June 14, 2018 07:43 PM GMT

FX Pulse

Liquidity Breaks Correlations

USD bulls run out of steam. The USD behavior post-Fed increased our conviction that the upward USD correction which began in February is complete. USD bullish positioning and market sentiment may soon be challenged by the US sharpening its protectionist rhetoric, which is likely to dampen risk appetite. Recent weeks have seen US equities and the USD rally simultaneously as investors moved funds into the US. We expect these flows to reverse from here, suggesting a lower USD as US markets become less supported. We remain bearish USD largely across the board.

The summer of de-correlation. Waning global liquidity means risk will no longer be universally supported, suggesting investors will withdraw from risk assets but only the riskiest and weakest ones first. This explains the sharp EM selloff which contrasts with solid US equity performance. Divergent performance is typical in the early stages of tightening liquidity conditions. Eventually, this liquidity-induced de-correlation transitions into a universal volatility spike which should benefit surplus currencies like the JPY and EUR. The upcoming "summer of de-correlation" may then continue as the "autumn of liquidation."

Lower US bond yields. Rising US fiscal deficits will require higher capital inflows, meaning the US will need to offer compensation via higher yields or a cheaper exchange rate. Given high US leverage, particularly in the corporate sector, higher yields will be more difficult to manage, suggesting a weaker USD is more likely.

EM rebound. Anticipated USD weakness should allow oversold EM assets to rebound. Attractive EM valuations may help, but the declining liquidity pool suggests our not getting too bullish on currencies requiring capital imports. Long-lasting bullish EM trends may be a thing of the past. KRW outperformance seems complete as the balance of headline risks reverses and we sell it against JPY. We add a bullish RUB position and buy SGD against MYR.

Exhibit 1: Current trade portfolio

Closed Trades			
Short USD/KRW 3m NDF		Closed at 1082 on 13-Jun-18	
Long AUD/MYR 3m NDF		Close at NY Close on 14-Jun-18	
Active Orders	**Entry**	**Stop**	**Target**
Short USD/CHF	0.9940	1.0065	0.9400
Long CLP,COP vs MXN	1.9175	1.8600	2.0300
Short USD/JPY	110.00	111.50	103.00
Short USD/INR 1m NDF	67.27	68.80	63.00
Short USD/NOK	8.06	8.20	7.50
Short USD/SEK	8.70	8.88	8.20
Short USD/PLN	3.62	3.72	3.45
New Trades			
Sell USD/RUB	NY Close 14-Jun-18	64.20	59.50
Buy SGD/MYR 3m NDF	NY Close 14-Jun-18	2.92	3.15
Buy JPY/KRW 3m NDF	NY Close 14-Jun-18	9.60	10.30

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

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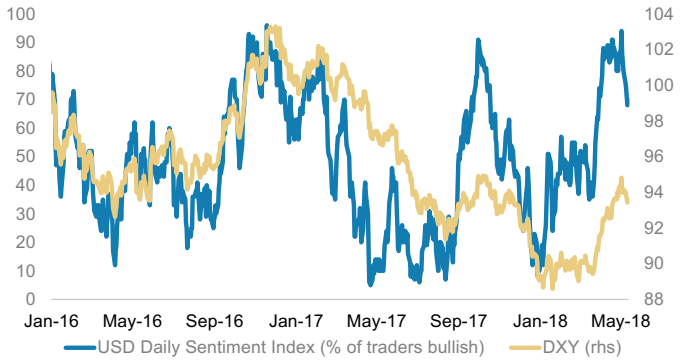
FX Overview

Hans Redeker

Bottom line: **While the global growth outlook remains favorable for risk, tighter liquidity conditions suggest a more cautious approach. Markets are trading accordingly, with increasing differentiation and de-correlation, credit trading weak while other markets are trading towards historical highs. The outlook for assets has become increasingly heterogeneous, with reduced correlations likely to continue, ultimately translating into higher volatility. It seems the ECB is now the next central bank to take away the QE punch bowl, which will not only sow the seeds for a meaningful future EUR appreciation, but also lead to NOK and SEK outperforming and CHF moving lower, we believe.**

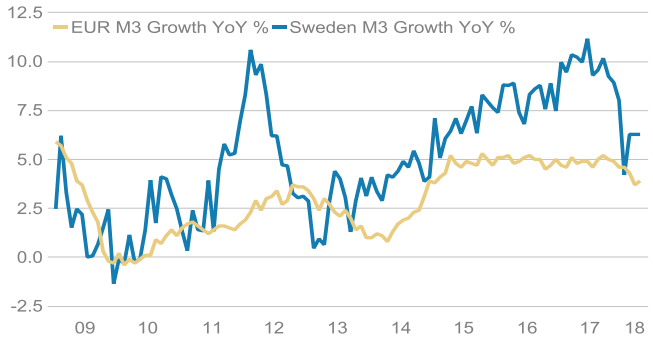
Buying the EUR dip. The ECB suggested terminating QE in December, but leaving interest rates at current levels into the summer, which has led our economists to push back the timing of the first depo rate hike to October 2019. The ECB is providing the market with the impetus for a steeper EGB yield curve, as net asset purchases ending coupled with a lower-for-longer path of front end rates should keep EGBs on a steepening trajectory. We believe the pace of the European economic recovery will only bolster this process further.

Exhibit 2: USD bullish sentiment comes off the highs seen in late May



Source: Daily Sentiment Index provided by www.trade-futures.com, Morgan Stanley Research

Exhibit 3: Dovish ECB and Riksbank policy has supported Swedish credit growth



Source: Macrobond, Morgan Stanley Research

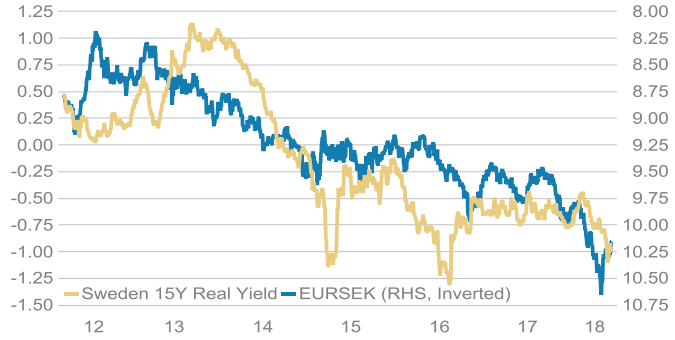
A steeper curve incentivizes investors to buy local assets on a currency-hedged basis, which is FX neutral. For FX, then, it is the second round effects that matter. The capital inflow helping local assets to rally can spark future currency-unhedged positions. Moreover, the improvement in financial conditions provided by these flows supports the growth outlook. Finally, a steeper curve works in favor of bank profitability and may support lending as well, fueling further recovery and growth. This is why a steeper curve supports a currency, explaining why we view EURUSD below 1.16 as attractive from a longer-term perspective.

The ECB guiding... The importance of the ECB's policy stance for other European currencies cannot be emphasized enough. Because of the deep trade and financial linkages between these economies and the eurozone, these countries' monetary policies were inexorably linked as well. The ECB's very dovish stance over recent years has meant that it is difficult for these other central banks to materially tighten policy, lest they see their currencies appreciate. This took place, for example, in 2011 as the Riksbank tried to turn more hawkish relative to the ECB, which led to a sharp appreciation in the SEK.

...the Riksbank... Since then the Riksbank has followed the ECB in a fairly consistent fashion, regardless of domestic economic conditions. This meant a lack of a hawkish response to Sweden's robust economic performance and inflationary pressures, which pushed local credit growth up and real yields lower, in turn enabling the increase in real estate prices to unprecedented levels both in nominal terms and relative to household income and GDP (Exhibit 3).

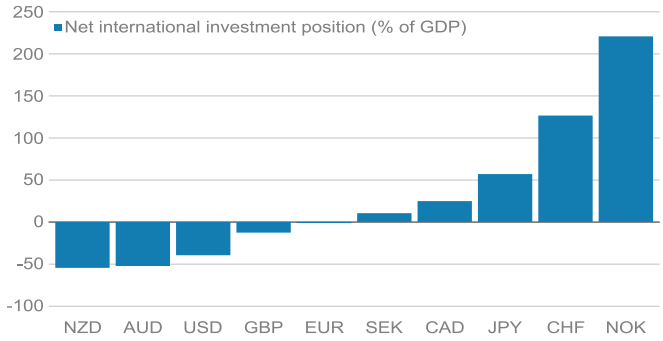
SEK has traded like USD did in 2004-07. Local entities looking for higher yields abroad kept the currency on the back foot. In the case of the US, it was the glut of Asian savings depressing US real yields, forcing domestic investors to seek returns abroad, in turn pushing USD lower. For Sweden, it was the ECB providing liquidity to European investors, depressing Swedish real yields. Now, as the ECB considers tapering its asset purchases and this mechanism weakens, SEK real yields are likely to rise, allowing SEK to rebound (Exhibit 4).

Exhibit 4: Rising Swedish real yields would support SEK



Source: Macrobond, Morgan Stanley Research

Exhibit 5: NOK, SEK, and CHF all have positive net foreign asset positions



Source: Macrobond, Morgan Stanley Research

...and to a lesser degree Norges Bank: Norges Bank has had a similar experience, suggesting that a tighter ECB policy stance would also have an impact on NOK. The recent change in Norges Bank's mandate to incorporate financial stability, coupled with the reduction in its inflation target from 2.5%Y to 2.0%Y, suggests a hawkish shift in the reaction function. This means that, unlike the Riksbank, Norges Bank may be poised to move more quickly and even ahead of the ECB, given this important distinction. This would allow NOK to outpace the projected rally.

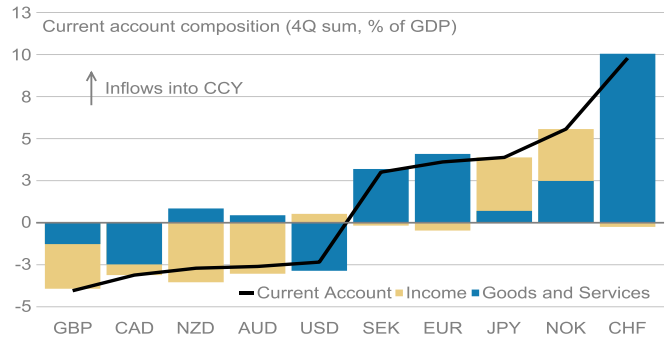
Tighter ECB, weaker CHF: CHF stands on the other side of this equation – it should weaken in response to ECB tightening. Some may find this surprising, given that Switzerland has similarities to Sweden and Norway. All three countries run significant current account surpluses, have accumulated foreign asset positions, and have seen their real yields fall significantly over recent years. However, key differences in their banking sectors with respect to funding suggest that CHF will weaken against SEK and NOK.

Bank funding... Norway's and Sweden's banks rely primarily on wholesale funding, while Swiss banks are more similar to Japanese banks in that they have high levels of deposits. This is why negative money market rates have undermined Swiss banking sector profitability though deposit subsidization, while its Nordic counterparts borrow at more negative rates via wholesale funding instruments. Nordic banks pushed low-cost liquidity into domestic markets, leading to higher asset valuations. These low yields prompted Nordic investors to search outside their borders for higher returns.

The reversal of this process should have different effects, then. The ECB turning more hawkish and tightening policy, in turn allowing Norges Bank and the Riksbank to move as well, should have a more material effect on domestic wholesale funding costs than in Switzerland, where subsidized deposit rates are unlikely to move until money market rates reach positive territory.

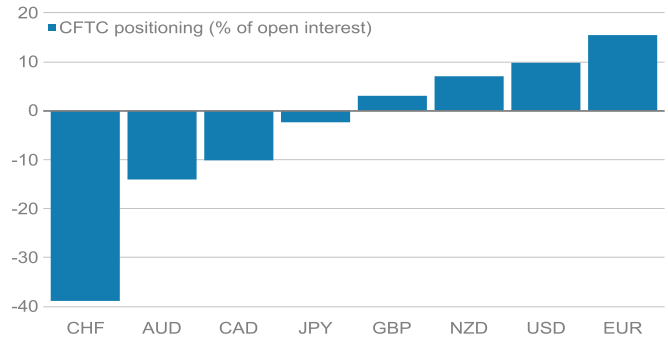
...holds the key to anticipated CHF weakness: The reliance of Swiss banks on deposits rather than wholesale funding has meant that the cost of liabilities have fallen less than the returns on assets because banks are unable to pass the negative rates along to depositors. This reduction in net interest margins has reduced the incentive for Swiss banks to expand their balance sheets. The relative high cost of deposits reduces the incentive to borrow from depositors to invest, including into other areas like the eurozone where asset returns remain low relative to Swiss deposit rates.

Exhibit 6: Swiss current account surplus is almost entirely driven by trade



Source: Macrobond, Morgan Stanley Research

Exhibit 7: CHF short futures positioning is the shortest in the G10 and nearly the shortest since the crisis



Source: Macrobond, Morgan Stanley Research

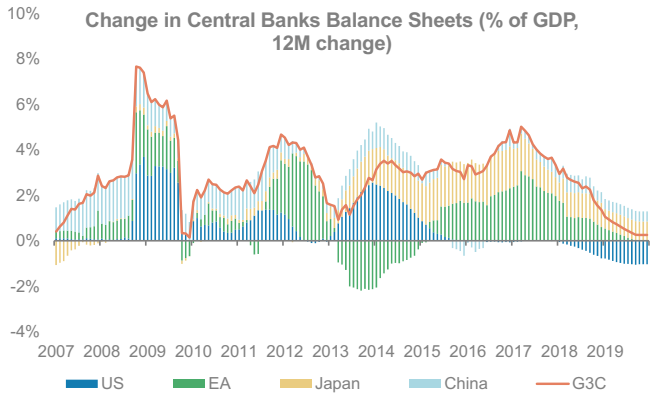
The strength of CHF has largely been explained by the trade size of the current account. The lack of a high income balance may partly be explained by this relatively low foreign investment return argument (Exhibit 6). This may change, though, as the ECB begins to tighten policy. If returns on European foreign assets rise, then the incentive to borrow from Swiss depositors and invest abroad increases. Thus, it may be the ECB tightening policy that provides the starting point for prolonged CHF weakness if this mechanism plays out and the incentive for Swiss institutions to add to foreign asset holdings increases.

The yield curve steepening ECB may boost Swiss bank profitability by widening the yield spread between CHF-denominated deposits and EUR-denominated assets. This in turn would ease the balance sheet consolidation pressures as it renders balance sheet expansion more attractive. It is this pressure that had prevented Swiss real money investors from converting short-term foreign asset holdings into long-term asset holdings.

CHF short opportunity: Our analysis of income balances suggests that Switzerland is investing its foreign assets into low-yielding, and thus short-term and liquid, instruments. The weakening of CHF in 2017 may have been driven by speculative investors, rather than by real money investors themselves, as evident in the substantial swing in CHF futures data (Exhibit 7). Markets may have gotten a bit ahead of themselves in this regard. However, the ECB now preparing to stop its balance sheet expansion may allow CHF to weaken because these real money flows genuinely emerge. It will be European yields that offer the signal here.

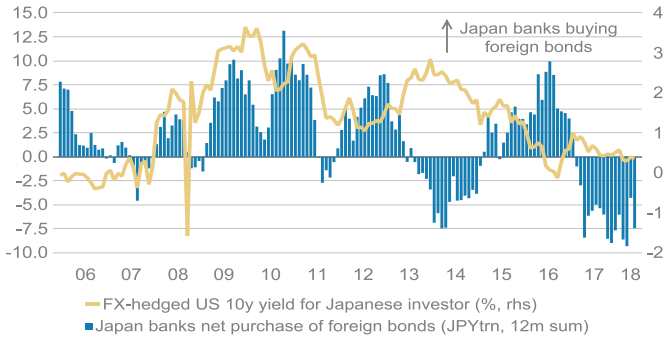
Global liquidity… The pool of global liquidity appears to be starting to shrink. Several factors are at play here. First, the Fed's balance sheet reduction is increasing pace while the ECB and BoJ are reducing their asset purchases (Exhibit 8). On net, global central bank liquidity is likely to turn negative over time when compared to GDP growth. Second, the global economic expansion suggests that capital will increasingly be allocated to 'real' economic uses as opposed to financial assets. A closed output gap suggests rising capital demand as spare capacity is eroded, and investment into new capacity requires financing.

Exhibit 8: Global central bank balance sheet growth expected to decline further



Source: Morgan Stanley Research

Exhibit 9: Japanese banks have been liquidating foreign bonds



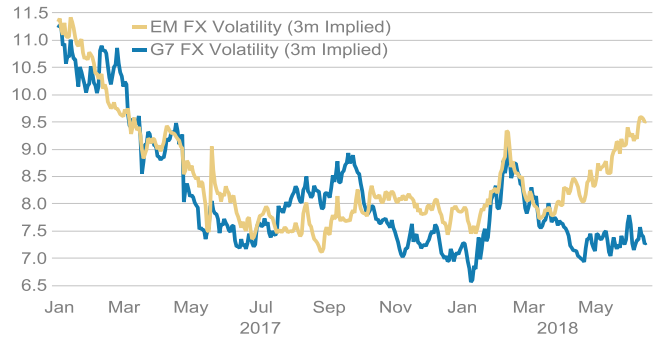
Source: Macrobond, Morgan Stanley Research

Third, the flattening of the US yield curve has reduced the incentive of local financial institutions to transform short-term liabilities into long-term assets (maturity transformation). If banks are less willing to generate liquidity through the maturity transformation process, another buyer will have to step in to make up for the shortfall. Japanese banks liquidating their FX-denominated assets is evidence that demand for US assets is falling outside the US as well, meaning tighter liquidity conditions as demand for financial assets declines (Exhibit 9).

...volatility... Tighter liquidity conditions suggest higher volatility as the risk-absorbing capacity of markets declines. When liquidity is ample, all boats tend to get lifted. The reverse effect may be more selective, though. EM volatility has risen sharply, but DM volatility, with the exception of some credit markets, has been relatively muted (Exhibit 10). Indeed, US equity markets are trading near historical highs, while the 10-year Treasury yield fell back from the recent 3.12% cycle high. It seems the liquidity pool is both shrinking and becoming more concentrated, too. One explanation for the differential in volatility is that we have simply seen a rotation – out of EM and into DM – which explains why DM volatility has been relatively muted compared to EM. This too suggests that a positive outlook for US shares may no longer imply that EM assets will perform well too if they increasingly attract funds at EM assets' expense.

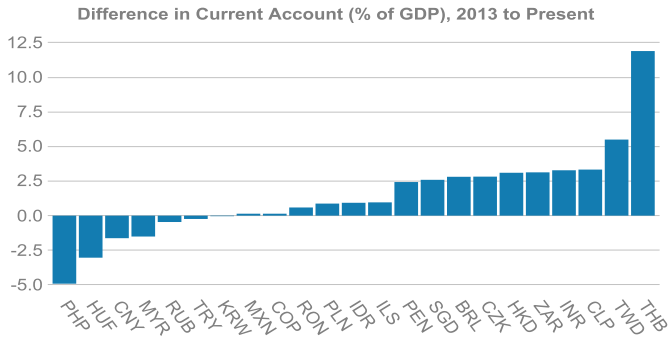
...and asset class de-correlation: We may be witnessing the start of a summer of asset class de-correlation, which is typical when liquidity is in retreat. Liquidity tends to withdraw first from vulnerable places. Often, credit markets lead equities near significant market peaks, and it is typical to see credit offering vulnerability when we are late-cycle as investor liquidity withdrawal is exacerbated by leverage. De-correlation is a symptom of tightening liquidity conditions as individual assets experience withdrawls and weakness first, and hence it is an early warning signal that things may be getting worse.

Exhibit 10: EM FX implied volatility rising relative to DM



Source: Macrobond, Bloomberg, Morgan Stanley Research

Exhibit 11: Many EMs have improved their external positions



Source: Macrobond, Morgan Stanley Research

The feedback loop: It is likely that recent market thinking and positioning have been, at least in part, impacted by RBI Governor Patel's recent op-ed where he suggested that the Fed's balance sheet reduction, coupled with rising US public deficits and private debt levels, is leading to an absorption of offshore USD liquidity. Many EM economies experienced recessions following the US taper tantrum in 2013, which in turn resulted in balance sheet consolidation and reduced foreign funding needs. Still, EM countries require capital inflows to keep the economic expansions in place, particularly in the current environment of closed output gaps where spare capacity is increasingly scarce.

Indeed, 2017 saw record inflows into EMs, but this has turned into outflows, tightening local financial conditions and thus their economic outlooks. If not addressed, this issue could create bearish economic feedback loops where liquidity outflows worsen the growth outlook, resulting in more outflows, and leading to even more weakness.

Thus, it may be argued that the US fiscal expansion, implemented at a time when the US output gap was closed and global funding costs were at the lows (and are now rising), may actually reduce the length of the global economic cycle, sowing the seeds for financial asset volatility and investors increasingly seeking safety. Our bearish risk outlook projected for 2H18 has gained traction, we think.

The FX message: Currencies not requiring capital imports and running net foreign asset positions should perform best in this scenario, explaining our bullish JPY call. EUR and Nordic currencies offer value too in this regard. As long as markets only de-correlate but do not fall collectively, CHF should weaken, though. As noted above, the relatively low risk of its asset position suggests that it is not much exposed to waning risk sentiment; otherwise, its income balance would be far higher. Thus, CHF may benefit less than the other surplus currencies should risk sell off. CHFJPY shorts may begin to look attractive again.

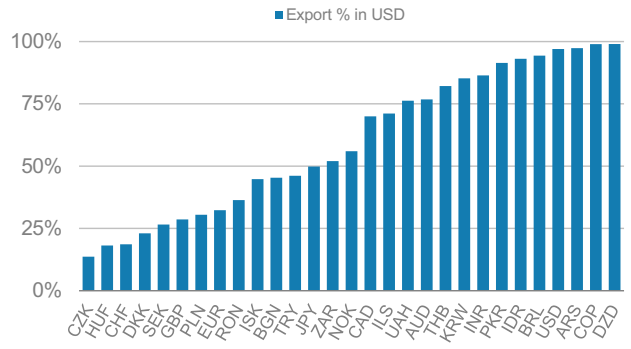
Positive Feedback Loops and USD

David Adams

Bottom line: A static analysis of USD would suggest that current concerns over geopolitics and global growth would keep USD supported and prevent a weakening trend. We argue that dynamic factors, positive feedback loops and the interrelationship between USD, growth, risk sentiment and global investment flows suggest that a modest USD weakening would be sufficient to kick-start a cycle of growth synchronicity, improved risk sentiment, and a pick-up in liability flows from the US into local markets, further weakening USD and thus bolstering further momentum. We argue that this is an important factor which can transform a modest currency move into a more sustained one.

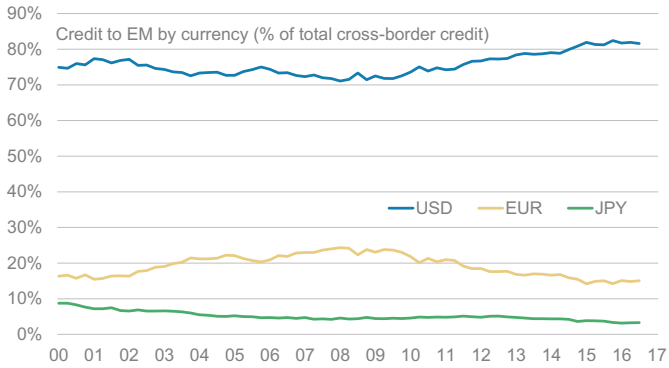
Think dynamic, not static: Investors questioning the potential for the USD weakening trend to emerge often point to static factors. Growth in places like the euro area, they say, is failing to rebound, and the recent turbulence seen in certain EM countries with current account deficits is suggestive of continued vulnerabilities and a potential rise in volatility. As we see it, a critical link being missed by market participants is that USD weakness is both caused by, and an effect of, positive risk sentiment and strong and synchronized global growth. Thus, investors should incorporate these dynamic forces in evaluating the future course of USD.

Exhibit 12: Significant portion of global trade invoiced in USD



Source: Gopinath 2016, Eurostat, Morgan Stanley Research

Exhibit 13: Hard currency EM credit largely USD-denominated



Source: Bank for International Settlements, Morgan Stanley Research

A weaker USD supports growth... How does a weaker USD support growth? Because global trade and global commodities are priced largely in USD, a weaker USD boosts trade volumes, which bolsters global exports, and supports primary producers (which are often in emerging markets) by raising their terms of trade (Exhibit 12). Rising commodity prices has a reflationary impact, and upward pressure on prices increases the incentive to consume, further boosting growth.

...and bolsters positive risk sentiment: A weaker USD also has an important positive impact on risk sentiment through asset prices. USD is used for the vast majority of cross-border funding flows and foreign borrowers often tap USD-denominated markets

(Exhibit 13), As a result, a rising USD makes these debts more difficult and expensive to service, which can weigh on countries with large foreign liability positions. Indeed, we find that USD has become an increasingly relevant factor for explaining performance of EM FX, with the share of variance in EM FX performance explained by USD having more than doubled since the financial crisis.

This explains why we saw an underperformance in FX of countries that have current account deficits relative to those with surpluses when USD was rallying. Conversely, though, a depreciating USD renders these debts easier to service, and may inspire inflows into EM assets as investors view the risk-adjusted returns in these areas as more attractive. Because of the positive correlation of these assets to risk and the relatively high hedging costs, these inflows are likely to be EM FX positive and weaken USD further.

Exhibit 14: Approximately 30% of US and Canadian equity revenues in foreign currency

Sector	Count	US & Canada	Developed Europe	Emerging Europe	Middle East & Africa	China	Japan	Asia Pacific ex Japan & China	Latin America	Total Foreign	S&P 500 Sector Weight
Consumer Discretionary	137	79%	11%	0%	0%	4%	2%	1%	2%	21%	13%
Consumer Staples	42	76%	7%	1%	1%	2%	1%	2%	8%	24%	7%
Energy	104	51%	6%	5%	8%	14%	2%	9%	4%	49%	6%
Financials	106	81%	7%	0%	0%	1%	5%	3%	2%	19%	14%
Health Care	113	83%	9%	1%	1%	2%	2%	2%	2%	17%	14%
Industrials	81	68%	12%	2%	3%	4%	1%	5%	5%	32%	10%
Information Technology	136	49%	21%	2%	3%	8%	5%	7%	5%	51%	26%
Materials	40	53%	18%	1%	1%	8%	2%	7%	10%	47%	3%
Real Estate	59	91%	3%	0%	1%	0%	1%	2%	2%	9%	3%
Telecommunication Services	14	98%	2%	0%	0%	0%	0%	0%	0%	2%	2%
Utilities	30	95%	1%	0%	0%	0%	0%	0%	3%	5%	3%
Total	862	73%	10%	1%	2%	4%	2%	3%	4%	27%	

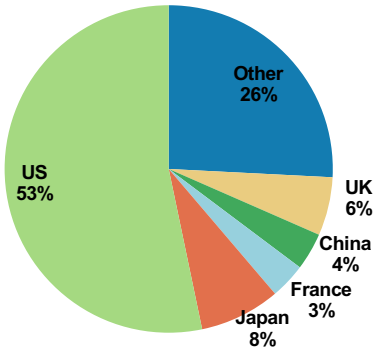
Source: Morgan Stanley Research

Another transmission mechanism relates to equities. Our equity colleagues recently analyzed the exposure of different equities to foreign revenues. A weaker USD means that foreign revenues are higher when translated back into USD, meaning a weakening USD is a positive for equity EPS all else equal (Exhibit 14). The S&P 500 sector-weighted percentage of foreign revenues is 31%, suggesting that a 3% depreciation in USD against all currencies should lead to a ~1% increase in revenues, all else equal.

Because the US equity market is the largest and most closely followed global equity market, an increase in US equities can have a significant impact on global equities. Indeed, more than half of the MSCI World Index is composed of US equities (Exhibit 15). As a result, global risk asset prices can benefit when USD weakens, in turn bolstering risk sentiment.

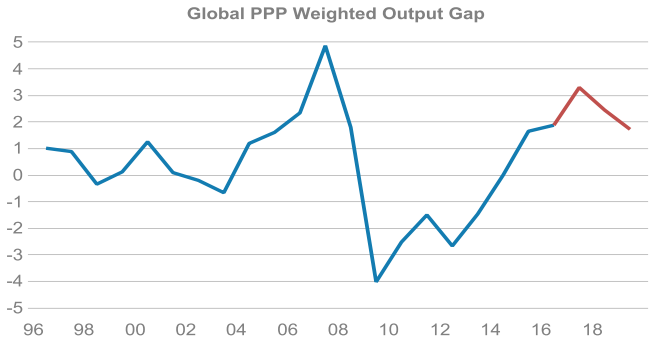
Positive growth and risk momentum increases liability flows: These two factors above, supported risk sentiment and supported macro data, are supportive of "liability" flows out of USD capital markets and into local markets, particularly in an environment like the current one where output gaps are closed and capital availability is low. In that scenario, borrowers seeking capital must look outside their own borders and often find it in places like the US where capital markets are deep and liquid. These funds are then converted back into local currency, resulting in USD selling and local currency buying. This is a further amplifying effect of USD weakness.

Exhibit 15: More than 50% of the MSCI ACWI in US equities



Source: MSCI, Morgan Stanley Research

Exhibit 16: Global output gap closed, suggesting capital demand outstripping capital supply



Source: OECD, Macrobond, Morgan Stanley Research
Note red line = OECD forecast

These three forces explain the substantial decline seen in USD since the start of 2017, where the DXY fell more than 14% over the calendar year. Global growth was strong and synchronous, and supportive risk sentiment and the closed output gaps globally suggested that liability flows would pick up. Robust growth (along with changes to the US tax code) boosted equities, aiding risk sentiment. USD served as both a catalyst here, and beneficiary, of these factors.

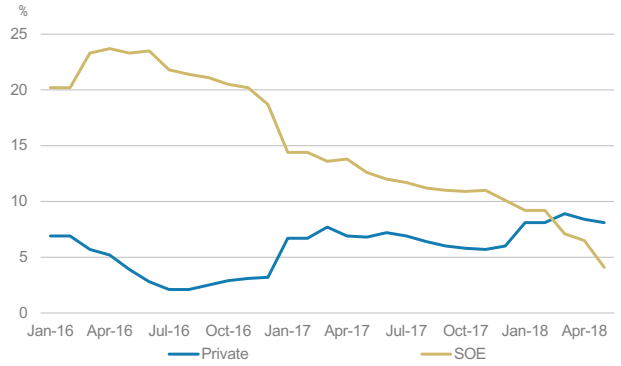
This means a modest initial USD weakening... The implications of these feedback loops are important. It means that a modest weakening in USD can ultimately lead to further weakening as these factors kick in. Importantly, then, the driver of the initial weakening in USD need not be so substantive as to justify a material USD decline, it just needs to be marked enough to kick off these feedback loops.

...which coupled with these feedback loops weakens USD further: Thus, we are particularly attentive to risk sentiment and signs that global data are recovering. It is no coincidence that much of our USD scorecard is a direct or indirect function of global growth synchronicity and risk sentiment. Even if the moves lower in USD are modest, a cessation in the strengthening trend may take the pressure off those deficit-financed EMs and stabilization therein may lead to declining implied volatility. Risk assets performing well should help to keep investor sentiment positive, and a pick-up in liability flows may follow, in turn weakening USD further. Given that USD is the longest position in the G10, even a squaring in positioning as investors turn more neutral on USD could be enough to kick-start this process.

Strategic FX Portfolio Trade Recommendations

Buy JPY/KRW 3m NDF

Exhibit 17: Chinese FAI (ytd, y/y) significantly slowed down in May and may indicate weakness in Korean exports in the months to come



Source: Bloomberg, Morgan Stanley Research

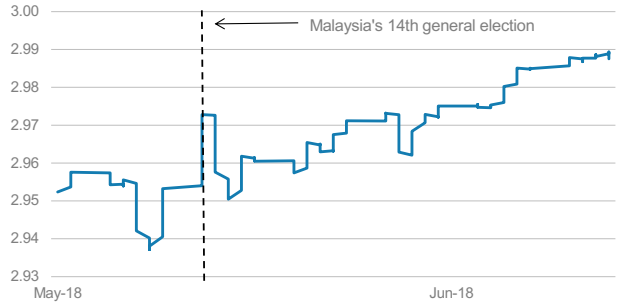
Limit Order (Entry: 14-Jun-18)

Entry: NY-Close 14-Jun-18; Stop: 9.60 Target: 10.30

The long-awaited US-NK Summit has ended and early indications point towards some cooperation between the two countries. However, with many promises and few tangible results achieved, we think the market will increasingly look at execution to determine the appropriate size of the geopolitical premium attached to KRW assets. We currently think there may be downside risks to KRW should prospects of de-nuclearization run into difficulties - especially now that China has shown early signs of a slowdown. May data for Chinese retail sales, industrial production and fixed asset investment all arrived below market consensus and may have negative spillover effects onto Korean exports. As for the Japanese leg, we increasingly see US curve flattening and scarcity of front-end JGBs to foreign investors to feed into weaker USD and indirectly contribute to JPY strength. Risk to the trade includes a revival in Chinese industrial demand leading to stronger Korean exports and higher KRW.

Buy SGD/MYR 3m NDF

Exhibit 18: SGDMYR has progressively moved higher since the Malaysian election



Source: Bloomberg, Morgan Stanley Research

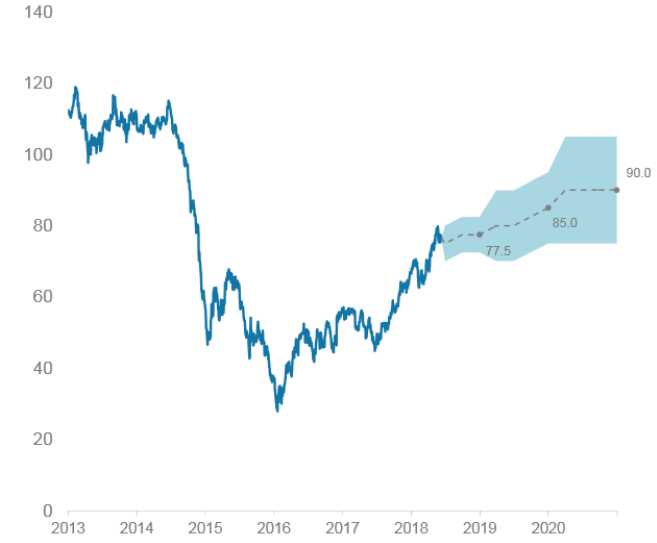
Limit Order (Entry: 14-Jun-18)

Entry: NY-Close 14-Jun-18; Stop: 2.92 Target: 3.15

We switched the long leg of this trade from AUD to SGD given the change in views on AUD. Given the robust strength in recent SGD data, we expect SGD will likely outperform especially should global trade conditions remain robust. For Malaysia, the BNM Governor unexpectedly announced his resignation and with the Malaysian government removing the GST and changing the definition of federal debt, we see more fiscal and policy uncertainties in the near future. With around 40% of outstanding MSGs held by offshore agents, a further increase in fiscal and policy uncertainties may trigger outflows and a weaker MYR. Risks to the trade are a reduction in policy uncertainties for Malaysia or a slowdown in intra-Asia trade.

Sell USD/RUB

Exhibit 19: Morgan Stanley Brent price forecast ($/bbl) suggests RUB support



Source: Morgan Stanley Research estimates

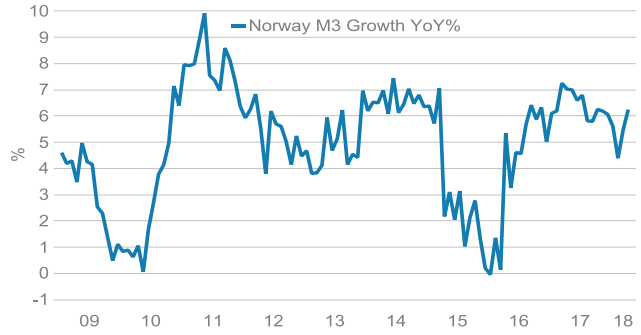
Limit Order (Entry: 14-Jun-18)

Entry: NY-Close 14-Jun-18; Stop: 64.20 Target: *59.50*

Given the idiosyncratic stories in other high- yielding EM countries, Russia now looks better than its peers. The Central Bank of Russia is likely to keep rates on hold at its meeting tomorrow and for the time being given the volatility in the rest of EM, supporting real rates in Russia. The MinFin's intervention and current account seasonality are negative for RUB but they could be offset by World Cup- related inflows and cleaner positioning among foreigners. The CBR data show foreigners sold $3bn of OFZs in the past two months, or 9% of foreign ownership. Lastly, oil prices are likely to stay high as we expect no production increase from OPEC at their meeting on 22 June. A risk to this trade would be renewed emphasis on sanctions from the US, weighing on sentiment.

Short USD/NOK

Exhibit 20: Rebounding Norwegian money supply growth suggests robust growth momentum



Source: Macrobond, Morgan Stanley Research

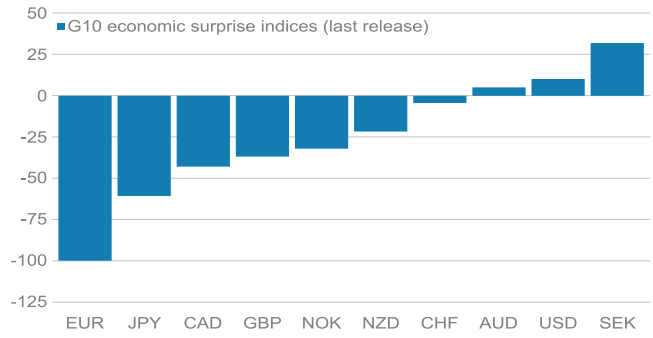
Hold (Entry: 7-Jun-18)

Entry: 8.06; Stop: 8.20; Target: 7.50

NOK longs continue to look compelling. Norges Bank's previous decision to lower its inflation target from 2.5%Y to 2.0%Y and its emphasis on financial stability when conducting its monetary policy approach suggest that real returns are likely to rise, supporting NOK, while longer-term volatility should fall. Norwegian data remain robust, with manufacturing production and the current account balance remaining supportive. The ECB continuing its policy of gradual normalization and a reduction in political risks should keep currencies tied to Europe, like NOK, supported. USD once again entering a bear trend should keep USD/NOK on a downward trajectory, and is particularly likely to weaken against currencies of countries with large net foreign asset positions like Norway. A key risk to the trade is that Norges Bank turns more dovish, supporting NOK weakness.

Short USD/SEK

Exhibit 21: Swedish economic surprise index is the highest in the G10



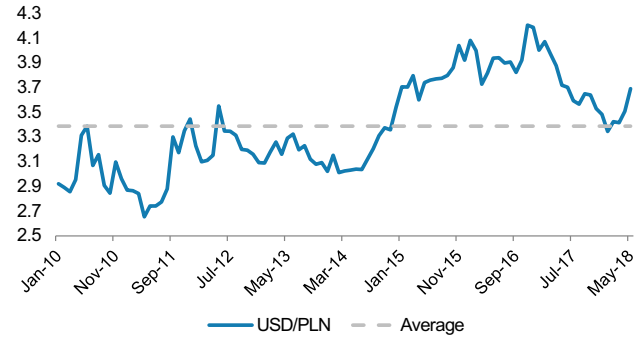
Source: Macrobond, Morgan Stanley Research

Hold (Entry: 7-Jun-18)
Entry: 8.70; Stop: 8.88; Target: 8.20

We see value in buying SEK, funded in USD. The global growth outlook appears to be stabilizing and beginning to improve, which should support USD weakness as markets price in a higher probability of synchronized global growth. This should also benefit small, open economies like Sweden, particularly as global trade figures continue to look positive. Waning political risks in Italy and the Eurozone should also support currencies highly linked to the euro-area like Sweden. Swedish domestic data also continue to improve, such as industrial orders data, with the economic surprise index for Sweden the highest among the G10. A key risk to the trade is that global growth momentum stalls, both strengthening the USD and weakening the SEK.

Short USD/PLN

Exhibit 22: PLN valuation attractive after recent sell-off



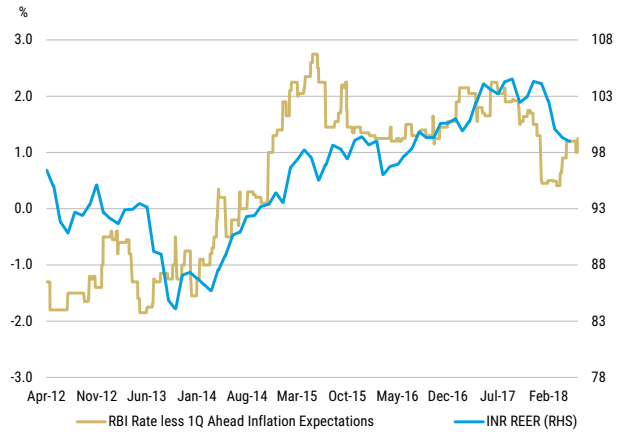
Source: Bloomberg, Morgan Stanley Research

Hold (Entry: 7-Jun-18)
Entry: 3.62; Stop: 3.72; Target: 3.45

A pick-up in the external backdrop alongside our expectation for accelerating EMU reform momentum supporting EUR should be conducive to zloty gains. Added to this, PLN valuation is attractive, especially after the recent sell-off, data have remained relatively strong despite the slowdown in euro area data, and there should be continued support stemming from EU fund inflows over the coming quarters. The NBP remains dovish but as the ECB has announced a likely end to its asset purchases, this may increase expectations for the NBP to turn incrementally more hawkish. This was inferred by MPC member Gatnar who stated that ECB fallout may hep to determine Polish rate hike timing. A risk to this trade would be a slowdown in Polish growth or inflation failing to rise sustainably, prompting a more dovish NBP response.

Short USD/INR 1m NDF

Exhibit 23: RBI real rates vs. INR REER



Source: Bloomberg, Morgan Stanley Research; Note: Rolling 1Q ahead Bloomberg consensus expectations

Hold (Entry: 4-Jun-18)

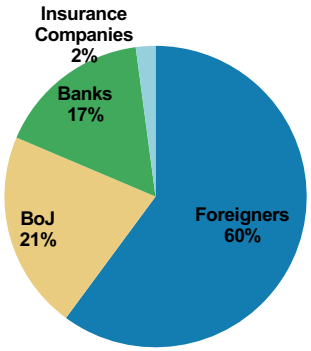
Entry: 67.27; Stop: 68.80; Target: 63.00

This trade first appeared in the FX Morning.

We widen our trading band, moving the stop up to 68.80 and the target lower, to 63.00. The RBI delivered a surprise hike and turned hawkish in its communication to further macro-stability and prevent inflation from escalating. Our economists have adjusted their forecasts for RBI hikes and they currently see the RBI front-loading the hiking cycle. The current forecast calls for two more 25bp hikes for the remainder of this year and the RBI to remain on hold throughout 2019. In addition, our economist sees inflation staying relatively stable; the real policy rate would rise to 205 bp from 165 bp currently. Historically, we have observed RBI real rates correlate with INR REER, further adding conviction towards our tactical long INR view. Risks to the trade include a more dovish RBI versus our economists' forecasts, continued USD strength, and higher oil prices.

Short USD/JPY

Exhibit 24: More than four-fifths of Japanese T-bills are held by the BoJ or foreigners



Source: Ministry of Finance, Morgan Stanley Research

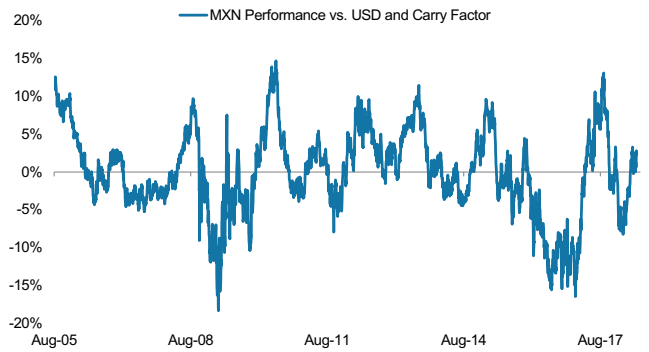
Hold (Entry: 24-May-18)

Entry: 110.00; Stop: 111.50; Target: 103.00

With the completion of the USD tactical rebound, the JPY-strengthening trend should begin to push USD/JPY lower. The continued flattening in the US yield curve has led to a reduction in hedging ratios, and the prospect of potential repatriation flows should keep JPY supported. Indeed, the US 2s10s curve is at its lowest level post-crisis. Furthermore, we argue that the limited availability of short-end JGBs due to the BoJ's asset purchase program may have the side effect of reducing the flow of USD from US institutions to Japanese banks, which may pressure them to liquidate their foreign holdings. Investors remain modestly short JPY, which suggests further room for positions to adjust. A risk to this trade is that our expected USD weakening trend fails to materialize and outflows from Japan increase, pushing USD/JPY higher.

Long CLP & COP/MXN

Exhibit 25: MXN risk premium remains relatively low



Source: Bloomberg, Morgan Stanley Research. Note: The two-factor model includes sensitivity of selected EM currency to an average USD move relative to DM and EM currencies and a carry trading strategy. We use 6-month cumulative performance vs. a 3-year rolling regression estimate of the two-factor model in order to isolate idiosyncratic factors driving USDMXN

Hold (Entry: 30-May-18)

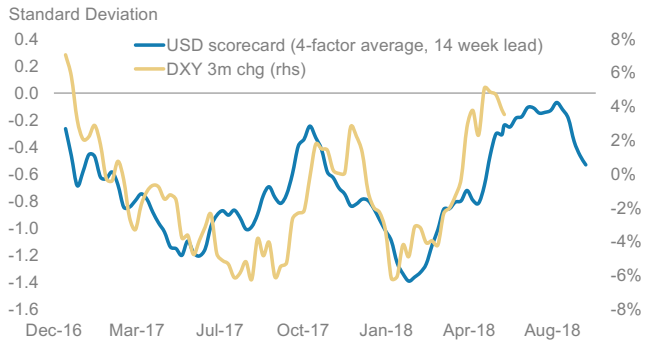
Entry: 1.9175; Stop: 1.8600; Target: 2.0300

This trade first appeared in the Global EM Morning.

We expect MXN to continue underperforming ahead of the presidential elections and prefer to sell it against a basket of LatAm currencies, which should remain supported on a relative basis. More specifically, we think MXN's low risk premium along with high carry costs and light positioning suggest that there is still ample room for depreciation. In addition, we see CLP and COP outperforming the region in the months to come, given the potential for market-friendly developments on the political front, improved external positioning (current account fully financed by FDI), and a weaker USD in the medium term. A risk to this trade would be negotiators reaching a preliminary NAFTA agreement in the near term, as this news would likely be perceived as MXN-positive by the markets.

Short USD/CHF

Exhibit 26: USD scorecard suggests USD weakness to begin



Source: Morgan Stanley Research

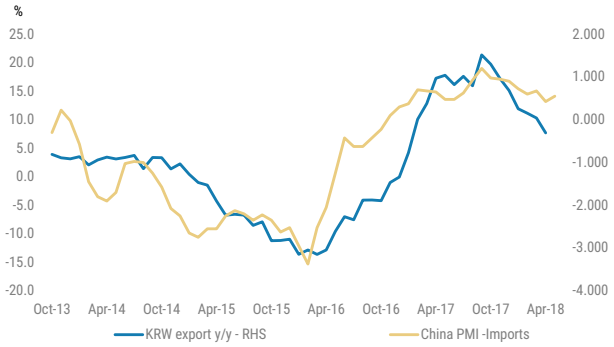
Hold (Entry: 24-May-18)

Entry: 0.9940; Stop: 1.0065; Target: 0.9400

Our scorecard suggests that the USD should continue to weaken, given robust global growth, a flattening US yield curve, and rising industrial commodities. Positioning in CHF remains short, the largest short within the G10, suggesting that a positioning adjustment may impact USDCHF more acutely. USDCHF saw a significant rally in the past few months as a wider LIBOR-OIS spread made this pair the most attractive carry trade in the G10, and LIBOR-OIS coming in should weaken this bullish USDCHF demand. A risk to this trade is that the SNB intervenes in the market to prevent CHF strength.

Short USD/KRW 3m NDF

Exhibit 27: The import component of Chinese PMI suggests further strength in Korean exports



Source: Bloomberg, Morgan Stanley Research

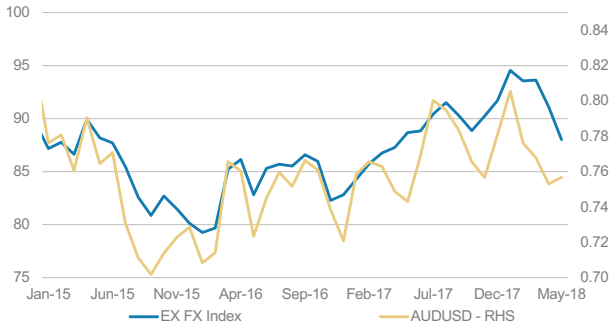
Closed (Entry: 31-May-18)
Entry: 1076; Closed at 1082 on 13-Jun-18

This trade was closed in the Global EM Morning.

We are closing out this position as the NK-US Summit concludes. We are skeptical that denuclearization of the Korean peninsula can be achieved quickly given historical precedent from previous peace talks, in which case the KRW may be adversely impacted. The latest industrial production and fixed asset investment data in China were weak relative to the previous month and market consensus, and serve as additional factors in our turning neutral on KRW. Should China's industrial sector pick up, we may seek to reengage in long KRW positions.

Long AUD/MYR 3m NDF

Exhibit 28: AUD has historically traded in sync with strong growth in EM



Source: Bloomberg, Morgan Stanley Research

Look to Close (Entry: 7-Jun-18)
Entry: 3.0485; Close at NY-Close 14-Jun-18

With Chinese industrial production and fixed asset investment figures turning around, in our view there may be an outsized chance of China's commodity demand being reduced in the near term. We turn neutral on AUD and seek to match a bearish view on MYR with SGD.

Strategic FX Portfolio

Trade Recommendation	Notional	Entry Date	Entry Level	Current	Stop	Target	Spot P&L	Carry P&L	Portfolio Contribution
Closed Trades									
Short USD/KRW 3m NDF	$10.0mn	31-May-18	1076		Closed at 1082 on 13-Jun-18		-$55.5k	$3.5k	-$51.9k
Long AUD/MYR 3m NDF	$10.0mn	7-Jun-18	3.0485		Close at NY Close on 14-Jun-18		-$184.7k	-$5.3k	-$190.0k
Active Trades									
Short USD/CHF	$10.0mn	28-May-18	0.9940	0.9971	1.0065	0.9400	-$31.1k	-$12.4k	-$43.5k
Long CLP,COP vs MXN	$10.0mn	30-May-18	1.9175	1.9908	1.8600	2.0300	$489.4k	-$18.2k	$471.3k
Short USD/JPY	$10.0mn	5-Jun-18	110.00	110.66	111.50	103.00	-$59.6k	-$5.1k	-$64.8k
Short USD/INR 1m NDF	$10.0mn	4-Jun-18	67.27	68.11	68.80	63.00	-$123.3k	$19.5k	-$103.9k
Short USD/NOK	$10.0mn	7-Jun-18	8.06	8.12	8.20	7.50	-$83.7k	-$2.3k	-$86.0k
Short USD/SEK	$10.0mn	7-Jun-18	8.70	8.73	8.88	8.20	-$30.6k	-$3.9k	-$34.5k
Short USD/PLN	$10.0mn	7-Jun-18	3.62	3.69	3.72	3.45	-$182.6k	-$0.3k	-$182.8k
New Trades									
Sell USD/RUB	$10.0mn	NY Close 14-Jun-18		62.50	64.20	59.50			
Buy SGD/MYR 3m NDF	$10.0mn	NY Close 14-Jun-18		2.97	2.92	3.15			
Buy JPY/KRW 3m NDF	$10.0mn	NY Close 14-Jun-18		9.81	9.60	10.30			

Source: Morgan Stanley Research; Changes in stops/targets in bold italics. (1) Stops are based on the WMR fixing. (2) The portfolio represents hypothetical, not actual, investments.

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year return
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	0.56	0.13	0.24	0.00	**-1.63%**
2017	-1.08	0.89	0.17	0.81	-1.03	-0.01	0.24	0.88	-1.06	0.25	-0.26	0.49	**0.29%**
2018	0.47	0.44	-0.06	0.00	0.73	-0.61							**0.97%**

Source: Morgan Stanley Research

Note: Portfolio monthly returns and carry calculations have been restated due to a calculation error. Please contact the FX Strategy Team if you have any questions.

For more details regarding calculations, please see "Reading FX Tactical Trade Performance" at the back of the FX Pulse. Trade FX Performance Data Package contains complete performance statistics. 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).

Exhibit 29: History of recommendations

Buy SGD/MYR 3m NDF												
Instrument	Maturity	Trade	Entry Date	Entry Level	Exit Date	Exit Level	Target/ Objective	Stop/Re-assess	Size of Trade or Unit/Notional	CUSIP/ISIN/ BLOOMBERG	Gross P&L BP	Gross P&L US$K
SGD/MYR	3m	Sell SGD Spot / MYR 3m NDF	18-Jan-18	3.00	25-Jan-18	2.98	2.92	3.04	$10m	SGD Curncy, MYR+3m Curncy		

Buy JPY/KRW 3m NDF												
Instrument	Maturity	Trade	Entry Date	Entry Level	Exit Date	Exit Level	Target/ Objective	Stop/Re-assess	Size of Trade or Unit/Notional	CUSIP/ISIN/ BLOOMBERG	Gross P&L BP	Gross P&L US$K
JPY/KRW	3m	Buy JPY/KRW 3m NDF	11-Jan-18	9.56	5-Feb-18	10.00	10.00	9.56	$10mm	JPY+3M, KWN+3M curncy		452k

Source: Morgan Stanley Research

G10 Currency Summary

Gek Teng Khoo, David Adams, Chun Him Cheung

USD

3.7%

USD Bear Trend Resumes **Bearish**

Watch: UMich Survey, Housing Starts, Current Account, Markit PMI

Our scorecard continues to indicate that the USD tactical rebound that began in February is done. The Fed's continued emphasis on further, albeit gradual, normalization should keep the US yield curve on a bear flattening trend, with the 2s10s curve reaching the flattest post-crisis level following the meeting. There are continued signs that the global growth outlook remains solid, which should lead to further global investment spending and in turn lead to more liability flows out of US markets. USD weakness against surplus currencies like NOK, SEK, JPY, and CHF should continue, particularly as waning global liquidity raises volatility.

EUR

-4.2%

Fading the Dovish ECB **Bullish**

Watch: Trade Balance, CPI, Consumer confidence, Markit PMI

We fade the selloff in EUR and European currencies in the wake of the ECB's provision of calendar guidance on the timing of the first rate hike. The USD weakening trend should keep EURUSD supported. Positioning also favors EURUSD higher. We emphasize that European reform momentum appears to be strengthening, with comments from Chancellor Merkel suggesting greater acceptance of further supranational integration, which should support EUR over time. EURUSD resistance at 1.1840/50 should be closely watched.

JPY

3.3%

Selling USDJPY at 110 **Bullish**

Watch: Trade Balance, Machine Tool Orders, CPI, Nikkei Mfg PMI

The continued bear flattening of the US yield curve suggests that risk-adjusted returns are falling given the costs of FX-hedging. Waning political risks and positive-yielding FX hedges may, instead, incentivize Japanese investors to pivot their holdings to EGBs from the US, suggesting USD weakness. The scarcity of short-end JGBs reduces investment opportunities for foreigners and may limit the incentive of US banks to lend USDs to Japanese banks, which in turn could liquidate their USD-denominated assets in response, further bolstering JPY. USDJPY is trading toward the top of the trend channel and a break below the previous low of 108.30 would be an important bearish signal

GBP

-3.9%

Political Risk Premium Being Priced Out **Bullish**

Watch: House Prices, BoE Decision

We turn bullish on GBPUSD. The USD weakening trend should keep GBPUSD supported, particularly if risk sentiment rebounds given GBP's positive correlation with risk and oil prices. Prime Minister May's compromise deal on the EU Withdrawal Bill increases the probability of its passage, which should lead to risk premium being taken out of UK asset prices. The upcoming EU summit on June 28-29 presents a key watchpoint, though discussions of additional EU summits being scheduled may take out some of the event risk associated with the meeting.

CHF

3.5%

Expect USDCHF to Trade Lower **Bullish**

Watch: Sight Deposits, SNB Decision

We maintain a bearish view on USDCHF. We continue to expect that the USD will resume its weakening trend, particularly against currencies with large net foreign asset positions such as CHF. Positioning in CHF remains the shortest in the G10, suggesting that risks are asymmetrically biased toward CHF strength. The continued narrowing in the USD LIBOR-OIS spread renders the USD a relatively less attractive carry trade, reducing USDCHF long incentives.

CAD

-1.3%

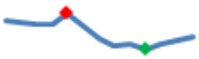
Robust Wage Growth to Keep CAD Supported **Bullish**

Watch: Manufacturing Sales, Retail Sales, CPI

USDCAD is likely to trade lower, though, over time, we retain our long-term CAD bearish view. Recent news flow related to US-Canadian political relations on trade offer an opportunity to sell; economic data remaining relatively supported along with oil prices should keep CAD stronger against USD for now. Robust wage data are likely to keep the BoC on track to hike rates in the coming months, as evident in their hawkish shift in tone at the May meeting. USDCAD has been trading toward the top of the range and may face resistance at 1.3070, the top of the trend channel.

AUD

-1.5%



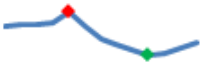
Dovish RBA and Weaker Chinese Demand **Neutral**

Watch: House Prices, Leading Index

We are turning neutral AUD on the back of weaker fixed asset investment numbers from China and the RBA Governor sounding more cautious and noting that rate hikes are still "some time away". With the Fed hiking and interest rate differentials between Australia and the US widening, and given the current weakness in the Australian housing market, we anticipate a long-term AUD sell-off. Given the mixed data around the Chinese industrial sector, we remain neutral on AUD but look to sell should global risks, possibly relating to trade tensions, increase.

NZD

-2.5%



Remaining Tactically Bullish **Bullish**

Watch: Current Account, GDP, Credit Card Spending

We remain buyers of NZD but have exited the short EURNZD position due the change in our view on EUR. Trend trade balance shows the New Zealand trade deficit stabilizing and should provide some support for NZD. On a technical basis, we think NZDUSD can reach 0.72 before reverting. Moreover, we see the NZDUSD cross staying supported by continued DXY weakness as indicated by our USD scorecard. We will watch for the coming week's 1Q GDP release and the implications it may have on the RBNZ's stance.

SEK

6.4%

SEK Strength **Bullish**

Watch: Unemployment Rate, Economic Tendency Survey

USDSEK downside should continue. While the weakening USD trend should keep crosses heavy, SEK looks poised to continue rallying as waning European political risk and the gradual normalization from the ECB enables the Riksbank to sound less dovish as well. Trade tensions diffusing should also support a small, open economy like Sweden's, which has a high degree of sensitivity to trade. Robust industrial orders are emblematic of a continued supportive economic backdrop. The next support level for USDSEK is around 8.53 which, if broken, could provide room for more downside.

NOK

4.2%

Norges Bank Is Key **Bullish**

Watch: Trade Balance, Norges Bank Rates Decision

We maintain a bullish view on NOK. The upcoming Norges Bank meeting is key for NOK near-term direction. A reaffirmation of the current repo rate path would bolster September rate hike expectations, supporting the NOK. Conversely, a delay on the timing of the first hike may lead to temporary NOK weakness, but we would use the dip to buy. Continued robustness in the current account surplus, in part a function of higher crude oil prices, rising house prices and a realignment of FX and rates market pricing should keep NOK on a strengthening trend, particularly against USD which should further weaken. We target 7.40 in USDNOK.

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

Ioana Zamfir (LatAm), Chun Him Cheung (AXJ), Ellie Heatherill (CEEMEA)

ARS

5.1%

Neutral

We see recent economic policy actions as enough to avoid nonlinear price action in local assets. We note that despite the recent nominal and REER depreciation, ARS is just below 'fair' value (assuming PPP holds). However, when adjusting for external imbalances, the currency is arguably expensive and would need to depreciate further (in real terms) in order to continue attracting sufficient portfolio flows to finance the current account deficit, within a regime of higher volatility.

BRL

2.7%

Neutral

BRL has been trading better over the past few days, on the back of last week's announcement by the BCB, stating that the institution would offer up to an additional $20bn in FX swaps, marking another step of a recently more aggressive strategy to stabilize the currency. While we think that this strategy could help decelerate BRL's decline, we note that risk premia should remain elevated, as the main factors that have led to the currency's depreciation year-to-date are likely to stay or intensify in the months to come.

CLP

1.2%

Bullish

In Chile, the fundamental story remains attractive and supportive for CLP, with growth continuing to surprise on the upside and investment – seen by our economists as the missing piece in Chile's story – also starting to rebound. Political uncertainty has diminished significantly after the elections, and we expect the new government to gradually implement a reform mix that should further encourage investment.

COP

0.7%

Bullish

The second round of presidential elections will take place this Sunday, June 17 and the next president is expected to assume office on August 7. Polls suggest a market-friendly outcome, which should continue supporting investor confidence in the near term. In the medium term, we expect strong oil prices and a weaker USD to continue providing support for COP, aided by cheaper valuation on a PPP basis.

MXN

5.2%

Bearish

We continue to believe that MXN's valuation is not as cheap as implied by PPP theory when adjusting for productivity differentials and see ample room for additional depreciation, preferring to short it against a basket of LatAm currencies. We are now two weeks ahead of the presidential and congressional election and expect MXN's subsequent trajectory to depend heavily on the policy path of the new government. We are watching out for the composition of the new Congress, as this could shed more light on the odds of policy continuity moving forward.

PEN

0.5%

Neutral

Loose monetary conditions with weak growth, lackluster investment and little-to-no inflation should keep monetary policy anchored. The weakness in government revenues should remain a headwind for the currency. However, the administration has started to put forth objectives on improving investment, increasing tax revenues and improving growth. We remain neutral on PEN until we see a material improvement in the new macroeconomic adjustment process.

CNY

0.9%

Neutral

Despite staying below its YTD high, the CFETS RMB Index remains at a high level relative to most of 2018. This week, the PBoC relaxed repatriation measures for foreign investors which, on balance, should make onshore Chinese assets more attractive, in our view. This relaxation around repatriation is in line with our economists' expectation of the selective opening of channels for capital outflows. With the PBoC Governor promising to accelerate the pace of financial market liberalization, we think rising net inflows will sustain the RMB's current valuation. Recently, the error term on our USDCNY fixing model has flattened, suggesting the PBoC is comfortable with the RMB following the DXY's downward trajectory.

INR

0.2%

Bullish

We remain tactically bullish on INR due to the oil price halting its advance and the RBI conducting an unexpected hike after its latest meeting. In its communique, the RBI noted that core inflation is gaining momentum and that household expectations of future inflation have increased. The RBI is increasingly positioning to preserve macro-stability and aiming to contain inflation. With the direction to preserve real yields, we see this latest hike and the message in the communique to be supportive for INR. Our economists have now updated their forecasts and expect the RBI to front-load the hike cycle with two additional hikes for the rest of 2018.

IDR

-0.3%

Neutral

We remain neutral on IDR. With the Fed hiking and the ECB discussing the end of QE, we see the risk of spillover effects onto rising US yields to which Indonesia is highly exposed. Given the risk/reward, we will stay on the sidelines and wait for further guidance from the ECB on its monetary policy intentions. However, over the medium term, we continue to like Indonesia's macro fundamentals, strong growth profile and thick real rates buffer.

KRW

0.9%

Bearish

The long-awaited US-NK Summit has ended and early indications point towards some cooperation between the two countries. The current situation most closely resembles the "getting engaged" scenario we have outlined in our previous note. However, with many promises and few tangible results achieved, we think the market will increasingly look at execution to determine the appropriate size of the geopolitical premium attached to KRW assets. We currently think there may be downside risks to KRW should prospects of de-nuclearization run into difficulties - especially now that China has shown early signs of a slowdown. Due to these factors, we are turning bearish on KRW.

MYR

1.1%

Bearish

The BNM governor has resigned and this has increased policy uncertainty for the new Malaysian government. Along with changes to the GST and expanding the definition of federal government debt, we see fiscal uncertainties ahead for Malaysia and subsequent bearish sentiment for MYR. According to our estimation, around 40% of outstanding MSGs are held by offshore agents and the increasingly uncertain political environment may trigger foreign selling and lead to MYR weakness. Over the medium term, we continue to see tailwind factors for MYR such as robust exports, higher oil prices and it remaining undervalued on REER terms.

SGD

0.5%

Bullish

We are turning bullish on SGD. We have seen regional trade perform above expectations. Singapore, with a current account surplus at 18% of GDP, should be a primary beneficiary of a rebound in regional trade. Latest trade data from Singapore show MoM non-oil domestic exports to have greatly exceeded consensus estimates and this mirrors the situation of regional peers such as Korea and Taiwan. However, we note the preliminary signs of an industrial slowdown in China may be a risk to our view. Currently, with our expectation for DXY to continue its sell-off, we think SGD should outperform relative to MYR given Malaysian policy uncertainties.

TWD

0.7%

Neutral

With Korea reporting strong export growth for May, we think Taiwan should follow suit. Strong trade is supportive for Taiwan's export-driven economy and should deliver TWD strength, in our view. However, the latest May headline CPI and core CPI missed consensus estimates by 40bp and 45bp respectively and may be a factor in preventing the CBC from turning more hawkish. However, similar to Korea, with strong demand coming from mainland China, we think this should be an overall tailwind that is supportive for Taiwan and TWD. However, without a strong domestic catalyst or signal from policy-makers, we remain on the sidelines and stay neutral on TWD.

THB

1.1%

Neutral

THB TWI has been relatively stable in the past month as the oil price slows its advance. Along with the overall trend of higher oil prices, inflation is returning to Thailand, with the latest print at 1.5%Y, a YTD high. For now, we remain on the sidelines in THB as we do not see an immediate catalyst for further appreciation. Over the medium term, we expect Thailand's current account to remain large, and this should drive FX outperformance vs. the rest of the region.

CZK

1.9%

Bullish

Further hawkish comments this week, from the likes of CNB members Nidetzky and Benda, support increasing market expectations for an earlier rate hike than forecast by the CNB. A weaker than expected CZK is prompting discussions on a return towards further hikes as inflation picks up, reaching 2.2%Y in May. Economic data continues to be strong which, along with our expectation for EUR appreciation, should support CZK. We continue to think monetary policy will be the principal driver of CZK and expect gradual koruna gains over the medium term.

HUF

2.8%

Neutral

Comments from Deputy Governor Nagy suggesting the NBH is prepared to shift policy and tighten monetary conditions if HUF depreciation endangers its inflation target imply the NBH doesn't like a fast depreciation in HUF. In our view, the NBH could be concerned that the market may start to push for rate hikes should HUF weaken too much. This may explain why the comment came out before the NBH's meeting next week and now focus will be on any signs of a similar shift in tone at the meeting. However, comments from Pleschinger today indicated no need to shift the easing bias yet. We see EUR/HUF topping out around current levels.

ILS

0.0%

Neutral

With our expectation for USD weakness to resume, the ILS TWI should stabilise with potential for USD/ILS to head lower supported by strong underlying fundamentals in Israel. In the minutes from their latest policy meeting, the BoI sounded constructive on the growth and inflation outlook. We will be looking for signs of continued strong growth and improving inflation in upcoming data releases. However, we highlight the latest trade balance data and 1Q18 current account data which showed continued deterioration and could pose a bigger risk to ILS if there are no signs of stabilisation over the coming quarters.

PLN

1.3%

Bullish

PLN should benefit from EUR stabilization and we stick to our bullish medium-term view. Zloty valuation remains attractive especially after the recent sell-off, data have remained relatively strong despite the slowdown in euro area data and there should be continued support stemming from EU fund inflows. After the ECB announced QE tapering, there may be expectations for an earlier than signaled rate hike in Poland, provided that inflation starts to move sustainably higher. We remain short USD/PLN.

RUB

1.1%

Bullish

Given the idiosyncratic story in other high yielding EM countries, Russia now looks more attractive relative to the majority of its EM peers. The CBR is likely to keep rates on hold for the time being given the volatility in the rest of EM, supporting real rates in Russia. The MinFin's intervention and current account seasonality are negative for RUB but they could be offset by World Cup related inflows and cleaner positions among foreigners. The CBR data shows foreigners sold $3bn of OFZs in the past two months, or 9% of foreign ownership. Lastly, oil prices are likely to stay high as we expect no production increase from OPEC on 22 June.

TRY

6.4%

Bullish

TRY has underperformed its EM peers over the past week, despite the fact that the CBT hiked much more than the market's expectation. This suggests to us that the market is concerned about the upcoming election, as one of Bloomberg's polls indicates that the election, especially the parliamentary election, is too close to call. We still think TRY offers value into the election but higher carry only works once broader EM starts to rebound. Recent comments from the CBT indicating that further tightening will be delivered if necessary, should boost sentiment.

UAH

-0.1%

Bullish

IMF cooperation is key for UAH stability; our economist expects Ukraine to stay on track with the programme and secure the fifth tranche by September. Barring any negative developments on that front, UAH should trade well. Added to this, the tight monetary policy stance of the NBU should also keep the currency supported. Comments from the NBU this week indicated it doesn't think it will be able to ease monetary policy until it sees a 'strong disinflation tendency'.

ZAR

7.9%

Neutral

South Africa has been under significant pressure since the weak GDP print early last week and recent data have continued to disappoint. Bond outflows have been significant and we believe that foreigners have now reversed most of the optimism and priced in no improvement in the macro story in South Africa post the election. However, we tend to disagree and look for an opportunity to fade the weakness should the data stabilise as we still expect structural reform and are constructive on South African growth in the medium term.

Charts show 1M performance against USD, as normally quoted.

Central Bank Watch

G10

- Australia
- Canada
- Euro Area
- Japan
- New Zealand
- Norway
- Sweden
- Switzerland
- UK
- USA

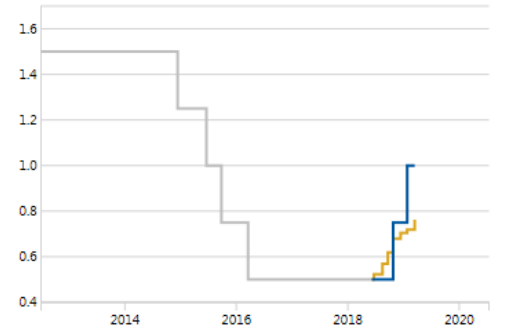
EM

- Brazil
- Chile
- Colombia
- Czech Republic
- Hungary
- Israel
- Malaysia
- Mexico
- Poland
- South Africa
- South Korea
- Taiwan
- Thailand

Norway

Economics: Pasquale Diana Recent Research

POLICY RATES latest (08 June 2018): **0.50%**

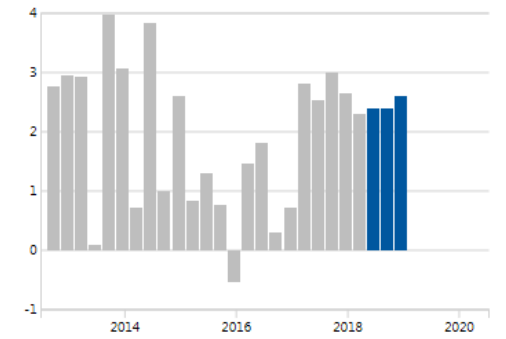


POLICY MEETING CALENDAR

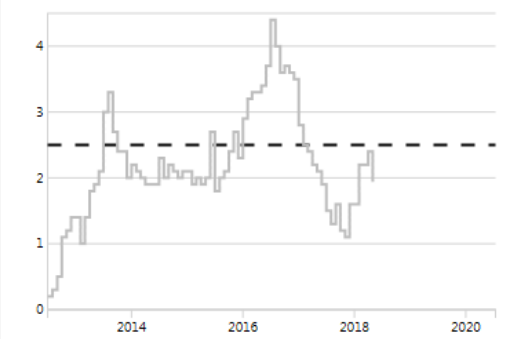
	Move at Meeting	Cumulative Moves	
	Market Implied	Market Implied	Our Forecast
June 21, 2018	2	2	0
August 16, 2018	5	7	0
September 20, 2018	5	12	0
October 25, 2018	6	18	25
December 13, 2018	2	20	25
January 25, 2019*	1	22	50
March 15, 2019*	4	26	50

* Indicates that a meeting date is estimated.

GDP GROWTH (QoQ SAAR, Mainland) latest (1Q 2018): **2.3%**



INFLATION (YoY) latest (April 2018): **2.4%**



Morgan Stanley Research. Please see the latest Global Macro Briefing for forecasts of countries not included in this interactive.
With thanks to the AlphaWise Interactive Team for their contribution to this report.

Global Event Risk Calendar

Gek Teng Khoo

Date	Time (Ldn)	Ccy	Event	Ref. Period	MS forecast	Market	Previous
15-Jun	**N/A**	**JPY**	**BoJ Rates Decision**		**-0.10%**	**-0.1%**	**-0.1%**
	N/A	JPY	BoJ 10y Yield Target		0.00%	0%	0%
	10:00	**EUR**	**CPI (YoY)**	**May F**	**1.9%**	**1.9%**	**1.9%**
	11:30	**RUB**	**CBR Rates Decision**		**7.25%**	**7.25%**	**7.25%**
	11:45	**SEK**	**Riksbank's Ingves spks (Macroprudential Conference)**				
	13:30	CAD	Manufacturing Sales (MoM)	Apr		0.6%	1.36%
	13:30	USD	Empire Manufacturing	Jun		19	20.1
	14:00	CAD	Existing Home Sales (MoM)	May		-1.7%	-2.9%
	14:15	USD	Industrial Production (MoM)	May	-0.1%	0.2%	0.7%
	14:15	USD	Capacity Utilization	May	77.8%	78.1%	78%
	15:00	USD	Univ. of Michigan Confidence	Jun P		98.5	98
	21:00	USD	Total Net TIC Flows	Apr			-38.5B
17-Jun	23:30	NZD	Performance Services Index	May			55.9
	N/A	**COP**	**Colombia Presidential Election (Second Round)**				
18-Jun	0:50	JPY	Trade Balance	May		-250B	624.6B
	9:00	CHF	SNB Sight Deposits				576.3B
	15:00	USD	NAHB Housing Market Index	Jun		70	70
	18:30	**EUR**	**ECB's Draghi spks (Sintra Conference)**				
19-Jun	0:30	AUD	Consumer Confidence				123
	2:30	AUD	RBA Minutes	Jun-5			
	8:30	SEK	Unemployment Rate	May			6.8%
	9:00	EUR	Euro-Area Current Account	Apr			32B
	9:00	**EUR**	**ECB's Draghi spks (Sintra Conference)**				
	10:00	EUR	Construction Output (MoM)	Apr			-0.3%
	13:00	**HUF**	**NBH Rates Decision**		**0.90%**	**0.9%**	**0.9%**
	N/A	NZD	Global Dairy Trade Announces Milk Auction Results				
	13:30	USD	Housing Starts	May	1298k	1309k	1287k
	20:00	**ARS**	**GDP (YoY)**	**1Q**			**3.9%**
20-Jun	0:50	JPY	BoJ Minutes	Apr-27			
	1:30	AUD	Westpac Leading Index (MoM)	May			0.19%
	7:30	**JPY**	**BoJ's Kuroda spks (National Credit Union)**				
	8:00	SEK	Economic Tendency Survey	Jun			108.8
	8:05	**THB**	**BoT Rates Decision**		**1.50%**	**1.5%**	**1.5%**
	9:00	**PHP**	**BSP Rates Decision**		**3.25%**	**3.5%**	**3.25%**
	13:30	USD	Current Account Balance	1Q		-129	-128.2
	14:30	**EUR**	**ECB's Draghi spks (Sintra Conference)**				
	14:30	**AUD**	**Fed's Powell (voter) spks (Sintra Conference)**				
	14:30	**JPY**	**BoJ's Kuroda spks (Sintra Conference)**				
	14:30	**AUD**	**RBA's Lowe spks (Sintra Conference)**				
	15:00	USD	Existing Home Sales	May	5.43m	5.56m	5.46m

	N/A	**BRL**	**COPOM Rates Decision**		**6.25%**		**6.5%**
	23:45	**NZD**	**GDP (QoQ)**	**1Q**		**0.5%**	**0.6%**
21-Jun	0:50	JPY	Japan MoF Weekly Security Flow				
	5:30	CHF	SNB Financial Stability Report				
	8:30	**CHF**	**SNB Rates Decision**				**-0.75%**
	9:00	CHF	SNB Press Conference				
	9:00	**NOK**	**Norges Bank Rates Decision**		**0.50%**	**0.5%**	**0.5%**
	9:00	NOK	Norges Bank Monetary Policy Report				
	N/A	**TWD**	**CBC Rates Decision**		**1.375%**		**1.375%**
	9:30	GBP	PSNB ex Interventions	May			7.8B
	9:30	NOK	Norges Bank Press Conference				
	12:00	**GBP**	**BoE Rates Decision**		**0.50%**	**0.5%**	**0.5%**
	13:30	USD	Initial Jobless Claims			223k	218k
	13:30	USD	Philadelphia Fed Business Outlook	Jun		26	34.4
	15:00	USD	Leading Index	May	0.3%	0.4%	0.4%
	15:00	EUR	Consumer Confidence	Jun A		-0.1	0.2
	19:00	**MXN**	**Banxico Rates Decision**		**7.50%**		**7.5%**
	21:15	**GBP**	**BoE's Carney spks (Mansion House)**				
22-Jun	**0:30**	**JPY**	**CPI (YoY)**	**May**		**0.6%**	**0.6%**
	4:00	NZD	Credit Card Spending (MoM)	May			0.6%
	5:30	JPY	All Industry Activity Index (MoM)	Apr		0.9%	0%
	6:30	JPY	Nationwide Dept Sales (YoY)	May			0.7%
	N/A	**INT**	**OPEC Meeting**				
	9:00	EUR	PMI Manufacturing	Jun P		54.8	55.5
	9:00	EUR	PMI Services	Jun P		53.5	53.8
	13:30	CAD	Retail Sales (MoM)	Apr			0.6%
	13:30	**CAD**	**CPI (YoY)**	**May**			**2.2%**
	14:45	USD	PMI Manufacturing	Jun P		56.5	56.4
	14:45	USD	PMI Services	Jun P			56.8
24-Jun	**15:00**	**TRY**	**Turkey Presidential Parliamentary Election (Polls Close)**				
25-Jun	0:50	JPY	BoJ Summary of Opinions	Jun-15			
	6:00	JPY	Leading Index CI	Apr F			105.6
	9:00	EUR	IFO Expectations	Jun			98.5
	9:00	CHF	SNB Sight Deposits				
	15:00	USD	New Home Sales	May		665k	662k
	15:30	USD	Dallas Fed Manufacturing Activity	Jun			26.8
26-Jun	0:30	AUD	Consumer Confidence				123
	15:00	USD	Richmond Fed Manufacturing Index	Jun			16
	15:00	USD	Consumer Confidence Index	Jun			128
	23:45	NZD	Trade Balance	May			263m
	N/A	**ARS**	**BCRA Rates Decision**		**40.00%**		**40%**
27-Jun	7:00	NOK	Unemployment rate (AKU)	Apr			3.9%
	9:00	EUR	M3 (YoY)	May			3.9%
	9:30	**GBP**	**BoE Press Conference (Financial Stability Report)**				
	12:00	**CZK**	**CNB Rates Decision**		**0.75%**		**0.75%**
	13:30	USD	Wholesale Inventories (MoM)	May P			0.1%
	13:30	USD	Durable Goods Orders	May P			-1.6%
	14:00	CHF	SNB Quarterly Bulletin				

	15:00	USD	Pending Home Sales (MoM)	May			-1.3%
	20:00	**CAD**	**BoC's Poloz spks**				
	22:00	**NZD**	**RBNZ Rates Decision**		**1.75%**	**1.75%**	**1.75%**
28-Jun	0:50	JPY	Japan MoF Weekly Security Flow				
	N/A	**IDR**	**BI Rates Decision**		**4.75%**		**4.75%**
	8:00	**EUR**	**German regional CPI start being released**	**Jun**			
	8:30	SEK	Trade Balance	May			-6.5B
	8:30	SEK	Retail Sales (MoM)	May			0.6%
	10:00	EUR	Consumer Confidence	Jun F		-0.1	0.2
	13:00	**EUR**	**German CPI (YoY)**	**Jun P**		**2.2%**	**2.2%**
	13:30	**USD**	**GDP (QoQ)**	**1Q T**			**2.2%**
	13:30	USD	PCE Core (QoQ)	1Q T			2.3%
	13:30	USD	Initial Jobless Claims				
	16:00	USD	Kansas City Fed Manufacturing Activity	Jun			29
	23:00	NZD	ANZ Consumer Confidence Index	Jun			121
29-Jun	0:01	GBP	GfK Consumer Confidence	Jun			-7
	0:50	JPY	Industrial Production (MoM)	May P			0.5%
	2:30	AUD	Private Sector Credit (MoM)	May			0.4%
	7:00	NOK	Retail Sales (MoM)	May			0.6%
	8:00	CHF	KOF Leading Indicator	Jun			100
	9:30	GBP	Mortgage Approvals	May			62.5k
	9:30	GBP	Current Account Balance	1Q			-18.4B
	9:30	**GBP**	**GDP (QoQ)**	**1Q F**			**0.1%**
	10:00	**EUR**	**CPI Estimate (YoY)**	**Jun**			**1.9%**
	13:30	**USD**	**PCE Core (YoY)**	**May**			**1.8%**
	13:30	USD	Personal Income	May			0.3%
	13:30	USD	Personal Spending	May			0.6%
	13:30	**CAD**	**GDP (YoY)**	**Apr**			**2.9%**
	15:00	USD	Univ. of Michigan Confidence	Jun F		98.5	98
	15:30	CAD	Business Outlook Future Sales	2Q			16
	15:30	CAD	BoC Senior Loan Officer Survey	2Q			-5.2
	N/A	**COP**	**BDRC Rates Decision**		**4.00%**		**4.25%**
Upcoming Risk Events							
3-Jul	5:30	AUD	RBA Rates Decision	Jul	1.50%		1.50%
3-Jul	8:30	SEK	Riksbank Rates Decision	Jul	-0.50%		-0.50%
11-Jul	15:00	CAD	BoC Rates Decision	Jul	1.25%		1.25%
26-Jul	12:45	EUR	ECB Rates Decision	Jul	-0.40%		-0.40%
1-Aug	19:00	USD	FOMC Rates Decision (Upper Bound)	Aug	2.00%		2.00%

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.

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FX Filter

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G10 CLEAR ALL

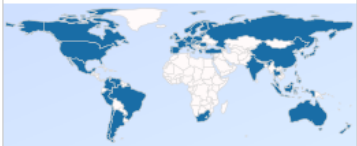
USD AUD CHF EUR
NZD NOK GBP CAD
SEK JPY

EM

AxJ
CNY IDR INR KRW
MYR PHP SGD TWD
THB

LatAm
BRL MXN ARS VEF
CLP COP PEN

CEEMEA
ZAR TRY ILS RUB
PLN CZK HUF RON



Date	Currencies	Report
13 Jun 2018	AUD; CLP; COP; ...	AUD and a more cautious RBA, Weaker USD positive for global growth, Falling political risk FX impact
13 Jun 2018	CNY; HUF; KRW; ...	Opportunity in Hungary, TRY offers value, Turning neutral on KRW, Sustainable RMB valuation
12 Jun 2018	EUR; GBP	Better GBP news, EUR bullish
12 Jun 2018	CZK; HUF; INR; ...	EUR support for CEE, Bearish EM sentiment
12 Jun 2018	KRW	South Korea Strategy & Economics: Waiting for More Progress on North Korea Issue
11 Jun 2018	EUR; GBP; NOK; ...	Improving EUR prospects, USD bearish despite potentially hawkish Fed, GBP medium term risks persist
11 Jun 2018	EM	Global EM Strategist: Feedback from the Road
08 Jun 2018	EM; EUR; GBP; ...	EUR/GBP is likely breaking higher, The USD concern, The EUR rally, DM-EM FX divergence
08 Jun 2018	ARS; EM; IDR; ...	KRW supported by Chinese import demand, ARS and IMF Stand-By Agreement, EM weakness continues
07 Jun 2018	EUR	FX Analytics: EUR Dynamics Over The ECB Meetings
07 Jun 2018	AUD; CAD; CHF; ...	FX Pulse: Winning Streak for EUR/USD
07 Jun 2018	ARS; CNY; EM; ...	Preference for AxJ FX, Bullish TRY ahead of CBT, PBoC liquidity injection, Value in PLN, ARS risk premia
07 Jun 2018	CHF; EUR; JPY; ...	Long JPY and CHF, Stay bearish USD, EUR leads currencies against USD
07 Jun 2018	CHF	Swiss Vollgeld Referendum
06 Jun 2018	AUD; CAD; EM; ...	Risk should support EM, Better EUR/USD outlook, Robust data should see USDCAD lower, Growth supports AUD
06 Jun 2018	ARS	Argentina Economics & Strategy: Sailing Windward

Morgan Stanley Research. With thanks to the AlphaWise Interactive Team for their contribution to this report.

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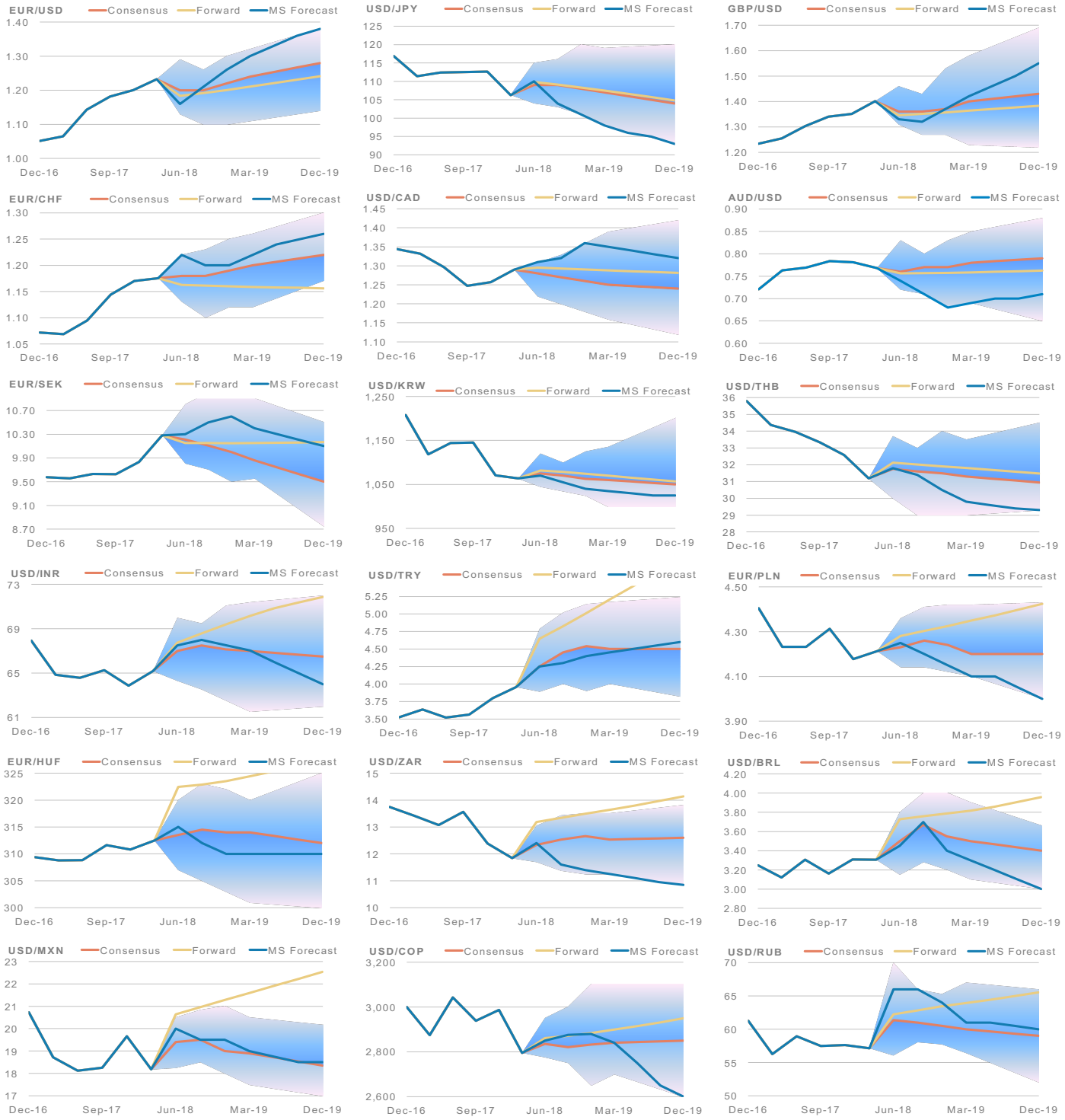
Search the whole historical timeline of research easily at the top.
Click on the map to find currency research from that region.

The research here is currency-specific. Please click here to search by our publications FX Morning and FX Pulse.

FX Forecasts Relative to Market

Exhibit 30: 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 31: FX forecasts – click here for custom forecasts

	2Q	3Q	4Q	1Q	2Q	3Q	4Q
EUR/USD	1.16	1.21	1.26	1.30	1.33	1.36	1.38
USD/JPY	110	104	101	98	96	95	93
GBP/USD	1.33	1.32	1.37	1.42	1.46	1.50	1.55
USD/CHF	1.05	0.99	0.95	0.94	0.93	0.92	0.91
USD/SEK	8.88	8.68	8.41	8.00	7.74	7.50	7.32
USD/NOK	8.02	7.77	7.54	7.23	6.99	6.76	6.59
USD/CAD	1.31	1.32	1.36	1.35	1.34	1.33	1.32
AUD/USD	0.74	0.71	0.68	0.69	0.70	0.70	0.71
NZD/USD	0.69	0.67	0.66	0.68	0.70	0.70	0.70
EUR/JPY	128	126	127	127	128	129	128
EUR/GBP	0.87	0.92	0.92	0.92	0.91	0.91	0.89
EUR/CHF	1.22	1.20	1.20	1.22	1.24	1.25	1.26
EUR/SEK	10.30	10.50	10.60	10.40	10.30	10.20	10.10
EUR/NOK	9.30	9.40	9.50	9.40	9.30	9.20	9.10
USD/CNY	6.40	6.32	6.25	6.20	6.17	6.12	6.10
USD/HKD	7.80	7.80	7.80	7.80	7.80	7.80	7.80
USD/IDR	13900	13800	13500	13400	13300	13200	13100
USD/INR	67.5	68.0	67.5	67.0	66.0	65.0	64.0
USD/KRW	1070	1055	1040	1035	1030	1025	1025
USD/MYR	4.15	4.25	4.20	4.15	4.10	4.05	4.00
USD/PHP	51.25	50.75	51.50	52.25	52.75	53.25	53.50
USD/SGD	1.34	1.32	1.29	1.26	1.25	1.24	1.23
USD/TWD	29.85	29.60	29.25	28.75	28.50	28.25	28.25
USD/THB	31.80	31.40	30.50	29.80	29.60	29.40	29.30
USD/BRL	3.45	3.70	3.40	3.30	3.20	3.10	3.00
USD/MXN	20.00	19.50	19.50	19.00	18.75	18.50	18.50
USD/ARS	25.00	25.50	26.50	27.25	27.75	28.00	30.00
USD/CLP	580	610	620	610	585	560	555
USD/COP	2850	2875	2880	2840	2750	2650	2600
USD/PEN	3.23	3.24	3.26	3.23	3.22	3.20	3.15
USD/ZAR	12.40	11.60	11.40	11.25	11.10	10.95	10.85
USD/TRY	4.25	4.30	4.40	4.45	4.50	4.55	4.60
USD/ILS	3.65	3.55	3.50	3.45	3.45	3.40	3.40
USD/RUB	66.0	66.0	64.0	61.0	61.0	60.5	60.0
EUR/PLN	4.25	4.20	4.15	4.10	4.10	4.05	4.00
EUR/CZK	25.50	25.25	25.25	25.00	24.75	24.50	24.50
EUR/HUF	315	312	310	310	310	310	310
EUR/RON	4.65	4.65	4.60	4.60	4.55	4.50	4.50
DXY Index	95	92	89	86	84	83	81
Fed's Broad USD Index	121	119	117	115	114	112	111

Source: Morgan Stanley Research forecasts. Forecasts were updated on May 13, 2018. USD/ARS forecast was updated on June 6, 2018.

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.
Receive: 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 decrease.

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When more than one issuer or instrument is included in a recommendation, the 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.

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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 here for a currency reference page:

Morgan Stanley Matrix

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