Maybank

Macro | FX Research & Strategy

Global

FX Monthly

2018, Issue 4: US Policies In The Driver Seat

What Has Changed This Month?

- We lowered the forecasts for all major currencies and selected AXJs including INR, IDR and SGD vs. USD due to the sharp pace of increase in UST yield that have somewhat surprised us. GBP downward revision was due to uncertainty on BoE policy normalisation plans and *Brexit*-related events.
- PHP and VND were revised upwards vs. USD due to idiosyncratic developments. PHP is due to expectations that BSP will raise policy rate to anchor inflationary expectations and the surprise upgrade by S&P in its outlook to positive. VND has found some foothold as trade war concerns eased. We look for some stability in this currency and our sanguine view of the US-China negotiation underscores our mild upgrade in the VND forecast

Our Strategies

- We continue to highlight the bouts of USD strength. In particular, we do not rule out the temporary return of monetary policy divergence trade which could favour USD rebound. Fed is probably the only central bank tightening this quarter while other central banks (ECB, RBA, RBNZ, BoJ, MAS, BNM, etc.) are not in any hurry to tighten. Recent flow of economic data also suggests growth/activity divergence between US and other developed nations including EU, UK, etc. To add, USD is a countercyclical currency, decelerating global growth momentum tends to see USD outperform. Growing divergence in both monetary policy and growth between US and other developed nations could see further widening in yield differentials (in favour of UST yields) and that should continue to keep USD broadly supported in the interim. In particular we pay attention to the pace of UST yield increase. A sustained and rapid rise in 10Y yield above 3% could see more USD upside.
- Lower yielders in particular EUR, CHF and JPY could come under pressure (assuming equity markets hold up well). AUD and NZD have lost its allure as a carry play as they have now turned negative. AUD, NZD and KRW will be vulnerable due to real rate weakness, FX over-valuation and highly responsive government bond markets in an environment of tighter monetary conditions and any sell-off in equity markets. In the EM space, CNY is likely to be the least vulnerable.
- Nonetheless, we believe the return of monetary policy divergence thematic is only temporary. Higher energy and commodity prices as well as tightness in labor market in other developed world including UK, AU, EU should feed through to inflation and brings back the case of policy convergence at a later stage. This scenario would see other currencies' strength play catch-up. In particular we look for dips towards 1.20-1.21 in EUR to buy into.
- We still see opportunities for relative value plays in Asia, favouring currencies that benefit from the export-led recovery and commodity price rebound. We continue to favour MYR, SGD, THB, CNY, KRW, TWD and AUD over IDR and INR. We add PHP long to the above basket trade.

Analysts

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

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

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

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

FX Forecast Revision

Upward	Downward
PHP, VND	EUR, GBP, NZD, AUD, JPY, SGD, IDR, INR

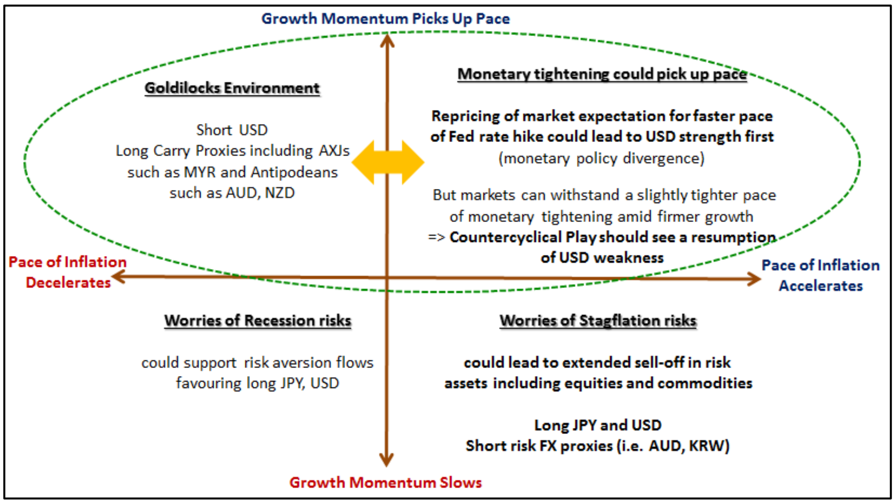
Top 3 Currency Plays for May

- Bias to Buy EUR on dips towards 1.20-1.21 for move towards 1.30 Objective
- Accumulate AUD on dips towards 0.75
- Buy PHPIDR on dips towards 265 for the target at 271/279. S/L below 260

Key Events for the Month Ahead

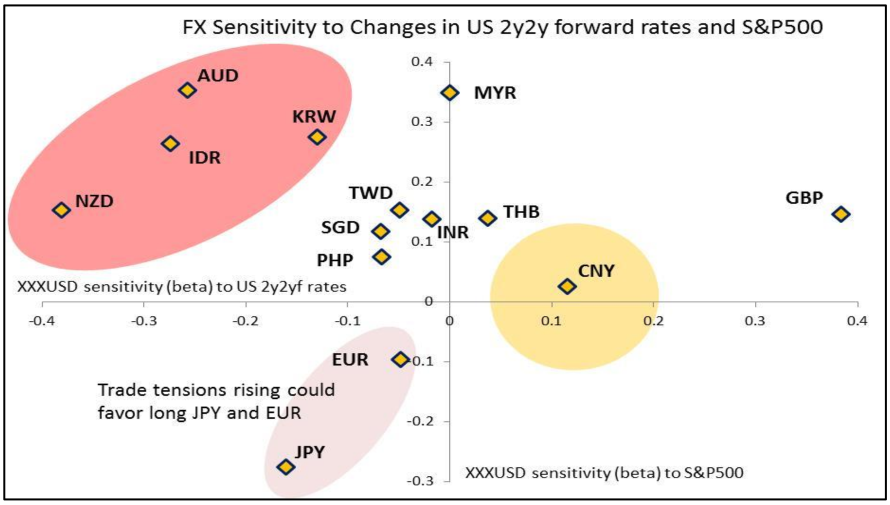
Date	Event
End-May/ Early Jun	North Korea- US Summit
8 May	Australia's Budget 2018-19
15 May	Public Hearing on the US list of tariff on China
22 June	OPEC Meeting

Markets Pivoting Between Goldilocks and Monetary Tightening Environment



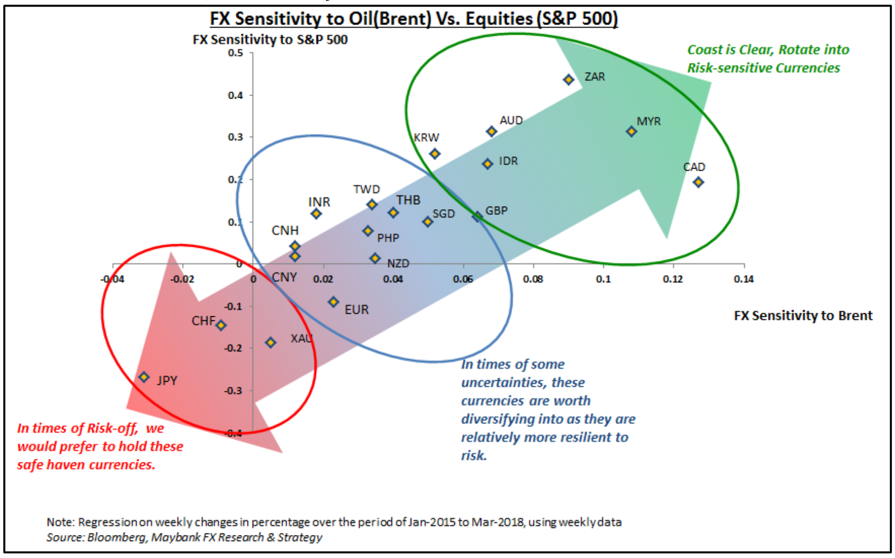
Note: The grid-scenario is in the context of US economy and does not take into consideration black swan events such as trade wars, geopolitical tensions, etc.
Source: Bloomberg, Maybank FX Research & Strategy

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



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

Pace of Inflation, Monetary Shifts are Risks to Our Outlook



G7 Global Overview

USD: Interim Dollar Rebound In May

Forecast	2Q 2017	3Q 2018	4Q 2018	1Q 2019
USD Index	90.57 (88.91)	89.08 (87.18)	87.42 (86.18)	86.81 (--)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** The USD index was slightly revised higher due to downward revisions to GBP (under pressure on signs of moderation in growth and activity, doubts on BoE's plan on policy normalisation, lack of material progress with UK-EU future trade relations and potential return of uncertainty on PM May's leadership amid broad rebound in USD and UST yields); downward revision to EUR (slower than expected rise in CPI and policy divergence pressures); AUD & NZD (carry turned negative - policy divergence issues) & JPY (policy divergence developments).

- USD downtrend is likely to remain in place for second half of 2018 but we do not rule out bouts of USD strength like what we had witnessed in the past few months in May and June. The DXY index broke above the 90-figure in the last month of Feb and again in March, and more recently broke through the 91 level in late April as we saw 10y yields rally and cross the 3.0% level for the first time since 2014. In addition, we saw robust US data, aided by expansionary fiscal policy. By end April it has fallen to below 3.00% at current around 2.96% as UST sales moderated. It will take some time before the scenario will go back to a goldilocks environment, most likely in June and 2H and eventually the countercyclical play led to USD weakness again. We do remain wary of more bouts of USD strength (as previously cautioned) that could emanate from a few scenarios - 1) trade war escalation; 2) inflation pick up - price pressure is still subdued but sustained global recovery could stoke demand-pull inflation and a global bond rout; 3) markets to re-price a more aggressive tightening trajectory as the Fed becomes more hawkish under the new Chair Powell; 4) US fiscal and debt issues could lead to more issuance. These could in turn trigger another sell-off in global bonds and correction in riskier assets. However, despite the rise in US libor, widening of libor-OIS spread (partially attributable to surge in funding needs for US Treasury owing to Trump's fiscal measures) could potentially moderate when 1) US funding requirements slows and US Treasury receives tax receipts. This could lead to a less tight global funding market and typically weigh on the dollar; 2) The peak in earnings growth and over-shooting on the bond front could lead to some volatility in the equity market and eventually potentially lead to some moderation in any bond sell-off.

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

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

- To add further on the USD inverse relationship with global trade and economic growth is that a large share of international trade is transacted in USD even when the US itself is not the party to the transaction. This suggests that world trade volumes are driven in large part by USD. Appreciation in the USD crimps demand for US exports but also for all USD-denominated exports.

- Upcoming May are many geopolitical events which could affect Fed risks. The coming first week of May has important macro releases with the Fed policy decision coupled with earnings releases as the first quarter reporting season ends. We don't expect the FOMC in May to see policy action and is likely to be straightforward in its statement wordings. June 13th FOMC would be a greater risk and the run up would be highly volatile. The key May risks are 1) the deadline to recertify a US waiver banon sanctions or break the Iran the nuclear deal is May 12th; 2) NAFTA agreement could come out in May with Congress approval in late 2018; 3) Section 301 Committee holding a public hearing on May 15th – the aim is to consider what Chinese products to hit with tariffs and the ensuing process could see trade retaliation; 4) timing of the summit between President Trump and North Korean leader Kim Jong-Un is uncertain. Overall, if by mid June, oil prices rise sharply, and if there is a significant escalation of US-China trade tensions and a failed attempt at greater stability on the Korean Peninsula – we could see higher financial volatility and eventually some effects on global growth with impact on the USD upside being constrained and bond yields falling.

- **Growth and Inflation Outlook:** The advance estimate of Q1 GDP showed a moderation in Q1 growth, although the moderation was less than expected and largely concentrated in domestic activity. GDP increased 2.3% q/q saar, higher than consensus estimates of 2.0%. Growth in final sales to domestic purchasers (GDP less trade and inventories), an indicator of domestic activity, slowed to 1.6% q/q saar from 4.5% previously. On the other hand, trade and inventories made substantial positive contributions to GDP growth this quarter (0.6pp), in stark contrast to 4Q, when they subtracted nearly 1.7pp from growth. In all, it shows a soft patch in Q1 growth, especially in domestic demand, as transitory and expect growth in 2Q and 3Q to make up for the shortfall as the boost from fiscal stimulus kicks in. Expect the US growth forecast of 3.0% q/q saar for Q2 2018.

- Inflation is firming based on 1) deflation in wireless service pricing and disinflation in medical drug prices as exerting largely transitory effects on inflation; 2) Expect fiscal stimulus to keep the economy growing above trend, despite anti-trade policy and geopolitical risks, and look for further resource utilization to support a return of inflation to the Fed's target, if not modestly above. The March CPI report provides evidence that the transitory drags from some categories of inflation are fading and, as such, provides a clearer view of underlying inflation trends. We maintain our outlook that further progress toward the Fed's mandate will keep the FOMC on a path of gradual policy normalization. We expect the next 25bp increase in the target funds rate to occur as early as June or 2H 2018 with a total of 3 hikes this year.

- The minutes to the March FOMC meeting were clear in stating that the committee already expects core inflation to rise in the coming months on the removal of base effects alone and that this does not warrant a steeper policy path (above what is already contained in the current projections). In addition, the Fed wants to test the benefits of a tight labor market by allowing fiscal stimulus to support its inflation objective. There is a high degree of consensus within the committee on the outlook for the economy and less concern about inflation running persistently below target. Hence, nearly all participants see gradual rate hikes as appropriate, and some see the fed funds rate rising above its longer-run neutral rate for a time. Under the assumption that anti-trade policies do not derail the outlook, we expect the Fed to hike rates again in June and look for four 25bp rate increases this calendar year.
- **Monetary Policy Forecast:** Fed funds rate (FFR) was raised by +25bps to 1.50%-1.75% at the first FOMC meeting chaired by Jerome Powell. No change in Fed's guidance of three rate hikes this year but Fed signalled one additional hike each in 2019 and 2020.

- The other highlight from this FOMC meeting is the "dot plots" that represent Fed's guidance on interest rate direction. There is a change in the fed funds rate hike formation for 2018-2020 to "3-3-2" from "3-2- 1½ " indicated back in Dec 2017. Based on the latest FOMC's fed funds rate median forecasts, Fed maintains its guidance of three rate hikes totaling +75bps for this year, but signaled three rate hikes totaling +75bps in 2019 (+56bps implying two rate hikes previously) and two rate hikes totaling +50bps in 2020 (+37bps implying between one hike or two hikes previously).

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

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

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

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

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

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

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

- **Key domestic events and issues to watch in May 2018:** ISM Mfg (1 May); FOMC (3 May); Factory orders and Durable Goods Orders (3, 25 May), ADP Employment (2 May); NFP (4 May, 1 June); CPI (10 May); Retail Sales (15 May); FOMC Meeting Minutes (24 May); GDP 1QA (30 May); Core PCE (30 May); PCE Deflator (31 May).

- **Technical Outlook:** USD rebounded sharply (by about 3%) from 89-handle to 91-handle in April. This was well flagged out in our call in last month’s outlook where we shared ***Signs of upside pressure may be re-emerging***. DXY was last seen at 91.50 levels. Price action (27 Apr) saw DXY traded an intra-day high near 200 DMA but up-move was rejected and subsequent price action saw DXY ended the session weaker. This produced a shooting star pattern on the daily chart and could potentially sets up the case for a bearish reversal of an uptrend. Bullish momentum on daily chart remains intact while stochastics is showing signs of turning lower from overbought conditions. Downside risks ahead but bullish momentum and stochastics indicators still intact. Resistance at 91.90 levels (200 DMA, 23.6% fibo retracement of 2017 high to 2018 low), 92.60 levels. Area of support at 90.5-90.90 (previous area of resistance now-turned support) before 90 levels (50 DMA). Bias remains to lean against strength.

EUR: Weighed by Temporary Return of Policy Divergence

Forecast	2Q 2018	3Q 2018	4Q2018	1Q2019
EUR/USD	**1.2300** (1.2500)	**1.2500** (1.2800)	**1.2800** (1.3000)	**1.3000** (--)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** Taking stock, our caution in the last issue of FX Monthly for EUR to trade lower materialised. Our motivation for this call was on the back of market coming to terms that ECB policy normalisation will be gradual owing to softer than expected pace of pick-up in inflation (leading to unwinding of EUR longs) and concerns on Italy's government formation which could take up to months to form (uncertainty a source of volatility for EUR). Pair was last seen at 1.21 levels.

- Looking ahead, we do not rule out further downside risk as monetary policy divergence thematic returns temporarily (Fed likely to tighten in Jun while ECB is not expected to commit prematurely to end of APP). Policy divergence thematic typically favors USD strength. Furthermore extended uncertainty with Italy government formation remains a source of volatility for EUR. We see chance that EUR downside could extend towards 1.2040, 1.2010 and 1.1910 in the near term (up to 6 weeks). Bias remains to look for dips to buy into for a move back towards 1.23 – 1.24 levels in end-1H. We calibrate EUR forecasts lower in light of slower than expected rise in EU CPI and moderation in growth momentum. These factors reinforce the case that ECB is in no hurry to normalize monetary policy.

- Policy divergence thematic could potentially deepen further over the next 4 – 6 weeks. Fed tightening (probably by another 2 to 3 hikes this year) is almost a base line scenario for most, other central banks including ECB somewhat do not seem to be in a hurry to quicken their pace of normalisation. For ECB's case, Euro-area inflation remains below ECB's 2% target and shows little signs of re-acceleration. This gives ECB the optionality of not committing prematurely to a decision on how and when the APP will end. With UST yields rising rapidly (10Y UST yield challenging above 3% handle) and EU 10Y bond yield still near record low of 0.63%, the yield differential between UST-EU bonds stand at historical high of +236bps (positive carry for owning UST). Previous high was seen in 2016 high at +235bps. Recall that back in 2015 and 2016 when policy divergence thematic traded in favor of higher UST yields and stronger USD, at the expense of weaker EUR. We see a relatively high risk that policy divergence thematic could weigh further on EUR in the interim.

- On ECB's monetary policy stance, we expect the Governing Council to keep policy status quo at its next meeting in Jun. There is no meeting scheduled in May. We do however see chance of discussion on the future of ECB's asset purchase program (i.e. if it will be extended after the end of Sep 2018). Currently, APP is proceeding at the monthly pace of €30 billion. We **do not expect ECB to commit to a decision ahead of Sep-2018 as inflation remains soft for now** and have yet to show signs of re-acceleration. We do not expect ECB to jump the gun ahead of inflation upticks. Slower than expected pick-up in inflation should continue to reinforce expectations for gradual pace of policy normalisation.

- In addition, political uncertainty in Italy remains a source of uncertainty. President Mattarella has already kicked off the fourth round of consultations among Italy's political parties to try to form a new government. In particular the focus this round is on a potential tie-up between anti-establishment Five Star Movement party and centre-left Democratic Party (PD). This will be the least negative outcome and could end up being a positive factor for the EUR. Such a coalition government represents a balance between the centre-left and centre-right. Euroscepticism would somewhat be mitigated as Five Star has also shelved its opposition to the EUR currency while PD advocated further European integration.

- On a broader term perspective into 2H 2018, we remain constructive of EUR's outlook on (1) receding political risks in Europe (Germany managed to form coalition government with Merkel elected as Chancellor again for the 4th term though Italy government formation remains a source of uncertainty); (2) sustained signs of growth momentum in Europe (though growth cycle may have picked), supported by private consumption, business sentiment, construction investment, sizeable current account surplus (3.5% of GDP) and export recovery; (3) signs of growing demand for EUR as a share of world FX reserves amid ongoing reserve diversification and (4) ECB's gradual pace of policy normalisation is expected to proceed as planned. These underlying fundamentals should continue to support the case for buy EUR on dips and builds the case for us to keep EUR forecast unchanged over the forecast horizon.

- **Growth and Inflation Outlook: Euro-area recovery continues with 19 consecutive quarters of growth** while unemployment fell to 9-year low of 8.5% in Feb. 4Q GDP growth rose 0.6% q/q (vs. 0.7% in 3Q). On y/y basis, GDP growth rose 2.7% (vs. 2.8% in 3Q). For the year, Euro-area expanded 2.5%. This is the best pace since global financial crisis in 2008 and the latest ECB Economic bulletin suggests that Euro-area economy should continue to expand at around 2.5% for 1H 2018. On the other hand, activity indicators such as industrial production. retail sales and services PMI show some signs of deceleration.

Services PMI was a touch softer at 54.9 for Mar (vs.55.0 expected and prior) but remains in expansionary territories.

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

- **Euro-area inflation was steady in Mar** (1.3% y/y vs. 1.1% y/y in Feb vs. 1.4% expectations); core inflation also held steady at 1% (unchanged from prior read). Underlying inflation remains subdued for now but is expected to rise over time as higher energy prices of late (oil price rose above $70/bbl) is likely to feed through. ECB's monetary policy measures, continuing economic expansion and rising wage growth should also continue to support the case for inflation to return to ECB's 2% target over time. Inflation projection for 2019 was lowered to 1.4% from 1.5% but remains unchanged at 1.4% for this year and 2020, as of the last ECB quarterly assessment in Mar.

- **Monetary Policy Forecast:** We expect ECB to keep the rate of Main Refinancing operations, deposit facility and marginal lending facility unchanged at 0%, -0.4% and 0.25%, respectively at the upcoming meeting on 14 Jun. There is no ECB meeting in May. However **we see chance of discussion on the future of ECB's asset purchase program** (i.e. if it will be extended after the end of Sep 2018). Currently, APP is proceeding at the monthly pace of €30 billion. We **do not expect ECB to commit to a decision ahead of Sep-2018 as inflation remains soft for now** and have yet to show signs of re-acceleration. We do not expect ECB to jump the gun ahead of inflation upticks. Slower than expected pick-up in inflation should continue to reinforce expectations for gradual pace of policy normalisation. There are also market chatters that ECB policy makers see scope to wait until their July meeting to announce how they'll end their bond buying program (Bloomberg article 23 Apr) and Draghi's comments in a statement at the IMF meeting last Fri where he acknowledged the Euro-area's growth cycle may have peaked but maintained his optimism that growth momentum is expected to continue.

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

- We noted that ECB member Nowotny commented on raising deposit rate by 20bps from -40bps to -20bps (10 Apr) and then to include the main refinancing policy rate as a second step. We believe this is not the base line scenario for the ECB Governing Council - ECB released a press statement to say that Governor Nowotny's comments are his owns and they do not represent the view of the Governing Council. We believe the sequencing of ECB stimulus removal (i.e. no rate hike before end of APP) is unlikely to change.

- At the last ECB meeting (26 Apr), ECB GC kept policy rates (Main Refinancing operations, deposit facility and marginal lending facility unchanged at 0%, -0.4% and 0.25%, respectively) and APP (at monthly pace of €30 billion) on hold as widely expected. There was no discussion on monetary policy, in particular how the APP may end. The press conference devoted a fair amount of time on the flow of economic growth data since start of 2018. ECB acknowledged the moderation in the pace of growth but added that moderation may in part reflect a pullback from the high pace of growth while temporary factors may also be at work. He emphasized that ECB will have to monitor the development and try to get a better view on the temporariness of the slowdown. On inflation, Draghi reaffirmed his confidence that inflation will eventually rise to ECB's target of just under 2% even if there are still no convincing signs of a sustained upward trend.

- **Latest Fiscal and External Balance Outlook:** Euro area's current account surplus narrowed to EUR35.1bn in Feb from 4-month high of EUR39bn as net exports of goods declined. Current account surplus to GDP was last seen at 3.5%.

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

- **Key domestic events and issues to watch:** 1Q Advance GDP, Apr Mfg PMI (2 May); Mar PPI, Apr CPI (3 May); Apr services PMI, Mar retail sales (4 May); Mar IP, 1Q prelim GDP, May ZEW (15 May); Apr CPI (16 May); Mar trade, Construction output (17 May); Mar current account (18 May); Prelim PMIs for May, May consumer confidence (23 May); Apr unemployment rate, May CPI (31 May).

- **Technical Outlook:** Our caution in last month's FX Outlook for pullback risks in the EUR met all objectives with EUR weakness extending beyond our expectations. Pair was last seen at 1.2130 levels. **Bearish momentum on daily chart remains intact while stochastics shows signs of rising from oversold conditions. Near term rebound risks on the horizon.** Resistance at 1.2140, 1.2240 levels. Support at 1.2010 (200 DMA). Look for opportunity to buy dips.

GBP: Temporarily Weighed by Brexit Progress and BoE

Forecast	2Q 2018	3Q 2018	4Q2018	1Q2019
GBP/USD	1.4000 (1.4400)	1.4400 (1.4800)	1.4500 (1.4800)	1.4400 (--)

Previous Forecast in Parenthesis

- **Motivation for the FX View**: GBP could potentially stay under pressure on signs of moderation in growth and activity, doubts on BoE's plan on policy normalisation, lack of material progress with UK-EU future trade relations and potential return of uncertainty on PM May's leadership amid broad rebound in USD and UST yields. We do not rule out a move lower towards 1.3710, 1.3650 levels in the interim. Recent development including disappointing economic data (softer than expected 1Q GDP, retail sales and faster than expected moderation in CPI suggests that BoE could defer its rate hike to 2H 2018), *Brexit* and political development (split views among MPs on UK's exit of EU and departure of May's ally Amber Rudd due to immigration scandal could threaten May's leadership) led us to lower our GBP forecast.

- We maintain our strategic call on "buy dips", on the back of expectation for orderly *Brexit* (now seen as a key source of volatility for GBP) and continued improvement in labor market to pose upward pressure for wage growth providing room for BoE to tighten possibly in 2H 2018. Eventual return of market bets on BoE tightening should support GBP while an agreement with EU on future trade relationship and other *brexit* matters should mitigate *brexit* fear factor and bolster the GBP. Nonetheless uncertainty on the above key factors will continue to see a great deal of variability on the exchange rate. We still look for opportunities on dips towards 1.36-1.37 levels to buy into for a move to re-test 1.42-1.44 levels.

- The UK and EU have started talks on future trade relations after the 21-month transition phase ends in Dec-2020. The first round (16 – 18 Apr) was inconclusive, as expected. Talks are scheduled once every fortnight in the lead up to the next EU Summit on 28 – 29 Jun. We expect talks to remain preliminary and inconclusive for now until we get closer to the EU Summit.
  - According to various media reports, the EU has offered the UK an extensive free trade agreement for their future deal but that fell short of the "bespoke" deal the Brits have wished for. Other matters such as the Irish border remains unresolved.
  - We do not rule out the risks of negative headlines on Brexit that could pose temporary downside pressure on GBP.

- For the upcoming BoE MPC meeting on 10th May, we see **room for BoE to keep policy rate on hold at 50bps** as inflation decelerated faster than expected amid concerns on global growth momentum and trade war. OIS futures showed that implied probability of hike at the upcoming meeting in May has been reduced to 22% (27 Apr) from 99%

(16 Apr). This is an indication that markets have almost pared back expectation of a May rate hike, which was previously assumed to be a done deal. The earliest market is pricing in a rate hike is now in Aug (54% probability). Lack of expectation for BoE to tighten is one factor that should weigh on GBP.

- Into the medium term (12-month), we maintain our bias that GBP could trade higher from current levels towards 1.48 – 1.50 as GBP is perceived to be undervalued from both historical and fundamentals perspective (our BEER model puts GBP at 1.40). But this could be delayed due to recent development where (1) BoE could defer its rate hike decision and (2) brexit uncertainty. House of Commons voted (26 Apr) for UK to stay in customs union after Brexit (This is against the government's intent to leave the EU). Though the vote is not legal-binding, recent development suggests that Conservatives pro-Europe may have enough support to defeat Theresa May in crucial votes in coming months. Split view between MPs is a source of uncertainty for GBP. More downside can be expected if split views persist and May's leadership is threatened.

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

- **Growth and Inflation Outlook:** 1Q GDP growth slowed to weakest level since 2012 at +0.1% q/q (vs. +0.3% expected vs. +0.4% prior). Shortfall in growth rate was due to decline in construction output and the Office of National Statistics attributed this to the winter weather. This data continues to validate our caution that growth momentum is decelerating and is below its long term average. The OECD leading indicator also indicated easing growth momentum in UK. Retail sales, industrial production, PMIs (manufacturing, services and construction) and pace of wage growth all disappointed to the downside.

- But decelerating momentum should not be mistaken as downturn. Though Mfg and non-Mfg PMIs were lower than expected or previous prints, they remain in expansionary territories (above 50). Labor market has also continued to tighten with unemployment rate falling to more than 4-decades low of 4.1%. There are also signs that wage growth may gain traction amid tightness of labor market conditions and this could generate domestic price pressures. Wage-squeeze conditions for UK consumer could ease and that should support consumption going forward.

- In that last BoE's Quarterly Inflation Report (8 Feb), growth forecast was revised upwards to 1.7 in 2018 (vs. 1.5% projection in Nov) and to 1.8% in 2019 (vs. 1.7% projection in Nov). This is due to the "strength in global growth, lessening drag from fiscal consolidation, accommodative financial conditions and a modest recovery in household real income growth. BoE's judged that that risks to the central outlook are skewed to the upside stemming from the possibility of a great boost from global demand". It did however add a caveat that "the anticipation of and uncertainty around Brexit, however, appear to be weighing on investment, and the associated fall in sterling's exchange rate is squeezing households' real incomes and dampening consumption growth". The next QIR will be released on 10th May.

- **UK headline inflation slowed faster than expected** to 2.5% y/y in Mar (vs. 2.7% in Feb). This is the lowest level in a year and the pace of slowdown exceeded expectations. The biggest drag came from clothing and footwear as well as alcohol and tobacco. This is the second consecutive slowdown in inflation; another round of faster than expected slowdown could suggest that inflation could undershoot BoE's 2% target and dampen market expectation for BoE rate hikes this year. Nonetheless inflation at current levels remains well above BoE's threshold and the recent increase in oil prices as well as tightness of labor market (likely to generate price pressures) should feed through to inflation at some stage. Our internal forecast on UK inflation trajectory suggests that inflation may have peaked at 3% in 4Q 2017 and is slowly easing towards 2% in 1Q 2019. Core inflation also slowed modestly to 2.3% y/y in Mar (vs. 2.4% for Feb). Next BoE Quarterly Inflation Report (10 May) should provide further insights into BoE's inflation and growth outlook - which may contain downward calibration to its 2018 forecasts.

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

- **Monetary Policy Forecast:** For the upcoming BoE MPC meeting on 10th May, we see **room for BoE to keep policy rate on hold at 50bps** as inflation decelerated faster than expected amid concerns on global growth momentum and trade war. While growth and activity indicators show momentum is decelerating. OIS futures showed that implied probability of hike at the upcoming meeting in May has been dramatically cut to 22% (27 Apr) from 99.9% (early Apr). A rate hike was thought to be a done deal until the poor run of inflation, wage growth, retail sales, 1Q GDP data as well as Carney's comments which were interpreted as dovish-leaning:
  - In an interview with BBC (19 Apr), Carney said there was still a lot to consider such as strength of global growth before any announcement is in May... Brexit uncertainty could slow the pace

of interest rate rises and he acknowledged the “mixed” economic data (relating to inflation and retail sales).

– But he did add that interest rate increase is likely this year but increases will be gradual as major decisions are taken on Brexit.

- We see **room for BoE to keep policy rate on hold at 50bps** as inflation surprisingly decelerated faster than expected amid concerns on global growth momentum and trade war. The earliest market is pricing in a rate hike is now in Aug (54% probability). We **maintain our call for a 25bps rate hike possibly as early as August**. Unemployment rate falling to 43-year low and signs of real wages rising underscores the tightness of labor market conditions and this could generate domestic price pressures and builds the case for BoE to normalize policies

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

- **Latest Fiscal and External Balance Outlook:** UK’s current account deficit narrowed to -4.1% of GDP for 2017. This is the narrowest level since 2011, helped by depreciation in GBP. The Office of Budget Responsibility has projected current account deficit to be about -4.4% of GDP in 2021, rather than -2% of GDP initially forecasted in Mar 2017. Foreign inflow of capital is needed to fund the deficit. But if Brexit uncertainty takes a turn for the worse (not our base case scenario) or persists for longer, investor/business sentiment can be adversely impacted. Slowdown in foreign inflows could worsen the situation and the GBP could come under pressure as a result.

- UK government borrowing also hit its lowest level in more than a decade. Shortfall between government spending and earnings came in below GBP42.6bn (about 8% lower than the last 12 months) and was the smallest shortfall since 2006-7.

- **Key domestic events and issues to watch:** Apr Mfg PMI (1 May); Apr Construction PMI (2 May); Apr services PMI (3 May); Mar trade, IP, construction output; BoE MPC meeting and QIR report (10 May); Mar labor report (15 May); Apr public finances (22 May); Apr inflation (23 May); Apr retail sales (24 May); 1Q preliminary GDP (25 May); May GfK consumer confidence (31 May).

- **Technical Outlook:** GBP had a month of 2 halves – rebounded off sub-1.40 to trade a high of 1.4377 (mid Apr) and reversed gains to trade sub-1.38 into end-Apr. Waning bets on BoE rate hike in May amid poor run of economic data and renewed uncertainty on political front can be attributed to GBP’s decline for the second half of Apr. Pair was last seen at 1.3790 levels. Bearish momentum on weekly and daily charts remains intact while stochastics is entering oversold conditions on the daily chart. Further downside not ruled out but may be limited towards 1.3710, 1.3650 levels. We look for opportunities on dips to buy into for a return back above 1.40-handle. We will re-assess our "buy dips" call if the decline breaches below the lower bound (1.3650 levels) of the bullish trend channel formed since mid-2017 and 200 DMA (now at 1.3530).

AUD: Moment of Weakness

Forecast	2Q 2018	3Q 2018	4Q 2018	1Q 2019
AUDUSD	0.7700 (0.8000)	0.7800 (0.8100)	0.8000 (0.8300)	0.8000 (0.8300)

No Change to Previous Forecast

- **Motivation for the FX View:** The rise of the UST 10y yield in the 3rd week of Apr lifted the USD against most other currencies. AUD was one of the worst hit in the G10 space, penalized for RBA's reluctant to raise its cash target rate. Even the 1Q inflation report was unable to lend much support for the AUD with core CPI a tad firmer than expectations. RBA Lowe had said he expects to see lower unemployment rate and CPI moving to the mid of the 2-3 % inflation target range for interest rates in Australia to start moving up. Looking at the sovereign yield curve, 10y1y spread has widened to almost 0.90bps at last seen. 10y yield has been trending higher though its discount to the UST 10y yield adds pressure on the AUD. Iron ore has been lending support on AUD dips but sell-in-May has started to weigh on the AUD. This moment of weakness arise from wide expectations for RBA to hold for the next 12 months. We continue to hold on to our bullish medium term view on the AUD, looking for an eventual stabilization in the UST rates, stronger wage growth as the local hiring keeps momentum and an eventual rise in CPI in the backdrop of swift upmove in commodity that would move the RBA in Aug.

- Turnbull's budget will be delivered by Scott Morrison on 8 May and one of the possible changes that the Treasurer has talked about is the scrapping of the planned hike in the health levy. The proposed 0.5% hike that was announced last year was supposed to raise A$8.2bn over the first three years to help cover cost of National Disability Insurance Scheme. We see a risk of a credit downgrade should this budget fail to convince S&P of its original commitment to a balance budget by 2020-21. A downgrade may see a test of 0.75-figure but we perceive a downgrade as a potentially liberating move for the government. The past few governments have been too shackled by concerns over the AAA rating. Dips remain opportunities for investors to buy in the medium term and we look for AUD to head higher thereafter. Given the market developments, we have decided to shift our AUDUSD forecast by 3 cents and we still look for the pair to end around 0.80 by the end of this year.

- **Growth and Inflation Outlook:** Retail sales surprised to the upside in Feb at 3.0%y/y (s. adj.), quickening from previous 2.1%. This gives an indication that household expenditure has been improving. The rise in export price for Q1 from 2.8%q/q to 4.9% suggests that the external demand could be stabilizing from the soft patch seen in 4Q last year. That is in line with the improvement in industrial profitability for China seen so far this year and that also reflects in the stabilization in the iron ore prices as well as the recent rise in copper prices. Much of the big move lower in iron prices seem to be behind us and that could suggest a bottom in the external demand, positive for the AUD.

- 1Q CPI came in roughly in line with expectations with headline steady at 1.9%y/y, undershooting the consensus around 2.0%. Trimmed mean at 1.9%y/y, firmer than the expected at 1.8% and CPI weighted mean was also around 2.0%. Putting them together, the underlying inflation is around 1.95%y/y, firmer than the expected around 1.85%. That is still well under the "mid of 2-3% inflation target range" that Lowe prefers in order to move the cash target rate.

- **Monetary Policy Forecast:** The latest CPI print from the last quarter is unlikely to provide much impetus for the central bank to move rates at the May meeting. RBA Lowe was explicit in his comments that he expects to see lower unemployment rate and CPI moving to the mid of the 2-3 % inflation target range for interest rates in Australia to start moving up. Household debt level has been high. Slow wage growth and concomitant impact on household consumption have been holding RBA back from raising the policy rate. In most of its past statements, the central bank has kept the sentence "An appreciating exchange rate would be expected to result in a slower pick-up in economic activity and inflation than currently forecast". As a result, there is an immense reluctance to signal any increase in the cash target rate. Something of some relevance is APRA's recent move to remove the 10% limit on banks that have been below the benchmark for the past 6 months, meet APRA's guidelines on assessing mortgage affordability and who commit to strengthening debt and spending verification processes.

- That said, we continue to hold on to our call for RBA to raise rates in Aug as we think the recent pace of oil prices has been swift and likens to what we witness in the end of 2008 to mid-2009 where brent rose from around U$45 to around U$75. RBA hiked rates thereafter. Headline CPI also rose in tandem but pace and magnitude was likely capped by the successive hikes by the RBA. With brent making a very similar jump from U$47 to around U$73 and likely to head higher should OPEC continue to commit to their supply cuts, price pressure has a real risk of heading higher. The recent improvement in retail sales (a proxy for household consumption) also suggests more room for the RBA to act ahead of the curve in Aug.

- **Latest Fiscal and External Balance Outlook:** As we close in on the annual Budget to be announced on 8 May, Australia Treasurer Scott Morrison said that the planned increase to health levy could be scrapped. This comes amid higher commodity prices and stronger growth that could underpin growth and government's tax revenue. Based on last available data, Australia's current account deficit narrowed slightly to A$9.13 billion (s.a.) in 3Q from A$9.7bn in the quarter prior. In related news, PM Turnbull said that the country wants to pour A$3.8bn to boost defense exports. As the mining investment declines, resource exports are rising. We may see a rise in export receipts given more government investment on that front along with rising commodity prices for energy and metals in an environment of synchronized global growth. Current account to deficit stands at -2.3% of GDP.

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

- **Key domestic events and issues to watch:** RBA rate decision on the 1st; trade and building approvals on the 3rd, SoMP on the 4th; NAB business survey on 7th; retail sales on the 8th; Westpac consumer confidence on the 9th; home loans on 11th; RBA minutes on the 15th; **Wage price index on the 16th;** labour report on the 17th;

- **Technical Outlook:** AUDUSD has broken the trend line around the 0.7630 in the last week of Apr. Support is seen around the 0.75, last Dec low. Risks are to the downside at this point but stochs indicate oversold conditions.

NZD: Interim Weakness Remains

Forecast	2Q 2018	3Q 2018	4Q2018	1Q2019
NZD/USD	**0.7100** (0.7400)	**0.7300** (0.7500)	**0.7400** (0.7600)	**0.7500** (0.7600)

No Change to Previous Forecast

- **Motivation for the FX View:** Our call in the previous month's FX outlook for NZD gains to moderate in coming weeks was more than met. In fact the more than 4% decline from Apr high of 0.7395 (13 Apr) to a low of 0.7056 (26 Apr) was much more than our expectations. This was due to the sharp pace of UST yield increase (10Y UST breached above 3%), NZ-UST yield curve inversion (-1bps on 25 Apr) and ongoing correction in global equity markets. Looking ahead, we see risk of further downside as those factors abovementioned looks set to extend into the month of May amid "sell the May and go away".

Key support at 0.7050 levels. Break below could see a move towards 0.6970 levels. Interim weakness could last a bit longer than expected. We look for opportunity on further dips to buy into.

- We **maintain our view that the interim weakness in NZD should reverse possibly into 2H** due to government policy uncertainty subsiding, global synchronous economic recovery to keep agri-commodities prices supported, inflation to materially pick up (owing to fiscal impulse, minimum wage increase) leading to RBNZ first rate hike in 2H 2018 amid environment of broad USD downtrend. We believe the narrowing of NZ-UST yield differentials is only a temporary phenomenon and should not be a permanent feature. NZ-UST yield differentials should start to widen when RBNZ signals for normalisation or Fed signals a slowdown in pace of normalisation at some stage. This should add to support for NZD.

- **Growth and Inflation Outlook:** Growth for 2018 is likely to continue at current pace. PMI for manufacturing slowed modestly to 52.2 in Mar (vs. 53.4 in Feb) but services sector expanded at it fastest pace in 14 months at 58.8 in Mar (vs. 55.3 in Feb). 4Q GDP surprised to the downside at +0.6% q/q (vs. 0.8% expectation) but held steady (vs. 0.6% in 3Q). Weakness was due to declines in the primary sector – drought (hottest summer on record) at end-2017 saw a reduction in agricultural production due to lack of feed. For full-year 2017, the economy grew by 3.1%, driven by services sector which makes up about 2/3 of GDP. Momentum has slipped vs. 2016 where growth was at +4.2%.

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

- **1Q CPI slowed to 18-month low of 1.1% y/y** (vs. 1.6% in the last quarter). This comes close to the lower bound of RBNZ's inflation target range of 1 – 3% and is within our internal forecast for inflation to dip towards RBNZ lower bound of its range at 1% in mid-2018. Our estimation shows inflation rising towards RBNZ's median target of 2% in early 2019. We believe potential fiscal impulse and proposed minimum wage increase (minimum wage to be raised to NZ$20/hour by 2020; and to NZ$16.50 by Apr-2018) could support consumer spending and result in faster pick-up in inflation.

- **The m**oderation in CPI was due to decline in education cost after government's decision to make the first year of tertiary education free while house construction prices rose at the smallest magnitude in 7 years. Breaking it down by tradables and non-tradable inflation, tradable prices fell 0.4% y/y due to airfares and appliances while non-tradable prices rose 2.3% y/y (due to rent and tobacco, the latter due to government imposition of tobacco taxes). The divergence between non-tradable and tradables suggests that early appreciation in NZD made imports cheaper.
- In the last MPS, RBNZ lowered inflation forecasts and predicted that inflation won't reach the 2% midpoint of its 1 – 3% target range until 3Q 2020. It also sees inflation softer at 1.1% in 1Q 2018 (vs. previous projection of 1.5%). Survey measures of inflation expectations remained anchored around the 2% target across all horizons.
- **Monetary Policy Forecast:** We expect RBNZ to keep OCR on hold at 1.75% at its upcoming meeting on 10 May amid softer inflation outlook and signs of moderation in activity. This MPC will see Adrian Orr chairing for the first time since appointment in late-Mar. Focus will be on his tone and bias in the press conference.
- There was no MPC meeting in Apr. The last RBNZ meeting (22 Mar) saw OCR on hold at 1.75%, as widely expected. Accompanying statement noted that "growth is expected to strengthen supported by accommodative monetary policy, high terms of trade, government spending and population growth".
- While there appeared to be big changes at the RBNZ, these changes (phase 1) were previously flagged and should not impact the direction of RBNZ in a big way. Adrian Orr has taken office as the Governor of RBNZ on 27 Mar for a period of 5 years. Finance Minister Grant Robertson and RBNZ Governor Orr had signed a new Policy Targets Agreement (PTA) to include targeting maximum employment (no numerical target) and keeping inflation in a 1-3% range on average over the medium term. RBNZ inflation targeting regime has long included employment and output variability in its deliberations on interest rate decision and the recent change in PTA is to make it explicit and to account for transparency. Another confirmation is the change in monetary policy voting/decision that will come in 2019 where a Monetary Policy Committee of about 5 to 7 members (majority will be RBNZ internal staff and a minority will be external members) will vote on rate decision (vs. the current model is where Governor is solely responsible for rate decision). Phase 2 of the RBNZ Review will focus on the Reserve Bank's financial stability role and broader governance reform. Announcements will be made by mid-2018 and subsequent policy work will commence in the second half of 2018.
- Looking ahead into 2H, policy bias and expectations could change in light of a new structure, dual mandate and new leadership going forward. We do not rule out a shift in guidance towards tightening. We still expect the central bank to begin raising rates as early as in

2H 2018 as inflation is expected to pick up further towards end-2018 (owing to fiscal impulse, minimum wage increase).

- **Latest Fiscal and External Balance Outlook:** NZ government's operating surplus continues to surprise to the upside as high employment rates boost income and consumption tax. Operating Surplus before gains and losses (OBEGAL) was a surplus of $2.85bn in the 8 months ended Feb, more than $2.36bn surplus predicted in Dec. As a % of GDP, debt stood at about 21.1%

- Finance Minister Robertson will deliver his first Budget on 17 May. He has signaled capital investment as a key focus for future budgets while unions are calling to reduce the debt to GDP to 20% of GDP.

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

- **Key domestic events and issues to watch:** 1Q labor report (2 May); 2Y inflation expectations (8 May); RBNZ meeting (10 May); Apr Mfg PMI (11 May); Apr services PMI (14 May); 1Q PPI; NZ Budget (17 May); Apr net migration, 1Q retail sales (21 May); Apr trade (24 May). GDT trade auctions take place on 1 and 15 May.

- **Technical Outlook:** NZD continued to trade lower for the month of Apr. Move lower may have shown signs of stabilisation at 0.7050 levels (61.8% fibo retracement of Dec low to 2018 double-top). Bearish momentum on weekly and daily chart remains intact. Key support at 0.7050. Break below could open way for further downside towards 0.6970 (76.4% fibo). But we observe stochastics is showing signs of turning from oversold conditions. Rebound risks not ruled out. Resistance at 0.7130 (50% fibo), 0.72 (38.2% fibo).

JPY: Monetary Policy Divergence Plays Re-emerge

Forecast	2Q 2018	3Q 2018	4Q 2018	1Q 2019
USDJPY	109.50 (107)	107.00 (106)	105.00 (--)	105.00 (--)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** JPY is among the worst performing currencies among the G10. In Apr so far, the JPY has fallen by over 2.5% vs. the USD. Aside from improving risk appetite as global trade and geopolitical tensions ease, the widening yield differentials between the UST-JGB that had taken a backseat since the beginning of the year is now front and centre again. This widening spread between 10Y UST and JGB yields has dragged the JPY lower by about four-big figure since 23 Mar.

- The JPY is currently hovering around 109-levels at the point of writing. The widening spread is likely to persist into May and this suggests that further downside pressure on the JPY is likely. A move towards the 110 levels vs. the USD cannot be ruled out but we do not expect the JPY to remain at those levels for long. Risk to this outlook though is that UST yields rises too rapidly, resulting in risk-on sentiments and sell-off in risk assets and triggering safe haven plays. The JPY is likely to be pressured lower in this scenario with the possibility of the JPY climbing higher back towards the 105-106 levels.

- Our broad thematic remains for a broad USD downtrend to persist in 2018 though intermittent bout of USD strength that could lift the USDJPY higher cannot be discounted. The current episode is an example of this with the USD getting an extra lift due to rising concerns that goldilocks conditions in the US and rising commodity prices, particularly oil, could lift inflationary pressures in the US and lead to a more aggressive Fed. Even if this does not come to pass, the expectations of a faster pace of Fed tightening should be sufficient to lift UST yields and USD higher.

- Given that the BOJ remains on an easing mode and the Fed on a tightening bias, further monetary policy divergence between the two is to be expected. We expect the BOJ to maintain its current policy stance for the foreseeable future, while the Fed is expected to hike rate again at its Jun meeting and possibly tighten even more in 2H. Even if the Fed does not tightened even more than expected, this divergence in policy should see yield differentials between the UST and JGB continue to widen, putting downside pressure on the JPY and boosting the USDJPY.

- Market expectations that JPY could still strengthen appear to be waning. Recent CFTC data showed investors reducing their net long-JPY positions. Investors are still making large long-JPY bets with 59253 contracts purchased in the week of 24 Apr vs. 49433 contracts in the previous week but are also increasing their short-JPY bets to 58670 contracts in the same week compared to 46842 contracts in previous week. In short, the market is looking for reduced JPY strength in the weeks ahead. This is not surprising given the rise in UST yields that widens the yield differentials between UST and JGB. Unless safe-haven plays return or there is rising expectations of a BOJ exit from monetary stimulus, we expect upside pressure to the USDJPY to persist in May.

- The re-emergence of monetary policy divergence between the US and Japan should widen the yield differentials and keep the USDJPY supported. Renewed downside pressure on the JPY from monetary policy divergence on rising UST yields is expected now to lift the USDJPY higher in 2Q to 109.50 instead of 107 previously and then to 107 in 3Q instead of 106. That said, we do not expect the JPY to weaken significantly from thereon. Our USD view remains for the weakness in 2H and this should put downside pressure on the USDJPY towards the end of 2018. We continue to look for the USDJPY to end 2018 at 105.

- **Growth and Inflation Outlook:** After expanding by 0.4% q/q seasonal-adjusted (1.6% annualised) in 4Q 2017, the Japanese economy is expected to expand more moderately in 2018. Stronger JPY (which hurts exports and damps imported inflationary pressures) and trade tensions between China and US could have weighed on risks sentiments and temper investment and consumption. Still, we do not expect the economy to tank given that industrial production expansion in the first two months of the year remains intact (average: +2.6% y/y) though moderating from 4Q (+4.6%). Core machine orders also remained on the uptick, rising by about 2.7% y/y in the Jan-Feb period compared to +0.5% in 4Q. Just as important, external demand is still healthy, though experiencing some slowdown due to the strong JPY in 1Q with exports up 7.0% in Jan-Feb vs. +13.2% in 4Q. Imports also moderated to +12.1% y/y vs. +17.1% in 4Q. The data suggests that the economy is likely to expand for the ninth straight quarters in 1Q 2018. More importantly, support from the government's FY2017 supplementary spending package of around JPY2tn as well as preparations in the run-up to the 2020 Olympics in Tokyo should bolster economic growth for the whole of 2018. Broadly though, the economic outlook in 2018 remains mixed with the economy unlikely to outperform in the quarters ahead. In its latest Outlook Report, the BOJ expects the economy to remain relatively healthy, expanding by a better 1.6% in FY2018 and 0.8% in FY2019 than the 1.4% and 0.7% previously forecast.

- Optimism that inflationary pressures could be picking up was shattered in Mar when all three gauges of inflation used by the BOJ underperformed. Headline, core and core-core inflation rose by 1.1%, 0.8% and 0.5% respectively in Mar vs. expectations of 1.1%, 0.9% and 0.5%. In Feb, the inflation gauges had come in at 1.5%, 1.0% and 0.5% respectively in Feb. Still, this should not be taken to mean that price trends are reversing. Crude oil prices are on the rise, while recent weakness in the JPY could lift import prices and these should put upside pressure on consumer prices. Still, even with expectations of inflation grinding higher ahead, the central bank's 2% inflation target will be difficult to achieve. This is because wage growth continues to rise at a moderate pace. In its latest monetary policy statement, the BOJ removed the deadline for achieving the inflation target but Kuroda still expects 2% inflation rate to be achieved around fiscal 2019. The BOJ left its inflation forecast mostly intact; it lowered slightly its projection for core inflation in 2018 to 1.3% from 1.4% in FY2018. The BOJ kept its core inflation forecast unchanged at 1.8% (excluding the effects of the consumption tax hike) in FY2019 and to hover around that level in FY2020 as well.

- **Monetary Policy Forecast:** As expected, the BOJ maintained its ultra-loose monetary policy stance at its policy meeting on 26-27 Apr. The central bank also left its balance (short-term) rate unchanged at -0.1% as was its 10Y JGB yield target at around 0%. The pace of asset purchase of JPY80tn annually was kept in place even though this measure is no longer central to its "QQE with Yield Curve Control" policy regime. BOJ Governor Kuroda has taken every opportunity possible to reiterate the mantra that the BOJ will continue with its persistent monetary easing until the 2% inflation target is achieved.

- As mentioned above, a key changed in the policy statement on 27 Apr was the abandonment of the deadline for achieving the 2% inflation target. This should not be seen as an abandonment of the target itself. Rather, this change appears to signal the BOJ's determination to achieve the target no matter how long it takes. With the urgency of an approaching timeline taken away, this provides the BOJ with more flexibility in achieving the target and avoids the need for more aggressive monetary stimulus.

- While all of these suggest that there will no change in the existing persistent monetary stimulus, we believe that this will not stop market from speculating that the BOJ is preparing for an exit strategy. This speculation has capped attempts by the JPY-bears to push the JPY lower towards the 110-levels.

- **Latest Fiscal and External Balance Outlook:** It was reported in the local press that the government was mulling plans for an initial budget that would include economic stimulus measures for the fiscal year starting Apr 2019. The budget proposal is expected to cross the JPY100tn for the first time. The inclusion of the stimulus measures is to prevent an economic slowdown after the planned hike in the consumption sales tax to 10% in Oct 2019 from 8% currently.

- The current account (CA) ballooned to JPY2.08tn in Feb after coming in at just JPY0.61tn in Jan. The larger surplus was attributable to rebound in the goods and services balance to a surplus of JPY0.19tn in Feb from Jan's -JPY0.67tn as well as the pick-up in the primary income of JPY1.95tn surplus (vs. JPY1.55tn in Jan). The financial account surplus rose to JPY1.54tn in Feb from JPY1.21tn in Jan, lifted by a rebound in the "other investment" segment of JPY2.29tn vs. -JPY6.30tn in Jan that more than mitigated the JPY1.54tn portfolio investment outflow. Consequently, the overall balance of payments (BoP) surplus rose to JPY3.08tn in Feb compared to JPY2.41tn in Jan.

- **Key domestic events and issues to watch:** Key focus in the month will be preliminary 1Q18 GDP due on 16 May. We will also be keeping an eye on BOJ minutes of 8-9 Mar policy meeting on 7 May and BOJ summary of opinions of 26-27 Apr meeting on 10 May. JGB auctions in May: 10-year (8 May), 30-year (15 May), 5-year (17 May), 1-year (17 May) and 20-year (22 May).

- **Technical Outlook:** USDJPY traded higher for the month of Apr. This is consistent with our technical call, flagged out in the last issue of FX Monthly - ***we said that falling wedge patter appears to be forming and this is typically associated with a bullish reversal***. Pair was last seen at 109.20 levels. Stochastic indicator on daily chart shows signs of turning lower from overbought conditions - this could suggest that USDJPY bulls fatigue may be setting in and some upside momentum could temporarily dissipate. Nonetheless, bullish momentum on weekly, daily chart remains intact. Key area of resistance at 110-110.30 (200DMA, 61.8% fibo retracement of 2018 high to low). An extended move towards 111.30 (76.4% fibo) should not be ruled out if equity risk sentiment stays supported and UST-JGB yield differentials stay wide. We do however caution that rapid pace of UST yield increase could derail risk sentiment. If that happens, risk sentiment could suffer and sell-off in risk assets could trigger risk aversion proxy plays. USDJPY gain could reverse as a result. Support at 109 (50% fibo), 107.90 (38.2% fibo).

RMB: Look Past the Near-term Downside Risks

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

No Change to Previous Forecast

- **Motivation for the FX View:** As the fear of trade war takes a backseat, PBoC announced a surprise RRR cut of 100bps that is meant to released CNY900bn for banks to meet their MLF obligations and an additional CNY400bn for small and medium sized businesses to smooth liquidity demand ahead of tax season into the end of Apr. USDCNY has been hovering within 6.26-6.33 range before heading higher on the back of this RRR cut as well as the rise in the USD and UST rates. The pair is not testing the upper bound of this range and we see risks of this pair breaking out higher towards 6.39-figure should the resistance around 6.3386 give way.

- While we acknowledge that this USD strength could stay on for these two weeks, we are still bullish on the RMB against the USD and the rest of regional peers in the medium term for a number of reasons. Capital outflow is much less of a fear given the stabilized forex reserves. The inclusion of RMB government and policy bank bonds in the Bloomberg Barclays Global Aggregate index is said to trigger around U$100 billion of inflows as investors adjust their portfolio to match the benchmark index. That puts yuan in a more favourable environment for PBoC to relax capital controls in a reversion towards the yuan internationalization plan. Indeed, China has granted the fourth batch of QDLP quotas to several foreign institutions last month and also granted additional quota for domestic funds to invest in overseas securities. The QDII approval was raised to U$98.33bn as of 24 Apr according to SAFE. This underscores the confidence that China has in its currency. Sustained global growth, potential inflows from the index inclusions, stronger trade relations with the EU and even the US (a possible outcome out of the current trade negotiations) could sustain balance of payment surplus for China and lift the RMB. In addition, CNY seems to be one of the least vulnerable to rate hike environment of the US. So a more aggressive tightening trajectory should not affect the CNY as much as other regional peers.

- Looking into May, trade war risks have not yet completely dissipated and we cannot rule out a return to fear. However, RMB has demonstrated that it can be well behaved in these episodes and we look for this currency to remain resilient. In fact, China has indicated plenty of compromise amid rumours that it is said to consider halving the import duties of cars. President Xi reiterated his calls at the Boao Forum for free trade and even pledged to improve access to the banking, auto manufacturing sectors for foreign investors. That sets a positive tone before Treasury Secretary Mnuchin meets China for the negotiation on trade. The meeting is said (on 24 Apr) to happen “within days” according to Trump. A failure to reach an agreement could mean that the US tariff would take effect after a 15 May public hearing. There could be a count-down to that but that is not our base case scenario. There is quite a bit of optimism given the fact that China has already made some compromise and we look for even stronger trade relations as an outcome to this trade spat. We look for USDCNY to arrive at 6.10 at the end of this year.

- **Growth and inflation outlook**: Apr had a strong start in terms of data with PMI-mfg surprising to the upside with a headline of 51.5 vs. the previous 50.3. PMI-mfg of small and medium enterprises actually rose above the 50-figure. Caixin version on the other hand, disappointed though the headline at 51.0, still indicates expansion. For Mar, retail sales exceeded expectations with a double-digit growth of 10.1%y/y for retail sales. Foreign reserves in Mar rose to U$3.14trn from previous U$3.13trn, underpinning the perception of RMB strength.

- Trade data for Mar was a surprise with China recording a trade deficit of CNY29.78bn. Exports contracted 9.8%y/y in Mar and imports rebounded to 5.9%y/y from a previous decline in -0.2%. The fall in exports and trade deficit was largely pinned to the Lunar New Year effect as the LNY break this year was much later than usual compared to the usual Jan-early Feb seen in the past few years. We like to look past this data and expect trade balance to return to a surplus for Apr. Given the detractor of net exports from the national income, 1Q GDP turned out to be rather strong at 6.8%y/y, underpinned by the strong retail sales that came in to be 9.8%y/y for the first quarter. Industrial production actually disappointed in Mar with a deceleration to 6.0%y/y from the previous 6.2%.

- Recall that the economic target for 2018 was softened to “around 6.5%” and the omission of the phrase “higher if possible” underscored the emphasis on better quality growth as opposed to more growth. So thus far, 1Q data has met expectations. The 6.5% economic growth still allows the China economy to be on course to achieve its 2020 target of doubling national income of 2010. The reduction of budget deficit from 3% to 2.6% for 2018 is rather drastic. While the economic target is lowered, it is worthy to note that the real economic activity index shows that economic rebalancing has been progressing and that new sectors of growth are showing a rise in activity.

- Apart from the growth target as indicated above, China had made good its word to use differentiated reserve and credit policies to guide investments into smaller companies, agricultural sectors and poverty-stricken areas for 2018 with the latest RRR cut that took effect on 25 Apr. China will also maintain a "reasonable" growth of M2, credit and social financing, also to ensure appropriate and stable liquidity. The share of direct (especially equity) financing will also be raised.

- CPI slowed to 2.1%y/y from previous 2.9% on the back of the deceleration in food and transport costs. The meat and poultry component remains on the decline, registering a steeper of 6.1%y/y compared to the previous 3.1%. Floor space under construction actually dipped into negative last Dec while growth of residential buildings sold decelerates to 11.4%y/y from previous 15.7%. Residential price sub component of CPI steadied around 2.2%y/y in Mar from the month prior.

- **Monetary Policy Forecast:** Right after the release of the activity data for Mar including 1Q GDP, PBoC announced a surprise RRR cut of 100bps that is meant to released CNY900bn for banks to meet their MLF obligations and an additional CNY400bn for small and medium sized businesses to smooth liquidity demand ahead of tax season into the end of Apr. Following the announcement, there were quite a few comments from different government bodies and local research institutions calling for RRR to be dropped further. The researcher at at the Chinese Academy of Social Sciences Fei Zhaoqi, looking for more RRR cuts. According to him, RRR cuts will release low-cost, long-term liquidity. Another official Yu Xuejun, Chairman of Supervisory Board of key State-owned financial institutions look for 6-8ppts in 3 years as normal level of RRR should be around 6-8% vs. China's 14-16%.

- Bear in mind that the 7-day reverse repo was raised 5bps right after the FOMC decision to raise rates by 25bps. The central bank also raised the MLF rates by 5bps earlier that day (before the RRR cut was announced. The 14-day reverse repo rate was also adjusted 5bps higher the day before (16th Apr). So it is hard to see the RRR cut as an easing move. If we weight the OMO rates according to the outstanding securities, we can see that the cost of funding has actually been on the rise and the RRR cut in the past few quarters, served to dampen the rise of cost of funding but not reverse it. For an economy that has become overly reliant on debt, PBoC requires the use of these OMO tools (reverse repo, repo, SLF, MLF etc) in the hope of encouraging a better pricing of risk by banks and for the purpose of deleveraging. However, the use of RRR serves to lower cost of funding and ensure that the deleveraging process does not become too painful for the real economy. With rates still likely to head higher, RMB is also poised to head higher in the medium term.

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

Bear In mind that fiscal deficit has always been above the target 3% since 2015, at 3.7% of GDP for 2017.

- **Key domestic events and issues to watch:** NBS PMI numbers for Apr due on 30th Apr, Caixin PMI is due on the 2nd May. Preliminary BOP current account balance for 1Q is released on the 4th; FX Reserves on the 7th; trade data on the 8th; inflation on the 10th; **Public hearing on US tariff on China imports watched on 15th May.** Money supply, new yuan loans, aggregate financing on 10-15th; surveyed jobless rate, activity data on the 17th; new home prices on the 16th; FX net settlement (clients) on the 18th; industrial profits on the 27th; May NBS PMI-mfg on the 31st.

- **Technical Outlook:** Momentum indicators show a tentative bottom for the USDCNH and this pair could head towards the 38.2% Fibonacci retracement of the Oct-2017 to Mar 2018 low at 6.41. Still, broad USDCNH downtrend could remain beyond the upside risks in the near-term.

KRW: Easing Geopolitical Tensions Could Buffer against Rising UST Yield

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

No Change to Previous Forecast

- **Motivation for the FX View:** We retain our bullish bias for KRW. Recent meeting (27 Apr) between North-South Koreas is a positive for the currency and local equities as this paves the way for the North Korea-US Summit sometime in end May/early Jun. However one risk factor to watch is the pace of rising UST yields. A sustained and rapid pace of increase could pose downside risk to risk assets (i.e. equities in the month of May due to seasonality effect) and limit declines in USDKRW. Widening UST-KTB yield differentials could also keep USDKRW broadly supported. As such we see some upside risk to USDKRW for the month of May, possibly towards 1080-1090 levels but continue to hold to our bias to lean against strength. Key area of support for USDKRW at 1050 - 1055. We caution that a break below could trigger more downside play for the pair.

- Our call for KRW strength to persist comes on the back of (1) synchronised global economic recovery continues to bode well for Korean exports, benefitting trade-dependent currencies such as KRW; (2) signs of pick up in inflationary pressures leading to room for BoK to tighten monetary policy in 2Q-3Q; (3) subsiding trade tensions - US have reached an agreement in principle with South Korea on the bilateral KORUS FTA and the new FTA is expected to be rolled out soon; (4) hopes of easing geopolitical tensions. We maintain our forecast over the horizon.

- Skepticism still remains on North Korea's true intent. As such we believe the **full positive effect of easing tensions may not be fully priced in**. But we think **it is also too early to write off the risk of geopolitical tension returning** as (1) North-South Korea meetings have yet to produce any concrete commitment to total denuclearization (though both Koreas are seen to be making efforts to restore relations); (2) North Korea-US Summit is a bigger risk event to watch as lack of material progress or agreement could reignite tensions and pose risks to financial markets (recall that Trump said that he will walk away from the Summit if the talks are not fruitful). As such we still urge caution on this front and expect the currency to trade cautiously in 1050 – 1085 for the month of May.

- But in the event of a successful Summit, we believe local equities and KRW does have further upside to run. In the 2007 episode when North Korea agreed to close its main nuclear facility in Feb 2007, KOSPI rose by more than 30% from Feb/Mar to Jun while KRW gained more than 3% vs. USD in the same period. We acknowledge there may however be other market factors that took place at the same period that may have partially contributed to this. But for reference over the same period, MSCI World equities rose by about 30% while DXY fell about 2.3% (note that this is less than the decline in USDKRW).

- We are not entirely committed to say the Summit will be successful (i.e. complete denuclearization in just one meeting), but we believe there shouldn't be a case of deterioration in relations nor a resumption of threats. We believe the Summit could form the building blocks and result in some roadmap or future plan for North Korea to denuclearize in phases in return for security and other benefits (such as ascension/ as observers into WTO at a later stage, etc.).

- **Growth and Inflation Outlook:** South Korea's economy expanded 2.8% y/y in 1Q (unchanged from 4Q). On a sequential basis, 1Q GDP rose +1.1% vs. -0.2% in 4Q, bolstered by exports recovery (rise in shipment of memory chips), corporate investment and government spending (due to policy change that increased the government's support for public health insurance). For 2018, BoK still expects the economy to grow by 3% this year, subject to global demand for memory chips and other manufactured goods. President Moon's proposed supplementary budget and wider budget deficit, to focus on job creation could further support growth, if it passes. Minimum wage increase (by about 16%) should also enlarge household wallet size and support private consumption

- **March headline CPI fell 0.1% m/m,** due to decline in fresh produce, meat prices and utility fees and slower rise in petroleum prices. On y/y terms, CPI slowed to 1.3% in Mar (vs. +1.2% in Feb). Core CPI continue to rise modestly, for the third consecutive month in a row, to 1.3% (vs. 1.2% in Feb). BoK projects CPI to pick up in 2H 2018, after remaining in the mid-1% range. For 2018, CPI is expected to be slightly below the level projected in Jan at 1.7%. Core inflation is still expected to gradually rise.

- **Monetary Policy Forecast**: We retain our view for BoK to keep policy rate on hold at 1.5% at the upcoming meeting on 24 May. Inflation has been relatively benign and stuck in the range of 1% – 1.4% so far this year. Though projection for 2H shows inflation is expected to pick up, the overall level however remains below BoK's 2% target. This suggests that BoK can afford to keep monetary policy status quo as it continues to monitor if inflationary pressures from the demand side picks up and if higher oil prices over the past month translates into higher CPI prices ahead. We are still expecting BoK to raise rate by 25bps this year, probably in the 3Q window if demand-induced price pressures picks up pace amid reacceleration in growth momentum. Minimum wage will increase by 16% this year, its largest magnitude of increase since 2001. Wage pass-through may have positive impact on consumption spending, growth and lead to inflationary pressures.

- At the last BoK meeting on 12 Apr, MPC kept policy rate on hold at 1.5% (unanimous decision), as widely expected. Accompanying statement noted that CPI for the year will be slightly below the previous 1.7% projection as inflation pressure from demand side will not be high for the time being while domestic economy is expected to continue its solid growth amid accommodative policy stance. BoK continue to cite spreading trade protectionism, the paces of monetary policy normalization in major countries, and the directions of the US government's economic policies as factors that will affect global economic growth.

- **Latest Fiscal and External Balance Outlook:** Current account surplus narrowed sharply to $4.03bn in Feb from 8.18bn in Feb last year. This is due to a sharp rise in the deficit in the service account, in particular the rise in overseas trips and foreign business services. Nonetheless this marked the 72nd consecutive month of current account surplus which started in Mar-2012.

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

- **Key domestic events and issues to watch:** S. Korea releases Apr trade data (1 May); Apr PMI Mfg, CPI (2 May); Apr import, export price index (15 May); Apr unemployment rate (16 May); Apr PPI (21 May); BoK meets on 24 May; Apr industrial production, Business survey for Mfg and Non-Mfg (31 May).

- **Technical Outlook:** USDKRW consolidated in the range of 1054 – 1081 for the month of Apr. Last seen at 1068 levels. Mild bullish momentum is waning while stochastics is falling from near-overbought conditions. Interim support levels at 1065 before 1058. Our focus remains on the key area of support at 1050-55 levels. Decisive break below this should open way for further downside towards 1040 levels. We are however cautious in the lead-up to North Korea-US Summit end-May/early-Jun and do not rule out rebound risks. Resistance at 1080, 1092. Bias to lean against strength. A successful Summit outcome could see gains in KRW resuming. Bias remains to lean against strength.

SGD: Bulls Taken A Notch Down

Forecast	2Q 2018	3Q 2018	4Q 2018	1Q 2019
USDSGD	1.3000 (1.2700)	1.2800 (1.2500)	1.2700 (1.2400)	1.2600 (1.2200)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** SGD failed to sustain gains that followed MAS move to normalise policy on 13 Apr. Up till the week after MAS meeting, the SGD was still showing gains, though small of around 0.1% against the USD. The rise in 10Y UST yields towards and then pass the 3% psychological level was sparked by inflation concerns in the US on rising oil prices, relatively buoyant economy and hawkish tone of Fed speakers that also lifted the USD higher. Expectations of a more aggressive Fed have probably resulted in a reduction in short-USD against long-SGD positions as market positions for a stronger USD in the near term. Consequently, the SGD has slipped 0.9% vs. the USD month-to-date in Apr. Still, we remain positive in the SGD in the next six-to-twelve months but expect some weakness in the SGD in the near term.

- We do not expect the SGD to climb as aggressively as we had previously anticipated given the bounce in the USD so far. We believe that the USD strength has legs to move higher in the near term, not least because May tends to be a seasonally weak month for the SGD against the USD. Moreover, it does not look like oil prices are about to edge lower anytime soon and should continue to provide the impetus for market expectations of more aggressive Fed rate hikes. This suggests then that our 1.27 target for 2Q is unlikely to be reached. Instead, the SGD is likely to hover around 1.30 levels for now.

- Nevertheless our positive view of the SGD remains intact and is premised on both domestic and external factors. Domestically, the synchronous global growth recovery that has lifted the trade-dependent economy to date should continue to be supportive of the economy. This was reflected in the economic outperformance in 1Q 2018 where GDP expanded by 4.3% y/y in the advanced estimate vs. 4Q 2017's +3.6%. We expect growth to cool off slightly in 2018 as manufacturing and trade growth momentum ease but this slack should be taken up by a private investment recovery in the economy (as firms expand capacity to meet rising domestic and global demand).

- In addition, the government's infrastructure programme, including developing Changi Airport Terminal 5, redeveloping Jurong Lake District and the KL-Singapore High-speed rail among others should also bolster growth ahead. Together, these should keep economic growth supported at 2.8% in 2018, close to the upper band of the government's 1.5-3.5% forecast range. MTI/MAS expect the economy to come in slightly above the middle of that forecast range in 2018. Aside from the government's mildly expansionary fiscal policy, the country's triple-A status and persistent high balance of payments surpluses are also supportive of the SGD. These should provide investors with an incentive to not completely unwind their long-SGD positions.

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

- Given recent market developments as discussed above, we have changed our forecast to the USDSGD accordingly. We now expect the USDSGD to hover around the 1.30-levels by end-2Q. USD weakness in 2H should see the USDSGD headed lower to 1.28 by end-3Q before ending the year at 1.27.

- **Growth and Inflation Outlook:** The economy outperformed expectations and expanded by a robust 4.3% in the advanced estimates for 1Q 2018. GDP had expanded by 3.6% in 4Q 2017. Driving growth in 1Q was manufacturing, which accelerated 10.1% y/y. Services sector grew at the fastest pace in three years by 3.85 y/y in 1Q (vs. 3.5% in 4Q), primarily driven by finance & insurance and wholesale & retail trade sectors. Construction, which had contracted for sixth consecutive quarter, declined at a more moderate pace of -4.4% y/y in 1Q vs. -5.0% and -9.3% in 4Q and 3Q 2017 respectively. Our economic team believes that services growth will broaden more firmly in 2018 to the domestically-oriented sectors such as retail trade and business services. Services growth should contribute a greater proportion to growth in 2018 as manufacturing cools off. Manufacturing though will remain the key driver of growth in 2018 but at a more moderate pace. Construction is likely to contribute positively in 2018 as private sector works pick-up and some public infrastructure projects are brought forward. The team expects the economy to expand by 3.1% in 2018, while MTI expects growth to come in slightly above the middle of its forecast range of 1.5-3.5% in 2018.

- Headline inflation eased in Mar, rising by just 0.2% y/y compared to 0.5% in Feb due to the smaller increase in services inflation and a dip in private road transport cost. Services inflation rose by 1.4% y/y in Mar compared to 1.9% in Feb, while cost of private road transport fell 0.6% y/y in Mar from +0.6% in Feb due to lower COE premiums. Core inflation gathered pace in Feb underpinned by higher services and food inflation. Core inflation (headline inflation less accommodation & private transport) moderated to 1.5% y/y in Mar vs. 1.7% in Feb reflecting the softer services inflation.

- In its monetary policy statement, the MAS appeared confident that inflation was on the uptick compared its Feb CPI press release. In the statement, the MAS maintained its forecast range for headline and core inflation at 0-1% and 1-2% in 2018, but noted that both prints should come in at the upper half of the range. It was particularly upbeat about the outlook for core inflation, expecting "upward pressure ... to persist over the course of this year and beyond, underpinned by an improving labour market." Our house projection for headline and core inflation remains at 0.9% and 1.7% respectively for 2018, which are at the upper range of the official forecasts.

- **Monetary Policy Forecast**: The MAS normalised monetary policy at its semi-annual policy meeting on 13 Apr after pursuing an accommodative policy the past two-and-a-half years. The MAS shifted to a 'slight appreciation bias' for the SGD NEER by increasing slightly the slope of the policy band. The level at which the band is centred and the width of the policy band was left unchanged. Underpinning this move was MAS expectations that core inflation will rise gradually on the back of improving labour market and on moderate rise in oil and food commodity prices amid the steady expansion path of the economy.

- In its statement, the MAS adjusted the slope of the SGD NEER with a slight increase from zero percent previously. Note than typically when MAS increases the slope "slightly", it means an increase of up to 1.0%. The warning by MAS of downside risks from trade tensions however suggests that a 1% appreciation per annum (p.a.) path might be too aggressive at this juncture. A 0.5% appreciation p.a. of the SGD NEER though may not be sufficient to mitigate inflationary pressures that are expected to pick-up in 2H 2018 and extending into 2019. With inflation expected to hover at the upper end of the MAS forecast ranges amid a healthy domestic and external economic environment, a 0.5% p.a. appreciation path might not fundamentally indicate a SGD path sufficient enough to anchor inflationary expectations.

- For this current move, we assume the adjustment of the slope of the SGD NEER policy band to be at the stronger end of the 0-1% range at 0.75% p.a. This should allow for a stronger SGD on a trade-weighted basis to mitigate the expected climb in core inflation in both 2018 and 2019.

- The USDSGD has been a gradual grind lower for the most part of Apr. The jump in 10Y UST yields on 20 Apr underpinned by speculation that the Fed would hike rates more aggressively this year pushed the pair higher. This lifted the USDSGD from the 1.31-levels to the 1.32-levels at the point of writing. The firmer USDSGD and rising 10Y UST yield has put renewed upside pressure on the 3-month SOR, lifting the 3-month SOR back above the 1.59 levels on 27 Apr, though this was just a tad off its near 27-month high of 1.5915% (on 21 Mar). Meanwhile, 3-month SIBOR has climbed to a new 10-year high of 1.5095% on 27 Apr. The 3-month SIBOR had been hovering around above the 1.50-levels for all of Apr so far. The climb in domestic rates can be attributed to the market re-pricing of a more aggressive Fed rate hikes in 2018 as well as the withdrawal of monetary stimulus in the other advanced economies that have kept the global financial markets flushed with liquidity. We are now gradually seeing mortgage rates respond to the climb in domestic rates. Deposit rates (for 12-month fixed) though have been on the slow grind higher and remains at 0.34% since end-Jan 2018. This continues to suggest that risks related to interest rate increases affecting financial and economic stability, particularly in interest rate- and property-related sectors, remains limited for now, though the risk is rising.

- US rates are on the uptick with the US 3MLIBOR climbing to a new 2018 high not seen since 2008 at 2.37% on 25 Apr. There are now signs that liquidity is being drained from the system and this has resulted in the recent moves higher in domestic rates vis-à-vis the US 3MIBOR. We continue to expect the 3MSIBOR and 3MSOR to edge higher to 2.25% and 2.03% respectively by end 2Q 2018. For end-2018, we continue to expect the rates to accelerate to 2.43% and 2.21% respectively.

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

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

- **Key domestic events and issues to watch:** Market will be watching final GDP print for 1Q due sometime on 18-25 May as well as CPI print for Apr on 23 May for further clues on the health of the economy.

- **Technical Outlook:** USDSGD broke out of its symmetrical triangle and traded to the upside. Last seen at 1.3250 levels. Bullish momentum on daily chart remains intact while stochastics is rising into overbought conditions. Gains could moderate; but risks seem tilted to the upside. Weekly technical remains bullish. We caution that a clean break above 1.3278 (38.2% fibo retracement of Nov high to 2018 low) could see a move towards 1.3350/60 levels (50% fibo) and 1.3390 (200 DMA). Support at 1.3220 (100 DMA), 1.3175 (23.6% fibo).

MYR: Fundamentals Support Remain

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

No Change to Previous Forecasts

- **Motivation for the FX View:** In line with most other regional currencies, the MYR weakened against the USD by around 1.4% in the month of April. It reached a high of 3.9220 on 27 Apr 2018. In the run up to the general elections on 9 May, the MYR has remained largely cautious in 2018 – ranging tightly around the 3.85-3.95 range.

- Our study on how Ringgit performs in previous episodes of Malaysia General Election since 1980 shows that (1) MYR typically appreciates up to 2% (vs. the USD) between parliament dissolution day and polling day and (2) should continue to remain steady around current spot levels with chance for modest gains (up to 1.5%) in the event that BN wins a majority or manages to secure a 2/3 majority at the parliamentary level. But in the event of a negative surprise on the election outcome, MYR could underperform. The GE in 2013 saw MYR fell about 9% 90 days post-polling day. That said every election period is unique. MYR has appreciated around 6% vs. the USD in the 90 days prior to the dissolution of parliament in the current episode. This is the largest magnitude of gains in the same period (90D before dissolution date) relative to previous episodes of Malaysia GEs since 1982. We caution that excessive optimism might already be in the price and the MYR could potentially trade cautiously in the lead up to polling day. External environment of trade tensions between US and China is also a major risk factor that may pose risks to MYR outlook.

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

- Current external environment of monetary policy continuity, oil price increase (our baseline scenario for oil has been revised higher slightly to $65/barrel vs previous $60/barrel in 2018) and still subdued inflationary pressures in US as well as synchronous global economic recovery should continue to bode well for robust exports recovery and benefit countries that are trade-dependent including the MYR. An extension of crude oil production cut into end-2018 amid steady demand should lend further support for oil prices and Ringgit. This is especially significant as MYR has more recently regained its sensitivity to upside risks in Brent oil prices currently at $74.30/bbl.

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

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

- Total gross external reserves jumped +USD2.2b to USD110.0b at mid-Apr 2018, highest since end-Feb 2015, following the +USD4.1b surge in

Mar 2018 (end-Mar 2018: USD107.8b; end-Feb 2018: USD103.7b), supported by capital, trade and corporate flows. The latest tally is equivalent to 7.7 months of retained imports and 1.1 times of short-term external debt.

- Foreigners were net buyers of Malaysian equities during 1-19 Apr 2018 period totaling +MYR1.2b which pushed the FBM KLCI to record close of 1,895.18 points on 19 Apr 2018. Net foreign buying in the equity market was among others spurred by expectations of “status quo” outcome in the upcoming 14th General Election on 9 May 2018 as well as positive impact to the economy and Ringgit from the rise in crude oil price, which reached USD73.71/bbl (Brent) on 20 Apr 2018. Meanwhile, net foreign flows for bond market for Apr 2018 will only be available by the first week on May 2018, but our Fixed Income (FI) Research team does not expect big swings in foreign flows in the bond market after the +MYR2.9b net buy in Mar 2018 (Feb 2018: -MYR3.9b).

- Trade flows remain supportive of external reserves via the repatriation of export earnings. Trade surplus increased to +MYR18.7b in Jan-Feb 2018 vs +MYR13.5b in Jan-Feb 2017 despite moderation in gross export growth to +7.9% YoY in Jan-Feb 2018 from +20.1% YoY in Jan-Feb 2017. External reserve is expected to continue on its uptrend this year on sustained trade surplus amid the volatility in portfolio capital flows as we expect the trade surplus to be sustained at +MYR103.8b or +USD27.2b this year (2017: +MYR97.2b; +USD22.6b). The surge in external reserves also reflect corporate inflows, possibly from the oil & gas sector, taking cue from the Petronas-Saudi Aramco deal involving the latter’s USD7b purchase of stake in RAPID.

- Despite the strong rise in external reserves last month and in the first half of this month on the abovementioned capital, trade and corporate flows as well as the surge in crude oil price, instead of strengthening further against the greenback, MYR movement against USD was rather “flattish” or “sideways” in recent months after the earlier gains (20 Apr 2018: 3.8945; end-Mar 2018: 3.8630; end-Feb 2018: 3.9215; end-Jan 2018: 3.8985; end-Dec 2017: 4.0475). This suggests possible FX market intervention by BNM to prevent excessive MYR strengthening or volatility i.e. buying of USD which also contributes to the rise in external reserves.

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

- **Growth and Inflation Outlook:** Our current full-year 2018 growth forecast is +5.3% (2017: +5.9%) and is "under review" pending the outcome of the 14th general election on 9 May 2018 and the release of 1Q 2018 GDP scheduled on 17 May 2018. To recap, we expect the Malaysian economy to maintain 5%-plus growth in 2018, although the pace moderates to 5.3% from 5.9% in 2017, driven mainly by the sustained domestic demand growth (2018E: 6.4%; 2017: 6.5%). Meanwhile, with the revised official growth forecast being just marginally above the potential output growth of 5.0%- 5.5%, and the official inflation rate forecast trimmed to 2.0%-3.0% from 2.5%- 3.5% previously (2017: 3.7%), these appear supportive of our "one and done" view on BNM's overnight policy rate (OPR) i.e. staying at 3.25% for the rest of the year after the 25bps hike on 25 Jan 2018. The only revision made at this point is on crude oil price, which we now expect to average USD65/bbl vs USD60/bbl previously (2018YTD: USD67/bbl; 2017: USD54/bbl), which is supportive of our FX Research forecast of further strengthening in MYR against USD to 3.65 at end- 2018 (end-2017: 4.05) 3.82 full-year average (2017 average: 4.30).

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

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

FY2018 and the 80% jump in Danainfra's issuance of infrastructure bond in 2018 to MYR18.4b from MYR10.2b in 2017.

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

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

- However, MIER takes the view that the growth momentum in 2017 will carry through to 2018 and expects real GDP growth to be at 5.5% but weakened to 4.8%-5.3% in 2019. Economy will be driven by domestic demand and reinforced by strong external sector. Nevertheless, geo-economic and geo-political risks remains as concerns that will influence the growth prospect of the economy i.e. US protectionist trade policy and the attendant risk of US-China trade war; Middle East conflict affecting global crude oil prices.

- Growth outlook will also be impacted by the outcome of 14th general election (GE14) that will be held on 9 May 2018. We see potential upside to our current 2018 real GDP growth forecast of +5.3% from Barisan Nasional (BN) win, primarily in view of the additional boost to consumer spending growth from the "goodies" in BN's GE14 manifesto e.g. increase in 2018 BR1M amount and the introduction of new category of BR1M recipients; second-round annual increment in civil service salaries; additional one-off cash aids. ***Under this circumstance, our Economics team will revise upwards our 2018 real GDP growth forecast, pending details of the 1Q 2018 GDP that is scheduled to be released on 17 May 2018. In the unprecedented event of a change in the Federal Government, there will be uncertainties to 2018 growth outlook arising from the potential implications of some key policy measures outlined in the GE14 manifesto of the opposition alliance (Pakatan Harapan or PH), especially the first 100-day measures such as GST***

***abolition, re-instatement of Sales & Services Tax (SST), return of fuel price stabilization/subsidies, as well as the review of major infrastructure projects awarded to foreign countries*. In such an event, we will keep our existing 2018 growth forecast of +5.3% pending more information and details for greater clarity on the implementation of PH Government economic policies.**

- Inflation rate in Mar 2018 eased further to +1.3% YoY (Feb 2018: +1.4% YoY) on slower rise in food prices and bigger decline in transport costs. Core inflation rate also slowed to +1.7% YoY (Feb 2018: +1.8% YoY). Revised our 2018 headline inflation rate forecast to +2.3% from +2.8% (1Q 2018: +1.8% YoY; 2017: +3.7%) and expect BNM to keep OPR at 3.25% for the rest of this year after the +25bps hike on 25 Jan 2018.

- Headline inflation rate eased further to +1.3% YoY in Mar 2018 (Feb 2018: +1.4% YoY; 1Q 2018: +1.8% YoY), contributed mainly by slower rise in "Food & Non-Alcoholic Beverages" prices (Mar 2018: +2.8% YoY; Feb 2018: +3.0% YoY) as well as further and larger decline in "Transport" costs (Mar 2018: -1.5% YoY; Feb 2018: -0.3% YoY). Meanwhile, core inflation rate (excludes volatile food and energy prices as well as pricecontrolled/price-subsidised components of the CPI, including fuel prices) eased further to +1.7% YoY in Mar 2018 (YTD 2018: +1.9% YoY; Feb 2018: +1.8% YoY).

- We revised our 2018 inflation rate forecast lower to +2.3% from +2.8% earlier after averaging only +1.8% YoY in 1Q 2018 (2017: +3.7%), as we expect domestic fuel prices to remain relatively stable in Apr and into May 2018. Note that despite the +31.2% YoY rise in global crude oil (Brent) price in Mar 2018, prices for RON95, RON97 and diesel under the managed float system declined by -4.4% YoY, -5.2% YoY and -1.2% YoY respectively during the month. In 1Q 2018, while Brent price rose by +24.3% YoY RON95 and diesel prices went up by just +0.9% YoY and +4.8% YoY respectively while RON97 price dropped by - 0.5% YoY. This is in contrast to the trend in 4Q 2017 where the Brent price increase of +25.7% YoY (almost similar to +24.3% YoY posted in 1Q 2018) was accompanied by double-digit increases in RON95, RON97 and diesel prices of +19.6% YoY, +13.7% YoY and +19.5% YoY respectively. This observed divergence between global crude oil price and domestic fuel prices suggests domestic fuel prices are currently being subsidised as the country heads into the general election on 9 May 2018 to mitigate the impact of the continued rise in crude oil price under the "manage float" fuel price system.

- **Monetary Policy Forecast:** After raising the OPR by +25bps to 3.25% on 25 Jan 2018, BNM kept the policy rate unchanged during the second Monetary Policy Committee (MPC) meeting for the year on 7 Mar 2018. The decision is to ensure continued steady growth path amid prospect of lower inflation this year. BNM sees inflation rate in 2018 to average lower on expectations of a smaller effect from global cost factors (2018E official: 2.0-3.0%, revised from 2.5-3.5%; 2017: +3.7%) as well as the Ringgit's appreciation trend but acknowledges the risk to inflation coming from the trend in global crude oil prices. Overall, the current and expected inflation path are supportive of our "one and done" view on BNM's overnight policy rate (OPR) i.e. staying at 3.25% for the rest of the year.

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

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

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

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

- **Key domestic events and issues to watch:** Trade data (4 May); FX reserves (7 & 22 May); Industrial Production (10 May); CPI (23 May), BNM Policy Meeting (10 May), GDP 1Q (17 May).

- **Technical Outlook:** USDMYR inched higher for the month of Apr. Last seen at 3.92 levels. Weekly momentum and stochastic indicators are mild bullish bias. Resistance at 3.9440 (100 DMA). Cautious trading expected in the lead up to polling day. Bias to lean against strength. Interim support at 3.89. Key area of support at 3.84 – 3.85 remains intact.

IDR: Foreign Portfolio Outflows Weigh

Forecast	2Q 2018	3Q 2018	4Q 2018	1Q 2019
USDIDR	13800 (13500)	13600 (13300)	13500 (13200)	13400 (13300)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** The IDR had plunged to a new 2018 low not seen since Jan 2016 at 13982 on 23 Apr amid expectations that the Fed could hike rates more aggressively while BI hold its benchmark policy rate steady as it did at its 19 Apr meeting. Consequently, this widening policy divergence sparked a further unwinding of carry trade plays and profit-taking in Apr. The sell-off in Indonesian debt was also exacerbated by market perception that the current account deficit was deteriorating amid rising commodity prices, including oil; possibility of poor corporate earnings given lackluster private consumption; and concerns that BI was running down its reserves in the defense of the IDR. Even the positive sentiments emanating from Moody's upgrade of Indonesia's sovereign credit rating by one notch to Baa2 from Baa3 on 13 Apr failed to prevent the IDR from sliding lower.

- These concerns saw foreign investors selling USD78.4mn and USD475.3mn in equities and debt in the week of 23 Apr. This brought the sell-off of equities and debt to USD683.6mn and USD608.2mn respectively for Apr so far. Year-to-date though, foreign investors remained vested in debt with USD1.07bn purchased while they sold USD2.40bn in equities. This is not surprising as we had already noted previously that in the event of a global equity correction and global rate increase, the IDR is among the most vulnerable currency given portfolio re-allocation globally and real yield weakness. We expect weak foreign portfolio inflows into Indonesia assets to be the main driver of IDR weakness this year.

- Near-term concerns that policy divergence plays could further depreciate the IDR beyond the psychological 14000-handle should keep BI on its toes. Already the BI has made a "quite large" intervention in the FX and bond markets that has bolster the IDR. While the exact size of the intervention remains a question mark, we believe that it must be significantly more than the USD6bn the BI had used to defend the IDR in Feb and Mar combined. We expect further BI intervention to smooth our IDR volatility in the months ahead.

- Further support for the IDR comes from the commitment of BI governor Agus Martowardojo to hike rates if necessary to stabilise the IDR. According to the BI, rate hikes would serve as the next line of defence of the IDR after intervention in the currency and bond markets. We expect BI to move on policy and raise rate sometime in 2Q 2018. Not only would this stem the build-up in inflationary pressures as a result of improvement in economic growth but it would also ensure that the rate-differentials between the US and Indonesia do not diverge significantly. A rate hike should be supportive of the IDR ahead.

- Meanwhile, relatively healthy economic growth of 5.1-5.5% in 2018 driven by the synchronous global recovery and government spending on infrastructure should also be supportive of the IDR. Other key factors that is supportive of the IDR in 2018 includes the improvement in the terms of trade as demand for commodities such as oil, CPI and coal rises that should lift exports, mitigating any drag from domestic consumption. More importantly is the government's USD400bn infrastructure programme that should not only bolster near term growth but potential growth as well. Campaign spending ahead of legislative and Presidential elections on 17 Apr 2019 should also keep the growth momentum going. In addition, spending in preparation for the Asian games slated to take place 18 Aug-2 Sep should be supportive of growth ahead. The 15 reform/stimulus packages introduced so far should help to cut red tape and liberalize rules that have been a drag on the economy.

- Still, we do not expect the downside pressure on Indonesian assets from expected weak corporate earnings and rising UST yields to subside in May as investors take this opportunity to take profit. This in turn should keep the IDR on the backfoot compared to its ASEAN peers for the time being. As we have discussed, we do not expect though for this sell-off to extend beyond 2H 2018 as economic momentum should pick-up underpinned by the acceleration of the government's USD400bn infrastructure spending, and campaign spending ahead of legislative and Presidential elections scheduled on 17 Apr 2019. In addition, spending in preparation of the Asian Games (18 Aug-2 Sep) should also bolster growth momentum. We now expect the USDIDR to climb higher to 13800 by end-2Q 2018 before easing to 13500 by year-end.

- **Growth and Inflation Outlook:** The outlook for the economy in 1Q 2018 does not look that dreary. Motorcycle sales – a proxy for consumer spending – rebounded in 1Q, rising by 4.0% y/y vs. -2.2% in 4Q 2017. Similarly for motor vehicle sales, which expanded by 2.9% y/y in 1Q compared to -1.5% in 4Q. This suggest that private consumption remains relatively healthy in 1Q 2018. However, external demand appears to have softened in Mar and this has resulted in exports rising by just 8.8% y/y in 1Q 2018 compared to 13.4% in 4Q 2017. Import growth though maintained its momentum, expanding by 20.2% y/y in 1Q. This suggests that the growth momentum should be sustained in 1Q 2018 on the back of a pick-up in private consumption and the President's USD400bn infrastructure programme push. For the rest of 2018, accelerated infrastructure spending ahead of legislative and Presidential elections in Apr 2019 should keep the growth momentum going. Spending in preparation for the Asian games slated to take place 18 Aug-2 Sep should also be supportive of growth ahead. Still, lackluster private spending is likely to be a drag on growth and cap GDP growth. For 2018, BI is projecting GDP growth of 5.1-5.5% in 2018. Meanwhile, our economic team is penciling in GDP growth at 5.30% for 2018.

- Headline inflation re-accelerated in Mar after slowing in the previous two months, rising 3.40% y/y in Mar from 3.18% in Feb. Mar inflation was lifted by higher food prices and transport cost, up 4.24% and 1.83% y/y respectively compared to 3.4% and 1.41% in Feb. Core inflation also picked-up for the first time in six months, rising by 2.67% y/y in Mar vs. 2.58% in Feb. Ongoing efforts by the government to improve food supply and control prices of key commodities via stricter monitoring should help keep food inflation down to a certain extent. In particular, the government is mulling plans to regulate the price of non-subsidised fuel to help stem inflationary prices amid rising global oil prices. Political considerations aside (given presidential and legislative elections in Apr 2019), we doubt that these measures will be sufficient to hold down consumer prices in the near term. Our economic team is still projecting headline and core inflation to average 3.52% and 2.82% in 2018 respectively. By comparison, BI is projecting inflation to average 2.5-4.5% for 2018, lower than 2017's 3.0-5.0% target range.

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

- The BI itself has acknowledged that the window for further rate cut is relatively small. Instead, the focus will be to use a mix of monetary and macro-prudential measures to tackle issues like inflation and maintain stability. The central bank is now tilted to the 'other' side in that it is now open to adjusting its key policy rate to ensure IDR stability, aside from continuing with intervention in the currencies and debt markets.

- **Latest Fiscal and External Balance Outlook:** According to the FinMin Sri Mulyani, the budget deficit hit 0.58% of GDP in 1Q 2018, well below the fiscal deficit target of 2.19% of GDP for 2018. The smaller deficit could be attributed to rising tax collection, which suggests healthy economic activities. Total tax revenue rose 16% to IDR262.4tnn. For 1Q 2018, total state revenue rose 12.7% y/y to IDR333.8tn, while state spending climbed 4.9% y/y to IDR419.6tn.

- The current account deficit came in at USD5.8bn in 4Q 2017 or 2.23% of GDP vs. 3Q's deficit of USD4.56bn (1.73% of GDP). This was due to higher deficit in the services account and also a moderation in the surplus in the goods account. The overall balance of payments narrowed to USD0.97bn in 4Q vs. 3Q's USD5.56bn, weighed by the smaller surplus in the financial account. For the whole of 2017, the current account deficit widened to USD17.29bn from 2016's -USD16.95bn. Consequently, the surplus in the overall balance of payments moderated slightly to USD11.59bn in 2017 compared to the surplus of USD12.09bn in 2016. For 2018, the BI expects the current account deficit to widen to 2.0-2.5% of GDP, while our economic team expects a deficit of about 2.2% of GDP. For 1Q 2018, BI is penciling a deficit of 2.1% of GDP.

- **Key domestic events and issues to watch:** All eyes will be on 1Q 2018 GDP on 7 May and on BI's monetary policy meeting on 17 May. In addition, focus will be on CPI print for Apr on 2 May for signs of inflationary pressures.

- **Technical Outlook:** USDIDR traded higher; last seen at 13900 levels. Bullish momentum on weekly and daily chart shows early signs of waning while stochastics is running into overbought conditions. Upside pressure may ease. Support at 13800, 13620 levels. Resistance at 14000.

PHP: Buoyed by Positive Sentiments

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

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** The PHP appears to have turned the corner in Apr. After being the laggard in ASEAN in the early part of 2018, the PHP is now the region's best performing currency in Apr. It has gained nearly 0.4% against the USD so far in Apr compared to its slippage of around 0.1% for the whole of Mar. The strength in the PHP can be attributed to rising expectations that the BSP will hike its policy rate to anchor inflationary pressures. At the same time, the upgrade of its sovereign credit rating outlook to positive from stable on 26 Apr also lifted sentiments. For much of Mar, markets have been punishing the PHP on the perception that the BSP was "behind-the-curve" in hiking rates to temper inflationary pressures. That perception resulted in increased short-PHP positions against the USD, putting downside pressure on the PHP. These moves have now been reversed with PHP bulls re-asserting themselves. PHP bulls have pushed the PHP back below the 52-handle as a result.

- Previously, the BSP had been adamant that inflation was transitory and would dissipate in 2019, resisting calls for a tighter monetary policy. Recent inflation prints (using both the 2006 and 2012 base years) showed inflationary pressures intensifying. Based on both the 2006 and 2012 series, headline inflation rose by 4.8% and 4.3% y/y respectively in Mar. Inflation using both series are now above the 2-4% inflation target set by BSP. With inflation coming in at the fastest pace in more than five years, the BSP now will "carefully evaluate the appropriateness of a measured policy response to firmly anchor inflation expectations". At the same time, the BSP's reiteration of its commitment to price and financial stability mandates also suggests action on the policy rate front. This change in tack by the central bank has been viewed positively by the market, leading to some unwinding of long USDPHP positions.

- We continue to expect the BSP to adjust its benchmark policy rate in 2018. Headline inflation by either the 2006 measure or 2012 one shows an uptrend. We believe that it is a matter of when and not if the BSP will move to hike rates. Pending petitions for adjustments in minimum wages and transportation fares, the effects of a weaker PHP as well as continuing impact of the tax reforms on inflation could be the trigger points for the BSP to take action. Our house view remains for the BSP to hike its benchmark interest rate twice by 25bp each time, once at end-2Q 2018 and the other at end-4Q 2018. These moves should be positive for the PHP. Given recent comments from BSP officials, market appears to be penciling in May for a rate moves, providing the impetus for the PHP move higher recently.

- Just as important, the S&P upgrade of the Philippines sovereign credit rating outlook to positive from stable is also keeping the PHP buoyant. The move was attributed to its strong external position and improving policymaking that have contributed to sustainable public finances. By itself, the outlook upgrade is a positive for the PHP. This upgrade could also be seen as a prelude to an S&P upgrade in the Philippines sovereign credit rating in the next 12-24 months, which adds even more upside to the PHP. Note that Philippines' credit rating was reaffirmed by the S&P at BBB.

- The credit rating outlook upgrade should provide impetus to the government to continue with its tax reforms. The subsequent phases of the tax reforms could reinforce the next phase of investment-led growth. Already, the first phase of the tax reform has led to a budget surplus in Jan – the first since Aug 2017. With partial funding secured and the commitment of the government to infrastructure building intact, this should inspire investor confidence and spur both portfolio and FDI inflows that should be supportive of the PHP.

- We could also see positive surprises coming from inflows into the stock market in 2018. Based on our analysis using the Cyclical Adjusted P/E (CAPE) ratio model, domestic equities appears relatively cheap (as reflected by the estimated P/E ratios minus their 10-year average P/E ratios) compared to its regional peers. This is particularly given the expected strong economic performance this year. Greater inflows should thus lift the PHP higher. So far, risks aversion and rising UST yields have made Philippines assets less attractive with foreign investors selling USD780.1mn in equities so far in 2018.

- Despite our optimism for the PHP, we do not expect the currency to move back towards the 50-levels for now. Key reason for this is that the Philippines have yet to fix its deteriorating current account deficit problem. Unlike it regional peers, Philippines remains the only economy with a deteriorating current account balance. The broad trend in the current account deficit remains to the downside. The government's ambitious infrastructure building programme should also keep the current account in deficit for at least in 2018. In addition, risks are to the downside for overseas remittances growth due to the repatriation of Filipino workers from Kuwait and government policy on tightening immigration. This has increased expectations that remittances are unlikely to improve the current account deficit significantly. In addition, the current account deficit is likely to deteriorate further on rising oil prices (in value terms) given that Philippines is an oil-importing economy. This should work to keep the USDPHP supported above the 51-leves for now.

- Given the positive factors to date, we have tweaked our USDPHP forecast for 2018. We now expect the USDPHP to move lower towards the 51.50 levels by end-2Q from 52 previously. Thereafter, USD weakness should allow the USDPHP continue to hover around 51.50 levels (previous: 52) by end-3Q and then to 51.00 by end-2018 (vs. 51.50 previously\.

- **Growth and Inflation Outlook:** According to the BSP, the growth momentum in 1Q 2018 was sustained due to the boost from infrastructure spending. Recent data released showed infrastructure and other capital spending at PHP63.4bn in Mar with 1Q expenditure expanding by 33.7% to PHP157.1bn. Private consumption too should have lifted GDP growth in 1Q. In Jan-Feb period, overseas remittances rose by 7.1% y/y compared to 5.9% in 4Q. Healthy government spending and private consumption should help to offset the weak external demand in the Jan-Feb period. In the first two months of the year, exports were down by 6.8% y/y. The BSP remains optimistic and expects growth to come in close to 7-8% goal set by the government for 2018. We, like the BSP, believes that the catalyst for growth is likely to come from investment spending, particularly from the government's planned PHP8tn infrastructure building programme that should mitigate the slowdown in contribution from exports. As we have previously written, favorable demographics and job market conditions should provide the impetus to growth in 2018. More likely than not, growth is likely to outperform last year's with our economic team penciling in growth of 7.0% for 2018. For 2019, our team is looking at real GDP growth of 6.8%.

- Recent inflation prints (using both the 2006 and 2012 base years) showed inflationary pressures intensifying. Based on both the 2006 and 2012 series, headline inflation rose by 4.8% and 4.3% y/y respectively in Mar compared to 4.5% and 3.8% in Feb. Inflation using both series are now both above the 2-4% inflation comfort zone set by BSP. With inflation coming in at the fastest pace in more than five years, the BSP now will "carefully evaluate the appropriateness of a measured policy response to firmly anchor inflation expectations". At the same time, the BSP's reiteration of its commitment to price and financial stability mandates also suggests action on the policy rate front. Our economic team sees expects inflation to average 4.2% and 3.8% respectively in 2018 and 2019 (based year = 2012). The BSP is more sanguine, expecting inflation to average 3.9% and 3.0% in 2018 and 2019 respectively (base year = 2012) and 4.3% and 3.5% in 2018 and 2019 respectively (under the 2006 base-year).

- **Monetary Policy Forecast:** There was no monetary policy meeting in Apr and this puts focus on the 10 May meeting where some in the market are expecting the BSP to tighten policy to anchor inflation expectations. At its Mar meeting, the BSP had left its policy rates unchanged at 3.0%. The interest rate corridor was left intact with the overnight lending rate and overnight deposit rate holding steady at 3.5% and 2.5% respectively. This left the interest rate corridor symmetrical on either side of the policy rate by 50bp. Our reading of the BSP monetary policy statement suggests that the BSP remains vigilant to the need for action to anchor inflationary pressures as the central bank believed that "... economic growth remain solid enough to absorb some policy tightening if warranted ...".

- With the central bank hinting that it may tweak its monetary policy stance should inflation persist, there is increasing speculation of an imminent move by the BSP. We cannot rule out the possibility of a 25bp BSP adjustment to its policy rate in May. Inaction in May raises significantly the probability of a Jun move. Thereafter, we expect the BSP to hike once more by 25bp at end-4Q 2018. These moves should be supportive of the PHP.

- **Latest Fiscal and External Balance Outlook:** The budget deficit widened in Mar to PHP110.7bn vs. the PHP61.7bn deficit in Feb. This brought the budget balance to -PHP162.2b in 1Q, though this was still below the PHP220bn ceiling. The good news was that 1Q revenue was higher by PHP84bn as revenue collected to date exceeded targets. That said, the government aims to cap the budget deficit at 3% of GDP up to 2022.

- The balance of payments (BoP) recorded a narrower deficit of USD266mn in Mar vs. USD429mn in Feb. Still the BoP deficit ballooned to USD1.23bn in 1Q, surpassing the estimate for the entire 2018 of USD1.0bn. The BSP though is not overly concern by this as it expects this overshooting of its estimates to be temporary and was due to the widening trade balance of USD6.23bn in the first two months of the year. The BSP continues to expect the overall BoP deficit to come in at USD1bn in 2018 vs. the 2017 deficit of USD863mn. The current account is expected to also be in deficit of USD700mn in 2018.

- **Key domestic events and issues to watch:** Aside from CPI print for Apr on 4 May and Mar overseas remittances on 15 May, market will be eyeing 1Q 2018 GDP print on 10 May for signs that the growth momentum remains intact. In addition, BSP meeting on 10 May will be closely watched for hints of policy tightening.

- **Technical Outlook:** USDPHP eased off recent highs. Last seen at 51.75 levels. Momentum is turning bearish while stochastics is falling. Sustained close below 51.80 (23.6% fibo retracement of 2018 low to high) should see the pair inch lower towards 51.40 (38.2% fibo), 51.22 (200 DMA) and 51.07 (50% fibo). Resistance at 51.80, 52.10 (21, 50 DMAs).

THB: Thai Assets Losing Their Luster For Now

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

No Change to Previous Forecast

- **Motivation for the FX View:** The THB has gone from being one of the best performing currency in ASEAN in Mar to one of its worst performers in Apr. The THB lost around 1.3% against the USD so far in Apr after gaining about 0.6% in Mar. This weakness in the THB had been triggered by the rise in UST yields that lifted the USD higher, which triggered a sell-off in Thai assets as well as some unwinding of long-THB positions vs. short-USD. This pushed the THB lower back towards the 31.650 levels (26 Apr) after hovering range bound within 31.086-31.320 since mid-Mar. There could be further THB weakness in May given the THB is seasonally weak in May against the USD but we could see a rebound thereafter.

- This weakness in the THB is reflected in the sell-off in Thai assets in Apr. Previously, Thai assets had been highly favoured by foreign investors. However, concerns over trade disruption from US protectionist measures and aggressive Fed rate hikes in 2018 had triggered a sell-off by foreign investors, particularly in equities. In Apr so far, foreign investors have sold USD597.5mn and USD794.4mn in equities and debt. This foreign portfolio outflow has put downside pressure on the THB.

- Nevertheless, the overall sentiments so far remains positive for debt as reflected in the foreign purchases of USD3.01bn in debt year-to-date that more than offset their sell-off of USD2.44bn in equities. While the broad trend appears to be inflows into Thai assets in the months ahead, some re-allocation of assets from Thailand cannot be ruled out, especially should political uncertainty re-emerges in the run-up to the general elections expected sometime between Nov 2018 and Feb 2019. Consequently, we could see some weakness in the THB in 2H 2018.

- THB strength should find support from its strong economic fundamentals, particularly its persistent current account surpluses (around 10% of GDP), as well as the synchronous global and regional recovery. In addition, its high real yields vis-à-vis the US and its regional peers make its debt relatively more attractive to foreign investors. The strong inflows to date have been supportive of the THB and continue to backstop the currency.

- So far, the synchronous global cyclical recovery has been supportive of exports and economic growth, keeping the THB supported. More importantly, we look for a pick-up in private investment to drive the next phase of growth and the THB higher. Our optimism arises from the high correlation between private investment and trade for Thailand. Thus, this current economic cycle should provide the economy and hence the THB with another leg up. In addition, the government's resolve to push forward with its infrastructure projects, especially the USD47bn Eastern Economic Corridor project ahead of general elections, could deliver upside surprises to domestic demand and growth. This investment-led recovery should be a boon for the THB.

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

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

- Our base scenario is for the general elections to proceed as planned in Feb 2019. We believe that a majority government by a single party is unlikely given the new Constitution. We are likely to see a fractious parliament made up of smaller parties; the Senate dominated by 250 members appointed by the military junta; military to retain influence in the government since no single party will be able to command a majority; and PM Prayuth to remain as PM as a result. We do not expect any change in economic policy direction and for the BoT to begin policy normalisation in 2H 2018. Some initial volatility is expected in the aftermath of the election but we expect the THB to stabilise and continue on its appreciation path thereafter.

- We are broadly positive on the THB for its economic fundamentals, though in the near term, there could be bouts of THB weakness. We caution though that political tensions in 2H 2018 could stall gains in the THB. We maintain our 2018 USDTHB forecast for now.

- **Growth and Inflation Outlook:** The economic environment remains positive for the Thai economy. Government spending ahead of the general elections together with planned infrastructure building projects including transport networks and the Eastern Economic Corridor should be a boon for economic growth. In addition, ongoing synchronised cyclical recovery should keep exports supported in 2018 with exports on the expansion path for the 13th straight month. Exports rose by a more moderate 7.1% y/y in Mar compared to 10.3% and 17.6% in Feb and Jan. More importantly, we look for the export-led recovery to spark a revival in private investment that should sustain growth in 2018, given the high correlation between export recoveries and machinery & equipment investments for Thailand. Still, the decline in private investment in Mar (down 4.96% y/y) suggests some moderation in investment spending in 1Q. Nevertheless, BoT remains optimistic and believes that 1Q 2018 growth could come in on par with 4Q 2017, that is, at around 4.0%. For the full-year, the Finance Ministry is looking for growth of 4.2 in 2018 compared to 3.9% in 2017. Our economic team is just as sanguine, penciling in GDP growth of 4.1% in 2018. Even the BoT has turned more bullish on the economy, revising its 2018 GDP growth forecast higher to 4.1% from 3.9% previously.

- Headline inflation accelerated 0.79% y/y in Mar after moderating to 0.42% in Feb. Lifting inflation higher was the rebound in food prices to 0.19% in Mar from Feb's -0.16% and the spike in transport cost by 1.02% in Mar from 0.06% in Feb. Core inflation remained elevated at 0.63% y/y, unchanged from Feb – still the highest since Jan 2017. The BoT continues to target headline inflation within the 1-4% range for 2018. The Commerce Ministry expects inflation to average 1.14% in 2018, while the Finance Ministry is penciling in 1.2%, both of which are near the bottom of the BoT's forecast range. Our economic team continues to expect inflationary pressures to edge higher in 2018, averaging 1.3% in 2018, fueled by higher energy/fuel prices, minimum wage increase and improving domestic demand.

- **Monetary Policy Forecast:** The BoT has maintained the status quo on monetary policy since Apr 2015. At its most recent meeting on 28 Mar, the BoT held its benchmark policy rate - the one-day repo rate - steady at 1.5%. The last time the policy rate was even lower was during the Great Financial Crisis in 2009 at 1.25%. The current environment of economic recovery amid a modest inflationary environment has enabled the BoT to keep its policy rate at current levels.

- Note though that this decision was not unanimous. For the first time in three years, there was a dissension with a policy maker calling for an increase. The BoT though clarified that the dissenting vote was not to be interpreted as a move toward policy normalization. Instead, the BoT reiterated that most members of the monetary policy committee agreed that accommodative policy was still needed. Despite the BoT's comments, our economic team continues to look for the BoT to normalise this year amid a pick-up in inflationary pressures. They expect such a move to take place in 2H 2018.

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

- The current account surplus narrowed slightly to USD5.75bn in Mar from USD6.16bn in Feb. This brought the current account surplus to USD17.12bn in 1Q 2018 from USD11.33bn in 4Q 2017. Aside from the trade surplus of USD3.02bn in 1Q, the current account surplus was also supported by strong tourist receipts. Tourist arrivals had averaged 15.4% in 1Q vs. 19.5% in 4Q 2017. The overall balance of payments ballooned to USD2.97bn in Mar after coming in at just US40mn in Feb. For 1Q 2018, the overall BoP ballooned to USD11.98bn compared to USD3.20bn in 4Q 2017. While details are unavailable at the moment, we believe that the strong investment inflows could have account for the strong overall BoP in 1Q.

- **Key domestic events and issues to watch:** GDP print for 1Q 2018 is on tap 21 May but before that market will be eyeing BoT monetary policy meeting on 16 May.

- **Technical Outlook:** USDTHB firmed, in line with our call for rebound play (in last month's FX Outlook). Pair was last seen at 31.52 levels. Bullish momentum on daily chart remains intact but shows early signs of waning while stochastics is running into near-overbought conditions. This could suggest that the recent up-move could moderate. Underlying momentum remains bullish (as seen from weekly technical). Upside may have further to run if resistance at 31.67 (100 DMA) gives way. Next resistance at 31.78 (38.2% fibo retracement of 2018 high to low), 32 levels (50% fibo). Support at 31.30 (21, 50 DMAs).

INR: Pulling The Rug From Under The Rupee

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

Previous Forecast in Parenthesis

- **Motivation for the FX View:** The rug is being pulled from under the rupee amid an environment of higher UST yields and rising oil prices. INR is one of the most sensitive to changes in the UST yields and the recent breach of the 3% level by the UST 10y yield weighed on the currency even more. A key game changer is the rising crude price that affects India on two aspects – 1) current account deterioration given the fact that India is an oil importer, 2) rising inflation risks that could force RBI to act in accordance to its inflation targeting mandate. The central bank has been hawkish. The release of the Apr minutes spurred a renewed selling in the bond markets in the third week of Apr in an environment of rising US rates. The threat of a rate hike weighed on equity and bond markets with U$1.779bn of bonds and

U$477.7bn of equities sold by foreigners during that week (16-20 Apr) alone. 10y yield jumped almost 40bps from 7.40% at the start of the week (16 Apr) to a high of 7.795% on 20 Apr. With oil prices looking to head towards U$80/bbl and Saudi Arabia calling for U$100 and the psychological 3% broken to make way for higher UST rates, INR could remain on the backfoot notwithstanding a potential retracement in the USIDNR in the near-term. We shifted our USDINR forecast higher and expect the currency to end the year around 66.00.

- **Growth and Inflation Outlook:** The manufacturing sector seems to be gaining quite a bit of traction according to the latest details in the industrial production release. Output of the manufacturing sector quickened to 8.7%y/y in Feb. Also worth noting is the industrial production of capital goods that accelerated to 20%y/y from 13% in month prior, underscoring strong momentum in investment. This underpins the strong growth forecasts that RBI projects at 7.4% for FY2018-19. Private consumption could moderate from the 10%y/y growth seen in quarter ending Dec 2017 as an inflationary environment might crimp on spending power even with an increase in the minimum support price could even contribute to price pressure even more.
- Inflation forecast has risks to the upside. This was very clearly outlined by RBI in the past few meetings including crude prices, staggered impact of HRA revisions, revised formula for MSP as announced in the Union Budget 2018-19 for kharif crops, fiscal slippage from the union Budget estimates that could result on higher committed revenue expenditure and a deficient monsoon that could affect food inflation.
- Overall, while risks of inflation are tilted to the upside, expect a global growth to support the demand for India's exports, improve its current account deficit and an eventual stabilization in crude prices and UST rates to anchor INR in the medium term. Before that happens, INR could remain vulnerable to further sell-off.
- **Monetary Policy Forecast:** Minutes of the Apr RBI meeting revealed that members of the MPC remained rather hawkish. Households' inflation expectations, reported by the Mar 2018 round of survey of households, rose for both 3-month and 1-year ahead horizon. Manufacturing firms in the Industrial Outlook survey also reported higher selling prices in the last quarter of the FY 2017-18. Looking forward, RBI held its CPI forecasts at 5.1% for 4Q of FY2017-18 and in the range of 5.1-5.6% in the first half of the FY2018-2019, 4.5-4.6% in H2 taking into account the impact of HRW with risks tilted to the upside. Excluding the impact of HRA, CPI is forecasted to be 4.4-4.7% in H1 of 2018-19 and 4.4% in H2. There were a number of factors listed by the RBI that could quicken the pace of economic activity over this year (2018-19), counting on signs of rising investment, improving global demand. The central bank expects output to close and GDP is projected to strengthen from 6.6% in 2017-18 to 7.4% in 2018-19. We anticipate RBI to raise repo rate by 25bps in Oct.
- Should CPI rise and we see that as a real risk because of 1) current bout of INR weakness, 2)higher oil, gold and other 3) commodity prices, 3)increase in minimum support prices that would affect various agricultural prices, RBI is likely to be forced to hike.

Hearteningly, industrial production index of capital goods have been showing rather strong growth, as indicated in chart 5. It is not just industrial production of capital goods that is strong. The industrial production of consumer durables, infrastructure and construction, intermediate goods have moved higher although recent data show some signs of tapering. We are cautiously optimistic that in an environment of continued synchronized recovery, India's industrial production could continue to strengthen.

- **Latest Fiscal and External Balance Outlook:** Finance Minister announced that the fiscal deficit for FY17 is poised to come in at 3.5%, well above the 3.2% projected as tax collections following the implementation of GST was lower than expected. For the coming year, the government estimates fiscal deficit to improve to 3.3%.

- Brent prices hovered around $74/bbl levels at last sight (25 Apr). While global demand is likely to sustain and OPEC and non-OPEC producers agreeing that the supply glut has almost cleared, crude prices could continue to climb ahead of the next full OPEC meeting in June. That affects the current account deficit for India. In addition, India is affected by the US' new tariff on steel and aluminum. Export of steel and aluminum products to the US was recorded at around U$330mn and U$350mn in 2017. The government has filed a WTO dispute over the tariff and repeatedly US for steel and Aluminium tariff exemption.

- We also keep an eye on gold prices. In a sustained global growth backdrop, modest inflation is likelier than not. The price of gold has a significant impact on its trade balance given the country's voracious appetite for it. With gold as a common hedge against inflation, an increasing inflationary environment could spur demand for the precious metal and add pressure on India's current account as well.

- **Key domestic events and issues to watch:** PMI-mfg for Apr on 2nd May; IP on 11th; WPI and CPI on 14th; trade data on 15th; 1Q GDP on 31st.

- **Technical outlook:** The 1M USDINR NDF remained above the 65-figure, likely to end the month on a bullish note. Momentum indicators are signaling overbought conditions. We are tactically bearish on this pair, looking for a break of the 65-figure for a move towards 64.45.

- **Technical outlook:** The 1M USDINR NDF rallied to a high of 67.40 at one point in Apr and was last seen around 66.70. Momentum indicators are signaling overbought conditions. There could be a retracement towards 66.27. Retracements in oil, UST rates and the USD could bring this pair lower. Time for bulls to take a breather and wait for next move. Resistance seen at 67.60.

VND: Stabilizing But Eyes on US-China Trade Negotiable

Forecast	2Q 2018	3Q 2018	4Q 2018	1Q 2019
USDVND	22750 (22800)	22750 (22780)	22740 (22750)	22780 (--)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** We adjusted our USDVND forecast just 50 dong lower based on our sanguine expectations of the US-China trade negotiations. USDVND came off from highs of 22808 as trade tensions ease between the US and China. The improvement in risk appetite actually coincided with China President Xi's comments made at the Boao Forum. Urging for free trade and even pledges to lower import tariff on automobile, allowing wider access for foreigners to China's markets boosted the VND via equity-related inflows. The decline in the Vietnam Nominal Effective Exchange Rate has come to a pause as a result. Just as what we had stated last month, State Bank of Vietnam (SBV) has allowed VND to remain stable against the trading partners once trade war concerns eased. Still, we do not expect the VND NEER to gain much as Vietnam likely to keep VND slightly weaker to boost exports growth and increase the allure of its domestic assets to foreign investors. Guiding the dong weaker ensures an element of stability and control in the exchange rate that could be reassuring for investors. We anticipate USDVND to remain roughly stable in the next few months, barring no negative surprises coming out of the negotiating table between the US and China. With China striking an almost conciliatory tone at the Boao Forum, we can expect US and China to come to an amicable agreement within the first half of May. 15 May is the public hearing for Trump's latest list of import tariff on China to take effect.

- VND is likely to remain weaker against its regional peers. However, we are still looking for USD to remain on its broad downtrend and that could see USDVND slightly bias to the downside into the end of the year. It is worth noting that visitor arrivals from China continue to remain in double digit growth. That could really underpin the exports of services and another reason for VND to remain competitive.

- In a backdrop of broad USD downtrend, we see mild downside risks to the USDVND towards 22740 by the end of this year. Yet, the appreciation is likely to lag that of key trading peers like CNY, JPY, THB and SGD. With inflation creeping higher, SBV might choose to keep VND competitive to boost exports and FDIs. We look for VND to head lower towards 3728 against CNY, 217 against the JPY, 17906 against the SGD by year end.

- **Growth and Inflation Outlook:** The Markit reported weaker rises in output and new orders for Mar that underpins the weaker headline of 51.6 (vs. the previous 53.5). New export order growth quickens while input cost inflation eased sharply with output prices also decelerating in the final month of the first quarter. Industrial production came in stronger than expected at 9.4%y/y from previous 8.7%. Retail sales for softened just a little from 9.9%y/y for the first three months to 9.8%y/y in Jan-Apr. Inflation on the other hand, came in well under expectations at 2.75%y/y. Still, price pressure was a tad higher from the previous at 2.66%. The data releases from over the weekend (29 Apr) saw USDVND head lower in relief. SBV could continue to keep VND competitive to underpin demand and output. The National Financial Supervisory Commission said that the GDP growth for this year is likely to surpass 6.5-6.7% if consumer demand maintains the momentum from the first quarter of this year, private investment continues to grow, and the disbursement of public investment gains momentum from early 2Q. 2018 inflation is seen to be around 3.5-3.8%, barring surprises.

- CPI quickened to 2.75%y/y in Apr from previous 2.66% amid an acceleration in food costs (from 0.52%y/y to 1.0%), housing and construction material, transportation and education. The subcomponent healthcare decelerated from 22%y/y to 13% this month, albeit still a major driver of price pressures for Vietnam. We had cautioned that food inflation could rise on the back of strong economic activity and currency weakness (against non-US trading partners) and that food price pressure has indeed risen accelerated in the past month.

- **Monetary Policy Forecast:** In terms of exchange rate, we see mild upside risks to the VND against the USD, in line with our expectations for broad USD weakness this year. However, as we have stated in this note, the NEER has come off significantly. SBV could continue to keep this VND weak against trading partners to boost trade as well as to attract foreign direct investment into the country. According to the PMI-mfg release earlier this month, that seems to have worked as new export orders have accelerated. FDI has continued to rise but year-on-year, the flows have declined. But inflows remain supported by IPOs and state divestment.

- While price pressure remains contained, we see little room for SBV to cut policy rates this year after a rate cut made last Jul boosted growth in the industry, construction and manufacturing sector towards the end of 2017. However, this also comes at a price of greater debt in those industries. The credit outstanding grew to around 30% y/y for the trade, construction and industrial sector. Deputy Governor said that the central bank will "manage credit growth in a flexible and cautious manner in order to help companies and boost economic growth, while still being able to limit risks in some business areas". As central banks in other parts of the world start to tighten, we see less room for further monetary easing for SBV without risking currency stability. Rather, SBV could continue to focus on managing the currency as a way to boost its manufacturing, exports, FDI and tourism.

- **Latest Fiscal and External Balance Outlook:** Vietnam's fiscal position is likely to remain in consolidation mode as fiscal deficit remains wide. The National Assembly stated that the average state budget deficit planned is estimated to be 3.7% of GDP for 2018 and NFSC commented earlier this month that the budget is on track to meet that target set.

The government needs to fund state budget deficit of VND 206.15trn and pay principal loans of CNY157.13trn this year. The government aims to reduce budget deficit to 3.5% of GDP by 2020.

- Current account recorded a sizeable surplus of USD3.1bn in 4Q last year, narrowing from the previous U$4.3bn. This data comes from smaller trade surplus of goods of U$4.93bn (vs. prev. U$5.22bn). The competitive dong could keep the current account in surplus.
- **Key Domestic Events and Issues to Watch:** PMI Mfg on the 2nd; domestic vehicle sales in 6th-13th; CPI, trade numbers, retail sales, IP are due 25th-31st. 15 May is the public hearing for Trump's latest list of import tariff on China to take effect.

FX Forecasts

	End Q2-18	End Q3-18	End Q4-18	End Q1-19
USD/JPY	109.50	107.00	105.00	105.00
EUR/USD	1.2300	1.2500	1.2800	1.3000
GBP/USD	1.4000	1.4400	1.4500	1.4400
AUD/USD	0.7700	0.7800	0.8000	0.8000
NZD/USD	0.7100	0.7300	0.7400	0.7500
USD/SGD	1.3000	1.2800	1.2700	1.2600
USD/MYR	3.8500	3.7000	3.6500	3.6000
USD/IDR	13800	13600	13500	13400
USD/THB	31.00	31.50	32.00	32.50
USD/PHP	51.50	51.50	51.00	51.00
USD/CNY	6.20	6.20	6.10	5.90
USD/HKD	7.80	7.80	7.80	7.80
USD/TWD	29.20	29.00	29.00	29.20
USD/KRW	1050	1040	1060	1050
USD/INR	66.00	66.50	66.00	65.50
USD/VND	22750	22750	22740	22780
DXY Index	90.57	89.08	87.42	86.81
SGD Crosses	**End Q2-18**	**End Q3-18**	**End Q4-18**	**End Q1-19**
SGD/MYR	2.9615	2.8906	2.8740	2.8571
SGD/IDR	10615	10625	10630	10635
SGD/THB	23.85	24.61	25.20	25.79
SGD/PHP	39.62	40.23	40.16	40.48
SGD/CNY	4.77	4.84	4.80	4.68
SGD/HKD	6.00	6.09	6.14	6.19
SGD/TWD	22.46	22.66	22.83	23.17
SGD/KRW	808	813	835	833
SGD/INR	50.77	51.95	51.97	51.98
MYR Crosses	**End Q2-18**	**End Q3-18**	**End Q4-18**	**End Q1-19**
EUR/MYR	4.74	4.63	4.67	4.68
JPY/MYR	3.52	3.46	3.48	3.43
MYR/HKD	2.03	2.11	2.14	2.17
MYR/CNY	1.61	1.68	1.67	1.64
GBP/MYR	5.39	5.33	5.29	5.18
AUD/MYR	2.96	2.89	2.92	2.88
NZD/MYR	2.73	2.70	2.70	2.70
MYR/IDR	3584.42	3675.68	3698.63	3722.22
MYR/INR	17.14	17.97	18.08	18.19
MYR/KRW	272.73	281.08	290.41	291.67
MYR/PHP	13.38	13.92	13.97	14.17
CNY/MYR	0.6210	0.5968	0.5984	0.6102

Source: Maybank FX Research as of 30 Apr 2018

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

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