March 29, 2019

FX Monthly

2019, Issue 3: Easy Monetary Policy Lifebuoy Thrown

What Has Changed This Month?

- Our currency forecasts and trajectories served us well in 1Q. In particular, we were spot on for AUD, NZD, VND, TWD and JPY. Other currencies like the GBP, CNY, SGD and PHP also hovered close to our respective forecasts for much of Mar. We also like to make special mention to our out of consensus forecast for INR while MYR touched a low of 4.0545 (vs. our forecast at 4.05).
- We keep our trajectories and forecasts unchanged for all our currencies for the year, only tweaking our USDTHB forecast slightly higher to reflect the political uncertainty that has re-emerged post-elections. The formation of the next government could be a long-drawn affair as no single party commands the majority in Parliament. Two competing camps have emerged that could create some instability and lift political tensions.

Our Strategies

- Concerns of a global slowdown saw policymakers and central banks respond swiftly with stimulus measure/easy policies. The Fed has taken the lead to pause in their monetary tightening cycle while ECB, RBA, RBNZ, BoC started to turn dovish along with various Asian central banks (RBI, BNM, BSP). These could help to cushion against a deeper slowdown.
- An environment of (1) dovish monetary policies amid benign inflation, (2) global growth slowing but not tanking (not hot not cold), (3) hopes of US-China trade deal suggest the opportunistic return to "goldilocks" thematic play. Higher yielders such as the INR, PHP, IDR in the EM space have an edge.
- We still look for USD strength to fade but trade within 95 – 98 range on softer US data, dovish-leaning Fed rhetoric and renewed optimism on US-China trade deal. US' widening twin deficits of budget and current account should fundamentally be detrimental for the USD.
- Built-up in political risk premium could limit EUR gains but provide for opportunity to buy dips as political noise give way to ECB normalization and data rebound. Look for 1.13 – 1.17 range, with bias to buy dips
- We highlight 3 upside risks to our USD view: (1) the risk of further gains in oil prices possibly due to supply-disruption or material progress on US-China trade deal could translate into inflation ticking higher in US and this could reignite pressure for Fed to tighten and would be supportive of the USD. OR (2) if global growth and monetary policy divergence resumes in favor of US, then the USD could be poised for further upside risk. OR (3) if global equities enter into a deeper sell-off owing to deep economic slowdown globally or stagflation concerns, then the USD could also be poised to strengthen .

Analysts

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

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

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

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

Top 3 Currency Plays for April

Long INR, IDR on Dips

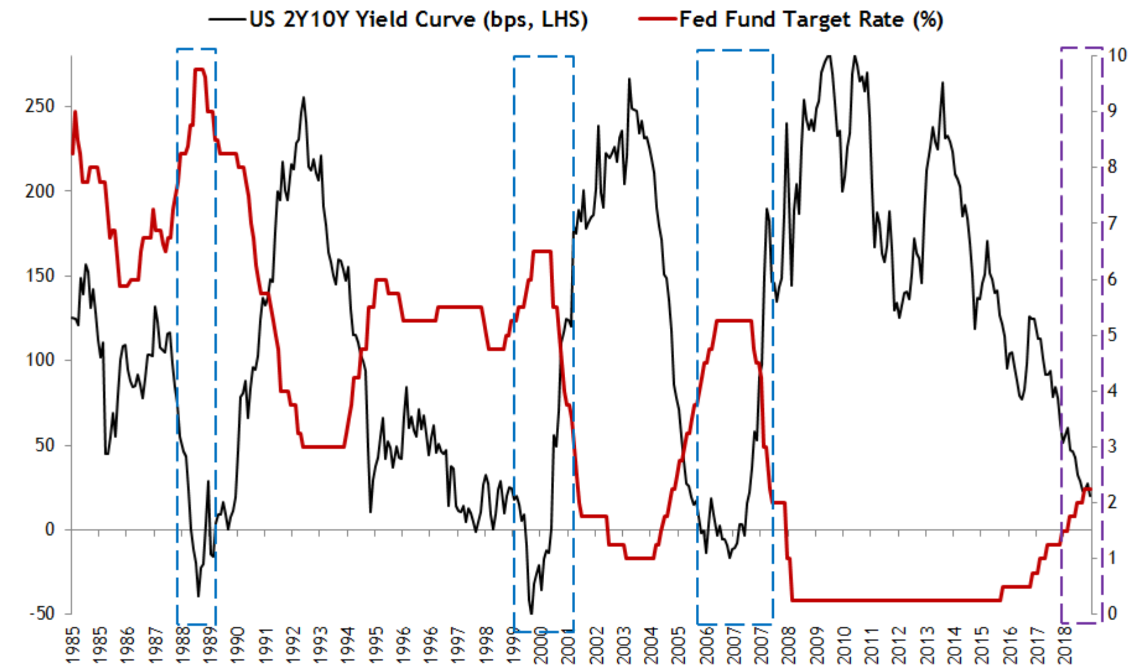
Fade The USD

Buy JPY, GBP and EUR on dips

Key Events for the Month Ahead

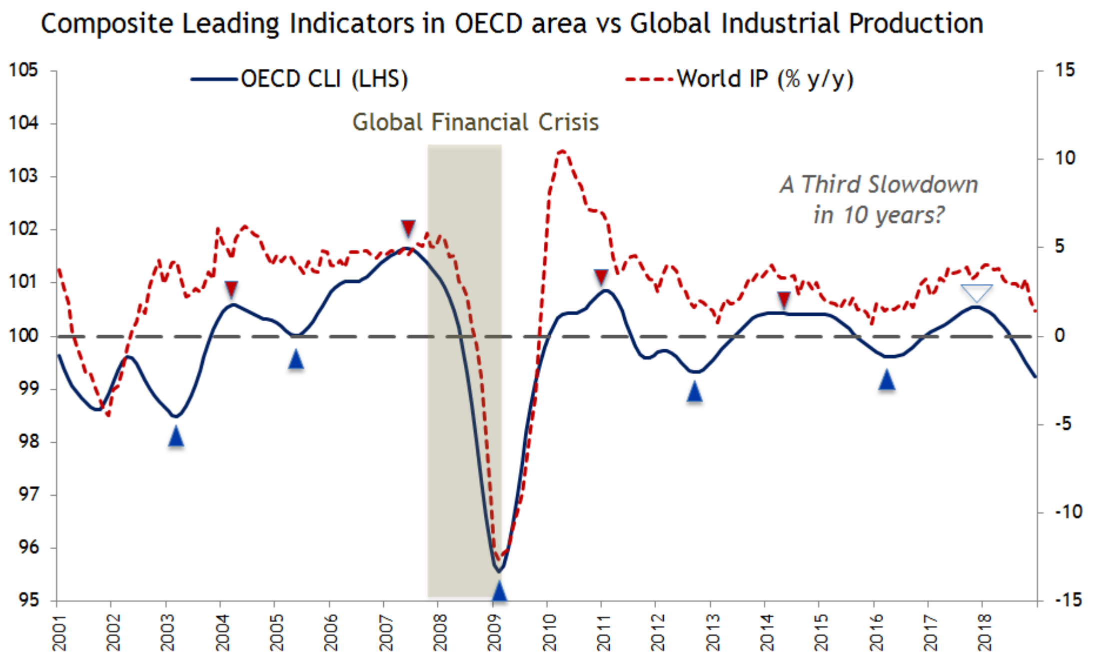
Date	Event
2 Apr	Australia's Federal Budget
3 Apr	Vice Premier Liu He in the US for trade talks
5-14 Apr	MAS Semi-Annual Policy Meeting
7 & 21 Apr	Local Elections In Japan
11 – 19 Apr	India's General Election for Lok Sabha
12 Apr	Brexit
17 Apr	Indonesia Presidential & General Election
28 Apr	Spain General Election

The Window for Further Fed Hikes Closes…



Source: Bloomberg, Maybank FX Research & Strategy

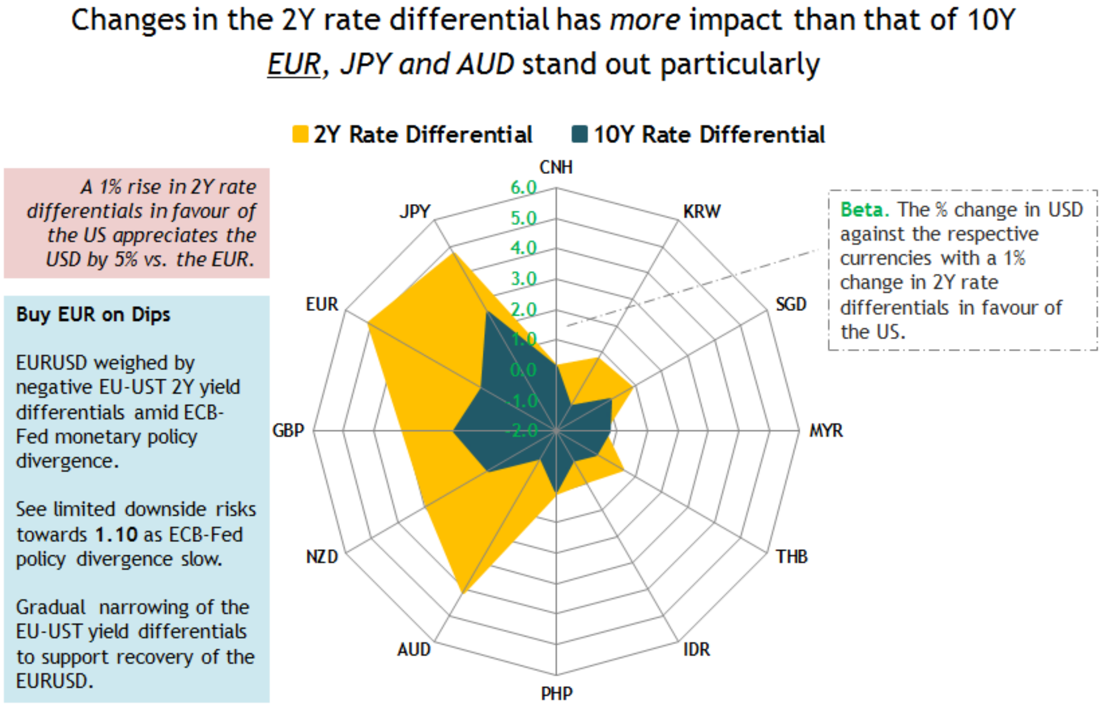
As Global Growth Momentum Eases



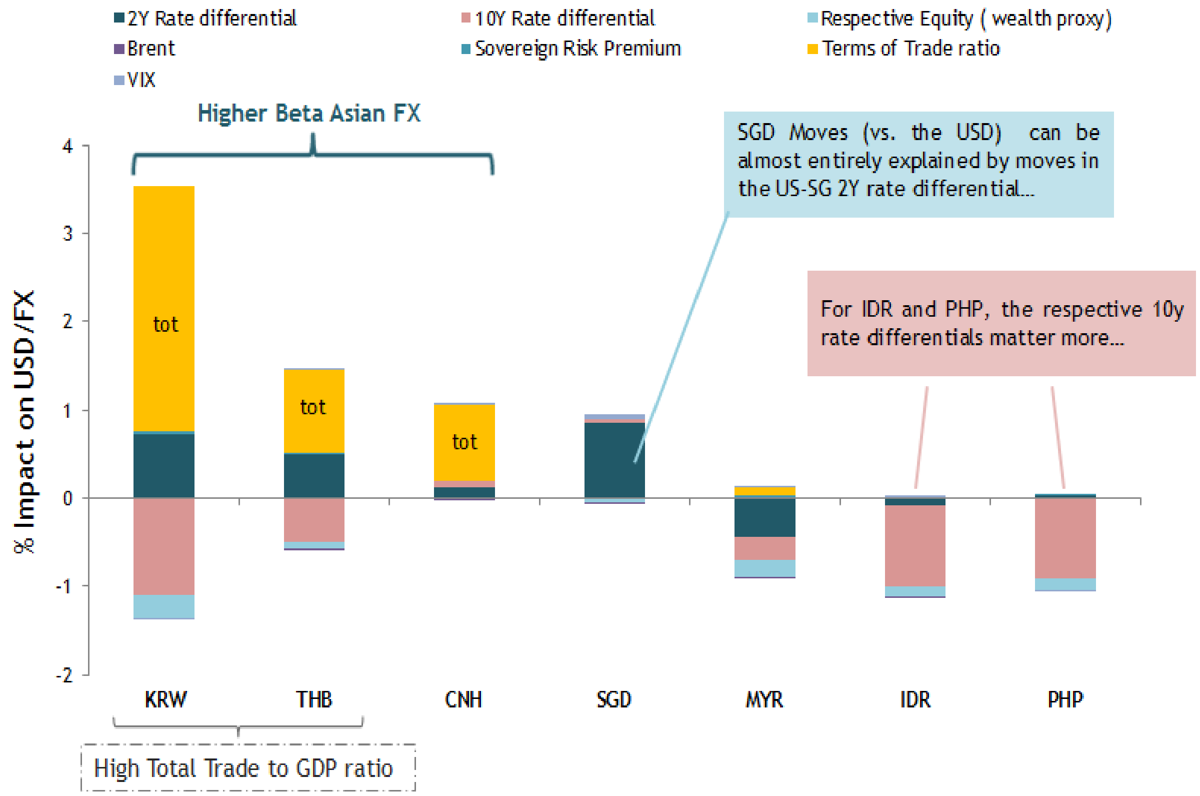
Note: CLIs or Composite Leading Indicators are designed to anticipate turning points in economic activity relative to trend 6 - 9 months ahead. Horizontal line at 100 represents the trend of economic activity. Colored triangles mark confirmed turning points of CLI while unshaded ones mark provisional turning points that may be reversed

Source: OECD, Bloomberg, Maybank FX Research & Strategy

We found that EUR is *Most* Sensitive to Changes in Rate Differentials



Terms of Trade matter more to KRW, THB, CNH while SGD is mostly moved by 2Y rate differential



Source: Maybank FX Research & Strategy's What Makes FX Skip a Heartbeat

G7 Global Overview

USD: Softer Dollar Trajectory Remains on Track

Forecast	2Q 2019	3Q 2019	4Q 2019	1Q 2020
USD Index	95.88 (--)	94.64 (--)	94.86 (--)	94.62 (--)

No Change to Previous Forecast

- **Motivation for the FX View:** We have priced in an earlier than expected Fed rate pause and waning momentum from fiscal support into our forecasts in 2019 and this has been validated by the recent Fed policy statement. Our USD softness remains as speculative USD longs are gradually unwinding as EM risk premiums remain overstretched amid lengthened easy monetary policy. Towards the end of 2019, our baseline builds in some expectations of heightened concerns about weaker global and US growth intensifying thus leading to some level of global risk off, supporting the USD somewhat.

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

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

- A fundamental factor the past week is the Fed rate hike cycle and the most recent FOMC statement has been a key factor. The Fed's "dots plot" implies no rate hike this year and +25bps hike next year. Our economics team have revised their fed fund rate call to "no change in 2019-2020" from previous "two hikes totaling +50bps in 2019 and no change in 2020". Fed is also unwinding its balance sheet reduction, especially by slowing the pace of cut in its US Treasury holdings starting May 2019 before ending the process in Sep 2019.

- For other majors, policy normalisations are still in their early stages (ECB, BoE) or may not have begun for most including RBA, RBNZ. We emphasize that policy divergence between the Fed and other DMs should slow and policy convergence could well be a thematic to position for into 2019. This should add to USD weakness. In addition, in the near term we could see month end flows supporting strong dollar selling versus most majors. However, the dollar can potentially has mildly bounce back vis-à-vis the safe haven currencies such as the JPY although most of its underperformance recently has been against the riskier G10 FX and EM.

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

- February CPI rose 0.2% m/m vs est. 0.2%. CPI excluding food, energy m/m up 0.11% while headline CPI y/y rose 1.5% vs consensus 1.6%. The results suggest core inflation is poised to remain near 2%, whilst energy prices have temporarily dragged headline inflation down to 1.5%. While the five-year/five-year forward inflation expectations rate rebounded from the lows at the turn of the year, it remains below 2%.

- U.S. Core Inflation unexpectedly eased in February amid falling prices for autos and prescription drugs, giving the Federal Reserve more room to stick to its plan for being patient on raising interest rates. Excluding food and energy, the so-called core consumer price index rose 0.1% from the prior month and 2.1% from a year earlier. Those figures trailed the median estimates of economists. The broader CPI rose 0.2%t from January, the first increase in four months, though the 1.5% annual gain missed projections and was the smallest rise since 2016.

- **Monetary Policy Forecast:** Target fed funds rate (FFR) kept at 2.25%-2.50% at this month's FOMC. Fed's "dots plot" implies no rate hike this year and +25bps hike next year. Revised our fed fund rate call to "no change in 2019-2020" from previous "two hikes totaling +50bps in 2019 and no change in 2020". Fed is also unwinding its balance sheet reduction, especially by slowing the pace of cut in its US Treasury holdings starting May 2019 before ending the process in Sep 2019.

- Despite Fed's assessment that the labour market conditions remain tight, view on growth is toned down as economic activity moderated amid slower household spending and business fixed investment, coupled with muted inflation. Fed is also monitoring global economic and financial developments.

- Latest 2019-2021 median macro forecasts showed slight downward revisions to growth and headline inflation rates, no change in the forecast of steady core inflation rate at 2.0%, and marginal upward revisions in the still sub-4% unemployment rate.

- Fed's "dots plot" is also tweaked as it now shows a FFR guidance of no rate hike in 2019 and a +25bps hike in 2020, versus +50bps hike in 2019 and +25bps hike in 2020 back in Dec 2018. Our view of Fed's rate hike cycle ending this year remains, but the FFR trajectory is now revised to "no change in 2019-2020" from previous "two hikes totaling +50bps in 2019 and no change in 2020". Based on FFR futures, market is currently pricing in no change this year and -25bps cut next year.

- In a separate statement on "Balance Sheet Normalisation Principles and Plan", Fed now plans to slow the reduction of its US Treasury holdings from current USD30b a month to USD15b a month starting May 2019 and end the reduction process in Sep 2019. At the same time, Fed will continue with its plan to reduce its holdings of agency debt and agency mortgage-backed securities (MBS). However, starting Oct 2019, Fed will re-invest principal payments from these securities into US Treasuries at a maximum amount of USD20b per month, with any excess plough back into agency MBS. We expect this to result in a relatively "flat" Fed's balance sheet from 4Q 2019 onwards.

- As at mid-Mar 2019, Fed's balance sheet declined -USD482.8b to USD4,019.45b from USD4,502.2b at end-Sep 2017 when the balance sheet reduction began. Over the same period, Fed's holdings of US Treasuries fell -USD289.9b to USD2,175.5b from USD2,465.4b, while its holdings of agency debts and agency MBS dropped -USD164.7b to USD1,610.2b from USD1,774.9b. To note, Fed's balance sheet reduction since its start in Oct 2017 is progressing at a slower pace than the guidance of raising the run off rate by USD10b every three month from USD10b per month at the start of the programme in Oct 2017 until USD50b per month from Sep 2018 onwards, which should have resulted in a cumulative -USD590b balance sheet reduction to-date.

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

- **Key domestic events and issues to watch in Apr 2019: ISM Manuf (1 Apr),** PCE deflator (29 Apr); ISM Manuf (1 Mar), Factory Orders (8 Apr), Durable Goods Orders (8 & 25 Apr), Trade Balance (17 Apr), NFP (5 Apr), CPI (10 Apr), Retail Sales (1 & 18 Apr), FOMC Minutes (11 Apr), GDP 4Q & Personal Consumption (26 Apr), Core PCE (26 Apr), FOMC (2 May).

- **Technical Outlook:** DXY was last seen at 97.15 levels. Daily momentum is bullish bias but stochastics is rising towards near-overbought conditions. While risks may appear to be skewed to the upside in the interim, we do not rule our USD bulls running into exhaustion again. The rise in DXY early March stalled at 97.70 (7 Mar). This is also the same level that had kept DXY from breaking higher in 2018. We continue to watch this 97.70 (triple top resistance). Another failed attempt to break above should see USD strength fade and trade lower. On chart pattern, a large rising wedge is in the making from Mar 2018. This is typically associated with a bearish reversal. Our bias to sell rallies remains intact. Area of support at 96.4 – 96.7 (21, 50, 100 DMAs), 95.9 (200 DMA) before 94.10 levels (38.2% fibo retracement of 2018 low to high).

EUR: Build-up in Political Risk Premium May Limit Gains

Forecast	2Q 2019	3Q 2019	4Q 2019	1Q 2020
EURUSD	1.1500 (--)	1.1600 (--)	1.1600 (--)	1.1600 (--)

No Change to Previous Forecast

- **Motivation for the FX View:** We continue to maintain a constructive outlook for EUR over our forecast horizon on growing signs of stabilisation in activity momentum and expectations for ECB policy normalisation to gather traction towards 4Q 2019. We do caution that the risk of a build-up in political risk premium owing to potential election uncertainties out of Spain (28th Apr), European parliament (23 – 26th May) and Belgium elections (26th May) could limit EUR gains in the interim. But reiterate our stand that EUR pullback owing to the rise in political risk premium should present opportunities to buy into. We look for 1.12 – 1.15 trading range for Apr.
- Growth momentum easing in the Euro-area does not necessarily translate into a Euro-area wide recession. Expansion in the Euro-area continues to be supported by accommodative financing conditions, steady oil prices as well as promising labor market conditions (with unemployment rate falling to decade low and wage growth rising to 9-year high of 2.4% q/q). In addition there are some pockets of stabilisation showing up in some areas including France. Industrial production is also rebounding for Italy, France, Spain while ZEW survey and German IFO also rebounded. We believe further stabilisation in activity data could provide the confidence for portfolio re-allocation into underweight European assets and capital flow story should be supportive of EUR. Heavyweight Germany activity momentum has been on a poor form owing to new emission test affecting its auto sectors and US trade tensions with China and Europe. Recovery from one-off events on emission tests and rising prospects of US striking a trade deal with China (possibly in coming quarter) could be another factor supporting Euro-area data and EUR.
- Furthermore EUR short positions at 2-year record levels do suggest that many negatives have been priced in. Unwinding of these negatives could lend the positive impulse to EUR recovery. Though ECB's timeline of policy normalisation may have been pushed back (ECB expects rate to stay at current levels till end-2019), Fed's pause on rate normalisation and slowdown in balance sheet normalisation (starting May and end in Sep), could help to reduce the negative EU-UST yield differentials. This divergence-convergence of ECB-Fed policies, albeit slow pace, is another factor supportive of EUR recovery (given that EUR is most sensitive amongst DM FX to changes in yield differentials). We note that 2Y EU-UST yield differentials have

already started narrowing from -354bps in Nov-2018 to -275bps (Mar-2019). We expect EUR gains to pick up traction when market speculation for ECB policy normalisation plans kick in at some stage towards end-2020.

- Taking stock, our caution that *a decision to re-introduce TLTRO could dampen EUR gains as time of ECB policy normalisation will be pushed back*ed came to fruition. EUR traded as low as 1.1177 (7th Mar) before erasing losses to trade an intra-month high of 1.1448 (20th Mar). Pair was last seen at 1.1270 levels (at time of writing 27th Mar).

- **Downside Risks to Outlook: EUR could be vulnerable for further downside** if (1) Euro-area activity rebound momentum proved to be unsustainable and results in growth slipping into a recession; (2) a prolonged delay in ECB policy normalisation plans into 2H 2020; (3) negative political surprises (i.e. risk of early election in Italy, Brexit uncertainties, etc.) dragging on for longer. Italy may appear to be the weakest link as the economy entered into technical recession for the second time in 4 years while tensions between coalition partners appear to be on the rise. Italy's build-up of sovereign debt has also kept its credit rating (BBB) one-notch above junk status with a negative outlook (Fitch) and there are concerns if the massive Italian debt could pose contagion fears for European banks, in particular French banks (highest credit exposure to Italy).

- **Growth and Inflation Outlook:** The latest ECB macroeconomic projection in Mar 2019 report shows that growth **projections were revised much lower to 1.1% and 1.6% for 2019 and 2020,** respectively (vs. 1.7% as previously projected in the last quarterly assessment). Investments and exports saw the main revision lower. **Inflation was also** revised much lower to 1.2% (vs. 1.6%) for 2019 and **revised lower to 1.5% for 2020 (vs. 1.7% previous projection).**

- **Euro-area growth came in at 1.1% y/y in 4Q.** This is the slowest pace of growth since 2013. Italy entered into technical recession while German economy stagnated. Spain, Netherlands and Portugal surprisingly saw growth picked up pace. **Concerns of Euro-area growth slowdown continue to rise** as preliminary manufacturing PMI slipped further into contractionary territory in Mar (47.6 vs. 49.3 prior). Our view remains for a **deceleration in growth momentum but short of an outright recession for the Euro-area as a whole**. Services PMI remain in expansionary territory at 52.7 while IPs for Italy, France, Spain rebounded.

- **Headline Euro-area CPI modestly picked up pace to 1.5% y/y in Feb,** from 1.4% in Jan. Acceleration was due to rise in food, non-alcoholic and transportation prices. Core CPI held steady at 1.1% y/y owing to services. Looking ahead, the ECB expects inflation pressure to gradually rise owing to favourable labor market dynamics (falling unemployment and rising wage growth).

- **Monetary Policy Forecast: The next ECB Governing Council meeting is scheduled on 10 Apr.** ECB is widely expected to keep key policy rates including Main Refinancing operations, deposit facility and marginal lending facility on hold at 0%, -0.4% and 0.25%, respectively till end-2019. Our base case scenario remains for ECB to normalize policy later this year with modest increase **in** deposit rate from -0.4% to -0.3% to end-2019 (should (1) inflation data, in particular core CPI continues to surprise to the upside while (2) recent decline in growth and activity data proved to be one-off.

- ECB President Draghi will step down on 31 Oct 2019 and the race for the next ECB President remains wide open. Market chatters of former Finnish Governor Lilkanen and French central banker Villeroy front running German central banker Weidmann (whom is viewed as a hawk). Both Lilkanen and Vileroy are considered close aides of Draghi and are supportive of accommodative monetary policies. We continue to monitor this space as we run closer to the rotation of ECB leadership. Shift in expectation in support of Weidman could further be supportive of the EUR.

- ECB's Draghi said (27th Mar) that ECB is still confident that it is on track to hit its inflation target despite a raft of bad data and this is due to resilience of its labor market. He elaborated that *unlike the US where stronger growth has not fed through to higher wages, eurozone workers were getting a stronger pay rise due to lower unemployment. These higher wages would lead to stronger price increases once the current shock to the region's economy dissipated.* He also sounded optimistic on growth in saying that *soft patch does not necessarily foreshadow a serious recession. The Euro-area faces an analogous situation in 2016 when the economy also went through a soft patch triggered by contraction in world trade and at that time, the strength of the domestic economy was able to shield the recovery from external uncertainties.*

- At the last Governing Council meeting (7th Mar), ECB announced its decision to (1) re-introduce cheap funding via quarterly TLTRO with rate indexed to MRO interest rate (currently at zero) starting in Sep-2019; (2) shifts in forward guidance on policy normalisation – ECB now expect rates to remain at present levels through end-2019, from end Summer-2019 and (3) relatively large downward revisions to 2019 growth forecast to 1.1% from 1.7%. The shift in forward guidance and the decisive act to use TLTRO surprised us as these could be interpreted as signs that deceleration in Euro-area economic growth could come faster than expected and that slower growth was not just due to one-off event. We think this warrants caution and monitoring but we refrain from overly bearish as there are pockets of stabilisation. In addition, ECB's earlier policy response via cheap funding could well be timely to maintain favourable liquidity conditions.

- **Latest Fiscal and External Balance Outlook:** Euro area's current account surplus rose sharply to EUR37bn in Jan, up from EUR16bn in Dec. This was due to a rise in trade surplus. In the 12 months to Jan, Euro-area current account surplus was 3% of GDP, down from 3.4% in the same period a year ago. ECB expects current account surplus to narrow further to 2.7% of GDP in 2019 and 2.5% of GDP in 2021.

- Euro-area government deficit widened to -0.5% of GDP in 3Q, from -0.3% of GDP in 2Q. This was due to lower government revenue while expenditure picked up. Government debt to GDP was lower at 86.1%

for 3Q (vs. 86.3% in 2Q). Greece (182.2%), Italy (133%) and Portugal (125%) continue to have the highest debt to GDP ratio.

- **Key domestic events and issues to watch:** Mar mfg PMI, Mar CPI estimate (1 Apr); Feb PPI (2 Apr); Mar services PMI, Feb retail sales (3 Apr); ECB GC meeting (10 Apr); Feb IP (12 Apr); Feb construction output, ZEW survey expectations (16 Apr); Feb current account, trade, Mar CPI (17 Apr); Apr prelim PMIs, consumer confidence (23 Apr); Mar unemployment rate, 1Q GDP (30 Apr).

- **Technical Outlook:** EUR was last seen at 1.1230 levels. Bearish momentum on daily chart remains intact while stochastics is falling into oversold conditions. We do not rule out chance of rebound from 1.1220, 1.1190 levels. Immediate resistance at 1.1280, 1.1340 (50 DMA). Beyond short term perspective, we remain convicted to our call to buy EUR on dip. Monthly chart shows tentative signs of turn-around in stochastics from oversold conditions – hint that room for further downside could be limited. A potential falling wedge pattern (began wide at the top in early 2018 and contracts as prices move lower towards the end-2018/early 2019) also appears to be in the making. This is typically associated with a bullish reversal. We continue to look for moves towards 1.15, 1.17 beyond short term. Bigger support at 1.1050 – 1.11 levels.

GBP: No End to *Bre*(Sick)?

Forecast	2Q 2019	3Q 2019	4Q 2019	1Q 2020
GBPUSD	1.3200 (--)	1.3400 (--)	1.3600 (--)	1.3600 (--)

No Change to Previous Forecast

- **Motivation for the FX View**: We continue to call for **2 way trade in the GBP as fluid brexit development continues to evolve and intensify**. But beyond near term whippy trades, we **hold to our bias to buy dips as brexit uncertainty gradually subsides**. We continue to keep our forecast levels and trajectory unchanged across the next 4 quarters. Though there remains a lack of clear majority for any alternative brexit plans to PM May's plan, the clearest result from the series of non-binding votes (held on 27th Mar) saw MPs voted 400 votes to 160 to oppose a no-deal brexit. This **reinforced our bias to buy GBP on dips as the distribution of risks and preferences of UK lawmakers have shifted from no deal, hard brexit to delayed and softer brexit.**

- Brexit development remains fluid and continues to evolve as we write. **What we know at this point is that the 29th Mar brexit date has been unconditionally pushed back to 12th Apr. A vote on PM May's withdrawal agreement will be put to a vote on 29th Mar but the non-binding political declaration on future relations will not be.**

- If UK parliament accepts PM May's agreement, the UK can delay exit past 12th Apr till 22nd May to ratify the text however
- If the UK parliament does not accept the deal, the UK will have up till 12th Apr to decide whether to leave without a withdrawal agreement or request for a longer extension. If it does seek a longer delay, then the UK will have to vote in the upcoming European elections. PM May's preference is for leaving EU with her negotiated deal and not participating in the EU parliament elections.

- PM May is expected to leverage on the threat of either backing her deal or risk a longer brexit delay or no brexit at all. GBP could rise meaningfully if PM May can win the backing of DUP MPs and get the reluctant support from rebel Tory MPs. However another defeat on her deal could shift the balance of risk towards the nuclear option of no deal, hard brexit (which we see as a lesser probability) and this would be negative for GBP.

- The first time May's plan (withdrawal agreement and political declaration) was put to a vote saw an overwhelming defeat by 432 to 202 votes and the second time saw another defeat (but a slight improvement) by 391 to 242 votes. **We think there is a good chance of PM May winning this by a slim margin (out-of-consensus call) as the vote tonight involves only the withdrawal agreement (to be put in place during the transitional phase) and not the political declaration. This would at least reduce some negativity on GBP.**

- The alternative course could be (1) No to PM May's deal; (2) a longer extension beyond 22nd May possibly by another 9 months and somewhat, UK to participate in EU parliamentary elections as the longer than expected extension is not a technical one. Given that PM May's deal is not accepted, she would continue to serve as PM. She had earlier said she will resign if lawmakers accept her deal.

- **Second Referendum still Not Ruled Out but the chance of it happening is rather low.** To be sure, the series of non-binding votes last Wed (27th Mar) showed that MPs voted 295 to 268 to oppose holding a second referendum on any withdrawal bill (Margaret Beckett's proposal). Ken Clarke's proposal for a customs union came close to securing a majority (MPs voted 272 against the proposal to 264). Other vote showed that 184 MPs voted to revoke Article-50 while 293 MPs opposed.

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

- **Growth and Inflation Outlook: Near term economic outlook is not expected to improve** as intensification of brexit uncertainty continues to weigh on investment, business decision. Construction PMI contracted in Feb (49.5 vs. 50.6 in Jan) for the first time in 11 months as brexit uncertainty results in a delay in new building projects. UK PMI though in expansionary territory, hit a 4-month low of 52 in Feb as manufacturers stockpiled to mitigate any potential disruption arising out of Brexit. The only less dim spot is the services sector where PMI rose to 51.3 in Feb (vs. 50.1 in Jan). That said PMI surveys suggest the risk of downward pressure on UK economy. Elsewhere industrial production rebounded +0.8% m/m in Jan (vs. -0.7% in Dec) while unemployment rate continues to fall to multi-decade low of 3.9% in Jan. For 4Q, UK economy expanded at a slower pace by +0.2% q/q (vs. +0.6% in 3Q vs. 0.3% expected). Consumption, government spending contributed to growth but back-to-back declines in business investments remain the main drag.

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

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

- UK headline inflation accelerated in Feb to 1.9% y/y (vs. 1.8% in Jan) on higher cost of food, drink, tobacco and computer games. Core inflation dipped modestly to 1.8% y/y (vs. 1.9%prior). Robust labor market conditions in UK with unemployment rate at >40-year low and wage growth at decade high of +3.4% y/y is expected to add to domestic price pressures. Overall, the steady decline in headline CPI and the rise in wage growth above 3% provides a welcome relief for consumers and household finances.

- **Monetary Policy Forecast:** We expect BoE MPC to keep policy rate and size of BoE balance sheet unchanged at 0.75%, GBP 435bn, respectively at the upcoming meeting on 2nd May. Steady decline in headline CPI to below 2% target leaves room for BoE to keep policy stance status quo. BoE has warned that continuing brexit uncertainty could take a toll on business investment decisions, paving the way for weaker economic growth in future. BOE also highlighted the possibility of further cliff-edge uncertainties that could have significant effect on spending as brexit deadline nears. Maintaining accommodative monetary conditions is the least BoE can do to help support growth. We **expect BoE MPC to keep policy stance status quo for as long as until end-2019** as **uncertainty over Brexit takes precedence over policy normalisation.** BoE's forward guidance shows another 2 hikes expected to end-2020 (this implies about 1 hike/year). GBP OIS future is now pricing in a 10% chance of rate cut in Dec-2019. We remain watchful of inflationary pressures as tight labor market can further generate domestic price pressures while a case of no-deal brexit could result in sharp depreciation on GBP (brings about higher imported prices and this translates into higher CPI). Sustained rebound in CPI towards 3% again could pressure BoE to hike earlier reluctantly.

- **External Balance Outlook** UK's current account deficit widened to 5% of GDP in 3Q, from 3.8% in 2Q. This is the widest level in 2 years. Worsening of current account deficit was due to rise in trade deficit and a shortfall in investment income. (4Q data will only be released on 29^{th} Mar after we send this to press).

- **Key domestic events and issues to watch:** Mar PMI Mfg (1 Apr); Mar construction PMI (2 Apr); Mar services PMI (3 Apr); Mar house prices (5 Apr); Feb trade, industrial production, construction output, monthly GDP (10 Apr); Feb labor report (16 Apr); Mar CPI, PPI, RPI (17 Apr); Mar retail sales (18 Apr); Mar public finances (24 Apr); Apr GfK consumer confidence (30 Apr).

- **Technical Outlook:** GBP was last seen at 1.3070 levels. Bearish pressure continues to build with daily momentum bearish and stochastics falling. Near term risks skewed to the downside. Support at 1.3020 (lower bound of the bullish trend channel), 1.2980 (200 DMA) before 1.2920 (100 DMA). Bias to buy dips. Bullish trend channel intact. Resistance at 1.3180 (38.2% fibo retracement of 2018 high to low, 21 DMA), 1.3260 before 1.3410 (50% fibo).

AUD: Lackluster Trade To Continue With Some Chance of Upside

Forecast	2Q 2019	3Q 2019	4Q 2019	1Q 2020
AUDUSD	0.73 (--)	0.74 (--)	0.73 (--)	0.72 (--)

No Change to Previous Forecast

- **Motivation for the FX View:** Markets are increasingly desensitized to talks by officials (on either side) with regards to the progress of the trade deal. What is priced in at this moment, in our view, is a basic agreement to continue the dialogue, to keep the communication channels open between the two great nations (as White House Economic Adviser Kudlow suggested, it can take weeks or months to get a deal). As such, the "optimism" priced is still on a fairly conservative scenario with perhaps at most no additional tariffs expected from either nation. Hence, we also do not want to discount surprises on either side. At this point, outcome is still skewed slightly to the upside with a deal still likely to see a kneejerk reaction for the AUDUSD higher. That could include the removal of the existing tariffs that the US has in place on China imports.

- The reason for AUD's lackluster trade in 2019 so far is the downbeat prospect of its domestic demand that has concomitant drag on policy rate expectations. Earlier this month, the interpolated OIS implied an almost 40% chance of a rate cut by May this year in early Mar but this probability has dropped to sub-20% level as we write. Decent hiring momentum unwound some of the rate cut expectations and propped up the AUD. The chance of a rate cut priced within this year is 80% at this point with more than 55% chance of it happening by Jul. However, USD and US rates are benign enough for AUDUSD to remain above the 0.70 much of this year and we see potential for this pair to head higher towards 0.73/0.74 as rate cut expectations are priced and the room for upside surprises from the US-China trade talks are ample.

- We do not think AUD bulls are likely to take full control soon as election risks could cap AUD gains and this time, compounded by the softness in the residential property sector, weak household income growth and concomitant downside risks to employment and growth momentum. Despite the recent win in New South Wales by the coalition, recent poll trends still favour the opposition Labor Party and one of the most contentious policies that they proposed is to scale back negative gearing policy which could further dampen the demand for residential property in the longer-run (though could induce a short-term boom in the interim before the policy takes effect given the grandfathering clause). The negative gearing policy allows taxpayers to claim deduction on mortgage for your expenses for the period your property is rented or available for rent. The rental property is negatively geared if it is purchased with borrowed funds and the net rental income, after deducting other expenses, is less than the interest on the borrowings. Labor proposed to halve the capital gains tax discount and restrict negative gearing to only new homes. This is supposed to raise A$32bn in over 10 years from a yet-to-be-determined date after the election. A poll conducted by Newspoll on 10 Mar show a +3.5% swing towards Labor. As such, we AUD bulls are likely to be capped by the possibility of a Labor win increase. There are whispers of 11 May as the likely date of the Federal Election. Budget is expected to be delivered on 2 Apr and PM Scott Morrison may call election on 7 Apr.

- **Growth and Inflation Outlook:**

— The latest retail sales (ex-inflation) print for Jan came in weaker than expected at 0.1%m/m vs. previous -0.4% (expected 0.3%). Breakdown reveals some improvement in apparel (-0.3%m/m vs. -2.9% previously), household goods (0.0%m/m vs. -2.9%) and other retailing (+0.7%m/m vs. -0.1%). However, these could not offset the weaker retail sales of food (+0.3%m/m vs. 0.6% previously), department stores (-2.1% vs. -1.3% previously) and cafes, restaurants (0.3%m/m vs. prev. 1.1%).

— Part of the fall in the housing market was due to the rise in the wholesale funding cost that triggered out of cycle mortgage rate hikes but those costs of financing have come off more recently. The 3M BBSW has fallen further to 1.81% (as of 26 Mar). With the recent retracement and a more data-dependent Fed, very benign inflation outlook at home and abroad, another round of mortgage hikes is less likely than 2018. As such, we think the residential property market should not experience as much pressure in 2019 compared to 2018.

- Separately, NAB business surveys actually show further deterioration in both the business conditions and confidence from 7 to 4 and 4 to 2 respectively. This adds to the leading indicators of weak consumer and business confidence. The AiG Performance of Services index improved a tad to 44.5 for Feb from previous 44.3 but still retains a downtrend since its peak in 2018. The same goes PMI-mfg prints at 52.0 (prelim.) for Mar though the Aig Performance of Construction index came in to be 43.8, up from more than 5 year low of 42.65. These could be early signs of stabilization in the building approvals and perhaps a signal that property developers look for a bottom in the housing sector.
- Latest available data show a weaker print for China's PMI-mfg at 49.2 for Feb vs. previous 49.5 with new export order significantly lower at 45.2 vs. the previous 46.9. However, new order actually expected to expand, at a 50.6 print vs. previous 49.6. This contrasts to the 45.2 print for new export orders for Feb, a further deterioration from previous 46.9. While this could still be an early sign that demand out of China could stabilize even as the rest of the world slows. Breakdown of the fixed asset investment for China also suggests some improvement for real estate and stabilization in manufacturing that is positive for the AUD. These are the probably signs of stabilization that we have been looking for in the growth momentum of China as policymakers bolstered consumption and investment.
- Inflation wise, RBA revised CPI for year-ended Dec 2019 lower to 1.75% from 2.25%. Weak domestic demand and global growth suggest that the outlook for consumer prices should remain benign. In addition, IEA forecasts for the year suggest that there should not be any excessive swings in supply and demand deficit of crude oil that should threaten the global inflation outlook. We look forward to the next quarterly CPI print to release in Apr.

- **Monetary Policy Forecast:** The RBA meeting in Mar did not offer anything fresh for markets after the shift to neutral in Feb. Amid signs that household spending are starting to weaken after a prolonged period of housing price decline, that could translate at some point to some slowdown in hiring and ticks higher in the unemployment rate. And RBA has historically been rather sensitive to upticks of this measure, reacting within a quarter to signs of weakness in the labour market – namely upticks in unemployment rate.
- That said, we have mentioned in the above that the housing market is unlikely to be under as much pressure as we have seen in 2018 and there are signs of stabilization in China's growth momentum. Hence, a call for a rate cut remains a close one and we expect only one this year. We anticipate that the stabilization in the domestic housing market should stem further deterioration in business and consumer confidence and a pick-up in China's demand, moderate as it may be, may improve its external balance, terms of trade and strengthen the AUD. At this point, the interpolated OIS implies a 50% probability of a

rate cut by the Jul RBA meeting. That could simply suggest that room for further AUD downside from the rate cut perspective is limited and there is further headroom should data start to improve.

- **Latest External Balance Outlook:** Trade balance for Jan was a bumper surplus of A$4.55bn vs. previous A$3.77bn. Improvement in external demand could continue to be supportive of the AUD. The Budget will be delivered on 2 Apr and PM Morrison had promised a surplus budget.

- **Key domestic events and issues to watch:** PMI-mfg for Mar, Melbourne Institute inflation expectation for Mar, NAB Business survey and commodity index for Mar on 1^{st} Apr; **Federal Budget on 2^{nd} Apr;** building approvals for Feb and RBA meeting on the 2^{nd}; **PM Morrison could call election on 7^{th} Apr;** trade and retail sales on 3^{rd}; home loans for and investment lending for Feb on the 9^{th}; Westpac consumer confidence for Apr on 10^{th}; RBA Minutes of Mar Policy meeting on the 16^{th}; labour report for Mar due on 18^{th}; CBA PMI-mfg on Apr (Prelim.) on 23^{rd}; 1Q CPI for 24^{th}; PPI on 1Q; Private Sector Credit for Mar on 30^{th}; Federal Election possibly on 11^{th} May;

- **Technical:** This AUDUSD is pressed against the 0.7060 support for much of the past few months and there is little directional impetus for this pair. On the daily charts, the 200-dma is closing in on the rest and a compression of these moving averages may herald a breakout on either side. That said, no impetus yet at this point. Range play within 0.69-0.72 seen.

NZD: RBNZ Should Not Have *Doved* In

Forecast	2Q 2019	3Q 2019	4Q 2019	1Q 2020
NZDUSD	0.7100 (--)	0.7200 (--)	0.7100 (--)	0.7000 (--)

No Change to Previous Forecast

- **Motivation for the FX View:** The **near term risk for NZD is skewed to the downside** thanks to RBNZ's explicit intent to not stand out like a sore thumb in the face of most developed world central banks turning dovish. In particular RBNZ's accompanying statement highlighted that *weaker outlook has prompted central banks to ease their expected monetary policy stances, placing upward pressure on the New Zealand dollar.* To be sure, NZD has indeed risen nearly 3% vs. USD YTD (26 Mar) and is the top performing Gt FX, apart from GBP (owing to idiosyncratic factors). It is no surprise that RBNZ was trying to engineer a softer NZD to ensure relative gains are curbed.

- However we **stand firm in our view that RBNZ should have remained neutral and there is little need for RBNZ to join other DM central banks at this stage in turning dovish. Inflationary pressures as capacity builds and the risk of further upward pressure on domestic prices including wage growth (owing to tightening of**

labor market) are sufficient for RBNZ to remain on hold. We caution that sustained rise in CPI and activity picking up further could see market pare back rate cut expectations. For now OIS-implied is pricing in 56% chance of rate cut in Jun-2019 MPC meeting, much earlier than previously expected at Mar-2020. Unwinding of rate hike bets could support NZD recovery.

- In addition, chance of US-China trade deal possibly coming in coming quarter, sustained rise in dairy prices (already seeing upward revisions to Fonterra mild prices), Fed's pause are some of the other factors that could pose upward pressure on NZD.
- We continue to keep our forecast, trajectory and bias unchanged - remain mildly positive on NZD outlook and expect the NZD to gradually rise above 0.70 in 2Q-3Q 2019. Our 1Q forecast for NZD at 0.68 appears on track, at time of writing (spot ref 0.6806).
- **Growth and Inflation Outlook:** GDP picked up pace to +0.6% q/q in 4Q (vs. 0.3% in 3Q). 9 out of 11 service sectors including retail, accommodation, transport, warehousing expanded as well as investment rebounded, thanks to business spending and homebuilding. Primary industries and goods-producing industries in manufacturing and utilities were the main drags. Survey indicators remain mixed but a swing around in fortune. Manufacturing PMI rebounded (53.7 vs. 53.0) in Feb owing to increases in production and new orders while services slowed down (52.8 vs. 56.2) this time. Nonetheless both sectors remain in expansionary territory. Retail sales, on the other hand, surprised to the upside (+1.7% q/q in 4Q). 11 out of the 15 store categories including F&B, pharmaceuticals reported gains.
- **In the last quarterly MPS (13 Feb), RBNZ expects growth to pick up pace to 3% for 2019,** up from 2.6% in 2018. Monetary stimulus and population growth will underpin household spending and business investment while government spending on infrastructure and housing is expected to support demand. In particular on the fiscal front, the families package should support household consumption, Kiwibuild plan to support real estate investment while increase in minimum wage is expected to support household income.
- On inflation outlook, CPI is projected to ease in the near term owing to decline in petrol prices but to rise and reach the middle of its target range of 1 – 3% as both tradables and non-tradables inflation rise (the latter due to increasing capacity pressure).
- **Headline CPI slowed on sequential terms to +0.1% in 4Q,** from +0.9% in 3Q. The moderation was dragged by tradable prices (typically transitory in nature, defined as imported goods & services) while non-tradable inflation (proxy for domestic price pressures) rose +0.7% q/q. On y/y terms, headline CPI rose 1.9%, close to the middle of RBNZ's inflation target range of 1 – 3%. On sectoral breakdown, decline in oil and food prices were the main drags while accommodation-related prices such as rental provided the buffer. 4Q PPI (+1.6% q/q) rose amid electricity cost increases.
- **Monetary Policy Forecast:** We expect **RBNZ to keep OCR on hold at 1.75% at the upcoming meeting on 8th May.** While OCR was kept at

1.75% as widely expected at the last meeting (27th Mar), accompanying statement emitted a **dovish tilt.** Notably **RBNZ made the shift from "direction of our next OCR move could be up or down" to "more likely direction our next OCR move is down".** It **also noted that *global economic outlook has continued to weaken, in particular amongst some of our key trading partners including Australia, Europe, and China. This weaker outlook has prompted central banks to ease their expected monetary policy stances,*** *placing upward pressure on the New Zealand dollar*. **Clearly the RBNZ does not favor relative NZD strength as other DM central banks' monetary stances have turned dovish. We stand firm on our view that RBNZ should have remained neutral and there is little need for RBNZ to join other DM central banks at this stage in turning dovish. Rise in NZ CPI towards the middle of RBNZ target range of 1% - 3% as capacity builds and the risk of further upward pressure on domestic prices including wage growth (owing to tightening of labor market) are sufficient for RBNZ to remain on hold.** We caution that sustained rise in CPI and activity picking up further could see market pare back rate cut expectations. For now OIS-implied is pricing in 60% chance of rate cut in Jun-2019 MPC meeting, much earlier than previously expected at Mar-2020. RBNZ's Orr added **that policy stance adopted earlier this week will be the starting point for deliberation of the new MPC when it meets ahead of May rate decision. This is now fueling expectations that a cut may be imminent before Jun. OIS-implied shows a jump in probability of a cut to 60% in Jun, up from 8% probability a week ago.** Unwinding of rate hike bets could unwind NZD short and support NZD recovery.

- **External Balance Outlook:** NZ current account deficit further widened to -3.7% of GDP in 4Q from -3.6% of GDP in 3Q 2018. This was due to goods deficit widening while services surplus narrows. This is the widest current account deficit since 3Q 2013.

- Key **domestic events and issues to watch:** Mar house prices (3 Apr); Mar food prices (11 Apr); Mar mfg PMI (12 Apr); Feb net migration (12 Apr); 1Q CPI (17 Apr); Apr consumer confidence, Mar trade (26 Apr); Apr activity outlook, business confidence (30 Apr).

- **Technical Outlook:** NZD reversed early month's rally into end-month after RBNZ surprised with a dovish tilt in policy stance. Pair was last at 0.68 levels. Bearish momentum on daily chart remains intact while stochastics has fallen into near-oversold conditions. Further downward play is not ruled out but 200-DMA support at 0.6840 levels should limit downside. **Resistance at 0.6840 (21 DMA), 0.6910** (50% fibo retracement of 2018 high to low) **levels.**

JPY: Bulls Are Back In The Driver Seat

Forecast	2Q 2019	3Q 2019	4Q 2019	1Q 2020
USDJPY	108 (--)	106 (--)	107 (--)	105 (--)

No Change to Previous Forecast

- **Motivation for the FX View:** JPY has been the best performing currency against the USD in the G10 space in Mar. The JPY gained 0.6% against the USD in Mar to date, helped by the unexpected move announced by the Fed. The Fed's pivot to a prolonged pause in its rate hike has played a key role in dragging the USDJPY back towards our target level at the 110-levels for 1Q.

- A consequence of the Fed's move to keep its interest rates at current levels for a prolonged period should see USD strength fade and UST yields slip lower. The dot plots shared by the Fed showed that a rate hike is no longer in the cards in 2019 compared to two hikes previously. For 2020, the Fed is looking for just one rate hike. This move to signal that the Fed is near the end of its current tightening cycle, which suggest limited room for further Fed tightening ahead. We could thus see the unwinding of stale long USD positions against its G10 peers, pressuring the USD lower. USD weakness should lift the JPY higher.

- At the same time, the prolonged pause by the Fed on rate hike and its suggestion of no further rate hike this year should not provide any impetus for UST yields to climb aggressively higher. In the absence of further rate hikes, UST yields are likely to remain soft. Softer UST yields, particularly 10Y UST, should narrow the yield differentials between 10Y UST and 10Y JGB. This in turn provides scope for the USDJPY to slip lower.

- Most recent CFTC positioning data suggests that market is positioning for further JPY weakness ahead. This data though was released before the Fed's move to keep further rate hikes on hold for a prolonged period. In the week of 19 Mar, market had reduced their positioning for long JPY to 20081 contracts from 22144 contracts the previous week. Short JPY positions were also reduced but by a slower pace at 79302 contracts vs. 80925 contracts previously. Consequently, net long-JPY positions in the week of 19 Mar were lifted to 59221 from 58781 in the week of 12 Mar. With expectations now for no Fed rate hike in 2019 and only one hike in 2020, and exacerbated by concerns over global growth, could see stale long-USD bets being unwound. Establishment of long-JPY vs. short-USD should be put downside pressure on the USDJPY.

- Market expectations are largely for some kind of compromise between China and US. There are expectations for some kind of resolution to the Sino-US trade negotiations as Trump needs to show some policy triumph to rouse his voter base to bolster his 2020 re-election bid. Of course, a breakdown in trade talks between the two sides cannot be ruled out though this is no our base case. A breakdown in trade negotiations is likely to spur safe haven proxy FX demand and lift the JPY higher. More likely than not, safe haven demand for FX proxy plays is likely to come from concerns over global growth than the failure in talk talks between China and the US. To date, slowing PMIs globally and mixed US and European economic data suggests that growth momentum could be running out of steam. More recently, the 3m10Y UST yield curve has inverted, raising fears of an impending US recession in 12-24 months. These fears have whetted appetite for safe-haven FX proxy plays including the JPY and weigh on the USDJPY.

- As we had cautioned previously, further impetus for the USDJPY to move lower should come from the potential upside political risks and concerns over the impact of the sales tax hike in Oct that could weigh on risk appetite. Additionally, there are some concerns over the local elections in Apr 2019 (7 Apr for gubernatorial elections in 11 prefectures and 21 Apr for mayoral and municipal assembly elections) and Upper House elections scheduled in Jul 2019. Dissent expressed through local and Upper House elections could create some political instability in 2H 2019 and possibly limit the Abe cabinet from pursuing more radical measures to transform the economy. This uncertainty could in turn lead to safe-haven proxy FX demand for the JPY. Implementation of the consumption sales tax hike in Oct 2019 and its negative impact on domestic consumption and overall growth could also add downside pressure on the USDJPY in 2H 2019.

- Given the recent market developments, we maintain our forecast for the USDJPY to slide further to around 108, 106 and 107 by end-2Q, -3Q and -4Q respectively before global growth concerns weigh and push the pair lower to 105-levels by end-1Q 2020.

- **Growth and Inflation Outlook:** Final GDP print surprised to the upside after disappointing in the preliminary print. 4Q 2018 GDP rose by +1.9% annualised (+0.5% q/q) in the final estimates vs. preliminary print of +1.4% (+0.3%). The gains were partially attributed to stronger business investment that was up +11.3% annualised (+2.7% q/q) rebounding from -10.0% (-2.6%) in 3Q. In addition, strong domestic demand, which rose +3.1% annualised (+0.8%) in 4Q vs. 3Q's -1.8% (-0.5% q/q). External demand remained unfavourable to GDP growth with exports rebounding +4.0% annualised (+1.0% q/q) in 4Q vs. -5.6% (-1.4%) in 3Q that were more than offset by the +11.3% annualised (+2.7% q/q) jump in imports compared to 3Q's -2.6% (-0.7%). For the full-year, the economy expanded by 0.8% in 2018, a slowdown from 2017's 1.9%.

- We do not expect the economy to slip into another recession in 2019, though growth could remain lackluster given economic uncertainties and the looming consumption sales tax hike in Oct. Still, the government's record budget of JPY101tn for FY2019 could prove to be supportive of the economy, while preparation works in the run-up to the 2020 Olympics in Tokyo is expected to also bolster economic growth in 2019. The BOJ's baseline assessment is for the economy to "expand(ing) moderately", growing by up to 0.9% in FY2019 and by 1.0% for FY2020.

- Feb headline inflation rose at the same pace as in Jan at 0.2% y/y. This was slightly lower than market expectations of 0.3%. The softer inflation print was due to still soft food prices and transport cost. Core inflation (headline inflation less fresh food - the key inflation gauge for the BOJ) and core-core inflation (headline inflation less fresh food and energy) also did not gain much traction. Core and core-core inflation rose by 0.7% and 0.4% y/y respectively in Feb vs. +0.8% and +0.4% in Jan. Feb consumer prices showed that inflation have failed to gain traction and remains a distance from the central bank's 2% inflation target. This supports the BOJ's view for the need to persist with its ultra-loose monetary policy until its 2% inflation target is achieved and could be supportive of the USDJPY. The BOJ left its inflation outlook unchanged at 1.1% for FY2019 and 1.5% for FY2020.

- **Monetary Policy Forecast:** The BOJ maintained its current policy stance at its policy meeting on 14-15 Mar. Its yield curve control policy and asset purchases programme were left intact with the policy balance rate maintained at -0.1%, the 10-year JGB yield target at around zero percent, and asset purchase target of JPY80tn. It also kept its forward guidance unchanged, reiterating that it "intends to maintain the current extremely low levels of short- and long-term interest rates for an extended period of time". Though its policy stance was left on hold, the BOJ downgraded its overall view of the economy, citing weakness in exports and manufacturing from a slowdown in overseas economies. Nevertheless, the BOJ maintains its baseline view that the economy is expanding moderately. Governor Kuroda reiterated during his press conference briefing that the BOJ does not see the need for any changes to its price target despite the criticism from Finance Minister Aso on the focus on the 2% inflation target. He also highlighted that domestic negative rates are helping to bolster monetary easing.

- **Latest Fiscal and External Balance Outlook:** The Upper House has approved the government's JPY101.5tn budget for fiscal year 2019 starting 1 Apr. This record budget included extra spending and measures to consumers to offset the impact of the sales tax that is to be implemented in Oct. Importantly, this will lead to a budget deficit of JPY9.2tn in FY 2019. The government is targeting a primary surplus by FY 2027. Note that the budget has already received the approval other Lower House.

- The current account (CA) surplus widened slightly to JPY0.60tn in Jan from Dec's surplus of JPY0.45tn. The surplus can be attributed to the larger surplus in the primary income account of JPY1.76tn that more than offset the deficit in the goods & services account of JPY1.12tn (due to the deficit in the goods account). The deficit in the financial account ballooned to JPY2.71tn in Jan from JPY0.19tn in Dec on the back of a wider direct investment of JPY7.11tn out of Japan (vs. Dec's -JPY1.01tn) that more than offset portfolio investment, financial derivative and "other" investment inflows (totaling JPY4.8tn).

Consequently, the overall balance of payments (BoP) registered a deficit of JPY2.1tn, a reversal of the JPY0.26tn surplus seen in Dec.

- **Key domestic events and issues to watch:** Eyed in Apr will be Tankan survey results for 1Q that could provide clues on business sentiments and investment plans. BOJ meets on 25 Apr to decide on monetary policy and will release its Outlook Report at the same time. We also have BOJ Governor Kuroda and Deputy Governor Wakatabe speaking on 10 and 15 Apr respectively. Politically, 7 Apr will see gubernatorial elections in 11 prefectures and 21 Apr for mayoral and municipal assembly elections. JGB auctions in Apr: 10-year (2 Apr), 30-year (4 Apr), 5-year (9 Apr), 1-year (18 Apr) and 20-year (16 Apr).

- **Technical Outlook:** Early month's gains in USDJPY were retraced into month-end. Pair was last seen at 110.60 levels. Bias remains to sell on rallies, targeting a move towards 109.70, 109.50 levels. Resistance at 111 (21, 100 DMAs) before 111.50 (500 DMA).

RMB: What Will Be in the Currency Pact?

Forecast	2Q 2019	3Q 2019	4Q 2019	1Q 2020
USDCNY	6.70 (--)	6.65 (--)	6.70 (--)	6.68 (--)
USDCNH	6.70 (--)	6.65 (--)	6.70 (--)	6.68 (--)

No Change to Previous Forecast

- **Motivation for the FX View:** USDCNY swiveled around 6.70 for most part of Mar, totally in sync with our view when we had looked for gains in the RMB to slow. Insofar, there is supposed to be another round of trade talks between the US and China in Beijing 28-29 Mar before Vice Premier travels to the US next week. The dialogue continues. While markets are watchful for developments and Trump is cheering for progress ("excellent" deal). CNY is rather affected by a few factors – We have recently done a study and found that USDCNH is rather closely correlated with copper prices and that copper price could be a proxy to track its activity, especially its new initiatives like electric car production and super grid infrastructure. That could give us a clue on whether China's domestic activity is improving and so far, the copper prices have not exhibited much bullishness.

- The NPC and CPPCC ended with a few priorities outlined that include ensuring hiring momentum and opening up of capital account and access for foreign investors. This is achieved through the following measures - a 3% VAT cut for manufacturing companies, 1% for transport and construction sectors, special bond issuance quota for local government was increased to CNY1.35trn last year. More RRR cuts are expected for small and medium enterprises.

- Since China has started to launch broad and targeted RRR cuts as well as the targeted MLF, the improvement in data has been gradual and modest. Retail sales worsened in its latest print of 8.2%y/y vs. previous 9.0%. Services PMI also came off rather significantly to 51.1 vs. previous 53.6, indicating that consumer sentiment is still cautious, possibly crimped by the impacts of trade war and reduced profit margins in the manufacturing sector. However, there are some signs of improvement in the data basket - namely fixed asset investment (ex-rural) where we see a pick up. Break down suggests that FAI (ex-rural) has bounced off lows in the real estate sector and even showed some stabilization in the manufacturing sector. Premier Li has also called for a quick implementation of the VAT rate cut so that the real economy can benefit from the tax plan. That could translate into better profit margin and hiring and household spending. We anticipate more evidence of these to show up gradually in second half of this year.

- Into the next quarter, the trade talks are still in focus. As we had written in the section on the Australian dollar, what is in the price is probably not the removal of the existing tariff that the US has for China. Trump has recently made known that the existing tariffs could be retained until they are sure that China can comply with any trade deal. USDCNH moved up in reaction to his comments but magnitude of the reaction was mild. We think that the market has priced in a rather conservative scenario of a basic agreement which could include a pledge not to add more tariffs on China's imports and to continue the current dialogue in exchange for intellectual property protection, some promised purchase of energy and agriculture goods from the US. China's position seems to be vying for a little more than that - that the US removes the tariffs on China. So China is unlikely to accept a deal without the removal of existing tariff and that is not within the market expectation. With the USD still relatively supported broadly, the risks are still tilted to the downside for the USDCNH. Given that market expectations are rather conservative and our view is rather optimistic, USDCNH could still head lower towards the 6.60-figure in case a deal is cut. Insofar, a Trump-Xi summit is supposed to take place in Apr although no date is set. That could also mean that the deal should be done within the next two months.

- Recently, there is a lot more mention of a currency pact that could be imbued in the upcoming Memorandum of Understanding between the US and China. US Secretary Treasurer Mnuchin mentioned last Fri (22 Mar) that "the currency pact" could be the strongest ever whilst still not providing further details. According to sources quoted by Bloomberg, the US had requested for China to maintain its currency so that China would not be able to gain export competitiveness by devaluing its currency as a counter to tariffs from the US. This idea of keeping the yuan stable was floated earlier in Feb. We think it is unlikely for the yuan to be managed at certain levels against the USD. That can have undesirable effects on its inflation and monetary policy. The more logical and enforceable agreement is on no competitive devaluation. That would be easier for both sides to monitor and enforce and does not really require much action on China's part (aka maintaining status quo). However, that does not mean that the US will not accuse China of currency manipulation the next time yuan weakens and use that as a pretext to slap on more tariffs. A large part of the almost 12% depreciation in the CNY against the USD in 2018 was market driven and intervention by the central bank was mostly to slow its decline but the US officials still accused China of currency manipulation then. That is why we still prefer the scenario of a RMB float. The 12M forward points for USDCNH have been creeping higher as USDCNH retraced higher from its recent lows but at 252pips, it is still way lower than historical average which is around 1000pips. In addition, USD positioning from CFTC is still rather elevated, although reduced from last year. The elevated net long USD position still suggests that the greenback is vulnerable for further unwinding in an environment where the US growth continues to slow and there are increasing speculation for US to cut. That reinforces our view that the USD and US rate environment is benign and thus ideal for China to force a regime change to a RMB float at this point. In addition, the level of FX reserves is still high at this point to combat any market volatility that is triggered from such an event but that amount should be less this year compared to floating the RMB when the Fed was on a more aggressive phase of its tightening cycle. As such, the window for the next step of RMB internationalization is here.

- Beyond the 1Q, we look for USDCNY to head gradually lower in a softer USD environment whilst the current account balance stands at risk of deterioration due to a trade agreement for China to make a substantial purchase of American goods.

- **Growth and inflation outlook:** China's exports tumbled in Feb down -16.6%y/y vs. previous 13.9% while imports slipped -0.3%y/y. The trade balance shrunk to just CNY34.5bn vs. CNY271.2bn previously. Averaging the trade performance for the past two months, exports growth worsened to -1.3%y/y from almost a flat growth in Dec while imports improved marginally to 1.20%y/y from -3.1% in Dec. Details reveal that the trade surplus with the US has been coming off from U$27.3bn in Jan to U$14.7bn. Exports to and imports from the US contracted -15.7%y/y and 33.6% respectively. So while trade balance has improved in the favour of the US, the US also lost a significant export earnings. We see this as an additional impetus for US to come to a trade deal with China, even if Trump is satisfied with the improvement in the trade balance.

- Latest available data show a weaker print for PMI-mfg at 49.2 for Feb vs. previous 49.5 with new export order significantly lower at 45.2 vs. the previous 46.9. However, new order actually expected to expand, at a 50.6 print vs. previous 49.6. This contrasts to the 45.2 print for new export orders for Feb, a further deterioration from previous 46.9. While this could still be an early sign that domestic demand in China could stabilize even as the rest of the world slows. Breakdown of the fixed asset investment for China also suggests some improvement for real estate and stabilization in manufacturing that is positive for the AUD. These are the probably nascent signs of stabilization that we have been looking for in the growth momentum of China as policymakers bolstered consumption and investment.

- Inflation continued to remain on the downtrend with CPI at 1.5%y/y for Feb vs. 1.7% in Jan. PPI came in almost flat at 0.1%y/y steady form the previous month. The swine flu did not seem to have an impact as food inflation drifted lower in Feb. PPI was almost flat for Feb and this followed by the release of the industrial profit which shrank -14.0%y/y for the first two months of the year. Manufacturing sector profits fell -15.7%y/y for Feb. The fall in producer price had indicated that profit margins are squeezed. That said, the upcoming policy measures like the VAT cuts that Premier Li had so urgently asked to be implemented are likely to alleviate some pressure on manufacturers.

- **Monetary Policy Forecast:** There were a few mentions of the monetary policy at the NPC including some explicit mentions of more targeted RRR cuts for small and medium enterprises. Premier Li also urged to "improve the formation mechanism" of the RMB exchange rate and keep currency basically stable at reasonable levels. The NDRC also said that China will increase the yuan exchange rate flexibility, strengthen regulations on cross-border capital flows in 2019 and keep the equity, bond and currency market stable. We have to take these comments in the context that there is still a major and hurried trade negotiation happening in the backdrop between the US and China. Premier Li has reiterated that China's economic growth faces downside pressure and these targeted stimulus (which will remain targeted, as opposed to 2009 flood-style) are meant to bolster domestic demand in view of these risks. The phrase of "keeping currency basically stable" is not new and gels with what the US is rumored to request for in a supposed FX pact and seems to suggest that the agreement on FX may not require China to make a drastic change to its forex policy.

- Another 50bps RRR cut for small and targeted firms could happen in Apr should PMI-mfg for small and medium enterprises continue to deteriorate. The Feb print for the manufacturing PMI for medium and small enterprises came in at 46.9 and 45.3 respectively. Mar typically shows an improvement from Feb and should they disappoint, we anticipate more targeted MLF to be released as well as RRR cuts for these firms. We also continue to hold our view that a broad interest rate cut would be meaningless as monetary policy is now targeted at aiding credit access for small and medium enterprises. The targeted MLF is a new lending facility that is meant for banks that lend to SMEs.

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

- Insofar, personal income tax deductions were announced, personal income tax thresholds were also raised with new tax brackets, import tariffs on industrial and consumption goods and tax cuts for R&D spending.

- China announced a U$29bn annual tax cuts for SMEs for the next three years. A 3% VAT cut (16% to 13%) for manufacturing companies. A 1% VAT cut (10% to 9%) for transport and construction sectors

- China to increase its defense expenditure by 7.5% to CNY1.19trn, a slower increase compared to 8.1% in 2018.

- Infrastructure spending is encouraged. The government issued CNY1.35trn worth of special bonds meant to finance local government infrastructure projects and this is expanded to CNY2.15trn this year.

- **Key domestic events and issues to watch:** PMI-mfg for Mar is due on 31st Mar (NBS); Caixin PMI (Mar) on 1st Apr; foreign reserves due 7th; aggregate financing and new yuan loans on 10-15th; CPI and PPI are due on 11th; trade data on the 12th; new home prices on 16th; 1Q GDP, Mar urban FAI, industrial production and retail sales, Jan-Mar property investment due on 17th; FX Net settlement on 18th; industrial profits on 27th;

- **Technical Analyst:** USDCNH turned higher towards our 6.75 forecast towards the end of Mar. Last seen around 6.7250, the weekly chart indicates some upside bias in the coming weeks though resistance is still seen around 6.8050. Moving averages are moving into a bearish set up. Resistance at 6.7320 before the next at 6.80. Support at 6.67 before 6.61.

KRW: Still Keeping the Cautious Optimism

Forecast	2Q 2019	3Q 2019	4Q 2019	1Q 2020
USDKRW	1100 (--)	1105 (--)	1120 (--)	1130 (--)

No Change to Previous Forecasts

- **Motivations for the FX View:** Near term market bias for USDKRW remains skewed to the upside amid growing concerns of slowing global growth, exports decline and down-cycle in global semiconductor market weighing on Korean corporate profits and Korea asset prices. However slowing growth momentum does not always necessitate a serious slump and some of this global growth concerns may be overblown. There are some early signs of stabilisation with activity data in China, Europe picking up while policymakers are responding fairly quick with fiscal support (in the case of China VAT, income tax cuts and potential supplementary budget for Korea). Central banks across most DM and EM are also putting rate normalisation plans on hold (such as Fed and ECB), with some pledging extra liquidity support such as potential RRR cuts in China, ECB with TLTRO, etc. We believe these measures could be timely to cushion against any hard landing and when growth concerns proved to be blown out of proportion, some of this USDKRW upside pressure will fade. Key resistance at 1145, 1152 levels.

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

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

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

- **For 2019 inflation outlook, BoK revised projection lower to 1.4% y/y** (down from 1.7% in 2018) owing to decline in oil prices.

- Meanwhile headline inflation **continued to slow to 0.5% y/y in Feb,** down from 0.8% in Jan owing to decline in oil and food prices. Healthcare cost also weighed on inflation owing to government-administered prices on goods and services related to social welfare. Core CPI, on the other hand, rose 1.3% y/y, up from 1.2% in Jan.

- **Monetary Policy Forecast**: There is no MPC meeting scheduled for Mar. We **expect BoK to keep policy rate unchanged at 1.75% at the upcoming MPC meeting on 18 Apr**. Slowing pace of inflation, downside risks to global/domestic growth amid semiconductor down-cycle underway are some of the factors supporting the case for BoK to stay on hold. Pause in Fed tightening cycle also takes the pressure off BoK in tightening to prevent US-KR rate differentials from widening (fear of capital outflow).

- At the last MPC meeting on 28th Feb, BoK MPC voted unanimously to keep policy rate unchanged at 1.75%. Governor Lee again ruled out the option of a rate cut, maintaining that Korean monetary conditions are "accommodative" and they are lower compared to other markets.

He added that exports have been falling in value terms owing to falling prices for semiconductors but volume of shipment has actually sustained a small increase.

- **External Balance Outlook:** Current account surplus narrowed further to 9-month low of $2.77bn in Jan (down from $4.82bn in Jan). The decline was due to slowing exports as demand for Korea-made semiconductors fell. Meanwhile services account balance posted its largest deficit in 12 months.
- **Key domestic events and issues to watch:** S. Korea releases Mar exports, Mfg PMI (1 Apr); CPI (2 Apr); Mar FX reserves (3 Apr); Feb current account (4 Apr); Mar unemployment rate (10 Apr); BoK MPC meeting (18 Apr); Mar PPI (19 Apr); 1Q GDP (25 Apr); Apr consumer confidence (26 Apr); Mar Industrial production (30 Apr).
- **Technical Outlook:** USDKRW drifted higher for the month of Mar. Last seen at 1135 levels. Momentum indicators are still not showing a clear bias. Price action since Jun-2018 continues to show a holding pattern in the range of 1110 – 1140. We are biased to sell rallies. Immediate resistance at 1140, 1145 (2018 high). Support at 1123 (23.6% fibo retracement of 2018 low to high, 50, 100, 200 DMAs). Break-out play could happen in due course as a compression of moving averages (50, 100, 200 DMAs) is seen around 1123 – 1126 levels. This typically precedes a break-out trade, which could happen either side.

SGD: MAS Unlikely To Surprise

Forecast	2Q 2019	3Q 2019	4Q 2019	1Q 2020
USDSGD	1.3400 (--)	1.3300 (--)	1.3500 (--)	1.3600 (--)

No Change to Previous Forecast

- **Motivation for the FX View:** The SGD's run higher appears to have extended into Mar. The SGD is among the best performing currencies against the USD in Mar-to-date, having gained about 0.15% compared to its regional peers who had slipped against the USD. The prolong Fed pause in rate hike was key to the SGD's outperformance so far, allowing the pair to hover around the 1.35-figure at the point of writing.
- Fading USD strength as a consequence of the Fed's pivot to a prolonged pause in rate hike should keep pressure on the USDSGD on the downside. The recent dot plots by the Fed suggest that a rate hike is no longer in the works in 2019 (two hikes were previously pencilled in). For 2020, the Fed is looking for just one rate hike. The latest move by the Fed appears to signal that the end is near for its tightening cycle and there is limited room for further Fed tightening ahead. We could see the unwinding of stale long USD positions against

its G10 peers and selected AxJs, including the SGD. A softer USD could lift the AxJs including the SGD higher.

- Similarly, the moves by China to support its economy and the potential for even further cuts to the RRR should ensure a soft-landing for the Chinese economy. The successful conclusion of the Sino-US trade negotiations would also put a healthy spin on the Chinese economy. This should bolster risk appetite and see increased demand for EM Asia risk assets and hence, EM Asia currencies, including the SGD.

- The slippage in the USDCNH 12-month forward suggests risks to the USDCNH are to the downside in 12-month ahead. There could thus be less depreciation pressure on the CNH ahead. Given that the USDSGD tracks the USDCNH 12-month forward closely, this suggests that upside pressure on the USDSGD are also limited. Our regression analysis confirms this close correlation between the USDSGD to the USDCNH. Our results showed that the SGD is among the most sensitive to moves in the CNH with a sensitivity of 0.60%. Thus, as concerns over China (trade war, hard-landing etc.) moderate, the SGD should be among the currencies to benefit.

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

- While previously the SGD had been kept buoyant by some market expectation for further tightening by the MAS at its Apr meeting, such expectations have faded. **Our house view is for the MAS to remain on hold on policy after tightening moves at its Apr and Oct meetings last year. We expect the MAS to persist with its current slightly appreciation bias given that growth is expected to moderate and inflation to remain muted this year.** The lack of significant pressure on inflation, particularly core inflation, suggests that there is little pressure for the MAS to be more aggressive on monetary policy. In addition, with energy prices expected to stay relatively soft compared to 2018, core inflation might not see any significant upside and this could lead to some unwinding of long-SGD bets vs. short-USD, keeping the USDSGD supported in Apr.

- The two moves in Apr and Oct 2018 saw the MAS steepen the slope of the policy band of the SGD NEER to around 1% (our house estimates) from zero percent prior to accommodate expected stronger inflationary pressures. This has allowed the SGD NEER to trade around 1.11% above the implied mid-point of 1.3707 at the point of writing. This suggests that the SGD NEER trades on the stronger side vs. its trading partners. Aside from the end of the Fed's tightening cycle, the peaking of the US economy and US twin deficits (that could see a surge in US borrowing) – all of which could lead to softer UST yields and USD - are likely to keep the USDSGD on a downward trajectory into 2Q and 3Q. However, this could change with the SGD NEER expected to slide lower below the mid-point by end-2019 as global growth concerns intensify in 4Q. This could trigger a global risk-off and providing the USD with some support. This in turn could lift the USDSGD higher in the quarter.

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

- **Growth and Inflation Outlook:** After contracting in Jan, industrial production (IP) and NODX rebound to rise by +0.7% and +4.9% y/y in Feb (Jan: -0.4% and -10.0%) respectively. The bounce in Feb IP was due to the volatile pharmaceutical sector (up +18%) while electronics remained on the downtrend (Feb: -1.1% vs. Jan: -4.0%). The NODX recovery was attributable to the still healthy pharmaceutical shipment (+12.0%) and non-monetary gold exports (+258%) that offset the persistent decline in electronics exports (-8.0%). Manufacturing and NODX growth could be a tale of two halves this year. The average for the first two months (+0.1% and -3.4% respectively) suggests a manufacturing and NODX downturn in 1H 2019 as Sino-US trade concerns and faltering demand for electronics weigh. A more sanguine 2H is likely, should a Sino-US trade deal be reached as we expect that could lift both manufacturing and exports. Still, the team believes risks to GDP is to the downside and maintains its GDP forecast at +1.8% in 2019 and 2020 forecast of +2.1%. The team's forecast for 2019 is at the lower end of MTI's 1.5-2.5% forecast range.

- Headline inflation picked up slightly in Feb, rising +0.5% vs. +0.4% in Jan on the back of smaller drops in private road transport and accommodation costs. Core inflation – headline inflation less costs of accommodation and private road transport - moderated to +1.5% y/y in Feb from +1.7% in Jan, reflecting lower services inflation, slower increases in retail prices and easing electricity & gas prices. This is below the MAS' core inflation forecast of 1.5-2.5%. Our economic team expects core inflation to edge lower in 2019 underpinned by the extension of the Open Electricity Market that should lower utility costs further. The team has cut its core inflation forecast to +1.4% for 2019 consequently (from +1.6% previously). The team though maintained its headline inflation forecast at +1.2%. The team also expects the MAS to lower its core inflation forecast range to 1-2% (from 1.5-2.5%) in the coming months.

- **Monetary Policy Forecast**: The MAS had tightened monetary policy at both of its semi-annual policy meeting last year. The MAS moves in 2018 steepened the slope of the SGD NEER policy band by 1.0% in total (our assumption given the absence of information from the MAS). This should allow for a stronger SGD on a trade-weighted basis to mitigate the expected climb in core inflation in 2019 and anchor inflationary expectations. MAS had revised its headline inflation forecast lower but maintain its core inflation forecast range at 1.5-

2.5% for 2019, suggesting that it sees upside risks to core inflation this year. However, our economic team believes that the MAS will likely lower its core inflation forecast range to 1-2% from 1.5-2.5% in the coming. In this scenario then, further tightening moves by the MAS will be unlikely. Further steepening of the policy slope is not our base case. Our view remains for the MAS to stand pat on policy at its Apr 2019 meeting after the two tightening moves at its Apr and Oct meetings last year. The MAS is likely to maintain its current slightly appreciation bias.

- The USDSGD trades around the 1.35-figure at the point of writing, off its 2019 high of 1.3680 on 3 Jan. Weighing on the pair was the unexpected Fed prolonged pause on further rate hike announced on 21 Mar. The USDSGD slow grind higher has kept domestic interest rates elevated. The 3-month SOR (3MSOR) had hit a 10-year high of 2.0253% on 23 Jan that remains unmatched in the year so far. The 3-month SIBOR (3MSIBOR) climbed to 1.9528% on 28 Feb - a new high for 2019 as domestic liquidity continues to tighten. For now, there does not appear to be any signs that increases in the 3-month SOR and 3-month SIBOR will stall as the withdrawal of monetary stimulus in the advanced economies continues, albeit at a slower pace. We are now gradually seeing mortgage rates climb in tandem to the rise in domestic rates. Deposit rates (for 12-month fixed) is edging higher, last seen at 0.48% since end-Feb 2019. This suggests that risks related to interest rate increases affecting financial and economic stability, particularly in interest rate- and property-related sectors, are picking up. We expect the 3MSIBOR and 3MSOR to edge higher to 2.11% and 1.99% respectively by end-4Q 2019. For 1Q 2019, we are penciling the 3MSIBOR and 3MSOR to come in at 1.92% and 1.80% respectively.

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

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

- **Key domestic events and issues to watch:** Focus in Apr will be on MAS semi-annual policy meeting expected something around 12 Apr. Advanced estimates for 1Q 2019 GDP will also be released around the same time.
- **Technical Outlook:** USDSGD traded lower this month but trading range remains confined to a well-defined 1.3440 – 1.3620 range. Continue to trade this range, with bias to lean against strength.

MYR: Continue to See Mild Gain as Global Risk Assets See Boost from US Pause

Forecast	2Q 2019	3Q 2019	4Q 2019	1Q 2020
USDMYR	4.0000 (--)	3.9800 (--)	4.0600 (--)	4.0700 (--)

No Change to Previous Forecast

- **Motivation for the FX View:** The MYR reached a low of 4.0955 on 8 Mar on the back of a few factors including the release of disappointing Chinese industrial production data. MYR potentially remains supported by Brent crude oil price moving higher to above $65/bbl. At the same time, crude palm oil prices which continue to fall albeit smaller by around 2.4% in Mar is expected to see a turnaround, potentially contributing to the MYR support.
- We maintain our view for MYR appreciation vis-à-vis the dollar, consistent with our USD weakness view in 1H 2019 and for the medium term. Over the next 3-6 months or so we expect USD/MYR could potentially approach 4.00 and potentially breach in 3Q, if regional currencies strengthen relative to the USD and risk factors dissipate. With the recent dollar softness, it is inevitable that market participants may take a step back on their positive views on economically sensitive assets across global equities, EM rates and FX, and commodities, although this mostly reflects less attractive valuations following the strong rally of the past three months. Fundamentally, we think the picture for risk assets including EM FX such as MYR remains quite bright in an environment of gradually stronger global growth and easy monetary policy, provided markets and policymakers manage to navigate near-term risk events such as Brexit and US-China trade.
- Overall though, domestic policy uncertainty risk may still somewhat weigh on the MYR despite somewhat fundamentals. Recent market concerns about the revised higher budget deficit and concerns about its impact on the bond market and concerns about potential ratings outlook revisions could play a part in weighing on the MYR. Recent BNM downward revision in GDP growth forecast on the back of slower domestic demand and sluggish external demand as well as expectations of a BNM rate cut could in part in the short term weigh on MYR but on a relative basis with the USD, US-MY real rate

differentials still remain somewhat supportive for MYR in the context of a Fed pause environment for EM assets.

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

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

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

- External reserves increased for a second month in a row by +USD0.3b to USD102.4b at end-Feb 2019 (end-Jan 2019: USD+0.7b to USD102.1b) on capital and traded-related inflows. Latest figure covers 7.4 months of retained imports, 1.0x total short-term external debt and above the estimated minimum required reserves of USD96.9b under IMF's Assessing Reserve Adequacy (ARA) framework.

- There was +MYR3.7b net foreign buying of Malaysian equities and bonds in Feb 2019 (Jan 2019: -MYR1.3b) after three straight months of net selling. The key driver was the +MYR4.5b net foreign buying of Malaysian bonds (Jan 2019: -MYR2.3b), also reversing three consecutive months of net selling, largely on net foreign buying of Malaysian Government Securities (MGS – Feb 2019: +MYR4.9b; Jan 2019: -MYR1.7b) and Government Investment Issues (GII - Feb 2019: +MYR0.8b; Jan 2019: +MYR0.7b). In Jan-Feb 2019, there was net foreign buy of +MYR2.2b Malaysian bonds (2018: –MYR21.8b).

- Foreign investors net sold –MYR0.8b Malaysian equities last month, reversing the +MYR1.0b net buy in Jan 2019, due to a combination of MSCI quarterly index review that saw Malaysia's weighting on the MSCI Asia ex-Japan index trimmed by 2bps to 2.7%; lackluster 4Q 2018 results season amid the -15% YoY and -5% QoQ drop in core net profit of MKE Equity Research universe; as well as the lack of fresh lead or catalyst on domestic front.

- YTD, foreign net buying of Malaysian equities and bonds totaled +MYR2.4b (2018: -MYR33.7b), driven by net buys in both bonds (Jan-Feb 2019: +MYR2.2b; 2018: -MYR21.8b) and equities (Jan-Feb 2019: +MYR0.2b; 2018: -MYR11.9b).

- Trade-related flows remains positive amid the sustained trade surplus, which in Jan 2019 rose +19.2% YoY to +MYR11.5b (+USD2.8b). To recap, since Dec 2016 when BNM re-imposed the export earnings repatriation requirement up to Dec 2018, the net export earnings repatriated totaled USD14b, equivalent to 25.5% of trade surplus. We expect this year's trade surplus to be at +MYR127.7b or around +USD31.5b (2018: +MYR120.3b/+USD29.9b).

- In addition, other capital flows should also be supportive of external reserves, at least in the near term. In particular, there will be inflows from the proceeds of Government of Malaysia's JPY200b (~USD1.8b) Samurai bond. The book-building process of the Samurai bond closes on 8 Mar 2019 and the issue date is 15 Mar 2019.

- BNM's net FX shorts positions fell for the third consecutive month in Jan 2019 by –USD1.7b to USD19.3b (Dec 2018: USD20.9b) from the high of USD22.8b in Oct 2018 as rise in external reserves allowed BNM to pare down its net FX shorts positions.

- **Growth and Inflation Outlook:** Key takeaway from BNM's Annual Report 2018 is the downward revision in official 2019 real GDP growth forecast to 4.3%-4.8% from 4.9% previously (2018: 4.7%). We also trimmed our 2019 real GDP growth forecast to 4.7% from 4.9% previously, and expect BNM's OPR to be cut by -25bpsto 3.00% vs no change at 3.25% previously.

- Following the release of BNM Annual Report 2018, the official real GDP growth forecast for 2019 is lowered to a range of 4.3%-4.8% from 4.9% in the Ministry of Finance's Economic Report 2018/2019 released together with the tabling of Budget 2019 back in Nov 2018.

- BNM lowered domestic demand growth forecast (2019E: 4.4% v s4.8% previously; 2018: 5.6%) reflecting across-the-board cuts in private consumption (2019E: 6.6% vs 6.8% previously; 2018: 8.1%), private investment (2019E: 4.9% vs 5.0% previously; 2018: 4.5%), public consumption (2019E: 1.2% vs 1.8% previously; 2018: 3.3%) and public investment (2019E: -7.1% vs -5.4% previously; 2018: -5.2%).

- Net external demand is expected to be muted (2019E: 0.1% vs 0.7% previously; 2018: 13.4%) following the downward revisions in exportsof goods and services (2019E: 0.1% vs 1.6% previously; 2018: 1.5%) and imports of goods and services (2019E: 0.0% vs 1.8% previously; 2018: 0.1%).

- The official 2019 growth forecast range of 4.3%-4.8% signifies risks to growth are tilted to the downside due to external and domestic factors e.g. unresolved US-China trade tension could lead to slower-than-expected global growth impacting Malaysia through trade and investment channel; policy uncertainties such as the direction of US monetary policy which could heighten volatility in financial markets, currencies and capital flows; commodity price volatility and recurrence of commodity supply disruptions affecting commodity output and exports; oversupply in property market dampening construction activities.

- We also cut our 2019 real GDP growth forecast to 4.7% from 4.9% previously, mainly reflecting lower growth forecast for domestic demand (2019E: 4.7% vs4.8% previously) as we trimmed forecasts for public consumption (2019E: 1.5% vs 2.0% previously) as well as gross fixed capital formation (2019E: 2.1% vs 2.5% previously) that reflects downward revisions in both private investment (2019E: 5.0% vs 5.3% previously) and public investment (2019E: -4.8% vs -4.5% previously). No change in our consumer spending growth forecast (2019E: 6.5%). We also maintain projection for net external demand (2019: 6.6%) for now pending clarity on US-China trade situation.

- Given the downside risk facing 2019 growth, plus the outlook of benign inflation as the official inflation rate forecast is lowered to 0.7%-1.7% from 2.5%-3.5% previously - in line with our projection of 1.5% (2018: 1.0%) - we now expect BNM's Overnight Policy Rate (OPR) to be cut this year by -25bps to 3.00% vs no change at 3.25% previously.

- Exports and imports in Jan 2019 grew +3.1% YoY (Dec 2018: +5.1% YoY) and +1.0% YoY (Dec 2018: +1.0% YoY) and rebounded +2.2% MoM and +1.4% MoM ahead of Lunar New Year holidays in Feb 2019 after the backto-back declines in Nov-Dec 2018. Maintain our 2019 forecasts of slower exports and imports growth of +4.0% (2018: +6.8%) and +3.7% (2018: +4.9%) due to disruption from last year's escalation in US-China trade war amid hope for US-China trade deal by late-Mar 2019.

- Industrial production growth in Jan 2019 grew by +3.2% YoY (Dec 2018: +3.4% YoY), supported by continued - albeit slightly slower - expansion in manufacturing (Jan 2019: +4.2% YoY; Dec 2018: +4.4% YoY) and pick up in electricity (Jan 2019: +7.8% YoY; Dec 2018: +2.7% YoY) despite the dip in mining (Jan 2019: -0.9% YoY; Dec 2018: +1.0% YoY).

- Data suggest continued momentum of a gradual deceleration in real private consumption growth in early-2019 from +8.5% YoY recorded in 4Q 2018 (3Q 2018: +9.0% YoY). We are currently forecasting +6.5% growth in real private consumption this year after the consumption tax holiday-driven +8.1% growth last year.

- The positives for consumer spending include the outlook of continued benign inflation and stable job market conditions. CPI fell -0.7% YoY in Jan 2019 (Dec 2018: +0.2% YoY) mainly on transport costs drop (Jan 2019: -7.8% YoY; Dec 2018: -2.0% YoY. we expect monthly inflation rate to stay slightly negative in 1Q 2019 and zero-bound in 2Q 2019 before gradually picking up in 2H 2019 to average +1.5% full year (2018: +1.0%). Unemployment rate in Jan 2019 held at 3.3% for the fifth month in a row and has been in the 3.3%-3.4% range since Aug 2017.

- However, supporting our outlook of slower consumer spending growth, banking system's household loans applications fell for the third straight month in Jan 2019 by -3.5% YoY (Dec 2018: -0.7% YoY) amid sluggish household loans approvals (Jan 2019: -1.5% YoY; Dec 2018: +0.6% YoY). In addition, Department of Statistics' Business Tendency Survey showed the diffusion index (difference between % of surveyed firms that are optimistic and pessimistic) on retails trade industry's business confidence and business situation expectations for 1Q 2019 deteriorated to -19.4% (4Q 2018: +2.5%) and -16.6% (4Q 2018: +11.1%), indicating more companies are "pessimistic" than "optimistic" about the current quarter.

- Inflation rate fell for the second month in Feb 2019 by -0.4% YoY (Jan 2019: -0.7% YoY) mainly on transport cost decline. Maintain our full-year +1.5% inflation rate forecast (2019 YTD: -0.5% YoY; 2018: +1.0%) on return of positive monthly inflation rates by mid-2019 on factors such as the broader Sales and Services Taxes coverage, imposition of Sugar Tax and Airport Departure Levy, minimum wage and utility hikes, and impact of firmer global crude oil prices on domestic retail fuel prices.
- No change to our 2019 inflation forecast. Headline inflation declined by -0.4% YoY in Feb 2019 (Jan 2019: -0.7% YoY; 2019 YTD: -0.5% YoY) mainly due to the continued drop in transport costs as global crude oil price - thus retail fuel prices – fell YoY.
- However, core CPI stayed positive at +0.3% YoY (Jan 2019: +0.2% YoY; 2019 YTD: +0.2% YoY; 2018: +0.8%) as food and non-alcoholic beverages; housing, water, electricity, gas and other fuels; education; and restaurants & hotels continued to increase YoY.
- We expect the return of positive % YoY monthly inflation rate by mid 2019 to result in benign full-year headline inflation of +1.5% (2018: +1.0%), reflecting factors such as the broadening of Sales Tax and Service Tax (SST) coverage, Budget 2019's new tax/levy (Sugar Tax, Airport Departure Levy), hikes in minimum wage and utility costs, and the impact of firmer global crude oil prices on domestic retail fuel prices.
- **Monetary Policy Forecast:** We now forecast a -25bps cut in BNM's Overnight Policy Rate (OPR) this year to 3.00% vs no change at 3.25% previously. The move – which could happen as soon as at the next BNM Monetary Policy Committee (MPC) meeting on 6-7May 2019 - is to support domestic demand growth as well as shoring up consumer and business sentiment/confidence. This is in view of the downside risks facing the revised 2019 official and in-house real GDP growth forecasts. In addition, the inflation outlook is benign as the official inflation rate forecast is lowered to 0.7%-1.7% from 2.5%-3.5% previously, in line with our projection of 1.5% (2018: 1.0%).
- BNM kept the Overnight Policy Rate (OPR) at 3.25% at the Monetary Policy Committee (MPC) meeting on 4-5 Mar 2019, unchanged for the seventh consecutive meeting after the +25bps hike back in Jan 2018. No change in our baseline view of OPR staying at 3.25% this year, but the monetary policy bias is "dovish" due to downside risk to the outlook of sustained growth amid the benign inflation outlook.

- Risks to growth remain tilted to the downside, mainly due to unresolved trade tensions. And there is a "dovish" tweak in the latest MPS' conclusion i.e. while BNM maintained that the current OPR level is consistent with intended policy stance, it added that the MPC recognizes the downside risks in the economic and financial environment in assessing the outlook for domestic growth and inflation.

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

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

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

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

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

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

- **Key domestic events and issues to watch:** FX reserves (15 Apr); Industrial Production (11 Apr); CPI (24 Apr), Trade Balance (4 Apr), BNM Policy Meeting (7 May).

- **Technical Outlook:** Our bias to sell USDMYR on rallies remains spot on. USDMYR traded a low of 4.0545 (21 Mar), a whisker away from our 4.05 1Q forecast. Pair was last seen at 4.0810 levels. Daily momentum is turning mild bullish while stochastics is rising from oversold conditions. Rebound risks not ruled out. Resistance at 4.0870 (50 DMA), 4.0950 levels. Decisive break above these levels may suggest that a sharper rebound towards 4.12 cannot be ruled out. Support at 4.0620, 4.05 levels.

IDR: Elections Could Lure Bulls To Seize Control

Forecast	2Q 2019	3Q 2019	4Q 2019	1Q 2020
USDIDR	12900 (--)	12700 (--)	12900 (--)	12900 (--)

No Change to Previous Forecast

- **Motivation for the FX View:** The USDIDR's trajectory downward faces further obstacles. Concerns about its current account deficit that had re-emerged in Feb and into early Mar and that have kept the USDIDR elevated above the 14000-levels has given way to concerns over global growth. Fears of an impending recession in the US and elsewhere have spooked markets, spurring demand for safe-haven assets and a sell-off in riskier assets, including the IDR. This suggests that there could be further unwinding of long-IDR positions vs. the USD that is putting upward pressure on the USDIDR.

- Nevertheless, we expect this roadblock to be temporary as reflected in the reversal in the inversion of the 3m10Y UST yield curve. The Goldilocks environment (where global growth is neither expanding nor contracting amid low inflation) should be supportive of higher yielding FX including the IDR. This should return the USDIDR to its downward trajectory ahead.

- Further optimism comes from the efforts undertaken by both the BI and the government to reduce the current account gap and stabilize the IDR, including import tightening measures, some moderation in infrastructure spending, steps to promote tourism and maintaining the tight monetary policy stance. The flows into Indonesian assets reflect this confidence in the Indonesian economy. To date in Mar, foreign investors have purchased USD37.7mn and USD1.04bn in equities and debt respectively. Efforts to reduce the gap should add to sentiment and help the USDIDR return to its downward trajectory.

- Further impetus for the USDIDR to move lower should come from diverging yield differentials between Indonesian bonds and UST. The Fed's move to a prolonged pause in its rate hike should weigh on UST yields, possibly spurring yield seeking activities which could benefit the IDR. At the same time, the capacity of BI to tighten policy if the need arises even as it pauses on further rate hikes for now to support growth. We have revised our rate hike expectations. We are no longer looking for any rate hikes this year and in 2020 vs. earlier expectation of two 25bp hikes in 2019. Together, these should buoy demand for riskier assets and lift the IDR higher.

- More importantly, our enthusiasm for further downswings in the USDIDR comes from our study of the moves in the IDR in the lead-up to the presidential elections. As we have flagged previously, in the run-up to the presidential elections, the IDR tend to appreciate – typically strengthening by an average 10% in the last two elections. Campaign spending and pre-election promises should buoy sentiments and put upside risks to the IDR in the lead-up to the elections.

- Market volatility is likely to increase as the 17 Apr Presidential and general elections draw closer. Current opinion polls point to strong but mildly narrowing support for Jokowi over his opponent Prabowo. The situation nevertheless remains fluid with the election for Jokowi to lose. Any mis-steps by the Jokowi campaign or waning support for Jokowi could shake market confidence, a sell-off in Indonesian assets, particularly equities, and see the USDIDR climb even higher. Our house view is for a Jokowi to win at this juncture, which is a IDR-positive event. With a proven track record, a Jokowi win will be market positive and should encourage further inflows on expectations that Jokowi and his economic team will follow-through with further fiscal policies that will ensure not only economic growth but tame the twin deficits as well.

- Some of the measures that are likely to be implemented should Jokowi get re-elected or have already been implemented include tax reforms (of tax rule revision to support the property sector, removing value-added tax on some service exports, revising corporate taxes for coal miners, etc.) and changes to the “Negative Investment List” to open up previously partly closed sectors to foreign ownership. There could also be an extension and expansion of import tightening measures (including tariffs) and measures to encourage exports to curb the current account deficit (CAD). Other measures already announced included intensifying the use of biodiesel to reduce import of oil given its status as a net oil importer. All of these are positive for the IDR, and could potentially lead to a repricing of Indonesian assets and spur greater inflows.

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

- **Growth and Inflation Outlook:** After expanding by +5.17% in 2018 (2017: +5.07%), the government is penciling a fast pace of economic growth of 5.3% in 2019. This is despite potential for economic growth to be impacted negatively by BI’s 175bp rate hikes since May 2018 that could take its toll on consumption and investment. At the same time, the government’s move to raise taxes to curb imports is likely to manifest in slower investment and import growth in 2019. Plans to hold back some import-heavy infrastructure projects and to curb imports of luxury consumer goods could similarly stem investment and consumption expenditure. The failure of consumption to backstop GDP growth could see growth wane into 2019. The 5.3% growth penciled in by the government though reflects its belief that a steep economic slowdown is unlikely. We believe that the government will go all out to ensure that growth does not falter especially in the run-up to the Presidential and general elections on 17 Apr 2019. Campaign spending as well as ongoing reconstruction efforts following the devastating earthquake and tsunami in 2018 should lift consumption. Nikkei PMI manufacturing index also does not indicate any slowdown concern with the index at 50.1 (back in expansionary mode) in Feb compared to 49.9 in Jan. For 2019, our economic team projects growth at 5.14%, a slightly moderation from 2018.

- After easing below the 3.0% levels to start the year, headline inflation slipped even lower in Feb. Headline inflation rose by 2.57% y/y, easing further from Jan’s 2.82% – the slowest since Nov 2009. As in Jan, the main culprit for the slow pace of price increases was the still decelerating food prices (Feb: +0.72% vs. Jan: 1.98%). At the same time, the statistical agency flagged the recent fuel price cut by Pertamina for easing the pressure on consumer prices. Core inflation rose by 3.06% y/y in Feb – the same pace as Jan. This was attributable to supported administered prices (of 3.38% y/y) that continued to mitigate partially the moderation in volatile and energy price increases. The government’s move to curb imports and the current account deficit and the 175bp rate hikes by BI should prove to be deflationary. The 7.5% tariff on around 900 consumer goods should reduce demand for imported goods and put downside pressure on prices. After averaging 3.20% and 2.81% for the whole of 2018, our economic team expects headline and core inflation to come in around

3.44% and 3.08% respectively in 2019. The forecasts are well-within the BI's target range of 2.5 and 4.5% for 2019.

- **Monetary Policy Forecast:** As expected, BI maintained the status quo at its policy meeting on 20-21 Mar. The BI left its benchmark policy rate unchanged at 6.0% on 21 Mar and the deposit and lending facility rates unchanged at 5.25% and 6.75% respectively. This kept the interest rate corridor at 75bp on either side of the policy rate. The Fed's move to prolong the pause in its rate hike as well as the relative stability of the IDR provided the BI with policy space to hit the pause button. In addition, the Governor said that the decision was consistent with BI and the government's efforts to "strengthen external stability, especially to control the current account deficit (CAD) and maintain the attractiveness of domestic financial assets".

- While the BI remains focused on the CAD and IDR stability remains, there appears to be a pivot towards supporting economic growth. This was highlighted by the governor who said that the central bank was "still pushing for economic growth", suggesting that a more accommodative bias has crept into the BI policy stance. This was reflected in the BI's more to implement some accommodative macro-prudential measures, including the increase in frequency of term-repo auctions; lifting the macro-prudential intermediation ratio (MIR) to 84-94% from 82-92% previously; and the encouragement of the use of interest rate derivatives for hedging purposes (IRS and OIS).

- The governor attempted to remove any doubts that the BI was walking back on tighter monetary policy by reiterating that the central bank remains preemptive, and ahead of the curve. In light of the Fed's recent pivot, our economic team is no longer looking for any rates this year and in 2020. Previously, the team had expected two 25bp hikes in 2019.

- **Latest Fiscal and External Balance Outlook:** The budget deficit rose to 0.34% of GDP in the Jan-Feb period from 0.28% as a result of the shortfall in government revenue vs. government spending. Government spending came in at IDR271.8tn vs. revenues of IDR217.2tn, resulting in a budget deficit of USD54.6tn in Jan-Feb. Of the total revenue of IDR217.2tn, the bulk of it or IDR177.24tn was from tax revenue.

- After suffering persistent CAD, there appears to be some light at the end of the tunnel. The policy measures introduced by both the BI and the government seem to be effective to curb the CAD. Some of these measures include lifting tariffs on imports of luxury goods and developing the tourism sector. For the first time in five months, there was a trade surplus of USD0.33bn after imports fell sharply (by 14% y/y) in Feb even as exports decline as well. This could go some ways to curb the ballooning current account deficit and bring it to a more manageable level. BI's goal is to manage the CAD such that it comes in below 3.0% of GDP. For 2019, the central bank is looking for a CAD of 2.5% of GDP.

- **Key domestic events and issues to watch**: Market's interest will be on the Presidential elections on 17 Apr where incumbent President Jokowi will face off with his challenger Prabowo. General elections will also be held simultaneously. Politics aside, BI's monetary policy decision on 25 Apr will also be keenly watched.

- **Technical Outlook:** USDIDR traded higher in Mar. Last seen at 14220 levels. Bearish momentum on weekly chart is waning while stochastics is turning higher from oversold conditions. 21 DMA looks on track to cut 100 DMA to the upside. Rebound risks not ruled out. Resistance at 14400 levels. Support at 14040, 13900.

PHP: BSP Dovish Tilt, Growth Concerns Weigh

Forecast	2Q 2019	3Q 2019	4Q 2019	1Q 2020
USDPHP	53.30 (--)	53.00 (--)	53.50 (--)	53.80 (--)

No Change to Previous Forecast

- **Motivation for the FX View:** The USDPHP move lower was not sustained and stalled in Mar. This was despite global risk sentiment climbing higher after the Fed signaled that it would prolong its pause on further rate hikes in 2019. Instead, the USDPHP was dragged higher by market concerns that the current tightening cycle could be reversed prematurely by the new BSP governor. At the same time, rising risks to growth, both domestic and global, also put upward pressure on the USDPHP. Together, these concerns have kept the pair elevated in Mar.

- The appointment of an outsider and former cabinet member as the new BSP governor raised concerns over the independence of the central bank as well as concerns that monetary policy could be even more closely aligned to President Duterte's domestic agenda. Concerns that the new governor could cut policy rates prematurely sparked some sell-off in Philippine assets, particularly equities, driving the USDPHP higher. Gains in equities moderated sharply in Mar-to-date. So far in Mar, foreign investors have purchased just USD58.1mn in equities compared to the larger gains in Feb of USD178.48mn and Jan's USD355.93mn. Further foreign portfolio outflows could keep the USDPHP supported into Apr.

- At the same time, the brief inversion of the 3m10y UST yield curve amid slowing global PMI prints sparked concerns that the growth momentum in the G3 signaled an imminent recession in 12-24 months. Domestically, risks to economic growth in 2019 have risen, especially from the delay in the passage of the FY2019 budget that could see key infrastructure spending delayed. This lack of fiscal support for the economy could see growth of 1-2 percentage points slashed from overall growth in 2019. These global and domestic growth concerns should weigh on global sentiments, setting off a shift away from riskier asset FXs, including the PHP. Global and domestic growth concerns will be negative for the PHP and see the USDPHP climbing higher in Apr.

- Intermittently, constrains from its twin deficits, particularly the current account deficit, could put upside pressure on the USDPHP. So far, the focus on the government's ambitious infrastructure building programme is likely to keep the current account in deficit in 2019. In addition, trade disruption caused by the Sino-US trade war had weighed on external demand, worsening the trade deficits. Further deterioration in the current account deficit should weigh on the PHP, and keep the pair supported ahead.

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

- On the bright side, fading USD strength as a consequence of the Fed's pivot to a prolonged pause in rate hike should slow the USDPHP grind higher. The guidance of no rate hikes in 2019 just one rate hike for 2020 could see the Fed tightening cycle nearing its end. We could see the unwinding of stale long USD positions against its G10 peers and selected AxJs, which could provide the PHP with some support and keep the USDPHP from climbing too aggressively higher.

- We maintain our USDPHP outlook over the forecast horizon with the pair expected to come in higher at around 53.30-levels in 2Q on political concerns before recovering to 53-figure in 3Q. However, global growth concerns could re-emerge towards the end of the year could see USD re-emerge and push the pair higher to 53.50 and 53.80 in 4Q and 1Q 2020 respectively.

- **Growth and Inflation Outlook:** Growth momentum, which had been expected to pick up pace in 2019 after a slightly lackluster 2018, could falter. The risks to domestic growth have risen. Net FDI fell for the first time in three years in 2018 to USD9.8mn vs. USD10.3mn in 2017 and could lag again in 2019 as foreign ownership restrictions, high power costs and poor infrastructure impede. Softer remittances could also moderate household spending in 2019. Overseas remittances had moderated to +3.1% in 2018 from +4.3% in 2017 and appears poised to further slow in 2019 on concerns over global growth.

- Just as important, the delay in the passing the FY2019 budget is expected to weigh on growth with BSP governor Diokno warning that the delay could hit expansion by 1-2 percentage points. Private sector economists are less sanguine, predicting a hit of as much as 2.3 percentage points on growth. Still, growth is unlikely to tank in 2019. The Comprehensive Tax Reform Program (CTRP) should help to fund the government's infrastructure program and increase Filipinos' spending power. The second package of the CTRP when passed should prove favourable to corporates (via corporate tax reform and rationalization of tax incentives) and lift investment. Despite the risks to growth, BSP is looking for growth to come in at 7% in 2019, while our economic team maintains its 2019 growth forecast of +6.5%.

- Headline inflation eased further in Feb to 3.8% y/y (base year = 2012) vs. Jan's 4.4%. The more moderate increase in consumer prices can be attributed to slower increases in both food prices (Feb: +4.7% vs. Jan: +5.6%) and transport cost (Feb: +1.2% vs. Jan: +2.5%). Food costs continued to moderate, which was attributed to government measures to boost food supply and ensure efficient distribution, while transport cost slowed amid lower global crude oil prices. Core inflation (which excludes selected food items such as rice, meat, fruit and vegetables as well as energy prices from CPI) also eased to +3.9% y/y in Feb from +4.4% in Jan. Given the latest inflation print are supportive of our economic team's view of decelerating inflation, the team's 2019 and 2020 inflation forecasts at +3.0% and 2.8% respectively are maintained. The forecasts are largely in line with the BSP's inflation forecasts of +3.1% and 3.0% for 2019 and 2020 respectively.

- **Monetary Policy Forecast:** The BSP's first monetary policy meeting under new governor Benjamin Diokno on 21 Mar saw the BSP leaving its benchmark overnight borrowing rate unchanged at 4.75% for the third successive meeting. The BSP had lifted rates by a cumulative 175bp in 2018. The interest rate corridor was also left intact (symmetrical on either side of the policy rate by 50bp) with the overnight lending and overnight deposit rates at 4.25% and 5.25% respectively.

- The BSP was able to hit the pause button on its benchmark interest rate as a result of receding domestic inflation and the Fed's pivot to a prolonged pause on its interest rate hikes. The BSP appears to be in no rush to adjust its policy rate until inflation is firmly entrenched within its 2-4% target range. More importantly, the central bank also wanted to avoid the misconception about its independence following the appointment of an outsider to the position of BSP governor, and to avoid been seen playing politics by cutting interest rates ahead of the mid-term elections on 13 May.

- Still, given our house view of no more US Fed's interest rate hike in 2019-2020, receding domestic inflation and recent downgrade in official growth forecast, our economic team now expects the BSP to cut its policy rate by 50bp to 4.25% in 2H 2019 and then by another 25bp to 4.00% in 1Q 2020. This compares to its previous call for no change in 2019 and a 75bp cut in 2020.

- We believe that the BSP is waiting for the right time to reduce the required reserve ratio (RRR) so as to ensure that its action will not dislodge inflation expectations. The team maintains its view that the central bank will cut the RRR by a steady pace of 200bp p.a. in 2019-2020 – the same quantum as in 2018 as part of its monetary policy reform. However, our team is not ruling out larger RRR cuts on the recent indication given by governor Diokno of more aggressive RRR cuts.

- **Latest Fiscal and External Balance Outlook:** The budget balance position started the year in good shape, recording a surplus of PHP44.54bn in Jan 2019 – the first surplus since Apr 2018. The surplus was due to government expenditure moderating in Jan. Government revenue rose to PHP256.7bn in Jan from PHP232.2bn in Dec, while spending moderated to PHP212.2bn in Jan from Dec's PHP313.3bn. However with the government intent on accelerating infrastructure building in 2019, including a subway in the capital and a commuter rail across the main island of Luzon, persistent monthly budget surpluses are unlikely. This reality is reflected in the government setting the full-year deficit ceiling for 2019 at PHP631.5bn or 3.2% of GDP.

- The current account deficit (CAD) widened again in 4Q 2018 after narrowing in 3Q. The CAD rose to USD2.4bn (or equivalent to 2.6% of GDP) in 4Q from USD1.64bn in 3Q 2018 (or equivalent to 2.1% of GDP). This was on the back of a larger deficit in the good, services and income accounts (4Q: -USD9.50bn vs. 3Q: -USD8.17bn). The financial & capital accounts recorded a larger surplus of USD3.75bn in 4Q (vs. 3Q's +USD1.61bn). Consequently, the overall balance of payments rebounded back into a surplus of USD2.83bn in 4Q from a deficit of USD1.88bn in 3Q.

- **Key domestic events and issues to watch:** In the absence of BSP monetary policy meeting in Apr, market will watched CPI print for Mar closely for further evidence that inflation is receding, which could signal an imminent rate adjustment.

- **Technical Outlook:** USDPHP rebounded for the month of Mar. Pair was last seen at 52.52 levels. Bearish trend channel should continue to guide the overall direction unless channel top is broken. Eyes on resistance at 52.90 (upper bound), 53 (200 DMA). Break to the upside would see USDPHP trade towards 53.30. Support at 52.50 (21, 100 DMAs) before 52.37 (50 DMA), 52 levels. Bias to lean against strength.

THB: Political Tension Could Persist

Forecast	2Q 2019	3Q 2019	4Q 2019	1Q 2020
USDTHB	32.00 (31.70)	31.70 (31.50)	32.00 (--)	32.20 (--)

Previous Forecast In Parenthesis.

- **Motivation for the FX View:** The THB remains on the backfoot in Mar as politics continues to take centre-stage, though year-to-date it remains the best performing ASEAN currency. In Mar though the THB is still down nearly 1% against the USD, which is not surprising as we had flagged previously that the THB tended to depreciate in the run-up to general elections, and appreciates post-election as political clarity emerges. The THB's move lower in Mar though was mitigated in part by the Fed's move to prolong its pause on rate hikes in 2019. We no longer hold the view of a prolonged recovery in the THB post-elections. Instead, political uncertainty is likely to persist for a while longer and should weigh on the THB in the three-to-six months ahead. Consequently, we have tweaked our USTHB forecast accordingly.

- While the elections have been largely peaceful and allowed the THB to briefly recover somewhat post-elections, the mood has since changed. Political uncertainty has re-emerged and political tensions have heightened as two competing camps attempt to form the next government – one led by the pro-military government Palang Pracharath Party (PPRP) and the other by the Pheu Thai Party (Thaksin-linked party) and the Future Forward Party. Each side has laid claims to forming the next government – PPRP on its win of the popular votes (8.4m) and Pheu Thai on its winning the most number of seats in the new Parliament (137 seats).

- We had flagged that horse-trading will take place to form the next government that could create some instability and weigh on sentiments. Allocation for the 150 party-list seats will be announced 29 Mar, which could change the dynamics in the new parliament. Seven parties including the Future Forward and Pheu Thai parties with an unofficial estimated 255 seats in the new parliament have come together to stake their claims to forming the next government. The pro-military camp led by PPRP has brushed aside this claim, saying that no coalition can be officially announced until the election results have been official released and certified on 9 May. This lack of clarity as to who will form the next government could keep foreign investors on the sidelines and provide little impetus for foreign investment and the THB to climb higher.

- The PPRP though has the inside track in forming a government as the Constitution is stacked in its favour (note that the 250 senators that will vote along-side the elected-MPs to select the PM are appointed by the military junta). Thus, it is more likely than not that PM Prayuth would remain as PM. We do not expect any changes in economic policy direction and for the BoT to maintain the status quo on monetary policy for the rest of 2019. Still, any government formed under the Constitution is unlikely to be stable and should be short-lived.

- So while there was some relief that the election has taken place peacefully, lifting the THB, some weakness in the THB is likely to persist ahead as the reality of new political situation sets in. Initial gains in Thai assets post-election have since dissipated as political uncertainty sets in during the coalition-building phase. We could see the sell-off continue as the coalition-building attempts intensify the political noise that could lift the USDTHB higher.

- We could thus see the USDTHB pick-up further in the months ahead as the two main coalition groups jostle for pole position. So far, volatility (as measured by USDTHB 1 month at-the-money implied volatility) has edged higher in Mar after sliding in the lead-up to the elections. The USDTHB though continues to move in the opposite direction, highlighting the divergence between movements in the USDTHB and the 1-month vols. As we have cautioned, this could potentially leave the USDTHB vulnerable to playing catch-up as political tensions heighten.

- Mitigating some of this upward pressure on the USDTHB is the Fed's move to pause its rate hikes for an extended period. This suggests that the Fed's current tightening cycle is near its end and could portend a softening of the USD ahead. This together with softer US economic data and likelihood that Sino-US trade war concerns will fade should weigh on the USD. This in turn could keep the USDTHB from climbing higher too aggressively in the three-months ahead and then potentially provide some relief to the USDTHB when the political noise fades.

- In addition, Thailand's macroeconomic underpinning remains healthy. Economic fundamentals are generally sound including healthy growth momentum and persistent current account surpluses that are supportive of the THB. The persistent current account surpluses (BoT projects a surplus of 6.4% of GDP in 2019) continue to favor the THB. In addition, low domestic inflation (where headline CPI has averaged 1.0% for the whole of 2018 which is at the lower end of the BoT's 1-4% target range) has also helped the THB, producing an environment that leaves the BoT with policy room to remove its accommodative policy at a gradual pace. A less aggressive pace of rate hikes should be supportive of economic growth and less likely to stifle price increases, which turn should be positive for the THB. Given the recent move by the Fed to prolong its pause in rate hike, we no longer expect any further rate hikes by the BoT in 2019, though the tightening bias of the central bank remains.

- We now expect the USDTHB to climb higher to the 32-levels by end-2Q 2019 as political tensions intensify. Thereafter, we expect the THB to resume its appreciation trajectory with the USDTHB ending 3Q at 31.70 as some semblance of political détente among the camps is reached. Risk aversion though could re-emerge from 4Q on concerns over a possible global economic slowdown that could see USD gather strength somewhat and lift the USDTHB back to the 32.00- and 32.20-levels by year-end and by end-1Q 2019.

- **Growth and Inflation Outlook:** The growth outlook for the economy has darkened slightly. The BoT at its Mar policy meeting had downgraded its 2019 growth outlook to 3.8% from 4.0% previously. Softer export growth due to fallout from trade tensions between China and US weigh on domestic growth momentum. Government spending and domestic demand should remain healthy and offset this slowdown in exports. Government spending together with planned infrastructure building projects including transport networks and the Eastern Economic Corridor development project should continue to attract FDI and keep growth supported in 2019. Our economic team maintains its full-year growth of 3.8% for 2019.

- Headline inflation accelerated in Feb for the first time in three months, rising by +0.73% from just +0.27% in Jan. The quickened pace of inflation was due to higher oil prices and fresh food prices. Food prices continued to tick higher the past three months by +1.89% y/y in Feb (Jan: +1.34%), while the contraction in transport cost moderated to -0.66% in Feb from -1.92% in Jan. Core inflation (headline inflation excl. raw food and energy) though moderated +0.60% y/y in Feb from +0.69% in Jan. For 2019, overall prices should trend gradually higher fueled by election spending. The Commerce Ministry expects headline inflation to range within 0.7-1.7% in 2019. Our economic team expects inflation come closer to the top end of the Commerce Ministry forecast range at 1.5% in 2019 before easing to 1.1% in 2020.

- **Monetary Policy Forecast:** The BoT monetary policy committee voted unanimously at its 20 Mar meeting to keep its benchmark one-day repurchased rate steady at 1.75%. This compares to the 4-2 vote in Feb where the two dissenting voters had advocated a 25bp rate hike. The BoT attributed the decision to hold policy rate steady to heightened global and domestic uncertainties in the current period, particularly the general elections on 24 Mar.

- These uncertainties was reflected in its GDP downgrade for 2019 to +3.8% from +4.0% previously, while keeping its inflation forecast intact at +1.0% for 2019. Softer GDP growth combined with the Fed's pivot to a prolonged pause in its rate hike suggests that the BoT has scope to be patient in its rate normalisation process. Consequently, our economic team now expects the BoT to remain on hold for the rest of the year since the Fed is no longer signaling any more rate hikes in 2019. Previously the team had expected a 25bp rate hike to 2.00% to take place in 4Q 2019. The team has now pushed back the timing of its 25bp hike to 2020 as financial stability risks in risks remain a concern for the central bank.

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

- The large current account surplus recorded in Dec 2018 of USD5.03bn proved to be fleeting with the surplus moderating to USD2.29bn in Jan 2019. This moderate was largely due to the shrinkage in the trade surplus to USD0.06bn in Jan from USD2.48bn in Dec. Details for the financial account are not available at the point of writing but the overall balance of payments slipping rebounded to a surplus of USD2.26bn in Jan from a deficit of -USD0.18bn in Dec. This is likely due to portfolio inflows in the month. The BoT is projecting a current account surplus of 6.4% of GDP in 2019.

- **Key domestic events and issues to watch:** In the aftermath of the general elections on 24 Mar, the horse-trading between political parties will be watched by foreign investors for policy continuity and consistency. Politics aside, market will eye the BoT's MPC minutes on 3 Apr for nuances to potential moves by the central bank.

- **Technical Outlook:** Our caution for USDTHB to test higher towards 31.92 materialised. Pair traded a high of 31.94 (28 Mar); last seen at 31.80 levels. Bearish momentum on weekly chart is waning while stochastic is rising. Further upside risk not ruled out. Resistance at 31.92 before 32.20. Support at 31.60 levels.

INR: More Portfolio Inflows To Support

Forecast	2Q 2019	3Q 2019	4Q 2019	1Q 2020
USDINR	66.00 (--)	66.00 (--)	68.00 (--)	69.00 (--)

No Change to Forecasts

- **Motivation for the FX View:** Since last Nov, we had an out-of-consensus view that USDINR would head below the 70-figure towards 67. We based our view on two factors 1) Benign oil, US and USD rates environment that could provide Asia a window to shine and that includes the high-carry rupee; 2) Rupee typically strengthens ahead of election based on its performance in the lead up to the past two general elections. In the past month, USDINR made a rather decisive move lower towards the 68-figure, just 1 big figure shy of our 1Q forecast of 67. INR only took a breather in the last few sessions as we approach the end of the fiscal year for India. Once it was clear that the tension between Pakistan and India dissipated, INR reacted favourably and the incident provided the PM Modi a narrative to garner support. The major event ahead is the General election and it happens in 7 phases from 11 Apr. Results to be announced on 23rd May. Portfolio inflows have been supportive of the currency as foreign investors bet on a victory by PM Modi. Month to date (26 Mar), foreign investors have bought U$4.06bn of equities and almost U$2.5bn of bonds.

- Based on the average performance of the rupee (against the USD) in the past two Federal elections, INR typically strengthens around 50 days before the event (which should be within Apr-May 2019).

- Our India equity analyst Jigar detailed three poll scenarios with the first being a Modi-led BJP win but in a coalition unlike the majority win in 2017. The second possibility is a Congress-led coalition in the event Congress secures more than 120 seats. The third possibility (a more unlikely one) is a non-Congress and non-BJP led coalition which may not survive the full term.

- We had been leaning towards the first scenario as our base case. We anticipate Modi to weld the recent conflict with Pakistan in his favour, as written here. The lack of a united opposition and BJP's superior poll campaign and last-mile presence as pointed out by our colleague also reinforce our view that INR is poised for strength into the election period.

- In a backdrop of a Fed pause, we expect the USD, US rates and oil environment to remain benign, we look for opportunities to buy the INR on dips and the USDINR to head towards the 67-handle still in Apr, a view we held since last Nov. Into the rest of the quarter however, the gains could moderate and we look for this pair to maintain only a slight downside bias towards 66.00.

- **Growth and Inflation Outlook:** Industrial production weakened in Jan to 1.7%y/y from previous 2.6%, weighed by softer output from manufacturing and electricity. Into Mar, fading high base effects may prop up activity prints. There has been a deviation between the PMI-mfg prints and the actual industrial production numbers. While industrial production remains rather weak, PMI-mfg improved to 54.3 with a strongest improvement in business conditions reported by Markit since Dec 2017. Purchasing managers also noted the sharpest increase in factory orders in the past 28 months for Mar. Either one has to catch up/down with each other as they have been moving in tandem for much of 2017-2018. The latest industrial outlook survey conducted by RBI suggests that demand conditions are weak but surveys indicate that business conditions have improved.

- Inflation quickened to 2.57%y/y from previous 1.97% (revised lower) as food inflation saw a smaller decrease in Feb to 0.7%y/y from previous -1.3%. This is just as the fuel and light component saw a deceleration to 1.2% from previous 2.1%. The rabi harvest is watched now given the longer winter and impact of the weather is yet to be assessed fully. Food inflation will be closely monitored and the persistently elevated crude price could mean that overall CPI headline could head higher.

- Trade deficit narrowed to U$9.6bn in Feb from U$14.7bn in Jan, better than the consensus looking for only a slight improvement to U$13.7bn. That was due to contraction in imports for Feb by -5.4%y/y - a sign of weak domestic demand. External demand is also declining with exports slowing to 2.4%y/y from 3.7%.

- **Monetary Policy Forecast:** We see potential for RBI to cut in the second quarter but not in Apr. We anticipate that the central bank would watch for the impacts of the previous cuts as well as the cash handout to the farmers that could boost the household spending and capital expenditure before deciding to make another cut in Jun. In addition, the impact of the longer winter on the rabi crops have not been fully assessed and food inflation has already shown some signs of turning higher. Still, inflation is still benign and weak activity momentum at this point renders our call for RBI to watch and wait for this Apr meeting a close one. Even as RBI has switched to neutral stance in Feb, Governor Das' view that the neutral stance "will provide flexibility and the room to address challenges to sustained growth of the Indian economy over the coming months, as long as the inflation outlook remains benign" suggests that he is still biased towards more rate cuts in the future. Other members who voted for a cut highlighted slower global growth momentum as a key risk. The loudest dove was Dr. Ravindra H. Dholakia who called for a 50 to 60 bps cut starting with a 25bps cut on 7 Feb.

- Apart from monetary policy, RBI conducted a 3Y tenure FX swap auction on 26 Mar that received a very healthy response. The central bank received $5bn and is said to inject as much as INR345.6bn into the system, meant to address cash demand at the end of its fiscal year. Concerns that the central bank may rely on this rather than OMO dampened the bond market but that was offset by the revision of the foreign portfolio investment limit higher for debt. Separately, the central bank has been getting banks' feedbacks on how to lift the ban on exotic currency derivative products with some safeguards (ET). Also on a related note, the central bank had released rules to allow non-residents to partake in interest rate derivatives on stock exchanges electronic trading platforms and OTC markets listed by the central bank. Transactions in interest rate futures face a limit of net long position of INR50bn.

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

- **Congress (the main opposition party)** has promised INR72000 annually for poor families that earn less than INR12000 a month. The "minimum income plan" is supposed to cost U$52bn. That could mean that a government under Congress is less likely to focus on fiscal consolidation as there was no projection from the party on how it is likely to finance it.

- **Key domestic events and issues to watch:** PMI-mfg on 2nd Apr; RBI meeting on 4th; CPI and industrial production on the 12th; WPI and trade data on 15th

- **Technical Analyses:** The 1M USDINR NDF has been edging higher towards the end of the month, quarter and fiscal year as inflows slowed. We see this as a retracement before the next leg lower for this pair, last seen at 69.50. Moving averages on the weekly chart are poised for a bearish signal (21-wma to cut the 50-wma lower) and bearish momentum is still intact. We look for this pair to head towards 68 next before 66.00.

VND: Unmoved

Forecast	2Q 2019	3Q 2019	4Q 2019	1Q 2020
USDVND	23000 (--)	22800 (--)	22900 (--)	23000 (--)

No Change to Forecasts

- **Motivation for the FX View:** The VND remains little moved around 23200 against the USD since the start of the year. Vietnam continues to see modest FDI inflows as well as portfolio inflows in view of the recent implementation of the CPTPP and potential FTA with the EU. Strength in the RMB could continue to anchor the dong against the USD. In the meantime, VND's competitiveness against its trading partner waned a little in the past month. Our estimate of the VND trade weighted index (TWI) edged higher to 64.0 at last sight (28 Mar) from 63.6 in Feb as most of its trading partners registered mild weakness against the USD (including the RMB) while VND remains steadfast at 23200. Along with hopes for the US and China trade relations to improve, the CNY recovery also set a positive tone for the year and we look for modest CNY strength to provide an anchor for the VND this quarter, if not for most part of this year.

- We hold our view that slower global growth is likely to crimp on the VND and the government is reported to consider lowering serviced fees for containers stored at the seaports for a long time. The moderation in global growth has weighed on exports growth in the past few months for Vietnam with single digit growth/ contractions recorded for the past few months. Trade balance has been in deficit between Nov-Feb but finally recovered in Mar. Nonetheless, a slight deterioration in its balance of payments is expected for 1Q as capital inflows have been modest at best.

- In an environment of a Fed pause, softer USD and strong RMB, the VND could appreciate modestly against the USD and to end the next quarter at around 23000.

- **Growth and Inflation Outlook:** 1Q GDP came in to be firmer than expected at 6.79%y/y vs. the median estimate of 6.50%. Growth momentum was likely dragged by the weakness in the external demand. PMI-mfg slipped to 51.2 from previous 51.9 and respondents to the survey reported a fall in hiring, the first seen since Mar 2016. Growth of output and new orders rose but momentum is weak. Output prices fell. Industrial production also slipped in sympathy to 9.1%y/y from previous 10.3%. Retail sales for the first three months eased a tad to 12.0%y/y from 12.2% in the first two months.

- Exports rebounded in Mar to 5.4%y/y vs the previous 1.6%. Imports growth surged to 14.7%y/y from previous 10.4%, possibly indicating decent private consumption at home. As a result, Vietnam recorded a surplus of +$600mn vs. -$900mn previously.
- **Monetary Policy Forecast:** Inflation pressure surprised to the downside though the trend is tilted to the upside of late. That really narrows the room for monetary policy support even as global growth moderation crimps on Vietnam's export performance. Still, Vietnam benefits from FDI inflows because of the trade agreements and that could cushion the effects of the decline in external demand. Sustained imports growth and retail sales suggest that household consumption could also support growth. As well, we look for China's RRR cuts to do some of the heavy lifting to cushion global growth slowdown.
- In this environment where growth outlook for Vietnam is still rather balanced, we see little need for a rate cut by SBV now. In terms of TWI, the VND has weakened against its regional peers in the past few months. We anticipate that VND is likely to remain a laggard in an environment of softer USD and that could provide more export competitiveness that could improve its trade balance. That said, our view on the VND would be downgraded if the African Swine Virus spreads and threatens price stability.
- **Latest Fiscal and External Balance Outlook:** As of last available data, current account surplus was at U$1.24bn in 3Q. Net trade surplus of goods slipped to U$3.0bn from previous U$5.2bn. The competitive dong could keep the current account in surplus Slower growth momentum could mean a deterioration on the trade front and we expect the current account surplus to be eroded. That would underscore the need for VND to remain competitive and our view that VND could lag in its recovery against the USD compared to regional peers.
- **Key Domestic Events and Issues to Watch:** PMI-mfg on 1st; domestic vehicle sales in 6th-13th; CPI, trade numbers, retail sales and IP are due 25th-30th Apr.

FX Forecasts

	End Q2-19	End Q3-19	End Q4-19	End Q1-20
USD/JPY	108	106	107	105
EUR/USD	1.1500	1.1600	1.1600	1.1600
GBP/USD	1.3200	1.3400	1.3600	1.3600
AUD/USD	0.7300	0.7400	0.7300	0.7200
NZD/USD	0.7100	0.7200	0.7100	0.7000
USD/SGD	1.3400	1.3300	1.3500	1.3600
USD/MYR	4.00	3.98	4.06	4.07
USD/IDR	12900	12700	12900	12900
USD/THB	32.00	31.70	32.00	32.20
USD/PHP	53.30	53.00	53.50	53.80
USD/CNY	6.70	6.65	6.70	6.68
USD/HKD	7.79	7.78	7.78	7.79
USD/TWD	30.70	30.60	30.70	30.80
USD/KRW	1100	1105	1120	1130
USD/INR	66.00	66.00	68.00	68.00
USD/VND	23000	22800	22900	23000
DXY Index	95.88	94.64	94.86	94.62
SGD Crosses	End Q2-19	End Q3-19	End Q4-19	End Q1-20
SGD/MYR	2.9851	2.9925	3.0074	2.9926
SGD/IDR	9627	9549	9556	9485
SGD/THB	23.88	23.83	23.70	23.68
SGD/PHP	39.78	39.85	39.63	39.56
SGD/CNY	5.00	5.00	4.96	4.91
SGD/HKD	5.81	5.85	5.76	5.73
SGD/TWD	22.91	23.01	22.74	22.65
SGD/KRW	821	831	830	831
SGD/INR	49.25	49.62	50.37	50.00
MYR Crosses	End Q2-19	End Q3-19	End Q4-19	End Q1-20
EUR/MYR	4.60	4.62	4.71	4.72
JPY/MYR	3.70	3.75	3.79	3.88
MYR/HKD	1.95	1.95	1.92	1.91
MYR/CNY	1.68	1.67	1.65	1.64
GBP/MYR	5.28	5.33	5.52	5.54
AUD/MYR	2.92	2.95	2.96	2.93
NZD/MYR	2.84	2.87	2.88	2.85
MYR/IDR	3225	3191	3177	3170
MYR/INR	16.50	16.58	16.75	16.71
MYR/KRW	275.00	277.64	275.86	277.64
MYR/PHP	13.33	13.32	13.18	13.22
CNY/MYR	0.5970	0.5985	0.6060	0.6093

Source: Maybank FX Research as of 29 March 2019.

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

DISCLAIMER

Published by:

Maybank

Malayan Banking Berhad
(Incorporated in Malaysia)

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