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FX Morning

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A political market. Commodity and share markets have come under significant selling pressure as investors are beginning to doubt the potential pace of US economic fiscal policy reform. The outcome of tomorrow's vote on the [Obamacare repeal bill](#) is seen by some commentators as an important data point allowing markets to make a judgement on the ability of the US government to deliver on other reform projects, particularly on taxes and banking sector reform. Republicans currently hold a 237-to-193 majority in the House with six vacant seats. The GOP holds a 52-to-48 majority in the Senate. All Democrats are expected to oppose the House GOP health bill and Ryan can afford only 21 Republican defections and still pass the bill. [NBC News was reporting yesterday](#) there are 26 Republicans who are opposed or strongly leaning towards no for this bill. Should the bill be rejected, the current high valuations in equity markets, particularly on US cyclicals and financials, may be at risk. Overnight US bank stocks declined by 4%, while the overall US stock market experienced its biggest setback since the Presidential election day. Financials and inflation expectations tend to correlate and with financials declining, US inflation expectations should scale back too. US nominal yields coming off will only act as a risk stabiliser once nominal rates fall faster compared to inflation expectations, pushing US real yields lower.

Leaving a 'sweet spot'. Should the bill be rejected, this may have the potential to tighten US financial conditions. In particular we watch to see if the decline in the USD and yields are sufficient to compensate for declines in oil and equities. Our [US economists note](#) that this wasn't an issue yesterday (when financial conditions have eased by over 80bp since the Dec Fed hike). So far, the Fed operated within a 'sweet spot' where its nominal yield increases were more than fully compensated by improving financial conditions. The problem was that financial conditions were a function of Trump's team being seen to be able to deliver swiftly on tax reform and other projects. Hence, the Obamacare repeal act vote could develop possible implications going beyond the day, taking markets from a 'sweet' into a 'sour' spot with weakening financial conditions reducing the scope for the Fed hiking rates. This argument gains further weight considering the wide gap between forward looking survey data and current hard data. So far, the US economy has not translated excessive optimism into better hard data, promoting US politics into the centre of market attention.

The Fed turning into a sideshow. Accordingly, markets are not paying too much attention to hawkish Fed commentary with Ester George (non-voter) mentioning four rate hikes for this year and Loretta Mester (non-voter) discussing the Fed taking first steps to shrink its massive USD4.5trn balance sheet later in the year as the economy continues to expand steadily. For risk markets to look better by the end of this week two things may have to happen. First, Ryan and Trump

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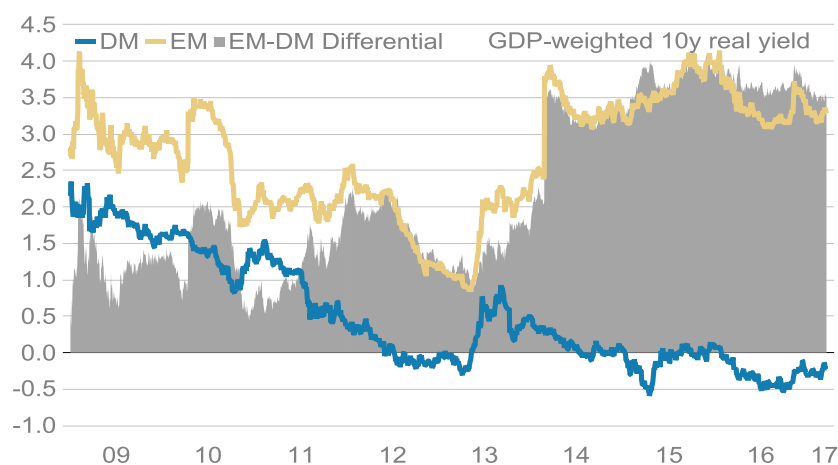
winning Thursday's vote and, secondly, Friday's US durable goods order report finally showing first indications of US business investment picking up. In this case, USDJPY would turn around, stabilising at levels above 112.40. However, a bearish outcome opens potential to 109.40.

Beating the GBP drum. Given the symmetry of potential outcomes we have restrained ourselves from trading USDJPY and EURUSD (where we closed the position early last week). Instead we beat the drum on markets where there are risk:position asymmetries such as with GBP. Yesterday did see GBP breaking higher with the support of [strong inflation data](#). Headline inflation has reached its highest level since September 2013 and core inflation has advanced from 1.6% to 2.0%. BoE's Carney suggesting not putting too much emphasis on a single data point is the correct attitude a central bank's target. Moreover, the CPI reported manufacturing optimism reaching levels not seen since John Major was PM. All this information finds a heavily short positioned GBP market.

AUD and NZD bearish. We have expressed our bullish GBP view via funding in NZD. Likewise we could have chosen the AUD. Both currencies have experienced significant equity related inflows funding their foreign liability positions. Accordingly, both currencies will lose should shares continue to fall. China tightening its monetary conditions and commodities coming off their highs will not bode well for the AUD. On the NZD side we expect the RBNZ today providing a dovish statement (relative to current market pricing) reacting to the weak Q4 GDP report and sluggish household income data. GBP/NZD has tested its 200-day MAV this morning, but set to break higher. Both currencies may in the future not qualify in the high yield FX category as real yields have come down.

Don't develop an EM scare. The chart shows G-10 real yield comparing it with [EM real yield](#). Leaving short-term fluctuations aside the attractiveness of EM is still too substantial to assume current risk wobble spilling over into EM.

Exhibit 1: Global FX Reserves Stabilise When Commodity Prices Do



Source: Bloomberg, Macrobond, Morgan Stanley Research

Below are the risk events for today, [click here](#) for an interactive, searchable, longer calendar.

Date	Time (Ldn)	Co	Event	Ref. Period	MS forecast	Market	Previous
22-Mar	08:00	ZAR	CPI (YoY)	Feb	6.3%	6.3%	6.6%
22-Mar	08:30	EUR	ECB's Villeroy spks (Frankfurt)				
22-Mar	09:00	EUR	Euro-area Current Account	Jan			31B
22-Mar	09:30	EUR	Italian Current Account Balance	Jan			5534.9m
22-Mar	10:30	INT	EU's Barmer spks (Brussels)				
22-Mar	11:00	EUR	Les Echos French Election Poll				
22-Mar	11:30	EUR	ECB's Lautenschlaeger spks (Frankfurt)				
22-Mar	11:30	NOK	Norges Bank's Nicolaisen spks (Sogndal)				
22-Mar	12:00	BRL	IPCA Inflation (MoM)	Mar	0.14%	0.15%	0.54%
22-Mar	12:00	NOK	Norges Bank's Olsen, Maitzen spk (Mo i Rana)				
22-Mar	13:00	USD	House Price Index (MoM)	Jan		0.4%	0.4%
22-Mar	14:00	USD	Existing Home Sales	Feb	5.57m	5.55m	5.69m
22-Mar	14:00	CHF	SNB Quarterly Bulletin	Q1			
22-Mar	14:30	USD	EIA Crude Oil Inventories			3000k	-237k
22-Mar	17:00	EUR	Paris Match French Election Poll				
22-Mar	17:30	GBP	Scottish Parliament Votes on Independence Referendum				
22-Mar	20:00	NZD	RBNZ Rates Decision			1.75%	1.75%
22-Mar	N/A	CAD	Canada Federal Budget				
23-Mar	01:10	JPY	BoJ Rinban (>10y JGB)				
23-Mar	05:00	SGD	CPI (YoY)	Feb		0.7%	0.6%
23-Mar	06:25	CHF	SNB Annual Report				
23-Mar	07:00	EUR	German GfK Consumer Confidence	Apr	10	10	10
23-Mar	07:45	EUR	French Business Confidence	Mar		104	104
23-Mar	07:45	EUR	French Manufacturing Confidence	Mar	107	107	107
23-Mar	N/A	TWD	CBC Rates Decision		1.375%	1.375%	1.375%

Source: Bloomberg, Morgan Stanley Research

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(as of February 28, 2017)

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	COUNT	% OF TOTAL	COUNT	% OF TOTAL IBC	% OF RATING CATEGORY	COUNT	% OF TOTAL OTHER MISC
Overweight/Buy	1148	35%	286	43%	25%	551	36%
Equal-weight/Hold	1418	43%	297	45%	21%	699	46%
Not-Rated/Hold	61	2%	8	1%	13%	8	1%
Underweight/Sell	638	20%	76	11%	12%	269	18%
TOTAL	3,265		667			1527	

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