Maybank

Macro | FX Research & Strategy

Global

FX Monthly

2019, Issue 7: *Trumping* the Fed with the Tariff Card

What Has Changed This Month?

- We revised USD forecast broadly higher, taking into consideration the Fed's less dovish-than-expected guidance. Asian currency forecasts were calibrated in the face of potential re-emergence of trade war escalation risks.

Our Strategies

- This could be "*Sell-in-May*" all over again. August is another seasonally bearish month for risk assets with the MSCI Emerging Markets Index down in 7 Augusts over the past 10 years, similar to the seasonality of May. This time, trade war is not the only concern although it could still be a dominant driver of risk assets into Aug, with Trump wielding his tariff hammer again on China. The undecided, uncommitted Fed was a disappointment to those who looked for a long and deep easing cycle. Nearer to home, Japan and South Korea took their trade spat to another level by removing each other off their respective white list. The result is - USD King extends its reign against most Asia-ex Japan currencies.

- Ongoing trade spats could render trade-oriented currencies such as SGD, KRW, CNH more vulnerable than regional peers. Safe havens like the JPY and CHF are favored.

- After favouring higher-yielding currencies in the past month, we caution that INR and IDR may come under pressure as carry plays unwind in a more volatile environment. On the other hand, safe haven gold-linked THB could outperform. (Tactical)

- In an environment where antipodeans are under pressure, we see potential for AUD to outperform the NZD as domestic data starts to turn positive for the former, cushioning the AUD from further weakness. That could keep RBA on hold while RBNZ considers unconventional monetary policy with a potential rate cut in Aug. (Tactical)

- We expect GBP to stay under pressure in the interim amid rising probability of no-deal hard brexit being a base-case scenario following the appointment of Boris Johnson (BoJo) as PM and a newly-installed pro-Brexit cabinet. Softer economic activity data and growing fears that the UK economy could suffer amid Brexit uncertainties are expected to weigh further on the GBP.

Analysts

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

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

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

Tan Yan Xi
(65) 6320 1378
tanyx@maybank.com.sg

Top 3 Currency Plays for Aug

Short SGD, KRW, CNH vs. Long JPY
Long USD vs. AXJs
Long AUDNZD

Key Events for the Month Ahead

Date	Event
2 Aug	White House Announcement on EU trade
2-3 Aug	RCEP Intersessional Ministerial Meeting at Beijing
23 - 24 Aug	Jackson Hole Symposium

SEE PAGE 52 FOR IMPORTANT DISCLOSURES.

G7 Global Overview

USD: Fed "Wait-and-See Pause" Window for USD Strength

Forecast	3Q 2019	4Q 2019	1Q 2020	2Q 2020
USD Index	98.67 (96.16)	97.87 (95.85)	97.17 (95.67)	96.69 (95.32)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** The latest FOMC statement was not unanimous, it was also non-committal to a further rate cut and any future ones will be data dependent, Chairman Powell's relatively hawkish response during the press conference and the Fed will end its balance sheet rundown in August, two months earlier than previously planned. All the above, initially pointed to a high likelihood of a pause in the Sep FOMC and paves the way for expectations that the Fed will stay on pause, with upside to the USD and 10 year yields over the next few months at least. Given that markets were expecting some dovish bias, we expect further USD strength to pick-up in Aug. However, the latest Trump tariff announcement and possible China retaliation could worsen global sentiment and growth concerns may emerge, and as such raise some likelihood of a Fed cut in Sep and/or Dec this year.

- The next US-China trade talk discussion due in Sep could either be brought forward or postponed following the announcement by Trump that he would impose 10% tariff on $300bn worth of Chinese imports (wef 1 Sep), a move possibly in response to the less dovish move by the Fed a day ago. This fresh 10% tariff could be raised even higher.

- With his latest threat, expectations of another rate cut in Sep surged to 90% from around 60% seen a day before. 10y yield touched a low of 1.8746%. Aug seasonality tends to be bearish for equities, somewhat similar to May.

- However in the near term, now with the Fed uncertainty out of the picture for the next few months, we are likely to see trade/tech war concerns come to the fore again for the next 1-2 months window where EUR and JPY funding currency status will be further enhanced due to their relative "cheapness". The re-escalation in trade tensions may well see funding currencies (more for JPY) in demand. That can limit the DXY strength but the same cannot be said for USD vs. Asians as US-China trade tensions typically weigh on trade-dependent currencies such as KRW, SGD, CNH.

- We had also highlighted the risk of Fed adopting a wait-and-see approach after a cut, in our last monthly report. We had mentioned that we could see long positioning in USTs unwind forcing a move higher in yields and possibly the USD. As such, our DXY forecasts this month was calibrated higher to reflect these new developments as well as some downward revisions in the other G7 currencies such as the euro, GBP, AUD due to domestic considerations. JPY remains strongly supported and helps to mitigate the DXY strength. However, in the 6-12 month horizon we continue to reiterate our call looking for DXY strength to mildly ease lower as positioning levels fall off by end of this year as market participants focus on potential Dec Fed rate cut as trade tensions re-emerge and some likelihood the Trump administration may increase rhetoric to see USD ease off due to discomfort from sustained USD strength over the next few months.

- Nonetheless, this FOMC pause signaling remains in line with our economics team revisions last month to the FFR to "25bps cut per annum in 2019-2020" from "no change in 2019-2020" previously, in view of the overhang in US-China trade situation. The Fed's target measure of inflation remains well below its 2% target, making more room for Fed to sustain the easing this year.

- Into the end of the year, our base grey-swan scenario is still that of a protracted period of negotiation with "lines of communication" remaining open. Progression on talks taking both sides closer to a deal in late-2019/early-2020 is not impossible and this could help support sentiment and support our view for trade/tech-linked FX to recover. A reversion back to risk-on mood, low vol environment amid central banks on easy monetary policies could still see carry plays outperform at the expense of lower yielders such as JPY.

- **Growth and Inflation Outlook:** Real 2Q GDP growth of 2.1% (QoQ SAAR) was slightly firmer than consensus expectations, as consumer spending posted the strongest performance since the 4Q 17. Consumers accounted for the largest share of growth, as business fixed investment, residential investment and net exports all weighed on the headline. The deceleration from 1Q was largely due to the reversal of positive contributions from inventories and net exports. Final sales to domestic purchasers accelerated to 3.5% from 1.8%. The year-on-year rate of real GDP change slowed to 2.3% from 3.2%. The composition of growth in the second quarter tilted heavily toward consumers, and to a lesser degree, government.

- Information received since the FOMC met in June indicates that the labor market remains strong and that economic activity has been rising at a moderate rate. Job gains have been solid, on average, in recent months, and the unemployment rate has remained low. Although growth of household spending has picked up from earlier in the year, growth of business fixed investment has been soft. On a 12-month basis, overall inflation and inflation for items other than food and energy are running below 2 percent. Market-based measures of inflation compensation remain low; survey-based measures of longer-term inflation expectations are little changed

- Core personal consumption expenditures showed signs of rebounding back toward the central bank's target in June just before a widely anticipated interest-rate cut spurred partly by weak price gains. The core personal consumption expenditures price gauge, which excludes food and energy, climbed 0.2% from the prior month and 1.6% from a year earlier. The broader PCE rose 0.1% on the month and 1.4% annually. While the annual core measure was below the 1.7% median estimate and prior months were revised lower, there were signs of gathering momentum. The core PCE index increased at a 2.5%

annualized rate over the past three months compared with a 1.7% pace in the three months through May and just 0.5% in March.

- **Monetary Policy Forecast:** The FOMC cut its policy Fed Funds Target Rate (FFTR) by 25bps to the 2-2.25% range in its latest 31 Jul meeting, but it was not a unanimous decision (8-2) as Boston Fed President, Eric Rosengren and Kansas Fed President, Esther George wanted to keep rates unchanged. The Fed also announced an earlier termination of its Balance Sheet Reduction (BSR) program in Aug 2019 (from Oct 2019 previously).

- The Jul Fed rate cut was due to implications of global developments for the economic outlook as well as muted inflation pressures even though US domestic conditions remain robust. The FOMC statement did not commit to a further rate cut but it remains a wait-and-see as it says it "contemplates the future path of the target range for the federal funds rate, it will continue to monitor the implications of incoming information for the economic outlook and will act as appropriate to sustain the expansion, with a strong labor market and inflation near its symmetric 2 percent objective."

- Chairman Powell eased build-up pressure in the markets by commenting at the press conference that it is not the beginning of a long series of rate cuts, thus building up likelihood that the Fed will stay on pause in the Sep FOMC with a wait-and-see data dependent phase. Market participants remain for another 25bps cut only in Dec, bringing the upper bound of FFTR to 2.00% by end-2019, which matches the Fed's 2% inflation target. Our Economics team had last month revised the FFR forecast to "25bps cut per annum in 2019-2020" from "no change in 2019-2020" previously.

- **Latest Fiscal and External Balance Outlook:** Overall, growth in US economic activity is likely to slow toward trend as the impulse from the fiscal stimulus fades. The tax plan has not generated a sustained pickup in investment spending. The tax cut and Jobs Act are likely to widen deficit by about $1.5trn over 10 years. The bipartisan budget Act of 2018 to add $320mn in additional spending through FY 2020.

- **Key domestic events and issues to watch in Aug:** ISM mfg (1 Aug); Factory orders, durable goods orders (2 Aug, 3 Jul, 25 Jul); NFP (2 Aug); Trade Balance (2 Aug); Jul CPI (13 Aug); Jul retail sales (15 Aug), Conf Board consumer Confidence (27 Aug); GDP qoq (29 Aug); PCE deflator (30 Aug).

- **Technical Outlook:** Our caution for potential bullish divergence for DXY in the last FX Monthly outlook panned out but the move higher more than met our expectations. DXY was last seen at 98.34 levels. Bullish momentum on daily chart remains intact but stochastics is showing signs of turning from overbought conditions. A rising wedge appears to be forming - typically associated with a bearish reversal. Resistance at 98.90 (2019 high). We still look for a move lower towards support at 98.2 (23.6% fibo retracement of Jun low to Aug high), 97.80 (38.2% fibo), 97.40 levels (50% fibo).

EUR: Funding Currency Status Enhanced

Forecast	3Q 2019	4Q 2019	1Q 2020	2Q 2020
EURUSD	**1.1050** (1.1400)	**1.1100** (1.1450)	**1.1150** (1.1500)	**1.1200** (1.1500)

Previous Forecast in Parenthesis

- **Motivation for the FX View: We revised our EUR forecasts and trajectory profile lower** across the forecast horizon as our downside risks to forecast (previously cautioned for) *unfortunately* materialized. In particular hopes for green shoots of recovery in Euro-area proved short-lived as pace of growth slowed further with risks of a prolonged slowdown while the case of ECB easing in Sep continues to build. In addition, Trump is expected to make an announcement on EU trade (relating to expanded tariff list) - this could further drag EUR lower. Nonetheless, EUR's enhanced status of fund currency may on the contrary provide some buffer against further weakness as risk-off environment typically see funding currencies including JPY and EUR in demand.
- **Tariffs Can Dampen Sentiment and Weigh on EUR:** US Trade Representative's Office released a list of additional EU products including Italian cheese, Scotch Whiskey, Olives, worth about $4bn that could be subjected to tariffs. This is in addition to the $21bn list previously announced. A hearing on the proposed list was scheduled on 5th Aug but it appears that Trump has shifted this earlier to 2 Aug (145pm Washington time). Confirmation of tariffs on EU goods could pose downside risks to EUR.
- **Growth outlook for Germany remains one of the weakest links:** There are some risks that the soft patch in Germany could persist for longer. The Rhine river shipping route is crucial to commerce in the region as the river runs through key industrial zones in Switzerland, Germany and Netherlands before reaching the North Sea in Rotterdam port and is a key passageway for goods including car parts, iron ore, coal, chemicals, etc. Recall that the hot summer in 2018 resulting in low water levels in Rhine River disrupted the shipping of goods, negatively impacting German's economy. Weather forecast suggests the same could be repeated in coming weeks (Germany already hit above 40 C in Jul) and this poses risks to the passageway being disrupted once more (due to low water levels) and pose downside risks to prolonging Germany's economic pains.
- **More Dovish ECB than Fed Weigh on EUR:** The Fed signaled that the recent 25bps cut (31 Jul) was not the beginning of a series of cuts but a mid-cycle adjustment policy but the ECB said that a **significant degree of monetary stimulus** continues to be necessary and they could cut rates or re-introduce QE. **We acknowledge that a "precautionary easing" by ECB to counter downside risks to growth is possible, especially in an environment when most central banks are easing** but an **all-out easing is probably not required at this stage unless economic and financial conditions are far worse than**

known. Potential appointment of Christine Lagarde as the next ECB President (Nov-2019) could see her pushing the European governments to work on fiscal policies to stimulate growth, rather than over-rely on monetary policies.

- **Though the risk of early snap elections in Italy was averted,** General Elections may still be held in early-2020. Political uncertainty could see further weakness on EUR.

- **Growth and Inflation Outlook: Euro-area economy expanded at a slower pace of +0.2% q/q in 2Q**, (vs. 0.4% in 1Q) based on advanced estimates. Growth slowdown was seen broadly across most key economies in Europe including Germany, France, Spain, Belgium and Austria while Italy failed to record any growth for the 4th time in 5 quarters. In terms of activity data, German's data still look soft, in particular, industrial production, retail sales, IFO expectations, ZEW survey expectations, etc. PMIs for Germany, France, Italy, Spain slumped further into contractionary territories. Germany saw steepest drop in export orders since 2009; France saw a sharp fall in output with new orders falling into contraction territory; Italy also saw a reduction in new orders and further decline in business confidence.

- **Headline CPI estimate slowed to 1.1% y/y in Jul, down from 1.3% y/y in Jun.** Services inflation (possibly due to packaged tours in Germany) was the main drag, followed by energy prices. Core inflation also slowed to 0.9% y/y, down from 11.1% in Jun. CPI remains well below ECB's sub-2% goal. In the recent ECB's release of latest survey of professional forecasters, 2019 inflation was revised lower to 1.3% (from 1.4% previously).

- **Monetary Policy Forecast:** The next ECB GC meeting is scheduled on 12th Sep and is shaping up to be an eventful one as the last meeting (25 Jul) suggests that ECB is setting the stage for another dosage of monetary stimulus soon. In particular ECB said that "a **significant degree of monetary stimulus** continues to be necessary to ensure that financial conditions remain very favourable and is supportive of Euro-area expansion". ECB also said that they are examining **a tiered system** for reserve remuneration - lowering charge that banks pay to park their excess cash at the ECB and could **re-introduce QE**. Overall, the ECB **expects its key interest rates to remain "at their present or lower levels"** at least through 1H 2020.
- It does appear that Draghi is attempting another *whatever it takes* (first used 7 years ago to save the euro-zone) by showing off its policy toolkit. **We acknowledge that a "precautionary easing" to counter downside risks to growth is possible, especially in an environment when most central banks are easing** but an **all-out easing is probably not required at this stage unless economic and financial conditions are far worse than known**. There is a limit to the efficacy of policy stimulus (in terms of supporting growth or sentiment) and there is no need to expend all ammunition unnecessarily especially when there are tentative signs of stabilization in Euro-zone ex-Germany's economic activity. We believe fiscal policy can do it's part and is likely the appointment of Christine Lagarde as the next ECB

President (Nov-2019) could see her pushing the European governments to work on fiscal policies to stimulate growth.

- A **downward adjustment to deposit facility to -0.5%** (from -0.4%) at the Sep meeting is now 83% priced in by markets (via Eurozone OIS). **TLTRO-III, previously announced, will be launched as planned but we think the rate will be at par to MRO** (as opposed to +10bps above the average rate applied to MRO) over the life of the respective TLTRO and as low as the average deposit facility rate +10bps for banks exceeding a certain lending benchmark. We expect **Main Refinancing operations (MRO) to remain on hold at 0%** but see **some risk to marginal lending facility being lowered by 25bps to 0%** (from 0.25% currently). We **do not expect ECB to re-introduce asset purchase program** (aka. QE) but **believe ECB will continue to sound dovish and caution on the use of QE** if economic and financial conditions deteriorate further (moreover Draghi does not have the full support of his Governing Council).
- Elsewhere in the accompanying statement/press conference, Draghi said the economic "outlook is getting worse and worse… in manufacturing especially and it's getting worse and worse in those countries where manufacturing is very important". But he did say that the risk of a broad recession is "pretty low". On inflation, he said that CPI remains well short of ECB's target of sub-2%.
- **Latest External Balance Outlook:** Euro area's current account surplus widened to EUR29.7bn in May (vs. EUR22.4bn in Apr). Goods trade surplus rose while surpluses on services fell. In the 12 months to May, current account surplus fell to EUR323bn (vs. EUR392bn in the same period last year). ECB had earlier expected current account surplus to narrow further to 2.7% of GDP in 2019 and 2.5% of GDP in 2021.

- **Key domestic events and issues to watch:** Jul mfg PMI (1 Aug); Jun PPI, retail sales (2 Aug); Jul services PMI (5 Aug); Aug ZEW survey expectations (13 Aug); Jun IP (14 Aug); 2Q GDP (14 Aug); Jun trade (16 Aug); Jun current account, CPI (19 Aug); Jun construction output ((20 Aug); Aug prelim PMIs (22 Aug); Jul unemployment, Aug CPI (30 Aug).

- **Technical Outlook:** Our call (in the last FX Monthly) looking for a move higher more than met our resistance levels. Pair was last seen at 1.1330 levels. Bullish momentum on daily chart is waning while stochastics is showing signs of turning from near overbought conditions. Risk of acceleration in the recent pullback lower is not ruled out. Decisive close below area of support at 1.1345 (200 DMA) - 1.1320 levels could see a sharper pullback towards 1.1260 (21, 100 DMAs), 1.1230 levels (50 DMA). Resistance at 1.1420, 1.1450 (23.6% fibo retracement of 2018 high to 2019 low).

GBP: Can BoJo Manage the Art of Negotiation

Forecast	3Q 2019	4Q 2019	1Q 2020	2Q 2020
GBPUSD	**1.2000** (1.2700)	**1.2400** (1.2700)	**1.2500** (1.2800)	**1.2600** (1.2900)

Previous Forecast in Parenthesis

- **Motivation for the FX View**: We expect GBP to stay under pressure in the interim amid **rising probability of no-deal hard brexit being a base-case scenario** following the appointment of Boris Johnson (BoJo) as PM and a newly-installed pro-brexit cabinet. Softer economic activity data and growing fears that the UK economy could suffer amid brexit uncertainties are expected to weigh further on the GBP. We lowered GBP forecast over the forecast horizon to reflect the recent change in brexit developments but caution that the state of brexit play is very fluid and the directional bias can turn around very quickly if fears of hard brexit dissipate especially if EU agrees to re-negotiate the withdrawal deal (soft brexit) or provide a technical extension to brexit date (beyond 31 Oct).

- **BoJo's appointment as PM is perceived as a GBP-negative**. Recall that he recently said he would take Britain out of EU by 31st Oct come what may, with or without a deal, "do or die"… and there is "no ifs, no buts" on brexit on 31st Oct. He was even looking for ways to suspend parliament to force through brexit. In addition his party's recent loss in the by-election in the Brecon and Radnorshire region of Wales (to Liberal Democrat) reduced BoJo's already narrow working majority in parliament to just one. This poses risk to passing legislation during crucial brexit votes and he would need to further rely on Northern Ireland's DUP party (confidence-and-supply support for the Conservative-minority government). So all of these and his newly-installed pro-brexit cabinet gave markets the impression that he is prepared for hard-brexit though he did say he wants to negotiate a new deal with EU.

- BoJo will not start talks with EU leaders over Brexit unless they first agreed to his demand to reopen the deal that was struck with former PM May. Basically he wants a deal with the EU but has 2 key conditions: (1) to re-negotiate the withdrawal agreement and (2) scrap the backstop guarantee for Irish border (as this risk locking UK into a trading relationship with the EU). The EU, on the other hand, has said they are not prepared to re-negotiate the deal. So that leaves the option of brexit with no-deal on 31st Oct.

- **However GBP weakness can reverse at some point.** Matters of politics and brexit are very fluid, things can turn around very quickly. Though President-elect of the European Commission Ursula did previously say that there is no room for re-negotiation but she added that amendments will only be forthcoming if EU leaders deem them workable and are convinced BoJo commands a majority in parliament (low likelihood now) to get the Brexit deal through once and for all.

So if BoJo can achieve the uphill task of narrowing the divide within his Conservative party members, then perhaps this could force the EU to sit up and re-negotiate with a leader who has undivided backing from his country. At this point, GBP-weakness can reverse.

- **We believe BoJo is attempting the art of negotiatio**n by showing the EU that they are prepared to leave without a withdrawal agreement. In using this tactic, they hope to force the EU to return to the negotiation table as the EU may also not be prepared for no-deal brexit given that EU export more (in terms of goods) to UK than the other way round. Disruption to trade can affect Europe, in particular German, Spanish and French businesses. Vice versa, we believe the UK is probably not prepared for no-deal brexit as well given that services exports to EU is about 7% of UK GDP (vs. 1% of EU GDP). Both parties will stand to lose in no-deal brexit. The optimal outcome will be for both parties to ultimately re-open their lines of communication and compromise towards a modified deal. In this scenario, hard brexit fears should fade and GBP could recover then.

- **2 Way Risks to GBP Nonetheless:** GBP could: (1) more than undershoot our forecasts if a General Election is held before Halloween or a case of hard brexit with no deal (i.e. disorderly exit) takes place or (2) more than overshoot our forecast if brexit is interpreted to be "market friendly" (characterized by smooth exit with a modified deal). Recovery in investments and growth could come as businesses get more visibility on the road ahead. In this "better" scenario 2, the BoE may need to bring forward its policy normalisation plans. Taken together, GBP could recover more meaningfully via the market sentiment and investor confidence channels (first order effects). Risks to our trajectory and forecast would be a case of brexit without a deal by 31st Oct. We are also wary of the Opposition tabling a motion of no-confidence on BoJo's government. This could see 2-way risks for GBP depending on the state of Brexit at the time of trigger. For instance, if UK is proceeding with hard brexit, a no-confidence vote on the government may prevent BoJo from taking UK out of EU – this should be interpreted as a relief for GBP. However if UK is on track to a compromised deal then a no-confidence vote on the government would be deemed disruptive - GBP negative.

- **Brexit timeline ahead of 31st Oct:** Though the House of Commons breaks for a long recess till 3 Sep, brexit headlines are still likely to surface given that PM BoJo is making his rounds around the UK (and giving his comments on TV-interviews) while his newly-installed pro-brexit cabinet is rather vocal. Negative brexit headlines will weigh on GBP. Conservative party conference is scheduled to be held from 29th Sep to 2nd Oct; an EU summit scheduled for 17th – 18th Oct may well be dominated by brexit-related events as Brexit deadline (31st Oct) approaches**. Questions remain if this deadline could be extended again.**

    - **If it is not extended and there is no deal agreed (i.e. hard brexit), then <u>there is no transitional agreement</u>.** In this scenario UK will leave EU and will strive to forge fresh trade relations with trading partners.

- A **transitional agreement will only kick in if a deal is agreed**. This will then last till 31st Dec 2020 (with an option for extension till end-2022. If at the end of transition period, there is no deal to avoid a hard border with Northern Ireland, the so-called backstop will automatically kick in and this will keep UK in a temporary customs union with the EU.

- **We retain our mild upward trajectory for GBP (albeit forecast values being revised lower).** This is premised on our base case assumption that calls for a smooth exit (i.e. UK to leave EU with a modified deal by 31st Oct or another brexit extension). Based on our model estimates which take into account current account differentials, interest rate differentials and inflation differentials, GBP's fair value estimate fall in the range of 1.42 – 1.46. This justifies our upward forecast trajectory over the forecast horizon (delayed further into the medium term). The -15% or so deviation (spot to fair value estimate) largely reflects the Brexit premium and should help the UK economy to rebalance and grow sustainably over time - current account deficit should narrow, exports should become more competitive and tourism and education receipts should pick up further. We hold to our belief that UK should be able to manage the exit, transform itself into a global marketplace and continue to attract capital (longer-term). In the last episode where UK left the ERM back in 1992, GBP saw a period of consolidation (for a few years) at historical lows before the eventual move higher in the following years, where GBP TWI traded above 100-levels in 1998 (from the lows of 80 in 1993-1996) due to buoyant demand fueled by rapid growth of wealth, credit and money. If history is a guide (assuming UK manages the transition well and takes the opportunity to correct its imbalances), its currency may start climbing higher.

- **Growth and Inflation Outlook: Quarterly Inflation Report (QIR) on 2nd Aug showed that MPC lowered its growth projections for 2019 and 2020 to 1.3%,** down from previous projection of 1.5% and 1.6%, respectively. This is due to increased brexit worries and a slowing global economy. These forecasts assume UK leaves EU with a transitional deal but suggests that growth could be much lower in the event of no deal hard brexit. It also said there is a 1-in-3 chance that the economy will shrink at the start of next year. Inflation is expected to slip below BoE's 2% target in coming months partly because of lower gas and electricity prices. We are cautious on this guidance as the sharp depreciation in GBP and potential stockpiling ahead of brexit on 31st Oct could lead to upward price pressures. 2020 and 2021 inflation forecasts have been revised upwards to 1.9% and 2.2%, respectively, from 1.7% and 2.1%.

- **2Q GDP is scheduled for release on 9 Aug.** Survey indicators painted a much sombre outlook for Jun - manufacturing and construction PMIs slumped further into contractionary territories at 48 and 43.1, respectively. Services PMI fell towards 50.2, very close to falling into contractionary zone. Activity indicators were mixed with rebound seen in Industrial production for May at +0.9% y/y (vs. -1.4% in Apr) but remains well below expectations of 1.2% while retail sales rebounded to +3.6% y/y in Jun, surpassing expectations of 2.6% and prior print of 2.2%.

- Taking stock, UK GDP rose +1.8% y/y in 1Q (vs. 1.4% in 4Q) thanks to Brexit-related stockpiling. On q/q basis, economy expanded +0.5% q/q (vs. +0.2% in 4Q). The manufacturing sector grew at its fastest pace (+2.2%) since 1988, possibly due to manufacturers rushing to deliver orders before the initial brexit date of 29th Mar while the surge in imports (of cars and gold) drove the deficit in net trade for 1Q. Service and construction sectors also contributed to 1Q growth, though momentum eased off in Mar. **We caution this GDP surge could fade in 2Q as stockpiling efforts may wear off and brexit fatigue could weigh on consumer spending and investments**. Manufacturing and construction PMIs slipped into contractionary territories in May while retail sales decelerated in May.

- **UK headline CPI held steady at 2% y/y in Jun.** Decline in clothing & footwear prices were offset by rising rentals and utility bills. Core inflation inched modestly higher at 1.8% y/y (vs. 1.7% in May). A softer GBP (depreciated by >9% since Mar-2019) and higher wage growth may result in higher inflation upticks ahead.

- **Monetary Policy Forecast:** We still expect BoE MPC to keep policy rate and size of BoE balance sheet unchanged at 0.75%, GBP 435bn, respectively at the upcoming meeting on 18th Sep. **Relatively steady CPI (no run-away pressure from BoE MPC's 2% target), with chance of some slight pullback due to lower oil prices and Brexit uncertainty leaves room for BoE to keep policy stance status quo for now**. Maintaining accommodative monetary conditions is what the BoE can do to help support growth amid ongoing Brexit uncertainties. **But inflation may go higher at some stage towards later part of the year amid weaker GBP** (depreciated >9% from the high this year) **and potentially front-loading of stockpiling/imports ahead of *Brexit* on 31st Oct.** Increasingly we see some risks of BoE being stuck in a situation wherethe BoE may need to tighten rates (to arrest inflation) in the face of synchronous easing and brexit uncertainties. This was a risk we have long highlighted - *remain watchful of inflationary pressures as tight labor market is capable of generating domestic price pressures while a case of no-deal brexit could result in sharp depreciation on GBP (brings about higher imported prices and this translates into higher CPI). Sustained rebound in CPI towards 3% again could pressure BoE to hike earlier reluctantly.* This is probably the last thing BoE want to do.

- **External Balance Outlook** UK's current account deficit widened to 5.6% of GDP for 1Q 2019. This was the largest deficit since 3Q 2016 and was driven by imports of gold. The ONS said that stripping out the large imports of gold, UK currency account deficit would have stood at 3.7%. Imports of goods amid brexit stockpiling also contributed to the widening of the current account deficit.

- **Key domestic events and issues to watch:** Jul Mfg PMI, BoE MPC meeting (1 Aug); Jul construction PMI (2 Aug); Jul services PMI (5 Aug); Jul house prices (7 Aug); 2Q prelim GDP, Jun IP, construction output, trade (9 Aug); Jun labor market report (13 Aug); Jul CPI, PPI, RPI (14 Aug); Jul retail sales (15 Aug); Jul public finances (21 Aug); Aug GfK consumer confidence (30 Aug).

- **Technical Outlook:** GBP fell sharply (by almost 5% vs. USD) for the month of Jun after breaking key support at 1.2440. Last seen at 1.2120 levels. Bearish momentum on weekly, daily chart remains intact though stochastics is in oversold conditions. Bearish bias intact. Support next at 1.2120, 1.20 before 1.18. Immediate resistance at 1.2450 (21 DMA).

AUD: Still Vulnerable To Trade War

Forecast	3Q 2019	4Q 2019	1Q 2020	2Q 2020
AUDUSD	0.69 (0.71)	0.70 (0.73)	0.71 (0.74)	0.72 (0.73)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** AUD came under fresh pressure as RBA Governor Lowe remarked that the central bank is ready to ease policy further if necessary. The Fed's non-committal stance to easing on 31st Jul brought the AUDUSD back near its Jun-low around 0.6830. This cross seems stretched at this point though bias is still to the downside, not helped the least by fresh tariff threats from Trump on China. We revise AUDUSD lower on recent USD upmove but keep our trajectory biased to the upside into 4Q.

- Recent data has shown some promise with manufacturing indices indicating some improvement in the sector. 2Q CPI came in firmer than expected, possibly giving RBA Lowe some assurance with regards to inflation expectations. Even manufacturing PMI numbers out of China showed some improvement, albeit still in contractionary territory. Retail sales for Jun came in stronger than expected at 0.4%m/m vs. previous 0.1%. These are signs that AUD should see a turn soon, to the upside, and underpins our view for AUD to rise from 0.69 (with some risk of undershooting in the near-term) before heading higher towards the end of the year towards 0.70 on the base case that Trump's end goal is still to get a deal. We take into account the building expectations for Fed to cut in Sep and then again in Dec.

- However, these signs of stabilization could be threatened if Trump goes ahead with his threats of 10% tariffs on China on 1st Sep. As such, we are turning a tad more negative on the AUD in the near-term for Aug and would not rule out a test of the 0.68-level for this pair to head towards 0.66 should the US-China trade war continues to escalate. The month is turning out to be some kind of déjà vu of May and these events and accompanied volatility tend to dissipate as soon as there is some kind of positive development on the trade talks front.

- **Another key *r*isk that could add further pressure on the AUD is the potential for USD funding squeeze that could send ripples to the Australian money markets and force local banks to raise the mortgage rates. This comes amid projections that the US**

government could issue more Treasury Bills after Congress compromised on the debt ceiling. The plausible concomitant rise in BBSW could also force RBA to cut policy rates another time which would translate to further AUD weakness.

- **Growth and Inflation Outlook:** The combination of US-China trade war, China's structural slowdown, soft-albeit-improving-housing outlook continues to weigh on consumer and investor sentiment but there were some signs of stabilization in household consumption and manufacturing.

- Hiring growth has been positive with employment up around 2.9%y/y in Jun, albeit moderated from the previous 3.1% but the NAB business survey for 2Q suggests that the employment outlook for the next three months has fallen and is quite negative, especially for SMEs. Trading conditions fell to a score of 1 from 7 in the previous quarter.

- Retail sales for Jun rebounded to 0.4%m/m vs. 0.1% in the month prior, firmer than the expected 0.3%. That said, Westpac consumer confidence index for Jul suggests further deterioration (down 4.1%) although this measure could still be volatile. Although there are tentative signs of stabilization in the housing sector, the persistent decline in home prices still weigh on consumer sentiment. A look at the historical business survey and housing data suggest that the stabilization in established housing prices in 2011 took around a year before investors and consumers start to regain confidence.

- Australia's manufacturing outlook brightened in Jul with the AiG Performance of Manufacturing index firmer at 51.3 from previous 49.4. PMI Mfg also improved to 51.6 from 51.4. These are signs of stabilization that should signal a bottoming in the AUD but Trump just threw a spanner in the works. Infrastructure spending also buoyed the construction index which was higher at 43.0 in Jun vs. previous 40.4. There was quite a bit of hiring in that sector as well. The construction sector is the third largest hirer in Australia, after Health Care and Social Assistance and Retail trade.

- 2Q CPI came in a tad higher at 0.6%q/q vs. previous 0.0% (expected 0.5%). Underlying inflation (taken as the average of the trimmed mean and weighted median) is around 1.4%y/y, steady from previous quarter. Tradable component rebounded rather sharply to 1.2%q/q from previous -0.6% although non-tradables weakened to 0.2%q/q from previous 0.3%, which still suggests soft domestic demand. The acceleration was rather broad-based across all sub-components with notable rise in food inflation (+0.8%q/q vs. prev. -0.3%), housing (+0.8%q/q vs. flat).

- **Monetary Policy Forecast:** RBA is increasingly less sensitive to deterioration in the employment outlook (NAB survey) as its ammunition becomes limited. We anticipate that RBA should pause and watch the transmission mechanism of the recent cuts (Jun and Jul) before doing more. Recent surveys done (2Q) suggest that hiring sentiment could deteriorate and weigh on private consumption even more and that has continued to build expectations for RBA to take the cash target rate lower from the current 1.00%. That said, the rate cuts that took place in June and Jul may mitigate downside risks for this quarter. In addition, the government's push for more infrastructure spending could also cushion against further deterioration in household spending. We do not look for RBA to make another move next Tue (6 Aug 2019).

- In addition, home auction clearance rates have been rising in the past few months as local banks transfer the rate cuts to the mortgage rates. However, given the fact that the US-China trade tension still weigh on the investor sentiment, expect recovery in household spending to be slow.

- However, we do not rule out further cuts if hiring sentiment deteriorates sharply or the USD funding squeeze triggered by the issuance of a large amount of US treasury bills could put the Australia money market under pressure and force RBA to lower policy rates to keep monetary conditions accommodative.

- **Latest External Balance Outlook:** Current account deficit narrowed to A$2.9bn (s.adj) for 1Q from previous –A$6.3bn. We may continue to see improvement in the current account as Australia continues to show trade surplus. Apr trade surplus came in at A$4.87bn. Terms of trade continues to improve, possibly due to the depreciation in the currency vs. its trading partners as well as the rise in commodity prices. Export price index slowed to 3.8%q/q from previous 4.5%. Imports price index accelerated to 0.9%q/q from previous -0.5%.

- **Latest Fiscal Outlook:** Treasurer Josh Frydenberg projects a fiscal surplus of $7.1bn for the year through 2020. Post budget, PM Scott Morrison announced a plan to set up an Australian Business Growth Fund that is projected to grow to A$1bn when it matures, aimed at creating 250K new small businesses over the next five years. The government has recently passed the A$158bn tax-cut package that could be supportive of household spending.

- **Key domestic events and issues to watch:** Trade data and RBA meeting on 6th Aug; AiG Perf of Construction Index for Jul, Home loans for Jun on 7th Aug; foreign reserves for Jul on 8th; RBA SoMP for 9th Aug; NAB business conditions and business confidence (Jul); Westpac consumer confidence index for Aug, wage price index for 2Q on 14th; labour report for Jul on 15th; RBA Minutes for Aug on 20th; Private CAPEX (2Q);

- **Technical Outlook:** July proved to be a month of two halves and AUDUSD is back under pressure. Momentum is very bearish though stochastics remain oversold which suggests some risk of a rebound. Pressure is thus to the downside for the AUD at this point and 0.6750 is seen as the next support for AUD before 0.6640. Retracements to meet 0.6860 before the next at 0.6890 (76.4% Fibonacci retracement of the Jun-Jul rally).

NZD: Another Cut Is On the Way

Forecast	3Q 2019	4Q 2019	1Q 2020	2Q 2020
NZDUSD	**0.6500** (0.6800)	**0.6700** (0.6800)	**0.6800** (0.7000)	**0.6800** (0.7000)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** We expect NZD to trade lower in the lead up to RBNZ meeting (7 Aug) as we believe RBNZ is in favor of a 25bps rate cut, coupled with dovish guidance (though we do not see an imminent need to ease). A move lower towards 0.65 levels should not be ruled out but weakness may be mitigated if Fed steps in with more dovish guidance and/or US-China trade talks see material progress.

- As synchronous monetary easing bias gets underway in most parts of the world including US, Euro-area and Asia in response to slowing global growth momentum, the RBNZ is expected to join the easing party given its explicit preference for accommodation and somewhat softer NZD. In addition, news (23rd Jul) of RBNZ starting on a project to refresh unconventional monetary policy strategy and implementation is perceived as RBNZ shoring up its policy toolbox (though we still think QE remains a far cry for NZ at this stage) and reinforced RBNZ's preference for more accommodation. With Aussie-peer (RBA) cutting cash rate twice in May and Jun and possibly more this year, the RBNZ (armed with only 1 cut in Mar) could do more to play "catch-down" to RBA. In RBNZ's recent MPS (26th Jun), there seems to be a rate cut "consensus" among MPC members and the central bank is likely to use the services sector drag on 1Q growth as a motivation for the rate cut.

- **Growth and Inflation Outlook: The next MPS to be released on 7th Aug will be scrutinized for RBNZ's projection on growth, inflation and rates assumption.** In the last MPS (released on 8th May), RBNZ cut economic growth forecast to 2.2% in the year through Mar-2019 (vs. 2.9% previously). RBNZ said that growth slowed sharply over 2H 2018 reflecting a moderating global growth and slower growth in domestic demand and the 1H 2019 growth is expected to remain subdued as slowing global growth, subdued housing market and low business sentiment are dampening domestic activity. Slowdown is also expected to see slight softening in labour market over 2019. Increased monetary stimulus and improvement in terms of trade are expected to drive a re-acceleration in growth and capacity pressure from late-2019 as RBNZ looks for growth to rebound to 3.2% in 2020. The outlook of domestic inflationary pressure has softened due to slowdown in growth. Non-tradables inflation is expected to ease before gradually picking up in as capacity pressure build. RBNZ only sees a return to 2% mid-point of its target range in mid-2021. This is 6 months later than its previous projection.

- **2Q GDP will be released on 19th Sep. High frequency data including manufacturing and services PMIs for Jun raises caution that 2Q GDP growth may decelerate further.** Services PMI slipped to 52.7 in Jun (vs. 53.5 in May); way below its 5-year average of 56.3 (though the last print is still in expansionary territory). Though manufacturing PMI picked up to 51.3 in Jun (vs. 50.2 in May), the sub-indices of employment and delivery fell into contractionary zones. Earlier, 1Q GDP saw a sequential uptick to +0.6% q/q (vs. +0.4% in 4Q 2018). Uptick was supported by goods-producing industries, in particular construction and manufacturing sectors. But growth in services sector (which account for 2/3 of GDP) decelerated. Retail trade & accommodation, transport, drop in tourist arrivals surprised to the downside. On the expenditures side, private consumption was soft but business investment and net exports came in stronger than expected. On annual basis, 1Q GDP held steady at 2.5% y/y.

- **Headline CPI re-accelerated to +0.6% q/q in 2Q** (vs. +0.1% in 1Q) owing to higher petrol prices and housing cost. Petrol prices (tradable inflation) are transitory and the upward pressure on petrol prices is likely to ease off in 3Q as oil prices stabilise. As such the next print for inflation could remain around current levels as oil prices stabilise and slowing global growth momentum amid US-China trade tensions feed-through to NZ economy. On annual basis, headline CPI rose +1.7% y/y, from 1.5% in 1Q. The uptick is in line with RBNZ and market expectations. Non-tradeable inflation remain steady at 5-year high of 2.8% y/y

- **Monetary Policy Forecast: RBNZ could cut OCR by 25bps to 1.25% at the next MPC meeting on 7th Aug though we still believe there is no urgency to cut** given that inflation (2Q at 1.7%) is near the midpoint of its target range of 1 – 3%, headline growth is still looking healthy at 2.5% and labor market conditions remain tight. What tilts us to say that RBNZ could potentially cut at the Aug meeting is due to RBNZ's explicit bias to ease as recent MPC statement (26th Jun) reveals a rate cut "consensus" among MPC members given its dovish assessment to global economic outlook while 1Q GDP growth report shows that services sector (accounts for 2/3 of NZ economy) remains a drag on the domestic economy. And in light of most Developed World central banks including Fed, ECB taking a dovish tilt in their respective monetary policy stances and in particular, RBA (cut twice so far this year), it is very likely the RBNZ does not want to stand out in the crowd of doves as that would result in a firmer NZD and could tighten financial conditions. Markets expectation for a cut at the Aug MPC stands at nearly 89% (implied via OIS). In addition RBNZ has shared that they have begun a project to refresh unconventional monetary policy strategy and implementation, albeit at a very early stage (23 Jul). There is no further detail beyond the disclosure to Official Inflation Act in requesting for work on non-standard policy measures. We do not expect RBNZ to join ECB, BoJ to unleash QE-type of monetary policies but the mere mention of conducting such a project reinforced the dovish bias of RBNZ.

- At the last MPC meeting (26th Jun), RBNZ kept OCR on hold at 1.50% as widely expected. Tone of the statement was dovish as MPC judged that *global economic outlook has weakened and downside risks* *related to trade activity have intensified* but the dovishness appeared to be perceived as less than market expectations. In particular **RBNZ's explicit use of the phrase "over time" in the line "*lower OCR may be needed* *over time*" was interpreted as less urgent need for more easing.** Other points touched on by the MPC include discussions around ongoing weakening in global trade activity and that a period of protracted tension could suppress global business confidence and weigh on growth. But a resolution of these tensions could see uncertainty ease. Bottom line is more support from monetary policy was likely to be necessary given continues falls in global growth and subdued domestic demand.

- **External Balance Outlook:** NZ current account deficit narrowed to -3.6% of GDP in 1Q from -3.8% of GDP in 4Q 2018. This was due to an improvement in trade balance due to higher dairy exports and a slowdown in imports.

- **Key domestic events and issues to watch:** Jul consumer confidence (2 Aug); 2Q labor report (6 Aug); Jul house prices, RBNZ MPC (7 Aug); Jul food prices (13 Aug); Jul Mfg PMI (16 Aug); Jul services PMI (19 Aug); 2Q PPI (19 Aug); 2Q retail sales (23 Aug); Jul trade (26 Aug); Aug activity outlook (29 Aug); Aug consumer confidence, Jul building permits (30 Aug).

- **Technical Outlook:** NZD traded a month of 2 halves: rising in the first half towards 0.6790 (19 Jul) before reversing into losses towards month-end. Last seen at 0.6530 levels. Bearish momentum on daily chart remains intact while stochastics is falling into oversold conditions. Area of critical support at 0.6490 – 0.6510 levels. Break below this puts next support level at 0.6420/30 (2018 low). Resistance at at 0.6560 (76.4% fibo retracement of Jun low to Jul high), 0.66 (61.8% fibo) and 0.6640 (50% fibo).

JPY: VAT and Trade Spat Weighs on USDJPY

Forecast	3Q 2019	4Q 2019	1Q 2020	2Q 2020
USDJPY	108 (--)	107 (108)	106 (110)	106 (109)

Previous Forecast in Parenthesis.

- **Motivation for the FX View:** Current-quarter forecasts are kept unchanged. While the Fed sounded less dovish than markets had hoped in the latest FoMC (stronger USD), this could be offset by renewed trade war risks in the interim after Trump's announcement of a fresh round of 10% tariffs on US$300bn worth of Chinese goods (stronger yen on safe haven flows). We note that the Fed continues to have a tad more room for easing compared to BoJ, and yield differentials could narrow in JPY's favour (although this would likely take time to play out). Further, concerns over domestic growth and expected VAT imposition in Oct could hit Japanese equity market sentiments somewhat over time. So far, the Korea-Japan trade spat has hit confidence levels in Korea more than that in Japan, but there is a risk that downsides in Japanese risk assets could materialize if Korea takes on more retaliatory measures. A step-down in Japanese equity performance could support the Yen (i.e., down-move in USDJPY) in 4Q and into 2020.

- While our baseline continues to envisage some signs of positivity coming out of US-China negotiations around the turn of the year, we think that any developments would be unlikely to involve a full retracement in tensions (i.e., back to pre-2018 levels), especially with the latest shift in Trump rhetoric. Concerns over intellectual property, tech transfers and market access would probably continue to be part of long-term policy negotiations between the two superpowers. From past experience, moderation in trade tensions tends to support the USDJPY pair. Nonetheless, we see this as a factor helping to mitigate the extent of USDJPY down-move, rather than contributing to a weakening of JPY on risk-on tones.

- PM Abe's ruling coalition (LDP and Komeito) won 57.5% of Upper House seats, compared to 62.2% pre-elections, and short of the two-thirds majority required to pursue more aggressive objectives, such as revising the country's constitution. This could mean that short-term focus of the coalition could continue to be on growth-enhancing policies, to anchor their support base. There are also reports of increased spending on infrastructure ahead of the 2020 Tokyo Olympics. There is a new sewage system, new luxury hotels and 21km of monorail from new international airport to downtown. Such developments could continue to support Japanese equities in the interim.

- Nonetheless, the Nikkei 225 has already run up around 6% since its recent trough in early June, and weakening economic growth momentum might be slowly filtering through to sentiments. Abe's political win also means that the planned sales tax hike (from 8% currently to 10% in October) would likely take place. The negative impact on domestic consumption and overall growth could dampen stock sentiments, and potentially lead to a sell-off in Japanese equities and the unwinding of hedges, supportive of the JPY.

- We note that the yield differential between Japanese 10 year bonds and US 10 year bonds have narrowed from -2.7% at the start of the year to around -2.1% now. Fed's Powell left the door open for further rate cuts even if his tones were less dovish than markets desired—"I didn't say it's just one…". Meanwhile, it is unlikely that negative yields in Japan (-0.169% for 10 year government bond as of writing) can get much lower. Any signs of further yield compression would be supportive of the JPY.

- The latest developments in the Korea-Japan spat does not bode well for trade ties. As of this morning, Japan has removed South Korea from the "whitelist" of countries which are deemed trusted export destinations and are exempted from strict export checks. The removal will take place on 28 Aug, and will affect about 900 or more products including building materials, chemicals and technology components. This is an explicit sign of escalation in tensions after Japan's move last month to restrict exports of three materials crucial to Korea's tech industry. Tech majors Samsung and SK Hynix have already suffered from earlier restrictions and will likely struggle further. Korean officials have commented that the whitelist removal would gravely threaten security ties. South Korean President Moon Jae-in said the move was cleared intended to block Korea's growth.

- While the negative impact of such developments on Japan has been mild till now, repercussions are starting to emerge, and could potentially worsen going forward. The public backlash in South Korea against Japanese products appears to be gathering momentum, and has started to dent sales of beer and tour packages. Brewer Asahi said some stores have stopped selling its beer. Apparels and luxury cars could also potentially take a hit. President Moon has called an emergency cabinet meeting after the whitelist removal by Japan, and as of writing, Korean Finance Minister Hong Nam-ki just mentioned Korea could remove Japan from its whitelist too. These developments could pose a potential drag on the Japanese economy at a time when growth momentum is already slow.

- **Growth and Inflation Outlook:** Japan's June industrial production (-4.1%y/y vs. -2.1% in May) showed its second-largest drop in the past five years, as trade tensions and slowing external demand weighed on exports. Autos and flat panels led the drop. The Tankan survey showed mixed results for large firms, with sentiments improving slightly for manufacturers, but deteriorating modestly for non-manufacturers. Meanwhile, consumer confidence had dipped to 37.8 in July from 38.7 in June. Core machine orders in May also dropped by -3.7%y/y vs. +2.5% in April. Despite the swathe of weak-looking data in May-June, the prelim July Jibun Bank Composite PMI indicator seems to paint signs of resilient growth momentum, coming in at 49.6 for Manufacturing and 52.3 for Services, compared to 49.3 and 51.9 prior. On balance, growth indicators seem to indicate soft, but non-recessionary outcomes for the economy.

- Exports came in at -6.7%y/y in June, compared to -7.8% in May. While private consumption in 2Q is unlikely to improve significantly from the -0.1% q/q in 1Q, June retail sales actually came in slightly better than expected (0.5%y/y vs. 0.2% expected). Nonetheless, this could reflect some front-loading of purchases ahead of the sales tax hike in Oct, and growth could dampen further once this effect fades. Consensus estimates are for the Japanese economy to expand by 0.7% in 2019 for now, with a higher likelihood of a contractionary reading for 2Q. With both external and domestic challenges to overcome, consensus figures also expect growth to dip further to 0.4% by 2020.

- Headline CPI slowed to +0.7% y/y in June (vs. +0.7% y/y in May) due to softness in energy prices. Core inflation, which excludes fresh food, slipped to +0.6% y/y (vs. +0.8% in May). Inflation is expected to ease further alongside cheaper mobile phone charges, as well as free pre-school education starting in Oct. Softer inflationary pressures suggest that BoJ will need to persist with its ultra-loose monetary policy for an extended period, if it's reluctant to change its 2% inflation target.

- **Monetary Policy Forecast:** As expected, the MPC voted 7-2 to keep monetary policy at status quo at the meeting on 30th Jul, with yield curve control at -0.1% for short term rates and 10Y JGB yield at around 0%; asset purchase of JGB holdings, ETF and J-REIT will be maintained at JPY80tn, JPY6tn and JPY90tn, respectively. BoJ intends to maintain "the current extremely low levels of short- and long-term interest rates … at least through around spring 2020". There was also a new addition at the end of the statement—"will not hesitate to take additional easing measures if there is a greater possibility that momentum towards achieving the price stability target will be lost".

- We note that while BoJ retained its dovish slant and reiterated its commitment to additional easing if needed, there was still a lack of clarity on the type of tools it can credibly rely on to deliver further easing. The characterization of growth/inflation risks in the statement also seemed to imply that any further easing could be more likely triggered by "developments in overseas economies", rather than domestic events (e.g., consumption tax hike). Interestingly, the two (voting) dissenters also argued against the manner in which additional easing might be triggered, i.e., the phrasing of "…if there is a greater possibility that momentum towards achieving the price stability target will be lost". They largely felt that this particular form of forward guidance was relatively vague, and needed to be clearer with regards to the price stability target. On balance, markets' immediate reaction to the statement was relatively muted.

- **Latest External Balance Outlook:** Current account surplus narrowed for the third consecutive month in May to JPY1.59tn. For June, the trade balance turned positive (JPY0.59tn vs. -JPY0.97tn prior), as imports tanked to a larger-than-expected extent alongside contracting exports. The drag on exports came mostly from the semiconductor segment and auto parts. Exports to China had also slid 10.1%y/y, even as exports to US increased by 4.8%. We note that Japan's dispute with South Korea is a pertinent concern, while Tokyo is also in talks with US to prevent Trump from moving forward with slapping tariffs on Japanese cars.

- **Key domestic events and issues to watch:** Jul PMI mfg (1 Aug); Jul PMI Svcs, Composite (5 Aug); Jun coincident index (6 Aug); 2Q GDP (9 Aug); Jul PPI (13 Aug); Jun core machine orders (14 Aug); Jun IP (15 Aug); Jul trade (19 Aug); Jul CPI (23 Aug); Jul retail sales (30 Aug); Jul preliminary IP (30 Aug).

- **Technical Outlook:** Pair last seen around 107, on knee-jerk reaction to weaker US data and Trump's new tariffs last night. Daily momentum is mildly bearish and stochastics are inching downwards. Bearish divergence earlier has played out with the recent down-move. Key support at 106.80 (June low). If this breaks, next support is around 104.90 (Jan flash crash low). Area of resistance at 108.20 (21 DMA, 50 DMA) - 108.50 (61.8% fibo retracement of 2018 low to high).

RMB: May Not Shy Away From 7 This Time

Forecast	3Q 2019	4Q 2019	1Q 2020	2Q 2020
USDCNY	7.00 (6.80)	6.96 (6.78)	6.90 (6.75)	6.85 (6.72)
USDCNH	7.00 (6.80)	6.96 (6.78)	6.90 (6.75)	6.85 (6.72)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** Fed's refusal to commit to an easing cycle pared expectations for further rate cuts this year and lifted the DXY index to around two-year high. USDCNY traded higher in tandem with most Asian peers, breaking above the 6.90-figure after "toe-ing the line" in the past several sessions. Trump's fresh threat to impose 10% tariff on another $300bn of Chinese goods, to take effect, on 1st Sep sent USDCNH surging to 6.97. The countercyclical adjustment factor is back again in the USDCNY daily fixing as PBoC gets back into business in limiting the RMB weakness vs. the USD in an environment of trade war escalation concerns as well as broad USD strength. However, this time USDCNY may not shy away from the 7.00 figure as the DXY index remains supported. That said, moves towards the key-psychological figure will still be a grind as the countercyclical adjustment factor will be in play.
- This month is turning out to be like another "sell-in-May" with the seasonality for Aug also similarly bearish for risk assets. We revised our USDCNY higher to 7.00 because of the USD upmove and also to include a more cautious take on the US-China relation. The latest tariff threat from Trump that should take effect on 1st Sep. Bear in mind that these events and accompanied volatility tend to dissipate as soon as there is some kind of positive development on the trade talks front.
- We could still be at the juncture where it could get worse before it can get better but if US data disappoints and the Fed continues to remain non-committal to an easing cycle, the accumulation of economic casualties of the trade war may just be able to motivate both sides (US and China) to come to an interim solution that could give investors a bit more certainty compared to a temporary truce and that should bring down the USDCNY. For now, the supported USD profile may underpin the USDCNY for the rest of the year and we pencil in our USDCNY forecast to be around 6.96 (end 2019) as we hold on to our slightly optimistic view. We also take into account the build-up of Fed cut expectations in Sep and Dec that should be USD-negative.

- **US-China Trade Talk Update:** The next US-China trade talk would happen in early Sep, according to the White House (could be brought forward as Trump seems to be impatient), and China has "confirmed its commitment to boost purchases of US agricultural products". Even though talks were supposed to resume in early Sep, Foreign Minister Wang Yi has met Pompeo (at the ASEAN Foreign Ministers meeting in Bangkok on 1st Aug) to discuss on issues including US-China relations as well as North Korea. State Media Xinhua also sounded rather positive stating that "China, US can push forward trade talks on basis of equality". Ministry of Commerce spokesperson Gao Feng said that the working-level teams would "talk intensively in Aug".

- Further progress on the US-China trade negotiations could be made towards the end of the year with the WTO mini-ministerial meeting in Shanghai (early Nov) and APEC Summit in Chile (11-17 Nov) that can serve as checkpoints.

- Huawei Chairman Liang Hua told the media that the overseas smartphone sales have recovered 80% since the US ban. The company had abandoned some non-essential products because of the US sanction but the US sanction did not impact the 5G roll-out. Huawei is still a core interest of China and the 23%y/y sales growth in 1H 2019 suggests that Huawei is somewhat resilient. Eyes on whether Huawei is still able to have access to Google's android software and any removal of restrictions on Huawei should be positive to CNY and could pose a downside risk to our forecast.

- **Growth and inflation outlook:** While growth print for 2Q slowed to 6.2%y/y from previous 6.4%, higher frequency data such as industrial production quickened to 6.3%y/y from previous 5.0%. Retail sales also accelerated to 9.8%y/y from previous 8.6% and urban fixed asset investment also firmed to 5.8%y/y from previous 5.6%.

- Inflation steadied around 2.7%y/y in Jun. The African swine flu continues to keep poultry price pressure supported while a large supply of vegetables that entered the market drove down prices of fresh vegetables. On the other hand, fresh fruits subcomponent was bumped higher to 42.7%y/y from previous 26.7% on weather conditions that affected harvest and transport conditions of certain fruits. As a result, the food inflation inched higher to 8.3%y/y from previous 7.7%. On the producer front, PPI slipped to zero from 0.6%y/y previously as soft domestic demand and softening commodity prices squeeze profit margins of producers at home. This gave rise to deflationary concerns again especially in the face of trade war that has impacted the manufacturing sector and crude oil price. That certainly increases the bet on more stimulus from the policymakers but PBoC did not seem keen to commit.

- Industrial profit fell -3.1%y/y in Jun from previous 1.1%. Profitability has clearly worsened and that in itself could dampen hiring sentiment and runs counter to the acceleration in the industrial production released earlier in the month, revealing some inherent weakness in the manufacturing space. Breakdown suggest that both private enterprises and public /state-owned enterprises have suffered declines in profitability.

- There are some silver linings to count on for a soft landing in China. China's exports seem to be showing tentative signs of stabilization, in tandem with the smaller declines seen in exports of its manufacturing subcomponents such as data processing machines and other machine and equipment. Inward shipments also show some nascent signs of bottoming recently for both manufacturing and primary goods which includes petroleum. Signs of stabilization in imports came as retail sales show a rather sharp rebound recently. Taken together, this could mean that stabilizing external and domestic demand spur more fiscal stimulus that could have a direct impact on domestic demand.

- **Monetary Policy Forecast:** It has been one month since the G20 Summit and PBoC had already signaled that the current interest rate setting is appropriate amid speculation that there could be a rate cut that could follow the Fed when it delivers its insurance cut end Jul. The local government bond yield tracked the rest of global rates lower, but to a lesser extent, with 10y yield seen around 3.1780%. As a result, the CGB-UST 10yr yield differential widened in the past few months and stabilized around 113bps.

- Recently, Governor Yi Gang said that the current interest rate settings are appropriate and any rate action will be based on domestic considerations. That was a signal from the central bank that it is unlikely to track the Fed in lowering the policy rates. He also mentioned about a potential reform to the rate framework and the benchmark lending rate may be phased out and replaced by the Loan Prime rate, or the rates banks offer to their best clients, which would take guidance from market-oriented interest rates such as the MLF rates or the TMLF rates that the central bank have been using to provide loans to financial institutions. Targeted MLF is recently provided at 3.15% for 1y (catered to FIs that loan to SMEs) and the regular MLF is provided at 3.30%. On the bond side, Yi Gang's stance suggests that local bond prices could remain thereabouts.

- As PBoC continues to prioritize deleveraging, there are certain forms of moral suasion going on. Local PboC branches have urged commercial lenders to step up on their lending "appropriately" by allowing more lending quotas. This came after the Politburo pledge to "effectively deal with trade frictions" with proactive fiscal policies. Policymakers seem to be focused on domestic demand, whilst steering away from investing directly in property, by spending on rural areas to refresh old neighborhoods and build infrastructure projects like parking lots and cold-chain logistic facilities to stabilize investment.

- With Yi Gang unlikely to cut interest rates, we still look for more RRR cuts and the central bank to tap on these medium-term lending facility to improve credit growth in the real economy. Based on the latest PMI-mfg prints released by the NBS, purchasing managers from SMEs are still bearish on their production outlook. Only the PMI-mfg of large enterprises supports the improvement in the headline. Real rates are unlikely to be cut further as deleveraging is still quite a priority, that could lend the RMB some support.

- **Latest Fiscal and External Balance Outlook: The** fiscal target is 2.8% of GDP in 2019. The politburo meeting that ended on 30th Jul concluded with promise of more fiscal stimulus targeted on rural rejuvenation, infrastructure projects such as carpark lots so as to boost investment and consumption at home. There is no detail on this fiscal package yet. With exports still rather soft and external headwinds, there could be further subsidies for exporters as well, especially for SMEs. Focus is on infrastructure spending as well as tax cuts in order to boost domestic demand and the Politburo reiterated “housing is for staying, not for speculation”.

- **Key domestic events and issues to watch:** Foreign Reserves for Jun on the 7th; trade data on 8th; CPI and PPI on the 9th; Money supply, aggregate financing and new yuan loans on 9-15th; Urban FAI, industrial production and retail sales, Jan-Mar property investment on 14th; new home prices due on 15th; FX Net settlement on 19th; Mfg PMI on 31st;

- **Technical Analysis:** USDCNH finally trades above the 6.90-figure and was last seen around 6.9610. Bullish momentum has been rising and even as stochastics flag overbought conditions, retracement could be shallow. Support around 6.9455 before the next at 6.9120. Next resistance at 6.9805 and then 7.0. There is also a cup and handle formation for the USDCNH that could herald further upside. 6.98-figure is a key resistance to break.

KRW: Double Whammies of Macro and Geopolitical Woes

Forecast	3Q 2019	4Q 2019	1Q 2020	2Q 2020
USDKRW	**1220** (1150)	**1185** (1145)	**1165** (1140)	**1160** (1135)

Previous Forecasts in Parenthesis

- **Motivations for the FX View:** KRW could still retain some bearish pressure amid a double whammy hit from both macro and geopolitical factors, including a slowdown in global, domestic growth momentum; continued exports decline; down-cycle in global semiconductor market weighing on Korean corporate profits and Korea asset prices, ongoing trade spat with Japan over wartime labor row issues (adversely impacting the production of microchips and smartphones) and re-escalation of US-China trade tensions (US announced additional 10% tariff on $300bn worth of Chinese imports). We calibrated KRW forecasts lower to reflect fading hopes of a recovery in 2H due to the double whammies of macro and political pressures. Near term, we do not rule out USDKRW overshooting our forecast if 1,200 breaks out but expect some of these weaknesses to fade towards end-year or early next year on our assumption of some concretization of details on trade deal between US and China.

- There are also factors that may mitigate against KRW negativity including (1) easier global financial conditions amid synchronous easing, (2) the risk of BoK intervention to smooth excessive volatility (if any) and (3) ongoing trade truce between US-China (one less negative factor on sentiment). Sustained recovery in KRW would still require material upticks in economic activity, recovery in tech sector to reverse the fortunes of Korean exports where shipments of semiconductors account for 1/5 of overall Korean exports or the easing of geopolitical tensions between Japan and South Korea.
  - Though Samsung reported a 56% decline in 2Q profits due to falling memory chip prices, the company shared that its memory unit saw increased demand despite volatility in the overall industry due to increase external uncertainties. A delayed recovery to 2020 (from 2H 2019) could see more weakness in KR equities and KRW for now before a recovery could take hold towards the turn or early next year;
  - Though US recently surprised with 10% tariff on $300bn worth of Chinese imports, we think ongoing trade negotiations between the US and China may lead to some gradual concretization of details into later part of the year could reboot investor sentiment and business confidence. This could spur a pick-up in business, investment and exports activity and lend support to growth. The semi-conductor down-cycle could also turn around and further lift exports and fuel an investment recovery (KRW-positive). There could be several signposts along the way to guide market sentiments—(i) whether China commits to buying goods from the list provided by the US to narrow the trade gap, (ii) the extent to which US removes trade restrictions placed on Huawei and other Chinese entities currently on the trade blacklist, (iii) negotiations on eventual rollback of existing tariffs, (iv) positive guidance from tech-companies. If these events play out in a positive manner, trade-linked FX such as KRW could benefit.

- **Growth and Inflation Outlook: South Korea avoided a technical recession as 2Q growth rebounded +1.1% q/q (vs. -0.4% in 1Q).** On annual basis, 2Q GDP was +2.1% y/y (vs. 1.7% in 1Q). Public investment was the main support for growth amid government spending. Supplementary budget of KRW6.7tn (if passed in parliament) could provide some support for 4Q 2019. Private consumption was largely stable at 2% y/y while private investment was the main drag on growth, with facilities (-7.8% y/y) and construction investment (-3.5% y/y) falling sharply. Exports remain on a decline (-13.5% y/y) in Jun and the trade spat with Japan over wartime labor row issues - Japan has restricted exports of three chemicals that are crucial to South Korea's major companies such as Samsung Electronics SK Hynix in the production of microchips and smartphones. Prolonged trade spat could dampen hopes for a recovery in 2H.

- South Korean Finance Ministry lowered growth projection for 2019 by 0.2ppts to 2.4 - 2.5% amid decline in exports and downturn in tech cycle. The recent downward revision by the government is a "catch-down" to Korean Development Institute's (state-run think-tank) earlier forecast of 2.4% (which had come much earlier). BoK has also revised lower growth projection for 2019 to 2.2% (vs. 2.5% previously) with BoK's Lee citing Japan-Korea friction as one of the factors for the growth downgrade. Looking ahead, a recovery in chip sector is needed to reverse the fortunes of Korean exports where shipments of semiconductors account for 1/5 of overall Korean exports. The Ministry has also lowered its 2019 inflation forecast to 0.9%, from 1.6%. KDI's forecast stands at 0.7% for 2019.

- **Headline inflation saw a sequential slippage to -0.2% m/m in Jun, down from 0.2% in May.** BoK attributed the low inflation to weak consumption and the fall in oil prices. Core inflation remains steady at +0.9% y/y in Jun (vs. +0.8% y/y in May).

- **Monetary Policy Forecast**: We **expect BoK to keep policy rate unchanged at 1.50% at the upcoming MPC meeting on 30 Aug,** as BoK allows for the recent 25bps at the last MPC meeting (18 Jul) to work its way into the economy. **There is some chance for another 25bps cut this year given that hopes for growth rebound in 2H seem to be fading while inflation remains sub-1% for the 6th consecutive month.** Ongoing trade spat between Japan-Korea and unresolved trade dispute between US and China are not helping with the investment, growth cycle. Another cut could come soon possibly in Oct's meeting if domestic economic activity, exports and inflation continue to show no signs of recovery; supplementary budget is not approved and if Fed cuts more than expected. The latter will give BoK some policy space to maneuver.

- At the last MPC meeting (18 Jul), BoK cut rate by 25bps to 1.5%. BoK Governor Lee cited that the need to support economic recovery has become bigger and he also voiced concerns over the trade spat with Japan Accompanying statement noted that pace of global economic growth has continued to slow as trade contracted mainly due to US-China trade dispute… domestic economic growth will be moderate and it is forecast that inflationary pressures on the demand side will remain at a low level. BoK will monitor "developments such as the US-China trade dispute, Japan's export restrictions, any changes in the economies and monetary policies of major countries, the trend of increase in household debt, and geopolitical risks, while examining their effects on domestic growth and inflation".

- **External Balance Outlook:** Current account balance posted a surplus of $4.5bn in May after a deficit of $660m was seen in Apr (first deficit in 7 years due to dividend paid to foreigners). Improvement was due to service balance which posted its smallest deficit since Dec-2016 due to tourist arrivals while primary account posted a surplus. Trade balance, on the other hand, posted the smallest surplus since Jan-2014 at $5.39bn amid falling trade volumes and DRAM chip prices. Semi-conductor exports fell nearly 30% in May.

- **Key domestic events and issues to watch:** S. Korea releases Jul exports, PMI mfg, inflation (1 Aug); Jul FX reserves (5 Aug); Jul unemployment rate, export/import prices (14 Aug); Jul PPI (21 Aug); Aug consumer confidence (27 Aug); Sep business surveys (29 Aug); Jul Industrial production, BoK MPC meeting (30 Aug).

- **Technical Outlook:** USDKRW traded firmly higher over the past few weeks; consistent with our caution (in the last FX Monthly) for rebound risks (though the pace of the rebound was far larger than expected). Last seen at 1197 levels. Bullish momentum on daily chart remains intact though stochastics is in overbought conditions. Key resistance at 1200 (76.4% fibo retracement of 2016 high to 2018 low). Break above that may expose USDKRW towards 1230 - 1240 level (objective of inverted head & shoulders from 20107 - 2019). Support at 1177 - 80 (21, 50 DMAs), 1172 (61.8% fibo).

SGD: SGD NEER Still Too Elevated

Forecast	3Q 2019	4Q 2019	1Q 2020	2Q 2020
USDSGD	1.3850 (1.3600)	1.3750 (1.3650)	1.3700 (1.3600)	1.3650 (1.3600)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** We revised USDSGD forecasts broadly higher to take into account a less-dovish than expected Fed, a worsening in domestic growth momentum in Singapore, as well as the latest escalation in trade tensions between US and China. SGD is expected to remain soft in 2H given increased likelihood of a MAS easing in Oct, potentially to neutral slope. Using historical performance as a guide, we see more room for SGD NEER to decline. Nonetheless, we caution that USD's share in the NEER basket is small, and USD could also see less upside catalysts now that expectations have reset post-FoMC. We prefer to short the NEER via a proxy basket. (See piece here; proxy basket trade is up by +1.4% excluding carry as at 1 Aug.) On balance, upside bias in USDSGD heading into Oct is intact, but modest. Our base case still factors in a period of ongoing negotiations between the US and China, with potential concretization of some positive details perhaps towards the end of the year. If this translates to a gradual turnaround in sentiments further out, SGD could see some relief from year-end onwards.

- July was largely a USD-strengthening on re-adjustments in market expectations of Fed easing story, as macro growth indicators in the US economy held up. Even as there were some good news with regards to developments in US-China trade relations—working level talks between Us and China are expected to be "intensive" in August; there are talks of restoring Huawei access to US components—markets are cautious of pricing too much positivity into AxJ currencies. This caution was warranted, as Trump announced a new round of tariffs on US$300bn of Chinese imports late last night.

- A recent report by our Economists showed that the ongoing trade conflict produced winners and losers among the AxJs. (See piece here.) Notably, Vietnam was a clear winner from the trade diversion from US tariffs on China, while Malaysia was a clear winner from

China tariffs on US. CLM and Thailand were seen benefiting to lesser extents as well. On the other hand, Singapore did not see any visible gains from trade diversion flows, but continued to suffer from the slowdown in the global tech cycle and heightened trade policy tensions. Slowing growth momentum in China, with 2Q growth falling to record-low of 6.2%y/y, probably added to woes of Singapore exporters. Double-digit contraction was observed in Jun NODX (-17.3%y/y vs prior -16.3%) and electronics exports (-31.9%y/y vs -31.6% prior). A 2018 study by MTI reports that nearly 10% of our GDP is attributable to our exports to China (both final and intermediate demand).

- The damage from softer demand, disruptions to supply chains etc., can already be seen in the domestic manufacturing growth figures. Overall industrial production plunged by a sharper -6.9% y/y in June (vs. revised -2.0% in May), while the electronics cluster also tanked by -18.8% in June (vs. -10.8% in May). Notably, US firms with a presence in Singapore such as Broadcom, Intel and Micron, could also potentially see negative impact from US export controls going forward. The re-configuration in regional tech supply chains could still pose growth drags on Singapore in the quarters ahead. Negativities in the growth outlook support our call for authorities to ease in Oct, with a potential shift to neutral slope for the SGD NEER (from current estimated 1.0%), i.e., upward bias for USDSGD.

- Nonetheless, we caution that the extent of upsides in USDSGD could be modest. One factor weighing on the pair is potential USD softness further out, as an environment of higher tariffs and heightened trade tensions might in turn cause the Fed to shift to more dovish tones once again down the road. Potential weakness in global growth and trade policy uncertainties were explicitly flagged out by Powell as factors which contributed to their case of a 25bps cut in the end-July decision.

- **Growth and Inflation Outlook:** Advance 2Q GDP figures came in relatively dismal at -3.4%qoq saar and 0.1%y/y (vs. 0.5%qoq saar and 1.1%y/y expected), and significantly worse compared to the +3.8%qoq saar and 1.1%y/y in the previous quarter. The sharp downside surprise led most economists to revise downwards their full-year growth estimates, and we note that the likelihood of a technical recession in 3Q has also increased. DPM Heng Swee Keat had to assuage sentiments on the ground by clarifying that "a full-year recession" for the economy was not expected at this point. Authorities have indicated that the official 2019 GDP growth forecast of "1.5 to 2.5%" is currently under review.

- Taking into account a swathe of weak growth data recently—Jun PMI (49.6 versus prior 49.9), May retail sales (-2.1%y/y versus prior -1.9%), double-digit contraction in Jun NODX (-17.3%y/y vs prior -16.3%) and electronics exports (-31.9%y/y vs -31.6% prior), IP data (-6.9%y/y versus prior -2.0% y/y)—our Economists' latest GDP forecast for 2019 is now lowered to +1.1%, from 1.3% previously. Potential disruption to intermediate goods demand from the reconfiguration of regional supply chains would still likely continue to play out in the quarters ahead. Stricter foreign worker measures (DRC cut in services starting

Jan 2020) could also pose modest drags on GDP growth into 2020. While sectors such as ICT, construction, health & education can potentially impart some resilience to the economy, they are unlikely to fully offset drags from externally-oriented sectors such as manufacturing and transport & storage in H2 2019.

- On the inflation front, Headline CPI rose by +0.6%y/y in Jun (from +0.9% in May) due to lower private road transport, services and retail inflation, as well as a larger decline in the costs of electricity & gas and accommodation. Core CPI edged down to +1.2% in Jun, from +1.3% in May, due largely to the same factors (except private road transport). MAS still expects Core Inflation to come in near the mid-point of the forecast range of 1-2% in 2019. Note that this was revised downwards from 1.5–2.5% previously in April, due to lower global oil price projections, as well as the impact of the liberalisation of the retail electricity market on electricity prices. Headline inflation is expected to average 0.5-1.5% this year. Our Economist's estimates for Core and Headline Inflation are revised to +1.2% and +0.7% for 2019, from +1.4% and +1.2% previously.

- **Monetary Policy Forecast**: After tightening monetary policy at both of its semi-annual policy meeting last year, the MAS affirmed a pause in its policy normalisation process in April as growth eased and inflationary pressures remain mild. Its policy of a "slight appreciation bias" for the SGD NEER was maintained, with the slope of the SGD NEER policy band still assumed at 1.0% (house estimate). The pause came as the MAS turned more cautious given the uncertainties in the global environment, cautioning in its statement that "significant uncertainty remains over the short-term outlook". This was largely warranted, as trade tensions flared up shortly after in May, global growth remained soft, and domestic growth indicators tanked. Notably, US also added Singapore to a monitoring list for currency manipulation in its US Treasury report end-May. This was largely a non-event in FX impact for the SGD, with the MAS coming out to clarify the role of the exchange rate as a monetary policy tool for Singapore.

- Our Taylor Rule estimates for the SGD NEER highlight that an appropriate SGD NEER slope consistent with current growth and inflation projections could be in the 0-0.5% range; the extent of appreciation has come down significantly given the recent downward revisions in growth and inflation. Given increased likelihood of technical recession in 3Q and continued benign inflation, there is an **increased probability that the MAS could ease at its next policy meeting in Oct,** compared to conditions three months ago. Our recent note on SGD NEER (see here) makes the case for a potential easing to neutral slope, and estimates the extent of fall-off in SGD NEER between now and post-policy at up to 1.0%-1.5%. A risk to this view is a sharp decline in USD strength at some point, which could mitigate the extent of weakness in SGD NEER.

- As at writing, USDSGD is around 1.3750, and trades around 0.9% above the implied mid-point of 1.3890, with the top estimated at 1.3610 and the floor at 1.4170. While having come off quite a fair bit since the end of June (from 1.8% above mid-point then), SGD NEER remains in the upper half of the band, and this continues to imply some risk asymmetries with regards to S$ related trades. For instance, shorting the SGD via a proxy basket could still be a useful hedge against Sg-specific growth concerns, especially for investors significantly exposed to SGD-denominated assets.

- Domestic interest rates have continued to trend downwards from the highs in May. The 3-month SOR (3MSOR) and 3-month SIBOR (3MSIBOR) are at 1.75771% and 1.88625% respectively at the time of writing, lower than the 1.83260% and 2.00167% recorded at end-June. With Fed's dovish tilt moderated, but intact, there could be downward pressure on rates going forward, although the extent of decline could be mitigated by increased expectations for policy easing by the MAS. Deposit rates (for 12-month fixed) was unchanged at around 0.57% (last data point at end-July). The interest rate easing bias should help mitigate financial stability risks in interest-sensitive sectors (e.g., property) for now. We expect the 3MSOR and 3MSIBOR to decline to around 1.67% and 1.82% respectively by end-4Q 2019.

- **Latest Fiscal and External Balance Outlook:** The FY2019 budget is modestly expansionary, with the primary deficit projected at SGD5.4bn (1.1% of GDP). Authorities estimate a fiscal impulse of around +0.7%, providing an appropriate boost to the economy given presence of external headwinds. This comes on the back of an increase in projected expenditure of SGD1.3bn to SGD80.3bn, and an increase in operating revenue of SGD1.2bn to SGD74.9bn. The overall deficit is pencilled to come in at SGD3.5bn (0.7% of GDP) due to the record-high special transfers of SGD15.3bn in the FY2019 budget (FY2018: SGD9bn).

- Delving into Budget FY2019, we see that various measures were specifically targeted at SMEs, with the intention of providing credible upgrading support to viable enterprises. The Productivity Solutions Grant extension, Automation Support Package and Industry Digital plans will encourage businesses to adopt automation and other tech-solutions to a greater extent in their operations. Co-investment programmes will see the government helping to catalyse private sector funding of SMEs that are ready to scale up. These measures aim to overcome medium-term challenges in capital and labour allocation for the economy.

- To assuage near-term growth concerns, DPM Heng Swee Keat has said that the government is ready to roll out a package to help businesses and workers, should the global economy worsen. Details are scant for now, but gauging from the mix of policies in the 2009 Resilience Package, the focus could likely be on helping workers keep their jobs via wage credits (subsidies to corporates' wage bills), skills upgrading, and income supplements for low-wage earners. Corporate and personal income tax rebates would likely come into the mix too.

- The current account (CA) surplus started 2019 on a positive note. The CA surplus widened to SGD20.3bn in 1Q 2019 from SGD18.0bn in 4Q 2018. As a percentage of GDP, the CA surplus was at 17.7% in 1Q 2019 vs. 17.9% in 4Q 2018. The larger CA surplus (in levels) was due partly to an increase in the goods and services surplus of SGD30.7bn (from 4Q's SGD30.2bn) and the smaller outflow from both the primary (1Q: -

SGD8.3bn vs. 4Q: -SGD9.9bn) and secondary (1Q: -SGD2.1bn vs. 4Q: -SGD2.4bn) accounts. Of some concern is the continued impact of the US-China trade tensions on Singapore's trade balance outlook. There are signs that while Singapore's current account started from a position of strength at the start of the year, heightened global trade policy tensions are starting to have an impact. Latest CEIC-estimated 2Q data for goods balance was US$6.7bn, compared to US$8.3bn in 1Q and US$12bn over the same period last year.

- **Key domestic events and issues to watch**: Jul PMI (2 Aug); Jul Foreign Reserves (7 Aug); Jun Retail Sales (8 Aug); Jul Exports (16 Aug), Jul CPI (23 Aug); 2Q Final GDP (19 to 23 Aug); Jul IP (26 Aug).
- **Technical Outlook**: USDSGD largely trended up for the month of July, after reaching a trough in end-June of 1.3530. Last seen at 1.3750. Daily charts indicate a modest bullish momentum, while stochastics are in overbought conditions. The 21 DMA has cut the 100 DMA and 200 DMA to the upside, which is a bullish indicator. But some resistance could be seen at around 1.3830 (May high). We caution of retracement risks back towards support of 1.3710 (61.8% fibo retracement from May high to Jul low), 1.3630 (200 DMA) if upward momentum loses steam.

MYR: Weighed by Global Trade Underperformance

Forecast	3Q 2019	4Q 2019	1Q 2020	2Q 2020
USDMYR	4.1600 (4.1300)	4.1400 (4.1200)	4.1300 (4.1000)	4.1200 (4.1000)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** The MYR reached a low of 4.1455 on 1 Aug 2019 as the USD strengthened following the 31 Jul FOMC statement and Powell's non-committal press conference comments. We are looking for DXY strength to continue into end 3Q and early 4Q now. However, for 2H 2019, we see regional central banks likely to still stay accommodative although threat from global trade underperformance has kept MYR soft. However, resumption of US-China trade talks including positive outcomes thus far on the tech war (Huawei related issues), signs of positive news from FTSE Russell in their Sep 2019 decision on Malaysia bonds in the WGBI, or further investment inflows into Malaysia and MYR-denominated assets could support the MYR.
- However, in the emerging markets space, we could see a sustained rally in emerging-market bonds as EM central banks may continue to embark on a rate-cutting cycle to support growth. Even though, the Fed has eased to "insure against downside risks" but did not signal the start of a lengthy easing cycle, we acknowledge that the market has moved very quickly to pricing in rather dovish outcomes

for the Fed. As such we are not aggressive on all EM currencies except for Indonesia within the region, given its carry allure under current environment. The level of vulnerabilities in aggregate across EM are relatively controlled and contained for now. However there is the risk of the lingering U.S.-China trade tensions curbing appetite for riskier assets. If the EM inflows intensify, we could see some of it cascading into the MYR assets. Our Malaysia economics team do not rule out another 25bps OPR cut in 2019 if downside risk to growth from the trade tension persist and/or worsens, considering that the recent OPR cut was "event-driven" in reaction to the negative development on US-China trade situation. At the same time, we do not see BNM making any move until up to Sep 2019, pending announcement by FTSE Russell on Malaysia's status in the World Government Bond Index (WGBI).

- We expect market participants will start to focus again on the Fed rate cuts around Sep and Dec even as the US-China trade truce helps to calm trade concerns and the Fed's target measure of inflation remains well below the 2% level. We have generally revised the USDMYR higher to reflect the shift in the Fed wait-and-see stance now and see USD strength to remain entrenched subject to no interventions by the Trump administration. USDMYR is expected to end around 4.16 in 3Q19 and end the year at 4.14 to the USD.

- We still expect crude oil and palm oil prices to remain range bound over the next few months and should have limited impact on the MYR. Fundamentally, we think the picture for risk assets including EM FX such as MYR remains quite bright if global growth sees some sustained green shoots amid extended easy monetary policy, provided markets and policymakers manage to navigate near-term risk events such as Brexit and US-China trade and tech wars. But these could likely pan out more in the middle of 2020.

- External reserves up +USD0.6b to USD103.3b at mid-Jul 2019 from USD102.7b at end-Jun 2019, equal to 7.3 months of retained imports, 1.2x total short-term external debts and 6.1% above the estimated minimum required reserves of USD97.4b under IMF's Assessing Reserve Adequacy (ARA) framework. YTD, external reserves trend was volatile i.e. up +USD2.1b in Jan-1H Apr 2019, down –USD1.2b in 2H Apr-May 2019, and up +USD1b in June-1H July 2019.

- Foreign investors were net buyers of Malaysian equities so far this month (1-18 Jul 2019) of +MYR0.3b (Jun 2019: +MYR0.1b). Sentiment improved in reaction to the dovish tones of US Federal Reserves and the European Central Bank (ECB) that led to expectations of US interest rate cuts - as soon as the next FOMC meeting on 30-31 July 2019, and fresh rounds of monetary stimulus in Europe. Investors also reacted positively on the resumption of US-China trade truce and talks.

- Net foreign flows data for Malaysian bonds in Jul 2019 will be out in first week of Aug 2019, but this month sees MYR1.1b worth of Government Housing Sukuk (SPK) matured on 12 Jul 2019 with another MYR7.3b worth of MGS will be expiring on 30 Jul 2019. To recap, foreign investors were net buyers of +MYR6.6b of bonds in Jun 2019 (May 2019: –MYR4.2b).

- Nonetheless, we expect portfolio capital flows to remain volatile amid the following near-term key external and internal outlook and lookouts: (1) FOMC meeting on 30-31 July 2019. Fed policymakers are signaling for a rate cut in the upcoming FOMC meeting amid the trade uncertainties and slowing global growth. Market will also be looking for clues and direction on Fed's monetary policy going forward. (2) Outcome of US-China Trade Truce 2.0. According to Xinhua News Agency, face-to-face meetings between the two countries' trade negotiators could happen soon after a few rounds of telephone conversations. The state media also reported that several Chinese companies have applied for exemptions from the tariffs imposed on American agricultural products. (3) FTSE Russell's decision on Malaysia's status in the World Government Bond Index (WGBI) in Aug or Sep 2019 i.e. "remain in WGBI", "removal from from WGBI" or "extension of being in the watch-list", which will have impact on foreign flows in the bond market given our Fixed Income Research estimate of MYR15b-MYR20b holdings of Malaysian bonds by foreign passive funds that track WGBI.

- **Growth and Inflation Outlook:** For Malaysia, our Economics team have trimmed 2019 real GDP growth forecast to +4.4% from +4.7% on trade tension overhang plus factoring in the actual +4.5% YoY growth in 1Q 2019. Apart from taking into account of the actual 1Q 2019 growth of 4.5% YoY, the revision mainly reflects the earlier mentioned US-China/global trade situation and the attendant risks.

- However, we remain constructive on the economy given the better-than-expected 1Q growth in consumer and Government spending as well as services; rebounds in agriculture and mining sectors; domestic stimulus via BNM's 25bps OPR cut –with room for more -as well as the revival of major infrastructure and development spending projects; evidence of trade diversions and investment relocations; and fiscal consolidation that is on track.

- Industrial production grew +4.0% YoY in May 2019, the same as in Apr 2019, sustained by expansions in all components i.e. manufacturing (May 2019: +4.2% YoY; Apr 2019: +4.3% YoY), mining (May 2019: +3.0% YoY; Apr 2019: +2.3% YoY), electricity (May 2019: +5.7% YoY; Apr 2019: +5.8% YoY). Apr-May 2019 growth picked up from +2.7% YoY in 1Q 2019 while YTD growth was +3.2% YoY (Jan-May 2018: +3.6% YoY; 2018: +3.0%).

- Manufacturing growth momentum was sustained (May 2019: +4.2% YoY; Apr 2019: +4.3% YoY; Apr-May 2019: +4.2% YoY; 1Q 2019: +4.0% YoY) on the back of continued expansions in key clusters, namely E&E (May 2019: +3.7% YoY; Apr 2019: +4.1% YoY); Petroleum, Chemical, Rubber & Plastic Products (May 2019: +3.2% YoY; Apr 2019: +3.6% YoY); and Food, Beverages & Tobacco (May 2019: +4.7% YoY; Apr 2019: +4.2% YoY). Domestic-oriented industries growth was steady at +4.6% YoY (Apr 2019: +4.6% YoY) while exports-oriented industries expanded slightly slower at +3.8% YoY (Apr 2019: +4.0% YoY).

- Mining recovery is gaining legs as output rose for the second month (May 2019: +3.0% YoY; Apr 2019: +2.3% YoY) and rebounded +2.6% YoY in Apr-May 2019 (1Q 2019: -1.9% YoY), underpinned by natural gas output (May 2019: +7.6% YoY; Apr 2019: +6.1% YoY) as production normalized after last year's supply disruption. In contrast, crude oil output fell -2.0% YoY in May 2019 (Apr 2019: -1.9% YoY), marking the 16th decline over the preceding 19 months. Together with OPEC and non-OPEC producers last month, Malaysia extended its output cut commitment of -15,000bpd for another nine months until Mar 2020. Electricity production growth momentum was also sustained (May 2019: +5.7% YoY; Apr 2019: +5.8% YoY).

- After "zero-bound" 5M2019, inflation surged in Jun 2019 by +1.5% YoY (May 2019: +0.2% YoY) mainly on lower base effect from consumption tax holiday (0% GST) in Jun-Aug 2018. Expect base effect and potential implementation of targeted fuel subsidy – hence flotation of currently fixed RON95 petrol and diesel prices - this quarter to contribute to higher inflation in 2H 2019. Maintain our 2019 and 2020 inflation rate forecasts at +1.0% and +2.1% respectively (1H 2019: +0.2%; 2018: +1.0%).

- As expected, after the "zero-bound" inflation in Jan-May 2019 averaging -0.1% YoY, headline inflation "surged" to +1.5% YoY in Jun 2019 (May 2019: +0.2% YoY). The rise was mainly contributed by "food & nonalcoholic beverages" (FNAB) and "housing, water, electricity, gas & other fuel" (HWEGOF) as the lower base effect kicks in as the Goods and Services Tax (GST) was zerorised from 6% for the period Jun-Aug 2018. On MoM basis, CPI was unchanged (May 2019: +0.2%). Meanwhile, core CPI also "jumped" to +1.9% YoY (May 2019: +0.4% YoY; 1H 2019: +0.6% YoY; 2018: +0.8%). All core CPI sub-indices rose during the month except for clothing & footwear and transport, which posted smaller declines.

- In addition to the base effect, we continue to expect factors such as the broadening of the SST base; Budget 2019's new taxes e.g. Sugar Tax (postponed to 1 Jul 2019 from 1 Apr 2019), departure levy for all outbound air passengers (1 Sep 2019); hikes in minimum wage and utility costs; and the expected floatation of RON95 & diesel prices in 3Q 2019 after the roll out of the new fuel subsidy mechanism for B40 households to result in higher inflation in 2H 2019.

- Maintain our 2019 and 2020 headline inflation forecasts at +1.0% and +2.1% respectively (1H 2019: +0.2%; 2018: +1.0%).

- **Monetary Policy Forecast:** BNM kept the Overnight Policy Rate (OPR) at 3.00% after its Monetary Policy Committee (MPC) meeting on 8-9 July 2019. This followed the 25bps cut at the MPC meeting on 6-7 May 2019, at the time when the global growth and trade outlook darkened as US-China trade talks broke down, leading the re-escalation in Us-China trade war before US-China "Trade Truce 2.0" was announced at end of June 2019.

- We see no change in OPR this quarter pending FTSE Russell's decision on Malaysia's status in the World Government Bond Index (WGBI), but we do not rule out possibility of another 25bps cut in 4Q 2019 if US-China trade tension – hence downside risk to global and domestic growth - persist or worsens.

- **Latest Fiscal and External Balance Outlook**: Aside from the headwinds from external uncertainties, businesses are also awaiting clarity on domestic policy changes post-GE14, particularly reviews of tax systems and 130 investment incentives under 32 approving authorities as stated in Budget 2019 Speech in 2 Nov 2019, which could be announced in Budget 2020 to be tabled on 11 Oct 2019.

- Fiscal consolidation on track via implementation of Budget 2019's revenues and expenditure measures. The Government aims to lower its budget deficit to MYR52.1b or 3.4% of GDP in 2019 vs MYR53.4 or 3.7% of GDP. Indicating fiscal consolidation is on track, as at Jan-May 2019, the budget deficit was MYR21.4b, down from MYR35.1b in Jan-May 2018 and 41% of the full-year 2019 target.

- Crude oil price's year-to-date average of USD66/bbl sits well within the Government's medium-term fiscal framework assumption of USD60-70/bbl that also underpins the target to lower budget deficit further to 3.0% of GDP in 2020 and 2.8% of GDP in 2021.

- **Key domestic events and issues to watch:** FX reserves (7 & 22 Aug); Trade Balance (2 Aug), Ind Production (9 Aug), GDP (14 Aug), CPI (16 Aug), BNM Monetary Policy Statement (12 Sep).

- **Technical Outlook:** Our bias (in last FX Monthly) for USDMYR to ease lower met our 1st objective at 4.12 but fell short of meeting the second objective at 4.09. Pair traded a low of 4.1038 (19 Jul) before rebounding. Last seen at 4.1565 levels. Bullish momentum on daily chart remains intact while stochastics is rising. Resistance at 4.1650 (61.8% fibo retracement of May high to Jul low), 4.18 (76.4% fibo). Upside risks ahead but pace of up-move could moderate towards 4.17-4.18. Support at 4.1420 (38.2% fibo), 4.12 (23.6% fibo) levels.

IDR: Constructive Bias from Jokowi-led Reforms

Forecast	3Q 2019	4Q 2019	1Q 2020	2Q 2020
USDIDR	14000 (--)	13950 (--)	13900 (--)	13850 (--)

Forecasts Unchanged

- **Motivation for the FX View:** The USDIDR pair had seen a sharp dip alongside Jokowi's announcements of broad tax and labour policy reforms on 12 July, touching an intra-year low of 13922 at one point. Post mid-July however, re-adjustments in expectations regarding the extent of Fed easing, on the back of resilient US economic data, slowly led the pair to retrace part of its losses. After a less-dovish than expected Fed forward guidance at end-July, and reports of new Trump trade tariffs this morning, the pair is hovering above the 14200-level as of writing. We think the pair may potentially have some room to decline in the coming months, as markets increasingly place bets on Indonesia as a (relative) outperformer in Asia, or if Trump changes rhetoric again, and signs of tentative progress in US-China trade talks emerge towards year-end. Potential bets on IDR continue to be consistent with the broader macro backdrop. Dovish tones from global and regional central banks in a low-growth, low-inflation environment could continue to translate to greater interest in higher-yielding risk assets, and EM assets stand out as clear picks in the region, especially after S&P's recent upgrade of Indonesia's sovereign rating from BBB- to BBB. Sustained FDI or infrastructure-related flows could also be a supporting factor for IDR's medium-term outlook as well.

- We note that MTD flows into Indonesian government bonds had moderated to US$1.73bn (as at 31 Jul), from US$2.77bn in June. Despite BI's recent 25bps policy rate cut from 6.00% to 5.75%, current ten-year government bond yields are still more than three times that of US Treasuries. Further rate cuts are still very much on the table, but resilient growth (above 5.0%) and under-control current account deficit (2.5-3.0% of GDP) means that any upcoming rate cuts would also likely be relatively modest in magnitude, compared to the six hikes last year. We think there is a fair chance that bond inflows could remain net positive in 2H, even if levels are more modest compared to highs in June. Nonetheless, with the increase in perceived trade tensions globally, there might be some unwinding of EM carry trades in the very short run.

- Another potentially significant driver of inflows could be longer-term FDI and infrastructure investments. Due in part to its archipelagic nature, infrastructure needs in the country are massive, comprising of highways, toll roads, sea ports, airports, mass transit, telecommunications and power generation, and some estimates place the required investment at as high as US$500bn per annum. Besides partnerships with programs such as China's Belt & Road Initiative and Japan's Partnership for Quality Infrastructure, various domestic projects will also likely tap on funds and expertise from the multilateral development banks, i.e., World Bank, Asian Development Bank, and most recently the China-led Asian Infrastructure Investment Bank.

- Examples abound of public-private partnerships in the domestic infrastructure scene. Fee-charging motorways on Java are looking to Hong Kong investors for funding, while deals were signed with UAE recently to develop projects including the Balikapapan refinery, an integrated supply chain and LNG storage. Maspion and DP world also jointly invested US$1.2bn to develop a container port in Gresik East Java. Meanwhile, Softbank is reported to invest US$2bn through Grab over 5 years to accelerate the development of Indonesia's digital infrastructure, including an electric vehicle ecosystem. These anecdotes, alongside positive 2Q FDI data showing 9.6%y/y growth, portends a bright outlook for FDI-related flows in H2 2019 and likely 2020 as well. We note that Jokowi's "I have nothing to lose" attitude amid his announcement of sweeping reforms on 12 Jul, could serve to accelerate such flows. Reforms include lowered corporate tax rates (likely to 20% from current 25%), easing of stringent labor laws and lifting of curbs on foreign ownership in more industries, including petrochemicals and other manufacturing industries. Bank merger rules are also set to be relaxed to boost FDI.

- The Constitutional Court ruling earlier in June had rejected allegations of "systemic electoral fraud" by Prabowo and effectively awarded the presidential election win to Jowoki. There are signs recently, after Prabowo met Jokowi as well as Megawati Sukarnoputri (chief of ruling PDI-P party), that he's seeking support to have some of his own party officials take up important roles in the new government despite his elections defeat. For markets, signs of such horse-trading could portend a further moderation in political tension, and increased stability in the new government would be IDR-positive. Nonetheless, there are news that some Jokowi allies are unhappy with Prabowo's push, and are looking to fill the top posts for their own officers instead. To this end, Jokowi's appointments for the key economic ministries, particularly Finance, will be closely watched. The re-appointment of Sri Mulyani to the Finance Ministry, or a more powerful role (e.g., Coordinating Minister for Economic Affairs) is highly anticipated, as she is highly respected for helping to reduce unnecessary government spending and trimming the fiscal deficit to below 2% of GDP, and could be IDR positive as well.

- The government has also recently extended tax breaks to the luxury property segment as it has seen sluggish sales in the past five years. Tax on income from sales of luxury houses and condominiums priced at more than IDR30bn (US$2.1mn) or more was reduced to 1% from 5%. Value-added tax on mass-market housing has also been waived up to a certain value. Earlier announcements stated that Indonesia would intensify the use of biodiesel to reduce import of oil given its status as a net oil importer. These measures would help support housing investment while helping to curb current account deficits.

- Despite the host of factors supporting the IDR (i.e., weighing on USDIDR pair), there is still a modest upside risk for the pair. This could come about on volatility in the midst of US-China trade talks, which has already seen multiple U-turns. In addition, Indonesia itself could potentially see the removal of its Generalized System of Preferences (GSP) privileges, a US trade program which allows tariff-reduced imports from certain US trade partners. Indonesia's eligibility status is currently under review, as a wide array of Indonesian trade barriers was deemed to have created serious negative effects on US commerce, including significant concerns on IP protection. Around US$2.1bn worth of Indonesian exports (1.2% of total exports) are covered under the GSP, including rubber tires, jewelry and chemicals.

- **Growth and Inflation Outlook:** After growth of 5.07%y/y in 1Q, BI expects 2Q growth to remain soft due to falling export performance. In particular, ongoing trade tensions could continue to pressure world trade volume and undermine global economic growth. The slowdown in exports has also fed through somewhat to investment expectations, weighing on non-building investments. Nonetheless, solid consumption, on the back of positive public confidence, should help to mitigate external demand weaknesses somewhat. The above-mentioned tax cuts and other pending stimulus measures should also help to anchor growth going forward. BI expects full-year growth for 2019 to come in below the mid-point of the 5.0-5.4% official growth range.

- Headline inflation came in slightly lower at 3.28% y/y for June (vs. 3.32% in May), largely due to lower transportation costs, which increased at a slower rate in June by 1.91% (vs. 3.58% in May). Ticketing prices for airplanes, trains and buses had softened after the end of the Ramadhan month. On the other hand, fresh food prices had increased 4.91% y/y (vs. 4.08% in May), driven by an increase in the price of beef and other vegetables. Despite the recent 25bps rate cut, effects of the previous 175bps rate hikes by BI could continue to cap price pressures. Without volatile energy prices, our Economists expect full-year inflation to be manageable and to come in within the central bank's 2.5% to 4.5% official range.

- **Monetary Policy Forecast:** In the recent Monetary Policy meeting on 18th Jul, BI had lowered the BI 7-day Reverse Repo Rate, Deposit Facility and Lending Facilities, by 25bps each, to 5.75%, 5.00% and 6.50% respectively. This was largely in line with our Economists' estimates, given their views that the rate cut was necessary to prevent growth from falling below 5%. BI said that the policy stance was "consistent with low inflation expectations and the need to build economic growth momentum" amid external challenges such as "global financial market uncertainty". In particular, the statement's focus on growth was clear, with at least four references to the need to buttress economic growth. With the Fed likely to remain on a modest dovish slant in 2H, we see BI continuing to act to address potential deterioration in external demand conditions as well. In particular, given that there were six hikes totaling 175bps between May and Nov 2018, there is significant room downwards for the BI to cut rates. After the Jul 25bps cut, our Economists are penciling in another 25bps reduction by year-end.

- Post the recent Fed cut (which was viewed as less dovish than desired) and Trump tariff announcements, there was strong upward pressure on the USDIDR pair (i.e., weakening IDR). The BI has in turn stepped up efforts to cool a sell-off in IDR bonds and currencies by intervening in the NDF market. This commitment to anchor IDR stability should help calm markets and ease volatility as well.

- **Latest Fiscal and External Balance Outlook:** The budget deficit for Indonesia came in at 0.84% of GDP for 1H due to continued external demand pressures. State revenues rose 7.8% y/y to IDR898.8tn in 1H, equivalent to 41.5% of budget, with taxation revenues accounting for IDR688.9tn. State expenditure similarly increased by +9.6% y/y over the period to IDR1034.5tn. This led to a primary balance deficit of IDR1tn in 1H2019, compared to a deficit of IDR10tn in the same period last year. Finance Minister Mulyani cautioned that realization of oil prices and oil & gas lifting which is lower than first semester assumptions will also weigh on state revenues. For the year as a whole, the government will try to keep budget deficit as targeted at

1.84% of GDP, or smaller than previous year's deficit target of 2.19% of GDP, which should be sufficiently supportive of growth.

- External demand in Jun continued to be weak with exports down -8.98%y/y (compared to revised -8.48% prior). On the other hand, imports registered positive growth of +2.80% (compared to revised -17.30% prior), resulting in a trade surplus of US$196mn, slightly lower than the US$219mn in May. Products-wise, the y/y exports fall was driven by the slump in the shipments of crude oil and gas products. Indonesia's mainstay commodities products, such as palm oil, coal, other agricultural & mining products, also seem to be on sustained downtrends recently. Any moderation in trade tensions could take some time to play out, especially with Trump's latest announcements, and 2H is unlikely to see a significant recovery in trade growth.
- **Key domestic events and issues to watch:** 2Q GDP (5 Aug); Jul Foreign Reserves (7 Aug); Jul Trade (15 Aug); Jul Local Auto Sales (15-21 Aug); Monetary Policy Decision (22 Aug).
- **Technical Outlook:** On daily charts for USDIDR, momentum indicators are bullish, while stochastics indicators are in overbought conditions. There is a risk that bullish momentum might bring the pair higher towards 14280 (61.8% fibo retracement of May high to Jul low) in the interim, but we think overbought conditions might lead to some retracement in the pair further out. The 50 DMA has just cut the 100 DMA to the downside, another tentative bearish indicator. Nearby support at 14210 (50% fibo), 14140 (38.2% fibo), then 14040 (23.6% fibo). Resistance at 14280 (61.8% fibo), 14350 (200 DMA).

PHP: Looking for BSP to Ease in Due Course

Forecast	3Q 2019	4Q 2019	1Q 2020	2Q 2020
USDPHP	51.50 (--)	51.30 (--)	51.20 (--)	51.20 (--)

No Change to Previous Forecast

- **Motivation for the FX View:** We stick to our constructive call on the Peso amid (1) continued foreign inflow into local equity markets following S&P's upgrade to PH sovereign rating to BBB+ and President Duterte's mid-term victory; (2) relatively higher-yielding behind Indonesia and India bonds in a falling rates, growth not-hot-not-cold and subdued inflation environment; (3) synchronous global easing including a dovish Fed providing support for easy financial conditions, supporting sentiment; (4) a dovish Fed could limit USD upside; (5) potential rate cut undertaken by BSP as soon as in Aug though may weaken PHP in the near term but is supportive of growth and activity and could boost PH assets - this could in turn keep PHP supported; (6) PHP less vulnerable amongst AXJ FX if US-China trade tensions escalate; and (7) though Philippines suffers from current account deficit, the deficit-to-GDP ratio is improving and is not a top concern as deficit is investment-driven and have been funded by relatively healthy inflow from tourism, Business process outsourcing receipts and OFWR. Tax reform plans (lower corporate taxes and increase levies on alcohol and tobacco) recently announced by President Durterte could support businesses and is a medium term positive that may even buld hopes of another credit rating upgrade – this will be another positive for PHP.

- **Upside Risks to USDPHP forecast:** There are risks to our constructive outlook on the Peso, namely (1) if foreign inflows slowed then current account deficit outlook could be affected and this could expose PHP to downward pressure; (2) easing of monetary policies did not translate into any support for the economy and this could impact investor confidence; (3) Fed easing did not materialize. These factors could pose downward pressure on PHP.

- **Growth and Inflation Outlook: 2Q GDP will be release on 8 Aug**. Manufacturing PMI for Jun rose marginally to 51.3, from 51.2 in May due to output gains. But survey revealed slower pace of gains in total new orders due to contraction in new export orders. We think this pullback may be due to the last print where new export orders reported the fastest pace in 12 months. Overall, the outlook remains cautious amid pockets of new trade tensions including US-EU trade dispute over aircraft manufacturing subsidies, JP-KR trade spat and US duties on steel imports from Vietnam, Mexico and China. Our Economist noted that PH imports were down by -5.4% YoY in May 2019 (vs. Apr 2019: -1.9% YoY), as a result of the high base effect last year where its growth averaged +26% YoY between Apr-Oct 2018

- 1Q GDP growth decelerated to 5.6% y/y, down from +6.3% y/y in 4Q. The decline was due to a slowdown in government expenditure (owing to budget impasse which lasted till mid-Apr) and the consequential drag on private investment. Net export was another drag with exports slowing faster than the slowdown in imports. On the other hand, domestic demand held up well via a pick-up in consumer spending. Industry breakdown showed construction sector growth fell sharply while manufacturing and services growth improved.

- Our Economist revised 2019 growth forecast to +6%, down from 6.5%, owing to the budget impasse and persistent contraction in net exports. The budget impasse resulted in the Government applying re-enacted budget instead of new budgets. That has negative macroeconomic impact in terms of slowing aggregate demand, hence economic growth, which in turn worsened the budget balance growth. Nonetheless growth is expected to recover in 2H to the 6 – 6.5% range as budget 2019 has finally been signed into law on 15th Apr and the ban on government spending now gets out of the way post-elections. The official forecast for 2019 is at 6 – 7%.

- Headline inflation eased towards 2.7% y/y in Jun, after the one-off uptick in May (3.2%). Our Economist noted that Food and non-alcoholic beverages was the biggest drag following government measures to boost good supply, ensure efficient distribution is in place amid moderate global food prices while crude prices also eased. Core inflation also eased to 3.3% y/y in Jun (vs. 3.5% in May).

- Our Economist revised 2019 inflation forecast to 2.6%, from 3% on moderate global growth and commodity prices. The team also expect, headline inflation to average below +2.0% YoY in 2H 2019 given the high base in 2H 2018. This should be positive to consumer sentiment and spending to help uplift economic growth, which slowed to +5.6% YoY in 1Q 2019 (4Q 2018: +6.3% YoY) amid Budget 2019 overhang that was resolved last quarter. BSP's inflation forecast for 2019 is at 2.7%.

- **Monetary Policy Forecast:** Our house view continues to look for another 25bps cut each in 3Q and 4Q 2019 to bring policy rate down to 4% this year. We think **a 25bps cut as soon as at the upcoming MPC meeting on 8th Aug to** take overnight borrowing rate down to 4.25% should not be ruled out. Governor Diokno has said future rate cuts are "inevitable" but the timing would be "data dependent and evidence based." Our Economists kept our RRR cut forecast of -200bps p.a. intact after the announced schedule of the -200bps RRR cuts to 16% in stages; -100bps on 31 May, -50bps on 28 Jun, and -50bps on 26 Jul 2019. Last year, BSP cut RRR by a total of -200bps i.e. -100bps on 2 Mar 2018 to 19% from 20%, and another -100bps on 1 Jun 2018 to 18%. The trajectory is based on the stated target to lower RRR to single digit by 2023.

- At the last BSP meeting (20 Jun), the central bank kept policy rate on a prudent hold at 4.5%, as expected to assess the impact of the recent -25bps policy rate cut in May 2019 and series of banks' RRR cuts in May-Jul 2019. Our Economist noted that the prudent pause also allows BSP to assess developments of the US-China trade war as well as trends in quarterly GDP growth and inflation. Accompanying MPS also acknowledged that while real sector activity moderated in 1Q 2019, overall domestic economic activity is likely to remain firm, supported by a projected recovery in household spending and the continued implementation of the government's infrastructure spending program.

- **Latest Fiscal and External Balance Outlook:** BoP posted a deficit of $404m in Jun as national governments made principal and interest payments to its foreign debts. On a cumulative basis, BoP for Jan – Jun posted a surplus of $4.79bn vs. a deficit of $3.26bn in the same period in 2018. Strong performance of BoP can be attributed to remittance inflows from overseas Filipinos during Jan – May and net inflows of foreign portfolio investments during Jan-Apr.

- **Current account deficit remains at 2.4% of GDP** but IMF expects an improvement to 2.2% of GDP in 2019. Governor Diokno said he was "not at all worried about CAD especially if deficit is less than 3% of GDP as the composition of imports was for raw materials, equipments". He stressed that BoP position is manageable and provides resilience against external headwinds… external position is adequately supported by structural sources of FX inflow such as OFWR, IT/business-process outsourcing revenues and tourism receipts". His comments were also consistent with S&P's recent assessment - "the deficit is largely investment driven, and that this is a healthy development in light of its historical underinvestment".

- The S&P upgrade Philippines sovereign credit rating to BBB+ (30th Apr). The rating agency cited strong economic growth trajectory, solid government fiscal accounts and sound external settings for its upgrade to the Philippines ratings. This should support investor sentiment and spur inflows into Philippine assets, supportive of the PHP. Recently announced tax reform plans, if passed may also increase the likelihood of any upgrade.

- **Key domestic events and issues to watch:** Jul Mfg PMI (1 Aug); Jul CPI (6 Aug); Jun trade (7 Aug); 2Q GDP, BSP meeting (8 Aug); Jun Overseas remittances (15 Aug); Jul BoP (19 Aug).

- **Technical Outlook:** Decline in USDPHP found support at 50.80 levels (interim double bottom) before rebounding into early-Aug. Last seen at 51.40 levels. Daily momentum turned bullish while stochastics is rising. A potential bullish divergence appears to be forming on the weekly chart. Technically there may be further upside to go. Immediate resistance at 51.50 (50 DMA) before 51.66 (23.6% fibo retracement of Oct high to Jul low) and 51.86 (100 DMA). An extension of the break-out towards 52.20 (38.2% fibo) should not be ruled out. Support at 51.14 (21 DMA), 50.80 (double bottom)..

THB: Supported by Resilient CA & Gold Prices

Forecast	3Q 2019	4Q 2019	1Q 2020	2Q 2020
USDTHB	30.80 (--)	30.60 (--)	30.40 (--)	30.20 (--)

Forecasts Unchanged

- **Motivation for the FX View:** THB strength broadly moderated in July, as BoT officials first utilized verbal intervention, then implemented measures targeted at foreign inflows—i.e., reducing limits on outstanding balances of non-residents' THB accounts. (See piece here.) Movement of the USDTHB pair was in line with the broad uptrend in DXY strength over most of July. Nonetheless, signs of reversal (i.e., strengthening in THB) have emerged in the last week of July. Potential factors supporting THB include still-firm gold prices, healthy macro fundamentals and an expected pause in BoT policy rate. Further rallies in THB strength could be constrained in the interim, with concerns over the effectiveness of the 19-party Junta-led coalition still on the minds of foreign investors. We hence look for two-way ranged trades for the rest of the quarter, before (i) potential recovery in sentiments further out, perhaps alongside some concretization of trade deal details between US and China at the turn of the year, and (ii) further proof from the new Thai government with regards to its capability to implement pro-growth policies, lead the THB on a more sustainable strengthening path (i.e., downtrend for USDTHB).

- A recent report by our Economists showed that there were winners/losers from the trade conflict among the AxJs. (See piece here.) While not a clear winner, Thailand was seen benefiting to lesser extents as well, from diversion flows. Although exports in June continued to contract by -2.1%y/y, we note that this was a shallower decline compared to May's -7.2%. Further, alongside a -9.6% decline in imports, trade and current account balances came in positive at US$4.4bn and US$3.9bn respectively. We think markets will look beyond the likely 2019 export contraction and focus on the healthy current account surplus projection for the year in assessing macro conditions. Nonetheless, a risk to this view is US' ongoing review of Thailand's Generalized System of Preferences (GSP) status, with the US citing market access for US porks and worker rights as reasons for the review. Up to US$4.3bn worth of goods (1.7% of exports) currently covered under GSP could be negatively impacted if GSP status is revoked.

- Meanwhile, net portfolio flows over the past month have moderated or turned negative. July data (as at 30 Jul) shows net flows of around +US$659mn (inflow) into Thai equities and -US$786mn (outflow) from Thai bonds, compared to figures of +US$1.5bn and +US$2.3bn in the previous month. The decline could be due in part to BoT's latest restrictions on non-residents' THB account balances (announced on 12 July), which was aimed specifically at curbing THB strength. Officials also confirmed that cuts in bond supply were utilized for the same purpose. Alongside signs that foreign inflows have moderated, we think that an escalation of foreign capital controls is not likely in the near term; rather, officials are more likely to continue to rely on existing means to discourage currency speculation. In such a scenario (i.e., no further capital control measures), expectations for BoT to hold policy rates (consensus for Aug 7 meeting) even as major central banks adopt more dovish tones, could lead yield differentials to favour Thai bonds on relative terms, and support THB somewhat in the near term.

- A third factor that could be supportive of THB is its correlation with gold prices. A 52-week rolling correlation of THBUSD and gold prices reached a high of around 0.92 in July 2019, compared to a recent low of 0.73 in Aug 2018. Thailand is a regional gold hub, and Thai gold traders' profit-taking in times of gold price increases could increase demand for THB alongside gold sales. Firm gold prices above the US$1350 to US$1400 levels could see THB supported somewhat.

- The political environment is deemed to have improved further in July, with Prayuth officially taking on the PM mantle, sworn in by the Thai King, and having assembled his cabinet. Fitch had revised its outlook on Thailand (long-term foreign currency issuer default rating) to Positive from Stable, and reaffirmed the rating at "BBB+" in July, based on their views that lingering political risks were unlikely to derail sound macro-economic management. This conflicts somewhat with World Bank comments (also in July) highlighting politics remaining as a key risk for the Thai economy. On the ground, some observers have commented that the new Cabinet is "dominated by patronage politics and paybacks", and various members are known to have questionable reputations and capabilities.

- On balance, we assess political concerns to have moderated somewhat compared to June, but think that it will continue to weigh on sentiments. It will take time for residual risks (such as petitions against 32 lawmakers among the ruling coalition for potential flouting of media shareholding rules) to be resolved and for investors to trust in the policymaking capabilities of the 19-party coalition. Concomitantly, business and consumer sentiment indices slipped again in June. Over time though, the unfair advantage that the Junta-coalition have in government (i.e., the presence of the 250-member senate which was chosen by the Junta) should allow them to push through most pro-growth policies and market confidence could gradually improve. Latest reports highlight that the government is due to announce economic stimulus this month, and has no plans to raise VAT or other levies for now. A series of small explosions in Bangkok this morning is unlikely to affect investor confidence.

- **Growth and Inflation Outlook:** At its last policy meeting, the BoT lowered its GDP forecast to +3.3% in 2019 (from +3.8%), the third downward revision since end-2018. Weaker expectations of goods & services exports growth (+0.3% vs. previous +3.1%) were cited as the main factor in BoT's revision, amid US-China trade tensions and regional supply chain disruptions. In June, private consumption indicators were estimated to have expanded more slowly in almost all spending categories, while public spending contracted in both current and capital expenditures. Tourism was supported by an increase in the number of Indian tourists, while Chinese tourist figures continued to contract. We caution for further growth downsides should there be greater-than-expected delays in the disbursement of Budget 2020 and corresponding postponement in some state investments. Our Economists sees outlook for the second half to remain weak and downgrade full-year GDP forecast to +2.8% (from +3.2% previously).

- Headline inflation inched down to +0.9% in June (vs. +1.1% in May), mainly due to declining transportation & communication costs on the back of lower oil prices. Energy prices also fell by a steeper -3.9% (vs. -0.5% in May), registering the second month of decline. In contrast, food prices had picked up to a 4.5-year high of +3.1% (vs. +2.8% in May), driven by vegetables and fruits, meat and rice. Core inflation (excluding raw food & energy) remained stable at +0.5%, on par with the previous month. BoT expects headline inflation to average 1.0% for both 2019 and 2020, and core inflation to average 0.7% and 0.9% for 2019 and 2020, respectively. Our Economists expect headline inflation to come in at +1.1% for 2019 and 1% in 2020.

- **Monetary Policy Forecast:** At its 26 Jun policy meeting, the BoT monetary policy committee had voted unanimously to keep the benchmark one-day repurchase rate steady at 1.75%, reiterating that the current policy rate was accommodative for continued growth and appropriate given the inflation target. This is the third unanimous vote, compared to the split vote in Feb (2 out of 6 members voted for hike). Expectations of softer economic growth this year, coupled with a more dovish Fed, could potentially lead the BoT to be more patient in its policy normalization process.

- While weak growth indicators have led to some whispers on the street for a potential easing in 2H, consensus views are for policy rate to remain pat at 1.75% during the next policy meeting on 7 Aug. The BoT governor recently stated that cutting the policy rate may have limited impact on the Thai baht as the real interest rate is low compared to regional countries. Our Economists also expect the BoT to maintain its policy rate throughout 2019, in part due to financial stability risks (e.g., auto loans remain an area of concern), but think that the probability of a surprise cut could rise if growth deteriorates further in 3Q. Increased concerns over trade war impact could also increase the likelihood of a cut.

- **Latest Fiscal and External Balance Outlook:** With the recent convening of the new cabinet, the wheels of the new government are finally starting to turn. Nonetheless, it now seems increasing likely that the implementation of the FY2020 Budget could be delayed by 3-4 months, as the new coalition government looks to review current investment projects for realignment with the government's master plan. The draft Budget bill is expected to be debated by the lower house in September in its first reading, with the second and third readings in December before it is forwarded to the senators for consideration. Budget-related delays were cited as factors impacting on public investment spending in recent BoT reports. Any significant pushbacks in schedules, i.e., longer than current expected delays, in much-awaited mega projects such as the new mass transit lines in Bangkok and the Eastern Economic Corridor could dent market confidence.

- The current account balance recovered to a positive US$3.92bn in June, from the -US$376mn deficit in May, in part due to a shallower contraction in exports (-2.1%y/y vs. -7.2% prior) and a sharper decline in imports (-9.6%y/y vs. -0.2% prior). Nonetheless, the slower export decline was in part due to a jump in gold exports, and external demand conditions facing agricultural products and electronics remained weak. The sharp contraction in imports was due to a fall-off in demand for raw & intermediate goods, which could weigh on export performance in the months ahead. Our Economists see hopes for an export recovery in 3Q to be dim as risks of the trade war broadening into a tech war are still very much valid. However, despite weaker trade flows, the current account balance is still expected to remain healthy at above 6% of GDP for the year.

- **Key domestic events and issues to watch:** BoT Benchmark Interest Rate (7 aug); Jul Consumer Confidence (8 Aug); Jul Car Sales (18-23 Aug); 2Q GDP (19 Aug); Jul Customs Trade (21 Aug); Jul Manufacturing Production (29-30 Aug); Jul Trade and BoP (30 Aug).

- **Technical Outlook:** Levels last seen at 30.80. Momentum indicators on the daily charts show a bullish bias (but moderating), while stochastics are neutral. Stochastics on weekly charts are in oversold conditions. Given this, there could continue to be some upward movement in USDTHB pair in the interim. Besides key resistance at 31.07 (Feb low), we also see resistance at 31.27 (50% fibo retracement from May high to June low). Immediate support at 30.81 (21 DMA). Then at 30.50 (recent low in early Jul).

INR: Near-term Pressure as Carry Unwinds

Forecast	3Q 2019	4Q 2019	1Q 2020	2Q 2020
USDINR	69.50 (68.50)	68.80 (67.80)	68.00 (67.20)	67.50 (67.00)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** In spite of the USD strength, the INR seems to be a darling of investors in an environment of lower rates. While equity underperformed in Jul, as warned by our India Analyst, India saw a net bond-related inflow of $1.1bn for the month of Jul (1-30th Jul) and this trend could sustain. 10y yield, as a result, is pressured around 6.4% as we write (1st Aug). At this point however, INR stands at risk of weakening as carry trades unwind in an environment higher volatility and risk-off and we do not rule out a re-visit of 70-level.

- Beyond the near-term, yield-hungry investors would continue to favour the INR over other lower yielding currencies in a low growth, low inflation, lower global rates environment. That in itself could keep the rupee stable, limit imported inflation and allow RBI some room to cut – a virtuous cycle. With the current repo rate (policy) still 100bps above its GFC 2009 low, the perceived return for bonds is substantial enough to continue to underpin investors' demand for India's debt. In addition, INR has also proven to be the one of the few resilient currencies in the face of a US-China trade war.

- INR may continue to remain a tad more resilient vs. the rest of the regional peers even though its profile against the USD may still be weaker in this quarter. We mildly adjust our 3Q forecast to be a tad higher at 69.50 (vs. the previous 68.50), taking into account the expectations for Fed to cut in Sep and Dec. Into the end of the year, potential positive developments out of the US-China trade talks could still be risk-positive and therefore rupee-positive as well. As such, we look for USDINR to taper off mildly towards 68.80.

- **Key risk to our forecast** is the potential for USD funding squeeze that typically affects emerging market currencies and twin-deficit economies. Should that arise in an environment where US issues a lot more treasury bills after the congressional compromise of the debt ceiling, USDINR may overshoot our forecast.

- **Growth and Inflation Outlook:** Industrial production slowed less than expected to 3.1%y/y in Jun from previous 3.4%. The heavily weighted manufacturing slowed significantly to 1.9%y/y from previous 3.1% along with mining, at +0.4%y/y vs. previous 0.6%. Electricity saw a mild pick up to 0.8%y/y from previous 0.6%. Primary goods decelerated to 0.8% from previous 1.7% while capital goods steadied around 0.1%y/y. Infrastructure subcomponent also slowed to 0.7% y/yfrom 1.0%. Consumer durables also slowed to 0.0%. Activity continues to slow and build expectations for RBI to ease further.

- PMI-mfg for Jun slowed to 52.1 from previous 52.7. According to market, slower new order was observed and output growth was affected. Manufacturing is still one of the most resilient in India as output continues to expand (compared to elsewhere in the region) where we see contractions. However, the pro-long trade tensions and protectionist measures imposed have also started to affect India, not helped the least by US decision to remove the beneficial trade status for India's exports on 5 Jun. The lost in momentum is unmistakable in exports growth which contracted for the first time this year. Imports also shrank in Jun and that resulted in a slightly wider-than-expected trade deficit, albeit narrower than the previous print. The fall in inward shipment also underscores the soft domestic demand and India's retaliatory tariffs on the imports of 29 US products.

- From that perspective, and taking into account the imports growth that could be bumped up by the seasonal monsoon disruption, current account deterioration translates to less support for INR in the near term. Inflation rose more than expected, buoyed by costs of food which accelerated to 2.2%y/y from previous 1.8%. Looking forward, Monsoon deficit seems to be narrowing and that could alleviate some food inflation and keep inflation in the lower bound of 4% (+/-2%) target. A rather stable rupee could also limit imported price pressure, allowing room for RBI to cut.

- 2Q GDP is out on the 30th of Aug and pick-up in the output for the first two months of the quarter so far suggest that growth should come in a tad firmer but weaker net exports should detract from the headline.

- **Monetary Policy Forecast:** Another rate cut is expected from RBI on 7th Aug as growth momentum continues to deteriorate in the face of external headwinds. Manufacturing output softened in May and that has prompted more pressure on the central bank to do more. The Finance Minister Nirmala Sitharaman had told the press that she "honestly wish" for a rate cut. At the current level of 5.75%, the repo rate is still 100bps away from the 4.75% low seen in 2009 and current growth momentum suggests that more rate cuts are more probable than not. In fact, with the monsoon deficit narrowing, food inflation may remain unthreatening and allow the central bank the room to deliver the next 25bps cut for repo rate to 5.50% and reverse repo to 5.50%. Cash reserve ratio should be left at 4.00% as liquidity is in surplus condition now.

- **Latest Fiscal and External Balance Outlook:** We see a small risk for current account deficit to widen in the next few months as external demand remain weak and domestic demand may increase due to the production disruption from the monsoon. However, the latter is also somewhat mitigated by the retaliatory tariff imposed by India on the US.

- Eyes are on the RCEP negotiations that take place in Beijing on 2-3 Aug. India has been trying to explore ways of structuring trade concessions or tariff cuts to be provided in phases over long stretches of time in order to prevent a flood of cheap imports from China that could jeopardize their current account deficit.

- **Key domestic events and issues to watch:** RBI decides on policy on 7th Aug; IP on 9th; CPI and trade data on 13-14th; WPI on the14th ; GDP on the 30th.

- **Technical Analyses:** The 1M USDINR NDF hovered around 69.70 and stochastics on the daily chart suggests that there could be some risks to the upside with a bullish divergence forming on the MACD and the stochastics rising from oversold condition. We do not rule out a move towards 70-figur in the near-term.

VND: Resilience in the face of USD Strength

Forecast	3Q 2019	4Q 2019	1Q 2020	2Q 2020
USDVND	23300 (23200)	23100 (--)	23000 (--)	22900 (--)

Previous forecasts in Parenthesis.

- **Motivation for the FX View:** Solid growth momentum and external demand should be positive for the VND and that has brought the USDVND towards our 3Q forecast of 23300. We see a potential for VND to remain resilient against the USD as Vietnam comes under pressure to open up its market access to foreigners. With Vietnam still under the US Treasury watch list for currency manipulation, VND may be one currency that should see less weakness against the USD compared to its regional peers. The trade surplus with the US has been growing (from $15.5bn in 1H2018 to $20bn in 2H2019) as a result of the trade diversion that Vietnam benefits from the US-China trade war. Not coincidentally, the US Trade Representative Lighthizer had recently (30 Jul 2019) urged the country to cut its trade surplus with the US and increase market access for foreigners. The VND is also highly guided by the SBV, resulting in active FX purchases that weaken the VND against other key trading partners such as the USD and CNY. That puts Vietnam at risk of being labelled as a currency manipulator in Oct. With USDCNH looking a tad vulnerable to the upside, VND could to weaken only slightly towards 23300 against the USD.

- **In addition, outcomes from US-**China trade talks are still perceived to be highly uncertain. With stock markets not getting any boost from the Fed, Trump may be even more motivated to get a deal with China so as to mitigate the damage that has already been inflicted by existing tariffs imposed on the real economy, especially on agriculture.

- In an environment of USD strength, VND's competitiveness against its trading partner slipped in Jul. Our estimate of the VND trade weighted index (TWI) slipped to 64.5 end of Jul vs. 63.8 end Jun as most of its trading partners depreciated more against the USD (including the RMB) relative to the VND.

- **Growth and Inflation Outlook:** Growth momentum remains solid compared to its peers, with added affirmation from the latest PMI-mfg for Jul which came in at 52.6 vs. previous 52.5. Industrial production quickened to 9.7%y/y from 9.6%y/y previously. Apart from the slightly softer manufacturing output at 10.4%y/y vs. 10.6%, the rest of the sub-components accelerated with exceptional strength in the electricity output to 10.5%y/y vs. previous 8.6%. "Water Supply" and "Mining & Quarrying" also saw stronger growth in Jul.

- Private consumption as proxied by retail sales remained buoyant at around 12.7%y/y in Jul vs. previous 11.7%. This is in spite of the slowdown in tourism receipt growth to 7.8%y/y in Jul from previous 13.1% as strong investment in manufacturing give rise to better hiring sentiment and stronger consumer spending.
- Exports growth also picked up pace for Vietnam from 8.5%y/y to 9.3% for Jul, beating expectations for a slower 7.3%. As noted by our Economist, Vietnam is the biggest beneficiary of trade diversion due to higher US tariffs on Chinese goods and the US is still the largest growth contributor to Vietnam's exports. Imports on the other hand slowed more than expected to 5.0%y/y from previous 10.0%. Trade balance returned to narrowed to $200mn from previous $400mn. However, optimism on its trade could be dampened by recent comments by US trade representative Lighthizer who urged Vietnam to cut trade surplus with the US and to open its markets to more US goods and services. (In response, Deputy Spokesperson Vietnam Foreign Ministry Nguyen Phuong Tra aid that Vietnam has "made multiple efforts" to increase imports of US products and to improve the investment and business environment for US firms.) Vietnam records a U$3.6bn of trade surplus with the US for Jun. This brings to mind the fact that Vietnam is on the watch-list of the US Treasury for currency manipulation and could mean less depreciation pressure for the VND vs. the USD over the next few months as SBV could adjust its foreign exchange management.
- Total registered FDI for the first 7 months of 2019 was down -37.4%y/y on high base effects due to exceptionally large FDI inflows seen in Jul last year. However, FDI inflows actually remained rather decent at $939mn for Jul, vs $876mmn in Jun, a 7.2%m/m increase.
- Inflation picked up pace in Jul from 2.4%y/y to 2.2%, as the surge in cost so medical products/healthcare (+5.93%y/y) offset the moderation in food inflation to 2.3%y/y from previous 2.4%. Headline inflation forecast is expected to be at 2.9% this year and 3.7% in 2020.
- Our economic team maintains their full year GDP forecast at +6.8% for 2019 on robust manufacturing performance, positive export growth and rising FDI along with buoyant private consumption.
- **Monetary Policy Forecast:** With growth outlook still intact and inflation subdued, there seems to be little motivation for SBV to use its monetary policy tools at this point. As for the VND, we see upside risks to the currency as Vietnam continues to benefit from manufacturing and trade diversion flows and FDI that resulted from the US-China trade conflicts though that uptrend could be dampened by recent comments coming out of the USTR office. VND could stand to strengthen further from a stronger demand out of China as China is likely to increase monetary stimulus to support growth momentum and that could in turn increase the demand for Vietnam's exports. We

still expect FDI inflows to continue because of the trade agreement/diversions and that could cushion the effects of the decline in external demand. Retail sales suggest that household consumption could also support growth.

- In terms of TWI, the VND strengthened in Jul as VND remains shielded from thee USD strength because of its relatively closed capital account and managed exchange rate policy. In addition, positive balance of payment surplus (trade surplus, positive FDI inflows) also underpins the currency. As VND remains under the US watchlist for currency manipulation, we see limited weakness in the VND.
- **Latest Fiscal and External Balance Outlook:** As of last available data, current account surplus was at U$1.24bn in 2Q. Net trade surplus of goods slipped to U$3.0bn from previous U$5.2bn. The competitive dong could keep the current account in surplus. However, as the US continues to pressure Vietnam to reduce its trade surplus with itself and with VND still on the watchlist, the VND may lose its trade competitiveness and erode the current account surplus.
- **Key Domestic Events and Issues to Watch:** Domestic vehicle sales in 6th-13th Aug; CPI, trade numbers, retail sales and IP are due 25th-31st.

FX Forecasts

	End Q3-19	End Q4-19	End Q1-20	End Q2-20
USD/JPY	108	107	106	106
EUR/USD	1.1050	1.1100	1.1150	1.1200
GBP/USD	1.2000	1.2400	1.2500	1.2600
AUD/USD	0.6900	0.7000	0.7100	0.7200
NZD/USD	0.6500	0.6700	0.6800	0.6800
USD/SGD	1.3850	1.3750	1.3700	1.3650
USD/MYR	4.1600	4.1400	4.1300	4.1200
USD/IDR	14000	13950	13900	13850
USD/THB	30.80	30.60	30.40	30.20
USD/PHP	51.50	51.30	51.20	51.20
USD/CNY	7.00	6.96	6.90	6.85
USD/HKD	7.80	7.80	7.80	7.80
USD/TWD	31.50	30.90	30.60	30.50
USD/KRW	1220	1185	1165	1160
USD/INR	69.50	68.80	68.00	67.50
USD/VND	23300	23100	23000	22900
DXY Index	98.67	97.87	97.17	96.69
SGD Crosses	End Q3-19	End Q4-19	End Q1-20	End Q2-20
SGD/MYR	3.0036	3.0109	3.0146	3.0183
SGD/IDR	10108	10145	10146	10147
SGD/THB	22.24	22.25	22.19	22.12
SGD/PHP	37.18	37.31	37.37	37.51
SGD/CNY	5.05	5.06	5.04	5.02
SGD/HKD	5.63	5.67	5.69	5.71
SGD/TWD	22.74	22.47	22.34	22.34
SGD/KRW	881	862	850	850
SGD/INR	50.18	50.04	49.64	49.45
MYR Crosses	End Q3-19	End Q4-19	End Q1-20	End Q2-20
EUR/MYR	4.60	4.60	4.60	4.61
JPY/MYR	3.85	3.87	3.90	3.89
MYR/HKD	1.88	1.88	1.89	1.89
MYR/CNY	1.68	1.68	1.67	1.66
GBP/MYR	4.99	5.13	5.16	5.19
AUD/MYR	2.87	2.90	2.93	2.97
NZD/MYR	2.70	2.77	2.81	2.80
MYR/IDR	3365	3370	3366	3362
MYR/INR	16.71	16.62	16.46	16.38
MYR/KRW	293	286	282	282
MYR/PHP	12.38	12.39	12.40	12.43
CNY/MYR	0.5943	0.5948	0.5986	0.6015

Source: Maybank FX Research as of 2 Aug 2019.

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

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(Incorporated in Malaysia)

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