Morgan Stanley

MORGAN STANLEY RESEARCH

Global Currency Research Team
For research analysts, please see contact list at the back of this material.

July 3, 2014

Currencies

Global

Outlook

FX Pulse

USD Strikes Back

Adding to USD Longs. A robust US labor report has reinforced our conviction in the long USD trade, where we expect strength to broaden. The unemployment rate continued its drop to 6.1% with labor participation staying constant, suggesting limited slack left in the economy. On the less constructive side, wage growth has yet to accelerate, raising questions on whether the Fed will drag its feet on rate liftoff. Still, we emphasize that wages tend to lag and the market is still pricing in a slower pace of tightening than forecast by the FOMC itself. Normalization of the front end of the yield curve should provide USD with a steady lift in coming months. We add USD longs against CHF and NOK, in addition to our current long USD positioning against SEK and EUR.

Central Banks Fight Back. In contrast to the US, several countries are facing disinflationary pressures, and their central banks are acting aggressively. The Riksbank delivered a larger than expected cut, joining the Norges Bank's dovish meeting last week. While SEK and NOK have sold off significantly, we don't think the moves are done. Central banks have escalatory power and are showing urgency in fighting off deflation. This includes the ECB, which provided attractive TLTRO conditions that should keep EONIA low and potentially crowd foreign investors out of EU bonds. Should inflation fail to pick up, the ECB will not hesitate to do more. We continue to see an asymmetric risk profile for the common currency.

In This Week's Edition

We explore the challenged fundamentals in Norway, Sweden and Switzerland. High private-sector leverage makes these countries vulnerable to higher global funding costs. In Turkey, negative real yields and high external vulnerabilities put TRY at significant risk.

China's reserves have grown to approximately US$4 trillion. Much of these have been recycled into EUR and other reserve currencies, in some cases suppressing FX volatility. As China liberalizes its FX regime, we expect these diversification flows to slow, bringing EUR more in line with fundamentals and boosting G10 FX vol.

Trade Recommendations

Closed Trades			
Short TRY/RUB	Closed at 16.1 on 30-Jun-14		
Short EUR/AUD	Close at WMR 4-Jul		
Active Trades	**Entry**	**Stop**	**Target**
Short EUR/GBP	0.8130	***0.8030***	0.7800
Long USD/SEK	6.6200	***6.6700***	7.1000
Long USD and JPY v EUR CHF and SEK	100.00	98.00	106.00
Short EUR/USD	1.3620	1.3740	1.3100
Limit Orders	**Entry**	**Stop**	**Target**
Buy USD/NOK	6.1800	6.0500	6.7000
Buy USD/CHF	Enter WMR 4-Jul	0.8880	0.9450

See page 10 for more details. Changes in stops/targets in bold italics.

MS Major Currency Forecasts

	2Q14	3Q14	4Q14	1Q15
EUR/USD	1.35	1.33	1.31	1.27
USD/JPY	98	102	105	108
GBP/USD	1.72	1.75	1.73	1.69
USD/CHF	0.90	0.91	0.94	1.00
USD/CAD	1.12	1.16	1.18	1.19
AUD/USD	0.92	0.98	1.00	0.96
NZD/USD	0.84	0.84	0.85	0.82
EUR/JPY	132	136	138	137
EUR/GBP	0.78	0.76	0.76	0.75
EUR/CHF	1.22	1.21	1.23	1.27
EUR/SEK	9.15	9.25	9.20	9.15
EUR/NOK	8.10	8.15	8.20	8.30

Note: Forecasts for end-of-period. G10 forecasts updated June 8, 2014

FX Overview

Hans Redeker, Calvin Tse, Sheena Shah

- The US rate outlook holds the key to global volatility and the carry trade.
- Correlations breaking sharply lower is a sign of complacency.
- Higher US yields will likely hit leverage accounts and economies most.
- SEK and NOK stay top of our selling list. The Riksbank cutting rates by 50bp and lowering its rate projection is a long-term bearish factor for SEK.
- EUR's short-term upside correction seems complete, with yield differentials increasingly working against EURUSD.
- The risks to the TRY are rising, given the upside surprise in inflation and the reduction in carry on the currency.
- ZAR and TRY are among the more vulnerable currencies should the strong US employment report translate into higher US rate volatility.

Carry and Volatility

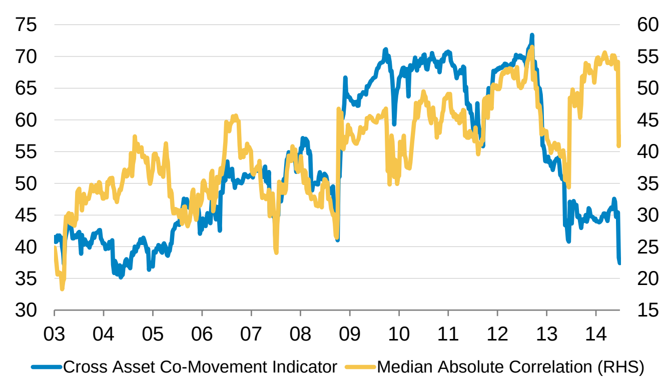
Central banks have remained dovish, driving risk appetite to further extremes. The Fed's dovish stance and the subsequent bearish USD implications have impacted other central banks in their communication and interest rate-setting. In EM, the weakening USD has allowed a number of monetary authorities to ease rates (Mexico, Hungary and Turkey). In DM, some central banks have changed course too from fears about capital inflows due to attractive interest rate differentials. Norway falls into this category. Sweden's Riksbank has explicitly referred to previous Fed and BoE statements when lowering its interest path. Finally, the RBA has warned about AUD strength, bringing rate cuts back into play.

In the low FX volatility environment, nominal rate differentials have become the main differentiator between underperformers and outperformers. When volatility stays low, currencies tend to be driven by only rates and yields, which is unlike times when volatility is closer to normal levels and other factors come into play. This process has been self-reinforcing, with the Fed providing the fuel for the yield-driven carry trade. Central banks which see their FX rates reaching high levels relative to expectations introduce easing conditions, adding even more liquidity into the system. No wonder markets have chased yield, despite building risks.

But the BIS annual report has warned against the accumulation of risks, seeing the costs of monetary accommodation rising exponentially with the increasing duration of easy policies. The critical stance of the BIS concerning too easy conditions provided by central banks is not new, but this does not mean that those concerns should be dismissed. Undoubtedly, credit and asset valuations have reached ambitious levels and flourishing high yield markets have led to a wave of new issuance, suggesting that portfolio asset quality has started to weaken. At the same time, investors seem to be well aware of asset liquidation risks, diversifying their asset holdings aggressively. Consequently, asset correlation has come down to levels not seen since 2004.

Exhibit 1

Asset Correlation Has Eased to Its Lowest Level Since 2004



Source: Bloomberg, Morgan Stanley Research; For a description of the model, see *FX Pulse: The Return of Alpha: Updating the MS Asset Co-Movement Indicator* (30 May 2013).

Our ACMI has dropped quite considerably, and so has the MAC (median asset correlation), consistent with increased risk appetite. This is quite a big drop similar to May 2007, April 2008, October 2008, November 2009, April-June 2011 and before the 'Taper Tantrum'. The main contributors to our index (see Exhibit 2) are unsurprisingly the most bullish, while interestingly commodities and the dollar have had no impact. Note, all these dates mentioned above were followed by stronger risk reactions, pushing volatility temporarily higher.

Risk-seeking and aggressive diversification into various asset classes finds its main reason in the Fed's dovish interpretation of monetary policy. Fed Chair Yellen used her speech at the IMF's financial stability work forum to reiterate her view that monetary policy should focus on employment and inflation while sufficient regulation should take care of financial stability. The Fed's staff work suggests that the costs – in the form of lower inflation and employment – of a central bank focusing on financial stability are higher compared to the costs of dealing with the clean-up of a bursting bubble.

Exhibit 2
Composition of Correlation Analysis

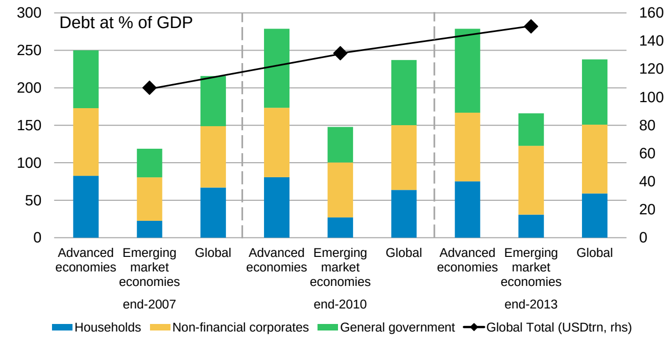
Asset Class	Contribution	Return
US Real Estate	18.9%	15.0%
EM Local Bonds, FX-unhedged	14.7%	8.1%
EM Equity	13.6%	6.8%
World Equities	12.3%	5.8%
US Equity	11.1%	8.1%
EM Sovereign Credit	7.7%	9.2%
EM Money Market	5.9%	2.7%
EM Local Bonds, FX-hedged	4.9%	5.9%
EM Corporate Credit	4.2%	6.2%
US High Yield	3.7%	4.9%
US Investment Grade	3.6%	5.9%
Global Bonds	2.9%	5.1%
US Bonds	2.1%	4.1%
Commodities	-0.7%	9.6%
Gold	-1.0%	6.4%
Dollar	-3.8%	-0.9%

Source: BIS, Morgan Stanley Research

Sell FX Where Debt Hinders Growth

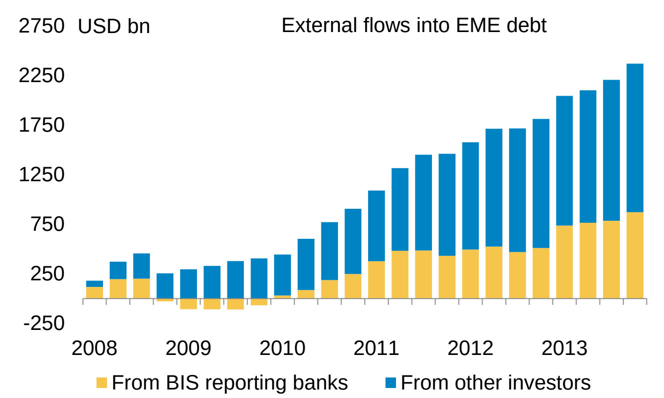
Most DM countries have experienced private sector debt deleveraging post-Lehman so their risk of too accommodative monetary conditions is mainly related to portfolios (via the accumulation of yielding, but fundamentally weak assets). On the other hand, EM and some DM countries have seen their private sector accumulate leverage and therefore face risks going beyond portfolio effects. Exhibit 3 shows that global leverage has increased over recent years. In the US, UK and parts of Western Europe, private sector debt has been transformed into public debt, suggesting that here the private sector has now room to re-leverage while simultaneously being less sensitive to higher global funding costs. Other economies, where private sector leverage has increased, often reaching critical levels relative to income, may need adjustments in their balance sheets when global balance sheet funding costs start to rise. Here private credit demand is set to weaken, with the potential to break the credit multiplier. Within the G-10, we emphasize this risk in the case of Sweden and Norway. In EM, inflows accelerated from 2010 onwards at a time when global funding costs fell sharply (see Exhibit 4). Especially, corporate debt has experienced a sharp rise within the post-Lehman world (see Exhibit 5). Subsidiaries of EM corporates have often used low-yielding hard currency markets to raise debt, mostly in USD. When leverage is high, economies react sensitively to rising funding costs. This is why the evolution of DM funding costs – and here especially USD yields – have a significant impact on economic performance, asset volatility and related FX moves.

Exhibit 3
Global Debt Is Rising



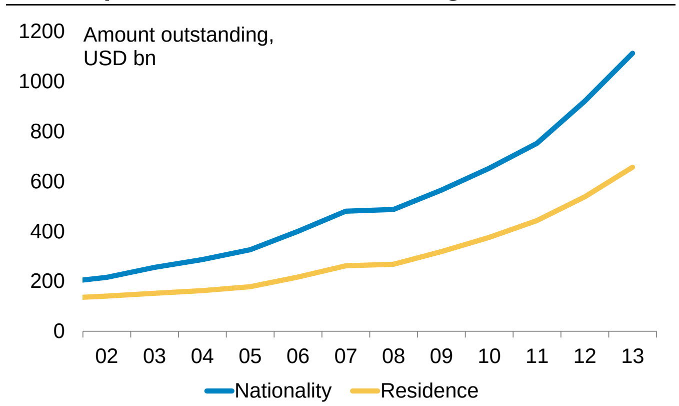
Source: BIS, Morgan Stanley Research

Exhibit 4
External Flows into EME Debt



Source: BIS, Morgan Stanley Research

Exhibit 5
EM Corporate Debt Issuance Rising



Source: BIS, Morgan Stanley Research

The Two-Pillar Trading Strategy

Our FX trading strategies rest on two pillars. First, we assume that the record-low FX volatility is not going to stay with us for very long, suggesting to us that we should enter defensive FX trades, such as selling JPY crosses.

Given that USD has acted as the globe's funding currency for the past decade, we believe that an increase in FX volatility will come from the US side of the equation. Specifically, we look at three indicators when gauging potential for volatility to rise.

The first indicator we are watching is the US housing data. With real estate the largest asset of middle America, a continued recovery in the housing market will be a necessary ingredient to help boost wealth effects, which in turn should support domestic demand in the US. Things are looking brighter on this front, with the latest existing, new and pending home sales all beating expectations.

Second, we watch the Fed's preferred measure of inflation, core PCE, very carefully. Importantly, our economists believe that inflation has bottomed and that PCE should keep rising going forward; encouragingly, the past three readings have steadily moved higher. Should we see continued improvement towards the Fed's 2%Y target, it will be increasingly difficult for Chair Yellen to dismiss the data as noise.

And third on our watch list is wage growth in the US. With so much uncertainty over the structural damage done to the US economic post financial crisis, many major central banks have moved away from targeting the unemployment rate, but rather are using wages as an indicator for labor market slack. Though headline nonfarm payrolls prints have been coming in on the stronger side of expectations over the past few months, average earnings growth remains slow. But we are optimistic that wages will soon begin to rise more broadly, given that they have already started to rise at small to medium sized entities, which have in the past led broader earnings increases.

Should these aforementioned indicators continue to improve as we expect, the US yield curve is likely to bear flatten as the markets re-price and move closer towards the Fed's own rates guidance via the SEP. As this occurs, rising US yields are likely to dampen risk appetite, which should result in higher volatility across asset classes.

The second pillar of our FX trading strategy looks into those currencies where credit efficiency has declined over the past few quarters. SEK, NOK and CHF fall into this category.

NOK and CHF Offer Weak Fundamentals…

Post Lehman, Norway benefited from substantial safe-haven flows. In the absence of a liquid local bond market and its equity market offering few diversification opportunities outside the energy sector, inflows into Norway were concentrated on money market investments and bank deposit holdings. Banks benefiting from this inflows increased local lending activities. Outside the energy sector, the relatively non-competitive corporate sector offered little investment opportunity so there was little credit demand coming from this side. Consequently, banks offered increasingly lucrative mortgage lending opportunities, pushing leverage and house prices up. Developments in Switzerland followed a similar rationale. Consequently, foreign inflows into bank deposits and local banks recycling foreign deposit holdings into domestic mortgage lending pushed real house prices higher. Local household balance sheets deteriorated and debt levels rose to historical highs. The problem is that Norwegian households mainly hold non-liquid assets, including real estate. Norway's total liability/liquid asset holdings ratio is now negative. Meanwhile, Norwegian house prices have lost 7%Y and credit growth has eased to 5.5%Y. With Norway's energy sector slowing its investment spending too, credit demand growth should become additionally impaired.

…as Does SEK

In Sweden, household balance sheets look equally heavy, but here house prices are still going up. However, Swedish households keep most of their assets in non-liquid pension funds or real estate, and the ratio between liquid asset holdings and liabilities has reached low levels. Real estate assets relative to income have reached high levels, suggesting that the Swedish economy is becoming increasingly sensitive to rising global funding costs. Bank balance sheets offer two vulnerabilities. First, mortgage exposure on bank balance sheets has reached a high at 38%. Falling house prices would weaken banks' collateral positions, which could force them to shrink their 400% of GDP sized balance sheets. Second, Sweden's households are typically non-deposit savers, pushing funds into trusts or into real estate. Hence, Swedish banks depend on covering finance requirements mainly via issuing covered bonds. As long as volatility and global funding costs are low, this model is stable, but should Swedish house prices fall and rising global funding costs drive volatility higher, matters will change.

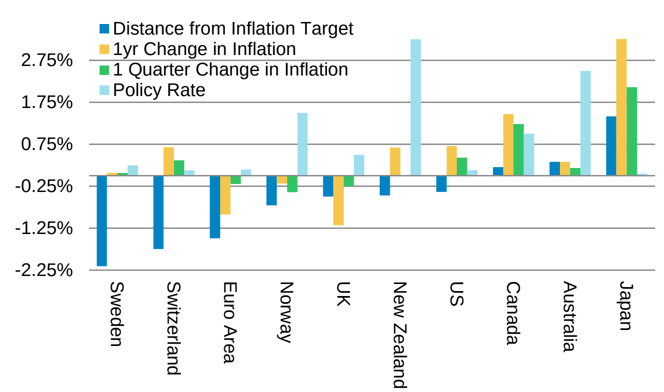
The divergence between Swedish domestic and foreign prices is interesting. While import and producer prices have moved sharply higher, the domestically generated service sector inflation rate has continued to ease. Sweden does not face a competitiveness concern; instead, it has balance sheet issues, which have started unleashing domestic deflationary pressures. This is why producer and service sector prices have started to diverge (see *SEK: Disinflationary Decline*, May 29, 2014).

Today, the Riksbank has cut interest rates by 50bp to 0.25%, addressing increasing domestic deflationary pressures. It has lowered its growth, inflation and interest rate projections. The aggressiveness of the move suggests two things. First, the surprise within the Riksbank witnessing signs of a break of the transition of growth towards inflation, and second, the central bank was eventually reacting to political pressure. Remember, the government has established an auditing group to judge if the Riksbank's past policies were applying to the central bank, target namely achieving price stability, i.e., inflation fluctuating around 2%Y.

Will NZD Follow that Path?

NZD has stayed supported, with many participants putting NZD into the same camp as GBP. We disagree and think that similarities are greater with Nordic currencies. The RBNZ's rate projection profile is based on the assessment of a closed output gap leading to higher inflation rates down the road. Not so long ago, Norges Bank and the Riksbank presented similar views, but with the absence of inflation progressing along the projected path, both central banks had to review their once relatively hawkish stances, leading to drastic FX moves.

Exhibit 6
New Zealand Runs High Real Rates as Inflation Surprises to the Downside



Source: Haver Analytics, Morgan Stanley Research

New Zealand's inflation has surprised to the downside too. Relative to inflation dynamics in New Zealand, the interest rate path seems too aggressive. Milk prices have declined by 29% since February and terms of trade gains, which reached 7.5% last autumn, have eased to 1.8%. The housing market has turned around. While price gains are still 8%Y, activity data have eased. Current real rate levels seem to be too high, keeping housing supported when income takes a hit from the falling terms of trade.

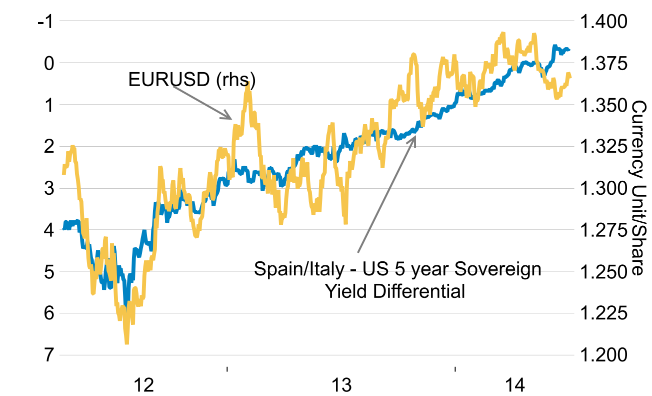
EUR Is a Sell

EUR has rebounded over recent weeks, but we stay convinced that EUR will trade lower in the medium term. Of course, with EMU banks awaiting the outcome of the AQR, these banks are unlikely to add to their portfolio of foreign asset holdings. Hence, the recycling of the current account surplus into non-EUR-denominated long-term assets will have to work via non-bank private portfolios. Indeed, the outlook of EMU private non-bank accounts shifting funds into non-EUR-denominated assets has improved over recent months. Peripheral bond yields have come down and with the €400 billion TLTRO standing ready to boost commercial bank balance sheets, peripheral bond yields are likely to fall further. However, falling peripheral yields should reduce the attractiveness of this asset class for non-bank investors. Investors will likely look for alternatives and, with cross-currency yield differentials widening in favor of non-EUR currencies, EUR should come under selling pressure.

The level of volatility will decide if EUR is falling slowly or at a brisk pace. Should volatility stay low, carry will remain the dominant theme, suggesting EUR crosses trading moderately lower. Nonetheless, as soon as volatility picks up, EURUSD should trade sharply lower. The reason is two-fold. First, foreign investors have bought more than €1 trillion of foreign assets since August 2012. Most of these asset purchases have remained currency-unhedged (see *Channels of EUR Weakness*, June 12, 2014).

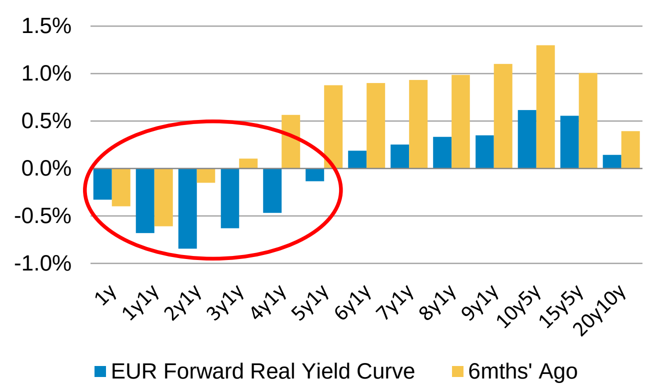
Higher asset volatility should see investors either reducing or currency-hedging their asset positions, resulting in EUR selling. Second, unless triggered by geopolitics, the rise of volatility should come from US rates breaking higher (see: Triggering FX Volatility, May 29, 2014), suggesting EURUSD yield differentials widening sharply. With liquid peripheral bond yields no longer offering a yield advantage, foreign holdings in this asset class should soon start to fall. Exhibit 7 shows the yield differential of the average Spanish and Italian 5-year bond yield compared to the US 5-year Treasury bond yield. As long as foreign bond investors helped in reducing the spread, EUR rallied, supported by bond flows. With bond spreads turning negative, the motivation for these flows will no longer exist. Instead, foreign investors buying €229 billion in EUR-denominated bonds since August 2012 now have an incentive to shift these funds into higher-yielding US bonds. Meanwhile, aggressive ECB action pushed real rates across the yield curve sharply lower (see Exhibit 8).

Exhibit 7
EURUSD and Sovereign Yield Differential



Source: Macrobond, Morgan Stanley Research

Exhibit 8
EUR Real Yield Term Structure



Source: Bloomberg, Morgan Stanley Research

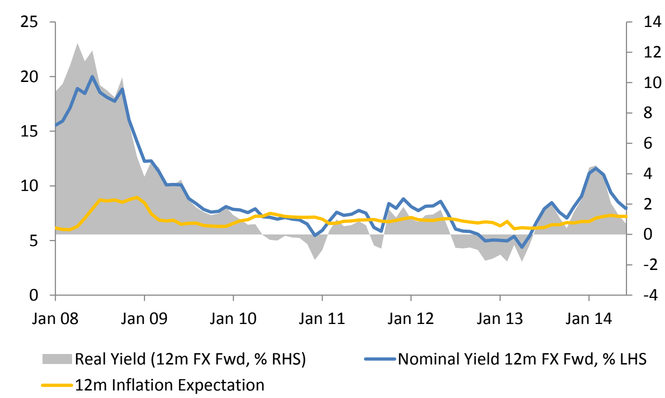
TRY Increasingly at Risk

The Turkish lira has long been one of the more vulnerable currencies to external shocks. The reasons are well known, and revolve around the dependency of the economy and balance of payments on foreign capital. The risks are often exacerbated by the pro-cyclical nature of monetary policy, and the appropriateness of the Central Bank of Turkey's easing cycle is being increasingly questioned by the market in light of the more limited than expected fall in inflation for June. Inflation came in at 9.16% y/y, down only a little, from 9.66% in June 2013. Core inflation remains high at 9.65% y/y too. TRY yields are only at 7.75%, heavily negative given current inflation, and also negative based on consensus expectations of inflation trajectory.

We were stopped out of our short TRY/RUB position, after we moved the stop to protect the gains made. We continue to like the trade from a medium-term perspective, and expect the tighter monetary policy from the Central Bank of Russia to continue to benefit the RUB over other high yielding currencies where central banks are more willing to keep monetary policy on a dovish path.

Should the stronger than expected US labour market report result in an increase in volatility and a stronger USD, the TRY will be particularly at risk and the Central Bank of Turkey will need to increasingly resort to applying funding using the upper end of its interest rate corridor to tighten funding rates in the economy.

Exhibit 9
Real Yield Compression in Turkey Undermining TRY



Source: Bloomberg, Morgan Stanley Research

The 4 Trillion Dollar Question

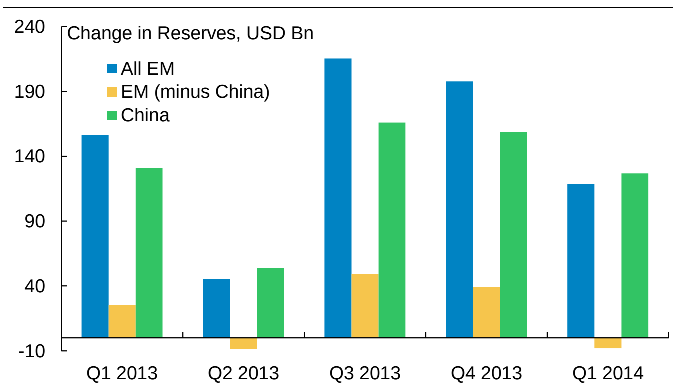
Evan Brown, Vandit D. Shah

- China's FX reserve holdings have risen to about US$4 trillion. How has this affected global FX so far, and how will it continue going forward?
- In line with anecdotal reports, our analysis suggests that China has diversified substantially into EUR. There has also been steady Reserve Manager (RM) interest in CAD and JPY.
- China's reserve accumulation is set to slow over time, as we expect the need to offset speculative inflows to decline. This would mean less diversification into EUR and other FX, and increased G10 FX volatility.

There's China and Then Everyone Else

China continues to drive global FX reserve accumulation, with close to US$4 trillion in holdings. In fact, EM ex-China net *sold* FX reserves in 1Q14, while China accumulated over US$125 billion (see Exhibit 1). China's FX purchases have meaningful impacts on global markets. They may well have contributed to the rally in US fixed income entering the year. And China's diversification outside of USD can provide a cushion for other FX, most notably EUR, which serves as the world's second major reserve currency.

Exhibit 1
China Drives Global FX Reserve Growth



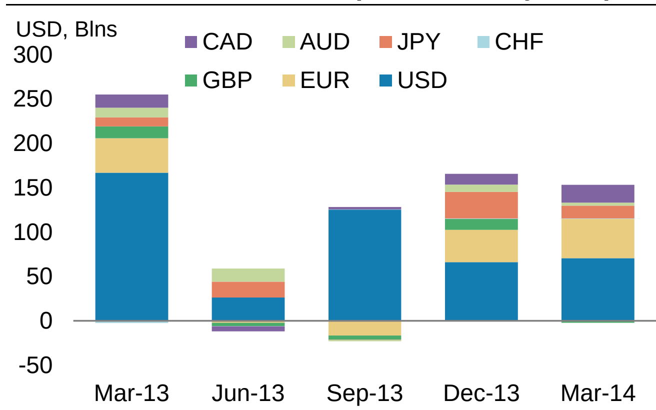
Source: Haver Analytics, Morgan Stanley Research

Unfortunately, China does not report its reserve allocations to the IMF. So, when we receive the COFER data (Currency Composition of Official Foreign Exchange Reserves), we must assume that China's allocations generally mirror those who do disclose their holdings. We tested this assumption against balance of payments data from large reserve managers and found that the assumption does not bias overall conclusions on reserve accumulation (for details on our analysis, see *How Reliable Is COFER Analysis? FX Reserve Diversification Reconsidered*, October 6, 2011). So, while we cannot pin down China's exact behavior, we can get a reasonable idea on what it is likely buying and selling.

Where's the Money Going?

After adjusting for valuation, we estimate that RMs bought over US$80 billion worth of EUR from 4Q13 through 1Q14 (see Exhibit 2). This provided meaningful support for the common currency, in addition to the private sector inflows to riskier eurozone assets (see *EUR: What Does the Flow Say?* May 15, 2014). All in, RM divestment from EUR stabilized last year and is now ticking gradually higher, with the EUR share of EM reserve holdings nearly back to 25% (see Exhibit 3). RMs have also been healthy buyers of CAD and JPY.

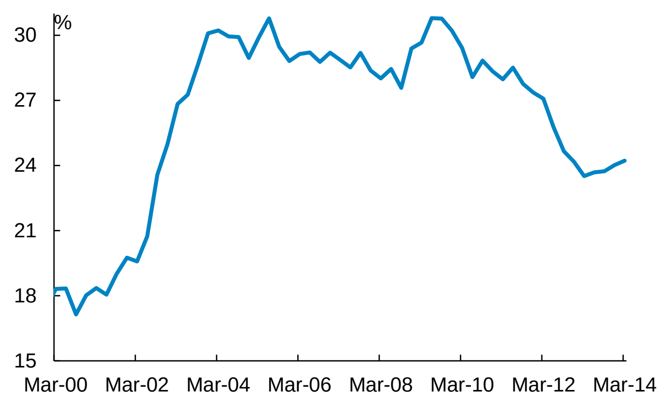
Exhibit 2
EM FX Reserve Purchases (Valuation-Adjusted)



Source: IMF, Haver Analytics, Morgan Stanley Research

Exhibit 3

EUR Share of EM Reserves in Modest Recovery



Source: IMF, Haver Analytics, Morgan Stanley Research

What's Next?

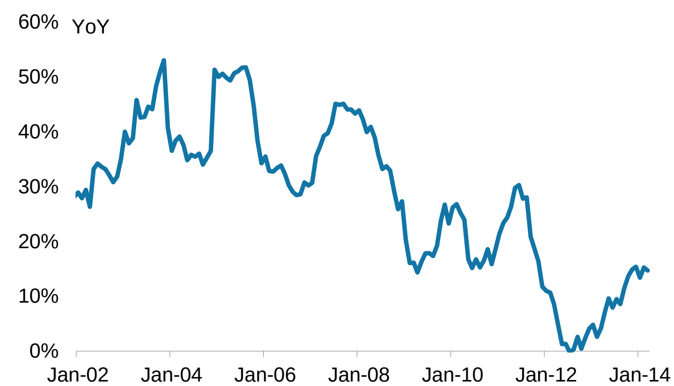
Over time, China's FX reserve accumulation is likely to slow, in line with intended liberalization of RMB, policy-makers' desire for a more flexible domestic monetary policy, and global rebalancing. We have seen no shortage of statements from China's leaders, including Premier Li Keqiang in May, suggesting that such sizeable FX reserves would make it difficult to control inflation over time. In June, officials from China's State Administration of Foreign Exchange (SAFE) made similar warnings and stated that the pace of reserve accumulation will slow going forward.

Indeed, we continue to view the sharp increase in reserves in 1Q14 as a tactical move to drive off speculative inflows, and introduce two-way risk, rather than embark on sustained RMB weakness. China releases FX reserve data for 2Q next week, where we expect to see a slowing of purchases. In Exhibit 5, we proxy 'hot money' inflows by subtracting the trade balance and FDI from FX purchases. Here we can see that the PBOC has been successful in discouraging capital inflows (perhaps even too successful, as outflows may have begun).

Should large inflows restart, we think there's a chance of another round of RMB weakness (and reserve accumulation) in 3Q14, but do not expect this to develop into a trend (see *China FX: What's Going On?* June 16, 2014). A slowing pace of China reserve accumulation likely means less accumulation and less diversification into other currencies. We have shown previously that, at least in the case of EUR, RMs tend to rebalance opportunistically (see *What China's FX Policy Means for EUR*, April 4, 2014). In other words, they buy on dips and sell on rallies, thereby reducing volatility. A structural decline in reserve accumulation and diversification will have the effect of lifting suppressed FX vol, in our view. It would also likely allow EUR to trade lower, more in line with underlying fundamentals such as rate differentials.

Exhibit 4

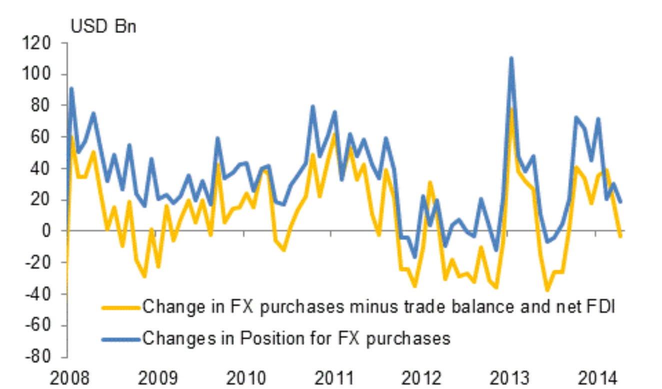
Is China Reserve Growth Topping Out?



Source: Bloomberg, Morgan Stanley Research

Exhibit 5

The PBOC Has Discouraged Inflows for Now

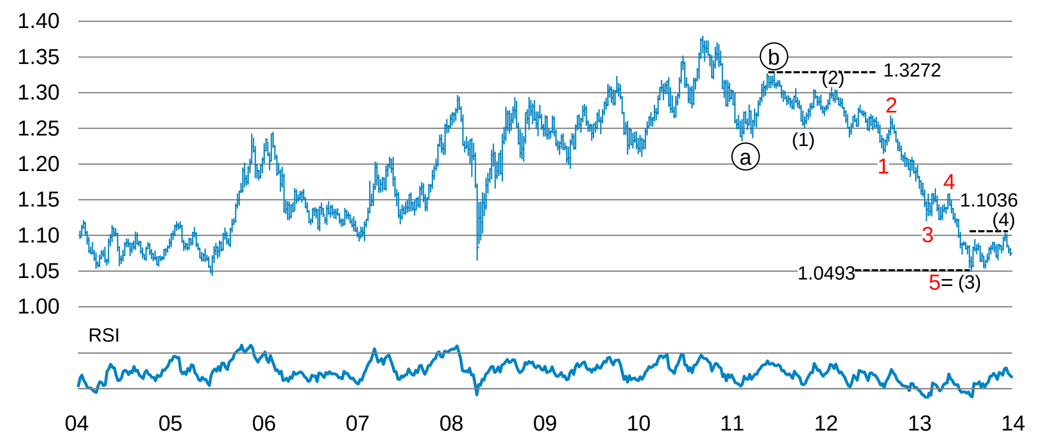


Source: Haver Analytics, Morgan Stanley Research

Technical Chart of the Week – AUD/NZD

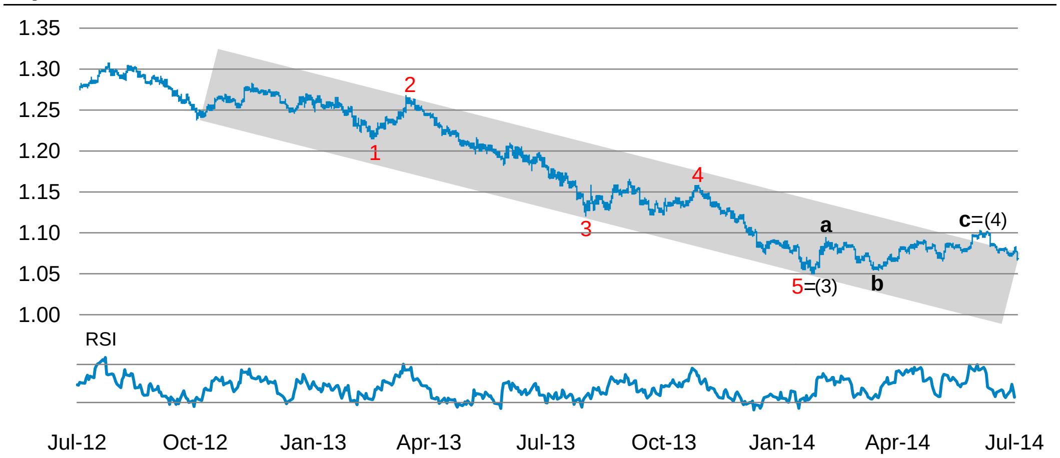
Sheena Shah

10-year AUDNZD Chart



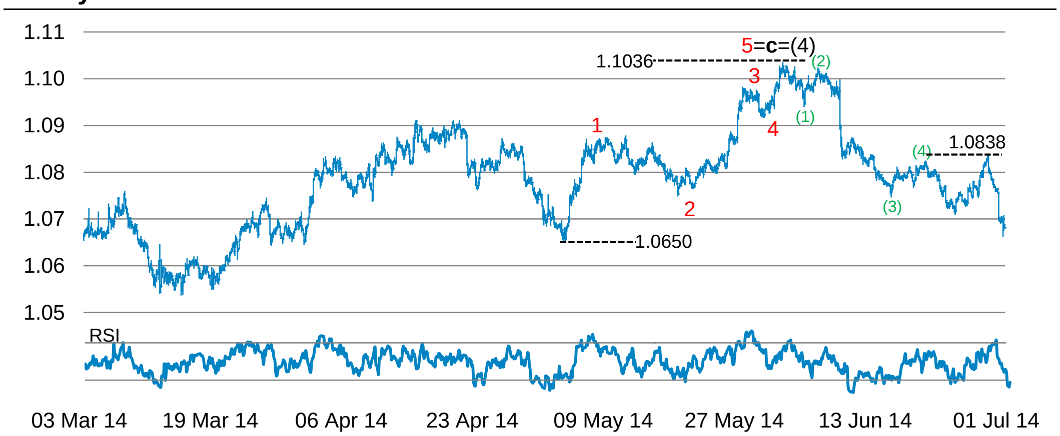
Trading from a high of 1.3796 in March 2011, AUDNZD has depreciated 24%. We believe that the (3)rd wave January low at 1.0493 was only an intermediate bottom and there is further to go lower. We expect a move below here to complete the (5)th wave, suggesting the AUDNZD extends the broader downtrend.

2-year AUDNZD Chart



AUDNZD has formed a 5-wave sequence to a low at 1.0493, completing a (3)rd wave. The currency pair recently had a false break out of the 2 year trend channel around 1.0930 and as now come back to trade within it. We now expect AUDNZD to travel toward the bottom end of the channel around 0.99.

90-day AUDNZD Chart



We believe that AUDNZD has room to decline lower in the near term since it is in a (5)th wave. We would expect AUDNZD to trade below the recent low at 1.0650.

For a description of the Elliott Wave Theory see: *Trading Technicals – The Elliott Wave Method*, January 10, 2014.
Source: Bloomberg, Morgan Stanley Research

Strategic FX Portfolio Trade Recommendations

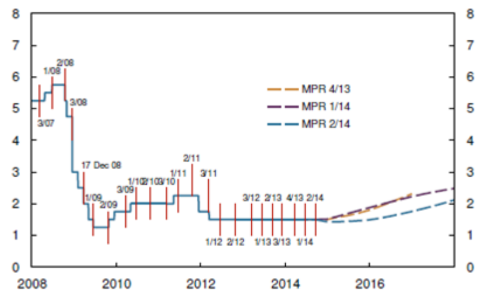
Vandit D. Shah

Limit Order: Buy USD/NOK

Enter: 6.1800, Target: 6.7000, Stop: 6.0500

With a strong US employment report this week indicative of a rebounding US economy, in our view, we look for US nominal yields to move higher in coming weeks and add to our bullish USD view via this trade. The unemployment rate continued its drop to 6.1%, with labor participation staying constant, suggesting limited slack left in the economy. On the other side, the Norges Bank recently came out on the dovish side, pushing out rate hikes by 6 more months. As such, we like playing a bearish NOK view by buying USD/NOK. The key risk to this trade is US nominal yields staying suppressed due to a dovish Fed.

Norges Bank Signals Dovish Rate Path

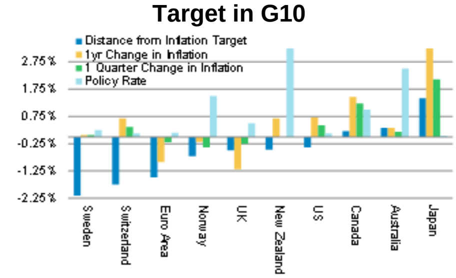


Limit Order: Buy USD/CHF

Enter: WMR on 04-July-14, Target: 0.9450, Stop: 0.8880

We add to our long USD exposure against the low-yielding CHF. With deflationary risks still high in Switzerland, we expect the SNB to maintain their currency policy for the foreseeable future. Should inflation this week significantly surprise to the downside, the markets may even price in a higher probability of more aggressive SNB action. As global bond yields rise and volatility picks up, we expect capital to flow out of Switzerland.

Switzerland 2nd Farthest from Inflation Target in G10

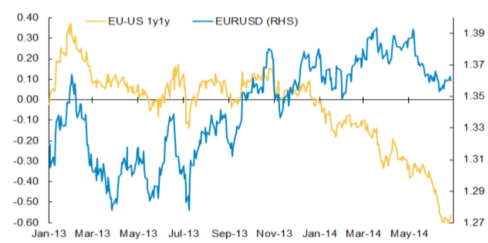


Enter: Short EUR/USD

Enter: 1.3620, Target: 1.3100, Stop: 1.3740

We recommend selling EUR on rallies in the medium term. The ECB delivered a comprehensive package of dovish measures in June that we think will lower real rates over time. It may take the passing of the AQR and an end to European bank repatriation to accelerate the decline, but ECB President Draghi has capped EUR upside in the near term, in our view. A very strong US employment report this week is indicative of a rebounding US economy, and we expect US rates to gradually move more in favor of USD in coming weeks.

EUR Has Decoupled from 1y1y Spread



17-Jun-14 Hold: Long USD/SEK

Enter: 6.6200, Target: 7.1000, Stop: 6.6700

With Swedish CPI printing in deflationary territory on the one hand, and US CPI rising on the other, we continue to like this trade as a way to express this divergence. The Riksbank this week surprised on the dovish side, cutting rates by 50 bps – very much in line with our cautious view on the Swedish economy and SEK. We look for this inflation divergence to play out further and hold on to this position.

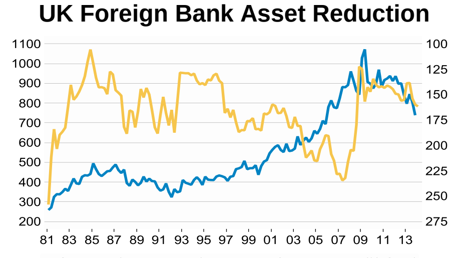
Riksbank Forecasts Are Too Optimistic

27-May-14 Hold: Short EUR/GBP

Enter: 0.8130, Target: 0.7800, Stop: 0.8030

With the UK economy continuing to show strength and the BoE taking on an asset-market-supportive monetary policy approach, we expect GBP to stay supported in the medium term. As UK banks embark on further consolidation, bank repatriation flows supplemented by foreign investor flows should further help GBP appreciate. With the ECB delivering a comprehensive dovish package in June, we think the signaling aspect is important as President Draghi left the door wide open for further measures, keeping a cap on the EUR. For more, see *Bearish EURGBP*, May 15, 2014.

UK Foreign Bank Asset Reduction



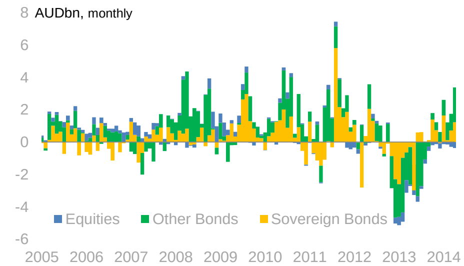
30-Jun-14

Close: Short EUR/AUD

Enter: 1.4500, Close at WMR on July 4, 2014

We remain bearish on the EUR, as highlighted above, but look to close this trade as this week's US employment report could see UST yields move higher and hurt high-beta AUD. The RBA as well came out on the dovish side this week, so we suggest caution with long AUD positions in this environment, especially as asset market volatility could pick up.

Japanese Have Returned to AUD Assets



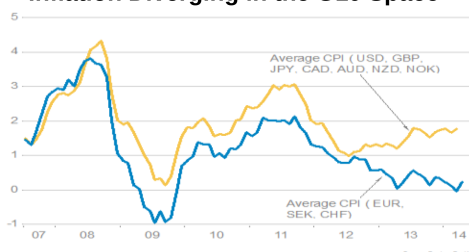
13-Jun-14

Hold: Long JPY and USD against Short Basket of EUR, CHF, and SEK

Enter: 100, Target: 106, Stop: 98

We see a clear divergence in inflationary pressures within the G10 space with the EMU, Sweden and Switzerland facing disinflation, while the US experiences rising inflation. As such, we short these currencies in a basket against USD and JPY as central banks keep policy easy for longer – as buttressed by the Riksbank's aggressively dovish rate cut decision this week and the ECB's dovish tone. While the FOMC did not adjust its policy outlook at its last meeting, the strong US employment report this week added to the possibility of the Fed moving to a less dovish stance going forward, in our view.

Inflation Diverging in the G10 Space



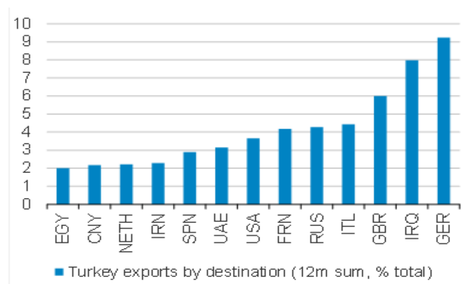
20-Jun-14

Closed: Short TRY/RUB

Enter: 16.10, Stopped: 16.10

While we were stopped on this trade for now, we do highlight that tail-risk scenarios entail a significant rise in oil prices which could push TRY/RUB lower. TRY is sensitive to these dynamics on three counts: (i) around 8% of Turkey's exports are to Iraq, making it the country's second-largest export destination; (ii) TRY is sensitive to rising oil prices given high reliance on imported energy; and (iii) regional security risks. Hence, we caution against long TRY positions. Meanwhile, RUB is a natural beneficiary of higher oil prices. We will closely monitor potential geopolitical concerns in the context of this trade going forward.

Turkey Exports by Destination



Source for all charts: Bloomberg, Haver Analytics, Macrobond, Reuters EcoWin, Morgan Stanley Research

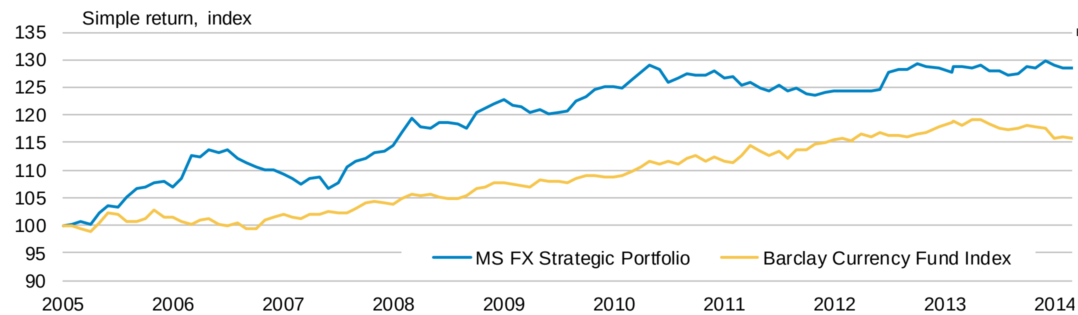
Strategic FX Portfolio

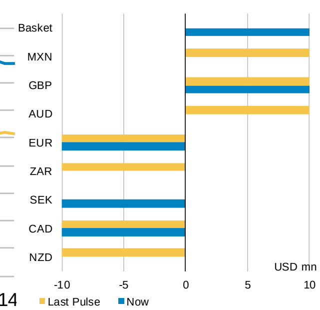
Trade Recommendation	Notional	Nominal Weight	Entry Date	Entry Level	Current	Stop	Target	Spot P&L	Carry P&L	Portfolio Contribution
Closed Trades										
Short TRY/RUB	$10.0mn	10.0%	20-Jun-14	16.1	Closed at 16.1 on 30-Jun-14				-$1.2k	-$1.2k
Short EUR/AUD	$10.0mn	10.0%	30-Jun-14	1.4500	Close at WMR 4-Jul				$2.4k	-$28.4k
Active Trades										
Short EUR/GBP	$10.0mn	10.0%	28-May-14	0.8130	0.7935	0.8030	0.7800	$246.6k	$3.5k	$250.1k
Long USD/SEK	$10.0mn	10.0%	17-Jun-14	6.6200	6.8188	6.6700	7.1000	$299.8k	-$2.6k	$297.2k
Long USD and JPY v EUR CHF and SEK	$10.0mn		13-Jun-14	100.00	100.43	98.00	106.00	$39.0k	-$0.7k	$38.3k
Short EUR/USD	$10.0mn	10.0%	27-Jun-14	1.3620	1.3608	1.3740	1.3100	$17.5k	-$2.0k	$15.5k
Limit Orders										
Buy USD/NOK	$10.0mn	10.0%		6.1800	6.1869	6.0500	6.7000			
Buy USD/CHF	$10.0mn	10.0%		Enter WMR 4-Jul	0.8936	0.8880	0.9450			
Cash	$39.2mn	39.4%								
Portfolio Mark to Market	$99.5mn									

Source: Morgan Stanley Research;

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. Our FX Trade Performance Data Package (22 May 2014) 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 (*FX Pulse: Watching Europe*, October 13, 2011).

Performance on Recommended Discretionary Currency Portfolio and Market Benchmark





Simulated Managed Account Monthly Gross Performance - %													
Year	**Jan**	**Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sep**	**Oct**	**Nov**	**Dec**	**Year return**
2006	-1.11	1.70	4.36	-0.37	1.24	-0.44	0.52	-1.47	-0.85	-0.84	-0.58	-0.01	**2.03%**
2007	-0.75	-0.77	-1.08	0.94	0.36	-2.02	1.07	2.75	1.26	0.45	1.16	0.18	**3.52%**
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	1.08	-0.68	-0.47	-0.02	-0.20								**-0.29%**

Source: Morgan Stanley Research; see notes above. We will calculate June performance in next week's Pusle.

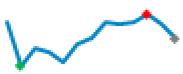
G10 Currency Summary

Calvin Tse, Sheena Shah

Click here for interactive currency pages: Morgan Stanley Matrix

USD

-0.5%

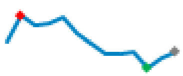


Employment Situation Improving — **Bullish** — *Watch: JOLTS job openings, Wholesale Inventories, FOMC Minutes*

The strong employment report and subsequent rise of US bond yields has supported the USD. We remain bullish on USD as we expect USD bond yields to continue to rise, creating volatility. However, we remain selective on our long USD strategy, against the disinflationary currencies (EUR, CHF and SEK) and those at risk of rising bond yields (CAD). We are selective because the Fed's current dovish stance could have bearish implications for the USD.

EUR

-0.4%



Rate Differentials to Drive EUR Lower — **Bearish** — *Watch: German Trade Balance, German Factory Orders*

The ECB's dovish stance and strong US data keep EUR at a sell for now. We particularly like the risk-reward in trading EURGBP lower, driven by the divergence in monetary policy. Falling Euro area peripheral yields should reduce the attractiveness of this asset class for non-bank investors, resulting in investors looking for alternatives and, with cross-currency yield differentials widening in favor of non-EUR currencies, EUR should come under selling pressure.

JPY

-1.8%

Vol and JPY — **Bullish** — *Watch: Trade Balance, M3, Machine Orders,*

We expect JPY to remain supported as long as market expectations about the pace of policy are disappointed. The JPY should see support on many of the crosses, in particular NOK, EUR and SEK. The recent USD rally after the strong employment report and rising bond yields could challenge our bullish view; however, we still expect the BoJ to remain on hold with monetary accommodation and to look through a dip in inflation expected in the summer, reducing the probability of easing then.

GBP

2.8%

Rate Hikes in the Pipeline — **Bullish** — *Watch: Industrial Production, House Prices, Trade, BoE Rate Decision*

The UK data continue to outperform, with leading indicators suggesting that further expansion is likely to be seen broadly across the economy. In addition, recent macro-prudential measures were less restrictive than expected; as such, house prices are likely to continue to rise, increasing wealth effects and supporting domestic demand. On the back of these developments, the BoE remains hawkish. Divergent growth and rate paths should support GBP, especially against EUR.

CHF

-0.1%

Watching Inflation — **Bearish** — *Watch: Unemployment Rate, CPI, Retail Sales*

With deflationary risks still high in Switzerland, we expect the SNB to maintain their currency policy for the foreseeable future. Should inflation this week significantly surprise to the downside, the markets may even price in a higher probability of more aggressive SNB action. But for the time being, EURCHF is likely to continue hovering above the floor; given our bearish EUR view, we believe that CHF will also trade lower against USD.

CAD

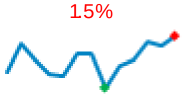
-2.9%

It's All About Inflation — **Neutral** — *Watch: Ivey PMI, BoC Loan Survey, Canadian Payrolls*

We maintain our medium-term bearish CAD view but see near-term room for further strength, as data have improved and inflation is picking up. The Bank of Canada has looked through the pickup in pricing pressures thus far, but it is unlikely that it will continue to do so should CPI continue to rise above its target. Over the medium term, we are concerned about competitiveness in Canada, but the focus in the near term will be on the data, including payrolls next week.

AUD

1.5%

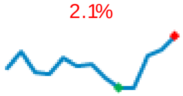


RBA Talks AUD Down — **Neutral** — *Watch: Business Confidence, Employment Change, Home Loans*

The domestic situation in Australia is diverging from the international environment. Australia's trade deficit has widened and RBA governor Stevens has opened the door to rate cuts, putting monetary policy into the context of recent AUD strengths. Stevens has called the AUD "overvalued, and not by a few cents", a statement that is bearish for the currency. Rising US bond yields, driving volatility, are also likely to put AUD under pressure.

NZD

2.1%

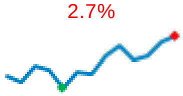


RBNZ Aggressive Rate Path — **Neutral** — *Watch: House Prices, Manufacturing PMI, Food Prices*

With inflation in New Zealand weakening and an aggressive rate hike path from the RBNZ, we have turned bearish again on the NZD. Milk prices have declined 29% since February and previous terms of trade gains have started to ease. The housing market has also turned around. All these factors suggest that NZD should trade lower against the USD, especially if US bond yields continue to move higher. The risk is the RBNZ hiking rates, driving NZD higher.

SEK

2.7%

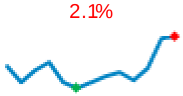


Aggressive Easing — **Bearish** — *Watch: Industrial Production, Unemployment Rate, CPIF*

With medium-term inflation expectations at risk of de-anchoring, and with pressure on the Riksbank from the government to prevent a further falling of prices, the Swedish central bank surprised markets by cutting interest rates by 50bp this week. This was done despite rapidly rising home prices in Sweden, suggesting a new stance from the central bank. Consequently, we expect SEK to increasingly be used as a funding currency.

NOK

2.1%



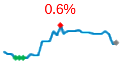
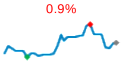
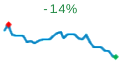
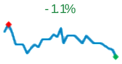
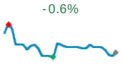
Dovish Norges — **Bearish** — *Watch: Industrial Production, CPI*

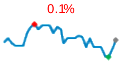
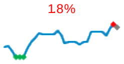
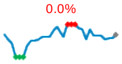
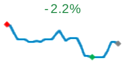
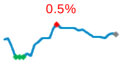
With the Norges Bank significantly pushing back the timing of its first rate hike to maintain lower rate differentials between Norway and the rest of its major trading partners, Governor Olsen is implicitly attempting to weaken NOK, in our view. This is unsurprising, given the increasingly uncompetitive Norwegian economy, which has been extremely levered to the petroleum sector. Over the next week, industrial production and CPI data are the key data releases in Norway.

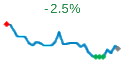
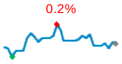
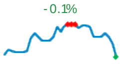
Charts show 1M performance against USD, as normally quoted and DXY for USD. Click on any currency for a reference webpage on Matrix.

EM Currency Summary

Jessica Liang (AXJ), Meena Bassily (CEEMEA), Felipe Hernandez (LatAm)

CNY	**Neutral**	-0.7% 	PBoC introduced unexpected volatility into the CNY fixing this year to discourage speculative positioning in USD/CNY. We see some likelihood of another round of CNY weakness in 3Q.
INR	**Neutral**	0.6% 	INR continues to trade well and we expect further gains in the short term, driven by portfolio flows – particularly into the equity market. The RBI will likely smooth the trend. Longer-term prospects will hinge more on the success of reform efforts.
IDR	**Neutral**	0.9% 	Moves in IDR will depend on Presidential Election results on 9th July. A Jokowi win with a divided government is likely priced by the FX markets. In contrast, a Prabowo win may create capital outflows, driving USD/IDR spot above 12,300. We think a Jokowi win with Golkar switching sides would be IDR positive, driving USD/IDR spot to 11,000.
KRW	**Bullish**	-1.4% 	Korea's GDP and trade numbers point to economic recovery. At the same time, the BoK has allowed USD/KRW to break below key levels, which opens the door for more downside, in our view. Korean bonds continue to see strong inflows from reserve diversification.
MYR	**Neutral**	-1.1% 	MYR stands to benefit from higher oil prices, global growth recovery and subsiding portfolio outflows. BNM has turned hawkish at the May meeting, signaling potential rate hikes which will encourage inflows into the bond market.
PHP	**Bullish**	-0.5% 	The Philippines' fundamentals are strong, with a more hawkish central bank bias supporting the peso. That said, the currency remains susceptible to the broader risk sentiment on EM and Asian currencies.
THB	**Bearish**	-0.6% 	Continued political uncertainty is likely to remain a drag on GDP growth and exports. Thailand is also exposed to funding risks, given its weak current account cushion, and FDI flows that supported THB through last year have taken a hit since November. We remain most bearish on THB in the region.

CZK	**Neutral**	0.1% 	EUR/CZK has remained more or less flat, just below 27.50 for the entire year. We expect that it would take a large shift in data – and particularly inflation – for questions to be raised concerning the CNB's current FX regime and recent ranges to be tested.
HUF	**Bullish**	1.8% 	The continued decline in inflation has cushioned the market impact of the recent cuts from the NBH as real rates remain positive. In addition, the ECB's easing means rate differentials on short EUR/HUF positions remain attractive. We think there is good value positioning for HUF strength.
ILS	**Neutral**	-1.8% 	We do not think positioning for ILS weakness on the back of the recent rise in geopolitical risks alone is a profitable strategy, given Israel's reduced reliance on imported energy and Israel's strong balance of payment dynamics. We think the bigger risk for ILS is BoI intervention, which keeps us neutral on ILS.
PLN	**Bullish**	0.0% 	Recent leaked recordings of government and central bank officials have soured the political backdrop for the zloty. Given already heavy long PLN positioning and some signs of weakness in the most recent data, we think PLN may underperform in the very near term, though keep to a bullish medium-term view.
RUB	**Neutral**	-2.2% 	The CBR has maintained tight monetary policy and our economists expect it to keep rates on hold for the remainder of the year. While geopolitical risks remain significant, the risk of imminent sanctions is lower now – while higher oil prices are naturally supportive for RUB.
TRY	**Bearish**	0.5% 	Heightened security risk in northern Iraq could have a negative impact on TRY, given Turkey's high trade exposure – Iraq is Turkey's second-largest export destination – and on the back of any related rise in Brent crude price, given Turkey's large dependency on energy imports. We stay bearish TRY.
ZAR	**Bearish**	0.0% 	On the back of promising news regarding the labour market strikes and a strong current account print for 1Q, we could see more relief for the rand. However, we still see medium-term risks for the currency as being significant and unresolved, and would therefore look to buy USD/ZAR on dips.

BRL	**Bearish**	-2.5% 	A tight presidential election race and the highest carry in emerging markets amid low core yields and muted volatility support the currency in the short term. However, we expect BRL to trade above 2.40 after the election, given deteriorating fundamentals and less favourable market conditions.
CLP	**Neutral**	-0.2% 	We expect further rate cuts in response to weak economic growth and this, together with less favourable market conditions, may push USD/CLP back above 570 in 2H14. A narrowing C/A deficit should help to limit downside risks, but copper prices and demand from China raise uncertainty.
COP	**Neutral**	-3.0% 	Inflows from the higher weight in the GBI-EM and those attracted by rate hikes and higher growth should keep COP well supported and allow it to outperform. However, intervention and weaker market conditions could push USD/COP to the unofficial target of 1,900-1,950 later in 2014.
MXN	**Bullish**	0.2% 	In the short term MXN maintains a high beta to broader risks, and upside is limited if market conditions turn less favourable. However, we expect the approval of complementary legislation to energy reform and recovering growth to support the currency in 2H14, with USD/MXN likely to outperform.
PEN	**Neutral**	-0.1% 	Official intervention should continue to limit volatility and the speed of currency adjustments in the short term, but decelerating economic growth and eroding external accounts show valuations need to adjust. We expect USD/PEN to gradually weaken to 2.82 by end-2014, driven by weaker market conditions.

Charts show 1M performance against USD, as normally quoted

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Morgan Stanley Matrix

Global Event Risk Calendar

Sheena Shah

Date	Day	Time (Ldn)	Ccy	Event	Ref. Period	MS forecast	Market	Previous
Fri	04-Jul							
		SEK	08:30	Industrial Production (MoM)	May		0.1%	3.02%
Mon	07-Jul							
		AUD	07:30	Foreign Reserves	Jun			65.1B
		CAD	13:30	Building Permits (MoM)	May			1.1%
		CAD	15:00	Ivey PMI	Jun			48.2
		CHF	06:45	Unemployment Rate	Jun		2.9%	3%
		CHF	08:00	Foreign Currency Reserves	Jun			444.4B
		EUR	08:00	Spanish Industrial Production (YoY)	May			4.3%
		JPY	00:50	Official Reserve Assets	Jun			1283.9B
		JPY	06:00	Leading Index CI	May P		106	106.5
		NOK	09:00	Industrial Production (MoM)	May			-0.1%
		NZD	01:00	QV House Prices (YoY)	Jun			8.2%
Tue	08-Jul							
		AUD	00:30	Consumer Confidence				105.4
		AUD	02:30	NAB Business Confidence	Jun			6.9
		CHF	08:15	**CPI (YoY)**	**Jun**		**0.2%**	**0.2%**
		CHF	08:15	Retail Sales Real (YoY)	May			0.4%
		EUR	07:45	French Trade Balance	May			-3.9B
		GBP	09:30	Industrial Production (MoM)	May		0.2%	0.4%
		GBP	15:00	NIESR GDP Estimate (QoQ)	Jun			0.9%
		JPY	00:50	Trade Balance BoP Basis	May		¥-845.2B	¥-780.4B
		JPY	06:00	Eco Watchers Survey Outlook	Jun			53.8
		NZD	23:45	Card Spending Retail (MoM)	Jun			1.3%
		USD	12:30	NFIB Small Business Optimism	Jun			96.6
		USD	20:00	Consumer Credit	May		19.05B	26.85B
Wed	09-Jul							
		CAD	13:15	Housing Starts	Jun			198k
		CNY	02:30	**CPI (YoY)**	**Jun**	**2.4%**	**2.5%**	**2.5%**
		GBP	00:01	BRC Shop Price Index (YoY)	Jun			-1.4%
		IDR	N/A	Indonesia Presidential Elections				
		JPY	00:50	M3 (YoY)	Jun		2.5%	2.6%
		NZD	23:30	Manufacturing PMI	Jun			52.7
		SEK	07:00	TNS Sifo Prospera publishes Swedish inflation expectations				
		USD	19:00	**FOMC Minutes**	**Jun 17-18**			
Thu	10-Jul							
		AUD	02:30	Employment Change	Jun			-4.8k
		CAD	13:30	New Housing Price Index (MoM)	May			0.18%
		CNY	N/A	Trade Balance	Jun		35B	35.92B
		GBP	00:01	RICS House Price Balance	Jun		55%	57%
		GBP	09:30	Visible Trade Balance GBP/Mn	May		£-9000	£-8920
		GBP	12:00	**BoE Rates Decision**		**0.5%**	**0.5%**	**0.5%**
		JPY	00:50	**Domestic CGPI (YoY)**	**Jun**		**4.6%**	**4.4%**
		JPY	00:50	Tertiary Industry Index (MoM)	May		1.8%	-5.4%
		JPY	06:00	Consumer Confidence Index	Jun		40.5	39.3
		KRW	02:00	**BoK Rates Decision**		**2.5%**	**2.5%**	**2.5%**
		MYR	11:00	**BNM Rates Decision**		**3%**	**3%**	**3%**
		NOK	09:00	CPI Underlying (YoY)	Jun			2.3%
		NZD	23:45	Food Prices (MoM)	Jun			0.6%
		SEK	08:30	**CPI (YoY)**	**Jun**			**-0.16%**
		USD	13:30	Initial Jobless Claims			312.5k	315k
		USD	15:00	Wholesale Inventories (MoM)	May		0.6%	1.1%
N/A	N/A	CNY	N/A	New Yuan Loans	Jun	1100bn	950B	871B
Fri	11-Jul							
		AUD	02:30	Home Loans (MoM)	May			0%
		CAD	13:30	Unemployment Rate	Jun			7%
		GBP	09:30	Construction Output (MoM)	May			1.2%
		MXN	15:00	**Banxico Rates Decision**		**3.5%**		**3%**
		PEN	00:00	**BCRP Rates Decision**	**Jul**	**4.00%**	**4%**	**4%**
Sun	13-Jul							
		NZD	23:30	Performance Services Index	Jun			54.2
Mon	14-Jul							
		EUR	10:00	Industrial Production (MoM)	May			0.8%

Date	Day	Ccy	Time (Ldn)	Event	Ref. Period	MS forecast	Market	Previous
Mon	14-Jul							
		JPY	05:30	Industrial Production (MoM)	May F			0.5%
N/A	N/A	CNY	N/A	FDI (YoY)	Jun		-5.6%	-6.7%
Tue	15-Jul							
		AUD	02:30	**RBA Minutes**	**July**			
		CAD	14:00	Existing Home Sales (MoM)	Jun			5.9%
		CLP	23:00	**CBCH Rates Decision**		**4.0%**		**4%**
		EUR	10:00	German ZEW Survey Expectations	Jul			29.8
		EUR	10:00	Eurozone ZEW Survey Expectations	Jul			58.4
		GBP	09:30	**CPI (YoY)**	**Jun**			**1.5%**
		GBP	09:30	ONS House Price (YoY)	May			9.9%
		JPY	N/A	**BoJ Rates Decision**		**0.1%**		**0.1%**
		NOK	09:00	Existing Homes (QoQ)	2Q			2.14%
		USD	13:30	Retail Sales Advance (MoM)	Jun			0.3%
		USD	13:30	Empire Manufacturing	Jul			19.28
		USD	15:00	Business Inventories	May			0.6%
Wed	16-Jul							
		AUD	01:30	Westpac Leading Index (MoM)	Jun			0.1%
		BRL	N/A	**COPOM Rates Decision**		**11.0%**		**11%**
		CAD	13:30	Manufacturing Sales (MoM)	May			-0.1%
		CAD	15:00	**BoC Rates Decision**		**1.00%**		**1%**
		CAD	16:15	**BoC's Poloz spks (Ottawa)**				
		CHF	10:00	ZEW Survey Expectations	Jul			4.8
		CNY	03:00	Industrial Production (YoY)	Jun	9.0%	9%	8.8%
		CNY	03:00	**GDP (YoY)**	**2Q**	**7.2%**	**7.4%**	**7.4%**
		EUR	10:00	Trade Balance	May			15794
		EUR	N/A	EU Leaders Summit (Brussels)				
		GBP	09:30	Average Weekly Earnings 3M/YoY	May			0.7%
		GBP	09:30	ILO Unemployment Rate 3Mths	May			6.6%
		USD	14:00	Total Net TIC Flows	May			136.8B
		USD	14:15	Industrial Production (MoM)	Jun			0.59%
		USD	14:15	Capacity Utilization	Jun			79.1%
		USD	15:00	NAHB Housing Market Index	Jul			49
		USD	19:00	Fed Beige Book				
Thu	17-Jul							
		CAD	13:30	Int'l Securities Transactions	May			10.1B
		EUR	10:00	**CPI (YoY)**	**Jun F**			**0.5%**
		NZD	02:00	ANZ Consumer Confidence (MoM)	Jul			3.4%
		TRY	12:00	**CBT Rates Decision**				**8.75%**
		USD	13:30	Housing Starts	Jun			1001k
		USD	13:30	Initial Jobless Claims			312.5k	315k
		USD	15:00	Philadelphia Fed Business Outlook	Jul			17.8
		ZAR	N/A	**SARB Rates Decision**		**5.5%**		**5.5%**
Fri	18-Jul							
		CAD	13:30	CPI (YoY)	Jun			2.3%
		CNY	02:30	China Property Prices	June			
		EUR	09:00	Euro-area Current Account	May			21.5B
		USD	14:55	Univ. of Michigan Confidence	Jul P			82.5
		USD	15:00	Leading Index	Jun			0.5%
Upcoming Risk Events								
24-July		22:00	NZD	**RBNZ Rates Decision**	**Jul**	**3.50%**		**3.25%**
30-July		19:00	USD	**FOMC Rates Decision**	**July**	**0.1%**		**0.1%**
05-Aud		05:30	AUD	**RBA Rates Decision**	**Aug**	**2.5%**		**2.5%**
04-Sep		08:30	SEK	**Riksbank Rates Decision**	**Sep**			**0.25%**
18-Sep		09:00	NOK	**Norges Bank Rates Decision**	**Sep**			**1.5%**
25-Sep		08:30	CHF	**SNB Rates Decision**	**Sept**	**0.0%**		**0.0%**

N/A Denotes timing approximate or not confirmed / All times and dates are GMT and correct as of the date of publication / For a full list of economic events see the calendar on the *Morgan Stanley Matrix Platform* / Source: Morgan Stanley Research, Bloomberg

Cross-Currency Carry and Vol Heat Map

Morgan Stanley Matrix

Vandit D. Shah

Volatility and Carry Global Heatmap

7/2/2014		Implied Vol Metric									RR Metric			Carry Metric						
		3M Im Vol	1W Chg	5-Year Perc.	Imp vs Real	5-Year Perc.	1Y/3M Imp Rat	5-Yer Perc.	5Y/1Y Imp Rat	5-Yer Perc.	3M 25d RR	RR/ Imp	Ratio Perc		3M Carry	1W Chg	5-Year Perc.	Vol-Adj. Carry	5-Year Perc.	1Y/3M Carry Rat
G10 USD	USDCAD	4.7	0.2	1%	1.03	30%	1.21	93%	1.23	99%	0.6	-12%	60%	USDCAD	0.9	0.0	1%	0.19	99%	0.99
	USDCHF	5.5	-0.3	0%	1.20	68%	1.23	99%	1.30	100%	0.6	-11%	20%	USDCHF	-0.3	0.0	57%	-0.06	18%	1.26
	USDJPY	5.6	-0.2	0%	1.15	54%	1.35	100%	1.53	100%	-0.4	7%	45%	USDJPY	-0.3	0.0	57%	-0.05	17%	1.36
	USDNOK	6.6	-0.2	0%	1.14	66%	1.18	94%	1.27	100%	0.7	-11%	58%	USDNOK	1.5	0.1	47%	0.23	100%	0.84
	USDSEK	6.7	-0.2	0%	1.04	39%	1.20	98%	1.25	100%	0.7	-10%	61%	USDSEK	0.4	0.0	19%	0.06	22%	0.76
	GBPUSD	5.3	0.1	3%	1.22	70%	1.21	89%	1.25	92%	-0.2	-4%	98%	GBPUSD	-0.3	0.0	21%	-0.06	0%	1.77
	NZDUSD	7.1	-0.3	0%	1.04	43%	1.19	92%	1.28	100%	-1.2	-16%	70%	NZDUSD	-3.6	-0.1	0%	-0.51	0%	1.04
	AUDUSD	6.4	-0.3	0%	1.04	38%	1.24	96%	1.24	99%	-1.2	-18%	68%	AUDUSD	-2.7	-0.1	73%	-0.42	0%	0.93
	EURUSD	4.9	-0.2	0%	1.22	69%	1.26	100%	1.31	100%	-0.6	-12%	58%	EURUSD	0.1	0.0	63%	0.03	83%	1.35
G10 EUR	EURAUD	6.4	-0.3	0%	1.07	41%	1.16	83%	1.29	100%	0.8	13%	76%	EURAUD	2.8	0.0	20%	0.44	91%	0.97
	EURCAD	5.4	0.1	1%	1.03	21%	1.24	99%	1.28	100%	-0.3	-6%	28%	EURCAD	1.1	0.0	72%	0.20	99%	1.04
	EURCHF	2.1	-0.1	0%	1.47	70%	1.39	81%	2.12	100%	0.5	-24%	21%	EURCHF	-0.2	0.0	86%	-0.09	28%	1.23
	EURGBP	5.3	0.1	2%	1.37	92%	1.19	87%	1.25	91%	-0.4	-8%	21%	EURGBP	0.5	0.0	77%	0.08	96%	1.68
	EURJPY	5.7	-0.4	0%	1.27	85%	1.40	100%	1.55	100%	-0.9	16%	34%	EURJPY	-0.1	0.0	74%	-0.02	54%	1.40
	EURNOK	6.2	0.2	19%	1.05	36%	0.98	11%	1.17	95%	0.5	-8%	79%	EURNOK	1.6	0.0	43%	0.25	74%	0.91
	EURNZD	7.1	-0.3	0%	1.20	82%	1.15	80%	1.29	100%	0.7	10%	55%	EURNZD	3.7	0.0	100%	0.53	100%	1.08
	EURSEK	6.0	0.1	3%	1.00	27%	1.02	34%	1.31	100%	0.4	-7%	83%	EURSEK	0.5	0.0	22%	0.09	27%	0.94
G10 Crosses	GBPAUD	6.4	-0.4	2%	1.12	51%	1.19	87%	1.21	98%	0.7	-10%	61%	GBPAUD	2.3	0.0	17%	0.36	73%	0.84
	GBPCAD	5.5	0.1	2%	1.07	44%	1.21	93%	1.28	100%	0.3	-5%	1%	GBPCAD	0.6	0.0	56%	0.11	92%	0.56
	GBPCHF	5.7	0.0	4%	1.27	74%	1.23	89%	1.26	77%	0.5	-8%	1%	GBPCHF	-0.6	0.0	50%	-0.11	12%	1.54
	GBPJPY	6.0	-0.4	0%	1.12	58%	1.36	100%	1.52	100%	-0.3	5%	6%	GBPJPY	-0.6	0.0	43%	-0.09	2%	1.63
	CHFJPY	5.4	-0.3	0%	1.23	84%	1.37	100%	1.46	98%	-0.4	7%	26%	CHFJPY	0.1	0.0	41%	0.02	79%	1.01
	AUDCAD	5.7	-0.2	3%	1.06	35%	1.17	88%	1.15	92%	-0.5	9%	16%	AUDCAD	-1.7	0.0	81%	-0.30	71%	0.94
	AUDCHF	6.8	-0.3	0%	1.09	54%	1.17	80%	1.30	100%	-1.0	15%	48%	AUDCHF	-2.9	0.0	82%	-0.43	10%	1.00
	AUDJPY	6.9	-0.1	0%	1.21	80%	1.32	100%	1.49	99%	-1.5	22%	37%	AUDJPY	-2.8	0.0	80%	-0.41	1%	1.00
	AUDNZD	5.4	-0.1	3%	0.94	12%	1.07	68%	1.29	100%	0.0	0%	31%	AUDNZD	0.9	0.1	100%	0.17	100%	1.37
	NOKSEK	6.2	0.1	28%	1.05	47%	0.94	5%	1.16	97%	-0.1	2%	93%	NOKSEK	-1.0	0.0	22%	-0.17	19%	0.90
AXJ BLOCK	USDCNY	1.8	0.0	32%	1.96	73%	1.34	34%	1.98	14%	0.4	-23%	33%	USDCNY	1.9	-0.2	84%	1.11	87%	0.70
	USDHKD	0.3	0.0	0%	2.85	78%	1.69	75%	7.27	95%	-0.3	77%	46%	USDHKD	0.0	0.1	100%	0.14	100%	0.55
	USDIDR	10.5	0.0	53%	1.24	30%	1.07	20%	1.08	9%	2.5	-24%	90%	USDIDR	6.4	0.5	76%	0.61	73%	1.06
	USDINR	7.5	-0.5	3%	1.22	53%	1.21	95%	1.36	88%	1.1	-15%	78%	USDINR	6.1	0.1	43%	0.81	86%	1.10
	USDKRW	5.4	-0.2	0%	1.12	32%	1.36	97%	1.59	95%	0.6	-11%	99%	USDKRW	1.5	-0.1	22%	0.28	81%	0.95
	USDMYR	5.2	0.0	2%	1.02	27%	1.17	83%	1.51	97%	0.8	-14%	87%	USDMYR	2.0	0.1	65%	0.39	99%	1.05
	USDPHP	4.8	-0.3	4%	1.02	19%	1.26	92%	1.40	72%	0.8	-17%	90%	USDPHP	0.3	-0.1	36%	0.06	41%	1.29
	USDSGD	3.0	-0.1	0%	1.03	21%	1.32	98%	1.54	83%	0.5	-15%	74%	USDSGD	0.0	0.0	65%	0.00	51%	4.10
	USDTHB	5.2	0.0	25%	1.40	45%	1.23	64%	1.61	69%	0.8	-15%	49%	USDTHB	1.4	-0.1	36%	0.28	52%	1.16
	USDTWD	2.9	-0.1	0%	1.08	19%	1.26	90%	1.61	83%	0.6	-19%	36%	USDTWD	-0.8	0.5	82%	-0.29	60%	1.12
LATAM BLOCK	USDARS	17.0	0.0	61%	19.16	96%	1.62	33%	1.71	33%	7.0	-41%	65%	USDARS	47.2	11.3	82%	2.78	80%	0.85
	USDCLP	8.2	0.0	6%	0.93	3%	1.21	86%	1.45	94%	1.7	-20%	93%	USDCLP	4.2	0.3	47%	0.52	81%	0.85
	USDCOP	7.3	-0.3	3%	1.24	12%	1.14	64%	1.56	91%	1.8	-25%	76%	USDCOP	3.7	0.4	76%	0.51	94%	1.13
	USDMXN	6.8	0.0	0%	1.46	83%	1.27	96%	1.39	98%	1.7	-24%	80%	USDMXN	2.7	0.2	3%	0.39	97%	0.95
	USDBRL	10.4	0.6	16%	1.13	35%	1.20	74%	1.34	75%	2.2	-21%	90%	USDBRL	11.0	0.1	99%	1.05	99%	0.93
	EURBRL	10.8	0.6	21%	1.15	58%	1.19	68%	1.28	55%	2.0	-18%	89%	EURBRL	11.4	0.2	99%	1.05	99%	0.92
	EURMXN	7.3	0.0	0%	1.27	58%	1.26	98%	1.34	88%	1.4	-19%	81%	EURMXN	2.8	0.3	21%	0.39	90%	0.98
	MXNJPY	8.4	-0.1	0%	1.28	79%	1.35	100%	1.43	99%	-2.3	27%	64%	EURMXN	-2.9	-0.3	98%	-0.34	0%	0.99
EMEA BLOCK	EURCZK	2.7	0.0	0%	2.25	100%	1.22	100%	1.83	98%	1.6	-59%	0%	EURCZK	-0.2	0.1	29%	-0.06	24%	1.63
	EURHUF	6.9	0.4	3%	1.20	72%	1.18	79%	1.26	98%	1.9	-28%	49%	EURHUF	1.6	0.1	1%	0.23	2%	0.92
	EURILS	4.9	-0.1	0%	1.21	56%	1.19	97%	1.37	100%	0.5	-10%	13%	EURILS	0.3	0.1	26%	0.07	45%	0.87
	EURPLN	5.4	0.1	1%	1.41	87%	1.19	79%	1.06	78%	1.3	-23%	69%	EURPLN	2.4	0.0	32%	0.45	80%	0.90
	EURRUB	8.7	-0.1	26%	0.94	19%	1.18	65%	1.41	55%	1.7	-20%	55%	EURRUB	9.1	0.3	95%	1.05	99%	0.91
	EURTRY	9.6	-0.4	27%	1.03	24%	1.14	39%	1.49	86%	2.2	-23%	58%	EURTRY	7.8	-0.2	73%	0.82	82%	1.00
	EURZAR	10.6	-0.1	1%	1.06	31%	1.14	76%	1.39	99%	2.1	-20%	59%	EURZAR	6.6	0.2	86%	0.63	100%	1.05
	USDCZK	6.1	0.0	0%	1.45	99%	1.22	100%	1.40	98%	2.0	-33%	0%	USDCZK	-0.3	0.1	11%	-0.05	1%	1.49
	USDHUF	9.0	0.0	1%	1.23	89%	1.22	98%	1.19	99%	2.3	-26%	17%	USDHUF	1.5	0.1	1%	0.17	7%	0.85
	USDILS	4.4	0.0	0%	1.50	93%	1.23	98%	1.45	99%	1.3	-30%	0%	USDILS	0.2	0.1	13%	0.04	19%	0.47
	USDPLN	7.3	0.0	1%	1.45	98%	1.26	95%	1.04	75%	1.8	-24%	31%	USDPLN	2.4	0.1	19%	0.33	99%	0.85
	USDRUB	8.6	-0.1	14%	0.99	17%	1.20	75%	1.41	74%	2.2	-26%	58%	USDRUB	9.0	0.4	95%	1.04	100%	0.90
	USDTRY	9.6	-0.4	20%	1.09	34%	1.16	54%	1.48	87%	2.6	-27%	71%	USDTRY	7.7	-0.1	74%	0.80	90%	0.99
	USDZAR	10.8	-0.1	0%	1.12	61%	1.16	86%	1.40	99%	2.6	-24%	49%	USDZAR	6.7	0.5	88%	0.62	100%	1.02
	Gold	12.5	0.5	3%	1.0	22%	1.1	30%	1.1	13%	-0.3	0.0	31%	Gold	-1.3	-1.2	52%	-0.1	48%	0.4
	Silver	20.3	0.5	1%	1.0	65%	1.1	58%	1.0	45%	1.5	0.1	89%	Silver	-1.1	0.8	19%	-0.1	11%	2.2
	Platinum	17.0	1.1	5%	1.2	62%	1.0	21%	1.3	25%	1.5	0.1	94%	Platinum	-0.9	-0.7	34%	-0.1	19%	1.1

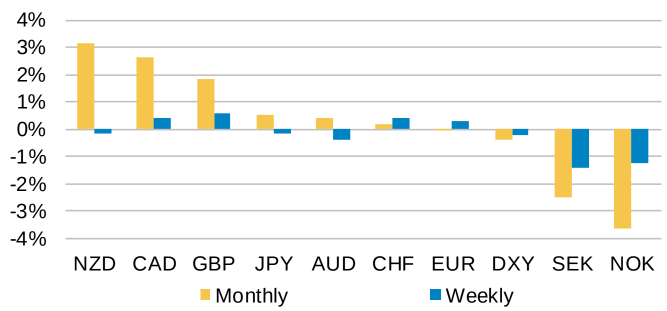
Note: Access is available to the carry metrics on an interactive basis on the *Morgan Stanley Matrix Platform*. Contact your Morgan Stanley sales representative if you do not have access. For a user's guide to this heatmap, please see *FX Pulse*, pg 22.

Click here for interactive charts
Morgan Stanley Matrix

G10 FX Tactical Indicators

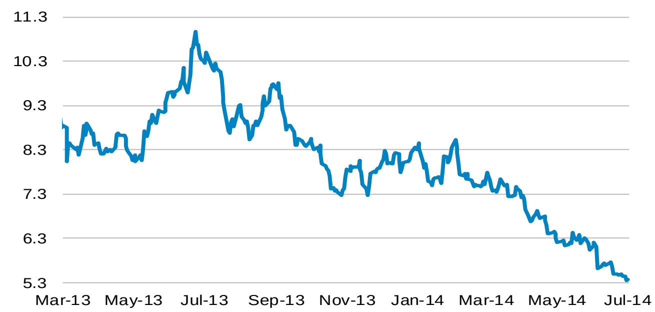
Vandit D. Shah

Exhibit 1
Historical Currency Performance



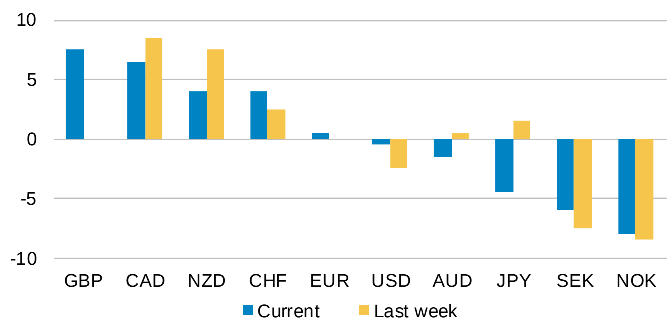
Source: Bloomberg, Morgan Stanley Research

Exhibit 2
FXVIX (FX Volatility Index)



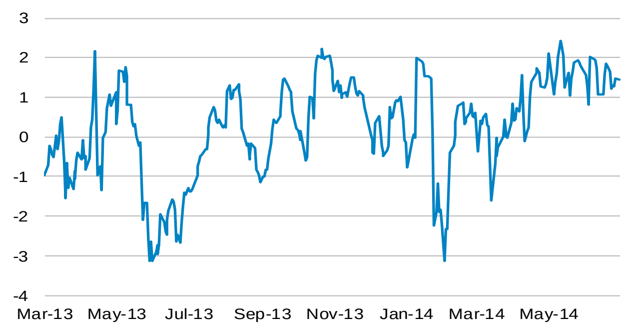
Source: Bloomberg, Morgan Stanley Research

Exhibit 3
Relative Momentum Indicator



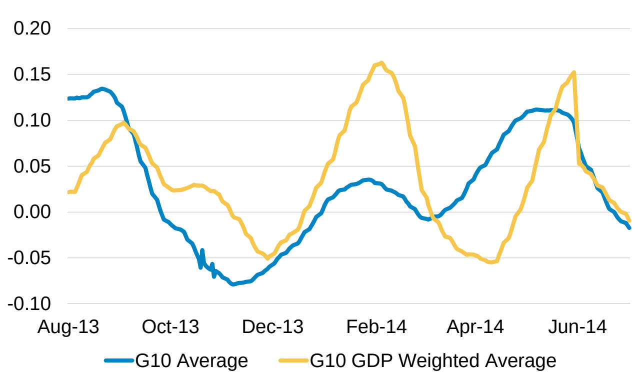
Source: Bloomberg, Morgan Stanley Research

Exhibit 4
MS GRDI – Standardized



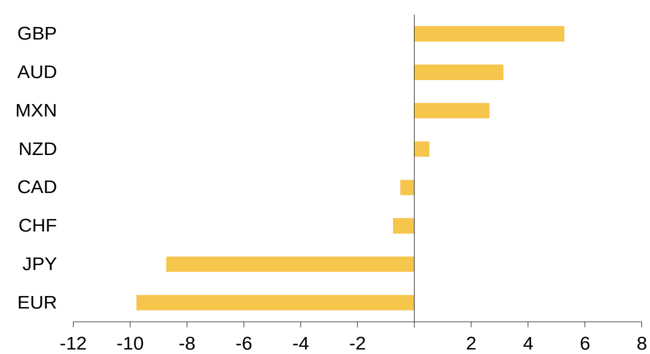
Source: Bloomberg, Morgan Stanley Research
Global Risk Demand Index – US Pat. No. 7,617,143

Exhibit 5
G10 Surprise Index



Source: Morgan Stanley Research

Exhibit 6
IMM Positions Summary ($bn)



Note: Aggregate USD positioning in nominal terms, see appendix for details.
Source: Bloomberg, Morgan Stanley Research

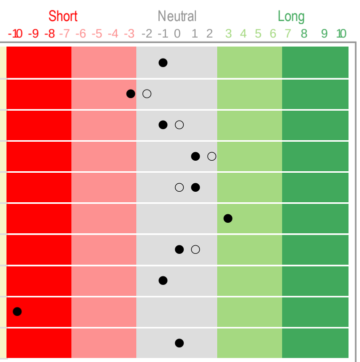
Click here for a full positioning history
Morgan Stanley Matrix

Morgan Stanley FX Positioning Tracker

Calvin Tse, Evan Brown

Overall Score

	This Week ●	Last Week ○
USD	-1	-1
EUR	-3	-2
JPY	-1	0
GBP	1	2
CHF	1	0
CAD	3	3
AUD	0	1
NZD	-1	-1
NOK	-10	-10
SEK	0	0



Component Scores

MS Flow	IMM	Toshin	TFX	Beta	Senti-ment	
6	-1		-3	-2	-7	USD
-9	-6		-3	0	3	EUR
-3	1	2	2	-3	-5	JPY
-2	10		-6	-3	7	GBP
6	-4				0	CHF
-2	3				7	CAD
-7	3		0		4	AUD
3	-6		-7		8	NZD
-10						NOK
0						SEK

- Since Monday, June 30, positioning in currencies has shifted. The largest long position is in CAD. The largest short in the majors is in EUR.
- EUR positioning moved into short territory from neutral. This was driven primarily by selling from Japanese retail.
- JPY positioning is moving towards short territory as both Toshin accounts and global macro hedge funds have been sellers of the currency.
- We will provide a full updated report and refresh positioning scores for all of our underlying sub-indicators on Monday.

For Methodology see Appendix

Morgan Stanley High-Frequency Misalignment Monitor

Morgan Stanley Matrix

2-Jul-14

1Yr

	EUR	JPY	GBP	CHF	AUD	CAD	NZD	NOK	SEK
USD	0.8%	2.7%	-0.1%	-1.1%	3.4%	2.3%	1.6%	-1.5%	-0.4%
EUR		1.9%	-1.0%	-1.9%	2.6%	1.5%	0.8%	-2.3%	-1.2%
JPY			-2.8%	-3.8%	0.7%	-0.4%	-1.0%	-4.2%	-3.1%
GBP				-1.0%	3.5%	2.4%	1.8%	-1.3%	-0.3%
CHF					4.5%	3.4%	2.7%	-0.4%	0.7%
AUD						-1.1%	-1.7%	-4.9%	-3.8%
CAD	> +/- 1 sd						-0.6%	-3.8%	-2.7%
NZD	> +/- 2 sd							-3.1%	-2.0%
NOK	> +/- 3 sd								1.1%

2Yr

	EUR	JPY	GBP	CHF	AUD	CAD	NZD	NOK	SEK
USD	1.1%	4.3%	-1.5%	-0.1%	4.4%	1.9%	1.8%	-6.4%	-0.5%
EUR		3.2%	-2.6%	-1.2%	3.3%	0.7%	0.7%	-7.5%	-1.6%
JPY			-5.8%	-4.4%	0.1%	-2.4%	-2.5%	-10.7%	-4.8%
GBP				1.4%	5.9%	3.4%	3.3%	-4.9%	1.0%
CHF					4.5%	1.9%	1.9%	-6.4%	-0.5%
AUD						-2.5%	-2.6%	-10.8%	-4.9%
CAD	> +/- 1 sd						-0.1%	-8.3%	-2.4%
NZD	> +/- 2 sd							-8.2%	-2.3%
NOK	> +/- 3 sd								5.9%

3Yr

	EUR	JPY	GBP	CHF	AUD	CAD	NZD	NOK	SEK
USD	0.9%	4.5%	-1.4%	-0.8%	1.0%	-1.5%	1.3%	-6.6%	-0.6%
EUR		3.6%	-2.2%	-1.6%	0.1%	-2.4%	0.4%	-7.5%	-1.5%
JPY			-5.9%	-5.3%	-3.5%	-6.0%	-3.2%	-11.1%	-5.1%
GBP				0.6%	2.3%	-0.2%	2.6%	-5.3%	0.7%
CHF					1.7%	-0.8%	2.0%	-5.9%	0.1%
AUD						-2.5%	0.3%	-7.6%	-1.6%
CAD	> +/- 1 sd						2.8%	-5.1%	0.9%
NZD	> +/- 2 sd							-7.9%	-1.9%
NOK	> +/- 3 sd								6.0%

Note: Misalignment measured as the overvaluation of the column currency versus the row currency

- The one-year model, which generates the most reliable trading signals, is showing plenty of misalignments this week. The Scandies, particularly NOK, are undervalued. AUD, CAD and JPY are significantly overvalued.
- Misalignments over a 2-year look-back window continue to show JPY and AUD overvaluation. GBP and in particular NOK are undervalued. NOKJPY looks like a convincing tactical long-trade.
- The model estimated over a three-year look-back window emphasizes NOK and GBP undervaluation. JPY again looks overvalued on our metrics.
- Our suite of high-frequency misalignment models suggests JPY is a good tactical short against GBP and NOK.

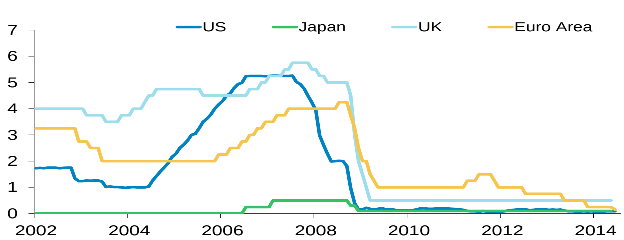
For Methodology, see Appendix

Central Bank Watch

	Next rate decision	Market expects (bp)	MS expects (bp)	Current	Morgan Stanley Forecasts 3Q14	4Q14	1Q15	2Q15
US	30 Jul	-1.0	0	0.125	0.125	0.125	0.125	0.125
Euro Area	07 Aug	2.0	0	0.15	0.15	0.15	0.15	0.15
Japan	15 Jul	0.0	0	0.10	0.10	0.10	0.10	0.10
UK	10 Jul	-0.1	0	0.50	0.50	0.50	0.75	0.75
Canada	16 Jul	0.0	0	1.00	1.00	1.00	1.00	1.00
Switzerland	17 Sep	-3.4	0	0.00	0.00	0.00	0.00	0.00
Sweden	04 Sep	-1.0	0	0.25	-	-	-	-
Australia	05 Aug	-1.4	0	2.50	2.50	2.50	2.50	2.50
New Zealand	24 Jul	21.7	25	3.25	3.50	3.50	3.50	3.75
Russia	25 Jul	-	0	7.50	7.50	7.50	7.00	6.75
Poland	03 Sep	-1.0	0	2.50	2.50	2.50	2.50	2.50
Czech Rep	31 Jul	-4.0	0	0.05	0.05	0.05	0.05	0.05
Hungary	22 Jul	-3.0	-10	2.30	2.00	2.00	2.00	2.25
Romania	04 Aug	-	-	3.50	3.50	3.50	3.50	3.50
Turkey	27 Aug	-17.0	-	8.75	-	-	-	-
Israel	28 Jul	-9.0	0	0.75	0.75	0.75	0.75	1.25
South Africa	17 Jul	24.0	0	5.50	5.50	5.50	5.50	6.00
Nigeria	22 Jul	-	-	12.00	13.00	13.00	13.00	12.00
Ghana	09 Jul	-	-	18.00	18.00	18.00	18.00	18.00
China	-	-	-	6.00	5.75	5.75	5.75	5.75
India	05 Aug	-	0	8.00	8.00	8.00	7.75	7.75
Hong Kong	18 Jul	-	0	0.50	0.50	0.50	0.50	0.50
S. Korea	09 Jul	0.0	0	2.50	2.50	2.75	3.00	3.00
Taiwan	30 Sep	30.0	-	1.88	2.00	2.13	2.25	2.38
Indonesia	10 Jul	-	-	7.50	8.00	8.00	8.00	8.00
Malaysia	10 Jul	8.0	-	3.00	3.25	3.25	3.25	3.25
Thailand	06 Aug	0.0	-	2.00	1.75	1.50	1.50	1.50
Brazil	16 Jul	1.0	0	11.00	11.00	11.00	12.00	12.25
Mexico	11 Jul	-	0	3.00	3.50	3.50	3.50	3.50
Chile	15 Jul	-10.0	-25	4.00	3.50	3.50	3.50	3.50
Peru	10 Jul	-	0	4.00	4.00	4.00	4.25	4.25
Colombia	31 Jul	26.0	0	4.00	4.00	4.00	4.00	4.00

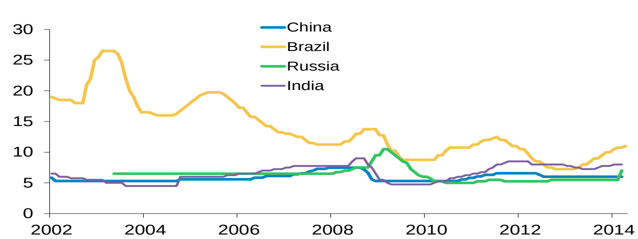
Source: National Central Banks, Morgan Stanley Research forecasts; Note: Japan policy rate takes a mid-range value. Market expects for G10 as of July 03, 2014. What's In the Price.

G4 Policy Rates



Source: Morgan Stanley Research, Haver Analytics

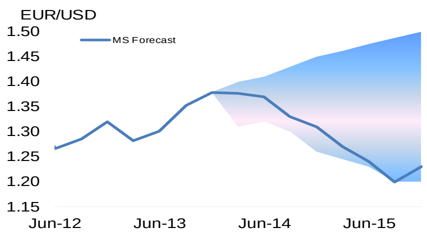
BRICs Policy Rates



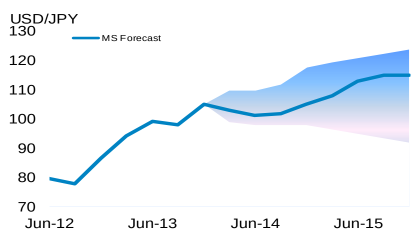
Source: Morgan Stanley Research, Haver Analytics

FX Bull/Bear Projections

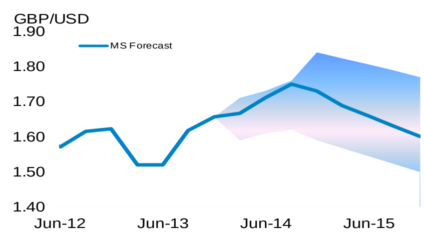
EURUSD



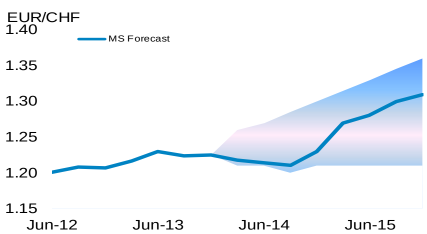
USDJPY



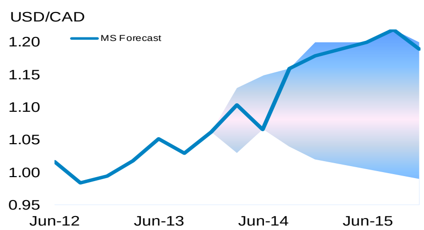
GBPUSD



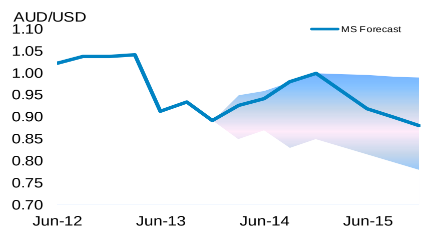
EURCHF



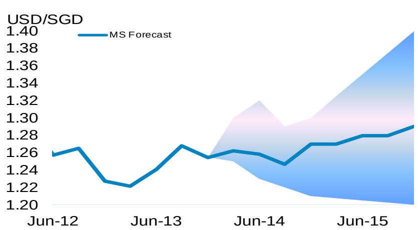
USDCAD



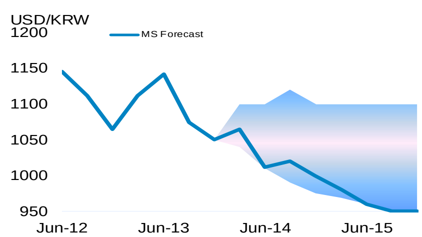
AUDUSD



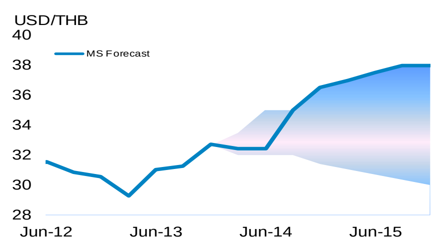
USDSGD



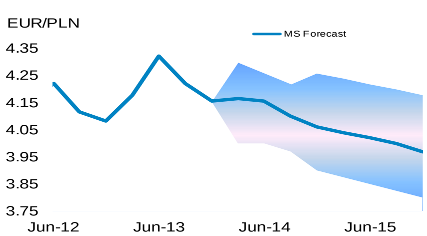
USDKRW



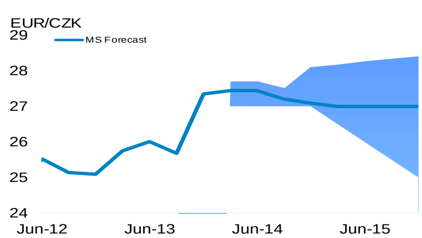
USDTHB



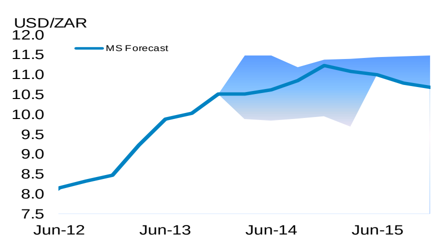
EURPLN



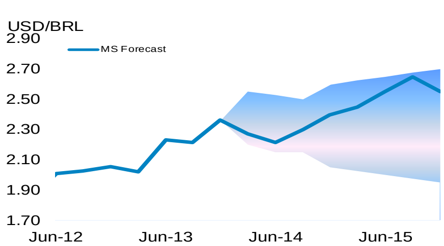
EURCZK



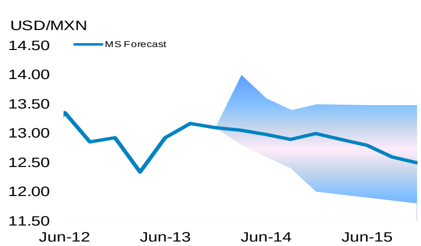
USDZAR



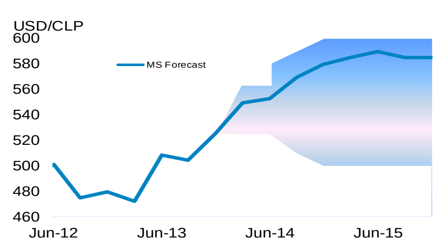
USDBRL



USDMXN



USDCLP



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

Click here for custom cross forecasts
Morgan Stanley Matrix

Morgan Stanley Global Currency Forecasts

- We updated our G10 and EM forecasts in the week of June 8.

	Current	2014			2015				2016	4Q14 % change to:	
		2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	Consensus	Forward
EUR/USD	1.37	1.37	1.33	1.31	1.27	1.24	1.20	1.23	1.23	-0.8	-4.1
USD/JPY	102	101	102	105	108	113	115	115	114	-0.9	3.2
GBP/USD	1.72	1.71	1.75	1.73	1.69	1.66	1.63	1.60	1.57	3.0	1.1
USD/CHF	0.89	0.89	0.91	0.94	1.00	1.03	1.08	1.07	1.08	1.0	5.8
USD/SEK	6.72	6.69	6.95	7.02	7.20	7.34	7.54	7.40	7.48	3.0	4.4
USD/NOK	6.17	6.13	6.13	6.26	6.54	6.65	6.83	6.67	6.75	3.1	0.7
USD/CAD	1.07	1.07	1.16	1.18	1.19	1.20	1.22	1.19	1.20	6.3	10.1
AUD/USD	0.94	0.94	0.98	1.00	0.96	0.92	0.90	0.88	0.88	11.1	8.1
NZD/USD	0.88	0.87	0.84	0.85	0.82	0.79	0.77	0.73	0.74	1.2	-1.3
EUR/JPY	139	139	136	138	137	140	138	141	140	-1.8	-1.1
EUR/GBP	0.80	0.80	0.76	0.76	0.75	0.75	0.74	0.77	0.78	-4.1	-5.1
EUR/CHF	1.21	1.21	1.21	1.23	1.27	1.28	1.30	1.31	1.33	-0.8	1.4
EUR/SEK	9.17	9.16	9.25	9.20	9.15	9.10	9.05	9.10	9.20	2.8	0.1
EUR/NOK	8.43	8.40	8.15	8.20	8.30	8.25	8.20	8.20	8.30	2.5	-3.4
USD/CNY	6.21	6.20	6.17	6.14	6.12	6.13	6.14	6.09	6.10	-0.2	-1.3
USD/HKD	7.75	7.75	7.80	7.80	7.80	7.80	7.80	7.80	7.80	0.5	0.6
USD/IDR	11945	11875	11800	12000	12100	12200	12300	12300	12300	0.8	-2.6
USD/INR	59.7	60.2	57.5	58.0	58.5	59.0	59.5	60.0	60.5	-3.2	-5.6
USD/KRW	1009	1012	1020	1000	980	960	950	950	950	-2.2	-1.6
USD/MYR	3.21	3.21	3.25	3.26	3.27	3.28	3.29	3.30	3.30	0.3	0.7
USD/PHP	43.6	43.7	44.0	44.1	44.2	44.3	44.4	44.5	44.5	0.5	0.9
USD/SGD	1.25	1.25	1.27	1.27	1.28	1.28	1.29	1.29	1.29	0.0	1.8
USD/TWD	29.9	29.9	30.6	30.7	30.8	30.9	31.0	31.0	31.0	3.0	3.1
USD/THB	32.4	32.4	35.0	36.5	37.0	37.5	38.0	38.0	38.0	10.6	11.9
USD/BRL	2.22	2.21	2.30	2.40	2.45	2.55	2.65	2.55	2.55	0.0	2.8
USD/MXN	13.0	13.0	12.9	13.0	12.9	12.8	12.6	12.5	12.3	1.6	-1.1
USD/ARS	8.14	8.13	8.80	9.20	9.73	10.29	10.88	11.50	11.50	-1.1	-4.8
USD/VEF	6.29	6.29	6.30	12.00	12.00	14.00	14.00	14.00	14.00	0.0	90.7
USD/CLP	552	553	570	580	585	590	585	585	580	2.4	3.2
USD/COP	1857	1877	1920	1930	1980	1980	1970	1970	1960	-0.4	2.0
USD/PEN	2.79	2.80	2.80	2.82	2.84	2.86	2.88	2.90	2.90	-0.4	-0.7
USD/ZAR	10.77	10.63	10.85	11.25	11.10	11.00	10.80	10.70	10.70	4.2	1.3
USD/TRY	2.13	2.12	2.15	2.20	2.20	2.17	2.15	2.12	2.10	1.4	-0.3
USD/ILS	3.43	3.43	3.50	3.48	3.46	3.45	3.44	3.43	3.42	-0.3	1.5
USD/RUB	34.2	34.0	35.3	36.5	36.0	37.0	37.5	38.0	38.3	1.7	2.6
RUB basket	39.81	39.6	40.5	41.6	40.4	41.0	40.88	41.93	42.26	1.3	0.3
EUR/PLN	4.15	4.16	4.10	4.06	4.04	4.02	4.00	3.97	3.95	-1.0	-3.2
EUR/CZK	27.44	27.45	27.20	27.10	27.00	27.00	27.00	27.00	27.00	-0.6	-1.1
EUR/HUF	312	310	302	298	296	294	292	290	288	-2.5	-5.1
EUR/RON	4.39	4.38	4.42	4.38	4.35	4.33	4.33	4.30	4.30	-0.5	-0.9
MS Dollar Index	80.09	80.13	82.09	83.51	85.64	87.78	89.82	89.01	89.40		
MS AXJ Index	108.03	107.97	108.09	108.26	108.40	108.54	108.37	108.39	108.24		

Source: Morgan Stanley Research

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.

The FX Tactical Indicators table highlights the most recently updated indicators we, as a research team, use as inputs to generate both longer and more tactical forecasts. **Matrix** charting codes are given in brackets. Change the G10 currency in italics as required.

•**Historical Currency Performance**: Price changes in currency over the past week and past month. ***(EURUSD)***
•**FXVIX (Volatility Index)**: An index of 3 month implied volatility calculated using 30 G10 and EM crosses **(MSFXVIX)**
•**Relative Momentum Indicator**: Measures the momentum of a currency relative to all other currencies; not indicative of historical performance. **(MSRM*US*)**
•**MS GRDI*:** An index to assess risk sentiment. It looks at ten different asset classes to gauge risk demand. The GRDI index seen in the graph is a standardized reading of the index based on the 365-day rolling average. **(GRDIIDX)**
•**G10 Surprise Index**: Measures the performance of actual economic data in G10 countries relative to expectations. G10 Average Index is a simple index; G10 GDP weighted average is based on GDP weights. **(MSSI*USD*)**
•**IMM Commitment of Traders Report**: The "Aggregate USD Index" is the cumulative aggregate positioning of currencies we track on the IMM against the USD. We combine IMM positioning on the AUD, CAD, CHF, EUR, GBP, JPY, and MXN to calculate an aggregate USD index to measure overall net positioning. **(MSPI*US*)**

FX Positioning Tracker Methodology (MSPI*US*) *See the primer*

•**MS Flow** - Our internal flow data track all spot and forward trades transacted by Morgan Stanley FX globally.
•**IMM** - We use the US Commodity Futures Trading Commission's IMM report to track positioning of non-commercial traders.
•**Toshin** - The Toshin accounts are Japanese foreign currency investment trusts that seek yield abroad. They typically cater to retail investors and offer a higher return by investing in foreign assets on a currency un-hedged basis.
•**TFX** - The Tokyo Financial Exchange (TFX) measures Japanese currency trading on margin accounts, and comprises an estimated 10% of the retail margin market.
•**Beta** - As an alternative proxy for positioning, our Beta-Tracker measures one-month rolling betas of currency managers' and global macro hedge funds' daily returns on major currency indices.
•**Sentiment** - The Daily Sentiment Index gathers opinions on all active US futures, eurozone interest rates, and eurozone equities futures markets.

Morgan Stanley FX High Frequency Misalignment Monitor Methodology: *See the full report* (MSSTM*EUR*)

Historic 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

* US Pat. No. 7,617,143.

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