Macro | FX Research & Strategy

Global

FX Monthly

2017, Issue 8: Inflation Still in Focus as Growth Navigates Global Political Risks?

What Has Changed This Month?

- We are revising EUR, CNY, and INR stronger whilst slightly revising AUD, NZD, GBP and PHP lower in the medium term forecasts. The EUR forecasts are calibrated higher in light of recent shifts in sentiment. The USD DXY forecast has been adjusted lower accordingly as a result of the combined changes above on the index.

Our Strategies

- US fiscal impulse is likely to be delayed into 2018. Inflationary pressures in US are now still not certain with recent data showing a bit of softness. Nonetheless, US activity seems to remain positive. The July meeting suggests that the Fed may be starting to waver in its determination to tighten monetary policy further this year with one more hike plus balance sheet reduction. **Our house view is for a 25bps rate hike, likely in Dec now and balance sheet reduction announcement to start as early as Sep**
- We maintain our **positive outlook on the EUR in the medium term but caution that the recent rapid pace of appreciation opens up the vulnerability for short term correction** as speculation for ECB to remove stimulus may have been overdone for now. ECB is progressing towards removing stimulus at some stage in the near future, we believe the pace of stimulus removal is likely to be very gradual as inflation pick-up in the Euro-area remains gradual and wage growth remains subdued. Upcoming German Federal elections in Sep should attract some volatility and uncertainty and we believe this political risk premium is under-priced. We see **room for EURUSD to correct lower towards 1.17-1.18 levels.** We are also in favor of **tactical short EURGBP for a move towards 0.8980 levels.**
- Global policy unwinding will take shape at differing pace. **We maintain our view of EUR long vs. JPY, on the basis that ECB is likely to normalize policies ahead of BoJ.**
- Base metals had a rather strong run up in the past three months including zinc, copper, iron ore and most recently, aluminium. At these levels, we see some risks of correction as we look for moderation in China's growth and global trade. These drivers **could pull AUD lower, providing new opportunities for bargain hunters to buy on dips.** We see **downside risks to NZD** on the back of RBNZ's explicit discomfort for currency strength (even highlighted the use of currency intervention as a tool), inflation to decline in coming quarters and upcoming NZ General election to pose some degree of uncertainty and we believe this political risk premium is under-priced.
- Amongst AXJs, we remain negative on PHP, KRW, TWD due a range of factors including idiosyncratic risks and potential of global risk aversion. We are neutral on MYR as foreign investors' confidence gradually return in current low volatility and low yield environment. We still see some scope for MYR to play catch up with regional peers and potentially extend its gains further towards 4.25, 4.20 levels (vs the USD). On a tactical basis, prefer to long the CNY, THB, IDR, SGD (in order of preference) against short PHP, JPY. Fundamentally, we are still short PHPINR on diverging current account balances.
- Any delay in Fed's timeline of normalising monetary policies is likely to impact on asset allocation in ASEAN. UST yields are likely to remain soft resulting in widening of yield differentials in favor of ASEAN bonds. At the same time, the low interest rate environment for longer could spur a further re-weighting of equities and re-ignite foreign interest in ASEAN equities. Furthermore our view of global synchronised recovery story should further support inflows into ASEAN selectively.

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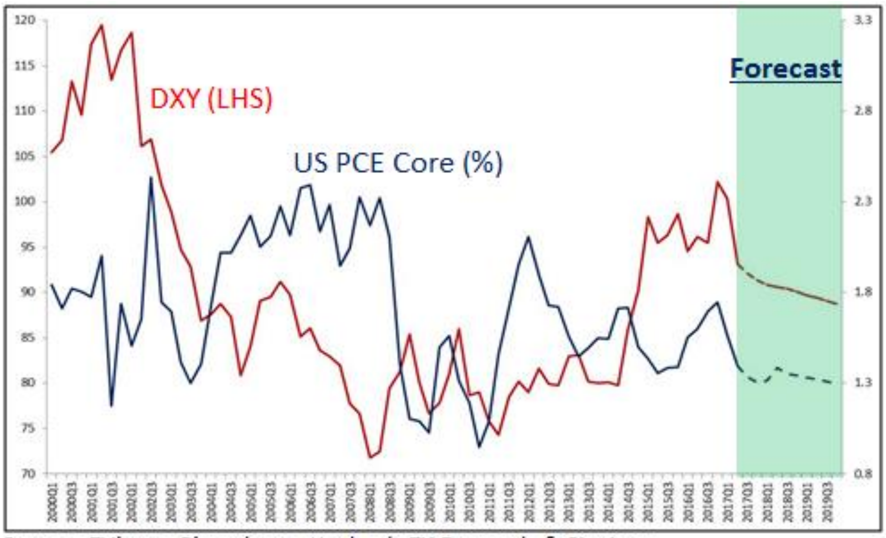
SEE PAGE 56 FOR IMPORTANT DISCLOSURES.

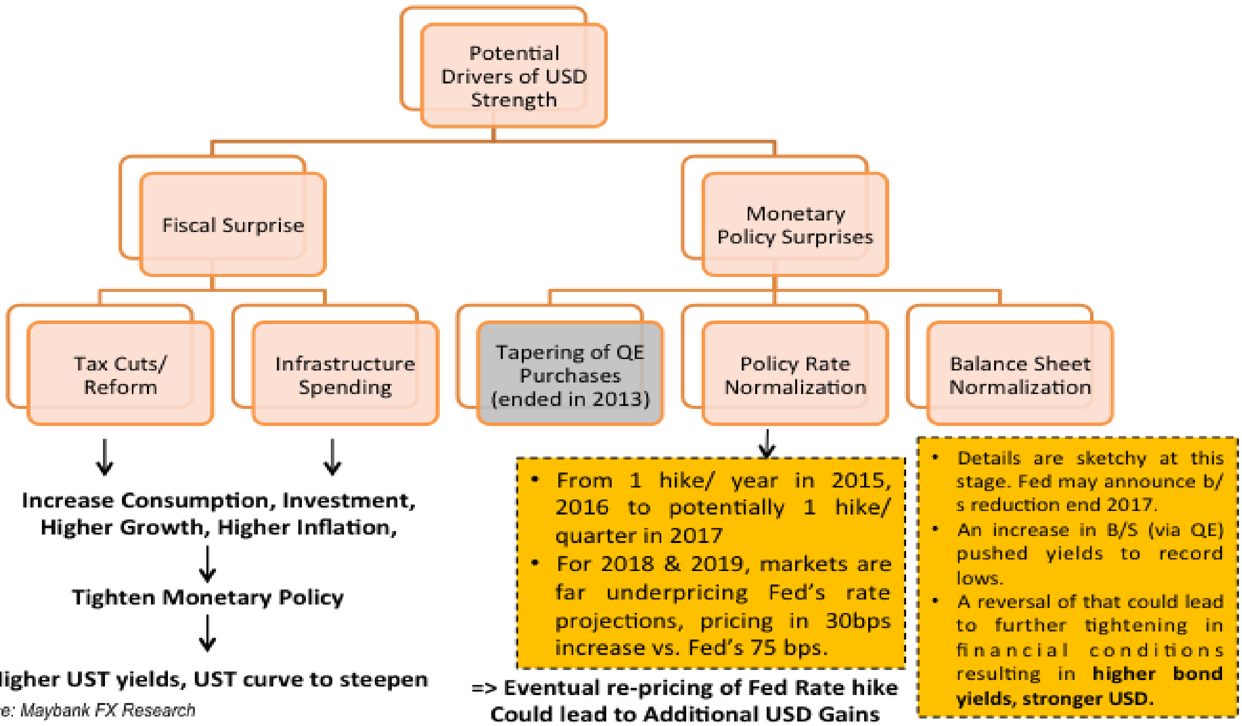
So What?

USD softness may persist for longer than expected, in the event US inflation remains subdued (deviates away from Fed's 2% inflation target). DXY Support around 88 – 90 Levels



Source: EViews, Bloomberg, Maybank FX Research & Strategy

Where Can USD Strength Come From?



Source: Maybank FX Research

G7 Global Overview

USD: Potentially Marred by Domestic Politics (Upcoming Debt Ceiling Concerns, Trump-Inspired Volatility), Sep FOMC and Softer Data.

Forecast	3Q 2017	4Q 2017	1Q 2018	2Q 2018
USD Index	94.14 (94.89)	93.52 (94.96)	93.38 (94.33)	94.22 (95.20)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** We have turned slightly more bearish on the USD over the next 3-6 months. Nonetheless, we expect at least one more rate hike in 2017, more likely in Dec now followed by the announcement of the start of balance sheet reduction possibly as early as Sep 2017. We do caution that additional repricing of a surprise balance sheet reduction over the course of the year could continue to see UST yields higher in particular Treasuries 2y and below, and see USD strength (buy the rumor) in the lead-up to FOMC meetings. The DXY forecasts saw downward revisions due to our upward revisions to the key G7 currencies such as the EUR and JPY. ***However, we expect USD to rebound late this year and early next year with occasional swings within a tight range in the interim by around 5% or so. At current levels, long USD positions vis-à-vis G7 currencies, in particular the euro is beginning to look attractive from a tactical perspective. But medium term, we still expect USD advantage to be eroded by eventual gradual stronger growth trends in rest of the world and assist USD reversion towards fair value but at slower pace compared to the past.***

- The recent July FOMC statement plus the latest probabilities of Fed's rate hike in the next three remaining FOMC meeting this year derived from the fed fund futures suggests the third rate hike is unlikely to happen at the 19-20 Sep 2017 and the 31 Oct – 1 Nov 2017 FOMC meetings given the above-90% probability of no change, although the odds of a hike at the final FOMC meeting of the year on 12-13 Dec 2017 is now at around 30%. Still, the 19-20 Sep 2017 FOMC is important as we expect Janet Yellen to provide more colour on Fed's next move at the post-FOMC meeting press conference. We are not ruling out a third rate hike at the Dec 2017 FOMC and the start of Fed balance sheet's reduction in 4Q 2017.

- We continue to expect domestic data and a repricing of the future stance of monetary policy to support the USD. But given further delays in the US tax reforms (possibly in middle of 2018) and trade policies as well as softer inflation pressures to support a strong US reflation view, we do not expect the Dollar to appreciate as strongly as expected in 2017. Nonetheless during this phase and around FOMC announcements, we believe the USD could still be mildly supported at times given potential concerns about Fed changes in FFR guidance on hikes and balance sheet normalisation.

- **Growth and Inflation Outlook:** The latest 2Q advanced GDP came in at 2.6% compared to 2.7% expected, while 1Q GDP numbers were revised down to 1.2% from 1.4% previously, indicating a slower start to 2017 after the 2016 GDP was revised down to 1.5% from previous 1.6%. The second quarter saw increases in household spending, commercial construction, exports and federal spending, while homebuilding, business inventory investment and state and local government spending were down. Higher imports also weighed on GDP growth.

- NFP in July grew by 209k and employment for June was revised slightly higher to 231k from 222k previously. The July employment gains were higher than consensus at180k due to both service and goods sector employment outperforming. Within the goods sector, manufacturing added 16k jobs, while construction payrolls rose by 6k. Within services, gains in professional and business service payrolls, education and health services and leisure and hospitality offset further weakness in retail employment which sees e-commerce pressures taking effect on the traditional retail sector.

- Core CPI inflation came in weaker than expected in July, rising only 0.1% m/m. On a y/y basis, core CPI was unchanged at 1.7%. Headline inflation rose 0.1% m/m and 1.7% y/y, also lower than expected. Energy prices fell less, stabilizing after the strong falls in May and June. Food prices increased 0.2% on the month, taking a breather after rising consistently since January. Overall the trend in core inflation has been softening in recent months.

- US retail sales rose 0.6% m/m in Jul, stronger than consensus of 0.3%. Auto sales, building materials, miscellaneous and non-store retailer categories saw strong growth in Jul. In addition to a strong report for July, there were upward revisions to prior months' data of May and June.

- **Monetary Policy Forecast:** The Fed funds rate was kept at 1.00%-1.25%. FOMC statement on inflation and balance sheet normalisation raised uncertainty on timing of next rate hike and start of balance sheet reduction. We are not ruling out third rate hike in Dec 2017 FOMC and commencement of balance sheet reduction in 4Q 2017.

- The recent FOMC statement plus the latest probabilities of Fed's rate hike in the next three remaining FOMC meeting this year derived from the fed fund futures suggests the third rate hike is unlikely to happen at the 19-20 Sep 2017 and the 31 Oct – 1 Nov 2017 FOMC meetings given the above-90% probability of no change, although the odds of a hike at the final FOMC meeting of the year on 12- 13 Dec 2017 is relatively high at 40% (Figure 1).

- Still, the 19-20 Sep 2017 FOMC is important as we expect Janet Yellen to provide more colour on Fed's next move at the post-FOMC meeting press conference. Meanwhile, minutes of the 25-26 July 2017 FOMC will be out on 16 Aug 2017. We are not ruling out a third rate hike at the Dec 2017 FOMC and the start of Fed balance sheet's reduction in 4Q 2017.

- The minutes to the July FOMC meeting were largely in line with our expectation. The discussion was focused on inflation, with some increased concern about whether it would return to the Fed's 2% target over time, while also signaling that an announcement on balance sheet policy is imminent. We continue to expect an announcement on balance sheet normalization at the September meeting and a third rate increase this year in December but at a lower likelihood. Many participants reduced their expectation for fiscal policy stimulus, while also noting that better-than-expected growth outside the US boosted the prospects for export growth. These factors were largely offsetting and resulted in no material change in the outlook for activity and labor markets.

- Increased concern on inflation, but no critical mass for a pause in rate hikes (yet). On inflation, Fed staff and the committee, on balance, continued to view the recent softness as reflecting transitory or idiosyncratic factors. Staff reduced its inflation forecast for 2017 "slightly" in response to weaker incoming readings on inflation, but kept its 2018 and 2019 forecasts essentially unchanged. Staff also saw the risks to inflation as balanced, with downside risks from lower inflation expectations, dollar appreciation, or further weakness in incoming inflation data. Upside risks to inflation were seen as coming mainly from growth in economic activity that was projected to remain above trend.

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

- Factoring in the rather slow US legislative process, a limited number of Congressional working days in Sep, rising tensions between President Trump and Congressional Republicans, as well as Trump's demands that any budget agreement include border wall funding, among others, raises the risk of a federal government shutdown or debt ceiling breach. Recent comments by the president have raised concerns of a shutdown. There is the risk that Trump may veto or reject a GOP appropriations bill if it fails to meet his requirements. The other question is whether Congress can override such a veto. All these point to some volatility in the second half of Sep weighing on the USD.

- **Key domestic events and issues to watch in Sep 2017:** Key US events: ISM Manufacturing (1 Sep); Factory Orders (5 Sep); Durable Goods Orders (5 Sep); Trade Balance (6 Sep); NFP (1 Sep); CPI (14 Sep); Retail Sales (15 Sep); GDP 2Q (28 Sep); PCE Deflator (29 Sep), Housing Starts (19 Sep); FOMC Meeting (21 Sep).

- **Technical Outlook:** DXY index looks on course to close weaker for the 6th consecutive month, as of writing. DXY was last seen at 92.35 levels. Bearish momentum on monthly, weekly and daily chart remain intact but stochastics on the weekly and daily chart shows tentative signs of turning higher from oversold conditions. These signals continue to suggest risk of rebound. Support at 91.40 (50% fibo retracement of 2014 low to 2016 high) should hold. Bigger support seen at 88.40 (61.8% fibo). Resistance at 93.20, 94.30 (50 DMA).

EUR: Strength Unstoppable?

Forecast	3Q 2017	4Q 2017	1Q 2018	2Q 2018
EURUSD	1.1800 (1.1600)	1.2000 (1.1700)	1.2000 (1.1800)	1.1800 (1.1600)

Previous Forecasts in Parenthesis

- **Motivation for the FX View: We continue to maintain our positive view on the EUR and reiterate it as a story of bottoming and remains a buy on dips** on a combination of factors including (1) ECB potentially normalising monetary policies soon; (2) sustained signs of economic recovery broadening in Europe; (3) receding political risks in Europe (early this year we were cautious due to Netherlands and French elections and the wave of support for Right wing); (4) while the USD continues to stay soft owing to Trump's slow progress on tax reforms, healthcare reforms and infrastructure spending as well as lack of monetary impulse as recent spate of softer inflation prints dampen market expectations for 3rd rate hike this year (markets only pricing in 30% of Fed rate hike). Given recent market development, we calibrate our EUR forecasts higher. We do not rule out spikes above 1.22 next month but do not expect such moves to be sustainable.

- Our short term view remains for EUR to correct lower, possibly towards 1.17 - 1.18 levels. We think the run-up in the EUR since late-Jun (from under 1.12 to high of 1.2070) has been relatively sharp (more than 8%) and we do not rule out the short term risk of mild correction. Market expectations are high for ECB to normalise but we think any normalisation is likely to be gradual – resulting in **disappointment with ECB's normalization timeline** - as **inflation pick-up remains very gradual** and the **stronger EUR is expected to weigh on imported prices** (imported consumer products account for around 15% of industrial goods in the Euro-area) and result in **negative feedback loop to core inflation** (risk of derailing ECB's efforts to get inflation higher). We are also in favor of **tactical short EURGBP for a move towards 0.8980 levels.**

- Recent ECB minutes (published 17 Aug) also noted similar observations: (1) highlighted that repricing in some financial markets in particular FX and bond markets had led to some deterioration in financial conditions since the previous meeting; (3) On FX, while the appreciation of the EUR was seen in part as reflecting changes in relative fundamentals in the Euro-area vs. Rest of the world, concerns were expressed about the risk of the EUR overshooting in the future;

(3) On inflation, there were no convincing signs of a sustained upward adjustment in underlying inflation, price pressures in the early stage of the supply chain remained strong but had not been transmitted to producer prices at later stages and domestic cost pressures, including wage growth remained subdued.

- Moreover German Federal election risk premium may not have been priced in by markets. We think this warrants some caution as election campaign may intensify as we get closer to election day and may temporarily swing sentiment and the EUR (though we do note that polls and election forecast models currently indicates that Merkel remains in the lead). Other downside risks to our outlook include the return of monetary policy divergence with Fed especially if US data (in particular inflation, wage growth) surprise to the upside. That will encourage market to re-price Fed's monetary normalisation plans and put upward pressure on UST yields and the USD.

- **Growth and Inflation Outlook:** Euro-area recovery continues with 17 quarters of growth while unemployment fell to 9-year low of 9.1%. 2Q GDP growth accelerated to 0.6% q/q (vs. 0.5% in 1Q). And on y/y basis, GDP growth rose to 2.1% (vs. 1.9% in 1Q). This is the best level in 5 years. Forward looking surveys also suggest that growth momentum remains robust. Preliminary composite PMI for Aug rose to 55.8 (vs. 55.7), helped by manufacturing PMI which rose to its highest level (57.4 vs. 56.6 prior) since Apr 2011, though services PMI slipped to its lowest level (54.9 vs. 55.4 prior) since January.

- **The next quarterly assessment is due at the 7 Sep ECB meeting.** In the last quarterly assessment report (8 Jun), ECB modestly revised 2017 and 2018 growth to 1.9% and 1.8% (from 1.8% and 1.7%), respectively. ECB acknowledged that risks are now "broadly balanced" (a shift from "tilted to the downside" in last ECB statement) and there is stronger momentum in the Euro-area economy.

- **Euro-area inflation head steady at 1.3% y/y in Jul.** Core inflation also held steady at 1.2% in Jul. While inflation has picked up gradually, it remains well below ECB's policy mandate to maintain inflation rate below but close to 2%. Current level of inflation confirms Draghi's point that core inflation has yet to see a meaningful recovery. A stronger EUR (more than 6% rally in the EURUSD since late-Jun and about 15% gains YTD to Aug high) could also weigh on imported prices (imported consumer products account for around 15% of industrial goods in the Euro-area) and result in negative feedback loop to core inflation.

- **The next quarterly assessment is due at the 7 Sep ECB meeting.** In the last quarterly assessment report (8 Jun), the ECB revised inflation forecast lower to 1.5% for 2017 (vs. 1.7% in prior report) and to 1.3% for 2018 (vs. 1.6% in prior report) despite acknowledging the strength of the Eurozone's accelerating economic growth. The downward revision was due to lower oil and food prices. Our inflation forecast shows headline inflation may reach a high of 1.5% in 3Q (still below ECB's "around 2%" target) before easing off towards 1.2% in 4Q 2017 and then gradually pick up again for 2018 and 2019.

- **Monetary Policy Forecast:** We expect ECB to keep monetary policy status quo – maintain current pace of asset purchase and keep rates unchanged - at its upcoming meeting on 7 Sep. We do however see risk of ECB announcing plans to normalize monetary policy in the form of slowing its asset purchases gradually (which is currently at a pace of EUR60bn per month) in Jan-2018 after the current program expires in end-2017.
  - One potential option is to phase in slower purchase of EUR40bn for a few months before reducing it to EUR20bn then to nil over the course of 2018, with option to adjust the pace of purchase as ECB deems consistent with achieving inflation objective. We still expect ECB to maintain a considerable degree of monetary accommodation for inflation dynamics to become durable and self-sustaining. Take note that this is not to be confused with what the Fed is currently contemplating with its unwinding of balance sheet.
  - Another possible option (not our base case scenario) is that ECB ends QE purchase (with no taper) when the current QE program ends in end-2017. This option is likely to see financial conditions tighten by a fair bit and could result in markets chasing for EUR longs. We do not expect ECB to pursue this option as ECB desires for favorable financial conditions as a necessary to secure a sustained convergence of inflation rate towards levels below but close to 2% target
- ECB Minutes (published 17 Aug) of the last meeting (20 Jul) highlighted that repricing in some financial markets in particular FX and bond markets had led to some deterioration in financial conditions since the previous meeting. On FX, while the appreciation of the EUR was seen in part as reflecting changes in relative fundamentals in the Euro-area vs. Rest of the world, concerns were expressed about the risk of the EUR overshooting in the future. On inflation, there were no convincing signs of a sustained upward adjustment in underlying inflation, price pressures in the early stage of the supply chain remained strong but had not been transmitted to producer prices at later stages and domestic cost pressures, including wage growth remained subdued.
- To recap, QE was extended beyond Mar 2017 for another 9 months to end-2017, at a reduced pace of €60bn per month. There were also a handful of technical tweaks to the APP to ensure smooth implementation of the program. Our take is ECB's monthly purchase after Apr 2017 may seem like a tapering at first glance but in actual fact, the option chosen between the 2 (either €80bn per month for 6 months or €60bn per month for 9 months) implies a larger QE amount (€540 bn).
- **Latest Fiscal and External Balance Outlook:** Euro area's current account surplus narrowed to EUR21.2bn in Jun (from EUR30.1bn in May), amid a sharp decline in primary income balance and worsening on that for secondary income. Current account surplus to GDP fell to 3.1% (vs. 3.5%) for 12-month period ending Jun 2017.

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

- **Key domestic events and issues to watch:** Aug Mfg PMI (1 Sep); Jul PPI (4 Sep); Aug Services PMI, Jul retail sales, Final 2Q GDP (5 Sep); Aug Retail PMI (6 Sep); ECB meeting (7 Sep); Jul IP (13 Sep); Aug CPI (18 Sep); Jul Current account, Construction Output, ZEW Expectations (19 Aug); Sep Flash PMIs (22 Sep); Sep consumer confidence (28 Sep); Sep CPI Estimate (29 Sep).

  Technical Outlook: EUR saw a sharp run-up towards 1.2070 high (29 Aug) breaking several key technical levels, before easing slightly. Last seen at 1.1970 levels. Uptrend remains intact, as indicated by monthly, weekly and daily momentum charts. But stochastics indicator suggests momentum may wear off in the short term. We are biased to call for a pullback given that the rally so far has been sharp (since late-Jun, EUR has seen more than 6% rally and YTD, the EUR has gained over 15%). Support at 1.1910 (resistance before the current break-out higher), 1.1820 (21 DMA), 1.1740 (38.2% fibo). Next big resistance at 1.2180 (50% fibo retracement of 2014 high to 2016 low).

GBP: *Brexit* Negotiation Timeline May be Pushed Back

Forecast	3Q 2017	4Q 2017	1Q 2018	2Q 2018
GBPUSD	1.2900 (1.3150)	1.3000 (--)	1.2900 (--)	1.3200 (--)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** GBP has seen some downward adjustment over the past few weeks from 1.3267 high (3 Aug) to a low of 1.2774 (24 Aug), in line with our call to lean against GBP strength in the last issue of FX Monthly. The move lower was due to BoE keeping policy rate on hold at its last meeting (disappointing GBP bulls), slowing economic growth momentum with slowdown seen in household spending and business investments as well as recent headlines concerning *Brexit* negotiations which seems to suggest that progress remains very slow.

- Looking into Sep, we do however see some short term risks of rebound in the GBP possibly towards 1.30 – 1.31 levels but strength is likely to fade as (1) macro-fundamentals continue to show more signs of crack, (2) inflationary overshoot may potentially ease in coming months as base effects wear off, GBP stabilizes and input costs shows signs of deceleration; (3) Brexit negotiation timeline may potentially be pushed back; (4) risk of market re-pricing higher US rates and USD strength into FoMC meeting in Sep. Taking into consideration the above risk factors, 3Q forecast has been adjusted lower. For the month of Sep, we expect GBP to trade 1.27 – 1.31 range.

- The after-effects of *Brexit* appear to only hit the UK economy with a 3-4 quarters "transmission lag". Recent economic data confirms that UK is in "notable slowdown". This is consistent with our long-standing caution that UK growth momentum is slowing and should continue to persist amid *Brexit* uncertainties. Recent headlines suggest that the pace of *Brexit* negotiations over the past month have seen little progress. Most recently (29 Aug), EU President Juncker said that UK's *Brexit* position papers are "not satisfactory" and there were still an "enormous" number of issues to be settled in negotiations (current round started 28 Aug). Some of these issues EU Juncker were referring to include Northern Ireland border and how regulations will function after *Brexit*, status of European citizens living in the UK and UK citizens living in Europe. And these issues need to be resolved by the first round, Oct-2017 (the scheduled timeline) before EU will commence negotiations on economic and trade relationships with the UK. The next two dates for the current stage of negotiation are scheduled on 18-Sep and 9-Oct. We expect the timeline to be pushed back and uncertainty should see GBP strength fade towards the second half of Sep 2017.

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

- **Growth and Inflation Outlook:** The after-effects of *Brexit* appear to hit the UK economy with a 3-4 quarters "transmission lag". The UK economy expanded by +0.3% q/q for 2Q vs. +0.2% q/q for 1Q. Breakdown of the GDP by expenditure confirmed **household spending and business investment slowed** from previous quarter. Breakdown by industry shows robust services growth offset by weak performances from manufacturing and construction in the second quarter. Cumulatively for 1H, the data confirms that UK is in "notable slowdown" (according to Office for National Statistics) and this is consistent with our long-standing caution that UK growth momentum is slowing.

- Much uncertainty relating to whether London still hold as a financial hub, if investments inflows will slow and lead to weaker labor market or if jobs get relocated, remain unknown. Recent development saw Nomura and Daiwa picking Frankfurt as its post-Brexit HQ and will move jobs out of London. Deutsche Bank is also considering moving 1/5 of its balance sheet from London to Frankfurt. JP Morgan, UBS and Goldman Sachs also mentioned moving staff out of London. Certainly these job losses have yet to materialise and may still be at early stages but eventually when consideration translates into decision, the pain will be felt and GBP is expected to bear the brunt of the painful *Brexit* consequences.

- **UK inflation holds steady at 2.6% in Jul.** Falling motor fuel prices were offset by higher prices for clothes, utilities and food. Though inflation has overshoot BoE's target of 2% for several months, PPI on the other hand is decelerating to 6.5% from 10% prior. Slowing input prices could result in softer consumer prices. Core inflation (ex food and energy) also hold steady at 2.4% in Jun. While inflation may inch closer to 3%, we do not expect price pressures to be self-sustainable as effects from travel (Easter holiday), fuel prices easing and GBP stabilization from depreciation could stabilize import price pressures. BoE also judged that inflation overshoot (above BoE's target of 2%) reflects entirely the effects of the referendum-related decline in GBP

- **Monetary Policy Forecast: Our base case scenario remains for BoE to keep monetary policy status quo, with policy rate on hold at record low of 0.25% and stock of QE at GBP435bn, at the upcoming meeting on 14 Sep. Our stand remains that BoE is not likely to tighten policy as decelerating growth momentum is expected to weigh on macro-fundamentals while *Brexit* uncertainties remain.** Recent 2Q GDP data confirms that UK is in "notable slowdown" (household spending and business investment slowed from previous quarter) and inflation-overshoot (above BoE's 2% target) may ease in coming months as input prices (via PPI) show signs of slowing down. Moreover BoE has also lowered economic growth and wage growth forecast in the recent QIR report.

- At the last MPC meeting (3 Aug), BoE kept rate unchanged (MPC voted 6 -2) at 0.25% and maintained the stock of QE at GBP435b (unanimous vote from MPC). The MPC also announced that Term Funding Scheme (TFS – introduced in Aug 2016 after *Brexit*, offering cheap 4Y funding to banks) will end in Feb 2018.

- On the Aug Quarterly Inflation Report (or QIR), there were downward revisions to its macro assessment – economic growth from 1.9% to 1.7% for 2017 and from 1.7% to 1.6%; CPI projected to remain around 2.75% in coming months before falling back towards 2% target in 2018 while wage growth forecast was cut to 3% for 2018 (vs. 3.5% in May's QIR report). It also said that attempting to offset fully the effect of weaker GBP on inflation would be achievable only at the expense of higher unemployment and in all likelihood, even weaker income growth. For this reason, the MPC's remit specifies that, in exceptional circumstances, the Committee must balance any trade-off between the speed at which it intends to return inflation sustainably to the target and the support that monetary policy provides to jobs and activity

- **Latest Fiscal and External Balance Outlook:** UK ran its first July budget surplus in 15 years owing to increase in self-assessed income tax and boost from value-added tax revenue. But this could be one-off as July is typically a good month for public finances. That said spending remains under pressure from higher inflation making interest payments on index-linked government bonds more expensive. Debt costs (+23%) in the fiscal year saw its biggest increase for the period since 2010. Office for Budget Responsibility expects GBP58.3bn of public sector borrowing for current financial year. This represents an increase of GBP13.2bn increase from year ending Mar-2017. Net borrowing (excl. banks) was last at 87.5% of GDP at end-Jul. Budget deficit has been greatly reduced to 2.3% of GDP in 2016, from about 10% of GDP in 2010. The deficit is likely to re-widen again to 2.9% of GDP this year.

- UK's current account deficit to GDP narrowed further to -3.9% of GDP for 1Q 2017 from about -4.4% of GDP for 4Q 2016. Improvement was due to trade deficit narrowing (thanks to increase in exports amid softer GBP)

- **Key domestic events and issues to watch:** Aug Mfg PMI (1 Sep); Aug Construction PMI (4 Sep); Aug services PMI (5 Sep); Jul IP, construction output, trade (8 Sep); Aug CPI, PPI, RPI (12 Sep); Jul jobs report (13 Sep); Aug retail sales, BoE meeting (14 Sep); public finances (21 Sep); 2Q GDP (29 Sep).

- **Technical Outlook:** GBP has corrected lower in the past few weeks from 1.3267 high (3 Aug) to a low of 1.2774 (24 Aug), in line with our call to lean against GBP strength in the last issue of FX Monthly. Pair was last seen at 1.2920 levels. Bearish momentum on daily chart is waning and stochastics is rising – an indication of short term upside bias while weekly momentum suggest otherwise. We recognize the risks of short term rebound, possibly towards 1.3060, but prefer to lean against strength. Support at 1.28, 1.2660 levels.

AUD: Correction Not Complete

Forecast	3Q 2017	4Q 2017	1Q 2018	2Q 2018
AUDUSD	0.78 (0.81)	0.78 (0.80)	0.80 (0.78)	0.79 (0.82)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** AUDUSD is poised to end the month where it started, last seen around 0.7940. This pair was brought lower at first by risk-off sentiments and a sharp sell-off in fellow antipode NZD though firm iron ore prices continue to support the pair on dips. We revised AUDUSD forecast for 3Q slightly lower towards 0.78 as we see some downside risks to the pair should volatility pick up in Sep. In addition, we see plausible correction in iron ore prices after run-up for three consecutive months amid possible slowdown in demand from China as we envision more deleveraging affecting real economy, industrial profits and even more property market cooling measures. That said, even as we look for further correction, pullbacks should not be drastic. Iron ore is not the only exports that Australia can count on. China's thirst for LNG is also boosting export receipts of Australia and that could be also somewhat supportive of its current account.

- Looking inward, recent strength in the local labour report continues to paint a positive picture for the AUD. However, with the wage growth still low, household debt to disposable income ratio still high (at 190%) and increasing reliance on the services sector, a rate hike may not come until we are well into 2018. In addition, it is worthy to note that RBA devoted a full paragraph of its post-monetary policy statement to the strength of the AUD and how it is likely to affect price pressures, output and employment. Rather than sticking to its usual one-liner "an appreciating exchange rate would complicate this adjustment" (the adjustment here refers to the economic transition following the mining investment boom), the central bank pointed out that "the AUD strength would be expected to result in a slower pick-up in economic activity and inflation than currently forecast". The central bank would clearly be wary of signaling any rate hike in the near future even as we see some recovery in labour market conditions.

- **Even as** RBA is unlikely to move within the next few months, perceptions matter and those are data dependent. We watch 2Q CAPEX this Thu which could indicate how well the economic has transitioned from its mining investment to broader non-mining sectors. While business surveys have been decent, they have not translated to strong CAPEX and some upticks on the latter could bode well. Even as we envision softer demand from China and some downside risks to AUD, any pullbacks are likely to be short-term. We shift our AUDUSD for 3Q towards 0.78 taking into account these considerations. The medium term story for AUDUSD is still one of a slow bottoming story, underpinned by stability in metal prices, less drag from the sluggish USD and nascent signs of domestic recovery.

- **Growth and Inflation Outlook:** Retail sales slowed, but not as much as feared as the print came in at 0.3%m/m vs. the median foreast of 0.2%. Ex-inflation, retail sales picked up pace in 2Q to 1.5%q/q from 0.2% in the quarter prior. Breakdown revealed strong purchases of food, household goods, apparel and goods from department stores. This was despite the moderation in tourist arrivals and that could also mean that household spending has improved. Trade surplus narrowed to A$856mn from A$2024mn for Jun as the import bills rose on the month while that of exports fell. Still, year on year growth of key commodities remains on the uptrend. We anticipate external demand to remain somewhat supported by decent growth in China, US and EU.

- Much optimism has been placed on the improving labour market conditions in the past few months. Hiring growth has been on the acceleration on a seasonally adjusted basis, +2.0%y/y for Jul from around 1% at the start of the year and an increasing portion of the hires has been for full-time rather than part-time along with the rising labour participation. While RBA Lowe has warned that low wage growth could be something to get used to due to structural change in the economy, technological shocks and simply competition, he has also been repeatedly commenting on his expectations for wage growth from an improving labour market. Wage growth is still near historic lows, last printed 0.5%q/q for 2Q steady from the quarter prior. Put together, we see only nascent sign of wage growth bottoming, not a robust rebound like what is observed in Canada. Furthermore, the unit labor cost index has been on the decline. The fall of productivity could weigh on wage growth in the medium term.

- **Monetary Policy Forecast:** RBA kept cash target rates on hold at 1.5% in Aug and we anticipate this could be the case for the rest of this year well into next. The earliest it can raise its cash target rate could be in May 2018. In the past month, RBA Lowe reiterated that markets have misread or read too much into the mention of the neutral rate. The central bank revised its headline inflation higher in its Statement on Monetary Policy from 1½-2½ % for year ended Jun 2018 that was seen in May this year to 1¾-2¾% this month. For much of the forecast period into Jun 2019, CPI is expected to lie between 2-3%. Even so, the central bank has managed expectations of rate hike relatively well and AUD did not strengthen as a result of the revision.

- We hold our view that RBA is likely to take this neutral tone into next year. While there has been plenty of comparison between Canada and Australia, Canada has seen a faster pace of real wage recovery than Australia. The stage of economic recovery is just not comparable between two countries although RBA has been sounding optimistic. With household debt at 190% of disposable income, a rise in rates could affect household consumption in an environment of low wage growth. A stronger AUD could also, still derail the recovery in the retail sales which has picked up pace to 3.8%y/y (s/adj) from previous 3.1%, strongest pace seen since last Apr. Hence, while risks to rates seem to have tilted to the upside more recently, the AUD direction is more likely to be dictated by the USD, China's ability to maintain its growth stability, metal price swings and concomitant impact from its terms of trade.

- In the meantime, the front end of the Australian sovereign curve rose in the last month while those of the longer end slipped, resulting in a slight flattening of the curve. 10y yield remained steady around 2.66% for most of Aug. AU-US yield differential widened to 49bps in the past month, mostly attributed to the slide in UST 10yr yield. That has also lent support to the AUDUSD. Low volatility environment could continue to boost the demand for good quality and positive yielding bonds such as Australia's. Softened inflation prints observed of late could also continue to buoy demand for bonds.

- **Latest Fiscal and External Balance Outlook:** As reported in May, the 2017-18 budget deficit is A$29.4bn and projected to return to a surplus of A$7.4bn by 2020-21. Economic assumptions include inflation at 2% this year, real GDP of 2.75%. Total revenue is expected to be A$444.4bn, up from A$412.1bn in 2016-17. Net debt is projected to peak at 19.8% of GDP in 2018-19. Infrastructure spending will amount A$75bn from 2017-18 to 2026-27. More spending also on early learning and childcare via new system of fee subsides. Cuts seen in tourism, public service (diplomats). More revenue is to be generated from visa application, cigarettes levy and taxes on banks' liabilities. The budget managed to help the government avert a loss of its AAA rating by S&P. That said, the head of **S&P Global Fixed Income Research Diane Vazza recently commented that there could be a rise in credit risk due to potentially ongoing budget deficits. Australia still has a negative credit rating outlook as its deficits run the risk of being persistent for several years with little improvement if the government is not able to implement more forceful fiscal policy decision. The situation is all the more weighed by the uncertain political climate where five of its lawmakers face a high court ruling on their fate to remain in parliament. That ruling (due in Oct) will determine whether the Liberal-National coalition can retain its one-seat majority in parliament and affect its ability to push through its policies.**

- **Key domestic events and issues to watch:** M-I inflation due on Sep 4^{th}. 2Q current account on 5^{th}, GDP on 6^{th} along with RBA meeting. Trade, retail sales on 7^{th}, home loans on 8^{th}, NAB business survey on the 12^{th}, Westpac consumer confidence on the 13^{th}, labour report on the 14^{th}, RBA minutes on the 19^{th}, RBA Ellis to give speech on the 20^{th}, private sector credit on 29^{th}.

- **Technical Outlook:** AUDUSD traded a month of two halves August. Last seen at 0.7970 levels. Bullish trend channel formed since early-2016 remains intact, consistent with bullish momentum on monthly chart. Bias remains to buy on dips. Watch for pullbacks towards 0.7850, 0.7780 to buy into. Immediate resistance at 0.8070 before 0.8170 (50% fibo retracement of 2014 high to 2016 low).

NZD: Consolidation with Risks Skewed to Downside

Forecast	3Q 2017	4Q 2017	1Q 2018	2Q 2018
NZDUSD	0.7100 (0.7300)	0.7400 (0.7500)	0.7500 (0.7700)	0.7600 (--)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** Our call (in our last FX Monthly) for NZD strength overdone and that the currency will face some correction in coming weeks, panned out well, despite USD weakness elsewhere. NZD traded a low of 0.7192 (24 Aug), after traded a high of 0.7558 (27 Jul). Sell-off was triggered by labor market downside surprise (2Q employment shrank for first time since 3Q 2015), weighed by RBNZ's outright discomfort with NZD strength and pre-election Treasury's report (downgraded growth and fiscal surplus projection).

- For the next few weeks, we expect **NZD to consolidate in 0.7100 - 0.7350 range with biased to the downside** on a few factors: (1)

RBNZ has explicitly voiced discomfort with NZD strength and verbally cautioned for the use of currency intervention (as seen from its MPS and RBNZ Governor's testimony to parliament on 10 Aug). A comfortable level in NZD TWI could be somewhere around 75 levels (where RBNZ last made its projections using this assumption). Current level of NZD TWI stands at 76.2. We do not rule out declines of another 1 – 2% over the next few weeks. (2) **Inflation is expected to decline in coming quarters** as base effects of higher fuel and food prices wears off. Our inflation projection also forecasted a dip in headline CPI towards low 1% for 1Q before picking up (consistent with RBNZ's forecast for a drop in 1Q CPI towards 0.7%). This should ease market expectation for an earlier than expect rate hike. Moreover RBNZ faces a leadership transition from Graeme Wheeler to Grant Spencer for a period of 6 months (wef 26 Sep) before Spencer retires while a search is ongoing for the next Governor. We expect **monetary policy to remain status quo** till Mar-2018 unless inflation overshoots upper band of target range of 3% (not our base case scenario). (3) **NZ General election poses some degree of uncertainty** and **we believe NZ political risk premium is under-priced. This** could result in further unwinding of long positions on Kiwi assets, including NZD longs (net CFTC positioning still show NZD longs at 4-year high though positions had been reduced from historical highs). 1m NZD vols on FX options has also seen some interest, moving higher since mid-Aug to 9.51-levels. With financial market volatility at relative subdued levels for some time, we see rising risk that **financial market volatility** may pick up towards middle to end-Sep arising out of FoMC meeting on 21 Sep (likely to begin balance sheet reduction) and elections in NZ and Germany as political risk premium could affect risk sentiment leading to weakness in risk proxies such as NZD, AUD.

- As such we **revised our NZD forecast slightly lower** to take into account the above factors but maintain the forecast trajectory with Kiwi still softer in 3Q before picking up into mid-2018. We remain broadly positive on NZD owing to solid underlying fundamentals - resilient growth underpinned by tourism, consumer spending, population growth and fiscal stimulus (highlighted in Budget 2017)

- **Potential upside Risks to our Outlook:** We caution that could be risks that may limit NZD downside or even subject NZD to further gains - PM English wants RBNZ to plan for removal of property cooling measures in particular the removal of loan to value ratio and that debt to income ratios are now off the table. These restrictions previously helped to cool the housing market and house price inflation to some extent; a removal may reignite demand amid population growth and result in boost to inflation trajectory. These could bring back expectations for RBNZ to tighten monetary policy. Other risks include prolonged USD weakness, strong risk appetite amid low volatility and/or rebound in dairy prices could see Kiwi supported.

- **Growth and Inflation Outlook: 2Q GDP is scheduled for release on 21 Sep and may show a pick-up in momentum** given higher export volumes, improved terms of trade and spending from the British and Irish Lions rugby tours. On the other hand, forward looking surveys such as business manufacturing PMI and services PMI for Jul continue to decline albeit from recent highs. Persisting trend here may well imply a slower GDP growth for 3Q.

- Recent **1Q GDP growth was weaker than expected** (+0.5% q/q vs. +0.7% q/q expectation). On y/y basis, GDP slowed from peak of 3.6% in 2Q 2016 to 2.5% in 1Q 2017. Slowdown in construction activity and export volumes weighed on growth. **2Q employment gains surprisingly shrank for the first time since 3Q 2015 (-0.2% q/q) while wage growth remains subdued (+0.4% q/q).**

- NZ's economy is expected to continue growing at an average of 3.1% over the next 4 years, according to recent RBNZ Monetary Policy Statement (10 Aug). Though NZ construction sector (accounts for 6.5% of GDP) could peak this year as investments in residential building construction slows, activity should remain high as the economy is still supported by tourism, immigration (strong population growth), consumer spending, high terms of trade and fiscal stimulus (as highlighted in Budget 2017) amid still-accommodative monetary policies.

- **RBNZ expect headline inflation to decline in coming quarters** as effects of higher fuel and food prices wears off. Outlook for tradables inflation remains soft while non-tradables inflation remains moderate. Longer term inflation expectations remain well anchored at around 2%.

- **2Q CPI slowed to 0% q/q from 1% in 1Q,** owing to decline in fuel costs and airfares, telecommunication products and services. On y/y basis, 2Q CPI moderated to 1.7% (vs. 2.2% in 1Q). A stronger Kiwi over the past few months may also have dampened tradables inflation (0.9% at 2Q 2017). The softer than expected print should dampen market speculation for earlier than expected rate hike and remains consistent with RBNZ Wheeler's earlier comments that the spike in 1Q inflation is likely to be temporary and may lead to some variability in headline inflation. Non-tradables inflation has been running around 2.4%, persistently below the average levels, reflecting weak price setting behaviour while a key driver holding up non-tradables inflation was housing-related items (Auckland construction cost inflation was around 8% and around 5% of areas outside Auckland). Core inflation (stripping volatile food and energy prices) was slightly softer at 1.4% (vs. 1.5% between 4Q-2015 and 1Q 2017). This is consistent with subdued domestic inflationary pressures.

- **Monetary Policy Forecast:** We expect RBNZ to keep OCR on hold at record low of 1.75% at the upcoming meeting (28 Sep) and possibly for the next 6 months. Accompanying monetary policy statement is likely to remain "neutral" and continue to flag the risks of slower headline and core inflation in coming quarters. RBNZ should also welcome the recent 3.5% decline in NZ TWI from above 79-levels to 76.20 levels (as of writing). Leadership transition at RBNZ due to change of RBNZ Governor from Graeme Wheeler to Grant Spencer (as acting Governor for 6 months before retirement), effective 26 Sep could see monetary policy remain status quo till Mar-2018 unless inflation overshoots upper band of target range of 3% (not our base case scenario).

- At the last RBNZ meeting (10 Aug), RBNZ kept OCR on hold at record low of 1.75%. Accompanying statement acknowledged the lower than expected economic growth in 1Q but expect growth to improve going forward, supported by accommodative monetary policy, strong population growth, high terms of trade and fiscal stimulus outlined in Budget 2017. Statement also highlighted that moderation in house prices (due to LTV restrictions, affordability constraints and tightening in credit conditions) should persist though there remains a risk of resurgence due to continued strong population growth and resource constraints in the construction sector. **Strong emphasis was also placed on NZD exchange rate**, with RBNZ Governor Wheeler saying (10 Aug) the **"we would like to see a lower exchange rate"** before saying that **intervention in the FX market is "always open" to RBNZ**. The last time RBNZ intervened was in Aug-2014. He also shared that RBNZ does have intervention capability and it uses a traffic-light system to gauge if the currency has gauged sustainable or unjustified levels, at which point it assesses whether to intervene. Assistant Governor John McDermott said that the markets should notice that the RBNZ policy statement on exchange rate ("a lower NZD is needed" in Aug statement vs. "a lower NZD would be helpful" in Jun statement) a subtle change of language.

- **Latest Fiscal and External Balance Outlook:** Government finances continue to perform well ahead of General Elections. OBEGAL is forecast to show a surplus of $3.7bn (vs. $1.6bn) for the 12-months ending Jun-2017 thanks to strong tax returns. Core Crown tax revenue expected to grow by 7.4% compared to an increase of around 4% in core Crown expenses. While the 2016/17 fiscal results are estimated to be better than previously forecast, the OBEGAL forecasts for the next four years remain fairly close to the Budget Update.

- In NZ budget, the government plans to raise tax thresholds, increase accommodation payments and adjust family tax credits. **Though the package will cost $6.5bn over 4 years and is expected to eat into budget surpluses, the package is expected to boost spending. The package will result in a modest increase in inflationary pressure and earlier monetary tightening.** Net debt is projected to decline to 19.3% of GDP by 2021 from 23.2% this year. A target of reducing debt to 10-15% of GDP by 2025 has also been set.

- 1Q current account deficit widened to $2.8bn (vs. deficit of $1.7bn in 4Q 2016). For the year ending Mar-2017, the current account deficit widened to 3.1% of GDP (vs. 2.7% of GDP). The deterioration was due to record high imports (good deficit widened to levels not seen since 2Q 2008 and came as a surprise as consensus was expecting a surplus of $1bn.

- **Key domestic events and issues to watch:** 2Q terms of trade (1 Sep); 2Q Mfg activity (8 Sep); Aug food prices (13 Sep); Mfg PMI (15 Sep); 2Q current account balance (20 Sep); 2Q GDP (21 Sep); Aug trade (26 Sep); RBNZ meeting (28 Sep). GDT auctions on 5 and 19 Sep.

  Technical Outlook: NZD drifted lower for the month of Aug - traded as low as 0.7192 (24 Aug) before rebounding. Last seen at 0.7250 levels. Price action suggests a classic textbook head (H) and shoulders (S) pattern - with H at 0.7558, S1 at 0.7355 and S2 at 0.73 levels, with the neckline seen at 0.7190 levels. Will this pan out to be a bullish to bearish trend reversal? Weekly momentum is showing signs of turning bearish. Key support to watch at 0.7190 (H&S neckline). A sustained close below this neckline should see downside gather momentum and the complete reversal of H&S should see the pair find support at 0.6820. We do not rule out short term bounce but inclined to lean against strength towards resistance at 0.7280, 0.7330 (50 DMA) levels. Immediate support seen at 0.7190 (neckline), 0.7130 (200 DMA).

JPY: Still Poised For Weakness

Forecast	3Q 2017	4Q 2017	1Q 2018	2Q 2018
USDJPY	112 (--)	115 (--)	115 (--)	117 (--)

No Change to Previous Forecasts

- **Motivation for the FX View:** The JPY remains among the top performers in Asia, rising 7.1% against the USD since the beginning of the year. Even for the month of Aug so far, the JPY has outperformed most of the regional currencies with the notable exception of the CNY and CNH. Since the start of Aug, the JPY has gained by 1.6% against the USD. Further pullback in the JPY has yet to take off and this can be attributed to geopolitical risks over North Korea and policy uncertainty in the US, which in both situations led investors to seek safety in Japanese assets. The re-emergence of geopolitical risks over North Korea at the end of Aug dragged the pair to touch a four month low of 108.27 (29 Aug), though the pair has since rebounded back above the 110-handle at the point of writing.

- Though the current environment has not led to sharp increases in UST yields, we do not expect this state of affairs to persist. We expect policy uncertainty over US tax reforms to eventually dissipate and monetary policy divergence between Japan and its G7 peers to be even starker, providing the impetus for the USDJPY to climb higher. Already, its G7 peers have either tightened policy (US and Canada) or are in the process of tightening policy (ECB and BOE). Tightening moves by its G7 peers, particularly the US, should lift sentiments, which in turn should support G7 yields. In particular, higher UST yields while JGB yields remain depress should widen the yield differentials between the two, supporting the USDJPY.

- Market positioning data still points to further JPY weakness ahead. This is even though there were some paring of these short positions in the week of 22 Aug compared to the previous week. Speculators were remain net short-JPY, decreasing the number of short-JPY contracts to 119248 as of the week of 22 Aug (vs. 149507 contracts as of the week of 25 Jul), while long-JPY contracts were increased to 45162 (vs. 28018), resulting in net short-JPY contracts at 74086 (vs. 121489). The dip in net short contracts suggested markets were still convinced of further JPY weakness but were reducing their short JPY positions to reflect concerns about US economic policies including restrictive trade policy. current market conditions. We continue to hold that there could be room for further net short-JPY bets ahead, especially with a re-pricing of Fed tightening bias. This could lift UST yields higher with JGB at least holding steady around current levels, leading to further increases in net short-JPY bets and hence, more upside to the USDJPY in the remainder of 2017.

- Underpinning this view for further JPY weakness against the USD, albeit at a more gradual pace, is the central bank's ongoing ultra-loose monetary policy. Unlike its G7 peers, there does not appear to be any end in sight to this easing policy. BOJ governor Kuroda in an interview at Jackson Hole reiterated this message when he suggested that "yield curve control has been well-managed" and did not see a need to adjust it at present. He also commented that as "JGB remaining in the market is going to decline, that means that with one unit of JGB purchase, the impact on interest rate could be bigger". The continuation of powerful easing should be supportive of the USDJPY.

- Though Kuroda himself has suggested that the BOJ cannot expand QE at this stage, he did not rule out completely additional easing measures either. Should inflation fail to gain traction going into 2018, we cannot discount the BOJ unleashing even more easing measures to lift inflation towards the BOJ's 2% target. These easing measures could include cutting interest rate further to -0.3% (from -0.1% currently) and increasing asset purchases of ETFs and J-REITs and other instruments to JPY10tn and JPY6tn.

- Despite the occasional global risk-off episodes, the overall sentiment for Japanese equities remains broadly supported. The weak JPY since 2013 has boosted earnings of Japanese firms and their stocks, and lifted the domestic stock markets. This in turn has attracted foreign investment to the equity markets. So far in Aug, foreign investors have purchased JPY0.92tn in equities as compared to the JPY5.67tn sold off for the whole of 2016. The recent risk-off episodes have led to a drop in the Nikkei 225 index from a month ago. The Nikkei 225 is currently at 19360 levels, off the 2017 high of 20,230 (20 Jun). Further inflows into equities could see the index climb within striking distance of the multi-year high of 20,868 (24 Jun 2015).

- Foreign inflows into the equity markets should continue to lift the USDJPY higher given the strong positive correlation between the Nikkei 225 Index and the USDJPY. This is because foreign investors usually hedge their equity purchases against further JPY depreciation by short-selling the JPY. Thus, improvement in global sentiment improves amid low volatility should encourage even more inflows into Japanese equities and provide even more upside to the USDJPY. We caution though the possibility of intermittent JPY strength due to global risk-off episodes especially in an environment of exceptional low volatility, but these should eventually subside. We do not expect such episodes to hamper further depreciation of the JPY against the USD.

- We maintain our USDJPY forecast for now. We continue to project the pair to climb higher towards 112 by end-3Q 2017 before ending the year at 115. Going into 2018, we expect the USDJPY to hover around the 115 in 1Q 2018 before continuing its climb higher to 117 by end-2Q 2018.

- **Growth and Inflation Outlook:** The economy continues to strengthen as reflected in the recent GDP print for 2Q 2017. Preliminary 2Q17 GDP showed the economy expanding for a sixth straight quarter by a better-than-expected 4.0% q/q annualised in 2Q (1Q: +1.5%). Market had expected growth of just 2.5%. Stronger domestic demand (+5.2% q/q annualised), including private consumption, was the main driver of growth in the quarter. This helped to completely mitigate the weakness in the external sector, where exports have fallen 1.9% q/q annualised. There could be further upside to manufacturing activities should the synchronized recovery in exports be sustained. Exports have risen by 13.4% y/y in Jul, an improvement over Jun's 9.7% and 2Q's 10.7%. That said, the BOJ governor does not expect this growth pace to be sustainable and expects growth to moderate to around 2%. BOJ expects the economy to expand by 1.8% in FY2017 and for the economy to expand by 1.4% in FY2018.

- CPI print for Jul failed to impress even though it was in line with market expectations. Headline inflation rose 0.5% y/y in Jul (vs. Jun: 0.3%) while core inflation (headline inflation less fresh food and energy) inched higher to 0.1% y/y from zero percent in Jun. The lack of inflationary pressures is not surprising given that there has been no significant pick-up in wage growth (with growth in base wages, i.e. excluding OT and bonuses, capped below 0.5% for the past 12 months) despite the improved domestic economic conditions, including the tightening labour market. The persistently low inflationary environment suggests that the BOJ's ultra-loose monetary policy is likely to continue for the foreseeable future unlike its US and EU peers who are looking to unwind their QE programmes. This should hopefully allow the BOJ 2% inflation target to be achieved around FY2019, i.e. fiscal year starting Apr 2019 to Mar 2020. The BOJ continues to forecast core CPI to average 1.1% and 1.5% respectively for FY2017 and FY2018.

- **Monetary Policy Forecast:** There was no policy meeting in Aug. At the last meeting on 20 Jul, the BOJ maintained its ultra-easy policy stance and kept its policy balance (short-term) rate at -0.1% and 10Y JGB yield target at around 0%. It also pledged to maintain its asset purchase program until the 2% inflation target is achieved. According to the governor, the central bank will persistently continue with powerful easing even as further monetary stimulus is deemed unnecessary currently. In addition, the BOJ continues to take a divergent path from its G7 peers, considering it premature to discuss any exit strategy. This is unlike its other G7 peers who have either begun normalizing rates (Fed and Bank of Canada) or are planning to withdraw monetary stimulus in due time (ECB and BOE).

- Market continues to watch the BOJ's monthly bond purchases for hints of QE tapering. For the third consecutive month, the BOJ has left its planned range for bond purchases unchanged. However intra-month, the BOJ can reduce the amount of bonds it purchases within its planned purchase range for the month so long as yields allow. For Aug, the BOJ has reduced this amount twice so far, reducing the amount of 5-10Y bonds it purchase on 25 Aug to JPY410bn from JPY440 at its previous operation on 18 Aug. On 16 Aug, it had reduced the amount from JPY470bn. Thus far, the BOJ has yet to taper its asset purchases.

- We do not expect additional easing measures by the BOJ anytime soon but we also cannot rule out such moves completely. In an environment of mute inflation, the central bank could be prompted into action, unleashing even more easing measures to lift inflation towards the BOJ's 2% target. These easing measures could include cutting interest rate further to -0.3% (from -0.1% currently) and increasing asset purchases of ETFs and J-REITs and other instruments to JPY10tn and JPY6tn.

- **Latest Fiscal and External Balance Outlook:** The government has approved an outline for FY2018 budget that government agencies should use as a guideline when submitting their budget request. The government is expected to introduce a JPY4tn budget with investment in key areas including human capital and raising productivity in the services sector. Increases in social security spending is expected to be limited to JPY630bn, while a 10% spending cut from the current FY is targeted in other areas.

- For the third consecutive month, the current account (CA) surplus narrowed to JPY0.93tn in Jun from JPY1.65tn in May due to the deterioration in the primary income account surplus even as the balance of goods and services rebounded back into a surplus (Jun: JPY0.52tn vs. May: JPY0.12tn). The surplus in the primary income account narrowed sharply to JPY0.51tn in Jun from May's 1.92tn. The financial account surplus also narrowed to JPY1.34tn in Jun from JPY2.18tn in May as the moderation in portfolio investment, deterioration in financial derivatives offset the improvement in the outflows from "other investment". Unsurprisingly, the overall balance of payments (BoP) surplus narrowed to JPY2.69tn in Jun from JPY4.37tn in May. On a quarterly basis, the current account balance narrowed to JPY4.54tn in 2Q from JPY5.97tn in 1Q underpinned by a smaller goods and services balance (2Q: JPY0.65tn vs. 1Q: JPY1.10tn) and moderation in the primary income account surplus (2Q: JPY4.28tn vs. 1Q: JPY5.48tn). This together with a narrower financial account surplus of JPY4.60 (1Q: JPY5.24tn) resulted in a moderation in the overall balance of payment surplus of JPY9.20tn in 2Q (1Q: JPY10.48tn).

- **Key domestic events and issues to watch:** Final 2Q GDP will be released on 8 Sep. Economic data aside, we have BOJ meeting to decide on monetary policy on 20-21 Sep and followed by BOJ governor Kuroda's press conference thereafter. A summary of opinions of the meeting will issued on 29 Sep. On the political front, an extraordinary session of the Diet could be called at the last week of Sep (possibly around the week of 25 Sep) to debate PM Abe's cherished amendment of the Constitution. Market will also be closely eyeing BOJ minutes of the 19-20 Jul meeting on 26 Sep. JGB auctions in Sep: 10-year (5 Sep), 30-year (7 Sep), 5-year (12 Sep), 1-year (15 Sep) and 20-year (14 Sep).

- **Technical Outlook:** USDJPY drifted lower for the month of Aug. Low was seen at 108.27 (29 Aug), breaching our support at 108.90 but pair subsequently rebounded. Last seen at 110 levels. Technicals on weekly and daily charts are showing signs of rebound risks. Sustained close above 110.15 (23.6% fibo retracement of May high to Jun low) may see the pair gather momentum towards next area of resistance at 110.90 (38.2% fibo) – 111.20 (50, 100 DMAs). Support remains at 108.80, 108.30 levels. Bias to buy on dips.

CNY: Tight Liquidity Conditions To Support

Forecast	3Q 2017	4Q 2017	1Q 2018	2Q 2018
USDCNY	6.65 (6.77)	6.60 (6.80)	6.63 (6.81)	6.58 (6.83)
USDCNH	6.65 (6.77)	6.60 (6.80)	6.63 (6.81)	6.58 (6.83)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** The past month has been another strong one for the RMB, buoyed by 1) rising interbank rates as PBOC continues to keep onshore liquidity somewhat tight; 2) the use of countercyclical adjustment factor in times of risk aversion; 3) strength of the EUR (It is no longer just about the USD). We expect the environment for the next few months to remain somewhat supportive of the renminbi with underpinnings from either coming strong EUR conditions or PBOC coming in to support the currency with the use of the countercyclical adjustment factor should risk sentiment sour and to maintain its (CNY) strength against not just the USD but also the other heavy-weights like the EUR. An important observation is that the CNY has strengthened against the basket ever since the introduction of the countercyclical adjustment factor. Tight liquidity conditions also ensure a favourable carry environment for CNY and we are seeing more net inflows as indicated by 2Q BOP data breakdown in terms of other investment. That said, there is potential for USDAsians to head moderately higher into Sep as Fed could start to reduce balance sheet (in Sep/Oct)
-) and that could lift USDCNY towards 6.65 by end Sep though we anticipate persistent strength in the EUR to keep USDCNY pressured towards 6.60.
- The sovereign curve bear steepened in the past month. CBG 10y yield rose, widening the differential with UST 10y yield and driving the USDCNY and USDCNH lower. Aug has hardly been a good month for risk-taking. There were more moments of risk aversion. It did not help that China also released a tranche of weaker activity data for Jul – the first data for 3Q, a sign that growth momentum is likely to slow from its robust pace of 6.9%y/y seen in the first half of the year. On the other hand, PBOC seems to have used the countercyclical

adjustment factor to buffer the CNY against risk aversion when tensions between the US and North Korea heightened. This scenario could happen again should risk take a dive. In addition, the emphasis by the Chinese government on deleveraging and reforms in mid-Jul, along with the release of strong growth report for 1H suggests that China could have room to pursue its deleveraging efforts by compromising some growth momentum.

- **In a backdrop of sluggish USD, strong capital controls, PBOC can afford to widen the trading band without injecting more volatility. It is thus, highly likely that PBOC could widen the trading band from +/-2% to +/-3% to demonstrate more symbolic commitment towards yuan liberalization before the November Party Congress.**
- **Our monthly Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) showed a deterioration for China to 5.2 from previous 4.8 (with 1 being the best and 9 being the worst) as its scores for current account and fiscal deteriorated significantly compared to regional peers.
- **Growth and inflation outlook:** Jul started well with relatively decent PMI-mfg reports. NBS recorded a slight deterioration in headline figure of 51.40 vs. the previous 51.70. While large enterprises reported stronger production and new order. The same cannot be said for medium and small enterprises whose purchasing managers reported contraction. The Caixin version indicated better operating conditions and stronger output and new orders. This paints a mixed albeit still growing picture of the manufacturing scene in China. Activity numbers were surprisingly weak with IP falling to 6.4%y/y from previous 7.6%. Retail sales slowed to 10.4%y/y from 11.0%. Fixed assets ex rural also decelerated to 8.3%y/y from 8.6%. After a strong performance of 6.9%y/y for first half of the year, there is plenty of room for China to see growth moderating and yet still be able to meet the 6.5-7.0% GDP target set for this year. Trade numbers are also seeing some softening to 11.2%y/y (in CNY terms) from previous 17.3% and imports also significantly slowed to 14.7%y/y from previous 23.1%.
- PPI steadied around 5.5%y/y in Jun as metal prices started to firm in recent months. On the other hand, CPI slipped a tad to 1.4%y/y from previous 1.5%, weighed by food inflation. With food and fuel inflation rather anchored, price pressure is likely to remain in check. Unless we see a jump in energy and food prices, we see limited upside in PPI and CPI in the months ahead. That could mean that real rates could actually rise, limiting the room for PBOC to raise funding costs.
- Adding to the downside risks to growth for the second half of the year is the potential property measures expected by our Hong Kong Strategist, Willie Chan as he noted that the property inventory absorption period in tier-3 cities has dropped to 9.5 months, rather close to the levels in tier-1 and tier-2 cities.
- **Monetary Policy Forecast:** The liquidity management by PBOC has been rather tight, lifting the volume weighted average price of short term rates. The 7-day repo rate (VAMP) swung higher to levels around 2.9591% as of 25 Aug. Bond demand was also driven higher by geopolitical tensions between the US and North Korea. Liquidity pressure may continue to support CNY. Offshore rates are also

affected on 25 Aug as overnight yuan interbank rate in Hong Kong spiked to 2.39%. We do not expect PBOC to do anything on RRR and 1Y lending rate, basically keeping monetary policy "prudent and neutral" and focus on influencing funding rates by limiting liquidity injection. With strong 6.9%y/y growth reported for the first half of the year, it is now more likely that PBOC would choose to press on with its deleveraging agenda as China is still able to meet its GDP target of 6.5-7.0% for 2017 with a moderate slowdown in the second half of the year.

- **Latest Fiscal and External Balance Outlook:** The Ministry of Finance stated that fiscal revenue rose 11.1%y/y to CNY1.65trn in Jul. PBOC had stated that China will coordinate fiscal and monetary policy. IN addition, Vice Finance Minister Liu Wei suggested tax breaks to ease funding cost in real economy. So while real rates could rise and PBOC can continue to tighten, the government may be able to offset the rise in funding cost by offering tax breaks.
- Current account surplus widened to U$52.9bn in 2Q from previous U$18.4bn due to a wider goods trade balance (U$133.2bn) that more than offsets the slightly wider deficit in services deficit (U$74.4bn). BOP (other investment) recorded an inflow for the first quarter of the year though that was offset by outflows recorded in the portfolio investment and direct investment. Still, it is noteworthy for currency and deposits to record a positive net inflow of U$49.4bn and trade credit of U$12.4bn. FX reserves saw another mild increase in Jul, likely due to valuation to U$3080.7bn from previous U$3056.8bn. This is due to strong capital controls, sluggish USD and an increasing bullish view of the CNY.
- **Key domestic events and issues to watch:** NBS Mfg PMI due on 31st Aug, Caixin PMI on 1st Sep, foreign reserves on 7th, trade on the 8th, CPI, PPI on 9th, Money supply M2, new yuan loans and aggregate financing on 10-15th. Retail sales, FAI, industrial production on 14th. Property prices on 18th followed by FX Net settlement on 20th. Industrial profits on 27th.
- **Technical Outlook:** USDCNH looks on course to clock its second largest monthly decline this year. The last time USDCNH declined close to 3% was in Jan 2017. Pair was last seen at 6.5920 levels at time of writing. Bearish momentum on monthly, weekly and daily charts remain intact. Next key support at 6.5030 levels (50% fibo retracement of 2014 low to 2016 high) before 6.3880 (61.8% fibo). Near term given the sharp decline, we do not rule out short term pullbacks in the days ahead. Resistance at 6.6180 (38.2% fibo), 6.6780 levels (21 DMA).

KRW: Still in the Broad Range

Forecast	3Q 2017	4Q 2017	1Q 2018	2Q 2018

USDKRW	1150 (--)	1160 (--)	1170 (--)	1180 (--)

No Change to Previous Forecasts

- **Motivation for the FX View:** We continue to expect **2-way risks to persist for USDKRW, within 1110 - 1150 range** over coming weeks. External drivers, including geopolitical tension in Korean peninsula, KORUS FTA, ongoing China-Korea relations with regards to THAAD deployment (unlikely to see this issue resolved anytime soon especially with higher frequency of N.Korea's launches) resulting in falling tourism revenue from Chinese tourists, Fed and ECB monetary policies and global risk sentiment are likely to play a dominant role over domestic factors. USDKRW may face some upside risks towards 2H of Sep as focus turns back to Fed's monetary policies (which we expect Fed to proceed with reducing the size of its balance sheet). With markets not pricing in any Fed rate hike this year, we believe markets run the risk of underpricing market vols, risk sentiment, US rates and USD strength. A scenario of deterioration in risk sentiment, pick up in FX vols and markets pricing in tighter financial conditions may see USD strength return and support USDKRW.

- **Geopolitical tension in the Korea peninsula has been ongoing** but the frequency of N.Korea firing missiles has increased rapidly this year. In particular N.Korea's recent launch (29 Aug) flew over Hokkaido and landed on the eastern coast of Hokkaido which subsequently saw South Korean President ordering military to stage show of force by conducting drills dropping bombs. True that the increased frequency of the missile launches has seen no sustained impact on asset markets or the KRW so far, but we caution against complacency as an escalation into outright military conflict could translate into adverse shocks for risk assets and KRW. The **recent launch flew over sovereign land (Japan) and certainty warrants some caution**. Our FX forecasts above takes into account this risk but does not take into account an outright military conflict.

- Trade restrictive policies - **Korea-US (KORUS) FTA may come under renewed focus** as Trump has criticized the KORUS for its large trade deficit with S.Korea and have asked for renegotiation or risk termination again. While S.Korea authorities have rejected the proposal from US with no date being set for future meeting, the USTR said discussions will continue in coming weeks. The KORUS could potentially be terminated if either country said it wants to do so and the process will take 180 days. We do not expect the US-Korea relations to break down but do caution that unexpected deterioration could subject USDKRW to more upside pressure.

- We **maintain our USDKRW forecast over the forecast horizon and keep the upward trajectory in USDKRW** into the turn of the year as we expect markets to reprice Fed's monetary tightening and Trump's plan on tax reforms and fiscal spending take shape towards end-2017.

- **Downside Risks to Our Outlook:** USDKRW may trade lower or break below our expected support level should the case for global policy unwind proceed at an even moderate pace than gradual – such as a situation whereby Fed does not tighten monetary policies at the Sep FoMC meeting while macro environment of low vols, generally subdued inflation, global growth rebound and synchronized trade recovery in the region gathers pace. This should favor risk on appetite and fuel further gains in the KRW.

- **Our monthly Maybank Vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for S.Korea improved to 6.4 (vs. 7.0 prior), owing to relative improvement in fiscal and inflation while GDP and current account deteriorated slightly.

- **Growth and Inflation Outlook: BoK expects domestic economy to continue to improve and record a growth rate of 2.8% in 2017,** as exports and facilities investment show robustness amid global economic recovery while slump in private consumption gradually eases. BoK also expects the economy to pick up in 2018, with growth projected to come in at 2.9% due to expansion in increasing trend of private consumption. We think fiscal stimulus (KRW11tn supplementary budget) as highlighted by President Moon (and approved by parliament in end-Jul) should help with supporting private consumption and economic growth. But not all is rosy, there are still a handful of risks including the ongoing decline in tourism spending from Chinese in Korea (due to tension between China and S.Korea over the deployment of the THAAD); US-S.Korea FTA re-negotiation risks – Trump has criticized the KORUS FTA and have asked for renegotiation or termination. At this point, S.Korea have pushed back against demand for renegotiation; and geopolitical tensions in the Korea peninsula

- **2Q GDP eased to 0.6% q/q (vs. 1.1% in 1Q).** On y/y basis, 2Q GDP eased to 2.7% (vs. 2.9% in 1Q). The **pullback was due to decline in exports (-3% q/q)**, with decreased outbound shipments of transportation equipment and petroleum & chemical products. On the plus points, consumption firmed 2.4% y/y (vs. 2.2% in 1Q) and investment spending in plant and equipment/facilities remain strong.

- **Headline inflation rose to 2.2% y/y in Jul (vs. 1.9% in Jun),** due to jump in food prices while cost of housing, fuel, light and water also climbed higher. The rise in headline inflation above BoK's 2% target is now at levels not seen since 2012. The uptrend is likely to be sustained at around current levels of 2%, which is also BoK's target CPI for 2016 – 2018. Core inflation also rose to 1.8% y/y in Jul (vs. 1.4% in Jun) and is expected to stay in the mid-to-upper range of 1%.

- **Monetary Policy Forecast**: There is no MPC meeting scheduled for Sep. We still do not see a strong case for BoK to rush into raising rates at the next meeting (19 Oct) despite the rise in Korea's inflation above BoK's target level of 2% level. This is unlikely to force the hand of BoK to tighten prematurely as inflation has been supply-side driven. Inflationary pressures from the demand side remain soft for now. We expect BoK to keep monetary policy accommodative, with policy rate on hold at record low of 1.25% for this quarter to keep growth supported. There could be risk of tightening in 1Q 2018 should growth momentum picks up further and generate demand-pull inflation.

- **Latest Fiscal and External Balance Outlook:** Current account surplus widened on m/m basis to US$7.01bn in Jun (vs. US5.94bn in May) but narrowed sharply on y/y basis (vs. 12.09bn in Jun 2016). The sharp y/y narrowing on currency account surplus was due to trade deficit widening (owing to rise in overseas trips while number of Chinese travellers are down 66.4% from a year ago). That said S.Korea recorded 64 consecutive months of surplus.

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

- **Key domestic events and issues to watch:** S. Korea releases 2Q final GDP, Aug CPI, exports, PMI (1 Sep); Aug FX reserves, Jul current account balance (5 Sep); Aug unemployment rate (13 Sep); Aug PPI (19 Aug); Sep consumer confidence (26 Sep); Aug IP (29 Sep).

- **Technical Outlook:** August has been a month of 2 halves for USDKRW with the pair running higher in first half of the month (from 1110 to 1148) before turning lower for the second half of the month to 1120 levels. Pair was last seen at 1124 levels. Bearish momentum on daily chart remains intact but shows signs of waning while stochastics also show tentative signs of rising from oversold conditions. These may pose some upside risks in the near term. Rebound could re-visit 1134 (50, 100 DMAs, 50% fibo retracement of Jul high to low) and 1140 (61.8% fibo), 1145 (200 DMA). Key area of support remains at 1105 - 1115 levels. Break below this may see the pair trade towards 1090.

SGD: Holding Steady

Forecast	3Q 2017	4Q 2017	1Q 2018	2Q 2018
USDSGD	1.3500 (--)	1.3500 (--)	1.3600 (--)	1.3650 (--)

No Change to Previous Forecasts

- **Motivation for the FX View:** The USDSGD climb higher stalled towards the end of Aug amid USD weakness. Note that Aug is seasonally a bearish month for the SGD. Instead, the SGD is little changed against the USD so far in Aug. The lack of upward momentum could be attributed to geopolitical risks over North Korea and to policy uncertainty in the US, both of which weighed on the USD, lifting the SGD higher. In addition, the lack of tax reforms and fiscal spending in the US (now expected to come in only in 2H 2018) is also keeping USD bulls off-balance and allowing SGD to climb higher. Not surprisingly, the SGD has risen by 6.8% against the USD year-to-date, the second best performing currency in ASEAN.

- The strength in the SGD to date is not surprising. The lack of Trump reflation trades, the healthy macroeconomic fundamentals of the economy led by the synchronized recovery in exports in the region has played a part in dampening aggressive upside in the USDSGD. In addition, the government's mildly expansionary fiscal policy, which together with still accommodative monetary policy, its triple-A status and persistent balance of payments surpluses, has also been supportive of the SGD and have capped overly climb in the USDSGD.
- We do not expect this SGD strength to continue unabated. Our underlying assumption remains for the USDSGD to be supported in the next three-six months, underpinned by a moderate rise in UST yields. The rise in UST yields should continue to be underpinned by steady US economic growth, the ongoing normalization of US rates (expected in Dec 2017) and expectation of Fed's unwinding of its QE (that could possibly be announced as early as Sep). Thus, should US data continue to surprise on the upside, further uptick in UST yields are likely, keeping the USD and hence the USDSGD supported.
- We also cannot discount the possibility that the global reflation trade (possibly in 2H 2018) could re-emerge that could lift UST yields. The rise in UST yields is likely to have a significant impact on the USDSGD, given that the USDSGD is one of the most sensitive currency pair to moves in 10Y UST yields. This rise in UST yields is likely to narrow the yield differentials between the UST and SGS (assuming no change in SGS yields) and result in outflow of funds back to the US, lifting USD and supportive of the USDSGD.
- Other downside risks facing the SGD include the possibility that the synchronized recovery in exports in the region could come to an abrupt end. The call by Trump to repudiate North America Free Trade Agreement and the increasing risk of a trade war with China could damp global trade. Even if these are negotiating tactics by the Trump administration, looming shadow of trade wars could still cast a pall on global trade and slow trading activities. Already the more moderate growth in China is expect to dampen sentiments in the region with the risks of slowing exports to China and slowing Chinese tourist. We do not expect global trade to be as strong as in 1H and this could weigh on the SGD.
- To date, the ongoing synchronized recovery in exports in the region, likely convergence of monetary policy with the US, and the historically low volatility environment as reflected in the equity and FX volatility indices has spurred greater flows into emerging market assets, including those in Singapore. This should be supportive of the SGD. Episodes of global risk-off could spur a sell-off in regional assets, including Singapore, and weigh on the SGD, posing upside risk to the USDSGD.
- Still, it should not be all bad news for the SGD. We continue to expect some upside to the SGD when the MAS meets in Oct. This is because we continue to expect MAS to shift from its current 'neutral' policy stance to a 'mild appreciation bias' at the Oct meeting. Expected

acceleration in core inflation and economic growth momentum continues to underpin this decision. Policy tightening by the MAS should be supportive of the SGD and mitigate some of the upside risks discussed above. Should MAS maintain its neutral policy bias at its Oct meeting, the USDSGD could climb higher beyond the 1.36-levels by year-end. We continue to monitor incoming data in the next month or so for evidence of accelerating inflationary pressures that would be supportive of a policy tightening in Oct.

- We maintain our forecast for the USDSGD to end the 3Q at 1.3500. Thereafter, MAS tightening move in Oct should be supportive of the SGD and mitigate the possible USD strength from higher UST yields. This should allow the USDSGD to hold steady at 1.3500 by end-2017. We expect markets to begin re-pricing US reflation trades in 1H 2018 and should provide the USD with a lift and push the USDSGD higher to 1.3600 and 1.3650 by end-1Q 2018 and -2Q 2018 respectively.

- **Singapore's monthly Maybank Vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) slipped to 4.3 from 4.4, an improvement over the previous month. This should be supportive of the intrinsic value of the SGD. Our model shows that the SGD NEER was last seen 0.52% above the mid-point implied at 1.3650. Upper bound is implied at 1.3378 while lower bound is now at 1.3922.

- **Growth and Inflation Outlook:** Final estimates for 2Q17 GDP showed the economy accelerating by 2.9% y/y compared to the 2.5% advanced estimates with almost all engines of growth fired up. The details showed growth broadening from manufacturing to now include services. All of these suggest the domestic economy is starting to benefit and strengthen from the trade-led growth recovery. Growth in services (up 2.4% y/y in 2Q vs. 1Q: 1.4%) is now broad based, led by finance & insurance (2Q: 3.8% vs. 1Q: 0.7%), business services (2Q: 1.8% vs. 1Q: 0.9%) and wholesale & retail trade (2Q: 1.5% vs. 1Q: 0.1%). Manufacturing remained the main driver of growth, rising 8.1% y/y in 2Q though this was a slight moderation from 1Q's 8.5%, bolstered by electronics output. In contrast, construction was a drag on growth in 2Q, contracting by 5.7% (1Q: -6.3%), weighed by lower public and private sector contracts. Our economic teams maintains their full-year growth forecast at 3.0% for 2017 with growth in services helping to offset the moderation in manufacturing in 2H17. For 2018, our team is penciling growth of 2.4%. As expected, MTI upgraded and narrowed its full-year GDP growth forecast to 2-3% for 2017 from 1-3% previously.

- Headline inflation edged higher in Jul, rising by 0.6% y/y from 0.5% in Jun on increases in retail and water prices, which combined together increased by 1.2% y/y (Jun: -0.2%). Core inflation (headline inflation less owner-occupied accommodation and private transport) accelerated mildly by 1.6% y/y in Jul (Jun: +1.5%). Driving core inflation higher was the rise in services inflation (up 1.4% y/y in Jul vs. Jun's 1.3%). Our economic team has lowered its 2017 headline inflation forecast to 0.9% (from 1.2%) given the muted inflation so far in the first seven months of the year as generous government subsidies damp inflationary pressures. Core inflation though could exceed our team's full-year forecast of 1.6%, supported by the cyclical recovery. MAS continues to expect headline inflation to average 0.5%-1.5% in 2017 and core inflation to rise by 1%-2%.

- **Monetary Policy Forecast:** The MAS has maintained its 'neutral policy' stance since Apr 2016 with the slope of the SGD NEER policy kept at zero percent. There was also no changes to the width of the policy band or the level at which the policy band is centered. The forward guidance that the neutral policy stance is appropriate for "an extended period" remains in place, suggesting a more accommodative policy remains appropriate amid benign inflationary pressures. Our house view remains for a possible adjustment in the MAS policy stance at the Oct meeting. We expect the MAS will likely shift to a 'slight appreciation bias', underpinned by potential upside risk to inflation due to the uptick in administrative prices (water, service and conservancy charges) and a cyclical growth recovery.

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

- The USDSGD continues to trade higher away from the 2017 low of 1.3543 (on 27 Jul) – a level not seen since Sep 2016 – and in recent days have been trading within the confines of 1.3590-1.3650 range. The oscillation in the USDSGD so far this year has seen the 3-month SOR (3MSOR) touch a 2017 high of 1.02% on 7 Jul before coming off to hover around the 0.98% levels at the point of writing. The 3-month SIBOR (3MSIBOR) continues to hover above the 1.0% levels and was last seen around the 1.12% levels. The still modest rise in rates suggests that the rise in mortgage rates remains on the slow grind higher. Deposit rates (for 12-month fixed) have also not risen since end-Jan but has remained at 0.33%. This continues to suggest that risks related to interest rate increases affecting financial and economic stability, particularly in interest rate- and property-related sectors, seems limited for now, though the risk could be rising.

- Upward pressure on domestic rates remains, with Fed balance sheet reduction expected to begin in Oct and a further Fed rate hike penciled in for Dec. US 3MLIBOR continues on its upward trajectory and is currently hovering around 1.32% at the point of writing, a 2017 high. Ample liquidity has so far kept domestic rates from tracking the US 3MLIBOR higher though, allowing domestic rates to continue with its rather slow grind higher. For now, we expect the 3MSIBOR and 3MSOR to hold steady at 1.16% and 0.94% respectively by end-3Q 2017. For the full-year, we continue to expect the rates to end 2017 at 1.31% and 1.09% respectively.

- **Latest Fiscal and External Balance Outlook:** The government collected a record SGD47bn in tax revenue in FY2016/2017, i.e. Apr 2016 to Mar 2017, underpinned by the economic growth of 2% in 2016 and low unemployment of 2.1%. This tax revenue collected amounted to 68.2% of the government operating revenue. Personal income tax collected amounted to SGD10.5bn (from SGD9.2bn a year ago), while corporate income tax collected slipped slightly to SGD13.6bn from SGD13.8bn in FY2015/2016. With the economy poised to expand by around 2.5% this year, there could be upside to tax revenue collection in FY2017/2018. This should provide more fiscal room for the government to spend and support the economy in 2018.

- The current account (CA) surplus widened to SGD21.05bn in 2Q 2017 from SGD19.40bn in 1Q 2017. The increase in the CA surplus was due to larger surplus in the goods and services account (2Q: SGD26.96bn vs. 1Q: SGD25.19bn) that more than offset the deficits in the primary income (2Q: -SGD2.06bn vs. 1Q: -SGD1.50bn) and secondary income (2Q: -SGD3.85bn vs. 1Q: -SGD3.60bn) balances. The financial and capital deficit rebounded sharply to SGD16.74bn in 2Q from SGD3.28bn in 1Q, underpinned by portfolio and 'other' investment outflows of SGD17.77bn and SGD18.88bn respectively vs. inflows of SGD0.50bn and outflow of SGD33.69bn in 1Q that more than mitigated the inflow of SGD12.56bn and SGD7.35bn in direct investment and financial derivatives respectively. Consequently, the overall balance of payments (BoP) surplus narrowed sharply to SGD4.44bn in 2Q from 1Q's SGD16.61bn.

- **Key domestic events and issues to watch:** Markets will be watching closely inflation print for Aug on 23 Sep as precursor to MAS meeting in Oct.

- **Technical Outlook:** USDSGD traded a month of two halves in Aug – higher for the first half before turning lower into month-end. Last seen at 1.3560 levels. While bearish momentum on monthly chart remains intact, we see early signs of bearish momentum on weekly and daily chart waning. Stochastics is at oversold conditions on both weekly and daily chart. Signs are emerging that the pair could be poised for rebound. Next resistance seen at 1.3610 (21 DMA), 1.3640 (38.2% fibo retracement of Jul high to Aug low) and 1.3680 (50 DMA, 50% fibo). Support remains at 1.35 levels.

MYR: Still Remaining Resilient in a Tight Range

Forecast	3Q 2017	4Q 2017	2Q 2018	2Q 2018
USDMYR	4.2500 (--)	4.2750 (--)	4.3000 (--)	4.2500 (--)

No Change to Previous Forecasts

- **Motivation for the FX View:** We remain positive on the Ringgit outlook given support for fundamentals remain intact as data released over the first two months of 2Q such as industrial production, retail trade and trade data remain positive. Besides, BNM initiatives to broaden and deepen the onshore financial markets remain intact and help to shore up confidence. We interpret these steps as positive development and expect foreign investors' confidence to gradually return. Thus far foreign investors interest in Malaysian equities and bonds which have picked up the past few months has tapered slightly, with data up until Aug still showing inflows in current low volatility, low interest rate and softer dollar environment, seeing interest in emerging market assets.

- Foreigners were small net sellers of Malaysian equities so far this month (1-21 Aug 2017) at –MYR3.7m versus +MYR11.2b net buying in Jan-July 2017. Monthly net foreign buying of equities has been tapering since Apr 2017. Meanwhile, foreign investors were net sellers of Malaysian bonds for second consecutive month in July 2017 totaling –MYR2.3b (June 2017: -MYR0.3b) after the +MYR16.9b net buys in Apr-May 2017 which briefly reversed the –MYR62.7b net sell in Nov 2016 – Mar 2017. For the period Jan-July 2017, net foreign selling of Malaysian bonds totaled –MYR24.1b.

- Trade flows have been supportive of the MYR thus far. Between Dec 2016 and June 2017, a total of +USD3.6b net exports earnings have been repatriated, larger than the +USD2.5b increase in external reserves during the period, indicating the supportive role played by trade flows via the repatriation of export earnings as it offset the net portfolio capital outflows especially during the period 4Q 2016 – 1Q 2017 that was mainly caused by net foreign selling in the bond market.

- The level of foreign bond holdings are also more stable now with the foreign holdings of Malaysian government bonds (MGS & GII) at 26.5% of total outstanding in June 2017, down from the high of 36.0% in Oct 2016, reflecting lower foreign holdings of both MGS (July 2017: 40.1%; Oct 2016: 51.9%) and GII (July 2017: 7.4%; Oct 2016: 12.6%). The ratio has been at 26.5%-27.5% last four months.

- Long-term "sticky" investors such as foreign central banks, governments, pension funds and insurance companies made up 55% of foreign holdings as at June 2017, up from 41% in Mar 2016 (Figure 14). The "less sticky" foreign asset managers and banks account for 37% and 8% of foreign holdings respectively in June 2017, down from 41% and 15% back in Mar 2016. The 8% share of foreign banks may also include investment on behalf of clients that are longer term investors noted above. Our Fixed Income Research team believed that currently around 80% of foreign asset managers are "Index-Tracker" funds vs 20% "Absolute Returns" fund, which should further contribute to a more stable foreign holdings. Previously when foreign holdings of Malaysian government bonds were rising to its high, these two categories foreign asset managers were roughly evenly split prior to the foreign net selling in the bond market that were largely driven by the "absolute returns" funds.

- According to BNM, the top-50 foreign investors make up slightly over 70% of total foreign holdings and 10.9% of total bonds outstanding, with no single foreign investors holding more than 1% of total bonds outstanding. A more stable foreign bondholding eases the main source of pressure on external reserves since "Taper Tantrum" i.e. volatile foreign flows in the bond market.

- Given improved investors' sentiment, well-managed expectation for Fed rate hike given pricing in of forward guidance this year, less dependence on oil for revenue, and MYR being fundamentally and historically undervalued, we see scope for Ringgit to play catch up with regional peers and extend its gains towards 4.25 levels (vs the USD) for 3Q, before some strength in the USD towards year end potentially supporting the pair at around 4.2750 by end of the year. Our forecasts already reflect our concern that there could be some risk of delayed tightening by the Fed and further delays in a US fiscal stimulus.

- We reiterate our **long-standing bias that the Ringgit remains fundamentally undervalued.** Our fair value estimate (which takes into account interest rate differential, inflation differential, current account differential and reflation variables) puts USDMYR at 3.70 levels. We had previously said that Ringgit weakness was temporary and was not a reflection of underlying fundamentals (which remain intact). We believe stability is gradually returning to Ringgit as political/ contingent liability risk subsides, fiscal consolidation gains traction, oil prices continue to stabilize and uncertainty subsides. Solid underlying fundamentals and policies, backed by domestic demand, re-calibrated supportive budget (on a lower oil price assumption suggests flexibility in the fiscal space), relative stability in oil prices though some downside pressure exists, relative attractive yields in the MGS, stabilizing FX reserves to retained imports & short-term debt, accommodative monetary conditions (to support businesses) remain intact and should provide an anchor for MYR stability once short-term noises subside. We believe USDMYR range of 4.20-4.40 is likely to remain relatively sustained for 2017.

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

- External reserves reached USD100b mark for the first time since 15 Jul 2015 as it rose to USD100.4b as at 15 Aug 2017 (end-Jul 2017: USD99.4b) amid a more subdued portfolio capital flows trend in recent months, indicating positive contributions from trade flows via repatriation of exports earnings, and other capital flows, namely FDI.

- **Growth and Inflation Outlook:** Our economics team have upgraded the 2017 full-year growth forecast to +5.5% from +5.1% previously, mainly on firmer domestic demand growth (2017E: +6.5% vs +6.3% previously; 2016: +4.3%) as net external demand is expected to be a drag rather than driver on growth, although less than previously projected (2017E: -4.6% vs -6.6% previously; 2016: +1.5%). The upward revision is mainly on account of faster growth forecasts for manufacturing (to +5.6% from +5.0%) and services (to +5.9% from +5.8%) on the supply side, and the higher growth of consumer spending (to +6.7% from +6.4%), private investment (to +9.4% from +8.7%) as well as exports (to +8.5% from +7.8%) and imports (to +10.3% from +9.7%) of goods and services on the demand side. We expect the above-5% growth momentum to be sustained in 2018, albeit at a slightly slower pace of 5.1% (+4.9% previously).

- Our full-year 2017 real GDP growth forecast of +5.5% factored in moderation in 2H 2017. This is partly due to base effect as growth slowdown since 2H 2014 bottomed in 1H 2016, and picked up in 2H 2016, which was sustained in 1H 2017. Consumer spending which makes up 54% of GDP will be key to watch. It has surprised on the upsides to support the real GDP growth recovery since 3Q 2016 despite the prolonged weak consumer sentiment. We see consumer spending growth staying relatively firm in 3Q 2017 but expect moderation to set in thereafter. 3Q 2017 consumer spending growth will be underpinned by the third and final installment of this year's BR1M payments in Aug 2017; the recently announced cash and financial aids for FELDA settlers and army veterans; and the expected rise in tourist arrivals and spending as Malaysia hosts the SEA Games (19-30 Aug 2017) and Para-ASEAN Games (17-23 Sep 2017). However, we see the effect of the measures to boost disposable income to dissipate later in the year. We also do not expect Budget 2018 to contain broad-based "goodies" for consumers, but instead being more focused on the welfare of the bottom-40% of the household income groups or "B40". Consequently, we forecast real private consumption growth to "normalized" by moderating to +5.9% in 2018 (1H 2017: +6.9%; 2017E: +6.7%) i.e. around the +6.0% growth recorded in 2015-2016.

- Headline inflation rate in June 2017 slowed further to +3.6% YoY (May 2017: +3.9% YoY) while core inflation was little changed at +2.5% YoY (May 2017: +2.6% YoY). In 1H 2017, headline inflation rate accelerated to +4.1% YoY (1H 2016: +2.7% YoY) but core inflation rate eased to +2.5% YoY (1H 2016: +2.9% YoY). No change in our full-year 2017 inflation rate forecast at 3.5%-4.0% (2016: +2.1%) and view that there will be no change in OPR this year.

- Headline inflation rate eased for the third month in a row to +3.6% YoY in June 2017 (May 2017: +3.9% YoY; Maybank-KE: +3.6% YoY; Consensus: +3.9% YoY). The trend in headline inflation continued to be dominated by "Transport", which also decelerated for the third consecutive month (June 2017: +10.5% YoY; May 2017: +13.1% YoY). Meanwhile, core inflation rate which exclude volatile food and energy prices as well as price-controlled/price-subsidised components of the CPI, including fuel prices) was stable at +2.5% YoY (May 2017: +2.6% YoY). Compared with May 2017, headline inflation declined -0.2% MoM while core inflation was unchanged.

- Our economics team reiterate their view that the current trend in inflation is in line with our assessment that headline inflation has peaked in Mar 2017 and the outlook is for inflation to moderate further in 2H 2017 to average 3.0%- 3.5% YoY. Hence, they maintain their 2017 and 2018 headline inflation rate forecasts of 3.5%-4.0% (official 2017: 3.0%-4.0%; 2016: +2.1%) and 2.0%- 2.5% respectively.

- This expectation reflects the view that the current "cost-push" headline inflation – largely due to the impact of the earlier surge in crude oil price on the domestic fuel prices which is a key element of the CPI's "Transport" component - will taper as "demand-pull" and "wage-driven" inflationary pressures are contained as suggested by the relatively stable core inflation rate.

- Maintain call that the Overnight Policy Rate (OPR) will be kept at 3.00% p.a. as the current trend in inflation is consistent with BNM's view of moderating headline inflation in 2H 2017, while core inflation rate is contained. Together with the pickup in real GDP growth, MYR that has stabilised and strengthened in recent months, and gradual monetary policy normalization by US Fed, we see little motivation for BNM to alter current monetary policy stance.

- **Monetary Policy Forecast:** BNM kept the Overnight Policy Rate (OPR) at 3.00% at its MPC meeting on 13 Jul 2017. The Monetary Policy Statement (MPS) reflects confidence of a better growth prospect in 2017 with inflation expected to moderate in 2H 2017. Together with MYR having stabilised and strengthened, there is no pressure for BNM to alter course, hence our view of OPR staying at 3.00% this year.

- The MPS essentially suggests the Monetary Policy Committee's (MPC) confidence of a better growth prospect in 2017 as expansion in domestic economy is supported by favourable external demand. BNM is keeping its monetary policy stance to remain accommodative and supportive of the domestic economy which picked up +5.6% YoY in 1Q 2017. The momentum is expected to be sustained in 2H 2017 amid the synchronized pick up in global economic activities that is positive for Malaysia's exports in addition to the steady domestic demand driven by continued wage and employment growth as well as the implementation of new and on-going investment projects together with capacity expansion in manufacturing and services sectors.

- Notwithstanding the potential upside in growth, BNM maintained its view that headline inflation will moderate in 2H 2017 (Jan-May 2017: +4.2% YoY), reflecting the waning effect of "cost-push" factors. Core inflation will be sustained by robust domestic demand but to remain contained for the rest of the year.

- No change in our view of OPR staying at 3.00% this year. Overall, we see no motivation for BNM to alter current monetary policy stance this year since growth momentum is intact as per latest statistics on industrial production, external trade and leading indicators, receding inflationary pressures with the slowing headline and the stabilisation and strengthening of MYR. A key area for caution is the uncertainty on external front arising from the emerging prospect of synchronised monetary policy normalisation by major central banks amid current low financial market volatility.

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

- Budget deficit target for 2017 is set at -3.0% of GDP, sustaining the policy of fiscal consolidation since 2010. This year's aim of -3.1% of GDP is maintained and achievable. Based on monthly data, we estimated budget deficit in Jan-Aug 2016 was -3.9% of GDP as the deficit of -5.6% of GDP in 1H 2016 turned into an estimated surplus of +1.2% of GDP in July-Aug 2016. We expect the fiscal deficit to remain flat at 3.1% of GDP, as government spending is likely to pick up (as we enter the election campaign).

- Current account surplus widened in 2Q 2017 to +MYR9.6b or +2.9% of GDP (1Q 2017: +MYR5.3b or +1.6% of GDP) on larger goods account surplus and smaller deficits both services and income accounts. We revised current account surplus forecast to +MYR31.1b or +2.3% of GDP from +MYR23.2b or +1.8% of GDP previously (2016: +MYR29.0b or +2.4% of GDP).

- Despite the persistent worries over the current account surplus tipping into deficit given the earlier narrowing trend, our economics team maintain their view of that current account surplus will be sustained, especially with the on- going global economic growth recovery (2017E: +3.5%; 2016: +3.2%) that uplifts world trade growth.

- Given the 1H 2017 performance, they revised upwards this year's growth in gross exports and gross imports to +15.3% (+10.1% previously; 1H 2017: +21.0%; 2016: +1.1%) and +16.8% (+12.0% previously; 1H 2017: +23.3%; 2016: +1.9%) respectively. As a result of the relatively bigger upward revisions in exports relative to imports, they revised upwards this year's trade surplus to +MYR90.2b (+MYR83.0b previously; 1H 2017: +MYR42.9b; 2016: +MYR87.3b), in turn translating into upgrade in our current account surplus forecasts to +MYR31.3b or +2.3% of GDP in 2017 (+MYR23.2b or +1.8% of GDP previously; 2016: +MYR29.0b or +2.4% of GDP).

- **Key domestic events and issues to watch:** BNM policy decision (6-7 Sep); Trade data (6 Sep); FX reserves (6, 22 Sep); Industrial Production (11 Sep); CPI (20 Sep).

- **Technical Outlook:** USDMYR traded lower for the month but trading range remains subdued and confined to 4.2640 – 4.2990. Pair was last seen at 4.2710 levels. Daily momentum is mild bearish bias but stochastics shows tentative signs of turning from near-oversold conditions. We do not rule out near term rebound towards 4.28-4.29 levels but bias remains to lean against strength. Next firm support at 4.25 levels.

IDR: Carry Trades Still Attractive

Forecast	3Q 2017	4Q 2017	1Q 2018	2Q 2018
USDIDR	13350 (--)	13400 (--)	13450 (--)	13450 (--)

No Change to Previous Forecasts

- **Motivation for the FX View:** Like the SGD, the IDR has proven itself to be one of the more resilient currencies in ASEAN. So far in Aug, the IDR has been little changed against the USD. This unsurprising given that the USDIDR has been oscillating within a tight 13300-13390 range in Aug. The IDR continues to find support from healthy macroeconomic fundamentals, including improving current account deficit and ongoing reforms, which have helped to keep the IDR relatively stable amid external headwinds.

- Healthy macroeconomic fundamental continues to underpin the IDR. Even though growth is not as strong as some of its regional peers, real GDP is expected to improve and expand by at least 5% this year. Support for growth will likely come from the 15 reform/stimulus packages introduced so far that should help to cut red tape and liberalize rules that have been a drag on the economy as well as the government infrastructure push. In addition, the current account deficit is improving with 1H 2017 deficit at 1.5% of GDP. BI expects 2H CAD to average 1.91% of GDP, bringing the full-year CAD to 1.7% of GDP. This is an improvement over the deficit of 2.2% in 2Q last year. It is also important to note that the CAD can be attributed to capital goods import for infrastructure building, which should eventually lift potential growth higher.

- At the same time, the government is taking the necessary steps to rein in the budget deficit. Unlike the previous year where the focus was on raising revenue, efforts this year are on cutting unnecessary expenditure. Reducing waste and using resources more efficiently should provide the government in 2017 to push forward its ambitious USD400bn infrastructure building programme. This should not only lift potential growth but the IDR as well.

- We caution that there could be some slowdown in inflows to Indonesian debt. So far, the historically low volatility environment as reflected in the equity and FX volatility indices has spurred greater flows into emerging market assets, including those in Indonesia. The risk is that a global risk off episode could trigger a sell-off in Indonesian assets. Still, we not expect a complete reversal of flows as IDR carry trades remain favourable for now, albeit waning. The IDR has generated volatility-adjusted carry trade returns of 2.6% so far in Aug, moderating from 2.97% in Jul. These inflows should be supportive of the IDR ahead.

- So far, UST yields have not risen sharply, lessening the risk to emerging market, including Indonesia, that rates have to rise accordingly to prevent portfolio outflows. For now, foreign funds continue to remain vested in Indonesian assets given that real yield differentials between Indonesian 10Y bonds and 10Y UST is still one of the highest in the region. Month-to-date in Aug, foreign investors have purchased USD472.7mn of government debt compared to the USD379.57mn bought for Jul. In contrast, they sold off USD351.4mn of equities compared to USD797.9mn sold for the whole of Jul.

- Thus, healthy economic fundamentals, low volatility, cyclical growth recovery, favourable global growth conditions and relatively easy financial conditions should continue to favour IDR as a carry currency. This should cap USDIDR upside for the remainder of the year. In addition, there have been market whispers suggesting that official agents have been in the market intermittently to curb IDR strength above the 13300 levels so far this year to smooth out volatility in the IDR and to ensure that the country's competitiveness is maintained. Thus, the pair should remain supported around the 13300 levels for the foreseeable future.

- There are risks to our IDR outlook, including falling commodity prices that could depress private consumption and potential disruption to global trade from restrictive trade policy in the US that could moderate the synchronized export recovery in the region. Both of these scenarios could diminish the attractiveness of the IDR carry trade as further cuts to the policy rate could lower domestic yields.

- We continue to look for the USDIDR forecast to hover around 13350 levels by the end of 3Q before inching higher to 13400 by end-2017. The pair's climb is likely to be extended into 2018, hovering around the 13450 levels in 1H 2018.

- **Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for Indonesia fell to 5.2 from 5.3, signaling a mild improvement. This should be supportive of the intrinsic value of the IDR.

- **Growth and Inflation Outlook:** The economy expanded by 5.01% y/y in 2Q, the same pace as in 1Q but coming in below market expectations of 5.08%. Growth was largely driven by investment spending, which rose 5.35% y/y. Weighing on the economy though was sluggish private consumption (steady at 4.95% y/y) and a drop in government spending of -1.93% y/y (1Q: +2.68%).

- Still, private consumption could remain supported ahead. Motorcycle sales – a bellwether for consumer spending – rose by 76.4% y/y in Jul, a good start to 3Q. Even motor vehicle sales show improvement, rising 37.5% y/y in Jul. Similarly, after a dismal Jun, exports rebounded strongly in Jul, increasing by 41.12% y/y, while imports climbed 54.02% y/y. This suggests that the synchronized export recovery still has legs. Moreover, the government's push ahead with its infrastructure programme should also bolster growth ahead.

- Not surprisingly, our economic team continues to expect the government's fiscal push to drive growth for the rest of the year, pencilling full-year growth to still come in at 5.07% for 2017. For the full-year, BI is expecting GDP to come in at 5.4% in 2017.

- After hovering above the 4.0% levels for the past three months, headline inflation has moderated, rising by 3.88% in Jul. The slower rise in inflation can be attributed to softer food prices (up 1.5% y/y in Jul vs. 2.43% in Jun), lower housing costs (Jul: 5.99% vs. Jun: 6.18%) and transport costs (Jul: 4.44% vs. Jun: 5.8%). Core inflation also slipped lower, rising by 3.05% y/y in Jul from 3.13% in Jun. Our economic team is now looking for more benign inflationary pressures in 2017. Food prices is expected to be tame given the government's readiness to import food supplies, while it also stands ready to adjust energy subsidies to maintain inflation stability. As a result, our economic team now expects headline inflation to average 4.08% in 2017 from 4.26% previously. This forecast is in line with BI's projection of 4.0% for 2017. For 2018, the team is looking for price stability with inflation averaging 4.07% for the full-year.

- **Monetary Policy Forecast:** The BI surprised market with a cut to its benchmark policy rate – the 7-day reverse repo – by 25bp to 4.5%. The last time BI had cut rates was in Oct 2016. The deposit and lending rates were also cut by 25bp to 3.75% and 5.25% respectively, maintaining the interest rate corridor at 75bp on either side of the policy rate. The BI took advantage of the relative stability of the IDR as well as inflation well-within the BI's comfort zone of 3-5% this year and the next, amid benign Fed rate hike expectations to cut the rate. The rationale for doing so as per the BI statement was to boost "optimum banking intermediation to support national economic recovery", i.e. to lower borrowing cost to support credit growth. This in turn could lift private consumption and investment and lift the economy out of its anemic growth pattern.

- Despite the rate cut, it could be premature to assert that further cuts are on tap. We believe that any further moves by BI will be data-dependent, including inflation and growth data. Risk to further moves by BI includes the likelihood that the Fed will normalize its balance sheet as soon as Sep and that a further rate hike is possible in Dec. This suggests that the room for further rate cut could be limited. Our economic team does not expect any further rate cut this year.

- Instead of cutting rates further, the BI is more than likely to use macro-prudential policies to lower lending cost and boosting growth. Already BI has announced that it would allow commercial banks to include holdings of corporate bonds as part of loan-to-funding ratio as well as relaxation of financing-to-funding ratio, allowing more lending room to banks. Further macro-prudential measures will be rolled out by the central bank "soon".

- **Latest Fiscal and External Balance Outlook:** President Jokowi has outlined his budget plan for 2018 to Parliament on 16 Aug. His government aimed to narrow the fiscal deficit to 2.2% of GDP by rising tax revenue while boosting growth to 5.4%. Government expenditure is expected to rise by 5% to JPY2.20tn while tax revenue is projected to increase by 9.3% to JPY1.61tn. These assumptions could prove to be overly optimistic given that growth is hovering just above the 5% levels with government revenue under pressure given the lack of one off revenue increases from one-off events like the tax amnesty programme, and with debt rising. Already, various political parties have raised concerns that the government revenue target for 2018 was unrealistic. FinMin Sri Mulyani has responded to these concerns with a pledge to review the assumptions and allocations in detail.

- The current account deficit (CAD) widened to USD4.96bn in 2Q, almost double the USD2.36bn deficit in 1Q 2017. This deficit is equivalent to 1.96% of GDP in 2Q compared to 0.98% in 1Q. The deterioration in the current account was attributable to a drop in the goods and services account surplus to USD2.48bn from USD4.39bn in 1Q and wider deficit in the primary account (-USD8.54bn in 2Q compared to -USD7.77bn in 1Q). The financial account surplus narrowed to USD5.86bn in 2Q from 1Q's USD7.97bn due to the wider outflow from the other investment account of USD6.16bn (1Q: -USD1.28bn). Consequently, the overall balance of payments surplus narrowed sharply to USD0.74bn in 2Q from USD4.51bn in 1Q. The BI expects the BoP to remain in a surplus in 2017 but to moderate to USD8-9bn from USD12bn in 2016. Given the larger deficit in 1H17 of USD3.57bn, our economic team now expects the CAD widen even more to 1.38% of GDP from 1.15% previously. The team continues to expect greater import of capital goods to support the government's infrastructure programme to underpin the CAD in 2017. In comparison, the government is penciling a CAD of 1.7% for 2017.

- **Key domestic events and issues to watch**: Markets will eye BI meeting on 21-22 Sep to see if the central bank will follow up with another rate cut.

- **Technical Outlook:** USDIDR was last seen at 13340 levels. Momentum indicators on weekly and daily charts are not providing a clear bias. Pair may continue to trade sideways between 13300 – 13400.

PHP: Held Back By Domestic And External Headwinds

Forecast	2Q 2017	3Q 2017	4Q 2017	1Q 2018
USDPHP	51.50 (50.80)	52.00 (50.90)	52.00 (50.90)	51.80 (50.70)

Previous forecasts in parenthesis

- **Motivation for the FX View:** The PHP remained the worst performing currency, weakening 1.5% against the USD month-to-date after inching higher by 0.1% for the whole of Jul. Even the IDR decline was markedly lesser (only 0.2% in Aug) in comparison, while the MYR and THB have gained around 0.3%. The weakness in the PHP has been most pronounced since 4 Aug, diverging from its peers. We believe that it was a confluence of factors that drove the PHP lower, including the increasing likelihood that the BSP would hold its policy rate steady this year amid manageable inflation vs. earlier expectations of a rate hike. Consequently, the USDPHP touched a new multi-year high of 51.610 (18 Aug) but has since eased amid BSP jawboning. The pair continues to hover above the 51-handle at the point of writing.
- Aside from the potential lack of domestic monetary impulse, geopolitical tensions over North Korea and the ongoing conflict in Marawi City on Mindanao Island are likely to have spurred a sell-off in Philippine assets, weighing on the PHP. In addition, the deteriorating current account deficit – the first deficit in 15 years of USD600mn – could have encouraged greater short net-PHP bets, which is supportive of the USDPHP. The sell-off was not seen in equities, but instead in government bonds, particularly at the longer end. With up-to-date volume or value data for government debt not available, we sourced qualitatively market participants and together with our analysis of the yield data, we infer that there continue 2.1-6.8bp since the start of the month. Not surprisingly, this sell-off in debt has weighed on the PHP. We caution that this sell-off could accelerate should market volatility, currently at historic lows, spike due to a global risk-off episode. We could see even greater upside risk to the USDPHP as a result.
- In addition, ongoing concerns about the President's anti-drug policy have left some foreign investors at the sidelines. This is reflected in the deceleration in FDI inflows in May, rising USD572mn in May from Apr's USD874mn. In the first five months of the year, FDI inflows amounted to USD3bn, a 23.8% y/y decline. Further decline in FDI is possible should the US engage in trade restrictive policies. This could also dampen the synchronized export recovery in the region has so far been supportive of domestic growth. For now, we expect global trade and synchronized recovery to continue, albeit at a more moderate pace in 2H 2017. As we had previously cautioned, there is a need for a more nuanced dissipation of these risks before a markedly improvement in the PHP can be realized.
- As global rates have not risen sharply as the advanced economies tighten policy, there is no threat to emerging market rates, including the Philippines. Still, this could change should UST yields move higher by year end should the Fed hike its short-term rate one last time in Dec. The narrowing yield differentials in favour of the US could exacerbate portfolio outflows. As well, the normalization of the Fed's balance sheet (announcement) may take place as soon as Sep. Taken together, these could lift UST yields higher by 4Q and bolster the USD. Meanwhile, risk of a re-pricing of EU debt in anticipation of the ECB

QE tapering. Others in the G7 space are also either tightening or in the process of tightening policy and the higher returns elsewhere could encourage greater outflows from Philippine assets. This should weigh on the PHP with the USDPHP ending the year at the 52-handle from 51.50 at end-3Q (our previous forecast was 50.80 and 50.90 for 3Q and 4Q 2017 respectively).

- As we had pointed out above, there is now increasing risk that the BSP will hold its policy rate unchanged for the remainder of the year. With growth still expanding at a healthy above-6% pace, and inflation manageable and well-within the central bank's comfort zone of 2-4%, the central bank does not appear to be in any hurry to adjust its key policy rate. Our economic team now holds a view similar to the BSP, expecting the manageable inflation outlook to allow the central bank to maintain its current accommodative policy to support domestic growth momentum. Moreover, the impact of the tax reform bill on consumer prices is likely to be limited given that the Senate has watered down key components. The absence of further monetary impulse this year should keep the USDPHP supported above the 51-handle in 2017.

- Still, further acceleration in the USDPHP above the 52-handle appears unlikely for now. The BSP had recently threatened to use its ample international reserves and deploy its full policy and regulatory arsenal if necessary should speculative behavior persist. This jawboning by the central bank has been successful in keeping USDPHP in check at the point of writing. The USDPHP has since eased off to trade around the 51.10 levels after hitting multi-year highs earlier. Still, we can expect the market to test the BSP resolve to head of further weakness ahead.

- Supportive of the PHP ahead are the continuing inflows into the Philippines equity market. This is because of favourable valuations in the stock market after the sell-off in the equity market between Aug 2016 and Mar 2017. According to our estimates using the Cyclical Adjusted P/E (CAPE) ratio, equities are now relatively cheaper (as reflected by estimated P/E ratios minus their 5-year average P/E ratios) compared to its peers and this could attract even greater foreign inflows. We are already seeing inflows into Philippine equities with foreign investors having purchased USD42.7mn so far in Aug. In contrast, they had purchased USD38.4mn in Jul. These inflows though pale in comparison to the USD386mn of equities purchased for the whole of Jun. Still, further inflows should go some ways to mitigating some of the downside risks to the PHP and be supportive of the PHP. We look for the USDPHP to still hover around the 52-handle (vs. 50.90 previously) in 1Q 2018 before tapering off to end 2Q 2018 at 51.80 (previously 50.70).

- In sum, we have adjusted our USDPHP forecast to reflect the rising near-term risks to the PHP. To reiterate, we expect further upside to the pair ahead with the USDPHP to climb even higher to 51.50 and 52.00 by end-3Q and end-2017 respectively compared to our previous forecast of 50.80 and 50.90. The USDPHP is expected to hover around the 52-handle by end-1Q 2018 before easing off to around 51.80 by end-2Q (vs. 50.90 and 50.70 previously).

- Our monthly **Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, improved slightly to 4.9 from 5.0. This should be supportive of the intrinsic value of the PHP.

- **Growth and Inflation Outlook:** The economy expanded by 6.5% y/y in 2Q17, sustaining growth above the 6.0% levels for the eighth consecutive quarter. Growth was driven by steady domestic demand that balanced the slower growth in net external demand. Manufacturing grew by 7.9% y/y in 2Q on sustained domestic and improved external demand as well as the pick-up in agriculture. Services, which accounts for 60% of GDP, rose by a more moderate 6.1% y/y in 2Q vs. 1Q's 6.7%. Net external demand expanded by 8.3% y/y in 2Q, a moderation from 1Q's 9.4% as export of goods and services rose at a marginally slower pace, while imports of goods and services sustained it growth pace. For 1H 2017, the economy grew by 6.4% y/y (1H 2016: 7.0%). Our economic team expects consumer spending to remain resilient in 2H 2017, supported by favourable demographics and job market conditions, sustained by overseas remittances. They also expect some acceleration in spending towards the end of the year ahead of the possible tax hike should the proposed tax reform is passed before year-end. Should there be any delay in the passage and implementation of new infrastructure projects, our team expects growth to come in at the lower end of the government's 6.5-7.5% growth forecast for 2017. Our economic team maintains their 2017 growth projection at 6.4%.

- Headline inflation accelerated mildly in Jul, rising by 2.8% y/y compared to 2.7% in Jun, driven largely by the rise in transport cost, which had risen by 3.8% y/y vs. Jun's 2.4%. Core inflation (headline inflation less selected food items and energy prices) eased for the third consecutive month, rising by 2.1% y/y in Jul vs. 2.6% in Jun. Core inflation is now at its lowest level for the year. For the first seven months of 2017, headline and core inflation averaged 3.1% y/y and 2.7% respectively. With inflation accelerating at a much slower pace than anticipated, our economic team has revised lower its full-year forecast to 3.0% from 3.3% for 2017. They however maintain their 2018 headline inflation forecast at 3.5%. In contrast, the BSP has raised its full-year headline inflation forecast to 3.1% for 2017 from 3.0% previously, attributable to the recent increase in global oil prices. Nevertheless, our team sees risks still to the upside on transitory impact of the proposed tax reform programme and adjustments in transportation fares, though improvement in productivity should likely temper the impact on inflation over the medium term.

- **Monetary Policy Forecast:** There were no surprises from the BSP at its fifth policy meeting of 2017. The BSP maintained its key policy rate – the overnight reverse repurchase rate - at 3.0% as anticipated by the market. There was also no change to the overnight lending rate and overnight deposit rate at 3.5% and 2.5% respectively, and this maintained the interest rate corridor symmetrical on either side of the policy rate by 50bp. The reserve requirement ratio (RRR) was also kept steady at 20%.

- Like at previous meetings, the BSP remained data-driven and "will adjust its policy setting as needed", though it does not appear in any hurry to adjust its key policy rate. This is despite growth still expanding at a healthy pace of above-6%, and inflation manageable and well-within the central bank's comfort zone of 2-4%. Our economic team now holds a similar view as the BSP. Our team believes that the manageable inflation outlook should allow the BSP to maintain an accommodative policy to support domestic growth momentum. No rate hikes are foreseen this year as a result. The team though however expects the BSP to hike the policy rate by 25bp twice in 2018.

- **Latest Fiscal and External Balance Outlook:** The budget deficit widened to PHP50.5bn in Jul, though this was narrower than the deficit of PHP90.9bn in Jun. Revenue rose by 14.3% to PHP194.6bn, while expenditure climbed 11.0% to PHP245.1bn. For the first seven months of the year, the budget deficit was PHP205.0bn compared to the PHP171.0bn shortfall over the same period a year ago. Despite the widening budget shortfall, the government aims to cap the deficit at 3% of GDP until 2022. This target though could be blow wide open should the Senate fail to pass the tax reform bill is not passed this year or is diluted. The tax package is forecast to bring in PHP134bn in tax revenue within a year and would be used to fund the USD170bn infrastructure programme. Without the tax reform, the government may be forced to either cut spending, undermining its goal of sustaining growth above 6%.

- The balance of payments (BoP) deficit widened for the third consecutive month to USD678.1mn in Jul as compared to USD569.4mn in Jun. Detailed breakdown of the components of the BoP is still not available for now but we can infer from this slippage that both the current account and financial account balances continued to deteriorate in Jun. As in the previous months, the main culprits were likely the deficit in the merchandised goods account due to the government's infrastructure programme and the narrower surplus in the income account. As for the possible financial account deficit, this could be due to portfolio outflows in the month. The BSP expects the current account to record its first deficit in 15 years of USD600mn in 2017. Meanwhile, the BoP deficit is expected to widen to USD500mn (-0.2% of GDP) in 2017 from -USD400mn (-0.1% of GDP) in 2016.

- **Key domestic events and issues to watch:** BSP will meet on 21 Sep to decide on monetary policy.

- **Technical Outlook:** USDPHP continues to trade higher in the past month. High was seen at 51.61 (18 Aug) before easing lower into month-end. Bullish trend channel formed since mid-2013 remains intact. Resistance seen at 51.70. Support seen at 50.70 (50 DMA) before 50.10 (200 DMA). We do not rule out pullback towards those levels in the weeks ahead.

THB: Supported By Healthy Macro-Fundamentals

Forecast	3Q 2017	4Q 2017	1Q 2018	2Q 2018
USDTHB	33.50 (--)	34.00 (--)	34.00 (--)	34.30 (--)

No Change to Previous Forecasts

- **Motivation for the FX View:** The THB has been among the best performing currency in ASEAN against the USD so far in 2017. The THB has gained 0.44% against the USD so far in Aug. Year-to-date, The THB has also outperformed its regional peers, appreciating at a faster pace than its peers in ASEAN. It has risen by 8% against the USD since the beginning of the year. The strength in the THB has been largely powered by its double-digit current account surplus, healthy inflows into Thai assets (due to its still positive real yield differentials between Thai bonds and UST) and rising gold prices (up by more than 12% since the start of the year). Note that there is a strong negative correlation between gold prices and USDTHB since 2016. Consequently, the THB had appreciated to a new two-year high of 33.144 on 29 Aug.

- In the next three months at least, current account surpluses, positive real yields and strong inflows into government debt should continue to be supportive of the THB. Thailand is only one of the few ASEAN economies enjoying not only current account surpluses and but double-digit surpluses as well. Recent data showed the current account surplus at 10.9% of GDP for 1Q 2017. This persistent current account surplus (since 1Q 2014) should continue to put the spotlight on the THB vis-à-vis its regional peers (with the exception of Singapore) and backstop the THB against any aggressive moves to push it lower. The persistent and strong current account surplus is positive for investor sentiments and hence the PHP.

- Real 10Y Thai bond yield has risen from 1.2% at the beginning of the year to around 2.5% currently, while US real bond yield is now around 0.7% vs. -0.05% in Jan 2017. The widening of real yield differentials between the Thai government bond and 10Y UST continues should spur further inflows into Thai government debt in search of higher returns and lift the THB higher. Relative low foreign ownership in Thailand at 15% (compared to Indonesia at 38% as of end-Mar 2017) suggests that there is room for even more foreign ownership of Thai assets.

- Just as important is that the higher real 10Y yield helps the THB retain its attractiveness as a carry trade amid an environment where global rates have not risen sharply. Carry trade returns adjusted for volatility for the THB is relatively high compared to its regional peers including the IDR and PHP, given the relatively low inflation rate there. The favourable carry makes Thai bonds more attractive than its regional peers including Indonesia, where the carry trade returns adjusted for volatility is around 2.60% while that for Thailand is at 2.84%. The attractiveness of the THB as carry should continue to provide support for the THB.

- Recent flows data confirms the attractiveness of Thai bonds to foreign investors. In the month of Aug so far, foreign investors have purchased USD0.99bn of debt, more sold THB0.28bn of debt sold for the whole of Jul. The same cannot be said for equities. The underperformance of the economy so far has led foreign investors to flee the equity market. Month-to-date, they have sold a greater USD0.35bn of equities compared to USD0.20bn sold off in Jul. The net portfolio inflows so far in Aug are supportive of the THB. There is a risk that market volatility could spike ahead. A severe risk-off episode could trigger a sell-off in both Thai equities and bonds with equities likely to bear the brunt of the sell-off given its current weak disposition. Thai bonds should hold up better given its high real yield differentials with the UST, though slower inflows are still likely. This should weigh on the THB.

- Despite the strength in the THB so far, we remain bearish on the THB on our expectations that simmering political tensions could heighten towards the end of the year. The importance of the political environment cannot be understated as shown in our study using VAR decomposition analysis (which shows the percentage of the forecast variance due to each endogenous variable). The study highlighted the political environment as the most important factor impacting the USDTHB. For now, the current political calm in the kingdom is providing the impetus for an economic growth recovery and investment inflows, keeping the THB supported around the 33-levels. Even the recent self-imposed exile of former PM Yingluck did not rock the political calm.

- Still political sentiments are likely to deteriorate as the election schedule becomes clearer towards the end of the year after the funeral ceremony for the late King HM Bhumibol, expected sometime in Nov, and the coronation of HM King Maha Vajiralongkorn, which should follow soon after. Simmering tensions could resurface in the run-up to the general elections, expected sometime mid-2018. Political uncertainty ahead of the general elections could keep foreign investors on the sidelines until there is clarity on the political front. This could weigh on THB sentiments and support the USDTHB around the 34-handle by the end of the year.

- Though the Fed moves so far has not led to a sharp rise in global rates, helping to keep emerging market rates, including Thailand's, relatively stable. Still, this could change when the Fed begin their balance sheet reduction (which could come as early as Oct) and its hikes its short-term rates for the last time in 2017 in Dec. These moves could lift UST yields and support the USD. Similarly, expectations of ECB tapering could accelerate in the fall and this could lift euro-zone yields higher. In addition, Canada has already begun the process of normalizing rate with its recent rate hike, while the UK is likely to follow suit as soon as it can. Higher returns elsewhere then could see outflows from Thai assets and weigh on the THB.

- We maintain our USDTHB forecast for the pair to end 3Q17 and end-2017 at 33.50 and 34.00 respectively. We also look for the USDTHB to come in at 34.00 and 34.30 by end-1Q and -2Q 2018.

- **Our Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for Thailand improved to 4.1 from 4.7. This should be supportive of the intrinsic value of the THB.

- **Growth and Inflation Outlook:** The economy continued on its recovery path, expanding by 3.7% y/y in 2Q, outperforming expectations for 3.2% growth and up from 1Q's 3.3%. Driving growth in 2Q was external demand as well as government expenditure. Exports of goods and services rose by 6.0% y/y in 2Q vs. 1Q's 2.7%, while government spending rose 2.7% compared to a mere 0.3% in 1Q. For 1H 2017, the economy expanded by 3.5% y/y. Going forward, the synchronize export recovery in the region should continue to lift export demand and keep growth supported. In addition, the government's infrastructure push, including transport networks and the Eastern Economic Corridor should lift government spending further and also private investment. Still, our economic team has revised full-year growth lower to 3.5% from 4.0% previously in 2017, in line with the BoT's projection of 3.5%. The team has also revised lower the 2018 growth outlook to 3.8% from 4.5%, which is slightly higher than the BoT's 3.7%.

- For the first time in three months, headline inflation rose by 0.17% y/y in Jul after falling in May and Jun. Lifting headline inflation higher were higher transport cost and health and personal care cost, both of which rose by 0.73% and 0.42% y/y in Jul respectively (Jun: 0.03% and 0.26%) and rising housing cost of 0.62% y/y. This was even as food prices fell by 0.55% in Jul. Core inflation inched higher, rising by 0.48% y/y in Jul from 0.45% in Jun. For the first seven months of the year, headline inflation averaged 0.6% y/y, well below the BoT's target of 1-4%. Despite the lack of traction in inflation so far, our economic team expects inflationary pressures to return later this year on the back of low base effects, higher energy/fuel prices, improving domestic demand amid a weaker THB. This should allow inflation to average 1.0% in 2017, though this is lower than our previous forecast of 2.5%. Nevertheless, this is in line with the BoT's headline inflation forecast for 2017 of 0.8%. For 2018, the BoT expects inflation to accelerate 1.6%.

- **Monetary Policy Forecast:** The BoT has left its benchmark policy rate unchanged since 29 Apr 2015, when the policy rate was last cut by 25bp to 1.50%. The policy rate at 1.50% is just a tad of the historic low of 1.25% during the Great Financial Crisis in 2009-10. During its recent meeting on 16 Aug, the BoT did not allow its concerns about the THB appreciation to overshadow its optimism over growth. The BoT continues to expect growth to come from external demand and gradual pick-up in domestic demand. According to the BoT, the lack of inflationary traction could be attributed to favourable supply-side factors with a gradual recovery in prices expected in the next six months. Despite the favourable growth outlook, there remains pockets of concerns about the domestic economy that is holding back any policy rate adjustment by the BoT, namely household debt and SME debt serviceability. Our economic team now no longer expects the central bank to hike its benchmark policy rate in 2017 but instead expects any rate hike to come only in 2018.

- The recent appreciation of the THB had created angst among policy makers as a stronger THB is seen as undermining the competitiveness of the economy. The BoT has attempted to jawbone the domestic currency lower by noting it its policy statement on 16 Aug that the appreciation of the THB could affect "business adjustments" and warned that it would "closely monitor developments in the foreign exchange market". This warning apparently was not heeded with the THB continuing on its uptrend. On 21 Aug, the BoT issue a statement that it required "commercial banks to provide additional information of usually high volume of transfers between non-resident THB accounts, which may relate to baht speculation" in an attempt to deter speculation and damp THB appreciation. The central bank also warned it might consider extra measures to limit speculation in the THB. These measures could include further cuts to its bond issuance, particularly short-dated bonds as it had done before.

- **Latest Fiscal and External Balance Outlook:** The government plans to leave the value-added tax (VAT) at 7% for another year. Initially, the plan was for the VAT to be raised to 10% from 1 Oct. However, in view of the need to sustaining growth momentum the planned increase in the VAT was scrapped. This move would result in an estimated loss of THB232.6bn of additional fiscal-year revenue.

- The current account surplus widened in Jun to THB145.61bn after narrowing for three consecutive months to USD38.92bn in May. This sharp jump in the surplus was attributable to the wider surplus in the trade account of THB99.88bn (vs. May's THB76.87bn) and the rebound in the primary and secondary income account back to a surplus of THB45.61bn (May: -THB37.94bn). Details on the financial account are currently not available, but the surplus in the overall balance of payments (BoP) of THB66.94bn suggests that the financial account was in deficit in Jun, possibly due to a deficit in the 'others' segment.

- **Key domestic events and issues to watch:** The BoT meets on 27 Sep to decide on monetary policy.

- **Technical Outlook:** USDTHB drifted slightly lower for the month of Aug. Last seen at 33.22 levels. Bearish momentum on monthly and weekly chart remains intact but signs are emerging that bearish momentum on weekly chart is waning while stochastics could be on the cusp of turning higher from oversold conditions. Sustained close above 33.40 (76.4% fibo retracement of 2015 low to high) may see the pair climb higher towards 34 levels (200 DMA, 61.8% fibo). But broader trend remains biased for the downside. Support at 33 levels before 32.40.

INR: Not Immune to Risk Sentiments

Forecast	3Q 2017	4Q 2017	1Q 2018	2Q 2018
USDINR	64.80 (65.20)	63.00 (65.40)	62.50 (64.90)	64.00 (65.30)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** The next move by RBI is likely to be in Dec as the central bank focuses on resolving distressed assets in the banking system. Recently, Governor Urjit had spoken about "de-clogging bank balance sheets" and for "efficient reallocation of capital". The end goal is to place the private economy "structurally on a path of sustained growth". From the Minutes, reigniting private investment and getting rid of infrastructure bottlenecks are seen as an urgent needs by the MPC. With those as priority, the recent upticks in inflation prints also served to damp rate cut bets. India has recorded two consecutive week of debt outflows (-U$924.24). Demand for equities also looking weak with a MTD (24 Aug) sell-off of U$1.866bn. Putting that together, we should be expecting rupee to exhibit considerable weakness but 1M NDF was last seen around 64-figure, with recent price action biased to the downside. The weak USD is mostly to blame for this. As we look for financial market volatility to pick up in late Sep, we anticipate a bit more support for USDINR that is not entirely immune to risk sentiments. We see spot arriving around 64.80 by the end of the Sep.

- There have been glitches in the GST return filing and payment via its GSTN portal. Even industrial production and PMI-mfg numbers showed some negative impact from the introduction of the tax overhaul. However, for the rest of the year, the benefits of the new tax system should be realized as the economy adjusts to the new system. Inflation pressure (emanating from the GST) is likely limited as price cuts were seen right after the tax overhaul rollout. Consumer benefits are also protected by a newly formed GST Anti-Profiteering Authority, an agency to ensure that the reduction in tax on supply of goods or services is fully passed to the consumers. That could pave the way for RBI to deliver one more cut at the end of the year.

- **Our Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for India worsened to 4.6 (with 1 being the best score and 9 being the worst) from previous 4.4 due to a weaker score for current account, inflation that was partially offset by an improvement in the fiscal account relative to peers.

- **Growth and Inflation Outlook:** Industrial production was still soft, as indicated by the -0.1%y/y decline for Jun compared to the 2.8%

recorded previously. The breakdown reveals that output was flat for mining, contracted -0.3%m/m in manufacturing and a mild 0.2% in electricity. Looking forward, mfg PMI made a rather steep drop into contractionary region of 47.9 in Jul from previous 50.9 as a result of the introduction of the GST. New orders and output slipped and companies purchased fewer quantities of inputs for use in the production process according to the report by Markit. That said, we view the conditions reported as transitory and growth should pick pace into the next few months after the real economy has adjusted to the GST system.

- Inflation prints surprised to the upside for Jul, confirming suspicions that price pressures have troughed in Jun. Fading base effects, higher food inflation and the implementation of the house rent allowance under the 7th Pay Commission could keep CPI on the uptrend. We expect these factors to lift the CPI towards the 4%-medium term target.
- Trade growth continued to soften into Jul with exports growth weakening to 3.9%y/y from previous 4.9%. Imports growth also saw significant slowdown from 19.0%y/y to 15.4%. The trade deficit narrowed to U$11.4bn from previous U$13.0bn. Trade momentum in the region is expected to continue albeit with some moderation into the next few months. That should keep India's balance of payment in surplus.
- **Monetary Policy Forecast:** RBI delivered a 25bps rate cut on 2 Aug with only 2 out of 6 dissenters – one of whom (Dr. Ravindra H.Dholakia) urged for a 50bps rate cut. Most of the MPC members noted that inflation prints have come off while investment growth remains weak. That said, many are still wary of the upside risks to headline inflation in the months ahead and that explains the 25bps cut rather a 50bps one. This was justified by the firmer-than-expected inflation print that came out later in the month. CPI came in at 2.36%y/y vs. the previous 1.46% (expected at 2.05%). WPI came in at 1.88%y/y vs. the previous 0.9%. We look for another rate cut later this year – likely to be in Dec rather than Oct as the MPC pauses to observe the inflation trend before acting. Risks to inflation are skewed to the upside with the HRA, fading base effects and upside food pressure underpinning though good monsoon rainfall, stable international commodity prices could keep key price drivers in check.
- In the meantime, focus is on the resolution of NPLs. RBI Governor Urjit had called for a "swift, time-bound resolution or liquidation of stressed assets". He also urged for a "sense of urgency". This tie in with what he had said in his statement in the Minutes of the Jun meeting as "it is… imperative to ensure resolution of stressed assets of banks and timely recapitalization of PSBs". We look for more progress on that front and a coordinated effort with the government to recapitalize lenders along with another 25bps rate cut in Dec in order to boost private investment before a prolong pause in rates should the inflation environment be non-threatening at that point.
- **Latest Fiscal and External Balance Outlook:** The Union Budget is pro-rural. Finance Minister Jaitley pledged support to the farmers, infrastructure spending and personal income tax cuts and corporate

tax cuts for small and medium businesses to boost consumption and investment. Investors will closely watch for the implementation of the GST, scheduled on 1 Jul. As stated above, our equity strategists estimate a 100-150bps boost to growth from the implementation.

- From last available data, the current account deficit narrowed to $3.4bn in the quarter ending Mar 2017. Financial account actually recorded a net inflow of U$5bn of direct investment and U$10.8bn of portfolio investment. That resulted a net U$12bn of balance of payment surplus, lending significant support to the rupee. That is just for the first quarter of the year. Expect financial account to show strong inflows of portfolio inflows for the quarter ending Jun that has propped up the rupee so far. Low price pressure, soft activity numbers and sanguine medium term prospect of the economy after the successful roll-out of the GST and India's resolution to reduce non-performing assets of PSBs has seen eager take up of the domestic bonds. INR could remain the favoured currency for the rest of the year.
- **Key domestic events and issues to watch:** 2Q GDP is due on the 31st Aug, Mfg PMI on 1st Sep, trade on 8-15th, IP and CPI on 12th, WPI on the **14th.**
- **Technical Outlook:** 1m USDINR NDF was last seen at 64.10 levels. Underlying momentum remains bearish, as indicated by monthly indicators. Key support seen at 64-levels (50% fibo retracement of 2014 low to 2016 high). Decisive close below this level may expose the pair to further downside. Bigger support at 62.70 (61.8% fibo). Resistance at 64.50 (50, 100 DMAs), 65.30 levels.

VND: Stable

Forecast	3Q 2017	4Q 2017	1Q 2018	2Q 2018
USDVND	22760 (--)	22760 (22800)	22730 (--)	22780 (--)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** USDVND remains stable in the past month and with USD looking sluggish, we might not see a lot of volatility in the USDVND for the rest of the year. According to SBV, the demand for foreign currencies from the economy has been met and international reserves rose. The absence of USD strength was able to cap inflation and allowing more room for the central bank to boost credit growth at home by a rate cut delivered in Jul. SBV had said that the cut was meant to "support business and economic growth". Recall that World Bank also upgraded its 2018 growth forecast for Vietnam to 6.4%. Portfolio inflows continue to rise in Jul and Vietnam recorded a higher amount of USD45.74mn (mtd of 28 Aug) of equity inflows.

- Extending the FDI momentum, strong foreign investment interest in terms of real estate, infrastructure and even via portfolio flows could continue to generate income for Vietnam and provide some cushion for the VND from external depreciation pressures. We still see mild upside risks to the USD, especially against the USDAsians, though our levels are calibrated lower to take into account the recent downdrift in the USD. That said, the strong yuan could provide a counter-anchor for the dong and we now see USDVND flat at 22760 for the rest of the year.

- **Growth and Inflation Outlook:** July PMI-mfg slipped to 51.7 vs. previous 52.5. Markit reported that managers see slower expansions in outputs and new orders in the month. That said, new businesses still are still rising at a strong pace while input cost inflation slipped to 13-month low. Industrial production in Aug rose to 8.4%y/y from 8.1%, buoyed by stronger manufacturing growth of 12.4%y/y vs. previous 11.3%. That basically offset the rest the slowdown/contraction seen in other sub-components including mining & quarry, electricity and water supply. The flow of FDI into the manufacturing sector continues. Pace of registered FDI growth was at 37.4%y/y in Aug, slowing from 48.7% in Jul. With VND likely less threatened by the USD, stable CNY also providing an anchor for the currency, price pressures are thus also concomitantly capped.

- In this environment and with plenty of FTAs in the pipeline, Vietnam may continue to attract foreign investors for its infrastructure development. In the meantime, Vietnam has been seeing double digit growth in visitor arrivals, although at a slower pace of 22.5%y/y in Jul vs. the previous 35.5%. Trade numbers are still in high double digit growth for both exports and imports and trade balance rebounded into surplus of U$400mn from a deficit of U$300mn in Jul. Retail sales rose to 10.3%y/y (Jan-Aug) from previous 10.0% (Jan-Jul), buoyed by strong tourist receipts.

- Recently, PM Nguyen Xuan Phuc has urged all government agencies, ministries and localities “to have more drastic efforts and solutions” to meet the growth rate of 6.7% for 2017. In order to do that, the economy must grow by at least 7.42%. That was also a reason why SBV had reduced its policy rates last month. As highlighted by our Macro Strategist, Dr. Chua Hak Bin, the focus on China-style point target, set at 6.7% for 2017, via pushing credit growth (already at +20%) could risk worsening NPL problems and weaken bank balance sheet.

- Inflation rose to 3.35%y/y from previous 2.52%, driven by smaller decrease in food and foodstuffs component at -1.36%y/y vs. the previous 2.52% and faster rise in housing and construction materials prices. With energy prices unlikely to register strong gains, USD less threatening before and concomitant less depreciation pressure on the VND, the inflation trajectory could remain benign for the rest of the year.

- **Monetary Policy Forecast:** SBV cut its official policy rates in Jul, reduced the annual refinancing rate by 25bps to 6.25%, rediscount rate from 4.5% to 4.25% and overnight electronic interbank rate and rate of loans to offset capital shortage in clearance between the SBV and credit institutions (from 7.5% to 7.25%). The absence of USD strength was able to cap inflation and allowing more room for the central bank to boost credit growth at home. SBV had said that the cut was meant to "support business and economic growth". We also recall that the National Assembly passed a resolution on 21 Jun that allows bad debt to be bought and transferred with special bonds into bad debt at market prices under the guidance of the SBV. This move might be also one that could ease up credit conditions so that the resolution on NPL could be more easily executed. In the meantime, the cut in policy rates have triggered commercial banks to lower its deposit rates to retain their Net Interest Margin (NIMs). With USD remaining on a sluggish trend, USDVND could remain at the current range and that could actually be conducive for foreign investment. As of Apr, total outstanding credit rose 20%y/y. Credit growth in the first 7 months could reach 9.3% according to the National Financial Supervisory Commission.

- **Latest Fiscal and External Balance Outlook:** Little development on this front though the Finance Minister Dinh Tien Dung assured that the government continues to aim for balanced budget in the long run. The state budget collection met 46.5% of the annual target this year. Domestic collection is expected to make up 84-85% of state budge income while 14-16% should arrive from crude oil export and other import-export activities (Vietnamnet).

- Vietnam set a lower budget deficit of 3.38% of GDP for 2017 from previously 3.50%. 2016-18 public debt (including government debt, debt guaranteed by government, municipal debt) is capped at 65% of GDP. 2016-18 government debt is set at no more than 54% of GDP while foreign debt is set at no more than 50% of GDP.

- The government has an ongoing effort to divest VND67trn from SOE in the years leading to 2020. Key use of the capital is to develop important infrastructure projects like the Long Thanh International airport, along with the recent plans to build the Chrey Thom Bridge that will connect the southern province of An Giang in Vietnam to Cambodia's Kandal province. This is meant to promote bilateral trade and bring about more economic benefits for those communities along the border areas though a time frame was lacking.

- Current account recorded a deficit of U$1.169bn in 1Q (latest data available), just as we have expected, deteriorating from the surplus of U$155mn seen in 2016 4Q on the back of net U$26mn trade deficit of goods and net U$600mn trade deficit of services in addition to the net primary income payment of U$2.38bn. That said, the financial account recorded a net inflow of U$3.745bn. External trade balance continues to record deficit for 2Q though that could be partially offset by a more positive portfolio inflow seen for the quarter. Current account may continue to record a deficit in this quarter.

- **Key Domestic Events and Issues to Watch:** PMI-mfg is due on 1st Sep. CPI is due on the 24th. 3Q GDP, Sep trade balance, industrial production and retail sales within 25-31st.

FX Forecasts

	End Q3-17	End Q4-17	End Q1-18	End Q2-18
USD/JPY	112	115	115	117
EUR/USD	1.1800	1.2000	1.2000	1.1800
GBP/USD	1.2900	1.3000	1.2900	1.3200
AUD/USD	0.7800	0.7800	0.8000	0.7900
NZD/USD	0.7100	0.7400	0.7500	0.7600
USD/SGD	1.3500	1.3500	1.3600	1.3650
USD/MYR	4.2500	4.2750	4.3000	4.2500
USD/IDR	13350	13400	13450	13450
USD/THB	33.50	34.00	34.00	34.30
USD/PHP	51.50	52.00	52.00	51.80
USD/CNY	6.65	6.60	6.63	6.58
USD/HKD	7.80	7.80	7.80	7.80
USD/TWD	30.40	30.60	30.80	31.00
USD/KRW	1150	1160	1170	1180
USD/INR	64.80	63.00	62.50	64.00
USD/VND	22760	22760	22730	22780
DXY Index	94.14	93.52	93.38	94.22
SGD Crosses	End Q3-17	End Q4-17	End Q1-18	End Q2-18
100 JPY/SGD	1.2054	1.1739	1.1826	1.1667
EUR/SGD	1.5930	1.6200	1.6320	1.6107
GBP/SGD	1.7415	1.7550	1.7544	1.8018
AUD/SGD	1.0530	1.0530	1.0880	1.0784
NZD/SGD	0.9585	0.9990	1.0200	1.0374
SGD/MYR	3.1481	3.1667	3.1618	3.1136
SGD/IDR	9889	9926	9890	9853
SGD/THB	24.81	25.19	25.00	25.13
SGD/PHP	38.15	38.52	38.24	37.95
SGD/CNY	4.93	4.89	4.88	4.82
SGD/HKD	5.78	5.78	5.74	5.71
SGD/TWD	22.52	22.67	22.65	22.71
SGD/KRW	852	859	860	864
SGD/INR	48.00	46.67	45.96	46.89
MYR Crosses	End Q3-17	End Q4-17	End Q1-18	End Q2-18
EUR/MYR	5.02	5.13	5.16	5.02
JPY/MYR	3.79	3.72	3.74	3.63
MYR/HKD	1.84	1.82	1.81	1.84
MYR/CNY	1.56	1.54	1.54	1.55
GBP/MYR	5.48	5.56	5.55	5.61
AUD/MYR	3.32	3.33	3.44	3.36
NZD/MYR	3.02	3.16	3.23	3.23
MYR/IDR	3141.18	3134.50	3127.91	3164.71
MYR/INR	15.25	14.74	14.53	15.06
MYR/KRW	270.59	271.35	272.09	277.65
MYR/PHP	12.12	12.16	12.09	12.19
CNY/MYR	0.6391	0.6477	0.6486	0.6459

Source: Maybank FX Research as of 31 Aug 2017

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

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