

FX Viewpoint

Currencies
Global

EM currencies: Slow recovery

- ◆ The outlook for EM currencies on the whole has not yet become favourable...
- ◆ ...with the Fed in no rush to cut rates soon, the USD staying strong, and global growth at risk of losing momentum
- ◆ Domestic policies are also likely to receive closer attention

Emerging markets (EM) currencies have been weakening lately, and the road to recovery still appears to be a fractured one, as the necessary conditions for EM currencies to keep improving are still missing.

Global growth is at risk to losing momentum. In particular, for manufacturing, recent downside surprises in US data may become an emerging concern, given the importance of US demand for EM exports. On a positive note, services PMIs have been improving faster in developed markets lately. Our lack of enthusiasm towards EM currencies is not just about growth, however. There is more to it.

One clear headwind for EM currencies is how the level of shorter-term US interest rates remains high, thereby keeping the USD in a strong position. **If the Federal Reserve (Fed) stays on a path of lowering interest rates gradually over the next few quarters, this may still be a challenge for EM currencies.** The level of USD yields is likely to remain comparatively high, in particular against those in Asia. This somewhat explains why most Asian currencies weakened further in June.

Meanwhile, EM central banks may begin to feel more at ease again about lowering their policy rates. This could also bring back renewed concerns about easing monetary policy too quickly, which could test the respective EM currencies if such steps are not deemed prudent. **The point being we cannot rely on the Fed cutting interest rates slowly as a panacea for EM FX.** As always, much will continue to rest of the domestic policy choices – monetary and fiscal. There has been a good reminder of this lately, with uncertain fiscal paths for some Latin American currencies, like the BRL and the MXN.

While the high-yielding Asian currencies do not look likely to appreciate over the near term, **we look for a modest decline in USD-INR, amid index inclusion.** India government bonds will be added to a global bond index, the JPMorgan Government Bond Index-Emerging Markets (GBI-EM), starting from 28 June 2024 over a period of 10 months until March 2025. That being said, comments from the Reserve Bank of India (RBI) Governor Shaktikanta Das suggest that FX reserves will keep rising, because “*strong buffers help prevent volatility in the market*” (Bloomberg, 18 June 2024). **We are cognisant of the upside risk that the RBI’s FX policy poses to USD-INR.**

Among the low-yielding Asian currencies, we think that **the SGD should remain a strong currency**, while our near-term concern is that the nominal effective exchange rate of the SGD (S\$NEER) seems quite elevated in the policy band. For the RMB, it is worth noting that **the USD-CNY fixing rate (i.e., central parity rate) has been rising quite smoothly over May and June, albeit at a glacial pace**, from around 7.10 to around 7.12, and **the Third Plenum will take place on 15-18 July** (Xinhua News Agency, 27 June 2024).

There are mixed signals for global growth

The Fed is expected to lower its policy rate gradually over the coming quarters, supporting the USD

Domestic policies are likely to receive closer attention

USD-INR may remain within a tight range, amid the RBI’s FX policy

For the RMB, markets will be closely watching the USD-CNY fixing rate and the Third Plenum in mid-July

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