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Weak month of May

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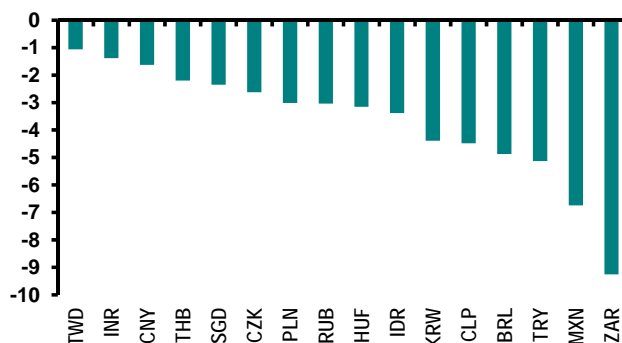
- **A weak month of May for EM FX**
- **Moderate yuan depreciation path this year**
- **US-China Strategic and Economic Dialogue on 5-7 June**

A weak month of May for EM FX

In May most emerging market currencies fell, especially currencies of commodity exporting countries. Hawkish rhetoric from Fed officials triggered an upward adjustment in interest rate hike expectations resulting in a higher US dollar, lower commodity prices (except oil) and lower emerging market currencies. Since the end of last week, the picture is more mixed. On the one hand, the recovery in the US dollar came to a halt as financial markets await the release of the US employment report tomorrow. This has supported emerging market currencies. On the other hand, uncertainty surrounding the outcome of the OPEC meeting today has weighed somewhat on the sentiment of currencies of oil-exporting countries. Overall, we remain relatively constructive on emerging market currencies.

Performance in May

Performance in %, USD as basis



Source: Bloomberg, Bank of England

More dovish Bank of Korea minutes weighed on the won...

In Asia, the South Korean won (KRW) declined by about 1% to 1190 after the Bank of Korea minutes was rather dovish tone. This has raised market expectations that a rate cut is likely sooner than later. The latter has mostly been priced in by financial markets. Economic data releases in South Korea were also generally weak with inflation falling in

May and the current account surplus narrowing in April. This weighed on sentiment in the KRW.

...while weakness in the rupiah was not welcomed by Bank Indonesia...

Bank Indonesia (BI) has expressed some discomfort with the pace of depreciation of the IDR from 13,200 to above 13,600 since early May. BI stated that the IDR is deviating from fundamentals and that the IDR is unlikely to hit 14,000. Indeed, Indonesia's inflation and external imbalances have improved and foreign reserves have risen. Having said that Indonesia's weak fiscal performance due to expected larger budget deficits and decline in corporate credit quality have resulted in S&P Global Ratings refraining from upgrading Indonesia's to investment grade, although keeping its positive outlook.

...and concerns that Rajan may not stay for another term hurt the rupee

Separately, despite economic growth in India gaining momentum in the first quarter (see our Asia outlook, *Growth stable at 6%, risks around China and Fed remain*, published earlier this week), the Indian rupee was sold off on concerns that RBI Governor Rajan may not stay for another term. His current term expires in September this year. These concerns have weighed on the rupee because RBI governor Rajan has been instrumental in taming India's high inflation, improving the current account balance and building up foreign currency reserves.

Moderate yuan depreciation path

Since the end of April the US dollar has strengthened across the board, including versus the Chinese yuan. As a result, USD/CNY has moved from 6.47 to above 6.58. However, the weakness in the yuan has been more modest than weakness of other currencies versus the US dollar. Therefore, the yuan has appreciated against currencies of China's trading partners. The People's Bank of China (PBoC) tends to limit the extent of depreciation against the US dollar because it would like to avoid that weakness in the yuan would trigger concerns about the state of the Chinese economy and unrest on financial markets. In addition, it would like to avoid large capital outflows. We continue to hold the view that the depreciation on the yuan will be modest. Our year-end forecast for USD/CNY is 6.7.

US-China Strategic and Economic Dialogue

The eight session of the US-China Strategic and Economic Dialogue will be held in China on 5-7 June 2016. The dialogue will focus on the challenges and opportunities that both countries face on bilateral, regional and global areas. US Treasury Secretary Lew is likely to urge China policy makers to move towards an orderly transition to a more market based yuan. In addition an establishment of a yuan trading hub in the US is also on the agenda. On the exchange rate, we expect the PBoC to keep the CNY TWI relatively stable. Market bets that policy makers in China will not be able to control volatility and potential depreciation in the yuan have declined. We expect only a modest depreciation of the CNY versus the USD in the remainder of this year (our year end USD/CNY forecast is 6.70).

ABN AMRO emerging market currency forecasts

	02-Jun	Q2 2016	Q3 2016	Q4 2016	Q1 2017	Q2 2017	Q3 2017	Q4 2017
USD/CNY (onshore)	6.58	6.55	6.60	6.70	6.75	6.80	6.80	6.80
USD/CNH (offshore)	6.59	6.55	6.60	6.70	6.75	6.80	6.80	6.80
USD/INR	67.3	66.5	67.0	67.0	67.0	66.0	65.5	65.0
USD/KRW	1,187	1,165	1,165	1,165	1,150	1,140	1,130	1,120
USD/SGD	1.38	1.36	1.38	1.40	1.38	1.36	1.35	1.35
USD/THB	35.61	35.00	35.00	35.00	34.80	34.60	34.40	34.00
USD/TWD	32.40	32.50	32.80	33.00	32.80	32.50	32.20	32.00
USD/IDR	13,643	13,200	13,400	13,500	13,400	13,300	13,200	13,000
USD/RUB	67	66	64	60	59	58	57	55
USD/TRY	2.94	2.85	2.80	2.75	2.75	2.75	2.75	2.75
USD/ZAR	15.58	15.00	14.75	14.50	14.25	14.00	13.75	13.50
EUR/PLN	4.40	4.40	4.40	4.35	4.30	4.25	4.20	4.20
EUR/CZK	27.03	27.00	27.00	27.00	27.00	27.00	26.50	26.00
EUR/HUF	314	310	310	305	300	300	295	290
USD/BRL	3.60	3.60	3.55	3.50	3.45	3.40	3.35	3.30
USD/MXN	18.55	17.25	17.00	16.75	16.50	15.75	15.50	15.25
USD/CLP	692	670	660	650	640	630	620	600

Source: ABN AMRO Group Economics

Find out more about Group Economics at: <https://insights.abnamro.nl/en/>

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