ASIA PACIFIC CURRENCIES IN A FED TIGHTENING CYCLE

BACKGROUND

In December, the United States Federal Reserve (the 'Fed') raised interest rates 25 basis points, marking the first time in nine years the central bank has hiked rates. The move was well-telegraphed and anticipated by the market leading ANZ Research to test a "buy-the-rumour, sell-the-fact" pattern around major currencies against the United States Dollar (USD)[1].

They found that, looking at past Fed tightening cycles, major currencies tend to weaken against USD heading into the start of a Fed hiking cycle, but rebound following the first rate increase. However, the pattern is more varied against a basket of Asian currencies.

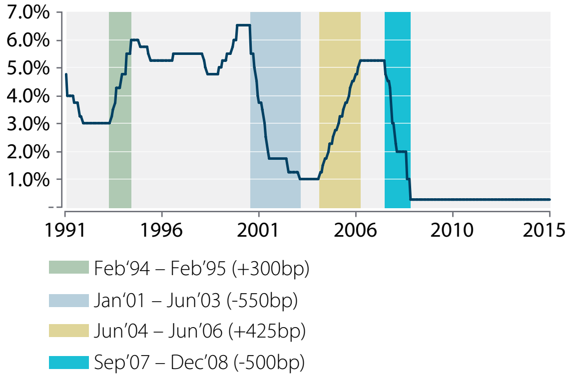
A CLOSER LOOK

ANZ's financial institutions clients predominantly have operations in Asia Pacific (APAC) countries with exposure to local currencies, as well as the USD and Euro (EUR). Anecdotally, the FIG team saw large payments flows in AUD, USD, SGD from Malaysia and Indonesia as corporates and sophisticated retail clients alike anticipated local currency depreciation and sought to prepay future expenses in those currencies.

It seems intuitive and most Asian currencies have indeed weakened significantly in the lead up to the Fed's tightening cycle, but how they will perform now that the cycle is underway remains uncertain. Further, ANZ acknowledges that volatility stemming from China's rebalancing creates a whole new environment this time round for currencies, particularly those in the APAC region.

However, with many clients reconsidering their hedging strategies in this time of heightened volatility, ANZ has sought to provide the historic performance context of APAC currencies over the course of the four longest tightening and easing cycles from the past 25 years.

FIGURE 1
Fed Funds Target Rate time series with cycles shaded



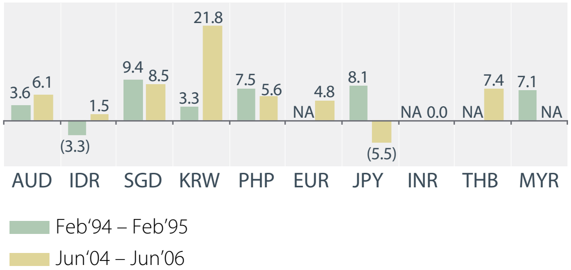
Sources: Bloomberg, ANZ Analysis

In the two most recent prolonged rate hiking cycles, many currencies actually strengthened against USD

Contrary to expectations, most of the currencies shown strengthened vs. USD while the Fed was raising U.S. interest rates.

1 "How Will Asia FX Fare Following a Fed Rate Hike?" (ANZ Research, 8-Dec-2015)

FIGURE 2
Currency Movements in Rate Hiking Cycles



Sources: Bloomberg, ANZ Analysis

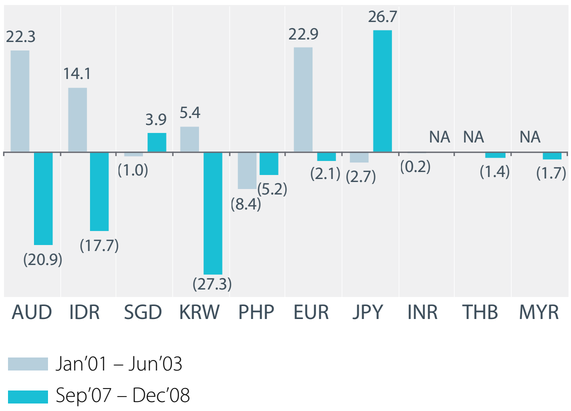
- **For the Feb 1994 – Feb 1995 cycle, the sole exception was Indonesian Rupiah (IDR), which depreciated by 3.3%**
- **From June 2004 – June 2006, the only currency to weaken against USD was the Japanese Yen (JPY), which generally tends to behave differently from other Asian currencies because of its role as a "safe haven" currency**

Although these results should not be taken as conclusive evidence that currencies strengthen against the USD while U.S. rates are rising, they do suggest that the relationship is not always as straightforward as commonly assumed. USD has appreciated significantly against most currencies in recent months in anticipation of the Fed's eventual move, so it is possible that the rate increase is already largely priced in.

Results during the two easing cycles are fairly mixed, with no clear trend

Conversely, USD is generally expected to weaken when the Fed begins loosening monetary policy, as lower U.S. rates make investments in other currencies relatively more attractive.

FIGURE 3
Currency Movements in Rate Easing Cycles



Sources: Bloomberg, ANZ Analysis

- **From Jan 2001 – June 2003, when the Fed lowered rates by 550bp over 2.5 years, the Australian Dollar (AUD), IDR, Korean Won (KRW) and EUR appreciated against USD, while the Singapore Dollar (SGD), Philippine Peso (PHP) and JPY depreciated.**
- **In the easing cycle that began in Sep 2007, every currency except the JPY and SGD weakened, with the Global Financial Crisis creating a broad "risk-off" mentality that hurt most currencies, and benefited JPY because of its safe haven status.**

SHARING OUR INDUSTRY INTELLIGENCE WITH CLIENTS

The analysis suggests that the relationship between U.S. interest rate cycles and APAC currency performance is not as clear as commonly believed.

Currency movements are driven by many factors besides Fed policy or interest rate differentials, and since markets are forward-looking, it could be the case that the expected USD appreciation has largely taken place before the Fed began raising rates.

ANZ FIG have had a number of FX hedging conversations with investor clients, particularly those with assets in APAC, in particular China and Indonesia, where currency fluctuations can have material impacts on returns as well as loan to value (LTV) covenants on USD denominated bank facilities.

Please reach out to your FIG banker if you would like to discuss terms relevant to loan document hedging requirements; best practice approaches to currency risk management; and/or structuring and assessment of various FX hedging alternatives to achieve specific objectives, including for example, target returns, accounting and cash flow impacts.

GLOBAL MARKETS
Nick Angove
E: Nick.Angove@anz.com

FINANCIAL INSTITUTIONS GROUP
Peter Szekely
E: Peter.Szekely@anz.com

For further detail or any questions, please contact GlobalFIGInsights@anz.com or call your ANZ relationship banker directly.