Maybank

FX Monthly

2019, Issue 4: Watch Out for Trade Deal and Green Shoots

What Has Changed This Month?

- We adjusted the INR and VND lower, taking into account the moves of the crude oil and the USD recently although the trajectory is still maintained as we hold our view for USD strength to fade into the rest of this quarter and the next as well. However, higher crude price could still dim the allure of the INR even as USD is softer and underpins our decision to downgrade our outlook for the currency. We also lowered KRW and MYR to reflect recent market developments.
- We revised PHP forecast higher vs. USD to reflect the S&P credit rating (30 Apr).

Our Strategies

- Investors scurried to the USD ahead of the most seasonally bullish month of the year for the greenback, spooked by concerns over global growth - putting EM and other pro-cyclical currencies on the backfoot, exacerbated by thin liquidity conditions and "sell in May" fears. However, we are not in a hurry to write off green shoots yet, fragile as they may look at this point. China policymakers will remain on the standby to support activity which has exhibited signs of stabilization while a potential US-China deal can still boost sentiment and take the drag off the global growth. In addition, we look for a potential turn-around in semi-conductor down-cycle to back exports, investment recovery which should in turn see USD strength fade.
- An environment of (1) dovish monetary policies amid benign inflation, (2) global growth slowing but not tanking (not hot not cold), (3) hopes of US-China trade deal suggest some opportunistic play favoring selected higher yielding FX proxies INR, IDR in the EM space.
- We still look for USD strength to fade but trade within 95 - 98 range on softer US data, dovish-leaning Fed rhetoric and renewed optimism on US-China trade deal. US' widening twin deficits of budget and current account should fundamentally be detrimental for the USD.
- The 3 upside risks to our USD view still hold: (1) the risk of further gains in oil prices possibly due to supply-disruption or material progress on US-China trade deal could translate into inflation ticking higher in US and this could reignite pressure for Fed to tighten and would be supportive of the USD. OR (2) if global growth and monetary policy divergence resumes in favor of US, then the USD could be poised for further upside risk. OR (3) if global equities enter into a deeper sell-off owing to deep economic slowdown globally or stagflation concerns, then the USD could also be poised to strengthen.

Analysts

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

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

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

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

Top 3 Currency Plays for May

Long INR, IDR on Dips

Fade The USD

Buy JPY, GBP and EUR on dips

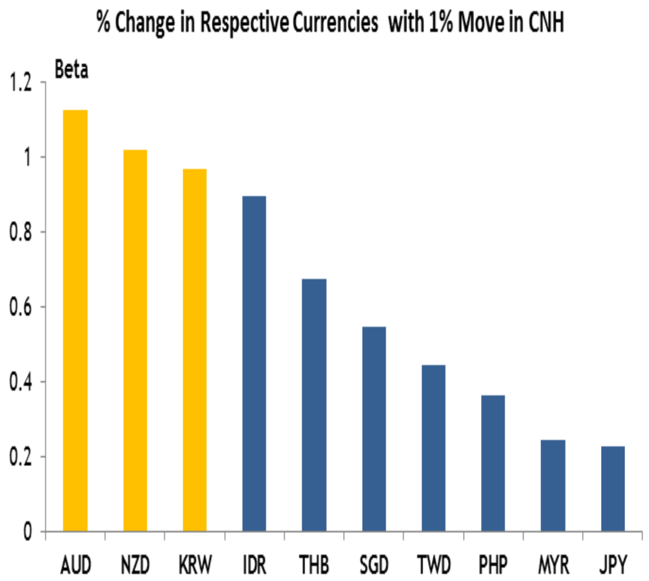
Key Events for the Month Ahead

Date	Event
2 May	Local Elections in UK
8 May	Vice Premier Liu He in the US for trade talks
9 May	Official Results for Thai General Election held on 24 Mar
13 May	Philippines Mid-Term Elections
22 May	Official Results for Indonesian Presidential & General Elections held on 17 Apr
23 May	India's General Election for Lok Sabha (Election)
26 May	European parliamentary elections and Belgium Federal Elections

Exports Recovery Can Lift Asian FX, Just Like in 2016-2017

Note: Asian FX index is an index that consists of the average performance of CNY, KRW, TWD, MYR, SGD and THB agaisnt the USD. Export performance here is the year on year export growth of China, South Korea, Taiwan, Singapore, Malaysia, Thailand and Japan.

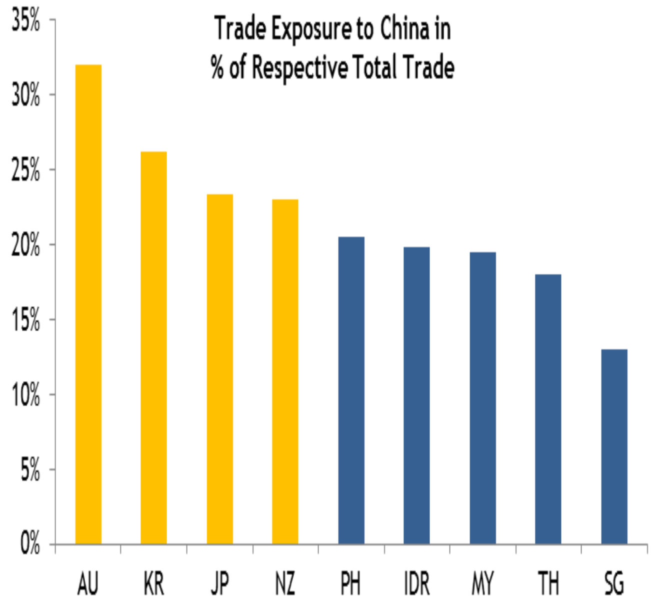
AUD, NZD and KRW Are Most sensitive to CNH



Note: OLS regression on daily values for sample period of 1 Nov 2018-11 Apr 2019. For example, a 1% appreciation in CNH vs. the USD could see a 1.1% appreciation in AUD vs. the USD.

Source: Bloomberg, Maybank FX Research & Strategy

AU, KR, JP and NZ have the highest trade exposure to China



Note: Trade exposure to China in % of Their Respective Trade in 2018

G7 Global Overview

USD: Strength to Fade

Forecast	2Q 2019	3Q 2019	4Q 2019	1Q 2020
USD Index	96.18 (95.88)	95.18 (94.64)	95.40 (94.86)	94.87 (94.62)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** Near term, there may be some support for safe-haven proxy plays including USD and JPY as markets worry about sell-in-May and poor market liquidity into the start of May (due to market closure in Japan till 7-May and several key market closures in HK, SG, EU, etc. on 1st May). But we think upside is limited and we expect USD strength to fade.

- We argue that USD strength could fade on a combination of factors including (1) Fed pause amid benign inflation environment; (2) moderation in US activity momentum while global activity shows some signs of stabilisation; (3) fiscal and monetary support globally may well prove timely to cushion against a deeper global growth slowdown and support sentiment; (4) growing optimism of a trade deal between US and China possibly coming earlier than later (possibly end-May/early-Jun) should also further support sentiment and provide the lift for activity and exports. To add, investors have started to bet more on puts on the USD relative to calls vs. the other non-USD majors. This case of risk reversals turning negative for the first time in mid-Apr (not seen for a year; and has been trending lower from a 6-months perspective) against an environment of USD strength, suggests that markets' complacency with USD strength could be vulnerable to a sell-off. When all these factors are in play, the unwinding of stale and speculative USD long positions could send USD lower. US' widening twin deficits of budget and current account as well as ongoing diversification in global central banks' reserves away from USD should also continue to weigh on the USD.

- Our DXY forecast was mildly calibrated to the upside due to upward revision to our USDCHF and USDSEK forecasts to factor in the easing biases in their domestic respective monetary policies. Overall we continue to look for USD softness into 2Q - 3Q 2019 on the above-mentioned factors. Towards the end of 2019, our baseline builds in some expectations of heightened concerns about weaker global and US growth intensifying thus leading to some level of global risk off, supporting the USD somewhat.

- **Risks to our Outlook:** (1) the risk of further gains in oil prices (possibly due to supply-disruption or material progress on US-China trade deal) could translate into inflation ticking higher in US and this could reignite pressure for Fed to tighten and would be supportive of the USD (recall that oil prices and USD rose in tandem in 2018); (2) no US-China trade deal and lack of follow-through (pick-up) in global economic activity could result in a deeper economic slowdown (sell in May adage). In this scenario, volatility will jump from current compressed levels and risk assets including equities will enter into a deeper sell-off and USD could strengthen (flight to safety); (3) if growth and monetary policy divergence resumes in favor of US, then tighter monetary conditions could expose vulnerabilities in EM assets including Turkey, Venezuela (spillover contagion) and USD could then be poised for further upside (risk-off trade).

- **Growth and Inflation Outlook:** 1Q GDP came in much better than expected (+3.2% q/q vs. +2.3% expected vs. +2.2% in 4Q). However devil appears to be in the details as the breakdown shows inventories and net trade boosted headline GDP while consumer spending was weak. Final sales to domestic purchasers ex-inventories and trade (as proxy for underlying growth trend) saw a sharper slowdown to 1.4% in 1Q (down from 2.1% in 4Q. This marks the weakest quarterly print since end-2015. It is probably no surprise that USD gave up knee-jerk gains to trade lower on the back of slowing momentum in underlying growth.

- Mar PCE core coming in softer (+1.6% y/y) than expected (+1.7%) further confirmed the benign inflationary environment in US. Prices for healthcare services fell 0.2% in Mar after rising 0.3% in Feb while cost of apparel also fell. Taken together, weaker-than-expected US data including softer retail sales, industrial production, core PCE, Chicago PMI, factory orders, 4Q GDP warrant Fed's patience on policy normalisation.

- **Monetary Policy Forecast:** FFTR is expected to remain on hold at 2.25 – 2.5% at the upcoming FoMC (1 -2 May). We also expect the Fed to **reiterate its patience stance and data-dependence approach**. Any deviation from its previous communicated stance could see USD react. There is however some risk of potential adjustment to bring interest of excess reserves (IOER) down to 2.35% from 2.4%. This is because the effective fed fund rate (EFFR) has moved 4bps above the IOER. Historically the EFFR is close to where the IOER is. The Fed attributed higher EFFR to higher rates on reverse repo markets while other market participants suggest it could be due to Fed's balance sheet unwinding, resulting in some proceeds from its portfolio rolling off and putting upward pressure on rates. And we think there is a small risk that the Fed could bring forward the timeline (slower pace of reduction from May with a complete stop in Sep) of balance sheet reduction or tweak details. This if it happens, would add to Fed's dovish rhetoric.

- Our **House view is now looking for FFTR to remain unchanged at 2.25 - 2.5% for 2019 - 2020**.

- Putting the current Fed rate hike cycle in perspective, the Fed started normalising monetary policy on Dec-2015 and since then, the Fed has raised Fed funds target rate on 9 occasions by 25bps each over 40 months. Going by Fed's forward guidance, only 1 more rate hike is expected in 2020 while markets are even pricing in a 53% chance of a 25bps rate cut as early as at the Oct-2019 FoMC meeting. We believe the Fed is nearing its end of policy normalisation (previously highlighted in our earlier report). Going back to 1980s, previous episodes of yield curve inversions tend to coincide with the peak of each Fed rate hike cycle. In the current episode, the low of 2Y10Y UST yield spread was about +10bps away from being flat (before steeping to +23bps in Apr). Historically the low in 2y10y yield spread was about -40bps in 1989 and 2000. While there may still be room for Fed to tighten, historical observation suggests that the room may well be limited.

- In the last FoMC meeting (21 Mar), though the Fed target range of 2.25% – 2.50% was kept unchanged as widely expected, there were a few changes in terms of forward guidance. In particular, Fed lowered the dots plot down to signal no more rate hike for 2019 (down from 2 previously) - this was more dovish than expected. Looking out, Fed is expecting just 1 hike for 2020. This is in line with our call that Fed nearing the end of tightening cycle implies there is limited room for Fed to tighten. On balance sheet normalisation, Fed plans to slow the pace of normalisation in May and end normalisation in Sep. Financial conditions are expected to ease. Fed Chair Powell added that rates could be on hold for “some time” as global risks weigh on the economic outlook and inflation remains muted.

- Despite Fed’s assessment that the labour market conditions remain tight, view on growth is toned down as economic activity moderated amid slower household spending and business fixed investment, coupled with muted inflation. Fed is also monitoring global economic and financial developments. Fed’s latest 2019-2021 median macro forecasts (as of 21 Mar) showed slight downward revisions to growth and headline inflation rates, no change in the forecast of steady core inflation rate at 2.0%, and marginal upward revisions in the still sub-4% unemployment rate.

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

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

- **Key domestic events and issues to watch in May:** Apr ADP Employment change, ISM mfg, construction spending (1 May); Mar durable goods order; FoMC meeting (2 May); Apr ISM non-mfg, NFP, unemployment rate, hourly earnings (3 May); Apr PPI, trade (9 May);

Apr CPI (10 May); Apr retail sales, May empire manufacturing, Apr IP (15 May); FoMC minutes (23 May); May prelim PMI (23 May); May conference board consumer confidence, Dallas Fed Mfg (28 May); 1Q GDP second print (30 May).

- **Technical Outlook:** DXY traded a 2-year high of 98.33 (26 Apr). Last seen at 98 levels. Though bullish momentum on daily chart remains intact, signs are emerging that it could fade. Daily stochastics also shows signs of turning lower from overbought conditions. Resistance at 98.20, 98.50. Break above this exposes DXY to 99-levels. But failure to test above followed by a subsequent decline past 97.7 (previous triple top-resistance now turned key support) could see a reversal lower, possibly towards 97.30 (21 DMA, upward sloping trend-line support from the lows in Mar and Apr-2019), 97 levels (50 DMA) and 96.20 (200 DMA). Bias remains to lean against strength.

EUR: Recovery Could Come when Political Uncertainties Subside and Green Shoots Extend

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

No Change to Previous Forecast

- **Motivation for the FX View:** We continue to caution that a build-up in political risk premium owing to potential election uncertainties out of Spain (28th Apr but results only after first week of May), European parliament (23 – 26th May) and Belgium elections (26th May) could limit EUR gains in the interim. But reiterate our stand that EUR pullback owing to the rise in political risk premium should present opportunities to buy into. Unwinding of political risk premium and green shoots of recovery extending could help with EUR recovery. We look for 1.1050 – 1.1450 trading range for May.
- Immediate focus on the formation of the Spanish coalition government. With 99% of the votes counted (as of 29th Apr), Pedro Sanchez's Socialist PSOE has won with 123 seats but still short of 176-seat majority. A hung parliament outcome was roughly in line with what was expected in the polls hence the relative stability in the EUR. Question next is which parties PSOE would choose to form the coalition government. A partnership with Podemos only managed 165 seats and the coalition may need to partner with 1 or more minority parties to govern. Elsewhere traditional conservative party of government, People's party (PP) suffered a humiliation as seats were more than halved to 66, from 137 in 2016 while far-right party (anti-feminist, anti-immigration) VOX, won 24 seats in parliament. Risks of Pedro Sanchez failing to form coalition government could weigh on sentiment and pose downside pressure to EUR.
- Beyond the short term, we maintain a constructive outlook for EUR over our forecast horizon on hopes of green shoots in Euro-area (early

signs of stabilisation in activity momentum) and some expectations for ECB policy normalisation to gather traction towards 4Q 2019. Many bad news have been priced into EUR (as seen from CFTC positioning where EUR shorts is at more than 28-month record high while most asset managers are underweight/neutral EU equities. Unwinding of these negatives could lend the positive impulse to EUR recovery. Further stabilisation in EU data, in particular coming from Germany (which has seen a soft patch) could provide the confidence for potential portfolio reallocation in favor of EU assets and this could provide the recovery for EUR. A potential US-China trade deal in end-May or Jun could also be a factor supporting the green shoots of recovery story in China and Europe. Taken together, this could support EUR recovery. Though ECB's timeline of policy normalisation may have been pushed back (ECB expects rate to stay at current levels till end-2019), Fed's pause on rate normalisation and slowdown in balance sheet normalisation (starting May and end in Sep), could help to reduce the negative EU-UST yield differentials. This divergence-convergence of ECB-Fed policies, albeit slow pace, is another factor supportive of EUR recovery (given that EUR is most sensitive amongst DM FX to changes in yield differentials). We expect EUR gains to pick up traction when market speculation for ECB policy normalisation plans kick in at some stage towards end-2019-early-2020.

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

- **Growth and Inflation Outlook: Signs of growth stabilisation in the Euro-area remain mixed**. While industrial production in Germany, France, Spain, Italy, ZEW survey expectations rebounded, German IFO, factory orders, EU consumer confidence and preliminary estimates of Euro-area PMIs slipped. No doubt Germany is undergoing a soft patch for now, we think this is one-off and the economy should recover once the one-off event relating to auto emission scandal fades. We believe further stabilisation in EU data, in particular coming from Germany could translate into a real pick-up.

- 1Q GDP advanced estimates for Euro-area is scheduled for 30th Apr and preliminary estimate is schedule for release on 15th May. For 4Q, Euro-area growth came in at +0.2% q/q. This was the slowest pace of growth since 2013. Italy entered into technical recession while German economy stagnated. Spain, Netherlands and Portugal surprisingly saw growth picked up pace. **Concerns of Euro-area growth slowdown remain** as manufacturing PMI in still in contractionary territory in Apr (47.8 vs. 49.5 prior). Our view remains for a **deceleration in growth momentum but short of an outright recession for the Euro-area as a whole**. Services PMI remain in expansionary territory at 52.5 while IPs for Germany, Italy, France, Spain rebounded in Feb.

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

- **Headline Euro-area CPI slipped modestly to 1.4% in Mar, from 1.5% in Feb.** Slowdown was due to lower contributions from transport, recreation and accommodation arising out of the earlier-than-normal Easter holidays. This holiday-driven effect could dissipate and headline CPI could possibly rise in the next inflation estimate for Apr on 3rd May (amid higher oil prices as well). Looking ahead, the ECB expects inflation pressure to gradually rise owing to favourable labor market dynamics (falling unemployment and rising wage growth). Core CPI held steady at 0.8% y/y in Mar.

- **Monetary Policy Forecast: There is no ECB Governing Council meeting scheduled for May. The next ECB GC meeting is scheduled on 6th Jun. We expect the** ECB to reiterate its commitment to maintain key policy rates including Main Refinancing operations, deposit facility and marginal lending facility on hold at 0%, -0.4% and 0.25%, respectively till end-2019. **We expect further details (including conditions, pricing) on TLTRO** (announced in Mar-2019 and starting in Sep-2019) at the Jun GC. We lowered our base case expectation for ECB to normalize policies in end-2019 to some risks for ECB to normalize policy later this year with modest increase in deposit rate from -0.4% to -0.3% in end-2019 should (1) inflation data, in particular core CPI surprises to the upside while (2) recent decline in growth and activity data proved to be one-off.

- In the last ECB Governing Council meeting (10th Apr), policy rates and forward guidance for rates to remain at present levels through end-2019 were left intact as widely expected. The ECB sounded dovish. Draghi acknowledged that the economic weakness had proved 'somewhat longer lasting' than previously expected and ECB is willing and able to act is Eurozone economy remains weak. He added that ECB could even tolerate a period of above-target inflation in order to put the economy back on track. On market speculation of the possibility of a tiered deposit scheme, Draghi confirmed that policymakers were considering measures to mitigate the impact on banks of its negative deposit rates but it remains too early to decide as they need further information that will come in between now and June. In short, Draghi's overnight comments may appear dovish and could possibly raise the risk of further rate cut but we doubt if a cut would materialise as signs of stabilisation are already showing up in European activity including German survey expectations.

- ECB President Draghi will step down on 31 Oct 2019 and the race for the next ECB President remains wide open. Market chatters of former

Finnish Governor Lilkanen and French central banker Villeroy front running German central banker Weidmann (whom is viewed as a hawk). Both Lilkanen and Vileroy are considered close aides of Draghi and are supportive of accommodative monetary policies. We continue to monitor this space as we run closer to the rotation of ECB leadership. Shift in expectation in support of Weidman could further be supportive of the EUR.

- At the ECB GC meeting (7th Mar), ECB announced its decision to (1) re-introduce cheap funding via quarterly TLTRO with rate indexed to MRO interest rate (currently at zero) starting in Sep-2019; (2) shifts in forward guidance on policy normalisation – ECB now expect rates to remain at present levels through end-2019, from end Summer-2019 and (3) relatively large downward revisions to 2019 growth forecast to 1.1% from 1.7%.

- **Latest External Balance Outlook:** Euro area's current account surplus narrowed to EUR27bn in Feb, down from EUR37bn in Jan. In the 12 months to Feb, Euro-area current account surplus was 2.9% of GDP, down from 3.3% in the same period a year ago. ECB expects current account surplus to narrow further to 2.7% of GDP in 2019 and 2.5% of GDP in 2021.

- **Key domestic events and issues to watch:** Apr mfg PMI (2 May); Mar PPI, Apr CPI estimate (3 May); Mar retail sales, Apr services PMI, May Ssentix investor confidence (6 May); Mar IP, May ZEW survey expectations (14 May); 1Q prelim GDP (15 May); Mar trade (16 May); Mat construction output, Apr CPI (17 May); Mar current account (20 May); May consumer confidence (21 May); prelim PMI (23 May). Formation of Spanish coalition government (within coming weeks); EU Summit (16 – 17 May); European parliamentary elections (23 – 26 May); Belgium Federal Elections (26 May).

- **Technical Outlook:** Our call (in the last FX Monthly) looking for chance of rebound towards 1.1280, 1.1340 was close to full materialization. EUR traded an intra-month high of 1.13224 (17 Apr) before turning lower for the month. Low was seen at 1.1174 (26 Apr); last seen at 1.1160 levels. Bias remains bearish but signs of recovery are showing up. A bullish divergence could potentially be in the making (lows in Feb, Mar and Apr-2019). Bearish momentum on daily chart remains intact but shows tentative signs of waning while stochastics shows early signs of turning from near-oversold conditions. Resistance at 1.1230 (21 DMA), 1.1340 (100 DMA, downward sloping trend-line resistance from the highs in Sep-2018 and Mar-2019) before 1.1420 (200 DMA). Support at 1.1110, 1.1050 levels. Bias to buy dips.

GBP: Risk of Political Paralysis

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

No Change to Previous Forecast

- **Motivation for the FX View**: 2-way trade remains the name of the game. Domestic political uncertainties (relating to local elections, snap election, risks of PM May's departure) are likely to snatch the limelight from *Brexit* uncertainties. Local elections are held on 2nd May and according to poll estimates, Tories is set to lose 1 in every 5 seats as voters may express their disappointment and anger with brexit by voting the government out. Political stresses could still keep GBP bulls at bay. But beyond near term whippy trades, we hold to our bias to buy dips as hard brexit uncertainty subsides. Clarity on local elections (if Conservatives do not lose as many seats as feared) and PM May's leadership would be some factors supporting GBP's recovery. We look for a range of 1.28 – 1.32 for the month of May. We keep our forecast and trajectory unchanged for now unless UK suffers from political paralysis.

- EU is said to offer PM May brexit delay until 31st Oct with a review to be held in Jun to take stock of progress. The compromised date is longer than PM May's earlier request for 30th Jun but shorter than Tusk's proposal for Apr-2020. Now this raises question if a snap elections could be called to overturn PM May (GBP-negative) or if a second referendum could be held in time (possibly GBP-positive). Focus is also on the outcome of the technical discussion between Conservative and Labour parties – which may have stalled for now. We continue to argue that soft, delayed brexit is a base case scenario and that forms the basis to buy GBP on dips as no-deal brexit is less likely to take place (parliament passed a law designed to ensure UK does not leave the EU without a deal) and the extension of brexit is also expected. The risk to our view is if there is a change of leadership (as some Tory MPs are believed to be plotting for PM May's departure while PM May has previously indicated that she will step down after a deal is reached) or a snap elections. Both of these domestic factors pose downside risks to GBP.

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

- **Growth and Inflation Outlook: 1Q preliminary GDP will be released on 10th May. Economics data released in the past 1 month seems to suggest that activity momentum in UK is not as bad as feared.** Manufacturing PMI unexpectedly rebounded to 13-month high of 55.1 in Mar (vs. 52 in Feb) thanks to increase in output, employment and new orders. Retail sales for Mar jumped to highest level since Oct-2016 (though some argued that the jump was due to low base last year) while the surprised jump in industrial production for Feb was led by durables and intermediate goods. Unemployment rate remains near 44-year low of 3.9% while wage growth was steady at +3.5% y/y. Despite the positives, there are also some drags with services and construction PMI in contractionary territories. For the former, this is the first time since post-Brexit in Jul-2016 that services PMI entered contractionary territory. We expect ongoing brexit uncertainty to weigh on investment and business decision and that could still keep UK prospects dimmed for the moment.

- The next quarterly inflation report (QIR) is scheduled for release on 2nd May. The last QIR (7 Feb) saw **growth projection for 2019 and 2020 lowered** to 1.2% and 1.5%, respectively (vs. 1.7% in Nov-2018 report). This was the biggest downgrade to growth projection since 2009 and it reflects the intensification of Brexit uncertainty and weakening global growth. UK growth could pick up later this year when those risks factors fade. Growth projection for 2021 was raised to 1.9% (vs. 1.7% in Nov-2018 report). Looking ahead, UK's economic outlook is highly dependent on future trade arrangement (beyond 1 Jan 2021) of the EU withdrawal agreement, the transition agreement (effective 30 Mar 2019 to 31 Dec 2020) and the journey (orderly or disorderly) towards Brexit day. Prolonged brexit uncertainty will weigh on business decision and investments and this could dampen growth outlook. For inflation, BoE MPC expects inflation to fall slightly below MPC's 2% target in the near term due to the sharp decline in oil prices since Nov-2018 but fading effects of oil and rising excess demand should see inflation return and remain a little above the 2% target for 2020, 2021 forecast periods.

- **UK headline inflation held steady at 1.9% y/y in Mar** as higher fuel prices were offset by falling cost of food and computer games. Core inflation also held steady at 1.8% y/y. Overall inflation below BoE's target of 2% and the rise in wage growth above 3% provides a welcome relief for consumers and household finances.

- **Monetary Policy Forecast:** We expect BoE MPC to keep policy rate and size of BoE balance sheet unchanged at 0.75%, GBP 435bn, respectively at the upcoming meeting on 2nd May. Steady CPI below 2% target leaves room for BoE to keep policy stance status quo. Maintaining accommodative monetary conditions is what the BoE can do to help support growth amid ongoing Brexit uncertainties. BOE had earlier cautioned for the possibility of further cliff-edge uncertainties that could have significant effect on spending as brexit deadline nears. We **expect BoE MPC to keep policy stance status quo for as long as until end-2019** as **uncertainty over Brexit takes precedence over policy normalisation.** BoE's forward guidance shows another 2 hikes expected to end-2020 (this implies about 1 hike/year). 90D sterling futures imply 1 hike of 25bps at the Jun-2020 MPC meeting. We remain watchful of inflationary pressures as tight labor market is capable of generating domestic price pressures while a case of no-deal brexit could result in sharp depreciation on GBP (brings about higher imported prices and this translates into higher CPI). Sustained rebound in CPI towards 3% again could pressure BoE to hike earlier reluctantly.

- **External Balance Outlook** UK's current account deficit widened to 4.4% of GDP for 4Q-2018. This was the largest deficit since 3Q 2016 owing to trade in good deficit widening. For 2018, current account deficit widened to 3.9% of GDP, from 3.3% in 2017.

- **Key domestic events and issues to watch:** Apr PMI Mfg (1 May); Local elections, Apr construction PMI (2 May); Apr services PMI (3 May); Apr Halifax house prices (7 May); Mar trade, industrial production, construction output, 1Q GDP (10 May); Mar labor report (14 May); Apr CPI, PPI, RPI, public finances (22 May); Apr retail sales (23 May); May GfK consumer confidence (31 May).

- **Technical Outlook:** GBP traded lower for the month of Apr, breaking below 1.29-handle at one point (25 Apr). The move lower was in line with our caution (highlighted in the last FX Monthly). Pair was last seen at 1.2940 levels. Though bearish momentum on daily chart remains intact, stochastics shows signs of turning around from oversold conditions. A golden cross was formed with 100DMA looking on track to cut 200 DMA to the upside – this is typically a bullish signal. Support at 1.2860 before 1.28. Key resistance at 1.2970 (100, 200 DMAs) before 1.3030 (21 DMA). Move higher possible in the near term but a more sustained rebound requires a break above 100, 200 DMAs.

AUD: Rate Cut, Election and Maybe, A Trade Deal

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

No Change to Previous Forecast

- **Motivation for the FX View:** AUD tends to underperform in Mays but with a potential trade deal between the US and China expected in this month, investors may not be keen to add to short AUD positions even with a Federal election on the 18th. That said, 1Q CPI turned out to be worse than expected at 1.3%y/y vs. previous 1.8%. The headline was flat in the quarter reflecting the deterioration in consumption, housing correction, low wage growth as well as lower oil prices in the first quarter. The data release spurred AUD offers immediately, sinking AUDUSD towards the 0.70-figure. However, note that recent housing data such as building approvals suggest signs of stabilization in the sector. While this does not mean that inflationary pressures could be revived back towards the 2-3% target range, it does mean that further decline in spending is less likely to worsen and that the inflation print, much like the 1Q GDP, is a lagging indicator rather than a leading one. In addition, oil prices have been rising for the past several weeks, which could boost the fuel subcomponent in the CPI. The OIS implied indicates a probability of 55% for a rate cut at the RBA meeting on 7th May. That is quite a jump from 12% seen earlier this week. Rate cut expectations have been brought forward from Aug to May. Our view for rate cut is also brought forward to May as RBA may want to err on the side of caution to insure against further deterioration in growth momentum. However, that does not mean that we look for AUD to head much lower. We see a likely month of two-halves. Downside bias is likely to play out towards 0.69 in the first half before focus is shifted towards a trade deal between the US and China which could then propel it back towards the 0.72-figure (200-dma).

- On the election front, with a fiscal surplus projected by PM Scott Morrison of $7.1bn for the fiscal year through 2020, there is room for policy maneuvers even if Labour Party takes over the government. Recent polls still suggest that Labour could take over. That said, there is always a chance of a hung parliament which could happen if no party is able to get a majority (76 out of 151 seats for the House of Representatives). Failure to get a majority would mean that the political parties would need to approach each other to form a coalition government. This period of uncertainty add to the drag on the AUD but with the budget projected to be back in balance (amid the upswing in commodity prices), retaining Australia's AAA credit rating would be less of an issue and that leaves more room for policy maneuvers like Labour's pledge to raise taxes in the form of scaling back negative gearing and gradual changes to capital gains tax.

- Our view on the US-China trade deal is that China would only accept a deal that includes the removal of existing tariffs on their goods and that has not been priced in fully by investors yet. While comments by the US officials have been mostly positive, Trump's tendency to walk out of a deal or behave unexpectedly as well as a lack of details kept investors from pricing in a positive outcome fully. The impact of the tariffs is manifested in the form of the global slowdown we witness at this point. Any rollback in tariffs could be taken positively and that could propel this AUD towards 0.72-figure. We anticipate the deal to take a more concrete form in May, as hinted by various press.

- **Growth and Inflation Outlook:** The latest retail sales print for Feb picked up pace to 0.8%m/m from previous 0.1% (expected 0.3%). Breakdown reveals some improvement in food retailing (+4.9%y/y vs. +4.2% previously), household goods (-0.1%y/y vs. -0.6%), clothing, footwear and personal accessory (3.5%y/y vs. 2.4%), department stores rebounded (1.3%y/y vs. previous -1.3%).

- Part of the fall in the housing market was due to the rise in the wholesale funding cost that triggered out of cycle mortgage rate hikes but those costs of financing have come off more recently. The 3M BBSW has fallen further to 1.69% (as of 24 Apr). With the recent retracement and a more data-dependent Fed, very benign inflation outlook at home and abroad, another round of mortgage hikes is less likely. As such, we think the residential property market should not experience as much pressure in 2019 compared to 2018. In fact, recent data such as building approvals rebounded rather strongly to 19.1%m/m from previous 2.4%. Year-on-year, building approvals fell -12.5% vs. -28.9%, a sign of bottoming in the real estate sector. In addition, home loan also rebounded +0.8%m/m (s. adj) in Feb from -0.8% in Jan.

- Separately, NAB business surveys show improvement in business conditions (score of 7 for Mar vs. previous 4) though business confidence dropped to 0 from 2 previously. Other leading indicators have been a tad more positive. The AiG Performance of Services index improved to 44.8 for Mar from previous 44.5. PMI-mfg came in lower at 52.0 for Mar vs. previous 52.9 though the Aig Performance of Construction index came in to be 45.6, up from 43.8, with a smaller decline in housing new order seen for Mar at -2.2pts vs. previous -7.1ppts.

- Signs of stabilization in China are there but still nascent and mixed. Apr kicked off with strong PMI-mfg prints out of mainland China with Caixin version at 50.8 vs. previous 49.9. NBS released mfg PMI at 50.5 vs. 49.2 previously on 31st Mar. That boded better data for Mar activity that was to be released later in the month. Industrial production turned out much stronger than expected at 8.5%y/y from 5.7% in Dec. Retail sales picked up pace to 8.7%y/y from 3.3% last Dec. Even as a RRR cut did not materialize from PBoC, the central bank continued to render support for SMEs by providing the targeted MLF. That could also be in turn, supportive of the demand for Australia's resources and cushion the AUD from deeper pullbacks.

- **Monetary Policy Forecast:** Eyes are on the RBA meeting on the 7th May as the OIS implied probability of a rate cut had jumped to 55% vs. 12% before the release of the 1Q CPI. For this reason, we are of the view that even as we have brought forward our rate cut call to May, we do not think AUD would see a lot more downside from here. We do not see a need for RBA to ease by a lot more as hiring is still solid. The concern here is that weakness in wage growth, fall in housing prices and concomitant declines in household spending could translate at some point to some slowdown in hiring and ticks higher in the unemployment rate. And RBA has historically been rather sensitive to upticks of this measure, reacting within a quarter to signs of weakness in the labour market - namely upticks in unemployment rate. However, that has not shown up yet so I think that a rate cut at this point could still be a tad pre-mature.

- In addition, we have mentioned that there are signs of stabilization in the housing market and China's growth momentum. Hence, a call for a rate cut remains a close one and we expect only one this year. We anticipate that the stabilization in the domestic housing market should stem further deterioration in business and consumer confidence and a pick-up in China's demand, moderate as it may be, may improve its external balance, terms of trade and strengthen the AUD.

- **Latest External Balance Outlook:** Trade balance for Feb was a wider surplus of A$4.8bn vs. previous A$4.5bn. Improvement in external demand could continue to be supportive of the AUD.

- **Latest Fiscal Outlook:** Australia's budget deficit shrank to just 0.15% of GDP in 2018 from a peak of 4.1% in 2009. Treasurer Josh Frydenberg projects a fiscal surplus of $7.1bn for the year through 2020. Post budget, PM Scott Morrison announced a plan to set up an Australian Business Growth Fund that is projected to grow to A$1bn when it matures, aimed at creating 250K new small businesses over the next five years.

- **Key domestic events and issues to watch:** PMI-mfg, AiG Perf of Mfg Index and CBA PMI Mfg for Apr on 1st May, AiG Perf of Services Index for Apr, building approvals for Mar on 3rd; Melbourne Institute Inflation for Apr on the 6th; AiG Perf of Construction Index for Apr, Mar trade, retail sales, RBA meeting on the 7th; SoMP released on the 10th; home loans, owner-occupier loan value and investment lending for Mar on 13th; NAB business conditions and confidence survey for Apr on 14th; Westpac consumer confidence for May and 1Q wage price index on the 15th; labour report for Mar due on 16th; **Federal Election** on the 18th; Minutes of the May RBA meeting on the 21st; 1Q Capex on 30th. **We also continue to keep an eye on the progress of the US-China trade deal that could be done as soon as this month.**

- **Technical Outlook:** A month has passed and AUDUSD is back at the 0.7060-key technical level. On the daily and monthly chart, stochastics show signs of turning higher. Key resistance is still 0.7060 before 0.7120 and then 0.7170. Support is seen around the 0.70-figure. We see a probable triple bottom for this pair and risk reward ratio suggests that tilts the odds towards the AUD bulls.

NZD: Possibly a Rare Recovery in May

Forecast	2Q 2019	3Q 2019	4Q 2019	1Q 2020
NZDUSD	**0.6800** (0.7100)	**0.6900** (0.7200)	**0.6800** (0.7100)	**0.6700** (0.7000)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** We expect NZD's weakness seen in Apr to retrace in May, possibly towards 0.68-handle. Our call comes on the back of our bias that RBNZ will not cut rate, sustained recovery in dairy prices and chance of a potential US-China trade deal towards end-May (provide a boost to sentiment and trade-sensitive FX including the NZD). We **stand firm on our view that there is no urgency for RBNZ to cut rate at the upcoming MPC meeting (8th May).** Though 1Q CPI slipped, the decline was led by tradable inflation while non-tradable component (a proxy for domestic price pressures) continues to show an upward trajectory. Going forward tradable inflation could be poised for rebound as oil prices recovered further and NZD depreciated. Taken together, the potential rise in NZ CPI towards the middle of RBNZ target range of 1% – 3% as capacity builds, oil prices rose and the risk of upward pressure on domestic prices including wage growth owing to tightening of labor market are some of the factors to justify that our call for RBNZ to remain on hold. Furthermore RBNZ Governor Orr admitted (in an interview on 26th Apr) that he is "not particularly worried" by the recent slowdown in NZ growth as the country has a strong labor market, strong fiscal position, strong terms of trade and has room to cut rates if required.

- It may be somewhat rare to call for NZD to stage a recovery in May as May is seasonally a bearish month for NZD (sell in May adage). In the past 10 years, NZD declined on 7 occasions. But we think it not entirely impossible as we are looking for green shoots of recovery in China and Europe. The synchronous recovery in global growth on the back of exports recovery in 2017 saw NZD appreciate by 3.2% then. Moreover NZ exports surged in Mar, owing to jump in dairy, cheese as well as exports to China (surging by 52%).

- The risks to our view is that Orr has shown that he somewhat favours a softer NZD and an easing bias. And RBNZ does not want to stand out like a sore thumb in the face of most DM central banks including Fed and ECB turning dovish. What he could possibly do on 8th May is to continue to sound dovish but keep OCR unchanged at 1.75%. Other risks include an outperformance in US economy while hopes of green shoots of recovery in China and Europe proved short-lived, decline in commodity prices including dairy prices and oil (impact on tradable-inflation), deep sell-off in equity markets, no trade deal between US and China and/or renewed expectations for Fed to resume rate hike given economy outperformance.

- Given recent market development and RBNZ's explicit bias in favor of less strong NZD, we calibrated our NZD forecast a touch lower but still maintain the trajectory over the forecast horizon.

- Taking stock, our caution for downside risks (in the last FX Monthly) materialized. NZD traded 5-month low of 0.6593 (24th Apr) before turning higher. Move lower was due to rising expectation for RBNZ to cut rate as soon as in May following RBNZ last MPC (27th Mar) which indicated a dovish tilt in monetary stance, softer than expected 1Q GDP, CPI and PMI surveys.

- **Growth and Inflation Outlook: 1Q GDP is scheduled for released on 20th Jun.** Data was mixed as survey indicators indicated both services and manufacturing slowed in Mar (though both remain in expansionary territories) while card spending (retail) posted a sequential decline to -0.3% m/m (vs. +0.9% in Feb); while exports surged (owing to jump in dairy, cheese and exports to China surging 52%) and consumer confidence rose. 4Q GDP picked up pace to +0.6% q/q (vs. 0.3% in 3Q). 9 out of 11 service sectors including retail, accommodation, transport, warehousing expanded as well as investment rebounded, thanks to business spending and homebuilding. Primary industries and goods-producing industries in manufacturing and utilities were the main drags.

- **The next quarterly MPS is scheduled for release on 8th May.** In the last quarterly MPS (13 Feb), RBNZ expects growth to pick up pace to

3% for 2019, up from 2.6% in 2018. Monetary stimulus and population growth will underpin household spending and business investment while government spending on infrastructure and housing is expected to support demand. In particular on the fiscal front, the families package should support household consumption, Kiwibuild plan to support real estate investment while increase in minimum wage is expected to support household income. On inflation outlook, CPI is projected to ease in the near term owing to decline in petrol prices but to rise and reach the middle of its target range of 1 – 3% as both tradables and non-tradables inflation rise (the latter due to increasing capacity pressure).

- **Headline CPI held steady at +0.1% q/q in 1Q. On annual basis, 1Q CPI declined to +1.5% y/y, from 1.9% in 4Q.** Softer oil prices dragged down tradable inflation while non-tradable inflation (proxy for domestic price pressures) rose +1.1% q/q, up from +0.7% q/q. Going forward, the next print in CPI is likely to show a higher print given the oil prices have risen while NZD depreciated. Taken together, we continue to see risks skewed to the upside for headline inflation.

- **Monetary Policy Forecast:** We still expect **RBNZ to keep OCR on hold at 1.75% at the upcoming meeting on 8th May.** We stand firm on our view that there is **no urgency for RBNZ to cut rate at the upcoming meeting**. Rise in NZ CPI towards the middle of RBNZ target range of 1% – 3% as capacity builds and the risk of further upward pressure on domestic prices including wage growth (owing to tightening of labor market) are sufficient for RBNZ to remain on hold. In a recent interview (26 Apr), RBNZ Governor Orr admitted he is "not particularly worried" by the recent slowdown in NZ growth as the country has a strong labor market, strong fiscal position, strong terms of trade and has room to cut rates if required. The risk to our view is that Orr has shown that he somewhat favours a softer NZD and an easing bias. And RBNZ does not want to stand out like a sore thumb in the face of most DM central banks including Fed and ECB turning dovish.

- At the last MPC meeting (27th Mar), OCR was kept at 1.75% as widely expected. The accompanying statement emitted a **dovish tilt.** Notably **RBNZ made the shift from "direction of our next OCR move could be up or down" to <u>"more likely direction our next OCR move is down"</u>.** It **also noted that *<u>global economic outlook has continued to weaken</u>, in particular amongst some of our key trading partners including Australia, Europe, and China. This <u>weaker outlook has prompted central banks to ease their expected monetary policy</u> stances*, *<u>placing upward pressure on the New Zealand dollar</u>*. Clearly the RBNZ does not favor relative NZD strength as other DM central banks' monetary stances have turned dovish.** RBNZ's Orr added **that policy stance adopted will be the starting point for deliberation of the new MPC when it meets ahead of May rate decision.**

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

- Key **domestic events and issues to watch:** 1Q labor report (1 May); 2Y inflation expectations (7 May); RBNZ MPC (8 May); Apr Mfg PMI, 1Q PPI (17 May); Apr services PMI (20 May); 1Q retail sales (22 May); Apr exports (24 May); May business confidence (29 May); May consumer confidence (31 May).

- **Technical Outlook:** The month-long decline in the NZD finally showed signs of abating. NZD traded a low of 0.6580 (25 Apr) before turning higher. Last seen at 0.6670 levels. Bearish momentum on daily chart remains intact but signs of fading are emerging while stochastics is showing signs of turning from oversold territories. Rebound possible. Immediate resistance at 0.6710 (21 DMA), 0.6730 (200 DMA) and 0.6780 (50, 100 DMAs). Support at 0.6580 (2019 low) before 0.65 levels.

JPY: Seasonality In May Could Be Supportive

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

No Change to Previous Forecast

- **Motivation for the FX View:** JPY has lost a lot of its shine in Apr, slipping around 0.7% against the USD in the month as risk sentiments improved amid signs of green shoots and resurgence in USD strength. These have provided the impetus for the USDJPY to hover above the 111-levels for most of Apr.

- The USDJPY may find relief and face downward pressures in May. The month of May is seasonally a strong month for the JPY. In 6 out of 10 years, the USDJPY has slipped lower in the month of May. Thus we could see some unwinding of long USDJPY positions that could push the pair lower in the next month. Markets are generally net short-JPY, i.e. looking for further JPY weakness, currently. In the week of 16 Apr, long JPY bets have increased from 19914 contracts in the week of 9 Apr to 31807 contracts. In contrast, the short positioning has risen to 118913 contracts in the week of 16 Apr from 91434 contracts in the previous week. This suggests there is room for JPY to climb higher should some of the net short-JPY positions be unwound.

- However, gains in the JPY could be partially mitigated by an improvement in global risk appetite should a Sino-US trade deal be reached. Further talks have been scheduled in early May with an eye to a deal to be signed by Trump and Xi at a summit planned for the end of May. Expectations for some kind of compromise deal between China and US will be market positive and drive sentiments higher, which in turn will see a shift away from safe haven assets to riskier assets. This should support the USDJPY higher. A breakdown in trade talks between the two sides cannot be ruled out though this is no our base case. A breakdown in trade negotiations is likely to spur safe haven proxy FX demand and lift the JPY higher.

- We continue to look for USD strength to fade and that should drag the USDJPY lower towards 108-levels by end-2Q. The Fed's move to keep its interest rates at current levels for a prolonged period should see USD strength fade and UST yields slip lower. The dot plots shared by the Fed showed that a rate hike is no longer in the cards in 2019 compared to two hikes previously. For 2020, the Fed is looking for just one rate hike. This move to signal that the Fed is near the end of its current tightening cycle suggests that the bias is no longer for a tightening ahead. We could thus see the unwinding of stale long USD positions against its G10 peers, pressuring the USD lower. USD weakness should lift the JPY higher.

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

- As we had cautioned previously, further impetus for the USDJPY to move lower should come from the potential upside political risks and concerns over the impact of the sales tax hike in Oct that could weigh on risk appetite. Additionally, there are some concerns over the Upper House elections scheduled in Jul 2019. Dissent expressed through Upper House elections could create some political instability in 2H 2019 and possibly limit the Abe cabinet from pursuing more radical measures to transform the economy. This uncertainty could in turn lead to a sell-off in Japanese equities and the unwinding of hedges, supportive of the JPY. Implementation of the consumption sales tax hike in Oct 2019 and its negative impact on domestic consumption and overall growth could also add downward pressure on the USDJPY in 2H 2019.

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

- **Growth and Inflation Outlook:** 1Q 2018 GDP may not outperform 4Q 2018's +1.9% annualised (+0.5% q/q). In the first two months of the 2019, industrial production has fallen by 0.2% y/y, core machine orders by -8.4% y/y and machinery orders by 6.0% y/y. External demand is likely to also be a drag on economic growth in 1Q. So far in 1Q 2019, exports have contracted by 3.9% y/y, and imports by 2.0% y/y. For the full-year, we however do not expect the economy to slip into another recession, though growth could remain lackluster given economic uncertainties and the looming consumption sales tax hike in Oct. Still, the government's record budget of JPY101tn for FY2019 should be supportive of the economy, while preparation works in the run-up to the 2020 Olympics in Tokyo is expected to also bolster economic growth in 2019. The BOJ's baseline assessment is for the economy to "continue on a moderate expanding trend", but because of "high uncertainties" in the outlook for economic activity and prices the central bank has revised its growth forecasts for FY2019 and FY2020 slightly lower to 0.8% and 0.9% respectively from 0.9% and 1.0% previously.

- Headline inflation accelerated to 0.5% y/y in Mar from Feb's 0.2%, in line with market expectations. The firmer inflation print was attributable to smaller drop in food prices in the month at -0.3% vs. -1.4% in Feb, and more moderate dip in transport cost (Mar: -0.3% vs. Feb: -0.6%). Core inflation (headline inflation less fresh food - the key inflation gauge for the BOJ) rose slightly to 0.8% y/y in Mar from 0.7% in Feb, while core-core inflation (headline inflation less fresh food and energy) rose at the same pace as in Feb at 0.4%. The inflation prints show prices on the rise but still a distance from its 2% inflation target. This supports the BOJ's view for the need to persist with its ultra-loose monetary policy until its 2% inflation target is achieved. The BOJ continues to look for inflation to come in at 1.1% for FY2019 but now expects inflation to come in more moderately at 1.4% vs 1.5% previously for FY2020.

- **Monetary Policy Forecast:** There were no major surprises from the BOJ at its policy meeting on 24-25 Apr. The central bank maintained its current policy stance with the yield curve control policy and asset purchases programme left unchanged. The policy balance rate was also maintained at -0.1%, the 10-year JGB yield target at around zero percent, and asset purchase target of JPY80tn. It however tweaked its forward guidance to make "clearer its policy stance to continue with powerful monetary easing" by vowing to keep extremely lower short- and long-term interest rates at least through spring 2020. Previous forward guidance was "to maintain the current extremely low levels of short- and long-term interest rates for an extended period of time". At the same time, the BOJ also suggested that it could introduce a lending facility for its ETF buying programme, i.e. temporarily lending ETFs to market participants. This would allow for the creation of a market and greater activity for the ETF market that is 77% owned by the central bank. This measure is not a JPY mover though.

- **Latest Fiscal and External Balance Outlook:** Despite the extra spending and measures to consumers to offset the impact of the sales tax that is to be implemented in Oct, there is growing disquiet even among the ruling LDP regarding the increase. This has resulted in a push back from key stakeholders, namely Finance Minister Taro Aso and Chief Cabinet Secretary Yoshihide Suga, defending the need to push ahead with the consumption sales tax hike. They defended the tax increase as necessary to ensure stable funds to sustain a welfare system over the long term.

- The current account (CA) surplus ballooned to JPY2.68tn in Feb after rising by JPY0.60tn in Jan due to the rebound in the good & services account and larger surplus in the primary account. The good & services account returned to a surplus of JPY0.73tn in Feb from a deficit of JPY1.12tn in Jan, while the surplus in the primary income account widened to JPY2.01tn from JPY1.76tn. The deficit in the financial account narrowed to JPY2.55tn in Feb from Jan's JPY2.71tn underpinned by a smaller outflow in direct investment of JPY1.05tn compared to Jan's JPY7.11tn outflow even as the combine outflows from portfolio investment, "other" investment and reserve assets of JPY1.53tn weighed. Consequently, there was a small overall balance of payments (BoP) surplus of JPY0.10tn, a rebound from Jan's deficit of JPY2.10tn.

- **Key domestic events and issues to watch:** There is no BOJ policy meeting in May, but the Minutes for the Mar Policy Meeting will be released on 8 May followed by the Summary of Opinion for the 25 Apr policy meeting on 10 May. We also have BOJ Policy Board member Yutaka Harada speaking in Nagasaki on 22 May. Preliminary GDP print for 1Q 2019 will be released on 20 May. JGB auctions in May: 10-year (8 May), 30-year (14 May), 5-year (16 May), 1-year (16 May) and 20-year (22 May).

- **Technical Outlook:** Early month's rise in USDJPY above 112-handle proved unsustainable as the pair drifted lower into month-end. Pair was last seen at 111.30 levels. We remain bias to lean against strength looking for a move lower towards 111.05 (50% fibo retracement of Mar low to Apr high), 110.70 (61.8% fibo). Further decline towards 110.30 (76.4% fibo) is not ruled out. Resistance at 112.20, 112.40 likely to cap any up-move.

RMB: A Deal to Boost

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

No Change to Previous Forecast

- **Motivation for the FX View:** USDCNY has been stuck in a holding pattern for much of the past two months. There were plenty that happened in Apr including the Politburo's statement suggesting that policymakers have found comfort with the recent data. As a result, there was less emphasis on stabilizing economic growth, employment, financial markets and some reversion towards priorities on deleveraging and structural reforms in the statement released after the review. USDCNH rose towards 6.74 as investors come to terms with the possibility that the bar for PBoC to ease further is higher than before. The use of the targeted medium term lending facility (TMLF) on 24 May underscored the shift from broader liquidity injection to targeted credit support. At 3.15%, this rate is still higher than cost of funds that are provided by a targeted RRR cut. As a result, the 7-day repo rate rose above 2.9% after trading between 2.0-2.9% for much of the year so far. Easing expectations have diminished but credit support is still there. Recently, PBoC mentioned about "fine-tuning monetary policy", keeping to its "prudent" stance as well as ensuring that monetary condition is neither "too loose" nor "too tight".

- This shift towards a less accommodative monetary policy underscores how serious China is about limiting the growth of corporates and local government debt. The resulting impact on bonds was significant. CGB yield rose with the 10y last seen (25 Apr) around 3.4%, 30bps rise from 3.10% seen at the start of the month. A sense of caution as we approach May has kept the USD broadly elevated against most other currencies including RMB. The widening CGB-UST yield differential may not serve to support the RMB now but once the bond market has stabilized, there could be some return in carry trades that favour the CNH vs. the USD.

- Into May, US-China could forge a deal as soon as this month. While much has been assured about the agreements with the Chinese side cautioning more on the last few tough nuts to crack, there are very few details of what have been agreed on so far, leaving the RMB on a backfoot against the USD in more recent sessions, albeit still in tandem with the rest of regional peers. Recently (25^{th} Apr), Trump said that President Xi could soon come to the White House, suggesting that a deal is close. This came ahead of another round of negotiation in Beijing scheduled from 30^{th} Apr and then Vice Premier Liu He will also be scheduled for another round in Washington the following week. We hold our view that the market has priced in a rather conservative scenario of a basic agreement which could include a pledge not to add more tariffs on China's imports and to continue the current dialogue in exchange for intellectual property protection, some promised purchase of energy and agriculture goods from the US. China is unlikely to accept a deal without the removal of existing tariff and that not entirely priced in by investors. With the USD still relatively supported broadly, the risks are still skewed to the downside for the USDCNH. USDCNH could head towards 6.68 in case a deal is cut before the next at 6.65.

- President Xi mentioned on 25^{th} Apr that "China will keep yuan stable at reasonable and equilibrium level" at the Belt and Road forum in Beijing. He also said that China "won't engage in currency depreciation that harms other countries". We take this in the context that the US and China are at the final leg of their upcoming deal, even if it is a preliminary one. Earlier, Treasury Secretary Mnuchin talked about a currency pact that could be imbued in the upcoming Memorandum of Understanding between the US and China. Recall that the US was said to request for China to maintain its currency so that China would not be able to gain export competitiveness by devaluing its currency as a counter to tariffs from the US earlier in Feb.

- The 12M forward points for USDCNH had been on the upmove before tapering off recently. The high seen was around 340pips but that is still way lower than 2-yr (2017-2018) average which is around 1000pips. This could mean that depreciation expectations have come off significantly compared to the last two years. In addition, USD positioning from CFTC is still rather elevated, although reduced from last year, which indicates room for further unwinding of stale long USD positions in an environment where the US growth continues to slow. That reinforces our view that the USD and US rate environment is still likely to be largely benign for the CNH to strengthen further towards 6.65 by 3Q.

- **Growth and inflation outlook:** Apr kicked off with strong PMI-mfg prints with Caixin version at 50.8 vs. previous 49.9. NBS released mfg PMI at 50.5 vs. 49.2 previously on 31st Mar. Industrial production turned out much stronger than expected at 8.5%y/y from 5.7% in Dec. Retail sales picked up pace to 8.7%y/y from 3.3% last Dec. That said, online retail sales actually slowed for the first quarter from the last quarter. Breakdown of the PMI-mfg print from the NBS show that mfg PMI numbers for small and medium enterprises are still in contractionary region. New orders improved to 51.6, a 6-month high, suggesting some stabilization in domestic demand but imports growth for Mar suggests that consumption and investment activity have not gained a lot of traction yet. Exports on the other hand, accelerated to 21.3%y/y from previous -16.6%. Trade surplus widened significantly to CNY221bn from previous CNY34.4bn.

- Signs of stabilization are there but still nascent and mixed. The recent politburo meeting revealed that policy makers noted that the recent data turned out to be stronger than expected but “downside risks to economic growth” were still noted. That said, the recent data seem to give them enough comfort for them to focus back on deleveraging and structural reforms and less on ensuring economic stability according to the statement released. As a result, the expectations for another RRR cut were unwound in the form of yuan weakness.

- Inflation rebounded in line with expectation to 2.3%y/y for Mar vs. 1.5 % in Feb. PPI came in a tad higher at 0.4%y/y vs. 0.1% previously. The impact of the swine flu finally showed up as the meat and poultry subcomponent accelerated 4.7%y/y from -0.9%. The impact of the swine flu is expected to be transient though higher crude price might fan inflationary expectations higher and that could limit the room for monetary policy easing.

- **Monetary Policy Forecast:** There were a few mentions of the monetary policy at the NPC including some explicit mentions of more targeted RRR cuts for small and medium enterprises. However, expectations of that were dispelled by the recent data which came in to be stronger than expected. The statement released by the Politburo also underscored the shift from growth stabilization back to deleveraging and structural reforms even as downside risks to economic growth were acknowledged. To seal the deal, PBoC also provided targeted MLF for banks that lend to small and medium enterprises at 3.15%, diminishing the possibility of a near-term RRR cut. That said, we do not think that China is out of the woods entirely.

- We had mentioned earlier in this note that although activity seemed stronger on the whole. Imports growth and online retail sales suggest that consumption has not gained a lot more traction. PMI-mfg for

SMEs are still in contractionary region. That has prompted PBoC to provide CNY267.4bn of TMLF at 3.15% for 1 year. 7D repo rate shot towards 3.2% before drifting back to levels around 2.7%. PBoC also emphasizes that monetary policy is still prudent. Official Sun Guofeng commented that the timing of the TMLF is normally in the 4th week of the first month of the quarter. Deputy Governor Liu Guoqiang also said that the central bank has no intent to tighten or loosen monetary policy and adjustments would be on short term liquidity only. We do not rule out RRR cuts in 3Q. We anticipate a targeted RRR cut for 3Q to give SMEs more momentum. A failure to reach a deal that includes a rollback of US tariffs on China's goods could mean that this targeted RRR cut could be earlier within this quarter.

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

- **Key domestic events and issues to watch:** PMI-mfg for Apr is due 30th Apr (NBS); Caixin PMI (Mar) on 2nd May; foreign reserves due 7th; trade data on 8th; CPI and PPIon the 9th; aggregate financing and new yuan loans on 10-15th; Apr urban FAI, industrial production and retail sales, Jan-Mar property investment due on 15th; new home prices on 16th; FX Net settlement on 20th; industrial profits on 27th;

- **Technical Analyst:** USDCNH bounced towards the 6.75 in the past few sessions, buoyed by the rise in the USD. Stochastics are still overstretched and could mean some consolidation under the 6.7670 although bullish momentum could mean that dips are likely to be shallow. 21-wma just cut the 50-dma to the downside, a bearish signal. We still see more downside risks than up for this pair.

KRW: Near Term Weakness to Correct

Forecast	2Q 2019	3Q 2019	4Q 2019	1Q 2020
USDKRW	1130 (1100)	1135 (1105)	1140 (1120)	1130 (--)

Previous Forecasts in Parenthesis

- **Motivations for the FX View:** Our caution (in the last FX Monthly) for near term upside bias for USDKRW materialized but the move higher was sharper than expected. USDKRW spot traded more than 2-year high of 1161.40 (25 Apr). Move higher came amid surprise contraction in Korea's 1Q GDP and sharp move in oil prices (weigh on net oil importers). **Near term risks remain skewed to the upside** as hopes for green shoots of recovery were dampened by softer sentiment, activity data out of Germany while sluggish Korea's exports amid semi-conductor down-cycle showed no signs of rebound for now. Resistance at 1172 should cap the recent rally unless risk assets suffer a sharp correction (cautious of sell-in-May adage).

- But we continue to maintain our cautious optimism view: (1) that early signs of stabilisation in China, Europe could turn into growth recovery; (2) potential US-China trade deal in coming quarter could translate into a pick-up in business, investment and exports activity and this could support growth; (3) central banks including the Fed, ECB putting policy normalisation plans on hold and fiscal stimulus measures could be timely to cushion against deep economic slowdown; (4) expectations that semiconductor down-cycle could be near the bottom and a subsequent turn-around would support exports and investment recovery. And we expect USDKRW upward pressure to fade when the above-mentioned factors come into play. We **maintain our view for KRW to recover from weak levels but revised our overly-bullish KRW forecasts lower to reflect recent market development**.

- **Growth and Inflation Outlook: South Korea's economy unexpectedly contracted in 1Q (-0.3% q/q vs. +1% in 4Q).** This is the largest magnitude of decline in 10 years. Contraction was led by facilities, construction investment as well as exports. On y/y terms, 1Q GDP growth expanded 1.8% in 1Q (vs. 3.1% in 4Q).

- **BoK lowered 2019 GDP growth for a second time this year to 2.5%** (vs. 2.6% previously). The downgrade was due to weakening exports in particular semiconductors and slowing business investments. Governor Lee said that concerns over recessions were "excessive" and the economy is still expected to grow roughly in line with its potential rate. He added that exports and capital spending should improve in 2H 2019. As of writing, the supplementary budget of KRW6.7tn has been approved and is expected to create at least 73,000 jobs and lift GDP by 0.1 ppts. **BOK also lowered 2019 inflation outlook for a second time this year to 1.1% y/y (down from 1.4% y/y previously).**

- Headline inflation **continued to slow to 0.4% y/y in Mar,** down from 0.5% in Feb owing to lower energy prices and government-administered prices on goods and services (government cut fuel tax by 15%.

- **Monetary Policy Forecast**: We **expect BoK to keep policy rate unchanged at 1.75% at the upcoming MPC meeting on 31 May**. Though there may be some risks of BoK potentially cutting policy rate by 25bps given slowing inflation and the decline in 1Q growth, we believe there is justification for BoK to maintain patience on policy stance. The slowdown in growth is not entirely unexpected (though the magnitude may be larger than expected) given semiconductor down-cycle while policymakers have responded with supplementary budget of KRW6.7tn. In addition BoK officials and policymakers remain optimistic of growth turnaround in 2H and believe that semiconductor down-cycle is nearing its end. This is also consistent with our call that a potential US-China trade deal in coming quarter could translate into a pick-up in business, investment and exports activity and this could support growth. These reasons justify the case for BoK to keep accommodative monetary conditions status quo.

- At the last MPC meeting on 18th Apr, BoK MPC voted unanimously to keep policy rate unchanged at 1.75%. BoK also lowered growth and inflation forecasts for the second time this year but maintained the view that economy will still grow in line with trend while low inflation projection was due to government policies and lower oil & agricultural prices.

- **External Balance Outlook:** Current account surplus widened to $3.6bn in Feb, from $2.82bn in Jan (upward revision from $2.77bn). Services account deficit narrowed owing to improvement in travel accounts (rising number of tourist arrivals from China and Japan).

- **Key domestic events and issues to watch:** S. Korea releases Apr exports (1 May); Apr Mfg PMI (2 May); Apr FX reserves (7 May); Apr import, export prices (14 May); Apr unemployment rate (15 May); Apr PPI (21 May); 1Q short term external debt (23 May); May consumer confidence (28 May); Apr industrial production, BoK meeting (31 May)

- **Technical Outlook:** USDKRW continued to trade higher for the month of Apr. Last seen at 1168 levels. Bullish momentum on weekly and daily chart remains intact while stochastics is rising into overbought conditions. The move higher may seem stretched. Resistance at 1172 (61.8% fibo retracement of 2016 high to 2018 low) should limit further gains. But we do caution that a decisive break above that could put next resistance of 1200 in sight. We favor leaning against strength. Immediate support at 1150 (50% fibo), 1135 (50 DMA).

SGD: Lift From Re-Emergence Of Green Shoots

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

No Change to Previous Forecast

- **Motivation for the FX View:** The SGD move higher in Feb and Mar stalled in Apr amid a resurgence in USD strength. The SGD dipped around 0.6% against the USD. The lack of sustained green shoots, as reflected in underperforming NODX and industrial production, has proven to be a drag on sentiments, which in turn, has translated into a softer SGD so far in Apr.

- This state of affair may not last should trade talks between China and US reach a successful conclusion. A Sino-US trade deal in May should lift sentiments and demand for trade-dependent FX including the SGD. At the same time, a Sino-US trade deal could potentially trigger a synchronised global recovery and serve as a catalyst for the USD to move lower. This could be the catalyst for a rebound in the SGD in May.

- In the next three-to-six months, optimism from this trade deal together with Fed pause; moderation in US activity momentum; and more accommodative stance of other central banks and fiscal support from governments could see USD strength fade and put downward pressure on the USDSGD. Thus a combination of the peaking of US growth cycle and the end of its tightening cycle suggests that there is limited room for further rate hikes by the Fed. We could thus see the unwinding of stale long USD positions against its G10 peers and selected AXs, including the SGD. A softer USD should lift the AXJs including the SGD higher.

- We continue to look for further targeted measures in China to support its economy, including the potential for even further cuts to the RRR (although this has fallen in probability because China had signalled they will do more targeted measures rather than broad cuts), and to ensure a soft-landing for the Chinese economy. The successful conclusion of the Sino-US trade negotiations would also put a healthy spin on the Chinese economy. Green shoots from China should bolster risk appetite and see increased demand for EM Asia risk assets and hence, EM Asia currencies, including the SGD.

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

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

- As we had expected, MAS kept its policy on hold at its Apr meeting. Though MAS has paused on its policy normalisation process, it does not mean the end of its tightening bias. **We expect the MAS to persist with its current slightly appreciation bias given that growth is expected to moderate and inflation to remain muted this year.** The slope of the policy band of the SGD NEER is still around 1% (our house estimates) from the two tightening moves in 2018. This has allowed the SGD NEER to trade around 1.32% above the implied mid-point of 1.3773 at the point of writing. This suggests that the SGD NEER trades on the stronger side vs. its trading partners. The lack of significant pressure on inflation, particularly core inflation, suggests that there is little pressure for the MAS to be more aggressive on monetary policy. There is potential for the SGD to appreciate further.

- We maintain our outlook for the USDSGD in 2019, looking for the pair to end-2Q and -3Q around the 1.34- and 1.33-levels respectively on trade optimism and fading USD. Thereafter, concerns over a possible global economic slowdown could see USD strength re-emerge somewhat and lift the pair higher to 1.35-levels to end the year and 1.36-levels at end-1Q 2020.

- **Growth and Inflation Outlook:** Flash GDP for 1Q 2019 saw growth come in at its weakest pace since the Global Financial Crisis at +1.3% y/y (vs. +1.9% in 4Q 2018) as manufacturing contracted for the first time in three years. On a seasonally-adjusted q/q annualised basis, GDP expanded by +2.0% (compared to +1.4% in 4Q). Manufacturing fell -1.9% y/y in Mar (vs. 4Q18's +5.1%), dragged lower by fading global electronics cycle and disruption from the Sino-US trade war. The bright spot though was services and construction. Services rose +2.1% y/y vs. +1.8% in 4Q despite the deterioration in trade-related data such as transport & storage. Construction rebounded, rising +1.4% y/y in 1Q (4Q: -1.0%) on the back of private sector activities. Our economic team is projecting a weak manufacturing and trade recovery in 2H 2019, predicated on an imminent Sino-US trade accord. Clouds though remain in the horizon as the US is likely to turn its focus on the EU, having threatened to impose tariffs on EU auto imports and other tariffs on USD11bn of EU imports. Domestically, the property tightening measures and the stricter foreign worker measures (DRC cut in services starting Jan 2020) are also dampening the medium-term growth outlook. Our economic team maintains its GDP forecast at +1.8% and +2.1% in 2019 and 2020 respectively. The team expects MTI to downgrade the official GDP growth forecast later in the year to 1-3% (from the current 1.5-3.5%). MAS is expecting GDP to come in slightly below the mid-point of that range

- Headline CPI rose for the third month by +0.6% y/y in Mar (from +0.5% in Feb) due to the softer decline in private road transport costs (Mar: -0.9% y/y vs. Feb: -2.3%) as COE prices rebounded in the month after a 14-month decline. Core CPI though softened further from +1.5% in Feb to +1.4% yoy in Mar underpinned by more moderate increase in electricity & gas tariffs that offset the pick-up in services and food inflation. Electricity & gas prices (following the phased nationwide launch of the Open Electricity Market (OEM)) eased further, rising +3.9% y/y in Mar vs. +5.5% in Feb, as well as the lower electricity tariffs set by SP Group for the Apr-Jun period. Mar CPI brings headline and core inflation print to +0.5% and +1.6% respectively in 1Q 2009. Our economic team expects core inflation to edge lower in 2019 underpinned by the further extension of the OEM. The MAS had cut its core inflation forecast for 2019 to 1-2% (from 1.5-2.5%) on the sharper than expected decline in electricity prices. The team though maintains its forecast for core inflation to average +1.4% for 2019 and headline inflation to average +1.2%.

- **Monetary Policy Forecast:** After tightening monetary policy at both of its semi-annual policy meeting last year, the MAS affirmed a pause in its policy normalisation process as growth slows and inflation eases though it should remain contained. Its policy of a "slight appreciation bias" for the SGD NEER was maintained with the slope of the SGD NEER policy band still assumed (house view given the absence of information from the MAS) at 1.0%. This pause comes as the MAS turns more cautious given the uncertainties in the global environment, cautioning in its statement that "significant uncertainty remains over the short-term outlook". Still, the statement is not overly dovish and signs of stabilisation in China and Europe are showing up amid policy stimulus support (which could be timely to ease financial conditions and provide the support for growth to pick up). We are also looking for signs of US-China trade deal coming in earlier than expected. This could help with both the real economy channel (via exports and investment recovery) and via sentiment (further supportive of trade-sensitive currencies including SGD).

- As expected, MAS revised its core inflation forecast lower at 1-2% in 2019 (from 1.5-2.5%) due to the decline in electricity prices on the back of the sharper-than-expected roll-out of the Open Electricity Market (OEM)and expected pick-up in the take-up rate in the months ahead. Headline inflation forecast was maintained at 0.5-1.5%. Meanwhile, MAS expects 2019 GDP growth to come in slightly below the mid-point of its 1.5-3.5% range.

- Our Taylor Rule estimates for the SGD NEER highlight that the SGD NEER remains on the upward trajectory and should remain within the upper half of the policy band in the forecast horizon. Under this scenario then, further tightening moves by the MAS may not be necessary for now. Further steepening of the policy slope is not our base case. **We expect the MAS to extend its pause at its next policy meeting in Oct**.

- The USDSGD trades around the 1.3600-levels at the point of writing, easing off from its recent high of 1.3658 (25 Apr). Supporting the pair higher was the resurgence in USD strength. Still, the Fed's prolonged pause on further rate hike announced on 21 Mar which could see USD strength fade among other reasons thus mitigating the upmoves in the USDSGD.

- The USDSGD slow grind higher has kept domestic interest rates elevated. Domestic interest rates though have not returned to the highs reached earlier in the year. The 3-month SOR (3MSOR) had hit a 10-year high of 2.0253% on 23 Jan that remains unmatched in the year so far, while the 3-month SIBOR (3MSIBOR) climbed to 1.9528% on 28 Feb. For now, there does not appear to be any signs that increases in the 3-month SOR and 3-month SIBOR will stall as the withdrawal of monetary stimulus in the advanced economies continues, albeit at a slower pace.

- We are now gradually seeing mortgage rates climb in tandem to the rise in domestic rates. Deposit rates (for 12-month fixed) is edging higher, last seen at 0.55% since end-Mar 2019. This suggests that risks related to interest rate increases affecting financial and economic stability, particularly in interest rate- and property-related sectors, are picking up. We expect the 3MSIBOR and 3MSOR to edge higher to 2.06% and 1.94% respectively by end-4Q 2019. For 2Q 2019, we are penciling the 3MSIBOR and 3MSOR to come in at 2.07% and 1.95%

respectively. Nonetheless with the Fed rate hike pause, we should expect the interest rate increases domestically to moderate.

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

- The current account surplus narrowed to SGD17.80bn in 4Q 2018 from USD24.69bn in 3Q due to the smaller surplus in the goods and services account (4Q: +SGD30.28bn vs. 3Q: +SGD33.82bn) and larger deficit in the income account (4Q: -SGD12.48bn vs. 3Q: -SGD9.14bn). The capital and financial account deficit also widened to SGD21.31bn in 4Q from SGD18.31bn in 3Q due largely to the large outflow from portfolio investment account of SGD25.14bn (3Q: +SGD6.24bn) and financial derivatives account of SGD4.44bn (3Q: -SGD1.73bn) as well as smaller direct investment flows of SGD9.30bn (3Q: +24.75bn). Consequently, the overall balance of payments slipped into a deficit of SGD3.91bn in 4Q compared to a surplus of SGD6.22bn in 3Q. For the full-year, the current account surplus ballooned to SGD86.20bn in 2018 underpinned by the larger surplus in the goods and services account of USD127.64bn. The capital and financial account deficit also ballooned to SGD67.79bn, aided by the larger outflow from the “others” account (-SGD73.63bn). The overall balance of payments narrowed to SGD16.92bn in 2018 vs. 2017’s SGD37.84bn.

- **Key domestic events and issues to watch:** Final print for 1Q 2019 GDP will also be released some time 17-24 May.

- **Technical Outlook:** USDSGD traded higher for the month of Apr. Last seen at 1.3625. Weekly, daily momentum and stochastics are indicating a bullish bias. Risks skewed to the upside in the interim but bias remains to lean against strength. Area of resistance at 1.3650 (200 DMA) – 1.3670 (23.6% fibo retracement of 2018 low to high). Break above could usher in further upside play towards 1.37-1.38 levels. Support at 1.3550, 1.3520 levels.

MYR: Temporary Idiosyncratic Concerns Weigh

Forecast	2Q 2019	3Q 2019	4Q 2019	1Q 2020
USDMYR	4.0800 (4.0000)	4.0500 (3.9800)	4.1000 (4.0600)	4.1200 (4.0700)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** The MYR reached a low of 4.1453 (vs. USD) on 24 Apr on the back of a few factors including in part idiosyncratic concerns, as: (1) MYR loses temporary carry appeal (as markets look for 25bps BNM rate cut in the upcoming meeting in May) and (2) in reaction to recent news (16 Apr) that FTSE Russell may consider dropping Malaysian debt from FTSE World Government Bond Index as part of a review (in Sep-2019) into the accessibility of global bond markets. This came after Norway MoF's proposal to omit EM government and corporate bonds including Malaysia from the government's fixed income benchmark for the Government Pension Fund Global (GPFG) earlier in Apr. Such developments do not bode well for MYR-denominated assets and MYR amid portfolio outflows. Preliminary estimates suggest the risk of US$ 6 – 8 bn worth of outflows. However, external environment of green shoots and supported brent, palm oil prices may mitigate the temporary negativity surrounding the MYR. Key resistance around 4.15 levels. Breach above 4.15 puts next resistance at 4.17. Nonetheless we expect the recent up-move in USDMYR to retrace below 4.12 as the FTSE review is still ongoing and the external environment of green shoots and moderate USD softness could help MYR recover. Taking all the above into consideration, we revise the MYR forecasts to reflect some of the temporary concerns weighing in the MYR but with growing optimism of a trade deal between US and China possibly coming earlier than later supporting sentiment and provide the lift for activity and exports, eventual softer USD could help weigh on USDMYR.

- MYR potentially remains supported by Brent crude oil price moving higher to above $70/bbl. At the same time, crude palm oil prices which continue to fall albeit smaller by around 6.4% in Apr contributed to the MYR support but has fallen off slightly. Recent BNM downward revision in GDP growth forecast on the back of slower domestic demand and sluggish external demand as well as expectations of a BNM rate cut could in part in the short term, weigh on MYR but on a relative basis with the USD, US-MY real rate differentials still remain somewhat supportive for MYR in the context of a Fed pause environment for EM assets.

- We maintain our view for MYR appreciation vis-à-vis the dollar, consistent with our USD weakness view in 1H 2019 and for the medium term. Over the next 3-6 months or so we expect USD/MYR could potentially approach 4.08 and potentially reach 4.05 in 3Q, if regional currencies strengthen relative to the USD and risk factors dissipate. With the recent dollar softness, it is inevitable that market participants may take a step back on their positive views on economically sensitive assets across global equities, EM rates and FX, and commodities, although this mostly reflects less attractive valuations following the strong rally of the past three months. Fundamentally, we think the picture for risk assets including EM FX such as MYR remains quite bright as long as global growth sees some sustained green shoots amid extended easy monetary policy, provided markets and policymakers manage to navigate near-term risk events such as Brexit and US-China trade.

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

- External reserves sustained its upward momentum as it rose +USD0.5b in 1H Apr 2019 to USD103.5b and up +USD2.1b YTD, reflecting trade-related and other capital inflows, including proceeds from the Government's JPY200b (USD1.8b) Samurai bond issuance, despite net foreign sell in equities. External reserves may see a more volatile trend ahead via bond-related flows due to the emerging risk of Malaysia's potential exclusion from FTSE Russell's World Government Bond Index in Sep 2019.

- Foreign investors remained net sellers of Malaysian equities so far this month (1-19 Apr 2019: -MYR1.1b; Mar 2019: -MYR1.6b) resulting in a cumulative -MYR2.5b net sell YTD. Meanwhile, net foreign flows in the Malaysian bond market may be a story of two halves this month with risk of volatility ahead after the net buys of +MYR2.9b in Mar 2019 and +MYR5.1b in 1Q 2019.

- We believe foreign investors initially remained net buyers of Malaysian bonds this month amid the earlier positive sentiment driven by sustained "positive carry" thanks to US Fed's dovish turn in its monetary policy and domestic deflation/disinflation which are supportive in terms of interest rate differential and real yield, plus expectation of BNM's Overnight Policy Rate (OPR) cut and the view of MYR under-valuation.

- However, FTSE Russell in mid-April announced that Malaysia has been put on its watch list for potential removal from its flagship World Government Bond Index (WGBI) due to the review in the index's inclusion criteria that now include a new criteria "market accessibility" - in addition to the existing "market size" and "credit rating" - that looks at factors such as 1) market, macroeconomic and regulatory environment, 2) FX market structure, 3) bond market structure and 4) global settlement and custody.

- Final decision on Malaysia's status in the FTSE Russell's WGBI will be announced in the annual review in Sept 2019 pending further engagements with regulators and market participants, especially on "operational issues" pertaining to FX market as well as settlement/custody issues which we believe to be the issues behind FTSE Russell's announcement. In a worst-case scenario, our Fixed Income Research team estimated that exclusion could lead to as much as USD6b-USD8b foreign outflows from Malaysian bond market, although there is ample liquidity from domestic institutional investors to absorb any foreign investors' selling and mitigate the impact on yields.

- Trade-related flows are accretive to external reserves, taking cue from the larger trade surplus in Jan-Feb 2019 of +MYR22.6b (Jan-Feb

2018: +MYR18.6b), consistent with our forecasts of larger trade surplus of +MYR127.7b this year (2018: +MYR120.3b).

- In addition, from our channel checks, proceeds from the Government's JPY200b (USD1.8b) Samurai bond issued on 15 Mar 2019 were received by end-Mar 2019. However, the impact on external reserves was "muted" as we understand that the inflows from the Samurai bond proceeds was negated by the drawdown on external reserves due to the sizeable maturity of BNM's net FX shorts position last month, which means continued decline in BNM's net FX shorts position in Mar 2019 after the steady drop from the high of USD22.8b in Oct 2018 to the latest figure of USD17.8b in Feb 2019. Mar 2019 figure on BNM's net FX shorts position will be out on 30 Apr 2019.

- Latest external reserves figure of USD103.5b covers 7.7 months of retained imports, 1.0x total short-term external debt and above the estimated minimum required reserves for this year of USD96.87b estimated under the IMF's Assessing Reserve Adequacy (ARA) framework.

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

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

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

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

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

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

- Industrial production growth slowed in Feb 2019 to +1.7% YoY (Jan 2019: +3.2% YoY) on a combo of slower Manufacturing (Feb 2019: +3.7% YoY; Jan 2019: +4.2% YoY) and Electricity (Feb 2019: +4.9% YoY; Jan 2019: +7.8% YoY) and decline in Mining (Feb 2019: -5.0% YoY; Jan 2019: -0.9% YoY). In Jan-Feb 2019, industrial output grew +2.5% YoY compared with +3.2% YoY in 4Q 2018, suggesting slower 1Q 2019 real GDP growth (4Q 2018: +4.7% YoY).

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

- **Inflation returned in Mar 2019 after two months of deflation.** CPI rose by +0.2% YoY (Feb 2019: -0.4% YoY; YTD 2019: -0.3% YoY) mainly on smaller decline in transport costs. Maintain our 2019 inflation forecast at +1.5% (2018: +1.0%) amid factors such as the broadening of Sales Tax and Service Tax (SST) coverage, Budget 2019's new taxes (Soda Tax, Airport Departure Levy), hikes in minimum wage and utility costs, and rising global crude oil prices hence domestic retail fuel prices.

- Inflation made a comeback in Mar 2019 after the deflation in Jan-Feb 2019. Consumer Price Index (CPI) rose +0.2% YoY in Mar 2019 (Feb 2019: -0.4% YoY; YTD 2019: -0.3% YoY) mainly due to smaller drop in transport costs as global crude oil prices pick up during the month, pushing up prices of unsubsidized fuels. On MoM basis, inflation rose +0.2% (Feb 2019: +0.2%). Meanwhile, core CPI rose +0.5% YoY (Feb 2019: +0.3% YoY; YTD 2019: +0.3% YoY; 2018: +0.8%). While most components in core CPI recorded negative YoY change during the month, FNAB, HWEGOF, education and restaurants & hotels continue to rise YoY during the month.

- No change in our view that 2019 headline inflation to stay benign with gradual pick-up in 2H 2019 to average +1.5% for the year (2018: +1.0%), reflecting factors such as the broadening of the SST base; Budget 2019's new taxes e.g. Sugar Tax (postponed to 1 Jul 2019 from 1 Apr 2019), departure levy for all outbound air passengers (1 June 2019); hikes in minimum wage and utility costs; firmer global crude oil prices and the expected floatation of RON95 & diesel prices in 2H 2019 after the roll out of the targeted and quota-based fuel subsidy for B40 households.

- Following the release of BNM Annual Report 2018 on 27 Mar 2019, the official real GDP growth forecast for 2019 is lowered to a range of 4.3%- 4.8% from 4.9% in the Ministry of Finance's Economic Report 2018/2019 released together with the tabling of Budget 2019 back in Nov 2018. We also trimmed our 2019 real GDP growth forecast to 4.7% from 4.9% previously.

- **Monetary Policy Forecast:** Given the downside risk facing 2019 growth, plus the outlook of benign inflation as the official inflation rate forecast is lowered to 0.7%-1.7% from 2.5%-3.5% previously - in line with our projection of 1.5% (2018: 1.0%) - we now expect BNM's Overnight Policy Rate (OPR) to be cut this year by -25bps to 3.00% vs no change at 3.25% previously. The move – which could happen as soon as at the next BNM Monetary Policy Committee (MPC) meeting on 6-7 May 2019 - is to support domestic demand growth as well as shoring up consumer and business sentiment/confidence.

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

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

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

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

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

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

- **Key domestic events and issues to watch:** FX reserves (15 May); Industrial Production (10 May); CPI (24 May), Trade Balance (3 May), BNM Policy Meeting (7 May).

- **Technical Outlook:** Our caution for USDMYR to head higher (in the last FX Monthly) towards 4.12 materialized. USDMYR traded a 3-month high of 4.1453. Last seen at 4.1375 levels. Bullish momentum on weekly chart remains intact but short term technical suggests tentative signs of easing. Decline could have more room to run if support at 4.1280, 4.12 levels give way. Key resistance at 4.15. Breach above this level puts next resistance at 4.17.

IDR: Still Awaiting Post-Elections Rally

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

No Change to Previous Forecast

- **Motivation for the FX View:** The IDR reacted positively to the expected victory of incumbent Jokowi in the presidential election on 17 Apr that saw strong inflows into domestic equities in Apr. The USDIDR's move lower though was limited by the resurgence in USD strength and the lack of inflows into Indonesian government debt. Nevertheless, the IDR managed to eke out some gains of 0.4% against the USD so far in Apr, among the best performing Asian currencies. We maintain our optimism that once the official hurdles to a Jokowi victory have been overcome and no disappointment in the appointment of office-holders in the key economic ministries we could see the USDIDR continue its downward moves. We keep unchanged our USDIDR projection and trajectory over the forecast horizon.

- We have yet to see the inflows into Indonesian assets that should drag the USDIDR lower. There have been strong inflows into the equity market, which were not sufficient to drag the pair lower. Similarly, the USDIDR have been supported higher by outflows from Indonesia government bonds (IndoGB) in the month, possibly on the rise in UST yields. To date, foreign investors have purchased USD3.73bn in equities in Apr, but this was not matched by IndoGB. Instead, foreign investors sold USD213.3mn in IndoGB in Apr. The lack of foreign inflows into IndoGB has kept the USDIDR moves lower subdued so far.

- As we had noted above, our enthusiasm for further downswings in the USDIDR is premised on our expectations that the victory by Jokowi is positive for markets. With a proven track record, confirmation of a Jokowi win should encourage further inflows. In addition, his appointments for the key economic ministries, particularly Finance, will be closely watched with the re-appointment of Sri Mulyani to the Finance Ministry highly anticipated. News of her re-appointment could fuel gains in IDR. This is because of the build-up in expectations that Jokowi and his economic team will follow-through with further fiscal policies that will ensure not only economic growth but tame the twin deficits as well.

- Some of the measures that are likely to be implemented in Jokowi's second term or have already been implemented include tax reforms (of tax rule revision to support the property sector, removing value-added tax on some service exports, revising corporate taxes for coal miners, etc.) and changes to the "Negative Investment List" to open up previously partly closed sectors to foreign ownership. There could also be an extension and expansion of import tightening measures (including tariffs) and measures to encourage exports to curb the current account deficit (CAD). Other measures already announced included intensifying the use of biodiesel to reduce import of oil given its status as a net oil importer.

- Some of the fiscal reforms that can be expected include (1) continuation in tax reforms, (2) optimizing non-tax income, (3) increasing savings from export receipts in domestic accounts, and (4) better and stronger coordination of fiscal and monetary policies in order to improve financing availability, lower interest, and increase GDP. These measures to bolster growth and curb the current account deficits are positive for the IDR, and could potentially lead to a repricing of Indonesian assets and spur greater inflows.

- Political factors aside, further downward pressure on the USDIDR could come from diverging yield differentials between Indonesian bonds and UST. The Fed's move to a prolonged pause in its rate hike should weigh on UST yields, possibly spurring yield seeking activities which could benefit the IDR. At the same time, the capacity of BI to tighten policy if the need arises even as it pauses on further rate hikes for now to support growth. Though we have revised our rate hike expectations to no rate hikes this year and next, this still keeps BI's policy rate at 6.0% vs. FFTR at 2.25-2.50%. This together with regional green shoots, including from Indonesia, should buoy demand for riskier assets and lift the IDR higher.

- We maintain our USDIDR forecast, and look for the pair to end-2Q and -3Q at 12900 and 12700 respectively before bouncing mildly higher to 12900 in 4Q and 1Q 2020 as growth risks in the final quarter and going into 2020 could provide some support for the USD.

- **Growth and Inflation Outlook:** After expanding by +5.18% in 4Q 2018, the economy is expected to accelerate mildly by +5.20% y/y in 1Q 2019, helped by still healthy private consumption amid campaign spending ahead of the 17 Apr Presidential and general elections. Government spending is also likely to have picked-up pace in 1Q as a result of the elections preparation. Still, 1Q growth is unlikely to significantly outperformed average growth rate of +5.00% of the past five-year. The Finance Ministry is expecting growth to come in around +5.05% in 1Q, weighed by the disruption caused by fallout from Sino-US trade tensions. Exports fell -10.1% y/y in Mar from -11.16% in Feb, while imports slipped -6.76% y/y from Feb's -13.81%. Nevertheless, growth remains supported as there does not appear to be a slowdown in economic activities as reflected by the rise in Nikkei PMI mfg of 51.2 in Mar from 50.1 in Feb. The government continues to look for economic growth of 5.3% in 2019. The 5.3% growth penciled in by the government though reflects its belief that a steep economic slowdown is unlikely. Our economic team is less sanguine, projecting growth to average 5.14% in 2019. For 2020, Finance Minister Sri Mulyani is looking for growth of 5.3-5.6% in 2020 on investment growth and an export recovery.

- Headline inflation continued to ease, moderating to +2.48% y/y in Mar from +2.57% in Feb and +2.82% in Jan. Weighing on inflation was softer food prices, which slipped even lower to +0.56% in Mar from +0.72% in Feb. Core inflation also eased by +3.03% y/y in Mar vs.

+3.06% in Feb due to softer administered, volatile and energy prices. This was attributable to supported administered prices (of 3.38% y/y) The government's move to curb imports and the current account deficit and the 175bp rate hikes by BI should continue to cap prices. The 7.5% tariff on around 900 consumer goods should reduce demand for imported goods and put downside pressure on prices. For 1Q 2019, headline and core inflation averaged +2.62% and +3.05% y/y compared to +3.17% and +3.02% in 4Q 2018. For Apr, the BI expects headline inflation to come in around +2.74% y/y, helped by the uptick in food prices. Our economic team maintains its headline and core inflation at 3.44% and 3.08% respectively in 2019. The forecasts are well-within the BI's target range of 2.5 and 4.5% for 2019.

- **Monetary Policy Forecast:** BI kept its benchmark policy rate unchanged at 6.0% at its 24-25 Apr policy meeting as expected. It also left the deposit and lending facility rates unchanged at 5.25% and 6.75% respectively, keeping the interest rate corridor at 75bp on either side of the policy rate. The emphasis remained on strengthening external stability, particularly closing the current account gap. Still, the bias in monetary policy appears to be geared towards greater accommodation than before to support growth. This tilt is reflected in the liquidity-supportive measures introduced to bolster domestic demand.

- The measures included: (1) Increasing available liquidity and supporting financial market deepening by strengthening the monetary operations strategy; (2) Enhancing retail payment efficiency by expanding National Clearing System (SKNBI) services, namely through an extended settlement time with faster settlement, an increase in the nominal transaction ceiling and lower tariffs; (3) Increasing the supply of Domestic Non-Deliverable Forward (DNDF), in particular by simplifying the regulations concerning underlying transactions; (4) Implementing market operator regulation in the money market and foreign exchange market; (5) Developing the Commercial Papers (SBK) market as an alternative source of short-term funding for the corporate sector; and (6) Expanding electronification of the noncash social aid program (bansos), village fund program, transportation sector and fiscal operations. These measures should be supportive of IDR stability in the longer term.

- **Latest Fiscal and External Balance Outlook:** The budget deficit is expected to come in higher at 0.63% of GDP in Mar, significantly higher than the deficit of 0.34% of GDP in the Jan-Feb period. This was the result of a shortfall in government revenue vs. government spending. Government spending came in at IDR452.1tn vs. revenues of IDR350.1tn, resulting in a budget deficit of USD102bn. Taxation revenue came in at IDR279.9tn, of which IDR249tb was from tax revenue and IDR31tn from customs and excise revenue.

- There is reason to optimistic over the measures introduced by both the government and BI to curb the persistent CAD. Already these measures, including lifting tariffs on imports of luxury goods and developing the tourism sector, have resulted in two straight months of trade surpluses. In Feb and Mar, there were trade surpluses of USD0.33bn and USD0.54bn respectively. The measures should inspire confidence in policy makers and should spur inflows into Indonesian assets. The effectiveness of the measures has increased confidence that the BI's forecast for a smaller current account deficit of 2.5% of GDP for 2019 is achievable.

- **Key domestic events and issues to watch**: GDP print for 1Q 2019 will be released on 6 May, while BI will meet to decide on monetary policy on 16 May. Market will be watching the election commission's certification of the winners in the Presidential and general elections due by 22 May (the law prescribes that the election results must be announced within 35 days of the vote).

- **Technical Outlook:** USDIDR continued to trade higher for the month of Apr, in line with call for rebound risks. Pair was last seen at 14260 levels. Bullish momentum on weekly and daily chart remains intact. Sustained price action above 14220 (23.6% fibo retracement of 2018 high to 2019 low) could see an extension of the rally towards 14425 (38.2% fibo), 14485 (200 DMA).

PHP: Election Risks In Focus

Forecast	2Q 2019	3Q 2019	4Q 2019	1Q 2020
USDPHP	52.30 (53.30)	52.00 (53.00)	52.50 (53.50)	52.80 (53.80)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** After spending Mar at the bottom of the heap, the PHP has rebounded to take the top spot among Asian FX in Apr. Gains in the PHP in the first half of Apr were attributable to the continued easing in inflation from its peak in Oct/Nov 2018, accompanied by comments from the BSP that signaled no imminent cut in interest rates. The PHP's climb higher though was capped by the resurgence in USD strength amid the lack of sustainable green shoots from the rest of the world, including the Philippines. In addition, the rising probability of a rate or RRR cut following Governor Diokno's recent comments that suggested a bias for a policy adjustment also weighed on the PHP. In addition, slippage in the PHP into the mid-term elections should limit gains. We have adjusted our USDPHP forecast to account for the credit rating upgrade but maintain its trajectory over the forecast horizon..

- The S&P surprised move to lift the long-term sovereign credit rating of the Philippines to BBB+ from BBB saw the PHP spike nearly 0.7% to 51.766 in response. The S&P cited strong economic growth trajectory, solid government fiscal accounts and sound external settings for its upgrade to the Philippines ratings. This should lift investor sentiments and spur inflows into Philippine assets, supportive of the PHP higher.

- At the same time, the new BSP governor's affirmation of the central bank's policy stance in early Apr together with easing inflation lifted sentiments and spurred demand for Philippine assets, particularly equities. This has led to larger gains in equities than in the previous two months. Foreign investors have purchased +USD185.93mn in equities in Apr so far, sharply higher than the +USD88.28mn bought in Mar and a tad higher than Feb's +USD178.48mn. This inflow into Philippine equities in Apr has kept the PHP buoyant so far.

- Risks to domestic economic growth in 2019 have risen though, especially from the delay in the passage of the FY2019 budget that are likely to see some key infrastructure spending delayed. This delay in fiscal support for the economy could see growth of 1-2 percentage points slashed from overall growth in 2019. These domestic growth concerns could weigh on sentiments, weighing on demand for equities, and put downward pressure on the PHP in May.

- Meanwhile, constrains from its current account deficit could put upward pressure on the USDPHP. So far, the government's ambitious infrastructure building programme makes it unlikely that the current account deficit will dissipate anytime soon. In addition, trade disruption caused by the Sino-US trade war should weighed on external demand, worsening the trade deficits, while elevated oil prices on global supply constraints could add to the deficit woes. Further deterioration in the current account deficit should weigh on the PHP, and keep the pair supported ahead.

- **We continue to caution that the USDPHP could remain elevated in 2Q as some political uncertainties could manifest in the lead up to the general elections on 13 May 2019. This election will see 12 seats in the Senate and all seats in the House of Representatives as well as all regional, provincial, city and municipal positions up for grabs**. Should the opposition win a majority of the seats in both Houses of Congress, they could effectively block the parliamentary agenda of President Duterte who would be mid-way through his one-term in office. The uncertainty in the lead-up to the elections could force investors to sit on the side-lines until clarity in the political environment emerges.

- Anecdotal evidence suggests that approval ratings of the President will typically affect the ruling party. Former President Benigno Aquino's strong approval rating resulted in his ruling coalition coming out victorious with 9 out of 12 seats up for grabs in 2013, while former President Arroyo's weak ratings dragged her party down, resulting in the opposition gaining the most seats (8 out of 12 up for elections) in the Senate during the mid-term elections in 2007. Latest ratings show Duterte's approval, trust and satisfaction rating still high at 76%, 81% and 74% respectively in 4Q 2018 and could translate into his ruling coalition retaining its majority in the Senate. On average over the two mid-term elections (in 2007 and 2013), the PHP outlook has been mixed. A win by pro-Duterte parties in the mid-term elections might not necessarily translate into a stronger PHP, possibly on concerns over a lack of new policy initiatives to drive the economy further, given the President's term limits. Thus, the outlook for the PHP should remain cautious.

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

- Taking into account the S&P credit rating upgrade, we now expect the USDPHP to end-2Q at 52.30 as political concerns are supportive. Pair should then retrace towards the 52-levels in 3Q. However, global growth concerns could re-emerge towards the end of the year could see USD re-emerge and push the pair higher to 52.50 and 52.80 in 4Q and 1Q 2020 respectively.

- **Growth and Inflation Outlook:** Economic growth in 1Q 2019 is unlikely to outperform 4Q 2018's upwardly revised 6.3%. Dragging growth lower is likely to be the drop in FDI with latest data from the BSP showing that FDI fell by 38.2% y/y in Jan. At the same time, remittances eased in Feb to just 1.5% after rising 4.4% in Jan, bringing remittances growth to just 3.0% in the first two months of the year. Support from the external environment was also lacking with exports contracting for the third consecutive month by -0.9% y/y in Feb from -6.7% in Jan. More importantly, the delay in the passage of the 2019 budget should weigh on growth. The Planning Secretary is optimistic that real GDP can come in around 6% in 1Q, while Governor Diokno is even more sanguine, looking for growth of above 6.0% despite the budget delay. For the full-year, the government has cut its 2019 growth target to 6-7% from 7-8% to reflect the delayed passage of the budget and also the disruption from Sino-US trade tensions. Our economic team though maintains its 2019 growth forecast of +6.5%.

- Headline inflation continued to ease, moderating to +3.3% y/y in Mar 2019 vs. Feb's +3.8%, but still well-within BSP's inflation target range of 2-4%. This is the lowest headline inflation since Jan 2018. This moderation was due to easing food costs underpinned by the government's measures to boost food supply and ensure efficient distribution. Core inflation (Headline inflation excluding selected food items such as rice, meat, fruit and vegetables as well as energy prices) also eased to +3.5% y/y in Mar from +3.9% in Feb. The latest print suggests that risk to inflation remains to the downside. Consequently, our economic team maintains its forecasts for headline inflation to average +3.0% and 2.8% respectively 2019 and 2020. The forecasts are largely in line with the BSP's inflation forecasts of +3.0% for both 2019 and 2020.

- **Monetary Policy Forecast:** There was no BSP meeting in Apr. The Mar meeting - the first under new governor Benjamin Diokno – held no surprises with the BSP leaving its benchmark overnight borrowing rate unchanged at 4.75%. This comes after the BSP had lifted rates by a cumulative 175bp in 2018. The interest rate corridor was also left intact (symmetrical on either side of the policy rate by 50bp) with the overnight lending and overnight deposit rates at 4.25% and 5.25% respectively. The new governor had chosen not to rock the boat even though receding domestic inflation amid the Fed's pivot to a prolonged pause on its interest rate hikes provided policy room for the BSP to cut rates. Instead, it chose to hit the pause button on concerns that it would be seen as retracing its tightening moves prematurely and too quickly. However, recent comments by Governor Diokno suggested that a rate cut or even a RRR cut was "only a matter of timing". For now, the BSP remains constrained by data, particularly that of oil prices.

- Our economic team does not expects any rate adjustments by the BSP until 2H 2019 where the team has penciled in a rate cut of 50bp to 4.25% and then by another 25bp to 4.00% in 1Q 2020. At the same time, the team believes that the BSP is waiting for the right time to reduce the required reserve ratio (RRR) so as to ensure that its action will not dislodge inflation expectations. The team maintains its view that the central bank will cut the RRR by a steady pace of 200bp p.a. in 2019-2020 – the same quantum as in 2018 as part of its monetary policy reform.

- **Latest Fiscal and External Balance Outlook:** After months of delay, the budget for 2019 was passed by both houses of Congress and signed into law by President Duterte. The PHP3.66tn budget though did not include some items as they were vetoed by Duterte, including PHP95.3bn in proposed spending items allocated to the Department of Public Works and Highways for "pork-barreling" purposes. The vetoes meant that this year's budget was slightly lower than last year's PHP3.77tn budget.

- There was a budget deficit of PHP58.4bn in Mar and this was due to the shortfall in revenue of PHP228.9bn compared to spending of PHP287.3bn. Of the PHP228.9bn in revenue collected, revenue from taxes came in at PHP147.4bn and from tariffs PHP49.3bn. For 1Q 2019, the deficit was PHP90.2bn with revenue collected at PHP687.7bn and spending at PHP778bn. The full-year deficit ceiling target set by the government for 2019 remains at PHP631.5bn or 3.2% of GDP.

- The balance of payments recorded a surplus of USD3.80bn in 1Q 2019, widening from 4Q's surplus of USD2.83bn. While details are not available, it is likely that there was a current account deficit (CAD) due to the widening deficit in the trade-in-goods account that more than offset the higher net receipts posted in the trade-in-services and income accounts. The CAD though was likely to have been more than offset by the surplus in the financial & capital accounts. The IMF expects the CAD to improve to 2.2% of GDP in 2019 from 2.6% in 2018 and then to 1.8% of GDP in 2020. For 2019, the BSP projects a balance of payments deficit of USD3.5bn vs. a deficit of USD2.31bn in 2018.

- **Key domestic events and issues to watch:** 9 May will be a busy day as not only will BSP meet to decide monetary policy but the government will also release GDP print for 1Q 2019 that day. On the political front, mid-term elections for half the seats in the Senate and all the seats in the House of Representatives will be up for grabs on 13 May. This could serve as a referendum on the President Duterte and his policies.

- **Technical Outlook:** USDPHP traded a month of 2 halves; falling in early month before partially erasing losses into month-end. Pair was last seen at 52.10 levels. A potential bullish divergence appears to be forming on the weekly charts. An eventual move higher towards 52.60, 52.90 should not be ruled out. Bias to buy dips towards support at 52 (21 DMA), 51.65 likely.

THB: Near-Term Economic & Political Headwinds

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

No Change to Previous Forecast

- **Motivation for the FX View:** The THB's move lower so far in Apr toppled the currency from its pole position atop Asian FX year-to-date. The THB slipped to being the third best performing Asian currency after the yuan and the rupiah. The THB was dragged lower by ongoing political uncertainty following the 24 Mar general elections that produced no clear winner. Political uncertainty is likely to persist for a while longer and should weigh on the THB in the next month or so. This slippage in the THB was reinforced as well by the resurgence in USD strength amid the lack of sustainable green shoots from the rest of the world, including Thailand. We maintain our USDTHB outlook and trajectory for the forecast horizon for now.

- The peaceful elections on 24 Mar belie the ongoing schism in Thai society. The political environment has been split into two camps – the pro-junta group led by the Palang Pracharath Party (PPRP) and the anti-junta group led by the Pheu Thai Party (Thaksin-linked party) and new up-start the Future Forward Party. Each side has laid claims to forming the next government – PPRP on its win of the popular votes (8.4m) and Pheu Thai on its winning the most number of seats in the new Parliament (137 seats).

- Political tension could flare when the Election Commission announces how it tends to allocate the 150 party-list seats. The formula favoured by the Commission would allocate seats to smaller parties. This is likely to create an even more fractious parliament and makes it more likely that the military-led government will retain power. Even before this, the PPRP has the inside track in forming a government as the Constitution is stacked in its favour (note that the 250 senators that will vote along-side the elected-MPs to select the PM are appointed by the military junta). Thus, it is more likely than not that PM Prayuth would remain as PM.

- Still any government though is likely to be unwieldy and unstable given the different political parties involved. The lack of clarity as to who will form the next government and the possibility of an unstable and short-lived government could keep foreign investors on the sidelines and provide little impetus for foreign investment and the THB to climb higher.

- We are already seeing the THB come under pressure due to the lack of political clarity. Further weakness in the THB is likely to persist ahead as the reality of new political situation sets in. Initial gains in Thai assets post-election have since dissipated as political uncertainty sets in during the coalition-building phase. We could see the sell-off continue as the coalition-building attempts intensify the political noise and lift the USDTHB higher.
- Market angst over domestic political uncertainty was reflected in the outflows from Thai assets in Apr. Foreign investors had purchased USD93.6mn in equities so far in Apr, but this was completely offset by their sell-off of USD439.4mn in debt. This net foreign portfolio outflows in the month weighed on the THB, keeping it pressured to the downside. Further net foreign outflows cannot be ruled out should political clarity and domestic green shoots remain lacking. This could keep the THB under pressure in the month ahead.
- We however do not expect the THB to take a deep dive. Some of this downward pressure on the THB is likely to be mitigated by supported sentiments from the Fed's move to pause its rate hikes for an extended period. This pause suggests that the Fed's current tightening cycle is near its end and that a softening of the USD cannot be ruled out. This together with the possibility of softer US economic data and likelihood that Sino-US trade war concerns will fade should weigh on the USD. Together, these should keep the THB from slipping too aggressively lower in the three-months ahead and then potentially provide some relief to the USDTHB when the political noise fades.
- Additionally, Thailand's macroeconomic underpinning remains healthy, albeit there are some soft spots currently. Still healthy growth momentum and persistent current account surpluses remain supportive of the THB. The persistent current account surpluses (BoT projects a surplus of 6.4% of GDP in 2019) continue to favor the THB. In addition, low domestic inflation (where headline CPI has averaged 1.1% for the whole of 2018 which is at the lower end of the BoT's 1-4% target range) has also helped the THB, producing an environment where the BoT has policy room to remove its accommodative policy at a gradual pace. A less aggressive pace of rate hikes should be supportive of economic growth and less likely to stifle price increases, which turn should be positive for the THB. Given the recent move by the Fed to prolong its pause in rate hike, we no longer expect any further rate hikes by the BoT in 2019, though the tightening bias of the central bank remains.
- We maintain our USDTHB outlook for the pair to climb higher to the 32-levels by end-2Q 2019 as political tensions intensify. As some semblance of political détente among the different political camps is achieved, the THB has room to climb higher to the 31.70-levels by end-3Q. Risk aversion though could re-emerge from 4Q on concerns over a possible global economic slowdown that could see USD gather strength somewhat and lift the USDTHB back to the 32.00- and 32.20-levels by year-end and by end-1Q 2019.
- **Growth and Inflation Outlook:** The growth outlook for the economy remains dim. Politics aside, the economy faces other headwinds.

Domestic demand has eased on the back of a decline in private investment, while exports continue to contract. Private consumption grew at a slightly softer +4.3% in Feb vs. Jan's +5.6%, but our economic team expects private consumption to remain robust in 1Q boosted by pre-election and campaign spending. Private investment declined by -0.6% in Feb from +1.8% in Jan due to the continued plunge in permitted construction area, drop in capital goods import and weaker construction materials index. Private investment for the full-year should remain supported by higher manufacturing FDI, as companies impacted by the Sino-US trade war diversify their production bases. Thus growth in 1Q could remain subdued and unlikely to exceed 4Q 2018's +3.7%.

- Still, government spending together with planned infrastructure building projects including transport networks and the Eastern Economic Corridor development project should continue to attract FDI and keep growth supported in 2019. Our economic team looks for economic expansion of +3.8% in 2019. Meanwhile, the Finance Ministry has cut its growth outlook for 2019 to +3.8% from 4.0% previously underpinned by slowing exports. This brings the government's growth forecast in line with that of the BoT which had earlier revised its 2019 growth outlook to +3.8% (from 4% previously) at its Mar policy meeting.

- Headline inflation surprised to the upside in Mar, climbing to a 5-month high of +1.2% y/y vs. Feb's +0.7%. This was mainly due firmer food prices (+2.4% vs. +1.9% in Feb), which the Ministry of Commerce attributed to the drought. Energy prices (Mar: +2.1% vs. Feb: -0.9%) also drove up headline inflation as Brent climbed to USD67 a barrel in the month. Core inflation (headline inflation excl. raw food and energy) remained steady at +0.6% in Mar, unchanged from Feb. Our economic team maintains its inflation forecast at +1.1% for 2019, which falls within the Commerce Ministry's forecast range 0.7-1.7%.

- **Monetary Policy Forecast:** There was no monetary policy meeting in Apr. At its 20 Mar policy meeting, the BoT monetary policy committee had voted unanimously to keep the benchmark one-day repurchased rate steady at 1.75%. This is in contrast to its Feb meeting where the decision to hold rate was not unanimous with 2 out of the 6 members voting to hike rates by 25bp. The decision to hold policy rate steady was due to heightened global and domestic uncertainties in the current period, particularly the general elections on 24 Mar. These uncertainties have not dissipated but have been swept under the carpet ahead of the HM the King's coronation ceremony on 4-6 May. The political uncertainty together with expectations of softer economic growth this year should allow the BoT to be patient in its rate normalisation process. At the same time, the Fed signaling of a prolonged pause in future rate hikes in 2019 removes any pressure on the BoT to match the Fed's moves. Our economic team expects the BoT to keep the policy rate steady for the rest of the year. Any rate hike should come in 2020 where the team is penciling a 25bp adjustment as financial stability risks remain a concern for the central bank.

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

- The current account surplus ballooned to USD6.5bn in Feb after narrowing to USD2.01bn in Jan from USD4.51bn in Dec 2018. This jump could be attributed to the gains in the trade surplus to USD3.45bn in Feb from USD0.21bn in Jan as imports plunge. There was a small deficit in the financial account of USD0.26bn and a large net errors and omission term of -USD2.90bn. Consequently, the overall balance of payments recorded a surplus of USD3.34bn, wider than Jan's surplus of USD2.26bn. Note that the BoT is projecting a current account surplus of 6.4% of GDP in 2019.

- **Key domestic events and issues to watch:** BoT will meet to decide on monetary policy on 8 May, and minutes will be released on 22 May. 1Q 2019 GDP will be released on 21 May. On the political front, HM King Maha Vajiralongkorn will be crowned in an elaborate ceremony on 4-6 May in Bangkok. On 9 May, the Election Commission will officially announce the winners of the 24 Mar general elections, beginning the tussle among the various parties to form the next government.

- **Technical Outlook:** Our caution for USDTHB to head higher (as shared in the last FX Monthly) materialized. USDTHB traded high of 32.15 (25 Apr). Last seen at 31.94 levels. Mild bullish momentum on daily chart is fading while stochastics is turning lower. Near term retracement towards 31.88, 311.70 possible. Resistance at 32.15.

INR: Election, Oil and USD

Forecast	2Q 2019	3Q 2019	4Q 2019	1Q 2020
USDINR	68.00 (66.00)	67.00 (66.00)	68.00 (--)	68.00 (--)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** FX is rarely a one-directional play and the rupee is no exception. The combination of the crude and the USD upmove lifted the USDINR above the 70-figure. The broad USD strength that resurfaced, came as we approach the most seasonally bullish month for the USD and amid some familiar concerns that lifted the We still stand by our view that USDINR could still head lower towards the 66-figure. This is based on our assumption that USD would not test much higher and brent crude could extend its bearish retracement. We adjusted our forecast a tad higher to take into account the unexpected combination of USD and crude strength that had exacerbated the rupee weakness in the past few weeks. However, we still look for a Modi victory on 23 May and expect USDINR to head lower towards the 68 and eventually 67 in 3Q later this year.

- Voting has started in India (11 Apr) and the results would only be announced on 23rd May. Portfolio inflows have been supportive of the currency as foreign investors bet on a victory by PM Modi. Even as rupee weakened against the USD, inflows via equities kept INR from being the worst performer in Asia. Month to date (29 Apr), foreign investors have bought U$1.65bn of equities, outweighing the U$1.3bn of bonds that were sold. The bond market was hurt when RBI delivered a rate cut that was expected but the accompanying rationale was not as dovish as investors had anticipated it to be. That had triggered the unwinding of rupee bonds before the RBI more recently announced that foreign portfolio investors can invest in municipal bonds, albeit still subject to limits. Regardless, 10y yield came off from recent highs of 7.5% to 7.41% (as of 29 Apr).

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

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

- **Growth and Inflation Outlook:** Industrial production slowed unexpectedly to just 0.1%y/y for Feb with the Jan print also revised lower to 1.4%. The breakdown suggests that manufacturing shrank in the month, down -0.2%y/y. Mining weakened to 0.2%y/y from previous 0.5% while electricity output steadied around 0.1%. Capital goods and intermediate goods saw deeper contractions in the month while consumer durables also slowed from 0.3%y/y to 0.2%. The broad weakness in activity likely buoyed the USDINR and added pressure on the sovereign bonds. Abroad, exports picked up pace to 11.0%y/y from 2.4%y/y while imports rebounded just a tad to 1.4%y/y from -5.4%. Trade deficit still widened to -10.9bn vs. previous at -$9.6bn. The widening trade deficit likely added to concerns on its external balance as the imports of oil rebounded to 5.6%y/y from previous -8%.

- Inflation quickened to 2.86%y/y from previous 2.57% (revised lower) as food inflation accelerated to 0.3%y/y in mar from -0.7% previously. There are also reports of isolated rain forecast for Punjab Uttar Pradesh and Rajasthan that could hamper wheat harvest. However, food inflation is not expected to run away as the Ministry of Earth Science have forecast annual rainfall (Jun-Sep rainy season) to be 96%

of the long-term average, adequate for the agriculture output. Headline would be still kept elevated with fading low base effect to prop up the inflation measure. Other subcomponent may also remain subdued such as that of housing. Increasing supply of houses could continue to cap inflationary pressures there. This could continue to offset the higher prices of fuel and light that has picked up pace to 2.4% in Mar from 1.2% in Feb.

- **Monetary Policy Forecast:** RBI made a back to back cut in Apr after the cut in Feb, contrary to our expectations. The 4-2 majority vote underscored the fact that it was a contested decision even though the consensus had called for it. The reaction in the rupee was muted. RBI's decision to leave its monetary policy stance neutral (voted 5-1) also suggests that the next cut may not be so soon. According to the Minutes, the MPC members who backed the 25bps reduction to policy rates were concerned about the global slowdown and the weakness in the domestic activity. Inflation outlook, on the other hand, is fraught with uncertainties with vegetable prices having a risk of abrupt reversal in summer months and fuel prices could still be at the mercy of the international crude price movements. Fiscal management would be watched as the election could still have a risk of having a different government. The next meeting is scheduled on the 3,4 and 6th June and we do not expect any policy action then as RBI should wait and assess the impact of the recent rate cuts as well as the impact of the fiscal support.

- **Latest Fiscal and External Balance Outlook:** As of last available data, India's current account deficit narrowed in 3Q FY18-19 to U$ 16.9bn from U$19bn. This year could be another challenging one for its external balance as global growth continues to moderate.

- **Congress (the main opposition party)** has promised INR72000 annually for poor families that earn less than INR12000 a month. The "minimum income plan" is supposed to cost U$52bn. That could mean that a government under Congress is less likely to focus on fiscal consolidation as there was no projection from the party on how it is likely to finance it. Should Congress (not our base case) take over the government, there could be concerns on how the government can manage its fiscal deficit.

- **Key domestic events and issues to watch:** PMI-mfg on 2nd May; industrial production on the 10th and CPI on the 13th; WPI and trade data on the 15th and 1Q GDP on the 31st.

- **Technical Analyses:** The 1M USDINR NDF tested the 100-dma before drifting lower on the back of USD and oil. This pair could continue to be dictated by these two drivers. Bullish momentum is waning while stochastics also show signs of easing from overbought condition. Support is seen around 69.80 before 69.50, 68.80. Resistance at 70.54 before 71.22.

VND: Weakness Unlikely To Persist

Forecast	2Q 2019	3Q 2019	4Q 2019	1Q 2020
USDVND	23100 (23000)	23000 (22800)	23100 (22900)	23000 (--)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** The USDVND spiked towards the 23250 just before the end of Apr on the back of the strong USD. The move up was in tandem with the rest of USDAxJ (especially the USDCNY) as USD liquidity was squeezed during the Easter holidays and just ahead of the most bullish month of the year for the greenback (May). Vietnam continues to see steady FDI inflows as well as portfolio inflows. In an environment of USD resurgence, VND's competitiveness against its trading partner waned. Our estimate of the VND trade weighted index (TWI) edged higher to 64.0 at last sight (29 Apr) from 63.9 in Mar as most of its trading partners depreciated more against the USD (including the RMB) compared to the VND. We do not expect USD strength to sustain for long. Along with hopes for the US and China trade relations to improve, we see more CNY recovery which could set a positive tone for the year and we look for modest CNY strength to provide an anchor for the VND this quarter, if not for most part of this year.

- We hold our view that slower global growth is likely to crimp on the VND. The moderation in global growth has weighed on exports growth in the past few months for Vietnam with single digit growth/ contractions recorded for the past few months. Trade balance swung back into deficit for Apr at -U$700mn vs. the U$600mn surplus for Mar.

- In an environment of a Fed pause, softer USD and strong RMB, the VND could appreciate modestly against the USD and to end the 3Q at around 23000. In an environment of weaker USD, expect VND recovery to lag that of its trading partners, resulting in a weaker trade-weighted index.

- **Growth and Inflation Outlook:** PMI-mfg rose to 51.9 for Mar vs. 51.2 in the month prior. Respondents to the survey conducted by Markit reported signs of acceleration in output for Mar and total new business and exports also picked up pace from Feb. The rate of input cost inflation remain subdued.

- Industrial production rose to 9.3%y/y from previous 9.1%. Retail sales steadied somewhat for the first four months of the year at 11.9%%y/y vs. 12.0%y/y seen in 1Q. The headline is underpinned by the tourism spending which rose to 13.1%y/y vs. 12.8% in 1Q.

- CPI continues to trend higher to 2.93%y/y from previous 2.70%, beating the already firmer forecast at 2.80%. The headline is boosted by a rebound in transportation, household equipment's and appliances. Housing and construction materials also picked up pace to 3.25%y/y from 2.81% previously. While inflation is still well under the 4% target, the rise in crude prices pose a threat of un-anchoring inflationary expectations. That said, headline may ease on higher base effects in the next few months.

- **Monetary Policy Forecast:** Rising inflation could narrow the room for monetary policy support in a backdrop of slowing global demand for Vietnam's export performance. While Vietnam seems to have benefitted from diversion flows and FDI that resulted from the US-China trade conflicts, VND could stand to strengthen further from a stronger demand out of China given that China is still its biggest export destination. We still expect FDI inflows to continue because of the trade agreements and that could cushion the effects of the decline in external demand. Sustained imports growth and retail sales suggest that household consumption could also support growth. As well, we look for China's demand to recover (albeit modestly) to cushion against global growth slowdown.
- In this environment where growth outlook for Vietnam is still rather balanced, we see little need for a rate cut by SBV now. In terms of TWI, the VND has been rather stable in the past few months. We anticipate that VND is likely to remain a laggard in an environment of softer USD and that could provide more export competitiveness that could improve its trade balance. That said, our view on the VND would be downgraded if the African Swine Virus spreads and threatens price stability.
- **Latest Fiscal and External Balance Outlook:** As of last available data, current account surplus was at U$1.24bn in 3Q. Net trade surplus of goods slipped to U$3.0bn from previous U$5.2bn. The competitive dong could keep the current account in surplus Slower growth momentum could mean a deterioration on the trade front and we expect the current account surplus to be eroded. That would underscore the need for VND to remain competitive and our view that VND could lag in its recovery against the USD compared to regional peers.
- **Key Domestic Events and Issues to Watch:** PMI-mfg on 2nd; domestic vehicle sales in 6th-13th; CPI, trade numbers, retail sales and IP are due 25th-31st May.

FX Forecasts

	End Q2-19	End Q3-19	End Q4-19	End Q1-20
USD/JPY	108	106	107	105
EUR/USD	1.1500	1.1600	1.1600	1.1600
GBP/USD	1.3200	1.3400	1.3600	1.3600
AUD/USD	0.7300	0.7400	0.7300	0.7200
NZD/USD	0.6800	0.6900	0.6800	0.6700
USD/SGD	1.3400	1.3300	1.3500	1.3600
USD/MYR	4.08	4.05	4.10	4.12
USD/IDR	12900	12700	12900	12900
USD/THB	32.00	31.70	32.00	32.20
USD/PHP	52.30	52.00	52.50	52.80
USD/CNY	6.70	6.65	6.70	6.68
USD/HKD	7.84	7.83	7.84	7.79
USD/TWD	30.80	30.80	30.90	30.80
USD/KRW	1130	1135	1140	1130
USD/INR	68.00	67.00	68.00	68.00
USD/VND	23100	23000	23100	23000
DXY Index	96.18	95.18	95.40	94.87
SGD Crosses	End Q2-19	End Q3-19	End Q4-19	End Q1-20
SGD/MYR	3.0448	3.0451	3.0370	3.0294
SGD/IDR	9627	9549	9556	9485
SGD/THB	23.88	23.83	23.70	23.68
SGD/PHP	39.03	39.10	38.89	38.82
SGD/CNY	5.00	5.00	4.96	4.91
SGD/HKD	5.85	5.89	5.81	5.73
SGD/TWD	22.99	23.16	22.89	22.65
SGD/KRW	843	853	844	831
SGD/INR	50.75	50.38	50.37	50.00
MYR Crosses	End Q2-19	End Q3-19	End Q4-19	End Q1-20
EUR/MYR	4.69	4.70	4.76	4.78
JPY/MYR	3.78	3.82	3.83	3.92
MYR/HKD	1.92	1.93	1.91	1.89
MYR/CNY	1.64	1.64	1.63	1.62
GBP/MYR	5.39	5.43	5.58	5.60
AUD/MYR	2.98	3.00	2.99	2.97
NZD/MYR	2.77	2.79	2.79	2.76
MYR/IDR	3162	3136	3146	3131
MYR/INR	16.67	16.54	16.59	16.50
MYR/KRW	276.96	280.25	278.05	274.27
MYR/PHP	12.82	12.84	12.80	12.82
CNY/MYR	0.6090	0.6090	0.6119	0.6168

Source: Maybank FX Research as of 30 April 2019.

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

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(Incorporated in Malaysia)

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