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Maybank

FX Monthly

2017, Issue 5: Taking Cue from the Fed in June

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What Has Changed This Month?

- We revised JPY (weaker), CNY (stronger) and GBP (weaker) forecast. The USD DXY forecast is also calibrated slightly higher accordingly. Some downward adjustments to the JPY vs. USD, due to continuation of BoJ's ultra-loose monetary policy, and thus further monetary policy divergence is expected to push yield differentials between the UST and JGB wider. We expect USDJPY to climb higher to 116, 120 by end 2Q and 4Q 2017, respectively.
- We revised GBP 2Q forecast slightly lower to take into account that PM May could end up with a smaller majority at the upcoming 8th Jun elections and formal Brexit talks to begin on 19 Jun (this came earlier than initially expected and we expect initial talks to be challenging).
- The year-end USDCNY forecast have been calibrated lower towards 6.90, taking into account suspected intervention that PBoC has made recently and possible consolidation in the next few months given the new "counter-cyclical adjustment factor" introduced in the new USDCNY fixing model.

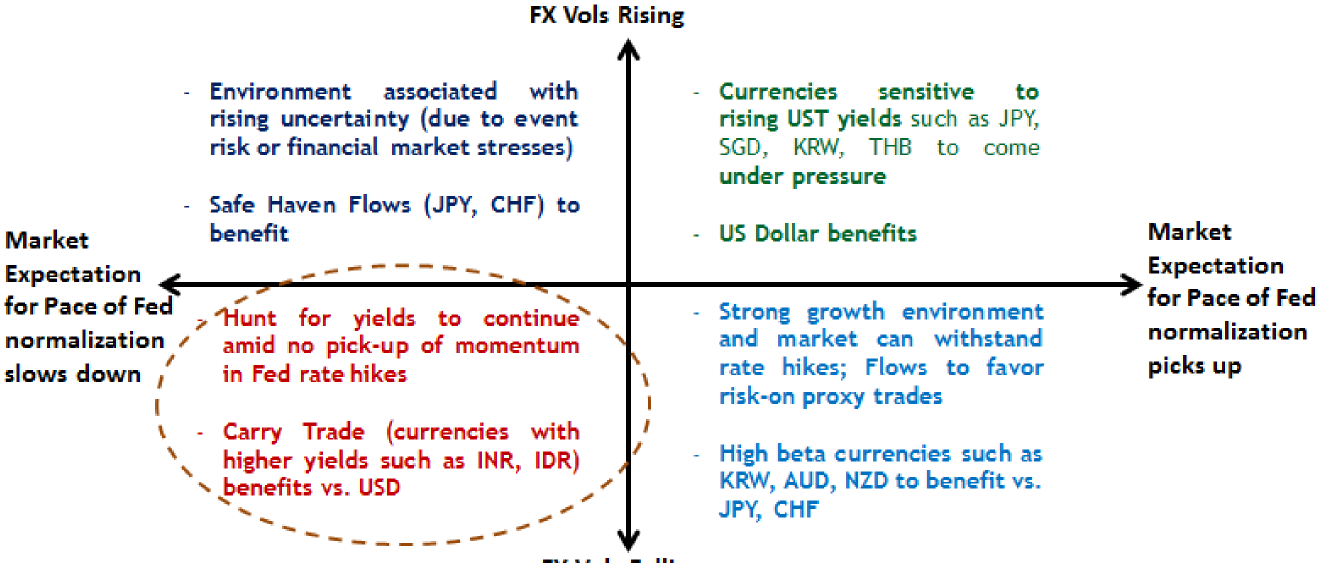
Our Strategies

- Policy normalization has gained momentum in the US as the Fed started hiking earlier this year (as opposed to Dec in 2015, 2016) and there are already talks of balance sheet reduction. A June signal in terms of the pace of Fed normalization (updated normalization principles and plans, ahead of a balance sheet reduction in Sep to 4Q) could still help support UST yields and USD.
- We expect markets to price out political risk premium as political risks have somewhat receded and this should keep the EUR supported (but not elevated). We are not of the view that ECB will change its stance on accommodative monetary policy soon given benign inflation outlook but relative to BoJ (the other central bank on easing bias), we see scope for ECB to move earlier than BoJ in terms of taper/signal change in monetary policy stance. **We favor long EURJPY, as one of our strategic trade for 2017 on receding political risks and to position for eventual monetary policy divergence.**
- Amongst AXJs, we are positive on the MYR given the recent initiatives from BNM. We expect foreign investors' confidence to gradually return. **We see scope for Ringgit to play catch up with regional peers and potentially extend its gains further towards 4.25, 4.20 levels (vs the USD) in June. Prefer to long the MYR against the SGD, THB, IDR, PHP and JPY.** If UST yields start to rise, we would suggest **long USDSGD (target 1.42), USDJPY (target 116, 118) on sensitivity to UST yields rising. Among the Asian central banks we favour RBI and BOT given their likelihood to hike earliest thus favouring long INR and THB against short JPY. While fundamentally, we could short PHPINR on diverging current account balances,** although if oil stabilises currencies of oil importers such as INR and KRW could weaken.

SEE PAGE 54 FOR IMPORTANT DISCLOSURES.

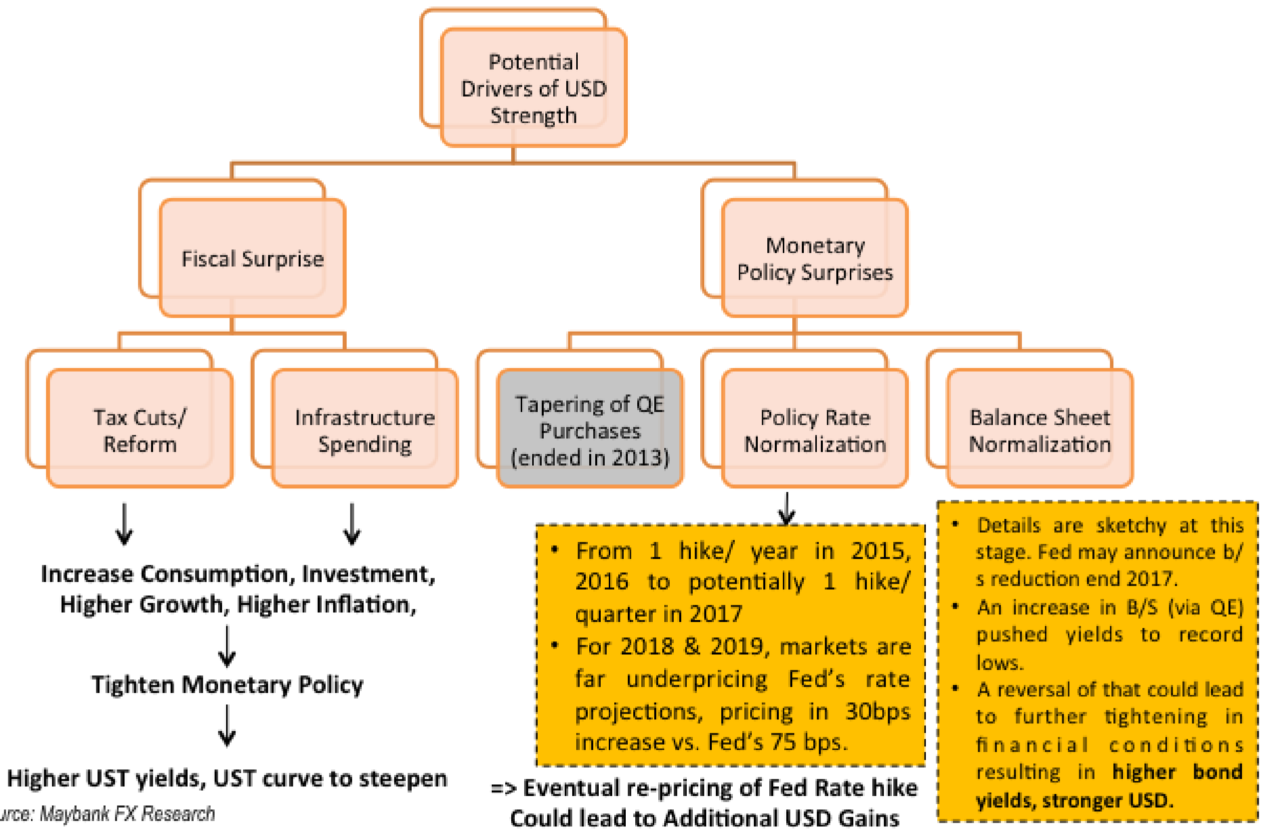
So What?

In the short to medium term, FX Vols and Pace of Fed Rate Hikes are Determinants to FX Bias, Current Environment Favours: INR, IDR



Source: Maybank FX Research

Where Can USD Strength Come From?



Source: Maybank FX Research

G7 Global Overview

USD: Still Looking out for Fiscal Policy Deliberations and Dual Mandate Objectives

Forecast	2Q 2017	3Q 2017	4Q 2017	1Q 2018
USD Index	100.94 (99.22)	102.06 (100.16)	101.50 (99.83)	99.95 (97.98)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** We expect at least two more rate hikes in 2017, more likely in June onwards. We do caution that additional repricing of a surprise Fed hike over the course of the year (due to market complacency over Fed rate hike trajectory) could continue to see UST yields higher in particular Treasuries 2y and below, and see **USD strength (buy the rumor) in the lead-up to FOMC** meetings. The DXY forecasts saw slight revision upwards due to our upward revisions to the USDJPY forecasts.

- We continue to expect domestic data and a repricing of the future stance of monetary policy to support the USD. Even though the market's expectations on the Fed tightening cycle have moved, we think market underpricing for the federal funds rate is still there and we still expect the Dollar to appreciate on average for the remainder of 2017. During this phase and around FOMC announcements, we believe the **USD could still be mildly supported**. In addition, we may need clarity on both fiscal and trade policies from the Trump administration to support a US reflation view. If one of these falters, we could see softness in the USD and further sharp ups and downs in the dollar in 2017. The Trump administration success in its efforts to introduce tax reform remains unclear at this juncture. Continued absence of an agreement on revenue raising measures, President Trump's tax plan will likely have to be scaled back and unclear signals on the tax reforms could soften the USD over the next month or so.

- Nonetheless, as long as there are less economic growth downgrades by supranationals and the market, some signs of global inflation emerging, rising expectation of faster pace of Fed rate hike and if oil remains somewhat stabilized around $50-60/bbl, then we will expect USD strength to be sustained in 2017 and UST yield steepening to appear more entrenched. Oil having dropped to below $50 continue to weigh on the USD.

- **Growth and Inflation Outlook:** The second estimate of Q1 GDP saw a 0.5pp upward revision and the US economy is reported growing at 1.2% q/q saar versus 0.7% in the advance release. The main source of the upward revision came from personal consumption, which was revised higher to 0.6% (from 0.3%), and fixed investment. Government consumption was revised to show a smaller drag on growth, mainly due to stronger spending at the state and local level. Revisions to inventory data and trade were largely offsetting, as slightly weaker growth in private inventories was offset by a stronger contribution to activity from net trade.

- The second estimate of Q1 GDP paints a better picture about the degree of slowing in activity at the start of the year, but the main concern about soft growth in private consumption remains from warmer weather to start the year, an industry transition in autos toward a more balanced mix of production and pricing, delayed tax rebates, and the rebound in headline inflation due to the removal of energy base effects. April employment and auto sales data were relatively solid, and we expect next week's data on April personal consumption, May auto sales, and May employment to put consumption on more solid footing in Q2.
- Non-farm payrolls rose by 211k in April, with the private sector adding 194k and the government sector increasing by 17k. The headline number was above the consensus of 190k. Most broad categories of employment showed improvement in April. The NFP numbers shows better economic momentum in 2Q is likely relative to 1Q, but is in line with employment growth over the past year. Overall, US labor markets continue to point to steady economic activity in 2017. Unemployment rate fell to 4.4% against consensus expectations of a marginal rise. The participation rate fell modestly to 62.9 in January. Average hourly earnings for all employees rose a solid 0.3% m/m and 2.5% y/y. Revisions to past months' data show less wage growth y/y than we had anticipated. Wage inflation simply is not taking root in the economy.
- As long as payroll increases are in the 175k to 200k range the US remains in economic expansion, and as long as labor markets improve at or around this pace, we view risks surrounding the recovery as broadly balanced and see no substantive recession concerns.
- US CPI inflation came in slightly weaker than expected in April on the core measure. Headline CPI inflation rose 0.2% m/m, while core inflation rose only a modest 0.1%, after having declined for the first time since 2010. Core CPI has surprised on the downside for two consecutive months now. Much of that weakness is likely to be transitory, particularly in the core services components. However, we see core goods as remaining a significant headwind to inflation.
- As the headwind from dollar strength and soft imported inflation has faded, and as long as labor markets remain strong, and communications about the desire to normalize policy from FOMC members has been clear and consistent. We should expect headline CPI to reach 2.0% by end 2017 and around 2.5% by end 2018.
- **Monetary Policy Forecast:** We expect the FOMC to move in June. We had expected two further hikes this year – in June and Q3-Q4 (Sep or Dec) followed by balance sheet normalization in Dec. This is evident in the Mar FOMC minutes. Weak data could derail a June hike, but the bar to disrupting the Fed's plans is higher now than it was in previous years. The Minutes from the last meeting echoed what was revealed in the post-decision statement – that the slowdown in economic activity is acknowledged in the first quarter of the year BUT labour market conditions continued to strengthen. "The fundamentals underpinning the continued growth of consumption remained solid,

while business fixed investment had firmed". However, there seems to be a consensus to "await additional evidence" to confirm that the economic slowdown is transitory before taking another step in removing accommodation. This strongly explains why the FOMC decided to pause in May and more than likely to hike in Jun. Any signaling interpreted as Fed reducing its pace over the next few months could lead to UST yields and USD retreating.

- The FoMC minutes showed that a few FoMC participants expressed concerns on inflation but it also suggested a rate hike may come in June meeting though some members said it is prudent to wait for additional evidence indicating that the recent slowing in growth is transitory. On balance sheet normalisation, there was new information - pre-announcing a schedule of gradually increasing caps to limit the amounts of securities that could run-off each month. The caps would be set low for a start and then raised every 3 months. These cap limits will reach a level that would be designed to reduce the balance sheet down to a level (which is not mentioned but could potentially be in the region of 2-2.5tn according to previous Fed speaks). Once this is set in motion, the process would not be altered unless there is a material deterioration in economic conditions. Nearly all policymakers support this gradual approaching of unwinding Fed's balance sheet. Such an approach (and flagged early) amid favourable growth conditions is aimed at giving the markets a heads-up to prevent any disorderly moves (as opposed to Bernanke's mention of tapering in 2013).

- But any substantive deceleration in data this year, and we could see Fed step back toward their more dovish bias. The fiscal stimulus this year if it materializes is the main factor likely to support growth but with the NFP showing deceleration rather than acceleration and if the weakness continue, if Congress disappoints by failing to implement the fiscal stimulus, monetary policy could be more dovish and weigh the USD lower.

- **Latest Fiscal and External Balance Outlook:** Fiscal policy should be expansionary over the next few years as the tax reforms take shape and some investment in infrastructure becomes apparent under the Trump administration. The deficit has fallen sharply from its peak. Fiscal sustainability risk continues to weigh on the outlook and may emerge sooner than later. In the long term, an improved US economy and manufacturing sector, US shale oil and gas production may improve the US current account leading to dollar support but this is likely to be long drawn and may probably begin only in 2018. The US other deficits - current account and BOP deficits have moved slightly wider and is expected to continue.

- **Key domestic events and issues to watch in June 2017:** Key US events: US Fed Reserve Beige Book (1 June); ISM Manufacturing (1 June) (expected: 56.5); NFP (2 June); Trade Balance (2 June); Factory Orders (5 June); CPI (14 June); Retail Sales (14 June); FOMC (15 June); Durable Goods (26 June); Current Account Balance (1Q), (20 June); GDP 1Q (29 June), PCE Deflator (30 June).

- **Technical Outlook:** DXY traded to 6-month low of 96.80 (23 May) before partially reversing some losses, Last seen at 97.60 levels. Price action shows a potential falling wedge in the making – characterized by lower lows and lower highs, with a contracting range. This pattern suggests bullish reversal. Bearish momentum on daily chart is waning while stochastics shows further signs of rising from oversold conditions. We expect USD rebound to continue. Next resistance at 98 levels (38.2% fibo retracement of May high to low) before 98.30 (21 DMA, 50% fibo) and 98.70 (61.8% fibo). Area of support at 96.80 – 96.90.

EUR: Mean-Reverting into June

Forecast	2Q 2017	3Q 2017	4Q 2017	1Q 2018
EURUSD	**1.0800** (--)	**1.0700** (--)	**1.0800** (--)	**1.0800** (--)

No Change to Previous Forecasts

- **Motivation for the FX View:** We expect **EUR to correct lower into Jun after recent gains** amid upcoming Fed meeting in Jun and short term political risks (French Legislative election and risk of early Italy elections). We expect these political pressures to be temporary and **look for opportunity to accumulate EUR on dips.** We expect **EUR's trading range profile to shift into 1.0750 - 1.1250 for the next few weeks** (assuming no negative shocks from France Legislative elections on 11 and 18 Jun or surprise announcement of early Italian elections).

- We reiterate our call for **EUR to stay supported but not elevated** on (1) Europe-US political risk divergence (receding political concerns in Europe as Netherlands and French elections produced no negative surprises and early polls showed an early lead for Merkel's coalition at the upcoming German Federal election vs rising political risks in US arising out of Trump-Comey incident); (2) sustained signs of economic recovery broadening in Europe; (3) and less compelling reasons for ECB to add to further easing (amid stabilizing economic recovery and rising inflation) remain intact and are likely to keep EUR supported on dips.

- The impulsive move higher in the EUR (above 1.1250 levels on 22-23 May) can be attributable to German Chancellor Merkel's rare comment (on 22 May) that EUR was "too weak" and escalation of US political drama involving President Trump and the firing of ex-FBI Director James Comey, which sparked off talks of rising risk (though very marginal at this stage) of Trump's impeachment arising out of Trump's obstruction with justice. Hopes of Trump's administration advancing tax reforms and infrastructure spending are likely to be delayed as Trump is expected to prioritize on defending his case. This resulted in broad USD weakness. We believe eventual stabilisation of political development in US may see some unwinding of this excessive move in the EUR.

- In the coming weeks, we see some **factors that may weigh on the EUR** and those factors include (1) upcoming FoMC meeting in Jun (which our house view is for 25bps rate hike and markets have already priced in) – watch out for any hawkish shift in FoMC dots plot projection (which could weigh on the EUR as monetary policy divergence play could re-emerge). We are also watching for further information with regards to Fed's balance sheet reduction. So far Fed is giving the impression that the process will be gradual and slow and will take place in the background. Fed runs the risk of not meeting expectation as the bar has now been set low. Subsequent change in tone (hawkish tilted) could lead to rebound in UST yields and a firmer USD. (2) Legislative election in France (11 and 18 Jun) is also another factor that could pose downside risks to the EUR – eyes on whether President Macron can secure a parliamentary majority of 289 seats to advance his reform plans or risk being 'lame duck' President (this scenario could see EUR erasing post-election gains). Our base case is for no negative surprise - Macron to secure a parliamentary majority. Opinion polls (as of 18 May) showed that President Macron's party could be on course to win more than 27% of votes in the first round and about 280 – 300 of the 535 seats in the lower house for the second round. (3) Risk of early elections in Italy could also foil sentiment and re-ignite political risk in Europe and weigh on EUR. Already, former PM Renzi flagged the possibility of an early election in Sep-2017 (Italy must hold election latest by 20-May-2018) in his recent interview with Il Messaggero. He said he favoured a German-styled electoral system based on proportional representation and suggested that Italy could vote on the same day as Germany (24 Sep-2017). Other Italian parties – Forza Italia and populist Five Star Movement also favoured this model.

- Beyond the 1-month horizon, German Federal elections (24-Sep 2017) should also warrant some caution. Greater clarity on German opinion polls should after Jun-Jul 2017. Like France and Netherlands (which both held their elections in Apr and Mar, respectively), German opposition (AfD) party is banging on anti-immigration and is perceived to be a hard critic of the Euro and Islam. But given a poor showing of the parties favoring anti-establishment, anti-Euro and far-right ideologies at the Netherlands and French Presidential elections, it seems that the rise in populism in Europe is expected to face a backlash and this add to support for the EUR.

- Into end-3q-4Q2017, although US balance sheet reduction plans (on timing and scale) could be revealed and should translate into higher UST yields, widening UST-EU yield differentials resulting in renewed pressure for EUR, expectation for ECB QE taper into end-2017 or ECB rate hike speculation into 2018 could buffer against EUR downside. Divergence of ECB's monetary policy with the Fed could narrow and possibly play catch up (convergence). This should lend support to the Euro towards our current medium term fair value of around 1.15 over time. We believe Euro-area needs deeper structural reforms in government debt and labor market to lift long term growth potential and push EUR meaningfully higher above 1.20 but pushing through policies within the Euro-area are often complicated and challenging. Besides, if Brexit materializes, EU will be losing its second largest economy (representing 18% of its GDP and 13% of its population) and its global financial centre.

- **Growth and Inflation Outlook:** Euro-area recovery continues to broaden. PMI releases since Aug 2016 continued to show acceleration in growth momentum. Flash PMI rose further to 73-month high in May, supported by manufacturing PMI while services PMI moderated slightly (albeit still at elevated levels). Breakdown by country also showed strong contribution from both Germany and France. ZEW Eurozone expectation of economic growth climbed to 21-month high of 35.1 while German IFO survey showed that sentiment in Germany rose to levels not seen since 1991.

- In the last quarterly assessment report (9 Mar), ECB modestly revised 2017 and 2018 growth to 1.8% and 1.7% (from 1.7% and 1.6%), respectively. ECB's Draghi acknowledged that the survey results suggested that economic expansion will continue to firm and broaden. Domestic demand including recovery in investment is expected to benefit from favorable financing conditions. The next report will be released 8 Jun at the ECB meeting. We do not expect major changes.

- **Euro-area inflation rebounded in Apr, with headline rising to 1.9% y/y** (vs. 1.5% in Mar). Acceleration was due to transport, package holidays and heating oil. Core inflation (which is ECB Draghi's main focus) also rebounded to 1.2% y/y for Apr (vs. 0.7% in Mar). Despite the uptick in inflation, ECB Draghi said (10 May) that it is **too early to declare victory** in its quest to boost inflation in the Euro-area; underlying inflation pressure continue to remain subdued and have yet to show a convincing upward trend. His comments suggest that he remains patient and prefers to wait for sustained signs before moving away from accommodative monetary policy stance.

- In the last quarterly assessment report (9 Mar), ECB revised 2017 inflation to 1.7%, from 1.3%. The ECB expects headline inflation to remain at 2% in coming months due to energy prices. Measures of underlying inflation remained low and are expected to rise only gradually over the medium term. The next ECB assessment will be released on 8 Jun, we do not expect major changes.

- **Monetary Policy Forecast:** We expect ECB to keep **monetary policy status quo at the upcoming meeting on 8 Jun,** after its decision (back in Dec 2016) to extend QE till end 2017. We reiterate that it **remains too early to call for further tapering, given that core inflation has yet to see a meaningful recovery.**

- At the last ECB meeting (27 Apr), Draghi reiterated that inflation remains subdued and has yet to show a convincing upward trend, in particular core inflation. He added that the ECB is not confident that inflation will rise and stay at the bank's goal of just below 2%. He reiterated that the ECB could increase the size or lengthen the duration of its asset purchase program if inflation looks set to fall far back below ECB's target. But **our base case is for no new addition to QE purchase and QE purchase will run its scheduled course till end-2017. Some form of monetary tightening - either rate hike or unwinding of balance sheet could potentially take place in 2018**.

- ECB's chief mandate is getting Inflation higher. Without upward and sustainable prices pressures, there is no strong basis for ECB to move into neutral or tightening stance. Previously, ECB Draghi had said that higher inflation will not automatically result in QE tapering. For inflation to be considered as 'sustained adjustment', there are four elements that need to be fulfilled: Inflation (1) is affecting the medium term, (2) is durable, (3) is self-sustained and (4) is region wide. So far it remains too soon to tell if the four elements above are met as core inflation continued to hold (slipped slightly in the past month) and is not showing any signs of uptick. The ECB had placed strong emphasis on core inflation and increasingly stressed that wage growth is a key indicator of domestic underlying inflation. He said that policy rates would remain at "present or lower levels" even if headline inflation is at 2%. In Draghi's recent comments at the European Parliament in Brussels (29 May), he said that an **"extraordinary amount of monetary policy support.. is still necessary.. domestic cost pressures notably from wages are still insufficient to support a durable and self-sustaining convergence towards our medium-term objective".** His comments dashed markets' expectation that ECB could signal a shift in bias at the upcoming meeting (8 Jun). He also highlighted that key risks to Euro-area growth are now from external factors. He said "the neo-protectionist stances that have been stated in the US are certainly of concern".

- To recap, QE was extended beyond Mar 2017 for another 9 months to end-2017, at a reduced pace of €60bn per month. There were also a handful of technical tweaks to the APP to ensure smooth implementation of the program. Our take is ECB's monthly purchase after Apr 2017 may seem like a tapering at first glance but in actual fact, the option chosen between the 2 (either €80bn per month for 6 months or €60bn per month for 9 months) implies a larger QE amount (€540 bn). This implies ECB is still far from tapering and is expected to remain on easing bias.

- **Latest Fiscal and External Balance Outlook:** Euro area's current account surplus narrowed to EUR34.1bn (from EUR37.8bn in Feb), owing to widening shortfall on secondary income. Nonetheless this is still a large current account surplus.

- The government deficit ratio is projected to decline to 1.5% in 2017, from 2.1% of GDP in 2015. Projected government debt ratio is projected to decline gradually to 88.4% in 2017, from 91.5% of GDP in 2015.

- **Key domestic events and issues to watch:** Apr PPI (2 Jun); Mar Retail sales (6 Jun); 1Q Final GDP (7 Jun); ECB meeting (8 Jun); ZEW survey (13 Jun); Apr IP (14 Jun); May core CPI (16 Jun); Mar current account (20 Jun); May flash PMIs (23 Jun); Jun CPI estimate (30 Jun).

- **Technical Outlook:** EUR turned lower into month-end after hitting 6-month high of 1.1268 (23 May). Pair was last seen at 1.1130 levels. Bullish momentum on daily chart shows signs of waning while stochastics is turning lower from overbought conditions. Bearish divergence on MACD is also being shown. Next support at 1.1050 (21 DMA, 23.6% fibo retracement of 2017 low to high), 1.0920 (38.2% fibo). We look for short term downside pressure. Area of resistance remains at 1.1230 – 1.1260.

GBP: Runway Limited for Now as Election Outcome Priced

Forecast	2Q 2017	3Q 2017	4Q 2017	1Q 2018
GBPUSD	1.2800 (1.3000)	1.2600 (--)	1.2800 (--)	1.3000 (--)

No Change to Previous Forecasts

- **Motivation for the FX View**: We maintain our medium term (18-24month) bias that GBP could trade higher from current levels towards 1.35 – 1.40 but the same cannot be said for the next few weeks. We expect GBP to trade in choppy waters within wide range of 1.27 – 1.31 as election risk (8 Jun), post-Brexit negotiation talks with EU (likely to begin formal talks after UK elections and last for many months) and economic data dominates. We believe **GBP upside may have limited runway** (topside likely to be capped at 1.3050 – 1.31 levels) as a Conservative victory is likely to have been priced in and election outcome (Conservative win) may lead to "buy on rumor, sell on fact" play. As such, we are biased to lean against strength on tactical basis as potential narrowing of lead Conservative has over Labor, tough *Brexit* negotiations with EU and potential downside to economic data should limit GBP gains. We revised GBP 2Q forecast slightly lower to take into account recent development: that PM May could end up with a smaller majority at the upcoming 8th Jun elections and formal *Brexit* talks to begin on 19 Jun (this came earlier than initially expected and we expect initial talks to be challenging and weigh on the GBP).

- **Narrowing of Conservatives' lead over Labor** was observed in the recent opinion polls, after the Conservative manifesto was launched. Though ICM/Guardian (14 May) showed marginal drop for Conservatives to 47% (-1), Labor party saw a jump to 33% (+5). This is the highest level for Labor party since Jun-2016. Survation polls (13 May) saw a decline for Conservatives 43% (-5) while Labor jumped 34% (+5). YouGov poll (22 May) in Wales saw a stunning reversal with Labor in a 16-point lead over Conservative. YouGov polling projection (30 May) which estimated that UK Conservatives may miss the majority by 16 seats while Labour may gain 28 seats. **UK Conservatives need 326 seats in parliament for majority but polls suggest that Conservatives is only on track to win 310 seats. This scenario suggests a hung parliament and serves as a major setback for PM May's calculated move to call for election in attempt to secure a bigger majority in the house.** Further narrowing of the lead should see GBP unwinding post-election announcement gains towards 1.25-1.26 levels. But a widening of the lead may limit the downside. That said **matters of politics are fluid and fickle, and polls are not 100% reliable** (given the bad experience at the UK General Election 2015 and Referendum in 2016). While **polls were biased for Conservative to score at the upcoming General Election, it remains unclear at this stage even with only 1 week remaining** (as of writing). A surprise result (either Labor winning or hung parliament – both low probability but not impossible) will almost certainly jeopardize PM May's political career and unleash a new realm of uncertainty especially in the unfortunate event of a change in country leadership (GBP can re-test below 1.20).

- ***Brexit* negotiation with the EU has yet to commence formally** (PM May indicated that formal negotiations will commence 19 Jun) and talks are expected to be challenging at initial stages. For instance, UK already threatened to quit talks (22 May) on its departure unless the EU bloc drops its demands for a divorce payment (amounting to EUR100bn). Negotiation is also expected to be a long drawn process, fraught with many uncertainties relating to whether London can still hold as a financial hub, if investments inflows will slow and lead to weaker labor market or if jobs will get relocated. In recent headlines, Brussels is said to back euro clearing relocation after Brexit, from London to Paris potentially. Deutsche Bank also warned that up to 4,000 UK jobs could be moved to Frankfurt. JP Morgan, UBS and Goldman Sachs also mentioned moving staff out of London previously. Certainly these job losses have yet to materialise and may still be at early stages but eventually when consideration translates into decision, the pain will be felt and GBP is expected to bear the brunt of the painful *Brexit* negotiations.

- **For the medium term (18-24months),** we expect **GBP to trade higher than current levels, possibly towards 1.35 - 1.40** as GBP is perceived to be undervalued from both historical and fundamentals perspective (our BEER model puts GBP at 1.40). The 20% or so depreciation since referendum results (Jun 2016) should help the UK economy to rebalance and grow sustainably over time - current account deficit should narrow, exports should become more competitive and tourism and education receipts should pick up further. We believe UK should be able to manage the exit, transform itself into a global marketplace and continue to attract capital (longer-term). Past experience of UK leaving the ERM back in 1992 saw a period of consolidation (for a few years) at historical lows for GBP, before the eventual move higher in the following years, where GBP TWI traded above 100-levels in 1998 (from the lows of 80 in 1993-1996) due to buoyant demand fueled by rapid growth of wealth, credit and money. If history is a guide (assuming UK manages the transition well and takes the opportunity to correct its imbalances), its currency may start climbing higher.

- Taking stock of the past month, our expectation for GBP to drift higher towards 1.30 – 1.3055 levels materialized. GBP traded a high of 1.3048 (18 May) before easing off. Last seen at 1.2980, at time of writing. We expect upside to be capped at 1.3050 – 1.31 and caution that election outcome could see a kneejerk overshoot. We are biased to lean against strength, and look for a move back towards 1.2750 (50 DMA).

- **Growth and Inflation Outlook: UK economy showed signs of moderation in growth momentum for 1Q**, due to decline in household consumption and exports while business investments rose (mitigating the overall downside pressure). This is in line with our caution for downside surprises to economic data. 1Q GDP slowed to

0.2% q/q (vs. 0.7% in 4Q 2017). This is the slowest in a year. We had shared that rising inflation and slowing wage growth will crimp household spending. Elsewhere industrial, manufacturing production and construction output all shrank in Mar. Though we expect downside surprise to economic data to persist in coming months, we are not painting a gloom and doom scenario. Forward-looking surveys – PMIs are still surprising to the upside for Apr. Services PMI soared to 4-year high of 55.8 (vs. 55 in Mar) while manufacturing PMI rose to 3-year high of 57.3 (vs. 54.2 in Mar).

- **UK inflation jumped to 4-year high** of 2.7% in Apr, from 2.3% in Mar due to higher travel cost (Easter holidays), clothing, vehicle excise duty and electricity while decline in fuel prices partially offset the jump. This is above BoE's target of 2%. Core inflation (ex food and energy) also jumped to 2.4% (from 1.8% in Mar). We expect inflation to inch higher in coming months as fuel prices are likely to reverse the dip (due to OPEC extending production cuts).

- **Monetary Policy Forecast:** We expect BoE MPC to remain on hold at 0.25% at the next meeting on 15 Jun. Though inflation is ticking higher, we do not think BoE is in any hurry to rush to tighten as a **premature tightening to arrest inflation may upset growth momentum especially in an environment of slowing growth (due to potential consumer squeeze and falling business investment) and *Brexit* negotiation uncertainty.** BoE Carney has repeatedly stressed about challenging time for British households. He also said the monetary policy may need to be tightened by a somewhat greater extent over the forecast horizon than the very gently rising path implied by the market yield curve. This suggests a potential rate rise in end-Mar 2019 when UK is expected to exit the EU.

- At the last MPC meeting (11 May), BoE MPC voted 7 – 1(Charlotte Hogg did not participate in the voting) to keep rates unchanged at 0.25% as expected. Accompanying meeting minutes was a touch hawkish – UK may need tighter policy than yield curve implies but Quarterly Inflation Report contained a dovish tone – inflation now expected to peak in 4Q 2017 at 2.8%. This is below the 1 – 3% range that BoE initially expected. Carney also said that the recent gain in the GBP is a reflection of market expectation for a smoother Brexit post-elections but the BoE has not modelled a disorderly Brexit. He also discussed negative real income growth this year due to rising price pressures while wage growth decelerated.

- **Latest Fiscal and External Balance Outlook:** UK recorded a larger than forecast budget deficit in Apr as rising inflation pushed up debt costs and lower consumer spending (as VAT receipts fell to lowest growth since Aug-2016). Net borrowing jumped to GBP10.4bn (vs. GBP5.4bn in prior month). Though budget deficit has fallen to about 2.5% of GDP for FY2016/17, Chancellor Hammond may face difficulties in getting rid of budget deficit by 2025 if economy slows more sharply.

- Debt to GDP ratio is now projected to decline from 88.8% in 2017/18 to 88.5% in 2018/19 and 79.8% in 2021/22. The budget took into account fresh updates to 2017 growth forecast (2%, from 1.4% previously).

- UK's current account deficit to GDP narrowed from about -5% of GDP in 3Q 2016 to -2.4% of GDP for 4Q 2016. Massive improvement was due to trade deficit narrowing (thanks to increase in exports amid softer GBP)

- **Key domestic events and issues to watch:** May Mfg PMI (1 Jun); May Construction PMI (2 Jun); Apr services PMI (5 Jun); Apr IP, trade (9 Jun); May CPI, PPI, RPI (13 Jun); Mar jobs report (14 Jun); May retail sales, BoE Meeting (15 Jun); public finances (21 Jun); 1Q GDP (30 Jun).

- **Technical Outlook:** GBP's rally above 1.30-handle was short-lived. The pair traded lower into month-end, as of writing. Last seen at 1.2810 levels. Daily momentum is bearish while stochastics is falling. Next support at 1.2730 levels (50 DMA) before 1.2590 (200 DMA). Resistance at 1.2840, 1.2930 (21 DMA). We continue to see downside pressure in the short term. Bias remains to stay short and add to shorts on rally.

AUD: Range

Forecast	2Q 2017	3Q 2017	4Q 2017	1Q 2018
AUDUSD	0.7300 (--)	0.7500 (--)	0.7800 (--)	0.7800 (--)

No Change to Previous Forecasts

- **Motivation for the FX View:** AUD touched a low of 0.7380 before rebounding back towards the 0.75-figure more recently in a tug of war between the USD and metal prices. Long AUD positioning has unwound almost completely as of 16 May 2017. With Australia having averted a credit rating downgrade by S&P, high household debt, weak retail sales and mixed hiring trends leaves RBA likely to leave cash target rate unchanged for the rest of the year. Into Jun, we expect more range-trade for the AUD, with mild upside risks to our 2Q forecast at 0.73. We prefer to maintain our forecast as metal prices (iron ore and copper) are still at risk of deeper correction in the near-term and that adds pressure on the AUD from its current 0.75. Technical cues suggest little directional bias at this point. Into the next half of the year, we still look for AUD to head higher towards 0.78 (vs. the USD), as we expect the demand for commodities to be sustained somewhat on the back of global infrastructure demands and as prices (FX or those of metals) adjust from the sharp downswing recently.

- **Growth and Inflation Outlook:** The persistent trade surplus seen in the past few months has contributed to economic growth but recent events must be taken into account. Key metal prices have come off and terms-of-trade is expected to correct from its recent highs as well. One data that is positive is the labour market report. 37.4K was reported to have been hired in Apr (49.0K part-time, -11.6K full-time). RBA found that most part-time workers choose to work part-time because of life circumstance. This suggests that there is less distinction between part-time and full-time employment. Hence, the lower full-time hires and higher part-time hires may not be an indication of slack in labour market conditions. That said, the weak wage growth is telling and with household debt to disposable income still high, household consumption is likely to remain weak. Retail sales slipped -0.1%m/m from previous gain of 0.2%. Ex-inflation, retail sales eked out a small gain of 0.1%q/q for 1Q, well under the expected 0.5%.

- We also note that the capacity utilization rates in the manufacturing softened in Apr, although still above its 5-year average, possibly buoyed by the recent improvement in external demand. While momentum may not sustain at a high level given recent price corrections, we do not foresee significant deterioration. Capacity utilization rates in the services sector was last seen around its 5-year average, having softened quite a bit since 2016, a reflection of weaker household consumption, retail sales.

- **Taken together, downside risks still exist in the Australian economy as the services sector has not benefitted from the rebound in the external sector thus far. Wage growth is still slow and even the increase in part-time hires over the past decade was attributed to more hires in the services sector that is still experiencing a soft patch. That is hardly likely to translate into stronger wage growth and higher national income.**

- **Monetary Policy Forecast:** We expect RBA to hold rates at 1.5% for the rest of this year. The RBA had recently noted that the labour market has evolved such that there is less distinction between part-time and full-time employment as "majority of part-time workers worked part-time as a matter of choice given their personal circumstances". Market players clearly took heed of this latest findings and reacted less negatively to the drop in full-time employment and rise in part-time employment in Apr. That said, given rising household debt, household income growth is still important and wage price index for 1Q came in at a record low of 1.9%y/y. With AUD still dictated by swings in the metal prices, appreciation in the currency could also affect tourist arrivals, spending, crimping on the services sector, wage growth. The transition to an economy that is more reliant on exports of services could mean that low wage growth could be a new norm. That could mean inflation could remain at the lower bound of the 2-3% and the cash target rate is thus more likely to be stuck at 1.50% for a while, at least well into 2018.

- In the meantime, Australian bonds are still in demand as investors continue to favour positive yielding, better quality bonds. The Australian sovereign curve saw downward shift in yields across the curve in the past month, last checked on 24 May. 10-year was last seen around 2.49%, around 10bps lower from a month ago. With inflation still subdued and mixed outlook on its economic growth trajectory and uncertainties in the labour conditions, Australian bonds are less at risk of a rate hike in the medium term relative to other developed nations. That could continue to support the domestic bond demand. With central banks around the world (with the exception of the US) reluctant to allow rates to run much higher, wholesale funding cost for Australian banks are also likely to be capped for now but we are less sure if this is sustainable once US rates start to rise. Barring any data surprises, AUD is more likely to be driven by other factors like commodity prices, terms of trade rather than policy rate expectations.

- **Latest Fiscal and External Balance Outlook:** The 2017-18 budget deficit is A$29.4bn and projected to return to a surplus of A$7.4bn by 2020-21. Economic assumptions include inflation at 2% this year, real GDP of 2.75%. Total revenue is expected to be A$444.4bn, up from A$412.1bn in 2016-17. Net debt is projected to peak at 19.8% of GDP in 2018-19. Infrastructure spending will amount A$75bn from 2017-18 to 2026-27. More spending also on early learning and childcare via new system of fee subsides. Cuts seen in tourism, public service (diplomats). More revenue is to be generated from visa application, cigarettes levy and taxes on banks' liabilities. The budget managed to help the government avert a loss of its AAA rating by S&P but uncertainties of its revenue projections saw the rating agency maintain a negative outlook for Australia. Ahead of the budget, the government had put through populist measures including tightening of citizenship rules and curbs on gas exports to ensure domestic supply. These measures might contribute to better ground sentiments in time and allow more room for policy maneuvers to revive the economy before the next election in 2 years.

- **Key domestic events and issues to watch:** CAPEX, Retail sales on 1st, M-I inflation on 5th, BOP Current account , RBA meeting on 6th, GDP on 7th, trade on 8th, home loans on 9th, NAB survey on the 13th, followed by labour report on the 15th, RBA minutes on 20th.

- **Technical Outlook:** This May was especially kind to AUD (against the USD). Still, AUD weakens more against other currencies, especially against its antipode, NZD. Weekly, momentum indicators are bearish. Next support around 0.7390, before 0.73 and then perhaps even 0.72 as iron ore prices not showing much of let-up in its bearish moves. Copper prices also seem to be trending lower.

NZD: Weighed by Compression of Yield Differentials but Fundamentals to Limit Downside

Forecast	2Q 2017	3Q 2017	4Q 2017	1Q 2018
NZDUSD	0.7100 (--)	0.7300 (--)	0.7500 (--)	0.7700 (--)

No Change to Previous Forecasts

- **Motivation for the FX View:** NZD may face some downside pressure amid Fed tightening in coming weeks (resulting in narrowing of NZ-US yield differentials), little urgency for RBNZ to signal a rate hike (despite the sharp rise in inflation) and RBNZ's desire for sustained weakness in exchange rate. But downside is likely to be limited as factors supporting the NZD remain intact: solid underlying fundamentals (resilient growth underpinned by tourism and consumer spending, rising budget surplus, etc.) and an improving dairy sector (upward revision to Fonterra's milk forecast).

- In the NZ budget announced on 25 May, budget surplus is forecasted to rise to NZ$7.2bn by 2021, from forecasted $1.6bn (Jun-2017). The government plans to raise tax thresholds, increase accommodation payments and adjust family tax credits. Though the package will cost $6.5bn over 4 years and is expected to eat into budget surpluses, the package is expected to boost spending. The package will result in a modest increase in inflationary pressure and earlier monetary tightening. Treasury forecasts short term interest rate will rise from 3Q 2018. This is consistent with our out-of-consensus call for RBNZ to tighten earlier than RBNZ's forecast. We believe the RBNZ should be one of the next major central banks to raise rates, possibly as early as end-2017 as inflation is already showing further signs of uptick owing to higher commodity prices, construction-related cost pressures and strength of the domestic economy.

- We maintain our NZD forecast across the forecast horizon, expecting Kiwi to gradually rise into 1Q 2018, due to RBNZ rate hike expectations and domestic resilience. Our fair value (fast tracking model based on real yield differentials, current account differentials and reflation proxy) puts Kiwi at 0.76.

- Taking stock of the past month, our expectation for Kiwi to trade in lower range of 0.68 – 0.7050 (from 0.69-0.71) materialized. NZD traded an intra-month low of 0.6818 (11 May) before reversing losses to trade above 0.70-handle on the back of widening trade surplus, upward revision to Fonterra milk forecast and budget surplus.

- **Growth and Inflation Outlook:** NZ's economy is expected to continue growing at an average of 3.1% over the next 5 years, according to PM English (25 May). The government is expecting 3.2% growth for 2017 followed by acceleration to 3.7% for 2017-18, supported by tourism and consumer spending and exports. We still expect the NZ economy to outperform most of G7 economies this year.

- **1Q 2017 GDP growth is scheduled to be released on 15 Jun**. We expect growth to return in 1Q 2017 as wet weather factors (which resulted in the dip in 4Q GDP) are deemed to be temporary. There are also signs that activity picked up - Manufacturing and services PMI expanded at faster pace in Mar. 4Q GDP surprised to the downside (+0.4% q/q vs. +0.7% Consensus), due to the drag on manufacturing and agricultural production (amid wet weather conditions) as well as mining sector (owing to closure of the Maari oilfield).

- **1Q CPI rose to 2.2% y/y** (vs. +1.4% in 4Q 2016). The move higher was driven by fruits/vegetables and cigarettes/tobacco components. This is the first time since 3Q 2011 that CPI has risen above the mid-point of RBNZ's 1-3% target band. RBNZ wrote off the jump in headline inflation saying that it was mainly due to higher tradables inflation (petrol and food prices) and is likely to be temporary. Focus is on non-tradables inflation and wage inflation which remain moderate and is expected to increase gradually.

- **Monetary Policy Forecast:** We expect RBNZ to maintain an accommodative monetary policy, with OCR on hold at record low of 1.75% at the upcoming meeting on 22 Jun. Accompanying monetary policy statement is likely to remain "neutral" and re-emphasize the need for weaker exchange rate to achieve more balanced growth. That said we continue to expect RBNZ to raise rates earlier than their own forecast – Mar 2020. We believe the RBNZ should be one of the next major central banks to raise rates, possibly as early as end-2017 as inflation is already showing further signs of uptick owing to higher commodity prices, construction-related cost pressures and strength of the domestic economy.

- At the last RBNZ meeting (11 May), MPC kept rate on hold at 1.75%, as widely expected at the last meeting on 24 Mar. But market expectation for RBNZ shift in tone/signalling towards a rate hike was met with disappointment. RBZN did not seem interested to do any pre-emptive signalling. RBNZ Wheeler dismissed the sharp rise in inflation as temporary and non-tradables inflation remains subdued. His admittance to parliament (after RBNZ press conference) that he is "pleased" with the 5% decline in TWI since Feb is a strong testament that RBNZ continues to favor a weaker currency. He attributed the decline to global developments and reduced interest rate differentials. He added that "if sustained, will help to rebalance the growth outlook towards the tradables sector". On inflation expectations, RBNZ believes longer term expectations remain well anchored at around 2%.

- **Latest Fiscal and External Balance Outlook:** Government finances continue to perform well above expectations with OBEGAL showing a surplus of $1.5bn (vs. forecast surplus of $147mil) for the 9-months to Mar 2017. This was due to higher than forecasted tax revenue (from corporate taxes) while expenses were lower than expected (in relation to Kaikoura earthquakes and lower than expected impairment of debt and bad debt write-offs for tax-receivables).

- In NZ budget (25 May), surplus is forecasted to rise to NZ$7.2bn by 2021, from forecasted $1.6bn (Jun-2017). The government plans to raise tax thresholds, increase accommodation payments and adjust family tax credits. Though the package will cost $6.5bn over 4 years and is expected to eat into budget surpluses, the package is expected to boost spending. The package will result in a modest increase in inflationary pressure and earlier monetary tightening. (Treasury forecasts short term interest rate will rise from 3Q 2018). Net debt is projected to decline to 19.3% of GDP by 2021 from 23.2% this year. A target of reducing debt to 10-15% of GDP by 2025 has also been set.

- 4Q current account deficit narrowed to $2.3bn (vs. revised $5bn in 3Q). The improvement was due to services balances (thanks to tourism). For 2016 NZ current account improved to -2.7% of GDP (vs. -3.4% of GDP in 2015).

- **Key domestic events and issues to watch:** 1Q terms of trade (1 Jun); 1Q Mfg activity (7 Jun); 1Q current account (14 Jun); 1Q GDP (15 Jun); May BusinessNZ Mfg PMI (16 Jun); RBNZ meeting, (22 Jun); May trade (27 Jun). GDT auctions on 6 and 20 Jun.

- **Technical Outlook:** NZD drifted higher for the month of May. Last seen at 0.7050 levels. Bearish momentum on weekly chart is waning while bullish momentum on daily chart remains intact. Underlying momentum remains bullish. But we observed that stochastics on the daily chart is heading into near overbought levels. This may suggest some unwinding of recent gains. Next support at 0.7020 (23.6% fibo retracement of May low to high) before 0.6980 (38.2% fibo) and 0.6950 (50% fibo). Resistance at 0.71 levels (200 DMA). Decisive close above this could see further upside towards 0.72 levels.

JPY: Further Weakness Ahead

Forecast	2Q 2017	3Q 2017	4Q 2017	1Q 2018
USDJPY	116 (108)	118 (110)	120 (113)	120 (113)

Previous forecasts in parenthesis

- **Motivation for the FX View:** We remain bearish on the JPY. The JPY has been among the top performers against USD so far this year, having risen by 4.6% against the USD year-to-date, just behind the KRW, TWD and INR. Initially in the first two weeks of May, the JPY had gained against the USD, attributable to safe-haven flows due to global risk aversion. Political turmoil in Europe, US and South America and geopolitical tensions in Middle East and the Korean peninsula had kept risk in the limelight, including the recent scandal in the US engulfing Trump resulting not only in a re-positioning of long-USD bets but also a sell-off in UST. This sell-off in the UST and its concomitant dip in yields had narrowed the yield differentials with JGB and had weighed on the USDJPY. Since then, such risks have faded and together with widening yield differentials between the UST and JGB are supportive of the USDJPY ahead.

- While long-USD positions are receding, the same cannot be said for JPY bets. Recent CFTC data showed that speculators are still positioned for JPY weakness ahead. The number of short-JPY contracts as of the week of 16 May (increasing to 101,971 contracts) continue to outweigh long-JPY ones (slipping to 41,963 contracts). The net JPY bets continue to be short-JPY, though they remain off the recent end-Dec 2016 highs. These net contracts have increased and we still think that there could be room for even more net short-JPY bets ahead. We watch for a re-pricing of Fed rate hike expectations. A continuous climb in UST yields with JGB at least holding steady around current levels could lead to further increases in net short-JPY bets. Such bets should provide the USDJPY with another leg up in 2017.

- We do not believe that global risk sentiments will deteriorate persistently given that European political risk has already faded with the “uneventful elections” in the Netherlands and France; and geopolitical tensions in North Korea and the Middle East appears contained for now. Even the turmoil enveloping Trump at the moment is unlikely to lead to his removal from office at this point in time, unless more damning information emerges, and should eventually recede. That said, intermittent strength in the JPY due to global risks aversion is to be expected, though these should eventually subside as well and should not stem the depreciating tide of the JPY against the USD.

- The improvement in the global risk environment is particularly important to the JPY. The return of global calm refocuses attention back to earnings of Japanese firms and their stocks, and hence the Japanese stock markets. The stock index as such can be used as a proxy for the global risk environment in this context.

- As we had discussed elsewhere, there is a strong positive correlation between the Nikkei 225 Index and the USDJPY. This is because foreign investors usually hedge their equity purchases against further JPY depreciation by short-selling the JPY. Thus, once global risk aversion fades and with volatility at lows, we can expect even more inflows into Japanese equities and hence more upside to the USDJPY. The calm in the global risk environment encourages foreign fund inflows seeking higher returns from Japanese equities. In the first three months of the year, the sell-off by foreign investors of JPY2.04tn in equities had dragged the USDJPY from its Dec 2016 high of 118.18 to around the 111 levels by end-Mar 2017. The pair had slipped lower to the 108-levels in early Apr before bouncing off that low as foreign buying of Japanese equities returned. Since Apr, foreign investors have purchased JPY1.74tn in equities. The inflows of foreign funds into Japanese equities have help to lift the Nikkei within striking distance of the high seen in Jun 2015 (20868; currently at 19554). Further inflows into the Nikkei should be supportive of the USDJPY ahead.

- Market rumblings about the need for the BOJ to articulate an exit strategy aside, we doubt that the central bank is anywhere close to ending its ultra-loose monetary policy. BOJ governor Kuroda comments on 20 Apr that the BOJ's "very accommodative monetary policy" will continue and the current pace of asset purchase to be maintained for some time reinforces our view. These comments suggest that the BOJ is in no hurry to provide an exit strategy. The governor had further reiterated that monetary policy was not constrained by "the fact that (the BOJ has) acquired 40 percent of JGBs already or that (its) balance sheet is about 80 percent of GDP". Thus, the policy bias remains for the continuation of existing monetary easing and low domestic interest rates for as long as the 2% inflation target is not achieved. This then should continue to put downward pressure on the JPY.

- More importantly, the governor's view is given even more credence by PM Abe's appointment of two additional policy doves to the Monetary Policy Board of the BOJ. Hitoshi Suzuki – banker with commercial banking and financial markets expertise in Japan and abroad – and Goshi Kataoka – an economist viewed as a reflationist – are set to replace the last two policy hawks on the board, namely Takahide Kiuchi and Takehiro Sato, when their term ends on 23 Jul. With these two joining the board in Jul, there will be no known hawks on the board. This should ensure that the ultra-loose monetary policy continues unabated as long as the 2% inflation target is not achieved.

- As our discussion above has shown, the BOJ remains on an aggressive easing mode. In contrast, the Fed is still on a tightening bias and remains on track to hike its short-term policy rate at least twice more this year. This suggests then that further monetary policy divergence between the two can be expected. Even if the Fed does not tightened even more aggressively, this divergence in policy amid supported risk sentiments should still push yield differentials between the UST and JGB further apart. This in turn should weigh on the JPY and boost the USDJPY. In addition, global reflation trades could re-emerge should Trump manage to push through his ambitious tax reforms and infrastructure spending program. The resulting widening of the yield differentials between the UST and JGB should also be supportive of a higher USDJPY.

- We do not expect the BOJ to embark on additional easing measures for now but such moves cannot be ruled out completely. We expect the BOJ to stay on course for now, maintaining its Quantitative and Qualitative Easing (QQE) with Yield Curve Control. But should inflation fail to gain traction going into 2018, we cannot discount the BOJ unleashing even more easing measures to lift inflation towards the BOJ's 2% target. The easing measures could include cutting interest rate further to -0.3% (from -0.1% currently) and increasing asset purchases of ETFs and J-REITs and other instruments to JPY10tn and JPY6tn. Further measures should provide a boost to the USDJPY.

- Our expectations of dissipating safe-haven plays ahead should be supportive of further inflows into Japanese equities and provide more upside to the USDJPY. This together with the continuation of the ultra-loose monetary policy by the BOJ and expectations of further widening of the yield differentials between the UST and JGB should see the USDJPY climb higher from current levels. We now expect the USDJPY to climb higher to 116 by end 2Q before ending the year at 120.

- **Growth and Inflation Outlook:** The economy is on its longest streak of growth since 2006 after expanding by a preliminary estimate of 2.2% annualized in 1Q17. This was an improvement over 4Q16's 1.7% growth. Driving growth in 1Q was private consumption that rose 1.4%, a strong rebound from 4Q's 0.2% as well as private investment, which rose 3.0% vs. 1.4% in 4Q. Government spending only rose by 0.6%, just slightly better than the 0.3% in 4Q. High frequency data is pointing to an uneven and gradual economic recovery. Industrial production rose by 3.5% y/y in Mar vs. 4.7% in Feb, while core machinery orders fell by a larger 11.9% y/y in Mar from Feb's -0.9%. Exports remained healthy, rising 7.5% y/y in Apr vs. Mar's 12.0% while imports climbed 15.1% y/y, just a tad off Mar's 15.8%. The double-digit rise in imports continues to point to a pick-up in domestic demand. Taken together, the high frequency data suggests the economy still on a slow grind higher. This would be in line with the BOJ's project that GDP would come in at 1.6% and 1.3% in FY2017 and 2019 respectively.

- Headline inflation bounced higher in Apr in line with expectations, rising by 0.4% y/y vs. Mar's 0.2%. Core inflation edged higher by 0.3% y/y in Apr from 0.2% in Mar – the fastest pace since Apr 2015. The climb in inflation was underpinned by higher oil prices. The BOJ preferred gauge of inflation - "core-core" inflation, which is headline inflation less fresh food and energy prices – rebounded to come in flat in Apr after falling by 0.1% in Mar. While the Apr print shows inflation on the rise, it remains a way off the 2% target set by the BOJ, underscoring the lack of inflationary pressures despite modest growth recovery. It reinforces our view that the ultra-loose monetary policy needs to be kept in place for the foreseeable future and that this could portend a possible cut to the BOJ inflation forecast. Note that the BOJ had already revised down its FY2017 core CPI forecast to 1.4% from 1.5% previously and expects FY2018 and FY2019 core CPI to come in at 1.7% and 1.9% respectively. The BOJ still expects the 2% inflation target to be reached only around FY2018 (i.e. Apr 2018-Mar 2019).

- **Monetary Policy Forecast:** The end of the BOJ's ultra-loose monetary policy does not appear close at hand as the recent comments of BOJ governor Kuroda revealed. He had commented on 20 Apr that the BOJ's "very accommodative monetary policy" will continue and the current pace of asset purchase would be maintained for some time. These comments suggested that the BOJ does not appear to be in a hurry to provide an exit strategy. The governor had also further reiterated that monetary policy was not constrained by "the fact that (the BOJ has) acquired 40 percent of JGBs already or that (its) balance sheet is about 80 percent of GDP". Thus, the policy bias remains for the continuation of existing monetary easing and low domestic interest rates for as long as the 2% inflation target is not achieved.

- It is also important to note that the BOJ monetary policy board will consist of doves by end-Jul with PM Abe's appointment of Hitoshi Suzuki – banker with commercial banking and financial markets expertise in Japan and abroad – and Goshi Kataoka – an economist viewed as a reflationist – to replace the last two policy hawks on the board, namely Takahide Kiuchi and Takehiro Sato, when their term ends on 23 Jul. With these two joining the board in Jul, there will be no known hawks on the board. This should ensure that the ultra-loose monetary policy continues unabated as long as the 2% inflation target is not achieved.

- We do not expect the BOJ to embark on additional easing measures for now but such moves still cannot be ruled out completely. We expect the BOJ to stay on course for now, maintaining its Quantitative and Qualitative Easing (QQE) with Yield Curve Control. Additional measures that could be introduced if needed include cutting interest rate further to -0.3% (from -0.1% currently) and increasing asset purchases of ETFs and J-REITs and other instruments to JPY10tn and JPY6tn. Further measures should provide a boost to the USDJPY.

- **Latest Fiscal and External Balance Outlook:** The Finance Ministry's fiscal system council had recommended that the government should not abandon its goal of achieving a primary balance surplus by FY2020. It also pointed out that stably lowering the debt-to-GDP ratio is necessary to achieve a primary balance surplus. It recommended that the 2018 budget spending cap be maintained at JPY530bn.

- The current account (CA) surplus widened to JPY2.91tn in Mar from JPY2.81tn in Feb, lifted by a mildly higher goods and services surplus (Mar: JPY1.05tn vs. Feb: JPY1.01tn) and still healthy surplus in the primary account (Mar: JPY2.20tn vs. Feb: JPY1.98tn). The financial account surplus ballooned to JPY5.02tn from Feb's JPY1.78tn in Feb. The larger surplus could be attributed to the stronger FDI and portfolio inflows of JPY2.42tn and JPY3.51tn (Feb: JPY2.14tn and –JPY2.86tn) that helped to offset the deficits in 'other investment' and reserve assets (Mar: -JPY0.76tn and –JPY0.38tn). Consequently, the overall balance of payments (BoP) surplus ballooned to JPY10.05tn in Mar from JPY3.55tn in Feb. For the first quarter of the year, the current account surplus was a healthier JPY5.79tn compared to JPY4.09tn in 4Q16, helped by surpluses in the goods and services, and primary income accounts (Mar: JPY0.97tn and JPY5.44tn respectively) that more than offset the deficit in the secondary income account of JPY0.62tn. The financial account surplus also ballooned to JPY5.27tn in 1Q from 4Q16's JPY2.21tn. This could be attributed to the larger healthy inflows into FDI, financial derivatives, other investment and reserve assets portfolio investment that more than offset the deficit in portfolio flows of JPY4.06tn. The overall balance of payments surplus ballooned to JPY10.53bn in 1Q from JPY4.42tn in 4Q16.

- **Key domestic events and issues to watch:** Note that on 9 Jun, the cabinet is likely to approve its basic statement of economic priorities and policies for FY2017. Final GDP print for 1Q 2017 will be released on 8 Jun. BOJ meets on 16 Jun to decide on monetary policy with the summary of opinions of that meeting released later on 26 Jun. In the meantime, minutes of the BOJ meeting on 26-27 Apr will be released on 21 Jun. There are several BOJ speaks in Jun, kicked off by BOJ board member Harada speaking in Gifu on 1 Jun. This is followed by BOJ governor Kuroda speaking in Tokyo on 21 Jun and then by BOJ deputy governor Iwata in Aomori on 22 Jun. JGB auctions in Jun: 10-year (1 Jun), 30-year (6 Jun), 5-year (8 Jun), 1-year (15 Jun) and 20-year (13 Jun).

- **Technical Outlook:** USDJPY did trade higher and hit above our objective of 112.70. The move higher was in line with our technical call. The pair traded high of 114.37 (10 May) before turning lower. Last seen at 111 levels. Monthly candlestick formation - long wicks on Apr and May candlesticks - suggest an undecided market. Even monthly and weekly momentum indicators are not providing a clear bias. Daily momentum has turned bearish. Pair is biased for the downside in the coming days, possibly towards 110.20 levels (200 DMA) which should serve as a firm support level. Decisive move below that suggest further downside possibly towards 109.60, 108.20. Biased to buy on dips, targeting objective at 112.40.

CNY: PBOC's Boosts

Forecast	2Q 2017	3Q 2017	4Q 2017	1Q 2018
USDCNY	6.80 (6.95)	6.83 (7.01)	6.90 (7.04)	6.85 (7.04)
USDCNH	6.75 (6.95)	6.80 (7.02)	6.88 (7.05)	6.85 (7.04)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** The USDCNY had been stable since the start of the year, largely due to the lack of USD strength and capital controls. What has been keeping this particular USDCNY pair stable is also the widening CH-US 10y spread that was observed since the end of last year and to sustain this could be challenging. With activity indicators slowing, possibly slower fiscal impulse, the liquidity management may not be as tight as what we have seen in the past few months. With risks still to the upside in UST yields, there is a real potential for the CH-US 10y spread to narrow, bringing the next leg of CNY weakness towards our *original* year-end forecast of 7.04.
- **Given the external and domestic challenges ahead, China clearly does not want to relinquish the stability in the yuan that it has enjoyed for the past few months. The USDCNY reference rate has been fixed persistently below the previous day USDCNY closing price in May and this had spurred speculation of persistent USD demand onshore. Moody's downgrade of China's credit rating also saw a spike in USDCNH and that might have been the straw that broke the camel's back. PBoC clearly did not want a revival of yuan depreciation bets. USDCNH and USDCNY slipped sharply on 25 May, in a manner that resembles past episodes of suspected intervention. Offshore CNH Hibor rates and deposit rates also exhibited abnormal spikes towards 8%.**
- **Then came their next move, an additional "counter cyclical factor" could be added to the yuan fixing formula. The counter cyclical factor is meant to soften the impact of sharp market swings, and weaken possible "herd effects" in forex market. While resurgences in USD and UST rates could certainly nudge the USDCNY higher, the recent moves, including the obvious**

intervention by the PBOC in the offshore markets today (31 May 2017), reflect its determination to bring USDCNY and USDCNH lower. That is why we have correspondingly calibrated our year end USDCNY and USDCNH forecasts lower towards 6.90 and 6.88 respectively, albeit still looking for mild depreciations in CNY and CNH against the USD from current spot levels.

- The authorities have been taking the opportunity (the absence of USD strength) to encourage foreign investors to delve into the domestic equity and bond markets. Eyes are on whether MSCI will decide to include the A-shares into its Emerging Market Index on 21 Jun. Their new proposal (compared to the one last year) would reduce the number of companies to 169 from the previous 448 under the proposal last year by including only large cap companies. CNH is to be used for index calculation instead of the originally proposed CNY in order to "minimize currency drag and potential tracking error due to divergence of CNY and CNH". The weight of the A-shares will also be reduced to 0.5% from the previous 1.0%. This could raise the chances of China's A Shares inclusion into the MSCI EM index and boost foreign inflows into China's domestic equity market. While the inclusion has been tweaked to allow more flexibility to entice international investors, further capital account liberalization may be required for investors to say yes to the MSCI proposal to alleviate concerns over potential uncertainties regarding the broad preapproval restrictions imposed by the Shanghai and Shenzhen stock exchanges on launching financial products by any financial institution on any stock exchange internationally.
- **Our monthly Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) showed the score for China remained steady at 5.0 (with 1 being the best and 9 being the worst).
- **Growth and inflation outlook:** April numbers suggests that growth momentum might be slowing for China. Industrial production softened to 6.5%y/y from previous 7.6%. The slowdown was broad-based with the exception of pharmaceutical sub-component and general-purpose equipment. Production of most other industries came off this month including car manufacturing, non-metal, metal, and telecommunication. Investment growth also slowed to 8.9%y/y for the first four months of this year from 9.2%.The deceleration is also across most sectors (primary, secondary and tertiary). Most significantly, real estate investment also saw a slowdown in fixed-asset investment to 6.4% from previous 6.8%. Investment in infrastructure also slowed slightly to 23.3% from previous 23.5%. All these points to mild slowdown from the 6.9% growth in first quarter, in line with our full year forecast of 6.7%, as forecast by our Economic team.
- PPI slowed quite sharply to 6.4%y/y in Apr, not to our surprise and more than the median forecast of 6.7% polled by Bloomberg from the previous 7.6%. This is in tandem with the softer base metal prices. On the other hand, CPI edged higher to 1.2%y/y from previous 0.9%y/y, still depressed by declines in food prices. With food and fuel inflation rather anchored, it is possible for CPI to continue to lag that of PPI for now.

- **Monetary Policy Forecast:** For so far this year, PBoC has raised 1-day SLF rates by 55bps, 7-day and 1 month by 20bp, MLF rates by 10bps and 7-day reverse repo by 20bps. The Apr numbers suggest that China is beginning to see a slowdown. Whilst the government still desires less debt taking, risk taking and more deleveraging, we think liquidity management might not be as tight as we noticed that the industrial profitability of those sectors that have risen in past few months have started to see a deceleration in profit growth. The sharp fall in metal prices have also probably slashed loan collateral values, slow credit growth and squeezed the profit margins of those commodity-related producers. Loan demand may slow in the coming months. Recall that PBoC had stated in the (Central Economic Work Conference, 4Q Monetary Report) that monetary policy will be "prudent and neutral". The central bank has been tightening in the first quarter and we expect a more neutral theme in the rest of the year.
- **Latest Fiscal and External Balance Outlook:** From the NPC, Finance Minister Xiao Jie announced that budget deficit for the year is retained at -3% of GDP for 2017 though the absolute deficit amount is raised CNY200bn to RMB2.38trn this year. Fiscal expenditure has been rather aggressive in the first four months of the year, compared to past years. We are less confident that the government can maintain this pace of fiscal spending. Government debt is low at 36.7% of GDP, local government debt ceiling is to be raised by 10%. China aims to reduce the VAT brackets from four to three. China to target lowering CNY1trn in corporate tax and expenses including the broadband fees, electricity tariffs and logistics. At a state council in Apr, Premier Li Keqiang unveiled more details on tax cuts by lowering VAT rates for natural gas and agricultural items to 11% from previous 13%, lending a boost to demand. The insurance sector also received a boost as individuals who have purchased commercial health insurance could be allowed an exemption of up to CNY2400 from personal income tax every year. Tax break measures were also passed for small companies with annual taxable revenue of CNY500K and below.
- China is still at a nascent stage of looking into public-private-partnership (PPP). Implementation is to speed up with the third batch of MoF PPP taking 11 months to start compared to 15 months for the first batch. This could boost private investment with less fiscal commitment from the government.
- Current account surplus widened to U$19bn in 1Q from previous U$11.8bn due to a smaller deficit in services trade and smaller deficit in income outflows. Trade balance saw a narrower trade surplus of U$81.7bn. BOP has been recording outflow via loan, trade credit and currency deposit that amounted to U$116bn in 4Q. Expect this outflow to narrow into 1Q given that China imposed more capital account restrictions for individuals and corporates to remit or invest overseas since the start of the year. FX reserves saw another mild increase in Apr. In Mar, PBoC was even comfortable enough to ease some capital restrictions. SCMP reported that PBoC has now allowed banks to process outbound yuan payment and remittance requests for their corporate and individual clients. The central bank had required the procedures to meet certain requirements like a show of outbound yuan that match inbound to gain approvals.

- **Key domestic events and issues to watch:** NBS Mfg PMI due on 31st May, Caixin PMI on 1st Jun, foreign reserves on 7th, trade on the 8th, CPI, PPI on 9th, monetary data on 10-15th. Apr retail sales, FAI, industrial production on 14th. Property prices on 19th. MSCI A-shares inclusion decision on 21 Jun, 4am Beijing Time. Industrial profits on 27th.
- **Technical Outlook:** USDCNH dropped sharply on suspected intervention just before China and Hong Kong SAR break for Dragonboat Festival and then dropping sharply again today (31 May 2017). Daily momentum suggests waning bearish bias. Should this be a brief USD rebound, weekly and monthly charts beckon the bears. Rebounds to meet resistance around 6.8330 (200-DMA) before 6.8570 and then 6.8800 (50-DMA). Support around 6.80, before 6.7750.

KRW: Bulls Exhausted

Forecast	2Q 2017	3Q 2017	4Q 2017	1Q 2018
USDKRW	1140 (--)	1150 (--)	1160 (--)	1170 (--)

No Change to Previous Forecasts

- **Motivation for the FX View:** USDKRW is likely to trade modestly higher, within recent range in coming weeks, supported by potential USD strength as Fed shifts into raising rates and possibly offers more guidance on balance sheet unwinding and dots plot projection, potential worsening of US-Korea trade relations and *leaning against the wind* activities. Foreign fund inflows in search of Korean equities and bonds as well as exports-rebound recovery (which we could be seeing signs of waning momentum) may mitigate the upside pressure. In addition, if oil prices stabilize and creeps higher following the expectations of an extension in OPEC oil supply tapering, currencies of oil importers such as KRW could be weighed down too.

- US-Korea trade relations may come under scrutiny as President Trump said his administration has informed (11 May) Seoul of renegotiations for a bilateral free trade deal. His comments came after Vice-President Pence said (18 Apr) that the US may review and reform its FTA with Korea. US trade deficit with S.Korea stood at 27.7bn and US has the largest trade deficits with Korea in motor vehicles and electronic products. Korean trade officials said that the government has not been notified. We believe trade protectionism risks here have not been well priced and further unexpected development could lead to USDKRW upside pressure.

- Though geopolitical tension (relating to firing on missiles by North Korea) in the region remains and is known to see spikes in USDKRW, its effects have been short-lived and has no sustained impact on asset markets so far. (YTD, North Korea has fired 9 ballistic missiles but the

KOSPI has gained over 16%, one of the big gainers after India and HK equities). But we do caution against complacency if tensions escalates into near-war as that would translate into negative shocks for KOSPI and KRW. But for now, we are not pricing in this risk premium into our forecast.

- We **maintain our USDKRW forecast over the forecast horizon and keep the upward trajectory in USDKRW** into 4Q 2017 as we expect markets to reprice Fed's monetary tightening and Trump's plan on tax reforms and fiscal spending take shape towards end-2017. For the month of Jun, we expect 1105 – 1145 range to hold.
- **Our monthly Maybank Vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for S.Korea improved to 6.9 (vs. 7.1), due to GDP and yields.
- **Growth and Inflation Outlook:** BoK hinted that **growth could be revised upwards from 2.6% in Jul-2017 given robust exports, economic recovery and incumbent government's employment oriented policy stance**. 1Q 2017 prelim GDP came in stronger than expected (+0.9% q/q vs. 0.8% expected vs. 0.5% in 4Q), owing to strong pick-up in exports and capital investment. This is the fastest quarterly growth since 2Q 2016.
- Though exports saw a sharp rebound, we observed that 1st 20 days exports for May saw a deceleration in momentum to 3.4% y/y (vs. 28.4% y/y), due to declines in handset and auto parts while petroleum and semiconductors exports held up. Preliminary data also showed that exports growth to China, US and EU slowed.
- The incumbent government headed by President Moon is expected to unleash KRW10.2tn supplementary budget (pending submission to National Assembly for approval on 7 Jun) focused on public sector job creation, to support growth. This was part of Moon's election campaign and is in response to rising unemployment rate since Dec-2013 (from 3%) to 7-year high of 4% (Apr-2017). Unemployed persons have also risen to 1.17 million, one of the highest in recent months.
- **Headline inflation for Apr slowed slightly to** 1.9% (vs. 2.1% Consensus vs. 2.2% in Mar). This was due to food and non-alcoholic as well as transport components. Core inflation slipped slightly to 1.3% (vs. 1.4% in Mar). BoK Governor Lee expects wage inflation to pick up in 2H 2017 amid economic recovery and government's stance on creating jobs**.** We continue to expect inflation to stay firm but moderate from recent highs as base effects from oil prices are likely to ease going forward.
- **Monetary Policy Forecast**: There is no MPC meeting scheduled for June. The next one is scheduled on 13 Jul. We expect BoK to keep monetary policy accommodative, with policy rate on hold at record low of 1.25%. There is no strong case for BoK to raise rates as recent rising pressures (headline CPI) were due to base effects from oil prices and is likely to ease going forward. BoK's expectation for wage growth upside pressures in 2H 2017 remains too soon to be seen for

BoK to get ahead of the curve. **Higher and sustained inflation may tip the BoK's hand in 1H 2018.**

- **Latest Fiscal and External Balance Outlook:** Current account surplus narrowed to US$5.93bn in Mar (vs. 8.4tn in Feb) due to widening services deficit (also due to sharp decline in Chinese tourists) and increased imports. Nonetheless this is the 61st consecutive month of surplus.

- Korea's sovereign debt is expected to increase to KRW682.4tn by end-2017, from KRW641tn. Government debt now stands at 44.8% of GDP. The rising debt has to do with tax cuts and increasing welfare spending made during former President Lee's era. The National Assembly Budget Office estimates government debt will rise to KRW800tn in 3 years' time.

- **Key domestic events and issues to watch:** S. Korea releases May trade data (1 May); CPI, PMI (1 Jun); 1Q GDP F (2 Jun); unemployment rate (14 Jun); first-20 days of exports data (21 Jun); and May Industrial Production (30 Jun).

- **Technical Outlook:** USDKRW retraced losses into end-May, as we write. Last seen at 1124 levels. Price action suggests an interim base at 1114-1115 levels. Stochastics is near oversold conditions while bearish momentum is waning. These signals suggest rebound risks. We hold to our bias to buy dips. Next resistance at 1125 (21 DMA), 1128 (38.2% fibo retracement of Apr high to May low, 21, 50 DMAs) before 1132 (50% fibo). Support at 1114 levels.

SGD: Rising UST Yields To Weigh

Forecast	2Q 2017	3Q 2017	4Q 2017	1Q 2018
USDSGD	1.4100 (--)	1.4200 (--)	1.3950 (--)	1.3950 (--)

No Change to Previous Forecasts

- **Motivation for the FX View:** The weakness expected in May did not pan out. The SGD strengthened by around 1.1% month-to-date against the USD instead. Aside from the ongoing synchronized recovery in exports in the region and possible monetary policy convergence with the US, the low volatility environment as reflected in the VIX index, is spurring flows into riskier assets, including those in Singapore. This is turn has been supportive of the SGD so far. Year-to-date, the SGD has risen by an even stronger 4.7% against the USD. Despite these gains, we remain bearish on the SGD.

- Our study showed that the USDSGD is one of the most sensitive currency pair to moves in 10Y UST yields. The narrowing of yield differentials between the UST and SGS then should spur a resurgence in USD and hence the USDSGD. The rise in UST yields is likely to be underpinned by steady US economic growth, the ongoing normalization of US rates with a hike possibly in Jun and then another in 2H, expectation of Fed's unwinding of its QE, and possible EUR pullback amid disappointment with ECB policy. We also cannot discount the possibility that the global reflation trade could re-emerge. The narrowing yield differentials should spur fund outflows from Singapore back to the US, boosting USDSGD.

- This sell-off in the SGD against the USD is unlikely to be overly aggressive. The SGD should find support from the improvement in the macroeconomic fundamentals of the economy led by the synchronized recovery in exports in the region that is boosting investment sentiments. The government's mildly expansionary fiscal policy, together with still accommodative monetary policy, its triple-A status and persistent balance of payments surpluses should all also be supportive of the SGD ahead. With the SGD supported amid USD strength, a sharp climb in the USDSGD is thus likely to be mitigated ahead.

- Long-USDSGD positions continue to be unwound amid low volatility and doubts about global reflation trades. This together with expectations that any Fed hike in the remainder of the year is likely to be gradual should lend support to Singapore debt instruments and equities, which should provide some support for the SGD. Though data on foreign ownership of Singapore equities and government debt is lacking, recent yield movements as well as gains in the STI suggest healthy demand for sovereign debt that should also include foreign interest. Month-to-date, yields of sovereign debt are mostly lower by 1.2-11bps across all tenors except the 30Y, while the STI is up by nearly 1.4%.

- Support for the SGD is also likely to come from monetary policy. Our house view remains for a possible adjustment to the current 'neutral' policy stance in Oct to one of a 'mild appreciation'. This is premised on our expectations of accelerating inflation, especially core, and the pick-up in economic momentum. This policy shift towards a tightening bias would be supportive of the SGD. We will continue to monitor the inflationary pressure indicators over the next few months to assess the likelihood of any policy tightening in Oct.

- As a result, we still maintain our bearish bias for the SGD. We continue to expect the pair to grind mildly higher to 1.41 and 1.42 by end-2Q and -3Q before easing to 1.3950 by end-4Q 2017 and 1Q 2018.

- **Singapore's monthly Maybank Vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) deteriorate from 4.1 to 4.7. This deterioration could be attributed to worsening GDP, yield, current account, and inflation risks. This should weigh on the intrinsic value of the SGD. Our model shows that the SGD NEER was last seen 0.03% above the mid-point implied at 1.3830. Upper bound is implied at 1.3553 while lower bound is now at 1.4106.

- **Growth and Inflation Outlook:** Final GDP was revised higher to 2.7% for 1Q 2017 from its preliminary estimates of 2.5% y/y. On a q/q seasonally adjusted annualized basis, GDP contracted by a smaller 1.3% vs. the advanced estimates of 1.9% but still a reversal from the 4Q 2016 surge of 12.3% surge. While manufacturing growth was upgraded to 8.0% (from flash estimates of 6.5%) as expected, services sector growth was lifted by just 0.1ppt to 1.6%. The lack of significant gains in services was due to the downgrade in construction sector growth to -1.4% from the flash estimates of -1.1% as private sector construction works remained weak. Despite the underperformance in services, our economic team continues to expect services growth to improve with financial, business and wholesale services growing more firmly in the coming quarters. These would be supported by stronger bank lending activities in 2Q and 3Q, property transactions and acceleration in Asian trade. This improvement in services should lend support to stronger growth in 2017. Our economic team has upgraded their full-year GDP forecast to 3.0% for 2017 from 2.5% previously. Even MTI's outlook for the year is more upbeat, with the ministry expecting growth to come in "higher than 2.0%", barring downside risks. IE Singapore has also raised its 2017 NODX forecast to 4.0-6.0% from 0-2%.

- Headline and core (headline ex-accommodation and private transport) inflation diverged in Apr. Headline inflation moderated to 0.4% in Apr from Mar's +0.7%, while core inflation accelerated 1.7% y/y (Mar: +1.2%). The former was dragged lower by lower accommodation cost due to base effects stemming from the disbursement of services & conservancy charges (S&CC) rebates. The latter was lifted in part by rising prices of electricity and gas. Inflationary pressures appear to be intensifying as reflected in rising core inflation. Higher commodity prices and a cyclical recovery, as well as the planned administrative price increase (such as the hike in service & conservancy charges and water prices) should push inflation higher gradually over the year. With the risks to the upside, our economic team maintains their headline inflation and core inflation forecast at 1.2% (MAS forecast 0.5%-1.5%) and 1.6% (MAS forecast 1%-2%) respectively in 2017.

- **Monetary Policy Forecast:** The MAS maintained its 'neutral policy' stance that has been in place since Apr 2016 at its Apr meeting. There were no surprises as the slope of the SGD NEER policy was kept at zero percent, with no change to the width of the policy band or the level at which it is centered. The forward guidance that the neutral policy stance is appropriated for "an extended period" was maintained, against expectations of some participants in the market. The removal of this phrase would have signaled a move towards a tightening bias.

- Despite the dovish tilt in policy, our house view remains for a possible adjustment in the MAS policy stance at the Oct meeting. Our house view is for a shift to a "mild appreciation bias". This view is premised on our economic team's expectations that inflation could surprise on the upside this year due to the uptick in administrative prices (water, service and conservancy charges) and higher commodity prices (including both oil and food). At the same time, our economic team is also expecting 2017 growth to strengthen, allowing greater flexibility for the MAS to adjust policy.

- Support for a "mild appreciation bias" also comes from our estimates using the Taylor Rule, which showed that a shift in policy stance is appropriate. Our estimates show that the SGD NEER is expected to strengthen ahead and suggests that the current policy parameters could be adjusted at the next policy meeting in Oct. This should temper inflationary pressures that could arise in the next six-to-nine months amid a synchronize recovery in exports in the region and possibility of stronger global growth led by the US.

- The USDSGD slipped to a new low for 2017 at 1.3808 (on 28 May) – a level not seen since Oct 2016 – amid a moderation in the USD. Pair has since mildly rebounded but remains still at the low 1.38-levels at the point of writing. This oscillation in the USDSGD so far this year has seen the 3-month SOR (3MSOR) coming off from 1.0152% on 4 Jan to hit a low of 0.7370% on 23 Jan. 3M SOR is currently hovering around 0.7874% at the point of writing. Similarly, the slide in the 3-month SIBOR (3MSIBOR) has been more gradual with the rate falling from 0.9689% at the start of the year to hit a low of 0.9391% on 24 Feb before climbing gradually to hit a new high for 2017 of 1.0015% on 13 Apr. The 3MSIBOR has since eased off and is currently hovering around the 0.9938% level. The more modest rise in rates suggests that the rise in mortgage rates is unlikely to be significant for now. Deposit rates (for 12-month fixed) have not risen since end-Jan but has slipped lower to 0.33%. This continues to suggest that risks related to interest rate increases affecting financial and economic stability, particularly in interest rate- and property-related sectors, seems limited for now.

- Upward pressure on domestic rates remains given our expectations of two more Fed rate hikes for the remainder of 2017. US 3MLIBOR continues on its upward trajectory and is currently hovering around 1.20% at the point of writing, a new high for 2017. Ample liquidity has so far kept domestic rates from tracking the US 3MLIBOR higher though. With US rate hike trajectory still on a gradual path, domestic rates should continue its slow grind higher. We continue to expect the 3MSIBOR and 3MSOR to end 2Q 2017 at 1.37% and 1.15% respectively. For the full-year, we expect the rates to end 2017 at 1.62% and 1.40% respectively.

- **Latest Fiscal and External Balance Outlook:** Operating revenues rose moderately to SGD69.45bn in Mar from SGD68.67bn in Feb, while total expenditure rose to SGD75.07bn in Mar from Feb's SGD71.39bn. This led to a primary deficit of SGD5.62bn in Mar, up from -SGD2.72bn in Feb. Nevertheless, with special transfers, top-ups and net investment income, the overall budget was in a surplus of SGD1.91bn in Mar (Feb: SGD5.18bn).

- The current account surplus widened to SGD19.40bn in 1Q 2017 from SGD18.13bn in 4Q 2016. The larger surplus was attributable to the more moderate deficits in the primary income (1Q: -SGD1.68bn vs. 4Q: -SGD3.74bn) and secondary income (1Q: -SGD3.63bn vs. 4Q: -SGD3.81bn). The financial and capital deficit however narrowed sharply to SGD3.28bn in 1Q17 from 4Q's SGD22.73bn on the back of a sharp drop in portfolio investment outflows of SGD2.90bn (4Q: SGD13.96bn) and an inflow to financial derivative of SGD8.27bn (4Q:

+SGD3.37bn). As a result of the smaller deficit in the financial and capital account, the overall balance of payments (BoP) rebounded back into surplus of SGD16.61bn from 4Q's deficit of SGD3.93bn.

- **Key domestic events and issues to watch:** We will be watching NODX, CPI and industrial production prints for May on 16 and 23 Jun for hints that the economy remains on the recovery path.

- **Technical Outlook:** USDSGD traded lower for the month. Last seen at 1.3570 levels. Bearish momentum on daily and weekly chart remains intact. But we observed that bearish momentum on daily chart is waning and stochastics shows signs of rising from oversold conditions. We see risks of rebound. Resistance at 1.3950 levels. Interim support at 1.3806 (61.8% fibo retracement).

MYR: Will Sentiment Continue to Improve?

Forecast	2Q 2017	3Q 2017	4Q 2017	1Q 2018
USDMYR	4.3000 (--)	4.2500 (--)	4.3000 (--)	4.3500 (--)

No Change to Previous Forecasts

- **Motivation for the FX View:** We are positive on the Ringgit outlook given the recent initiatives from BNM to broaden and deepen the onshore financial markets. We interpret these steps as positive development and expect foreign investors' confidence to gradually return. Thus far foreign investors interest in Malaysian equities have picked up, with data up until April showing inflows with possibly net foreign selling of Malaysian bonds dissipating somewhat as pressures eased on the portfolio capital flows front.

- Our Fixed Income Research team expects foreign net selling of Malaysian bonds to recede sharply - and may even reverse - given that there are no maturities of government bonds in Apr- May 2017, while the next two maturities are the Government Investment Issue (GII) notes on 15 June 2017 and 30 Aug 2017 where foreign holdings are much lower than that of MGS. Furthermore, the record-high monthly net foreign selling of bonds in Mar 2017 may have included partial disposal by foreign investors holding MGS maturing on 15 Sep 2017 and 31 Oct 2017.

- Given improved investors' sentiment, well-managed expectation for Fed rate hike, supported oil prices and MYR being fundamentally and historically undervalued, we see scope for Ringgit to play catch up with regional peers and extend its gains towards 4.25 levels (vs the USD) for the month of June before some strength in the USD potentially supporting the pair at around 4.30. We are maintaining our USDMYR forecast across the forecast horizon.

- We reiterate our **long-standing bias that the Ringgit remains fundamentally undervalued.** Our fair value estimate (which takes into account interest rate differential, inflation differential, current account differential and reflation variables) puts USDMYR at 3.65 levels. We had previously said that Ringgit weakness was temporary and was not a reflection of underlying fundamentals (which remain intact). We believe stability is gradually returning to Ringgit as political/ contingent liability risk subsides, fiscal consolidation gains traction, oil prices continue to stabilize and uncertainty subsides. Solid underlying fundamentals and policies, backed by domestic demand, re-calibrated supportive budget (on a lower oil price assumption suggests flexibility in the fiscal space), relative stability in oil prices though some downside pressure exists, relative attractive yields in the MGS, stabilizing FX reserves to retained imports & short-term debt, accommodative monetary conditions (to support businesses) remain intact and should provide an anchor for MYR stability once short-term noises subside. We believe USDMYR range of 4.20-4.40 is likely to remain relatively sustained for 2017.

- **Positive Development to Deepen Onshore Financial Markets**. According to BNM press release (13 Apr), the Financial Markets Committee (FMC) announced a number of initiatives targeted to promote (1) a fair and effective market, (2) improve bond market liquidity; (3) ease hedging activities and; (4) enhance transparency and market information. All the initiatives under (1) to (3) will take effect on 2 May 2017 (Tue) while enhancement to financial market infrastructure will be implemented on a gradual basis and is expected to be completed over a 12 – 18 month period. In particular on points 2 and 3, the regulated short-selling of securities in wholesale money market will be liberalized to allow all residents to participate in short selling activities. This is to facilitate a more effective avenue for the hedging of interest rate risk exposure as well as to generate more trading activities and liquidity in the secondary government bond market. Eligible securities for short-selling transactions will also be expanded to include Malaysian Government Investment Issue (MGII) with an outstanding nominal amount of at least MYR2bn, on top of Malaysian Government Securities (MGS). The aim is to elevate liquidity in the MGII issue and narrow the pricing gap between MGS and MGII. A consultation paper will be issued for market feedback (by 28 Apr) on this proposed inclusion of MGII for short-selling activities. Registered non-bank entities (including institutional investors, companies) will be allowed to hedge up to 100% of their underlying assets and to manage an additional 25% of FX exposures. This allows registered investors to fully hedge and actively manage their FX exposures including unwinding of hedging positions.

- **External** reserves have stabilized and risen since end-Jan 2017. External reserves increased further to USD97.3b as at 15 May 2017 (end- Apr 2017: USD96.1b) on the rise in the foreign currency reserves component to USD90.7b (end-Apr 2017: USD89.5b). Latest tally is equivalent to 7.8 months of retained imports and 1.2 times of short-term external debt.

- **Growth and Inflation Outlook:** Our Economists have upgraded the 2017 real GDP growth forecasts to +5.1% from +4.4% previously (2016:

+4.2%) factoring in the 1Q 2017 GDP numbers, and reflecting mainly upward revisions in the growth of manufacturing (to +5.0% from +4.5%), services (to +5.8% from +5.6%) and agriculture (to +7.0% from +1.5%) on the supply side, and the growth of consumer spending (to +6.4% from +5.9%), public consumption (to +5.5% from +2.9%), investment (to +6.7% from +3.9%), exports (to +7.8% from +1.3%) and imports (to +9.7% from +1.5%) of goods and services on the demand side.

- The prospect of better than expected pick up in real GDP growth this year after the slowdown in 2015-2016 adds to the list and sense of easing macro pains experienced in the past 2-3 years, which include the expected corporate earnings recovery after 3 years of “no growth” which triggered net foreign buying in the equity market year-to-date; sustained current account surplus; delivery of fiscal consolidation targets; stabilization and strengthening of MYR; as well as the receding “foreign holding risk” in the bond market.

- The wild card is external trade in view of the uncertainties over the US trade policy under President Trump, especially the risk to US-China trade relation. However, under the current expectation of a moderate pick up in global economic growth and firmer commodity prices, we are looking at relative better trade growth in 2017 i.e. higher growth in exports and imports of goods and services.

- We continue to keep a close tab on key high frequency domestic data, namely the monthly economic indicators such as the indices on industrial production and distributive trade, external trade, money and banking statistics, as well as major commodity output and prices. In addition, our focus is also on the economic trends as well as policy and political developments in the major economies i.e. US, Europe (including UK), China, Japan.

- Exports and imports surged in Mar 2017 to +24.1% YoY (Feb 2017: +26.6% YoY) and +39.4% YoY (Feb 2017: +27.7% YoY) but trade surplus slumped - 51.7% YoY to +MYR5.4b (Feb 2017: +MYR8.7b). Similarly, exports and imports jumped in 1Q 2017 +21.4% YoY (4Q 2016: +2.8% YoY) and +27.7% YoY (4Q 2016: +5.0% YoY) but trade surplus shrank -21.1% YoY to +MYR18.8b (4Q 2016: +MYR27.5b or -10.2% YoY) implying net exports was not GDP growth accretive last quarter despite impressive trade growth.

- External trade volumes were robust in Mar 2017 as exports volumes on a seasonally adjusted basis climbed +12.4% YoY (Feb 2017: +16.6% YoY) while imports jumped by +28.7% YoY (Feb 2017: +19.0% YoY). Export prices accelerated +10.4% YoY in Mar 2017 (Feb 2017: +8.6% YoY), largely reflective of the commodity price momentum in early-2017, especially crude oil (Brent crude Mar 2017: +25.8% YoY; Feb 2017: +35% YoY).

- Exports in 1Q 2017 surged by +21.4% YoY (4Q 2016: +2.8% YoY) but was outpaced by import growth of +27.7% YoY (4Q 2016: +5.0% YoY), resulting in the trade surplus narrowing by -21.1% YoY to +MYR18.8b (4Q 2016: +MYR27.5b or -10.2% YoY). This suggests that despite the impressive external trade growth in the first three months of the year, net external demand may not be GDP growth accretive.

- Although lead indicators on global economic activities and tech demand suggest the trade growth momentum in 1Q 2017 is continuing into 2Q 2017, recent slips in crude oil price and cyclical industrial commodities like copper, nickel and iron ores suggest that the global economy reflation theme, while still in motion, may be plateauing.

- Current account surplus narrowed in 1Q 2017 to +MYR5.3b or +1.6% of GDP (4Q 2016: +MYR12.5b or +3.8% of GDP) due to smaller goods account surplus (1Q 2017: +MYR25.3b; 4Q 2016: +MYR31.2b) and larger deficits in both income account (1Q 2017: -MYR13.8b; 4Q 2016: -MYR13.3b) and services account (1Q 2017: -MYR6.2b; 4Q 2016: -MYR5.4b). Due to data revision, 2016 current account surplus is now at +MYR29.0b or +2.4% of GDP vs +MYR25.2b or 2.0% of GDP previously (2015: revised to +MYR35.2b from +MYR34.7 or 3.0% of GDP).

- We maintain our view of that current account surplus will be sustained on the back of the pick up in global economic growth (2017E: +3.4%; 2016: +3.1%), hence world trade growth.

- Headline inflation rate in Apr 2017 eased to +4.4% YoY (Mar 2017: +5.1% YoY) while core inflation was steady at +2.5% YoY (Mar 2017: +2.5% YoY). Year-to-date headline inflation rate picked up to +4.3% YoY (Jan-Apr 2016: +3.1% YoY) while core inflation rate slowed to +2.4% YoY (Jan-Apr 2016: +3.3% YoY). No change in our full-year 2017 inflation rate forecast at 3.5%-4.0% (2016: +2.1%).

- We think the +5.1% YoY headline inflation posted in Mar 2017 was the peak and expect headline inflation for the rest of the year to gradually decline from Apr 2017 onwards, although it will average around or slightly above +4.0% YoY in 1H 2017.

- This expectation reflects the view that the current "cost-push" headline inflation – largely due to the impact of the earlier surge in crude oil price on the domestic fuel prices which is a key element of the CPI's "Transport" component - will taper as "demand-pull" and "wage-driven" inflationary pressures are contained as suggested by the stable core inflation rate, the sticky unemployment rate of around 3.4%-3.5% since Dec 2015, and the indication of slower growth in salaries and wages so far this year compared with last year (refer to our report "Labour Statistics, Mar 2017: Stable Jobless Rate, Slowing Income Growth", 18 May 2017).

- Therefore, we maintained our 2017 and 2018 headline inflation rate forecasts of 3.5%-4.0% (official 2017: 3.0%-4.0%; 2016: +2.1%) and 2.0%- 2.5% respectively.

- **Monetary Policy Forecast:** We also maintain our call that the Overnight Policy Rate (OPR) will be kept at 3.00% p.a. as the latest data on inflation is consistent with BNM's view that the surge in headline inflation is temporary and will moderate, while core inflation rate is contained.

- BNM kept the Overnight Policy Rate (OPR) at 3.00% at its MPC meeting on 12 May 2017. The tone of the accompanying Monetary Policy Statement (MPS) remained "neutral". No change in our view of OPR staying at 3.00% this year.

- The tone of the latest Monetary Policy Statement (MPS) is largely unchanged vs the previous MPS issued after the 1-2 Mar 2017 MPC. Essentially, BNM is keeping its monetary policy stance to remain accommodative and supportive of the domestic economy whose growth momentum in 2H 2016 should strengthen in 1Q 2017 and will be sustained for the rest of the year amid the synchronized pick up in global economic activities such as output and trade in both the advanced and the emerging economies that is positive for Malaysia's exports on top of the steady domestic demand driven by continued wage and employment growth as well as the implementation of new and on-going investment projects.

- No change in our view of OPR staying at 3.00% this year. BNM is hinting at a stronger 1Q 2017 growth after the pick up in 2H 2016, in line with our estimate of around +5.0% YoY real GDP growth last quarter (4Q 2015: +4.5% YoY) based on supply side indicators such as the industrial production index, index of services, value of construction works done and palm oil output (see out note on 1Q 2017 Real GDP Preview, 12 May 2017). 1Q 2017 real GDP numbers will be released on 19 May 2017.

- Notwithstanding the potential upside surprise in growth, BNM maintained its view that the surge in headline inflation so far this year (1Q 2017: +4.3%; 2016: +2.1%) is temporary and will moderate in 2H 2017, while core inflation will rise only modestly as the cost-driven inflation is not expected to have a significant impact on the broader price trends given the stable domestic demand conditions.

- Furthermore, BNM still see risks to global and local economy from protectionism, geopolitical developments and uncertain trajectory of global crude oil prices, which could reignite financial market volatility.

- **Latest Fiscal and External Balance Outlook:** Themed "Accelerating Growth, Ensuring Fiscal Prudence, Enhancing Wellbeing of People", Budget 2017 maintains commitment to fiscal discipline and consolidation; supports domestic demand via corporate income tax rate cut, incentives for tourism, SMEs, exports and digital economy, and infrastructure investment; and focuses on the wellbeing of the low-and middle-income groups by addressing the issues of inclusivity, equality, cost of living and affordable housing.

- Budget deficit target for 2017 is set at -3.0% of GDP, sustaining the policy of fiscal consolidation since 2010. This year's aim of -3.1% of GDP is maintained and achievable. Based on monthly data, we estimated budget deficit in Jan-Aug 2016 was -3.9% of GDP as the deficit of -5.6% of GDP in 1H 2016 turned into an estimated surplus of +1.2% of GDP in July-Aug 2016.

- We expect the fiscal deficit to remain flat at 3.1% of GDP, as government spending is likely to pick up (as we enter the election campaign).

- **Key domestic events and issues to watch:** Trade data (5 June); FX reserves (7 and 22 June); Industrial Production (9 June); CPI Inflation (21 June).

- **Technical Outlook:** USDMYR traded lower for a third consecutive month in May, hitting all our objectives. Low was seen at 4.2675; last seen at 4.2840 levels. Bearish momentum on monthly and weekly chart remains intact. But bearish momentum on daily chart shows signs of waning and stochastics is at extreme oversold conditions. These signals suggest a rebound is on the cards. Though we remain constructive of MYR strength, we see stretched signs of oversold conditions. Rebound is expected to re-visit 4.30, 4.32 levels. Support at 4.24 – 4.25 levels.

IDR: Lacking Directional Impetus

Forecast	2Q 2017	3Q 2017	4Q 2017	1Q 2018
USDIDR	13300 (--)	13400 (--)	13450 (--)	13500 (--)

No Change to Previous Forecasts

- **Motivation for the FX View:** The IDR has been stuck within the 13200-13450 range since the beginning of the year. Even the softer USD amid lower UST yields and the S&P upgrade of its credit rating to investment grade failed to inspire a break out from either side of the range. The IDR is struggling against the USD to date. In May so far, the IDR has gained barely 0.1% against the USD, while year-to-date, the IDR rose by just 1.1% against the USD. This makes the IDR one of the stragglers in the ASEAN FX space. We remain neutral on the IDR.

- The IDR carry trade has benefited in an environment of low volatility, favourable global growth conditions, synchronized recovery in Asia, fading political risks and generally easy financial conditions. In addition, the investment grade from S&P also favours the IDR carry trade. This should be positive for the IDR over the medium term as it broadens the appeal of Indonesian assets.

- In the near-term though, seasonal weakness in the IDR in May is weighing on the USDIDR. This is likely due to higher UST yields in May, near-term fading the S&P moves and the growing attractiveness of Malaysia and Thailand as destination of choice for investment flows have resulted in a moderate inflow into Indonesian assets. So far in May, foreign investors have sold off nearly USD0.6mn in equities, a reversal of the USD1.05bn purchased for the whole of Apr. At the same time, foreign funds have added IDR5.75tn to their outstanding holdings of government debt since the beginning of May, moderating from the IDR22.6tn added for the whole of Apr. These have helped in part to keep the IDR supported around current levels.

- In addition, the two more Fed rate hikes expected in Jun and in 4Q should narrow the yield differentials in favour of the US. This could spur some reversal in flows from Indonesian assets back into the US and reduce carry, weighing on the IDR. While political uncertainty in Europe have dissipated, geopolitical tensions emanating from North Korea's belligerence and threat of protectionist measures from the US could spur safe-haven plays and an aversion for riskier assets, weighing on the IDR as well. We could thus see increase volatility in the IDR with the USDIDR bouncing higher as a result.

- For now, market has brushed aside any concerns of political instability in Indonesia from the loss of Jokowi-ally Ahok in the Jakarta gubernatorial elections in Apr or his conviction and subsequent jailing for blasphemy. Even the recent terrorist bombings in East Jakarta have failed to affect both domestic and foreign investors significantly. Still, the failure to stem further bombings, and/or should the opposition galvanize in the wake of their victory in Jakarta to delay the pace of reforms could weigh on Jokowi's popularity and sour the investment climate. Consequently, investment decisions could be delayed until political certainty and policy clarity are in sight, which will be IDR-negative. Already a recently released poll by Kompas showed the President's approval rating slipping in Apr from Oct and further slippages could be a concern for the pace of reforms. We will continue to watch the political arena closely and update our outlook for the USDIDR should the political situation change.

- We expect the USDIDR to remain supported around current levels and for any climb higher to be a gradual grind. This is because of the healthy macroeconomic fundamentals that have underpinned the S&P upgrade that should cap upside to the pair. The 14 reform/stimulus packages introduced with a 15th (relating to logistics) underway have helped to cut red tape and liberalize rules that have been a drag on investment and growth, and also supportive of specific growth industries. In addition, government's efforts to rein in the budget deficit by cutting unnecessary expenditure last year and the successful implementation of the tax amnesty program that have increased government revenue have provided more fiscal space to the government in 2017. As well, the government's USD400bn infrastructure spending spree should lift potential growth and hence the IDR.

- **Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for Indonesia deteriorated to 5.3 from 5.1 from 5.4. This reversal in fortune was due to the deterioration in GDP, inflation and fiscal risks that more than offset the improvement in current account risk. This weigh on the intrinsic value of the IDR.

- **Growth and Inflation Outlook:** After expanding by 4.94% in 4Q 2016, the economy accelerated mildly by 5.01% y/y in 1Q 2017. This though was below consensus expectation of 5.10% but within our economic team's 5.06%. Growth in 1Q was weighed by private consumption, which expanded by 4.93% y/y in 1Q, a tad slower than the 5.0% recorded in the two previous quarters. Boosting growth though was the rebound in government expenditure by 271% y/y from -4.05% in 4Q, steady fixed investment expenditure at 4.80% y/y in 1Q, and surge in exports of goods and services by 8.0% y/y. Despite the tepid start to the year, the government believes that the recovery in exports would continue and stronger investment in the wake of S&P's investment grade for Indonesia should lift growth higher amid stable consumption and boost full-year growth to 5.3% in 2017. In contrast, the BI believes a more reasonable growth forecast range is 5.1-5.2. Our economic team's outlook for the economy is more in line with that of BI, expecting full-year real GDP to expand by 5.1% for 2017.

- For the first time in 14 months, headline inflation has climbed back above the 4.0% levels. Headline inflation rose by 4.17% y/y in Apr from 3.61% in Mar. This acceleration could be attributable mainly to higher housing and utility cost (Apr: 5.19% vs. Mar: 4.09%) and transport cost (Apr: 5.12% vs. Mar: 3.16%) amid more subdued food prices (Apr: 2.8% vs. Mar: 3.0%). Core inflation though was little change at 3.28% y/y in Apr vs. 3.30% in Mar. We continue to expect inflationary pressures to rise on the back of a rise in administered electricity tariff and volatile food prices, especially during the month of Ramadan. These, together with the weaker domestic currency, should work in tandem to lift imported prices. Consequently, our economic team continues to project headline inflation to average 4.26 in 2017, in line with the central bank's forecast for inflation to accelerate above 4.0% in 2017.

- **Monetary Policy Forecast:** The current policy stance has been in place since Oct 2016. Since that time, the BI has kept its policy intact to anchor inflationary expectations and maintain IDR stability. The 7-day reverse repo rate has been kept steady at 4.75%, and both the lending facility and deposit facility rates at 5.5% and 4.00% respectively. This has kept the interest rate corridor steady at 75bp on either side of the policy rate. The front-loading of rate cuts (amounting to 150bp) in 2016 has given some breathing space to BI to hold its policy rate steady amid US Fed rate hikes this year and threats of protectionism.

- Despite comments from BI deputy governor Perry Warjiyo of room to ease policy from the domestic perspective but have not done so to take into account global events such as US Fed fund rate hikes, the macroeconomic environment continues to suggest a rate hike rather than a cut. Rising global oil prices and domestic factors such as electricity tariff rates that could see headline inflation accelerate back above 4% in 2017 amid steady economic growth. Our economic team believes that the BI will use other monetary tools such as macroeconomic-prudential policies to boost growth rather than the policy rate while keeping the policy rate on hold for the rest of the year and in 2018.

- **Latest Fiscal and External Balance Outlook:** The government is expected to submit the revised 2017 state budget to parliament on 5 Jun. Among the changes made to the revised state budget is the growth target for 2017, which has been raised to 5.3% from 5.1% previously. For the 2018 budget assumption, the government has set the growth target at 5.4-6.1%, inflation to hover around 2.5-4.5%, crude oil lifting at 717,000-815,000bpd and gas lifting 1.1m-1.2m boepd. The exchange rate was set at IDR13500-13800 per USD.

- After showing improvement in 4Q 2016, the deficit in the current account (CAD) rose mildly to USD2.40bn in 1Q 2017 or 1.0% of GDP (4Q: -USD2.10bn or 0.9% of GDP). This mild deterioration was due to the larger deficit in the primary income account (1Q; -USD7.15bn vs. 4Q: -USD6.14bn) and smaller surplus in the secondary account (1Q; +USD0.78bn vs. 4Q: +USD0.93bn) that more than off the slight improvement in the goods and services account of USD4.23bn (4Q: USD3.11bn). The overall balance of payments surplus was little changed at USD4.51bn. The BI expects the BoP to remain in a surplus in 2017 but to moderate to USD8-9bn from USD12bn in 2016. This narrowing in the BoP surplus is due to declining capital and financial account and deficits in the current account (expected around 1.8-1.9% of GDP). For 2017, our economic team expects the CAD deteriorate to 1.15% of GDP due to greater import of capital goods to support the government's infrastructure programme, in line with the BI's outlook for 2017.

- **Key domestic events and issues to watch**: The government will submit the revised 2017 state budget to parliament on 5 Jun. BI meets on 14-15 Jun to decide on monetary policy.

- **Technical Outlook:** USDIDR traded 13250 – 13400 range this month. Last seen at 13330 levels. Underlying momentum remains bearish bias but shorter term momentum shows signs of turning mild bullish. Daily stochastics is also showing signs of turning higher from near-oversold conditions. Interim support remains at 13280. Resistance at 13400 (recent high). Expect recent range to hold with mild bias to the upside.

PHP: Weighed By Domestic Factors

Forecast	2Q 2017	3Q 2017	4Q 2017	1Q 2018
USDPHP	50.30 (--)	50.50 (--)	50.70 (--)	50.70 (--)

No Change to Previous Forecasts

- **Motivation for the FX View:** After being among the outperformers in Apr, the PHP has slipped to near the bottom of the pile among Asian currencies, just a tad above Indonesia. So far in May, the PHP has risen by just 0.24% against the USD, helped by USD weakness amid dips in the UST. This spurred foreign investment inflows to Philippine assets and helped to keep the PHP supported so far. Month-to-date, foreign investors have purchased USD161.45mn in equities, a moderation from Apr's +USD108.18mn.

- However domestic factors such as ongoing concerns about the President's anti-drug policy, declaration of martial law in Mindanao and the delay in passage of the much-touted tax reforms have led to some slowdown in inflows into Philippine assets, weighing on the PHP and capping upside. This was reflected in the more moderate purchase of equities by foreign funds in 2017 so far. Year-to-date, foreign investors have purchased just USD10.74mn of equities since the beginning of the year, in contrast to the USD83.39mn purchased for the whole of last year. Though foreign bond purchases data is not available, a look at Philippine sovereign bond yield movement suggests that there has been a sell-off in government debt so far this year and this could well include foreign investors. Year-to-date, sovereign bond yields have been broadly higher by 5.25-98.48bp in across all tenors. It is such concerns that we remain bearish on the PHP in the next three-to-six months.

- An examination of USDPHP price action for the past 10 years, risk appears to be tilted to the upside for the pair in Jun. Seasonality factors aside, the potential USD comeback underpinned by steady US economic growth, the ongoing normalization of US rates (one hike in Jun and another sometime in 2H), expectation of Fed's unwinding of its QE, and possible EUR pullback amid disappointment with ECB policy could see USD bulls back in action, lifting the USDPHP higher. The possibility of the re-emergence of global reflation trade or hints of a re-emergence could see outflows from riskier assets back to the USD.

- As we had caution previously, we need to see a more nuanced dissipation of this risk premium before an improvement in the PHP can be realized. While indiscriminate killings are still being reported, signs that the campaign against illegal drugs is slowing. Similarly, martial law appears contained within Mindanao and plans for the House of Representatives to move forward to pass the tax reform bill as early as in the first week of Jun. This should allay foreign investor concerns and could eventually lead to further foreign inflows into the Philippine assets and lift the PHP higher.

- Note though that there is a risk that martial law could be extended across the Philippines should violence erupts in Manila or in main island of Luzon. Should this happen, our estimate from our examination of the recent martial law episode in Thailand suggests that the USDPHP could climb higher by at least 5% from current levels in the lead-up to the imposition of martial law.

- In the longer term, we could see more inflows into the Philippines equity market. This is because valuations in the Philippines have fallen after the sell-off in the equity market over the past few months. According to our estimates using the Cyclical Adjusted P/E (CAPE) ratio, equities are now relatively cheaper (as reflected by estimated P/E ratios minus their 5-year average P/E ratios) compared to its peers and this could eventually attract foreign inflows as a result.

- In the next three-to-six months, pressure on the PHP is still to the downside. The expected resurgence in the USD due to the two Fed rate hikes pencilled in for the remainder of this year, together with the potential re-emergence of global reflation trades, could spur outflows from Philippine assets and weigh on the PHP. In addition, protectionist measures that could disrupt global trade by the Trump administration cannot be discounted and this could also add to downside pressure on the PHP.

- Downside risks to the PHP are expected to be accentuated by the deteriorating current account. Already, available data showed that the current account slipped into a deficit of 1.2% of GDP in 4Q for the first time since 1Q 2012. As we had previously noted, a 25bp rate hike (as expected by our economic team in either 2Q or 3Q of this year) to keep the economy from overheating and for inflation to stay within the BSP comfort zone of 2-4% is unlikely to be a panacea for its currency woes. We continue to expect the PHP to remain under pressure for the remainder of the year underpinned by USD strength and the Duterte risk premium that should keep the pair supported above the 50-figure in 2017.

- Our monthly **Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, was improved marginally to 5.2 from 5.3. The improvement was due in part to the improvement in fiscal risk that more than offset the deterioration in inflation risk. This should be supportive of the intrinsic value of the PHP.

- **Growth and Inflation Outlook:** The economy expanded by 6.4% y/y in 1Q 2017, easing from 4Q 2016's 6.6% as both domestic demand and net external demand decelerated. Domestic demand grew by a more moderate 6.8% y/y in 1Q from 9.0% in 4Q, pulled-down by moderations in consumer spending (1Q: 5.7% y/y vs. 4Q: 6.2%) and gross fixed capital formation (1Q: 11.8% y/y vs. 4Q: 18.5%) as well as flattish government consumption of 0.2% y/y vs. 4Q's 4.5%. Net external demand rose by a slower 1.8% y/y in 1Q 2017 compared to 23.8% in 4Q 2016. The government continues to target growth of 6.5-7.5% for 2017, supported by its expansionary spending program (where the ceiling for deficit spending was raised to 3% of GDP from 2017 to 2019). In addition, the cyclical recovery in exports led by the US and China should also be supportive of the government's outlook. However, private consumption spending could face uncertainties from the proposed tax reform package, especially plans to raise the consumption-based taxes. In addition, the expected 25bp policy rate hike in mid-2017 should slow consumption. This though could be mitigated by expectations that sustained growth in overseas remittances could be supportive. In light of fiscal spending and supportive consumption spending, our economic team maintains their growth projection at 6.4% for 2017, just a tad below the lower bound of the government's 6.5-7.5% growth projection.

- Headline inflation rose 3.4% y/y in Apr, the same pace as in Mar, while core inflation edged up to 3.0% y/y vs. Mar's 2.9%. The main culprit for the climb in headline inflation was food prices, which rose 4.2% y/y in Apr from 3.4% in Mar. The other culprit was transport cost which pick-up by 3.2% y/y in Apr from Mar's 2.6%. In the first four months of the year, headline and core inflation averaged 3.2% and 2.8% y/y respectively. Given the volatility in commodity prices and the indication of delay and watered down consumption-based tax hikes under the proposed tax reforms, our economic team revised their 2017 and 2018 headline inflation rate forecasts to 3.3% (from +3.5% previously) and 3.5% (from +3.8% previously) respectively.

- **Monetary Policy Forecast:** The BSP has left its benchmark policy rate unchanged at 3.0% since 16 May 2016. Also left unchanged were the overnight lending rate and overnight deposit rate at 3.5% and 2.5% respectively. The 50bp symmetrical corridor on either side of the policy rate was also kept in place. However, it is likely that the current policy stance might not last. This is because, unlike most of it regional peers in the region, the BSP is expected to be the first central bank in the region to hike rates in 2017 given the outperformance of the economy - expanding at a healthy pace above 6% - and inflation accelerating close to the upper bound of the government's comfort zone for inflation. The BSP could also be mindful that the gap between UST and Philippines treasury yields could narrow when US Fed resume its rate hikes in 2017 that could spur capital outflow. To counter these challenges, our economic team expects the central bank to hike the policy rate by 25bp rate hike once in 2Q 2017. This modest rate adjustment should ensure that real interest rate remain positive, though we doubt that this would be sufficient to ease downside pressure on the PHP.

- **Latest Fiscal and External Balance Outlook:** The fiscal position rebounded to a surplus of PHP52.80bn for the first time in three months. This was helped by the climb in tax collection during the month that saw total revenue climb to PHP235.88bn in Apr while expenditure rose to a more moderate PPH184.08bn due to a decline in interest payments. Despite the fiscal surplus in Apr, the fiscal position in the first four months of 2017 remained in a deficit of PHP30.18bn, narrower than the deficit of PHP57.47bn in the same period last year. There was no change to the government expectations of the deficit ceiling being kept at 3% of GDP through 2022.

- After three consecutive months of deficits, the balance of payments (BoP) recorded a surplus of USD917mn in Apr. While a detailed breakdown of the components of the BoP is unavailable for now, we surmise that the turnaround could possibly be due to an improvement in the merchandised trade balance and a return of portfolio flows into Philippine assts. As mentioned earlier, foreign funds had purchased USD108.18mn in equities in Apr after two straight months of sell-off. After maintaining that the overall BoP and current account would remain in a surplus of USD1bn and USD800mn respectively in 2017, the BSP now expected to revise these projections sometime in Jun to take into account development in exports, remittances and investment flows.

- **Key domestic events and issues to watch:** The BSP meets on 22 Jun to decide on monetary policy. The much-touted tax reform bill is expected to be passed by the House of Representative at the earliest in the first week of Jun. The outlook for BoP and the current account is likely to be revised sometime in Jun.

- **Technical Outlook:** USDPHP traded 49.70 – 50.20 range for the month of May. Last seen at 49.80 levels. Daily momentum and stochastics are not indicating a clear bias. But underlying momentum (as shown from weekly and monthly charts) remains bearish bias. Moves toward 50.30

are likely to attract fresh selling interest. Support remains at 49.30 (200 DMA). Bias to trade range of 49.50 – 50.10 next month.

THB: Downside Risks

Forecast	2Q 2017	3Q 2017	4Q 2017	1Q 2018
USDTHB	34.80 (--)	35.30 (--)	36.00 (--)	36.20 (--)

No Change to Previous Forecasts

- **Motivation for the FX View:** After lagging its regional peers in Apr, the THB has reasserted itself in May to be the best performer among the Asian currency we cover. In May so far, the THB has risen by 1.44% against the USD, a complete reversal from the 0.7% dip in Apr. Aside from a weaker USD, the strong gains in the THB was attributable to the inflow foreign funds into Thai assets. This has contributed to the THB being the outperformer among ASEAN currencies, gaining 4.9% against the USD so far this year. Nevertheless, we believe the risk to the THB is to the downside and we maintain our bearish outlook for the THB.

- Our VAR decomposition analysis (which shows the percentage of the forecast variance due to each endogenous variable) suggests that the factor most important to changes in the USDTHB is the political environment. For now, the political calm in the kingdom is providing the impetus for an economic growth recovery and a stable investment environment for foreign funds, thus supportive of the THB. However, any shifts in political sentiments could impact the USDTHB.

- Aside from the political environment, real yields, foreign purchases of government debt and current account balances also drive the USDTHB. The widening of real yield differentials between the 10Y UST and Thai government bond should encourage capital inflows in search of higher returns, lifting the THB higher. Relative low foreign ownership in Thailand at 15% (compared to Indonesia at 38% as of end-Mar 2017) suggests that there is room for even more foreign ownership of Thai assets. This continues to make Thai bonds more attractive than Indonesian ones, and this should be supportive of the THB.

- Also helping to support the THB to date is the ballooning current account surplus. With the exception of Singapore, which historically has persistent and high current account surpluses, Thailand has seen its current account surplus balloon to more than 10% of GDP since 2014. In contrast, the current account surpluses of both Malaysia and Philippines are tapering, while Indonesia continues to see persistent current account deficits.

- The strong foreign inflow into Thai assets recently attests to its healthy macroeconomic fundamentals, namely the persistent current account surplus and widening real yield differentials. In May so far, foreign investors have purchased THB37.88bn of government bonds, while year-to-date, they have purchased THB139.75bn of government bonds. Further purchases by foreign investors in the months should be supportive of the THB, capping upside to the USDTHB.

- This is a risk that market is underpricing US Fed fund rate hike risks. There could be sharper upward swings in UST yields as well as in the USD as a result. This could spark a sell-off in EM assets, including those from Thailand and put upside pressure on the USDTHB. We also cannot discount the fact that remedial action could be taken against Thailand for its large trade surplus with the US. This could come even though the Apr US Treasury Department foreign-currency report did not categorize Thailand as a currency manipulator. The Commerce Department is expected to recommend measures, which could include protectionist measures, to reduce the US trade deficits with its trading partners when it issues its report in Jun. This could potentially disrupt trade and weigh on the THB ahead.

- We expect further upside risk to the USDTHB to come from the political arena. So far, the political calm and stability belies underlying tensions. We believe this simmering tension could break to the surface towards the latter part of the year after the funeral of the late King HM Bhumibol, which is expected sometime in Nov, and the coronation of HM King Maha Vajiralongkorn, which should follow soon after, have concluded. The current political calm and stability could give way to political tensions once the election schedule is announced.

- Driving this tension is the continued domination of the military (and the elites) in the political arena to the exclusion of nearly everyone else. The new constitution gives the military power to appoint the 250 members of the new Senate in the first five years after the first parliament convenes. More importantly, the new constitution allows for the appointment of a non-elected PM to head the government especially in a divided lower house of parliament. These powers would allow the military and its allies to dominate politics long after the return of power to civilian rule. Consequently, this could re-ignite political temperature in the run up to the general elections, expected sometime mid-2018. Rising political temperature could keep foreign investors on the sidelines until the political climate clears up. This could weigh on the THB sentiments and possibly keep the USDTHB supportive around the 36-handle by the end of the year.

- **Our Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for Thailand has improved from 4.3 to 4.0. This was due to improvement in both current account and inflation risks. This should be supportive of the intrinsic value of the THB.

- **Growth and Inflation Outlook:** The economy recovery appears on track with 1Q 2017 GDP rising by 3.3% y/y (4Q 2016: 3.0%), beating consensus estimates for 3.1%. Growth was bolstered by improvement in private consumption, which rose 3.2% y/y in 1Q vs. 2.5% in 4Q and exports (1Q: +2.7% y/y vs. 4Q: 1.1%), while gross fixed capital formation held steady at 1.7% y/y (4Q: 1.8%). This helped to offset the mild increase in government spending of 0.2% y/y (4Q: +1.8%). Our economic team remains optimistic about growth prospects as they expect improvement in consumption spending and exports will reinforce the rise in public investment and tourist arrivals. They have tweaked their full-year growth forecast to 4.0% for 2017, a downward adjustment from 4.5% previously. This is still above-consensus with market expecting growth to come in at 3.3% in 2017.

- All the concerns of inflationary pressure appeared to have faded with the Apr inflation print. Headline inflation moderated even further in Apr, rising by just 0.38% y/y in Apr from 0.76% y/y in Mar. Inflation was weighed by a decline in food foods (Apr: -0.26% y/y vs. Mar: +0.68%) and housing cost (Apr: -1.17% y/y vs. Mar: +1.19%) and a moderation in transport cost (Apr: +3.07% y/y vs. Mar: +3.30%). Core inflation also moderated in Mar, rising by 0.50% in Apr y/y from 0.62% in Feb. Nevertheless, our economic team remains sanguine over inflation prospects in 2017. They maintain their forecast for inflation to average 2.5% in 2017, higher than the 2.2% projected by the BoT. This is because of the expected sharper economic recovery, rising commodity prices and still weak THB that should spur inflation higher.

- **Monetary Policy Forecast:** The BoT has left its benchmark interest rate unchanged since it last cut the rate by 25bp to 1.50% on 29 Apr 2015. The last time the policy rate was even lower was during the Great Financial Crisis in 2009-10 where the policy rate was cut to 1.25%. With monetary policy already accommodative and near historic low, and the central bank viewing expansionary fiscal policy to be more appropriate to drive economic growth, further rate cuts is unlikely at this point. The central bank prefers monetary policy to play a supportive and complementary role to fiscal policy in driving economic growth than taking the lead.

- That said, our economic team believes that the central bank could hike its benchmark policy rate to anchor inflationary expectations and to prevent the economy from overheating sometime in 2017. At the same time, a rate hike would also lift domestic yields, keeping the current spread between the UST and Thai bonds or widen it, helping to reduce any outflow from Thai assets. Our economic team is thus penciling two 25bp rate hikes this year, one in Sep and the other in Dec to lift the benchmark policy rate to 2.0% by end-2017.

- Aside from rate adjustments, the BoT is also concerned about the strength of the THB as a result of hot money inflows into Thai assets. The central bank governor recently warned that BoT was ready to introduce further measures to curb such inflows to stem the strength of the THB 'without advance notice'. Already, the BoT has taken steps in Apr to reduce the supply of 3-months and 6-months bond supply in May to curb inflows and this has been extended to Jun. Other measures that the BoT could consider includes increasing the withholding tax for government bonds on foreign investors (currently at 15%) and expanding measures to encourage greater investment outflows by residents.

- **Latest Fiscal and External Balance Outlook:** According to Fiscal Policy Office, the total tax revenue collected in the Oct 2016-Apr 2017 period was THB1.22tn. This was THB49.5bn higher than targeted. For FY2018, the cabinet has approved a planned THB2.9tn budget that should aid the economy to grow above 3% in 2018.

- The current account surplus narrowed sharply to THB9.88bn in Mar from THB200.82bn in Feb. This could be attributed to moderations in the trade surplus to THB101.51bn from Feb's THB140.58bn and the deficit in the primary and secondary income account of THB11.63bn (Feb: +THB60.23bn). The overall balance of payments (BoP) slipped into a deficit for the first time this year at THB110.35bn in Mar, likely due to outflows from Thai assets in the month.

- **Key domestic events and issues to watch:** We will be watching pre-poll bills that will be scrutinized by Parliament in Jun, which if passed will form the basis for the general elections expected mid-2018. In addition, the BoT is expected to revise its GDP growth forecast for 2017 within the month.

- **Technical Outlook:** USDTHB traded a high of 34.83 (9 May), somewhat near our first target of 34.87, before gains were more than retraced into month-end. Pair was last seen at 34.15 levels. Bearish momentum on monthly, weekly and daily charts remain intact. But stochastics on daily chart suggests USDTHB is oversold and is showing signs of rebound. Next resistance at 34.30 (38.2% fibo retracement of May high to low), 34.45 levels (21, 50 DMAs), 34.63 (76.4% fibo). Bias to sell rallies, looking for move towards 34-levels.

INR: GST Rollout Eyed

Forecast	2Q 2017	3Q 2017	4Q 2017	1Q 2018
USDINR	65.00 (--)	65.70 (--)	66.20 (--)	66.00 (--)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** We are one-month away from the end of the quarter and we anticipate that the USDINR could still remain where it is now. Spot price is seen around 64.50. Positive sentiments around the GST roll-out on 1 Jul are likely built in in the equity and bond markets already. Investors are also somewhat less concerned about inflation as the GST committee has demonstrated a lot of care in ensuring that most basic food essentials are exempted so that the CPI basket is not affected by the implementation of the new tax system. With inflation rather benign at this point and still positive impact expected on growth and revenue, demand for domestic bonds have been strong with a bull flattener seen on the India sovereign curve in the past month. Month-to-date (23 May), foreign investors have already bought U$2.5bn of bonds and U$1.43bn of equities. We expect the bond inflows to slow as debt utilization for central government securities has already reached 80%. We are still wary of any rebound in the USD that could negate the gains in the rupee.

- Another key reform that the government has done in May is to give RBI more power to resolve bad assets in the banking system. RBI has since released a series of measures including getting a panel to ensure a consistent decision making process for cases that may be determined for resolution under India's rules on insolvency and bankruptcy and to increase the number of members in the Oversight Committee that deals with stressed assets. This could pave the way to the next move which is to reinject capital into banks, increasing credit growth and private investment that has been lacking in the economy.

- While the RBI has been a hawk on inflation, the GST committee has taken special care to keep price pressure in check with a 4-tier GST rates system along + exemptions. Theoretically, with most food essentials (fresh food, fresh milk) exempted, the impact on inflation should be minimal and overall. The four tax rates – 5,12,18 and 28%+cess that is also applicable on services have also meant to ensure that the taxes are revenue-neutral. However, the exemptions and multi-tax rates could mean that the GST system is less efficient and more administratively cumbersome than a simple single rate tax system. We concur with our India equity strategist that the major benefit is that in the medium to long term, it is expected to improve tax compliance and GDP growth, by 100-150bps (their estimates). Greater uniformity of tax will also enhance the ease of doing business. What we are more concerned is execution could still be an issue as a vast number of SMEs are required to adopt the digital system and equipment and the multi-tax rate system could mean that revenue collection is likely to administratively cumbersome and could even distort spending behavior.

- For a while, RBI has been intervening in the forex markets, buying USD to "smooth volatility". RBI made a net forward purchase of USD10.8bn in Mar However, more recently, the leaning against the wind activities were meant to boost the rupee when the Indian Army's recent launched military raids into a Pakistan-controlled part of Kashmir to eradicate camps that has terrorists. This likely happened for just a day to stem rupee volatility. USDINR forecast for 2Q is maintained at 65. Trajectory towards the end of the year is still likely to be to the upside, led by mild USD strength but we expect rupee to withstand US tightening better than its peers.

- Our **Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for India improved to 4.4 (with 1 being the best score and 9 being the worst) from previous 4.6 as the improvement in the score for inflation offset the deterioration in current account.

- **Growth and Inflation Outlook:** Industrial production rose 2.7%y/y from previous 1.9% in Mar from the previous 1.9%. Strong output gains were seen in most electricity and mining sectors though partially offset by the weaker growth in the manufacturing sector. That's the release for Mar. External demand for Apr seems to have weakened with exports slowing from 27.6%y/y to 19.8%. Imports on the other hand have surged to 49.1%y/y from previous 45.3%, resulting in a widened trade deficit of U$13.2bn.
- CPI slowed to 2.99%y/y from previous 3.81%y/y, on the back of lower food and beverages, housing. The fuel subcomponent accelerated to 6.1%y/y from previous 5.5%. Apr WPI also slowed to 3.9%y/y from previous 5.7%y/y. Slower price increase was noted across the board including primary articles, fuel, power, light and manufactured products. With the southwest monsoon rainfall forecasted to be near normal, price pressure of food should be benign and that should cap CPI in the months ahead.
- The latest industrial outlook survey released in Apr reveals an improvement in sentiments on demand conditions including production, order book and capacity utilization this quarter. Respondents are optimistic about transferring the rising cost of materials to selling price which should leave the profit margin unaffected in 1Q 2017-2018 (Mar-Jun). While the survey suggests potential improvements in the outlook of the industrial sector, the stagnant profit margin (albeit an improvement from the contraction seen in the previous quarter) does not bode well for private investment. This situation could see an improvement as RBI has started to upsize the committee meant to oversee cases of stressed assets.
- **Monetary Policy Forecast:** The minutes of the Apr meeting has showed that most RBI MPC committee members were concerned about the inflation risks that emanate from the potential El Nino that could affect monsoon rain, the implementation of the HRA allowances and the one-off GST kick-off. However, inflation has repeatedly surprised to the downside, the GST is also not expected to affect inflation and monsoon rainfall is projected to be normal. That could mean that RBI might turn dovish in its next statement on 7 Jun but a rate cut could still be pre-mature given the fact that the multi-tax rates and exemption features in the GST rollout on 1 Jul could still distort spending behaviour and affect price pressure. We note that RBI Patel could still desire a lower policy rate as he flagged that there is still room for banks to cut lending rates. We look for RBI to keep policy rate unchanged at the next policy meeting on 7 Jun.
- **Latest Fiscal and External Balance Outlook:** The Union Budget is pro-rural. Finance Minister Jaitley pledged support to the farmers, infrastructure spending and personal income tax cuts and corporate tax cuts for small and medium businesses to boost consumption and investment. Investors will closely watch for the implementation of the GST, scheduled on 1 Jul. As stated above, our equity strategists estimate a 100-150bps boost to growth from the implementation.
- The current account deficit widened to $7.9bn in the quarter ending Dec. Trade deficit deteriorated to U$33.3bn vs. previous U$25.6bn.

Capital account recorded an outflow of U$19.1bn. Portfolio investment also recorded a net outflow of U$11.3bn. Trade deficit is likely to improve in the first three months of the year as indicated by the higher frequency releases and financial accounts are also likely to register strong inflows from equities and bonds. Expect an improvement in balance of payments.

- **Key domestic events and issues to watch:** 1Q GDP on 31^{st} May, PMI is due on the 1^{st} Jun, RBI meeting on 7^{th}, trade on 9-15^{th}, CPI and industrial production on the 12^{th}, WPI on 14^{th}.

- **Technical Outlook:** 1M NDF broke out of the downward sloping trend channel and was last seen around 64.85. The mild reversal that we flagged came to fruit in May, in tandem with the bearish rupee reversal that we expected. The pair seems to be hovering within the 64.20-65.40 range for now, with mild downside bias.

VND: When The USD Bulls Awaken…

Forecast	2Q 2017	3Q 2017	4Q 2017	1Q 2018
USDVND	22900 (--)	23100 (--)	23300 (--)	23400 (--)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** The lack of USD strength has left USDVND within the 22650-22760 range. The stability in the dong has also capped price pressures, also helped by the downtrend in food prices in the region. That said, note that the upmoves on 26-27 May were rather sharp, sensitive to any rebounds in the USD. We still see upside risks to the USD, compelled by the fact that technical charts indicate that the DXY index seems to be forming a base. The bids in USDVND in a stronger USD environment could be aggressive and we see it as a matter of when, not if. Even as the pair last printed 22741, the pair can easily surpass our 2Q forecast of 22900 once the USD bulls awaken.

- Regional trade numbers have softened from its uptrend in 1Q, in tandem with softer activity numbers in China. FDI growth softened year-on-year for the first five months of this year. The pace of investment inflow has certainly been slower than before, statistically. This is perhaps due to the die-down in the hype over TPP despite having the FTA with the EU. USDVND remains vulnerable to the USD trajectory. Despite the USD retracement, we are still wary of its potential resurgence in view of two more likely hikes by the Fed (the next one to happen this month). Portfolio inflows have been strong, keeping a lid on the USDVND. Expect pressure on the USDVND to be mostly on the upside as we anticipate further rate hikes by the Fed to lift the currency pair into 3Q and 4Q this year, looking for the pair to reach 23400 by year end, after taking into account the recent USD retreats.

- **Growth and Inflation Outlook:** Apr PMI-mfg came in at 54.1 (vs. previous 54.6) with new orders rising sharply, boosted by strong export growth. Purchasing managers also reported signs of inflation easing and improvement in business conditions in each of the past 17 months. Industrial production for May softened correspondingly to 7.2%y/y from previous 7.4%. Exports accelerated to 17.4%y/y for the first five months from 15.4% seen in Jan-Apr. Imports slowed slightly to 23.9%y/y from previous 24.9%y/y in the same period. Trade balance dipped into a deficit of U$800mn from a previous surplus of U$186mn. Looking forward, the external sector may soften in line with regional trends though sharp deterioration is unlikely. Retail sales accelerated to 10.2%y/y in Jan-May from 9.6% in Jan-Apr. The tourism sub-component saw marginal softening from 6.3%y/y to 6.2% but retail sales in trade sub-components as well as services saw robust pick-up in growth respectively, underscoring the rising household consumption that is backed by the rise in the middle class.

- Inflation in May extended its downtrend to 3.19%y/y from previous 4.30%, tempered by the stability in the Vietnamese dong. The slow-down was broad-based but particularly significant decline was seen in the food sub-component, which recorded a fall of -3.4%y/y for rural areas, -1.04% in urban areas. Transport in urban also decelerated markedly to 7.56%y/y from previous 9.35%. In the last month, we recall that the Head of GSO Price Statistics Department urged Ministries to keep an eye on prices of essential goods in particular rice, gasoline, steel and fertilizer in order to keep CPI below 4%. Food inflation may be low now but any rise in fuel prices, coupled with a weak dong (that is derailed by a resurgence of USD) could threaten the headline CPI to the upside. The Ministry of Planning and Investment's National Centre for Socio-Economic Information and Forecast expects inflation to average around 4.7% in 2Q with potential weakness in dong likely to keep price pressure.

- But more recently, PM Nguyen Xuan Phuc said he is confident economic growth this year will meet the target of 6.7% without threatening the inflation target of 4%. The acceleration in exports, foreign investment and agriculture production should foster stronger growth in 3Q and 4Q. In addition, Phuc also expressed eagerness to explore "new mechanisms" to expand bilateral trade between Vietnam and the US.

- **Monetary Policy Forecast:** According to a statement by the central bank on 10 Apr, they continue to ensure stable interest rate and stand ready to respond to any extraordinary movement. The SBV would strictly monitor and promptly intervene when needed through open market operations and refinancing to manage money supply. The central bank is working to resolve and restructure NPLs so as to improve the monetary transmission system. We continue to expect little action from SBV in terms of rates and since credit growth has been picking up strongly to 20.1%y/y in Apr.

- Elevated price pressure has effectively reduced the real borrowing rates. Expectations for a strong USD, higher US rates could continue to keep the dong on the backfoot. SBV is likely to keep policy rates (currently base rate at 9.0%, refinancing rate at 6.5% and discount rate at 4.5%). USDVND could continue to keep a mild uptrend into 2Q and 3Q. Resurgence in USD strength would still leave USDVND vulnerable to the upside. In addition, exports growth is still weak whilst imports growth has been robust, leaving the trade balance in wider deficits. Lean FX reserves-import ratio of barely above 2 would mean that any external shocks in the FX space could force SBV to devalue the dong. Should USD remain on the upmove, expect USDVND reference rate to be fixed higher and that should guide the USDVND towards our 23400 forecast by 4Q.

- **Latest Fiscal and External Balance Outlook:** It was rather quiet in terms of further fiscal policies in May. Vietnam reported a state deficit of VND21.8trn from Jan-Mid May, that's 5.64% of GDP in the first five months. Expenditure on infrastructure is slow according to the Chairman of national Assembly Economic Committee. Recall that in April, Vietnam set a lower budget deficit of 3.38% of GDP for 2017 from previously 3.50%. 2016-18 public debt (including government debt, debt guaranteed by government, municipal debt) is capped at 65% of GDP. 2016-18 government debt is set at no more than 54% of GDP while foreign debt is set at no more than 50% of GDP. The government has an ongoing effort to divest VND67trn from SOE in the years leading to 2020. Key use of the capital is to develop important infrastructure projects like the Long Thanh International airport, along with the recent plans to build the Chrey Thom Bridge that will connect the southern province of An Giang in Vietnam to Cambodia's Kandal province. This is meant to promote bilateral trade and bring about more economic benefits for those communities along the border areas. That said, there was no timeframe for the construction.

- Current account recorded a surplus of U$155mn in 4Q (latest data available), narrowing drastically from the U$3.5bn seen in 3Q on the back of narrower net trade surplus of goods. Expect 1Q 2017 print to possibly dip into deficit but we remain cautiously optimistic on Vietnam's external position, expecting the improvement in regional demand to boost Vietnam's trade in 2Q.

- **Key Domestic Events and Issues to Watch:** PMI-mfg is due on 1st Jun. CPI is due on the 24th. 2Q GDP, Trade balance and retail sales within 25-30th. Industrial production between 27-30th.

- **Technical Outlook:** USDVND hovered within 22650-22770 for much of May, swiveling around the 50-DMA. Daily momentum is mild bullish. Momentum indicators suggest range-bound trade within 22650-22770. A break of the 22700 support opens the way to Apr low of 22650 while a break to the topside gives way to 22850.

FX Forecasts

	End Q2-17	End Q3-17	End Q4-17	End Q1-18
USD/JPY	116	118	120	120
EUR/USD	1.0800	1.0700	1.0800	1.1000
GBP/USD	1.2800	1.2600	1.2800	1.3000
AUD/USD	0.7300	0.7500	0.7800	0.7800
NZD/USD	0.7100	0.7300	0.7500	0.7700
USD/SGD	1.4100	1.4200	1.3950	1.3950
USD/MYR	4.3000	4.2500	4.3000	4.3500
USD/IDR	13300	13400	13450	13500
USD/THB	34.80	35.30	36.00	36.20
USD/PHP	50.30	50.50	50.70	50.70
USD/CNY	6.80	6.83	6.90	6.85
USD/HKD	7.80	7.80	7.80	7.80
USD/TWD	30.80	31.50	32.00	32.00
USD/KRW	1140	1150	1160	1170
USD/INR	65.00	65.70	66.20	66.00
USD/VND	22900	23100	23300	23400
DXY Index	100.94	102.06	101.50	99.95
SGD Crosses	End Q2-17	End Q3-17	End Q4-17	End Q1-18
100 JPY/SGD	1.2155	1.2034	1.1625	1.1625
EUR/SGD	1.5228	1.5194	1.5066	1.5345
GBP/SGD	1.8048	1.7892	1.7856	1.8135
AUD/SGD	1.0293	1.0650	1.0881	1.0881
NZD/SGD	1.0011	1.0366	1.0463	1.0742
SGD/MYR	3.0496	2.9930	3.0824	3.1183
SGD/IDR	9433	9437	9642	9677
SGD/THB	24.68	24.86	25.81	25.95
SGD/PHP	35.67	35.56	36.34	36.34
SGD/CNY	4.82	4.81	4.95	4.91
SGD/HKD	5.53	5.49	5.59	5.59
SGD/TWD	21.84	22.18	22.94	22.94
SGD/KRW	809	810	832	839
SGD/INR	46.10	46.27	47.46	47.31
MYR Crosses	End Q2-17	End Q3-17	End Q4-17	End Q1-18
EUR/MYR	4.64	4.55	4.64	4.79
JPY/MYR	3.71	3.60	3.58	3.63
MYR/HKD	1.81	1.84	1.81	1.79
MYR/CNY	1.58	1.61	1.60	1.57
GBP/MYR	5.50	5.36	5.50	5.66
AUD/MYR	3.14	3.19	3.35	3.39
NZD/MYR	3.05	3.10	3.23	3.35
MYR/IDR	3093.02	3152.94	3127.91	3103.45
MYR/INR	15.12	15.46	15.40	15.17
MYR/KRW	265.12	270.59	269.77	268.97
MYR/PHP	11.70	11.88	11.79	11.66
CNY/MYR	0.6324	0.6223	0.6232	0.6350

Source: Maybank FX Research as of 31 May 2017

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

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