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UPDATE

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FX Pulse

The ECB Can't Weaken the EUR

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Fed's USD rally limited. The Fed's broad USD index has bounced back with Fed hike expectations. Better US data – including rebounding fixed investment, benign financial conditions and increasing concerns about low rates for longer – have sparked mis-allocation risks, and this seems to have influenced the debate. However, the Fed is on course to miss its inflation target again and with weak productivity suggesting corporate profitability and investment returns will remain lackluster, any tightening of monetary conditions needs careful consideration and implementation.

EM high yield inflow to stay strong. If the Fed does hike, then we expect it to be a 'dovish hike', coming with a further downside adjustment of the Fed's assumed terminal rate. In this week's pulse, we discuss several reasons why conditions for EM are better even if the Fed does hike this year, and could offer some protection. We believe higher yielding currencies with positive idiosyncratic stories (such as IDR and BRL) should outperform, while we remain cautious on low yielding Asia.

Low-yielding AxJ FX has topped out. With China turning from a growth toward a deflation risk, the EM block may break into two halves. Fixed income flows into low-yielding AxJ have abated and low CPIs could bring the monetary easing debate back into focus, weakening the currencies. These currencies may soon convert from an asset toward funding status, with KRW and SGD looking most vulnerable.

Further EUR and CHF strength, JPY weaker for now. Low bond yields make the ECB's easing policy ineffective on the EUR. In addition, financial institutions unable to export sufficient EUR- and CHF-denominated capital to recycle external surpluses should help their currencies. Stronger currencies however only enhance deflationary risks. Ahead of the 21 September BoJ meeting, the JPY should remain offered with USDJPY testing 108.

GBP relief rally. Post-Brexit-vote data holding up well should keep the GBP relief rally going for now. Any sign that the UK is considering a 'hard Brexit' instead of keeping EMU market access would likely terminate the GBP rally abruptly.

Exhibit 1: Current Trade Portfolio

Closed Trades			
Short USD/IDR 3m NDF	Close at NY Close on 1-Sep-16		
Short USD/SEK	Closed at 8.60 on 1-Sep-16		
Active Orders	**Entry**	**Stop**	**Target**
Short CAD/NOK	6.46	6.59	5.98
Short CHF/SEK	8.74	8.90	8.25
Long EUR/KRW 1m fwd	1261	1220	1300
Long PLN/ZAR	3.70	3.60	4.00
Short USD/BRL	3.24	3.40	3.00
Limit Orders	**Entry**	**Stop**	**Target**
Buy EUR/AUD	1.45	1.42	1.54
Sell SGD/IDR 1m fwd	NY Close 1-Sep	9850	9500
Buy EUR/JPY	113.30	112.30	120.00

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

FX Overview

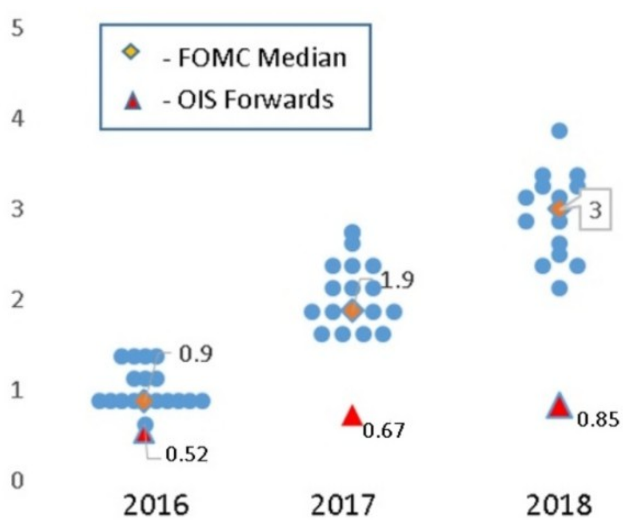
Hans Redeker

Bottom line: We maintain our bullish EUR view, but think the JPY will come under temporary selling pressure from here as markets react to recent weak Japanese data releases which are pushing the BoJ closer to progressive easing steps. We believe USDJPY could reach 108. GBP is due for a short covering rally as the UK's post-Brexit economy does not look as weak as feared. However, UK politics' potential to turn toward a hard Brexit has imposed a new long-term bearish sterling risk. Global deflation pressures have remained intact, suggesting the Fed will stay slow when adjusting rates. Hence, the current USD rally is likely to quickly run out of steam, with high-yielding EM remaining resilient (IDR, INR, BRL). However, the high-yielding EM carry trade may see increasing funding flows coming out of low-yielding AxJ.

Why USD strength is limited. The chorus of Fed officials calling for higher interest rates has become louder, with even previously dovish Fed officials like Williams, Dudley and Rosengren arguing the case for the Fed hiking rates earlier than our MS expectations. Likewise, officials have made clear that markets should not assume the Fed will hike rates aggressively. Instead, the neutral real rate assumed by Fed officials has come down, suggesting the Fed may opt for a 'dovish hike,' if it should hike. Hence, the impact that higher US short-term rates has on long-term yields should be muted.

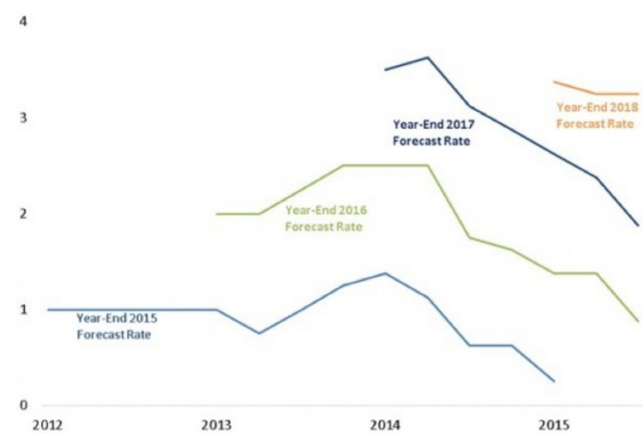
Markets are nowhere near the scenarios of 2013's 'taper tantrum' or December 2015 when the Fed hiked rates for the first time since 2006. In both cases, investors assumed higher terminal rates, pushing over-positioned bond markets into higher yield environments. During the 'taper tantrum', US 10y yields topped out near 3%, and in December 2015, bond yields reached 1.95%. Our rates strategy team argues that US bond yields may have already peaked even if the Fed would opt for higher interest rates. Hence, rate-related USD strength should be short-lived.

Exhibit 2: FOMC versus market expectations



Federal Reserve

Exhibit 3: Fed rate projections have come down



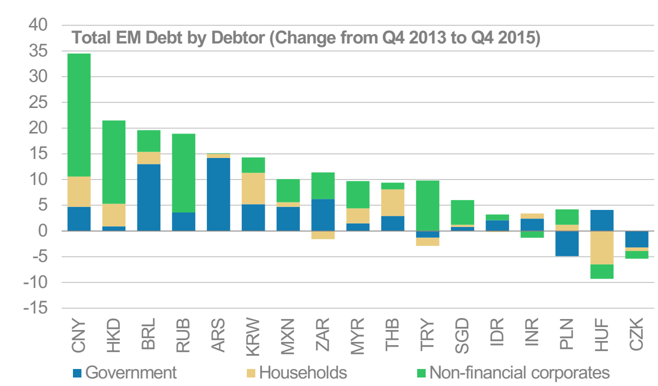
Federal Reserve

The case for a slow Fed stays in place. US inflation expectations have not recovered and our PCE projections suggest the Fed missing its inflation target for the eighth year in a row. Indeed, hiking rates when there is high debt and low investment returns bears the risk of balance sheets de-leveraging at a faster than wanted pace. This applies not only to the US. Global debt levels are at record highs and investment returns – due to overcapacities – have remained too low to be able to withstand higher funding costs without impacting medium term growth prospects. Here we agree with Larry Summers' warning that the Fed hiking early could dampen medium-term growth prospects.

Despite recent data strength, we would regard it as a mistake for the Fed to hike rates when inflation expectations are pointing lower. Proponents of an early, pre-emptive Fed move suggest time lags of monetary policy would require the Fed operating 'ahead of the curve', preventing inflation to overshoot. This interpretation had its merits within lower leveraged economies with sufficient investment returns. Those days are gone. Leverage is high and profitability is low. Worse, productivity trends have globally weakened and in the US productivity has stopped expanding at all.

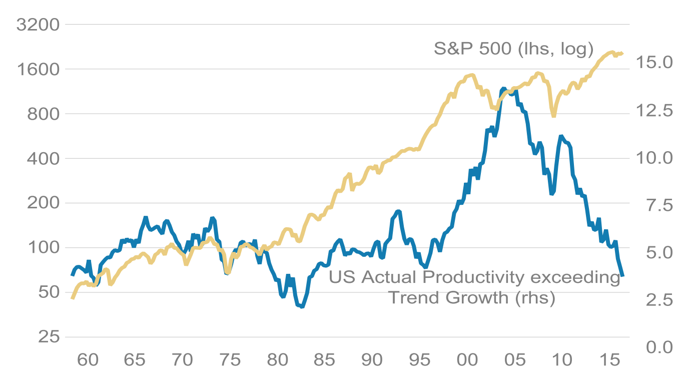
Productivity weakness has currency implications working from two angles. First, weak productivity undermines corporate profitability returns and second, it suggests to the Fed to apply a weaker terminal rate and lower the real neutral rate. Hence, the Fed hiking rates is likely to see bond yields staying – despite the low term premium – stable. Accordingly, the impact of higher US interest rates on cross-border capital flows will remain muted unless the Fed leaves the impression that it wants to hike rates at a quickened pace.

Exhibit 4: Global leverage has reached record levels



BIS, Morgan Stanley Research

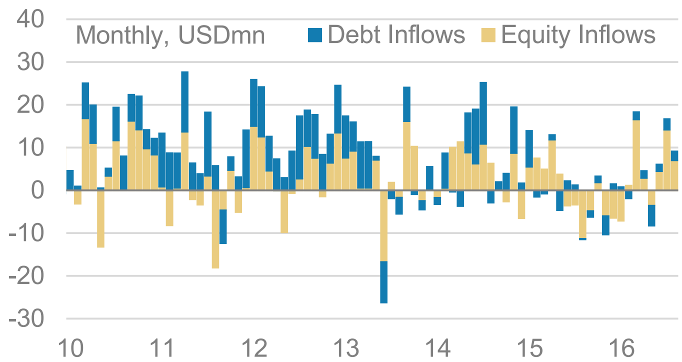
Exhibit 5: US productivity has declined relative to its 10-year average, leaving an ambitious asset valuation behind



Macrobond, Morgan Stanley Research

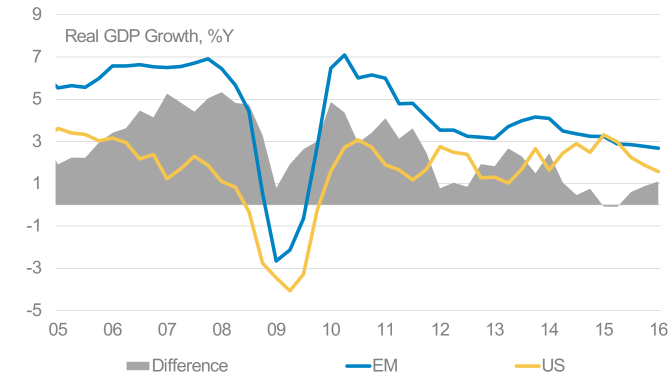
USD/EM still heading lower. Ironically and unlike previous occasions where markets discussed the prospects of higher US interest rates, we expect the USD to turn lower against high-yielding FX. Indeed, the current setup is in sharp contrast to what we saw in 2013 and 2015 when EMFX weakness was pronounced. There are a number of reasons for the contrast. First, high-yielding EMFX is particularly sensitive to the evolution of long-end US yields. With US bond yields likely staying muted, the incentive to liquidate the EM carry trade is low. Nominal and real yield differentials may remain attractive as US bond yields stay near current levels. Second, the aggregate current account deficit for high yield EM has turned into a surplus, suggesting the region is now capital self-sufficient. Third, EM capital inflows, although slowing down from July highs, have remained positive. Fourth, EM-DM growth differentials have widened recently (Exhibit 7), reversing the contracting trend that had been in place since 2012.

Exhibit 6: EM inflows have moderated from July levels, but have remained EM asset class supported



Bloomberg, Morgan Stanley Research

Exhibit 7: The EM-DM growth differential has widened



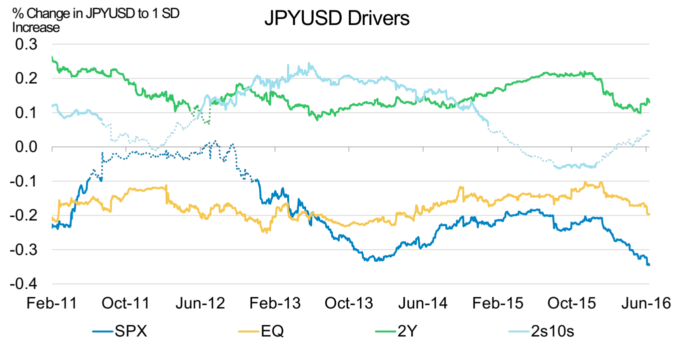
Haver Analytics, Morgan Stanley Research

EUR and CHF supported. A higher Fed rate would likely support the USD vs. currencies sensitive to front-end rate differentials. Generally, low-yielding currencies fall into this category, but even here differentiation is required. The EUR and CHF should remain supported as both regions have financial institutions with weak balance sheets and so are unable to export sufficient local-currency-denominated long-term capital to compensate for the current account surpluses. Resistance from core EMU countries to more aggressive policies that could push inflation rates higher should keep local real rates high, pushing the EUR and CHF higher against most other currencies.

Where we stand on the JPY. For now, JPY may be in a better position to weaken in light of higher US interest rates, suggesting EURJPY and CHFJPY could trade higher in the short term. Both the BoJ and the Fed will decide on interest rates on 21 September. Should Friday's US unemployment report come in strong, expectations about an early Fed hike will ride high, lending USDJPY support via prospects of higher US interest rates.

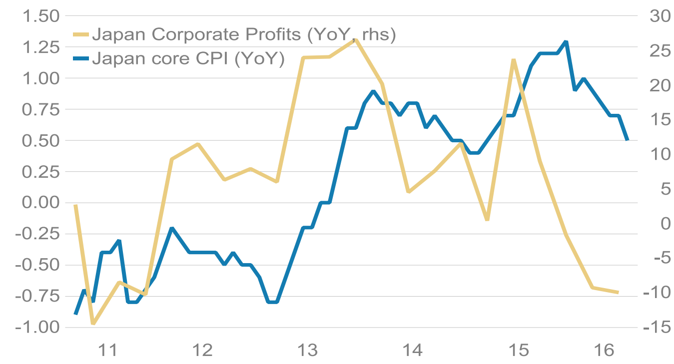
An even greater impact on the JPY could come from the interpretation of BoJ policy. Policy tools, including negative interest rates, QE and the BoJ buying private sector assets, have failed to increase Japan's growth and inflation outlook. Nominal GDP growth has remained disappointing and voices of those seeing increasing risks of 'Abenomics' to fail have become louder. This week, it has been PM Abe's adviser Hamada openly discussing aggressive debt monetisation, reiterating his call for Japan's authorities to buy foreign-currency-denominated bonds. It seems the renewed decline of Japan's business activity at the start of Q3 may spark another discussion about a more aggressive monetary and fiscal approach. This debate could have a profound impact on the JPY in the run-up to the BoJ meeting. Should the BoJ fail to deliver and not enter a more progressive approach, going beyond its current NIR and QQE approach, USDJPY may fall back again.

Exhibit 8: JPY still driven by front-end yields



Bloomberg, Morgan Stanley Research. Note: Dependent Variable is daily % chance in CCY vs USD. Regression is calculated on the standardized daily % changes for S&P and Relative Equity and standardized daily changes in bps for the rest. Rolling window is 252 trading days. Dotted lines signal statistically insignificant at the 5% confidence level.

Exhibit 9: Japan's core inflation declines as corporate profitability deteriorates



Macrobond, Bloomberg, Morgan Stanley Research

Central bank inflation target debate. Globally, a new way of thinking is making the rounds. Inflation targeting is no longer regarded as a static approach. San Francisco Fed President John Williams discussed the advantage of using a higher inflation target given the fall in neutral real rates. In Sweden, the Riksbank started a debate in April about softening its inflation target and members of the government in Australia have promoted the idea of targeting nominal GDP instead of the more static inflation-targeting approach. To the extent that a country's policy change would imply higher inflation over time (which is likely for a nominal GDP target), we should expect that country's currency to depreciate (given the effect of rising inflation in pushing the real effective exchange rate higher).

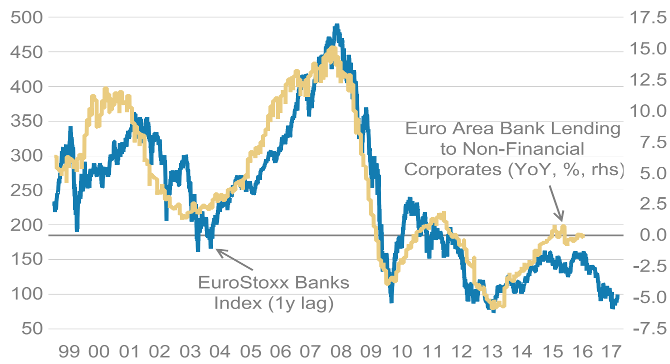
Fiscal policy debate. In addition, there is a renaissance of growth-supportive fiscal policies. After having relied for almost six years entirely on monetary policies to increase inflation expectations, authorities increasingly consider – despite high debt levels – reengaging in higher fiscal expenditures to boost inflation expectations. Interestingly, Japan, running the highest debt levels globally, seems most willing to use a more aggressive fiscal approach.

Fiscal policy debate in the Eurozone. The EMU is not leading the debate about policies; instead, it lags. Italy is considering more fiscal spending to deal with the devastating damage to its infrastructure caused the recent earthquake, but that is all we should expect to see. The EMU is not ready to remove the debt brakes implemented in 2009, even if fiscal stimulus could boost the economic outlook. A similar interpretation applies to the inflation target discussion. All in all, the EMU's policy approach will not be progressive enough to sufficiently boost its inflation expectations, allowing its real rate levels to fall to a level that would weaken the currency.

Internally, the EMU may find it difficult to boost inflation given the slack within its labor market, its poor corporate profitability and weak financial institution balance sheets preventing credit picking up. Exhibit 12 shows the weak banking sector share price performance, predicting weaker credit growth within the eurozone. A central-bank-induced liquidity impulse will find it difficult to develop multiplying effects, but without improving credit demand inflation is unlikely moving higher.

International aspects have stayed deflationary too. Commodity prices have rolled over and China's exchange rate adjusted PPI, now falling at a 7.5%Y rate, does not bode well for the G-7 core inflation outlook as illustrated in Exhibit 11

Exhibit 10: Falling EMU bank equities predict credit to decline



Bloomberg, Macrobond, Morgan Stanley Research

Exhibit 11: Imports from China come at ever cheaper costs

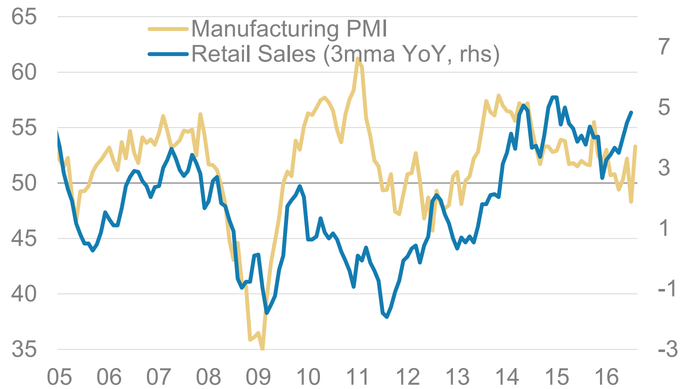
Bloomberg, Macrobond, Morgan Stanley Research

The EMU's disruptively high real rates could not only undermine fixed asset investment prospects within EMU they may also take the EUR into overvalued territory. The EUR does not rise due to a better economic outcome within EMU. Instead it may rise due to the lack of capital exports held back by balance sheet constraints of EMU financial institutions and too high real EUR rates allowing the recycling of EMU's current account surplus at current FX levels. For now, the EUR may punch well above its economic weight. Due to the 'exhausted' position of EMU's yield curve, there is very little the ECB can do to prevent EUR strength.

GBP has recovery potential from here as post-Brexit data have come in stronger than anticipated. Even the August house price index has firmed up again, joining with stronger retail sales and labour market conditions. Against this background, the oversold but still yielding GBP may bounce back. In the short term, GBP may well be the best performing G10 currency, especially offering recovery potential against the JPY. Even against the otherwise strong EUR, GBP may gain 3% over the next few months.

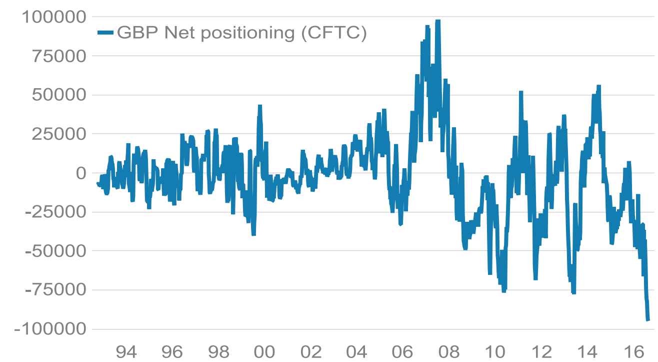
The current situation may leave the impression that Brexit risks were overblown. Despite our short-term-constructive GBP view, we are not complacent about post-Brexit risks. We could go even as far as arguing that the absence of near-term economic weakness may increase long-term GBP risks. First, the UK's domestic demand strength could push the trade and current account balance further into deficit, increasing foreign funding needs. Second, and more important, is the political impact of current economic calmness. The absence of a cohesive opposition party (Labour) allows the Tory government to run its own opposition. PM May has ruled out early elections (for which legal hurdles are now higher) and a second EMU referendum. She has used 'out means out' frequently to keep the right wing of her party under control. The problem is that the Tory party's Brexit camp is now advocating for a hard exit, suggesting that maintaining full EMU market access no longer seems a top priority. A 'hard exit' strategy implemented by the British government would not only weaken the economic outlook, in our view, it would also raise questions about Scotland's status within the UK. All in, a GBP rebound should be limited and reverse later this year.

Exhibit 12: UK Retail Sales and PMIs looking Up



Bloomberg, Morgan Stanley Research

Exhibit 13: Short GBP positioning is at an extreme



Bloomberg, Macrobond, Morgan Stanley Research

China keeps global prices low and ... The Fed increasing USD funding costs, falling commodity prices and China-related stability risks are the most often named risks for EM assets staying supported. With the Fed aiming for a dovish rate hike - if it hikes at all - keeping EM-relevant US long-term bond yields under control, the Fed's bearish impact on EM should be limited. What remain potential risks to derail the EM rally are bearish commodity price moves and markets putting China's economic stability into question.

Over the past three years China's seeing its real economic growth slowing from 12% in 2012 to 6.8% this year had profound negative effects on EM economies' trade, commodity prices and EM asset and FX valuation. While we expect China growth to stay weak, the delta on global growth should be lower given reduced risks of a similar 'hard landing' over the next few years. In addition, China does not represent a credit risk, as its corporate sector debt mainly sits with SOEs funded by local, not foreign, creditors. However, China's overcapacity combined with RMB weakness have dampened China's export prices. Given the significance of China for global trade, the deflationary implications could hardly be overestimated.

....hence liquidity conditions supportive. China shifting from a 'growth' toward a 'price' risk should have implications for asset markets. When China growth risk dominated, it mainly hurt EM and particularly China's trading partners or those countries whose terms of trade weakened due to falling commodity prices. The price risk will work differently. Falling inflation rates raising real rates may reduce the growth outlook too as leveraged companies and households increase savings. These savings will find their way into global financial markets. First, they will support local markets and then, via rising interest rates and yield differentials, lead to weaker local FX.

AxJ's significant fixed income rally has not only been supported by domestic savings piling in but also by foreign funds, reminding us of what happened in the Eurozone in 2013. Here too the rebound of EMU economies created savings piling into EUR-denominated bonds. Foreign funds participated here too, leading to the rare combination of sharply falling local bond yields and a higher EUR. AXJ surplus currencies currently create a similar experience, with higher currencies despite yield differentials turning less FX supportive. The EMU experience taught us to prepare for the time when AXJ surplus currencies may convert from an asset toward a funding status. We think, we may be closer to this switch than often currently assumed by the market consensus.

Low-yielding AxJ currencies may convert from asset to funding currencies. Hence, FX weakness should be concentrated here. However, the outcome for high-yielding currencies will be different. Here, the combination of global deflationary pressures keeping DM and low-yielding AXJ central banks accommodative and investors looking for investment opportunities will lead to inflows. Take Indonesia as an example. Inflation has eased from around 7% to 2.8%, boosting real yields to levels above 5%. Within an environment where an increasing amount of DM bonds trade at negative yields, the inflow into high-yielding EM is likely to remain strong.

Why EM should not dread the Fed

Dara Blume, James Lord, Gilberto Hernandez-Gomez

Market pricing of the probability of a Fed hike has risen dramatically over the past month, from 20% and 35% for September and December respectively at the start of August to roughly 33% and 66% today. Our economists' base case is for no hikes over the foreseeable time horizon, given persistently low inflation expectations, our own forecasts for low growth, and a stable real equilibrium real interest rate (US Economics: In the Wake of Jackson Hole (30 Aug 2016)), though recognise the risk of a hike is rising. Given the base case, we therefore like to fade USD rallies, but even if the Fed does tighten we believe that EM will still trade well provided the pace of expected future hikes remains subdued.

Regardless of one's view of whether or not the Fed will tighten, however, it's interesting to note that USD/EM has not moved as much as one might expect given the shift in market pricing of Fed hikes. Since the end of July, our MSPOKE indicator, which measures the market implied pace of hikes for the next twelve months, has risen by 38 basis points. At the same time, USD/EM has rallied 0.3%. As a comparison point, over October 2015, this pace of tightening rose by 77 bp, but drove a 0.9% move in USD/EM.

Exhibit 14: MS POKE and USD/EM

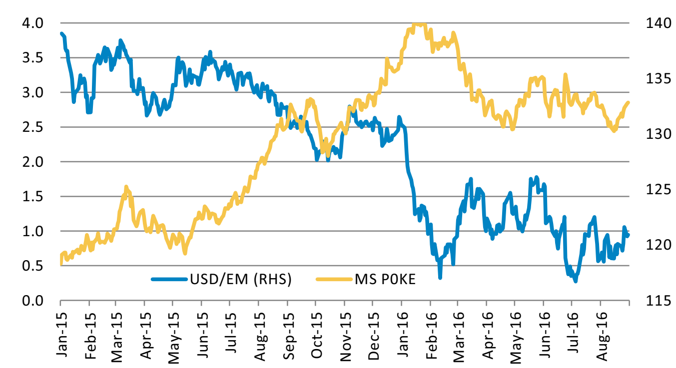


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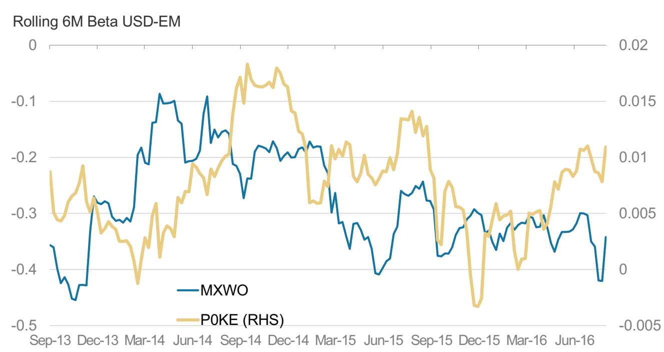
Exhibit 15: USD/EM Beta to MXWO and POKE



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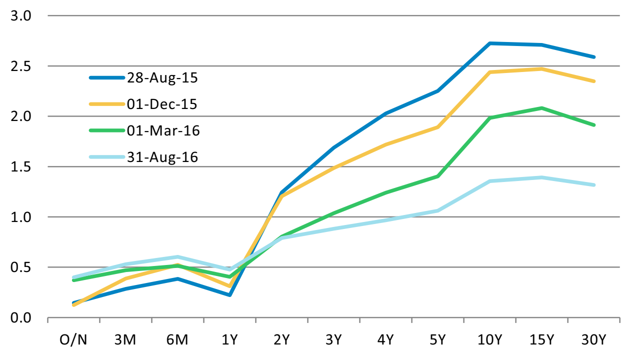
To investigate this further, we look at the rolling beta of MSPOKE on USD/EM. Our goal is to estimate what expectations of Fed hiking will do to EM FX, but we want to isolate this impact as much as we can – that is to say, we want to ensure we are capturing the impact of tighter Fed policy, rather than the broad risk environment. For this reason, we control for risk via the MSCI World. Our results suggest that, for the most part, as one would expect, MSPOKE is positively correlated with USD/EM.

While our base case is that the Fed doesn't hike, it's worth considering what could happen if we're wrong. As markets begin to price in a higher chance of a rate hike in December, we see reasons to believe this time is different. A lot has changed since the fourth quarter of last year when the Fed last hiked. Commodity prices have stabilized, albeit at low levels. The last large scale CNY devaluation was more than six months ago. Importantly, there has been some fundamental improvement in EM, especially at the margin (see FX Pulse: Doubling Down on EUR Strength (25 Aug 2016)).

Perhaps the biggest difference, however, and one of the reasons we think that even if we're wrong on

Exhibit 16: 1M OIS Forward Curve



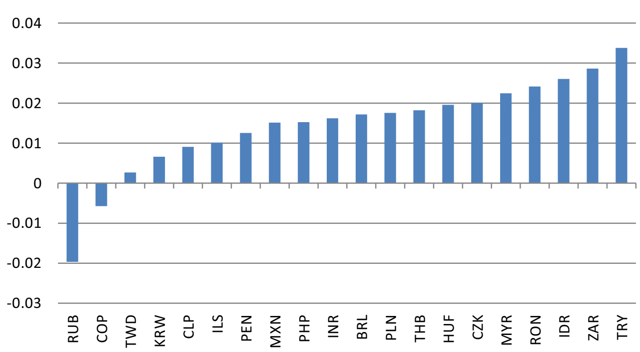
Bloomberg, Morgan Stanley Research

the timing of the Fed hike there is reason to believe that EM can still rally, is that the market is now pricing in far fewer cuts going forward than it was last year at this time. As mentioned above, the market now believes the real equilibrium interest rate is low. The Fed has consistently brought down its long term rate forecast. Over the next five years, the market is currently pricing in roughly 65 bp of hikes. At this time last year, this number was nearly four times as large, at 210 bp.

There's also an argument to be made that it is the uncertainty of the hike, rather than the hike itself, which concerns markets. Note that as we approached the December Fed hike, the beta of POKE on USD/EM fell, and actually moved negative the week before the hike. Given the improved fundamentals mentioned above, it's possible that even if the Fed does hike, we could see a similar shift in beta. This could be even more dramatic than last year given how much flatter the US rates curve is now.

As a result, we believe that even if the Fed does hike, it's unlikely to weaken EM much, and in fact any weakness in EM FX would in time be faded.

Exhibit 17: Sensitivity to Increases in POKE



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There could be some turbulence into the hike, however, and it's worth examining which currencies have been most sensitive to tightening historically. To do this, we isolate ten 20-40 day episodes since mid 2013 which saw large upward moves in POKE. We calculate the sensitivity of each currency by dividing its move in each episode by the corresponding move in POKE, and then taking the average sensitivity over all the periods. Our results are not hugely surprising. High beta currencies TRY, ZAR, and IDR have been most at risk in the past, on this analysis. Of these, we see the first two, TRY and ZAR, as particularly vulnerable given their still challenged fundamentals and large year to date moves. Indonesia's progress both in terms of the reduction in external vulnerabilities, as shown by improvement in the current account deficit, as well as the drop in inflation, suggests that it may not be as vulnerable this time around as in past episodes. On the other hand, we think that RUB and COP's vulnerability may be masked by the fact that they are both oil exporters. Rising oil prices likely boost US inflation expectations, boosting the market expectation of tightening at the same time as supporting RUB and COP. It's worth noting as well that PLN and BRL did not see outsized moves in their currency during previous tightening cycles. This supports our long position in both currencies.

For us, the bottom line is that so long as markets keep pricing in a slow pace of tightening beyond the Fed, EM should remain supported. To avoid the turbulence as we navigate the next few months, we prefer to avoid being long currencies with challenged fundamentals and historically high sensitivities to Fed rate hikes - TRY and ZAR stand out here. Relative value trades such as our long PLN/ZAR position also make sense. We also like being long currencies that offer carry and positive idiosyncratic stories, and haven't been underperformers in previous bouts of expected Fed tightening - we hold our short USD/BRL position. The cheap valuation and attractive yields on offer in Indonesia leave us long IDR, particularly amid the improvement in key fundamental metrics. We have however rotated out of short USD/IDR and into short SGD/IDR. As we head toward the Oct MAS meeting, we expect to see SGD underperformance. We are underweight the low yielding currencies in Asia. Recent downside surprises in inflation leave us more confident in our long EUR/KRW position.

Technical Chart of the Week

Sheena Shah

As the markets have priced in higher probabilities of the Fed hiking rates this year, there are signs emerging that the rally in some USDCCY's has become overextended on a technical basis.

Spot vs moving averages. On our scale of G10 and EM currencies, USDPEN and USDCLP appear to have moved the most relative their 50DMAs, indicating there is room for a short-term correction in these pairs. At the other end of the scale, the size of the divergence between spot and the 50DMA is not large. Only USDILS stands out as having underperformed in the recent USD upswing. USDILS hasn't quite reached the lower end of the trend channel, which is around 3.72.

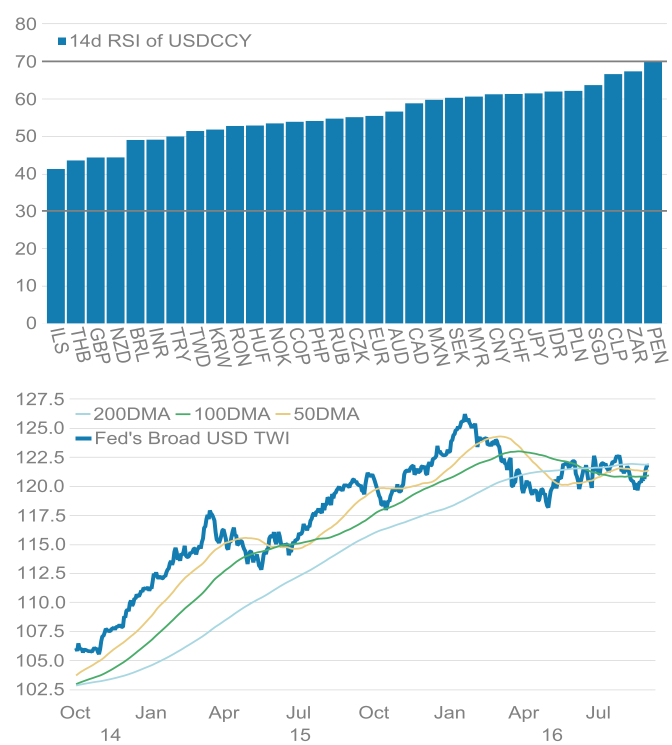
Overbought based on RSI? Similar to the MA analysis, USDPEN and USDCLP are approaching overbought territory with the 14 day RSI at 70 and 67 respectively. USDGBP is no longer in overbought territory (44.6) as it was reaching in the middle of August, indicating there is room for downside for this pair. USDJPY RSI at 62 is not quite yet overbought but should be watched as the pair has not had a 14d RSI above 64 this year.

The Fed's Broad USD Index indicates that it is sitting exactly at the 200DMA. The index appears to still be trading within a range, 0.7% away from the upper end. There are few signs of overextension here.

Exhibit 18: Spot relative to Moving Averages

% away from spot	50DMA	100DMA	200DMA
USDILS	-1.3%	-1.1%	-1.9%
USDNZD	-1.3%	-3.2%	-5.6%
USDHUF	-0.9%	-0.3%	-1.1%
USDTHB	-0.8%	-1.3%	-2.1%
USDGBP	-0.7%	4.0%	6.5%
USDBRL	-0.7%	-4.5%	-10.8%
USDKRW	-0.7%	-2.2%	-3.9%
USDRON	-0.6%	-0.1%	-1.0%
USDTWD	-0.4%	-1.3%	-2.5%
USDNOK	-0.4%	0.6%	-1.2%
USDINR	-0.2%	0.0%	-0.1%
USDPHP	-0.2%	0.1%	-0.3%
USDTRY	-0.2%	0.7%	0.8%
USDCZK	-0.2%	0.6%	-0.3%
USDEUR	-0.1%	0.7%	-0.2%
USDPLN	0.1%	0.5%	0.0%
USDCNY	0.3%	1.2%	2.0%
USDCOP	0.3%	0.0%	-4.1%
USDAUD	0.4%	-0.5%	-2.1%
USDSEK	0.7%	2.6%	2.1%
USDCAD	0.7%	1.4%	-1.3%
USDIDR	0.9%	0.1%	-1.0%
USDJPY	0.9%	-1.8%	-6.6%
USDCHF	0.9%	1.1%	0.3%
USDRUB	0.9%	0.2%	-5.2%
USDSGD	1.0%	0.7%	-0.9%
USDMXN	1.2%	2.4%	4.1%
USDMYR	1.3%	1.3%	-0.6%
USDPEN	2.2%	2.3%	0.7%
USDZAR	2.9%	0.0%	-3.0%
USDCLP	3.0%	1.6%	-0.7%

Exhibit 19: USD Index Sits at the 200DMA

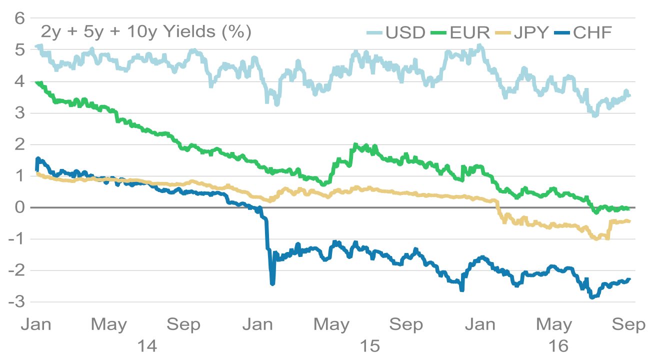


Macrobond, Morgan Stanley Research出所：

Strategic FX Portfolio Trade Recommendations

Buy EUR/JPY

Exhibit 20: Low Rates Make It Difficult for the ECB to Weaken the EUR



Source: Bloomberg, Morgan Stanley Research

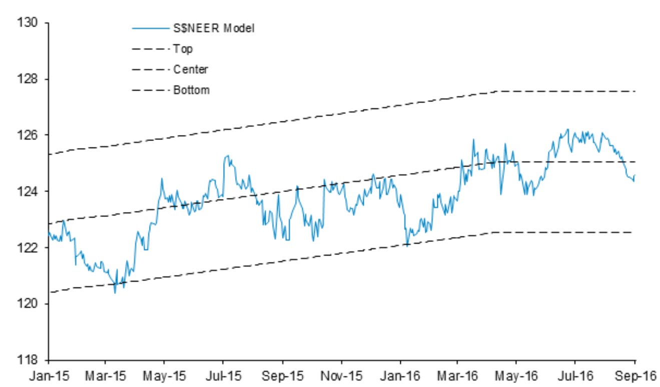
Limit Order (1-Sep-16)

Enter: 113.30; Target: 120.00; Stop: 112.30

A tactical way to express our bullish EUR view is via EURJPY. Weak data from Japan and low inflation expectations are adding to market expectations for a shift in BoJ policy on 21 September. In particular, July Japan industrial production falling by 3.8%Y showing its worst performance since February and corporate profits declining in 2Q have added to pressure for the BoJ to act. We note however that we remain bullish on the JPY and are playing tactically for market expectations into the BoJ meeting. In contrast, the ECB meeting next week is likely to show little change. While the ECB is also facing low inflation expectations, there is little they can do right now to weaken the EUR. Any changes to the capital key or extra corporate bond purchases would not be able to weaken the currency. Eurozone economic data is also showing signs of stability with the August manufacturing PMI holding steady while weakening in most other regions in the world. The risk to this trade would be earlier than expected easing from the ECB.

Sell SGD/IDR 1m fwd & Short USD/IDR 3m NDF

Exhibit 21: SGD NEER To Move to Bottom of Band



Source: Haver Analytics, Morgan Stanley Research

Short USD/IDR 3m NDF

Look to Close (Entry: 7-Jul-16)

Entered: 13398; Close at NY Close on 1-Sep-16

Sell SGD/IDR 1m fwd

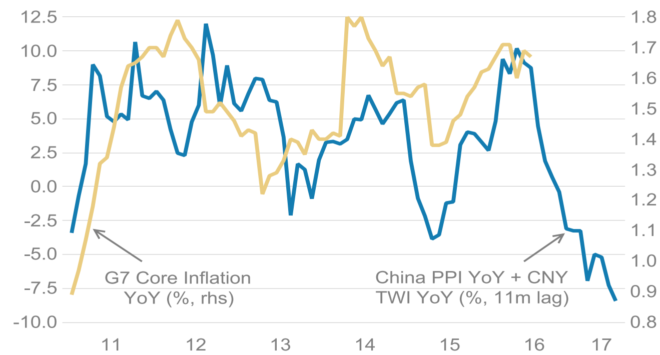
Limit Order (1-Sep-16)

Enter: NY Close on 1-Sep-16; Target: 9,500; Stop: 9,850

We have chosen to close our short USD/IDR trade to rotate into a short SGD/IDR position as we think SGD will likely underperform USD going into the October MAS meeting. While Morgan Stanley expects the MAS to maintain status quo at the upcoming meeting, market expectations for easing may well take SGD NEER to the bottom of the band, as has been the pattern going into the last few meetings. In addition, July CPI and IP data released last week were lower than consensus expectations, while band loan growth has also been weak. The broader outlook for SGD remains bearish as declining RMB TWI creates further headwinds for Singapore's exports and inflation. On the other hand, we continue to like IDR given its high real rates, improved macrostability and a political make-up supportive of further reforms. Tax amnesty has also gathered pace, with the MOF reporting ~USD 800Mn repatriation flows through this scheme. The risks to the trade could come from a sharp repricing of more Fed hikes or a pick up in China and Singapore data. Risks to the trade could also arise from commentary from MAS policymakers before the October meeting.

Buy EUR/AUD

Exhibit 22: China exports disinflationary pressure



Source: Bloomberg, Macrobond, Morgan Stanley Research

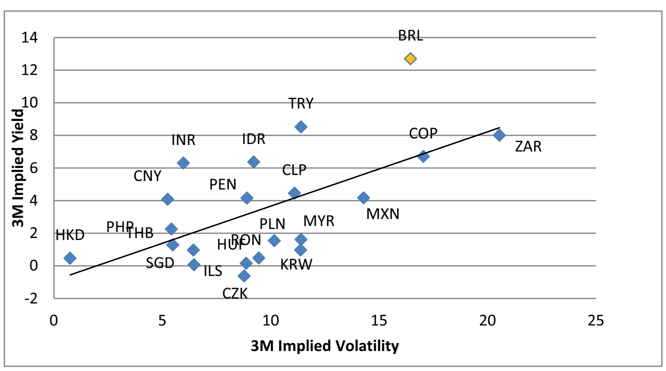
Limit Order (25-Aug-16)

Enter: 1.45; Target: 1.54; Stop: 1.42

We continue to promote long EURAUD as a limit order. The Australian economy not having contracted in 2Q and a neutral RBA should allow us to enter the trade this week. Global Manufacturing PMIs are showing signs of weakness and iron ore prices have started to weaken over recent days. A slowing Chinese economy, coupled with overcapacity in China's steel industry, should reduce demand and prices of iron ore, hitting Australia's exports and terms of trade. Weak Chinese growth may also translate into a weaker RMB, feeding into lower Chinese export prices. Given Australia imports about 4% of GDP from China, Australia's muted inflation may fall further as a result of imported disinflation. In response to declining inflation and exports growth, the RBA may have to cut rates, driving AUD lower. On the other hand, EUR should remain supported as the EMU economy has held up well post-Brexit, increasing the risk of ECB inaction at its September meeting. Even if the ECB eases, already-low long-term bond yields may not decline materially to weaken the EUR, in our view. The risk to this trade is the FOMC sounding overly dovish next week, supporting high carry currencies like the AUD.

Short USD/BRL

Exhibit 23: Vol-Adjusted Carry in Brazil Is Attractive



Source: Bloomberg, Morgan Stanley Research

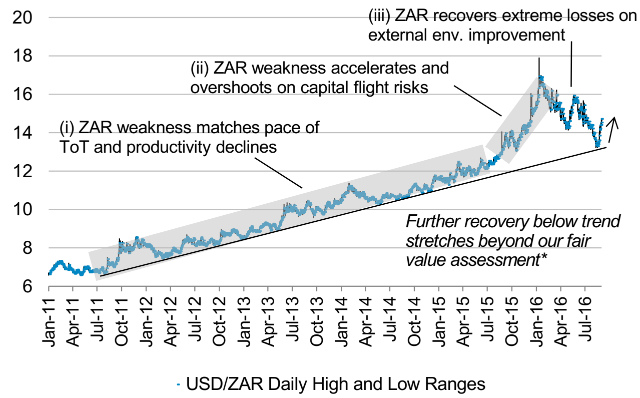
Hold (Entry: 30-Aug-16)

Entered: 3.24; Target: 3.00; Stop: 3.40

The bulk of nominal appreciation in BRL may be behind us, but we believe that even stability and moderate appreciation will make the currency attractive given its carry. Our sense is that the BCB is aiming to mute volatility, rather than to push back against FX appreciation. As such, vol adjusted carry is particularly attractive in Brazil. The currency has seen outflows from debt markets year to date, but expectations of a cutting cycle and improved political stability could increase inflows here. We do not see a BCB cutting cycle as a threat to our trade, as even after 425 bp of cuts, BRL will be the highest yielding currency in EM. The main risks stem from domestic politics, the external environment, and stretched positioning.

Long PLN/ZAR

Exhibit 24: USD/ZAR rebound from six-year trendline fits with underlying fundamentals



*See here. Source: Bloomberg, Morgan Stanley Research

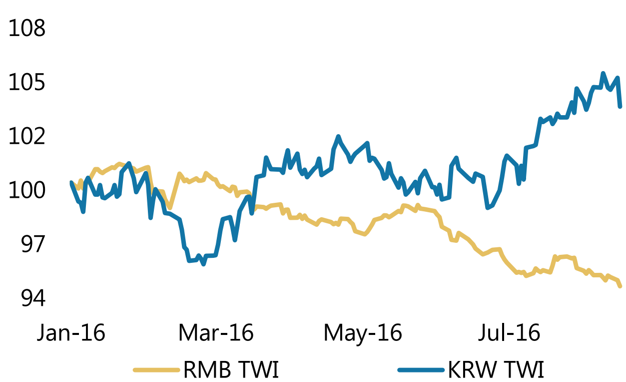
Hold (Entry: 25-Aug-16)

Entered: 3.70; Target: 4.00; Stop: 3.60

There has already been a significant weakening in the ZAR on the back of a resurfacing of the Hawks investigation into Finance Minister Gordhan. The investigation has also caused a backlash in the media and local business sentiment, with a local investment fund stopping future lending to state owned companies. In the past when confidence starts to weaken in the ZAR the weakness tends to become increasingly disorderly until a circuit breaker is found, be it a reversal in the investigation, a policy response or a big enough change in the external environment. At present, we don't see such a circuit breaker and think the ZAR will remain highly sensitive to headlines, thus we must now factor in a higher probability of further spikes in USD/ZAR. In addition our previous analysis had shown ZAR gains were becoming unsupported by fundamentals. We like selling ZAR versus PLN, since we think PLN has lagged the rally on domestic risks which have not materialised as feared by the market, including the FX-mortgage solution and Brexit-driven market weakness. At the same time our view for EUR/USD to rise over coming weeks add support to PLN versus ZAR, since PLN trades primarily against EUR. The main risk to this trade is the investigation becoming drawn out, or, the current backlash resulting in the investigation being dropped, though there is not yet any hard evidence of this occurring.

Buy EUR/KRW 1m fwd

Exhibit 25: KRW TWI appreciation vs. RMB TWI depreciation



Source: Bloomberg, BIS, Morgan Stanley Research

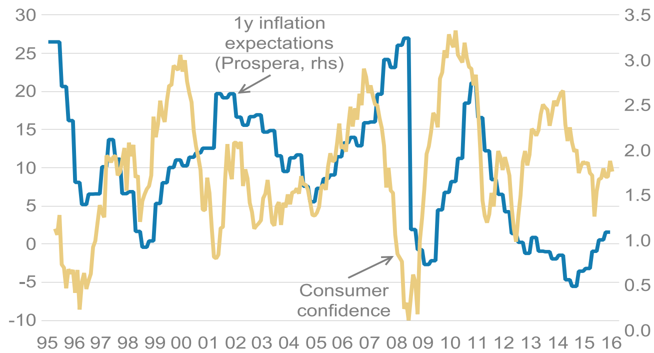
Hold (Entry: 25-Aug-16)

Entered: 1261; Target: 1300; Stop: 1220

The latest inflation numbers should put KRW under more pressure in our view, as the low inflation prints, which admittedly were partly driven by tariff adjustments, but nonetheless have driven core CPI down to a multi-year low. Amid recent currency strength and strong inflows, KRW is vulnerable to reversal. Next week's BoK meeting will be interesting to see if there is any shift in stance. The decline in the RMB is potentially taking some toll. The ongoing slowdown in China will be impacting sentiment about its major trade partners such as Korea. Policymakers could increasingly push back on further KRW strength and we therefore think risk/reward is favourable for short KRW positions. We prefer to short KRW against EUR, where we expect the exploited yield curves, rising real yields and potential non-action from the ECB at the upcoming meeting to support the EUR. The trade also works as insurance, in case the Fed changes its stance in September, as KRW would react to the Fed more than the EUR, in our view. The risk to this trade is strong equity inflows supporting the KRW more than we expect.

Short CHF/SEK

Exhibit 26: Sweden: Inflation expectations and consumer confidence work higher



Source: Bloomberg, Macrobond, Morgan Stanley Research

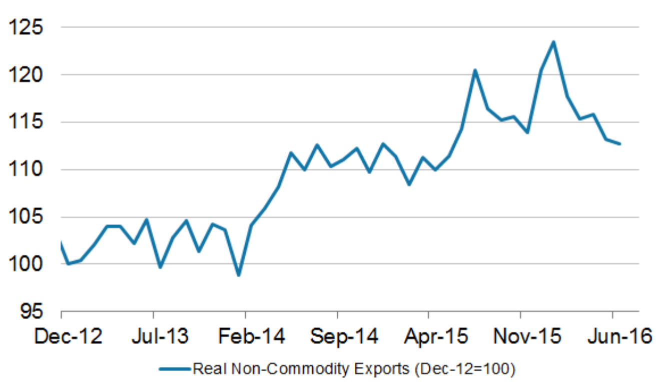
Hold (Entry: 16-Aug-16)

Entered: 8.74; Target: 8.25; Stop: 8.90

We hold on to our short CHF/SEK position as we expect the SNB to limit CHF's upside via continued intervention. The SNB's strategy survived risk sell-offs seen in August 2015 and January 2016. Despite the recent weak Swedish economic data, we do not expect the Riksbank to cut rates as there are increasing signs of inflation bottoming out. The front end of the SEK curve is priced for the Riksbank remaining dovish for now, so another positive Swedish inflation surprise combined with some improvement in the data should allow SEK to rally. The risk to this trade is a more dovish Riksbank.

Short CAD/NOK

Exhibit 27: Another weak trade report in Canada



Source: Bloomberg, Macrobond, Morgan Stanley Research

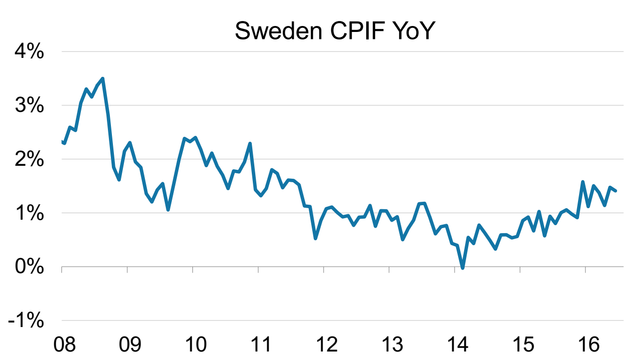
Hold (Entry: 5-Aug-16)

Entered: 6.46; Target: 5.98; Stop: 6.59

We continue to promote this oil price immune trade given the build up of weakness in Canadian economic data. Some may ask whether there is a risk emerging from the NOK side, where the manufacturing PMI underperformed. We think there is limited risk for currency impact for now. The weak employment and trade data increase the probability of a rate cut this year and are likely to lead to CAD underperformance in the coming weeks. The risks to this trade are better Canadian data or weak Norway data.

Short USD/SEK

Exhibit 28: CPI ticking higher in Sweden



Source: Bloomberg, Macrobond, Morgan Stanley Research

Closed (Entry: 4-Aug-16)

Entered: 8.52, Closed at 8.60 on 1-Sep-16

Markets pricing in a higher probability of a US rate hike and very weak manufacturing data from Sweden meant we were stopped out of this trade. For now will wait for the US labour data and the Fed meeting next week before looking at the USDSEK trade again. Next week's Riksbank meeting is not likely to bring any surprises as the SEK has been on a weakening trend.

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 USD/IDR 3m NDF	$10.0mn	10.3%	07-Jul-16	13398	Close at NY Close on 1-Sep-16			-$35.0k	$72.2k	$37.2k
Short USD/SEK	$10.0mn	10.3%	04-Aug-16	8.52	Closed at 8.60 on 1-Sep-16			-$92.6k	-$8.7k	-$101.2k
Active Trades										
Short CAD/NOK	$10.0mn	10.3%	05-Aug-16	6.46	6.36	6.59	5.98	$143.2k	-$0.1k	$143.1k
Short CHF/SEK	$10.0mn	10.3%	16-Aug-16	8.74	8.73	8.90	8.25	$17.5k	$1.3k	$18.7k
Long EUR/KRW 1m fwd	$10.0mn	10.3%	25-Aug-16	1261	1254	1220	1300	-$55.7k	-$2.7k	-$58.4k
Long PLN/ZAR	$10.0mn	10.3%	25-Aug-16	3.70	3.75	3.60	4.00	$145.3k	-$9.6k	$135.7k
Short USD/BRL	$10.0mn	10.3%	30-Aug-16	3.24	3.26	3.40	3.00	-$49.1k	$3.5k	-$45.7k
Limit Orders										
Buy EUR/AUD	$10.0mn			1.45	1.48	1.42	1.54			
Sell SGD/IDR 1m fwd	$10.0mn	Enter at NY Close on 1-Sep-16			9799	9850	9500			
Buy EUR/JPY	$10.0mn			113.30	115.57	112.30	120.00			
Cash	$27.3mn	28.0%								
Portfolio Mark to Market	$97.4mn									

Source: Morgan Stanley Research

Simulated Managed Account Monthly Gross Performance - %

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year return
2008	1.07	2.25	2.72	-1.41	-0.53	1.28	-0.17	-0.24	-0.86	3.12	0.62	0.87	**8.96%**
2009	0.74	-0.97	-0.15	-1.09	0.50	-0.87	0.30	0.22	2.00	0.77	1.27	0.55	**3.27%**
2010	-0.01	-0.27	1.71	1.13	1.39	-0.86	-2.36	0.95	0.67	-0.30	0.13	0.66	**2.80%**
2011	-1.20	0.29	-1.71	0.51	-1.11	-0.33	0.84	-1.02	0.50	-1.03	-0.18	0.44	**-3.97%**
2012	0.34	0.46	-0.42	0.52	1.78	-0.43	0.39	0.56	0.43	0.53	0.96	0.47	**5.72%**
2013	-0.23	-0.66	0.08	0.10	0.26	0.05	-0.71	-0.13	-0.62	0.23	1.17	-0.27	**-0.75%**
2014	1.09	-0.67	-0.54	-0.02	-0.20	-0.26	1.20	0.30	1.23	0.35	-0.30	0.37	**2.54%**
2015	2.21	0.09	1.07	-1.96	1.40	-0.63	2.20	2.80	0.29	-0.35	0.49	0.17	**7.77%**
2016	-0.22	1.07	-1.46	-0.33	-1.11	0.03	-0.55	0.00	-0.07				**-2.63%**

Source: Morgan Stanley Research; see notes below

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

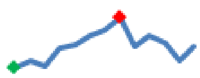
** Global Risk Demand Index – US Pat. No. 7,617,143. We updated our methodology for our portfolio in 2011 (see FX Pulse: Watching Europe, October 13, 2011).*

G10 Currency Summary

Charles Rubenfeld and Gek Teng Khoo

USD

1.6%



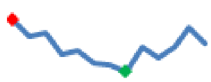
USD Rally Limited — **Neutral**

Watch: NFP, Durable Goods, ISM, LMCI, Fed Beige Book, Fed Commentary

The recent Fed-induced USD rally has gone against our expectations, and we believe that this momentum could push USD higher in the short term. Therefore, USD may rally in the short term against some of G10 (particularly JPY) and vulnerable EM. However, we maintain our view that this is a rally to sell should it occur. Given where inflation expectations are and the asymmetrics risks to hiking too early, we expect any Fed hike to be dovish, leading to a flatter curve and keeping financial conditions easy. We maintain a view of USD weakness against EM as well, given our view that long-end G4 rates, which matter more for emerging markets, will stay low and lead to continued EM inflows.

EUR

-1.5%



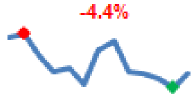
Buy EUR Crosses — **Bullish**

Watch: Retail Sales, GDP, ECB Rates Decision

We remain bullish on EUR. The eurozone economy has held up well post-Brexit, supported by the recent release of eurozone August PMIs. Our economists are now expecting the ECB to ease only in December instead of September, with the risk that it may not ease at all, supporting our bullish EUR view. Even if the ECB extends its QE programme or cuts rates further, we think it will not be able to push down long-term bond yields substantially to weaken the currency, as eurozone bond yields are already low or negative. EUR may weaken against USD but this would likely be driven by USD rising broadly if the market prices in a greater likelihood of Fed rate hikes.

JPY

-4.4%



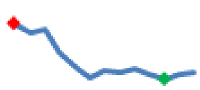
Room to Sell Off — **Neutral**

Watch: Labor Cash Earnings. Leading Index, Trade Balance, GDP, Eco Watchers Survey

We are now more cautious on JPY and see room for USDJPY to continue to rally, particularly if we get increased expectations of Fed rate hikes and the possibility of unconventional policy at the September BoJ meeting. FX hedging costs have risen (with hedged foreign bond yields, particularly USD, fluctuating around 0), which would also provide a marginal boost to USDJPY (though we don't expect much of an increase in unhedged outflows). However, we ultimately expect such a rally to eventually reverse unless we get much faster Fed tightening than the market is expecting or the introduction of unconventional policy at the September meeting (both against our base case).

GBP

-9.5%



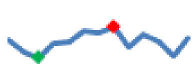
Tactical Rally Continues — **Neutral**

Watch: Services PMI, IP, Trade Balance, Inflation Expectations

We think the GBP rally could continue, with GBPUSD and GBPJPY potentially reaching 1.35 and 145, respectively. In line with recent data trends, upcoming UK data such as services PMI could continue to surprise on the upside after dipping sharply in July, given that market expectations are low and there are signs of the weaker GBP working to boost the economy. This alleviates market fears about a Brexit-related economic slowdown and could lead to markets pricing out further BoE easing, providing support for GBP. With CFTC data showing markets' GBP short positioning increasing further last week to reach a record high, the rebound in UK data could be met by swift appreciation of GBP due to short covering.

CHF

0.2%



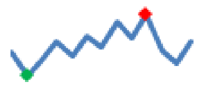
Staying Bullish — **Bullish**

Watch: Sight Deposits, GDP, CPI, FX Reserves, Unemployment

We stay bullish on CHF on the basis of rising real yields and commercial demand from Switzerland's current account surplus outweighing long-term capital exports as the banks' weak balance sheets reduce their ability to export capital. The Swiss economy may also receive a boost from a weaker GBP, as increased tourists' demand for luxury goods in the UK has reportedly helped Swiss watch exports to the UK rise by 13.4% in July. We like buying CHF crosses such as against JPY, AUD and CAD. This week, we watch GDP, CPI and FX reserves.

CAD

0.5%



Bearish Following Weak Data — **Bearish**

Watch: Trade, BoC Rates Decision, Ivey PMI, Housing Starts, Unemployment

We remain bearish CAD, though we expect the BoC to remain neutral in its statement next week. Data overall have been weak, but not weak enough to shift the BoC's tone, in our view. 2Q GDP released yesterday was worse than the BoC's MPR forecast on the headline (-1.6% SAAR vs. -1% SAAR) but was better when excluding the effects of the wildfires. Furthermore, June's GDP growth was better than expected and consumption held up well despite weak retail sales. This is not to say that we are optimistic about the outlook; 2Q GDP received a large inventories boost and we are still skeptical that exports can rebound enough in the second half for the BoC to hit its forecasts. Tomorrow's trade data will therefore be important. Given what is priced in the curve and pessimistic forecasts about the future, we remain bearish CAD.

AUD

2.7%

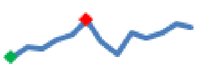
Room for Rally This Week — **Neutral**

Watch: Inflation Expectations, RBA Rates Decision, GDP, Trade Balance, Home Loans

We think AUD may have room to rally this week, but remain bearish over the medium term and like selling AUD crosses on rallies. Our economists are expecting 2Q GDP this week to show an expansion and the RBA to stay on hold, which will provide support for AUD. In line with strong building approvals and auction clearing rates in Sydney, there are also upside risks to the home loans print. If the RBA does not provide an indication that further easing is imminent, the current 14bp rate cut priced for this year may be reduced, supporting AUD further. However, we think that weak China July data, which points to slower China growth and weakness in commodity prices, will impact AUD over the coming months. China's slowdown as well as a higher AUD TWI may increase market focus on rate cuts down the line.

NZD

4.0%



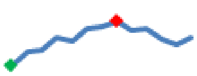
Bullish without RBNZ Action — **Bullish**

Watch: QV House Prices, Manufacturing Activity, House Sales

Recent retail sales and employment data reinforce the strong domestic growth environment, but NZD's rise continues to complicate the inflation outlook. In the short term, we expect NZD to outperform other commodity currencies amid the continued search for yield. We are still focused on the RBNZ in the medium term, particularly as two "scenarios" in the latest MPS forecast include substantially more easing based on either lower inflation expectations or a flat TWI (as opposed to forecasted depreciation). Gov. Wheeler's speech did nothing to push market expectations towards these scenarios though, as he reaffirmed the easing forecast of the MPS despite the rising TWI. Eventually, we may see aggressive cuts by the RBNZ but, with the next MPS not until November, we don't expect much depreciation in the near term.

SEK

4.2%



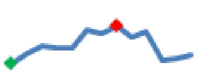
Watch Riksbank — **Neutral**

Watch: Services PMI, IP, Riksbank Rates Decision

After weak manufacturing PMI numbers, EURSEK rallied but failed to break the 9.60 resistance level. A break of this level is required for the pair to gain further upside to around 9.65. While the economic tendency survey and manufacturing PMI continue to point to a feeble Swedish economy, we do not expect this to change the Riksbank's policy reaction this week as the KIX has continued weakening since the last meeting. Sweden's CPIF has also been picking up in recent months, which could continue as the effect of previous SEK depreciation passes through to inflation. If this trend stays in place, the current dovish pricing of the Riksbank by the markets may be reduced, giving the SEK some upside potential. We remain short CHF/SEK in our portfolio, with the SNB's continued intervention limiting CHF upside.

NOK

1.2%



CPI in Focus — **Neutral**

Watch: Unemployment, IP, CPI

As oil prices are likely to remain volatile, we still like trading NOK longs against CAD to neutralise the exposure to oil prices. Norway's economy may be starting to look up, as suggested by Norges Bank and supported by the latest GDP print pointing to a slower pace of decline in the petroleum sector. We would monitor subsequent data points to confirm this trend. This week's CPI number will be in the limelight as another stronger print continuing last month's trend, coupled with the recent GDP number coming approximately in line with expectations, is likely to reduce market pricing of Norges Bank easing this year, helping NOK to rally.

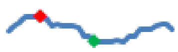
Charts show 3M performance against USD, as normally quoted and DXY for USD. Click on any currency for a reference webpage on Matrix.

EM Currency Summary

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

CZK

0.2%



Neutral

EUR/CZK is going nowhere fast. The changeover in CNB governor has not resulted in any change in messaging or policy, with the CNB expecting the floor to be removed by 2017. Disinflationary pressures remain a concern on a domestic and external level. While the improvement in other fundamentals and the external environment keeps CZK under strengthening pressure, we look for a sideways EUR/CZK just above 27 for the coming months.

HUF

-0.3%

Bullish

Hungary's external balance has seen continued improvement on the back of rising exports of manufactured products and lower energy imports. However, at the same time, financial outflows have remained significant which is in part being driven by the government's self financing plan, reducing external debt. Foreign ownership of bonds has fallen to lows not seen since 2011 at 28%. This leaves EUR/HUF in the balance and has kept the cross in a 308/318 range for the last year. With no change in policy insight we prefer to play the ranges for now, though acknowledge these trends make for a more structurally bullish HUF outlook, once outflows stabilise.

ILS

-1.1%

Bearish

There has been some improvement in growth-related data over the last few months, and in particular in consumption. Still, the BoI is likely to continue to intervene since its intervention policy is tied to export performance (remains weak) and disinflationary pressures. However, the BoI targets the trade weighted index, which has a high (near 30%) EUR weight, and thus the recent rise in EUR/ILS means USD/ILS can fall further without interventions increasing. We like buying dips in USD/ILS. See here for our latest ILS article.

PLN

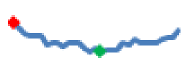
1.1%

Bullish

PLN has retraced almost 50% of the gains made following the decision to delay FX-conversion of mortgages by another year. We prefer to fade the weakness in PLN, since real rates remain amongst the highest in EM and are likely to stay high given the NBP's on-hold stance, the current account deficit remains very small and political risks are less imminent given the delay of mortgage conversions. Also worth noting is reference by the NBP that the PLN is undervalued. We like buying PLN vs ZAR, but also look to sell rallies in EUR/PLN.

RUB

-1.2%



Bullish

We think RUB valuations to oil are back to being fair, after looking rich earlier in the year. Government officials' comments on RUB being expensive and the escalation in Crimea tensions may have contributed to bringing RUB into better allignment with oil. With CBR policy remaining cautious in easing, financial outflows not as large a risk, and valuations fair, we think RUB remains an attractive currency to own given high carry levels. The main risk is oil declining further, and the build up in positioning.

TRY

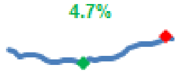
-1.0%

Bearish

We stick to a bearish stance on the TRY and our forecast for USD/TRY to reach 3.20 by the end of the year, though given the strong external environment we do not think it is the correct time to enter short TRY positions. Our view is based on the combination of declining real rates and a widening current account deficit.

ZAR

4.7%



Bearish

Political risks have come back to the fore with the investigation into Finance Minister Gordhan reaching a more critical point. ZAR has already weakened significantly, but we think the tail risks surrounding the currency have clearly increased, and that should stop ZAR from participating in the broader EM rally. We also think the currency was already starting to look expensive to fundamentals. Accordingly we like buying PLN/ZAR. See here for our latest ZAR article.

CNY

0.7%

Bearish

While the China PMI showed an improvement in business sentiment, our economists expect activity data to show renewed weakness in the coming months as stimulus is reduced. We think the RMB will remain on a declining trend as diminishing onshore returns will keep the pressure on FDI and portfolio outflows. Post G20 meeting this weekend, we will keep an eye on the fixings and the CNH-CNY spread.

INR

0.3%

Bullish

While strong fundamentals as well as weaker USD and high carry are positive for the INR, the currency has not gained momentum as uncertainties still remain around the upcoming FCNR outflows between Sep - Nov. The announcement of Urjit Patel as the next RBI governor has provided assurance of policy continuity, implying that INR REER will remain the key gauge for the currency policy.

IDR

1.4%

Bullish

We remain bullish on IDR on positive reform momentum and the support from high real rates. Foreign inflows in local currency bonds continue to rise at a steady pace. The recent cabinet reshuffle and appointment of Dr. Indrawati as the Finance Minister signal a positive setting for reforms to continue. In addition, tax amnesty flows have picked up with MOF reporting that ~USD 800Mn has been repatriated under the scheme since its implementation on 18th July.

KRW

-1.1%

Bearish

China spillover risks are increasing as we expect activity to slow down, while the weakening RMB continues to pose risks to Korean exports and imported disinflation. Korea PMI and CPI data have underlined our concerns on the economy and our economists call for further rate cuts. In addition, with the Korean curve below the UST curve, we expect domestic outflows to increase in the hunt for yield.

MYR

-1.1%

Neutral

While bond inflows in Malaysia remain strong, the uncertainty around oil and commodity prices will keep a lid on MYR, in our view. The relatively low carry in MYR forwards may also have led to bond investors hedging their FX exposure. On a fundamental basis, MYR has remained vulnerable to potential Fed hike concerns as well, given its low reserves , high external debt and declining current account surplus.

SGD

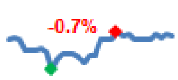
-0.5%

Bearish

We think the downward pressure on SGD NEER will likely increase into the October MAS meeting as investors look for potential FX easing by the MAS. SGD NEER has been strengthening YTD, at a time when the RMB TWI has declined by ~6%. We think this adds pressure on Singapore's exports, growth and imported disinflation, which have been negatively impacted by the weak global trade demand and headwinds from China.

TWD

-0.7%



Bearish

Weaker USD and stronger RMB have led to clearing up of short positioning that had built up in TWD following the RMB depreciation last year. Taiwan also gains from having a significant current account surplus; however, we remain cautious on the medium term view, given Taiwan's high exports to GDP ratio. While exports were already on a weakening trend from slowing Chinese growth, Brexit and CBC rate cuts add to the medium-term risk for the TWD, in our view.

THB

-0.5%

Neutral

Thailand's current account surplus continues to rise sharply on the back of declining imports as well as strong services exports from tourism. The weaker USD has added to the caution from the BoT on the THB, leading to a considerable rise in Thailand's FX reserves this year. However, with REER valuations close to fair for THB, we do not expect any immediate measures against the recent currency strength.

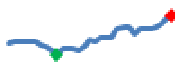
BRL — **Bullish**

-0.6%

We remain medium-term bullish on BRL, as we believe that an environment of low core yields should incentivize investors to look for idiosyncratic, high-carry stories with positive political pictures, such as Brazil's. We do not see the upcoming cutting cycle as a risk for BRL, as it will still remain the highest yielding currency in EM, even after 425 bp of cuts. We like being long BRL.

CLP — **Neutral**

3.8%



CLP's domestic story continues to deteriorate. In addition to the protests over pensions which have picked up recently, domestic data deteriorated further recently, most notably with unemployment reaching a 5 year high. Employment year to date has been largely driven by self-employment, which is concerning. The central bank has turned more dovish, and given already relatively low yields, support for CLP could be limited.

COP — **Neutral**

-3.6%

COP is impacted mostly by two things: commodity prices and external demand for yield. With oil falling and markets becoming increasingly concerned about a Fed hike, the external environment has turned against COP for now. We have resisted going long even in the good times, as fiscal fundamentals in Colombia remain concerning, even if this is more of a rates play.

MXN — **Neutral**

-0.7%

MXN has returned to its usual position as an underperformer following S&P's decision to move the country to negative outlook. At current levels, we see room for a pullback as MXN approaches the key 19 technical level. Medium term, risk/reward remains unattractive, as the currency can move much more quickly on negative news than positive news given its low yields and high liquidity.

PEN — **Neutral**

1.4%

Positive political momentum amid a broader EM rally should support PEN, but we expect that the central bank will continue to mute volatility, taking advantage of strength to unwind its swap position. With USD rally,ing PEN could outperform as the central bank has more room to add to its swap position, having already unwound it somewhat. As such, we expect PEN to remain a low-beta EM for the near future.

Charts show 1M performance against USD, as normally quoted

Global Event Risk Calendar

Gek Teng Khoo

Date	Time (Ldn)	Ccy	Event	Ref. Period	MS forecast	Market	Previous
2-Sep	8:30	SEK	Sweden CA Balance	2Q			64.3B
	9:30	GBP	PMI Construction	Aug		46.3	45.9
	13:30	USD	Trade Balance	Jul		-41.5B	-44.5B
	13:30	CAD	Trade Balance	Jul		-3.3B	-3.63B
	13:30	**USD**	**Change in Nonfarm Payrolls**	**Aug**	**185k**	**180k**	**255k**
	13:30	USD	Unemployment Rate	Aug	4.9%	4.8%	4.9%
	15:00	USD	Factory Orders	Jul	2.2%	2%	-1.5%
	15:00	USD	Durable Goods Orders	Jul F		4.4%	4.4%
4-5 Sep	N/A	CNY	G20 Leaders Meeting (Hangzhou)				
5-Sep	1:00	JPY	Labor Cash Earnings (YoY)	Jul			1.4%
	2:45	CNY	PMI Composite	Aug			51.9
	3:30	**JPY**	**BoJ's Kuroda spks (Tokyo)**				
	7:30	SEK	PMI Services	Aug			57.8
	8:30	SEK	Industrial Production (MoM)	Jul			-0.4%
	9:00	CHF	SNB Sight Deposits				515.6B
	9:00	EUR	PMI Services	Aug F			53.1
	9:30	GBP	PMI Services	Aug			47.4
	10:00	EUR	Retail Sales (MoM)	Jul			0%
6-Sep	0:30	AUD	Consumer Confidence				118.4
	2:30	AUD	Current Account Balance	2Q		-21B	-20.8B
	5:30	**AUD**	**RBA Rates Decision**		**1.50%**	**1.5%**	**1.5%**
	6:45	**CHF**	**GDP (QoQ)**	**2Q**		**0.5%**	**0.1%**
	8:15	**CHF**	**CPI (YoY)**	**Aug**		**-0.1%**	**-0.2%**
	10:00	**EUR**	**Eurozone GDP (QoQ)**	**2Q F**			**0.3%**
	N/A	NZD	Global Dairy Trade Announces Milk Auction Results				
	14:45	USD	PMI Services	Aug F			50.9
	15:00	USD	Labor Market Conditions Index	Aug			1%
	15:00	USD	ISM Non-Manufacturing Composite	Aug		55.4	55.5
	17:15	**CHF**	**SNB's Jordan spks (Lucerne)**				
7-Sep	N/A	CNY	Foreign Reserves	Aug		3198B	3201.1B
	0:01	GBP	BRC Shop Price Index (YoY)	Aug			-1.6%
	2:30	**AUD**	**GDP (QoQ)**	**2Q**		**0.5%**	**1.1%**
	6:00	JPY	Leading Index CI	Jul P			99.2
	8:00	**MYR**	**BNM Rates Decision**		**2.75%**		**3%**
	8:30	**SEK**	**Riksbank Rates Decision**		**-0.50%**		**-0.5%**
	8:30	SEK	Riksbank MPR				
	9:00	NOK	Industrial Production (MoM)	Jul			-5.1%
	9:30	GBP	Industrial Production (MoM)	Jul			0.1%
	N/A	**PLN**	**NBP Rates Decision**		**1.50%**	**1.5%**	**1.5%**
	14:15	**GBP**	**BoE's Carney, Cunliffe, Forbes, McCafferty spk (Parliament, London)**				

	15:00	**CAD**	**BoC Rates Decision**		**0.50%**	**0.5%**	**0.5%**
	15:00	CAD	Ivey PMI	Aug			57
	15:00	USD	JOLTs Job Openings	Jul			5.62m
8-Sep	N/A	CNY	Trade Balance	Aug		$59.05B	$52.31B
	N/A	CNY	Exports (YoY)	Aug		-3.8%	-4.4%
	0:50	JPY	Trade Balance BoP Basis	Jul		¥559.7B	¥763.6B
	0:50	**JPY**	**GDP (QoQ)**	**2Q F**		**0.2%**	**0.2%**
	2:30	AUD	Trade Balance	Jul		-3200m	-3195m
	6:00	JPY	Eco Watchers Survey Outlook	Aug			47.1
	8:30	SEK	Household Consumption	Jul			-0.1%
	12:45	EUR	ECB Rates Decision		0%		0%
	12:45	**EUR**	**ECB Deposit Facility Rate**		**-0.40%**		**-0.4%**
	13:30	USD	Initial Jobless Claims			265k	263k
8-12 S	N/A	CNY	Foreign Direct Investment (YoY, CNY)	Aug			-1.6%
9-Sep	**0:00**	**PEN**	**BCRP Rates Decision**		**4.25%**	**4.25%**	**4.25%**
	0:50	JPY	M3 (YoY)	Aug		2.9%	2.9%
	N/A	**KRW**	**BoK Rates Decision**		**1.25%**	**1.25%**	**1.25%**
	2:30	**CNY**	**CPI (YoY)**	**Aug**		**1.7%**	**1.8%**
	5:30	JPY	Tertiary Industry Index (MoM)	Jul		0.2%	0.8%
	6:45	CHF	Unemployment Rate	Aug		3.2%	3.1%
	8:00	EUR	Eurogroup Meeting (Bratislava)				
	9:00	**NOK**	**CPI Underlying (YoY)**	**Aug**			**3.7%**
	9:30	GBP	Visible Trade Balance GBP/Mn	Jul			£-12.4B
	13:15	CAD	Housing Starts	Aug			195k
	13:30	CAD	Employment Change	Aug			-31.2k
	15:00	USD	Wholesale Inventories (MoM)	Jul F		0%	0%
9-10 S	N/A	EUR	ECOFIN Meeting (Bratislava)				
10-15 S	N/A	CNY	New Yuan Loans	Aug		750B	464B
12-Sep	0:50	JPY	Machine Orders (MoM)	Jul			8.3%
	0:50	JPY	Domestic CGPI (YoY)	Aug			-3.9%
	9:00	CHF	SNB Sight Deposits				515.6B
13-Sep	0:30	AUD	Consumer Confidence				118.4
	2:30	AUD	NAB Business Confidence	Aug			4
	3:00	CNY	Industrial Production (YoY)	Aug		6.2%	6%
	3:00	CNY	Retail Sales (YoY)	Aug		10.1%	10.2%
	3:00	CNY	Fixed Assets Ex Rural YTD (YoY)	Aug		7.9%	8.1%
	7:00	**EUR**	**German CPI (YoY)**	**Aug F**			**0.4%**
	8:30	**SEK**	**CPI CPIF (YoY)**	**Aug**			**1.4%**
	9:30	**GBP**	**CPI (YoY)**	**Aug**			**0.6%**
	10:00	EUR	German ZEW Survey Expectations	Sep			0.5
	10:00	EUR	Eurozone ZEW Survey Expectations	Sep			4.6
	13:00	**PLN**	**CPI Core (YoY)**	**Aug**		**-0.4%**	**-0.4%**
14-Sep	5:30	JPY	Industrial Production (MoM)	Jul F			0%
	8:30	**SEK**	**GDP (QoQ)**	**2Q F**			**0.3%**
	8:30	**THB**	**BoT Rates Decision**		**1.50%**	**1.5%**	**1.5%**
	9:30	GBP	Average weekly wages (ex bonuses) (3m Av, YoY)	Jul			2.3%
	9:30	GBP	ILO Unemployment Rate 3Mths	Jul			4.9%
	10:00	EUR	Industrial Production (MoM)	Jul			0.6%

	10:00	CHF	ZEW Survey Expectations	Sep			-2.8
	23:30	NZD	Manufacturing PMI	Aug			55.8
	23:45	**NZD**	**GDP (QoQ)**	**2Q**			**0.7%**
15-Sep	2:30	AUD	Employment Change	Aug			26.2k
	8:30	SEK	Unemployment Rate	Aug			6.3%
	8:30	**CHF**	**SNB Rates Decision**				**-0.75%**
	9:00	NOK	Trade Balance	Aug			13.95B
	9:30	GBP	Retail Sales (MoM)	Aug			1.5%
	10:00	**EUR**	**CPI (YoY)**	**Aug F**			**0.2%**
	12:00	**GBP**	**BoE Rates Decision**		**0.25%**		**0.25%**
	13:30	USD	Current Account Balance	2Q		-125	-124.67
	13:30	USD	Retail Sales Advance (MoM)	Aug		0.2%	0%
	13:30	USD	Initial Jobless Claims			265k	263k
	13:30	USD	Philadelphia Fed Business Outlook	Sep			2
	13:30	USD	Empire Manufacturing	Sep			-4.21
	14:00	CAD	Existing Home Sales (MoM)	Aug			-1.3%
	14:15	USD	Industrial Production (MoM)	Aug		-0.2%	0.74%
	14:15	USD	Capacity Utilization	Aug		75.7%	75.9%
	15:00	USD	Business Inventories	Jul			0.2%
	22:00	**CLP**	**CBCH Rates Decision**		**3.50%**		**3.5%**
16-Sep	2:00	NZD	ANZ Consumer Confidence Index	Sep			117.7
	N/A	GBP	EU Leaders Meet on Brexit (Bratislava)				
	11:30	**RUB**	**CBR Rates Decision**		**10.00%**		**10.5%**
	13:30	CAD	Manufacturing Sales (MoM)	Jul			0.79%
	13:30	**USD**	**CPI (YoY)**	**Aug**			**0.8%**
	15:00	USD	Univ. of Michigan Confidence	Sep P			89.8
	21:00	USD	Total Net TIC Flows	Jul			-202.8B
Upcoming Risk Events							
21-Sep	N/A	JPY	BoJ Rates Decision	Sep	-0.10%		-0.10%
21-Sep	19:00	USD	FOMC Rates Decision (Upper Bound)	Sep	0.50%	0.50%	0.50%
21-Sep	22:00	NZD	RBNZ Rates Decision	Sep		2.00%	2.00%
22-Sep	9:00	NOK	Norges Bank Rates Decision	Sep	0.25%		0.50%
26-28 S	N/A	INT	OPEC Informal Meeting (Algiers)				

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

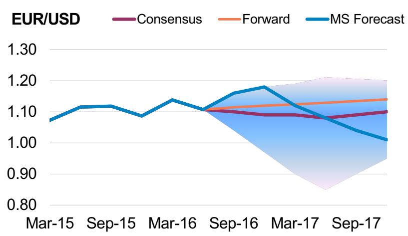
Central Bank Watch

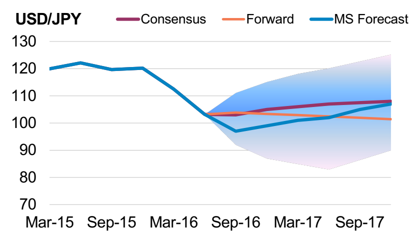
Exhibit 29: Macro forecasts: For more, see the What's Priced In Interactive

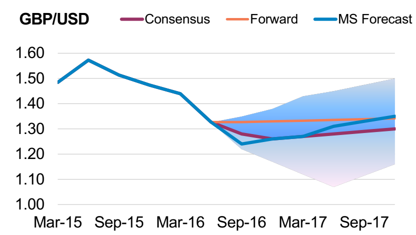
	Next rate decision	Market expects (bp)	MS expects (bp)	Current	Morgan Stanley Forecasts			
					3Q16	4Q16	1Q17	2Q17
US	21-Sep	7	0	0.375	0.375	0.375	0.375	0.375
Euro Area	08-Sep	-1	0	-0.40	-0.40	-0.50	-0.50	-0.50
Japan	21-Sep	-5	0	-0.10	-0.30	-0.30	-0.30	-0.30
UK	15-Sep	-5	0	0.25	0.25	0.10	0.10	0.10
Canada	07-Sep	0	0	0.50	0.50	0.25	0.25	0.25
Switzerland	15-Sep	0	-	-0.75	-	-	-	-
Sweden	07-Sep	0	0	-0.50	-0.50	-0.50	-0.50	-0.50
Norway	22-Sep	0	0	0.50	0.25	0.25	0.00	0.00
Australia	06-Sep	-1	0	1.50	1.50	1.50	1.25	1.00
New Zealand	21-Sep	-3	-	2.00	-	-	-	-
Russia	16-Sep	-	0	10.50	10.00	9.50	8.50	8.00
Poland	07-Sep	-1	0	1.50	1.50	1.50	1.50	1.50
Czech Rep	29-Sep	0	0	0.05	0.05	0.05	0.05	0.05
Hungary	20-Sep	-6	0	0.90	0.90	0.90	0.90	0.90
Romania	30-Sep	-	0	1.75	1.75	1.75	1.75	1.75
Turkey	22-Sep	-	0	7.50	7.50	7.50	7.50	7.50
Israel	26-Sep	0	0	0.10	0.10	0.10	0.10	0.10
South Africa	22-Sep	8	0	7.00	7.00	7.00	7.00	7.00
China	-	-	-	4.35	4.10	4.10	3.85	3.85
India	04-Oct	-	0	6.50	6.50	6.25	6.00	6.00
Hong Kong	19-Sep	-	0	0.75	0.75	0.75	0.75	0.75
S. Korea	09-Sep	0	0	1.25	1.25	1.00	0.75	0.50
Taiwan	29-Sep	-	0	1.38	1.25	1.25	1.25	1.25
Indonesia	4-Oct	-	0	5.25	5.25	5.25	5.25	5.25
Malaysia	07-Sep	0	-25	3.00	2.75	2.75	2.75	2.75
Thailand	14-Sep	2	0	1.50	1.50	1.50	1.50	1.50
Brazil	19-Oct	-16	0	14.25	14.25	13.25	12.00	10.50
Mexico	29-Sep	7	0	4.25	4.25	4.25	4.25	4.25
Chile	15-Sep	0	0	3.50	3.50	3.50	3.25	3.00
Peru	08-Sep	-	0	4.25	4.25	4.25	4.25	4.25
Colombia	30-Sep	10	0	7.75	7.75	7.75	7.25	6.50

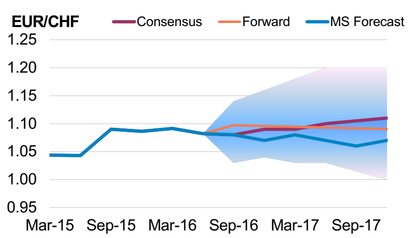
Source: National Central Banks, Morgan Stanley Research. Forecasts Last Updated on July 17, 2016. Note: Japan policy rate takes a mid-range value. Market expects for G10 as of September 1 and EM as of September 1. For more, see the What's Priced In Interactive.

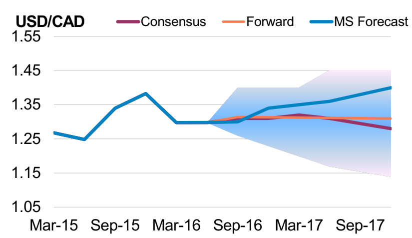
FX Forecasts Relative to Market

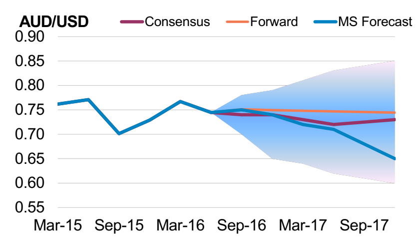


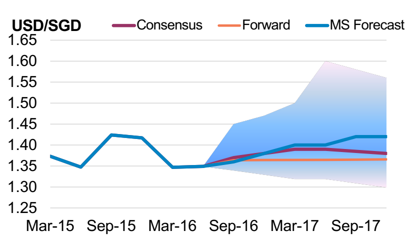


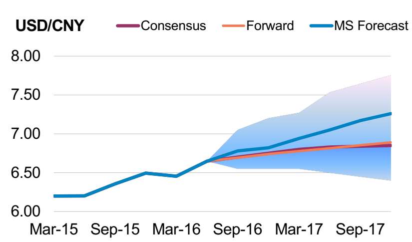


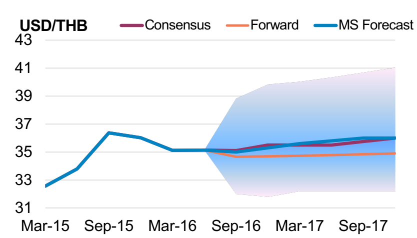


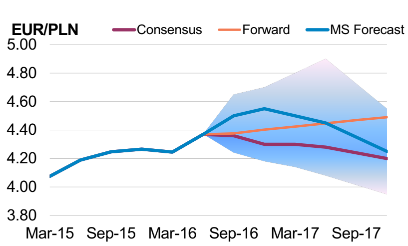


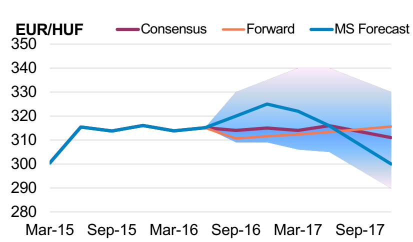


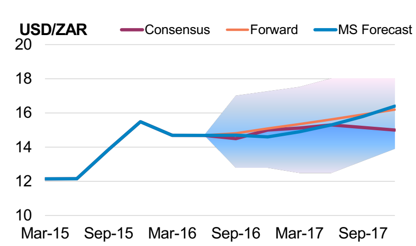


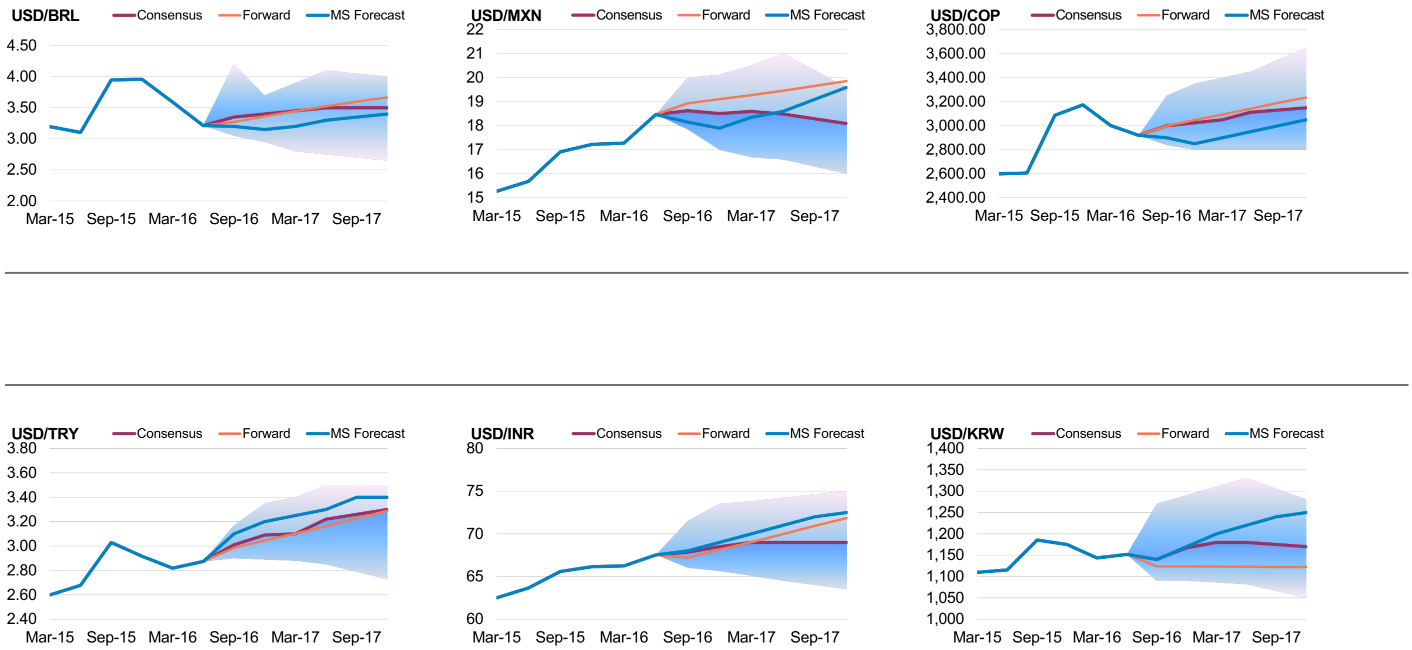












Source: Bloomberg, Morgan Stanley Research Forecasts; shaded area is the range of market forecasts.

Morgan Stanley Global Currency Forecasts

Exhibit 30: FX forecasts - click here for custom cross forecasts

	3Q16	4Q16	1Q17	2Q17	3Q17	4Q17
EUR/USD	1.16	1.18	1.12	1.08	1.04	1.01
USD/JPY	97	99	101	102	105	107
GBP/USD	1.24	1.26	1.27	1.31	1.33	1.35
USD/CHF	0.93	0.91	0.96	0.99	1.02	1.06
USD/SEK	8.28	8.05	8.39	8.61	8.85	9.01
USD/NOK	8.10	8.01	8.30	8.52	8.75	8.91
USD/CAD	1.30	1.34	1.35	1.36	1.38	1.40
AUD/USD	0.75	0.74	0.72	0.71	0.68	0.65
NZD/USD	0.73	0.75	0.76	0.73	0.70	0.67
EUR/JPY	113	117	113	110	109	108
EUR/GBP	0.94	0.94	0.88	0.82	0.78	0.75
EUR/CHF	1.08	1.07	1.08	1.07	1.06	1.07
EUR/SEK	9.60	9.50	9.40	9.30	9.20	9.10
EUR/NOK	9.40	9.45	9.30	9.20	9.10	9.00
USD/CNY	6.78	6.82	6.94	7.05	7.17	7.26
USD/HKD	7.80	7.80	7.80	7.80	7.80	7.80
USD/IDR	13000	13000	13400	13500	13600	13700
USD/INR	68.0	69.0	70.0	71.0	72.0	72.5
USD/KRW	1140	1170	1200	1220	1240	1250
USD/MYR	4.00	4.05	4.10	4.15	4.20	4.25
USD/PHP	47.0	47.5	48.0	48.0	48.5	48.5
USD/SGD	1.36	1.38	1.40	1.40	1.42	1.42
USD/TWD	32.0	32.3	32.5	33.0	33.3	33.5
USD/THB	35.0	35.3	35.6	35.8	36.0	36.0
USD/BRL	3.20	3.15	3.20	3.30	3.35	3.40
USD/MXN	18.15	17.90	18.35	18.60	19.10	19.60
USD/ARS	16.16	16.49	17.32	17.32	17.85	18.39
USD/CLP	655	645	655	670	685	700
USD/COP	2900	2850	2900	2950	3000	3050
USD/PEN	3.25	3.23	3.25	3.35	3.45	3.55
USD/ZAR	14.70	14.60	14.90	15.30	15.80	16.40
USD/TRY	3.10	3.20	3.25	3.30	3.40	3.40
USD/ILS	3.95	4.00	4.05	4.00	3.95	3.90
USD/RUB	63.0	62.0	63.0	64.0	66.0	68.0
EUR/PLN	4.50	4.55	4.50	4.45	4.35	4.25
EUR/CZK	27.25	27.50	27.30	27.10	27.03	27.03
EUR/HUF	320	325	322	316	308	300
EUR/RON	4.55	4.52	4.50	4.45	4.40	4.35
DXY Index	93	93	96	98	101	103
Fed's Broad USD TWI	120	120	123	125	128	130

Source: Morgan Stanley Research, last updated on July 17, 2016.

Appendix

The **Strategic FX Portfolio Trade Recommendations** page presents the portfolio of tactical trade ideas of the FX Strategy team and the performance of this portfolio over time.

Strategic FX Portfolio Trade Recommendations *(Note: The portfolios represent hypothetical not actual investments.)*

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

Performance Statistics

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

Definition of terms

Buy/Long: The analyst expects the total or excess return (depending on the nature of the recommendation) of the instrument or issuer that is the subject of the investment recommendation to be positive over the relevant time period.
Sell/Short: The analyst expects the total or excess return (depending on the nature of the recommendation) of the instrument or issuer that is the subject of the investment recommendation to be negative over the relevant time period.
Selling protection or Buying Risk: The analyst expects that the price of protection against the event occurring will decrease over the relevant time period.

Buying protection or Selling Risk: The analyst expects the price of protection against the event occurring will increase over the relevant time period.
Pay: The analyst expects that over the specified time period the variable rate underlying the swap agreement that is the subject of the investment recommendation will increase.
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When more than one issuer or instrument is included in a recommendation, analyst expects one part of the trade to outperform the other trade or combination of other trades included in the recommendation on a relative basis.

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

Morgan Stanley Matrix

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(as of August 31, 2016)

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STOCK RATING CATEGORY	COVERAGE UNIVERSE COUNT	COVERAGE UNIVERSE % OF TOTAL	INVESTMENT BANKING CLIENTS (IBC) COUNT	IBC % OF TOTAL IBC	IBC % OF RATING CATEGORY	OTHER MATERIAL INVESTMENT SERVICES CLIENTS (MISC) COUNT	MISC % OF TOTAL OTHER MISC
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Equal-weight/Hold	**1458**	**44%**	**305**	**47%**	**21%**	**727**	**46%**
Not-Rated/Hold	**73**	**2%**	**7**	**1%**	**10%**	**10**	**1%**
Underweight/Sell	**651**	**20%**	**86**	**13%**	**13%**	**291**	**18%**
TOTAL	**3,322**		**648**			**1592**	

Data include common stock and ADRs currently assigned ratings. Investment Banking Clients are companies from whom Morgan Stanley received investment banking compensation in the last 12 months.

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