Macro | FX Research & Strategy

Global

February 28, 2019

FX Monthly

2019, Issue 2: Crunch Time for Trade and *Brexit*

What Has Changed This Month?

- We calibrated USDKRW forecast slightly lower to reflect cautious optimism on US-China trade deal and GBP forecast marginally higher as fears of no-deal brexit give way to hopes of softer, delayed brexit.

Our Strategies

- External environment of (1) benign inflation, (2) global growth neither robust nor tanking (not hot not cold), (3) Fed pause in tightening cycle and (4) hopes of US-China trade deal suggest the opportunistic return to "goldilocks" thematic play. This should favour carry plays and is supportive of higher-yielder Asian FX including MYR, IDR, PHP and INR.

- **However we do see some near term risks of USD rebound**. While optimism on US-China trade deal is supportive of risk assets and risk-proxy FX, caution remains warranted. Markets pricing-in more good news than bad news for the moment suggest there is room for disappointment if US-China trade negotiations did not progress smoothly. In addition we are cautious of technology-protectionism (US and its allies' including Australia imposing ban on Huawei's 5G network and other Chinese tech including solar panels) that could complicate trade talks, strain international relations and weigh on global risk sentiment. Also in the Far East, **fears that the geopolitical conflict could further escalate between India and Pakistan could keep the downside pressure on the rupee.** However, potential for this event to garner support for Modi at the upcoming Federal Election could be positive for the rupee into the election (to be held by May 2019)

- ECB is expected to discuss TLTRO at the 7th Mar ECB Governing Council meeting. A decision to re-introduce will weigh on EUR as timeline of ECB policy normalisation will be pushed back. We **do not expect an imminent decision at the March meeting** as policymakers continue to assess the slowdown in Euro-area and monitor external development (trade war, global growth, etc.). Bias to buy EUR on dips remains.

- **Brexit development is expected to intensify** in the run-up to 12th Mar (2nd Meaningful vote on PM May's deal) ahead of Brexit day (29th Mar). We argue that GBP is expected to retain 2-way trade in 1.30 - 1.34 range with risk of overshooting as distribution of risks has once again shifted away from fears of a no-deal brexit and towards a delayed and softer brexit.

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Top 3 Currency Plays for March

Long INR, IDR, THB on Dips

Fade The USD

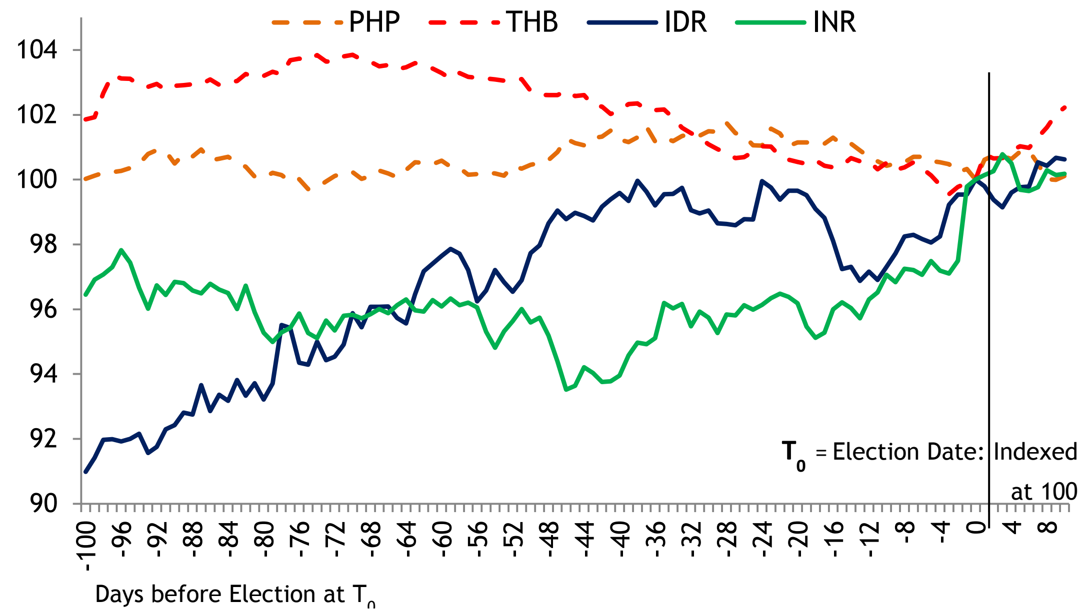
Buy GBP and EUR on dips

Key Events for the Month Ahead

Date	Event
3 Mar	CPPCC Meeting in China
5 Mar	NPC Meeting in China
7 Mar	ECB Meeting - *Focus on the discussion on TLTRO*
12 Mar	Second Meaningful Vote in UK
24 Mar	Thailand General Election
29 Mar	Official UK Brexit Date according to Article 50

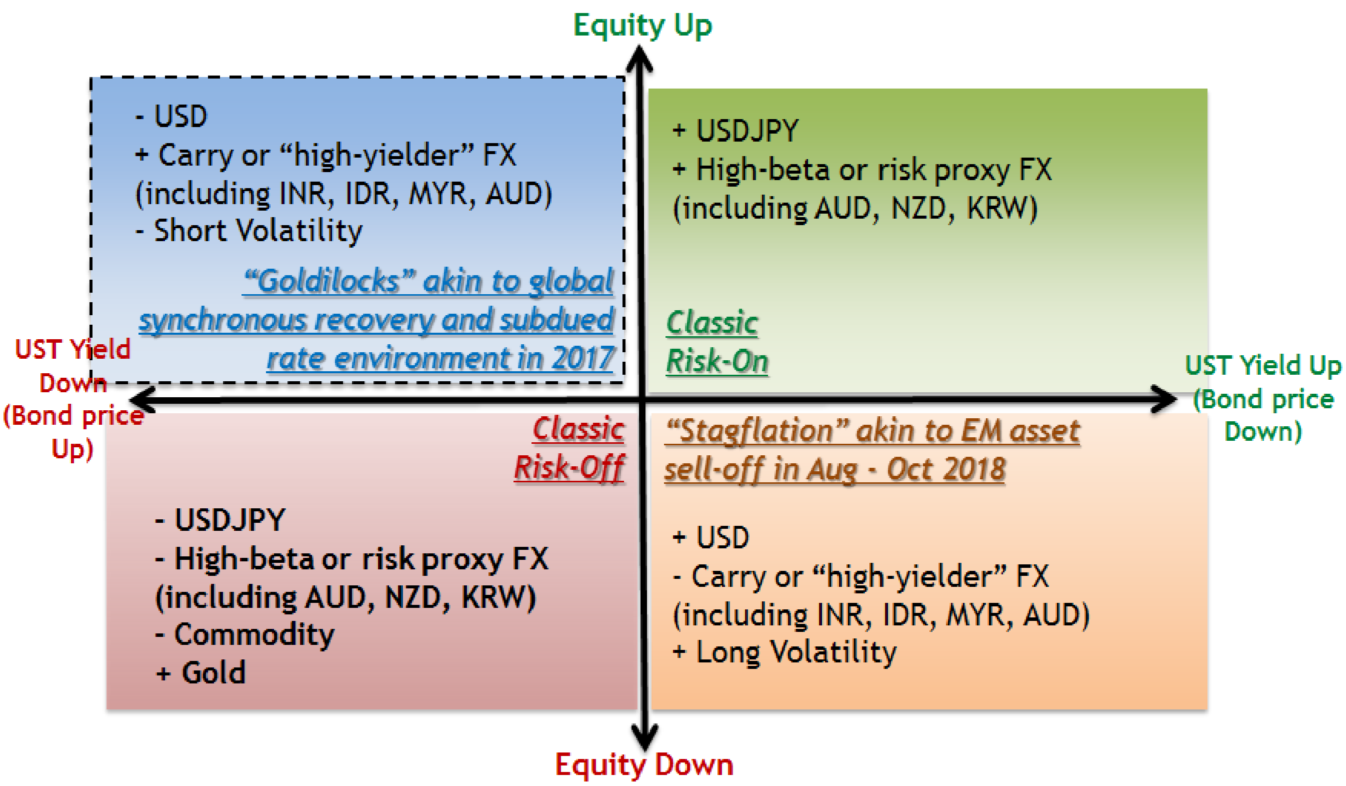
SEE PAGE 54 FOR IMPORTANT DISCLOSURES.

IDR, INR Typically Appreciate in the Lead-Up to Elections while THB Weakens. Most currencies Normally Strengthen After Their Elections



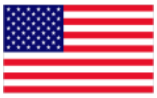
Source: Bloomberg, Maybank FX Research & Strategy

A Return of 'Goldilocks' Play?



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

G7 Global Overview



USD: Trade War Premium Dissipates

Forecast	1Q 2019	2Q 2019	3Q 2019	4Q 2019
USD Index	96.69 (96.87)	95.88 (--)	94.64 (--)	94.86 (--)

Previous Forecast in Parenthesis

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

- **A combination of softer set of US data, dovish-leaning Fed rhetoric, optimism on US-China trade deal, benign inflation globally, global growth neither 'hot nor cold' as well as potential US-China trade deal possibly in coming weeks creates a 'goldilocks', risk-conducive environment. This is typically supportive of risk-on/higher yielder play and will weigh on the USD.**

- In 2019, the key factors supporting a sell USD on rally are (i) the FED is near its end of tightening. With the Fed already 200bps up from its record low and neutral rate to be around 50-100bps away, the rate hiking cycle could be near its end. Policy normalization of central banks elsewhere could catch up with the Fed. (ii) US economic growth peaking soon; and (iii) US twin deficits in focus as treasury sees a surge in borrowing. Other broader term shifts were already underway to support the case for broad USD downtrend, including (1) US tax reforms and its wider implication on deficit, debt and the USD; (2) reserve diversification away from the USD; (3) USD countercyclical play (USD typically underperforms when relative global growth momentum picks up).

- A fundamental factor is the Fed rate hike cycle. FOMC's next meeting is on 21 Mar. We and consensus expect no change in the Fed Funds rate. The Fed will likely try to balance its still constructive view of the economy with its message of patience and prudence, with further softening of forward guidance while maintaining the tightening bias. These should not affect the benign market pricing for the rates path. For other majors, policy normalisations are still in their early stages (ECB, BoE) or may not have begun for most including RBA, RBNZ. We emphasize that policy divergence between the Fed and other DMs should slow and policy convergence could well be a thematic to position for into 2019. This should add to USD weakness. In addition, in the near term we could see month end flows supporting strong dollar selling versus most majors. However, the dollar has mildly bounced back vis-à-vis the safe haven currencies such as the JPY and most of its underperformance recently has been against the riskier G10 FX and EM.

- **Growth and Inflation Outlook:** Most market participants have lowered their 4Q GDP by 0.1%. 4Q 2018 advanced estimate are expected to come in at around 2.2% q/q saar, a moderation from 3Q of around 3.4%. Growth is still driven by personal consumption expenditure and a substantial contribution from public consumption and investment. However private investment is likely to have seen a slowdown in momentum coupled with a drag from net exports.

- Headline CPI remained unchanged in Jan for the third consecutive month, below market expectations for a modest increase (0.1%) and in-line with consensus. The recent deceleration in headline year-on-year consumer price growth has been driven by a sharp slide in energy prices at the end of last year, and should not be taken as a sign of broadly easing price pressures.

- Core inflation increased 0.2% in January, matching the prior four months' gain, and in-line with the consensus. The 12-month rate was unchanged at 2.2%. Both goods ex. Food and energy (0.4% vs. 0.0% prior) and services ex. energy (0.2% vs. 0.2% prior) contributed to January's monthly increase. While core goods' strength in the month is partially a result of transitory factors, core services inflation will likely accelerate as the year progresses, in-line with building wage pressures in the labor market. Core CPI momentum is building, based on the three-, six- and 12-month annualized growth rates. The three-month rate advanced to 2.6% in January from just 1.8% a year ago, while the six- and 12-month rates each rose to 2.2%. Core consumer prices will likely continue to accelerate throughout the year, and the core PCE metric will exceed the Fed's inflation target of 2.0% in 2019

- Monetary Policy Forecast: Target fed funds rate (FFR) kept at 2.25%-2.50% at 2019's first FOMC. Post-meeting statements indicate Fed is flexible on its interest rate and balance sheet policies to reflect economic and market situations. We are currently on the same page with Fed's guidance of up to two hikes totaling +50bps this year, but expect FFR to peak this year vs Fed's guidance of another +25bps hike in 2020. Fed's balance sheet reduction so far is slower than planned.

- Although Fed continues to expect sustained economic growth, strong labour market and inflation around its 2% target, the latest FOMC statement removed the wordings "some further gradual increases in the target FFR". Based on fed funds rate futures, market is currently pricing in no rate hike this year and the possibility of a cut next year.

- FoMC minutes released on 21 Feb reinforced Fed's 'patience' stance. Many participants suggested it was not yet clear what adjustments to the target range for the Fed fund rate may be appropriate later this year". Minutes also showed split views in interest rate trajectory as several officials argued that it would be appropriate to raise rates if economy evolved as they expected while another group argued that rate increases might only be required if inflation were higher than baseline outlook. On balance sheet reduction, officials agreed that an announcement soon to (stop shrinking Fed's $4tn balance sheet) would provide more certainty about the process for completing the normalisation of the size of the balance sheet. We do not rule out further details of a timeline on ending balance sheet tapering, possibly as early as at the March FoMC meeting. A plan to provide some clarity could help to ease monetary conditions.

- Fed Chair's testimony to Senate Banking Panel reinforced Fed's dovish stance while housing data surprised to the downside. There was no new information as Powell reiterates patience in policy stance. He added that Fed is ready to adjust balance sheet normalisation if needed and highlighted that the main risk facing US economy is slower growth from abroad. There were also few questions about monetary policy from the senate. He will testify to the House Panel again later tonight – no major surprises expected.

- The next FOMC meeting on 19-20 Mar 2019 takes place around several key events that can affect economic outlook and market movements i.e. the end of 90-day US-China trade war ceasefire on 1 Mar 2019; Brexit deadline on 29 Mar 2019; Trump-Xi meeting and conclusion of trade talks in March. Fed will also present its quarterly FFR guidance and macroeconomic forecasts pertaining to its monetary policy mandate i.e. growth, inflation, unemployment. To note, all FOMC meetings this year are accompanied by Fed Chair's press conference vs quarterly previously.

- In a separate statement on "Monetary Policy Implementation and Balance Sheet Normalisation", Fed is prepared to adjust its balance sheet normalization policy as well as altering the size and composition of its balance sheet, depending on future economic conditions. As at 23 Jan 2019, Fed's balance sheet declined –USD407.5b to USD4,094.7b from USD4,502.2b at end-Sep 2017. Over the same period, Fed's holdings of US Treasury securities fell -USD245.3b to USD2,220.1b from USD2,465.4b, while its holdings of agency debts and mortgage-backed securities dropped –USD143.6b to USD1,631.3b from USD1,774.9b. To note, Fed's balance sheet reduction since its start in Oct 2017 is progressing at a slower pace than the guidance of raising the run off rate by USD10b every three month from USD10b per month at the start of the programme in Oct 2017 until USD50b per month from Sep 2018 onwards, which should have resulted in a cumulative -USD540b balance sheet reduction to-date.

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

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

- **Key domestic events and issues to watch in Mar 2019:** PCE deflator (1 Mar, 25-29 Mar); ISM Manuf (1 Mar), Factory Orders, Durable Goods Orders (4-9 Mar), Trade Balance (6 Mar), NFP (8 Mar), CPI (12 Mar), Retail Sales (14 Mar), FOMC (21 Mar), GDP 4Q & Personal Consumption (28 Mar), Core PCE (29 Mar).

- **Technical Outlook:** DXY looks on track to retrace early month's gains into Feb close. Last seen at 96.10 levels. A potential head & shoulders pattern on the monthly chart (with S1 formed in 2015, H formed in 2017 and S2 formed in 2018) suggests that a broader bearish move appears intact. This **supports our bias to lean against strength but in the near term, we caution for the risks of a mild rebound**. A potential mini falling wedge pattern is observed. This is typically associated with a bullish reversal and in this case, the rebound could be mild given the magnitude of the mild decline in DXY from above-97 levels to 96. Daily stochastics falling into oversold conditions adds to risks of rebound. Resistance at 96.45 (21, 100 DMAs), 96.8 before 97.40. Immediate support at 95.65 (200 DMA), 95 levels.

EUR: Re-introduction of TLTRO Could Dampen Gains

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

No Change to Previous Forecast

- **Motivation for the FX View:** We continue to see **range-bound trade for EUR in the range of 1.1250 - 1.1550** for the following few weeks, with **technical bias for upside play** but gains could be limited by the risks of ECB re-introducing TLTROs, the build-up in political risk premium (Spain election uncertainty, risk of snap elections in Italy, fears of imposition of US tariff on EU cars, brexit risks) and softer than expected EU economic data. On the other hand, external environment of dovish Fed rhetoric, US economic data playing 'catch-down' to EU data, supported risk sentiment (owing to hopes of US-China trade deal) is somewhat providing a breather for non-USD currencies.

- The **topic of TLTRO will be a key focus at the ECB Governing Council meeting on 7th** Mar as the use of TLTRO tool will give markets an impression that the deceleration in Euro-area economic growth is faster than expected and that slower growth was not just due to one-off event. This is also **likely to delay the timeline of ECB policy**

normalisation and pose downside pressure on the EUR. We **do not expect an imminent decision to re-introduce TLTRO at the March meeting** as policymakers continue to assess the slowdown in Euro-area and monitor external development (trade war, global growth, etc.). Our EUR forecast does not assume the re-introduction of TLTRO at this stage (pose downside risks to our forecast trajectory).

- We **maintain our mildly constructive outlook on the EUR**. Though growth momentum is slowing, we are of the view that the slowdown in momentum does not necessarily translate into an Euro-area wide recession. The expansion in the Euro-area continues to be supported by accommodative financing conditions, steady oil prices as well as promising labor market conditions (as unemployment rate falling to decade low and wage growth rising to 9-year high of 2.4% q/q). Eventual ECB policy normalisation and new ECB President (as Draghi steps down) in later part of the year could see ECB-Fed policy divergence start to narrow. We expect EUR strength to pick up pace when ECB policy normalisation gathers momentum, political noises in Euro-area subside (after European parliament) amid USD weakness. Our bias to buy EUR on dips remains intact.

- **Downside Risks to Our Outlook: EUR could be poised for further downside** if (1) Euro-area/ global growth decelerate sharply and broadly into a recession; (2) a delay in ECB policy normalisation plans into 2020 and the re-introduction of TLTRO in 2Q 2019; (3) negative political surprises (i.e. risk of early election in Italy, etc.). In particular, Italy appears to be the weakest link as the economy enters into technical recession for the second time in 4 years while tensions between coalition partners appear to be on the rise. Italy's build-up of sovereign debt has also kept its credit rating (BBB) one-notch above junk status with a negative outlook (Fitch) and there are concerns if the massive Italian debt could pose contagion fears for European banks, in particular French banks (highest credit exposure to Italy).

- **Growth and Inflation Outlook: Euro-area growth came in at 1.2% y/y in 4Q.** This is the slowest pace of growth since 2013. Italy entered into technical recession while German economy stagnated. Spain, Netherlands and Portugal surprisingly saw growth picked up pace. **Concerns of Euro-area growth slowdown continue to rise** as indicated by the poor run of activity and survey-based indicators. Preliminary manufacturing PMI slipped into contractionary territory in Feb (49.2 vs. 50.5 in Jan) while industrial production and retail sales shrunk. Our view remains for a **deceleration in growth momentum but short of an outright recession for the Euro-area as a whole**.

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

- **Headline Euro-area CPI further decelerated to 1.4% y/y in Jan,** from 1.6% in Dec. Slippage was due to sharp deceleration in energy prices. Core CPI, on the other hand, was steady at 1.1% y/y owing to services. Looking ahead, the ECB expects inflation pressure to gradually rise owing to favourable labor market dynamics (falling unemployment and rising wage growth).

- **Monetary Policy Forecast: The next ECB Governing Council meeting is scheduled on 7 Mar.** ECB is widely expected to keep rates unchanged (Policy rates, Main Refinancing operations, deposit facility and marginal lending facility on hold at 0%, -0.4% and 0.25%, respectively) till Autumn 2019 (around Oct-Nov). **Markets are expected to scrutinize on the topic of TLTROs** (targeted long-term refinancing operations first introduced by the ECB during the GFC as a form of financing to banks). Governing Council members Nowotny, Praet and Coeure indicated that TLTRO tool could be discussed at the 7th March ECB GC meeting but we think it does not automatically lead to a decision for the use of TLTRO. The use of TLTRO is a sign that the deceleration in Euro-area economic growth is faster than expected and that slower growth was not just due to one-off event. And if TLTRO is used, that could delay the timeline of ECB policy normalisation as TLTRO is typically used in accommodative monetary policy stance. This poses risks to our expectation on ECB normalisation and could add to the list of factors weighing on EUR. **We do not expect an imminent decision to re-introduce TLTRO at the March meeting** as policymakers continue to assess the slowdown and monitor external development (trade war, global growth, etc.).
  - Nowotny said that TLTRO decision to come later than Mar and if slowdown is driven by one-offs such as emissions and the German car industry, then there is no need for TLTRO
  - Praet said that TLTRO will be considered at the March meeting, noting that banks suffering from weak profitability might cut credit to the real economy amid recent slowdown.

- Our baseline remains for ECB to normalize policy later this year with modest increase of deposit rate from -0.4% to -0.3% should (1) inflation data, in particular core CPI continues to surprise to the upside while (2) recent decline in growth and activity data proved to be one-off. ECB President Draghi will step down on 31 Oct 2019 and the race for the next ECB President remains wide open. Market chatters of former Finnish Governor Lilkanen and French central banker Villeroy front running German central banker Weidmann (whom is viewed as a hawk). Both Lilkanen and Vileroy are considered close aides of Draghi and are supportive of accommodative monetary policies. We continue to monitor this space as we run closer to the rotation of ECB leadership. Shift in expectation in support of Weidman could be supportive of the EUR.

- There was no ECB Governing Council meeting scheduled for Feb. At the last ECB meeting (24 Jan), ECB's Draghi sounded cautious on the economic outlook. Governing Council members were unanimous about acknowledging weaker momentum and changing the balance of risk for growth. He said that risks to outlook have moved to the downside and cited persistency of geopolitical uncertainties, threat of protectionism, vulnerabilities in EM and financial market volatility. However Draghi did say the likelihood of Euro-area recession is low as financing conditions remains favourable, developments in the labor market continued to be positive, wage growth continued to be significant and lower energy prices support real disposable income. He downplayed deploying LTROs as the last meeting was focused on assessment rather than policies. He elaborated that TLTROs have to have a monetary policy role and would not be implemented as a sectoral subsidy (recall that TLTROs were previously introduced to address cases of existing or likely fragmentation in monetary policy space).

- **Latest Fiscal and External Balance Outlook:** Euro area's current account surplus narrowed to EUR16bn in Dec Nov, down from EUR20bn in Nov. This was due to faster than expected fall in trade surplus. In the 12 months to Dec, Euro-area current account surplus was 3% of GDP, down from 3.2%. ECB expects current account surplus to narrow further to 2.7% of GDP in 2019 and 2.5% of GDP in 2021..

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

- **Key domestic events and issues to watch:** Feb mfg PMI, Feb CPI estimate (1 Mar); Jan PPI (4 Mar); Feb services PMI, Jan retail sales (5 Mar); 4Q employment, GDP, ECB GC meeting (7 Mar); Jan IP (13 Mar); Feb CPI (15 Mar); Jan trade (18 Mar); Jan construction output, ZEW survey expectations (19 Mar); consumer confidence (Mar); Jan current account, Mar prelim PMIs (22 Mar); CPI estimate for Mar (29 Mar).

- **Technical Outlook:** EUR traded a month of 2 halves in Feb with losses seen in first part of the month before partially retracing those losses into month-end. Last seen at 1.1380 levels. There are some signs of fatigue in the recent run-up. Though bullish momentum on daily chart remains intact, stochastics shows tentative signs of turning from overbought conditions. Downside play could take over in the near term. Short term support at 1.1360, 1.13, 1.1230 (2019 low). That said, stepping away from short term perspective, the monthly chart shows waning bearish momentum and tentative signs of turn-around in stochastics from oversold conditions – hint that room for further downside could be limited. A potential falling wedge pattern (began wide at the top in early 2018 and contracts as prices move lower towards the end-2018/early 2019) also appears to be in the making. This is typically associated with a bullish reversal. Immediate resistance at 1.1390 (50, 100 DMAs), 1.1430. Break above these levels could see further upside pressure towards 1.1510, 1.1690. Bigger support at 1.1190, 1.10. Underlying bias remains to buy on dips.

GBP: Deal, No Deal or Extension?

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

Previous Forecast in Parenthesis

- **Motivation for the FX View**: We continue to call for 2 way trade in the GBP amid intensification of brexit development in the run-up to brexit deadline (29th Mar) but **bias remains for further upside play** as the timeline shared by PM May (on 26th Feb) provided some clarity on brexit. **Distribution of risks has once again shifted away from fears of a no-deal brexit and towards a delayed and softer brexit. This should continue to support GBP gains.** We now expect the trading range to shift higher to 1.30 – 1.34 (with risk of overshooting the upper bound) from 1.28 – 1.32 previously. We revised higher 1Q GBP forecast to reflect receding fears of hard Brexit.

- **Amended Deal, No-Deal or Extension of Brexit?** In PM May's address to parliament (26th Feb), she said she will continue to re-negotiate for a withdrawal agreement with EU, which is expected to contain changes to the Irish backstop and has proposed the below timeline:

  - She will allow for a **second meaningful vote on the re-negotiated withdrawal deal on 12th Mar.** If PM May is successful in securing a majority, the UK will leave the EU on 29th Mar as planned and the transitional phase with EU will kick in until Dec-2020. [Orderly Brexit; GBP-positive]

  - However **if the deal fails to win an approval, a motion will be tabled for a vote by 13th Mar, asking if the House supports leaving the EU without a withdrawal agreement (i.e. no-deal Brexit).** If there is an explicit consent from the House in favor of exit without a deal, then UK will leave on 29th Mar. [Disorderly Brexit; GBP-negative]

  - However if it fails to get the House consent, then the **Government will bring forward a motion on 14th Mar, on whether the House want to seek an extension to Article 50 (i.e. Brexit delay beyond 29th Mar).** PM May is <u>not in favor of an extension</u> of Article 50 as an extension beyond Jun would mean UK will participate in European parliament elections in May. But she is willing to make concession for a short extension of up to 3 months while EU had previously said that they are willing to consider an extension of up to 21 months. An **approval from the House to extend brexit date [GBP-positive]** would see PM May making formal request to EU with a decision from the EU expected at 20-21 Mar EU Summit. Without a majority from the House consenting am extension, UK will proceed to leave on 29th Mar as scheduled. [GBP-negative]

- **Second Referendum still Not Ruled Out but Low Likelihood.** It is clear that PM May does not favor revoking Article 50 nor does she favor a second EU referendum. But recent development has seen Labour party backing one to avoid PM May's deal and a no-deal brexit. Labour party has also said that it would put forward an amendment calling on the government to adopt its brexit proposals which include a permanent customs union with the EU and close alignment with the EU's single market.

- In the broad scheme of things, PM May's interim **proposal on the timeline (12-14 Mar) has somewhat appeared to have bridged the divide within her party (GBP positive).** While we call for 2-way trade on the GBP in the near term, we **retain our cautious optimism on GBP outlook** beyond the near term nuances. Our baseline scenario remains for a **case of no-deal brexit being avoided and expect both EU and UK to come to terms on a compromised withdrawal agreement, at the eleventh hour.** We also argued that the distribution of risks have once again **shifted away from fears of a no-deal, hard brexit to potentially a delayed and softer brexit. We retain our bias to accumulate GBP on dips and expect recovery towards 1.40 to take hold as brexit uncertainties recede.**

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

- **Growth and Inflation Outlook:** In the recent quarterly inflation report (7 Feb), **BoE lowered 2019 and 2020 growth projections** to 1.2% and 1.5%, respectively (vs. 1.7% in Nov-2018 report). This is the biggest downgrade to growth projection since 2009 and it reflects the intensification of Brexit uncertainty and weakening global growth. UK growth could pick up later this year when those risks factors fade. Growth projection for 2021 was raised to 1.9% (vs. 1.7% in Nov-2018 report). Looking ahead, UK's economic outlook is highly dependent on future trade arrangement (beyond 1 Jan 2021) of the EU withdrawal agreement, the transition agreement (effective 30 Mar 2019 to 31 Dec 2020) and the journey (orderly or disorderly) towards Brexit day (29 Mar 2019, 11pm GMT). Prolonged brexit uncertainty will weigh on business decision and investments and this could dampen growth outlook.

- **UK economy expanded at a slower pace by +0.2% q/q in 4Q** (vs. +0.6% in 3Q vs. 0.3% expected). Consumption, government spending contributed to growth but back-to-back declines in business investments remain the main drag. Near term economic outlook is not expected to improve as intensification of brexit uncertainty ahead of Brexit day (29th Mar) weighs on investment. Slippage in Jan PMI across services, manufacturing and construction sectors as well as decline in industrial production suggest the risk of no/negative growth in 1Q.

- In the last Quarterly Inflation report (7 Feb), BoE **MPC expects inflation to fall slightly below MPC's 2% target in the near term** due to the sharp decline in oil prices since Nov-2018 but fading effects of oil and rising excess demand should see inflation return and remain a little above the 2% target for 2020, 2021 forecast periods.

- UK headline inflation fell further to +1.8% in Jan, from 2.1% in Dec. Decline was due to steep fall in petrol prices and lower hotel costs. Core inflation, on the other hand, held steady at 1.9% y/y. Robust labor market conditions in UK with unemployment rate at >40-year low and wage growth at decade high of +3.4% y/y is expected to add to domestic price pressures. Overall, the steady decline in headline CPI and the rise in wage growth above 3% provides a welcome relief for consumers and household finances.

- **Monetary Policy Forecast:** We expect BoE MPC to keep policy rate unchanged at 0.75% and the size of BoE balance sheet (GBP435bn) to stay unchanged at the upcoming meeting on 21st Mar. Steady decline in headline CPI and the rise in wage growth above 3% provides a sweet spot for BoE to keep monetary conditions accommodative, including rate to stay on hold to support growth and to allow for Brexit uncertainties to clear up. We **expect BoE MPC to keep policy stance status quo for as long as over the next 6 months or so** as **uncertainty over Brexit takes precedence over policy normalisation. We see some risks of 25bps rate hike towards final quarter of 2019 as brexit uncertainty fades and inflationary pressures regain pace.** BoE's forward guidance shows another 2 hikes expected to end-2020 (this implies about 1 hike/year). 90D Sterling future implies market expectation for 25bps rate hike in Nov-2019, a shift earlier from Dec-2019 (as seen in Jan). We remain watchful of inflationary pressures as tight labor market can further generate domestic price pressures while a case of no-deal brexit could result in sharp depreciation on GBP (brings about higher imported prices and this translates into higher CPI). Sustained rebound in CPI towards 3% again could renew market expectations for an earlier rate hike.

- At the last BoE meeting on 7 Feb, MPC voted 9-0 to keep policy rate unchanged at 0.75%, as widely expected. BOE cut both the GDP and investment projections to reflect the impact and uncertainty of Brexit. However, BoE kept the view that "limited and gradual rate hikes will likely be needed", warns of substantial contraction in a scenario of a no-deal Brexit.

- **Latest Fiscal and External Balance Outlook** UK's current account deficit widened to 5% of GDP in 3Q, from 3.8% in 2Q. This is the widest level in 2 years. Worsening of current account deficit was due to rise in trade deficit and a shortfall in investment income.

- Jan budget surplus rose to GBP14.9bn in Jan (vs. GBP9.3bn a year ago) owing to the increase in self-assessment receipts and increase in capital gains. Borrowing for the year is expected to undershoot OBR's forecast. Focus next on Chancellor Hammond's Spring budget statement on 13th Mar.

- **Key domestic events and issues to watch:** Feb PMI Mfg (1 Feb); Feb construction PMI (4 Mar); Feb services PMI (5 Mar); Feb house prices (7 Mar); Jan trade, industrial production, construction output, monthly GDP (12 Mar); Jan labor report (19 Mar); Feb CPI, PPI, RPI (20 Mar);

Feb public finances, retail sales and BoE MPC meeting (21 Mar); Feb GfK consumer confidence, 4Q final GDP (29 Mar).

- **Technical Outlook:** GBP more than reversed Feb's weakness below 1.28-handle (1.2773 low on 14th Feb) to trade as high as 1.3350 (27 Feb). Pair was last seen at 1.3310 levels. 2 golden crosses seen – 21 DMA cuts 200 DMA and 50 DMA cuts 100 DMA to the upside – there are bullish signals. On price pattern, a falling wedge is also observed – bullish reversal. Bullish momentum on daily, weekly and monthly chart remains intact while stochastics is rising. Bias remains for upside play. Resistance at 1.3360 before 1.3410 (50% fibo retracement of 2018 high to 2019 low). Break above these levels could see further upside pressure gathering momentum towards 1.3640 (61.8% fibo). Support at 1.3180 (38.2% fibo), 1.3080, 1030 and 1.29 levels (23.6% fibo).

AUD: Domestic Concerns to Check Risk-On Exuberance

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

No Change to Previous Forecast

- **Motivation for the FX View:** The AUDUSD remains firmly entrenched within the range 0.70-0.7260 range in the past several weeks, held by opposing forces. Insofar, apart from the flash crash in early Jan, AUDUSD was kept above the 0.70-figure by cautious optimism over the US-China trade talks. However, the AUD bulls were indeed held back (as flagged by our AUD title in the last Monthly) when RBA acknowledged that housing market weighs on the outlook of household spending and that the risks of a rate increase or decrease are now "broadly equal". At the RBA meeting, Governor Philip Lowe sounded more cautious than ever before on Australia's growth outlook, noting that downside risks have increased at home and abroad. He noted that "the main domestic uncertainty remains around the outlook for household spending and the effect of falling housing prices in some cities."

- We do not think AUD bulls are likely to take full control soon as election risks are likely to cap AUD gains and this time, compounded by the softness in the residential property sector. Recent poll trends favour the opposition Labor Party and one of the most contentious policies that they proposed is to scale back negative gearing policy which could further dampen the demand for residential property. The negative gearing policy allows taxpayers to claim deduction on mortgage for your expenses for the period your property is rented or available for rent. The rental property is negatively geared if it is purchased with borrowed funds and the net rental income, after deducting other expenses, is less than the interest on the borrowings. Labor proposed to halve the capital gains tax discount and restrict negative gearing to only new homes. This is supposed to raise A$32bn in over 10 years from a yet-to-be-determined date after the election. As reported on 17 Feb, the opposition leads the Liberal-National Coalition 51-49 on the two-party preferred measure base on the poll conducted for Nine's Sydney Morning Herald and the Age, the narrowest gap yet but Labor still leads. As such, we see some risks that AUD would weaken should probability of a Labor win increase.

- In the near-term, AUD could head higher amid positive progress on events such as the US-China trade talk as well as better risk sentiments stemming from a potential delay in Brexit. This is especially so in an environment where the Fed continues to keep future policy move data-dependent (in other words, no threat of a rate hike in the near-term) and if global price pressure is not significant. We do not rule out a re-visit of the 0.74-figure should the 0.73-figure be taken out.

- **Growth and Inflation Outlook:**
  - The latest retail sales (ex-inflation) print for 4Q suggests that private consumption expenditure is still weak with a deceleration seen from 0.2%q/q to 0.1%, undershooting expectations of 0.5%. The subcomponent for food, household goods, other retailing, cafes and restaurants posted decline on the quarter. That is in line with RBA's concern that the persistent weakness in the residential property sector would eventually crimp on household spending.
  - Part of the fall in the housing market was due to the rise in the wholesale funding cost that triggered out of cycle mortgage rate hikes but those costs of financing have come off more recently. The 3M BBSW has fallen from 2.09% to sub-1.90% (as of 25 Feb). With the recent retracement and a more data-dependent Fed, very benign inflation outlook at home and abroad, another round of mortgage hikes is less likely than 2018. As such, we think the residential property market should not experience as much pressure in 2019 compared to 2018.
  - Separately, NAB business surveys actually show an improvement in business conditions and business confidence for Jan. According to their report, this could still be due to statistical and seasonal volatility.
  - Trade surplus widened to A$3.68bn in Dec vs. the previous A$2.26trn. For the Oct- Dec 2018 period, we still expect sizeable net export contribution to GDP to offset deterioration in the private consumption. But that could actually moderate into the year. China's Caixin PMI-mfg print for Jan deteriorated further to 48.3 for Jan from previous 49.7. More recently, NBS posted a weaker print for PMI-mfg at 49.2 vs. previous 49.5 with new export order significantly lower at 45.2 vs. the previous 46.9. However, new order is actually expected to expand, at a 50.6 print vs. previous 49.6. In any case, demand for China remains weak. A slower China could shrink net exports contribution to GDP, along with some negative impact from the drought in 2018 on agriculture.

- Apart from the impact of a slower China and the US on net exports, much of China's slowdown is likely to be factored into business investments and hiring. We look for stabilization in the growth momentum of China as policymakers in China has already reacted to bolster consumption and investment. More infrastructure spending should also be cushion demand for Australia's exports.
- Inflation wise, RBA revised CPI for year-ended Dec 2019 lower to 1.75% from 2.25%. Weak domestic demand and global growth suggest that the outlook for consumer prices should remain benign. In addition, IEA forecasts for the year suggest that there should not be any excessive swings in supply and demand deficit of crude oil that should threaten the global inflation outlook.

- **Monetary Policy Forecast:** Feb saw RBA shift its tightening bias to neutral and we anticipate that nothing much will change at the next RBA meeting on 5 Mar. The shift was due to a significant downgrade in growth outlook with consumption growth now expected to be 2.75% over the forecast period vs. 3%. The central bank partially attributed the downgrade to the declines in the housing markets. Governor Lowe mentioned at a speech that the risk of a rate cut/hike is "broadly evenly balanced". OIS interpolated puts the probability of a rate cut by the Aug RBA meeting at 32%.

- We also watch for more developments from RBNZ's proposal for common equity tier 1 capital ratio requirement of the big 4 Australian banks' New Zealand subsidiaries to be raised 14.5% by 2024 from 7% currently. That translates to at least U$9bn in Tier- 1 capital requirement.

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

- **Key domestic events and issues to watch:** PMI-mfg for Feb on 1st Mar; Melbourne Institute inflation expectation for Feb and building approvals on 4th; 4Q net exports of GDP and RBA meeting on 5th; 4Q GDP on 6th; Jan trade and retail sales on 7th; NAB business survey for Feb and home loans for Jan; Westpac consumer confidence for Mar on 13th; house price index for 4Q; RBA Minutes of Mar Policy meeting on the 19th; skilled vacancies for Feb on 20th; labour report for Feb on 21st; PMI-mfg on Mar for 22nd;

- **Technical:** AUDUSD does not show much impetus to break out of the range that has been established since the last quarter, last seen around 0.7145. The 0.7060-0.7260 range must be broken for a more decisive directional bias. Daily and weekly momentum is mild bullish. The monthly chart show stochastic rising from oversold condition. Bias is still to the upside though there is a lack of conviction at this point.

NZD: Slight Risk to the Upside

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

No Change to Previous Forecast

- **Motivation for the FX View:** We continue to hold to our neutral outlook on NZD, in the near term (<3 months), with risks mildly skewed to the upside. Risks are broadly balanced which chance to surprise to the upside: (1) optimism on US-China trade deal possibly in coming weeks could further support sentiment; (2) sustained rebound in dairy prices (at GDT auctions) this year amid seasonal slowdown in production in the Northern hemisphere could see upward revision to Fonterra milk prices next season (typically supportive of NZD); (3) NZ economic data such as employment, wage growth, retail sales, credit card spending, services PMI were not as bad as feared; (4) RBNZ not as dovish as expected, stance remain neutral; (5) Fed pause on tightening cycle. On the other hand, there are also factors limiting gains in NZD: (1) RBNZ's proposal to increase lenders' capital requirements could raise borrowing costs and lead to tighter monetary conditions and this could eventually require a rate cut to OCR (RBNZ consultation closes 3 May and a decision will be made on 3Q 2019); (2) downside risks to global growth outlook. We look for NZD to trade a range of 0.68 – 0.71 over the next few weeks.

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

- **Downside Risk to NZD Outlook:** While optimism on the back of potential trade deal between US and China is supportive of risk assets and risk-proxy FX including AXJs and NZD, **caution remains warranted.** Trump did note that a deal "might not happen at all". We opined that the current market skew of more good news priced in than bad news suggest there is room for disappointment to seep in. This could pose headwinds to NZD. **Elsewhere US and its allies' (including Australia) ban on Huawei's 5G network and other Chinese tech including solar panels may complicate trade talks, strain bi-lateral relations and weigh on risk sentiment. Though NZ has not made clear its stance on joining the ban, there were already chatters of diplomatic**

retaliation: (1) Air NZ flight forced to do a mid-air U-turn after it was refused permission to land at Shanghai; (2) PM Jacinda inability to arrange a visit to China and (3) late cancellation of a China-NZ tourism launch event for 2019. A NZ ban on Chinese tech could prove negative for NZD.

- **Growth and Inflation Outlook: In the last quarterly MPS (13 Feb), RBNZ expects growth to pick up pace to 3% for 2019,** up from 2.6% in 2018. Monetary stimulus and population growth will underpin household spending and business investment while government spending on infrastructure and housing is expected to support demand. In particular on the fiscal front, the families package should support household consumption, Kiwibuild plan to support real estate investment while increase in minimum wage is expected to support household income. On inflation outlook, CPI is projected to ease in the near term owing to decline in petrol prices but to rise and reach the middle of its target range of 1 – 3% as both tradables and non-tradables inflation rise (the latter due to increasing capacity pressure).

- **4Q GDP is scheduled for release on 21 Mar.** 3Q GDP decelerated to +0.3% q/q, from 1% in 2Q. While the 3Q pace of expansion is the slowest in nearly 5 years, it is likely the print represented some degree of “payback” as 2Q print recorded its fastest pace of expansion in 2 years. Breakdown by industry shows manufacturing contracted while construction fell. In expenditure terms, the drag on growth was due to lower private investments and government spending though consumption held up. Survey/activity indicators were mixed with services PMI inching higher to 56.3 in Jan, up from to 53.2 in Dec while manufacturing PMI slowed to 53.1 in Jan, from 8-month high of 54.8 in Dec. Notably, new orders gauge dropped to 13-month low and production fell to 51.1. Retail sales, on the other hand, surprised to the upside (+1.7% q/q in 4Q). 11 out of the 15 store categories including F&B, pharmaceuticals reported gains.

- **Headline CPI slowed on sequential terms to +0.1% in 4Q,** from +0.9% in 3Q. The moderation was dragged by tradable prices (typically transitory in nature, defined as imported goods & services) while non-tradable inflation (proxy for domestic price pressures) rose +0.7% q/q. On y/y terms, headline CPI rose 1.9%, close to the middle of RBNZ’s inflation target range of 1 – 3%. On sectoral breakdown, decline in oil and food prices were the main drags while accommodation-related prices such as rental provided the buffer. 4Q PPI (+1.6% q/q) rose amid electricity cost increases.

- **Monetary Policy Forecast:** We expect **RBNZ to keep OCR on hold at 1.75%** amid downside risks to economic growth momentum, risks of China slowdown and ongoing trade war concerns between US and China, **at the upcoming MPC on 27th Mar.** Rise in CPI towards the middle of RBNZ target range of 1 – 3% and the risk of further upward pressure on domestic prices including wage growth (owing to tightening of labor market) should reduce market speculation for RBNZ rate cut this year. In our opinion, should the rise in inflation be sustained together with activity picking up further, there could even be a case of 25bps rate hike in 2H 2019 (out-of-consensus expectations).

- At the last MPC meeting (13 Feb), RBNZ MPC kept OCR unchanged at 1.75% as widely expected. RBNZ did not provide the dovish, easing cues that many in the markets were looking for. Instead, the central bank said that the official cash rate is expected to stay at this level in 2019 and 2020. The forecast for rate hike is pushed further into early 2021. Governor Orr mentioned in a statement that the direction of the next OCR move could be “up or down”, underscoring the “neutral stance” of the central bank.
- **Latest Fiscal and External Balance Outlook:** NZ current account deficit further widened to -3.6% of GDP in 3Q 2018 and this was due to increase in primary income deficit and rising cost of imported fuels. This is the widest current account deficit since 2009.
- NZ government surplus for the 6-months ended Dec was at $1.1bn, ahead of the forecast $589mil forecast. Rise was due to bigger than expected GST, customs and excise duties offsetting smaller than expected personal income and corporate tax. Net debt was 21.3% of GDP while gross debt was at 30.3% of GDP.
- Key **domestic events and issues to watch:** Feb consumer confidence, Jan building permits, 4Q terms of trade (1 Mar); 4Q mfg activity (8 Mar); Feb card spending (11 Mar); Feb food prices (13 Mar); Feb mfg PMI, Jan net migration (15 Mar); Feb services PMI (18 Mar); 4Q current account (20 Mar); 4Q GDP (21 Mar); Feb trade (26 Mar); RBNZ MPC meeting (27 Mar); Mar business confidence (28 Mar); Mar consumer confidence and Feb building permits (29 Mar).
- **Technical Outlook:** NZD retraced early-Feb’s losses. Last seen at 0.6845 levels. Mild bullish momentum on weekly, daily chart remains intact while stochastics is showing signs of turning from overbought conditions. Near term downside pressure not ruled out. Support at 0.68 (38.2% fibo, 0.6750 (200 DMA) - 60 (100 DMA). Bearish momentum on monthly chart continues to fade while stochastics is rising. Bias remains to buy dips. Key resistance at 0.6910 (50% fibo retracement of 2018 high to low) if broken, could see the pair trade higher towards 0.6970, 0.7020 (61.8% fibo).

JPY: Fed Dovish Pivot, Growth Concerns Could Spur Bulls

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

No Change to Previous Forecast

- **Motivation for the FX View:** JPY has gone from being the best performing currency against the USD in the G10 space to among the worst in Feb. The JPY has fallen by 1.57% against the USD so far in Feb. This could be attributed to the mild pick-up in USD strength amid healthy US economic data, as well as some unwinding of safe-haven proxy plays including the JPY on optimism over Sino-US trade talks. We do not expect the USDJPY's move higher to continue but instead expect the pair to remain on its downward trajectory over the forecast horizon before edging mildly higher in 4Q. We maintain our USDJPY forecast to end 1Q at 110 and then to climb even lower to 106-levels but 3Q before inching slightly higher to 107 in 4Q.

- The USDJPY remains pressured to the downside as a result of the pivot in the tone of the Fed, who is now signaling a more "patient" approach to rate hikes in 2019 and beyond. This could be a prelude to a pause by the Fed in its current tightening cycle. The possibility that the current Fed tightening cycle is near its end should weigh on UST yields, narrowing the yield differentials between the 10Y UST and JGB and providing room for the USDJPY to slip lower. Our economic team still thinks one-to-two further Fed rate hikes are in the card this year, down from three previously. This should weigh on UST yields and narrow the gap between 10Y UST and JGB yields, putting downside pressure on the USDJPY.

- Upside moves in Mar looks limited consequently and pressure on the USDJPY appears to be tilted to the downside. The Fed's dovish pivot should still weigh on UST yields and narrow the gap between 10Y UST and JGB yields. This should drag the USDJPY to the downside ahead.

- Beyond 1Q, the impetus for the USDJPY to move lower should come from the potential upside political risks and concerns over the impact of the sales tax hike in Oct that could weigh on risk appetite. Some concerns over the local elections in Apr 2019 and Upper House elections scheduled in Jul 2019, together with the possible referendum to amend the pacifist constitution could create some political instability in 2H 2019, which could in turn lead to safe-haven demand for the JPY. Implementation of the consumption sales tax hike in Oct 2019 and its negative impact on domestic consumption and overall growth could also add downside pressure on the USDJPY in 2H 2019.

- Given the sound-bites out from the US recently, the re-emergence of Sino-US trade war concerns as intense as prior to the G20 summit in Nov 2018 are unlikely. It would appear that there will be some kind of resolution to the Sino-US trade negotiations given the imperative for Trump to show some results to bolster his presidency ahead of his 2020 re-election bid. Safe haven demand for FX proxy plays is likely to come from concerns over global growth instead. The slowing PMIs globally and mixed US economic data suggests that growth momentum could be running out of steam. Consequently, this could whet appetite for safe-haven FX proxy plays including the JPY and weigh on the USDJPY.

- CFTC positioning data for 12 Feb showed that market appears to have reduced their net positioning for long JPY against short-USD. Net long-

JPY positions were reduced to 30,742 contracts vs. 31,410 contracts in the week of 5 Feb, which was supportive of the USDJPY. Still, expectations of a less aggressive Fed in 2019 and concerns over global growth could see stale long-USD bets being unwound. This unwinding of long-USD bets should benefit the JPY where there are expectations of appreciation bias in 2019. Establishment of long-JPY vs. short-USD should be put downside pressure on the USDJPY.

- Given the recent market developments, we maintain our forecast for the USDJPY to end 1Q around the 110-levels and then to slide even further to around 108 and 106 by end-2Q and -3Q respectively before edging slightly higher to 107 by end-4Q.

- **Growth and Inflation Outlook:** Preliminary GDP print showed the economy expanding by 0.3% q/q (1.4% annualised) in 4Q 2018, rebounding from the downwardly revised contraction of -0.7% q/q (-2.6% annualised) in 3Q. The rebound could be attributed to an improvement in domestic demand, which rose 0.7% in 4Q from a decline of 0.6% in 3Q. External demand remained unfavourable to GDP growth with exports rebounding 0.9% q/q in 4Q vs. -1.4% in 3Q, but which were more than offset by the 2.7% jump in imports (3Q: -0.7%). Additionally, public investment remained a drag on the economy, contracting by 1.2% q/q in 4Q, though this was a smaller drop than 3Q's -2.1%. For the full-year, the economy expanded by 0.7% in 2018, a slowdown from 2017's 1.9%. Still, we do not expect the economy to slip into another recession in 2019, though growth could remain lackluster given economic uncertainties and the looming consumption sales tax hike in Oct. Still, the government's record budget of JPY101tn for FY2019 should be supportive of the economy, while preparation works in the run-up to the 2020 Olympics in Tokyo should also bolster economic growth in 2019. The BOJ maintains its assessment that the economy is "expanding moderately" and expects the economy to grow by up to 0.9% in FY2019 and by 1.0% for FY2020.

- Headline inflation moderated in Jan as oil prices and mobile chargers slipped lower, rising by just +0.2% y/y (Dec: +0.3%) in line with market expectations. Also coming in within expectations were core (headline inflation less fresh food - the key inflation gauge for the BOJ) and core-core inflation (headline inflation less fresh food and energy) which inched higher by +0.8% and +0.4% y/y respectively in Jan (Dec: +0.7% and +0.3% respectively). While rising (core) inflation print is a positive sign, it remains a distance from the central bank's 2% inflation target, highlighting the need for the BOJ to persist with its ultra-loose monetary policy and possibly even adding new easing measures if necessary should downside risks to inflation increases markedly. Continuation of the current policy stance should be supportive of the USDJPY. The BOJ's inflation projection remains at 1.1% for FY2019 and 1.5% for FY2020.

- **Monetary Policy Forecast:** The BOJ took a short break in Feb after deciding to leave its monetary policy unchanged at its first meeting of the year in Jan. Its yield curve control policy and asset purchases programme were left intact with the policy balance rate maintained at -0.1%, the 10-year JGB yield target at around zero percent, and asset purchase target of JPY80tn. It also kept its forward guidance unchanged, reiterating that it "intends to maintain the current extremely low levels of short- and long-term interest rates for an extended period of time". While its policy stance was left on hold, the BOJ cut its near-term inflation and growth forecast to match reality.

- To reinforce his mantra that the BOJ will persist with its ultra-loose monetary policy, Governor Kuroda emphasized his willingness to introduce additional easing measures should the momentum toward the 2% inflation target falters. He highlighted in an interview on 22 Feb the measures that he could use from his current arsenal, namely lower the negative short-term rate, cut the long-term yield target below zero percent, buy more assets including government bonds and increase the pace of expansion of the monetary base. His comments showed the resolved of the BOJ to follow through with its current policy until the 2% inflation target is achieved.

- **Latest Fiscal and External Balance Outlook:** The parliament has approved the JPY3tn second supplementary budget for the FY2018 (Apr 2018 to Mar 2019) on 7 Feb. This additional spending will allocated to bolster defence, prevent natural disaster and provide subsidies for agriculture. This brings the total government expenditure to nearly USD1tn in FY2018. To allay concerns that this would add to debt, the government aims to finance the bulk of this additional spending from left-over funds from the FY2017 budget and from the upswing in FY2018 tax revenue. The government continues to aim for a primary surplus by FY2027.

- The current account (CA) surplus narrowed in Dec to JPY0.45tn from JPY0.76tn in Nov from JPY1.31tn in Oct on the back of a sharply smaller surplus in the primary income account (Dec: JPY0.40tn vs. Nov: JPY1.44tn) that mitigated the JPY0.10tn surplus in the goods and services account (Nov: -JPY0.56tn). The deficit in the financial account narrowed sharply to JPY0.19tn in Dec from JPY1.12tn in Nov due to the smaller deficits in the direct and "other" investment segments as well as the smaller portfolio investment inflows. The deficit in the overall balance of payments (BoP) seen in Nov reversed and turned into a surplus of JPY0.26tn in Dec.

- **Key domestic events and issues to watch:** Focus this month will be on final 4Q18 GDP on 8 Mar and BOJ policy meeting on 14-15 Mar. BOJ will release the minutes of its Jan policy meeting on 20 Mar and a summary of opinions from the 14-15 Mar meeting on 26 Mar. We also have BOJ Policy Board member Yutaka Harada speaking in Kofu on 6 Mar. JGB auctions in Feb: 10-year (5 Mar), 30-year (7 Mar), 5-year (12 Mar), 1-year (19 Mar) and 20-year (19 Mar).

- **Technical Outlook:** USDJPY traded higher for the month of Feb. Last seen at 110.80 levels. Bearish momentum on weekly chart shows signs of waning while stochastics is rising. We do not rule out near term risk of rebound. Resistance at 111.30/40 (100, 200 DMAs), 112.20. But bias to sell on rallies. Price action shows a rising wedge pattern – typically a bearish reversal. 100 DMA looks on track to cut 200 DMA to the downside – bearish signal. We look to sell rallies, looking for a move towards 109.50, 108.40.

RMB: Gains To Slow

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

No Change to Previous Forecast

- **Motivation for the FX View:** USDCNY is likely to see a deceleration in its decline unless the US and China come to a concrete and detailed trade agreement in Mar. USDCNY tested below the 6.69-support level again after Trump announced that the 1Mar deadline for more tariffs (10% tariff on U$200bn Chinese goods that could be raised to 25%) will be delayed. In addition, there are plans also for Trump to have another summit meeting with Xi and that further increases the likelihood of the deal. Risk appetite was however curbed by subsequent reports by state press Xinhua which warned of fresh uncertainties at the final stage of the US-China talk and even mentioned about the “long-term, complicated and arduous” nature of the trade frictions between the US and China (25 Feb). The commentary literally stopped USDCNH bears in their path that day and prices rebounded towards the 6.70-figure at one point. The US team also sounded more words of caution. At a testimony to the House Committee on 27 Feb, US Trade Representative Lighthizer mentioned more about getting China to agree on “no more competitive devaluations”. His testimony seems to be one that caution against excessive optimism (again) on a deal with China and that the US team is pushing for a very hard deal (all or nothing). He said that President Trump has constitutional authority to negotiate for a deal which suggests that details of the deal do not need to go through Congress approval. He elaborated that agreements have to be made on structural reforms in China and that “more purchases by China is not enough” for a deal. We expect RMB gains to slow from here as quite a bit of optimism is in the price in addition to the promise of a stable yuan that has to be part of the deal. However, the threat of a “no deal” by Lighthizer could limit the downmove in USDCNH.
- We do not rule out another rally in the RMB when a more concrete agreement is announced but it will likely be short-lived. We also hold our view that the initial positivity on the deal could eventually fizzle out along with the perception that China’s needs to keep the yuan strong during the negotiating process. Domestically, the impact of the credit support insofar should be modest and the outsized aggregate financing in Jan is also meant for seasonal demand. Hence, momentum of the credit growth may not continue at this pace. Also, the impact of greater infrastructure spending and multiplier effect could still take time

and the reaction to stimulus as such, could still be repriced. As a result, weak data for Feb that is to be released in Mar could lift the USDCNY 6.75 in the month. Beyond the 1Q, we look for USDCNY to head gradually lower in a softer USD environment whilst the current account balance stands at risk of deterioration due to a trade agreement for China to make a substantial purchase of American goods. We do caution that intermittent upside risks to the greenback remain (and is underpriced) as the Fed could still raise rates according to its guidance, sometime in 2Q should its growth sustain. However, the fact that the Fed is likely to be near its tightening cycle suggests that episodes of USD strength are likely to be sporadic and intermittent and that should also be reflected in the USDCNY.

- We eye CPPCC (3rd Mar) and NPC (5th Mar) this month for the yearly growth, inflation, credit and other economic targets. We anticipate that the growth target will remain a range, possibly around 6% as global growth continue to moderate. There had been plenty of focus on support for small and medium enterprises, financing of government infrastructure by bonds, more liquidity tools such as the bill swap mechanism through which FIs can swap commercial bank perpetual debt for central bank bills which can then be used as borrowing collateral. The Bank of China became the first commercial bank to issue the perpetual bonds. Income tax has been reduced and there are mentions of more tax cuts or benefits. So, while growth is not likely to be fantastic, there will be more public investment and bolsters to private consumption. We recall that Shanghai cut GDP target for 2019 to 6-6.5%, aims to expand its free trade zone, set up a pilot registration system for listed companies and a new “science and technology innovation board” on its stock exchange, and to promote higher quality growth and integration of the Yangtze River Delta region. The focus will be on joint projects in infrastructure, technological innovation and environmental protection. The government may also make further improvements on elderly care and social security that should also boost the spending power of households. Hence, there is a definite shift of priority from a quantitative measure of success such as GDP growth to other objectives that are meant to foster a more sustainable, inclusive and productive city.

- **Growth and inflation outlook:** Trade surprised to the upside this month. China's exports surged well above expectations to 13.9%y/y in Jan from previous 0.2%. Imports also made a small rebound to 2.9%y/y from a decline of -3.1% in the month prior. Trade surplus narrowed to CNY271.16bn from previous CNY395bn. Details reveal that the latest trade numbers show that the trade surplus with the US has been coming off from U$29.9bn in Dec to U$27.3bn in Jan. Exports growth to the US fell -2.8%y/y while imports growth fell 41%y/y. High base and possible Lunar New Year distortion contributed to drastic contraction seen in imports print.

- The outlook for the manufacturing sector remains rather downbeat as Caixin PMI-mfg for Jan came in with another contractionary print, at 48.3 vs the previous at 49.7. NBS also turned in another weak number more recently for Feb at 49.2 vs. previous 49.5, underpinned by the improvement of the new order although new export order posted a shocking decline to 45.2 vs. previous 49.1. Still, bear in mind that there could be seasonal distortion at work here with the Lunar New Year earlier in the Feb his year compared to last year.

- There is no activity data available for Jan.

- Inflation continued to remain on the downtrend with CPI at 1.7%y/y for Jan vs. 1.9% in Dec. PPI came in almost flat at 0.1%y/y vs. previous 0.9%. The release raises concerns on corporate profitability and private investment sentiment. That could increase the expectations of further monetary policy easing especially as softer inflation prints suggest a benign environment to do so. The soft inflation headline was due to weak food inflation (but this trend could be less certain amid reports of swine flu in China). Consumer goods subcomponent fell to 1.3%y/y from previous 1.7% (a sign of weakening domestic demand). Core inflation (excluding food and energy) actually saw a mild increase to 1.9%y/y from 1.8%.

- **Monetary Policy Forecast:** PBoC just released its quarterly monetary policy report, reiterating their desire *to keep yuan stable at equilibrium level* and amidst calls for an interest rate cuts for the past several weeks, highlighted the use of *targeted reserve ratio cuts*, *targeted medium-term lending facilities* and *tweaking re-lending and re-discounting quotes*. This seems to suggest that a rate cut is not in order in the near future. In fact, our observation is that the recent broad RRR cuts, policy tweaks to the targeted reserve ratio cuts as well as more targeted reserve ratio cut (on 25 Jan) were effective in injecting enough liquidity such that the market rates were brought lower.

- For one, 7-day repo has dipped below 2% a number of times since the start of the year, though it has most recently crept to levels around 2.57% as demand for cash increases in tax payment season (end Feb). The 3M SHIBOR also fell to 2.75% at last seen from its recent peak of 3.36% last Dec. Despite the fall in market rates, the amount of local note defaults continue to rise into 2019 with more than CNY12bn already taken place so far this year. This is 10% of the CNY120bn for 2018. That is still a sign of inadequate credit access for smaller companies and also underpins the recent endeavours by the government to encourage lending to these smaller enterprises. What China needs is to improve the transmission mechanism of its monetary policy. Before that happens, a broad "interest rate cut" would be rather meaningless.

- As a result of the clarification from PBoC, expectations of the rate cut have come off and the support for local bonds waned. However, this dip could present opportunities for investors later. We anticipate concomitant support for RMB as well

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

- Insofar, personal income tax deductions were announced, personal income tax thresholds were also raised with new tax brackets, import tariffs on industrial and consumption goods and tax cuts for R&D spending.
- China announced a U$29bn annual tax cuts for SMEs for the next three years.
- Infrastructure spending is encouraged. The government issued CNY1.35trn worth of special bonds meant to finance local government infrastructure projects and this is likely to be expanded to CNY2.15trn this year.
- **Key domestic events and issues to watch:** Caixin PMI-mfg for Feb is due on 1st Mar; foreign reserves for Jan due 7th; trade data on 8th; CPI and PPI are due on 9th; aggregate financing and new yuan loans on 10-15th; urban FAI, industrial production and retail sales due on 14th; new home prices on 15th; FX Net settlement on 18th; industrial profits on 27th;
- **Technical Analyst:** USDCNH slipped under the 6.70-figure but not before the pair rose back towards the 6.80 figure before coming to rest around 6.68 as we write. A clearance of the support at 6.6960 can see a move towards 6.6080 is. 50-dma has just cut the 200-dma – death cross ahead. That's a bearish signal there and we expect bias to remain to the downside.

KRW: Cautious Optimism

Forecast	1Q 2019	2Q 2019	3Q 2019	4Q 2019
USDKRW	1115 (1125)	1100 (1115)	1105 (--)	1120 (--)

Previous Forecasts in Parenthesis

- **Motivation for the FX View: We expect USDKRW to trade lower** as US-China trade war fears give way to optimism of a real deal, possibly in coming weeks while Fed pause in tightening cycle provides a breather. USDKRW trading range for the next few weeks could shift slightly lower to trade 1100 – 1130, from 1110 – 1129 in a "goldilocks" environment (characterized by benign inflation, interim Fed pause in tightening cycle, growth momentum easing but economy still growing) amid supported risk sentiment (owing to hopes of trade deal). However we still expect gains in KRW to lag other AXJs as soft domestic fundamentals amid semiconductor down-cycle could still weigh on the economic outlook and currency while goldilocks play typically benefited higher yielder FX (such as IDR, MYR, PHP) over lower yielder KRW. **We revised our USDKRW forecast slightly lower to reflect our cautious optimism on KRW.**

- While we acknowledge that global semiconductor down-cycle has yet to reach a cyclical bottom, we opined that fears of the down-cycle may have over overly priced and stretched by valuations. A material progress of a US-China trade deal could further translate into a pick-up in business and investment activity. From valuation perspective, unwinding of fears could lead to a re-rating of Korean assets and is supportive of the KRW. We do not expect the down-cycle to last beyond 1H 2019. An eventual recovery as supply-demand dynamics corrects, is likely to be supportive of KRW.

- **Upside Risks to USDKRW Outlook:** While optimism is supportive of risk assets and risk-proxy FX including KRW, **caution remains warranted**. Trump did note that a deal "might not happen at all". **Markets pricing-in more good news than bad news for the moment suggest there is room for disappointment** in US-China trade negotiations. And that could pose upside risks to our USDKRW outlook. On the other note, we are **cautious of technology-protectionism** (US and its allies' including Australia imposing ban on Huawei's 5G network and other Chinese tech including solar panels) that could result in retaliation from China. This could complicate trade talks, strain international relations and weigh on global risk sentiment (another potential negative for KRW). In addition, recent development on Trump-Kim Summit in Vietnam which saw no joint communique may see geopolitical tensions re-build - another factor that could pose upside risk to USDKRW.

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

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

- **For 2019 inflation outlook, BoK revised projection lower to 1.4% y/y** (down from 1.7% in 2018) owing to decline in oil prices. **Headline CPI slowed to 0.8% y/y in Jan, down from 1.3% in Dec** owing to decline in oil prices and fuel tax cut by 15%. Core CPI held steady at 1.2% y/y (vs. 1.3%). For 2018, CPI rose 1.5% y/y (vs. 1.9% in 2017).

- **Monetary Policy Forecast**: There is no MPC meeting scheduled for Mar. We expect BoK to keep policy rate unchanged at 1.75% at the upcoming MPC meeting on 18 Apr. Slowing pace of inflation, downside risks to global/domestic growth amid semiconductor down-cycle underway are some of the factors supporting the case for BoK to stay on hold. Interim pause in Fed tightening cycle also takes the pressure off BoK in tightening to prevent US-KR rate differentials from widening (fear of capital outflow). But the risk of Fed resuming rate hike (possibly by another 1 – 2 hikes this year) could bring back expectations of BoK move in 4Q 2019 – 1Q 2020.

- At the last MPC meeting on 28th Feb, BoK MPC voted unanimously to keep policy rate unchanged at 1.75%. Governor Lee again ruled out the option of a rate cut, maintaining that Korean monetary conditions are “accommodative” and they are lower compared to other markets. He added that exports have been falling in value terms owing to falling prices for semiconductors but volume of shipment has actually sustained a small increase.

- **Latest Fiscal and External Balance Outlook:** Current account surplus narrowed to 8-month low of $4.82bn in Dec (down from $5.06 in Nov). The decline was due to slowing exports. While current account surplus extended its run for the longest on record at 82 months, the surplus seen was the smallest since Apr 2018. Elsewhere services account deficit fell thanks to the jump in tourist arrivals.

- **Key domestic events and issues to watch:** S. Korea releases Feb exports (1 Mar); Mfg PMI (4 Mar); 4Q final GDP, Feb CPI (5 Mar); Feb FX reserves (6 Mar); Jan current account (8 Mar); Feb unemployment rate (13 Mar); Feb PPI (20 Mar); Mar consumer confidence (27 Mar); Feb industrial production (29 Mar).

- **Technical Outlook:** USDKRW traded higher for the month of Feb. Last seen at 1124 levels. Momentum indicators are not showing a clear bias for now. Price action since Aug-2018 continues to show a holding pattern in the range of 1110 - 1140. We see some chance of break-out play in due course. A compression of moving averages (21, 50, 100 DMAs) is seen around 1122 - 1125 levels. This typically precedes a break-out trade, which could happen either side. Immediate support at 1120 (200 DMA). Resistance at 1128 (downward sloping trend-line resistance from the highs in 2016, 2017, 2018 and 2019). Break above could see USDKRW test towards 1140 while a test below could see 1105/1110. We stay sidelined for now.

SGD: Still Poised For Further Upside

Forecast	1Q 2019	2Q 2019	3Q 2019	4Q 2019
USDSGD	1.3600 (--)	1.3400 (--)	1.3300 (--)	1.3500 (--)

No Change to Previous Forecast

- **Motivation for the FX View:** The SGD continues to enjoy a good run in Feb. The Fed's dovish pivot that is likely to slow further US rate hikes as well as market optimism that a Sino-US trade deal is within reach weighed on the USDSGD. The USDSGD has since breached the 1.35-levels and is currently hovering around the 1.3480-levels.

- News flow from the Trump administration painted an optimism picture of the ongoing trade negotiations between the two sides. This together with China's pump-priming to engineer a soft-landing has led to the collapse in the USDCNH premium over its 12-month forward. The yuan may thus not come under much depreciation pressure as before. Though no deal has been announced or even details of what could be on the table have emerged, the market is nevertheless pricing in a successful outcome to the trade talks between China and the US.

- This should bolster risk appetite and see increased demand for EM Asia risk assets and hence, EM Asia currencies. The slippage in the USDCNH 12-month forward suggests risks to the USDCNH are to the downside in 12-month ahead. Given that the USDSGD tracks the USDCNH 12-month forward closely, downside USDCNH moves should concomitantly drag the SGD lower, capping any significant USDSGD upside. Should the trade negotiation outcome not match market expectations though, we could see some unwinding of risk appetite, spurring a sell-off in risk assets and weigh on trade-related FX like the SGD.

- Our regression analysis confirms this close correlation between the USDSGD to the USDCNH. Our regression study with the SGDUSD as the dependent variable and CNHUSD as the independent variable showed that the SGD is among the most sensitive to moves in the CNH with a sensitivity of 0.60%. Thus, as concerns over China (trade war, hard-landing etc.) moderates, the SGD should be among the currencies to benefit.

- Weighing on the USDSGD as well is fading USD strength. Aside from rising optimism over Sino-US trade talks that had led to more risk-taking activities, the dovish pivot by the US Fed suggests that less aggressive rate adjustments can be expected in 2019. This could also possibly signal the end of the current rate cycle in the US which in turn could trigger a possible pause by the Fed in 2019. We could see some unwinding of stale long USD positions against its G10 peers and even the AXJs. A softer USD could lift the AXJs including the SGD higher.

- The SGD has also been kept buoyant by some market expectation for the MAS to tighten policy further at its Apr meeting. These participants point to the MAS keeping their core inflation forecast intact even as they revise downward its headline inflation forecast for the year as evidence of rising core inflationary pressures. Still with energy prices expected to stay relatively soft compared to 2018, core inflation might not see any significant upside and this could lead to some unwinding of long-SGD bets vs. short-USD, putting the USDSGD back on track to end 1Q around the 1.36-levels.

- Going into 2Q and 3Q, aside from the end of the Fed's tightening cycle, the peaking of the US economy, and US twin deficits (that could see a surge in US borrowing) – all of which could lead to softer UST yields and USD - are also likely to keep the USDSGD on a downward trajectory. Thereafter, global growth concerns could intensify in 4Q, triggering global risk-off and providing the USD with some support. This in turn could lift the USDSGD higher in the quarter.

- Still, we do not expect the USDSGD to slip aggressively lower in 2019. This is because **we now expect the MAS to remain on hold on policy after tightening moves at its Apr and Oct meetings last year. We expect the MAS to persist with its current slightly appreciation bias given that growth is expected to moderate and inflation to remain muted this year.** The two moves in Apr and Oct 2018 saw the MAS steepen the slope of the policy band of the SGD NEER to around 1% (our house estimates) from zero percent prior to accommodate expected stronger inflationary pressures. This has allowed the SGD NEER to trade around 1.13% above the implied mid-point of 1.3639 currently. This suggests that the SGD NEER trades on the stronger side vs. its trading partners. However, this could change in the coming quarters with the SGD NEER expected to slide lower below the mid-point by end-2019.

- Still healthy domestic economic fundamentals continue to underpin the SGD. The healthy budget surpluses of the past few years provide fiscal space for the government to accelerate its infrastructure programme, including development of Changi Airport Terminal 5 and the redevelopment and rejuvenation of the Jurong Lake District if necessary. The expansionary FY2019 Budget (for details see below) should stimulate the economy and mitigate downside risks to growth. Also ensuring that the SGD remains supported is its triple-A status and persistent high balance of payments surpluses. These fundamentals should provide the backstop to the SGD in 2019.

- We maintain our outlook for the USDSGD in 2019. The pair should end 1Q around the 1.36-levels before trade optimism and fading USD strength drag the pair lower to 1.34 and 1.33 in 2Q and 3Q respectively. Thereafter, concerns over a possible global economic slowdown could see USD strength re-emerge somewhat and lift the pair higher to 1.35-levels to end the year.

- **Growth and Inflation Outlook:** Final 4Q GDP came in below expectations, dragged lower by the trade-oriented services sectors amid a slowing global economy and the US-China trade war disruptions. Economic growth eased to +1.9% in 4Q (vs. adv. est. of +2.2% and +2.4% in 3Q), weighed by services that offset the improvement in manufacturing and construction. The services sector growth slowed to +1.8% y/y in 4Q vs. 3Q's +2.7% due to a slowdown in trade and tourism-related services. The bright spot in services were finance & insurance and infocomm, which rose +4.1% and +6.1% y/y respectively in 4Q (vs. 3Q: +3.9% and +5.4%). Manufacturing expanded by +5.1% y/y in 4Q, better than 3Q's +3.5%, though some weakness and contraction in 1H is expected given fading global demand for semiconductor demand. Construction looks set to recovery, declining by just -1.0% y/y compared to adv. est. of -2.2%. On a q/q seasonallyadjusted annualised basis, GDP rose by +1.4%, a pace similar to 3Q. For the whole of 2018, GDP rose by a more moderate +3.2% compared to +3.9% in 2017.

- Looking ahead, the first decline in 13 months in industrial production (IP) in Jan – down -3.1% y/y, suggested that manufacturing growth could be a tale of two halves. Our economic team is penciling a brief manufacturing downturn in 1H, including a negative 1Q. A more sanguine 2H is likely should a Sino-US trade deal be reached as we expect. Still, the team believes risks to GDP is to the downside and maintains its recently downwardly revised GDP forecast of +1.8% (from +2.2%) in 2019 and 2020 forecast of +2.1%. The team's forecast is at the lower end of MTI's 1.5-2.5% forecast range.

- Headline and core inflation moderated to start the new year amid easing electricity & gas cost that mitigate the uptick in services inflation. Headline inflation edged lower to +0.4% in Jan (vs. +0.5% in Dec) while core inflation softened to +1.7% (vs. +1.9% in Dec). Electricity & gas prices slowed to +6.5% y/y in Jan from Dec's +14.6% as Brent oil prices slipped lower to averaged USD68/bbl in 4Q 2018 from USD76/bbl in 3Q. On the bright side, services inflation inched up to +1.7% (vs. +1.5% in Dec), mainly on the back of the +4.3% increase in public transport fares since 29 Dec 2018. Food inflation (+1.4%) though stayed unchanged for the fourth month. Given the sharp decline in global oil prices, MAS has revised downwards its headline inflation forecast range for 2019 to 0.5% to 1.5% (from previous 1% to 2%), and kept its core inflation forecast range at 1.5% to 2.5%. In contrast, our economic team maintains its forecasts for both headline and core inflation in 2019. The team expects muted price pressures in 2019 as Sino-US trade war presents downside risks to growth and inflation. Base effects are likely to help headline inflation edge higher to average +1.2% in 2019 from +0.4% in 2018. Core inflation should moderate to +1.6% in 2019 vs. 2018's +1.7% on contained energy prices.

- **Monetary Policy Forecast**: The MAS had tightened monetary policy at both of its semi-annual policy meeting last year. The MAS moves in 2018 steepened the slope of the SGD NEER policy band by 1.0% in total (our assumption given the absence of information from the MAS). This should allow for a stronger SGD on a trade-weighted basis to mitigate the expected climb in core inflation in 2019 and anchor inflationary expectations. MAS had revised its headline inflation forecast lower but maintain its core inflation forecast range at 1.5-2.5% for 2019, suggesting that it sees upside risks to core inflation this year. Thus, further tightening moves cannot be ruled out but any adjustments by the MAS will be data-dependent according to the MAS central bank managing director Ravi Menon.

- Nevertheless, this is not our base case. We maintain our view that the MAS is unlikely to move again at its Apr 2019 meeting after the two tightening moves at its Apr and Oct meetings last year. Instead, we expect the MAS to leave its policy stance unchanged and maintain its current slightly appreciation bias. This is because growth is expected to moderate with MAS expecting growth to come in at nearly 2.5% in 2019 from last year's +3.2%. Mr Menon added that the more moderate growth will be "more sustainable and closer to the economy's potential growth path" and core inflation to come in within the MAS projected forecast range. Our economic team expects core inflation to average +1.6% in 2019, moderating from 2018's +1.7% and has revised economic growth lower to +1.8% (from +2.2%) for 2019 vs. +3.2% in 2018.

- The USDSGD trades below the 1.35-levels around 1.3485 at the point of writing, coming gradually off its 2019 high of 1.3680 on 3 Jan, helped by the Fed's dovish pivot and improving prospects for a Sino-US trade deal. Softer USDSGD though should moderate the increases in domestic interest rates. Domestic interest rates though have remained elevated, particularly the 3-month SOR (3MSOR), which hit a 10-year high of 2.0253% on 23 Jan that remains unmatched in the year so far. The 3-month SIBOR (3MSIBOR) climbed to 1.9502% on 27 Feb - a new high for 2019 as domestic liquidity continues to tighten. For now, there does not appear to be any signs that increases in the 3-month SOR and 3-month SIBOR will stall as the withdrawal of monetary stimulus in the advanced economies continues. We are now gradually seeing mortgage rates climb in tandem to the rise in domestic rates. Deposit rates (for 12-month fixed) are edging higher as well, currently at 0.45% since end-Dec 2018. This suggests that risks related to interest rate increases affecting financial and economic stability, particularly in interest rate- and property-related sectors, are picking up. We expect the 3MSIBOR and 3MSOR to edge higher to 2.37% and 2.25% respectively by end-4Q 2019. For 1Q 2019, we are penciling the 3MSIBOR and 3MSOR to come in at 2.05% and 1.93% respectively.

- **Latest Fiscal and External Balance Outlook:** The FY2019 budget is expansionary with the primary deficit projected at SGD5.4bn (1.1% of GDP). This comes at the back of an increase in projected expenditure to SGD1.3bn to SGD80.3bn, and operating revenue by SGD1.2bn to SGD74.9bn. The overall deficit is penciled to come in at SGD3.5bn (0.7% of GDP) due to the record-high special transfers of SGD15.3bn (FY2018: SGD9bn) in the FY2019 budget.

- The bulk of the special transfers was to healthcare under the SGD6.1bn Merdeka Generation Fund & SGD5.1bn Long-Term Care Support Fund. There was also a SGD1.1bn Bicentennial Bonus (GST Voucher, Workfare bonus, personal income tax rebate capped at SGD200, Edusave & CPF top-up) for Singaporeans. In terms of policy, aside from tighter foreign labour measures, the budget also highlighted plans by the government to invest in national security and infrastructure. The budget for defence, home affairs and foreign affairs collectively is projected to grow +3.4% in FY2019. As for infrastructure spending, the government will provide a guarantee for Changi East loans for the airport expansion with the concurrence of the President. Another SGD2bn was set aside for the Rail Infrastructure Fund for MRT projects. Other highlights included the SGD100mn SME Co-Investment Fund III, hike in diesel taxes and tightening GST relief for travelers.

- The current account surplus narrowed to SGD17.80bn in 4Q 2018 from USD24.69bn in 3Q. The larger current account gap can be attributed to the larger deficits in the trade services balance (4Q: -SGD2.11bn vs. 3Q: -SGD0.40bn) and primary income account (4Q: -SGD10.34bn vs. 3Q: -SGD7.03bn). The capital and financial account deficit also widened to SGD21.31bn in 4Q from SGD18.31bn in 3Q due largely to the large portfolio outflow of SGD25.14bn (3Q: +SGD6.24bn) and outflow from financial derivatives of SGD4.44bn (3Q: -SGD1.73bn). Consequently, the overall balance of payments slipped into a deficit of SGD3.91bn in 4Q compared to a surplus of SGD6.22bn in 3Q. For the full-year, the current account surplus ballooned to SGD86.20bn in 2018due to the larger surplus in the goods and services account. The capital and financial account deficit also ballooned to SGD67.79bn, aided by the larger outflow from the “others” account (-SGD73.63bn). The overall balance of payments narrowed to SGD16.92bn in 2018 vs. 2017’s SGD37.84bn.

- **Key domestic events and issues to watch:** CPI and industrial production data for Feb on 25 and 26 Mar will be among the last data point that could provide clues to the MAS policy decision at its semi-annual policy meeting in Apr.
- **Technical Outlook:** USDSGD’s early-Feb gains were retraced into end-month. Last seen at 1.3490 levels. Underlying momentum remains mild bearish bias. 100 DMA looks on track to cut 200 DMA to the downside – another bearish signal. However near term risks appear skewed to the upside; stochastics on daily chart shows signs of turning from oversold conditions. Support at 1.3440 (50% fibo retracement of 2018 low to high) before 1.3340 (61.8% fibo) and even 1.3210 (76.4% fibo). Resistance at 1.3540 (38.2% fibo), 1.3570 (50 DMA), 1.3660 (100, 200 DMAs, 23.6% fibo). Bias to lean against strength.

MYR: Catching Up with EM Asia Upside

Forecast	1Q 2019	2Q 2019	3Q 2019	4Q 2019
USDMYR	4.0500 (--)	4.0000 (--)	3.9800 (--)	4.0600 (--)

No Change to Previous Forecast

- **Motivation for the FX View: Motivation for the FX View:** In line with most other regional currencies, the MYR strengthened slightly by around 0.8% against the USD in the month of Feb (relatively strongest among regional currencies). It reached a low of 4.0627 on 11 Feb. MYR could potentially in part be supported by Brent crude oil price moving higher to above $65/bbl. At the same time, crude palm oil prices which fell around 7% in Feb is expected to see a turnaround, potentially contributing to the MYR support.
- We now see some MYR appreciation vis-à-vis the dollar, coming onstream earlier than expected consistent with our USD weakness view in 1H 2019 and for the medium term. Over the next 3-6 months

or so we expect USD/MYR could potentially approach 4.00 and potentially breach in 3Q, if regional currencies strengthen relative to the USD and risk factors dissipate. Overall though, domestic policy uncertainty risk may still somewhat weigh on the MYR despite solid fundamentals. Recent market concerns about the revised higher budget deficit and concerns about its impact on the bond market and concerns about potential ratings outlook revisions could play a part in weighing on the MYR.

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

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

- In addition, our economics team sees rising likelihood that the BNM could keep rates on hold until 2019 to support domestic demand especially consumer spending.

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

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

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

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

- Recent data showing weak export performance in late-2018 that is likely to spill into early-2019. This is due to the fallout from the earlier US China trade war escalation as the effect of front-loading in shipments to beat the "tit-for-tat" tariffs between US and China dissipated. However, trade/current account surplus is sustainable to keep trade flows supportive of external reserves. This is because softer exports will also translate into softer imports given that nearly 80% of imports are correlated to exports i.e. imports of intermediate goods - including inputs for exports - and imports for re-exports. In addition, other flows should also be supportive of external reserves e.g. proceeds from the issuance of Samurai bond by the Government of Malaysia in Mar 2019 totaling JPY200b (~USD1.8b) and Khazanah's sales of 16% stake in IHH Healthcare Bhd. to Japan's Mitsui & Co. Ltd.

- **Growth and Inflation Outlook:** The index of leading economic indicators fell -1.7%y/y in Dec 2018 and -1.5%y/y in 4Q 2018. This suggests slower growth in this quarter. We look for seasonal distortion due to the Lunar New Year holidays that reduces the number of working days and also inventory unwinding to crimp on the growth momentum. Hence, we look for Sub-5% quarterly growth momentum is likely to extend into 1Q 2019 and we maintain our full-year 2019 growth forecast at +4.9% (average).

- Latest update in exports reveals a pick-up to +4.8%y/y in Dec vs previously +1.6% which is a contrast to export declines across the region. Imports slowed to +1.0%y/y in the month resulting in a wider trade surplus to MYR10.4bn. Malaysia's relatively resilient export performance vs peers may well reflect the diversified export structure that is not too concentrated on particular product or commodity. The exports growth for 2018 stands at +6.7%y/y and imports at 4.9%. We look for moderation to 4.0%y/y and 3.7%y/y respectively in 2019 as global growth slows. This is also base on the assumption that there is a "basic" US-China trade deal to materialize to mitigate downside risks on overall external trade growth.

- While BNM acknowledges that global growth momentum is moderating as trade tension impact materializes with risks to growth tilted to the downside, it expects the Malaysian economy to remain on a steady growth path on the back of private sector demand amid lower public spending and softer external demand. To note, the official real GDP growth forecast for 2019 is 4.9% vs the estimate of 4.7% for 2018. BNM also expects inflation to be moderately higher in 2019 after the 1.0% rate recorded in 2018. Official inflation rate forecast for 2019 is 2.5%-3.5%. Monetary Policy Statement's (MPS) conclusion is the same as previous MPS, signaling no imminent policy change i.e. at current OPR level, the degree of monetary accommodativeness is consistent with intended policy stance, and the MPC will continue to monitor and assess the balance of risks surrounding the outlook for domestic growth and inflation.

- CPI undershot expectations with a print of -0.7%y/y vs. the already contractionary consensus of -0.4%. The core measure rose 0.2%y/y. Price pressure was greater in the food/beverage subcomponent, up +1.0%y/y vs. previous 0.7%. In contrast, "transport" subcomponent recorded a rather sharp decline of -7.8%y/y, falling at a faster pace from the previous -2.0%. There was also notable declines in clothing/footwear, furnishings/household, health, communication, recreation and miscellaneous, likely due to the softer crude price seen in Jan vs. a year before. We see deflation in consumer prices to continue in the early months of 2019 with gradual pick-up in 2H 2019 to average +1.5% for the year. We cut our inflation forecast from +2.1% to 1.5% for 2019. The still benign inflation outlook reflects the broadening of Sales Tax and Service Tax (SST) base, Budget 2019's new taxes (Soda Tax, Airport Departure Levy), hikes in minimum wage and utility costs, and lower global crude oil prices hence domestic retail fuel prices.

- **Monetary Policy Forecast:** BNM meets on 5 Mar and we see no change to the OPR at this one or anytime in 2019. Downside risk to OPR is contingent upon real GDP growth, which we forecast to expand by 4.9% this year (2018E: 4.7%). The slightly better but still sub-5% growth reflects our expectations of a US-China trade deal to mitigate the downsides to global growth and trade, hence Malaysia's external demand and trade-oriented manufacturing and services sectors. In addition, we expect recoveries in mining and agriculture sectors this year via normalization in palm oil and natural gas output after last year's contractions that dragged headline GDP growth. To note, OPR movements is highly influenced by real GDP growth movements since 2014 i.e. OPR hike when growth picked up to >6% YoY and OPR cut when growth threatened to go <4% YoY.

- At the last meeting 23-24 2019, BNM kept the Overnight Policy Rate (OPR) at 3.25% unchanged for the sixth consecutive meeting since the +25bps hike a year ago. The monetary policy statement was roughly the same as previous ones, suggesting no imminent policy change.

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

- In fact, on 7 Dec 2018, Moody's reaffirmed Malaysia's investment-grade sovereign credit rating of "A3" and the "Stable" rating outlook. The rationales for the reaffirmations in credit rating and rating outlook reflect Malaysia's credit profile strengths i.e. (1) Diversified economy and resilient growth; (2) Stable financing conditions and deep domestic capital market arising from large domestic institutional investor base that mitigate risk from sizeable non-resident presence in domestic financial market, especially the foreign holdings of Government bonds i.e. 38.8% of total Malaysian Government Securities (MGS) and 24% of total MGS and Government Investment Issues (GII) as at Nov 2018; (3) Sustained current account surplus; (4) Institutional framework that include sound monetary policy and Government's commitments to improve transparency, accountability, governance as well as checks and balances in the public sector.

- But fiscal situation remains challenging. However, Moody's cautioned that Malaysia's fiscal strength has weakened as fiscal policy flexibility and debt affordability are constrained. Government debt to GDP ratio of 52.8% (including 1MDB debt) and its debt servicing or interest payments of 13.1% of revenues estimated for 2018 are above the medians of 39.7% and 4.7% respectively for Moody's A-rated sovereigns.

- Moody's also highlighted potential catalysts for upgrade and downgrade in rating. Rating upgrade factors include significant increase in scope for and speed of fiscal consolidation (e.g. measures that broaden revenue base). Rating downgrade factors include economic growth shock that adversely affect fiscal conditions via negative impact on revenue and limited scope for expenditure cuts. Moody's also cautioned that rising political tensions and divergences in view within the Government could undermine fiscal policy effectiveness and delivery of other policy pledges like on transparency, governance and corruption.

- Credible measures to broaden tax revenue base are important. Moody's is of the opinion that Budget 2019's tax and non-tax measures like broadening the Services Tax, reviewing property-related tax (RPGT, stamp duty), introducing "minor" new taxes ("Sugar Tax"; airport departure levy) as well as asset monetization (Airport REIT, land sales) are not sufficient and sustainable means to widen the revenue base.

- **To achieve the Medium-Term Fiscal Framework target of lowering budget deficit to GDP ratio over the next 3 years.** Meanwhile, rating reviews of other major international rating agencies (S&P, Fitch) are still pending. And we expect crude oil price to stay volatile, hence our assumption of USD65/bbl average in 2019 against Budget 2019's assumption of USD72/bbl average. These are the posers the Government's mid-term target of steadily lowering budget deficit to GDP ratio from -3.7% in 2018 to -3.5% in 2019, -3.0% in 2020 and -2.8% in 2021 followed by the longer-term aim of around -2.0%. In the interim, PETRONAS strong cash position currently should help the Government to forestall any need to recalibrate Budget 2019 despite the recent fall in crude oil price – unlike what happened to Budget 2016 that had to be recalibrated in Jan 2016 after its tabling in Oct 2015 as crude oil price plunged 60% from USD66/bbl in early-May 2015 to a low of USD26/bbl in Jan 2016, against the Budget 2016's crude oil price assumption of USD48/bbl. Thus a key lookout for 2019 is the Tax Reform Committee's (TRC) recommendations and proposals for tax system reforms and overhaul. The TRC was "operational" in Sep 2018 and is expected to complete its task by mid2019.

- **Key domestic events and issues to watch:** FX reserves (7 & 22 Mar); Industrial Production (14 Mar); CPI (20 Mar), BNM Policy Meeting (5 Mar).

- **Technical Outlook:** Our call for USDMYR to trade lower towards 4.0690 more than materialized. Pair traded a low of 4.0615 (25 Feb); last seen at 4.0715. Bearish momentum on monthly and weekly chart remains intact. Bias for downside play remains intact but near term rebound risks not ruled out. Resistance at 4.08 (21 DMA), 4.0950 (200 DMA). Bias to sell rallies. Support at 4.0690 (38.2% fibo retracement of 2018 low to high) needs to be broken before 4.06, 4.05 levels.

IDR: Bulls Could Still Take Charge

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

No Change to Previous Forecast

- **Motivation for the FX View:** The USDIDR's downtrend since end-Oct 2018 appears to have hit a roadblock in Feb. The pair has bounced off the 2019 low of 13895 to hover within the 13950-14160 range at the point of writing as concerns about its current account deficit re-emerged. The widening of the current account gap to 3.6% of GDP in 4Q 2018 from 3.3% in 3Q – the largest gap since 2014 - spooked markets, spurring some unwinding of long-IDR positions vs. the USD. We expect this roadblock to be temporary with the USDIDR still likely to return to its downward trajectory in the next month and for most of 2019.

- Our optimism is premised on the efforts undertaken by both the BI and the government to reduce the current account gap, including import tightening measures, some moderation in infrastructure spending, steps to promote tourism and the delivery of 175bp of rate hikes. In addition, foreign investors have also not given up Indonesia. Their sale of USD145.7mn in equities in Feb though was more than offset by their purchased of USD1.38bn in government bonds. Efforts to reduce the gap should add to sentiment and help the USDIDR return to its downward trajectory.

- Further impetus for the USDIDR to move lower should come from diverging yield differentials between Indonesian bonds and UST. The Fed's dovish pivot – which signaled less aggressive rate adjustments ahead – should weigh on UST yields, possibly spurring yield seeking activities which benefits the IDR. At the same time, rising optimism of Sino-US trade deal is supportive of risk sentiments. Together, these should buoyed demand for riskier assets and lift the AXJs including the IDR higher.
- Our enthusiasm for further downswings in the USDIDR also comes from our study of the moves in the IDR in the lead-up to the presidential elections. In the 100-days prior to the presidential elections, the IDR tend to appreciate – typically strengthening by an average 10% in the last two elections. Campaign spending and pre-election promises should buoy sentiments and put upside risks to the IDR in the lead-up to the elections.
- Market volatility is likely to increase as the 17 Apr Presidential and general elections draw closer. Currently, the opinion polls point to strong support for Jokowi but the situation remains fluid with any mis-steps by the Jokowi campaign or waning support for Jokowi could shake market confidence and keep the USDIDR elevated. Our house view is for a Jokowi to win at this juncture, which should ease upside pressure on the USDIDR post-elections. With a proven track record, a Jokowi win will be market positive and should encourage further inflows on expectations that Jokowi and his economic team will follow-through with further fiscal policies that will ensure not only economic growth but tame the twin deficits as well.
- Some of the measures that are likely to be implemented should Jokowi get re-elected include tax reforms (of tax rule revision to support the property sector, removing value-added tax on some service exports, revising corporate taxes for coal miners, etc.) and changes to the "Negative Investment List" to open up previously partly closed sectors to foreign ownership. There could also be an extension and expansion of import tightening measures (including tariffs) and measures to encourage exports to curb the current account deficit (CAD). Other measures already announced included intensifying the use of biodiesel to reduce import of oil given its status as a net oil importer. All of these are positive for the IDR, and could potentially lead to a repricing of Indonesian assets and spur greater inflows.
- After 175bp of moves in 2018, it is unlikely that BI will hike the policy rate by the same quantum this year. The Fed's shift to a more dovish stance and the stability in the IDR amid a benign inflationary environment should provide BI will policy space to slow the pace of rate hikes. While some market analysts are convinced that the current tightening cycle has ended, we are not of this camp. We expect the BI to hike by a further 50bp hike to match the Fed's expected two moves in 2019. Still, should volatility in the IDR increase due to ECB policy normalisation or a step-up in Fed rate hikes, BI is likely to step-in and adjusts its policy rate as necessary. Central bank credibility and policy certainty should provide support for the IDR and keep the USDIDR on a downward trajectory in 2019.

- We maintain our USDIDR forecast for now, expecting the pair to end 1Q around 13400 still and then to 12900 and 12700 in 2Q and 3Q respectively before bouncing mildly higher to 12900 in 4Q as growth risks in the 4Q could provide some support for the USD.

- **Growth and Inflation Outlook:** Real GDP growth expanded by +5.18% y/y in 4Q 2018, just a tad faster than the +5.17% recorded in 3Q. Growth was largely supported by private consumption and investment, which rose by +5.08% and +6.01% respectively in 4Q (3Q: +5.0% and +6.96%). Net exports remained a drag on growth with exports and imports growth slowing to +4.33% and +7.10% respectively in 4Q from +8.08% and +14.02% in 3Q. For the full-year, the economy expanded by a faster +5.17% in 2018 than the +5.07% seen in 2017. For 2019, the impact of the 175bp of rate hikes by the BI should take some toll on consumption and investment. The government's move to raise taxes to curb imports and the BI's rate hikes last year is likely to manifest in slower GDP growth in 4Q. At the same time, plans to hold back some import-heavy infrastructure projects and to curb imports of luxury consumer goods could stem investment and consumption expenditure. The failure of consumption to backstop GDP growth could see growth wane into 2019. Nevertheless, we do not believe that the government will allow growth to falter especially in the run-up to the Presidential and general elections in 17 Apr 2019. Campaign spending as well as ongoing reconstruction efforts following the devastating earthquake and tsunami in 2018 should lift consumption. For 2019, our economic team projects growth at 5.14%, a slightly moderation from 2018.

- Inflation failed to gain traction at the start of the new year. Headline inflation rose by just 2.82% y/y in Jan – the slowest pace of price gains since Aug 2016. The slow pace of price gains was driven mainly by a deceleration in food prices (Jan: 1.98% vs. Dec: +3.41%). Supportive of consumer prices were housing and transport cost, which edged higher by 2.48% and 3.28% respectively in Jan (Dec: 2.43% and 3.16%). Core inflation was little changed, rising 3.06% y/y in Jan compared to 3.07% in Dec as the rise in the administered prices (of 3.39% y/y) continued to be mitigated partially by the more moderate increases in volatile and energy prices. The government's move to curb imports and the current account deficit should prove to be deflationary. The 7.5% tariff on around 900 consumer goods should reduce demand for imported goods and put downside pressure on prices. After averaging 3.20% and 2.81% for the whole of 2018, our economic team expects headline and core inflation to come in around 3.44% and 3.08% respectively in 2019. The forecasts are well-within the BI's target range of 2.5 and 4.5% for 2019.

- **Monetary Policy Forecast:** There were no surprises at the BI's policy meeting on 20-21Feb. The BI left its benchmark policy rate unchanged at 6.0% yesterday as expected. The deposit and lending facility rates similarly left unchanged at 5.25% and 6.75% respectively, keeping the interest rate corridor at 75bp on either side of the policy rate. The dovish pivot by the Fed and the stability in the IDR have provided the BI with policy space to hit the pause button.

- Post-decision press conference suggested that BI could hit the pause button for an extended period given the Fed's dovish pivot and stable

IDR. Though the BI appeared less hawkish than at previous meetings (BI governor did not reiterate his “pre-emptive, frontloaded and ahead of the curve” mantra at the briefing), this does not necessarily signal the end of the current tightening cycle. The recent Fed minutes suggests that rate hikes are still live, and this keeps our economic team’s expectations for two more Fed rate hikes this year intact. This in turn supports our house view for the BI to hike rates twice more by 25bp each time to match the Fed’s move expected in 2Q and 3Q.

- **Latest Fiscal and External Balance Outlook:** The country was off to a good start managing its finances. Total revenue from taxes came in at IDR82.6tn in Jan – 5% of the 2019 target with IDR86tn coming from tax revenue including oil and gas, IDR6.3tn from corporate income tax and IDR29.3tn from VAT. As for expenditure, IDR76.1tn was spent in Jan – 47% of full-year expenditure target. This resulted in the budget deficit coming in at IDR45.8tn in Jan or just 0.28% of GDP.

- The current account deficit (CAD) widened to a record USD9.1bn (3.57% of GDP) in 4Q 2018 that had not been seen since 2014. In comparison, 3Q deficit had come in at USD8.6bn (3.28% of GDP). The record deficit can be attributed the record deficit in the good account of –USD2.58bn, which reinforced the deficits in the services account (-USD1.62bn) and the income accounts (-USD4.5bn). The overall balance of payments though remained in surplus of USD5.42bn due to the surplus in the capital and financial account of USD15.68bn. For the full-year, CAD came in at USD31.1bn (2.98% of GDP), while the capital and financial account ended in a surplus of USD25.20bn, resulting in an overall balance of payments deficit of USD7.13bn the first deficit in three years. Still, both the government and BI remained sanguine regarding the prospects for a lower CAD. Moves to curb the CAD through import restrictions and tariffs as well as boosting tourism among others are expected to help narrow the current account gap. For 2019, the BI is targeting a CAD of 2.5% GDP. Similarly, our economic team is also looking for the CAD to narrow to 2.50% of GDP in 2019.

- **Key domestic events and issues to watch**: Focus in Mar will be on BI’s policy meeting on 20 and 21 Mar for any dovish pivot in its policy stance.

- **Technical Outlook:** USDIDR consolidated around 14000 levels following the >8% decline since Oct-2018 high. Pair was last seen at 14080 levels. 100 DMA longs on track to cut 200 DMA to the downside – another bearish signal. Support at 14000, 13910 needs to be decisively for further downward play to gain momentum, possibly towards 13745, 13660 (200 DMA). Failing which the cross may consolidate with some near term technical rebound risks. Bearish momentum on weekly chart shows signs of waning while stochastics shows signs of turning higher from oversold conditions. Resistance at 14222 (23.6% fibo retracement of Dec high to Feb low) before 14425 (38.2% fibo).

PHP: Hawkish BSP, Positive Risk Environment Buoys

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

No Change to Previous Forecast

- **Motivation for the FX View:** The optimism we had seen in the PHP in Jan extended into Feb. Market optimism that Sino-US trade war will dissipate and fading USD strength underpinned by a dovish Fed together with effective domestic fiscal and monetary policies have kept the PHP buoyant. We maintain our outlook for the USDPHP over the forecast horizon. We expect the pair to end 1Q around 52.80 levels and pick-up as political risks mounts in the lead-up to the elections with the pair seen around the 53.30-levels by end-2Q. Thereafter, we expect the pair to ease to 53-levels as political clarity re-emerges post-election. Concerns over a possible global economic slowdown could see USD strength re-emerge somewhat and lift the USDPHP higher to 53.50 by end-4Q 2019.

- The potential for a trade deal between China and the US should be positive for risk sentiments and bolster the AXJs as demand for riskier assets increases. In the Philippines, this is likely to manifest itself in greater inflows into equities. So far in Feb, foreign investors have purchased USD106.6mn in equities, a moderation from Jan's USD355.93mn. Continued inflows into Philippine equities should be supportive of the PHP.

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

- At the same time, the BSP's move to raise its policy rate by 175bp to anchor inflationary expectations has shown results with the peaking of inflation in Oct/Nov 2018. The commitment of the central bank to keep policy in place until price stability returns is positive for the PHP. The still "hawkish bias" put downside pressure on the USDPHP.

- Still, USDPHP move lower is unlikely to be a straight line. Slide in the pair could face constrains from its twin deficits, particularly the current account deficit. So far, the focus on the government's ambitious infrastructure building programme is likely to keep the current account in deficit in 2019. In addition, trade disruption caused by the Sino-US trade war had weighed on external demand, worsening the trade deficits. The saving grace is that oil prices are likely to average USD65/bbl in 2019, down from its 2018 average of USD71/bbl, possibly providing some relief to the current account deficit. Further deterioration in the current account deficit should weigh on the PHP, and limit the pair's move lower.

- **As we had previously highlighted, the USDPHP should remain elevated in 1Q and 2Q as some political uncertainties could manifest in the lead up to the general elections on 13 May 2019. This election will see 12 seats in the Senate and all seats in the House of Representatives as well as all regional, provincial, city and municipal positions up for grabs**. Should the opposition win a majority of the seats in both Houses of Congress, they could effectively block the parliamentary agenda of President Duterte who would be mid-way through his one-term in office. The uncertainty in the lead-up to the elections could force investors to sit on the side-lines until clarity in the political environment emerges. Our study of the past two mid-term elections showed that the PHP typically depreciates in the days before the elections and continues to soften even after. We therefore can expect the USDPHP to come under stress in the lead-up to the elections in 2Q before easing off in 3Q as political clarity emerges.

- **Growth and Inflation Outlook:** After moderating in 2018, the economy is expected to pick-up pace in 2019 as higher investment, government spending on infrastructure and policy measures to boost enterprises. According to the Finance Secretary, FDI had hit USD89.1bn in the first 11 months of 2018, just a tad off the pace of 2017 which saw a record FDI inflow of USD10bn. Faster pace of government disbursements like in 2018 should also be supportive of growth in 2019. At the same time, the Comprehensive Tax Reform Program (CTRP) should help to fund the government's infrastructure program and increase Filipinos' spending power. The second package of the CTRP when is passed should prove favourable to corporates (via corporate tax reform and rationalization of tax incentives) and lift investment. Not surprisingly, the government is sticking with its growth target of 7-8% for 2019, while our economic team maintains its 2019 growth forecast of +6.5%.

- Headline inflation moderated in Jan (base year = 2012), rising by 4.4% y/y in Jan (Dec 2018: +5.1%) underpinned by still slower increases in food prices (Jan: +5.6% vs. Dec: +6.7%) and transport costs (Jan: +2.5% vs. Dec: 4.0%). Aside from favourable base effects, government policies to increase supplies of food items particularly rice have helped to dampen food price increases. Meanwhile, softer oil prices in Jan weighed on domestic petrol and diesel prices. Core inflation (which excludes selected food items such as rice, meat, fruit and vegetables as well as energy prices from CPI) also eased to +4.4% y/y in Jan compared to +4.7% in Dec. In view of the easing CPI prints amid easing global oil prices, The BSP has revised downward slightly to +3.1% for 2019 from +3.2% previously but kept its 2020 inflation forecast intact at +3.0%. Our economic team maintains its 2019 and 2020 inflation forecasts of +3.0% and 2.8% respectively.

- **Monetary Policy Forecast:** The BSP met for its first monetary policy meeting on 7 Feb. For the second successive meeting, the BSP left its benchmark overnight borrowing rate unchanged at 4.75% after lifting rates by a cumulative 175bp in 2018. The interest rate corridor was also left intact with the overnight lending and overnight deposit rates at 4.25% and 5.25% respectively, leaving the interest rate corridor symmetrical on either side of the policy rate by 50bp.

- The BSP again hit the pause button on its benchmark interest rate amid the peaking of inflation in Sep-Oct 2018 and stable PHP. The use of non-monetary measures to curb inflationary pressures, including increasing supplies of key food items and improving their distribution, have provided the BSP with some policy room to stay on hold for now. Nevertheless, the pause did not signal the end of the current tightening cycle. Deputy Governor Diwa Guinigundo stressed that the central bank's bias remains hawkish and that it was not ready to cut interest rate just yet. The BSP remains on its toes as risks on the market persist, especially the potential for oil prices on the rise again. Thus, the central bank could be set for a prolonged pause in policy. Our economic team shares this view and believes that the BSP is in no rush to make any changes to its monetary policy stance until inflation is firmly entrenched within its 2-4% target range. The team expects the BSP to keep its policy rate steady for the rest of the year at 4.75% before embarking on 75bp of cuts in 2020 to bring the benchmark policy rate to 4.0 amid peaking of the Fed rate hike cycle in 2019 and downside risks to global growth over the medium term.

- As for a reduction in required reserve ratio (RRR), the BSP is waiting for the right time to do take action so as to ensure that its action will not dislodge inflation expectations. Our economic team though expects the central bank to cut the RRR by a steady pace of 200bp p.a. in 2019-2020 – the same quantum as in 2018 as part of its monetary policy reform. This could fulfil the late BSP governor's goal of reducing the RRR to single digit.

- **Latest Fiscal and External Balance Outlook:** The budget deficit for 2018 widened to PHP558.3bn from PHP350.6bn in 2017. The deficit at 3.2% of GDP is higher than the target of 3% set for 2018. The deficit was underpinned by the rise in expenditure by 21% to PHP3.41tn (target: PHP3.37tn) that more than offset the 15% rise in revenue of PHP2.85tn. The overshoot in the budget gap is worrying analysts at Moody's, who are concerned that this could lead to higher debt or to a reversal in the improvement of debt affordability. Moody's is monitoring the deficit gap for signs of further deterioration. For 2019, the deficit target has been set by the government at 3.2% of GDP due to several major infrastructure projects including a subway in the capital and a commuter rail across the main island of Luzon that is like to widen the shortfall this year. Still, the Finance Secretary is confident that budget shortfall will be kept in check and that this deficit target was "certainly very manageable".

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

- **Key domestic events and issues to watch:** Key event in Mar that will be closely eyed will be BSP policy decision on 21 Mar for any pivot from its current 'hawkish' stance.

- **Technical Outlook:** USDPHP traded lower, in line with our bias for downside play. Pair was last seen at 51.73 levels. Bearish momentum on monthly, weekly and daily chart remains intact. Next support at 51.52 (61.8% fibo retracement of 2018 low to high). Resistance at 52.10 (50% fibo). Bias to add to short USDPHP.

THB: Temporary Weakness As Politics Takes Centre-Stage

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

No Change to Forecast.

- **Motivation for the FX View:** After starting the year on a strong footing, the THB is now on the backfoot as politics takes centre-stage. The THB has gone from being the best performing currency in ASEAN to the worst performer in Feb. The THB dip against the USD could have been worse if not for the USD412mn purchase of Ramkhamhaeng Hospital Pcl by a Singapore-registered company that provided support for the THB between 14-20 Feb. As the impact of the cross-border purchase faded, so did THB strength. In the month ahead, there could be more upside pressure on the USDTHB, albeit temporarily, as political risks returns to the forefront. We expect the USDTHB to climb higher from current levels to the 32.00-levels by end-1Q as political tension mounts.

- Consequently, there could be some re-allocation of assets away from Thailand in 1Q as political tensions re-emerges in the run-up to the general elections on 24 Mar. Political temperature is expected to rise, particularly if the Thaksin-linked political parties are pick-on by the authorities in the lead-up to the elections. Already, the Constitutional Courts will deliver its ruling on a petition to dissolve the Thai Raksa Chart Party for involving royalty in politics that could be a trigger point for Thaksin and Red-Shirt supporters to vent their frustrations at a system gamed against them. This should keep investors on the sidelines until political uncertainty dissipates.

- Our study of the past two mid-term elections suggests as much with the THB typically depreciating in the days before the elections but recovers thereafter as the political uncertainty clears post-elections. We therefore can expect the USDTHB to come under upside pressure in the lead-up to the elections before easing off to hover lower in 2Q.

As we have flagged previously, our study on the price action of the THB in the 100 days preceding the elections suggests that the USDTHB could climb higher. The tendency for political temperature/tensions to rise ahead of elections due to fractious politicking by different interest groups coupled with the possibility that the Thai Raksa Chart Party could be disbanded could lift risk premium and weigh on the THB.

- Our base scenario for the 24 Mar general elections is for no single party (especially the Democrats or Pheu Thai Party) to win a simple majority in parliament to form a government given the new Constitution. Instead, a fractious parliament made up of smaller parties is likely, while the Senate will remain dominated by 250 members appointed by the military junta for the next five years. This should allow the military to retain influence in the government as no single party will be able to command a majority. We do not expect the Democrats or Pheu Thai to lead a coalition together to prevent the military-backed political parties from forming a government given the bad blood between the two parties. More likely than not, the Democrats or the Pheu Thai could try to convince the Future Forward Party to form a coalition with them. This could attract smaller parties to join their coalition and block one backed by the military. This uncertainty should keep the USDTHB supported.

- More likely than not, PM Prayuth should remain as PM as a result. We do not expect any change in economic policy direction and for the BoT to continue normalising policy in 2019. Some initial volatility is expected in the aftermath of the election but we expect the THB to stabilise and continue on its appreciation path thereafter.

- We could thus see the USDTHB pick-up in the lead-up to the general elections scheduled on 24 Mar. So far, volatility (as measured by USTHB 1 month at-the-money implied volatility) has edged higher in Feb to levels not seen since 15 Jan, while the USDTHB is moving in the opposite direction, highlighting the divergence between movements in the USDTHB and the 1-month vols. This could potentially leave the USDTHB vulnerable to playing catch-up as political tensions heighten.

- As we have previously flagged, the THB typically underperforms in the lead-up to the general elections but recovers post-elections, and there could be opportunities to buy the THB on dips.

- Despite the near-term upside risks to the USDTHB, the underlying strength of the THB remains intact. Healthy economic fundamentals including healthy growth momentum, relatively stable government, and removal of monetary policy accommodation by the BoT are supportive of the THB. The persistent current account surpluses (around 8% of GDP in 3Q) continue to favor the THB. In addition, low domestic inflation (where headline CPI has averaged 1.0% for the whole of 2018 which is at the lower end of the BoT’s 1-4% target range) has also helped the THB, producing an environment that leaves the Bank of Thailand (BoT) with policy room to remove its accommodative policy at a gradual pace unlike the Philippines (Chart 3). A less aggressive pace of rate hikes should be supportive of economic growth and less likely to stifle price increases, which turn should be positive for the THB. We expect the BoT to continue to normalise policy in 2019 with one more 25bp hike to its policy rate.

- The external environment is also conducive for the USDTHB to move lower in the three-to-six month horizon. Softening USD economic data, US Fed's dovish pivot and optimism that the Sino-US trade war concerns will fade are weighing on the USD. A softer USD should put downside pressure on the USDTHB.

- We maintain our USDTHB outlook for the forecast horizon, looking for the USDTHB to climb higher to the 32-levels by end-1Q 2019 in the lead-up to the general elections as political tensions intensify. Thereafter, we expect the THB to resume its appreciation trajectory posts-elections with the USDTHB ending 2Q and 3Q at 31.70 and 31.50 respectively as political clarity emerges. Risk aversion though could re-emerge in 4Q on concerns over a possible global economic slowdown that could see USD gather strength somewhat and lift the USDTHB back to the 32.00-levels by year-end.

- **Growth and Inflation Outlook:** Growth strengthened in 4Q, bolstered by a pick-up private consumption and private investment as well as an improvement in the external balance. Private consumption – the key driver of growth in 4Q – rose to a 6-year high of +5.3% (vs. 3Q's +5.2%), while private investment surged +5.5% y/y – a 4-year high. The external sector rebounded, rising +0.6% y/y vs. 3Q's -0.9% on improving goods exports and foreign tourism receipts. The bounce in these three segments helped to offset the drag from public consumption (4Q: +1.4% vs. 3Q: +1.9%) and public investment (4Q: -0.1% vs. 3Q: +4.2%). For the full-year, growth expanded by +4.1% in 2018 compared to +4.0% in 2017 – the fastest annual pace since 2012. Looking ahead, growth is likely to come in at a more moderate pace in 2019. Government spending, especially ahead of the general elections expected early next year, together with planned infrastructure building projects including transport networks and the Eastern Economic Corridor development project should continue to attract FDI and keep growth supported in 2019. However, a slowdown in exports of goods and services and a slight moderation in domestic demand as the easing private consumption offset the pick-up in investments. Consequently, our economic team maintains its full-year growth of 3.8% for 2019, which is at the lower half of the NESDC's forecast of 3.5-4.5%.

- Headline inflation moderated for the fifth straight month, rising by just +0.27% y/y in Jan compared to +0.36% in Dec. This moderation was due once again to softer energy prices that weighed on transport costs, which contracted for the second straight month by -1.92% y/y in Jan from -0.65% in Dec. The uptick in food prices by +1.34% y/y in Jan (Dec: +0.9%) helped to prices from sliding even lower. Core inflation (headline inflation excl. raw food and energy) rose +0.69% y/y in Jan little changed from Dec's +0.68%. For 2019, overall prices should trend gradually higher fueled by election spending. The Commerce Ministry expects headline inflation to range within 0.7-1.7% in 2019 with 1Q CPI coming in at 0.86%, 2Q at 0.98%, 3Q at 1.27% and 4Q at 1.81%. Our economic team expects inflation come closer to the top end of the Commerce Ministry forecast range at 1.5% in 2019 before easing to 1.1% in 2020.

- **Monetary Policy Forecast:** The BoT met for the first time in 2019 after hiking it benchmark one-day repurchased rate by 25bp to 1.75% Dec 2018. By a 4-2 vote, the BoT kept its key policy rate unchanged at 1.75% in Feb. The two members had wanted a 25bp hike in order to build policy space and curb financial stability risk. This is in contrast to the vote in Dec where two members favored the status quo to assess the external risks to growth and the sustainability of growth momentum.

- We believe the move by the BoT provides the central bank with more policy space should shocks emerges. Unlike most of its peers in the region who are likely to maintain the status quo in monetary policy this year, the BoT is expected to be one of the few central banks to remove monetary policy accommodation further. In its minutes for the Feb meeting, the central bank flagged that further policy moves will be data-dependent. Still, the BoT's reiteration that even after the hike, monetary policy remains accommodative and appropriate. This appears to suggest that the central bank is in no rush to add to its rate hike. Our economic team expects another 25bp rate hike, possibly sometime in 3Q 2019 and then for the BoT to stay on hold thereafter in 2020. We do not expect the BoT to move on policy in 1Q, mindful of the perception a rate hike might have during the elections scheduled for 24 Mar.

- **Latest Fiscal and External Balance Outlook:** Though the FY2020 budget has been approved by the cabinet, there is a possibility that its implementation on 1 Oct 2019 could be delayed. This is because of the general elections that is due to take place on 24 Mar could result in fractious parliament that may not only delay the formation of a new government due to political wrangling but also the delay in the passage of the budget legislation. This could put a dampener on economic growth in 2019.

- The current account surplus jumped to its widest since Mar 2018, coming at +USD5.03bn in Dec from Nov's +USD1.63bn. This was attributable to the rebound in both the trade and income account surpluses. The trade balance rose to USD2.48bn in Dec from +USD0.66bn in Nov, while the income account surplus surged to +USD2.54bn in Dec vs. +USD0.97bn in Nov. Details for the financial account are not available at the point of writing but the overall balance of payments slipping back into a deficit of -USD0.18bn in Dec from a surplus of +USD0.38bn in Nov suggests a deficit in Dec. This is likely due to portfolio outflows in the month.

- **Key domestic events and issues to watch:** BoT will meet on 20 Mar to decide on monetary policy though no moves are expected. Key risk event in Mar is the general elections on 24 Mar that will see the return to civilian rule.

- **Technical Outlook:** USDTHB's decline failed to push beyond 31. And as we cautioned in the last monthly technical outlook - *a failure to push through 31-support could see rebound risks, given overstretched technical*. USDTHB was last seen at 31.52 levels. Double bottom formed around 31.10 levels. Daily momentum turned bullish while stochastics is rising. Rebound could test 31.6 (23.6% fibo retracement of Oct high to Feb low), 31.92 (38.2% fibo). Support at 31.3 (21 DMA) before 31 levels.

INR: A Delicate Concoction of Geopolitical Flares and Election

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

No Change to Forecasts

- **Motivation for the FX View:** USDINR has been resilient to recent developments, probably capped by RBI intervention. The pair moved just a tad higher in reaction to the terror attack in Pulwama that killed more than 40 Central Reserve Police Force (CRPF) soldiers. That triggered security forces in Kashmir to kill a top commander of the Jaish-e-Mohammed (the Pakistan-based Islamist militant group that have claimed responsibility) suspected to have plotted the terror attack (Hindustan times). Since then, there have been vows of a strike back by the Pakistan PM should India launch an attack. India withdrew the “most-favored nation” status to Pakistan and slapped an import duty of 200%. The timing of the attack, ahead of the Federal elections that must be held by May probably pressured Modi to attack.

- On 26 Feb, India Foreign Minister announced that India has destroyed the largest JEM (Jaish-E-Mohammed) camp after some reports of Indian airjets violating the airspace along the Line of Control - a defacto border following the Simla Agreement in Jul 1972 that was meant to end a long drawn conflict between the two nations. He stressed that the military action was specific to the JEM (Jaish-E-Mohammed) Camp and now requests for Pakistan to follow up and dismantle all JEM Camps. He said that JEM was planning more attacks on India. The swift retaliation that was directed at the terrorist group, as well as calls for Pakistan to cooperate brought some relief in the equity markets. However, Pakistan FM Qureshi said that India strikes are a “grave aggression”.

- On 27 Feb, Pakistan reported that its fighter jets struck down two Indian aircraft in Indian-controlled Kashmir from their own airspace. The Pakistan Foreign Ministry issued a statement saying that “we have no intention of escalation, but are fully prepared to do so if forced into that paradigm. That is why we undertook the action with clear warning and in broad daylight”. India is reported to have shot down one Pakistani jet. USDINR rose in reaction, touching a high of 71.48 before drifting back lower. Pakistan PM Imran Khan called for talks with India, saying “better sense should prevail” and “we should sit down and talk”. Fears that this geopolitical conflict could further escalate and broaden between the two nuclear-armed nations could keep the downside pressure on the rupee and domestic assets/

- **That said, there is also a possibility for this event to unite the nation behind Modi at the upcoming Federal Election against a historical enemy, which could be positive for the rupee into the election (to be held by May 2019) if the tension is managed well and the escalation is stopped in time.**

- Base on the average performance of the rupee (against the USD) in the past two Federal elections, INR typically strengthens around 50 days before the event (which should be within May 2019). In a backdrop of a Fed pause, we expect the USD, US rates and oil environment to remain benign, we look for opportunities to buy the INR on dips and the USDINR to end the first quarter at around 67.

- **Growth and Inflation Outlook:** Industrial production rose a tad to 2.4%y/y from previous 0.3%, underpinned by the stronger output in manufacturing in Dec. Manufacturing rose 2.1%y/y, a rebound from previous -0.5%. Much of the output is meant for infrastructure or Construction with output there picking pace to 1.3%y/y from previous 0.6%.

- Inflation softened from 2.11%y/y to 2.05%, brought lower by the decline in the food subcomponent as well as the fuel and light. Housing prices softened at tad to 5.2%y/y from 5.3%. Barring near-term spikes in the crude price, supply and demand projections by the IEA suggest that crude price could be capped for much of this year, especially in the first half and that could bring tailwinds for the rupee.

- Trade deficit widened to U$14.7bn in Jan from U$13bn in Dec. Exports grew 3.7%y/y and imports came in flat year-on-year. Outlook is not optimistic with slower global growth likely to dampen the demand for India's exports. That said, as long as brent crude remains stable, India's current account could be buffered from significant deterioration.

- **Monetary Policy Forecast:** RBI started the year by lowering repo rate from 6.50% to 6.25%, reverse repo rate was also cut 25bps to 6.00%. The decision was voted 4-2 and we were part of the minority who called for the cut. The central bank also shifted its monetary policy stance from calibrated tightening to neutral. We had looked for a rate cut as industrial activity had started to slow and exports lost momentum along with global growth. In addition, benign inflation provided RBI the environment to deliver a timely cut ahead of election. Even though this is a shift to neutral, Governor Das' view that the neutral stance "will provide flexibility and the room to address challenges to sustained growth of the Indian economy over the coming months, as long as the inflation outlook remains benign" suggests that he is still biased towards more rate cuts in the future. Other members who voted for a cut highlighted slower global growth momentum as a key risk. The loudest dove was Dr. Ravindra H. Dholakia who called for a 50 to 60 bps cut starting with a 25bps cut on 7 Feb.

- Since then industrial production has improved from previous 0.3%y/y in Nov to 2.4% in Dec, led by stronger output in the manufacturing sector. WPI softened to 2.76%y/y in Jan while CPI also softened to 2.05%y/y from previous 2.11%. Trade deficit widened to U$14.7bn from U$13bn as imports was flat for Jan.

- **Latest Fiscal and External Balance Outlook:** India's current account deficit widened in Jun to Sep last year to U$19bn from U$15.9bn in the quarter prior. This year could be another challenging one for its external balance as global growth continues to moderate. Crude price-wise, the IEA supply and demand condition should see gains capped at around U$70/bbl.

- The interim budget was a tad populist with U$10.6bn allocated to support the farmers. Fiscal deficit is seen to remain at 3.4% of GDP in the FY19-20. Tax exemption limits for income-tax payers were raised to INR500K and this was seen as tax proposal to attract the middle income class. There was also income tax exemption for the second homeowner. INR1.84trn is allocated to food subsidy, INR374.8bn for petroleum subsidy, INR749.9bn for fertilizer subsidy and INR3.05trn on defense. This is supposed to be funded by divestment in state run companies (INR900bn), dividend from RBI (INR829bn) and state run banks as well as tax revenue (INR25.52trn for FY20 Gross). Just announced, RBI has decided to transfer an interim surplus of INR280bn to the government for Jul-Dec 2018 base on a limited audit review and after applying the extant economic capital framework.

- **Key domestic events and issues to watch:** 4Q GDP due on 28th Feb; MI-mfg for Feb on 1st Mar; Feb CPI on the 12th; Jan industrial production on 12th; Feb WPI on 14th; trade for Feb on 15th;

- **Technical Analyses:** On the daily chart of the 1M USDINR NDF, this pair has been consolidating within the 70.70-72.30 range, bound by the 200-dma and the 100-dma. However, the compression of the 21,50,100,200 dma suggests that there could be a break-out on either side. Resistance is seen next at the 73-figure. A break-out to the downside could push this pair towards Jan low of 69.44 (support).

VND: Trump-Xi Summit To Boost Spending?

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

No Change to Forecasts

- **Motivation for the FX View:** The VND remains little moved around 23200 against the USD for much of the past two months. Vietnam continues to see FDI inflows as well as portfolio inflows in view of the recent implementation of the CPTPP and potential FTA with the EU. The equity-related net inflow rose from U$575.4mn to U$136mn (mtd as of 26 Feb). Strength in the RMB could continue to anchor the dong against the USD. In the meantime, VND gains competitiveness against its trading partner. Our estimate of the VND trade weighted index (TWI) weakened to 63.3 from 64.1 in Dec before making some recovery recently to 63.6. Along with hopes for the US and China trade relations to improve, the CNY recovery also set a positive tone for the year and we look for modest CNY strength to provide an anchor for the VND this quarter, if not for most part of this year.

- We hold our view that slower global growth is likely to crimp on the VND. While Vietnam is seen as the "beneficiary" of the trade war amid some reallocation of production from China here, slower external demand as a result of slower global trade could still weigh on the VND. Vietnam's trade balance has been in deficit for the last three months (including Jan). That limits the VND gains. While investors can find solace in China's recent slew of economic stimulus, growth stabilization is the aim of policymakers and not a sharp rebound. We can also expect support for the VND from China to also be as modest.
- Should trade war become trade deal, it is unlikely that there could a reversal of gains for Vietnam as well. The trade war essentially was an "event disruption" that quickens the process of reallocation of production plants that are of relatively lower value in China to Vietnam in the short term. Over time however, investors are likely to increase the value of the production as the Vietnamese workers gain experience.
- In an environment of a Fed pause, softer USD and strong RMB, the VND is thus expected to remain stable against the USD and to end the quarter at around 23200.
- **Growth and Inflation Outlook:** PMI-mfg slipped to 51.9 from previous 53.8. Growth weakens in output, new orders and hiring. However, improving operating conditions in the manufacturing sector were reported. We see the fall in PMI-mfg index as a sign of slower growth momentum. Input costs rose marginally while output prices fell.
- Industrial production picked up pace in Feb to 10.3%y/y from previous 7.9%y/y. Retail sales steadied around 12%y/y in Feb, keeping pace with Jan. Demand for goods picked up pace to 14.4%y/y while that of accommodation, food & beverage service fell to 5.7%y/y (possibly due to Tet).
- A widely watched event was the Trump-Kim summit, even though no agreement was said to have been reached at this one. Local press reported that small businesses are benefitting from the summit. So as the effect of slower global growth becomes more apparent, retail sales could offset some of the weakness in exports growth.
- Exports remained weak at 1.6%y/y vs the previous -1.3%. Imports growth surged to 10.4%y/y, distorted by the seasonal effect of Tet. Still, Vietnam recorded a trade deficit of U$900mn, widening from the previous U$800mn.
- Infrastructure will still be a key driver of growth in medium term if Vietnam wants to continue to attract foreign investors. As such, we

anticipate that fiscal deficit consolidation would still be a challenge for the government (VnExpress).

- More FDI approval: Universal Alloy Corporation Asia will invest U$170mn in Danang airplane parts plant. This company provides parts for Airbus and Boeing and expects exports at U$25mn in 2021 and U$180mn annually after 2026.
- Inflation prints have been easing but the recent flare up of the South African swine flu could lift pork prices. Northern Vietnamese province of Hai Phong is the third province to report an outbreak of the African swing fever (Thanh Nien). Only 35 infected pigs were culled as of 23 Feb.
- **Monetary Policy Forecast:** Inflation pressure remains subdued while risks to growth have tilted lower as global growth slow. While Vietnam benefits from FDI inflows because of the trade agreements, external environment still have headwinds. Slower global growth could weaken demand for Vietnam's exports and trade balance has tilted into deficit for the past three months. Still, China's RRR cuts may do some of the heavy lifting to cushion global growth slowdown. The US-China trade truce could turn into a trade deal that could lift global trade volume. In the meantime, sustained imports growth and retail sales suggest that household consumption could support growth should external conditions turn less favourable.
- In this environment where growth outlook for Vietnam is still rather balanced, we see little need for a rate cut by SBV now. In terms of TWI, the VND has weakened against its regional peers in the past two months. We anticipate that VND is likely to remain a laggard in an environment of softer USD and that could provide more export competitiveness that could improve its trade balance. That said, our view on the VND would be downgraded if the African Swine Virus spreads and threatens price stability.
- **Latest Fiscal and External Balance Outlook:** Minister of Finance had said that the budget deficit will remain at a ratio of 3.6% of GDP. State budget collection in 2019 is projected to reach VND1.411 trn vs. budget spending estimated to be at VND1,633 trn.
- As of last available data, current account surplus was at U$1.24bn in 3Q. Net trade surplus of goods slipped to U$3.0bn from previous U$5.2bn. The competitive dong could keep the current account in surplus. Financial account surplus narrowed to U$2.295bn. Slower growth momentum could mean a deterioration on the trade front and we expect the current account surplus to be eroded in the fourth quarter of 2018. That would underscore the need for VND to remain competitive and our view that VND could lag in its recovery against the USD compared to regional peers.
- **Key Domestic Events and Issues to Watch:** PMI-mfg on 1st; domestic vehicle sales in 6th-13th; 1Q GDP, CPI, trade numbers, retail sales and IP are due 25th-31st Mar.

FX Forecasts

	End Q1-19	End Q2-19	End Q3-19	End Q4-19
USD/JPY	110	108	106	107
EUR/USD	1.1400	1.1500	1.1600	1.1600
GBP/USD	1.3200	1.3200	1.3400	1.3600
AUD/USD	0.7100	0.7300	0.7400	0.7300
NZD/USD	0.6800	0.7100	0.7200	0.7100
USD/SGD	1.3600	1.3400	1.3300	1.3500
USD/MYR	4.05	4.00	3.98	4.06
USD/IDR	13400	12900	12700	12900
USD/THB	32.00	31.70	31.50	32.00
USD/PHP	52.80	53.30	53.00	53.50
USD/CNY	6.75	6.70	6.65	6.70
USD/HKD	7.80	7.79	7.78	7.78
USD/TWD	30.80	30.70	30.60	30.70
USD/KRW	1115	1100	1105	1120
USD/INR	67.00	66.00	66.00	68.00
USD/VND	23200	23000	22800	22900
DXY Index	96.69	95.88	94.64	94.86
SGD Crosses	End Q1-19	End Q2-19	End Q3-19	End Q4-19
SGD/MYR	2.9779	2.9851	2.9925	3.0074
SGD/IDR	9853	9627	9549	9556
SGD/THB	23.53	23.66	23.68	23.70
SGD/PHP	38.82	39.78	39.85	39.63
SGD/CNY	4.96	5.00	5.00	4.96
SGD/HKD	5.74	5.81	5.85	5.76
SGD/TWD	22.65	22.91	23.01	22.74
SGD/KRW	820	821	831	830
SGD/INR	49.26	49.25	49.62	50.37
MYR Crosses	End Q1-19	End Q2-19	End Q3-19	End Q4-19
EUR/MYR	4.62	4.60	4.62	4.71
JPY/MYR	3.68	3.70	3.75	3.79
MYR/HKD	1.93	1.95	1.95	1.92
MYR/CNY	1.67	1.68	1.67	1.65
GBP/MYR	5.35	5.28	5.33	5.52
AUD/MYR	2.88	2.92	2.95	2.96
NZD/MYR	2.75	2.84	2.87	2.88
MYR/IDR	3309	3225	3191	3177
MYR/INR	16.54	16.50	16.58	16.75
MYR/KRW	275.31	275.00	277.64	275.86
MYR/PHP	13.04	13.33	13.32	13.18
CNY/MYR	0.6000	0.5970	0.5985	0.6060

Source: Maybank FX Research as of 28 February 2019.

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

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