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Maybank

Macro | FX Research & Strategy

Global

FX Monthly

2019, Issue 1: Asian FX Window of Opportunity

What Has Changed This Month?

- We revised USD lower against most currencies including Asia FX and selected G7s to reflect an earlier than expected materialization of some factors including Fed pause, hopes of US-China trade deal, prolonged US government shutdown and China stimulus to support growth.
- We reiterate our view as shared in our Annual Outlook that 2019 will be a better year for Asian FX in the environment of benign inflation, moderate global growth, lower USD and as costs of funding stabilize.

Our Strategies

- Fed's monetary policy stance has shifted into "wait-and-see" mode, with *patience on rate hike* and *flexibility on balance sheet normalisation*. Our house view remains for 2 Fed hikes in 2019.
- An environment of (1) pause in Fed rate hike, (2) a relatively constructive outlook on US economic growth, (3) global inflation not at risk of overshooting most central bank's medium-term objectives (i.e. benign inflation) and (4) global growth 'neither hot nor cold' (global growth momentum slowing but not tanking) suggests a return to 'goldilocks' play and this typically favors short vol-long carry trades and risk-on FX proxies. On AXJ FX, we continue to favor higher-yielder FX including IDR, PHP, MYR. A material progress could further support risk-on sentiment and risk-on/RMB-sensitive FX such as AUD, NZD, AXJs including KRW at the expense of a softer USD
- We do however caution that ongoing US-China trade negotiations could still disrupt the risk-seeking play if there is no material progress. Outcome is expected sometime later today. On the other hand, a material progress could further support risk-on sentiment and risk-on/RMB-sensitive FX such as AUD, NZD, AXJs including KRW at the expense of a softer USD.
- In the near term, GBP gains could moderate and possibly even retrace towards 1.30 as brexit plan (initially agreed with EU) goes back to the drawing board. However we retain our cautious optimism on GBP beyond near term nuances. We argue that the distribution of risks have shifted away from a no-deal brexit (given that the House of Commons also voted in favor of Dame Caroline Spelman's amendment) to a delayed and softer brexit. Bias to accumulate GBP on dips and expect recovery towards 1.40 to take hold as brexit uncertainties recede.

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Top 3 Currency Plays for February

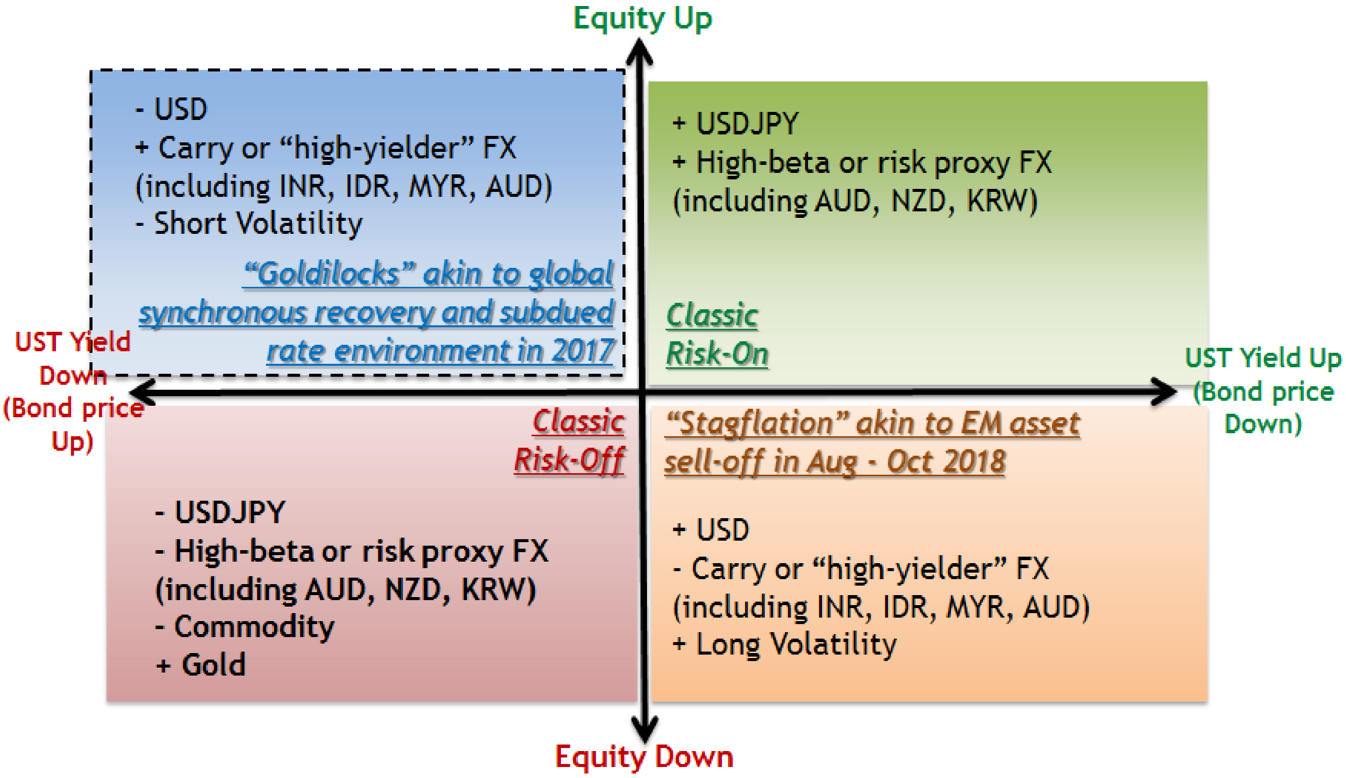
Long higher-yielder FX including IDR, MYR, PHP
Short DXY
Buy GBP on dips below 1.30

Key Events for the Month Ahead

Date	Event
1 Feb	India Budget
13 Feb	PM May to present proposal on Irish backstop
18 Feb	Singapore Budget
1 Mar	90-day US-China trade truce ends

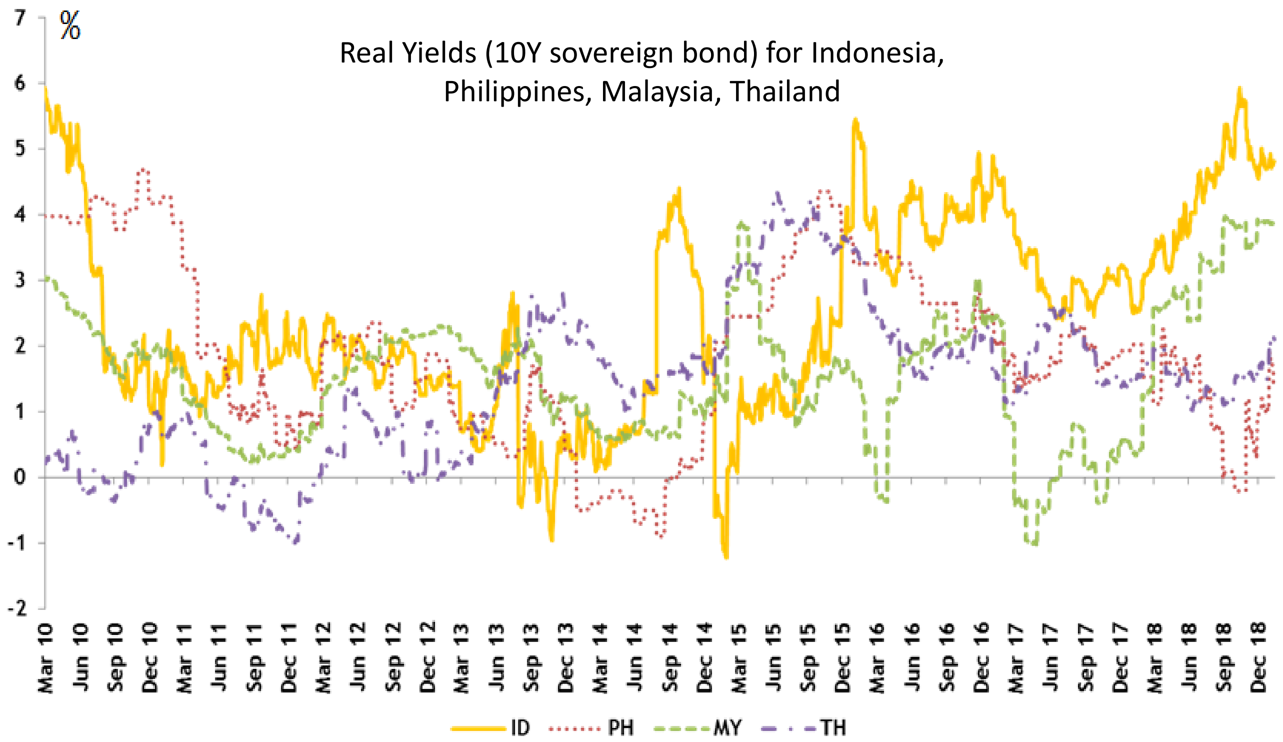
SEE PAGE 52 FOR IMPORTANT DISCLOSURES.

A Return of 'Goldilocks' Play?



Note: EUR and GBP were not included as idiosyncratic factors (political uncertainties at home) taking precedence over exogenous macro factors in driving the respective currencies

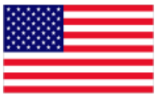
Yield Seeking Plays Support Gains in EM Asia FX including IDR, PHP, MYR and THB



Note: Real yields derived by subtracting headline CPI from bond yields

Source: Bloomberg, Maybank FX Research & Strategy

G7 Global Overview



USD: Growth Momentum Concerns

Forecast	1Q 2019	2Q 2019	3Q 2019	4Q 2019
USD Index	96.87 (99.16)	95.88 (96.39)	94.64 (94.64)	94.86 (95.40)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** We are pricing in a reduction of some support for the USD in 1Q 2019 on the back of an earlier than expected Fed rate pause and waning momentum from fiscal support. This sees our USD softness setting earlier in 1H 2019 as speculative USD longs are at risk of unwinding and fatigue sets in for USD bulls as EM risk premiums look overstretched. Towards the end of 2019, our baseline builds in some expectations of heightened concerns about weaker global and US growth intensifying thus leading to some level of global risk off, supporting the USD somewhat.

- In 2019, the key factors supporting a sell USD on rally are (i) the FED is near its end of tightening. With the Fed already 200bps up from its record low and neutral rate to be around 50-100bps away, the rate hiking cycle could be near its end. Policy normalization of central banks elsewhere could catch up with the Fed. (ii) US economic growth peaking soon; and (iii) US twin deficits in focus as treasury sees a surge in borrowing. Other 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 (USD typically underperforms when relative global growth momentum picks up).

- A fundamental factor is the Fed rate hike cycle. FOMC is not slated to hold any announcements in Feb after the Jan 31 meeting. We and consensus expect no change in the Fed Funds rate. The Fed will likely try to balance its still constructive view of the economy with its message of patience and prudence, with further softening of forward guidance while maintaining the tightening bias. These should not affect the benign market pricing for the rates path. For other majors, policy normalisations are still in their early stages (ECB, BoE) or may not have begun for most including RBA, RBNZ. We emphasize that policy divergence between the Fed and other DMs should slow and policy convergence could well be a thematic to position for into 2019. This should add to USD weakness. In addition, in the near term we could see month end flows supporting strong dollar selling versus most majors. However, the dollar has mildly bounced back vis-à-vis the safe haven currencies such as the JPY and most of its underperformance recently has been against the riskier G10 FX and EM.

- **Growth and Inflation Outlook:** Most data releases scheduled for January were postponed due to the government shutdown, which entered its third week. Most market participants have lowered their 4Q GDP by 0.1%. 4Q 2018 advanced estimate are expected to come in at around 2.5% q/q saar, a moderation from 3Q of around 3.4%. Growth is still driven by personal consumption expenditure and a substantial contribution from public consumption and investment. However private investment is likely to have seen a slowdown in momentum coupled with a drag from net exports.

- The Dec CPI inflation report was broadly in line with consensus expectations. Headline CPI fell 0.1% on the month and core CPI was up 0.2%m/m. The annual pace of headline CPI slowed to 1.9% (Nov: 2.2%), while core CPI was stable at 2.2%. The fall in the headline CPI was driven by energy commodities. This weakness in energy prices was as expected and will likely continue to be a drag on inflation in the coming months. But food prices were up 0.4% m/m and have been improving steadily suggesting that it is unlikely to be a significant headwind to headline inflation in 2019. Core goods inflation rose 0.1% m/m for the third consecutive print, driven by recreating commodities. Expect core goods inflation to continue improving modestly.

  Monetary Policy Forecast: Target fed funds rate(FFR) kept at 2.25%-2.50% at 2019's first FOMC. Post-meeting statements indicate Fed is flexible on its interest rate and balance sheet policies to reflect economic and market situations. **We are currently on the same page with Fed's guidance of up to two hikes totaling +50bps this year, but expect FFR to peak this year vs Fed's guidance of another +25bps hike in 2020. Fed's balance sheet reduction so far is slower than planned.**
  Although Fed continues to expect sustained economic growth, strong labour market and inflation around its 2% target, the latest FOMC statement removed the wordings "some further gradual increases in the target FFR". **Based on fed funds rate futures, market is currently pricing in no rate hike this year and the possibility of a cut next year.**

- The next FOMC meeting on 19-20 Mar 2019 takes place around several key events that can affect economic outlook and market movements i.e. the end of 90-day US-China trade war ceasefire on 1 Mar 2019; the re-instatement of US debt ceiling on 2 Mar 2019 (suspended since 9 Feb 2018) which risks worsening US political and fiscal gridlock following recent Government shutdown that is now temporarily re-opened until mid-Feb 2019; Brexit deadline on 29 Mar 2019. Fed will also present its quarterly FFR guidance and macroeconomic forecasts pertaining to its monetary policy mandate i.e. growth, inflation, unemployment. To note, all FOMC meetings this year are accompanied by Fed Chair's press conference vs quarterly previously.
- In a separate statement on "Monetary Policy Implementation and Balance Sheet Normalisation", Fed is prepared to adjust its balance sheet normalization policy as well as altering the size and composition of its balance sheet, depending on future economic conditions. As at 23 Jan 2019, Fed's balance sheet declined -USD407.5b to USD4,094.7b from USD4,502.2b at end-Sep 2017. Over the same period, Fed's

holdings of US Treasury securities fell –USD245.3b to USD2,220.1b from USD2,465.4b, while its holdings of agency debts and mortgage-backed securities dropped –USD143.6b to USD1,631.3b from USD1,774.9b. To note, Fed's balance sheet reduction since its start in Oct 2017 is progressing at a slower pace than the guidance of raising the run off rate by USD10b every three month from USD10b per month at the start of the programme in Oct 2017 until USD50b per month from Sep 2018 onwards, which should have resulted in a cumulative -USD540b balance sheet reduction to-date.

- Market chatters on Fed's balance sheet reduction has increased amid impact on liquidity and cost of funds. Based on the research paper "Measuring the Macroeconomic Impact of Monetary Policy at the Zero Lower Bound" (Wu & Xia, 2013) and Atlanta Fed's calculation of the Wu-Xia Shadow FFR, we estimated that the previous USD3.6tr Fed's balance sheet expansion had the equivalent effect of additional-360bps FFR cuts on top of the actual –500bps cuts in FFR. Simple arithmetic therefore suggests the current balance sheet reduction so far would have the equivalent effect of around +40bps "shadow" FFR hikes on top of the actual +225bps FFR hikes to-date.

- **Latest Fiscal and External Balance Outlook:** The portion of the shutdown at the end of Q4 will likely lead to some loss but we could see some of the loss in activity emerge in 1Q 2019 in the form of investment spending. Overall, growth in US economic activity is likely to slow toward trend as the impulse from the fiscal stimulus fades. The tax plan has not generated a sustained pickup in investment spending. The tax cut and Jobs Act are likely to widen deficit by about $1.5trn over 10 years. The bipartisan budget Act of 2018 to add $320mn in additional spending through FY 2020.

- **Key domestic events and issues to watch in Feb 2019:** NFP (1 Feb), ISM Manuf (1 Feb), Factory Orders, Durable Goods Orders (4 Feb, 27 Feb), Trade Balance (5 Feb), CPI (13 Feb), Retail Sales (15 Feb), GDB 4Q (28 Feb), Core PCE (28 Feb), Personal Consumption (28 Feb).

- **Technical Outlook:** DXY fell for the second consecutive month in Jan; last seen at 95.30 levels. Underlying momentum remains bearish, as shown on weekly charts. The move lower confirms the break-out of the rising wedge pattern. This is typically bearish and should see further downside ahead. Daily momentum has also turned bearish while stochastics is falling. 21DMA has cut 100 DMA to the downside, with 50 DMA likely on track to cut 100 DMA to the downside. These signals are typically bearish. Immediate support at 95.20 (200 DMA), 95 (2019 low). A decisive break below these support levels could open way for further downside towards 94 (38.2% fibo retracement of 2018 low to high), 93 levels (50% fibo). Resistance at 95.80/90 (21, 100 DMAs), 96.40 (50 DMA). Bias to play DXY from the short side. Bearish bias to be nullified if DXY closes back above 97.70..

EUR: Lack of Catalysts to Drive It Meaningfully Higher

Forecast	1Q 2019	2Q 2019	3Q 2019	4Q 2019
EURUSD	**1.1400** (1.1100)	**1.1500** (1.1400)	**1.1600** (--)	**1.1600** (1.1400)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** We expect EURUSD to trade range-bound for the following few weeks, with risks slightly skewed to the upside owing to fading of political risk premium in EU, broad USD softness and supported risk sentiment in global markets (as trade war premium fades). Though downside risks have somewhat faded, EUR still lack catalysts in the near term to drive it meaningfully higher as growth momentum continues to decelerate and the ECB is in no hurry to normalize monetary policies. As such we see range bound play in 1.13 - 1.16 in the following weeks. In light of fading political risk premium and USD softness setting in earlier than expected, we revised our forecast slightly higher.
- Beyond 1Q, we maintain our mildly constructive outlook on the EUR. Though growth momentum is slowing, we are of the view that the slowdown in momentum does not necessarily translate into a recession. Euro-area expansion continues to be supported by accommodative financing conditions, steady and lower oil prices as well as promising labor market conditions including unemployment rate falling to decade low and wage growth rising to 9-year high of 2.4% q/q. Eventual ECB policy normalisation in later part of the year (based on ECB's forward guidance) could see ECB-Fed policy divergence narrowing. We expect EUR strength to pick up pace from 2Q as ECB policy normalisation gathers momentum, political noises in Euro-area subside (after European parliament) amid USD weakness. Our bias to buy EUR on dips remains intact.
- Our initial concerns on the political outlook in Euro-area, owing to lack of clarity on German political landscape, Italy budget impasse, French protests and risk of early elections in Spain) have somewhat receded: (1) for Germany, CDU party elected Merkel's protégé, Annegret Kramp-Karrenbauer (AKK for short) instead of Friedrich Merz, a long-time critic of Merkel, ex-politician, German lawyer whom was preparing to launch a political comeback as CDU party head and was promising radical changes. AKK is perceived as a candidate of policy continuity; and that helped to provide some clarity. (2) Italy, on the other hand, reached a deal with EU (19^{th} Dec) to bring down its 2019 budget deficit target to 2.04%, from original plan of 2.4% That said the risks of further blow-up in French yellow shirt protests, early elections in Spain or even Italy, uncertainty on European parliament election (26^{th} May) remain. **The return of political uncertainties could limit EUR's interim bounce.**
- **Downside Risks to Our Outlook: EUR could be poised for further downside below 1.10** if (1) Euro-area/ global growth decelerate sharply into a recession; (2) a delay in ECB policy normalisation plans

into 2020; (3) negative political surprises (i.e. risk of early election in Italy, etc.).

- **Growth and Inflation Outlook:** The latest ECB macroeconomic projection in Dec 2018 report shows that growth **projections were revised lower to 1.9% and 1.7% for 2018 and 2019,** respectively (vs. 2% and 1.8% as previously projected in the last quarterly assessment). **Inflation was** revised up to 1.8% (vs. 1.7%) for 2018 and **revised lower to 1.6% for 2019 (vs. 1.7% previous projection). The next set of update will be released on 7th Mar.**

- **Concerns of Euro-area growth slowdown are on the rise**, given the recent poor run of activity and survey-based indicators. Euro-area services and manufacturing PMIs slipped in Jan (though still in expansionary territories) while industrial production fell further to -1.7% y/y in Nov. 4Q GDP (to be released on 31st Jan) could show further slippage in economic growth from 3Q growth of +0.2% q/q (already the slowest pace in more than 4 years). Our view remains for a **deceleration in growth momentum but short of an outright recession for the Euro-area as a whole.** We do not rule out a potential technical recession for Italy.

- **Headline Euro-area CPI decelerated to 1.6% in Dec,** down from 1.9% in Nov. Main drags (by country) came from Denmark, Portugal and Greece. In terms of sectors, energy, tobacco, processed food and alcohol were the main drags. Core CPI held steady at 1%. Due to current future prices for oil, headline CPI could decline over the coming months however looking ahead, the ECB expects inflation pressure to gradually rise owing to favourable labor market dynamics (falling unemployment and rising wage growth).

- **Monetary Policy Forecast: There is no ECB Governing Council meeting scheduled for Feb. The next meeting is scheduled on 7 Mar.** We expect greater market scrutiny on any mention of TLROs again as Draghi mentioned that the last meeting was about assessment and assessment will have implications about policy (thoughts/decision on TLTROs) but were not discussed. **On policy rates, ECB is expected to keep rates unchanged** (Policy rates, Main Refinancing operations, deposit facility and marginal lending facility on hold at 0%, -0.4% and 0.25%, respectively) **till Autumn 2019 (around Oct-Nov).** We continue to caution that ECB may need to proceed with baby steps to modestly raise deposit rates (currently at -0.4%) earlier than expected (relative to ECB's timeline) should (1) inflation data, in particular core CPI continues to surprise to the upside while (2) growth and activity data rebound. **ECB policy normalisation could play catch up with the Fed from 2Q- 3Q 2019** and this could pose upward pressure on EUR especially when market starts to price in a slowdown in ECB-Fed monetary policy divergence.

- At the last ECB meeting (24 Jan), ECB's Draghi sounded cautious on the economic outlook. Governing Council members were unanimous about acknowledging weaker momentum and changing the balance of risk for growth. He said that risks to outlook have moved to the downside and cited persistency of geopolitical uncertainties, threat of protectionism, vulnerabilities in EM and financial market volatility. However Draghi did say the likelihood of Euro-area recession is low as financing conditions remains favourable, developments in the labor market continued to be positive, wage growth continued to be significant and lower energy prices support real disposable income. He downplayed deploying LTROs as the last meeting was focused on assessment rather than policies. He elaborated that TLTROs have to have a monetary policy role and would not be implemented as a sectoral subsidy (recall that TLTROs were previously introduced to address cases of existing or likely fragmentation in monetary policy space).

- **Latest Fiscal and External Balance Outlook:** Euro area's current account surplus narrowed to EUR20bn in Nov, down from EUR27bn in Oct). This was due to lower trade surplus. In the 12 months to Nov, Euro-area current account surplus was 3.1% of GDP, down from 3.2%. ECB expects current account surplus to narrow further to 2.8% of GDP in 2019.

- Euro-area government deficit widened to -0.5% of GDP in 3Q, from -0.3% of GDP in 2Q. This was due to lower government revenue while expenditure picked up. Government debt to GDP was lower at 86.1% for 3Q (vs. 86.3% in 2Q). Greece (182.2%), Italy (133%) and Portugal (125%) continue to have the highest debt to GDP ratio.

- **Key domestic events and issues to watch:** Jan Mfg PMI, Jan CPI estimate (1 Feb); Dec PPI (4 Feb); Jan services PMI, Dec retail sales (5 Feb); Dec IP (13 Feb); 4Q employment report (14 Feb); Dec trade (15 Feb); Dec current account, construction output (19 Feb); Feb prelim PMIs (21 Feb); Feb consumer confidence (27 Feb).

- **Technical Outlook:** EUR drifted higher for the month of Jan. Last seen at 1.15 levels. Bullish momentum on weekly chart shows signs of picking up. Daily momentum is mild bullish while stochastics is rising. Risks skewed to the upside. Next resistance at 1.1510 (50% fibo retracement of Sep high to Nov low) before 1.1560 (200 DMA). Break above these levels could see EUR trade higher towards 1.1730 levels (38.2% fibo retracement of 2018 high to low). Support at 1.1390 (50 DMA), 1.1360, 1.1320 (upward sloping trend-line support from the low in Nov-2018 and Jan-2019).

GBP: Of Twists & Turns; Opportunity to Accumulate Dips

Forecast	1Q 2019	2Q 2019	3Q 2019	4Q 2019
GBPUSD	**1.3000** (1.2800)	**1.3200** (--)	**1.3400** (--)	**1.3600** (--)

Previous Forecast in Parenthesis

- **Motivation for the FX View**: The near term outlook for GBP remains driven by the twists and turns of *Brexit* progress. In the **near term, we expect GBP gains to moderate and possibly even retrace towards 1.30** as *brexit* plan (initially agreed with EU) goes back to the drawing board. PM May will renege on the initial plan and attempt to re-negotiate the Irish backstop, which the EU had earlier said it was not willing to. The **risk of an EU-UK deadlock on withdrawal agreement as well as "to-and—fro" to reach a compromise on Irish backstop in the House of Commons could bring back fears of no-deal, hard brexit as deadline of 29th Mar looms. This could form the trading backdrop in the unwinding of earlier optimism.**

- While we caution for downside risks and 2-way volatility on the GBP in the near term, we **retain our cautious optimism on GBP outlook** beyond the near term nuances. **We revised GBP's 1Q forecast slightly higher as we see a case of no-deal brexit being avoided and expect both EU and UK to come to terms on a compromised deal, at the eleventh hour.** The amendments passed on 29th Jan were not binding on the government (though they do have the implicit political influence on PM May to accommodate them). **We argue that the distribution of risks have shifted away from a no-deal brexit (given that the House of Commons also voted in favor of Dame Caroline Spelman's amendment) to a delayed and softer brexit with the likelihood of second referendum rising. We retain our bias to accumulate GBP on dips and expect recovery towards 1.40 to take hold as brexit uncertainties recede.**

- **A review of Brexit votes in January and Going Forward:** Following PM May's brexit deal being overwhelmingly rejected by the House of Commons at the 1st "meaningful vote" on 15th Jan and subsequently surviving the no-confidence vote (triggered by Opposition) on 16th Jan by a slim margin on 19 votes, PM May is now tasked with the mandate to re-open negotiations on the Irish backstop section of the withdrawal agreement after Conservative MP Sir Graham Brady's amendment won by 317 votes to 301. This calls for parliament to seek 'alternative arrangements to avoid a hard border' for the Northern Ireland backstop but otherwise supports PM May's deal. This amendment was supported by PM May and is now known as the Brady amendment. In the same seating, there was another amendment (amongst many others) by Conservative MP Dame Caroline Spelman and Labor MP Jack Dromey which seeks to prevent a "no-deal" brexit by adding to the PM's motion that Parliament "rejects the UK leaving the EU without a withdrawal agreement and a Framework for Future Relationship". This was jointly raised by Conservative and Labour MPs due to concerns in local manufacturing supply chains in the two neighborhood constituencies. This is known as the Dame Caroline Spelman's amendment and has won by 318 votes to 310. We note that these amendments are not binding on the government but implicitly conveys the intents of MPs. To summarize the **amendments passed, PM May is tasked with re-negotiating the Irish backstop with EU and MPs seek to prevent no-deal brexit in the event of no withdrawal agreement and Framework for Future Relationship.**
  - While the Brady amendment will give PM May the mandate to re-negotiate the Irish backstop section of the withdrawal agreement, the EU has made clear that they are ready to consider a brexit delay but **do not support the Brady amendment**. This re-negotiation process means PM May would need to iron out a proposal internally, return to EU to get an approval and then bring the deal back for a second meaningful

vote by next month. This brings back the fear of no-deal brexit if the EU does not approve PM May's plan B (in light of time decay to Brexit deadline). Renewed uncertainty on this front could dampen GBP bulls in the interim.

- According to BBC, PM May has invited Conservative MP Caroline Spelman, Labor MP Jack Dromey and other MPs who tabled amendments to prevent no-deal to discuss the way forward; PM May will also hold talks with Labor party leader Jeremy Corbyn to attempt to get a deal the House would support.
- The **Brady amendment could pave the way for a plan known as the "Malthouse compromise" as an alternative to Irish backstop**. This will be led by Conservative Minister Kit Malthouse and supported by both *Bremainers* and *Brexiters*. Proposal is likely to include extending transition period for a year and protecting EU citizen rights instead of using the backstop [source: BBC]. Other options include a time limit on the backstop and seeking a way to exit it. The revised deal will return to the House of Commons for a vote before it will be put forth to the EU for approval. If the deal does not receive majority support by 13th Feb, she will need to table an amendable motion for debate on 14th Feb. The "to-and-fro" process could heighten uncertainty and weigh on GBP.

- **Downside Risks to Our Outlook:** (1) no-deal brexit (akin to hard brexit scenario) concerns if re-emerged will dampen confidence on GBP bulls; (2) Delay in finalising a deal heightens uncertainty (raises fears of disorderly brexit), dampen investor/business confidence and expose GBP to further vulnerabilities; (3) slowing economic momentum including deceleration in wage growth, PMIs, IP will weigh on GBP.

- **Growth and Inflation Outlook: UK economy grew by +0.6% q/q in 3Q** (from 0.4% in 2Q). Services, manufacturing and construction contributed positively to growth. Survey-based and activity data remains a mixed bag with industrial production, retail sales on the decline fell while construction output, manufacturing and services PMI rose. 4Q GDP preliminary data is scheduled for release on 11 Feb, and is expected to see a pullback as one-off jump in activity for 3Q was due to weather-related softness earlier this year fades.

- In the last Quarterly Inflation report (1 Nov), BoE MPC **expects GDP to grow by around 1.75% per year on average over the forecast period**. Consumption is projected to grow modestly while growth in business investment is expected to be subdued in the near term and subsequently pick up as brexit uncertainty wanes. Net trade is also expected to support growth. Next release of quarterly QIR on 7 Feb would in focus for any growth projection changes.

- Looking ahead, UK's economic outlook is highly dependent on future trade arrangement (beyond 1 Jan 2021) of the EU withdrawal agreement, the transition agreement (effective 30 Mar 2019 to 31 Dec 2020) and the journey (orderly or disorderly) towards Brexit day (29 Mar 2019, 11pm GMT). Prolonged brexit uncertainty will weigh on business decision and investments and this could dampen growth outlook.

- According to recent market chatters, five of the largest banks including Deutsche, JPM, Goldman Sachs, Citi and MS intend to shift EUR750bn of balance sheet assets out of London to Frankfurt while some brokers including EBS, BrokerTec could shift their trading floors to Amsterdam. Shifts in regional HQs out of London not only affect business investments, but the property and tourism-related sectors.

- UK headline inflation eased further to 1-year low of 2.1% y/y in Dec, from 2.3% in Nov. The decline was largely due to the drop in oil prices, cost of air and sea travel as well as clothing and footwear. Core inflation, on the other hand, rose to 1.9% y/y. up from 1.8%. Wage growth held steady at 3.3% y/y for the 3-months ending Nov. Overall, the steady decline in headline CPI and the rise in wage growth above 3% provides a welcome relief for consumers and household finances.

- **Monetary Policy Forecast:** We expect BoE MPC to keep policy rate unchanged at 0.75% and the size of BoE balance sheet (GBP435bn) to stay unchanged at the upcoming meeting on 7th Feb. Steady decline in headline CPI and the rise in wage growth above 3% provides a sweet spot for BoE to keep monetary conditions accommodative, including rate to stay on hold to support growth and to allow for Brexit uncertainties to clear up. We **expect BoE MPC to keep policy stance status quo for as long as over the next 6 -9 months** as uncertainty over Brexit **takes precedence over policy normalisation. We see some risks of 25bps rate hike towards final quarter of 2019 as brexit uncertainty fades.** BoE's forward guidance shows another 2 hikes expected to end-2020 (this implies about 1 hike/year). 90D Sterling future implies market expectation for 25bps rate hike in Dec-2019. We remain watchful of inflationary pressures as tight labor market can further generate domestic price pressures while a case of no-deal brexit could result in sharp depreciation on GBP (brings about higher imported prices and this translates into higher CPI). Sustained rebound in CPI towards 3% again could renew market expectations for an earlier rate hike.

- At the last BoE meeting on 20 Dec, MPC voted 9-0 to keep policy rate unchanged at 0.75%, as widely expected. Minutes showed that the MPC's discussion was less upbeat than in November with Brexit uncertainty seen as the main drag for the growth slowdown. BoE's internal model suggests growth to decelerate to +0.2% in 4Q, down from previous projection of +0.3%. BoE's Carney said that BoE is prepared for whatever from brexit and is not automatic which way policy would go in the event of a hard brexit.

- **Latest Fiscal and External Balance Outlook** UK's current account deficit widened to 5% of GDP in 3Q. This is the widest level in 2 years. Worsening of current account deficit was due to rise in trade deficit and a shortfall in investment income.

- UK public sector net borrowing rose by GBP300mil in Dec to GBP3bn after UK received less money from the EU (due to amendments to member states' contribution) and jump in government expenditure (owing to more money spent on social benefits and goods and services). That said borrowing in the current FY to date was GBP35.9bn. This is the lowest YTD borrowing for 16 years. UK Spring statement is scheduled on 13th Mar.

- **Key domestic events and issues to watch:** Jan PMI Mfg (1 Feb); Jan construction PMI (4 Feb); Jan services PMI (5 Feb); BoE MPC, Jan house prices (7 Feb); 4Q GDP, Dec IP, construction output (11 Feb); Jan CPI, PPI, RPI (13 Feb); Jan retail sales (15 Feb); Dec labor report (19 Feb); Jan public finances (21 Feb); Feb GfK consumer confidence (28 Feb).

- **Technical Outlook:** GBP has made an impressive run-up of >5% gains vs. USD since Dec from sub-1.25 levels to a high above 1.32-levels in Jan. Pair was last seen at 1.3110 levels. Underlying momentum remains bullish as indicated on weekly charts but daily chart suggest a potential pause or possibly a near term retracement from recent run-up. Bullish momentum on daily chart is waning while stochastics is turning from overbought conditions. Immediate support at 1.3040-50 (200 DMA, 23.6% fibo retracement of Dec low to Jan high), 1.30 and 1.2930 (38.2% fibo). Resistance at 1.3160, 1.3210 (2019 high) and 1.3410.

AUD: Bulls To be On Leash

Forecast	1Q 2019	2Q 2019	3Q 2019	4Q 2019
AUDUSD	0.71 (--)	0.73 (--)	0.74 (--)	0.73 (--)

No Change to Previous Forecasts

- **Motivation for the FX View:** AUD is increasingly stuck within a range as optimism over a trade deal between US-China is negated by domestic concerns. The "flash crash" seen at the start of Jan underscores the vulnerability of the AUD to swings in risk sentiment but the subsequent recovery is also in tandem with the upmove in US stocks from its Dec lows. Support for this pair is seen around 0.7070 in interim while topsides can be resisted at 0.7240, if not 0.7296. At this moment of writing, we see room for more upside as expectations for a trade deal between the US and China is now dampened by news of Huawei sued by the US prosecutors for stealing trade secrets and bank fraud. However, we look for a positive outcome from the trade talks (possibly in a form of an extension in the trade truce beyond 1 Mar) however fragile it could be. As long as the US and China continue to keep communications open (and there are economic motivations to do so), AUDUSD could still have some room to head higher.

- That said, AUD moves will be asymmetric. We look for the AUD to react more to a risk-off scenario than a risk-on scenario as gains could still be crimped by domestic concerns. The recent mortgage rate hike by NAB triggered a sharp sell-off in the AUD. Owner-occupiers will see their interest rate increase by 0.12ppt. While this suggests that interest rate burden could increase for consumers and thus dampen their spending power, the NAB mortgage hike is unlikely to trigger another round of mortgage increases given that it is the last of the big four local banks to do so.

- Domestic data will be eyed as well as RBA's language and potential revision to their growth and inflation outlook. Focus will also be on whether RBA sticks to the stance that the next interest rate move will still be up rather than down. OIS implies a 30% probability of a rate cut, higher vs the start of the year. Should RBA keep its monetary policy stance, AUD may see some brief unwinding of short positions. That said, with Fed likely to tighten not much more, AUD could still be kept above the 0.70-figure for most part of this year.

- **Growth and Inflation Outlook:**

  - 3Q GDP came in to be 2.8%y/y vs. the previous 3.1% (also revised lower). The details revealed that household consumption slowed to 2.5%y/y from previous 2.9%. Given the mortgage rate hikes and low wage growth, the housing interest to household disposable income has likely risen. That, and the negative wealth effect from the equity sell-off could continue to dampen private consumption.

  - Resource demand is expected to remain weak as Australia's biggest consumer-China flags weak growth in its last PMI-mfg prints. The new exports order for China in Dec worsened to 46.6 in Dec from previous 47.0. Trade surplus narrowed a tad in Nov to AUD1.925bn from previous AUD2.0bn. For the Oct-Dec 2018 period, we still expect sizeable net export contribution to GDP to offset deterioration in the private consumption. Looking forward, a slower China could shrink net exports contribution to GDP.

  - Separately, the NAB also reported a sharp deterioration in business conditions in Dec with a score of 2 vs. the previous 11. The long term average is at 6. According to the report, every state and industry had reported declines in business conditions with retail seen as the weakest, reporting negative conditions. Profitability fell from 8 to 0. The measure for hiring was significantly lower as well. However, bear in mind that this is surveyed in a month of equity sell-off, soft housing markets and softer projections for retail sales. A look at the employment data suggests that the labour market is still tightening even as pace of employment eased from its Jan 2018 highs. The number of unemployed (seasonally adjusted) has been shrinking. Hence, hiring may be progressing at a slower pace but there is still hiring. Labour force participation continues to grow but at a slower pace, possibly due to the lack of wage increase.

- Apart from the impact of a slower China and the US on net exports, much of China's slowdown is likely to be factored into business investments and hiring. We look for stabilization in the growth momentum of China as policymakers in China has already reacted to bolster consumption and investment. More infrastructure spending should also be cushion demand for Australia's exports.

- **Monetary Policy Forecast:** We do not see much impetus for RBA to move their cash target rate on 5 Feb. However, communication will be watched. The Statement on Monetary Policy will be released on the Fri right after the decision. We anticipate some acknowledgement that the downside risks that they have cautioned for in private consumption had materialized to some extent and there could even be a revision in the growth and inflation forecasts stated in the last policy statement (4 Dec 2018). The central scenario was for GDP to average around 3½% for 2018 and 2019 before some deceleration in 2020. For the SoMP on 8 Feb, we also watch for concomitant tweaks to the line seen in the last SoMP *"The Board is expecting further progress in reducing employment and ensuring inflation is consistent with the target. If that progress is made, higher interest rates are likely to be appropriate at some point"*.
- A downgrade in the outlook is partially in the price of the AUD. In fact, the OIS implied a 33.7% probability of a rate cut by Aug this year as of 29 Jan vs. 10% on 1 Jan. A series of weaker data out of China and Australia has dragged on the AUD but should the line above be left intact within the SoMP, we caution for short AUD bets to be unwound.
- In other news that could tighten liquidity conditions, RBNZ has proposed that the common equity tier 1 capital ratio requirement of the big 4 Australian banks' New Zealand subsidiaries to be raised 14.5% by 2024 from 7% currently. That translates to at least U$9bn in Tier- 1 capital requirement.

- **Latest Fiscal and External Balance Outlook:** The government released the mid-year economic and fiscal outlook for 2018-2019 with real GDP in 2019-2020 expected to be around 2¾%, with 70% confidence interval ranging from 2¼ to 3¼%. Treasurer Frydenberg has projected a larger surplus of A$4.1bn in 2019-20, higher than the previous projection of A$2.2bn, owed to a surge in company and superannuation taxes. With that windfall, the government is likely to pledge more spending ahead of the election (that has to be held by May 2019).

- **Key domestic events and issues to watch:** 4Q CPI on 30th Jan; import price index for 4Q and private sector credit for Dec on 31st; PMI-mfg for Jan and 4Q PPI on 1st Feb; Melbourne Institute inflation expectation for Jan and building approvals on 4th; trade, retail sales for Dec as well as RBA meeting on 5th; NAB business for 4Q on 7th; RBA SoMP on 8th; Dec home loans and NAB business conditions and confidence for Jan on 12th; Westpac consumer confidence for Feb on 13th; Minutes of the Feb policy meeting on 19th; wage price index for 4Q on 20th; labour report for Jan on 21st; RBA Lowe's parliamentary testimony on 22nd; Private CAPEX for 4Q on 28th Feb.

- **Technical:** We look for AUDUSD to head higher in the interim though eyes are on whether the 200-dma at 0.7290 can be broken. A break there opens the way towards the 0.74-figure, Dec high. Support at 0.7160 (21,50,100-dma) before the 0.7070.

NZD: Neutral Outlook in the Near Term

Forecast	1Q 2019	2Q 2019	3Q 2019	4Q 2019
NZDUSD	0.6800 (--)	0.7100 (--)	0.7200 (--)	0.7100 (--)

No Change to Previous Forecast

- **Motivation for the FX View:** We retain a neutral outlook on the NZD in the near term (< 3 months) and expect NZD to trade in the range of 0.68 – 0.70 for the following month. Downside risks to global and NZ growth outlook, ongoing trade tensions between US and China as well as a lack of impetus for RBNZ to tighten are some of the factors temporarily weighing on NZD but downside is cushioned in a softer USD environment and signs of stabilisation in dairy prices (typically supportive of NZD) as supply-demand dynamics rebalance. Key focus on the outcome of the trade talks between US and China. Positive progress towards a trade deal before the 90-day deadline on 1st Mar could support sentiment and provide a lift to both hard and soft commodities; this could alleviate concerns of slowing growth momentum and potentially expose NZD to further upside, possibly above 0.70.

- In the medium term, we remain mildly positive on NZD outlook and expect the NZD to gradually rise above 0.70 in 2Q-3Q 2019. We still see some risks of RBNZ tightening OCR by 25bps in 2H 2019. **NZ growth is expected to accelerate to 3.4% in 2019,** from 2.7% in 2018. Monetary stimulus and population growth will underpin household spending and business investment while government spending on infrastructure and housing is expected to support demand. Rebound in business and consumer confidence could add to NZD upside. Sustained increase in CPI towards the middle of RBNZ target range of 1 – 3% coming from further upward pressure on domestic prices including wage growth (owing to tightening of labor market) could support the out-of-consensus case for RBNZ to tighten.

- if CPI can see a sustained increase towards the middle of RBNZ target range of 1 – 3% coming from further upward pressure on domestic prices including wage growth (owing to tightening of labor market) coupled together with activity picking up further, there could even be a case of 25bps rate hike in 2H 2019 (out-of-consensus expectations).

- **Growth and Inflation Outlook: NZ GDP decelerated to +0.3% q/q in 3Q, from 1% in 2Q.** While the 3Q pace of expansion is the slowest in nearly 5 years, it is likely the print represented some degree of "payback" as 2Q print recorded its fastest pace of expansion in 2 years. Breakdown by industry shows manufacturing contracted while construction fell. In expenditure terms, the drag on growth was due to lower private investments and government spending though consumption held up. Survey indicators were mixed with services PMI slowing to 53.0 in Dec while manufacturing activity rebounded sharply to 8-month high of 55.1 in Dec owing to gains in production, finished stocks and deliveries.

- **In the last quarterly MPS (8 Nov), NZ growth is expected to accelerate to 3.4% in 2019,** from 2.7% in 2018. Monetary stimulus and population growth will underpin household spending and business investment while government spending on infrastructure and housing is expected to support demand.

- On inflation outlook, **MPC expects CPI to ease below 2% this year when increase in fuel prices drop out of the annual calculation.** CPI is expected to return back to around 2% over 2020, supported by higher non-tradables inflation as capacity pressure gradually increases.

- **Headline CPI slowed on sequential terms to +0.1% in 4Q,** from +0.9% in 3Q. The moderation was dragged by tradable prices (typically transitory in nature, defined as imported goods & services) while non-tradable inflation (proxy for domestic price pressures) rose +0.7% q/q. On y/y terms, headline CPI rose 1.9%, close to the middle of RBNZ's inflation target range of 1 - 3%. On sectoral breakdown, decline in oil and food prices were the main drags while accommodation-related prices such as rental provided the buffer.

- **Monetary Policy Forecast:** We expect **RBNZ to retain the slightly dovish rhetoric and keep OCR on hold at 1.75%** amid signs of moderation in global activity, risks of China slowdown and ongoing trade war concerns between US and China, **at the upcoming MPC on 13th Feb.** Rise in CPI towards the middle of RBNZ target range of 1 - 3% and the risk of further upward pressure on domestic prices including wage growth (owing to tightening of labor market) should reduce market speculation for RBNZ rate cut this year. In our opinion, should the rise in inflation be sustained together with activity picking up further, there could even be a case of 25bps rate hike in 2H 2019 (out-of-consensus expectations).

- At the last MPC meeting (8 Nov), RBNZ MPC kept OCR unchanged at 1.75% as widely expected. On forward guidance, Governor Orr reiterated that OCR is expected to remain low at 1.75% into 2020 but removed an explicit reference to cut rate in the statement (though he later told reporters that rate cut still remains an option). He said that downside risks remain. Weak business sentiment could weigh on growth for longer while ongoing trade tensions in major economies may undermine global growth.

- **Latest Fiscal and External Balance Outlook:** NZ current account deficit further widened to -3.6% of GDP in 3Q 2018 and this was due to increase in primary income deficit and rising cost of imported fuels. This is the widest current account deficit since 2009.

- NZ government surplus for the 5-months ended Nov was at $261mil, in contrast to $88mil deficit expected by Treasury. Tax revenue was the main contributor due to higher than expected deductions at source, GST and offset by lower corporate tax rate. Net debt was 21.3% if GDP while gross debt was at 30.3% of GDP.

- Key **domestic events and issues to watch:** Jan consumer confidence (1 Feb); Dec building permits (4 Feb); 4Q unemployment rate, wage growth (7 Feb); RBNZ meeting, 2Y inflation expectations (13 Feb); Jan Mfg PMI (15 Feb); Jan services PMI (17 Feb); 4Q PPI (20 Feb); 4Q retail sales (25 Feb); Jan trade (27 Feb); Feb activity and business confidence (28 Feb). GDT auction takes place on 6 and 19 Feb.

- **Technical Outlook:** NZD reversed early month's weakness (owing to flash-crash) and traded higher for the month of Jan. Last seen at 0.69 levels. Bullish momentum on weekly, daily chart remains intact. A handful of MA crossovers to the upside suggests bullish that the bullish bias remains. Key resistance at 0.6910 (50% fibo retracement of Apr high to Oct low) if broken, could see the pair trade higher towards 0.6970, 0.7020 (61.8% fibo). Support at 0.68 (50 DMA, 38.2% fibo) likely to hold.

JPY: Yield Differentials/Safe Haven Plays Continues To Provide Support

Forecast	1Q 2019	2Q 2019	3Q 2019	4Q 2019
USDJPY	110 (113)	108 (--)	106 (--)	107 (106)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** JPY was among the best performing currencies in the G10 space against the USD. The JPY has gained nearly 3.4% against the USD since Nov 2018 to date. Driving gains in the JPY was the change in tone from the Fed that signal a potentially less aggressive rate hike in 2019, which could be a prelude to a pause by the Fed. The expectations that the current Fed tightening cycle is near its end weighed on UST yields, narrowing the yield differentials between the 10Y UST and JGB. This in turn has kept the JPY supported. Also supportive of the JPY are expectations of slower global growth that weigh on risk appetite, lifting demand for safe-haven assets including the JPY. Given these developments, we have revised our USDJPY forecast slightly in 1Q 2019 to 110 from 113 previously, and to 107 from 106 in 4Q. The pair's trajectory was kept intact.

- We no longer expect the USDJPY to accelerate towards the 113 levels by end 1Q 2019. We potentially see the Fed hike rates less aggressively in 2019 to take into account rising global risks. Our economic team is now looking for the Fed to hike its fund rates twice in 2019 compared to three hikes previously (with risk of a pause for longer), in line with the Fed dot plots. This dovish tone should weigh on UST yields and see the yield differentials between 10Y UST and JGB narrowing. Narrowing yield gap will weigh on the USDJPY and cap the rise in the pair in 1Q. We now look for the USDJPY to end-1Q at 110 instead of 113 previously projected.

- Our economic team now expects the two Fed rate hikes to take place in 2Q and 3Q. While this should nominal lift the USD and keep the USDJPY supported, other factors are likely to come into play to cap upside pressure on the pair, namely political risks and concerns over the impact of the sales tax hike in Oct. Some concerns over the local elections in Apr 2019 and Upper House elections scheduled in Jul 2019, together with the possible referendum to amend the pacifist constitution could create some political instability in 2H 2019, which could in turn lead to safe-haven demand for the JPY. Implementation of the consumption sales tax hike in Oct 2019 and concerns of its impact on domestic consumption and overall growth could also add downside pressure on the USDJPY in 2H 2019.

- Safe-haven plays due to the re-emergence of Sino-US trade war concerns to the same intensity prior to the G20 summit in Nov 2018 are unlikely. We do not expect Sino-US trade tensions to intensify significantly given the imperative for Trump to show some results to bolster his presidency after the record-breaking government shut-down. Instead, safe haven demand is likely to come from concerns over global growth. Already, the IMF has lowered its global growth outlook recently, projecting global growth to come in at 3.5% in 2019, which is lower the 3.7% projected in Oct 2018. Deteriorating risk appetite could lift the JPY and keep the USDJPY pressured lower in 2019.

- While CFTC positioning data are unavailable due to the shut-down in the US government, we believe that there could be some positioning for long JPY against short-USD. This is because the stale long-USD bets may have been unwound somewhat in light of the expectations of a less aggressive Fed in 2109. This unwinding of long-USD bets should benefit the JPY where there are expectations of appreciation bias in 2019. Establishment of long-JPY vs. short-USD should be put downside pressure on the USDJPY.

- Given the dovish tone of the Fed and concerns over slowing global growth should weigh on the USDJPY in 1Q 2019. We expect the pair to end-1Q around the 110-levels instead of 113-levels as we had earlier projected. We continue to expect the USDJPY to come in around 108 and 106 by end-2Q and -3Q before climbing higher to 107 by end-4Q.

- **Growth and Inflation Outlook:** Economic growth momentum appears to be slowing as recent data appears to point to some fatigue. Machine orders for Dec contracted by 18.3% y/y in Dec – the third straight month of contraction, while exports dipped 3.8% y/y in Dec after flattish growth in Nov. Meanwhile, preliminary print for the Nikkei manufacturing PMI slipped to 50 in Jan from 52.6 in Dec. Industrial production decelerated in Nov, rising by +1.5% from +4.2% in Oct. The softer data print is likely to be reflected in the GDP print for 4Q 2018 due 14 Feb, and which could persist into 1Q 2019. Still, the better-than-expected performance in retail sales offered support for the economy in 4Q, lessening the impact from manufacturing and trade. We continue to expect fiscal support to keep the economy from slipping into a recession in 2019. The government's record budget of JPY101tn for FY2019 should be supportive of the economy, while preparation works in the run-up to the 2020 Olympics in Tokyo should also bolster economic growth in 2019. This was reflected in the BOJ's latest economic outlook report where it kept its assessment of the economy unchanged, describing it as "expanding moderately". The BOJ now expects full-year growth to come in around 0.9% in FY2019 from 0.8% previously and by 1.0% from 0.8% for FY2020.

- Headline inflation moderated, rising by just +0.3% y/y in Dec after climbing to +0.8% in Nov. The BOJ's preferred gauge of inflation -core (headline less fresh food) rose by +0.7% y/y, slowing from Nov's +0.9%, while core-core (headline less fresh food & energy) edged up by +0.3% y/y, unchanged from Nov. The lack of inflationary traction can be attributed to softer crude oil prices. While oil prices continue to provide support to overall prices, this support has weakened, suggesting that overall price traction might not be significant. Thus, it will be difficult to keep the price momentum going. Consequently, the BOJ cut is inflation outlook to 1.1% for FY2019 from 1.6% previously and to 1.5% from 1.6% for FY2020.

- **Monetary Policy Forecast:** As expected, the BOJ left its monetary policy unchanged at its first meeting of the year that started on 22 Jan. Its yield curve control policy and asset purchases programme were left intact with the policy balance rate maintained at -0.1%, the 10-year JGB yield target at around zero percent, and asset purchase target of JPY80tn. It also kept its forward guidance unchanged, reiterating that it "intends to maintain the current extremely low levels of short- and long-term interest rates for an extended period of time". While its policy stance was left on hold, the BOJ cut its near-term inflation and growth forecast to match reality. Nevertheless, the BOJ and its governor continue to expect inflation to pick up toward 2% over time. At his press conference, BOJ governor Kuroda defended the central bank's ongoing ultra-loose monetary policy, arguing that the scope for such unconventional policy has not narrowed. In fact, he warned that the BOJ would take additional measures if needed, especially should price momentum stalls. While there are some expectations in the market for the BOJ to unwind its stimulus programme due to its side effects, we are not in that camp. We expect the BOJ to follow through with its current policy until the 2% inflation target is achieved.

- **Latest Fiscal and External Balance Outlook:** The cabinet approved a record initial budget for the 2019 fiscal year starting Apr in Dec last year. This budget will help to offset any hardship caused to consumer from the higher sales tax that will kick in in Oct and will top JPY100tn for the first time as the government tries to head off any potential economic downturn from the sales tax hike. Key elements of the budget included: (1) general spending of JPY62tn; (2) debt servicing cost of JPY23.5tn; (3) transfers to regional/local governments of JPY16tn; (4) forecasted tax revenue of JPY62.5tn; (5) bond issuance revenue of JPY32.7tn; and (6) other revenue of JPY6.34tn. Despite the record budget, the government is expecting a budget deficit of JPY9.2tn in FY2019, the lowest level in 12 years. The government is aiming for a primary surplus by FY2027.

- The current account (CA) surplus narrowed sharply to JPY0.76tn in Nov from JPY1.31tn in Oct on the back of a much smaller surplus in the primary income account (Nov: JPY1.44tn vs. Oct: JPY2.05tn) and widening deficit in the goods and services account (Nov: -JPY0.56tn vs Oct: -JPY0.55tn). The deficit in the financial account narrowed to JPY1.12tn in Nov, down from Oct's JPY1.55tn deficit and this was because of rise in portfolio investment inflows that partially offset the increased deficits in the direct and "other" investment segments. The deficit in the overall balance of payments (BoP) widened slightly to JPY0.37tn in Nov from Oct's JPY0.25tn deficit.

- **Key domestic events and issues to watch:** Key data release this month is preliminary 4Q18 GDP on 14 Feb. Also closely watched will be CPI on 22 Feb. JGB auctions in Feb: 10-year (5 Feb), 30-year (7 Feb), 5-year (13 Feb), 1-year (19 Feb) and 20-year (19 Feb).

- **Technical Outlook:** USDJPY partially retraced Oct's losses into month-end as we speak. Pair was last seen at 113.25 levels. Daily momentum and stochastics indicators suggest the risk of near term upside towards 113.50, 113.80 levels. But weekly chart suggests the risk of pullback. Bearish divergence is potentially forming on the weekly charts, with higher highs seen for USDJPY in Jul and Oct-2018 but lower highs in the MACD (Price and Indicator divergence). This suggests there is waning upside momentum and may signal a reversal may come into play. Bias to lean against strength. Key support level to watch at 111.60. A decisive close below the key support on weekly basis could open way for further downside towards 110.26 (50 DMA). A break above 114.55 (2018 high) on the upside will nullify the bias.

RMB: Trade War Risk Premium Fades

Forecast	1Q 2019	2Q 2019	3Q 2019	4Q 2019
USDCNY	6.75 (7.05)	6.70 (6.95)	6.65 (6.92)	6.70 (--)
USDCNH	6.75 (7.05)	6.70 (6.95)	6.65 (6.92)	6.70 (--)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** As we write ahead of the Lighthizer-Liu He trade talks scheduled on 30-31 Jan, CNY trades at around 6.73 vs. the USD. Trade war risk premium has been fading since Trump hinted of a trade deal just before the mid-term elections in 2018. Since then, USDCNY has slipped from near-7.00-levels to levels around 6.7380 as we write (28 Jan). That is a 35% retracement of its Apr-Oct rally last year. The following are key factors impacting the CNY trajectory. Any shifts in these factors could affect the CNY. 1) The trade truce was a slightly more optimistic development than what we had envisioned and CNY rallied as a result. 2) Market players are also increasingly hopeful for a trade deal or at least an extension of a trade truce beyond the 1 Mar. 3) The 35% retracement was also due to a softer USD environment as Fed started to signal a pause in its tightening cycle. 4) The possibility of a Fed rate hike within the year also diminished in the eyes of investors in light of the ongoing government shut-down that had broken records that saw private sector analysts slashing growth forecasts for 1Q. 5) China's policymakers have promised fiscal stimulus and lowered RRR cuts and provided other targeted credit support for SMEs.

- China posted slower growth, as evidenced by its recent trade, credit and activity data. However, the policy makers have been managing investors' expectations with plenty of reiterations on how China's economy is still under downside pressure including Premier Li Keqiang's. At State Council meeting, he also spoke of economic growth to maintain within a "reasonable range" and that China seeks to improve business environment this year. President Xi Jinping also stressed on the need to maintain social and political stability, calling on greater efforts "to prevent and resolve major risks". Separately, Vice President Wang also spoke at the World Economic Forum, warning of uncertainties in the year but he assured that China's growth will be sustained. He also highlighted that while "speed does matter, but what really matters for the time being is the quality, structure and efficiency of our economic development". As such, there has been announcement of more tax cuts, more liquidity injections via new credit tools and broad and targeted RRR cuts that should stabilize growth. However, a growth recovery is not expected to be dramatic. For example, Shanghai just cut GDP target for 2019 to 6-6.5%, aims to expand its free trade zone, set up a pilot registration system for listed companies and a new "science and technology innovation board" on its stock exchange, and to promote higher quality growth and integration of the Yangtze River Delta region. The focus will be on joint projects in infrastructure, technological innovation and environmental protection. The government may also make further improvements on elderly care and social security.

- Some optimism in the trade talks could still bring the USDCNY lower towards the 6.60-figure (38.2% Fibonacci retracement of the 2018 rally). CNH gains are capped at this point as US has just filed criminal charges against Huawei for stealing trade secrets and bank fraud. The Department of Justice also requested for the extradition of the CFO Meng Wanzhou. While the US stressed on the fact that this has nothing to do with the trade talks, market optimism on the outcome of the trade talks could still be crimped by China's reaction to the indictment, calling it unfair and immoral.

- As recent corporate earnings out of the US start to underscore the exposure the economy is to a slower China, there is also increasing motivation for both nations to come to a trade deal. Hence, risks of the outcome (that may only be made known some time in Feb) are still skewed to the upside for CNY and CNH. In addition, the initial positivity on a potential deal might fizzle out along with the perception that China's needs to keep the yuan strong during the negotiating process. Domestically, the impact of the credit support insofar should be modest. The impact of greater infrastructure spending and multiplier effect could still take time and the reaction to stimulus as such, could still be repriced. Slower global growth and fading frontloading effect also mean that weak external demand. As a result, weak data for Jan and Feb could lift the USDCNY 6.75 by the end of 1Q. Beyond the 1Q, we look for USDCNY to head gradually lower in a softer USD environment whilst the current account balance stands at risk of deterioration due to a trade agreement for China to make a substantial purchase of American goods.

- **Growth and inflation outlook:** Growth slowed significantly in the last quarter and NBS revealed that the slowdown is seen across all sectors including the tertiary industry which encompasses real estate, wholesale and retail trade, accommodation and catering. Manufacturing also slowed from 10.1%y/y to 8.3% in nominal terms. Full year growth met expectations at 6.6% for 2018, slowing from previous 6.7%. Activity in Dec showed some stabilization. Urban FAI steadied around 5.9% while industrial production picked up pace to 5.7%y/y from previous 5.4%. Retail sales, on the other hand, accelerated slightly to 8.2%y/y from previous 8.1%. Commodity retail steadied at 8.0%y/y whilst catering rose 9.0%yy/y vs. Nov 8.6%. Activity in Dec somewhat stabilized after President Trump and Xi announced a 90-day truce at the G20 Summit right at the start of Dec.

- The Dec print for credit growth was not as bad as feared (better than consensus) but not entirely reassuring either. Local currency grew 13.2%y/y in the month, steadying from the previous month. Net corporate bond financing saw stronger expansion in the month while local government special bond financing kept pace. On the other hand, entrusted loans, trust loans, banker's acceptance bills are still contracting. China is said to plan a raise in the special bond quota from CNY1.35trn in 2018 to CNY2.15trn this year. Along with the news, NDRC also spoke about more bond sales in sectors that align with the "national strategy". Bond sales in sectors that benefit the Yangtze River Economic Zone, rural development, environment protection are encouraged and the government agency aims to help high-quality private firms to increase their bond issuance. Loan tenors of more than three years are encouraged. Perpetual bonds were issued for the first time by a bank. On 25 Jan, Bank of China issued CNY40bn of perpetual bonds in the interbank market. PBoC said that the issuance could increase the tier 1 capital adequacy of BoC by 0.3 ppt. Coupon rate at 4.5%. This comes as PBoC launched a new facility named Central Bank Bill Swap which is meant to encourage banks to improve their capital adequacy by issuing perpetual bonds. This provides primary dealers bills that can be used as high-quality collateral in exchange for perpetual bonds purchased from banks. The perpetual bonds sold by banks with a rating equal or higher than AA is also accepted as eligible collateral for monetary policy operations (MLF, targeted MLF and standing Lending Facility). The capital buffers are necessary as policymakers seek to force China banks to shift their off-balance sheet lending (entrusted funds, trust funds, etc) onto their books.

- External demand sagged in Dec. Exports collapsed to almost zero growth while imports contracted -3.1%. Apart from fading front-loading effects, the fall in crude price as well as trade-war triggered substitution of soybeans also played a part. Breakdown of the imports print suggest that demand for high technological products saw a steep decline, in sync with negative outlook from Apple and Xiaomi. Market did not react too negatively as policy makers have already promised more tax cuts, flexible monetary policy (liquidity injections) as well as infrastructure spending. Interestingly, the trade surplus with the US continued to widen to record high.

- Inflation slipped in Dec with PPI taking the cue from the commodity prices down to 0.9%y/y from previous 2.7%. CPI edged lower to 1.9%y/y from 2.2%. The food subcomponent steadied at around 2.5%y/y, while the non-food subcomponent eased. That includes the transport & telecom which contracted -0.7%. Residence subcomponent slipped to 2.2%y/y from 2.4%. Softer price pressure provides PBoC a benign environment for RRR cuts.

- **Monetary Policy Forecast:** Apart from the two RRR cuts, the PBoC has provided markets with new liquidity tools such as the targeted medium-term lending facility in Jan. Bank of China priced CNY40bn of perpetual bonds at a yield of 4.5% this morning. According to a recent statement by the central bank, a total of CNY800bn longer-term funds were released to financial markets due to recent PBoC actions including the CNY300bn after an RRR cut on 4 Jan to provide for the maturing MLF. Then, there was the CNY257.5bn targeted medium-term lending facility and CNY250bn injected after the inclusive finance review so that more banks are eligible to enjoy lower RRR on 25 Jan. Liquidity is injected to cater to seasonal liquidity demands ahead of the Lunar New Year festival. 7-day repo rate slipped towards 2.0% at one point before inching higher towards 2.8% as we write. 3-month SHIBOR was brought noticeably lower to sub-3.00%. The 3-

month CNY HIBOR is also lower at 3.13%. As we have indicated in the earlier sections, perpetual bonds are also issued to boost the capital adequacy of Chinese banks as they continue to shift the off-balance lending to their books.

- More RRR cuts cannot be ruled out but like almost every other banks in the world, actions could be data dependent. With global growth slowing however, there could still be a need to cut RRR again in Apr.

- In addition, the monetary policy transmission had been a concern and PBoC hinted that there could be a merge of the benchmark lending rate (the re-discount rate) with the borrowing cost of the 7-day reverse repo. Now, the 7-day reverse repo agreement is widely deemed as the policy rate as it affects the open market operations directly. In fact, the central bank has been tweaking the 7-day reverse repo in reaction to some of the Fed rate hikes in the past. The increasing importance of OMO suggests that the 7-day reverse repo rate is the more relevant and effective policy tools for the central bank. Should that be in place, we anticipate that PBoC may want to lower the 7-day reverse repo as well when it becomes the official lending rate.

- **Latest Fiscal and External Balance Outlook**: China had raised its fiscal target from 2.6% of GDP to 2.8% of GDP in 2019. Focus is on infrastructure spending as well as tax cuts in order to ensure economic and social stability. This is also to ensure that China avoids the “flood-style stimulus” that had resulted in the surge in corporate debt since 2019.

- Insofar, personal income tax deductions were announced, personal income tax thresholds were also raised with new tax brackets, import tariffs on industrial and consumption goods and tax cuts for R&D spending.

- China announced a U$29bn annual tax cuts for SMEs for the next three years.

- Infrastructure spending is encouraged. The government issued CNY1.35trn worth of special bonds meant to finance local government infrastructure projects and this is likely to be expanded to CNY2.15trn this year.

- **Key domestic events and issues to watch:** CAixin PMI-mfg for Jan due on 1st Feb; Aggregate financing and new yaun loans for Jan on 10-15th; foreign reserves for Jan due 11th; trade data on 14th; CPI and PPI, BOP current account balance on 15th; new home prices and FX Net settlement on 22nd; PMI mfg on 28th.

- **Technical Analyst:** USDCNH is at the brink of testing the 6.70-figure. A clearance of the support at 6.6960 can see a move towards 6.6080 is. 21-dma, 50-dma are on their way to cut the 200-dma - death crosses ahead. That’s a bearish formation there.

KRW: Relative Softness in the Interim

Forecast	1Q 2019	2Q 2019	3Q 2019	4Q 2019
USDKRW	1125 (1140)	1115 (1120)	1105 (1110)	1120 (1130)

Previous Forecasts in Parenthesis

- **Motivation for the FX View: We expect KRW to retain some degree of relative weakness** in the near term (<4weeks) as slowdown in global growth outlook, semiconductor market (typically weigh on KRW assets) and US-China trade war tensions weigh in the interim. We do not rule out USDKRW overshooting our 1Q forecast towards 1135 - 1145 during this period but **expect upside pressure on USDKRW to fade** as USD softness (owing to US growth deceleration, Fed nearing end of rate hike cycle) becomes more entrenched and semiconductor down-cycle probably nearing its end as investment for 5G network picks up pace. Progression towards a US-China trade deal would be another **additional factor benefiting KRW (via sentiment and trade channel). We revised our forecast slightly lower to reflect our slight optimism on KRW.**

- The global semiconductor market is expected to contract in 2019 (according to a report published by the World Semiconductor trade statistics) and the down-cycle (already underway) may weigh further on Korea whose economy is reliant on semiconductors (exports of memory chips accounted for about 20% of Korea's total exports). Some of Korea's large conglomerates such as Samsung Electronics and SK Hynix command a combined global DRAM market share of nearly 75%. The chip supply glut amid a ramp-up in production and sluggish smartphone sales could further drag DRAM prices lower and weigh on Korean exports and equity markets (as earnings are impacted). This would have negative repercussion on KRW. **But we expect the down-cycle to be temporary (possibly nearing its end) and do not expect it to last beyond 1H 2019. An eventual recovery, as supply-demand dynamics corrects, is likely to be supportive of KRW.**

- **Downside Risk to USDKRW:** An immediate resolution to trade deal between US and China resulting in risk-on rally and a sharp move lower in USDCNH could see USDKRW trading closer to 1090 - 1120 range on a shift into "goldilocks" environment (characterized by benign inflation, Fed tightening to pause, growth momentum easing but economy still growing) could benefit risk-on FX proxies including KRW. However we see differentiated pace of gains to favour higher-yielder FX such as IDR, INR, MYR, as compared to KRW (lower yielder amongst AXJs).

- **Growth and Inflation Outlook: South Korea's economy expanded at a faster pace of 1% q/q in 4Q** (vs. +0.6% in 3Q). On y/y terms, 4Q GDP growth expanded 3.1%. 4Q Growth was led by government spending, private consumption and investments while exports contracted. For 2018, South Korea's economy expanded 2.7% y/y (in line with BoK's estimates).

- For 2019 growth outlook, BoK revised GDP lower to 2.6% (vs. 2.7% previously) owing to signs of global slowdown and heightening economic uncertainties over trade tensions. But BoK Governor Lee does not seem to reflect the bearishness in his speech. He said that *while headline GDP was revised lower, South Korea will maintain growth momentum similar to that of 2018* and he *expects increases in consumption and exports amid ongoing government's expansionary fiscal policies*. He shared that the 1H of 2019 will be hard but a recovery will come in 2H, due to expected improvement in demand in the semiconductor industry. Governor Lee is also optimistic in expecting new job creation to increase by 140k, up from 97k in 2018.

- **Headline CPI slowed to 1.3% y/y in Dec** (vs. 2% in Nov) owing to decline in oil prices and agricultural goods prices rising at a slower pace. Core CPI held steady at 1.3% y/y. For 2018, CPI rose 1.5% y/y (vs. 1.9% in 2017). **For 2019 inflation outlook, BoK revised projection lower to 1.4% y/y** (down from 1.7% in 2018) owing to decline in oil prices.

- **Monetary Policy Forecast**: We expect BoK to keep policy rate unchanged at 1.75% at the upcoming MPC meeting on 28 Feb. Slowing pace of inflation, downside risks to growth amid semiconductor down-cycle and trade war tensions between US and China builds the case for BoK to remain on hold. We no longer look for a rate hike this year given the recent downward revision to South Korea's growth and inflation outlook. Potential pause in Fed rate hike cycle also takes the pressure off BoK in tightening to prevent US-KR rate differentials from widening (fear of capital outflow).

- At the last MPC meeting on 24th Jan, BoK MPC voted unanimously to keep policy rate unchanged at 1.75%. Governor Lee ruled out the option of a rate cut, maintaining that Korean monetary conditions are "accommodative" and they are lower compared to other markets and he also warned about over-pessimism on the economic outlook. BoK last voted 5-2 to raise policy rate by 25bps to 1.75% at its 30th Nov 2018 MPC meeting, reflecting BoK's intent to ease financial imbalances.

- **Latest Fiscal and External Balance Outlook:** Current account surplus narrowed to 7-month low of $5.06bn in Nov (down from $7.43bn a year ago). The decline was due to reduction in goods balance account. While current account surplus extended its run for the longest on record at 81 months, the surplus seen was the smallest since Apr 2018. Elsewhere services account deficit fell thanks to the jump in tourist arrivals.

- **Key domestic events and issues to watch:** S. Korea releases Jan exports, CPI, manufacturing PMI (1 Feb); Jan FX reserves (8 Feb); Jan unemployment rate (13 Feb); Dec current account (15 Feb); Jan PPI (22 Feb); Feb consumer confidence (26 Feb); Jan IP and BoK MPC meeting (28 Feb).

- **Technical Outlook:** USDKRW traded a month of 2 halves – higher in the first part of Jan before reversing out those strength into month-end. Last seen at 1111 levels. Bearish momentum on weekly, daily chart intact. Sustained price action below key area of support at 1110

(38.2% fibo retracement of 2018 low to high) - 1115 (200 DMA) could see further downside play towards 1099 (50% fibo) come on-stream. Bigger support at 1089 (61.8% fibo). Resistance at 1123 (23.6% fibo), 1130 (downward sloping trend-line resistance from the high of 2016, 2017 and 2018). Caution that a break above this trend-line resistance could nullify the bearish bias.

SGD: Buoyed By Favorable Risk Environment

Forecast	1Q 2019	2Q 2019	3Q 2019	4Q 2019
USDSGD	1.3600 (1.4000)	1.3400 (1.3900)	1.3300 (1.3800)	1.3500 (1.3800)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** The SGD had a good run towards the end of 2018. Upside pressure on the SGD against the USD was triggered by the Fed's dovish tone on further fund rate increases and rising optimism over Sino-US trade talks. The USDSGD, which had been hovering around the 1.3870-levels at end-Oct 2018, bounced lower past the 1.35-handle before settling around the 1.36-levels currently.

- The USDSGD failure to drift higher towards the end of 2019 can be attributed to several factors. First, the concerns that the Sino-US trade war could escalate failed to materialise. The world was brought back from the brink of an all-out trade war between the two world-largest economies when the two sides agreed to trade talks and delay any punitive trade actions till 1 Mar 2019. At the same time, China's policymakers' support of SME via RRR and corporate tax cuts, boosting the fiscal deficit for 2019, and more targeted monetary tools, has lifted optimism that it will orchestrate a soft-landing.

- The optimism generated by dissipating trade war concerns and China's pump-priming has led to the collapse in the USDCNH premium over its 12-month forward. This suggests that the yuan might not be under much depreciation pressure as before. The resulting optimism should bolstered risk appetite and hence demand for EM Asia risk assets and concomitantly, EM Asia currencies. The slippage in the USDCNH 12-month forward, suggests risks to the USDCNH are to the downside in 12-month ahead. The expected softness in the USDCNH has in turn has dragged the SGD higher and capped the rise in the USDSGD, given that the pair tracks the USDCNH 12-month forward closely.

- Just as important, the USDSGD is among the few currencies in the region that are very closely correlated to the USDCNH. Our regression analysis with the SGDUSD as the dependent variable and CNHUSD as the independent variable showed that the SGD is among the most sensitive to moves in the CNH with a sensitivity of 0.60%. Thus, as concerns over China (trade war, hard-landing etc.) moderates, the SGD should be among the currencies to benefit.

- Next, the absence of a strong acceleration in USD strength as we had anticipated also weighed on the USDSGD. Aside from rising optimism over Sino-US trade talks that had led to more risk-taking activities, we also had a shift in tone by the US Fed at the end of 2019. The lowering of the Fed's median dot plot projection to 2 hikes in 2019 from 3 hikes previously, while not a game-changer by itself, did trigger a re-think of further Fed rate hikes. The expectations that the Fed could slow its rate hikes and possibly even pause in 2019 set-off an unwinding of stale long USD positions against its G10 peers and even the AXJs. This weighed on the USD and provided the AXJs including the SGD a lift.

- The comments by Fed Chair Powell that the Fed "will be patient" with monetary policy and adjustment of the balance sheet and that of other Fed officials appear to re-affirm that the Fed could slow its rate hike trajectory and possibly even hit the pause as growth in the US moderates. Given the recent shut-down in the US government is likely to drag 1Q 2019 GDP lower, a Fed move in Mar is unlikely. The re-pricing of Fed expectations should put downside pressure on the USD and drag the USDSGD lower.

- Beyond 1Q 2019, a combination of factors is likely to support a softer USD in 2Q and 3Q, namely nearing the end of the Fed's tightening cycle, the peaking of the US economy, and US twin deficits that could see a surge in borrowing. This should keep the USDSGD on a downward trajectory for 2Q and 3Q. Thereafter, there could be some intensification of global growth concerns in 4Q, triggering global risk off and supporting the USD somewhat. This in turn could lift the USDSGD higher in the quarter.

- Still, we do not expect the USDSGD to slip aggressively lower in 2019 back to around the 1.30-levels as a consequence of the more optimistic external environment. This is because **we no longer expect the MAS to move again on policy after tightening moves at its Apr and Oct meetings last year. Instead, we expect the MAS to maintain its current slightly appreciation bias given that growth is expected to moderate and inflation to remain muted this year.** Our economic team is expecting core inflation to average +1.6% in 2019, moderating from 2018's +1.7% and economic growth to slow to +2.2% in 2019 vs. +3.2% in 2018.

- The two moves in Apr and Oct 2018 saw the MAS steepen the slope of the policy band of the SGD NEER to around 1% (Maybank estimates) from zero percent prior to 2018 to accommodate expected stronger inflationary pressures. This has allowed the SGD NEER to trade around 1.0% above the implied mid-point of 1.3675 currently. This suggests that the SGD NEER trades on the stronger side vs. its trading partners. However, this could change in the coming quarters with the SGD NEER expected to slide lower below the mid-point by end-2019.

- As we had previously written, still healthy domestic economic fundamentals provide support for the SGD. The healthy budget surpluses of the past few years provide fiscal space for the government to accelerate its infrastructure programme, including development of Changi Airport Terminal 5 and the redevelopment and rejuvenation of the Jurong Lake District if necessary. The upcoming Budget speech on 18 Feb will likely see the government put forward policies to stimulate the economy and mitigate any economic slowdown. Also ensuring that the SGD remains supported is its triple-A status and persistent high balance of payments surpluses. These fundamentals should provide the backstop to the SGD in 2019.

- Consequently, we have made changes to our USDSGD outlook for 2019, though we have maintained the currency's trajectory. We now expect the USDSGD to come in around the 1.36-levels by end-1Q. In an environment of trade optimism and fading USD strength, we look for the pair to slide lower to 1.34 and 1.33 in 2Q and 3Q respectively. Thereafter, concerns over a possible global economic slowdown could see USD strength re-emerge somewhat and lift the pair higher to 1.35-levels to end the year.

- **Growth and Inflation Outlook:** Preliminary 4Q 2018 GDP showed the economy expanding at a slower pace of +2.2% y/y vs (revised) +2.3% in 3Q. The more moderate growth was attributable to a slowdown in services, which rose +1.9% y/y vs. +2.3% in 3Q. Manufacturing growth improved but this recovery could be temporary as the gains appeared driven by front-loading of exports ahead of potential US tariff increases on Chinese goods. Construction remained a drag on the economy, contracting by 2.2% in 4Q vs. -2.5% in 3Q. For the full-year, GDP rose +3.3% in 2018, moderating from 2017's +3.6%. Our economic team is pencilling in sluggish growth of +2.2% in 2019 and +2.1% in 2020, below MTI's forecast of +1.5-3.5%, on Sino-US trade war concerns and tightening monetary conditions.

- Headline inflation rose +0.5% y/y in Dec (vs. +0.3% in Nov) on the back of rising petrol prices, but was partially offset by lower private road transport costs (on falling COE premiums and lower ERP charges). Core inflation edged higher to +1.9% y/y in Dec compared to +1.7% in Nov, helped by firmer clothing costs, household durables costs and a smaller dip in personal effect costs. Softer electricity prices though mitigated some of the upside pressure on headline inflation. For the full-year, headline and core inflation averaged +0.4% and +1.7% respectively in 2018 vs. 2017' +0.6% and +1.5%). Looking ahead, our economic team expects muted price pressures in 2019 as Sino-US trade war presents downside risks to growth and inflation. Base effects are likely to help headline inflation edge higher in 2019 to +1.2% from +0.4% in 2018. Core inflation should moderate to +1.6% in 2019 vs. 2018's +1.7% on contained energy prices (Maybank expects oil prices to average USD65/bbl in 2019 vs. 2018's USD71/bbl). In comparison, MAS is looking for headline and core inflation to come in at 1-2% and 1.5-2.5% respectively in 2019.

- **Monetary Policy Forecast**: The MAS had tightened monetary policy at both of its semi-annual policy meeting last year. The MAS moves in 2018 steepened the slope of the SGD NEER policy band by 1.0% in total (our assumption given the absence of information from the MAS). This should allow for a stronger SGD on a trade-weighted basis to mitigate the expected climb in core inflation in 2019 and anchor inflationary expectations.

- We no longer expect the MAS to move again on policy after tightening moves at its Apr and Oct meetings last year. Instead, we expect the MAS to leave its policy stance unchanged and maintain its current slightly appreciation bias. This is because growth is expected to moderate and inflation to remain muted this year. This is reflected in our economic team's projection for inflation and GDP growth in 2019. The team expects core inflation to average +1.6% in 2019, moderating from 2018's +1.7% and economic growth to slow to +2.2% in 2019 vs. +3.2% in 2018.

- The USDSGD trades softer around the 1.3520-levels at the point of writing, off its 2019 high of 1.3680 on 3 Jan. Softer USDSGD though stalled increases in domestic interest rates. Instead, domestic interest rates have accelerated, particularly the 3-month SOR (3MSOR), which hit a 10-year high of 2.0253% on 23 Jan. The 3-month SIBOR (3MSIBOR) rose to 1.889% levels in Jan, just a tad off from its 2019 high of 1.892% as domestic liquidity continues to tighten. For now, there does not appear to be any signs that increases in the 3-month SOR and 3-month SIBOR will stall as the withdrawal of monetary stimulus in the advanced economies continues. We are now gradually seeing mortgage rates climb in tandem to the rise in domestic rates. Deposit rates (for 12-month fixed) are edging higher as well, currently at 0.45% since end-Dec 2018. This suggests that risks related to interest rate increases affecting financial and economic stability, particularly in interest rate- and property-related sectors, are picking up. We expect the 3MSIBOR and 3MSOR to edge higher to 2.08% and 1.96% respectively by end-4Q 2018. For 1Q 2019, we are penciling the 3MSIBOR and 3MSOR to come in at 2.05% and 1.93% respectively.

- **Latest Fiscal and External Balance Outlook:** The Finance Minister will announce the 2019 budget on 18 Feb. The healthy budget surpluses of the past few years should provide fiscal space for the government to accelerate its infrastructure programme, including development of Changi Airport Terminal 5 and the redevelopment and rejuvenation of the Jurong Lake District amid the prospects of a slowing economy. The upcoming Budget speech could see the government put forward policies to stimulate the economy and mitigate any economic slowdown. The 2018 budget deficit is likely to come in below the projected 1.6% of GDP as the government typically over-estimates the deficit.

- We do not have a complete picture of the current account surplus for 2018 but the data to date suggests that the surplus is likely to match if not exceed the surplus of 2017. The current account (CA) surplus in the first nine months of the year was at SGD67.6bn compared to SGD66.5bn in the same period in 2017. In 3Q itself, the CA surplus came in at USD23.4bn or 20.1% of GDP vs. USD22.9bn in 2Q. The wider surplus was due to the larger surplus in the goods and services account (3Q: SGD30.5bn vs. 2Q: SGD29.6bn). The financial and capital deficit re-widened to SGD16.5bn in 3Q from SGD14.5bn in 2Q due to the larger "other investment" segment (3Q: -SGD29.4bn vs. 2Q: SGD13.1bn). Consequently, the overall balance of payments (BoP) surplus narrowed to SGD6.2bn in 3Q from SGD7.8bn in 2Q.

- **Key domestic events and issues to watch:** Final print for 4Q 2018 GDP print for 3Q18 will be released sometime 18-25 Feb will be eyed as will inflation print for Jan on 25 Feb. Watched keenly will be the 2019 Budget speech on 18 Feb.

- **Technical Outlook:** USDSGD has been on a decline since hitting a high of 1.3870s in Oct-2018. And the pair has gone on to trade a 7-month low of 1.3443 levels (31 Jan). Pair was last seen at 1.3450 levels. 50 DMA is about to cut 200 DMA to the downside (otherwise known as the death cross). This is typically a significant bearish signal. A break below 1.3440 (50% fibo retracement of 2018 low to high) could see the pair trade towards 1.3340 (61.8% fibo) and even 1.3210 (76.4% fibo). Resistance at 1.3540 (38.2% fibo, 21 DMA), 1.3630 (50, 200 DMAs). Bias to lean against strength.

MYR: Catching Up with EM Asia Upside

Forecast	1Q 2019	2Q 2019	3Q 2019	4Q 2019
USDMYR	4.0500 (4.2000)	4.0000 (4.1200)	3.9800 (4.1200)	4.0600 (4.1000)

Previous Forecast in Parenthesis

- **Motivation for the FX View: Motivation for the FX View:** In line with most other regional currencies, the MYR strengthened slightly by around 0.6% against the USD in the month of Jan (albeit a bit muted relative to other regional currencies). It reached a high of 4.1482 on 3 Jan 2019. MYR could potentially in part be supported by Brent crude oil price moving higher to around $60/bbl currently from the $54/bbl range earlier in Jan. At the same time, crude palm oil prices picked up in Jan by around 5.5%, potentially contributing to the MYR support.

- We now see some MYR appreciation vis-à-vis the dollar, coming onstream earlier than expected consistent with our USD weakness view in 1H 2019 and for the medium term. Over the next 3-6 months or so we expect USD/MYR could potentially approach 4.00 and potentially breach in 3Q, if regional currencies strengthen relative to the USD and risk factors dissipate. Overall though, domestic policy uncertainty risk may still somewhat weigh on the MYR despite solid fundamentals. Recent market concerns about the revised higher budget deficit and concerns about its impact on the bond market and concerns about potential ratings outlook revisions could play a part in weighing on the MYR.

- Inevitably, the risk of global trade war re-escalating, coupled with continuing Fed policy normalisation and repatriation of corporate earnings, may further add to USD tightness but the risk factors have dissipated somewhat in Jan and likely to continue in Feb. Given that scenario, riskier and commodity currencies are likely to see some interest as search for yield remains. USD underperformance on the back of a further flattening of the UST yield curve, concerns about the deteriorating US twin deficits and long USD positioning becoming a bit overstretched, will likely play a significant role over the next month or so.

- Indeed, we have yet to see the significant emergence of any these three risks for a disruptive reversal out of riskier assets such as high yield bonds, equities and emerging markets; (1) Higher US inflation; (2) Treasury supply; (3) ECB exit/higher EU rates.

- In addition, our economics team sees rising likelihood that the BNM could keep rates on hold until 2019 to support domestic demand especially consumer spending. This is happening in an environment where regional central banks are tightening more to keep pace with the hikes in US policy.

- MYR fundamentals remain well anchored by sustained current account surplus, rising FX reserves to retained imports & short-term debt, sustained growth pick-up backed by consumption, investment and exports as well as higher oil prices. We maintain our lower USDMYR forecast trajectory on efforts taken by the new government to improve governance, transparency and accountability. However, we acknowledge there could still be some uncertainty over the next few years as the new government navigates the new political environment and foreign investors still remain somewhat cautious for now. Domestically some concerns about a pullout in some of the investment projects from the previous administration may have inadvertently affected sentiment in the short term, although our medium term view remains supportive of the currency.

- External reserves increased +USD0.3b to USD101.7b at mid-Jan 2019 (end-Dec 2018: USD101.4b), locked in USD101b-USD102b range since end-Oct 2018. Latest figure covers 7.3 months of retained imports, 1.0x total short-term external debt and 8.8% above the estimated minimum required reserves of USD93.5b under IMF's Assessing Reserve Adequacy (ARA) framework.

- Foreign investors were net buyers of Malaysian equities so far in Jan 2019 at +MYR0.4b (Dec 2018: -MYR1.1b) after three consecutive months of net selling. Global equity market's sentiment improved and "risk-on" returned amid a "less hawkish/more dovish" Fed as the FOMC meeting on 18-19 Dec 2018 saw the dialing down of Fed's guidance on fed funds rate hikes to +50bps this year from +75bps previously. There is also the prospect of de-escalation in US-China trade war as US and China is scheduled to hold second round of trade talks on 30-31 Jan 2019 after the first round on 7-9 Jan 2019 under current 90-day "ceasefire" since 1 Dec 2018. China has offered to address the issues of intellectual property rights and foreign companies' access to China, as well as eliminate its trade surplus with US by buying USD1t worth of American goods to be implemented in stages over the next six-years (2019-2024).

- We expect portfolio capital flows to remain volatile. In particular, we remain wary of the "Ides of March", considering the key events during the month, namely: (1) Outcome of US-China trade talks as the "trade war truce" deadline is on 1 Mar 2019; (2) FOMC meeting on 19-20 Mar 2019 which comes after the end of the above 90-day US-China trade war ceasefire and the re-instatement of the US debt ceiling on 2 Mar 2019 (suspended since 9 Feb 2018) which risks worsening US political and fiscal gridlock amid current prolonged Government shutdown. Fed will also present this year's first quarterly review of the key macroeconomic forecasts that pertains to its monetary policy i.e. mandate i.e. growth, inflation, unemployment; (3) Risk of "No Deal Hard Brexit" on 29 Mar 2019.

- Recent data showing weak export performance in late-2018 that is likely to spill into early-2019. This is due to the fallout from the earlier US China trade war escalation as the effect of front-loading in shipments to beat the "tit-for-tat" tariffs between US and China dissipated. However, trade/current account surplus is sustainable to keep trade flows supportive of external reserves. This is because softer exports will also translate into softer imports given that nearly 80% of imports are correlated to exports i.e. imports of intermediate goods - including inputs for exports - and imports for re-exports. In addition, other flows should also be supportive of external reserves e.g. proceeds from the issuance of Samurai bond by the Government of Malaysia in Mar 2019 totaling JPY200b (~USD1.8b) and Khazanah's sales of 16% stake in IHH Healthcare Bhd. to Japan's Mitsui & Co. Ltd.
- **Growth and Inflation Outlook:** Our 2018 full-year +4.7% growth estimate point to 4Q 2018 growth of between +4.4% YoY and +4.7% YoY. We maintain our view of Malaysia's real GDP growth at +4.9% in 2019.
- While BNM acknowledges that global growth momentum is moderating as trade tension impact materializes with risks to growth tilted to the downside, it expects the Malaysian economy to remain on a steady growth path on the back of private sector demand amid lower public spending and softer external demand. To note, the official real GDP growth forecast for 2019 is 4.9% vs the estimate of 4.7% for 2018. BNM also expects inflation to be moderately higher in 2019 after the 1.0% rate recorded in 2018. Official inflation rate forecast for 2019 is 2.5%-3.5%. Monetary Policy Statement's (MPS) conclusion is the same as previous MPS, signaling no imminent policy change i.e. at current OPR level, the degree of monetary accommodativeness is consistent with intended policy stance, and the MPC will continue to monitor and assess the balance of risks surrounding the outlook for domestic growth and inflation.
- Inflation rate stayed sub-1.0% for the seventh straight month at +0.2% YoY in Dec 2018 (Nov 2018: +0.2% YoY). 2018 inflation rate was +1.0%. Maintain our 2019 inflation forecast of +2.1%. The still benign inflation outlook amid offsetting factors such as the broadening of Sales Tax and Service Tax (SST) base, Budget 2019's new taxes (Soda Tax, Airport Departure Levy), hikes in minimum wage and utility costs, and lower global crude oil prices hence domestic retail fuel prices.
- Expect modest inflation pick-up in 2019. Headline inflation stayed sub-1.0% YoY in Dec 2018 mainly on easing food and transport costs despite the implementation of SST on 1 Sep 2018. Core CPI also stayed sub-1% at +0.4% YoY (Nov 2018: +0.5% YoY; 2018: +0.8%; 2017: +2.4%).

- We expect 2019 headline inflation to stay benign with gradual pick-up to +2.1%, reflecting offsetting factors such as the broadening of the SST base; Budget 2019's new taxes e.g. Sugar Tax (1 Apr 2019), departure levy for all outbound air passengers (1 June 2019); hikes in minimum wage and utility costs; and the floatation of RON95 and diesel prices amid the low global crude oil prices.

- Given the forecast of modest pick-up in inflation rate, we expect BNM's Overnight Policy Rate (OPR) to remain at 3.25% until end-2019. We see no upside risk to OPR given our outlook of continued benign inflation. Downside risk to OPR is contingent upon real GDP growth, which we currently forecast to expand steadily by 4.9% this year (2018E: 4.7%). Yesterday at its first Monetary Policy Committee (MPC) meeting of the year, BNM kept the OPR unchanged at 3.25% for the sixth consecutive MPC meeting and since the +25bps hike back in Jan 2018. BNM expects inflation to be moderately higher in 2019. Official inflation rate forecast for 2019 is 2.5%-3.5%. BNM also expects the economy to be on steady growth path, with the official real GDP growth forecast for 2019 is 4.9% vs the estimate of 4.7% for 2018.

- **Monetary Policy Forecast:** BNM kept the Overnight Policy Rate (OPR) at 3.25% after this year's first Monetary Policy Committee (MPC) meeting on 23-24 Jan 2019, unchanged for the sixth consecutive meeting and since the +25bps hike a year ago. No change in our view of OPR staying at 3.25% this year. We see no upside risk to OPR given our forecast of continued benign inflation (2019E: 2.1%; 2018: 1.0%).

- Downside risk to OPR is contingent upon real GDP growth, which we forecast to expand by 4.9% this year (2018E: 4.7%). The slightly better but still sub-5% growth reflects our expectations of a US-China trade deal to mitigate the downsides to global growth and trade, hence Malaysia's external demand and trade-oriented manufacturing and services sectors. In addition, we expect recoveries in mining and agriculture sectors this year via normalization in palm oil and natural gas output after last year's contractions that dragged headline GDP growth. To note, OPR movements is highly influenced by real GDP growth movements since 2014 i.e. OPR hike when growth picked up to >6% YoY and OPR cut when growth threatened to go <4% YoY.

- **Latest Fiscal and External Balance Outlook:** There was no immediate downgrades in Malaysia's sovereign credit rating and/or rating outlook by the international rating agencies (IRCs) after the tabling of Budget 2019 back on 2 Nov 2018 which saw the resetting of 2018's budget deficit to GDP ratio to -3.7% vs the original target of - 2.8%, followed by -3.5% for 2019.

- In fact, on 7 Dec 2018, Moody's reaffirmed Malaysia's investment-grade sovereign credit rating of "A3" and the "Stable" rating outlook. The rationales for the reaffirmations in credit rating and rating outlook reflect Malaysia's credit profile strengths i.e. (1) Diversified economy and resilient growth; (2) Stable financing conditions and deep domestic capital market arising from large domestic institutional investor base that mitigate risk from sizeable non-resident presence in domestic financial market, especially the foreign holdings of Government bonds i.e. 38.8% of total Malaysian

Government Securities (MGS) and 24% of total MGS and Government Investment Issues (GII) as at Nov 2018; (3) Sustained current account surplus; (4) Institutional framework that include sound monetary policy and Government's commitments to improve transparency, accountability, governance as well as checks and balances in the public sector.

- But fiscal situation remains challenging. However, Moody's cautioned that Malaysia's fiscal strength has weakened as fiscal policy flexibility and debt affordability are constrained. Government debt to GDP ratio of 52.8% (including 1MDB debt) and its debt servicing or interest payments of 13.1% of revenues estimated for 2018 are above the medians of 39.7% and 4.7% respectively for Moody's A-rated sovereigns.
- Moody's also highlighted potential catalysts for upgrade and downgrade in rating. Rating upgrade factors include significant increase in scope for and speed of fiscal consolidation (e.g. measures that broaden revenue base). Rating downgrade factors include economic growth shock that adversely affect fiscal conditions via negative impact on revenue and limited scope for expenditure cuts. Moody's also cautioned that rising political tensions and divergences in view within the Government could undermine fiscal policy effectiveness and delivery of other policy pledges like on transparency, governance and corruption.
- Credible measures to broaden tax revenue base are important. Moody's is of the opinion that Budget 2019's tax and non-tax measures like broadening the Services Tax, reviewing property-related tax (RPGT, stamp duty), introducing "minor" new taxes ("Sugar Tax"; airport departure levy) as well as asset monetization (Airport REIT, land sales) are not sufficient and sustainable means to widen the revenue base.
- **To achieve the Medium-Term Fiscal Framework target of lowering budget deficit to GDP ratio over the next 3 years.** Meanwhile, rating reviews of other major international rating agencies (S&P, Fitch) are still pending. And we expect crude oil price to stay volatile, hence our assumption of USD65/bbl average in 2019 against Budget 2019's assumption of USD72/bbl average. These are the posers the Government's mid-term target of steadily lowering budget deficit to GDP ratio from -3.7% in 2018 to -3.5% in 2019, -3.0% in 2020 and -2.8% in 2021 followed by the longer-term aim of around -2.0%. In the interim, PETRONAS strong cash position currently should help the Government to forestall any need to recalibrate Budget 2019 despite the recent fall in crude oil price – unlike what happened to Budget 2016 that had to be recalibrated in Jan 2016 after its tabling in Oct 2015 as crude oil price plunged 60% from USD66/bbl in early-May 2015 to a low of USD26/bbl in Jan 2016, against the Budget 2016's crude oil price assumption of USD48/bbl. Thus a key lookout for 2019 is the Tax Reform Committee's (TRC) recommendations and proposals for tax system reforms and overhaul. The TRC was "operational" in Sep 2018 and is expected to complete its task by mid2019.
- **Key domestic events and issues to watch:** FX reserves (12 & 22 Feb); Industrial Production (11 Feb); CPI (22 Feb), BNM Policy Meeting (5 Mar), GDP 4Q (14 Feb).

- **Technical Outlook:** USDMYR traded a month of 2 halves - higher in the first 3 weeks of Jan before turning much lower into month-end. Last seen at 4.09 levels - a 5-month low. 50 DMA cut 100 DMA to the downside - typically a bearish signal. Bullish momentum on daily chart is fading fast while stochastics is falling. Bias for further downside play. Key support at 4.08 (200 DMA) before 4.0690 (38.2% fibo retracement of 2018 low to high) and 4.05 levels. Area of resistance at 4.1170 (21 DMA) - 4.12 (23.6% fibo) before 4.15 (50, 100 DMAs)..

IDR: Upside Risks

Forecast	1Q 2019	2Q 2019	3Q 2019	4Q 2019
USDIDR	13400 (--)	12900 (--)	12700 (--)	12900 (--)

No Change to Previous Forecast

- **Motivation for the FX View:** We maintain our USDIDR outlook for the forecast horizon. We look for the USDIDR to slip lower to 13400-levels by end-1Q due to election optimism and fading USD strength among others. Thereafter, expectations that the end is near in the current Fed tightening cycle should provide further support for the IDR with the USDIDR sliding even lower to 12900-levels and 12700-levels by end-2Q and -3Q. There is some risk aversion in the 4Q as expectations builds for a US economic slowdown, weighing on riskier assets including the IDR. This could lead to a slight bump up in the USDIDR back to 12900-levels by end-2019.

- The USDIDR has been on the downtrend since Oct 2018, gaining around 7.2% against the USD. The slide in the pair was prompted by the BI's 175bp rate hikes, fiscal measures to dampen the twin deficits, optimism over receding threat of an all-out Sino-US trade war and dovish shift in the Fed (portending fading USD strength). At the same time, optimism is building for a Jokowi victory in Apr that could see tough choices made to temper the twin deficits amid softer oil prices. These together with a possible pause by the Fed should weigh on the USDIDR.

- The improvement in overall risk sentiments towards the end of 2018 and into 2019 was reflected in the increased demand for Indonesian assets over the period. Foreign investors had bought USD1.01bn and USD6.25bn in equities and debt since Nov 2018. The return of foreign portfolio flows has proven to be positive for the IDR and helped to make the IDR one of the best performing Asian currency. For the month of Jan so far, foreign investors had purchased USD0.76bn and USD0.49bn, helping to sustain the IDR move higher. With yields of IDR debt on the rise and expectations of IDR appreciation, demand for Indonesian assets should remain intact, providing support for the IDR.

- Market volatility is likely to increase as the 17 Apr Presidential and general elections draw closer. Currently, the opinion polls point to strong support for Jokowi but things can change from now till Apr next year. Mis-steps by the Jokowi campaign or waning support for Jokowi could shake market confidence and keep the USDIDR elevated. Our house view is for a Jokowi to win at this juncture, which should ease upside pressure on the USDIDR post-elections. Our analysis of the average performance of the IDR in the past two presidential elections supports this. In the days leading to the election and then post-election, the IDR typically appreciates.

- With a proven track record, a Jokowi win will be market positive and should encourage further inflows on expectations that Jokowi and his economic team will follow-through with further fiscal policies that will ensure not only economic growth but tame the twin deficits as well. Measures likely to be implemented include tax reforms (of tax rule revision to support the property sector, removing value-added tax on some service exports, revising corporate taxes for coal miners, etc.) and changes to the "Negative Investment List" to open up previously partly closed sectors to foreign ownership. There could also be an extension and expansion of import tightening measures (including tariffs) and measures to encourage exports to curb the current account deficit (CAD). Other measures already announced included intensifying the use of biodiesel to reduce import of oil given its status as a net oil importer. All of these are positive for the IDR, potentially leading to a repricing of Indonesian assets and spur greater inflows.

- After 175bp of moves in 2018, it is unlikely that BI will hike the policy rate by the same quantum in 2019. The Fed's shift to a more dovish stance and the stability in the IDR amid a benign inflationary environment should provide BI will policy space to slow the pace of rate hikes. We are expecting only a further 50bp hike by BI in 2019, probably front-loaded in 1H, to match the Fed's expected two moves in 2019. Still, should volatility in the IDR increase due to ECB policy normalisation or a step-up in Fed rate hikes, BI is likely to step-in and adjust its policy rate as necessary. This should provide support for the IDR and keep the USDIDR on a downward trajectory in 2019.

- **Growth and Inflation Outlook:** Real GDP growth had moderated to 5.17% y/y in 3Q 2018 from 5.27% in 2Q and should slow even further in 4Q. The government's move to raise taxes to curb imports and the BI's rate hikes last year is likely to manifest in slower GDP growth in 4Q. At the same time, plans to hold back some import-heavy infrastructure projects and to curb imports of luxury consumer goods could stem investment and consumption expenditure. The failure of consumption to backstop GDP growth could see growth wane into 2019. We do not believe that the government will allow growth to falter especially in the run-up to the Presidential and general elections in Apr 2019. Campaign spending as well as reconstruction efforts following the devastating earthquake and tsunami last year should lift consumption. The government expects full-year growth to come in around 5.15% in 2018, while BI is looking at 5.1%. The two forecasts imply that GDP should print 4.90-5.10% in 4Q. Our economic team is slightly more sanguine, projecting 2018 growth at 5.16%. For 2019, the team expects GDP to rise 5.14%.

- Price pressures decelerated in Dec with headline CPI rising by a moderate +3.13% y/y in Dec vs. +3.23% in Nov, driven mainly by softer food prices (Dec: +3.41% vs. Nov: 4.25%). Weighing on overall prices was firmer transport cost, which surged +3.16% y/y in Dec, compared to 2.62% in Nov. Core inflation though edged higher to 3.07% y/y in Dec from 3.03% in Nov as the administered price increases (of 3.36% y/y) was mitigated partially by the more moderate increases in volatile and energy prices. The government's move to curb imports and the current account deficit should prove to be deflationary. The 7.5% tariff on around 900 consumer goods should reduce demand for imported goods and put downside pressure on prices. After averaging 3.20% and 2.81% for the whole of 2018, our economic team expects headline and core inflation to come in around 3.44% and 3.08% respectively in 2019. The forecasts are well-within the BI's target range of 2.5 and 4.5% for 2019.

- **Monetary Policy Forecast:** There were no surprises at the BI's first policy meeting of the year on 16-17 Jan. This was the second straight meeting that the BI had left its 7-day reverse repurchase rate unchanged after hiking by a cumulative 175bp to 6.00% since May 2018. The deposit and lending facility rates similarly left unchanged at 5.25% and 6.75% respectively, keeping the interest rate corridor at 75bp on either side of the policy rate. A more dovish Fed and the rebound in the IDR over the past three months had provided the BI with policy space to hit the pause button.

- The governor in his post-meeting press conference noted that the central bank policy rate has almost reached its peak as it had almost achieved its goals of maintaining the yield of domestic financial assets and stability of the IDR. This though did not suggest that the central bank is on the verge of changing its policy stance. The governor reiterated that the policy stance remained "hawkish, pre-emptive and forward looking". Instead, the door remains open for the BI to hike rates further should the situation warrants it. Despite the more benign domestic inflationary and global interest rates environment, our economic team still expects the BI to hike its policy rate twice by 25bp each time to bring the 7-day reverse repurchase rate to 6.50% by end-2019 to match the Fed's two rate hikes expected this year.

- **Latest Fiscal and External Balance Outlook:** The country posted its smallest fiscal deficit in six years in 2018. The estimated budget gap came in at IDR259.9tn or equivalent to 1.76% of GDP. This was narrower than the government's initial projection of IDR325.9tn or 2.19% of GDP. The deficit was due to state revenues coming in higher at IDR1942.3tn compared to state spending of IDR2202.2tn. The primary balance (that is, budget balance before interest payments) was at IDR1.8tn, but inching closer to zero. The narrowing budget deficit should allay concerns that the government would need to issue even more debt to finance the budget, which is positive for the IDR.

- The current account deficit (CAD) rose to USD8.03bn (equivalent to 3.37% of GDP) in 3Q 2018, widening from 2Q's USD8.02bn (3.02%). The widening deficit was attributable to the ballooning trade deficit of

USD2.64bn in 4Q. The CAD was a tad below the 3.5% of GDP target. The CAD is not expected to come off from those levels in 4Q, given that the trade deficit had ballooned to USD4.87bn. This suggests that the CAD is likely to remain above 3.0% of GDP in 4Q, but though it is not expected to exceed 3.5% of GDP. According to BI Governor Perry Warjiyo, the CAD may reach USD8.8bn in 4Q, but the larger capital account surplus could offset the CAD and result in an overall balance of payments of around USD4-5bn in 4Q. Our economic team is more sanguine, expecting the CAD to come in around 2.92% of GDP in 2018. For 2019, the team expects the CAD to narrow to 2.50% of GDP.

- **Key domestic events and issues to watch**: 4Q 2018 GDP print, to be released on 6 Feb, will be in focused in the month. Also keenly watched will be BI policy meeting on 20-21 Feb.

- **Technical Outlook:** USDIDR has fallen sharply lower (>8%) since Oct-2018 high. Pair was last seen at 13,980 levels. 50 DMA cuts 200 DMA to the downside – death cross – typically a strong bearish signal. Sustained price action below 14,040 (61.8% fibo retracement of 2018 low to high) could fuel further downside move towards 13,745 (76.4% fibo), 13,500. Resistance at 14,140 (21 DMA), 14,285 (50% fibo). Bias remains to trade from the short side and add on rallies.

PHP: Buoyed By Foreign Portfolio Inflows

Forecast	1Q 2019	2Q 2019	3Q 2019	4Q 2019
USDPHP	52.80 (54.20)	53.30 (54.00)	53.00 (53.80)	53.50 (--)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** We now no longer expect the USDPHP to rise beyond the 54-levels given market developments, namely optimism that Sino-US trade war will dissipate and fading USD strength underpinned by a dovish Fed. We now look for the USDPHP to hover around 52.80 levels by end-1Q. As political risks mounts in the lead-up to the elections, we expect upside pressure on the pair to persist with the pair likely to climbing higher to around the 53.30-levels by end-2Q. Thereafter, we expect the pair to ease to 53-levels as political clarity re-emerges post-election. Concerns over a possible global economic slowdown could see USD strength re-emerge somewhat and lift the USDPHP higher to 53.50 by end-4Q 2019.

- The PHP rebounded since Nov 2018, tracking gains in its regional peers. It up 2.2% against the USD. Aside from the BSP's aggressive moves to tighten policy last year, optimism that an all-out trade war between China and the US can be avoided and the dovish shift in tone by the Fed could signal a pause in rate hikes and for USD strength to fade are refocusing attention back to EM Asia. Philippines also stands out as one of the EM Asian economies that will print growth of above 6% in 2019 that should continue to serve as a magnet for further foreign portfolio inflows. Amid these developments, we have taken the opportunity to revise our USDPHP outlook for the year but maintain its trajectory over the forecast horizon. We look for the USDPHP to come in around the 52.80 levels by end-1Q 2019 and slip further lower before climbing higher in 4Q to end the year at the 53.50 levels amid global growth concerns.

- The potential for a trade deal between China and the US is likely to lift risk sentiments and remove the albatross that had weighed on the AXJs. The resulting optimism should bolster demand for riskier assets in the region. In the Philippines, this is likely to manifest itself in greater inflows into equities. Since Nov 2018, foreign investors have purchased USD1.03n in equities. This is in contrast to their sell-off of USD1.77bn in equities in the first 10 months of 2018 as investors abandon riskier assets for safer-havens amid Sino-US trade war concerns and Fed rate hike concerns. Continued inflows into Philippine equities should be supportive of the PHP.

- The sell-off in the equity market during the period of market angst over Fed rate hike trajectory and Sino-US trade war concerns may have been overdone. Our analysis using the Cyclical Adjusted P/E (CAPE) ratio model remains relevant and the results still suggests that domestic equities appears relatively cheap (as reflected by the estimated P/E ratios minus their 10-year average P/E ratios) compared to its regional peers. This is especially so given the expected relative strong economic performance this year. The return of foreign investors to Philippine equities amid improving risk appetite and valuation perspective should weigh on the USDPHP.

- The shift in tone by the Fed has also been supportive of the PHP. Our economic team now expects just two hikes by the Fed in 2019 instead of three hikes. This could be a prelude to a pause by the Fed as growth concerns weigh and lead to fading USD strength. Given the recent shut-down in the US government, and its impact of growth there, makes a move in 1Q unlikely. The re-pricing of Fed hike risk should lead to some unwinding of stale long-USD positions, which weighs on the USD. A softer USD should benefit the AXJs including the PHP.

- Still, USDPHP is unlikely to slide lower unabated with moves lower constrained by its twin deficits, particularly its current account deficit. So far, the focus on the government’s ambitious infrastructure building programme is likely to keep the current account in deficit in 2019. In addition, trade deficits persist, putting pressure on the current account deficit. The saving grace is that oil prices are likely to average USD65/bbl in 2019, down from its 2018 average of USD71/bbl, possibly providing some relief to the current account deficit. Further deterioration in the current account deficit should weigh on the PHP, and limit the pair’s move lower.

- **As we had previously highlighted, the USDPHP should remain elevated in 1Q and 2Q as some political uncertainties could manifest in the lead up to the general elections on 13 May 2019. This election will see 12 seats in the Senate and all seats in the**

House of Representatives as well as all regional, provincial, city and municipal positions up for grabs. Should the opposition win a majority of the seats in both Houses of Congress, they could effectively block the parliamentary agenda of President Duterte who would be mid-way through his one-term in office. The uncertainty in the lead-up to the elections could force investors to sit on the side-lines until clarity in the political environment emerges. Our study of the past two mid-term elections showed that the PHP typically depreciates in the days before the elections and continues to soften even after. We therefore can expect the USDPHP to come under stress in the lead-up to the elections in 2Q before easing off in 3Q as political clarity emerges.

- **Growth and Inflation Outlook:** The economy expanded mildly by +6.1% y/y in 4Q 2018 from a downwardly revised +6.0% in 3Q. This brought full-year GDP growth to +6.2% in 2018, a slowdown from 2017's +6.7%. 4Q18 GDP print also fell short of the government's forecast range of +6.5-6.9%. This growth in 4Q was driven by robust private consumption, which rose +5.4% y/y vs. +5.2% in 3Q. Investment and government spending moderated though in 4Q, coming at +9.8% and +11.9% y/y in 4Q compared to +17.4% and +14.3% in 3Q. The decline in net external demand moderated, falling by just -6.3% y/y in 4Q vs. 3Q's -41.8%. A key factor for the slower growth was the surge in inflation (2018: +5.2% vs. 2017: +2.9%) due to the impact of tax increases under TRAIN, rising fuel and food prices, as well as weaker PHP vs USD, which prompted the aggressive +175bps hikes in BSP's policy rates from May 2018. With moderation in inflation expected to persist going forward on falling fuel and food prices, our economic team has maintained its 2019 growth forecast of +6.5% for now.

- Headline inflation rate (base year = 2012) eased to +5.1% y/y in Dec from +6.0% in Nov on the back of slower increases in food prices and transport costs. Core inflation (which excludes selected food items such as rice, meat, fruit and vegetables as well as energy prices from CPI) also eased to +4.7% y/y in Dec vs. +5.1% in Nov. In view of the easing CPI prints amid easing global oil prices, our economic team has adjusted their outlook for inflation in 2019 and 2020. The team now expects inflation to average +3.0% and +2.8% respectively (from +4.1% and +3.0% and +4.8%) respectively after coming in around +5.2% in 2018. By comparison, the BSP expects inflation to average +32% and +3.0% in 2019 and 2020 respectively.

- **Monetary Policy Forecast:** There was no BSP meeting in Jan with the first policy meeting of the year taking place on 7 Feb. The BSP is likely to keep its benchmark overnight borrowing rate unchanged at 4.75% at that meeting after lifting rates by a cumulative 175bp since May 2018. The interest rate corridor is also likely to be left intact with the overnight lending rate and overnight deposit rate at accordingly to 4.25% and 5.25% respectively. The interest rate corridor remained symmetrical on either side of the policy rate by 50bp.

- At the last policy meeting of 2018 on 13 Dec, the BSP hit the pause button on its benchmark interest rate for the first time since May given easing inflation pressures and PHP stability. With headline inflation likely to have peaked in Sep/Oct, this pause provides the BSP with some breathing space to prevent over-stressing the economy. Nevertheless, the pause did not signal the end of the current tightening cycle. The central bank is likely to keep all its options open in the event it needs to anchor inflation expectations should global oil prices rise or to tame the current account deficit. That said, our economic team expects the pause to continue into 2019 and is not penciling any rate hikes as inflation is expected to be well-anchored. The team is looking for 75bp of cuts in 2020 to bring the benchmark policy rate to 4.0 amid peaking of the Fed rate hike cycle in 2019 and downside risks to global growth over the medium term.

- The pressure to be more aggressive on rates was because of "persistent signs of sustained and broadening price pressures" as inflation has outpaced the upper bound of the central bank's target range of 2-4% for this year and next.

- As we had articulated in our last monthly, the current BSP tightening cycle has yet to reach its end. The BSP governor himself has reiterated that there is the need to do more for at least the next policy meeting (i.e. in Nov). However, he hinted that the rate hike would be more modest to anchor inflationary expectations and dependent on data, particularly the impact of recent measures on inflation. Our economics team is more hawkish on this front. It believes that it may be necessary to hike the policy rate by another 100bp within the next six months to curb inflationary pressures. The team is looking for another 50bp rate hike to come by the end of 2018.

- **Latest Fiscal and External Balance Outlook:** The budget for 2019 has yet to be passed by Congress. There are currently two different versions of the budget bill which is undergoing reconciliation at the moment. It seems unlikely that the budget will be approved by both Houses of Congress anytime soon. In the meanwhile, the government is re-using the 2018 budget plan as required by law. The delay in 2019 budget passage should delay much needed infrastructure building and planning. Projects that have been delayed include the PHP11.5bn railway and airport upgrade for the Siargao tourist spot in Mindanao. The delay in passing the budget is expected to cost the country as much as 2.3 percentage point of GDP this year.

- The current account deficit (CAD) narrowed to USD2.91bn in 3Q 2018 (or equivalent to 3.7% of GDP) from a deficit of USD3.24bn (or equivalent to 3.9% of GDP) in 2Q. The BSP expects the CAD for the whole of 2018 to come in at USD6.4bn (-1.9% of GDP). With the year-to-date deficit at USD6.47bn, this suggests that the central bank is penciling a return to very mild surplus in 4Q. For 2019, the BSP is projecting a deficit of USD8.4bn (or 2.3% of GDP) due to the increased demand for capital goods as the economy expanded.

- **Key domestic events and issues to watch:** Focus in the month will be on CPI (Jan) on 5 Feb and then on BSP meeting on 7 Feb.

- **Technical Outlook:** USDPHP was last seen at 52.20 levels. Daily momentum is turning bearish while stochastics is falling. 100 DMA looks on tract to cut 200 DMA to the downside. This is typically bearish. A decisive break below 51.95/52-support (50% fibo retracement of 2018 low to high) puts next support at 51.52 (61.8%). Area of resistance at 52.45 (21 DMA) – 52.60 (50 DMA). Bias to sell the pair on rallies.

THB: Politics To Disrupt But Not Stall Climb Higher

Forecast	1Q 2019	2Q 2019	3Q 2019	4Q 2019
USDTHB	32.00 (33.80)	31.70 (33.50)	31.50 (33.00)	32.00 (--)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** Given recent market developments, we have revised lower our USDTHB outlook for the forecast horizon. We expect the USDTHB to climb higher to the 32-levels (from 33.80 previously) by end-1Q 2019 in the lead-up to the general elections as political tensions intensify. Thereafter, we expect the THB to continue on its appreciation path posts-elections with the USDTHB ending 2Q at 31.70 (previously at 33.50) as political clarity emerges. Risk aversion though could re-emerge in 4Q on concerns over a possible global economic slowdown that could see USD gather strength somewhat and lift the USDTHB higher to 32.00 by year-end.

- The THB has been among the best performing currencies since Nov 2018. The THB has gained 5.6% against the USD to date since Nov 2018, second only to the IDR. The more positive outlook for the THB can be attributed to the improving risk environment on optimism that China and US can resolve their trade differences as well as the dovish tilt in the Fed's policy stance. Together, these have lifted risk appetite for emerging Asia assets including Thailand and allow the THB to appreciate more than we had anticipated. The unwinding of stale long USD positions amid optimism over Sino-US trade talks and fading US strength on Fed's dovish shift provides support for the USDTHB to move lower in 2019.

- The improving risk environment is manifested in the foreign flows into Thai assets. Since Nov 2018, foreign investors have not shown much interest in Thai equities, selling off USD176.9mn in equities. In contrast, they were more enamored with Thai bonds, purchasing USD450.6mn in debt since Nov 2018. The net foreign portfolio inflow since Nov 2018 has provided support for the THB and allowed the USDTHB to slip lower.

- Also making the THB attractive is its still healthy economic fundamentals including healthy growth momentum, relatively stable government, and monetary policy normalisation by the BoT. We expect the BoT to continue to normalise policy in 2019 with another 25bp hike to its policy rate. In addition, the possible shift of manufacturing away from China to Thailand could also be positive for the THB. More importantly, the persistent current account surpluses (around 8% of GDP in 3Q) continue to favor the THB. In addition, we are looking for a pick-up in private investment to drive the next phase of growth and provide even more support for the THB. Our optimism arises from the high correlation between private investment and trade for Thailand. Meanwhile, the government's push to accelerate infrastructure projects, especially the USD47bn Eastern Economic Corridor project ahead of general elections expected in Feb 2019 could also deliver upside surprises to domestic demand, growth and weigh on the USDTHB.

- We do not expect THB strength to go unabated though. There could be some re-allocation of assets away from Thailand in 1Q as political tensions re-emerges in the run-up to the general elections on 24 Mar. This is because we believe that political risk could re-emerge in the lead-up to the general elections and weigh on the THB. However, political temperature could rise as pent-up frustrations are released in the lead-up to the elections. This should keep investors on the sidelines until political uncertainty dissipates. Our study of the past two mid-term elections suggests as much with the THB typically depreciating in the days before the elections but recovers thereafter as the political uncertainty clears post-elections. We therefore can expect the USDTHB to come under upside pressure in the lead-up to the elections before easing off to hover lower in 2Q.

- Our base scenario is for the general elections to proceed as planned on 24 Mar 2019. We believe that a majority government by a single party is unlikely given the new Constitution. A fractious parliament made up of smaller parties is likely with the Senate dominated by 250 members appointed by the military junta. This should allow the military to retain influence in the government as no single party will be able to command a majority. More likely than not, PM Prayuth should remain as PM as a result. We do not expect any change in economic policy direction and for the BoT to continue normalising policy in 2019. Some initial volatility is expected in the aftermath of the election but we expect the THB to stabilise and continue on its appreciation path thereafter.

- **Growth and Inflation Outlook:** After moderating in 3Q 2018, the growth momentum is likely to stabilize in 4Q. The economy had slowed to +3.3% in 3Q from +4.6% in 2Q. This view is shared by the Deputy PM Somkid, who estimated that GDP expanded by 4-4.2% in 2018. This implied the economy grew by at least the same pace as in 3Q in 4Q. Looking ahead, government spending, especially ahead of the general elections expected early next year, together with planned infrastructure building projects including transport networks and the Eastern Economic Corridor development project should attract FDI and keep growth supported in 2019. We continue to expect the export-led recovery to spark a revival in private investment that should drive growth in 2019, given the high correlation between export recoveries and machinery & equipment investments for Thailand. Our economic team is penciling full-year growth of 3.8% for 2019 (from 4.1% estimated for 2018), slightly lower than the 4.0% projected by the Finance Ministry for the year.

- Headline inflation moderated in Dec, rising by just 0.364% y/y vs. 0.94% in Nov. This was the fourth straight month that inflation has slowed. This moderation was largely due to softer energy prices that saw transport costs contracting by 0.65% y/y from +1.59% in Nov. Also not helping is the slower increase in food prices, which were up by 0.90% y/y in Dec vs. Nov's 1.04%. Core inflation (headline inflation excl. raw food and energy) rose 0.68% y/y in Dec, little changed from Nov's 0.69%. For the full-year, headline and core inflation averaged 1.1% and 0.7% respectively in 2018 vs. 2017's 0.7% and 0.6%. For 2019, overall prices could trend on gradually higher fuel by election spending. The Commerce Ministry expects headline inflation to range within 0.7-1.7% in 2019 with 1Q CPI coming in at 0.86%, 2Q at 0.98%, 3Q at 1.27% and 4Q at 1.81%. Our economic team expects inflation come closer to the top end of the Commerce Ministry forecast range at 1.5% in 2019 before easing to 1.1% in 2020.

- **Monetary Policy Forecast:** The BoT lifted its one-day repurchased rate from 1.50% to 1.75% for the first time since Aug 2011, and the first rate change since Apr 2015. This rate hike though was not a unanimous decision. 5 members voted for a 25bp hike, considering the environment still accommodative after the hike, while 2 members favored the status quo to assess the external risks to growth and the sustainability of growth momentum. Even after the hike, the BoT highlighted that monetary policy remains accommodative and appropriate. We believe the move by the BoT provides the central bank with more policy space should shocks emerges. Unlike most of its peers in the region who are likely to maintain the status quo in monetary policy this year, the BoT is expected to be one of the few central banks to remove monetary policy accommodation further. Our economic team is penciling a 25bp rate hike in 2019 and then staying on hold thereafter in 2020. We do not expect the BoT to move on policy in 1Q, mindful of the perception a rate hike might have during the elections scheduled for 24 Mar.

- **Latest Fiscal and External Balance Outlook:** The Thai cabinet has approved the FY2020 budget deficit of THB450bn. The deficit is based on projected spending of THB3.2tn and net revenue of THB2.75tn in the fiscal year starting in Apr 2019. Investment spending is seen at THB691.2bn in FY2020, an increase of 6.5%, and accounts for 21.6% of total expenditure, unchanged from FY2019.

- The current account surplus narrowed slightly to USD1.63bn in Nov from Oct's USD1.89bn surplus. This could be attributed to the shrinking trade surplus in Nov of +USD0.66bn vs. Oct's +USD1.26bn. Even the larger income account surplus of USD0.97bn failed to make up for the smaller trade surplus. The overall balance of payments rebounded back into a surplus of USD0.38bn in Nov after slipping into a deficit of USD0.90bn in Oct. Details for the financial account are lacking at the point of writing, but it is likely that there were portfolio inflows in the month.

- **Key domestic events and issues to watch:** BoT meeting on 6 Feb will be eyed for clues on further hints of policy normalisation. Also eyed will be 4Q 2018 GDP print on 18 Feb for the signs that growth momentum remains on track ahead of general elections.

- **Technical Outlook:** USDTHB has been on a decline (of >6%) since Oct-2018. Pair was last seen at 31.25; levels not seen in the last 9 months. Bearish momentum on weekly and daily chart remains intact though we caution that stochastics is in oversold conditions. Immediate support at 31-psychological level. Decisive pierce-through the support puts next support at 30.48 (76.4% fibo retracement of 2013 low to 2015 high). We caution that a failure to push through 31-support could see rebound risks, given overstretched technical. Rebound could re-visit 31.76 (21 DMA), 32 levels.

INR: Eye The Interim Budget and RBI

Forecast	1Q 2019	2Q 2019	3Q 2019	4Q 2019
USDINR	67.00 (--)	66.00 (--)	66.00 (--)	68.00 (--)

No Change to Forecasts

- **Motivation for the FX View:** USDINR hovered around 71.40 as we write at the end of the month. The pair made some retracement higher along with the crude oil price as the demand for domestic bonds weakened ahead of the Federal Budget on 1 Feb. As indicated by our India Analyst Jigar Shah in his latest piece here, the government will present an interim budget ahead of the general election and by convention, the new government will present the final budget which the new parliament would pass (estimated Jul 2019). He cautioned that despite rampant discussions of package for farm and SME sectors, it would be difficult to implement without threatening the fiscal deficit target. An expansionary fiscal deficit would also run the risk of driving up interest rates.

- The end of last year saw Modi lose three significant North Indian states, we still see a risk for Modi to put out as many electoral promises as possible within this budget. Given the fact that Modi will not be able to count on a lot of fiscal stimulus or if he did, risk driving financing cost for the private sector higher, we see a real possibility for RBI to cut reverse repo rate by 25bps to 6.25% to give growth a boost. Activity has been slowing and inflation is also subdued.

- The demand for domestic assets weakened with flows into bonds and equities down around U$283mn and USD446.4mn respectively between 1-25 Jan. This was perhaps in tandem with the rise in the crude prices. Short-term, we see some risks for USDINR to head higher as the government is trapped in a rock and a hard place in terms of delivering the interim budget. Beyond the near-term, we caution for volatility 100days ahead of the General election (likely to be in May) and then INR typically strengthens 50 days before the event. We look for opportunities to buy the INR on dips. Expect USDINR to end the first quarter at around 67.

- **Growth and Inflation Outlook:** Industrial production decelerated to just 0.5%y/y from previous 8.1%. The decline was broad-based, observed in the output of manufacturing, mining and electricity. Manufacturing contracted -0.4%y/y but that was due to high base effect. Capital goods contracted -3.4%y/y from the previous growth of 17%. PMI-mfg softens to 53.2 from previous 54.0. However, the print is still considered to be rather healthy with strong production and employment "in response to strong inflows of new business". Subdued input cost inflation also likely mean that factory charges are likely to remain steady. According to Markit, managers noted that strong sales and technological progress supported the increase in output.

- Inflation softened from 2.3%y/y to 2.2% as the fall in crude price brought the fuel and light subcomponent lower. Housing prices also remain on the decline, easing from 6.0%y/y to 5.3%. Barring near-term spikes in the crude price, supply and demand projections by the IEA suggest that crude price could be capped for much of this year, especially in the first half and that could bring tailwinds for the rupee.

- Trade deficit narrowed substantially to around U$13bn in Dec with exports and imports slowing significantly. Exports eased to just 0.4%y/y from previous 0.8%. Imports contracted -2.4%y/y from previous 4.3%. High base effects should not be ruled out here. However, outlook is not optimism with slower global growth likely to dampen the demand for India's exports. That said, as long as brent crude remains stable, a slower growth environment could still be a sweet spot for a higher yielder INR as global rate (especially the US) start to peak.

- **Monetary Policy Forecast:** This would be the first MPC meeting after the resignation of Governor Urjit Patel. Shaktikanta Das takes over as Governor and he has pledged that he will uphold the credibility and the autonomy of the RBI. While making a rate cut at this juncture could be perceived as yielding to the government's demand and compromising the central bank's credibility, we see a risk for Governor Das to start with a rate cut as activity momentum slows and as inflation environment remains benign enough for RBI to do so. His intention was signaled when he mentioned about growth as being part of RBI mandate apart from inflation targeting. The decision to cut would be after the interim budget is presented this Fri (1 Feb).

- **Latest Fiscal and External Balance Outlook:** India's current account is still at risk of further deterioration should crude brent rise move higher. However, the IEA supply and demand condition should see gains capped at around U$70/bbl. That should provide a benign environment for India's external balance. As for the budget on 1st Feb, we do not look for fireworks in this interim budget but we see risk that the government could jeopardize the fiscal targets by including electoral goodies in order for Modi to win back some of the states he lost.

- **Key domestic events and issues to watch:** The Government presents the Federal budget for 2019 on 1st Feb; PMI-mfg for Jan is due on 1st as well; RBI MPC meeting is scheduled on 7 Feb; Jan CPI and Dec industrial production due on 12th; WPI for Jan is due 14th; trade data for Jan on 15th; 4Q GDP on 28th;

- **Technical Analyses:** 1M USDINR NDF met resistance at around 71.80 and has softened since. Weekly chart shows potential range-bound action within 70-71.80. Momentum shows some upside bias there Breakout to the upside to open the way towards the 73.55.

VND: Resilient

Forecast	1Q 2019	2Q 2019	3Q 2019	4Q 2019
USDVND	23300 (23000)	23200 (22900)	23100 (22800)	23100 (--)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** The VND has been rather stable against the USD, last seen at 23200, underpinned by a late year surge in FDI, especially in the manufacturing sector. The strengthening of the currency along with the RMB was in line with our view that the trade war was started with the mid-term elections as an aim. Along with hopes for the US and China trade relations to improve, the CNY recovery also set a positive tone for the year and we look for modest CNY strength to provide an anchor for the VND this quarter, if not for most part of this year. Portfolio inflows have been supportive of the currency as well ahead of the implementation of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) that took effect on 14 Jan 2019. That includes the lifting of 86% of tariff from Japan on Vietnamese goods. Investors were also excited about the introduction of the FTA with the EU.

- While Vietnam is seen as the "beneficiary" of the trade war amid some reallocation of production from China here, slower external demand as a result of slower global trade could still weigh on the VND. Vietnam's trade balance has been in deficit for the last three months (including Jan). That limits the VND gains. While investors can find solace in China's recent slew of economic stimulus, growth stabilization is the aim of policymakers and not a sharp rebound. We can also expect support for the VND from China to also be as modest.

- Should trade war become trade deal, it is unlikely that there could a reversal of gains for Vietnam as well. The trade war essentially was an "event disruption" that quickens the process of reallocation of production plants that are of relatively lower value in China to Vietnam in the short term. Over time however, investors are likely to increase the value of the production as the Vietnamese workers gain experience.

- VND is thus expected to remain relatively stable against the USD and to end the quarter at around 23200.

- **Growth and Inflation Outlook:** PMI-mfg slipped to 53.8 from previous 56.5. Markit noted "further solid rises in output and new orders" while input costs decrease for first time in 34 months. That is in line with the softening commodity prices that we have witnessed in the last few months. Stronger new orders led to stronger hiring. That really keeps the employment rate at nearly full employment. Our Vietnam Analyst has written in the report here that the rise in FDI typically correlates to nationwide employment in industrial business. Strong hiring momentum therefore supports the private consumption. Retail sales (a proxy for private consumption expenditure) accelerated to 12.2%y/y from previous 9.4% and that is taking into account softer retail sales from tourists.

- That said, industrial production for Jan weakened to 7.9%y/y vs. the previous 11.4%. This can be due to a slightly earlier Lunar New Year celebration this year (Tet falls on 4-8 Feb 2019 vs. 14-20 Feb 2018) that could have led to a rather high base effect. The seasonal effect would mean that the Feb print is needed for a more accurate assessment on the industrial production momentum.
- Infrastructure will still be a key driver of growth in medium term if Vietnam wants to continue to attract foreign investors. As such, we anticipate that fiscal deficit consolidation would still be a challenge for the government.
- **Monetary Policy Forecast:** 2019 brings another environment for Vietnam as inflation pressure remains subdued while risks to growth is roughly balanced. While Vietnam benefits from FDI inflows and even some support for the VND is seen from portfolio inflows amid hopes that the CPTPP and an upcoming FTA with the EU could boost exports, external environment still have headwinds. Slower global growth weakens demand for Vietnam's exports and trade balance has tilted into deficit for the past three months. Still, we can count on stimulus in China to ensure that demand would not continue to deteriorate while the US-China trade truce could turn into a trade deal that could boost global trade volume. In the meantime, sustained imports growth and retail sales suggest that household consumption could support growth should external conditions turn less favourable.
- In this environment where growth outlook for Vietnam is still rather balanced, we see little need for a rate cut by SBV as yet even though risks have tilted towards that action. In terms of NEER, VND has weakened against its regional peers in the past month. We anticipate that VND is likely to remain a laggard in an environment of softer USD and that could provide more export competitiveness that could improve its trade balance.
- Latest Fiscal and External Balance Outlook: Minister of Finance had said that the budget deficit will remain at a ratio of 3.6% of GDP. State budget collection in 2019 is projected to reach VND1.411 trn vs. budget spending estimated to be at VND1,633 trn.
- As of last available data, current account surplus was at U$1.24bn in 3Q. Net trade surplus of goods slipped to U$3.0bn from previous U$5.2bn. The competitive dong could keep the current account in surplus. Financial account surplus narrowed to U$2.295bn. Slower growth momentum could mean a deterioration on the trade front and we expect the current account surplus to be eroded in the fourth quarter of 2018. That would underscore the need for VND to remain

competitive and our view that VND could lag in its recovery against the USD compared to regional peers.

- **Key Domestic Events and Issues to Watch:** PMI-mfg on 1st; domestic vehicle sales in 6th-13th; CPI, trade numbers, retail sales and IP are due 25th-28th Feb. Tet holiday falls on 4-8 Feb this year.

FX Forecasts

	End Q1-19	End Q2-19	End Q3-19	End Q4-19
USD/JPY	110	108	106	107
EUR/USD	1.1400	1.1500	1.1600	1.1600
GBP/USD	1.3000	1.3200	1.3400	1.3600
AUD/USD	0.7100	0.7300	0.7400	0.7300
NZD/USD	0.6800	0.7100	0.7200	0.7100
USD/SGD	1.3600	1.3400	1.3300	1.3500
USD/MYR	4.05	4.00	3.98	4.06
USD/IDR	13400	12900	12700	12900
USD/THB	32.00	31.70	31.50	32.00
USD/PHP	52.80	53.30	53.00	53.50
USD/CNY	6.75	6.70	6.65	6.70
USD/HKD	7.80	7.79	7.78	7.78
USD/TWD	30.80	30.70	30.60	30.70
USD/KRW	1125	1115	1105	1120
USD/INR	67.00	66.00	66.00	68.00
USD/VND	23200	23000	22800	22900
DXY Index	96.87	95.88	94.64	94.86
SGD Crosses	End Q1-19	End Q2-19	End Q3-19	End Q4-19
SGD/MYR	2.9779	2.9851	2.9925	3.0074
SGD/IDR	9853	9627	9549	9556
SGD/THB	23.53	23.66	23.68	23.70
SGD/PHP	38.82	39.78	39.85	39.63
SGD/CNY	4.96	5.00	5.00	4.96
SGD/HKD	5.74	5.81	5.85	5.76
SGD/TWD	22.65	22.91	23.01	22.74
SGD/KRW	827	832	831	830
SGD/INR	49.26	49.25	49.62	50.37
MYR Crosses	End Q1-19	End Q2-19	End Q3-19	End Q4-19
EUR/MYR	4.62	4.60	4.62	4.71
JPY/MYR	3.68	3.70	3.75	3.79
MYR/HKD	1.93	1.95	1.95	1.92
MYR/CNY	1.67	1.68	1.67	1.65
GBP/MYR	5.27	5.28	5.33	5.52
AUD/MYR	2.88	2.92	2.95	2.96
NZD/MYR	2.75	2.84	2.87	2.88
MYR/IDR	3309	3225	3191	3177
MYR/INR	16.54	16.50	16.58	16.75
MYR/KRW	277.78	278.75	277.64	275.86
MYR/PHP	13.04	13.33	13.32	13.18
CNY/MYR	0.6000	0.5970	0.5985	0.6060

Source: Maybank FX Research as of 31 January 2019.

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

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