Emerging Market Monthly Roadmap

FIM RESEARCH 04 May 2011

Desperately seeking tightening!

Summary
Inflation may peak at some point in Q3, but until then it will accelerate. From where will the required tightening come? EM currencies have appreciated … but mostly vs USD, not so much on a trade-weighted basis. Yields have increased in Asia but stabilised or decreased in many non-Asian markets. Something’s got to give… The case remains strong for both short-term rates moving higher and EM FX continuing to appreciate, to some extent, as headline inflation accelerates.

Key macro calls
- EM inflation to moderate during Q3…
- …until then: rates to go up!
- India: tighter policy, stronger INR
- Brazil: monetary policy in uncharted land
- Egypt: too big to fail

Main strategic calls
- Bear flattening ahead on Asia
- Keep ZAR flattener
- Turkey: closer to rate hike
- Pay TWD and KRW 1Y IRS
- Stay long Asia FX (CNY, PHP, KRW)

EM: monetary tightening intensifies

* Weighted average for 25 EMs

Source: Bloomberg, Crédit Agricole CIB

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Emerging markets at a glance: A tighter rate/FX mix

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EMs have remained resilient to the still-strong challenges. The focus is now back on inflation-fighting. Central banks will continue to tighten in coming months, particularly in Asia, but will try not to overreact. Inflation should remain strong until Q3 inclusive … and could moderate thereafter. FX appreciation is part of the toolkit, but the current USD softness makes EM FX effective appreciation more difficult to engineer.

Enjoy the ride

EMs have been resilient to the bunch of challenges that have remained strong in April. The Libyan issue is far from being fixed. The turmoil is growing in Syria. Oil prices have kept on rising in April (Brent: from USD115/bl to USD125/bl). Even if it no longer make the first lines of newswires, the Japanese catastrophe remains unfixed. Still, the MSCI EM index is holding relatively well, and risk appetite has pushed many EM currencies higher, at least vs USD. The reasons behind such resilience include the strength of domestic demand, the relatively good shape of corporate balance sheets, and the fact many emerging markets are commodity exporters and actually benefit from the current high commodity prices.

Back to inflation-fighting

As worries have abated, and against a backdrop of high commodity prices, the focus is now back on inflation-fighting. Rate hikes have intensified in recent weeks. EM central banks tightened by 13bp in April, after already 12bp in March (GDP-weighted average – see chart).

EM inflation: how bad is it?

13bp… this does not look like very aggressive tightening, considering that we are coming from a particularly low level of interest rates, and also given the size of the current inflation problem. But, wait a minute, this inflation problem … how bad is it actually?

Commodity-induced inflation may moderate in Q3

Firstly, in terms of soft commodities, we agree that there are many reasons to expect food prices to go up structurally, beginning with the upgrade of eating standards in emerging markets in relation to the expansion of the urban middle classes (a multi-year story). However, the acceleration of global food prices over the past 12 months has been particularly strong, and markets may actually have gone ahead of themselves. It would not be so surprising to see a stabilisation or consolidation going forward.

Secondly, in terms of oil prices, the relationship between EM inflation and the YoY change in oil prices suggests that, under reasonable scenarios for oil prices, oil-induced inflation may stop accelerating at some point in Q3.
Emerging Market Monthly Roadmap

EM inflation and oil prices: disinflation to start in Q3?

Given the uncertain situation in the Middle East, it is quite clear that there is a risk to the upside. However, under a base-case scenario where the country-risk situation stabilises at least in the large oil producers, it seems reasonable to expect commodity-induced inflation to moderate at some point in Q3.

This is reflected in our rate forecasts. We expect EM central banks to continue tightening gradually up to and including Q3. Then the tightening pace could slow in Q4 and into 2012.

From a geographical point of view, inflation seems to be a hotter issue in Asia. As charted below, the acceleration of sequential inflation was the strongest in many Asian markets such as India, Singapore, Vietnam, Philippines and Hong Kong. Outside Asia, South Africa and Hungary are worth monitoring. We expect Asia to tighten somewhat more strongly than other EMs in the rest of Q2 and in Q3.

Inflation pressure: where?

Source: Bloomberg, Crédit Agricole CIB

FX appreciation to do part of the job

Since in large part the inflation risk stems from global commodity prices and not only from domestic demand, it seems wise to ask FX appreciation to do part of the tightening job. In our view, central banks would be ready to allow more appreciation to cap imported inflation. However, the current softness of the USD is polluting such an action plan somewhat, as it makes it more difficult for policymakers to engineer trade-weighted appreciation of their currencies (since some EM currencies are softly pegged to the USD).

Source: Bloomberg, Crédit Agricole CIB

FX appreciation on the cards, but softer USD makes EMs' effective appreciation more difficult to achieve
While we expect inflation in Asia to go higher still in coming months, we believe central banks will be vigilant enough to curb inflation expectations, leading to continued flattening of Asian curves. From a risk-reward perspective, we favour pay positions at the short end over flatteners. In the EMEA space, since the autopilot has been turned off, rates markets are in waiting mode looking for a clear direction. Such a hesitant mode should last as there is no obvious catalyst in sight for a quick change. We would advise to focus on local stories – Poland, Turkey, South Africa.

### Asia: Back to fundamentals

After the risk-off mode trading in March amidst the Japan earthquake, Asian rates have largely been paid up in a flattening fashion in the past month when investors shifted focus back to fundamentals as we had expected. Meanwhile, bond/swap spreads widened, in line with our long-held view about bond outperformance, in the CNY, TWD, IDR and THB rate markets. We expect the trend of bear flattening and bond outperformance to continue in coming months.

We have commented on the race between central banks and inflation. Asian central banks appear to have become more hawkish in recent weeks, with a determination to fight inflation. In April, China hiked its key policy rates for the fourth time in the current tightening cycle by 25bp, and the required reserve ratio (RRR) for the tenth time by 50bp. Bank of Thailand, which started the hiking cycle relatively early, hiked its policy repo rate further by 25bp on 20 April. Although the Bank of Korea kept its policy rate unchanged at 3.00% on 12 April, it nevertheless continues to sound hawkish, pointing to a possible hike in May.

Inflation has been picking up across most Asian economies, and quite rapidly in some places. We expect higher inflation still in the coming months. Nevertheless, policymakers will be vigilant enough to curb inflation expectations by hiking rates and withdrawing liquidity, leading to flatter rate curves in general. Also, commodity/energy-induced inflation pressure could be easing according to our commodity forecasts, which will help curb inflation expectations and thus mitigate increases in long-end rates, though pass-through of inflationary pressures to other consumer items means inflation will still remain elevated in coming months.

### Bear flattening and bond outperformance to continue

The changes in IRS slopes over the past month show that bear flattening is continuing. The table below illustrates the changes in IRS slopes for various currencies. The graph on the right shows the outstanding central bank CDs/NCDs and the overnight rate (RHS) for Taiwan.

#### Changes in IRS slopes over the past month

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<tr>
<th>Currency</th>
<th>2/5Y</th>
<th>2/10Y</th>
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<td>-10</td>
</tr>
<tr>
<td>HKD</td>
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<td>-5</td>
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<td>INR</td>
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<td>-20</td>
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<td>IDR</td>
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<td>-25</td>
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<td>MYR</td>
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<td>-30</td>
</tr>
<tr>
<td>PHP</td>
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<td>-15</td>
</tr>
<tr>
<td>SGD</td>
<td>-10</td>
<td>-15</td>
</tr>
<tr>
<td>KRW</td>
<td>-5</td>
<td>-10</td>
</tr>
<tr>
<td>TWD</td>
<td>-10</td>
<td>-15</td>
</tr>
<tr>
<td>THB</td>
<td>-15</td>
<td>-20</td>
</tr>
</tbody>
</table>

#### Taiwan steps up effort to tighten

The chart on the right shows the increase in Taiwan's central bank CDs/NCDs and the overnight rate (RHS) leading to an upward trend in the TWD.

#### Flatteners versus outright pay

While we do see some more scope for curves to flatten, we favour pay positions at the front end over flatteners. Firstly, some curves are already quite flat where consolidation in the near term cannot be ruled out. Secondly, we expect rates to rise across the curve, which means potentially fewer gains for flatteners than simple pay positions, although the deep negative carry of the latter is a
consideration. If rates are paid up within a relatively short period of time then the negative carry will become less of an issue. We will be monitoring our pay positions closely and will not hesitate to take profit.

We have been paying 1Y CNY IRS (Emerging Market Trade Idea: China; pay 1Y CNY IRS@ 3.37%, target 3.77%, 15 April 2011), as we expect PBoC efforts to mop up liquidity via RRR hikes and open market operations to outweigh inflows in the coming weeks. The injection of funds via OMOs in the last two weeks of April could be a move to smooth money market rate movement, when the 7-day repo experienced fluctuation of 200bp plus. We do not see these net injections as reflecting a change in the hawkish stance of the central bank and therefore hold on to our pay 1Y CNY IRS position. We would like to initiate pay positions at front-end TWD and KRW rates here as well.

Pay front-end TWD and KRW rates

Taiwan is behind the curve in terms of rate hikes, but the central bank has been putting more effort into bringing the overnight rate higher since February, though the rate remains low. We see a chance for the central bank to step up its rate-hike effort as well, from the baby-step of 12.5bp to a 25bp hike in Q2, especially when there is only one MPC meeting per quarter and Q1 GDP surprised to the upside. Even if the Taiwan central bank chooses still to hike in baby-steps, there is a very high possibility for more increases in NCD rates as a signal of a more hawkish stance. The market is not prepared for this yet so we would like to take this opportunity to pay 1Y TWD IRS at 0.90% with a target of 1.10% and stop loss of 0.80%. Carry and slide is a negative 4bp per quarter. Movement in the TWD rate market tends to be very mild, so we are not setting too high a target for this trade in view of the local market dynamics.

In Korea, the BoK kept its policy rate unchanged at 3.00% on 12 April. We see this as a short pause, as the BoK continued to sound very hawkish, with an upbeat assessment of the domestic economy and expectations for consumer prices to sustain their upward trend. The BoK is to resume its hiking soon, probably in May, while the market is split between a May and a June hike. We therefore recommend paying 1Y KRW IRS at 3.77%, with a target of 4.17% and a stop loss of 3.57%. Carry and slide is a negative 10bp per quarter.

Front-end THB IRS has always been our top pick for pay position. Assets under management by Thai foreign investment funds have been declining over recent months, as Thai investors liquidated their overseas investments, primarily Kimchi funds. We do not see too many alternatives to Korean asset swap trades for Thai investors, and so expect a portion of the returning money to be parked at THB assets, improving onshore USD liquidity and pushing up the 6M THBFIX and front-end THB IRS further. This is already happening, as evident from the surges in front-end THB rates, which was also partly due to rate hike expectations. We estimate there are still over USD6bn of Kimchi funds maturing for the rest of the year. As such, there is further upside for front-end THB IRS, but we would like to wait for better entry levels for pay positions, with likely consolidation near-term due to the light maturing profile in May.

EMEA: lost in the direction

Last month, we recommended ‘turning off the autopilot’ – with rising uncertainties in the EMEA countries one had to be more selective than ever. EM assets have no longer been a one-way bet. Since then, this has proved accurate as rates markets are continuing to range-trade with a slight downward bias. They seem to be in a sort of waiting mode while the global EM rate picture has hardly changed.

Indeed, the EMEA macro outlook still advocates higher rates across the board and inflation has not receded at all, but markets are struggling to find a clear direction. Curve-wise, flattening of the EM curve remains a fashionable theme in our view but the ongoing bull flattening is quite surprising as we would have expected a bear flattening given the ongoing macro outlook.

Given the absence of clear catalysts for a mood change, this hesitant mode should last a few weeks more. One of the potential triggers could be an extension of the Eurozone peripheral worries and thus contagion to the Central European countries. In addition, the market is forgetting that a batch of strong inflation
Local stories dominate

Polish rates: large discrepancy, receive FRAs

There have been large discrepancies since the beginning of the NBP tightening cycle between what the market is expecting – 100bp more hikes this year – and the 50bp view of the economics consensus and us. We like receiving the very short end of the PLN rate curve, especially the 6x9 FRA contract. Past comments from Mr Kazmierczak, a hawkish central banker, indicate that he is more hesitant to vote for further large hikes. We see the NBP going for another 50bp in hikes as inflation is likely to peak around 5% this summer but decline quickly thereafter. In addition, the economy is not overheating while the employment market is still convalescent.

PLN market is too aggressive regarding rate hikes. We like the shortest part of the curve

Poland: market is pricing too many rate hikes

Source: Crédit Agricole CIB, Bloomberg

South Africa: inflation points to further flattening

Source: Crédit Agricole CIB, Bloomberg

ZAR and TRY flatteners as inflation trade

A ZAR flattener is gaining some momentum. The higher-than-expected March figure reminds the market that the SARB cannot remain on the sidelines for too long and that the swap curve was very likely too steep, close to its seven-year highs. The short-term inflation dynamic (see chart below) suggests rate hikes by the end of this year. Whilst the recent flattening move has been triggered by lower long rates, the rising inflationary threats could this time push the shortest part of the curve significantly upwards.

In Turkey, we notice a hawkish change in the central bank’s tone in its latest MPC statement. They made it clear that short interest rates are the right instrument to control prices and the reserve ratio the one to manage credit growth and financial stability. With the deterioration of the inflation outlook they are trying to manage a possible turn in their monetary policy stance, which would push the CCS curve flatter.
## Interest rates: What’s priced in vs our forecasts

<table>
<thead>
<tr>
<th>Country</th>
<th>1M view</th>
<th>3M view</th>
<th>6M view</th>
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<tr>
<td></td>
<td>Spot</td>
<td>Our forecasts</td>
<td>Market</td>
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<tr>
<td><strong>Asia</strong></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Korea (7D repo)</td>
<td>3.00%</td>
<td>25</td>
<td>12</td>
</tr>
<tr>
<td>China (1Y lending)</td>
<td>6.31%</td>
<td>25</td>
<td><strong>-8</strong></td>
</tr>
<tr>
<td>Taiwan (rediscout)</td>
<td>1.75%</td>
<td>nm</td>
<td>nm</td>
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<tr>
<td>Thailand (repo)</td>
<td>2.75%</td>
<td>25</td>
<td>17</td>
</tr>
<tr>
<td>India (repo)</td>
<td>7.25%</td>
<td>nm</td>
<td>nm</td>
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<tr>
<td><strong>Latin America</strong></td>
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<tr>
<td>Brazil (selic)</td>
<td>12.00%</td>
<td>25</td>
<td>25</td>
</tr>
<tr>
<td>Mexico (overnight)</td>
<td>4.50%</td>
<td>0</td>
<td>nm</td>
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<td><strong>EMEA</strong></td>
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<tr>
<td>Czech Rep. (14D repo)</td>
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<td>0</td>
<td>9</td>
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<tr>
<td>Hungary (2W repo)</td>
<td>6.00%</td>
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<tr>
<td>Poland (7D repo)</td>
<td>4.00%</td>
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<td>26</td>
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<tr>
<td>Russia (O/N deposit)</td>
<td>3.25%</td>
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<td>Turkey (1W repo)</td>
<td>6.25%</td>
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<tr>
<td>South Africa (repo)</td>
<td>5.50%</td>
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</table>

**Legend:**
- Green: Where we are more hawkish than the market
- Blue: Where we are more dovish than the market
- nm: No monetary policy meeting during that period

**Source:** Bloomberg, Reuters, Crédit Agricole CIB

The above table illustrates how many basis points rate markets are pricing in over the next 1M, 3M and 6M (cumulative) for the movements of benchmark money market rates, while our calls are on policy rates. Interpretation of the above should take into account the possibly varying spreads between money market rates. In particular, INR and RUB rates reflect to a large part expectations regarding the liquidity situation. However, in the current form it gives a relevant proxy for the next rate move from the EM central banks.
Most EM currencies appreciated against the USD in April, but only a handful – mostly in Eastern Europe – managed to gain against EUR. Further into 2011, central banks, in particular in Asia, should be increasingly willing to allow appreciation to fight imported inflation, even though equity flows may moderate on tightening fears, capping FX appreciation. We expect the solid fundamentals of EM Asian currencies to allow for gains versus both the USD and the EUR. Bets on other EM FX may be funded from a EUR-USD basket.

**EM FX: not so strong**

EM currencies have rallied strongly vs USD over the past weeks. This does not seem too surprising, considering that the underlying EM story remains rather strong. But the main reason behind such an appreciation is actually the USD’s own weakness, with DXY USD index heading towards record-low levels.

Our EM 21-currency index has appreciated by 2.5% vs USD in April … but has actually depreciated by -2.4% vs EUR. As a whole, EM FX gained a marginal 0.5% vs a USD-EUR-JPY-GBP basket last month. From a regional point of view, European currencies appreciated the most, driven up by proximity to EUR. Latam currencies also did rather well. By contrast, Asia was actually down vs basket.

**EM FX vs DM FX: modest and differentiated appreciation in April**

EM Europe appreciated the most vs a USD-EUR-JPY-GBP basket in April

**Increased willingness to use FX to fight inflation**

As we explain in the first section of this report, inflation will likely peak only in Q3 in many EMs. It should remain strong and accelerate in many countries until then. This is likely to incite many EM central banks to be more tolerant vis-à-vis FX appreciation. This topic is particularly hot in Asia. On the one hand, inflation momentum seems to be particularly strong there (see *Emerging Markets at a glance: A tighter rate/FX mix*). On the other hand, Asian currencies were down vs the DM basket last month — and since the beginning of the year actually. Hence it seems pretty obvious that the FX policy has hardly helped to control inflation in Asia since the beginning of the year.

There have been recent talks emanating from the ADB on the increasing commitment of Asian policymakers towards FX co-operation, in April. Even if the short-term outcome of this remains unclear, it may reflect increased focus on FX as a way to possibly control inflation.

**China’s lock to remain in place**

However, China’s conservative CNY policy will likely remain a cap for EM appreciation. In our view, China’s obsession with stability means it will keep the...
USD as the CNY’s main reference for now. Another reason why China focuses on the USD is that imported inflation is for a large part commodity-driven; and these commodities’ prices are USD-denominated. Where the CNY goes moving forward depends to a large extent on how EUR/USD behaves. Should the USD remain soft, then the CNY’s appreciation could accelerate in coming weeks. However, should EUR/USD correct downwards at some point (our EUR strategist’s view), then the CNY could appreciate only modestly, as the PBOC may then try to cap the CNY’s trade-weighted appreciation. In any case, the CNY-lock to broader-based EM FX appreciation is likely to remain somewhat in place. Keeping this in mind, it is worth remaining selective on long EM FX stories, as well as cautious when choosing the funding currency.

CNY and USD vs basket

CNY has delcined versus its NEER bas ket YTD

Source: Bloomberg, Crédit Agricole CIB

TRY: false start…

TRY is a good example. We were stopped out at the end of April on our short EUR/TRY trade idea, partly because the EUR went up by 4.4% vs USD in April. Still, in the meantime, Turkey’s imbalances have intensified. Inflation pressure is building up, and the base effect will likely make it more obvious when the May data is released. The trade deficit widened to an all-time record level in March. In our view, this unfortunate mix (inflation and trade deficit) increases the probability the central bank will have to begin hiking rates (and not only the reserve ratio) in Q3, in order to cap domestic demand. The TRY should benefit from these growing rate hike expectations. In contrast, should the central bank fail to deliver, the risk is that widening trade and current account deficits could weigh on the currency. We do expect the central bank to deliver.

SGD: beware of the basket

SGD is another case where the issue of funding currency is particularly tricky. It is managed against an NEER basket and can move within a band of roughly 6% width. As the SGD is currently trading at the top – judging by central bank interventions to prevent further gains – it cannot gain faster than at the 2.5% annual pace at which we estimate the Monetary Authority of Singapore is appreciating the band. We believe that due to a strong external surplus the currency will remain under upward pressure, fluctuating near the band’s upper end. It is even possible that – if CPI inflation does not decline enough – the MAS will tighten policy again in October, leading to another one-off gain in SGD NEER akin to what occurred in April.

However, high likelihood of further appreciation versus the basket still leaves unanswered the question of how to play this outlook. As the USD and the EUR each account for roughly 10% of Singaporean trade, they likely have similar and significant shares in the basket. This implies that a sharp move of the EUR/USD rate will lead to a substantial rise of the SGD against one and a simultaneous fall against the other. Therefore, choosing the funding currency has to be done based on a view on the EUR/USD rate. As our EUR strategist forecasts its sharp drop by year-end, we expect USD/SGD to end 2011 above current levels, making
a long SGD position funded in USD an unsuccessful bet. On the other hand, going long SGD versus the EUR is likely to yield double-digit gains.

**SGD NEER**

![Graph showing SGD NEER](image)

SGD NEER is trading near the top of the band again, which limits future gains.

**Source:** Bloomberg, Crédit Agricole CIB

**MXN and RUB still look promising**

The MXN remains a good candidate for further appreciation. MXN should benefit from the US Fed’s efforts to secure the US recovery, given the strong integration between the two economies. MXN also benefits marginally from the upside risk on oil prices. Mexico’s underlying story is not tremendously exciting, but it is a reasonably robust one, with the ongoing recovery slowly opening the door to more central bank hawkishness settling in coming quarters. On top of that, the recent trade performance suggests that the export sector could still withstand some further appreciation, which does not seem that surprising given that the MXN stands 2% below its pre-crisis level on a real effective basis (vs CNY: 11% above, and BRL: +23% above). The trade surplus widened to an all-time high in March.

The RUB also looks promising. It will likely benefit from high oil prices. It will also be supported by rate hikes. After the upward revisions to retail sales data, the CBR surprised the market (but not ourselves) by hiking its main policy rates at the end of April. We play the RUB upside vs EUR-USD currency basket.

**KRW: another solid bet**

Another currency that is likely to continue doing well is the KRW. We have long been bullish on the KRW and have an outstanding buy recommendation as its fundamental story is compelling. It is trading about 11% below pre-crisis levels, while most Asian currencies are well above them, and there is no fundamental reason for such underperformance. In fact, fundamentals argue for appreciation. First, the KRW is highly sensitive to inflows of foreign portfolio capital into Korean equity markets. This relationship was highlighted in April, when the currency was in the top three in the region in terms of both such flows and performance. Given continued undervaluation of Korean stocks, we expect further foreign interest in the near term, which should not only maintain appreciation pressure on the KRW but also keep it among the fastest rising in emerging Asia.

Secondly, the Bank of Korea is likely to maintain its recent more benign attitude towards currency appreciation. CPI inflation has breached the top of the target range and is likely to remain elevated in months to come, providing rationale for using the currency tool to curb imported price pressures. Crucially, Q1 GDP data makes this BoK stance easier as 80% of YoY growth came from trade, with exports growth accelerating, which suggests that exporters are likely to be able to withstand more currency gains. Finally, we expect further rate tightening, with two 25bp hikes, in Q2 and Q3. The increases should add to the attractiveness of holding KRW vis-à-vis the USD, although the same should be true for most other regional currencies as we expect rate increases of similar magnitude throughout emerging Asia. Such solid fundamentals have allowed us recently to revise down our USD/KRW year-end target to 1,040.
## FX: What’s priced in vs our forecasts

<table>
<thead>
<tr>
<th>Country</th>
<th>Spot</th>
<th>3M forecast</th>
<th>6M forecast</th>
<th>Gap</th>
<th>3M rates</th>
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<td>1088</td>
<td>1081</td>
<td>-0.7%</td>
<td>3.5%</td>
</tr>
<tr>
<td>USD/TWD</td>
<td>28.6</td>
<td>29.7</td>
<td>28.4</td>
<td>-4.6%</td>
<td>0.6%</td>
</tr>
<tr>
<td>USD/THB</td>
<td>30.0</td>
<td>29.5</td>
<td>30.1</td>
<td>1.9%</td>
<td>2.9%</td>
</tr>
<tr>
<td>USD/VND</td>
<td>20650</td>
<td>21067</td>
<td>21790</td>
<td>3.4%</td>
<td>13.2%</td>
</tr>
<tr>
<td><strong>Latin America</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>USD/ARS</td>
<td>4.08</td>
<td>4.12</td>
<td>4.18</td>
<td>1.5%</td>
<td>10.8%</td>
</tr>
<tr>
<td>USD/BRL</td>
<td>1.59</td>
<td>1.65</td>
<td>1.61</td>
<td>-2.3%</td>
<td>12.1%</td>
</tr>
<tr>
<td>USD/MXN</td>
<td>11.57</td>
<td>11.77</td>
<td>11.68</td>
<td>-0.8%</td>
<td>4.4%</td>
</tr>
<tr>
<td><strong>EMEA</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>USD/RUB</td>
<td>27.3</td>
<td>29.4</td>
<td>27.5</td>
<td>-6.4%</td>
<td>4.1%</td>
</tr>
<tr>
<td>USD/TRY</td>
<td>1.53</td>
<td>1.49</td>
<td>1.57</td>
<td>5.0%</td>
<td>8.0%</td>
</tr>
<tr>
<td>USD/ZAR</td>
<td>6.62</td>
<td>6.70</td>
<td>6.72</td>
<td>0.2%</td>
<td>5.6%</td>
</tr>
<tr>
<td>EUR/CZK</td>
<td>24.2</td>
<td>24.1</td>
<td>24.2</td>
<td>0.3%</td>
<td>0.8%</td>
</tr>
<tr>
<td>EUR/HUF</td>
<td>265</td>
<td>271</td>
<td>268</td>
<td>-1.2%</td>
<td>6.1%</td>
</tr>
<tr>
<td>EUR/PLN</td>
<td>3.94</td>
<td>3.88</td>
<td>3.97</td>
<td>2.1%</td>
<td>4.1%</td>
</tr>
<tr>
<td>EUR/RON</td>
<td>4.11</td>
<td>4.25</td>
<td>4.15</td>
<td>-2.4%</td>
<td>5.4%</td>
</tr>
</tbody>
</table>

*Obtained by extrapolation from our quarterly forecast grid (included at the end of this report)*

**Legend**

- Where we are more bullish than the market
- Where we are more bearish than the market

**Source:** Crédit Agricole CIB
Trade ideas

Rates: We initiate three pay positions in the Asian rates space, riding on the view that central banks are becoming more determined to fight inflation via liquidity withdrawal and policy rate hikes. We keep ZAR and TRY flatteners.

FX: We remain long CNY, PHP and KRW. We keep our long KZT position.

Interest rate

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Entry date</th>
<th>Entry level</th>
<th>Target</th>
<th>Stop loss</th>
<th>Now</th>
<th>Performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>2/5Y ZAR IRS flattener</td>
<td>15/12/10</td>
<td>133bp</td>
<td>95bp</td>
<td>152bp</td>
<td>110bp</td>
<td>24bp</td>
</tr>
<tr>
<td><a href="mailto:guillaume.tresca@ca-cib.com">guillaume.tresca@ca-cib.com</a></td>
<td>Rationale: The inflation acceleration coupled with a more hawkish central bank should push higher the 2Y part of the curve and lead to a curve flattening. In addition, slope levels remain attractive.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sell Brazilian future DI/13-Jan contracts</td>
<td>26/01/11</td>
<td>12.77%</td>
<td>12.20%</td>
<td>13.05%</td>
<td>12.66%</td>
<td>11bp</td>
</tr>
<tr>
<td><a href="mailto:guillaume.tresca@ca-cib.com">guillaume.tresca@ca-cib.com</a></td>
<td><a href="mailto:vladimir.vale@ca-cib.com">vladimir.vale@ca-cib.com</a></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rationale: The front-end of the rate curve has range-traded for a while. Nevertheless, uncertainties about the BCB’s credibility in fighting inflation are decreasing, which will allow the inflation premia to diminish somewhat.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2Y/5Y TRY CCS flattener</td>
<td>06/04/11</td>
<td>51bp</td>
<td>0bp</td>
<td>77bp</td>
<td>58bp</td>
<td>-7bp</td>
</tr>
<tr>
<td><a href="mailto:guillaume.tresca@ca-cib.com">guillaume.tresca@ca-cib.com</a></td>
<td>Rationale: TRY curve has already flattened significantly but we are still far from pre-crisis levels, when inflation and rates were significantly higher. We still stick to the view that inflation can only come back sharply. We see the first repo rate hike this summer.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pay 1Y CNY IRS</td>
<td>15/04/11</td>
<td>3.37%</td>
<td>3.77%</td>
<td>3.17%</td>
<td>3.45%</td>
<td>8bp</td>
</tr>
<tr>
<td><a href="mailto:frances.cheung@ca-cib.com">frances.cheung@ca-cib.com</a></td>
<td><a href="mailto:dariusz.kowalczyk@ca-cib.com">dariusz.kowalczyk@ca-cib.com</a></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rationale: China is adopting a firmer determination to fight inflation primarily through liquidity withdrawal. We expect PBoC’s effort to withdraw liquidity via RRR hikes and open market operations to outweigh expected inflows for the weeks ahead. We expect a further 25bp hike in key policy rates and at least a 50bp hike in RRR in Q2, with risk still to the upside.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Receive PLN 6x9 FRA</td>
<td>20/04/11</td>
<td>5.04%</td>
<td>4.70%</td>
<td>5.21%</td>
<td>4.99%</td>
<td>5bp</td>
</tr>
<tr>
<td><a href="mailto:guillaume.tresca@ca-cib.com">guillaume.tresca@ca-cib.com</a></td>
<td>Rationale: The errors and omissions issue and the current inflationary pressures suggest a rate hike of 50bp more, in our view – less than the 100bp priced in by the markets for the remainder of the year. The discrepancy between market expectations and the economic consensus has been large for a while. Inflation will peak this summer and decline gradually as pressures remain manageable.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pay 1Y Hibor-Libor basis</td>
<td>03/05/11</td>
<td>-26bp</td>
<td>-2bp</td>
<td>-38bp</td>
<td>-26bp</td>
<td>-</td>
</tr>
<tr>
<td><a href="mailto:frances.cheung@ca-cib.com">frances.cheung@ca-cib.com</a></td>
<td>Rationale: HKD liquidity could become tighter in coming weeks (likely IPO activity); meanwhile we do not expect USD liquidity to get meaningfully tighter as corporates are able to raise USD funds from the debt capital markets. Front-end Hibor-Libor basis has been pushed down to near the lows seen during the credit crisis in 2008. We see relative value paying the 1Y as the 1/5Y looks steep.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pay 1Y TWD IRS</td>
<td>04/05/11</td>
<td>0.90%</td>
<td>1.10%</td>
<td>0.80%</td>
<td>0.90%</td>
<td>-</td>
</tr>
<tr>
<td><a href="mailto:frances.cheung@ca-cib.com">frances.cheung@ca-cib.com</a></td>
<td>Rationale: Taiwan’s central bank has stepped up efforts to withdraw liquidity, bringing the overnight rate higher. We see a chance that it may step up its rate hike effort as well, and hike by 25bp in Q2 instead of the previous 12.5bp baby-step. The central bank is also likely to let NCD rates rise more to signal a more hawkish stance.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pay 1Y KRW IRS</td>
<td>04/05/11</td>
<td>3.77%</td>
<td>4.17%</td>
<td>3.57%</td>
<td>3.77%</td>
<td>-</td>
</tr>
<tr>
<td><a href="mailto:frances.cheung@ca-cib.com">frances.cheung@ca-cib.com</a></td>
<td>Rationale: While the BoK left its key rate unchanged at 3.00% at the April meeting, it continues to sound hawkish, with an upbeat assessment of the domestic economy and expectations for consumer prices to sustain their upward trend. The BoK is to resume its hiking soon, probably in May, while the market is split between a May and a June hike.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### FX

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Entry date</th>
<th>Entry level</th>
<th>Target</th>
<th>Stop loss</th>
<th>Now</th>
<th>Performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sell USD/CNY (6M NDF)</td>
<td>30/11/10</td>
<td>6.6123</td>
<td>6.3610</td>
<td>6.7387</td>
<td>6.4768</td>
<td>2.1%</td>
</tr>
<tr>
<td>Rationale: CNY appreciation against USD accelerated in April. Policymakers are using currency gains as a tool to fight imported inflation, which reflects the continued rise in global commodity prices. The NDF market has begun to reflect expectations that this new policy posture will continue. We believe that there is more upside in the trade and plan to keep it open till maturity near the end of May.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| Sell USD/PHP (6M NDF) | 19/01/11 | 44.58 | 41.91 | 45.92 | 42.85 | 4.0% |
| Rationale: This trade was very profitable in April and is currently 4.6% in the money. We see still more upside as central bank rhetoric has become increasingly hawkish and we expect two more rate increases, in Q2 and Q3. Moreover, the PHP is barely up versus levels before the financial crisis, while most of its Asian peers are trading significantly stronger, and we see no fundamental justification for this discrepancy. |

| Sell USD/KRW (12M NDF) | 16/2/11 | 1140.34 | 1070.00 | 1175.51 | 1091.72 | 4.5% |
| Rationale: This idea performed quite strongly last month and is 5.0% in the money. We keep it open as we believe that KRW remains undervalued. It is trading about 11% below pre-crisis levels while most Asian currencies are well above them, and there is no fundamental reason for such under-performance. Moreover, we see further rate tightening in Q2 and Q3, which should add to the attractiveness of holding KRW. Finally, Korean equities are modestly undervalued according to our model, which is likely to attract further portfolio inflows. All in all, the case for even firmer KRW remains strong. |

| Sell USD/KZT 12M NDF | 4/4/11 | 144.9 | 140.0 | 147.3 | 144.92 | -0.0% |
| Rationale: KZT has depreciated strongly versus RUB in real terms. The balance of payments will benefit from high oil, metal and wheat prices. NBK to use appreciation as an inflation-fighting tool. |

*For NDFs: target, stop-loss and current level (now) calculated on the basis of the remaining maturity.*
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