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FX Monthly

2016, Issue IV: The Elusive Dollar Strength

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Key themes[1]

- First, US Fed timeline for eventual future rate hike remains data dependent and remains affected by the tightness of financial conditions. US growth recovery remains on track but recent global developments out of China and volatile market activity may potentially affect the number of hikes in 2016. *Markets are now expecting 1 Fed hike in 2016;* we are expecting 1-2 rate hikes by end 2016. *Key US events: US Apr NFP (6 May) (expected: 200k); ISM Manufacturing Mar (2 May) (expected: 51.5); Factory Order (4 May (expected: 1.2%); Durable Goods Orders (4 May and 26 May); Trade balance (5 April); Retail Sales, (13 May); Mar CPI (17 May); Fed minutes from Apr26-26 meeting (19 May); GDP 1Q (27 May); Fed Williams (3 & 14 May); Evans (9 May); Bullard (5, 6, 23, 26 May); Williams (14 May); Lockhart (2 May).*

- Second, Japan's 2% inflation target has been pushed back to 1H FY 2017 (by Sep 2017) due to oil softness and slow traction in wage increases. The credibility of Abenomics has waned somewhat in 2016 even though the easing bias is still clear. We do not expect any further moves by the BOJ until Jul meeting at the earliest and further jawboning is likely until then. *Preliminary estimates for 1Q16 GDP will be released on 18 May. BOJ Governor and Deputy Governor speak separately on 13 May (at the Research Institute of Japan in Tokyo) and 12 May (BOJ's retail settle conference in Tokyo) respectively. JGB auctions in May: 10-year (10 May), 30-year (12 May), 5-year (17 May), 1-year (18 May) and 20-year (19 May).*

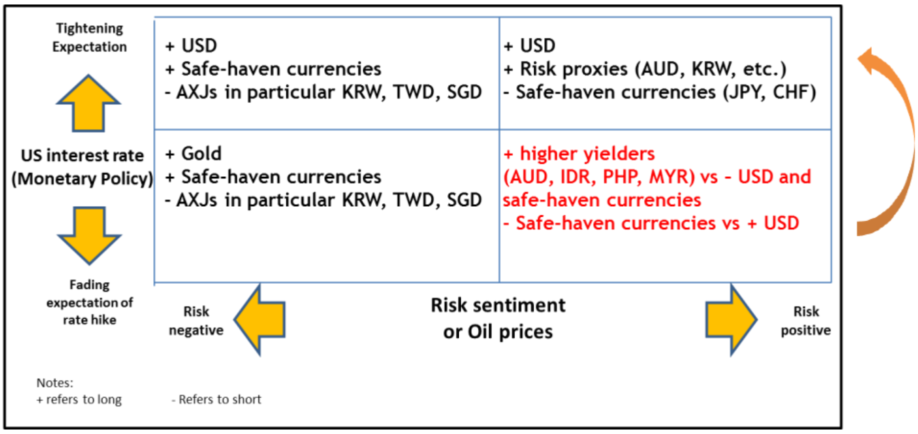
- Third, subdued core inflation and structural headwinds in the Euro-area (high debt, possible fiscal slippages, slow reform, etc.) will continue to weigh on the Euro. With ECB easing out of the way, a dovish Fed weighing on the USD and slowing monetary policy divergence between ECB and Fed, the EUR could see further upside. *A potential "floor" on ECB deposit rate may limit the downside for European bond yields while market expectation for Fed to tighten has also been fading. EU-UST bond yields could continue to narrow and that suggest near-term upside risk for EURUSD. Euro-area 1Q GDP (13 May); Apr inflation (18 May); ZEW survey (24 May). Next ECB meeting on 2 Jun.*

- Fourth, ongoing reforms in China policies to address domestic, financial, and growth issues continue amid RMB internationalisation efforts. We expect at most one interest rate cut of 25bps and RRR to be cut in intervals by another 150bps within the year. PBOC likely to keep CNY stable against the USD and stable against the basket. This will naturally keep the gap between onshore and offshore yuan from widening drastically this year. However, China still has excess capacity, heavily indebted corporations and huge liquidity injections continue to add immense pressure on the economy and the yuan medium term. *Some signs of improvements in China data in leading and activity indicators (i.e. urban investments, industrial production and retail sales). Apr PMI-mfg is due on 1 May, followed by the Caixin version on the 3rd. Foreign reserves for Feb will be watched on the 7th. Trade data is due on the 8th. CPI, PPI on the 10th. Liquidity numbers are due from 10th-15th. Activity data for Mar will be released within the 10-15th.*

- *We see AXJs could see some weakness in 2H of May in the run up to the June FOMC. We could see some unwinding of high yielding currencies such as IDR, MYR, AUD accumulated during times of easy monetary policy environment.*

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

So what?



Potential shift in the lead up to Jun FOMC meeting

- **Macro Themes:** Dollar tends to strengthen leading into the next hike which we project to be in Jun. This quarter could be somewhat similar to 4Q 2015 leading into the first hike. However, we expect markets to have learnt from the previous quarter. Rate hike "fears" are unlikely to be as sharp and accompanying risk relief rallies will be correspondingly less dramatic. This assumes Fed keeps the current pace of rate hikes at 2 per year. **Current environment seems to favour high yielding currencies (bottom right quadrant of our 2by2 grid shown above) but there could very well be a move towards the top right grid in the lead up into the Jun FOMC meeting.** In addition, we have to ask the question **"Are we too bearish on China?"** as we notice a pick-up in demand especially in the property sector which could have positive spill-over effects on other industries.

- **Major Currencies:** UST curve suggests that markets expect only 1 hike at most within the year but economic data still suggest that 2 hikes are not impossible. Put that together and USD strength could resurface. Meanwhile, a potential "floor" on ECB deposit rate (as signalled by Draghi may limit downside for European bond yields. EU-UST bond yield differential may narrow, entailing upside risks for EURUSD. Elsewhere, GBP is still under pressure as Brexit debate intensify and the saga could drag on. For the bold hearted, we see opportunities to accumulate GBP on fear. For AUD, good news out of China translates to boosts to the currency but as economic transition is still slow, there are caps to how high AUD can fly. Nonetheless, range trading for the AUD has shifted higher. On the other hand, USDJPY will remain under downside pressure until confidence in Abenomics is restored.

- **China:** CNY adjustment is not over but PBOC is likely to continue to keep yuan stable to stem capital outflows as the economy remains under pressure. Markets seem to be convinced of the central bank's ability to ensure yuan stability and downside pressure has eased significantly. We eye the moves of USD and the RMB index and look for rangy moves between 6.40-6.60.

- We see some risk of technical rebound in USD amid a Fed hike in June, and would reduce our dollar short exposure given our earlier strategy to long IDR, INR, MYR, AUD in times of easy monetary policy environment (high yield currencies). In addition, Brexit saga might drag so we see no hurry to buy GBP though we look for opportunities to accumulate GBP on fear. Risks to our view is - What if Abenomics fails?, China Deterioration, Oil Supply Overhang to drag on oil and a Donald Trump Win.

G7 Global Overview

USD: Not Writing Off the Dollar Just Yet - Strength Likely to Precede Fed Hikes

Forecast	2Q 2016	3Q 2016	4Q 2016	1Q 2017
USD Index	96.42 --	97.53 --	96.78 --	97.16 --

Previous Forecast in Parenthesis

- **Motivation for the FX View:** We remain mildly bullish on the 2016 dollar outlook but only during periods of run up ahead of June and Dec as we expect the dollar to see strengthening spurts ahead of the FOMC hikes. The DXY is currently at 93.45 (as at 29 Apr 2016). Thus far firmer US data and the Fed rate hike in Dec 2015 have been supporting the USD. However, the recent 17 Feb Fed minutes suggests a more dovish bias with the Fed officials likely need to see more information to assess the impact of recent developments on the growth outlook. This was followed by the dovish bias from the recent 17 Mar and more recently the dollar headed for its biggest weekly decline in almost two months on speculation the Fed will maintain a gradual pace for raising interest rates after Yellen reiterated global headwinds may restrain the US economy.
- The FOMC Feb minutes had highlighted that the risks from the recent tightening in financial conditions have increased and if the recent financial tightening were to persist, the effects would be "roughly equivalent to those from further firming in monetary policy". In addition, there were some concerns about “the possibility of a significant weakening of some foreign economies." Many participants saw "favorable fundamentals" supporting the consumption outlook and a few pointed to the potential positive effects of lower energy costs. Several participants also noted evidence of strength even in some parts of the struggling manufacturing sector. But overall, participants concluded that uncertainty had increased and many saw recent developments as increasing downside risks.
- “Caution” is the word stressed by Fed Chair Yellen when she made her **address titled “The Outlook, Uncertainty, and Monetary Policy” to** the Economic Club of New York. She opined that caution is needed because of the “asymmetric” effect of conventional monetary policy on economic disturbances - that the FFR could be raised readily should the economy strengthen more than expected but cutting the FFR would only be able to provide a “modest degree of additional stimulus” in an environment of weak economic growth and inflation. The dollar fell on her dovish tone thereafter.
- We now see 1 – 2 rate hikes in 2016. This suggests excessive US strength is limited with likelihood of some softness in periods following the likelihood of FOMC hikes on 2Q and 4Q 2016. In between in 3Q 2016 and 1Q 2016, we expect periods of dollar strength. We expect the dollar to end 2016 at around 96.78.
- Other G7 currency developments against the USD are mixed. Further developments out of Eurozone **with a potential “floor” on ECB deposit rate (as signalled by Draghi) may limit downside for**

European bond yields. EU-UST bond yield differential may narrow, entailing upside risks for EURUSD. Besides, with ECB easing (10 Mar) out of the way, a dovish Fed (as seen from previous FoMC meeting) weighing on the USD and slowing monetary policy divergence between ECB and Fed, the EUR could see further upside. Brexit concerns have led to some downward changes in GBP, thus affecting the DXY (upwards) to some extent via the interest differential perspective. The lack of credibility on Abenomics and Nikkei equity sell off have led to significant JPY strength in Feb and remained weak in Mar, which have put downward pressure on the USD.

- **Oil remaining somewhat soft could be slightly dollar positive if rate hike expectations remain.** Global crude oil prices and commodity prices is likely to remain soft and in tight range. Our baseline scenario is predicated on oil ranging between $35-45/bbl. We expect limited upside in long-term interest rates, partly driven by concerns in the global macro outlook which could help offset any shocks to the US real economic growth. This remains dollar positive.
- **The likelihood of further Fed rate hikes in 2016 remains but 2-year rate differentials have fallen off since the beginning of 2016 which has in part led to some softness in the USD.** The trade weighted dollar should be stronger if not for the Fed's signaling inconsistencies in between FOMC announcements and lack of 2016 policy forward guidance. In the medium term, there could still be USD trade weighted support as the 2-year rate differentials will eventually rise further.
- **Growth and Inflation Outlook**: In the latest Mar FOMC, Fed's forecasts for US GDP growth and inflation rate for 4Q 2016 were trimmed to 2.2% annual rate (from 2.4% annual rate) and 1.2% YoY from 1.6% YoY respectively, although the unemployment rate forecast remain at 4.7%.
- Fed maintained its view that the economy is expanding at moderate pace; household spending, are increasing at solid rates and housing sector continues to improve while business investment and net exports have been. This outlook lends justification for the recent rate hike in Dec 2015.
- Inflation picked up in recent months; however, it continued to run below the 2% longer-run objective, partly reflecting declines in energy prices and in prices of non-energy imports. Market-based measures of inflation compensation remain low; survey-based measures of longer-term inflation expectations are little changed, on balance, in recent months.
- In the medium term, the Fed is likely to closely monitor global economic and financial developments and to continue to assess their implications for the labor market and inflation, and for the balance of risks to the outlook. Global economic and financial developments continue to pose risks. If the recent tightening of global financial conditions was sustained, it could be a factor amplifying downside risks.
- Inflation is expected to remain low in the near term, in part because of the further earlier declines in energy prices, but to rise to 2% over the medium term as the transitory effects of declines in energy and import prices dissipate and the labor market strengthens further.
- **Monetary Policy Forecast:** Fed kept the target fed funds rate (FFR) unchanged at 0.25%-0.50% for the third consecutive FOMC

meeting in Apr 2016 after the 25bps hike at Dec 2015's FOMC meeting.

- FOMC statement was balanced **(acknowledged the recent slowdown in economic activity but noted that labor market conditions remain healthy; household spending moderated while real income growth has risen at a solid rate),** well-worded and less dovish **(than in Mar FOMC) -** the line which **said "global economic and financial developments continue to pose risks" has been removed and replaced with "closely monitoring inflation indicators and global and economic and financial developments".** To sum up. **Fed maintains optionality with regards to Jun FOMC meeting. This remains consistent with our long-held view of 2 hikes in 2016 - one in Jun and another hike in Dec.**

- **Latest Fiscal and External Balance Outlook:** Fiscal sustainability risk continues to weigh on the outlook and may emerge after the Nov 2016 presidential election. In the long term, an improved US economy and manufacturing sector, US shale oil and gas production may improve the US current account leading to dollar support but this is likely to be long drawn and may probably begin only in 2017/2018.

- **Key domestic events and issues to watch in Feb 2015:** Key US events: US Apr NFP (6 May) (expected: 200k); ISM Manufacturing Mar (2 May) (expected: 51.5); Factory Order (4 May (expected: 1.2%); Durable Goods Orders (4 May and 26 May); Trade balance (5 April); Retail Sales, (13 May); Mar CPI (17 May); Fed minutes from Apr26-26 meeting (19 May); GDP 1Q (27 May); Fed Williams (3 & 14 May); Evans (9 May); Bullard (5, 6, 23, 26 May); Williams (14 May); Lockhart (2 May).

- **Technical Outlook:** USD Index extended its decline. The move lower was in line with our bearish call. We reiterate that a top appears to have been formed on the DXY at 100 levels (double top in Mar and Dec 2015). A death cross was observed on the DXY, where 50 DMA cuts 200 DMA (Feb 2016). This is typically bearish. Monthly and weekly momentum indicators are also bearish bias. Next support at 93.60 (Apr 2016 low). A break below could expose further downside towards 92.20 (38.2% fibo retracement of 2014 low to double top in 2015). Resistance at 95.70 (50 DMA).

EUR: Monetary Policy Divergence Back in Focus

Forecast	2Q 2016	3Q 2016	4Q2016	1Q 2017
EUR/USD	1.1300 --	1.1100 --	1.1200 --	1.1100 --

No Change from Previous Forecast

- **Motivation for the FX View:** EUR/USD continues to track EU-UST 2Y bond yield spreads closely and spreads have widened since early-Apr (from +120bps to -134bps), which also saw the EUR/USD easing off its recent highs of 1.1460s to 1.1320 levels at time of writing. **Renewed focus on monetary policy divergence could be in focus next as we head into US FOMC meeting in Jun.**

- There is no ECB meeting scheduled in May and monetary conditions are already accommodative and are expected to stay that way, for extended period. ECB has also detailed plans on how the Corporate Sector Purchasing Program will work (effective Jun) and this should serve to ensure that financing conditions in the real economy remain accommodative. The Fed, on the other hand, could potentially raise rates in Jun/Jul (our base case scenario but not consensus) and the markets could potentially be underpricing this risk.
- While **technical signs do suggest further upside in the near term**, a turn of events such as **further hints of Fed signaling via Fed speaks developing in the coming weeks could see a re-adjustment of positions and that could see more upward pressure on UST yields and USD positioning. Widening of EU-UST spreads (a case of growing policy divergence) could result in EUR falling but we see the downside to be limited at 1.09 - 1.10 levels.**
- **Upside risk to our view:** On the topside, 1.15 remains a key resistance and needs to be broken for any move towards 1.18 levels. For that to happen, yield spreads may need to narrow (possibly towards to region of -100bp to -120bps). Current 2Y spreads is at -135bps, at time of writing.
- **Growth and Inflation Outlook:** Economic recovery (backed by private consumption) in the Euro-area continues but has yet to recover back to pre-GFC levels. Looking ahead domestic demand should continue amid accommodative monetary policy support, recent credit easing support, earlier progress made with fiscal consolidation and ongoing structural reforms. Low oil prices, weaker EUR and still accommodative monetary conditions should continue to provide support for private consumption. ECB expects GDP to rise by 1.4% in 20016, 1.7% in 2017 and 1.8% in 2018.
- Euro-area 4Q GDP grew 0.3% q/q (vs. 0.3% in 3Q). Recent consumer and business sentiment indicators declined but still suggest continued moderate growth in activity in the first half of 2016. **Euro-area composite PMI firmed in Mar (53.7 vs 53.0 in Feb). Both manufacturing and services PMIs firmed as well.** Risk remains to downside growth outlook.
- **Euro-area inflation is expected to remain near zero or even slip into negative territories amid lower energy prices.** ECB expects inflation to recover into later part of 2016, supported by ECB measures and economic recovery. Mar headline inflation was at 0% y/y (vs. -0.2% in Feb). Core inflation rose to +1% in Mar (vs. +0.8% in Feb). Looking ahead we expect inflation to remain subdued for most part of the year and only gradually pick up from end-year off the back of oil prices stabilizing, and continued pick-up in demand.
- **Monetary Policy Forecast:** Monetary policy is expected to remain accommodative for a prolonged period after recent move in Mar, where ECB eased on multiple fronts including cutting all key policy rate including the main refi to 0% (from 0.05%), marginal lending rate to 0.25 (from 0.3%) and deposit rate to -0.4%. ECB will also increase the monthly purchase by €20bn to €80bn per month (from €60bn previously). There were also technical adjustments being made to the QE program (i.e. introduce corporate sector purchase program, etc.) to strengthen the monetary and credit transmission. There is no ECB meeting in May; the next one is in 2 Jun. We do not expect further moves.

- ECB elaborated details of corporate sector purchase program (CSPP). Objective is to **strengthen the transmission mechanism of monetary easing (via bond purchase) on the financing conditions of the real economy.** Purchases will commence in Jun; carried out by 6 national central banks acting on behalf of the Euro system. **In combination with other non-standard measures, monetary policy will be eased further and help inflation return to 2% medium term target.** ECB will purchase eligible debt instruments (BBB- and above credit rating; minimum remaining maturity of 6m and maximum of 30y; denominated in EUR) from non-bank corporations incorporated in the Euro area even if the ultimate parent is not based in the Euro-area (as long as they fulfil all other eligibility criteria including issuer not a credit institution, not an asset management vehicle, etc.). A share limit of 70% per ISIN on the basis of outstanding amount will be applied. While this **non-standard easing is expected to ensure accommodative monetary conditions,** this may also lead to a flurry of bond issuance from foreign non-bank corporates.
- **Latest Fiscal and External Balance Outlook:** The government deficit ratio is projected to decline to 1.5% in 2017, from 2.1% of GDP in 2015. Projected government debt ratio is projected to decline gradually to 88.4% in 2017, from 91.5% of GDP in 2015.
- Euro-area current account surplus narrowed to EUR19bn in Feb from 27.5bn in Jan 2016. Current account surplus to GDP maintained at 2.2%.
- **Key domestic events and issues to watch:** Euro-area 1Q GDP (13 May); Apr inflation (18 May); ZEW survey (24 May). Next ECB meeting on 2 Jun.
- **Technical Outlook:** Double-bottom appears to have been formed in 2015 at 1.05 levels. Monthly and weekly momentum and oscillator indicators are bullish bias (we highlighted this in the previous issue of the monthly outlook). Key resistance at 1.15 levels. A break to the upside on daily/weekly close basis could see an extension towards first objective of 1.1850 (38.2% Fibonacci retracement of 2014 high to 2015 low), before the final objective of 1.2260 (50% fibo).

GBP: Brace for Directional Swings Both Ways

Forecast	2Q 2016	3Q 2016	4Q 2016	1Q 2017
GBP/USD	1.4000 --	1.4400 --	1.4800 --	1.4800 --

No Change from Previous Forecast

- **Motivation for the FX View:** it is not a straight road for GBP. **Extreme GBP-short positioning could unwind further and bullish daily technical suggest that GBP could see upside risk towards 1.47 levels in the next 1-2 weeks.** We then expect **fresh shorts to re-emerge, taking GBP back towards 1.40 - 1.42 levels as *Brexit* campaigners fight back amid potential USD upside risk** (as market re-adjusts positioning for potential Jun rate hike). **But we maintain our call that UK will vote to remain**

in EU, which could subsequently take GBP higher again post-23 Jun Referendum.

- In the next 1.5 months ahead, **focus remains fixated on whether UK will vote in the Referendum (scheduled on 23 Jun) to "Remain in EU" or to "Leave EU".** Debate is expected to intensify in the coming weeks and weigh on investor and business sentiment. Recent FT article reported that IPO and M&A deals were deferred due to *Brexit* concerns, with UK IPO fees fallen by 50% on y/y basis (QTD). Hiring decision have also been delayed. We expect upcoming data (especially labor, retail sales) to show some signs of deceleration. GBP could face some downside pressure taking the above factors into consideration.
- **But that said, we reiterate our base case scenario that UK will vote to "Remain in EU". Public is gradually becoming more aware of negative repercussion arising out of *Brexit* -** UK leaving EU could trigger BoP crisis especially when UK's current account deficit is already large (-4.7% of GDP as at 3Q 2015) while FDI and portfolio inflows could continue to slow (on concerns surrounding UK's fate after an exit). Jobs may be affected as MNC HQs could relocate/ pullout capital/investment (FDI from EU to UK stood at about 62% over past 10 years and 76% of EU FDI goes into UK's financial services) and trade relations with EU could be strained (UK imports from EU stood at 53% for 2015 vs. 47% to non-EU).
- **The recent FT poll of polls (as of 19 Apr) have now started to show that "Remain in EU" is gathering some traction with 47% opined to "Remain in EU" and 40% opined to Leave EU.** The bookmakers have also shown that the odds are favoring "Remain in EU". President Obama in his latest visit to UK (21 Apr) warned that it could take up to 10 years to strike a trade deal with US should UK exits from the EU – which some media has dubbed the *Obama Intervention*. GBP has also reacted, by rising as high as 1.4546 (26 Apr at time of writing).
- With **GBP short positioning at stretched levels, GBP could face considerable upside risks especially in the event that Referendum results point to "Remain in UK"** (which is our base case scenario). Investors will start piling back into UK assets and embark on deferred M&A and IPO deals. To put things in perspective, **GBP has traded 1.40 - 2.00 range for most of the last 26 years, with occasional spikes up and below those ranges. And GBP at or near 1.40 levels should be considered as a strategic buy on dips.** Our preliminary **fair value estimate (which took into account yield differentials adjusted for inflation, current account differentials and reflation) puts GBP at 1.58 levels.**
- **Downside risks to our view if UK votes to Leave the EU**. Then GBP could potentially break below its previous low of 1.3840 (2016 low) and test even lower beyond 1.33 (2 standard deviation away from fair value estimate) as markets react in respond to uncertainty.
- **Growth and Inflation Outlook:** 1Q GDP (+0.4% q/q) was a touch weaker than 4Q (+0.6% q/q) as *Brexit* fear weighs. The expansion was more than accounted for by the services industry, while construction and production dragged on growth. Mar PMIs inched higher, as seen for manufacturing (51.0 vs. 50.8 prior) and services PMI (53.7 vs. 52.7 prior) while construction PMI held steady at 54.2. Latest Labor report was dismal amid slowdown in hiring decision driven by *Brexit* concerns – job growth slowed;

unemployment rate steady while weekly earnings (ex-bonus) slipped to 1.8% (vs. 2.1% prior).

- UK inflation rose above expectation. Headline CPI rose 0.5% y/y (vs. 0.3% prior) and core CPI rose 1.5% y/y (15 month high vs 1.2% prior). The headline figure was however distorted by a spike in volatile airfares as a result of early Easter holiday.
- In the Feb Quarterly Inflation Report the MPC revised down the inflation outlook (to 1.2% vs. 1.5% in 2016) given recent falls in oil and other commodity prices. BoE expects inflation to return to target in around 2 years.
- **Monetary Policy Forecast:** A benign inflation outlook (at 0.5% y/y in Feb remains far from BoE's medium term target of 2%) and *Brexit* risks are expected to keep BoE on the sidelines for longer than expected. Markets are only pricing in first BoE rate hike in Sep 2017 (as implied from 90 days Sterling futures). We continue to expect BoE to stay in the dovish rhetoric for time being, till inflation shows further signs of pick-up and after the referendum is over.
- The previous BoE meeting on 14 Apr saw a continuation of dovish rhetoric. BoE MPC was unanimous to keep rate unchanged at 0.5% and asset purchase facility unchanged at £375bn. MPC commented that greater caution is required in interpreting data over the next few months due to Referendum-related uncertainty.
- **Latest Fiscal and External Balance Outlook:** UK posted a smaller than expected budget deficit at GBP4.8bn (vs. GBP6bn expected). 2015/16 financial year ended with the first estimate showing that the government overshot borrowing by GBP1.8bn. That said this is still an improvement of GBP17.7bn, as compared with 2014/15.
- UK's 4Q current account deficit widened to record levels of 7% of GDP since data collection began in 1955. This was due to drop in exports and a rise in imports, large increase in primary deficit (lower returns to UK from investment abroad).
- **Key domestic events and issues to watch:** BoE meeting/ Quarterly Inflation Report (12 May), CPI inflation (17 May), labor report (18 May), Apr retail sales (19 May). We had articulated earlier that we expect data to start showing deceleration amid *Brexit*-related risks.
- **Technical Outlook:** GBP rebounded for the month of Apr. Last seen at 1.4550 levels (vs. 1.40 lows last month). Monthly and weekly technical indicators are showing tentative signs of bullish bias. But we expect GBP bulls could meet some resistance as Brexit debate is expected to intensify in the lead-up to EU referendum on 23 Jun. We continue to see opportunity to buy on dips (due to Brexit fear) – set upon our base case assumption that UK will vote to remain in EU. Support at 1.38-1.40 – bias to buy there. Resistance at 1.4670 (2016 high). Break above on daily/weekly close basis could see eventual move towards 1.4880 (50% fibo retracement of Jun 2015 – Mar 2016).

AUD: Sell In May

Forecast	2Q 2016	3Q 2016	4Q 2016	1Q 2017
AUD/USD	0.78 --	0.75 --	0.78 --	0.75 --

No Change From Previous Forecast

- **Motivation for the FX View:** We are bias to sell this pair in May but the question is always when? We believe that May could be a month of correction for the AUD after a rather decent run up of 13% against the USD from the 0.69 lows of Jan to Apr highs of 0.78. Markets may start to become more cautious of a potential rate hike by the Federal Reserve which may impact on Asia sentiments. In addition, a re-accumulation in long USD position could also bring the AUDUSD lower towards the 0.7450.
- The upcoming Federal Budget for 2016-2017 is important to the economy but historical episodes have shown that the event has typically little impact on the AUD. However, this may not always be the case. Moody's had already flagged that risks of rising government debt could threaten its Aaa rating, citing likely limited and difficult spending cuts. At the same time, there is little innovation to raise revenue. Further risks to its credit rating could dampen the AUD strength.
- The macro environment and financial conditions continue to warrant easy monetary conditions. Ceteris paribus, beyond the near term, bulls will be fueled by good risk appetite, decent yields in the current low rate environment, a central bank that is comfortable with the current cash target rates albeit with an easing bias and Australia's AAA sovereign credit rating. In addition, any positive news out of China could boost AUD as well. While we, do not rule out pullbacks in the iron ore prices, technical chart of the metal suggests that a bottom might have been found for the medium term. **Hence, we see a limit to how low AUD can go in the rest of the year. AUDUSD could continue to trade largely in the range of 0.72-0.78.**
- We have seen signs of bottoming for the economy as well for the AUD. Household consumption is underpinned by strong hiring sentiments, low interest rates, and cheaper oil prices. Over the past few months, cheaper AUD has boosted Australia's tourism and education even fanned the tradable CPI higher. Recent rise in commodity price index could mean an improvement in terms of trade. With oil seemingly sticky around the USD35-45-level, we continue to expect the pair trade within 0.72-0.78 for the rest of the year.
- **Growth and Inflation Outlook:** High frequency data was supportive of the AUD in Apr. Commodity index improved to 86.6 in Mar from previous 86.3. NAB business conditions and confidence saw significant improvements in Mar. Business conditions improved to 12 from a score of 8 previously while that of business confidence also jumped to 6 from 3. Firms surveyed also reported tighter capacity and better confidence.
- The rest of the Mar data was less inspiring including the labour report though it did gave comfort that labour conditions have not deteriorated. At first glance, the employment addition of 26.1K

looked better than expected. However, the firmer headline was due to higher part-time hires, up 34.9K in the month. In fact, Australia lost 8.8K full time employment. Jobless rate slipped to 5.7% from previous 5.8%.

- Signs of demand pick up in the property sector in China, tentative as it might be, could probably sustain the bounce in metal prices or at least provide an interim anchor. Credit growth keeps pace, capacity utilization extends its uptrend, retail sales had softer print for Jan but rise in tourist arrivals and visitor spending and cheap AUD should continue to support the retail sales.
- The CAPEX report remains a key data to track the rebalancing progress and the last available report for 4Q revealed a slow transition still from a mining-investment reliant economy to one that is more diversified. The mining (investment) cliff had been taken into account by RBA's growth projection for 2016 at 2-3%. 2015 GDP is projected to be around 2.5% with key drivers from stronger net exports from the resource sector, household consumption and non-mining business investment. On those fronts, we saw little progress so far but we had known that the revival of non-mining business investment hinges on signs of a re-invigorated economy and any optimism at this point could be tempered by an overhang of uncertainties.
- **1Q CPI surprised to the downside with a print of -0.2%q/q, undershooting the consensus of +0.2%.** In addition, the trimmed mean measure of CPI, taken by the RBA as core inflation, decelerated to 0.2%q/q from the previous 0.6%. Year-on-year, the trimmed mean slowed to 1.7% from previous 2.1%. Weakened price pressures were observed with the heavily weighted food component declining -0.2%q/q as well as that of Recreation and culture which fell -0.1%. Housing rose 0.3%q/q.
- **Monetary Policy Forecast:** While there is certainly more scope for RBA to ease, we do not think the central bank will do so. Credit growth, capacity utilization rate, retail sales have been holding up and even employment has been resilient, notwithstanding recent softening in the trend measure. For those looking for a cut to weaken the AUD, the exchange rate has clawed back its competitiveness against its trading partners since 2014 and the next cut may not come with the same mileage as the last for AUD bears. More importantly, a cut to boost inflation would waste ammunition in the current global environment which is disinflationary anyway. Rather, RBA would save the gunpowder in case demand from China deteriorates further.
- **Latest Fiscal and External Balance Outlook:** The delivery of the next Federal Budget is scheduled on 3 May. From the last MYEFO, the present budget deficit was revised higher to A$37.4 from the original projected A$33.7bn. We anticipate little improvement in the budget deficit and downside risks in budget deficit. Welfare is unlikely to be cut ahead of a potential elections and Treasurer Scott Morrison has to come up with more innovative ways to raise revenue in order to ensure fiscal discipline. Failing which may risk a hit on its credit rating.
- Beyond 3rd May, expect a double dissolution election which could be held on 2 Jul after the industrial laws reconstituting the Australian Building and Construction Commission had been rejected.

- Current account deficit widened to -A$21.1bn 4Q from previous –A18.8bn in 3Q (last available data).
- **Key domestic events and issues to watch:** RBA sets cash rate target on 3 May, the same day that the Federal Budget 2016-2017 is presented. May retail sales is due on the 5th. The SoMP (Statement of Monetary Policy) will be released on the 6th. We also watch the Apr NAB business conditions/confidence on the 2nd. Minutes are due on the 17th. RBA Debelle speaks on the 18th, followed by labour report for Mar on the 19th. 1Q CAPEX due on 26th.
- **Technical Outlook:** We had flagged bearish divergence for a while now for the AUDUSD and it is now being played out. A break of the support at 0.76 (23.6% Fibonacci retracement of the Jan-Apr rally) should see this pair move towards the 0.7450 (38.2% Fibo), which lies near the 100,200 DMA. However, AUD bears need to clear the 50-DMA at 0.7540 for greater extension. Right now, the pair was last seen around 0.7640. Momentum indicators are bearish but we see risks to the upside given the depressed USD tones, AUDUSD still within the upward sloping trend channel and general Asian strength thanks to BOJ. Support is seen at 0.7500 but that could be largely out of reach. Rather, we are more bias towards a revisit of the resistance at 0.7720 (Mar high) before the next at 0.7850.

NZD: Higher But for How Long?

Forecast	2Q 2016	3Q 2016	4Q 2016	1Q 2017
NZD/USD	0.6800	0.6600	0.6700	0.6600
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No Change from Previous Forecast

- **Motivation for the FX View:** The theme we highlighted in our last FX monthly outlook – that **USD dynamics continue to eclipse NZ fundamentals remain intact**. **USD remains soft** amid little commitment from Fed (Apr FOMC) on rate hike (in Jun) while **RBNZ signaled no cut** (although maintained easy monetary policy as usual). Against an environment of low rate and easy monetary conditions, **market continues to favor high-yield plays (Kiwi bonds yield 2.25% and is AA-rated) and this is expected to keep the NZD supported**.
- Technically the pair has been trading well-within the upward sloping trend channel – lower bound at 0.6745; upper bound at 0.7130. Bias over the next 1-2 weeks remains to the upside.
- While NZD upside risks persist, we **retain our bearish take on the NZD off the back of weak macro-fundamentals - benign inflation outlook**, still **challenging dairy market dynamics**, high risk of **current account deficit widening**, **and further downside risk to growth outlook.** These factors will come into play and weigh on the NZD when Fed resumes rate hike cycle (which we believe there is a case for rate hike in Jun). We wish to reiterate that **RBNZ retain its explicit bias for further easing and a weaker NZD.**

- **Growth and Inflation Outlook:** While the domestic economy remains supported by net immigration, tourism amid accommodative monetary conditions, there are signs that momentum is decelerating. BusinessNZ Mfg eased to 54.7 in Mar (from 56.0 in Feb). Dairy sector remains challenging – while dairy prices picked up slightly, they remain below break-even levels for farmers. 1Q retail sales out on 13 May and 1Q GDP data is due for release on 16 Jun.

- 1Q headline CPI rose 0.2% q/q and 0.4% y/y basis. Non-tradable inflation rose 1% q/q while tradables fell 0.9% q/q. **NZ inflation remains well below its 1-3% target range and is now at 16-year lows, due to earlier NZ strength and the large decline in oil and commodity prices.** Dairy prices have risen in the past 2 GDT auctions but it remain well below its 5-year average. We expect dairy prices to remain low for longer until global dairy over-supply and under-demand dynamics adjust

- **Monetary Policy Forecast:** At the last RBNZ MPC meeting on 28 Apr, RBNZ kept OCR unchanged at at 2.25%, as expected. In the accompanying statement, RBNZ continues to express its desire for lower NZD to boost tradables inflation and assist the tradables sector; continues to highlight weakness in dairy sector, decline in inflation expectations and upward pressure on housing market due to high net immigration. RBNZ concluded by saying that further policy easing may be required to ensure that future average inflation settles near the middle of target range. On the 10 Mar RBNZ meeting, RBNZ surprised with 25bps cut **taking the OCR to record lows of 2.25%. Statement specifically noted "there has been a material decline in a range of inflation expectation measures… a concern because it increases the risk that the decline in expectations becomes self-fulfilling and subdues future inflation outcomes".** Statement also noted **dairy sector is facing difficult challenges** and that the **TWI is more than 4% higher than projected and a decline would be appropriate given weakness in export prices.**

- **Latest Fiscal and External Balance Outlook:** 4Q current account deficit narrowed to -NZD2.61bn (from -NZD4.75bn in 3Q). 4Q 2015 current account deficit stood at 3.1% of GDP (narrowed slightly from -3.3%).

- OBEGAL (Operating balance before gains and losses) saw a surplus of NZ$398 mil for the 8-months ending 29 Feb 2016, NZ$730 mil higher than forecasted.

- **Key domestic events and issues to watch:** 1Q retail sales (13 May); 2y inflation expectation (17 May); 1Q PPI (18 May); Apr trade (25 May). GDT auction on 3 May and 17 May.

- **Technical Outlook:** NZD continues to trade well-within the upward sloping trend channel – lower bound at 0.6745; upper bound at 0.7130. Last seen at 0.6960. Weekly momentum remains bullish but stochastics is entering near-overbought conditions. Expect the pair to continue trading in the trend channel formed since Jan 2016.

JPY: Further BOJ Measures Not Imminent

Forecast	2Q 2016	3Q 2016	4Q 2016	1Q 2017
USDJPY	110 --	114 --	116 --	120 --

No Change from Previous Forecast

- **Motivation for the FX View:** The JPY has been one of the best performers not only in Apr but so far this year as well, gaining 0.7% and 7.5% respectively against the USD. The USDJPY touched a new low of 110.63 (11 Apr) for 2016 as risk appetite waned, sparking off a scramble for safe-havens. Pair has rebounded back above the 111-levels on trial balloons – negative lending rates - put out by BOJ. In the absence of further BOJ easing measures for now, we continue to expect the pair to end 2Q at 110 by end-2Q before rebounding towards the 116-levels by end-2016 and then to 120 by end-1Q 2017.
- Backstopping the JPY is the more gradual pace of Fed fund rate hike, which together with dovish comments by most Fed speakers, strong current account surplus (2015: JPY16.64bn) as well as global reserve managers need to diversify reserves away from dollar and euro and into one of the most liquid currencies - the JPY – are likely to be supportive of the JPY ahead.
- Expectations of further JPY strength have led to Japanese investors selling off JPY0.71tn and JPY0.33tn of foreign equities and government debt in the first two weeks of Apr and repatriating the funds onshore. This should put further upside pressure on the JPY. Similarly, foreign investors have purchased JPY0.69tn and JPY1.59tn in equities and debt in the first two weeks of Apr. These inflows by both Japanese and foreign investors have helped to keep the JPY supportive so far. Unless there is further easing measures by BOJ or structural reforms by the government, inflows are likely to continue and put downward pressure on the USDJPY ahead.
- Despite expectations of further easing as soon as the Apr meeting, our base case remains for the BOJ to be on hold until 2H 2016. The central bank is likely to pause to evaluate the impact of the various easing measures on the economy so far. As well, given the unpopularity of the negative interest rate policy (NIRP) among the public, the BOJ has to be mindful of the impact of further easing on the Upper House elections due early summer. Measures that the BOJ is likely to take post-Upper House elections, possibly in Jul, include extension of the base money, purchasing more ETFs and cutting interest rate further. Until then, we can expect further jawboning by the BOJ and government as they did on 22 Apr about negative lending rates. This moves by the BOJ together with the expected hike by the US Fed in 2Q and 4Q could lift the USDJPY higher towards the 116 by end-4Q 2016 and 120 by end-1Q 2017.
- The risk ahead is the rising concern of the efficacy of the policies of Abenomics, putting PM Abe's and BOJ governor Kuroda's credibility at risk should the economy fail to reflate. More importantly, the collapse in confidence could trigger a sell-off in

the Nikkei and force large unwinds of JPY-hedges and risk the USDJPY falling further.

- **Growth and Inflation Outlook:** Tankan survey results for 1Q 2016 were weak with current business conditions and capital spending came in weaker than expected, particularly for larger manufacturers. In addition, the outlook for 2Q deteriorated, underpinned by sluggish Asian demand and JPY strength. This less-than-stellar Tankan print suggests that further stimulus is needed to prevent the economy from slipping into a technical recession. Data out so far have not been encouraging. Core machine orders - an indicator of future capital spending by private companies – continued to contract in Feb, falling by 8.2% y/y in Feb. However, there could be signs of an uptick in the economy. Industrial production, which had contracted by 5.2% in Feb, rebounded by 3.6% y/y in Mar. Also, unemployment rate slipped lower to 3.2% in Mar from Feb's 3.3%, while wage growth rose by 0.7% y/y in Feb, an pick-up after three months of flat growth and this could lift retail sales in Mar after contracting by 2.3% y/y in Feb. External demand though remained sluggish with exports down 6.8% y/y in Mar from -4.0% in Feb. Imports fell by a larger 14.9% y/y in Mar from Feb's -14.2%. The BOJ lowered its GDP projection in its Apr quarterly review, lowering its real GDP growth to 1.2% for FY 2016-17 (previously 1.5%) and 0.1% for FY 2017-18 (previously 0.3%). For FY 2018-19, expectations are for growth of 1.0%.

- The pick-up in wages could portend some upside to inflation ahead in the wake of recent weak inflation prints. But for now, softer global oil prices and sluggish domestic demand is weighing on consumer prices. Mar CPI fell 0.3% y/y, the first decline since May 2013, while core inflation – CPI less fresh food – declined for the fourth straight month by 0.3% y/y. More disconcerting is that the ultra-loose BOJ monetary policy and negative interest rate policy have failed to ignite inflationary pressures. This puts achieving the 2% inflation target by around 1H FY 2017 at risk. However, the inflation indicator favoured by the central bank - core-core inflation, i.e. headline inflation less fresh food and energy prices – remained resilient in inflation, rising by 1.1% y/y in Feb – the same pace as in Jan. This provides some comfort to the central bank that inflation is gaining traction. BOJ expects core inflation to average 0.5% in FY 2016-17 (from 0.8%) and then to 1.7% in FY2017-18 (from 1.8%). Core inflation should rise to 1.9% in FY 2018-19.

- **Monetary Policy Forecast:** Risks of a BOJ policy move increased following feelers put out by the central bank on negative interest rate for lending facilities, sparking a sell-off in the USD/JPY. But as we had expected, the BOJ stood pat on policy at its 28 Apr meeting. This should allow the BOJ to evaluate the impact of the NIRP on the economy. As well, with the Upper House election due sometime in early summer (i.e. in Jul) and with NIRP unpopular among the public, the BOJ may want to refrain from further easing until the election is over. We thus expect BOJ to remain on hold for the rest of 1H 2016 and any further easing moves are likely to come in Jul only. Nevertheless, this does not preclude the BOJ from further measures if necessary as the BOJ governor has constantly warned. Any further action by the BOJ cannot be piecemeal as seen when the NIRP was introduced. Instead, we expect the BOJ to introduce a comprehensive suite of measures including expanding the monetary base to JPY100tn from JPY80tn currently, increasing the purchase of ETFs to JPY10tn from JPY3tn and cutting interest rate further to -0.3%. Other possible measures that could be used include a tax on corporate profits to induce companies to spend rather than hoard cash. Helicopter money – i.e. the BOJ directly financing the government's budget deficit – is unlikely for now. But we believe this 'nuclear option' could be used as a last resort should other measures fail to reflate the economy.

- **Latest Fiscal and External Balance Outlook:** Despite the sluggish growth outlook, the government has refused to consider an extra budget of stimulus measures to bolster the economy. Instead, plans are moving ahead to front-load the spending of the record JPY96.7tn budget. An extra budget is being planned though but is unlikely to include any economic stimulus measures. Instead, this extra budget is to help rebuild the communities that have been devastated by the Kumamoto Earthquake. In addition, Finance Minister Aso reiterated that the government intends to proceed with the sales tax hike as planned to maintain confidence.

- The current account surplus ballooned in Feb after waning since Jul 2015. The current account surplus was recorded at JPY2.43tn in Feb – a level not seen since Mar 2016 (JPY2.79tn). The large surplus was due to the rebound in the goods and services account of JPY0.58tn as well as an improvement in the primary income account of JPY2.05tn. The overall balance of payments (BoP) surplus ballooned as well to JPY6.33tn in Feb from JPY2.43tn in Jan on the back of larger surpluses in both the current and financial accounts. The wider financial account surplus could be attributed to the large portfolio inflow of JPY9.52tn and increase in direct investment of JPY1.53tn that more than offset the spike in the other investment account deficit of JPY7.06tn.

- **Key domestic events and issues to watch**: Preliminary estimates for 1Q16 GDP will be released on 18 May. BOJ Governor and Deputy Governor speak separately on 13 May (at the Research Institute of Japan in Tokyo) and 12 May (BOJ's retail settle conference in Tokyo) respectively. JGB auctions in May: 10-year (10 May), 30-year (12 May), 5-year (17 May), 1-year (18 May) and 20-year (19 May).

- **Technical Outlook:** USDJPY plunged following BoJ meeting (28 Apr) as hopes of BoJ easing were dashed. Pair was last seen at 108 levels. We reiterate our last issue of monthly outlook that monthly momentum remains bearish bias. Next support at 106.90 levels (38.2% fibo retracement of 2016 low to 2015 high). Break that on weekly close should see an extension of the decline towards 101 levels (50% fibo). Resistance at 112.60.

CNY: Yuan Weakness Against Basket Like To Continue

Forecast	2Q 2016	3Q 2016	4Q 2016	1Q 2017
USD/CNY	6.50 --	6.55 --	6.50 --	6.55 --
USDCNH	6.50 --	6.55 --	6.50 --	6.55 --

No Change From Previous Forecast

- **Motivation for the FX View:** The headline grabber for the yuan index was the break of the 98-level in the first week of Apr. From that point, we have changed our view on the RMB index. **Dollar weakness continues to allow room for PBOC to adjust the CNY weaker against major non-US trading partners so that CNY can be more competitive on the REER basis.** The break of the 98-level came amid better data for China for 1Q. The 1Q growth print, at 6.7%, was snug within the target range of 6.5-7.0% for the year and the release was accompanied by upside surprises in the Mar activity data including industrial production, urban FAI and retail sales. While all of these were likely supported by a significant degree of monetary accommodation, we think these growth stabilization measures, albeit short-term, is necessary to buy time for further structural reforms that should take more time.
- **Tactically, we expect the depreciation in the yuan against the basket may take a pause in May as we anticipate USD resurgence. However, we do not anticipate USD bulls to hang around for long. Medium term bias is for greater yuan weakness against the EUR, GBP, JPY, CAD and MYR.** With FX Reserves still recorded at USD3.2trn, markets are more or less convinced of PBOC's ability to keep CNY stable against the USD. This will naturally keep the gap between onshore and offshore yuan from widening drastically this year.
- A more stable yuan does not mean that the economy has seen fundamental improvements. **China still has excess capacity, heavily indebted corporations and huge liquidity injections continue to add pressure on the yuan in the medium term.** However, the State Council has shown a certain level of commitment to eradicating excess capacity including a plan for 1.8mn job losses in the coal and steel sector. The Chairman of the State Owned Asset Supervision and Administration Commission assured that big SOEs will strengthen as a result of the plan to cut overcapacity and duplication will be eliminated. In addition, the government is also focusing on emerging and higher-value industries including aerospace, nuclear power, high speed rail, renewable energy, smart grid technology. We are hopeful that liquidity could be channeled into building new growth engines. However, economic rebalancing efforts are likely to take time. To buy time, PBOC has to continue to provide liquidity. Industrial profits have rebounded from a year of contraction. Notwithstanding favourable base effects, a rebound of around 4% still indicates some sort of stabilization and we also see that 60% of industrial profits are now made up of non-overcapacity sectors. Real estate investment has also started to show signs of stabilization, an indicator that gels well with rising mortgage

loans. Real estate dependent industries should continue to get a boost, easing capital outflows and the downward pressure on the yuan.

- **Our monthly Maybank vulnerability score (using 9 economic and market variables:** GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) showed the score for China was unchanged at 5.2.
- **Growth and inflation outlook:** 2016 is set to be a year focused on achieving growth stability, yuan stability and deleveraging with stability. As our macro strategist *Willie Chan* had pointed out, the debt to equity swap is a key source of uncertainty. The scheme was first announced in Mar as a way to restructure corporate debt. The finer details are still being discussed and perhaps the most important question is what kind of debt the banks should take on - performing or non-performing? Non-performing loans has risen to 2008 levels (last seen at CNY1.27trn). To be sure, debt to equity swap can still happen under the current banking regulation. Debts can be swapped for shares if the latter were used as collateral for loans with the condition that the banks sell the shares within two years. While ordering banks to swap NPLs for equities could free up the capital for banks to engage in more productive lending, there is wide concerns that the practice could increase moral hazard. Firms may engage in aggressive borrowing knowing that the banks would be able take the bad loans from them if they are not able to pay up. The most adverse impact is on banks which will no longer have the first claim to risk in times of bankruptcy.
- Mar PMI-mfg came in at 50.2 vs previous 49.0 and beat expectations at 49.4. The release herald the upside surprise in the rest of the Mar data. Non-mfg also came in at 53.8 from previous 52.7. The Caixin version was in line with the NBS version, higher at 49.7 from previous 48.0. Exports grew 20.6%y/y, a rebound from the previous decline of -20.6%. Imports shrank less than expected by -1.7%y/y. Trade balance narrowed further to CNY194.6bn from previous CNY209.5bn. Inflation steadied at 2.3%y/y for Apr. PPI showed less contraction by -4.3%y/y from previous -4.9%. **With PBOC resuming liquidity injections in Apr, we continue to expect liquidity support for the old and new economies in China.** Home mortgage loans continued to rise in 1Q on the back of easy monetary conditions. Macro prudential measures should remain in place in the tier-one cities. The growth in the real estate sector should continue to have positive spillover effects in mining, construction, consumer goods and real estate services.
- **Monetary Policy:** After draining an approximate CNY780bn of liquidity via open market operations in Mar, PBOC has resumed to injecting a net CNY490bn of liquidity for so far in Apr. The central bank also resumed lending via its medium term lending facility in three instances and over shorter tenures such as 3M and 6M.The total volume of medium term lending for Apr is estimate to be CNY715bn. In total, PBOC has injected CNY1.205trn, an assuring start for 2Q. Even so, it is still well the amount of liquidity injected in Jan via OMO and MLF, recorded at CNY2.0375 trn.
- **Liquidity management is still key and with the cases of defaults rising**, the 7-day repo rate and 3M-SHIBOR have also started to rise in the past three weeks. While the use of targeted liquidity measures such as pledged supplementary lending (PSL) and medium term lending facility are likely to continue, we do

not rule out further broad based easing and continue to look for 150bps cut – 50bps in each quarter.

- Supply side reforms imply changes to its monetary policy as well. PBOC is in the midst of establishing an interest rate corridor and has mentioned to use the SLF rates as the ceiling of the interest rate corridor. Moving forward, the central bank has to ensure the transmission mechanism of future rate cuts to be filtered down to the SMEs before there can be significant breakthroughs in its exchange rate policy.
- **Latest Fiscal and External Balance Outlook:** The budget deficit widened to 2.4% of GDP in 2015 from previous 2.1% in 2014. Supply side reforms also apply to its fiscal plan for 2016. In fact, Vice FinMin Zhu Guangyao had said the threshold of 3% implies that there is still room for expansionary fiscal policy. This could serve to boost disposable income and domestic consumption.
- The 4Q current account surplus widened to US$84.3bn from the previous US$60.2bn in 3Q15. The outflows via its financial accounts had increased to USD84.4bn. The latest release of BOP for 4Q 2015 suggests that the capital outflow via trade, deposit and currency, loans have peaked in 3Q last year. The option market suggests that a strong majority of investors still expect CNY to weaken and that should also mean outflow pressure will persist but existing capital account management as well as RMB management suggest that yuan capital outflow could remain at an orderly pace.
- **Key domestic events and issues to watch:** Mar PMI-mfg is due on 1 May, followed by the Caixin version on 3 May. Foreign reserves and trade data are curiously scheduled for release on a weekend, 7th and 8th respectively. CPI and PPI on the 10th. Activity data will be released on the 14th. Liquidity numbers are due from 10th-15th. We also like to watch Apr industrial profits due on the 27th.
- **Technical Outlook:** USDCNH could see some consolidation ahead. MACD on the weekly forest indicates waning bearish momentum and the pair tests the upper bound of the trend channel at 6.4860. Monthly chart indicates some bearish momentum still and we look for 6.5380 (50% Fibonacci retracement of the Oct-Jan rally, 21WMA) as a good barrier to watch. Support is seen at 6.4200 (50WMA, 76.4% fibo).

KRW: A Rate Cut Requires 2 Hands to Clap

Forecast	2Q 2016	3Q 2016	4Q2016	1Q 2017
USD/KRW	1160 --	1190 --	1170 --	1180 --

No Change from Previous Forecast

- **Motivation for the FX View:** We continue to **maintain our bearish bias on the currency** against a backdrop of factors previously highlighted (and more) – ongoing sluggish external demand (15 consecutive months of decline), rising risks of slowing recovery in domestic demand, benign inflation outlook, ongoing geopolitical tension, monetary and political risks. The

recent surprising defeat (of Saenuri Party) at the parliamentary elections on 13 Apr may result in longer than expected election deadlock as Saenuri Party struggles to get the 60% parliamentary support required to form a majority and adopt new legislation. As of 13th Apr parliamentary elections, President Park's Saenuri Party only has 122 seats while opposition party Minjoo has 123 seats and People's Parties had 38 seats. **Extended delay could derail Saenuri Party's reform efforts in labor laws, and prevent deregulation in some industries** (including medicine, food, technology, cosmetics and oil products). **Without a parliamentary majority, investor sentiment and confidence could be dampened especially with the Presidential elections coming up in Dec 2017.** These **political worries could press on for longer than expected and weigh on KRW.**

- We also noted 4 out of 7 MPC members have ended their tenure, as of 20 Apr. The incumbents have joined and will officially participate in the next BoK meeting (13 May). **3 out of these 4 members are perceived to be dovish and is expected to tilt the MPC to the dovish camp.** Finance Minister Yoo's recent interview to Bloomberg (13 Apr) – that the BoK still has room for rate cut – is expected to reinforce the bias. **Further monetary easing could almost certainly be warranted - questions are by what magnitude, how soon will it come and if unconventional easing could even take place.** Previously we noted (prior to the election defeat) that Saenuri Party announced potential Korean-styled quantitative easing. This is unlikely to happen soon given the election defeat, due to a lack of mandate.
- **We think the BoK is ready to cut rates as soon as the next meeting (13th May) but is skeptical how effective it would be for the BoK to act alone.** In his press conference, he mentioned that the **cut would be more effective if supported by fiscal stimulus and structural reform (hence our title for rate cut requires 2 hands - BoK and Government - to clap)** For the upcoming BoK meeting we **do not expect the new MPC to kick off with a cut** unless **there is greater clarity on the political front (if Saenuri party manages to form majority).**
- **We keep our USDKRW forecast on hold over the forecast horizon.** In our technical comments in the last monthly outlook, we cautioned that the pair could head lower towards 1126. The move materialized. For the weeks ahead, there are tentative signs for some upside. First resistance at 1155 (50% fibo retracement of the up-move from 2014 low to 2016 high) before 1175 (200 DMA). Support remains at 1126 (previous low).
- Downside risks to our USDKRW forecast include sustained improvement in China data, further reduction in depreciation pressures on CNY, dovish Fed and/or further improvement in risk sentiment.
- USDKRW extended its decline from Mar to a low of 1128.50 (20 Apr), before rebounding towards 1148 levels (25 Apr) as we write. The continuous decline since March was due to a few reasons and they are mainly exogenous factors including flows driven (market talks of large liquidation of USD long position), China growth stabilization, broad USD weakness (as markets pared down expectation for Fed hike) and improvement in risk sentiment (as oil prices continued to hold on to gains above the US$40/bbl).
- **Our monthly Maybank Vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation,

Fiscal, Equity Valuation, Population, Reserves) for S.Korea improved to 6.3 (from 6.6 in Mar). The improvement was due to inflation.

- **Growth and Inflation Outlook:** BoK lowered 2016 GDP growth again to 2.8% (from 3%) and inflation forecast to 1.2% (from 1.4%), due to weaker than expected domestic economic growth in 1Q 2016 and downward revision to global economic growth.
- **Manufacturing PMI remained in contractionary territory in Mar (49.5 vs. 48.7 in Feb).** There are tentative improvement in recent domestic data – IP rebounded in Feb (+3.3% m/m vs. -1.8% in Jan) and exports declined by less in Mar (-8.2% y/y vs. -12.2% in Feb).
- **Mar headline inflation slipped (-0.3% m/m vs. 0.5% prior), off the back of lower housing and clothing.** On y/y terms, inflation fell to 1% (vs. 1.3% in prior month). Core inflation marginally slipped to 1.7% y/y (from 1.8% y/y in prior month).
- **Monetary Policy Forecast:** We continue to expect the BoK to maintain its accommodative monetary stance, for extended period so as to support economic recovery. Given the new replacement of members, we see high likelihood that BoK will cut rate by at least once in 2Q. We think the BoK is ready to cut rates as soon as the next meeting (13th May) but is skeptical how effective it would be for the BoK to act alone. In his press conference, he mentioned that the cut would be more effective if supported by fiscal stimulus and structural reform. Hence for the upcoming BoK meeting we **do not expect the new MPC to kick off with a cut** unless **there is greater clarity on the political front (if Saenuri party manages to form majority).**
- **We reiterate the profiles of the new MPC members - 3 out of the 4 new members are perceived to adopt a dovish stance.** 1) Dr Cho Dong Chul (Chief Economist for Korea Development Institute) has been highlighting concerns that Korea faces deflationary risks and has been calling for accommodative monetary policy to boost inflation. 2) Dr Shin In Seok (member of the National Economic Advisory Council which offers advice to the President) has recently mentioned that there is no reason to follow the Fed to hike rate against a backdrop of current growth and inflation environment; called for more efforts to internationalize the KRW; 3) Dr Koh Seung Beom (Commissioner of the Financial Services Commission) is known to be dovish. The exception is 4) Dr Lee Il Houng (Head of Korea Institute for International Economic policy) who may resist further cuts. But his stance may be unclear as he mentioned the risk of sustained trade stagnation and monetary and fiscal policies could help as temporary solutions but structural reforms are necessary to move away from low growth.
- We also reiterate there is a risk for Korean-style QE (announced on 29 Mar by Saenuri Party's recent election campaign) which is aimed at corporate restructuring via the BoK printing money. This is different to QE in US, Europe, UK, Japan where BoK Lee claimed was intended to increase money supply after near zero interest rate failed to make a difference. The "Korean-style" quantitative easing involves the purchase of Korea Development Bank bonds to finance corporate restructuring as well as direct purchase of mortgage-backed securities to convert household mortgages into longer term amortizing mortgages. This is a **targeted form of quantitative easing to help with financing corporate restructuring as well as aimed at lowering the**

burden of servicing mortgages for households (in an attempt to ensure debt sustainability and reduce risk of households NPLs). These plans are yet to be approved. The government is also looking to explore fiscal impulse to do its fair share of heavy lifting to improve growth potential and re-design of tax structure to encourage corporate investment, R&D, etc. **This is unlikely to happen soon given the election defeat, due to a lack of mandate.**

- At the last MPC meeting (19 Apr), BoK kept policy rate on hold at historical low of 1.5% for the 10th straight meeting as expected. But the **decision was not unanimous as one MPC member voted for a rate cut.**
- **Latest Fiscal and External Balance Outlook:** Current account surplus widened to $7.51bn in Feb from revised $6.82bn in Jan due to narrowing deficit in the services sector and lower imports.
- According to the Public Finance 2015 report issued by National Assembly Budget Office, fiscal deficit for 2016 is expected to widened to -2.3% of GDP. Sovereign debt to GDP is expected to climb to 40% of GDP for 2016.
- **Key domestic events and issues to watch:** S. Korea releases Apr exports (1 May); Apr CPI inflation (3 May); BoK meets on 13 May; Apr IP (31 May).
- **Technical Outlook:** USDKRW extended its decline, falling to as low as 1126 levels (a level we highlighted in our previous monthly outlook). Technical signs are sending mixed signals - Monthly momentum remains bearish. A death cross was formed (29 Apr) – 50DMA cuts 200 DMA to the downside. But weekly stochastics is showing tentative signs of turning higher from oversold conditions. And that could potentially see some rebound towards 1155 levels (38.2% fibo), 1176 (50, 200 DMA). But rebound may be shallow. Support remains at 1126 levels (50% fibo retracement of the up-move from 2014 low to 2016 high), before 1100.

SGD: Pressured Lower By Policy Shift

Forecast	2Q 2016	3Q 2016	4Q 2016	1Q 2017
USD/SGD	1.3550 (1.3400)	1.3750 (1.3600)	1.3850 (1.3700)	1.3900 (1.3800)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** The surprise shift in policy to neutral by MAS from a "gradual and modest" appreciation path of the SGD NEER policy band has provided the USDSGD with a leg up. The USDSGD spiked above the 1.36-handle to 1.3668 following the policy announcement on 14 Apr though the pair has retraced and has been hovering around the 1.3550-levels since. Given this development, we now expect a sharper climb in the USDSGD to 1.3550 by end-2Q before edging even higher to 1.3750 by end-3Q before ending 2016 at 1.3850. The pair should climb higher by end-1Q 2017 to 1.3900.

- The MAS shift in policy had triggered a sell-off in Singaporean assets, particularly government debt. The lower hurdle that the MAS has now set to trigger a policy shift has increased speculation of a further move by the MAS down the road. This risk has exacerbated the sell-off in domestic assets by foreign funds and weighed on the SGD. The sell-off was manifested in the government bond yields rising by 9.46-22.80bp across the longer end of the curve since the beginning of the month, while those at the shorter-end have come off by 11.95-15.05bp. This reverses the unwinding of long USDSGD positions and foreign demand for government debt we saw in Mar as a consequence of the MAS policy. Nevertheless, foreign demand for government debt remains healthy with bonds yields down by 4.05-60.77bp across all tenors. This should help keep the USDSGD grounded and prevent the pair from climbing higher too aggressive for now.

- Our base case remains for a more gradual pace of fund rate hikes by the US Fed. We expect two hikes by the Fed – one in Jun and the other by Dec – that should keep the pair buoyed as the SGD continues to track dollar moves ahead. Expectations of a more gradual rate hike together with the MAS shift in policy should keep the USDSGD buoyant ahead.

- **Our monthly Maybank Vulnerability score:** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for Singapore held steady at 3.8. This should continue to be supportive of the intrinsic value of the SGD. Our model shows that the SGD NEER was last seen 0.30% above the mid-point implied at 1.3478. Upperbound is implied at 1.3209 while lowerbound is now at 1.3747.

- **Growth and Inflation Outlook:** Advanced estimated for 1Q 2016 GDP indicated that the economy expanded at a steady pace as 4Q 2015 at 1.8% y/y. However, growth stalled in 1Q as the economy saw flat growth on a q/q seasonally-adjusted annualized rate (SAAR) basis. The drag on the economy is still from manufacturing, which contracted 2% y/y in 1Q (4Q: -6.7%) but rebounded 18.2% q/q SAAR (from –4.9% in 4Q). Recently released data for Mar seems to indicate that industrial production has bottomed and could be on a gradual recovery path and the pick-up in manufacturing PMI and electronics PMI (Mar: 49.4 and 49.0 vs. Feb: 48.5 and 48.2) seems to confirm this trend. A key risk glimpsed from the advanced estimates was the slowdown in the services sector, up by just 1.9% y/y vs. 4Q's +2.8% (1Q: -3.8% vs 4Q: +7.7% q/q SAAR). Further slowdown in this sector could remove an important pillar of strength from the economy, especially in the midst of sluggish external demand. NODX has contracted by 9.0% y/y in 1Q 2016. As well, the ongoing re-structuring of the economy has also weighed on growth. With no significantly lift to the economy in sight, our economic team is maintaining its 2016 growth forecast at 1.7% in 2016 before expecting a rebound to 2.0% in 2017.

- Recently released inflation print for Mar seemed to be in tandem with the government's concern that core inflation could come in at the lower end of its 0.5-1.0% forecast range. Core inflation – which excludes accommodation and private road transport cost - rose by 0.6% y/y in Mar, a tad higher than the 0.5% recorded in Feb, mostly on account of higher food prices. In contrast, headline inflation fell 1.0% y/y in Mar on the back of lower transport and housing cost - the 17th consecutive month of decline. The outlook for inflation remains benign. Imported inflation does not pose a problem for the economy given ample supply buffers and weak global demand. Moreover, oil prices are expected to remain subdued for the whole of 2016 compared to last year. Domestically, labour market tightness is expected to come off slightly with wages growth projected to slow. The pass-through from wage costs to consumer prices should continue to be constrained by the subdued economic growth environment. So barring a sharp rebound in oil prices, the MAS continues to expect core inflation to come in at the lower half of its 0.5-1.5% forecast range. Headline inflation is projected to remain negative throughout 2016 and average -1.0-0.0%.

- **Monetary Policy Forecast:** The MAS surprised market this morning by shifting to a neutral policy stance. This marked the third easing move by the monetary authority in one-and-half years. There was no change in the width of the policy band or the level at which it was centred. The SGD reacted by depreciating about 1.0% against the USD. At same time, the SGD NEER had slipped below the mid-point, where it had been hovering prior to the MAS announcement, to -0.6% following the announcement. However, **the impact of the move could be limited as the shift is from a 0.5% appreciation path to 0% and the current SGD weakness could be somewhat temporary.** The MAS statement reiterated that this was not a policy to depreciate the SGD but to only remove the modest and gradual appreciation stance that has been in place. Possible reasons for this move by the MAS include the dimming global outlook since Oct and that core inflation could come in at the lower half of the forecast range. With this move, it appears that the hurdle for any policy adjustment is now no longer that elevated.

- The USDSGD has come off from its Jan high of 1.4444 to a recent low of 1.3352 to date, underpinned by a softer dollar as well as continued unwinding of long USDSGD positions. The move lower by the USDSGD suggests that the climb in domestic interest rates is likely be more gradual. To date, the 3-month SIBOR (3MSIBOR) has come off from its five-year high of 1.254% (19-27 Jan) to hover around the 1.0% levels at the point of writing. The more gradual pace of rate increase should also moderate the rise in mortgage rates for now. Deposit rates (for 12-month fixed) have risen gradually from 2014 lows of 0.31% to hover around 0.35% currently. This continues to suggest that risks related to interest rate increases affecting financial and economic stability, particularly in interest rate- and property-related sectors, seems limited for now. We continue to expect the 3MSIBOR and 3MSOR to end 2016 and 2017 at 1.44% and 1.55% and 1.74% and 1.85%respectively.

- **Latest Fiscal and External Balance Outlook:** Budget 2016 announced on 24 Mar was prudent and crafted to guide the economy to a new phase of development for future growth. The three key thrusts of the budget were adopting an expansionary fiscal spending; Industry Transformation Programme (ITP) and supporting people through demographic, cyclical and structural changes. An overall budget surplus of SGD3.4bn (+0.8% of GDP) was envisaged in FY2016 with FY2015 projected deficit at SGD4.9bn (-1.2% of GDP). More importantly, the primary fiscal balance (that is, without special transfers and top-ups and net investment returns contributions) was in a larger deficit of SGD4.99bn. That said, the fiscal impulse of the budget as stated above is over 1% of GDP.

- **Key domestic events and issues to watch:** Uneventful month with just the by-election for the Bukit Batok single-member constituency on 7 May of note.
- **Technical Outlook:** USDSGD traded 1.3350 – 1.3670 range for the month of Apr. Monthly momentum indicators remain bearish bias. But bearish momentum on weekly chart shows signs of waning. There could be risk of rebound. Resistance at 1.3650 (38.2% fibo retracement of 2014 low to 2016 high), 1.3990 (23.6% fibo, 200 DMA). Support on the downside at 1.3405 (50% fibo) before 1.3350 (Apr low), and 1.3160 (61.8% fibo).

MYR: Still on Track despite Some Hiccups

Forecast	2Q 2016	3Q 2016	4Q2016	1Q2017
USD/MYR	3.9000 --	3.9500 --	3.8500 --	3.9000 --

Previous forecast in parenthesis.

- **Motivation for the FX View: Our conviction for limited weakness in the MYR and our more optimistic view than market consensus were finally validated.** USDMYR has fallen by nearly 7% to a 9-month low of 3.83 levels (at time of writing) from above-3.87 levels (end-Feb). Currently at around 3.90 levels. The **move lower was largely due to relative stability in oil prices (oil volatility has eased towards Nov 2015 lows while oil prices have moved above $40/bbl), stabilizing portfolio flows (anchoring investor sentiment), domestic concerns gradually dissipating and a dovish Fed as seen from recent FOMC meeting (17 Mar) and Fed Chair Yellen's speech (29 Mar) which were dovish and has been exerting downside pressure on the USD and helping to keep sentiment positive for risk assets.** Broadly speaking in addition to those factors above-mentioned, a positive recalibrated budget (Jan 2016), and resilient domestic demand is expected to help offset some of the sluggish external demand concerns. **Near term outlook for portfolio flows have stabilized and further improvement is expected to contribute to the positivity surrounding the MYR.** As such we **remain convicted to our more-than-optimistic-view-than the market on the MYR and further revised USDMYR lower across the forecast horizon.**
- **Our fair value estimate which takes into account interest rate differential, inflation differential, current account differential and reflation variables shows USDMYR at 3.54 levels (as at 26 Apr 2016).** We had previously said that Ringgit weakness was temporary and was not a reflection of underlying fundamentals (which remain intact). We expected to see some stability returning to Ringgit as political/contingent liability risk subsides, fiscal consolidation/reforms gains traction and oil prices stabilize at lower levels. These are now gradually coming in place.
- As a positive correlation exists between oil prices and Ringgit, we our analysis found that **an asymmetric relation exists between oil and ringgit. When oil price is rising, Ringgit rises faster as compared to when oil price was falling.** In previous episode (end 2014-15) when oil price was falling, a 10% move lower in oil

prices corresponded with about 1.5% move lower in the Ringgit against the USD. This time round in the episode of oil prices rising (since early 2016), **a 10% move higher in oil prices saw a 2.6% move higher in Ringgit. To put that in perspective, if oil rises from $40 to $48 (representing a 20% rise), USDMYR could potentially fall to 3.82 levels.**

- External reserves as at 15 April 2016 rose to USD97.2b (MYR382.1b) from USD97.0b (MYR381.6b) on 31 Mar 2016, driven mainly by portfolio capital inflows. The latest tally is equivalent to 8.1 months of retained imports and 1.1 times of short-term external debt. Year-to-date, external reserves increased by +2.0% from USD95.3b at end-2015(2015: -17.8%) and 4.2% from the low of USD93.3b at end-Sep 2015. The rise in external reserves so far this year largely reflects foreign buying of equities and bonds.
- The Government of Malaysia last week raised USD1.5b worth of USD Sukuk in two tranches i.e. USD1b in 10-year note and USD0.5b in 30-year note. It was oversubscribed by 4.2 times given the USD6.3b orders. According to the Ministry of Finance, for the 10-year sukuk, 65% was taken up by investors in Asia, 19% from the Middle East, 11% from Europe and 5% from US, while for the 30-year sukuk, about 54% was distributed to Asia, 12% to Europe, 24% to the US and 10% to the Middle East. The bulk of the proceeds is to refinance USD1.2b Sukuk maturing in July 2016. This will contributeto a net USD0.3b addition to the external reserves
- We are also keeping an eye on China-related and other central bank flows. The development in Malaysia's external reserves will also be influenced by "China-related flows". Recall back in Nov 2015, Premier Li Keqiang announced that People's Bank of China will buy more of Malaysian government debt securities. China's companies were the key players in the 1MDB's debt rationalisation process following China General Nuclear Power Corporation's (CGN) acquisition of Edra Global Energy Berhad's entire power assets for MYR9.83b,and the sale of 60% equity in Bandar Malaysia worth MYR7.41b to China Railway Group Ltd – Iskandar Waterfront Holdings (CREC-IWH) consortium. Further, CREC will invest USD2b (MYR8.13b)to build an integrated complex in Bandar Malaysia to house its Asia-Pacific regional office, which represents 30% of the first phase of Bandar Malaysia and construction is expected to begin next year. In addition, the Thailand's cabinet approved a change in law to allow Bank of Thailand (BoT) to invest its external reserves (latest USD170.9b as at 11 Mar 2016) in international equities. BoT may initially invest some 3%-4% of its reserves in shares and funds linked to stock indices.
- Month to date, foreigners were net buyers of equity and bonds. They were net buyers of Malaysian equities in the first half of Apr 2016 at +MYR0.5b, sustaining the foreign net buying recorded in the past two months (Mar 2016: +MYR6.1b; Feb2016: +MYR0.4b). Foreigners were net buyers of Malaysian bonds in Mar 2016 at +MYR11.5b (Feb 2016: -MYR1.4b), the highest since +MYR13.5b in May 2014.
- **Our monthly Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for Malaysia held steady at 4.8 in Mar.
- **Growth and Inflation Outlook:** 4Q 2015 real GDP growth slowed for the third consecutive quarter to +4.5% YoY (3Q 2015: +4.7%

YoY) due to a decline in inventories. Full-year 2015 growth moderated to +5.0% (2014: +6.0%). Our 2016 real GDP growth forecast is revised to +4.3% from +4.5% (2015: +5.0%) amid moderating domestic demand, especially in consumption expenditure and private investment and to take into account of actual 2015 GDP figures which affect the base for calculating 2016 growth, plus incorporating factors like Budget 2016 recalibration impact and changes in the assumptions on variables like crude oil price and unemployment rate. Overall, we expect moderation in domestic demand (2016E: +4.0%; 2015: +5.1%) mainly on slower growth in consumer spending (2016E: +5.1%; 2015: +6.0%) and decline in public consumption (2016E: -0.8%; 2015: +1.1%), although we see pick up in gross fixed capital formation (2016E: +4.2%; 2015: +3.7%) on the rebound in public investment (2016E: +2.8%; 2015: -1.0%) amid moderating private investment (2016E: +4.9%; 2015: +6.4%). Net external demand will be less of a drag (2016E: -2.2%; 2015: -3.7%) thanks to firmer exports (2016E: +2.4%; 2015: +0.7%) and imports (2016E: +3.1%; 2015: +1.3%).

- The index of leading economic indicators in Feb 2016 fell for the fourth month in a row, pointing to further slowing of real GDp growth in1Q 2016. It is useful in predicting the direction & turning point in real GDP growth rather than the magnitude of real GDP growth. We observed that the index of leading economic indicators leads quarterly GDP growth by 2months. On this basis, we calculated that it contracted further by -1.0% YoY in 1Q 2016 (4Q 2015:-0.2% YoY). Overall, the trend in the index of leading economic indicators is consistent with real GDP growth slowing further in 1Q 2016, sustaining the downward momentum in growth since 2Q 2015.

- There have been downward revisions to full-year growth by local and international institutions recently. The IMF cut Malaysia's 2016 GDP forecast to 4.4% from 4.5% previously. The Malaysian Institute of Economic Research (MIER) also lowered its growth forecast for the Malaysian economy for this year to 4.2% from 4.7% previously. Our full-year forecast is 4.3%, with quarterly trajectory of 4.1% YoY in 1Q 2016, 4.2%YoYin 2Q 2016, 4.5% YoY in 3Q 2016 and 4.4%YoYin 4Q 2016.

- Headline inflation rate eased to +2.6% YoY in Mar 2016 (Feb 2016: +4.2% YoY) but core inflation remained steady +3.6% YoY (Feb 2016: +3.6% YoY). YTD 2016 headline inflation is +3.4% YoY while core inflation is at +3.6% YoY. No change to our 2016 headline inflation rate forecast of +3.0% to +3.5%.

- Inflation rate eased by more than expected to +2.6% YoY in Mar 2016 (Feb 2016: +4.2% YoY; Maybank-KE: +3.4% YoY; Consensus: +3.4% YoY) largely due to the drop in "Transport" (Mar 2016: -8.2% YoY; Feb 2016: +3.6% YoY). However, the underlying inflation rate remained elevated as the official core inflation rate (excluding volatile and price-controlled/price-subsidised components of the CPI) stayed at +3.6% YoY in Mar 2016 (Feb 2016: +3.6% YoY; Mar 2015: +1.9% YoY), reflecting sustained price increases in other goods and services.

- 1Q 2016 inflation rate was +3.4% YoY (1Q 2015: +0.7% YoY). The monthly inflation rate trend so far this year is consistent with our view as per previous CPI note that inflation rate had peaked in Feb 2016 and expect it to taper gradually for the rest of the year as the base effect diminishes.

- Our Maybank economics team maintains our 2016 inflation forecast of 3.0%-3.5% (2016 YTD: +3.4%; 2015: 2.1%) notwithstanding the tapering of GST impact as inflationary pressures is being sustained by other factors, such as the adjustments in domestic subsidies (e.g. rice, flour, electricity bill rebates) and administered prices (e.g. hikes in intra-city highway toll rates; rail fares: gas prices) in late-2015 and early-2016; the impact of MYR depreciation (average USDMYR – 2016E: 4.03; 2015: 3.91; 2014: 3.27) on prices and costs of imported goods and services; as well as the potential pass through of higher labour cost following the hikes in levy on foreign workers effective 18 Mar 2016 (Peninsula Malaysia for now) and the Minimum Wage increase on 1 July 2016. The official inflation rate forecast for this year is 2.5%-3.5%.

- Nevertheless, we see upsides to inflation are capped somewhat mainly by external factors as global inflation continued to be subdued and persistently low domestic fuel prices which on average expected at USD35/bbl this year (2015: USD 52/bbl) – based on Brent crude. At the same time, domestically, we estimate that Malaysia's growth in 2016 will be below its potential growth, which would help to cap demand-pull inflation. The output gap is already almost zero in 4Q 2015 and we see negative output gap in 1Q 2016, the first since 4Q 2013.

- **Monetary Policy Forecast:** BNM kept the Overnight Policy Rate (OPR) and the Statutory Reserve Requirement (SRR) ratio unchanged at 3.25% and 3.50% respectively on 9 March. We were expecting another 50bps cut in SRR. Maintain our OPR forecast range of 3.00%-3.25% this year, and together with any further SRR cut, it will be data dependent in terms of the balance of risk between growth and inflation, as well as liquidity condition and movement in market interest rates.

- The tone of the Monetary Policy Statement (MPS) remains "dovish" given BNM's assessment that growth will moderate this year after expanding by 5% last year amid vulnerability to downside risks. Although inflation is expected to be higher this year, BNM sees the upside risk is mitigated.

- Our Economists are penciling in a range of 3.00%-3.25% for OPR this year. **A 25bps OPR cut in 2H 2016 is possible if growth threatens to slip below what we believe to be BNM's comfort zone of 4%-6%.** BNM outgoing Governor Zeti had said that she is confident Malaysia can achieve the growth target this year. Having said that, latest inflation rate of 4.2% YoY as of Feb 2016 is over what we deemed to be BNM's tolerance range of 2%-3%. Therefore, OPR decision will ultimately be dependent on data – including external developments – that affect the balance of risk between growth and inflation. Similarly, any further SRR cut will depend on liquidity situation and movement in market interest rates.

- Our eyes are on the 18-19 May and 12-13 July MPC meetings. **The leadership transition at BNM in terms of a new Governor is done. The government has appointed former Dy Governor Muhammad Ibrahim as the new governor. He has been with BNM for the past 32 years and is largely positive for markets. He will begin his five year term on 1 May and will chair his first policy meeting on 19 May. He will also make his first public appearance on 13 May for 1Q GDP growth release.** 1Q 2016 GDP is out (by mid-May 2016) and BNM can see whether inflation is moderating post-1Q 2016 as expected.

- **The composition of Malaysian Government bonds' foreign investors was revealed for the first time.** As at Jan 2016, 44% of non-resident holdings of Malaysian Government bonds were by asset managers, followed by central banks / governments (29%), pension funds (13%), banks (10%), insurance companies (1%), nominees / custodians (1%) and others (1%). From now on, such data will be published on quarterly basis
- **Latest Fiscal and External Balance Outlook:** According to the latest revised budget (released 28 Jan), the government aims to maintain its 2016 fiscal deficit at 3.1% of GDP via a series of restructuring steps (operating and development expenditures cuts) that are expected to save the government MYR9bn. Malaysia's fiscal and broader economic outlook could still be under pressure from weaker commodity prices in 2016. **The revised Budget has adjusted lower its oil price assumption to US$30-35/bbl (from $48/bbl).** Downside pressure on rating agencies' 'Stable' outlook could arise in 2H 2016 if oil price averages below US$30/bbl as that may trigger projection of fiscal revenue shortfall.
- Exports growth rebounded in Feb 2016by+6.7% YoY (Jan 2016 - 2.8% YoY) whilst imports registered a slower expansion rate of+1.3% YoY (Jan 2016: +3.3% YoY) which resulted in a bigger trade surplus of MYR7.35b (Jan 2016: MYR 5.39b). Despite solid exports growth in Feb 2016 which was partially down to the low base registered last year, factors including the recent rally in the MYR, softer intermediate goods imports and lag effect of weaker LNG pricing should weigh down on exports trends in coming months.
- This year, we expect moderate growth in exports (2016: +3.4%; 2015: +1.9%) and imports (2016: +3.9%; 2015: +0.4%) as well as narrower trade surplus (2016: +MYR93.8b;2015: +MYR94.3b).
- **Key domestic events and issues to watch:** Key domestic events and issues to watch: Trade balance (6 May); Exports (6 May), FX reserves (6 May); GDP (13 May), BNM Policy Announcement (19 May) and CPI inflation (18 May). Noteworthy 1MDB has another US$52m interest payment due on 11 May for 5.99% notes due 2022. Markets may be cautious but in our view the risks are manageable and spillovers are mitigated by guarantees from the IPIC and the Malaysian government.
- **Technical Outlook:** USDMYR consolidated in the range of 3.8440 – 3.95 for the month of Apr. Last seen at 3.8970. Monthly momentum continues to point to bearish bias but weekly technicals suggest tentative signs that the pair may rebound - stochastics at oversold conditions and show signs of turning higher. Resistance at 3.95 before 3.9850 (23.6% fibo retracement of 2016 high to low). Support at 3.8440 (2016 low). Below that sees 3.80.

IDR: Buoyed By Policy Moves

Forecast	2Q 2016	3Q 2016	4Q 2016	1Q 2017
USDIDR	13200 --	12950 --	12500 --	12400 --

No Change from Previous Forecast

- **Motivation for the FX View:** The central bank's accommodative policy has so far not stymied the USDIDR downward trajectory. Accommodative monetary policy together with the positive carry on government debt amid expectations of a more gradual pace of US Fed fund rate hikes (our house expectations are for two hikes - one in Jun and the other in Dec) should continue to encourage foreign fund inflows. The introduction of 12 stimulus packages (the 12th was just announced on 28 Apr evening) is burnishing the reformist credentials of the government and lifting sentiments among investors. This too has been IDR-positive. With risks still to the downside in 2016, the USDIDR remains poised to end the year below the 13000-levels at 12500.

- Aside from the improvement in economic fundamentals (including narrower current account deficits), government initiatives to liberalize and reform the domestic economy have been key to risk-supported sentiments and the IDR. To date, the 12 stimulus packages introduced by the government have encouraged greater foreign investment, both direct and portfolio. FDI rose by 4.5% y/y to USD6.9bn in 1Q in dollar terms while in rupiah terms, it was up 17.6% y/y to IDR146.5tn. Investments flowed into manufacturing, services, trade and tourism. Strong portfolio inflows on the back of positive carry stemming from negative interest rate policies of the major economies have also been IDR-positives.

- Foreign funds have bought USD117.328mn in equities so far in Apr, a slower pace when compared to Mar's USD177.83mn and nearly half of Feb's inflow of USD302.65mn. Similarly, they have added a net USD17.32tn to their outstanding holding of government debt as of 25 Apr vs. Mar's IDR18.30tn. These inflows in Apr have so far been supportive of the IDR. Year-to-date, these foreign investors have purchased a net USD0.43bn of equities and added a net IDR62.80tn to their outstanding holding of government debt. This compares to the sell-off of USD1.58bn in equities and addition of a net IDR97.17tn to their outstanding holdings of government debt for the whole of 2015.

- We recalculated our fair value and the new estimates continue to favor downside pressures on the USDIDR as well. Our new fair value estimate of the USDIDR is around 10905 by end-2016. We expect the spot exchange rate to move towards the fair value estimate but not necessarily converge with it. Instead, we expect the pair to inch towards the 13000-region by end-1H 2016 and then break below that level to 12500 by end-year. Further downside moves should see the pair end 1Q-2017 around 12400.

- Though we remain bullish on the IDR, there are several caveats of note to our USDIDR forecast. These caveats include the continued consolidation of power/influence by President Jokowi to enable him to push through his economic visions (including tax amnesty rules) through parliament, and continuation of positive carry for government debt that would encourage further FDI and portfolio inflows.

- **Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for Indonesia held steady at 5.2. This should be supportive of the intrinsic value of the IDR.
- **Growth and Inflation Outlook:** The outlook for the economy remained sanguine. The BI expects growth to bounce above 5.0% in 1H 2016 after hovering below the 5.0% level for the past two years. BI is looking for growth to come in at 5.1-5.2% y/y in 1Q and then at 5.2-5.3% in 2Q. This suggests that the economy is on track to expand by 5.20% this year as our economic team is expecting. Growth remains domestically driven given that external demand continues to be weak, led by sluggish demand for commodities. Exports have contracted for the 18th straight month, falling by 13.51% y/y in Mar vs. 7.07% in Feb, while imports slipped 10.41% y/y from Feb's 11.59%. Key drivers of growth remain greater government spending on the push for more infrastructure building, and stronger investment as a consequence of the government's series of policies and reforms. Private consumption could also provide support for the economy with the recent rebound in motorcycle sales (up 3.1% y/y in Mar) that point to a nascent pick-up in consumer sentiments.
- The latest and twelve stimulus package of the government was announced by President Jokowi on 28 Aug. This package looks to simplify processes for companies, especially small- and medium size enterprises, such as permit, tax and access to credit. The government also intends to simplify conflict resolution procedures to cut the time limit taken for a resolution. Also on the cards is to simplify process for connecting electricity.
- Headline inflation has been climbing higher since bottoming in Dec 2015. From 3.35% recorded in Dec, headline inflation has headed higher to 4.45% y/y in Mar 2016 on the back of higher food prices. Food prices were up by 9.09% y/y in Mar compared to 7.55% in Feb. Core inflation continues to moderate after peaking at 5.07% y/y in Sep 2015, lifted by higher tobacco, car and gold jewelry prices. BI maintained their inflation forecast at 3-5% for 2016. Our economic team now expects headline and core inflation to average 3.98% and 3.53% respectively by end-2016 compared to their previous forecast of 4.36% and 3.68%.
- **Monetary Policy Forecast:** After cutting the policy rate by 25bp in each of its meetings in Jan to Mar, the BI finally took a breather at its Apr meeting. The possibility of such a move had been signaled at the Mar meeting that it would be more cautious in considering easing monetary policy further. This pause does not necessarily suggest that the easing cycle has ended. Rather the pause is to allow for the transition to a new benchmark rate – the 7-day reverse repurchase rate (currently at 5.5%) – and the re-adjustment of the interest rate corridor that would be effective 19 Aug. These moves would improve the transmission mechanism of monetary policy as the current BI reference rate, which had been in place since 2005, had been ineffective in influencing market rates.
- The 7-day reverse repo is expected to have a better pass-through to market rates given that it is a short-term money market rate. In addition, the new interest rate corridor will be symmetric and

have a band of +/- 75bp around the benchmark rate. This corridor, while narrower than the existing corridor at 250bp, should still be flexible enough for liquidity management, lower intraday volatility and make lending rates more reflective of the benchmark rate. Until the new mechanism is in place on 19 Aug, we expect the central bank to keep the current policy rate steady as the new benchmark rate at 5.5% would be an easing from the current policy rate of 6.75%, even as policy makers deny such an interpretation; and for the central bank to evaluate efficacy of and allow the market to adjust to the new benchmark rate.

- **Latest Fiscal and External Balance Outlook:** The government's planned tax amnesty is expected to result in an estimated IDR560tn of funds being repatriated onshore. The central estimates that the amnesty could generate around IDR45.7tn in revenue for the state coffers. The central bank governor suggested that the tax amnesty should be only done once and once the grace period is over, heavy penalties should be imposed on those who disregard the amnesty. Among the proposals for where these incoming funds could be parked included government bonds, SOE bonds or in financial investment in banks appointed by the finance minister. The tax amnesty bill is currently awaiting approval from parliament.
- The Finance Minister has laid out the underlying assumptions for the 2017 budget that will be submitted to parliament in May or Jun. He is proposing to strengthen the budget financing in 2017 by targeting a higher tax base. Infrastructure and healthcare spending will be the key focus area of the budget in 2017. The key assumptions of oil price, GDP growth, exchange rate and inflation were set at USD35-45/bbl, 5.5-5.9%, 13650-13900 and 3-5% respectively. The Finance Ministry expects the budget deficit to widen to 2.4-2.5% of GDP from the planned 2.15% of GDP, likely as a result of the greater spending emphasis on infrastructure and healthcare.
- BI expects the current account deficit (CAD) to improve in 1Q 2016, coming in at 2.2% of GDP. This is higher than the full-year CAD of 2.06% of GDP for 2015. The central bank continues to expect the CAD to come in around 2.5% of GDP in 2016, less than the 3.0% of GDP target. Our economic team continues to maintain its 2016 CAD forecast at 2.45% of GDP.
- **Key domestic events and issues to watch**: 1Q16 GDP is due sometime in 5-7 May and BI meets to decide monetary policy on 19 May.
- **Technical Outlook:** USDIDR traded a relatively muted range of 13080 - 13340 in Apr. Monthly momentum remains bearish bias but weekly and daily momentum/oscillator indicators suggest some risk of rebound soon. Resistance at 13220 (23.6% fibo retracement of 2016 high to low, 50 DMA), before 13370 (38.2% fibo) and 13490 (50% fibo, 100 DMA). Support at 12980 (2016 low).

PHP: Election Risks At Play

Forecast	2Q 2016	3Q 2016	4Q 2016	1Q 2017
USDPHP	47.00 --	47.50 --	47.80 --	47.50 --

No Change from Previous Forecast

- **Motivation for the FX View:** The recent fillip from a softer dollar seen so far in Apr could come to an end soon, not least because of the uncertainty arising from the upcoming presidential and general elections on 9 May. In addition, the risks emanating from the El Nino weather phenomenon as well as possible decelerating overseas remittances amid global economic uncertainty and softer global oil prices could also weigh on the currency. Backstopping the PHP slide lower towards the 47-handle has been the strong economic fundamentals and the BSP's steady hand on the policy rate (with the possibly of a rate hike at the end of the year due to the expected strong growth this year). We remain bearish on the PHP as a consequence.
- The strong economic fundamentals to date should allow the BSP to keep policy rates steady for the most part of the year. Persistent current account surpluses and economic growth outperformance (above 5%) as well as the implementation of the interest rate corridor (possibly by 2Q) to allow for more effective transmission of the policy rate should allow central bank to stand pat on the policy rate steady in the near-term. Even the political uncertainty from the presidential election in May 2016 is unlikely to pressure BSP to move as the BSP is likely to view it as a short-term phenomenon that will dissipate eventually. This should provide the PHP with some support for the year.
- We continue to expect the USDPHP to climb higher from current levels. Risk-supported sentiments as a result of expectations of a more gradual pace of Fed fund rate hikes which has led to portfolio inflows, particularly into equities, could reverse just as easily because of political risks and a hawkish tone from the Fed. This is already being manifested in foreign investment in equities. So far in Apr, foreign investors have sold off a net USD41.33mn of equities compared to the purchase of a net USD203.86mn in the Mar. Despite the weak Apr so far, foreign funds have purchased a net USD34.88mn in equities so far this year, way off the pace of USD948.12mn bought in the same period last year. In contrast, demand for government debt appears to be mixed as seen in the yields with the 1M, 6M, 3Y, 4Y and 7Y all lower while the 3M, 1Y, 2Y, 5Y, 10Y and 20Y were higher.
- The PHP has fallen 2% against the USD in Apr to date as a result of the portfolio outflows which was mainly due to political risks. Year-to-date, the PHP underperformed relative to other AXJs. Further political risks are expected given that the economic policies of the current front runner in the presidential race - Davao Mayor Rodrigo Duterte - remains unknown. Our analysis showed that there is a tendency for equities to be sold-off in the lead-up to the elections and for at least another six months after

the elections as a result of the uncertainty surrounding the policies of the incoming president.

- Also putting upside pressure on the USDPHP this year is the El Nino weather phenomenon and the possible tapering of overseas remittances from the global slowdown. A severe El Nino weather phenomenon is expected in 2H 2016 with the resultant floods and droughts to negatively affect crops and hence agricultural export earnings and could exacerbate the sell-off in the equity market. In addition, slower remittances due to sluggish global growth particularly in the G3 and lower global oil prices affecting the Middle East, could put downward pressure on private consumption, a key driver of domestic economic growth and weigh on the PHP consequently.
- Consequently, we maintain our forecast for the USDPHP to climb higher towards 47.50 by end-3Q from 47.00 in 2Q and then to 47.80 by end-4Q. We expect the pair to settle lower to 47.50 by 1Q 2017 after the uncertainty surrounding the elections dissipates.
- Our monthly **Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for Philippines was unchanged at 5.0. This should be supportive of the intrinsic value of the PHP.
- **Growth and Inflation Outlook**: Despite its best attempts, government spending continues to lag. Recently released data showed that government spending rose by just 7.3% y/y in Jan. Spending had been dampened by the 11% decline in interest payments, otherwise growth would have been a healthier 15%. For the past three years, under-spending by government has dampened growth. The last time government spending was double-digit in 2012, growth was boosted to 7.1% the following year. Thus, there is still some way to go for government to accelerate spending to bolster growth. Unless government spending accelerates into double-digit levels, growth is likely to hover around current levels in 1Q 2016. Concerns about a slowdown in remittances remain even as recent data showed a rebound. Remittances rose 9.1% y/y in Feb after a lackluster 3.4% in Jan. However, our economic team continues to expect remittance to gradually slow to average 3-4% for the full-year. Sluggish external demand should also remain a drag on the economy. Exports contracted by 4.5% y/y in Feb, the 11th straight month of decline, while imports rose by just 1.2% y/y after spiking 30.8% in Jan. Nevertheless, our economic team continues to believe that election-related spending and accelerated government spending should lift the economy to 7.0% in 2016.
- Though inflation picked up, rising by 1.1% y/y in Mar, this was only a marginal increase compared to Feb's +0.9%. The modest pick-up was attributed to the abundant supply of food and low fuel prices. Even the risks of El Nino are unlikely to impact significantly on consumer prices. The central bank maintained its 2016 inflation forecast at 2.1% and 2017 inflation at 3.1%. Our economic team continues expect inflation to average 2% in 2016 based on sustained low fuel prices and modest impact from El Nino.
- **Monetary Policy Forecast:** We do not expect any surprises from the BSP at its next policy meeting on 12 May. The central bank is expected to stand pat on its key policy rate, holding it steady at 4.0% and should also leave the SDA rate unchanged at 2.5%.

Underlying this decision would be the BSP's sanguine assessment of the economy - that domestic demand was still firm and liquidity conditions still adequate. In addition, inflation expectations remained well-anchored in both 2016 and into 2017. More importantly, the shift to an interest-rate corridor by 2Q is likely to give pause to any policy rate adjustment by the BSP as it prepares for the transition. The interest-rate corridor is expected to make monetary policy transmission more effective by more narrowly bracketing the policy rate or the reverse repurchase rate (RRP) between the repurchase rate (RP) or overnight lending rate and the SDA. Thus, in the near-term, policy rate is likely to remain on hold. Nevertheless, given the likely outperformance of the economy compared to its regional peers, the policy bias remains tilted to tightening than an easing. Still, any rate hike is expected only at the end of 2016.

- **Latest Fiscal and External Balance Outlook:** After ballooning at the end of Dec 2015 to PHP75bn, the deficit has narrowed sharply to just PHP3.5bn in Jan. This was due largely to the more moderate expenditure in Jan of PHP185.7bn compared to PHP238.7bn in Dec. As discussed above, the smaller expenditure in Jan could be attributed to the 11% decline in interest payments. This should be temporary and given the plans to accelerate government spending, larger expenditure is expected ahead and should revenue growth lag behind, the fiscal deficit could widen again.

- The overall balance of payments (BoP) saw its largest surplus in nearly a year in Mar amid strong inflows from foreign direct investment and overseas remittances. The BoP surplus ballooned to USD854mn in Mar after recording deficits of USD813mn and USD316mn in Jan and Feb respectively. Despite the large surplus in Mar, the overall BoP was in deficit of USD275mn in 1Q compared to the surplus of USD877mn in the same period last year. Despite the deficit so far, the BSP remained sanguine regarding prospects for the BoP. It continued to expect the BoP to register a surplus of USD2.2bn or 0.7% of GDP in 2016.

- **Key domestic events and issues to watch:** BSP meets on 12 May to decide on policy and this is followed by 1Q16 GDP print on 19 May. More importantly, presidential and general elections on 9 May that will decide on the policy direction for the Philippines for the next 5 years.

- **Technical Outlook:** USDPHP bottomed out at 45.90 levels (mid Apr) before getting the squeeze up. Last seen at 46.80 levels. Weekly momentum is bullish bias. Resistance at 47 (50% fibo retracement of 2016 high to low), 47.2 (61.85% fibo). Support at 46.40 (50 DMA).

THB: Domestic Challenges Persist

Forecast	2Q 2016	3Q 2016	4Q 2016	1Q 2017
USD/THB	35.50 --	36.50 --	37.00 --	37.00 --

No Change from Previous Forecast

- **Motivation for the FX View:** The recent moves lower by the USDTHB seems to suggest that the tide could be turning for the pair. The THB rose by just 0.1% vs. the USD in Apr to date but it was the second best performer in the region after Indonesia. However, we believe that this could be short-lived and that the risks that we highlighted in our previous monthly remains. Upside risks to the USDTHB from the government's stimulus packages could be limited and a sharp economic recovery is not expected. Moreover, political tensions could intensify as the referendum on the new constitution approaches and push USDTHB volatility higher. These are likely to weigh on investor sentiments and put downward pressure on the THB.
- Portfolio inflows have been mixed in Apr so far. While inflows into equities have been weak, foreign buying of government debt remained strong. Month-to-date, foreign funds have sold off a net THB4.32bn in equities but purchased a net THB15.21bn in debt, helping to support the THB. Year-to-date though, foreign funds been bullish on Thai assets, purchasing a net USD14.66bn and THB176.06bn in equities and government debt, in sharp contrast to the sell-off seen in the same period last year. The risks are that these inflows are short-term flows and a black swan event could just as easily result in a reversal and weigh on the THB.
- We remain convinced that no further rate adjustments are expected in 2016, barring unforeseen risks to the economy. Rate cuts are not a panacea to the kingdom's export woes as a weak THB is unlikely to offset the weakness in global demand. Moreover, the policy rate is already at near historical lows and is unlikely to be effective in spurring further lending or investment activities. In addition, the central bank views accommodative monetary policy as complementary to fiscal policy, which it believes a weak external demand than lowering borrowing rates further. More importantly, the central bank is likely to save its limited ammunition for even more averse shocks to the economy. A possible risk to our policy rate outlook is a rate hike in 2016 in 4Q as the economy rebounds by year-end, but this not our base case for now.
- The key risks to the USDTHB remains the referendum set for 7 Aug to seek the approval for the new constitution. Political tensions could gradually build and intensify towards the referendum date given the military government's attempt to solidify the military's role in the constitution and limit the role of civilians. There are risks that the tensions could blow up and impact investor sentiments, putting downside pressure on the THB.
- While the USDTHB could find some relief in the near term from portfolio inflows, risks remain to the downside for the THB. Mild

dollar strength when US Fed hikes its fund rate in Jun and Dec should keep the pair supported ahead. We expect the USDTHB to climb higher to 35.50 by end-2Q and to 36.50 by end-3Q as the referendum approaches. The pair is then expected to settle higher at 37.00 by year-end and into 1Q 2017.

- **Our Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for Thailand deteriorated slightly to 4.7 from 4.6 underpinned by an increase in current account risk. This should weigh on the intrinsic value of the THB.
- **Growth and Inflation Outlook:** The recovery/stabilization of the economy continues. Exports slowed but remained positive at 1.3% y/y in Mar compared to 10.27% in Feb. Though external demand has provided the economy with a sparkle of hope, the still weak imports suggest that the economic recovery will only be gradual. Imports slipped by a more moderate 6.94% in Mar vs. Feb's 16.82%. There are upside risks to growth from the ongoing stimulus measures as well as the continued improvement in tourist arrivals. So far in the first two months of the year, tourist arrivals have seen double-digit growth of 15.5% y/y. Despite the sluggishness in the economy currently, our economic team is still looking for a rebound, especially in 2H 2016 to lift growth to 4.5% in 2016. This compares to the BoT's growth projection of 3.1%. The Finance Ministry has lowered its growth forecast for 2016 to 3.3% on the back of continued weakness in external demand.
- The economy remains in disinflationary mode for the 15th consecutive month. Headline inflation declined by 0.46% y/y in Mar, a slight moderation from Feb's 0.50%. The decline could again be attributed to lower energy prices (-11.2% y/y) and transportation cost (-4.3% y/y). Core inflation continued to pick up, rising by 0.75% y/y in Mar from 0.68% in Feb. Despite the current disinflationary pressures, our economic team remains sanguine on inflation prospects for this year. Our team expects low base effects, improving domestic demand, the impact of the drought on raw food prices, the firmer oil prices and the weak THB to lift consumer prices ahead. Consequently, our economic team expects headline inflation to average 2.5% in 2016 compared to BoT's projection of 0.8%.
- **Monetary Policy Forecast:** Since cutting its policy rate to 1.50% in Apr last year, the BoT has stood pat on policy. With the policy rate already close to historical lows, there was little need for the BoT to adjust the policy rate for now. Still, this does not preclude the central bank from adjusting rate if required. In fact, in its 23 Mar policy meeting minutes, the BoT declared its readiness "to utilize an appropriate mix of available policy tool in order to support the economic recovery and ensure financial stability". Nevertheless, barring black swan events, we do not expect any rate adjustments in 2016 as the concomitant weakness in the THB from a rate cut is unlikely to be a panacea for the kingdom's export woes. Fiscal policy is still the preferred policy tool to do the heavy lifting of supporting the economy with monetary policy playing a complementary role. A risk to our policy view is the possibility of a rate hike by the BoT should the economy grow at a more rapid pace than expected by the government and market. In such a situation, our economic team expects a 25bp hike by the end of the year.
- **Latest Fiscal and External Balance Outlook:** Government revenues collected rose 6.4% above target in the first half of the fiscal year. Total revenue collected in the first 6 months of the

year rose 10.2% y/y mainly because 4G auctions. VAT and corporate income tax collection however were 6.6% and 7.3% below target respectively because of the economic slowdown.

- Current account surplus widened to THB263.5bn in Feb from THB147.03bn in Jan. This was largely on the back of an improvement in the trade surplus (THB213.8bn vs. Jan: THB95.32bn) that more than offset the moderation in the primary and secondary income surplus (THB51.71bn vs. Jan: THB50.69bn). The overall balance of payments (BoP) recorded a wider surplus in Feb of THB216.14bn compared to the THB164.33bn surplus in Jan.
- **Key domestic events and issues to watch:** Eventful month ahead with BoT policy meeting up on 11 May and 1Q16 GDP on 16 May.
- **Technical Outlook:** USDTHB traded a low of 34.80 (mid-Apr) before turning higher into month-end as we write. Last seen around 35 levels. Momentum indicators are not showing a clear bias. Could see consolidation in the range of 34.80 – 35.50. Beyond this range puts next support at 35 (50% fibo retracement of 2015 low to high) and next resistance at 35.65 (23.6% fibo).

INR: Potential Weakness

Forecast	2Q 2016	3Q 2016	4Q 2016	1Q 2016
USD/INR	65.80 --	67.50 --	66.00 --	67.00 --

No Change From Previous Forecast

- **Motivation for the FX View:** USDINR could be biased to the upside in May. Mild election jitters and doubts on GST approval by the Congress saw USDINR hover within the 66-67-range for much of Apr. USDINR is especially sensitive to Fed hike expectations and the lead up to a potential rate hike in Jun should translate to upside risk in this pair. That said, we are not looking for particular dollar strength and see upside risks as opportunities to sell into.
- Fundamentally, the currency is still attractive based on growth differentials with regional peers. Industrial production prints improved in Feb with a print of 2.0%y/y from a decline of -1.5% previously. Forward looking indicator PMI-mfg for Mar improved to 52.4 from previous 51.1. That bodes well for the manufacturing sector. In addition, we continue to see extended period of low oil prices which could allow RBI time to tackle “agflation” and savings from oil prices could be re-invested into the agriculture sector. In a global environment of low rates, rupee is high yielding and that gives it an extra edge over regional peers.
- We still see risks to the upside for elections at West Bengal, Tamil Nadu, Kerala, Puducherry and Assam, given the fact that the incumbent does not hold many seats in the Rajya Sabha (Upper House) anyway. According to recent polls done in Mar for West Bengal, the voters still favour Trinamool Congress so investors may not be too hopeful for an improvement in the seat tally. Hence, USDINR could be set to reach towards the 65.80-target within the next quarter.

- **Our Maybank vulnerability score (using 9 economic and market variables:** GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for India held steady at 4.6 with scores for all variables unchanged in the past month.
- **Growth and Inflation Outlook:** High frequency data suggests that domestic activity has picked up slightly with industrial production rebounding to 2.0% Feb from the previous contraction of -1.5%. PMI-mfg continued to improve to 52.4 from previous 51.1, boosted by the acceleration in output growth along with new orders. Selling prices were noticeably raised by manufacturers as they transfer the rise in costs to consumers. The external sector remained weak with another decline for exports by -21.6%y/y in Mar, a larger contraction than the previous -5.0%. We continue to look for fiscal efforts in the rural sector and manufacturing to boost consumption and investment.
- Mar CPI decelerated to 4.83%y/y from previous 5.18% as food and housing costs remain subdued. The WPI also fell more than expected by 0.85% in Mar vs the expected -0.7%, weighed by the food component. The non-food component of primary articles accelerated to 8.1%y/y in Mar from previous 5.9%.
- The industrial outlook survey conducted for the last quarter of 2015 (Jan-Mar) reveals “moderate increase in optimism for production, order books, financial situation and salary” compared to the quarter prior. However, sentiments on other indicators including exports, imports, employments, profit margin and overall business situation deteriorated. We expect household consumption will continue to be a strong pillar of support while the government and central bank strive to crowd in private investment with reform measures.
- **Monetary Policy Forecast:** The Reserve Bank of India increased the degree of monetary accommodation by lowering policy repo rate by 25bps from 6.75% to 6.5%. The cut was widely expected, albeit smaller than what we had anticipated and meant to encourage private investment. Whilst cost pressures have edged higher, CPI is projected to “decelerate modestly” and remain around 5% over 2016-17.
- What took the market by surprise was the fact that the central bank tightened the policy rate corridor from +/-100basis points to +/-50bps by lowering the marginal standing facility by 75bps and increasing the reverse repo rate by 25bps such that the reverse repo rate was adjusted to 6.0%, the repo rate was adjusted to 6.5% and the marginal standing facility rate is now cut to 7.0%.
- RBI aims to ensure that the weighted average call rate is better aligned with the repo rate to improve the transmission mechanism of the monetary policy. The move to narrow the interest rate corridor would not have been possible without the variable rate reverse repo auctions that enable the central bank to absorb short term liquidity from the system. This variable rate reverse repo auctions have been in place since 2014. **This move is a show of confidence that RBI has a firm control of the liquidity conditions. The central bank also does not see a need to keep the system in “significant average liquidity deficit” and wants to shift “position closer to neutrality”.**
- **Latest Fiscal and External Balance Outlook:** Foreign investors bought USD485.8mn of equity and USD297.5mn of bonds. The upbeat sentiment in the stock market remains in line with the region.

- India's fiscal targets were held steady at 3.5% for FY16/17. The government highlighted "Transform India" that is meant to boost domestic demand, continue the pace of economic reforms and policy initiatives. There was also focus and budget allocation for agriculture and farmers' welfare - Irrigation projects will be sped up, a dedicated Long Term Irrigation Fund will be created as well as programme for sustainable management of ground water resources. There is also a substantial amount allocated to education and health care, as well as infrastructure and investment. Total expenditure projected to be INR19780bn – INR14280bn of which is non-plan and INR5500bn is plan. The plan and non-plan classification will be scrapped in the next fiscal year.
- Current account deficit narrowed slightly to $7.1bn in the quarter ending Dec from the previous $8.7b due to the better performance of net exports of goods (-U$34.0bn vs previous U$37.4bn) and greater net current account services surplus at USD18bn.
- **Key domestic events and issues to watch:** India has Apr PMI-mfg due on the 2nd, Apr trade numbers on the 10-16th. Mar industrial production and Apr CPI are due on the 12th. WPI is due on the 16th. 1Q GDP is due on the 31st.
- **Technical Outlook:** A critical month ahead as USDINR drifted out of the upward sloping trend channel that has formed since 2014. Last seen around 66.50, the pair seems to be in consolidation mode still and we want to watch for a break of the 200-DMA at 66.00 which could risk extending downsides towards 64.77 (38.2% Fibonacci retracement of the 2014-2016) before the next at 63.54 (50%). Failing to break below may set the USDINR back on the upmove back within the upward sloping trend channel.

VND: Eye The Dollar For Potential Mild Weakness

Forecast	2Q 2016	3Q 2016	4Q 2016	1Q 2017
USD/VND	22300 --	22600 --	22400 --	22800 --

Previous Forecast in Parenthesis

- **Motivation for the FX View:** The pair steadied for much of Apr. Administrative measures continue to deter dollar hoarding and ease upside pressure on the USDVND. Into May, we anticipate potential volatility as we still anticipate a rate hike by the Fed. There is room for dong weakness in the face of potential dollar rebound but limited dollar strength could mean upside moves could remain capped. Beyond the Jun Fed meeting, USDVND could still trend towards 22300 by the end of the month.
- Medium term, Vietnam continues to benefit from the Trans Pacific Partnership and the key sector to get the boost is its apparel, footwear, agro-forestry and seafood industry. However, benefits in terms of export earnings could only be felt as early as end 2016 as the agreement has to be ratified by member countries and political obstacles in US, Australia and Canada may delay the process. In the meantime, foreign direct investment continues to surge (into Vietnam as foreign invested enterprises

strives to raise their capital and production capacity. That could continue to strengthen the VND.

- Given our expectations for limited dollar strength, Fed hike in Jun, we still see USDVND at 22300 for 2Q. We also take into account resilience exhibited by VND and less depreciation for VND towards 22800 by the end of this year.
- **Growth and Inflation Outlook:** Apr PMI-mfg jumped to a nine-month high of 52.3 from 50.7. The month saw a steeper increase in output and new business along with rise in hiring. Input prices continue to rise as the rate of inflation rose sharply on capital goods (as opposed to consumer and intermediate goods). That should foretell a further improvement in industrial production and the manufacturing sector.
- Apr industrial production growth rose to 7.9%y/y from previous 6.2%y/y, boosted the most by output from manufacturing which picked up pace to 12.5%y/y. Retail sales softened further to 8.8%y/y in Jan-Apr from 9.1% in the first quarter. The slowdown was broad based with trade, hotel/restaurants, tourism and services recording deceleration on the year. Trade surplus was maintained at U$100mn in Apr with the previous figure revised higher from U$100mn to U$624mn. Exports growth improved to 6.0%y/y in Jan-Apr from 6.0%y/y for Jan-Mar. Imports bill shrunk less by -1.2%y/y (Jan-Apr) from previous -4.8% for Jan-Mar.
- CPI sped to 1.9%y/y in Apr from 1.7% in Mar, lower than consensus. Higher price pressures in food, education and medical products/healthcare continue to be the key components which boosted the headline. Despite the higher food costs, low energy costs have capped inflationary pressures and keep the CPI near historic low levels.
- **Monetary Policy Forecast:** Apart from the appointment of a new Governor, Le Minh Hung, SBV had been rather quiet in the past month. The last move by the central bank was an adjustment in the maximum USD mobilizing interest rates for entities (excluding credit institutions and foreign bank branches) and individuals to 0% p.a. with effect from 18 Dec. This was a move to reduce dollar hoarding. Previously on 5 Oct, SBV restricted dollar trading to only those who can settle with their counterparties within two working days. The administrative measures and exchange rate reforms seem to have supported the dong to a fair extent.
- **Latest Fiscal and External Balance Outlook:** While monetary policy targets business funding cost, fiscal policy will continue to be used to boost private and public consumption. We eye more infrastructure projects. Inflation is capped at 5% and the budget deficit capped at 4% of GDP. According to our Vietnamese analyst Le Hong Lien, fiscal expenditures have been outpacing that of revenue in recent years and could be reined in with the recent revised Budget Law meant to take effect from FY2017 that could guide the fiscal deficit below 4% of GDP from 5% in 2015. Our analyst is also of the view that it is in the interest of the Communist Part of Vietnam to continue with the implementation of Vietnam's structural reforms.
- Vietnam's external balance is expected to weaken this year on weaker exports as external environment remains challenging. Current account recorded a surplus of USD1.077bn in 4Q (latest data available). The expected deterioration on the external front was a key reason for us to expect an approximate 3% depreciation in the VND. However, the amount of foreign direct investment has surpassed our expectations and we now expect less than 2%

depreciation in the dong within the year. Looking ahead, expect FDI growth to maintain pace including the second thermal power plant in Vietnam that requires an estimated $1.5bn of investment.

- **Key Domestic Events and Issues to Watch:** May CPI is due on the 24th. Trade balance, retail sales and industrial production for the same month will be released anytime within 25-31 May.

2016 FX Forecasts

	End Q2-16 f	End Q3-16 f	End Q4-16 f	End Q1-17 f
USD/JPY	110.00	114.00	116.00	120.00
EUR/USD	1.1300	1.1100	1.1200	1.1100
GBP/USD	1.4000	1.4400	1.4800	1.4800
AUD/USD	0.7800	0.7500	0.7800	0.7500
NZD/USD	0.6800	0.6600	0.6700	0.6600
USD/SGD	1.3550	1.3750	1.3850	1.3900
USD/MYR	3.9000	3.9500	3.8500	3.9000
USD/IDR	13200	12950	12500	12400
USD/THB	35.50	36.50	37.00	37.00
USD/PHP	47.00	47.50	47.80	47.50
USD/CNY	6.50	6.55	6.50	6.55
USD/HKD	7.80	7.80	7.80	7.80
USD/TWD	33.40	33.40	33.50	32.80
USD/KRW	1160.00	1190.00	1170.00	1180.00
USD/INR	65.80	66.50	66.00	66.50
USD/VND	22300.00	22600.00	22400.00	22800.00
SGD Crosses	**End Q2-16 f**	**End Q3-16 f**	**End Q4-16 f**	**End Q1-17 f**
100 JPY/SGD	1.2318	1.2061	1.1940	1.1583
EUR/SGD	1.5312	1.5263	1.5512	1.5429
GBP/SGD	1.8970	1.9800	2.0498	2.0572
AUD/SGD	1.0569	1.0313	1.0803	1.0425
NZD/SGD	0.9214	0.9075	0.9280	0.9174
SGD/MYR	2.8782	2.8727	2.7798	2.8058
SGD/IDR	9742	9418	9025	8921
SGD/THB	26.20	26.55	26.71	26.62
SGD/PHP	34.69	34.55	34.51	34.17
SGD/CNY	4.80	4.76	4.69	4.71
SGD/JPY	81.18	82.91	83.75	86.33
SGD/HKD	5.76	5.67	5.63	5.61
SGD/TWD	24.65	24.29	24.19	23.60
SGD/KRW	856.09	865.45	844.77	848.92
SGD/INR	48.56	48.36	47.65	47.84
MYR Crosses	**End Q2-16 f**	**End Q3-16 f**	**End Q4-16 f**	**End Q1-17 f**
EUR/CNY	7.35	7.27	7.28	7.27
EUR/MYR	4.41	4.38	4.31	4.33
JPY/MYR	3.55	3.46	3.32	3.25
MYR/HKD	2.00	1.97	2.03	2.00
MYR/CNY	1.67	1.66	1.69	1.68
GBP/MYR	5.46	5.69	5.70	5.77
AUD/MYR	3.04	2.96	3.00	2.93
NZD/MYR	2.65	2.61	2.58	2.57
MYR/JPY	28.21	28.86	30.13	30.77
MYR/IDR	3385	3278	3247	3179
MYR/INR	16.87	16.84	17.14	17.05
MYR/KRW	297	301	304	303
MYR/PHP	12.05	12.03	12.42	12.18

Source: Maybank FX Research as at 29 April 2016. *These forecasts are meant to be indicative of FX trends and not meant to be point forecasts.

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