September 30, 2016

FX Monthly

2016, Issue IX: Rising Volatility and Steeper Yield Curves

Key themes[1]

- First, US Fed timeline for eventual future rate hike still remains data dependent but has heightened following recent official comments by Fed officials. US growth recovery remains on track even as enhanced volatile market activity remains likely. Still expect USD to be mildly positive as we hold our call for a hike in 4Q 2016.

- Second, the dateline for achieving Japan's 2% inflation target is now open-ended though the BOJ continues to aim for FY 2017 (by Mar 2018) due to oil softness and the lack of traction in wage increases. BOJ have scrapped its target for the average maturity of its government bond holdings and forward guidance has been strengthened, with the BOJ stating asset purchases will continue until inflation is stable above 2%, making it clear that exit won't happen immediately if they hit 2%. BOJ kept the benchmark rate unchanged at -0.1% and have stated that the JPY 80trn annual monetary base target will now fluctuate in the short term in order to shape the slope of yield curve. *As well, the 10-year bond yield is targeted around 0%. BOJ policy announcement generated only temporary upside for USDJPY. A steeper curve in Japan will likely be followed by steepening in the EUR and USD curves, which should coincide with a weakening in the global risk environment despite financial stocks outperforming.*

- Third, *renewed concerns over European banks could exert some downside pressure on the EUR in the short term but we do not expect any blow-up*. We do note there are plenty of political events in Europe and could weigh on the EUR, in the medium term.

- Fourth, China still has excess capacity, heavily indebted corporations and huge liquidity injections continue to add immense pressure on the economy and the yuan medium term. PBOC continues to rely on SLF, MLF and PSL as liquidity tools rather than interest rate cuts and RRR cuts. The 6.70-level is seen as the line to be defended by PBoC for now, ahead of key events such as the SDR inclusion on 1 Oct. *We expect PBoC to limit the depreciation in the CNY trade weighted index in the next 3 months. CNY and CNH will depreciate against the USD but at a smaller magnitude compared to other currencies. That implies a potential for CNH to outperform other non-USD currencies that has higher beta. We see opportunity to long CNH against EUR, SGD and NZD.*

- In the lead up to the Dec FoMC, USD could be more supported against G7 majors (i.e. GBP and EUR) than against AXJs. Time to time, high yield plays may emerge that could favour AUD, IDR, INR, MYR in an environment of low rate, mildly supported risk sentiment and somewhat stable commodity prices. We take opportunity to add hedges to our view by buying USD on dips. Given EU contagion risks, we continue to favor selling EUR and GBP on rallies. Nonetheless, we could also see higher volatility from currently low volatility environment, which may lead to outflows from some currencies which have seen significant inflows and are exposed to trade swings such as KRW, TWD and SGD.

- Oil supply & demand likely to improve, so prices should be moving higher in 2H16. However some risk of weaker demand over next 6-12 months, affected oil prices. Nonetheless, the oil market is in a "shoulder season", where all the refiners have already finished stocking for the summer driving season, and the next seasonal pick up will be 4Q for winter demand. Despite, new equilibrium post Brexit and the recovery in US rig counts, diminishing supply of oil surplus remains due to the lag of capex in the past 18 months. For next 6 months we are supportive oil and metal prices benefitting MYR, CAD and AUD.

[1] Underlined words represent new developments in the FX themes.

Analysts

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

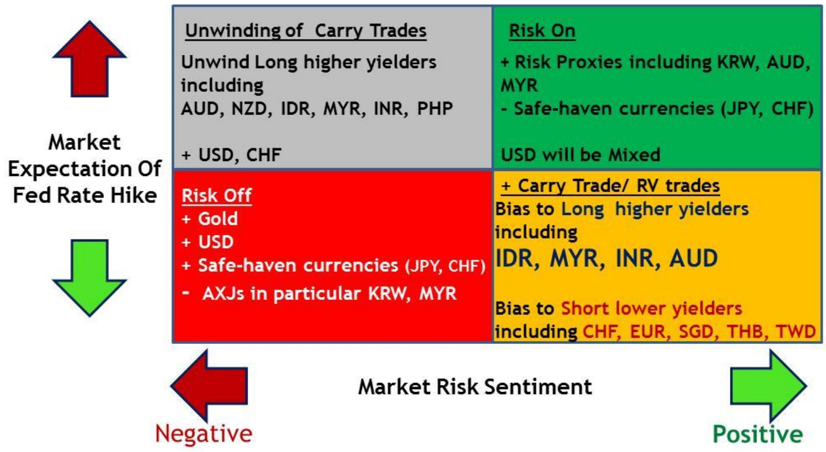
Christopher Wong
(65) 6320 1347
wongkl@maybank.com.sg

Leslie Tang
(65) 6320 1378
leslietang@maybank.com.sg

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

SEE PAGE 46 FOR IMPORTANT DISCLOSURES

So what?



- The **FX GamePlan Grid** above assumes all major central banks except US remain on accommodative monetary policy (low rates for longer); global growth outlook remains subdued/below-trend growth and that markets remain driven by US Fed rate hike expectation and risk sentiment. We think that assumption and environment remains and has not changed for the past few months.
- **Macro Themes:** Global growth remains anemic (lethargic global business investment outlook), inflation risks remains minimal, bond market yield curve steepening (or is it a bubble), central banks (except US) still easing, global QE levels at record high, tighter regulation and lower global credit multipliers, widening credit spread divergence between EM and DM and rising asset market volatility – are unprecedented. We have not seen a congruence of these in history since under the current global financial architecture. Question is when some of these will unravel.
- We see an eventual re-pricing of fear for Trump victory that could heighten volatility and trigger further risk aversion. We stick to our view that Fed is likely to raise target rate in Dec 2016 and possible volatility going into the Nov FOMC. There was also news report of Congress passing a stopgap funding bull that expires on 9 Dec, raising the risk of a potential government shutdown in Dec, a week before the FoMC is scheduled to meet. We anticipate occasional potential shifts towards the top left quadrant from the bottom right (yellow quadrant) in the 2by2 grid shown above as we proceed ahead to Dec FOMC.
- **Major Currencies:** Expect USD to see modest strength but not by the magnitude we have seen last year. Risk aversion and re-pricing of Fed hike expectation could support the USD. GBP to see bearish bias, weighed by political/Brexit uncertainty, risk of BoP crisis and BoE easing. EUR is trying find its equilibrium level now (although it is still far away from our fair value of 1.20) but is likely to be weighed down by medium to long term concerns of EU contagion risks (arising out of Brexit), European banking sector stress (Italian banking sector and Deutsche Bank) and ongoing risk of ECB easing. Higher yielding and good quality sovereign bonds benefit in low global rates environment, given AAA rating. Near-bottom commodity prices, stronger iron ore prices and weaker domestic financial sector profits which reduce the risk of an easing, also protect the downside for AUD. NZD continues to be weighed by expectation for RBNZ monetary easing and macro-prudential policies but recent upswing in dairy prices and tourism sector growth has delayed the move in the near term. Yield

differentials in favor of Kiwi could mitigate some of the negativity. Occasional safe-haven flows and its trade surplus could limit weakness in the JPY. Carry currencies and EM Asia FX such as IDR, MYR etc and NZD and AUD most vulnerable to higher volatility. Any further rise in volatility could provide more support to safe haven currencies such as USD and JPY. Overall, monetary policy in G7 excluding the US, have been ineffective and reliance on fiscal policy to boost the environment is likely to be a protracted process.

- **AXJs:** We continue to expect some weakness in the MYR in the short term but expected to see gains amid fund inflow, supported oil prices and positive risk appetite into Asia for now. Domestic and external headwinds continue to weigh on the SGD. Government spending and quasi-safe haven inflows though should be supportive. Risks of further MAS easing cannot be ruled out but is not our base case. SGD should remain weak. The improving economic fundamentals and introduction of reforms and economic liberalization (including the tax amnesty law) should continue to generate positive sentiments and encourage greater FDI and portfolio inflows into Indonesia. These should be IDR-positive. The Philippines economy should outperform its regional peers but concerns about the government’s extra-judicial killings, policy flip-flops and the president’s unpredictable temperament could weigh on the PHP for the next 12 month. Risks from regional geopolitical tensions arising from the South China Sea claims could undermine the Philippines economy. We remain bearish on the PHP. Elsewhere, high yield, strong growth, recent policy reforms underpin the INR. We are wary of GST implementation uncertainties.
- We still see potential inflows into AXJs as markets search for higher yielding plays amid a near-zero rate environment (in the developed world). In the medium term, we favor IDR and INR.
- Risks to our view are faster and larger than expected US Fed rate hikes, sharp deterioration in China’s growth, crude supply overhang that could drag on oil price and a risk of underpricing a Donald Trump Win. Any Fed signaling that is seen as overly hawkish and significant spike in global FX volatility could unravel some of the inflows we have already seen into Asia.

G7 Global Overview

USD: Strength To Be Sustained

Forecast	4Q 2016	1Q 2017	2Q 2017	3Q 2017
USD Index	98.39 (98.91)	96.79 (99.51)	98.95 (99.04)	97.58 (--)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** We expect at least one rate hike in 4Q 2016, more likely in Dec after the US Presidential elections. We do caution that additional repricing of a surprise Fed hike earlier in Nov (due to market complacency over Fed rate hike trajectory) could continue to see UST yields higher in particular Treasuries 2y and below, and see **USD strength (buy the rumor) in the lead-up to the FOMC** meetings. At the same time, post Brexit search for FX equilibrium and surprise Fed hikes may lead to lower risk sentiment and rising risk premiums, before it affects global consumption, investment growth and then the real economy. During this transition phase and around FOMC announcements, we believe the **USD could still be mildly supported**.
- Recent economic data including home sales, retail sales, consumer sentiment, durable goods orders have remained generally firm. Labor market is at or near full employment and inflation progressing towards Fed's medium term objective of 2%. Within the context of Fed's mandates of "maximum employment and stable prices", we think the trends in key indicators that appear to be supportive of the Fed's decision and market expectation on US interest rate policy, namely data on job market conditions (unemployment rate, non-farm payrolls), inflation indicators (personal consumption expenditure or PCE deflator, wage growth), and economic growth and activity (real GDP, purchasing managers index or PMI) during 2015 and so far in 2016.
- However, we think any moves on the dollar is conditional on upcoming FOMC statements, Fed speaks and projections. We expect the Fed to acknowledge that recent economic data remains relatively resilient, continues to reiterate gradual and cautious pace of tightening; economic/inflation projection have been revised lower from previous quarter's projection; but dots plot still signal at least one rate hike this year.
- **Growth and Inflation Outlook:** The third reading on GDP figures announced on 29 Aug, showed that 2Q GDP was revised higher to +1.4% from previous +1.1%, quickening from the +0.8% reading seen in 1Q16. Household spending grew at a 4.3% pace vs. previous 4.4%. Imports, exports and private investment were revised higher.
- In the Sep FOMC, the Fed's projection of the US growth outlook was again less upbeat for 2016 and the US GDP 2016 growth *f*orecast is now expected at 1.7-1.9% (from 1.9-2.0% in June) while 2017 & 2018 growth forecasts are unchanged at 1.9-2.2% and 1.8-2.1% respectively. The Fed provided its first forecast for 2019 GDP growth at 1.7-2.0% while the longer run growth was revised a tad lower to 1.7-2.0% (from 1.8-2.0%).
- The 2016 unemployment rate was revised up slightly to 4.7-4.9% (from 4.6-4.8%) while 2017 is kept unchanged and 2018 is revised lower to

4.4-4.7% (from 4.4-4.8%). The longer run unemployment rate remains unchanged at 4.7-5.0%.

- The Fed's view of headline PCE inflation was revised lower for 2016-2018 in the latest Sep projections while the core PCE inflation forecasts remained mostly intact, except for 2017 which is revised lower to 1.7-1.9% (from 1.7-2.0%).
- Inflation indicators are heading in the right direction as per the guidance in FOMC statement. The PCE deflator–Fed's preferred measure of inflation -is still below Fed's preferred 2% level. However, it is at higher level this year averaging +0.9% in Jan-July 2016, compared with last year's average of +0.4%. This is consistent with one particular recurring line in the FOMC statements i.e. low inflation in the near term but rising to 2% over the longer run. Fed's outlook of inflation rate uptrend in the medium term is supported by the trend in wage growth, which averaged +2.3% in Jan-Aug 2016 vs in +1.5% 2015.
- **Monetary Policy Forecast:** Fed kept the target fed funds rate (FFR) at 0.25%-0.50% for the fifth consecutive FOMC meeting this year after the 25bps hike at the 15-16 Dec 2015's FOMC meeting. We are pricing in a 25bps hike at this year's final FOMC meeting on 13-14 Dec 2016 i.e. after US Presidential Election.
- Despite the recent rate hike rhetoric by its senior officials, US Fed kept the target fed funds rate (FFR) at 0.25%-0.50% **for the sixth consecutive FOMC meeting this year after the 25bps hike at the 15-16 Dec 2015 FOMC meeting. Maintain our view since mid-year of Fed doing a replay of 2015 i.e. +25bps hike at this year's final FOMC meeting on 13-14 Dec 2016.**
- The tone of the latest FOMC statement is little changed from the previous statement issued after the 26-27 July FOMC meeting i.e. labour market "continue to strengthen"(vs "strengthened" previously); economic activity "picked up from modest pace"(vs "expanding moderately" previously); household spending "growing strongly"(same as previously); business investment "remained soft" ("soft" previously); inflation "continues to run below the Committee's 2% longer-run objective(same as previously); and "the Committee continues to closely monitor inflation indicators and global economic and financial developments" (same as previously). However, the Fed stated that "near-term risks to the economic outlook *appear roughly balanced*", which is slightly more "hawkish" than "near term risks to the economic outlook *have diminished*" previously.
- Fed also updated its median fed fund rate forecasts i.e. it lowered the forecasts for end-2016, end-2017 and end-2018 to 0.625%, 1.125% and 1.875% from 0.875%, 1.625% and 2.375% previously. It also introduced the end-2019 forecast at 2.875%. Meanwhile, the fed fund rate's "terminal level" is lowered to 2.875% from 3.00% previously.
- Overall, the internal fed fund rate projections indicate Fed is guiding for a +25bps hike this year, with the pace of interest rate hike rising to +50bps in 2017, +75bps in 2018 and +100bps in 2019.
- Our view since mid-2016 that Fed will do a replay of 2015 is panning out i.e. another year of single 25bps hike at the final FOMC meeting of this year on 13-14 Dec 2016, given the above-mentioned change in the fed fund rate forecast for end-2016 to 0.625% from 0.875%. This is exactly the same as what happened at the 16-17 Sep 2015 FOMC when the median forecast was cut to 0.375% form 0.625%, leading to the fed fund rate to be hiked at the 15-16Dec 2015 FOMC to 0.25%-0.50% (simple average or mid-point of 0.375%) from 0%-0.25%. **The FOMC meeting on 1-2 Nov 2016 is too close to the US Presidential Election**

on 8 Nov 2016, and we noted that since the 1990s, Fed tends to not make any move on its benchmark interest rate at its November FOMC meeting in the Presidential election years. Meanwhile, we are currently pricing in a +50bps hike in fed fund rate next year.

- **Latest Fiscal and External Balance Outlook:** Fiscal sustainability risk continues to weigh on the outlook and may emerge after the Nov 2016 presidential election. 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 2017/2018.

- **Key domestic events and issues to watch in Oct 2016:** Key US events: ISM Manufacturing Sep (3 Oct) (expected: 50.2); Factory Orders (5 Oct); NFP (7 Oct); FOMC Meeting Minutes (21 Oct); CPI (18 Oct); GDP 3Q (28 Oct); PCE Core (28 Oct). Fed Mester speaks in Kentucky (2 Sep); Fed speaks Kaplan (1 Oct); Mester in NY (8 Oct); Brainard (8 Oct); Evans (11 Oct); Harker (14 Oct); Williams (19 Oct);

- **Technical Outlook:** Move higher failed to break above 200 DMA at 96-levels. Last seen at 95.50 levels. Bullish momentum on weekly chart remains while stochastics has been falling. Expect some short-term downside pressure. Next support at 95 levels (38.2% fibo retracement of 2016 high to low), 94.80 (upward-sloping trend-line support from the lows in May and Aug) and 93.80 levels (23.6% fibo). Resistance at 95.80 (50% fibo) before 96 levels (200 DMA). Biased to buy on dips.

EUR: Same Old Boring Range

Forecast	4Q2016	1Q 2017	2Q 2017	3Q 2017
EUR/USD	**1.1000** (--)	**1.1200** (1.0800)	**1.0900** (1.1000)	**1.1000** (--)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** We expect EUR/USD to stay largely confined within 1.10 – 1.14 range over the next few weeks in the absence of key event risks to focus on, apart from renewed concerns over European banks (potentially contagion risks and could exert some downside pressure on the EUR) and ECB meeting (20 Oct), which we are expect the central bank to maintain status quo.

- We expect external events such as US Presidential elections (8 Nov) and next FoMC meeting (1-2 Nov) to drive sentiment and there could be moderate USD strength in the run-up to those events and weigh on EUR towards the later part of Oct.

- Renewed concerns over European banks amid recent decline in Deutsche bank shares below EU10/share and CDS rising to highest level, after Focus news magazine published reports (23 Sep) that Merkel had categorically ruled out stepping in to help Deutsche Bank with its US legal trouble. Deutsche bank shares had earlier came under renewed selling pressure after US Justice Department suggested that the German lender pay $14bn to settle a number of investigations related to mortgage securities. We expect some degree of stresses should Deutsche default/delay any bond repayment obligations. **Hard stance from German Chancellor Merkel could exacerbate market stresses, lower investors' confidence and trigger contagion risks and we think these have the capability to weigh on the EUR**, to some extent. But **our base case assumes no Lehman-type of bankruptcy or crisis** and Deutsche Bank Is likely to be bailed out in the worst case scenario (given its status as the most important contributor to systemic risk – IMF report end Jun 2016 or some dubbed *too big to fail*). At time of writing (28 Sep), there were already market talks (Weekly *Die Zeit* newspaper) of German regulator preparing a rescue plan in case Deutsche Bank is not able to raise capital and the German government would even offer to take a direct stake of 25%. This information was however denied by some sources that German regulator BAFIN is not working on a rescue plan.

- On political events in Europe and UK, there are plenty but those risks are now pushed back due to postponement of Austria Presidential re-elections and Italy referendum on Constitution reforms to 4th Dec (instead of in Oct). 2017 remains a very busy year for European politicians, with Netherlands elections in Mar 2017, France elections in Apr 2017 and Germany elections in Aug-Oct 2017. These could add to uncertainty and weigh on growth recovery as risk of Far-Right parties stoking anti-EU sentiment could rise leading to risk of "Leave EU" referendums (if held) could undermine the future of the Euro-club, create noises, heighten the level of market uncertainty, and weigh on the EUR. But we see these as medium term risks for now. We expect FX vols to start picking up into 4Q 2016.
- For the rest of the forecast horizon, we are keeping 4Q 2016 EUR forecast unchanged on expectation of monetary policy divergence (between Fed and ECB). Our long-standing house view remains for Fed to hike 25bps in Dec and ECB to remain on easing bias. This is expected to drive a widening in yield differentials, depressing EUR to our lower bound. For 2017, we revised higher our 1Q and lowered our 2Q forecast, due to a change in house view for Fed rate hike trajectory (which we are now expecting 2017 rate hike to occur in Jun and Dec, from Mar and Sep, previously).
- **Risks to our outlook:** A Lehman-type bankruptcy to Deutsche Bank will trigger not only financial contagion but political backlash for German Chancellor Merkel's political career and spell disaster to Euro-zone club as far right parties could exploit the situation and stoke sentiment. This could renew fears of Euro-club break up and exert downside pressure on the EUR towards parity.
- **Growth and Inflation Outlook:** In ECB staff assessment of macroeconomic projections (8 Sep), 2016 GDP forecast was revised marginally higher to 1.7% (from 1.6% in Jun's projection) but revised lower to 1.6% (from 1.7% previously) for 2017 and 2018. Economic recovery is expected to remain moderate, supported by domestic demand amid accommodative monetary and supportive fiscal policies. The ECB expects private consumption to grow strongly in 2016 and remain resilient as outlook for nominal disposable income stays positive and consumer confidence remains well above historical averages.
- Impact of *Brexit* is expected to adversely affect the Euro-area economy, via multiple channels including trade, financial, sentiment, etc. From a trade perspective, UK represents 37% of EU's total trade and a number of European countries ran trade surpluses (i.e. exports more than imports) to the UK. Disruption to trade flow will have impact on growth prospects for the EU region. From a political standpoint, there are numerous political events coming up including

the Austrian Presidential elections (postponed to 4 Dec), Italy referendum on constitutional reform (postponed to 4 Dec), Netherlands elections in Mar 2017, France elections in Apr 2017 and Germany is also scheduled to hold elections in Aug-Oct 2017, could add to uncertainty and weigh on recovery as risk of Far-Right parties stoking anti-EU sentiment is rising. Not forgetting the timing of UK triggering Article 50. All these are medium term negative on Euro-area.

- 2Q Euro area growth grew by +0.3% q/q (vs. +0.6% in 1Q). Household final consumption expenditure had a positive contribution to GDP growth (+0.1 percentage points), while the contribution from gross fixed capital formation was neutral. The contribution of the external balance to GDP growth was positive, while the contribution of changes in inventories was negative. On y/y terms, 2Q GDP grew 1.6% (vs. +1.7% previous print). Jul IP fell by -1.1%% m/m (vs. +0.8% in Jun). Decline was due to capital, intermediate goods.
- **On inflation expectations**, the ECB continues to project 2016 inflation at +0.2% (unchanged from Jun projection); reduced 2017 inflation marginally to 1.2% (from 1.3% in Jun projection) and kept 2018 inflation projection unchanged at 1.6%. ECB expects inflation to start picking up towards end-2016 due to fading effects of the previous large decline in oil prices (base effects). On the basis of the oil price futures curve, the contribution of HICP energy inflation to headline inflation is expected to swing from -0.6 percentage point in 2016 to around +0.1 to 0.2 percentage point in 2017 and 2018, thereby contributing 0.7 percentage point to the pick-up in headline inflation between 2016 and 2017. ECB also expects core inflation to rise as economic slack slowly fades. Improvements in labour market conditions, as reflected in a notable decline in the unemployment rate, are expected to bolster a gradual pick-up in wage growth over the projection horizon.
- Euro-area inflation held steady at +0.2% y/y in Aug. Core inflation was a touch softer at +0.8% y/y in Aug, from +0.9% in Jul.
- **Monetary Policy Forecast:** We expect ECB to keep monetary policy status quo at the upcoming meeting on 20 Oct. We reiterate our bias that ECB is in no urgency to rush into adding more stimulus. Previous ECB meeting in Jul suggested that Draghi was less dovish than expected and data over the past few weeks did not show any break in growth momentum. Moreover Draghi also said “the transmission mechanism is really working very well... It’s never worked better”.
- On the issue of bond scarcity, ECB has tasked the relevant committees to evaluate options to ensure its QE program does not face bond scarcity problem. We believe ECB will continue to monitor financial conditions as a result of the UK fallout and not rush into adding more stimulus, unless necessary. We do see some chance of ECB making some tweaks to its bond buying parameters soon. These includes increasing issuer limits from 33% or eliminate the floor rule (yield > deposit rate), allow for deviations in ECB capital key requirements or extending its bond purchase program beyond Mar 2017. The reason for making those tweaks stems from shrinking pool of eligible bonds for ECB to purchase.
- At the last ECB meeting (8 Sep), ECB kept rates, APP size and period of purchase unchanged, as we expected. The parameters of the APP were also unadjusted. In fact Draghi revealed that the Governing Council only discussed growth projections and did not discuss anything else. In the press conference, Draghi added that ECB stands ready to act if second round effects are seen.

- **Latest Fiscal and External Balance Outlook:** 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.
- Euro area current account surplus narrowed to EUR21bn in Jul (vs. EUR29.5bn in Jun), on seasonally adjusted basis. This is the lowest level since Feb 2016 and was due to decline in secondary income. Current account surplus stood at 3% to GDP.

  Key domestic events and issues to watch: ECB Minutes (6 Oct); ECB meeting (20 Oct); Oct ZEW survey (11 Oct); Sep CPI (17 Oct); Oct flash PMIs (24 Oct); Euro-area 3Q advanced GDP (31 Oct).
- **Technical Outlook:** EUR traded a tight range of 1.1120 – 1.1330, in line with our call for range-trading. Pair was last seen at 1.1230 levels. Weekly and daily momentum is not indicating a clear bias. We continue to expect range-trading, with a bias to lean against strength. Resistance at 1.1360 (23.6% fibo). Key area of support remains at 1.1150 (200 DMA) - 1.1160 (50 DMA). Below that puts 1.1070 (50% fibo retracement of Dec low to May high) in focus.

GBP: Too Soon to Call A Low

Forecast	4Q 2016	1Q 2017	2Q 2017	3Q 2017
GBP/USD	1.2600 (1.3000)	1.2700 (1.3000)	1.2400 (1.3500)	1.2800 (--)

Previous Forecast in Parenthesis

- **Motivation for the FX View**: We remain bearish on the outlook of UK economy and the GBP over the medium term horizon (6-9 months), as much uncertainty remains over the timing of trigger of Article-50, exit plan/ strategies the incumbent government has in place and the medium term repercussion of all these on UK's outlook and prospects (in terms of trade relationships, London's status as financial hub, investment/portfolio flows and job creation).
- While recent economic data have surprised to the upside, it is premature to assume that GBP has found its new equilibrium low. We expect trigger of Article-50 to come near the turn of the year, and that could exert some downside pressure on the GBP.
- We do not expect BoE to ease monetary policy at its 13th Oct MPC meeting, as recent stream of better than expected data buys BoE time. We expect the BoE to conserve its monetary policy tools for use at a later stage if need arises (i.e. when more data becomes available or after Article 50 is triggered). In addition, aggressive/pre-mature move to ease rates could trigger inflation to spike. Already, a much weaker GBP is expected to result in upward price pressures (UK imports more than exports), and BoE may want to avoid a scenario where UK faces a potential stagflation in 2017 – where prices are rising and economic growth could slip into recession (arising out of the uncertainty surrounding UK exit).
- In light of the factors above, we revised our GBP forecasts lower over the next 3 quarters to reflect our bearish bias outlook for GBP that could potentially materializes (conditional upon the trigger of Article-

50). We also expect monetary policy divergence (between BoE on easing bias and Fed near the cusp of another rate hike in Dec) to add to some downside pressure on the GBP (but this is a risk for a later stage in Dec).

- For the month ahead, we expect GBP to trade 1.28 – 1.33 range. Stretch GBP shorts positions could see a squeeze especially if oil prices manage to hold up. We look for opportunities on rally to fade into.
- **Growth and Inflation Outlook:** Recent data continue to suggest that activity is holding up for now. And some of these data include Aug retail sales (5.9% y/y vs. 4.8% Expected), Jul Industrial production (+2.1% y/y vs. +1.9% Expected), Aug PMI manufacturing (53.3 vs. 49 Expected), Aug construction PMI (+49.2 vs. 46.3 Expected), Jul employment change (+174k vs. +171k Expected) - all beating expectations. 2Q prelim GDP was also in line with expectations.
- Looking out, our concerns of growth outlook remains, especially nearing the trigger of Article-50, as much uncertainty remains over its outlook (in terms of trade, investment flows, jobs, exchange rate etc.) on the trigger. And with regards to the timing of trigger, there is no scheduled date but we think sometime around the turn of the year is likely.
- In Jul, the IMF has cut UK growth outlook for 2016 and 2017 by -0.2 ppts and -0.9 ppts, to 1.7% and 1.3% respectively. IMF noted that the referendum will damage short-term growth prospects via lower confidence and investment but factored in favorable trade terms into its forecasts. Increase in uncertainty is projected to weaken domestic demand significantly.
- **On inflation outlook**, we expect the large decline in GBP exchange rate to exert upside pressure on prices (via the import price channel), given UK imports more than it exports. This should erode the purchasing power of the UK consumer and weigh on growth slowdown.
- Both headline and core CPI held steady at 0.6% y/y and 1.3% y/y in Aug, respectively.
- **Monetary Policy Forecast:** We expect BoE to keep monetary policy status quo at its next meeting on 13 Oct, so as to allow pre-emptive monetary easing (conducted at Aug meeting) to work its way into the economy. While there are some expectations from the market for BoE to ease at its Nov meeting, we think it remains too soon to tell at this stage. Furthermore recent activity/survey data post-*Brexit* came in much better than expected. Economic conditions are not entirely at a stage which requires immediate and aggressive easing, and BoE may want to conserve its monetary policy toolbox for use at a later stage if need arises.
- At the last MPC meeting (15 Sep), BoE MPC kept rate unchanged at 0.25% and APP at GBP435bn/month, as expected. On forward guidance, BoE maintained their easing bias, saying that another cut is only likely if August outlook is confirmed. On MPC meeting (4 Aug), BoE unleashed a broad-based package of easing measures (more than we and consensus expected): (1) policy rate was cut by 25bps to 0.25% (this was the first cut in 7 years); (2) GILT purchases of GBP60bn over 6months; (3) Corporate bond purchases of GBP10bn over 1.5 years; (4) Term Funding Scheme (TFS) of GBP100bn for 4Y at close to bank rate (to help with transmission mechanism).
- **Latest Fiscal and External Balance Outlook:** UK public finances improved but at a much slower pace than expected this year despite

strong tax receipts in Aug. Public sector borrowing has fallen GBP4.9bn since Apr or 12.7% so far this year compared with a forecast decline of 27.4%. In the first 5 months, total central government tax receipts were growing at annual rate of 4.4%, compared with OBR's forecast of 6.1%. The OBR still expects tax revenue growth to accelerate in 2H of the financial year with expectations of bumper self-assessment revenues in Jan 2017 due to change to taxation of dividends.

- UK's 1Q 2016 current account deficit was last at 6.9% of GDP. This could potentially narrow due to the drop in GBP resulting in higher demand for UK exports, outweighing the higher prices of imports.
- **Key domestic events and issues to watch:** Sep PMI (3 Oct); Aug IP (7 Oct); BoE meeting (13 Oct) – likely to be non-event; Sep CPI, PPI (18 Oct); Aug jobs report (19 Oct); Sep retail sales (20 Oct) and 3Q final GDP (27 Oct).
- **Technical Outlook:** GBP traded lower for the month of Sep but decline failed to push below 1.29-support. While an interim support may have been formed around 1.28-1.29 levels, it remains too soon to call an equilibrium low as Article-50 is yet to be triggered. Pair was last seen at 1.3010 levels. Bearish momentum on daily chart remains intact but showing signs of waning while stochastics is near-oversold conditions. These could suggest a rebound. Resistance at 1.3050, 1.3150 (50 DMA), 1.3320 (23.6% fibo retracement of the decline from Jun high to Jul low). Support at 1.28 (2016-lows).

AUD: Bulls On Leash

Forecast	4Q 2016	1Q 2017	2Q 2017	3Q 2017
AUD/USD	0.7600 (--)	0.7800 (0.7500)	0.7500 (0.7600)	0.7800 (--)

No Change To Previous Forecasts

- **Motivation for the FX View:** Our view on the AUD is broadly unchanged as we continue to expect the currency to remain resilient, albeit sensitive to the Fed. The few underpinnings that we highlighted last month still hold. One, iron ore prices could be looking at a medium term bottoming as the world steel association projects slightly higher demand prices amid a well-supplied global market in 2017. While that is unlikely to give a material boost to the iron ore prices and AUD, the major part of the decline in iron ore prices is likely to already be in the price of AUD. Two, we are still in a world of fragile growth and low inflation which suggests that yield hunting will still dominate notwithstanding episodes of carry trade unwinding in times of Fed hike expectations (like now) or risk-off. In that respect, AUD is still likely to be in favour given its room for further rate cut that should boost the allure of its government bonds both in terms of yields and price gains. Third, its AAA-rating, albeit at risk, give comfort to those who seek that rare commodity.
- We have been bullish about the AUD and we remain so in the currency, even against the USD, in the medium term. In particular, Japanese investors have been favouring Australian bonds in the past two year and we expect their interest to hold as domestic bonds do

not offer much yields and are unlikely to do in the near future after BOJ declared that they are likely to keep 10y yields around 0%. Hence, interest in Australian bonds is expected to sustain even as we recently witnessed how domestic bonds curve were caught in the global bond sell-off that led to the significant bear steepening of the Australian yield curve. Bond markets could correct further, globally and in Australia but Australian bonds has enough yield and quality to reasonably withstand a modest impact on the global fixed income space. We still look for Fed to raise target rate by 25bps in Dec. Although markets are currently rejoicing over the stand-pat decision by the Fed for Sep, we expect the FX markets to start pricing in a Dec soon. Against other currencies, expect AUD to retain its strength.

- Focus is shifting towards the US Presidential Elections. A tight race between Donald Trump and Hillary Clinton may weigh on sentiments as a Trump Win is seen as negative for Asia. There have already been talks of “Trump hedging”. In addition, we still see some risk for a Nov rate cut by the RBA which would be more effectively timed to cheapen the AUD (compared to the Aug one) ahead of a Fed hike in Dec but this time RBA faces a high hurdle of maintaining the banks’ profitability as previous cuts have translated to narrower net interest margin for the banks. The AUDUSD is still sensitive to the Fed rate trajectory. Combination of risks should rein in AUD bulls and keep AUDUSD within the 0.74-0.78 range in the most part of 4Q.
- **Growth and Inflation Outlook:** Data paints a picture of cautious optimism and we refer especially to the NAB business survey for Aug. Details of the report show strong business conditions in recreation & personal services, finance/property/business but deterioration in mining, retail and wholesale. However, capacity utilization in retail rose the most compared to the rest of the sectors in the country. With retail sales on a downtrend since 2014, Australia is still lacking the traction of a broadbased recovery. Bright spots remain in the construction and services industry. Growth for 2Q disappointed those who expected a stronger print after the better 2Q current account raised the expectations for net exports contribution.
- As we recall, 2Q Inflation had rebounded by +0.4%q/q from -0.2%, buoyed by higher costs in food, transport and housing. Year-on year, inflation slowed to 1.0% from previous 1.3%. The trimmed mean version surprised with a firmer than expected print of 0.5%q/q vs. previous 0.2%. With demand still deficient and AUD rather elevated, inflation outlook is likely to remain benign.
- **Monetary Policy Forecast:** New Governor Philip Lowe has confirmed that RBA will stick to the 2-3% inflation target. “Both the Reserve Bank and the government agree that a flexible medium term inflation target is the appropriate framework for achieving medium-term price stability”, “allowing for natural short-run variation in inflation over the economic cycle”. The statement also highlighted “financial stability” as one of its broad objectives. This suggests that RBA may not be so pressured to lower policy rate in order to nudge inflation back within the 2-3%.
- In the past easing policy decisions, AUD has been emphasized as a great source of uncertainty and could impact inflation as well as the growth momentum of increasingly important services exports. We think that there could still be a chance of a rate cut in Nov that could bring the AUD lower. Positioning a cut ahead of a potential Fed hike in Dec may have the best effect of lowering the AUD. However, we see the chances of a rate move greatly decreased at this point. While we think November could be an opportune time for a rate cut, AUD is

unlikely to cheapen by very much and for very long as allures of Australian bonds would support demand for the currency in a low rate global environment.

- **Latest Fiscal and External Balance Outlook:** Post election, Treasurer Scott Morrison has announced changes to the superannuation system on 15 Sep. The A$500,000 lifetime non-concessional cap is removed. Rather, people will be able to make both concessional and nonconcessional contribution up to a cap of A$1.6mn in their super retirement account, subject to a yearly cap of A$100,000 on non-concessional contribution. This would cost the budget A$550mn in revenue over the next four years.
- To recall, the budget deficit presented in May for 2016 is expected to be A$37bn. The deficit is projected to exist for the next four years. The government expects to raise tax on tobacco and commit a record A$50bn in infrastructure investment between 2013-14 and 2019-20 for roads, rail, airports and dams. Fiscal deficit is estimated to be around -2.2% of GDP for 2016-2017 before gradually narrowing towards -0.1% by 2019-20. Real GDP is estimated to be 2.5% this year before accelerating to 3% for the next 3 subsequent fiscal years. One of the key plans is the Ten Year Enterprise Tax Plan meant to boost new investment, create and support jobs ad increase real wages. The Plan will see lower tax rates for small businesses first before progressively extending cuts to all companies by 2026-27. For personal tax, the government will also lift the tax threshold on the middle tax bracket to prevent average full time wage earners from moving into the second top tax bracket. This could serve to boost consumption in the long run.
- Current account deficit came in at a narrower -A$15.5bn for 2Q versus previous –A$14.9bn in 1Q (which was revised a lot lower). Worth noting is that the imports of general merchandise and capital goods have been on a decline. The latter underscores the lack of investment that belies the narrower current account deficit recently.
- **Key domestic events and issues to watch:** RBA decides on cash target rate on the 4th. Building approval for Aug is also due that day. Trade on the 6th. NAB business surveys are due on 11th. Minutes of the Sep meeting is due on the 18th.Labour report is due on the 20th. 3Q CPI is due on the 26th.
- **Technical Outlook:** We see potential for this pair to break the 0.76-figure. This pair has been in a consolidation mode within 0.7450-0.7750 and is poised to finish the week with a weekly shooting star candlestick which may herald a bearish reversal. For a pair that has been in consolidation, there is certainly more room to the downside at this point as well. On the chart, support is seen at 0.7520 (38.2% fibo retracement of the May-Aug rally) before the next at 0.7450 (50% fibo). 0.77 is still a strong barrier for this pair.

NZD: Bias to Sell on Rallies

Forecast	4Q 2016	1Q 2017	2Q 2017	3Q 2017
NZD/USD	0.7100 (0.7000)	0.7300 (0.6900)	0.7200 (--)	0.7500 (0.7200)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** We expect NZD to trade the range of 0.71 – 0.74 over the next few weeks. While yield differentials in the G7 space continues to keep NZD generally supported, we expect rising markets' expectation for the potential of 25bps rate cut at Nov RBNZ meeting, risk of Trump win at US Presidential Elections and eventual pricing of Fed rate hike in Dec to moderate gains on the Kiwi.
- On the upcoming RBNZ meeting in Nov (the last for 2016 and coincides with quarterly MPS), market expectations for a 25bps rate cut (due to falling inflation) are building up but we prefer to wait for further price-related data (such as 3Q CPI on 18 Oct, dairy auction prices, commodity prices) before making a call as we still have concerns over rising property prices (and aggressive rate cuts could inflame an overheated property market). We note that recent comments from RBNZ Wheeler suggests that the central bank is not in a hurry to cut rates, despite stressing its desire for lower NZD and reiterating further easing is necessary.
- **Risks to our 1-month outlook:** We observed that markets are already pricing in 73% chance of a 25bps rate cut at the Nov RBNZ meeting. We caution that a RBNZ no-move could see NZD shorts unwinding and this could lead to Kiwi strength.
- Looking out into 2017, we are revising NZD marginally higher from previous forecasts, due to change in house view for US rate hike trajectory in 2017 (to 2Q and 4Q 2017, from 1Q and 3Q previously) and we expect some NZD weakness during those periods.
- **Growth and Inflation Outlook:** In the RBNZ MPS (22 Sep), RBNZ noted that 2Q GDP growth were consistent with RBNZ's expectations. 2Q GDP was in line with expectations (+3.6% y/y) while Aug Manufacturing PMI slipped to 55.1 (from 55.8 last month). Looking ahead, domestic growth is expected to remain supported by strong net immigration, construction activity, tourist spending, and accommodative monetary policy.
- On the dairy market, dairy prices have been on a rebound since Aug (4 back to back price increases although the recent auction saw only a 1.7% jump, much lower from the 12.7% jump in 16 Aug auction). Cumulatively dairy prices have risen nearly 32% since Aug 2016 and are at their highest level since Mar 2015. Fonterra has also raised its forecast payout to farmers by 50cents/kg to $5.25. The breakeven price is about $5/kg. In the general scheme of things, these are signs to suggest the dairy sector is stabilizing after a sharp decline in prices in 2015.
- Subdued global environment continues to dampen inflationary pressures in NZ. This is especially so as spare capacity contributed to the decline in commodity prices and strong NZD exchange rate translated into lower import prices, suppressing tradables inflation

(negative since 2012), and weigh on headline inflation (now at 16-year low and below RBNZ's 1-3% target range). The outlook for low inflation is expected to persist for longer. RBNZ cautioned there remains a risk of further declines in expectations stemming from persistent low inflation.

- 2Q headline CPI rose 0.4% q/q (vs. +0.2% in 1Q) and 0.4% y/y (unchanged vs. 1Q). 3Q CPI is due for release on 18 Oct, and a lower than expected print could intensify rate hike expectations and pressure the Kiwi lower.
- **Monetary Policy Forecast:** Markets are now pricing in 73% chance of a 25bps cut to OCR (to take it down to 1.75%) at the 10 Nov RBNZ meeting. We think the **risk of a rate cut is rising, but we prefer to wait for further data (such as 3Q CPI on 18 Oct, dairy auction prices, commodity prices) before making a call as we still have concerns over rising property prices** (aggressive cutting could inflame an overheated property market). While RBNZ has been stressing the desire to have a lower exchange rate and that further easing is required, we also noted that RBNZ Governor Wheeler is not in any hurry to cut rate (as seen from his speech on 23 Aug - "*Rapid ongoing decreases in interest rates would likely result in an unsustainable surge in growth, capacity bottlenecks, and further inflame an already seriously overheating property market. It would use up much of the Bank's capacity to respond to the likely boom/bust situation that would follow, and place the Reserve Bank in a situation similar to many other central banks of having limited room to respond to future economic or financial shocks.*").
- There is **no RBNZ meeting scheduled in Oct**, we will update our RBNZ rate call for Nov meeting in due time.
- At the 22 Sep RBNZ meeting, RBNZ kept OCR on hold at 2%, as *expected*. RBNZ again noted "*The **trade-weighted exchange rate is higher than assumed in the August Statement**. Although this may partly reflect improved export prices, the **high exchange rate continues to place pressure on the export and import-competing sectors** and, together with low global inflation, is causing negative inflation in the tradables sector. A **decline in the exchange rate is needed**.*". RBNZ reiterated that "*Monetary policy will continue to be accommodative. Our current projections and assumptions indicate that **further policy easing will be required** to ensure that future inflation settles near the middle of the target range.*"
- **Latest Fiscal and External Balance Outlook:** 2Q current account swung back into deficit of NZD945mil (vs. NZD1.184bn revised surplus in 1Q). Record spending by New Zealanders overseas was cited as the main reason behind the surprise deficit. NZ's net external debt position increased to NZD141.6bn (about 56.3% of GDP).
- NZ government posted a larger-than-expected operating surplus of $2.3bn in the first 11 months of the financial year. This was above the $1.98bn forecasted in the Budget update and suggests that the forecast full-year surplus is likely to be achieved.
- **Key domestic events and issues to watch:** Sep commodity prices (5 Oct); 3Q CPI (18 Oct); Sep trade data (27 Oct). GDT auctions on 4 and 18 Oct.
- **Technical Outlook:** September was a month of 2 halves for the NZD - rose as high as 0.7486 but reversed gains into month-end. Last seen at 0.7280 levels. Price action on the weekly chart suggests a rising wedge formation (typical bearish reversal). Bullish momentum on weekly chart is showing signs of waning while stochastics is showing

signs of turning lower. Daily momentum remains bearish. Key support at 0.7230 (50 DMA). Break below targets 0.7130 (100 DMA). Resistance at 0.7310 (21 DMA), 0.7360. Bias remains to sell on rally.

JPY: A Crisis In Confidence?

Forecast	4Q 2016	1Q 2017	2Q 2017	3Q 2017
USDJPY	105 (112)	103 (112)	106 (114)	105 (--)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** The bounce that was hoped for after the BOJ's 20-21 Sep meeting failed to materialize. The "Quantitative & Qualitative Easing (QQE) with Yield Curve Control" failed to impress market and was instead seen as a stealthy way of removing easing measures. The more gradual pace of Fed rate hike trajectory is also not doing the USDJPY any favors. The subsequent unwinding of long USDJPY positions saw the pair slide towards the 100-levels. The JPY has gained 3.1% against the USD so far in Sep.
- Most recent data from CFTC showed that speculators continued to increase their net long-JPY bets in the week of 20 Sep. Such bets increased to 58,785 contracts from 56,846 contracts the week before. Since the start of the year, net long-JPY positions have been favored compared to previous years where bets have been net short-JPY. More net long-JPY bets are likely in the aftermath of the failure of the BOJ to add further easing measures at its Sep meeting. This should pressure the USDJPY lower.
- The new policy framework of QQE with Yield Curve Control is an unprecedented experiment in monetary policy. The BOJ attempts to control both the short- and longer-term interest rates in an effort to prevent further NIM compression to bring relief to banks, lifting their share prices and hence the stock market. At the same time, the central bank has set a target of 0% for the 10-year yield and downgraded the target for expanding the monetary base. All of these suggested a possible stealthy move away from further easing, a view likely shared by the market as reflected in the sell-down in the USDJPY.
- Aside from the lack of confidence in the BOJ to achieve the 2% inflation target and in Abenomics in general, also capping upside is the persistent current account surpluses we have previously written about. So in the first seven months of the year, there has been a surplus of JPY12.56tn, possibly matching or even exceeding last year's surplus of JPY16.413 for the full-year. There has been a current account surplus since 1996.
- Should the USDJPY pull back towards the 100-levels and below, it may be the catalyst needed for the BOJ to ease policy further by cutting interest rates and/or increasing its asset purchase of ETFs and J-REITs at either of its last two meetings of the year. This could be supportive of the USDJPY towards the end of the year.

- The failure to introduce additional easing measures suggests that a more gradual climb in the USDJPY can be expected ahead. Even a hawkish Fed is unlikely to provide enough of a catalyst to push the USDJPY much higher beyond the 105-106 levels in the next 6-12 months. Moreover, the persistent current account as discussed above should also cap USDJPY upside. Given these market developments, we now look for the USDJPY grind gradually higher towards 105 by end-2016 underpinned by a Fed rate hike in Dec (our house view) and possible moves by the BOJ to ease policy further. Modest Fed rate hike expectations in 2017 should help keep the USDJPY elevated around the 105-levels by end-3Q17.
- **Growth and Inflation Outlook:** Economic growth has yet to gain traction with the economy expanding by just 0.2% q/q annualized in 2Q. High frequency data does not point to any significant change in the outlook ahead – growth remains lackluster. Industrial production and core machinery orders remained in the doldrums, contracting by 2.1% and 6.5% y/y respectively in the first seven months of the year. Similarly, external demand remains a drag with exports and imports contracting by 9.5% and 18.2% y/y respectively in the first eight months of the year. A bright spot though was capital spending (ex-software), which rose by 3.1% y/y in 2Q, though this was a moderation from the 1Q's 4.3% increase. The supplementary budget of JPY4.52tn for FY2016, which is expected to come into effect by Oct, should help bolster the economy into 1Q 2017.
- Anchoring inflationary expectations continues to be a challenge for BOJ. Headline inflation fell for the sixth consecutive month in Aug by 0.5% y/y (Jul: -0.4%), while core inflation (headline less fresh food) slipped 0.5% y/y in Aug, the same pace as in Jul. At its 21 Sep policy meeting, the BOJ reiterated its commitment to achieve the 2% inflation target as soon as possible, an open-ended deadline instead of the rigid timeframe previously. Nevertheless, BOJ governor Kuroda in his post-meeting press conference has said that the BOJ still intends to achieve the target by FY2017, but conceded that it has "high uncertainties". Market remains skeptical as well of the target being achieved especially after the failure to add further easing measures. Still the preliminary agreement among OPEC members to restrict oil output should lift global oil prices and help anchor inflationary expectations.
- **Monetary Policy Forecast:** The BOJ did not overwhelm the market with its policy decision on 21 Sep. It has chosen now to take a longer term perspective in achieving its 2% inflation target and at the same time, taking note of the cost and benefit of existing easy policy measures. This has resulted in a re-jig of the policy framework to "QQE with Yield Curve Control" to focus on ensuring a 'normal' yield curve (see Table 1 below). This entailed the BOJ controlling both short-term and long-term rates.
- There is no longer a monetary base expansion target, though the BOJ expects the pace of JGB purchased to be "more or less in line with the current pace … of JPY80tn" and the average maturity target of JGB holdings will be scrapped. In the short-run, the pace of increase could fluctuate as the BOJ aims at controlling the yield curve. In the longer-run though, the BOJ expects to expand the monetary base until price stability target of 2% is stable.
- The new "twist" to the BOJ policy framework includes measures to ensure that the 10-year yield stays around the 0% region through purchases of JGBs, conducting fixed-rate purchase operations (i.e. outright purchases of JGBs with yields the BOJ designates) and fixed-

rate funds-supplying operations for a period of up to 10-years (from 1 year currently).

- Despite market skepticism, there remains policy space for the BOJ to add to its easing measures. With the central bank now focused on the yield curve and no longer constrained by expansion of the monetary base, short-term rates can be pushed lower. We could see the rates cut to -0.3% from -0.1% currently. At the same time, asset purchases of ETFs and J-REITs and other instruments could be possibly increased to JPY10tn from JPY6tn currently. We could see this move as soon as Nov (there are two more BOJ meetings for the year).

Table 1: BOJ's New Policy Framework - QQE with Yield Curve Control - What's New?

QQE with Yield Curve Control	Measures
1. Monetary base expansion	No longer fix target but that the pace of increase could fluctuate in the short run but **will expand monetary base until inflation is stable above 2%**
2. Asset purchases	Continuation of purchases of ETFs and J-REITs at an annual pace of about JPY6tn and JPY90bn respectively
3. Interest rate	Interest rate on the policy-rate balances in current account held by financial institutions at BOJ still at -0.1%
4. Yield curve control	*Longer-term interest rate*: **(a) Purchase JGBs so that the 10-year yield is around 0%** (b) The amount of JGBs to be purchased more or less around current pace of JPY80tn p.a. **(c) Average maturity target of JGB holdings scrapped** *New Tools*: (a) BOJ will conduct **fixed-rate purchase operations**, i.e. outright purchase of JGBs with yields it designates (b) **Fixed-rate funds-supplying operations** for a period of up to 10-years (extending the longest maturity of the operation from 1 year at present)
5. Inflation target	BOJ is committed to **achieving the 2% inflation target "at the earliest possible time"**

Source: BOJ, Bloomberg, Maybank FX Research

- **Latest Fiscal and External Balance Outlook:** The Diet is meeting in extraordinary session currently where a slew of economic policies as well as a constitutional amendment will be debated. Of note among the bills to be considered by the Diet is the second supplementary budget for the current fiscal year ending March. The supplementary budget plan of JPY4.52tn could be implemented as soon as the middle of next month once it has legislative approval has been given by the Diet. As we had written previously, JPY713.7bn will be used to enhance welfare measures including supporting childcare and distributing cash to low-income earners to boost consumer spending. Another JPY1.41tn will be set aside for infrastructure improvement to attract foreign tourists to Japan and promote agricultural exports. The government also intends to increase low-interest government loans – zaito – by JPY1.5tn to bring forward the launch of the high-speed maglev train services between Tokyo and Osaka from 2045 and another JPY828bn to accelerate construction of shinkansen bullet train lines on other routes.

- After narrowing to JPY0.97tn in Jun, the current account surplus widened to JPY1.94tn in Jul. This was attributable to the larger surplus in the primary income account of JPY1.69tn in Jul compared to JPY0.42tn in Jun. The surplus in the goods and services account narrowed to JPY0.39tn in Jul from Jun's JPY0.60tn. The financial account surplus ballooned to JPY3.67tn in Jul (Jun: JPY1.45tn) due to turnaround in the other investment segment. The other investment segment registered a surplus of JPY0.55tn in Jul compared to a deficit of JPY1.25tn in Jun. Consequently, the overall balance of payments surplus widened to JPY7.35tn in Jul from JPY2.90tn in Jun.

- **Key domestic events and issues to watch:** 2Q Tankan survey results are out on 3 Oct. Final GDP print for 2Q will be released on 8 Sep. The 66-day extraordinary session of the Diet that began on 26 Sep and end 30 Nov will see the debates and ratification of the TPP, the second supplementary budget for the current fiscal year ending Mar 2017 as well as working practices reforms and minimum wage increases of JPY25/hour. More controversially, there are plans afoot to amend the war-renouncing article in the constitution. JGB auctions in Oct: 10-year (4 Oct), 30-year (12 Oct), 5-year (14 Oct), 20-year (25 Oct) and 1-year (18 Oct).
- **Technical Outlook:** While bearish momentum on monthly chart remains bearish, there are some signs of that slowly diminishing. Stochastics is also fast approaching oversold conditions. We had indicated in our last monthly outlook, that weekly momentum is showing tentative signs of turning bullish (and indeed it is bullish bias). Pair was last seen at 101.50 levels. We stick to our bullish bias. Next resistance at 102.30 (50 DMA, upper bound of the bearish trend channel). Break above that could see a move towards 104 (100 DMA), 108 levels. Support remains at 100 (interim double bottom).

CNY: Limited Slides Against the USD

Forecast	4Q 2016	1Q 2017	2Q 2017	3Q 2017
USD/CNY	6.67 (--)	6.65 (6.70)	6.72 (--)	6.70 (--)
USDCNH	6.67 (--)	6.65 (--)	6.72 (--)	6.70 (--)

No Change From Previous Forecast

- **Motivation for the FX View:** USDCNH is poised to remain bid for the rest of the year as volatility picks up and markets reposition for a Fed hike in Dec. While risks are certainly leaning towards a hike by year end, as indicated by the implied Fed Fund rates, the probability at 55% suggest that bets are somewhat half-hearted and there is still some room for USD bulls. Capital outflow will persist in the face of more risk events but we also want to keep in mind that China has been garnering interest in its domestic financial markets. The recent opening up of the China interbank bond market (CIBM) to a wider array of institutional investors has seen more reforms that are done in the right direction. PBoC has recently permitted CDS trading so as to offer investors a form of insurance against corporate bond defaults. The year has seen more cases of defaults compare to 2015 which could lead to a better pricing of credit risk. In addition, the allowance of CDS trading also signals that the government would allow more defaults to happen since investors are now able to insure themselves from a default event. That has lifted the 5Y CDS from its recent lows. The National Association of Financial Market Institutional Investors also intends to increase the requirements for bond issuance including a clause to require immediate repayment if a company's owner changes or if a firm sells its main income-earning business. Debt-limit metrics and cross-default triggers are also likely to be included in future requirements which should lift the quality of the massive bond markets and attract foreign interest in its interbank bond market. That should temper the USDCNY upmove and keep USDCNY under 6.70 this year.

- On 1 Oct, CNY will be officially included in the SDR basket after 10 months of preparation for technicalities of the inclusion itself. The inclusion per se should not have material impact on CNH or CNY but the recent issuance of the SDR-denominated bonds by China Construction Bank underscores how the renminbi's inclusion can drive "the use of the SDR" at home and potentially, abroad.

- **Our monthly Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) showed the score for China has improved marginally to 5.3 from previous 4.4 (with 1 being the best and 9 being the worst) due to a softer inflation relative to Asian peers.
- **Growth and inflation outlook:** Leading indicators like the Caixin PMI-mfg pared to 50.0 from 50.6 while the official version bounced to 50.4. The breakdown of the NBS PMI-mfg shows that only large firms are registering expansion. Aggregate financing also rebounded to CNY1.47trn with total loans doubling from the previous. Strong credit support seems to be the major underpinning of recent PMI readings.
- Managing growth stability, yuan stability and deleveraging with stability is a challenging juggling task. There has been a lot of credit-driven growth recently so short-term growth stability is somewhat secured, perhaps just to meet China's growth target for the rest of the year. However, the loose monetary policy has also spurred higher property prices and raised the profitability of sectors that have excess capacity. Aug industrial profit jumped 19.5%y/y. Non over-capacity sectors also benefitted, but to a lesser extent. All three activity also saw improvement in Aug. Industrial production rose 6.3%y/y from previous 6.0%. Retail sales also accelerated to 10.6%y/y from 10.2%, on the back of better automobiles sales, office supplies, construction materials. Even urban FAI quickened to 8.1%y/y vs. previous 7.9% with investment mostly made in the primary industry. Railway transportation rebounded into positive growth of 8.1%y/y from the previous decline of -30.4%y/y, suggesting that the fiscal spending may be taking effect in the economy.
- Deleveraging seems to have taken a backseat until recently. The rise in onshore interbank rates seem to sending a signal that PBoC wants to keep money market rates elevated to drive their message of prudent monetary policy in the face of the hot property market. To note, there has been an exponential rise in the overnight interbank turnover to record high of USD9.4trn and the central bank is trying to reduce the reliance of the overnight funding by injecting yuan liquidity via longer tenor reverse-repo like the 14-day and 28-day. The overnight interbank makes 88% of the total interbank volume as of Aug. By increasing the funding cost, banks will be forced to manage their cash flows more efficiently. That is starting to be reflected in the 3-month SHIBOR which rose to 2.8% from its Sep low of 2.78%. We anticipate this phenomenon to continue into the last quarter of the year.

- Inflation softened to 1.3%y/y for Aug from previous 1.8% on lower food costs. PPI also saw a smaller contraction of -0.8%y/y compared to previous -1.7%. Meanwhile, the Alibaba Core Shopping Price seems to show a deflationary picture with only food inflation supporting the negative headline of -0.66%y/y for Aug. Prices of clothes, transport/communication, entertainment, office appliances declined in Aug year-on-year. Expect inflation pressures to remain benign for the rest of the year.
- We are cautiously optimistic about the economic data. The recent announcement to cut consumption tax rate for “luxury cosmetic products” by half to 15% could boost private consumption and income at home. Home mortgage loans continued to rise in 2Q on the back of easy monetary conditions within individual residential loans rising 32% from the last quarter. Macro prudential measures should remain in place. The growth in the real estate sector should continue to have positive spillover effects in mining, construction, consumer goods and real estate services.
- **Monetary Policy Forecast:** We stick to our view that PBoC will use pledged supplementary lending, medium term lending facility and standing lending facility to supply credit to the targeted sectors that require more liquidity support. Broad based RRR cuts may risk generating flows to assets that are prone to bubbles (real estate in the tier-one property sectors), undo deleveraging efforts in the economy and increase downside pressure on the CNY. The government has been implementing cooling property measures.
- Aug saw less additional liquidity boosts via the medium term lending facility, about CNY289mn vs. Jul’s CNY486mn. An estimated CNY 871.6bn of liquidity was also injected via open market operations, the most seen since Jan. That was likely to bring down the 7-day repo rates which spiked above 3.24% in Aug. Rates still elevated as we write, around 2.9%. We anticipate rates to remain elevated. For the past month, the China sovereign curve has flattened with the front end rising around 12bps for the 3M. The 3Y and 30Y yield has slipped 2bps and 4bps respectively. The flattened yield curve is meant to discourage arbitrage activities.
- **Latest Fiscal and External Balance Outlook:** There has been some estimates floating around that the budget deficit for 2015 was three times the official print at 10% of GDP in 2015. Official statistics have shown that growth of government expenditure is still likely to head higher as the government works to pump prime the economy with infrastructure investment. The recent tax overhaul which moves construction, property, finance and consumer service sectors under the value-added structure could mean less revenue for the local governments. The central government plans to increase budget deficit to redistribute the VAT revenue back to provinces. Small businesses with less than CNY500,000 in annual sales will drop to 3% from 5%.
- Current account surplus widened to U$59.4bn from previous U$39.3bn in the quarter prior. The outflow via its capital accounts was much lower at -U$30mn vs the previous -U$112.2mn amid capital account controls. The latest release of BOP for 1Q 2016 show that there has been capital inflow via trade credit, deposit and currency in the period. Loans outflow has resumed in the first quarter of the year, suggesting that banks are lending to overseas entities. We expect outflows to resume this month but existing capital control and a lack of aggressive fed tightening suggest that outflows should be manageable.

- **Key domestic events and issues to watch:** Caixin PMI-mfg is due on 30th Sep. Final current account for 2Q is due as well. Into Oct, NBS PMI-mfg and non-mfg are due on the 1st. Foreign reserves is scheduled for release on the 7th. Trade is due on the 13th. CPI and PPI on the 14th. Liquidity prints are due anytime from 10th-15th. Activity data is due on 19th along with 3Q GDP. Property prices are eyed on the 21st. We also like to watch Jun industrial profits due on the 27th.
- **Technical Outlook:** This pair has downside potential into Oct as weekly chart shows MACD tilting into the negative. However, stoch is still bullish so we reckon downmove could be a grind. Upsides capped by strong barrier around 0.7034 before the next at 0.7198 (Jul high) and then the Jan high of 6.7620. Support is seen around 6.6550 before 6.6100.

KRW: Gains Are Expected to Moderate

Forecast	4Q2016	1Q 2017	2Q 2017	3Q 2017
USD/KRW	1130 (1170)	1100 (1170)	1130 (1180)	1100 (--)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** We expect some gains in the KRW over the coming 1-2 weeks in light of externalities: lack of urgency to hike from the Fed (creating a still accommodative monetary conditions environment) and a limitation of outright easing from the BoJ (which is expected to bring about renewed USDJPY downside pressure). KRW enjoys a positive correlation with the JPY (correlation coefficient at above 0.80 YTD). We expect some USDKRW downside pressure towards 1090 (2016 lows) in the coming days. We caution a move towards 1065 levels should not be ruled out, should risk appetite jumps.
- **But gains in KRW are likely to moderate** as we expect BoK to smooth excessive one-way moves and KRW could turn weaker (vs USD) in the lead-up to the next US FoMC meeting (1 - 2 Nov) and US Presidential Elections (8 Nov). We also see rising risk of BoK cutting rate by 25bps to another record low of 1% as early as on 13 Oct MPC meeting, in light of renewed concerns of disinflation and potential slowdown in growth momentum due to corporate restructuring plans and Hanjin Shipping incident (may lead to more layoffs and weigh on investments). But we note that this is an out-of-consensus call as BoK may opt to wait for more data (such as 3Q GDP on 25 Oct) before deciding whether to cut rates.
- Taking into consideration the factors above, we expect downside to stay supported at 1190 (with a risk of extension towards 1065 should appetite for risk jumps and inflows into equities intensify). But pair to eventually rise towards 1120, 1130 levels into end-Oct.
- **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 held steady at 6.1.

- **Growth and Inflation Outlook:** 2Q GDP accelerated +0.8% q/q; +3.2% y/y, better than previous quarter of +0.5% q/q and +3.3% y/y. Expansion was helped by private consumption and capital investment. We believe the growth momentum for 2H may slow on corporate restructuring plans which are expected to see some short term pain due to job cuts, impacting growth.
- BoK had earlier lowered 2016 GDP growth to 2.8% (from 3%) and inflation forecast to 1.2% (from 1.4%), due to weaker than expected domestic economic growth in 1Q 2016 and downward revision to global economic growth.
- Aug headline inflation increased at its slowest pace (-0.1% m/m) in 16 months, owing to housing/utilities and transport. On Y/Y basis, CPI rose 0.4% y/y (from 0.7% in Jul). Core inflation also slumped to 1.1% y/y (vs. 1.6% in Jul).
- **Monetary Policy Forecast:** We see rising risk of BoK cutting rate to 1% as early as in Oct, in light of renewed concerns of disinflation and potential slowdown in growth momentum due to corporate restructuring plans and Hanjin Shipping incident (may lead to more layoffs and weigh on investments). Risks to our out-of-consensus call is BoK may want to wait for more data (such as 3Q GDP which is only released on 25 Oct) to confirm that growth momentum is waning, to avoid cutting rate aggressively as household debt is rising and to conserve monetary policy tools to fend off adverse economic conditions (if any).
- At the previous meeting on 9 Sep, BoK kept policy rate on hold at record low of 1.25% for the third consecutive time. BoK said the Board will conduct monetary policy so as to ensure that the recovery of economic growth continues and CPI approaches the target over a medium term horizon while paying attention to financial stability, trend of increase in household debt, changes in the monetary policies of major countries and the progress of corporate restructuring.
- **Latest Fiscal and External Balance Outlook:** Current account surplus narrowed to the lowest level in 3 months to US$8.71bn in Jul (from record levels of $12.17bn in Jun), due to widening of service balance deficit and lower primary account.
- Fiscal deficit for 2017 is expected to improve to 1.7% of GDP, from deficit of 2.3% of GDP this year (expected). Next year's budget will focus on creating more jobs (but did not give a specific number) and increasing spending for health, welfare and labor. The government plans to reduce deficit to 1% of GDP by 2020. Sovereign debt will stand at 40.4% of GDP in 2017, compared with 40.1% this year.
- **Key domestic events and issues to watch:** S. Korea releases Sep trade data (1 Oct); CPI (5 Oct), BoK meets (13 Oct) and 3Q prelim GDP (25 Oct).
- **Technical Outlook:** USDKRW tested multi-month low of 1091 (29 Sep) for the third time this year before rebounding. Last seen at 1098 levels. Bearish momentum on weekly chart is waning while stochastics is near oversold conditions. There could be some rebound risks towards 1126 levels (neckline of the H&S pattern and also the 50% Fibonacci retracement of 2014 low to 2016 high) before 1140 (21, 100 DMAs). We caution a break below 1090 support could trigger further downside towards 1065 levels.

SGD: Antsy Awaiting MAS

Forecast	4Q 2016	1Q 2017	2Q 2017	3Q 2017
USDSGD	1.3750 (--)	1.3800 (--)	1.3850 (--)	1.3850 (--)

No Change From Previous Forecast

- **Motivation for the FX View:** In Sep, the USDSGD has oscillated between gains and losses while on the slow grind higher with the pair broadly tracking USDJPY movements, given the strong correlation of the USDSGD to the USDJPY. Concerns about the fall-out from a Deutsche Bank collapse affecting the financial markets, increasing risk of higher global oil and expectations of a US Fed fund rate hike in Dec are lifting the USDSGD higher. Nevertheless, pair has come off from the high of the month at 1.37-levels. This has allowed the SGD to rise marginally about 0.1% against the USD so far in Sep. Year-to-date, the SGD is still up 4.5% against the USD.
- We continue to expect the USDSGD to grind higher at a more gradual pace for the rest of the year, barring any surprises from the MAS or external events. Though detailed breakdown of foreign portfolio flows is not available, an examination of government debt yields in Sep showed that yields have generally risen across the board by 3.57-11.53bp except for the 1Y which slipped 1.6%. This suggested that there was some sell-off in government debt by foreign funds, weighing on the SGD.
- As well, domestic challenges persist for the next year or two. The ongoing economic restructuring of the economy and property curbs is likely to constrain growth ahead. Still lackluster global growth is also weighing on export-oriented industries. All of these should continue to see a softer labor market. Already the overall and resident unemployment rate has increased to 2.1% and 3.0% respectively in 2Q from 1.9% and 2.7% in 1Q. It is in this unfavorable environment that Deputy PM (DPM) Tharman warned that growth could be below the normal 2-3% for the next few years. He also suggested that growth could come in at the lower half of the 1-2% forecast range, more pessimistic than what private sector analysts are expecting.
- Still, a recessionary situation is not envisioned as the economy should find support from expansionary fiscal policy. In its budget for FY2016, the government intends to spend SGD5bn - higher than FY2015's total spending - that should prevent the economy from sliding below the lower bound of the government's 1-2% growth forecast range for 2016. Unlike DPM Tharman's outlook for the economy in 2016, our economic team is more sanguine and expects the economy to expand by 1.8% in 2016 and at a similar pace in 2017.
- On the monetary front, while the hurdle for another move by the MAS has been set lower as a result of the previous two easing moves, a further easing move is not our base scenario for now. Though a negative output gap remains and the risk of a further slackening of the labor market amid a weak global economic environment, most of these have been within MAS expectations. Most of these economic concerns can be dealt with better with fiscal and manpower policies rather than monetary policy. Hence, the MAS is expected to maintain

its current neutral policy stance until its next monetary policy meeting in Apr 2017, barring a significant deterioration in the global economy or shift in the core inflation outlook. Standing pat on policy should be supportive of the SGD and keep the USDSGD on a slower grind higher.

- Expansionary fiscal policy, accommodative monetary policy as well as its triple-A status and persistent balance of payments surpluses should backstop the USDSGD and moderate the pair's climb higher. These though are unlikely to offset completely the impact of a Fed fund rate hike expected at the end of the year and further easing moves by BOJ. We should continue to see the pair edge higher towards 1.3750 by end-2016. The pair should continue its gradual upward trajectory in 2017 on modest Fed rate hikes expectations that could see the pair end-3Q 2017 at 1.3850.
- **Our monthly Maybank Vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for Singapore was unchanged at 4.3 from the previous month. This was due to an improvement in current account and reserves risks that offset the deterioration in fiscal risk as there were no changes to its risk profile. This should be supportive of the intrinsic value of the SGD. Our model shows that the SGD NEER was last seen 0.498% below the mid-point implied at 1.3587. Upper bound is implied at 1.3314 while lower bound is now at 1.3860.
- **Growth and Inflation Outlook:** Despite the bright 2Q growth, the outlook for the economy for the rest of the year is less sanguine. Deputy PM Tharman expects growth to come in below the normal 2-3% for the next few years. As for 2016, growth could come in at the lower half of the 1-2% forecast range, more pessimistic than what private sector analysts are expecting. This reading of the economy by the DPM follows lackluster domestic data. In the first eight months of the year, industrial production remains in negative territory though mildly at -0.1% y/y, while non-oil domestic exports was down 4.9% y/y over the same time frame. At the same time, services faces challenges as well from possible slowdown in tourist arrivals and wholesale trade on the back of slower global growth/demand, while financial services could be weighed by financial markets volatility and in particularly from any fallout from a Deutsche Bank collapse. Given these developments, our economic team expects growth to come in at 1.8% for both 2016 in contrast to DPM Tharman's less optimistic forecast. Our team expects real GDP to expand by 1.8% in 2017.
- Headline inflation remains in negative territory for the 22 consecutive months. Headline inflation fell by 0.3% y/y in Aug, a more moderate pace than the -0.7% recorded in Jul, due to a smaller drop in the private road transport cost. MAS core inflation (CPI ex-accommodation and private transport) was unchanged at 1.0% in Aug – the same pace as Jul – as the uptick in services inflation (Aug: 1.7% y/y) was offset by the more moderate rise in food prices (Aug: 2.0%). There was no change to the MAS outlook for both headline and core inflation with imported inflation expected to remain muted and slower wage inflation given the reduction in labor market tightness. The pass-through of wage costs to consumer prices remains constrained by the subdued economic growth environment. MAS continues to expect headline and core inflation to come in at -1.0-0.0% in 2016 and around 1.0% respectively in 2016. MAS expects headline inflation to return to positive territory and move towards 1.0% in 2017. Our economic team maintains its headline inflation to average -0.4% in 2016 and expects core inflation to come in at +1.0%

in 2016 as disinflationary effect of oil and budgetary and other one-off measures fade.

- **Monetary Policy Forecast:** The two easing moves by the MAS since 2015 suggest that the hurdle for an adjustment has been lowered. Even then, we do not expect the MAS to be blasé about its next policy decision. The economy still faces a negative output gap and there is a risk that the labor market could slacken further amid a weak global economic environment. Nevertheless, we believe that most of these concerns have come in within MAS expectations. In addition, some of these issues are best dealt with fiscal, manpower and other policies rather than monetary policy. Hence, the likelihood is for the MAS to maintain its current neutral policy stance until its next monetary policy meeting in Apr 2017, barring a significant deterioration in the global economy or a drastic shift in the core inflation outlook.

- Still, the weak outlook for domestic and global growth in 2H as highlighted by DPM Tharman has increased the risks that that the MAS could ease policy further (i.e. re-centering lower) at its Oct meeting. Past episodes suggest that a re-centering is triggered during periods of economic recession. The risk of an MAS move in Oct remains positive but is not significant for now. Our base scenario remains for the MAS to maintain their “zero appreciation of the SGD NEER” stance. The monetary authority had progressively removed the crawl as there was no need for an appreciation path on balance and the medium term path is closer to a constant now than upward sloping given current domestic and external conditions. Unlike past occasions when the slope was flattened swiftly, the recent change in the slope was more gradual and in response to the slow drift to inflation. In the short term, in absence of significant shocks, an adjustment to the NEER band would be unnecessary.

- In the past month, the USDSGD has been on the bounce back above the 1.36 levels from the 1.34 levels but this has not resulted in large swings to domestic interest rates. In fact, domestic interest rates continue its gentle slide lower. The 3-month SIBOR (3MSIBOR) has come off from 0.8732% at the beginning of the month to hover around 0.8724% at the point of writing. The 3-month SOR (3MSOR) has fallen by an even faster pace in Sep to 0.5710% currently from 0.7638% on 1 Sep. Year-to-date, the 3MSIBOR and 3MSOR have fallen by slightly over 30% and nearly 70% from its Jan high of 1.254% and 1.76235% respectively. The relatively low rates suggest that the rise in mortgage rates is unlikely to be significant for now. Deposit rates (for 12-month fixed) have not risen since end-Jan and remains at around 0.35% currently. 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.

- The recent re-pricing of a Fed rate hike risk in 2017 suggests that upward pressure on domestic rates remains gradual. US 3MLIBOR continues to edge higher in Sep, rising by 0.75% to 0.8456 Ample liquidity has so far kept domestic rates from tracking the US 3MLIBOR higher. Still, with US rate hike trajectory on a gradual plane, domestic rates should continue on its slow grind higher. We expect the 3MSIBOR and 3MSOR to end 2016 and 2017 at 1.56% and 1.29% and 2.62% and 2.35% respectively.

- **Latest Fiscal and External Balance Outlook:** The current account surplus widened to SGD20.85bn in 2Q 2016 from SGD18.85bn in 1Q. The larger current account surplus could be attributed to the larger surplus in the goods and services account of SGD27.63bn (1Q:

SGD24.45bn) that offset the increase in the primary balance account deficit of SGD6.78bn (1Q: -SGD5.60bn). The financial account surplus narrowed to USD15.78bn (1Q: SGD26.90bn) as portfolio inflows (2Q: USD25.04bn) and smaller 'others' segment (2Q: SGD26.22bn) that offset the larger outflow of direct and financial derivative investment (2Q: -SGD14.68bn and -SGD9.80bn respectively). The overall balance of payments returned to a surplus of SGD4.76nm in 2Q 2016 compared to SGD8.72bn in 1Q.

- **Key domestic events and issues to watch:** Flash estimates for 3Q 2016 GDP will be released sometime on 10-14 Oct, while MAS bi-annual meeting will be held sometime in mid-Oct.
- **Technical Outlook:** We flagged in our last monthly outlook that USDSGD appeared to have formed an interim base around 1.3350 (2016 low). This level has been tested about 4 times this year (Apr, Jun, and twice in Aug). The pair subsequently moved higher towards 1.37-handle (mid-Sep). Pair was last seen at 1.3630 levels. Weekly momentum remains bullish bias. We expect further upside and remained bias to buy on dips. Resistance at 1.3720 (200 DMA), 1.3770 (38.2% fibo retracement of 2016 high to low). A stretch towards 1.39 (50% fibo) cannot be ruled out. Support at 1.3550 (100 DMA), 1.34 levels.

MYR: Extended Weakness before Strength

Forecast	4Q 2016	1Q 2017	2Q 2017	3Q 2017
USD/MYR	4.1000 (4.0000)	4.0000 (3.9500)	4.1000 (3.9500)	3.9500 (--)

No Change from Previous Forecast

- **Motivation for the FX View:** Over the past 1 month, MYR has generally weakened, as oil prices fell on average, USD mildly stronger overall despite negligible domestic idiosyncratic risks.
- USDMYR traded as high as 4.1600 (21 Sep). It has broken the 3.98-4.15 range we called for, over the past few months. We still think it should be capped at 4.20 unless there are Fed surprises leading to a strong dollar scenario. And we think this weakness could still persist in the short term but solid underlying fundamentals and policies {backed by domestic demand, re-calibrated 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 ratio of 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 subsided.
- We note that **oil prices may face some downside pressure in the near term as refiners have already finished stocking for the summer (now to Oct) season. On the big picture, oil supply-demand is projected by EIA to rebalance further over the next 1 year. Oil surplus supply is also winding down due to the lack of capex in the last 18 months while seasonal demand for winter in 4Q should see oil prices picking up.** We still expect oil prices to see support around

$40-42/bbl. Hence it is **not our baseline scenario to see MYR suffer another round of high-single digit rout** (in 3Q 2015 – end-2015).

- We do expect to see broad but modest USD strength into 2H 2016, as we head into US Presidential Elections in Nov (which typically saw USD strength in the lead-up and post-Elections). Some post-*Brexit* uncertainty (on timing of trigger of Article 50, trade talk negotiations with EU and other trade partners) is also expected to weigh on sentiment and keep the USD modestly supported. Risk of potential Fed rate hike in Dec 2016 (now our base case scenario with some risk of a Sep hike first) could also see a firmer USD in the lead up to the Dec meeting. While all the above factors (Presidential Elections, *Brexit uncertainty and Fed rate hike)* may keep the USD supported, investors' hunt for attractive yields could continue to see inflows into local bond markets and counteract to support the MYR, mitigating the upside pressure in the pair.
- We continue to caution for USDMYR to trade in wide ranges. 4.15/4.20 should keep the lid on USDMYR (assuming that oil prices do not fall more than 15%). **We slightly revise our FX forecasts over the forecast horizon, and slightly increase the USDMYR forecast for end 2016 to 4.10 to reflect some of the recent bond, commodities and USD developments.**
- **Our fair value estimate (which takes into account interest rate differential, inflation differential, current account differential and reflation variables) puts USDMYR at 3.55 levels.** We had previously said that Ringgit weakness was temporary and was not a reflection of underlying fundamentals (which remain intact). We still expect to see some stability returning to Ringgit as political/contingent liability risk subsides, fiscal consolidation/reforms gains traction, oil prices stabilize and uncertainty and likelihood of Fed rate hike subsides for the next 6 months.
- External reserves at end-Aug 2016 were the same as at mid-Aug 2016 i.e. USD 97.5 (MYR391.9b), which is slightly higher than USD97.3b (MYR391.1b) at end-July 2016. The current level is the highest since July 2015, and equals 8.1 months of retained imports and 1.2 times of short-term external debt.
- Foreigners were net buyers of Malaysian equities in Aug 2016, totaling +MYR1.6b, sustaining the +MYR1.0b net buying in July 2016.On weekly basis, according to the latest data released by Bursa, foreigners turned net sellers in the week ended 2 Sept 2016 totaling -MYR193.1m, the first net selling after eight consecutive weeks of net buyings. No update yet on foreign net buying/selling in the Malaysian bond market in Aug 2016. In July 2016, foreigners were net buyers of +MYR5.7b, the same as in June 2016.
- **Our monthly Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for Malaysia worsened to 5.1 in Sep (vs. 4.9 in Aug), due to owing to inflation.
- Malaysia's current account surplus narrowed in 2Q 2016 to MYR1.9b or +0.6% of GDP (1Q 2016: +MYR5.0b or 1.7% of GDP) on smaller goods account surplus and wider income account deficit but as we calculated the score on a relative basis, the improvement suggests that other current account in Asia fared worse than Malaysia. Our economics team full-year forecast for the current account is +MYR24.3b or 2.0% of GDP.
- **Growth and Inflation Outlook:** 2Q 2016 GDP growth slowed to +4.0% YoY and seasonally-adjusted +0.7% QoQ (1Q 2016: +4.2% YoY; +1.0%

QoQ SA), in line with our and consensus estimates. Broad-based pick up in domestic demand negated the contraction in net external demand. No change in our 2016 and 2017 growth forecasts of +4.1% and +4.5% for now as we closely monitor key domestic indicators and developments in major economies.

- Domestic demand picked up (2Q 2016: +6.3% YoY; 1Q 2016: +3.6% YoY) on faster growth in all components i.e. private consumption(2Q 2016: +6.3% YoY; 1Q 2016: +5.3% YoY), public consumption (2Q 2016: +6.5% YoY; 1Q 2016: +3.8% YoY) and gross fixed capital formation (2Q 2016: +6.1% YoY; 1Q 2016: +0.1% YoY), which reflected firmer private investment (2Q 2016: +5.6% YoY; 1Q 2016: +2.2% YoY) and rebound in public investment (2Q 2016: +7.5% YoY; 1Q 2016: -4.5% YoY).
- Net external demand was a drag (2Q 2016: -7.0% YoY; 1Q 2016: -12.4% YoY) as import growth (2Q 2016: +2.0% YoY; 1Q 2016: +1.3% YoY) outpaced export growth (2Q 2016: +1.0% YoY; 1Q 2016: -0.5% YoY). Another drag on GDP growth last quarter was “change in inventory” which turned negative (2Q 2016: –MYR1.1b; 1Q 2016: +MYR2.4b), indicating inventory drawdowns or corrections, namely in the consumer-related manufacturing industries and the agriculture sector amid the slump in palm oil output.
- Growth picked up in services, mining and construction amid slower manufacturing and deeper decline in agriculture.
- Our Economics team sees no change in our 2016 full-year forecast of +4.1% (1H 2016: +4.1%), implying growth is expected to hover at just over +4.0% in 2H 2016. The projection for 2017 also remains at +4.5%.
- At this juncture, we need to keep a close tab on key high frequency domestic data, namely the monthly economic indicators such as the indices on industrial production and distributive trade, external trade, money and banking statistics, as well as major commodity output and prices. In addition, our eyes are also on the economic trends as well as policy and political developments in the major economies i.e. US, Europe (including UK), China, Japan.
- **Headline inflation rate** picked up by a higher than expected +1.5% YoY (Jul 2016: +1.1% YoY). Core inflation also moved up to +2.2% YoY (Jul2016: +2.0% YoY). YTD 2016 inflation and core inflation are +2.3% YoY and +2.7% YoY respectively. Maintain our 2016 and 2017 inflation rate forecasts of 2.0%-2.5% for both years.
- Inflation rate rose to +1.5% YoY in Aug 2016 (Jul 2016: +1.1% YoY; Maybank-KE: +1.3% YoY; Consensus: +1.3% YoY), while core inflation rate (excluding volatile and price-controlled/price-subsidised components of the CPI) edged up to +2.2% YoY (Jul 2016: +2.0% YoY). The rise in headline CPIwas brought about by faster increases in the prices of services like “Health” and “Recreation Services & Culture” amid slower decline on “Transport” costs and despite the moderation in “Food and Non-Alcoholic Beverages”. Compared to Jul 2016, both headline and core inflation rates edged up by +0.4% MoM and +0.5% MoM respectively. Year-to-date, headline and core inflation rates were +2.3% YoY and +2.7% YoY respectively.
- As mentioned in our July 2016 CPI note last month, inflation in Jul 2015 was the highest for 2015 at +3.3% YoY. The base effect means the +1.1% YoY inflation rate in Jul 2016 could well be the lowest monthly inflation rate for 2016i.e. we do not expect it to go lower for the rest of 2016. The +1.5% YoY inflation in Aug 2016 supports this view and we see moderate inflation for the rest of 2016 at +1.5%-2.0% YoY range for Sept-Dec 2016 period.

- We maintain our full-year inflation rate forecast at 2.0%-2.5%, with expectation that inflation could very well be at the lower end of the forecast range on moderate domestic and external inflationary pressures. The range forecast reflect various factors such as the volatile currency and commodity prices –especially crude oil prices; weather and seasonal effects on food-related commodity and food prices e.g. surge in world raw sugar prices impacting domestic sugar prices; scheduled reviews and the still-pending decisions on "administered prices" like gas and electricity tariffs, PLUS highway toll rates and Indah Water sewerage charges; cost impact of specific domestic labour market policies, such as the hike in levy on foreign workers effective 18 Mar 2016 (Peninsula Malaysia for now) and the Minimum Wage increase on 1 July 2016; and extension of the Price Control & Anti-Profiteering Act to 31 Dec 2016 from 30 Jun 2016, which helps to reduce the risk of excessive price hikes, although pass-through of cost increases and price increases could be more prevalent next year.
- **Monetary Policy Forecast:** As we expected, BNM maintained the Overnight Policy Rate (OPR) at 3.00% after the 25bps cut in Jul 2016. The Statutory Reserve Requirement (SRR) was also unchanged at 3.50%. The tone of the Monetary Policy Statement (MPS) is still "dovish" in our opinion, implying BNM is "risk-aware", "data-dependent" and "event-driven". Therefore, we maintain our OPR forecast of 2.75%-3.00% for end-2016 and end-2017.
- Although BNM expects Malaysia's real GDP to be within the official forecast of 4.0%-4.5% for this year and to remain on steady growth path in 2017, supported by domestic demand, namely consumer spending and investment in infrastructure, manufacturing and services, the Monetary Policy Statement (MPS) is still "dovish" in our opinion as BNM sees downside risk to global economic growth, while global markets are vulnerable to setbacks and changes in sentiments. In addition, domestic inflation this year will be at the lower end of its 2%-3% forecast and to remain relatively stable in 2017.
- The still "dovish" tone of MPS implies to us that BNM is being "risk-aware, data-dependent and event-driven" amid the downside risks to global economy and markets, uncertainty over monetary policy shifts in major economies, and unresolved issues post-EU Referendum in the UK. Therefore, we maintain our OPR forecast of 2.75%-3.00% for end-2016 and end-2017, meaning we are not ruling out the possibility of another 25bps cut in the OPR. The next MPC on 22-23 Nov 2016 will be the last for this year, and is one month after the tabling of the 2017 Budget on 21 Oct 2016 and two weeks after the US Presidential Election on 8 Nov 2016.
- Our Economists are also pricing in the **possibility of another 25bps cut over the next 6 - 12 months,** but **do not expect rapid-fire OPR cuts over the next few meetings as BNM turns "risk aware", "data-dependent" and "event-driven".**
- **Latest Fiscal and External Balance Outlook:** According to the latest revised budget (released 28 Jan), the government aims to maintain its 2016 fiscal deficit at 3.1% of GDP via a series of restructuring steps (operating and development expenditures cuts) that are expected to save the government MYR9bn. Malaysia's fiscal and broader economic outlook could still be under pressure from weaker commodity prices in 2016. **The revised Budget has adjusted lower its oil price assumption to US$30-35/bbl (from $48/bbl).** Downside pressure on rating agencies' 'Stable' outlook could arise in 2H 2016 if oil price

averages below US$30/bbl as that may trigger projection of fiscal revenue shortfall.

- Both exports and imports fell in July 2016by -5.3% YoY (June 2016: +3.4% YoY) and 4.8% YoY (June 2016: +8.3% YoY) as public holiday cut short the working days in the month. Trade surplus narrowed to +MYR1.9b (June 2016: +MYR3.3b).Year-to-date, exports and imports are flattish at 0.3% and 0.4% respectively with trade surplus of +MYR43.7b. Our economics team expects external trade condition to remain challenging in 2H 2016.
- July 2016 trade data was affected by the public holiday following the Eid celebrations in the first week of the month. This was clear from the MoM slumping exports of -9.9% MoM after the +10.9% MoM jump in June 2016, suggesting front-loading of shipments ahead of the festive breaks.
- Furthermore, major manufacturing exports dropped for the first time in 14 months in July 2016 by -2.4% YoY (June 2016: +7.3% YoY). MoM, the major manufacturing exports literally reversed the +9.2% rise in June 2016 by falling -9.3% in July 2016. The main factor was E&E shipments which similarly declined -6.0% YoY and -10.6% MoM (June 2016: +4.9% YoY and +11.7% MoM).
- Other key manufacturing exports were also weaker YoY in July 2016 after posting steady growth in the preceding six months to underscore the “seasonal effect” i.e. chemicals & chemical products (July 2016: 0.0% YoY; June 2016: +9.2% YoY) ; machinery, appliances & parts (July 2016: -2.0% YoY; June 2016: +6.7% YoY).
- Exports to China was the biggest drag as it fell by -22.3% YoY (June 2016: -20.3% YoY) on lower shipments of ‘Machinery & Transport Equipment’ which consists of E&E products (July 2016: -24.9% YoY; June 2016: -17.8% YoY) and‘Mineral Fuels’ (July 2016: -37.8% YoY; June 2016: -50.7% YoY). Japan was another major drag as exports slumpedby -14.5% YoY (June 2016: +2.4% YoY) due toweakerdemand for‘Mineral Fuels’ which is mainly LNG exports (July 2016: -23.6% YoY; June 2016: -12.7% YoY). Shipments to the EU (July 2016: -2.0% YoY; June 2016: +4.1% YoY) wasalso down,pulled by lower exports to Netherlands (July 2016: -12.7% YoY; June 2016: -5.4% YoY) amid slower export growth to Germany (July 2016: +5.9% YoY; June 2016: +19.0% YoY).
- Only exports to ASEAN and US rose in July 2016 i.e. +4.7% YoY (June 2016: +8.5% YoY) and +4.1% YoY (June 2016: +22.0% YoY) respectively. The higher shipments to ASEAN was led by Singapore (July 2016: +5.9% YoY; June 2016: +12.7% YoY), Thailand (July 2016: +11.1% YoY; June 2016: -1.4% YoY)and Vietnam (July 2016: +24.7% YoY; June 2016: +76.6% YoY)which offset the declines in shipments to Indonesia (July 2016: -11.2% YoY; June 2016: -27.2% YoY)and Philippines (July 2016: -14.2% YoY; June 2016: +7.5% YoY).
- **Key domestic events and issues to watch:** Trade data (7 Oct); FX reserves (7 Oct); CPI Inflation (19 Oct), Palm Oil production (10 Oct), Issuance of 20 yr bonds (Oct), Issuance of 3.5yr and 10yr Islamic bonds (Oct).
- **Technical Outlook:** USDMYR traded higher for the month, in line with our caution (in our previous monthly outlook). USDMYR was last seen at 4.1200 levels. Bullish momentum on daily chart is waning while stochastics is falling from near-overbought conditions. Resistance remains at 4.1440 (50% fibo retracement of 2016 high to low) before 4.2170 (61.8% fibo). Support at 4.09 (200 DMA), 4.0700 (38.2% fibo). We see range of 4.07 – 4.15 next month.

IDR: Confluence Of Positive Factors

Forecast	4Q 2016	1Q 2017	2Q 2017	3Q 2017
USDIDR	12950 (13300)	12500 (13200)	12800 (13200)	12600 (13300)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** So far in Sep, the IDR has been the best performer not only among the ASEAN currencies but also among the Asia-Pacific currencies ex-Japan (as tracked by Bloomberg). The IDR has gained nearly 2.4% against the dollar since the start of the month, second only to the JPY that gained nearly 3.0%. More importantly, the USDJPY broke below the 13000-levels to record a new low for the year when it touched 12886 briefly on 27 Sep. This attributable to a confluence of positive factors that are renewing investor confidence in the economy, spurring long-IDR bets. This was manifested in the forward points that suggested further downside to the USDIDR in the 1-month, 3-month and 12-month ahead.
- Bolstering investor confidence in recent days has been the tax amnesty program. The program had an initial slow start but had picked up pace as the first deadline for declaring unreported assets and most generous penalties of 2% (for assets located in Indonesia) and 4% (for overseas assets) approaches. The penalty increases as the end of the program draws closer. As of 28 Sep, the amount repatriated under the program has reached IDR128tn with IDR2386tn declared. The success of the program so far has allowed the government to earn nearly IDR60tn in revenue as of 26 Sep and because of this the government has achieved 55% of this year's non-oil and gas tax revenue compared with 49% in the same period last year.
- Driving the government's reform efforts and tax amnesty program is Finance Minister Sri Mulyani Indrawati, whose appointment in early Aug has given President Jokowi's economic policy a new lease of life and renewed foreign confidence. Steps taken by FM Sri Mulyani so far included introducing revisions to the existing state budget that was more in tune with reality (i.e. the budget deficit was raised to 2.5% of GDP instead of 2.35%) and ensuring the success of the tax amnesty program.
- In addition, the reform process has been moving forward slowly but surely with 13 stimulus packages introduced by the Jokowi administration to date. These reform packages aimed to cut red tape, liberalize rules that have been a drag on investment and growth, and support specific growth industries. As well, fiscal spending of more than USD400bn for infrastructure projects is in the works to build ports, roads and railways. Together, these efforts should continue to support domestic demand, particularly private consumption, and encourage private investment ahead, all of which are IDR-positive.
- The optimism over the tax amnesty program, the more realistic assumptions for the state budget as well as the ongoing reform of the economy suggest the economy could be on track to receive an upgrade in its sovereign credit in the next 6-12 months. To date, among the major credit rating agencies, only S&P has yet to move

Indonesia to investment grade. The potential for an improvement in its credit rating outlook or an upgrade to its credit rating could weigh on the USDIDR going into 2017.

- Flows-wise, equities did not find favor with foreign investors even with the BI's 25bp cut to the policy rate. Instead, rich valuations and disappointment with the initial results of the tax amnesty program inflows have contributed to outflows. Month-to-date, USD351mn has been withdrawn from the equity market, compared to the gains of USD985mn in Aug. On the other hand, the Fed's decision to pause on further rate hike in Sep and the expected more gradual pace of rate hikes in 2017 have proven favorable to government debt. In Sep so far, foreign investors have added IDR9.36tn to their outstanding holding, a slight improvement over Aug's IDR9.06tn. Overall, the flows into government debt have offset the outflows from equities and have supported the IDR. Going forward, Indonesian assets should remain attractive to foreign investors especially as the tax amnesty program picks up pace and the reforms move forward. These should continue to weigh on the USDIDR.
- Our house expectations of a rate hike in Dec and then twice more in Jun and Dec 2017 should weigh on the IDR. Still, we do not expect Fed actions to be sufficient to outweigh the increasing optimism in the Indonesian economy, particularly the expected success of the tax amnesty program, the economic transformation of the economy and the push for infrastructure building. We now expect the USDIDR to remain below the 13000-figure for the foreseeable future as a result. The pair should end the year on a high note at 12950. Thereafter, the pair should hover within 12500-12850 in 2017 as it adjusts to the Fed's rate adjustments. We remain positive on the IDR.
- **Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for Indonesia was unchanged at 5.6 from the previous month as there were no changes to its risk profile in the month. This should supportive of the intrinsic value of the IDR.
- **Growth and Inflation Outlook:** After expanding by around 5.04% y/y in 1H, the government expects growth to come in at around the same pace in 2H. This was even after the government announced a spending cut in its revised state budget for 2016. Private consumption should continue to underpin the economy for the rest of the year, helped by stable inflation and lower borrowing cost. Recent data showed that motor vehicle and motorcycle sales are picking up. Motor vehicle sales rose 53.8% m/m in Aug, while motorcycle sales expanded by 72.9% m/m. External demand remains soft with exports and imports down by 0.74% and 0.49% y/y respectively in Aug from -16.88% and -10.56% in Jul. The more moderate growth is a good sign and could suggest that external demand could be on the uptick. For the full-year, our economic team expects the economy to grow by 5.09% in 2016, in line with the 5.0% growth expected by both the FinMin and BI.
- Inflation has come a long way from the days of 7% inflation rate. Headline inflation rose by 2.79% y/y in Aug, slipping below the 3.0% for the first time since the data was rebased to 2010. Lower food prices continued to weigh on headline inflation, moderating to 5.14% y/y in Aug from 6.81% in Jul. This was reinforced by the deflationary pressures in transport, which fell 1.93% y/y (Jul: -1.49%). Core inflation also slipped in Jul, rising by 3.32% y/y in Aug from 3.49% in Jul. Inflationary expectations remain well-anchored, and continuing strength in the IDR as well as government policies to slow the pace of

prices increases (e.g. by giving subsidy for school fees) should cap consumer price rises. Our economic team maintains its headline inflation at 3.53% in 2016, which is at the lower end of BI's headline inflation projection of 3-5% for 2016. Core is expected to come in at 3.48% in 2016.

- **Monetary Policy Forecast:** The BI cut its policy rate – the 7-day reverse repo rate – by 25bp to 5.0% as expected – at its policy meeting on 22 Sep. This was the first time that the new policy rate has been cut since its adoption (the previous occasion it was cut was when the 12-month reference rate was still the policy rate). This cut marks the fifth time that the central bank has adjusted its policy rate this year. This brings the total cuts to the policy rate (BI 12-month reference rate and 7-day reverse repo rate) to 125bp this year. The deposit and lending facility rates were also reduced by 25bp to 4.25% and 5.75% respectively, maintaining a 75bp symmetrical corridor on either side of the policy rate. The move to cut rate was necessitated by concerns about domestic growth, especially domestic demand, amid a sluggish global economic environment. This concern comes on the back of lackluster private investment though household consumption has continued to backstop growth so far.
- With credit growth on the downtrend and growth plodding at the same pace as in 1H 2016, it is likely that the BI will continue to set its sights on optimizing credit growth to boost domestic demand. Given that the room for the government to expand its fiscal space might be limited in 2H17 as it re-adjusts its spending, the central bank will have to take up the slack to provide the impetus for domestic credit growth ahead via monetary policy and macroprudential policy. Thus, our economic team is of the view that there would be another 25bp cut to the 7-day reverse repo rate but only in 2017 (likely in 1H). But given the imperative of boosting credit growth to spur domestic demand and hence economic growth, a move to reduce rate further in 4Q this year cannot be ruled out.
- **Latest Fiscal and External Balance Outlook:** For the 2017 budget, the FinMin provided some clues as to what to expect. She has plans to include a 'fiscal buffer' in anticipation of any revenue shortfall, reducing the need for frequent revision to the budget. Revenue from tax, excise and duty is expected to increase by 13-15% in 2017 compared to 2016 expectations. Underpinning the 2017 budget are the following assumptions: modest GDP growth of 5.1%; inflation at 4%; exchange rate at 13,300 rupiah/USD. The budget deficit is estimated at around 2.5% of GDP – the same pace as expected in 2016.
- The current account deficit (CAD) narrowed moderately to USD4.68bn in 2Q 2016 or 2.0% of GDP compared to USD4.76bn (2.2% of GDP) in 2Q. The narrower deficit was attributable to a larger goods and services surplus of USD1.7bn (1Q: USD1.6bn) and lower-than-expected deficit in the income account, which came in at USD6.4bn vs. 1Q's USD6.3bn. The overall balance of payments returned to a surplus of USD2.2bn in 2Q after slipping into a deficit of USD0.3bn in 1Q on the back of a wide surplus in the financial account, which more than offset the CAD. Meanwhile, our economic team now expects the 2016 CAD to come in at 2.2% of GDP instead of 2.45%, given the lower CAD in 1H 2016. Similarly, the BI expects the current account deficit to be lower than 2.5% of GDP in 2016.
- **Key domestic events and issues to watch**: BI meets to decide on policy on 20 Oct.

- **Technical Outlook:** USDIDR has broken psychological support at 13000 and made fresh multi-year lows of 12886 (27 Sep). Last seen at 12970 levels. Weekly momentum is flat. Bearish momentum on daily chart shows some signs of waning while stochastics is near oversold conditions. Potential risk of rebound but likely to be capped at 13050, 13150 resistance. Support at 12900, 12850.

PHP: Weighed By Duterte Risk Premium?

Forecast	4Q 2016	1Q 2017	2Q 2017	3Q 2017
USDPHP	49.00 (46.50)	48.50 (46.70)	49.50 (46.90)	49.00 (47.00)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** The positive sentiments surrounding the USDPHP has quickly faded and replaced with much negativity. This has led to the pair being traded bid since the end of Aug, hitting a high of 48.435 on 26 Sep and is currently hovering just below that level. Since the start of the month, the PHP has weakened by nearly 3.4% against the USD – the worst performer among the ASEAN currencies month-to-date.
- Several factors account for this weakness in the PHP. First, market remained guarded against a Fed fund rate hike at the end of the year. Second, there are increasing concerns about the government's extra-judicial killings, policy flip-flops and the president's unpredictable temperament. Third, equity valuation appears stretched with current P/E ratios above their 5-year averages. These have resulted in a deterioration in investor sentiments and led foreign investors to sell-off over USD357mn in equities since the start of Sep compared to the USD33.53mn sold off for the whole of Aug. It also did not help that this outflow, together with deceleration in overseas remittances, is putting downside pressure on the current account surplus.
- The USDPHP faces risks from the US Fed resuming its fund rate hike in Dec. Increasing expectations of a Fed move this year could keep the pair elevated towards the year-end and into 2017. As well, the uncertainty in the lead-up to the US presidential election could pose upside risk to the USDPHP. Concerns about a "President Trump", particularly his lower commitment to the security pact with Manila and to trade relations, could increase market volatility and spark safe-haven outflows from riskier Philippine assets.
- These concerns have clouded its healthy economic fundamentals, namely its growth outperformance. Growth has so far been supported by consumer spending as reflected in the acceleration in private consumption of around 7% in 1H2016 compared to the 6% for the whole of 2015. We expected growth to remain on the upward trajectory underpinned by the government's intention to progressively increase infrastructure spending from 5% of GDP in 2016 until it hits 7% by the end of its six-year term in 2022. Continued robust domestic demand should allow the economy to expand by at least 7% in 2016. Until investor confidence is restored, the healthy economic fundamentals will remain in the background.

- The continued sell-off in the equity market on the back of the president's erratic behavior, reinforced by the deterioration in overseas remittances (as Middle East economies slow) could weigh on the PHP. A move towards the 50-figure cannot be ruled out should outflows persist and begin to affect other investments. We however do not expect such a move in the next three-six months. In the near term, there could be some technical retracement given overbought conditions and that could be an opportunity to accumulate for a move back up toward the 50-levels.
- Until then, we expect the USDPHP to stay elevated underpinned by Fed fund rate hike risk and ongoing concerns about "un-statesman"-like behavior of the president and end the year at 49.00 (from 46.50 previously). Further expectations of rate hike by the Fed in 2017 and the unlikely resolution to the extra-judicial killings and the president's unpredictable temperament anytime soon could see the pair headed close to the 50-levels at 49.50 by the end of 2Q 2017 before ending 3Q at 49.00.
- Our monthly **Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, was unchanged at 4.8. This was due to its risk profile remaining unchanged in the month. This should be supportive of the intrinsic value of the PHP.
- **Growth and Inflation Outlook:** After expanding by 7.2% y/y in 1H 2016, growth looks to decelerate at least in 3Q. The BSP expects 3Q GDP growth to come in at least 6% on strong fundamentals. The slower growth is not worrying as it is likely to due to the higher base of comparison in the same period last year. Growth remains domestically driven, helped by both private and public infrastructure spending. The 5% of GDP to be spent on infrastructure this year will keep growth supported. Moreover, the import growth of 14.4% y/y in the first seven months of the year (M7 2016) bodes well for consumer spending and capital spending. This should help to offset any slowdown in remittances (M7 2016: +3.0% vs. M7 2015: +7.7%) as a result of slower growth in the G3 and oil-producing Middle Eastern economies as well as the continuing weakness in external demand. Still, the weaker PHP should be helpful to exporters even though it is unlikely to be a panacea for its export woes. In the first seven months of the year, exports have contracted by 8.3% y/y.
- Headline inflation rose by 1.8% y/y in Aug, a slightly moderation from Jul's 1.9%. The more moderate increase in inflation was due to a slower rise in food prices (Aug: +2.4% vs. Jul: 2.7%) that more than offset the rebound in housing and transport costs (Aug: +0.2% and +0.1% respectively vs. Jul: -0.2% and -0.1%) in helped by the moderation in food prices (Jul: 2.7% y/y vs. Jun: 2.9%) that offset the more moderate decline in housing cost (Jul: -0.2% y/y vs. Jun: -0.4%). Year-to-date, inflation has averaged 1.5% and much of this underperformance in inflation is due to oil prices. The stabilization in global oil prices should lift inflationary pressures. Even the risks of El Nino/La Nina and election spending are unlikely to lift inflation significantly higher. Given the weak inflationary pressures so far, the BSP is now expecting inflation to average 1.7% in 2016 from 1.8% previously. However, it kept its inflation expectations at 2.9% and 2.6% respectively for 2017 and 2018.
- **Monetary Policy Forecast:** The BSP kept its policy rate unchanged at 3.0% at its 22 Sep meeting as expected given manageable inflation and firm economic activity. It also kept its overnight lending rate and overnight deposit rate unchanged at 3.5% and 2.5% respectively,

maintaining the symmetrical 50bp corridor on either side of the policy rate. We continue to expect the BSP to stay on course and keep its policy rate steady for the rest of the year as economic growth is expected to remain healthy for the rest of the year and inflation benign. This is to keep its ammunition dry in the event of a black swan event. According to the BSP Governor Tetangco, the current monetary settings remain appropriate.

- **Latest Fiscal and External Balance Outlook:** The government is planning to overhaul the tax system. It has submitted to Congress the first of four packages on tax reforms that includes a personal income tax (PIT) cut over time to 25% from 32% (except for the highest income earners); expand the value-added tax (VAT) base by reducing the number of exemptions; adjust excise taxes on petroleum products; restructure the excise tax on automobiles (except for certain types of vehicles). This would help the government achieve it target of boosting revenue by 3% of GDP by 2019. The savings from these tax reforms is to be allocated as conditional cash transfers, lifeline electricity subsidies, direct discounts and higher Philippine Health Insurance coverage among other targeted subsidies to mitigate the impact on low income families and any uptick in inflation.
- The overall balance of payments (BoP) surplus widened to USD682mn in Aug, more than triple the surplus of USD215mn in Jul. This was the sixth consecutive month that the BoP has been in surplus. For the first eight months of the year, the surplus was USD1.53bn, on track to hit the BSP target of USD2bn for 2016. Accounting for the surplus was the strong fund inflows, net USD deposits from the national government and gains from the central bank's foreign exchange operations. Dispelling concerns that the sell-off in equities by foreign funds, BSP governor Tetangco said that the current account and BoP would remain in surplus.
- **Key domestic events and issues to watch:** There are no events or issues of note in Oct.
- **Technical Outlook:** USDPHP had a big move up, to a fresh 7-year high of 48.43 (26 Sep). Weekly momentum and stochastics continue to indicate a bullish bias. But daily momentum and stochastics suggest a potential pullback. Support at 47.50 (21 DMA). Resistance at 48.50, 49 levels.

THB: Fueled By Portfolio Inflows

Forecast	4Q 2016	1Q 2017	2Q 2017	3Q 2017
USDTHB	34.70 (--)	35.00 (--)	35.20 (--)	35.50 (--)

No Change From Previous Forecast

- **Motivation for the FX View:** The USDTHB continues on its downtrend from Aug, still pushed lower by portfolio inflows searching for higher returns. Just as important, the relative stability in the political arena compared to its neighbors – the Philippines and Malaysia – makes it an attractive destination for foreign investors. The economy though still pale in comparison to its historical growth patterns and when compared to its regional peers is showing signs of recovering, helping to create a conducive environment for foreign investment. This has allowed the THB to gain 0.1% against the dollar so far in Sep, ahead of the MYR and PHP.

- The domestic macroeconomic environment remains favorable to the THB. A combination of accommodative monetary policy and expansionary fiscal policy has helped the Thai economy to rebound from its subpar growth performance in 2015 to around 3% in 1H16. The boost from the planned THB1.8tn infrastructure programme embarked by the government should help to lift consumer spending, mitigating the weaknesses in exports. The lift from government spending, infrastructure expenditure and consumer spending could push growth higher to as much as 4.0% in 2016 and 5.0% in 2017.
- Expansionary fiscal policy aside, monetary policy should remain accommodative as well. Policy rate is near historical lows at 1.5% and further rate cuts are unlikely for the rest of the year, barring unforeseen risks to the economy. Rate cuts would not solve the kingdom's export woes and is unlikely to be effective in spurring further lending or investment activities. In addition, the central bank believes that fiscal policy should take the lead in bolstering the economy, while accommodative monetary policy should play a complementary and supportive role. Just as importantly, the central bank would like to keep its ammunition dry for even more adverse shocks to the economy like a disorderly Brexit or China hard landing (all not our base case).
- The successful and peaceful conclusion of the referendum on the draft constitution triggered a re-rating of risks and bolstered investor confidence, supporting the inflow of foreign funds. Though the political situation could very easily flip, the relative calm and stability in the political arena has encouraged foreign investment inflows. A key risk here is the health of the King, who is currently in the hospital, and the royal succession. Despite lofty valuations, foreign funds have purchased THB19.08bn and THB37.77bn of equities and government debt in Sep so far, though this was still a moderation from Aug's THB34.37bn and THB62.70bn. Year-to-date, THB134.33bn and THB334.77bn in equities and government debt have been purchased by foreign investors compared to the sell off of THB15.43bn and THB23.97bn for the whole of 2015. Continued inflows into Thai assets remain supportive of the THB.
- External challenges are likely to keep the USDTHB supported above 34.50 levels, particularly the US Fed's resumption of its rate hike in Dec, the US presidential election, and post-Brexit developments. The risk from a US Fed fund rate hike in Dec could put upside pressure on the USDTHB as foreign funds could reallocate some of their portfolio away from Thailand back to the US. We could see similar consequences in the lead up to the US presidential election. The US presidential election could pose upside risk to the USDTHB as a "President Trump" could increase market volatility and uncertainty, resulting in safe-havens flows and sparking another round of outflows from riskier Thai assets. In addition, Brexit concerns could spark another round of risk haven flows. Altogether, these risks should weigh on the THB.
- The continuing inflows of foreign portfolio investment should be supportive of the THB. We maintain our USDTHB to end the year at 34.70 on back of the possible move by the US Fed in Dec. Thereafter, expectations of further rate hikes in 2017 should keep the pair elevated with the pair climbing higher to 35.50 by end-3Q.

- **Our Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for Thailand did not show at changes. The score remained at 4.2 as there were no changes to its risk profile. This should be supportive of the intrinsic value of the THB.

- **Growth and Inflation Outlook:** After impressing with a of 3.5% y/y growth in 2Q, economic growth is expected to moderate in 3Q before picking up going into 2017. Unlike 2Q, there were no new boosters of growth in the quarter and there was a certain degree of political uncertainty in the lead-up to the referendum that weighed on growth. Moreover, the focus of the military government on the referendum and the subsequent general elections process meant the economy was neglected to a certain extent during that time period. The bombing and arson attacks in the South did not help as it could have mildly impact tourism in Aug. Nevertheless, a pick-up is expected going into 2017 as the new fiscal year begins and government disbursement is accelerated. As well, infrastructure spending should also accelerate. The BoT has turned slightly more optimistic about economic prospects in 2016, revising upward its growth forecast to 3.2% from 3.1% previously on the back of higher government investment that should offset the weakness in exports and private investment. 2017 growth expectations were left unchanged at 3.2%. Our economic team continues to expect stronger growth underpinned by infrastructure spending. Real GDP is expected to come in at an above-consensus 4.0% this year before accelerating to 5.0% in 2017.

- Headline inflation remained in positive territory for the fifth straight month, accelerating to 0.29% y/y in Aug compared to 0.1% in Jul. Mildly higher food prices, which rose 1.88% y/y in Aug vs. 1.83% in Jul together with a less negative transport cost (Aug: -1.44% y/y vs. Jul: -2.03%) helped to push up consumer prices in Aug. Still, the positive inflation prints so far, headline inflation was flat in the first eight months of the year. Given the weak consumer prices to date, the central bank has lowered its full-year inflation forecast to 0.3% in 2016 from 0.6% previously. Our economic team continues to expect a loftier inflation outcome in 2016 because of a low base effect, improving domestic demand, the impact of the drought on raw food prices, firmer oil prices and weak THB. The team is looking for headline inflation to average 2.0% in 2016.

- **Monetary Policy Forecast:** The BoT has not adjusted its key rate since 29 Apr 2015 with the policy rate held steady at 1.50%. The last time the policy rate was lowered was during the Great Financial Crisis in 2009-10. With the rate already at near historical lows, there is little need for the BoT to adjust the policy rate for now. Going forward, we expect the central bank to remain on hold for the rest of the year. Note though that this does not preclude the central bank from adjusting its policy rate if the situation calls for it. For now though, the BoT believes that fiscal policy should do the heavy lifting in boosting growth, with monetary policy playing a complementary and supporting role. Moreover, the concomitant weakness in the THB from a rate cut is unlikely to be a panacea for the kingdom's export woes. As well, pausing on policy would allow the central bank to keep its ammunition dry for black swan events.

- **Latest Fiscal and External Balance Outlook:** The government will spend THB6.5bn in FY2017 to ease the financial burden of small-scale farmers suffering from the economic slowdown, drought and flooding. The program will entail cash handouts and debt restructuring. Cash handouts of THB1500-3000 will be handed out to farmers depending on their income. As for debt moratorium, among the plan is for the Bank of Agriculture and Cooperatives to write-off debts of farmers without heirs, dead, disabled or suffering from long-term health problems. Other proposal under the debt moratorium included a debt payment delay and extension at a lower rate will be offered to those with heirs.

- The current account surplus widened to THB128.63bn in Jul from THB105.12bn in Jun – the second straight month that the surplus has widened. The wider surplus was largely to the surplus in the primary and secondary income account of THB16.57bn in Jul compared to -THB28.73bn in Jun that reinforced the trade surplus of THB493.96bn. The overall balance of payments (BoP) surplus however shrank in Jul to THB0.40bn in Jul vs. Jun's THB65.65bn.
- **Key domestic events and issues to watch:** There are no events or issues of note in October.
- **Technical Outlook:** USDTHB continues to trade within the downward sloping trend channel – hitting both the upper (35-levels) and lower bound (34.48) of the trend channel. Pair was last at 34.65 levels. Daily momentum remains bearish bias while stochastics is near oversold conditions. Downside moves could be limited towards 34.48 levels (50% fibo retracement of 2015 low to high). Break below targets34 levels (61.8% fibo). Resistance at 34.80 (50 DMA).

INR: Resilience Amid Volatility

Forecast	4Q 2016	1Q 2017	2Q 2017	3Q 2017
USD/INR	68.00 (--)	66.00 (69.00)	68.00 (69.00)	66.00 (--)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** Sep has passed and much has been achieved including the new policy rate committee just in time for the next policy meeting next Tue (4 Oct). Bets are on the MPC to cut rates as Finance Minister Jaitley has heavily hinted for them to do so Surprisingly, Urjit Patel also assured that the growth is also part of the objective of the central bank. We take his words as an indication that the bank is on easing bias, but not as a sure sign that he is ready to cut next Tue. We like to think that RBI should not lower policy rate so soon even as growth momentum has not met expectations as one downtick in inflation prints cannot be taken as a sure sign of reversal.
- After the President Pranab Mukherjeee approved the GST bill. The GST Council, the government is racing against time to get the GST implemented by Apr 2017. The GST Council had decided that businesses in the Northeastern and hill states with annual turnover below Rs. 10lakh would be exempted. The threshold for the rest of India would be an annual turnover of Rs. 20lakh. Finance Minister Jaitley said that the actual GST rates should be decided by October. Near-term impacts of GST are likely sharp, albeit transient, rise in prices next year. Medium term impacts are still uncertain even though there has been much optimism about it simplifying the tax

system to avoid double taxation, spurring better supply mobility across inter-state borders that could eventually boost India's GDP level by 1-2%.

- USDINR should remain somewhat steady for the rest of the year amid decisive reform progression with regards to GST implementation, deepening the corporate bond market and positive carry of the rupee for yield hungry environment to offset the strength of the USD. However, we are watchful of the rupee for its sensitivity to risk sentiments. The recent "surgical attack" on the Pakistan base, reportedly inflicting serious damage on terrorists. This was after an attack on an army camp in northern Kashmir's Uri earlier in Sep. We anticipate the USD20bn outflows (from the FCNFR (B) redemptions) that the RBI has estimated to happen in the rest of the year but we are also comforted by the fact that the central bank has probably amassed a substantial of USD363bn of FX reserves as of Jun.
- Our **Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for India steadied at 4.3 (with 1 being the best score and 9 being the worst).
- **Growth and Inflation Outlook:** Industrial production slipped -2.4%y/y in Jul from the previous growth of 2.0%. However, we prefer to look at the leading indicator of the PMI-mfg for Aug which had shown stronger growth of new work and output. The improvement to 52.6 from previous 51.8 may mean better growth in the manufacturing output in Aug compared to its negative performance in Jul. In fact, manufacturers surveyed had indicated that demand comes from domestic and external sources. Consumer goods is the strongest-performing sector.
- The RBI industrial outlook survey for 2016-2017 shows improvement in demand condition in the first quarter of 2016-2017 compared to a the same period a year ago. Net percentage responses indicate higher production, order books, exports/imports and employment during the quarter went up. The business sentiment of the manufacturing sector was deemed more upbeat than the quarter prior. Firms responded positively on most metrics with the exception of cost of finance and cost of raw material.
- The monsoon rainfall hovered around 3-5% below normal for most of Sep. This has been a pretty decent monsoon season and we anticipate a boost to rural income and private consumption. Household consumption will continue to be a pillar of support as the government and central bank strive to crowd in private investment with reform measures.
- Food inflation brought the headline CPI down from 6.07%y/y to 5.05% for Aug. Wholesale prices remained elevated around 3.74%y/y compared to previous 3.55%, on faster increase in fuel, power, light prices after the government raised kerosene prices. Although the CPI has softened in Aug, we are not sure if consumer prices will be on the retreat as the recent pay hike for central government employees that would be implemented within the financial year 2016-2017 is expected to fan demand-led price pressures.
- **Monetary Policy Forecast:** The Reserve Bank of India will make its next rate decision on 4th Oct. We continued to anticipate an extended pause by the central bank. The Aug CPI print was well under expectations but that one point of data can hardly confirm a downtrend. With persistent upside surprise for a number of CPI print (apart from the Aug one), a recent kerosene price hike and a recent pay hike for central government employees, we think it is more prudent for MPC to keep rates as it is for now. Growth could still gain

traction from good monsoon season that should boost rural income, raise private consumption and as well as the same from central government employees that had benefitted from a pay hike. In addition, a potential rebound in manufacturing output is signaled in the latest PMI-mfg numbers and MPC should not be pressured to act at this point. That said, as it is the first meeting of the MPC. The dynamics of the committee is still unknown. Risk for a cut stem from the pressure of the government as the import tariff for a number of goods have been reduced ahead of festive demand to keep a check on prices.

- Latest Fiscal and External Balance Outlook: Foreign investors bought USD769.9mn of equities and USD259.5mn of bonds in Sep as of 27 Sep. Sentiments have been buoyed by a number of positive news at home while the foreign holdsing of government and corporate bonds rose amid pledges by the government to deepen the corporate bond markets and after India sold INR46.15bn rupees of government debt quota to foreign institutional investors.
- India's fiscal targets were held steady at 3.5% for FY16/17. The government highlighted "Transform India" that is meant to boost domestic demand, continue the pace of economic reforms and policy initiatives. There was also focus and budget allocation for agriculture and farmers' welfare - Irrigation projects will be sped up, a dedicated Long Term Irrigation Fund will be created as well as programme for sustainable management of ground water resources. There is also a substantial amount allocated to education and health care, as well as infrastructure and investment. Total expenditure projected to be INR19780bn – INR14280bn of which is non-plan and INR5500bn is plan. The plan and non-plan classification will be scrapped in the next fiscal year. The plans outlined should work to improve inflation expectations via the supply side measures whilst boosting rural demand.
- The current account deficit remained steady at $0.3bn in the quarter ending Jun. Trade deficit was lower at U$23.8bn vs. previous U$24.8bn. Capital account saw a stronger surplus. Portforlio investment recorded a net inflow of U$2.1bn due to strong equity demand.
- **Key domestic events and issues to watch:** Sep PMI-mfg is due on the 3rd. RBI meets on the 4th. Trade is due anytime within 10-17th. CPI and industrial production are due on the 12th, WPI on 14th. We watch for FinMin Jaitley's announcement of the actual GST rate to be implemented next Apr 2017 in Oct.
- **Technical Outlook:** 1M NDF remains stuck within the 66-67 range. Momentum indicators signal bearish tendencies for this pair and support is seen around 66.25 before the next at 64.90. Barrier is seen around 67.50. We need a breakout of the 66-67 range before a trend can be seen.

VND: Ample Dollar Supply But Still Dong Vulnerable

Forecast	4Q 2016	1Q 2017	2Q 2017	3Q 2017
USD/VND	22500 (22600)	22400 (22700)	22650 (22800)	22500 --

Previous Forecast in Parenthesis

- **Motivation for the FX View:** USDVND had a few sessions of upside pressure before easing back once it is clear that the Fed is only likely to hike in Dec. USD supply seems ample at this point as foreign invetsors have bought a net $1bn of government bonds. We adjusted the forecast slightly lower because of that but we still see vulnerability to the USD strength that could be more pervasive towards the end of the year. VND has been mainly underpinned by strong FDI inflows and trade surplus. The support of the FDI inflow could be ebbing but that of the trade surplus seem to be still intact, as indicated by stronger PMI-mfg numbers, sustained growth of exports growth. Trade balance slipped into mild deficit of U$100mn and that should add further upside pressure to the USDVND. Our forecast assumes Japan fires enough monetary and fiscal stimulus to keep USDJPY largely within 100-110 for the rest of the year.
- Vietnam's apparel, footwear, agro-forestry and seafood industry were meant to get the boost from the Trans Pacific Partnership. However, we are cautious of the fate of TPP since both US Presidential Candidates are not supportive of the pact. Vietnam has delayed the vote to ratify the pact until next year. To be sure, Vuoong Duc Anh, a negotiator of the TPP has indicated that the terms of the pact cannot be renegotiated. That could be a primary reason why FDI inflows have slowed significantly in recent months. Year-to-date, the FDI flows has slowed to a trickle of just 1.1% for Jan-Sep from triple digit growth seen in the earlier parts of the year.
- **Growth and Inflation Outlook:** PMI-mfg rose to 52.2 in Aug from previous 51.9. Markit reported a modest improvement in operating conditions that was slightly more marked than in the previous month. The report saw a divergence of slower expansion in output and new orders and stronger hiring growth. Signs of softening demand does not bode well on the manufacturing sector. In the meantime, exports growth accelerated to 6.7%y/y in Jan-Sep from 5.5% in Jan-Aug. Private consumption seems to be holding up as its proxy, retail sales for Jan-Sep rose to 9.5%y/y from 9.3% for the first 8 months of the year. Growth picked pace to 5.93%y/y for the first 3 quarters of the year from the previous 5.52% in the first six months, on the back of higher growth in the industrial sector and forestry. In fact, the fishery sector also showed recovery from the fishing disaster in 2Q.
- Inflation firmed to 3.34%y/y for Sep from the previous 2.57%. The rise in CPI seen in 2Q was due largely to higher food, housing and construction prices. We continue to expect inflation to remain on a gradual upward trend given supply side impact on agriculture and fishery. In addition, fuel prices have increased with effect from 20 Sep. Price of RON 92 petrol and bio-fuel E5 rose VND156 and VND145 per litre.

- **Monetary Policy Forecast:** SBV has not moved policy rates for a while and room for easing is becoming smaller given the rise in inflation. That said, CPI is still low relative to historical records. With the growth target seemingly out of reach, SBV might need to ease rates (currently base rate at 9.0%, refinancing rate at 6.5% and discount rate at 4.5%) in order to nudge the growth engine a little by boosting domestic spending. That would take its credit growth towards its annual target of 18-20% from the current 10.46% as of 20 Sep. FX-wise, the central bank has not been tweaking the USDVND reference rate much day-to-day despite broad yuan weakness. With exports growth decelerating and lean FX reserves-import ratio of around 2, any external shocks in the FX space could force SBV to devalue the dong. Should USD remain on the upmove, expect USDVND reference rate to be fixed higher and that should guide the USDVND towards our 22400 forecast by 3Q.
- **Latest Fiscal and External Balance Outlook:** Vietnam is running out of fiscal room to boost growth. The Ministry of Finance revised the fiscal deficit significantly higher to 6.6% of GDP in 2014 and 6.1% for 2015. We see upside risk as MOF has just proposed to lower existing tax rates for SMEs from 20% to 17% so as to encourage companies to engage in productive investment.
- We still watch the Japanese yen as Vietnam's external debt/GDP stood at 41.5% as of end 2015. Strong relationship with Japan suggests that JPY-denominated debt could be at least 30% of total debt (as reported by our Vietnamese analysts) and a stronger JPY could weaken Vietnam's debt position. That said, given the threat of BOJ intervention and potential monetary and fiscal stimulus, we expect USDJPY to remain within 100-110 for the rest of this year. That should in turn alleviate pressure on Vietnam's debt.
- Growth of exports remains positive for the past nine months at around 6.7%y/y although PMI-mfg for Sep signal a deceleration in new export orders growth. Current account recorded a surplus of USD2.24bn in 2Q (latest data available), narrowing from the U$2.63bn seen in 1Q on the back of smaller net trade surplus of goods and wider net trade deficit of services. Further deterioration in the balance of payment position could weaken the VND.
- **Key Domestic Events and Issues to Watch:** PMI-mfg is due on the 3rd. CPI is due on the 24th. Trade balance, retail sales, industrial production within 25-31st.

FX Forecasts

	End Q4-16	End Q1-17	End Q2-17	End Q3-17	End Q4-17
USD/JPY	105	103	106	105	107
EUR/USD	1.1000	1.1200	1.0900	1.1000	1.0800
GBP/USD	1.2600	1.2700	1.2400	1.2800	1.2600
AUD/USD	0.7600	0.7800	0.7500	0.7800	0.7600
NZD/USD	0.7000	0.7300	0.7200	0.7500	0.7300
USD/SGD	1.3750	1.3800	1.3850	1.3850	1.3900
USD/MYR	4.1000	4.0000	4.1000	3.9500	4.1000
USD/IDR	12950	12500	12800	12600	12850
USD/THB	34.70	35.00	35.20	35.50	35.50
USD/PHP	49.00	48.50	49.50	49.00	50.00
USD/CNY	6.67	6.65	6.72	6.70	6.72
USD/HKD	7.80	7.80	7.80	7.80	7.80
USD/TWD	32.40	32.80	32.80	32.80	32.80
USD/KRW	1130	1100	1130	1100	1120
USD/INR	68.00	66.00	68.00	66.00	67.00
USD/VND	22500	22400	22650	22500	22650
SGD Crosses	**End Q4-16**	**End Q1-17**	**End Q2-17**	**End Q3-17**	**End Q4-17**
100 JPY/SGD	1.3095	1.3398	1.3066	1.3190	1.2991
EUR/SGD	1.5125	1.5456	1.5097	1.5235	1.5012
GBP/SGD	1.7325	1.7526	1.7174	1.7728	1.7514
AUD/SGD	1.0450	1.0764	1.0388	1.0803	1.0564
NZD/SGD	0.9625	1.0074	0.9972	1.0388	1.0147
SGD/MYR	2.9818	2.8986	2.9603	2.8520	2.9496
SGD/IDR	9418	9058	9242	9097	9245
SGD/THB	25.24	25.36	25.42	25.63	25.54
SGD/PHP	35.64	35.14	35.74	35.38	35.97
SGD/CNY	4.85	4.82	4.85	4.84	4.83
SGD/HKD	5.67	5.65	5.63	5.63	5.61
SGD/TWD	23.56	23.77	23.68	23.68	23.60
SGD/KRW	822	797	816	794	806
SGD/INR	49.45	47.83	49.10	47.65	48.20
MYR Crosses	**End Q4-16**	**End Q1-17**	**End Q2-17**	**End Q3-17**	**End Q4-17**
EUR/MYR	4.51	4.48	4.47	4.35	4.43
JPY/MYR	3.90	3.88	3.87	3.76	3.83
MYR/HKD	1.90	1.95	1.90	1.97	1.90
MYR/CNY	1.63	1.66	1.64	1.70	1.64
GBP/MYR	5.17	5.08	5.08	5.06	5.17
AUD/MYR	3.12	3.12	3.08	3.08	3.12
NZD/MYR	2.87	2.92	2.95	2.96	2.99
MYR/IDR	3158.54	3125.00	3121.95	3189.87	3134.15
MYR/INR	16.59	16.50	16.59	16.71	16.34
MYR/KRW	275.61	275.00	275.61	278.48	273.17
MYR/PHP	11.95	12.13	12.07	12.41	12.20

Source: Maybank FX Research as at 30 September 2016

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

DISCLAIMER

Published by:

Maybank

Malayan Banking Berhad
(Incorporated in Malaysia)

Saktiandi Supaat	Christopher Wong	Fiona Lim	Leslie Tang
Head, FX Research	Senior FX Analyst	Senior FX Analyst	Senior FX Analyst
saktiandi@maybank.com.sg	wongkl@maybank.com.sg	Fionalim@maybank.com.sg	leslietang@maybank.com.sg
(+65) 63201379	(+65) 63201347	(+65) 63201374	(+65) 63201378