Maybank

Macro | FX Research & Strategy

Global

FX Monthly

2022, Issue 6: Global Recession Risk Rises

What Has Changed This Month?

- We calibrated JPY, AUD, NZD as well as most AxJ FX lower versus USD, as persistent inflation pressures forced Fed to speed up the pace of near-term rate hikes (supporting the dollar), and commodity-linked and pro-cyclical FX saw increasing drags on rising global recession risks.

Our Strategies

- We enter July on a more cautious mood in markets, as major central banks step on the policy pedal to combat inflation. Notably, Powell, Lagarde and Bailey said that inflation maybe longer-lasting and that monetary policy may pivot more aggressively to combat inflation before it gets de-anchored. Lagarde is not expecting a return to environment of low inflation while Powell agreed that the world of disinflationary forces we had seen in the last 10 years "seems to be gone now at least for the time being". Concomitantly, Fed's +75bps hike in June (versus earlier communicated +50bps) has been supportive of the dollar recently. Looking on, USD could be mixed with gains likely pronounced vs. procyclical FX but softness vs. those DM FX, such as EUR and CHF that could see their respective policy normalisation pick up pace.
- Global growth concerns are rising. Recent US activity have been mixed but demand shows increasing signs of softening. Regional PMIs for June appear lukewarm. Indonesia, Philippines, S.Korea slipped (though remained in expansionary territories); Taiwan slipped into contractionary territory while Japan Tankan mfg outlook for 2Q fell. Some haven demand for dollar, and perhaps to a more modest extent, the JPY, looks to be in play. But we note that rising growth concerns have also led to recent decline in treasury yields, as markets see increasing bets for Fed to tilt dovish next year. The decline in UST yields could help to mitigate the drags to pro-cyclical AxJ FX from global growth risks, even as near-term caution is warranted.
- China PMIs rose in June. Such nascent signs of China's economic recovery have been underpinning the yuan which has risen 2.2% against its trading partners since its trough in May. That said, we expect recovery to remain slow and uneven given Xi Jinping's "unwavering" zero-Covid strategy and sporadic credit events (and close shaves) amongst property developers (hurt by a vicious spiral of low confidence, low demand and weak financing access). With Fed arguably past peak hawkishness, PBoC may resume easing cycle as soon as Jul. Rate cuts are likely measured. Yuan depreciation pressure could thus be manageable, offset by equity-related inflow (barring severe Covid outbreaks).

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Top 3 Currency Plays for Jul

Sell GBP, DXY on Rallies vs. Long EUR, CHF
Long CAD, AUD
Long CNH vs. Short KRW

Key Events for the Month Ahead

Date	Event
Mid-Jul	Biden's Visit to Saudi Arabia
Ongoing	US-Iran talks

G7 Global Overview

USD: Balancing Inflation and Growth Risks

Forecast	3Q 2022	4Q 2022	1Q 2023	2Q 2023
USD Index	**104.36** (103.69)	**101.71** (101.03)	**100.87** (100.53)	**99.30** (--)

Previous Forecasts in Parentheses

- **Motivation:** The USD DXY strengthened around 3% in June (relative to around 2% in May), continuing its monthly ups and downs, to end at around 104.91 (as at 30 June). The euro, GBP and JPY weakness vs USD were stark amid concerns about sharper Fed tightening and eventual 75bps moves.
- 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 (the CNY risk however has dissipated slightly). 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 30 June, OIS-implied futures still pricing in 175bps rate increases for the rest of the year in line with the dot plot provided at the Jun FOMC. Powell mentioned that the 75bps hike in Jun is unusually large and does not expect moves of this size to be common.
- 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 +5bps 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 still 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. We revise our forecasts for JPY, and some regional currencies in 3Q to reflect the recent domestic and market developments.
- However, eventually, USD may near its peak or soften earlier than expected, closer to early 4Q 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) possibility of 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 -1.6% (consensus: -1.5%) in the third estimate of Q1, with large downward revisions to services consumption growth which was partially offset by a faster pace of inventory investment. YoY core PCE inflation was revised up to +5.22% (consensus 5.1%). May core CPI rose 0.63% MoM, above consensus and the fastest pace since June, in part due to a sharp rise in airfares but it was broadly strong as well, including strength in autos and rent inflation.
- Nonfarm payrolls rose 390k in May, above consensus of 318k but saw a slowdown from the 516k average of the previous quarter. The unemployment rate was unchanged at 3.6% against expectations for a drop, the underemployment rate increased for the second month, and household employment rose by just 45k on a nonfarm-payroll-adjusted basis. Job gains were fairly broad-based in the month, with increases in 69.3% of industries, slightly below the recent trend - strong in professional services (+75k), education and health (+74k), government (+57k), and construction (+36k). Leisure and hospitality jobs also rose a solid 84k. On the negative side, manufacturing job growth slowed to 18k (vs. +56k 3ma) and retail payrolls fell 61k, both consistent with the continued shift in the economy from goods back to services. The household survey was somewhat softer, as household employment increased by 321k but only by 45k on a nonfarm-payroll-adjusted basis.
- **Monetary Policy Forecast:** The FOMC raised the funds rate target range by 75bps to 1.5%-1.75%, above consensus expectations and the largest rate hike since 1994. There was one dissenting vote - Kansas City Fed President Esther George preferring a 50bps hike. The median dot in the Summary of Economic Projections (SEP) now shows a funds rate midpoint of 3.375% at end-2022, up from the 1.875% rate projected at the Mar meeting - which may correspond to a 75bp hike at the July meeting, 50bp at Sep, 25bp at Nov, and 25bp at Dec meetings. Sixteen out of eighteen participants projected a funds rate above the median

longer-run dot in 2024, with the longer-run median edging back up to 2.5% (vs. 2.375% in March).

- Fed's latest "dot plot" signals another +175bps FFR hikes in the remaining four FOMC meetings this year to 3.375% in 2022 vs 1.625% mid-point of current target FFR range, with current hikes cycle ending in early-2023 at 3.75%.

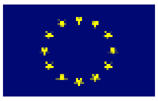
- Latest Fed's dot plot signals another +175bps FFR hikes in the remaining four FOMC meetings this year to 3.375% in 2022 vs 1.625% mid-point of current target FFR range that was raised by 75bps to 1.50%-1.75% at the 14-15 June 2022 FOMC meet with current hikes cycle ending in early-2023 at 3.75%. Fed's policymakers expect FFR to be at 3.375% in 2024.

- For next FOMC meeting on 26-27 July 2022, Fed Chairman Powell indicates 50bps to 75bp hike. Fed raised its 2022 inflation rate forecasts to 5.2% vs 4.3% in Mar 2022 but trimmed inflation rate forecasts for 2023 and 2024 to 2.6% and 2.2% respectively from the Mar 2022s's projections of 2.7% and 2.3%. Fed bumped up its unemployment rate forecasts to 3.7%, 3.9% and 4.1% for 2022, 20223 and 2024 respectively from 3.5%-3.6% range previously. Fed's 2022-2024 real GDP growth forecasts are trimmed to sub-2% i.e. 1.7% in 2022-2023 and 1.9% in 2024 vs 2.8% in 2022, 2.2% in 2023 and 2.0% in 2024 previously.

- **Latest Fiscal and External Balance Outlook:** The trade deficit decreased by $20.6bn to $87.1bn in Apr from a downwardly-revised $107.7bn in March. The total volume of trade decreased, with a large decrease in imports (-$14.5bn) partially offset by an increase in exports (+$4.8bn).

- **Key domestic events and issues to watch in July**: ISM Manuf (1 Jul); Factory orders, durable goods orders (5 & 27 Jul); NFP (8 Jul); Trade balance (7 Jul); CPI (13 Jul); FOMC (28 Jul); Current account balance (23 June); FOMC Meeting Minutes (7 Jul); PCE deflator (29 Jul); 2Q GDP (28 Jul).

- **Technical Outlook:** DXY rebounded sharply in Jun, reversing its weakness in May. Last seen at 104.97 levels. On the daily chart, momentum and RSI indicators are not showing a clear bias at this point. Bullish momentum on monthly, weekly chart intact though RSI is in overbought conditions. Overall the bullish bias for DXY remains intact though RSI shows how technically stretched it may be. Potential snapback may risk a sharp pullback. Hence on a risk-reward perspective, bias to lean against strength. Resistance at 105.20/30 levels, 105.78 (Jun high) and 109.14 (76.4% fibo retracement of 2001 high to 2008 low). Support at 104.1 (21 DMA), 103.10/20 (23.6% fibo retracement of 2022 low to high, 50DMA) and 101 levels (100 DMA).



EUR: Start of Journey to End of NIRP Regime

Forecast	3Q 2022	4Q 2022	1Q 2023	2Q 2023
EURUSD	1.0500 (--)	1.0800 (--)	1.0800 (--)	1.1000 (--)

No Change to Previous Forecasts

- **Motivation for the FX View: We look for EUR gains to extend as ECB policy normalisation gets underway while USD strength and hawkish Fed may have found an interim peak.** A 25bps rate hike is now ECB's base case with prospect for larger pace of rate hike in Sep if inflation outlook deteriorates. Further narrowing in 2y EU-UST yield differentials (currently at -216bps) can add to EUR upside. While there may still be lingering doubts if ECB will exit negative interest rate policy (NIRP) regime, we opined that one should not underestimate ECB's resolve to tighten or even front-load rate hikes to arrest inflation. IMF official Tobias also warned that investors might be underestimating ECB's need to do more to fight high inflation. Tobias argued that on top of unexpected shocks due to Russia-Ukraine conflict and worsening supply bottlenecks, strong monetary and fiscal support in recent years might have contributed to protracted period of high inflation. Furthermore the introduction of anti-fragmentation tool to compress yield spreads, alongside flexibility in PEPP reinvestments will allow ECB to tighten policy. ECB's guidance on tightening path is clear with inflation the critical factor for any increase in pace of hike. Other risk that may derail ECB normalisation path is downside surprises to growth. We look for EUR to trade 1.04 – 1.08 range in coming weeks.

- **ECB Policy Normalisation Plan Cast In Stone.** At the ECB forum (28 Jun), Lagarde again reaffirms intention to raise rates by 25bps in Jul. She also renewed the stance that policymakers are ready to step up action to tackle record inflation if needed as "there are clearly conditions in which gradualism would not be appropriate". She gave some examples of how ECB would need to withdraw accommodation more promptly: (1) higher inflation threatening to de-anchor inflation expectations or (2) signs of a more permanent losss of economic potential that limits resource availability. She also assured that orderly transmission of policy stance through the Euro-area is preserved as policymakers will address every obstacle that may pose a threat to price-stability mandate. This reinforces ECB's work on anti-fragmentation tool. Separately, ECB's Kazaks floated the idea that "front-loading" hikes including a possible larger move (such as 50bps) in Jul,could be reasonable. As of 28 Jun, markets are pricing in slightly more than 25bps rate increase at July meeting and a further 50bps rate hike at the Sep meeting.

- **A Credible Anti-Fragmentation Tool Can Compliment ECB's Policy Normalisation Plan.** Risk of fragmentation in European government bond (EGBs) increases as ECB withdraws monetary support from the system and start to signal policy normalisation. Hence to deal with higher bond yields or widening spreads in periphery EU, the ECB is working on a tool to limit bond spreads and will kick in if borrowing costs for weaker nations rise too far or too fast beyond certain threshold. Lagarde did not mention whether the threshold will be made public but Bank of Italy Governor Visco opined that Italy-Germany bond spreads should only be 150bps. Currently the spread is around +200bps (10y). In a way, it is a form of QE but for the peripheral EU nations. Work is still ongoing on devising the new tool and details are to be firmed up by 21 Jul ECB meeting. ECB's Villeroy had earlier said that "constructive ambiguity" should govern officials' approach and that the tool should demonstrate officials' determination to defend integrity of Euro has no limits. The availability and effectiveness of this new tool to shield Eurozone periphery from fragmentation could suggest that ECB could tighten monetary policy with more confidence.

- **Energy Crisis in EU may Add to Growth Risks.** Germany raised the risk level of its national gas emergency plan to the second highest "alarm" phase, allowing the government to enact legislation to allow energy firms to pass cost increase to households and businesses. Energy providers have been forced to take significant losses after Russia gradually reduces gas supplies. While Germany Economy Minister Habeck assured that short-term gas supply is still secured, he warned of a "Lehman effect" as the "whole market is in danger of collapsing at some point", if losses for energy suppliers pile up too high. EU Climate Chief Frans Timmermans also highlighted in his speech to parliament that 12 EU member states are affected by the gas crisis and a "full gas disruption is now more real than ever before". Earlier, 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.

- **Further Upside Risks to EUR 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: ECB assumes growth of 2.8% and 2.1% in 2022 and 2023, respectively**. Final 1Q growth saw upward revision to 0.6% q/q vs. 0.3% in initial estimate. Higher revision was due to trade even though household consumption fell. On annual basis, Euro-area growth came in at 5.4% y/y vs. 5.1%. Looking on, preliminary composite PMI for Jun was slightly softer at 51.9 (vs. 54.8 in May) but remains in expansionary territory nonetheless. Other surveys and activity indicators were mixed. EU investor confidence and ZEW survey were less worse while retail sales and German IFO worsened. We continue keep a close watch on development.

- **ECB projected inflation at 6.8% and 3.5% in 2022 and 2023,** respectively with assumption of average oil price of $105.8/bbl and $93.4/bbl for 2022 and 2023, respectively. Headline CPI 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: A 25bps rate hike at the 21st Jul GC meeting is almost a certainty, as guided by ECB.** As of 28 Jun, markets are pricing in slightly more than 25bps rate increase at July meeting, a further 50bps rate hike at the Sep meeting and another cumulative 75bps rate increases for Oct and Dec-2022 meetings. In sum, markets are pricing rate to rise to 1%, from current -0.5%.

- At the last meeting (9 Jun), ECB confirmed that QE program will end on 1 Jul and a 25bps hike will follow at the next meeting on 21 Jul and then increase it again in Sept meeting, possibly by a larger magnitude "if the medium term inflation outlook persists or deteriorates". ECB also said that a gradual but sustained path of further rate increases will be appropriate beyond Sep meeting, based on its current assessment. ECB projected inflation at 6.8% and 3.5% in 2022 and 2023, respectively with assumption of average oil price of $105.8/bbl and $93.4/bbl for 2022 and 2023, respectively. YTD average inflation is already 6.8% while May headline CPI was 8.1%. Higher food and energy prices may continue to pose upside risks to ECB's assumption, implying a strong case for 50bps hike at Sep meeting. Even Lagarde admitted that risks to inflation as primarily to the upside and inflation may top 7% this year. She also touched on deploying either existing, adjusted or even new instruments to address any potential bond market panic or fragmentation issues.

- **Latest Fiscal and External Balance Outlook**: Euro-area current account deficit widened in Apr to EUR5.8bn (vs. deficit of EUR1.6bn in Mar). This was due to jump in oil and gas prices, dragging on trade. In the 12 months to Apr-2022, EU area current account surplus narrowed to 1.5% of GDP (vs. 2.7% of GDP in the preceding 12 months).

- **Key domestic events and issues to watch:** Jun mfg PMI, CPI estimate (1 Jul); Jul sentix investor confidence, May PPI (4 Jul); Jun services PMI (5 Jul); May retail sales (6 Jul); Jul ZEW survey expectations (12 Jul); May IP (13 Jul); May trade (15 Jul); May construction output, Jun CPI (19 Jul); May current account, Jul consumer confidence (20 Jul); ECB meeting (21 Jul); prelim Jul PMIs (22 Jul); Jul consumer confidence (28 Jul); Jul CPI estimate, 2Q GDP (29 Jul).

- **Technical Outlook:** EUR drifted lower in Jun. Last at 1.0460 levels. Daily momentum and RSI indicators are not showing a compelling bias for now. Bearish momentum on monthly chart intact but there are tentative signs of it fading while RSi is near oversold conditions. We are biased to buy dips. Support at 1.0410 and 1.0340 levels (double bottom). Resistance at 1.0540 (21 DMA), 1.06 (50DMA) and 1.08 levels (100 DMA).

GBP: Still Favor Shorts; Political Risks Not Priced

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

No Change to Previous Forecasts

- **Motivation for the FX View**: We retain our view that **short GBP remains the best proxy trade to express a view on stagflation fears** – growth downturn, surge in living cost and BoE being caught between a rock and a hard place. There is little room for BoE to catch-up on policy normalization as economy risks being tripped into a hard-landing yet inflationary expectations are at risk of being de-anchored. Elsewhere, political pressures, including risk of EU-UK trade war due to parts of NI protocol being scraped, Scottish referendum and weaker leadership may be piling up though they have yet to pose much downside pressure on GBP at the moment. We look for 1.20 – 1.24 range in coming weeks. But we expect some of the drags – energy woes, supply chain disruptions to fade towards year-end. Potential improvement in the geopolitical space and positive developments out of China, coupled with reopening globally (drivers of growth) should allow for GBP to intermittently strengthen relative to USD.

- **Political Uncertainties Appear to be a Side Show for Now**. MPs voted 295-221 to advance proposed legislation to allow UK to unilaterally scrap parts of brexit deal arrangement with Northern Ireland in second reading stage. This may have constituted to a breach of international treaty and risks of EU-UK trade war should not be ruled out. Elsewhere First Minister Nicola Sturgeon told members of the Scottish Parliament (MSPs) that her government want to stage a second Scottish independence referendum on 19 Oct 2023. She has asked the supreme court to rule on the legality of holding a new referendum without Westminster's permission. It is believed that the court will rule it unlawful without Westminster giving it the powers to do so under section 50 of the Scotland Act. Last week, ruling party Conservatives lost 2 by-elections inTiverton and Honiton as well as industrial city of Wakefield. Double defeat exposed party vulnerabilities as it prompted resignation of party chairman and revived talk of another no-confidence vote. While current party rules say PM Bojo is immune from another challenge for a year, these rules can be changed if there is genuine discontent and appetite within the party to do it. Recall that in 2018, former PM Theresa May resigned a few months later even after she won the confidence vote. As of now, GBP may seem unperturbed by political factors at home as GBP take cues from broader exogeneous factors. But at some stage, we opined that the play-up of multiple political risks, including a case of weakened leadership can undermine GBP.

- **GBP Short a 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.

- **Growth and Inflation Outlook: 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. Elsewhere, 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 for 2023 growth (vs. earlies projection of 1.25%). **UK economy unexpectedly saw a sequential shrinkage by 0.3% m/m in Apr, following an earlier contraction of 0.1% m/m in Mar.** The contraction was due to contraction in health, manufacturing and construction output. **Back to back decline exposes UK economy to a contraction for 2Q.** Looking on, forward looking surveys and activity indicators continued to show signs of fading momentum. GfK consumer confidence slumped further to multi-year low of -41 in Jun, down from -40 in May while retail sales slipped. Prelim PMIs were mixed asn services held up while manufacturing slipped. Nonetheless both remains in expansionary territory.

- BoE projected inflation to hit above 11% in Nov, 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. Headline CPI surged to 40-year high of 9.1% y/y in May, up from 9% y/y in Apr. Energy, fuel and food remain the main drivers of higher prices. 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 eased from all-time high of 6.2% y/y to 5.9% in May.

- **Monetary Policy Forecast: There is no MPC schedule for Jul. We expect BoE to keep pace with its back-to-back hike of +25bps rate increase at the next MPC on 4th Aug.** This will be the 6th increase to bring policy rate to 1.50%. Bringing inflation down to its medium term target of 2% remains BoE's priority but at the same time, most BoE policymakers are trying to combat inflation without pushing the economy into a recession. That said the last MPC saw a hawkish shift in tone – policymakers signaled they are prepared to **"act forcefully" to tame inflation if needed.** Markets are now pricing in 50bps hike each at Aug and Sep MPCs.

- At the last BoE meeting (16 Jun), the MPC voted 6-3 to raise rates by 25bps. 3 members voted for 50bps increase while 6 voted for 25bps. BoE also projected inflation to jump above 11% in Oct, due to another round of increase (40%) in UK energy price cap. In a speech in Germany (24 Jun), BoE Chief Economist Huw Pill said that "given the tightness of the labor market and perceived strength of pricing power in large parts of the corporate sector, the threat exists that higher headline CPI leads to second round effects in prices, wages and costs that exacerbate the magnitude and crucially, the persistence of the target overshoot". He also supports BoE to act "more aggressively" if needed. In an MNI event (20 Jun), BoE's Mann said that BoE needs to raise rates more aggressively to stave off a drop in GBP that would drive up inflation. She added that domestic price pressures are likely to prove firmer because of government stimuli, strong employment, big bonus payments to workers, strength of housing market and build-up of savings by consumers. She also made reference to faster pace of tightening from Fed and ECB, and that BoE should move more quickly. She was one of the MPC dissenter whom voted for 50bps hike at previous BoE MPCs.

- **Fiscal and External Balance Update:** Public sector net borrowing was GBP14bn in May 2022, GBP4bn less than in May-2021. Public sector net debt, excluding public sector banks, totalled GBP2.36tn or 95.8% of GDP. 1Q current account deficit widened sharply to GBP51.7bn, from deficit of GBP7.3bn in 4Q. This represents a deficit of 8.3% of GDP, the largest shortfall since 1955. Goods deficit widened sharply while primary income turned into deficit. ONS did caution that there is more uncertainty than usual due to impact post-Brexit in how data for goods imported and FDI are being collected.

- 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.

- **Key domestic events and issues to watch:** Jun PMI Mfg (1 Jul); services PMI (5 Jul); construction PMI (6 Jul); May industrial production; monthly GDP, construction output, trade (13 Jul); May labor market report (19 Jul); Jun CPI, PPI (20 Jul); Jun public finances (21 Jul); Jun retail sales, Jul prelim PMIs (22 Jul).

- **Technical Outlook:**GBP's rise in month of May did not see follow-through as GBP fell 4% in Jun. Pair was last at 1.2115 levels. Daily momentum and RSI indicators are not showing a clear bias. But on the monthly chart, bearish momentum is intact even though RSI is dipping into oversold conditions. Immediate support at 1.2080 (76.4% fibo retracement of 2020 low to 2021 high), 1.1934 (Jun low). Decisive break below these support levels puts next support at 1.1840 (2016 low), 1.1412 (2020 low). Resistance at 1.2290 (21 DMA), 1.2450 (50 DMA) and 1.2495 (61.8% fibo).

AUD: The Rapid Pricing in of Recession Fears

Forecast	3Q 2022	4Q 2022	1Q 2023	2Q 2023
AUDUSD	**0.7000** (0.7450)	**0.7000** (0.7450)	**0.7100** (0.7500)	**0.7200** (0.7500)

Previous Forecasts in Parentheses

- **Motivation for the FX View:** We adjusted our forecast levels for the next four quarters into 2023 as persistent inflation in the developed world start to crimp on demand and increase recession risks. Even so, we retained an upward trajectory on the AUDUSD as a reflection of our constructive bias on the AUD. Commodity prices have swung lower, adding to drags on the AUD in the past few weeks but potential for recession risks to be too aggressively priced could mean some unwinding potential of pro-cyclical AUD shorts. Meanwhile, an increasingly hawkish RBA should provide some support for the AUD as inflation is projected to reach 7% by the end of 2022.

- **Electricity Market Failure at Home.** AUD could also have been weighed by concerns on the electricity supply at home after Australian Energy Market Operator (AEMO) suspended spot markets for five eastern states on 15 Jun. The combination of an early onset of winter (in May), domestic supply shocks to coal generation (32% unavailable) due to maintenance requirements, the surge in global commodity prices as well as the introduction of price caps on generators resulted in significant losses (and some failures) for energy market retailers. The market operators took over the generation dispatch to ensure continuation of power supplies for consumers and to avoid blackouts. AEMO formally ended the suspension of the wholesale electricity spot market on 24 Jun but warns of dynamic market conditions. During the suspension, residents were asked to curb their electricity usage to avoid a blackout. High electricity prices and the threat of blackouts may start to have an impact on consumer confidence and likely contributed to AUD weakness in Jun. Looking forward, Climate change and Energy Minister Chris Bowen pledged to invest more in renewable generation and storage instead of lengthening the life of coal-fired generation stations to mitigate the electricity issue at home, in line with the country's recent pledge to reduce carbon emission by 43% by end of 2030 compared to 2004 levels.

- **AU-Sino Relations Remain Chill while Albo Warms to NATO Allies.** As the new Federal government settles in, China seems keen on resetting its bilateral relations with Australia. China's ambassador Australia Xiao Qian spoke of "opportunity of possible improvement to (China-Australia) bilateral relations. This comes after New Deputy PM Richard Marles conversed with China's Defense Minister Wei Fenghe in Singapore in early Jun. However, PM Albanese kept a cool attitude towards China, highlighting his awareness of an alliance reached between Russia and China before the former's invasion of Ukraine on ABC radio and that China should learn the lessons from Russia's "strategic failure" in Ukraine. Australian officials also complained about the interception of its surveillance planes by Chinese fighter jets over South China Sea. Meanwhile, Albanese has embraced the 2015 Paris climate accords and the new Trade Minister Don Farrell flags a trade deal with the European Union, India and UK by the end of 2022. It seems that the Australia is preparing for further deterioration of AU-Sino trade relations and the chances of success could be improved by the current environment of geopolitical tensions (between US and China/Russia) and high commodity prices. Further diversification of export destinations could strengthen its external balance, a positive for the AUD.

- **Growth and Inflation Outlook:** Australia's preliminary Jun Mfg PMI edged higher to 55.8 from previous 55.7 on strong domestic and external demand. Flash services PMI on the other hand, softened to 52.6 from previous 53.2, an indicator of growth slowing in the services industry. According to the survey, higher supplier prices, fuel costs and interest rates contributed to higher input costs and some of the cost burden was transferred to clients. It is unlikely for these input costs to dissipate anytime soon given the unprecedented wage hike of 5.2% that will take effect on 1 Jul as well as a hawkish RBA. Business confidence dropped to a two-year low in Jun while consumer inflation expectation picked up pace to 6.7%y/y in Jun from previous 5.0%, not helped the least by the power crisis at home. Westpac consumer confidence fell for the 7^{th} consecutive month to 86.4 for Jun, en-route to record low.

- Labour market conditions remain tight with a net 60.6K jobs added in May (+69.4K full-time and -8.7K parti-time). Participation rate rose to 66.7% from previous 66.4%, leaving the jobless rate was unchanged at 3.9%. Recession fears and rising input costs (energy, wages, interest rates) may dampen hiring momentum into Jun.

- 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 increase of the minimum wage of around 5.2% comes into effect on on 1 Jul, potentially having a knock-on effect on broader price pressure that could eventually keep the CPI on the rise.

- **Monetary Policy Forecast:** RBA raised cash target rate by 50bps to 0.85%, above most estimates. The interest rate on the Exchange Settlement balances by 50bps to 0.75%. The central bank flagged that inflation has risen significantly because of global factors including supply chain disruptions, war in Ukraine, tight labour market and capacity constraints. This came after M-I inflation expectations for May sped to 4.8%y/y from previous 3.4%. In addition, the Reserve bank viewed the strengthening economy (labour market, wage growth) no longer requires the degree of monetary accommodation that was provided before. Later in the month, Lowe urged Australians to brace for further interest rate hikes as inflation is projected to accelerate to 7% in the last quarter of the year before easing in 2023. He clarified that the 50bps move two weeks ago was due to "additional information suggesting a further upward revision to an already high inflation forecast" and that the level of interest rate "was still very low".

- **Lowe's emphasis on the low current level of interest rate could mean another back-to-back 50bps rate hike on 5 Jul that will lift cash target rate to 1.35%. Afterall, the consumer inflation expectations have sped to 6.7%y/y in Jun from previous 5.0%, closing in on the 7% projected for the end of the year. May's labour report suggest market conditions are still strong enough to withstand further rate increases and Lowe may prefer to frontload rate hikes in order to anchor inflation expectations.**

- **Latest External Balance Outlook:** As of last available data, current account surplus was recorded at 2.9% of GDP for 1Q 2022, narrowing from the previous 3.53%. Current account balance fell to A$7.5bn from A$4635b on narrower goods and services surplus (from previous $A29.1bn to $28.2bn) and wider primary income deficits.

- **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. **Treasurer Jim Chalmers warned that inflation could worsen in coming months and the situation is only expected to improve in 2023.**

- **Key domestic events and issues to watch:** Jun Melbourne-Institute Inflation, Jun ANZ Job advertisements, May home loan data, May building approvals (4 Jul); Final Jun Services, Composite PMI (5 Jul); RBA policy decision; May trade, foreign reserves (7 Jul); Jun NAB business survey (12 Jul); Jul Westpac consumer confidence (13 Jul); Jul consumer inflation expectation, Jun labour report (14 Jul); Minutes of the Jul RBA meeting (19 Jul); 2Q NAB business Confidence (21 Jul);

Prelim. Jul Composite, Services, Mfg PMI (22 Jul); 2Q CPI (27 Jul); Jun retail sales (28 Jul); 2Q PPI (29 Jul).

- **Technical Analysis:** AUDUSD sank towards the 0.68-figure into Jul. MACD is bearish and so are the stochastics. Next support level is the 0.6760 (50% Fibonacci retracement of the 2020 rally). On the weekly chart, bearish momentum remains intact and AUDUSD is poised to close the week with a bearish engulfing candlestick. Bears in control at this point. Rebounds to meet resistance at 0.7050.

NZD: Pricing in Global Growth Scares

Forecast	3Q 2022	4Q 2022	1Q 2023	2Q 2023
NZDUSD	0.6400 (0.6600)	0.6500 (0.6700)	0.6600 (0.6800)	0.6600 (--)

Previous Forecasts in Parentheses

- **Motivation for the FX View: We opined that the >5% decline (peak to trough) in Jun alone was a re-price for global growth concerns. To some extent, this sell-off might have been overdone and we expect the pace of NZD's decline to moderate and possibly partially reverse some of its weakness.** Improving covid situation in China, alongside borders relaxation/economy reopenings should help support growth to some extent. The near 50% bounce in Chinese tech shares since Mar lows and potential peak in Fed hawkishness/USD strength may also serve as mitigating factors for Kiwi to find some support. Looking on, markets will also focus on US review on China tariffs. Potential removal of US tariffs on Chinese imports can be supportive of risk sentiment. In addition, a hawkish RBNZ walking its talk should also be supportive of NZD. 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 zero covid policy and see a reopening of their borders and economy.

- **Hawkish RBNZ Can Mitigate Against Hawkish Fed.** RBNZ is expected to continue raising rates in clips of 50bps by as much as 4 more times this year to bring OCR to 4%. 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 can help mitigate against hawkish Fed and provide some support for Kiwi.** A stronger Kiwi can also help to mitigate against imported inflation.

- **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. On net, global growth concerns, inflation worries and fears of tighter monetary conditions may keep risk appetite on a leash.

- **Growth and Inflation Outlook**: NZ economy surprisingly contracted 0.2% q/q in 1Q (vs. 0.6% expected vs. 3% in 4Q). Primary industries, including mining, fishing and forestry as well as manufacturing output in F&B, tobacco and machinery led declines. Retail and restaurant spending also fell. The surge in omicron infection back in 1Q dampened economic momentum as multiple sectors including tourism were affected amid border closure and tighter restrictions. In annual terms, 1Q GDP grew 1.2% y/y, down from 3.1% y/y in 4Q. Looking on, we do not expect a technical recession in 2Q as economy gradually normalises post-omicron wave and the reopening of borders in Apr, May should boost tourism and partially help support growth. Mfg (52.9 vs. 51.2 in Apr) and services PMIs (55.2 vs. 52.2 in Apr revised) rebounded in May while credit card spending also saw a sequential uptick of 1.8% m/m in Jun (vs/ 0.7% in May) Though we note that ongoing supply chain disruptions and labor constraints are likely to hold back growth momentum.

- **Food prices continued to see sequential increases**, rising by 0.7% m/m in May (up from 0/1% in Apr). Increase was across the board with fruit and vegetables as well as dairy prices leading increases. Continued rise in food prices alongside higher oil prices in May suggest that headline CPI should continue to rise further for 2Q (to be release on 18 Jul). Taking stock, 1Q CPI surged 6.9% y/y in 1Q, up from 5.9% in 4Q. This is the fastest pace of rise since 1990. Gasoline priced led gains (+8.8% y/y) This is the 4th quarter in a row that headline CPI breached above RBNZ's 1% - 3 target band. 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. **RBNZ expects headline CPI to remain near its current peak of around 7% in 2Q 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.

- **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 4* 50bps hike fully priced for upcoming MPCs for remainder of the year in Jul, Aug, Oct and Nov (as of 29 Jun). All in, markets are looking for another 2000bps hike to bring OCR to ~4% by end-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 current account deficit widened to NZ$8.5bn in 1Q, from NZ$6.6bn in 4Q 2021.** This was due to higher imports, driven by demand for vaccines, antigen test kits and consumption goods while exports was smaller. For the year ended 1Q 2022, current account deficit widened to 6.5% of GDP, from -5.8% of GDP in 4Q.

- 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.

- 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

- Key **domestic events and issues to watch:** Jun consumer confidence, May building permits (1 Jul); Jun commodity prices (5 Jul); Jun card spending (11 Jul)); Jun food prices, RBNZ MPC (13 Jul); Jun mfg PMI (15

Jul); Jun services PMI, 2Q CPI (18 Jul); Jun trade (21 Jul); Jul activity outlook, business confidence (28 Jul); Jul consumer confidence (29 Jul).

- **Technical Outlook:** Kiwi extended decline last month. Pair was last at 0.6180 levels. Bearish momentum on monthly, daily chart intact. Risks remained skewed to the downside. Key support at 0.62 (interim triple bottom) appears broken. Sustained price action close below this key support could point to further downside. Descending triangle also appears broken – continuation of bearish pressure. Next key support at 0.5940 (76.4% fibo retracement of 2020 low to 2021 high). Resistance at 0.6320 (21 DMA), 0.6420 (50 DMA) and 0.6470 (50% fibo).

CAD: Room For Gains

Forecast	3Q 2022	4Q 2022	1Q 2023	2Q 2023
USDCAD	1.2500 (--)	1.2400 (--)	1.2400 (--)	1.2300 (--)

No Change to Previous Forecasts

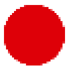
- **Motivation for the FX View:** We retain a sanguine view of the CAD for the rest of the year, looking for some stability in crude oil prices at some point. With Libya and Ecuador still facing political unrest that threatens their supply and G7's urgent plan to limit Russia's energy revenue by capping the price of its oil and gas, risk could be roughly balanced in the near-term. Eyes also on US-Iran nuclear negotiatiions for the latter to return back to the market as well as Biden's mid-Jul trip to Saudi Arabia where he is expected to persuade the leader of OPEC producers to ramp up crude oil production but there are already whispers that UAE and Saudi Arabia are near their maximum capacity. That really dampens hope of a significant increase in crude oil supply in the near-term. 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 70bps hike for the policy decision on 13 Jul and a 190bps increase by end year. Base on CFTC data, net long-CAD positions have reduced from 23202 contracts to 4105 as of 21 Jun, indicating some room for CAD gains ahead of the coming BoC meeting where we expect a 75bps hike.

- **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 currency.

- **Growth and Inflation Outlook:**
- Canada continues to experience **strong growth momentum and tight labour market conditions**. Retail sales for Apr picked up pace from 0.2%m/m to 0.9% in Apr with higher volume and the preliminary data for May was a stronger +1.6%m/m, underscoring resilience in spite of inflation. That said, there are signs of some slowdown with the ex-auto retail sales growth slowed to 1.3%m/m from previous 2.6% in a backdrop of rising price pressure.
- Inflation still threatens - CPI accelerated to 7.7%y/y from previous 6.8%, well above expectations. Month-on-month, CPI rose to 1.4%m/m from previous 0.6%. Strong price pressure was seen for most categories, most notably transportation (+3.5%m/m vs. previous 0.5%). Household operations also picked up pace to 1.3%m/m from previous 0.5% while clothing, footwear was up 2.2%m/m from previous 0.6%. Recreation, education was up 1.9%m/m vs. previous -1.2%. The industrial product price also picked up pace towards 1.7%m/m for May vs. previous 0.8% as prices of crude energy, crop products and non-metllic minerals continue to rise for May, at risk of fanning inflation higher into the second half of the year in strong demand conditions.
- Canada's labour market condition remains very tight. The country added a net 39.8K jobs in May which likely saw strong conversion of part-time jobs (95.8K loss) to full-time hires (+135.4K gain). As a result, unemployment rate a tad lower at 5.1% vs. previous 5.2%. The average hourly hourly wage rate was up 3.9%y/y in May vs. 3.3% previously with wage gains for permanent workers up 4.5%y/y vs. 3.4% in Apr.
- Not only is the labour market tight, Canada's capacity utilization steadied at an elevated 82.0%, closing in on the record high of 83.8% (seen in 2018, pre-Covid). Taken together, high capacity utilization rate, strong labour demand and rising wage growth could spur BoC to tighten aggressively in order to cool domestic demand.
- Housing starts came in stronger than antipated at 287.3K for May vs. expected 255K as housing demand remains resilient to higher mortgage rates as hot bidding wars for rental continue to increase the allure of home ownership. With labour market still tight and wages still rising, the housing market could remain supported for a while more.
- **Monetary Policy Forecast:** BoC would need to raise overnight rate by 75bps to 2.25% on 13 Jul, stepping up the pace from its 50bps hike on 1Jun. In its Jun statement, the central bank expressed concerned about the risisng "risk of elevated inflation becoming entrenched" and the need to use monetary policy to bring inflation back to target. The subsequent CPI print for May (released in Jun)) brought little comfort with a strong upside surprise at 7.7%y/y and higher Jun industrial product price and the elevated level of industrial capacity utilization rate could mean further upside risks to inflation in an environment of strong demand. The BoC might have risked falling behind the curve with a 50bps hike for Jun and we cannot rule out a significant 100bps hike on 13 Jul given the strong upside risks to the already accelerating inflation.
- **Latest External Balance Outlook:** As of last available data, Canada's current account balance was at a surplus of C$4.6 for 1Q22, widening from the previous U$0.8bn surplus. Firm commodity prices 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:** Jun S&P Global Canada manufacturing, 2Q BoC overall business outlook (4 Jul); May building permits (5 Jul); May trade, Jun PMI (7 Jul); Jun labour data (8 Jul);BoC rate decision (13 Jul); May Mfg sales (14 Jul); May wholesale trade sales, Jun existing home sales (15 Jul); Jun housing starts (18 Jul); Jun industrial product price, Jun CPI (20 Jul); May retail sales (22 Jul); CFIB business barometer (28 Jul), May GDP (29 Jul).
- **Technical Analysis:** USDCAD was last seen around 1.2920, at the brink of breaking out of the 1.2820-1.2920 range that it has traded in the last week of Jun. Double top at 1.3080 still intact and we prefer to sell on rallies. Support at 1.2830 (21,50-dma) before the next at 1.2740.



JPY: Fed-BoJ Policy Divergence a Sustained Drag

Forecast	3Q 2022	4Q 2022	1Q 2023	2Q 2023
USDJPY	**137** (130)	**132** (125)	**128** (123)	**125** (--)

Previous Forecasts in Parentheses

- **Motivation for the FX View:** USDJPY found renewed support in June on widening divergence between hawkish Fed and BoJ. At one point, pockets of the markets were betting for BoJ to hint at possible tweaks to the YCC framework, given hawkish pivots from other major central banks, but BoJ ended up maintaining a strongly dovish stance. UST yields also pushed higher on net ealier in June, as persistently higher inflation forced Fed to shift even more hawkish, eventually hiking by +75bps in Jun. While there was some jawboning by authorities, markets appear to be less sensitive to authorities' comments on "concerns" on weak JPY, as long as these seem some way off in translating to more discernible action on the intervention front. Concomitantly, oil is also seeing greater support amid new signs of constraints among major producers, likely leave Japan with an elevated oil import burden for longer. Taking these developments into consideration, we revise higher our USDJPY trajectory. **The higher-than-spot end-3Q projection is not a point forecast per se, but rather, reflects residual upward risks in the pair on potential inflation surprises, hawkish Fed comments, momentum plays etc**. BoJ policy aside though, USDJPY biases could still fall to shifts in UST yields, which are in turn tied to global price and growth trends. We see greater likelihood for global price pressures to moderate later in 2H, as global withdrawal of monetary support dampens demand and Europe proceeds further along in efforts to delink from dependencies on Russia. Meanwhile, if US growth drags materialize more discernibly, pace of expected Fed hikes could slow after front-loading of larger hikes. **UST yields have already seen some retracement lower lately, capping USDJPY gains, and any clearer signs of potential Fed dovish pivot (down the road) could lead USDJPY on a gradual retracement further out**.

- **Fed stance and UST-JGB yield differentials are likely to remain as key drivers of the USDJPY pair**. June largely saw another hawkish pivot in Fed stance, on account of persistently high inflation. Fed hiked by +75bps and warned that it might have to do the same in Jul, even though Powell explicitly said that moves of this size are uncommon. Latest dots plot (median expectations) also show policy rate peaking near 3.75% next year before heading lower towards 3.375% in 2024, with terminal rate coming in at about 2.5%. 2Y UST-JGB yield differentials remain wide at around +300bps at last seen, albeit having moderated from high near +348bps in mid-Jun. Going forward, the currently steeper Fed policy trajectory could keep UST yields (and USDJPY) supported on dips, even as chances of yields retesting interim highs in mid-Jun could be relatively low for now, with some corners of the markets betting that Fed might have to tilt dovish next year as growth risks escalate. **While upside risks to USDJPY are still intact at this point, calmer UST yields could slow up-swings.**

- 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 offset the support that JPY conventionally receives from an expected current account surplus**—consensus estimates see current account coming in at 1.7% 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 could be skewed to the downside for the pair (versus current spot levels) into 2023.**

- 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 supported above US$100, 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. Admittedly, inpact of (iii) could be more modest near-term. Market chatters are that UAE and Saudi Arabia are already pumping almost as much oil as they can. Latest data also show OPEC+

members producing 2.7mn b/d below their collective target. **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 into 2023 could help nudge USDJPY lower then.**

- **Growth and Inflation Outlook:** 1Q (F) GDP came in at -0.5%q/q SAAR, contracting on a sequential basis versus +4.0% prior, but still slightly better versus expected -1.1%. Private consumption growth was largely flat (+0.1%) on a sequential basis, while business spending contracted by -0.7%q/q, worse than expected +0.3%.

- 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 Jun (F) came in at 52.7, in modest expansionary territory. But industrial production (P) for May contracted by -7.2%m/m, worse than expected -0.3%, likely tied to partial lockdowns in China.

- Japan CPI for May came in at 2.5%y/y, on par with expectations and prior. The reading ex fresh food came in at 2.1%y/y, also as expected. 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 could eventually 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 stood pat on policy settings (policy rate at -0.1%) on 17 June. The YCC will be maintained at current settings (0% target yield for 10Y with 25bps cap). There was arguably less of an impetus for an immediate move given that domestic prices have yet to see runaway momentum (May CPI at 2.5%) and the economy is still in a fragile state. **While the BoJ monetary policy statement added a rare line on FX, saying it needs to watch its impact on economy and markets, the statement as well as Kuroda's comments in the QA session remained largely dovish**. There also appears to be no plans to review the YCC framework for now. On net, it was concluded that easing needs to continue to support the economy, with comments from PM Kishida in agreement. Ultra-accommodative monetary settings might be maintained until Kuroda's term ends in Apr 2023.

- **Meanwhile, even as Kuroda quashed hopes for near-term policy changes, chatters of potential tweaks will likely continue into 2H and 2023, especially if inflation pressures broaden more sustainably**. A recent Nikkei survey showed that 46% if the Japanese public wishes for the ultraloose monetary policy to end, while 36% favors maintaining the approach. Recent external developments (larger Fed move, unexpected hike from SNB, hawkish signalling from ECB) as well as domestic developments (discontent on weaker JPY impinging on household spending power) could continue to add to pressures on BoJ to tilt hawkish in tones.

- On possibility of FX intervention, we note that officials from the BoJ, the Ministry of Finance and the Financial Services Agency met in mid-Jun after the JPY saw a bout of softening, and in a joint statement, expressed their concern about the sudden weakening of the JPY, saying they will take action if necessary. BoJ Governor Kuroda, who had earlier also largely kept to the rhetoric that a softer yen was on net still good for the economy, also said that the recent abrupt yen slide was bad for the economy. **Risks on direct intervention by authorities might be higher now, and could help keep USDJPY resist upswings towards the psychological threshold of 140, even as the threshold for intervention might be high**.

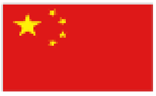
- **Latest Fiscal & External Balance Outlook:** In Feb 2022, **a parliamentary committee approved a record JPY107.6trn (US$936bn) spending plan for FY2022 (starting Apr)**. Kishida has vowed seamless spending for 16 months (beginning with supplementary budget mentioned above) to provide sufficient support 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 surplus for Apr narrowed significantly to JPY501bn versus JPY2549bn prior, adding to dampened sentiments for JPY. Trade balance also came in at a deficit of -JPY2384mn, widening significantly from -JPY854mn prior, likely tied to partial lockdowns in China and elevated energy import burdens. We note that the trade balance has seen deficit readings from Aug 2021 to May 2022, versus average surplus outturns in the first 7 months of 2021. **Such developments will be a tentative interim drag on JPY**.

- **Key domestic events and issues to watch:** 2Q Tankan activity surveys (1 Jul), Jun Vehicle sales (1 Jul); May Labor cash earnings (5 Jul); May (P) Leading Index CI (7 Jul); May Current account (8 Jul); May Core machine orders (11 Jul); Jun (P) Machine tool orders (11 Jul); May Tertiary industry index (15 Jul), Jun Trade (21 Jul); BoJ Policy decision (21 Jul); Jun CPI (22 Jul); Jul (P) Jibun Bank PMIs (22 Jul); Jun Jobless rate (29 Jul), Jun Retail sales (29 Jul); Jun (P) Industrial production (29 Jul).

- **Technical Outlook:** USDJPY pair was last seen near the 135-handle. On weekly chart, RSI is still in overbought territory, while bullish momentum in pair shows very tentative signs of moderating. Risks of up-moves still intact, though extent could be capped. Support at 134.50 (23.6% fibo retracement of May low to Jun high), 133.00 (38.2% fibo), 129.00 (76.4% fibo). Resistance at 137 (recent high), before psychological threshold of 140. As USDJPY remains in elevated ranges, there could be less points of psychological support and resistances and magnitude of interim swings could be amplified. We note potential bearish divergence forming on daily chart, even as it might take some time for swings to play out.



RMB: Two-Way Trades Remain as China Embarks on Slow Recovery

Forecast	3Q 2022	4Q 2022	1Q 2023	2Q 2023
USDCNY	**6.75** (6.80)	**6.70** (6.74)	**6.68 (6.70)**	**6.65 (6.70)**
USDCNH	**6.75** (6.80)	**6.70** (6.75)	**6.68 (6.70)**	**6.65 (6.70)**

Previous Forecasts in Parenthesis.

- **Motivation for the FX View:** There is little to suggest that USDCNY could break out of ongoing two-way trades as focus shifts from Covid-anxiety to lockdown recovery. We look for USDCNY to remain within 6.60-6.80 range as China signals targeted easing in its zero-covid strategy by announcing a shorter quarantine period for inbound travellers on 28 Jun. While this measure alone cannot be a key growth booster, we think that it is still a significant sign of greater confidence in coping with future outbreaks. In a speech at Wuhan on the following day, President Xi was keen to affirm his zero-Covid strategy (which has become synonymous with Xi's leadership) as being the "most economic, effective for China", driving the yuan back down again. He clarified that China would rather endure some temporary impact on economic development than let the virus hurt people's safety and health. This suggest that the overarching zero-Covid strategy is likely to remain but we cannot rule out further targeted easings. Meanwhile, nascent signs of the economy could continue to underpin the yuan.

- USDCNY ends the quarter around the 6.70-figure, in the middle of the 6.60-6.80 range. USDCNH-USDCNY gap is back to fluctuations around zero, which suggests the dissipation of bets against the yuan. While US-CH 10y yield premium widened to 30+bps compared to near zero (end-May), the USDCNY has been considerably resilient, staying within the aforementioned range. We anticipate RRR cuts and MLF cut in 2H to potentially weigh on the yuan but its combination with fiscal spending (infrastructure construction) could mean that the current easing cycle is likely to be shallow and thus, depreciation pressure on the yuan should be easily offset by growth optimism. PBoC Yi Gang pledged to keep monetary policy accommodative whilst noting that the "current level of real interest rates are quite low already".

- **The greenback remains a significant driver of the USDCNY but directional cues could be lacking in the near-term.** While lingering concerns on US inflation and concomitantly risk of aggressive tightening by the Fed keeps the USD supported, the rising risk of recession from potentially restrictive monetary policy may keep a lid on UST yields too. Such opposing factors may mean the greenback itself can gain little directional traction and thus may not provide strong cue for the USDCNY pairing.

- **Growth and Inflation Outlook:** Along with the easing of restrictions and the push for production to restart first during the worst of Shanghai lockdown, activity data show signs of bottoming out for China's economy with industrial production eking out a mild growth of 0.7%y/y for May vs. previous -2.9%. Retail sales still clocked declines of -6.7%y/y vs. previous -11.1%. FAI ex rural disappointed with a slower growth of 6.2%y/y vs. previous 6.8%. Since late May, there has been continuous pledges of policy supports from the government which also helped to underpin domestic sentiments. Most recently, local press noted China could be planning "extraordinary" new policies to help downstream industrial firms that have been hurt by costly raw materials. The Ministry of Industry and Information Technology also looks into measures to enhance supply-side policies, boost consumer demand and incentivise investments in technology.

- **Into Jun,** a set of mildy optimistic PMI was just released. The official mfg PMI rebounded to a print of 50.2, albeit still under the expected 50.5. The print was barely in expansionary region with new orders also only modestly improving to 50.4, barely in expansionary terrain. Non-manufacturing on the other hand, leapt to 54.7 from previous 47.8. Business activity in both services and construction showed a marked improvement with new order also rising. Employment for both sectors on the other hand, is still in contractionary region. Steel industry PMI fell to 36.2 from 40.9 in May, underscoring weak demand. This was especially evident in the new orders which slumped to 25.9 vs. 32.4. Taken together, we could be witnessing a set of marginally better activity data for Jun that will be released in mid-Jul, showing signs of a weak recovery as Covid restrictions ease in major cities.

- **Xi's recent affirmation of his zero-Covid strategy is a clarification to all that there is no shift in zero-Covid strategy.** This comes after the quarantine period for inbound travelers was announced to be shortened to 7 days (quarantine facility) + 3 days (self monitoring at home) - which we perceive to be the first sign of China being a tad more comfortable with Covid. While Xi's comment suggests that China is still susceptible to lockdowns, we take heart that officials seem to be finding success in short and sporadic lockdowns to avert a city-wide lockdown thus far. This could mean that a harsh city-wide lockdown is unlikely to repeat but recovery in private consumption and investment will be slow given the overarching zero-Covid strategy.

- Of late, PBoC Yi Gang signals further monetary policy easing and barring severe lockdowns in China, a combination of cheaper credit and Li Keqiang's 33 point stimulus package should stimulate demand. Eyes especially on China's property developers, a few (Sunac, Country Garden) face default risks and credit downgrades, exacerbating their access to financing. **Land spending for Sep21-May 2022 is down 57% compared to a year ago and could indicate fewer project launches and smaller income streams for developers for the second half of the year.** Meanwhile, the combination of Covid restrictions and non-completed projects dampened consumer confidence and demand and without a meaningful recovery for the property sector, economic recovery could remain uneven and measured.
- **Monetary Policy Forecast**: We look for 1Y and 5Y LPRs to be adjusted by another 10bps lower by Chinese banks. The RRR to be lowered another 50bps within the next two quarters. **Given that demand has started to pick up and US treasury yields seem to be nearing a peak by recession fears, PBoC might feel more comfortable with easing monetary policy further at this point.** We anticipate RRR cuts and MLF cut in 2H to potentially weigh on the yuan but its combination with fiscal sepnding could mean that the current easing cycle is likely to be shallow and thus, depreciation pressure on the yuan should be easily offset by growth optimism. PBoC Yi Gang pledged to keep monetary policy accommodative whilst noting that the "current level of real interest rates are quite low already".
- **Latest Fiscal and External Balance Outlook:** Fiscal target for 2022 was projected to be 2.8% of GDP, down from 3.2%, underscoring a stance of fiscal consolidation but that is increasingly unlikely as we look for further fiscal spending to support the economy. Recently, China Center for international Economic Exchanges Vice Chair Wang Yiming said that the fiscal deficit-to-GDP ratio could be raised to support domestic demand.
- **Key domestic events and issues to watch:** Jun Caixin Mfg PMI (1 Jul), Jun composite and services PMI (5 Jul); Jun foreign reserves (7 Jul); Jun CPI and PPI (9 Jul); aggregate financing, new yuan loan, money supply (9-15 Jul); Jun FDI on (9-15 Jul); trade on (13 Jul), 1Y MLF (13-16 Jul), Jun industrial production, retail sales, FAI ex rural, 2Q GDP (15 Jul), 1Y, 5Y LPR (20 Jul), Jun SWIFT global payments (21 Jul); Jun FX Net settlement (22 Jul), Jun industrial profits (27 Jul), Jul Composite PMI, Mfg, non-Mfg PMI (31 Ju1).
- **Technical Analysis:** USDCNH hovered around 6.71 on 1 Jul. Pair as formed an arguable symmetrical triangle after much consolidation within the 6.60-6.80. Momentum indicators do not show much directional bias but price action since Mar seems to have formed a bullish pennant that could augur a move above the 7.00.

KRW: Larger Pace of 50bps Hike Not Ruled Out

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

Previous Forecasts in Parentheses

- **Motivations for the FX View:** We expected KRW to trade on the back foot amid global growth concerns, stagflation warnings as flagged by World Bank, OECD. On this note, we revised higher USDKRW forecasts. But we are not ruling out sporadic rebounds in KRW especially from stretched levels. Improvement in China's covid situation, potential green shoots of growth in China (albeit bumpy), Asia reopening story and room for China equities to sustain its recovery following near 50% bounce since Mar lows, potential peak in Fed hawkishness and USD strength are some factors that could support the intermittent bounces in KRW. Furthermore the prospect of BoK raising rate by 50bps should also not be ruled out, especially after minimum wage increase and this can mitigate against KRW softness. Elsewhere we keep a look out on US review of China tariffs. Potential removal of US tariffs on Chinese imports can be perceived as positive for broad risk sentiment and is supportive of KRW. Nonetheless, a more meaningful recovery in KRW will however requires a better assessment on global growth, sharper pullback in UST yields and these may not be as forthcoming at this point of time. We look for USDKRW to trade in a wide range between 1260 and 1320, with a tactical bias to sell rallies in USDKRW. Technically we also note that past periods of sharp USDKRW run-up in 2014-16, 2018-20 saw KRW depreciate by around 22% vs. USD on average. The current run-up since late-2020 is similarly seeing ~20% depreciation in KRW (vs. USD). We opined that the current sell-off in KRW could potentially be near a turning point. Taking other technical signals in consideration, the bearish divergence in MACD and RSI alongside interim double tops around 1307 levels may add to further signals that pace of decline in KRW may moderate and a USDKRW interim top may be near.
  - Other market measures of fear-greed index, AAII investor sentiment and BofAML fund manager survey (FMS) cash balances were also 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.

- **Global Growth Downgrades a Drag on High-Beta/Pro-Cyclical KRW.** World Bank projected global growth to slump to 2.9% in 2022, from 5.7% in 2021. This is also significantly lower than its Jan's projection for growth at 4.1%. The downward revision was due to war in Ukraine disrupting activity, investment and trade while pent-up demand fades and fiscal, monetary accomdation is withdrawn. World Bank warned that even if a global recession is averted, the pain of stagflation could persist for several years. The OECD also projected global growth to decelerate sharply to around 3% for 2022 and 2.8% in 2023. OECD cited Russian war, covid pandemic – more aggressive or contagious variants may emerge as well as China's zero covid policy disrupting supply chain. At the same time, OECD doubled its inflation outlook to nearly 9% for its 38 member states.

- **A Larger Magnitude of Rate Hike is Not Ruled Out.** Market expectations for 50bps hike at 13th Jul BoK MPC is rising especially after Governor Rhee did not deny 50bps as an option and reinforced his stance in prioritising the combat against inflation. Senior Deputy Governor Lee also weighed in to say that early reining-in of inflation expectations is needed to promote economic stability and the BoK should focus on containing it. Separately Deputy Governor Park said that BoK does not completely rule out the possibility of a "big step" 50bps hike though the BoK currently thinks that 25bps increments are more appropriate. We keep a look out on upcoming release (5 Jul) of CPI for further indication of larger hike. In addition ITS Minimum Wage Commission had agreed to raise minimum hourly wage by 5% in 2023. This may further add to inflationary expectations and support the case for more aggressive monetary policy.

- **Korea May Have to Wait Further for MSCI Inclusion.** It was previously expected that Korea could be placed on watch list for possible upgrade from EM to DM at some point. But MSCI maintained status quo on Asia during its annual market review and this decision may suggest that Korea's hopes of being re-classified as DM may have to be put on hold till 2024 or later. 'Market accessibility' is a key factor within MSCI metrics for a country to be considered for DM status. Some examples include access to onshore FX markets, foreign ownership limits of local corporates and market infrastructure. Authorities' recent decision to extend onshore KRW trading hours from 930am - 330pm to 930am – 2am (local time) with a view to 24h trading in subsequent stages is an attempt to attract more foreign investors and improve market accessibility. Authorities are also looking to allow foreign FIs to participate in domestic interbank bank market without establishing a local presence.

- **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: 1Q growth was revised slightly lower to 0.6% q/q, from 0.7% in earlier estimates.** This was due to weak investment in construction and facilities while private consumption also fell. Elsewhere the surge in exports led by chips and chemical products partially offset the downward revisions. Looking on, the forward looking surveys and activity indicators suggest that underlying growth, activity momentum somewhat slowed. Mfg PMI slipped to 51.8 in May, down from 52.1; retail sales rose 10.1% y/y in May, down from 10.6% in Apr while consumer confidence slumped to 96.4 in Jun, its lowest level in 17 months. **South Korea government lowered its 2022 growth projection to 2.6%, from 3.1% previously. This is lower than BoK's projection** for growth in 2022 and 2023 to come in at 2.7% and 2.4%, respectively. BoK expects investments and export growth to slow while private consumption should pick up amid relaxation in covid restrictions.

- **Korea CPI surged 5.4% y/y in May,** up from 4.8% y/y in Apr. Energy and food prices led gains. This is also the 14th consecutive month of CPI staying above BoK's 2% target and the fastest pace since 2008. Core CPI accelerated to 4.1% y/y in May, up from 3.6% in Apr. BoK now expects headline CPI to accelerate beyond the 4.5% annual forecast it projected back in May-2022. Finance Ministry looks for inflation to rise to 4.7% in 2022.

- **Monetary Policy Forecast**: A 50bps hike is not ruled out though we expect BoK to keep pace with another 25bps hike to bring policy rate to 2% at the upcoming MPC on 13 Jul. BoK Governor Rhee indicated that the BoK is prioritizing the combat against 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 turned deficit ($0.08bn in Apr vs. surplus of $7.06bn in Mar). This is the first time in 2 years the current account shrank and this was due to lower trade surplus (higher energy and commodity prices drove up import bill) and annual dividend payment. Weaker KRW also added to imported inflation.

- 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.

- On 29 May, South Korea approved 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.

- **Key domestic data to watch:** S. Korea releases Jun trade, mfg PMI (1 Jul), Jun CPI, FX reserves (5 Jul); May current account (7 Jul); Jun unemployment rate, BoK MPC (13 Jul); 1st 20 days of exports (21 JulAug Jun PPI (22 Jul); 2Q GDP (26 Jul); Jul consumer confidence (27 Jul); Jul Business survey – mfg and services (28 Jul); Jun IP (29 Jul).

- **Technical Outlook:** USDKRW rose sharply last month, in line with our caution for rebound play. Last at 1297 levels. Bullish momentum on weekly chart intact while RSI is near overbought conditions. Further upside not ruled out but bias to lean against strength. Resistance at 1307 (interim double top), 1320 levels. Support at 1292, 1280 (21 DMA), and 1269 (50 DMA).

TWD: Weakness to Peak This Quarter

Forecast	3Q 2022	4Q 2022	1Q 2023	2Q 2023
USDTWD	**30.00** (--)	**29.80** (--)	**29.60** (--)	**29.50** (--)

No Change to Previous Forecasts

- **Motivations for the FX View: Our long-standing contrarian call (first shared in Annual outlook) for TWD to underperform in 2022 has so far been spot on.** We opined TWD softness may continue to linger in coming weeks amid (1) de-rating of global growth – weighs on cyclical TWD; (2) ongoing 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) risk of worsening China-Taiwan relations that may affect investment inflows; (5) housing market and equity market softness. But we strongly believe the >7% sell-off in TWD YTD may be coming to a close. The 25% sell-off in TWSE could potentially present attractive re-entry points for investors, from a valuation standpoint. Potential foreign inflows can support TWD. The global demand for technology is also intact and Taiwan has its competitive advantage to benefit from the trend. First signs of green shoots was also observed in the sharp rebound in export orders. Elsewhere Asia reopening, including gradual pace in China and Taiwan may also provide some support to tourism and growth.. We look for USDTWD to peak in 3Q before easing into year-end. A potential peak in Fed hawkishness, USD strength and UST yields coming off should also lend support to the narrative.

- **Softer Property Market May Partially Curb CBC Aggressiveness.** Housing transactions in Taiwan are already showing signs of moderation. 6 largest cities, including Taipei, New Taipei, Taoyuan, Taichung, Kaohsiung and Tainan reported 7.7% y/y drop in transaction volume in May. In the 5 months to May-2022, housing transactions in the 6 cities only rose 0.7% from a year earlier. CBC's 4 round of seclective credit controls measures since Dec-2020 as well as policy rate hikes this year have undermined housing transaction and home mortgage growth. Taiwan's housing market can be sensitive to interest rates and we believe CBC does not want to cause a housing market meltdown with its aggressive rate hike cycle even though it wants to combat inflation. Apart from credit control measures previously imposed to target house prices, CBC's cumulative hikes of 37.5bps in 1H may already have dampened housing market sentiments, alongside covid-19 spread. To some extent, we expect CBC to continue monitoring housing market while still keeping its rate hike cycle alive with a step-down in pace of hike.

- **Not all is Gloom and Doom.** Taiwan stock benchmark index (TWSE) saw its worst performance in the half-year to date (30 Jun) in the last 20 years. YTD, TWSE fell by nearly 25%. This was mainly due to external risks including global recession concerns, inflation worries and tighter monetary policies. To some extent, we believe that our long-standing caution (first shared in 2022 annual outlook) for the worsening of China-TW relations may also have played a part in affecting investment inflows. YTD, foreigners net sold $34bn of local equities amid unwinding of tech holdings. The massive 25%-sell-off this year saw PE ratio for TWSE crumbling to about 12x (as of end May-2022). On an average basis over 22years, TWSE PE is about 23x while the 5y average stands at 16.8x. From a valuation standpoint, re-entry levels for TWSE may seem attractive for investors, especially when tech fundamentals remain intact.

- **Tech Fundamentals Intact and Taiwan Has Competitive Advantage.** IDC projected worldwide semiconductor revenue to rise by 13.7% y/y to reach $661bn in 2022, after a bumper record in 2021. Resilience is seen in cloud, network infrastructure and automotive markets. There were challenges for most of this year amid supply-demand disruptions caused by unexpected war in Ukraine and covid shutdowns in China. But some of these disruptions may start to fade especially with the reopening of more economies including China from covid lockdowns. Global semiconductor demand will also increasingly shift towards high performance ones. TSMC has confirmed in its Technology Symposium (Jun-2022) that 3nm (N3) chips will be introduced in 2H this year while 2nm (N2) will come sometime in 2025. New technologies will be used to make advanced CPUs, GPUs and SoCs. Apple, Intel are some of the companies that demand N3 chips. TSMC, amongst other Taiwanese foundries have the competitive edge and should continue to build on increasing its global market share. TrendForce forecast Taiwanese foundries will increase in size by 19.8% in 2022. The data company also project Taiwanese share of global market to increase to 66% in 2022, up from 64% in 2021. As global demand dynamics continue and supply constraints start to ease, we should expect renewed interest in Taiwanese assets.

- **Strong Export Orders First Sign of Green Shoots.** May export orders posted a sharp rebound to 6% y/y, up from -5.5% in Apr. The sharp rebound was attributed to easing shortages in production capacity, raw materials as China eased covid-19 restrictions alongside continuing demand for emerging technologies and applications. In particular, there was solid demand for 5G applications, high performance computing devices, automotive electronics solutions and web-based communication services. In terms of buyers by geography, US was the largest, followed by China, HK and Europe.

- **Growth and Inflation Outlook: Activity momentum is showing signs of slowdown** in recent months amid covid spread in Taiwan. Mfg PMI slipped into contractionary territory of 49.8 in May, from 50 in Apr while industrial production rose at a slower pace of 4.48% y/y in May (vs. revised 6.42% in Apr). DGBAS had earlier 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. That said, not all is gloom and doom, export orders posted a sharp rebound to 6% y/y in May, up from -5.5% in Apr. The rebound was led by mineral products, electronics and electrical products. Taking stock, 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.

- Headline CPI continued to print higher at 3.39% y/y in May, up from 3.38% y/y in Apr. This is the 10th consecutive month that CPI comes in above 2%-target. Food (led by fruits, vegetables) and fuel remain the main drivers of higher inflation. Core inflation also rose 2.6% y/y in May, up from 2.53% in Apr. Ongoing military conflict in Ukraine could continue to complicate supply chain disruptions, keep commodity prices supported and that would continue to feed through to higher CPI in coming months. 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.

- **Monetary Policy Forecast: We expect CBC to continue with its rate hike cycle to raise rate by 12.5bps again at the upcoming MPC on 22 Sep.** We opined that CBC policymakers may opt to preserve monetary ammunition (i.e. not raising rate by larger magnitude of 25bps) as some sectors of the economy (i.e. tourism, self-employed, etc.) still need support as covid/ border restrictions remain – a constraint on domestic demand, tourism sectors. Taiwan’s housing market can be sensitive to interest rates and we believe CBC does not want to cause a housing market meltdown with its aggressive rate hike cycle even though it wants to combat inflation. So far this year, CBC's cumulative hikes of 37.5bps may already have dampened housing market sentiments, alongside covid spread. To some extent, we expect CBC to continue monitoring housing market while still keeping its rate hike cycle alive with a step-down pace of hike.

- At the last MPC (15 Jun), CBC raised rate for a second consecutive time this year but pace of hike reverted to +12.5bps, as we expected. Benchmark interest rate was raised to 1.50%. CBC also raised RRR on NT$ demand deposits and time deposits by 0.25ppts each, effective 1 Jul. The interest on refinancing of secured loans and temporary accommodation are also raised to 1.875% and 3.75%, respectively. The Board judged that raising both the policy rates and RRR would send a clear message that CBC continues to adopt a monetary policy stance of tightening. Governor Yang estimated that 25bps hike in RRR translate to withdrawing NT$120bn from the system

- **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:** Jun mfg PMI (1 Jul); Jun FX reserves (5 Jul); Jun CPI (6 Jul); Jun trade (8 Jul); Jun export orders (20 Jul); Jun unemployment (22 Jul); Jun industrial production (25 Jul); 2Q GDP (29 Jul).

- **Technical Outlook:** USDTWD rebounded in Jun. Pair was last at 29.785 levels. Bullish momentum on daily monthly chart intact though RSI shows signs of turning from near overbought conditions. Bias to lean against strength. Resistance at 29.88 (triple top), 30 levels. Support at 29.65 (21 DMA), 29.53 (50 DMA) and 29.32 levels (23.6% fibo retracement of 2022 low to high).

SGD: Relative Appeal Versus Peers Intact

Forecast	3Q 2022	4Q 2022	1Q 2023	1Q 2023
USDSGD	1.3700 (1.3600)	1.3600 (1.3550)	1.3500 (1.3500)	1.3400 (--)

Previous Forecasts in Parentheses

- **Motivation for the FX View:** Lack of domestic market-moving headlines could imply continued mirroring of broader dollar biases near-term for the USDSGD pair. Dollar is broadly bid against most FX as we head towards month and quarter-end. Haven demand on global/US growth concerns could be supporting the dollar even as the same concerns are leading to increasing bets for a Fed rate cut next year and weighing on UST yields. We adjust our near-term USDSGD forecasts slightly higher to account for such trends. Still, backing off in UST yields from recent highs could help constrain the extent of interim USDSGD upswings. On a basket basis, SGD NEER has been edging higher gradually (likely hovering in upper half of our earlier +0.5% to 1.5% above par projection range), in line with relative "haven" demand as regional and global uncertainties rise. We remain buyers of SGD NEER on dips. We also note tentative improvement in sentiments tied to China growth/Covid outlook, particularly towards late Jun. While broader global growth risks could lead dollar to see near-term support, risks for USDSGD pair could still be tilted to downside (albeit gradually) in the coming quarters, as relative appeal of SGD remains intact, aided by front-loading of monetary policy tightening and favorable macro fundamentals such as ample fiscal space, resilient trade outturns and current account surpluses.

- June largely saw another hawkish pivot in Fed stance, on account of elevated price pressures in the US and signs of resilience in the US labor market. Fed hiked by +75bps and warned that it might have to do the same in Jul, even though Powell explicitly said that moves of this size are uncommon. Latest dots plot (median expectations) also show policy rate peaking near 3.75% next year before heading lower towards 3.375% in 2024. Dollar and UST yields saw some support as a result. **On net, global growth risks remain elevated, and haven demand for dollar could be intact near-term**. Still, we note signs of markets pricing in an earlier peak in Fed policy rate (around 3.5%), by early 2023, given recessionary concerns. So while a softer global growth outlook could weigh on pro-cyclical SGD, **lower/earlier peak in Fed policy rate and concomitant dip in UST yields could help constrain SGD losses**. UST yields continue to shy away from recent highs, with UST10Y yield near 3% last seen versus June high near 3.5%.

- **Domestically, lower likelihood of return to strict Covid curbs could help anchor sentiments.** 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 14 June, capacity limits and requirements for negative ART tests were also removed for nightlife establishments. Continued recovery in domestic consumption could put a floor on GDP growth, despite concerns over softer interim external demand. Nonetheless, some caution could be warranted given signs of a broad recent uptrend in recent cases (week-on-week infection ratio >1.5 in late Jun), but given sufficient healthcare capacity, high vaccination rates, well-communicated policy measures and significantly-reduced chance of wider lockdowns, domestic sentiments are unlikely to sour excessively.

- **Negative contagion from China growth moderation or yuan depreciation concerns to SGD could be easing.** In the last few monthly reports, 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. This largely came to pass subsequently, with more signs of easing in curbs in key cities, despite the official Covid-zero stance. China PMIs, both manufacturing and non-manufacturing, also returned to expansionary territory in Jun, giving cause for cautious optimism.

- We also note some pertinent domestic developments on various fronts. Finance Minister Lawrence Wong, a key figure in the Covid crisis management and budget design, was promoted to DPM on 13 Jun. This represents the next phase of the closely-watched domestic leadership transition. Meanwhile, authorities have also launched a governance framework for sovereign green bond issuances under the Significant Infrastructure Government Loan Act 2021 (Singa), establishing guidelines for green bonds issued by the public sector and serving as benchmark for the corporate green bond market. Such developments should be supportive of Singapore's development as a green finance hub longer-term.

- **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, our economist team noted that manufacturing growth accelerated to +13.8% in May as semiconductor production levels climbed to another record high amid resilient demand. Chip production is more resilient than initial expectations despite disruptions from China's lockdowns and slowing global growth. This will provide some lift to 2Q GDP (out in July), which our economist team expects to come in at around 3.5%-4%, extending the +3.7% growth in 1Q. The broader growth momentum is clearly slowing outside of semiconductors. **2022 growth forecast is maintained at 2.8%.**

- Core CPI soared to +3.6% in May, the fastest pace since 2008, with broad increases in food, services, retail and utilities costs. Headline CPI (+5.6%) inched up on rising private transport costs and rentals. **Our**

economist team raises 2022 average inflation forecasts for core CPI to +3.2% (from +3%) and headline CPI to +5.1% (from +4.8%) to account for the stronger than expected price pressures.

- **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.

- MAS may still maintain the current appreciation stance in October, as core CPI will likely peak in 3Q, but any signs of sustained inflation momentum could lead to an additional tightening move (likely steepening of slope, 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 1.3920, and trades around +1.4% from the new implied mid-point of 1.4120, with the top estimated at 1.3838 and the floor at 1.4403. 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 near-term. 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". The trading range has been well respected in recent months and 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 0.7720% and 1.9125% at the time of writing, higher than the 0.5263% and 1.3379% seen in end-May. While risks might continue to be skewed to the upside for rate moves, MAS' stress test (published Dec 2021) shows that the household mortgage servicing ratios (MSRs) remain manageable under a conservative scenario of shocks to income and interest rates arising from a virulent virus outbreak. Specifically, the observed median MSR remains below the maximum threshold of 60% for the Total Debt Servicing Ratio (TDSR) guideline, even if income falls by 10% from the lows seen during the COVID-19 pandemic and interest rate increases by 250bps. As the bulk of the household liabilities are housing loans, the results suggest that the median household would still be able to service its debt. **House view for 3M SIBOR forecast is raised to 3% (from 2.3%) in 2022 and 3.2% in 2023 (from 2.8%). 3M SORA**

forecast is also raised to 2.75% (from 2.05%) in 2022 and 2.95% (from 2.55%) in 2023.

- **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.

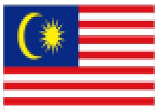
- Budget 2022 stays expansionary with a small deficit of $3bn (0.5% of GDP). There will be increases to the GST rate (7% to 9%), property taxes, personal income tax (for top earners), and carbon tax. Foreign worker policy will be tightened with the hike in minimum qualifying salaries for EP and S Pass 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.

- In Jun, a S$1.5bn package was announced to help combat domestic inflation, including cash handouts (GST vouchers), utilities credits and one-off relief for taxi and private-hire car drivers. Given the overall limited scope of the new measures, spillover impact to SGD should be relatively limited.

- 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. On higher-frequency indicators, NODX rose by the +12.4% in May, the fastest pace in 4 months, but increase was mainly driven by the surge in non-monetary gold from last year's low base. **Further boosts to current account from trade outturns could be somewhat limited, even as some resilience is likely**. Our economist team maintains 2022 NODX forecast at 4%-6%.

- **Key domestic events and issues to watch**: Jun PMI (4 Jul); May Retail sales (5 Jul); 2Q (A) GDP (11-14 Jul); Jun NoDX (18 Jul); Jun CPI (25 Jul); Jun Industrial production (26 Jul), 2Q Unemployment rate SA (28-29 Jul).

- **Technical Outlook**: USDSGD pair last seen modestly above 1.39, swinging discernibly higher in recent weeks versus recent lows below 1.37 in early June, on dollar recovery. But bullish momentum on daily chart shows signs of moderating while RSI is not showing a clear bias. Earlier upswings in the pair could take a breather, and upsides could be constrained from here. Bias to sell rallies, with potential resistance at 1.3960, 1.40, 1.42 levels. Support at 1.3850 (21-DMA), 1.3770 (61.8% fibo retracement from May low to Jun high), 1.3660 (May low).



MYR: Global Growth Concerns and Policy Catch Up Factors

Forecast	3Q 2022	4Q 2022	1Q 2023	2Q2023
USDMYR	**4.35** (--)	**4.30** (--)	**4.30** (--)	**4.25** (--)

No Change to Previous Forecasts

- **Motivation for the FX View: USD/MYR reached a peak of 4.4250 on 14 June as dollar strength continued in the run up to the FOMC meeting before falling on dollar moderation.** 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 and will likely support the pair.

- Malaysia's external trade outlook is still a "battle" between the ongoing commodity price support and the downside of global economic outlook amid Russia-Ukraine war, US monetary tightening and China growth developments. Risks of fallouts from Russia-Ukraine war (especially on Europe), US-led global monetary policy tightening and China's lockdowns are clouding global economic – hence trade - outlook. Thus far, Malaysia is benefitting from commodity and tech exports. Palm oil, LNG and crude oil contributed to 23% of 5M 2022's +23.5% exports growth, with E&Eaccounted for another 48%.

- Meanwhile, Malaysia exports to EU remained robust (May 2022: +30.2% YoY; Apr2022: +31.1% YoY; 5M2022: +22.4%; 2021: +22.8%), notwithstanding Russia-Ukraine war. Exports growth to US continued at healthy pace (May 2022: +15.5% YoY; Apr 2022: +18.1% YoY; 5M2022: +13.2%; 2021:+30.4%). And there is no major "damage" from China's lockdown amidcontinued growth in exports to (May 2022: +10.1% YoY; Apr 2022: +12.4%YoY; 5M2022: +16.0%; 2021: +26.0%) and imports from (May 2022: +11.9%YoY; Apr 2022: +8.6% YoY; 5M2022: +16.4%; 2021: +33.0%) China.

- 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 picked up to +2.8% YoY in May 2022 (Apr 2022: +2.3% YoY; 2021: +2.5%) mainly on food & non-alcoholic beverages (FNAB) inflation (May 2022: +5.2% YoY; Apr 2022: +4.1% YoY), partly also due toseasonal demand effect i.e. Ramadhan and Eid. Transport inflation rose +3.9% YoY (Apr 2022: +3.0% YoY; 5M 2022: +3.9% YoY; 2021: +11.0%) as theimpact from current elevated global crude oil price was mitigated by fuel subsidies. MoM, headline CPI was up by +0.6% (Apr 2022: +0.2%). Meanwhile, headline inflation rate ex-fuel price accelerated to +2.7% YoY(Apr 2022: +2.2% YoY; 2021: +1.2%). Core CPI quickened to +2.4% YoY (Apr 2022: +2.1% YoY; 2021: +0.7%) amid pent up discretionary spending andservices demand effect of economic opening e.g. restaurants & hotels;recreation services & culture; furniture, household equipment & routinehousehold maintenance.

- We revised upwards our 2022 & 2023 inflation rate forecasts to +3.4% (from +2.7%) and +4.1% (from +2.5%) respectively as we incorporate higher chicken and cooking oil prices starting Jul 2022 following higher ceiling price for chicken and removal of cooking oil price subsidies, aswell as the assumption of fuel price subsidy review in 2023. Governmentannounced the removals of ceiling price for chicken and price subsidiesor (pure, unblended) cooking oil in 2kg, 3kg and 5kg bottles, effective 1Jul 2022, but maintain the subsidy for cooking oil in 1kg polybag priced at MYR2.50/packet. We also assume higher prices for RON95 and diesel starting Jan 2023 on fuel subsidy review. Our revised 2022-2023 inflation rate forecasts assumed e.g. unsubsidized 5kg bottled cooking oil price of around MYR40 (from around MYR30); ceiling price for chicken of around MYR12/kg (from MYR8.90/kg); and 25% increase in RON95 and diesel prices next year. Meanwhile, to mitigate the cost of living impact from the mainly food and fuel inflation, the Government also announced no hikes in power and water tariffs in Peninsular Malaysia.

- **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 two more 25bps hikes coming in July 2022 and in 4Q 2022, to be followed by 50bps 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 +75bps hikes to 2.50% in 2022 and +50bps 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-19 level 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:** Jun PMI Mfg (1 Jul); BNM Monetary policy decision (6 July); Foreign Reserves (7 & 22 Jul); Industrial Production (8 Jul); Jun Trade (20 Jul); Jun CPI (22 Jul).

- **Technical Outlook:** USDMYR extended gains. Last at 4.41 levels. Bullish momentum on monthly chart intact though RSI is near overbought conditions. On the daily charts, mild bearish momentum shows signs of fading while RSI rose. Risks are to the upside. Resistance at 4.4280, 4.4450. Support at 4.4020 (21 DMA), 4.38 and 4.3780 (50 DMA).

IDR: Caution Warranted Near-term

Forecast	3Q 2022	4Q 2022	1Q 2023	2Q 2023
USDIDR	**14,700** (14,400)	**14,500** (14,300)	**14,400** (14,200)	**14,300** (14,200)

Previous Forecasts in Parentheses

- **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 towards May-Jun, alongside reports of China partial Covid lockdowns in some cities (likely weighing on commodity demand outlook), worries over Fed normalization (i.e., portfolio outflows), and uncertainty relating to export policy. To some extent, global growth concerns emanating from the complex confluence of Ukraine war, global Covid risks, withdrawal of global monetary stimulus etc. could lend some support to USDIDR near-term. 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 gradually unwinding. Latest data out of China also shows some signs of demand recovery. We adjust USDIDR forecast trajectory modestly higher to take into account BI's relative laggard status in policy normalization and some signs of interim softness in commodity prices. But medium-term view of IDR (2023) continues to lean towards cautious optimism, given expectations for relatively resilient Indonesia growth pace and fiscal discipline. In the coming quarters, constrained UST yields (as recessionary fears induce bets for turnaround in Fed stance next year) and potential recovery in Indonesian CPO prices (as export curbs continue to ease), could also be supportive of IDR sentiments over time.

- **Trade surpluses could see modest near-term drags from global growth concerns, export policy volatility**. 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 significantly in recent months, most of these commodities continue to see elevated price ranges versus pre-Russian invasion. This will help provide some support to the trade surplus, even as intermittent drags could occur on above-mentioned factors.
  - Late Apr saw 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.
  - On net, CPO prices are seeing some signs of support after the earlier declines. Our equity strategists believe Indonesia's low net CPO prices (partly on slow issuance of export permits) is temporary. Under normal circumstances, the net CPO price in Indonesia would have been ~MYR1,000/t higher than current level (late-Jun).
- **April-June rout in US treasuries triggered by recent hawkish shifts in Fed signalling dampened IDR sentiments, with the June bout of UST yield climb above 3% having a more discernible drag.** 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 415bps. **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**. Near-term drags on IDR from portfolio flows appear intact, with June MTD net outflows in equities and bonds reaching -US$501mn and -US$2185mn, respectively. But on bond outflows in particular, we note that magnitude is more modest versus Covid onset in Mar 2020 (-US$7538mn). Meanwhile, we note signs of markets pricing in an earlier peak in Fed policy rate (around 3.5%), by early 2023, given recessionary concerns. 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.

- **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, still resilient 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 0.5% of GDP in 2022 compared to pre-pandemic deficit of above 2.5% of GDP. Foreign reserves for May came in at US$135.6bn, largely on par with US$135.7bn prior, and remaining near historical highs.

- On Covid, 7-day average in Covid-19 cases was seen at around 2k in late Jun. While there are signs of a gradual uptick in recent weeks, case counts remain low 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 May came in at 50.8 versus 51.9 prior. But retail sales (+5.4%) rose to the highest level in 3 years in May, boosted by the Ramadan holidays. **Our economist team maintains 2022 GDP growth forecast at +5.1%**. While private consumption is expected to remain resilient in 2Q, supported by growing consumer confidence and the Ramadan holidays, rising food and energy costs may weigh on consumer optimism in the second half of the year.

- On price data, headline CPI (+4.3%) breached BI's target range in June, driven by the jump in food prices. But core inflation (+2.6%) rose at the same pace for the third month. Our economist team maintains headline inflation forecast at +3.7% in 2022 (1H22: +3%), with inflation likely to stay above +4% in the second half of the year.

- **Monetary Policy Forecast:** BI maintained its policy rate at 3.5% on 23 Jun, placing it as an outlier in terms of policy normalization trends. Governor Perry stated that there is no rush to raise the policy rate as inflation remains manageable thanks to government subsidies. The governor reiterated that inflation will likely exceed the upper band of BI's target range (2%-4%) this year, but return to within the target range in 2023. The decision to hold will support economic growth amid rising external pressures such as stagflation risks. BI expects the Fed fund rate to rise to 3.5% by the end of 2022 and 4% in 2023.

- The current account is expected to remain in surplus in 2Q with healthy exports of main commodities such as coal, steel, and metal ore. BI maintained its 2022 current account deficit forecast at 0.5%-1.3% of GDP. More resilient current account dynamics could help mitigate sentiment drags from recent portfolio outflows.

- BI governor Perry Warjiyo recently reiterated that the central bank is in no rush to hike interest rates, as core inflation remains low due to subsidies that have kept energy prices stable. This implies that BI will leave policy rate unchanged in the next meeting on 21 July (which takes place before the Fed's meeting on 26-27 July), barring a significant pressure on the IDR in the run-up to the meeting. **Our economist team maintains view that BI will hike by +75bps this year, but the first rate hike may be pushed back to August or September when core inflation picks up more visibly**. Divergence in Fed-BI policy stances could be supportive of USDIDR near-term.

- **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 for 2021, 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 IDR1070trn as of May, representing 58% of the targeted revenues for 2022, and a 47.3% 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**.

- Export growth eased to +27% in May due to the 3-week ban on palm oil shipments, resulting in the trade surplus ($2.9bn) narrowing to the lowest level since Jan 2022. We expect drags on the trade surplus to moderate as the export ban unwinds, but this could take several months. On net, house view looks for current account to come in at a modest deficit of -0.5% of GDP, versus mild surplus of +0.3% of GDP in 2021. **Outlook remains resilient for the year, which could help mitigate recent IDR drags.**

- **Key domestic events and issues to watch**: Jun PMI Mfg (1 Jul); Jun CPI (1 Jul); Jun Foreign reserves (7 Jul); Jun Trade (15 Jul); Jun Local auto sales (15-21 Jul); BI Monetary policy decision (21 Jul).

- **Technical Outlook:** USDIDR last seen at 14,950, significantly higher versus near-14600 in end-May. Bullish momentum on daily chart remains intact although RSI has notably breached overbought conditions. Pair could test key resistance at 15,000 intermittently, even as sustained breakout higher for longer looks less likely at this point. Signs of bearish divergence could constrain extent of upswings. Besides 15,000, next resistance at 15,200. Support at 14,720 (21-DMA), 14,600 (50-DMA).

PHP: Current Account Woes, Policy Uncertainty and Fed-induced Drags

Forecast	3Q 2022	4Q 2022	1Q 2023	2Q 2023
USDPHP	**54.50** (52.50)	**54.00** (52.00)	**53.50** (51.50)	**53.00** (--)

Previous Forecasts in Parentheses

- **Motivation for the FX View:** Between late March and early Apr, PHP benefited from a 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 ongoing rapid Fed normalization, supported oil prices (larger energy import burden, current account deterioration), incremental policy uncertainty (change of leadership with Marcos winning May Philippines presidential elections), China growth concerns etc., the earlier bout of positivity has unwound and PHP has seen a significant bout of depreciation pressures in June. USDPHP is now at highs last seen in 2005. To some extent, despite the start of its rate hike cycle in May, BSP is now perceived to be a laggard versus other central banks. Widening Fed-BSP divergence in pace of tightening could keep USDPHP supported for now. Still, we note signs that BSP may be more willing to utilize larger rate hikes if downward pressures of PHP are viewed as too excessive. Domestic manufacturing recovery is also gaining traction (PMI Mfg for May at robust 54.1, following 54.3 in Apr). Signalling from President Marcos that he will continue Duterte's aggressive infrastructure programme, as well as potentially more signs of credible policymaking in 2H, could help to anchor domestic sentiments. 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**. While global growth concerns towards late-Jun has led to some paring of earlier gains, brent is last seen still >US$100/bbl. Extent of oil price upsides 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. Admittedly, impact of (iii) could be more modest near-term. Market chatters are that UAE and Saudi Arabia are already pumping almost as much oil as they can. Latest data also show OPEC+ members producing 2.7mn b/d below their collective target. 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 800 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. For the first half of July, Metro Manila 47 provinces and some cities will be observing Alert Level 1 restrictions. Modestly stricter restrictions (Level 2) will be in place in 34 provinces; affected localities are mainly in Mindanao. 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 further in Apr to +3.9%y/y (Mar 2022: +3.2%), a net positive for sentiments. Our economist team's 2022 OFWR growth forecast is +4.2% (4M 2022: +2.7%; 2021: +5.1%). OFWR outlook faces the upsides from host economies' re-openings and the downsides from Russia-Ukraine war drags on Europe plus risk of US hard landing. Historical data suggests positive correlation between OFWR and crude oil price, USDPHP in the event of stronger USD/weaker PHP, and domestic inflation rate. Meanwhile, foreign reserves came in at US$103.5bn, seeing a mild decline versus US$105.4bn prior, but remaining high versus historical averages (2012-19 average around US$81bn). **On net, resilient remittances flows and adequate reserves could still help mitigate PHP drags over the year**.

- On domestic politics, **interim challenge for Marcos is in building 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. **Concerns on policy uncertainty could moderate a tad in 2H as policies are rolled out**.

- **Some spillovers from soft yuan and China Covid/growth risks was likely in play for the AxJ FX complex, but concerns could have eased a tad.** We note more signs of easing in curbs in key Chinese cities, despite the official Covid-zero stance. China PMIs, both manufacturing and non-manufacturing, also returned to expansionary territory in Jun, giving cause for cautious optimism. **PHP could also 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. But alongside heightened external risks and BSP interest rate hikes cycle kicking off, **our economist team maintains GDP growth for 2022 at 6.5%.**

- On higher frequency indicators, PMI Mfg for Jun came in at 53.8, following outturns of 54.1 prior, reflecting some traction in the domestic economic recovery. Unemployment rate improve further to 5.7% in Apr (Mar 2022: 5.8%; 4M2022: 6.1%), the lowest since the start of the pandemic. Nevertheless, labour force participation rate dropped to 63.4% (Mar 2022: 65.4%), attributed to the global supply chain disruptions and seasonal factors in agriculture. Underemployment rate eased to 14.0% (Mar 2022: 15.8%). Our economist team revises 2022 and 2023 unemployment rate forecasts to 5.5% and 5.0% respectively from 6.0% and 5.3% previously (2021: 7.8%).

- Headline inflation rate accelerated further to +5.4%y/y in May 2022 (Apr 2022: +4.9%; 5M2022: +4.1%), well above the upper end of BSP's target range of 2%-4%, on higher FNAB, HWEGOF and transport costs. **Our economist team maintains 2022 and 2023 headline inflation rate forecasts at +4.6% and +3.3%, respectively (2021: +3.9%).**

- **Monetary Policy Forecast:** BSP raised policy interest rate by another +25bps to 2.50% at the fourth meeting of 2022 (23 Jun), the second +25bps rate hike this year. BSP also raised its inflation forecasts for 2022 and 2023 to +5.0% (from +4.6%) and +4.2% (from +3.9%) respectively. As the economy expanded by +8.3%y/y in 1Q 2022 (4Q 2021: +7.8%), mainly driven by domestic demand while unemployment rate fell to pandemic-era low of 5.7% in Apr 2022 (4M 2022: 6.1%), BSP's focus now is clearly on taming inflation. Furthermore, BSP also estimated that output gap could have closed in 1Q 2022 and is expected to remain broadly neutral during the year as economic recovery continues to gain traction. **Our economist team now expects a total of +100bps rate hike this year to 3.00% vs +75bps to 2.75% previously, while maintaining the forecast of 4.00% in 2023.**

- At one point, incoming Governor Felipe Medalla had said that he aimed to raise rates at a measured pace beyond Aug, as "monetary policy cannot turn back this kind of global pressures on prices". Outgoing BSP Governor Diokno also commented on letting PHP "determine its own level", suggesting that likelihood of BSP intervening to prop up the currency is somewhat low for now. These developments could have dragged on PHP sentiments a tad. **But more recently, we note some tentative shift in tones from Medalla, who said that the central bank might consider bigger rate hikes (than planned +25bps) to support the PHP, even as it would not be obliged to match policy tightening by the Fed.**

- **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 May 2022 is around -PHP92bn, 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.

- Finance chief-designate and BSP Governor Benjamin Diokno said that the Marcos administration will not be reducing government spending just to address widening budget deficits. Instead focus should be on raising sufficient taxes through reasonable means. The plan is still to bring down government deficit to 3% of GDP by 2028. For 2022 to 2025, the budget deficit ceilings are currently set at 7.7%, 6%, 5.1%, 4.1% of GDP, respectively.

- In Apr 2022, exports growth stayed single-digit at +6.0%y/y (Mar 2022: +5.9%) on high-base effects, manufacturing exports slip and commodity exports surge amid continued double-digit imports growth of +22.8%y/y (Mar 2022: +27.8%) mainly reflecting impact of high global commodity and input prices amid slower capital and consumption goods imports. Trade deficit was -US$4.8b (Mar 2022: -US$5.0b). Shipments to EU and China are showing impact of Russia-Ukraine war and China's lockdown.
    - **Alongside signs of recent widening in trade deficit, PHP sentiments could be dampened by recent revisions in current account deficit forecast by BSP, as elevated commodity prices raises import burdens**. The 2022 deficit is now expected at US$19.1bn, 17% higher than the US$16.3bn deficit forecast made in the first quarter. BoP for May came in at deficit of -US$1606mn, deteriorating from -US$415mn prior.

- **Key domestic events and issues to watch:** Jun PMI Mfg (1 Jul); Jun CPI (5 Jul); May Unemployment rate (7 Jul); Jun Foreign reserves (10-15 Jul); May trade (12 Jul); May Overseas Remittances (14-17 Jul); Jun BoP Overall (18-23 Jul); Jun Budget balance (22 Jul).

- **Technical Outlook:** USDPHP last seen at 55.09, seeing a surge in June. Momentum on daily chart shows very tentative signs of moderation while RSI suggest significantly overbought conditions, suggesting that pace of gains could slow. Resistance at 55.30 (recent high), 56.00. If up-moves remain resisted by key resistances, we could see pair paring gains towards support at 54.3 (23.6% fibo retracement from Apr low to Jun high), 53.7 (38.2% fibo).

THB: Cautious Optimism in Tourism Outlook Unable to Offset Policy Laggard Woes

Forecast	3Q 2022	4Q 2022	1Q 2023	2Q 2023
USDTHB	**34.80** (34.30)	**34.40** (33.90)	**34.00** (33.40)	**33.60** (33.00)

Previous Forecasts in Parentheses

- **Motivation for the FX View:** Towards end-Jun, USDTHB saw another bout of upswing, and is now back near YTD highs (35.60) as of writing. External risks in the form of disruptions to supply chains from Russian war, more cautious China outlook, removal of monetary stimulus by major central banks etc., remain intact. Policy divergence versus Fed is notably inducing interim portfolio outflows, but earlier stretched view of how hawkish the Fed can be has unwound a tad given a modest shift in market chatter towards growth concerns. We note signs of US treasury yields heading lower from recent highs towards end-June. There have also been modest positive adjustments in the tourism outlook in Thailand (despite maintainance of Covid zero stance in China). On net, some caution is warranted near-term and USDTHB pair could remain in buoyant trading ranges for a while yet, especially with signs of weaker trade balance (elevated energy bills), but as tourism revenue receipts provide incremental support over time, THB drags could ease into 2023.

- A key market mover in March-Jun was an increasingly hawkish Fed, as persistently high inflation readings eventually forced Fed to hike byb+75bps in June. But in recent weeks, markets appeared to have pared back hawkish expectations on Fed. Chatters of US recession risks could lead Fed to be more careful in calibrating rate hike pace later in the year. Reflecting these sentiment shifts, OIS-implied market expectations for year-end Fed policy rate has moderated to around 3.3% at last seen, from high of around 3.8% in mid-June. 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. For THB, trends in portfolio flows might be an indicator to watch. Some net inflows into bond assets were seen in the second half of May but this reversed into outflows as QT began in June. Ongoing portfolio outflows (-US$841mn in equity outflows and -US$440mn in bond outflows MTD as of 30 Jun) weighed on THB for much of this month. **Some caution could be warranted on the portfolio flow front for now.**

- THB continues to be impacted by oil price swings, given its role as an net oil importer. While global growth concerns towards late-Jun has led to some paring of earlier gains, brent is last seen still >US$100/bbl. Extent of oil price upsides 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. Admittedly, inpact of (iii) could be more modest near-term. Market chatters are that UAE and Saudi Arabia are already pumping almost as much oil as they can. Latest data also show OPEC+ members producing 2.7mn b/d below their collective target. On net though, **conditional on oil gains potentially seeing some moderation in 2H, THB sentiments could see modest support over time**.

- On a related note, reports in June suggest state run-importers of LNG reducing purchases at some point due to elevated prices and limited availability. Concerns over potential energy shortages (about 2/3 of Thailand's electricity was generated from natural gas from Jan-Apr) could add to growth worries.

- 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 2k in late-Jun, 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. Authorities announced that they were abandoning the pre-registration ("Thailand Pass") for foreign visitors from 1 Jul and would also no longer require face masks to be worn in public. Tourism recovery is ongoing, with authorities expecting about ~1.5mn tourists a month in 2H versus <300k in Apr. Recent reports of China shortening quarantine for inbound tourists also induced a positive THB reaction, even as gains were short-lived. It could take more time for a more discernible recovery in tourism activity, given that Chinese tourists (28% of total visitor arrivals in 2019) will unlikely return this year. But sequential growth in tourism receipts can still help to stem THB drags. Pre-Covid levels were closer to 40mn, with tourism sector accounting for about 12% of GDP.

- **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.

- On higher-frequency indicators, PMI Mfg came in at 50.7 for June, moderating from 51.9 prior but remaining in expansionary territory. Domestic demand picked up in May as both private consumption and investment improved with the reopening tailwind. Exports were resilient while tourist arrivals climbed with the easing of travel restrictions. **Our economist team maintains 2022 GDP growth forecast at +3.2%**. While tourism will support growth, we remain cautious on the outlook for private consumption, which may be dampened by surging living costs and high household debt.

- Headline CPI jumped to +7.1% in June, the fastest pace since July 2008, fuelled by the acceleration in energy costs and food prices. **Our economist team raises 2022 average headline CPI forecast to +6.0% (from +5.2%)**, accounting for BoT's guidance, as well as the faster than expected rise in food prices and energy costs. 2023 inflation estimate is also raised to +2.2% (from +1.5%), as energy and food prices may remain elevated due to prolonged supply disruptions.

- **Monetary Policy Forecast:** On 8 June, the MPC voted 4-3 to keep its policy rate at 0.5%. BoT cited that given the upside risks for economic recovery and inflation, there would be less need for the current accommodative monetary policy going forward. It raised its headline CPI forecast to +6.2% (from +4.9% in March) in 2022 and +2.5% (from +1.7%) in 2023. House view is now for BoT to hike twice this year for the policy rate to reach 1% by year-end, with the first hike at the next meeting on 10 Aug and the second hike likely in 4Q, given the significantly higher inflation projections. But in terms of rate hike pace, BoT will still lag behind peers. **Widening policy divergence versus Fed could lend support to USDTHB near-term**.

- An MPC member Kanit commented that the MPC has no plan for an emergency meeting and the next one will be in Aug, as scheduled. Instead, authorities will be combating inflation with energy subsidies, price caps on essential items. But we note a BoT comment that officials were closely monitoring capital movements as well as THB, and would be ready to take action on excessive volatility.

- **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.

- Parliament passed the first reading of a THB3.185trn draft budget bill for FY2023 (starting 1 Oct), with 278 votes in favour, 194 against and 2 abstentions. The budget sees spending growth of 2.74% in spending and projects deficit at around 3.9% of GDP. The bill still has to pass second and third readings in Aug before being sent for senate and royal approval. Signs of progress in the budget process could be net positive for THB, even as broader external cloudy outlook could mitigate extent of positive spillovers.

- Recent comments from Finance Minister Arkhom suggests that authorities will focus on maintaining fiscal discipline after the large bout of borrowing earlier. 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**.

- The current account deficit widened to US$3.7bn in May (vs. $3.4bn in Apr), the largest monthly deficit since April 2013, despite the jump in tourist arrivals. This was mainly due to the larger deficit in the net services, income & transfers balance ($5.7bn vs. $4.2bn in Apr) following a large remittance of profits and dividends by foreign businesses, that offset the larger goods trade surplus ($2bn vs. $1.1bn in Apr). Exports (measured on a balance of payments basis) surged by +11.3% in May (vs. +6.6% in Apr), driven by agriculture (+24.5% vs. +1.5% in Apr) which benefited from rising food prices and supply concerns. But imports also surged by 23.3%, constraining the boost to trade balances. **Near-term underperformance on the 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. The deficit in the services account could narrow in the coming quarters as visitor arrivals improve.

- **Key domestic events and issues to watch:** Jun PMI Mfg (1 Jul), Jun Business sentiment (1 Jul); Jun CPI (5 Jul); Jun Consumer confidence (7-11 Jul); Jun Customs trade (22 Jul); Jun Manufacturing Production (26-29 Jul); Jun BoP Current account (29 Jul).

- **Technical Outlook**: USDTHB last seen near 35.60, seeing a step-up in June. Bullish momentum on daily chart has largely moderated, while RSI is nearing overbought conditions. Double-top in USDTHB (bearish signal) could be emerging if resistance at 35.60 holds. Besides 35.60, next resistance at 36.00 (2017 high), 36.50. Support at 35.00 (21-DMA), 34.60 (50-DMA).

INR: Crude Drags and Tightening Pressure

Forecast	3Q 2022	4Q 2022	1Q 2023	2Q 2023
USDINR	79.00 (75.00)	79.50 (74.50)	79.50 (74.50)	80.00 (74.50)

Previous Forecasts in Parenthesis.

- **Motivation for the FX View:** We downgraded rupee on elevated energy prices, potential for aggressive tightening that could slow domestic demand and persistent equity-outflows. Recent activity data show promise of manufacturing and agriculture recovery, buoyed by various subsidies for now. Growth recovery may start to slow as RBI continues to raise policy rates.

- Thus far, India's oil import bill had also likely been cushioned by the rising import of Russian oil. Russia has become one of India's largest supplier of crude oil (at 840K bpd for May vs. 136K in May 2021 and projected to be almost 25% of India's total imports vs. 2% last year according to Kpler) and that has attracted the attention of G7 looking to impose a price cap on Russia oil. US has started talks with India on a potential agreement and implementation of a price cap. At this point, there is still a lack of details on the execution but there are speculations that NATO may allow retention of insurance coverage for Russian oil shipments (95% of which are provided by the International

Group of Protection & Indemnity Clubs in London) as long as they adhere to a certain price cap. Such talks could have contributed to the recent decline in oil prices but chances of success could be difficult to determine as Russia had chosen to cut gas shipment on EU nations before. Meanwhile, prices of Russian crude oil have started to rise on strong demand which could increase India's oil import bill.

- The abrupt start of the rate hike cycle on 4 May had unnerved markets, spurring almost $15bn of equity outflow for 2Q 2022. SENSEX and NIFTY clocked ytd declines of 14% each (as of 30 Jun) and tightening financial conditions, elevated commodity prices, risks of global recession could exacerbate outflows and weigh on the INR. RBI has been defending the INR to slow the pace of its depreciation but the bearish trend needs a significant unwinding of long USD position to reverse.

- **Growth and Inflation Outlook:** Industrial production beat expectations with a 7.1%y/y growth in Apr vs. previous 2.2% (revised higher). Strong growth was seen in all categories with heavily-weighted manufacturing (4.9%y/y vs. previous 0.5%) contributing the most to the headline, underpinned by subsidies for manufacturing facilities and agriculture (fertilizers). Mining and electricity output also picked up pace with expected at 1.9%y/y for Mar vs. 1.5% in Feb, buoyed by faster growth in electricity production and manufacturing production.

- May PMI suggests that pace of growth steadied for the manufacturing sector with new orders and output growth rates relatively unchanged from Apr. Demand is strong enough for firms to raise selling prices at the fastest rate in over 8.5 years, backed by strong international orders. That said, business confidence seem to have waned a tad amid concerns of rising input costs (commodities, financing rates).

- CPI eased from 7.79%y/y to 7.04% for May. The softening of inflation was across the board in its breakdown. Food inflation softens to 7.97% from previous 8.31%. Clothing and footwear weakens to 8.85% from pervuous 9.85%. Fuel and light eased to 9.54%y/y from previous 10.80%. There were quite a number of factors at work including india's choice to import oil from Russia that caps the oil prices for May, various subsidies such as those for fertilizers, export bans on sugar and wheat as well as the surprise rate hike by RBI that probably dampen inflation expectations. The back-to-back rate hike by RBI could mean that inflation could ease further but the recent increase in Russian oil price could mean that Modi's administration and the RBI may need to do more to help alleviate cost pressure. India raised basic import tax on gold to 12.5% fom 7.5%, as well as tax on exports of gasoline and jet fuel. We reckon the gold import tax was imposed to keep its trade deficit from widening. Tax revenues from gasoline and jet fuels may be used help with its fiscal deficit.

- **Monetary Policy Forecast:** RBI is likely to take the repo rate by another 50bps to 5.40% at the Aug meeting. Recent decline in CPI was modest and May's print of7.04%y/y could still be uncomfortable for the MPC and the central bank may continue to tighten monetary policy further to arrest inflation. A hawkish RBI could continue to spook investors and spur equity outflows. We look for the central bank to ease pressure on the INR by means of intervention so as to keep depreciation at a measured pace.

- 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 widened to $24.3bn in May vs. previous $20bn. Exports growth slowed to 20.6%y/y vs. 30.7% while imports doubled in pace to 62.8%y/y vs. 31.0% previously. The deficit likely deteriorated given 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: Jun** Mfg (1 Jul), Services PMI (5 Jul); May industrial production, Jun CPI (12 Jul); Jun WPI, Jun trade (14 Jul); Jun Fiscal deficit (29 Jun).

- **Technical Analysis:** 1M USDINR NDF retains a bullish bias and was last at 79.30. This pair retains a bid tone with MACD bullish and stochastics still rising. The NDF seems to have formed a rising wedge. While risks are still to the upside for this pair, there is reversal risks. Support at 78.40 (21-dma) before the next at 77.90 (50-dma).

VND: Oversold

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

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. Some stabilization of the yuan as well as a potential for further USD and UST yield decline could also lend some support to the VND. Net equity outflow (due to the scrutiny of the stock markets by the government that had weighed on bourses in the past several weeks) seems to have ebbed and inflow could be more supportive of the VND into 2H.

- Chief of the General Statistics Office Nguyen Thi Huong projected full-year growth to be between 6.5-7.0%, beating official target of 6-6.5%. Vietnam continues to benefit from open borders, strong tourism arrivals and foreign direct investment with disbursement up 8.9% to $10.6bn (highest in 5 years). Low base effects could potentially result in a stronger GDP print for the next quarter. Large infrastructure projects (highways to link southern provinces, eastern part of North-South Expressway) are in the works and Vietnam is one of the few Asian countries to possibly receive new financing for its transition to clean energy that will be linked to the rebranded global infrastructure investment partnership formed by the G7 leaders recently. This scheme is an alternative to China's Belt and Road Initiative.

- While inflation has started to rise, the focus of the government is still on growth so any monetary action to raise policy rates would have to be deferred to 4Q.

- USDVND has crept above the 23200-level. Room for USD upside could be limited (given an incredible 175bps rate hikes priced for the Fed for the rest of the year). VND weakness seems to have played catch-up with regional currencies in May-Jun. 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: Vietnam continues to benefit from open borders, fading omicron wave and healthy FDI flows.** GDP accelerated to 7.7%y/y from previous 5.1%, driven by industry and construction as well as services.

- **Manufacturing output was strong at 11.5% (vs. 7.7% in 1Q) while clothing's accelerated to 23.5% (vs. 19.2% in 1Q). Computer, electronic and optical products accelerated to 15.4% from 5.7%, led by electronic components (+15.6%y/y vs. 10.5% in 1Q). Consumer electronics output was comparatively softer at 8.6% (vs. 2.5% in 1Q) due to the halt in procurement and shipments by Samsung Electronics - which could have knock on effect on its exports. Industrial production firmed to 11.5%y/y from previous 10.4%. The ability to get more coal supply from Australia has enabled electricy and gas output to pick up in growth to 6.3%y/y from Apr-May average of 2.6%.**

- **Services** surged to 8.6%y/y from previous 4.6%, buoyed by strong spending on accommodation & food services (25.9%y/y) vs. previous -1.18% after Vietanm reopening its borders to international tourists in Mar. Arts, entertainment & recreation was up 14% vs. previous 2.5%. Retail sales for Jun rose 27.3% vs. previous 19.5%. However, retail sales growth had actually slowed to 1.4% from previous 1.6%. Much as Vietnam has had multiple rounds of tax cuts for its fuels, rising price pressure is still an issue and likely to affect household expenditure. The good news is that there is no sign of a new Covid wave and healthy tourist arrivals could continue to underpin retail sales.

- **CPI accelerated** more than expected to 3.37%y/y from previous 2.86%, underpinned by food and energy. Core inflation also picked up pace to 2%y/y from previous 1.6%. Our economist continues to expect headline inflation to rise steadily throughout the year as firming demand encourages businesses to pass on higher costs to consumers. He looks for annual average headline inflation to come in at 3.74% for 2022.

- Our economist revised 2022 GDP forecast to +6.9% from previous 5.58%, cautioning that the risk of moderation in global growth in 2H could weigh on Vietnam's economic momentum (notwithstanding flattering base effects for 3Q) while rising price pressure crimp on consumption recovery.

- **Monetary Policy Forecast:** Our economist maintains view for a hike of 50bps for the refinancing rate (to 4.5%) and the discount rate (3%) in the 4Q as inflation pressure broadens. Vietnam's lending has risen 8.5%y/y ytd (as of 20 Jun).

- **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. The SBV is said to start tightening lending regulation especially to finance the purchases of properties and stocks in order to stabilize the 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%. 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 Q3-22	End Q4-22	End Q1-23	End Q2-23
USD/JPY	137.00	132.00	128.00	125.00
EUR/USD	1.0500	1.0800	1.0800	1.1000
GBP/USD	1.2200	1.2500	1.2800	1.2800
AUD/USD	0.7000	0.7000	0.7100	0.7200
NZD/USD	0.6400	0.6500	0.6600	0.6600
USD/CAD	1.2500	1.2400	1.2400	1.2300
USD/SGD	1.3700	1.3600	1.3500	1.3400
USD/MYR	4.3500	4.3000	4.3000	4.2500
USD/IDR	14700	14500	14400	14300
USD/THB	34.80	34.40	34.00	33.60
USD/PHP	54.50	54.00	53.50	53.00
USD/CNY	6.75	6.70	6.68	6.65
USD/CNH	6.75	6.70	6.68	6.65
USD/HKD	7.80	7.80	7.80	7.80
USD/TWD	30.00	29.80	29.60	29.50
USD/KRW	1260	1240	1220	1210
USD/INR	79.00	79.50	79.50	80.00
USD/VND	23000	22900	22900	22700
DXY Index	104.36	101.71	100.87	99.37
SGD Crosses	End Q3-22	End Q4-22	End Q1-23	End Q2-23
SGD/MYR	3.18	3.16	3.19	3.17
JPY/SGD	1.00	1.03	1.05	1.07
EUR/SGD	1.44	1.47	1.46	1.47
GBP/SGD	1.67	1.70	1.73	1.72
AUD/SGD	0.96	0.95	0.96	0.96
NZD/SGD	0.88	0.88	0.89	0.88
CAD/SGD	1.10	1.10	1.09	1.09
SGD/IDR	10730	10662	10667	10672
SGD/THB	25.40	25.29	25.19	25.07
SGD/PHP	39.78	39.71	39.63	39.55
SGD/CNY	4.93	4.93	4.95	4.96
SGD/HKD	5.69	5.74	5.78	5.82
SGD/TWD	21.90	21.91	21.93	22.01
SGD/KRW	920	912	904	903
SGD/INR	57.66	58.46	58.89	59.70
SGD/VND	16788	16838	16963	16940
	End Q3-22	End Q4-22	End Q1-23	End Q2-23
JPY/MYR	3.18	3.26	3.36	3.40
EUR/MYR	4.57	4.64	4.64	4.68
GBP/MYR	5.31	5.38	5.50	5.44
AUD/MYR	3.05	3.01	3.05	3.06
NZD/MYR	2.78	2.80	2.84	2.81
CAD/MYR	3.48	3.47	3.47	3.46
MYR/IDR	3379	3372	3349	3365
MYR/THB	8.00	8.00	7.91	7.91
MYR/PHP	12.53	12.56	12.44	12.47
MYR/CNY	1.55	1.56	1.55	1.56
MYR/HKD	1.79	1.81	1.81	1.84
MYR/TWD	6.90	6.93	6.88	6.94
MYR/KRW	290	288	284	285
MYR/INR	18.16	18.49	18.49	18.82
MYR/VND	5287	5326	5326	5341

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

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