November 5, 2024

Three EM Currency Trades, Regardless Of U.S. Election

In This Report

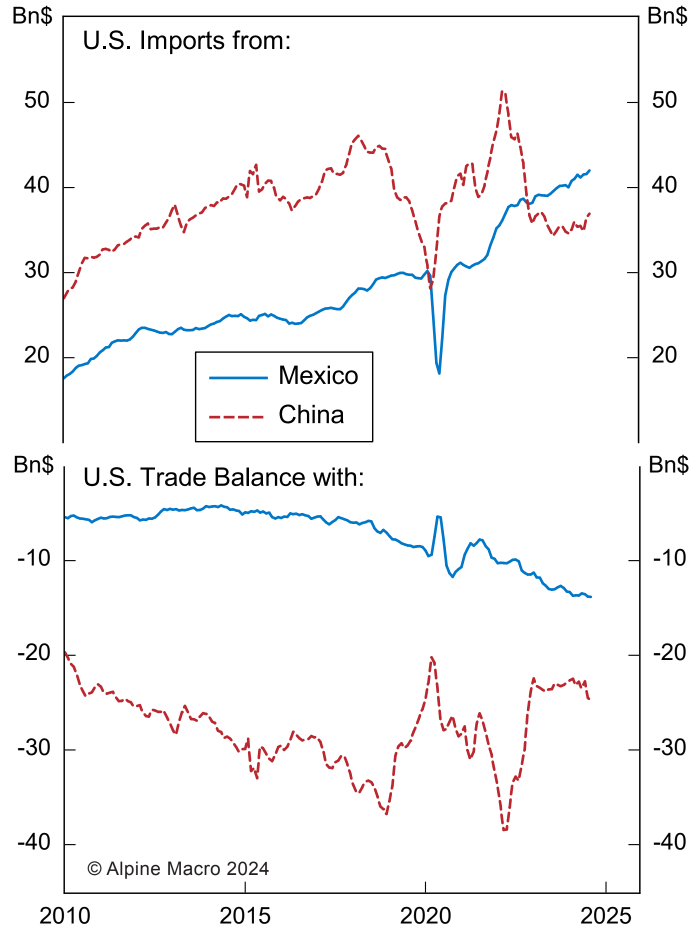
The outcome of the U.S. presidential election, expected later today, will be one of the most significant macro events for investors. Our geopolitical team sees a slightly higher chance of the Republicans taking both the White House and full control of Congress.[1] In recent weeks, financial markets have also been pricing in a Trump victory, with higher stock prices, increased real bond yields, and a stronger dollar.

For EM, it is premature to adjust strategy before the U.S. political dust settles, and we will follow up in due course. However, there are three EM currency trade ideas that make macro sense and are likely to perform particularly well if the U.S. election ushers in more protectionist trade policies. Specifically, we recommend shorting the Mexican peso versus the Brazilian *real*, shorting the Chinese yuan versus the Japanese yen, and shorting the Thai baht versus the Singapore dollar.

These trades share similar themes: the countries on the short side are all struggling with growth downturns, facing intense pressure for further monetary easing, and are likely to encounter strong protectionist backlash in a "Trump 2.0" scenario. In contrast, the countries on the long side are almost the polar opposite on these factors – less vulnerable to trade tensions, with stronger domestic economic performance and a tightening bias in their monetary policies.

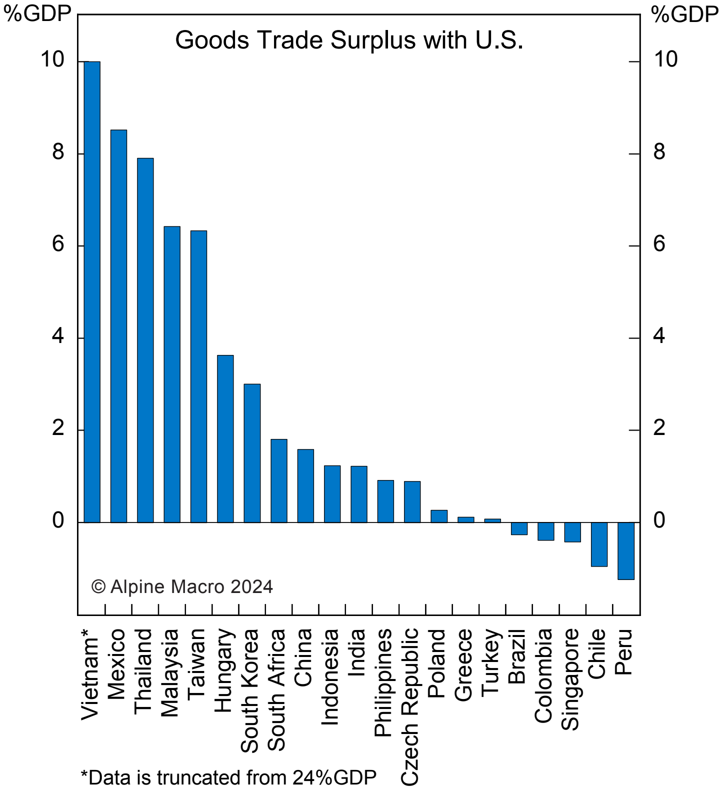
1 Alpine Macro *Geopolitical Strategy* "U.S. Election Monitor, November 2, 2024 - A Narrow Trump Lead, And A Higher GOP Sweep Potential" (November 2, 2024).

Chart 1 Mexico: Second In Line In A U.S. Trade War



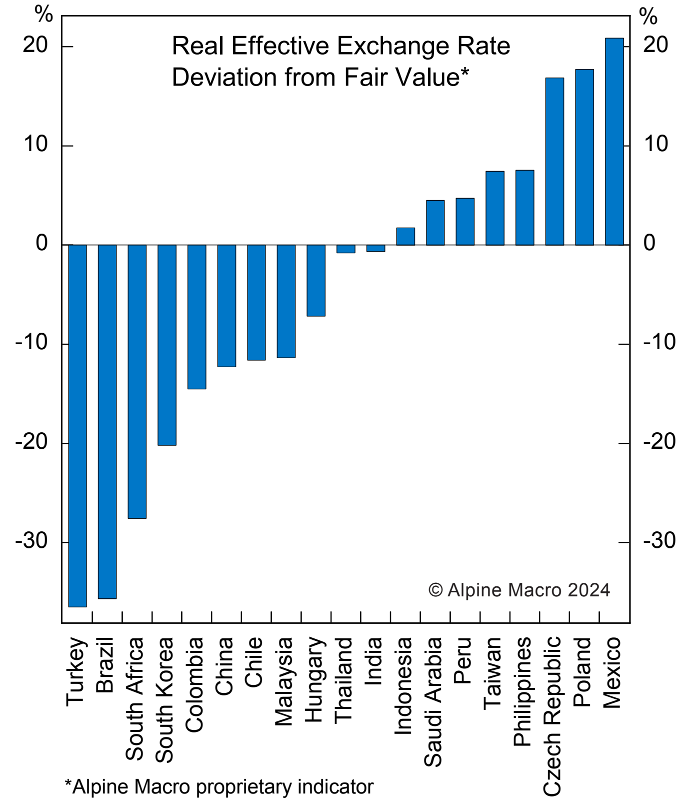
Note: All series are shown as 3-month moving average

Chart 2 Ranking EM Trade Imbalances With The U.S.



*Data is truncated from 24%GDP
Source: IMF DOTS

Chart 3 Ranking EM Currency Valuation



*Alpine Macro proprietary indicator

Short Mexican Peso Versus Brazilian *Real*

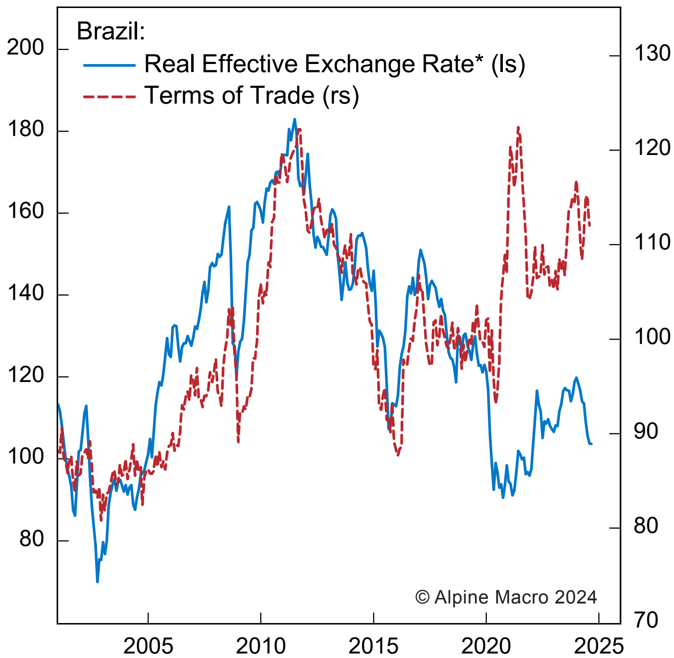
We have been recommending shorting the MXN versus the BRL since September, and so far, this trade is largely flat. We still believe this is one of the best ways to position for both the political and economic cycles.

Politically, Mexico is highly vulnerable to potential protectionist backlash under another Trump administration. Mexico recently surpassed China as the largest exporter to the U.S., and its trade surplus with the U.S. is rapidly catching up to China's (Chart 1). Since the start of Trump's first term in January 2017, U.S. imports from and deficits with China have remained largely stable, but the "imbalance" with Mexico has worsened significantly. This could make Mexico a primary target, second only to China, in any potential U.S. trade war. Unlike China, however, Mexico's relatively small economy and heavy reliance on the U.S. market make it far more vulnerable in a trade conflict (Chart 2).

Even without political factors, we see intense downward pressure on the MXN in trade-weighted terms, and shorting it versus the BRL is particularly attractive from a risk-return perspective. Brazil has limited trade with the U.S. and runs a trade deficit with it, making the country likely immune to protectionist policies in a second Trump term. Additionally, the MXN and BRL differ fundamentally across several important areas:

Currency Valuations: Despite a decline of over 15% from last year's peak, the MXN remains one of the most overvalued currencies in EM (Chart 3).

Chart 4 BRL: Divergence With Terms Of Trade



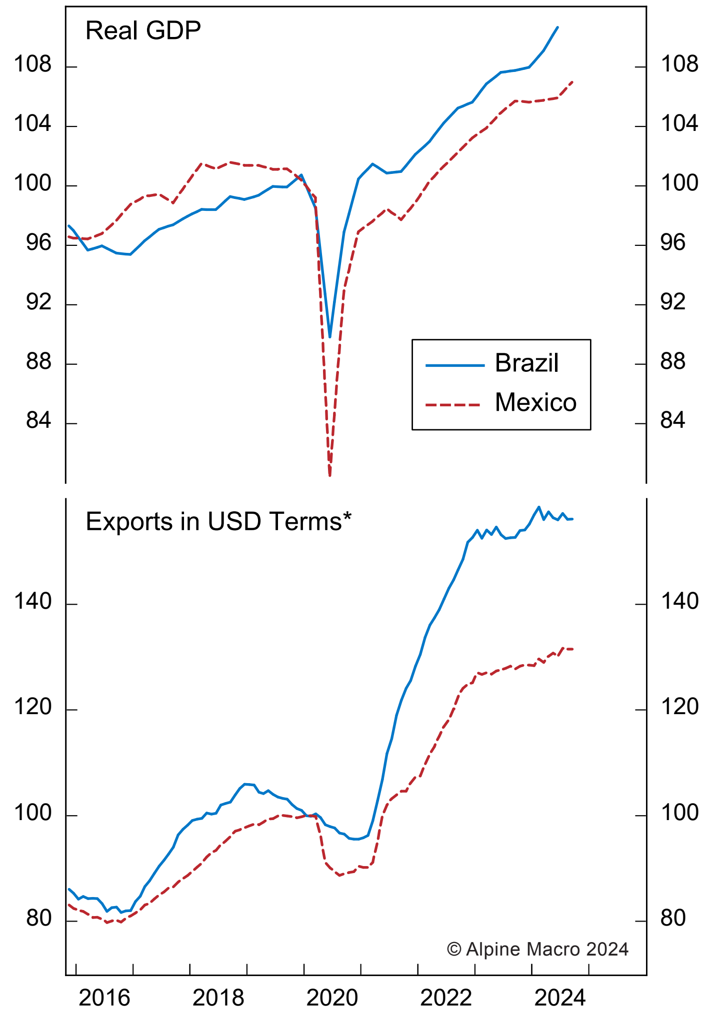
*Source: BIS

Alongside sluggish productivity and rapidly rising nominal wages, an expensive currency undermines Mexico's manufacturing and "nearshoring" competitiveness — the very foundation that previously supported the MXN. In other words, "nearshoring," which has boosted the MXN, may have also sown the seeds of its own destruction.

In contrast, the BRL is among the cheapest EM currencies based on our fair value assessment. It has lagged behind Brazil's terms of trade, a historically key driver of BRL performance (**Chart 4**).

Growth Conditions: The diverging trajectories of these currencies may have played a role in the contrasting economic performance of Mexico and Brazil. Brazil's post-COVID recovery has been stronger than Mexico's, with its export sector significantly outpacing the latter (**Chart 5**).

Chart 5 Brazil Vs Mexico: Divergence In Growth And Exports



*Shown as 12-month moving average
Note: All series are rebased to Jan 2020=100

Forward-looking indicators suggest this growth divergence will persist: Brazil's latest manufacturing PMI is at 53, comfortably above the expansionary threshold, and the service PMI is even stronger. In contrast, Mexico's manufacturing PMI has remained in contraction for four consecutive months.

Monetary Policies: This growth divergence has led to differing monetary policies despite similar

Chart 6 Brazil Vs Mexico: Divergence In Monetary Policies

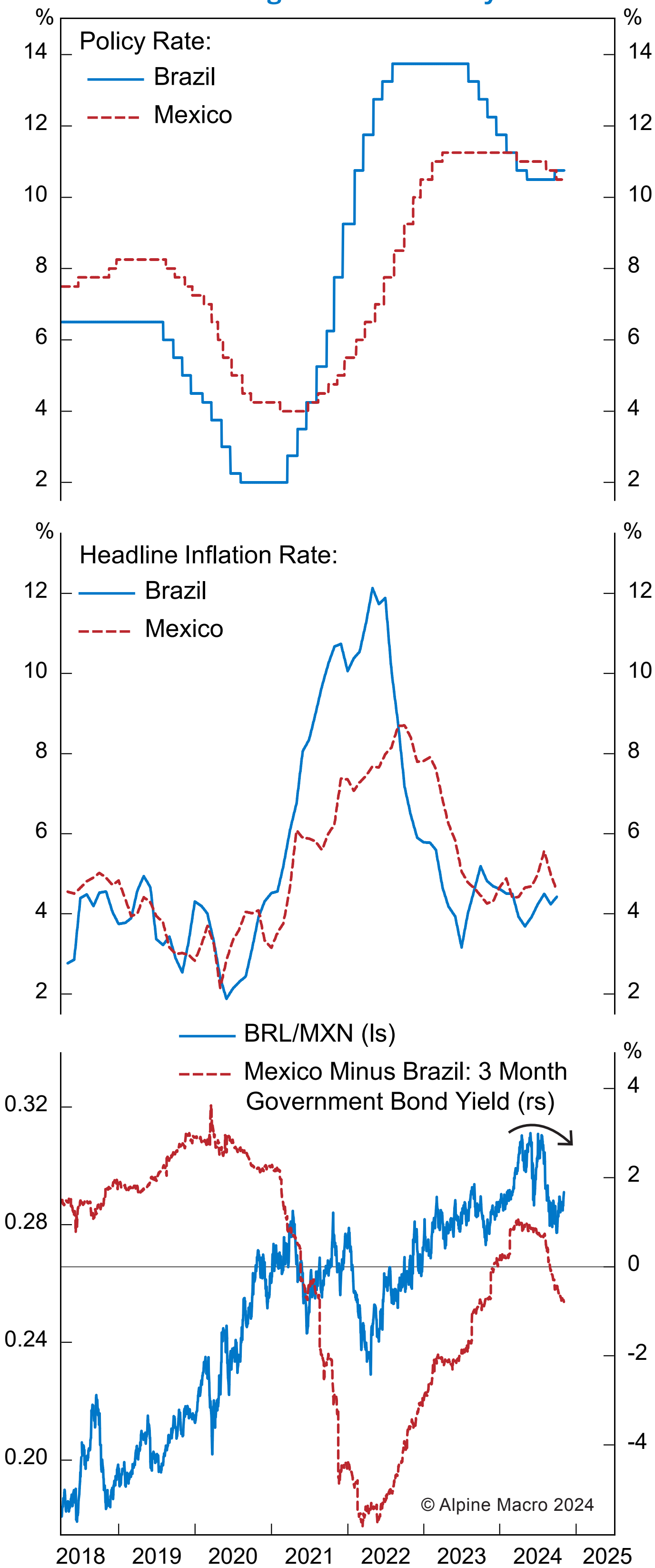
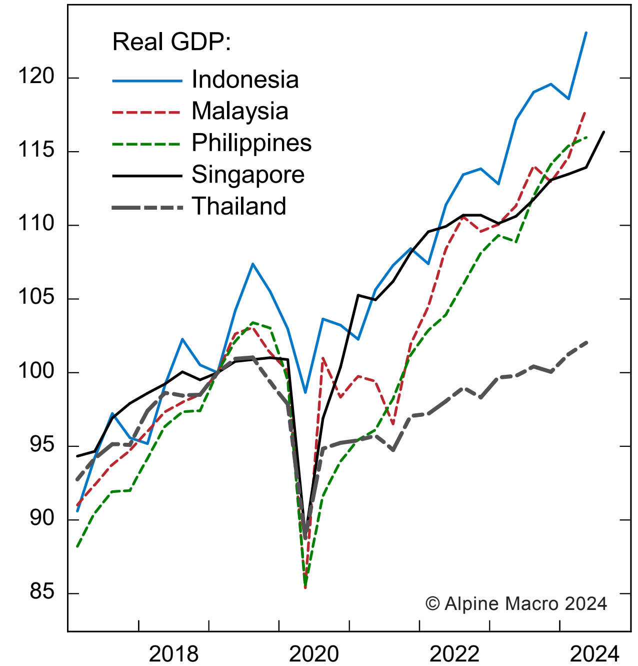


Chart 7 Thailand Has Lagged Regional Peers



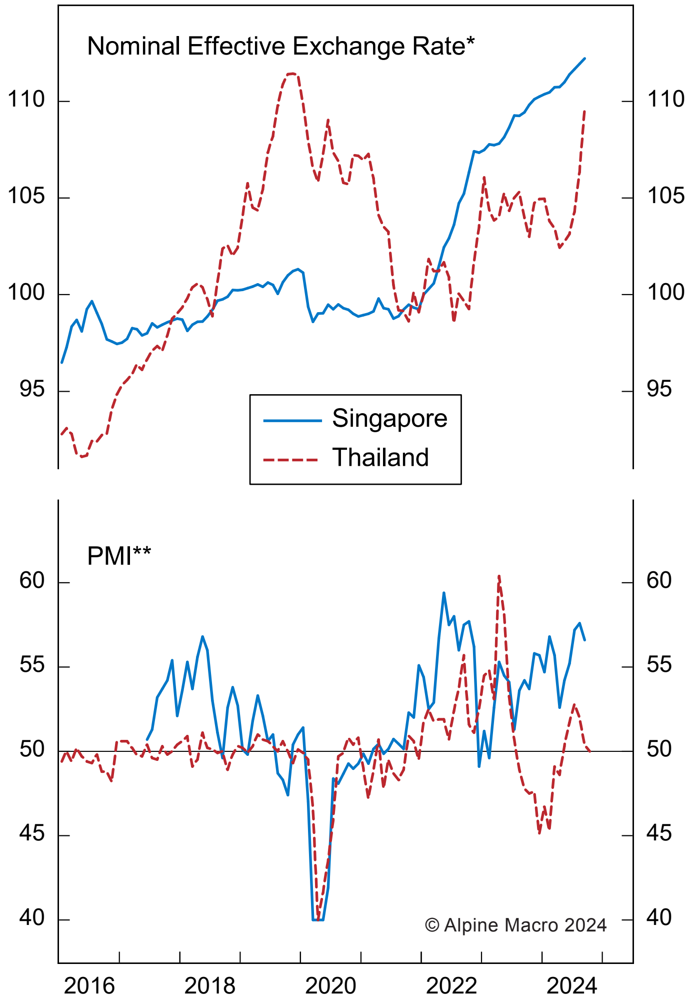
Note: All series are rebased to Q1 2019=100

inflation backdrops (Chart 6). The Bank of Mexico has cut its policy rate three times since March and signaled more easing may be forthcoming. Meanwhile, Brazil's central bank has recently begun tightening after an aggressive 330-basis-point easing cycle during which Banxico held steady. As a result, interest rate differentials are now shifting in favor of the BRL over the MXN.

Short Thai Baht Versus Singapore Dollar

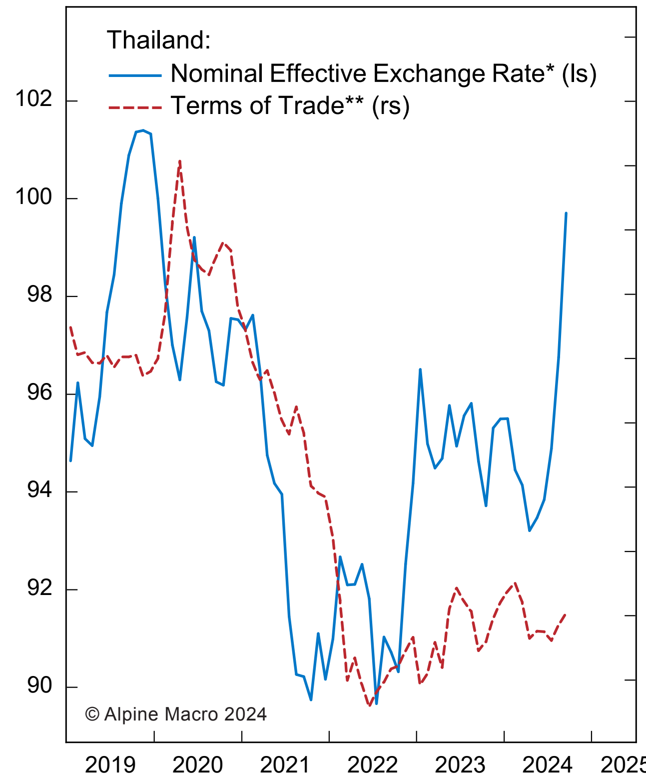
Shorting THB/SGD offers a way to capitalize on the differing policy and economic conditions in Thailand and Singapore, even without considering U.S. election uncertainties. Thailand's post-pandemic recovery has been significantly weaker than that of its regional peers (Chart 7). Thai GDP is barely above pre-COVID levels, and the crucial tourism sector remains far below its pre-pandemic trend.

Chart 8 THB Matches SGD Strength Despite Sluggish Economy



*Both series are rebased to Jan 2022=100; source: BIS
**Composite whole economy for Singapore and manufacturing for Thailand; both series are truncated at 40; source: S&P Global

Chart 9 THB: Divergence With Terms Of Trade



*Source: BIS
**Source: Bank of Thailand (BOT)
Note: Both series are rebased to Jan 2020=100

The contrast with Singapore is stark. Singapore weathered the pandemic well, and its financial sector has benefited from foreign inflows from Hong Kong, driven by Hong Kong's political and geopolitical instability. As a result, Singapore's economy has been on the verge of "overheating," prompting the Monetary Authority of Singapore (MAS) to tighten policy. Since the exchange rate is Singapore's primary monetary tool, the MAS has been explicitly guiding the SGD gradually higher (**Chart 8**).

Remarkably, the performance of the THB has largely matched the strength of the SGD in trade-weighted terms over the past three years, despite Thailand's much weaker growth situation. Additionally, the strength of the THB is not supported by the country's terms of trade, as shown in **Chart 9**. More recently, Thailand's economy has weakened anew, prompting the central bank to begin easing. All of this should create downward pressure on the THB.

In a "Trump 2.0" scenario, Thailand's economic outlook could face even greater challenges. Thailand may also be on the "hit list" in a potential Trump trade war due to its large trade surplus with

Chart 10 CNY/JPY: A Massive Overshoot

the U.S., currently totaling $32 billion – meeting one of the U.S. Treasury's "currency manipulator" criteria. As a share of GDP, Thailand's surplus with the U.S. ranks among the highest globally, as shown in **Chart 2** on page 2. Any trade friction with the U.S. would likely have a significant negative impact on Thailand's economy and currency.

In contrast, Singapore may face pressure to further strengthen its exchange rate. It is already on the U.S. Treasury's watchlist for currency manipulation, given its massive external surplus (nearly 20% of GDP) and vast and growing foreign reserves. Thus, both economic and political factors are likely to push the SGD to appreciate.

Short Chinese Yuan Versus Japanese Yen

Shorting the CNY versus the JPY makes sense for both fundamental and political reasons, as discussed in last week's report.[2] In summary:

- The RMB could face significant downward pressure if the U.S. raises tariffs on Chinese goods. During Trump's first trade war, the CNY weakened notably with each new U.S. tariff on Chinese products. Given the slim margins of Chinese exporters, a weaker exchange rate may be essential to maintain profitability.

- While the CNY is not overvalued in our fair value assessment or in international purchasing power parity comparisons, the JPY is exceptionally cheap across all metrics. The CNY/JPY cross rate currently sits at a two-sigma deviation above the long-term trend line (**Chart 10**).

2 Alpine Macro *EM & China Strategy* "Trump 2.0: EM Lessons From His First Term" (October 29, 2024).

- The Chinese central bank is firmly in easing mode, while the Bank of Japan, along with central banks in Singapore and Brazil, are among the few "orthodox" banks currently tightening.

- Historically, the JPY has been a "safe haven" currency, performing well amid heightened global uncertainty. This makes it particularly attractive if the U.S. election leads to prolonged political volatility.

Last week's political surprise in Japan could add temporary uncertainty for the JPY, but the impact will likely be short-lived. Prime Minister Shigeru Ishiba's decision for a snap election backfired, with his Liberal Democratic Party, which has ruled Japan almost continuously since its founding in 1955, losing its parliamentary majority with its coalition partner. This has led to political uncertainty, as major parties maneuver to form a governing coalition in the coming weeks or even months.

Nonetheless, the impact on the JPY is likely to be limited. Since approval ratings for all major parties are quite low, increased fiscal transfers to households may be a likely outcome to gain public support. If this happens, more stimulative fiscal policy could push the Bank of Japan toward even tighter monetary policy. From an investor's perspective, the combination of accommodative fiscal policy and tight monetary policy has historically been bullish for the exchange rate.

Bottom Line: Stay short CNY versus JPY.

Yan Wang, CFA
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Investment Recommendations

Strategic Positions (6 - 12 months)				
Recommendations	**Open Date**	**Closing Date**	**Total P&L**	**Notes**
Long Colombian 10-year Government Bond, Currency Unhedged	11/21/2023		0.4%	Long Colombian 10-year Government Bond, Currency Unhedged; stop point at -10%.
Long MSCI Greece Equity Index	11/21/2023		6.2%	Long MSCI Greece Equity Index in US$ terms; stop point at -10%.
Long Indian 10-year Government Bond, Currency Unhedged	06/04/2024		3.6%	Long Indian 10-year Government Bond, Currency Unhedged; stop point at -10%.
Long Malaysian Equities, Currency Unhedged	08/20/2024		-1.1%	Long MSCI Malaysia Equity Index in US$ terms; stop point at -10%.
Long ASEAN Equities, Currency Unhedged	09/17/2024		-4.2%	Long MSCI EM ASEAN Index in US$ terms; stop point at -10%.
Long BRL/MXN	09/23/2024		-0.6%	Long Brazilian *Real* versus Mexican Peso; stop point at -10%.
Short CNY/JPY	10/29/2024		0.2%	Short Chinese Yuan against Japanese Yen; stop point at -5%.

Tactical Investment Positions (3 - 6 months)				
Recommendations	**Open Date**	**Closing Date**	**Total P&L**	**Notes**
Short CZK/HUF	06/05/2023		3.4%	Short Czech Koruna versus Hungarian Forint; rolling stop point at -5%, or -1.2% from current level.
Long MSCI China Equity Index	02/20/2024		29.7%	Long MSCI China Equity Index in US$ terms; rolling stop point at -10%, or -8.2% from current level.
Short COP/CLP	03/05/2024		7.5%	Short Colombian Peso versus Chilean Peso; rolling stop point at -5%, or -4.7% from current level.
Long CSI 300 Index	02/20/2024*		10.2%	Long China A-shares Index in US$ terms; stop point at -10%. *Trade opened on Feb 20, 2024, closed on Sep 13, 2024 and reopened on Sep 24, 2024.
Short CNY/USD	10/29/2024		-0.3%	Short Chinese Yuan against US Dollar; stop point at -5%.
Short THB/SGD	11/05/2024		-	Short Thai Baht versus Singapore Dollar; stop point at -5%.

EM Equity Country Allocation				
Strong Overweight	**Overweight**	**Neutral**	**Underweight**	**Strong Underweight**
	Brazil Chile China Colombia Greece South Africa Indonesia Philippines Malaysia Thailand South Korea		India Czech Republic Hungary Mexico Peru Poland Taiwan Turkey	

EM Equity Sector Allocation	
Strong Overweight	**Overweight**
	Materials Health Care Consumer Discretionary Consumer Staples
Neutral	
Energy Communication Services Information Technology Financials	
Strong Underweight	**Underweight**
	Industrials Utilities

EM Local-Currency Government Bond Allocation		
Overweight	**Neutral**	**Underweight**
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