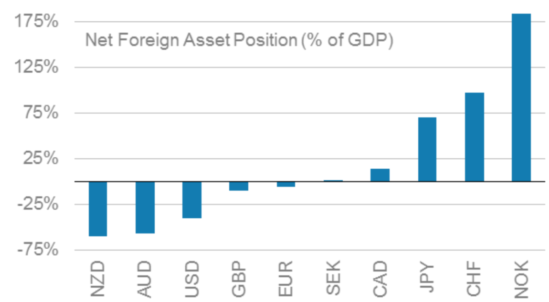
The dividing line between currencies with strong or weak outlooks is not only drawn by how much value is left in local bond markets. The other factor coming into play is the foreign asset position of countries. Notably, the financial net asset position requires increasing attention within a low-yielding global environment. Foreign asset holdings suggest risk management dealing not only with notional capital risk but also with valuation changes coming on the back of FX movements. Japan and Switzerland tick both boxes. Their domestic yield curves provide negative yield, reducing the scope for bond yields to fall further, and their net foreign financial holdings require FX management.

Exhibit 4: Japan and Switzerland Have Negative 2yr Yields...



Source: Bloomberg, Morgan Stanley Research

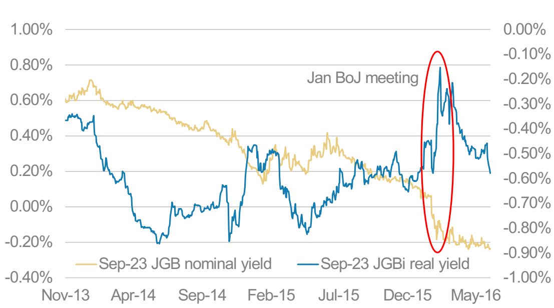
Exhibit 5: and Large Net Foreign Asset Positions



Source: Haver, Morgan Stanley Research

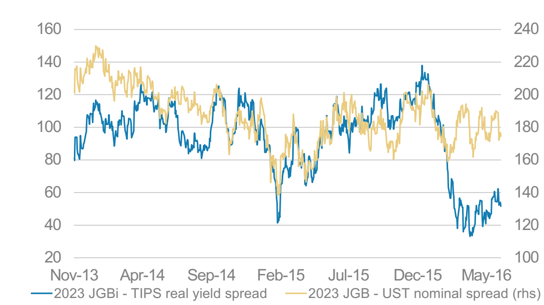
Currency hedging decisions are based on two pillars: the cost of hedging and where the FX trades relative to the investor expectations. Hence, FX hedging increases when currency investors are positioned in declines. From the perspective of Japan- and Switzerland-based asset managers, many currencies produced valuation losses, which increases the desire to FX hedge, furthering the appreciation.

Exhibit 6: Japan: Real Yields Have Diverged from Nominal Rates



Source: Bloomberg, Morgan Stanley Research

Exhibit 7: Causing Real USDJPY Yield Spreads Moving Away from Nominal Yield Spreads



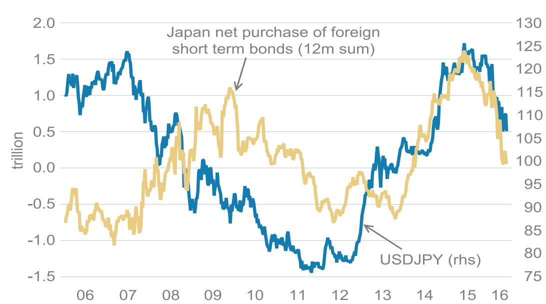
Source: Bloomberg, Morgan Stanley Research

Finding Winning Currencies

With the Fed holding back from hiking rates, USD hedging costs have remained cheap. Even more important, real yield differentials have turned USDJPY bearish. Higher real returns push JPY higher, which then triggers more hedging interest. The higher the net foreign asset position and the lower the currency hedges of the existing stock of foreign-currency -denominated assets are, the bigger the impact on currency valuation. Here, the JPY comes first, followed by the CHF.

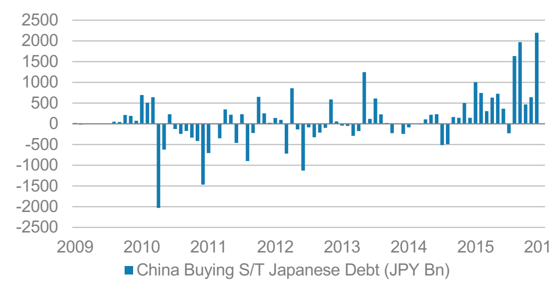
Exhibit 8 shows the relationship between JPY performance and money market flows. It is the money market flow driving the JPY higher and this flow is fed by Japan's asset managers reducing currency exposures. Analyzing currency flows must always reflect what caused the flow. When there is little to no foreign asset exposure, then currency appreciation needs the support of net long-term foreign asset inflows. When there is a substantial stock of foreign asset holdings, then money market flows generated by FX hedging activities can **dominate FX markets for some time**.

Exhibit 8: JPY Receives Support via Money Market Flows



Source: Macrobond, Bloomberg, Morgan Stanley Research

Exhibit 9: Purchases of Short-dated JGBs from China



Source: Bloomberg, MoF, Morgan Stanley Research

'Never bet against central banks' is the most often used argument against our bullish JPY call. However, what would be the difference to markets if the BOo cut rates further or increased the size of its QQE operations? It is the exhausted yield curve that tells the story and the yield curve would not change dramatically enough should the BoJ use instruments it has deployed before. In order to weaken the JPY, the BoJ would have to engage in policies such as helicopter money, increasing inflation expectations and reducing the JPY real yield support. Legal constraints make such an outcome unlikely for now.

Foreign buying of short-dated JGBs may add to JPY appreciation pressure. Recent data provided by the MOF show that China continued buying JGBs in large quantities.While these bonds provide negative nominal yield, their real yield seems attractive and to have convinced RMB accounts to pile into the JGB markets. Given China's substantial private- and public-sector savings, markets are sensitive to this type of information. Against this background, our call for USDJPY to reach 98 seems well placed.

The USD Post-NFP

Last Friday's US labor market report did not only provide a surprisingly low NFP reading of 38k for May. It also had significant downward revisions for prior months, taking the 3-month NFP average down to 120k from a 282k peak experienced last year (**Exhibit 10**). While the May report could still be an aberration, it was a weak enough report to put the Fed on the sidelines. The Yellen Fed is unlikely to take any risks and a rate hike therefore needs to be prompted by US data strength.

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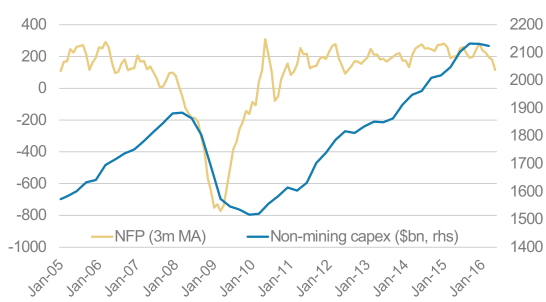
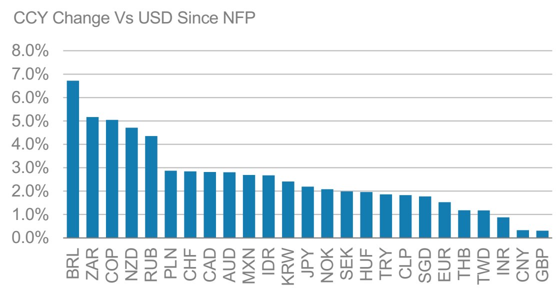
Exhibit 10: 3- Months MAV NFP Has Fallen Rapidly as US Non-Mining Investment Has Slowed Down



Source: Haver, Morgan Stanley Research

Exhibit 11: US Dollar Has Lost Across the Board



Source: Bloomberg, Morgan Stanley Research

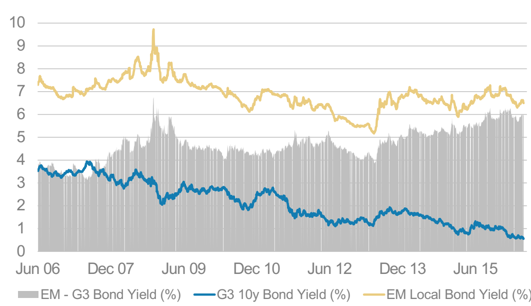
When the USD came off its February high, it fell 6.5% before bottoming out in early May. However, the spring USD downward correction received support from two sides. First, US rate-hike expectations eased with the help of disappointing US data releases turning the Fed dovish. Second,hopes for a China economic rebound were boosted by the sharp rise of **China-related leading indicators** (MS-CHEX) and social funding data showing a record expansion of credit. Now China has started reporting weaker data and commodity prices driven by China demand have declined, diverging from other commodities such as oil. Following this rationale, the current USD downward correction should be smaller than the spring USD decline.

The downward correction in the USD is likely to help EM currencies, particularly with interest rate differentials so wide in favour of EM. When we look at EM local currency bond yields, we can see that spreads to an average of US, Japan and German yields are at similar levels that we saw during the depths of the financial crisis in 2008. During periods where investors are seeking yield, EM local currency government bonds clearly stand out as an attraction option, which should help foster inflows in the asset class.

Positioning

Do we feel comfortable positioning for further strength in high yield EM currencies? This does make us a little nervous. After all, the inflows to EM are principally about carry and it is hard to make a fundamental case for why currencies in EM should see strong gains. Many feel similarly about equity markets, which are trading well primarily because relative valuations to bonds look attractive, despite US stocks being expensive relative to history in absolute terms amid concerns of a slowing economy and an earnings recession. So asset price inflation without real economic progress does not sound like a healthy combination for the medium-term outlook. This is particularly the case as the problems of rising misallocation of capital are likely to be even larger as core bond yields head increasingly into negative territory, with all the attendant implications for productivity growth.

Exhibit 12: EM Local Bond Yields Historically Wide



Source: Bloomberg, Morgan Stanley Research

Nevertheless, this is not the time to be short high yield EM currencies. We have thus rotated our portfolio away from long USD vs EM currencies and have added some relative value trades. We have turned a long USD/MXN into a long BRL/MXN trade, and a long USD/SGD into a short SGD/IDR trade.

Political risks are still significant in Brazil, but we believe the market will continue to focus on the positives rather than some of the recent negatives. We also believe that the higher carry currencies will benefit more before MXN catches up, suggesting that BRL should outperform MXN on a spot basis. Monetary policy is also supportive of BRL, with the BCB continuing to hold a relatively cautious stance ahead of what we expect to be a deep rate-cutting cycle later this year. The long BRL/MXN trade also benefits from around 7% carry. A key risk would be a deterioration in sentiment around Brazilian politics.

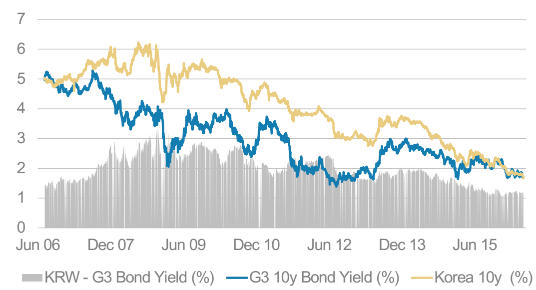
We have rotated our long USD/SGD position into a long IDR position as IDR should benefit as a relatively high carry currency versus SGD's low-yielding status, while a further rise in commodity prices will benefit IDR over SGD too. Finally, the tax-amnesty bill in Indonesia should, if it passes, result in strong inflows into Indonesia and thus help support the currency. The tax-amnesty bill not passing, or a renewed strengthening of the USD and falling commodity prices would be the main risks to this trade.

What about low-yield EM?

There are some EM currencies where yield differentials are not at historic wides, but at historic lows. Korea is one example, where following the surprise rate cut earlier this week, bond yields at the 10y point are now more or less flat to the US, and converging on Japan and German bond yields.

While the rate cut did not have a significant impact on KRW in the immediate aftermath of the decision, we expect the trend of narrowing rate differentials and low returns in the real economy thanks to weak economic activity to weigh on the currency over time. Indeed, capital outflows have been accelerating from Korea over the past few quarters, and we expect this to continue as local pension funds continue to rebalance to offshore assets amid falling local returns. The Bank of Korea sounded notably more downbeat on the outlook for domestic demand.

Exhibit 13: Korea Bond Yields Converging on G3



Source: Bloomberg, Morgan Stanley Research

An Alternative Viewpoint

For the FX markets, the reason US labor data moderated over recent weeks will make a significant difference. Is it because the labor market is approaching NAIRU and the decline in new-job creation will come along with rising wages? The Beige Book reporting tighter labor market conditions in 14 districts and average hourly earnings holding steady at 2.5% may be evidence of this. In this case, the Fed would keep its tightening bias intact, pushing the USD higher, and we would be wrong to make the above adjustments to our portfolio.

But what if the US economy really is in worse shape than it appears? We would certainly then see the Fed maintaining its dovish tone and pushing out rate hikes even further. The broad USD has fallen about 2% since the poor NFP report as expectations for a rate hike by December went from 76% to 58% (as of today). If we extrapolate from the relationship between front-end yield differentials and USD since mid-April, we find that a fall in December rate hike expectations to 30% would push USD down an additional 2%.

Moreover, this alternative interpretation would see the US economy reopening its output gap, adding to global deflationary pressure. This outcome would push the JPY and CHF higher with real yield differentials becoming more supportive. US bond yields would fall as local capital demand declined, reducing the attractiveness of USD-denominated debt investments. The USD could then fall harder than we expect.

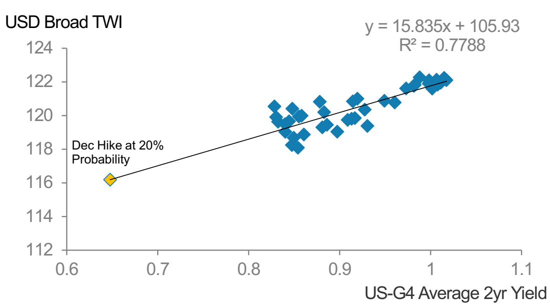
This scenario would offer interesting features. Globally falling nominal yields would increase the demand for risky assets. Equities' and other assets' valuations would increase as risk-free assets increasingly provided negative yields. Zero-yield looks better than negative yields, suggesting valuations would adjust accordingly, ignoring associated risks related to the yield pick-up. Investment flows into EM would pick up, reducing local funding costs, delaying the necessary rebalancing of supply-driven economies, and, worse, the renewed availability to cheap capital could prolong the supply boom, creating even more capacity for which there will be very little future demand.

The deflation problem becomes even more emphasised, but investors would not recognise these risk in the short term. This scenario may see commodity and EM currency strength unfolding in the short term, but deflation concerns would mean it comes along with a higher CHF and JPY, which would be new. So far, the JPY and CHF have weakened when EM/commodity FX strengthened.

How does all this fit into our USD smile framework? EM increasing an economic imbalance and reducing the return of capital in the long run works against risk in the long term. The US economy slowing down and triggering capital flows into EM may be a positive factor in the short term, but the US is too important a global demand provider and with underutilised AXJ capacities local investment returns will fall. Capital flows would reverse, shares would fall and the USD rise. In this case, we could see US yields (and yield differentials) falling but the USD rising, similar to what we saw in Jan/Feb. It is unclear when this playbook might emerge, but we believe it could be sooner than the market would expect.

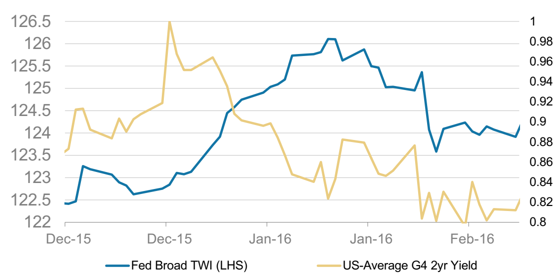
All in, we stay firmly convinced that the USD's secular bull market is not yet complete. Should US wages turn higher, the USD would likely move higher later this summer. Should the US be entering a cyclical slowdown, the USD would have more short-term downside potential of around 5% from here, before EM overcapacity worries put the USD back into its bull trend. For now CHF and JPY offer better value than the USD.

Exhibit 14: Further Pricing Out of Rate Hikes Would Hurt USD



Source: Bloomberg, Federal Reserve,Morgan Stanley Research . Regression since April 15, 2016

Exhibit 15: USD Rose in Jan/Feb Despite Falling Yields

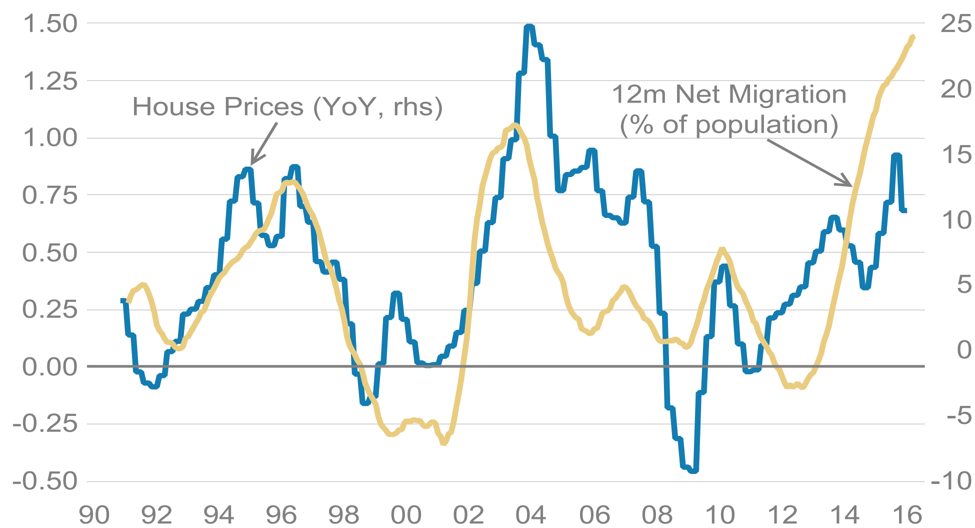


Source: Bloomberg, Federal Reserve,Morgan Stanley Research

Why New Zealand and Sweden are very similar

Reduced Fed-hike expectations resulting in a weaker USD and lower volatility in asset markets have led the NZD TWI to trade almost 6% above the RBNZ's September forecast. Despite the focus on the strong currency in March and its disinflationary impact, the RBNZ surprised markets by keeping rates unchanged today and revised their 2016 core inflation projection higher. The decision was driven by low market volatility, reduced worries about low global growth and a fairly well supported housing market. How do we choose to trade the NZD now? Our previous analysis of yield curves suggested that the steeper the curve and higher the monetary policy rate, the more effective rate cuts and QE can be at weakening a currency. In this respect, the NZD has the largest weakening potential within the G10. However, we believe the story building within the domestic economy and the RBNZ's interpretation may reduce and even limit the pace of the NZD decline.

Exhibit 16: NZ House Prices Supported by Net Migration



Source: Macrobond, Morgan Stanley Research

We see great similarities between New Zealand's domestic economy and Sweden's. Both countries have experienced high net migration over recent years, with New Zealand seeing 1.4% of its population arrive in the last 12 months. Both countries are seeing strong house price rises both as a result of the higher population and to some degree a lack of supply in major cities. The higher consumption effect of a population increase has had a positive impact on growth, which both the Riksbank and the RBNZ are now having to account for. Generally, higher consumption is assumed from the population increase and in the case of New Zealand, households taking equity out from their homes which are rapidly appreciating in value. The resulting stronger growth should result in higher domestic inflation. While the RBNZ has stated that the consumption impact from house price rises is less than in the past, it still has the potential to provide a cushion for inflation as global inflation expectations fall. In this respect, we are watching consumption data (e.g., GDP (15th June), card spending (22nd June)) and the impact of this on inflation (CPI, 17th July), inflation expectations (2nd August).

In the coming weeks, we expect the NZDUSD to trade higher as global volatility stays low and the USD weakens. Going forward, the view is dependent on the probability of the RBNZ cutting rates at their August meeting. While inflation and the strength of the NZD are known important factors, should global volatility stay low and growth stay relatively stable, the probability of a rate cut will be significantly reduced. The issues with the profitability in the dairy sector and potential risks to financial stability may be pushed backward if consumption data stays strong, limiting NZD's downside. However, as soon as risk appetite starts selling off, we would be sellers of the NZD strength. Higher market volatility has had an impact on the largely wholesale-funded banking sector, which had to then use bank deposits as a source of funding, squeezing profit margins. Longer term, the RBNZ may be able to weaken the currency via rate cuts but the pace of cuts and thus currency decline could be limited by the counteracting growth support from a higher population and strong house prices.

We would like to thank James Lord for his contribution to this report.

PLN: Little Carry and Plenty of Risks

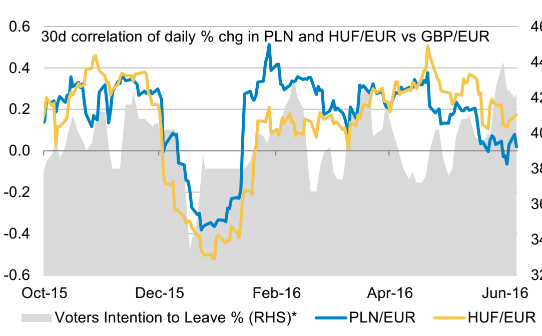
Meena Bassily

Bottom Line: Since the weak US May employment report there has been strong performance in high yielding EM currencies as Fed hikes have been priced out of the curve for the summer months. In this environment, we think PLN should underperform EM FX with carry comparably low and given several domestic and external risks on the agenda. We outline these risks below and think any moves in EUR/PLN to 4.25 represent an attractive buying opportunity, and we continue to prefer HUF over PLN. Our analysis points to attractive PLN valuations versus the EUR which may be a source of support later in the year, but not yet.

PLN often features as a currency that could depreciate on a vote from the UK to leave the EU. The key channels of contagion include: (i) High levels of trade between Poland and the EU (7.6% of Poland's exports are to the UK and 56% to the eurozone) that could weaken with our economists estimating a 0.3pp hit to eurozone growth in 2016 in the event of Brexit. (ii) A decline in the sizeable net inflows enjoyed by Poland from the EU (yearly average of EUR 12.4b between 2011 and 2014), to which the UK is the second largest net contributor (though the UK is already committed to contribute to the EU budget under the 2014-2020 programme). (iii) The implication of a less unified EU and increase in anti-EU rhetoric emboldening the characteristically nationalistic PiS government's stance on several issues. Other less clear channels of contagion include a weakening of remittances from the UK to Poland, while a potential support could be reverse migration helping Poland's adverse demographics. For more see **European Economics & Strategy: What Brexit Would Mean for Europe**, March 7, 2016.

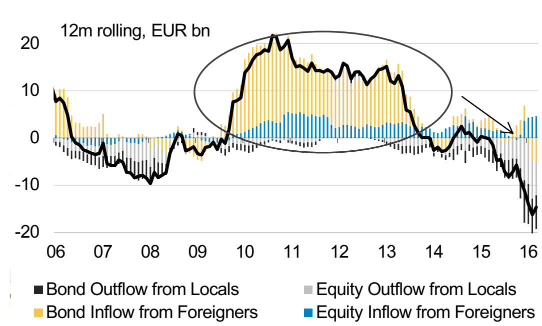
But Brexit risks are not impacting performance. All of this considered, the correlations of PLN (and HUF) against GBP, and the correlation of their performance against the polls for the EU referendum show no real increase in sensitivity over recent months. Similarly, Poland's bond spread has continued to narrow over recent months and shows no meaningful relationship to the changing probability of a Brexit vote. True, Polish assets have lagged the rally in EM, but not by much more than lower betas would imply. We aren't quick to call the market complacent since such a binary event with ever tighter probabilities is unlikely to define a trend or volatility in a currency beyond particular days. However, should Brexit occur we expect PLN (along with HUF) will be sold as one of few natural proxies to the event within the EM asset class. We doubt such an event will be the basis of continued PLN weakness, but there are other reasons we see an upward skew around our EUR/PLN forecasts.

Exhibit 17: Little Evidence of Brexit Risk Impacting PLN Performance



Source: Bloomberg, Morgan Stanley Research

Exhibit 18: Equity Inflows Have Been an Offset to Bond Outflows from Foreigners

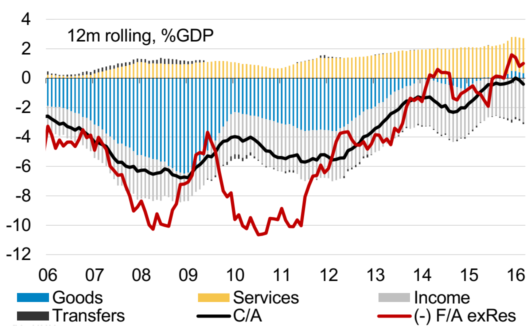


Source: Haver, Morgan Stanley Research

FX-Mortgage saga. If a binary outcome and tight probabilities were impacting the transmission of Brexit risks onto PLN performance, then it is scarcity of detail which makes the FX loan plan equally difficulty to express a view on via the exchange rate. However, and similar to Brexit risks, we view the skew of this risk is for EUR/PLN to head higher rather than lower. President Duda's team has proposed a draft plan to help Poles who took CHF-loans in the pre-crisis period which have become more expensive given the rise in CHF/PLN. The current FX loan book stands at EUR 32b. Our economists think this week's press conference on the matter raises as many questions as answers, with the proposals still referred to as a draft, the timing of completion uncertain, and given a lack of clarity on how the banks will spread the costs over time. For more see **Poland Economics: FX Loan Plan Leaves Too Many Questions Unanswered**, June 9, 2016. The lack of detail creates an uncertain environment for Polish banks, which is important for the PLN outlook to the extent that it may have negative impact on the equity market which has continued to see foreign inflows (partially offsetting the outflows in the bond market). In addition any negative implication on Poland's credit rating which is already under pressure should impact PLN.

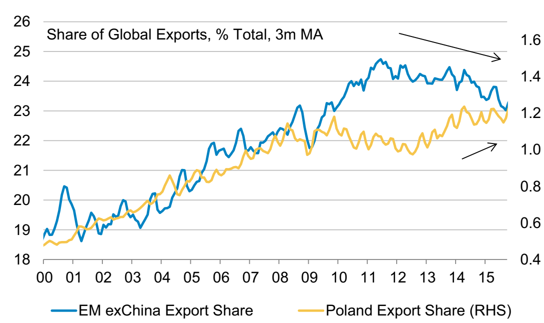
Rule of Law. Of less immediate market relevance is that the EU has adopted a critical opinion on the Rule of Law in Poland related to (i) the appointment of judges to the constitutional tribunal (ii) the functioning of the constitutional tribunal and (iii) the effectiveness of constitutional review of new legislation (media law and other laws). For more see **here**. With there being no specific deadline for the EU to issue a Rule of Law Recommendation, these issues are likely to remain as background noise to PLN performance . If there is no resolution this can result in eventual sanctions on Poland which could count for some risk premium in Polish assets, though we acknowledge it may take a while for this to be the case.

Exhibit 19: Current Account Improvement



Source: Haver, Morgan Stanley Research

Exhibit 20: Polish Trade Remains Competitive



Source: Haver,Morgan Stanley Research

PLN is still cheap on many measures. Our concerns on PLN are related to events and their potential impact on capital flows, and less to valuations. True, most recently, there has been a loss of momentum in trade balance improvement with the breakdown of real GDP growth (3.0%Y for Q1) showing a negative contribution from net trade (-0.9%Q) as domestic demand has remained resilient (supported by higher real wages and employment growth) while exports have contracted given external demand weakness. However, taking a step back, Poland has still experienced an impressive narrowing of its current account deficit from 5.7%GDP in 2011 to 0.4%GDP in March (12m sum) over a period in time in which growth has outperformed peers and inflation has remained low. Improvements in Poland's terms of trade and competitiveness would have played a role in this rebalancing, with Poland's share of German imports rising from 3.4% to 4.7%, and share of global exports rising from 1% to 1.3% over this period. Note this is a period of time in which EM exChina export share has declined (see exhibit).

Accordingly, Poland's REER depreciating by 13% from the 2011 peak is difficult to explain via Poland's macro story alone, and is more likely related to EM and European issues which have weakened the financial account. This implies that the currency has no valuation issues and looks cheap. Certainly the level of EUR/PLN is of no issue to Polish corporations with the latest NBP survey suggesting an average pain threshold level (below which FX valuations become a concern to corporate profitability) at around 3.90 for EUR/PLN, over 10% below current levels.

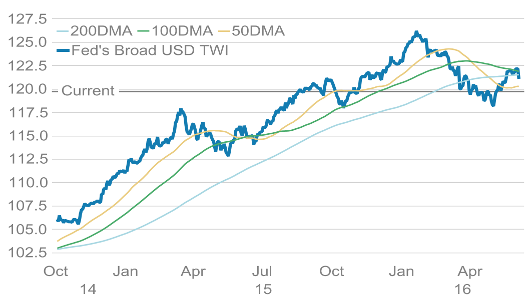
As such, our concerns for PLN are event driven and less to do with competitiveness issues (ZAR) or policy issues (TRY, ILS). However when weighing up the several risks on the agenda, and the 1.65% carry return on long PLN positions (versus a CEEMEA average of 4.3%), we don't see compelling reason to buy PLN on the basis of relatively cheap valuations. This may be a story for 2017, which we would only consider positioning for once the above mentioned events have passed and should the negative credit ratings cycle stabilise.

Technical Chart of the Week: The USD

Sheena Shah

The Fed's broad trade weighted USD has declined just under 2% from its peak at the start of the month, so we try to put the USD weakness into a historical context and see what momentum indicators are suggesting for individual currencies.

Exhibit 21: Fed's Broad USD Index

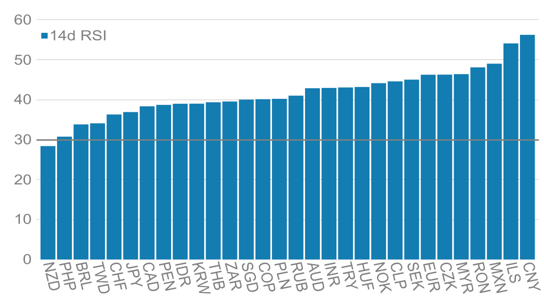


Source: Bloomberg, Morgan Stanley Research

The USD has moved back toward the 120 level which we have crossed several times since the middle of July. The USD is now trading below the 50-, 100- and 200-day moving averages but has not yet reached the 61.8% retracement level (119.65) of the rally since the start of May. The current level is 1.6% higher than the May 2 low but still 4.9% below the January peak. We expect only a small further decline in the USD. The technical level to watch to the downside is the May low of 118.11. A break towards 117 could provide further downside momentum.

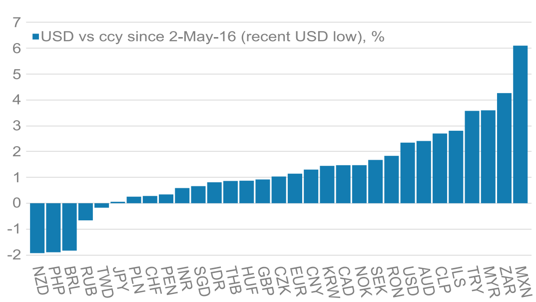
Using the 14-day RSI, the USD is most oversold relative to the NZD and PHP, while being closer to being overbought vs CNY, ILS and MXN. The RSI could also be used as an indicator of market positioning, suggesting the market remains long the USD vs ILS and MXN, meaning these currencies are likely to rally the most should the USD sell off further.

Exhibit 22: 14-day RSI



Source: Bloomberg, Morgan Stanley Research

Exhibit 23: Relative to the recent USD low



Source: Bloomberg, Morgan Stanley Research

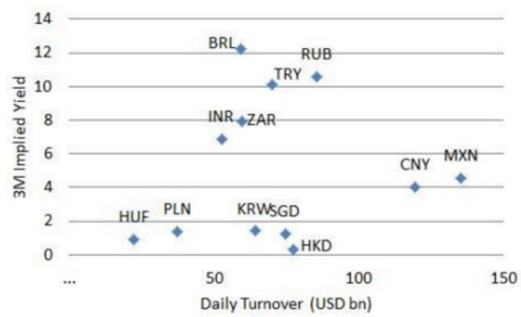
MXN, ZAR and MYR have weakened the most relative to the USD's low on 2 May, suggesting they could move the most in a USD selloff. Interestingly the BRL stands out at the other end as having strengthened the most in the recent USD move. USDCHF is very close to breaking the 2 May low, indicating that it is close to generating more downside momentum, unlike the EUR, which is a bit further away. Momentum indicators also have USDMXN and USDMYR standing out as having underperformed by being higher than their 50DMA, unlike currencies such as USDBRL, USDRUB and USDCOP, which have already fallen much below their 50DMA.

Strategic FX Portfolio Trade Recommendations

Buy BRL/MXN

Closed Long USD/MXN (*Entry: 19-May-16)*
USD/MXN: Entered: 18.42; Closed: 18.2481 on 9-Jun-16
BRL/MXN (*Entry 9-Jun-16)* Entered at 5.37; Stop: 5.20; Target: 6.00

Exhibit 24: MXN is relatively low carry and highly liquid



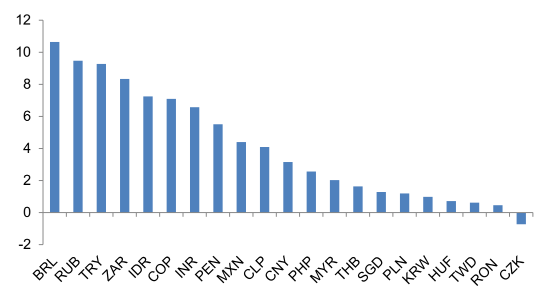
Source: Bloomberg, BIS, Morgan Stanley Research

We rotate our long USD/MXN position into a long BRL/MXN position in light of the prolonged period of USD weakness. We still expect MXN to be an underperformer, given its low carry makes it an unattractive way to play EM rally. MXN tends to underperform EM in both the good and bad times given this low carry, as well as its high liquidity. On the other hand, with the BCB not yet stepping in and some positive steps on fiscal measures, BRL is attractive in the current environment. The 7% carry differential between the two provides a cushion against losses as well. There are two main risks to this trade. The first is a negative turn in Brazilian politics. The second is that stretched short positioning in MXN sees an unwind if the EM rally continues. We put this trade on in **EM Strategy: Biding time (09 Jun 2016).**

Sell SGD/IDR

Closed Long USD/SGD(*Entry: 12-May-16)*
USDSGD: Entered: 1.373; Closed: 1.3528 on 9-Jun-16
SGD/IDR 3M NDF (*Entry: 9-Jun-16)*: Entered at 9930, Stop: 10,100; Target: 9580

Exhibit 25: IDR Yields Higher Than Most



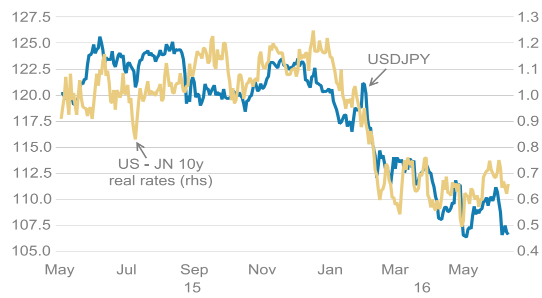
Source: Bloomberg, Morgan Stanley Research

We have closed our long USD/SGD trade given recent US data and dovish commentary from Chair Yellen, and we expect that the risk appetite will remain reasonably firm given the high level of carry available on EM fixed income assets related to G3 bonds. This will aid IDR, given its high yield and status as a commodity currency. IDR should also benefit from the upcoming tax amnesty bill. The primary risk for this trade would be a resumption of the stronger USD theme driven by better US economic data, or should the tax amnesty bill not pass. We put this trade on in **EM Strategy: Biding time (09 Jun 2016).**

Sell USD/JPY

Limit Order (9-June-16)
Enter: 108.60; Stop: 112.00; Target: 98.00

Exhibit 26: Real Rates Drive USDJPY Lower



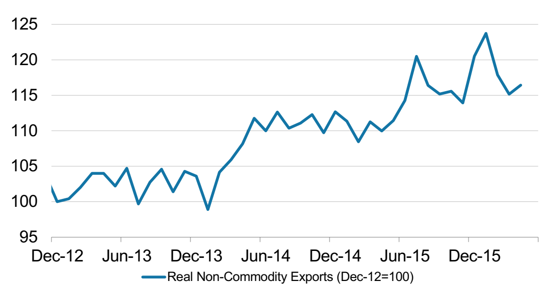
Source: Bloomberg, Macrobond, Morgan Stanley Research

Building negative risk appetite, the BoJ's decreasing ability to weaken their currency and the market's reduced expectations for a large fiscal support package should all help the JPY strengthen. Our bullish JPY view may be supported by portfolio flows too, with Japanese investors selling foreign bond exposures for the first time in eight weeks. The flat JPY yield curve and low monetary policy interest rate suggests that further BoJ easing measures may have a limited impact on weakening the currency. This morning it was the BoJ's Takehiro Sato stating the obvious, namely that negative interest rates combined with QE does not work. With the BoJ's JGB purchases hitting the wall in 2017 due to bond shortages, the BoJ faces an increasing dilemma concerning the effectiveness of its policy. Equity investors are increasingly looking to fiscal expansion but were left disappointed recently as Abe didn't provide details about any **fiscal** stimulus after announcing that he will delay the sales tax rise. Investors will be looking for further commentary from Abe given that no change is expected at the upcoming BoJ meeting. The JPY remains the most sensitive currency to any moves in local equity markets. We chose to sell USDJPY on rallies as this provides better risk reward given the recent volatility in the local equity market.

Short CAD/JPY

Hold (Entry: 12-May-16)
Entered at 85.10; Stop: 85.50; Target: 70.00

Exhibit 27: Weak Real Non-Commodity Exports Poses Risks to Outlook



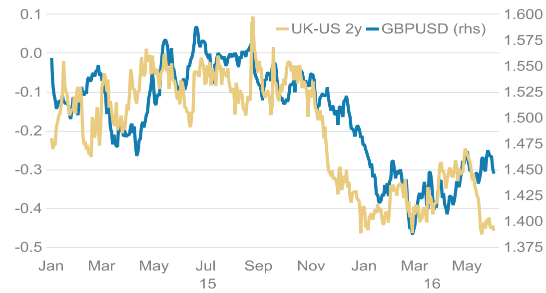
Source: Statistics Canada, Morgan Stanley Research

We retain our CAD shorts despite the continued rally in oil. We still like trading vs the JPY and have closed our USDCAD trade. We don't believe the BoC's statement was as hawkish as the market took it to be given our expectations for few changes (as there was no MPR) and some dovish shifts (acknowledging poor business investment and the "uneven" structural adjustment). We believe Canada will continue to struggle with its rotation towards the non-resource sector and recent trade and GDP figures point to little progress. With rates markets pricing in little chance of a cut this year, we believe risk/reward for CAD short positions is still very attractive. . We like to buy against the JPY as low inflation expectations in Japan are turning lower due to a stronger currency. The market is seeing that the BoJ may have a limited monetary policy toolbox to weaken the currency as they have already cut rates to negative and the yield curve is flat. Any weakness in risk appetite may add to repatriation pressures from Japanese pension funds. The risk to this trade is better Canadian data or risk appetite rebounding sharply.

Short GBP/USD

Look to Close *(Entry: 5-May-16)*
Entered: 1.4485; Close at WMR on 10-Jun-16
Recent rebounds in equity markets, oil and potential risk reduction ahead of the EU referendum mean we are taking off our short GBPUSD position. Overall we believe the risk reward of being long USDs has reduced so our portfolio is being shifted into cross currency trades. The markets will continue to be sensitive to referendum polls but with our economist's expecting the result to be "a remain", the probability for a GBPUSD rebound by the end of the month has increased. The risk to our view was a repricing of the rate hike expectations from the Fed after the FOMC meeting.

Exhibit 28: 2y Rate Differentials Point to Lower GBP

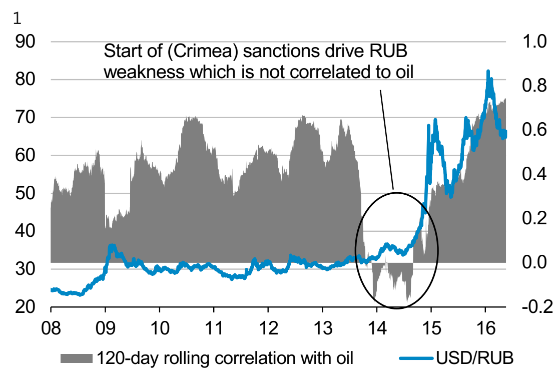


Source: Bloomberg, Morgan Stanley Research

Long USD/RUB

Closed (Entry: 19-May-16)
Entered: 66.77; Closed at 64.00 on 8-June-16
We recommend being long USDRUB, on the back of expectations for increasingly negative price action in risk assets however we were stopped out of the trade due to the continued rally in oil prices and USD sell off post the payrolls report. The recent strength in the currency increases the risk of dovish CBR policy, however, in the current external environment we doubt cuts will have a negative impact on RUB, particularly considering how fast inflation has fallen. A potential risk to RUB is the CBR using recent strength to start building reserves.

Exhibit 29: RUB Correlation to Oil At the Highs



Source: Bloomberg, Morgan Stanley Research

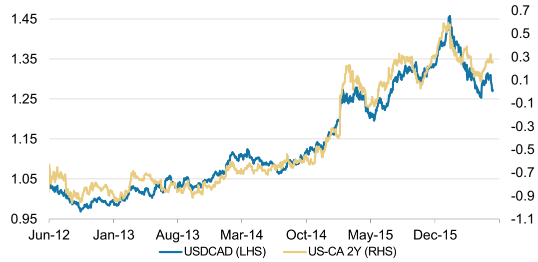
Long USD/CAD

Closed (Entry: 19-May-16)

Entered: 1.3094; Closed at 1.2750 on 7-June-16

The continued rally in oil prices and USD sell off post the payrolls report meant we were stopped out of our USDCAD position. We still stay short CADJPY and retain our bearish CAD view but would recommend waiting before entering long USD positions again.

Exhibit 30: Yield Differentials Drives USDCAD



Source: Bloomberg, Morgan Stanley Research

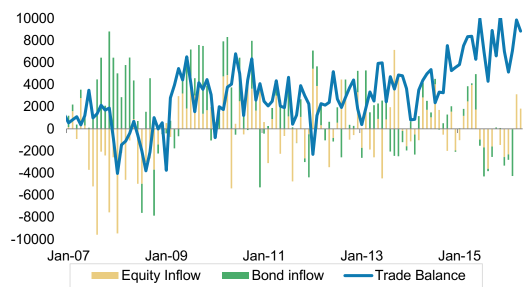
Long USD/KRW

Closed (Entry: 19-May-16)

Entered: 1192; Closed at 1158 on 8-June-16

The weaker USD environment after payrolls stopped us our of the USDKRW trade. On top of this the equity markets continued to rebound, which KRW is particularly sensitive too. Our views on the economy continue to be supported by the BoK who unexpectedly cut rates this week but with little impact on the currency markets. The USD will start to rally again when the market has decided if the US labour market is strong meaning the Fed can hike this year. We wait for this period before entering long USDKRW positions again.

Exhibit 31: Capital Outflows to Offset Trade Balance



Source: Haver Analytics, Morgan Stanley Research

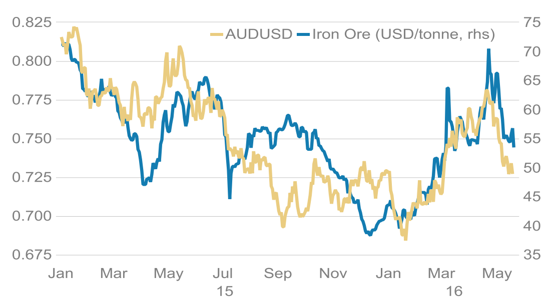
Short AUD/USD

Closed (Entry: 19-May-16)

Entered: 0.7228; Closed at 0.7375 on 6-June-16

The USD sell off post-payrolls and the continual support for risky assets stopped us out of the short AUDUSD position. There is still a case to sell on rebounds but after the market has assessed the state of the US labour market. Longer term we believe the AUD is still vulnerable from weakening industrial metals prices, China no longer providing stimulus to its steel sector and general equity market weakness but we would wait before entering short AUD positions again.

Exhibit 32: AUD is at risk from weak commodities



Source: Bloomberg, Morgan Stanley Research

Strategic FX Portfolio

Trade Recommendation	Notional	Nominal Weight	Entry Date	Entry Level	Current	Stop	Target	Spot P&L	Carry P&L	Portfolio Contribution
Closed Trades										
Short AUD/USD	$10.0mn		19-May-16	0.7228	Closed at 0.7375 on 6-Jun-16			-$203.4k	-$5.9k	-$209.3k
Long USD/KRW	$10.0mn		19-May-16	1192	Closed at 1158 on 8-Jun-16			-$292.0k	-$5.3k	-$297.2k
Long USD/RUB	$7.5mn		19-May-16	66.77	Closed at 64.00 on 8-Jun-16			-$324.1k	-$41.8k	-$365.9k
Long USD/CAD	$10.0mn		19-May-16	1.3094	Closed at 1.2750 on 7-Jun-16			-$269.8k	-$0.4k	-$270.2k
Long USD/SGD	$10.0mn		12-May-16	1.373	Closed at 1.3528 on 9-Jun-16			-$149.3k	$2.9k	-$146.4k
Long USD/MXN	$7.5mn		19-May-16	18.42	Closed at 18.2481 on 9-Jun-16			-$72.4k	-$14.9k	-$87.3k
Short GBP/USD	$10.0mn		05-May-16	1.4485	Close at WMR on 10-Jun-16			$17.3k	$0.2k	$17.4k
Active Trades										
Short CAD/JPY	$10.0mn	10.3%	12-May-16	85.10	84.15	85.50	70.00	$109.2k	-$6.1k	$103.1k
Long BRL/MXN	$7.5mn	7.8%	09-Jun-16	5.37	5.37	5.20	6.00	-$0.5k	$0.0k	-$0.5k
Short SGD/IDR 3M FWD	$10.0mn	10.3%	09-Jun-16	9930	9913	10100	9580	$18.6k	$0.0k	$18.6k
Limit Orders										
Sell USD/JPY	$10.0mn			***108.60***	107.06	***112.00***	***98.00***			
Cash	$59.4mn	61.5%								
Portfolio Mark to Market	$96.7mn									

Source: Morgan Stanley Research

Simulated Managed Account Monthly Gross Performance - %													
Year	**Jan**	**Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sep**	**Oct**	**Nov**	**Dec**	**Year return**
2008	1.07	2.25	2.72	-1.41	-0.53	1.28	-0.17	-0.24	-0.86	3.12	0.62	0.87	**8.96%**
2009	0.74	-0.97	-0.15	-1.09	0.50	-0.87	0.30	0.22	2.00	0.77	1.27	0.55	**3.27%**
2010	-0.01	-0.27	1.71	1.13	1.39	-0.86	-2.36	0.95	0.67	-0.30	0.13	0.66	**2.80%**
2011	-1.20	0.29	-1.71	0.51	-1.11	-0.33	0.84	-1.02	0.50	-1.03	-0.18	0.44	**-3.97%**
2012	0.34	0.46	-0.42	0.52	1.78	-0.43	0.39	0.56	0.43	0.53	0.96	0.47	**5.72%**
2013	-0.23	-0.66	0.08	0.10	0.26	0.05	-0.71	-0.13	-0.62	0.23	1.17	-0.27	**-0.75%**
2014	1.09	-0.67	-0.54	-0.02	-0.20	-0.26	1.20	0.30	1.23	0.35	-0.30	0.37	**2.54%**
2015	2.21	0.09	1.07	-1.96	1.40	-0.63	2.20	2.80	0.29	-0.35	0.49	0.17	**7.77%**
2016	-0.22	1.07	-1.46	-0.33	-1.11	-1.26							**-3.30%**

Source: Morgan Stanley Research; see notes below

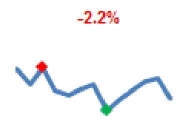
*Notes: (1) Stops are based on the WMR fixing. (2) The portfolio represents hypothetical, not actual, investments. For more details regarding calculations, please see "Reading FX Tactical Trade Performance" at the back of FX Pulse. **FX Performance Data Package**, contains complete performance statistics. (3) Reported returns are unleveraged. Reported returns do not take into account transaction fees and other costs; past performance is no guarantee of future results. (4) In the case that trade allocations are increased, entry levels are a weighted average.*

** Global Risk Demand Index – US Pat. No. 7,617,143. We updated our methodology for our portfolio in 2011 (see **FX Pulse: Watching Europe**, October 13, 2011).*

G10 Currency Summary

Charles Rubenfeld and Gek Teng Khoo

USD

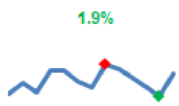


Cautious on USD **Neutral**

Watch: UMich. Survey, Retail Sales, PPI, IP, FOMC Rates Decision, CPI, Housing Starts

The recent labor market report is a game changer for USD, and we are no longer bullish in the near term. Until there is more clarity on whether the report is actually a sign of a deceleration in the economy, USD will have a hard time rallying. We will be watching upcoming US data closely, particularly the next labor market report. However, we retain our medium-term bullish view on USD and also believe a large enough data deterioration from here would push us to the left side of the USD smile as recession risks come back into focus, similar to the beginning of the year.

EUR

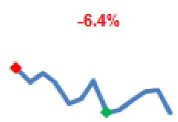


Real Yield Support **Neutral**

Watch: IP, Trade Balance, CPI

We expect the EUR to be supported by rising real yields. Inflation expectations tend to fall when growth worries emerge. The problem is that nominal yields are unable to fall far to compensate because they are already trading close to zero or in negative territory, resulting in the rise of real yields. As EMU has a neutral net foreign asset position, the commercial demand for EUR arising from its 2% of GDP current account surplus will also help support the currency. However, EUR should find it hard to rally strongly due to the regional risk events this month (EU referendum, German Constitutional Court ruling on OMT, Spanish elections).

JPY

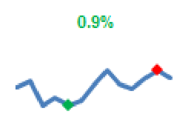


Still Bullish **Bullish**

Watch: Tertiary Industry Index, IP, Machine Tool Orders, BoJ Rates Decision

We maintain our structurally bullish JPY view. We don't expect intervention, particularly in light of the current G7 meeting, and don't expect fiscal stimulus to change the trajectory on JPY. With questions about the future success of Abenomics, FX hedging and repatriation flows will continue to drive the currency, and we ultimately expect USDJPY to fall through 100. We believe the BoJ needs to abandon its current framework of NIRP and expanding QQE and adopt more unconventional policy in order to weaken JPY.

GBP

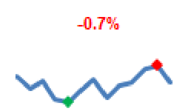


Focus on Medium Term **Bearish**

Watch: CPI, Unemployment Rate, Retail Sales, BoE Rates Decision

While GBP may receive some support from rising oil prices and risk staying supported in the near term, it is likely to remain sensitive to Brexit poll results, which can be volatile. Our economists expect a vote to Remain, so there is also potential for a relief rally after the EU referendum. However, given the uncertainty, we prefer focusing on the medium-term picture, which would mean staying bearish on the currency. This week, we watch CPI and BoE rates decision.

CHF



Supported by Real Yield and Risk **Bullish**

Watch: PPI, SNB Rates Decision

In the current low interest rate environment, we view CHF as attractive as it is likely to appreciate both in times of risk-on and risk-off. With a large part of its yield curve in negative territory, CHF's nominal yields have low elasticity to the downside, contributing to rising real yields supporting the currency strength even when risk is supported. If risk sells off, CHF tends to appreciate given its safe haven status. It is also likely to receive additional support from the European risk events this month.

CAD

-2.1%

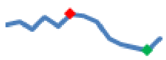
Fade CAD Strength — **Bearish**

Watch: Unemployment Rate, Manufacturing Sales, CPI

Despite recent price action, we maintain our bearish view on CAD as we believe the most recent BoC meeting was not as hawkish as the market took it to be, and expect further economic weakness will cause markets to price a higher chance of rate cuts. The BoC did not have a large shift in tone, but some dovish changes on capex and the wildfires open the door for a larger shift at the July meeting (which is accompanied by an MPR). Canada's rotation away from the resource sector is in doubt, with April's trade data showing little rebound after a sharp reversal of export growth in the last few months. Last week's poor GDP data print points to a decelerating economy and we expect the BoC may shift its tone at the upcoming MPR in July.

AUD

-2.6%



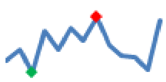
Selling AUD Rallies — **Bearish**

Watch: Consumer Inflation Expectation, Business Confidence, Unemployment Rate

We remain bearish AUD and look to sell AUD rallies as we expect RBA easing to push AUD lower. The RBA was hawkish this week by failing to include an explicit easing bias in its statement, which implies easing in July is almost certainly off the table. However, we still believe the RBA will eventually need to react to the worrying inflation trend and still vulnerable external accounts and our economists are now expecting another 75bp of rate cuts. House price growth is the key risk here; recent acceleration has given the RBA pause, but we still believe the trend will reverse and see further macro-prudential regulation as possible if it does not.

NZD

3.1%



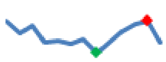
Scope for Further Appreciation — **Neutral**

Watch: House Sales, Food Prices, Current Account Balance, GDP

We no longer like holding short NZD positions and believe it could even extend its appreciation in coming weeks. The RBNZ's surprised to the hawkish side yesterday as it upgraded its inflation forecasts and sounded more upbeat about consumption growth. It also pointed to signs of reaccelerating house price growth which, according to the MPS, could lead to rate hikes in the coming quarters if it continues. However, we do note that the RBNZ expects to cut rates by 150bps in the scenario of no depreciation of NZD (as opposed to the 3% expected depreciation). With the TWI already trading above levels assumed in the "flat TWI" scenario, there is risk of rate cuts down the line to cause currency depreciation.

SEK

-2.4%



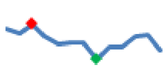
Limited USDSEK Downside — **Neutral**

Watch: House Prices, CPIF, Unemployment Rate

Recent Swedish economic data has continued to point to a strong economy, with industrial and service production both beating market expectations. While USDSEK may be driven lower by broad USD weakness, the downside is limited as the currency pair trades only about 2% away from the 8.00 support level and SEK is the G10 currency that is most likely to weaken when the US yield curve flattens. This week, we watch the CPIF release, which may be boosted by the rise in oil prices.

NOK

-2.9%



Support from Oil — **Neutral**

Watch: CPI, PPI, Trade Balance

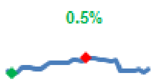
With increasing market expectations for a delayed Fed rate hike, the recent rebound in equity markets and oil prices may continue in the near term, helping NOK stay supported. The rally in oil prices has helped drive NOK higher against EUR and USD. EURNOK is now approaching the key support area at 9.20, which should be watched closely as a break could open room for further downside. This week, we watch CPI and trade balance data.

Charts show 3M performance against USD, as normally quoted and DXY for USD. Click on any currency for a reference webpage on Matrix.

EM Currency Summary

Kritika Kashyap (AXJ), Meena Bassily (CEEMEA), Dara Blume (LatAm)

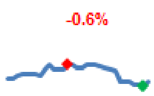
CZK



Neutral

The CNB has stated that it does not expect to remove the floor until mid-2017, while it remains open to the possibility of lowering rates or lifting the EUR/CZK floor should disinflationary pressures build. We accordingly see greater risk of EUR/CZK going higher over the next 12 months than lower, as the CNB has made efforts to distance its floor policy from that of the SNB.

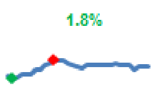
HUF



Bullish

Our framework for HUF has centered on when financial outflows, driven in recent years by bank deleveraging and foreigners exiting the bond market, would slow and allow for improvements in the current account to materialize in HUF strength. Given that the NBH remains in an easing cycle and EU-related risks are on the rise, we don't think it is yet the time to position for HUF strength.

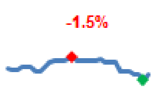
ILS



Neutral

The BoI views ILS appreciation as having contributed to weakness in exports, and has therefore continued to purchase USD. We expect interventions to remain high and limit moves in the ILS basket (EUR-USD) below 4. That said, we do not look for renewed dovishness, which would otherwise be needed to drive significant gains in USD/ILS, since the overall BoP remains conducive to ILS strength. We therefore look for modest moves in USD/ILS up to 3.90 before falling next year.

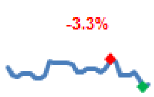
PLN



Neutral

We take a deep dive into PLN this week, and think it should underperform EM with carry comparably low and given domestic and external risks on the agenda which we look at in detail. We think any moves in EUR/PLN to 4.25 represent a buying opportunity, and we continue to prefer HUF over PLN. Attractive PLN valuations vs the EUR may be a source of support later in the year, but not yet

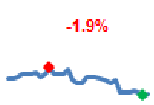
RUB



Bearish

We are sidelined on the RUB with the rise in oil prices taking us by surprise and providing meaningful support to RUB. The correlation of USD/RUB to oil remains near all-time highs, and unless the CBT starts intervening we don't see this correlation changing (with the macro rationale to it remaining the same). We see no major misalignment between RUB and oil prices. Given the steep declines in inflation we doubt CBT easing will have much impact on the currency either. We also note our economists' view that there is a low chance of sanctions being lifted in July.

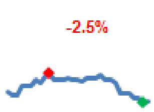
TRY



Bearish

We have been bearish on TRY for some time, but the view hasn't played out for a combination of reasons including less pressure from short-term US rates, overcrowded short positioning and a sharp fall in inflation which has kept real rates elevated despite CBT cuts. Most of the decline in inflation has been from food prices and our economists expect the declines to slow. Should the CBT also keep cutting this should support our bearish stance on the currency.

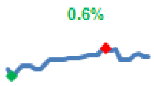
ZAR



Bearish

Weakness in growth and its implication on South Africa's credit rating and ability to attract capital to finance a current account deficit that is rebalancing at a disappointingly slow pace is central to our long term bearish stance on the rand. A negative turnout in growth at -0.2%Y for Q1 is a reminder of these risks and keeps us bearish. In the near term a repricing of Fed hikes may provide temporary support to ZAR but we would use moves to 14.25 as USD buying opportunities.

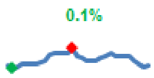
CNY



Neutral

CNY is weakening against USD even as the RMB TWI remains broadly stable and capital outflows have been constrained. However, recent data are showing signs of growth slowing and we are cautious on the build-up in leverage earlier in the year to support growth amid falling returns. Over the medium term, we expect capital outflow pressure to remain, putting pressure on the currency.

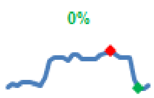
INR



Bullish

INR is testing the 200DMA once again as Fed turns cautious on hikes. Domestic reform momentum remains strong and the fundamentals of a stable balance of payments, sufficient foreign exchange reserves and positive real rates remain supportive of INR over the medium term.

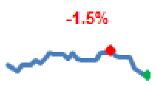
IDR



Bullish

In addition to the USD bearishness post NFP and overall risk environment turning bullish, we expect potential positive news around the tax amnesty bill, if approved by the parliament, to bring significant near-term support for IDR. We add short SGD/IDR forward positions to our trade portfolio.

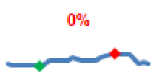
KRW



Neutral

Korea's trade flows come back into focus as USD has retreated. Over the medium term however, we remain concerned about Korea's growth outlook, given continued weakness in external growth and the ongoing debt restructuring in the manufacturing sector. We believe that further currency depreciation is needed to alleviate disinflationary pressures and support exports.

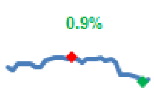
MYR



Neutral

MYR continues to get support from rising crude oil prices and renewed USD bearishness. However, we believe that the de-linkage of oil prices from other commodities may not last for long and remain cautious on the outlook for MYR.. We think MYR remains vulnerable, given high foreign ownership in its local currency bond markets, commodity exposure and low reserves.

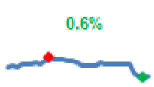
SGD



Bearish

We remain structurally bearish on SGD, given soft global trade demand as well as weak domestic demand from the ongoing decline in the manufacturing and property sectors. We think that from a competitiveness perspective SGD is also likely to come under pressure from a rapidly declining RMB TWI, given Singapore's significant trade exposure to China.

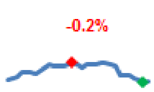
TWD



Neutral

TWD trades with a low beta to dollar moves, with the central bank likely to resist currency strength amid weak export growth. Over the medium term, we remain bearish on TWD, given the lack of domestic growth drivers and increasing competition from China as it moves up the value chain.

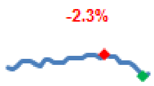
THB



Bearish

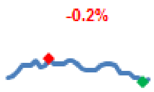
The BoT has raised concern on THB's relative strength versus regional FX and its impact on Thailand's slowing external growth. We are also seeing the BoT add more USD reserves and turn less concerned about domestic outflows. We are of the view that although the government's fiscal stimulus has boosted domestic growth and CPI in the near term, weak external growth and deflation will continue to be a pressure point for the currency, given its high leverage and overcapacity issues.

BRL **Bullish**



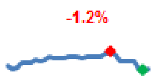
We expect BRL to continue outperforming in the current EM rally. Its high carry and lack of BCB pushback on strengthening should both allow the current trend to continue in the near term. The main risks to BRL are a) a shift back towards using appreciation to unwind BCB swaps, b) a negative turn in politics and c) a broader correction in EM, though in this case BRL would likely still outperform its high beta peers.

CLP **Neutral**



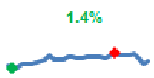
CLP is caught between conflicting forces at the moment. While EM FX is broadly rallying, copper continues to weaken as it is not exposed to the industrial strength in China. While we would expect CLP to be an outperformer, we recognize that this can be difficult with copper prices falling, and remain neutral for the time being.

COP **Bearish**



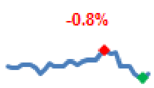
COP could continue to outperform as it catches up with oil, as it did not benefit quite as much from the latest rally as it normally does. Of course, over the medium term we remain concerned, as even with oil at 50 fiscal concerns remain, particularly as the finance ministry reiterated its optimistic 3% growth assumption this week . We look to buy dips in USD/COP once the weaker EM FX trend resumes.

MXN **Bearish**



Even amidst the broader EM rally, MXN continues to underperform is high beta peers, as its low carry makes it an unattractive way to play the rally. While a catchup is likely if the rally is too prolonged, given short MXN positioning, we expect only a short lived rally in which MXN is the underperformer and then one of the first to be sold in the resumption of the USD/EM uptrend.

PEN **Neutral**



For the first time since 2014, BCRP bought USDs this week. As the BCRP likes to limit PEN volatility, it will likely mute gains in the ongoing EM rally, making long USD/PEN positions somewhat attractive. However, shifts in pension regulations and the possibility of a more hawkish central bank stance could support the currency. On the other hand, at the time of writing we await the final results for the presidential elections, and the closeness of the race could keep uncertainty elevated.

Charts show 1M performance against USD, as normally quoted

Global Event Risk Calendar

Gek Teng Khoo

Date	Time (Ldn)	Ccy	Event	Ref. Period	MS forecast	Market	Previous
10-Jun	**9:00**	**NOK**	**CPI Underlying (YoY)**	**May**		**3.1%**	**3.3%**
	11:30	**RUB**	**CBR Rates Decision**		**11.00%**	**10.5%**	**11%**
	13:30	CAD	Employment Change	May		1.8k	-2.1k
	15:00	USD	Univ. of Michigan Confidence	Jun P		94	94.7
10-15 J	N/A	CNY	Foreign Direct Investment (YoY, CNY)	May		5%	6%
10-15 J	N/A	CNY	New Yuan Loans	May	650B	750B	556B
13-Jun	3:00	CNY	Industrial Production (YoY)	May	5.9%	6%	6%
	3:00	CNY	Retail Sales (YoY)	May	10.1%	10.1%	10.1%
	3:00	CNY	Fixed Assets Ex Rural YTD (YoY)	May	10.3%	10.4%	10.5%
	9:00	CHF	SNB Sight Deposits				493.5B
	15:40	**SEK**	**Riksbank's Ingves spks (Sopot)**				
14-Jun	2:30	AUD	NAB Business Confidence	May			5
	5:30	JPY	Industrial Production (MoM)	Apr F			0.3%
	8:30	**SEK**	**CPI CPIF (YoY)**	**May**			**1.4%**
	9:30	**GBP**	**CPI (YoY)**	**May**		**0.4%**	**0.3%**
	9:30	GBP	ONS House Price (YoY)	Apr			9%
	10:00	EUR	Industrial Production (MoM)	Apr			-0.8%
	13:00	**PLN**	**CPI Core (YoY)**	**May**			**-0.4%**
	13:30	USD	Retail Sales Advance (MoM)	May	0.2%	0.3%	1.3%
	15:00	USD	Business Inventories	Apr		0.2%	0.4%
	16:50	**NOK**	**Norges Bank's Olsen spks (Trondheim)**				
15-Jun	0:30	AUD	Consumer Confidence				116.8
	9:30	GBP	Average weekly wages (ex bonuses) (3m Av, YoY)				2.1%
	9:30	GBP	ILO Unemployment Rate 3Mths	Apr			5.1%
	N/A	NZD	Global Dairy Trade Announces Milk Auction Results				
	13:30	CAD	Manufacturing Sales (MoM)	Apr			-0.9%
	13:30	USD	Empire Manufacturing	Jun		-4.95	-9.02
	14:00	CAD	Existing Home Sales (MoM)	May			3.1%
	14:15	USD	Industrial Production (MoM)	May	-0.4%	-0.2%	0.66%
	14:15	USD	Capacity Utilization	May	75.0%	75.2%	75.4%
	19:00	**USD**	**FOMC Rate Decision (Upper Bound)**		**0.50%**	**0.5%**	**0.5%**
	19:00	USD	Fed Summary of Economic Projections				
	21:00	USD	Total Net TIC Flows	Apr			-98.3B
	23:45	**NZD**	**GDP (QoQ)**	**1Q**			**0.9%**
16-Jun	**N/A**	**IDR**	**BI Rates Decision**		**6.75%**		**6.75%**
	N/A	JPY	BoJ Monetary Base Target				¥80tr
	N/A	JPY	BoJ Basic Balance Rate				0.1%
	N/A	JPY	BoJ Macro Add-On Balance Rate				0%
	N/A	**JPY**	**BoJ Rates Decision**		**-0.10%**		**-0.1%**
	N/A	JPY	BoJ MPS				
	0:40	**CAD**	**BoC's Poloz spks (Whitehorse)**				
	2:30	AUD	Employment Change	May		16.5k	10.6k

16-Jun	**8:30**	**CHF**	**SNB Rates Decision**			**-0.75%**	**-0.75%**
	8:30	CHF	SNB Press Conference				
	9:00	NOK	Trade Balance	May			10.6B
	9:30	GBP	Retail Sales (MoM)	May			1.5%
	10:00	**EUR**	**CPI (YoY)**	**May F**			**-0.1%**
	12:00	**GBP**	**BoE Rates Decision**		**0.50%**	**0.5%**	**0.5%**
	13:30	USD	Current Account Balance	1Q		-125	-125.31
	13:30	USD	Initial Jobless Claims			270k	267k
	13:30	USD	Philadelphia Fed Business Outlook	Jun		2	-1.8
	13:30	**USD**	**CPI (YoY)**	**May**	**1.1%**	**1.1%**	**1.1%**
	13:30	USD	CPI Ex Food and Energy (YoY)	May	2.2%	2.2%	2.1%
	14:00	**SEK**	**Riksbank's Ingves spks (Oslo)**				
	14:00	**NOK**	**Norges Bank's Olsen, Nicolaisen spk (Oslo)**				
	14:00	EUR	EcoFin Mtg. (Luxembourg)				
	15:00	USD	NAHB Housing Market Index	Jun		59	58
	23:00	**CLP**	**CBCH Rates Decision**		**3.50%**	**3.5%**	**3.5%**
	23:30	NZD	Manufacturing PMI	May			56.5
17-Jun	2:00	NZD	ANZ Consumer Confidence Index	Jun			116.2
	8:00	EUR	EcoFin Mtg. (Luxembourg)				
	8:30	SEK	Unemployment Rate	May			7.3%
	9:00	EUR	Euro-area Current Account	Apr			27.3B
	13:30	USD	Housing Starts	May	1180k	1160k	1172k
	13:30	**CAD**	**CPI (YoY)**	**May**		**1.7%**	**1.7%**
17-20 J	N/A	JPY	Nationwide Dept Sales YoY	May			-3.8%
19-Jun	23:30	NZD	Performance Services Index	May			57.7
20-Jun	0:50	JPY	Trade Balance	May			823.2B
	8:50	**JPY**	**BoJ's Kuroda spks (Tokyo)**				
	9:00	CHF	SNB Sight Deposits				493.5B
	10:00	EUR	Construction Output (MoM)	Apr			-0.9%
21-Jun	0:30	AUD	Consumer Confidence				116.8
	0:50	JPY	BoJ Minutes	Apr-28			
	2:30	AUD	RBA Minutes	Jun-7			
	5:30	JPY	All Industry Activity Index (MoM)	Apr			0.1%
	7:00	CHF	Trade Balance	May			2.5B
	9:30	GBP	PSNB ex Interventions	May			7.19B
	10:00	EUR	German ZEW Survey Expectations	Jun			6.4
	10:00	EUR	Eurozone ZEW Survey Expectations	Jun			16.8
	12:00	**TRY**	**CBT Rates Decision**		**7.50%**		**7.5%**
	13:00	**HUF**	**NBH Rates Decision**		**0.90%**	**0.9%**	**0.9%**
	15:00	**USD**	**Fed's Yellen (voter) spks (Senate, Washington, DC)**				
22-Jun	1:30	AUD	Westpac Leading Index (MoM)	May			0.2%
	4:00	NZD	Credit Card Spending (MoM)	May			2.5%
	8:00	SEK	Economic Tendency Survey	Jun			102.2
	8:30	**THB**	**BoT Rates Decision**		**1.50%**	**1.5%**	**1.5%**
	9:00	NOK	Unemployment rate (AKU)	Apr			4.7%
	10:00	CHF	ZEW Survey Expectations	Jun			17.5
	13:30	CAD	Retail Sales (MoM)	Apr			-1%
	15:00	EUR	Consumer Confidence	Jun A			-7
	15:00	USD	Existing Home Sales	May			5.45m
	N/A	**COP**	**BDRC Rates Decision**		**7.50%**		**7.25%**

23-Jun	6:00	JPY	Leading Index CI	Apr F			100.5
	9:00	**NOK**	**Norges Bank Rates Decision**		**0.50%**		**0.5%**
	9:00	**PHP**	**BSP Rates Decision**		**2.50%**		**2.5%**
	9:00	EUR	PMI Manufacturing	Jun P			51.5
	9:00	EUR	PMI Services	Jun P			53.3
	9:30	**NOK**	**Norges Bank Press Conference**				
	13:30	USD	Initial Jobless Claims			270k	267k
	14:45	USD	PMI Manufacturing	Jun P			50.7
	15:00	USD	New Home Sales	May			619k
	15:00	USD	Leading Index	May			0.6%
	16:00	USD	Kansas City Fed Manufacturing Activity	Jun			-5
24-Jun	9:00	EUR	IFO Expectations	Jun			101.6
	13:30	USD	Durable Goods Orders	May P			3.4%
	15:00	USD	Univ. of Michigan Confidence	Jun F		94	94.7
Upcoming Risk Events							
5-Jul	5:30	AUD	RBA Rates Decision	Jul	1.75%		1.75%
13-Jul	15:00	CAD	BoC Rates Decision	Jul	0.50%		0.50%
21-Jul	12:45	EUR	ECB Rates Decision	Jul	-0.40%		-0.40%
11-Aug	22:00	NZD	RBNZ Rates Decision	Aug			2.25%

N/A denotes timing approximate or not confirmed / All times and dates are GMT+1 and correct as of the date of publication / For a full list of economic events, see the calendar on the Morgan Stanley Matrix Platform

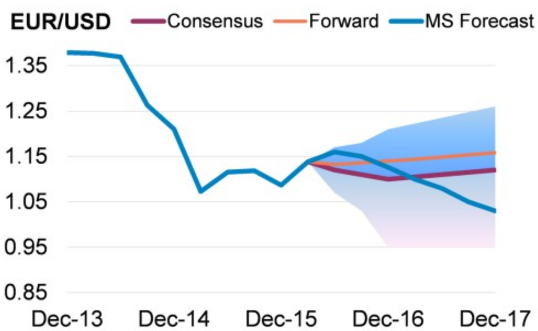
Central Bank Watch

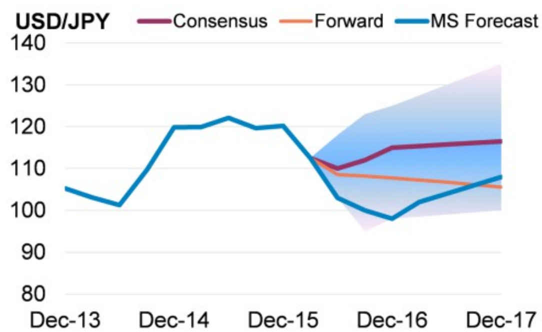
Exhibit 33: Macro forecasts: For more, see the What's Priced In Interactive

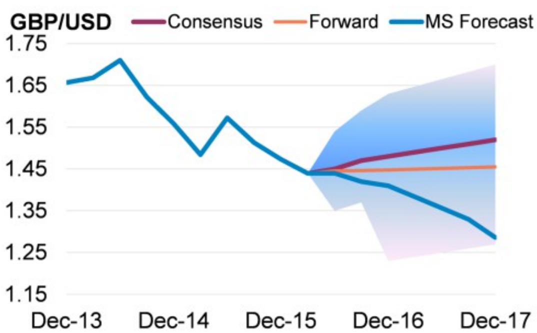
	Next rate decision	Market expects (bp)	MS expects (bp)	Current	Morgan Stanley Forecasts			
					2Q16	3Q16	4Q16	1Q17
US	15-Jun	0	0	0.375	0.375	0.375	0.625	0.625
Euro Area	21-Jul	-1	0	-0.40	-0.40	-0.50	-0.50	-0.50
Japan	16-Jun	-7	0	-0.10	-0.10	-0.30	-0.30	-0.30
UK	16-Jun	-1	0	0.50	0.50	0.50	0.50	0.75
Canada	13-Jul	-3	0	0.50	0.50	0.50	0.50	0.50
Switzerland	16-Jun	-2	-	-0.75	-	-	-	-
Sweden	06-Jul	-1	0	-0.50	-0.50	-0.50	-0.50	-0.50
Norway	23-Jun	-6	0	0.50	0.50	0.25	0.25	0.25
Australia	05-Jul	-4	0	1.75	1.75	1.50	1.50	1.50
New Zealand	10-Aug	-10	-	2.25	-	-	-	-
Russia	10-Jun	-	0	11.00	11.00	10.50	10.00	9.00
Poland	06-Jul	0	0	1.50	1.50	1.50	1.50	1.50
Czech Rep	30-Jun	-1	0	0.05	0.05	0.05	0.05	0.05
Hungary	21-Jun	-2	0	0.90	0.90	0.90	0.90	0.90
Romania	30-Jun	-	0	1.75	1.75	1.75	1.75	1.75
Turkey	21-Jun	-	0	7.50	7.50	7.50	7.50	7.50
Israel	27-Jun	-1	0	0.10	0.10	0.10	0.10	0.10
South Africa	21-Jul	4	0	7.00	7.00	7.00	7.25	7.25
Nigeria	26-Jul	-	Under Review	12	12	12	12	11
China	-	-	0	4.35	4.35	4.10	4.10	3.85
India	09-Aug	-	0	6.50	6.50	6.50	6.25	6.00
Hong Kong	17-Jun	-	0	0.26	0.75	0.75	1.00	1.00
S. Korea	14-Jul	-1	0	1.25	1.25	1.25	1.25	1.00
Taiwan	30-Jun	-	-12.5	1.50	1.375	1.375	1.375	1.375
Indonesia	16-Jun	-	0	6.75	6.75	6.75	6.75	6.75
Malaysia	13-Jul	-2	0	3.25	3.25	3.25	3.25	3.25
Thailand	22-Jun	0	0	1.50	1.50	1.50	1.50	1.50
Brazil	20-Jul	0	0	14.25	14.25	13.75	13.25	12.00
Mexico	30-Jun	9	25	3.75	4.00	4.00	4.25	4.25
Chile	16-Jun	1	0	3.50	3.50	3.50	3.50	3.25
Peru	09-Jun	-	25	4.25	4.50	4.50	4.50	4.50
Colombia	22-Jun	10	25	7.25	7.50	7.50	6.75	6.00

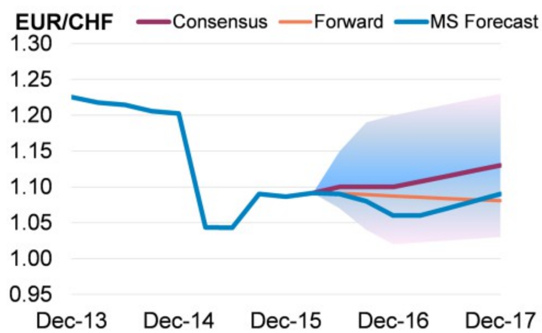
Source: National Central Banks, Morgan Stanley Research. Forecasts Last Updated on March 13, 2016. Note: Japan policy rate takes a mid-range value. Market expects for G10 as of June 9 and EM as of June 9. For more, see the What's Priced In Interactive.

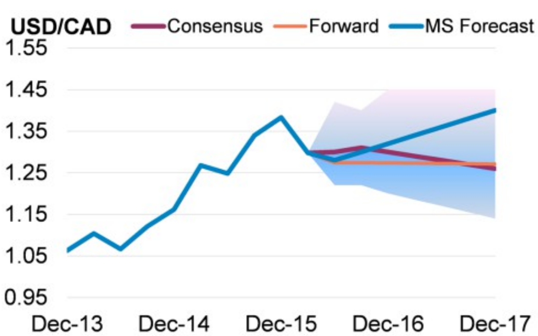
FX Forecasts Relative to the Market

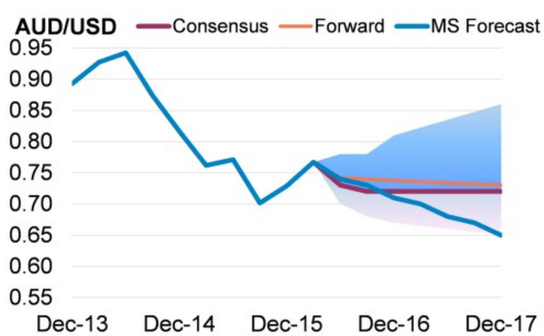


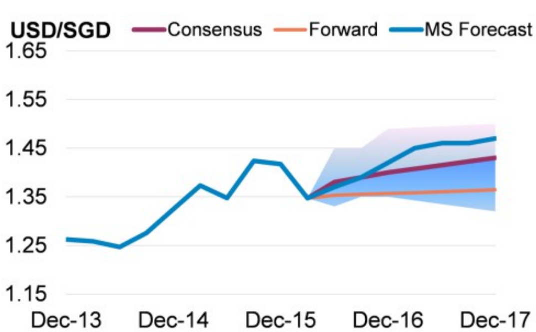


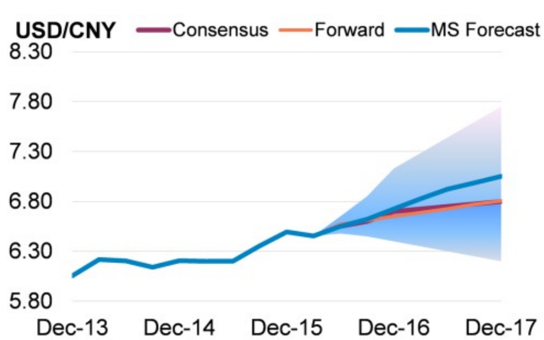


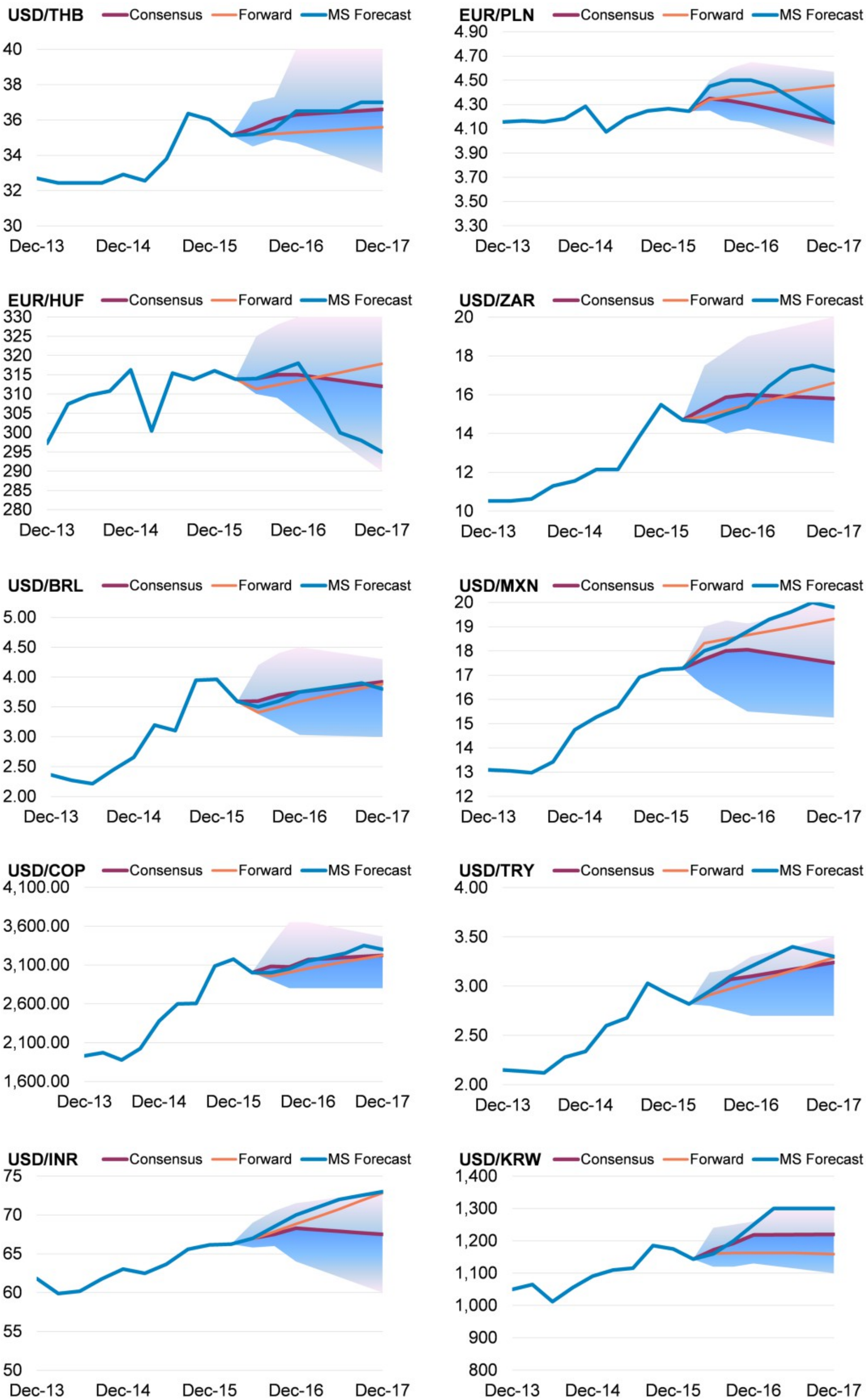












Source: Bloomberg, Morgan Stanley Research Forecasts; shaded area is the range of market forecasts.

Morgan Stanley Global Currency Forecasts

Exhibit 34: FX forecasts - click here for custom cross forecasts

	2016			2017			
	2Q	3Q	4Q	1Q	2Q	3Q	4Q
EUR/USD	1.16	1.15	1.13	1.10	1.08	1.05	1.03
USD/JPY	103	100	98	102	104	106	108
GBP/USD	1.44	1.42	1.41	1.38	1.36	1.33	1.29
USD/CHF	0.94	0.94	0.94	0.96	0.99	1.03	1.06
USD/SEK	7.84	7.83	7.94	8.08	8.17	8.35	8.45
USD/NOK	7.84	7.96	8.17	8.45	8.66	9.05	9.51
USD/CAD	1.28	1.30	1.32	1.34	1.36	1.38	1.40
AUD/USD	0.74	0.73	0.71	0.70	0.68	0.67	0.65
NZD/USD	0.68	0.66	0.64	0.63	0.62	0.61	0.60
EUR/JPY	119	115	110	112	112	111	111
EUR/GBP	0.81	0.81	0.80	0.80	0.80	0.79	0.80
EUR/CHF	1.09	1.08	1.06	1.06	1.07	1.08	1.09
EUR/SEK	9.10	9.00	8.94	8.88	8.82	8.77	8.71
EUR/NOK	9.10	9.15	9.20	9.30	9.35	9.50	9.80
USD/CNY	6.55	6.62	6.72	6.83	6.92	6.99	7.05
USD/HKD	7.80	7.80	7.80	7.80	7.80	7.80	7.80
USD/IDR	13400	13700	14000	14200	14500	14200	14200
USD/INR	67.0	68.5	70.0	71.0	72.0	72.5	73.0
USD/KRW	1160	1200	1250	1300	1300	1300	1300
USD/MYR	4.05	4.15	4.20	4.25	4.20	4.20	4.20
USD/PHP	47.5	48.0	48.5	48.5	48.5	48.0	48.0
USD/SGD	1.37	1.39	1.42	1.45	1.46	1.46	1.47
USD/TWD	32.5	32.7	33.2	34.0	34.0	34.0	34.0
USD/THB	35.2	35.5	36.5	36.5	36.5	37.0	37.0
USD/BRL	3.50	3.60	3.75	3.80	3.85	3.90	3.80
USD/MXN	18.00	18.30	18.80	19.30	19.60	20.00	19.80
USD/ARS	16.29	16.79	17.29	18.17	18.82	19.39	19.97
USD/CLP	675	690	710	725	750	740	730
USD/COP	3000	3050	3150	3200	3250	3350	3300
USD/PEN	3.35	3.50	3.70	3.80	3.90	3.90	3.80
USD/ZAR	14.60	15.00	15.35	16.44	17.27	17.50	17.23
USD/TRY	2.95	3.10	3.20	3.30	3.40	3.35	3.30
USD/ILS	3.80	3.85	3.90	3.90	3.85	3.80	3.75
USD/RUB	66.0	67.5	68.1	71.3	75.7	75.0	75.0
EUR/PLN	4.45	4.50	4.50	4.45	4.35	4.25	4.15
EUR/CZK	27.05	27.00	27.00	27.00	26.75	26.50	26.20
EUR/HUF	314	316	318	310	300	298	295
EUR/RON	4.52	4.51	4.50	4.45	4.40	4.35	4.30
Broad Fed USD TWI	119	121	123	125	127	129	130

Source: Morgan Stanley Research, last updated on May 6, 2016.

Appendix

The **Strategic FX Portfolio Trade Recommendations** page presents the portfolio of tactical trade ideas of the FX Strategy team and the performance of this portfolio over time.
Strategic FX Portfolio Trade Recommendations *(Note: The portfolios represent hypothetical not actual investments.)*

- On 10 June, 2010, we implemented changes to our portfolio to make it more robust and to better reflect our confidence levels and relative risk. A detailed explanation of this change can be found in "*Portfolio Methodology Update*" (10 June 2010).
- In summary, the trades and the weightings are primarily reviewed weekly on Thursdays and published in the Pulse. However, if we think there has been a material change to the risk-reward, we will make intraweek changes. We monitor trades daily. We will continue to publish the portfolio as a list of trades where our strongest conviction ideas will be given the largest weightings. We will, however, also adjust the weights of trades in order to manage our risk exposure.
- A table showing the trade, trade weight, trade entry date, risk allocation and levels for (average) entry, current, stop and target will be shown in the Strategic FX Portfolio Trade Recommendations section of the *FX Pulse*.
- If we increase the weighting allocated to a trade, the entry level published in the table will be changed to reflect a proportionally weighted rate of the initial entry level and the entry level on the date the weight was increased.

Performance Statistics

- We rebalance our portfolio daily at the NY close to keep the weight of each trade consistent with the published weight.
- We will primarily enter and exit trades using the bid or offer rate of the WMR fixing. If we make an intraday change to our portfolio, we will cite the closest Bloomberg half hourly fix in our published note and enter/exit at this rate.
- Stops or targets will be triggered if the stated level is met at the WMR fix.
- Returns shown include the cost of carry using the 1W interbank deposit rate if this is quoted liquidly but do not include any other expenses, slippage or fees and no interest on cash holdings are included. Reported returns are not levered.
- We have re-estimated our returns from 22 June 2006 to 10 June 2010, when we re-launched the portfolio, to take into account our more robust calculation technique.
- We provide a monthly breakdown of our historical portfolio performance back to Jan 2005 in the Strategic FX Portfolio section of the Pulse.

Historical data for all these models can be found on the Morgan Stanley Matrix Platform. See *New FX Strategy Interactive Features* (January 17, 2014). Click on the Matrix logo throughout this document or here for a G10 currency reference page:

Morgan Stanley Matrix

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We would like to thank James Lord for his contribution to this report

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Not-Rated/Hold	**78**	**2%**	**7**	**1%**	**9%**
Underweight/Sell	**663**	**20%**	**87**	**12%**	**13%**
TOTAL	**3,349**		**714**		

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