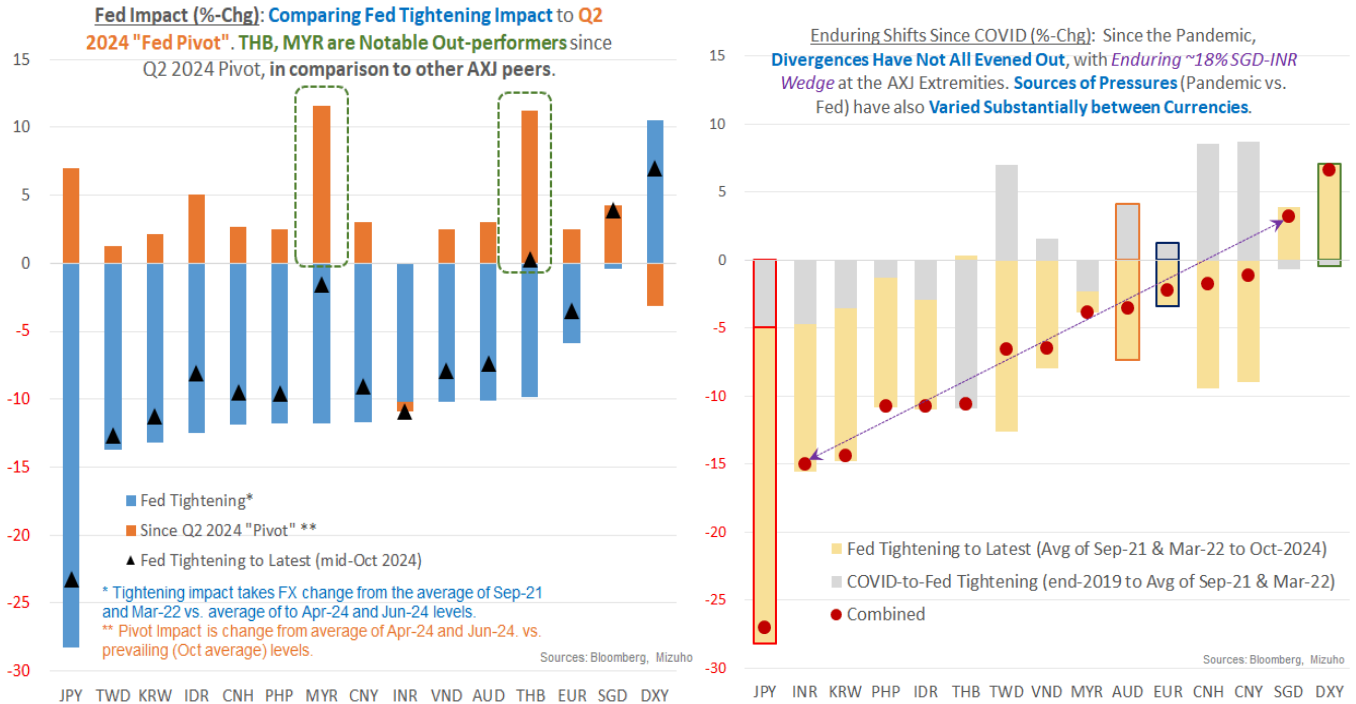


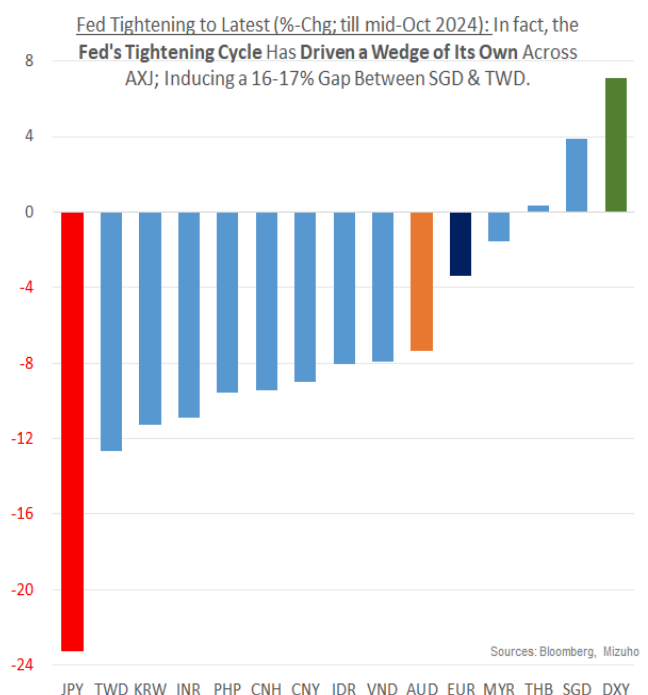
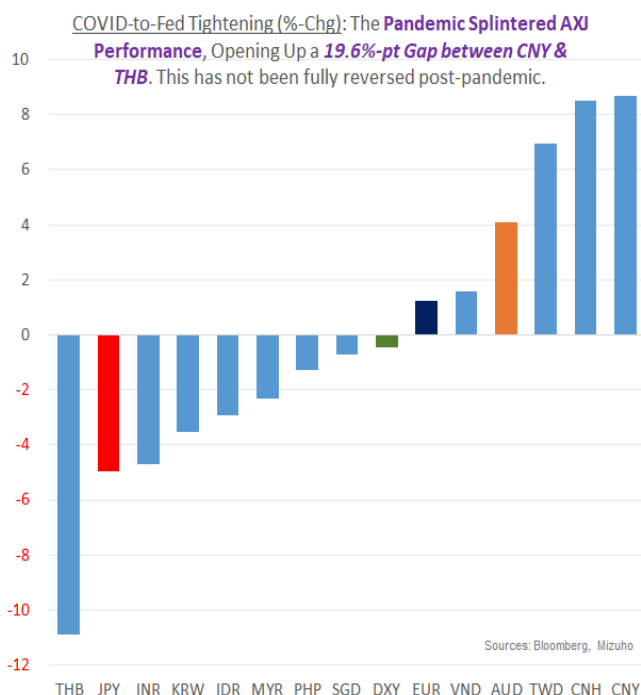
FX: (The Challenge of) Shifting FX Sands



In a Nutshell

- **A bumpy course for AXJ**, with rapidly shifting volatility, **rather than a smooth upward trend on “pivot USD”**, looks to be par for the course.
 - **It’s the USD:** For one, pockets of perkiness in the US economy inducing swings in Fed cut expectations, suggest USD volatility frustrating hopes for unambiguous AXJ grind higher.
 - **It’s the Elections:** What’s more, with US elections, the risks are tilted to a stronger USD, compromising AXJ. And more acutely so, with Trump 2.0 outcomes.
 - **It’s the Sensitivities:** Crucially, **AXJ beta** (to periods of USD decline) are **highly differentiated and time-varying**. So, a re-ordering of performance depending on the drivers of risks is notable.
 - **It’s Complicated (by post-pandemic distortions):** Finally, **inherited post-pandemic distortions**, with the *distinction between cyclical-structural shifts blurred*, shroud AXJ outcomes.
- It is **tempting to suggest a distinct shift into bearish USD territory accompanying the Fed pivot** (into a Fed rate cut cycle) **supportive of AXJ** buoyancy, if **not ascendancy**.
 - Admittedly, to some extent, the recent (since Q2) bounce in AXJ squares with this hypothesis.
 - Nonetheless, it would be **careless, if not outright cavalier, to suggest linear (positive) projections in AXJ** based on simplistic dovish Fed (and corresponding bearish USD) views.

- Instead, **AXJ look set to endure heightened interim volatility on Fed shifts**, with *more profound downside risks from US elections*, before turning around on a *bumpy path to recovery further out*.
- First one, the **Fed’s rate cut path expectations remain exceptionally fluid, and the USD significantly volatile**; with recent upside volatility as pockets of economic resilience temper views of the Fed’s dovish intent. This in turn translates into *far more pronounced two-way USD volatility* than might be otherwise assumed a very bumpy path in any case.
- Second, **US elections risks** entailing strong **USD impulses could easily** (albeit temporarily) derail Fed pivot bets, supplanting bearish USD trend with *haven-driven USD demand resulting in AXJ turbulence*.
- Third, even if (presumably bullish) **USD shocks from US elections fade, eventually deferring to a softer USD from Fed pivot, positive AXJ response could vary substantially**.
- This is evident in *differentiated* and *time-varying* the **“beta” of the various AXJ currencies to USD decline**. Highlighting the differentiation is the fact that THB and MYR have by far outperformed in the initial USD pivot on Fed rate cut bets since Q2 2024.
- But what’s problematic is that the *time-varying (unstable) beta shrouds visibility on sustained sensitivities*. Especially as other **competing factors** such as *China stimulus, US-China trade antagonism* and *domestic political risk premium* evolve and interact.
- Finally, *unprecedented post-pandemic distortions* compounded by an *aggressive Fed cycle* challenge the ability to gauge prospects and potential for AXJ.
- Highly differentiated starting points inherited from pandemic shifts alongside the juxtaposition of cyclical and structural shifts **distorts AXJ response sensitivities**. Consequently, **measures of “reversion”** pegged to levels just before the Fed kicked off policy normalization may be **biased, if not flawed**. Hence, through the Fed rate cut cycle, **reactions across various AXJ are set to be very differentiated**, with *varying degrees of incomplete reversion*.



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