Macro | FX Research & Strategy

Global

FX Monthly

2022, Issue 4: USD and RMB Extremes

What Has Changed This Month?

- We revised most of our non-USD forecasts weaker, in light of recent concerns of sharp and rapid decline in CNH, JPY; signs of slowing global growth and fast withdrawal of monetary stimulus globally.

Our Strategies

- Last month, IMF lowered 2022 global growth to 3.6%, down from projection of 4.4% earlier. Growth downgrade was due to Russian invasion and China lockdowns. It said that the war threatened to erase much of the recent recovery from the pandemic, and identified "frequent and wider-ranging lockdowns in China—including in key manufacturing hubs", as another driver of slowing activity due to bottlenecks in global supply chains. Concomitantly, Euro-area, UK forecasts were cut sharply due to impact from war in Ukraine. Rising debt levels in EMs is also a risk as policymakers in advanced economies tighten monetary policy. IMF cautioned for global trade to slow to 5% in 2022, half the rate of 2021. Slowdown in growth, withdrawal of monetary stimulus in DM world and elevated inflationary pressures could continue to keep AxJ FX under pressure in the interim.
- China extended the shutdown for Shanghai into Apr and its repeated vows to stick to zero-covid triggered downgrades for its 2022 GDP forecast. USDCNY broke out of the 6.30-6.40 range and its recent rally brought back memories of the ~15% CNY rout recorded in 2015 (one-off devaluation) and 2018 (trade war). We downgraded our CNY and CNH forecasts accordingly, taking into account fragile yuan sentiment and potential for broadening lockdown (albeit assuming bulk of lockdowns to be within 2Q). Wider US-CH yield premium can also boost USDCNY. Weaker CNY add headwinds to regional currencies. That said, China's current account surplus and step-ups in macro supports can mitigate drags on the CNY and prevent the USDCNY from taking the same path seen in 2015/18. Infrastructure spending is touted as a key thrust for recovery and if followed through, should serve as a ToT boost for AUD.

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Top 3 Currency Plays for May

Sell DXY on Rallies
Short CNH, TWD vs. Long AUD, INR
Long SGD NEER

Key Events for the Month Ahead

Date	Event
9 May	Philippines Presidential Elections
21 May	Australia Federal Elections

G7 Global Overview

USD: Global Growth and Rate Hike Concerns Intensify

Forecast	2Q 2022	3Q 2022	4Q 2022	1Q 2023
USD Index	**105.85** (97.56)	**103.69** (97.09)	**101.03** (95.46)	**100.53** (95.11)

Previous Forecasts in Parentheses

- **Motivation:** The USD DXY appreciated at a quicker paced than expected of around 5% in the month of Apr (relative to around 1.5% in Mar) to end at around 103.50 (as at 28 Apr). The euro, JPY and CNY weakness vs USD were relatively sharp in Apr. The USD is likely to remain supported on the back of the protracted Russia-Ukraine geopolitical situation, with the expectations of tighter Fed policy move and global growth concerns intensifying amid concerns from Covid-related lockdowns in China and sharp downward currency adjustments in the RMB sensitive currencies. We had earlier this year held the view that USD may see some risk of peaking by mid 2022, as (1) most of the hawkish expectations so far are in the price; (2) on a relative basis with other central banks, albeit with a lags, the Fed is not the only one tightening. But despite synchronous global policy normalization (excluding China) in the face of inflationary pressures, the protracted nature of the geo-political situation in Ukraine/Russia, continued expectations of additional hawkish Fed moves and global growth concerns suggest that markets may be mired in a risk-based cautious view based on the global economic backdrop. These factors are likely to lead to USD support and delay any further USD retracement towards end of the year at the earliest. Nonetheless, an improvement in the geopolitical space and positive developments out of China, coupled with reopening globally can quickly allow for some space for cyclical FX to intermittently strengthen relative to USD.

- As of 25 Apr, OIS-implied futures shows further front loading of rate hikes with 50bps hike priced for next 3 FOMC (in May, Jun and Jul), up from 2 FOMCs previously. There is 56% probability for a move in Sep FOMC. But while higher US rate expectations typically add to USD upward pressure, we think it may be useful to consider how USD sensitivity to rate moves can vary in different yield curve regimes (i.e., steepen vs flattening period). For 2022, Fed funds futures are expecting another 243 bps rate hikes.

- If we look at past 32 years of daily data since 1990 on DXY sensitivity (90d rolling basis) to 2y and 10y UST yields against different regimes of 2y10y yield curve episodes. Historically, USD sensitivity to yields picks up when 2y10y yield curve steepens – a proxy for brighter economic prospects. However, the relationship starts to weaken in episodes of yield curve flattening. This may suggest that markets are cautious that aggressive Fed tightening may hurt US economic growth and thus dent its appeal of its rate advantage. The current yield curve regime is one where 2y10y is flattening (last at+20bps vs +89bps peak of the year in early-Jan 2022). So technically, USD's sensitivity to yield uptick should be weaker as compared to periods when the yield curve is steepening.

- Amongst ASEAN FX, Fed's hawkish monetary policy divergence may marginalize some ASEAN FX, including MYR whose monetary policy maybe perceived to be relatively accommodative. On the other hand, SGD could find solace from a hawkish MAS.

- To sum up, near-term (coming 3-6 months) risks could be skewed to the upside for broad USD for a bit longer, and our forecasts for currencies like EUR, JPY, and regional currencies are revised lower due to a confluence of negative factors.

- However, eventually, USD may near its peak or soften earlier than expected, closer to the end of this year if there is no further escalation in geo-political tension and no further surprises in Fed tightening materialize; underpinned by the (1) hawkish Fed expectations somewhat in the price and that USD's sensitivity to yield moves tend to weaken during current episode of yield curve flattening; (2) Fed is not the only one tightening; (3) global economic backdrop to remain somewhat supportive (no recession or stagflation) to support synchronous policy normalisation; (4) ongoing talks between Russia-Ukraine in hope of reaching a comprehensive deal (that may take weeks to month to forge).

- **Growth and Inflation Outlook:** Real GDP growth came in 2.4bp below consensus as it declined 1.4% annualized in 1Q even as private-sector domestic demand rose 3.7% annualized. Nonetheless, rising imports accounted for a significant proportion of the decline and likely reflected strong domestic demand and some Ukraine-related front-loading. In addition, higher prices also contributed to the decline, particularly from construction cost rises.

- On a m/m basis March core CPI rose by 0.32%, going below consensus of 0.5% since the Aug numbers, largely in part due to the larger than expected decline in used car prices and partly too from a deceleration in shelter categories. YoY CPI rose firmly to 6.5% from 6.4%. Headline CPI rose 1.2%, in line with consensus, reflecting sharply higher energy (+11.0%) and home food (+1.5%) prices.

- NFP rose at a strong pace of 431k in Feb, but below consensus of 490k. Job growth over the past two months was also revised up by 95k. The Mar job gains were quite broad-based, with increases in 69.7% of industries compared to 81.3% in Feb and 62.9% in Jan. By industry, job growth was strong in professional and business services, retail, and manufacturing. The unemployment rate fell to 3.6% from 3.8%, on the back of strong household employment growth.

- **Monetary Policy Forecast:** At the last FoMC (16-17Mar), FoMC voted 8-1 to raise rate to 0.25% - 0.5%. Bullard was the only dissenter as he called for 50bps hike. Dots plot signalled another 6 more hikes this year (vs. their Dec-2021 FoMC projection for 3 hikes). For 2023, Fed is now looking for about 3 – 4 more hikes and none for 2024.

- 15-16 Mar 2022 FOMC meet saw the target fed funds rate (FFR) raised by +25bps to 0.25%-0.50%. FOMC Statement and “dot plot” signal FFR hikes in all the remaining six FOMC meetings for this year i.e. seven hikes in total amounting to +175bps in 2022 plus another 3-4 hikes in 2023. Balance sheet reduction (quantitative tightening) is also guided to commence soon after the start of the FFR hikes cycle.

- Latest FOMC statement and dot plot shows Fed is focusing on its price stability mandate given the consumer price index (CPI) trends. This is as Fed raised its 2022 inflation rate forecasts to 4.3% vs 2.6% in Dec 2021. Fed also revised upwards the inflation rate forecasts to 2023 and 2024 to 2.7% and 2.3% respectively from the Dec 2021’s projections of 2.3% and 2.1% respectively. Core inflation is also expected to be higher now i.e. 4.1% vs 2.7% previously in 2022; 2.6% vs 2.3% previously in 2022; 2.3% vs 2.1% previously in 2022.

- Updated dot plot indicates a total of seven rate hikes this year totalling +175bps and another 3-4 hikes in 2023 to result in the median FFR reaching 2.75% by end-2024 and a longer-term rate of 2.375%. Back in Dec 2021, the forecasts were 3 hikes totaling +75bps per year in 2022-2023 followed by another 2 hikes amounting to +0.50bps in 2024 with a longer-term rate of 2.50%.

- Fed’s unemployment rate forecasts for 2022-2023 remain at 3.5% with a slightly higher 3.6% in 2024 vs 3.5% previously, while 2022 real GDP growth forecast is trimmed to 2.8% from 4.0% previously while the projection for 2023 and 2024 are maintained at 2.2% and 2.0% respectively.

- Fed also alluded to balance sheet reduction or “quantitative tightening” to commence soon after the start of FFR hike cycle as per the FOMC statement i.e. “The Committee expects to begin reducing its holdings of Treasury securities and agency debt and agency mortgage-back securities at a coming meeting”. QT may begin as soon as the next FOMC meeting on 3-4 May 2022 but we think no later than the 26-27 July 2022 FOMC meeting. To note, QE Taper that started Nov 2021 ended this month.

- Fed Chair Powell then told reporters that inflation is too high, labor market is over-heated and price stability is a “pre-condition” for Fed. While he noted that Ukraine war had highly uncertain implications for US economy that create near term upward pressure on inflation while weighing on economic activity, he played down the risk of recession and emphasized that US economy is “very strong” and can handle tighter policy. Powell also signalled that balance sheet announcement could come as soon as May and the rolldown framework to move faster than last time.

- Comments made by Fed officials are starting to shift significantly, looking for much faster pace of policy normalisation, in terms of magnitude of rate hikes and trajectory. We believe this is due to inflation showing no signs of abating and may even be at risk of going higher for longer amid Ukraine situation exacerbating supply chain disruptions. So far, markets have taken Fed’s hawkish shift in its stride (i.e., no major sell-off in equities or FX) and we opined that this is because the Fed is playing catch-up with markets (i.e., dots plot have been lagging markets' pricing). But if the tide shifts and markets end up playing catch-up with the Fed instead, then we would be more cautious as surprise shocks can undermine sentiment and add to USD support. And the risk is that markets may not have priced in rates above 3% or 4% into 2023. This is also 1 risk to be mindful of and how that can intermittently add to USD support.

- Mester is not ruling out 50bps hike and backs front-loading rate hikes in 1H this year, given the underlying strength of the economy and the Fed fund rate is at low levels. She also wants to get policy rate up to 2.5% this year and follow up with more increases next year to rein in 40y high inflation.

- Daly also share similar view in **getting rates up to neutral** (Fed estimates neutral at ~2.4%) and that **Fed could consider tightening to restrictive policy** to ensure that inflation comes back down. She is also looking at +50bps hike and decision to shrink balance sheet at May FoMC (if economics data in coming weeks support).

- Bullard reiterate his stance that the Fed needs to move aggressively to keep inflation under control. He is also looking for rates to get to neutral at least so as not to put upward pressure on inflation. Bullard's estimate neutral at 2% while the median of FoMC officials is at 2.4%. He also cited the 1994 tightening cycle as an analogy on how fast Fed should move. That cycle was indeed one of the fastest but most compressed cycle since 1980s, where then-Fed Chair Greenspan tightened by 300bps over a 1y period in 1994-95, which included two 50bps hike and one 75bps hike. "Soft-landing" was achieved, recession and inversion of 2y10y yield curve was also averted.

- During a NABE seminar (21 Mar), Powell had also sounded more hawkish in saying, *"We will take the necessary steps to ensure a return to price stability. In particular, if we conclude that it is appropriate to move more aggressively by raising the federal funds rate by more than 25 basis points at a meeting or meetings, we will do so. And if we determine that* ***we need to tighten beyond common measures of neutral and into a more restrictive stance, we will do that as well***.

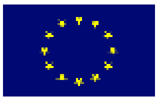
- The Mar FOMC minutes revealed some information on the balance sheet reduction process, including that the monthly cap would likely be set at \$95bn, split at \$60bn and \$35bn respectively between Treasury and mortgage-backed securities and that the caps would be phased in "over a period of three months or modestly longer." The minutes also indicated stronger than expected support for a 50bp hikes at the Mar meeting that was dampened by uncertainty related to the war in Ukraine. The minutes also indicated the expeditious speed at which the participants judged it appropriate to move towards a neutral policy position.

- **Latest Fiscal and External Balance Outlook:** The trade deficit remained unchanged at \$89.2bn in Feb.

- **Key domestic events and issues to watch in May**: ISM Manuf (2 May); Mar Factory orders, durable goods orders (3 & 25 May), NFP (6 May); Trade balance (4 May); FOMC (5 May); FOMC Meeting Minutes (26 May);

CPI (11 May); Retail sales (17 May); PCE deflator (27 May); 1Q GDP (26 May).

- **Technical Outlook:** DXY traded sharply higher after breaking out of its 100-pyschological resistance. Last at 103.53 levels. On weekly chart, bullish momentum intact though RSI is in overbought conditions. On daily chart. Bullish momentum shows tentative signs of slowing while RSI has started to ease lower from overbought conditions. Taken together, weekly, daily price indicators suggest potential moderation in pace of rise. Immediate resistance at 103.80/90 (2017 high) before 105 (cup and handle textbook objective). We still hold to our bias that DXY is closer to peaking soon. Bias to sell rallies. Support at 101, 99.5 (21 DMA).



EUR: On the Defensive

Forecast	2Q 2022	3Q 2022	4Q 2022	1Q 2023
EURUSD	**1.0200** (1.1200)	**1.0500** (1.1250)	**1.0800** (1.1500)	**1.0800** (1.1500)

Previous Forecasts in Parentheses

- **Motivation for the FX View: We expect EUR to be on the defensive** in coming weeks amid a repricing of worsening Ukraine situation (threat of nuclear), rising fears of stagflation scenario and growing ECB-Fed policy divergence (wide at -261bps vs. -246bps as of last FX Monthly). In addition, the recent rapid and sharp decline in CNH (>3.5% vs. USD in a week) as well as extended lockdowns in Shanghai and risk of Beijing following suit further added to woes as external demand looks set to come under pressure. Global economic growth is expected to be dragged lower while broad market sentiment is bruised. The recovery in EUR that we were looking for may need to be pushed back at least until (1) war in Ukraine shows signs of abating; (2) ECB catches up on policy normalisation (i.e. exit NIRP this year); (3) EU growth momentum though may be impacted but not derailed. Before the above positivity materialises, EUR could trade in lower range of 1.04 – 1.09 in coming weeks before drifting higher into 1.09 – 1.14 range into 2H 2022. In light of the above consideration, we revised EUR forecasts lower for remainder of the year.

- **Geopolitics a Drag on EUR.** Russian war in Ukraine has now crossed into the 3rd month and there are signs of further escalation. Russian Foreign Minister Labrov warned about the serious risk of nuclear war and that it cannot be underestimated. Russia is now targeting Donbas region and Southern city of Maruipol. Meanwhile Germany will allow delivery of 50 Gepard anti-aircraft tanks to Ukraine to counter Russia's attack. Earlier Russia also warned that it may put nuke arms in Baltic borders if Finland, Sweden join NATO. Most recently Russia has confirmed that gas deliveries to Poland via Yamal line and Bulgaria will halt, adding to energy crisis in Europe. There is also rising risk that Russia cuts may extend to Germany These are all negatives for EUR. Nonetheless Russia will continue negotiations with Ukraine officials in attempt to reach a peace agreement. A comprehensive deal for ceasefire, withdrawal of troops, neutralisation and demilitarization would turn things around but this can take up to weeks to resolve.

- **Growing Fears of Stagflation but ECB Dismissed Possibility.** German Bundebank warned that German economy may shrink 2% this year if Ukraine tensions escalates and an embargo on Russia coal, oil and gas leads to restrictions on power providers and industry. Protracted military conflict is also worsening global supply chain disruptions and in turn exacerbating inflation woes. The risk of a prolonged rise in energy and food prices could mean even higher price pressures adding constraints to growth, triggering stagflation concerns. Some European companies in industries like fertiliser, steel mill, especially those energy-intensive ones have reportedly cut production due to high input cost. EUR is at risk of being dragged lower given its trade, energy and investment ties with Russia. In 2020, Russia was 5th largest partner for EU exports and imports while EU relies heavily on Russia for energy consumption (41% gas comes from Russia). At one point, Russia even threatened to cut natural gas supplies to Europe (via Nord Stream 1 pipeline) as part of its counter-response to sanctions imposed (though it has not yet made that decision). That said, **ECB officials have played down fears of stagflation in EU**. Lagarde said that "even in the bleakest scenario with second round effects with a boycott of gas and petrol and worsening of war that goes on for a long time, the Euro-area will still manage a 2.3% growth". This is assuming a severe scenario of stricter sanctions on Russia that leads to disruptions in global value chains, higher energy prices due to reduction in supply, a stronger repricing in financing markets and larger second round effects. ECB's base case scenario with CPI at 5.1% could still see GDP growth at 3.7% for 2022. Under a less extreme adverse scenario, the hit to growth and jump in inflation is not as pronounced.

- **Growing Consensus for ECB Rate Hike As Soon As 3Q.** ECB's Lagarde recently struck a more hawkish tone in saying that APP is likely to end in early 3Q and there is a strong chance that rates will be raised this year. We also note that is an incremental shift in ECB members leaning towards normalizing policy faster. For instance, ECB's Kazaks said that a rate rise in Jul is possible and reasonable and that he does not object market pricing for 2 -3 25bps hike by end-2022. He also talks about getting rates to neutral and estimates puts the neutral rate at 1% - 1.5%. ECB's Wunsch also voiced support for rate faster pace of policy normalization. Specifically he said in an interview (21 Apr) that "without any really bad news from from that front, hiking by end-2022 to zero or slightly positive territory would be a no brainer". He also spoke about Jul hike as a scenario to consider as he backs raising rates to zero by this year. Earlier ECB's Knot said he does not rule out 2 interest rate hikes this year should forecasts for already soaring consumer prices shift higher still while ECB's Lane, Vasle and Muller have also earlier backed support for hike this year while Kazimir wants ECB to end negative rates in next 12 months. A shift towards the scenario of ECB catching up on policy normalisation or ending NIRP (negative interest rate regime) may catch markets by surprise and that can help with EUR's recovery. For now, markets-implied are pricing in 80bps hike by end-year and another 50bps hike 1H 2023.

- **Growth and Inflation Outlook: 1Q growth expanded at a much slower pace of 0.2% q/q,** down from 0.3% in 4Q. Breakdown shows Italy contracted (-0.2% q/q) while France (0), Spain (+0.3% q/q) and Germany (+0.2% q/q) disappointed. War in Ukraine, supply chain disruptions weighed on activity and sentiments. Nevertheless looking on, Euro-area prelim PMIs continue to come in firmer for both manufacturing (55.3 vs. 54.9 est.) and services (57.7 vs. 55) in Apr. That said, other surveys are starting to indicate softness ahead. ZEW survey fell to near 2-year low in Apr (-43 vs. -38.7 in Mar), investor confidence also fell (-18 vs. -9 exp) while retail sales also slipped in Feb. We continue keep a close watch on development.

- **Headline CPI surged to another fresh record high of 7.5% y/y in Mar,** up from 5.9% in Jan. The rise was fuelled by sharp increases in the price of energy (+44.7% y/y) and food (+5% y/y) as well as cost of services and manufactured goods. Core inflation rose to another record high of 3% y/y, up from 2.7% in Jan. We retain our view that inflation could still head higher amid worsening supply chain disruptions, higher energy prices amid ongoing war in Ukraine while energy prices remain supported amid geopolitical tensions between US-Russia over Ukraine. Weaker EUR may also have resulted in some imported inflation while the pursuit of climate change goals could also further keep commodity price pressures broadly supported. Overall, we still expect that ECB could be forced to play catch-up in normalizing policies especially if inflation proves to stay elevated for longer. This can be a positive for EUR.

- **Monetary Policy Forecast:** There is no Governing Council meeting scheduled for May. **The next one is on 9th Jun and will be of importance for policy outlook** as guided by ECB officials previously. **This review will contain an update on APP plans - end date and potentially hint/guidance on rate trajectory. We note that the bias of the Governing Council is finally shifting to policy normalization and that a rate hike in 3Q is starting to formalize as a consensus. A rate hike in 3Q is not ruled out.** For the 9th Jun meeting, we expect ECB to maintain deposit rate at -0.5%. For now, markets are pricing in about 2 hikes (of 25bps each) to 0% by end-2022 with the first hike potentially coming at 8th Sep GC. A further 3 hikes (to 0.75%) are now priced in a year's time.

- The last ECB meeting (14 Apr) saw no further steps taken to accelerate policy normalization. Lagarde offered no clues on when exactly (end asap at start of 3Q or later part of 3Q) APP will end as she stuck to prior messaging that APP will end in 3Q and that rate hikes could begin "some time after" APP ends. Some time after refers to between a week and several months - as previously communicated. For now, bond purchases (or APP) is slowing from May to EUR30bn then to EUR20bn in Jun and that APP could end as soon as 3Q. At the press conference, Lagarde said "that policymakers gathering in 8 weeks' time will have to incorporate an "element of judgement" as they assess fresh economic forecasts amid heightened uncertainty caused by the war in Ukraine"… "forward guidance will be determining and helping us determine at the June projection meeting if we decide to terminate net asset purchases, what exactly will be the policy going forward in terms of rates." Of interest, the ECB is also working on a crisis (backstop) tool to deploy against debt market stress caused by exogenous shocks outside individual governments. Basically to counter any excessive rise in bond yields on the euro-zone periphery. There is little details at the momentum and is not known how the tool will look like or if the tool is meant as a contingency tool. Recall back in 2012 in response to market stress, then ECB president Draghi and his staff first came up with a famous pledge to do "whatever it takes" in Jul-2012 and then subsequently launched the Outright Monetary Transaction (OMT) 6 weeks later in Sep-2012 - the potentially unlimited purchase of euro area sovereign bonds on the secondary market by the European Central Bank. This OMT program was never activated but its existence itself was sufficient to stem market turmoil (EU sovereign debt crisis then).

- **Latest Fiscal and External Balance Outlook**: Euro-area current account surplus was EUR21bn in Feb, down from EUR22bn in Jan. Surpluses were recorded for goods (EUR10bn), services (EUR14bn) and primary income (EUR7b These were partly offset by a deficit for secondary income. For 12 months to Jan-2022, EU area current account surplus stood at 2.1% of GDP (vs. 2.4% of GDP in 2020).

- **Key domestic events and issues to watch:** Apr mfg PMI (2 May), Mar PPI, unemployment rate (3 May); Apr services PMI, Mar retail sales (4 May);May Sentix investor confidence (9 May); May ZEW survey (10 May); Mar IP (13 May); Mar IP (13 May); Mar trade (16 May); 1Q prelim GDP (17 May); Apr CPI (18 May); Mar current account (19 May); May prelim PMIs (24 May); May CPI estimates (31 May).

- **Technical Outlook:** EUR traded sharply lower for the month of Apr, breaking below key psychological support levels at 1.10, 1.05. Last at 1.0495 levels. Bearish momentum on weekly chart intact though RSI is at oversold conditions. On daily chart, bearish momentum intact but RSI shows tentative signs of rising from oversold conditions. We look for clearer signs of turnaround. Support at 1.0460, 1.0341 (2017 low) and 1.0073 levels (76.4% fibo retracement of 2000 low to 2008 high). Resistance at 1.0750 (21 DMA), 1.08 and 1.0870 levels

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GBP: Stagflation Proxy Trade

Forecast	2Q 2022	3Q 2022	4Q 2022	1Q 2023
GBPUSD	1.2400 (1.3200)	1.2200 (1.3250)	1.2500 (1.3400)	1.2800 (1.3100)

Previous Forecasts in Parentheses

- **Motivation for the FX View: GBP remains the best proxy trade to express a view on stagflation fears** and we expect the pound to stay on the back foot in the near term amid **further deterioration in global markets and macro dynamics:** (1) While the IMF downgraded global growth for 2022, the UK assessment was more gloomy as economic **growth was projected to "slump to the bottom of the league table of comparable economies in G7"** and "it will also **face the highest inflation**"; (2) protracted war in Ukraine worsening global supply chain disruption, higher energy costs and adding to inflationary pressures; (3) signs of BoE softening its stance on policy tightening as it balances supporting growth and arresting price pressures; (4) sentiment shifts (to risk-off) following extended lockdown in parts of China and rapid depreciation in CNH. In light of recent development, we revised GBP forecasts lower and modestly flatten the trajectory.

- **UK Growth to Lag Peers in 2023 while Debt Burden Rises.** Following World Bank's move to cut global growth to 3.2% for 2022 (down from earlier estimate of 4.1%), IMF lowered global growth to 3.6%, down from 4.4% earlier projection. Growth downgrade was due to Russia invasion and China lockdowns. In particular, **IMF projected UK growth to slow to 1.2% in 2023**, from 3.7% growth projection in 2022 (already a cut from earlier forecast of 4.7%). The sharp downward revision was due to projection for consumption to be weaker than expected as inflation erodes real disposable income, while tighter financial conditions are expected to cool investment. IMF sees UK inflation averaging 7.4% in 2022 and 5.3% in 2023. Earlier Chancellor Sunak also warned that future generations are at risks from UK debt burden. Public debt levels in UK is at the highest since 1960s and rising inflation is pushing up debt interest costs. For instance in Mar alone, interest bill was GBP2.9bn, about GBP1bn higher than a year ago. The total bill for servicing government debt surged 77% to GBP69.9bn.

- **Growing BoE-Fed Policy Divergence Adds to GBP Woes.** There are tentative signs of shifts and tilts in the monetary policy leanings of BoE officials as they shift focus to growth concerns. Governor Bailey noted in a speech at PIIE (21 Apr) that "we are walking a very tight line between tackling inflation and the output effects of real income shock, and the risk that could create a recession". Deputy Governor Broadbent said (30 Mar) that "even when central banks attempt to engage in more standard, conditional statements about future policy, they can be sometimes mistaken for firmer commitments than they really are. Seperately, Governor Bailey also said that that further tightening of policy "might be" appropriate in coming months. The phrase "might be" was used instead of “likely” as seen from previous statement. Subsequently, at a speech in Brussels (28 Mar), he said that “we are facing a very big shock by any historical standard and there is a very high level of uncertainty.. the task we have is clear but its’s hard”. This was a follow-up emphasis from his earlier remarks that BoE had softened its guidance on future rate increases to reflect the high level of economic uncertainty. To make matters worse, the scenario of Fed upping the ante on policy normalization (double tightening of rates and QT) vs. potential slowdown in BoE policy normalization is already seeing a sharp widening of UK-US 10y yield differentials to more than 2y low -95bps. Further widening amid growth BoE-Fed policy divergence can drag GBP lower.

- **Growth and Inflation Outlook: 1Q prelim GDP is scheduled for release on 12 May.** Forward looking surveys and activity indicators are increasingly showing signs of fading momentum. GfK consumer confidence slumped to multi-year low of -38 in Apr, from -31 in Mar; retail sales saw sequential decline to -1.4% m/m in Mar (vs. -0.3%) while momentum in prelim mfg PMI (55.3 vs. 55.2) and services PMI (58.3 vs. 62.6) slows in Apr (though still in expansionary territory). On a positive note, labor market remains tight with unemployment rate falling further to 3.8%, down from 3.9%. UK has cut 2022 GDP forecast to 3.8%, from 6% citing impact of Ukraine war, high global inflation and continuing supply chain pressures. Taking stock, UK economy expanded 1.3% q/q (final print) in 4Q, (up from 1% in preliminary print). Services sector and exports led the expansion.

- **Headline CPI surged to 30-year high of 7% y/y in Mar,** up from 6.2% y/y in Feb. Main drivers of higher prices are still the usual culprits of energy, fuel and food. Raising the cap on household energy bill will dd to inflationary pressure. BoE now expects CPI to peak at 8% in 2Q. We see risks of inflation staying elevated as war in Ukraine continued to result in cost-push inflation, affecting prices of food, energy, fertiliser and industrial metals. These will further add to upward pressure in coming months. Meanwhile core inflation rose to all-time high of 5.7% y/y, up from 5.2% in Feb.

- **Monetary Policy Forecast: We expect BoE to continue with its back-to- back hike of +25bps rate hike at the next MPC on 5th May.** Taking inflation down to its medium term target of 2% is still BoE’s priority but at the same time, BoE Governor seemed to have hint at softening guidance on future rate increases to reflect high level of economic uncertainty as it starts to weigh growth risks. We also noted that some BoE officials also seem to favor raising rate in a “measured” way - (earlier) BoE Chief Economist said that BoE will seek to bring inflation down in a way “that doesn’t disturb the rest of the economy”, BoE Governor Bailey gave a heads-up that inflation could again overshoot BoE’s forecasts but warned that markets should not get carried away about the likely magnitude of hike. For now (as of 27 Apr), markets are still pricing in over 140bps hike up to Dec-2022.

- At the last BoE meeting (17 Mar), the MPC raised policy rate by 25bps to 0.75%, as widely expected. BoE cautioned that inflation looks set to climb to around 8% in 2Q, up from its previous projection of a peak of 7.25%. BoE explained that the spike in inflation means the squeeze on households incomes in the U.K. will be “materially larger” than implied in February. It also warned that the war in Ukraine will exacerbate global supply chain disruptions. The squeeze on incomes will lead to a weaker outlook for growth and raise unemployment. On forward guidance, we noted the slight dovish shift in tone as Governor Bailey said that further tightening of policy “might be” appropriate in coming months. This constitutes to a shift in tone and language from “likely”.

- **Fiscal and External Balance Update:** Public sector net borrowing (PSNB ex) for year ending Mar 2022 was GBP151.8bn (or 6.4% of GDP). This was the third highest financial year borrowing since 1947, but was less than half of the GBP317.6bn borrowing in the same period last year. Public sector budget deficit was 3.8% of GDP for year ended Mar-2022. Public sector net debt, excluding public sector banks, totalled GBP2.34tn or 96.2% of GDP.

- At the spring statement, Chancellor Sunak attempted to address rising costs as a GBP22bn support package for households was unveiled in Mar. Some highlights include: (1) cutting fuel levy by 5p per litre until Mar 2023 – worth about GBP2.4bn; (2) increased threashold at which Britons start paying payrolls tax (a national insurance) by GBP3k instead of the panned GBP300 – this move will help 30mio people; (3) cut basic rate of income tax to 19% in 2024 (down from 20%) – measure worth GBP5bn/ year; (4) double grant to GBP1bn for stuggling Britons amongst others. While it does seem generous, skeptics have it that the support may not be sufficient to help those with lowest incomes while Office for Budget Responsibility said that net tax cuts offset only 1/6 of the tax rises introduced since Sunak becomes Chancellor in 2020.

- 4Q current account deficit narrowd sharply to GBP7.3bn, from GBP24.4bn. Trade deficit shrank as exported rebound sharply. Investment income also rose to GBP4.7bn surplus, for the first time since 2011. As % of GDP, current account deficit was at 1.2% of GDP vs. 3Q of 4.2% of GDP.

- **Key domestic events and issues to watch:** Apr PMI Mfg (3 May); services PMI, BoE MPC (5 May); construction PMI (6 May); Mar industrial production; monthly GDP, construction output, trade, 1Q GDP (12 May); Mar labor market report (17 May); Apr CPI, PPI (18 May); Apr retail sales (20 May); Apr public finances, May prelim PMIs (24 May).

- **Technical Outlook:** GBP consolidated after the >5% decline in Apr below 1.25 at one point. Last seen at 1.2520 levels. Bearish momentum on daily chart intact though there are signs of it fading slowing while RSI shows signs of it rising from oversold conditions. Rebound risks not ruled out. Resistance at 1.2825 levels (50% fibo retracement of 2020 low to 2021 high), 1.3050 levels (50 DMA). Support here at 1.2490 (61.8% fibo), 1.2410 levels..

AUD: RBA Officially Joins the Ranks of Hawks

Forecast	2Q 2022	3Q 2022	4Q 2022	1Q 2023
AUDUSD	0.7350 (0.7400)	0.7450 (0.7500)	0.7450 (0.7500)	0.7500 (0.7600)

Previous Forecasts in Parentheses

- **Motivation for the FX View: We did a slight calibration of the AUD forecast to take into account the downgrade of global growth and China's demand. That said, our forecast reflects headroom for AUD gains from this point (last at 0.7100) as RBA catches up on normalization and inflation combatting. In addition, we cannot rule out potential for gains alongside base metals should China move towards gradual reopening and as Xi Jinping urged for infrastructure construction to offset the lockdown drags on growth in China.**

- **In the past month,** AUD plunged alongside commodity prices on expectations that China's lockdowns will weaken its demand. The breakout of the USDCNY also triggered further sell-off in the AUD towards the 0.71-figure by the end of Apr. That said, we see potential for recovery as China pushes out more construction spending that could raise demand for Australia's base metals. In addition, the escalation of Nato-Russia conflict may be less negative for the AUD compared to other G7 peers should prices of energy spike again, providing some terms-of-trade boost to the antipode.

- Into May, we have the Federal Election that has the potential to dampen AUD sentiment. Based on campaigns thus far, policy propositions have not been very different. The ruling coalition pledged $23.3bn in fiscal spending, far exceeding Labour's pledge of $1.9bn spending for 100 projects. This is despite fiscal deficit projected for $80bn this year and gross debt to reach a record $1.2trn by 2025-26. The opposition labour party blamed PM Scott Morrison's administration for the rising inflation, rising interest rates and falling real wages and pledged to ensure more jobs and to generate stronger real wage growth. The labour party also voiced support for OECD's drive to have multinationals face minimum 15 % tax rate and to limit debt-related deductions.

- **Key risk to AUD could be a hung parliament. According to the poll conducted by Newspoll, coalition's primary vote remained at 36, behind Labour's 37. However, coalition's Scott Morrison's poll ratings advanced ahead of Labor's Anthony Albanese as preferred Prime Minister. Foreign policy are somewhat similar for both parties, especially with regards to China. A clear outcome regardless of party is thus unlikely to have lasting swing on the AUDUSD.**

- **Growth and Inflation Outlook:**

- Innflation environment is becoming less benign. 1Q CPI picked up pace to 5.1%y/y from previous 4.6%. Price pressure was *rather broad-based* with food, alcohol and tobacco, housing, health, transportation and education prices picking up pace in the quarter compared to a year ago. Underlying inflation came in around 3.5%y/y vs. previous 2.65%. The stronger-than-expected print underpin calls for an even earlier hike in May with OIS implying a 15bps rate increase for next week.

- Strong inflationary pressure could be starting to hurt consumption as the Westpac consumer confidence softened by another 0.9%m/m to 95.8 vs. previous 96.6.
- NAB business conditions jumped to 18 in Mar from 9 previously while business confidence also improved to a score of 16 from 13. Manufacturing Stong business conditions on the back of benign trading environment (positive terms of trade for exporters) that boosted profitability and the return of tourists likely supporting retail sector. Eyes on whether elevated fuel prices may start to narrow margin and hurt demand.
- The value home loans fell -3.7%m/m in Feb vs. 2.5% in the month prior, underscoring signs of softening housing market as RBA is set to raise cash target rate soon. Owner-occupier loan value fell more by -4.7%m/m vs. previous 0.8%. Investor loan value fell a milder -1.8%. That said, this set of data could also still be affected by the Omicron wave.
- On the labour market, hiring intention seems to have eased. Unemployment rose to 5.2% from previous 4.9%. Net employment was up +17.9K vs. previous 77.4K. Participation rate steadied at 66.4%. Eyes are on whether the open borders, work-related migration could start to have any dampening effect on wage growth.
- **Monetary Policy Forecast:** RBA kicked off its own hiking cycle yesterday by raising its cash target rate by a respectable 25bps to 0.35%, a tad more than the token 15bps hike expected of the central bank. Interest on Exchange Settlement was also raised 25bps and RBA's balance sheet is allowed to shrink. The decisions were accompanied by a hawkish speech by Governor Lowe who saw evidence of labour costs rising and broadening price pressure.
- Any upside surprise ot the 1Q wage price index on 18 May could force RBA to step up pace of tightening. There is also a minimum wage review to be announced in mid-June and the Australian Council of Trade Unions had recently urged for a 5% increase for the minimum wage vs. 2.5% last year. We look for RBA to take cash target rate up by another 40bps in June to 0.75%.
- **Latest External Balance Outlook:** As of last available data, current account surplus was recorded at 3.55% of GDP for 4Q 2021, narrowing from the previous 3.8%. Trade surplus was last at A$7.5bn for Feb, still maintaining a strong support for the AUD. Since the invasion of Ukraine, Australia has been enjoying a terms-of trade boost and that could continue to underpin the AUD.
- **Fiscal Outlook:** The 2022-23 federal budget was presented with a focus on helping Australians with the rising cost of living. Key highlights of the budget include a 50% reduction to fuel excise for the next six months, one-off $250 "cost of living payment" for six million Australians, separate one-off $420 tax offset for low- and middle income earners from 1 Jul as well as tax-deductions for SMEs for employee training and digital technology expenses. Fiscal deficits

narrowed to A$78bn for FY2023 or 3.4% of GDP from expected A$79.8bn for FY2022. Real GDP is forecast to soften from 4.25% for FY2022 to 3.5% for FY2023 and then to 2.5% in each of the following three years. Unemployment rate to fall to 3.75% in the 3Q of 2023 and should remain thereabouts to FY2025. Key commodity prices to fall from current elevated levels by the end of 3Q. CPI is expected to rise 4.25% for FY2022 before easing to 3% FY2023. Wage price index to rise 2.75% in Fy2022 and then to 3.25% for FY2023-2024. Eyes on the Federal Election on 21 May as the two campaigning parties compete and match each other in fiscal plans with the coalition proposing increasingly large spending which could worsen Australia's fiscal position.

- **Key domestic events and issues to watch:** Mfg PMI (Apr), CoreLogic House Price (Apr), M-I inflation (Apr) on 2 May; RBA cash rate on 3 May; retail sales (Mar), home loans, investor loan, owner-occupier loan on 4 May; trade and building approvals (Mar) on 5 May; foreign reserves (Apr) on 6 May; CBA household spending (Apr) on 10 May; NAB business conditions, confidence (Apr) on 10 May; Westpac consumer confidence (May) on 11 May; Minutes of the RBA meeting on 17 May; Westpac leading index (Apr), 1Q Wage price index on 18 May; labour report (Apr) on 19 May; S&P PMI Mfg (prelim. May) on 24 May; construction workd down (1Q) on 25 May; private capital expenditure (1Q) on 26 May; retail sales (Apr) on 27 May; BoP current account balance (1Q) on 31 May, building approvals (Apr) on 31 May.

- **Technical Analysis:** AUDUSD looks poised to have reached an interim trough. Bearish momentum is fading and stochastics show tentative signs of turning higher. AUDUSD could stage a rebound towards 0.7180 (first resistance) before the next at 0.7280 (200,100,21-dma). Support at 0.7030, 0.6970.

NZD: External Drivers a Drag

Forecast	2Q 2022	3Q 2022	4Q 2022	1Q 2023
NZDUSD	**0.6400** (0.7000)	**0.6600** (0.7100)	**0.6700** (0.7100)	**0.6800** (0.7100)

Previous Forecasts in Parentheses

- **Motivation for the FX View: The emergence of downside risk factors such as rapid depreciation in CNH, extended lockdown in China amid covid spread hitting demand, worries of global growth slowdown, fears of aggressive Fed double tightening and signs of escalation in geopolitical tensions made the case for NZD forecasts to be lowered sharply (from our prior forecasts) in 2Q, 3Q 2022.** That said we still maintain a mild upward trajectory profile for NZD into 2023 on the back of continued rise in commodity prices (in particular soft/agri commod such as food, dairy), NZ economy reopening and still-hawkish RBNZ.

- **Rapid Depreciation in CNH Unnerves Sentiments, Weigh on NZD.** Recent weakening in CNH by >3.5% (vs. USD in a week) was due to a myriad of factors: (1) extension of lockdowns in Shanghai while at the same time, there were chatters of lockdown in parts of Beijing as China stuck to dynamic zero covid strategy; (2) fears of China hard landing; (3) narrowing in UST-CGB yield differential, which even turned into a premium. Currencies that closely correlate with CNH moves such as NZD, MYR, AUD came under pressure. Question here remains whether USDCNY will repeat the 15% move higher seen in 2015 (due to one-off devaluation and change in fixing methodology) as well as the 2017-2018 US-China trade war. Further rapid and sharp weakening in CNH will further undermine NZD (via trade, sentiments channels).

- **Reopening/Tourism Can Support Growth Momentum.** NZ is preparing to ease border measures much earlier than expected as Omicron situation shows signs of improvement. Phased reopening has been brought forward from Oct-2022 with Australians are already allowed to enter the country without needing to quarantine or isolate from 13 Apr and to open fully to visa-waiver countries from 1 May, including US, UK, Japan, Singapore, Taiwan and others. While economic momentum may be temporaily affected in 1Q, we expect a a decent rebound in 2Q. But looking out, we acknowledge there are increasing downside risks to growth, especially with the war in Ukraine persisting. That can pose downward pressure on NZD at some point when more data comes on stream.

- **Another 50bps Hike in May Likely as Inflation Runs Hot.** Price pressures continue to run red hot on multiple fronts from wages to food, dairy and petrol prices. 1Q CPI rose at its fastest pace in >30years while RBNZ is also projecting headline CPI to peak at 7% in 1H 2022. This justified RBNZ guiding for a faster pace of monetary policy normalization: (1) a 50bps hike that was brought forward in Apr while another 3*50bps hike is expected for next 3 MPCs in May, Jul and Aug. As of 28 Apr, OIS-implied is looking for another 210bps increase in rates to bring OCR to 3.6% by end-2022; (2) Quantitative tightening will commence in Jul with a sell-down in QE holdings at pace of NZ$5bn per year and RBNZ will not reinvest proceeds of expired debt. On policy divergence play, NZD may still gain the upper hand over its DM peers though a hawkish Fed (now pricing in about +230bps hike for remainder of year) turning more hawkish can further narrow NZD’s yield advantage and weigh on NZD.

- **Downside Risks to NZD Outlook.** Though some of the downside risks we highlighted earlier came into fruition (and hence the sharp decline in NZD), we believe it is worth flagging them again as these factors may intensify: (1) War in Ukraine futher escalates into biochemical/ broaden to involve more countries or last longer may hamper global economic momentum and that will have negative spillover effects on NZ. (2) further slowdown in China growth (hard landing risks), or further weakening in CNH can also weigh on NZD, given its high sensitivity to global growth and China. (3) RBNZ fails to live up to hawkish guidance will be a drag on NZD (unwinding risk); (4) Much faster shifts in Fed’s pace of policy tightening will weigh on sentiment and narrow NZD’s yield advantage.

- **Growth and Inflation Outlook: 1Q GDP is scheduled for release on 16 Jun.** 1Q economic activity may have moderated amid Omicron variant spread then and subsequent tightening of measures. While consumer confidence did fell further to 77.9 in Mar, down from 81.7 in Feb, other indicators painted a less bleak sceneraio with activity outlook rebounded 3.3 for Mar (vs. -2.2), Manufacturing PMI also ticked higher to 53.8 in Msr (up from 53.6 prior) while services PMI swung into positive expansionary territory of 51.6 (up fro, 48.9). At the Apr policy meeting, RBNZ said that *heightened global economic uncertainty and inflation are dampening consumer confidence. The rise in mortgage interest rates – amongst other factors – have acted to reduce mortgage demand and house prices. However, economic capacity pressures remain, with a broad range of indicators highlighting domestic capacity constraints and ongoing inflation pressures. Employment is above its maximum sustainable level and labour shortages are impacting many businesses.* Taking stock, NZ economy expanded +3% q/q in 4Q, up from -3.6% in 3Q. Rebound was led by services and goods producing industries, including manufacturing output (+6.5%), construction gain (+8.7%) while primary sector output fell.

- **1Q CPI surged 6.9% y/y in 1Q**, up from 5.9% in 4Q. This is the fastest pace of rise since 1990. . Gasoline priced led gains (+8.8% y/y) This is the 4th quarter in a row that headline CPI breached above RBNZ's 1% - 3 target band. RBNZ now expected headline CPI to peak at around 7% in 1H 2022. We expect price pressure to stay supported given supply chain disruption and higher commodity prices amid protracted war in Ukraine.

- **Monetary Policy Forecast:** We expect RBNZ to maintain the tempo in raising rate by 50bps to bring OCR to 2% bat the next MPC on 25 May. Immediate focus of RBNZ is to ensure that current high CPI (1Q qt 32y high of 6.9%) does not become embedded into longer-term inflation expectations. Markets' implied now sees another 50bps hike fully priced for upcoming MPC while another 2 more hikes of 50bps were fully priced as of 28 Apr) for Jul, Aug MPCs. All in, markets are looking for another 210bps hike to bring OCR to 3.6% by end-year. There are 5 more MPCs remaining for this year.

- The last MPC (13 Apr) saw RBNZ raise rates by larger than usual magnitude of 50bps to bring OCR to 1.5%. Accompanying statement noted that "underlying strength remains in the economy, supported by sound balance sheets, continued fiscal support, and strong export earnings." On inflation, MPC acknowledged that the "risk of more persistent high inflation expectations has increased." MPC also agreed that their policy 'path of least regret' is to increase the OCR by more now, rather than later, to head off rising inflation expectations and minimise any unnecessary volatility in output, interest rates, and the exchange rate in the future. MPC agreed that moving the OCR to a more neutral stance sooner will reduce the risks of rising inflation expectations. A larger move now also provides more policy flexibility ahead in light of the highly uncertain global economic environment. All in, members agreed that 'stitch in time' approach is consistent with near-term financial market pricing. Elsewhere it was earlier announced that quantitative tightening will commence in Jul with a sell-down in QE holdings at pace of NZ$5bn per year and will not reinvest proceeds of expired debt. Recall that RBNZ bought a total of NZ$55bn of government bonds under its QE program over 2020-21 due to pandemic.

- **External Balance and Fiscal Outlook: NZ posted record annual current account deficit of $20bn.** Imports more than overwhelmed exports in 4Q. YTD current account deficit stood at -5.8% of GDP. Quarterly current account deficit surged to $6.5b in 4Q, up from $4.7b the previous quarter.

- **NZ government expects budget deficit to return to surplus by the fiscal year ending June 2024 (FY24),** according to its Half Year Economic and Fiscal Update. This is 2 years ahead of previous forecasts due to significantly stronger tax revenue than forecast in its mid-2021 budget. Net debt will be higher at 37.6% of GDP in 2021/22 compared to 34.0% forecasted in May. The net debt peaks at 40.1% by 2022/23 before falling to 30.2% by the end of the forecast period.

- **Key domestic events and issues to watch:** 1Q labor market report (4 May) Apr food prices (12 May); mfg PMI (13 May); services PMI (16 May); 1Q PPI (19 May); Apr trade (20 May); 1Q retail sales (24 May); RBNZ MPC (25 May); May consumer confidence (27 May); May activity, business confidence (31 May)..

- **Technical Outlook:** Kiwi fell sharply in Apr. Last seen at 0.6431 levels. Bearish momentum on weekly chart intact while RSI in near oversold conditions. On daily chart, momentum and RSI are still bearish bias for now. Risks remain skewed to the downside. Support at 0.64, 0.6230 (61.8% fibo retracement of 2020 low to 2021 high). Resistance at 0.6470 (50% fibo), 0.6530 and 0.67 (38.2% fibo, 21 DMA).

CAD: Propped Up By Hawkish BoC

Forecast	2Q 2022	3Q 2022	4Q 2022	1Q 2023
USDCAD	**1.2600** (1.2400)	**1.2500** (1.23004)	**1.2400** (1.2300)	**1.2400** (1.2200)

Previous Forecasts in Parentheses

- **Motivation for the FX View:** We shifted our USDCAD forecast to 1.26 for 2Q. Pair had surged above the 1.28-figure on softer crude oil prices well as the combination of hawkish Fed and weakened EUR (Russia-EU conflict) that fed into USD strength. That said, CAD is still considered one of the most resilient amongst non-USD peers due to BoC's hawkish stance and our forecasts still reflect a constructive view of the CAD, barring an escalation of conflict between the Nato and Russia. Strong economic performance (manufacturing PMI, rising home prices, trade surplus, upside surprise to Feb retail sales) and strong Mar labour report have well justified the first hike to be 50bps.

- OIS now implies 50bps rate increase each for the 1 Jun and 13-Jul meeting. Macklem even mentioned a possibility of a 75bps hike as he warned that monetary policy needs to be normalized "reasonably quickly" and in a more recent address to the Senate committee, spoke about the possibility that neutral rate would rise gradually. That should leave CAD as one of the best currencies to withstand aggressive Fed tightening given limited policy divergence.

- **Longer term, expect broadening growth, climate change transformation to also be structural factors for oil prices to stay supported in the medium term.** As broadening growth recovery underpin flight and freight demands, fuel consumption could also rise and keep crude oil prices and concomitantly, the CAD supported. Even as more nations pledge net zero carbon emission, infrastructure needs for energy transformation would also require fossil fuel in the interim. CAD is thus likely to benefit from structural shifts and oil prices should remain broadly benign for the currency.
- **Growth and Inflation Outlook:** Mar CPI came in at 6.7%y/y vs. expected 6.1% (5.7% prior). Core inflation rose from a revised 3.5%y/y to 3.7% for Mar. Breakdown suggests that the increase in price pressure has broadened with most subcomponents (food, shelter, household, transportation, healthcare, personal car, recreation) seeing yoy rise. Unlike the US that sees potentially peak in CPI, this does not seem to be the case for Canada and strengthens the case for BoC to make another 50bps rate increase at the next meeting.
- Retail sales slowed less than expected to 0.1%m/m in Feb vs. previous 3.3% (revised higher). Estimates were looking for a small decline of -0.5%m/m. Ex-auto, retail sales softened to 2.1%m/m vs. previous 2.9%. Mmore recently, estimates of retail sales for Mar suggest a strong rebound by around 1.4% according to Statistics Canada, a sign of a post-Omicron rebound.
- With regards to the labour market, Canada added a net 72.5K of jobs in Mar with strong full-time hire of net 92.7k jobs far exceeding the -20.3k drop in part-time employment. Jobless rate fell further to 5.3% from 5.5%, below median estimate of 5.4%. Hourly wage rate picked up pace to 3.7%y/y from previous 3.3%, underscoring tight labour market.
- **Monetary Policy Forecast:** BoC raise policy rate by 50bps to 1.00% on 13 Apr. Governor Macklem assured that BoC would normalize monetary policy "relatively quickly" to "prevent inflation expectations from hardening". Officials flagged rates to return to estimated neutral range of 2-3% to cool inflation. CPI projection was lifted significantly, expected average almost 6% in 1H2022 and to remain well above targeted 1-3% range throughout 2022 before easing to around 2.5% by 2H 2023 and 2% in 2024.The housing market and the economy should be able to withstand new rates.
- Thereafter, BoC Macklem referred to the "50bps hike" as an unusual move and that a 75bps hike could also be an option as the central bank combats inflation. OIS now implies 50bps rate increase each for the 1 Jun and 13-Jul meeting. That should leave CAD as one of the best currencies to withstand aggressive Fed tightening given limited policy divergence.
- Given broadening price pressure and strong domestic demand, BoC has shown quite strong commitment to counter inflation. Notably, retail sales had fallen in volume in Feb, underscoring some demand

destruction from rising prices. We anticipate a 50bps rate hike from the BoC in June. OIS implied suggest that markets have priced in almost 200bps hike over the next five meetings.

- **Latest External Balance Outlook:** As of last available data, Canada's current account balance was at a surplus of C$1.2 for 4Q, an improvement from the previous -U$1.6bn deficit. Firm commodity prices continue to bode well for Canada's external balances.
- In terms of the fiscal, defict for FY2021/22 came in at C$114bn , better than projected C$145bn seen in Dec. Finance Minister Chrystia Freeland's budget delivered on 8 Apr was mostly focused on fiscal consolidation and prudence. She gave a projection of $31mn in net new spending over the next five years that pales in comparison to allocations in previous budgets. The budget was focused on innovation and productivity Canada Growth Fund which is a $15bn investment vehicle to incentivize businesses to embrace change and adapt to changing usiness landscape. Looking into the medium term, fiscal deficit is projected to narrow to C$8.4bn by 2026. Debt to GDP ratio to fall to 41.5% by 2026 from 46.5% this year.
- **Key domestic events and issues to watch:** Mfg PMI (Apr) on 2 May; trade (Mar) on 4 May; labour report (Apr) on 6 May; building permits (Mar) on 9 May; existing home sales (Apr) on 13 May; housing starts, manufacturing sales, wholesale trade sales (Mar) on 16 May; CPI (Apr) on 18 May; industrial product price (Apr) on 19 May; CFIB business barometer (May) and retail sales (Mar) on 26 May; GDP (1Q, Mar) on 31 May.
- **Technical Analaysis:** USDCAD has reached the upper bound of the well-established 1.24-1.29 range. Pair could be poised for a pullback given stretched conditions and waning bullish momentum. Resistance at recent high of 1.2914 while support is seen at 1.2790, 1.2720 and 1.2660.

JPY: Stubbornly Dovish BoJ Boosts USDJPY

Forecast	2Q 2022	3Q 2022	4Q 2022	1Q 2023
USDJPY	**135** (120)	**130** (120)	**125** (118)	**123** (117)

Previous Forecasts in Parentheses

- **Motivation for the FX View:** USDJPY's exponential surge continued in Apr. While a turn lower in US treasury yields at one point appeared to dampen the pair's upward momentum, up-moves resumed as broad dollar rally persisted amid escalation in global uncertainties, and BoJ stuck to a stubbornly dovish stance in the face of hawkish moves by other major central banks, reiterating that a weaker JPY is positive for the Japanese economy. **On net, while we could see more two-way swings in UST-JGB differentials (vs. quick pace of widening earlier)**

in the months ahead, broader dollar demand on escalating global uncertainties (Russia-Ukraine war, turmoil in energy markets as Europe weans itself off Russian supply, drags on China growth from Covid lockdowns) can still lead USDJPY to see upward pressures near-term. As we head into 2H though, global price pressures could still moderate as energy inventories rebuild and supply chain disruptions ease. If growth drags materialize more discernibly, major central banks' policy focus could also start to shift away from combating inflation towards supporting growth or engineering soft landing. Conditional on UST yields easing off alongside, USDJPY could see a gradual retracement lower later in the year. **Our USDJPY projections above should not be taken as point forecasts, but rather, reflect risks that USDJPY pair could be prone to overshooting higher near-term amid heightened global uncertainties before averaging lower in 2H.**

- **Haven demand for JPY on Ukraine crisis was much more limited than expected, relative to dollar.** Russia-Ukraine tensions had escalated quickly in Feb-Apr, and expected drags on global growth from the conflict also broadened over time, with Europe and Russia trading blows in terms of sanctions, energy trade restrictions. **In current episode of market turmoil, USD seems to be the preferred haven of choice amid periods of heightened market volatility.** FRA-OIS spread has begun heading higher again in Apr (despite coming off from Mar highs), indicating continued stresses in dollar money markets. From a trade balance perspective, US also seems to be benefitting from substitution in European demand for energy products.

- **Apart from buoyant dollar demand, Fed stance and UST-JGB yield differentials are also likely to remain as key drivers of the USDJPY pair too.** In Mar, FoMC voted 8-1 to raise rate to 0.25% - 0.5%. Dot plot signalled another 6 more hikes this year (vs. their previous projection for 3 hikes). **But since then, rhetoric from Fed officials have turned increasingly hawkish.** As of writing, OIS-implied shows further front-loading of rate hikes with 50bps hike priced for next 3 FoMCs (in May, Jun and Jul), up from 2 FoMCs previously. For the rest of the year, Fed fund futures are expecting another ~250bps rate increase (equivalent of 9 – 10 hikes of 25bps each). This is in sharp contrast to BoJ's dovish stance, with authorities standing pat in the policy meeting on 28 Apr and **signaling commitment to ultra-dovish policy via pledging to buy 10Y JGBs at 0.25% every business day in fixed rate operations with no upper limit if needed.**

- But while UST yields could remain in elevated ranges near-term, certain combinations of developments going forward could still see them easing off potential 2Q highs. As (i) growth drags emerge more discernibly and (ii) inflation readings gradually edge lower in 2H, Fed policy focus could start to shift away from combating inflation towards supporting growth or engineering soft landing. **Taken together, the rise in UST yields may start to moderate in 2H while steepening of UST yield curve could also start to taper, providing an opportunity for USDJPY to ease off lower.**

- Still, the prospect of a quicker normalization in US interest rates, while the BoJ remains committed to an easing stance, could help sustain relative demand for overseas investments (e.g., US treasuries). Demand from pension funds such as GPIF as well as private sector entities could be in play. **Such outflows could temper the extent of support that the JPY receives from an expected current account surplus**—consensus estimates see current account coming in at 2.0% of GDP in 2022 (versus 2.8% in 2021). **This could mean that USDJPY could remain in elevated ranges for some time versus pre-Covid range of 105 to 115.**

- Admittedly, over the course of the last few months, Japan's energy importer status also likely meant drags on JPY on higher import costs amid elevated commodity prices. On energy outlook, even as interim supply disruption fears are keeping brent prices above the US$100-handle, extent of oil price gains could be constrained going forward given (i) mounting concerns over softening global aggregate demand, (ii) signs of interest in Russian oil from parts of Asia, including China, India and Indonesia, (iii) planned ramp-ups in OPEC+ supplies over time, and (iv) planned release of strategic reserves over the next several months from US and allies. **This could translate to some moderation in global price pressures in 2H, conditional on pandemic-induced supply-side constraints starting to ease as well.**

- **Growth and Inflation Outlook:** 4Q (F) GDP came in at 4.6% q/q SAAR, seeing a turnaround from -2.8% prior. Private consumption growth came in at 2.4%q/q, slightly worse than expected 2.7%. Business spending expanded at 0.3%q/q, also lower than expected 0.8%.

- Latest macro indicators point to more mixed domestic growth momentum. PMI Mfg for Apr (P) came in at 53.4 versus 54.1 prior. Services activity also remains cautious at 50.5, albeit improving from 49.4 prior. 1Q Tankan surveys suggest outlook sentiments deteriorating a tad versus prior. Reading for 1Q large Mfg outlook dipped to 9 from 13 prior, while that for large non-Mfg outlook slipped to 7 from 9 prior. BoJ projections also seem to imply modest drags from deteriorating global growth outlook. **FY2022 growth was lowered to 2.9% from 3.8% (Jan projection).**

- Mar CPI came in at 1.2%y/y, on par with expectations. The indicator ex fresh food came in at 0.8%, on par with expectations. Base effects, a weaker JPY and ongoing supply disruptions may still skew headline CPI higher in the coming months, possibly to around 2%, but BoJ views these developments as transitory. The current cost-push inflation cannot be sustained as the impact of energy prices will ease, while wages have yet to rise sustainably. **BoJ sees FY 2022 CPI (all items less fresh food) at 1.9% (versus 1.1% forecast in Jan), before easing off to 1.1% in FY2023.**

- **Monetary Policy Forecast:** BoJ left interest rates and asset purchases unchanged in its 28 Apr meeting, as expected, but **surprised markets with a promise to buy unlimited amount of JGBs at fixed rates every business day if needed to maintain the 0.25% ceiling for JGB10Y yield**. The central bank views cost-push inflationary pressures as being transitory, and ultra-dovish policy being needed to support growth. **There was also no change in Kuroda's stance that a weak yen was positive overall for the Japanese economy, even as he noted downsides of "excessive moves" in the currencies for companies.**

- As an aside, we note that Yellen's meeting with FM Suzuki earlier had led to market chatters on possibility of coordinated FX intervention to prop up the JPY, but likelihood remains low when US is trying to fend off inflationary pressures. The 28 Apr BoJ policy announcement likely also unraveled bets that BoJ could sound a tad more cautious on forward-looking policy, e.g., some hints for potential YCC yield adjustments later in 2023 if inflation conditions and continued weak JPY warrant a reconsideration of the current framework. This "doubling" down on BoJ's dovish commitment could continue to help boost the USDJPY pair near-term.

- **At some point though, if persistent rallies in USDJPY are seen for the rest of the quarter (towards 135-140 range), we do not rule out more discernible signs of intervention from BoJ or the finance ministry**. For instance, upswing above 131 on 28 Apr was resisted as MoF came out strongly to say that it would respond "appropriately" to abrupt moves. Japan's energy importers are warning that recent fall in JPY is exacerbating a surge in fuel costs, and may weigh on their margins while raising prices for consumers. If the perceived harm to the economy from falling JPY becomes larger, MoF may be forced to act.

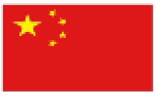
- **Latest Fiscal & External Balance Outlook:** In Feb 2022, **a parliamentary committee approved a record JPY107.6trn (US$936bn) spending plan for FY2022 (starting Apr)**. Kishida has vowed seamless spending for 16 months (beginning with supplementary budget mentioned above) to provide sufficient support to lift the economy from Covid-induced doldrums. Consensus forecasts see the fiscal deficit coming in at around -6.5% of GDP in 2022, on par with the -6.4% seen in 2021, and still wider than the -3.2% average seen in 2015-2019 (pre-Covid).

- **To counter the impact of rising energy costs on the domestic economy, PM Kishida is rolling out a combined JPY6.2trn emergency economic package**. The key features of the package include cash handouts of JPY50k per child for low-income households, more subsidies for oil wholesalers to reduce retail gasoline costs, and support for SMEs and livestock farmers. The package aims to prevent rising raw material costs from adding to supply-chain bottlenecks as the domestic economy attempt to recover from Covid drags. To finance the new spending, the government will tap JPY1.5trn from reserve funds allocated for emergency spending in the current FY beginning Apr, around JPY2trn secured in the FY2022 budget and other sources, as well as JPY2.7trn from an extra budget to be compiled later.

- Current account for Feb came in at a surplus of JPY1648bn, seeing a turnaround from the deficit of -JPY119bn prior. But subsequent trade balance for March saw a downside surprise (deficit of -JPY412.4bn versus expected -JPY71.5bn), likely partly on account of higher energy bills. Exports growth moderated to 14.7%y/y from 19.1% prior while imports growth remained robust near 31.2% (prior at 34.1%). We note that the trade balance has seen deficit readings from Aug 2021 to Mar 2022, versus average surplus outturns in the first 7 months of 2021. **Such developments could weigh on the JPY in the interim**.

- **Key domestic events and issues to watch:** Apr Vehicle sales (2 May); Mar Labor cash earnings (9 May); Mar (P) Leading Index CI (11 May); Mar Current Account (12 May); Apr (P) Machine tool orders (16 May); 1Q (P) GDP (18 May); Apr Trade (19 May); Mar Core machine orders (19 May); Apr CPI (20 May); May (P) Jibun Bank PMIs (24 May); Apr Jobless rate (31 May); Apr (P) Industrial production (31 May); Apr Retail sales (31 May).

- **Technical Outlook:** USDJPY pair was last seen slightly above 130. On weekly chart, RSI is in overbought territory, while momentum in pair is modestly bullish. Risks of up-moves still intact, with key resistance some way off at 135.15 (2002 high). We note signs of bearish divergence (bearish signal) forming on the daily chart, although the last such pattern in mid-Apr only led to a very short period of USDJPY down-move before upswings resumed. Dollar and UST yield developments could continue to overwhelm TA nuances in terms of impact on USDJPY under current volatile market conditions. Support at 127.40 (21-DMA), 124.50 (23.6% fibo retracement from Jan low to Apr high). As USDJPY shifts to higher ranges, there could be less points of psychological support and resistances and magnitude of interim swings could be amplified.



RMB: Self-Inflicted Weakness

Forecast	2Q 2022	3Q 2022	4Q 2022	1Q 2023
USDCNY	**6.85** (6.35)	**6.80** (6.33)	**6.74** (6.32)	**6.70** **(6.30)**
USDCNH	**6.86** (6.35)	**6.81** (6.33)	**6.75** (6.32)	**6.70** **(6.30)**

Previous Forecasts in Parentheses

- **Motivation for the FX View:** We revised our USDCNY forecasts and expect the pair to end the year around 6.75. Our assumptions are for growth to bottom out in 2Q and bulk of major lockdowns to be within the quarter.

- *Recap:* USDCNY broke out of the 6.30-6.40 range after weeks of Shanghai closure followed by a mixed set of economic data for Mar that included rise in unemployment rate and retail sales decline for Mar. Apr's data could be ugly and the recent yuan weakness could be in anticipation of that (and more) as the President adheres firmly to zero-Covid management as well as the US-CH yield discount that flipped into premium. Sorely needed monetary policy action has disappointed with the smallest 25bps RRR cut ever provided by the PBoC (announced on 15 Apr, to take effect on 25 Apr). This not only indicate central bank's preference for prudence in easing but also underscores limited room for further action. As a result, banks held their loan prime rates unchanged for the third consecutive month.

- To be clear, this leg of CNY weakness came with the blessings from the central bank (albeit not to the extent of yuan weakness engineering). USDCNY central parity was fixed 101pips above the median estimates on 20 Apr after a volatile overnight session. The higher fix gave USDCNY headroom as well as policy greenlight for a breakout of the long-held 6.30-6.40 range. With capital outflows already seen in the first quarter, private consumption severely impaired by lockdowns, China's engines of growth seem to be left with infrastructure construction and export-oriented manufacturing sector which needs to be kept humming as the external demand pie is shrunk by war. Allowing yuan to depreciate could help in that aspect.

- In our past FX monthlys, we had pencilled in a few key risks to our forecast including *a lack of recovery in the housing market that can precipitate into an economic hard landing or a credit crisis - With the Chinese authorities so unwilling to let go of dynamic zero-Covid policy and the three red lines for property developers, there is a chance that growth recovery could be slower than desired and PBoC is forced to ease monetary policy more aggressively. An absence of inflation at home and a runaway inflation in the US could even force Fed to be more aggressive in tightening. <u>That could drastically narrow (or even invert) the US-CH yield differentials and at that point, fears of hard landing could dampen CNY sentiments further and spur the currency into a more dramatic tailspin.</u>* To some extent, these risks were realized and that certainly warrant a change in forecast.

- **Question here** remains on whether USDCNY will repeat the 15% move up seen in 2015 (one-off devaluation and change in fixing methodology) as well as the 2017-2018 trade war. Both are arguably exogenous factors that drove the yuan decline. In the near-term, there could be more lockdowns such as the freshly-imposed one on Yiwu while Hangzhou and Guangzhou start mass testing. In Shanghai, authorities has allowed 12mn residents to leave their homes (albeit still confined to respective compounds). The authorities now allows "limited freedom" for areas with no community spread in the past. Such stringent measure could mean that China is still susceptible to more areas of lockdown and that could mean lingering downside risks to the CNY from this point even as substantial catch-up in weakness vs. peers is done. But as with most countries, the wave of Omicron typically last for 1-3 months, we look for bulk of lockdowns to be within 2Q, concomitant economic damage to be contained within this period as well.

- On 29 Apr, the Politburo finally followed up with Vice Premier Liu He's pledge of support with specific targets that the authorities will render support to, including (1) the promote of healthy group for platform companies, (2) strengthen macro policy adjustment, (3) boosting domestic consumption and (4) to support stable, healthy development of property market. The emphasis on macro supports and economic targets suggest that they have not entirely abandon economic targets including GDP target of 5.5%. This came right after NHC's warnings the China will not pivot away from zero-covid.

- Politburo's assurance triggered substantial unwinding of the long USDCNY positions. The sharp USDCNH and USDNCY decline could also be due to the fact that market players did not want too much exposure ahead of a long weekend for most of Asia. Regardless, the timing of the Politburo readout for Apr certainly provide a breather for USDCNY bulls just before the Golden Week holiday.

- **Taken together, CNY could remain sensitive to news of lockdowns in the near term as China sticks to zero-Covid. The path of least resistance could remain to the downside as China sticks to targeted policy supports and there is little moderation of restrictive Covid measures. That being said, just as zero-covid strategy is likely to be moderated only very gradually, officials may also prefer to step up on more growth supports from here on and that could keep a check on aggressive CNY declines.**

- **Growth and Inflation Outlook:** Non-mfg PMI sank more than expected to 41.9 for Apr from previous 48.4, underscoring the impact on services sector from the lockdowns. Mfg PMI deteriorated a tad to 47.4 from previous 49.5. The extent of deterioration in the Caixin print was similar – at 46.0 vs. previous 48.1. While GDP target for 2022 is set around 5.5%, the recent slew of lockdowns especially in Shanghai and possibly in Beijing alongside other areas could mean greater challenge in meeting the full year target. In fact, for a while, President Xi seemed to have prioritized zero-Covid strategy over economic growth with *a vow on 13 Apr that China needs to adhere to "Covid Zero" even as "economic costs mount".* This could suggest that the Chinese authorities Growth outlooks are downgraded to 4.4% by our economists.

- China 1Q GDP came in well above expectations at 4.8%y/y for 1Q vs. previous 4.0%. Mar IP also surpassed expectations at 5.0%y/y vs. median estimates at 4.0%. Given that the Shanghai lockdown only took effect from 28 Mar, impact of the restrictions may be more fully captured in the Apr print. FAI ex rural softened to 9.4%y/y (Jan-Mar) from12.2% (Jan-Feb) while retail sales contracted -3.5%y/y. The upside surprises provide some justification for PBoC to lower RRR by 25bps (smaller than mkt exp) and additional 25bps for smaller banks with reserve ratio still above 5% to unleash CNY530bn as stimulus. Given China's lockdown remain a key drag on growth, local authorities had asked major firms in automobiles, semiconductors and biomedicines to submit plans to safeguard against Covid spreads in order to get the greenlight for production to restart. However, restrictions to combat Covid infections have been imposed on other cities such as Suzhou, Zhengzhou.

- Meanwhile, China's Mar trade data suggest that exports performance were not yet affected by the lockdown. Trade surplus was surprisingly strong $47.4bn with exports up 14.7%y/y compared to 6.2%. Imports fell unexpectedly -0.1%y/y vs. previous 10.4%. However, trade surplus may not sustain at this level and risks are for the gap to narrow.

- Looking at the breakdown, agriculture imports slipped -0.97%y/y compared to +8.34% previously, driven by a fall in meat (-27.7%), grain (11.6%y/y) and soya bean (1.4%). The slowdown in soya bean shipment underscores some impact from the weakness in the hog rearing industry that could be affected by slowing domestic demand. Meanwhile, we also saw slowing imports for iron ore & concentrate, textile yarn and fabric as well as mechanical & electrical product, underscoring some potential issues for intermediary goods that could be due to logistic disruption. This could affect production capability of the manufacturing sector that could show up in trade numbers for subsequent months. Given Shanghai's lockdown only took effect in late Mar, the impact of Covid restrictions on both imports and exports may only be better assessed from trade data sets in Apr.

- **Monetary Policy Forecast**: Loan prime rates were left unchanged - 1Y at 3.70% and 5Y at 4.60% for the third consecutive month. This follows the 1Y MLF rate which was also kept steady at 2.85%, contrary to market's expectations for a cut on 15 Mar including our own.
- PBoC announced a broad RRR cut by 25bps (to take effect on 25 Apr) and an additional 25bps for smaller banks with reserve ratio still above the 5% in order to provide additional support for the development of micro and small-sized enterprises as well as "agriculture, rural areas and farmers". A broad 25bps cut for RRR by PBoC is the first in the history of the central bank, underscoring narrowing room for further reduction. The RRR cut was announced late Fri after the 1Y MLF was held unchanged at 2.85% that morning, a surprise to most including ourselves looking for 10bps reduction. The central bank fully rolled over the outstanding CNY150bn of loans maturing this month, also disappointing those that were looking for additional liquidity injection.
- Into the end of Apr, the Politburo had pledged stronger and more urgent macro supports. We expect 1Y MLF to be lowered 10bps and RRR to be lowered another 50bps within 1H 2022.
- **Latest Fiscal and External Balance Outlook:** Recall that Fiscal deficit target for 2022 is lowered to 2.8% of GDP, down from 3.2%, underscoring a stance of fiscal consolidation. The key word for 2022 seems to be frontloading and overall fiscal stance could remain neutral. Current account surplus for 4Q 2021 came in at $118.4bn vs. previous at $82.6bn.
- **Key domestic events and issues to watch:** Current account balance for 1Q is due 6 May, Apr foreign reserves on 7 May, credit data for Apr (9-15 May); Apr CPI and PPI on 11 May; FDI on (11-18 May); 1Y MLF (13-16 May); Apr activity data (16 May); Apr new home prices (18 May); Apr Swift Global Payments (19 May); FX Net settlement (20 May); industrial profits (27 May), May composite PMI (31 May).
- **Technical Analysis:** USDCNH touched a high of 6.6980 before reversing lower to levesl around 6.6410. Support is seen around 6.6150 before the next at 6.5860 and then at 6.5630. Stochastics show signs of turning lower while MACD is also waning in bullish momentum.

KRW: Shaken by CNH and JPY

Forecast	2Q 2022	3Q 2022	4Q 2022	1Q 2023
USDKRW	**1260** (1190)	**1240** (1180)	**1220** (1160)	**1210** (1150)

Previous Forecasts in Parentheses

- **Motivations for the FX View: USDKRW may still stay supported** on dips amid lingering concerns over CNH's rapid depreciation, JPY softness, worries of slowing global growth, protracted war in Ukraine and fears of aggressive Fed tightening. But we believe the large run-up of more than 5.5% (vs. USD) in Apr may have been overdone for now and there is room for USDKRW to correct lower on the back of (1) hawkish Fed in the price and any less than hawkish Fed guidance could bring USD lower; (2) reopening boosts in Korea as covid restrictions are stepped down; (3) BoK likely to continue with rate hike cycle amid inflation showing little signs of peaking for now; (4) oil prices stabilising after easing 15% from highs provide a breather for net oil importer including KRW; (5) MSCI review (in coming weeks) for possible inclusion can boost inflows and KRW. We revised USDKRW forecasts higher, taking into consideration current levels and the above-mentioned risk factors. In addition, we also keep in view Korea—China tensions for possible deterioration if Korea's foreign policy shifts

- **Indonesia Palm Oil Ban Add to Korea Inflation Woes.** Indonesia's ban on palm oil exports, including crude palm oil (CPO), refined palm oil (RPO), refined, bleached & deodorised palm olein (RBD), palm oil mill effluent (POME) and used cooking oil, came into effect on 28 Apr and will last until the price of cooking oil in the country is below 14,000Rph per litre. Intent of export ban was to prioritise domestic needs and fulfill people's basic necessities amidst shortages. Products from Indonesia accounted for more than ½ of Korea's collective palm oil imports and the export ban could drive up palm oil prices, in turn pushing up local prices of snacks, ramen, fried chicken, cosmetics - as palm oil products and cooking oil are key ingredients in those products. Korea headline CPI is already running at more than 10y high of 4.1% and policymakers are already expecting inflation to stay elevated at 4%-level for longer. Higher inflation may curb spending and weigh on growth (cost of living crunch).

- **BoK Rate Hike Cycle Likely Intact Even Under New Governor Rhee.** Inflation being de-anchored remains a key concern for policymakets and it is likely price pressures could be sustained for coming months amid higher production costs (i.e. palm oil, cooking oil, etc.) and from demand side as economy reopens following easing of covid restrictions. Looking at Apr meeting, the decision to hike rates was unanimous even without a Governor, unlike previous meetings when there was a dissenter. Incoming BoK Governor Rhee had also hinted at further rate increases though he also said that the pace of hike need not follow Fed's 50bps hike. Taken together, these may signal that policy normalization has further room to go and that another 25bps hike at upcoming meeting is desired especially with US quickening its pace of policy normalization and inflation risks being de-anchored in S. Korea.

- **Keep an Eye on MSCI Revision.** Potential MSCI inclusion of Korean equities (May/jun review) may also bring about foreign inflows as global fund managers rebalance their portfolios. This can be a potential positive for KRW. Memory chips are a key component in the metaverse world, in which users interact with each other in digital worlds. And Korea accounts for >70% of global DRAM memory market share. The current downcycle in memory chip market could reverse when the world races to adopt metaverse technology. Samsung has indicated that the widely expected downturn in memory market is unlikely to be as severe as precious episodes while SK Hynix said that supply flexibility has changed from the past as chip suppliers are managing capacity with demand. Potential bottoming in the sector and pick-up thereafter could see foreign inflow of funds again and this should bode well for KRW. Elsewhere as the world embark on their transition to clean energy. Korea also has a part to play in global supply chain via battery (LG Energy) and electric vehicles (Hyundai Motor).
    - Efforts Taken to Increase Foreign Accessibility to Onshore Markets. The government is currently considering whether to allow greater foreign participation in KRW onshore forwards and swap markets. Earlier the government also announced extension of trading hours for onshore spot and eased restrictions against overseas investors to encourage foreign participation. These efforts (current still under consideration) could help with satisfying some of MSCI inclusion criteria.

- **Potential Deterioration in China-Korea Relations.** We reiterate that Yoon as a President may undermine KRW due to his foreign policy bias that leans towards resetting China ties. He had indicated plans to buy an additional Terminal High Altitude Area Defense (THAAD) anti-missile system. This may be a concern for KRW and markets as this risks retaliation from China. Recall that China-Korea relations deteriorated in 3Q 2016 over US-Korea alliance decision to deploy a US THAAD to defend against North Korea missile threat. In response, Beijing then used economic coercion, among other levers, to try to force Seoul to abandon the THAAD deployment.

- **Risks to outlook include** (1) a much faster pace of Fed tightening; (2) covid variant evolution proving more fatal than past strains resulting in fresh lockdowns, delayed reopenings; (3) another round of sharp increases in oil prices as KRW is highly sensitive to market moves and is a net oil importer. Highly sensitive KRW could succumb to sell-off in the above risk-off scenarios.

- **Growth and Inflation Outlook: 1Q GDP growth slowed to +0.7% q/q,** down from +1.2% in 4Q-2021. Earlier covid restrictions hit consumption (-0.5%, first contraction in 5 quarters) while capital einvestments also saw a sharp decline (-4%). BoK could modestly lower GDP forecast from current 3% projection at its May review, in light of slower demand from China potentially (due to covid lockdowns). The MoF still sees the economy expanding 3.1% in 2022, following a 4% growth in 2021. Forward looking surveys, activity indicators suggest that underlying growth, activity momentum should still remain intact and possibly rebound as covid restrictions eased (as omicron wave peaked). Apr consumer confidence rose to 103.8, (up from 103.2; business survey mfg and services were also up for May at 88, 85 (vs. prior months's 85 and 82 levells), respectively; IP rose 1.3% m/m in Mar (vs. 0.6% in Feb); retail sales rebounded in Mar (7.1% vs. 4.7% prior); 1st 20 days exports rebounded (+16.9% y/y vs. 10.1% prior). Mfg PMI slipped in Mar but still in expansionary territories (51.2 vs. 53.8 prior).

- The IMF Article IV projected Korea's growth to come in at 3%. It also noted that *comprehensive policy response, which, along with strong economic fundamentals, has underpinned a remarkable post-pandemic recovery and limited long-term scarring. However, uncertainty surrounding the outlook is high, linked to global and COVID-related risks.*

- **Korea CPI surged to 4.1% y/y in Mar,** up from 3.7% y/y in Feb. The is the fastest pace of rise since 2011. Energy prices led gains but there are signs that price pressures are broadening to other items, including services within the CPI basket. This is also the 12th consecutive month of CPI staying above BoK's 2% target. Core CPI accelerated to 3.3% in Mar, up from 3.2% y/y. BoK now expects headline CPI and core CPI to remain at 4%-level, 3%-level, respectively for some time.

- **Monetary Policy Forecast**: The upcoming MPC will see former IMF Director Rhee Changyong taking the role of BoK Governor for the first time. We expect BoK to continue with its tightening cycle by raising rates by 25bps at the next MPC on 26 May as BoK attempts to curb decade-high inflation. In particular, the last MPC dropped one of its factors, "effects of base rate hikes" it will thoroughly assess in making its judgement. We also noted that the decision to hike rates at the Apr meeting was unanimous, unlike previous meetings when there was a dissenter. BoK Governor Rhee also hinted at further rate increases but he also said that the pace of hike need not follow Fed's 50bps hike. Taken together, these may signal that policy normalization has further room to go and that another 25bps hike at upcoming meeting is desired especially with US quickening its pace of policy normalization and inflation risks being de-anchored in S. Korea.

- At the last MPC (14 Apr), members voted unanimously to raise rates by 25bps to 1.50% even in absence of a governor (as Lee's term was up and Rhee has yet to obtain parliamentary approval. The decision was a surprise and is in contrary to our expectations for hold. Acting Governor Joo said that BoK cannot wait for the formal appointment of Rhee to continue efforts to combat inflation, which is projected to remain at 4%-level for some time. The higher inflation for longer view and somewhat optimistic assessment of growth outlook reinforces our case for BoK to carry on policy tightening in 2Q.

- **External Balance and Fiscal Outlook:** Current account surplus narrowed to $6.42bn in Feb, down from $8.06bn the previous year as higher oil prices boosted oil import bills. BoK is cautious about the possibility that current account may swing into a deficit as a result of higher oil prices. That said, this is the 22nd consecutive month of current account surplus.

- Korea's national debt rose at a rapid pace and fiscal deficit widened. The national debt is forecast to reach KRW1,075.7tn this year, marking the first time that the debt would exceed the 1,000 trillion-won mark. Debt-to-GDP ratio is also expected to rise to a record high of 50.1 percent this year and the fiscal deficit is likely to reach 70.8 trillion won, equivalent to 3.3 percent of the GDP.

- Under the 2023 budget guidelines, the government plans to normalize COVID-19 related emergency spending to pre-pandemic levels and make efforts to secure fiscal space to support new policy goals by the incoming government. Spending plans should be drafted by end-may for the 2023 national budget. Taking stock, the Korean government had drawn up 7 rounds of supplementary budgets with record high national budget of KRW607.7tn (or US$496 billion) for 2022. In February, it created this year's first extra budget of KRW16.9tn to support merchants hit by the pandemic.

- **Key domestic data to watch:** S. Korea releases Apr trade (1 May), mfg PMI (2 May); Apr CPI (3 May); Mar current account (10 May); Mar unemployment rate (11 May); Apr PPI (20 May); 1st 20 days of exports (23 May), Jun consumer confidence (24 May); Jun Business survey - mfg and services (25 May); BoK MPC (26 May); Apr IP (31 May).

- **Technical Outlook:** USDKRW extended its rally, nearly one-way into the fifth month this year. Last at 1267 levels. Bullish momentum on weekly, daily chart intact though there are some early signs of it fading while RSI fell from overbought conditions (daily chart). Retracement move lower not ruled out. Support at 1252 (pre-breakout resistance), 1239 (21 DMA) and 1229 levels (23.6% fibo retracement of Dec low to Apr high). Resistance at 1274 (recent high), 1285 and 1293 (2020 high).

TWD: Under Pressure

Forecast	2Q 2022	3Q 2022	4Q 2022	1Q 2023
USDTWD	**29.62** (28.40)	**30.00** (28.20)	**29.80** (28.00)	**29.60** (28.00)

Previous Forecasts in Parentheses

- **Motivations for the FX View: We still see room for USDTWD to stay supported** amid (1) continued weakening in tech peers such as JPY, CNH and KRW - somewhat destabilizing AXJ sentiments, including TWD; (2) signs of slowing global and domestic growth - weighs on cyclical TWD; (3) zero covid strategy (though being unwound gradually) remains a hindrance to borders relaxation and economic recovery; (4) sharp rise in UST yield undermining risk assets and AXJs, including TWD; (5) though CBC tightened 25bps in Mar, it still lags on policy tightening (vs. hawkish Fed) Fed-CBC policy divergence can undermine TWD in the interim; (6) still-elevated energy prices undermine energy importers like TW while rising prices hurt household wallet; (7) ongoing supply chain disruptions (raw materials like neon gas for chip making) that may weigh on economic activities, exports; (8) risk of worsening China-Taiwan tensions that may affect investment inflows, sentiment channels. On this note, we revised USDTWD forecasts higher to 3Q 2022 before easing slightly thereafter.

- **Fed-CBC Policy Divergence Weighs on TWD.** Comments from Fed officials are starting to shift significantly, looking for much faster pace of policy normalisation, in terms of magnitude of rate hikes and trajectory as Fed prepares for double-barreled tightening of rate hike and QT. OIS-implied (as of 25 Apr) shows further front-loading of rate hikes with 50bps hike priced for next 3 FoMCs (in May, Jun and Jul), up from 2 FoMCs previously while about 56% probability is priced for Sep FoMC. For remainder of the year, Fed fund futures are expecting another 243bps rate increase (equivalent of 9 – 10 hikes of 25bps each). We are cautious of Fed turning even more restrictive. This is one risk that is not fully priced and may well provide that intermittent upward pressure to UST yield and USD. Most recently, 10y UST yield also rose above 3%. CBC may not be as hawkish as the Fed, as indicated by Governor Yang that CBC's tightening path may not mirror Fed. Fed-CBC policy divergence here could drive USDTWD higher for now.

- **Geopolitics Undermine Sentiment and Flows.** Russian invasion of Ukraine raises fears of potential China invasion of Taiwan as the former may prefer better control over South China Sea (to deter US other unfriendly forces). Chatters of such threats are gaining traction this year as Taiwan stepped up measures - government has issued its first war survival handbook advising citizens how to find bomb shelters, water and food supplies while defence ministry confirmed of war games exercises including simulations of various possible actions of Chinese Communist Party to invade Taiwan. YTD, foreign selling of Taiwanese equities have also beat other peers in the region, with $26bn foreign net sale of domestic equities, far surpassing India (-$17bn) and Korea (-$11.5bn). While tech unwinding amid higher rates may often be attributed as the main culprit, we believe the massive foreign selling could also be partially attributable to geopolitics. A China invasion in Taiwan is not our base case scenario but we acknowledged that the play up of such fears can undermine sentiments and weigh on TWD for longer.

- **Rating Upgrade Provides Marginal Benefits to TWD.** On 29th Apr, S&P upgraded Taiwan's credit rating to AA+, up from AA. S&P attributed the upgrade to TW's fiscal management – flexible and well-executed and that its strong economic performance alleviated the need for large-scale financial support measures. Budget deficit is expected to have peaked at 3.6% of GDP in 2021 and fall to 1.5% of GDP in 2022, with gradual decline thereafter. It also pointed out that the economy has benefited from strong global demand for semiconductor chips. It also mentioned that tension across Taiwan Strait should not affect TW's manufacturing sector. Seperately TW's MOF said it will actively reduce the tax burden on commodity and implement relief and revitalisation measures to facilitate TW's economic stability and resiliency.

- **Tech Supercycle Underpins TWD Fundamentals but Near Term Challenges a Drag.** While the ongoing shortage in the semiconductor world may gradually ease into later part of 2022 and as more production capacity comes onstream in 2023, the metaverse thematic in the medium term still underpins a core demand for chips and this can keep prices of chips supported. Inflow of foreign funds into metaverse thematic at some stage could pick up again, providing support for the likes of tech-proxy FX, including TWD. For Taiwan, apart from TSMC being the world's largest suppliers of semiconductor chips, there are also other electronic devices ODMs such as Quanta, Inventec that have the capability to ride the metaverse trend, in terms of layering the infrastructure and technology that enable devices to connect to the faster network (moving beyond 5G to 6G) to access the content. Looking forward, **semiconductor supply-demand rebalancing with China and US ramping up production, adding to supply chain may help to address the demand-supply imbalances. This underpins our view that markets could move to price a peak in demand-supply imbalance in 2022 and that the tech proxy linkages with TWD may ease**, as such.

  — Ukraine produces about 50% of the world's supply of semiconductor-grade neon, a key component for lasers in chipmaking. Based on research from Techcet, The gas, a biproduct of Russian steel manufacturing, is purified in Ukraine. Russia is also the source of 35% of the palladium used in the United States. The metal is used in sensors and memory, among other applications. Companies that supply chipmakers with materials for semiconductor fabrication buy gases, including neon, palladium and C4F6, from Russia and Ukraine. Now with US sanctions on Russia and Russian-related firms as well as military conflict in Ukraine (affecting production), there could be shortage in supply and this could affect the semiconductor industry in general. We do note that based on various reports, semiconductor firms are saying that it has diversified sourcing for its supplies and stockpiles hence disruption may be kept at a minimal. We continue to watch this space as protracted war could affect supply chain and production beyond the short term (>3 months).

- **Growth and Inflation Outlook: Taiwan's economy expanded by 3.06% y/y for 1Q,** down from its fastest pace (in over a decade) of 4.88% in 4Q. Sharp slowdown in domestic demand to 2.15% y/y, from 5.76% in 4Q and government spending (0.45% y/y vs. 4.68% in 4Q were the main drags. Covid outbreak and multiple occasions of blackout and water shortages proved challenging for growth momentum. That said, headline growth still surpasses expectations, owing to robust exports. DGBAS said that demand for new technology applications and cargo shipping services remained vibrant amid eased supply chain bottlenecks.

- DGBAS will provide an official update of its GDP forecast next month after cautioning 2022 growth forecast may be lowered from its current projection of 4.42%. The agency cited the ongoing war (if it persists) in Ukraine as the main reason for possible adjustment. But growth is still expected to stay above 4%-level. Other forward leading/activity indicators, surveys suggest potential slippage in activity momentum: monitoring indicator slipped to 34 levels in Feb, from 36 while mfg PMI also slipped to 51.7, from 54.1 (though PMI still in expansionary territory, the slippage was the sharpest in almost 2y) while industrial production, export orders grew slower at 2.15% y/y in Mar, down from 9.47% in Feb. Export orders also grew slower at 16.8% y/y, down from 11.98% prior.

- Headline CPI rose to more than 9-year high of 3.27% y/y in Mar, up from 2.36% y/y in Feb. This is the 8th consecutive month that CPI comes in above 2%-target. Food and international commodity prices were the main drivers of higher inflation. Core inflation also rose sharply at 2.47% y/y, up from 1.65% y/y. Ongoing military conflict in Ukraine could continue to complicate supply chain disruptions, keep commodity prices supported and that would feed through to higher CPI in coming months.

- **Monetary Policy Forecast: We expect CBC to raise rate again at the upcoming MPC on 16 Jun,** following its surprise early move to tighten at Mar meeting (by 25bps). Focus has shifted to curbing inflationary pressures, from supporting growth. Magnitude of rate hike may revert to its typical 12.5bps increase, instead of the 25bps seen at Mar meeting as some sectors of the economy (i.e. tourism, self-employed, etc.) still need support. We also opined that prospects of a faster Fed is one reason for CBC to tighten and It is likely that we could see Fed embark on multiple 50bps hike in coming FoMCs.

- At the last MPC (17 Mar), CBC surprised with a 25bps hike (vs. no hike expectations) to take policy rate to 1.375%. Decision was unanimous. CBC sees private consumption warming up. Raw material prices will affect inflation this year and that rate hike is helpful to contain inflation. Inflation forecast was raised to 2.37%, from 1.59%. Depuity Governor, Tzung-ta told lawmakers that interest rate hike was helpful to tame housing market. The aggressive move then also saw TWD gained the most (in a day) since May 2021.

- **External and Fiscal Outlook: Current account surplus widened to US$32.19bn in 4Q,** from US$26.1bn in 3Q. Both goods and services surplus expanded. Trade was driven by demand for electronics used in digital transformation and emerging technology applications while services was due to rising freight rates mid container shortages and port congestion. For 2021, Taiwan's current account surplus climbed to a historic high of US$116.12bn. As of 4Q, Current account surplus stood at 14.95% of GDP. Taiwan's debt as % of GDP last stood at 35.2 while fiscal surplus was at 0.37% of GDP. Taiwan has a self-mandated cap of 40% of debt to GDP

- **Key domestic events and issues to watch:** Apr mfg PMI (2 May); Apr FX reserves (5 May); Apr CPI (6 May); Apr trade (9 May); Apr export orders, 1Q current account (20 May); Apr industrial production, unemployment (23 May); 1Q GDP (31 May).

- **Technical Outlook:** USDTWD extended its sharp run up again for Apr. Last seen at 29.54 levels. Bullish momentum on weekly chart intact but RSI shows signs of turning from deeply overbought conditions. On daily chart, bullish momentum is fading while RSI is showing signs of turning from overbought conditions. Fatigue setting in for USD bulls here. Corrective move lower puts support at 29.10 (21 DMA, 23.6% fibo retracement of 2022 low to high), 28.80 (38.2% fibo). Resistance at 29.60 (2022 high), 29.80 levels.

SGD: NEER Basket to See Resilience

Forecast	2Q 2022	3Q 2022	4Q 2022	1Q 2023
USDSGD	**1.3900** (1.3200)	**1.3800** (1.3100)	**1.3700** (1.3000)	**1.3550** (1.2900)

Previous Forecasts in Parentheses

- **Motivation for the FX View:** SGD continues to see some resilience on a basket basis on favorable macro fundamentals as well as recent MAS double-tightening move, but USDSGD pair will continue to be subject to broader dollar biases near-term. On net, USDSGD saw a sharp spike in Apr, given the current confluence of dollar supportive and risk-negative events globally, including increasingly hawkish Fed (OIS-implied shows further front-loading of rate hikes with 50bps hike priced for next 3 FoMCs in May, Jun and Jul), rising risks to global growth outlook (as flagged recently by World Bank and IMF) amid Ukraine war spillovers and China partial lockdowns. In particular, the latter is relevant for USDSGD given the significant positive correlation between SGD and CNY. Yuan has softened recently on broadening of Covid risks, with more cities seeing partial lockdowns or subject to mass testing. For USDSGD to revert to a downtrend, we would require clearer signs of turnaround in sentiments in China, perhaps when curbs start easing in the weeks ahead or when authorities implement more discernible policy support. Markets would also require more certainty that we've reached the end of hawkish surprises from US Fed. Note that in past Fed tightening episodes, SGD tends to see losses against USD heading into the Fed rate hike cycle, but losses tend to unwind in part as expected rate hikes proceed.

- **USD upswing has dominated FX markets for the last few months, and this overwhelming dollar dominance could continue for a while yet. In this case, moves in USDSGD will likely continue to mirror broader DXY biases.** On the other hand, on a relative basket basis, SGD should retain resilience or modest outperformance versus peers, with SGD NEER projected to remain in +0.5% to +1.5% trading range.

  - In Mar, FoMC voted 8-1 to raise rate to 0.25% - 0.5%. Dot plot signalled another 6 more hikes this year (vs. their previous projection for 3 hikes). **But since then, rhetoric from Fed officials have turned increasingly hawkish.** As of writing, OIS-implied shows further front-loading of rate hikes with 50bps hike priced for next 3 FoMCs (in May, Jun and Jul), up from 2 FoMCs previously. For the rest of the year, Fed fund futures are expecting another ~250bps rate increase (equivalent of 9 - 10 hikes of 25bps each).

- Besides hawkish Fed, haven demand for USD and USTs could also be contributing to the recent dollar rally, alongside escalation of geopolitical tensions in Europe, dampening in China's growth outlook on renewed Covid wave and partial lockdowns, and concomitant additional pressures on global supply chains from aforementioned two key risk events.
- Historically, AxJ FX tend to see losses in the lead-up to the start of the Fed hike cycle, although SGD tends to see more modest drags versus IDR, THB and MYR in such periods. With Fed action priced in prior, AxJ FX losses then tend to unwind once the actual Fed rate hike cycle starts. Aforementioned dollar-positive factors appear to be overwhelming this usual pattern of AxJ FX biases, but it may be too soon to dismiss AxJ FX recovery potential in the quarters ahead if dollar-supportive conditions reverse a tad.

- **Domestically, latest rounds of policy announcements reflect a commitment to Covid-endemic stance from authorities**. 7-day average in Covid cases has fallen from around 18k at the start of March to around 3k as of late-April. Policy changes on 24 Mar saw many Covid-related restrictions being eased, with group sizes doubled to 10, masks made optional outdoors and most restrictions lifted for fully vaccinated visitors. Subsequently on 22 Apr, the DORSCON level was adjusted from Orange to Yellow, with group sizes being removed for mask-off activities and household visitors. More importantly, all workers may now return to the workplace (up from 75% prior) and safe distancing will no longer be required between individuals or between groups. Capacity limits for larger settings/events (75% prior) have also been removed. On border entry, fully vaccinated and well travellers will not require any tests to enter Singapore. In addition, from 1 May 2022, fully vaccinated non-Malaysian Work Permit Holders no longer need to apply for entry approvals to enter Singapore. Significant easing of Covid restrictions could continue to support SGD sentiments.

- **Negative contagion from China growth moderation or yuan depreciation concerns to SGD stepped up in Apr.** At this point, China authorities have voiced support for a continued Covid Zero strategy, even as curbs may be optimized at margins to reduce growth drags. On net though, China is still susceptible to more instances of partial lockdowns and more downside risks to the CNY from this point cannot be dismissed, even as much of the catch-up in weakness vs. peers is done. In the interim, CNY is likely to remain more sensitive to Covid headlines. But as with most countries, each Covid wave typically lasts for around two months. **Bulk of lockdowns, and concomitant economic damage, could be contained to the next few months**.

- **Growth and Inflation Outlook:** Industrial production rose by +3.4% in March (vs. +17.5% in Feb), but this is notably above the 1Q advance GDP's implied estimate of flat growth. On net, March numbers bring 1Q manufacturing growth to +7.1% (vs. +16% in 4Q21), higher than the advance estimate of +6%. This will add around +0.3%pt to headline GDP growth. Our economist team thus expects an upgrade in the 1Q final GDP estimate (to be released in May) to +3.7% (from advance estimate of +3.4%).

- Manufacturing growth slowed in March, as electronics eased from last year's high base while the volatile pharmaceuticals segment plunged. Transport engineering, particularly the aerospace segment, was the key growth driver in March, boosted by the resumption of air travel as countries eased their border controls. Going forward, our economist team expects manufacturing growth to ease to low single-digit pace in the remaining quarters, as chip production is operating near full capacity and on high base effects. China's lockdown, weaker EU growth and rising energy prices will dampen global manufacturing and trade.

- **House view for GDP growth forecast is hence maintained at +2.8% in 2022, below MTI's 3%-5% forecast**. A stronger Singapore dollar (basket NEER basis) and rising interest rates may also hurt the relative competitiveness of Singapore firms as chip production is operating near full capacity and on high base effects. 1Q (A) GDP came in at 3.4%y/y versus expected 3.8%.

- Core CPI surged to +2.9% in March on the back of higher costs of food and services, mainly on airfares. Headline CPI jumped to +5.4% on the back of private transport costs and housing rents. **Our economist team recently raised 2022 forecasts for headline CPI to +4.8% (from +3.6%) and core CPI to +3% (from +2.7%), in line with MAS' higher inflation projections. Core inflation could breach +3% in 2Q on rising commodity prices, supply disruptions and worker shortages**. The MAS expects the labour market to remain tight and support a firm pace of wage growth, which will filter through to higher services costs.

- **Monetary Policy Forecast**: In mid-Apr, MAS re-centred the mid-point of the policy band at the prevailing level of the SGD NEER, while also increasing slightly the policy slope, predicated on still-resilient growth expectations, rising inflation risks. By our estimates, the decision shifts the policy band upwards by +2.0%, and increases the slope from 1.0% p.a. prior to 1.5% p.a. There is no change to the width of the policy band. The re-centring decision and policy rationale were largely in line with our MAS preview note published on 6 Apr. The slight steepening of the slope was not in our baseline, but we had noted the risk of such an accompanying parameter change.

- Depending on whether inflation risks surprises to the upside in the coming months, we could see MAS either standing pat or engineering a mild upwards adjustment to the policy slope in Oct (another +0.5%p.a. increment, taking slope towards 2.0%p.a.). In any case, the bulk of the policy parameter adjustment could have already been front-loaded in Oct 2021, Jan, Apr 2022.

- As of writing, USDSGD is around 1.38, and trades around +0.8% from the new implied mid-point of 1.3922, with the top estimated at 1.3644 and the floor at 1.4200. Output gap is now expected to close and see a slight positive reading in 2022, while core inflation could see a broad-based step up in 2022 and risks remaining elevated for some time. Given these macro conditions, our Taylor rule estimates suggest that SGD NEER is likely to see a modest upward bias over the next few quarters. Post MAS announcement, SGD NEER has been trading on the stronger side of the new trading band. **We had proposed on 6 Apr that "if a re-centering materializes, a tentative trading range post-**

announcement could be +0.5% to +1.5% above the new mid-point". We maintain this projection range for now.

- Domestic interest rates continued rising in April. The 3-month SOR (3MSOR) and 3-month SIBOR (3MSIBOR) are at 1.219% and 1.094% at the time of writing, higher than the 0.953% and 0.789% seen in end-Mar. While risks might continue to be skewed modestly to the upside for rate moves, financial stability risks among households and corporates are likely to remain manageable. We expect the 3M SIBOR to rise to around 1.80% at end-4Q 2022.

- **Latest Fiscal and External Balance Outlook:** Finance Minister Lawrence Wong delivered the Budget on 18 Feb. Our economist team assesses that Budget FY2022 shores up finances to meet priorities for a post-pandemic future, including growing healthcare spending; expanding the social safety net; and transitioning to a green economy.

- Budget 2022 stays expansionary with a small deficit of $3bn (0.5% of GDP). There will be increases to the GST rate (7% to 9%), property taxes, personal income tax (for top earners), and carbon tax. Foreign worker policy will be tightened with the hike in minimum qualifying salaries for EP and S Pass holders. Notably, the GST rate increase from 7% to 9% will be conducted in two stages—one percentage point each time on 1 Jan 2023 and 1 Jan 2024. A $6.6bn Assurance Package will cushion the impact of the GST hike. The GST offset package includes cash payouts, GST vouchers, U-Save rebates, MediSave top-ups and CDC vouchers. The package will cover at least 5 years of additional GST expenses for a majority of Singaporean households, and 10 years for lower income households.

- The current account surplus improved to 18.1% of GDP in 4Q 2021, from 17.0% prior. A broad recovery trend has been observed since the trough in 4Q 2019. But on higher-frequency indicators, we note that NODX growth eased to +7.7% in March, weighed down by slowing global trade and supply disruptions due to the Russia-Ukraine war and China's flash lockdowns. Real NODX (-3.4%) contracted for the second straight month, reflecting manufacturing capacity limits. NODX to China (+4.8%) and Hong Kong (-22.4%) weakened significantly, likely caused by lockdowns and port delays. Our economist team maintains 2022 NODX growth forecast at 4%-6%, as the outlook is clouded by the Russia-Ukraine war and China's lockdowns.

- **Key domestic events and issues to watch**: Apr PMI (4 May); Mar Retail sales (5 May); Apr NoDX (17 May); 1Q (F) GDP (19-26 May); Apr CPI (23 May); Apr Industrial production (26 May).

- **Technical Outlook**: USDSGD pair last seen modestly above 1.38, versus the 1.35 to 1.37 trading range seen in March. Momentum on daily chart is bullish (albeit showing very tentative signs of moderating) while RSI shows signs of dipping lower from overbought conditions. Risks for the pair could be skewed modestly to the downside on a 1-3 month basis, but broader dollar and USDCNY developments could overwhelm TA nuances in terms of near-term impact on USDSGD under current volatile market conditions. Resistance at 1.39 (50.0% fibo retracement from Mar 2020 high to Feb 2021 low), before 1.4080 (61.8% fibo). Support is seen at 1.37 (21-DMA), 1.3570 (100-DMA).

MYR: China, Policy Differentials & Global Growth Concerns

Forecast	2Q 2022	3Q 2022	4Q 2022	1Q2023
USDMYR	**4.40** (4.20)	**4.35** (4.18)	**4.30** (4.15)	**4.30** (4.15)

Previous Forecasts in Parentheses

- **Motivation for the FX View:** In the past month, the MYR weakened by around 3.7% vs USD, reaching a peak of 4.3685 (as at 28 Apr). In the near-term, the epidemiological trajectory domestically has improved as curbs are eased further over time, borders are reopened and the government has vowed not to reimpose lockdowns, leading to potential positive economic upside. However, intensification of global growth concerns, in large part driven by Covid related developments out of China (including the easier China monetary policy moves) and impact of more hawkish Fed policy moves to address inflation, led to erosion of positive yield differentials for CNY assets and eventually led to sell down in regional currencies with significant China exposure, including the MYR. We are revising the MYR forecast to incorporate the latest market developments as market participants move to safe haven currencies and assets, sharp depreciation in the renminbi and factoring in some of the global growth concerns over the next 3-6 months.

- In addition, Malaysia's external trade outlook is now a "battle" between the upside of commodity prices and the downside of global economic outlook amid Russia-Ukraine war, US monetary tightening and China's lockdown. High commodity prices benefit Malaysia, a net commodity exporter. Palm oil, LNG and crude oil contributed to almost one-third of exports growth in Mar 2022 and 1Q 2022, with E&E contributing to nearly half.

- However, inflation risk from higher commodity prices, US monetary policy tightening and China's lockdown cast a cloud on global economic outlook. To note, the World Bank just cut its 2022 global economic growth forecast to +3.2% from the +4.1% projection made in Jan 2022. We estimated that a 1 percentage point drop in global GDP growth can shave up to 0.8 percentage point off Malaysia's GDP growth, underscoring the flipside of a trade-oriented economy.

- In summary, MYR weakness was largely driven by exogenous factors, including the continued rise in UST yields, USD (further triggered by hawkish comments from Powell and Daly), sharp and continued decline in CNH (of which MYR has a strong correlation to), IMF's downgrade of global growth, risks of China slowdown amid extended lockdowns and ongoing war in Ukraine (sentiment, china proxy play). The latter's move was mirrored in the MYR move vs USD. The USDCNY was at a low of 6.34 at end March and has since moved to 6.61 (as at 28 Apr) now, reflecting the close correlation between the two currencies relative to others in the region.

- But first, in particular on Fed speaks overnight, OIS-implied now shows further front-loading of rate hikes with +50bps fully priced for May and Jun FoMCs while >60% probability of 50bps hike is now priced for Jul and Sep FoMCs. To some extent, Fed's comments this week also prompted another increase in rate hike trajectory. Previously, markets were pricing about 9 hikes (of 25bps each) remaining for this year but this has shifted slightly more hawkish as OIS-implied now shows 10 (25bps) or 250bps total hikes this year.

- We note that MYR's sensitivity to abovementioned global/China risk events could be magnified given that its economy is more exposed to external demand (exports at 61% of GDP in 2020, second-highest among ASEAN-5 just behind SG), and that share of trade linkages are with China are outsized at just below a quarter. On monetary policy, Malaysia is also expected to lag most regional peers in terms of rate hike cycle—house view only expects 1 hike this year, reflecting increasing divergence with Fed's hawkish signalling.

- In comparison, while other regional FX are similarly down versus the USD MTD in Apr, the magnitudes of softening are softer. IDR sees support from elevated commodity export prices, in particular coal, following European commission's ban of coal imports from Russia. For SGD, MAS' front-loading of policy tightening (Oct, Jan off-cycle slope steepening, followed by band recentring and slope steepening in Apr) and continued reopening stance bodes well for sentiments. For PHP and THB (net oil importers), losses were more pronounced in late-Feb to March when Ukraine war led to a sudden shock in oil markets. Entering 2Q, oil has moderated from highs albeit remaining in elevated ranges. Similarly, both FX are trading near the softer end of 2022 ranges, but moves are less one-way now.

- We believe as long CNY continues fixing at a weaker rate and USD remains supported, the USDMYR could be vulnerable to upside risk even with a supported oil price especially with a slight lag in the policy rate move domestically. However, further moves could suggest further undervaluation in the MYR as the economy opens domestically. In the medium term, we still remain positive on the myr, as strong commodity prices and a healthy current account surplus underpinned by strong exports growth, benign inflation outlook relative to Asian partners and ample fx reserves should cushion further MYR decline. So as long as CNY softens further, and global growth sentiment worsens sharply, MYR should be on the backfoot into the 4.35-4.40 over the next hurdle then 4.40-4.50 if current driving factors continue.

- On domestic politics, 3 governments in 3 years underscore political instability after the 14th General Election (GE) in May 2018. Current government holds a slim majority via a fragile coalition. Memorandum of Understanding (MOU) on Transformation and Political Stability signed on 13 Sep 2021 ("effective" until July 2022) with Pakatan Harapan bloc of the oppositions supposedly provides a temporary respite from politicking to focus on policies for economic recovery. But the fractious and fluid dynamics of domestic politics does raise the possibility of general elections in 2H 2022.

- **Elections and associated near-term uncertainties could induce higher vols for the USDMYR pair, but a sustained period of volatility and extended MYR losses is not our base case**. While the USDMYR pair did rise by >8% from 2Q to 4Q 2018 (last elections in May 2018), the bulk of this upswing can be attributed to broad dollar strength (DXY >+6%) and oil softness (oil > -20%) over the same period. Accounting for these two factors, the actual elections-induced impact on MYR is likely modest—the BIS-estimated MYR REER (real effective exchange rate basket) notably fell by a modest 1.5% over this period. To a large extent though, a scenario of contained MYR vols/losses on election uncertainty is conditional on there being clear signs of ability of (potential) next ruling party/coalition to maintain policy continuity and economic traction post Covid-recovery.

- **Growth and Inflation Outlook: Our economist team maintains forecast of broad-based +6.0% growth in 2022**, underpinned by sustained economic opening as the Government proceeds with “Living with COVID-19” strategy and transitioning from the pandemic phase to the endemic stage of COVID-19. **However, the GDP forecast is currently under review with downside bias.** The existing GDP outlook is enabled by high primary vaccinations, rollouts of booster shots and inoculations of adolescent and children, which also prevented the healthcare system from being overwhelmed and suggest stronger immunity given the de-coupling between the Omicron-driven surge in COVID-19 cases and statistics on deaths as well as patients on ICU and ventilations. Progress in economic opening is further enhanced by the Government’s plan to fully open the country’s international borders on 1 Apr 2022. Where the Government is “tightening” as far as COVID-19 policy is concerned is on mandating booster shots to maintain full-vaccination status.

- Headline inflation was unchanged at +2.2% YoY in Mar 2022 (Feb 2022: +2.2% YoY) as diminishing base effect of transport cost offset higher food& non-alcoholic beverages (FNAB) cost. Core inflation edged higher to+2.0% YoY (Feb 2022: +1.8% YoY) amid pent up discretionary spending andservices demand. We maintain our 2022 inflation rate forecast at +2.7% (2021: +2.5%) but continue to see upside risk from global energy commodity prices – especially crude oil - as well as elevated food-related commodity prices, including crude palm oil (CPO) price; global commodity and manufacturing supply chain risks and disruptions in the wake of Russian invasion of Ukraine and the latest bout of China lockdown; as well as theimplementation of minimum wage hike on 1 May 2022.

- Mitigations to the supply driven inflation include the continued “blanket” fuel price subsidies so far; implementation of price administration and supply-side measures (e.g. freeze on base electricity tariffs for allelectricity users in Peninsular Malaysia from 1 Feb 2022 until end-2024;introduction of subsidy to poultry farmers for chicken (MYR0.60/kg) andegg (MYR0.05/kg) production; allowing short term (Dec 2021-Feb 2022)importation of frozen whole chicken); no highway toll rate hike until up to mid-2032 on 4 key Klang Valley highways; as well as remaining slacks in the economy to contain demand-pull and wage-driven inflation.

- **Monetary Policy Forecast:** OPR kept at record-low 1.75% at the 2-3 March 2022 BNM's Monetary Policy Committee (MPC) meeting i.e. for the tenth consecutive MPC meeting and since July 2020. Monetary Policy Statement (MPS) acknowledged downsides from Ukraine-Russia military conflict. Maintain our call of unchanged OPR for much of 2022 before a +25bps rise in 4Q 2022 i.e. 2-3 Nov 2022 MPC meeting.
- BNM Annual Report 2021 was out on 30 Mar 2022, which comes with reviews of official 2022 macro forecasts. Overall, the key takeaway is that of continued outlook of firmer economic expansion this year given the marginal downward revision in real GDP growth forecast despite downside risks to growth as well as theexternal uncertainty caused by the Russia-Ukraine War. At the same time, the outlook of faster core inflation rate signals broader inflationary pressures amid pent-up domestic demand/spending from economic and international border openings as well as the pass-through effect of higher input costs following Russia-Ukraine War's risk premiums on commodity supplies and prices. Nevertheless, BNM still sees sizeable negative output gap remaining in 2022 at between -3.0%to -4.0% (2021: -6.0%; 2020: -6.8%) which BNM views as the key and lingering "slack" or "spare capacity" factor to contain the upside to core inflation rate.
- BNM also stated that monetary policy in 2022, first and foremost, will continue to support a sustainable economic recovery, while preserving price stability. BNM states that interest rate is not the best tool to deal with cost-push inflation e.g. surge in commodity prices due to geopolitical factors and prolonged supply-related disruptions, which is better addressed with price administration and supply-side measures. Current monetary policy stance is therefore appropriately accommodative. Still, BNM acknowledges the need to strike a balance between the need for continued monetary policy support to sustain the economic recovery momentum, and the risk of keeping low interest rate for too long that could lead to the emergence of financial imbalances. Going forward, BNM will ensure the degree of monetary policy accommodation is consistent with the expected firming of real GDP growth and moderate rise in inflation rate. Overall, this confirm the monetary policy normalization/tightening intention on BNM part. But BNM makes it clear that adjustments in monetary policy stance will be gradual and measured, indicating no US Fed-like aggressive interest rate hikes.
- **For this year, we still expect a single +25bps hike to 2.00% p.a. on 2-3 Nov 2022 MPC. However, for 2023, we are now penciling in a total of +100bps hikes to 3.00% p.a. vs +50bps hikes to 2.50% previously. The OPR view for 2023 - reflect "catch up" on monetary policy normalisation as we factor the outlook of aggressive interest rate hikes by US Federal Reserve.**
- **Fiscal and External Balance Outlook:** Budget 2022 will likely see a third consecutive year of >6% budget deficit to GDP at 6.0% (2021E: 6.5%). Meanwhile, Fiscal Outlook 2022 report indicates budget deficit to GDP ratio will go sub-5% from 2023 onwards (2023E: 4.8%; 2024: 4.3%) en-route to the 12th Malaysia Plan target of 3.0%-3.5% in 2025. Trajectory of narrowing fiscal deficits, if maintained, should be net positive for medium-term MYR sentiments.

- **Key domestic events and issues to watch:** Apr PMI Mfg (5 May); BNM Monetary policy decision (11 May); Foreign Reserves (11 & 23 May); GDP 1Q (13 May); Feb Industrial Production (10 May); Apr Trade (19 May); Apr CPI (25 May)..

- **Technical Outlook:** USDMYR was driven sharply higher for the month of Apr as the pair rose ~4%. Pair was last at 4.35 levels. Bullish momentum on daily chart is waning while RSI shows signs of turning lower from deep overbought conditions. Corrective move lower not ruled out. Immediate support at 4.35, 4.32 before 4.2820 (21 DMA). Key area of resistance at 4.38-40. If broken, the pair could mount a test on 2020 pandemic levels of 4.45.

IDR: Uncertainty in Commodity Export Policy a Modest Drag Near-term

Forecast	2Q 2022	3Q 2022	4Q 2022	1Q 2023
USDIDR	**14,600** (14,250)	**14,400** (14,200)	**14,300** (14,100)	**14,200** (14,100)

Previous Forecasts in Parentheses

- **Motivation for the FX View:** Despite a broader dollar rally amid global growth uncertainties and hawkish Fed, USDIDR pair has been relatively stable (14,330 to 14,380 range) for the first 3 weeks of Apr. It only broke out higher in late Apr amid reports of China partial Covid lockdowns in some cities (likely weighing on commodity demand outlook) and concomitant upswing in USDCNY. Towards end-Apr, some confusion over palm oil export ban policy (in extent of range of products covered) likely dampened sentiments further. To some extent, while benign commodity prices are still a positive for the IDR, reduction in trade surpluses over the next few months over the palm oil export ban could weigh on IDR near-term. We adjust our USDIDR forecasts higher, to take into account the aforementioned risk factors, but continue to look for a net gradual IDR recovery subsequently, alongside domestic economic activity gaining traction, easing of export restrictions, potential moderation in China-related concerns lending support to regional risk sentiments etc., over time.

- **Trade surpluses could see near-term drags from China partial lockdowns, palm oil export ban, but expect concerns to ease over time**. Indonesia's top exports include palm oil, coal, copper and nickel. It ships about a third of the world's edible oil supplies, consuming just over a third of production domestically. Despite signs of earlier price rallies moderating, most of these commodities continue to see elevated price ranges versus pre-Russian invasion. This will help sustain the trade surplus, even as intermittent drags will occur amid China demand concerns, palm oil export ban (see below). Risk is if eventual easing in global supply disruptions lead to a more discernible downturn in commodity prices, but such dynamics are likely to take time, and will be mitigated to some extent by resilient demand from continued global reopening trends.

- Amid broadening Covid risks and continued partial lockdowns of cities, China authorities have voiced support for a continued Covid Zero strategy. Still, curbs may be optimized at margins to reduce growth drags. Experience of other countries also suggests that each Covid wave typically lasts for around a few months. Bulk of lockdowns, and concomitant economic damage, could be contained to the next few months.
- An export ban on coal was implemented in Jan, to boost inventories at power plants and ensure energy sufficiency at home. Subsequently, coal miners compliant with new regulations on domestic market sales were cleared to restart shipments. Baseline assumption is for ban-induced drag on exports to ease as more firms comply with the regulations.
- With Russia and Ukraine accounting for about 80% of global sunflower oil exports, palm oil has risen in costs as buyers raced to find substitutes for sunflower oil. In a bid to cool domestic cooking oil prices, authorities first introduced domestic market obligation rules for crude palm oil (which required companies to direct 30% of exports to local markets), then replaced it with higher export duties (around US$675 a ton based on current prices, up from US$375) instead. Higher export duties tend to make it more profitable (on relative basis) to sell domestically rather than abroad.
- This was followed in late Apr by the introduction of a more explicit ban on palm oil exports, including crude palm oil (CPO), refined palm oil (RPO), refined, bleached & deodorised palm olein (RBD), palm oil mill effluent (POME) and used cooking oil, which came into effect on 28 Apr and will last until the price of cooking oil in the country is below IDR14,000 per litre. Intent of export ban was to prioritise domestic needs and fulfill people's basic necessities amidst shortages. It could take several months for prices to slip discernibly lower from current >IDR17,000 per litre, but in any case, some combination of moderation in domestic prices and pressures from domestic producers and international buyers could still lead authorities to revisit policy curbs in 1-2 months.

- **Recent rout in US treasuries triggered by hawkish Fed signalling via Fedspeaks likely impeded IDR recovery, but did not lead to large IDR losses as in earlier Fed tapering episodes.** IGB-UST 10Y yield differential narrowed from around interim high of 500bps in early Mar to interim low of around 413bps at last seen, as UST yields spiked. But in the second half of Apr, UST yields are seeing more two-way swings. **On net, carry appeal of IGB assets might have moderated a tad and dampened IDR sentiments accordingly, but yield differentials likely remain sufficiently wide to avoid triggering a larger exodus of foreign funds.** On bond flows, we note that net outflows in Apr (-

US$928mn MTD as of 27 Apr) has moderated significantly versus magnitude of outflows in Mar (-US$2868mn). Outflows from bonds are also more than made up for by inflows into IDR equities (US$2783mn MTD as of 28 Apr).

- **In any case, extent of broad volatility spillovers from external risk events to IDR assets should be contained, given lower foreign holdings in Indo sovereign bonds, healthier current account balance, larger FX reserves vs. earlier Fed tapering episodes**. House view looks for current account to come in at a modest deficit of 1.0% of GDP in 2022 compared to pre-pandemic period (deficit of above 2.5% of GDP). Foreign reserves for Mar came in at US$139.1bn, lower versus US$141.4bn prior, but remaining near historical highs.

- On Covid, 7-day average in Covid-19 cases were seen at around 500-600 in late April, versus interim highs near 56k on 20 Feb. Covid-related risks have fallen significantly. On net, **authorities are largely sticking to a Covid-endemic and reopening policy stance.** The government announced extended Idul Fitri leave days (Apr 29 and May 4, 5, 6, 2022) for this year and vowed to ramp up the rollout of booster shots across the country. Restrictions on many activities during the holy month of Ramadan were eased, with worshippers now allowed to hold congregational evening prayers. Authorities also allowed people to go back to their hometowns during the Idul Fitri holiday, a tradition known as mudik, marking the first time it has officially eased restrictions on holiday festivities in the last two years.

- **Growth and Inflation Outlook:** GDP growth firmed to +5% in 4Q as the easing of mobility restrictions drove a recovery in domestic demand and the global commodity boom kept the export engine roaring. For 2021 overall, GDP rose by +3.7%, reversing the -2.1% decline in 2020.

- On higher-frequency indicators, S&P Global PMI Mfg for Mar came in at 51.3 in March, on par with 51.2 in Feb. Feb retail sales growth eased to +14.5% (from 15.2% prior) as the Omicron wave saw cases jumping to record highs then, but we note that drags could ease with cases reverting to a downtrend since late Feb.

- BI cut its global GDP growth forecast to 3.5% (from 4.4%) due to supply chain disruptions from the Russia-Ukraine war, which are expected to weigh on global trade and markets. BI downgraded its Indonesia GDP growth forecast for the first time this year to 4.5%-5.3% (**Maybank forecast: +5.1%**), on the back of slower global growth and weaker domestic demand due to higher energy and food prices. It remained optimistic on 1Q growth, as indicated by the positive performance in March for retail sales, non-construction investment and exports.

- Headline CPI (+2.6%) rose to a near 2-year high in March, mainly driven by food prices as the government scrapped caps on cooking oil prices. Pertamina finally raised the price of its unsubsidized high-grade fuel Pertamax (13% of total gasoline consumption) by around +38% to between IDR12,500 and IDR13,000/litre from 1 April, up from the previous range of IDR9,000-IDR9,400/litre, which had been the level since 2019. Our economist team estimates that the fuel price hike will add around +0.3%pt to headline CPI, and **has earlier raised average**

headline CPI forecast to +3.7% (from +3.2%) in 2022, to account for the increase in unsubsidized fuel prices and higher food prices.

- **Monetary Policy Forecast:** On 19 Apr, BI maintained its policy rate to maintain IDR stability while supporting the economic recovery, amid rising downside risks stemming from the Russia-Ukraine war and faster monetary policy normalization in advanced economies. Deposit and lending facility rates were kept at 2.75% and 4.25% respectively. BI downgraded its GDP growth forecast range to 4.5%-5.3% (from 4.7%-5.5%), while keeping its inflation target range at 2%-4%. Governor Perry stated that inflation remains manageable and is expected to average within its 2%-4% target range this year, even as upside risks might emerge from global food and fuel prices. Notably, BI also raised its 2022 current account balance forecast to a narrower deficit of 0.5%-1.3% of GDP (from 1.1%-1.9% of GDP), on the back of higher commodity prices. Healthier current account balance should be IDR-supportive.

- House view looks for BI to deliver its first +25bps rate hike this quarter, which could be as early as the next meeting on 24 May, following the US Fed's anticipated +50bps hike in early May. **Base case is for the BI to raise its policy rate by +75bps this year, but risks are on the upside if inflation exceeds BI's target range**. The government is considering hikes in prices for Pertalite, 3-kg LPG cylinders, and electricity tariffs in the coming months to protect the state budget. In the scenario of a 15%-20% price hike for Pertalite (63% of fuel consumption) around June, our economist team expects headline inflation to increase to around 4.5% to 5% in 2022 (vs. current forecast of 3.7%). In this scenario, BI could even tighten more aggressively by around 125 to 150bps (5 to 6 hikes). Still, likelihood such such a fast pace of rate hikes could be low for now, with latest comments from BI officials citing rate hikes as last resort in combating inflation (noting priority usage of RRR hikes),

- For the whole of 2021, BI purchased IDR358trn (2.1% of GDP) worth of government bonds to fund the budget deficit (which came in at 4.65% of GDP). Under the extended burden sharing agreement, BI will purchase IDR224trn (1.3% of GDP) in 2022.

- **Latest Fiscal and External Balance Outlook:** In Sep 2021, parliament proceeded to approve Jokowi's 2022 budget with a total spending of IDR2,714.2trn (US$190bn), a slight decrease from IDR2,750trn budget for 2021. Government revenue is expected to rise discernibly, as both income tax and value-added tax (VAT) are projected to grow by more than +10% with the expansion of VAT collection and the normalization of growth. Fiscal deficit was estimated at 4.85% of GDP.

- In early Jan, it was estimated that Indonesia recorded a budget deficit of 4.65% of GDP for 2021, "far smaller" than initial estimates, according to FM Sri Mulyani. The government collected IDR2,003trn (US$140 billion) in revenues, while spending reached IDR2,787trn. Tax revenues were 19% higher than in 2020 and about 104% of the target. F**ollowing better than-expected revenue collections in 2021**, **the 2022 fiscal deficit estimate was lowered to 4.3% of GDP.** Fiscal conditions also seem to be improving YTD, with realization of state revenues reaching IDR501trn as of March, a 32.1% increase from IDR379.4trn a year ago.

- Tax reforms in 2022, including a VAT hike and a tax amnesty program, could generate additional revenue of around 0.7% to 1.5% of GDP, helping the government meet its lower fiscal deficit target. In a recent public address, **President Jokowi called on public agencies to prepare a "detailed, correct and precise" spending plan to return the state budget to below 3% of the GDP in 2023**, in accordance with Law no. 2 of 2020 on State Financial Policy and Deficit Financial System Stability, after allowing the deficit to exceed 3% in FY2020-FY2022 to meet pandemic financing needs. **Signs of fiscal discipline can help mitigate drags on IDR from a return of current account surplus into modest deficit territory**.

- Exports climbed to a record high in March, as prices of key exports including coal, palm oil, nickel, and steel surged following the Russia-Ukraine war. Total export growth accelerated to +44.4% (vs. +34.2% in Feb), boosted by both non-oil & gas (+43.8% vs. +35.3% in Feb) and oil & gas (+54.8% vs. +15.6% in Feb). Imports (+30.9% vs. +25.4% in Feb) picked up as the surge in non-oil & gas (+27.3% vs. +14.8% in Feb) offset the slowdown in oil & gas (+53.2% vs. +123% in Feb). Trade surplus widened to US$4.5bn (vs. $3.8bn in Feb), the largest since Aug 2021. For 1Q, goods trade surplus came in at US$9.3bn, only slightly narrower than the $10.3bn recorded in 4Q21. Our economist team expects the current account balance to remain in a small surplus in 1Q for the third straight quarter (4Q recorded $1.4bn surplus or 0.4% of GDP), boosted by strong commodity exports. The current account deficit forecast was recently narrowed to 1% of GDP (from 1.4% of GDP) in 2022 on a stronger goods trade balance. **Outlook remains benign for the year, even as some near-term downside risks could be in focus following the latest palm oil export bans**.

- **Key domestic events and issues to watch**: Apr PMI Mfg (4 May); Apr CPI (9 May); 1Q GDP (9 May); Foreign reserves (10 May); Apr Local auto sales (15-21 May); Apr Trade (17 May); 1Q Current Account (20 May); BI Monetary policy decision (24 May).

- **Technical Outlook:** USDIDR last seen at 14,500. The pair largely saw ranged trading between 14,330 and 14,380 for the first few weeks of Apr before breaking out higher. Momentum on daily chart is bullish, but RSI is nearing overbought conditions. Risks for pair could be skewed to the upside although extent of upswings could be constrained somewhat. Resistance at 14,640 (2021 high). Support at 14,370 (21-DMA), 14,320 (200-DMA).

PHP: Elevated External Uncertainty Meets Domestic Macro Resilience

Forecast	2Q 2022	3Q 2022	4Q 2022	1Q 2023
USDPHP	**52.80** (51.00)	**52.50** (50.50)	**52.00** (50.00)	**51.50** (49.50)

Previous Forecasts in Parentheses

- **Motivation for the FX View:** Between late March and early Apr, PHP benefited from a confluence of hawkish tilt in BSP signalling and down-moves in oil prices, but the pace of recovery then was likely a tad overdone. Subsequently, against a backdrop of relentless surge in US treasury yields, upcoming May Philippines presidential elections, China partial lockdown concerns etc., the earlier bout of positivity unwound relatively aggressively and PHP is last seen near the softer end of YTD ranges. More cautious sentiments could have been compounded by underwhelming Feb reading for remittances as well. Still, we note signs of traction in domestic manufacturing recovery (PMI Mfg for Apr at robust 54.3). Some tentative resilience for PHP may be emerging despite weakening global growth outlook, given the more domestic-oriented nature of the Philippines economy. Recent (net) bearish moves in oil could have softened the energy import burden for the economy as well. May could bring about some volatility in sentiments alongside implementation of Fed normalization plans and domestic elections in Philippines, but once the dust on these risk events settle, we remain cautiously optimistic on the PHP. Risks for the USDPHP pair could then be skewed mildly to the downside in 2H. In the event that current bout of global risk aversion persists for longer though, PHP recovery could be delayed.

- **While oil is not the dominant factor for PHP in this complex risk environment, rise or decline in energy import bills could continue to influence PHP**. Brent has moderated quite significantly from near-US$140 peak in March, on account of strategic oil reserves release by US (+180mn bbl over 6 months) and IEA (+60mn bbl), concerns over moderation in aggregate demand on global growth drags (hawkish central banks, China partial lockdowns, Russian sanction drags). In this case, conditional on oil gains potentially seeing some moderation on continuation of abovementioned factors, PHP sentiments could see modest support over time.

- On Covid curbs, it was announced in late Feb that Metro Menila and 38 other areas will be downgraded to Alert level 1, starting 1 March. Under Alert Level 1, intrazonal and interzonal travel will be allowed. All establishments, persons, or activities are permitted to operate, work, or be done at full on-site capacity, provided that health standards are observed. Philippines also began reopening in Feb to foreign visitors who have been vaccinated and test negative for the virus. Tourists from about 150 nations were allowed to visit for the first time in nearly two years. **Easing Covid drags on the domestic economic should lend support to PHP on net.**

- But we note one potential Covid risk factor. The Department of Health reported the country's first case of Omicron BA2.12 on 27 Apr, a subvariant linked to the fresh surge of infections in the US. Initial studies have suggested that BA2.12 is estimated to be 20% more transmissible than BA.2, which is the dominant Omicron strain in the Philippines and the rest of the world. **We opine that while related headlines on the new sub-variant could lead to some interim caution, drags could fade if daily case counts remain low overall** (7-day average at around 200 versus peak of 35k in mid-Jan).

- PHP sentiments were likely also dampened a tad by the recent underwhelming reading for remittances. Overseas Filipino Workers Remittances (OFWR) growth slowed for the third month in a row in Feb 2022 to +1.3%y/y (Jan 2022: +2.5%). Currently, our economist team's 2022 OFWR growth forecast is +4.2% to US$32.75b (2M 2022: +1.9%; 2021: +5.1%) while BSP expects +4% growth. Caveat to OFWR outlook now is the global economic impact of Russia-Ukraine war, especially if the conflict drags on Europe which accounts for 12% of 2021 OFWR vs a miniscule 0.008% share for Russia and Ukraine. Meanwhile, foreign reserves came in at US$108.5bn for Mar, versus revised $107.8bn prior, remaining near historical highs. **Resilient remittances and adequate reserves can still be supportive of PHP at the margin**.

- **May 2022 elections could be a volatility event**. Some level of policy uncertainty given the change in political regime could induce some caution in PHP in the lead-up to and during elections. Candidate Marcos currently hold an wide lead in polls (some estimates seeing him taking more than half of the votes), but details regarding his stances on various policy prongs are still lacking for now.

- **House view is for the series of legislative reforms introduced by the Duterte government to boost Philippines' long term economic competitiveness**. Beginning with the Tax Reform for Acceleration and Inclusion Act (TRAIN) in 2018 (implemented in stages), recent reforms in place included Corporate Recovery and Tax Incentives for Enterprises (CREATE), Financial Institutions Strategic Transfer (FIST) and Retail Trade Liberalisation Act (RTL). Latest amendments to the Public Service Act (PSA) will lift foreign ownership restrictions on all public services that are not public utilities, and possibly accelerate capital formation. Sectors impacted include air transport, telecoms, toll roads, and rail and shipping. These reforms are expected to act as catalysts to boost private investment including FDI and thus economic growth.

- **Some spillovers from weakening yuan and rising China Covid risks could be in play for the AxJ FX complex, but PHP could see relative resilience on this front given the more domestic-oriented nature of the Philippines economy**. As of 2020, share of exports to GDP is relatively low for Philippines at 25%, versus 61% for Malaysia, 176% for Singapore, 52% for Thailand. While Indonesia has a lower share at 17%, it is more sensitive to global commodity trends given its pre-dominantly commodity-linked exports.

- **Growth and Inflation Outlook:** Philippines' real GDP growth picked up to +7.7%y/y in 4Q (3Q 2021: +6.9%), resulting in full year 2021 growth of +5.6%, in line with our economist team's +5.5% estimate. Except for agriculture, which posted marginal decline, all sectors of the economy recovered from the contraction in 2020. The decision to allow economic activities to operate with strict standard health protocols and procedures have mitigated the downsides to growth in 2Q-4Q 2021.

- On higher frequency indicators, PMI Mfg for Apr came in at 54.3 versus 53.2 prior, reflecting some traction in the domestic economic recovery. Unemployment rate for Feb came in at 6.4%, on par with prior, staying at the lowest since the start of the pandemic. Labour force participation rate improved to 63.8% (vs. 60.5% in Jan) with total of 2.46m jobs created during the month, mainly in agriculture and services. Our economist team maintains 2022 unemployment rate forecast of 6.3% (2021: 7.8%).

- **House view for 2022 real GDP growth remains at +7.0%**. Domestic demand will continue to drive the recovery, as the economy progressively re-opens. At the current recovery momentum, the economy's quarterly real GDP value could return to pre-pandemic levels by the 3Q/4Q of this year.

- Headline inflation rate jumped to +4.0%y/y in Mar 2022 (Feb 2022: +3.0%; 1Q2022: +3.4%), which is at the upper end of BSP's target range of 2%-4%, mainly on higher housing, utility, food & non-alcoholic beverages and transport costs. Our economist team revises upwards 2022 and 2023 headline inflation rate forecasts to +4.2% (+3.4% previously) and +3.2% (+2.7% previously), respectively (2021: +3.9%).

- **Monetary Policy Forecast:** BSP kept policy interest rate at 2.00% at the second meeting of 2022 (24 Mar) which has been unchanged since -25bps cut on 19 Nov 2020. It now expects inflation to breach the 2%-4% target in 2022 but to return within range in 2023. Monetary policy statement tilted to "hawkish" tone. I.e., Given the potential broadening of price pressures over the near term, BSP said it now stands ready to respond to the buildup in inflation pressures that can dis-anchor inflation expectations. Previously, BSP said it was prudent to maintain accommodative policy stance given a manageable inflation environment. **House view looks for two +25bps hikes at end-3Q 2022 and end-4Q 2022.**

- Governor Diokno commented that raising the policy rate to between 2.5% to 2.75% as part of an exit from Covid stimulus would be "reasonable and consistent" with Philippines' macroeconomic targets. Normalization would likely start in 2H, but would be data dependent. A 2.75% key policy rate "might be reached by next year." Meanwhile, as of writing, markets are looking for additional +250bps in rate hikes from Fed by end of 2022. **Faster Fed versus slower BSP policy divergence is still in focus, potentially constraining interim PHP recovery.**

- **Latest Fiscal and External Balance Outlook:** The expansionary Budget 2022 of PHP5.024trn (signed by President Duterte in Dec 2021), which is +11.5% higher than Budget 2021, should help to maintain underlying economic recovery momentum.

- **There are early signs of increasing fiscal stresses.** Budget deficit for Mar came in at -PHP187.7bn, widening from -PHP105.8bn prior. Average monthly budget deficit from Jan to Mar 2022 is around PHP106bn, vs. the pre-pandemic monthly average of PHP55bn in 2019, reflective of the fiscal challenges associated with the pandemic. Finance Secretary Carlos Dominguez recently said that the Philippines must grow by > 6% annually in the next five years so it can pay down debt incurred due to the pandemic. Both consensus and house view looks for growth pace at >6% for both 2022 and 2023.

- Exports in Feb surprised to the upside, growing by 15.0%y/y (vs. expected 10.0%). Imports continued to see double-digit growth, but pace was modestly slower at 20.1%y/y versus 29.4% expected. On net trade deficit is narrower at -US$3,529mn versus expected -US$4,696mn and -US$4,716mn prior. Our economist team expects 2022 exports & imports growth of +7.8% (2M2022: +11.9%; 2021: +14.5%) and +10.0% (2M2022: +24.0%; 2021: +31.1%) on base effect & -US$49b trade deficit (2M 2022: -US$8.2b; 2021: -US$43.2b). Key caveat to the forecasts is Russia-Ukraine war spillover to global economy, trade & commodity prices. On net, **house view sees current account at deficit of 1.8% of GDP in 2022 versus 0.1% deficit pre-Covid average over 2015-19**.

- **Key domestic events and issues to watch:** Apr PMI Mfg (2 May); Apr CPI (5 May); Mar Unemployment rate (6 May); Mar trade (6 May); Apr Foreign reserves (9-15 May); 1Q GDP (12 May); Mar Overseas Remittances (14-17 May); Apr BoP Overall (18-23 May); BSP Policy decision (19 May); Apr Budget balance (25 May).

- **Technical Outlook:** USDPHP last seen at 52.47, rising rapidly from interim trough of 51.2 in early April. Momentum and RSI on daily chart are both mildly bullish, suggesting that risks for pair could be skewed mildly to upside for now. Immediate resistance at 52.50 (Mar high), before next at 52.85 (76.4% fibo retracement from 2018 high to 2021 low). But if upswings are resisted by 52.50, a resulting double-top formation could lead to bearish moves towards support at 52.00 (21-DMA), 51.50 (100-DMA).

THB: Tourism Drags Persist on China Covid Zero

Forecast	2Q 2022	3Q 2022	4Q 2022	1Q 2023
USDTHB	34.60 (33.00)	34.30 (32.50)	33.90 (32.50)	33.40 (32.00)

Previous Forecasts in Parentheses

- **Motivation for the FX View:** USDTHB pair remains near YTD highs amid global growth drags (Ukraine war, Russian sanctions, China partial lockdowns, hawkish Fed), elevated global inflationary pressures and buoyant USD. THB sentiments could be more sensitive to recent developments out of China which suggests that authorities are still largely sticking to Covid zero policies. Hopes for an earlier return of Chinese tourists to Thailand could be dashed for now. Such an external environment could lead USDTHB pair to remain in buoyant trading ranges in the interim. Nonetheless, upward pressures on USDTHB from a strong dollar could be mitigated to some extent by recent net bearish moves in oil (i.e., lower burden in oil import bills), and recent positive portfolio inflows in Apr. A sharp surge in USDTHB from here could be less likely, conditional on (i) no further hawkish surprises from Fed (still some uncertainty in QT) and (ii) no exacerbating in oil supply crunch. Current conditions could see THB recovery pushed further out for now but we remain cautiously optimistic in the latter part of the year as interim risk events fade in impact.

- **A key market mover in March-Apr was an increasingly hawkish Fed.** FoMC voted 8-1 to raise rate to 0.25% - 0.5% in March, with dots plot signalling another 6 more hikes this year (vs. their previous projection for 3 hikes). But the hawkish-tilt in March FoMC was followed by a series of hawkish Fedspeaks from officials in recent weeks as well. At last check, markets are now looking for around +250bps of rate increases from Fed by Dec. To some extent, with aggressive rate hikes somewhat priced, market focus could turn to QT details. Earlier proposed balance sheet run-down with a cap of $95bn/month is nearly 2x the peak cap of $50bn/ month in the 2017 – 19 QT episode. **Historically, the impact of QT on AxJ FX has not been conclusive, but aggressive pace could still weigh on AxJ sentiments when broader external risk environment is already seeing heightened levels of uncertainty on Ukraine war, China partial lockdowns.** For THB, trends in bond flows might be an indicator to watch. While net outflows were seen for the month (US$2023mn MTD as of 31 Mar), we note that net inflows were seen for the month of Apr (+US$227mn as of 29 Apr), albeit modest in magnitude. Equities similarly saw inflows as well, at US$321mn as of 29 Apr.

- Although some support is seen for Brent at the US$100-handle, recent oil moves continued to be tentatively bearish. Brent has moderated quite significantly from near-US$140 peak in March, on account of strategic oil reserves release by US (+180mn bbl over 6 months) and IEA (+60mn bbl), concerns over moderation in aggregate demand on global growth drags (hawkish central banks, China partial lockdowns, Russian sanction drags). **Some easing in energy import bills for Thailand could help to reduce the likelihood of another sharp upswing in USDTHB.**

- Domestic Covid cases have been on an upswing for most of Feb-Mar, but **there are tentative signs that Covid cases is trending lower**. 7-day average in new daily cases is around 12k in early May, lower than peak of near-30k in end March. About three-quarters of the ~70mn population have received at least 2 shots. Earlier, authorities released a roadmap for transitioning from pandemic status to endemic, potentially by July.

- Thailand's urgency in reopening stems from its reliance on tourism, which contributed about one-fifth of economic output before the pandemic. After an earlier suspension on Omicron concerns, the Thai government lifted the suspension of "Test and Go" from 1 Feb 2022, which means re-implementation of quarantine-free travel for foreign visitors. Tourism improved slightly with the resumption of the Test & Go programme, but could see drags from ongoing Russia-Ukraine war. Visitor arrivals climbed to 211k in March, the highest since Dec 2021

(230k), with the highest arrivals from the UK (9.4% of total), Germany (8.1%) and US (6.7%). But tourists from Russia, the top source of arrivals in Jan-Feb, nearly halved to 9.2k in March (from 17.9k in Feb) due to the war and sanctions. **Russia is an important source of visitor arrivals for Thailand and forms the third highest share (5.4%) of Thailand tourism revenue after China (28%) and Malaysia (5.6%)**. Another risk for Thailand tourism at this point could be expectations of China Covid policy. THB sentiments could be more sensitive to recent developments out of China which suggests that authorities are still largely sticking to strict Covid zero stances. **Hopes for an earlier return of Chinese tourists to Thailand could be dashed for now**.

- **Risks of early elections needs to be monitored**. With PM Prayut's popularity rating in decline and growing rifts in his Palang Pracharath Party (PPRP), there is growing speculation that an election (required to be held by 1Q 2023) may be brought forward to 2022. House view is for the PPRP to renominate Prayut, allowing him to stay in power until 2025. But in the case of an early election, we could see risks of delay in passage of Budget FY2023. If results are contentious, ensuing social unrest could dampen THB sentiments as well. During the 2013/14 political crisis, THB had experienced losses of more than 6% against USD at one point.

- **Growth and Inflation Outlook**: 4Q GDP rebounded by +1.9% as domestic demand recovered with the relaxation of Covid measures, while exports benefited from improving external demand and reopening of borders. For 2021 overall, real GDP rose by +1.6% (vs. -6.2% in 2020).

- PMI Mfg came in at 51.9 for Apr, improving slightly from 51.8 prior. But domestic demand slowed in March as the Omicron variant outbreak, as well as rising production and consumer prices, weighed on consumption and investment. Alongside potential drags on global and EU growth from the Russia-Ukraine war, **our economist team forecasts a softer 2022 GDP forecast at +3.2%**. Drags could materialize via Thailand's manufacturing and exports. Tourism drags may also be a concern, as discussed earlier.

- Headline CPI jumped to +5.7% in March, breaching the BoT's target range for the third straight month, as the Russia-Ukraine war drove energy and food prices higher. The Commerce Ministry raised its 2022 headline inflation forecast to 4%-5%, from the previous estimate of 0.7%-2.4%. Meanwhile, PM Prayut stressed that prices of 18 controlled consumer and basic goods must remain capped. He also pledged to come up with measures to cushion the inflationary effects on consumers but said they must be devised carefully in light of budgetary constraints. Fiscal, rather than monetary policy tools are more likely to be utilized to combat inflation. **Our economist team's inflation forecast for 2022 is at +4.8%**, and inflation could exceed +5% in the second and third quarters (vs. +4.7% in 1Q) on the back of elevated commodity prices and tapering of government subsidies, especially for diesel prices.

- **Monetary Policy Forecast:** BoT kept its policy rate at 0.5% with a unanimous vote on 30 March, in line with expectations. The central bank cut its 2022 GDP growth forecast to +3.2% (from +3.4%), but expects the economic recovery to remain intact in 2022 and 2023 despite the impact from the Russia-Ukraine war, which has led to higher commodity prices and slower external demand. It hiked its headline inflation forecast to +4.9% (from +1.7%), mainly to account for rising energy and food prices, assessing that recent increases in inflation were primarily driven by cost-push factors, while demand-pull inflation pressures remained tame.

- **On net, BoT could still be a tad patient in moving away from accommodative policy given fragile growth dynamics**. Raising the policy rate at this juncture will not tame inflation as costs are mainly driven by energy prices rather than core components. Governor Sethaput said recently that "priority now is to ensure that the recovery remains intact". House view looks for just one 25bps hike from BoT later this year, while markets now expect +250bps worth of rate increases from Fed between now and year-end. Fed-BoT divergence could remain wide near-term, but given stretched expectations, extent of further widening could slow.

- **Latest Fiscal and External Balance Outlook**: Parliament earlier approved the budget for FY2022 (starting 1 Oct), which sees reduced spending on defence and education, and increased outlays on combating Covid fallout. The THB3.1trn (US$93bn) plan is 5.8% less than FY2021's, and estimates the budget deficit at THB700bn. In Oct, the cabinet approved a further THB92bn in relief measures, with about THB42bn going towards cash transfers under an existing co-payment scheme to support consumption, while around THB37.5bn will go towards smaller firms to help retain jobs. The Cabinet has also approved measures amounting to THB131.6bn to support rice farmers' incomes during production year 2021/22.

- In March 2022, relief measures worth THB70bn (US$2.1bn) to counter rising energy prices were approved. Retail diesel prices will be capped at THB30 (US$0.9) per liter until end April, after which the government will only subsidize 50% of any increase in prices. From May to July, cash assistance for cooking gas purchase will be raised to THB100/month (from THB45) for 3.6mn welfare card holders. Other measures include a THB250/month oil subsidy for motorcycle taxis, lower electricity charges for eligible consumers, and lower contribution under the social security system (from 5% to 1%) for both employers and workers.

- On debt dynamics, we note that a government panel approved raising public debt-to-GDP ratio to 70% from 60% in Sep 2021, in order to raise state borrowing to finance its stimulus and to ensure debt repayment ability. Authorities planned to significantly increase the share of longer-dated sovereign bonds (vs. short-term securities) for its financing needs, with the former expected to make up around 48%-56% of the government's THB2.3trn (US$68.4bn) borrowing in the new FY compared with 31% in the prior year. **House view is for fiscal deficit to narrow towards 4.3% of GDP in 2022 from 4.8% prior.**

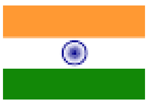
- **We note that authorities are considering various taxes to shore up fiscal revenue**. Plans include a 0.1% stock transaction tax, normalization of the land & buildings tax and a THB300 fee on foreign tourists from Apr 2022, but gains will likely be small at less than 0.5% of GDP. Other ways to raise tax revenue will be improving personal income tax collection, raising VAT from the current 7%, and imposing a carbon tax.

- Concomitantly, Moody's has affirmed the Thai government's Baa1 issuer rating and maintained its outlook at stable. The ratings agency expects the economy to display resilience to future shocks. While the agency expects government debt to rise and remain markedly higher than pre-pandemic norm, it still thinks that Thailand's fiscal metrics will be stronger than most Baa-rated peers. Meanwhile, comments from Finance Minister Arkhom suggests that authorities will focus on maintaining fiscal discipline after the large bout of borrowing earlier. **While efforts to maintain fiscal discipline are largely positive for THB sentiments over the long-run, there could be near-term concerns on potentially more constrained support to growth from fiscal policy**.

- Exports accelerated in March to a record high level, boosted by the surge in gold and electronics. Gold exports were 11 times higher than a year ago, most likely due to the rush to safe haven as the Russia-Ukraine war intensified. Imports also climbed to an all-time high, led by crude oil, electronics, and natural gas. Total exports surged by +19.5% (vs. +16.2% in Feb) to US$28.9bn, while exports excluding gold moderated to +9.5% (vs. +13.2% in Feb). Imports growth picked up to +18% (vs. +16.8% in Feb) to $27.4bn, resulting in the trade balance widening to a 17-month high of $1.5bn (vs. $123mn in Feb). As a result, the current account balance swung back to a surplus (US$1.2bn) in March for the first time in 4 months, reversing the $0.7bn decline in Feb. **But given potential spillovers to Thailand exports and tourism from ongoing Russia-Ukraine war, current account could still come in at a deficit reading in 2022 (house projection at 1.0% of GDP)**.

- **Key domestic events and issues to watch:** Apr PMI Mfg (3 May), Apr Business sentiment (3 May); Apr CPI (5 May); Apr Consumer confidence (10 May); 1Q GDP (17 May); Apr Customs trade (23 May); Apr Manufacturing Production (26-30 May); Apr BoP Current account (31 May).

- **Technical Outlook**: USDTHB last seen near 34.35. Momentum on daily chart is bullish, while RSI is in overbought conditions. If bullish momentum moderates further, and adds to signs of bearish divergence, risks for the pair could become tentatively skewed to the downside. Resistance at 34.60 (76.4% fibo retracement from Dec 2016 high to Feb 2021 low), 35.00. Support at 33.80 (21-DMA), 33.30 (100-dma).



INR: Displaying Resilience

Forecast	2Q 2022	3Q 2022	4Q 2022	1Q 2023
USDINR	**75.50 (--)**	**75.00 (--)**	**74.50 (--)**	**74.50 (--)**

No Change to Previous Forecasts

- **Motivation for the FX View:** Barring further oil volatility, we anticipate a potential peak in the greenback to coincide with the USDINR and bring the pair lower from current spot prices. RBI is also set to start hiking rates from the next meeting on 8 Jun and that could provide further underpinnings to the INR. Despite India's contentious oil deal with Russia, India is being seen as the democratic country to woo by the west amid Nato's conflict with Russia. Over the course of Apr, UK PM Johnson had sought a trade pact with India seeking to get tariff reduction for British whiskey, scotch and automobiles in exchange for India's request for access to visas for its skilled workers and students. The EU and India have also agreed to launch a joint trade and technology council on Monday, paving the way to accelerate trade talks with India. Australia is also expected to sign the Comprehensive Economic Cooperation Agreement with India to strengthen bilateral trades with a deal on digital trade. Ths US also plans a QUAD summit in May that is aimed at reaching out to India. The prospect of trade deals could certainly help India with its external balance and growth. INR's strength could be amplified should USD and UST yield pull back.

- **Growth and Inflation Outlook:** CPI rose more than expected to 6.95%y/y for Mar vs. 6.07% previously with food prices (7.7%y/y) providing strong underpinning to the headline. Similarly, Mar WPI accelerated a lot more than expected to 14.55%y/y from previous 13.11%. Headline is supported by strong price pressure for fuel, power, lighting prices up 34.5%y/y vs. previous 31.5%, manufactured product prices at 10.7%y/y vs. previous 9.8%. Key concern at this point is food prices that could be squeezed higher by the rising costs of fertlizers. On that front, the government pledged INR609bn of subsidies for fertilizers to support agriculture crops including soybeans and rice over the critical Apr-Sep monsoon period. That said, India is likely to face more price pressure given its strong reliance on Indonesia's palm oil which the country has just banned the export of.

- Industrial production undershot estimates at 1.7%y/y for Feb vs. previous 1.5% as the weaker manufacturing growth of output (0.7%y/y vs. previous 0.9%) only partially offset by the stronger mining and electricity output. Looking forward, industrial production faces headwinds in terms of external demand as war rages on, input cost rises. PMI Services continue to rise for Mar to 53.6 from previous 51.8 as the recovery from Covid restrictions continue. Meanwhile, manufacturing PMI slipped to 54.0 from previous 54.9 with output down to 56.2 from previous 57.7. Weakening external demand and elevated input costs may not bode well for the next set of PMIs.

- Trade deficit for Mar narrowed to $18.5bn vs. previous $20.9bn. Exports slowed to 19.8%y/y vs. previous 25.1%, matched by imports growth which also decelerated to 24.2%y/y from 36.1%. Trade deficit may not narrow further given rising global price pressure of key commodities as well as potential decline in external demand in light of China lockdowns. That said, into the medium term, we note that the government has been in active talks with several countries on trade agreements that could be positive for India's external balance.

- **Monetary Policy Forecast:** RBI has flagged the start of a rate hike cycle at the last meeting on 8 Apr. The central bank stood pat on most of its lending rates with policy repo rate at 4.0%, marginal standing facility rate and bank rate at 4.25%. RBI adjusted the floor for its liquidity adjustment facility (LAF) corridor to be the standing deposit facility at 3.75% (instead of the previous floor which was reverse repo rate 3.35%) in order to reduce liquidity surplus and thus underscoring a hawkish shift. The MPC retains accommodative stance but the adjustment of the LAF floor is meant to "withdraw accommodation to keep inflation within the target". OIS implied a

- RBI raised its inflation forecast for FY through Mar 2023 to 5.7% from 4.5% and lowered its growth forecasts for the same period to 7.2% from 7.8%. OIS implied at one hike in the next three months and 200bps rate increase over the next one year.

- Finance Minister Nirmala Sitharaman assured that economic growth will remain supported by fiscal spending whilst RBI pivots towards countering inflation. She highlighted that supply-side spending generates enough multiplier effect to spur the economic rebound from the pandemic which will act as the offset for RBI's plan to remove monetary policy accommodation.

- **Latest Fiscal and External Balance Outlook:** Budget 2022-23 was an expansionary one. **Fiscal deficit is projected to come in a tad higher than previous estimate at 6.9% of GDP for FY2021-2022 but should ease further to 6.4% for FY2022-23.** Finance Minister Nirmala Sitharaman had proposed increasing capital spending by 35% to INR7.5trn for 2022- 2023. In addition, there is a push for infrastructure-led growth with spending focused on roads, rail, logistics and energy, bringing to fruition the National Master Plan for economic transformation, multimodal connectivity and logistics efficiency that was approved by the Union Cabinet last Oct. Effective capital expenditure is estimated to be at 4.1% of GDP.

- **Key domestic events and issues to watch:** Markit Mfg (Apr) on 2 May, services, composite PMI (Apr) on 5 May; industrial production for Mar and Apr CPI on 12 May; Apr trade on 13-16 May, WPI (Apr) on 17 May, 1Q GDP no 31 May.

- **Technical Analysis:** USDINR is poised to finish the week with a bearish engulfing candlestick and we eye the week close carefully. A close below 76.77 could be form a strong bearish engulfing candlestick for the week which should precede further bearish moves.

VND: Lingering Risks to the Downside

Forecast	2Q 2022	3Q 2022	4Q 2022	1Q 2023
USDVND	23100 (22900)	23000 (22900)	22900 (22800)	22900 (22700)

Previous Forecasts in Parentheses

- **Motivation for the FX View:** We maintain our forecast trajectory but made slight calibrations, taking into consideration our expectations for further two-way actions of the USDVND with some risks to the upside in the near-term. USD strength, rising energy prices (coal, crude oil) and the USDCNY rally had underpinned the USDVND's creep higher. That said, VND's depreciation in the USD is relatively small vs. other non-USD peers. Despite the significant sell-off in the local equity markets, net equity inflow amounted to $152.9mn for Apr, helping to offset other drags on the VND. Some whispers of forex intervention (via USD sales in the forward market) by the SBV also likely helped steadied the USDVND. In addition, local deposit rates have risen at the turn of the year, also providing some cyclical support to the VND.

- Key risks at this point is still the rise in commodity prices that can culminate into significant Inflation risks, not helped the least by labour shortages. The government has taken action - environmental tax on petrol is halved to ease fuel costs. The industry and trade ministry also ordered importers to double Mar imports to 1m cbm in order to make up for the shortage at the local Nghi Son oil refinery. Meanwhile, the authorities also urged Vietnam Oil and Gas Group for greater oil exploitation output, exploration of new oil fields and to construct the Vung Tau refinery project. Into the medium term, Samsung C&T and Lilama declared a $940mn contract to construct Vietnam's first LNG-fueled power plant to be operated by PetroVietnam Power from 2024/2025. Local media suggest that there would be >20 LNG-fired power plant in the pipeline which could pave thw way for a significant pivot away from Vietnam's reliance on coal. That said, any rise in energy prices in the near-term could still narrow trade surplus and take away some support for the VND.

- USDVND has crept above the 22900-level. Room for USD upside could be limited (given an incredible 9-10 Fed hikes priced within the year). Despite the aggressive hawkish shift in Fed signaling via dots plot and Fedspeaks, and concomitant surge in UST yields, AxJ FX (including VND) have weathered the Fed normalization messaging relatively well. Aggressive upsides for the USDVND could be limited should greenback soften broadly and USDCNY stabilize. In addition, we may be able to count on leaning against the wind activities to pick up pace as inflation environment turns less benign.

- **Growth and Inflation Outlook:** Vietnam's activity data for Apr had exceeded expectations with trade faring better than expected. Export growth jumped to 25%y/y from previous 14.8% while imports growth also rose to 15.5% from previous 14.6%. Trade surplus narrowed less than expected to $1.07bn from previous $1.39bn. Breakdown showed strong external demand for shipments of fishing, coffee, footwear and textiles and electronic and machineries products. For import, the rising prices of coal, crude-related shipments, autos as well as intermediate goods such as electronic supplies, fabrics underpin.

- Coal prices had remained elevated in Apr, still around 160% up from the start of the year. Expensive coal had forced power plants to reduce output, resulting in rising risk of power outages that could eventually hurt production. Industrial production rose to 9.4%y/y from previous 8.5%. Looking at the breakdown, manufacturing picked up pace to 11.3%y/y for Apr vs. previous 9.6%. That offsets weaker output in electricity (2.8% vs. previous 4.8%) as well as weaker output from mining & quarrying and water supply. Retail sales, on the other hand, is well on the recovery with a 12.2%y/y growth vs. previous 9.4%. The easing of the borders has allowed tourism to quicken 49.4% growth in Apr vs. previous 29.9%. Services and hotel/restaurants also quickened to 14.8%y/y and 6/7% respectively. We can expect pent-up global tourism demand to continue to benefit Vietnam's retail scene. Various VAT cuts have been provided (with effect until Dec 2022) that could lend support to private consumption as well. Our economist forecast real GDP growth to be 5.8% for 2022, below the target range of 6-6.5% set by the government.

- **Our economic team raised 2022** headline inflation foreast to 4% from previous 3.8%, expecting food and fuel prices to lift CPI above SBV's 4% target cap from 2Q notwithstanding gover nment measures expected to mitigate some of the price pressure. CPI data for Apr is largely in line with expectations at 2.64%y/y vs. previous 2.41%, underpinned by prices in the food, housing, household appliances and medical products. Transportaiton saw a slight deceleration to 16.6%y/y from previous 18.3%, likely due to the cut in environment tax on fuel.

- Key risks to the economy remain unchanged and include the Russo-Ukraine war that could keep commodity prices elevated (pass-through effects on household consumption), trade (impact on vietnam's exports to Russia and to countries that supply to Russia, impact on external demand), tourism arrivals. In addition, China's intermittent lockdowns have proven to affect freight costs and Vietnam's supply chains. For USDVND, the rise in the USDCNY continue to present upside risks to the USDVND.

- **Monetary Policy Forecast:** Our economist looks for a hike of 50bps to lift policy rate (refinancing rate) to 4.5% from the current 4% but only towards the end of the year. SBV is likely to keep monetary policy accommodative for as long as possible to support growth recovery and will only start to hike policy rate when domestic demand show signs of affecting inflation expectations. SBV expects credit growth to be at 14.1% for 2022.

- On credit conditions, the SBV has started to sound the alarm for property prices as it instructed banks in HCM City to restrict lending for investments in high-end, tourism and resort properties along with real estate speculation. The banks are also urged to tightly control receipts from property transactions and monitor transfers overseas.

- **Latest Fiscal and External Balance Outlook: Right at the start of the year, the National Assembly has approved a $15bn economic recovery package for 2022-**2023. This package includes upgrading healthcare capacity and pandemic resilience (VND60 trn), ensuring social welfare and employment (VND53.15trn), businesses and cooperatives aid (VND 110trn), infrastructure development (VND113.85trn) alongside other reforms. VAT for certain goods and services will also be lowed by 2% to 8%. The budget defict is expected to be raised nu am average of 1-1.2% of the GDP. by about VND240trn. Our economist expects fiscal deficit to be 4% of GDP. Public debt ratio remains modest at around 43-44% of GDP in 2022 (vs. 43.7% of GDP in 2021), well below the debt ceiling of 60% of GDP.

- **Key Domestic Events and Issues to Watch:** Domestic vehicle sales (Apr) due on 6-13 May; May CPI, trade, retail sales, industrial production due on 25-31 May.

FX Forecasts

	End Q2-22	End Q3-22	End Q4-22	End Q1-23
USD/JPY	135.00	130.00	125.00	123.00
EUR/USD	1.0200	1.0500	1.0800	1.0800
GBP/USD	1.2400	1.2200	1.2500	1.2800
AUD/USD	0.7350	0.7450	0.7450	0.7500
NZD/USD	0.6400	0.6600	0.6700	0.6800
USD/CAD	1.2600	1.2500	1.2400	1.2400
USD/SGD	1.3900	1.3800	1.3700	1.3550
USD/MYR	4.4000	4.3500	4.3000	4.3000
USD/IDR	14600	14400	14300	14200
USD/THB	34.60	34.30	33.90	33.40
USD/PHP	52.80	52.50	52.00	51.50
USD/CNY	6.85	6.80	6.74	6.70
USD/HKD	7.80	7.80	7.80	7.80
USD/TWD	29.62	30.00	29.80	29.60
USD/KRW	1260	1240	1220	1210
USD/INR	75.50	75.00	74.50	74.50
USD/VND	23100	23000	22900	22900
DXY Index	105.85	103.69	101.03	100.53
SGD Crosses	End Q2-22	End Q3-22	End Q4-22	End Q1-23
SGD/MYR	3.17	3.15	3.14	3.17
JPY/SGD	1.03	1.06	1.10	1.10
EUR/SGD	1.42	1.45	1.48	1.46
GBP/SGD	1.72	1.68	1.71	1.73
AUD/SGD	1.02	1.03	1.02	1.02
NZD/SGD	0.89	0.91	0.92	0.92
CAD/SGD	1.10	1.10	1.10	1.09
SGD/IDR	10504	10435	10438	10480
SGD/THB	24.89	24.86	24.74	24.65
SGD/PHP	37.99	38.04	37.96	38.01
SGD/CNY	4.93	4.93	4.92	4.94
SGD/HKD	5.61	5.65	5.69	5.76
SGD/TWD	21.31	21.74	21.75	21.85
SGD/KRW	906	899	891	893
SGD/INR	54.32	54.35	54.38	54.98
SGD/VND	16619	16667	16715	16900
	End Q2-22	End Q3-22	End Q4-22	End Q1-23
JPY/MYR	3.26	3.35	3.44	3.50
EUR/MYR	4.49	4.57	4.64	4.64
GBP/MYR	5.46	5.31	5.38	5.50
AUD/MYR	3.23	3.24	3.20	3.23
NZD/MYR	2.82	2.87	2.88	2.92
CAD/MYR	3.49	3.48	3.47	3.47
MYR/IDR	3318	3310	3326	3302
MYR/THB	7.86	7.89	7.88	7.77
MYR/PHP	12.00	12.07	12.09	11.98
MYR/CNY	1.56	1.56	1.57	1.56
MYR/HKD	1.77	1.79	1.81	1.81
MYR/TWD	6.73	6.90	6.93	6.88
MYR/KRW	286	285	284	281
MYR/INR	17.16	17.24	17.33	17.33
MYR/VND	5250	5287	5326	5326

Source: Maybank FX Research and Strategy as of 4 May 2022.
*These forecasts are meant to be indicative of FX trends and not meant to be point forecasts.

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