1 June, 2022

FX Monthly

2022, Issue 5: Whack-a-Mole on Risk Triggers

What Has Changed This Month?

- We calibrated EUR, JPY and SGD forecasts modestly. For EUR, the earlier than expected hawkish shift was notable, hence the 2Q upward revision but we kept forecast under current spot due to prospects of slowing growth and rising energy concerns owing to EU partial ban on Russian oil. For JPY, 2Q adjustment higher was on net narrowing in UST-JGB yield differentials—despite upward pressures in UST yields in recent days, early-May peak could be a strong resistance. For SGD, relative "haven" characteristics (among AxJ FX) look to be emerging more strongly, amid complex confluence of external risk triggers.

Our Strategies

- We enter Jun with cautious optimism as Shanghai reopens gradually and attention is now more on the pace of recovery rather than Covid lockdown concerns in China. Recovery uncertainties there (given supply-chain disruptions, hammered consumer, investor confidence) could continue to provide the USDCNY some buoyancy but the worst of zero-Covid is likely past and we are more likely to see two-way trades rather than a one-way fear being manifested in the currency direction. Recent emphasis on growth supports (local government bond issuance, slashing car purchase levies, targeted relending quota amongst others, easing of property measures) by the authorities as well as infrastructure spending can provide support for commodity-linked currencies (CAD, AUD, NZD).
- We see some room for EUR to extend gains amid surprise hawkish shift in ECB policy guidance. Lagarde stepped up tempo on ECB policy normalisation, in saying that she expects ECB to raise rates in July and exit sub-zero territory by end-Sep. The hawkish shift was notable and came against a backdrop of Fed potentially reaching peak hawkishness. 9th Jun ECB meeting will be of key focus as policymakers provide a more formal update to policy bias. A case of ECB walking the talk in catching up on policy normalisation can further narrow 2y EU-UST yield differentials, and add to EUR upside. We also keep in view ECB forum on 27 – 29 Jun for possible policy signaling.
- We note that there are tentative signs that portfolio drags in Asia are dissipating with higher frequency data noting net inflows into multiple regional economies in late May. Notably, valuations for AxJ equities have reached relative lows versus US assets in May, and risk-reward dynamics could suggest Asian assets gaining some appeal alongside easing of China-induced drags over time. Historically, the last period of rising US rates did see an improvement in Asian risk asset appeal, so regional portfolio flows could be another factor to watch for in the months ahead.

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Top 3 Currency Plays for Jun

Sell GBP, DXY on Rallies
Long CAD, AUD
Long SGD NEER

Key Events for the Month Ahead

Date	Event
10-12 Jun	Shangri-La Dialogue
27-29 Jun	ECB Forum on Central Banking

G7 Global Overview

USD: Exposed to Policy Timing Risks and Surprises

Forecast	2Q 2022	3Q 2022	4Q 2022	1Q 2023
USD Index	103.85 (105.85)	103.69 (--)	101.03 (--)	100.53 (--)

Previous Forecasts in Parentheses

- Motivation: The USD DXY softened around 2% in May (relative to around an appreciation of around 4.5% in April) to end at around 101.67 (as at 31 May). The euro, JPY and CNY weakness vs USD were relatively sharp in Apr but in May the USD softened as on concerns that the Fed might slow or even pause its tightening cycle in 2H 2022. This follows from the released May FOMC minutes released last week which showed concerns that most future 50 bp hikes could become a key threat to the economy's performance. Market participants are pricing in that Fed may not be too aggressive with tightening and that some of the sell-off seen on risky assets might have overshot as US Treasury yields also fell from multi-year highs.

- The USD is likely to remain remained supported on the back of the protracted Russia-Ukraine geopolitical situation, with the expectations of tighter Fed policy move and global growth concerns intensifying amid concerns from Covid-related lockdowns in China and sharp downward currency adjustments in the RMB sensitive currencies. However, some elements of our view that USD may see some risk of peaking materialized in May, such as (1) most of the hawkish expectations so far are in the price; (2) on a relative basis with other central banks, albeit with a lags, the Fed is not the only one tightening. But despite synchronous global policy normalization (excluding China) in the face of inflationary pressures, the protracted nature of the geo-political situation in Ukraine/Russia, continued expectations of additional hawkish Fed moves and global growth concerns suggest that markets may be mired in a risk-based cautious view based on the global economic backdrop. These factors are likely to lead to USD support and delay any further sharp USD retracement towards end of the year. Nonetheless, an improvement in the geopolitical space and positive developments out of China, coupled with reopening globally can quickly allow for some space for cyclical FX to intermittently strengthen relative to USD.

- As of 31 May, OIS-implied futures still price in Fed front loading rate hikes with 50bps hike priced for each of next 2 FOMCs (in Jun and Jul) while total rate increases for the year remain unchanged at ~270bps. There is 45% probability (down from 67% probability a month ago) for another 50bps hike at Sep FOMC. We also note that recently released FoMC minutes stopped short of talking about more aggressive hikes (i.e. 75bps). The key takeaway was that Fed saw aggressive hikes (front-loading) as providing flexibility later this year, instead of aggressive hikes picking up pace. Recall last week, Fed's Bostic even floated the idea of a Sep pause if price pressures cooled. This is consistent with our proposition that Fed may have hit peak hawkishness for now.

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

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

- To sum up, near-term (coming 3-6 months) risks remain skewed to the upside for broad USD but we are revising our forecasts for currencies like EUR, JPY, and some regional currencies in 2Q to reflect the recent market developments.

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

- **Growth and Inflation Outlook:** US real GDP growth was revised down to -1.5% in 1Q (consensus: -1.3%), dragged down by downward revisions to inventories, business equipment, and structures, even as consumption and investment rose. YoY core PCE inflation was revised down 5.21% from 5.22%.

- On a m/m basis March core CPI rose by 0.32%, going below consensus of 0.5% since the Aug numbers, largely in part due to the larger than expected decline in used car prices and partly too from a deceleration in shelter categories. YoY CPI rose firmly to 6.5% from 6.4%. Headline CPI rose 1.2%, in line with consensus, reflecting sharply higher energy (+11.0%) and home food (+1.5%) prices. For April, US core CPI rose by 0.57% m/m above consensus at the fastest pace since Jan. This was on the back in part from a spike in airfares but the composition was generally broadly firm as well, with a surprisingly sharp rebound in rents, restaurant inflation, and strength in core goods prices driven by supply chain disruptions in Ukraine and China.

- NFP rose at a strong pace of 431k in Feb, but below consensus of 490k. Job growth over the past two months was also revised up by 95k. The Mar job gains were quite broad-based, with increases in 69.7% of industries compared to 81.3% in Feb and 62.9% in Jan. By industry, job growth was strong in professional and business services, retail, and manufacturing. The unemployment rate fell to 3.6% from 3.8%, on the back of strong household employment growth. Nonfarm payrolls data showed it rose 428k in Apr and were revised down by 39k for the previous two months (in line with consensus). The unemployment rate was unchanged at 3.6%. Average hourly earnings rose 0.3% m/m and 5.5% y/y, slightly less than expected.

- **Monetary Policy Forecast:** The May FOMC announcement was within expectations as Fed raised rates by 50bps to 0.75% - 1% and agreed to start QT in Jun with an initial pace of $47.5bn/month stepping up over 3 months to a cap of $95bn/month. Most importantly, Fed Chair Powell quashed market expectations for 75bps hike at future meetings and that 50bps pace of increase should be on the table for next couple of meetings. He further commented that there are some evidence core PCE is peaking. He also said that "The American economy is strong and well positioned to handle tighter monetary policy. I think we have a good chance to have a soft or soft -ish landing. I think we have a good chance to restore price stability without a recession. It will be very challenging, it won't be easy."

- There was no dots plot guidance overnight as the next quarterly dots plot will be released at Jun FoMC. From what Fed fund futures are pricing, markets expect another 50bps hike each for Jun, Jul and Sep FoMCs. The implied policy rate for end -year remains unchanged at 2.75%. There was no surprise out of the Fed as the Fed largely stuck to its “script” – as guided by its forward guidance.

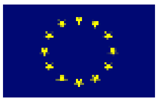
- There were little surprises out of the May FoMC minutes. The May FOMC minutes indicated a broad consensus for Powell’s baseline of 50bp hikes at both the upcoming June and July meetings. Participants also viewed it important to return the funds rate to “more neutral levels”, and noted that a restrictive stance of policy “may well become appropriate.” They also supported the balance sheet normalization process that was announced at the May meeting.

- While minutes emphasized “the strong commitment and determination” to restore price stability and reiterated 50bps rate increment, the minutes stopped short of talking about 75bps hike. The messaging is such that Fed saw aggressive hikes (front-loading) providing flexibility later this year, instead of aggressive hikes picking up pace. This is consistent with our proposition that Fed may have hit peak hawkishness. Fed’s Bostic even suggested that a Sep pause “might make sense” if price pressures cooled.

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

- **Key domestic events and issues to watch in June**: ISM Manuf (1 June); ADP, Factory orders, durable goods orders (2 & 27 June), NFP (3 June); Trade balance (7 June); CPI (10 June); FOMC (16 June); Current account balance (23 June); FOMC Meeting Minutes (26 May); Retail sales (15 June); PCE deflator (30 June); 1Q GDP (29 June).

- **Technical Outlook:** DXY posted its first monthly decline in May for the first time in this year. Move lower (>3% from May peak to trough) was in line with what was flagged in last FX Monthly's technical – *weekly, daily price indicators suggest potential moderation in pace of rise… hold to our bias that DXY is closer to peaking soon. Bias to sell rallies.* DXY last seen at 101.99 levels. Bearish momentum on daily chart shows signs of fading while RSI shows signs of turning higher. Near term rebound not ruled out but room for further upside remains unclear. Resistance at 102.55 (23.6% fibo retracement of 2022 low to high), 103 (21 DMA) and 104.1 levels. Support at 101.00/25 levels (38.2% fibo, 50 DMA) before 99.8 (50% fibo).



EUR: Gains Can Extend on Faster ECB Normalisation

Forecast	2Q 2022	3Q 2022	4Q 2022	1Q 2023
EURUSD	1.0450 (1.0200)	1.0500 (--)	1.0800 (--)	1.0800 (--)

Previous Forecasts in Parentheses

- **Motivation for the FX View: We see some room for EUR to extend gains amid surprise hawkish shift in ECB policy guidance.** Lagarde stepped up tempo on ECB policy normalisation, in saying that she expects ECB to raise rates in July and exit sub-zero territory by end-Sep. The hawkish shift was notable and came against a backdrop of Fed potentially reaching peak hawkishness. 9th Jun ECB meeting will be of key focus as policymakers provide a more formal update to policy bias. A case of ECB walking the talk in catching up on policy normalisation can further narrow 2y EU-UST yield differentials (last at -216bps vs. -253bps in Apr), and add to EUR upside. The next CPI report (1 Jul) will also be key. Sustained rise in inflation prints above 8% may intensify chatters of 50bps hike and that can add to EUR upside. Nonetheless, EUR is not without its own drags. The protracted war in Ukraine (into its 4th month) worsens global supply chain disruptions and partial EU ban (on sea-delivered crude) further aggravate energy crisis in EU. Taken together, rising cost if prolonged can hurt consumption and weighs on growth momentum in EU. Elsewhere, potential slowdown in China growth owing to extended lockdowns amid zero covid policy will also drag on global growth. Any deterioration in above-mentioned drivers can undermine EUR's recovery. We look for EUR to trade 1.04 – 1.08 in coming weeks. We calibrated EUR forecast modestly higher to reflect the earlier than expected hawkish shift in ECB bias.

- **Faster ECB Policy Normalisation Not Too Distant.** ECB minutes for Apr meeting noted that "some members viewed it as important to act without undue delay in order to demonstrate Governing Council's determination to achieve price stability in the medium term". These members also judged that the accommodative monetary stance “was no longer consistent with inflation outlook”. On ECB speaks, **Lagarde signalled that Jul is likely a lift-off date** for ECB rates and that **ECB will exit sub-zero territory by end-3Q**. Previously policymakers were only contemplating for exiting sub-zero around end-year. Villeroy said that short term priority is fighting and mastering inflation. Earlier, Nagel, Isabel, Guindos, Kazaks and Wunsch also backed rate hike at Jul meeting. To add, hawkish Knot became the first ECB official to float the idea that bigger rate increases (such as 50bps) must not be excluded if inflation shows signs of “broadening further or accumulating”. Other ECB members Kazimir and Holzmann have also jumped in the bandwagon to acknowldge the option for 50bps hike in Jul. That said, there remains no consensus for 50bps hike at this point. Markets will be keeping a look out on normalization trajectory and how urgent ECB officials are.

- **Stagflation Fears Can Undermine EUR’s Recovery.** German Bundebank warned that German economy may shrink 2% this year if Ukraine tensions escalates and an embargo on Russia coal, oil and gas leads to restrictions on power providers and industry. Protracted military conflict is also worsening global supply chain disruptions and in turn exacerbating inflation woes. The risk of a prolonged rise in energy and food prices could mean even higher price pressures adding constraints to growth, triggering stagflation concerns. Some European companies in industries like fertiliser, steel mill, especially those energy-intensive ones have reportedly cut production due to high input cost. EUR could still be dragged lower given its trade, energy and investment ties with Russia. That said, **ECB officials have played down fears of stagflation in EU**. Lagarde said that “even in the bleakest scenario with second round effects with a boycott of gas and petrol and worsening of war that goes on for a long time, the Euro-area will still manage a 2.3% growth”. This is assuming a severe scenario of stricter sanctions on Russia that leads to disruptions in global value chains, higher energy prices due to reduction in supply, a stronger repricing in financing markets and larger second round effects. Under a less extreme adverse scenario, the hit to growth and jump in inflation will not be as pronounced.

- **Geopolitics Remains a Drag on EUR.** Finland, Sweden are holding talks to join NATO. Finland’s move broke its neutral defense policy (in response to Russia invasion of Ukraine). Senior advisor to Putin, Dimitry Medvedev had earlier said that “NATO countries pumping weapons into Ukraine, training troops to use western equipment, sending in mercenaries and the exercises of Alliance countries near our borders increase the likelihood of a direct and open conflict between Nato and Russia”. He further warned that “such a conflict always has the risk of turning into a full-fledged nuclear war”. This was in line with Russia’s earlier threat that it will deploy nuclear weapons close to reinforce Baltic borders if Finland and Sweden join NATO. Elsewhere, German Economy Minister said that Russia weaponized energy as gas cut amounts to 3% of gas imports. Germany is the largest buyer of Russia gas, which accounts for about 35% of Germany’s supply. Escalation in geopolitical concerns will weigh on EUR.

- **Further Upside Risks to EUR Can Happen if** (1) war in Ukraine shows signs of abating; (2) ECB catches up on policy normalisation (i.e. +50bps hike); (3) EU growth momentum though may be impacted but not derailed.

- **Growth and Inflation Outlook: 1Q growth expanded more than expected in 1Q** (0.3% q/q vs. 0.2% expected), despite war in Ukraine. Breakdown shows Germany, Austria, Poland, Portugal and Latvia expanded while Demark, Italy and Norway contracted in 1Q. On annual basis, Euro-area growth came in at 5.1% y/y. Looking on, preliminary composite PMI for May was slightly softer at 54.4 (vs. 55.5) but remains in expansionary territory nonetheless. Other surveys and activity indicators are mixed. EU investor confidence, retail sales came in softer but German IFO and ZEW survey came in much better than expected. We continue keep a close watch on development.

- **Headline CPI continued to hit record high of 8.1% y/y in May,** up from 7.5% in Apr. The rise was fuelled by sharp increases in the price of energy (+39.2% y/y) and food (+7.5% y/y) as well as cost of services and manufactured goods. Core inflation rose to record high of 3.8% y/y. ECB's Guindos said that Euro-area CPI is close to reaching peak inflation and ECB sees price pressures diminishing in 2H 2022 though elevated energy prices are expected to keep inflation high. We retain our view that inflation could still head higher amid worsening supply chain disruptions, higher energy prices amid ongoing war in Ukraine. Pursuit of climate change goals could also further keep commodity price pressures broadly supported. Weaker EUR (prior to this run-up) may also have resulted in some imported inflation. Overall, we still expect ECB to play catch-up in normalizing policies especially if inflation proves to stay elevated for longer. This can be a positive for EUR.

- **Monetary Policy Forecast: The upcoming Governing Council meeting on 9th Jun will be of importance for policy outlook** as guided by ECB policymakers. **A confirmation to end APP and a 25bps rate hike projected for Jul meeting is the base case.** Any policy move short of expectation will be a negative for EUR. Markets have re-priced for first rate hike to come in Jul vs. Sep (as indicated previously). For remainder of the year, markets have priced in an end to NIRP in Sep (implicitly a +50bps hike) and for rates to rise another 50bps in 4Q.

- ECB minutes for Apr meeting noted that "some members viewed it as important to act without undue delay in order to demonstrate Governing Council's determination to achieve price stability in the medium term". These members also judged that the accommodative monetary stance "was no longer consistent with inflation outlook". On ECB speaks, Lagarde signalled that Jul is likely a lift-off date for ECB rates and that ECB will exit sub-zero territory by end-3Q. Villeroy said that short term priority is fighting and mastering inflation. Earlier, Nagel, Isabel and Guindos also backed rate hike at Jul meeting. To add, Hawkish Knot became the first ECB official to float the idea that bigger rate increases (such as 50bps) must not be excluded if inflation shows signs of "broadening further or accumulating". That said, his base case remains for 25bps hike. M**arkets will be keeping a look out on normalization trajectory and how urgent ECB officials are.**

- At the last ECB meeting (14 Apr), the ECB said it is working on a crisis (backstop) tool to deploy against debt market stress caused by exogenous shocks outside individual governments. Basically to counter any excessive rise in bond yields on the euro-zone periphery. There is little details at the momentum and is not known how the tool will look like or if the tool is meant as a contingency tool. Recall back in 2012 in response to market stress, then ECB president Draghi and his staff first came up with a famous pledge to do "whatever it takes" in Jul-2012 and then subsequently launched the Outright Monetary Transaction (OMT) 6 weeks later in Sep-2012 - the potentially unlimited purchase of euro area sovereign bonds on the secondary market by the European Central Bank. This OMT program was never activated but its existence itself was sufficient to stem market turmoil (EU sovereign debt crisis then).

- **Latest Fiscal and External Balance Outlook**: Euro-area current account turned into a deficit of EUR2bn in Mar, down from EUR16bn surplus in Feb. This was due to small trade deficit and outflow of secondary incomes. In the 12 months to Mar-2022, EU area current account surplus narrowed to 1.8% of GDP (vs. 2.6% of GDP in the preceding 12 months).

- **Key domestic events and issues to watch:** May mfg PMI, APpr unemployment rate (1 Jun), Apr PPI(2 Jun); May services PMI, Apr retail sales (3 Jun); Jun Sentix investor confidence (7 Jun); 1Q GDP (8 Jun); ECB meeting (9 Jun); Jun ZEW survey, Apr IP (14 Jun); Apr trade (15 Jun); Apr construction output, May CPI (17 Jun); Apr current account (21 Jun); Jun prelim PMIs (23 Jun); Jun consumer confidence (29 Jun); May unemployment rate (30 Jun).

- **Technical Outlook:** EUR rebounded for most of the days in month of May. The turn higher was also in line with our observation that *RSI shows tentative signs of rising from oversold conditions as we* look for clearer signs of turnaround. Pair rebounded from multi-year low of 1.0350 (13 May) to trade a high of 1.0787 (30 May). Bullish momentum on daily chart shows signs of turning while RSI eased. Near term risks to the downside. Support at 1.07, 1.0670 and 1.0595 (21 DMA). Key resistance remains at 1.0760 (50 DMA). A decisive break above this is needed for EUR bulls to gather further traction. Next resistance at 1.0860/65 (76.4% fibo retracement of 2016 low to 2018 high)..

GBP: Short Squeeze; Bias to Sell Rallies

Forecast	2Q 2022	3Q 2022	4Q 2022	1Q 2023
GBPUSD	**1.2400** (--)	**1.2200** (--)	**1.2500** (--)	**1.2800** (--)

No Change to Previous Forecasts

- **Motivation for the FX View**: We retain our medium term view that **short GBP remains the best proxy trade to express a view on stagflation fears** – growth downturn, surge in living cost and BoE not front-loading policy tightening. That said we keep a lookout on whether GBP (>3%) rebound since mid-May has further room to run. A decisive close above the neckline (at 1.2620) of the inverted head and shoulders could see gains go as far as 1.28, 1.31 levels in coming weeks. But bias to fade rallies on stagflation and lingering Brexit concerns.

- **Stagflation Proxy Trade**. BoE's dire economic projection that UK growth will stagnate into 2024, alongside double-digit inflation makes a strong case for stagflation in UK and underscores our bias for short GBP as a stagflation proxy trade. BoE was not alone with its bearish assessment. Earlier, the IMF also assessed UK's economic growth to be more gloomy as it projected UK to **"slump to the bottom of the league table of comparable economies in G7"** and "it will also **face the highest inflation"**. The protracted war in Ukraine and extended covid lockdowns in China further worsened global supply chain disruption, driving up food and energy prices, in turn adding to inflationary pressures and dragging on household disposable income and overall growth. Moreover the 4-5% depreciation in GBP on trade-weighted basis YTD will further pushed up imported inflation.
  - IMF projected UK growth to slow to 1.2% in 2023, from 3.7% growth projection in 2022 (already a cut from earlier forecast of 4.7%). The sharp downward revision was due to projection for consumption to be weaker than expected as inflation erodes real disposable income, while tighter financial conditions are expected to cool investment.
  - BoE projected inflation to jump above 10% in Oct, due to another round of increase (40%) in UK energy price cap. Households are also projected to face a 1.75% drop in real disposable income this year, the second biggest decline since 1964. Though it predicted that UK will avoid a technical recession, it said output will collapse by close to 1% in 4Q 2022 and in 2023, annual GDP is projected to shrink 0.25% and continue to stagnate in 2024 when growth is +0.25%.

- **Near Term Relief.** On 26th May, Chancellor Sunak unveiled the latest set of support measures as part of a GBP15bn package targeted at alleviating rising costs. Millions of households will receive GBP400 discount on their energy bills, a one-off GBP650 payment for 8mio of the worst-off households, a one-off GBP300 payment to 8mio pensioner households and GBP150 each to 6mio disabled people. A 25% windfall tax was imposed on profits of oil and gas (O&G) companies, but with a 90% tax relief for firms that invest in O&G extraction in the UK. The 25% windfall tax will raise around GBP5bn revenue to finance the latest set of measures. Sunak said that the latest measures will have minimal impact on inflation as measures are targeted and partially funded by raising new money.

- **BoE's Pace of Tightening to Lag Developed Peers.** While the BoE was one of the first DM central banks to tighten policy, they have now given away the early lead as other DMs such as RBNZ, ECB and perhaps even the RBA play catch up. From recent BoE speaks, it appears that BoE is not stepping up pace of tightening (i.e. front-loading rate hikes) even with inflation set to rise to double-digit as policymakers weigh growth concerns. BoE officials seem to favor raising rate in a “measured” way “that doesn’t disturb the rest of the economy”. We opined this is a tall order and some trade-offs may have to be made at some stage especially with the real risk of inflation expectations being de-anchored. But until then, it just appears that BoE’s future hikes are taken as dovish hikes and hence any run-up in GBP could present itself as opportunity to fade into.

- **Lingering Brexit Concerns.** EU ambassador to the UK has rejected UK foreign secretary Liz Truss’s demand that NI protocol be rewritten and issued a blunt warning of retaliation if UK government passes a law disapplying effects of the NI protocol. Truss has indicated plans to scrap parts of NI protocol saying that it was a matter of peace and security. It is likely that UK could begin legislation to scrap the NI-protocol. European Commission has earlier said that the re-negotiation of NI protocol was not an option and it would respond to any unilateral UK move, using “legal and political tools at its disposal”. Any signs of EU-UK trade war could implicate GBP. We continue to keep a look out on Northern Ireland (NI) Protocol developments

- **Growth and Inflation Outlook: BoE warned of UK recession** as it cited concerns on the impact of extended covid lock down in China (hitting supply chain and price pressures). That said 2022 growth forecast was maintained at 3.75% but a 0.25% contraction was pencilled in on 2023 growth (vs. earlies projection of 1.25%). **UK economy unexpectedly shrank by 0.1% m/m in Mar amid supply side disruptions and high living costs.** Breakdown shows that the drag came from both production (led by declines in manufacturing and utilities) and consumer (led by declines in wholesale and retail trade). The one sector that surprised to the upside was construction as activity rose to highest level since Jan-2010. On quarterly basis, GDP came in 0.8% q/q, weaker than the 0.9%, 1% forecasts by BoE and consensus, respectively. Despite failing to meet expectations, UK growth in 1Q still outpaced US (1.5% q/q) and Euro-area (+0.3% q/q). Labor market remains very tight with unemployment rate falling to lowest level (3.7% in 1Q vs. 4.1% in 4Q) since 1974. Employment rose 83k in Mar quarter vs. 10k prior vs. 4k expected. Looking on, forward looking surveys and activity indicators are increasingly showing signs of fading momentum. GfK consumer confidence slumped further to multi-year low of -40 in May, down from -38 in Apr and prelim PMI slipped, in particular services fell sharply to 51.8 for May, down from 58.9 while manufacturing was largely steady at 54.6 (vs. 55.8 prior)

- **Headline CPI surged to 40-year high of 9% y/y in Apr,** up from 7% y/y in Mar. Energy, fuel and food remain the main drivers of higher prices. BoE now projects CPI to reach 10% in Oct (up from 8% in 2Q) as another round of increase in energy price cap by another 40% in Oct will add to price pressures. Recall that the energy price cap increase by 54% wef 1 Apr partly contributed to the record high 9% headline CPI. We see risks of inflation staying elevated as protracted war in Ukraine continued to result in cost-push inflation, affecting prices of food, energy, fertiliser and industrial metals. These will further add to upward pressure in coming months. Meanwhile core inflation rose to all-time high of 6.2% y/y, up from 5.7% in Mar.

- **Monetary Policy Forecast: We expect BoE to continue with its back-to-back hike of +25bps rate increase at the next MPC on 16th Jun.** This will then be the 5th increase to bring policy rate to 1.25%. Bringing inflation down to its medium term target of 2% is still BoE's priority but at the same time, most BoE policymakers are trying to combat inflation without pushing the economy into a recession. And it appears that they have ruled out 50bps hike for the remainder of its MPCs this year. OIS-implied suggests that markets are still pricing in 25bps hike at each of the 5 remainder MPCs for 2022 to bring policy rate to about 2.25%.

- At the last BoE meeting (6 May), the MPC raised policy rate by 25bps to 1%, as widely expected. But the vote was not unanimous. 3 members voted for 50bps increase while 6 voted for 25bps. BoE also projected inflation to jump above 10% in Oct, due to another round of increase (40%) in UK energy price cap. Households are also projected to face a 1.75% drop in real disposable income this year, the second biggest decline since 1964. Though it predicted that UK will avoid a technical recession, it said output will collapse by close to 1% in 4Q 2022 and in 2023, annual GDP is projected to shrink 0.25% and continue to stagnate in 2024 when growth is +0.25%. BoE indicated that 2 years of stagnant growth and nearly 600k job losses are the price of taming UK inflation.

- **Fiscal and External Balance Update:** Public sector net borrowing fell to GBP18.6bn in Apr, well below GBP24.2bn in the same month in 2021. The figure also undershot OBR's earlier projection for GBP19.1bn borrowing. Dip in borrowing was due to higher tax receipts while government spending saw reduction (as cost of covid vaccines and covid testing fell). Public sector net debt, excluding public sector banks, totalled GBP2.34tn or 95.7% of GDP.

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

- **Key domestic events and issues to watch:** May PMI Mfg (1 Jun); services PMI (7 Jun); construction PMI (8 Jun); Apr industrial production; monthly GDP, construction output, trade (13 Jun); Apr labor market report (14 Jun); BoE MPC (16 Jun); May retail sales (17 Jun); May CPI, PPI (22 Jun); May public finances, Jun prelim PMIs (23 Jun); 1Q GDP (30 Jun).

- **Technical Outlook:** GBP rebounded in May, consistent with our call for rebound risks though the rebound did not reach our ambition target of 1.2825 as.it failed to make headway past 1.2650. Last at 1.2595 levels. Bullish momentum on daily chart is showing signs of fading but RSI shows signs of turning lower. Potential rising wedge pattern formed - typically associated with bearish reversal – is in play. Resistance here at 1.2650 (50% fibo retracement of Apr high to May low) needs to be broken for further upside to gather momentum towards 1.2770 (61.8% fibo). Failing which pair could consolidate in 1.24 – 1.2650 range. Support at 1.2535 (38.2% fibo), 1.2455 (21 DMA), 1.2390 (23.6% fibo)..

AUD: The New Government and RBA to Continue Catch-Up

Forecast	2Q 2022	3Q 2022	4Q 2022	1Q 2023
AUDUSD	**0.7350** (--)	**0.7450** (--)	**0.7450** (--)	**0.7500** (--)

No Change to Previous Forecasts

- **Motivation for the FX View:** AUDUSD touched a low of 0.6830 before making a rather sharp rebound on easing restrictions in Shanghai, more support measures in China as well as signs of inflation peaking in the US. Broader USD decline as Fed showed signs of reaching peak hawkishness also helped lift the AUDUSD back above the 0.71-figure. We acknowledge some risks of undershooting our 2Q forecast on weaker global growth but continue to keep our constructive bias for the rest of the year on expectations for China to step up the fiscal spending pedal, concentrating on infrastructure construction, loosening property measures to mitigate the negative effects of the zero-covid strategy.

- **Australia has a new government,** led by Prime Minister Anthony Albanese. As Prime Minister, Anthony Albanese's first mention of foreign policy with regards to China was done with a lot of caution, flagging that their relationship could remain a "difficult" one. We keep in mind that these comments come ahead of the quad summit in Tokyo whose primary purpose is to keep a check on China. He elaborated that "it is China that has changed, not Australia, and Australia should always stand up for our values and that we will in a government that I lead". **This could signify some sort of concurrence with how the previous government has dealt with China and that the new Prime Minister is highly unlikely to change its foreign policy on that aspect. That said, there could still be slight nuancing that could help prevent further deterioration in relations.** China Premier Li Keqiang reached out to congratulate the new government and state media Xinhua cited Li saying that "the Chinese is ready to work with the Australian side to review the past, look into the future… to promote the sound and steady growth of their comprehensive strategic partnership". These words suggest that the Chinese is willing to forge warmer ties with the new Australian government, positive for the AUD. That said, any deterioration in US-China relations could still keep Australia between a rock and a hard place and that makes this olive branch still vulnerable.

- **Growth and Inflation Outlook:** May Mfg PMI slipped to 55.3 from previous 58.8, in tandem with the rest of the world. Other cyclical leading indicators such as NAB business conditions rose to 20 (for Apr) from previous 15 as trading conditions and profitability improve at home. Domestic demand seem to remain broadly intact but there are are increasing signs of concerns on inflation. NAB business confidence slipped to 10 from previous 16, possibly crimped by rising labor costs and purchases at home. Elsewhere, consumer confidence also slipped to a 21-month low of 90.4 for May from previous 95.8. Household spending intentions also softened a tad rising at a slower 5.0%y/y for

Apr vs. prevous 5.6. 1Q capex report showed a weak print at -0.3%q/q for 1Q but projections seem to be healthy expected CAPEX for FY2021-2022 (through Jun 2022) at $142.8bn, 1.4% higher than what was seen last quarter. The projection for FY2022-23 is $130.5bn, 11.8% higher than what was seen in the previous quarter, a significantly robust revision for the next year.

- **Upcoming Annual Minimum Wage Review Could Fan Inflation Higher.** M-I inflation expectation for Apr softened as well to 3.4%y/y from 4.0% (13-year high), easing for the first time since the start of the year. While one point hardly makes a trend, this could still be the first sign of price pressure moderating at home as oil prices eased off its highs in Mar and traded sideways ever since. Recall that 1Q CPI picked up pace to 5.1%y/y from previous 4.6%. Price pressure was *rather broad-based* with food, alcohol and tobacco, housing, health, transportation and education prices picking up pace in the quarter compared to a year ago. Underlying inflation came in around 3.5%y/y vs. previous 2.65%. Meanwhile, wage price index for 1Q rose modestly by 2.4%y/y vs. previous 2.3%. The print missed estimates of around 2.5% but wage growth could pick up pace as the annual minimum wage is being reviewed in Jun – the current minimum wage is $20.33/hr and the Australian Council of Trade Union has proposed a rise in the minimum wage of 5.5% to the Fair Work Commission to $21.45/hr. New PM Anthony Albanese has backed a wage increase of at least 5.1% (during the election campaign) in order to ensure wage growth is in line with inflation, albeit still slightly under the Unions' proposal. The new minimum wage will take effect on 1 Jul.

- The labour report for May remains rather solid Tue with full time employment up +92.4K vs. the drop of -88.4K for part-time hire, underscoring pretty robust business conditions and confidence. Jobless rate came in at 3.9% and the Mar print was also revised lower to 3.9%. Labour force paarticpation rate fell a tad to 66.3% from previous 66.4%. Looking at business surveys, hiring intensions remain firm for May and we can expect another strong labour report release in Jun.

- **Monetary Policy Forecast: We look for a 25bps rate hike by the** RBA. We seek a continuation of its hiking cycle from the first hike in May. Another 25bps rate hike could bring the cash target rate to 0.60%. Given the downside surprise in wage price index and softer inflation expectation prints, we think RBA is in no hurry to ramp up the magnitude of the next hike and could proceed with a more regular pace of tightening.

- That said, we think a 40bps hike could come in Jul if the Fair Work Commission were to approve the 5% wage increase (as called by Labor PM as well as the ACTU) in Jun (to take effect on 1 Jul). Raising the minimum wage could increase the upside pressure on broader wage growth and concomitantly increase inflation expectations. RBA is likely to act with a one-off bigger rate hike then to dampen it.

- Meanwhile, RBA Kent flagged that its balance sheet is likely to remain largely stable for the most of this year as the central bank will not sell its holdings early but instead allow to mature and only $4bn (out of the total $600bn) will mature this year followed by another $13bn in 2023. Amid concerns about the effects of aggressive tightening on the local housing market, emphasizing on a gradual roll-off of RBA's balance sheet could ease pressure on domestic bonds as RBA starts rate tightening cycle.

- **Latest External Balance Outlook:** As of last available data, current account surplus was recorded at 3.55% of GDP for 4Q 2021, narrowing from the previous 3.8%. Trade surplus was last at A$7.5bn for Feb, still maintaining a strong support for the AUD. Since the invasion of Ukraine, Australia has been enjoying a terms-of trade boost and that could continue to underpin the AUD.

- **Fiscal Outlook:** *With Australia's Labor party now helming the government, there is little change in terms of individual tax reform that was announced by the Coalition but the current government aims to get $1.89bn via new measures that target the multinational enterprises including adoption of the OECD BEP 2.0 proposals for a global minimum tax of 15%, denial of deductions for royalty payments to recipients in low tax jurisdiction from 1 Jul 2023. During the campaign, the ALP said that election commitments (on childcare, training/eduation/cheaper energy) will add an extra $7.4bn to the federal deficit over the next four years*. However, more recently, new Treasurer Jim Chalmers flagged that budget is under pressure as the central bank hikes policy rate. This could hint at scaling back fiscal spending for the economy for the sake of fiscal consolidation. Recall that key highlights of the FY2022-23 federal budget include a 50% reduction to fuel excise for the next six months, one-off $250 "cost of living payment" for six million Australians, separate one-off $420 tax offset for low- and middle income earners from 1 Jul as well as tax-deductions for SMEs for employee training and digital technology expenses. Fiscal deficits narrowed to A$78bn for FY2023 or 3.4% of GDP from expected A$79.8bn for FY2022. Real GDP is forecast to soften from 4.25% for FY2022 to 3.5% for FY2023 and then to 2.5% in each of the following three years. Unemployment rate to fall to 3.75% in the 3Q of 2023 and should remain thereabouts to FY2025. Key commodity prices to fall from current elevated levels by the end of 3Q. CPI is expected to rise 4.25% for FY2022 before easing to 3% FY2023. Wage price index to rise 2.75% in Fy2022 and then to 3.25% for FY2023-2024.

- **Key domestic events and issues to watch:** Mfg PMI for May, 1Q GDP (1 Jun); Apr trade (2 Jun); May Services PMI, Apr loan value (3 Jun); May inflation expectations, May Job advertisements (6 Jun); RBA policy decision on 7 Jun; May NAB business survey (14 Jun); Westpac consumer confidence (15 Jun); May labour report (16 Jun); Minutes of the Jun policy meeting (21 Jun); May retail sales (29 Jun); May private sector credit (30 Jun).

- **Technical Analysis:** AUDUSD hovered around 0.7190 as we write with bearish MACD forest dissipating and stochastics showing signs of turning higher. This pair needs to break above an area of resistance around 0.7230-0.7260. Support at around 0.7110 before the next at 0.7060. Notwithstanding some retracement, we look for bias to be skewed to the upside for the month ahead.

NZD: Hawkish RBNZ Can Marginally Add to Kiwi Upside

Forecast	2Q 2022	3Q 2022	4Q 2022	1Q 2023
NZDUSD	0.6400 (--)	0.6600 (--)	0.6700 (--)	0.6800 (--)

No Change to Previous Forecasts

- **Motivation for the FX View: We see room for NZD to build on momentum** on the back of a more hawkish RBNZ, relative stabilisation in CNH and signs of Shanghai reopening. The sharp pullback in 10y UST yields by nearly 50bps amid moderation in pace of rise in US core PCE and potential peak in Fed hawkishness also supported broad sentiment. Looking on, markets will increasingly focus on the US's China tariff review before it lapses on 6th Jul. Potential removal of US tariffs on Chinese imports can be supportive of risk sentiment. Kiwi can benefit from these drivers. We still maintain a mild upward trajectory profile for NZD into 2023 on the back of continued rise in commodity prices (in particular soft/agri commod such as food, dairy), NZ economy reopening and still-hawkish RBNZ. The case for a more solid Kiwi rebound would however require global growth to pick up momentum, China to stand-down on their covid policy and see a reopening of their borders and economy. That said, NZD's recovery still face downside risks. Ongoing concerns of global growth, supply chain disruptions owing to protracted war in Ukraine and zero covid policy in China may still counter against Kiwi gains, to some extent.

- **Temporary Stimulus to Help Households Cope with Inflation.** In the annual budget (19 May), the government unveiled a package of measures worth NZ$1bn targeted to help low and middle household cope with rising inflation. 2.1mio people (those earning led than $70k per year) will receive a weekly payout of NZ$27/week for 3 months from 1 Aug while reduction in fuel duties (25c/litre) to offset rising petrol prices will be extended by 2 months, alongside hald-price public transport. Budget deficit is projected to widen to NZ$6.63bn for coming year (vs. NZ$831mio projected in Dec) and is not expected to return to surplus until sometime in 2025. The stimulus measures are targeted instead of broad-based and is temporary, hence is not likely to add to inflation pressures but to help targeted group of people cope with the surge in living costs.

- **Hawkish RBNZ Can Buffer Against Fed.** RBNZ is expected to continue raising rates in clips of 50bps by at least 2 more times this year to bring OCR to 2% while also projecting for OCR to rise further to around 4% by 2H 2023. Governor Orr is concerned of inflationary expectations becoming unanchored and more persistent and hence wants to avoid doing 'too little too late'. While it is likely RBNZ may pause or even slow its pace of tightening at some stage in the future, we opined the aggressive guidance today in terms of raising its pace of tightening and allowing for rates to go much higher is supportive of Kiwi gains in the near term. A stronger Kiwi can also help to mitigate against imported inflation. A more aggressive RBNZ vs. Fed potentially hitting peak hawkishness can also further support NZD.

- **Downside Risks to NZD Outlook**: (1) War in Ukraine futher escalates into biochemical/ broaden to involve more countries or last longer may hamper global economic momentum and that will have negative spillover effects on NZ. (2) further slowdown in China growth (hard landing risks), or further weakening in CNH can also weigh on NZD, given its high sensitivity to global growth and China. (3) RBNZ fails to live up to hawkish guidance will be a drag on NZD (unwinding risk); (4) Much faster shifts in Fed's pace of policy tightening will weigh on sentiment and narrow NZD's yield advantage.

- **Growth and Inflation Outlook**: Economic growth momentum may moderate further amid effects of higher interest rates and softer business/consumer confidence. Though the reopening of borders can boost tourism and partially help support growth, ongoing supply chain disruptions and labor constraints are likely to drag on growth. Other activity and survey indicators also pointed to moderation in economic momentum: (1) retail sales slumped to -0.5%q/q (vs. 8.6% in 4Q) and partially this softness was due to omicron variant spread and subsequent tightening of measures; (2) both mfg and services PMIs though slipped to 51.2 and 51.4 in Apr, from 53.8 and 51.6, respectively. They remained in expansionary territories. 1Q GDP is scheduled for release on 16 Jun.

- **RBNZ expects headline CPI to remain near its current peak of around 7% in 1H 2022** before projecting for CPI to ease towards 5.5% in 4Q 2022. In terms of tradables inflation, RBNZ expects a peak of 9.1% in 2Q 2022 before falling to 7.1% by end-2022. This reflects easing but still strong inflationary pressures from ongoing global supply chain disruptions. 1Q CPI surged 6.9% y/y in 1Q, up from 5.9% in 4Q. This is the fastest pace of rise since 1990. Gasoline priced led gains (+8.8% y/y) This is the 4^{th} quarter in a row that headline CPI breached above RBNZ's 1% - 3 target band. We expect price pressure to stay supported given supply chain disruption and higher commodity prices amid protracted war in Ukraine and extended covid lockdowns in China.

- **Monetary Policy Forecast:** We expect RBNZ to maintain its pace of raising rate by 50bps to bring OCR to 2.5% at the next MPC on 13 Jul. Key focus of RBNZ is to ensure that current high CPI (1Q at 32y high of 6.9%) does not become embedded into longer-term inflation expectations. Markets' implied still see another 2* 50bps hike fully priced for upcoming MPCs for Jul, Aug (as of 27 May). All in, markets are looking for another 130bps hike to bring OCR to 3.3% by end-year. There are 4 more MPCs remaining for this year.

- At the last MPC (25 May), RBNZ raised rate by 50bp, as expected to bring OCR to 2%. RBNZ also projected more aggressive rate hikes into 2023 with OCR now projected to peak higher at close to 4% by 2Q 2023. Governor Orr said that RBNZ needs to raise rates "at pace" to prevent inflation expectations from being unanchored. Accompanying MPS noted that *monetary conditions need to act as a constraint on demand until there is a much better match with NZ's productive capacity*. Hence *a larger and earlier increase in the OCR reduces the risk of inflation becoming persistent while also shoring up more policy* *flexibility in light of the uncertain global economic environment*. It also noted that the *Committee agreed to continue to lift the OCR at pace to a level that will confidently bring CPI to within the target range of 1% - 3%. The Committee viewed the projected path of the OCR as consistent with achieving its primary inflation and employment objectives without causing unnecessary instability in output, interest rates and the exchange rate. Once aggregate supply and demand are more in balance, the OCR can then return to a lower, more neutral, level*. Elsewhere it was earlier announced that quantitative tightening will commence in Jul with a sell-down in QE holdings at pace of NZ$5bn per year and will not reinvest proceeds of expired debt. Recall that RBNZ bought a total of NZ$55bn of government bonds under its QE program over 2020-21 due to pandemic

- **External Balance and Fiscal Outlook: NZ posted record annual current account deficit of $20bn.** Imports more than overwhelmed exports in 4Q. YTD current account deficit stood at -5.8% of GDP. Quarterly current account deficit surged to $6.5b in 4Q, up from $4.7b the previous quarter. 1Q current account data will be released on 15 Jun.

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

- **Key domestic events and issues to watch:** 1Q terms of trade (2 Jun); 1Q mfg activity (10 Jun); May food prices (14 Jun); 1Q current account (15 Jun); 1Q GDP (16 Jun); May mfg PMI (17 Jun); May services PMI (20 Jun); May trade (22 Jun); Jun activity outlook, business confidence (30 Jun).

- **Technical Outlook:** Kiwi fell further in early part of May to a low of 0.6217 (12 May), in line with our downside risk caution in the last FX Monthly. Pair subsequently rebounded to end the month. Last seen at 0.6508 levels. Bullish momentum shows early signs of fading while RSI shows early sighs of turning. Near term pullback is not ruled out. Support at 0.6485, 0.6400/10 levels (23.6% fibo, 21DMA) and 0.6350 levels. Resistance at 0.6530 levels (38.2% fibo retracement of Apr high to May low), 0.6630 (50% fibo) and 0.6650/80 (50, 100 DMAs).

CAD: Environment Remains Benign for CAD Bulls

Forecast	2Q 2022	3Q 2022	4Q 2022	1Q 2023
USDCAD	1.2600 (--)	1.2500 (--)	1.2400 (--)	1.2400 (--)

No Change to Previous Forecasts

- **Motivation for the FX View:** Pair whipsawed for much of May but the combination of easing restrictions in Shanghai alongside more growth supportive measures in China, inflation peaking in the US, concomitant recovery in crude oil prices drove the USDCAD from a peak of 1.3077 to levels around 1.27-figure. We continue to keep a constructive view on the CAD given Canada's strong growth momentum and BoC's hawkish leanings. Based on OIS, markets have priced in a 60bps hike for the policy decision on 1 Jun and a full percentage increase by mid-Jul. To some degree, the upcoming series of rate hikes BoC might have been priced in the CAD but further emphasis on combating inflation or a larger-than-expected 75bps hike on 1 Jun could give CAD bulls a tad more boost.

- **Longer term, expect climate change transformation to also be structural factors for oil prices to stay supported in the medium term.** Protracted war in Ukraine and potential turnaround in China's covid situation could keep crude oil supply-demand in tight balance and such an environment is constructive for the CAD. Even as more nations pledge net zero carbon emission, infrastructure needs for energy transformation would also require fossil fuel in the interim. CAD is thus likely to benefit from structural shifts and oil prices should remain broadly benign for the scurrency.

- **Growth and Inflation Outlook: Focus remains on inflation back home** - Apr CPI quickened to 6.8%y/y from previous 6.7%, underpinned by faster shelter costs (1.1%y/y v. prev. 1.0%), elevated food inflation at 0.9%y/y vs. previous 0.9% as well as health, personal care (1.6%y/y vs. 0.2%). Unlike the US that sees potential peak in CPI, this does not seem to be the case for Canada and strengthens the case for BoC to raise rates by 50bps rate increase in Jun and Jul.

- Industrial product price rose 0.8%m/m in Apr. Whilst the headline was softer than the previous 3.4%, the rise continues to underscore the upside pressure from prices of raw materials such as fuel, base metals, agriculture whilst the decline in lumber prices softened the headline.

- Other metrics of demand seem to remain mostly firm with headline of CFIB business barometer for May only moderately lower at 61.6 vs. previous 64.9, masking still solid details including an improvement in general business situation (42.6% reporting good vs. previous 37.8%). Price adjustments were projected to average at 4.4% for May vs. previous 4.9% while wage adjustments on average are expected to be higher at 3.5% vs. previous 3.2%. That said, 76.2% of firms report that fuel, energy costs are causing difficulties (vs. previous 74.6%) while 61.9% cited wages as a challenge vs. prev. 59.8%. 18% surveyed reckon firm performance is somewhat weaker/ much weaker vs. 16.4% in the month prior.

- Meanwhile, housing starts remain strong at 267.3K for Apr vs. 248.4K. Retail sales ex auto surprised to the upside at 2.4%m/m for Mar vs. previous 1.8%. The labour report for Apr was decent with 15.3K net employment gained for the month. Jobless rate inched to 5.2% from previous 5.3%. Hourly wage rate eased only a tad to 3.4% vs. previous 3.7% (13-month high). ***Based on the CFIB business barometer, wage growth could pick up pace***.

- **Monetary Policy Forecast:** BoC raised policy rate by 50bps to 1.00% on 13 Apr and another accumulative 100bps hike for Jun and Jul could be fully priced. At the Apr meeting, Governor Macklem assured that BoC would normalize monetary policy "relatively quickly" to "prevent inflation expectations from hardening". Officials also wanted rates to return to estimated neutral range of 2-3% to cool inflation but more recently, Deputy Governor Toni Gravelle said that the central bank will "normalize our policy rate quickly and are prepared to be as forceful as needed". **We do not rule out a 75bps hike as inflation showed little signs of easing thus far. CPI projection for the near-term could be lifted again, already projected to be well above targeted 1-3% range throughout 2022 before easing to around 2.5% by 2H 2023 and 2% in 2024. Based on the recent indicators, the housing market and the economy should be able to withstand new rates.**

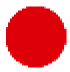
- Recall that BoC Macklem referred to the "50bps hike" as an unusual move (already) and that a 75bps hike could also be an option as the central bank combats inflation. *OIS now implies an accumulative 100bps rate increase for the Jun and Jul meetings. A 75bps rate hike is not priced yet for the Jun meeting and doing so could be positive for CAD. We cannot rule that out as inflation show little sign of peaking and Gravelle also flagged that raising borrowing costs above neutral (2-3%) range could be necessary if supply chain issues continue.*

- **Latest External Balance Outlook:** As of last available data, Canada's current account balance was at a surplus of C$1.2 for 4Q, an improvement from the previous -U$1.6bn deficit. Firm commodity prices, especially the recent recovery in crude oil, continue to bode well for the external balance of net-energy exporters such as Canada.

- In terms of the fiscal, recall that deficit for FY2021/22 came in at C$114bn , better than projected C$145bn seen in Dec. Finance Minister Chrystia Freeland's budget delivered on 8 Apr was mostly focused on fiscal consolidation and prudence. She gave a projection of $31mn in net new spending over the next five years that pales in comparison to allocations in previous budgets. The budget was focused on innovation and productivity Canada Growth Fund which is a $15bn investment vehicle to incentivize businesses to embrace change and adapt to changing usiness landscape. Looking into the medium term, fiscal deficit is projected to narrow to C$8.4bn by 2026. Debt to GDP ratio to fall to 41.5% by 2026 from 46.5% this year.

- **Key domestic events and issues to watch:** Mfg PMI (May) as well as BoC policy decision on 1 Jun; Apr building permits (2 Jun), 1Q Labor Productivity (3 Jun); Apr trade (7 Jun); May labour report (10 Jun); Apr manufacturing sales (14 Jun); May housing starts (15 Jun); Apr wholesale trade sales (16 Jun); May industrial product price (17 Jun); May CPI (on 22 Jun); Jun CFIB business barometer (30 Jun), Apr GDP (30 Jun).

- **Technical Analysis:** USDCAD hovered around 1.2655. Momentum indicators are bearish bias with next support around 1.2590 and then next at 1.2480. Resistance at 1.2835 (21-dma).



JPY: Near-Term Swings in Haven Demand, UST Yields

Forecast	2Q 2022	3Q 2022	4Q 2022	1Q 2023
USDJPY	130 (135)	130 (--)	125 (--)	123 (--)

Previous Forecasts in Parentheses

- **Motivation for the FX View:** Decline in pair from ~131-levels since second week of May was due in part to some revival in haven JPY demand, while bets on Fed policy errors (possibility of a more dovish tone down the road if growth concerns come to the fore) also helped cap broad dollar strength while leading to UST yield declines. Recent high at 131 now looks to be a strong resistance for the pair. Nonetheless, we remain wary of one-way bets on USDJPY pullback lower, given modest upside risks to UST yields should energy markets pose renewed risks to global price pressures (e.g., EU looking to ban sea-delivered crude imports from Russia). We see greater likelihood for global price pressures to moderate more discernibly later in 2H, as global withdrawal of monetary support dampens demand and Europe proceeds further along in efforts to delink from dependencies on Russia. If US growth drags materialize more discernibly, policy chatter could again shift away from combating inflation towards supporting growth or engineering soft landing, and UST yields, USDJPY could see gradual retracement lower then. Again, **our USDJPY projections above should not be taken as point forecasts, but rather, reflect risks that USDJPY pair could be firmer near-term amid heightened global uncertainties before averaging lower in 2H.**

- Earlier, USD had seemed to be the preferred haven of choice amid periods of heightened market volatility, from late Feb to Apr. But FRA-OIS spread has begun heading lower again from mid-Mar, indicating some tentative easing in stresses in dollar money markets. Meanwhile on Covid trajectories, cases look to be moderating in Japan while trending higher in US. Japan also looks to be opening its doors to international tourists, even though inflows are still modest for now. **Such developments could have helped JPY regain some haven allure in May, relative to dollar.**

- **Apart from shifts in haven demand, Fed stance and UST-JGB yield differentials are also likely to remain as key drivers of the USDJPY pair too.** In May FoMC, Powell clarified that 75-bps moves were not something being actively considered and details on QT did not surprise in terms of pace (i.e., Treasuries and MBS to roll off in June at an initial combined monthly pace of US$47.5bn, stepping up over 3 months to US$95bn). Recently released FoMC minutes notably stopped short of talking about more aggressive hikes (i.e. 75bps). The key takeaway was that Fed saw aggressive hikes (frontloading) as providing flexibility later this year, instead of aggressive hikes picking up pace. On net, **any further bouts of upward pressures on UST yields could be more modest than what we saw in early May, when UST 10Y reached 3.2%, and UST-JGB differentials are unlikely to widen to early May highs** (10Y yield differentials at 265bps at last seen versus peak of 289pips in early May). May peak of 131 could be a strong resistance for the USDJPY pair for now.

- But while UST yields could remain in elevated ranges near-term, certain combinations of developments going forward could still see them easing off again later in the year. As (i) growth drags emerge more discernibly (with broad withdrawal of monetary stimulus among major central banks starting to weigh on consumption and investment spending) and (ii) global inflation readings gradually edge lower in 2H, possibly as as Europe proceeds further along in efforts to delink from dependencies on Russia, energy inventories rebuild and supply chain disruptions ease, Fed policy focus could start to shift away from combating inflation towards supporting growth or engineering soft landing. **Taken together, UST yields could face greater downward pressures later in the year, while steepening of UST yield curve could also start to taper, providing an opportunity for USDJPY to ease off lower**.

- Still, ongoing normalization in US interest rates, while the BoJ remains committed to an easing stance, could help sustain relative demand for overseas investments (e.g., US treasuries). Demand from pension funds such as GPIF as well as private sector entities could be in play. **Such outflows could temper the extent of support that the JPY receives from an expected current account surplus**—consensus estimates see current account coming in at 1.8% of GDP in 2022 (versus 2.8% in 2021). **This could mean that USDJPY could remain in elevated ranges for some time versus pre-Covid range of 105 to 115, even as risk is likely skewed to the downside for the pair (versus current spot levels) in 2H**.

- Admittedly, over the course of the last few months, Japan's energy importer status also likely meant drags on JPY on higher import costs amid elevated commodity prices. On energy outlook, even as interim supply disruption fears are keeping brent prices above the US$110-handle at last seen, extent of oil price gains could be constrained going forward given (i) mounting concerns over softening global aggregate demand as financial conditions tighten, (ii) signs of interest in Russian oil from parts of Asia, including China, India, (iii) planned ramp-ups in OPEC+ supplies over time (including possibility of OPEC suspending Russia from its oil production deal, which could provide room for other producers to raise supplies), and (iv) ongoing releases of strategic reserves over the next several months from US and allies. **Oil price shifts could act as an amplifier for USDJPY moves—elevated oil import burdens could be supportive of USDJPY near-term, while**

easing in oil import burden towards the latter part of the year could help drag USDJPY lower then.

- **Growth and Inflation Outlook:** 1Q (P) GDP came in at -1.0%q/q SAAR, contracting on a sequential basis versus +3.8% prior, but still slightly better versus expected -1.8%. Private consumption growth was flat on a sequential basis, slightly outperforming expected -0.5%. Business spending expanded at 0.5%q/q, slightly lower versus expected 0.7%.

- BoJ projections in Apr seemed to imply modest drags from deteriorating global growth outlook. **FY2022 growth was lowered to 2.9% from 3.8% (Jan projection).** But we note that latest macro indicators seem to point to some resilience in the domestic growth outlook. PMI Mfg for May (P) came in at 53.2 versus 53.5 prior. Services activity also improved to 51.7, from 50.7 prior. Leading index for Mar (P) came in at 101.0 versus 100.1 prior. Retail sales for Apr grew by 2.9%y/y (better than expected 2.6%), but industrial production (P) contracted by -1.3%m/m (versus expected -0.2%), likely due in part to disruptions tied to China partial lockdowns.

- Apr CPI came in at 2.5%y/y, on par with expectations, but notably rising from 1.2% prior. The indicator ex fresh food came in at 2.1%, slightly above expected 2.0%. Base effects, a weaker JPY and ongoing supply disruptions may still mean an elevated headline CPI higher in the coming months (2% or higher), but BoJ views these developments as transitory. BoJ thinks that the current cost-push inflation cannot be sustained as the impact of energy prices will ease, while wages have yet to rise sustainably. As of Apr, **BoJ sees FY 2022 CPI (all items less fresh food) at 1.9% (versus 1.1% forecast in Jan), before easing off to 1.1% in FY2023**.

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

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

- **At some point though, if persistent rallies in USDJPY are seen for the rest of the quarter (significantly above 130), we do not rule out more discernible signs of intervention from BoJ or the finance ministry**. For instance, upswing above 131 on 28 Apr was resisted as

MoF came out strongly to say that it would respond "appropriately" to abrupt moves. Japan's energy importers are warning that recent fall in JPY is exacerbating a surge in fuel costs, and may weigh on their margins while raising prices for consumers. If the perceived harm to the economy from falling JPY becomes larger, MoF may be forced to act.

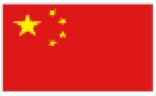
- **Latest Fiscal & External Balance Outlook:** In Feb 2022, **a parliamentary committee approved a record JPY107.6trn (US$936bn) spending plan for FY2022 (starting Apr)**. Kishida has vowed seamless spending for 16 months (beginning with supplementary budget mentioned above) to provide sufficient support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

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

- Current account for Mar came in at a surplus of JPY2549bn, improving from surplus of JPY1648bn prior. But subsequent trade balance for Apr came in at a deficit of –JPY839bn, deteriorating from -JPY424bn prior, likely partly on account of higher energy bills. Exports growth moderated to 12.5%y/y from 14.7% prior while imports growth remained robust near 28.2% (prior at 31.4%). We note that the trade balance has seen deficit readings from Aug 2021 to Apr 2022, versus average surplus outturns in the first 7 months of 2021. **Such developments be a tentative interim drag on JPY**.

- **Key domestic events and issues to watch:** 1Q Capital spending (1 Jun), May Vehicle sales (1 Jun); Jun Labor cash earnings (7 Jun); Apr (P) Leading Index CI (7 Jun); 1Q (F) GDP (8 Jun); Apr Current account (8 Jun); May (P) Machine tool orders (9 Jun); 2Q BSI Surveys (13 Jun); Apr Core machine orders (15 Jun); May Trade (16 Jun); BoJ Policy decision (17 Jun); Jun (P) Jibun Bank PMIs (23 Jun); May CPI (24 Jun); May Retail sales (29 Jun); May (P) Industrial production (30 Jun).

- **Technical Outlook:** USDJPY pair was last seen modestly below 130. On weekly chart, RSI is still in overbought territory, even as overbought extent had moderated in May, while bullish momentum in pair shows tentative signs of moderating. Risks of up-moves still intact, though extent could be capped. Resistance at 131.35 (May high), before 135.15 (2002 high). Support at 127.00 (50-DMA), 124.60 (38.2% fibo retracement from Jan low to May high). As USDJPY remains in elevated ranges, there could be less points of psychological support and resistances and magnitude of interim swings could be amplified.



RMB: One-way Fear Morphs into Two-Way Risks

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

No Change to Previous Forecasts

- **Motivation for the FX View:** USDCNY is likely to remain in two-way trades as focus shifts from Covid-anxiety to lockdown recovery. Impetus from further hawkish Fed cues and fears of another Shanghai-like lockdown on another significant city in China seem to have waned but growth concerns for China are unlikely to dissipate and could keep the USDCNH buoyant on dips. 6.60-6.80 range could hold with more support measures from the authorities to keep a check on aggressive USDCNY bulls.

- More recently, market metrics have shown easing upside pressure on the USDCNY and USDCNH. During the peak of yuan depreciation pressure, the USDCNH had been trading at a large premium to USDCNY and to some extent, leading the onshore pairing higher. More recently, this gap has moderated which translates to easing downside pressure on the yuan. In addition, the US and CH 10y yields have been hovering around par, not providing much directional cues to the USDCNY. **The recent stabilization in the yuan reflects fears of more Shanghai-like lockdown for other Chinese cities as well as recession concerns in the US that ease bets on aggressive Fed tightening.**

- We looked at the different lockdowns imposed and found that China has been administering aggressive testing in order to enact early, localised and short lockdowns for more recent outbreaks. Whilst adhering to the overarching strict zero-covid policy, China's restrictions are more nuanced within cities and officials continue to rely on mass testing in order to enact early, very localised and short lockdowns. While these may still be disruptive, it is unlikely to be as painful as the lockdown endured by Shanghai. Looking at the nationwide infections, Covid counts have tapered off. Should infections remain suppressed effectively, fears of another Shanghai-like lockdown could ease and that could continue to translate to less negativity for the yuan.

- As with most countries, the wave of Omicron typically lasts for 1-3 months, we had looked for bulk of lockdowns to be within 2Q and concomitant economic damage to be contained within this period as well. Moves of the USDCNY over the past two months reflect this scenario. Despite the stabilization in the yuan, we are wary that flash lockdowns are still likely to weigh on consumer confidence as well as investor confidence and limit efficacy of all the policy supports provided (be it tax cuts, mortgage rate cuts or cheap loans). **USDCNY could thus remain in two-way trades within 6.60-6.80 range, buoyed by a lack of carry advantage, the possibility that more infectious Covid-19 variants could lengthen the period of flash lockdowns and worsen growth prospects, or any escalation in geopolitical tensions that could intensify capital outflows. CNY TWI (CFETS weighted) could continue to drift lower under the 100-figure towards 98.**

- **Growth and Inflation Outlook:** Apr data was worse than estimates. Mfg PMI slipped to 47.4 from previous 49.5 while non-mfg PMI stunned with a 41.9 print vs. previous 48.4. Based on the breakdown of the official figures, the services PMI did take the brunt of the zero-covid impact at 40.0 vs. previous 46. for Mar. Construction PMI also slid rather sharply to 52.7 from previous 58.1, underscoring logistical impact of the lockdowns. Those leading indicators lowered the expectaions for the rest of the activity data for Apr which mostly missed estimates. Retail sales shrank by another -11.1%y/y vs. previous -3.5%. FAI ex rural also softened a tad more than expected to 6.8%y/y from previous 9.3%. Industrial production contracted in Apr by -2.9%y/y vs. previous 5.0%, bringing the ytd growth down to 4.0%y/y from previous 6.5%.
- Looking forward, despite Shanghai port capacity being revived back to 90%, production resumed (albeit in fits and starts), restrictions for most residents eased slightly, there were quite a bit of doubts on whether China has bottomed out. PMI release for May was better than expectations - manufacturing PMI improved to 49.6 (albeit still contractionary) from previous 47.4, beating expectations for a 49.0 print. The official non-mfg PMI rose to 47.8 from previous 41.9. The National Bureau of Statistics noted that economic sentiment seems to have improved in May. Economic activity could also be supported further by recent measures targeted at Shanghai as well as Beijing's easing of restrictions towards the end of May. The PMI numbers likely stabilize yuan sentiment but focus will be shifted towards efficacy of recovery rather than concerns on infections.
- The State Council has stepped up growth measures including a 33 point package that encompass a CNY140bn in additional tax rebates and CNY300bn in railway construction bonds. There were also mentions of infrastruction spending and measures to allow individuals and enterprises to postpone the payment of their housing provident fund contributions to a later date. SMEs are also given special attention as PBoC ease lending requirements in order to boost credit support for small firms and to support banks to issue perpetual bonds, tier-2 bonds.
- Meanwhile, China's Apr trade surplus widened from $47.06bn to $51.12bn. Exports slowed to 3.9%y/y from previous 14.6% while imports growth was flat for Apr vs. previous -3.0%. Breakdown suggests that shipment from most countries (including US, Canada, Hong Kong, Japan, South Korea, India, Singapore, European Union, Australia) fell year-on-year, painting a picture of slowing domestic demand. Of note, imports from Russia jumped +56.6%y/y vs. previous 26.4%. Widening trade

surplus is a sign of divergence in growth trajectory between China and the rest of the world. However, exports trend suggest that external demand softened as well with shipment to US, South Korea, Japan Hong Kong, Taiwan, India, European Union and even ASEAN mostly either softer or in decline. Global growth could continue to be impacted by supply shocks from China, war in Ukraine and protectionistic policies imposed by increasing countries. On balance, trade surplus could remain steady and that could provide some support for the CNY. However, falling exports earnings could eventually affect domestic demand and employment conditions at home.

- **Monetary Policy Forecast**: 1Y loan prime rates were left unchanged at 3.70% while 5Y was lowered by 15bps from 4.60% to 4.45% for May, underscoring increasing support on the property sector at home. According to the China Index Academy, more than 60 municipal authorities started easing property restrictions in the first quarter. Also recall that mortgage rates in more than 100 Chinese cities have been lowered by 20-60bps since Mar according to PBoC and the latest adjustment in LPR is a reflection of that.
- Apart from the acute fears of zero-Covid strategy's impact on the economy that drove the capitulation of the CNY, a significant part of the USDCNY rally is also due to the collapse of the US-CH 10y yield differential. However, since mid May, the 10y yield of US and China bonds have been trading at par.
- Recession fears in the US have started to limit Fed-PBoC divergence. In the past few months, multi-decade high US inflation headlines have driven UST yields to surge significantly even as we are at the start of the rate hike. This suggests significant frontloading of pressure on USTs compared to the 2015-2019 rate hike cycle. Powell's recent mention of raising policy rates past neutral have increased fears of US recession and could keep the UST 10y yield from making further headway. Recession fears for the US might keep the US-CH 10y yield premium from widening, thus reducing another bullish impetus for USDCNY. Meanwhile, with China embarking on cross-cycle policy designs that encompass a mix of fiscal spending for infrastructure construction, easing of macro-prudential measures to support the flailing property markets as well as targeted credit support measures (various relending quota programs), broad monetary policy rate action is thus limited. We do not rule out another 10bps cut for 1Y MLF. 1Y and 5Y LPRs are likely to be adjusted by another 10bps lower by Chinese banks. The RRR to be lowered another 50bps within the next two quarters.
- **Latest Fiscal and External Balance Outlook:** Recall that Fiscal deficit target for 2022 is lowered to 2.8% of GDP, down from 3.2%, underscoring a stance of fiscal consolidation. The key word for 2022 seems to be frontloading and overall fiscal stance was taken to be neutral. However, the recent urgency of growth prioritization suggest that this could change and we can expect a more expansionary fiscal stance for China.
- **Key domestic events and issues to watch:** Mfg PMI for May due on 1 Jun, May composite and services PMI on 6 Jun, May foreign reserves on 7 Jun. My trade on 9 May, aggregate financing, new yuan loan, money supply on 9-15 Jun, May CPI and PPI on 10 Jun, May FDI on 11-18 Jun, 13-16 Jun on 1Y MLF, May industrial production, retail sales, FAI ex

rural on 15 Jun, new home prices for May on 16 Jun. 1Y, 5Y LPR on 20 Jun, SWIFT global payments for May on 23 Jun, current account balance for 1Q on 24 Jun, FX Net settlement for May on 24 Jun, May industrial profits on 27 Jun, Composite PMI, Mfg PMI on 30 Jun.

- **Technical Analysis:** USDCNH hovered around 6.6950. Daily momentum is bearish and stochastics are also biased to the downside. 21-dma at 6.7250 is a resistance for the pair. On the weekly chart, momentum is bullish but waning and stochastics are overbought and turning lower. Bias could remain skewed to the downside notwithstanding two-way trades.

KRW: Further Recovery Hinges on Global Growth

Forecast	2Q 2022	3Q 2022	4Q 2022	1Q 2023
USDKRW	1260 (--)	1240 (--)	1220 (--)	1210 (--)

No Change to Previous Forecasts

- **Motivations for the FX View:** Our contrarian call in the last FX Monthly looking for USDKRW to correct lower in May panned out well so far. Both external and domestic factors contributed to KRW's recovery (+4% vs. USD from May troughs). Some of the exogenous drivers include RMB's recovery, Shanghai reopening as scheduled, sharp pullback in UST yields, USD and potential peak in Fed hawkishness. Endogenous drivers include BoK continuing with its tightening cycle, rebound in activity momentum as covid-related restrictions eased amid drop in covid infection. Looking on, any sustained gains in KRW would still require global growth conditions, supply chain disruptions to improve and USD, UST yields to pullback further. We expect the USDKRW pullback to stabilise and consolidate in 1220 – 1260 range in coming weeks as market await cues from FoMC guidance on policy bias (16 Jun) and how China reopening plays out. Importantly, if external demand improves and also, for any signs of end to war in Ukraine (supply side concerns). We also expect markets to focus on (1) MSCI review on 1st Jun for possible inclusion – a potential boost to inflows and positive KRW; (2) US's China tariff review before it lapses on 6th Jul. Potential removal of US tariffs on Chinese imports can be perceived as positive for broad risk sentiment and is supportive of KRW. If all these positives miraculously play out, a downward revision to USDKRW forecasts will be warranted. Elsewhere we keep in view Korea-China relations for any signs of deterioration due to differences in foreign policy bias.

- **Supplementary Budget to Cushion against Rising Cost of Living.** On 29 May, South Korea apporoved a record extra budget worth KRW62tn (or US$49.5bn), in attempt offset the impacts of Covid-19 and rising cost of living. Budget measures include some subsidies for people vulnerable to faster gains in prices. Targeted groups are mainly owners of small and medium size businesses (estimate to be around 5.5mio owners). Budget will not be funded by any bond issuance but tax revenues from existing spending plans.

- **MSCI Decision on 1 Jun.** Potential MSCI inclusion of Korean equities may also bring about foreign inflows as global fund managers rebalance their portfolios. This can be a potential positive for KRW. Earlier S. Korea authorities said it was considering reforms that would extend trading hours of KRW and allow international traders to participate in the market. Improving market accessibility can improve its chances of being reclassified.

- **Equity Sell-off Overdone; Rebound Can Aid KRW's Rebound.** KRW remains highly correlated to moves in equity markets. With global equities experiencing a sharp sell-off (as of 20/May S&P fell 20% YTD), we look at the behavioral and sentiment aspects to get a gauge on how exuberant or stretched markets may be and to keep a look out for any potential contrarian signals. Popular market measures of fear-greed index, AAII investor sentiment and BofAML fund manager survey (FMS) cash balances were all pointing to (1) extreme fear at multi-year low; (2) AAII bull-bear spread and bullish sentiment at historical low while bearish sentiment at historical high; (3) BofAML's FMS shows cash balances at >10y high - indicating investors are extremely bearish. With bearish sentiments at extreme levels, contrarian buy signals for risk proxys were hence generated. The rebound in equities from oversold levels is also helping to fuel a sharp rebound in KRW. In the event of an extended rally in equities into Jun, KRW could see correlated moves play out.

- **Risks to outlook include** (1) a much faster pace of Fed tightening; (2) covid deterioration leading to fresh lockdowns, delayed reopenings; (3) another round of sharp increases in oil prices as KRW is highly sensitive to market moves and is a net oil importer; (4) potential deterioration in China-Korea relations. We reiterate that Yoon as a President may undermine KRW due to his foreign policy bias that leans towards resetting China ties. He had indicated plans to buy an additional Terminal High Altitude Area Defense (THAAD) anti-missile system. This may be a concern for KRW and markets as this risks retaliation from China. Recall that China-Korea relations deteriorated in 3Q 2016 over US-Korea alliance decision to deploy a US THAAD to defend against North Korea missile threat. In response, Beijing then used economic coercion, among other levers, to try to force Seoul to abandon the THAAD deployment.

- **Growth and Inflation Outlook: BoK downgraded growth forecasts for 2022 and 2023 to 2.7% and 2.4%,** from 3% and 2.5% respectively. BoK expects investments and export growth to slow while private consumption should pick up amid relaxation in covid restrictions. Near term, the forward looking surveys and activity indicators suggest that underlying growth, activity momentum is somewhat mixed. While May mfg PMI came in firmer (at 52.1 vs. 51.2 prior) and retail sales rebounded (10.6% y/y vs. 7.1% prior), IP (-3.3 m/m vs. 1.1% prior) and consumer confidence slipped (102.6 vs. 103.8 prior). Taking stock, 1Q

GDP growth slowed to +0.7% q/q, down from +1.2% in 4Q-2021. Earlier covid restrictions hit consumption (-0.5%, first contraction in 5 quarters) while capital investments also saw a sharp decline (-4%).

- **Korea CPI rose 4.8% y/y in Apr,** up from 4.1% in Mar. Energy and food prices led gains. This is also the 13th consecutive month of CPI staying above BoK's 2% target and the fastest pace in 14 years. Core CPI accelerated to 3.6% in Apr, up from 3.3% y/y. BoK now expects headline CPI and core CPI to remain at 4%-level, 3%-level, respectively for some time.

- **Monetary Policy Forecast**: There is no MPC in Jun. The next MPC is on 13th Jul and we expect BoK to keep pace with another 25bps hike to bring policy rate to 2%. BoK Governor Rhee indicated that the BoK is prioritizing combating inflation before it gets worse. He did expect price pressures to continue rising from 14-month high of 4.8% y/y (in Apr). He is also concerned how real wages will decline and financial instability can widen if inflation expectations broaden. Rhee also described as "reasonable" that the market view that the BoK could raise rates to as high as 2.5% by year-end.

- At the last BoK meeting (26 May), the MPC voted to raise rates by 25bps to 1.75%. BoK's sharp upward revision to headline CPI to 4.5% this year, from 3.1% previously reinforced expectations that BoK tightening cycle should continue. Earlier, Governor Rhee said that BoK could consider larger magnitude of interest rate increases of 50bps in coming months, depending on income data available around Jul and Aug.

- **External Balance and Fiscal Outlook:** Current account surplus narrowed to $6.73bn in Mar, down from $7.5bn a year ago. Elevated oil prices drove up import bill and weighed on surplus. That said this is the 23rd consecutive month of current account surplus.

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

- **Key domestic data to watch:** S. Korea releases May trade, mfg PMI (1 Jun), May CPI (3 Jun); May FX reserves (7 Jun); 1Q GDP (8 Jun); Apr current account (10 Jun); May unemployment rate (15 Jun); 1st 20 days of exports (21 Jun); May PPI (23 Jun); Jun consumer confidence (29 Jun); Jul Business survey - mfg and services, May IP (30 Jun).

- **Technical Outlook:** USDKRW traded sharply lower for the month of May, in line with our call for retracement play towards 1239, 1229 objectives. Move lower hit a low of 1235 (31 May). Last at 1245 levels. Bearish momentum on daily chart intact but RSI rose from near oversold conditions. Rebound likely. Resistance here at 1255, and 1267 (21 DMA). Support at 1242/44 levels (50 DMA, 23.6% fibo retracement of 2021 low to 2022 high), 1235, 1230, 1226 levels (100 DMA).

TWD: Likely Not Out of the Woods

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

No Change to Previous Forecasts

- **Motivations for the FX View:** Despite the >3% rebound in TWD since mid-May to end-May, we **still see room for USDTWD to stay supported** amid (1)) growing signs of slowing global and domestic growth – weighs on cyclical TWD; (2) Fed-CBC policy divergence can undermine TWD in the interim; (3) still-elevated energy prices undermine energy importers like TW while rising prices hurt household consumption pattern; (4) ongoing supply chain disruptions (raw materials like neon gas for chip making) amid protracted war in Ukraine will continue to weigh on economic activities, exports; (5) risk of inflation expectations being de-anchored amid rising food and energy prices could pose further upside to UST yields – undermining risk proxies; (6) risk of worsening China-Taiwan relations that may affect investment inflows,

- **Fed-CBC Policy Divergence Weighs on TWD.** We expect CBC to downshift its magnitude of rate hike to 12.5bps (from 25bps) at the upcoming MPC as some sectors of the economy (i.e. tourism, self-employed, etc.) still need support and there are signs of growth momentum slowing ahead (shift towards engineering soft landing over combating supply-side driven inflation). Furthermore, Governor Yang also indicated that the CBC would be very cautious on the pace of tightening. For the remainder of the year, we look for another 37.5bps of rate increases. On Fed, it is likely the next 2 FoMCs would see 100bps hike (2* 50bps in Jun and Jul) and likely another 2-3 more hikes of 25bps each to end of the year. The growing policy divergence will drive up UST-TW bond yield differentials and further add to USDTWD upside.

- **Geopolitics Undermine Sentiment and Flows.** Russian invasion of Ukraine raises fears of potential China invasion of Taiwan as the former may prefer better control over South China Sea (to deter US other unfriendly forces). Chatters of such threats are gaining traction this year as Taiwan also stepped up measures - government has issued its first war survival handbook advising citizens how to find bomb shelters, water and food supplies while defence ministry confirmed of war games exercises including simulations of various possible actions of Chinese Communist Party to invade Taiwan. Even Biden weighed in to say that US would use its military to defend Taiwan if Beijing attempts to take Taiwan by force YTD, foreign selling of Taiwanese equities have also beat other peers in the region, with $26.3bn foreign net sale of domestic equities, far surpassing India (-$22bn) and Korea (-$11.3bn). While higher rates may often be attributed as the main culprit behind the unwinding of tech stocks, we believe the massive foreign selling could also be partially attributable to geopolitics. A China invasion in Taiwan is not our base case scenario but we acknowledged that the play up of such fears can undermine sentiments and weigh on TWD for longer.

- **Semiconductor Supply Chain Disrupted by Protracted War in Ukraine.** Ukraine produces about 50% of the world's supply of semiconductor-grade neon, a key component for lasers in chipmaking. Based on research from Techcet, The gas, a biproduct of Russian steel manufacturing, is purified in Ukraine. The 2 largest processors of Ukrainian neon are based in Mariupol and Cryoin and they have halted production due to war in Ukraine. Russia is also the source of 35% of the palladium used in the United States. The metal is used in sensors and memory, among other applications. Companies that supply chipmakers with materials for semiconductor fabrication buy gases, including neon, palladium and C4F6, from Russia and Ukraine. Now with US sanctions on Russia and Russian-related firms as well as military conflict in Ukraine (affecting production), there could be shortage in supply and this could affect the semiconductor industry in general. Bigger semiconductor firms may have considerable stockpiles and diversified sourcing for its supplies hence disruption may be kept at a minimal. But smaller semiconductor firms do not. We continue to watch this space as protracted war could affect supply chain and production beyond the short term (3 - 6 months) and weigh on final products, exports.

- **Growth and Inflation Outlook: DGBAS lowered 2022 growth forecast to 3.91%, from 4.42% previously.** The agency cited global inflation and covid dampening domestic and external demand as main factors for the bearish adjustment even as export growth forecast was revised higher to 14.62% this year, from 9.69% prior. Looking on, growth momentum could moderate further. Mfg PMI slipped to 51.7 in Apr, from 54.1. Though PMI is still in expansionary territory, the slippage was the sharpest in almost 2y. While exports growth was robust (26.7% y/y in Apr vs. 12.1% expected), export orders unexpectedly saw a sharp decline of -5.55% y/y in Apr (vs. 11.5% expected). This is the first decline in more than 2 years. Larger than expected hit from extended lockdowns in Shanghai and broader supply chain disruptions are some of the factors contributing to weaker export demand. The Ministry of Economic Affairs see May orders between -1.1% and +1.7% y/y.

- 1Q GDP was revised slightly higher to 3.14% y/y (vs. prelim print of 3.06% earlier). But this is still a slowdown from its fastest pace (in over a decade) of 4.88% in 4Q. The slowdown was due to domestic demand and government spending. Covid outbreak in TW, resulting in extended lockdowns as well as multiple occasions of blackout and water shortages proved challenging for growth momentum. That said, headline growth still surpassed expectations, owing to robust exports. DGBAS said that demand for new technology applications and cargo shipping services remained vibrant amid easing supply chain bottlenecks.

- **DGBAS revised 2022 CPI forecast higher to 2.67%**, driven by rising import costs. Agency expects CPI to moderate from middle of this year though it also cautioned that uncertainty remain in place. Headline CPI rose to more than 9-year high of 3.38% y/y in Apr, up from 3.27%

y/y in Mar. This is the 9th consecutive month that CPI comes in above 2%-target. Food and fuel remain the main drivers of higher inflation. Core inflation also roise 2.53% y/y in Apr, up from 2.47% y/y. Ongoing military conflict in Ukraine could continue to complicate supply chain disruptions, keep commodity prices supported and that would feed through to higher CPI in coming months.

- **Monetary Policy Forecast: We expect CBC to raise rate again at the upcoming MPC on 16 Jun,** following its surprise early and larger than expected move to tighten at Mar meeting (by 25bps instead of 12.5bps). Focus has shifted to curbing inflationary pressures, from supporting growth. Magnitude of rate hike may revert to its typical 12.5bps increase, instead of the aggressive 25bps seen at Mar meeting as some sectors of the economy (i.e. tourism, self-employed, etc.) still need support and there are signs of growth momentum slowing ahead. In a legislative hearing (12 May) when asked if CBC plans to raise rate again in Jun, Governor Yang did not give a direct reply but instead said that there are many tightening measures including selective credit control and withdrawal of funds from FX markets. Seperately in a written report to Legislative finance committee, CBC said it will adjust monetary policy in a timely manner based on domestic inflation situation & outlook, impact of covid outbreak on economy as well as impact of external moves on Taiwan. Earlier in Apr, Governor Yang said that CBC would be very cautious on the pace of tightening.

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

- **External and Fiscal Outlook: Current account surplus widened to $30.68bn in 1Q 2022,** from $25.83bn in 1Q 2021. Both goods and services surplus expanded. Trade was driven by demand for electronics used in digital transformation and emerging technology applications while services was due to rise in income by cargo shipping providers amid tight supply of containers. Current account surplus expanded to 15.2% of GDP in 1Q (vs. 14.95% of GDP in 4Q). Taiwan's debt as % of GDP last stood at 35.2 while fiscal surplus was at 0.37% of GDP. Taiwan has a self-mandated cap of 40% of debt to GDP.

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

- **Key domestic events and issues to watch:** May mfg PMI (1 Jun); May FX reserves (6 Jun); May CPI (7 Jun); May trade (8 Jun); CBC MPC (16 Jun); May export orders (20 Jun); May industrial production, unemployment (23 Jun).

- **Technical Outlook:** USDTWD turned lower for the month of May after hitting a high of 29.88 (12 May). Move lower was in line with our observation then that fatigue appears to be setting in for USD bulls and corrective move lower could reach 29.10, 28.80 levels. Pair hit a low of 28.95 (30 May). Last seen at 29.20 levels. Bearish momentum on daily chart shows signs of fading while RSI shows signs of rising from oversold RSI. Rebound risks likely in the near term. Resistance at 29.32 (23.6% fibo retracement of 2022 low to high), 29.56 (21 DMA). Support at 28.97 (38.2% fibo), 28.69 (50% fibo).

SGD: NEER Basket Outperforming

Forecast	2Q 2022	3Q 2022	4Q 2022	1Q 2023
USDSGD	**1.3650** (1.3900)	**1.3600** (1.3800)	**1.3550** (1.3700)	**1.3500** (1.3550)

Previous Forecasts in Parentheses

- **Motivation for the FX View:** AxJ FX will continue to respond to broader shifts in risk sentiments (Ukraine war, China Covid developments and concomitant global supply chain woes), amid amplified moves in dollar and yields. Recent USDSGD decline from mid-May largely followed broad dollar DXY downward trajectory, which was in turn due in part to more certainty on next two Fed moves (likely +50bps each) and rising recession chatter potentially leading Fed to be more careful in subsequent rate hike pace. We also note tentative improvement in sentiments tied to China growth/Covid outlook, particularly towards late May. Besides these factors, our forecasts adjustments above also reflect some likely "flight to safety" to SGD in this phase of elevated external uncertainty. SGD NEER has notably been creeping higher (last seen at 1.1% above implied policy mid-point, versus near-0.6% in end-Apr)—aided by front-loading of monetary policy tightening and favorable macro fundamentals such as ample fiscal space, resilient trade outturns and current account surpluses—albeit remaining in our earlier assessed trading range of +0.5% to +1.5% above par. While broader global growth risks could lead dollar to see support on dips, risks for USDSGD pair could still be tilted to downside (albeit gradually) in the coming quarters, as relative appeal of SGD remains intact.

- **Near-term moves in USDSGD will likely continue to mirror broader DXY biases (recently exhibiting supported-on-dips characteristics).**
  - Markets appeared to have pared back hawkish expectations on Fed, after Powell clarified in May FoMC that 75bps moves were

not something being actively considered and details on QT did not surprise in terms of pace (i.e., Treasuries and MBS to roll off in June at an initial combined monthly pace of US$47.5bn, stepping up over 3 months to US$95bn).

- Bullish spillovers to USD sentiments from hawkish surprises in Fed policy tones have notably moderated, given higher certainty on size (+50bps) in next two Fed hikes. Chatters of US recession risks could lead Fed to be more careful in calibrating rate hike pace later in the year, in attempt to engineer soft growth landing. Global inflation momentum could start to peak, even as any easing in headline readings should be a slow grind. Likelihood of another bout of strong dollar rally could be reduced, even as DXY looks to remain in elevated ranges near-term.
- On net, we remain wary of one-way bets on dollar pullback lower, should energy markets pose renewed risks to global price pressures near-term (e.g., shocks from potential EU ban on sea-delivered crude imports from Russia). We see greater likelihood for global price pressures to moderate more discernibly later in 2H, as withdrawal of global monetary stimulus leads to demand destruction, and as Europe proceeds further along in efforts to delink from dependencies on Russia.
- Historically, AxJ FX tend to see losses in the lead-up to the start of the Fed hike cycle, although SGD tends to see more modest drags versus IDR, THB and MYR in such periods. With Fed action priced in prior, AxJ FX losses then tend to unwind as the actual Fed rate hike cycle starts. From Mar-Apr, dollar-positive factors appear to be overwhelming this usual pattern of AxJ FX biases, but dollar-supportive conditions seem to be moderating a tad now.

- **Domestically, latest rounds of policy announcements reflect a commitment to Covid-endemic stance from authorities**. On 22 Apr, the DORSCON level was adjusted from Orange to Yellow, with group sizes being removed for mask-off activities and household visitors. More importantly, all workers could return to the workplace (up from 75% prior) and safe distancing will no longer be required between individuals or between groups. Capacity limits for larger settings/events (75% prior) have also been removed. On border entry, fully vaccinated and well travellers will not require any tests to enter Singapore. As of early May, authorities estimate that MRT and bus ridership has reached 78% of pre-Covid levels (likely higher now) with recent easing of Covid rules. Continued recovery in domestic consumption could put a floor on GDP growth, despite concerns over softer interim external demand.

- **Negative contagion from China growth moderation or yuan depreciation concerns to SGD eased in late May.** In the last monthly, we postulated that as per other countries' experiences, each Covid wave typically lasts for around several weeks to a few months, and sentiments surrounding the China Covid situation could see tentative turnaround over time. Shanghai officials said earlier that they're seeking to fully resume normal life and production by mid- to late-June.

Recent messaging out of China also seems to be more cognizant of economic costs of keeping strict Covid curbs for longer, and greater efforts could be in play to balance growth/Covid objectives (while maintaining broad Covid-zero stances). Shanghai laid out the criteria it would use to categorize parts of the city as low-risk, a model other cities could follow. More recently, Shanghai also unveiled a 50-step economic support package (tax rebates, allowing resumption of manufacturing ops in Jun etc.), which could aid regional risk sentiments.

- **Growth and Inflation Outlook:** 1Q (F) GDP showed slight outperformance versus prelim releases (3.7%y/y, 0.7%q/q SA), but outturns were largely expected. Alongside signs of softer external demand (slippage in US, Europe, China economic readings), headline growth figures for Singapore could moderate from here.

- On higher-frequency indicators, manufacturing growth held steady at +6.2% in April, mainly driven by transport engineering. Electronics continued to rise on resilient chip demand, but growth eased to a 3-month low. Our economist team expects manufacturing growth to ease to a low single-digit pace in the coming quarters, as chip production is operating near full capacity while global electronics demand is slowing. Non-chip sectors, such as petrochemicals, will be weighed down by weakening global demand. **House view for GDP growth forecast is kept at +2.8%**.

- Core CPI soared to +3.3% in April, driven by higher inflation for food, retail & other goods, and electricity & gas. Headline CPI (+5.4%) also remained at a decade high as rentals and private transport costs continued to climb. **Our economist team maintains 2022 forecasts for headline CPI at +4.8% and core CPI at +3%**.

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

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

- As of writing, USDSGD is around 1.3740, and trades around +1.1% from the new implied mid-point of 1.3887, with the top estimated at 1.3610 and the floor at 1.4165. Output gap is now expected to close and see a slight positive reading in 2022, while core inflation could see a broad-based step up in 2022 and risks remaining elevated for some time. Given these macro conditions, our Taylor rule estimates suggest that SGD NEER is likely to see a modest upward bias over the next few quarters. Post MAS announcement, SGD NEER has been trading on the stronger side of the new trading band. **We had proposed on 6 Apr that "if a re-centering materializes, a tentative trading range post-announcement could be +0.5% to +1.5% above the new mid-point". We maintain this projection range for now.** We reiterate bias to long SGD NEER (basket basis) on dips—EDB had noted potential "flight to safety" flows to Singapore given Singapore's pro-business environment and predictable policies (versus regulatory uncertainty and surging inflation elsewhere), as well as structural factors such as "regionalization" of supply chains.

- Domestic interest rates continued rising in May. The 3M SORA and 3M SIBOR are at 0.5263% and 1.3379% at the time of writing, higher than the 0.3065% and 1.0938% seen in end-Apr. While risks might continue to be skewed to the upside for rate moves, financial stability risks among households and corporates are likely to remain manageable. Our economist recently raised year-end 3M SORA forecast to 2.05% (from 1.55%), and 3M SIBOR forecast to 2.3% (from 1.8%), predicated on the Fed hiking a total of +275bps this year.

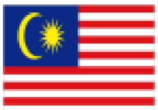
- **Latest Fiscal and External Balance Outlook:** Finance Minister Lawrence Wong delivered the Budget on 18 Feb. Our economist team assesses that Budget FY2022 shores up finances to meet priorities for a post-pandemic future, including growing healthcare spending; expanding the social safety net; and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

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

- The current account surplus improved to 19.75% of GDP in 1Q 2022, from 18.12% prior. A broad recovery trend has been observed since the trough in 4Q 2019. But on higher-frequency indicators, we note that Apr NODX growth (+6.4%) eased to the slowest pace in 8 months, as exports to China and Hong Kong contracted due to lockdowns and supply disruptions. Further boosts to current account from trade outturns could be somewhat limited, even as some resilience is likely. Consumer and tourism-related services such as retail trade, accommodation, and food services will recover with the reopening and partially offset the weaker manufacturing and trade-oriented services in the coming quarters. Our economist team maintains 2022 NODX growth forecast at 4%-6% (versus 12.1% in 2021).

- **Key domestic events and issues to watch**: May PMI (2 Jun); Apr Retail sales (3 Jun); May NoDX (17 Jun); May CPI (23 Jun); May Industrial production (24 Jun).

- **Technical Outlook**: USDSGD pair last seen modestly above 1.37, swinging discernibly lower in recent weeks versus highs near 1.40 in early May. But bearish momentum on daily chart shows tentative signs of moderating while RSI is ticking higher. Earlier downswing in the pair could take a breather, and pair could see some near-term support. Bias to sell rallies, with potential resistance at 1.3850 (23.6% fibo retracement from Feb low to May high), before 1.3990 (May high). Support is seen at 1.3630 (61.8% fibo), 1.3540 (76.4%).



MYR: MYR: Global Growth Concerns and Policy Catch Up Factors

Forecast	2Q 2022	3Q 2022	4Q 2022	1Q2023
USDMYR	4.40 (--)	4.35 (--)	4.30 (--)	4.30 (--)

No Change to Previous Forecasts

- **Motivation for the FX View: USD/MYR reached a peak of 4.4070 on 19 May as dollar strength continued in the first few weeks of May, but with the dollar retracement in the latter part of May, the pair has retraced back to around 4.38 by end May on the back of CNY recovery and dollar softness.** In the near-term, the epidemiological trajectory domestically has improved as curbs are eased further over time, borders are reopened and the government has vowed not to reimpose lockdowns, leading to potential positive economic upside. However, global growth concerns still lingers, even as Covid related developments out of China (including the easier China monetary policy moves) has eased. The impact of more hawkish Fed policy moves to address inflation on the rest of the world will still remain for the remainder of this year.

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

- In summary, MYR weakness was largely driven by exogenous factors, including the earlier rise in UST yields, USD strength, sharp and continued decline in CNH (of which MYR has a strong correlation to), IMF's downgrade of global growth, risks of China slowdown amid extended lockdowns and ongoing war in Ukraine (sentiment, china proxy play). Some of these drivers have eased but lingering concerns about global growth and risk aversion will continue to support USD and raise cautious view of risky assets for the next month or so, which may keep MYR range bound.

- On the domestic front, the fractious and fluid dynamics of domestic politics does raise the possibility of general elections in 2H 2022. **Elections and associated near-term uncertainties could induce higher vols for the USDMYR pair, but a sustained period of volatility and extended MYR losses is not our base case**. While the USDMYR pair did rise by >8% from 2Q to 4Q 2018 (last elections in May 2018), the bulk of this upswing can be attributed to broad dollar strength (DXY >+6%) and oil softness (oil > -20%) over the same period. Accounting for these two factors, the actual elections-induced impact on MYR is likely modest—the BIS-estimated MYR REER (real effective exchange rate basket) notably fell by a modest 1.5% over this period. To a large extent though, a scenario of contained MYR vols/losses on election uncertainty is conditional on there being clear signs of ability of (potential) next ruling party/coalition to maintain policy continuity and economic traction post Covid-recovery.

- **Growth and Inflation Outlook:** Our economist team maintains forecast of broad-based +6.0% growth in 2022, in view of the potential 2Q 2022 and 2H 2022 GDP growth dynamics, but tweaked the supply-side and demand-side forecasts to factor in 1Q 2022 performance, and trimmed 2023 growth forecast to +4.7% from +5.0%.

- Headline inflation inched higher to +2.3% YoY in Apr 2022 (Mar 2022: +2.2%YoY; 4M2022: 2.2% YoY) mainly on higherfood & non-alcoholic beverage(FNAB) cost. Core inflation also edged upto +2.1% YoY (Mar 2022: +2.0%YoY) amid pent up discretionary spending and services demand. No change to our full-year 2022 inflation forecast at +2.7% (2021: +2.5%) but acknowledged the upside risks amid cost-push factors (including minimumwage hike) plus potential fuel price subsidy review.

- Maintain our 2022 inflation rate forecast at +2.7%, with upside risk from global energy commodity prices - especially crude oil - as well as elevated food-related commodity prices, including crude palm oil (CPO) price; global commodity and manufacturing supply chain risks and disruptions in the wake of Russian invasion of Ukraine and the latest bout of China lockdown; the implementation of domestic minimum wage hike on 1 May2022; and weaker MYR vs USD. Mitigations to the supply-driven, cost-push inflation include the continued “blanket” fuel price subsidies; implementation of and supply-side measures (e.g. freeze on base electricity tariffs for all electricity users in Peninsular Malaysia from 1 Feb 2022 until end-2024; introduction of subsidy to poultry farmers for chicken (MYR0.60/kg) and egg (MYR0.05/kg) production; allowing short term (Dec 2021-Feb 2022) importation of frozen whole chicken); no highway toll rate hike until up to mid-2032 on 4 key Klang Valley highways; ban on chicken exports and abolish approved permit (AP) for selected food import.

- **Monetary Policy Forecast:** There was a surprise Overnight Policy Rate (OPR) hike of 25bps to 2.00% by BNM at its 10-11 May 2022 Monetary Policy Committee (MPC) meeting. BNM’s Monetary Policy Statement (MPS) stated that with the firmer domestic economic growth, the time is right to start normalising - thus gradually raising - OPR (“BNM Monetary Policy - OPR Normalisation Brought Forward”, 11May 2022). We are now factoring in a total of 125bps hikes in OPR in 2022-2023.

- With one 25bps hike out of the way, we see another 25bps hike coming later this year, to be followed by 75bps hikes in 2023. Our economics team sensitivity analysis is that a 25bps hike in OPR cuts real GDP growth by 0.2 percentage point, ceteris paribus, over a period of one year from the hike, with the biggest impact occurring 3 to 4 quarters after the hike. Further potential domestic policy and political drags or overhangs include Government decision on fuel subsidy review ("Malaysia MacroUpdate - Fuel Subsidy: Policy vs Politics", 24 Mar 2022) as well as the potential of 15th General Election in 2H 2022.
- BNM's Monetary Policy Statement (MPS) maintained the assessment of continued global economic recovery and firmer domestic economic growth this year, mainly as countries transition from the pandemic phase to the endemic stage of COVID-19, thus sustained economic opening vsthe ins and outs of lockdowns in 2020-2021, as well as labour marketimprovement. These are cushioning the risks to economic outlook from Ukraine-Russia military conflict and strict containment measures in China that worsen the commodity price shocks and supply chain disruption. Meanwhile, the official 2022 forecast for headline inflation rate is +2.2%to +3.2% (1Q 2022: +2.2% YoY; 2021: +2.5%; 2020: -1.2%) and for corinflation rate is +2% to +3% (1Q 2022: +1.7% YoY; 2021: +0.7%; 2020:+1.1%).
- BNM sees upward pressure on prices to be partly contained by existing price controls and the continued spare capacity in the economy as per the still sizeable negative output gap and the still elevated unemployment, youth unemployment and under-employment rates vs pre-COVID-19 levels. Policy responses to address inflation and cost of living so far involved price control/stabilisation and supply-side measures e.g. maintain fuel (RON95, diesel) price subsidies since Feb 2021; MYR680m allocation to stabilize prices and supplies of items such as cooking oil, general flour, liquefied petroleum gas (LPG or cookinggas); freeze on base electricity tariffs for all electricity users in Peninsular Malaysia from 1 Feb 2022 until end-2024; introduced subsidy to poultry farmers for chicken (MYR0.60/kg) and egg (MYR0.05/kg production; no highway toll rate hike until up to mid-2032 on four key Klang Valley highways.
- Amid the cautious optimism on domestic growth and inflation, thesurprise and earlier-than-expected OPR hike indicates BNM is responding to recent market developments, namely the downward pressure on MYR vs USD, upward pressure on 10-Year MGS yield and the narrowing of MGS-US Treasury 10-Year yield spread. MPS concluded that with domestic economic growth on firmer footing, the time is right to start reducing the degree of monetary accommodation which will be done in a measured and gradual manner.Our OPR outlook is revised to +50bps hikes to 2.25% in 2022 and +75bps hikes to 3.00% in 2023 vs previous forecast of +25bps hike to 2.00% in 4Q2022 and +100bps hikes to 3.00% in 2023. Total OPR hikes in 2022-2023 remains +125bps to restore OPR back to the immediate pre-COVID-19level of 3.00% next year. Interest rate swap (IRS) curve is currently pricing in OPR hikes of +50bps next 6 months and +125bps increases over next 12 months.
- **Fiscal and External Balance Outlook:** Budget 2022 will likely see a third consecutive year of >6% budget deficit to GDP at 6.0% (2021E: 6.5%). Meanwhile, Fiscal Outlook 2022 report indicates budget deficit

to GDP ratio will go sub-5% from 2023 onwards (2023E: 4.8%; 2024: 4.3%) en-route to the 12th Malaysia Plan target of 3.0%-3.5% in 2025. Trajectory of narrowing fiscal deficits, if maintained, should be net positive for medium-term MYR sentiments.

- **Key domestic events and issues to watch:** May PMI Mfg (1 June); BNM Monetary policy decision (6 July); Foreign Reserves (8 & 22 June); Apr Industrial Production (10 June); May Trade (17 June); May CPI (24 June).

- **Technical Outlook:** USDMYR eased off highs above 4.40-figure into end-May. Pair was last at 4.3875 levels. Bullish momentum on weekly chart intact though RSI shows signs of turning from overbought conditions. While upside risks remain intact, pace of gains could slow. Resistance at 4.4085 (previous high), 4.4490 (2020 high). Support at 4.36, 4.3420 (76.4% fibo retracement of 2020 high to 2021 low).

IDR: Recovery More Likely in 2H

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

No Change to Previous Forecasts

- **Motivation for the FX View:** USDIDR was in a consolidative phase for most of the first four months of the year and only broke out higher recently, alongside reports of China partial Covid lockdowns in some cities (likely weighing on commodity demand outlook), worries over Fed normalization, and announcement of the palm oil export ban. Still the magnitude of USDIDR upswing has been somewhat contained versus historical episodes of IDR depreciation. The palm oil export ban was relatively short-lived and is unwinding. Messaging out of China also seems to be more cognizant of economic costs of keeping strict Covid curbs for longer, and greater efforts could be in play to balance growth/Covid objectives. On net though, it could be too early to call for a turnaround lower in USDIDR. To some extent, global growth concerns emanating from the complex confluence of Ukraine war, ongoing China Covid wave, withdrawal of global monetary stimulus etc. could lend some support to USDIDR near-term. But longer-term view of IDR continues to lean towards cautious optimism, given expectations for relatively resilient ID growth pace, fiscal discipline, and support from benign commodity outlook.

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

- An export ban on coal was implemented in Jan, to boost inventories at power plants and ensure energy sufficiency at home. Subsequently, coal miners compliant with new regulations on domestic market sales were cleared to restart shipments. Baseline assumption is for ban-induced drag on exports to ease as more firms comply with the regulations.
- With Russia and Ukraine accounting for about 80% of global sunflower oil exports, palm oil has risen in costs as buyers raced to find substitutes for sunflower oil. In a bid to cool domestic cooking oil prices, authorities first introduced domestic market obligation rules for crude palm oil (which required companies to direct 30% of exports to local markets), then replaced it with higher export duties instead. Higher export duties tend to make it more profitable (on relative basis) to sell domestically rather than abroad.
- This was followed in late Apr by the introduction of a more explicit ban on palm oil exports, including crude palm oil (CPO), refined palm oil (RPO), refined, bleached & deodorised palm olein (RBD), palm oil mill effluent (POME) and used cooking oil. Measures came into effect on 28 Apr and were supposed to last until the price of cooking oil in the country is below IDR14,000 per litre. Intent of export ban was to prioritise domestic needs and fulfill people's basic necessities amidst shortages.
- But the worst of the earlier palm oil export ban seems to have passed, with authorities having pushed out new regulations in late May. Domestic market obligation and domestic price obligation policies for crude palm oil will be effective as of 31 May, in place of the earlier export ban. Companies' compliance with these requirements will be the basis to determine the volumes of palm oil products they can export.

- **Apr-May rout in US treasuries triggered by earlier hawkish shifts in Fed signalling dampened IDR sentiments but did not lead to large IDR losses as in earlier Fed tapering episodes.** IGB-UST 10Y yield differential narrowed from around interim high of 500bps in early Mar to interim low of around 384bps in early May as UST yields spiked, but has on net headed higher since; last seen at around 420bps. **On net, carry appeal of IGB assets might have moderated a tad, but yield differentials likely remain sufficiently wide to avoid triggering a larger exodus of foreign funds**. A look at portfolio flows also suggests that recent outflows from bonds and equities could be petering out in the second half of May. Recently released FoMC minutes notably stopped short of talking about more aggressive hikes (i.e. 75bps). Any additional support for the "peak hawkish Fed" narrative could help cap interim UST yield upswings and help moderate the extent of sentiment drags on IDR.

- Towards late May, Finance Ministry raised US$3.25bn by selling USD-denominated Islamic bonds with 5Y and 10Y tenures, in the country's largest sukuk issuance. Total order books had reached US$10.8bn. The favourable demand conditions could reflect longer-term confidence in the Indonesian economy.

- **In any case, extent of broad volatility spillovers from external risk events to IDR assets should be contained, given lower foreign holdings in Indo sovereign bonds, healthier current account balance, larger FX reserves vs. earlier Fed tapering episodes**. House view looks for current account to come in at a modest deficit of 1.0% of GDP in 2022 compared to pre-pandemic deficit of above 2.5% of GDP. Foreign reserves for Apr came in at US$135.7bn, lower versus US$138.1bn prior, but remained near historical highs.

- On Covid, 7-day average in Covid-19 cases was seen at around 200-300 in late May, versus interim highs near 56k on 20 Feb. Covid-related risks have fallen significantly. On net, **authorities are largely sticking to a Covid-endemic and reopening policy stance.** PCR or Antigen tests will no longer be required for completely vaccinated foreign and domestic travellers. The mask mandate for outdoor activities has also been lifted.

- **Growth and Inflation Outlook:** GDP growth was steady in 1Q as the relaxation of pandemic curbs drove a pickup in household consumption. GDP expanded by +5%y/y, the same pace as 4Q. 1Q real GDP came in +7.4% higher than pre-pandemic (1Q19) levels.

- On higher-frequency indicators, S&P Global PMI Mfg for Apr came in at 51.9, improving modestly from 51.3 in Mar. But retail sales growth (-0.5%) contracted in April from a year ago, possibly due to higher costs dampening consumer confidence.

- **Our economist team maintains 2022 GDP growth forecast at +5.1%** (vs. BI's forecast range of 4.5% to 5.3%). Domestic demand likely picked up in May during the Ramadan-Idul Fitri festivities, with tourism and transportation businesses seeing a spike in demand as the government lifted restrictions on the seasonal mudik (returning to hometown) for the first time in two years. According to prelim data from the Transportation Ministry, 85 million people travelled during the Idul Fitri holiday. People mobility to retail & recreation venues rose to nearly 30% above pre-pandemic levels in the first two weeks of May. On the other hand, export growth could moderate in the coming months alongside more cautious global growth outlook.

- Headline inflation jumped to a 5-year high in April on the back of the lifting of some price controls (cooking oil) and hike in unsubsidized fuel, as well as higher domestic demand during the Ramadan-Idul Fitri period. Headline CPI climbed to +3.5% in April (vs. +2.6% in Mar), while increasing +0.9% from the previous month (vs. +0.7% in Mar). Core inflation rose to a 2-year high of +2.6% (vs. +2.4% in Mar) and rose by +0.4% on a month-on-month basis (vs. +0.3% in Mar), signaling broadening price pressures. **Our economist team maintains inflation forecast at +3.7%, but risks are on the upside if the government raises prices of subsidized fuel.**

- **Monetary Policy Forecast:** BI maintained its policy rate at 3.5% on 24 May, despite a pickup in inflation and the tightening trend globally and regionally, including the recent rate hikes from BNM and BSP. House view had expected BI to hike by +25bps, but recent policy decisions to raise energy subsidies (to contain inflation) and lift the ban on palm oil exports (supporting the current account balance) may have provided additional space for BI to hold for longer. Deposit and lending facility rates were kept at 2.75% and 4.25% respectively. Governor Perry Warjiyo elaborated that the decision was consistent with the need to support growth amid a build-up of external pressures, while managing inflation and maintaining IDR stability. BI expects the Fed to hike by +250bps in 2022 to 2.75%, then by another +50bps in 2023 to 3.25%.

- While keeping its policy rate unchanged, BI unveiled faster hikes in the reserve requirement ratio (RRR), which will be raised from the current 5% to 6% in Jun (as planned) to 7.5% in Jul and 9% in Sep (vs. original plan to raise to 6.5% in Sep). Warjiyo stated that the additional increases in the ratio will absorb about IDR110tn (US$7.5bn) from the banking system, on top of the expected IDR200tn under the previous policy.

- **Our economist team maintains house view for +75bps hikes in 2022** as the economy has climbed above pre-pandemic levels, inflation edges up closer to the upper end of BI's target range (2-4%), and with the Fed expected to hike a total of +275bps this year. BI may deliver its first rate hike in the next meeting on 23 June, which would follow the Fed's rate announcement on 16 June (where we expect the Fed to hike by +50bps, bringing the cumulative hike to +125bps).

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

- In early Jan, it was estimated that Indonesia recorded a budget deficit of 4.65% of GDP for 2021, "far smaller" than initial estimates, according to FM Sri Mulyani. The government collected IDR2,003trn (US$140 billion) in revenues, while spending reached IDR2,787trn. Tax revenues were 19% higher than in 2020 and about 104% of the target. **Following better than-expected revenue collections in 2021, the 2022 fiscal deficit estimate was lowered to 4.3% of GDP.** Fiscal conditions also seem to be improving YTD, with realization of state revenues reaching IDR854trn as of Apr, representing 46% of the targeted revenues for 2022, and a 45.9% increase from a year ago.

- Tax reforms in 2022, including a VAT hike and a tax amnesty program, could generate additional revenue of around 0.7% to 1.5% of GDP, helping the government meet its lower fiscal deficit target. In an Apr public address, **President Jokowi called on public agencies to prepare a "detailed, correct and precise" spending plan to return the state budget to below 3% of the GDP in 2023**, in accordance with Law no. 2 of 2020 on State Financial Policy and Deficit Financial System

Stability, after allowing the deficit to exceed 3% in FY2020-FY2022 to meet pandemic financing needs. **Signs of fiscal discipline can help mitigate drags on IDR from a return of current account surplus into modest deficit territory**.

- Exports climbed to a historical high in April (+47.8% vs. 44.4% in Mar), buoyed by prices of key exports such as coal, palm oil, nickel, and steel. Trade surplus widened to US$7.6bn (vs. US$4.5bn in Mar), the highest on record. Given recent strength in trade balance, the current account deficit is expected to be relatively modest this year, at around 1% of GDP. **Outlook remains benign for the year, which is broadly IDR-supportive.**

- **Key domestic events and issues to watch:** May PMI Mfg (2 Jun); May CPI (2 Jun); May Foreign reserves (8 Jun); May Trade (15 Jun); May Local auto sales (15-21 Jun); BI Monetary policy decision (23 Jun).

- **Technical Outlook:** USDIDR last seen at 14,580. The pair headed higher above 14,700 in May but has eased since. Momentum on daily chart has turned mildly bearish (versus strongly bullish in mid-May) and RSI has slipped lower from overbought conditions earlier. Risks could be more balanced now, and pair could see some near-term consolidation alongside two-way swings in broader dollar strength. Resistance at 14,640 (23.6% fibo retracement from Apr low to May high), 14,740 (May high). Support at 14,490 (61.8% fibo), 14,430 (76.4% fibo).

PHP: New Economic Managers to Face Tests from Elevated External Uncertainties

Forecast	2Q 2022	3Q 2022	4Q 2022	1Q 2023
USDPHP	52.80 (--)	52.50 (--)	52.00 (--)	51.50 (--)

No Change to Previous Forecasts

- **Motivation for the FX View:** Between late March and early Apr, PHP benefited from a confluence of hawkish tilt in BSP signalling and down-moves in oil prices, but the pace of recovery then was likely a tad overdone. Subsequently, against a backdrop of elevated UST yields, recovery in oil prices (larger energy import burden), incremental policy uncertainty (change of leadership with Marcos winning May Philippines presidential elections), China partial lockdown concerns etc., the earlier bout of positivity has unwound and PHP is last seen near the softer end of YTD ranges. Still, we note signs of traction in domestic manufacturing recovery (PMI Mfg for May at robust 54.1, following 54.3 in Apr). Some tentative resilience for PHP may be emerging despite weakening global growth outlook, given the more domestic-oriented nature of the Philippines economy. Continued naming of familiar names for economic manager roles, as well as signalling from Marcos that he will continue Duterte's aggressive infrastructure programme, also look to be anchoring sentiments for now. On net, near-term depreciation risks for PHP could be contained, and sentiments could improve gradually in 2H. In the event that current bout of global risk aversion persists for longer though, PHP recovery could be delayed.

- **While oil is not the dominant factor for PHP in this complex risk environment, rise or decline in energy import bills could continue to influence PHP**. Brent has largely headed higher in May, alongside rising likelihood of continued supply disruptions in Europe, and is last seen >US$110/bbl. Notably, EU leaders just agreed to pursue a partial ban on Russian oil. This sixth round of sanctions on Russia would forbid the purchase of Russian crude and petroleum products delivered to EU members by sea (but include a temporary exemption for pipeline crude), and is expected to cover about 2/3 of oil imports from Russia. Still, extent of oil price gains could be constrained going forward given (i) mounting concerns over softening global aggregate demand as financial conditions tighten, (ii) signs of interest in Russian oil from parts of Asia, including China, India, (iii) planned ramp-ups in OPEC+ supplies over time (including possibility of OPEC suspending Russia from its oil production deal, which could provide room for other producers to raise supplies), and (iv) ongoing releases of strategic reserves over the next several months from US and allies. In this case, **conditional on oil gains potentially seeing some moderation in 2H, PHP sentiments could see modest support over time**.

- On Covid curbs, it was announced in late Feb that Metro Menila and 38 other areas will be downgraded to Alert level 1, starting 1 March. Over time, as Covid case counts in the country remained low (7-day average around 200 as of end-May), more areas have been placed under Alert level 1. Under Alert Level 1, intrazonal and interzonal travel will be allowed. All establishments, persons, or activities are permitted to operate, work, or be done at full on-site capacity, provided that health standards are observed. Philippines also began reopening in Feb to foreign visitors who have been vaccinated and test negative for the virus. As of late May, visitors who have received their booster sgots are now allowed to enter without having a negative PCR test. **Sustained easing in Covid drags on the domestic economic should lend support to PHP on net**.

- Overseas Filipino Workers Remittances (OFWR) growth picked up in Mar 2022 to +3.2%y/y (Feb 2022: +1.3%) after three months of slowdown. Our economist team projects 2022 OFWR growth forecast at +4.2% to US$32.75b (3M 2022: +2.4% to US$7.8b). OFWR outlook is a tug of war between the upsides from host economies're-openings and global macro downsides from Russia-Ukraine war, especially if the conflict drags Europe, plus risk of hard landings in US and China. Meanwhile, foreign reserves came in at US$106.8bn, seeing a mild decline versus US$107.3bn prior. **On net, resilient remittances flows and adequate reserves could still be supportive of PHP over the year**.

- While PHP saw some jitters heading into the presidential elections, confirmation of Marcos' landslide victory after a relatively peaceful elections and removal of election uncertainty saw some of those jitters ease. **Interim challenge for Marcos is in picking a credible economic team to build investor confidence in the new administration's policymaking abilities**, especially as he was initially perceived (in market surveys) as being less market-friendly versus rival Robredo. On this front, we note recent naming of familiar names for economic manager roles. Current BSP Governor Diokno, who also served as Budget Secretary from 2016 to 2019, will be the new Finance Secretary. Veteran economist Arsenio Balisacan will join Marcos's Cabinet as economic planning secretary. There is also signalling from Marcos that he will continue Duterte's aggressive infrastructure programme. Given these developments, sentiments look to be anchored somewhat.

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

- **Growth and Inflation Outlook:** Philippines' real GDP growth in 1Q 2022 accelerated +8.3%y/y (versus +7.8% prior), underpinned by stronger domestic demand—especially private consumption—amid easing of movement restrictions and improved labour market conditions. Nevertheless, with heightened external risks and BSP interest rate hikes cycle kicking off, **our economist team adjusts downward 2022 real GDP growth forecast to +6.5% from +7.0% previously**. Policymakers also noted the cloudy external outlook, calibrating GDP growth range this year to around 7-8%, versus 7-9% earlier.

- On higher frequency indicators, PMI Mfg for May came in at 54.1, following outturns of 54.3 prior, reflecting some traction in the domestic economic recovery. Unemployment rate for Mar came in at 5.8% versus 6.4% prior, lowest since the start of the pandemic. Labour force participation rate rose to 65.4% in Mar (Feb 2022: 63.8%), with total of 1.50m jobs created during the month, mainly in agriculture and services. Our economist team revises 2022 unemployment rate forecast to 6% from 6.3% prior (2021: 7.8%).

- Headline inflation rate accelerated to +4.9%y/y in Apr 2022 (Mar 2022: +4.0%; 4M2022: +3.7%), well above the upper end of BSP's target range of 2%-4%, mainly on higher food, utilities and transport costs. **Our economist team adjusts upward 2022 and 2023 headline inflation rate forecasts to +4.6% from +4.2% and +3.3% from +3.2%**, respectively (2021: +3.9%).

- **Monetary Policy Forecast:** BSP raised policy interest rate by +25bps to 2.25% at the third meeting of 2022 (19 May), as both growth and inflation surprised on the upsides. The Monetary Board now sees balance of risks to the inflation outlook leaning toward the upside for both 2022 and 2023, with upside pressures emanating from the potential impact of higher oil prices, including on transport fares, as well as the continued shortage in domestic pork and fish supply. In addition, the Board also observed the emergence of second-round effects, including the higher-than-expected adjustment in minimum wages in some regions. Accordingly, BSP raised its inflation forecasts for 2022 and 2023 to +4.6% (from +4.3%) and +3.9% (from +3.6%) respectively. On balance, with rate normalization underway, our economist team maintains projection of total +75bps rate hike this year, to 2.75%.

- **There may be some risks of a Jun rate hike**. BSP Governor Diokno had commented that the monetary board is likely to pursue a gradual tightening of the monetary policy stance in Jun, as had incoming BSP Governor Felipe Medalla, signalling policy continuity. **Continuation of the rate hike cycle (avoiding wider divergence in Fed-BSP policy paths) could help constrain USDPHP upswings in the interim**.

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

- **There are early signs of increasing fiscal stresses.** Public debt climbed to 63.5% of GDP as of end-Mar, 3.1%-pts higher on year-ago basis. Average monthly budget deficit from Jan to Apr 2022 is around -PHP78bn, vs. the pre-pandemic monthly average of -PHP55bn in 2019, reflective of the fiscal challenges associated with the pandemic. Finance Secretary Carlos Dominguez recently said that the Philippines must grow by > 6% annually in the next five years so it can pay down debt incurred due to the pandemic. Both consensus and house view looks for growth pace at >6% for both 2022 and 2023.

- Exports growth moderated in Mar, coming in at 5.9%y/y (vs. 15.8% prior), while imports continued to see double-digit growth (27.7% vs. 28.6% prior). On net, trade deficit is wider at -US$5,004mn versus expected -US$4,433mn and -US$4,172mn prior. For the full year, **house view sees current account potentially coming in at deficit of 2.5% of GDP, versus 0.1% deficit pre-Covid average over 2015-19**. This could be a drag factor on PHP in the interim.

- **Key domestic events and issues to watch:** May PMI Mfg (1 Jun); May CPI (7 Jun); Apr trade (9 Jun); Apr Unemployment rate (10 Jun); May Foreign reserves (10-15 Jun); Apr Overseas Remittances (14-17 Jun); May BoP Overall (18-23 Jun); May Budget balance (22 Jun); BSP Policy decision (23 Jun).

- **Technical Outlook:** USDPHP last seen at 52.49, remaining in tight trading ranges for most of May. Momentum and RSI on daily chart are not showing a clear bias, suggesting that pair could see some consolidation near-term. Immediate resistance at 52.50 (recent high), before next at 52.85 (76.4% fibo retracement from 2018 high to 2021 low). But if upswings continue to be resisted, bearish moves could emerge towards support at 52.20 (50-DMA), 51.80 (100-DMA).

THB: Greenshoots in Tourism, But Recovery to Take Time

Forecast	2Q 2022	3Q 2022	4Q 2022	1Q 2023
USDTHB	34.60 (--)	34.30 (--)	33.90 (--)	33.40 (--)

No Change to Previous Forecasts

- **Motivation for the FX View:** USDTHB pair showed signs of easing lower in late May, but remains nearer the stronger end of YTD ranges, as risks to global growth from Russian sanctions, China partial lockdowns, removal of monetary stimulus by major central banks etc., remain intact. Still, earlier stretched view of how hawkish the Fed can be has unwound a tad given a slight shift in market chatter towards growth concerns, and we note modest positive adjustments in the tourism outlook in Thailand (despite maintainance of Covid zero stance in China). There are also signs of recovery in portfolio inflows in the second half of May. Such developments could help to reduce the likelihood of a more significant USDTHB rally from here, even as USDTHB pair could remain in buoyant trading ranges for a while yet. Some caution is likely warranted, given that energy import bills could remain elevated (THB drag) with oil prices supported above US$100/bbl, especially as EU pursues new sanctions on Russia which would ban sea-delivered imports of Russian oil.

- A key market mover in March-Apr was an increasingly hawkish Fed. But in recent weeks, markets appeared to have pared back hawkish expectations on Fed, after Powell clarified in May FoMC that 75bps moves were not something being actively considered. Chatters of US recession risks could lead Fed to be more careful in calibrating rate hike pace later in the year, in attempt to engineer soft growth landing. Reflecting these sentiment shifts, **OIS-implied market expectations for year-end Fed policy rate reached 2.88% in early May, but has moderated to around 2.75% at last seen**. As such, likelihood of another bout of strong dollar rally could be reduced, **which could help cap extent of USDTHB upswings**.

- Historically, the impact of Fed QT on AxJ FX has not been conclusive, and we will closely monitor AxJ sentiment shifts when QT begins in Jun. For THB, trends in portfolio flows might be an indicator to watch. While net outflows were seen for the first half of May, **portfolio flows show signs of recovering from drags since mid-May**. As of 31 May, bond and equity assets have recorded net +US$876mn and +US$592mn MTD in inflows, respectively.

- THB continues to be impacted by oil price swings, given its role as an net oil importer. Brent has largely headed higher in May, alongside rising likelihood of continued supply disruptions in Europe, and is last seen >US$110/bbl. Notably, EU leaders just agreed to pursue a partial ban on Russian oil. This sixth round of sanctions on Russia would forbid the purchase of Russian crude and petroleum products delivered to EU members by sea (but include a temporary exemption for pipeline crude), and is expected to cover about 2/3 of oil imports from Russia. **Supported energy prices could be a drag on THB near-term.** Still, extent of oil price gains could be constrained going forward given (i) mounting concerns over softening global aggregate demand as financial conditions tighten, (ii) signs of interest in Russian oil from parts of Asia, including China, India, (iii) planned ramp-ups in OPEC+ supplies over time (including possibility of OPEC suspending Russia from its oil production deal, which could provide room for other producers to raise supplies), and (iv) ongoing releases of strategic reserves over the next several months from US and allies.

- Domestic Covid cases have been on an upswing for most of Feb-Mar, but **has largely reverted to a downtrend from Apr**. 7-day average in new daily cases is around 4-5k in late-May, versus peak of near-30k in end March. Earlier, authorities released a roadmap for transitioning from pandemic status to endemic, potentially by July.

- **We also note a modest improvement in sentiments tied to the tourism outlook**, post recent scrapping of Covid testing and quarantine requirements. Nightlife entertainment venues in 31 provinces can be reopened and serve alcohol until midnight, from 1 June. Foreign tourist arrivals topped 1.1mn through mid-May, but the Tourism Authority of Thailand now expects more than a million visitors each month from June. We note though, that it will take significantly more time for a more discernible recovery in tourism activity, given that pre-Covid levels were closer to 40mn, with tourism sector accounting for about 12% of GDP. The absence of China tourists (28% of total visitor arrivals in 2019) will be a significant stumbling block to recovery efforts.

- **Growth and Inflation Outlook**: 1Q GDP growth picked up slightly due to the recovery in private consumption with the reopening and return of tourists. GDP rose by +2.2% from a year ago (vs. +1.8% in 4Q), above consensus (+1.7%) but slightly below our economist team's estimate (+2.4%). On a q/q SA basis, GDP expanded by +1.1% (vs. +1.8% in 4Q). For now, Thailand remains the laggard among ASEAN-6 countries with the softest GDP recovery in 1Q, as compared to +5% in Indonesia, Malaysia, and Vietnam, and +8.3% in the Philippines. 1Q GDP remained around 2.4% below pre-pandemic (1Q19) levels, as services exports (tourism) are around 64% below pre-pandemic levels.

- PMI Mfg came in at 51.9 for May, on par with prior and still in expansionary territory. But the NESDC downgraded its GDP growth forecast range to 2.5% to 3.5% (from 3.5% to 4.5%), accounting for the impact of the Russia-Ukraine war and China slowdown. **Our economist team maintains 2022 GDP growth forecast at +3.2%**. External headwinds including the prolonged Russia-Ukraine war, China's lockdowns and global monetary tightening will likely dampen growth in 2Q and the second half of the year. Private consumption will be weighed down by rising living costs.

- Headline CPI softened to a 3-month low of +4.6% in May, mainly due to the higher base for utilities costs last year as the government's relief measures for electricity and water bills (for Feb/Mar 2021) were discontinued in May. The soft print will likely be a one-off. **Our economist team maintains inflation forecast at +4.8%**, driven by elevated energy (with diesel and electricity tariffs rising in May) and food prices.

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

- The BoT board chairman recently made a public remark that Thailand's policy rate will have to rise, but the timing will depend on the monetary policy committee's view with the economy growing below its potential and the recovery facing uncertainty. Our economist team expects the BoT to deliver its first +25bps rate hike in 3Q, either in the Aug or Sep meeting, as core inflation rises due to larger pass-through from higher commodity prices. **Amid continued wide divergence in Fed-BoT policy stances, USDTHB could remain in elevated ranges for now**. But we note that officials also said earlier that they may consider intervening to support the THB if necessary, so larger routs in THB look less likely.

- **Latest Fiscal and External Balance Outlook**: In recent months, fiscal efforts largely revolve around managing cost-of-living pressures, involving cash assistance, discounts or excise-tax cuts for products such as retail diesel, cooking gas purchases, electricity. Contributions under the social security system were also lowered (from 5% to 1%) for both employers and workers.

- Meanwhile, the first reading of the Budget 2023 (which begins on 1 Oct 2022) bill started in end-May, with the government proposing higher spending at THB3.18bn (US$93.2bn), a +2.7% increase from FY2022, to accelerate the economic recovery. Revenue is budgeted at THB2.49bn (+3.8% from FY2022), resulting in a fiscal deficit of THB695bn (or 3.9% of GDP). Budget 2023 assumes GDP growth coming in at 3.2%-4.2% in 2023 (vs. recently lower 2.5%-3.5% estimate for 2022).

- On debt dynamics, we note that a government panel approved raising public debt-to-GDP ratio to 70% from 60% in Sep 2021, in order to raise state borrowing to finance its stimulus and to ensure debt repayment ability. Authorities planned to significantly increase the share of longer-dated sovereign bonds (vs. short-term securities) for its financing needs, with the former expected to make up around 48%-56% of the government's THB2.3trn (US$68.4bn) borrowing in the FY2022 compared with 31% in the prior year.

- Recent comments from Finance Minister Arkhom suggests that authorities will focus on maintaining fiscal discipline after the large bout of borrowing earlier. The government's net revenue collection in the first seven months of FY2022 stood at THB1.27trn, exceeding the target by 3.7%. House view is for fiscal deficit to narrow towards 4.3% of GDP in 2022 from 4.8% prior. **While efforts to maintain fiscal**

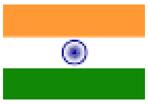
discipline are largely positive for THB sentiments over the long-run, there could be near-term concerns on potentially more constrained support to growth from fiscal policy.

- Export growth eased to a 3-month low in April, weighed down by supply chain disruptions and the slowdown in China and the EU. Exports to China (-7.2%) and EU (-0.6%) declined for the first time since Nov 2020 and Jan 2021 respectively. Imports accelerated on the back of the rebound in raw materials and intermediate products, and surge in fuel lubricants. Total exports eased to +9.9% (vs. +19.5% in Mar), while imports rose by +21.5% (vs. +18% in Mar), resulting in a trade deficit of US$1.9bn (vs. surplus of $1.5bn in Mar).

- Concomitantly, the current account balance swung back to a deficit of US$3.4bn, the largest monthly deficit since April 2013. This was mainly due to both the shrinking goods trade surplus to US$1.1bn (vs. US$5.2bn in Mar)—mainly from lower exports of gold—and a larger deficit in the net services, income & transfers balance (US$4.4bn vs. US$3.9bn in Mar). **Near-term underperformance on the trade/current account front could lead to some caution in THB sentiments.** Our economist team maintains current account deficit forecast at 1% of GDP in 2022 (1Q deficit came in at 1.2% of GDP). The deficit in the services account should narrow in the coming quarters as visitor arrivals (293k in Apr vs. 211k in Mar) improve.

- **Key domestic events and issues to watch:** May PMI Mfg (1 Jun), May Business sentiment (1 Jun); May CPI (6 Jun); BoT Policy decision (8 Jun); May Consumer confidence (9-10 Jun); May Customs trade (22 Jun); May Manufacturing Production (24-30 Jun); May BoP Current account (30 Jun).

- **Technical Outlook**: USDTHB last seen near 34.33 (on par with levels in end-Apr), seeing mostly two-way swings in May. Bearish momentum on daily chart shows tentative signs of moderating, while RSI is showing a mild uptick. The earlier downswing in the pair could pause and risks could be skewed modestly to the upside in the interim. Resistance at 34.80 (recent high), 35.00. Support at 34.10 (23.6% fibo retracement from Feb low to May high), 33.75 (38.2% fibo).



INR: Crude Drags

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

No Change to Previous Forecasts

- **Motivation for the FX View:** We keep the USDINR forecast **even as stronger-than-expected rebound in crude oil prices has kept the pair elevated. We continue to remain cautiously optimistic on the INR for some recovery into the end of the year.** In the past month, USDINR peaked at around the same time as USDCNY but unlike the latter, rising crude oil prices kept the pair from making sharper pullbacks (albeit likely mitigated by cheaper oil from Russia). The lack of recovery in the INR is a reflection of inflation concerns at home as well as more recent protectionistic measures that could weigh on its trade balance. RBI's off-cycle rate hike on 4 May provided only brief support for the INR then and FX intervention by the RBI likely capped USDINR gains at around the 78-figure. The abrupt start of the rate hike cycle spurred $5.04bn of equity outflow between 1-27 May while India's bond outflow recorded was at a more benign $800mn over the same period, possibly supported by upcoming tweaks in investment regulation for by RBI to boost banks' demand for government securities. Also mitigating factors on INR weakness could be FX intervention by RBI, signs of recovery in the manufacturing sector as well as government's additional excise duty cuts announced in May (INR 1trn) that could cool inflation, support demand.

- In addition, there are rising evidence of strong refined petroleum production that could boost its external balance and mitigate impact on the INR. Taken together, the ramping up of fiscal spending, RBI rate hikes could continue to bring the USDINR lower into the rest of the year.

- **Growth and Inflation Outlook:** Industrial production rose faster than expected at 1.9%y/y for Mar vs. 1.5% in Feb, buoyed by faster growth in electricity production and manufacturing production. **Apr PMIs suggest that recovery could extend into 2Q and companies have started to transfer their cost burden to customers.** Base on the survey, strong demand as well as rising input costs have spurred firms increase their inventory level with the rate of stock accumulation fastest in four months.

- CPI picked up pace to 7.79%y/y for Apr from previous 6.95%. Breakdown reveals that price pressure is picking up broadly with food inflation, clothing & footwear , fuel and light as well as housing all recording faster price increases. This eye - popping upside surprise may nudge RBI to lift repo rate by 35bps to take it to a more conventional level of 4.75%. However, RBI is clearly not alone in taming inflation. WPI has picked up pace to 15.1%y/y in Apr from previous 14.6%, beating median estimates of 14.9%. The increase is broadbased with components such as fuel, power, lighting; food prices and manufactured products all posting higher rate of growths for Apr compared to the month prior.

- The government has provided supply side measures to ease inflation pressure including the export ban of wheat (shipment subject to specific requests) as well as curbs on sugar exports (up to 10mn ton allowed). The export ban of wheat was in particular, a disappointment as India Modi had claimed that the country was able to fill the gap created by the Ukraine war but made a U-turn on 20 May as the heat wave in India affected harvest. Restrictions on rice export is speculated to be next but an unnamed government official was cited saying that rice stocks are sufficient and should continue to be available for exports. **Broadly, such supply-side measures could help to cool inflation, not least of all the more recently announced excise duty cuts for fuel and subsidy for fertilizers to keep slow price increase**

and ensure that the nascent recovery in spending momentum does not get derailed by rising inflation.

- **Monetary Policy Forecast:** RBI raised the reverse repo by 40bps to 4.40% and took the cash reserve ratio by 50bps to 4.5%. This was an unscheduled announcement and underscores a scramble to get ahead of the curve amid the inflation build-up. Das said that the RBI will focus on "calibrate withdrawal of pandemic steps" and sought to temper inflation expectations. The governor also expressed concerns about food price pressure given the rise in edible oil pressure, wheat shortage and the elevated pump prices. Even with the start of a tightening cycle, the central bank keeps its monetary policy stance as accommodative and assure adequate liquidity in the system.

- **The relentless rise in CPI and WPI could mean that RBI is likely required to act again on 8 Jun with a 35bps hike that could take the repo rate to 4.75%. Signs of stronger domestic demand alongside infrastructure investment plans by the government and somewhat resilient exports growth could also mean that the economy is able further tightening. That said, RBI's choice to act more aggressively now is meant to bring inflation lower and coordination with supply side measures from the government could reduce the need for RBI to do more in the future. Markets implied around 200bps of rate hike needed by the end of the year as of 31 May.**

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

- **Latest Fiscal and External Balance Outlook:** Budget 2022-23 was an expansionary one. **Fiscal deficit was projected to ease to 6.4% of GDP for FY2022-23 from 6.9% in the year prior but this could be increasingly challenging given the amount of fiscal spending the government has planned to help in the coping of inflation pressures.** Finance Minister Nirmala Sitharaman had proposed increasing capital spending by 35% to INR7.5trn for 2022- 2023. In addition, there is a push for infrastructure-led growth with spending focused on roads, rail, logistics and energy, bringing to fruition the National Master Plan for economic transformation, multimodal connectivity and logistics efficiency that was approved by the Union Cabinet last Oct. Effective capital expenditure is estimated to be at 4.1% of GDP.

- Trade deficit for Apr widened to $20.1bn vs. previous $18.5bn. Both exports and imports growth picked up pace to >30%y/y in the month. The deficit stands to deteriorate given recent enactment of export bans on wheat and sugar. Recovery in domestic demand and rising international oil prices could continue to increase the oil import bill, adding pressure to external balances.

- **Key domestic events and issues to watch:**1Q GDP (31 May); May Mfg (1 Jun), Services PMI (3 Jun); RBI policy decision (8 Jun); Apr industrial production (10 Jun); May WPI (14 Jun); May Fiscal deficit, 1Q current account balance (30 Jun).

- **Technical Analysis:** 1M USDINR NDF remained rather elevated around 77.80 by the end of May. The recent peak formed a bearish divergence with the MACD forest on the daily chart which can precede a reversal. Support at 77.60 before the next at 76.95.

VND: Bears Looking a Tad Stretched

Forecast	2Q 2022	3Q 2022	4Q 2022	1Q 2023
USDVND	**23100** (--)	**23000** (--)	**22900** (--)	**22900** (--)

No Change to Previous Forecasts

- **Motivation for the FX View:** We maintain our forecast trajectory but we acknowledge some potential for USDVND to overshoot. We look for further two-way actions of the USDVND but risks are less skewed to the upside given the recent run-up. Further CNY gains as well as USD decline could also lend some support to the VND. Despite the significant sell-off in the local equity markets, net equity outflow seems to have ebbed towards the end of May and could turn into inflow supporting the VND into June.

- The government continues to keep growth target at 6-6.5% this year but Deputy PM Le Van Thinh warned that meeting this target is challenging. Large infrastructure projects (highways to link southern provinces, eastern part of North-South Expressway) are in the works. Focus is on growth so any monetary action to raise policy rates would have to be deferred to 4Q. DPM pledged to quicken disbursements especially for infrastructure. He had recently also signed a decree to allow a delay of land rental and some tax payments for businesses and individuals by 3-6 months. Payments of VAT and personal income tax of household businesses and individuals will be delayed until 30 Dec. These could potentially boost consumption, investment as well as prevent a rapid accumulation of bad debts in the banking system.

- USDVND has crept above the 23200-level. Room for USD upside could be limited (given an incredible 180bps rate hikes priced for the Fed within the year). VND weakness seems to have played catch-up with regional currencies in May. Aggressive upsides for the USDVND could be limited from here should greenback soften broadly and USDCNY stabilize. In addition, we may be able to count on leaning against the wind activities to pick up pace as inflation environment turns less benign.

- **Growth and Inflation Outlook:** Production picked up pace to 10.4%y/y from Apr's 11.1% (revised upwards), buoyed the most by stronger output of wearing apparel (+26.8%y/y) and pharmaceutical (+38.3%) . Of note, production of computers, electronic and optical products fell

5% from the month prior because of the supply chain disruptions caused by China lockdown. Looking forward, China's reopening could potentially give a modest boost to Vietnam's production.

- Retail sales roared 22.6%y/y vs. the previous 12.1%. Iinternational visitor arrivals jumped 70.6% vs. Apr due to the SEA games and as international borders were eased further.

- Our economist maintain our full year growth forecast at 5.8% for 2022, taking into account softening global growth to affect Vietnam's exports and smaller net exports could offset the reopening boost to service sectors. 2Q GDP is expected to come in around 4%y/y vs. 5% in 1Q.

- The return of tourists as well as elevated commodity prices can continue to culminate into significant Inflation risks. That said, our economist noted Vietnam's status as a significant agricultural producer and made a slight downward revision to the CPI forecast for 2022 to 3.7% from previous 4.0% as abundant domestic supply of crops and livestock alongside supply-side measures from the government could offset price pressure stemming from international commodity prices.

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

- **Monetary Policy Forecast:** Our economist maintains view for a hike of 50bps for the refinancing rate (to 4.5%) and the discount rate (3%) as inflation pressure broadens. Bank lending rose 7.18%ytd (as of Apr). SBV is likely to continue to prioritize growth and may only seek to tighten by the end of the year.

- **Perhaps of more concern is the rise of bad debts on bank balance sheet that pose financial stability risk.** Potential bad debts have jumped 30% in the first quarter while bad debt balance rose 11%. The extension of resolution 42/2017 could help given its provision for banks to seize collateral from debtors. Other fiscal supports (such as the delay tax, rental repayments) could also prevent a rapid accumulation of bad debts in the banking system.

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

FX Forecasts

	End Q2-22	End Q3-22	End Q4-22	End Q1-23
USD/JPY	130.00	130.00	125.00	123.00
EUR/USD	1.0450	1.0500	1.0800	1.0800
GBP/USD	1.2400	1.2200	1.2500	1.2800
AUD/USD	0.7350	0.7450	0.7450	0.7500
NZD/USD	0.6400	0.6600	0.6700	0.6800
USD/CAD	1.2600	1.2500	1.2400	1.2400
USD/SGD	1.3650	1.3600	1.3550	1.3500
USD/MYR	4.4000	4.3500	4.3000	4.3000
USD/IDR	14600	14400	14300	14200
USD/THB	34.60	34.30	33.90	33.40
USD/PHP	52.80	52.50	52.00	51.50
USD/CNY	6.85	6.80	6.74	6.70
USD/CNH	6.86	6.81	6.75	6.70
USD/HKD	7.80	7.80	7.80	7.80
USD/TWD	29.62	30.00	29.80	29.60
USD/KRW	1260	1240	1220	1210
USD/INR	75.50	75.00	74.50	74.50
USD/VND	23100	23000	22900	22900
DXY Index	103.85	103.69	101.03	100.53
SGD Crosses	End Q2-22	End Q3-22	End Q4-22	End Q1-23
SGD/MYR	3.22	3.20	3.17	3.19
JPY/SGD	1.05	1.05	1.08	1.10
EUR/SGD	1.43	1.43	1.46	1.46
GBP/SGD	1.69	1.66	1.69	1.73
AUD/SGD	1.00	1.01	1.01	1.01
NZD/SGD	0.87	0.90	0.91	0.92
CAD/SGD	1.08	1.09	1.09	1.09
SGD/IDR	10696	10588	10554	10519
SGD/THB	25.35	25.22	25.02	24.74
SGD/PHP	38.68	38.60	38.38	38.15
SGD/CNY	5.02	5.00	4.97	4.96
SGD/HKD	5.71	5.74	5.76	5.78
SGD/TWD	21.70	22.06	21.99	21.93
SGD/KRW	923	912	900	896
SGD/INR	55.31	55.15	54.98	55.19
SGD/VND	16923	16912	16900	16963
	End Q2-22	End Q3-22	End Q4-22	End Q1-23
JPY/MYR	3.38	3.35	3.44	3.50
EUR/MYR	4.60	4.57	4.64	4.64
GBP/MYR	5.46	5.31	5.38	5.50
AUD/MYR	3.23	3.24	3.20	3.23
NZD/MYR	2.82	2.87	2.88	2.92
CAD/MYR	3.49	3.48	3.47	3.47
MYR/IDR	3318	3310	3326	3302
MYR/THB	7.86	7.89	7.88	7.77
MYR/PHP	12.00	12.07	12.09	11.98
MYR/CNY	1.56	1.56	1.57	1.56
MYR/HKD	1.77	1.79	1.81	1.81
MYR/TWD	6.73	6.90	6.93	6.88
MYR/KRW	286	285	284	281
MYR/INR	17.16	17.24	17.33	17.33
MYR/VND	5250	5287	5326	5326

Source: Maybank FX Research and Strategy as of 1 Jun 2022.
*These forecasts are meant to be indicative of FX trends and not meant to be point forecasts.

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