Macro | FX Research & Strategy

Global

Maybank

FX Monthly

2018, Issue 1: Staying The Synchronized Recovery Course

What Has Changed This Month?

- We revise all our forecasts stronger against the USD. The upward revisions on Asian FX are amplified by the appreciation in the CNY and the rapid depreciation in the USD.
- Our CNY and CNH forecasts are revised stronger given the weak USD, absence of hard-landing fears in spite of initiatives to clean up environment and deleverage greater global demand for CNH due to central bank reserve diversification away from the USD and Belt and Road initiative, further improvement in current account balance could see the RMB appreciate against the USD.
- We made a few out-of-consensus call on SGD, MYR, CNY and GBP.

Our Strategies

- USD downtrend is likely to remain in place for 2018 but we do not rule out bouts of USD strength. Broader term shifts were already underway to support the case for broad USD downtrend, including (1) US tax reforms and its wider implication on deficit, debt and the USD; (2) reserve diversification away from the USD; (3) USD countercyclical play; (4) USD downtrend cycle.
- In an environment of broad USD downtrend, we see opportunities for relative value plays in Asia, favouring currencies that benefit from the export-led recovery and commodity price rebound. We continue to favour MYR, SGD, THB CNY, KRW, TWD and AUD over INR, IDR and PHP (which suffer from twin deficits and are oil importers).
- Global policy unwinding continues to take shape at differing pace. We maintain our bias of EUR long vs. JPY, on the basis of monetary policy divergence between ECB and BoJ. In addition, we add GBP long to the mix. Stronger commitment from BoE to bring down inflation (conditional on orderly Brexit) could build up market expectation for an earlier than expected rate hike. These drivers support the case for stronger GBP. Our house view is for the next rate hike in Aug 2018.
- Risks to our Outlook: (1) If US trade protectionism measures intensify, AXJs in particular KRW could come under pressure; (2) US fiscal impulse, in particular repatriation inflows to US, infrastructure spending gathers momentum and translate into faster than expected pick-up in inflation. This could trigger risk aversion flows favoring JPY longs and pose downside pressure to AXJs; (3) Lack of agreement or clarity on transition agreement may dampen markets' enthusiasm on soft *Brexit* and renewed fears of disorderly *Brexit* will pose downside risks to GBP; (4) political risk in Italy, Spain and Germany may also exert temporary downside pressure on EUR.

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Our Research Intern, Randall Ho, contributed this report

FX Forecast Revision

Upward	Downward
G7, Asians	USD

Top 3 Currency Plays for February

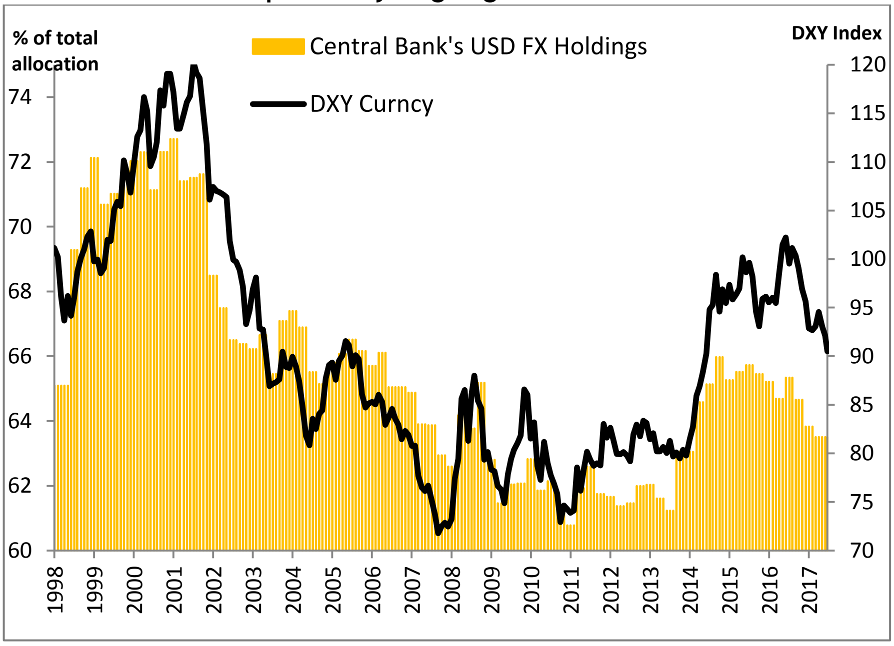
- Retain our USD Shorts for the year.
- Favour MYR, SGD THB, CNY, KRW, TWD and AUD over INR, IDR and PHP (export recovery vs. twin deficit, oil importers)
- Long EUR, GBP vs. the JPY on monetary policy divergence

Key Events for the Month Ahead

Date	Event
1 Feb	India Union Budget
6 Feb	RBA Meeting
8 Feb	BoE and RBNZ MPC Meetings
19 Feb	Singapore Budget
Feb - Mar	Italy General Elections Opinion Polls

Ongoing diversification away from the USD should continue to underpin USD weakness…

USD Weakness Underpinned by Ongoing Reserve Diversification

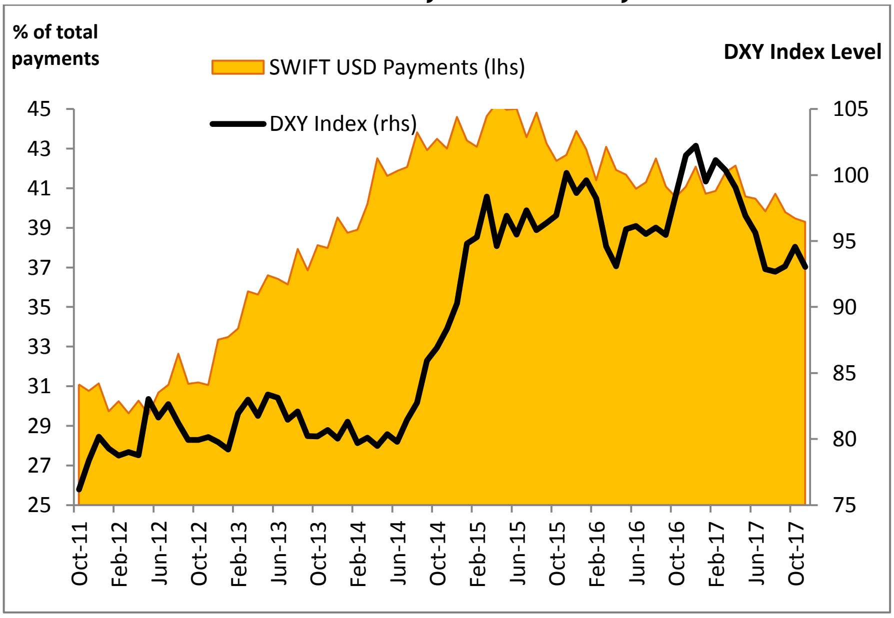


Source: Bloomberg, Maybank FX Research & Strategy

Gradual Shift Away from USD as Global Payment Currency?

While USD remains the most commonly used currency in global payments (based on SWIFT payments), its share as a % of total payments have started to see a steady decline from 45.3% since 2015 to about 39% in Nov 2017. Growing preference in the use of EUR (second most commonly used payment currency) or even CNY could continue to see a shift away from the USD as global payment currency and that may weigh further on the USD.

USD Share as Percent of Global Payment on Steady Decline



Source: Bloomberg, Maybank FX Research & Strategy

G7 Global Overview

USD: Dollar Downtrend Cycle

Forecast	1Q 2017	2Q 2018	3Q 2018	4Q 2018
USD Index	89.69 (95.18)	88.91 (94.10)	87.18 (93.02)	86.18 (92.31)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** USD downtrend is likely to remain in place for 2018 but we do not rule out bouts of USD strength. Dollar index traded below 89-handle, for the first time in more than 3 years yesterday. The move lower in the USD was already underway but comments at Davos from Treasury Secretary Steven Mnuchin added fuel to fire. He said "a weaker USD is good" for US economy via trade and opportunities. However Trump's subsequent comments overnight (25 Jan) - "Dollar is going to get stronger and stronger" saw a rebound in the USD. That said we believe broader term shifts were already underway to support the case for broad USD downtrend, including (1) US tax reforms and its wider implication on deficit, debt and the USD; (2) reserve diversification away from the USD; (3) USD countercyclical play; (4) USD downtrend cycle.

- The USD started the New Year on a softer footing, with DXY falling more than 3% and US TWI down by about 2%. While the USD decline can be attributed to recent development including Steven Mnuchin's comments (24 Jan) – "that a weaker dollar is good for us as it relates to trade and opportunities", EUR strength on progress with German coalition and hopes of faster than expected pace of policy normalisation, GBP strength amid positive development with Brexit and gains in commodity-linked currencies such as AUD, CAD and MYR owing to stable and higher oil prices, we believe broader macro trends are underpinning the USD downtrend since 2017 (DXY fell more than 12% since start of 2017). Against most Asian FX, USD has also fallen, in particular against trade-dependent and commodity-linked FX including MYR, THB and KRW between 13 – 15%.

- Notwithstanding rebounds which may be sporadic and short-lived amid stretched positioning, we believe there are a handful of broader term shifts to support the case for broad USD downtrend, including (1) US tax reforms and its wider implication on deficit, debt and the USD; (2) reserve diversification away from the USD; (3) USD countercyclical play; (4) USD downtrend cycle.

- **Growth and Inflation Outlook:** The latest print of the 4Q GDP came in at a 2.6% annualized rate (est. 3.0%) following a 3.2% gain in 3Q. Consumer spending rose 3.8% following a 2.2% pace in the prior period. Both goods and services consumption contributed to growth in the quarter (176 bps and 82 bps, respectively), implying consumer activity remains the dominant engine of growth going into 2018, as durables (14.2% vs. 8.6% prior), non-durables (5.2% vs. 2.3%) and services (1.8% vs. 1.1%) all saw a sizable acceleration in the quarter. Part of this is due to the tailwind to consumer spending from a mild pickup in household wage and salary gains, but activity at the start of the quarter is at least in part attributable to hurricane recovery spending.

The positive trend in personal consumption will likely spill into this year's first quarter as tax cuts for households will likely boost growth. Business investment rose 6.8% in 4Q compared to 4.7% prior. A key driver is improving conditions in the petroleum sector in particular, due to a price rebound for crude oil. However, more broadly, a faster pace of growth is creating capacity-constraint issues that require capital investment to ameliorate. Typical at mid-cycle, businesses are spending more aggressively to expand their production capabilities. Improving prospects for corporate profits no doubt help. Residential investment posted a strong reading (11.6% vs. -4.7% prior). The strength was driven by rebuilding efforts in the aftermath of the last year's hurricanes.

- NFP in Dec 2017 came in add 148K (expected 190K) held back by a drop in retail positions. The jobless rate was at 4.1% for a third month, while average hourly earnings increased by 2.5% from a year earlier, after a 2.4% gain in Nov that was revised downward.

- The underlying pace of U.S. inflation unexpectedly accelerated in Dec amid increased housing costs, reinforcing the outlook for the Fed to raise interest rates several times in 2018. Excluding food and energy, the core CPI index increased 1.8% from a year earlier after a 1.7% previously, including a 0.3% monthly gain. Including all items, the broader CPI showed a smaller gain in Dec line with estimates.

- **Monetary Policy Forecast:** Fed guides for a steady pace of interest rate hikes (2018E: +75bps; 2017: +75bps) that will peak at around 3.00% by end-2020, below the previous pre-GFC high of 5.25%, and adds balance sheet reduction to the process of unwinding its monetary policy stimulus. Fed's balance sheet reduction began in Oct 2017 with the planned reduction rate of USD10b per month (via USD6b cut per month in US Treasury securities holdings and USD4b cut per month in agency debt and mortgage-backed securities holdings). The monthly balance sheet reduction amount will be raised by USD10b per month every 3 month until it reaches USD50b per month on the 12th month (i.e. Sep 2018) which Fed envisages as the maximum amount of monthly balance sheet reduction thereafter. Actual data showed in Oct-Nov 2017, Fed's balance sheet size dropped by –USD17.7b to USD4,484.5b at end-Nov 2017 from USD4,502.2 at end-Sep 2017 – within the targeted USD10b per month or USD20b for the first two months of the balance sheet reduction, further underscoring the benign normalization of US monetary policy.

- President Trump announced on 2 Nov 2017 the nomination of Jerome Powell – currently a member of Fed's Board of Governors - as the next Fed's Chair to replace Janet Yellen. As Fed expands its monetary policy normalization from interest rate hikes to now include balance sheet reduction that involves reducing Fed's holdings of US Treasury securities, and as financial de-regulation is one of President Trump's key policy agenda, having a Fed Chair with experience in these areas is a plus. Powell served as an Assistant Secretary and as Undersecretary of the Treasury under President George H.W. Bush in the areas of financial institutions policy and Treasury debt market. In addition, having an insider to replace the incumbent gives a sense of "policy continuity" and reduces the risk of "policy surprises" at Fed, especially with Powell seen as a supporter – rather than a dissenter – of Fed's monetary policy moves thus far.

- **Latest Fiscal and External Balance Outlook:** The "Tax Cuts and Jobs Act" (TCJA) was signed into law on Dec 22, 2017. Although the tax policy left out many controversial overhauls that have been put forth, the final reconciled bill between the House and the Senate still saw major reforms including corporate tax cuts to 21% from 35% and one-time tax repatriate of earnings and profits at 15.5% and 8% for reinvestments (further details are outlined in Appendix 1 at the end of this report). These tax reforms will have implications on broader economy, politics and the US Dollar.

- Briefly on the economic front, the TCJA is expected to increase US GDP by 0.8% in 2018, reduce marginal tax rates and increase personal consumption. Output and aggregate demand will be lifted, hence boosting government revenue, according to Tax Policy Center's (TPC) analysis on macroeconomic effects of tax reforms.

- On the tax reforms' implications on FX, it is not as clear cut. The one-time repatriation could lead to demand for USD. In the current episode that is unfolding, tax reforms is expected to widen US budget deficit to -5.4% of GDP (vs. -3.4% currently) while debt to GDP will rise to 97.5% of GDP (vs. 75% of GDP currently), according to Congressional Budget Office (CBO) estimates.

- And if history is of any guide, the current period of tax reforms (widening budget deficit and rising debt to GDP) is akin to expansionary fiscal policies and like previous periods, the USD should weaken.

- **Key domestic events and issues to watch in Feb 2018:** Key US events: ISM Manufacturing (1 Feb); Factory Orders (2 Feb); Durable Goods Orders (2 and 27 Feb); Trade Balance (6 Feb); NFP (2 Feb); CPI (14 Feb); Retail Sales (14 Feb); GDP 4Q (28 Feb); PCE Deflator (28 Feb); FOMC Meeting (1 Feb); FOMC Meeting Minutes (22 Feb).

- **Technical Outlook:** Dollar's decline extended into the new year, with DXY on course to close weaker for the 3rd consecutive month. DXY traded a low of 88.44 (25 Jan) for the first time in more than 3 years. Last seen at 89.10 levels. Bearish trend channel formed since start of 2017 remains intact. Bearish momentum on monthly, weekly and daily charts are also intact. Trend remains your friend though stochastics is cautioning for oversold conditions and that DXY could face some rebound risks. Resistance at 90.70 (21 DMA). Support at 88.40 (previous low, 61.8% fibo retracement of 2014 low to 2017 high), 87.30 (upward sloping trend line support from the low of 2011 and 2014) and 84.80 (76.4% fibo).

EUR: Strategic Buy on Dips

Forecast	1Q 2018	2Q 2018	3Q 2018	4Q2018
EUR/USD	1.2400 (1.1700)	1.2500 (1.1800)	1.2800 (1.2000)	1.3000 (1.2100)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** We are broadly positive on the outlook of EUR on (1) growing demand for EUR as a share of world FX reserves; (2) sustained signs of economic recovery broadening in Europe, supported by private consumption, business sentiment, construction investment, sizeable current account surplus (3.5% of GDP) and export recovery; (3) political risks gradually abating in Europe (though caution is still warranted pertaining to progress on the formation of German coalition government and Italy General Elections in Mar) and (4) ECB policy normalisation (which could play catch up with the Fed). The dollar side of the equation also matters here as broad USD downtrend is expected to amplify EUR's gains. We revised upwards our EUR forecast for the year to reflect the upgraded assessment.

- But we caution that the recent "bull" run in the EUR may be checked in coming weeks amid political risk events and we do not rule out near-term pullback towards 1.20 – 1.21 levels. Some of these political risk events in EU include:

  - Formation of German coalition government will still require a postal vote from Social Democrats party (SPD's) 450,000 members – failure to get past this should bring back talks of re-election or minority government - such a scenario should heighten risks and weigh on sentiment and the EUR;

  - Italy General Election is scheduled on 4 Mar and should matter as recent business and consumer confidence fell and the economy appears to have slowed in 4Q 2017. We believe opinion polls released between now and then is another source of volatility for the EUR. First glance at opinion polls suggests the risk of hung parliament and the election could possibly shape up to be a three-way contest between ruling centre-left coalition led by Democratic Party (PD), centre-right coalition led by Berlusconi's Forza Italy and anti-establishment Five Star Movement. Based on coalition votes collected from various sources including Ipsos, IPR at this stage, support for the ruling coalition (centre-left led by PD) slumped and has been falling behind Berlusconi's centre-right coalition, which included Northern League party (campaigned for anti-immigration), Lega Nord party (campaigned to leave the single currency) and Brothers of Italy party (far-right/eurosceptic). Five Star Movement party is the single most popular party but has refused to take part in coalition. We see some risk that this could change and could alter the landscape of Italy GE if happens;

- Catalan crisis in Spain is still ongoing but latest GDP release suggests that the Spanish economy shrugged off the political crisis to extend its solid growth momentum in 4Q (Spain full year GDP was at 3%). Nonetheless Catalan parliament is set to elect its next President. Catalan house speaker could still propose an alternative candidate to self-imposed exile Carles Puigdemont or risk new regional elections if no government is formed. This present some element of uncertainty and caution is warranted.

- Beyond short term hurdles, we wish to highlight an ongoing fundamental shift to support the case for EUR strength. IMF currency composition of official foreign exchange reserves (COFER) showed a marginal pick-up in EUR as a share of global central banks' reserves to 20% in 3Q 2017, from all-time low of 19.13% in 4Q 2015. That said, the current level remains relatively low by historical average of 23% and historical high of 28% (in 2009). We believe there is **room for global central banks' demand for EUR to pick up further amid ongoing reserves diversification** and broadening recovery in Euro-area. And that should keep EUR supported.

- **Downside risk to our broader term outlook:** The risk of yield curve compression/inversion particularly in the UST space can at times be a reliable predictor of US recession (as seen from examples of historical experiences) could be a risk to our bullish EUR forecast as risk-off sentiment coupled with recession risks could see demand for safe haven plays and this could see USD strength offsetting EUR gains. We also caution that a faster pace of Fed rate hikes amid US fiscal impulse (earnings repatriation, infrastructure spending, tax cuts) could risk higher UST yields and that could lead to disorderly bond sell-off. Risk aversion flows there may lead to USD strength and could dampen EUR strength.

- **Growth and Inflation Outlook:** In the last quarterly assessment report (Dec-2017), ECB revised 2018 growth forecast to 1.9% (vs. 1.8% as seen from Sep projections), The next ECB quarterly assessment report will be available on 8 Mar. Euro-area recovery continues with 19 consecutive quarters of growth while unemployment fell to 9-year low of 8.7% in Nov. 4Q GDP growth increased to 0.6% q/q (vs. 0.7% in 3Q). On y/y basis, GDP growth rose to 2.7% (vs. 2.8% in 3Q). For the year, Euro-area expanded 2.5%. This is the best pace since global financial crisis in 2008. Consumer confidence is also near 17-year high in Jan 2018. Forward looking surveys also suggest that activity levels remains robust for the Euro-area, with services PMI still on the rise (57.6 for Jan prelim vs. 56.6) though Mfg PMI slipped slightly (59.6 vs. 60.6) but remains near recent highs.

- ECB's recent assessment (25 Jan) is that (1) private consumption is supported by rising employment, which is benefiting from past labour market reforms, and by increasing household wealth; (2) business investments continue to strengthen on the back of very favourable financing conditions, rising corporate profitability and solid demand (3) housing investment has improved further; (4) broad-based global recovery is supporting Euro-area exports.

- **Euro-area inflation slipped to 1.4% y/y in Dec while core inflation held steady at 0.9% y/y in Dec.** Breakdown showed energy prices falling, reflecting base effects. Country-level inflation also showed German, Spanish and Italian CPI edged modestly lower in Dec while French CPI rose modestly. ECB expects headline CPI to hover around current levels in coming months. ECB reiterated that measures of underlying inflation remain subdued and have yet to show convincing signs of a sustained uptrend but they expect a gradual increase in the medium term supported by monetary policy measures, continuing economic growth and rising wage growth. We believe the strong run in the EUR (>5.5% gains since mid-Dec 2017) could weigh on imported prices (imported consumer products account for around 15% of industrial goods in the Euro-area) and result in negative feedback loop to core inflation.In the last quarterly assessment report (Dec-2017), the ECB revised upwards its inflation forecast for 2018 to 1.4%, from 1.2% in the last projection in Sep.

- **Monetary Policy Forecast:** There is no ECB meeting scheduled in Feb. The next meeting is on 8 Mar. We do not expect any change to policy rates and expect ECB to keep APP ongoing till Sep-2018. We believe there will be market chatters speculating on the change in forward guidance relating to how APP should end and expectations of an abrupt end to APP on Sep-2018 should keep EUR well-bid. However we think it remains too soon to commit to communication at this stage. On how APP will end, we expect a gradual “taper” from Sep-2018 to Dec-2018 rather than an abrupt end on Sep-2018, followed by potential rate increases in 1H 2019.

- At the last ECB meeting on 25th Jan, the Governing Council (GC) left rate of Main Refinancing operations, deposit facility and marginal lending facility unchanged at 0%, -0.4% and 0.25%, respectively. The GC expects the key ECB interest rates to remain at their present levels for an extended period of time, and well past the horizon of the net asset purchases. ECB’s Draghi said that robust economy justified EUR strength. He added that speculation about changes in future communication and recent statements from US policymakers on FX (US Treasury Secretary Mnuchin that “a weaker USD is good” for US economy via trade) led to EUR strength. Draghi also expressed confidence that Euro-area could attain its inflation goals. Overall the statement/press conference was balanced. When asked about whether interest rate will rise this year, he said he did not believe conditions warrant that.

- Recent ECB speaks in Jan have seen a string comments from ECB officials attempting to dampen EUR gains.
  - ECB Nowotny said that Euro’s recent strength against the USD “is not helpful”;
  - Vice-President Constancio said he did not rule out that monetary policy would still continue to be “very accommodative for a long time”;
  - Villeroy’s earlier commented that recent euro appreciation is a source of uncertainty and requires monitoring as it could damp inflation.

- We reiterate the Governing Council's decision at the Oct-2017 meeting that ECB's Asset purchase program (APP) will be extended for another 9 months to Sep-2018 at a reduced purchase amount of EUR30bn (down from current pace of EUR60bn which will run till Dec-2017) starting Jan-2018. The GC left the asset purchase program open-ended – it can extend APP beyond Sep-2018 or increase the size of APP if the GC sees financial conditions inconsistent with further progress towards a sustained adjustment in the path of inflation or if inflation outlook is too weak.

- **Latest Fiscal and External Balance Outlook:** Euro area's current account surplus widened to EUR32.5bn in Nov (from EUR30.3bn in Oct) on increase in surplus on trade in goods while surplus on services fell. Current account surplus to GDP inched higher to 3.5% for 12-month period ending Nov 2017.

- The EA19 government deficit fell to 0.3% of GDP in 3Q, down from deficit of 1% of GDP in 2Q, owing to modest increase in government revenue while government expenditure fell.

- **Key domestic events and issues to watch:** Dec PPI (2 Feb); Dec retail sales (5 Feb); Dec IP, 4Q prelim GDP (14 Feb); Dec trade (15 Feb); Dec current account (19 Feb); Feb ZEW Expectations (20 Feb); Feb prelim PMIS (21 Feb); Jan CPI (23 Feb); Feb consumer confidence (27 Feb); Feb CPI estimate (28 Feb).

- **Technical Outlook:** EUR traded higher for the month of Jan, Last seen at 1.2430 levels. Bullish momentum on monthly, weekly chart remains intact but bullish momentum on daily chart shows signs of waning. Daily stochastics also shows signs of falling from overbought conditions. Short term signals suggest the risk of pullback. Support at 1.2320 (previous high now turned support) before 1.2211 (21 DMA). Bias to buy on dips. Next resistance at 1.2460, 1.2540, 1.2598 (61.8% fibo retracement of 2014 high to 2016 low).

GBP: Sharp Gains to Face a Reality Check

Forecast	1Q 2018	2Q 2018	3Q 2018	4Q2018
GBP/USD	**1.4200** (1.3200)	**1.4400** (1.3400)	**1.4800** (1.3600)	**1.4800** (1.3800)

Previous Forecasts in Parenthesis

- **Motivation for the FX View**: Our medium term view of GBP to trade higher towards 1.38-1.42 levels as mentioned last year was met early in Jan 2018. We revised upwards our FX forecast for 2018, due to positive development on *Brexit* and expectation for orderly exit (boost to sentiment shifts), continued improvement in labor market (upward pressure for wage growth providing room for BoE to tighten) and potentially greater tolerance (from policymakers) for GBP appreciation and rate increases to curb inflationary pressures. We believe GBP gains could be amplified amid broad USD weakness.

Eventual recovery (on broad picture perspective) towards 1.50 should not be ruled out as UK manage its orderly transition out of EU and corrects its imbalances (relating to twin deficits, productivity growth, normalising of monetary policies, etc.).

- But we **do not expect one way uptrend** and FX price movements should contain a **great deal of variability driven by risk factors** including *Brexit* negotiations (hard or soft exit from EU, progress of transitional agreement, trade terms with other countries outside of EU, etc.), risk of further deceleration in growth momentum (2017 growth already slipped to lowest level in 5 years), risk of slowdown in foreign inflows and business investment if expectations of positive *Brexit* development was overly enthusiastic.

- **Recent development with *Brexit* has been positive but requires a reality check on enthusiasm**. Spain and Netherlands' Ministers have indicated their preference for soft Brexit citing trade and investment ties while influential lawmakers in EU parliament reportedly considering watering down legislative proposals relating to clearing houses, helps to dispel fears of negative impact on London's financial centre (should clearing houses be relocated out of London). That said **EU negotiates with UK on a unified front and comments from EU Chief Negotiator for Brexit Michel Barnier probably carries more weight.** As of writing, EU 27 meets in Brussels (29 Jan) - this is one **key risk event that may provide a reality check on recent more than 6% GBP gains since end-Oct 2017.** EU27 Ministers will meet to agree the bloc's red lines regarding the transition period and EU demands include all of EU law; UK to not take part in EU decision-making processes; UK abide by regulatory structures of the EU and its budgetary commitments; UK to recognize European Court of Justice and that the transition period last for a fixed period of time. We caution that **lack of agreement or clarity on transition agreement may dampen markets' enthusiasm on soft *Brexit* and renewed fears of disorderly *Brexit* will pose downside risks to our GBP forecasts**. We do not rule out pullback risks below 1.40 levels but strategic bias remains to buy on dips.

- Recent BoE Carney's testimony (30 Jan) to Britain's House of Lords Economic Affairs committee added to GBP strength. He said the central bank's focus is increasingly shifting to return inflation to target sustainably, as slack in the economy has been taken out. When asked if BoE had a bias against *Brexit*, Carney denied and added that investments could pick up again next year when more uncertainty from Brexit lifts. Inflation was last seen at 3% and BoE's target is at 2%. Stronger commitment from BoE to bring down inflation (conditional on orderly *Brexit*) could build up market expectation for an earlier than expected rate hike. These drivers support the case for stronger GBP. Our house view is for the next rate hike in Aug 2018. Next BoE QIR (released on 8 Feb) could signal upward change in projections.

- We upgraded our medium term (12-month) bias that GBP could trade higher from current levels towards 1.48 – 1.50 as GBP is perceived to be undervalued from both historical and fundamentals perspective (our BEER model puts GBP at 1.40). The 20% or so depreciation (from

Jun to Oct 2016) should help the UK economy to rebalance and grow sustainably over time - current account deficit should narrow, exports should become more competitive and tourism and education receipts should pick up further. We believe UK should be able to manage the exit, transform itself into a global marketplace and continue to attract capital (longer-term). Past experience of UK leaving the ERM back in 1992 saw a period of consolidation (for a few years) at historical lows for GBP, before the eventual move higher in the following years, where GBP TWI traded above 100-levels in 1998 (from the lows of 80 in 1993-1996) due to buoyant demand fueled by rapid growth of wealth, credit and money. If history is a guide (assuming UK manages the transition well and takes the opportunity to correct its imbalances), its currency may start climbing higher.

- **Growth and Inflation Outlook: Advanced estimates showed 4Q GDP surprised to the upside** (+0.5% q/q vs. +0.4% expected vs +0.4% in 3Q). Sequential growth was supported by manufacturing and services sectors while construction sector weighs. On y/y terms, 4Q GDP was 1.5% (vs. +1.7% in 3Q). For the year, UK GDP slowed to 1.8% y/y (vs. 1.9% in 2016), its lowest level in 5 years. This data further validates our caution that growth momentum is decelerating and is below its long term average. Moreover retail sales have been trending lower for the whole of 2017, with Dec retail sales falling to +1.3% y/y (vs. 2.6% expected vs. 1.5% in Nov).

- **UK inflation declined for the first time since Jun**, with headline inflation at 3% y/y (vs. 3.1% in Nov) and core inflation at 2.5% y/y (2.7% in Nov). Decline was due to lower air fares despite petrol and tobacco prices rising. The move lower was in line with our expectations that *we do not expect price pressures to stay above 3% for extended period as seasonal effects from travel ease*. We expect recent GBP gains to have an effect in moderating inflation via import price channel. However given rising oil prices in recent months, retail fuel prices should see some upward pressure on CPI in coming months.

- In the last Quarterly Inflation Report (published Nov), CPI is projected to rise a little further in the near term, peaking around 3.25% in Oct before easing back towards 2.4% in end-2018 and remain slightly above 2% target over the next 3 years. The speed at which inflation returns to 2% target will depend on how quickly those upward pressures (import price channel) generated from GBP depreciation and higher energy price pass-through to retail consumers via petrol and diesel prices diminish. BoE QIR also highlighted that the period of above-target inflation could be more persistent if it leads households and companies to revise upwards their expectation for inflation and if that feeds through to wage and price setting decisions. That said medium term inflation expectations remain consistent with BoE's target of 2% and modest wage growth amid tightening of labor market reflects the low rate of productivity growth. Next QIR is published on 8 Feb 2018.

- **Monetary Policy Forecast:** BoE QIR projects 2 rate increases of 25bps each over the next 3 years to 2020. We believe **BoE could raise rates by another 25bps to 0.75% as early as in Aug-2018**, as inflation (3% y/y in Dec) remains persistently above BoE's 2% inflation target. UK OIS is penciling in 65% chance of next rate hike sometime in Aug-2018. We believe policymakers are increasingly more tolerant of allowing exchange rate appreciation to arrest runaway inflation, given that recent >6% appreciation (since late-Oct 2017) in GBP above 1.40-handle apparently did not seem to create any discomfort with policymakers. This is in addition to the use of interest rate policy tool (BoE raised rate in Nov-2017, for the first time since 2007). Next BoE MPC meeting is scheduled on 8 Feb 2018. We expect policy status quo and put increasing focus on the QIR for clues on inflation, growth projection changes. Our house view is for the next rate hike in Aug 2018. There is now some risks that BoE could potentially move earlier than our expectation (which is already considered hawkish amongst consensus). Stronger commitment from BoE to bring down inflation (conditional on orderly *Brexit*) could support the case for BoE's hawkish rhetoric and earlier than expected rate hikes and this supports the case for stronger GBP.

- BoE MPC (7-2) voted for 25bps rate hike (first hike in 10 years) to take policy rates to 0.50% at its last meeting on 2 Nov 2017. The move was well expected but forward guidance was interpreted as dovish. BoE statement removed the line "markets under-pricing future rate hike". It also indicated that the BoE is in "no hurry to raise interest rates again and that further increases will be limited". This is in line with our expectation - *we do not see an aggressive rate hike cycle and is likely to be one hike and an extended pause as BoE is constrained due to ongoing Brexit uncertainties, decelerating wage growth and economic growth momentum. We expect the BoE to strike a balance between arresting inflation and making sure they do not derail growth momentum*. This underscores the point that BoE is raising rates to curb rising inflationary pressures beyond tolerance level and not because the country's growth is overheating.

- **Latest Fiscal and External Balance Outlook:** UK's current account deficit to GDP narrowed slightly to -4.6% of GDP from -5.2% of GDP in 2Q. The Office of Budget Responsibility has projected current account deficit to be about -4.4% of GDP in 2021, rather than -2% of GDP initially forecasted in Mar 2017. Foreign inflow of capital is needed to fund the deficit. But if Brexit uncertainty takes a turn for the worse (not our base case scenario) or persists for longer, investor/business sentiment can be adversely impacted. Slowdown in foreign inflows could worsen the situation and the GBP could come under pressure as a result.

- Public sector borrowing (ex-banking) was at GBP2.6bn in Nov, a decline from Nov's GBP8.1bn and below expectations of GBP5bn. Improvement in public finances were due to GBP1.2bn EU credit reflecting a cut in the EU's overall budget and rising VAT receipts. Eyes on March Budget – if Chancellor Hammond spends more on healthcare as requested by Foreign Secretary Johnson or aims to cut public debt (representing some degree of spending control).

- **Key domestic events and issues to watch:** Jan Mfg PMI (1 Feb); Jan Construction PMI (2 Feb); Jan services PMI (5 Feb); BoE meeting, Quarterly Inflation Report (8 Feb); Dec IP, construction output, trade (9 Feb); Jan CPI, PPI, RPI (13 Feb); Jan retail sales (16 Feb), Dec labor report, Jan public finances (21 Feb); 4Q prelim GDP (22 Feb); Feb GfK consumer confidence (28 Feb).

- **Technical Outlook:** GBP rose sharply in Jan, on rising expectations of soft Brexit. At the same time gains were amplified amid USD weakness. Pair was last seen at 1.4180 levels. Underlying momentum remains bullish, as indicated on month and weekly charts. But shorter term technical suggests some pullback risks ahead - bullish momentum on daily chart is waning while stochastics has eased away from overbought conditions. We do not rule out retracement risks towards 1.3980, 1.3840 (21 DMA). Resistance at 1.4270 (76.4% fibo retracement of EU referendum high to Oct-2016 low), 1.45 levels. Bias to take dips as opportunity to buy into.

AUD: Look out for Possible Correction

Forecast	1Q 2018	2Q 2018	3Q 2018	4Q 2018
AUDUSD	0.8000 (0.7900)	0.8150 (--)	0.8350 (--)	0.8500 (0.8300)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** AUD has been on the upmove, lifted by a combination of rising base metal prices, soft USD and positive risk sentiments. The positive investor sentiments were also reflected in the CDS of the big Australian Banks which are near their 2014 lows. Yield differentials have not been driving the FX space in the past several weeks and thus even as AU-US 10y spreads hovered around 21bps since the start of Dec 2017, AUDUSD rallied 8% from its Dec lows. Fundamentals have been improving with retail sales recording a strong growth for last Nov, even with seasonal adjustment. Building approvals for the same month was also way above market's expectations with a print of 17.1%y/y vs. 4.6% expected. Even though this is a moderation from the previous 17.5% growth, the two digit growth bodes well for the construction sector. That sets a pretty upbeat backdrop for business confidence, non-mining capex and consumer sentiments.

- In the month ahead, we see chances of a technical correction in the AUDUSD as iron ore prices seem to be reaching a tentative ceiling and at risk of a temporary reversal. However, this correction could be purely technical and brief given the fact that there are signs of wage growth bottoming at the current trough. We have been in a low inflation environment for quite a while now and that leaves more room for upside surprises to price pressures and FX price action. This is not helped the least by the rise in commodity prices which could fan price pressures. In a backdrop of a cooler property market and high household debt, once wage price start to rise, RBA may find room to raise rates and that could happen as soon as May.

- **Growth and Inflation Outlook:** Data has been improving with retail sales recording a strong growth for last Nov, even with seasonal adjustment. Building approvals for the same month were also way above market's expectations with a print of 17.1%y/y vs. 4.6% expected. Even though this is a moderation from the previous 17.5% growth, the two digit growth bodes well for the construction sector. Capacity utilization for all sectors has been hovering well above the 10-year average. RBA noted that the outlook for non-mining business investment has been improving and growth is also supported by public infrastructure investment. Labour conditions are looking healthy with plenty of growth in part time and full time employment. Wage pressures are still subdued with the wage price index waffling around near historical lows of around 0.5%q/q. However, that measure has been steady for a while now and that could indicate a bottoming in wage growth and we might even see a pick up as capacity falls further in the labour market.

- Eyes are on CPI at the end of this month and we are looking for the headline to edge higher to around 2.0%y/y for 4Q. Any upside surprise could foil the correction in the AUD that we have been looking for. Wage price index is due next month and could be another key indicator to watch. According to the SoMP released last Nov, underlying inflation is expected to steady around 1¾ % until early 2019, before increasing to 2 percent. Headline inflation is also expected to rise to around 2 ¼ %. The CPI basket has been reweighted to take into consideration a change in consumption patterns but the change will be "gradually incorporated into the year-ended inflation rate over the next four quarters". With the trade-weighted index strengthening almost 1% in the past month (to date of 29 Jan 2018), inflation pressure may take some time to manifest.

- As of last available data, inflation picked up pace to +0.6 q/q in 3Q, from 0.2% in 2Q. The increase was due to electricity and tobacco prices while sharper declines in prices of vegetables and petrol weighed. Tradable inflation fell in 3Q (-0.3% q/q) while non-tradable inflation rose (+1% q/q), in part due to tobacco and electricity prices. That said, non-tradable inflation is now near 4-year high of 3.2% y/y.

- **Monetary Policy Forecast:** RBA will hold its first monetary policy meeting for the year on 6 Feb, continuing its tradition to hold its monetary policy meetings every first Tue of the month. The SoMP will be released later. We might see a shift in language to a more hawkish one should 4Q CPI (due on 31 Jan) turn out to be firmer than the expected 0.7%q/q. If headline starts to persist above 2%, expectations of a rate hike could be brought forward towards May. As of today, OIS data implies a 61.0% probability of a rate hike in Aug. This implied probability has been stable for a few months now. We are looking to the wage growth momentum for RBA to start normalizing the monetary policy rate. The next wage data is due 21st Feb. A combination of faster pick-up in wage growth, Australia inflation reaching its median target of 2.5% (range is 2 – 3%), steady economic growth in Australia, stabilization in local property markets, should lead to RBA tightening interest rate in due course.

- **Latest Fiscal and External Balance Outlook:** Australia's current account deficit narrowed slightly to A$9.13 billion (s.a.) in 3Q from A$9.7bn in the quarter prior. In related news, PM Turnbull said that the country wants to pour A$3.8bn to boost defense exports. As the mining investment declines, resource exports are rising. We may see a rise in export receipts given more government investment on that front along with rising commodity prices for energy and metals in an environment of synchronized global growth. Current account to deficit stands at -2.1% of GDP.

- The 2017-18 budget deficit is A$29.4bn and projected to return to a surplus of A$7.4bn by 2020-21. Economic assumptions include inflation at 2% this year, real GDP of 2.75%. Total revenue is expected to be A$444.4bn, up from A$412.1bn in 2016-17. Net debt is projected to peak at 19.8% of GDP in 2018-19. Infrastructure spending will amount A$75bn from 2017-18 to 2026-27. The budget managed to help the government avert a loss of its AAA rating by S&P. That said, Australia still has a negative credit rating outlook as its deficits run the risk of being persistent for several years with little improvement if the government is not able to implement more forceful fiscal policy decision. In fact, S&P has recently affirmed its AAA credit rating for Australia and retained its negative outlook given the existing risks to the fiscal consolidation plan and financial stability. This is in spite of governments' forecasts of a narrower budget deficit released at its Mid-Year Economic and Fiscal outlook.

- **Key domestic events and issues to watch:** Jan PMI-mfg, Export, Import Price on 4Q; building approvals for Dec on 1st Feb; 4Q PPI on 2nd; M-I inflation for Jan on 5th; Dec trade, retail sales, **RBA policy decision on 6th;** Dec home loans, **SoMP on the 9th;** NAB business surveys on 13th; Westpac consumer confidence for Feb on 14th; **Jan Jobs Report on 15th; RBA Feb Minutes on 20th; Wage Price index for 4Q on 21st; Jan** Private sector credit on 28th.

- **Technical Outlook:** The month ahead has quite a bit of downside risks for AUDUSD but as we have written above, the pullback might be swift and brief. After a 8% rally since its Dec lows, we see a correction due for this pair. A 50% correction could bring the pair towards the 0.78-level but we are not calling for a collapse – not in a growth environment globally and domestically. Interim support is seen around 0.7987 (23.6% Fibonacci retracement of the Dec-Jan rally) before 0.7895.

NZD: Gains to Moderate; Eye on RBNZ MPS

Forecast	1Q 2018	2Q 2018	3Q 2018	4Q2018
NZD/USD	0.7100 (0.6800)	0.7400 (0.7100)	0.7500 (0.7200)	0.7600 (0.7200)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** We revised NZD forecasts higher, in part reflecting sentiment shifts relating to Labor/NZ First led coalition government (as previous uncertainty on government policies relating to immigration, trade and RBNZ mandate review is gradually subsiding), global synchronous recovery to keep agri-commodities prices supported, inflation to materially pick up (owing to fiscal impulse, minimum wage increase) leading to RBNZ first rate hike in 2H 2018 amid environment of broad USD downtrend. Our fair value model estimates for NZD is at 0.72 levels. In the near term, we expect Kiwi's recent gains of around 9% (since start of Dec-2017) to moderate, with risks of pullback towards 0.70 – 0.71 levels in coming weeks. Upcoming RBNZ MPS will be a key focus especially given the recent 9% run-up in NZDUSD, more than 4% run-up in NZ TWI amid inflation falling in 4Q.

- Fear of more inward-looking government policies arising out of change in government (led by Labour, NZ First coalition) is subsiding:

    - Pulling out of TPP was overblown as NZ has confirmed its participation in the revised TPP and is expected to sign on the agreement on 8th Mar in Chile;

    - Uncertainty over RBNZ reforms is gradually dissipating on the appointment of Adrian Orr as the new RBNZ Governor (takes office in March 2018). NZD strengthened when this news was announced back in Dec. He was formerly a RBNZ deputy Governor (2003-06), CEO of NZ superannuation fund (an appointment he held for the past 10 years in which he reportedly had a stellar performance), and was largely perceived as a qualified candidate to head up the central bank. But one risk to note is he is known to be more vocal than former RBNZ Governor Wheeler and we should expect to see more volatility on the NZD going forward;

    - Consideration of introducing dual mandate for RBNZ to target full employment in addition to price stability has well been flagged out. The risk here is timing of first rate hike could be delayed if unemployment rate does not fall towards 4% (Labor Party's target);

    - Initial concerns that net immigration would be cut to 10,000 per year (NZ First's campaign) from about 70,000 is now out of the way as focus shifts to Labor Party's promise to reduce net immigration by 20,000 - 30,000 per year. And the cuts will come from (1) limiting student visas and ability to work for those in low-value courses (constitute to about 10,000); (2) restrictions on post-study work visas (constitute to about 12,000) and (3) regionalizing occupation lists and encouraging a Kiwi-first hiring policy (constitutes to about 8,000 cut).

- **Growth and Inflation Outlook:** 3Q GDP expanded +0.6% q/q, +2.7% y/y. The expansion was due to contribution from services sector including health and residential care, business services, arts & recreation as well as from construction activity. Household spending was also firmer, owing to spending on durable goods and services.

- The last RBNZ MPS (dated 9 Nov) showed that NZ economy is projected to continue growing at an average of 3.3% over the next 2 years. Above-trend pace of growth is expected to be strong enough to maintain inflation around the midpoint of the RBNZ target range of 1 – 3% over the medium term. Housing and construction sectors are likely to be weaker (possibly due to LTV restrictions, reduced foreign demand, etc.) but continued high terms of trade, fiscal stimulus amid accommodative monetary policies should offset. RBNZ also took into consideration new policy changes including new government spending, tighter visa requirements, KiwiBuild program (to build 100,000 affordable homes in 10 years, half of those supply will be in Auckland) and increases in minimum wage but the impact of these policies remain very uncertain.

- RBNZ expects CPI to remain near the midpoint of the target range and longer term inflation expectations are well anchored at 2%. Non-tradables inflation is moderate but expected to increase gradually as capacity pressures increase. Tradables inflation has increased due to the lower New Zealand dollar and higher oil prices, but is expected to soften in line with projected low global inflation.

- **4Q NZ inflation was weaker** (+0.1% q/q and +1.6% y/y) than expected (+0.4% q/q and 1.9% y/y). Higher petrol prices, airfares were more than offset by decreases in telco services, purchase of vehicles, new cars, household goods and vegetable prices. Core inflation further reinforced the soft headline CPI, raising question if inflation could pick up further sustainably especially in the environment of stronger exchange rate. However we believe potential fiscal impulse and proposed minimum wage increase (minimum wage to be raised to NZ$20/hour by 2020; and to NZ$16.50 by Apr-2018) could support consumer spending and result in faster pick-up in inflation.

- **Monetary Policy Forecast:** We expect RBNZ to keep OCR on hold at 1.75% at its upcoming meeting on 8 Feb. Since the last MPS (in Nov 2017), the NZD has strengthened by nearly 9% (vs. USD) since mid-Dec 2017, and NZ TWI has risen by more than 4% in the same period to 75 levels, we see risks of acting and outgoing Governor Grant Spencer reiterating “the need for weaker exchange rate to achieve more robust growth”. He may also take a cautious stance on the dip in 4Q inflation. Overall we see risks skewed to the downside in the upcoming RBNZ (possibly turning neutral from slight hawkish in Nov) and this could provide a tactical trading opportunity in the lead up to upcoming RBNZ meeting. But looking beyond, **we expect the central bank to begin raising rates as early as in 3Q-4Q 2018 as inflation is**

expected to pick up further towards end-2018 (owing to fiscal impulse, minimum wage increase).

At the last MPS meeting (9 Nov), RBNZ kept rates on hold at 1.75% as widely expected, the tone of the statement was interpreted as slightly hawkish. The statement noted that the exchange rate has eased since August Statement and, if sustained, will increase tradables inflation and promote more balanced growth. Inflation forecasts were revised upwards and RBNZ's expectation for first rate hike has been brought forward slightly by a quarter to 2Q 2019. RBNZ Acting Governor Spencer said he was "happy" with the exchange rate and it was in the vicinity of fair value".

Uncertainty over RBNZ reforms is gradually dissipating on the appointment of Adrian Orr as the new RBNZ Governor (takes office on 27th March 2018). NZD strengthened when this news was announced back in Dec 2017. He was formerly a RBNZ deputy Governor (2003-06), CEO of NZ superannuation fund (an appointment he held for the past 10 years in which he reportedly had a stellar performance), and was largely perceived as a qualified candidate to head up the central bank. But one risk to note is he is known to be more vocal than former RBNZ Governor Wheeler and we should expect to see more volatility on the NZD going forward. Consideration of introducing dual mandate for RBNZ to target full employment in addition to price stability has well been flagged out. The risk here is timing of first rate hike could be delayed if unemployment rate does not fall towards 4% (Labor Party's target). Finance Minister Robertson is expected to sign a Policy Targets Agreement with Adrian Orr in Mar 2018 before he takes up his appointment. First phase of the review of the Reserve Bank Act is expected to be completed by end-Mar.

- **Latest Fiscal and External Balance Outlook:** In the first 5 months of the financial year ended 30th Nov, NZ government recorded an unexpected operating surplus of NZ$125m (vs. forecast deficit of NZ$457m) thanks to GST and income tax receipts.

  In Finance Minister Robertson's 100-day plan last month, he projected smaller surpluses and higher borrowings than National party. It has also set aside for unallocated spending in next year's budget of NZ$2.6bn (vs. National party's NZ$1.7bn). Capital commitments within the 100-day plan are to resume contribution to the superannuation fund which has begun at NZ$500b and NZ$2bn for Kiwibuild program. Capital allowances outside the 100-day plan will be NZ$12.6bn over 4 years including NZ$3.6bn for NZ First's provisional Growth Fund and $100m for Green party's Green Investment fund.

- 3Q current account deficit narrowed to -2.6% of GDP (vs. -2.7% in 2Q). In absolute terms, current account deficit was larger than expected as overseas income of domestic companies was lower relative to foreign-owned firms operating in NZ.

- **Key domestic events and issues to watch:** Dec building permits (2 Feb); 4Q unemployment rate, wages (7 Feb); RBNZ meeting (8 Feb); Jan card spending (12 Feb); Jan food prices (14 Feb); Jan PMI (16 Feb); Jan Services PMI, 4Q PPI (19 Feb); 4Q retail sales (23 Feb); Jan trade

(27 Feb); Jan net migration (28 Feb). GDT trade auctions take place on 6 and 20 Feb.

Technical Outlook: Kiwi's uptrend since mid-Dec remains intact, as indicated on bullish momentum on monthly and weekly charts. Daily chart suggests some signs of slowing momentum on Kiwi bulls. Chance of pullback could re-visit 0.7270 (21 DMA), 0.7160 levels (38.2% fibo retracement of 2014 high to 2015 low). A golden cross patterns appears to be forming – 50 DMA to cut 200 DMA to the upside – bullish signal. This should add to bias for building Kiwi longs on dips. Resistance at 0.7480 (50% fibo), 0.78 (61.8% fibo).

JPY: No Stealth Tightening But Market Is Not Buying It

Forecast	1Q 2018	2Q 2018	3Q 2018	4Q 2018
USDJPY	108 (117)	107 (115)	106 (116)	105 (116)

Previous forecasts in parenthesis

- **Motivation for the FX View:** The USDJPY has been among the top performers in the G7 space so far this year. The year had started on a high note for the USDJPY with the pair climbing higher above the 113-levels initially. But market speculation of BOJ tapering following the reduction in JGB purchases on 9 Jan sent the pair on a tailspin from which the pair has yet to recover. BOJ governor Kuroda reiteration of the bank's ultra-loose monetary policy failed to stem the pair's losses. Instead, market remained focus on BOJ tapering as it is the last G7 central bank to maintain easy monetary policy, and would take any opportunity to long-JPY on tapering speculation. In addition, a broad sell-off in the USD following comments by Trump administration officials, including Treasury Secretary Mnuchin, about favouring a weak USD policy is adding to the USD downtrend. So far in Jan, the JPY has gained about 3.8% against the USD, matching its gains for the whole of 2017! We expect these gains to continue though some rebound cannot be ruled out. We are now positive on the outlook for the JPY.

- We expect the broad downtrend in the USD to persist in 2018 and put downside pressure on the USDJPY. The weakness in the USD is due to structural factors such as the counter-cyclical nature of the USD, rising budget deficit, reserve diversification away from the USD, and the end of the 78-month USD rally cycle that is likely to weigh on the USDJPY. We caution though that there could be intermittent USD rebound on risk aversion that could see USDJPY climbing higher.

- Despite the sell-off in the USD and market speculation about BOJ tapering moves, market remains positioned for further JPY weakness ahead. Recent CFTC data showed that net short-JPY positions have increased to 122870 in the week of 23 Jan (end-2017 at 116086) after increasing short-JPY positions to 160130 contracts and its cutting its long-JPY bets to 37260 contracts. 101286 in the week of 17 Oct. This reflected the market's bias for further JPY weakness ahead. Still, we expect these net short positions to unwind in the months ahead as USD weakness and speculation of BOJ tapering persist. Should this happen, and given the amount of short-JPY position, there is potential for further downside moves by the USDJPY in 2018.

- Despite our expectations of broad USD weakness ahead, we do not expect the USDJPY to fall towards the 100-handle. We expect the BOJ's continued easy monetary policy to underpin the pair. Governor Kuroda has constantly reiterated the central bank's position of maintaining its ultra-loose stimulus programme for as long as it takes to get inflation back up to around the 2% target. This ongoing powerful easing measures and yield curve control should see 10Y JGB yield hovering around the zero percent levels. This is in contrast to its G7 peers where policy tightening has taken place or is in the works. This should lift yields in the G7 space and widen the yield differentials between JGBs and those of its G7 peers, providing support for the USDJPY.

- We expect easy monetary policy to continue no matter who is at the helm of the BOJ. Governor Kuroda's term in office ends in Apr and there has been no news whether he will be re-appointed. Kuroda has had positive reviews from PM Abe, Finance Minister Aso as well as other key players in the policy scene and looks set for a re-appointment. Still there is a chance that he might not be re-appointed. But we believe that whoever PM Abe chooses to replace him will continue with the dovish policy of his predecessor. This should keep the USDJPY supported ahead.

- The synchronous global recovery is helping Japanese exports and hence the economy. This in turn should lift profits of exporters. Better corporate earnings then should make the equity market more attractive and see greater inflows. However, the positive correlation between the Nikkei 225 Index and the USDJPY might no longer hold. With expectations now of a JPY appreciation, foreign investors might not be too eager to hedge their purchases in such a situation and this should weigh on the USDJPY instead.

- So far in Jan, Japanese investors have not taken to overseas assets as they did last year. In 2017, Japanese investors had purchased JPY1.15tn and JPY4.09tn in equities and debt overseas that helped to keep the USDJPY supported. Given the synchronous growth recovery that has kept the domestic economy in expansion for the past seven quarters, Japanese investors are now less inclined to invest overseas. So far in the first two weeks of Jan, Japanese investors have been net sellers of overseas assets. They purchased JPY0.35mn in overseas equities but sold off JPY1.22tn in overseas long- and short-term debt with the funds likely repatriated back into Japanese assets onshore. Continued inflows back into Japan are likely to keep the JPY supported in 2018.

- Given the developments described above, we are now positive on our outlook for the JPY in 2018. We now expect the USDJPY forecast to hover around the 108-levels by end-1Q 2018. Thereafter, further weakness in the USD is likely to weigh on the USDJPY and see the pair edge lower to 107 and 106 by end-2Q and -3Q before ending 2018 at 105.

- **Growth and Inflation Outlook:** The economy has been roaring so far in 2017, expanding for seven straight quarters and possibly the eighth when 4Q17 GDP is released later in Feb. In the first three quarters of the year, the economy has expanded by an average 1.7% y/y. Domestic economic activity remains relatively healthy with core machine orders accelerated 5.7% y/y in Nov after rising by 5.0% in Oct, while industrial production expanded 3.6% y/y in Nov vs. 3.7% in Oct. External demand remains supportive of the economy as well, rising 9.3% y/y in Dec though this was a moderation from the double-digits growth of the previous five months. Imports continued to expand at a double-digit pace though in Dec, up 14.9% y/y. For the full-year, exports and imports expanded by 11.8% and 14.0% respectively compared to -7.4% and 15.8% in 2016. Given that the BOJ expects the full-year growth to come in at 1.9% for the full-year in 2017, this means that GDP is expected to rise by at least 2.3% in 4Q. Growth is likely to remain healthy in 2018 given the government's FY2017 supplementary spending package of around JPY2tn as well as preparations for the 2020 Olympics in Tokyo. After likely rising by 1.9% in 2017, the economy is projected by the BOJ to expand by 1.4% and 0.7% for 2018 and 2019 respectively, largely due to base effects in 2018 and an expected slowdown in domestic demand in 2019.

- Inflation ended 2017 on a relatively high note. Headline inflation rose 1.0% y/y in Dec compared with 0.6% in Nov, coming just slightly below market expectations for 1.1%. Core inflation (headline CPI less fresh food) climbed 0.9% y/y in Dec, the same pace as in Nov, while core-core inflation (headline CPI less fresh food, energy) rose 0.3% y/y in Dec (Nov: 0.3%). For the whole year, headline, core and core-core inflation rose by 0.5%, 0.5% and 0.1% on average in 2017. This suggests that though inflation is picking up, it is doing so only modestly. It is still nowhere close to the central bank's 2% inflation target. Recent comments by BOJ Governor Kuroda highlighted some success policy is having on prices, enthusing that "we are finally close to the target". These comments were later clarified by the BOJ to suggest that the 2% inflation target would likely be reached around 2019. To defeat the deflationary mindset of the Japanese public, powerful easing by the BOJ is likely to persist. The BOJ continues to expect core inflation at 0.8% and 1.4% for FY2017 and FY2018 respectively before accelerating to 1.8% in FY2019.

- **Monetary Policy Forecast:** The BOJ continued with its ultra-loose monetary policy at its first policy meeting on 23 Feb. The central bank kept its balance (short-term) rate unchanged at -0.1% and its 10Y JGB yield target at around 0%. The pace of asset purchase of JPY80tn annually was also maintained even though this measure is no longer central to its "QQE with Yield Curve Control" policy regime. Some in the market had been anticipating some forward guidance on tapering given their reading of the central bank's balance sheet (which has not been expanding at the JPY80tn annual pace), the reduction in JGB purchases on 9 Jan, and Kuroda's comments on the "reversal rate". We did not share the view that BOJ is on the verge of tightening policy views but instead expected the BOJ to continue with its very-easy stimulus policy until its inflation objective is met. Note that PM Abe had signalled his hope that the BOJ continued with its policy to reflate the economy. This should put the BOJ as the last remaining central bank among the G7 to maintain an easy monetary policy.

- **Latest Fiscal and External Balance Outlook:** As we had pointed out, the government plans to postpone its goal of achieving a primary balance/surplus beyond 2020. This was confirmed by Finance Minister Aso in a speech made to parliament recently. Instead the focus of the government will be on achieving sustained economic growth and the government intends to employ all policy measures to realise this goal, thus putting the goal of a primary balance surplus in the backburner. The government intends to put forward a new plan on fiscal discipline sometime in Jun-Aug period. In the meantime, the Cabinet Office is projecting that the primary budget surplus will be achieved only in fiscal 2027, a further delay from its earlier projection of fiscal 2025.

- The current account (CA) remains in surplus. The CA surplus rose by a more moderate JPY1.35tn in Nov vs. JPY2.18tn in Oct as the surpluses in the good & services and primary income segments moderated. The financial account surplus widened though, rising JPY1.4tn in Nov compared to -JPY0.85tn from JPY0.85tn in Oct. Driving the financial account surplus higher was the larger inflows into the other investment account (Nov: +JPY2.25tn vs. Oct: +JPY0.10tn) and smaller portfolio outflows of JPY1.95tn vs. Oct's -JPY2.23tn. Consequently, the overall balance of payments (BoP) surplus widened to JPY2.81tn in Nov from -JPY1.71tn in Oct. For the first 11 months of 2017, the CA surplus widened to JPY21.08tn, larger than the CA surplus of JPY30.34tn for the whole of 2016. The persistent CA surplus is likely to underpin the JPY in 2018.

- **Key domestic events and issues to watch:** Preliminary GDP print for 4Q17 will be released on 14 Feb. There is no BOJ meeting in Feb, but we will have BOJ Suzuki speaking in Wakayama. JGB auctions in Nov: 10-year (1 Feb), 30-year (8 Feb), 5-year (14 Feb), 1-year (16 Feb) and 20-year (22 Feb).

- **Technical Outlook:** USDJPY traded lower for the month of Jan. Last seen at 108.70 levels. Monthly, weekly and daily momentum indicators are mild bearish bias. A death cross pattern appears to be forming, with 50 DMA about to cut 200 DMA to the downside in the next few sessions – bearish signal. Support seen 108.10 (trend line support from the low of 2012 to 2016) before 106.90 (61.8% fibo retracement of 2016 low to 2017 high). Resistance at 109.20, 110, 111.40 (38.2% fibo). Bias for downside play.

CNY: More Market Driven… Higher

Forecast	1Q 2018	2Q 2018	3Q 2018	4Q 2018
USDCNY	6.25 (6.65)	6.20 (6.60)	6.20 (6.60)	6.10 (6.55)
USDCNH	6.25 (6.65)	6.20 (6.60)	6.20 (6.60)	6.10 (6.55)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** USDCNY plunged with the USD from levels around 6.50 to low-6.30. This was largely in line with most of the USDAsians. Fundamentally, there is much to cheer about. 2017 growth came in at the firmer end of the targeted 6.5-7.0% range. CNY is in a much better place than what we saw this time, last year. Capital outflow is much less of a fear given the persistent rise in forex reserves and softening USD. There are fewer speculations on whether China is heading for a hard-landing. With a weak USD in the backdrop, USDCNY is set to head lower towards 6.10 from the current 6.34. That said, we are not exceptionally bullish on growth but rather, the global growth recovery provides China a rather conducive setting to engineer a soft-landing for the economy as the government commits further to its deleveraging agenda. Firmer inflation (owed to better global demand) and deleveraging efforts could naturally give rise to tighter monetary conditions and a naturally stronger CNY vs. the USD and we look for the pair to end the year at 6.10.

- Monetary policy will be kept "neutral and prudent". We expect PBoC to maintain sufficient liquidity, especially in times of high demand like the upcoming Chinese New Year. However, recent data of open market operations suggest that there has been net liquidity withdrawal since 24 Jan and the weighted average rate of the OMO has begun to creep higher. Rates are likely to extend this uptrend for the rest of the year as PBOC does its part to encourage deleveraging. Focus will still be on environmental protection and industrial activity could slow as a result. Private consumption is thus, an increasingly important role for supporting demand.

- Our monthly Maybank vulnerability score (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) showed a deterioration in the score for China to 5.6 from previous 5.3 (with 1 being the best and 9 being the worst) due to deterioration in the scores for inflation, fiscal, population which outweigh the slight improvements in PE valuation and FX reserves.

- **Growth and inflation outlook**: 4Q GDP surprised to the upside with a print of 6.8% y/y for 4Q (vs. the expected 6.7%). The slowdown in growth momentum expected in that period did not happen as industrial production remained steady at 6.2%y/y vs the previous 6.1%.

This was in spite of government's effort to clampdown on factories in a bid to drastically reduce pollution. Retail sales actually slowed markedly from 10.3%y/y to 9.4% in Dec while urban FAI steadied at 7.2%. For the year ahead, the NDRC has stated a target range of 6.5-6.8%, with the upper bound lowered from 7% to 6.8%. Upon the release of the 2017 growth numbers, NBS highlighted that growth of new sectors have started to gain traction. Focus for the year ahead is still on deleveraging and to underscore their commitment, PBoC has even stated that daily OMO could be utilized to encourage deleveraging. Even with China's commitment to reduce its debt, there is less fear of a hard-landing for the economy compared to last year. On the side, the Southern province of Hainan took away GDP and FAI targets for some cities and counties and government assessment would place greater emphasis on environmental protection. These are signs that China is willing to allow more room for economic slowdown in exchange for more sustainable growth. And, there are signs that the economy is slowing down with SOE profitability falling by 33.8%y/y in Dec while that of private companies lower by 46%, a third consecutive month of decline. In general, the industrial enterprise profits only grew by 4.5%y/y in Dec 2017, a marked slowdown from 30% at the start of the year. This is definitely a sign that growth should lose some momentum from the 6.9% recorded for 2017.

- Dec CPI was slightly softer than expected at 1.8%y/y, albeit firmer than Nov's 1.7%. Price pressure was weighed by the fall in food inflation though prices of other sub-components including clothes, transport and telecom, residence remained firm. PPI slowed to 4.9%y/y from the previous 5.8%. Look for price pressure to be underpinned by firmer commodity prices.

- **Monetary Policy Forecast:** We expect PBoC to keep monetary policy "prudent and neutral". The central bank had warned that OMO could be used to encourage deleveraging and they have been. Since 24 Jan, PBOC has been conducting net withdrawals. That has caused the weighted average rate in OMO to rise to 2.65% at last sight (29 Jan). Deleveraging seems to be the main agenda for the year and we expect the central bank to tighten rates for most part of 2018.

- Right at the start of the year, PBOC removed the counter-cyclical adjustment factor that has stabilized the CNY against the USD and the rest of the trading basket. This CCAF was seen as a regression from its yuan internationalization agenda but its removal suggests that it is merely a reset button. For the past two years, PBOC has engineered stability in the CNY. In times of USD strength, CNY would be allowed to weaken against the USD but strengthen against the basket. In times of USD weakness, CNY would strengthen against the USD and weaken against the basket. However, since 2Q last year, USD has been seeing persistent USD weakness and this exchange rate model is no longer sustainable. Thus, PBOC introduced the CCAF which allows CNY to strengthen against the basket even in USD weakness. This was all necessary in the past few years as USD strength was a threat to yuan stability and there were still fears of hard landing and capital outflows. The CNY is in a much better position now as fears of hard-landing and capital outflows have dissipated. We see less need for

PBOC to guide the CNY in this environment. At the same time, we can look forward to a very gradual removal of capital controls.

- In recent comments, Yi Gang stated that *changes in monetary policies of major developed economies will squeeze room for PBoC monetary policy. Global economic recovery, rising commodity prices may lift China CPI. PBOC will continue to deepen reform on yuan exchange rate formation mechanism and strengthen market's role in setting exchange rate. Yuan exchange rate to stay basically stable at reasonable equilibrium level. Chinese economy is expected to keep stable growth in 2018. Financial regulations framework needs to be further improved (BBG, China Finance).*

- **Latest Fiscal and External Balance Outlook:** Fiscal revenue in China rose 7.4% y/y to CNY17.3trn for 2017. The Finance Minister had stated last year that the 2017 fiscal deficit is likely less than the target of 3% of GDP. According to the Central Economic Work Conference, there will be fiscal support for "major fields and projects". The Finance Ministry said its focus for 2018 is to prevent and mitigate major risks. The Ministry prioritizes on reining local government debt, banning illegal financing guarantees, banning disguised borrowings in the name of government-invested funds, public-private partnerships or government purchases. Expect little fiscal room for expansionary policies this year.

- FX reserves recorded its 13th consecutive increase to U$3.14bn for Dec. We can expect a significant increase for the Jan number base on valuations given the slide in USDCNY in the past month. Exports growth slowed to 10.9%y/y from 11.5%. Imports growth slowed to just 4.5% from 17.6%. As a result, trade surplus widened to CNY361.98bn to CNY255.44bn in Dec.

- Key domestic events and issues to watch: Jan Caixin PMI is due on the 1st Feb; FX Reserves on the 7th; trade balance, FDI, BOP on the 8th, CPI, PPI on the 9th, Money supply, Aggregate financing on 10-15th; Property on the 24th and Non-mfg PMI on the 28th.

- **Technical Outlook:** Pressure is still to the downside on the daily chart and bears are even more compelling on the weekly chart. Resistance is seen at 6.3254 (76.4% fibo retracement of the end 2014- 2016 rally). Pair is testing the support at 6.30 and there is little support between 6.30 and 6.20. Thereafter, the big-6.0 is at risk. All technical signals suggest that risk is to the downside (in line with our outlook for the year).

KRW: US Protectionist Measures to Weigh

Forecast	1Q 2018	2Q 2018	3Q 2018	4Q 2018
USD/KRW	1060 (1118)	1030 (1100)	1020 (1090)	1040 (1090)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** We revised USDKRW forecast lower for 2018 on the back of (1) synchronised global economic recovery and increasing demand for information technology products like semiconductors, OLED continues to bode well for Korean exports, benefitting trade-dependent currencies such as KRW; (2) growth momentum accelerating and signs of pick up in inflationary pressures leading to room for BoK to tighten monetary policy; (3) political risks abating - easing geopolitical tensions in Korean peninsula, signs that China-Korea relations are improving (to bode well for inbound tourism); (4) broad USD decline underpinned by macro trends amplifying gains in KRW.
  - Easing tensions in the North Korea peninsula should support KRW. North Korea KCNA calls for 2 Koreas to make a breakthrough for independent reunification and bring great changes to North-South relations as early as possible and it was also reported that North Korea is scaling back annual military exercises. We believe this could be due to Winter Olympics in Pyeongchang county (80km away from DMZ) in S.Korea that is scheduled to take place between 9 and 25 Feb and will see North Koreans participating in. There are some hopes that this Winter Games could be a game changer for the 2 Koreas given that North Korea is sending athletes including a joint-hockey team and cheerleaders and that South Korea could take this opportunity to engage the North to de-nuclear. We are less optimistic in relation to this issue as the North took pains to build its nuclear capability and may well took this opportunity to press for further economic concessions.
  - We expect BoK to raise policy rate again by another 25bps in 2Q-3Q 2018 from 1.5% if demand-induced price pressures picks up pace amid reacceleration in growth momentum. We believe BoK is monitoring if inflationary pressures from the demand side picks up. Recent data showed inflation jumped back to middle of BoK's target range. Minimum wage will increase by 16% this year, its largest magnitude of increase since 2001. Wage pass-through may have positive impact on consumption spending, growth and lead to inflationary pressures. But for the upcoming meeting on 27 Feb, we expect BoK to keep monetary policy status quo at 1.5% as BoK monitor the effects from the previous rate increase back in end Nov on inflation and growth.
- However in the near term, we see risks of KRW gains moderating in the next 1- 3 weeks as policymakers grow increasingly cautious of excessive

one-way moves beyond 1060 levels and recent KORUS FTA development between US and S. Korea may be slightly negative and could impact Korean exports. Lunar New Year holidays in mid Feb (15 and 15 Feb for S. Korea) in Asia may also see some short term squeeze in onshore liquidity. These short term factors could see a mild rebound in USDKRW possibly towards 1085 – 1095 levels.

- South Korea Finance Ministry has advised policy banks and SOEs to refrain from selling international bonds as much as possible. According to Bloomberg report 23 Jan (which quoted a Finance Ministry official), the regulatory move was to minimize any unnecessary impact on the currency market as sale of foreign currency bonds could put pressure on local currency amid conversion to KRW. This should temporarily ease off appreciation pressures on KRW;
- BoK mentioned that strengthening of KRW was due to geopolitical risks easing, broad USD weakness and herd behaviour. In particular officials appear to sound more vocal when USDKRW tested 1055 – 1060 range in the past month. We do not rule out "invisible hand" to smooth out excessive one-way moves;
- Trump's latest trade protectionist measures on imposing import tariffs (above tariff-free quota) on washing machines (to last 3 years starting at 20% on the first year, 18% on second year and 16% on the 3rd year) and solar panels (to last 4 years starting at 30% on first year, 25% on second year, 20% on third year and 15% on 4th year) may affect Korean exports. According to some calculations reported on the media, both washing machines and solar panel exports stand at about US$2bn per year. Korean exports to US could be affected if US consumers switch preferences. Rise of US protectionism may impede KRW gains.

- **Our monthly Maybank Vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for S.Korea improved to 6.0 (vs. 6.2 prior). Relative improvement in current account, inflation and fiscal more than offset deterioration in GDP and reserves.

- **Growth and Inflation Outlook:** Korea's economy contracted in 4Q (-0.2% q/q vs. +1.5% in 3Q). On y/y basis, growth was at 3% (vs. 3.8% in 3Q). Decline was due to slowdown in car exports which more than offset the increase in shipments of semiconductors. This surprise contraction in 4Q GDP was the worst result since 4Q 2008 and it came right after its strongest expansion in 3Q in more than 8 years. A BoK spokesman said that the decline in 4Q GDP was due to fewer work days and base effects. On the details, government spending and private consumption rose while exports volume and construction investment were the main drags. For the year BoK upgraded Korea's GDP growth to 3.2% from 3% previously on the back of global economic growth expanding more than they had expected back in Oct-2017. BoK expects growth to be stronger in 1H than 2H 2018.

- One of the key risks we highlighted in our FX 2018 Annual Outlook was the disruption to Korea's export recovery momentum due to Trump's criticism on the KORUS for US' large trade deficit and have asked for renegotiation and even threatened to scrap the KORUS. Indeed, such fears materialised (23 Jan) – US imposed import tariffs on Korea's washing machines and solar panels. According to some calculations reported on the media, both washing machines and solar panel exports stand at about US$2bn per year. Korean exports to US could be affected if US consumers switch preferences. Rise of US protectionism may affect exports momentum and impede KRW gains.

- **Headline CPI rose to 1.5% y/y in Dec** (vs. 1.3% in Nov). The sharp rebound was due to food, clothing and transport prices. Core inflation also inched higher to 1.5% in Dec. For the full year, headline inflation was at 1.9% (vs. 1% in 2016), This is the highest level of inflation since 2012 and is in the middle of BoK's target range of 1.5 – 2.5%. BoK expects inflation at 1.7% this year, compared to previous projection of 1.8%.

- Monetary **Policy Forecast**: We expect BoK to raise policy rate again by another 25bps in 2Q-3Q 2018 from 1.5% if demand-induced price pressures picks up pace amid reacceleration in growth momentum. We believe BoK is monitoring if inflationary pressures from the demand side picks up. Recent data showed inflation jumped back to middle of BoK's target range. Minimum wage will increase by 16% this year, its largest magnitude of increase since 2001. Wage pass-through may have positive impact on consumption spending, growth and lead to inflationary pressures. But for the upcoming meeting on 27 Feb, we expect BoK to keep monetary policy status quo at 1.5%.

- At the last BoK meeting (18 Jan), BoK kept policy rate unchanged at 1.5% (unanimous decision), following its 25bps rate increase on 30 Nov (the last meeting of 2017). BoK Governor Lee said that rates are kept unchanged as there are still uncertainties inside and outside the country and it is necessary to observe the effect of these factors. He also added that the decision was also based on the premise that inflationary pressures are not high.

- **Latest Fiscal and External Balance Outlook:** Current account surplus widened to $7.43bn in Nov, compared with $5.72bn in Oct-2017. The improvement was due to the widening of goods account surplus to $11.46bn from $9.69bn in Nov 2016. Services deficit increased owing to deterioration in travel account while primary income surplus turned deficit due to increase in the payments on equity account.

- President Moon has planned to redistribute income from companies and wealthy to working class by raising taxes on large corporate (25%, up from 22% for companies earning profits of KRW300bn or more) to finance assistance for SMEs. Income tax of individuals earning KRW500m or more will be increased to 42% from 40%. To recap his campaign promises the creation of 810,000 public sector jobs.

- **Key domestic events and issues to watch:** S. Korea releases Jan CPI, exports, PMI (1 Feb); Jan FX reserves, Sep current account balance (5 Feb); Jan unemployment rate (14 Feb); Jan PPI (21 Feb); 20 Days Exports for Feb (21 Feb); BoK MPC meeting decision (27 Feb); Business survey for Mfg and Non-Mfg (28 Feb).

- **Technical Outlook:** USDKRW consolidated near 1060 levels, following the sharp decline (more than 3% since mid-Dec). Pair was last seen at 1068 levels. Bearish momentum on monthly chart remains intact. But bearish momentum on weekly and daily chart shows signs of waning. A falling wedge pattern appears to be in the making (but remains too soon to conclude. This is typically a bearish reversal. Area of support seen at 1050 – 1060 and may hold for time being. Caution that a decisive break below this could open way for further downside towards 1035 – 1045 levels. Rebound risks could revisit 1080-1095 area of resistance in the near term.

SGD: Global Synchronised Recovery A Boon

Forecast	1Q 2018	2Q 2018	3Q 2018	4Q 2018
USDSGD	1.2800 (1.3750)	1.2700 (1.3650)	1.2500 (1.3600)	1.2400 (1.3580)

Previous forecasts in parenthesis

- **Motivation for the FX View:** SGD gains in 2017 have extended into 2018. After rising by 8.3% against the USD for the whole of 2017, the SGD remains on the uptick, rising by 1.9% so far in Jan 2018. Since the start of the year, the SGD has found support from the broad USD sell-off underpinned by several factors, including comments by Trump administration officials, including Treasury Secretary Mnuchin that a weak USD policy was favourable to the US economy, is adding to the USD downtrend. Even the recent climb in UST yields above the 2.6% levels has failed to deter SGD strength. Consequently, the SGD has spiked to touch a new 2018 and multi-year high of 1.3009 (on 25 Jan), though it has since come off to hover around the 1.3100-levels.

- We reiterate our view that the resiliency of the SGD will continue in 2018, as the currency should benefit from the synchronous global growth recovery that has lifted the trade-dependent economy. Already, the advanced estimates for 4Q 2017 GDP showed the economy expanding by 3.1% y/y, bringing full-year growth to 3.5% in 2017 (vs. 2.0% in 2016). We expect gains in the SGD to continue with the cyclical export recovery serving as a catalyst for a private investment recovery in the economy (as firms expand capacity to meet rising domestic and global demand). This should keep economic growth supported at 2.8% in 2018, close to the upper band of the government's 1.5-3.5% forecast range.

- Seasonality also points to SGD strength in the coming months. For Feb, seasonal factors, including traditionally it being budget time in Singapore, suggest that we could see some upside to the SGD. Typically a feel-good factor from a generous budget if it materialises should lift sentiments and help keep the SGD supported in the near term.

- We also maintain our expectations for the MAS to normalise policy at its Apr meeting. With growth now back towards potential and core inflation on the uptick, we believe that the zero appreciation path of the MAS policy has outlived its usefulness. Our estimates for the SGD NEER using the Taylor Rule show that the SGD NEER is expected to strengthen ahead. Thus, normalising policy by shifting to a 'slight appreciation bias' would be more appropriate. This policy normalisation is expected to provide the SGD with another leg up in 2Q 2018 and this should push the USDSGD lower to 1.26 levels by end-2Q 2018.

- At the same time, the broad downtrend in the USD due to structural factors such as the counter-cyclical nature of the USD, rising budget deficit, reserve diversification away from the USD, and the end of the 78-month USD rally cycle is likely to provide support for the SGD ahead. We caution that there could be intermittent USD rebound on risk aversion that could lift USDSGD higher. **At the same time, persistent CNY strength via lower USDCNY daily fix in the aftermath of the removal of the counter-cyclical adjustment factor could provide an anchor for the SGD to appreciate given increasing positive sensitivity of USDCNY move on the USDSGD.** Meanwhile, the government's mildly expansionary fiscal policy, triple-A status and persistent balance of payments surpluses have also been supportive of the SGD. These should provide the impetus for the market to unwind their stale long-USD positions and increase their long-SGD bets.

- The ongoing synchronized global recovery and the historically low volatility environment as reflected in the muted equity and FX volatility indices have encouraged greater flows into emerging market assets, including those in Singapore. Already the STI index has hit 3,609 on 24 Jan, a high not seen since 2007. This should be supportive of the SGD. Taken together, there could be even more room for the USDSGD to move lower going into 2H 2018. Risk to this is that episodes of global risk-off could re-emerge, spurring a sell-off in regional equity assets, including Singapore, and weigh on the SGD, posing upside risk to the USDSGD.

- Given the recent market development, we have adjusted our USDSGD forecasts accordingly to reflect the gains from synchronised export recovery and the potential gains from any subsequent investment-led recovery. The risk-on sentiments from the synchronous global recovery has also spurred inflows into Singapore assets that have lifted the SGD higher. Consequently, we have revised our USDSGD forecast lower. We now expect the USDSGD to end 1Q at 1.2800 instead of 1.3450 and then push lower to 1.27 on MAS policy shift in Apr. Thereafter, the improving economic environment amid continued USD weakness should put further downside pressure on the pair. We should see the pair end 3Q and 2018 at 1.25 and 1.24 respectively.

- **Singapore's monthly Maybank Vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) slipped slightly to 4.3 from 4.2. This should weigh on the intrinsic value of the SGD. Our model shows that the SGD NEER at 0.59% above the mid-point implied at 1.3174. Upper bound is implied at 1.2912 while lower bound is now at 1.3436.

Growth and Inflation Outlook: Advanced estimates showed the economy growing at a more moderate pace in 4Q 2017, expanding by 3.1% y/y vs. 5.4% in 3Q due to base effects. On q/q seasonally-adjusted (sa) annualised basis, GDP advanced at a softer 2.8% (vs. 3Q17: 9.4%). accelerating sharply by 6.3% (4.6% y/y) from 2.4% (2.9% y/y) in 2Q. Driving 4Q growth was once again manufacturing, up 6.2% y/y, though this was off the 3Q pace of 19.2%. Services remained resilient, rising 3.0% y/y in 4Q vs. 3.2% in 3Q underpinned by finance & insurance, wholesale & retail trade and transportation & storage. A drag on growth though was construction, which slipped 8.5% y/y in 4Q, the sixth consecutive quarter of contraction. Our economic team does not expect GDP growth momentum to accelerate in 2018 given expectations that productivity growth will dissipate and tight labour market restrictions to constrain growth particularly for services. Consequently, our team expects GDP growth to come in at 3.5% in 2017 (on cooling manufacturing) before easing to 2.8% in 2018 and then to 2.5% in 2019. MTI projects growth to come in at 1.5-3.5% in 2018.

- Inflation did not end 2017 with a bang as much as a whimper. Headline inflation rose by just 0.4% y/y in Dec compared to 0.6% in Nov, while core inflation (headline inflation less accommodation and private transport costs) eased to 1.3% y/y – the slowest pace in nine months. Headline inflation was weighed by lower services inflation as well as private transport cost, which moderated to 1.3% and 2.6% y/y in Dec (Nov: 1.6% and 4.1%) respectively. For the whole of 2017, headline and core inflation averaged 0.6% (a reversal after two years of contraction with 2016 at -0.5%) and 1.5% (vs. 0.9% in 2016) to record the fast pace since 2014.

- Our economic team believes that inflation risks are to the upside in 2018 amid elevated global oil prices, measures to cap supply of COEs (starting in Feb), second phase of water price hike in Jul, and possibility of GST being imposed on e-commerce sales. Together, these should put upside pressure on consumer prices in 2018. Our economic team is projecting headline and core inflation to average 1.2% and 1.7% respectively in 2018. This is above MAS' benign forecast range of 0-1% for headline inflation for 2018, and at the upper end of its 1-2% forecast range for core inflation.

- **Monetary Policy Forecast:** MAS has maintained a neutral policy, i.e. zero appreciation path of the SGD NEER since its Apr 2016 meeting. Aside from the slope, there were also no changes to the width and center of the policy band. In the last policy meeting in Oct 2017, the MAS failed to deliver a policy shift as there was absence of (1) any sharp domestic growth momentum (MAS expects the economy "to expand at a steady, but slightly slower, pace in 2018 compared to 2017") and (2) inflationary pressures (where "core inflation is expected to trend towards but average slightly below 2%" in the medium term). In 2018 though, healthy economic growth and rising inflationary pressures should anchor the MAS shift to "a slight appreciation bias". Instead, our Taylor Rule estimates for the SGD

NEER continues to suggest such a policy move to be appropriate. Our estimates showed that the SGD NEER is expected to strengthen ahead with the SGD NEER expected to end 2018 around 128.43. We now expect such a move to take place at the MAS' Apr 2018 meeting.

- MAS chief Ravi Menon's recent warning about the three "bears" of risk that bears watching have been taken by some to suggest that the bar for a policy move has risen. He had suggested risks to the global economy from low inflation, rising protectionism, and financial instability was not too far away. We believe that MAS is cognizant of these risks and will be closely monitoring the situation. Nevertheless, we believe that this does not distract from the fact that growth has recovered amid a synchronised global recovery and that policy will have to be normalized.

- Since the start of the year, the USDSGD has been on the broad downtrend amid USD weakness with the pair touching a new 2018 and multi-year low of 1.3009 (on 25 Jan). Pair has since rebounded and is is currently seen around 1.3100-levels. The swing in the USDSGD has seen the 3-month SOR (3MSOR) touch a 2018 high of 1.14% on 3 Jan before coming off to hover at the recent 2018 low of 0.92% levels on 26 Jan. Note though that the 3-month SIBOR had spiked to a near 10-year high of 1.51% on 3 Jan before slipping lower to around the 1.13%-levels on 29 Jan. This spike could be largely attributed to attributed to the large issuance of MAS bills (3-month and 1-month tenors), in addition to tight liquidity at the end of 2017. This though has yet to translate into steep increases in mortgage rates, which continues to remain on the slow grind higher. Despite the spike in 3-month SIBOR, deposit rates (for 12-month fixed) have also not risen since end-Jan 2017 and has remained at 0.33%. This continues to suggest that risks related to interest rate increases affecting financial and economic stability, particularly in interest rate- and property-related sectors, seems limited for now, though the risk could be rising.

- US rates remains on the uptick with the US 3MLIBOR currently hovering around the 1.7669%-levels at the point of writing, a 10-year high. Ample liquidity has so far kept domestic rates from tracking the US 3MLIBOR higher though, allowing domestic rates to continue with its rather slow grind higher. We expect the 3MSIBOR and 3MSOR edge higher to 1.54% and 1.32% respectively by end 1Q 2018. For end-2018, we expect the rates to accelerate to 1.87% and 1.65% respectively.

- **Latest Fiscal and External Balance Outlook: The government will reveal its budget plans for the next fiscal year on 19 Feb**. Discussions about the need to raise revenue to meet ageing population needs have so far centered on the GST, where there is a consensus building for a 2%-point increase in the GST to 9% (expected to be implemented in 2 stages – 1%-point each in 2019 and 2020). This measure is expected to generate an additional SGD3.2bn in revenue. Still there are other measures that our economic team thinks could be under consideration which include a personal income tax hike and fine-tuning the overall tax brackets to make it more progressive. In addition, the GST may be expanded to e-commerce transactions and e-services to prevent tax leakages and to level the playing field for brick-and-mortar retailers. The government could also possibly surprise with a 0.5% to 1.0%-point corporate tax cut to address issues of falling competitiveness.

- Latest data print showed that the current account (CA) surplus widened to SGD21.7bn in 3Q 2017 from SGD19.8bn in 2Q 2017. The increase in the CA surplus was due to larger surplus in the goods and services account (3Q: SGD27.6bn vs. 2Q: SGD26.6bn) as well as smaller outflows from the primary and secondary income accounts, in line with the global synchronised recovery amid regional trade momentum. The financial and capital deficit moderated to SGD10.3bn in 3Q from SGD15.9bn in 2Q, underpinned by larger direct investment inflows of SGD17.6bn (vs. 2Q: SGD13.5bn), and smaller portfolio and 'other' investment outflows of SGD10.9bn and SGD23.5bn respectively vs. outflows of SGD16.6bn and SGD24.4bn in 2Q. Consequently, the overall balance of payments (BoP) surplus widened sharply to SGD11.2bn in 3Q from SGD4.44bn in 2Q.

- **Key domestic events and issues to watch:** Final estimates for 4Q17 GDP will be released sometime on 16-23 Feb. Closely watched will be the government's 2018 budget speech on 19 Feb.

- **Technical Outlook:** USDSGD continues to trade lower for the 3rd consecutive month. Pair was last seen at 1.3090 levels. Bearish momentum on monthly chart remains intact but weekly and daily charts suggest the risk of rebound (probably in the near term). Resistance seen at 1.32 (21 DMA), 1.3270 (50% fibo retracement of 2011 low to 2017 high). Support seen at 1.3010 before 1.2968 (61.8% fibo).

MYR: Stars Aligned Ahead of the Next Elections

Forecast	1Q 2018	2Q 2018	3Q 2018	4Q 2018
USDMYR	3.8000 (3.9500)	3.8500 (4.0200)	3.7000 (4.0000)	3.6500 (3.9000)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** We maintain a positive outlook on the Ringgit on the back of improving domestic factors amid favourable external environment. Some of these domestic factors include (1) sustained growth pick-up backed by consumption, investment and exports; (2) BNM initiatives (Apr-2017) to deepen and broaden domestic financial markets were positive steps to restore foreign investors' confidence and (3) BNM's pre-emptive move in Jan described the hike as pre-emptive to ensure that the stance of monetary policy is appropriate to prevent the build-up of risks that could arise from interest rates being too low for a prolonged period of time. General election (likely to be held within the next 6 months) could lend further support for Ringgit. Typically Malaysian equities, MYR tend to strengthen in the lead-up to elections due to rising confidence. Sustained current account surplus and rising FX reserves to retained imports & short-term debt should also provide an anchor for Ringgit.

- Current external environment of monetary policy continuity, oil price increase and still subdued inflationary pressures in US as well as synchronous global economic recovery should continue to bode well for robust exports recovery and benefit countries that are trade-dependent including the MYR. An extension of crude oil production cut into end-2018 amid steady demand should lend further support for oil prices and Ringgit.

- We reiterate our long-standing bias that the Ringgit remains fundamentally undervalued (by about 5%). Our fair value model which takes into account the relative differentials in interest rates, inflation, current account and a reflation proxy variable (defined as the change in the ratio of MSCI World index to JPM Global Aggregate Bond Index) estimates USDMYR at 3.70 levels. Based on BIS data, MYR REER is about 5-6% undervalued relative to its 10-year average. We had previously said that Ringgit weakness was temporary and was not a reflection of underlying fundamentals. We believe stability is gradually returning to Ringgit as political/ contingent liability risk subsides, fiscal consolidation gains traction (budget deficit expected to be cut further to -2.8% of GDP vs. 3% of GDP in 2017), oil prices continue to stabilize and uncertainty subsides.

- The key risks to our outlook are (1) sharp rise in UST yields due to more aggressive than expected Fed policy normalisation could lead to foreign outflows and weigh on Ringgit and (2) risk-off plays/ rise in vols (uncertainty) arising out of synchronous recovery stalling, swings in crude oil and/or palm oil prices to the downside may weigh on Ringgit.

- External reserves rose by USD0.6b to USD103.0b at mid-Jan 2018 (end-Dec 2017: USD102.4b), supported by positive portfolio capital and trade flows. The external reserves' retained import cover remains at just over 7 months (mid-Jan 2018: 7.1 months; end-Dec 2017: 7.2 months) while its ratio to short-term external debt is stable at 1.1x. Supported by positive portfolio capital flows. Foreigners remained net buyers of Malaysian equities in the first three weeks of Jan 2018 (1-19 Jan 2018) at +MYR2.4b (Dec 2017: +MYR0.9b). Meanwhile foreigners were net buyers of Malaysian bonds with +MYR2.7b net inflows in Dec 2017 (Nov 2017: +MYR6.7b) riding on the momentum of Ringgit strength and amid expectations of BNM rate hike this year. There is also the maturity of MYR24.9b worth of Government bonds in 1Q 2018 i.e. MYR2b worth MGS in Jan 2018, MYR14.1b worth MGS in Feb 2018 and MYR8.8b worth MGS in Mar 2018. However we believe the risk of maturity driven foreign selling in the domestic bond market has reduced as exemplified by the net foreign buying of +MYR6.6b between Sep-Oct 2017 despite the maturity of MYR24.8b MGS during the same period. Our Fixed Income Research team expects foreign flows to remain positive in the Malaysian bond market in Jan 2018, riding on the positive outlook for Ringgit. Firmer external trade growth is supportive too. External reserves are well supported by trade flows so far via the repatriation of export earnings, (Jan-Nov

2017: +20.4%; Jan-Nov 2016: +0.3% YoY) and larger trade surplus (Jan-Nov 2017: +13.6% YoY to +MYR90.0b; Jan-Nov 2016: -4.9% YoY to +MYR79.2b). Latest available data showed USD8.8b export earnings repatriation between Dec 2016 and Nov 2017 (Jan-Nov 2016: -USD0.5b), equivalent to 38% of trade surplus during the period (Fig 8-9).

- We reiterate our **long-standing bias that the Ringgit remains fundamentally undervalued.** Our fair value estimate (which takes into account interest rate differential, inflation differential, current account differential and reflation variables) puts USDMYR at 3.70 levels. We had previously said that Ringgit weakness was temporary and was not a reflection of underlying fundamentals (which remain intact). We believe stability is gradually returning to Ringgit as political/ contingent liability risk subsides, fiscal consolidation gains traction, oil prices continue to stabilize and uncertainty subsides. Solid underlying fundamentals and policies, backed by domestic demand, re-calibrated supportive budget (on a lower oil price assumption suggests flexibility in the fiscal space), relative stability in oil prices though some downside pressure exists, relative attractive yields in the MGS, stabilizing FX reserves to retained imports & short-term debt, accommodative monetary conditions (to support businesses) remain intact and should provide an anchor for MYR stability once short-term noises subside. We believe USDMYR range of 3.80-3.90 is likely to remain relatively sustained for 1H 2018 before potentially moving to a 3.60-3.80 range in the second half of 2018, on the back also in part from USD dynamics.

- **Growth and Inflation Outlook**: Continued 5%-plus real GDP growth for Malaysia (2018E: +5.3%; 2017E: +5.8%), driven by continued growth in private consumption (2018E: +6.5%; 2017E: +7.0%), public consumption (2018E: +5.8%; 2017E: +5.1%) and gross fixed capital formation (2018E: +6.6%; 2017E: +7.5%) on expansions in both private investment (2018E: +9.0%; 2017E: +9.5%) and public investment (2018E: +1.5%; 2017E: +3.5%). These reflect Budget 2018's consumer spending stimulus measures and increased Government spending, as well as progress and rollout of major infrastructure and investment projects as the country heads for the 14th General Election which we see taking place between Feb 2018 and Apr 2018. Exports (2018E: +4.9%; 2017E: +8.8%) and imports (2018E: +5.7%; 2017E: +11.0%) of goods and services will expand further in 2018 on the back of the sustained global and domestic growth momentum, but the paces are expected to moderate after the high base in 2017.

- Industrial production growth eased to +4.2% YoY in Oct-Nov 2017 (3Q 2017: +5.9% YoY) on slower growth in manufacturing (Oct-Nov 2017: +5.4% YoY; 3Q 2017: +7.1% YoY) and mining (Oct-Nov 2017: +0.5% YoY; 3Q 2017: +2.5% YoY) amid steady growth in electricity (Oct-Nov 2017: +4.3% YoY; 3Q 2017: +4.4% YoY). Other key indicators also moderated in Oct-Nov 2017 e.g. deceleration in retail trade index (Oct-Nov 2017: +8.5% YoY; 3Q 2017: +10.4% YoY) pointing to slower real private consumption growth in 4Q 2017; slower growth in volumes of exports (Oct-Nov 2017: +11.4% YoY; 3Q 2017: +14.1% YoY) and imports (Oct-Nov 2017: +12.8% YoY; 3Q 2017: +13.3% YoY) suggesting moderation in 4Q 2017 real exports and imports of goods and services. The notable exception is the surge in palm oil output (4Q 2017: +22.8% YoY; 3Q 2017: +8.9% YoY), implying faster agriculture sector growth in 4Q 2017. Overall, this is consistent with our full-year 2017 real GDP growth estimate of +5.8% (Jan-Sep 2017: +5.9%), which priced in slower 4Q 2017 (3Q 2017: +6.2% YoY), followed by +5.3% growth in 2018.

- Underlying inflation, as measured by core inflation, remains moderate. Headline inflation is expected to average lower on expectations of smaller effect from global cost factors. Stronger ringgit exchange rate will mitigate import costs. Global energy and commodity prices expected to trend higher. Dependent on future global oil prices which remain highly uncertain.

- Inflation in Dec 2017 inched up to +3.5% YoY (Nov 2017: +3.4% YoY) on firm fuel and food prices while core inflation remained at +2.2% YoY (Nov 2017: +2.2% YoY). For full year 2017, inflation rate was +3.7% (2016: +2.1%) while core inflation was +2.4% YoY (2016: +2.4%). Maintain our 2018 headline inflation forecast at 2.5%-3.0%. 2017: Higher headline but stable core inflation Headline inflation rate inched up to +3.5% YoY in Dec 2017 (Nov 2017: +3.4% YoY), contributed mainly by firm costs of “Transport” (Dec 2017: +11.5% YoY; Nov 2017: +10.8% YoY) and “Food & Non-Alcoholic Beverages” (Dec 2017: +4.1% YoY; Nov 2017: +4.0% YoY). Meanwhile, core inflation rate (excludes volatile food and energy prices as well as pricecontrolled/price-subsidised components of the CPI, including fuel prices) was steady at +2.2% YoY in Dec 2017 (Nov 2017: +2.2% YoY). For full year 2017, headline inflation rate substantially higher at +3.7% YoY (2016: +2.1%) while core inflation rate was stable at +2.4% YoY (2016: +2.4%).

- The recent jump in Brent oil price which briefly reached the USD70/bbl barrier in mid-Jan 2018 has again raised the prospect of upward inflationary pressure. Nevertheless, the based effect from uptrend in Brent price in 1Q 2017 at +51.8% YoY is expected to offset the impact from the recent crude oil price rise in 1Q 2018. As the based effect is expected to diminish in 2Q 2018, we could see upward pressure building up in headline inflation if Brent price stays firm at current level. **No change to our Brent crude oil price assumption at USD60/bbl for 2018, and maintain our 2018 headline inflation rate forecast range of 2.5-3.0% (official 2018F: 2.5-3.5%).**

- **Monetary Policy Forecast:** BNM raised the Overnight Policy Rate (OPR) by +25bps to 3.25% at its first Monetary Policy Committee (MPC) meeting of 2018, in line with our view of there being a +25bps hike this year, but the timing was earlier vs our view of a “post-election” hike. Maintain our view of single rate hike in 2018 unless there are upside surprises to growth and inflation vs our forecasts of growth and inflation moderation this year. While we have priced in a +25bps hike this year, it came earlier than we expected given our view of a “post-election” hike. The Monetary Policy Statement (MPS) described the hike as pre-emptive to ensure that the stance of monetary policy is appropriate to prevent the build-up of risks that could arise from interest rates being too low for a prolonged period of time. Global economic growth has strengthened further to become more entrenched and synchronized, and is expected to post faster expansion in 2018, in turn generating positive spillovers to the domestic economy. BNM sees inflation rate in 2018 to average lower on expectations of a smaller effect from global cost factors (2018E official: +2.5 to +3.5%; 2017: +3.7%) but acknowledges the risk to inflation coming from the trend in global crude oil prices.

- While the tone of the latest MPS implied the monetary policy is generally on "tightening" bias after the -25bps OPR cut in 2016 and the "neutral" stance in 2017, we continue to hold the view that this +25bps increase is the only hike for this year given our forecasts of moderating real GDP growth (2018E: +5.3%; 2017E: +5.8%) and easing inflation (2018E: +2.5% to +3.0%; 2017: +3.7%). Furthermore, stronger MYR alongside the interest rate hike means tighter monetary conditions, and the monetary policy normalization needs to balanced against the continued fiscal consolidation as the budget deficit is targeted to be lower at -2.8% of GDP (2017: -3.0% of GDP). What would prompt a change in our view would therefore be upside surprises in this year's real GDP growth, together with persistence in or upside risk to inflation, on top of aggressive and synchronized - rather than slow and unsynchronized - monetary policy normalization by the major central banks.

- **Latest Fiscal and External Balance Outlook**: In addressing the cost of living issues, Budget 2018 which was announced on 27 Oct 2017, increased the amount allocated for Subsidies & Social Assistance by +15.0% to MYR26.5b (2017E: -6.5% to MYR23.1b; 2016: -9.5% to MYR24.7b). These include for MYR3.9b subsidy allocation for cooking gas, cooking oil, flour, transportation, electricity and tolls as the total amount for cash handouts to lower income households (BR1M) is maintained at MYR6.8b. This was supplemented by the +2ppts cut in personal income tax rate targeted mainly for the middle income taxpayers and totaling MYR1.5b. There is also various other financial assistances for specific target groups e.g. special assistance of MYR1,500 for 1.6m civil service and MYR750 for Government retirees; set minimum pension of MYR1,000/month, benefitting more than 50,000 retirees with at least 25 years of service; financial assistances to rural households especially in the agriculture/plantation sectors and Orang Asli; schooling assistances and student book vouchers; GST exemption on local authorities' services and zero -rating of additional reading materials; abolish tolls on several highways; increase welfare payments for senior citizens and people with disabilities; extending the discounts on study loan (PTPTN) repayments until end - 2018; and establish 50 Kedai Rakyat 1Malaysia 2.0 (KR1M2.0) selling lower - priced five basic necessities (rice, sugar, oils, flour and cooking gas).

- Government may consider measures to ease the impact of higher global crude oil prices on inflation/cost of living if RON95 and diesel were to increase and remain above MYR2.50/litre for three consecutive months. While the measures were not specified by the Ministry of Finance, talks of re - introducing fuel subsidies and the lower grade petrol RON92 have surfaced. The risk of re-introducing fuel subsidies is the perception of the Government backtracking on fiscal reforms. Besides the effect on the retail prices of petrol and diesel, we estimated that every USD10/bbl rise in annual average crude oil price will boost Government oil&gas -related revenues (excluding Petronas dividends) by around MYR4b. The extra revenues can be used to enhance existing targeted cash handouts / financial assistance, namely BR1M which can be raised to accommodate the impact to lower income groups. The Government can also allocate additional fuel subsidies for the existing allocations provided to public and rural transportation (e.g. diesel subsides for buses; rural air transport in Sabah - Sarawak) and maybe even subsidising special fares for LRT/MRT during the period of above -MYR2.50.litre fuel prices, to further encourage usage of public transport and support the country's target to reduce carbon emissions.

- **Key domestic events and issues to watch:** BNM policy decision (7 Mar); Trade data (7 Feb); FX reserves (22 Feb); Industrial Production (9 Feb); CPI (21 Feb); Nikkei Malaysia PMI (2 Feb); GDP 4Q (14 Feb).
- **Technical Outlook:** USDMYR has seen a sharp decline of more than 5% since end-2017. Last seen at 3.8980 levels. Bearish momentum on monthly, weekly and daily chart remains intact. On the broad scheme of things (barring short term rebounds), we expect downtrend to continue. Next support at 3.8440 (2016 low), 3.8260 (50% fibo retracement of 2014 low to 2017 high). Resistance at 3.95.

IDR: Domestic & External Tailwinds Supportive

Forecast	1Q 2018	2Q 2018	3Q 2018	4Q 2018
USDIDR	13200 (13700)	13000 (13600)	12900 (13600)	12800 (13500)

Previous forecasts in parenthesis

- **Motivation for the FX View:** The IDR had been lagging its Asian peers in 2017. Since the first week of Dec though, the IDR shown signs of improvement, largely supported by carry trade plays. These carry trade plays have extended into 2018 as investors continue their search for higher returns in EM assets given that the US Fed is unlikely to aggressively hike rates in 2018. This has encouraged greater inflows into Indonesia assets, lifting the IDR higher, more than we have anticipated. So far in 2018, the IDR has gained 1.5% against the greenback. This was an improvement from the 0.7% decline for the whole of 2016.
- The strong gains in the IDR to date can undoubtedly be attributed to the strong inflows into its debt markets in the first week of 2018. Improving risk appetite as well as renewed interest in carry trades lifted both foreign demand for Indonesian assets. Foreign investors purchased USD26.95mn and USD621.25mn of equities and debt in the first week of Jan compared to USD190.20mn and -USD3.09mn respectively for the whole month of Dec 2017.
- We caution though that there could be some slowdown in inflows to Indonesian debt, though not necessarily a complete reversal of flows

as UST yields rise. The disfavor of the IDR as a carry trade could persist given the narrowing yield differentials between UST and Indonesian debt. This should weigh on Indonesia assets and the IDR in the quarters ahead. In addition, there are other risks to our IDR outlook, including the potential disruption to global trade from protectionist US policy that could moderate the synchronised export recovery. These risks are likely to diminish the attractiveness of the IDR carry trade and could potentially spur a sell-off in Indonesian assets.

- The IDR is also benefiting from the cyclical global recovery that has lifted demand for commodities such as oil, CPO and coal. The improvement in the terms of trade should lift exports, mitigating any drag from domestic consumption. This in turn should benefit the IDR. In addition, the healthy economic fundamentals, including improving current account deficit and fiscal discipline, should provide the impetus to accelerate President Jokowi's USD400bn infrastructure building programme.

- Domestically, the current account deficit (CAD) is poised to improve though some deterioration is expected in the near term as the government embarks on infrastructure building, while economic reforms are ongoing. BI does not expect the CAD to exceed 2.0% of GDP ahead. Note that the CAD can be attributed to capital goods import for infrastructure building, which should eventually lift potential growth higher. These have helped to keep the IDR supported amid external headwinds. Though real GDP is currently hovering around the 5% levels so far, but is expected to accelerate in 2018, aided in part by the two rate cuts by BI so far this year. In addition, the 15 reform/stimulus packages introduced so far that should help to cut red tape and liberalize rules that have been a drag on the economy. The government's infrastructure push, especially in the run-up to legislative and presidential elections in Apr 2019, should also be supportive of growth ahead.

- Note though that rising oil prices is also a double-edged sword as it could crimp the ability the government to spend on infrastructure building. The 2018 budget assumes oil prices at USD48/bbl and IDR94.53tn has been allocated to energy subsidies in 2018. Should oil prices hover at current levels (around USD68/bbl), the fuel subsidies allocated could rise towards the IDR100tn levels. This should be negative for the government's efforts to hold down the budget deficit in 2018 and should it affect the government's infrastructure spending, could hurt sentiments and mitigate the IDR's upmove. However, we believe that on the whole, the rise in oil prices above the government's budget assumption should prove to be positive for revenues and would mitigate the increase in energy subsidies.

- On the monetary policy front, our house views remain for the BI to remain on hold for now to allow growth to gain traction. Still with inflationary pressures building up as a result of the improvement in economic growth, we expect the central bank to normalise policy and raise rate sometime in 2Q 2018. This should be supportive of the IDR. We therefore remain positive on the IDR outlook in 2018.

- There is also the potential for an upgrade Indonesia's credit rating status by S&P in 2018. Coordinating Minister for Maritime Affairs Luhut Pandjaitan had suggested last year that S&P was planning to lift the credit rating to BBB from BBB- currently sometime this year. Finance Minister Sri Mulyani suggested that this potential upgrade could be due to the progress Indonesia has made on economic reforms, including paring its twin deficits – the fiscal and current account. An upgrade by S&P would be positive for the IDR as it should lead to a repricing of Indonesia assets, spurring greater inflows. We however do not expect a credit rating upgrade anytime soon with any such move to come on in the latter part of 2018.

- Compared to our fair value estimates for the IDR at 10850, the current level of the IDR is about 25% undervalued. This suggests that there is more room for further IDR gains amid improving domestic and global economic fundamentals.

- We revise downwards our USDIDR forecasts for 2018 to reflect the continuing inflow of foreign investment into Indonesian assets, particularly debt (underpinned by carry trade plays). These inflows have come amid a synchronous global export recovery that has been a boon to commodities and which has led to the appreciation of the IDR since early Dec. We expect the IDR to strengthen to 2018.

- We now expect the USDIDR to hover around the 13200 levels by end-1Q and then to 13000 levels by 2Q as BI tightens policy to anchor inflationary expectations. Thereafter we expect the pair to break below the 13000 levels to hover around 12900 and 12800 by end-3Q and -4Q 2018 respectively, helped by the acceleration in government spending in the run-up to the legislative and presidential elections in Apr 2019 amid the synchronous global recovery.

- **Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for Indonesia deteriorated slightly to 5.3 from 5.2. This should weigh on the intrinsic value of the IDR.

- **Growth and Inflation Outlook:** 4Q17 GDP will be released on 5 Feb and the economic growth momentum in 4Q is unlikely to be significantly different from the previous three quarters. So far in the first nine-months of 2017, the economy has expanded by 5.03% y/y. Growth outperformance is unlikely because household consumption is likely to be lackluster. Finance Minister Sri Mulyani expects household consumption to expand by 4.9-5% y/y in 4Q17, the same pace as the previous quarters. Declining car and motorcycle sales towards the end of 2017 appears to justify this claim. Car sales fell 4.6% and 2.1% y/y in Nov and Dec respectively, while motorcycle sales slipped 3.6% and 5.0% in the two months.

- Supportive of the economy though is likely to be external demand underpinned by the synchronized recovery in exports in the region. Exports growth moderated in 4Q, rising by 13.2% y/y vs. 24.1% in 3Q, while imports expanded by 20.2% in 4Q compared to 22.9% in 3Q. For the whole of 2017, exports and imports accelerated 16.2% and 15.7%, rebounding from the 3.4% and 4.9% decline seen in 2016. The healthy imports so far signals a pick up in consumption and investment spending ahead that could be a boon to the domestic economy in 2018

- Key to the economy in 2018 is the President's USD400bn infrastructure program that should not only bolster growth in the near term but also potential growth. Of the 245 projects in the pipeline, only 6 has been completed and a further 145 projects are under construction. This optimism in the economy has led BI governor Agus Martowardojo to project growth to come in at 5.1-5.2% in 2H 2017 compared to 5.01% in 1H. BI expects 2017 growth to remain within its 5.0-5.4% forecast range for the full-year before accelerating to 5.1-5.5% in 2018. Our economic team is not as sanguine even as they expect the government's fiscal push to drive growth for the rest of the year and into 2018, penciling full-year growth to come in at 5.07% for 2017. The team expects growth to accelerate to 5.30% for 2018.

- Headline inflation, which has slipped from the 4.0% levels in 1H 2017, is beginning to pick up again towards the end of 2017. Headline inflation rose 3.61% y/y in Dec, rebounding from the previous month's 3.3%. The jump in food prices to 1.26% in Dec from -0.49% in Nov was the main culprit for this reacceleration in headline inflation. Core inflation though moderated to 2.95% y/y in Dec after hovering above the 3.0% levels in the Aug-Nov period. For the full-year, headline and core inflation averaged 3.8% and 3.1% in 2017 compared to 3.5% and 3.4% in 2016. Going forward, we believe that the government's efforts to improve food supply and control prices of key commodities via stricter monitoring could go some ways to keep food inflation down. Political considerations aside (given presidential and legislative elections in Apr 2019), we doubt that these will be sufficient to hold down food prices, which should keep consumer prices under upside pressure. To keep inflation at bay, the BI may have little choice but to hike its policy rate at least once in 2018 and that should help lower inflationary pressures. The team expects headline and core inflation to average 3.52% and 2.82% in 2018 respectively. BI's inflation target range is 2.5-4.5% for 2018, lower than 2017's 3.0-5.0% target range.

- **Monetary Policy Forecast:** After cutting its benchmark 7-day reverse repo rate twice by 25bp each time in 2017, BI has discovered that it has little room left to cut rates to encourage credit growth and hence expansion in the economy. The benchmark policy rate is currently at 4.25% with the deposit and lending facility rates at 3.50% and 5.00% respectively. The interest rate corridor was maintained at 75bp on either side of the policy rate. According to BI governor Agus Martowardojo, policy rate at 4.25% was appropriate to maintain stability and help accelerate economic recovery. Nevertheless, our house view remains for the BI to embark on a 25bp rate hike sometime in 2Q 2018 to stem inflationary pressures and to maintain macroeconomic and IDR stability.

- In the meantime, with the window for policy rate adjustment (i.e. further rate cuts) arrowing as warned by Governor Martowardojo, the focus will instead turn to macro-prudential measures to tackle issues like inflation and credit slowdown instead. A recent measure rolled out by BI was lowering the daily minimum primary reserve requirement ratio (RRR) to 4.5% from 5.0% as long as the average for the two-week period is at least 6.5% (starting 16 Jul). Other macro-prudential measures could be rolled out by the central bank "soon".

- **Latest Fiscal and External Balance Outlook:** The unaudited budget deficit clocked in at 2.57% of GDP in 2017, in line with expectations for 2.6%. This compares with the 2016 budget deficit of 2.49% of GDP. The total revenue collected in 2017 was around IDR1.66tn (95.4% of the revenue target set by the government). Government spending totaled IDR2.0tn or 93.8% of target. The budget deficit for 2017 is slightly higher than the 2.42% projected by our economic team. For 2018, the team expects the budget deficit to widen further to 2.5% of GDP as spending of President Jokowi's infrastructure programme accelerates.
- Latest data showed that the current account deficit (CAD) is improving. The CAD narrowed to USD4.34bn (or 1.65% of GDP) in 3Q 2017 compared to the USD4.83bn deficit (or -1.91% of GDP) recorded in 2Q. The narrower deficit can be attributed to the rise in the goods and services surplus of USD5.30bn (2Q: USD4.83bn). The BI expects the trade surplus to come in at USD20bn in 2017 and this implies that we could see the CAD narrow further in 4Q. For the full-year, the BI does not expect the CAD to exceed 2% of GDP in 2017, while it projects a slightly wider current account deficit in 2018 due to the ongoing domestic economic recovery at 2.0-2.5% of GDP. In the same view, our economic team expects the CAD to widen to about 2.2% of GDP in 2018.
- **Key domestic events and issues to watch:** 4Q 2017 GDP will be released on 5 Feb, while BI will consider its policy options again on 14 Feb before releasing their decision on 15 Feb. Campaigning for local elections, including Bali governorship and Acheh mayoralship due on 27 Jun 2018, will begin in earnest on 15 Feb and end 24 Jun.

PHP: Healthy Domestic Fundamentals To Save The Day!

Forecast	1Q 2018	2Q 2018	3Q 2018	4Q 2018
USDPHP	51.00 (52.00)	50.50 (51.80)	50.50 (51.50)	50.00 (51.00)

Previous forecasts in parenthesis

- **Motivation for the FX View:** The PHP continues to lag behind its ASEAN and Asian peers. Though the synchronous cyclical economic recovery remains a driver of PHP strength in 2018, the deterioration in the current account remains an albatross around the PHP and is mitigating gains. Year-to-date, the PHP has dipped 2.5% against the USD, the worst performing currency in ASEAN as well as in the Asian FX space.

- Key to the underperformance of the PHP is the country's current account. Unlike its ASEAN peers where there are current account surpluses (Singapore, Malaysia and Thailand) or at least the current account deficit (CAD) is improving (Indonesia), the Philippines' CAD has been deteriorating. The BSP expects the CAD to rise markedly to USD700mn in 2018 from USD100 last year. The aggressive push in the government's ambitious PHP8tn infrastructure programme that includes roads, railways, bridges and airports should result in greater capital imports should push the current account deeper into deficit in 2018 consequently. This should weigh on the PHP.

- Concerns about the worsening current account deficit intensified with the record trade deficit of USD3.8bn in Nov (Oct: -USD2.8bn) (Chart 2). This was the result of imports rising at a faster pace of 18.5% compared to the 1.6% rise in exports. In addition, the weak overseas remittances in Nov, which rose by 2.0% y/y after rising by a stronger 8.4% in Oct, increased expectations that remittances is unlikely to lessen the current account deficit. More importantly, the positive effects from remittances should fade in 1Q 2018 as seasonality factors appear to weigh on remittances in the first quarter. Elevated oil prices are also likely to see oil imports rise in value terms given its oil-importing status and this should worsen the current account deficit. These concerns weigh on the PHP and should keep the USDPHP elevated above the 50-levels in 2017.

- Also weighing on the PHP is the perception in the market that the BSP could fall behind-the-curve in curbing inflationary pressures. After hovering below the 2.0% levels for the past two years, inflation has averaged 3.2% for the whole of 2017. Recent comments by the BSP governor suggest that the central bank is in no hurry to raise interest rates and this is contributing to the weakness in the PHP currently. More recently, BSP Deputy Governor Diwa Guinigundo suggested that there was no reason for the central bank to tighten monetary policy given ample liquidity. This triggered a sell-off in the PHP which sent the USDPHP back above the 51-levels. In the absence of monetary policy support and jawboning by the central bank, market is likely to remain short-PHP for the considerable future.

- These concerns though could be overdone. There are factors that could prove positive for the PHP in 2018, including tax reforms. The tax reforms starting 2018 should kick-start the next phase of investment-led growth. Even though there is doubt over the amount that would be generated by the tax reform, the push ahead with the infrastructure projects is not in doubt. This should lift investor confidence and spur both portfolio and FDI inflows that should be supportive of the PHP.

- In addition, inflows into the stock market could pick-up in 2018 according to our analysis using the Cyclical Adjusted P/E (CAPE) ratio model. Our estimates suggest that domestic equities are relatively cheap (as reflected by the estimated P/E ratios minus their 10-year average P/E ratios) compared to its regional peers. Greater inflows should lift the PHP higher. Already we have had a relatively good start to the year with foreign investors purchasing USD90.5mn of equities which should be supportive of the PHP.

- Despite recent rhetoric by the central bank, we continue to expect the BSP to hike rates twice by 25bp each in 2018 as inflation is likely to edge higher. Despite the recent comments by BSP governor Espenilla and Deputy Governor Guinigundo (as discussed above), we believe that the central bank stands ready to act preemptively to lift rates if prices climb beyond the BSP's comfort zone. Rate hikes, possibly in 2Q and 3Q, should be positive for the PHP.

- We maintain our forecast for the USDPHP to end 1Q 2018 around the 51-handle before edging lower towards 50.50 by end-2Q and -3Q 2018 on stronger domestic economic fundamentals and the two BSP rate hikes before settling to around the 50-handle by end-2018.

- Our monthly **Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, deteriorated to 5.1 from 4.9. This should weigh on the intrinsic value of the PHP.

- **Growth and Inflation Outlook:** The Philippine economy softened slightly in 4Q 2017 to 6.6% after roaring to a revised 7% in 3Q. The drag to 4Q growth came from net exports where imports outpaced export. At the same time, investment remained lackluster as it did for the past two quarters. Investment had risen by single-digits since 2Q 2017, a marked slowdown from the double-digit growth in 2015. Thankfully, government expenditure and private consumption (4Q: 6.1% & 14.3% y/y; 3Q: 5.3% & 8.3%) expanded strongly to lift overall growth. Going forward, favorable demographics and job market conditions, sustained by overseas remittances should provide the impetus to growth in 2018. These together with the synchronous global recovery should be supportive of growth ahead. Economic growth could get another leg up should the planned PHP8tn infrastructure programme accelerate in 2018. Our economic team has penciled in growth of 6.5% for 2018.

- Headline inflation ended the year at 3.3% y/y in Dec – the same pace as in Nov. Core inflation though eased to 3.0% y/y (Nov: +3.3%). The rise in food prices was largely offset by the slower increases in housing costs, helping to keep inflation steady in Dec. For the whole of 2017, headline and core inflation averaged 3.2% and 2.9% y/y respectively. Our economic team expects inflation to average 3.4% in 2018 and 3.2% in 2019. This forecast is well-within the official inflation target rate of 2-4% for the period 2018-2020. Upside risk from rising commodity prices, namely crude oil, are expected to be offset partially by the high base effects in late 2016. In addition, inflationary pressures could also come from the tax measures introduced at the beginning of the year. Some of the tax measures introduced were tax increases on fuels and excise tax on sugar-sweetened beverages. Our economic team has already priced in the impact from these measures into their inflation projections.

- **Monetary Policy Forecast:** The BSP will meet to decide on monetary policy on 8 Feb for the first time in 2018. Since the introduction of the interest rate corridor framework on 3 Jun 2016, the key policy rate – the overnight reverse repurchase rate – has been left unchanged at 3.0%. The overnight lending rate and overnight deposit rate were also left unchanged at 3.5% and 2.5% respectively, leaving the interest rate corridor symmetrical on either side of the policy rate by 50bp. The reserve requirement ratio (RRR) was also kept steady at 20%.

- Recent comments by BSP Governor Nestor Espenilla suggested that the central bank was in no hurry to raise interest rates. This was followed by an even more recent comment by BSP Deputy Governor Diwa Guinigundo that suggested that there was no reason for the central bank to tighten monetary policy given ample liquidity. Nevertheless, we do not think that these statements precluded any rate adjustment this year. As reiterated by BSP Governor Espenilla, the authorities stood ready to act preemptively if indications emerged that domestic prices would rise beyond levels deemed acceptable by the BSP. Thus, it would appear that future rate adjustments by the BSP would be data-dependent. Our economic team expects the BSP begin its tightening cycle in 2018 with two 25bp rate hikes penciled-in in 2018 to temper inflation pressures that are expected to edge higher this year.

- **Latest Fiscal and External Balance Outlook:** The tax reforms implemented at the start of the year is not expected to the last. The government plans to introduce three more bills to reform taxes this year. A measure to lower corporate income taxes and streamlining incentives to companies has been sent to Congress for consideration this month. In addition, the government expects Congress to pass a bill in 1Q that puts in place estate tax amnesty, general amnesty, motor vehicle user tax, and the relaxation of bank secrecy and automatic exchange of information. The passage of these bills will help to increase much need revenue of about PHP786bn in five years that could be used to finance the President's ambitious infrastructure building programme. It would also allow the government to maintain its deficit target of 3% of GDP through 2022 without having to cut spending. Already the recent tax changes are expected to generate around PHP89.9bn of revenue or 0.5% of GDP this year.

- The BoP ended 2017 with a surplus of USD917mn in Dec, the first surplus in three months and the largest on record since Feb 2015. Still, the strong year-end performance was not able to offset the short-fall recorded for the rest of 2017. The BoP remained in deficit for the second straight year at USD862.7mn, larger than the deficit of USD420.1mn recorded in 2016. This was lower than the BSP forecast of USD1.4bn. According to the BSP, the strong performance in Dec could be attributed to the central bank's FX operations, national government's deposits, and income from BSP's investment abroad. The full-year deficit was largely due to the trade deficit in the first 11 months of 2017 of USD25.7bn, on track to overtake the 2016 deficit of US26.7bn, as well as foreign portfolio outflows of USD205mn for the whole of 2017 (vs. 2016's inflow of USD404mn). For 2018m, the BSP expects the BoP deficit to hit USD1bn (due to the expected reversal in the financial account to a small deficit), while the current account is projected to widen to USD700mn (due to faster goods import growth compared to exports) from the expected deficit of USD600mn in 2017.

- **Key domestic events and issues to watch:** BSP will meet for the first time in 2018 to decide on monetary policy on 8 Feb. With BSP's decision data-dependent, market will also be watching closely CPI data out on 6 Feb and overseas remittances on 15 Feb for clues on the state of the economy.

- **Technical Outlook:** USDPHP was one of the few USD/AXJs that traded higher for the month of Jan, unlike most USD/AXJs. Pair was last seen at 51.34 levels. Weekly momentum remains bullish. Next resistance at 52.20 levels (upper bound of bullish trend channel formed since 2013). Support seen at 50.50 (50 DMA), 50 levels.

THB: A Year Of Two Halves

Forecast	1Q 2018	2Q 2018	3Q 2018	4Q 2018
USDTHB	31.00 (34.00)	31.00 (33.70)	31.50 (34.00)	32.00 (34.50)

Previous forecasts in parenthesis

- **Motivation for the FX View:** The THB continues to be among the best performing currency in ASEAN after the MYR. Supporting the THB higher have been its strong economic fundamentals as well as the synchronous global and regional recovery. Key among its healthy fundamentals is its persistent current account surpluses that continue to support the THB. Thailand is one of only two ASEAN economies (the other being Singapore) with a persistent and double-digit surplus in its current account (10.9% as of Sep 2017). This makes its assets more attractive to foreign investors, encouraging greater portfolio inflows and provides support to the THB against possible headwinds. Year-to-date, the THB has appreciated by around 3.7% against the USD. This comes after the THB had gained nearly 10% in 2017. Not surprisingly, the USDTHB has touched new multi-year lows of 31.277 (26 Jan) and is currently hovering around the 31.300-levels.

- Like the rest of its ASEAN peers, the THB has also been supported by the synchronous global cyclical recovery that has boosted its exports. More importantly, there is a high correlation between private investment and trade, and this current economic cycle should provide the economy and hence the THB with another leg up. At the same time, the government's push to implement its infrastructure projects including the USD47bn Eastern Economic Corridor could deliver upside surprises to domestic demand and growth. The investment-led recovery should be a boon for the THB.

- Expectations that growth will continue to outperform expectations in 2018 and persistent current account surpluses could spur further foreign portfolio inflows into Thai assets. Latest data showed that foreign investors have purchased USD2.44bn in debt so far in 2018 even as they sold USD0.1bn of equities. Further inflows into Thai assets in 2018, particularly to debt, should be supportive of the THB.

- We do not expect this THB strength to continue unabated in 2H 2018. This is because we expect political headwinds to weigh on the THB. The current calm in the political arena is expected to give way to political upheaval as simmering tensions could resurface once the ban on political activities is lifted in the lead-up to the election, tentatively scheduled for Nov. Tensions are expected to boil over on concerns that the political arena could be dominated by the military and the elites for the foreseeable future.

- The actual date for the election will be announced in Jun when the organic laws governing the election process is passed. The National Legislative Assembly had recently suggested that the election could be delayed to either later 2018 or early 2019 as it needs time to amend changes to the draft organic laws before it. Delays to the general elections are likely to raise political temperature even more and create further uncertainty in 2H 2018. This could keep investors on the sidelines until political uncertainty dissipates. Such political concerns are likely to put downside pressure on the THB in 2H 2018.

- The THB is likely to benefit from the synchronised export recovery that is likely to spark a revival in private investment in Thailand and from the government's push to accelerate its infrastructure spending programme. We have revised our USDTHB forecasts to reflect this and expect the USDTHB to end 1Q and 2Q 2017 around the 31.00 levels. In 2H 2018, rising political tensions ahead of general elections (for now expected in Nov) is likely to weigh on the THB and keep the USDTHB elevated at around the 31.50 and 32.00 levels by end 3Q and end-2018. Thus, we remain positive on the THB in the first half of 2018 but are bearish on the THB in 2H 2018.

- **Our Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for Thailand improved to 4.1 from 4.4. This should be supportive of the intrinsic value of the THB.

- **Growth and Inflation Outlook:** GDP had surprised on the upside in 3Q 2017, expanding by a faster 4.3% y/y (2Q: 3.9%). This outperformance so far was underpinned by a pick-up in exports and booming tourism, fueled by the synchronised global recovery. The Ministry of Finance expects full-year growth to come in at 4 .0% in 2017, suggesting that 4Q17 growth could come in a stronger 4.7%, likely supported by steady gains in private consumption and public investments in the wake of synchronised global recovery and government infrastructure building. Latest data showed industrial production edging higher by 4.2% y/y in Nov, while capacity utilization rate rose to 64.2% in Nov. Mfg PMI for Dec also rose to 50.4 (Nov: 50), pointing to continued healthy growth in 4Q17. In 2018, the government remains optimistic about growth prospects. Government spending ahead of the general elections together with planned infrastructure building projects including transport networks and the Eastern Economic Corridor is expected to lift growth further. In addition, the export-led recovery last year should spark a revival in private investment that should sustain growth in 2018. The government expects GDP growth to come in at 4.2% in 2018. This is because of the high correlation between export recoveries and machinery & equipment investments for Thailand. Our economic team expects full-year growth to come in at 3.8% and 4.0% in 2017 and 2018 respectively. We caution though that the strong THB since late 2017 could weigh on exports and boost imports.

- Headline inflation moderated to 0.78% y/y in Dec after accelerating in the previous four months. Weighing on consumer prices in Dec was transport cost, which rose by just 1.32% y/y in Dec, moderating from Nov's 2.54%. On the other hand, food and oil prices kept the inflation elevated. Core inflation rose by 0.62% in Dec, almost the same pace as in Nov. For the whole of 2017, headline and core inflation rebounded, rising by 0.7% and 1.0% respectively vs. 0.2% and -1.3% in 2016. Headline inflation though remained well below the BoT's target of 1-4%. Our economic team expects inflationary pressures to edge higher in 2018, fueled by higher energy/fuel prices, minimum wage increase and improving domestic demand. This should allow inflation to average 1.6% in 2018. The BoT expects headline inflation to average 1.1% in 2018, underpinned by rising oil prices.

- **Monetary Policy Forecast:** The BoT has maintained the status quo on monetary policy since Jun 2015. The policy rate - the one-day repo rate - has been held steady at 1.5%. The last time the policy rate was even lower was during the Great Financial Crisis in 2009 at 1.25%. The current environment of economic recovery amid a modest inflationary environment has enabled the BoT to keep its policy rate at current levels. Though inflation has so far remained benign, our economic team expects inflationary pressures to pick-up in 2018 as discussed above amid improving economic environment and could prompt the BoT to normalise policy. Any moves by the BoT to normalise policy could take place in 2H 2018.

- The strength of the THB to date has increased the angst of officials and exporters. Steps have been taken or planned to curb the strength of the THB. Already, the BoT has increased the size of the maximum international money transfer allowed each customer for non-commercial bank businesses from THB200000 per day to THB800000. In addition, the BoT governor Veerathai Santiprabhob had warned that the central bank was planning to investigate companies that have operations in Thailand for speculative activities. Other measures that could be under consideration include reducing the supply of bond issuances, particularly short-dated ones, in 2018. Nevertheless, capital controls are unlikely to be used to curb speculative activities. According to Monetary Policy Committee member Kanit Sangsubhan, the preference is to use market-based responses such as purchasing of USD than to impose capital controls like in 2006. This should bring relief to market participants who had anticipated harsher measures after BoT governor's warning.

- **Latest Fiscal and External Balance Outlook:** The government's planned budget for FY2019 will focus on infrastructure building, particularly the USD47bn Eastern Economic Corridor project. Total spending is projected at THB3tn and revenue of THB2.55tn for FY2019 that begins in 1 Oct. Of the THB3tn, THB600bn will be allocated for investment including the Eastern Economic Corridor. Consequently, the budget deficit is expected to increase to THB450bn in FY2019. In the meantime, the government is planning a supplementary mid-year budget of THB150bn that will include THB100bn financed by borrowing for government projects and THB50bn from revenues for the treasury reserves. The draft budget has been approved by the Cabinet and will head to the legislative assembly for approval in Jun.

- The current account surplus narrowed to THB125.96bn in Dec from THB173.03bn in Nov. The narrowing surplus was attributable to the smaller trade surplus of THB50.44bn in Dec vs. THB109.81bn in Nov that more than offset the higher services, primary & secondary income account surplus of THB75.52bn (Nov: THB64.22bn). Details on the financial account are currently not available, but the deficit in the overall balance of payments (BoP) of THB34.40bn in Dec (vs. THB74.55bn in Nov) suggests that the financial account could have recorded a large deficit in Dec. For 2017, the current account saw a surplus of THB1.67tn, slightly lower than the surplus of THB1.70tn in 2016.

- **Key domestic events and issues to watch:** BoT meets for the first time this year on 14 Feb to decide on monetary policy. We also have 4Q 2017 GDP estimates release on 19 Feb.

- **Technical Outlook:** USDTHB remains on a decline. Last seen at 31.34 levels (almost 5 year low). Bearish momentum on monthly and weekly chart remains intact. Trend remains your friend. Sustained price action below 31.65 (61.8% fibo retracement of 2013 low to 2015 high) could see the pair trade lower towards 30.47 levels (76.4% fibo).

INR: Voter-friendly Budget Could Weigh

Forecast	1Q 2018	2Q 2018	3Q 2018	4Q 2018
USDINR	64.50 (66.00)	63.50 (64.50)	63.00 (65.00)	62.50 (65.00)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** Finance Minister Arun Jaitley will present the Union Budget 2018 on 1 Feb (tomorrow). We see downside risks to the INR as the government is likely to prioritize the May 2019 elections rather than press forward with its fiscal consolidation endeavors after the success of major reforms seen in the years before. In other words, the upcoming budget could be more appealing to voters than to the investors. In fact, the sell-off in the sovereign bonds has already started ahead of the budget with the sovereign curve bear steepening significantly in the past five days as investors become concerned that India's credit rating could be at risk. With the budget likely to be expansionary, it is also likely for RBI to be wary of inflationary pressure. However, RBI might want to wait for the transmission of the previous rate cuts to feed into the economy and the positive growth impact of the bank recapitalization plan to come through before it starts to hike rates. As such, we look for the central bank to only start its hiking cycle in the second half of the year. In the meantime, expect some upside to the 1m USDINR NDF in the near term towards 65 levels as we look for mild USD strength and possible investor disappointment in the budget and rising crude prices that could widen its current account deficit. For the rest of the year, INR could strengthen against the USD but we see a milder appreciation in the rupee vs. the rest of the regional peers given election uncertainties.

- Note that 2018 is a busy year for state elections. For Feb, the state of Tripura will hold elections on 18 Feb, while state of Nagaland and Meghalaya on 27 Feb. Election results will be released on 3 Mar. Jitters would arise in states of Tripura and Meghalaya, as parties of the BJP's NDA coalition would be running against current ruling parties of the United Progressive Alliance (UPA) coalition of Congress.

- **Our Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) worsened to 5.0 (vs. 4.6 in Oct) as the deterioration in the score for inflation, fiscal and population offsets the improvement in that of GDP.

- **Growth and Inflation Outlook:** Leading indicators suggests that growth could pick up. IP quickened to 8.4% y/y in Nov from 2% y/y in Oct, surpassing the average forecast of 4.4%. Manufacturing PMI also rose to 54.7 for Dec. Real GDP accelerated from 5.7%y/y to 6.3% in 3Q last year, while GVA sped to 6.3% from 5.7%. Both prints were below consensus. Growth forecast for the year appear to be still sanguine with India's Chief Economic Advisor projecting nominal GDP growth to be at 10.5% for 2018, real GDP to be at 6.5%. The bank recapitalization programme would also support credit growth in order to spur lending and investments.

- CPI rose to 5.21% y/y in Dec, compared to estimated 5.1% y/y and 4.88% y/y in Nov. Core inflation is at 4.91% y/y, which has been rising since its trough in Jun 2017. Housing and food inflation kept CPI prints higher for the month of Dec. We note that oil prices remained around $60-70/bbl levels for most of Jan. The sustained high oil price could see inflation print for Jan to be higher than previous month. With inflation rising above the 4% median target, the RBI is likely to turn hawkish this year.

- **Monetary Policy Forecast:** Watch for RBI rate decision on 7 Feb. RBI kept repo rates steady at 6.00% in Dec, reverse repo at 5.75% and cash reserve ratio at 4.00%. 5 out of 6 MPC members voted for maintaining status quo. Dr Ravindra, the 1 member who voted for a rate cut, was concerned about economic recovery. After the RBI cut reverse repo and repo rates last Aug, further easing seem unlikely as we see inflation at risk of overshooting median targets. Minutes of the last Monetary Policy highlighted concerns on housing, oil, and food prices and that "*the moderation in inflation excluding food and fuel… has reversed*". The MPC also saw risks of an extension in the upward trajectory of inflation. That said, rate hikes may only happen in the second half of the year given the fact that recent growth numbers have been softer than expected. The government's advance estimate of FY2018 GDP is 6.5% compared to 7.1% in the year prior. While this is broadly in line with consensus, downside risks to demand may mean that the RBI would prefer to act with more evidence of growth stabilization. In fact, a steady rate policy could be still be stimulating to the real economy. With inflation likely to inch higher, a fall in real borrowing cost could be supportive of the manufacturing sector.

- **Latest Fiscal and External Balance Outlook:** Key focus in Feb will be the 2018 Budget release on 1 Feb, the last budget before the 2019 elections. Our Maybank India analysts anticipate difficulty in the government to walk an impossible trinity, namely 1) meeting the fiscal deficit target of 3.2-3.3% for FY18/19 to maintain India's credit rating, 2) cut corporate tax rates to boost the manufacturing sector and infrastructure as well as 3) accommodating loan waivers to farm sectors in anticipation of state elections. The government has to choose between getting more votes and gaining investors' confidence. Our analysts noted the possible reinstatement of long-term capital gains tax which could be taken negatively by investors. Although prospects of improved GST collection and government asset sales could support revenue, expect a pause in fiscal consolidation efforts. That could actually see USDINR reverse higher.
- With brent around $70/bbl levels, India's current account balance is at risk. Current account deficit has narrowed to just 0.6% of GDP in 2016 but for 2018, expectations are for it to widen to around -1.7% according to survey by Bloomberg. The government announced a cut excise tax on on petrol and diesel by 2 rupee per liter (3 Oct 2017). That could risk further deterioration in the fiscal deficit.
- From latest available data, current account deficit narrowed to $7.2bn in 3Q 2017, from $15bn in 2Q 2017. On the other hand, financial account recorded lower inflows of $6.9bn for 3Q 2017 from previous 2Q 2017 $14.3bn. Trade deficit also widened to $14.9bn in the month of Dec. Expect India's trade deficit to persist as high oil prices in Jan translates into India's import bill.
- **Key domestic events and issues to watch:** Union Budget of India, Mfg PMI (1 Feb); Svcs & Comp. PMI (5 Feb); RBI rate decision (7 Feb); CPI, IP (12 Feb); Wholesale Prices (14 Feb); Trade Bal (15 Feb); Fiscal Deficit, 4Q GDP, GVA (29 Feb).
- **Technical outlook:** The 1M USDINR NDF was stuck in a holding pattern for a while, last priced at 63.94. In the past few years, the Union Budget has been positive for the rupee as the government had been bold in its reforms and prioritizes its fiscal improvement. This year could be different as the government had delivered major initiatives in the past year and focus might turn to the May 2019 elections. With inflation risks rising, fiscal policies could be a little more expansionary as we look for more allocation of the budget to the farm sector. 1M NDF is showing bullish divergence vs. the MACD. We see risks of this pair towards 64.80 before 65.15 and 66.20. Support is seen at 63.50.

VND: Not Going Anywhere For Now

Forecast	1Q 2018	2Q 2018	3Q 2018	4Q 2018
USDVND	22700 (22780)	22600 (22730)	22550 (22700)	22500 (--)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** USDVND has been stuck at levels around 22700. Fundamentals support the currency but SBV seems unwilling to allow VND to strengthen in tandem with its regional peers. As a result, the VND has become rather competitive, boosting its exports as a result. We see risks for VND to strengthen in the year ahead on the back of FDI and portfolio inflow. Exports growth could continue but trade balance has been waffling between deficit and surplus as imports growth is significant too. Overall, the current account surplus has been widening and that is dong positive. On Oct 23rd Prime Minister Nguyen Xuan Phuc, officially set a real GDP growth target 6.5-6.7% in 2018. Our Maybank Vietnamese analysts project a 6.4-6.8% growth. Given the global synchronized growth environment, expectations are for growth in Vietnam to steady from 2017. The rate cut unleashed last year should be the last in this easing cycle and plausible price pressure this year could keep SBV from doing further monetary easing. Inflation is also expected to accelerate at 4% on average. In a backdrop of weak USD, we see downside risks to the USDVND towards 22500 by the end of this year. In the nearer term, Feb is a month made all the shorter by Tet holidays. Expect the USDVND to remain steady at current levels in the absence of strong catalyst.

- **Growth and Inflation Outlook:** Growth surprised to the upside at 6.81%y/y for 2017 vs. the expected 6.75%. SBV had lowered the official deposit rates last Jul and that succeeded in propelling the growth of manufacturing, industry and construction sectors. In nominal terms, industry and construction jumped 13.3%y/y in 4Q from 9.8%. Manufacturing accelerated to 19.1%y/y from just 12% in the quarter prior.

- PMI-mfg rose to 52.5 in Dec from 51.4 in Nov. In the survey, Markit noted an acceleration of new orders, job creation and business confidence reached a nine-month high. Jan saw a sharp acceleration in industrial production to 20.9%y/y from previous 11.2% as growth in mining & quarrying rebounded, manufacturing and electricity grew 23.8% and 15.4% respectively. FDI momentum was rather strong in 2017 with a full year inflow recorded at U$21.3bn, 40.1% growth from U$15.2bn in 2016. With investment pouring into Vietnam, the country seems poised to sustain a rather high level of growth for the rest of 2018 should global economy continue to recover.

- Consumption is underpinned by a growing middle class in Vietnam, sizeable number of visitor arrivals and stable inflation. Retail sales for Jan eased to 9.5%y/y from 10.9% seen for the whole of 2017. We expect retail sales to average around 10% in 2018. We do see a risk of rising inflation this year. CPI rose to 2.65%y/y from previous 2.60%, on the back of prices of health and personal care sub-component. Healthcare is still a major driver of price pressures for Vietnam and we caution that food inflation could rise on the back of strong economic activity and currency weakness (against non-US trading partners).

- **Monetary Policy Forecast:** We do not expect any moves by State Bank of Vietnam this year after a rate cut made last Jul boosted growth in the industry, construction and manufacturing sector towards the end of 2017. However, this also comes at a price of greater debt in those industries. The credit outstanding grew to around 30% y/y for the trade, construction and industrial sector. Deputy Govenor said that the central bank will "manage credit growth in a flexible and cautious manner in order to help companies and boost economic growth, while still being able to limit risks in some business areas". As central banks in other parts of the world start to tighten, we see less room for further monetary easing this year and that could put a lid on growth.

- In terms of exchange rate, we see upside risks to the VND against the USD, in line with our expectations for broad USD weakness this year. On a trade weighted basis, VND is likely to have weakened against its trading partners in the past few months. That could fan inflationary pressures should price pressure pick up globally.

- **Latest Fiscal and External Balance Outlook:** Vietnam's fiscal position is likely to remain in consolidation mode as fiscal deficit remains wide. The National Assembly stated that the average state budget deficit planned is estimated to be 3.7% of GDP for 2018. Our Vietnam analyst projects 3.6% for this year. The government needs to fund state budget deficit of VND 206.15trn and pay principal loans of CNY157.13trn this year. The government aims to reduce budget deficit to 3.5% of GDP by 2020.

- Current account recorded a sizeable surplus of USD4.3bn (latest data available) in 3Q last year, improving from the previous USD0.27bn. This data comes from strong trading of goods in surplus of USD5.2bn. The widening current account surplus could continue to support the dong.

- **Key Domestic Events and Issues to Watch:** PMI Mfg is due 1st Feb; Domestic vehicle sales in 6th-13th; CPI, trade numbers, retail sales, IP are due 25th-28th. Vietnam is away for Tet from 14-20th Feb.

FX Forecasts

	End Q1-18	End Q2-18	End Q3-18	End Q4-18
USD/JPY	108	107	106	105
EUR/USD	1.2400	1.2500	1.2800	1.3000
GBP/USD	1.4200	1.4400	1.4800	1.4800
AUD/USD	0.8000	0.8150	0.8350	0.8500
NZD/USD	0.7100	0.7400	0.7500	0.7600
USD/SGD	1.2800	1.2700	1.2500	1.2400
USD/MYR	3.8000	3.8500	3.7000	3.6500
USD/IDR	13200	13000	12900	12800
USD/THB	31.00	31.00	31.50	32.00
USD/PHP	51.00	50.50	50.50	50.00
USD/CNY	6.25	6.20	6.20	6.10
USD/HKD	7.80	7.80	7.80	7.80
USD/TWD	29.10	29.00	29.00	29.00
USD/KRW	1060	1030	1020	1040
USD/INR	64.50	63.50	63.00	62.50
USD/VND	22700	22600	22550	22500
DXY Index	89.69	88.91	87.18	86.18
SGD Crosses	End Q1-18	End Q2-18	End Q3-18	End Q4-18
100 JPY/SGD	1.1852	1.1869	1.1792	1.1810
EUR/SGD	1.5872	1.5875	1.6000	1.6120
GBP/SGD	1.8176	1.8288	1.8500	1.8352
AUD/SGD	1.0240	1.0351	1.0438	1.0540
NZD/SGD	0.9088	0.9398	0.9375	0.9424
SGD/MYR	2.9688	3.0315	2.9600	2.9435
SGD/IDR	10313	10236	10320	10323
SGD/THB	24.22	24.41	25.20	25.81
SGD/PHP	39.84	39.76	40.40	40.32
SGD/CNY	4.88	4.88	4.96	4.92
SGD/HKD	6.09	6.14	6.24	6.29
SGD/TWD	22.73	22.83	23.20	23.39
SGD/KRW	828	811	816	839
SGD/INR	50.39	50.00	50.40	50.40
MYR Crosses	End Q1-18	End Q2-18	End Q3-18	End Q4-18
EUR/MYR	4.71	4.81	4.74	4.75
JPY/MYR	3.52	3.60	3.49	3.48
MYR/HKD	2.05	2.03	2.11	2.14
MYR/CNY	1.64	1.61	1.68	1.67
GBP/MYR	5.40	5.54	5.48	5.40
AUD/MYR	3.04	3.14	3.09	3.10
NZD/MYR	2.70	2.85	2.78	2.77
MYR/IDR	3473.68	3376.62	3486.49	3506.85
MYR/INR	16.97	16.49	17.03	17.12
MYR/KRW	278.95	267.53	275.68	284.93
MYR/PHP	13.42	13.12	13.65	13.70
CNY/MYR	0.6080	0.6210	0.5968	0.5984

Source: Maybank FX Research as of 31 Jan 2018

*These forecasts are meant to be indicative of FX trends and not meant to be point forecasts.

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