Macro | FX Research & Strategy

Global

FX Monthly

2018, Issue 2: Familiar Uncertainties in a Normalizing World

What Has Changed This Month?

- We revised AUD lower against the USD this month as we anticipate slower wage growth recovery to weigh on inflation and the AUD. Market jitters and heightened volatility could see bears linger a while more.
- KRW was revised lower in light of intensification of US protectionism measures (imposing tariffs on imports of washing machines, solar panels and possibly on steel in Apr) that could impact Korean imports, worsen sentiment and impede KRW gains. Uncertainty on Fed's rate hike trajectory is also one consideration for lowering KRW forecasts.

Our Strategies

- We remain **cautious of more bouts of USD strength**, similar to what was witnessed in Feb. USD bulls could be inspired by safe haven flows should the following risk events manifest 1) trade war brewing - as the Trump administration mulls over import tariffs on steel and aluminium that could trigger more tit-for-tat exchange with China; 2) inflation pick up - price pressure is still subdued but sustained global recovery could stoke demand-pull inflation; 3) markets to re-price more Fed rate hikes as the Fed becomes more hawkish under the new Chair Powell. This could add to sell-off in global bonds and correction in riskier assets.
- Still, **broader term shifts were already underway to support the case for broad USD downtrend**, including (1) US tax reforms and its wider implication on deficit, debt and the USD; (2) reserve diversification away from the USD; (3) USD countercyclical play; (4) USD downtrend cycle. In an environment of broad USD downtrend, we see opportunities for relative value plays in Asia, favouring currencies that benefit from the export-led recovery and commodity price rebound. We continue to favour MYR, SGD, THB CNY, KRW, TWD and AUD over INR and IDR (which suffer from twin deficits and are oil importers). We think PHP is oversold at this level and could risk a retracement.
- **We would like to sell USDSGD on rallies into the MAS MPC in Apr towards first objective at 1.32 and then towards 1.3125. Stop-loss at 1.33. This is based on our house view for the MAS to normalise policy with a shift to a slight appreciation stance. Market appears to be under-pricing this risk, and re-pricing could see SGD rally.**
- **EUR could face temporary downside pressures** due to return of EU political risk premium on outcome uncertainty on German coalition deal and Italy General Elections(4-5 Mar) while ECB meeting (8 Mar) may disappoint as it remains too early to call for guidance shift. We see opportunities to buy EUR on dips.

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FX Forecast Revision

Upward	Downward
	AUD, KRW

Top 3 Currency Plays for March

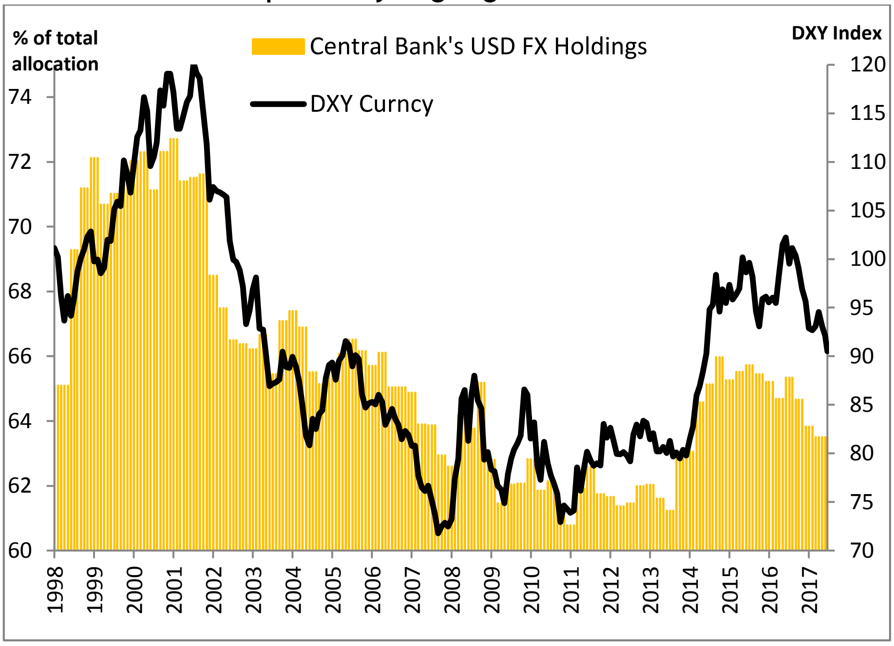
- Prefer to Sell USD into Rallies
- Sell USDSGD on rallies into Apr MPC
- Tactical Long USDKRW amid US protectionism measures and uncertainty on Fed rate hike trajectory

Key Events for the Month Ahead

Date	Event
3 Mar	China CPPCC starts
4 Mar	Italy Election/Results
5 Mar	China NPC
8 Mar	ECB Meeting
22 Mar	FOMC Meeting
22-23	EU Summit
11/20Apr	US decides on steel/aluminum import tariff

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

USD Weakness Underpinned by Ongoing Reserve Diversification

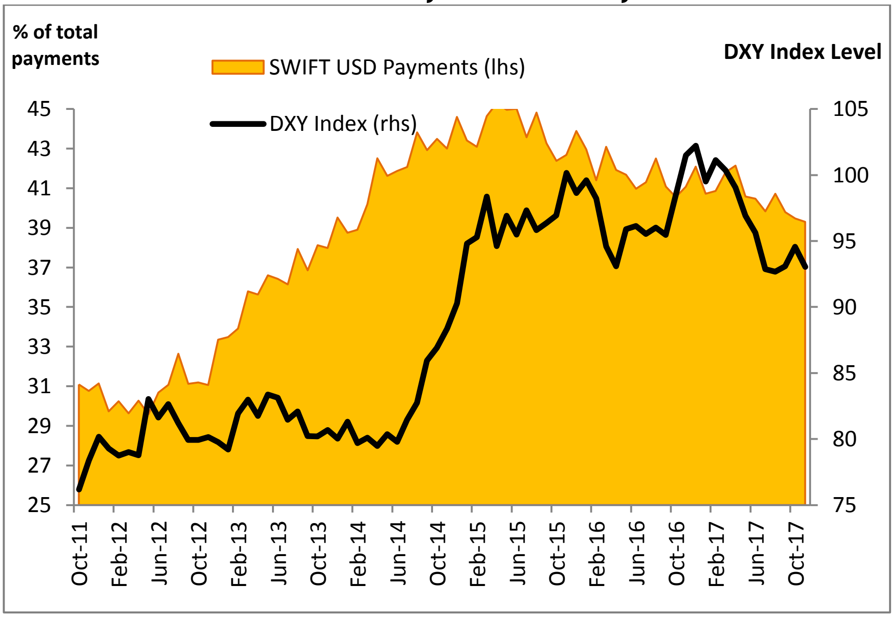


Source: Bloomberg, Maybank FX Research & Strategy

Gradual Shift Away from USD as Global Payment Currency?

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

USD Share as Percent of Global Payment on Steady Decline



Source: Bloomberg, Maybank FX Research & Strategy

G7 Global Overview

USD: Dollar Downtrend Cycle

Forecast	1Q 2017	2Q 2018	3Q 2018	4Q 2018
USD Index	89.69 (--)	88.91 (--)	87.18 (--)	86.18 (--)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** USD downtrend is likely to remain in place for 2018 but we do not rule out bouts of USD strength like what we had witnessed in the past month. The DXY index broke above the 90-figure in the last month of Feb and was last seen at 90.71. Feb had been a month of heightened volatility as stronger wage growth (spurred inflation fears) and Powell's testimony triggered sell-off in the USTs. 10y yields rallied 25bps from 2.70% to a high of 2.95%. We remain wary of more bouts of USD strength (as previously cautioned) that could emanate from a few scenarios - 1) trade war brewing - as the Trump administration mulls over import tariffs on steel and aluminium that could trigger more tit-for-tat exchange with China; 2) inflation pick up – price pressure is still subdued but sustained global recovery could stoke demand-pull inflation and a global bond rout; 3) markets to re-price a more aggressive tightening trajectory as the Fed becomes more hawkish under the new Chair Powell. This could in turn trigger another sell-off in global bonds and correction in riskier assets.

- That said we believe broader term shifts were already underway to support the case for broad USD downtrend, including (1) US tax reforms and its wider implication on deficit, debt and the USD; (2) reserve diversification away from the USD; (3) USD countercyclical play; (4) USD downtrend cycle.

- Synchronous global economic recovery, led by US, EU remains intact and it may be too soon to judge if recent inflation upticks could gather pace sustainably to warrant a shift for faster pace of rate hikes. As such we maintain our bias for broad USD downtrend and look for opportunities on USD upticks to fade into. We believe that a slightly faster pace of tightening amid healthy economic growth outlook and optimistic corporate earnings outlook should not derail the growth momentum or USD down-trend. That said the interim risk-off sentiment could remain as markets adjust from a period of policy certainty under Yellen's era to a period of policy uncertainty under a new leadership (Powell).

- To add further on the USD inverse relationship with global trade and economic growth is that a large share of international trade is transacted in USD even when the US itself is not the party to the transaction. This suggests that world trade volumes are driven in large part by USD. Appreciation in the USD crimps demand for US exports but also for all USD-denominated exports.

- Recent study[1] by Harvard Professor Gopinath, et al. found that 1% USD appreciation against all other currencies lead to a 0.6 – 0.8 % decline in volume of trade between countries in the rest of the world within a year. Depreciation in the USD seen over the past year or so is therefore likely to have played a significant role in the synchronous export recovery in the region – and this should continue to feed through to trade growth for the next few months, given the lags involved. This supports our story for synchronous global economic recovery to be sustained in at least 1H 2018.

- **Growth and Inflation Outlook:** The latest print of the 4Q GDP came in at a 2.6% annualized rate (est. 3.0%) following a 3.2% gain in 3Q. Consumer spending rose 3.8% following a 2.2% pace in the prior period. Both goods and services consumption contributed to growth in the quarter (176 bps and 82 bps, respectively), implying consumer activity remains the dominant engine of growth going into 2018, as durables (14.2% vs. 8.6% prior), non-durables (5.2% vs. 2.3%) and services (1.8% vs. 1.1%) all saw a sizable acceleration in the quarter. Part of this is due to the tailwind to consumer spending from a mild pickup in household wage and salary gains, but activity at the start of the quarter is at least in part attributable to hurricane recovery spending. The positive trend in personal consumption will likely spill into this year's first quarter as tax cuts for households will likely boost growth. Business investment rose 6.8% in 4Q compared to 4.7% prior. A key driver is improving conditions in the petroleum sector in particular, due to a price rebound for crude oil. However, more broadly, a faster pace of growth is creating capacity-constraint issues that require capital investment to ameliorate. Typical at mid-cycle, businesses are spending more aggressively to expand their production capabilities. Improving prospects for corporate profits no doubt help. Residential investment posted a strong reading (11.6% vs. -4.7% prior). The strength was driven by rebuilding efforts in the aftermath of the last year's hurricanes.

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

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

- **Monetary Policy Forecast:** Fed guides for a steady pace of interest rate hikes (2018E: +75bps; 2017: +75bps) that will peak at around 3.00% by end-2020, below the previous pre-GFC high of 5.25%, and adds balance sheet reduction to the process of unwinding its monetary policy stimulus. Fed's balance sheet reduction began in Oct 2017 with

[1] Boz, Emine, Gita Gopinath, and Mikkel Plagborg-Moller. 2017. "Global Trade and the Dollar". NBER Working Paper No. 23988. November 2017

the planned reduction rate of USD10b per month (via USD6b cut per month in US Treasury securities holdings and USD4b cut per month in agency debt and mortgage-backed securities holdings). The monthly balance sheet reduction amount will be raised by USD10b per month every 3 month until it reaches USD50b per month on the 12th month (i.e. Sep 2018) which Fed envisages as the maximum amount of monthly balance sheet reduction thereafter. Actual data showed in Oct-Nov 2017, Fed's balance sheet size dropped by –USD17.7b to USD4,484.5b at end-Nov 2017 from USD4,502.2 at end-Sep 2017 – within the targeted USD10b per month or USD20b for the first two months of the balance sheet reduction, further underscoring the benign normalization of US monetary policy.

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

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

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

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

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

- **Key domestic events and issues to watch in Feb 2018:** Personal Income, ISM Mfg (1 Mar); Factory orders and Durable Goods Orders (6 Mar); ADP Employment and trade (7 Mar); Beige Book (8 Mar); NFP(9 Mar); CPI (13 Mar); Retail Sales, PPI Final Demand (14 Mar); Empire Mfg, Philly Fed (15 Mar); Housing Starts and industrial production (16 Mar); Existing home sales (21 Mar); FOMC Rate decision(22 Mar); Markit PMI-mfg (22 Mar); Durable goods order and new home sales (23 Mar); consumer confidence (27 Mar); GDP, Core PCE (28 Mar); Personal Income, PCE Core (29 Mar);

- **Technical Outlook:** DXY traded a month of 2 halves in Feb - falling for the first half before rebounding into month end. DXY was last seen at 90.40 levels. Daily momentum and stochastics indicators are mild bullish bias and we do not rule out upside risks in the interim. Wall of resistance for the DXY at 90 - 90.50. We cautioned that if it breaks, USD could run higher towards 91.20 levels (50% fibo retracement of Dec high to Feb low). Failing which USD weakness could resume. Support seen at 89.60 (21 DMA), 88.40 (double-bottom low).

EUR: Return of Political Risks an Opportunity to Buy Into

Forecast	1Q 2018	2Q 2018	3Q 2018	4Q2018
EUR/USD	1.2400	1.2500	1.2800	1.3000
	(--)	(--)	(--)	(--)

No Change to Previous Forecast

- **Motivation for the FX View:** Our **caution for near term pullback risks (as highlighted in our last FX Monthly) is coming into play** and we retain our view for risk of further pullback in the next 1- 3 weeks. We **reiterate that the return of EU political risk premium could weigh on EUR but we do not expect political risks to escalate into concerns or full-fledged crisis.** Dips in EUR may provide opportunity to buy into. We do however warn that break below 1.2210 key support could bring about greater downside risks towards 1.2120, 1.2020 levels. Patience is encouraged. The lead-up to FoMC meeting (22 Mar) may also see support for the USD which could pose as temporary dampening pressures on EUR.

- Voting for German coalition deal (for 440,000 SPD members) has already started and final results will be made known on 4th Mar. Leading SPD Mayors appear to back coalition deal with Merkel according to polls. A German coalition government appears to be priced in. We caution that no-deal surprise could trigger EUR-long unwinding as fear of re-election may resurface.

- Italy General Election is scheduled on 4 Mar and should matter as recent business and consumer confidence fell and the economy growth momentum moderated in 4Q 2017. The election is shaping up to be a three-way contest between (1) ruling centre-left coalition led by Democratic Party (PD), (2) centre-right coalition led by

Berlusconi's Forza Italy, Northern League party (campaigned for anti-immigration), Lega Nord party (campaigned to leave the single currency) and Brothers of Italy party (far-right/eurosceptic) as well as (3) anti-establishment Five Star Movement party (single most popular party but has refused to take part in coalition). Final opinion poll on 16th Feb showed a **clear lead (34.7%) for Berlusconi's centre-right coalition but is unable to form a working majority (which requires 37% votes allocated using a first past the post voting** and remaining 63% using proportional largest remainder method with 1 round of voting).

- As such a **hung parliament is the baseline outcome for now** and the possible option is a coalition government between centre-left's DP and Centre-right's Forza Italia, which is being viewed as an unstable alliance. But in the event the centre-right coalition manages to obtain a working majority, there is huge competition among the partners on who will be in control – Berlusconi has thrown his support behind Mr Tajani (Forza Italia) while Matteo Salvini the leader of Northern League (anti-Euro, anti-immigrant) expects to be Prime Minister if his party received one more vote than Forza Italia. Uncertainty may temporary weigh on EUR. **But this should not be taken as an extended pullback. Instead we see opportunities to buy EUR on this dip.**

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

- There are also signs of growing demand for EUR amid reserves diversification. This could keep EUR broadly supported on dips. IMF currency composition of official foreign exchange reserves (COFER) showed a marginal pick-up in EUR as a share of global central banks' reserves to 20% in 3Q 2017, from all-time low of 19.13% in 4Q 2015. That said the current level remains relatively low by historical average of 23% and historical high of 28% (in 2009).

- **Downside risk to our broader term outlook:** (1) The risk of yield curve compression/inversion particularly in the UST space can at times be a reliable predictor of US recession (as seen from examples of historical experiences) could be a risk to our bullish EUR forecast as **risk-off sentiment coupled with recession risks could see demand for safe haven plays and this could see USD strength offsetting EUR gains**. (2) We also caution that a **faster pace of Fed rate hikes amid US fiscal impulse (earnings repatriation, infrastructure spending, tax cuts) could risk higher UST yields and that could lead to disorderly bond sell-off. Risk aversion flows there may lead to USD strength and could dampen EUR gains.**

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

- ECB's recent assessment (25 Jan) is that (1) private consumption is supported by rising employment, which is benefiting from past labour market reforms, and by increasing household wealth; (2) business investments continue to strengthen on the back of very favourable financing conditions, rising corporate profitability and solid demand (3) housing investment has improved further; (4) broad-based global recovery is supporting Euro-area exports. In the last quarterly assessment report (Dec-2017), ECB revised 2018 growth forecast to 1.9% (vs. 1.8% as seen from Sep projections). The next ECB quarterly assessment report will be available on 8 Mar.

- **Euro-area inflation fell further to 1.3% y/y in Jan** (vs. 1.4% in Dec). Amongst the EU, inflation fell in 21 countries, remained stable in 1 and rose for 6 countries. Component-wise, highest contribution came from services, food, alcohol & tobacco, etc. **Core inflation held steady at 1% y/y in Jan.** ECB expects headline CPI to hover around current levels in coming months. ECB reiterated that measures of underlying inflation remain subdued and have yet to show convincing signs of a sustained uptrend but they expect a gradual increase in the medium term supported by monetary policy measures, continuing economic growth and rising wage growth. We believe the strong run in the EUR (>5.5% gains since mid-Dec 2017) could weigh on imported prices (imported consumer products account for around 15% of industrial goods in the Euro-area) and result in negative feedback loop to core inflation. In the last quarterly assessment report (Dec-2017), the ECB revised upwards its inflation forecast for 2018 to 1.4%, from 1.2% in the last projection in Sep.

- **Monetary Policy Forecast:** For the upcoming meeting on 8 Mar, we do not expect any change to policy rates and expect ECB to keep APP ongoing till Sep-2018. There may be market chatters speculating on the change in forward guidance relating to how APP should end **but we think it remains too soon to commit to shift in communication at this stage.** On how APP will end, we expect a gradual "taper" from Sep-2018 to Dec-2018 rather than an abrupt end on Sep-2018, followed by potential rate increases in 1H 2019. **ECB minutes for Jan (released on 23 Feb) showed that inflation is picking up at a faster pace.** This somewhat sparked off speculations that ECB QE could end earlier than expected. Inflation expectations for 2018 – 2019 saw modest upward revision in ECB Survey of Professional Forecasters. Elsewhere in the Minutes, some members expressed preference for dropping easing bias but it was agreed that guidance shift was premature. We believe guidance shift could come when inflation shows clearer signs of sustainable uptick.

- ECB Draghi told European Parliament's committee on Economic Affairs (26 Feb) that "given the uncertainty surrounding the measurement of economic slack, the true amount may be larger than estimated and this could slow down the emergence of price pressures… particularly visible in the labour market". But Draghi also added that this is only temporary and prices will eventually climb as economic expansion continues and unemployment further declines. It seems this is **another attempt by Draghi to manage market expectation against an earlier than expected withdrawal of monetary stimulus** ahead of ECB meeting on 8th Mar.

- There was no meeting in Feb. The last ECB meeting on 25th Jan saw Governing Council (GC) kept rate of Main Refinancing operations, deposit facility and marginal lending facility unchanged at 0%, -0.4% and 0.25%, respectively. The GC expects the key ECB interest rates to remain at their present levels for an extended period of time, and well past the horizon of the net asset purchases. ECB's Draghi said that robust economy justified EUR strength. He added that speculation about changes in future communication and recent statements from US policymakers on FX (US Treasury Secretary Mnuchin that "a weaker USD is good" for US economy via trade) led to EUR strength. Draghi also expressed confidence that Euro-area could attain its inflation goals. Overall the statement/press conference was balanced. When asked about whether interest rate will rise this year, he said he did not believe conditions warrant that.

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

- **Latest Fiscal and External Balance Outlook:** Euro area's current account surplus narrowed to 6-month low of EUR29.9bn in Dec (from EUR35bn in Nov) on sharp decrease in primary income surplus despite recording rising surplus on trade in goods and services. Current account surplus to GDP was last seen at 3.5% for 12-month period ending Dec 2017.

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

- **Key domestic events and issues to watch:** Feb Mfg PMI (1 Mar); Jan unemployment rate (1 Mar); Jan PPI (2 Mar); Feb services PMI (5 Mar); Jan retail sales (5 Mar); 4Q GDP (7 Mar); ECB Governing Council meeting (8 Mar); Jan IP (14 Mar); Feb CPI (16 Mar); Jan trade, construction output (19 Mar); Mar ZEW Survey Expectations, Mar consumer confidence (20 Mar); Jan Current Account, Mar prelim PMIs (22 Mar); Mar consumer confidence (27 Mar).

- **Technical Outlook:** Our technical call for risk of pullback towards 1.2211 in last month's FX outlook came to fruition. Pair made a double/triple-top around 1.2520 levels and has traded lower. Last seen at 1.2220 levels. Mild bearish momentum on daily chart remains intact while stochastics is entering into near-oversold conditions. Support at 1.2210 (38.2% fibo retracement of Dec double-bottom low to Jan-Feb triple top). Caution that if key support at 1.2210 gives way, we warn of greater downside towards 1.2120 (50% fibo), 1.2020 (61.8% fibo). Interim resistance at 1.24 before bigger area of resistance at 1.2520 (double/triple top). Respect the current downward momentum but remain on the lookout for opportunity to buy on dips.

GBP: Caught in Tug of War

Forecast	1Q 2018	2Q 2018	3Q 2018	4Q2018
GBP/USD	1.4200 (--)	1.4400 (--)	1.4800 (--)	1.4800 (--)

No Change to Previous Forecasts

- **Motivation for the FX View**: Our call in last month's FX Outlook – Sharp GBP gains to face a reality check came in timely as GBP eased off highs from around 1.4278 (1 Feb) to trade an intra-month low of 1.3765 (9 Feb). Pair was last seen at 1.4050 levels. We expect GBP to be caught in a **tug of war between *Brexit* progress (main source of volatility) and BoE rhetoric (which has been hawkish) in the near term**. This underscores our view that GBP price movements should contain a great deal of variability driven factors. A more united view on Brexit should help with negotiation process but matters of politics are fluid and remain too early to conclude given factions within Conservative party and between different parties (Labour and Conservative). We also noted there was news in second part of Feb that EU parliament is said to be preparing a detailed resolution calling for more flexibility in future relationship talks with Britain that would allow for privileged single-market access. A more constructive approach towards negotiating a brexit deal with UK helps support our bias for smooth and orderly exit. Such a scenario if confirmed will support GBP strength amid BoE's explicit willingness to tighten monetary policy earlier than expected (seen a support for GBP). We see range of 1.38 – 1.42 in the interim, with risks skewed to the upside.

- We retain our optimistic FX forecast for GBP, due to expectation for orderly *Brexit* (boost to sentiment), continued improvement in labor market (upward pressure for wage growth providing room for BoE to tighten) and potentially greater tolerance (from policymakers) for GBP appreciation and BoE rate increases (to come earlier than expected) to curb inflationary pressures. At the last MPC meeting (8 Feb), BoE **said it is likely to raise interest rates earlier and faster than previous expectations of 2 hikes in 3 years (in Nov-2017 Quarterly Inflation Report) to dampen inflationary pressures. This is contingent on resilience of domestic economic data and further**

progresses in Brexit negotiations. Other BoE speakers for Feb joining in the hawkish rhetoric include A recap of BoE's recent hawkish rhetoric include BoE Vlieghe whom said there was increased evidence that "tight labour markets are finally starting to have some upward effect on wages… a bit more than 3 hikes over BoE's 3-year forecast period will be necessary to get rid of excess demand in the economy" while McCafferty said that "rates will need to go up earlier… but decisions are going to be based on how the economy evolves". These comments reinforced the more hawkish BoE Quarterly Inflation Report last week. We believe GBP gains could be amplified amid broad USD weakness. Eventual recovery (on broad picture perspective) towards 1.50 should not be ruled out as UK manages its orderly transition out of EU and corrects its imbalances (relating to twin deficits, productivity growth, normalising of monetary policies, etc.).

- Into the medium term (12-month), we maintain our bias that GBP could trade higher from current levels towards 1.48 – 1.50 as GBP is perceived to be undervalued from both historical and fundamentals perspective (our BEER model puts GBP at 1.40). The 20% or so depreciation (from Jun to Oct 2016) should help the UK economy to rebalance and grow sustainably over time - current account deficit should narrow, exports should become more competitive and tourism and education receipts should pick up further. We believe UK should be able to manage the exit, transform itself into a global marketplace and continue to attract capital (longer-term). Past experience of UK leaving the ERM back in 1992 saw a period of consolidation (for a few years) at historical lows for GBP, before the eventual move higher in the following years, where GBP TWI traded above 100-levels in 1998 (from the lows of 80 in 1993-1996) due to buoyant demand fueled by rapid growth of wealth, credit and money. If history is a guide (assuming UK manages the transition well and takes the opportunity to correct its imbalances), its currency may start climbing higher.

- Taking stock of recent Brexit development so far this year, it can be classified into two periods. The early part of Jan-2018 showed signs of constructive engagement from EU members with Spain and Netherlands' Ministers indicating their preferences for soft Brexit citing trade and investment ties, the Italians saying that it is "completely unrealistic" to exclude financial services from the deal while influential lawmakers in EU parliament reportedly considered watering down legislative proposals relating to clearing houses. The latter helps to dispel fears of negative impact on London's financial centre (should clearing houses be relocated out of London).

- However the second part of Jan-2018 to now showed signs that Brexit negotiations may not be as smooth as hoped and there seems to be renewed doubts over PM May's leadership:

- EU's Chief Brexit negotiator Barnier said that **brexit transition deal is not a given** if disagreements persist.
- Bloomberg report that said **UK investment firms will no longer benefit from the MiFID authorisation if there is no Brexit deal**. This means that those investment firms will no longer be allowed to provide services in the EU on the basis of their current authorisations.

This brings back fear that banks/financial/ investment firms may exit London to other parts of European cities - risk of investment outflow pressures could weigh on GBP.

- **EU officials have rejected the City of London's plan to strike a post-*Brexit* cross-border free trade deal on financial services** on the condition that each side preserves regulatory standards (endorsed by Britain's Brexit Minister David Davis). According to Reuters report, one senior British finance executive present at one of the meetings said that was their best and only proposal and they do not have a plan B. Chancellor Hammond had warned that hurting London's financial centre would push businesses to Singapore and New York at the expense of Europe;
- **UK PM May is said to reject EU's terms of demands** during Brexit temporary transition period from 29 Mar 2019 to 31 Dec 2020 (also known as implementation period post-exit to minimise disruption on businesses, security, etc.). EU's guidelines for the next stage of Brexit talks demand that UK obey all EU rules and regulations including those changes that are adopted after Mar-2019 and UK will have no say in them, UK to not take part in EU decision-making processes; UK to abide by regulatory structures of the EU and its budgetary commitments; UK to recognize European Court of Justice and work should continue on finding a solution to Northern Ireland borders;
- Talks of more **MPs demanding a vote of no confidence in PM May** as well as news (reported by The Times) of PM May facing fresh calls to step down at a fundraising event (25 Jan);
- PM May has ruled out staying in customs union after Brexit amid growing divisions within the cabinet. But **much remains unclear on UK's stand.** Greater clarity should help with negotiation.

- **Growth and Inflation Outlook:** In BoE's Quarterly Inflation Report released 8 Feb, **growth forecast was revised upwards** to 1.7 in 2018 (vs. 1.5% projection in Nov) and to 1.8% in 2019 (vs. 1.7% projection in Nov). This due to the "strength in global growth, lessening drag from fiscal consolidation, accommodative financial conditions and a modest recovery in household real income growth. BoE's judged that that risks to the central outlook are skewed to the upside stemming from the possibility of a great boost from global demand". It did however add a caveat that "the anticipation of and uncertainty around Brexit, however, appear to be weighing on investment, and the associated fall in sterling's exchange rate is squeezing households' real incomes and dampening consumption growth".
- **Preliminary estimates showed 4Q GDP disappointed to the downside** (+0.4% q/q vs. +0.5% expected). This marks a downward revision from previous estimates of 0.5% and was due to small revisions to mining, energy generation and services. On y/y terms, 4Q GDP was 1.4% (vs. +1.8% in 3Q). For 2017, **UK growth slowed to 1.4% y/y (vs. 1.9% in 2016). This is its lowest level in 5 years and the slowest growing major economy in the world. This data further validates our caution that growth momentum is decelerating and is below its long term average. The OECD leading indicator also indicated easing growth in UK.** Our caution for decelerating growth

momentum does contradict BoE's optimistic expectation of growth outlook.

- In the last Quarterly Inflation Report (published Feb 2018), **inflation is forecasted to be higher for 2018 at 2.9%** (vs. earlier projection of 2.6%). BoE said that current level of inflation 1ppt above MPC's 2% target was almost entirely due to effects of higher import prices following GBP depreciation. Recent rise in global oil prices has also added to external cost pressures. But inflation is projected to fall gradually but remains above the target in 2018 (2.3%) and 2019 (2.2%).
- **UK inflation held steady at 3% y/y for Jan while core inflation rose to 2.7% (vs. 2.5% in Dec).** Data reinforced BoE's hawkish rhetoric and add to expectation for BoE to raise rate earlier than expected. Markets are now pricing in 61% chance of BoE rate hike as early as in May (vs. 37% chance back in Jan-2018). **On inflation outlook,** we do not expect price pressures to stay above 3% for extended period as seasonal effects from travel ease. We expect recent GBP gains to have an effect in moderating inflation via import price channel. However given rising oil prices in recent months, retail fuel prices should see some upward pressure on CPI in coming months.
- **Monetary Policy Forecast:** BoE is expected to **maintain monetary policy status quo** at its upcoming meeting on 22 Mar. **We were initially more hawkish than market consensus in calling for 25bps rate hike in Aug-2018** but recent inflation uptick, BoE QIR upward revision to growth and inflation projections and hawkish shift in BoE rhetoric have **shifted market expectations to a possible rate hike in May-2018**. 90D Sterling futures are already implying a 50bps rate hike this year as opposed to BoE's 50bps rate hike for this and next year. We do not rule out a rate hike in May if Brexit development does not take a turn for the worse. In addition to this, we believe policymakers are increasingly more tolerant of allowing exchange rate appreciation to arrest runaway inflation, given that recent >6% appreciation (since late-Oct 2017) in GBP towards 1.42-1.43 levels in Jan-2018 apparently did not seem to create any discomfort with policymakers. Stronger commitment from BoE to bring down inflation (conditional on orderly *Brexit*) could support the case for BoE's hawkish rhetoric and earlier than expected rate hikes and this supports the case for stronger GBP.
- At the last MPC meeting (8 Feb), BoE said it is likely to raise interest rates earlier and faster than previously expected in Nov-2017 (2 hikes in 3 years) to dampen inflationary pressures. The Quarterly Inflation Report also upgraded growth and inflation projections. BoE Carney reiterated that rate path remains contingent on resilience of domestic economic data and further progresses in Brexit negotiations. BoE speaks in the past month also reinforced the hawkish shift - BoE Vlieghe said there was increased evidence that "tight labour markets are finally starting to have some upward effect on wages… abit more than 3 hikes over BoE's 3-year forecast period will be necessary to get rid of excess demand in the economy" while McCafferty said that "rates will need to go up earlier… but decisions are going to be based on how the economy evolves". BoE Carney's testimony (30 Jan) to Britain's House of Lords Economic Affairs committee added to GBP strength. He said the central bank's focus is increasingly shifting to

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

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

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

- Public sector borrowing (ex-banking) was at its lowest level in 10 years – GBP7.2bn lower in the period from Apr to Jan, than the same period in previous year. Eyes on March Budget – if Chancellor Hammond spends more on healthcare as requested by Foreign Secretary Johnson or aims to cut public debt (representing some degree of spending control).

- **Key domestic events and issues to watch:** Feb Mfg PMI (1 Mar); Feb Construction PMI (2 Mar); Jan services PMI (5 Mar); Jan trade, IP, construction output (9 Mar); Feb CPI, PPI, RPI (20 Mar); Jan labor report, Feb public finances (21 Mar); Feb retail sales, BoE MPC meeting (22 Mar), 4Q final GDP (29 Mar). EU leaders meet in Brussels (22-23 Mar); Last day of Commons session before Easter recess (29 Mar).

- **Technical Outlook:** Our call (in last month's FX Outlook) for GBP to trade lower towards 1.38-levels materialized. Pair traded a low of 1.3765 (9 Feb) and was last seen at 1.39 levels. Bearish momentum on weekly daily chart remains intact. Support at 1.3810 (61.8% fibo retracement of EU referendum high to Oct-2016 low). Resistance at 1.4150, 1.4270 (76.4% fibo). Risks are skewed to the downside.

AUD: Bears To Linger A While More

Forecast	1Q 2018	2Q 2018	3Q 2018	4Q 2018
AUDUSD	0.7850 (0.8000)	0.8000 (0.8150)	0.8100 (0.8350)	0.8300 (0.8500)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** The correction that we had called for materialized last month. The technical indicators were compelling but the move lower did not coincide with a fall in base metal prices. Rather, AUD was weighed by a combination of souring risk appetite and USD strength. Even though we had ***fully anticipated*** the technical correction in the AUDUSD, we still revised our AUDUSD forecast lower primarily because we now expect the wage growth to take more time to recover. This comes in spite of a stronger-than-expected wage price index for 4Q 2017 at 0.55%q/q vs. the previous at 0.48%. However, federal government agencies will now be able to employ their entire workforce on common law contracts and not enter into new enterprise agreements with unions and employees under the Turnbull government's new public sector bargaining policy. That could delay the wage recovery that we have been looking for. With that, our call for RBA to raise cash rate in May is also at risk and we now expect a rate hike to occur in August. With the first hike likely pushed to the second half of the year, we revise our AUDUSD forecast to 0.7850 for 1Q and the pair to come in at 0.83 by the end of the year.

- **Growth and Inflation Outlook:** Despite our forecast downgrade, we are still bullish on AUD in general. Fundamentally, the AiG Performance of Services index rose to 54.3 from previous 52.0. When we look at the breakdown, the index for manufacturing surged to 58.7. Selling price has actually been on the climb and that is normally a leading indicator for CPI. According to the survey, the diffusion index for the selling price of the construction sector has risen the most in the past few months. However, the gap between selling price index and CPI has been widening and headline CPI is still waffling around the lower bound of the 2-3% target band. The 4Q CPI will be released around the time that this report is sent, a key indicator.

- Private consumption is a key concern of RBA and the Dec retail sales number were weaker than market consensus at 0.2%m/m. The actual print came in at 0.5%m/m. Building approvals also disappointed with an fall of -5.5%y/y vs. the expected 11.5%. That has probably weighed on the AUDUSD. That said, capacity utilization rate are still on the rise across the board including services, manufacturing and construction.

- **Monetary Policy Forecast:** RBA Governor Philip Lowe has been quashing talks of a near-term rate hike. He said he does not see a "strong case" for a near-term interest rate adjustment and more recently, he had envisaged a central scenario of further reduction in the jobless rate and an increase in inflation towards the mid-point of the 2-3% target range before the central bank reduce monetary stimulus and raise interest rates. In addition, the wage recovery that we have been looking for could take even more time to come as Turnbull's public sector policy has allowed federal government agencies to hire base on common law contracts and they need not enter into new enterprise agreements with unions and employees. This new policy could slow wage growth and overall price pressure. We now look for RBA to move in August instead of May, timed in conjunction with the release of the quarterly SoMP for more room for policy explanation.

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

- The 2017-18 budget deficit is A$29.4bn and projected to return to a surplus of A$7.4bn by 2020-21. Economic assumptions include inflation at 2% this year, real GDP of 2.75%. Total revenue is expected to be A$444.4bn, up from A$412.1bn in 2016-17. Net debt is projected to peak at 19.8% of GDP in 2018-19. Infrastructure spending will amount A$75bn from 2017-18 to 2026-27. These are subjected to renewal in May and once again, Australia's credit rating outlook remains vulnerable to a downgrade as its deficits run the risk of being persistent. RBA Governor Lowe assures that it might not be a "big event".

- **Key domestic events and issues to watch:** Feb PMI-mfg, 4Q Private Capex is due on 1st Mar; M-I inflation and building approvals on the 5th; 4Q BoP, retail sales and RBA rate decision on the 6th; GDP on the 7th; trade on 8th; home loans and NAB business surveys on 13th; Westpac consumer confidence on 14th; 4Q house price index and RBA minutes on the 20th; labour report on the 22nd; Feb private sector credit on the 29th;

- **Technical Outlook:** The correction that we had called for materialized fully. With the AUDUSD seen at around 0.7790 last, the pair seems vulnerable to the downside as momentum indicators turn lower. Bears might have more legs to go, first support at 0.7770 needds to break before the next at 0.76. That said, AUDUSD has been in an upward sloping trend channel since 2015. The pair should head higher thereafter.

NZD: Temporarily Weighed by Divergence in Policies & Inflation

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

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** We still expect **NZD gains (**about 9% gains between Nov and Jan) **to correct possibly towards 0.71 - 0.72 levels in coming weeks** owing to divergence between Fed-RBNZ monetary policies. **Yield differentials between NZ and UST have been narrowing**, with 10Y differentials last seen at +16bps, near its historical lows (2017 highs were seen at +100bps). We see risk of yield differentials at risk of narrowing further towards par amid rising expectation for Fed to tighten while RBNZ stays on hold due to inflation taking on different trajectories (US CPI showing upticks while NZ CPI slips).

- **Divergence between Fed and RBNZ Monetary Policies as well as Inflation.** At the last RBNZ meeting (8 Feb), **RBNZ lowered inflation forecasts** and predicted that inflation won't reach the 2% midpoint of its 1 - 3% target range until 3Q 2020. It also sees inflation softer at 1.1% in 1Q 2018 (vs. previous projection of 1.5%). **Growth projections in the near term was also revised lower** (to 3.1% in 1Q from 3.8% as seen from Nov MPS projection), taking into account the new government's policies on immigration, housing, welfare and industrial relations on economic activity. **Contrast this with the Fed where hawkish rhetoric is building up** - Fed Officials viewed the latest US data on consumer and business spending as a sign of "substantial underlying economic momentum" and they specifically pointed to the tax reforms as a reason to be optimistic about the economy over the short term. Fed also saw b**road improvement in US economy and pointed to pickup in inflation towards the end of last year…** though Fed maintained its view that inflation is likely to hover at or below its 2% target in 2018. Recent price-related data in US also showed signs of pick-up. In particular average hourly earnings rose to 2.9% y/y and CPI accelerated. Taken together, this sparked off market talks of tighter pace of Fed tightening or potentially 4 Fed rate hikes this year (though our house view remains unchanged for 3 rate hikes). Divergence between Fed and RBNZ could weigh on NZD on the interim.

- But **declines owing to monetary policy and inflation divergence between NZ and US re not likely to persist**. We see this as temporary stresses – RBNZ policy stance may change in our view. We **maintain our view for NZD to trade higher this year** due to government policy uncertainty subsiding, global synchronous economic recovery to keep agri-commodities prices supported, inflation to materially pick up (owing to fiscal impulse, minimum wage increase) leading to RBNZ first rate hike in 2H 2018 amid environment of broad USD downtrend.

- Though the recent RBNZ MPS may be interpreted as neutral-dovish leaning, but we caution against over-interpreting this MPS as that meeting was the second last meeting Acting Governor Grant Spencer chairs (next RBNZ meeting and also his last is scheduled 22 Mar). We believe **RBNZ is managing expectations** and **laying the groundwork in the lead-up to new RBNZ Governor Adrian Orr taking office** (27 Mar). He was formerly a RBNZ deputy Governor (2003-06) and the CEO of NZ superannuation fund (an appointment he held for the past 10 years in which he reportedly had a stellar performance). He was largely perceived as a qualified candidate to head up the central bank and is known to be more vocal (more volatility on the NZD) than former RBNZ Governor Wheeler. Going forward, **RBNZ could potentially function differently amid review of the Reserve Banking Act** – possibly a dual mandate to target full employment in addition to price stability as well as new decision making structure. **Policy bias and expectations could change in light of a new structure, dual mandate and new leadership** going forward. We **do not rule out a shift in guidance towards tightening. Our house call remains for a rate hike in 2H 2018**. Adrian Orr is expected to chair his first meeting with the release of the next quarterly MPS on 10 May.

- **Growth and Inflation Outlook:** In the last quarterly Monetary Policy Statement, growth projections in the near term was revised lower to 3.1% in 1Q from 3.8% as seen from Nov MPS projection, taking into account the new government's policies on immigration, housing, welfare and industrial relations on economic activity.

- Manufacturing PMI rebounded in Jan (55.5 vs. 51.1 in Dec), with increases seen broadly across the sub-indexes including new orders. **4Q GDP is scheduled to be released 15 Mar.** 3Q GDP expanded +0.6% q/q, +2.7% y/y. The expansion was due to contribution from services sector including health and residential care, business services, arts & recreation as well as from construction activity. Household spending was also firmer, owing to spending on durable goods and services.

- The last RBNZ MPS (dated 8 Feb) showed that NZ economy is projected to continue growing at an average of 3.2% over the next 3 years. Above-trend pace of growth is expected to be strong enough to generate an increase in capacity pressure and lift inflation around the midpoint of the RBNZ target range of 1 – 3% over the medium term. Housing and construction sectors are likely to be weaker (possibly due to LTV restrictions, reduced foreign demand, etc.) but continued high terms of trade, fiscal stimulus amid accommodative monetary policies should offset. RBNZ also took into consideration new policy changes including new government spending, tighter visa requirements, KiwiBuild program (to build 100,000 affordable homes in 10 years, half of those supply will be in Auckland) and increases in minimum wage but the impact of these policies remain very uncertain.

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

- **In the last MPS, RBNZ lowered inflation forecasts and predicted that inflation won't reach the 2% midpoint of its 1 - 3% target range until 3Q 2020.** It also sees inflation softer at 1.1% in 1Q 2018 (vs. previous projection of 1.5%). Survey measures of inflation expectations remained anchored around the 2% target across all horizons.

- **Monetary Policy Forecast:** We expect RBNZ to keep OCR on hold at 1.75% at its upcoming meeting on 22 Mar amid softer inflation outlook. The upcoming meeting is also the final one Acting Governor Grant Spencer chairs. We **do not expect him to deviate from his recent neutral-dovish leaning rhetoric**. At the last meeting, OCR is only projected to start increasing from mid-2019 with a full 25bps increase in OCR only expected in 1Q 2020. Asst. Governor McDermott also said (8 Feb) that the central bank's stance on rates is "neutral". But we interpret this as managing expectations and laying the groundwork in the lead-up for new RBNZ Governor Adrian Orr taking office on 27 Mar. **We still expect the central bank to begin raising rates as early as in 2H 2018 as inflation is expected to pick up further towards end-2018** (owing to fiscal impulse, minimum wage increase).

- **RBNZ could potentially function differently** going forward amid review of the Reserve Banking Act – possibly a **dual mandate to target full employment in addition to price stability** as well as **new decision making structure**. Policy bias and expectations could change in light of a new structure, dual mandate and new leadership going forward. We **do not rule out a shift in guidance towards tightening.**

- **Latest Fiscal and External Balance Outlook:** In the first 6 months of the financial year ended 31st Dec 2017, NZ government recorded an unexpected operating surplus of NZ$1.1bn ($0.8bn more than forecast).

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

- 3Q current account deficit narrowed to -2.6% of GDP (vs. -2.7% in 2Q). In absolute terms, current account deficit was larger than expected as overseas income of domestic companies was lower relative to foreign-owned firms operating in NZ. Trade balance 12-month YTD deteriorated with deficit rising to -3.2bn in Jan (vs. -2.8bn in Dec). This could put widening pressure on current account deficit.

- **Key domestic events and issues to watch:** 4Q terms of trade (1 Mar); Feb consumer confidence, Jan building permits (2 Mar); Feb food prices (13 Mar); 4Q current account (14 Mar); 4Q GDP (15 Mar); Feb Mfg PMI (16 Mar); Services PMI (19 Mar); Feb net migration (21 Mar); RBNZ meeting (22 Mar); Feb trade balance (26 Mar). GDT trade auctions take place on 6 and 20 Mar.

- **Technical Outlook:** Our call in last month's FX outlook for NZD pullback to re-visit 0.7270, 0.7160 levels appear to be on its way. Pair was last seen at 0.7230 levels. Daily momentum and stochastics continue to indicate a mild bearish bias. Further pullback towards 0.72 levels (38.2% fibo retracement of Nov-Dec double-bottom low to Jan-Feb double-top high), 0.7180 (200 DMA) and 0.7130 (50% fibo) should not be ruled out. Resistance at 0.7290 levels (23.6% fibo), 0.74 levels.

JPY: Capped By Safe-Haven Plays

Forecast	1Q 2018	2Q 2018	3Q 2018	4Q 2018
USDJPY	108 (--)	107 (--)	106 (--)	105 (--)

No Change From Previous Forecasts

- **Motivation for the FX View:** The USDJPY is the best performing Asian and G7 currency so far in Feb. Pair has been largely on the downtrend in Feb, touching a low of 105.55 on 16 Feb before rebounding back above the 106-levels. This move was initially attributed to the speculation that the BOJ was preparing to unwind its easy monetary policy, playing catch up with its regional peers. This concern was soon overtaken by market fears that Fed could hike its short-term rates at a faster pace amid emerging inflationary pressures and spoil the party in the equity market. This concern sparked safe-haven plays with investors seeking the safety in Japanese assets while selling riskier assets. Safe-have plays have resulted in a reduction in short-JPY positions against the USD, putting downside pressure on the JPY. Consequently, the JPY has gained 2.2% against the USD. That said, we do not expect these gains to continue unabated ahead with some slippages cannot be ruled out. Nevertheless we remain positive on the JPY outlook and reiterate our sell USDJPY call for a move towards 105.

- Our USD view calling for a broad downtrend in the USD to persist in 2018 remains intact. This would reaffirm downside pressure on the USDJPY. The weakness in the USD is due to structural factors such as the counter-cyclical nature of the USD, rising budget deficit, reserve diversification away from the USD, and the end of the 78-month USD rally cycle that is likely to weigh on the USDJPY. We caution though that there could be intermittent bout of USD strength that could lift the USDJPY higher.

- Recent CFTC data showed investors paring their short-JPY positions, while increasing their long-JPY bets. As of 20 Feb (latest data available), investors have cut their short-JPY position to 153,972 contracts from 157,808 contracts the previous week, while increasing their long-JPY positions to 45,634 contrasts vs. 42,299 contracts previously. This has resulted in a reduction in net short-JPY positions in the week of 20 Feb (108,338 vs. 13 Feb's 115,509), suggesting market is looking for reduced weakness in the JPY in the weeks ahead. Further unwinding of net-short USDJPY positions ahead on safe-haven plays could add further downside pressure to the USDJPY in the months ahead.

- We maintain our view that the USDJPY is unlikely to fall towards the 100-handle anytime soon. We expect the BOJ's continued easy monetary policy to underpin the pair. Governor Kuroda has constantly reiterated the central bank's position of maintaining its ultra-loose stimulus programme for as long as it takes to get inflation back up to around the 2% target. This ongoing powerful easing measures and yield curve control should see 10Y JGB yield hovering around the zero percent levels. This is in contrast to its G7 peers where policy tightening has taken place or is in the works. This should lift yields in the G7 space and widen the yield differentials between JGBs and those of its G7 peers, providing support for the USDJPY.

- Governor Kuroda has been nominated to another five year term in office from Apr by PM Abe. At the same time, Masayoshi Amamiya, currently BOJ executive director in charge of monetary policy planning, close associate of Kuroda and brains behind many of BOJ's innovative policies, and Masazumi Wakatabe, a professor at Waseda University and reflationist, have been nominated to the two deputy governor positions. The nomination of the three suggests that dovish nature of the BOJ will continue and that the current QQE with Yield Curve Control framework will continue until the inflation overshoots the 2% target. This should keep the USDJPY underpinned ahead.

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

- So far in Jan, Japanese investors have not taken to overseas assets as they did last year. Unlike in 2017, Japanese investors have been less attracted by overseas assets. This is unsurprising given that the synchronous growth recovery has kept the domestic economy expanding for the past eight quarters, making Japanese investors less inclined to invest in overseas assets unless valuations are compelling. So far this year, JPY0.25tn and JPY3.72tn in overseas equities and debt have been sold off by Japanese investors. In comparison, Japanese investors have been net sellers of overseas assets in the first two weeks of Feb. They have sold off JPY0.30tn in overseas equities and JPY0.71tn in overseas long- and short-term debt with the funds likely repatriated back into Japanese assets onshore. These inflows back into Japan are likely to keep the JPY supported in the months ahead.

- **Growth and Inflation Outlook:** Preliminary GDP showed the economy expanding for eighth straight quarters in 4Q 2017. In the last quarter of 2017, GDP edged up by just 0.1% q/q (0.5% annualised) after expanding by 0.6% (2.5% annualised) in 3Q. For the full-year, the annual growth rate slipped from 1.9% to 1.5%. Growth in 4Q was supported by consumer spending, which rebounded by 0.5% from the 0.6% dip in 3Q. Also supportive of 4Q growth was the 0.7% q/q rise in capital (i.e. non-residential) investment. These more than offset the slippage in residential investment (-2.7% q/q) and public demand (-0.2% q/q). Looking ahead, economic activity looks likely to slow ahead. Core machine orders, which had accelerated by 4.1% in Nov, declined 5.0% y/y in Dec, while industrial production accelerated by 4.4% y/y in Dec from 3.6% in Nov. External demand remains supportive of the economy underpinned by the global synchronous export recovery with exports rising 12.3% y/y in Jan vs. 9.3% in Dec while imports moderated to 7.9% y/y in Jan from Dec's 14.9%. Though growth should moderate in 2018 it would nevertheless remain relatively healthy given the government's FY2017 supplementary spending package of around JPY2tn as well as preparations for the 2020 Olympics in Tokyo. After likely rising by 1.5% in 2017, the BOJ is projecting the economy to expand by 1.4% and 0.7% for 2018 and 2019 respectively, largely due to base effects in 2018 and an expected slowdown in domestic demand in 2019.

- After rising by 1.1% y/y in Dec, headline inflation accelerated by 1.4% y/y in Jan, beating market estimates for a 1.3% rise. Core inflation (headline CPI less fresh food) climbed 0.9% y/y in Jan at a pace unchanged from the previous two months. Core-core inflation (headline CPI less fresh food, energy) edged up by 0.3% y/y in Jan vs. Dec's 0.3%. The moves in consumer prices so far suggest that inflation is picking up only modestly. It is still nowhere close to the central bank's 2% inflation target. BOJ Governor Kuroda recently commented in Parliament that prices are rising gradually, and the economy is moving out of the deflationary situation. However, he warned that "powerful monetary easing" must continue as the 2% inflation target remains a distant. The BOJ continues to project core inflation at 1.4% for FY2018 before accelerating to 1.8% in FY2019.

- **Monetary Policy Forecast:** The BOJ did not make any changes to its ultra-loose monetary policy at its first policy meeting of 2018 on 23 Jan. The central bank kept its balance (short-term) rate unchanged at -0.1% and its 10Y JGB yield target at around 0%. The pace of asset purchase of JPY80tn annually was also maintained even though this measure is no longer central to its "QQE with Yield Curve Control" policy regime. In his post-meeting press conference, BOJ governor Kuroda dumped cold water on speculation that the BOJ was inching closer to unwinding its monetary stimulus. Since that policy meeting, Kuroda has taken any opportunities to reiterate the continuation of the BOJ's powerful easing bias to achieve its 2% inflation goal. At the same time, these comments so serve to dampen further speculation that the BOJ was preparing to adjust its monetary policy.

- **Latest Fiscal and External Balance Outlook:** The Diet approved the government's supplementary budget for FY2017 (year that ends 21 Mar). This budget includes JPY2.7tn of additional spending to fund programmes to raise corporate productivity, provide assistance in the agricultural sector and also public works eyeing better natural disaster recovery and prevention.

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

- **Key domestic events and issues to watch:** Final GDP print for 4Q17 will be released on 8 Mar ahead of the BOJ meeting on 9 Mar. Also eyed will be BOJ minutes for the policy meeting on 22-23 Jan (14 Mar) and summary of opinions for the 8-9 Mar (19 Mar). BOJ Kataoka will speak on 1 Mar. JGB auctions in Nov: 10-year (1 Mar), 30-year (6 Mar), 5-year (13 Mar), 1-year (16 Mar) and 20-year (15 Mar).

- **Technical Outlook:** USDJPY traded lower for the month of Feb, as cautioned in our last issue of FX Monthly. We highlighted that a death cross was formed and we were biased for downside play towards 106.90. Low traded for the month was 105.55 (16 Feb). Last seen at 107.10 levels. Bearish momentum on weekly chart shows signs of waning while daily momentum is mild bullish. We do not rule out rebound risks ahead towards 107.90 (21 DMA), 108.50. As of writing, 100DMA looks on track to cut 200 DMA to the downside – another bearish signal. We watch price action in coming days for confirmation. Support at 106.50, 105.50

RMB: Expect Pockets of Weakness

Forecast	1Q 2018	2Q 2018	3Q 2018	4Q 2018
USDCNY	6.25 (--)	6.20 (--)	6.20 (--)	6.10 (--)
USDCNH	6.25 (--)	6.20 (--)	6.20 (--)	6.10 (--)

No Change to Forecasts

- **Motivation for the FX View:** Following the big USDAsia plunge in the first week of Jan, USDCNY has been tracking the USDCNH in volatile moves. Much of the USDCNH moves were trapped in the wide range of 6.28-6.35. During this period of USD resurgence, the official CFETS RMB index climbed towards 97 before easing back to 95.80 last Fri (23 Feb). The weakness in the RMB coincides with not just the USD strength but also some announcements of China easing capital curbs. There is clearly some pent-up demand for foreign currencies even though yuan depreciation pressure has largely abated. As such, we expect pockets of RMB weakness this year as China relaxes more capital controls in a return back towards yuan internationalization. Ahead of the "two sessions" that will start on 3rd Mar, China Communist Party proposed to remove the term limits for the president, paving the way for President Xi Jinping to stay beyond 2023 which was supposed to mark the end of his second term. This is an unprecedented move and with more capital controls relaxing and USD to remain on a broad downtrend in an environment of global growth, we may even look towards a fully-convertible RMB by 2020.

- Fundamentally, we are still mildly bullish on the RMB. The yuan is in a much better place than what we saw this time, last year. Capital outflow is much less of a fear given the persistent rise in forex reserves and softening USD. There are fewer speculations on whether China is heading for a hard-landing. With a weak USD in the backdrop, USDCNY is set to head lower towards 6.10 from the current 6.30. That said, we are not exceptionally bullish on growth but rather, the global growth recovery provides China a rather conducive setting to engineer a soft-landing for the economy as the government commits further to its deleveraging agenda. Firmer inflation (owed to better global demand) and deleveraging efforts could naturally give rise to tighter monetary conditions and a naturally stronger CNY vs. the USD and we look for the pair to end the year at 6.10.

  - **The fight against graft and debt** has intensified after President Xi has been conferred the "core" leader. The takeover of Anbang Insurance Group Co Ltd (for one year to 22 Feb 2019) was a show of how the government is determined is to scrutinize financial risks. The takeover was made according to Article 144 of the Insurance Law which states that the commission has the right to take over an insurance company when it faces severe insolvency problems, or damages public goods by breaking laws. CIRC said Anbang had violated insurance regulations that may "severely" impair its ability to pay back debts. A statement by the prosecutors indicated that he was suspected of fraudulent fundraising and "infringement of duties". That said, the government maintains that Anbang will remain a private company. Markets did not react too negatively

- **Impending Trade War?** Separately, China has warned that it could retaliate if the US hurts China's interest. This was a respond to a recommendation by the US Commerce Secretary Wilbur Ross to impose a global tariff of at least 24% on imports of steel and 7.7% on aluminum amid allegations that the import growth of these metals in recent years "threaten to impair our(the US) national security". That has triggered an anti-dumping investigation into US exports of sorghum and possibly into soyabean and corn next. Given the heavy reliance of China on these agriculture products, an implementation of the trade tariff by the US might really spark off a tit-for-tat response for China on these products and translate into price pressure globally. It does not help that Trump is said to be promoting Peter Navarro, a harsh China critic, to the position of Assistant to the President soon. He would be included in more top strategy meetings.

- **Growth and inflation outlook**: At the upcoming NPCC and CPPCC, economic and fiscal targets for the year are normally announced. We recall that the NDRC has stated a target range of 6.5-6.8%, with the upper bound lowered from 7% to 6.8%. NBS highlighted that growth of new sectors have started to gain traction at the release of the growth numbers of 2017 and these include high-value manufacturing and renewable energy sectors such as industrial robots, new-energy vehicles, industrial robots, solar power and integrated circuit. These are the sectors that have outperformed in 2017 according to NBS. With President Xi's elevated position, economic targets may be softened this year or even be removed. The central economic work conference had released a statement stressing on high-quality development as a fundamental requirement for determining the development path, making economic policies and conducting macroeconomic regulation. We would not be surprised if removing economic targets could be a prelude to the Party quietly abandoning the Party's goal of doubling 2010 income. As we have noted last month, the Southern province of Hainan took away GDP and FAI targets for some cities and counties and government assessment would place greater emphasis on environmental protection.

- Focus for the year ahead is still on deleveraging and to underscore their commitment, PBoC has even stated that daily OMO could be utilized to encourage deleveraging. These are signs that China is willing to allow more room for economic slowdown in exchange for more sustainable growth and an abandon of economic targets nationwide could be the ultimate show of commitment to investors.

- According to the last available data, there are signs that the economy is slowing down with SOE profitability falling by 33.8%y/y in Dec while that of private companies lower by 46%, a third consecutive month of decline. In general, the industrial enterprise profits only grew by 4.5%y/y in Dec 2017, a marked slowdown from 30% at the start of the year. This is definitely a sign that growth should lose some momentum from the 6.9% recorded for 2017. PMI-mfg number for Jan came in steady at 51.5 vs. the previous month with Markit reporting strong degree of confidence and respondents generally optimistic of output growth for the year ahead.

- CPI eased to 1.5%y/y in Jan from previous 1.8%. The month saw a greater deceleration in food costs, down -0.5%y/y vs. the previous -0.5%. Residential property prices slowed at 5.8%y/y in 2017 vs 2016's 11.3%. Jan PPI slowed to 4.3%y/y from previous 4.9%. Price 1.8%y/y, albeit firmer than Nov's 1.7%. PPI slowed to 4.9%y/y from the previous 5.8%. The slide in pork prices and stabilizing commodity prices could cap price pressure for now.

- **Monetary Policy Forecast:** PBoC has reiterated repeatedly that monetary policy will be kept "prudent and neutral". The central bank has been injecting a relatively healthy amount of liquidity since onshore returned from the Chinese New Year break. There was a net liquidity injection of CNY150bn today (26 Feb). Liquidity injection has been reducing with each session. Weighted average cost of OMO came off as a result. However, for most of Feb, PBOC seems to have maintained a tight bias in terms of monetary conditions with mostly net withdrawals. We expect PBOC to retain a tightening bias for the rest of the year. This would be in line with their aim to facilitate deleveraging this year.

- PBoC continues to signal that they are willing to accept more volatile two-way moves in the CNY. There could even be an abandonment of the +/-2% trading band as a symbolic commitment to allowing the yuan to become more market-determined. Afterall, the band has not been tested since the 2015 fixing reform and has lost its relevance. In fact, PBoC adviser Fan Gang said that there is no need to smooth FX volatility in 2018. He does not expect yuan to be a one-sided trade this year. In fact, his anticipation for more two-way movements is in line with our expectations for China to ease capital curbs. More two-way volatility could also discourage one-way appreciation bets that tend to culminate into concerns of capital flow.

- **Latest Fiscal and External Balance Outlook:** Ahead of the "two sessions" that will start on the 3rd Mar, China is said to consider reducing its budget deficit target from 3% of GDP to 2.9%. This will be subjected to the National People's Congress (NPC) that starts on 5th Mar. Fiscal revenue in China rose 7.4% y/y to CNY17.3trn for 2017. The Finance Minister had stated last year that the 2017 fiscal deficit is likely less than the target of 3% of GDP. According to the Central Economic Work Conference, there will be fiscal support for "major fields and projects". The Finance Ministry said its focus for 2018 is to prevent and mitigate major risks. The Ministry prioritizes on reining local government debt, banning illegal financing guarantees, banning disguised borrowings in the name of government-invested funds, public-private partnerships or government purchases. Expect little fiscal room for expansionary policies this year.

- FX reserves rose (again) to U$3.161trn from previous U$3.14bn. SAFE Chief has warned that he "expected two-way cross border flows in 2018, and that it is normal for reserves to rise and fall". That is a sign that China is comfortable with yuan to weaken significantly given that yuan depreciation expectation is less likely to snowball in an environment of USD weakness.
- **Key domestic events and issues to watch:** Caixin PMI is due on the 1st; **CPPCC to start on 3rd Mar; NPC to start on 5th Mar;** FX Reserves on the 7th; trade balance, FDI, BOP on the 8th, CPI, PPI on the 9th, Money supply, Aggregate financing on 10-15th; Property on the 19th; **Crude futures start trading in Shanghai on 26th** and NBS PMI on the 31st.
- **Technical Outlook:** We see some upside risks as the stochastics on the monthly chart enter into oversold condition and USDCNH is poised to head higher. We see a bullish divergence between the price action and the MACD on the weekly chart and momentum indicators there seem to be turning higher as well. First resistance is at 6.3510 before the next at 6.4300.

KRW: Driven by US Protectionist Measures & FOMC

Forecast	1Q 2018	2Q 2018	3Q 2018	4Q 2018
USD/KRW	**1080** (1060)	**1050** (1030)	**1040** (1020)	**1060** (1040)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** Our call (in last month's FX Outlook) for USDKRW to rebound towards 1085 – 1095 levels materialized. Pair traded a high of 1098 (6 Feb) before easing lower towards 1070 levels, at time of writing. Our motivations then were and deteriorating development between US and Korea with regards to KORUS FTA (US protectionist measures on washing machine, solar panels) and excessive one way moves in USDKRW that warrant the risk of *leaning against the wind* activities.
- Looking ahead, we still expect the former to be one of the main drivers affecting USDKRW. Following Trump's trade protectionist measures (announced in Jan) on imposing import tariffs on washing machines and solar panels, the US again mentioned imposing tariffs on all steel imports (announced 16 Feb). Though this is not confirmed and a decision is expected sometime in Apr, **intensification in US protectionism measures could impact Korean exports and impede KRW gains**. We revised upwards our USDKRW forecast to reflect this.

– US Department of Commerce indicated a global tariff of at least 24 percent on all steel imports from all countries; a tariff of at least 53 percent on all steel imports from 12 countries (Brazil, China, Costa Rica, Egypt, India, Malaysia, Korea, Russia, South Africa, Thailand, Turkey and Vietnam), with a quota determined product-by-product on steel imports from all other countries equal to 100 percent of their 2017 exports to the U.S.; and, lastly, a quota on all steel products from all countries equal to 63 percent of each country's 2017 exports to the U.S. If implemented, this is expected to impact Korea's steel pipe industry;

- Back in Jan, US imposed import tariffs (above tariff-free quota) on washing machines (to last 3 years starting at 20% on the first year, 18% on second year and 16% on the 3rd year) and solar panels (to last 4 years starting at 30% on first year, 25% on second year, 20% on third year and 15% on 4th year) may affect Korean exports. According to some calculations reported on the media, both washing machines and solar panel exports stand at about US$2bn per year. Korean exports to US could be affected if US consumers switch preferences

- Other risk factors to watch include FoMC meeting (22 Mar), pace of US CPI increases and pace of UST yield increases. Should inflation picks up momentum for US, the Fed may upgrade its growth/inflation assessment, dots plot guidance on rates, and such could see shifts in expectation for Fed rate hike trajectory. As we had seen from the last 2 months, UST yields can rise rapidly to reflect changing expectations and rapid pace of increase could impact risk sentiment. Sell-off in bond market could spill-over to equity markets and could result in capital outflow of Korea. This could put upward pressure on USDKRW around the period leading to FoMC meeting. **We do not rule out temporary up-move towards 1080-1090.**

- We believe the macro-fundamental factors underpinning USDKRW lower remains intact: (1) synchronised global economic recovery and increasing demand for information technology products like semiconductors, OLED continues to bode well for Korean exports, benefitting trade-dependent currencies such as KRW; (2) growth momentum accelerating and signs of pick up in inflationary pressures leading to room for BoK to tighten monetary policy; (3) political risks abating - easing geopolitical tensions in Korean peninsula, signs that China-Korea relations are improving (to bode well for inbound tourism); (4) broad USD decline underpinned by macro trends amplifying gains in KRW.

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

- **Headline CPI slowed more than expected to 1% y/y in Jan** (vs. 1.5% in Dec). The slippage was due to contraction in food & beverage prices. This is also the lowest level in 17 months. Core inflation also slowed to 1.1% y/y in Jan (from 1.5% in Dec). BoK expects inflation at 1.7% this year, compared to previous projection of 1.8%.

- **Monetary Policy Forecast**: We expect BoK to raise policy rate by another 25bps in 2Q-3Q 2018 from 1.5% if demand-induced price pressures picks up pace amid reacceleration in growth momentum. We believe BoK is monitoring if inflationary pressures from the demand side picks up. Minimum wage will increase by 16% this year, its largest magnitude of increase since 2001. Wage pass-through may have positive impact on consumption spending, growth and lead to inflationary pressures. There is no policy meeting in Mar; next policy meeting is scheduled on 12 Apr and we expect no change to current policy rate of 1.5%. New BoK governor should be appointed by President Moon before Governor Lee's term ends on 31 Mar.

- On BoK accompanying statement (27 Feb), CPI is expected to be in the low to mid-1% range for now and will approach target of 2% from 2H 2018. Growth is in line with Jan projection. BoK will maintain accommodative policy stance as inflationary pressure on the demand side will not be high for the time being. BoK cited US protectionist trade policies, accelerated monetary policy normalisation in major countries as risks to the economy.

- **Latest Fiscal and External Balance Outlook:** Current account surplus narrowed to $4.09bn in Dec, down from a surplus of $6.96bn. This is due to a sharp rise in the deficit in the service account (rise in overseas trips and foreign business services). Nonetheless this marked the 70th consecutive month of current account surplus which started in Mar-2012.

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

- **Key domestic events and issues to watch:** S. Korea releases Feb trade data (1 Mar); Jan IP, Feb PMI Mfg (2 Mar); Feb CPI (6 Mar); Feb import, export price index (14 Mar); Mar consumer confidence (27 Mar); 4Q final GDP (28 Mar); Business survey for Mfg and Non-Mfg (29 Mar).

- **Technical Outlook:** Our caution for rebound risks towards 1080 – 1095 in the last FX Monthly materialized. Pair was last seen at 1083 levels. Weekly momentum shows signs of bullish bias. Break above 1092 could signal further upside towards 1100 – 1105 levels. Support at 1060 – 1070 levels.

SGD: Tailwinds Remain Supportive

Forecast	1Q 2018	2Q 2018	3Q 2018	4Q 2018
USDSGD	1.2800 (--)	1.2700 (--)	1.2500 (--)	1.2400 (--)

No Change from Previous Forecast

- **Motivation for the FX View:** SGD failed to sustain gains from Jan but instead saw those gains pared in Feb amid a rebound in UST yields and USD. Slippages in the SGD to a low of 1.3340 for Feb proved to be temporary with the SGD climbing to a Feb high of 1.3058. Since then, the SGD has been hovering within the Feb high and low as it awaits directional cues. Even the recent climb in UST yields towards the 3.0% levels has failed to weigh on the SGD significantly. So far in Feb, the SGD has fallen by 1.0% against the USD vs the 1.8% gains for the whole of Jan.

- We reiterate our view that the resiliency of the SGD will continue in 2018, as the currency should continue to benefit from the synchronous global growth recovery that has lifted the trade-dependent economy. As final estimates for 4Q 2017 GDP showed, the economy expanded by a faster 3.6% y/y vs. preliminary estimates of 3.1%, bringing full-year growth to 3.6% in 2017 (vs. 3.5% in the preliminary estimates and 2016's 2.0%). We expect gains in the SGD to continue with the cyclical export recovery serving as a catalyst for a private investment recovery in the economy (as firms expand capacity to meet rising domestic and global demand). This should keep economic growth supported at 2.8% in 2018, close to the upper band of the government's 1.5-3.5% forecast range.

- Seasonality factors continue to point to SGD strength ahead. The feel good factor from Chinese New Year and from the budget announcement in Feb could extend into Mar. Positive sentiments from "goodies" in this year's budget, including the SGD300 one-off "hongbao" and the postponement of any GST increase to 4-7 years down the road should help to keep the SGD supported in the near term.

- More importantly, the SGD should get its lift from MAS' move to normalise policy after maintaining the current zero appreciation stance since Apr 2016. We continue to expect the MAS to shift to a slight appreciation stance at its Apr meeting. With growth now back towards potential and core inflation on the uptick, we believe that the zero appreciation path of the MAS policy has outlived its usefulness. Our estimates for the SGD NEER using the Taylor Rule show that the SGD NEER is expected to strengthen ahead. Thus, normalising policy by shifting to a 'slight appreciation bias' would be more appropriate.

- This policy normalisation is expected to provide the SGD with another leg up in 2Q 2018 and this should weigh on the USDSGD. Currently, the

SGD NEER is hovering close to the mid-point of its policy band, market could be under-pricing a MAS normalisation move in Apr. A re-pricing of a MAS tightening stance could see the SGD edge higher in 2Q. We target the pair to hit the 1.26 levels by end-2Q 2018.

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

- The ongoing synchronized global recovery and the historically low volatility environment as reflected in the muted equity and FX volatility indices have encouraged greater flows into emerging market assets, including those in Singapore. Since hitting a high not seen since 2017 at 3,609 on 24 Jan, the STI index been lost some of its luster. As we had cautioned in last month's FX Monthly, global risk aversion on concerns of more aggressive Fed rate hikes have triggered global risk-off, spurring a sell-off in regional equity assets, including Singapore, and weigh on the SGD. Still, once markets stabilize, we expect flows to return and this should be supportive of the SGD.

- We remain positive on the SGD underpinned by synchronous global recovery and MAS move to normalise policy at its Apr meeting. Still, we cannot rule out possible further bouts of weakness that could lift the USDSGD higher. For now, we maintain our full-year USDSGD forecast.

- **Growth and Inflation Outlook:** Final print for 4Q17 GDP showed the economy expanding by 3.6% y/y, coming in better than the advanced estimates of 3.1%. On q/q seasonally-adjusted (sa) annualised basis, GDP advanced at an even softer 2.1% compared to 2.8% in the advanced estimates. Growth remained supported by manufacturing, rising 4.8% y/y, though this was a moderation from 3Q's 19.2%. Services growth came in stronger in the final print at 3.5% y/y vs. advanced estimates of 3.0% and faster pace than 3Q's 3.2% underpinned by information & communications, accommodation & food services, and other services. Construction remained a drag on growth, contracting by 5.0% y/y in 4Q (3Q: -9.3%), the sixth consecutive quarter of contraction.

- For the full-year, GDP rose by 3.6% in 2017 – the fastest pace of growth since 2014. Manufacturing and services accelerated in 2017 by 10.1% and 2.8% respectively (vs. 2016: 2.4% and 1.4%), while construction contracted by 8.4% - the first decline since 2004. Going forward, our economic team expects the GDP growth momentum to cool off in 201 on expectations that manufacturing will continue to support growth albeit at a more moderate pace as base effects sets in. Growth though is expected to be supported by firming domestically-oriented services. Consequently, our team expects GDP growth to come in at 2.8% in 2018 and then to 2.5% in 2019. MTI projects growth to come in at 1.5-3.5% in 2018 but expects growth will "come in slightly above the middle of the forecast range".

- Inflation was mixed in Jan with headline inflation coming in flat, while core inflation was slightly up by 1.4% y/y. Headline inflation moderated in Jan due to the sharp decline in accommodation cost (Jan: -5.3% y/y vs. Dec: -3.8%) as services & conservancy charges (S&CC) rebates were disbursed in Jan (but not in Jan 2017). Dragging headline inflation lower as well was lower private transport cost, which rose by 1.6% y/y in Jan compared to 2.6% in Dec on the back of lower car prices and COE premiums. Core inflation (headline inflation less accommodation and private transport costs) was supported by rising retail inflation that offset slower food inflation.

- Our economic team has revised its headline inflation forecast for 2018 lower to 0.9% from 1.2% previously to take into account that Budget 2018 continues to provide rebates for S&CC (to be disbursed in Apr/Jul/Oct 2018 and Jan 2019) and did not include a GST hike or e-commerce tax on goods & services for FY2018. Its core inflation forecast though was maintained at 1.7% respectively in 2018 as services inflation continues to pick-up on higher wages and the growth recovery. MAS continues to expect headline and core inflation to come in at 0-1% and 1-2% in 2018.

- **Monetary Policy Forecast:** MAS has left its policy unchanged since it shifted to a zero appreciation path of the SGD NEER in Apr 2016. Aside from the slope, there were also no changes to the width and center of the policy band. In the last policy meeting in Oct 2017, the MAS failed to deliver a policy shift as there was absence of (1) any sharp domestic growth momentum (MAS expects the economy "to expand at a steady, but slightly slower, pace in 2018 compared to 2017") and (2) inflationary pressures (where "core inflation is expected to trend towards but average slightly below 2%" in the medium term). In 2018 though, healthy economic growth and rising inflationary pressures should anchor the MAS shift to "a slight appreciation bias". Instead, our Taylor Rule estimates for the SGD NEER continues to suggest such a policy move to be appropriate. Our estimates showed that the SGD NEER is expected to strengthen ahead with the SGD NEER expected to end 2018 around 128.43. We expect the shift to a "slight appreciation bias" to come at the MAS' Apr 2018 meeting.

- In Feb so far, the USDSGD has been on bounce higher amid rising UST yields and USD strength. So far in the month, the USDSGD has been oscillating within its high and low for the month at 1.3340 and 1.3058 respectively. Pair is currently hovering within this band at around 1.3252. The rise in UST higher to touch a 2018 and near two-year high of 1.33% on 28 Feb. Meanwhile, 3-month SIBOR has been on the grind higher and was last seen around 1.37%, though this is still off its near 10-year high of 1.51% recorded on 3 Jan. The climb in domestic rates can be attributed to the jump in UST yields recently as markets re-price to the possibility that the Fed could hike its fund rate four times instead of the three expected currently. This though has yet to translate into steep increases in mortgage rates, which continues to remain on the slow grind higher. At the same time, deposit rates (for 12-month fixed) have also not risen since end-Jan 2017 and has remained at 0.33% despite the spike in 3-month SIBOR. This continues to suggest that risks related to interest rate increases affecting financial and economic stability, particularly in interest rate- and property-related sectors, remains limited for now, though the risk is rising.

- US rates remains pressured higher with the US 3MLIBOR climbing to a new 2018 high not seen since 2008 at 2.00625% on 27 Feb. Ample liquidity has so far kept domestic rates from tracking the US 3MLIBOR higher though, allowing domestic rates to continue with its rather slow grind higher. Still, recent moves in UST yields have led domestic rates to climb higher at a faster pace. We continue to expect the 3MSIBOR and 3MSOR to edge higher to 1.54% and 1.32% respectively by end 1Q 2018. For end-2018, we expect the rates to accelerate to 1.87% and 1.65% respectively.

- **Latest Fiscal and External Balance Outlook:** The government budget plans for FY2018 revealed a budget surplus of SGD9.6bn (2.1% of GDP) in FY2017. This not only far exceeded the projected surplus of SGD1.9bn but also the highest budget surplus as a % of GDP since FY2007 where growth was strong. For FY2018, the government is conservatively projecting a negligible budget deficit of 0.1% of GDP for FY2018. Other key highlights of the budget include a one-off "hongbao' of up to SGD300 to each adult Singaporean (costing SGD700mn) will be distributed even though this is not an election year. The much talked-about GST hike did not come to fruition. Instead, the government deferred any GST hike until 2021-25, though it likely to take place "earlier rather than later". The GST hike will be implemented progressively, with offsets from a permanent GST voucher and offset package to cushion the impact on lower and middle-income households. A 2%-point hike is expected to generate revenue of nearly 0.7% of GDP per year to fund healthcare and infrastructure spending. Another highlight was a hike in the top marginal stamp duty to 4% (from 3%) for residential property valued in excess of SGD1mn effective 20 Feb. This also applies to en bloc property deals. The government also intends to implement an imported services tax in 2020 and a carbon tax in 2019. Imported services affected included apps, software, online subscription fees, marketing, IT and management services. The carbon tax of SGD5/tonne of greenhouse gas emission will be implemented in 2019 - 23 to cut carbon footprint. Petrol, diesel & compressed natural gas are exempted as they already incur excise tax duties.

- The current account (CA) surplus narrowed to SGD17.8bn in 4Q 2017 (15.1% of GDP) from SGD21.7bn in 3Q 2017 (22.5% of GDP). The smaller CA surplus was due to smaller surplus in the goods and services account (4Q: SGD25.2bn vs. 3Q: SGD27.6bn) as well as larger outflows from the primary income account of SGD5.4bn vs. 3Q's SGD2.5bn outflow. The financial and capital deficit moderated again to SGD10.8bn in 4Q from SGD13.4bn in 3Q, underpinned by larger outflows from the portfolio investment, financial derivatives and others segments of SGD23.7bn that was offset partially by the larger direct investment inflows of SGD12.9bn (vs. 3Q: SGD9.5bn). Consequently, the overall balance of payments (BoP) surplus narrowed to SGD5.9bn in 4Q from SGD11.2bn in 3Q. For 2017, the current account surplus widened to SGD84.2bn (18.8% of GDP) vs. SGD81.3bn in 2016 (19% of GDP), while the overall BoP saw a record surplus of SGD37.8bn vs. a deficit of SGD2.5bn in 2016.

- **Key domestic events and issues to watch:** In the run-up to MAS' Apr meeting, CPI print on 23 Mar will be closely eyed for clues. Similarly, NODX (16 Mar) and industrial production (26 Mar) will be watched for the health of external demand and the manufacturing sector.

- **Technical Outlook:** USDSGD rebounded, in line with our call for rebound risks towards 1.32, 1.3270 levels. Pair was last seen at 1.3250. Bullish momentum on daily chart remains intact. Sustained close above 1.3275 (50% fibo) could see further upside towards 1.3340 (61.8% fibo retracement of Dec high to Jan low). Support at 1.3210 (38.2% fibo), 1.3130 (23.6% fibo).

MYR: Stars Aligned Ahead of the Next Elections

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

Previous Forecasts in Parenthesis

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

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

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

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

- External reserves rose by USD0.6b to USD103.0b at mid-Jan 2018 (end-Dec 2017: USD102.4b), supported by positive portfolio capital and trade flows. The external reserves' retained import cover remains at just over 7 months (mid-Jan 2018: 7.1 months; end-Dec 2017: 7.2 months) while its ratio to short-term external debt is stable at 1.1x. Supported by positive portfolio capital flows. Foreigners remained net buyers of Malaysian equities in the first three weeks of Jan 2018 (1-19 Jan 2018) at +MYR2.4b (Dec 2017: +MYR0.9b). Meanwhile foreigners were net buyers of Malaysian bonds with +MYR2.7b net inflows in Dec 2017 (Nov 2017: +MYR6.7b) riding on the momentum of Ringgit strength and amid expectations of BNM rate hike this year. There is also the maturity of MYR24.9b worth of Government bonds in 1Q 2018 i.e. MYR2b worth MGS in Jan 2018, MYR14.1b worth MGS in Feb 2018 and MYR8.8b worth MGS in Mar 2018. However we believe the risk of maturity driven foreign selling in the domestic bond market has reduced as exemplified by the net foreign buying of +MYR6.6b between Sep-Oct 2017 despite the maturity of MYR24.8b MGS during the same period. Our Fixed Income Research team expects foreign flows to remain positive in the Malaysian bond market in Jan 2018, riding on the positive outlook for Ringgit. Firmer external trade growth is supportive too. External reserves are well supported by trade flows so far via the repatriation of export earnings, (Jan-Nov 2017: +20.4%; Jan-Nov 2016: +0.3% YoY) and larger trade surplus (Jan-Nov 2017: +13.6% YoY to +MYR90.0b; Jan-Nov 2016: -4.9% YoY to +MYR79.2b). Latest available data showed USD8.8b export earnings repatriation between Dec 2016 and Nov 2017 (Jan-Nov 2016: -USD0.5b), equivalent to 38% of trade surplus during the period (Fig 8-9).

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

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

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

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

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

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

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

- While the tone of the latest MPS implied the monetary policy is generally on "tightening" bias after the -25bps OPR cut in 2016 and the "neutral" stance in 2017, we continue to hold the view that this

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

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

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

- **Key domestic events and issues to watch:** BNM policy decision (7 Mar); Trade data (7 Feb); FX reserves (22 Feb); Industrial Production (9 Feb); CPI (21 Feb); Nikkei Malaysia PMI (2 Feb); GDP 4Q (14 Feb).

- **Technical Outlook:** USDMYR was last seen at 3.9250. Mild bullish momentum on daily chart remains intact. Rebound risks on the horizon. Resistance at 3.9510 levels (38.2% fibo retracement of Jan high to low). Bias to sell on rallies. Support at 3.90, 3.88, 3.8660 (previous low).

IDR: Near Term Pain May Not Last

Forecast	1Q 2018	2Q 2018	3Q 2018	4Q 2018
USDIDR	13200 (--)	13000 (--)	12900 (--)	12800 (--)

No Change from Previous Forecast

- **Motivation for the FX View:** The IDR's uptrend in Jan came to a halt in Feb as it did for the AXJs. The IDR has gone from gains of 1.3% against the USD in Jan to being the worst performing currency among the Asian currencies we track in Feb so far. The IDR has weakened by nearly 2.0% against the USD in Feb month-to-date. When compared to its regional peers in ASEAN, the IDR has been weakening against its ASEAN peers since end-2016 except for the PHP. The IDR have been making new lows in Feb, briefly touching a new 2018 low not seen since Nov 2016 at 13700 on 22 Feb. Price action has eased off from that high but a re-test of that level cannot be ruled out in the near term.

- IDR strength in Jan had been due to the purchase of Indonesian assets by foreign investors due to carry trade plays. The purchase of Indonesia assets extended into Jan with foreign investors purchasing USD132.4mn and USD2.44bn in equities and debt. This led to an increased in short USD positions against the IDR, lifting the IDR higher and allowing the IDR to climb to a five-month high of 13263 on 25 Jan 2018. Since then, there has been a reversal in portfolio flows. The spike in volatility on expectations of higher global interest rates amid rising inflation pressures, particularly in the US, has made IDR carry trades play less attractive and assets of more advanced economies more attractive. This has led to a sell-off of USD0.73bn and USD0.93bn in equities and debt month-to-date in Feb. Not surprisingly, the net sell-off in Indonesian assets in Feb so far has weighed on the IDR.

- The waning attractiveness of Indonesian debt is clearly illustrated in the narrowing yield differentials between 10Y UST yields and the corresponding 10Y Indonesian government bond. Yield differentials have been narrowing since Dec 2017 but the sell-off was delayed as volatility remained low and there were no signs of inflation, especially in the US, hence, expectations of monetary policy withdrawal. But with expectations of inflation resurfacing in the US, and market is re-pricing rate hike expectations, steepening the UST yield curve. In Indonesia, the sovereign credit rating upgrade means that the government does not need to pay a premium to get international investors to buy its bonds, allowing yields of Indonesian sovereign debt to move lower. This has then resulted in a narrowing of the spread between 10Y UST and Indonesian government debt yields, making IDR carry trade plays less attractive and in turn, lead to a reduction in short USD positions against the IDR.

- We could thus see the IDR move further lower ahead though the length of this downmove remains up in the air. This will depend on whether global inflationary pressures, particularly the US, are sustained. Upside inflation surprises will see more aggressive global rate hike expectations and this could further dampen IDR carry trade plays and potentially spillover into a further sell-off in Indonesian equities. The converse though could see an unwinding of short USD positions against the IDR and push the IDR higher from current levels.

- Despite the weakness in the IDR so far in Feb, there are still several key factors going in its favour. Key among them is Indonesia's strong economic fundamentals. The economy continues to find strength from the cyclical global recovery that has lifted demand for commodities such as oil, CPO and coal, though this is likely to continue at a more gradual pace ahead. The improvement in the terms of trade should lift exports, mitigating any drag from domestic consumption. This in turn should benefit the IDR.

- Also supportive is the government's USD400bn infrastructure programme that should not only bolster near term growth but potential growth as well. The push to accelerate infrastructure spending ahead of legislative and Presidential elections in Apr 2019 should keep the growth momentum going. Spending in preparation for the Asian games slated to take place 18 Aug-2 Sep should also be supportive of growth ahead. In addition, the 15 reform/stimulus packages introduced so far that should help to cut red tape and liberalize rules that have been a drag on the economy.

- At the same time, support for the IDR should also come from a tightening of monetary policy. We continue to look for BI to normalise policy and raise rate sometime in 2Q 2018. This is due to our expectations of a build-up in inflationary pressures as a result of improvement in economic growth. In the near term though, the central bank should keep its benchmark policy rate on hold to allow growth to gain further traction.

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

- Thus, though some weakness in the IDR is likely in the near term due to unwinding of carry trade plays, we remain positive on the IDR in 2H 2018 on the back of its strong economic fundamentals and the possibility that IDR carry trade could return to favour as volatility stabilizes and the economy continues to outperform the rest of the world. We maintain our USDIDR forecast for now.

- **Growth and Inflation Outlook:** After five quarters of growth hovering around the 5% levels, the economy accelerated in 4Q17 on a year-on-year basis, helped by a low base of comparison. 4Q17 GDP rose by 5.19% y/y, supported by domestic demand. Private consumption rose 4.97% y/y (3Q: 4.93%), while investment gained 7.27% (3Q: 7.08%) and government spending by 3.81% (3Q: 3.48%). The external economy was a drag on growth with imports rising at a faster pace than exports (11.8% vs. 8.5%).

- Looking ahead, our economic team expects the growth momentum to be sustained, driven by the ongoing cyclical export recovery and the President's USD400bn infrastructure programme. The push to accelerate infrastructure spending ahead of legislative and Presidential elections in Apr 2019 should keep the growth momentum going. Spending in preparation for the Asian games slated to take place 18 Aug-2 Sep should also be supportive of growth ahead.

- Given the economic improvement will be sustained into 2018, the BI is projecting growth to still come in at 5.1-5.5% in 2018 after GDP rose by 5.07 in 2017 – its best performance in four years. Our economic shares the BI's optimism for growth prospects in 2018, penciling in GDP growth at 5.30% for 2018.

- Headline inflation decelerated in Feb, coming in at 3.25% y/y in Feb from Jan's 3.61%. Higher food prices (up 2.95% y/y from Jan's 1.26%) was mitigated by the moderation in housing and transport cost, which rose by 4.24% and 1.55% vs. Jan's 5.14% and 4.23% respectively. Core inflation moderated for the third consecutive month to 2.69% y/y in Jan from 2.95% in Dec. Going forward, we believe that the government's efforts to improve food supply and control prices of key commodities via stricter monitoring could go some ways to keep food inflation down. Political considerations aside (given presidential and legislative elections in Apr 2019), we doubt that these will be sufficient to hold down food prices, which should keep consumer prices under upside pressure. Consequently, our economic team expects headline and core inflation to average 3.52% and 2.82% in 2018 respectively. BI's inflation target range is 2.5-4.5% for 2018, lower than 2017's 3.0-5.0% target range.

- **Monetary Policy Forecast:** The BI has so far left the benchmark 7-day reverse repo rate unchanged at its two policy meetings so far this year. The benchmark policy rate is currently at 4.25% with the deposit and lending facility rates at 3.50% and 5.00% respectively. The interest rate corridor was maintained at 75bp on either side of the policy rate. According to BI governor Agus Martowardojo, the policy rate at 4.25% was in line with efforts to ensure economic stability. Nevertheless, our house view remains for the BI to embark on a 25bp rate hike sometime in 2Q 2018 to normalise rate and to stem inflationary pressures and to maintain macroeconomic and IDR stability.

- In the meantime, with the window for further rate cuts has largely dissipated given the moves by the G7 to tighten or preparing to tighten monetary policy. Instead, the focus will instead be to use macro-prudential measures to tackle issues like inflation and credit slowdown instead in the meantime. A recent measure rolled out by BI was lowering the daily minimum primary reserve requirement ratio (RRR) to 4.5% from 5.0% as long as the average for the two-week period is at least 6.5% (starting 16 Jul). Other macro-prudential measures could be rolled out by the central bank “soon”.

- **Latest Fiscal and External Balance Outlook:** Latest Ministry of Finance data showed that the budget deficit narrowed in Jan, helped by the rise in oil prices. The budget deficit came in at IDR37.1tn (0.25% of GPD) in Jan 2018 compared to the deficit of IDDR44.9tn (0.33% of GDP) in Jan 2017. Rising oil prices helped bolster non-tax revenue by 33% to IDR18.89tn, while tax revenue collected was at IDR79.94tn. Spending stood at IDR138.4tn. The government’s goal is to keep the state budget deficit at IDR325.9tn or 2.19% of GDP in 2018 compared to 2017’s deficit of IDR336.4tn (or 2.48% of GDP).

- The current account recorded a deficit of USD5.8bn in 4Q 2017 or 2.23% of GDP vs. 3Q’s deficit of USD4.56bn (1.73% of GDP) due to higher deficit in the services account and also a moderation in the surplus in the goods account. The overall balance of payments narrowed to USD0.97bn in 4Q vs. 3Q’s USD5.56bn, weighed by the smaller surplus in the financial account. For the whole of 2017, the current account deficit widened to USD17.29bn from 2016’s - USD16.95bn. Consequently, the surplus in the overall balance of payments moderated slightly to USD11.59bn in 2017 compared to the surplus of USD12.09bn in 2016. For 2018, the BI expects the current account deficit to widen to 2.0-2.5% of GDP. Our economic team expects the current account deficit to widen to about 2.2% of GDP in 2018.

- **Key domestic events and issues to watch**: Closely eyed will be BI’s policy meeting on 22 Mar. But before that CPI print will be watched for inflationary pressures.

PHP: Down But Not Out

Forecast	1Q 2018	2Q 2018	3Q 2018	4Q 2018
USDPHP	51.00 (--)	50.50 (--)	50.50 (--)	50.00 (--)

No Change from Previous Forecast

- **Motivation for the FX View:** The PHP is a laggard among its Asian peers, having been on the broad downtrend since the beginning of 2018. This move saw the PHP touch a new 2018 low against the USD not seen since Jul 2006 at 52.490 on 19 Feb. This comes after the PHP had climbed higher against the USD from the last quarter of 2017 to touch a new 2018 high of 49.705 on 5 Jan amid USD weakness. This makes the PHP the worst performing Asian currency so far this year with the currency declining by 3.0% against the USD, extending and accelerating from the 0.4% drop seen for the whole of 2017.

- The weakness in the PHP so far in 2018 was triggered by concerns over the deteriorating current account deficit given that the USDPHP tend to track the current account positions. These concerns intensified with the record trade deficit of USD4.0bn in Dec, extending the Nov deficit of USD3.8bn. This was the result of imports rising at a faster pace of 18.5% compared to the slippage rise in exports (by 4.9%). In addition, overseas remittances for the whole of 2017 grew more moderately by 4.3% vs. 5.0% in 2016. With risks to the downside to overseas remittances growth due to the repatriation of Filipino workers from Kuwait and government policy on immigration and foreign workers, there are increased expectations that remittances are unlikely to improve the current account deficit.

- More importantly, the positive effects from remittances should fade in 1Q 2018 as seasonality factors appear to weigh on remittances in the first quarter. The current account deficit is likely to deteriorate further on rising oil prices (in value terms) given that Philippines is an oil-importing economy. The deficit in the current account is unlikely to narrow anytime soon on account of the increased public spending and investments by the government in its pursuit of higher growth. These concerns weigh on the PHP and should keep the USDPHP elevated above the 50-levels in 2018.

- There are also market concerns that the BSP is behind-the-curve in curbing inflationary pressures. Market anxiety for central bank action was reinforced by the spike inflation to 4.0% - at the upper bound of the BSP's inflation comfort zone of 2-4% - for Jan. Early comments by central bank officials were not supportive of a BSP rate adjustment and this contributed to the weakness in the PHP. The PHP was sold-off, sending the USDPHP higher above the 51-levels where it has remained since.

- Since mid-Jan 2018 though, PHP volatility (as reflected in 1-month at-the-money implied volatility) has been on the rise on expectations that inflation, not only in the Philippines but in the advanced economies, particularly in the US, could be making a comeback. This has fueled risks of rising interest rates which in turn makes Philippine assets less attractive and those of the advanced economies more attractive. This has eventually led to a sell-off of USD0.22bn in equities month-to-date in Feb. Expectations of further risk aversion and sell-off in Philippines is likely to weigh on the PHP in the nearer term. Consequently, this has kept the USDPHP elevated above the 51-levels.

- Nevertheless, these weaknesses weighing on the PHP to-date could prove to be temporary. There are several factors that could be positive for the PHP this year, including tax reforms. The tax reforms, effective 1 Jan 2018, could be the catalyst that kicks off the next phase of investment-led growth. With partial funding secured and the commitment of the government to infrastructure building intact, this should inspire investor confidence and spur both portfolio and FDI inflows that should be supportive of the PHP.

- Positive surprises could also come from inflows into the stock market in 2018 based on our analysis using the Cyclical Adjusted P/E (CAPE) ratio model. Our estimates suggest that domestic equities are relatively cheap (as reflected by the estimated P/E ratios minus their 10-year average P/E ratios) compared to its regional peers. Greater inflows should lift the PHP higher. So far, risks aversion and rising UST yields have made Philippines assets less attractive with foreign investors selling USD197.6mn in equities so far in 2018.

- Since initial concerns of BSP inaction on the inflation front, the BSP has taken steps to reassure the market. The pledge by BSP governor Espenilla that the central bank will take timely action to anchor inflationary expectations after headline inflation rose at the fastest pace in more than three years in Jan appears to be a step in that direction. He did add the caveat that he does not believe any action is required at the moment as the central bank believed the surge in prices is temporary. Nevertheless, market appears confident that the central bank is unlikely to want to disappoint which could put further downside pressure on the PHP.

- Still, should the BSP disappoint market expectations at its 22 Mar policy meeting, PHP bears are likely to reassert and reinitiate short-PHP positions against the USD, putting downside pressure on the PHP. We could see renewed sell-off in Philippine assets and weakness in the PHP that could last until the BSP signals a more hawkish stance. We are seeing the PHP take a beating following comments by Deputy Governor Diwa Guinigundo that “there’s very little point in trying to adjust monetary policy at this point”.

- We continue to expect the BSP to hike rates twice by 25bp each in 2018 as rising inflation could prove unpalatable. Rate hikes could thus be in the works and the recent cut in the required reserve ratio by 1% to 19% could be a prelude to a rate adjustment. The first move by the

BSP to hike rates could come as early as at its 22 Mar meeting, and should be positive for the PHP.

- We are thus positive on the PHP in the next three-to-nine months, and maintain our 2018 USDPHP forecast for now. That said, bouts of weakness in the PHP in the interim cannot be ruled out. Though current price action points to some weakness in the PHP, the recent moves in the forward appear to be falling. This suggests downside pressure on the USDPHP ahead.

- **Growth and Inflation Outlook:** The Philippine economy is not expected to accelerate significantly in 2018. As 4Q17 GDP print showed, growth should slow in 2018 as the synchronised export recovery moderates. Already export growth has slowed with Dec print declining by 4.9% y/y after moderating to 2.7% in Nov from 7.1% in Oct. With exports likely to slow ahead, the government's growth target of 7-8% looks unlikely to be met in 2018. The next leg up for the economy should come from investment spending, particularly from the government's planned PHP8tn infrastructure building programme that should mitigate the slowdown in contribution from exports. As we have previously written, favorable demographics and job market conditions, sustained by overseas remittances should provide the impetus to growth in 2018. This continuing remittances from overseas workers should bolster consumption spending. More likely than not, growth is likely to come in around last year's levels. In fact, our economic team is penciling in growth of 6.5% for 2018.

- Headline inflation has spiked at the start of the year, rising concerns that the economy could be overheating. After hovering around the 3.4% on average in Sep-Dec 2017, headline inflation jumped to 4.0% in Jan. This climb in headline inflation was attributable to higher food prices (Jan: 4.5% y/y vs. Dec: 3.5%) as well as alcohol beverages and tobacco (Jan: 12.3% y/y vs. Dec: 6.4%) affected by the tax reforms. BSP governor expects the effects from the tax reform to be temporary but would continue to monitor and take appropriate action when necessary. Our economic team sees upside risk from rising commodity prices, namely crude oil and further inflationary pressures to come from the tax measures that became effective at the beginning of the year. Some of the tax measures introduced were tax increases on fuels and excise tax on sugar-sweetened beverages. Taking into consideration these measures and the BSP likely responses to anchor inflationary expectations, our economic team expects inflation to average 3.4% in 2018 and 3.2% in 2019. This forecast remains well-within the official inflation target rate of 2-4% for the period 2018-2020.

- **Monetary Policy Forecast:** At its last meeting on 8 Feb, the BSP had left its policy rates unchanged at 3.0%. The interest rate corridor was left intact with the overnight lending rate and overnight deposit rate holding steady at 3.5% and 2.5% respectively. This leaves the interest rate corridor symmetrical on either side of the policy rate by 50bp.

- Since that meeting, the BSP has acted to cut the reserve requirement ratio (RRR) by 1%-point to 19% effective 2 Mar. According to the BSP, aim of the cut is to help financial deepening by lowering intermediation cost. This cut is expect to support loan growth and help the government's infrastructure building programme along. All-in-all, the RRR cut is expected to release PHP90bn into the economy. More importantly, this move reflects BSP's goal of reducing the reliance of the RRR as a monetary policy tool and increase the usage of market-based monetary policy instrument.

- Pressure though is building on the BSP to take action to curb inflationary pressures after headline inflation rose to 4.0% in Jan. Our economic team believes that the recent cut in the RRR could be a prelude to a 25bp hike its benchmark policy rate at its 22 Mar meeting. In contrast, Deputy Governor Diwa Guinigundo does not appear to share this need to do so as he feels that "there's very little point in trying to adjust monetary policy at his point". The BSP Governor himself seems to favor the use of market-based measures to adjust it policy stance such as the term deposit facility (i.e. by allowing it to rise or fall by altering auction volumes).

- **Latest Fiscal and External Balance Outlook:** The most recent data showed the government enjoying a smaller budget deficit in Nov of PHP8.6bn than the PHP21.8bn in Oct. This was after revenue rose by 18.7% m/m to PHP243.5bn in Nov compared to the 11.0% m/m rise in expenditure. Though Dec print is not yet available, the government expects the budget deficit for the whole of 2017 to be narrower than its target of 3% of GDP on the back of strong revenue collection. Beyond 2017, the government looks to cap the deficit at 3% of GDP until 2022.

- Complete current account data for 2017 remains unavailable. Latest data up to Sep showed the current account in a small cumulative surplus of USD28.5mn. Still, the BSP expects the current account to have worsened since Sep to record a deficit of USD100mn for the whole of 2017. This is likely due to the largest trade deficit record of USD29.79bn for 2017 amid the government's infrastructure building programme. As for the overall BoP balance, it recorded a deficit of USD531mn in Jan 2018 after a surplus of USD917mn in Dec. ended 2017 with a surplus of USD917mn in Dec, the first surplus in three months and the largest on record since Feb 2015. According to the BSP, this deficit was due to the BSP's foreign exchange operations and government's payment of maturing obligations. For 2018, the BSP expects the BoP deficit to hit USD1bn (due to the expected reversal in the financial account to a small deficit), while the current account is projected to widen to USD700mn (due to faster goods import growth compared to exports) from the expected deficit of USD100mn in 2017.

- **Key domestic events and issues to watch:** BSP will meet on 22 Mar to decide on monetary policy. Given the BSP's dependence on data especially inflation to decide policy, CPI data print on 6 Mar and overseas remittances on 15 Mar will be closely watched.

THB: Strong Fundamentals Continues To Underpin

Forecast	1Q 2018	2Q 2018	3Q 2018	4Q 2018
USDTHB	31.00 (--)	31.00 (--)	31.50 (--)	32.00 (--)

No Change from Previous Forecast

- **Motivation for the FX View:** Even though the THB slipped about 0.5% against the USD in Feb, it remained the best performing currency in ASEAN in the month. Re-pricing of Fed rate hike expectations amid concerns about rising inflationary pressures sent UST yields higher and supported the USD, putting downside pressure on the THB. Even then, the THB was less impacted than its regional peers likely because of investor optimism over its strong economic fundamentals as well as the synchronous global and regional recovery. Key is its healthy fundamentals, particularly its persistent current account surpluses that should continue to support the THB. Thailand is one of only two ASEAN economies (the other being Singapore) with a persistent and double-digit surplus in its current account (10.9% as of Sep 2017). This makes its assets more attractive to foreign investors, encouraging greater portfolio inflows and provides support to the THB against possible headwinds.

- The synchronous global cyclical recovery continues to be supportive of exports and economic growth. This in turn should keep the THB supported. More importantly, there is a high correlation between private investment and trade for Thailand, and this current economic cycle should provide the economy and hence the THB with another leg up. More importantly, the government's resolve to push forward with its infrastructure projects, especially the USD47bn Eastern Economic Corridor project, could deliver upside surprises to domestic demand and growth. This investment-led recovery should be a boon for the THB.

- Expectations of accelerating economic growth in 2018 and persistent current account surpluses should spur further foreign portfolio inflows into Thai assets. The current market dislocation though has seen some sell-off in Thai assets. In Feb so have purchasing USD69.8mn in debt, but selling off USD1.18bn in equities. This net outflow is weighing on the THB. Still, the overall sentiments remain positive and this is reflected in the foreign purchases of debt of USD2.47bn year-to-date that more than offset their sell-off of USD1.36bn in equities. Thus, while some weakness in the THB cannot be ruled out should there be a further sell-off in Thai assets ahead, we expect flows to be positive in 2018, particularly to debt, and be supportive of the THB.

- Despite the strong economic fundamentals, we believe that the THB could face downside pressure in 2H 2018. This is because political headwinds could rise that could weigh on the THB. The current calm in the political arena is expected to give way to political upheaval as simmering tensions could resurface once the ban on political activities is lifted in the lead-up to the election, tentatively scheduled for Nov. Tensions are expected to boil over on concerns that the political arena could be dominated by the military and the elites for the foreseeable future.

- The actual date for the election will be announced in June when the organic laws governing the election process is passed. Recently, Somchai Swangkarn, the military government's whip in the National Legislative Assembly, suggested that the election is likely to take place inn Feb or early Mar 2019 instead of Nov as PM Prayuth had indicated earlier. He also suggested that the ban on political campaigning will be lifted by August. Should there be further delays to the general elections, political temperature is likely to rise even more and create further uncertainty in 2H 2018. This could keep investors on the sidelines until political uncertainty dissipates. Such political concerns are likely to put downside pressure on the THB in 2H 2018.

- While we are positive on the THB for its economic fundamentals, we remain cautious on its outlook beyond 1H 2018 on political consideration. Political uncertainty in 2H 2018 is likely to weigh on the THB and cap upside. We leave our 2018 USDTHB unchanged for now.

- **Growth and Inflation Outlook:** After rising by 4.3% in 3Q, economic growth moderated slightly to 4.0% y/y in 4Q. Nevertheless, full-year growth came in at 3.9% in 2017, the fastest pace of expansion since 2012. The deceleration in 4Q17 growth can be attributed to slower government spending (up by just 0.2% y/y vs. 1.8% in 3Q) and investment spending (up 0.3% y/y vs 3Q's 1.2%). Supportive of growth was private consumption and external demand. Looking ahead, the government remains optimistic about growth prospects. Government spending ahead of the general elections together with planned infrastructure building projects including transport networks and the Eastern Economic Corridor is expected to bolster economic growth. In addition, the export-led recovery last year should spark a revival in private investment that should sustain growth in 2018. This is because of the high correlation between export recoveries and machinery & equipment investments for Thailand. Our economic team expects full-year growth to come in at 4.0% in 2018, just a tad off the government projection of 4.2%. We caution though that the strong THB since late 2017 could weigh on exports and boost imports.

- Headline inflation moderated for the second straight month, rising by just 0.68% y/y in Jan from 0.99% and 0.78% in Nov and Dec respectively. Moderating consumer prices in Jan was lower food prices (up by just 0.09% in Jan vs. 0.2% in Dec) and transport cost (up just 0.92% y/y in Jan vs. Dec's 1.32%). Core inflation also moderated slightly by 0.58% y/y in Jan from 0.62% in Dec. The BoT continues to target within the range of 1-4%. Our economic team expects inflationary pressures to edge higher in 2018, fueled by higher energy/fuel prices, minimum wage increase and improving domestic demand. This should allow inflation to average 1.6% in 2018. The BoT expects headline inflation to average 1.1% in 2018, underpinned by rising oil prices.

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

- **Latest Fiscal and External Balance Outlook:** The government is planning to use loans to finance its THB100bn supplementary budget instead of taking the traditional route of issuing debt. The reason given by the Ministry of Finance for doing this is to avoid disrupting the secondary market. The plan though is to allow these loans to be converted into bonds later if market conditions allow. The government intends to borrow THB1.12tn under its current debt plan for FY2018 of which THB607.3bn will go to financing the budget deficit and government investment and THB516.8bn for debt restructuring.

- The current account surplus widened to THB166.16bn in Jan after narrowing to THB125.96bn in Dec. The widening surplus was due to the larger surplus in the services, primary & secondary income account of THB123.71bn (Dec: THB75.52bn) that offset the narrowing surplus in the goods and services account (Jan: THB42.45bn vs. Dec: 75.72bn). Details on the financial account are currently not available, but the record surplus in the overall balance of payments (BoP) of THB286bn in Jan suggests that the financial account could have recorded a large surplus in Jan, possibly from strong investment inflows.

- **Key domestic events and issues to watch:** BoT meets on 28 Mar to decide on monetary policy.

- **Technical Outlook:** Decline in USDTHB somewhat paused in Feb. Pair was last seen at 31.43 levels. Technical indicators suggest an interim consolidation with risk skewed slightly to the upside. Resistance seen at 31.58 (23.6% fibo retracement of 2018 high to low), 31.83 (38.2% fibo). Support seen at 31.2 levels.

INR: Weakened But May See Retracement

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

Previous Forecast in Parenthesis

- **Motivation for the FX View:** Bond yields have been on the rise for a few months now amid concerns of fiscal slippage. The Union Budget delivered on 1 Feb confirmed bond investors' fears as the Finance Minister announced that the fiscal deficit for FY18 is poised to come in at 3.5%, well above the 3.2% projected. Tax collections following the implementation of GST were lower than expected. For the coming year, the government estimates fiscal deficit to improve to 3.3%. Yields eased off before resuming its rally. 10y yields swung to a high of 7.746% before tapering to levels around 7.718%. Risk-off mood also weighed on the equity markets. The first 21 days of Feb saw foreign investors selling U$1.142bn of equities, in tandem with stocks around the world. As a result, the rupee also took a hit. USDINR rallied towards the 65-figure before easing off under the level. The widening trade deficit also did not help. This was not out of expectations as we had expected the voter-friendly budget to weigh on the currency. The liquidity deficit in the banking system, widening current account deficit, concomitant risk aversion and USD strength had given the USDINR an added boost above our 1Q forecast of 64.50. We do expect some retracement beyond the first Fed hike of the year projected to be in Mar and so we retain our forecast.

- **Growth and Inflation Outlook:** Manufacturing PMI fell to 52.4 for Jan from previous 54.7 (Markit). Growth of output and new orders decelerated though new export orders quickened. According to the industrial outlook survey of the manufacturing sector for Oct-Dec 2017, business sentiment improved with respondents optimistic about demand conditions for Jan-Mar. Improving demand conditions could translate to stronger industrial production. With more fiscal allocation to agriculture and social welfare schemes, we could see higher private consumption.

- Inflation is a key thing to watch in 2018 as headline CPI remained lofty around 5.01% y/y in Jan. As the RBI had noted, the decline in food inflation is less than expected and there are several upside risks to the inflation as we move into the year. Even as crude prices are unlikely to see a sustained climb, the weakened INR and expansionary fiscal policy could stoke demand-pull inflation. Wholesale prices eased to 2.84%y/y, more than the expected. Oil prices remained around $60-70/bbl levels in Feb. As what we have indicated last month, RBI has turned hawkish this year with plenty of inflation concerns and that could translate into a hike in the last quarter of 2018. Inflation could force the hand of RBI but if growth does not gain traction, INR might weaken further.

- **Monetary Policy Forecast:** RBI kept repo rates steady at 6.00% in Dec, reverse repo at 5.75% and cash reserve ratio at 4.00%. 5 out of 6 MPC members voted for maintaining status quo. Dr Michael Debabrata Patra voted for an increase of 25bps in the policy rate as he looks for inflation to drift well above target as international crude price rise, fiscal slippage, custom duty increase and imminent MSP increase. Even as the majority of the MPC voted to keep rates unchanged, the statement was rather hawkish. The Minutes indicated a number of upside risks to the inflation outlook including the HRA increase, potential rise in crude. The Union Budget is eyed as a source of price pressure as its expansionary policies could boosts domestic demand, feeding into inflation.
- Governor Urjit Patel's projected inflation to move in the "range of 5.1-5.6% in the first half of FY2018/19". Fading base effects could see inflation slipping back to 4.5-4.6% in the second half, with risks tilted to the upside. The GVA growth should pick up from 6.6% in FY2017/2018 to 7.2% in 2018/19. We hold on to our view for a rate hike in the second half of the year, possibly in Oct if the schedule of monetary policy meeting is similar to 2017-2018. The schedule for the next year should be released sometime in Mar. Next RBI meeting is on 5th Apr.
- Apart from the monetary decision in the early part of Feb, RBI also gave lenders 180 days to work out their biggest bad loans or the bankruptcy court will take over the major delinquent accounts. A clearance of these debts could translate to stronger credit growth and provide more scope for the RBI hike rates.
- **Latest Fiscal and External Balance Outlook:** Fiscal deterioration was a major reason for the bear steepening of the India sovereign yield curve in the past few months. The rise in the UST yields, USD strength, risk-off, PNB fraud further undermined the domestic debt market in Feb. Finance Minister announced that the fiscal deficit for FY18 is poised to come in at 3.5%, well above the 3.2% projected as tax collections following the implementation of GST was lower than expected. For the coming year, the government estimates fiscal deficit to improve to 3.3%.
- Brent prices have eased to around $66/bbl levels at last sight (23 Feb). While global demand is likely to sustain and IEA has indicated that supply glut has almost cleared, likely non-OPEC production like shale could continue to react to higher demand and rein in excessive spikes in crude prices. With that and the government's policy to curb gold import, India's current account balance may not see a lot more deterioration. Expectations are for it to widen to around -1.7% according to survey by Bloomberg. That could also mean that USDINR could stabilize at some point.
- **Key domestic events and issues to watch:** PMI-mfg (28- Feb); Svcs & Comp. PMI (5 Mar); CPI, IP (12 Mar); Wholesale Prices (14 Mar); Trade Bal (15 Mar); Fiscal Deficit (28 Mar).
- **Technical outlook:** The 1M USDINR NDF rallied above the 65-figure, likely to end the month on a bullish note. Momentum indicators on the weekly chart are also turning higher. This had turned out

according to what we expected, as we had look for risks of this pair towards 64.80 before 65.15 and 66.20. Support is seen at 64.44.

VND: To Remain Cheap

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

No Change To Forecast

- **Motivation for the FX View:** USDVND managed to inch higher towards the end of Feb as foreign investors started de-risk domestic equities. There were also some concerns of foreign banks pulling out of the local banking scene. We may see a relaxation of foreign ownership limit for capital withdrawals to retain foreign investors in the sector. This pair is last seen around 22745. Feb data is due for release anytime today and eyes are on the numbers to indicate a continuation of the momentum in exports. The release of the Feb numbers will be a better indication of growth from the end of last year instead of just relying on the Jan numbers given the seasonal skew of the Tet holidays.

- For the moment, we look for VND to strengthen moderately against the USD on the back of FDI (especially in real estate) in a backdrop of broad USD downtrend for 2018. Ministry of Planning and Investment stated that total pledged FDI was recorded at U$3.34bn in Jan-Feb, albeit -1.8%y/y, Exports growth could continue but trade balance has been waffling between deficit and surplus as imports growth is significant too. Overall, the current account surplus has been widening and that is dong positive. Bear in mind, Prime Minister Nguyen Xuan Phuc, officially set a real GDP growth target 6.5-6.7% in 2018. Our Maybank Vietnamese analysts project a 6.4-6.8% growth. Given the global synchronized growth environment, expectations are for growth in Vietnam to steady from 2017. The rate cut unleashed last year should be the last in this easing cycle and rising price pressure this year could keep SBV from doing further monetary easing. Inflation is also expected to accelerate at 4% on average. In a backdrop of weak USD, we see downside risks to the USDVND towards 22500 by the end of this year. However, volatility has increased and we expect USDVND to see periods of upside moves in between. While we expect VND to appreciate against the USD, the appreciation is likely to lag that of key trading peers like CNY, JPY, THB and SGD. With inflation creeping higher, SBV might choose to keep VND competitive to boost exports and FDIs. We look for VND to head lower towards 3689 against CNY, 214 against the JPY, 18145 against the SGD by year end.

- Eyes are on Trump's impending protectionist policies as his administration decides on whether to impose tariffs on steel and aluminum imports. The decision is supposed to be made by 11 Apr for steel and 20 Apr for aluminum. Rising prospect of a trade war could raise upside risks to the USDVND.

- **Separately, PM Nguyen Xuan Phuc appointed Nguyen Hoang Anh as Chair of the committee for the management of state capital to bolster the equitisation and divestment of State capital and improving the capacity and efficiency of SoE, especially large corporations.**

- **Growth and Inflation Outlook:** PMI-mfg rose to 53.4 in Jan from 52.5 in Dec. In the survey report, Markit noted stronger increase in output, new orders and employment. Price pressure also could rise as input prices and output charges have risen at sharper rates. Just released, Feb CPI also picked up pace to 3.15%y/y, firmer than the expected 2.90%. FDI momentum was rather strong in 2017 with a full year inflow recorded at U$21.3bn, 40.1% growth from U$15.2bn in 2016. With foreign investors still keen on Vietnam, the country seems poised to sustain a rather high level of growth for the rest of 2018 should global recovery continue.

- Growth surprised to the upside at 6.81%y/y for 2017 vs. the expected 6.75%. SBV had lowered the official deposit rates last Jul and that succeeded in propelling the growth of manufacturing, industry and construction sectors. In nominal terms, industry and construction jumped 13.3%y/y in 4Q from 9.8%. Manufacturing accelerated to 19.1%y/y from just 12% in the quarter prior. Vehicle sales rebounded to 29.4%y/y in Jan from a fall of -14.9% in the month prior.

- Consumption is underpinned by a growing middle class in Vietnam, sizeable number of visitor arrivals and stable inflation. Retail sales for Feb quickened to 10.1%y/y from 9.5% in Jan. We expect retail sales to average around 10% in 2018. We do see a risk of rising inflation this year. CPI rose to 2.65%y/y from previous 2.60%, on the back of prices of health and personal care sub-component. Healthcare is still a major driver of price pressures for Vietnam and we caution that food inflation could rise on the back of strong economic activity and currency weakness (against non-US trading partners).

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

- Note that while credit growth had been strong last year, SBV deputy governor Dao Minh Tu said that the central banks had given warnings to 15 lenders for raising credit to non-priority sectors. Chief of the Viet Nam Institute for Economic and Policy Research also warned that debt had risen to 135% of GDP and could pose a risk to the banking system.

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

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

- Current account recorded a sizeable surplus of USD4.3bn (latest data available) in 3Q last year, improving from the previous USD0.27bn. This data comes from strong trading of goods in surplus of USD5.2bn. The widening current account surplus could continue to support the dong. Trade balance swung into surplus in Feb of U$900mn from a deficit of U$300mn. Exports growth remained strong at 22.9%y/y for Jan-Feb, albeit eased from 33.1% for Jan. Imports eased more drastically to 15.3%y/y for Jan-Feb from 47.4% in Jan.

- **Key Domestic Events and Issues to Watch:** PMI Mfg is due the 1st; Domestic vehicle sales in 6th-13th; CPI, trade numbers, retail sales, IP are due 25th-31st.

FX Forecasts

	End Q1-18	End Q2-18	End Q3-18	End Q4-18
USD/JPY	108	107	106	105
EUR/USD	1.2400	1.2500	1.2800	1.3000
GBP/USD	1.4200	1.4400	1.4800	1.4800
AUD/USD	0.7850	0.8000	0.8100	0.8300
NZD/USD	0.7100	0.7400	0.7500	0.7600
USD/SGD	1.2800	1.2700	1.2500	1.2400
USD/MYR	3.8000	3.8500	3.7000	3.6500
USD/IDR	13200	13000	12900	12800
USD/THB	31.00	31.00	31.50	32.00
USD/PHP	51.00	50.50	50.50	50.00
USD/CNY	6.25	6.20	6.20	6.10
USD/HKD	7.80	7.80	7.80	7.80
USD/TWD	29.10	29.00	29.00	29.00
USD/KRW	1080	1050	1040	1060
USD/INR	64.50	63.50	63.00	62.50
USD/VND	22700	22600	22550	22500
DXY Index	89.69	88.91	87.18	86.18
SGD Crosses	End Q1-18	End Q2-18	End Q3-18	End Q4-18
SGD/MYR	2.9688	3.0315	2.9600	2.9435
SGD/IDR	10313	10236	10320	10323
SGD/THB	24.22	24.41	25.20	25.81
SGD/PHP	39.84	39.76	40.40	40.32
SGD/CNY	4.88	4.88	4.96	4.92
SGD/HKD	6.09	6.14	6.24	6.29
SGD/TWD	22.73	22.83	23.20	23.39
SGD/KRW	844	827	832	855
SGD/INR	50.39	50.00	50.40	50.40
MYR Crosses	End Q1-18	End Q2-18	End Q3-18	End Q4-18
EUR/MYR	4.71	4.81	4.74	4.75
JPY/MYR	3.52	3.60	3.49	3.48
MYR/HKD	2.05	2.03	2.11	2.14
MYR/CNY	1.64	1.61	1.68	1.67
GBP/MYR	5.40	5.54	5.48	5.40
AUD/MYR	2.98	3.08	3.00	3.03
NZD/MYR	2.70	2.85	2.78	2.77
MYR/IDR	3473.68	3376.62	3486.49	3506.85
MYR/INR	16.97	16.49	17.03	17.12
MYR/KRW	284.21	272.73	281.08	290.41
MYR/PHP	13.42	13.12	13.65	13.70
CNY/MYR	0.6080	0.6210	0.5968	0.5984

Source: Maybank FX Research as of 1 Mar 2018

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

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