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EM FX resilient in 2018

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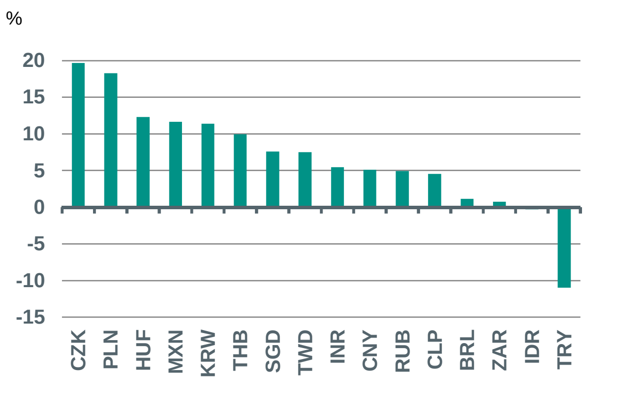
- **EM FX has outperformed the US dollar in 2017**
- **EM FX will probably weaken modestly versus US dollar in 2018…**
- **… reflecting general dollar strength and higher US Treasury yields**
- **But steady global growth/trade, …**
- **…higher commodity prices and less monetary policy accommodation in EM are supportive for EM FX**
- **We expect EM FX to outperform the euro in 2018**

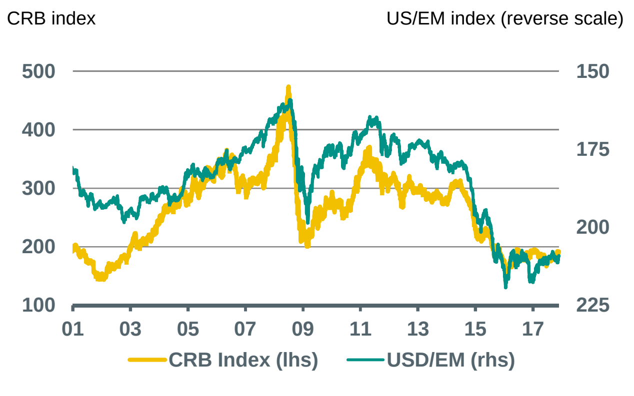
EM FX has outperformed the US dollar in 2017
In 2017 emerging market currencies have overall outperformed the US dollar by close to 5% with the strongest performing region being Central and Eastern Europe. The countries in Central and Eastern Europe have received strong support from the growth acceleration in the eurozone. In general, strong global growth and a weaker US dollar have supported emerging market currencies. However, the tightening of monetary policy by the Fed and political uncertainty in some countries has weighed on the sentiment towards emerging market currencies. What does 2018 bring for emerging market currencies?

Individual performance year-to-date



Source: Bloomberg, ABN AMRO Group Economics

Commodity prices is a crucial driver for EM FX



Source: Bloomberg, ABN AMRO Group Economics

Modest rise in US Treasury yields and US dollar to weigh on EM FX in 2018
In general, we expect emerging market currencies to weaken at a modest pace versus the US dollar in 2018. This is because the Fed will continue to tighten monetary policy

at a modest pace. Furthermore, US Treasury yields will rise in our view. As a result, the US dollar will probably rise as well across the board. This will not lead to a US dollar bull-run though.

…but global growth/trade and commodity price momentum are supportive…

However, other factors are more favourable for emerging market currencies. First, we expect EM growth and global growth to pick up and global trade growth to be resilient in 2018. This is supportive for growth-sensitive (CZK, PLN, HUF, BRL, TRY, INR) and trade-sensitive currencies (SGD, TWD, CNY, KRW, CZK, PLN, MXN). Second, we expect higher commodity prices, especially higher oil prices, and this should be positive for oil exporting countries. We are neutral to positive on base metals. Positive sentiment towards commodities will probably also spill over to currencies of commodity exporters such as CLP, BRL, ZAR, RUB and IDR.

…and central banks will probably become less accommodative

Last but not least, central banks in a number of emerging market countries will become less accommodative in 2018 or even more restrictive. Monetary policy easing in Asia is coming to an end. In China the PBoC will continue its policy of targeted tightening aimed at deleveraging particularly the most risky parts of the financial system, although we expect it to leave the benchmark policy rate unchanged. In India, there is room for one more rate cut because of low inflation, but stronger growth and the pick-up in inflation indicates that such a move would probably be the end of the easing cycle. The Bank of Korea has embarked on a moderate tightening path on 30 November, while we expect Bank Indonesia and Bank of Thailand to remain on hold for a while.

In Latin America the central bank in Brazil still has room to cut official rates because of low inflation but it is also close to the end of the easing cycle. In Mexico it is likely that lower inflation in 2018 will result in the end of the Banxico hiking cycle and some monetary policy easing. In Chile monetary policy will probably remain on hold.

It is likely that central banks in Central and Eastern Europe will move towards tighter monetary policy. The Czech Republic has already started its tightening cycle and it is likely that it will continue in 2018 because of strong growth and higher inflationary pressures. In 2018, the central bank of Hungary will probably follow suit and the central bank of Poland could signal in 2018 tighter monetary policy in 2019. These Central Eastern European central banks will all hike well before the ECB and this should give support to their currencies versus the euro. The central bank of Turkey has tried to stop the fall of the lira by reducing the amount of foreign currency lenders, providing favourable rates to exporters and auctioning non-deliverable forward contract to companies with FX liabilities. However, these tools had little effect on the exchange rate and we think that the lira will continue its deprecation path, passing the 'psychological boundary' of 4 USD/TRY. This will leave the central bank with no other option than increasing rates.

All in all, we think that emerging market currencies in 2018 will be relatively resilient versus the US dollar despite the Fed rate hikes and higher US Treasury yields. This is because other fundamentals (growth, monetary policy, sentiment, and commodity prices) are supportive. We expect that EM FX will outperform the euro in 2018. This is because of positive EM FX fundamentals as well as some profit taking in euro.

EM FX to outperform the US dollar in 2019

For 2019 we are positive on emerging market currencies versus the US dollar because we expect the US dollar to weaken and US treasury yields to stabilise and edge somewhat lower in 2019. Moreover, we remain positive on our commodity price outlook for 2019. Furthermore, it is likely that the positive momentum in global trade and global growth will continue in 2019. In general, emerging market central banks will probably move towards tighter monetary policy and this is also EM FX supportive. It is likely that the market focus is back on the ECB in 2019. Therefore, most EM FX will probably not outperform the euro in 2019. This with the exception of the Central European currencies CZK, PLN and HUF because their central banks will hike more aggressively than the ECB in our view.

Risks to our scenario

In our base scenario we assume that tightening by the Fed and higher US Treasury yields will not upset financial markets in 2018. We expect investor sentiment to remain relatively constructive. We also assume that NAFTA negotiations will be difficult but that the outcome in the end will be constructive. Furthermore, the modest slowdown of Chinese economy should not disrupt financial markets as this is well anticipated. However, a larger-than- expected slowdown will probably result is a considerable risk aversion wave in financial markets. Last but not least, we do not expect a full-blown crisis on the Korean peninsula. If these risks were to happen, emerging market currencies will sell off.

Our EM FX forecasts

	01-Dec	Q4 2018	Q4 2019
EUR/USD	1.1913	1.15	1.25
USD/CNY	6.61	6.65	6.8
EUR/CNY	7.87	7.65	8.5
USD/INR	64.5	66	64
EUR/INR	76.3	75.9	80.0
USD/KRW	1,086	1,100	1,050
EUR/KRW	1,294	1,265	1,313
USD/SGD	1.35	1.37	1.33
EUR/SGD	1.61	1.58	1.66
USD/THB	32.64	34.00	32.00
EUR/THB	38.88	39.10	40.00
USD/TWD	30.01	31.00	30.00
EUR/TWD	35.75	35.65	37.50
USD/IDR	13,536	13,700	13,400
EUR/IDR	16,125	15,755	16,750
USD/RUB	58.5	58.0	56.0
EUR/RUB	69.7	66.7	70.0
USD/TRY	3.94	4.20	4.00
EUR/TRY	4.69	4.83	5.00
USD/ZAR	13.70	14.50	14
EUR/ZAR	16.32	16.68	17.50
EUR/PLN	4.20	4.10	4.00
USD/PLN	3.53	3.57	3.20
EUR/CZK	25.51	25.00	24.00
USD/CZK	21.42	21.74	19.20
EUR/HUF	313	300	290
USD/HUF	263	261	232
USD/BRL	3.27	3.30	3
EUR/BRL	3.89	3.80	3.75
USD/MXN	18.64	19.00	18.00
EUR/MXN	22.21	21.85	22.50
USD/CLP	649	660	600
EUR/CLP	773	759	750

Source: ABN AMRO Group Economics

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