March 29, 2018

Maybank

FX Monthly

2018, Issue 3: Juggling Synchronised Growth vs. Higher Rate Concerns

What Has Changed This Month?

- We revised VND and INR weaker against the USD for 2Q, taking into account the upside risks of inflation in both currencies and current market developments. We think SBV is likely to keep VND weaker against the trading partners to boost exports and to attract foreign investors.
- USDINR has remained lofty as investors remain wary of current account deterioration. But, an early call for General elections and a possible upgrade in sovereign credit rating, even if it's just the outlook, by Fitch could strengthen the rupee from current levels.
- We tweaked IDR and PHP weaker against the USD to reflect current market developments. The IDR remains vulnerable to further unwinding of carry trade plays and sell-off in equities amid lackluster consumption spending. Central bank inaction as well as deteriorating current account deficit is likely to weigh on the PHP.

Our Strategies

- USD downtrend is likely to remain in place for 2018 but we do not rule out bouts of USD strength like what we had witnessed in the past few months that could emanate from a few scenarios - 1) trade war escalation; 2) inflation pick up – price pressure is still subdued but sustained global recovery could stoke demand-pull inflation and a global bond rout; 3) markets to re-price a more aggressive tightening trajectory as the Fed becomes more hawkish under the new Chair Powell. This could in turn trigger another sell-off in global bonds and correction in riskier assets, and pose risk to high beta FX.
- In an environment of tighter monetary conditions and sell-off in equity markets, AUD, NZD and KRW will be vulnerable due to real rate weakness, FX over-valuation and high sensitive to government bond markets. In the EM space, CNY is likely to be the least vulnerable.
- Still, broader term shifts were already underway to support the case for broad USD downtrend, including (1) US tax reforms and its wider implication on deficit, debt and the USD; (2) reserve diversification away from the USD; (3) USD countercyclical play; (4) USD downtrend cycle. In an environment of broad USD downtrend, we see opportunities for relative value plays in Asia, favouring currencies that benefit from the export-led recovery and commodity price rebound. We continue to favour MYR, SGD, THB, CNY, KRW, TWD and AUD over IDR and PHP.
- On global monetary policy stimulus removal, we believe normalisation will take shape at differing pace. Fed, BoE, BoC could tighten further this year. RBA could potentially normalize this year; ECB is expected to embark on gradual pace of policy normalisation; RBNZ still have room to wait before tightening. BoJ may still keep policy status quo amongst G7. Amongst ASEANs, BSP and MAS could tighten monetary policies while others are likely to remain on hold this year.

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FX Forecast Revision

Upward	Downward
	INR, VND, IDR, PHP

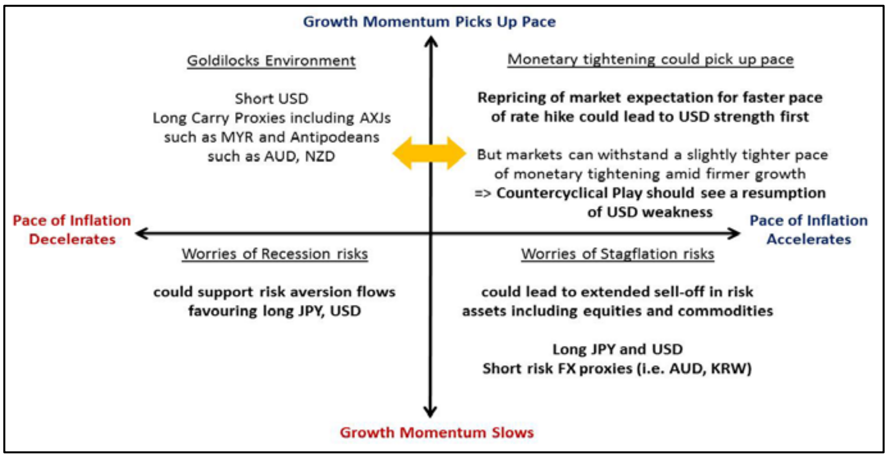
Top 3 Currency Plays for April

- Bias to Buy EUR on dips towards 1.20-1.21 for move towards 1.30 Objective
- Sell USDINR on rallies
- Buy AUD on dips towards 0.76

Key Events for the Month Ahead

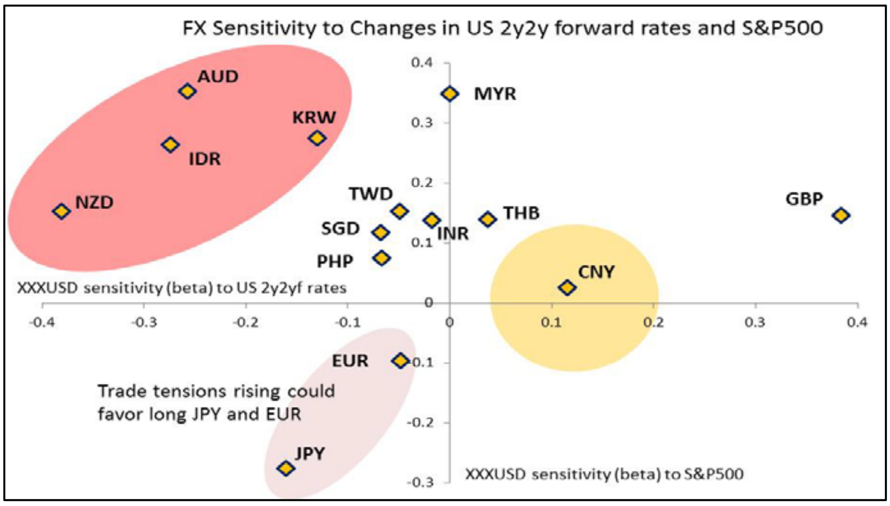
Date	Event
Apr	Potential North-South Korea Summit
Early-Apr	Italy President to start talks on who to lead in government formation
Mid-Apr	MAS Semi-Annual Policy Meeting

Markets Pivoting Between Goldilocks and Monetary Tightening Environment



Note: The grid –scenario is in the context of US economy and does not take into consideration black swan events such as trade wars, etc.
Source: Bloomberg, Maybank FX Research & Strategy

NZD, AUD, KRW and IDR Most Vulnerable to Rate Increases and Equity Declines



Note: Regression on weekly changes in percentage over the period of Jan-2015 to Mar-2018, using weekly data
Source: Bloomberg, Maybank FX Research & Strategy

Pace of Inflation, Monetary Shifts are Risks to Our Outlook

	2015	2016	2017	2018
Global Growth Momentum	Growth Downgrades from IMF, ADB	Lesser Downgrades from IMF, ADB; Growth "not hot not cold"	Synchronised Global Economic Recovery for First time in 7 years	Synchronised Global Economic Recovery But momentum to moderate into 2H
Pace of Inflation Increase - Faster or Slower than Expected	Deflation Risks; US CPI picked up slightly from 3Q-2015	Subdued Globally; but Inflation in US picked up and stabilized in 1 - 1.5% range	Price pressures Rose at slower pace than expected; Stabilized in Slightly Higher Range; VIX fell to all-time low of below 10	Faster than expected pick-up in inflation and wage growth; VIX jumped above 50; 10Y UST yield nearly touched 3%
Monetary Policy Expectation	Most central banks on accommodative monetary policies; First Fed rate Hike since GFC	Most central banks on accommodative monetary policies; Second Fed rate Hike since GFC	BoC, BoE, BoK joined Fed in slowly normalising monetary policies; Fed Hiked 3x	More monetary stimulus removal expected from more central banks*; Fed still expected to hike 3x
Impact on FX/ Asset Classes	Broad USD strength against most currencies; Oil price declined to 10Y low	Year of 2 Halves as USD fell in 1H 16 before ending the year higher	Broad USD Decline; Carry Trade was the preferred play amid goldilocks environment	Partial Unwinding of Carry Trade with bouts of USD Strength within Broad USD Downtrend

G7 Global Overview

USD: Maintaining the Dollar Downtrend

Forecast	2Q 2018	3Q 2018	4Q 2018	1Q 2019
USD Index	88.91 (--)	87.18 (--)	86.18 (--)	86.61 (--)

No Change to Previous Forecast

- **Motivation for the FX View:** USD downtrend is likely to remain in place for 2018 but we do not rule out bouts of USD strength like what we had witnessed in the past few months. The DXY index broke above the 90-figure in the last month of Feb and again in March, last seen this month at a high of 90.43. Again March saw heightened volatility as inflation fears and stronger data as well as the run-up to the FOMC in March triggered sell-off in the USTs and a rally in 10y yields from around 2.80% early March to a high of 2.93% around the FOMC announcement. But thereafter, once again as in Feb, the yields fell again to around current 2.77% levels as markets positioning for long USD unwound as expectations of an indication of more rate hikes in 2018 and 2019 did not materialise during the FOMC dot plots. The scenario went back to a goldilocks environment and the counteryclical play led to USD weakness again. However, we remain wary of more bouts of USD strength (as previously cautioned) that could emanate from a few scenarios - 1) trade war escalation; 2) inflation pick up – price pressure is still subdued but sustained global recovery could stoke demand-pull inflation and a global bond rout; 3) markets to re-price a more aggressive tightening trajectory as the Fed becomes more hawkish under the new Chair Powell. This could in turn trigger another sell-off in global bonds and correction in riskier assets. However, despite the rise in US libor, widening of libor-OIS spread (partially attributable to surge in funding needs for US Treasury owing to Trump's fiscal measures) could potentially ease in Apr when US funding requirements slows and US Treasury receives tax receipts. This could lead to a less tight global funding market and typically weigh on the dollar.

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

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

- To add further on the USD inverse relationship with global trade and economic growth is that a large share of international trade is transacted in USD even when the US itself is not the party to the transaction. This suggests that world trade volumes are driven in large part by USD. Appreciation in the USD crimps demand for US exports but also for all USD-denominated exports.
- Recent study[1] by Harvard Professor Gopinath, et al. found that 1% USD appreciation against all other currencies lead to a 0.6 – 0.8 % decline in volume of trade between countries in the rest of the world within a year. Depreciation in the USD seen over the past year or so is therefore likely to have played a significant role in the synchronous export recovery in the region – and this should continue to feed through to trade growth for the next few months, given the lags involved. This supports our story for synchronous global economic recovery to be sustained in at least 1H 2018.

- **Growth and Inflation Outlook:** The key takeaway from the FOMC Statement released after the 20-21 Mar 2018 FOMC meeting is the likelihood of slower 1Q 2018 growth (4Q 2017: +2.5% YoY; +2.5% QoQ SAAR), taking cue from the assessment that economic activity and growth in household spending and business fixed investment have moderated from their strong 4Q 2017 readings, which contrasted with the use of the word "solid" to describe these variables in the 30-31 Jan 2018 FOMC Statement.

- Nonetheless, underscoring the impact of the tax cuts approved by Congress and signed into law by President Trump in Dec 2017, there is the additional line in the latest FOMC Statement i.e. "economic outlook has strengthened in recent months", followed by the upward revisions in Fed's median real GDP growth forecasts for 4Q 2018 and 4Q 2019 to +2.7% YoY and +2.4% YoY respectively from the projections of +2.5% YoY and +2.1% YoY previously made in Dec 2017, while 4Q 2020 forecast remained at +2.0% YoY.

- The latest FOMC statement also indicated that Fed expects inflation "to move up in coming months" vs "to move up this year" previously, although its inflation rate forecasts (based on Fed's preferred measure i.e. personal consumption expenditure (PCE) deflator) are maintained for 4Q 2018 and 4Q 2019 at +1.9% YoY and +2.0% YoY respectively. Only the figure for 4Q 2020 was raised slightly to +2.1% YoY from +2.0% YoY. To note, PCE deflator was +1.7% YoY in Jan 2018, and with the exception of Jan-Feb 2017 when it was at between +2.0% YoY and +2.2% YoY, has remained sub-2% since May 2012.

- Nonfarm payrolls rose 313k in Feb – 108k above consensus and the fastest pace since July 2016, reflecting broad-based growth and a likely boost from unseasonably low snowfall. Average hourly earnings

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

rose by less than expected, and downward revisions resulted in the year-over-year rate falling to +2.6% (from +2.9% previously). Monthly wage growth was firmer and the unemployment rate held steady at 4.1%, as an outsized gain in the participation rate was offset by a similarly unusual rise in household employment. The Feb employment report indicates that job growth has accelerated and is likely to draw down additional labor market slack over the course of the year.

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- **Monetary Policy Forecast:** Fed funds rate (FFR) was raised by +25bps to 1.50%-1.75% at the first FOMC meeting chaired by Jerome Powell. No change in Fed's guidance of three rate hikes this year but Fed signalled one additional hike each in 2019 and 2020.

- The other highlight from this FOMC meeting is the "dot plots" that represent Fed's guidance on interest rate direction. There is a change in the fed funds rate hike formation for 2018-2020 to "3-3-2" from "3-2- 11/2 " indicated back in Dec 2017. Based on the latest FOMC's fed funds rate median forecasts, Fed maintains its guidance of three rate hikes totaling +75bps for this year, but signaled three rate hikes totaling +75bps in 2019 (+56bps implying two rate hikes previously) and two rate hikes totaling +50bps in 2020 (+37bps implying between one hike or two hikes previously).

- To recap, the balance sheet reduction plan was outlined in the statement released after the 13-14 June 2017 FOMC meeting with the starting date confirmed in the statement issued following the 19-20 Sep 2017 i.e. the programme would start in Oct 2017 with USD10b per month reduction in the balance sheet size via USD6b per month cut in US Treasury securities holdings and USD4b per month cut in agency debt and mortgage-backed securities. The size of the balance sheet reduction will be raised by USD10b at a 3-month interval leading to a total USD50b per month (i.e. USD30b per month cut in US Treasury securities holdings and USD20b per month cut in agency debt and mortgage- backed securities) by the end of the first year of the programme.

- Fed's balance sheet should have declined by –USD110b between Oct 2017 and mid-Mar 2018 based on the above. Thus far, it dropped by –USD47.6b to USD4,454.5b at 14 Mar 2018 from USD4,502.2b at end-Sep 2017.

- The slower Fed's balance sheet reduction suggests interest rate hikes remain the key element of monetary policy normalization process by Fed, and also indicate the dynamics in US Treasury market that need to be taken into consideration by the Fed in undertaking its balance sheet reduction e.g. the spike in US Treasury yield so far this year; large issuance of debt by the US Government to finance the expected larger budget deficit as a result of the tax cuts; lower foreign holding of US Treasury especially that of China.

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

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

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

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

- **Key domestic events and issues to watch in April 2018:** ISM Mfg (2 Apr); Factory orders and Durable Goods Orders, ADP Employment (4 Apr); and Trade Balance (5 Apr); NFP (6 Apr); CPI (11 Apr); FOMC Meeting Minutes (12 Apr); Retail Sales (16 Apr); Beige Book (19 Apr); GDP 1QA (27 Apr); Core PCE (27 Apr); PCE Deflator (30 Apr).

- **Technical Outlook:** The wall of resistance at 90 – 90.50 that we highlighted last month held well. We had cautioned for upside risks in the lead up to FoMC meeting (22 Mar) in last month's FX Outlook. USD index traded a high of 90.445 (20 Mar) before easing off post-FOMC. Index traded a low of 88.95 (27 Mar) before the mild retracement higher into month-end. Last seen at 89.95. Signs of upside pressure may be re-emerging. We still see resistance at 90.5 (50% fibo retracement of 2018 high to low), 91 (61.8% fibo) and 91.60 levels (76.4% fibo). Bias remains to lean against strength as underlying momentum remains bearish. Support at 89.28 (23.6% fibo) before 88.25 (2018 low).

EUR: Dips an Opportunity to Buy Into

Forecast	2Q 2018	3Q 2018	4Q2018	1Q2019
EUR/USD	1.2500 (--)	1.2800 (--)	1.3000 (--)	1.3000 (--)

No Change to Previous Forecast

- **Motivation for the FX View:** Our short term (1-3 weeks horizon) bias for EUR to see trade lower towards 1.2210 levels was in play for the month of March as EUR traded a low of 1.2240 (20 Mar). We **still expect bouts of EUR weakness to persist intermittently** on the back of concerns on Italy's government formation which could take up to months (possibly up to Jul) to form and market coming to terms that ECB policy normalisation will be gradual (owing to softer than expected pace of pick-up in inflation). Rising prospects of populist-led government could weigh on sentiment and the EUR. But we **do not expect a full-blown political crisis in Italy to materialise**. Key support to watch at 1.2120, 1.2020 levels. We believe **downside risks present opportunities for "buy on dips" play, targeting a move back towards 1.24-1.25 levels**.

- Slower than expected pick-up in inflation should continue to reinforce expectations for gradual pace of policy normalisation and see a slower pace of gains for EUR. Recent comments from ECB's Draghi should also act to temper excessive gains in EUR – he emphasized that adjustments to monetary policy will be predictable and measured; sequencing of monetary stimulus removal (as stated in forward guidance) will remain; rates will still remain low for a long time; and warned that Euro strength could weigh on inflation down the line (feedback loop into gradual pace of policy normalisation).

- Italy President Mattarella is expected to start talks with political leaders in April before deciding who to nominate to lead the next government. Coalition talks is expected to take up to several months (some senior officials believe the deadline to be sometime in July but we do not rule out an extension of the deadline given that Germany even took nearly 6 months to form a coalition government). We believe the process is likely to be long-drawn and is a source of volatility for the currency. We do not rule out renewed talks of another election (another source of volatility weighing on EUR if it happens).
  - Inconclusive election results (4 Mar) showed that neither Luigi Di Maio of anti-establishment Five Star Movement nor Matteo Salvini of Northern League has a parliamentary majority.
  - Center-right alliance (Northern League, Forza Italia and Brothers of Italy party) has taken the first step towards negotiating with Five Star Movement. This raised **concerns of the prospect of a populist-led coalition government (anti-EU sentiment and anti-immigration). Such a scenario weighs on investor sentiment and on the EUR.**

- However such a coalition has been ruled out at this stage due to differences between the 2 parties: the Northern League is based in the rich and industrial North and is known to be pushing for a flat tax while Five Star Movement is based in the South and wants a universal basic income. It is understood that both leaders of the parties are keen to be the Prime Minister of Italy (and there can only be one candidate). But matters of politics are always fluid – what was least expected can turn out to be a reality.
- A least negative scenario from Europe's perspective given today's election outcome results, would be a coalition between Five Star Movement and Democratic Party (PD) –a balance between the centre-left and centre-right. Euroscepticism would somewhat be mitigated as Five Star has also shelved its opposition to the EUR currency while PD advocated further European integration.

- On a broader term perspective, we remain constructive of EUR's outlook on (1) receding political risks in Europe (Germany managed to form coalition government with Merkel elected as Chancellor again for the 4th term though Italy government formation remains a source of uncertainty); (2) sustained signs of economic recovery broadening in Europe, supported by private consumption, business sentiment, construction investment, sizeable current account surplus (3.5% of GDP) and export recovery; (3) signs of growing demand for EUR as a share of world FX reserves amid ongoing reserve diversification and (4) ECB's gradual pace of policy normalisation is expected to proceed as planned.

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

- **Growth and Inflation Outlook: Euro-area recovery continues with 19 consecutive quarters of growth** while unemployment fell to 9-year low of 8.7% in Dec. 4Q GDP growth increased to 0.6% q/q (vs. 0.7% in 3Q). On y/y basis, GDP growth rose to 2.7% (vs. 2.8% in 3Q). For the year, Euro-area expanded 2.5%. This is the best pace since global financial crisis in 2008. Recent data from forward looking surveys showed some moderation in momentum - prelim services and manufacturing PMIs for March were at 55 and 56.6, respectively (vs. 56.2 and 58.6 in Feb) – but levels remain in expansionary territory and are still near recent highs.

- ECB's recent assessment (8 Mar) is that (1) private consumption is supported by rising employment, which is benefiting from past labour market reforms, and by increasing household wealth; (2) business investments continue to strengthen on the back of very favourable financing conditions, rising corporate profitability and solid demand (3) housing investment has improved further; (4) broad-based global recovery is supporting Euro-area exports. ECB projections for 2018 growth has been revised upwards to 2.4% (vs. 1.9% in Dec-2017 projection) while projections for 2019 and 2020 stay unchanged at 1.9% and 1.7%, respectively.

- **Euro-area inflation slowed to1.1% y/y in Feb** (vs. 1.3% in Jan). This is the weakest level since end-2016. Deviation away from ECB's 2% target leaves room for ECB's Draghi to emphasize on patience in normalizing monetary policies. Core inflation continued to hold steady at 1% y/y in Feb. ECB reiterates the headline CPI is likely to hover around 1.5% for the remainder of the year. While underlying inflation remains subdued overall, they are expected to rise gradually over the medium term supported by ECB's monetary policy measures, continuing economic expansion and rising wage growth. We believe the strong run in the EUR (>5.5% gains since mid-Dec 2017) could weigh on imported prices (imported consumer products account for around 15% of industrial goods in the Euro-area) and result in negative feedback loop to core inflation. In the last quarterly assessment report (Mar-2018), Inflation projection for 2019 was also lowered to 1.4% from 1.5% but remains unchanged at 1.4% for this year and 2020.

- **Monetary Policy Forecast:** For the upcoming Governing Council meeting on 26 Apr, we expect monetary policy to contain little/no excitement as policy is expected to remain status quo {i.e. policy rates and Asset purchase program (APP) to remain unchanged}. Slower than expected pick-up in inflation should continue to reinforce expectations for gradual pace of policy normalisation. The sequencing of ECB stimulus removal (i.e. no rate hike before end of APP) is not expected to change as well.

- At the ECB Conference in Frankfurt (14 Mar), Draghi said that he "still **need to see further evidence that inflation dynamics are moving in the right direction… so monetary policy will remain patient, persistent and prudent**". He emphasized that adjustments to monetary policy will be predictable and measured; reiterated that sequencing of monetary stimulus removal (as stated in forward guidance) will remain and that rates will still remain low for a long time; and warned that Euro strength could weigh on inflation down the line.

- At the last ECB meeting (8 Mar), the Governing Council (GC) kept rate of Main Refinancing operations, deposit facility and marginal lending facility unchanged at 0%, -0.4% and 0.25%, respectively. The GC expects the key ECB interest rates to remain at their present levels for an extended period of time, and well past the horizon of the net asset purchases. APP at the current monthly pace of €30 billion, are intended to run until the end of September 2018, or beyond, if necessary. However ECB omitted the sentence *"the commitment to increase the size of quantitative easing, if necessary"* from its last accompanying statement. Markets over-interpreted this omission as a removal of easing bias and EUR saw a sharp rally. But later at the press conference, Draghi clarified that **the statement removed was a**

backward looking statement that was introduced in 2016 when monthly APP was cut to EUR60bn (from EUR80bn) and not to be interpreted as a forward looking statement for forward guidance (which subsequently saw EUR gains reversed). Draghi also highlighted that protectionism is a risk to growth and reiterated ECB's commitment to maintaining rates at present levels for an extended period beyond the end of asset purchases, as well as a continued commitment to potentially extending those purchases beyond September, if necessary. Inflation projection for 2019 was also lowered to 1.4% from 1.5%. Overall the statement can somewhat be interpreted with a slight cautious tilt.

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

- **Latest Fiscal and External Balance Outlook:** Euro area's current account surplus widened to 4-month high of EUR37.6bn in Jan (from EUR29.9bn in Dec) owing to increase in surplus on services and primary income surplus. Current account surplus to GDP was last seen at 3.5%.

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

- **Key domestic events and issues to watch:** Mar Mfg PMI (3 Apr); Mar CPI estimate, Feb unemployment rate (4 Apr); Mar services PMI (5 Apr); Feb retail sales (5 Apr); Feb trade (17 Apr); Mar final CPI (18 Apr); prelim PMIs for App; ECB meeting; Apr consumer confidence (27 Apr)l

- **Technical Outlook:** EUR drifted higher for the month of Mar, in line with our bias to look for opportunities on dips to buy into. Pair was last seen at 1.2330 levels. Bullish momentum on monthly chart remains intact but shorter technical suggest the risks of pullback. Key support at 1.23 (upward sloping trend-line support from the lows in Dec 2017, Jan and Feb 2018), 1.2235 (38.2% fibo retracement of Dec low to 2018 high), 1.2140 (50% fibo retracement). Bias remains to buy on dips. Resistance at 1.2550 (double/triple top).

GBP: Game Plan Unchanged; Buy Dips Preferred

Forecast	2Q 2018	3Q 2018	4Q2018	1Q2019
GBP/USD	**1.4400** (--)	**1.4800** (--)	**1.4800** (--)	**1.4400** (--)

No Change to Previous Forecast

- **Motivation for the FX View**: Taking stock, GBP appears to be on track to meet our 1Q target at 1.42. We had called for a range of 1.38 – 1.42 in the interim, with risks skewed to the upside, in the last FX Monthly (sent 1 Mar). Pair was last seen at 1.4210 at time of writing (26 Mar) and was at 1.3712 on 1 Mar.

- Looking ahead, we broadly maintain our **"more optimistic" outlook than street consensus for GBP** on the back of our expectation for orderly *Brexit* (boost to sentiment), continued improvement in labor market (upward pressure for wage growth providing room for BoE to tighten) and potentially greater tolerance (from policymakers) for GBP appreciation (to help curb imported inflation) and rising market expectation for BoE rate increase to come earlier than expected. That said we **do not expect a one way trade and still see a great deal of variability on GBP exchange rate, driven by headlines on *Brexit* progress (which can be improvement or deterioration).** We see a **range of 1.3950 – 1.45 in the coming weeks; maintain our bias to buy on dips.**

- No BoE MPC meeting scheduled for month of Apr and the next meeting on 10th May will be closely watched. OIS-implied probability suggests 71% chance of 25bps rate hike – further bets for BoE to raise rate in the upcoming meeting could add to GBP upside pressure. Unemployment rate falling to 43-year low and signs of real wages rising underscores the tightness of labor market conditions and this could generate domestic price pressures and builds the case for BoE to normalize policies earlier than expected.

- Recent development on Brexit has been positive for GBP with a (1) transition deal nearing agreement (Spain and Ireland have yet to agree – Spain is seeking reassurance on Gibraltar while Ireland is still analysing UK's commitment on the Irish borders); (2) EU officials do not expect the sign-off to be a problem; (3) conciliatory tone from EU – Barnier (Chief Brexit negotiator for EU) said that "we have a much clearer position than we had last Dec" and whatever the outcome, there will be a Irish backstop solution. These are firmer signs of material progress with Brexit journey and should support the case for firmer GBP.

- A recap of the brexit transition agreement (to start from 29 Mar 2019 to 31 Dec 2020) - Key aspects of the agreement include EU citizens enjoying the same rights and guarantees as the one who arrive before the commencement of the transition agreement, UK able to negotiate, sign and ratify its own trade deals with other countries, etc. That said this transitional agreement is conditional on both sides agreeing a final withdrawal treaty – to be interpreted as a positive step forward but brexit journey is not out of the woods – still expect GBP to be driven by brexit headlines but less uncertainty given recent progress and more room for gains as final treaty (to include trade relationship with EU is yet to be finalised).

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

- **Growth and Inflation Outlook: 4Q prelim GDP disappointed slightly to the downside** (+0.4% q/q vs. +0.5% expected). This marks a downward revision from previous estimates of 0.5% and was due to small revisions to mining, energy generation and services. On y/y terms, 4Q GDP was 1.4% (vs. +1.8% in 3Q). For 2017, UK growth slowed to 1.4% y/y (vs. 1.9% in 2016). This is its lowest level in 5 years and the slowest growing major economy in the world. This data further validates our caution that growth momentum is decelerating and is below its long term average. The OECD leading indicator also indicated easing growth momentum in UK.

- That said our **caution for decelerating growth momentum does not lead to recession risks at this stage**. Labor market continues to tighten with unemployment rate falling to 4.3%, its lowest level since 1975. Employment change also saw a larger than expected increase amid rise in participation rate. In addition recent data suggests that falling real wages may have slowed due to slowing pace of price increase (+2.7% y/y in Feb vs. 3% in Jan) while wage growth picked up pace (+2.8% y/y in Jan vs. +2.5% in Dec). UK health service workers will also get a 6.5% pay increase over the next 3 years while a 4.4% increase in minimum wage is also expected to come into effect in Apr. All this bodes well for the household sector as **household consumption squeeze could ease**.

- In BoE's Quarterly Inflation Report released 8 Feb, **growth forecast was revised upwards** to 1.7 in 2018 (vs. 1.5% projection in Nov) and to 1.8% in 2019 (vs. 1.7% projection in Nov). This is due to the "strength in global growth, lessening drag from fiscal consolidation, accommodative financial conditions and a modest recovery in household real income growth. BoE's judged that that risks to the central outlook are skewed to the upside stemming from the possibility of a great boost from global demand". It did however add a caveat that "the anticipation of and uncertainty around Brexit, however, appear to be weighing on investment, and the associated fall in sterling's exchange rate is squeezing households' real incomes and dampening consumption growth".

- **UK inflation slowed to 2.7% y/y in Feb** (vs. 3% for Jan) while core inflation also slowed to 2.5% y/y in Feb (vs. 2.7% for Jan). The decline was more than expected but we do not expect one data point of decline to derail BoE's hawkish rhetoric. Modest decline in petrol prices and slower increase in food prices were the main factors for the slower than expected increase in Feb inflation. We reiterate our view on inflation **-** do not expect price pressures to stay above 3% for extended period as seasonal effects from travel ease. We expect recent GBP gains to have an effect in moderating inflation via import price channel. Our internal forecast on UK inflation trajectory suggests that inflation may have peaked at 3% in 4Q 2017 and is slowly easing towards 2% in 1Q 2019.

- In the last Quarterly Inflation Report (published Feb 2018), **inflation is forecasted to be higher for 2018 at 2.9%** (vs. earlier projection of 2.6%). BoE said that current level of inflation above MPC's 2% target was almost entirely due to effects of higher import prices following GBP depreciation. Recent rise in global oil prices has also added to external cost pressures. But inflation is projected to fall gradually but remains above the target in 2018 (2.3%) and 2019 (2.2%).

- **Monetary Policy Forecast:** There is no MPC meeting scheduled for Apr, and we see a possible 25bps dovish hike to take policy rate to 0.75% at the next MPC meeting (scheduled on 10th May) as current level of inflation remains above 2% target (despite the recent decline in Feb). Unemployment rate falling to 43-year low and signs of real wages rising underscores the tightness of labor market conditions and this could generate domestic price pressures and builds the case for BoE to normalize policies earlier than expected. We see risks that accompanying statement may attempt to temper market expectations for more BoE rate hikes – and this could possibly result in "buy rumor, sell on fact" into BoE meeting in May. We believe BoE could pause in its pace of policy normalisation to assess how tightening transmission has fed into the economy. OIS-implied probability suggests 71% chance of 25bps rate hike – further bets for BoE to raise rate in the upcoming meeting could add to GBP upside pressure.

- At the last BoE meeting (22 Mar), MPC voted 7 – 2 to keep policy rate unchanged at 0.5%. Though there were 2 dissenters at the MPC meeting – Saunders and McCafferty wanted an earlier rate increase as wage growth was picking up (presenting upside risks to inflation in the medium term), there appeared to be a lack of commitment on the timing of rate increase. Back in Sep-2017, BoE then explicitly mentioned "rate hike over the coming months) and a rate hike was subsequently delivered in Nov-2017. The lack of commitment this round could be due to recent activity data that have somewhat disappointed and that BoE may not want market to over-interpret pace of BoE policy normalisation.

- **Latest Fiscal and External Balance Outlook:** UK's current account deficit to GDP narrowed slightly to -4.6% of GDP in 3Q 2017 from -5.2% of GDP in 2Q. Latest set of numbers will be released end-Mar 2018. The Office of Budget Responsibility has projected current account deficit to be about -4.4% of GDP in 2021, rather than -2% of GDP initially forecasted in Mar 2017. Foreign inflow of capital is needed to fund the deficit. But if Brexit uncertainty takes a turn for the worse (not our base case scenario) or persists for longer, investor/business sentiment can be adversely impacted. Slowdown in foreign inflows could worsen the situation and the GBP could come under pressure as a result.

- Public sector borrowing (ex-banking) fell by GBP2.5bn to GBP41.4bn in the financial year to Feb-2018, compared with the same period in the prior financial year. This is the lowest YTD net borrowing since financial year to date ending Feb-2008.

- **Key domestic events and issues to watch:** Mar Mfg PMI (3 Apr); Mar Construction PMI (4 Apr); Mar services PMI (5 Apr); Feb trade, IP, construction output (11 Apr); Feb labor report (17 Apr); Mar inflation (18 Apr); Mar retail sales (19 Apr); Mar public finances (24 Apr); Apr GfK consumer confidence (27 Apr); 1Q advanced GDP (27 Apr).

- **Technical Outlook:** Our caution for "risks skewed to the downside" (in last month's FX Outlook) materialized. Pair was last seen at 1.4090 levels. Bullish momentum on daily chart is waning while stochastics is showing signs of turning lower from overbought conditions. We do not rule out further risks of pullback from recent highs in the near term. But bias remains to buy on dips towards 1.40 levels for a move towards 1.4250 (interim resistance) before 1.45 levels. Bullish trend channel formed since mid-2017 remains intact. Bigger support at 1.3885 (channel support).

AUD: When The Bearish Calls Are Getting Crowded...

Forecast	2Q 2018	3Q 2018	4Q 2018	1Q 2019
AUDUSD	0.8000 (--)	0.8100 (--)	0.8300 (--)	0.8300 (--)

No Change to Previous Forecast

- **Motivation for the FX View:** AUD seems poised to hit 0.76 against the USD, weighed at first by the USD resurgence and then because of the swift down-move in the iron ore. The iron ore correction that we had been looking for finally materialized. Despite bearish sentiments on the AUD, underpinned by the sharp pullback in the iron ore, the double top move on the charts seems to near its completion. The bond markets seem to be providing some support for the currency at this point. In fact, the yield curve bull flattened as investors became increasingly pessimistic on the Australian economy. It does not help that AGB-UST 10y spread has turned negative this month and the discount is poised to stay and widen even further. The last time this happened was in 1998. Looking at the sovereign yield curve, 10y1y spread narrowed to just 70.5bps from highs of 114 earlier this year. To be clear, apart from the sharp pullback on 26 Mar, 1y yield has been trending higher. However, demand was found more on the longer end of the curve as investors diversify into Australian bonds at the peak of trade war fears. With trade war concerns likely behind us, focus is on the domestic economy which is weighed by the recent plunge in the iron ore prices. Eyes are on the key USD50 as the base metal price extends its rapid descent. We watch for signs of stabilization with leading indicator from China NBS and Caixin mfg as the next cues to watch. We stick to our call for a rebound towards 0.80 within the next quarter, looking for dips towards 0.76-figure to buy into.

- **Growth and Inflation Outlook:** The pullback in the iron ore prices soured the outlook on the Australian economy. With 10y yield tracking the iron prices lower, that has also brought the AUD on the backfoot. It did not help that the 4Q GDP for 2017 underwhelmed with a 0.4%q/q print with exports of goods and services a key detractor (0.4 ppt) from GDP growth. What is heartening is the household final consumption that rose 1.0% for the quarter, still a strong driver of the national income. Nonetheless, external demand has been dragging on growth. Looking into the first quarter of this calendar year, trade balance rebounded into a surplus in Jan to A$1055mn from a deficit of A$1358mn which, a decent start to the quarter. Exports in particular rose 3.82%y/y that month, stabilizing from two months of decline. While we should not be too optimistic at a single positive data, what we can be sure is that industrial profitability for the first two months have also started to stabilize and that is positive for iron ore. PMI-mfg numbers are mixed for China though the NBS version is the one that is concerning.

- Private consumption remains weak with proxy retail sales slowing to 0.1%m/m from previous -0.5%. Home loans saw a smaller decline in Jan, of around -1.1%m/m vs. the previous -2.3%. The capacity utilization rate of services sector also fell to 78% in Feb from 81% in Jan. Capacity utilization rose in manufacturing sector and fallen in construction. Even so, Building approvals accelerating in Jan from a contraction of -20.6% previously and that bodes well for the construction sector.

- Inflation rose to 2.0%y/y (s.adj) in 4Q 2017 vs. the previous 1.8%. Breakdown suggests that food costs have risen in the quarter along with housing, rental and transport. Higher frequency indicators such as the Melbourne Institute inflation indicate that inflation is likely remain subdue for now.

- **Monetary Policy Forecast:** RBA Governor Philip Lowe did not hike in Mar and is unlikely to move in the next quarter as well. The central bank addressed the weak exports growth with assurance that "further growth in exports is expected after temporary weakness at the end of 2017" while remaining unsure about household consumption. Another fresh statement that stuck out to us is "rate of wage growth appears to have troughed". This is something that we had been expecting and backs our call for a rate hike in Aug, well ahead of market consensus.

- Household debt level remains high and may affect consumption, not helped the least as well by the slow wage growth. This is also why the central bank is unwilling to hike at this point as external demand is still weak and domestic demand should not be undermined. The interest rate expectations have been further anchored by comments by the RBA Govenor as he looks for further reduction in the jobless rate and an increase in inflation towards the mid-point of the 2-3% target range before the central bank reduce monetary stimulus and raise interest rates. In addition, the wage recovery that we have been looking for could take even more time to come as Turnbull's public sector policy has allowed federal government agencies to hire base on common law contracts and they need not enter into new enterprise agreements with unions and employees. This new policy could slow wage growth and overall price pressure. We now look for RBA to move in August instead of May, timed in conjunction with the release of the quarterly SoMP for more room for policy explanation.

- **Latest Fiscal and External Balance Outlook:** Based on last available data, Australia's current account deficit narrowed slightly to A$9.13 billion (s.a.) in 3Q from A$9.7bn in the quarter prior. In related news, PM Turnbull said that the country wants to pour A$3.8bn to boost defense exports. As the mining investment declines, resource exports are rising. We may see a rise in export receipts given more government investment on that front along with rising commodity prices for energy and metals in an environment of synchronized global growth. Current account to deficit stands at -2.3% of GDP.

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

- **Key domestic events and issues to watch:** RBA rate decision on the 3rd; building approvals and retail sales on 4th; trade on 5th; Westpac consumer confidence on 11th; home loans on 12th; RBA minutes on the 17th; labour report on the 19nd; **1Q CPI on 24th**; PPI on 27th; private sector credit on the 30th;

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

NZD: Interim Weakness Could Reverse

Forecast	2Q 2018	3Q 2018	4Q2018	1Q2019
NZD/USD	0.7400 (--)	0.7500 (--)	0.7600 (--)	0.7600 (--)

No Change to Previous Forecast

- **Motivation for the FX View:** NZD gains could moderate in coming weeks and possibly even trade range-bound between 0.71 – 0.74 as signs of moderation in global activity starts to surface. Other factors that are expected to weigh on NZD outlook in the interim include little impetus for RBNZ to signal policy tightening at this stage (as inflation remains below RBNZ target) and fears of global (US, China) trade tensions escalating into trade wars. The latter could impact global trade and derail synchronous global economic recovery momentum. This poses downward pressure on NZD (pro-cyclical currency to world growth). Tighter conditions in global funding markets (higher libor, US 2y2yf and wider libor-OIS spreads, etc.) is typically less favourable for NZD due to its dependence on foreign funding (negative beta - tighter cost of funding is typically associated with NZD losses) but tighter conditions could potentially ease next month and provide some support for NZD.

- Taking stock of the past month, NZD had a relatively "rough" session – traded to high of 0.7354 for the first half of Mar, turned lower to 0.7154 levels in the lead up to US FOMC meeting (22 Mar) and then traded a touch higher to 0.7260 levels - ending the month roughly where it started. We had in the last FX Monthly cautioned for the risk of yield differentials to narrow further towards par amid rising expectation for Fed to tighten while RBNZ stays on hold due to inflation taking on different trajectories (US CPI showing upticks while NZ CPI slips). NZ-UST 10Y yield differentials narrowed to historical low of 3bps from about +20bps. We **reiterate our view that the narrowing of NZ-UST yield differentials is only a temporary phenomenon and should not be a permanent feature. NZ-UST yield differentials should start to widen when RBNZ signals for normalisation or Fed signals a slowdown in pace of normalisation at some stage.** This should add to support for NZD. Furthermore the rise in US libor, widening of libor-OIS spread (partially attributable to surge in funding needs for US Treasury owing to Trump's fiscal measures) could potentially ease in Apr when US funding requirements slows and US Treasury receives tax receipts. A less tight global funding market should typically be favourable for NZD.

- We **maintain our view for NZD to trade higher this year** due to government policy uncertainty subsiding, global synchronous economic recovery to keep agri-commodities prices supported, inflation to materially pick up (owing to fiscal impulse, minimum wage increase) leading to RBNZ first rate hike in 2H 2018 amid environment of broad USD downtrend.

- **Growth and Inflation Outlook:** 4Q GDP surprised to the downside at +0.6% q/q (vs. 0.8% expectation) but held steady (vs. 0.6% in 3Q). Weakness was due to declines in the primary sector – drought (hottest summer on record) at end-2017 saw a reduction in agricultural production due to lack of feed. For full-year 2017, the economy grew by 3.1%, driven by services sector which makes up about 2/3 of GDP. Momentum has slipped vs. 2016 where growth was at +4.2%. Growth for 2018 is likely to continue at current pace with risks skewed slightly to the downside. PMI for Manufacturing and services were a touch softer at 53.4 and 55, respectively (vs. 55.6 and 55.8 respectively). That said PMIs are still in expansionary territories.

- In the last quarterly Monetary Policy Statement in Feb-2018, growth projections in the near term was revised lower to 3.1% in 1Q from 3.8% as seen from Nov MPS projection, taking into account the new government's policies on immigration, housing, welfare and industrial relations on economic activity. MPS also noted that NZ economy is projected to continue growing at an average of 3.2% over the next 3 years. Above-trend pace of growth is expected to be strong enough to generate an increase in capacity pressure and lift inflation around the midpoint of the RBNZ target range of 1 – 3% over the medium term. Housing and construction sectors are likely to be weaker (possibly due to LTV restrictions, reduced foreign demand, etc.) but continued high terms of trade, fiscal stimulus amid accommodative monetary policies should offset. RBNZ also took into consideration new policy changes including new government spending, tighter visa requirements, KiwiBuild program (to build 100,000 affordable homes in 10 years, half of those supply will be in Auckland) and increases in minimum wage but the impact of these policies remain very uncertain.

- **In the last MPS, RBNZ lowered inflation forecasts and predicted that inflation won't reach the 2% midpoint of its 1 – 3% target range until 3Q 2020.** It also sees inflation softer at 1.1% in 1Q 2018 (vs. previous projection of 1.5%). Survey measures of inflation expectations remained anchored around the 2% target across all horizons. **Our internal projection on CPI shows inflation could dip towards RBNZ lower bound of its range at 1% in mid-2018 before rising towards RBNZ's median target of 2% in early 2019.**

- **1Q CPI is expected to be released on 19 Apr. 4Q NZ inflation was weaker** (+0.1% q/q and +1.6% y/y) than expected (+0.4% q/q and 1.9% y/y). Higher petrol prices, airfares were more than offset by decreases in telco services, purchase of vehicles, new cars, household goods and vegetable prices. Core inflation further reinforced the soft headline CPI, raising question if inflation could pick up further sustainably especially in the environment of stronger exchange rate. However we **believe potential fiscal impulse and proposed minimum wage increase (minimum wage to be raised to NZ$20/hour by 2020; and to NZ$16.50 by Apr-2018) could support consumer spending and result in faster pick-up in inflation.**

- **Monetary Policy Forecast:** There is no RBNZ meeting scheduled in Apr and we expect RBNZ to keep OCR on hold at 1.75% at its upcoming meeting on 10 May amid softer inflation outlook and signs of moderation in activity. On the last RBNZ meeting (22 Mar), OCR was kept on hold at 1.75%, as widely expected. Accompanying statement noted that "growth is expected to strengthen supported by accommodative monetary policy, high terms of trade, government spending and population growth".

- While there appeared to be big changes at the RBNZ, these changes (phase 1) were previously flagged and should not impact the direction of RBNZ in a big way. Adrian Orr has taken office as the Governor of RBNZ on 27 Mar for a period of 5 years. Finance Minister Grant Robertson and RBNZ Governor Orr had signed a new Policy Targets Agreement (PTA) to include targeting maximum employment (no numerical target) and keeping inflation in a 1-3% range on average over the medium term. RBNZ inflation targeting regime has long included employment and output variability in its deliberations on interest rate decision and the recent change in PTA is to make it explicit and to account for transparency. Another confirmation is the change in monetary policy voting/decision that will come in 2019 where a Monetary Policy Committee of about 5 to 7 members (majority will be RBNZ internal staff and a minority will be external members) will vote on rate decision (vs. the current model is where Governor is solely responsible for rate decision). Phase 2 of the RBNZ Review will focus on the Reserve Bank's financial stability role and broader governance reform. Announcements will be made by mid-2018 and subsequent policy work will commence in the second half of 2018. Looking ahead into 2H, policy bias and expectations could change in light of a new structure, dual mandate and new leadership going forward. We do not rule out a shift in guidance towards tightening. We still expect the central bank to begin raising rates as early as in 2H 2018 as inflation is expected to pick up further towards end-2018 (owing to fiscal impulse, minimum wage increase).

- **Latest Fiscal and External Balance Outlook:** NZ government's operating surplus continues owing to rise in GST and income tax receipts as well as seasonal rise in tobacco duties. Operating Surplus before gains and losses (OBEGAL) was a surplus of $2.44bn (about $670mil more than expected). Net debt came in at about $1.23bn below forecast at $60bn. As a % of GDP, debt stood at about 21.6%

- Finance Minister Robertson will deliver his first Budget on 17 May. He has signaled capital investment as a key focus for future budgets.

- 4Q current account deficit narrowed to $2.77bn (vs. $4.83bn deficit in 3Q). The improvement was helped by a recovery in primary exports and spending by tourists. Annual deficit was at -2.7% of GDP (vs. -2.6%) due to net outflow of primary and secondary income.

- **Key domestic events and issues to watch:** Mar consumer confidence (4 Apr); Mar QV house prices (5 Apr); Mar Mfg PMI (13 Apr); Mar food prices (16 Apr); 1Q CPI (19 Apr); Mar net migration (24 Apr); Mar trade (27 Apr). GDT trade auctions take place on 3 and 17 Apr.

- **Technical Outlook:** Our technical call (in last month's FX outlook) looking for further pullback towards 0.72, 0.7180 were met. Low was seen at 0.7154 (21 Mar), short of our final objective at 0.7130. Pair was last seen at 0.7190 levels. Bearish momentum on daily chart remains intact. Next support at 0.7180 (200 DMA) before 0.7150 (100

DMA). Area of resistance at 0.7280 – 90 levels before 0.7350 (Mar high).

JPY: Unwinding Safe-Haven Plays Weigh

Forecast	2Q 2018	3Q 2018	4Q 2018	1Q 2019
USDJPY	107 (--)	106 (--)	105 (--)	105 (--)

No Change to Previous Forecast

- **Motivation for the FX View:** JPY had been on a steady keel for most of Mar before climbing to touch briefly a 2018 high of 104.56 on 25 Mar amid improving risk appetite as global trade tensions recede. Consequently, the unwinding of safe-haven trades, including JPYKRW trades, bolstered some paring of long-JPY positions. Unlike in Feb, the JPY has not been outstanding, gaining around 0.9% against the USD month-to-date in Mar. Year-to-date though, the JPY has been the best performing currency among the G7 and Asians, rising 6.6% against the USD. As we have cautioned, we do not expect these gains in the JPY to continue unabated ahead with some slippages expected. Nevertheless we remain positive on the JPY outlook and reiterate our sell USDJPY call for a move towards 105 going into the year-end and into 2019.

- We maintain our view for a broad USD downtrend to persist in 2018. The weakness in the USD can be attributed to structural factors such as the counter-cyclical nature of the USD, rising budget deficit, reserve diversification away from the USD, and the end of the 78-month USD rally cycle. USD weakness should continue to put downside pressure on the USDJPY. We caution though that there could be intermittent bout of USD strength towards month-end that could lift the USDJPY higher.

- Expectations that JPY could still strengthen appear to be shared by the market. Recent CFTC data showed investors still paring their net short-JPY positions. Investors though did not increase their long-JPY bets significantly, which was up marginally to 47902 contracts in the week of 20 Mar from 44296 contracts in the previous week. Instead, investors reduced their short-JPY bets by nearly half to 69901 contracts in the week of 20 Mar from 123835 contracts in the week of 13 Mar. In short, the market is looking for reduced weakness in the JPY in the weeks ahead. Further unwinding of net-short USDJPY positions ahead on safe-haven plays or increase expectations of a BOJ exit from monetary stimulus should add further downside pressure to the USDJPY in the months ahead.

- At the same time, the synchronous global recovery is helping Japanese exports and hence the economy. Improved exporter profits suggest better corporate earnings that should make Japanese equities more attractive and could encourage greater foreign inflows. Previously, foreign investors would hedge their purchases to prevent translation cost from a weakening JPY. This positive correlation between the Nikkei 225 Index and the USDJPY appears to have broken down for now though. Expectations for JPY appreciation suggest that foreign investors might not be too eager to hedge their purchases by selling the JPY. Instead, foreign inflows into Japanese equities should be supportive of the JPY.

- In the near term though, we expect further easing of global trade tensions and geopolitical tensions on the Korean peninsula to lead to an unwinding of safe-haven plays. Negotiated compromises between the US and its trading partners are likely as evidenced by the re-negotiated US-South Korea Free Trade Agreement and the ongoing trade talks between the US and China to grant improved access to US companies. The expected meeting between North Korean leader Kim Jung Un and Trump and the South Korean President should also ease tensions in the region. Taken together, the improved risk environment should see long-JPY bets unwind and put downside pressure on the JPY. In contrast, the ongoing political scandal involving PM Abe and his wife could spark some safe-haven plays and cap downside to the JPY. We look for the USDJPY to hover around the 107 levels in 2Q.

- That said, we do not expect the JPY to strengthen significantly towards the 100-handle in the near future. While there will be attempts by JPY-bulls to test that level, we do expect them to be successful as the USDJPY should remain supported by the BOJ's continued easy monetary policy. The reappointment of Governor Kuroda to another 5-year term and the appointment of his two new dovish Deputy Governors suggest that doves will continue to dominate the BOJ monetary policy board and that the current QQE with Yield Curve Control framework will persist until the inflation overshoots the 2% target. This means that Japanese yields will remain depressed with short-end yields at negative levels and 10-year yields at zero percent levels in contrast to its G7 peers where yields are rising due to the withdrawal of monetary easing. The widening yield differentials should keep the USDJPY supported.

- **Growth and Inflation Outlook:** Final GDP print for 4Q 2017 showed the economy expanding by 0.4% q/q seasonal-adjusted (1.6% annualised) compared to just 0.1% (0.5% annualised) in the preliminary estimates, helped by stronger capital spending (up 1% vs. 0.7% in the preliminary estimates). This kept the economy expanding for the eighth straight quarters in 4Q 2017. The economic outlook in 2018 remains mixed with the economy unlikely to outperform in the quarters ahead. Industrial production decelerated in Jan, rising by just 2.5% y/y in Jan vs. 4.4% in Dec, while core machine orders, rebounded by 2.9% y/y in Jan from the 5.0% decline in Dec. External demand has also come off in Feb weighed by the strong JPY rising by just 1.8% y/y after a good start in Jan of 12.3%. Though growth is expected to moderate in 2018, it should remain relatively healthy on support from the government's FY2017 supplementary spending package of around JPY2tn as well as preparations in the run-up to the 2020 Olympics in Tokyo. For now, the BOJ expects the economy to expand by 1.4% and 0.7% for 2018 and 2019 respectively, largely due to base effects in 2018 and an expected slowdown in domestic demand in 2019, though some tweaks to the BOJ projection is possible when it releases its outlook report on 27 Apr.

- Some headway were made in inflation in Feb with headline inflation rising to a 36 month high of 1.5% y/y (Jan: 1.4%), while core inflation (headline CPI less fresh food) climbed 1.0% y/y (Jan: 0.9%). Core-core inflation (headline CPI less fresh food, energy) climbed to a 20-month high in Feb at 0.5% y/y (vs. Jan's 0.4%). Consumer prices should remain on the uptick underpinned by higher crude oil prices, but recent JPY strength could weaken import prices and put downside pressure on consumer prices. This could keep underlying inflation from edging closer to the central bank's 2% inflation target. BOJ Governor Kuroda recently commented in Parliament that the BOJ remains committed to meeting its target and will persist with its "powerful monetary easing" until the 2% inflation target is achieved amid a virtuous economic cycle. The BOJ's outlook report will be eyed for any changes to its inflation forecast. Currently, the BOJ is projecting core inflation at 1.4% for FY2018 before accelerating to 1.8% in FY2019.

- **Monetary Policy Forecast:** The BOJ maintained the status quo at its policy meeting on 9 Mar, keeping its ultra-loose monetary policy intact. Its balance (short-term) rate was left unchanged at -0.1% as was its 10Y JGB yield target at around 0%. The pace of asset purchase of JPY80tn annually was kept in place even though this measure is no longer central to its "QQE with Yield Curve Control" policy regime. In his post-meeting press conference, BOJ governor Kuroda again reiterated that the BOJ will continue with monetary easing until the 2% inflation target is achieved, though adjustments could be made to maintain momentum. He also dampened expectations of any plans by the BOJ to exit monetary stimulus, saying that the BOJ was not thinking of weakening easing before the inflation target was achieved. He added that hitting the target itself would not trigger an immediate exit from policy stimulus. Despite these comments, there remains speculation that could be preparing for an exit strategy that has capped attempts by the JPY-bears to push the JPY lower.

- **Latest Fiscal and External Balance Outlook:** PM Abe has reiterated his commitment to hike the consumption sales tax to 10% by Oct 2019 from 8% currently. Half the revenue collected from the sales tax will be allocated to education and child care instead of cutting the budget to balance the primary budget. PM Abe said that he will consider a delay to the hike if there was a financial crisis-level shock.

- The current account (CA) started the new year with another surplus. The CA recorded a smaller surplus of JPY0.61tn in Jan compared to JPY1.35tn in Dec 2017, supported by the JPY1.6tn surplus in the primary income account that more than mitigated deficit in the goods & services account of JPY0.83tn (Dec: +JPY0.22tn). The financial account surplus moderated mildly to JPY1.21tn in Jan from JPY1.4tn in Dec 2017 with the strong inflows from direct and portfolio investment helping to mitigate the deficit in the "other investment" account. Consequently, the overall balance of payments (BoP) surplus moderated to JPY2.41tn in Jan from Dec's JPY2.81tn.

- **Key domestic events and issues to watch:** Kicking off the month is Tankan survey results for 1Q and rounding up the month is BOJ meeting on 27 Apr. Also eyed will be BOJ's release of its outlook report on the same day. JGB auctions in Nov: 10-year (4 Apr), 30-year (12 Apr), 5-year (17 Apr), 1-year (18 Apr) and 20-year (19 Apr).

- **Technical Outlook:** USDJPY drifted lower for the month of Mar with low seen at 104.56 on 26 Mar (15-month low) before the rebound into month-end. Pair was last seen at 106.70 levels. Bearish momentum on weekly chart shows signs of waning while stochastics is showing signs of turning higher from oversold conditions. Falling wedge pattern appears to be forming – typically associated with bullish reversal. Sustained close above 106.64 could see further upside gather momentum. Next resistance seen at 107.90. Support seen at 105.30, 104.60 levels (previous low).

RMB: Bulls Could Take A Breather

Forecast	2Q 2018	3Q 2018	4Q 2018	1Q 2019
USDCNY	6.20 (--)	6.20 (--)	6.10 (--)	5.90 (--)
USDCNH	6.20 (--)	6.20 (--)	6.10 (--)	5.90 (--)

No Change to Previous Forecast

- **Motivation for the FX View:** We expect RMB bulls to take a breather in Apr after a surge in the last week of month. The USDCNH dropped in the last week of Mar, 26 Mar to be exact, after weeks of staying within the 6.28-6.35 range. There was no apparent trigger for this although the RMB rally could be pinned to the start of the yuan oil futures trading in Shanghai on the same day as well as the announcement by that RMB-denominated government and policy bank financial bonds to be included in the Bloomberg Barclays Global Aggregate index from Apr 2019 with a 20-mth scaling in period. The strength in the currency could also be alluded to easing trade war fears amid talks that the US and China are "quietly negotiating" to improve US access to Chinese markets. Specifically, the Trump administration set out requests that include reduction of Chinese tariffs on US automobiles, more Chinese purchases of US semiconductors and greater access to China's financial sector by American firms. The "trade war" seemed to have lasted for a grand total of one weekend with few real casualties. With that move, this pair is poised to settle around our forecast for the first quarter. We continue to remain bullish on the RMB for the rest of the year, especially against the USD, expecting this pair to end the year around 6.10.

- Fundamentally, we are still mildly bullish on the RMB. The yuan is in a much better place than what we saw this time, last year. Capital outflow is much less of a fear given the persistent rise in forex reserves and softening USD. The inclusion of RMB government and policy bank bonds in the Bloomberg Barclays Global Aggregate index is said to trigger around U$100 billion of inflows as investors adjust their portfolio to match the benchmark index. That puts yuan in a more favourable environment for PBoC to relax capital controls in a reversion towards the yuan internationalization plan. Indeed, China has granted the fourth batch of QDLP quotas to several foreign institutions. Sustained global growth, potential inflows from the index inclusions, stronger trade relations with the EU and even the US (a possible outcome out of the current trade negotiations) could sustain balance of payment surplus for China and lift the RMB. In addition, CNY seems to be one of the least vulnerable to rate hike environment of the US. So a more aggressive tightening trajectory might not affect the CNY as much as other regional peers.

- **Growth and inflation outlook**: The economic target for 2018 is softened to “around 6.5%” and the omission of the phrase “higher if possible” underscored the emphasis on better quality growth as opposed to more growth. The 6.5% economic growth still allows the China economy to be on course to achieve its 2020 target of doubling national income of 2010. The reduction of budget deficit from 3% to 2.6% for 2018 is rather drastic. While the economic target is lowered, it is worthy to note that the real economic activity index shows that economic rebalancing has been progressing and that new sectors of growth are showing a rise in activity.

- Apart from the growth target as indicated above, China will use differentiated reserve and credit policies to guide investments into smaller companies, agricultural sectors and poverty-stricken areas for 2018. China will also maintain a “reasonable” growth of M2, credit and social financing, also to ensure appropriate and stable liquidity. The share of direct (especially equity) financing will also be raised.

- From the latest available data, industrial profitability is stabilizing with SOE profitability up 36.1%y/y in the first two months of 2018, rebounding from 40.8% in Dec. Firms in the non-overcapacity sectors saw profitability stabilized in the first two months. Industrial production for the first two months of the year firmed to 7.2%y/y from 6.6%. However, the outlook is less sanguine as leading indicators such as Caixin show an improvement in output from the manufacturing sector from 51.5 to 51.6. The official figure came in slightly lower at 50.3 vs. the previous at 51.3. Breakdown of the official numbers suggest that whenever manufacturing comes under pressure, the SMEs are the ones that are most affected. Purchasing price index came off sharply from 59.7 to 53.4. Purchasing managers are not optimistic about hiring though with the number showing further contraction at 48.1 from previous 48.3. Managers seem to be less optimistic in the Feb survey, perhaps ahead of the NPC and

CPPCC given the fact that the leadership has emphasized a lot on deleveraging, penalizing big corporations with huge oversea acquisitions and combatting pollution.

- CPI surged more than expected to 2.9%y/y from previous 1.5% on the back of low base effect on the year before. However, the upside surprise was also due to a spike in food costs. Residential price sub component of CPI slowed to 2.2%y/y in Feb vs 2.7% in the month prior. Residential property prices rebounded 13%y/y in the first two months of the year from 5.7% seen in 2017. Positive wealth effect could see greater private consumption that could lift the retail sales from 9.7%y/y seen in Jan-Feb. PPI slowed to 3.7%y/y in the same period from the previous 4.3%.

- **Monetary Policy Forecast:** PBoC has "hiked rates in tandem with the Fed". The 7-day reverse repo has been raised 5bps right after the FOMC decision to raise rates by 25bps. However, the 7-day reverse repo is just one of the myriad of tools to influence the credit conditions in the economy. It is a move more symbolic than anything else. The spread between CGB 10y yield and 10y UST slipped lower but that hardly weakened the RMB against the CNY. PBoC reiterated that monetary policy will be kept "prudent and neutral" even as Zhou Xiaochuan handed over the reins of the central bank to Yi Gang, his Deputy. This succession plan indicates policy continuity. The month of Mar has so far seen a net withdrawal of CNY200bn as of 23 Mar via open market operations. This is in line with its prudent and neutral monetary policy.

- China just announced Guo Shuqing as PBoC Secretary. This puts him above Yi Gang as PBoC Governor and could limit the autonomy that Yi Gang has over monetary policy and financial reforms even as the central bank has taken over some functions of the CIRC and CBRC. Guo Shuqing was the CRBC Chief and was a key personnel in reducing shadow financing and had a tight grip on the interbank lending market. Guo Shuqing is more likely to be more focused on the banking reforms, continuing his previous endeavours on risk mitigation. On the other hand, Yi Gang will focus on the monetary policy and perhaps improving the monetary policy transmission via the plethora of tools that his predecessor had created.

- **Latest Fiscal and External Balance Outlook:** China targets to reduce its budget deficit target from 3% of GDP to 2.6%, lower than speculated 2.9%. While we do think it signals less fiscal stimulus given the fact that growth is projected to be softer and budget deficit target is also lower, a senior official clarified that this does not suggest less government spending in 2018 or signal an intensified effort to reduce central government debt. It seems that there is a separate government-managed funds budget that financed via returns on investment projects that could see a CNY550bn addition of deficit. Bear In mind that fiscal deficit has always been above the target 3% since 2015, at 3.7% of GDP for 2017.

- **Key domestic events and issues to watch:** NBS PMI numbers for Mar due on 31st Mar, Caixin PMI is due on the 2nd Apr. FX Reserves on the 7th; trade balance, Money supply, Aggregate financing on 10-15th; CPI, PPI on the 11th, trade on the 13th; activity data including 1Q GDP on the

17th; Property prices on the 18th; industrial profitability on 27th; Apr NBS PMI-mfg on the 30th.

- **Technical Outlook:** Last seen at 6.2830, we see mild upside risks as the stochastics on the weekly chart. Stochs are rising from oversold conditions. We see a bullish divergence between the price action and the MACD on the weekly chart and momentum indicators there seem to be turning higher as well. First resistance is at 6.35 before the next at 6.43. Support around 6.24 before 6.21.

KRW: Supported by Unwinding of Geopolitical and Trade War Tensions

Forecast	2Q 2018	3Q 2018	4Q 2018	1Q 2019
USD/KRW	**1050 (--)**	**1040 (--)**	**1060** (--)	**1050** (--)

No Change to Previous Forecast

- **Motivation for the FX View:** The outlook for KRW is expected to brighten up as geopolitical tensions and trade war fears unwound further. Key area of support for USDKRW at 1050 – 1055. We caution that a break below could trigger more downside play for the pair. Recent development in Korea peninsular and KORUS FTA adds to the list of macro-fundamental factors underpinning broad KRW strength: (1) synchronised global economic recovery continues to bode well for Korean exports, benefitting trade-dependent currencies such as KRW; (2) signs of pick up in inflationary pressures leading to room for BoK to tighten monetary policy in 2Q-3Q; (3) broad USD decline underpinned by macro trends amplifying gains in KRW.

- In a surprise twist of events in the final week of Mar-2018, North Korea Kim's visit to Beijing and willingness to hold US summit is a strong commitment for denuclearization. We believe this should help to ease geopolitical tensions further and support gains in KRW in the broader term. Separately, it was announced that US have reached an agreement in principle with South Korea on the bilateral KORUS FTA and the new FTA is expected to be rolled out soon. These events are supportive of sentiment and should support gains in KRW. That said we caution that general risk sentiment remains fragile as US is likely to announce curbs on Chinese investments soon amid consideration of a crackdown on Chinese investments in technologies the US considers sensitive by invoking a law reserved for national emergencies brought back fears of trade war again. This could counter against the other "feel-good" factors (from new KORUS FTA with US and North Korea's plans to denuclearize). There were also market chatters that China would use US semiconductors rather than those produced in South Korea and Taiwan as part of the trade negotiations between China and

US. It not unclear if this is true at this stage but a risk factor to watch going forward as this could negatively impact the highly-sensitive KRW.

- Taking stock of our call in last month's FX Outlook, we had cautioned for the risk of USDKRW going higher towards 1080 – 1090 around the period in the lead up to US FOMC (22 Mar). The pair traded high of 1083 on 23 Mar before easing towards 1070 levels. Going forward we still pay close attention to signs of any global trade war as that could pressure sentiment, weigh on stocks and re-exert depreciation pressures on the KRW.

- **Growth and Inflation Outlook: Final estimates of 4Q GDP saw a contraction in** Korea's economy (-0.2% q/q vs. +1.4% in 3Q). On y/y basis, growth was at 2.8% (vs. 3.8% in 3Q). Decline was due to slowdown in car exports and construction which more than offset the strength in consumption and government spending. Surprise contraction in 4Q GDP was the worst result since 4Q 2008 and came after its strongest expansion in 3Q in more than 8 years. A BoK spokesman had previously said that the decline in 4Q GDP was due to fewer work days and base effects. For 2017, Korea economy expanded 3.1%, its fastest expansion in 3 years. BoK still expects the economy to grow by 3% this year, subject to global demand for memory chips and other manufactured goods.

- **Headline CPI surprised to the upside in Feb** (+1.4% vs. 1.2% consensus vs. 1% in Jan). Rebound was due to jump in fresh food prices on winter season. Petrol prices also rose while other components such as clothing, housing, health, held steady. Core CPI rose slightly to 1.2% (vs. 1.1% in Jan).

- **Monetary Policy Forecast**: We retain our view for BoK to keep policy rate on hold at 1.5% at the upcoming meeting on 12 Apr. Though inflation rebounded in Feb to 1.4% from 1% in Jan, it remains below BoK's 2% target. This suggests room for BoK to monitor further data flows. We are still expecting BoK to raise policy rate by another 25bps in 2Q-3Q 2018 from 1.5% if demand-induced price pressures picks up pace amid reacceleration in growth momentum. We believe BoK is monitoring if inflationary pressures from the demand side picks up. Minimum wage will increase by 16% this year, its largest magnitude of increase since 2001. Wage pass-through may have positive impact on consumption spending, growth and lead to inflationary pressures.

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

- **Latest Fiscal and External Balance Outlook:** Current account surplus narrowed sharply to $2.68bn in Jan from $4.09bn in Dec. This is due to a sharp rise in the deficit in the service account (rise in overseas trips and foreign business services). Nonetheless this marked the 71st consecutive month of current account surplus which started in Mar-2012.

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

- **Key domestic events and issues to watch:** S. Korea releases Mar trade data (1Apr); Mar PMI Mfg (2 Apr); Mar CPI (3 Apr); Mar FX reserves (4 Apr); Feb current account balance (5 Apr); unemployment rate (11 Apr); BoK meeting (12 Apr); Mar import, export price index (13 Apr); Apr consumer confidence (25 Apr); 1Q prelim GDP (26 Apr); Business survey for Mfg and Non-Mfg (27 Apr); Mar industrial production (30 Apr).

- **Technical Outlook:** USDKRW consolidated in a range of 1061 – 1087 for the month of Mar. Last seen at 1066 levels. Technical indicators show signs of downside pressure emerging. Key area of support at 1050-55 levels. **Decisive break below this should open way for further downside towards 1040 levels. Resistance at 1080, 1092. Bias to lean against any strength**

SGD: Eyeing MAS Policy Shift

Forecast	2Q 2018	3Q 2018	4Q 2018	1Q 2019
USDSGD	1.2700 (--)	1.2500 (--)	1.2400 (--)	1.2200 (--)

No Change to Previous Forecast

- **Motivation for the FX View:** After being pressured lower by rising UST yields in Feb, SGD regained lost ground in Mar. Market expectations for a MAS move at its monetary policy meeting in mid-Apr have been supportive of the SGD so far. Even global risk aversion on trade tension concerns did not dent optimism for the SGD in Mar. In Mar so far, the SGD has gained around 1.1% against the USD, almost totally reversing the 1.25% loss for the whole of Feb. Year-to-date, the SGD has gained around 2.1% vs. the USD. We remain positive on the SGD and reiterate our sell USDSGD call into the Apr MAS meeting.

- Our view that the SGD resilience will persist in 2018 remains intact. The synchronous global growth recovery that has lifted the trade-dependent economy to date should continue to be supportive of the economy. This was reflected in the strong economic performance in 4Q 2017 GDP where the economy expanded by a faster 3.6% y/y in the final estimate vs. the preliminary estimates of 3.1%. This brought full-year growth to 3.6% in 2017 (vs. 3.5% in the preliminary estimates and 2016's 2.0%).

- Growth is expected to cool off slightly in 2018 as manufacturing and trade growth momentum ease but we expect this slack taken up by a private investment recovery in the economy (as firms expand capacity to meet rising domestic and global demand). In addition, the government's infrastructure programme, including developing Changi Airport Terminal 5, redeveloping Jurong Lake District and the KL-Singapore High-speed rail among others. Together, these should keep economic growth supported at 2.8% in 2018, close to the upper band of the government's 1.5-3.5% forecast range.

- Aside from the government's mildly expansionary fiscal policy, the country's triple-A status and persistent high balance of payments surpluses are also supportive of the SGD. These should provide the impetus for the market to unwind their stale long-USD positions and increase their long-SGD bets

- The major impetus for the SGD's next leg up should come from the MAS' move to normalise policy after maintaining a neutral policy stance since Apr 2016. Our house view remains for the MAS to shift to a "slight appreciation stance" at its Apr meeting. With growth now back towards potential and core inflation on the uptick, we believe that the zero appreciation path of the MAS policy has outlived its usefulness. Our estimates for the SGD NEER using the Taylor Rule show that the SGD NEER is expected to strengthen ahead. Thus, normalising policy by shifting to a "slight appreciation bias" would be more appropriate.

- This policy normalisation is expected to provide the SGD with further upward momentum in 2Q 2018 as market position for SGD strength in the run up to the Apr meeting. Currently, the SGD NEER is hovering about 0.8% above the estimated midpoint, up from around the midpoint last month, but which still reflects the under-pricing of a MAS normalisation move in Apr. A re-pricing of a MAS tightening stance could see the SGD edge higher in 2Q. We target the pair to hit the 1.26 levels by end-2Q 2018.

- At the same time, the broad downtrend in the USD due to structural factors such as the counter-cyclical nature of the USD, rising budget deficit, reserve diversification away from the USD, and the end of the 78-month USD rally cycle is likely to provide support for the SGD ahead. We caution though that there could be intermittent USD strength on risk aversion that could be supportive of the USDSGD. **At the same time, persistent CNY strength via lower USDCNY daily fix in the aftermath of the removal of the counter-cyclical adjustment factor could provide an anchor for the SGD to appreciate given increasing positive sensitivity of USDCNY move on the USDSGD.**

- The ongoing synchronized global recovery and the historically low volatility environment as reflected in the muted equity and FX volatility indices have encouraged greater flows into emerging market assets, including those in Singapore. Since hitting a high not seen since 2017 at 3,609 on 24 Jan, the STI index has been tracking global indices and has lost some of its luster. Instead of aggressive Fed rate hike risk, fear of trade tensions escalating into trade wars is triggering bouts of global risk-off, spurring a sell-off in regional equity assets, including Singapore, and weigh on the SGD. Still, once markets stabilize, we expect flows to return and this should be supportive of the SGD.

- We remain positive on the SGD underpinned by synchronous global recovery that could provide the catalyst for an investment-led growth and MAS move to normalise policy at its Apr meeting. Still, we cannot rule out possible further bouts of weakness that could lift the USDSGD higher if trade tensions intensify and geopolitical tensions on the Korean peninsula and Middle-East re-emerge. For now, we maintain our full-year USDSGD forecast.

- **Growth and Inflation Outlook:** After outperforming expectations in 4Q17, GDP growth is expected to cool off in 2018 amid easing manufacturing and trade growth momentum. However, manufacturing growth should remain healthy in 2018, especially in the wake of the strong showing by industrial production in Feb where it expanded by 8.9% y/y. This helped to dispel concerns after NODX contracted by 5.9% in Feb. Given the resiliency in industrial production (up 13% in the Jan-Feb period - to account for seasonal factors), our economic team have revised upwards our house 2018 GDP forecast to 3.1% from 2.8% previously. The team expects 1Q 2018 GDP (due sometime 6-13 Apr) to come in around 4.0% due to the strong manufacturing performance so far.

- Headline and core inflation gathered pace in Feb underpinned by higher services and food inflation. Headline inflation rose by 0.5% y/y in Feb (Jan: 0%) while core inflation (headline inflation less accommodation & private transport) climbed 1.7% y/y (vs. Jan's 1.4%). The pick-up in headline inflation could be attributed to the dissipation of the service & conservancy charges (S&CC) rebates effect which translated into softer decline in accommodation cost (Feb: -3.6% vs. Jan: -5.3% as well as slowing private road transport cost (Feb: +0.6% vs. Jan: +1.6%) due to moderating petrol prices, ERP charges and COE premiums. Core inflation rose to a 10-month high on higher food prices and services cost (Jan: +1.5% and +1.9% y/y respectively) due partially to the Chinese New Year effects.

- Our economic team expects core inflation to creep up in 2018 on the back of rising wage pressures. This, together with recent tightening of foreign manpower measures, should translate into higher services costs. Expected hikes in public transport fares and airport charges will likely push up transport and recreation costs. Our house projection for headline and core inflation remains at 0.9% and 1.7% respectively for 2018, which are at the upper end of the 0-1% and 1-2% forecast by Mas for headline and core inflation in 2018.

- **Monetary Policy Forecast:** MAS left its policy unchanged since it shifted to a zero appreciation path of the SGD NEER in Apr 2016. Even before the 2016 move, the MAS had taken measured steps to reduce the slope of its policy band since Jan 2015. Since 2016, there have been no changes to the width and center of the policy band as well. In the last policy meeting in Oct 2017, the MAS failed to deliver a policy shift as there was absence of (1) any sharp domestic growth momentum (MAS expects the economy "to expand at a steady, but slightly slower, pace in 2018 compared to 2017") and (2) inflationary pressures (where "core inflation is expected to trend towards but average slightly below 2%" in the medium term).

- In 2018 though, healthy economic growth (that should not only close the negative output gap but could result in a positive gap) and rising inflationary pressures should anchor the MAS shift to "a slight appreciation bias". Our Taylor Rule estimates for the SGD NEER continues to suggest such a policy move to be appropriate. Our estimates showed that the SGD NEER is expected to strengthen ahead and we expect the shift to a "slight appreciation bias" to come at the MAS' Apr 2018 meeting. Trade war risks though are unlikely to put the brakes on MAS' normalization shift.

- The USDSGD has been a gradual grind lower since the start of Mar underpinned by market speculation of a MAS move in Apr amid USD strength. So far in Mar, the USDSGD has been oscillating within 1.3054 and 1.3286. Pair is currently edging lower and is hovering around 1.3088. The softer USDSGD and falling 10Y UST yield is putting downside pressure on the 3-month SOR recently, helping the 3-month SOR to climb down from its near 27-month high of 1.5915% (on 21 Mar) to around the 1.478% levels currently. Meanwhile, 3-month SIBOR has been on the grind higher after coming from its near 10-year high of 1.51% recorded on 3 Jan. It is edging back towards the 1.5% levels and was last seen around 1.448%. The climb in domestic rates can be attributed to the market re-pricing the withdrawal of monetary stimulus in the advanced economies that have kept the global financial markets flushed with liquidity. This though has yet to translate into steep increases in mortgage rates, which continues to remain on the slow grind higher. At the same time, deposit rates (for 12-month fixed) have been on the slow grind higher and is now at 0.34% since end-Jan 2018. This continues to suggest that risks related to interest rate increases affecting financial and economic stability, particularly in interest rate- and property-related sectors, remains limited for now, though the risk is rising.

- US rates remains pressured higher with the US 3MLIBOR climbing to a new 2018 high not seen since 2008 at 2.302% on 27 Mar. Ample liquidity has so far kept domestic rates from tracking the US 3MLIBOR higher though, allowing domestic rates to continue with its rather slow grind higher. Still, recent moves in UST yields have led domestic rates to climb higher at a faster pace. We continue to expect the 3MSIBOR and 3MSOR to edge higher to 1.69% and 1.47% respectively by end 2Q 2018. For end-2018, we continue to expect the rates to accelerate to 1.87% and 1.65% respectively.

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

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

- **Key domestic events and issues to watch:** Advanced estimates for 1Q18 GDP will be released sometime on 6-13 Apr. MAS monetary policy decision will also be released around the same time.

- **Technical Outlook:** USDSGD was last seen at 1.3120 levels. Episodes of past move-ups since Oct-2017 have been capped by the downward sloping trend-line resistance on 5 occasions. Question remains if USDSGD will make a clean break above or continue to trend lower. Momentum indicators are not providing a clear bias. We caution that a break above the trend-line resistance could see a sharp squeeze higher towards 1.3280 (38.2% fibo retracement of Oct high 2018 low), 1.3360 (50% fibo). Support seen at 1.31 levels (upward sloping trend-line support). Break below this puts next support at 1.3010 (2018 low). Putting price action in perspective – pattern this year has shaped out to be a symmetrical triangle in the making. Though there are instances where symmetrical triangles can signal a trend reversal, they tend to be associated with a continuation of current trend – in this case a downtrend. At this stage, it is hard to determine the direction of its next major move until a valid break-out happens – top side at 1.3190; downside at 1.31.

MYR: Fundamentals Providing Firm Support

Forecast	2Q 2018	3Q 2018	4Q 2018	1Q 2019
USDMYR	3.8500 (--)	3.7000 (--)	3.6500 (--)	3.6000 (--)

No Change to Previous Forecast

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

- Current external environment of monetary policy continuity, oil price increase (our baseline scenario for oil has not been revised higher slightly to $65/barrel vs previous $60/barrel in 2018) and still subdued inflationary pressures in US as well as synchronous global economic recovery should continue to bode well for robust exports recovery and benefit countries that are trade-dependent including the MYR. An extension of crude oil production cut into end-2018 amid steady demand should lend further support for oil prices and Ringgit.

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

- The key risks to our outlook are (1) sharp rise in UST yields due to more aggressive than expected Fed policy normalisation could lead to foreign outflows and weigh on Ringgit and (2) risk-off plays/ rise in vols (uncertainty) arising out of synchronous recovery stalling, swings in crude oil and/or palm oil prices to the downside may weigh on Ringgit; (3) As a trade dependent country, risks of trade war could weigh on the MYR as well as other currencies in ASEAN.

- Total gross external reserve rose to USD 103.9b at mid-Mar 2018 (end-Feb 2018: USD103.7b), on sustained positive trade flows amid net foreign selling in equities and the unwinding of BNM's net short forward position. The latest tally is equivalent to 7.3 months of retained imports and 1.1 times of short-term external debt.

- Foreigners remained net sellers of Malaysian equities in the first three weeks of Mar 2018 (1-20 Mar 2018) at –MYR0.8b (Feb 2018: -MYR1.1b) with most of the month-to-date net selling occurred in the first two weeks of the month amid concern over US protectionist trade policy following the imposition of a 25% tariff on imported steel and 10% tariff on imported aluminum in early-Mar 2018, and ahead of the US FOMC meeting on 20-21 Mar 2018. Meanwhile, net foreign flows in the Malaysian bond market for Mar 2018 will only be available by the end of the first week of Apr 2018, but our Fixed Income (FI) Research team doesn't expect large movements in foreign flows with a slight negative bias given the MYR8.8b worth of Malaysian Government Securities (MGS) that matured on 1 Mar 2018 (Fig 10). Foreigners were net sellers of Malaysian bonds at –MYR3.9b in Feb 2018 (Jan 2018: +MYR4.5b).

- Trade flows remain supportive of external reserves via the repatriation of export earnings. Trade surplus increased to +MYR9.8b in Jan 2018 (Dec 2017: +MYR7.3b) amid robust gross export growth of +17.9% YoY in Jan 2018 (Dec 2017: +4.7% YoY). To recap, USD9.2b export earnings (net of imports and other commitments like external debt repayments) were repatriated between Dec 2016 and Dec 2017, larger than the +USD6b increase in external reserves during the same period, and equivalent to 37.2% of trade surplus in Dec 2016 – Dec 2017 (Fig 8-9). External reserve is expected to continue on its gradual uptrend this year riding on sustained trade surplus amid the volatility in portfolio capital flows. We expect full-year 2018 trade surplus to increase to +MYR103.8b (2017: +MYR97.2b), equivalent to +USD27.2b (2017: +USD22.6b) based on our current assumption of average USDMYR of 3.82 for this year.

- BNM's "net short positions in forwards and futures of foreign currencies vis-à-vis domestic currency (including the forward leg of currency swaps)" dropped for the ninth straight month in Jan 2018 to USD8.0b from USD10.1b in Dec 2017. The latest figure consists of USD3.2b in positions up to 1 month (end-Dec 2017: USD1.9b), USD3.6b in positions over 1 month to 3 months (end-Dec 2017: USD6.7b), USD1.2b in positions over 3 months to 12 months (end-Dec 2017: USD1.5b). The steady build up in external reserves to current level from the low of USD94.3b as at mid-Jan 2017 enabled BNM to progressively pare down its net short FX positions from the high of USD19.1 in Apr 2017.

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

- **Growth and Inflation Outlook:** Our Economics team maintain their 2018 real GDP growth forecast of 5.3% for now, pending the release of 1Q 2018 GDP scheduled on 17 May 2018. To recap, we expect the Malaysian economy to maintain 5%-plus growth in 2018, although the pace moderates to 5.3% from 5.9% in 2017, driven mainly by the sustained domestic demand growth (2018E: 6.4%; 2017: 6.5%). Meanwhile, with the revised official growth forecast being just marginally above the potential output growth of 5.0%- 5.5%, and the official inflation rate forecast trimmed to 2.0%-3.0% from 2.5%- 3.5% previously (2017: 3.7%), these appear supportive of our "one and done" view on BNM's overnight policy rate (OPR) i.e. staying at 3.25% for the rest of the year after the 25bps hike on 25 Jan 2018. The only revision made at this point is on crude oil price, which we now expect to average USD65/bbl vs USD60/bbl previously (2018YTD: USD67/bbl; 2017: USD54/bbl), which is supportive of our FX Research forecast of further strengthening in MYR against USD to 3.65 at end- 2018 (end-2017: 4.05) 3.82 full-year average (2017 average: 4.30).

- We expect 2018 to be a year of two halves as far as consumer spending growth is concerned. While we acknowledge the positive impact from the stable job market conditions underpinned by low unemployment rate and income growth, as well as from the 2 percentage points personal income tax cut, our expected moderation in consumer spending growth to 6.5% this year from 7.0% last year take into account of BNM's interest rate hike of 25bps on 25 Jan 2018, and the normalisation of workers' monthly contribution to EPF back to 11% of gross monthly salary this year after the option for lower contribution of 8% between Mar 2016 and Dec 2017. At the same time, the bulk of the Budget 2018 measures to boost disposable income and spur consumer spending (e.g. BR1M, civil service bonus, other targeted financial assistances) are being disbursed in 1H 2018, implying diminishing consumer spending stimulus from such measures in 2H 2018.

- We are more positive on investment growth compared with BNM forecast. We project growth of gross fixed capital formation to quicken to 6.6% (2017: 6.2%) compared with the official forecast of slower 5.2% growth (5.0% previously), supported by the progress in on-going and the rollout of new major infrastructure projects; investments in manufacturing and services sectors such as electronics, petrochemicals, automotive, and e-commerce; capital expenditure relating to automation and digitalisation by industries and businesses; as well as the corporate earnings (correlated to private investment) rebound in 2017 being sustained in 2018 after period of "no growth" in 2014-2016. Consequently, the high single-digit private investment growth momentum is expected to be sustained (2018E: 9.0%; 2017: 9.3%), while public investment is expected to rebound (2018E: 1.5%; 2017: 0.1%), taking cue from the 22% rise in Petronas capex for FY2018 and the 80% jump in Danainfra's issuance of infrastructure bond in 2018 to MYR18.4b from MYR10.2b in 2017.

- Meanwhile, the firmer crude oil price is expected to be supportive Government consumption growth (2018E: 5.8%; 2017: 5.4%) despite the continued fiscal consolidation process to bring down the budget deficit to GDP ratio to sub-3% in 2018 as the extra oil-related revenues provides the Government with the fiscal space to support its spending. To note, the Government tabled a supplementary supply bill of MYR7.122b for 2017 Federal Government budget at current Parliamentary sitting (5 Mar – 5 Apr 2018). We estimated that every USD10/bbl increase in annual average crude oil price will boost Government coffers by MYR7b-MYR8b via higher oil-related taxes and royalties as well as Petronas dividend, and last year crude oil price averaged USD54/bbl, up USD10/bbl from UD44/bbl in 2016.

- Net external demand remains a drag rather than drive of real GDP growth as we expect to shrink further by -2.2% in 2018 (2017: -1.1%) as both exports and imports of goods and services are expected to be affected by the high base effect after they jumped 9.6% and 11.0% respectively in 2017, having barely grew in 2015-2016, hence our expectations of moderate growth of 4.9% and 5.7% respectively in 2018. There is also the export competitiveness effect following our expectations of firmer MYR vs USD (end-2018: 3.65 and 2018 average: 3.82; end-2017: 4.05 and 2017 average: 4.30). The outlook for major export commodities are mixed in 2018 i.e. firmer average crude oil price (2018E: USD65/bbl; 2017: USD54/bbl; 2016: USD44/bbl) but softer average CPO price (2018E: MYR2,600/tonne; 2017: MYR2,791/tonne; 2016: MYR2,652/tonne).

- Headline inflation rate slowed further sharply to +1.4% YoY in Feb 2018 (Jan 2018: +2.7% YoY; YTD 2018: +2.0% YoY), contributed mainly by slower rise in "Food & Non-Alcoholic Beverages" prices (Feb 2018: +3.0% YoY; Jan 2018: +3.8% YoY) and the decline in "Transport" costs (Feb 2018: -0.3% YoY; Jan 2018: +5.7% YoY). Meanwhile, core inflation rate (excludes volatile food and energy prices as well as price-controlled/price-subsidised components of the CPI, including fuel prices) fell to +1.8% YoY in Feb 2018 (Jan 2018: +2.2% YoY).

- **Monetary Policy Forecast:** After raising the OPR by +25bps to 3.25% on 25 Jan 2018, BNM kept the policy rate unchanged during the second Monetary Policy Committee (MPC) meeting for the year on 7 Mar 2018. The decision is to ensure continued steady growth path amid prospect of lower inflation this year. BNM sees inflation rate in 2018 to average lower on expectations of a smaller effect from global cost factors (2018E official: +2.5 to +3.5%; 2017: +3.7%) as well as the Ringgit's appreciation trend but acknowledges the risk to inflation coming from the trend in global crude oil prices.

- We continue to hold the view the +25bps OPR increase in Jan 2018 is the only hike for this year given our forecasts of moderating real GDP growth (2018E: +5.3%; 2017: +5.9%), easing inflation (2018E: +2.8%; 2017: +3.7%) and BNM is well ahead of the curve in normalizing monetary policy post- GFC.

- Key takeaway from BNM's Annual Report 2017 is the upward revision in official 2018 real GDP growth forecast to 5.5%-6.0% from 5.0%-5.5% made in Oct 2017 (2017: 5.9%). No change in our 2018 real GDP growth forecast of 5.3%, pending 1Q 2018 real GDP release on 17 May 2018.

- Latest official real GDP growth forecast for 2018 is raised to 5.5%-6.0% based on BNM Annual Report 2017, up 0.5 percentage point from 5.0%-5.5% in the Ministry of Finance's Economic Report 2017/2018 released together with the tabling of Budget 2018 back in Oct 2017. In value, real GDP is projected to be at MYR1.240tr in 2018, up 5.7% from MYR1.174tr in 2017, compared with previous forecast of MYR1.229tr or 5.2% growth.

- BNM raised growth forecasts for private consumption (2018E: 7.2% vs 6.8% previously; 2017: 7.0%) and private investment (2018E: 9.1% vs 8.9% previously; 2017: 9.3%) as it lowered the growth forecast for public consumption (2018E: 0.6% vs 1.3% previously; 2017: 5.8%) and maintained the projection of decline in public investment (2018E: -3.2% vs -3.1% previously; 2017: 0.1%).

- Net external demand is expected to expand faster (2018E: 5.5% vs 1.0% previously; 2017: -1.1%) following the upward revisions in exports of goods and services (2018E: 8.8% vs 2.3% previously; 2017: 9.6%) and imports of goods and services (2018E: 9.1% vs 2.5% previously; 2017: 11.0%). Similarly, there are upgrades in forecasts for gross exports (2018E: 8.4% vs 3.4% previously; 2017: 18.9%) and gross imports (2018E: 8.6% vs 3.5% previously; 2017: 19.9%) as well as in trade surplus (2018E: MYR104.2b vs MYR97.0b previously; 2017: MYR97.2b) and current account surplus (2018E: MYR38.0b or 2.6% of GDP vs MYR32.9b or 2.3% of GDP previously; 2017: MYR40.3b or 3.0% of GDP).

- BNM highlighted several key external risks to its growth outlook i.e. rising trade protectionism negatively impacting world trade; adverse market reaction to monetary policy shifts in major economies; re-emergence of volatility due to large swings in financial and commodity markets. Domestically, BNM continues to highlight its concerns on oversupply of non-residential properties over the next few years.

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

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

- **Key domestic events and issues to watch:** Trade data (5 Apr); FX reserves (6 & 20 Apr); Industrial Production (11 Apr); CPI (18 Apr).

- **Technical Outlook:** USDMYR consolidated for most parts of Mar until the final week when the pair declined nearly 1.5% to 23-month low of 3.8563. Pair was last seen at 3.8690 levels. Price pattern suggests a break-out of symmetrical triangle. Though there are instances where symmetrical triangles can signal a trend reversal, **they tend to be associated with a continuation of current trend - in this case a downtrend.** Barring false breaks, price action suggests that that start of the next major downtrend may have started. Area of support at

3.84 – 3.85 remains a key level to watch. Decisive break below this area of support puts next key support at 3.81. Resistance at 3.91 (21, 50 DMAs).

IDR: Bears' Hold Likely To Be Short-Lived

Forecast	2Q 2018	3Q 2018	4Q 2018	1Q 2019
USDIDR	13500 (13000)	13300 (12900)	13200 (12800)	13300 (--)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** The IDR continues to be among the worst performing currency in ASEAN. The IDR briefly hit a new 2018 low not seen since Nov 2016 at 13817 on 1 Mar. The main driving force of IDR weakness in Mar was the sell-off in equities, underpinned by lackluster domestic consumption. In addition, the unwinding of carry trade plays that begin in Feb, has extended into Mar though the pace of unwinding has eased. So far in Mar, the IDR has fallen by 0.15% against the USD as compared to the 1.65% lost in Feb. Year-to-date though the IDR has dipped by 1.43% against the USD. In the face of headwinds, we are no longer as optimistic about IDR prospects in 1H 2018. Note that in the event of a global equity correction and global rate increase, the IDR is among the most vulnerable currency given portfolio re-allocation globally and real yield weakness.

- Our lack of enthusiasm for the IDR stem from the weak foreign portfolio inflows into Indonesia assets so far this year. The sell-off was likely triggered by a couple of factors, namely lackluster private consumption; narrowing real yield differentials; reduced likelihood of a S&P sovereign credit rating in the next 12-24 months; and the unwinding of carry trades. Lackluster private consumption spending so far has dimmed the earning prospects of domestically-dependent corporates. This is even though the economy is expected to expand by a healthy 5.1-5.5% in 2018 but driven more by the synchronous global recovery and government spending on infrastructure than private consumption. Recall that private consumption makes up more than 50% of GDP. Thus, the inability to lift private consumption spending is likely to cool foreign appetite for equities.

- As for debt, the unwinding of IDR carry trade plays, triggered by concerns of aggressive Fed rate hikes in 2018 as well as by the JPY losing its allure as the funding currency of choice amid rising volatility, had led to a sell-off in Indonesian debt. In addition, the narrowing real yield differentials between 10Y UST yields and the corresponding 10Y Indonesian government bond are making Indonesian debt less attractive, exacerbating the sell-off in Indonesian debt. Also, the low probability of another credit rating upgrade by S&P in the next 12-24 months should dampen sentiments and delay a repricing of Indonesia assets and moderate inflows. Consequently, the sell-off in Indonesian equities and debt has led to a reduction in short USD positions against the IDR, keeping the USDIDR elevated.

- So far in Mar, foreign investors have sold off USD1.09bn and USD122.9mn in equities and debt. This brought the sell-off in equities by foreign investors to USD1.71bn year-to-date. In contrast, USD0.78bn in debt was purchased by foreign funds in the first three months of the year. Nevertheless, the dumping of equities and debt in Mar has led to a on the IDR, weighing on the IDR and keeping the USDIDR elevated above the 13700 levels.

- Despite the weakness in the IDR in the first three months of the year, there are still several key factors going in its favour in 2018. Key among them is its healthy economic fundamentals. The economy continues to find strength from the cyclical global recovery that has lifted demand for commodities such as oil, CPO and coal, though this is likely to continue at a more gradual pace ahead. The improvement in the terms of trade should lift exports, mitigating any drag from domestic consumption. This in turn should benefit the IDR.

- Also supportive is the government's USD400bn infrastructure programme that should not only bolster near term growth but potential growth as well. The push to accelerate infrastructure spending ahead of legislative and Presidential elections on 17 Apr 2019 should keep the growth momentum going. Spending in preparation for the Asian games slated to take place 18 Aug-2 Sep should also be supportive of growth ahead. In addition, the 15 reform/stimulus packages introduced so far that should help to cut red tape and liberalize rules that have been a drag on the economy.

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

- In light of the larger-than-expected outflows from Indonesian assets, we now expect the USDIDR to end 2Q at 13500 vs. 13000 previously. We remain positive on the IDR in 2H 2018 on the back of its strong economic fundamentals and the possibility that IDR carry trade could return to favour as volatility stabilizes and the economy continues to outperform the rest of the world. This should allow the USDIDR to ease to 13300 by end-3Q and then to 13200 to end 2018. In the run-up to the elections on 17 Apr 2019, we expect some political tensions to lift the USDIDR slightly higher to 13300 by end-1Q 2019.

- **Growth and Inflation Outlook:** The outlook for the economy remains mixed. Motorcycle sales – a proxy for consumer spending – declined by 3.1% y/y in Feb after rising by 1.8% in Jan. Car sales also slipped by 0.9% y/y in Feb from Jan's +11.3%. This continues to suggest that private consumption remains lackluster. The saving grace remains external demand, which remains relatively healthy supported by the synchronous global recovery. Exports rose 11.76% y/y in Feb (Jan: +8.59%). This suggests that the growth momentum should remain sustained on the back of the ongoing cyclical export recovery and the President's USD400bn infrastructure programme. The push to accelerate infrastructure spending ahead of legislative and Presidential elections in Apr 2019 should keep the growth momentum going. Spending in preparation for the Asian games slated to take place 18 Aug-2 Sep should also be supportive of growth ahead. Still, lackluster private spending is likely to be a drag on growth and cap GDP growth with Bi projecting GDP growth of 5.1-5.5% in 2018. Our economic team is as optimistic as BI, penciling in GDP growth at 5.30% for 2018.

- Headline inflation decelerated for the second straight month, rising by 3.18% y/y in Feb vs. Jan's 3.25%. This was despite food prices climbing higher by 3.4% y/y in Feb (Jan: +2.95%). Higher food prices continued to be mitigated by the moderation in housing and transport cost, which rose by 3.7% and 1.41% in Feb vs. Jan's 4.24% and 1.55% respectively. Core inflation also moderated and for the third consecutive month to 2.58% y/y in Feb from 2.69% in Jan. Ongoing efforts by the government to improve food supply and control prices of key commodities via stricter monitoring should help keep food inflation down. Political considerations aside (given presidential and legislative elections in Apr 2019), we doubt that these measures will be sufficient to hold down food prices. Consequently, our economic team expects headline and core inflation to average 3.52% and 2.82% in 2018 respectively. By comparison, BI is projecting inflation to average 2.5-4.5% for 2018, lower than 2017's 3.0-5.0% target range.

- **Monetary Policy Forecast:** The BI has so far left the benchmark 7-day reverse repo rate unchanged at its policy meetings so far this year. The benchmark policy rate is currently at 4.25% with the deposit and lending facility rates at 3.50% and 5.00% respectively. The interest rate corridor was maintained at 75bp on either side of the policy rate. We doubt that the BI will move on policy at this juncture especially with a new BI governor taking over in May. Our house view remains that any BI rate normalization to stem inflationary pressures, and maintain macroeconomic and IDR stability should take place sometime in 2Q 2018.

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

- **Latest Fiscal and External Balance Outlook:** Latest data from the Ministry of Finance data showed that the budget deficit widened in Feb after having narrowed in Jan. The budget deficit came in at IDR48.9tn (or 0.33% of GDP) in Feb compared to IDR37.1tn (0.25% of GPD) in Jan 2018. Despite the wider deficit in Feb, the government intends to maintain the state budget deficit at IDR325.9tn or 2.19% of

GDP in 2018 compared to 2017's deficit of IDR336.4tn (or 2.48% of GDP).

- The current account recorded a deficit of USD5.8bn in 4Q 2017 or 2.23% of GDP vs. 3Q's deficit of USD4.56bn (1.73% of GDP) due to higher deficit in the services account and also a moderation in the surplus in the goods account. The overall balance of payments narrowed to USD0.97bn in 4Q vs. 3Q's USD5.56bn, weighed by the smaller surplus in the financial account. For the whole of 2017, the current account deficit widened to USD17.29bn from 2016's – USD16.95bn. Consequently, the surplus in the overall balance of payments moderated slightly to USD11.59bn in 2017 compared to the surplus of USD12.09bn in 2016. For 2018, the BI expects the current account deficit to widen to 2.0-2.5% of GDP. Our economic team expects the current account deficit to widen to about 2.2% of GDP in 2018.
- **Key domestic events and issues to watch**: Key focus in the month is BI's monetary policy meeting on 19 Apr with Mar CPI print also closely watched for signs of emerging inflationary pressures.
- **Technical Outlook:** Pair was last seen at 13760 levels. Bullish momentum on weekly chart remains intact but shows tentative signs of waning while stochastics is running into overbought conditions. Upside pressure may ease. Support at 13627, 13560 levels. Resistance at 13860 should cap upside.

PHP: Watching BSP Next Move

Forecast	2Q 2018	3Q 2018	4Q 2018	1Q 2019
USDPHP	52.00 (50.50)	52.00 (50.50)	51.50 (50.00)	51.00 (--)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** The PHP remains a laggard in ASEAN in the early part of 2018. It is still on a broad downtrend that began at the start of the year. Initial enthusiasm for the PHP on speculation that BSP could hike rate at its Mar meeting was doused by jawboning by both BSP and government officials.
- As we had cautioned in our Feb Monthly, BSP failure to move on its benchmark policy rate allowed PHP bears to reassert and reinitiate short-PHP positions against the USD, putting downside pressure on the PHP. There has also renewed a sell-off in Philippine assets and weakness in the PHP that could last until the BSP signals a more hawkish stance. Market concerns that the BSP is behind-the-curve in curbing inflationary pressures have intensified. Recent CPI data showed headline inflation (using both the 2006 and 2012 base years)

accelerating. Based on the 2006 series, headline inflation rose by 4.5% y/y in Feb from 4.0% in Jan, while that for the 2012 series, showed a 3.9% y/y increase vs. Jan's 3.4%. Using the 2006 series, inflation is already above the 2-4% inflation target set by BSP. Even using the newer series, inflation is on an upward trend. Not surprisingly, the lack of action by the BSP has spurred investors to re-adjust their PHP positions, keeping the USDPHP on an uptrend.

- Another ongoing concern that has kept the PHP elevated above the 52-handle is its deteriorating current account deficit as the USDPHP tend to track the current account positions. While the trade deficit has eased from its record of USD4.0bn in Dec, and overseas remittances rebounded, the broad trend of the current account deficit remains to the downside. The government's ambitious infrastructure building programme should keep the current account in deficit for at least in 2018. In addition, risks are to the downside for overseas remittances growth due to the repatriation of Filipino workers from Kuwait and government policy on tightening immigration and foreign workers. This has increased expectations that remittances are unlikely to improve the current account deficit significantly.

- More importantly, the positive effects from remittances should fade in 1Q 2018 as seasonality factors appear to weigh on remittances in the first quarter. The current account deficit is likely to deteriorate further on rising oil prices (in value terms) given that Philippines is an oil-importing economy. The deficit in the current account is unlikely to narrow anytime soon on account of the increased public spending and investments by the government in its pursuit of higher growth. These concerns weigh on the PHP and should keep the USDPHP elevated above the 52-levels in 2018.

- Deteriorating risk appetite due perception that BSP could be behind the curve in battling inflation and external balances concerns is fueling asset reallocation away from Philippines equities. Month-to-date in Mar, foreign investors have sold USD370.8mn in equities compared to USD295.6mn in Feb. Cumulatively, foreign investors have sold USD621.2mn in equities so far this year compared to the USD1.10bn purchased for the whole of 2017. Expectations of further risk aversion could fuel further sell-off in Philippines equities which should weigh on the PHP in the nearer term. Consequently, this has kept the USDPHP elevated above the 52-levels.

- Nevertheless, we see low risk of a PHP move above the 53-handle and that the current bout of weaknesses could prove to be temporary. There are several factors for our optimism, including tax reforms. The tax reforms, effective 1 Jan 2018, could be the catalyst that kicks off the next phase of investment-led growth. Already, the tax reform has led to a budget surplus in Jan – the first since Aug 2017. With partial funding secured and the commitment of the government to infrastructure building intact, this should inspire investor confidence and spur both portfolio and FDI inflows that should be supportive of the PHP.

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

- We continue to expect the BSP to adjust its benchmark policy rate in 2018. Headline inflation by either the 2006 measure or 2012 one shows an uptrend. We believe that it is a matter of when and not if the BSP will move to hike rates. BSP is currently watching for any signs of second-round effects and inflation becoming broader-based. Pending petitions for adjustments in minimum wages and transportation fares as well as the effects of a weaker PHP could be the trigger points for the BSP to take action. Our house view remains for the BSP to hike its benchmark interest rate twice by 25bp each time, once at end-2Q 2018 and the other at end-4Q 2018. These moves should be positive for the PHP.

- Given the market developments to date including investor perception that the central bank is behind the curve and the still deteriorating current account deficit as well as rate hikes, we now expect the USDPHP to end-2Q and -3Q at 52.00 before ending 2018 around the 51.50-levels.

- **Growth and Inflation Outlook:** After a more moderate growth of 6.6% in 4Q 2017, slower growth in 2018 is to be expected as the synchronised export recovery moderates. Already export growth has slowed, rising by just 0.5% y/y in Jan from 2.3% in Dec 2017. With export growth momentum decelerating, the government's growth target of 7-8% looks unlikely to be met in 2018. The catalyst that is likely to drive the economy higher should come from investment spending, particularly from the government's planned PHP8tn infrastructure building programme that should mitigate the slowdown in contribution from exports. As we have previously written, favorable demographics and job market conditions should provide the impetus to growth in 2018. More likely than not, growth is likely to outperform last year's with our economic team penciling in growth of 7.0% for 2018.

- Recent CPI data showed headline inflation accelerating. Based on the 2006 base-year series, headline inflation rose by 4.5% y/y in Feb from 4.0% in Jan. This was due to the inflationary impact of the tax reform measures which took effect on 1 Jan as well as the relatively persistent higher global oil prices. On the other hand, using the 2012 base-year series showed a 3.9% y/y increase vs. Jan's 3.4%. BSP governor expects the effects from the tax reform to be temporary but would continue to monitor and take appropriate action when necessary. Our economic team sees upside risk from rising commodity prices, namely crude oil and further inflationary pressures to come from the tax measures. Our economic team maintains their 2018 and 2019 inflation rate forecast at 4.3% in 2018 and 3.4% in 2019 for now The BSP expects inflation to average 4.3% and 3.5% in 2018 and 2019 respectively (under the 2006 base-year).

- **Monetary Policy Forecast:** Despite growing calls for a rate hike to anchor inflationary expectations, the BSP decided to leave its policy rates unchanged at 3.0%. The interest rate corridor was left intact with the overnight lending rate and overnight deposit rate holding steady at 3.5% and 2.5% respectively. This leaves the interest rate corridor symmetrical on either side of the policy rate by 50bp. Our reading of the BSP monetary policy statement suggests that the BSP remains vigilant to the need for action to anchor inflationary pressures as the central bank believed that "… economic growth remain solid enough to absorb some policy tightening if warranted …".

- As we discussed earlier, headline inflation by the 2006 measure or 2012 one shows an uptrend. We believe that it is a matter of when and not if the BSP will move to hike rates. BSP is currently watching for any signs of second-round effects and inflation becoming broader-based. Pending petitions for adjustments in minimum wages and transportation fares as well as the effects of a weaker PHP cold be the trigger points for the BSP to take action. Our house view remains for the BSP to hike its benchmark interest rate twice by 25bp each time, once at end-2Q 2018 and the other at end-4Q 2018. These moves should be supportive of the PHP.

- **Latest Fiscal and External Balance Outlook:** The budget surplus came in at PHP10.2bn in Jan, recording the first budget surplus since Aug 2017. The unexpected surplus could be attributed to the higher collection of revenue due to the implementation of tax reforms on 1 Jan. The bump up in expenditure due to ramp up in infrastructure spending was easily overcame. However, as the government accelerates its infrastructure building programme, risk is that the budget position could return to a deficit in the months ahead. That said, the government aims to cap the budget deficit at 3% of GDP up to 2022.

- Latest available data showed the current account (CA) deficit narrowing to USD1.32bn in Dec 2017 from USD1.46bn in Nov due primarily to the larger merchandise imports compared to exports. The financial account deficit narrowed to USD0.89bn in Dec from USD1.50bn in Nov, helped by the improvement in the other investment and net unclassified items accounts. This brought the overall balance of payments (BoP) to a surplus of USD0.92bn from a deficit of USD0.04bn in Nov. For the full-year, the CA deficit ballooned to USD2.5bn in 2017, more than doubled the 2016 print of -USD1.20bn. The widening deficit was due to merchandise imports outstripping exports and also outweighing the improved surpluses in the primary and secondary income accounts. Note that the 2017 CA deficit exceeds the USD100mn projected by the BSP and raised doubts on whether the projection of USD700mn for 2018 will be met. The financial account deficit widened sharply to USD2.21bn underpinned by larger outflows in direct investment (of -USD8.11bn) that outweighed the improved portfolio investment inflows (of USD3.89bn) and other investment (of +USD2.06bn). This resulted in an overall BoP deficit of USD0.86bn in 2017, doubled the deficit of USD0.42bn in 2016. For 2018, the BSP expects the BoP deficit to hit USD1bn (due to the expected reversal in the financial account to a small deficit).

- **Key domestic events and issues to watch:** CPI print on 5 Apr will be closely watched for further inflationary pressures. Overseas remittances for Feb will be eyed for clues on the strength of consumer spending.

- **Technical Outlook:** USDPHP appears to be testing the upper-bound of the bullish trend channel formed since 2013. Pair was last seen at 52.27 levels. Momentum on weekly chart remains bullish but stochastics is running in overbought conditions. Gains in the pair may moderate. Immediate resistance at 52.80 (upper bound). Support at 51.80 (50 DMA).

THB: Near-Term Strength But Politics Could Weigh

Forecast	2Q 2018	3Q 2018	4Q 2018	1Q 2019
USDTHB	31.00 (--)	31.50 (--)	32.00 (--)	32.50 (--)

No Change to Previous Forecast

- **Motivation for the FX View:** The THB was among the best performing currency in ASEAN in Mar despite concerns about trade wars and geopolitical risks on the Korean peninsula. The THB gained just 0.42% against the USD so far in Mar, a complete reversal from the 0.18% decline in Feb. Market continues to position for THB strength because of its strong economic fundamentals, particularly its persistent current account surpluses (around 10% of GDP), as well as the synchronous global and regional recovery. In addition, its high real yields vis-à-vis the US and its regional peers make its debt relatively more attractive to foreign investors. The strong inflows to date have been supportive of the THB and continue to backstop the currency.

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

- Expectations of accelerating economic growth in 2018, persistent current account surpluses and high real yields vis-à-vis the US are flows into Thai assets. This is in contrast to Feb where concerns of aggressive Fed rate hikes in 2018 had triggered outflows. In Mar so far, foreign investors have purchased USD1.28bn in debt, but sold USD0.27bn in equities. This net inflow is supportive of the THB. The overall sentiments so far has been positive as reflected in the foreign purchases of debt of USD3.74bn year-to-date that more than offset their sell-off of USD1.76bn in equities. While the broad trend appears to be inflows into Thai assets in the months ahead, some re-allocation of assets from Thailand cannot be ruled out, especially should political uncertainty re-emerges in the run-up to the general elections expected sometime between Nov 2018 and Feb 2019. Consequently, we could see some weakness in the THB in 2H 2018.

- Strong economic fundamentals aside, political headwinds could put downside pressure on the THB in 2H 2018. The current calm in the political arena belie the simmering political tensions beneath the surface that could burst out into the open once the ban on political activities is lifted. This lifting of the ban is likely to come once the election time-line is announced in Jun and we could see political tensions build-up in the lead-up to the election. Tensions in the political arena could boil over on concerns that the political environment would remain dominated by the military and the elites for the foreseeable future.

- The actual date for the election will be announced in June when the organic laws governing the election process is passed and endorsed by HM King Vajiralongkorn. PM Prayuth himself recently indicated that the general elections will be held no later than Feb 2019 with the vote date to be set in consultations, including with political parties. Still, concerns that the elections could be skewed to keep PM Prayuth and the military in power could trigger political uncertainty. In addition, should there be further delays to the general elections, political temperature is likely to rise even more and create further uncertainty in 2H 2018. This could keep investors on the sidelines until political uncertainty dissipates. Such political concerns are likely to put downside pressure on the THB in 2H 2018.

- Thus, while we are positive on the THB for its economic fundamentals, we remain cautious on its outlook beyond 1H 2018 on political consideration. A repeat of the political upheaval seen during the closing days of former Yingluck Shinawatra's premiership could see a reversal of flows from Thai assets and weigh on the THB in 2H 2018. We maintain our 2018 USDTHB forecast for now.

- **Growth and Inflation Outlook:** The economic environment remains positive for the Thai economy. Government spending ahead of the general elections together with planned infrastructure building projects including transport networks and the Eastern Economic Corridor should be a boon for economic growth. In addition, ongoing synchronised cyclical recovery should keep exports supported in 2018 with exports on the expansion path for the 12th straight month Exports rose by 10.3% y/y in Feb, beating market estimates of 9.3% and compared to 17.6% in Jan. More importantly, we look for the export-led recovery to spark a revival in private investment that should sustain growth in 2018. This is because of the high correlation between export recoveries and machinery & equipment investments for Thailand. Already, we are seeing a pick-up in private investment, which rose by 1.24% in Jan compared to 0.26% in Dec. Consequently, our economic team expects full-year growth to come in at 4.0% in 2018, just a tad off the government projection of 4.2%. Even the BoT has turned more bullish on the economy, revising its 2018 GDP growth forecast higher to 4.1% from 3.9% previously. Nevertheless, we caution though that the strong THB since late 2017 and protectionist measures could disrupt trade and weigh on the economy.

- Headline inflation continues to moderate for the third straight month, rising by 0.42% y/y in Jan from 0.99% and 0.78% in Nov and Dec respectively. Once again, lower food prices and transport cost weighed on consumer prices in Jan. Food prices fell by 0.16% y/y in Feb vs. Jan's +0.09% gain, while transport cost moderated to 0.06% y/y in Feb from 0.92% in Jan. Core inflation edged up by 0.68% y/y in Feb compared to 0.58% in Jan – the highest since Jan 2017. The BoT continues to target headline inflation within the 1-4% range for 2018. The BoT has revised lower its headline inflation forecast to 1.0% from 1.1%. Our economic team expects inflationary pressures to edge higher in 2018, fueled by higher energy/fuel prices, minimum wage increase and improving domestic demand. This should allow inflation to average 1.6% in 2018.

- **Monetary Policy Forecast:** The BoT has maintained the status quo on monetary policy since Apr 2015. At its most recent meeting on 28 Mar, the BoT held its benchmark policy rate - the one-day repo rate - steady at 1.5%. The last time the policy rate was even lower was during the Great Financial Crisis in 2009 at 1.25%. The current environment of economic recovery amid a modest inflationary environment has enabled the BoT to keep its policy rate at current levels. Note though that this decision was not unanimous. For the first time in three years, there was a dissension with a policy maker calling for an increase. This could set the stage for a shift in policy with deputy governor Paiboon Kittisrikangwan already highlighting that the central bank should start thinking about a time-frame for policy normalization this year. Our economic team expects the BoT to normalise this year amid a pick-up in inflationary pressures. Any moves by the BoT to normalise policy should take place in 2H 2018.

- **Latest Fiscal and External Balance Outlook:** The National Legislative Assembly has given its approval to the government's THB150bn supplementary budget for FY2018 that ends in Oct. The supplementary budget aims to strengthen the economy, focusing on restructuring farm production and creating employment opportunities in the provinces. This would allow the government to help low income Thais ahead of the general elections expected sometime in Nov 2017 to Feb 2018.

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

- **Key domestic events and issues to watch:** All eyes will be on Mar CPI on 2 Apr as well as on current account balance for Mar on 30 Apr.

- **Technical Outlook:** USDTHB was last seen at 31.25 levels. Price pattern shows a potential falling wedge in the making. This is typically associated with a bullish reversal. We do not rule out the risk of rebound in the short term, especially with stochastics is oversold conditions. Retracement could take the pair higher towards 31.50 or 32 levels. Bias remains to fade as underlying momentum remains bearish as indicated by monthly technical.

INR: Bears Beware

Forecast	2Q 2018	3Q 2018	4Q 2018	1Q 2019
USDINR	64.00 (63.50)	64.00 (63.00)	63.50 (62.50)	63.00 (--)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** The rupee 1M NDF hovered within the 64.80-65.80 range for much of Mar, buoyed by concerns on trade war. Spot on the other hand, seems to be sticky around 65.00. Bonds have seen a return in demand for most of Mar and more recently, domestic bonds rallied after the Economic Affairs Secretary announced an issuance of INR2.88 trn of bonds in the six months to Sep, 48% of its annual borrowing plan. This is much lower than the 60%-65% seen in the same period of previous fiscal years. 10y yield dropped from 7.623% to 7.364%, a 25.9bps drop on 26 Mar, last seen around 7.333% (as of 28 Mar). That is an accumulative 29bps fall since then. No wonder the 10y is well on its way to reverse out its gain in Feb during which investors have been concerned about fiscal slippage and inflation pressure.

- Current account is still a concern as oil prices remain lofty around USD70/bbl. That could support the USDINR but there are also a few factors that could sink the pair back towards the 64-figure. First, there are talks of the Indian government vying for an upgrade in sovereign credit rating from its current BBB-. Rupee could benefit from an upgrade in the Fitch rating agency. Economic Affairs Secretary Subhash Chandra Garg had said earlier this month that the rating agency was “extremely positive” of the “economy, reforms and path forward”. Second, there are whispers of PM Modi calling for General Elections this year instead of May 2019. There are even talks of him trying to combine the state elections with the General election to cut costs and capitalize on the momentum it has garnered from its landslide victory at Uttar Pradesh although that could be operationally challenging. We would not rule out an attempt at this given his bold initiatives so far such as demonetization and implementation of GST. Given the momentum of BJP in key state elections so far, an early call for election could be positive for INR as a likely win by BJP could mean policy continuation and fiscal consolidation. We look for the USDINR to head towards 64.00 by the end of the Q2, revised higher because of recent developments but still on the downward trajectory in 2018.

- **Growth and Inflation Outlook:** Growth outlook is rather mixed with Nikkei PMI numbers in contraction. Business activity index came in at 47.8 vs, 51.7 with the Markit report noting a mild deterioration in Feb On the other hand, industrial production in Jan accelerated to 7.5%y/y from 7.1%. Manufacturing saw output rising to 6.7%y/y growth from 6.6% in the month prior. That has outweighed the deceleration in mining that saw no growth in the month. Feb CPI slipped to 4.44%y/y from 5.07%.
- Inflation has been a key thing to watch in 2018 and bond was sold off for quite a while due to rate hike expectations and concerns on rising inflation. The Feb print softened to 4.44%y/y from previous 5.01% with the deceleration seen in most subcomponents including food, housing, fuel and light. WPI also softened to 2.48%y/y from previous 2.84%. Food costs, fuel and power came off while manufactured goods saw modest increase such as basic metals. Overall price pressure seems pretty subdued but consumer prices may not be suppressed for long should crude remain at around USD70/bbl for the rest of the year.
- **Monetary Policy Forecast:** Minutes of the Feb meeting revealed that the MPC is still concerned over inflation. In fact, CPI inflation for 2018-19 is estimated in the range of 5.1-5.6% in H1 before easing to 4.5-4.6% in H2 with risks tilted to the upside. Inflation risks stem from fiscal slippage should cost of borrowing continue to rise, staggered impact of HRA increases by various state governments could trigger second-round effects, sustained global growth to elevate crude prices and proposal for a minimum support price for kharif crops. Ever since policy rate decision has been taken over by Urjit Patel and the rest of the MPC members, the statements that accompany the decisions have mostly been rather hawkish. Inflation is a key concern and understandably so given that the central bank's role is to keep inflation within the +/-4% range. A recent study by RBI shows that 15% of exchange rate changes are cumulatively passed through to CPI inflation over a period of five months. On average, a 1% change in the exchange rate translates to 15bps change in headline inflation. That could mean that a combination of weaker INR and rising price pressure may force RBI to hike.
- The GVA growth should pick up from 6.6% in FY2017/2018 to 7.2% in 2018/19. We hold on to our view for a rate hike in the second half of the year, possibly in Oct if the schedule of monetary policy meeting is similar to 2017-2018. The schedule for the next year should be released sometime in Mar. Next RBI meeting is on 5th Apr.
- The strong growth forecast take into considerations the stabilization of GST implementation that could spur economic activity and the revival of investment activity as well as the process of recapitalization of public sector banks that have already started.
- **Latest Fiscal and External Balance Outlook:** Fiscal deterioration was a major reason for the bear steepening of the India sovereign yield curve in the past few months. The curve has bull flattened since the start of Mar and even more so after the Economic Secretary announced a much lower issuance of bonds than expected. Finance Minister announced that the fiscal deficit for FY17 is poised to come in at 3.5%, well above the 3.2% projected as tax collections following

the implementation of GST was lower than expected. For the coming year, the government estimates fiscal deficit to improve to 3.3%.

- Brent prices have eased to around $70/bbl levels at last sight (28 Mar). While global demand is likely to sustain and IEA has indicated that supply glut has almost cleared, likely non-OPEC production like shale could continue to react to higher demand and rein in excessive spikes in crude prices. However, the appointment of the new US National Security Adviser John Bolton – a proponent of the Iraq war, has triggered speculation of war in the Middle East and kept the brent rather elevated. That could still threaten India's current account balance. In addition, India is affected by the US' new tariff on steel and aluminum. Exports of steel and aluminum products to the US was recorded at around U$330mn and U$350mn in 2017. The government has filed a WTO dispute over the tariff and repeatedly US for steel and Aluminium tariff exemption.
- **Key domestic events and issues to watch:** PMI-mfg (Mar); RBI rate decision on 5th; Mar CPI, Feb IP on 12th; trade on 12-15th; WPI on 16th.
- **Technical outlook:** The 1M USDINR NDF remained above the 65-figure, likely to end the month on a bullish note. Momentum indicators are signaling overbought conditions. We are tactically bearish on this pair, looking for a break of the 65-figure for a move towards 64.45.

VND: Weak Bias

Forecast	2Q 2018	3Q 2018	4Q 2018	1Q 2019
USDVND	22800 (22600)	22780 (22550)	22750 (22500)	22780 (--)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** USDVND sprung higher throughout Mar, last seen around 22800 amid talks of trade war. The Vietnam Nominal Effective Exchange Rate has declined significantly and we continue to see benefits for State Bank of Vietnam (SBV) to keep the exchange rate on the backfoot until trade protectionism fears entirely clears up. Even as CPI eased from its Feb highs (that was likely distorted by Tet), upside risks in cost pressures could keep SBV from cutting policy rates further for fear of un-anchoring inflation expectations. Vietnam is thus likely to keep VND slightly weaker to boost exports growth and increase the allure of its domestic assets to foreign investors. Guiding the dong weaker ensures an element of stability and control in the exchange rate that could be reassuring for investors.
- VND is likely to remain weaker against its regional peers. However, we are still looking for USD to remain on its broad downtrend and that could see USDVND slightly bias to the downside into the end of the year. It is worth noting that visitor arrivals from China jumped 42.9%y/y for the first quarter of the year. That could really underpin the exports.

- In a backdrop of broad USD downtrend, we see mild downside risks to the USDVND towards 22750 by the end of this year. However, volatility has increased and we expect USDVND to see periods of upside moves in between. While we expect VND to appreciate against the USD, the appreciation is likely to lag that of key trading peers like CNY, JPY, THB and SGD. With inflation creeping higher, SBV might choose to keep VND competitive to boost exports and FDIs. We look for VND to head lower towards 3689 against CNY, 214 against the JPY, 18145 against the SGD by year end.

- **Growth and Inflation Outlook:** PMI-mfg inched higher to 53.5 for Feb from previous 53.4. According to the survey report, Markit noted acceleration in production growth amid rising demand. Purchasing activity surged amongst manufacturers. Cost of production is elevated and selling price was also raised at a slower pace in the month. Industrial production rose 8.7%y/y in Mar from 8.0% in the month prior. However, retail sales slipped from 10.1%y/y for Jan-Feb to 9.9% for the quarter. This is inspite of the strong visitor arrivals from China. Mar exports remained at high double digit levels at 22.0%y/y, albeit from 22.9%. Imports moderated from 15.3%y/y to 13.6%. Trade surplus came in at U$800mn with the previous number revised much lower to U$294mn. 1Q GDP surged to 7.38%y/y from previous 6.81%, well above the expected 5.60%, buoyed by low base effect. Looking at sectoral breakdowns, the industry sector seemed to have outperformed. The industry/construction sector saw acceleration in growth from 8.0% in the last quarter to 9.7%. Keeping VND undervalued could continue to underpin demand and output.

- CPI eased from 3.15%y/y in Feb to 2.66% in Mar, weighed by the deeleration in health and personal care prices as well as the slowdown in cost pressure in transportation. Healthcare is still a major driver of price pressures for Vietnam and we caution that food inflation could rise on the back of strong economic activity and currency weakness (against non-US trading partners). We see the food subcomponent rising from months of deflation into positive growth again for the past two months and rising.

- **Monetary Policy Forecast:** In terms of exchange rate, we see upside risks to the VND against the USD, in line with our expectations for broad USD weakness this year. However, as we have stated in this note, the NEER has come off significantly. SBV might keep this VND weak against trading partners to boost trade as well as to attract foreign direct investment into the country. The pace of FDI inflows in the past few months have slowed year-on-year. But inflows remain supported by IPOs and state divestment. On the downside, weak VND could fan inflationary pressures should price pressure pick up globally.

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

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

- Current account recorded a sizeable surplus of USD4.3bn (latest data available) in 3Q last year, improving from the previous USD0.27bn. This data comes from strong trading of goods in surplus of USD5.2bn. The widening current account surplus could continue to support the dong. Expect Vietnam to maintain a surplus in the current account given the trade surplus we saw in the past few months.

- **Key Domestic Events and Issues to Watch:** PMI Mfg is due on the 2nd; Domestic vehicle sales in 6th-13th; CPI, trade numbers, retail sales, IP are due 25th-30th.

FX Forecasts

	End Q2-18	End Q3-18	End Q4-18	End Q1-19
USD/JPY	107	106	105	105
EUR/USD	1.2500	1.2800	1.3000	1.3000
GBP/USD	1.4400	1.4800	1.4800	1.4400
AUD/USD	0.8000	0.8100	0.8300	0.8300
NZD/USD	0.7400	0.7500	0.7600	0.7600
USD/SGD	1.2700	1.2500	1.2400	1.2200
USD/MYR	3.8500	3.7000	3.6500	3.6000
USD/IDR	13500	13300	13200	13300
USD/THB	31.00	31.50	32.00	32.50
USD/PHP	52.00	52.00	51.50	51.00
USD/CNY	6.20	6.20	6.10	5.90
USD/HKD	7.80	7.80	7.80	7.80
USD/TWD	29.00	29.00	29.00	29.20
USD/KRW	1050	1040	1060	1050
USD/INR	64.00	64.00	63.50	63.00
USD/VND	22800	22780	22750	22780
DXY Index	88.91	87.18	86.18	86.61
SGD Crosses	**End Q2-18**	**End Q3-18**	**End Q4-18**	**End Q1-19**
SGD/MYR	3.0315	2.9600	2.9435	2.9508
SGD/IDR	10236	10320	10323	10574
SGD/THB	24.41	25.20	25.81	26.64
SGD/PHP	39.76	40.40	40.32	40.98
SGD/CNY	4.88	4.96	4.92	4.84
SGD/HKD	6.14	6.24	6.29	6.39
SGD/TWD	22.83	23.20	23.39	23.93
SGD/KRW	827	832	855	861
SGD/INR	50.39	51.20	51.21	51.64
MYR Crosses	**End Q2-18**	**End Q3-18**	**End Q4-18**	**End Q1-19**
EUR/MYR	4.81	4.74	4.75	4.68
JPY/MYR	3.60	3.49	3.48	3.43
MYR/HKD	2.03	2.11	2.14	2.17
MYR/CNY	1.61	1.68	1.67	1.64
GBP/MYR	5.54	5.48	5.40	5.18
AUD/MYR	3.08	3.00	3.03	2.99
NZD/MYR	2.85	2.78	2.77	2.74
MYR/IDR	3376.62	3486.49	3506.85	3583.33
MYR/INR	16.62	17.30	17.40	17.50
MYR/KRW	272.73	281.08	290.41	291.67
MYR/PHP	13.12	13.65	13.70	13.89
CNY/MYR	0.6210	0.5968	0.5984	0.6102

Source: Maybank FX Research as of 29 Mar 2018

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

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