Maybank

FX Monthly

2017, Issue 3: Reflation Trade Still on Track Amid EU Political Risks

Analysts

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

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

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

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

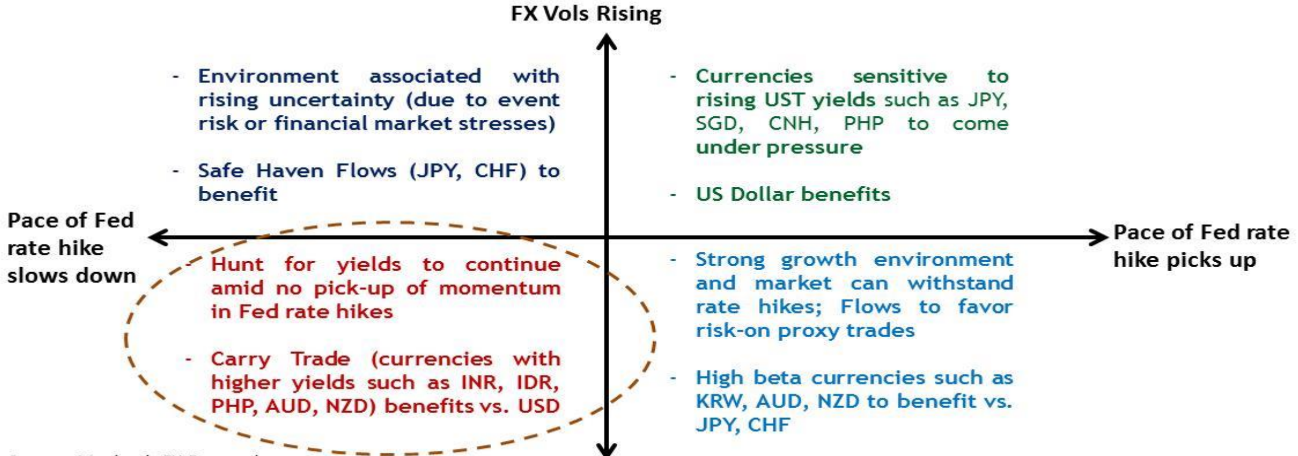
Key Themes[1]

- First, ***expectations of an improved US medium term growth and productivity outlook on the back of expectations of a targeted fiscal infrastructure package, changes in the regulatory environment and tax reforms (i.e. lower taxes) under the Trump administration***. Longer term, concerns about changes in trade and immigration policy, has raised concerns globally. Expected US fiscal boosts could lead to concerns of faster inflationary pressures and as such affect the Fed rate hike trajectory, with consensus expecting around 2 hikes in 2017 and the Fed, 3 hikes. In 1H 2017, we still expect on average a steepening of the UST curve with the back end rising faster than the front end (higher nominal rates). The dollar should still <u>*remain marginally*</u> supported in 2017. Overall the monetary policy divergence (Fed vs ECB & BOJ) should manifest in a long USD vs. short EUR and short JPY.
- Second, ***the deadline for achieving Japan's 2% inflation target is now*** open-ended with the deadline now at "around fiscal 2018" i.e. the year starting from Apr 2018. BOJ have scrapped its target for the average maturity of its government bond holdings and forward guidance has been strengthened, with the BOJ stating asset purchases will continue until inflation is stable above 2%, making it clear that exit won't happen immediately if they hit 2%. BOJ kept the benchmark rate unchanged at -0.1% and have stated that the JPY 80trn annual monetary base target will now fluctuate in the short term in order to shape the slope of yield curve. <u>*Risk of early election announcements soon.*</u>
- ***Third, major risk out of Eurozone likely to emanate via the political event risk channel. The election season in France coming up on 23 Apr and 7 May.*** Our base case is for no Eurozone break up. Market complacency on political risks is expected to face a reality check, and we expect EUR downside pressure to come into play again as political risk is still warranted, market speculation for ECB easing is likely to face disappointment and ECB-Fed's monetary policy paths remain on a divergent. EUR may regain strength towards end-2017 as monetary divergence slows (due to the possibility of an end to QE or even tapering amid pick-up in inflation closer towards medium term objective of 2%).
- ***Fourth, China still has excess capacity, heavily indebted corporations which continue to add pressure on the economy and the yuan medium term***. In a world of USD strength, we continue to expect PBoC to limit the depreciation in the CNY trade weighted. On the other hand, in the absence of USD strength, CNH has a different behaviour, underperforming other Asian currencies. We see that to reverse should USD bulls awaken again. We maintain our long CNH view against EUR. China potentially filling up the political, trade and military vacuum in the world left by the US, may lay the foundation for China's growth stabilisation. This could provide some buffer from US anti-trade policies and thus allowing some floor to RMB and EM weakness.
- Commodities have improved due to Asian infrastructure spending plans and low base global pick up, expected synchronised export recovery and oil prices seem to have stabilised, so overall commodity prices should be moving higher in 2017. <u>*However, in the near term, we expect some correction in the iron ore prices that could also effect a correction in the AUD.*</u> <u>*The divergence between metal and oil prices seen in 1Q has led to a rise in AUD against the CAD, MYR. We look for a potential convergence between the two commodity groups that allows for a tactical short AUDCAD trade*</u>.

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

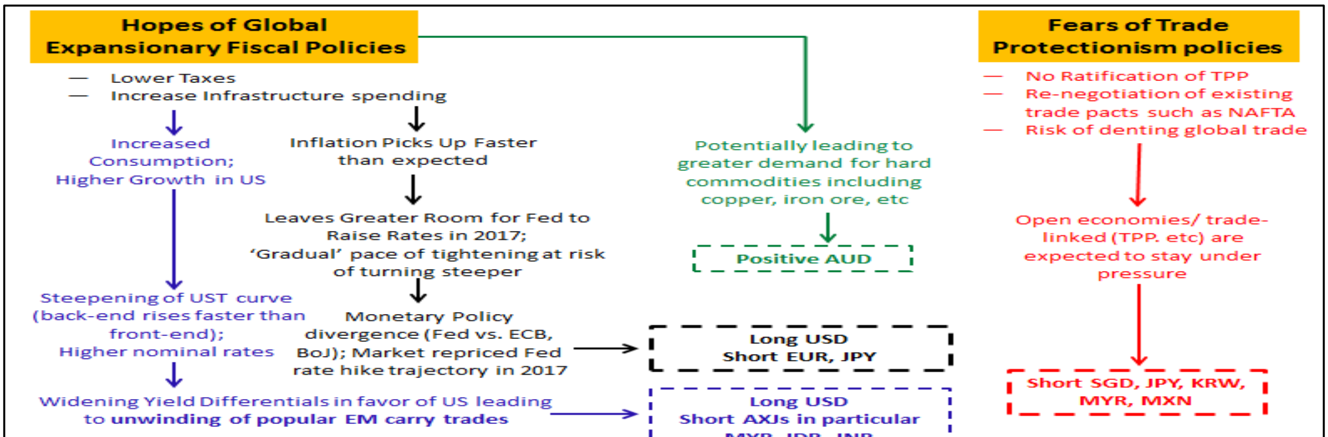
So What?

In the short to medium term, FX Vols and Pace of Fed Rate Hikes are Determinants to FX Bias, Current Environment Favours: INR, IDR, AUD, NZD



Source: Maybank FX Research

Hopes of Expansionary Fiscal Policies vs. Fears of Trade Protectionism



Source: Maybank FX Research

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

Source: Maybank FX Research

- Almost 100 Days into Trump world and we continue to witness the tussle between Trump Fears and Trump Hopes. Uncertainties between the two elements alone capped the USD strength thus far. More patience may be needed to revive the USD bulls and we anticipate this to manifest in June onwards. We look for USDAXJ to be broadly higher then. Ongoing domestic idiosyncratic factors should weigh on AXJs such as political risk factors in Indonesia, Philippines and Thailand; growth, credit concerns in China, and trade and investment concerns in Vietnam.
- Monetary policy divergence/ widening inflation difference to weigh on EUR and JPY. There is high chance of EUR moving towards 1.05 and USDJPY likely to move higher towards 113 levels.
- We look for some correction in base metals, in particular iron ore that could bring AUD lower. Trump's expansionary fiscal policies, capex spending upswing and Asian infrastructure spending may lead to demand for hard commodities AUD to find some support around 0.72 levels.
- In the absence of USD strength, CNH underperforms other Asian currencies. We see that to reverse should USD bulls awaken. We hold our view to favor relative beta plays ex-USD with long hard commodity vs short open economies/benign inflation, favouring CNH longs vs. EUR, JPY and SGD. We also favour long bias for IDR and THB against short JPY on the back of Asian Central Bank relative value plays. Our opportunist trades at some stage this year, given stretched spot levels vs. fundamentals are Long GBP, NZD & MYR.

G7 Global Overview

USD: "Trump Trade" Ups and Downs to Weigh on USD

Forecast	2Q 2017	3Q 2017	4Q 2017	1Q 2018
USD Index	102.22 (107.86)	102.50 (105.14)	101.36 (101.60)	99.46 (--)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** We expect at least two rate hikes in 2017, more likely in June onwards. We do caution that additional repricing of a surprise Fed hike over the course of the year (due to market complacency over Fed rate hike trajectory) could continue to see UST yields higher in particular Treasuries 2y and below, and see **USD strength (buy the rumor) in the lead-up to FOMC** meetings. Since the US Presidential elections, the focus has shifted back to a stronger USD due to a US cyclical upturn (from positive slew of US data) and the potential for a pickup in inflation. We continue to expect domestic factors and a repricing of the future stance of monetary policy to drive the USD stronger. Even though the market's expectations on the Fed tightening cycle have moved, we think market pricing for the federal funds rate may be dovish at times and we still expect the Dollar to appreciate in the short term. During this phase and around FOMC announcements, we believe the **USD could still be mildly supported**. In addition, we may need clarity on both fiscal and trade policies from the Trump administration to support a US reflation view. If one of these falters, we could see softness in the USD and further sharp ups and downs in the dollar in 2017. The Trump administration remains undecided on the tax reform and hopes that Congress will pass it by August recess. Continued unclear signals on the tax reforms could soften the USD over the next month or so.

- Nonetheless, as long as there are less economic growth downgrades by supranationals and the market, some signs of global inflation emerging, rising expectation of faster pace of Fed rate hike and if oil remains somewhat stabilized around $50-60/bbl, then we will expect USD strength to be sustained in 2017 and UST yield steepening to appear more entrenched.

- **Growth and Inflation Outlook**: The advance estimate of Q4 US GDP, at 1.9% q/q saar, was broadly in line with expectations. Consumer spending remained robust and inventories made a positive contribution, but net trade was a significant drag. Weaker than expected existing and new home sales implied less broker commission and slightly slower residential investment growth than expected. The advance trade report also showed a larger deficit than expected as well as weaker equipment investment, while inventory accumulation was a little stronger than expected. US pending home sales rose 1.6% m/m in Dec, beating expectations. However, the drag on home sales from higher mortgage rates is likely to play out in the near future. The data remain supportive of a modest recovery in the housing sector in 2017.

- CPI inflation came in slightly higher increasing 0.1% m/m against consensus of 0.0%. Core inflation came in line with expectations at 0.2%, slightly higher pace than headline due to a partial retracement in energy prices in Feb. On a y/y basis, CPI accelerated to 2.7% from 2.5%. The CPI results indisputably reflect firming price pressures in an economy that's showing stronger growth prospects. However, inflation gains remain moderate.
- **Monetary Policy Forecast:** In view of realized and expected labor market conditions and inflation, the Committee decided to raise the target range for the federal funds rate to 3/4 to 1 percent. The stance of monetary policy remains accommodative, thereby supporting some further strengthening in labor market conditions and a sustained return to 2 percent inflation.
- In determining the timing and size of future adjustments to the target range for the federal funds rate, the Committee will assess realized and expected economic conditions relative to its objectives of maximum employment and 2 percent inflation. This assessment will take into account a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial and international developments. The Committee will carefully monitor actual and expected inflation developments relative to its symmetric inflation goal. The Committee expects that economic conditions will evolve in a manner that will warrant gradual increases in the federal funds rate; the federal funds rate is likely to remain. We are currently pricing in a +50-75bps hike in fed fund rate this year.
- **Latest Fiscal and External Balance Outlook:** Fiscal policy should be expansionary over the next few years as the prospect of a tax reform and some investment in infrastructure becomes apparent under the Trump administration. The deficit has fallen sharply from its peak. Fiscal sustainability risk continues to weigh on the outlook and may emerge sooner than later. In the long term, an improved US economy and manufacturing sector, US shale oil and gas production may improve the US current account leading to dollar support but this is likely to be long drawn and may probably begin only in 2018. The US other deficits - current account and BOP deficits have moved slightly wider and is expected to continue. The latest Jan 2017 US nominal trade deficit was in line with consensus but rose from a month earlier, to $48.5bn from -$44.3bn. The U.S. chalked up its largest trade deficit since March 2012 as a jump in merchandise imports in January exceeded a smaller gain in shipments overseas.
- **Key domestic events and issues to watch in April 2017:** Key US events: Trade Balance (4 Apr); PCE Deflator (1 Mar and 31 Mar); ISM Manufacturing Mar (3 Apr) (expected: 56.8); Factory Orders (4 Apr); Durable Goods (4 Apr, 27 Apr); Trade Balance (4 Apr); NFP (7 Apr); CPI (14 Apr); GDP 4Q (30 Mar, 28 Apr), Ind Production 17 Mar; FOMC Meeting Minutes 15 Mar (6 Apr); Housing Starts (18 Apr)

- **Technical Outlook:** DXY drifted lower below 100-handle, following Fed rate hike. Low was seen around 98.85 levels (27 Mar) before a rebound back above 100-handle. The moves were in line with the bearish signals that were flagged out in our last monthly outlook. DXY was last seen at 100.40 levels. Price action on the daily chart suggests a falling wedge formation in the making – this is typically a bullish reversal. Bearish momentum on daily chart is showing signs of waning while stochastics is showing signs of turning higher from oversold conditions. These signals suggest USD rebound could continue. We think a weekly close above 100.80 (38.2% fibo retracement of Nov low to Jan high) is needed for further upside to regain momentum. Failing which DXY could slump back into 98.50 – 100.80 range. Support at 99.80 (200 DMA) before the key support at 98.50 (upward sloping trend-line from the rising lows of 2014 and 2016). A decisive break below that may cull USD bulls. We look for further upside.

EUR: Receding Political Concerns but Caution Warranted

Forecast	2Q 2017	3Q 2017	4Q 2017	1Q 2018
EURUSD	**1.0450** (0.9800)	**1.0350** (1.0200)	**1.0600** (1.0800)	**1.0800** (--)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** We expect the unwinding of EUR shorts positioning amid dissipating concerns over Netherlands/French elections and market speculation for ECB normalization to fade as we inch closer towards French elections (23 Apr and 7 May). CFTC positioning showed the smallest net short EUR positioning since Jun 2014 (in particular asset managers have been building net long EUR). While political risks in France may be receding, the risk of a surprise remains and caution is still warranted. **Over-optimism or complacency on political risks is expected to face a reality check, and we expect EUR downside pressure to come into play** as political risk is still warranted, market speculation for ECB easing is likely to face disappointment and ECB-Fed's monetary policy paths remain on a divergent. We **expect EUR upside to be limited towards 1.0980, and remain biased for renewed weakness towards 1.05-1.06 for the month of Apr**. The risk to our view – if Trump's fiscal spending/tax reforms plans fails to provide much clarity – the EUR could potentially test above our 1.0980 resistance.

- The recent move higher in the Euro above 1.08-handle (from below 1.05 in early Mar) was due to a few factors:
  - Market speculation that ECB normalization is on the cards (OIS-implied shows that market expects ECB to start raising rates in mid-2018). This came following the end of scheduled TLTRO (23 Mar) and ahead of the reduced bond purchases

(announced back in Dec 2016) to EUR60bn for periods Apr to Dec 2017 (vs. EUR80bn previously);

- Receding political risks in Europe as recent Netherlands election and French polls show faltering support for populism - there was no negative surprise from Netherlands elections (PM Rutte won the majority) while polls for upcoming French elections showed declining support for Front National party leader (Far Right) Marine Le Pen while Independent and Centrist Emmanuel Macron is gaining ahead amid political scandal involving Parti Socialiste leader Fillon;
- Economic data - sustained upticks in Euro-area PMIs, headline inflation and consensus of forecasters expecting Euro-area growth accelerate this year. The rise in EURO also came amid USD selling pressure post Fed rate hike (15 Mar) as Fed showed no indication of stepping up forward guidance while hopes of Trump’s fiscal spending and tax reforms (somewhat loosely termed as a basis of reflation trade) continue to fade.

- While the EUR may see some support as political risks and USD strength back-pedals (for now)**, we are not of the view that EUR can rise sustainably past 1.10-handle and should face renewed downside pressure** on the following factors:
  - (1) **Market speculation for ECB rate increases or further taper may have come too soon** and eventual disappointment could limit gains. The ECB had placed strong emphasis on core inflation and increasingly (at the last ECB press conference in Mar) stressed that wage growth is a key indicator of domestic underlying inflation. He said that policy rates would remain at "present or lower levels” even if headline inflation is at 2%. While headline inflation continued to print higher (2% y/y for Feb), the increase was due to base effects and energy prices (i.e. imported inflation). Imported inflation reduces real wages (since wage growth is subdued) and could weigh on household consumption. To add, these upticks in headline inflation were well within ECB’s expectations. ECB’s Draghi had also said that for inflation to be considered as ‘sustained adjustment’, there are 4 elements that need to be fulfilled: Inflation (1) is affecting the medium term, (2) is durable, (3) is self-sustained and (4) is region wide. Recent upticks do not exhibit any of those elements;
  - (2) **ECB and Fed’s monetary policy paths remain on divergence** - ECB is not expected to raise rates anytime soon while Fed is on tightening path (dot plots suggest 2 more hikes for 2017) and is in a better position compared to ECB to tighten further if required since US inflation comes from wage growth and economic growth. We believe divergence in monetary policies should re-exert downside pressure on the EUR in the meantime. We do expect ECB to play catch up at some stage towards 4Q 2017 on normalisation (hence the higher EUR trajectory into 2018);
  - (3) **Political risks (though have receded) still remain and caution is still warranted**. The UK will invoke Article-50 of the

Lisbon treaty to leave the EU while Europe still have 2 major elections coming up in France (first round on 23 Apr and second run-off on 7 May) and Germany (24 Sep). Sentiment can swing nearer to the election dates. And post-Brexit trigger of Article-50, UK will negotiate fresh trade relations with EU. Much uncertainty remains with regard to what arrangement UK will have with EU and anti-establishment parties may take the opportunity (with UK exiting EU) to stoke anti-Euro sentiments and undermine the stability of the Euro-club and pose risks to financial markets. Rising political risks in EU will weigh on the EUR (as seen from past few months' price movement between EUR and political polls and cds swaps). We expect EUR to come under downside pressure after mid-Apr into early-May on risks surrounding French elections.

- Taking into consideration recent developments, we revised our EUR forecast higher for 2Q and 3Q from prior forecast (as fear of support for anti-establishment parties diminishes). We price in some degree of EUR weakness for 3Q due to political risks from German elections and potential pick up in USD strength; maintained 4Q forecast, reflecting potential ECB tapering/rate hike speculation (potential monetary policy convergence with Fed).

- French Presidential elections is scheduled to take place on 23 Apr (first round) and 7 May (second round). This election had gathered much attention due to the rise of Front National party (Far Right) led by Marine Le Pen while the 2 main parties Les Republicains (Conservative) led by Francois Fililon and Parti Socialiste (Socialist) led by Benoit Hamon have seen weakening support. Centrist and Independent Emmanuel Macron is the new sensation. The former Economy Minister (age 39) has never run for an election but is gaining quite a bit of support in recent opinion polls. Amongst the top 4 candidates, he appears to lead Le Pen in the recent Elabe poll after the televised TV debate (21 Mar). Le Pen is well known for her anti-immigration stance and pledges to take France out of Euro club and wants to introduce the use French Franc. We are cautious of Le Pen riding on the rise of populism as upsetting the established order may undermine the stability of the Euro club and pose risks to financial markets. A sudden increase for support for her (via polls) in the lead-up to elections could renew EUR downside pressure. Macron, on the other hand, is pro-Euro zone and does not support Le Pen's campaign on anti-globalisation, anti-establishment. He positions himself as one that reconciles two Frances that have been growing apart for too long. We think he could stand to benefit from the current political landscape - the two main parties are weakening while Le Pen comes across as too extreme in her ideology. An eventual outcome with Macron emerging as President of France should bode well for risk sentiment and keep the Euro supported.

- **Growth and Inflation Outlook:** We continue to expect recovery in the Euro-area. PMI releases since Aug 2016 continued to indicate an expansion. Flash PMI - both manufacturing and services rose further to 71-month high and the increases were better than expected. Breakdown by country also showed strong contribution from both Germany and France.

- **In** the last quarterly assessment report (9 Mar), ECB modestly revised 2017 and 2018 growth to 1.8% and 1.7% (from 1.7% and 1.6%), respectively. ECB's Draghi acknowledged that the survey results suggested that economic expansion will continue to firm and broaden. Domestic demand including recovery in investment is expected to benefit from favorable financing conditions.

- **Euro-area inflation rose to fresh 4-year high of 2%** for the month of Feb. The increase was largely driven by energy prices (base effects) and food (supply shocks due to cold weather in Southern-Europe), alcohol and tobacco. Previous accounts of ECB meeting had already projected inflation to rise towards end-2017 and this uptick in headline inflation is well within the expectations of policymakers. In addition, core inflation was largely unchanged at 0.9% y/y in Feb (unchanged from previous 3 months) and ECB Draghi's main focus remains on underlying price pressures (core inflation), which remained subdued.

- In the last quarterly assessment report (9 Mar), ECB revised 2017 inflation to 1.7%, from 1.3%. The ECB expects headline inflation to remain at 2% in coming months due to energy prices. Measures of underlying inflation remained low and are expected to rise only gradually over the medium term

- **Monetary Policy Forecast:** We expect ECB to keep monetary policy status quo at the next meeting on 27 Apr, after its decision (back in Dec 2016) to extend QE till end 2017. **We reiterate that it remains too early to call for more tapering, given that core inflation has yet to see a meaningful recovery.** ECB Draghi had also said that higher inflation will not automatically result in QE tapering. For inflation to be considered as 'sustained adjustment', there are four elements that need to be fulfilled: Inflation (1) is affecting the medium term, (2) is durable, (3) is self-sustained and (4) is region wide. So far it remains too soon to tell if the four elements above are met as core inflation continued to hold steady at 0.9% and is not showing any signs of uptick. The **ECB had placed strong emphasis on core inflation and increasingly (at the last ECB press conference in Mar) stressed that wage growth is a key indicator of domestic underlying inflation.** He said that policy rates would remain at "present or lower levels" even if headline inflation is at 2%.

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

- **Latest Fiscal and External Balance Outlook:** Euro area's Jan current account surplus narrowed to EUR24.1bn from EUR 30.8bn in Dec. This is the lowest level since Oct 2015 and was due to decline in both goods and services surplus. 12-month cumulated current account for period ending Jan 2017 showed a surplus of 3.3% to GDP (down slightly from 3.4%).

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

- **Key domestic events and issues to watch:** Feb PPI (3 Apr); Feb Retail sales (4 Apr); Feb IP, Apr ZEW (11 Apr); Mar core CPI (19 Apr); Apr flash PMIs, Feb current account (21 Apr); ECB meeting (27 Apr); Apr CPI estimate (28 Apr).

- **Technical Outlook:** EUR traded as high as 1.0906 (27 Mar), in line with technical signals (flagged out in last month's outlook) – rebound risks. EUR was last seen at 1.08 levels. Bullish momentum on daily charts is showing signs of waning while stochastics is turning lower from overbought conditions. Price action shows a potential rising wedge formation in the making – typical bearish reversal. We see downside risks towards 1.0690 (38.2% fibo retracement of Jan low to Mar high) before 1.0620 (50% fibo). Area of Resistance remains at 1.0870 (200 DMA) - 1.0910 (previous high).

GBP: *Brexit* Enthusiasm to be curbed

Forecast	2Q 2017	3Q 2017	4Q 2017	1Q 2018
GBPUSD	1.2000 (--)	1.2300 (--)	1.2400 (--)	1.2600 (--)

Previous Forecast in Parenthesis

- **Motivation for the FX View**: The smooth exit towards trigger of Article-50 (29 Mar) and resilient economic data have seen a 500 pips rally from 1.21-handle to above 1.26-handle (27 Mar). We are doubtful if such enthusiasm over UK's exit can last. The fear of Article-50 may have been in the price but the uncertainties post-*Brexit* (trade relations with EU can be a long drawn process amid French/German elections, managing rising inflation and supporting growth, if regional HQs will happen and result in job losses, etc.) remain. We **expect these uncertainties and slowing momentum in growth (potentially a slowdown in household spending) to return (in the following 3 - 6 months or so) and dampen *Brexit* enthusiasm**.

- **In the coming weeks**, markets' enthusiasm on *Brexit* is likely to fizzle and further gains could be limited (key resistance to watch: 1.27). We stressed again that UK has barely just begun its journey and recent PMIs are showing early signs of fading momentum (albeit still in expansionary territories). We caution that **downside surprise to economic data (given the enthusiasm and complacency) may**

reignite fears and see GBP back-pedaling gains. We expect a range of 1.22 - 1.27 for month of Apr.

- **Beyond the 2-3y horizon,** we do however see GBP trading higher than current levels, possibly towards 1.35 – 1.40 as GBP is perceived to be undervalued from both historical and fundamentals perspective (our BEER model puts GBP at 1.40). The 20% or so depreciation since referendum results (Jun 2016) should help the UK economy to rebalance and grow sustainably over time - current account deficit should narrow, exports should become more competitive and tourism and education receipts should pick up further. We believe UK should be able to manage the exit, transform itself into a global marketplace and continue to attract capital (longer-term). We priced in a slightly higher GBP towards 1Q 2017 due to our expectations that trade negotiations may gain momentum towards year-end following German Federal elections (Sep 2017), shifts in BoE MPC (more dissenters due to rising inflation) and potentially better clarity (in terms of trade relations, MNC commitment to FDIs, ongoing job creation, if investment will start to pick up) on UK's exit. Past experience of UK leaving the ERM back in 1992 saw a period of consolidation (for a few years) at historical lows for GBP, before the eventual move higher in the following years. GBP TWI traded above 100-levels in 1998 (from the lows of 80 in 1993-1996) due to buoyant demand fueled by rapid growth of wealth, credit and money.

- Taking stock of the past month, **our call to buy GBP into trigger of Article-50 continued to work well**. Pair traded a high of 1.2615 (27 Mar) before easing towards 1.2550 (28 Mar). While momentum appears bullish, stochastics on daily chart suggests the pair is fast approaching overbought conditions and could start to turn lower. This should suggest that 1.27 (200 DMA) remains a key resistance to watch. Failure to break above decisively could see renewed downside pressure.

- **Growth and Inflation Outlook:** While PMIs remain in expansionary territories (above 50), recent releases since Jan have seen falling momentum. Feb Mfg, non-Mfg, and composite fell to 54.6, 53.3, 53.8, from 55.9, 54.5 and 55.5, respectively and were below expectations. Industrial production (-0.4% m/m vs. +1.1% in Dec) and manufacturing production (-0.9% y/y vs. +2.1% in Dec) fell in Jan – another indication that the rosy growth maybe showing early signs of losing momentum. We had also shared (in our last monthly outlook) that the strong 4Q 2016 GDP (+0.7% vs. +0.6%) was due to the jump in net exports while fixed investments declined and household consumption fell. **Rising inflation (+2.3% y/y in Feb), possibly faster than wage growth could depress real wages and eat into household budget (consumer squeeze).** While the economy may show resilience for now, we caution that the Brexit journey is only about to begin. Negotiating trade deals can take a long time (especially with the EU) and much remains unknown over London's status as a financial hub; if it can continue to attract foreign inflow of funds and investments, if HQs will relocate their HQs and result in job losses (Goldman Sachs is reported to consider 50% cut to London staff, with transfers to NY and Frankfurt offices while UBS and HSBC are considering moving their staff out of London). We see these uncertainties to return and re-exert downside pressure on the GBP.

- BoE's previous Quarterly inflation Report (Feb 2017), saw an **upgrade to UK growth forecast to 2% for 2017** (from 1.4% as projected back in Nov 2016's QIR. The upgraded outlook was due to government's plans for more spending, stronger world growth and that domestic growth has stayed relatively resilient since the referendum. That said BoE also highlighted that it expects business investment to fall and consumer spending to slow as inflation eats into household budgets.

- **Headline inflation jumped,** from 1.8% y/y to 2.3% y/y in Feb. The increase was due to food and fuel prices. Core inflation also rose to 2%, from 1.6%. Looking ahead we expect further increases in headline inflation due to sharp decline in GBP (impact import price channel). We continue to caution that rising inflation could erode UK consumer purchasing power at some stage and ultimately weigh on growth over time. **Wage growth is now decelerating from 2.8% y/y to 2.2% y/y for the 3 months ending Jan-2016. Wage growth has now been outpaced by CPI and could worsen further in coming months especially with BoE's inflation forecast for end-2017 at 2.7%.** Continued deceleration in wage growth could weigh on real wages and crimp household spending.

- **Monetary Policy Forecast:** We expect BoE MPC to remain on hold at 0.25% at the next meeting on 11 May. Though inflation is ticking higher, we think a premature tightening to arrest inflation may upset growth momentum especially in an environment of slowing growth (due to potential consumer squeeze and falling business investment) and *Brexit* uncertainty. We do however acknowledge that the MPC stance may shift (more dissenters but not enough to form a majority to vote for rate increase) and such shift could support GBP (as market speculates for tightening). BoE MPC member Vlieghe commented (23 Mar) that inflation doesn't mean rate increase. He elaborated that he needs to see evidence of strong wage growth before considering voting for a rate rise. He added that much of inflationary pressures (headline) was due to GBP's sharp depreciation and the consequential price action via the import price channel on fuel and food. This echoed BoE deputy Governor Broadbent's comments (23 Mar) that there is no material evidence of domestic inflation pressures.

- At the last MPC meeting (16 Mar), though policy rate was kept unchanged at 0.25%, the vote was not unanimous (8-1 voted to hold). Kristin Forbes voted for 25bps hike, she believes that MPC should be nimble to and willing to quickly adjust the appropriate path for monetary policy in either direction as needed. She believes a rate hike now to reduce upside inflation pressures and deliver fresh stimulus if it turned out that BoE had moved too early. The other surprise was that more than 1 other member believes it take little additional upside news to justify tightening. The recent meeting suggests that the BoE stance could be shifting and is preparing markets for a rate hike, possibly sooner than expected (we had initially expected to BoE to remain on hold as recent data suggests slowing momentum while real wages may fall and affect household spending).

- **Latest Fiscal and External Balance Outlook:** UK Chancellor Hammond presented the Spring budget statement (8 Mar) - maintained his plan to tighten fiscal policy by around 2% of GDP through 2020/21; expects to borrow GBP24bn less between 2016/17 and 2020/21 (as compared to his projection in the Nov's Autumn statement); which gives him the flexibility to loosen fiscal policy should there be a need. Debt to GDP ratio is now projected to decline from 88.8% in 2017/18 to 88.5% in 2018/19 and 79.8% in 2021/22. The budget took into account fresh updates to 2017 growth forecast (2%, from 1.4% previously).

- We had shared that persistent large current account deficit in UK, from both a historical and international perspective could pose risks to financial stability and vulnerability to its currency if the UK fails to attract inflow of funds to finance the deficit (due to *Brexit* uncertainty).

- **Key domestic events and issues to watch:** Mar Mfg PMI (3 Apr); Mar Construction PMI (4 Apr); Mar services PMI (5 Apr); Feb IP, trade (7 Apr); Mar CPI, PPI, RPI (11 Apr); Feb jobs report (12 Apr); Mar retail sales (21 Apr); public finances (21 Apr); 1Q GDP (28 Apr). No BoE meeting is scheduled for Apr. The next one is scheduled on 11 May.

- **Technical Outlook:** GBP sprang higher (above 1.26-handle) in the lead up to end-Mar Trigger of Article 50. The move was consistent with our technical call that indicators were suggesting bullish signals. Pair has since eased; last seen at 1.2440 levels. Bullish momentum on daily chart is waning while stochastics is showing signs of falling from overbought conditions. Support at 1.2350 (21 DMA) before 1.2180 levels. Resistance at 1.2680 (200 DMA), 1.2720 levels.

AUD: The Correction

Forecast	2Q 2017	3Q 2017	4Q 2017	1Q 2018
AUDUSD	0.7300 (--)	0.7500 (--)	0.7800 (--)	0.7800 (--)

No Change To Previous Forecasts

- **Motivation for the FX View:** We have been bullish on the AUD on the back of the commodity upswing. However, we see potential correction in the AUD at this point as we anticipate the correction in the metal prices (in particular iron ore) to continue amid tightening property measures in China, a pause in the Trump reflation theme, the stretched long AUD positioning that could be vulnerable to unwinding and perhaps, concomitantly bearish technical cues. In addition, the Federal Budget is due to be presented in early May. Failing to impress could result in the loss of its highly prized AAA-rated. Pressure might build in the AUD in the lead-up to the event. That could bring the pair towards 0.75 or even 0.72. Beyond the near-term, we still look for AUD to head higher towards 0.78 (vs. the USD) by the end of the year, as we expect the demand for commodities to be sustained somewhat on the back of global infrastructure demands.

- **Are we worried about Australia's AAA rating?** Australia may lose its AAA rating at the May budget delivery this year. Most of the impact on the AUD is likely to be a kneejerk and we even see risks of a near-term pressure in the lead-up amid all the uncertainties. It could be a mild knock on business confidence and a political blow. However, the economic consequence is more nuanced. Australia government debt is fully denominated in Australian dollars so the government is fully able to pay by its debt even if borrowing cost rise. The impact could however be on the banks' credit rating as a downgrade from their current AA- could raise their funding cost. In response, RBA may have to cut cash target rate to negate the rise. The ANZ 5Y CDS jumped a little around mid-Mar but remained rather low (at around 57) compared to the average seen last year. That said, growth outlook this year seems a bit more sanguine, albeit still uncertain, than the last. The recovery in external demand may allow more breathing room for services sector in Australia to fill the void left behind by the mining investment. The improvement in its external balance should boost the government's ability to finance its budget shortfall and avert the loss of its AAA rating within the year.

- **Growth and Inflation Outlook:** 4Q GDP came in rather strong with a 1.1%q/q growth seen, a rebound from the previous -0.5%. Growth was driven by a rebound in private (0.3ppt) and public investment (0.3ppt), strong household consumption (0.5ppt) and Australia's growth outlook. Jan retail sales quickened to 0.4%m/m from previous -0.1%. However, year-on-year, retail sales is still on the downtrend, still weak around 3.1% (s.adj) for the month, below the 2016 average of 3.5%. Last available data revealed that ratio of household debt to disposable income is still on the rise while wage growth is still weak. That could weigh on consumption. Labour data has been weakening with full time employment decline in the past few months and part time growth also losing momentum. Unemployment growth has been ticking higher. Actual hours worked actually decreased in the past two months. Spare capacity in the labour market has risen in recent months, increasing the downside risks to household consumption and growth prospects. Capacity utilization rates in the manufacturing and services sector have been softening, albeit still above the 5-year average.

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

- **Monetary Policy Forecast:** We expect RBA to hold rates at 1.5% for the rest of this year. Risks are still tilted to a cut rather than a hike given the rising unemployment, softening wage prospects, a buoyant property prices and high household debt to income ratio. If we recall, the last two cuts in 2016 was done to raise demand so that inflation could be nudged nearer to the 2-3% target. In the February Statement on Monetary Statement, RBA expects headline inflation to reach 2% by early 2017 whilst underlying inflation is likely to rise more gradually. That would mean that the central bank should not see any urgency for additional cuts from the inflation perspective. However, spare labour capacity in Australia is a downside risks to policy rates. Still, with an increasing concern of a "build-up of risks associated with the housing market" as indicated in the Minutes of the Mar meeting, a rate cut is thus unlikely in May.

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

- **Latest Fiscal and External Balance Outlook:** When it comes to the budget, the incumbent government is always wary about losing its AAA sovereign rating. The Mid-Year Economic and Fiscal Outlook (MYEFO) released in Dec 2016 saw its budget deficit rise by more than A$10bn. Australia kept its top-grade rating at all three agencies but S&P expressed pessimism about the government's ability to return the budget to surplus by end FY2021. There is a real risk that S&P could downgrade Australia at May. However, the rating agency had assured that a one-step rating downgrade on Australia would only affect those states and territories that have AAA ratings (namely New South Wales, Victoria and Australian Capital Territory).

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

- **Key domestic events and issues to watch:** Retail sales and building approvals on the 3rd, followed by Feb trade RBA meeting on the 4th, home loans on 10th, NAB business survey on the 11th, Westpac consumer confidence on the 12th, labour report on 13th, RBA Minutes on the 18th, 1Q CPI on the 26th, PPI on the 28th.

- **Technical Outlook:** We see potential correction in the AUD this month even though it is seasonally bullish. Last seen around 0.7650, daily chart shows little direction bias on the momentum indicators. Weekly momentum is bearish and we see a correction towards 0.75 first. A break there could bring the pair towards 0.7360 before a complete 1Q retracement towards 0.72.

NZD: Period of Consolidation

Forecast	2Q 2017	3Q 2017	4Q 2017	1Q 2018
NZDUSD	0.7100 (--)	0.7300 (--)	0.7500 (--)	0.7700 (--)

No Change to Previous Forecast

- **Motivation for the FX View:** We **expect Kiwi to consolidate in 0.6900 - 0.7200 range in the weeks ahead, with bias to buy on dips**. We see **supporting factors** from a **neutral RBNZ** (no longer on easing stance but yet to hike anytime soon); **better inflation outlook** - 4Q inflation jumped back into 1-3% target band and is expected to gradually move into the middle of the target band (focus on 1Q inflation data release on 20 Apr); **optimistic growth outlook** despite the dip in 4Q 2016 (due to one-off seasonal factors) and **favorable yield differentials** (in favor of NZ). Though the outlook of dairy prices has turned softer (due to increased supply) and expected to be volatile this year, we think the **soft dairy outlook has already been priced into NZD, to some extent**. The risk here is actually to the upside - especially if demand picks up and the outlook turns positive - this is NZD positive (but we are not of this view for now).

- **Mitigating factors that could limit NZD upside** include no imminent rate hike (though we think RBNZ could potentially raise rates much earlier than RBNZ and markets expectations - OIS suggests mid-2018 rate hike), **RBNZ's explicit discomfort for NZD to rise too quickly** (note that RBNZ found the 4% decline in NZD TWI encouraging) and external events including political event risk in France (23 Apr and 7 May) - negative surprise may see a pullback in risk sentiment hence countering NZD (risk proxy) upside. We do caution that expected decline in 1Q outside the 1 - 3% range could re-ignite NZD downside risks.

- We maintain our NZD forecast over the forecast horizon, expecting Kiwi to gradually rise into 1Q 2018, due to RBNZ rate hike expectations and domestic resilience. Our fair value based on current account differentials, bond yield differentials adjusted for inflation (between NZ and US) and reflation proxy puts NZD at 0.76.

- To take stock of the past month, NZD traded as low as 0.6890, in line with our call (in our last Monthly Outlook). The decline came amid back to back decline in dairy prices (7 Mar auction) and USD strength (in the lead-up to FoMC meeting in mid-Mar). Pair later rebounded to trade above 0.70-handle, following the stabilization in dairy prices (21 Mar auction) and RBNZ meeting (confirming neutral bias).

- **Growth and Inflation Outlook: 4Q GDP surprised to the downside** (+0.4% q/q vs. +0.7% Consensus), due to the drag on manufacturing and agricultural production (amid wet weather conditions) as well as mining sector (owing to closure of the Maari oilfield). 3Q growth was also revised lower to 0.8% q/q (vs. +1.1%). 2016 annual growth eased to 2.7% y/y. That said growth is still expected to return in 1Q 2017 as wet weather factors are deemed to be temporary.

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

- **Headline inflation has finally returned to RBNZ's 1 – 3% target band**, as seen from 4Q 2016 inflation (+1.4% y/y vs. +0.4% in 3Q). Though the jump was due to increases in petrol prices, inflation is expected to return to the middle of the target band gradually, in part reflecting the strength of the domestic economy and in part due to base effects (oil prices). Longer-term inflation expectations remain well anchored at about 2%. **1Q headline inflation is scheduled for release on 20 Apr.**

- **Monetary Policy Forecast:** We expect RBNZ to raise rates earlier than their own forecast – Mar 2020. We believe the RBNZ should be one of the next major central banks to raise rates as inflation is already showing further signs of uptick owing to higher commodity prices, construction-related cost pressures and strength of the domestic economy. NZ OIS shows markets are expecting a hike in Mar 2018. There is no RBNZ meeting in Apr; next meeting is scheduled on 11 May.

- RBNZ kept rate on hold at 1.75%, as widely expected at the last meeting on 24 Mar. Accompanying statement is "neutral", in line with Wheeler's speech (2 Mar) – confirming the shift to a neutral policy stance and describing the balance of risks to inflation as even (skewed to the upside for domestic growth and downside for global growth). He **acknowledged the 4% depreciation in the NZD TWI since Feb and partly attributed the decline to weaker dairy prices and interest rate differentials.** He **stressed again that further depreciation is needed to achieve more balanced growth**. On the softer than expected 4Q GDP, RBNZ Wheeler noted that the it was due to temporary factors and he expects GDP to track a bit above 3% over the next couple of years. On inflation expectations, RBNZ believes longer term expectations remain well anchored at around 2% and that the spike in food prices may see 1Q headline inflation around 2% (data to be released 20th Apr).

- **Latest Fiscal and External Balance Outlook:** Government finances continue to perform well above expectations with OBEGAL showing a surplus of $1.145bn (vs. forecast surplus of $442mil) for the 7-months to Jan 2017. This was due to higher than forecasted tax revenue (from corporate taxes) while expenses were lower than expected.

- 4Q current account deficit narrowed to $2.3bn (vs. revised $5bn in 3Q). The improvement was due to services balances (thanks to tourism). For 2016 NZ current account improved to 2.7% of GDP (vs. 3.4% of GDP in 2015). Net external debt position excluding financial derivatives and equity was $143.5 bn (or 55% of GDP at end-2016), down from $149.1 bn (or 58.2% of GDP) as of 3Q 2016. The narrowing of external debt position was due to faster increase in external lending (increased by $6.3bn) over external borrowing (Increased by $649m).

- **Key domestic events and issues to watch:** Mar food prices (13 Apr); 1Q CPI (20 Apr); Mar trade (28 Apr). GDT auctions on 4 and 18 Apr. No RBNZ meeting scheduled for Apr.

- **Technical Outlook:** NZD fell off a cliff in early-Mar to a low of 0.6890 (9 Mar) from above 0.72-handle. The move was in line with our observation (in the last monthly outlook) - *potential compression of 50, 100, 200D moving averages – this could represent periods of market contraction and is typically a predecessor to price expansion (otherwise known as break-outs) and a push beyond 0.7160 could see the pair venture lower towards 0.7050.* Pair retraced some of its losses into end-Mar; last seen at 0.7020 levels. Bullish momentum on daily remains intact but shows signs of waning. We expect the pair to consolidate in recent range of 0.69 – 0.71, with initial bias to the downside.

JPY: Outperformer So Far

Forecast	2Q 2017	3Q 2017	4Q 2017	1Q 2018
USDJPY	108 (120)	110 (124)	113 (125)	113 (--)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** We do not expect the JPY to depreciate as much as we had expected previously. Doubts about the US reflation trade and concerns about politics in the US have spurred some re-positioning of long-USD bets, providing JPY with a lift. This was also reflected in market positioning for short-JPY bets as well. CFTC data continue to show bearish bets on the JPY are intact but waning. This has led to recent downside moves by USDJPY with the pair now hovering below the 110-levels. In addition, the absence of an acceleration in the yield differentials between the UST and JGB is also constraining USDJPY upticks.

- Consequently, the JPY has been one of the best performing currencies in the region, having gained around 3.20% against the USD month-to-date. Nevertheless, we expect the JPY to remain on the depreciation trend ahead given that the ongoing monetary policy divergence between the US and Japan remains and yield differentials between the UST and JGB are still expected to widen, albeit more gradually. We have therefore tweaked our USDJPY forecast to reflect these market developments. We now expect the USDJPY upward trajectory to be more gradual with the pair ending 2Q, 3Q and 4Q at 108, 110, and 113 respectively.

- As we had noted before, the BOJ's ultra-loose monetary policy remains intact for now. Contrary to some expectations, the BOJ is in no hurry to provide an exit strategy. In its recent minutes for its 30-31 meeting, most members of the board expect the 2% inflation target to be achieved around FY2018 but they also said that the momentum to achieving the price target was "not sufficiently firm". This suggests that the current policy stance could be maintained, and possibly expanded if necessary, to achieve the target and any tapering remains a distant goal. Even in the opinion summary of the latest meeting on 15-16 Mar, there were concerns voiced among some board members the BOJ should continue with its current easing policy until the 2% price target is achieved. The policy bias thus appears to be for the continuation of existing monetary easing and low domestic interest rates for as long as the 2% inflation target is not achieved.

- With the BOJ on easing mode and the Fed on a tightening bias, we can expect the monetary policy to diverge even further. As such, the Fed's Jun meetings will be closely watched. There is a possibility that the Fed could be tightened even more than expected should US growth momentum picks up, spurring greater inflationary pressures. As yield differentials between the UST and JGB continue to widen, downside pressure on the JPY should persist and boost the USDJPY higher. Though doubts about Trump reflation trade exist currently that is weighing on the USDJPY, we cannot discount the possibility that the Trump reflation trade could g0ain some traction ahead that could result in yield differentials between the UST and JGB widening further. Thus, this could be supportive of the USDJPY bounce higher from the 108 levels in 2Q back towards the 113 levels by end-2017.

- We also do not discount the possibility of further BOJ easing measures in 2017 should inflation fail to gain traction. But we do not think any further moves by the BOJ are imminent. This is because the BOJ is likely to stay in the sideline for now and await further Fed moves as continues on its tightening bias. But should inflation falter and fail to accelerate by the end of the year, the BOJ may unleash even more easing measures then. The easing measures could include cutting interest rate further to -0.3% (from -0.1% currently) and increasing asset purchases of ETFs and J-REITs and other instruments to JPY10tn and JPY6tn.

- Aside from doubts about Trump reflation trades and concerns about the ability of the Trump administration to push ahead with tax reforms and infrastructure spending, other factors that is likely to constrain USDJPY upside includes its persistent current account surplus, safe-haven plays and continuing speculation of a BOJ tapering. The current account remains in a surplus in Jan 2017 at JPY1.26bn. This comes in the heel of the surplus for the whole of 2016 at JPY20.7tn, the largest since 2007. In addition, risk aversion on concerns about US protectionist measures, political uncertainties in the EU and geopolitical tensions on the Korean peninsula could spur safe haven plays. Though this is unlikely and not our base case, there is speculation that the BOJ will have to embark on tapering this year as it runs-up against operational limits where there could be greater demand for JGB than supply. These should work together to cap USDJPY upward trajectory.

- **Growth and Inflation Outlook:** The Cabinet Office's assessment that the economy is on a moderate recovery is being played in the final 4Q16 GDP print. Final GDP print showed the economy expanding by 1.2% q/q annualized, an improvement from the preliminary print of 1.0%. 4Q growth was bolstered by export-related business spending (+8.4% q/q saar) that offset the sluggish private consumption (+0.2% q/q saar). Support from the external sector was reflected in the gains in exports, which rose 11.0% q/q saar, while imports were up by 5.3%.

- Recent high frequency data is also showing an economy in recovery. Both industrial production and core machinery orders rose by 3.7% and 8.6% y/y respectively in Jan from Dec's 3.2% and 10.7%. Exports are also showing gains from a cyclical global recovery with exports rising by 11.3% y/y in Feb, the fastest increase since Jan 2015. Imports moderated to 1.2% y/y in Feb from 8.4% but this was still the second straight month of increase. Until private consumption catches up, the economy is likely to just chug along for the rest of the year. Even the record budget for FY2017 of JPY97.45tn is unlikely to provide much support for domestic demand as most of the budget has been allocated for military expenditure, debt-servicing expenses and social services cost. Only JPY5.98tn is set aside for public and other works. Thus, a marked economic recovery does not appear to be in sight anytime soon.

- Inflation has yet to gain traction even after all the efforts of the BOJ. Headline inflation for Feb showed some signs of life, rising by 0.3% y/y in Feb, helped by higher transport costs (up 0.3% y/y in both Jan and Feb) and the more moderate decline in utility cost (Feb: -2.1% y/y vs. Jan: -3.4%). Core inflation (headline inflation excluding fresh food) rose by 0.2% y/y – the first time that core inflation had risen for two consecutive months since 2015. While inflation is on the uptick, momentum though remains weak given that private consumption remains sluggish and wage growth limited. In addition, the favored gauge of the BOJ – 'core-core' inflation (headline inflation less fresh food and energy prices) continues to rise at an uneven pace, rising by 0.1% y/y in Feb from 0.2% in Jan. Nevertheless, the BOJ's 2% inflation target appears to be a distant goal and this suggests that the easing bias in policy should continue.

- **Monetary Policy Forecast:** The comments by BOJ governor Kuroda and other board members in recent weeks suggest that the BOJ is in no hurry to dismantle its ultra-loose monetary policy. The policy bias remains for the BOJ to its current policy framework of QQE with Yield Curve Control that it implemented in Sep 2016. This framework has short-term interest at -0.1% and the yield of the 10Y JGB targeted at about 0%. We expect the BOJ to refrain from adding to its policy measure for now as it focuses on achieving a "normal" yield curve through control of both the short- and longer-terms interest rates. We also expect the BOJ to maintain the pace of JGB purchases at around JPY80tn.

- We think that there is a possibility that the BOJ could ease policy further especially in light of the recent dovish Fed rate hike. Still, such moves are not imminent. Additional measures are likely only should domestic reflation efforts stall. Already, reflation efforts are facing external headwinds, namely from USD weakness and the slow pace of acceleration in yield differentials between the UST and the JGB. Thus, while the BOJ may not make a move at its next meeting at the end of Apr, instead choosing to watch for the impact of further US Fed rate hike and the fiscal plans before making its own moves. The additional measure that the BOJ could unleash includes cutting interest rate further to -0.3% (from -0.1% currently) and increasing asset purchases of ETFs and J-REITs and other instruments to JPY10tn and JPY6tn. Any further easing moves by the BOJ, if needed, could come in 2H 2017.

- **Latest Fiscal and External Balance Outlook:** The FY2017 budget of JPY97.45tn cleared its final hurdle when it was passed by the Upper House of parliament on 27 Mar. The Lower House had already given its approval in Feb. As note previously, the budget was a 0.8% increase from FY2016 with the bulk of it allocated for military expenditure, debt-servicing expenses and social services cost. Together, they account for slightly over 60% of the total budget. Of the total, only JPY5.98tn is set aside for public and other works that would directly impact the economy. The FY2017 takes effect on 1 Apr 2017.

- The current account (CA) surplus narrowed to JPY1.11tn in Dec from JPY1.42tn in Nov due to the smaller surplus in the primary account (Dec: JPY0.68tn vs. Nov: JPY1.20tn). The financial account surplus narrowed as well in Dec to JPY0.38tn from JPY1.10tn in Nov due the larger outflow in portfolio investment (Dec: -JPY5.16tn vs. Nov: -JPY2.34tn) that more than offset the surpluses in direct investment, financial derivatives and other investment. Consequently, the overall balance of payments (BoP) surplus narrowed to JPY0.76tn in Dec from JPY2.19tn in Nov. For the full-year, the current account surplus ballooned to JPY20.65tn – the largest surplus since 2007 – while the financial account rose to JPY28.90thn. Together, this resulted in a full-year BoP surplus of JPY57.80tn.

- **Key domestic events and issues to watch:** 1Q17 Tankan Survey result is due on 3 Apr. The BOJ will meet on 26-27 Apr to decide on monetary policy and the central bank's outlook report will be released on 27 Apr. BOJ Governor Kuroda speaks to Trust Companies

Association on 17 Apr. JGB auctions in Apr: 10-year (4 Apr), 30-year (13 Apr), 5-year (18 Apr), 1-year (18 Apr) and 20-year (20 Apr).

- **Technical Outlook:** USDJPY drifted lower for the month of Mar, in line with our caution for further downside on the break below 111.80 levels. Price action suggests an interim base may have been formed around 110 – 111. We look for further upside from here. Key resistance at 112 - a weekly close above this could see further upside towards 113.80, 114.50.

CNY: Deflating Trump Trade

Forecast	2Q 2017	3Q 2017	4Q 2017	1Q 2018
USDCNY	6.96 (7.03)	7.02 (7.08)	7.05 (7.04)	7.05 (--)
USDCNH	6.96 (7.05)	7.03 (7.10)	7.06 (7.02)	7.05 (--)

Previous Forecast In Parenthesis

- **Motivation for the FX View:** With Trump doubts seeping into the market, the USD slid in tandem. We have now revised our USDCNY trajectory in tandem as we closely eye the USD. While we still look for mild USD strength, we anticipate that bulls may only be invigorated later in the year when the Trump reflation trade comes back. We remain cautiously optimistic about his plans for corporate tax reforms and infrastructure despite his failure to push through a new healthcare bill. In the near term, we eye the Trump-Xi Summit scheduled on 6-7Apr, near the release of the FX Report by the US Treasury on 15 Apr. This report regularly reviews on whether major trading partners of the US can be labelled by Trump as currency manipulators. With US chocking the biggest trade deficit with China, it is one report that China will eye. By its traditional methods of assessment however, China is unlikely to fulfill all three criteria to be labelled as a currency manipulator simply because 1) it has not been buying foreign assets to cheapen the RMB and 2) its current account surplus is only 1.9% of GDP, less than the 3% required for it to fulfill criteria (2). Still, with a lack of cue from the USD, expect USDCNH and USDCNY to remain in sideway trades. Key support level around 6.83-6.84.

- The 12month USDCNH forward points continue to drift lower to 1800 as we write. This underscores 1) the lack of USD cues; 2) market players' confidence in the central bank to keep the RMB stable. This can continue as long as the USD and US rates do not see a sudden surge. In the midst of the current calm, China has been encouraging foreign inflows. Capital outflow is a concern in the backdrop as more Chinese nationals seek returns overseas and gain the USD exposure, in addition to the requirements of the One Belt One Road initiative. In recognition of China's efforts to improve its financial market accessibility, MSCI has proposed a new consultation to include China's A-shares in its EM index. Their new proposal would reduce the number of companies to 169 from the previous 448 under the proposal last year by including only large cap companies. CNH is to be used for index calculation instead of the originally proposed CNY in order to "minimize currency drag and potential tracking error due to divergence of CNY and CNH". The weight of the A-shares will also be reduced to 0.5% from the previous 1.0%. This could raise the chances of China's A Shares inclusion into the MSCI EM index and boost foreign inflows into China's domestic equity market.

- **Our monthly Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) showed the score for China improved to 4.9 (with 1 being the best and 9 being the worst) on the back of improvement in the scores for PE valuation, fiscal and inflation.

- **Growth and inflation outlook:** PMI-mfg for Mar came out stronger with a headline of 51.8 vs. the previous 51.6. Breakdown in the NBS release suggests that much of the expansion is still experienced by the larger enterprises. The medium enterprises also experienced expansion but to a smaller extent (50.4 vs. prev. 50.5). The small enterprises are still seeing contractions. Feb Caixin reported a strong number of 51.7 vs. the previous 51.0 with the report noting a stronger improvement in overall business conditions in Feb. The manufacturing sector seems rather divergent with "overcapacity" firms also posting higher industrial profits compared to those in sectors that are laden with excess capacity. Efforts to cut coal and steel capacity seem to be benefiting the firms that had excess capacity amid the recent surge in external demand. Tightening bias in the monetary policy with special focus on money market rates may continue to penalize smaller companies that are highly leveraged. The NBS Survey also shows that the ratio of Chinese companies facing capital pressure has risen to 41.1% in Mar. More than 50% of small companies say they face high cost of funding.

- Never in history has PPI accelerated so much ahead of CPI as it had in Feb 2017. PPI quickened to 7.8%y/y, underpinned by the surge in base metal prices, exacerbated by the weaker CNY and base effects from last year. On the other hand, CPI slipped to just a rise of 0.8%y/y from the previous month 2.5%. Decline in food costs dragged on the consumer prices headline. ***With food and fuel inflation rather anchored, it is possible for CPI to continue to lag that of PPI for now. In addition, the recent iron ore and oil price moves suggest softer PPI prints for the next few months.*** Subdued consumption and slow wage growth could mean CPI should remain

- At the NPC, growth forecast is lowered from 6.5-7.0% to around 6.5%. Money supply M2 growth is projected at a lower 12% vs. previous 13%. CPI projection is held at 3%. Budget deficit also held at 3% of GDP. FAI is expected to be higher at 9% from previous 8%, suggesting more reliance on infrastructure to support growth whilst PBoC keeps a tightening bias in monetary policy.

- **Monetary Policy Forecast:** PBoC raised 7-, 14-day and 21-day reverse repo rates by 10bps along with those of MLF by the same increase. This is likely meant to reinforce the message that the government desires less debt taking, risk taking and more deleveraging. While the timing of the rates increase (right after the Fed hike in Mar) suggests that PboC would like to prevent the rate-differential between the US-China from narrowing too much which could in turn aggravate capital outflow, the amount of rate increase suggests that the debt-laden economy is not able to withstand too much tightening. The fall in CPI also increases the real borrowing costs and we expect very marginal increments in the rates for the rest of the year.

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

- **Latest Fiscal and External Balance Outlook:** The IMF estimates that China's 'augmented' fiscal deficit is running at around 10% of GDP. From the NPC, Finance Minister Xiao Jie announced that budget deficit for the year is retained at -3% of GDP for 2017 though the absolute deficit amount is raised CNY200bn to RMB2.38trn this year. Government debt is low at 36.7% of GDP, local government debt ceiling is to be raised by 10%. China aims to reduce the VAT brackets from four to three. China to target lowering CNY1trn in corporate tax and expenses including the broadband fees, electricity tariffs and logistics.

- China is still at a nascent stage of looking into public-private-partnership (PPP). Implementation is to speed up with the third batch of MoF PPP taking 11 months to start compared to 15 months for the first batch.

- Current account surplus narrowed to U$11.8bn in 4Q from previous U$37.6bn as imports jumped and financial account also recorded an outflow. The outflow via its capital accounts was around -U$7.4mn, narrowing from U$194mn in 3Q.

- **Key domestic events and issues to watch:** NBS Mfg PMI due on 31st Mar, Caixin PMI on 3rd Apr, foreign reserves on 7th, CPI, PPI on 12th, trade on 13th, monetary data on 10-15th. 1Q GDP, Mar retail sales, FAI, industrial production on 17th. Property prices on 18th. Industrial profits on 27th. Also watch for Trump-Xi Summit at 6-7th Apr.

- **Technical Outlook:** USDCNH has been hovering within a tight range within 6.86-6.88 for the past few sessions. The 21-DMA caps the price action. The sell-on-Fed in the USD seems to have effect a throwback for the recent break out of the triangle in the USDCNH. We continue to watch the support level at 6.8410. Breaking that opens the way towards the next support at 6.8330. Despite the downside risks in the USD, we would like to hold the view that USDCNH could move higher. Resistance at 6.8815 (100-DMA), before the 6.90 again.

KRW: Supported by External Drivers

Forecast	2Q 2017	3Q 2017	4Q 2017	1Q 2018
USDKRW	1140 (1180)	1150 (1170)	1160 (1180)	1170 (--)

Previous Change in Parenthesis

- **Motivation for the FX View:** USDKRW saw 2 way risks: traded to 1-month high of 1157 (7 – 9 Mar) before tumbling to 5-month low of 1110.50 (28 Mar). The moves were within our call for 2-way risks between 1120 and 1170 and we continue to call for 2 way risks, but within lower range of 1090 - 1140 in Apr, with hopes of Trump's spending and tax reforms driving the USD leg and exports recovery, supporting the KRW.

- We see the **potential for KRW to extend its gains further**, possibly past 1,100-handle (vs the USD) on a combination of factors:
  - **Exports recovery gaining momentum**, driven by the shipment of semiconductors and electronic components;
  - **Strong current account surplus** ($5.3bn in Jan) and FX reserves ($374bn in Feb) can withstand external shocks;
  - External environment of **lower than average FX vols** and **well-managed expectations of Fed rate hikes** (2 more going forward according to FoMC's latest dots plot projection) while **absence of clarity on President Trump's tax reform and spending plans** continue to **fuel the hunt for risky assets** and unwinding of USD longs (built since Trump's election victory);
  - **Seasonal strength for KRW in Apr** – 16 out of the past 18 Aprils since 1999 saw KRW appreciating against the USD

- YTD, the KRW has gained nearly 8% (vs. the USD) and about 4% since early-Mar. These gains came despite the domestic negativities that we have flagged including, political scandal involving former President Park (potentially weighing on investors' sentiment), upcoming Presidential elections (in May 2017), slowing private consumption and ongoing corporate restructuring in troubled industries: shipping and shipbuilding (potentially job losses) weighing on domestic growth. Price action does seem to suggest that the recent exports recovery (Korea's exports is about 50% of GDP) and well contained Fed rate hike expectation for 2017 may have created a sweet environment for KRW to extend its gains. We are revising lower our 2Q – 4Q 2017 forecasts but maintained the upward trajectory in USDKRW trajectory into 4Q 2017 as we expect the Fed to step up their pace of tightening into 2018. For Apr, we look for the pair to trade within 1095 – 1140 range.

- **Risks to our Outlook:** We think USDKRW could be subjected to upside risks if the following happens especially against a build-up of short

USDKRW positioning (according to Reuters poll - USDKRW, USDTWD and USDTHB are the 3 pairs perceived to be more short relative to other USD/AXJ): risk off sentiment arising out of equity/commodity sell-off or an re-escalation of geopolitical tensions and/or a steeper and faster than expected Fed rate hike trajectory. We believe that if US stepped away from naming S.Korea as one of the currency manipulators in his semi-annual report (scheduled to be published in mid-Apr), the KRW strength we have seen so far may see some pare-back.

- **Our monthly Maybank Vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for S.Korea deteriorated slightly to 6.2 (vs. 6.0), due to inflation.

- **Growth and Inflation Outlook:** Korea's economy is expected to sustain a moderate pace in the mid-2% growth, driven by improvement in exports and investment despite sluggish domestic growth. 4Q GDP growth was revised higher (+0.5% m/m vs. +0.4% prior) due to increases in private and government consumption as well as construction investment growth. Agricultural, forestry and fishing fell due to deteriorating weather conditions. Per day exports for the first 20 days of Mar continued to jump higher (+14.8% y/y) - its highest level since Aug 2013, driven by semiconductor and petroleum products. Exports to Asia were strong – especially to Vietnam, China and Japan. Korea's industrial production also rebounded sharply (+3.3% m/m) in Jan, due to semiconductor and electronic parts production.

- The BoK expects S.Korea's economy to grow at 2.5% (vs. 2.7% previously forecasted) in 2017. Slowing consumption is the primary factor amid political uncertainty (leading to the decline in consumer confidence). Ongoing corporate restructuring on troubled industries such as shipping and ship-building and the potential risks of protectionist-related measures (from US) may continue to weigh on growth.

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

- **Headline inflation** saw a moderation in Feb: CPI rose by 1.9% y/y (largely driven by transport) but eased from its 4-year high of 2% y/y in Jan. We continue to expect inflation to stay firm but moderate from recent highs as base effects from oil prices are likely to ease going forward. Core inflation stayed unchanged at 1.5% y/y.

- **Monetary Policy Forecast**: We expect BoK to keep monetary policy accommodative, with policy rate on hold at record low of 1.25%, at its upcoming meeting on 13 Apr. There is no impetus for BoK to raise rates as recent rising pressures (headline CPI) were due to base effects from oil prices and is likely to ease going forward and the domestic economy remain sluggish amid slowing private consumption and ongoing corporate restructuring. There is also little incentive to stimulate the economy via lower rates as household debt remains high and BoK does not want to fuel higher debt. Latest BoK report on financial stability showed debt owed by so-called high risk households stands at 7% of total debt in 2016 (up from 5.7% in 2015). This group of people refers to those holding more debt than the value of assets and has a debt service ratio above 40%.

- **Latest Fiscal and External Balance Outlook:** Current account surplus narrowed to5.28bn in Jan (vs. $7.87bn in Dec) (vs. 8.89bn in Nov) due to goods account surplus narrowing while services account deficit rose. This is the 59th consecutive month of surplus.

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

- **Key domestic events and issues to watch:** S. Korea releases Mar trade data (1 Apr); CPI (4 Apr); BoK meeting (13 Apr); 1Q GDP (27 Apr) and Mar Industrial Production (28 Apr). Watch out for US Treasury report on currency manipulation (mid-Apr).

- **Technical Outlook:** USDKRW traded lower towards 1110.50 (28 Mar). The move lower was in line with our caution for bearish momentum, but fell short of reaching our support of 1100 levels. Pair was last seen at 1114 levels. Bearish momentum remains intact on daily and weekly chart but we caution that stochastics is in oversold conditions. Downside from here could be limited towards 1090-1100 and we expect rebound risks. Resistance at 1126 before 1136 levels.

SGD: Resilient

Forecast	2Q 2017	3Q 2017	4Q 2017	1Q 2018
USDSGD	1.4100 (1.4250)	1.4200 (1.4350)	1.3950 (1.4050)	1.3950 (--)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** We are now more sanguine over the outlook for the SGD for the next three-to-nine months. The occasional fades in the Trump reflation trades, the ongoing synchronized recovery in exports in the region and possible monetary policy convergence with the US are supportive of the SGD. The more sanguine SGD outlook is reflected in the gains in the currency against the USD so far in Mar. Month-to-date, the SGD has been one of the best performing currencies in ASEAN, rising about 1% against the USD. Year-to-date, the gains by the SGD against the USD has been even greater, up by 3.7%.

- The SGD remains supported by improvement in the macroeconomic fundamentals of the economy. The synchronized recovery in exports in the region led by the pick-up in US growth, and which appears to be broadening to services such as wholesale trade, and finance and business services, is helping to bolster investment sentiments amid broad dollar weakness. Recent exports and manufacturing data affirms this improvement in the domestic macroeconomic environment with NODX rising strongly by 21.5% y/y in Feb, while industrial production expanding by 12.6% y/y. Non-oil re-exports (NORX) – a proxy for wholesale trade services – rose by a robust 10% y/y. The SGD should also find support from the government's mildly expansionary fiscal policy, still accommodative monetary policy, its triple-A status and persistent balance of payments surpluses.

- Aside from macroeconomic fundamentals, the unwinding of stale long-USDSGD positions should also provide the SGD with some relief in the next month or so as market reassess the Trump reflation trades. This has allowed the SGD to depreciate at a more gradual pace than we had previously expected. Moreover, the lack of any accelerated Fed fund rate hikes in 2017 following the dovish rate hike in Mar is also leading to some reallocation of assets back into Singapore bonds and equities, providing some support for the SGD. Though data on foreign ownership of Singapore equities and government debt is lacking, inference from the gains in the STI as well as lower bond yields could suggest some foreign demand. Year-to-date, the STI is up nearly 10% while yields for the longer tenor government bonds (2-30 years) are lower by 3.4-13.5bp.

- In addition, market is also beginning to price in a possibly move by the MAS as inflation, especially core, is showing signs of re-accelerating and growth on the uptick. A policy shift by the MAS in Apr is not our base case. We continue to expect the MAS to maintain its current neutral policy at its Apr policy meeting amid global uncertainties that includes doubts about US fiscal policy to European politics. Beyond the Apr meeting, there is increasing probability of a policy shift to a "mild appreciation bias" as inflation, including core, and growth gain traction. This tightening bias could manifest itself at the MAS' Oct meeting. Such a move would be supportive of the SGD.

- This does not suggest that the SGD would get a free ride in 2017. We continue to expect a resurgence in USD on the back of the planned US Fed rate hike, possibly in Jun and then in 2H. We also cannot discount the possibility that the Trump reflation trade could gain some traction ahead that could result in narrowing of yield differentials between the UST and SGS. This could reverse some of the funds that had flowed into Singapore assets back towards the US, lifting the USD and the USDSGD at the same time.

- Given these recent market developments, we have revised our USDSGD forecast now expect the pair to grind higher more mildly to 1.41 and 1.42 by end-2Q and -3Q from 1.4250 and 1.4350 previously before holding steady at 1.3950 by end-2017 and into 1Q 2018.

- **Singapore's monthly Maybank Vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) was improved to 4.1 from 4.2 as fiscal risk improved. This should be supportive of the intrinsic value of the SGD. Our model shows that the SGD NEER was last seen 0.26% above the mid-point implied at 1.4011. Upper bound is implied at 1.3731 while lower bound is now at 1.4290.

- **Growth and Inflation Outlook:** As discussed earlier, the domestic macroeconomic environment is showing signs of improvement, spurred by the synchronized recovery in exports in the region. The NODX and industrial production prints so far this year shows the economy off to a good start in 1Q. In the first two months of the year, NODX rose by 14.7% y/y while non-oil re-exports climbed by 5.5% y/y, reaffirming that global demand remains firm. Meanwhile, industrial production also does not look too shabby, expanding by 7.9% y/y in Jan-Feb period. Should the healthy uptick continue into Mar, our economic team expects to see growth expand by 2.7% y/y in 1Q. Flash estimates are expected sometime in the second week of Apr. For the full-year, our economic team continues to expect real GDP to expand by 2.5% in 2017, at the upper end of the government's 1-3% growth forecast, and by 2.3% in 2018.

- Inflation edged higher in Feb. Headline inflation rose by 0.7% y/y in Feb (Jan: 0.6%) on higher transport cost (Feb: 4.2% y/y vs. Jan: 2.8%) even as cost of services (Feb: 1.5% y/y vs. Jan: 1.9%) and food prices (Feb: 1.3% y/y vs. Jan: 1.9%) slipped lower. This was the third straight month that headline inflation has accelerated. Core inflation – which excludes accommodation and private transport - rose by 1.2% y/y in Feb, a moderation from Jan's 1.5%, owing to lower services and food inflation. The government continues to expect headline inflation to pick-up to 0.5-1.5% in 2017 compared to -0.5% in 2016 due to energy-related components and administrative price increases. Our economic team maintains its projection that inflation will accelerate faster this year with headline inflation averaging around +1.2%, at the upper end of the government's forecast. The team expects higher commodity prices (both oil and food) and a cyclical recovery to lift inflation incrementally over the year. Inflation will also be lifted by higher water prices in Jul this year. The team is also keeping in place its core inflation forecast at 1.6% for 2017 (which is also at the upper half of the MAS forecast range of 1-2%).

- **Monetary Policy Forecast:** Despite the pick-up in inflation and firmer growth, we do not expect the MAS to shift away from its current neutral policy at its Apr policy meeting. Instead, the MAS is likely to sit on the sidelines for now amid global uncertainties ranging from US fiscal policy to European politics. "Neutral bias" means that the rate of appreciation of the SGD NEER will be kept at zero percent and the width of the policy band and the level at which it is centered will remain unchanged. Beyond the Apr meeting, there is increasing probability of a policy shift to a "mild appreciation bias" as inflation, including core, and growth gain traction. Our economic team is not only expecting stronger growth in 2017 (of 2.5%) but inflation at the upper half of the government's forecast range (for both headline and core). This shift then means that the SGD NEER will be allowed to appreciate mildly but the width of the policy band and the level at which it is centered is not expected to change.

- The USDSGD slipped to a recent low of 1.3909 (on 27 Mar) – a level not seen since Nov 2016) briefly touched a multi-year high (not seen since 9 Nov 2009 on the back of a pullback in the USD. Pair has since rebounded but remains below the 1.40-levels at the point of writing. This drop in the USDSGD has resulted in the 3-month SOR (3MSOR) coming off from 1.0118% on 3 Jan to 0.8389% on 29 Mar. The slide in the 3-month SIBOR (3MSIBOR) has been more gradual with the rate falling from 0.9689% at the start of the year to 0.9458% as of 29 Mar. Year-to-date, the 3MSIBOR and 3MSOR have fallen by around 2.38% and 17.09% respectively. The more modest rise in rates suggests that the rise in mortgage rates is unlikely to be significant for now. Deposit rates (for 12-month fixed) have not risen since end-Jan but has slipped lower to 0.33%. This continues to suggest that risks related to interest rate increases affecting financial and economic stability, particularly in interest rate- and property-related sectors, seems limited for now.

- Upward pressure on domestic rates remains given our expectations of two more Fed rate hikes for the remainder of 2017. US 3MLIBOR continues to edge higher and is currently hovering around 1.147% at the point of writing, just a tad off its 2017 high of 1.1568% on 22 Mar. Ample liquidity has so far kept domestic rates from tracking the US 3MLIBOR higher. With US rate hike trajectory still on a gradual path, domestic rates should continue its slow grind higher. We expect the 3MSIBOR and 3MSOR to end 2Q 2017 at 1.47% and 1.25% respectively. For the full-year, we expect the rates to end 2017 at 1.80% and 2.02% respectively.

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

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

- **Key domestic events and issues to watch:** Advanced GDP print for 1Q 2017 will be released sometime between 7-14 Apr. We also have MAS bi-annual policy decision expected sometime in the same period.

- **Technical Outlook:** USDSGD traded lower, past 1.40 handle to a low of 1.3909 (27 Mar). While downside pressure persists on the pair, the area of support at 1.3910-1.3930 appears firm. Pair was last seen at 1.3960. Bearish momentum is waning while stochastics shows signs of rising from oversold conditions - rebound risks may be on the horizon. Resistance at 1.4050 (21 DMA). Key support at 1.3920 (200 DMA) – if broken on weekly close may nullify rebound risks and suggest further downside. Bias to buy on dips.

MYR: Remains in tight range

Forecast	2Q 2017	3Q 2017	4Q 2017	1Q 2018
USDMYR	4.4000 (4.3500)	4.3500 (4.2000)	4.4000 (4.2500)	4.3500 (--)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** Over the past 1 month, MYR strengthened slightly by around 0.7%, ending the month at 4.42, as USD softened in the latter half of Mar.

- USDMYR traded as high as 4.46 (10 Mar) but has since retreated back 4.42 levels. We think this weakness could still persist in the short term but solid underlying fundamentals and policies {backed by domestic demand, re-calibrated supportive budget (on a lower oil price assumption suggests flexibility in the fiscal space), relative stability in oil prices though some downside pressure exists, relative attractive yields in the MGS, stabilizing ratio of FX reserves to retained imports & short-term debt, accommodative monetary conditions to support businesses} remain intact and should provide an anchor for MYR stability once short-term noises subsided. Given the openness of the economy and the high participation of foreign investors, the Malaysian Ringgit is highly exposed to the global economic environment. Nonetheless, the Ringgit could face downside risk on the back of the recent declining trend in the current account surplus, relatively limited FX reserves in comparison to other major EMs, exposure to Chinese demand for the country's export performance, and US rate normalization affecting emerging markets.

- USDMYR is likely to trade in very narrow ranges unlike in the past since the restrictions on the offshore market were made late 2016. Some dollar retracements remain possible following the actual Fed rate hikes and bond positioning thus far in 1Q 2017, which could be positive for the MYR. That said, in light of recent market development, we have calibrated our USDMYR forecasts a touch higher over the forecast horizon to reflect our assessment that the MYR demand would likely remain muted and that the 4.30-4.40 range would likely remain sustained in 2017.

- **Our fair value estimate (which takes into account interest rate differential, inflation differential, current account differential and reflation variables) puts USDMYR at 3.65 levels.** We had previously said that Ringgit weakness was temporary and was not a reflection of underlying fundamentals (which remain intact). We still expect to see some stability returning to Ringgit as political/contingent liability risk subsides, fiscal consolidation/reforms gains traction, oil prices stabilize and uncertainty subsides over the next 12 months.

- External reserves at end-Feb 2017 totaled USD95b, unchanged vs end-Jan 2017 as repatriation of export earnings and net foreign buying of equities offset continued net foreign selling of bonds. At USD95b, the external reserves are equivalent to 8.5 months of retained imports and 1.1 times of short-term external debt. Repatriation of export earnings kicking in In a statement by BNM's Financial Market Committee (FMC) on 17 Feb 2017, the repatriations of net exports were USD372.9m in Dec 2016 and USD741.3m in Jan 2017. Against the trade surplus of USD1,956.1m in Dec 2016 and USD1,057.7m in Jan 2017, repatriation as % of trade surplus increased from 19.1% in Dec 2016 to 70.1% in Jan 2017, indicating improved implementation and rising compliance with the required 75% repatriation of export earnings announced by BNM on 2 Dec 2016. For Dec 2016 – Jan 2017, the repatriation rate was 37%, compared with the average of just 1% in 2011-2015, which fell from the average of 28% in 2006-2010.

- Foreign investors buy equities, sell bonds Foreigners were net buyers of Malaysian equities in the first two months of 2017 totaling +MYR1.47b i.e. +MYR0.97b in Feb 2017 and +MYR0.5b in Jan 2017 vs the net selling of –MYR5.7b in the final four months of 2016. But they were net sellers of Malaysian bonds in the first two months of 2017 totaling –MYR11.2b i.e. –MYR7.3b in Feb 2017 and –MYR3.9b in Jan 2017, which also marked four consecutive months of net selling which totaled –MYR36.4b. Our attention is on the total of MYR66.8b of MGS and GII maturing this year, of which we estimated MYR30b-MYR35b are held by foreigners. MYR8.8b 10-year MGS note matured on 15 Feb 2017. However, the 10-year MGS yield fell to 4.06% at end-Feb 2017 vs 4.15% at end-Jan 2017, indicating the net selling by foreign bondholders was offset by domestic institutional investors' net buying. The next maturity is a MYR10.5b 3-year MGS note on 15 Mar

2017 – the day when the US Fed's FOMC meeting is expected to conclude with a 25bps hike in the fed fund rate.

- **Growth and Inflation Outlook:** Maintain our 2017 real GDP forecast of +4.4% (2016: +4.2%), underpinned by faster growth in domestic demand (2017E: +4.9%; 2016: +4.4%) reflecting sustained consumer spending growth (2017E: +5.9%; 2016: +6.1%), stronger investment growth (2017E: +3.9%; 2016: +2.7%) on progress of existing - and the rollout of - new major infrastructure and investment projects, and pick up in government consumption expenditure (2017E: +2.9%; 2016: +1.0%).

- The wild card is external trade in view of the uncertainties over the US trade policy under President Trump, especially the risk to US-China trade relation. However, under the current expectation of a moderate pick up in global economic growth (2017E: +3.1%; 2016: +2.9%) and firmer commodity prices, we are looking at relative better trade growth in 2017 i.e. higher growth in exports and imports of goods and services of +1.3% and +1.5% respectively (2016: +0.1% and +0.4% respectively).

- At this juncture, we still need to keep a close tab on key high frequency domestic data, namely the monthly economic indicators such as the indices on industrial production and distributive trade, external trade, money and banking statistics, as well as major commodity output and prices. In addition, our eyes are also on the economic trends as well as policy and political developments in the major economies i.e. US, Europe (including UK), China, Japan.

- Exports posted fastest growth in 3 years as it surged by +22.5% YoY in Jan 2017 (Dec 2016: +6.3% YoY) while imports growth decelerated to +9.1% YoY (Dec 2016: +13.8% YoY). However, trade deficit remained relatively unchanged at –USD2.3b (Dec 2016: -USD2.2b). Pick up in global economic activities and firmer commodity prices are boosting trade amid "overhangs" like directions of US trade and monetary policies, commodity price and China's economy.

- Manufacturing which make up 88% of exports accelerated to +23.1% YoY in Jan 2017 (Dec 2016: +1.7% YoY) on robust growth in shipments of 'Garments' (Jan 2017: +270% YoY; Dec 2016: -3.2% YoY), 'Electronic Products' (Jan 2017: +10.4% YoY; Dec 2016: -2.2% YoY), 'Machinery & Transport Equipment' (Jan 2017: +38.4% YoY; Dec 2016: +1.2% YoY), 'Chemicals' (Jan 2017: +104.7% YoY; Dec 2016: +77.1% YoY) and 'Metal Components' (Jan 2017: +66.3% YoY; Dec 2016: +31.1% YoY). Electronics exports, which accounts for 46% of total exports, was driven by increases in shipments of 'Components Devices, Semiconductor' (Jan 2017: +10.6% YoY; Dec 2016: +2.7% YoY), 'Electronic Data Processing' (Jan 2017: +10.7% YoY; Dec 2016: -13.4% YoY) and 'Communications, Radar' (Jan 2017: +83.6% YoY; Dec 2016: +60% YoY).

- Commodity exports are dominated by 'Agro & Forest Product' which made up 7.7% of Jan 2017's total exports compared with 'Mineral products' which accounted for 2.0% of total exports.

- We maintain our 2017 growth forecast at +4.4% (2016: +4.2%) in view of the still fluid global economic, market, commodity price, political and policy situations, although we acknowledge the potential upsides on the external trade side.

- Headline inflation rate in Feb 2017 jumped to +4.5% YoY (Jan 2017: +3.2% YoY) while core inflation rose moderately to +2.5% YoY (Jan 2017: +2.3% YoY). Inflation rate in the first two months was +3.9%, the same as a year ago. Maintain our full-year 2017 inflation rate forecast at 3.0%-3.5% (2016: +2.1%).

- Headline inflation rate surged to +4.5% YoY in Feb 2017 (Jan 2017: +3.2% YoY; Maybank-KE: +4.1% YoY; Consensus: +3.9% YoY) while core inflation rate (excluding volatile and price-controlled/price-subsidised components of the CPI) posted moderate rise at +2.5% YoY (Jan 2017: +2.3% YoY). Compared with Jan 2017, both headline and core inflation rate rose +1.3% MoM and +0.5% MoM respectively last month. The jump in headline inflation during the month was mainly attributed to the surge in “Transport” (Feb 2017: +17.9% YoY; Jan 2017: +8.3% YoY) while “Food and Non-Alcoholic Beverages” also picked up (Feb 2017: +4.3% YoY; Jan 2017: +4.0% YoY).

- Maintain our 2017 inflation rate forecast at 3.0%-3.5% (2016: +2.1%), while the official inflation forecast by Bank Negara Malaysia (BNM) was raised to 3.0%-4.0% from 2.0%-3.0% previously. BNM’s upward revision largely reflect the impact of firmer commodity prices like crude oil and raw materials, especially on domestic fuel and food prices. However, BNM views the higher inflation this year to be mainly cost-driven and not expected to significantly change the medium term inflation outlook i.e. not demand-driven given the stable domestic demand growth, economic growth that is within the potential output growth of 4.5%-5.0%. The unemployment rate forecast which is raised to a range of 3.6%-3.8% from 3.2% previously (2016: 3.5%) also helps to contain the risk of a wage-driven inflation, hence the underlying or core inflation is expected to increase only moderately. Hence, despite the higher inflation rate expected this year amid expectation of moderate core inflation, we maintain our call that the Overnight Policy Rate (OPR) will be unchanged at +3.0% as the focus of BNM’s monetary policy is to support growth given the continued uncertainties over key factors that could influence the global economy, trade and financial markets, namely the US trade policy stance and delivery of fiscal policy stimulus under President Trump.

- **Monetary Policy Forecast:** BNM kept the Overnight Policy Rate (OPR) at 3.00% at the MPC meeting on 2 Mar 2017. The Statutory Reserve Requirement (SRR) was also maintained at 3.50%. No change in our view of OPR staying at 3.00% this year.

- The Monetary Policy Statement (MPS) issued after the MPC sounds “neutral” to us. Growth momentum is expected to be sustained in 2017 after the 4.2% expansion in 2016, mainly on steady domestic demand. Any upside to growth this year is contingent upon a more positive contribution from the external sector. Inflation will average higher this year (2016: +2.1%) reflecting primarily the pass-through of higher global crude oil prices on domestic retail fuel prices. However, BNM sees the relatively high headline inflation in 1H 2017 to moderating thereafter, while core inflation will rise only modestly as the cost-driven inflation is not expected to have a significant impact on the broader price trends given the stable domestic demand conditions. Official real GDP growth and inflation rate forecasts for this year is 4.0%- 5.0% and 4.0%-5.0%. The next review on economic outlook is when BNM released its 2016 Annual Report on 23 Mar 2017.

- Overall, BNM remarks that growth momentum is sustainable, the recent surge in headline inflation is "transitory", and core inflation should be contained indicate no imminent change in OPR.

- **Maintain our view of stable OPR in 2017**: The "neutral" tone of the MPS is in line with our view of OPR staying at 3.0% this year as we see BNM's monetary policy stance is biased towards supporting growth as BNM still see risks to global and local economy from protectionism, geopolitical developments, heightened volatility of financial markets, and uncertain trajectory of global crude oil prices.

- The improved economic activity in the major advanced economy is expected to support domestic economy via improvement in export growth; as the global economy is expected to grow at a slightly faster pace supported by balanced policy environment with progressive use of fiscal policy by developed economies. Private sector activity is expected to continue driving domestic growth led by sustained growth in private consumption from stable wage and employment growth while investment to be driven by ongoing infrastructure development projects and capital spending in the manufacturing and services sector.

- The key risks to global and local economic outlook are protectionism, geopolitical developments and commodity price volatility which in turn potentially lead to increased financial market volatility.

- BNM expect 2017's growth to pick up after two years of slowdown as the official growth forecast is revised to 4.3%-4.8% from 4.0%-5.0% previously (2016: +4.2%). Inflation is expected to be faster at 3.0%-4.0% from 2.0%- 3.0% previously (2016: +2.1%) but largely "cost-push" rather than "demand-pull" or "wage-driven", so core inflation should be contained. Expect "status quo" BNM monetary and banking policies to support growth and maintain financial stability.

- BNM expects stable domestic demand growth (2017E: +4.4%; 2017E previous: +4.9%; 2016: +4.4%) mainly on sustained consumer spending growth (2017E: +6.0%; 2017E previous: +6.3%; 2016: +6.1%) amid mixed performance in other domestic demand components i.e. decline in public consumption (2017E: -0.2%; 2017E previous: +0.4%; 2016: +1.0%); rebound in public investment (2017E: +1.5%; 2017E previous: +1.1%; 2016: -0.5%), and slower private investment (2017E: +4.1%; 2017E previous: +5.8%; 2016: +4.4%). Net external demand is projected to rebound (2017E: +5.3%; 2017E previous: +1.9%; 2016: -1.8%) as faster global economic growth, recovery in trade activities and firmer commodity prices lifted exports of goods and services (2017E: +2.2%; 2017E previous: +2.5%; 2016: +0.1%) and imports of goods and services (2017E: +1.8%; 2017E previous: +2.6%; 2016: +0.4%). BNM's assumptions for the full-year average prices of major commodity exports are higher than Budget 2017 assumptions i.e. crude oil (2017E: USD50-55/bbl; 2017E previous: USD45/bbl; 2016: USD44/bbl) and CPO (2017E: MYR2,700/tonne; 2017E previous: MYR2,500/tonne; 2016: MYR2,652/tonne). BNM also revealed its assumption for USDMYR average for 2017 of 4.30-4.40 (2016: 4.14).

- BNM sees the faster inflation (2017E: 3%-4%%; 2017E previous: 2-3%; 2016: +2.1%) being "cost-push" due to impact of firmer global commodity prices on domestic prices, not "demand-pull" or "wage-driven" amid stable domestic demand growth, economic growth within the 4.5%-5.0% potential output growth, and unemployment rate forecast which is raised to a range of 3.6%-3.8% from 3.2% previously (2016: 3.5%). Therefore, the underlying or core inflation should be contained, allowing monetary policy to focus on supporting and sustaining growth. Meanwhile, despite the drop in household debt to GDP ratio (end-2016: 88.4%; end-2015: 89.1%), it is still high by historical standard and against regional peers, and BNM still frets about housing affordability and affordable housing, as well as oversupply risk in non-residential properties, signaling no change in the property and prudential measures.

- **Latest Fiscal and External Balance Outlook:** Themed "Accelerating Growth, Ensuring Fiscal Prudence, Enhancing Wellbeing of People", Budget 2017 maintains commitment to fiscal discipline and consolidation; supports domestic demand via corporate income tax rate cut, incentives for tourism, SMEs, exports and digital economy, and infrastructure investment; and focuses on the wellbeing of the low-and middle-income groups by addressing the issues of inclusivity, equality, cost of living and affordable housing.

- Budget deficit target for 2017 is set at -3.0% of GDP, sustaining the policy of fiscal consolidation since 2010. This year's aim of -3.1% of GDP is maintained and achievable. Based on monthly data, we estimated budget deficit in Jan-Aug 2016 was -3.9% of GDP as the deficit of -5.6% of GDP in 1H 2016 turned into an estimated surplus of +1.2% of GDP in July-Aug 2016.

- We expect the fiscal deficit to remain flat at 3.1% of GDP, as government spending is likely to pick up (as we enter the election campaign).

- **Key domestic events and issues to watch:** Trade data (5 Apr); FX reserves (7 Apr); CPI Inflation (19 Apr); Industrial Production (11 Mar); Foreign Reserves (14 Apr), MGS and GII bond auction (1-30 April)

- **Technical *Outlook:*** USDMYR traded slightly lower from its Mar-high (of 10 Mar), tracking other USD/AXJs (albeit at a slower magnitude). Last seen at 4.190 levels. Mild bearish momentum on daily chart is waning but stochastics is showing signs of turning higher from oversold conditions. Resistance at 4.44. Support at 4.4120 (100 DMA), 4.38.

IDR: Supported By Prospects Of S&P Credit Rating Upgrade

Forecast	2Q 2017	3Q 2017	4Q 2017	1Q 2018
USDIDR	13300 (13600)	13400 (13600)	13450 (13300)	13500 (--)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** The IDR has in recent days been consolidating near recent lows of around 13300 levels, helped by the continuing unwinding of long USD positions amid uncertainty over US fiscal policy, the relative peaceful conclusion of domestic regional elections, the cyclical recovery in exports in the region and firmer commodity prices. In addition, speculation of an imminent S&P credit rating upgrade (which we had been positing since last year) has also been positive for the IDR. These developments have allowed the IDR to gain about 0.4% against the USD so far in Mar. Year-to-date, the IDR has risen about 1.2% against the USD. We take this opportunity to tweak our USDIDR outlook over the forecast horizon as we no longer expect the pair to rise as aggressively. We now expect the USDIDR climb to 13300 and 13400 by end-2Q and -3Q from 13600 for both quarters previously and then ending the year at 13450 (previously 13300).

- To date, portfolio inflows into Indonesian assets due to unwinding of long USD positions against EM currencies, including the IDR, as well as speculation of an imminent credit rating upgrade from S&P – the only major rating agency that has yet to give Indonesia an investment grade – has been positive for the IDR. Month-to-date, foreign investors have purchased USD767.69mn in equities, a reversal of Feb's sell-off of USD60.31mn that could probably be attributable to global risk aversion. This brought the investment inflow to equities to USD634.74mn so far this year.

- The risk-on environment extended to government debt as well. Even the narrowing yield differentials between 10Y UST and Indonesian government debt have not discouraged flows into Indonesian government debt as market focused on the possibility of an S&P credit rating upgrade. Foreign funds have added IDR23.01tn to their outstanding holding of government debt in Mar so far – a more than three-fold increase over Feb (IDR6.38tn). Year-to-date, foreign investors have added IDR49.09tn to their outstanding holdings compared to IDR107.29tn in 2016. These inflows into Indonesian assets should be positive for IDR at least in the near term. But should the credit rating fail to materialize, we could see increase volatility in the IDR and for the USDIDR to bounce higher beyond the 13450 levels by the end of the year. This though is not our base case.

- The S&P credit rating upgrade follows from the reform process that has been pushed forward by President Jokowi. Already, the President has initiated 14 stimulus packages with a 15th (relating to logistics) in the works. These reform packages aim to cut red tape and liberalize rules that have been a drag on investment and growth, and support specific growth industries. In addition, government's efforts to rein in the budget deficit by cutting unnecessary expenditure last year amid falling tax revenue and commodity prices have provided more fiscal space to the government in 2017. The government has embarked on an USD400bn infrastructure spending spree as a result that should be positive not only in boosting growth in the near term but should also lift potential growth.

- Aside from improving macroeconomic fundamentals, political stability has also played an important role in ensuring the health of the economy. However, this could come under threat when the run-off for the Jakarta gubernatorial race takes place on 19 Apr. The first round election was peaceful enough but this could change as the run-off race heats up between the two top vote-getters in Jakarta. As the campaigns heats in the lead-up to the polls slated for 19 Apr, race and religion could once again rear their ugly heads and up the ante in the election.

- There is also the incumbent governor Ahok's ongoing trial for blasphemy where the verdict is expected sometime in Apr and May only after the run-off race. A conviction with a sentence of 5-years could disqualify Ahok from taking office even if he wins the run-off. But should calmer heads prevail, the fall-out from an Ahok conviction is likely to be limited given that his deputy will take over and continue their shared political agenda. Nevertheless, foreign investors will still keep a close eye on developments on this front and should tensions boil over, an outflow of foreign funds to safer-haven assets could take place. Otherwise, we expect no major fall-out from the Jakarta gubernatorial run-off race. This should keep the IDR supported in the months ahead.

- This does not mean though that the IDR will get a free ride in 2017. It will still be vulnerable to the two more Fed hikes that we are expecting this year that should narrow the yield differentials in favour of the US. This could spur some reversal in flows from Indonesian assets back into the US and weigh on the IDR. In addition, the political uncertainty in Europe and threat of protectionist measures from the US is likely to spur safe-haven plays and an aversion for riskier assets. Such outflows are likely to weigh on the IDR as well. Together, this is likely to keep the USDIDR supported for the rest of the year and prevent the pair from moving lower towards the 13000 levels just yet.

- **Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for Indonesia deteriorated to 5.4 from 5.2. This was attributable to the deterioration in fiscal risk that offset the mild improvement in current account, inflation and PE valuation risk and should weigh on the intrinsic value of the IDR.

- **Growth and Inflation Outlook:** After expanding by 5.02% in 2016, the outlook for 2017 looks brighter. Government spending, which has been subject to fiscal consolidation in 2016, is set to regain momentum. As we wrote above, the government is planning to spend around

USD400bn on infrastructure that should be supportive of growth. In addition, the cyclical recovery in the region is spurring a rebound in exports should bolster growth. Aside from fiscal stimulus, still accommodative monetary policy should be supportive of growth objectives though further rate cuts appear unlikely for now amid inflation concerns. We are already seeing some optimism in consumer spending as reflected in the uptick in motor vehicle sales, which rose by 7.5% y/y in Feb. External demand is also holding up well with exports rising double-digit for the fourth consecutive month in Feb, up 11.16% y/y. Imports are also up double-digits so far in 2017, suggesting that consumer spending could also be picking up. On the mix of government spending and pick-up in consumer spending, our economic team maintains their full-year real GDP forecast at 5.1% for 2017.

- Inflation appears headed back towards the 4.0% level after headline inflation re-accelerated to 3.83% y/y in Feb. Driving inflation higher in the month was again higher costs of housing and utility (Feb: 3.71% vs. Jan: 2.47%) and transport (Feb: 3.07%vs. Jan: 2.76%). Food prices were also supportive of inflation, accelerating by 4.39% y/y in Feb from Jan's 4.11%. Core inflation also crept higher, rising by 3.41% y/y in Feb (Jan: 3.35%). For 2017 though, inflationary pressures are expected to rise on the back of a rise in administered electricity tariff and volatile food prices. These, together with the weaker domestic currency, should work in tandem to lift imported prices. Consequently, our economic team expects inflation to average 4.28% in 2017, within the central bank's projection for inflation to accelerate above 4.0% in 2017.

- **Monetary Policy Forecast:** The BI has so far left its benchmark interest rate unchanged at its first two meeting this year. The 7-day reverse repo rate remained at 4.75%, while both the lending facility and deposit facility rates were held steady at 5.5% and 4.00% respectively. This kept the interest rate corridor steady at 75bp on either side of the policy rate. The front-loading of rate cuts (amounting to 150bp) in 2016 has given some breathing space to BI to hold its policy rate steady amid US Fed rate hikes this year and threats of protectionism. The central bank itself sees no room for further easing in 2017 given the challenges posed by inflation, the exchange rate, economic growth and lending rates. Already there is growing concern over the potential acceleration in inflation due not only to rising global oil prices but to hikes in domestic factors such as electricity tariff rates that could see headline inflation climbing back above 4% in 2017. Our economic team expects the central bank to keep the policy rate on hold for the rest of the year.

- **Latest Fiscal and External Balance Outlook:** With the tax amnesty programme winding down at end-Mar, the final tally might not be known for a while. Still, data released by the Finance Ministry suggested that the government has earned IDR110tn in penalty rates so far. This was on the back of IDR4668.77tn of assets held abroad declared by Indonesian. Of these, the bulk of the assets were in Singapore with IDR751.19tn, followed by the British Virgin Islands with IDR76.92tn and then by Hong Kong with IDR56.27tn. However, the assets repatriated were small compared to the total assets declared –

just 3.13% or IDR145.95tn. This was probably due to the lack of avenues for investment under the programme. An expansion of investment opportunities could spur more of these funds onshore. Nevertheless, the tax amnesty programme can be considered a success for the revenues it raised for the government as well as the number of participants, which totaled 832,631.

- The current account deficit (CAD) improved significantly in the last quarter of 2016, coming in at -USD1.81bn in 4Q or just 0.8% of GDP, compared to 3Q's -USD4.68bn (1.9% of GDP). This improvement can be attributed to the larger goods and services surplus of USD3.5bn (vs. 3Q: USD2.31bn) and the moderation in the primary income deficit to USD6.27bn from -USD8.01bn in 3Q. The overall balance of payments surplus narrowed to USD4.51bn in 4Q from USD5.71bn in 3Q, underpinned by the narrower CAD and smaller surplus in the financial account of USD6.76bn in 4Q vs. 3Q's USD10.55bn. For the full-year, the CAD improved to 1.75% of GDP in 2016 from 2.03% in 2015. For 2017, our economic team expects the CAD deteriorate to 1.95% of GDP due to greater import of capital goods to support the government's infrastructure programme. This is more sanguine that the BI's CAD projection of 2.11% for 2017.
- **Key domestic events and issues to watch**: Key event will be the Jakarta gubernatorial run-off elections between incumbent Ahok and Anies Basweden on 19 Apr. The campaign has already begun in earnest in Mar. We also have the BI meeting to decide on policy on 20 Apr.
- **Technical Outlook:** USDIDR continued to trade well within 13300 - 13420 range for the month of Mar. Last seen at 13320 levels. Daily momentum remains mild bearish bias. We expect the pair to consolidate in lower range of 13240 (200 DMA) - 13370 (100 DMA).

PHP: Still Pressured Lower

Forecast	2Q 2017	3Q 2017	4Q 2017	1Q 2018
USDPHP	50.30 (50.50)	50.50 (50.50)	50.70 (49.80)	50.70 (--)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** Our bearish view on the PHP in the next three-six months has not changed despite the Philippine's solid growth momentum augmented by the synchronized recovery in ASEAN exports and uncertainty in US fiscal policy. The PHP remains weighed by the Duterte risk premium - i.e. concerns over the government's overly aggressive anti-illegal drug programme and the President's intemperate temperament - that is spurring foreign investors to flee Philippine assets, particularly equities. This continues to put downward pressure on the PHP. Still the unwinding of long USD positions due to doubts about Trump's ability to deliver on his economic promises has provided some support for the PHP. This has allowed the PHP to gain marginally by 0.2% against the USD in Mar so far. Year-to-date though, the PHP has been the worst performer in the region against the USD, falling by 0.9%.

- Given the recent market development, we expect the uptick in the USDPHP to be more gradual in 2Q with the pair likely to end the quarter at 50.30 instead of 50.50 previously. Continued USD strength amid US Fed rate hikes in the remainder of the year should support the pair higher towards 50.50 and 50.70 (previous: 49.80) by end-3Q and end-4Q respectively.

- The PHP continues to be impacted negatively by the Duterte risk premium. This risk premium affects foreign investment decisions as seen in the sell-off of USD251.33mn in equities in Mar-to-date. This was the second straight month that foreign funds have sold off equities this year. Year-to-date then, USD348.98mn of equities has been sold compared to the gains of USD83.39mn for the whole of 2016. Foreign bond purchases data is not available but examination of the Philippine sovereign bond yield movement suggests that foreign funds could very well have sold off government debt as well. Month-to-date, sovereign bond yields were broadly higher by 12.7-37.1bp in Mar except for the 6M and 2Y.

- We need to see this risk premium dissipate before an improvement in the PHP can be seen. Already there have been reports that President Duterte has suspended his war against illegal drugs and assigning the task of cracking down on illegal drugs to the Drug Enforcement Agency rather than to the police force. The extra-judicial killings are unlikely to end but should be reduced significantly with the police force out of the picture. This should allay foreign investor concerns. The dissipation of the Duterte risk premium should eventually lead to the return of foreign investors into the Philippine assets and lift the PHP higher.

- In the longer term, we could see more inflows into the Philippines equity market. This is because valuations in the Philippines have fallen after the sell-off in the equity market over the past few months. According to our estimates using the Cyclical Adjusted P/E (CAPE) ratio, equities are now relatively cheaper (as reflected by estimated P/E ratios minus their 5-year average P/E ratios) compared to its peers and this could eventually attract foreign inflows as a result.

- Until the dissipation of the Duterte risk premium, the PHP remains under downside pressure for the remainder of the year. As we have mentioned earlier, a resurgence in the USD due to the two Fed rate hikes expected for the remainder of this year. In addition, the re-emergence of Trump reflation trades could see yield differentials between UST and Philippine debt (even with the BSP hiking rates once in 2017) narrow and spark further capital outflows. In addition, the potential trade disruption from protectionist measures implemented by the Trump administration could also add to downside pressure on the PHP.

- Macroeconomic fundamentals remain healthy but we doubt that the strong growth momentum, lifted by expansionary fiscal policy, will provide the PHP with a leg higher in 2017. Even the 25bp rate hike expected by our economic team either in 2Q or 3Q of this year to keep the economy from overheating and for inflation to stay within the BSP comfort zone of 2-4% is unlikely to be a panacea for its currency woes. We thus expect the PHP to remain under pressure for the remainder of the year underpinned by USD strength and the Duterte risk premium that should keep the pair supported above the 50-figure in 2017.

- Our monthly **Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, deteriorated to 5.3 from 5.1. This was due to a deterioration in current account, fiscal and PE valuation risks. This should weigh on the intrinsic value of the PHP.

- **Growth and Inflation Outlook:** Despite the challenges ahead, the government continues to target growth of 6.5-7.5% for 2017. The government's optimism stems from its expectations of the lift from expansionary fiscal policy (budget deficit is expected to increase to 3% of GDP from this year to 2019). In contrast, our economic team is projecting growth to come in around 6.4% in 2017, underpinned by infrastructure spending and the cyclical recovery in the region that is boosting exports. Already exports and imports have risen double-digit in Jan, up 24% and 12.2% respectively. Our team though expects a slower pace of consumer spending as a result of faster inflation amid weaker PHP and expected implementation of the first phase of the tax system reforms towards consumption taxes. In addition, the expected 25bp policy rate hike in mid-2017 should slow consumption. Moreover, more downside pressure on consumer spending could come from more moderate overseas remittances amid risks posed by Trump's trade and immigration policy.

- Headline inflation bounced back above the 3% levels for the first time since Nov 2014, rising by 3.3% y/y in Feb from Jan's 2.7%. Higher food prices (Feb: 4.1% y/y vs. Jan: 3.4%), housing and utility costs (Feb: 2.9% y/y vs. Jan: 1.8%) and transport cost (Feb: 2.8% y/y vs. Jan: 2.4%) were the main culprits for the uptick in inflation in the month. Core inflation also crept higher, rising by 2.7% y/y in Feb from Jan's 2.5%. Inflationary pressures remains intact and could accelerate further given a weaker PHP against the USD, impact of phase 1 of the proposed tax reform package and higher commodity prices (especially crude oil and food commodities). Consequently, our economic team expects full-year headline inflation to now average 3.5% in 2017, an upward revision from 3.0% previously. This forecast is at the upper half of the government's 2-4% inflation target for 2017 and in line with the BSP's expectations of 2.9%.

- **Monetary Policy Forecast:** The BSP has kept its benchmark policy rate unchanged since the shift to an interest rate corridor regime in Jun 2016. The overnight borrowing rate was left unchanged at 3.0% together with the overnight lending rate and overnight deposit rate at 3.5% and 2.5% respectively. The 50bp symmetrical corridor on either side of the policy rate was kept in place. Unlike most of it regional peers in the region, the BSP is one of the few central banks in the region to hike domestic rates in 2017. Healthy growth above 6% and accelerating inflation that could edge very close to the upper bound of the government's comfort zone for inflation should spur the central bank into action. There is also the likelihood that further US Fed rate hikes in the remainder of 2017 will narrow the yield differentials in favor of the US that could exacerbate capital outflow. Given these developments, our economic team expects the central bank to hike the policy rate by 25bp rate hike once in 2Q 2017. This modest rate adjustment should ensure that real interest rate remain positive, though we doubt that this would be sufficient to ease downside pressure on the PHP.

- **Latest Fiscal and External Balance Outlook:** Latest data showed that the government started the year on a good footing. The fiscal balance was in surplus for the first time since Jun 2015, coming in at PHP2.22bn. This was on the back of revenues of PHP200.31bn more than offsetting expenditures of PHP108.09bn. In 2016, the government had a budget deficit of PHP353.42bn (-2.4% of GDP) – the largest in the last 10 years. Nevertheless, it must be noted that this large deficit was still short of the government's target deficit of PHP388.9bn (or 3% of GDP) for the full-year as part of government spending plan to spur economic growth.

- The balance of payments (BoP) slipped into an even bigger deficit of USD436.1mn in Feb, a significant jump from Jan's shortfall of USD8.7mn. This large deficit could possibly be attributed to the widening merchandised trade gap and portfolio outflows. The BSP is currently expecting an overall BoP surplus of USD1bn for 2017, though the central bank is expected to revise their forecast in light of recent market development.

- **Key domestic events and issues to watch:** There are no major events in Apr.

THB: Portfolio Inflows Supportive

Forecast	2Q 2017	3Q 2017	4Q 2017	1Q 2018
USDTHB	34.80 (35.50)	35.30 (36.00)	36.00 (36.20)	36.20 (--)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** The THB has been the best performing currency in ASEAN against the USD in Mar as well as the year so far. Month-to-date in Mar, the THB has gained around 1.6% against the USD, which can still be attributed to the strong inflows into government debt. Year-to-date, the THB has gained 4.0% against the USD. Aside from inflows into Thai assets, healthy macroeconomic fundamentals, including current account surpluses, and some unwinding of stale long USD bets against the THB amid doubts about

Trump reflation trade has provided support for the THB. Externally, the cyclical pick-up in export in the region on the back of stronger US growth and more stable Chinese economy has also been supportive of the economy and the THB. On a relative basis, this outperformance among its ASEAN peers could have some legs still. But the recent market development suggests that the uptick in the USDTHB more be more gradual. We have therefore tweaked our USDTHB outlook for the forecast horizon to take into account these developments.

- The THB has so far received help from the unwinding of long-USD positions amid concerns about Trump's ability to deliver on his economic promises that reignited appetite for emerging market assets, including Thailand's. Also helping was the widening real yield differentials between the 10Y UST and Thai government debt. This has manifested in the healthy demand for Thai assets so far this year. So far in Mar, foreign funds have purchased THB3.89bn and THB2.77bn of equities and government debts. Year-to-date, foreign investors have purchased TH6.57bn and THB85.51bn of equities and government debt. These inflows have weighed on the USDTHB below the 35-levels at the point of writing.

- In addition, support for the USDTHB is also coming from the cyclical uptick in exports in the region due to the anticipated stronger growth in the US and China that could lift demand for Thai exports. This could not only lift demand for more Thai assets but would also keep the THB supported. Like its regional peers, the government's infrastructure program, amounting to THB1.8tn, should add to growth prospects and the THB. Our economic team estimates that the disbursement for infrastructure projects in 2017 could double to around THB200bn from less than THB100bn in 2016 and this should enable the economy to expand by 4.5% for the full-year, outpacing the BoT's projection of 3.2%. Persistent current account surpluses should also be supportive of the THB and curb any aggressive climb in the USDTHB in 2017.

- Further support for the THB could also come from the expected moves by the BoT this year. Healthy growth and rising inflationary pressures has increased the risk of a BoT move to lift policy rate higher this year. Rate hikes should prevent the economy from overheating while lifting domestic yields higher to maintain the current spread between the UST and Thai bonds or widen it. This should be positive for Thai assets. Our economic team expects two 25bp hike in the benchmark rate to 2.0% this year and then by another 50bp to 2.5% in 2018. The moves by the BoT should provide the THB with support and keep the USDTHB from rising too aggressively.

- Still, we doubt that the rate hikes by the BoT or the healthy macroeconomic fundamentals will remove upside risks to the USDTHB. Externally, the two US Fed rate hikes expected for the rest of the year by our economic team in 2017, underpinned by the ongoing recovery in the US should keep the USDTHB supported. These Fed rate hikes should lift the UST yields, narrowing the yield differentials in favor of the US, and sparking portfolio outflows. In addition, there is also the potential for some trade disruption arising from the Trump administration's implementation of protectionist measures that could put downward pressure on the THB.

- Domestically, politics could come back to the forefront towards the end of the year. Any general elections to return the government to civilian rule is likely on in the early part of 2018 as a result of the funeral of HM King Bhumibol expected sometime near the end of the year. At the same time, the general elections are unlikely until after the coronation of HM King Maha Vajiralongkorn, thus making any elections this year unlikely. Once the funeral and coronation are over, and the general elections are announced, simmering political tensions at the surface could break into the open ahead of the elections. The main areas of contention will be the dominant role of the military in political life and the appointment of a non-elected PM to head the government. This suggested that the military and its allies will continue to dominate politics long after the coup. The rise in political temperature in the run-up to the elections could impact investor sentiments and send the USDTHB higher towards the 36-levels by the end of the year.

- **Our Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for Thailand fiscal risk. This should weigh on the intrinsic value of the THB.

- **Growth and Inflation Outlook:** Beyond the headline GDP print for 4Q 2016, underlying high frequency data is also showing an economy that is improving in Feb. Private consumption and business sentiment indices are up 4.8% and 3.3% y/y respectively in Feb. Consumer confidence has also turned positive for the first time in five months, up 1.5% y/y in Feb. External demand is also holding up well due to the synchronized recovery in exports with exports and imports up 0.7% and 13.4% y/y respectively in Feb. Aside from the cyclical recovery in the region that is lifting exports higher, the government infrastructure spending programme is also helping to drive growth ahead. As a result of this pick-up, the BoT is now expecting real GDP to rise by 3.4% in 2017, up from 3.2% previously. In contrast, our economic team is even more sanguine about the economy, expecting an above-consensus growth of 4.5% in 2017 vs. market consensus of 3.3%.

- After accelerating for the past three months, headline inflation moderated in Feb, coming in by 1.44% y/y vs. Jan's 1.55%. This moderation comes in the face of slower decline in food prices (Feb: 1.0% vs. Jan: 1.53%) and housing cost (to -1.17% in Feb from 1.26% in Jan) that offset partially the higher transport costs (Feb: 5.58% vs. Jan: 4.76%). Core inflation also rose more moderately by 0.59% y/y in Feb from 0.75% in Jan as higher oil prices continue to have a muted impact on other prices. Given the expected sharper economic recovery, rising commodity prices and still weak THB, our economic team expects headline inflation to accelerate to 2.5% in 2017, higher than the 2.2% the BoT is looking for.

- **Monetary Policy Forecast:** The BoT has maintained its benchmark interest rate close to historic lows at 1.25% since 29 Apr 2015. The last time the policy rate was even lower at 1.25% was during the Great Financial Crisis in 2009-10. Though there have been calls for more cuts, including by the IMF, to spur growth, further rate cuts are unlikely. This is because monetary policy is already accommodative and the preference of the central bank is to allow fiscal policy to take the lead in driving economic growth with monetary policy playing a supportive role. Instead, the central bank is more likely than not to hike its benchmark policy rate to anchor inflationary expectations and to prevent the economy from overheating. At the same time, a rate hike would also lift domestic yields, keeping the current spread between the UST and Thai bonds or widen it, helping to reduce any outflow from Thai assets.

- **Latest Fiscal and External Balance Outlook:** The budget for FY2018 (Oct 2017 – Sep 2018) has been approved by the cabinet and now awaits legislative acquiescence for the budget to take effect. The FY2018 budget has penciled in a larger deficit of THB450bn (2.9% of GDP) for FY2018 compared to the expected deficit of THB390bn (2.6%) in FY2017. Expenditure for the new fiscal year is set at THB2.9tn, up 6% from FY2017, with 23% of total expenditure earmarked for investment. With the government still running a budget deficit, public debt is recorded at 42.2%of GDP as of end Dec, under the 60% threshold.

- The current account surplus widened even further at the start of 2017. The surplus rose to THB177.45bn in Jan from THB133.18bn in Dec. The wider surplus was due to the larger surplus in the income account of THB110.46bn that more than offset the moderation in the trade surplus of THB66.99bn. The overall balance of payments (BoP) flipped into a surplus of THB240.41bn in Jan, the largest surplus since Mar 2008. While details for the financial account are unavailable at the point of writing, it suggests it was also likely in a surplus for the first time since Jan 2016 due to strong fund inflows, reinforcing the current account surplus in the month.

- Key domestic events and issues to watch: There are no major events in Apr.

- **Technical Outlook:** USDTHB continued to trade lower, in line with our bias to sell rallies (since Jan's monthly outlook). We shared that – Sustained close below 35-levels (38.2% fibo retracement of Mar-Apr-2015 low to Sep-2015 high) puts next support at 34.50 (50% fibo). Pair was last seen at 34.49. While bearish momentum and the bearish trend channel (formed since Oct 2015) stay intact, we caution that the pair could face rebound risks. Bearish momentum on daily chart is showing signs of waning while stochastics is showing signs of turning from oversold conditions – these short term signals suggest rebound risks. Retracement from recent decline could see the pair heading up towards 34.87 (50% fibo, 21 DMA) before 35. We look for those levels to re-initiate shorts.

INR: Still In Favour

Forecast	2Q 2017	3Q 2017	4Q 2017	1Q 2018
USD/INR	65.50 (67.50)	66.50 (68.00)	67.00 (67.50)	66.00 (--)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** The landslide victory of the Uttar Pradesh election, the removal of cash withdrawal limit on 13 Mar along with strong confidence in the economy's recovery from the demonetization effort last Nov have lifted the INR. In addition, concerns of sticky core inflation diminished the chances of RBI of making another reduction in the repo rate. The prospect of strong growth and easier reforms lifted investor sentiments. Mar saw a net inflow of USD3300mn into equities and USD2580mn into bonds as of the 24th. The turn of events warrants an adjustment in our USDINR forecast as we now look for a possibility for the USDINR to head beyond the key 65-support towards 63.70 (50-MMA) in the near-term before heading back towards 65.50 by 2Q, underpinned by bearish rupee seasonality factors. We expect the pair to head towards 67.00 by 4Q as USD.

- PM Modi's Bharatiya Janata Party (BJP) managed to achieve a landslide victory in Uttar Pradesh that swings the odds towards BJP making its nominee the country's next president in July as well as the chances for Modi to seek a second term in 2019. In addition, it will be an indication on their popularity and Modi's chances in the next Presidential election given the sheer population of Uttar Pradesh. The BJP grabbed 325 of 403 seats at the state election, allowing Modi's better control of the Rajya Sabha, something that has eluded them since 2014 and caused the impasse of key bills including the land acquisition bill. Our India equity analysts Jigar Shah and Amit Zade also look for critical social and economic reform including the common civil code, social security system, removing article 370 in J&K and restoring its existence as an Indian state.

- Our **Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for India improved slightly to 4.6 (with 1 being the best score and 9 being the worst) from 4.7 due to an improvement in current account.

- **Growth and Inflation Outlook:** Industrial production rebounded in Jan, up 2.7%y/y vs. the previous -0.1%, backed by the 1.8% growth in the manufacturing sector. The small rebound could be the start of a recovery from the demonetization impact as the Feb PMI-mfg reported an acceleration in output and order books. 4Q GDP for 2017 (Oct-Dec) came in stronger than expected at 7.0%y/y, albeit slowing from the previous 7.4%, underpinned by resilient manufacturing, strong agricultural output and faster growth in the services sector.

Feb WPI seems to agree with a print of 6.55%y/y, accelerating from previous 5.25%. CPI also sped to 3.65%y/y from previous 3.17%, as food inflation rose in the month. Inflation outlook pretty much depends on the monsoon rainfalls that could affect the rabi harvest. The Australian Bureau of Meteorology has issued a warning of a 50% chance of El Nino developing this year. On the other hand, India meteorological department is not worried as they are looking for a late El Nino which may not affect rains. That said, more clarity is likely in Apr and May. Bear in mind, the PMI-mfg report also warns of quickening price pressures. For now, inflation is well within the medium term target of 4% (+/-2%) and under the CPI inflation target of 5% by 4Q of 2016-2017.

- India should see a growth spurt in the next quarter as "remonetisation" of the economy is expected to boost activity in the next few months. Private consumption should improve.
- **Monetary Policy Forecast:** It was the RBI decision that gave the INR bulls more legs (soon after the budget), explicitly stating that the central bank has switched to a neutral policy from an accommodative one and announcing the removal of cash withdrawal limit on 13 Mar. In addition, the MPC is clearly confident that growth is expected to see sharp recovery in 2017-2018 as they look for consumption to rebound after the impact of demonetization fades, the resumption of economic activities that are cash-reliant, further transmission of previous cuts owed to the demonetization efforts via the MCLRs (marginal cost-based lending rates) that should raise consumption and investment, and the growth boosting effect of the Union Budget.
- The Feb MPC meeting marks the start of a likely extended pause in monetary policy. We no longer expect a move for the rest of the year. Yet with food inflation still trending lower, there is still chance for RBI to effect a rate change either way (including a cut). We look for RBI to stand pat next Thu (6 Apr), holding repo rates at 6.25%, reverse repo at 5.75%, cash reserve ratio at 4.00%.
- **Latest Fiscal and External Balance Outlook:** Finance Minister Jaitley pledges support to the farmers, infrastructure spending and personal income tax cuts and corporate tax cuts for small and medium businesses to boost consumption and investment. The current account deficit remained steady widened to $3bn in the quarter ending Sep. Trade deficit was lower at U$25.6bn vs. previous U$23.8bn. Capital account recorded an outflow of U$17.5bn. Portfolio investment recorded a net inflow of U$6bn due to strong equity demand in the quarter.
- **Key domestic events and issues to watch:** PMI is due on the 3rd, RBI meeting on 6th, trade on 10-17th, CPI and industrial production on 12th, WPI on 17th.
- **Technical Outlook:** 1M NDF has slid a long way from the start of Mar, now pressuring the 65-figure. Pressure remains to the downside notwithstanding short-term retracements and risk a further extension towards 63.50 (Jul 2015-low). Retracements could meet support around 65.80. Momentum indicators signal bearish bias on the weekly chart though stochs flag oversold condition. Next support at 64.30 (200-WMA).

VND: Still Vulnerable To USD Upswings

Forecast	2Q 2017	3Q 2017	4Q 2017	1Q 2018
USD/VND	23100 (23300)	23400 (23600)	23500 (--)	23600 (--)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** USDVND retraced from its Feb highs, in line with our expectations. Deteriorating external position and weak FDI inflows are likely to keep USDVND supported on dips. Despite the USD retracement, we are still wary of a resurgence in view of two more likely hikes by the Fed. Equity inflows have been positive in Mar and keep the USDVND under pressure. Expect pressure on the USDVND to be mostly on the upside as we anticipate further rate hikes by the Fed to lift the currency pair into 3Q and 4Q this year, looking for the pair to reach 23500 by year end.

- **Growth and Inflation Outlook:** 1Q GDP came in lower than expected at 5.10%y/y, slowing from the previous 6.21%. The head of GDP department in the General Statistics Office Said that the 38% fall in Samsung's output in the quarter has shrunk electronics production in Vietnam by 1%. In addition, growth was weighed by the deceleration in agriculture, forestry and aquaculture. Industrial production decelerated to 5.5%y/y Mar from previous 15.2% in Feb. Slowdown was seen in manufacturing and electricity with mining and quarrying still clocking deep declines. Exports in Jan-Mar also slowed to 12.8%y/y from Jan-Feb 15.4% while imports quickened pace from 19.6%y/y to 22.4%. The acceleration was broad-based with both domestic and foreign-invested sector seeing around 20% growth each. Domestic consumption seems to be improving with retail sales for the first quarter seeing 9.2%y/y, quickening from Jan-Feb 8.7%. Still, PMI-mfg rebounded to 54.2 in Feb from previous 51.9 in Jan. Mfg managers reported acceleration in output growth and that of new orders, saw a record rise in stocks of purchases and a significant improvement in business confidence. Even new export orders are also expected to rise at a faster pace.

- Inflation for Mar came in at 4.65%y/y, slowing from previous 4.74%, weighed by lower food inflation. Head of GSO Price Statistics Department urged Ministries to keep an eye on prices of essential goods in particular rice, gasoline, steel and fertilizer in order to keep CPI below 4%. Food inflation may be low now but any rise in oil prices or those of food could threaten the headline CPI to the upside.

- **Monetary Policy Forecast:** Expect little action from SBV in terms of rates. Elevated price pressure has effectively has reduced the real borrowing rates. Expectations for a strong USD, higher US rates and rising price pressure could continue to keep the dong on the backfoot. We no longer look for SBV to ease rates (currently base rate at 9.0%, refinancing rate at 6.5% and discount rate at 4.5%). USDVND could continue to keep a broad uptrend into 2Q and 3Q. A resurgence in USD strength would mean that the USDVND is still vulnerable to the upside. In addition, exports growth is still weak whilst imports growth has been robust, leaving the trade balance in wider deficits. Lean FX reserves-import ratio of barely above 2 would mean that any external shocks in the FX space could force SBV to devalue the dong. Should USD remain on the upmove, expect USDVND reference rate to be fixed higher and that should guide the USDVND towards our 23600 forecast by 4Q.

- **Latest Fiscal and External Balance Outlook:** 2017 state revenue is seen at VND216.7trn through 15 Mar, 17.9% of the full-year goal whilst state spending for the same period amounts to VND229.1trn, 16.5% of the full year target. Finance Ministry reported that the government has raked in VND14.3trn from the sale of state stakes worth VND3.07trn. This is part of an ongoing effort by the government to divest VND67trn from SOE in the years leading to 2020. According to the State budget, the budget deficit is projected to be around 3.50% of GDP this year. Key use of the capital is to develop important infrastructure projects like the Long Thanh International airport. Keep in mind that MOF has just proposed to lower existing tax rates for SMEs from 20% to 17% so as to encourage companies to engage in productive investment.

- We still watch the Japanese yen as Vietnam's external debt/GDP stood at 41.5% as of end 2015. Strong relationship with Japan suggests that JPY-denominated debt could be at least 30% of total debt (as reported by our Vietnamese analysts) and a stronger JPY could weaken Vietnam's debt position. That said, given the threat of BOJ intervention and potential monetary and fiscal stimulus, we expect USDJPY to remain within 100-110 for the rest of this year. That should in turn alleviate pressure on Vietnam's debt.

- Current account recorded a surplus of U$3.5bn in 3Q (latest data available), widening from the U$2.2bn seen in 2Q on the back of wider net trade surplus of goods. We remain cautiously optimistic on Vietnam's external position, expecting the improvement in regional demand to boost Vietnam's trade.

- **Key Domestic Events and Issues to Watch:** PMI-mfg is due on the 3rd. CPI is due on the 24th. Trade balance, retail sales, industrial production within 25-30th.

FX Forecasts

	End Q2-17	End Q3-17	End Q4-17	End Q1-18
USD/JPY	108	110	113	113
EUR/USD	1.0450	1.0350	1.0600	1.0800
GBP/USD	1.2000	1.2300	1.2400	1.2600
AUD/USD	0.7300	0.7500	0.7800	0.7800
NZD/USD	0.7100	0.7300	0.7500	0.7700
USD/SGD	1.4100	1.4200	1.3950	1.3950
USD/MYR	4.4000	4.3500	4.4000	4.4000
USD/IDR	13300	13400	13450	13500
USD/THB	34.80	35.30	36.00	36.20
USD/PHP	50.30	50.50	50.70	50.70
USD/CNY	6.96	7.02	7.05	7.05
USD/HKD	7.80	7.80	7.80	7.80
USD/TWD	30.80	31.50	32.00	32.00
USD/KRW	1140	1150	1160	1170
USD/INR	65.50	66.50	67.00	66.00
USD/VND	23100	23400	23500	23600
DXY Index	102.22	102.50	101.36	99.46
SGD Crosses	End Q2-17	End Q3-17	End Q4-17	End Q1-18
100 JPY/SGD	1.3056	1.2909	1.2345	1.2345
EUR/SGD	1.4735	1.4697	1.4787	1.5066
GBP/SGD	1.6920	1.7466	1.7298	1.7577
AUD/SGD	1.0293	1.0650	1.0881	1.0881
NZD/SGD	1.0011	1.0366	1.0463	1.0742
SGD/MYR	3.1206	3.0634	3.1541	3.1541
SGD/IDR	9433	9437	9642	9677
SGD/THB	24.68	24.86	25.81	25.95
SGD/PHP	35.67	35.56	36.34	36.34
SGD/CNY	4.94	4.94	5.05	5.05
SGD/HKD	5.53	5.49	5.59	5.59
SGD/TWD	21.84	22.18	22.94	22.94
SGD/KRW	809	810	832	839
SGD/INR	46.45	46.83	48.03	47.31
MYR Crosses	End Q2-17	End Q3-17	End Q4-17	End Q1-18
EUR/MYR	4.60	4.50	4.66	4.75
JPY/MYR	4.07	3.95	3.89	3.89
MYR/HKD	1.77	1.79	1.77	1.77
MYR/CNY	1.58	1.61	1.60	1.60
GBP/MYR	5.28	5.35	5.46	5.54
AUD/MYR	3.21	3.26	3.43	3.43
NZD/MYR	3.12	3.18	3.30	3.39
MYR/IDR	3022.73	3080.46	3056.82	3068.18
MYR/INR	14.89	15.29	15.23	15.00
MYR/KRW	259.09	264.37	263.64	265.91
MYR/PHP	11.43	11.61	11.52	11.52
CNY/MYR	0.6322	0.6197	0.6241	0.6241

Source: Maybank FX Research as of 31 March 2017

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

DISCLAIMER

This report is for information purposes only and under no circumstances is it to be considered or intended as an offer to sell or a solicitation of an offer to buy the securities or financial instruments referred to herein, or an offer or solicitation to any person to enter into any transaction or adopt any investment strategy. Investors should note that income from such securities or financial instruments, if any, may fluctuate and that each security's or financial instrument's price or value may rise or fall. Accordingly, investors may receive back less than originally invested. Past performance is not necessarily a guide to future performance. This report is not intended to provide personal investment advice and does not take into account the specific investment objectives, the financial situation and the particular needs of persons who may receive or read this report. Investors should therefore seek financial, legal and other advice regarding the appropriateness of investing in any securities and/or financial instruments or the investment strategies discussed or recommended in this report.

The information contained herein has been obtained from sources believed to be reliable but such sources have not been independently verified by Malayan Banking Berhad and/or its affiliates and related corporations (collectively, "Maybank") and consequently no representation is made as to the accuracy or completeness of this report by Maybank and it should not be relied upon as such. Accordingly, no liability can be accepted for any direct, indirect or consequential losses or damages that may arise from the use or reliance of this report. Maybank and its officers, directors, associates, connected parties and/or employees may from time to time have positions or be materially interested in the securities and/or financial instruments referred to herein and may further act as market maker or have assumed an underwriting commitment or deal with such securities and/or financial instruments and may also perform or seek to perform investment banking, advisory and other services for or relating to those companies whose securities are mentioned in this report. Any information or opinions or recommendations contained herein are subject to change at any time, without prior notice.

This report may contain forward looking statements which are often but not always identified by the use of words such as "anticipate", "believe", "estimate", "intend", "plan", "expect", "forecast", "predict" and "project" and statements that an event or result "may", "will", "can", "should", "could" or "might" occur or be achieved and other similar expressions. Such forward looking statements are based on assumptions made and information currently available to us and are subject to certain risks and uncertainties that could cause the actual results to differ materially from those expressed in any forward looking statements. Readers are cautioned not to place undue relevance on these forward looking statements. Maybank expressly disclaims any obligation to update or revise any such forward looking statements to reflect new information, events or circumstances after the date of this publication or to reflect the occurrence of unanticipated events.

This report is prepared for the use of Maybank's clients and may not be reproduced, altered in any way, transmitted to, copied or distributed to any other party in whole or in part in any form or manner without the prior express written consent of Maybank. Maybank accepts no liability whatsoever for the actions of third parties in this respect. This report is not directed to or intended for distribution to or use by any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation.

Published by:

Malayan Banking Berhad
(Incorporated in Malaysia)

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