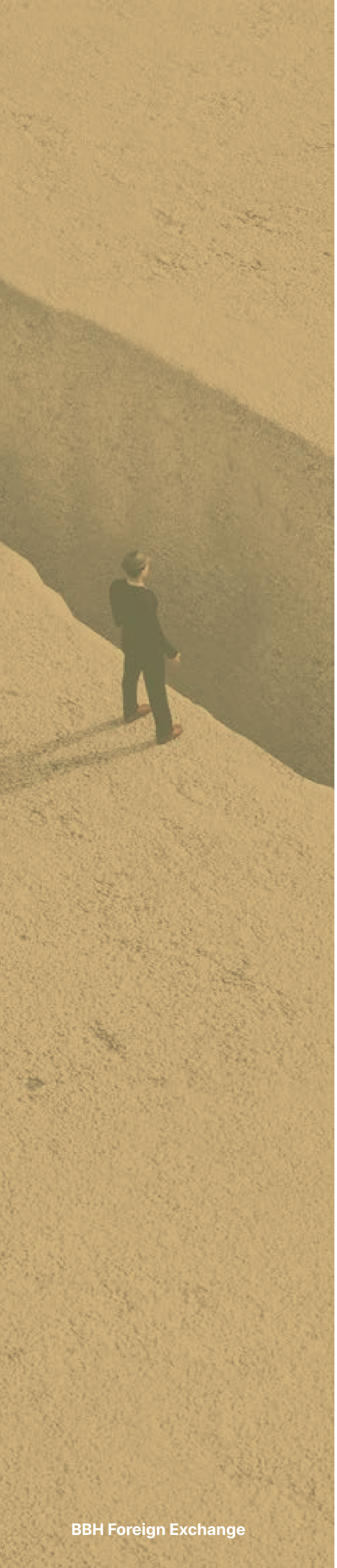
Brown Brothers Harriman

FOREIGN EXCHANGE

2024 THIRD QUARTER OUTLOOK

Dollar Divergence

What next?



What Divergence Means for the Dollar

With the global easing cycle under way, widening divergences should help USD gain further in Q3.

QUICK TAKES

The U.S. economy remains relatively robust, while Europe, the U.K., and Japan are all struggling to grow, and many composite PMIs flirt with a boom and bust cycle.

Global equities should continue to rally on ongoing rate cuts globally. The U.S. should outperform on its soft landing story. Despite signs of slowing in the U.S., growth remains well above many major economies.

Global bond markets should continue to rally on ongoing rate cuts globally as well as falling inflation. Easing in many major economies should continue. U.S. Treasuries should underperform near-term due to the hawkish Fed's story but could play some catch-up once Fed easing begins.

Given the ongoing slow growth in China that should offset the rise in global liquidity, we think a challenging backdrop remains for Emerging Markets (EM). Moreover, the end of certain EM easing cycles are likely to present challenges to growth as well.

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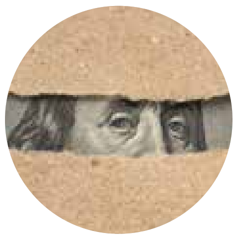

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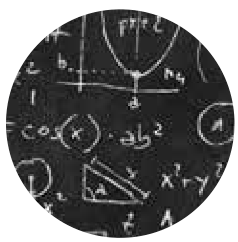

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MAJOR MARKETS GLOBAL OVERVIEW

Easy Does It

When will the Fed cut rates?

By Win Thin

The expected recession in the U.S. has not materialized and a soft landing looks increasingly likely even as growth remains relatively robust. The Fed is likely to keep rates on hold until September.

The labor market remains key. Job growth has slowed but if jobs are being created, consumption will remain the driver for solid U.S. growth.

The May and June inflation data suggests some progress in reaching the Fed's 2% target. However, Fed officials have cautioned against getting too optimistic over one number. Elsewhere, jobs growth is slowing, and unemployment is edging higher. If the recent softness in the data continues, we believe the Fed will deliver a dovish hold at the July 30-31 Federal Open Market Committee (FOMC) meeting that sets up a cut at the September 17-18 meeting.

Between those two meetings, we will receive July and August data for jobs, CPI, PPI, and retail sales data as well as one PCE print for July. While a September cut is fully priced in, we think it will come down to the data. Minutes from the June meeting were more dovish than we expected, with attention focused on the labor market and slowing growth.

The U.S. Elections are a Wild Card

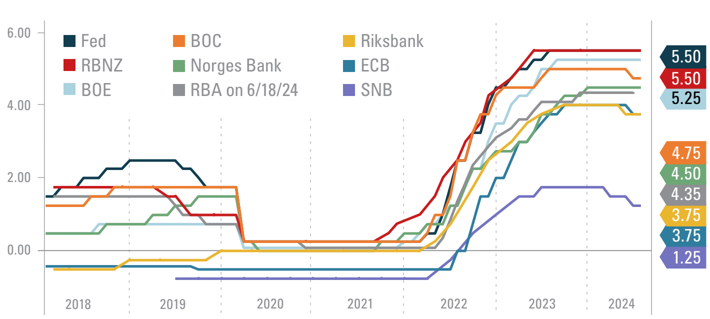
President Biden's poor debate showing has raised the odds that former President Trump will win in November. If Trump wins a second term, markets will be braced for increased fiscal stimulus. Coming at a time when the Fed is struggling to get inflation back to target, added fiscal stimulus would likely keep the Fed more hawkish than it otherwise would have been. Likely tariffs would also tend to be inflationary and would likely add to Fed hawkishness. If so, the strong dollar trade seems intact as the combination of loose fiscal policy and tight monetary policy is widely accepted to be positive for a currency.

Europe Leads Global Easing Cycle

The European Central Bank started its easing cycle in June with a 25 bp cut. While President Lagarde and her colleagues have not been forthcoming about the rate path, recent softness in the data support a second cut in September and a third in December.

- **Switzerland:** The Swiss National Bank (SNB) was the first major central bank to cut rates in March. It followed up with another 25 bp cut to 1.25% in June. With inflation running well below target, the SNB is likely to cut again in September. We believe the Swiss franc will continue underperforming.
- **U.K.:** The Bank of England will likely be the next to cut. With the U.K. general election out of the way, bank officials can now focus on the fact that inflation has moved back to the 2% target. The market sees 50% odds of an August cut, but we believe it is very likely as policymakers turn to boosting the economy.
- We believe that sterling outperforming will ebb once it begins its easing cycle, with the euro likely to become the top performer in this group.

Major Policy Rates, %



Bank of Japan Remains the Outlier

Bank of Japan (BOJ) finally hiked rates in March but has so far provided dovish forward guidance; it left policy unchanged at the June 13-14 meeting and is expected to do so again at the July 30-31 meeting. However, the market sees 50% odds of a hike at that meeting. The BOJ is also expected to reduce its bond-buying at the July meeting.

The economy contracted -0.7% q/q (-2.9% SAAR) in Q1 and is expected to contract again in Q2 which may be contributing to the BOJ's dovish approach. Due to the BOJ's cautiousness, the market is pricing in only 70 bp of tightening over the next three years. The USD/JPY uptrend likely remains intact given the ongoing monetary policy divergences between the hawkish Fed and the dovish BOJ. If the FX market becomes too one-sided, we expect the BOJ to intervene as needed but do not expect such an intervention to reverse the weak yen trend, as we believe only a more hawkish BOJ or more dovish Fed can yield such a result.

Widening Divergences Seen in the Dollar Bloc

Disinflation in the dollar bloc is happening at a varied pace; in turn, this is feeding monetary policy divergences.

- **Canada:** Bank of Canada is the most dovish in the dollar bloc and started easing in June. 25 bp cuts are priced in for September and December, with another 75 bp of easing expected in H1 2025. As a result, CAD should continue underperforming within the dollar bloc.
- **New Zealand:** Back in Q1, a major New Zealand bank called for two more Reserve Bank of New Zealand (RBNZ) hikes to 6.0%. Since then, the data has softened and the market is pricing in nearly 75 bp of easing in Q4, with another 75 bp of easing expected in H1 2025.
- **Australia:** The stickiness of Australian inflation may have contributed to the Reserve Bank of Australia (RBA) delivering hawkish holds in May and June, as rate hikes were discussed. With the data remaining firm, the market is pricing in around 50% odds of a hike in H2. The first cut is not anticipated until Q2 2025. Due to the monetary policy divergences, AUD should continue to outperform within the dollar bloc, with NZD in the middle of the pack and CAD continuing to underperform.

Scandies Also See Widening Divergences

- **Sweden:** Sweden's Riksbank was the second of the major central banks to cut back in May, with the next cut anticipated in August. The Swedish economy is slowing sharply and the Riksbank delivered a dovish hold at the June 27 meeting, warning that "the policy rate can be cut two or three times during the second half of the year"[1] versus two previously. The market is pricing in 75 bp of easing through year-end, with growing odds of a fourth cut in Q4. Another 25 bp of easing is seen in H1 2025.
- **Norway:** At the June 20 meeting, Norges Bank delivered a hawkish hold as it pushed out the timing of a first rate cut to Q1 2025 from Q3 2024 previously. The Norges Bank said it is concerned with "the possibility that if the policy rate is lowered prematurely, inflation could remain above target for too long." With the Norwegian economy remaining robust, the market is pricing in steady rates through year-end, with 75 bp of easing expected in H1 2025.

Monetary policy divergence between Riksbank and Norges Bank suggests NOK/SEK can edge higher.

	Change in Rates to Date (bp)	Expected Change Next 12 Months	Expected Change Next 24 Months	Expected Change Next 36 Months	TOTAL
Federal Reserve	0	-125	-175	-200	**-200**
Bank of Canada	-25	-125	-175	-200	**-225**
European Central Bank	-25	-100	-125	-125	**-150**
Bank of England	0	-100	-150	-175	**-175**
Swiss National Bank	-50	-75	-50	-50	**-100**
Norges Bank	0	-75	-150	-150	**-150**
Riksbank	-25	-125	-150	-175	**-200**
Bank of Japan	10	35	60	70	**80**
Reserve Bank of Australia	0	-25	-50	-50	**-50**
Reserve Bank of New Zealand	0	-150	-200	-200	**-200**

1. Source: Sveriges Riksbank Press Release, June 27, 2024

EMERGING MARKETS GLOBAL OVERVIEW

Emerging Markets Face a Challenging Backdrop

By Win Thin

Key trends driving easing and outlook for H2

Emerging markets face a poor outlook heading into H2. Downside risks from a sluggish China are likely to carry over into H2, while markets will likely continue to wrestle with idiosyncratic political risk. Election surprises in South Africa, Mexico, and India were a gut check to complacent markets, and we have yet to fully understand the economic impact of these events. We have also seen attempted coups in Bolivia and Kenya, adding to the overall outlook.

Carry trades, which typically do best in low volatility, weak dollar environments, have taken hit as those conditions have not been holding for much of Q2 and are unlikely to return in Q3.

Expect Easing Cycles to Continue

Slow growth has led several emerging markets central banks to start cutting rates over the past year. More are expected to begin cutting in H2 2024. While developed market (DM) rates are starting to slowly come down, some in emerging markets have begun aggressive rate cuts. With interest rate differentials narrowing significantly, many emerging markets currencies are coming under pressure.

LATIN AMERICA

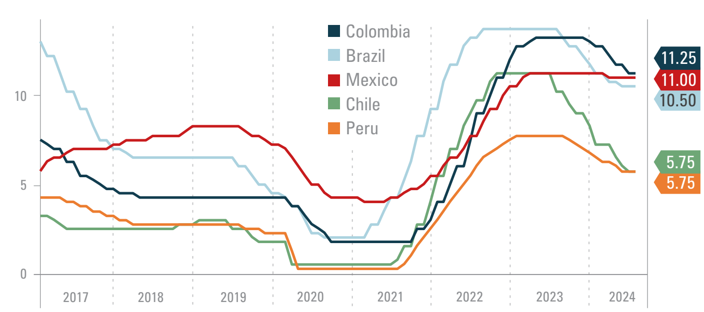
	Change in Rates to Date (bp)	Expected Change Next 12 Months	Expected Change Next 24 Months	Expected Change Next 36 Months	TOTAL
Brazil	-325	125	125	150	**-175**
Chile	-550	-75	-75	-75	**-625**
Colombia	-200	-275	-275	-275	**-475**
Mexico	-25	-125	-250	-250	**-275**
Peru	-200	-150	n/a	n/a	**n/a**

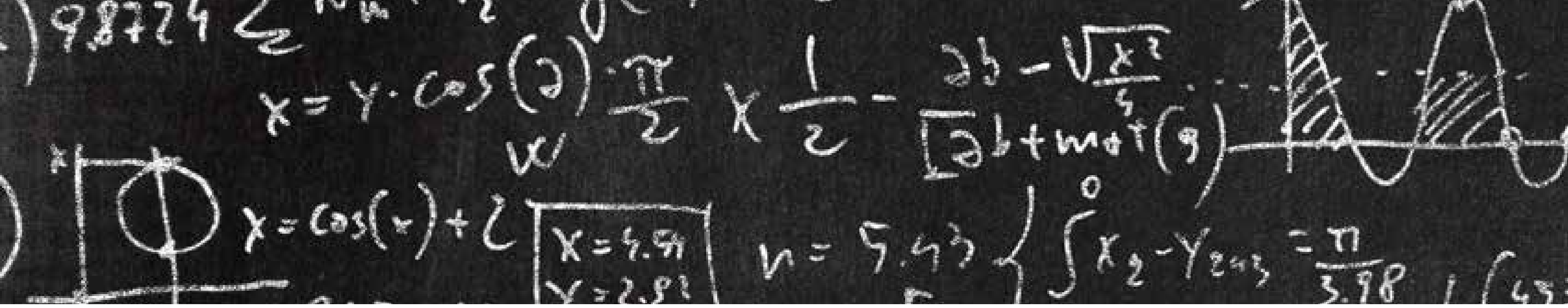
Source: Bloomberg pricing as of 7/12/24

Latin America, excluding Mexico, has been the most dovish of emerging markets, with aggressive rate cuts seen across Chile, Brazil, Colombia, and Peru.

- **Mexico** began with a 25 bp cut in March. Rates have remained steady at 11.00% and the market is pricing in 125 bp of easing over the next 12 months leaving the policy rate at 9.75%.
- **Chile** has taken an aggressive approach to rate cuts, with a 100 bp dovish surprise in July 2023. Since then, it has cut rates by another 450 bp to 5.75% currently. The market is pricing in 75 bp of easing over the next 12 months, taking the policy rate down to 5.0%.
- **Brazil**, having started in August 2023 with a dovish surprise 50 bp, has cut rates by another 275 bp to 10.5% currently. However, the easing cycle is likely over and the market is pricing in 125 bp of tightening over the next 12 months, taking the policy rate up to 11.75%.
- **Colombia**, beginning with a 25 bp cut in December 2023, has cut rates by another 175 bp to 11.25% currently. The market is pricing in 275 bp of easing over the next 12 months, leaving the policy rate down to 8.5%.
- **Peru** made a 25 bp cut in September 2023 and has since cut rates by another 175 bp to 5.75% currently. The market is pricing in 150 bp of easing over the next 12 months that would take the policy rate down to 4.25%.

Latam Policy Rates, %





EMEA

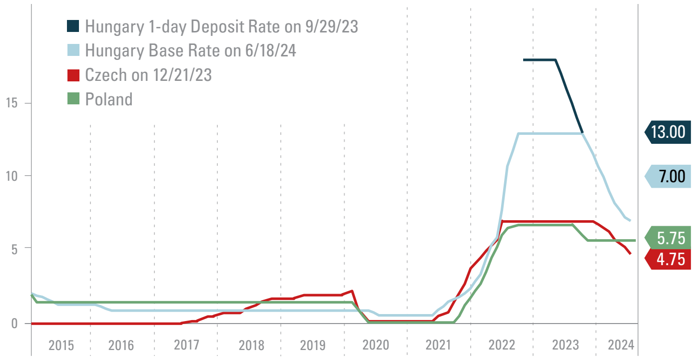
	Change in Rates to Date (bp)	Expected Change Next 12 Months	Expected Change Next 24 Months	Expected Change Next 36 Months	TOTAL
Czech Republic	-225	-75	-150	-150	**-375**
Hungary	-1100	-75	-150	-125	**-1225**
Israel	-25	-50	-75	-50	**-75**
Poland	-100	-25	-150	-150	**-250**
South Africa	0	-100	-100	-75	**-75**
Turkey	0	-1825	-2550	-2750	**-2750**

Source: Bloomberg pricing as of 7/12/24

The CEE region has proved the second most dovish region in emerging markets as Hungary, Czech National, and Poland have begun their easing cycle.

- **Hungary** took an aggressive approach with a 100 bp cut in May 2023 and continued rate cuts by another 1000 bp to 7.0% currently. The market is pricing in 75 bp of easing over the next 12 months, taking the policy rate down to 6.25%.
- **Czech National** followed with a 25 bp cut in December 2022 and cut rates by another 200 bp to 4.75% currently. The market is pricing in 75 bp of easing over the next 12 months taking the policy rate down to 4.0%.
- **Poland** started a dovish 75 bp surprise in September 2023, and another 25 bp in October 2023 but has kept rates steady at 5.75% since. 25 bp of easing is expected over the next 12 months, taking the policy rate to 5.5%.

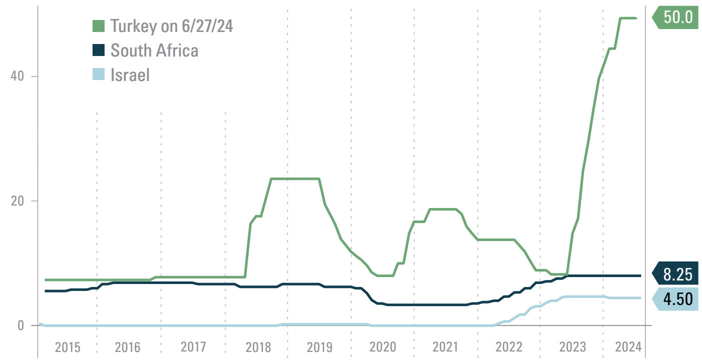
CEE Policy Rates, %

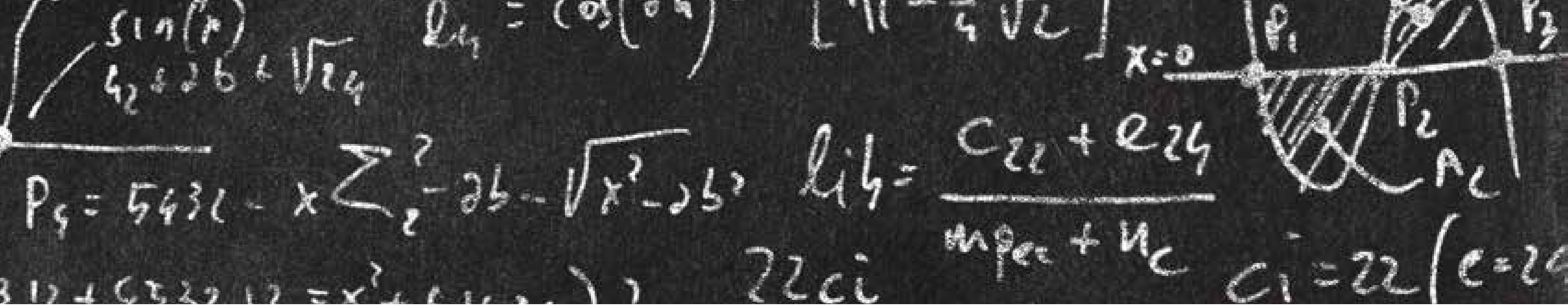


EMEA has been much less dovish than the CEE as both Turkey and South Africa refrain from starting their easing cycle, and Israel began only in January of this year.

- **Turkey**, despite rates peaking at 50.0% after the last hike in March 2024, is pricing in 1825 bp of easing over the next 12 months, leaving the policy rate down at 31.75%.
- **South Africa**'s rates peaked at 8.25% after the last hike in May 2023. The market is pricing in 100 bp of easing over the next 12 months bringing the policy rate down to 7.25%.
- **Israel** began with a 25 bp cut in January 2024 and has kept rates at 4.50%. The market is pricing in 50 bp of easing over the next 12 months taking the policy rate down to 4.0%.

EMEA Policy Rates, %





ASIA

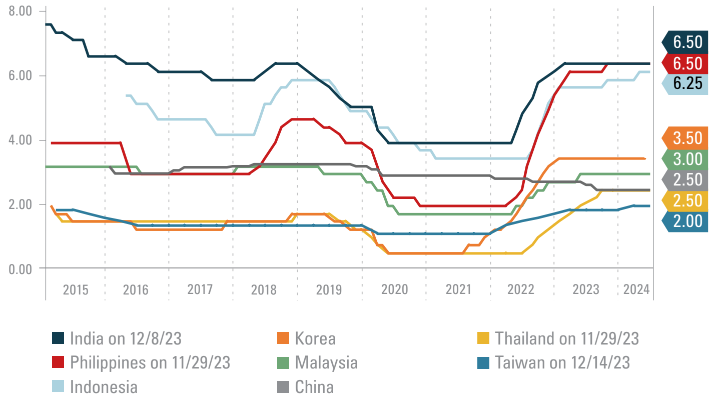
	Change in Rates to Date (bp)	Expected Change Next 12 Months	Expected Change Next 24 Months	Expected Change Next 36 Months	TOTAL
China	-75	0	0	25	**-50**
India	0	-25	-50	-50	**-50**
Indonesia	0	-75	n/a	n/a	**n/a**
Korea	0	-50	-75	-50	**-50**
Malaysia	0	0	0	0	**0**
Philippines	0	-125	-175	-150	**-150**
Taiwan	0	25	25	30	**30**
Thailand	0	-25	-50	-25	**-25**

Source: Bloomberg pricing as of 7/12/24

Asia, the least aggressive in its tightening cycle, saw no central banks beginning their easing cycles as they cannot afford to cut rates too soon as doing so would invite undue pressure on their currencies.

- **China** has been in an extended easing cycle dating back to 2019. Its key 1-year Medium-Term Funding rate has been cut 80 bp over the course of the cycle to 2.5% currently. The market is pricing in no easing over the next 12 months, keeping the policy rate at 2.5%.
- **India**, is remaining cautious, as rates peaked at 6.5% after the last hike in February 2023The market is pricing in 25 bp of easing over the next 12 months, leaving the policy rate down to 6.25%.
- **The Philippines**, whose rates peaked at 6.5% after the last hike in October 2023, is pricing in 125 bp of easing over the next 12 months leaving the policy rate down to 5.25%.
- **Indonesia**'s rates peaked at 6.25% after the last hike in May 2024.The market is pricing in 75 bp of easing over the next 12 months, which would take the policy rate down to 5.5%.
- **Korea**'s rates peaked at 3.5% after the last hike in January 2023. The market is pricing in 50 bp of easing over the next 12 months resulting in a 3.0% policy rate.
- **Malaysia** had rates peak at 3.0% after the last hike in May 2023. The market does not expect easing over the next 12 months, keeping the policy rate at 3.0%.
- **Thailand**'s rates peaked at 2.5% after the last hike in September 2023. The market is pricing in 25 bp of easing over the next 12 months, bringing the policy rate down to 2.25%.
- **Taiwan**, with rates peaking at 2.0% after the last hike in March 2024 is pricing in 25 bp of tightening over the next 12 months, resulting in the policy rate rising to 2.25%.

Asia Policy Rates, %



GLOBAL CURRENCY OVERVIEW

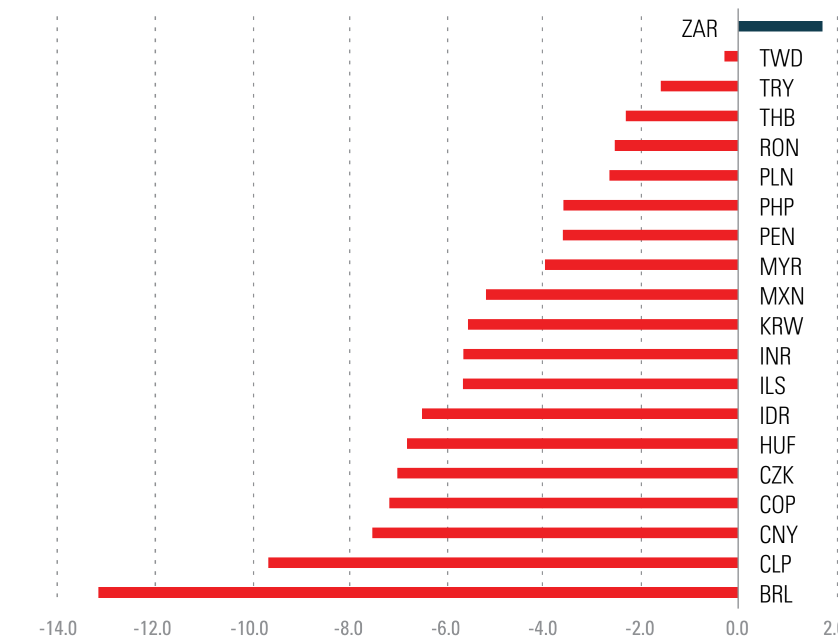
Snapshot of the EMFX Landscape

BBH markets strategist **Elias Haddad** shares key metrics to help shape investors' views on emerging market currencies.

Emerging market currencies (EMFX) have been under downside pressure versus the U.S. dollar (USD) since the start of the year on a more hawkish Fed. However, the decline in EMFX has largely been cushioned by steady global growth, easing inflation, and expectations of lower interest rates in advanced economies.

ZAR is the top performing EM currency so far this year while BRL underperformed the most (see chart below), reflecting diverging monetary policies. South Africa's central bank has kept rates on hold at 8.25% since lifting them to that level in May 2023. Brazil's central bank, by contrast, slashed the policy rate 125 bp this year to 10.50%. Encouraging political developments in South Africa also underpinned a strong ZAR. The African National Congress party agreed to a power-sharing deal with business-friendly opposition parties following the May 29 elections.

% Spot Return Versus USD
2/29/2023 – 07/01/2024



Source: Bloomberg

Going forward

In this FX Quarterly, BBH's Markets Strategy team provides overview tables by region of the fundamental landscape to unpack the structural and cyclical factors driving EMFX.[1] These tables complement our adjusted Purchasing Power Parity (PPP) model for the G10 currencies.

Here are the key takeaways:

- In LATAM, CLP and PEN should outperform BRL. We are neutral on MXN and COP.
- In EMEA, ZAR should outperform TRY (see chart above). We expect HUF to outperform PLN reflecting diverging valuations. We are neutral on ILS and RON.
- In Asia, IDR, THB, TWD, KRW should outperform INR and CNH. We are neutral on MYR and PHP.

The following summarizes our overview for each currency and whether we are bullish, bearish, or neutral. The bear, bull and equal indicators are an outlook based on factors like economic health, interest rates, debt, and GDP.

1. These tables are not scorecards nor performance dashboards but rather should serve as guides to help shape a relative EMFX view.

LATAM

		BRAZIL	MEXICO	CHILE	PERU	COLOMBIA	LATAM GDP-Weighted Average
VALUATION	REER* (% deviation from trend)	-7.2	24.1	-2.1	5.3	3.2	**6.3**
STRUCTURAL DRIVERS (5 years or more)	TOT** (Ann% Chg)	-0.2	0.2	2.1	2.2	0.9	**0.3**
	NIIP*** (% of GDP)	-38.9	-36.0	-18.1	-36.9	-49.6	**-37.2**
	FX Reserves**** (% of GDP)	14.8	10.6	13.7	24.5	15.4	**13.7**
	Net Government Debt**** (% of GDP)	86.7	55.6	40.5	33.0	54.4	**66.9**
	External Debt**** (% of GDP)	31.4	29.4	72.2	33.3	50.9	**34.7**
CYCLICAL DRIVERS (a few months to 3 years)	Real Policy Rate (%)	6.6	6.3	1.6	3.8	4.1	**5.8**
	2024 Monetary Stance % (1 year change in policy rate); Tight policy (+), Loose policy (-)	-3.3	-0.3	-5.5	-1.8	-2.0	**-2.1**
	2024 Fiscal Stance %**** (1 year change in cyclically-adjusted primary balance); Tight policy (+), Loose policy (-)	1.3	-2.5	1.6	0.1	0.2	**-0.3**
	Current Account Balance (% of GDP)	-1.5	0.2	-4.1	1.4	-2.1	**-0.9**
	Net FDI**** (% of GDP)	1.6	1.5	4.6	0.9	3.9	**1.9**

Source: Bloomberg July, 2024

* Real effective exchange rate. Source: Bank for International Settlements
** Terms of Trade. Source: Goldman Sachs
*** Net International Investment Position. Source: IMF
**** FDI denotes Foreign Direct Investment. Source: IMF

Brazilian Real

BRL is undervalued. Brazil's large net government debt and negative net international investment position are structural drags for BRL. The cyclical backdrop is more neutral for BRL. Brazil's positive real policy rate offers BRL support, but the country's tight fiscal/loose monetary policy mix is usually negative for a currency.

Moreover, the risk of political interference with monetary policy does not bode well for BRL. Brazil's President Lula has been critical of the current central bank head for not cutting the policy rate more aggressively and plans to nominate a governor that is immune to financial market hesitancy later this year.

Mexican Peso

MXN is significantly overvalued. Mexico's negative net international investment position remains a structural drag to MXN. The cyclical backdrop is positive for MXN backed by Mexico's high real policy rates and a tiny current account surplus alongside large net FDI inflows.

Real interest rates are forecast to continue offering MXN support. Mexico's central bank projects headline inflation to converge to the 3% target by the end of 2025 while the swaps market is pricing in a policy rate closer to 9% over the next three years. A downside risk to MXN is the potential for unchecked political power. Mexico President-elect Claudia Sheinbaum and her party won a strong mandate following the June 2nd election to move forward with controversial constitutional reforms.

Chilean Peso

CLP is modestly undervalued. The undervaluation is not justified by Chile's relatively low public debt, small net international investment liabilities, and rising terms of trade. Nevertheless, Chile's relatively low real policy rate and tight fiscal/loose monetary policy mix are cyclical headwinds for CLP.

The bullish outlook for copper prices (Chile's biggest commodity export) is the biggest tailwind for CLP. Demand for copper is anticipated to rise over the long term from the green energy transition, artificial intelligence, and greater military spending.

Peruvian Sol

PEN is overvalued. The structural drag to PEN from Peru's negative net international investment position is outweighed by the country's relatively low public debt, large FX reserves and rising terms of trade. Moreover, Peru's positive real policy rate and a current account surplus on top of net FDI inflows are a cyclical boost to PEN.

Colombian Peso

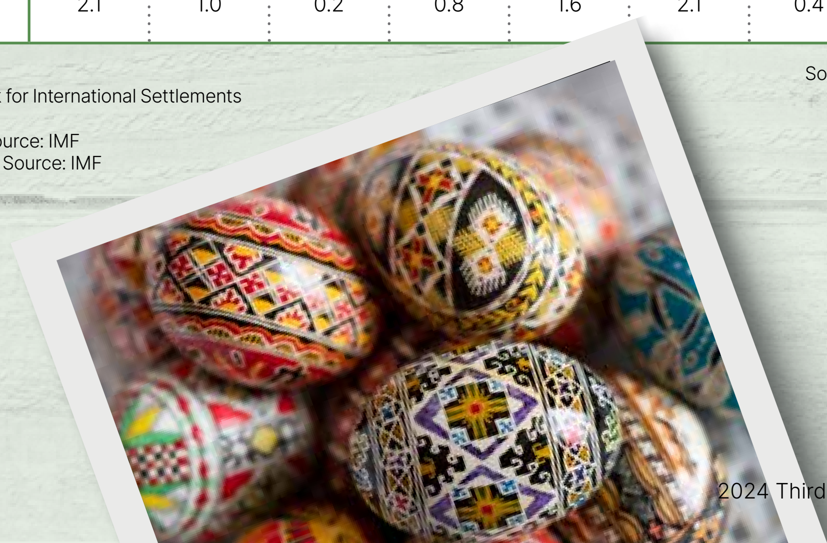
COP is slightly overvalued. Colombia's relatively high net international investment liabilities and external debt ratios remain structural drags for COP. Regardless, Colombia's positive real policy rates and a current account deficit that is more than made up for by net FDI inflows support COP on a cyclical investment horizon.

EMEA

		SOUTH AFRICA	ISRAEL	CZECH	ROMANIA	HUNGARY	POLAND	TURKEY	EMEA GDP-Weighted Average
VALUATION	REER* (% deviation from trend)	2.3	1.0	5.0	-1.5	-3.5	11.2	-25.4	**-4.6**
STRUCTURAL DRIVERS (5 years or more)	TOT** (Ann% Chg)	0.4	-0.3	-0.3	-0.6	-0.7	-0.4	-0.2	**-0.3**
	NIIP*** (% of GDP)	26.6	40.1	-13.6	-38.4	-41.0	-33.7	-25.6	**-14.2**
	FX Reserves**** (% of GDP)	14.1	39.7	44.5	19.1	20.0	21.3	5.9	**20.3**
	Net Government Debt**** (% of GDP)	75.4	67.3	45.1	53.0	74.7	55.1	30.9	**51.8**
	External Debt**** (% of GDP)	42.4	29.2	63.4	22.3	125.2	50.5	44.9	**47.8**
CYCLICAL DRIVERS (a few months to 3 years)	Real Policy Rate (%)	3.1	1.7	2.2	1.9	3.0	3.2	-25.5	**-5.7**
	2024 Monetary Stance % (1 year change in policy rate); Tight policy (+), Loose policy (-)	0.0	-0.3	-2.3	0.0	-6.0	-1.0	41.5	**11.4**
	2024 Fiscal Stance %**** (1 year change in cyclically-adjusted primary balance); Tight policy (+), Loose policy (-)	0.3	-2.6	1.5	-0.2	1.5	0.4	0.7	**0.2**
	Current Account Balance (% of GDP)	-1.7	5.1	0.4	-6.9	1.3	1.8	-2.8	**-0.4**
	Net FDI**** (% of GDP)	2.1	1.0	0.2	0.8	1.6	2.1	0.4	**1.2**

Source: Bloomberg July, 2024

* Real effective exchange rate. Source: Bank for International Settlements
** Terms of Trade. Source: Goldman Sachs
*** Net International Investment Position. Source: IMF
**** FDI denotes Foreign Direct Investment. Source: IMF



South African Rand

ZAR is modestly overvalued. South Africa's relatively high public debt ratio remains a structural drag on ZAR but is counterbalanced by the country's positive net international investment position. Importantly, ZAR benefits from South Africa's positive real policy rates, rising terms of trade and net FDI inflows that exceed the current account deficit.

Real interest rates are expected to continue offering ZAR support. South Africa's central bank projects headline inflation to stabilize at the 4.5% target by Q2 2025 while the swaps market is pricing in a policy rate of 7.50% over the next twelve months.

Israeli Shekel

ILS is around equilibrium. Israel's positive net international investment position and large FX reserves are structural tailwinds to ILS. Meanwhile, Israel's positive real policy rates and a current account surplus over and above net FDI inflows bode well for ILS on a cyclical investment horizon.

Real interest rates are expected to be less supportive for ILS. Israel's central bank projects headline inflation to remain around 2.8% by Q1 2025 and forecasts a policy rate of 3.75% over the same period. The swaps market is pricing in a less aggressive easing cycle with a policy rate of 4% over the next twelve months. Regardless, Israel's ongoing war with Hamas and a potential all-out conflict with Hezbollah complicates the policy rate path projection.

Czech Koruna

CZK is slightly overvalued. The structural drag to CZK from the Czech Republic's negative net international investment position and relatively large external debt ratio is partly mitigated by the country's substantial FX war chest. The cyclical backdrop is also neutral for CZK. CZK benefits form the Czech Republic's positive real policy rates and favorable balance of payments backdrop. However, the country's tight fiscal/loose monetary policy mix restrains CZK.

Real interest rates are expected to be less accommodating for CZK. The Czech central bank projects headline inflation to stabilize at 1.9% from Q2 2025 and forecasts the policy rate to average 3.7% over the same period.

Romanian Leu

RON is modestly undervalued. Romania's relatively high net international investment liabilities and large current account deficit remain structural and cyclical drags for RON. However, positive real policy rates are supportive of RON. Romania's central bank is expected to cut the policy rate 25 bp to 6.75% in July and projects inflation to ease to 4.9% y/y in Q4.

Hungarian Forint

HUF is undervalued. Hungary's negative net international investment position, negative terms of trade, elevated debt ratios, and tight fiscal/loose monetary policy mix justify HUF's undervaluation. Nevertheless, Hungary's relatively high real policy rates and favorable balance of payments backdrop offer HUF some cyclical support.

Real interest rates are expected to continue favoring HUF. After slashing the policy rate 375 bp in the first half of the year to 7%, Hungary's central bank sees limited room for additional easing the rest of the year and expects inflation to average 3.75%. The swaps market implies a policy rate of 6.75% over the next twelve months.

Polish Zloty

PLN is overvalued. Poland's net international investment liabilities and relatively elevated debt ratios are structural drags on PLN. However, Poland's high real policy rates and a current account surplus on top of net FDI inflows favor a firm PLN on a cyclical investment horizon.

However, the tailwind to PLN from a positive real interest rate will likely fade over the next several months. Poland's central bank plans to keep rates at 5.75% in 2024 while it projects inflation at 5.2% by year-end amid partial unfreezing of prices on food and energy.

Turkish Lira

TRY is significantly undervalued. The undervaluation is justified by Turkey's negative net international investment position, low FX reserves, deeply negative real policy rates, and a current account deficit.

ASIA

		INDONESIA	TAIWAN	THAILAND	MALAYSIA	PHILIP-PINES	SOUTH KOREA	INDIA	CHINA	ASIA GDP-Weighted Average
VALUATION	REER* (% deviation from trend)	-1.8	11.2	-3.6	-2.4	4.0	-2.9	1.1	-12.0	**-7.8**
STRUCTURAL DRIVERS (5 years or more)	TOT** (Ann% Chg)	-0.4	-0.2	-0.1	-0.3	-0.3	-0.2	-0.5	-0.2	**-0.2**
	NIIP*** (% of GDP)	-17.7	208.2	7.7	6.8	-10.9	4.6	-10.4	14.9	**13.8**
	FX Reserves**** (% of GDP)	8.8	84.9	37.7	24.9	19.6	23.1	14.8	17.3	**19.4**
	Net Government Debt**** (% of GDP)	39.3	22.5	64.5	66.4	56.9	56.6	82.5	88.6	**79.9**
	External Debt**** (% of GDP)	27.6	29.7	35.2	60.7	26.6	37.7	16.5	13.6	**18.1**
CYCLICAL DRIVERS (a few months to 3 years)	Real Policy Rate (%)	3.7	-0.2	1.0	1.0	2.6	0.8	1.8	3.2	**2.7**
	2024 Monetary Stance % (1 year change in policy rate); Tight policy (+), Loose policy (-)	0.5	0.1	0.5	0.0	0.3	0.0	0.0	-0.2	**-0.1**
	2024 Fiscal Stance %**** (1 year change in cyclically-adjusted primary balance); Tight policy (+), Loose policy (-)	-0.7	-1.3	-1.3	0.9	1.2	0.5	0.9	-0.5	**-0.2**
	Current Account Balance (% of GDP)	-0.5	14.9	1.4	1.8	-1.9	3.2	-0.7	1.2	**1.3**
	Net FDI**** (% of GDP)	1.0	-2.2	-1.1	-0.5	1.4	-1.1	0.4	-0.8	**-0.5**

Source: Bloomberg July, 2024

* Real effective exchange rate. Source: Bank for International Settlements
** Terms of Trade. Source: Goldman Sachs
*** Net International Investment Position. Source: IMF
**** FDI denotes Foreign Direct Investment. Source: IMF

Indonesian Rupiah

IDR is slightly undervalued. The structural drag to IDR from Indonesia's negative net international investment position is partly offset by a relatively low public debt burden. Cyclically, IDR benefits from Indonesia's loose fiscal/tight monetary policy mix and positive real policy rates. Moreover, Indonesia's central bank has sufficient FX reserves to continue intervening to stem the decline in IDR and help prevent imported inflation.

Taiwan Dollar

TWD is overvalued. Taiwan's substantial FX reserves and net international investment assets remain important structural tailwinds to TWD. Taiwan's loose fiscal/tight monetary policy mix and large current account surplus bode well for TWD on a cyclical investment horizon.

Meanwhile, the drag to TWD from Taiwan's negative real policy rate is expected to fade over the rest of 2024. Taiwan's central bank projects inflation to be closer to 2% in the second half of 2024 while the swaps market is pricing in the policy rate to be between 2.00 and 2.25% over the next six months.

Thai Baht

THB is undervalued. Thailand's positive net international investment position and large FX reserves are structural tailwinds to THB. Additionally, THB benefits from Thailand's loose fiscal/tight monetary policy mix and positive real policy rates. Thailand's central bank projects headline inflation to average 0.6% for 2024 while the swaps market is pricing in a policy rate between 2.25–2.50% over the next six months.

Malaysian Ringgit

MYR is undervalued. The structural drag on MYR from Malaysia's large external debt is lessened by the country's net international investment assets, rising terms of trade, and large FX reserves. Meanwhile, Malaysia's positive real policy rates and favorable balance of payments backdrop are supportive of MYR. Additionally, Malaysia's central bank has taken coordinated measures with the government to shore up the ringgit.

Philippine Peso

PHP is overvalued. The Philippine's net international investment liabilities and declining terms of trade are structural drags to PHP. Meanwhile, the cyclical tailwind to PHP from the Philippine's positive real policy rate is minimized by the country's current account deficit and the swaps market that is pricing in over 100bps of policy rate cuts over the next 12 months.

South Korean Won

KRW is undervalued. The undervaluation is not justified by South Korea's net international investment assets position. Additionally, KRW is backed by a positive real policy rate and a current account surplus that more than offsets net FDI outflows.

Indian Rupee

INR is around equilibrium. India's net international liability position, high public debt and negative terms of trade are structural drags for INR. Meanwhile, the cyclical support to INR from India's positive real policy rates is reduced by the country's small current account deficit.

Chinese Renminbi

CNH is deeply undervalued. The tailwind to CNH from China's positive net international investment position is mitigated by the country's large public debt overhang. Meanwhile, China's balance of payments backdrop is a cyclical drag on CNH, driven by net FDI outflows. Widening interest rate differentials with other major economies, concerns about China's growth prospects, and rising geopolitical risks suggest net FDI outflow pressures will continue.

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