Macro | FX Research & Strategy

Global

February 28, 2017

FX Monthly

2017, Issue 2: Making Sense of Potential US Tax Reforms, Fed Rate Hikes & Euro Political Risks

Key Themes[1]

- First, ***expectations of an improved US medium term growth and productivity outlook on the back of expectations of a targeted fiscal infrastructure package, changes in the regulatory environment and tax reforms (i.e. lower taxes) under the Trump administration***. Longer terms, concerns about changes in trade and immigration policy, have raised concerns globally. Expected US fiscal boosts could lead to concerns of faster inflationary pressures and as such affect the Fed rate hike trajectory, with consensus expecting around 2 hikes in 2017 and the Fed, 3 hikes. In 1H 2017, we still expect on average a steepening of the UST curve with the back end rising faster than the front end (higher nominal rates). The dollar should remain supported in 2017. Overall the monetary policy divergence (Fed vs ECB & BOJ) should manifest in a long USD vs. short EUR and short JPY.
- Second, ***the dateline for achieving Japan's 2% inflation target is now*** open-ended with the dateline now at "around fiscal 2018" i.e. the year starting from Apr 2018. BOJ have scrapped its target for the average maturity of its government bond holdings and forward guidance has been strengthened, with the BOJ stating asset purchases will continue until inflation is stable above 2%, making it clear that exit won't happen immediately if they hit 2%. BOJ kept the benchmark rate unchanged at -0.1% and have stated that the JPY 80trn annual monetary base target will now fluctuate in the short term in order to shape the slope of yield curve. ***Japan will regularise their bond purchases in March with the BOJ announcing its debt purchase plan on 28 Feb***.
- ***Third, major risk out of Eurozone likely to emanate via the political event risk channel. The election season is fast approaching with Netherlands coming up on 15 Mar and France coming up on 23 Apr and 7 May. Opinion polls of late suggest Far Right parties are leading in the polls for both Netherlands and France***. Our base case is for no Eurozone break up. EUR is expected to face further downside pressure amid an environment of growing divergence in monetary policies (between ECB and Fed) and political contagion risks, mainly in 1Q – 3Q 2017 before regaining strength towards end-2017 as monetary divergence slows (due to the possibility of an end to QE or even tapering amid pick-up in inflation closer towards medium term objective of 2%).
- ***Fourth, China still has excess capacity, heavily indebted corporations which continue to add pressure on the economy and the yuan medium term. Expect the upcoming CPPCC and NPC to continue to address these key issues***. PBOC continues to rely on SLF, MLF and PSL as liquidity tools rather than interest rate and RRR. ***They recently raised the rates for SLF, MLF and 7-day reverse repo***. In a world of USD strength, we continue to expect PBoC to limit the depreciation in the CNY trade weighted. ***On the other hand, in the absence of USD strength, CNH has a different behaviour, underperforming other Asian currencies. We see that to reverse should USD bulls awaken***. We maintain our long CNH view against EUR. China potentially filling up the political, trade and military vacuum in the world left by the US, may lay the foundation for China's growth stabilisation. This could provide some buffer from US anti-trade policies and thus allowing some floor to RMB and EM weakness.
- Commodities have improved due to Asian infrastructure spending plans, and low base global pick up, expected synchronised export recovery and oil prices seem to have stabilised, so overall commodity prices should be moving higher in 2017 ***but we may be seeing some retracement in commodity prices in March as concerns of strong USD and global glut and supply pullback***. For next 6 months we are still supportive oil and metal prices benefitting MYR, CAD and AUD.

Analysts

Saktiandi Supaat
(65) 6320 1379
saktiandi@maybank.com.sg

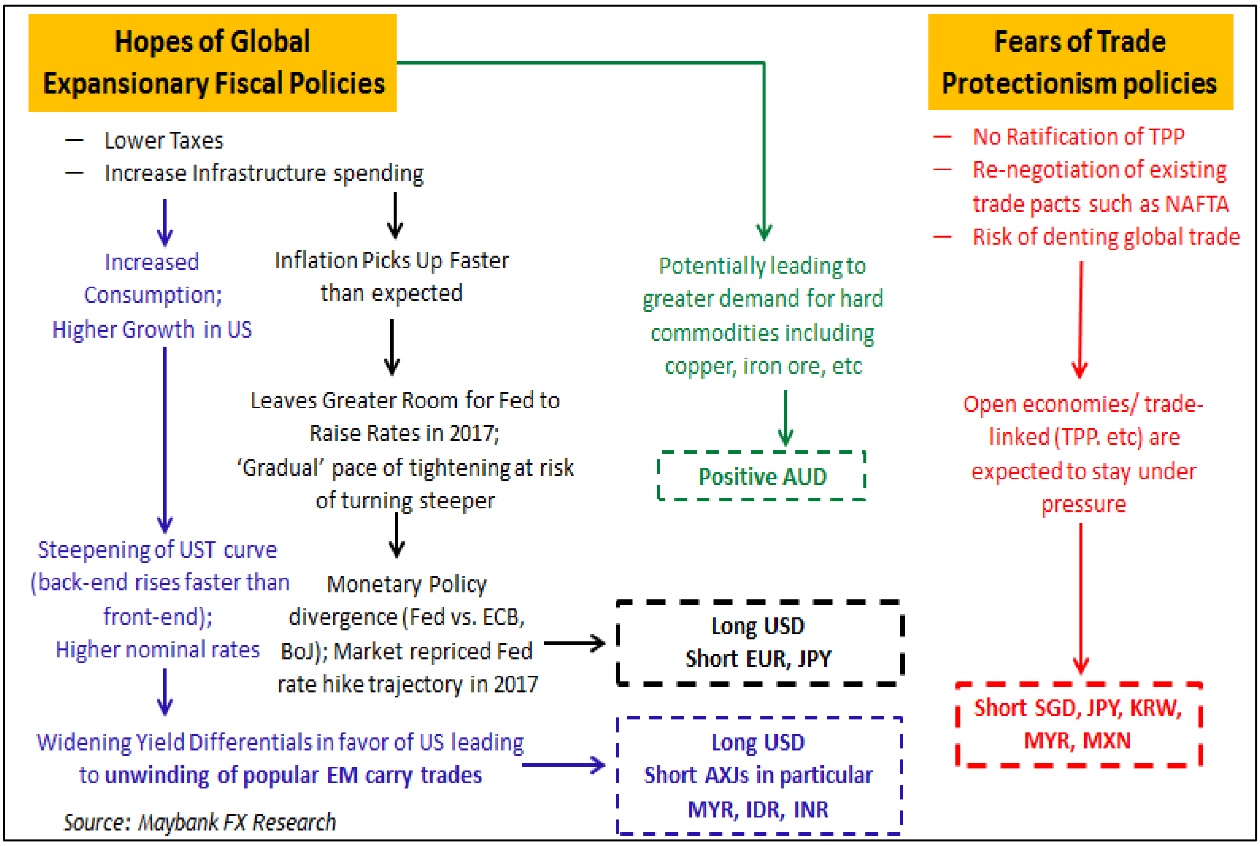
Christopher Wong
(65) 6320 1347
wongkl@maybank.com.sg

Fiona Lim
(65) 6320 1374
fionalim@maybank.com.sg

Leslie Tang
(65) 6320 1378
leslietang@maybank.com.sg

[1] Underlined words represent new developments in the FX themes.

So What?
Hopes of Expansionary Fiscal Policies vs. Fears of Trade Protectionism



	2015	1Q- 3Q 2016	4Q 2016	2017 Outlook?
Global Growth	IMF, ADB downgrades	Growth 'not hot not cold'	Lesser Downgrades from IMF, ADB	Early Signs of Stabilisation in 1H 17; & potential synchronised export recovery
Inflation	Subdued globally; Only US showed signs of pick up in end-2015	Subdued globally; but inflation in US managed to stabilize 1 – 1.5%	China, Europe started to show signs of uptick in headline inflation; US inflation holding up above 1.5%	Inflation shows signs of further pick up via the headline (base effects and pick-up in commodity prices)
US Rate Hike Expectation	First Fed rate Hike in 10 years	No rate hike	Rising expectation for rate hike in Dec	MBB Expects 50-75bps hike expectation vs. Markets' expectation for 48bps
Commodity/ Oil Prices	Decline to more than 10Y low of $30/bbl	Stabilised around $43 (1Q-3Q avg)	Stabilised at higher average of $50/bbl	Potentially Moving Higher into $55 – $65 Range
Impact on FX	USD strength against most currencies	USD Strength Eased; Carry trade returns (hunt for yield)	USD strength returning; UST yield steepening	Expect further steepening of UST yield curve; **Markets underpricing of rate hikes could lead to further USD strength ahead**

Source: Maybank FX Research

	3-months	6-months	12-months	24 to 36 months
Short Term Dynamics (Key risk event)	- FoMC meeting (1 Feb and 16 Mar) - Trump's State of the Union Address (End Jan-Early Feb) - Trump's cabinet appointments - Implementation of oil production cuts (Jan 2017) - Jakarta Governor election (15 Feb 2017)	- US debt ceiling - Potential announcement of US fiscal expansion plans - Netherlands Presidential Elections (15 Mar) - French Presidential Elections (Apr-May 2017) - Potential early Malaysian Elections - Potential early Korean Elections - Trigger of Article 50 in UK - Risk of snap elections in UK - OPEC review of oil production cut at May 2017 meeting	- Trump may push for more protectionist trade policies (no ratification of TPP, re-negotiation of NAFTA, etc.) - Speculation for Fed Governor appointments in 2018 - German Federal Elections (Oct 2017) - Thai Elections (Dec 2017) - NZ elections (by end Nov 2017)	Trump may continue to push for more protectionist trade policies (no ratification of TPP, re-negotiation of NAFTA, etc.)
Long-Term Thematic	Anti-globalization Anti-establishment (Protectionist-policies)			

Source: Maybank FX Research

- Almost 40 Days into Trump world and we continue to witness the tussle between Trump Fears and Trump Hopes (see Chart in page 2). Uncertainties between the two elements alone capped the USD strength thus far. More patience may be needed to revive the USD bulls and we anticipate this to manifest into 2Q-3Q. We expect USDAXJ to be broadly higher, in particular open economies (SGD, JPY, KRW) to be weaker; domestic idiosyncratic factors also weigh on AXJs such as political risk factors in Indonesia, Philippines and Thailand; growth, credit concerns in China, and trade and investment concerns in Vietnam.
- Monetary policy divergence/ widening inflation difference to weigh on EUR and JPY. There is high chance of EUR moving towards parity and USDJPY likely to move higher towards 115-120 levels.
- Trump's expansionary fiscal policies, capex spending upswing and Asian infrastructure spending may lead to demand for hard commodities AUD to find some support around 0.70-0.72 levels.
- In the absence of USD strength, CNH underperforms other Asian currencies. We see that to reverse should USD bulls awaken. We hold our view to favor relative beta plays ex-USD with long hard commodity vs short open economies/benign inflation, favouring CNH longs vs. EUR, JPY and SGD. Our opportunist trades at some stage this year, given stretched spot levels vs. fundamentals are Long IDR & MYR.

G7 Global Overview

USD: Patience needed for continued dollar upswing

Forecast	1Q 2017	2Q 2017	3Q 2017	4Q 2017
USD Index	103.55 (103.72)	107.86 (107.82)	105.14 (105.10)	101.60 (101.56)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** We expect at least two rate hikes in 2017, more likely in June onwards but with some risk this March 16. We do caution that additional repricing of a surprise Fed hike earlier in Mar (due to market complacency over Fed rate hike trajectory) could continue to see UST yields higher in particular Treasuries 2y and below, and see **USD strength (buy the rumor) in the lead-up to FOMC** meetings. Since the US Presidential elections, the focus has shifted back to a stronger USD due to a US cyclical upturn and the potential for a pickup in inflation. We continue to expect domestic factors and a repricing of the future stance of monetary policy to drive the USD stronger. Even though the market's expectations on the Fed tightening cycle have moved, we think market pricing for the federal funds rate is still too dovish and we expect the Dollar to appreciate. During this phase and around FOMC announcements, we believe the **USD could still be mildly supported**. As long as the Fed tightening expectations remain the USD appreciation trend should remain. In addition, we may need clarity on both fiscal and trade policies from the Trump administration to support a US reflation view. If one of these falters, we could see softness in the USD and further sharp ups and downs in the dollar in the first quarter of 2017. More recently, US Treasury Secretary Mnuchin comments in an interview with CNBC, signal that the Trump administration remains undecided on the tax reform and hopes that Congress will pass it by August recess. Continued unclear signals on the tax reforms could soften the USD in March.
- Nonetheless, as long as there are less economic growth downgrades by supranationals and the market, some signs of global inflation emerging, rising expectation of faster pace of Fed rate hike and if oil remains somewhat stabilized around $50-60/bbl, then we will expect USD strength to be sustained in 2017 and UST yield steepening to appear more entrenched.
- **Growth and Inflation Outlook:** The advance estimate of Q4 US GDP, at 1.9% q/q saar, was broadly in line with expectations. Consumer spending remained robust and inventories made a positive contribution, but net trade was a significant drag. Weaker than expected existing and new home sales implied less broker commission and slightly slower residential investment growth than expected. The advance trade report also showed a larger deficit than expected as well as weaker equipment investment, while inventory accumulation was a little stronger than expected. US pending home sales rose 1.6% m/m in Dec, beating expectations. However, the drag on home sales from higher mortgage rates is likely to play out in the near future. The data remain supportive of a modest recovery in the housing sector in 2017.
- CPI inflation came in higher increasing 0.6% m/m against consensus of 0.3%. Energy prices rose for the fifth consecutive month (4.0% m/m),

while food prices edged higher (0.1%) after being flat since July. On a y/y basis, CPI accelerated to 2.5% from 2.1%, as energy base effects continued to boost headline CPI and core CPI firmed further. Core inflation was also stronger than expected, rising 0.3% m/m and 2.3% y/y.

- Core goods CPI is most affected by dollar strength and soft imported inflation; as those deflationary pressures unwind, we expect core goods inflation to stabilize and turn neutral in 2018. The recent increase in China PPI and the improving import inflation trend, suggest to us that the drag from core goods on CPI is likely to bottom this year.

- **Monetary Policy Forecast:** FOMC left the target range for the federal funds rate unchanged at 0.25%-0.50% at the Feb 2017 FOMC meeting.. The risks to the US economic outlook appear roughly balanced in the Feb statement. Consistent with the recent tone adopted by the chair and other FOMC speakers, the committee took the opportunity to signal the continued progress towards their full employment mandate. On inflation, reflecting the recent firming in inflation data, but also the fact the PCE inflation remains stubbornly below target, the statement reiterates, "Inflation increased in recent quarters but is still below the Committee's 2 percent longer-run objective. **We are currently pricing in a +50-75bps hike in fed fund rate this year.**

- **Latest Fiscal and External Balance Outlook:** Fiscal policy should be expansionary over the next few years as the prospect of a tax reform and some investment in infrastructure becomes apparent under the Trump administration. The deficit has fallen sharply from its peak. Fiscal sustainability risk continues to weigh on the outlook and may emerge sooner than later. In the long term, an improved US economy and manufacturing sector, US shale oil and gas production may improve the US current account leading to dollar support but this is likely to be long drawn and may probably begin only in 2018. The US other deficits – current account and BOP deficits have moved slightly wider and is expected to continue. The latest Dec US nominal trade deficit narrowed to $44.3bn from -$45.7bn in November. The improvement was driven mainly by a smaller goods deficit, while the services trade surplus improved only modestly. The real goods balance narrowed by $1.5bn, to $62.3bn, and the real ex-petroleum goods balance narrowed by $1.0bn, to -$9.5bn. The surplus in trade in services rose modestly to $21.4bn (from $21.2bn).

- **Key domestic events and issues to watch in Feb 2017:** Key US events: PCE Deflator (1 Mar and 31 Mar); ISM Manufacturing Feb (1 Mar) (expected: 56); Factory Orders (6 Mar); Durable Goods (6 Mar, 24 Mar); Trade Balance (7 Mar); NFP (10 Mar); FOMC Meeting (16 Mar); CPI (15 Mar); GDP 4Q (30 Mar), Ind Production 17 Mar, Current Account Balance (21 Mar)

- **Technical Outlook:** Our call (in our last monthly outlook) for support at 99 – 99.50 to hold and potential falling wedge (bullish reversal) held up well. DXY traded a low of 99.23 (2 Feb) before rebounding. Intra-month high was seen at 101.76 (15 Feb). Last seen at 100.83 levels. Weekly and daily momentum indicators suggest some bearish signals. Next support at 100.50 (21, 100 DMAs). A break below this on weekly close could suggest some downside pressure towards 99.80 (50% fibo retracement of Nov low to Jan high). Resistance remains at 101.90 (23.6% fibo), 103.80. Bias remains to buy on dips.

EUR: Caution against Complacency

Forecast	1Q 2017	2Q 2017	3Q 2017	4Q 2017
EURUSD	1.0400 (--)	0.9800 (--)	1.0200 (--)	1.0800 (--)

No Change from Previous Forecast

- **Motivation for the FX View:** We continue to sound the caution alarm against market complacency on political risks in Europe. The election season is fast approaching with Netherlands coming up on 15 Mar and France coming up on 23 Apr and 7 May. Opinion polls of late suggest Far Right parties are leading in the polls for both Netherlands and France. Though past history of UK's Brexit and US elections showed that polls have lost its predictive powers, it is the only source of information available and looks set to swing sentiment in the lead-up to election day. Polls favoring Far Right parties could heighten the level of volatility and depress sentiment and the EUR. We **are bias to stay core short EUR vs. USD and JPY**, on a tactical proxy basis to express our caution on political events in Europe. We keep our EUR forecast unchanged over the forecast horizon.

- By tactical proxies we mean of long USD and JPY vs. EUR short. Long JPY on safe haven flows in the event of negative risk sentiment emanating out of negative surprise in Netherlands and France elections; long USD vs short EUR on view of growing divergence in monetary policies between Fed and ECB.

- ECB remains on monetary easing bias (extension of bond purchases to end-2017) and it is too early at this stage to call for a QE tapering especially when core inflation remains subdued. True headline inflation rebounded, but due to base effects and energy prices. Those upticks were well within ECB officials' expectation. In particular ECB Draghi said for inflation to be considered as 'sustained adjustment', there are four elements that need to be fulfilled: Inflation (1) is affecting the medium term, (2) is durable, (3) is self-sustained and (4) is region wide. Recent upticks do not exhibit any of those elements. We expect monetary policy divergence to grow further especially in the lead up to key FoMC meetings in Mar and Jun and this is expected to re-exert downside pressure on the EUR.

- While we have highlighted that the Euro-area faces a busy political calendar this year, we zoom in on 2 elections that are coming up next. We leave German Federal Elections (Aug - Oct) to later issues of our FX Monthly:

    - **Netherlands General Elections** (15 Mar) - The race is on between current Dutch PM Mark Rutte (People's Party for Freedom and Democracy or VVD, who is looking to extend his term for the 3rd time) and Geert Wilders (Far Right Freedom Party or PVV). PM Rutte (conservative-inclined) is banking on a strengthening economic recovery to restore popularity lost during the austerity years of 2012-2014. Geert Wilders (opposition) is well known to be a Eurosceptic; currently tops opinion polls with his populist campaign on anti-immigration, anti-EU and anti-Islam. He has pledged to close Netherlands' borders, shut down mosques and leave the EU if he gets elected. This will be the first test to see if the wave of populism upsets the established order. And in Netherlands case, the political situation looks especially fragmented, as no single party can win 76-seats majority (out of 150-seats) to form a government. The number of seats occupied by the top 3 mainstream parties has seen a decline from 89% to just over 60% in 2012. Latest polls suggest that these top 3 mainstream parties may well garner 42% share. And this year sees a record 28 parties on the ballot. Without going further into the details, **the bottom-line is even if Far Right leader Wilders win the most seats in the General Election, he may not become the Prime Minister because the other Dutch parties have explicitly said they are not willing to form a coalition with him. <u>The Prime Minister position is only reserved for the leader of the party with the largest number of seats in the coalition government.</u>** Latest polls suggest PVV (Wilder's party) may win about 30 seats, still short of 76-seat majority. What this suggests is the aftermath of Netherlands General Election could be a mess with up to potentially 5 parties forming a coalition government.

- **French Presidential Elections** (first round on 23 Apr and second run-off on 7 May) – More than 10 candidates have put their names up for the upcoming election. But focus is on a few leading candidates: Front National Party (Far Right) – **Marine Le Pen**; Les Républicains (Conservative) - **François Fillon**; Parti Socialiste (Socialist) - **Benoît Hamon**; and En Marche! (Independent and Centrist) - **Emmanuel Macron**. These candidates have varied ideologies and policies and the **concern is how these candidates may ride on the rise of populism and undermine the stability of the Euro-club and pose risks to financial markets**. For instance, Marine Le Pen is leading in opinion polls and is expected to reach the second round of the voting in May. **She is known for her anti-immigration stance and pledges to take France out of the Euro-zone**, if elected. We expect heightened level of volatility (resulting in EUR downside pressure) leading into elections should polls continued to show increasing support for her. Former Economy Minister Macron is running as an independent candidate under a newly-formed party (En Marche!). Though he has never ran for an election, the 39-year old candidate appears to be gaining quite some attention, polling above 18% in all opinion polls since Dec-2016. Amongst the top 4 candidates, Macron appears to be the second most popular, after Marine Le Pen. He is **pro-Euro-zone and does not support Le pen's campaign on anti-globalisation, anti-establishment.** He does not want to be categorised as a left or Right-wing but **positions himself as one that reconciles two Frances that have been growing apart for too long**. He is likely to benefit from the current situation (hard-left Benoît

Hamon and scandal-hit/Right-wing François Fillon). **An eventual outcome with Macron emerging as President of France is likely to support risk sentiment and the EUR.**

- **Upside risk to our Outlook:** In the event that political events this year surprise with no upsets (i.e. pro-euro establishment manages to secure victories, political stresses dissipate), monetary policy divergence slows – either due to ECB tapering earlier than expected or less hawkish Fed, or if inflation in Euro-area picks up sustainably. EUR shorts could unwind and EUR could turn higher on any of this reasons materializing.

- **Growth and Inflation Outlook:** We expect economic recovery in the Euro-area to continue, albeit at a moderate pace. PMI releases since Aug 2016 continue to point to an optimistic outlook. Preliminary composite PMI hit 70-month high at 56.0 in Feb. New business and export orders increased at its fastest pace since Apr 2011. Preliminary Services PMI also jumped to 55.6 in Feb (vs. 53.7 in Jan).

- In ECB staff members/Euro area national central banks' macroeconomic projection (dated Dec 2016), the ECB expects 2017 GDP to grow by 1.7%, supported by resilient domestic demand amid accommodative monetary conditions. The ECB projects exports to gradually gain momentum resulting in a gradually improving net trade contribution. 4Q GDP is scheduled for release on 31 Jan. 3Q GDP rose by 0.3%, thanks to private consumption and fixed capital formation. These projections will receive a refresh on 9 Mar.

- **Euro-area inflation** jumped to 1.8% y/y in Jan (vs.1.1% y/y in Dec 2016), thanks to energy prices. While this is a fresh 4-year high, we suspect this spike is temporary and due to base effects and remains well below the ECB's objective of 2%. Recall that previous accounts of ECB meeting had already projected inflation to rise towards end-2017 and this uptick in headline inflation is well within the expectations of policymakers. In addition, core inflation was largely unchanged at 0.9% y/y in Jan (unchanged from previous 2 months) and ECB Draghi's main focus remains on underlying price pressures (core inflation), which remained subdued.

- On inflation expectations, the ECB marginally raised 2017 projection to 1.3% (from 1.2% in Sep projection). ECB's projections will be updated on 9 Mar.

- **Monetary Policy Forecast:** We expect ECB to keep monetary policy status quo for the foreseeable months ahead (next meeting scheduled on 9 Mar), after its decision (back in Dec 2016) to extend QE till end 2017. We reiterate that it remains too early to call for more tapering, given that core inflation has yet to see a meaningful recovery. ECB Draghi had also said that higher inflation will not automatically result in QE tapering. For inflation to be considered as 'sustained adjustment', there are four elements that need to be fulfilled: Inflation (1) is affecting the medium term, (2) is durable, (3) is self-sustained and (4) is region wide. So far it remains too soon to tell if the four elements above are met as core inflation continued to hold steady at 0.9% and is not showing any signs of uptick.

- To recap, **QE was extended beyond Mar 2017 for another 9 months to end-2017, at a reduced pace of €60bn per month**. There were also a handful of technical tweaks to the APP to ensure smooth implementation of the program. Our take is ECB's monthly purchase after Apr 2017 may seem like a tapering at first glance but in actual fact, the option chosen between the 2 (either €80bn per month for 6 months or €60bn per month for 9 months) implies a larger QE amount (€540 bn). This implies ECB is still far from tapering and is expected to remain on easing bias.

- **Latest Fiscal and External Balance Outlook:** Euro area current account surplus narrowed to EUR31bn in Dec (vs. EUR36.4bn in Nov) due to decline in surpluses on services and primary account. 12-mont **cumulated current account for period ending in Dec-2016 showed current account surplus at +3.4% of GDP** (vs. 3.1% of GDP in 2015).

- The government deficit ratio is projected to decline to 1.5% in 2017, from 2.1% of GDP in 2015. Projected government debt ratio is projected to decline gradually to 88.4% in 2017, from 91.5% of GDP in 2015.

- **Key domestic events and issues to watch:** Jan PPI (2 Mar); Euro-area 4Q final GDP (7 Mar); ECB meeting (9 Mar); Jan IP, Mar ZEW Survey Expectations (14 Mar); Feb CPI (16 Mar); Mar Prelim PMI (24 Mar); CPI estimates for Mar (31 Mar).

- **Technical Outlook:** EUR traded lower towards 1.0494 (22 Feb), in line with our call for bearish reversal. We said (in our last monthly outlook) that a rising wedge formation appeared to be forming and we looked for downside pressure towards 1.0550 levels. Pair was last seen at 1.06 levels. Bearish momentum on daily chart shows signs of waning while stochastics shows signs of rising. These signals suggest near term rebound risks. Resistance at 1.07 levels (100 DMA) before 1.0760. We are bias to lean against strength, looking for a move lower towards 1.05, 1.0450 levels. We do however caution that a decisive move above 1.0890 (Dec high) nullifies our bearish bias.

GBP: Watch 2 Way Risks; Article-50 to be invoked

Forecast	1Q 2017	2Q 2017	3Q 2017	4Q 2017
GBPUSD	1.2200 (--)	1.2000 (--)	1.2300 (--)	1.2400 (--)

No Change from Previous Forecast

- **Motivation for the FX View**: Our **bearish bias on GBP and its economic prospects over the medium term (6-9 months) remains unchanged**, as UK's *Brexit* journey has barely just begun and negotiating for trade deal with the EU is likely to be a long-drawn process. Investors and business confidence are likely to be affected; risk of slowing capital inflows, relocation of HQs, job losses; twin (budget and current account) deficit worries and potentially slowing personal consumption (due to real wages falling), could pose downside risks on UK's medium term growth prospects and the GBP.

- We do however acknowledge that smooth process on Article-50 parliamentary debate has limited GBP downside so far. In fact the GBP did trade as high as 1.2702 (2 Feb); last seen around 1.2450 levels. This was well in line with our short term call (in our Monthly Outlook in Jan) that *GBP could be poised for more gains towards 1.27 levels.*
- **In the coming weeks, we see 2 way risks**: upside risks (possibly towards 1.27) to be driven by smooth process towards triggering Article-50 sometime in Mar 2017 and the political mess in Netherlands and France (which should see relative value trades favoring GBP over EUR in the short term); downside risks (towards 1.22, 1.20 levels) to be driven by uncertainty after the trigger of Article-50, potentially an independence referendum in Scotland and potential risk of Fed raising rates in March (resulting in divergence of monetary policies). We are in the bearish camp.
- We **keep our FX forecast unchanged over the forecast horizon**, but wish to add that GBP could be subject to even greater volatility in March. We expect GBP to trade in 1.22 – 1.27 range, with bias to the downside. We reckon a break below the 1.24 interim support could re-ignite GBP bears. We remain biased to lean against strength. We expect BoE to keep monetary policy status quo at least for the next 3-6 months as there is little room for BoE to ease monetary policy further given that inflation has begun to rise and projected to rise more while on the other hand, *Brexit* uncertainty is likely to constraint the BoE on raising rates prematurely.
- **Growth and Inflation Outlook:** In the last BoE's Quarterly inflation Report (Feb 2017), the **central bank significantly upgraded its growth forecast to 2% for 2017** (from 1.4% as projected back in Nov 2016's QIR. The upgraded outlook was due to government's plans for more spending, stronger world growth and that domestic growth has stayed relatively resilient since the referendum. That said BoE also highlighted that it expects business investment to fall and consumer spending to slow as inflation eats into household budgets.
- Data recap for the month showed that composite PMI and services PMI fell in Jan 2017 to 55.2 (vs. 56.5 in Dec) and 54.5 (from 56.2 in Dec), respectively. That said PMIs remain in expansionary territories. Industrial production for Dec-2016 exceeded expectation, rising 4.3% y/y owing to rise in manufacturing sector. **4Q GDP growth was surprisingly revised upwards to 0.7% q/q (vs. 0.6%). Net trade was the overall biggest contributor to growth while fixed investment was the main drag.** On y/y basis, 4Q growth was 2%. This is the 16th straight quarters of expansion and exceeded expectations despite UK's exit from EU. While the economy may show resilience for now, we caution that the Brexit journey is only about to begin (expect UK to formally trigger Article-50 in March). Negotiating trade deals can take a long time (especially with the EU) and much remains unknown over London's status as a financial hub; if it can continue to attract foreign inflow of funds and investments, if HQs will relocate their HQs and result in job losses (Goldman Sachs is reported to consider 50%

cut to London staff, with transfers to NY and Frankfurt offices while UBS and HSBC are considering moving their staff out of London). We see these issues potentially affecting the UK's growth prospects in the medium term.

- **Headline inflation rose further,** from 1.6% y/y to 1.8% y/y in Jan. However the rise was softer than expected due to decline in clothing/footwear prices while food and transport inflation continues to hold up. Core inflation held steady at 1.6%. Looking ahead we expect further increases in headline inflation due to sharp decline in GBP last year. Higher PPI suggests that inflationary pressure is building up. We continue to caution that rising inflation could erode UK consumer purchasing power at some stage and ultimately weigh on growth over time. Wage growth is now showing signs of deceleration from 2.8% y/y to 2.6% y/y for the 3 months ending Dec-2016. True that the wage growth still outpaced CPI but the gap is now narrowing. With BoE's inflation forecast for end-2017 at 2.7%, continued deceleration in wage growth could weigh on real wages and crimp household spending.

- **Monetary Policy Forecast:** BoE MPC kept policy rate on hold at 0.25%, as expected and ended its QE program, as scheduled. BoE's Carney said there is "slack in the labor market". Unemployment rate at 5% was previously thought to be full employment but BoE now says that unemployment rate can fall to 4.5%, meaning that economic growth may not be inflationary and suggests that the potential sharp increase in inflation for 2017 may not be as worrisome as previously thought (which markets had initially expected sharp increases in inflation to force the MPC into raising rates).

- We expect BoE MPC to keep monetary policy status quo (with policy rate at 0.25%) at its next meeting on 16 Mar. In our opinion there is **little room for BoE to ease monetary policy further** given that inflation has begun to rise and projected to rise further before peaking in 1Q 2018. On the other hand, the MPC may also be reluctant to raise rates despite rising inflation. This is due to *Brexit* uncertainty and potential slowdown in household spending and business investment.

- **Latest Fiscal and External Balance Outlook:** The UK faces the issue of twin deficits - rising budget deficit and widening current account deficit to more than 5% of GDP and needs to manage growth (which could suffer a dent if investment, consumer spending falls) and rising inflation (BoE may not be able to raise rates to arrest inflation as businesses will very likely need financing/monetary conditions to remain accommodative).

- Jan's budget surplus stood at GBP9.4bn (vs. GBP9.1bn a year ago). According to the latest report from EY (and reported on various media), Chancellor Philip Hammond may be on course to meet his fiscal targets when he sets out updated forecasts for government borrowing in March's Budget, due to stronger tax receipts. And this could lead to the Office of Budget Responsibility (OBR) cutting its forecast for public sector net borrowing in 2016-17 by about GBP3bn to GBP65bn. The improvement is largely due to unexpected resiliency of UK's economic growth despite the gloom and doom scenario associated with *Brexit*. Chancellor Hammond could use this short term relief to offset against the potential squeeze on household income (due to potential lower real wages). But we think an eventual tax increase or increase borrowings may be necessary in the medium term to cope with rising costs for healthcare, long-term care and state pensions. We believe these costs will outpace the growth of tax revenues.

- UK's 3Q current account deficit widened to -5.2% of GDP (from -4.6% of GDP in 2Q). We think the large current account deficit (by historical and international standards), could pose significant risks to financial stability, especially with UK government likely to experience higher budget deficit, borrowing at some stage while investor confidence may dwindle (leading to slower inflow of capital to finance the deficit).

- **Key domestic events and issues to watch:** Feb PMI (1 Mar); Feb Construction PMI (2 Mar); Jan IP (10 Mar); Jan jobs report (15 Mar); BoE meeting (16 Mar) – expected to maintain monetary policy status quo; Feb CPI, PPI (21 Mar); Dec retail sales (23 Mar) and 4Q final GDP (31 Mar). Trigger of Article 50 is scheduled to take place before end Mar-2017. We believe this is likely to be brought forward to early-mid-Mar.

- **Technical Outlook:** GBP drifted lower towards 1.2350 levels, in line with our call (as per our last monthly outlook). Pair was last seen at 1.2550 levels. Daily momentum and stochastics are showing tentative bullish signals. Sustained close above 1.2510 (21 DMA) may see some temporary upside pressure towards 1.2720 levels. Support remains at 1.24 (50, 100 DMAs).

AUD: Medium-term Bulls

Forecast	1Q 2017	2Q 2017	3Q 2017	4Q 2017
AUDUSD	0.7600 (--)	0.7300 (--)	0.7500 (--)	0.7800 (--)

No Change To Previous Forecasts

- **Motivation for the FX View:** AUD was stuck in range-trades within 0.7600-0.7750, underpinned by firm commodity prices and a rather rangy USD. At this point, Fed Funds Future prices in only 38% chance of a move in Mar. Recent comments from Fed Voters including Fed Chair Yellen suggest that a hike in Mar is still a very real possibility and that leaves room for the USD to run higher (Yes, we do not think the USD bull wave is over). As such, save for a potential temporary correction along with that of metal prices, the AUDUSD pair is likely to be capped in the month ahead. However, we also expect AUD to remain resilient relative to other peers like the NZD and SGD. That should see these crosses higher. AUD has a few fundamental reasons to see broad gains including supported metal prices, underpinned by a re-focus back on own infrastructure plans. The rise in demand for bulk commodities should improve Australia's terms of trade and boost its income. In addition, Australian bonds are in demand as higher yielders, lower risk of rate hike and relatively higher quality (in terms of sovereign credit rating). That said, AUD has had a pretty good run up and we would be wary of entering a bullish trade at this level. Support is seen around 00.7630 before 0.7540. With AUDUSD last seen around 0.77, we are on track to meet our forecast of 0.76.

- **Are we worried about Australia's AAA rating?** Australia may lose its AAA rating at the May budget delivery this year. Most of the impact on the AUD is likely to be a kneejerk. It could be a mild knock on business confidence and a political blow. However, the economic consequence is more nuanced. Australia government debt is fully denominated in Australian dollars so the government is fully able to pay by its debt even if borrowing cost rise. The impact could however be on the banks' credit rating as a downgrade from their current AA- could raise their funding cost. In response, RBA may have to cut cash target rate to negate the rise. In an environment of rising rates, that is a downside risk to our AUD forecast. That said, growth outlook this year seems a bit more sanguine, albeit still uncertain, than the last. The recovery in external demand may allow more breathing room for services sector in Australia to fill the void left behind by the mining investment. The improvement in its external balance should boost the government's ability to finance its budget shortfall and avert the loss of its AAA rating within the year.

- **Growth and Inflation Outlook:** We remain cautious of Australia's growth outlook. Household spending remains uncertain with Dec retail sales (a proxy for private consumption) declining by -0.1%m/m from the 0.1% growth in the month prior (also revised lower). Home loans slowed to a growth of +0.4%m/m in Dec from previous 1.3%. The labour report was also mixed with 44.8K of full time employment lost in Jan and 58.3K of part-time hires gained in the month. That said, other leading indicators are more optimistic with the score for both NAB business conditions and confidence jumping to 16 and 10 from 10 and 6 respectively. Note that Jan is a month of Chinese New Year and business confidence was also bolstered by a rather decent run-up (+12%) in the equity markets between Nov-Dec and rise in copper and iron ore prices. While NAB also reported that the trend for business conditions in retail is still soft, Westpac consumer confidence index rose to 99.6 from 97.4. We are also cautious because household debt to disposable income has been on the rise and that could continue to crimp on private consumption moving forward. Little support is also expected from private investment as Australia reported a steeper-than-expected decline in CAPEX in -2.1%q/q, albeit smaller than the previous -3.3%. The silver lining in the report is that the estimated CAPEX for Other selected industries for the next period is 8.3% higher than the estimate made 1 year back, suggesting some optimism in other non-mining and non-manufacturing sectors.

- CPI came in under expectations with Q4 headline print at 0.5%q/q vs. the previous 0.7%. Year-on-year, inflation picked pace to 1.5% from previous 1.3%, narrowly missing the average forecast of 1.6%. The trimmed mean version steadied around 0.4% vs. expected 0.5%. Excluding the volatile items and tobacco, the tradables inflation actually slowed to 0.1%y/y and -0.1%q/q, suggesting that the depreciation in the AUD did not fan higher price pressure at home. Non-tradables saw greater price pressure to 2.14%y/y from the 1.7% seen in the previous quarter, reflecting the tweaks in the composition of the traded/non-traded series in the quarter done by the bureau of statistics. As well, the 4Q wage price recorded a slight rise to 0.5%q/q from previous 0.4%. Year-on-year, wages steadied around 1.9%. The SoMP also revealed that measures of inflation expectations remain low.

- **Monetary Policy Forecast:** The next action move is still tilted to a cut rather than a hike but we think the risks of a cut this year has reduced. If we recall, the last two cuts done in 2016 was done to raise demand so that inflation could be nudged nearer to the 2-3% target. In the November Statement on Monetary Statement, RBA judged that “the risks to global inflation appear to be more balanced than they have been for some time”. Indeed, the Feb Statement on Monetary Statement noted that inflation has stabilized in 4Q but measures of inflation expectations remain low. Household debt is high, a concern expressed by RBA Governor Lowe. Hence, we do not see a need for RBA to move in Mar any more than in Feb.

- Australian bonds are well in demand as investors continue to demand higher yielding, better quality bonds. With inflation still subdued and mixed outlook on its economic growth trajectory, Australian bonds are less at risk of a rate hike in the medium term relative to other developed nations. That could continue to support the domestic bond demand. With central banks around the world (with the exception of the US) reluctant to allow rates to run much higher, wholesale funding cost for Australian banks are also likely to be capped for now, also lowering the risks for a rate cut. Thus, barring any data surprises, AUD is more likely to be driven by other factors like commodity prices, terms of trade rather than policy rate expectations.

- **Latest Fiscal and External Balance Outlook:** When it comes to the budget, the incumbent government is always wary about losing its AAA sovereign rating. The Mid-Year Economic and Fiscal Outlook (MYEFO) released in Dec 2016 saw its budget deficit rise by more than A$10bn. Australia kept its top-grade rating at all three agencies but S&P expressed pessimism about the government’s ability to return the budget to surplus by end FY2021.

- The macro economic assumptions for the budget are crucial. Real GDP growth forecast for 2016-17 is revised lower to 2¾% from previous 3%. Nominal GDP growth is also revised lower to 4½%, taking into account weaker commodity prices and moderate outlook for inflation. The government tries to reduce the share of fiscal spending of GDP From 25.9% in 2015-16 to 25.3% in 2018-19. The economy is very much predicated on how key commodities will perform and the recent commodity run-up bodes well. We even see upside risks to growth that could stem from stronger external demand this year, allowing room for economic rebalancing and domestic services to strengthen.

- **Key domestic events and issues to watch:** 4Q GDP is due on the 1st followed by Jan trade, building approvals on the 2nd, Jan retail sales due on the 6th, RBA meeting on the 7th, home loans on 10th, NAB business survey on the 14th, Westpac consumer confidence on the 15th, labour report on 16th, 4Q house price on the 21st, Westpac leading index on the 22nd.

- **Technical Outlook:** We see potential correction in the AUD for month of Mar as the pair is at risk of breaking lower from a rising wedge. Last seen around 0.7690, daily chart shows little direction bias on the momentum indicators. Slight bearish divergence also herald a correction towards 0.7360 bef9ore 0.7550. Resistance is seen around 0.7780, Nov high.

NZD: Strength Unwanted; Fundamentals Intact

Forecast	1Q 2017	2Q 2017	3Q 2017	4Q 2017
NZDUSD	0.7400 (--)	0.7100 (--)	0.7300 (--)	0.7500 (--)

No Change to Previous Forecast

- **Motivation for the FX View:** NZD could face some **near-term downside pressure over the next 2-3 weeks** on a few factors including RBNZ's explicit intent for a weaker exchange rate, risk of USD strength as markets re-price Fed's rate hike trajectory (leading into 14-15 Mar FOMC meeting) as well as risk of retracement of dairy prices from recent highs (Price of Whole Milk Powder futures has been seeing some consecutive decline of late). We also see risks of political uncertainty in Europe affecting risk sentiment (via equity markets), and NZD (as a risk proxy) may come under pressure. As such we look for a lower range of 0.70 – 0.7350 and revised our NZD 1Q forecast lower accordingly.

- NZD traded a touch softer over the past few weeks, and remains well within the 0.71 – 0.74 range we called for (in our last Monthly Outlook). To be sure the decline in the Kiwi was not due to adverse domestic economic data but more due to RBNZ's explicit intent for a weaker exchange rate.

- **It was clear that RBNZ clearly dislike the strength of the Kiwi.** The **accompanying MPC statement (9 Feb) was much more dovish than expected**, with RBNZ's forecast of OCR on hold at 1.8% through Jun 2019, 1.9% by Sep 2019 and 2% by Mar 2020. This **implies that RBNZ only see the first rate hike occurring sometime in 1Q 2020**! Recall that we previously highlighted that OIS futures were **already pricing in more than 80% chance of a hike in Nov 2017**. This has now shifted out to Aug 2018. And the Kiwi decline over the past few weeks can be attributed to this. The RBNZ also said that NZD's TWI is about 4% higher than forecast in the RBNZ Nov-2016 statement; the exchange rate remains higher than is sustainable for balanced growth and **a decline in exchange rate is needed.** We see **RBNZ's dovish statement as intent of outright verbal intervention to temper the strength of the NZD.** We expect RBNZ to signal the same dovish rhetoric, reiterating that monetary policy remains accommodative and rates are likely to stay low for longer at its upcoming meeting on 23 Mar.

- **Risks to our outlook:** NZD could reverse course and trade higher should the FoMC turns out to be a "paper-tiger" – kept the hype up on more rate increase but disappointed with inaction. A smoother than expected election process favoring pro-establishment could reinforce risk-on sentiment and support risk proxies. Further signs of upside price pressures amid tight labor market could also suggests that RBNZ risks inflation overshoot, and this could lead to renew expectation for an earlier than RBNZ-projected rate hike. These factors could support the Kiwi and pose risks to our short term bearish bias.

- **Growth and Inflation Outlook: The outlook on NZ's economy remains optimistic** (RBNZ expects 2017 GDP to be 3.7%), supported by strong labor market (4Q unemployment rate at recent lows of 5.2% while job creation outpaced population growth), pipeline of construction activity (expect an acceleration of activity on Kaikoura rebuilding efforts post-Earthquake), tourism spending (direct contribution to GDP at 5.6%; a further 4.3% is indirectly contributed; while tourism spending accounted for 20.7% of NZ total export earnings) amid accommodative monetary policy (OCR at record low of 1.75%). We expect the **NZ economy to outperform most of G7 economies** this year. 4Q 2016 GDP is due for released only in Mar 2017.

- **Headline CPI jumped to 1.3% y/y in 4Q** (vs. 0.4% in 3Q). **Note that inflation has finally returned to RBNZ's 1-3% target band** after languishing below the target range over the past 2 years. Inflation is expected to return to the middle of the target band gradually, in part reflecting the strength of the domestic economy and in part due to base effects (oil prices). Longer-term inflation expectations remain well anchored at about 2%. The jump in 4Q inflation was due to increases in petrol prices and housing-related costs. Tradable prices rose 0.3% q/q (-0.1% y/y), while non-tradable prices rose 0.6% q/q (2.4% y/y). Food prices also showed sequential uptick in Jan (+2.8% vs. -0.8% m/m) while 4Q PPI inched up to 1.5% q/q (vs. 1% in 3Q).

- **Monetary Policy Forecast:** We expect **RBNZ to keep monetary policy accommodative at current levels of 1.75% for the OCR over the next couple of meetings** as downward pressure on inflation is gradually dissipating. In fact inflation is already showing further signs of uptick owing to higher commodity prices, construction-related cost pressures and strength of the domestic economy, and RBNZ should have sounded a bit more hawkish (with rates projection). But it did not as RBNZ is aware that NZD could appreciate even further.

- At the last meeting on 9th Feb, RBNZ kept OCR unchanged at record lows of 1.75%, as expected. While the accompanying statement noted that economic outlook remains positive and inflation is expected to increase to the middle of its target range of 1 – 3% reflecting the strength of the domestic economy, **the statement was surprisingly more dovish than expected**. RBNZ said NZD's TWI is about 4% higher than forecast in the RBNZ Nov-2016 statement; the exchange rate remains higher than is sustainable for balanced growth and a **decline**

in exchange rate is needed. RBNZ projection for OCR shows steady rates till Mar 2020! This implies that the first rate hike is projected to take place only sometime in 1Q 2020. **We see this as an outright verbal intervention in an attempt to temper NZD gains.**

- **Latest Fiscal and External Balance Outlook:** Government finances continue to perform well with OBEGAL showing a surplus of $9mil (vs. forecast deficit of $666mil) for the 6-months to Dec 2016. Core tax revenue and GST were running higher than expected, reflecting the current buoyant economic conditions - growing economy and high immigration.

- 3Q current account deficit widened to $1.9bn (vs. deficit of $1.8bn in 2Q). This is due to higher import of goods and slightly lower tourism spending. Current account deficit for 3Q remained at -2.9% of GDP. NZ's net external debt position (as of 3Q 2016) increased to NZD148.5bn (about 58% of GDP), from $141.4 billion (55.9 percent of GDP) at 30 June 2016.

- **Key domestic events and issues to watch:** 4Q Terms of trade (1 Mar); Feb food prices (13 Mar); 4Q GDP (16 Mar); PMI (17 Mar); RBNZ meeting (23 Mar); Feb trade (24 Mar). GDT auctions on 7 and 21 Mar.

- **Technical Outlook:** In our last monthly outlook, we cautioned that upside is likely to be sticky and a potential rising wedge formation (bearish reversal) appeared to be in the making. We then called for a move towards 0.7140. Indeed the move materialized. Pair traded a low of 0.7130 (21 Feb). Last seen at 0.7210 levels. We caution that a decisive close above 0.7230 (21 DMA) – 0.7250 could see some upside risks towards 0.73 levels. This could materialize if market expectation for Fed rate hike remains muted. We also observed a potential compression of 50, 100, 200D moving averages - this could represent periods of market contraction and is typically a predecessor to price expansion (otherwise known as break-outs). Next area of support at 0.71 (50, 100, 200 DMAs) - 0.7160 (38.2% fibo retracement of Dec low to Feb high). Only a decisive push beyond this area of support could see further downside towards 0.7050 levels. Resistance at 0.7235 (23.6% fibo).

JPY: Downside Risk Still As Inflation Still Subdued

Forecast	1Q 2017	2Q 2017	3Q 2017	4Q 2017
USDJPY	118 (--)	120 (--)	124 (--)	125 (--)

No Change To Previous Forecasts

- **Motivation for the FX View:** We maintain our bearish outlook for the JPY over the medium term. Ongoing monetary policy divergence between the US and Japan remains in play and should become even more obvious in the coming months. We therefore maintain our current forecasts for the USDJPY for 2017. In the near term, some unwinding of long USDJPY positions is possible. Recent CFTC data shows that bearish bets on the JPY are intact but waning. This has led to recent downside moves by USDJPY with the pair primed to test the 112-levels. Not surprisingly, the JPY has been among the best performing currencies in the region against the USD in Feb. It has risen by slightly over 1% against the USD so far.

- The BOJ's ultra-loose monetary policy remains intact for now. Contrary to calls for the BOJ to provide an exit strategy, the central bank has maintained its current policy of expanding the monetary base by about JPY80tn per annum, while controlling the yield curve. The governor has constantly reiterated that the BOJ stand ready to ease further if it becomes necessary to achieve the 2% inflation target. More importantly, the governor has dismissed the possibility that the BOJ would raise its yield targets if global interest rate expectations rise, lifted by US Fed rate hikes. Instead, he argued that "it was necessary to maintain powerful monetary easing to achieve the (2% inflation) target at the earliest date possible. The policy bias thus appears to be for the continuation of existing monetary easing bias and low domestic interest rates for as long as the 2% inflation target is not achieved.
- With the BOJ just on easing mode and the Fed on a tightening bias, we can expect the monetary policy to diverge even further. As such, the Fed's Mar and Jun meetings will be closely watched. There is a possibility that the Fed could be tightened even more than expected should Trump follow through with his expansionary fiscal policy that could accelerate both US growth and inflation. This widening in yield differentials between the UST and JGB, with UST yields higher and JGB remaining at low levels) should continue to exert downward pressure on the JPY and provide the USDJPY with a leg higher.
- We also do not discount the possibility of further BOJ easing measures in 2017 should inflation fail to gain traction even amid concerns that the US could name Japan a currency manipulator. BOJ could unleash even more easing measures, including cutting interest rate further to -0.3% (from -0.1% currently) and increasing asset purchases of ETFs and J-REITs and other instruments to JPY10tn and JPY6tn. We do not expect any action by the BOJ at its next meeting on 16 Mar. Instead, we believe that the BOJ will watch for the impact of further US Fed rate hike before making its own moves.
- We still do not expect the USDJPY to climb into uncharted territory. This is because of several factors, including its large and persistent current account (CA) surpluses. For 2016, the surplus was JPY20.7tn, the largest since 2007. In addition, risk aversion on concerns about US protectionist measures, political uncertainties in the EU and geopolitical tensions could spur safe haven plays. Though this is unlikely and not our base case, there is speculation that the BOJ will have to embark on tapering this year as it runs-up against operational limits where there could be greater demand for JGB than supply. These should work together to cap upside to the USDJPY.
- **Growth and Inflation Outlook:** Preliminary 4Q16 GDP showed the economy expanding by just 1.0% q/q annualized, coming in just a tad below consensus' 1.1%. Growth in the last quarter of 2016 was supported by exports and capex gains of 2.6% and 0.9% q/q respectively. 4Q growth would have been stronger if not for the strong increase in imports of 1.3% q/q. Still, this may not be a sign of weakness in the economy but could reflect gains in domestic demand. Still, the Cabinet Office's outlook for the economy has not changed from Jan; it expects a moderate recovery though some delayed

improvement can be seen. This was reflected in moderation in both industrial production and core machinery orders in Dec, up by 3.2% and 6.7% y/y respectively from Nov's 4.6% and 10.4%. Even the gains in exports moderate to 1.3% y/y in Jan after rising for the first time in 15 months by 5.4% in Dec. Imports rose for the first time since Dec 2014 by 8.5% y/y. This resulted in a trade deficit of JPY1.09tn in Jan, the first deficit in five months.

- That said, the economy could get some help externally from a 'synchronized' recovery in exports in ASEAN that could in turn translate into stronger demand for Japanese exports. As well, the economy could receive a boost from the record budget of JPY97.45tn approved by the cabinet for FY2017 but the fiscal impulse could be limited as most of the budget has been allocated for military expenditure, debt-servicing expenses and social services cost. Only JPY5.98tn is set aside for public and other works. Thus, there does not appear to be a sharp economic recovery in the works.
- After rising by 0.3% in Dec, market is expecting inflation to continue climbing higher in Jan. Consensus is looking for headline inflation of 0.4% y/y and core inflation (headline inflation excluding fresh food) to come in flat at 0% after slipping lower by 0.2% y/y in Dec. This suggests that market is expecting some traction in inflation going forward. Still, we believe that this optimism is likely to be tempered by the favored gauge of the BOJ – 'core core' inflation (headline inflation less fresh food and energy prices). 'Core core' inflation continues to trend lower, rising by just 0.1% y/y in Dec from 0.2% in Jan. The gain in inflation is likely to be a slow grind.
- **Monetary Policy Forecast:** We expect the BOJ has maintain the status quo in its policy framework of QQE with Yield Curve Control that it implemented in Sep 2016 with short-term interest rate held steady at -0.1% and its 10Y JGB yield target at about 0%. As we have discussed above, BOJ governor Kuroda has already dismissed the possibility of a tapering or hike in interest rate, given that the 2% inflation target has yet to be achieved. Still, we expect the BOJ to refrain from adding to its policy measure for now as it focuses on achieving a "normal" yield curve through control of both the short- and longer-terms interest rates. We also expect the BOJ to maintain the pace of JGB purchases at around JPY80tn.
- We think that there is a possibility that the BOJ could ease policy further but such a move is not imminent. Instead, additional measures are likely to be taken should the reflation efforts stall. So far, USD strength underpinned by the steepening of the UST yield curve and more stable global oil prices should spur inflationary pressure. We expect the BOJ to remain on hold for now, including at its next policy meeting on 15-16 Mar, to watch for the impact of further US Fed rate hike before making its own moves. The additional measure that the BOJ could unleash includes cutting interest rate further to -0.3% (from -0.1% currently) and increasing asset purchases of ETFs and J-REITs and other instruments to JPY10tn and JPY6tn.
- **Latest Fiscal and External Balance Outlook:** The cabinet has approved a budget of JPY97.45tn for FY2017. The bulk of this record budget is allocated for military expenditure, debt-servicing expenses and social services cost, which together accounts for slightly over 60% of the total budget. Of the total, only JPY5.98tn is set aside for public and other works that would directly impact the economy. Tax revenue is expected to be flat, up just 0.2% to JPY57.7tn.
- The current account (CA) surplus narrowed to JPY1.11tn in Dec from JPY1.42tn in Nov due to the smaller surplus in the primary account

(Dec: JPY0.68tn vs. Nov: JPY1.20tn). The financial account surplus narrowed as well in Dec to JPY0.38tn from JPY1.10tn in Nov due the larger outflow in portfolio investment (Dec: -JPY5.16tn vs. Nov: -JPY2.34tn) that more than offset the surpluses in direct investment, financial derivatives and other investment. Consequently, the overall balance of payments (BoP) surplus narrowed to JPY0.76tn in Dec from JPY2.19tn in Nov. For the full-year, the current account surplus ballooned to JPY20.65tn – the largest surplus since 2007 – while the financial account rose to JPY28.90thn. Together, this resulted in a full-year BoP surplus of JPY57.80tn.

- **Key domestic events and issues to watch:** Final 4Q16 GDP will be released on 8 Mar and this will be followed by BOJ policy meeting on 15-16 Mar. The BOJ will also be releasing the 30-31 Jan meeting minutes on 22 Mar as well as the summary of opinions of the 15-16 Mar meeting. BOJ board member Takehiro Sato will speak in Tokushima on 1 Mar. JGB auctions in Mar: 10-year (2 Mar), 30-year (7 Mar), 5-year (9 Mar), 1-year (14 Mar) and 20-year (14 Mar).

- **Technical Outlook:** USDJPY traded 111.60 – 115 range for the month of Feb. Pair was last seen at 112.30 levels. Daily momentum is not indicating a clear bias for now. We expect 111.80 – 114.70 range to hold, with risks to the downside in the interim. Break below 111.80 (100 DMA) could see further downside pressure towards 109.90 levels (50% fibo retracement from Nov low to Dec high). Expect resistance at 114.70 (50 DMA) to hold for now.

CNY: Watch The Two Sessions

Forecast	1Q 2017	2Q 2017	3Q 2017	4Q 2017
USDCNY	6.92 (7.00)	7.03 (7.05)	7.08 (7.10)	7.04 (7.10)
USDCNH	6.92 (7.06)	7.05 (7.11)	7.10 (7.08)	7.02 (7.13)

Previous Forecast In Parenthesis

- **Motivation for the FX View:** USDCNH had been stuck in range since the start of the year. With markets still underpricing rate hikes (48 bp vs. dots plot 75bp this year), USD and rates still have room to rise. We continue to expect volatility to pick up as we progress further in 2017. Because of that, we hold our view that China needs to anchor the RMB against the basket (more than ever) as we brace for USD strength to return along with Fed tightening, higher inflationary pressures and higher rates. PBoC tweaked the fixing methodology on 20 Feb, now requesting market makers to submit quotes (of yuan moves against the global currencies) from 4.30pm to 7.30am instead of the original data collection for the full 24 hours. The new reference time makes more sense as it will only take into account the moves overnight when onshore activities have dulled (past 4.30pm) rather than include the price action during Asian session which should already be reflected in the USDCNY moves anyway. In that case, double counting is reduced. We should see less volatility in the central parity USDCNY fixing.

- In the absence of USD strength so far, USDCNY has languished in range along with USDCNH. The 12month USDCNH forward points have also fallen from 3660 to 2210 as we write. However, these could change once USD swings higher. Capital outflow is still a main concern as more Chinese nationals seek returns overseas and gain the USD exposure, in addition to the requirements of the One Belt One Road initiative. We also want to keep in mind that China has been garnering interest in its domestic financial markets. Interestingly, just after PBoC expressed its desire to create a conducive environment in its domestic bond market for foreign investors as a continuation of its CIBM efforts that started last year, SAFE announced (28 Feb) that foreign institutional investors in the interbank bond market can trade products including forwards, swaps, cross-currency swaps and options with domestic settlement agents. In addition, PBoC announced that foreign companies can remit profit normally. The recent relaxation of capital controls is a surprise move and may instill enough confidence amongst foreign investors to increase their bond holdings in China that should help offset the persistent capital outflow.

- Also, China is focused on mitigating its asset bubbles in the face of rising global rates as well. The 10bps hike in the 1-year and 6-month MLF rates (conducted on 24 Jan), the subsequent hike in 7-day reverse repo rate right after lunar new year holidays suggests that the central bank is keen to signal some form of tightening just as inflation picks up pace.

- Our USDCNH outlook hinges on our strong USD outlook, slower economic growth and structural capital outflows. However, let us not be too pessimistic as the recent improvement in regional exports data signal synchronized recovery in the external demand, notwithstanding the low base last year. Improvement in the external balance may in turn provide some support for the Asians (including China) FX in the face of a strong USD. Hence, we have also adjusted our forecast lower to 6.92 for 1Q.

- **Our monthly Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) showed the score for China steadied at 5.3 (with 1 being the best and 9 being the worst) as the marginal improvement in the scores for GDP and inflation offset the small deterioration in current account and reserves.

- **Growth and inflation outlook:** The Jan data releases included a number of surprises, recording a solid rise in aggregate financing and credit. Bearing in mind that PBoC had asked banks to cap credit growth at the same rate at last quarter. A strong growth in Jan would mean that credit growths should slow in the Feb-Mar. The government is particularly concerned with risk-taking in the asset management products that has become an important source of funding for banks. Hence, there are whispers that rules are being drafted to discourage investments in asset management products with explicit warnings that the products are not guaranteed by the government.

- The manufacturing sector performance is uneven with credit conditions likely to remain favourable for larger corporations. The headline NBS PMI-mfg inched lower to 51.3 in Jan from 51.3. Interestingly, output in medium enterprises has expanded with the PMI index at 50.8 vs. previous 49.6. Large enterprises expanded at a slower pace of 52.7 while small enterprises reported further contraction with the index recording a lower 46.4 vs. previous 47.2. Purchasing price index slipped to 64.5 from previous 69.6. Clearly, the demand conditions, weaker yuan have translated to higher CPI at 2.5%y/y vs. the expected 2.4%. PPI also leapt to 6.9%y/y from previous 5.5%.

- CPI surprised to the upside in Jan at 2.5%y/y vs. the expected 2.4%, accelerating from the previous 2.1%y/y. PPI jumped from 5.5% to 6.9%. Prices were inevitably lifted along with commodity prices as the government continues to cut capacity, along with weaker yuan and firm demand conditions. We will not be surprised if the CPI target for 2017 will be lifted from 3% in 2016 to 4-5%.

- Key event ahead is the NPC and CPPCC (两会) which will set out all the economic targets for the year. Premier Li Keqiang will also present the Government work report along with the economic targets on the first day of NPC (5 Mar). Eyes will be on the growth target, whether the target band will be widened from 6.5-7.0% last year to 6-7%. That, and a reduction in money supply M2 growth to the rumoured 12%, could lend more weight to their promise to focus on deleverage and financial reforms rather than growth boosting. We also keep an ear out for any additional infrastructure projects although we anticipate that the State Council will focus on curbing property bubble, implementing financial reforms as well as deleveraging.

- **Monetary Policy Forecast:** Post Lunar New Year holidays saw PBoC draining liquidity. The amount of net OMO withdrawal was last seen at -CNY845bn as of 19 Feb since the start of the month. The 7-day reverse was lifted 10bp to 2.35% right after the holidays, as we have warned in the last monthly. The MLF, SLF and 7-day reverse repo rates have so far been raised. While we still see downside risks in growth, the recent spikes in CPI and PPI and strong credit growth suggests that these rates may be lifted further in order to maintain the current real rates.

- PBoC had stated in their recent statements (Central Economic Work Conference, 4Q Monetary Report) that monetary policy will be “prudent and neutral” and the central bank is certainly sticking to this theme.

- **Latest Fiscal and External Balance Outlook:** The IMF estimates that China’s ‘augmented’ fiscal deficit is running at around 10% of GDP. Growth of government expenditure is still likely to head higher as the government works to pump prime the economy with infrastructure investment. In addition, local government has been accumulating a lot of off-balance sheet debt in order to finance infrastructure investment. The recent tax overhaul which moves construction, property, finance and consumer service sectors under the value-added structure could mean less revenue for the local governments. The central government plans to increase budget deficit to redistribute the VAT revenue back to provinces. Small businesses with less than CNY500,000 in annual sales will drop to 3% from 5%.

- Current account surplus narrowed to U$37.6bn in 4Q from previous U$69.3bn as imports jumped and financial account also recorded an outflow. The outflow via its capital accounts reduced to -U$10mn from U$194mn in 3Q.
- **Key domestic events and issues to watch: CPPCC will convene on 3 Mar. NPC will start on 5 Mar.** NBS Mfg PMI, Caixin PMI due on 1st, foreign reserves on 7th, Feb trade on 8th, CPI, PPI on 9th, monetary data on 10-15th. Retail sales, FAI, industrial production on 14th. Property prices on 18th. Industrial profits on 27th, Final BOP current account balance for 4Q on 30th.
- **Technical Outlook:** USDCNH seems to be pressing on the upper resistance of the triangle formation, last seen around 6.8580. A break out higher could see this pair testing Jan high of 6.92. Support is seen around 6.8160. 50-DMA still caps this pair, 6.86. Momentum indicators are flagging slight bullish bias. Risks are to the upside in this pair.

KRW: Political Risks May Take Centre-Stage

Forecast	1Q 2017	2Q 2017	3Q 2017	4Q 2017
USDKRW	1150 (1170)	1180 (1220)	1170 (1180)	1180 (--)

Previous Change in Parenthesis

- **Motivation for the FX View:** We maintain our call that KRW remains vulnerable to wild swings (2-way risks), given its high sensitivity to external events, including FoMC meetings, Trump's policies on fiscal expansion plans for US and labelling certain countries as currency manipulator, elections in Europe (as a proxy to risk sentiment) as well as domestic political risks (Park's impeachment verdict could be made known as early as mid-Mar). We still expect KRW to face renewed weakness but revised lower USDKRW forecast to reflect recent market development.
- Final impeachment hearing for defunct-President Park is now scheduled for 28 Feb (note that the date was being postponed from mid-Feb as Park's attorney asked for more time). The final verdict could be out as early as 13 Mar, at the earliest. If the Court upholds the verdict (need 6 out of 9 judges to agree), Park will be removed and a Presidential election must be held within 60 days. Under this scenario (our base case), we expect short term uncertainty arising out of who will be the next President but this uncertainty is expected to dissipate (investors' confidence to be gradually restored) as new regime comes into power. However in the event less than 6 judges

agree, Park will return to office and serve out her term through Feb 2018. We expect this scenario to see higher degree of market uncertainty as investors could lose confidence (may see portfolio outflows and is negative on KRW). Apart from political risks, growth momentum is likely to moderate further due to slowing private consumption (account for 40% of GDP) and construction investment amid ongoing political scandal (affecting investor sentiment) and corporate restructuring in troubled industries such as shipping and ship-building (job losses). There were market chatters that Daewoo shipbuilding has about 440bn won in debt due in Apr and is running out of cash to pay the debt amid delay of drill ships and no new orders. We expect the Finance Ministry to introduce supplementary budget again, possibly within the coming 2 months.

- External events are expected to keep the KRW busy – rising political risks in Europe could weigh on risk assets and exert depreciation pressure on the KRW (high beta and proxy to risk); risk of earlier than expected Fed rate hike in Mar (monetary policy divergence) may also see KRW under pressure. One expression of trade is to short KRW and long JPY – risk aversion trade expressed in regional FX. But we wish to add that some signs of synchronized recovery in Asia exports may act as buffer against KRW depreciation pressures. We expect USDKRW to trade 1120 – 1170 for the month of Mar. In the event that European political risks turn out to be less worse than expected or if Fed delays raising rates, we may see KRW appreciating further, possibly beyond 1130 (vs USD).

- **Our monthly Maybank Vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for S.Korea deteriorated slightly to 6.0 (vs. 5.9), due to GDP.

- **Growth and Inflation Outlook:** The BoK lowered S.Korea's 2017 GDP forecast to 2.5% from 2.8% (previously projected in Oct-2016), citing **slowing consumption as the primary factor amid political uncertainty** (leading to the decline in consumer confidence). Indeed Jan consumer confidence fell to 93.3 (vs. 94.1 prior month). This is the lowest level in 8 years. While the Constitutional Court has 180 days (from 9 Dec) to review the impeachment of defunct-President Park, there are already market chatters of an early verdict sometime as early as 13 Mar. She will be removed as long as 6 Judges out of the 9 agree. If that happens, an election will be held within 60 days. **If less than 6 Judges agree, then she will return to office and serve out her term through Feb 2018. We see higher degree of market uncertainty on the latter and investors' confidence could stay depressed for longer. On the former (our base case scenario), we expect short term uncertainty arising out of who will be the next President but this uncertainty is expected to dissipate (investors' confidence to be gradually restored) as new regime comes into effect.** Apart from political risks, ongoing corporate restructuring on troubled industries such as shipping and ship-building and the potential risks of protectionist-related measures (from US) could continue to weigh on growth.

- Data recap: Industrial production unexpectedly fell in Dec (-0.5% m/m vs. +3.4% prior) as slowdown in output of electronic components and transportation equipment weighed on manufacturing activity. The decline was also partially due to base effects and could show some improvement in the Jan data (due to improvement in exports and recovery in commodity prices. For 4Q 2016, the economy expanded at its slowest pace in more than a year (0.4% q/q vs. 0.3% Consensus vs. 0.6% in 3Q). The slowdown was due to construction investment (-1.7%) while private consumption also slowed (0.2% vs. 0.5% in 3Q). Infrastructure investment was the bright spot (+6.3%), contributing the most to growth in the 4Q. BoK said that the decline in construction investment was due to base effects and sees no sign of rapid fall in investment.

- On Trump's trade protectionist policies and possibly naming Korea a currency manipulator, we reiterate that S.Korea is highly dependent on exports (exports of goods and services make up about 50% of Korea's GDP) and Trump has previously singled out the Korea-US free trade agreement as a 'catastrophe' that needs to be renegotiated. Bear in mind that US accounts for 14%% of Korea's exports and Korea's trade surplus with the US swelled to 25.8bn in 2015 (vs. 11.6bn in 200 before US-Korea FTA went into effect). BoK Governor Lee sees low possibility of US naming Korea a FX manipulator. He emphasized that BoK do not intervene in FX for other purposes and only to smooth excessive FX volatility.

- **Headline inflation jumped most in over 4 years to 2% y/y in Jan** (vs. 1.3% in Dec), due to increase in food prices (again). This is in line with our expectations. We believe this is due to hot weather and typhoon that hit S. Korea during the Summer season and remains too soon to conclude if the higher prices were due tp stronger consumption (which we doubt it is). Separately a separate statement from the Finance Ministry said that Jan inflation surged due to agricultural prices and base effects from a drop in oil prices a year ago. Core inflation also rose to 1.5% y/y (vs. 1.2% in Dec). We continue to expect headline inflation to pick up in the coming months amid rising oil prices. And this is more of cost-push inflation rather than demand-pull.

- **Monetary Policy Forecast**: We expect BoK to keep monetary policy accommodative, with policy rate on hold at record low of 1.25%, at its upcoming meeting on 13 Apr. Against a backdrop of rising household debt, and rising price pressures at home (Jan CPI jumped to more than 4-year high of 2%), we see little impetus for BoK to lower rates for the time being. Neither do we see BoK raise rates prematurely as economy remains under pressure amid falling consumer sentiment to 8-year low and slowing private consumption. Moreover local corporates in troubled industries such as shipbuilding and shipping continue to undergo ongoing corporate restructuring efforts. There were market chatters that Daewoo shipbuilding has about 440bn won in debt due in Apr and is running out of cash to pay the debt amid delay of drill ships and no new orders. We expect the Finance Ministry to introduce supplementary budget again, possibly within the coming 2 months.

- **Latest Fiscal and External Balance Outlook:** Current account surplus narrowed to $7.87bn in Dec (vs. 8.89bn in Nov) due to goods account surplus narrowing. This is the 58th consecutive month of surplus.

- Korea's sovereign debt is expected to increase to KRW682.4tn by end-2017, from KRW641tn. Government debt now stands at 44.8% of GDP. The rising debt has to do with tax cuts and increasing welfare spending made during former President Lee's era. The National Assembly Budget Office estimates government debt will rise to KRW800tn in 3 years' time.

- **Key domestic events and issues to watch:** S. Korea releases Feb trade data (1 Mar); Jan Industrial Production (2 Mar); CPI (3 Mar), 4Q Final GDP (28 Mar); PMIs (29 Mar). There is no BoK meeting scheduled in Mar and the next BoK meeting is scheduled on 13 Apr.

- **Technical Outlook:** Our caution for head and shoulders pattern was being played out. We said downside risks towards 1130 could come if area of support at 1150-1158 gave way. Pair traded a low of 1127 (24 Feb). Last seen around 1130. Bearish momentum on weekly and daily chart remains intact. A sustained close below 1126 on weekly basis could see the pair test lower towards 1100. Resistance at 1150 (200 DMA).

SGD: Rising Risk Of An Oct MAS Tightening

Forecast	1Q 2017	2Q 2017	3Q 2017	4Q 2017
USDSGD	1.4000 (--)	1.4250 (--)	1.4350 (--)	1.4050 (1.4200)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** We maintain our view of the SGD for the next three-to-nine months, given the synchronized recovery in exports in the region, its sensitivity to external events and monetary policy divergence with the US. We are already seeing the effects of the improvement in regional exports and in Singapore that has bolstered growth and provided the SGD will a lift. This has allowed the SGD to be one of the best performers in ASEAN. The SGD has so far risen by 0.6% against the USD in Feb. Year-to-date the SGD has risen by 3.3% against the USD.

- As we have argued previously, the synchronized recovery in exports in the region due to expectations of stronger US growth has led to improved investment sentiments. The recent NODX print for Feb (+8.6% y/y vs. Jan: +9.1%) has not changed our view that a synchronized recovery in ASEAN exports could be beneficial to Singapore and the SGD. Even the more moderate IP growth in Feb (+2.2% y/y vs. Jan: +22.1%) has not distracted from our current views. This should support the SGD and weigh on the USDSGD at least in 1Q.

- Aside from the synchronized recovery in exports, the unwinding of stale long-USDSGD positions should also provide the SGD with some relief in the next month or so. The SGD should also find support from the government's mildly expansionary fiscal policy, still accommodative monetary policy, its triple-A status and persistent balance of payments surpluses.

- Still, our six- to nine-month view for the USDSGD trajectory has not changed in 2017. We expect the USDSGD to be supported by the ongoing economic restructuring of the economy and property curbs. There is also upside risk from a possible re-pricing of US Fed fund rate hikes, rising protectionism and uncertainty in the Trump administration economic policies that could cause the SGD to diverge from its macroeconomic fundamentals. Last but not least, the narrowing yield differentials between the US and Singapore could result in a re-allocation of assets back towards the US and spur portfolio outflows, putting downside pressure on the SGD.
- We cannot discount the possibility that the US Fed could embark on even more aggressive rate hikes in 2017, triggered by the Trump administration's plans for expansionary fiscal stimulus (infrastructure spending plus tax breaks) that could result in faster-than-expected inflation and growth in the US. Market could be underpricing US rate hike risks and more aggressive rate hikes could steepen the UST yield curve further, narrowing the yield differentials in favor of the US and this should keep the USDSGD supported higher at 1.4250 and 1.4350 in 2Q and 3Q.
- The upside risks to the USDSGD is likely to be mitigated by a policy shift in the MAS policy stance in Oct. In the near term, we continue to expect the MAS to maintain its current neutral policy at its Apr policy meeting amid global uncertainties ranging from US fiscal policy to European politics. Beyond the Apr meeting, there is increasing probability of a policy shift to a "mild appreciation bias" as inflation, including core, and growth gain traction. This makes the MAS only one of three central banks in the region that is on a tightening bias. We expect the MAS to shift to a slight appreciation bias at the Oct meeting. This move should be supportive of the SGD. We have tweaked our end-4Q 2017 USDSGD outlook as a result and now expect the pair to edge lower to 1.4050 from 1.4200 previously.
- **Singapore's monthly Maybank Vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) was improved from 4.6 to 4.2 as risks to GDP and fiscal fell, offsetting the increase in inflation risk. This should be supportive of the intrinsic value of the SGD. Our model shows that the SGD NEER was last seen 0.43% above the mid-point implied at 1.4048. Upper bound is implied at 1.3769 while lower bound is now at 1.4328.
- **Growth and Inflation Outlook:** Growth exceeded all expectations in the final estimates for 4Q16 GDP. The economy rose by a solid 2.9% y/y in 4Q, a significant upward revision from the advanced estimates of 1.8%. On a q/q SAAR basis, real GDP accelerated 12.3% in 4Q, a significant upgrade from the 1.9% in the advanced estimates. The stronger 4Q16 GDP print was due to the bounce in manufacturing (+11.5% y/y), transport & storage (+5.4%) and "other services" (healthcare, education & social services) (+3.9%). For the full-year, growth came in at 2.0%, above the government's 1-1.5% forecast range. Our economics team sees the economy receiving a strong cyclical lift from a regional synchronized recovery in exports. The recent NODX print for Feb (+8.6% y/y vs. Jan: +9.1%) suggests that a synchronized recovery remains on track. Even the more moderate IP growth in Feb (+2.2% y/y vs. Jan: +22.1%) has not distracted from our current views as it still suggest an expanding manufacturing sector. In addition, the 2017 budget has set aside SGD2.4bn over 4 years to drive the Committee for Future Economy (CFE) strategies that should help lift potential growth. Budget FY2017 is expected to have a limited impact on growth given its modest fiscal impulse of 0.9% of

GDP. Given these development, our economic team remains positive on growth prospects and maintains their expectations for GDP to expand by 2.5% in 2017 (at the upper half of the government's 1-3% forecast) and by 2.3% in 2018.

- Inflation continued its uptick with headline inflation edging higher to 0.6% y/y in Jan, the second straight month of positive inflation. Driving inflation higher was elevated transport cost (+2.8% y/y) supported by higher private road transport cost due to the rise in petrol and car prices. Prices on electricity, LPG & gas, fuels & lubricants increased by 5.9% y/y (Dec: -0.1%). Core inflation – which excludes accommodation and private transport - rose by 1.5% y/y in Jan, an uptick from 1.2% in Dec. Our economic team is more sanguine about the outlook for inflation. They now expect headline inflation to average around +1.2% in 2017 from 1.0%, lifted by higher water prices and increase in service and conservancy charges. In addition, higher commodity prices – both oil and food – would also likely continue to feed into consumer prices this year. The team's core inflation forecast is maintained at 1.6% (vs. MAS forecast of 1-2%).
- **Monetary Policy Forecast:** We continue to expect the MAS to maintain its current neutral policy at its Apr policy meeting amid global uncertainties ranging from US fiscal policy to European politics. This means that the rate of appreciation of the SGD NEER will be kept at zero percent and the width of the policy band and the level at which it is centered will remain unchanged. Beyond the Apr meeting, there is increasing probability of a policy shift to a "mild appreciation bias" as inflation, including core, and growth gain traction. Our economic team is not only expecting stronger growth in 2017 (of 2.5%) but also a slightly faster inflation rate of 1.2%. This shift in policy makes the MAS only one of three central banks in the region that is on a tightening bias. We expect the MAS to shift to a slight appreciation bias at the Oct meeting.
- The USDSGD briefly touched a multi-year high (not seen since Jul 2009) of 1.4547 at the start of the year (on 3 Jan). The pair has since retreated back towards the 1.40 levels. This drop in the USDSGD has resulted in the 3-month SOR (3MSOR) coming off from 1.0118% on 3 Jan to 0.8265% on 24 Feb. The slide in the 3-month SIBOR (3MSIBOR) has been more gradual with the rate falling from its recent peak of 0.9689% on 3 Jan to 0.9391% as of 24 Feb. Year-to-date, the 3MSIBOR and 3MSOR have fallen by around 3.5% and 18.6% respectively from their Jan high of 0.9726% and 1.0152% respectively. The more modest rise in rates suggests that the rise in mortgage rates is unlikely to be significant for now. Deposit rates (for 12-month fixed) have not risen since end-Jan and remains at around 0.35% currently. This continues to suggest that risks related to interest rate increases affecting financial and economic stability, particularly in interest rate- and property-related sectors, seems limited for now.
- Upward pressure on domestic rates remains given our expectations of at least two Fed rate hikes in 2017. US 3MLIBOR has edged above the 1.0% levels in Jan and is currently hovering at 1.054% at the point of writing, just a tad off recent high of 1.0565% on 16 Feb. Ample liquidity has so far kept domestic rates from tracking the US 3MLIBOR higher. With US rate hike trajectory still on a gradual path, domestic rates should continue its slow grind higher. We expect the 3MSIBOR and 3MSOR to end 1Q 2017 at 1.45% and 1.23% respectively. For the full-year, we expect the rates to end 2017 at 2.32% and 2.10% respectively.

- **Latest Fiscal and External Balance Outlook:** Budget FY2017, delivered on 20 Feb, was more conservative than expected by our economics team. There were some targeted help for the distressed marine & process sector and SMEs, as well as a modest SGD2.4bn set aside for the CFE strategies. Our economic team sees limited impact to growth from this budget as the budget is mildly expansionary with a primary deficit of SGD5.62bn for FY2017. The fiscal impulse is projected at about 0.9% of GDP given the fiscal surplus of 1.3% (+SGD5.2bn) in FY2016. Still, the actual fiscal impulse could be smaller given the standard conservatism in projecting future fiscal balances and inherent discipline imposed from the permanent 2% downward adjustment to the budget caps of Ministries.

- The current account surplus narrowed to SGD18.13bn in 4Q from SGD22.77bn in 3Q 2016. The smaller surplus was due to the narrower goods and services surplus (of SGD25.69bn vs. 3Q: SGD27.90bn) and the deterioration in both the deficits in the primary and secondary income deficits (to –SGD3.74bn and –SGD3.81bn respectively from –SGD2.54bn and SGD3.77bn in 3Q respectively). The financial and capital deficit ballooned in 4Q to SGD22.73bn (3Q: -SGD18.18bn) on the back of larger financial derivative and 'other investment' outflows (of SGD3.37bn and SGD24.25bn) and more moderate portfolio investment outflow of SGD13.96bn that more than offset the larger direct investment inflows of SGD18.86bn. As a result of the larger deficit in the financial and capital account, the overall balance of payments (BoP) slipped into a deficit of SGD3.93bn in 4Q from a surplus of SGD5.43bn in 3Q. For the full-year, the current account surplus of SGD78.06bn was more than offset by the deficit in the capital account of SGD81.90bn leading to a BoP deficit of SGD2.46bn in 2016 - the first deficit since 2001.

- **Key domestic events and issues to watch:** Parliament will debate Budget FY2017 and see Committee of Supply speeches from 28 Feb-10 Mar.

- **Technical Outlook:** USDSGD continued to trade lower for the month of Feb. Last seen at 1.4040 levels. Bearish momentum on weekly and daily chart remains intact. Key support at 1.4030 if broken on weekly close, could see the pair head towards 1.3950 (50% fibo retracement of Aug low to Jan high). Resistance at 1.42. Need a close above 1.4330 for uptrend to resume.

MYR: Remains in tight range

Forecast	1Q 2017	2Q 2017	3Q 2017	4Q 2017
USDMYR	4.3000 (4.2500)	4.3500 (--)	4.2000 (--)	4.2500 (--)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** Over the past 1 month, MYR weakened slightly by around 0.4% but ended the month largely unchanged even as oil prices seem to have stabilized, commodity prices trend still remain positive picking up and USD at times mildly softer.

- USDMYR traded as high as 4.46 (21 Feb) but has since retreated back to levels since earlier in the month. We think this weakness could still persist in the short term but solid underlying fundamentals and policies {backed by domestic demand, re-calibrated supportive budget (on a lower oil price assumption suggests flexibility in the fiscal space), relative stability in oil prices though some downside pressure exists, relative attractive yields in the MGS, stabilizing ratio of FX reserves to retained imports & short-term debt, accommodative monetary conditions to support businesses} remain intact and should provide an anchor for MYR stability once short-term noises subsided. Given the openness of the economy and the high participation of foreign investors, the Malaysian Ringgit is highly exposed to the global economic environment. Nonetheless, the Ringgit could face downside risk on the back of the recent declining trend in the current account surplus, relatively limited FX reserves in comparison to other major EMs, exposure to Chinese demand for the country's export performance, and US rate normalization affecting emerging markets.
- USDMYR is likely to trade in very narrow ranges unlike in the past since the restrictions on the offshore market were made late 2016. Some dollar retracements remain possible following the actual Fed rate hike and bond positioning in 1Q 2017 could be positive for the MYR. That said, in light of recent market development, we have calibrated our 1Q USDMYR forecasts a touch higher over the forecast horizon to reflect recent market developments.
- **Our fair value estimate (which takes into account interest rate differential, inflation differential, current account differential and reflation variables) puts USDMYR at 3.65 levels.** We had previously said that Ringgit weakness was temporary and was not a reflection of underlying fundamentals (which remain intact). We still expect to see some stability returning to Ringgit as political/contingent liability risk subsides, fiscal consolidation/reforms gains traction, oil prices stabilize and uncertainty subsides over the next 12 months.
- External reserves as at 15 Feb 2017 was the same as at end-Jan 2017 i.e. USD95b, indicating offsetting outflows and inflows amid the implementation of BNM's measure to boost external reserves via repatriation of export earnings, net foreign buying of Malaysian equities and net foreign selling of Malaysian bonds. The latest count equivalent to 8.4 months of retained imports and 1.1 times of short-term external debt. In a statement by BNM's Financial Market Committee (FMC) on 17 Feb 2017, the conversion of net export were USD372.9m in Dec 2016 and USD741.3m in Jan 2017 i.e. USD1,114.2m in total.
- There was mixed signals from equity and bond flows. Foreigners remained net buyers of Malaysian equities in the first three weeks of Feb 2017 at +MYR0.65b following the net buying of +MYR0.5b in Jan 2017 which ended the preceding four straight months of net selling totaling –MYR5.7b. But foreigners were net sellers of Malaysian bonds for three consecutive months to Jan 2017 totaling –MYR29.1b. This month, the highlight in the bond market was the maturity of a 10-year MGS note totaling MYR8.8b on 15 Feb 2017. 10-year MGS yield was steady on the day at 4.116%, little changed from 4.118% the day before, and dropped to 4.05% as of 21 Feb 2017. The trend in yield suggest either foreign bondholders re-invested the money from the matured MGS note, or in the event of net selling by foreign bondholders, there is offsetting net buys or absorption by domestic institutional investors. A total of MYR66.8b of MGS and GII are maturing this year, and we estimated MYR30b-MYR35b are held by

foreigners. The next maturity is a 3-year MGS note worth MYR10.5b on 15 Mar 2017.

- **Growth and Inflation Outlook:** Maintain our 2017 real GDP forecast of +4.4% (2016: +4.2%), underpinned by faster growth in domestic demand (2017E: +4.9%; 2016: +4.4%) reflecting sustained consumer spending growth (2017E: +5.9%; 2016: +6.1%), stronger investment growth (2017E: +3.9%; 2016: +2.7%) on progress of existing - and the rollout of - new major infrastructure and investment projects, and pick up in government consumption expenditure (2017E: +2.9%; 2016: +1.0%).
- The wild card is external trade in view of the uncertainties over the US trade policy under President Trump, especially the risk to US-China trade relation. However, under the current expectation of a moderate pick up in global economic growth (2017E: +3.1%; 2016: +2.9%) and firmer commodity prices, we are looking at relative better trade growth in 2017 i.e. higher growth in exports and imports of goods and services of +1.3% and +1.5% respectively (2016: +0.1% and +0.4% respectively).
- At this juncture, we still need to keep a close tab on key high frequency domestic data, namely the monthly economic indicators such as the indices on industrial production and distributive trade, external trade, money and banking statistics, as well as major commodity output and prices. In addition, our eyes are also on the economic trends as well as policy and political developments in the major economies i.e. US, Europe (including UK), China, Japan.
- Exports and Imports in Dec 2016 grew by +4.5% YoY (Nov 2016: -7.5% YoY) and +19.1% YoY (Nov 2016: +19.7% YoY) respectively while trade deficit steady at -USD2.6b (Nov 2016: -USD2.6b). Last year, exports shrank further by -4.4% (2015: -5.3%) while imports accelerated to +14.2% (2015: +8.7%), resulting in larger trade deficit of –USD24.9b (2015: - USD12.2b). This year, we expect +4.3% export growth, +9.8% import growth and –USD30.5b trade deficit.
- Headline inflation rate in Jan 2017 jumped to +3.2% YoY (Dec 2016: +1.8% YoY) while core inflation rose moderately to +2.3% YoY (Dec 2016: +2.1% YoY). Revised our full-year inflation rate forecast to 3.0%-3.5% from +2.5% previously (2016: +2.1%).
- In Jan 2017, headline inflation rate shot up to +3.2% YoY (Dec 2016: +1.8% YoY; Maybank-KE: +2.7% YoY; Consensus: +2.7% YoY) while core inflation rate (excluding volatile and price-controlled/price-subsidised components of the CPI) posted moderate rise at +2.3% YoY (Dec 2016: +2.1% YoY). The big jump in headline inflation during the month was mainly attributed to the surge in "Transport" (Jan 2017: +8.3% YoY; Dec 2016: -0.6% YoY) and the pick up in "Food and Non-Alcoholic Beverages" (Jan 2017: +4.0% YoY; Dec 2016: +3.7% YoY). Compared with Dec 2016, both headline and core inflation rate rose +1.1% MoM and +0.3% MoM respectively last month.
- We revised our 2017 inflation rate forecast to 3.0%-3.5% from +2.5% previously (2016: +2.1%) reflecting primarily the higher domestic fuel prices amid firmer global crude oil prices following the coordinated output cut by OPEC and non-OPEC oil producers (for at least six months from Jan 2017), as well as the new 2016 Price Control & Anti-Profiteering Act effective 1 Jan 2017, which is limited to food & beverages and household items only, in turn leading to the opportunity for businesses to raise prices of other goods and services to pass on higher costs. Other contributing factors to the higher inflation rate this year include higher import prices due to weaker

average MYR vs USD this year vs last year; weather and seasonal effects on food-related commodity prices; and scheduled and pending reviews of "administered prices" like gas prices, electricity tariffs and sewerage charges.

- Despite the higher inflation rate expected this year, we maintain the view that the Overnight Policy Rate (OPR) will be unchanged at +3.0% to support growth.
- **Monetary Policy Forecast:** BNM kept the Overnight Policy Rate (OPR) at 3.00% at the first MPC meeting for the year, while the Statutory Reserve Requirement (SRR) was also maintained at 3.50%. We maintain the view that OPR to stay at 3.00% in 2017. We expect BNM to keep OPR at 3.0% this year. Monetary policy stance is biased towards growth as per last year's 25bps cut in July 2016. However further cut(s) unlikely amid volatile MYR and pick-up in inflation rate to 2.5% this year from 2.1% last year. Neither is interest rate policy is also not used to support MYR via hikes given BNM's FX market measures to stabilise MYR and the re-imposition of export earnings repatriation to boost external reserves announced early last month.
- In the accompanying Monetary Policy Statement (MPS), BNM continues to expect the economy to be on track to expand as forecast for 2017 at 4.0%-5.0% range (2016E: 4.0%-4.5%; 2016YTD: 4.2%), while inflation expected to average higher in 2017 (official forecast: 2.0%-3.0%; Maybank KE: +2.5%; 2016: +2.1%) on prospect of higher global oil prices. Core inflation is expected to be stable indicating contained domestic demand condition.
- The improved economic activity in the major advanced economy is expected to support domestic economy via improvement in export growth; as the global economy is expected to grow at a slightly faster pace supported by balanced policy environment with progressive use of fiscal policy by developed economies. Private sector activity is expected to continue driving domestic growth led by sustained growth in private consumption from stable wage and employment growth while investment to be driven by ongoing infrastructure development projects and capital spending in the manufacturing and services sector.
- The key risks to global and local economic outlook are protectionism, geopolitical developments and commodity price volatility which in turn potentially lead to increased financial market volatility.
- **Latest Fiscal and External Balance Outlook:** Themed "Accelerating Growth, Ensuring Fiscal Prudence, Enhancing Wellbeing of People", Budget 2017 maintains commitment to fiscal discipline and consolidation; supports domestic demand via corporate income tax rate cut, incentives for tourism, SMEs, exports and digital economy, and infrastructure investment; and focuses on the wellbeing of the low-and middle-income groups by addressing the issues of inclusivity, equality, cost of living and affordable housing.
- Budget deficit target for 2017 is set at -3.0% of GDP, sustaining the policy of fiscal consolidation since 2010. This year's aim of -3.1% of GDP is maintained and achievable. Based on monthly data, we estimated budget deficit in Jan-Aug 2016 was -3.9% of GDP as the deficit of -5.6% of GDP in 1H 2016 turned into an estimated surplus of +1.2% of GDP in July-Aug 2016.
- We expect the fiscal deficit to remain flat at 3.1% of GDP, as government spending is likely to pick up (as we enter the election campaign).

- Current account surplus widened in 4Q 2016 to +MYR12.3b or +3.7% of GDP (3Q 2016: +MYR6.0b or +1.9% of GDP) due to improved goods account surplus (4Q 2016: +MYR31.4b; 3Q 2016: +MYR26.5b) which offset the deficits in both income account (4Q 2016: -MYR13.1b; 3Q 2016: - MYR15.4b) and services account (4Q 2016: -MYR6.0b; 3Q 2016: - MYR5.1b). For full year 2016, current account surplus was +MYR25.2b or 2.0% of GDP (2015: +MYR34.7 or 3.0% of GDP).
- We maintain our view of that current account surplus will be sustained on the back of moderate improvement in global economic - and hence world trade - growth as well as the firmer commodity prices this year. For 2017, we project gross exports growth of +2.0% (2016: +1.1%), gross imports growth of +2.5% (2016: +1.9%), trade surplus of +MYR85.5b (2016: +MYR87.3b), and current account surplus of +MYR24.7b or +1.9% of GDP (2016: +MYR25.2b or +2.0% of GDP).
- Current account surplus will also be supported by potential improvement in the services trade deficit on follow-through from higher tourist arrivals, which was on recovering trend last year (Jan-Oct 2016: +4.5% to 22.1m) and is expected to increase further by +5.0% this year.
- Nevertheless, current account balance will be affected by the persistent volatility in net portfolio capital flows, as this will impact the income account balance via net flows in foreign investors' investment income. The downside risk also emanated from President Trump's trade policy direction, which could disrupt the current improvement trend in trade sentiment.
- **Key domestic events and issues to watch:** BNM OPR Statement (2 Mar); Trade data (3 Mar); FX reserves (7, 22 Mar); CPI Inflation (22 Mar), GDP 4Q (16 Feb); Industrial Production (13 Mar).
- **Technical Outlook:** USDMYR retraced some of early month's marginal gains. Last seen at 4.44 levels. Daily momentum is not showing a clear bias while stochastics is falling from near overbought conditions. Pair could face some short term downside risks. Expect 4.4250 – 4.46 range, with a risk of further downside towards 4.35 levels. Resistance at 4.48 levels (double top between high of 2015 and 2017).

IDR: Inflation Risk But Monetary Policy Moves Unlikely

Forecast	1Q 2017	2Q 2017	3Q 2017	4Q 2017
USDIDR	13400 (--)	13600 (--)	13600 (--)	13300 (--)

No Change From Previous Forecast

- **Motivation for the FX View:** The IDR remains supported helped by the peaceful conclusion of regional elections, particularly that for the Jakarta governorship, the synchronized recovery in ASEAN exports, recovery in commodity prices as well as some unwinding in long USD positions against EM currencies, including the IDR, amid uncertainty in US fiscal policy. These factors have provided some relief for the IDR. As a result, the IDR managed to make some gains in the month, rising by about 0.2% against the USD in Feb so far. Year-to-date the IDR has risen by about 1% against the USD. We maintain our outlook for the USDIDR over the forecast horizon.

- Nevertheless, foreign investment sentiment remained mixed. Foreign funds continue their sell-off of equities. Month-to-date, they have sold USD54.45mn in equities, probably due to global risk aversion, while year-to-date, USD129.09mn of equities have been sold off. However this risk aversion did not extend to government debt. It would seem that the yield differentials between the 10Y UST and Indonesian government debt have not narrowed significantly, providing enough yield to entice foreign funds to remain vested in Indonesian government debt for now. Month-to-date, they have added IDR1.22tn to their outstanding holding of government debt. Year-to-date, foreign investors have added IDR20.92tn to their outstanding holdings. Thus, the demand for Indonesian government debt should continue to be supportive of the IDR and allow the USDIDR to settle around current levels at 13300 in 1Q.

- This situation though could prove to be temporary. Risks of the US Fed hiking interest rate at least twice this year remains and the rise in nominal US rates could lead to a narrowing of the yield differentials in favor of the US. In contrast, the BI is expected to keep policy on hold for the rest of the year. Should the US Fed engage in even more aggressive rate hikes as a result of Trump's expansionary fiscal policy plans, there could be a further steepening of the UST yield curve, narrowing the yield differentials between the UST and Indonesia government debt and spur portfolio outflows. Such outflows could weigh on the IDR and lift the USDIDR higher.

- Though the regional elections, especially in the Jakarta gubernatorial race, were peaceful, this could change as the run-off race heats up between the two top vote getters in Jakarta. As the campaigns heats in the lead-up to the polls slated for 19 Apr, race and religion could once again rear their ugly heads and up the ante in the election. Hanging in the background as well is Ahok's ongoing trial for blasphemy where the verdict is expected sometime in Apr and May only. Political tensions ahead of the run-off gubernatorial election could once again weigh on foreign investment sentiment and see an outflow of foreign funds to safer-haven assets. This could keep the USDIDR supported. The risks the USDIDR in the next 6-9 months are thus still to the upside.

- On a more positive note, the reform process continues in Indonesia. To date, the government has introduced 14 stimulus packages with a 15th (relating to logistics) slated to be released soon. These reform packages aimed to cut red tape, liberalize rules that have been a drag on investment and growth, and support specific growth industries. In addition, the USD400bn in infrastructure spending should be positive not only in boosting growth in the near term but should also lift potential growth. These improvements could very well result in a sovereign credit rating upgrade in next 12 months and the potentiality of such an event could weigh on the USDIDR in 2017.

- **Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for Indonesia deteriorated to 5.2 from 5.1. This was due an increase in inflation risk and should weigh on the intrinsic value of the IDR.

- **Growth and Inflation Outlook:** GDP rose by 4.94% y/y in 4Q16, coming in below market expectations of 5.0%. This was also a moderation from 3Q's growth of 5.02%. For the full-year though, the economy expanded by 5.02%, an improvement over 2015's 4.88%. The moderation in growth was attributable to more moderate private consumption (4Q: 3.43% vs. 3Q: 3.99%) and a larger pullback in government spending (4Q: -4.05% vs. 3Q: -2.95%). The outlook for 2017 though looks brighter. Government spending, which has been subject to fiscal consolidation in 2016, is set to regain momentum. The synchronized recovery in exports in the region should also be supportive of growth. Monetary policy remains accommodative to support growth objectives though further accommodation seems unlikely for now amid inflation concerns. Taking into consideration these factors, our economic team maintains their GDP forecast for 2017 at 5.1%.

- Inflation re-accelerated at the start of 2017, a foreboding of the possible state of things to come. Headline inflation rose by 3.49% y/y in Jan after easing off to 3.02% in Dec. Lifting inflation higher in Jan was higher housing and utility (Jan: 2.47% vs. Dec: 1.90%) and transport (Jan: 2.76% vs. Dec: -0.72%) costs. Food prices moderated in Jan, rising by just 4.11% y/y in Jan from Dec's 5.69%. Core inflation also jumped higher after holding steady for the past two months, rising by 3.35% y/y in Jan. For 2017 though, inflationary pressures are expected to rise on the back of a rise in administered electricity tariff and volatile food prices. Moreover, the weaker domestic currency is also likely to lift imported prices. As a result, the central bank is expected to accelerate to above 4.0% in 2017 while our economic team now expects inflation to average 4.32% for the full-year.
- **Monetary Policy Forecast:** The BI has maintained the status quo at its second policy meeting of the year on 16 Feb. This is the fourth consecutive meeting where the policy rate has been left untouched. The 7-day reverse repo rate remained at 4.75%, while both the lending facility and deposit facility rates were held steady at 5.5% and 4.00% respectively. This kept the interest rate corridor steady at 75bp on either side of the policy rate. The front-loading of rate cuts (amounting to 150bp) in 2016 has given some breathing space to BI to hold its policy rate steady amid downside pressure on the IDR and the outflow of portfolio investments. The central bank itself sees no room for further easing in 2017 given the challenges posed by inflation, the exchange rate, economic growth and lending rates. Already there is growing concern over the potential acceleration in inflation due not only to rising global oil prices but to hikes in domestic electricity tariff rates that could see headline inflation climbing above 4% in 2017. Our economic team expects the central bank to keep the policy rate on hold for the rest of the year.
- **Latest Fiscal and External Balance Outlook:** The budget deficit came in better-than-anticipated at 2.5% of GDP in 2016 vs. the targeted deficit of 2.7%. The smaller fiscal shortfall was on the back of government revenues coming in at IDR1314tn and spending at IDR1636tn. For 2017, our economic team expects further efforts by the government to expand and deepen the revenue base and more efficient spending to bring the fiscal deficit even lower down to 2.5%.
- The current account deficit (CAD) improved significantly in the last quarter of 2016, coming in at –USD1.81bn in 4Q or just 0.8% of GDP, compared to 3Q's –USD4.68bn (1.9% of GDP). This improvement can be attributed to the larger goods and services surplus of USD3.5bn (vs. 3Q: USD2.31bn) and the moderation in the primary income deficit to USD6.27bn from –USD8.01bn in 3Q. The overall balance of payments surplus narrowed to USD4.51bn in 4Q from USD5.71bn in 3Q, underpinned by the narrower CAD and smaller surplus in the financial account of USD6.76bn in 4Q vs. 3Q's USD10.55bn. For the full-year, the CAD improved to 1.75% of GDP in 2016 from 2.03% in 2015. For

2017, our economic team expects the CAD deteriorate to 1.95% of GDP due to greater import of capital goods to support the government's infrastructure programme. This is more sanguine that the BI's CAD projection of 2.11% for 2017.

- **Key domestic events and issues to watch**: BI meets on 15-16 Mar to decide on policy. The campaign for the final round of the Jakarta gubernatorial elections will begin in earnest in Mar. The run-off between incumbent Ahok and Anies Basweden will take place on 18 Apr.
- **Technical Outlook:** USDIDR continue to trade within 13300 - 13420 range for the month of Feb. Last seen at 13330 levels. Price action suggests the moves are within a wider symmetrical triangle defined by 2 converging trend-lines: upward sloping trend-line support between the lows of Sep, Oct-2016 and Jan-2017 and downward sloping trend-line resistance between the highs of Nov, Dec-2016 and Jan-2017. This can represent a either a continuation of a trend (bearish trend channel formed since start of 2016) or a reversal. The direction of the next move can only be confirmed after a valid breakout. Mild bullish momentum on daily chart is waning. Sustained price action outside the symmetrical triangle support of 13330 may suggest some downside risks towards 13250 (200 DMA), 13200.

PHP: Still Pressured Lower

Forecast	1Q 2017	2Q 2017	3Q 2017	4Q 2017
USDPHP	50.00 (--)	50.50 (--)	50.50 (--)	49.80 (--)

No Change From Previous Forecast

- **Motivation for the FX View:** We remain bearish on the PHP in the next three-six months, despite the Philippine's solid growth, the synchronized recovery in ASEAN exports and some unwinding in long USD positions against EM currencies, including the PHP, amid uncertainty in US fiscal policy. The PHP continues to be weighed by the Duterte risk premium - i.e. concerns over extra-judicial killings and the President's intemperate temperament - that is spurring foreign investors to exit Philippine assets, putting downward pressure on the PHP. So far in Feb, the PHP has fallen by 0.9% against the USD, while year-to-date, the drop was even greater at 1.1%. We maintain our USDPHP forecast over the forecast horizon.
- The Duterte risk premium continues to affect foreign investor sentiments. In Feb so far, foreign funds have sold off USD88.12mn in equities compared to USD5.82 sold off for the whole of Jan. Year-to-date then, USD82.30mn of equities have been sold. While data on foreign bond purchases are not available, examination of the Philippine sovereign bond yield movement appear to reinforce the view of a foreign sell-off as well. Month-to-date in Feb, sovereign bond yields were mostly lower by 2.5-188bp except for the 1Y, 20Y and 25Y. This is in contrast to Jan where yields were broadly lower by 8.9-84bp, suggesting demand that probably would have included foreign investors.

- We need to see this risk premium dissipate before an improvement in the PHP can be seen. Already there have been reports that President Duterte has ordered the suspension of his war on illegal drugs. This should reduce concerns that foreign investors have over the extra-judicial killings. The dissipation of the Duterte risk premium should eventually lead to the return of foreign investors into the Philippine assets and lift the PHP higher. It also helps that valuations in the Philippines have fallen after the sell-off in the equity market over the past few months. Equities are now relatively cheaper (as reflected by estimated P/E ratios minus their 5-year average P/E ratios) and attract foreign inflows as a result.

- Until the Duterte risk premium fades, the PHP is likely to come under pressure in the next three-six months. This is due to the two (at least) Fed rate hikes this year we expect this year due to recovery in the US. There could be even more aggressive rate hikes should the Trump's planned expansionary fiscal stimulus is implemented that could accelerate inflation and growth. Fed rate hikes narrow the yield differentials between UST and Philippine debt (even with the BSP hiking rates once in 2017), and sparking capital outflows. In addition, the potential trade disruption from protectionist measures implemented by the Trump administration could also add to downside pressure on the PHP.

- Even the strong domestic growth aided by expansionary fiscal policy (the budget deficit is expected to increase to 3% of GDP in 2017-2019) that should keep the economy humming at around the 7% ahead is unlikely to lift the PHP out of its current doldrums. The policy rate hike our economic team expects to keep the economy from overheating and inflation to stay within the BSP target of 2-4% is unlikely to be a panacea for its currency woes. We thus expect the PHP to remain under pressure for most of the year at least until 4Q where a moderation in dollar strength together with fading Duterte risk premium sees the pair headed back below the 50-figure by end-year.

- Our monthly **Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, improved to 5.1 from 5.2. This was due to a decrease in inflation and reserve risks that more than offset the deterioration in GDP risk. This should be supportive of the intrinsic value of the PHP.

- **Growth and Inflation Outlook:** After expanding by 6.8% in 2016, the government is aiming for growth of 6.5-7.5% for 2017. This is in contrast to our economic team which is expecting growth of only 6.4%. Our economic team expects infrastructure spending to support growth in 2017. The synchronized recovery in ASEAN exports should also bolster growth in 2017. However, the slower pace of consumer spending is likely to moderate growth. Faster inflation amid weaker PHP and expected implementation of the first phase of the tax system reforms towards consumption taxes as well as the expected 25bp policy rate hike in mid-2017 should slow consumption in 2017. In addition, more moderate overseas remittances amid risks posed by Trump's trade and immigration policy should also moderate consumer spending.

- Headline inflation picked up again by 2.7% y/y in Jan from 2.6% y/y in Dec, rising to a new high not seen since Dec 2014. Driving inflation higher was once again higher food prices, which rose by 3.4% y/y in Jan from 3.6% in Dec, as well as higher transport cost (up 2.4% y/y in Jan from 1.9% in Dec) due to higher global oil prices. Core inflation head steady, rising by 2.5% y/y in Jan, the same pace as in Dec. Inflation looks set to accelerate in 2017. A combination of weaker PHP against the USD, impact of phase 1 of the proposed tax reform package and higher commodity prices (especially crude oil and food commodities) should lift inflationary pressures this year. Consequently, our economic team expects full-year headline inflation to average 3.0% in 2017, a significant bump up from last year's 1.8%. This forecast is at the upper end of the government's 2-4% inflation target for 2017 and in line with the BSP's expectations of 2.9%.

- **Monetary Policy Forecast:** There has been no change to its policy rate since shifting to an interest rate corridor regime in Jun 2016. The key policy rate – the overnight borrowing rate – was left unchanged at 3.0% - together with the overnight lending rate and overnight deposit rate at 3.5% and 2.5% respectively. The 50bp symmetrical corridor on either side of the policy rate was maintained. Unlikely most of it regional peers in the region to hike domestic rates in 2017. Healthy growth of above 6% and an acceleration in inflation should spur the central bank into action. Moreover, expectations of US Fed rate hikes in 2017 that would narrow the yield differentials in favor of the US could exacerbate capital outflow. With risks to the economy tilted to the upside, our economic team expects the central bank to hike the policy rate by 25bp rate hike once at end-1Q 2017 or early 2Q 2017. This modest rate adjustment should ensure that real interest rate remain positive. This though might not be sufficient to ease downside pressure on the PHP and further PHP weakness is likely in the next three-six months.
- **Latest Fiscal and External Balance Outlook:** The government budget remained in deficit in Nov, coming in at PHP19.15bn – larger than the deficit of USD2.35bn in Oct. The deficit was due to the recovery in revenue, which climbed to PHP209.21bn in Nov from PHP174.64bn in Oct that was more than offset by the jump in expenditure to PHP228.36bn in Nov (Oct: PHP176.99bn). In the 11 months of 2016 so far, the budget deficit stood at PHP138.38bn, larger than 2015's – PHP121.69bn. Nevertheless, this remained way off the PHP388.9bn deficit targeted for the full-year as part of government spending plan to spur economic growth.
- The balance of payments (BoP) slipped into a deficit of USD9mn in Jan 2017, a significant narrowing of the gap from Dec (-USD214mn). According to the BSP, this was due to the carry-over of negative sentiment from Dec. For 2017, the BSP is forecasting an overall BoP surplus of USD1bn, a reversal from 2016's USD420mn deficit, buoyed by healthy remittances and business processing outsourcing (BPO). Mitigating these though would be rising imports from strong domestic demand, particularly private consumption, higher oil prices and a weaker PHP.
- **Key domestic events and issues to watch:** BSP meets on 23 Mar to decide on policy.

THB: Near-Term Rally

Forecast	1Q 2017	2Q 2017	3Q 2017	4Q 2017
USDTHB	35.00 (--)	35.50 (--)	36.00 (--)	36.20 (--)

No Change To Previous Forecasts

- **Motivation for the FX View:** The THB has been the best performing currency in ASEAN against the USD in Feb. In Feb so far, the THB has gained around 0.8% against the USD, attributable to the strong inflows in government debt. Helping as well is the healthy macroeconomic fundamentals, including current account surpluses, and the unwinding of stale long USD bets against the THB amid uncertainty in US economic policy direction. Like it regional peers, the economy has benefited from the synchronized export recovery that should bolster growth ahead and provide the THB will a lift going forward. Not surprisingly, the THB has been one of the better performing currencies in ASEAN, gaining 2.7% against the USD so far this year. Still, we think that this outperformance will be temporary given both external and domestic challenges. We therefore keep our USDTHB outlook intact for the forecast horizon.
- The outperformance of the THB so far received help from the unwinding of long-USD positions amid uncertainty over the Trump's administration's economic policies that have reignited appetite for emerging market assets, including Thailand's. This was manifested in the healthy demand for Thai assets so far this year with THB3.79bn and THB85.37bn of equities and government debts purchased by foreign investor. In addition, there has been support coming from the expected synchronized recovery in exports in the region due to the anticipated stronger growth in the US that could lift demand for Thai exports. This could not only lift demand for more Thai assets but would also keep the THB supported.
- The government's THB1.8tn infrastructure program should supportive of growth prospects and the THB. Our economic team estimates that the disbursement for infrastructure projects in 2017 could double to around THB200bn from less than THB100bn in 2016 and this should enable the economy to expand close to 5.0% for the full-year, a faster pace than expected by the government. As well, the current account has been in surplus for the past three years, coming in at THB1.64tn for the full-year in 2016 from 2015's THB1.10tn. These surpluses should also provide the THB with a backstop and cap any aggressive climb in the USDTHB in 2017.
- Healthy growth and rising inflationary pressures has increased the risk of a BoT move to lift policy rate higher this year. Such a move is expected sometime in 3Q. The BoT is expected to lift the policy rate this year by at least 25bp to 1.75%. Rate hikes could prevent the economy from overheating and at the same time, lift domestic yields to maintain the current spread between the UST and Thai bonds or widen it. This should help to reduce the flows out of Thai assets that could take place in search of higher returns. This should be supportive of the THB.
- Despite healthy macroeconomic fundamentals, the risks to the USDTHB remain to the upside in the next three-six months. The 2 US

Fed rate hikes (at least) expected by our economic team this year, underpinned by the nascent recovery in the US should keep the USDTHB supported. In addition, further upside USDTHB pressure could come should the Fed embark on an even more aggressive rate hike trajectory underpinned by the Trump administration moving forward on infrastructure building program and initiating tax cuts that could accelerate inflation and growth. These Fed rate hikes should lift the UST yields, narrowing the yield differentials in favor of the US, and sparking portfolio outflows. In addition, there is also the potential for some trade disruption arising from the Trump administration's implementation of protectionist measures that could put downward pressure on the THB.

- Domestically, the key risk to the THB in 2017 is politics. The promulgation of the new constitution has been delayed due to objection from the new monarch on certain clauses that impacted royal prerogatives. The planned general election to return power to a civilian government has been also delayed because of the death of HM King Bhumibol. The election is likely to take place only after the funeral of the late King and the coronation of HM King Maha Vajiralongkorn, making any elections this year unlikely. Thus, any general election is likely to now take place only in the early part of 2018.
- Even though elections will be pushed to 2018, unofficial campaigning will already begin once the once the funeral and coronation events are completed. This could bring simmering political tensions to a boil ahead of the election in early 2018. The main focus of the campaign by the opposition camp will likely focus on the dominating role of the military in political life and on the appointment of a non-elected PM to head the government. This suggested that the current PM could remain in office even after civilian rule is restored and also for the military to continue to dominate politics. The rise in political temperature in the run-up to the elections could impact investor sentiments and send the USDTHB higher.
- **Our Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for Thailand improved to 4.0 from 4.1 due to the reduction in inflation and fiscal risks that more than offset the increase in current account risk. This should be supportive of the intrinsic value of the THB.
- **Growth and Inflation Outlook:** The economic recovery continues to pick up steam with the economy expanding by 3.2% in 2016 from 2.9% in 2015 and 0.9% in 2014. This was even though the domestic economy faced tremendous challenges particularly with the passing of HM King Bhumibol. The economy managed to grow by 3.0% y/y in 4Q, a tad slower than 3Q's 3.2% despite these challenges. Government infrastructure spending helped to drive growth in 3Q, rising by 8.6% y/y in 4Q from 5.8% in 3Q. The synchronized recovery in ASEAN exports is also being manifested in Thailand with exports and imports rising by 1.4% y/y, rebounding from 3Q's -0.4%. Government infrastructure spending and tourist spending should be the main lifeline of the economy 2017. These together with the synchronized recovery in exports in the region (domestic exports were up for the third consecutive month, rising by 8.8% y/y in Jan) should boost the economy in 2017. As a result, our economic team expects the economy to expand by an above-consensus 4.5% in 2017 vs. market consensus of 3.3% and government forecast of 3.2%.

- Headline inflation came in by higher-than-expected 1.55% y/y in Jan from 1.13% in Dec, driven by higher transport costs (Jan: 4.76% vs. Dec: 3.01%) as a result of costlier fuel prices and food prices (Jan: 1.53% vs. Dec: 1.36%). Core inflation remained benign, rising by 0.75% y/y in Jan – little changed from Dec's 0.74% as higher oil prices again did not have any significant knock-on effects. Given the expected sharper economic recovery, rising commodity prices and still weak THB, our economic team expects headline inflation to accelerate to 2.5% in 2017. This is higher than the BoT's forecast of 2.2%.
- **Monetary Policy Forecast:** The BoT has kept the policy rate close to historic lows at 1.25% since 29 Apr 2015. The last time the policy rate was even lower at 1.25% was during the Great Financial Crisis in 2009-10. Though monetary policy remains accommodative, further rate cuts are unlikely. Our economic team believes that the window for any rate cuts has closed. The preference to use fiscal policy to stimulate the economy has removed the burden from monetary policy. This would allow the central bank to response to any re-emergences of inflationary pressures as result of the economic rebound and higher global oil and commodity prices. A rate hike could not only prevent the economy from overheating (should it expand as our economic team expects) but could also lift domestic yields, maintaining the current spread between the UST and Thai bonds or widen it. This should help to reduce the outflow out of Thai assets that could take place in search of higher returns. Thus, Thailand is one of the few economies in the region that may need to lift its policy rate in 2017.
- **Latest Fiscal and External Balance Outlook:** The budget for FY2018 (Oct 2017 – Sep 2018) has been approved by the cabinet and now awaits legislative acquiescence for the budget to take effect. The FY2018 budget has penciled in a larger deficit of THB450bn (2.9% of GDP) for FY2018 compared to the expected deficit of THB390bn (2.6%) in FY2017. Expenditure for the new fiscal year is set at THB2.9tn, up 6% from FY2017, with 23% of total expenditure earmarked for investment. With the government still running a budget deficit, public debt is recorded at 42.2%of GDP as of end Dec, under the 60% threshold.
- The current account surplus widened even further at the start of 2017. The surplus rose to THB177.45bn in Jan from THB133.18bn in Dec. The wider surplus was due to the larger surplus in the income account of THB110.46bn that more than offset the moderation in the trade surplus of THB66.99bn. The overall balance of payments (BoP) flipped into a surplus of THB240.41bn in Jan, the largest surplus since Mar 2008. While details for the financial account are unavailable at the point of writing, it suggests it was also likely in a surplus for the first time since Jan 2016 due to strong fund inflows, reinforcing the current account surplus in the month.
- **Key domestic events and issues to watch:** We have BoT meeting on 29 Mar to decide on monetary policy.
- **Technical Outlook:** USDTHB continues to trade lower, in line with our call for further downside (as per last monthly outlook). Last seen at 34.90 levels. Weekly momentum and stochastics remain bearish bias. 50DMA looks on track to cut 100 DMA to the downside. Sustained close below 35-levels (38.2% fibo retracement of Mar-Apr-2015 low to Sep-2015 high) puts next support at 34.50 (50% fibo). Resistance at 35.20 (200 DMA). We remain bias to sell rallies.

INR: Rally

Forecast	1Q 2017	2Q 2017	3Q 2017	4Q 2017
USD/INR	67.00 (68.45)	67.50 (69.00)	68.00 (69.30)	67.50 (69.60)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** We expect USDINR to remain heavy in the near-term, flagged by bearish technical signals on the daily and weekly charts. Although the outcome of the Uttar Pradesh election is highly uncertain even as we are past the halfway mark of polls (results are only out on 11 Mar), the removal of cash withdrawal limit as announced by the central bank on 9 Feb along with strong confidence in the economy's recovery from the demonetization effort last Nov have lifted the INR. In addition, concerns of sticky core inflation diminished the chances of RBI of making another reduction in the repo rate. The prospect of strong growth lifted investor sentiments. Feb saw a net inflow of USD1.327bn into equities and USD758.1mn into bonds as of the 22nd although there has been an outflow of debt more recently as prospect of a rate hike declines. The turn of events warrants an adjustment in our USDINR forecast and we now look for the pair to head towards 67.00 by Q1, expecting it to reach 68.00 by 3Q before tapering off towards 67.50 by year end.
- USDINR was last seen just below the 67-figure as we write (24 Feb). The government was able to pull off a budget that balances growth and fiscal consolidation. That had lifted the INR on 1 Feb. Budget deficit is targeted to be at 3.2% of GDP, similar to our projections expressed in our recently published monthly, slightly better than the expected 3.3%. The Union budget was warmly received as Finance Minister Jaitley pledges more support to the farmers, infrastructure spending and personal income tax cuts and corporate tax cuts for small and medium businesses to boost consumption and investment.
- The key event ahead is still the Uttar Pradesh legislative assembly election. It is the most watched state assembly election this year with the most Rajya Sabha and Lok Sabha seats at stake, 31 and 80 respectively. The notable contenders are BJP, BSP and the Congress-SP alliance. With an under-representation of BJP at Rajya Sabha, this election could be an important one to win to gain momentum. In addition, it will be an indication on their popularity and Modi's chances in the next Presidential election given the sheer population of Uttar Pradesh. We anticipate this event to bring more volatility throughout as we near the result. The election is held from Feb 11 to Mar 8 in 7 phases. Results declared on 11 Mar. There is so far little concrete evidence on who is in the lead now but ground intelligence suggests that the BJP, the SP-Congress alliance, and the BSP have held onto their core base.
- Our **Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for India steadied at 4.7 (with 1 being the best score and 9 being the worst).
- **Growth and Inflation Outlook:** Industrial production declined -0.4%y/y vs. the previous 5.7%, dragged by a drop of -1.6%y/y in the

manufacturing component. However, the drop could be only temporary as we saw Jan PMI-mfg rebounded into expansionary mode to 50.4, boosted by rise in new orders and output. This gives RBI's confidence in the economic recovery (from the demonetization impact) a bit more weight. We are still cautious, noting the findings of the RBI industrial outlook survey for 4Q 2016-17 (Jan-Mar 2017). Business expectation index declined with pressure from rise in cost of raw material expected to bring down profit margin. The order books outlook for 4Q of 2016-17 (Jan-Mar) deteriorated sharply and pending orders rose. Capacity utilization is also projected to inch lower. Generally, manufacturing companies have weaker expectations of demand conditions while inflationary expectations are heading higher on all fronts.

- The government's commitment to the inflation target of 4% (+/-2%) for the next five years could also help anchor inflation expectation. Jan CPI slowed to 3.17%y/y from previous 3.41%. However, WPI jumped to 5.25%y/y from previous 3.41% while PPI jumped to 5.25%y/y form previous 3.39%. Jan CPI was likely suppressed by demonetization as well as bountiful kharif harvest. Looking forward, base on the rabi crops sown, the monsoon trend as well as high levels of water reservoir, the rabi crop is likely to see a strong yield as well. That should keep a lid on inflation prices close to the target 4%.
- **Monetary Policy Forecast:** It was the RBI decision that gave the INR bulls more legs (soon after the budget), explicitly stating that the central bank has switched to a neutral policy from an accommodative one and announcing the removal of cash withdrawal limit on 13 Mar. In addition, the MPC is clearly confident that growth is expected to see sharp recovery in 2017-2018 as they look for consumption to rebound after the impact of demonetization fades, the resumption of economic activities that are cash-reliant, further transmission of previous cuts owed to the demonetization efforts via the MCLRs (marginal cost-based lending rates) that should raise consumption and investment, and the growth boosting effect of the Union Budget.
- Fiscal impulse expected from the Union Budget by the RBI is clearly stronger than what we have expected and the MPC seems assured that the impact of demonetization is transient and has even facilitated the transmission of monetary policies, rendering further cuts, unnecessary. RBI's confidence could instill investors' confidence.
- The Feb MPC meeting marks the start of a likely extended pause in monetary policy. We no longer expect a move for the rest of the year. Risks are tilted towards a hike should price pressure rise faster than anticipated.
- **Latest Fiscal and External Balance Outlook:** Finance Minister Jaitley pledges support to the farmers, infrastructure spending and personal income tax cuts and corporate tax cuts for small and medium businesses to boost consumption and investment. The current account deficit remained steady widened to $3bn in the quarter ending Sep. Trade deficit was lower at U$25.6bn vs. previous U$23.8bn. Capital account recorded an outflow of U$17.5bn. Portfolio investment recorded a net inflow of U$6bn due to strong equity demand in the quarter.
- **Key domestic events and issues to watch:** 4Q GDP is due on 28th Feb (after this report is sent out), Feb PMI is due 1st Mar, 4Q BOP current account balance due 6-31 Mar, industrial production on 10th, trade on 10-15th, CPI on 13th, WPI on 14th, Uttar Pradesh Elections on 7 Feb- 8 Mar, results on 11 Mar.
- **Technical Outlook:** 1M NDF is pressured to the downside and could remain bias to the downside within the 66.50-67.40 range in the near-

term. Momentum indicators signal bearish bias on the weekly chart. A break out of the range towards the downside could meet support at 66.25 (38.2% Fibonacci retracement of the 2014-2016 rally) before the next at 64.90 (50%).

VND: Shallow Retracements

Forecast	1Q 2017	2Q 2017	3Q 2017	4Q 2017
USD/VND	23000 (22500)	23300 (22400)	23600 (22650)	23500 (22500)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** The dong was under pressure for much of Feb as the support from FDI inflows ebbs. Further to that, whilst the rest of Asia have been seeing some pick up in trade and PMI numbers, the exports growth for Vietnam slowed with the trade deficit narrowing less than expected to -U$100mn from previous -U$300mn. Industrial production slowed to a crawl to 0.7%y/y in Jan compared to 8.3% in the month prior. Fortunately, equity-related inflow have cushioned the impact on the dong to some extent but heading into the rest of the year, barring potential retracement in the pair, expect pressure on the USDVND to be mostly on the upside as we anticipate further rate hikes by the Fed to lift the currency pair into 2Q and 3Q this year. The move up in Feb was not pre-empted and has to be taken into account. Thus, we still anticipate the pair to head higher towards 23600 in 3Q before easing into the year end.
- **Growth and Inflation Outlook:** Markit PMI-mfg slipped to 51.9 in Jan from 52.4. A deceleration in production and new orders were noted in Jan. Price pressures were high while business confidence was reportedly strongly positive. Industrial production slowed to a crawl to 0.7%y/y in Jan compared to 8.3% in the month prior. The slowdown is broad-based with manufacturing, electricity and water supply decelerating. That said, Jan output could be affected by the Tet holidays which started on 26 Jan. With strong business confidence reported for Jan and a rather decent PMI-mfg print at 51.9, we should not be overly pessimistic on Vietnam's outlook. In addition, the pick-up in trade numbers in the region could also lift the prospect of Vietnam's external balance. Retail sales for Vietnam also slowed a tad to 9.9%y/y from 2016 growth of 10.2%.
- Trade remains a strong focus for the government. Vietnam has committed to more tariff cuts for quite a number of products out of China, fulfilling its part in the ASEAN-China FTA. In return, China has also promised to do the same for Vietnamese goods. That should raise the trade volume between the two nations but it is premature to estimate the net impact on Vietnam's current account.
- Inflation for Jan came in at 5.22%y/y, accelerating from previous 4.74% on the back of higher transport costs. Higher oil prices may continue to spur price pressure as we look towards the end of the year.

- **Monetary Policy Forecast:** SBV is unlikely to move rates given the rise in inflation. The rise in inflation has effectively reduced the real borrowing rates. Expectations for a strong USD, higher US rates and rising price pressure could continue to keep the dong on the backfoot. We no longer look for SBV to ease rates (currently base rate at 9.0%, refinancing rate at 6.5% and discount rate at 4.5%). USDVND could continue to keep a broad uptrend into 2Q and 3Q. Broad yuan weakness, USD strength would mean that the USDVND is still vulnerable to the upside. In addition, exports growth is still weak. Lean FX reserves-import ratio of barely above 2 would mean that any external shocks in the FX space could force SBV to devalue the dong, notwithstanding the ample USD supply onshore. Should USD remain on the upmove, expect USDVND reference rate to be fixed higher and that should guide the USDVND towards our 23600 forecast by 3Q.
- **Latest Fiscal and External Balance Outlook:** Vietnam is running out of fiscal room to boost growth. More recently, the government has turned to online retail for tax revenue. According to the State budget, the budget deficit is projected to be around 3.50% of GDP this year. We see upside risk as MOF has just proposed to lower existing tax rates for SMEs from 20% to 17% so as to encourage companies to engage in productive investment. Separately, the government plans to divest VND67trn from SOE in the years leading to 2020. Key use of the capital is to develop important infrastructure projects like the Long Thanh International airport.
- We still watch the Japanese yen as Vietnam's external debt/GDP stood at 41.5% as of end 2015. Strong relationship with Japan suggests that JPY-denominated debt could be at least 30% of total debt (as reported by our Vietnamese analysts) and a stronger JPY could weaken Vietnam's debt position. That said, given the threat of BOJ intervention and potential monetary and fiscal stimulus, we expect USDJPY to remain within 100-110 for the rest of this year. That should in turn alleviate pressure on Vietnam's debt.
- Current account recorded a surplus of U$3.5bn in 3Q (latest data available), widening from the U$2.2bn seen in 2Q on the back of wider net trade surplus of goods. We remain cautiously optimistic on Vietnam's external position, expecting the improvement in regional demand to boost Vietnam's trade.
- **Key Domestic Events and Issues to Watch:** PMI-mfg is due on the 1st. CPI is due on the 24th. Trade balance, retail sales, industrial production within 25-30th.

FX Forecasts

	End Q1-17	End Q2-17	End Q3-17	End Q4-17
USD/JPY	118	120	124	125
EUR/USD	1.0400	0.9800	1.0200	1.0800
GBP/USD	1.2400	1.2000	1.2300	1.2400
AUD/USD	0.7600	0.7300	0.7500	0.7800
NZD/USD	0.7250	0.7100	0.7300	0.7500
USD/SGD	1.4000	1.4250	1.4350	1.4050
USD/MYR	4.3000	4.3500	4.2000	4.2500
USD/IDR	13400	13600	13600	13300
USD/THB	35.00	35.50	36.00	36.20
USD/PHP	50.00	50.50	50.50	49.80
USD/CNY	6.92	7.03	7.08	7.04
USD/HKD	7.80	7.80	7.80	7.80
USD/TWD	31.00	31.80	32.00	32.00
USD/KRW	1150	1180	1170	1180
USD/INR	67.00	67.50	68.00	67.50
USD/VND	23000	23300	23600	23500
DXY Index	103.55	107.86	105.14	101.60
SGD Crosses	End Q1-17	End Q2-17	End Q3-17	End Q4-17
100 JPY/SGD	1.1864	1.1875	1.1573	1.1240
EUR/SGD	1.4560	1.3965	1.4637	1.5174
GBP/SGD	1.7360	1.7100	1.7651	1.7422
AUD/SGD	1.0640	1.0403	1.0763	1.0959
NZD/SGD	1.0150	1.0118	1.0476	1.0538
SGD/MYR	3.0714	3.0526	2.9268	3.0249
SGD/IDR	9571	9544	9477	9466
SGD/THB	25.00	24.91	25.09	25.77
SGD/PHP	35.71	35.44	35.19	35.44
SGD/CNY	4.94	4.93	4.93	5.01
SGD/HKD	5.57	5.47	5.44	5.55
SGD/TWD	22.14	22.32	22.30	22.78
SGD/KRW	821	828	815	840
SGD/INR	47.86	47.37	47.39	48.04
MYR Crosses	End Q1-17	End Q2-17	End Q3-17	End Q4-17
EUR/MYR	4.47	4.26	4.28	4.59
JPY/MYR	3.64	3.63	3.39	3.40
MYR/HKD	1.81	1.79	1.86	1.84
MYR/CNY	1.61	1.62	1.69	1.66
GBP/MYR	5.33	5.22	5.17	5.27
AUD/MYR	3.27	3.18	3.15	3.32
NZD/MYR	3.12	3.09	3.07	3.19
MYR/IDR	3116.28	3126.44	3238.10	3129.41
MYR/INR	15.58	15.52	16.19	15.88
MYR/KRW	267.44	271.26	278.57	277.65
MYR/PHP	11.63	11.61	12.02	11.72
CNY/MYR	0.6214	0.6188	0.5932	0.6037

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Malayan Banking Berhad
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Saktiandi Supaat	Christopher Wong	Fiona Lim	Leslie Tang
Head, FX Research	Senior FX Strategist	Senior FX Strategist	Senior FX Strategist
saktiandi@maybank.com.sg	wongkl@maybank.com.sg	Fionalim@maybank.com.sg	leslietang@maybank.com.sg
(+65) 63201379	(+65) 63201347	(+65) 63201374	(+65) 63201378