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Macro | FX Research & Strategy

Global

FX Monthly

2019, Issue 9: A Waiting Game

What Has Changed This Month?

- We kept forecasts unchanged from last month, as September was a month of two-way swings and broad conditions remain similar. Trigger event could be higher-level US-China trade talks from 10 Oct onwards. Our base scenario, underpinning our year-end forecasts, still factors in a trade-deal towards the 1H of 2020 ahead of the US Presidential Election in Nov 2020.

Our Strategies

- Our tactical calls to short USDCNH and USDKRW exceeded our objectives. Our call to accumulate GBP on dips also performed well, as BoJo faced consecutive defeats in UK parliament and hard Brexit risks receded.

- Going into the month of Oct, we are back to a waiting-game on US-China tensions. With trade talks officially scheduled on 10-11 Oct, post Golden Week National Day Celebrations, the absence of onshore market cues along with potential bets that China no longer sees the need for strong RMB support after their 70th Anniversary celebrations could keep USD-AxJ supported on dips. Talks of US potentially limiting portfolio flow would also crimp on sentiments. Visibility in Oct is poor and dictated largely by US-China negotiating team. We watch a probable head and shoulders formation for the USDCNH nonetheless, with gains in the USDCNH above 7.20 to nullify this set-up.

- Taylor Rule estimates for the SGD NEER suggest that an appropriate slope consistent with expected macro conditions could be in the 0% to +0.5% range. This supports our call for policy easing by MAS in mid-Oct. Both options, i.e., mild easing (reduction of slope by 0.5%, from current estimated 1.0%) and easing to neutral slope, are arguably still in play. Regardless, we look for SGD NEER to come off further from current 1.1% above mid-point. (For proxy basket play, see here.)

- In the currency play, we prefer to short USDINR and USDIDR on rallies. For the latter, we see favorable growth dynamics in place for Indonesia, if short-term risks (i.e., protests and forest fires) can be credibly dealt with. INR may see a lift as we expect RBI to extend its easing cycle and the combination of the recent corporate rate cuts could drive this pair under the 70-figure. That said, eyes are also on geopolitical tensions with Pakistan.

- After a corrective rebound for GBP in Sep, we turn more cautious (expect 2-way directional risks) this month as brexit uncertainties are expected to intensify ahead of Brexit day (31^{st} Oct). Key focus on whether PM BoJo manages to get a modified deal with the EU and if this gets the nod from UK lawmakers. Our base case continues to look for a soft brexit (either a brexit extension or a modified deal).

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Top 3 Currency Plays for Oct

Short SGD NEER

Short USDIDR on Rallies

Short USDINR on Rallies

Key Events for the Month Ahead

Date	Event
10 Oct	Liu He to visit Washington for trade talks
Mid-Oct	US Treasury Semi-Annual Report on Macroeconomic and FX policies of Major Trading Partners
31 Oct	Brexit Day (or Extension)

G7 Global Overview

USD: Still Data Dependent, Event Driven

Forecast	4Q 2019	1Q 2020	2Q 2020	3Q 2020
USD Index	97.62 (--)	97.17 (--)	96.69 (--)	96.30 (--)

No change from previous forecasts

- **Motivation for the FX View:** The Sep FOMC policy announcement was again not unanimous, it was also non-committal to a further rate cut and any future ones will be data dependent. As expected, a large minority—seven participants, are projecting another cut in 2019. But the biggest surprise of the FOMC meeting was the forceful pushback to the Sep cut, with five participants submitting end-2019 dots of 2-2.25%. **In light of the pushback today, the risk of an Oct 25bp cut is likely reduced and that of a no change in Oct has risen slightly, but overall there is still a strong chance of at least one cut by year-end.**

- At the post-FOMC meeting press conference, Chairman Powell avoided comment on monetary policy stance or path, compared with previous press conference where he indicated that the 25bps cut at 30-31 July 2019 FOMC meeting was not the start of an easing cycle (as in a long series of successive interest rate cuts) but more of a mid-cycle adjustment in policy. Notwithstanding the latest “dots plot”, the avoidance of comment on monetary policy stance means Fed is “data dependent, event-driven” amid the above mixed signals about the economy’s current condition and outlook, implying it remains open for further cuts if needed. Our Economic team recently revised our FFR forecast to 100bps cuts until 1H 2020 (inclusive of the 50bps cut year-to-date) vs previous call of 25bps p.a. in 2019-2020 (ASEAN X Macro 6 Sep 2019). This forecast is subject to the assumption of there being some form of US-China trade deal within 1H 2020 ahead of US Presidential Election in Nov 2020. Market is currently pricing in the possibility of another 25bps cut before 2019 is over plus another 50bps cuts in 2020.

- Addressing recent pressures in funding markets, Chair Powell said that the Fed would use temporary open market operations “for the foreseeable future,” but would discuss resuming trend growth of the balance sheet at the next FOMC meeting in late October. We now expect trend growth to begin shortly thereafter in November. Likelihood of the pushback in the Sep FOMC, paves the way for expectations that the Fed will stay on pause in Oct, with upside to the USD and 10 year yields over next month a possibility.

- Into the end of the year, our base grey-swan scenario is still that of a protracted period of negotiation with “lines of communication” remaining open. Progression on talks taking both sides closer to a deal probably in 1H 2020 is not impossible and this could help support sentiment and support our view for trade/tech-linked FX to recover. A reversion back to risk-on mood at times, low vol environment amid central banks on easy monetary policies could still see carry plays outperform at the expense of lower yielders such as JPY.

- **Growth and Inflation Outlook:** The US 2Q Final GDP was unchanged at 2.0% compared to the second est. of 2.0%. Personal consumption rose 4.6% in 2Q after rising 1.1% prior quarter. Personal consumption contribution to change in GDP at 3.03% in 2Q. Core PCE q/q rose 1.9% in 2Q after rising 1.1% prior quarter. Nonresidential fixed investment, or spending on equipment, structures and intellectual property fell 1% in 2Q after rising 4.4%.

- Core CPI was higher than expected for a third consecutive month, increasing 0.3% m/m (0.256% to three decimals) and 2.4% y/y (from 2.2%), the highest annual rate of increase since September 2008. Headline CPI rose 0.1% m/m and 1.7%. The NSA CPI index was 256.558 (consensus 256.586). The annual trend in core goods inflation has improved substantially, to 0.8% y/y (from -0.2% y/y in May). However, core goods seems to have been boosted by apparel and used car prices, which have been affected by recent methodology changes at the BLS. Services CPI remained robust, although momentum in the shelter component slowed somewhat (to 0.2% m/m, from 0.3% in July).

- We expect overall US CPI inflation to remain broadly benign this year, but there is unusual uncertainty regarding its outlook. Increases to tariffs on China announced by the administration in May and Sep, as well as new tariffs to come into effect in Dec, imply upside risks to the outlook for inflation. Meanwhile, the recent softening in activity, specifically in the manufacturing sector, implies that upside pressures from capacity utilization are unlikely to build up as strongly. In addition, recent methodology changes by BLS to categories such as apparel and used cars will likely add to the volatility and uncertainty.

- As the FOMC focuses on inflation prints over the next few months, it will look for a broad-based and sustained improvement in momentum across categories before being confident that the recent weakness in inflation has been overcome. As a result, we maintain our call that the Fed may remain patiently supportive towards easing as it monitors risks to the economic outlook from trade tensions, the slowdown in global manufacturing, and low inflation.

- **Monetary Policy Forecast:** Fed delivered another expected 25bps cut in FFR to 1.75%%-2.00% at the 17-18 Sep 2019 FOMC meeting - second cut after the 25bps cut at the 30- 31 July 2019 FOMC meeting. Fed continued to cite "implications of global developments on economic outlook as well as muted inflation pressures" for the decision. However, it was again not a unanimous decision as three FOMC members dissented and split over the FFR path i.e. two for no change and one for a larger 50bps reduction.

- There are notable changes in the latest FOMC statement with regards to Fed's assessment of US economy i.e. household spending "rising at strong pace" vs "pick up from earlier in the year"; "weak" business fixed investment and exports (added vs no mentioned in previous statement) vs "soft" previously. Other remarks on economic conditions and outlook remained unchanged i.e. economic activity rising at moderate rate; strong labour market; solid jobs gains; low unemployment; sub-2% inflation ex-food and energy; survey-based measures of longer-term inflation expectations are little changed; and inflation compensation remains low. Fed also sees sustained expansion of economic activity, strong labour market conditions and inflation near its 2% objective as the most likely outcomes, although uncertainties about this outlook remain.

- Fed updated its macroeconomic forecasts i.e. growth, inflation, unemployment and the "dots plot". Latest Fed's "dots plot" guided for no change in FFR for the rest of 2019 and in 2020 vs no change in FFR in 2019 and 25bps cut in 2020 previously. Market is currently pricing in the possibility of another 25bps cut before 2019 is over plus another 50bps cuts in 2020.

- At the post-FOMC meeting press conference, Chairman Powell avoided comment on monetary policy stance or path, compared with previous press conference where he indicated that the 25bps cut at 30-31 July 2019 FOMC meeting was not the start of an easing cycle (as in a long series of successive interest rate cuts) but more of a mid-cycle adjustment in policy. Notwithstanding the latest "dots plot", the avoidance of comment on monetary policy stance means Fed is "data dependent, event-driven" amid the above mixed signals about the economy's current condition and outlook, implying it remains open for further cuts if needed. We recently revised our FFR forecast to 100bps cuts until 1H 2020 (inclusive of the 50bps cut year-to-date) vs previous call of 25bps p.a. in 2019-2020. **This forecast is subject to the assumption of there being some form of US-China trade deal within 1H 2020 ahead of US Presidential Election in Nov 2020.**

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

- **Key domestic events and issues to watch in Sep:** ISM mfg (1 Oct); Factory orders, durable goods orders (3 Oct, 24 Oct); NFP (4 Oct); Trade Balance (4 Oct); Aug CPI (10 Oct); Sep retail sales (16 Oct), GDP qoq (30 Oct); PCE deflator (31 Oct), FOMC Meeting Minutes (10 Oct), **FOMC meeting (31 Oct).**

- **Technical Outlook:** Our caution in the last FX Monthly for *DXY to move higher in the near term* has met our objective at 99 levels (on 25 Sep). Last seen at 98.90. Bullish momentum on weekly, daily chart remains intact while stochastics is still rising. Upward pressure possible but likely to be limited towards 99.40, 100.15 (76.4% fibo retracement of 2016 high to 2018 low). Support at 98.20 (50 DMA), 97.90 (61.8% fibo), 97.20 (200 DMA).

EUR: Weighed by German Slowdown but Fiscal Plans to Mitigate

Forecast	4Q 2019	1Q 2020	2Q 2020	3Q 2020
EURUSD	1.1100 (--)	1.1150 (--)	1.1200 (--)	1.1250 (--)

No change from previous forecasts

- **Motivation for the FX View:** We expect EUR to trade in the range of 1.0860 – 1.11 with weakness weighed by persistent slowdown in German activity but likely to be offset by other factors including a potential shift towards fiscal stimulus to spur growth, fading expectations for further ECB stimulus (after the recent dose) and some tentative signs of stabilization in other Euro-area members (ex-Germany). Relative calm in Italian politics may also provide some relief to EUR for the time being but any renewed stress with the fragile coalition government could weigh on EUR. In addition, possible 2-way volatility with GBP arising out of Brexit (ahead of Brexit day 31st Oct) could see spillover effects on EUR.

  Fiscal Stimulus to Take Over from Monetary: There is increasingly more talk on Euro-area members opening up to the idea of fiscal stimulus. Outgoing ECB-President Draghi called for more growth-friendly budget to spur economic activity and help raise inflation close to ECB's target. He said it is "high time for fiscal policy to take charge". Portuguese Finance Minister Centeno said that countries with fiscal space should use it to counter the slowdown of the economy. Germany could prepare a stimulus budget worth up to EUR50bn to address economic softness while Netherlands Finance Minister Hoekstra is planning to propose a draft 2020 budget to Dutch parliament and is expected to focus on increasing investment and cutting household taxes. If more Euro-area member countries become more receptive to use fiscal policies, they can possibly help to cushion against a deep economic slowdown. In addition, the appointment of ex-IMF chief, France Finance Minister Christine Lagarde as next ECB President (effective 1 Nov) could see her pushing for this to happen rather than relying on unconventional monetary policies alone. This takes the pressure off unorthodox ECB stimulus and help to mitigate against EUR weakness.

- **Political Uncertainties Remain a 2-Way Risks for EUR:** In particular the focus on Brexit is whether BoJo manages to get a modified deal with the EU and if this gets passed through UK parliament. There are also risk events that could evolved such as BoJo attempting another time to call for election when parliament returns on 14th Oct; or if UK Opposition triggers a vote of no-confidence on BoJo or government; or chance of second referendum resurfaces; or if Article-50 is revoked (cancel Brexit). These have the tendency to swing GBP both ways depending on the outcomes and will have spillover effect on EUR (in positive correlation fashion).

- **Downside Risks to EUR Forecasts:** (1) ECB surprises with another dose of easing at the Oct Governing Council meeting; (2) an Oct black swan event leading to sharp sell-off in equity markets; (3) Euro-area growth to contract.
- **Growth and Inflation Outlook:** ECB staff macroeconomic projection (released in Sep) for **2019 and 2020 growth have been revised lower** to 1.1% and 1.2%, respectively (vs. 1.2% and 1.4% previously in Jun report). ECB President Draghi cited global trade slowdown as the main reason for "more protracted weakness" in economic growth.
- **Euro-area economy expanded at a slower pace of +0.2% q/q in 2Q**, (vs. 0.4% in 1Q). Growth slowdown was seen broadly across most key economies in Europe including Germany, Spain, Belgium and Austria while Italy failed to record any growth for the 4th time in 5 quarters. Euro-area Industrial production slumped in Jul (-2% y/y) and German factory orders, IFO expectations, IP further declined. There were however some tentative signs of stabilization in Euro-area survey data: sentix investor confidence and ZEW survey expectations were less bad than prior. We remain watchful if these tentative signs of stabilization in economic conditions translates into a pick-up in activity.
- **Headline CPI** head steady at 1% y/y in Aug. Services and food, alcohol & tobacco were the main contributors to inflation while energy prices was the offsetting drag. Core inflation also held steady at 0.9% y/y. CPI remains well below ECB's sub-2% goal and the lack of inflationary pressures was one of the reasons being cited for monetary easing. Elsewhere German CPI and PPI saw a sequential downtick in Aug to -0.2% and -0.5% m/m, respectively. This is a reflection of lower energy prices and weak pipeline pressures. ECB staff macroeconomic projection (released in Sep) for 2019 and 2020 inflation have been revised lower to 1.2% and 1%, respectively (vs. 1.3% and 1.4% previously in Jun report).
- **Monetary Policy Forecast:** We expect the ECB to keep key policy rates: MRO at 0%, average deposit facility at -0.5% and asset purchase program to purchase EUR20bn/month starting 1st Nov unchanged at the upcoming ECB Governing council on 24th Oct, after the recent stimulus decision on 12th Sep. Though downside risks to economy remain, recent data suggest some tentative signs of stabilization. Recent monetary stimulus could also be timely to cushion against further slowdown.
- At the last ECB meeting on 12th Sep, ECB unleashed stimulus on all fronts via (1) 10bps cut to deposit rate to bring rate down to -0.5% from -0.4%; (2) re-introduce asset purchase program at the monthly pace of EUR20bn starting 1st Nov till "shortly after the first rate increase"; (3) TLTROs interest rate will start at 0% and could fall as low to where the deposit rate is (or -0.5% currently) while the maturity is extended to 3years (from 2 years previously). In addition, part of banks' excess liquidity will be exempted from negative rates in 2-tier system and forward guidance will be removed – ECB to see rates at present or lower levels until inflation "robustly" converges on goal, supported by underlying dynamics. Meanwhile MRO and marginal lending facility rates are kept unchanged at 0% and 0.25%, respectively. Scale of ECB stimulus was slightly more than what we

had expected (precautionary easing of 10bps cut and no APP) but much lesser than what street expectations were (20bps cut to deposit rate and restart of APP at EUR50-60bn/month).

- Nonetheless the recent decision was also not unanimous and revealed a growing divide as Austrian central bank Governor Holzmann, Netherlands Governor Knot and Bundebank Weidman disagreed with quantitative easing/ cutting rates further while Finland Governor Rehn was supportive of ECB stimulus measures, saying that this is in response to shortfall in inflation. We believe the bar for further monetary stimulus is raised even higher and the focus next is for the push for Euro-area member states to deploy fiscal stimulus to stimulate growth rather than relying on monetary policies alone. The appointment of ex-IMF chief, France Finance Minister as next ECB President (effective 1 Nov) could see her pushing for this to happen. In fact, outgoing ECB-President Draghi called for more growth-friendly budget to spur economic activity and help raise inflation close to ECB's target. He said it is "high time for fiscal policy to take charge". It is unclear if all Euro-area governments agree but Portuguese Finance Minister Centeno said that countries with fiscal space should use it to counter the slowdown of the economy.

- **Latest External Balance Outlook:** Euro area's current account surplus widened to EUR21bn in Jul (vs. EUR18bn in Jun). Surpluses was seen in goods, services and primary income while secondary income posted a deficit. In the 12 months to Jul, current account surplus was at EUR317bn of about 2.7% of GDP (held steady from 12 months to Jun-2019 but lower from the same period to Jul-2018 at 3.3% of GDP). ECB had earlier expected current account surplus to narrow further to 2.7% of GDP in 2019 and 2.5% of GDP in 2021.

- **Key domestic events and issues to watch:** Sep mfg PMI, CPI estimate (1 Oct); Sep services PMI, Aug PPI, retail sales (3 Oct); Oct sentix confidence (7 Oct); Aug IP (14 Oct); Oct ZEW survey expectations (15 Oct); Aug trade ep core CPI (16 Oct); Aug construction output (17 Oct); Aug current account (18 Oct); Oct consumer confidence (23 Oct); Oct prelim PMIs, ECB meeting (24 Oct); 3Q advance GDP, CPI estimate (31 Oct).

- **Technical Outlook:** Our caution for EUR to trade lower came into play for the month of Sep. Low traded at 1.0926 (3 Sep) and again on 2 separate occasions. Last seen at 1.0960 levels. Daily momentum turned bearish while stochastics is falling. Downside pressure remains intact though we remain cautious of weekly stochastics near oversold conditions. Immediate support at 1.0920 before 1.0860 levels (76.4% fibo retracement of 2017 low to 2018 high). Resistance at 1.1020 (21 DMA, 1.11 levels. Expect 1.0860 – 1.11 range to hold with bias to buy dips.

GBP: 2-Way Volatility Leading Up to Brexit Day (Again)

Forecast	4Q 2019	1Q 2020	2Q 2020	3Q 2020
GBPUSD	1.2400 (--)	1.2500 (--)	1.2600 (--)	1.2800 (--)

No change from previous forecasts

- **Motivation for the FX View**: As a quick recap, our call (in the last FX monthly) for corrective and sharp rebound for GBP played out well as GBP traded an intra-Aug high of above 1.25-handle from under-1.20 handle. Going forward, we caution for 2-way directional risks for GBP in the coming weeks ahead of Brexit day (31st Oct) as matters of brexit is about to get even more fluid. Key focus is whether BoJo manages to get a modified deal with the EU and if this gets passed through in UK parliament. With GBP volatility escalated and likely to rise further in an environment of possibly thinner than usual market liquidity, we do not rule our abrupt price movements either direction. Our bias remains for GBP to trend higher on the back of our base case assumption that calls for a smooth, orderly exit (i.e. either UK to leave EU with a modified deal by 31st Oct or another brexit extension). We do not rule out GBP trading sharply lower from current levels (spot ref 1.2480) towards 1.18-handle on a hard Brexit outcome (BoJo defies and triggers Article 50 without a deal or parliament approves no-deal brexit).

- **Parliament has been brought back from its suspension** (initially prorogued till 14th Oct). This could bring forth more 2-way trades as harsh exchanges of words and dares in parliament are expected to hit newswire (a big source of volatility for GBP). For instance (on 25 Sep), BoJo challenged his political opponents to trigger an election through a no-confidence vote and even declared that the Supreme court judges were "wrong" to overturn his decision to suspend parliament. It was understood that BoJo will not stand down if his government loses a no-confidence vote. Under the Fixed Term Parliaments Act, the PM and other parties have 14 days to win another confidence vote even if the government loses the first confidence vote. A general election will only be triggered if no one wins the next confidence vote.

- **Still Ironing Out a Modified Deal Nonetheless**. BoJo continues to re-negotiate a deal with the EU. This needs to be agreed by both EU and UK lawmakers by mid-Oct, possibly ahead of the EU summit (17 – 18 Oct). A few outcomes could emerge:

  - GBP-Positive: A deal is reached with EU and agreed by UK lawmakers. This would mean that UK leaves the EU on 31st Oct, but with a transitional deal. There will be some chance of a technical extension for the modified deal to be ratified by various parliaments. GBP could possibly trade higher towards 1.30-handle on this optimistic outcome;

- If no deal is reached with the EU or if modified deal is rejected by UK lawmakers then GBP movements may not be as clear cut. BoJo will attempt to convince the parliament to accept no deal Brexit:

  (1) If parliament agrees then that would mean UK to trigger Article 50, leaving the EU on 31st Oct with no deal. This is akin to hard Brexit. Immediate negative for GBP, possibly trading lower towards 1.18 – 1.20 levels;

  (2) If parliament disagrees then BoJo is bound by the law to request to the EU to extend Brexit deadline beyond 31st Oct 2019 by 3 months to Jan-2020. This is kicking the can down the road but may provide a relief bounce (+2% appreciation) for GBP as Brexit is again temporarily delayed till a later date. Uncertainty is likely to return hence the bounce is GBP may not be sustainable.

     a. We do not rule out BoJo defying Brexit law by still going ahead to trigger Article 50. This may be illegal but the act of triggering Article 50 means UK will leave EU without a deal on 31st Oct (hard Brexit). This would be an immediate negative for GBP.

- There can also be other permutations to the above – if BoJo decides to try his luck to call for another election when parliament returns on 14th Oct; or UK Opposition triggers a vote of no-confidence on BoJo or government; if chance of second referendum resurfaces; or if Article-50 is revoked (cancel Brexit). These have the tendency to swing GBP both ways depending on the outcomes. And in the meantime, news headlines will continue to swing GBP both ways. Recall that European Commission President Juncker's recent comments (19 Sep) that "We can have a deal" saw GBP strengthened but subsequent comments from Ireland Foreign Minister Simon Coveney that he doubted the accord was close took GBP off its highs.

- **We retain our mild upward trajectory for GBP,** premised on our base case assumption that calls for a smooth, orderly exit (i.e. either UK to leave EU with a modified deal by 31st Oct or another brexit extension). Based on our model estimates which take into account current account differentials, interest rate differentials and inflation differentials, GBP's fair value estimate fall in the range of 1.42 – 1.46. This justifies our upward forecast trajectory over the forecast horizon into the medium term. The -14% or so deviation (spot to fair value estimate) largely reflects the Brexit premium and this should help the UK economy to rebalance and grow sustainably over time - current account deficit should narrow, exports should become more competitive and tourism and education receipts should pick up further. We hold to our belief that UK should be able to manage the exit, transform itself into a global marketplace and continue to attract capital (longer-term). In the last episode where UK left the ERM back in 1992, GBP saw a period of consolidation (for a few years) at historical lows before the eventual move higher in the following years, where GBP TWI traded above 100-levels in 1998 (from the lows of 80 in 1993-1996) due to buoyant demand fueled by rapid growth of wealth, credit and money. If history is a guide (assuming UK manages the transition well and takes the opportunity to correct its imbalances), its currency should start to climb higher.

- **Growth and Inflation Outlook: Fears of UK entering into a technical recession receded** after recent activity/growth data including Jul GDP (+0.3% m/m vs. -0.2% prior), industrial production (+0.1% m/m vs. -0.1% prior), construction output (+0.5% m/m vs. -0/7% prior) rebounded. In particular, UK economy grew at its fastest pace in 6 months led by services sector which accounts for 80% of the economy (+0.3% m/m vs. 0% prior). Though one data point does not make a trend, risks of technical recession have receded. We stick to our earlier call that UK should manage to escape a technical recession. 3Q GDP is schedule for release on 11 Nov. As a recap, 2Q GDP unexpectedly contracted **0.2% q/q** (vs. +0.5% q/q in 1Q). Stronger household spending was more than offset by decline in business investment, construction and industrial output while services growth stagnated. Draw-down of stockpiling built in the lead-up to the initial 29th Mar brexit was also cited as a reason for the slump in 2Q GDP.

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

- **UK headline CPI slowed to 1.7% y/y in Aug,** down from 2.1% in Jul. The pullback was due to lower prices of recreation and restaurants & hotels. Inflation has now fallen below BoE's 2% target and is at levels not seen since 2016. Core inflation also slipped to 1.5% y/y. Wage growth (including bonuses), on the other hand continue to inch higher to 4% y/y in the 3-months to Jul (vs. 3.8% in Jun) amid tight labor market (unemployment rate at multi-decade low of 3.8%). Wage growth is the highest since 2008 and pay growth strongest in construction and financial services sectors.

- **Monetary Policy Forecast:** There is no MPC meeting schedule for Oct. For the next MPC on 7th Nov, we still expect BoE MPC to keep policy rate and size of BoE balance sheet unchanged at 0.75%, GBP 435bn, respectively. **Relatively steady CPI (no run-away pressure from BoE MPC's 2% target), with chance of some slight pullback due to lower oil prices and Brexit uncertainty leaves room for BoE to keep policy stance status quo for now**. Maintaining an accommodative monetary policy is what the BoE can do to help support growth amid ongoing Brexit uncertainties. But inflation may go higher at some stage towards later part of the year amid potential front-loading of stockpiling/imports ahead of *Brexit* on 31st Oct. We see **some risks of BoE being stuck between a rock and a hard place** as tight labor market continues to generate upward domestic price pressures (risk of monetary tightening) while on the other hand, BoE may be inclined to ease policies to support growth amid rising downside risks to growth, Brexit uncertainty and easing inflationary pressures

- At the last BoE meeting on 19th Sep, MPC voted 9-0 to keep monetary policy status quo as it balances Brexit uncertainty and weak global growth. Central bank also noted that "trade war between US and China has intensified and the outlook for global growth has weakened… shifting expectations about the potential timing and nature of brexit have continued to generate heightened volatility in UK asset prices, including its exchange rate".

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

- **Key domestic events and issues to watch:** Sep PMI Mfg (1 Oct); Sep construction PMI (2 Oct); Sep services PMI (3 Oct); Aug GDP, IP, manufacturing production, construction output, trade (10 Oct); Aug labor report (15 Oct); Sep CPI, PPI, RPI (16 Oct); Sep retail sales (17 Oct); Sep public finances (22 Oct).

- **Technical Outlook:** Our call in the last FX Monthly to accumulate GBP on dips on the back of bullish divergence played out well. Our objectives at 1.2350, 1.2440 were met as GBP surged to 1.2582 (20 Sep) before easing off into end-month. Pair was last seen at 1.2375 levels. Bullish momentum on daily chart is fading while stochastics is falling. Near term downside pressure possible. Immediate support at 1.2340 (21 DMA) if broken could a test lower towards 1.2270 levels (50 DMA). Bias remains to accumulate dips. Resistance at 1.25 (38.2% fibo retracement of 2019 high to low), 1.2670 (50% fibo) and 1.2730 (200 DMA).

AUD: Too Early For Another Cut

Forecast	4Q 2019	1Q 2020	2Q 2020	3Q 2020
AUDUSD	0.68 (--)	0.69 (--)	0.70 (--)	0.71 (--)

No change from previous forecasts

- **Motivation for the FX View:** AUDUSD is back to where it was when we were writing at this time in Aug, last seen around 0.68. We had called for some recovery in Sep and that has come to fruition but we kept our 3Q and 4Q forecast flat at 0.68 because we anticipated that moves would hover within 0.66-0.70 and price action within Sep has proven this point. We were also concerned about the labour report and that release proved to spur AUDUSD sales even though we disagree with those that look for a rate cut in Oct. The turn of the AUDUSD (lower) was triggered by calls for QE from local banks whose hopes for unconventional policies we fear are misplaced. At this point, We maintain our view that AUD moves are likely to remain within 0.66-0.70 for much of the rest of the year. Spot is now aligned with our forecast for 3Q.

- Based on the latest flash PMI releases out of Markit on 23rd Sep, manufacturing seems to be softening all over the world including the scene in Australia. Investors look for further signs of a rate cut out of RBA with 77.5% implied probability for a rate cut next Tue based on Australian cash rate futures and a 90% implied probability for a rate cut by Dec. The Aug labour report seems to have spurred greater expectations for a rate cut in Oct as jobless rate ticked higher on record-high labour force participation. The encouraged workers effect continues to increase the slack in the labour market conditions and keep the wage growth subdued. While growth of full-time employment softens, demand for labour is still firm with an acceleration in part-time hire. Taking all these factors into consideration, hiring conditions have not deteriorated enough for RBA to take the cash target rate lower from the current 1.00%.

- **Growth and Inflation Outlook:** The preliminary Markit PMI-mfg is a tad disappointing after the Aug AiG Perf of Mfg index print at 53.1 (vs. previous 51.3) suggests that manufacturing show some signs of stability.

- 2Q growth came in largely in line with consensus at 0.5%q/q, steady from the quarter prior (which was also revised higher). Headline was underpinned by government consumption and stronger net exports. Final consumption contributed 0.7ppt (s.adju) to the 0.5%q/q growth of which 0.5ppt came from government consumption. Net exports of services and goods contributed 0.6% while total gross fixed capital formation detracted -0.4ppt from the headline. Weak household consumption continues to be a concern, underscored by RBA Governor Lowe's urge for the government to "do more". Retail sales for Jul fell -0.1%m/m vs. previous at 0.4%, weighed by the weakening retail sales in cafes and restaurants. NAB business surveys for August also depicted weak business conditions and confidence with both scores deteriorated to 1 each from 3 and 4 respectively.

- A silver lining, apart from strong exports, is the rebound in housing prices with the CoreLogic house price for Aug up 1.0%m/m from previous 0.1%. We had previously noted that the stabilization in established housing prices in 2011 took around a year before investors and consumers start to regain confidence and the weak business confidence and retail sales are likely to take time, unless the government is more aggressive with fiscal stimulus. Also, central banks would continue to watch the effects of the US-China trade-war and its development that has weighed on global growth. Stronger global growth is likely to give a lift to international flows, business sentiments, consumer sentiments and concomitantly, growth in Australia.

- In the near-term, we continue to monitor the labour reports that show any signs of serious deterioration in hiring sentiments. The Aug labour report included employment of 34.7K consisting of 50.2K part-time and a fall of -15.5K full-time. Labour force participation rate rose to record high of 66.2%, also bringing the jobless rate firmer to 5.3% from previous 5.2%. Looking at the broader picture, the growth in part-time hires accelerated while full-time employment softened. The encouraged workers effect continued to grow the labour supply with more women and older workers joining the work force. This suggests that household income could increase and may even increase household spending. That said, rising labour supply could continue to keep wages growth subdued and RBA on an easing bias.

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

- **Monetary Policy Forecast:** RBA Lowe, in his recent economic update on 24 Sep, reiterated that the central bank is ready ease further if necessary but his mention of the "gentle turning point" was well quoted in the press as a sign of bottoming and unwound AUD shorts that were accumulated ahead of his speech in anticipation of more signs of urgency to take the cash target rate lower. He also acknowledged that "monetary policy has become less effective at the margin". When asked about unconventional monetary policy, Governor Lowe commented that the Reserve Bank would "consider QE, it's unlikely but possible".

- The easing bias has been clear and consistent but markets are more concerned on the timing and the pace of the easing. According to the Minutes of the Aug meeting. The Reserve Bank highlighted that the "upward trend in wages growth appeared to have stalled" and that "employment growth would moderate over the next six months". There were two considerations for monetary policy – 1) Hiring growth was strong and participation rate was at a record high but jobless rate persists at 5.2% over recent months with few indications that wage pressures were building. This suggests that there is still spare capacity and RBA desires lower rates of unemployment and underemployment – a sign of another rate cut coming. 2) Credit growth is subdued even as mortgage rates were at record low. Residential building approvals and information indicate that "further weakness in dwelling investment" could "sow the seeds of an upswing in the housing price cycle at some point". That could be a positive wealth effect that can boost private consumption which is a key concern of RBA at this point. The easing bias was emphasized with a reiteration that the Reserve Bank would ease monetary policy further "if needed". Taken together, we think that AUD seems to be at a sweet spot to support the external demand for its resources and there is no urgency to lower rates and we do not look for RBA to take the cash target rate lower from 1.00% in Oct. In fact, it is likely that RBA would prefer not to ease anymore this year given a chance of progression in the trade talks between the US and China.

- On the topic of QE which was queried by the House of Representatives earlier this month, a few considerations were noted by RBA including their success in lowering government bond yields which has also lowered borrowing costs for private borrowers along with other key lessons. Two additional considerations highlighted suggest that the bar is still high for RBA to resort to using up its ammunition completely and then move on to QE – 1) a full evaluation of the international experience cannot yet be undertaken as many of the measures that have been applied are yet to be unwound; 2) some of the measures used were meant to address severe financial market dislocation, which is not something that is of concern in the Australian context (link to the full comments here). As such, we like to think that RBA may not make the decision to lower rates from current 1.00% easily and that should keep AUDUSD supported on dips.

- RBA Deputy Governor Debelle, in his recent speech, said that the "lower bound" of policy rates could be "similar to overseas peers", interpreted to be around 0.25-0.5%. In that perspective, AUD may still need to adjust lower as terminal rates, based on futures implied is around 0.4%.

- **Latest External Balance Outlook:** 2Q current account surplus widened to A$5.9bn from previous deficit of -A$1.1bn (also revised narrower). This was underpinned by the wide trade surplus of goods of A$20.36bn. Terms of trade continues to improve, possibly due to the depreciation in the currency vs. its trading partners.

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

- **Key domestic events and issues to watch <u>in Oct</u>:** AiG Perf of Mfg index (Aug), CBA PMI Mfg for Sep (F), CoreLogic House Price, Commodity index (Aug, building approvals for Aug, RBA Meeting on 1st Oct; AiG Perf of Services Index (Sep), CBA Australia PMI ()Sep F(), trade (Aug) on 3rd; RBA Financial Stability Review, retail sales (Aug) on the 4th; foreign reserves (Sep), NAB business survey (Sep) on 8th; home loans, investment lending and owner-occupier loan value (Jul) on 10th; Minutes of the RBA Policy Meeting on the 15th; Labour report on the 17th; CBA PMI Mfg (Oct P); CPI (3Q), building approvals for Sep on 31st Oct.

- **Technical Analysis:** Our view for retracement came to fruition last month but price action has come down back to levels around 0.6750. Stochastics in oversold conditions and MACD is bearish bias. We see some potential for a rebound towards 0.6830, especially if RBA does not act tomorrow (1 Oct).

NZD: Oversold; TWI at 4-Year Low

Forecast	4Q 2019	1Q 2020	2Q 2020	3Q 2020
NZDUSD	0.6400 (--)	0.6600 (--)	0.6600 (--)	0.6800 (--)

No change from previous forecasts

- **Motivation for the FX View: We see some signs of moderation in the pace of NZD's decline (**following near-10% depreciation from its YTD high) on the back of hopeful signs of warmer US-China relations and RBNZ likely to remain in watch-and-see accommodative stance (after the surprise magnitude of 50bps cut in Aug). As such we retain our mild upward trajectory forecasts into 2020. Though consumer confidence remains near 7-year low and 2Q growth saw a sequential slippage, the services sector (2/3 of economy) rebounded. Survey indicators also show some signs of stabilisation in Aug reading.

- Unlike street expectations looking for another 25bps cut at the Nov meeting, we expect RBNZ to retain watch-and-see accommodative stance to allow for the 50bps cut in Aug and lower NZD to work its way into the economy. In particular, **RBNZ's measure of NZ TWI has fallen to 4-year low of below 70-levels from the high of 74 levels in Jul-2019. This level is now way below RBNZ's working assumption of NZ TWI range of 72.8 - 73.4 from 3Q 2019 to 4Q 2020.** On the interest rates aspect, OCR at historical low of 1% after the 50bps cut to deliver maximum effectiveness to meet its dual policy objectives of inflation and employment as well as to play catch-down with its RBA peer may imply that the bar for further rate cut may be set higher. Nonetheless we do caution that RBNZ will not drop its dovish tone anytime soon and this could still have the effect to keep market expectations for another rate cut intact, hence a risk factor weighing on NZD.

- **Growth and Inflation Outlook: 2Q GDP saw a sequential downtick** to 0.5% q/q (vs. +0.6% in 1Q). Goods-producing industries was the main drag driven by declines in manufacturing and construction while services industries rebounded, led by retail trade/accommodation, arts/recreation, public administration, etc. On expenditures, exports declined due to lower dairy and meat shipments while household spending rose at a faster pace led by durable goods and services. Other survey, activity and confidence data was mixed: Mfg PMI remains in contractionary territory in Aug at 48.4 while services PMI is steady in expansionary territory (54.6). Credit card spending rebounded in Aug while Westpac quarter consumer confidence holds near 7-year low for 3Q.

- **RBNZ expects NZ growth to remain subdued and have lowered growth forecasts through 2019 and 2020 to 2.7%, 2.4%, respectively** (as of the last MPS, Aug 2019). On inflation, RBNZ noted that most measures of core inflation remain below 2%. Subdued inflation partly reflects low imported inflation and this is expected to decline in the near term before gradual convergence to below its long-term average. RBNZ also noted on weak pricing behaviour.

- **3Q inflation is scheduled for released on 16 Oct. 2Q headline CPI re-accelerated to +0.6% q/q** (vs. +0.1% in 1Q) owing to higher petrol prices and housing cost. Petrol prices (tradable inflation) are transitory and the upward pressure on petrol prices is likely to ease off in 3Q as oil prices stabilise. As such the next print for inflation could ease as oil prices slipped and slowing global growth momentum amid US-China trade tensions feed-through to NZ economy. On annual basis, headline CPI rose +1.7% y/y in 2Q, from 1.5% in 1Q. The uptick is in line with RBNZ and market expectations. Non-tradeable inflation remains steady at 5-year high of 2.8% y/y

- **Monetary Policy Forecast:** There is no MPC scheduled in Oct. For the next MPC on 13th Nov, we still expect **RBNZ to keep OCR on hold at 1%. We believe RBNZ will allow for the transmission effects from the earlier 50bps surprise cut in Aug (cumulative 75bps cut YTD) to work its way into the economy. Moreover, RBNZ's measure of NZ TWI has now fallen below 70-levels from the high of 74 levels (Jul-2019). This is also the lowest level since Oct-2015. NZD depreciation (of 9.5% vs. USD YTD to 4-year low) is also another form of monetary easing which is feeding through to its economy and could help to support exports, growth. Though 2Q GDP disappointed to the downside, we think this has already been taken into consideration by MPC hence the 50bps cut decision in Aug. RBNZ Governor Orr had also earlier said (23 Aug) that RBNZ could afford wait-and-watch before deciding on further action to support the economy. On a side note, we are aware that markets (80% priced in via NZ OIS) are looking for another 25bps cut at the Nov meeting. To add, RBNZ could indeed be triggered to cut OCR again if the RBA does cut rate to another historical low of 0.75% either at their 1 Oct or 5 Nov meeting.**

- But caution remains as RBNZ could still ease further if need arises especially when synchronous monetary easing gains traction in most parts of the world including US and Asia. RBNZ shared (on 23rd Jul) that they have begun a project to refresh unconventional monetary policy strategy and implementation, albeit at a very early stage. There was no further detail beyond the disclosure to Official Inflation Act in requesting for work on non-standard policy measures. We **do not expect RBNZ to join ECB, BoJ to unleash unconventional QE-type of monetary policies in the near future, but the mere mention of conducting such a project can further reinforce the dovish bias of RBNZ.**

- At the last MPC meeting (25th Sep), RBNZ kept OCR unchanged at 1%, as expected. Accompanying statement noted that employment is around its maximum sustainable level and though inflation is within the target range, it is below the 2% mid-point. It also noted "there remains scope for more fiscal and monetary stimulus, if necessary, to support the economy and maintain inflation and employment objectives". It also made reference to global long-term interest rates near historically low levels which is consistent with low expected inflation and growth rate in the future. "Consequently, NZ interest rates can be expected to be low for longer".

- **External Balance Outlook:** NZ current account deficit narrowed to -3.4% of GDP in 2Q from -3.6% of GDP in 1Q. This was due to an improvement in services surplus owing to tourism receipts and narrowing in primary income deficit.

- **Key domestic events and issues to watch:** Sep house prices (2 Oct); Sep commodity prices (3 Oct); Sep food prices (10 Oct); Sep Mfg PMI (11 Oct); Sep services PMI (14 Oct); Aug net migration (15 Oct); 3Q CPI (16 Oct); Sep credit card spending (21 Oct); Sep trade (23 Oct); Sep building permits; Oct business confidence (31 Oct).

- **Technical Outlook:** NZD traded a month of 2 halves – rising in early part towards 0.6450 (12 Sep) from 0.6269 (3 Sep) before losing all gains to trade a low of 0.6255 (23 Sep). Last seen at 0.63 levels. Daily momentum is not indicating a clear bias though stochastics is in oversold conditions. While weekly momentum remains bearish, a bullish divergence pattern is potentially forming on the MACD. Coupled with stochastics (both weekly and daily) at oversold conditions, these signs suggest that downside moves may be sticky. Support at 0.6250, 0.6130. Should the bullish divergence come into play, NZD could see a bullish reversal towards 0.6340 (21 DMA), 0.6440 (50 DMA).

JPY: Demand in Environment of External Tensions, Domestic Growth Worries

Forecast	4Q 2019	1Q 2020	2Q 2020	3Q 2020
USDJPY	105 (--)	106 (--)	106 (--)	105.5 (--)

No change from previous forecasts

- **Motivation for the FX View:** Forecasts are unchanged from previous month. We see broad downward pressure for the USDJPY pair in an environment of uncertain global relations between major powers. Earlier step-up in the pair in the first half of Sep was largely based on signs of receding global risks, as US and China exchanged bouts of goodwill, and confirmed subsequent trade talks. Hard Brexit risks also seemed to be reduced somewhat, as BoJo faced continuous setbacks in the British Parliament. Nonetheless, the upward momentum fizzled by the middle of the month, just as the pair was slightly shy of 108.50, and we're currently in the midst of a downward retracement, alongside renewed concerns over US-Iran relations, beginnings of an impeachment inquiry against Trump in the US, and signs of re-escalation in US-EU tariff woes. We look for structural global tensions and potentially weaker domestic equity performance to boost the JPY in 4Q. Given that the US has a tad more room for easing compared to BoJ, yield differentials could also narrow in JPY's favour. Going into next year (perhaps before the Nov 2020 US elections), more concrete signs of positivity from US-China trade talks are possible, in which case the downward pressure on USDJPY might be arrested and the pair could trade ranged.

- The yield differential between Japanese 10 year bonds and US 10 year bonds have narrowed from -2.7% at the start of the year to around -1.9% now. When looking at the Fed's dot plot, if we compare changes over the past few projections, there has also been a steady shift downwards, with the median for end-2019 almost 100bps lower now compared to expectations in Dec 2018. This suggests that dovish voters may be slowly guiding the Fed policy rate downwards. Option prices also suggest that markets see a >70% probability of another Fed cut before year-end. Meanwhile, it is unlikely that negative yields in Japan (-0.228% for 10 year government bond as of writing) can get much lower. Any signs of further yield compression would be supportive of the JPY.

- Nonetheless, anecdotal evidence and fund flow statistics suggest that extent of yen rallies may be capped by one key channel—when the yen is strong, Japanese residents may be more inclined to send funds overseas for higher returns. Investments in overseas bonds by Japanese residents were at JPY16.1tn in the first eight months of 2019, significantly higher than the JPY3.1tn recorded in the same period last year. In current conditions, Japanese investors can potentially get >1% from some currency-hedged DM sovereign debt, while domestically 10-year bonds have negative yields. This supports our caution against projecting the USDJPY at below 105.

- The latest developments in the Korea-Japan spat shows that relations between the two countries continue to be tense. South Korea's decision to end a military intel-sharing pact with Japan had further soured relations between the two powers, after Japan announced curbs on exports (to Korea) of certain components needed for making smartphones and TV displays. Both Japan and Korea are now effectively removed from each other's trade whitelist, meaning that exports to the other party may be faced with increased administrative burden and delays.

- Repercussions for Japan are starting to emerge, and could potentially worsen going forward. Japanese auto sales had fallen to an 8-year low in Korea as tensions rose. As cautioned in the last Monthly, the impact on tourism for Japan is also starting to be more discernible in the statistics—South Korean visitors to Japan had plunged by almost half in August (to ~308,700). Both Korean and Japanese airlines are also starting to cut flights between the two countries. If the conflict escalates, negative sentiments on the Japanese bourse could lend support to JPY.

- **Growth and Inflation Outlook:** Final print for 2Q GDP growth was at 1.3%q/q SA annualized, compared with 1.8% in 1Q. The Economic & Social Research Institute's Coincident Business Cycle Indicator softened to 99.7 in Jul, from 100.4 in June. However, the Leading Indicator had improved slightly to 93.7, from 93.3 in June, hinting at some stabilisation in growth momentum. This was corroborated in part by the Business Survey Index (All Industry), which came in at 1.1 for 3Q (vs. -1.0 expected). Core machine orders for Jul grew at +0.3%y/y (vs. -3.7% expected). The prelim Sep Jibun Bank PMIs also seem to paint signs of resilience, only slipping slightly to 48.9 for Manufacturing and 52.8 for Services, compared to 49.3 and 53.3 prior. Aug retail sales came in better than expected (2.0%y/y vs. 0.7% expected), which could imply some resilience in consumption growth momentum for 3Q.

- On balance, growth indicators continue to indicate soft, but non-recessionary outcomes for the economy. Consensus estimates are for the Japanese economy to expand by a modest 0.9% in 2019 for now, slightly lower than the 1.0% estimate previously. With both external and domestic challenges to overcome, consensus figures also expect growth to dip further to 0.3% in 2020.

- Headline CPI slowed to +0.3% y/y in Aug (vs. +0.5% y/y in July) due to softness in food and energy prices. Core inflation, which excludes fresh food, came in at +0.5% y/y (slightly lower than July's 0.6%). Inflation is expected to ease further alongside cheaper mobile phone charges, as well as free pre-school education starting in Oct. A separate core gauge that strips out prices of fresh food as well as energy posted a 0.6%y/y gain, on par with July. Broadly tame inflationary pressures suggest that BoJ will need to persist with its ultra-loose monetary policy for an extended period, if it's reluctant to change its 2% inflation target.

- **Monetary Policy Forecast:** At the recent Sep 19 meeting, the MPC voted 7-2 to keep monetary policy at status quo, with yield curve control at -0.1% for short term rates and 10Y JGB yield at around 0%; annual asset purchases of JGB holdings, ETF and J-REIT will be maintained at JPY80tn, JPY6tn and JPY90bn, respectively. BoJ intends to maintain "the current extremely low levels of short- and long-term interest rates … at least through around spring 2020". The new line from the previous statement—"will not hesitate to take additional easing measures if there is a greater possibility that momentum towards achieving the price stability target will be lost"—was retained this time round.

- We note that the BoJ is setting up expectations for a re-examination of growth and inflation outlook at the next meeting on 30 Oct, post the implementation of the sales tax hike (from 8% to 10%) on 1 Oct. While BoJ retained its dovish slant and reiterated its commitment to additional easing if needed, markets were not entirely convinced. The yen had strengthened incrementally post-announcement. Still, Kuroda had said that he was more inclined toward increasing stimulus now than in late July, and there was some genuine concern on potential stalling of price momentum, i.e., "it is becoming necessary to pay closer attention to the possibility that the momentum toward achieving the price stability target will be lost". On balance, there is a fair chance that BoJ might fiddle with some combination of lower short-term rate, wider trading range on 10-year JBG, or higher ETF purchases, in Oct.

- **Latest External Balance Outlook:** Current account surplus widened in July to JPY2.0tn, from JPY1.2tn in Jun. For Aug, the trade balance remained at a mild negative (-JPY136.3bn vs. +JPY250.7bn prior), as imports (-12.0%y/y) contracted by a slightly larger extent compared to exports (-8.2%y/y). We note that exports have recorded y/y declines for 9 straight months since Dec 2018. The weakness in exports was due in part to weakening Asian demand for autos and chip-making equipment. Merchandise export volumes to Asia had slid -8.9%y/y, following a 4.7% fall in July, whereas exports to the US saw a reversal (-3.5%y/y vs. +10.1% prior). We note that Japan's dispute with South Korea is a pertinent concern for the trade outlook. South Korea accounted for about 7% of Japan's exports in 2018. Current account for the year is expected to be softer than 2018's 3.5% (of GDP), but may remain resilient at above 3%.

- **Key domestic events and issues to watch:** 3Q Tankan Surveys (1 Oct); Sep Jibun Bank Mfg PMI (1 Oct); Sep Vehicle Sales (1 Oct); Sep Consumer Confidence (2 Oct); Sep Jibun Bank Services, Composite PMIs (3 Oct); Aug ESRI Leading, Coincident Indices (7 Oct); Aug Current Account Balance (8 Oct); Aug Machine Tool Orders (9 to 12 Oct); Core Machine Orders (10 Oct); Aug IP (15 Oct); Sep National CPI (18 Oct); Sep Trade (21 Oct); Oct Prelim Jibun Bank PMIs (24 Oct); Sep Retail Sales (30 Oct); Sep Prelim IP (31 Oct); Sep Housing Starts (31 Oct); BoJ Policy Decision (31 Oct).

- **Technical Outlook:** Pair last seen around 107.80. It saw broad upward pressure in the first half of the month as bouts of US/China goodwill led to hopes of easing in trade tensions, and has traded ranged since mid-Sep. We note that bullish divergence on weekly chart observed last month has largely played out with the up-move in Sep. Daily momentum and stochastics on daily chart are not showing clear biases. Support at 107.50 (61.8% Fibonacci retracement from Aug high to low), 106.90 (50% fibo), 106. Resistance at 108.20 (76.4% fibo), 109.30 (Aug high).

RMB: It's the Will to Prepare to win that Matters

Forecast	4Q 2019	1Q 2020	2Q 2020	3Q 2020
USDCNY	7.20 (--)	7.18 (--)	7.15 (--)	7.10 (--)
USDCNH	7.20 (--)	7.18 (--)	7.15 (--)	7.10 (--)

No change from previous forecasts

- **Motivation for the FX View:** Our view that the USDCNY fix would beckon the spot came to fruition in the first half of September and it took 13 consecutive sessions of USDCNY fixes at the 7.08-handle for the spot to converge towards the fix of the daily reference rate. As a result, the USDCNY touched a low 7.0593 in the month (beyond our target of 7.07 stated in the last FX Monthly issue) before making a turn higher to levels around 7.12, in line with our 3Q forecast.

- By using various tools including technical analyses, our fixing model's estimates, our observation of the gap between the estimates and the actual fix as well as the behavior of the fix and spot prices along with other market/event clues, we were able to predict the break of the 7, the subsequent rally of the RMB and then even the retracement seen since 16th Sep that we have cautioned in our RMB Watch. Beyond the 70th anniversary of the PRCs, the trade talks development between the US and China could still be fluid and visibility is poor. The recent USDCNH move to a high of 7.1515 was spurred by news that the US may delist Chinese companies in the US stock exchanges and to limit portfolio flows from the US to China. That said, the US Treasury has denied that they would be in the plans for now.

- The USDCNY fix has been supporting the CNY in an environment of USD strength and we like to caution that these could still be a sign of goodwill, confidence in the US-China trade talk developments that could progress in Oct. In addition, a head and shoulders pattern seems to be forming on the daily USDCNH chart which suggest a potential break of the 7 (this time lower) and that could threaten our year-end forecast of 7.20. That said, should the 7.20 be breached, the head and shoulders formation would negated. That kind of scenario is likely to be one of disappointment on the US-China trade talks front.

- China's top Policy Makers held a briefing on 24th Sep and it seems that China hopes for the best but prepares for the worst (a prolonged trade war). PBoC Yi Gang assured that there is "ample room" for fiscal and monetary policy to tackle the headwinds in the economy. China is not keen on quantitative easing seen in other economies and the country prefers to preserve ammunition in the conventional policy toolkit. FinMin Liu Kun noted that the tax and fee reductions that have already been rolled out earlier have provided bigger savings than expected for corporates and households and the government will assess and decide if there is any need for further action. Amid the clampdown on shadow banking, PBoC Governor Yi Gang assured that lenders are encouraged to provide credit to the "real" economy. There are signs that policymakers are preparing for a long-drawn trade war as policy makers seem to be holding back on fiscal and monetary stimulus even as activity deteriorates. In the meantime, a broad 50bps RRR cut was provided on 6th Sep along with a 100bps targeted cut for regional banks. We continue to expect PBoC to ease monetary policy settings via RRR cuts rather than significant interest rate adjustments. That could mean that even as USDCNH could have some risks to the downside (in case of a progression for the US-China trade talks), retracements higher for the USDCNH would be likelier than not.

- We watch the fourth plenary session of the CPC that could see some policy changes. Next high level US-China trade negotiations are scheduled to take place in Washington in 10-11th of Oct. Beyond the near-term, the WTO mini-ministerial meeting in Shanghai (early Nov) and APEC Summit in Chile (11-17 Nov) can also serve as checkpoints for trade talks.

- **Growth and inflation outlook:** Outlook for China's growth remains weak with activity numbers still deteriorating for Aug. Industrial production slipped to 4.4%y/y vs. previous 4.8%. Retail sales also deteriorated to 7.5%y/y from previous 7.6%. FAI ex rural worsened to 5.5%y/y from previous 5.7%. With exports growth also deteriorating to low single digit growth for exports and contraction in imports, PBoC acted on 6th Sep to provide both broad and targeted RRR cuts in order to support the economy.

- Ahead of the activity numbers, credit numbers were released. Aggregate financing came in well above the expected CNY1980bn vs. expected CNY1604.5bn. New yuan loans came in roughly in line with the expectations. Most notably in the breakdown of the aggregate financing is the rising growth of the net local government special bond financing that saw an additional credit growth of CNY321.3bn, beating the amount of corporate bond financing of CNY304.1bn. This is in line with the government's aim to accelerate infrastructure projects in order to stimulate domestic activity. The local press reports that there will be more to come as local governments are told to submit plans for special purpose bonds as soon as they can. So we anticipate that the further tax reductions if any or other broad fiscal stimulus would only be tapped on at a later stage.

- Inflation steadied at 2.8%y/y for Aug, underpinned by the continuous surge in poultry costs (30.9%y/y vs. previous 18.2%) as pig culling due to the African swine flu underpins prices of the pork. Meanwhile, the poultry surge is negated by softer prices of vegetables and fresh fruit and also eggs. On the producer front, PPI slipped a deeper -0.8%y/y in Aug, albeit smaller than expected 0.9%. The fall in PPI indicate a squeeze in the industrial profitability and only underscores the headwinds faced by the manufacturers.

- **Monetary Policy Forecast:** MLF rates were kept at 3.30% but PBoC has lowered the 1Y Loan Prime Rate (LPR) from 4.25% to 4.20% and kept the 5Y LPR at 4.85%. This was roughly in line with consensus. The central bank seems adamant about keeping monetary policy prudent and to preserve ammunition in the conventional monetary policy space. That said, earlier in Sep, PBoC had cut broad RRR by 50bbps and targeted RRR for qualified banks by 100bps. We continue to expect the central bank to rely on RRR adjustments for its major monetary stimulus tool and we look for another one in Nov. Another 5bps cut to the 1Y LPR is also not ruled out in Nov, post Oct FOMC.

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

- China government bonds failed to win inclusion into FTSE Russell's WGBI, remaining on FTSE Russell's watch-list for potential upgrade to Market Accessibility Level 2. There were some concerns about limited hedging options and relative liquidity vs. other markets. While there have been some reported concerns that China's non-inclusion would mean that the country would not be able to benefit from inclusion-related portfolio inflows, we think that this is a matter of "when" not a "if". As such, the impact on RMB is rather muted. We would continue to monitor if there are more talks of US limiting portfolio flows into China as another branch of focus for the US-China tension.

- **Key domestic events and issues to watch <u>for Oct</u>:** NBS PMI (Sep), Caixin PMI-mfg due on 30th Sep; 70th Anniversary of the Founding of the People's Republic of China (Golden Week – National Day Holiday 1-7th Oct); **<u>Fourth Plenary Session</u>** of the CPC will take place sometime in Oct; Caixin PMI Composite, Services, Foreign Reserves for Sep on the 8th Oct; Aggregate financing, money supply M2, new yuan loans for Sep on 10-15th Oct; FDI for Sep on 11-18th Sep; trade data for Sep on 14th; CPI, PPI on 15th, US could raise tariff on$250bn of Chinese imports from 25% to 30% on 15th; urban FAI, industrial production, retail sales, property investment and 3Q GDP on 18th; LPR settings on 20th; new home prices for Sep on 21st Oct; industrial profits on 27th; NBS PMI on 31st Oct.

- **Technical Analysis:** Our view for USDCNH to head towards 7.07 came to fruition. At this point, the USDCNH seems to be forming the right shoulder of the head and shoulders formation that we expect to peak around 7.13-7.15. The recent high has been 7.1515. More USDCNH gains would threaten our view for USDCNH to come off sharply lower should the head and shoulders formation play out. However, insofar, the moves up have been within our thresholds. The neckline of this head and shoulders is slanted and a break of the neckline would be considered with a move below 7.05-7.06. Gains above 7.20 would nullify this bearish formation.

KRW: Plagued by Deflation Risks, Slowing Growth, BoK Cut

Forecast	4Q 2019	1Q 2020	2Q 2020	3Q 2020
USDKRW	**1200** (--)	**1185** (--)	**1170** (--)	**1160** (--)

No change from previous forecasts

- **Motivations for the FX View:** We remain less positive on KRW in the interim on a mix of slowing growth (with little signs of recovery in the near term), deflation risks and BoK rate cut. Ongoing trade disputes between Korea-Japan and US-China (though there may be glimmer of hopes on US-China front) and slowing global growth will continue to weigh on domestic growth, business confidence and KRW. Though there are efforts being made on the fiscal front for 2020, the real economy may not feel the positive impact so soon due to lagged transmission effects **of fiscal stimulus.** Hence KRW may remain on the weaker side (hit by double whammies of external and domestic woes) before it shows clearer signs of recovery into the turn of the year.

- **Fading Hopes of Recovery and Rising Risk of Deflation Suggests Imminent BoK Rate Cut.** Though Korea may have averted a technical recession in 2Q, ongoing trade disputes and rising concerns of slowing global growth have resulted in shifts in supply chain network and dented demand. With Aug inflation slowing to lowest on record at zero, S. Korea may be at risk of entering into a few months of deflation. If this is not quickly addressed and becomes longer than expected, investments, asset values and incomes could be affected and this can lead to lower consumption and further weigh on growth and its currency. We expect BoK to cut policy rate by 25bps as soon as at the upcoming MPC on 16th Oct especially if domestic economic activity, exports and inflation continue to show no signs of recovery.

- Our forecasts were already revised in the last FX Monthly to reflect our expectations. We however do add that there are downside risks to our USDKRW forecast: (1) if US-China trade talks do progress into a deal (instead of just mere headlines of "constructive progress" and/or: (2) global economy rebounds meaningfully and/or (3) Korea 3Q GDP/ consumer confidence turn higher (both intuitively correlates positively).

- **But KRW Weakness is Not Bottomless.** Korea's consumer sentiment has plunged to 31-month low in Aug, together with KRW towards 1220 levels (more than 3-year low vs. USD). Historically the correlation between Korea's consumer confidence and KRW is positive and the last time both consumer confidence and KRW declined this sharply was back in Jan-2017. But subsequently for the rest of 2017, both consumer confidence and KRW strengthened sharply amid global synchronous recovery. We are not suggesting that a recovery turn is coming but wish to highlight that should there be optimism; USDKRW could possibly be near its inflection point (i.e. room for further upside may be limited towards 1240/45 levels). Any meaningful recovery in KRW would still require material upticks in economic activity, recovery in tech sector to reverse the fortunes of Korean exports where shipments of semiconductors account for 1/5 of overall Korean exports or the easing of geopolitical tensions between Japan and South Korea.

- **Growth and Inflation Outlook: 2Q GDP was revised lower to 1% q/q** (vs. 1.1% preliminary print), owing to smaller contribution from exports (2% vs. 2.3% prelim) and government expenditure (2.2% from 2.5% prelim). On y/y basis, 2Q growth was 2%, revised lower from 2.1% y/y. Facility investment expanded 3.2% led by transportation equipment and comes at the strongest pace since 1Q 2018. That said Korea managed to escape from technical recession in 2Q. Looking ahead Ministry of Finance has proposed a record budget of KRW513tn (about US$423bn) for next year to cope with economic downturn arising out of trade disputes between US and China as well as between South Korea and Japan. Largest spending of KRW181tn will be committed to welfare while military spending will rise by >7% to KRW50.2tn. About KRW24tn is directed to accelerate exports and investments; KRW26tn for job creation; KRW23tn to social overhead projects such as schools, roads and hospitals; nearly KRW5th to prospective growth engines such as AI, future vehicles and another KRW2.1tn to localize imported goods. That said there is a lagged transmission effect for stimulus to be positively felt on the economy. For now, negative repercussions arising out of ongoing trade disputes between Korea and Japan, US-China, concerns of slowing global growth will continue to be of immediate focuses and will drag on domestic growth, business confidence and weigh on KRW.

- **Headline inflation slowed to zero on y/y terms in Aug, the lowest on record** since S.Korea first released CPI data in 1986. Authorities explained that slower inflation was due to supply side factors seen in price declines with agri, fisheries and oil and these are temporary. We think that its more than just supply-side factors as ongoing trade disputes and rising concerns of slowing global growth have dented demand and resulted in shifts in supply chain network. Potentially S. Korea may enter into a few months of deflation. If this is not quickly addressed and becomes longer than expected, investments, asset values and incomes could be affected and this can lead to lower consumption and further weigh on growth. Core inflation was largely steady at 0/9% y/y in Aug (vs. 1% prior).

- **Monetary Policy Forecast**: We expect the **BoK to cut policy rate once more this year by 25bps to 1.25%, possibly as soon as at the upcoming MPC meeting on 16 Oct** on persistent domestic growth concerns and deflation risks. Ongoing trade spat between Japan-Korea and unresolved trade dispute between US and China are not helping with the investment, growth cycle. In addition, Fed's back-to-back rate cuts (of 50bps cumulative) in Jul and Sep and potentially another 25bps by end-2019 should provide some breathing space for BoK to cut rate.

- At the last MPC meeting on 30th Aug, the BoK kept policy rate on hold at 1.5%, as expected. Decision was not unanimous as 2 members called for rate cut. Accompanying statement noted that uncertainties over its growth and inflation forecasts had increased and will judge whether to adjust the degree of monetary policy accommodation. BoK Governor Lee highlighted a number of geopolitical risks in addition to ongoing tensions between Japan and Korea, US-China trade dispute, Italy political uncertainty and Brexit, etc. He added there is some "room for maneuver" in its monetary policy to respond to economic situations but also cautioned against lowering interest rate too low in light of the accumulation in domestic debt. BoK last cut rate by 25bps at 18th Jul MPC meeting.

- **External Balance Outlook:** Current account surplus rose for a third consecutive month to 9-month high of $6.95bn in Jul, from $6.38bn in Jun. primary income surplus saw a sharp increase to $3bn from $1.5bn in Jul-2018 while services account deficit narrowed.

- **Fiscal Balance Outlook:** Ministry of Finance expects revenue to rise only 1.2% next year while fiscal deficit is expected to increase to KRW72tn next year from KRW42tn this year amid expanded budget. National debt to GDP is expected to rise to 39.8% of GDP in 2020, from 37.1% of GDP this year. Government is expected to fund its shortfall by selling KRW60tn of deficit-covering treasury bonds (nearly doubling this year's KRW34tn). We do not expect South Korea's rating to be affected in the near term as debt-to-GDP ratio is still generally healthy below 40% and expansionary fiscal stimulus amid downturn may help to address short term growth concerns and build the foundation for medium term resilience. Looking ahead government looks to gradually increase debt-to-GDP ratio to mid-40 levels in 2023.

- **Key domestic events and issues to watch:** S. Korea releases Sep exports, CPI, PMI Mfg; Oct mfg/non-mfg business surveys (1 Oct); Sep FX reserves (4 Oct); Aug current account (8 Oct); Sep unemployment rate; BoK MPC (16 Oct); Sep PPI (22 Sep); 3Q prelim GDP (24 Oct); Oct consumer confidence (25 Oct); Nov mfg/non-mfg business surveys (29 Oct); Sep IP (31 Oct).

- **Technical Outlook:** Our call in the last FX Monthly looking for a move lower towards 1180/85 levels were more than met. USDKRW traded a low of 1176 (13 Sep). Spot ref at time of call in last FX Monthly was 1210 levels. Pair was last seen at 1198 levels. Near term risks skewed to the upside as seen in daily momentum indicators. Resistance at 1210, 1220 levels. Potential bearish divergence seen on weekly MACD remains intact for now. Bias to sell rallies. Support at 1180, 1173 levels.

SGD: MAS Easing Expectations in Play

Forecast	4Q 2019	1Q 2020	2Q 2020	3Q 2020
USDSGD	1.3950 (--)	1.3900 (--)	1.3800 (--)	1.3700 (--)

No change from previous forecasts

- **Motivation for the FX View:** Forecasts remain unchanged from last month. With trade exposure at more than 3-times GDP and a significant share of high-tech manufacturing in economic output, Singapore is still vulnerable to (i) a decline in intermediate goods exports to China, (ii) re-configuration in regional supply chains, (iii) broad slowdown in external demand amid rising protectionism. Notably, some of the factors are structural in nature, and while an interim trade deal (if any) might boost sentiments, it might take several quarters to see positivity in Singapore's trade and GDP numbers. Notably, the USDSGD pair has already fallen by around -0.9% since the turn of the month, alongside bouts of "goodwill" between US and China in talks, and it could require more concrete evidence of progress in trade negotiations before downward momentum in the pair can re-exert. Instead, we see an upward bias as more likely, with continued weak growth momentum and tame inflation corroborating increasing likelihood of a MAS easing in Oct. Using historical performance as a guide, we see more room for SGD NEER to decline. Nonetheless, the extent of weakness could be capped, due in part to partial regional safe haven characteristics of SGD sovereign bonds.

- Despite recent positive news on the trade talk front, such as China's purchases of pork and beef from US, resolutions on more thorny issues such as IP protection and US access to sensitive industries in China might still take some time to be sorted out. Any potential interim deal, which Trump has made reference to, could potentially be light in substance. There are also concerns with regards to reports of potential limitations on US residents' portfolio flows into China. Two-way trades could be likely in interim, before more significant easing of trade tensions leads to some relief in the SGD in 2020.

- Comparing recent trade outcomes, Singapore does not appear to be seeing any significant gains from trade diversion flows (except potentially in minor categories such as non-monetary gold, to China). Given that Singapore-based electronics manufacturers account for around 11% of global market share for the semiconductor wafer foundry output, and that nearly 10% of Singapore's GDP is attributable to exports to China (both final and intermediate demand), the economy is likely to remain vulnerable to the current external environment. Meanwhile, China's Beige Book projects further deterioration in growth momentum among all sectors, particularly manufacturing in 3Q, which could portend softness in Singapore's trade and growth outlook for the rest of the year.

- Such an environment of slowing Chinese demand, coupled with signs that the Japan-Korea trade spat might be protracted, could exacerbate the softness in the global tech cycle. In particular, Korea and Japan are now both removed from each other's trade whitelists, and increased administrative burdens for electronics exporters on both sides are likely. Given key roles of Japan and Korea in regional supply chains, there could be some ensuing spillover effects on regional manufacturers. Meanwhile, companies globally could still be reluctant to commit to spending on capital goods. Global semiconductor sales had slumped more than 13%y/y in 1H 2019, the sharpest decline since 2009. Concomitantly, large contractions continued to be observed in Singapore's Aug NODX (-8.9%y/y vs. -11.4% prior) and electronics exports (-25.9%y/y vs -24.2% prior). Negativities in the global tech cycle and its implication for outlook among Singapore's manufacturers support our call for authorities to ease in Oct (from current estimated 1.0%), which is consistent with an upward bias for USDSGD.

- Nonetheless, the extent of weakness could be capped, due in part to partial regional safe haven characteristics of SGD sovereign bonds. Singapore sovereign bonds pay the highest returns currently among economies that have AAA credit ratings from all three major rating agencies. Auctions for SG sovereign bonds (both 2Y and 10Y) have drawn healthy bid-cover ratios of around 1.8 to 2.

- **Growth and Inflation Outlook:** Final 2Q GDP was at -3.3% qoq saar and 0.1% y/y. Manufacturing contracted (-3.1%y/y) while services rose at the slowest pace since the global financial crisis (+1.1%y/y). Construction growth, while positive, was also relatively modest at +2.9%. The initial sharp downside surprise during the advance release had led most economists to revise downwards their full-year growth estimates, with some noting that the likelihood of a technical recession in 3Q has also increased. At the release of the final 2Q figures, MTI downgraded full-year GDP growth estimate sharply to 0%-1%, from 1.5% to 2.5% previously. This factors in some chance for a technical recession (i.e., two quarters of negative sequential growth) in 3Q.

- Given that external circumstances have largely see-sawed in Sep, with no concrete deterioration or improvement in underlying conditions (US-China trade war, slowdown in China's growth momentum and Japan-Korea trade spat), our economists have maintained their GDP growth forecast at 0.6% in 2019 and 1.6% in 2020. While some mild positivity was seen in the Aug PMI (49.9 vs. 49.7 expected), actual Aug Industrial Production (-8.0%y/y vs. -0.6% expected) had surprised significantly on the downside. Electronics (-24%y/y) had slumped at the worst pace since Jan 2012, as semiconductors (-30%y/y) fell dramatically. Domestically, retail sales in Jul also remained soft, at -1.8%y/y. These trends suggest that it could be premature to call for a growth recovery. A larger proportion of the second US tariff wave (in Oct and Dec) will be on consumer goods (about 40%), especially electronics, versus the first wave (about 20%), and this could result in continued softness in China's demand for Singapore's intermediate products.

- On the inflation front, Core Inflation remained muted at 0.8%y/y in Aug, on par with outcomes in Jul. Sharp declines in utility costs and retail prices had offset the pickup in food and services inflation. Headline CPI rose by a mild +0.5%y/y in Aug (from +0.4% in Jul), on the back of private road transport costs (+0.6%y/y vs. +0.3% in Jul), alongside the rise in COE prices. MAS has maintained its core inflation outlook, expecting core inflation to come in within the lower half of its 1% to 2% forecast range. Headline inflation forecast range of 0.5% to 1.5% is also kept unchanged. Our Economist's estimates for Core and Headline Inflation are kept at +1.2% and +0.7% for 2019, respectively, as demand conditions remain muted.

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

- Our Taylor Rule estimates for the SGD NEER still highlight that an appropriate SGD NEER slope consistent with current growth and inflation projections could be in the 0% to +0.5% range; the extent of appreciation has come down significantly given the downward revisions in growth and inflation in Aug. Given non-zero chance of a technical recession in 3Q and continued benign inflation, there is an **increased probability that the MAS could ease at its next policy meeting in Oct,** compared to conditions at end-2Q. Both options, i.e., mild easing (reduction of slope by 0.5%, from current estimated 1.0%) and easing to neutral slope, are arguably still in play.

- As at writing, USDSGD is around 1.3820, and trades around 1.1% above the implied mid-point of 1.3966, with the top estimated at 1.3686 and the floor at 1.4245. While having come off quite a fair bit since the end of June (from 1.8% above mid-point then), SGD NEER remains in the upper half of the band. Our earlier note on SGD NEER (see here) makes the case for easing, which should exert downward pressure in the SGD NEER. A risk to this view is a sharp decline in USD strength at some point, which could mitigate the extent of weakness in SGD NEER.

- Domestic interest rates have continued to trend downwards from the highs in May. The 3-month SOR (3MSOR) and 3-month SIBOR (3MSIBOR) are at 1.69050% and 1.87700% respectively at the time of writing, slightly lower than the 1.73658% and 1.87933% recorded at end-Aug. With Fed's dovish tilt still intact on global trade uncertainty concerns, there could be downward pressure on US rates (and hence Sg rates) going forward. Options data put chance of at least one Fed cut by year-end at around three-quarters. House view is for another 50bps of Fed cuts through to mid-2020. Nonetheless, the extent of decline in Sg rates could be mitigated by expectations of a smaller appreciation (or even flattening of slope) in the SGD vis-à-vis the USD. Deposit rates (for 12-month fixed) was unchanged at around 0.57% (last data point at end-Aug). The interest rate easing bias should help mitigate financial stability risks in interest-sensitive sectors (e.g., property, O&G) for now. We expect the 3MSOR and 3MSIBOR to decline to around 1.53% and 1.71% respectively by end-4Q 2019.

- **Latest Fiscal and External Balance Outlook:** The FY2019 budget is modestly expansionary, with the primary deficit projected at SGD5.4bn (1.1% of GDP). Authorities estimate a fiscal impulse of around +0.7%, providing an appropriate boost to the economy given presence of external headwinds. This comes on the back of an increase in projected expenditure of SGD1.3bn to SGD80.3bn, and an increase in operating revenue of SGD1.2bn to SGD74.9bn. The overall deficit is pencilled to come in at SGD3.5bn (0.7% of GDP) due to the record-high special transfers of SGD15.3bn in the FY2019 budget (FY2018: SGD9bn). With sentiments relatively soft on the ground, DPM Heng Swee Keat had assuaged sentiments on the ground by clarifying that “a full-year recession” for the economy was not expected at this point, and that stimulus measures were ready in the event of any sharp downturn in external conditions. Nonetheless, he did not see the need for an “extraordinary budget” at this stage.

- The current account (CA) surplus remained at healthy levels, dipping very slightly to SGD21.5bn in 2Q, from SGD21.6bn in 1Q. As a percentage of GDP, the CA surplus was at 17.34% in 2Q 2019 vs. 17.99% in 1Q. Compared with 1Q, the services balance deteriorated slightly on higher imports of transport and travel services, while the goods balanced actually recovered on higher exports. Nonetheless, the goods exports level still saw a contraction on a year-ago basis (around -1%y/y). The continued impact of the US-China trade tensions on Singapore’s trade balance outlook will continue to be of some concern, although the structurally higher level of current account surpluses should still assure international investors of the country’s long-term resilience.

- **Key domestic events and issues to watch**: Sep PMI (3 Oct); Sep Foreign Reserves (7 Oct); Jul 3Q Advanced GDP (7 to 14 Oct); MAS Policy Decision (NLT 14 Oct); Aug Retail Sales (11 Oct); Sep Exports (17 Oct); Sep CPI (23 Oct); 3Q Unemployment Rate (25 Oct); Sep IP (25 Oct).

- **Technical Outlook**: USDSGD largely trended down for the first half of Sep, towards 1.3720, before seeing a gradual upwards climb over the past two weeks. Last seen at 1.3820. Daily charts indicate a modest bullish momentum, while stochastics are slowly heading towards near-overbought conditions. Nonetheless, we caution that the 21-DMA line has just crossed the 50-DMA to the downside, which could be a potential bearish indicator. 1.38 (21) has recently turned from resistance to strong support. Next support at 1.3730 (100 DMA), 1.3650 (200 DMA). Resistance at 1.3840 (23.6% fibo retracement from Jul low to Sep high), then 1.39.

MYR: Weighed by Global Trade Underperformance

Forecast	4Q 2019	1Q 2020	2Q 2020	3Q 2020
USDMYR	4.2500 (--)	4.2200 (--)	4.1800 (--)	4.1500 (--)

No change from previous forecasts

- **Motivation for the FX View:** The MYR reached a high of 4.2270 on 3 Sep as the USD strengthened amid escalation of US-China trade war concerns into late Aug and early Sep. Since then MYR has strengthened to around a tight range between 4.16-4.19. However, we are still looking for mild USD strength against the Asian currencies to continue into 4Q. For the remainder of 2H 2019, we see regional central banks likely to still stay accommodative although threat from global trade underperformance has continued to keep MYR soft. Similar to other regional currencies, the MYR still faces pressure as it faces external downside risk from US-China trade situation with mitigation from stimulus to domestic demand from existing and potential monetary policy easing, but it could see resilience via the sentiment channel from resumption in major infrastructure projects and Government development spending, as well as evidence of Malaysia benefiting from some trade diversion.

- The latest Trump tariff announcement and latest China retaliation could worsen global sentiment and growth concerns may emerge, and as such raise likelihood of a Fed cut in Sep and in the last few months this year. Our economics team is looking at a baseline of 100bps (including 50bps cut already delivered) up to 1H 2020 and it looks unlikely that the Fed will cut rates close to the US Presidential election amid moderating growth.

- Reports of the Trump administration considering ways to limit US portfolio flows into China (via potentially delisting Chinese companies from US stock exchanges, or limiting US residents' exposure to the Chinese market through government pension funds) could complicate the ongoing US-China trade talks. The US Treasury subsequently assured that there are "no current plans" to stop Chinese companies from listing on US exchanges. While Trump might see this as an additional measure he could leverage on to force China's hands, Beijing could see this as a lack of sincerity in negotiations. In any case, portfolio flows limitations remain a bearish risk for CNH, ahead of the higher-level US-China talks next week.

- **Any positive news emanating from the resumption of US-China trade talks including any potential positive outcomes, or further investment inflows into Malaysia and MYR-denominated assets**

could support the MYR. Into the end of the year, our base grey-swan scenario is still that of a protracted period of negotiation with "lines of communication" remaining open. Progression on talks taking both sides closer to a deal probably in 1H 2020 is not impossible and this could help support sentiment and support our view for trade/tech-linked FX to recover. But the risk of escalation remains.

- However, in the emerging markets space, we could see a sustained rally in emerging-market bonds as EM central banks may continue to embark on a rate-cutting cycle to support growth. Even though, the Fed has eased to "insure against downside risks" but did not signal the start of a lengthy easing cycle, we acknowledge that the market has moved very quickly to pricing in rather dovish outcomes for the Fed. As such we are not aggressive on all EM currencies except for Indonesia within the region, given its carry allure under current environment. The level of vulnerabilities in aggregate across EM are relatively controlled and contained for now. There is the risk of the lingering U.S.-China trade tensions and it worsening, curbing appetite for riskier assets. If the EM inflows intensify, we could see some of it cascading into the MYR assets. Our Economics team is penciling in 25bps reduction in OPR to 2.75% at the 4-5 Nov 2019 MPC meeting as escalation in US-China trade tantrum and tariff war resulted in heightened trade policy uncertainty, in turn affecting growth outlook.

- Following the Sep review by the Product Governance Board, FTSE Russell decides to maintain Malaysia on the watch list. We think this signifies the intent of FTSE Russell to continue engaging with the government and regulator to address specific feedback from investors on the fulfilment of the criteria to be retained a Market Accessibility Level of 2, which is a minimum level assessed by FTSE Russell to be eligible for inclusion its flagship World Government Bond Index (WGBI).

- In the announcement, it was indicated that both FTSE Russell and investors are encouraged by the efforts and engagement taken by the Malaysian authorities. The liberalisation measures taken thus far are likely working but haven't sufficiently crossed the hurdle to completely take Malaysia out of the watch list. We think there could be more follow-up measures by BNM on fine-tuning of policies. The next review cycle is expected in March when FTSE Russell conducts its interim assessment. As there will be at least another 6 months of wait before the interim review is due, investors will likely switch their focus back to the upcoming Budget 2020 which will be tabled on 11 October. This latest FTSE Russell development removes the risk of non-inclusion at least for the next 3-5 months or so until the next. But it suggests that the risk premium factor impacting the MYR from this still remains intact.

- However, against the backdrop of weaker global growth, rising uncertainty on the trade tariff exchanges over the next 6 months even after the Fed eases in Sep, we should on average still see mild USD strength against the regional currencies to remain entrenched subject to no interventions by the Trump administration. USDMYR is still expected to end around 4.25 in 3Q19 and end the year at 4.25 to the USD.

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

- External reserves stable at USD103.5b at mid-Sept 2019 vs end-Aug 2019 (not end-Sep 2019) amid signs of muted portfolio capital flows. We expect bond flows to be the key driver of external reserves over the next 12 months amid policy events like monetary policy outlook and upcoming Budget 2020, as well as bond market events such as FTSE Russell's review of Malaysia status in WGBI and inclusion of China - leading to changes in Malaysia's weights - in global bond index e.g. GBI-EM index.

- Foreign investors net sold –MYR0.2b Malaysian equities so far this month (1-19 Sept 2019) vs -MYR2.6b in Aug 2019. Selling pressure eased in reaction to news of US-China high-level trade talk resuming next month after several months of escalation in trade tensions between the two that saw fresh rounds of "tit-for-tat" tariffs. At the same time, major central banks eased their policies i.e. another 25bps cut in US fed funds rate at the 17-18 Sep FOMC meeting; fresh monetary stimulus by ECB via 10bps cut in interest rate to -0.5%, return of quantitative easing (QE) in Nov 2019 with EUR20b monthly purchases of bonds, and launch of new series of quarterly targeted longer-term refinancing operations (TLTRO III).

- In the Malaysian bond market, Aug 2019 saw muted net foreign selling of –MYR0.1b (Jul 2019: +MYR5.7b), in line with International Institute of Finance's (IIF) data on EM's debt flows (Aug 2019: +USD0.3b; July 2019: +USD26.7b). IIF data also showed still muted net flows into EM debt markets of +USD0.4b in 1-20 Sep 2109.

- Foreigners were net buyers of Malaysian bonds for two consecutive months in Jun-Jul 2019 as the prospect of prolonged low/negative interest rates in Developed Markets lifted demand for emerging market (EM) bonds that offers higher yields. But in Aug 2019 foreign investors turned net seller of -USD0.1b Malaysian bonds, indicating cautiousness ahead of events such as US FOMC meeting on 17-18 Sep 2019, FTSE Russell's announcement on its review on Malaysia's status in World Government Bond Index (WGBI) on 27 Sep (Asian time) and the tabling of Malaysia's Budget 2020 on 11 Oct 2019.

- **Growth and Inflation Outlook:** 2Q 2019 real GDP picked up to +4.9% YoY (1Q 2019: +4.5% YoY), in line with our +4.8% YoY estimate.

- Maintain full-year forecasts of +4.4% as we stay "cautiously constructive" on macro outlook that mainly reflects external downside risk from US-China trade situation vs mitigation from stimulus to domestic demand via monetary policy easing and resumption in major infrastructure projects and Government development spending, as well as evidence of Malaysia benefiting from some trade diversion. The full-year growth forecast implies 2H

2019 growth of around +4.2%% vs +4.7% expansion in 1H 2019. Official 2019 growth forecast remained at 4.3%-4.8%. Budget 2020 to be tabled in the Parliament on 11 Oct 2019 will provide update to 2019 growth forecast – if any – as well as the first official growth forecast for 2020. We currently expect next year's growth to be at +4.4%.

- On the supply side, growth benefited from mining rebound and manufacturing resilience amid slower services and agriculture, and flattish construction. On the demand side, domestic demand picked up on private expenditure growth as public spending slumped, on top of faster net external demand growth albeit due to import compression amid stagnant export.

- Staying "cautiously constructive", our economics team maintained its 2019 growth forecast of +4.4% (2018: +4.7%). We remained "cautiously constructive" on macro outlook as highlighted in our 2H 2019 Outlook and Lookout published on 2 July 2019 (2H 2019 Outlook and Lookout_MKE_20190702.pdf). The theme mainly reflects external downside risk from US-China trade situation vs mitigation from stimulus to domestic demand from monetary policy easing and resumption in major infrastructure projects and Government development spending, as well as evidence of Malaysia benefiting from some trade diversion.

- Inflation in Aug 2019 was +1.5% YoY, little changed from +1.4% YoY in Jul 2019 as most CPI components remain stable. Due to the delay in implementation of targeted fuel subsidy – hence flotation of currently subsidized and fixed RON95 petrol and diesel prices, we tweak our 2019 and 2020 inflation rate forecasts lower to 0.8% (previous: +1.0%) and +2.0% (previous: +2.1%) respectively (Jan-Aug 2019: +0.5% YoY; 2018: +1.0%).

- Headline inflation was little changed at +1.5% YoY in Aug 2019 (Jul 2019: +1.4% YoY; Jan-Aug 2019: +0.5% YoY; 2018: +1.0%). Inflation was mainly contributed by "food & non-alcoholic beverages" (FNAB) and "housing, water, electricity, gas & other fuel" (HWEGOF). On MoM basis, CPI picked up by +0.2% (Jul 2019: +0.1%). Meanwhile, core CPI rose by +2.0% YoY (Jul 2019: +2.0% YoY; Jan-Aug 2019: +1.0% YoY; 2018: +1.0%).

- Due to the delay in implementation of targeted fuel subsidy – hence flotation of currently subsidized and fixed RON95 petrol and diesel prices, we tweak our 2019 and 2020 inflation rate forecasts lower to 0.8% (previous: +1.0%) and +2.0% (previous: +2.1%) respectively.

- In addition to the base effect, we continue to expect factors such as the broadening of the SST base; Budget 2019's new taxes e.g. Sugar Tax (1 Jul 2019), airport departure levy (1 Sep 2019); hikes in minimum wage and utility costs; and the expected floatation of RON95 & diesel prices with the roll out of the new fuel subsidy mechanism for B40 households to result in higher but manageable inflation going forward.

- BNM envisaged headline inflation to average higher for remaining months and into 2020 but stable underlying inflation is expected to keep inflation low. BNM's current full-year inflation rate forecast is 0.7%-1.7%.

- **Monetary Policy Forecast:** As expected, BNM kept the Overnight Policy Rate (OPR) at 3.00% after its Monetary Policy Committee (MPC) meeting on 11-12 Sep 2019. BNM lowered OPR by 25bps back in May 2019 and kept it unchanged in Jul 2019. We are penciling in 25bps reduction in OPR to 2.75% at the 4-5 Nov 2019 MPC meeting as escalation in US-China trade tantrum and tariff war resulted in heightened trade policy uncertainty, in turn affecting growth outlook.

- BNM continues to see softening of near term global economic outlook amid slower growth in most major advanced and emerging economies. Going forward, recent escalation of trade tensions point to weaker global trade with increasing signs of spillovers to domestic economic activity in a number of countries. Trade dependent countries such as Singapore and Hong Kong already posted below par growth at +0.1% YoY and +0.5% YoY respectively in 2Q 2019 and expected to continue to register subdued growth going forward.

- No change to BNM's 2019 growth forecast for Malaysia at 4.3%-4.8% range made on 27 Mar 2019 and continue to emphasize the downside risks from worsening trade tensions, uncertainties in the global and domestic environment, and extended weakness in commodity-related sectors. Nevertheless, Malaysia's diversified exports is expected to partly mitigate the impact of softening global demand. Headline inflation is envisaged to average higher for remaining months and into 2020 but stable underlying inflation is expected to keep inflation low. BNM's current full-year inflation rate forecast is 0.7%-1.7%.

- We believe that BNM's decision today to keep OPR unchanged was due to current MYR volatility, pending FTSE Russell's decision on Malaysia's status in the World Government Bond Index (WGBI) on 27 Sep 2019 and the tabling of Budget 2020 on 11 Oct 2019. Our Economics team is penciling in 25bps reduction in OPR to 2.75% at the 4-5 Nov 2019 MPC meeting as escalation in US-China trade tantrum and tariff war resulted in heightened trade policy uncertainty, in turn affecting growth outlook.

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

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

- Rebound in Federal Government's development spending, on top of the continuation and revival of major infrastructure projects. Federal Government net development expenditure (NDE) jumped +18.2% YoY to MYR23.4b in 1H 2019 (1H 2018: -0.7% YoY; 2018: +28.5%) to account for 43% of Budget 2019's NDE allocation, up from MYR9.8b in 1H 2018 that was 36% of total actual NDE in 2018. At the same time, construction activities – which has the highest output multiplier effect on the economy - will be also be revitalised with the continuation and revival of major infrastructure projects that were previously put under review or deferred following the change in government after the 14th general election in May 2018.

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

- **Key domestic events and issues to watch:** FX reserves (7 & 22 Oct); Trade Balance (4 Oct), Ind Production (11 Oct), CPI (23 Oct).

- **Technical Outlook:** USDMYR eased off 2019 highs of above 4.22 to trade lower for the month of Sep. Last seen at 4.1940 levels. Bearish momentum on daily chart is fading while stochastics is rising – suggest near term risks skewed to the upside. Potential head & shoulders pattern appears to be in the making – typically associated with a bearish reversal. But it remains early to conclude if the downside could extend as the neckline (around 4.16 levels) is still not breached. Only a decisive break below the neckline can confirm the bearish reversal and if true, USDMYR could extend lower towards 4.10 levels. However, if the neckline is defended, price action could consolidate in 4.17 – 4.20, with risks skewed to the upside with an eye on breaking 2019 high of above 4.22 before 4.2540 levels (61.8% fibo retracement of 2017 high to 2018 low).

IDR: Reinvigorated Reforms Need to See Sustained Momentum

Forecast	4Q 2019	1Q 2020	2Q 2020	3Q 2020
USDIDR	14200 (--)	14100 (--)	14050 (--)	14000 (--)

No change from previous forecasts

- **Motivation for the FX View:** Forecasts are kept unchanged from last month. The USDIDR pair had seen a sharp fall (i.e., IDR strengthening) in the first two weeks of Sep, from ~14200 to below 14000, on trade talk optimism. But subsequently, it retraced upwards aggressively, paring a large part of the losses. Current levels are just a tad below where it was at the start of the month. Going forward though, we look for some relative stability in IDR in 4Q, as expectations of another BI cut in 4Q is arguably partly priced in, and BI has shown its determination in calming markets when needed. Barring sharp shifts in EM sentiments, Indonesia could be seen as a (relative) outperformer in Asia. GDP growth this year and next are still expected to hover at/above 5%, while fiscal and current account twin deficits are expected to be manageable. In a returns-hungry world, potential portfolio, FDI or infrastructure-related flows aimed at longer-term returns could be a supporting factor for IDR's medium-term outlook as well.

- While Indonesian equities continued to see net outflows this month (-US$514mn MTD, as at 27 Sep), after the -US$651mn net outflow in Aug, sovereign bonds saw a significant shift in sentiments. Net bond flows have reversed decisively from -US249mn in Aug to +US$1,333.8mn MTD (as at 26 Sep). Bouts of "goodwill" gestures by US and China in the lead-up to higher level negotiations (involving Vice Premier Liu He) in week of 7 Oct could have soothed EM sentiments somewhat. Even with BI's rate cut (from 5.5% to 5.25%) on 19 Sep, current ten-year government bond yields are still above 7%. Two-year government bond yields also remain above 6%. While BI could potentially have one more cut up its sleeve before the end of the year, tame inflation could mean that real yields are likely to remain attractive to foreign flows, especially when other global central banks are similarly in easing modes. We think there is a fair chance that bond inflows could be net positive for the whole of 2H, even if monthly flow levels are more modest compared to highs in June. Concerns over debt levels are also likely manageable, given that Indonesia's overall debt-to-GDP ratio of around 30% is significantly below levels during the global financial crisis or Asian financial crisis. Foreign holdings of government bonds have also stabilized at a tad below 40% (of overall outstanding government bonds).

- Another potentially significant driver of inflows could be longer-term FDI and infrastructure investments. New FDI in Indonesia was at a record high of US$29.3bn last year, spread over nearly 22,000 projects, while the figure in 1H this year shows promise at US$14.2bn. Singapore and Japan are top investors. We note that Indonesia's rank in the World Bank's Ease of Doing Business Index has jumped from 110th to 72nd position over the last three years, and President Jokowi is targeting rank 40 by 2024. His "I have nothing to lose" attitude amid his announcement of sweeping reforms could serve to accelerate such flows. Reforms include lowered corporate tax rates (25% now to 22% in 2020, then 20% in 2023), easing of stringent labor laws and lifting of curbs on foreign ownership in more industries, including petrochemicals and other manufacturing industries. Bank merger rules are also set to be relaxed to boost FDI.

- Nonetheless, a proposed new criminal code which would outlaw sex outside marriage, among other things, has led to protests by tens of thousands on the streets. Some protestors were also angry over a law passed earlier this month which weakened the effectiveness of the country's Corruption Eradication Commission. Foreign investors had probably not expected to see tens of thousands of Indonesians rallying on the streets, so soon after election risks had died down. There are concerns of potential drags on tourism if the "no sex outside marriage" laws were to be passed. The overall bundle of proposed changes might also be viewed by some as a winding back of democracy, and dampen longer-term investor sentiments.

- These developments possibly contributed partly to the recent softness in IDR. However, while the situation needs to be monitored, we think that the protests should die down soon. Lawmakers had already postponed a vote on the bill at the request of President Jokowi, and given Jokowi's focus on FDI flows, there is a fair chance that the bill might be shelved (or at least significantly amended). Downward pressure on IDR arising from this domestic factor could likely fade away soon.

- Due in part to its archipelagic nature, infrastructure needs in the country are massive, comprising of highways, toll roads, sea ports, airports, mass transit, telecommunications and power generation, and some estimates place the required investment at as high as US$500bn per annum. Besides partnerships with programs such as China's Belt & Road Initiative and Japan's Partnership for Quality Infrastructure, various domestic projects will also likely tap on funds and expertise from the multilateral development banks, i.e., World Bank, Asian Development Bank, and most recently the China-led Asian Infrastructure Investment Bank. In his latest Budget 2020 speech, Widodo unveiled a record IDR2,528.8trn (~US$178bn) in projected public spending in 2020, out of which approximately IDR419.2trn is earmarked for infrastructure projects (up from IDR399.7tn this year). Projects include 837km of roads, 239km of rail lines, and three new airports.

- Examples abound of public-private partnerships in the infrastructure scene. Fee-charging motorways on Java are looking to Hong Kong investors for funding, while deals were signed with UAE recently to develop projects including the Balikapapan refinery, an integrated supply chain and LNG storage. Maspion and DP World also jointly invested US$1.2bn to develop a container port in Gresik East Java. Such projects would support a sustained stream of FDI flows into Indonesia, which is positive for IDR's medium-term outlook.

- Despite the host of factors supporting the IDR (i.e., weighing on USDIDR pair), there is still a significant upside risk. This could come about on higher volatility in the midst of US-China trade talks, which has already seen multiple U-turns. Notably, trade talks with Liu He in the week of 7 Oct would be a key risk event. Recall that trade talks in May were also going well before the sudden escalation in tensions. The almost 500 pips spike at the start of Aug, while short-lived, also highlights the sensitivity of IDR to sharp shifts in global sentiments. BI's commitment to IDR stability, via intervention when needed, will need to hold for foreign market players to trust Indonesian assets again. To this end, Indonesia's level of foreign exchange reserves (currently around US$126.4bn) will be closely watched.

- **Growth and Inflation Outlook:** After growth of 5.07%y/y in 1Q, 2Q growth came in slightly lower at 5.05%. Resilient domestic spending had helped to offset a slump in exports. Government consumption grew 8.23%y/y, while household expenditures rose 5.17% (fastest pace since Mar 2014). Private investment growth also came in at 5.01%, down slightly from 5.14% in 1Q. 2Q exports, on the other hand, fell -

1.81%y/y, with exports of oil & gas products down -31%. Ongoing trade tensions could continue to pressure world trade volume and undermine global economic growth.

- In 2H19, our Economist team assesses that there is a chance for greater contribution from investment to growth, alongside improved political stability, more business-friendly regulations and the low interest rate environment. Should the outlook worsen significantly, the government will likely boost spending and "reactivate" measures used during the global financial crisis, which would imply a widening of the budget deficit and more judicious use of tax relief. BI expects full-year growth for 2019 to come in "at around" (as opposed to "slightly below" previously) the mid-point of the 5.0-5.4% official growth range. Higher-frequency indicators suggest that growth momentum is softening slightly, but underlying resilience should persist—Aug PMI came in softer at 49.0 (vs. 49.6 prior), while consumer confidence dipped slightly to 123.1 in Aug (from 124.8 in Jul).

- Headline inflation increased to 3.49%y/y in Aug from 3.32%y/y in Jul. The increase was mostly due to higher chilli and gold jewellery prices. The increase in the former was due to poor harvests caused by droughts, and price pressures should fade going forward as the drought is predicted to end soon. In the meantime, higher gold jewellery prices were due to the increase in global gold prices on safe haven demand. Core inflation accelerated slightly to 3.30%y/y in Aug from 3.18%y/y in Jul. Other than gold jewellery, the increase in core inflation was led by a rise in the costs of home rental, education, hospital expenses and cigarettes. Despite the modest increases, BI sees 2019 headline inflation at below the mid-point of its 2.5%-4.5% range, and some slight easing could potentially set in next year (to between 2%-4%).

- **Monetary Policy Forecast:** In the recent Monetary Policy meeting on 19 Sep, BI had expectedly lowered the 7-day Reverse Repo Rate, Deposit Facility and Lending Facilities, by 25bps each, to 5.25%, 4.50% and 6.00% respectively. This move anchored views that BI saw growth risks as outweighing that of potential capital outflows, especially in an environment of manageable inflation. With the Fed having just completed its second 25bps cut, easing slants by other central banks could also help keep interest rate differentials favorable for Indonesia. To further support growth, BI also announced measures to ease macroprudential policy, namely, revising loan-to-value ratios for property and environmentally-friendly vehicles (applicable only to banks with NPL of below 5%). Our Economists now expect one more cut in the Repo Rate by year end, to 5%. We note that the BI has been relatively committed in cooling any sell-offs in IDR bonds and currencies by intervening in the NDF market. This commitment to anchor IDR stability should help calm markets and ease volatility as well.

- **Latest Fiscal and External Balance Outlook:** The budget deficit for Indonesia came in at -1.14% of GDP for the first seven months of 2019. State revenues rose to IDR1052.8tn, equivalent to 48.6% of budget, with taxation revenues accounting for IDR810.7tn. State expenditure similarly increased to IDR1236.5tn. This led to a primary balance deficit of IDR183.7tn over the period. Finance Minister Mulyani cautioned that realization of oil prices and oil & gas lifting which is lower than first semester assumptions will also weigh on state revenues.

- As of Aug, there are signs that government revenue realisation has been lower than expected, while government spending is still high. This could raise concerns over the fiscal deficit, i.e., whether it can remain within the government's target—1.84% of GDP as budgeted, or at least smaller than previous year's deficit target of 2.19% of GDP. To avoid this, Our Economists think the government may cut back on discretionary spending in 2H19, on social assistance and capital purchases etc., which may in turn mildly dampen consumer spending momentum.

- For Budget 2020, the target fiscal deficit is actually lowered to 1.76% of GDP, despite record government spending (IDR2,528.8tn or US$178bn). It seems to suggest more effective tax collection (measures to achieve better tax compliance will be monitored), as well as some prudence on the government's part, in saving some fiscal policy space should external demand conditions turn ugly.

- The current account deficit widened more-than-expected to 3.0% of GDP in 2Q, from 2.6% in 1Q, due to a decline in net exports and an all-time high primary income outflow of US$8.7bn (overseas payments on equity capital). Higher-frequency indicators show that while exports in Aug still saw contraction of -9.99% (vs. -5.10% prior), a steeper slump in imports (-15.60% vs. -15.19% prior) meant that trade balance came in at a small surplus of US$85mn (vs. deficit of -$64mn in Jul). In particular, the large drop in oil imports could imply that the ongoing initiative of substituting oil with other energy sources (i.e., B20 programme; mandatory use of diesel containing 20% locally-produced biofuel) is having some positive impact in helping to rein in the current account deficit, which could in turn help support IDR stability. Current account could remain at around -2.5% to -3% deficit in 3Q and 4Q this year.

- **Key domestic events and issues to watch**: Sep Mfg PMI (1 Oct); Sep CPI (1 Oct); Sep Foreign Reserves (7 Oct); Sep Trade (15 Oct); Sep Local Auto Sales (15-21 Oct); Monetary Policy Decision (24 Oct).

- **Technical Outlook:** Pair last seen at 14180. On daily charts for USDIDR, momentum indicators are mildly bullish, while stochastics indicators remain in overbought conditions. Momentum and stochastic indicators on weekly chart are not showing clear biases. On net, we see a modest risk of downward retracement given overbought conditions on daily chart. 14190/200 (100 DMA, 200 DMA) is area of resistance. Next resistance at 14360 (Aug high). Support at 14100 (38.2% Fibonacci retracement from Aug high to Sep low), then 14000.

PHP: Interim Resilience, Constructive Bias into 2020

Forecast	4Q 2019	1Q 2020	2Q 2020	3Q 2020
USDPHP	52.50 (--)	52.00 (--)	51.50 (--)	51.00 (--)

No change from previous forecasts

- **Motivation for the FX View:** Forecasts remain unchanged from last month. Unlike other AxJ peers, Philippines exports have seen modest positive growth since April, suggesting that there could be some resilience against the ongoing US-China trade war. Pair has seen upward pressure since end-Jul, but there is a fair chance that further upsides in USDPHP (i.e., further weakening in PHP) could be capped. In addition to its lower trade dependence vis-à-vis its neighbours, other factors include (i) relatively attractive, higher-yielding sovereign bonds (behind Indonesia and India) in a falling rates, soft growth and subdued inflation environment; (ii) synchronous regional easing providing support for easy financial conditions, supporting sentiment; and (iii) favourable macro fundamentals including GDP growth near 6% and a manageable, improving current account deficit. We look for a slow recovery in PHP strength into 2020, as global trade policy could possibly see some clarity then. Consensus estimate also suggest an uptick in GDP growth into next year.

- AxJs might remain on the backfoot in the interim, even as global trade tensions show very tentative signs of thawing (high-level talks between US and China in week of 7 Oct), as markets have become more cautious of sudden flip-flops in policy tones. Nonetheless, Philippines' lower level of trade exposure compared to Korea, Malaysia, Singapore, could still impart it some resilience relative to trade-related currencies, even if US-China negotiations go awry. Philippines' export-to-GDP ratio was around 32% in 2018, compared to 44% for South Korea, 70% for Malaysia and 176% for Singapore (inflated by entrepot trade hub role). It also seems to be benefitting modestly from some import substitution by US/China arising from the trade war, in products such furniture, gloves, ethylene and polymers of ethylene.

- Philippines' 10-year government bond yield is still hovering above 4% at last reading (at 4.6%). Even though it has come down significantly from the ~7% yield at the start of the year, it remains relatively attractive for yield hunters, in an environment where around US$15tn of bonds (25% of market) are trading with negative yields in the DM part of the world. According to recent reports, the government is also looking at innovative debt sales such as prize bonds which other sovereigns offer to individuals. Such debt sales may incorporate both bonds and lottery elements.

- The current account deficit has dropped from around -4% of GDP in early 2015 to an impressive -1.7% in 2Q this year. Meanwhile, FDI has been on a sustained uptrend, from around US$5.6bn in 2015 to US$9.8bn last year. While the flows in the first six months of this year

(US$3.6bn) was lower than the US$5.8bn recorded in the same period last year, this was likely due to election-related uncertainties. As this eases, there is a fair chance that FDI could recover in 2H. The Board of Investments has approved 126.1% more committed investments at PHP609.04bn in the eight months to Aug, with the top sources being Singapore, Netherlands and Thailand. Notably, the August figure of investment approvals nearly matches the aggregate figure for the first seven months of 2019, showing that big-ticket projects have begun to roll in. There are also signs that the government is more focused on attracting FDI this term, with potential easing of restrictions in foreign employment, foreign ownership limits in utilities and required paid-up capital for entrants into retail etc.

- On 13 Sep, the House of Representatives also passed a tax omnibus bill. Key components in the bill are: 1) reduce the corporate income tax rate to 20% from 30% in 2% tranches every two years between 2021 and 2029; 2) provide a 15% withholding tax on corporate dividends paid to non-residents; 3) exempt capital gains tax and VAT on qualifying corporate reorganizations. The law would take effect at the start of 2020, and is expected to anchor more favourable foreign investor sentiments over the medium-term.

- **Upside Risks to USDPHP forecast:** There are risks to our outlook on the Peso. If trade war sees another shock u-turn from current reconciliatory tones, there is a chance that foreign investors will shun EMs as a whole, despite resilient macro fundamentals in Philippines. MTD net outflow from equities is modestly negative (-US$102mn as at 27 Sep), extending the –US$266mn outflow in Aug, showing that foreign investor sentiments have yet to see a significant recovery. If stimulus measures and monetary policy easing fail to translate into discernible support for the economy, investor confidence could be further dampened. These factors could pose greater-than-expected downward pressure on PHP.

- **Growth and Inflation Outlook:** 2Q GDP came in softer at 5.5%y/y, vs. 5.9% expected and 5.6% in 1Q. Domestic demand growth was sluggish, due in part to slightly softer private consumption (5.6%y/y vs. 6.1% prior) and public consumption (+6.9%y/y vs. +7.4% prior). Gross fixed capital formation actually saw a decline (-4.8%y/y vs. +5.7% prior), reflecting the impasse in Budget 2019 disbursements as well as the ban on government spending during the May mid-term elections. Meanwhile, net external demand rebounded (+33.0%y/y vs. -20.0% in 1Q), as exports of goods and services grew (+4.4%y/y vs. +5.7% prior) amid stagnant imports of goods and services (+0.0%y/y vs. +8.6% prior). Industry breakdown showed construction sector contracting while manufacturing growth eased and services growth improved. Manufacturing PMI for Aug dipped slightly to 51.9 from 52.1 in Jul, and 51.3 in June, but showed that manufacturing output remained in expansionary territory.

- The overall outlook remains cautious, amid turbulent global trade tensions (US/China, US/EU, Japan/Korea). But our Economist team maintains their 2019 real GDP growth forecast at 6.0% as they believe that ongoing and upcoming stimulus from monetary policy easing, as well as recovery in fiscal spending post-Budget 2019 impasse and midterm election spending ban will support firmer growth in 2H 2019. Latest monthly data shows improved government spending on infrastructure after the slump in Jan-Apr 2019. Consumer confidence has also improved in 3Q 2019 on expectations of higher incomes and improvement in job availability, while softer business confidence can be attributed in part to seasonal weakness in demand during the rainy season. Growth forecast for 2020 remains at 6.3%. Further out, realization of the government's Build Build Build programme, with up to 75 flagship projects planned, could support the longer-term economic outlook.

- Headline inflation eased further to 1.7%y/y in Aug, from 2.4% in Jul and 2.7% in June. The moderation in food & non-alcoholic beverages, housing, water, electricity, gas & other fuels and transport prices was the main cause of the softer inflation figures. Core inflation also slowed to 2.9%y/y in Aug (vs. 3.2% in Jul). Given that YTD headline inflation is averaging around +3.0% and that inflation is expected to stay subdued for the rest of 2019 on moderate global growth and stable commodity prices, our Economist team maintains their 2019 and 2020 inflation rate forecasts at +2.6% and +3.0% respectively (i.e., within BSP target of range of 2%-4%). In comparison, BSP had recently revised downwards their 2019 inflation rate forecasts to +2.5%, from +2.6% prior, while cautioning that inflation might continue to miss the 2-4% target band for a few more months. BSP's 2020 inflation forecast is kept at 2.9%.

- **Monetary Policy Forecast:** BSP cut its policy interest rate by 25bps to 4.00% at the 26 Sep 2019 policy meeting. This is the third 25bps cut this year after May and Aug 2019. BSP's Monetary Board's outlook on growth and inflation remained largely unchanged, i.e., firm domestic growth and benign inflation outlook. In the tame inflation environment, the Board also saw room for further rate cuts to support growth and reinforce market confidence. There were concerns that global economic growth could remain weak on uncertainty over trade policies, but firm domestic spending and progress on policy reforms could serve as buffers against global headwinds. Our Economists now expect another 25bps cut in the next 3 to 6 months, given the continued "dovish" tones of the monetary policy statement and sustained benign inflation outlook. Global risks highlighted in current statement remain very much intact. Next meeting is on 14 Nov.

- On RRR, last year, BSP cut RRR twice i.e., -100bps on 2 Mar 2018 from 20% to 19%, and another -100bps on 1 June 2018 to 18%. Earlier this year, BSP announced -200bps in RRR cuts, from 18% to 16% in stages during May-Jul 2019. Last Friday, just one day after the BSP rate cut, the central bank further lowered the RRR from 16% to 15%, which should be supportive of interim growth.

- **Latest Fiscal and External Balance Outlook:** Budget Balance in Aug came in at –PHP2.5bn deficit. It signals a tentative turnaround from the weakness in Jun (-PHP41.8bn) and Jul (-PHP75.3bn). For the first eight months of 2019, the budget deficit also narrowed by almost three-fifths on year-ago basis to -PHP120.4bn (US$2.3bn), although part of the "better" outcome was admittedly due to delayed implementation of some Budget 2019 initiatives.

- Congress seems to be moving fast to approve the National Budget this year, in an attempt to prevent potential delays that could weigh further on growth in this climate of soft external demand. Deficit is expected to remain around ~3% of GDP this year. This year's ceiling was kept at 3.2% even after a delay in the budget approval slowed spending. The government plans to borrow PHP1.4tn (US$27.4bn) in 2020 to support a planned budget of PHP4.1tn. About three-quarters of next year's borrowing will be from local sources. Notably, the deficit cap was also raised to 3.2% of GDP from 2020 to 2022 from a previous ceiling of 3%. Government officials have commented that the debt-to-GDP ratio will likely remain manageable, within 36.3%-41.0% between now and end-2022, "showing the resiliency of the debt portfolio against macroeconomic shocks and increased funding needs".

- Current account deficit was at -1.7% of GDP in 2Q, an improvement from the -2.7% of GDP in 1Q 2019. Full-year estimate is around -2.4% of GDP for 2019, and could narrow further to -2.2% in 2020. Governor Diokno had said he was "not at all worried about the deficit especially if deficit is less than 3% of GDP, as the composition of imports was for raw materials, equipment." He also sees BoP position as "manageable" and providing "resilience against external headwinds". Structural sources of FX inflows such as OFWR, IT/business-process outsourcing revenues and tourism receipts should support overall external position. His comments were also consistent with S&P's recent assessment— "the deficit is largely investment driven, and that this is a healthy development in light of its historical underinvestment".

- Looking at monthly indicators, BoP posted a surplus of US$493mn in Aug, extending the US$248mn surplus in July. On a cumulative basis, BoP for Jan-Aug posted a surplus of $5.53bn vs. a deficit of $2.44bn in the same period in 2018. Strong performance of BoP can be attributed to remittance inflows from overseas Filipinos during Jan-Jul and net inflows of foreign portfolio investments during Jan-Apr and Jul. Overseas Filipino Workers' Remittances (OFWR) had rebounded +7.5%y/y in Jul (vs. -2.9% in Jun), driven by gains in flows from North America. Growth in first seven months of 2019 was 3.9%y/y in aggregate. We note that downside risks remain, as US demand, the key driver of OFWR, could slow a tad going forward.

- **Key domestic events and issues to watch:** Sep Mfg PMI (1 Oct); Sep CPI (4 Oct); Aug trade (10 Oct); Aug Overseas remittances (15 Oct); Sep BoP (18 Oct); Sep Budget Balance (22 Oct).

- **Technical Outlook:** Upward swing in USDPHP around mid-Sep started losing momentum around the 52.4 levels. Subsequent reversal brought the pair to 51.815 as at writing. Overall volatility remained lower compared to Jun-Jul moves. Daily momentum turned mildly bearish, while stochastics is dipping towards near-oversold conditions. The 21-DMA just cut the 200-DMA to the downside, which may hint at potential bearishness in the interim. Support at 51.70 (50.0% Fibonacci retracement of Jul low to Aug high), then 50.80 (Jul low). Resistance at 52.20 (23.6% fibo), before 52.60 (Aug high), and 53.0.

THB: Resilience Amid External Uncertainties

Forecast	4Q 2019	1Q 2020	2Q 2020	3Q 2020
USDTHB	30.60 (--)	30.40 (--)	30.20 (--)	30.00 (--)

No change from previous forecasts

- **Motivation for the FX View:** Forecasts are unchanged from last month, despite slight improvement in sentiments regarding US-China trade talks. USDTHB saw relatively tight swings between 30.38 and 30.67 thus far in Sep, and we expect THB to remain relatively resilient ahead of higher-level US-China trade talks, likely in week of 7 Oct. Meanwhile, residual effects of BoT measures targeted at curbing foreign inflows—i.e., reducing limits on outstanding balances of non-residents' THB accounts (see piece here) should continue to help cap the extent of any THB strengthening, even as various private sector participants have called for additional measures on this front. We hence look for two-way ranged trades for the rest of the year, as domestic growth concerns contend with more news on the trade war front. Going into 2020, we look for more evidence from the new Thai government with regards to its capability to implement pro-growth policies. There might also be a potential recovery in regional sentiments next year, alongside some tentative easing in trade tensions globally. These developments could lead the THB on a more sustainable strengthening path (i.e., downtrend for USDTHB).

- While the ongoing trade war has led to a softer aggregate demand environment globally, some countries are seen benefitting to varying extents in certain sub-categories of goods due to diversion in trade flows. For instance, among goods categories where US had imposed tariffs on China, rubber products, auto products, consumer E&E products and agriculture products in Thailand saw greater import demand from the US in 1H 2019. Meanwhile, higher imports of tariffed goods by China from Thailand are dominated by agriculture (including "durians") and commodity-related (oils, chemicals & petrochemicals, copper) products. While the diversions might not fully offset the softness in aggregate external demand, we think markets will still look beyond the 2019 export softness and focus more on Thailand's resilient macro fundamentals. Thailand's current account balance could come in at 5-6% of GDP or higher this year, while the budget deficit could be capped at -3% of GDP. A risk to this view is US' ongoing review of Thailand's Generalized System of Preferences (GSP) status, with the US citing market access for US porks and worker rights as reasons for the review. Up to US$4.3bn worth of goods (1.7% of exports) currently covered under GSP could be negatively impacted if GSP status is revoked.

- We highlight that THB's positive correlation with gold prices remains intact. While Thailand is a net gold importer (on average), gold trading behavior appears to have deviated from longer-term norms in recent months. Alongside the rise in gold prices from just below US$1300 at the start of the year to >US$1500 recently, Thailand's gold imports have fallen by more than -50%y/y in the first eight months of 2019, while gold exports have risen by more than 100%y/y. This has led to a modest surplus in gold trade balance over the period. In particular, the share of gold in Thailand's export basket averaged around 7% over Jun-Aug 2019, compared to the longer-term average of around 2%.

- Reduction in gold purchases (imports), and drastic spikes in gold sales (exports) in an environment of rising/firm gold prices tend to give some support to THB—Thai gold traders presumably offer up less THB in exchange for USD in gold purchases, and exchange more USD sales proceeds back to THB post-sales. Concomitantly, such shifts in gold trading dynamics could portend tentative shifts in the tightness of relationship between gold and THB. The 52-week rolling correlation between THB (using THBUSD as proxy) and gold prices have increased in recent years, to above 0.9 now. As long as geopolitical risks (trade war, Iran, Hong Kong, Brexit) stay intact, and gold prices remain near or above US$1500, we expect this channel to continue to impart some support to THB in 4Q 2019.

- Fitch had revised its outlook on Thailand (long-term foreign currency issuer default rating) to Positive from Stable, and reaffirmed the rating at "BBB+" in July, based on their views that lingering political risks were unlikely to derail sound macro-economic management. This conflicts somewhat with World Bank comments (also in July) highlighting politics remaining as a key risk for the Thai economy. On the ground, some observers have commented that the new Cabinet is "dominated by patronage politics and paybacks", and various members are known to have questionable reputations and capabilities. PM Prayut's failure to recite a key sentence ("I will also uphold and comply with the constitution of the kingdom in every aspect") in his oath of office is also proving to be a point of contention in Thai politics. Constitutional courts refuse to hear the case (which opposition MPs have brought against Prayut) on grounds that the swearing-in ceremony took place in front of the king and was outside of its jurisdiction. Thai opposition MPs recently called for his resignation.

- Despite such developments, we think that current level of political risk is unlikely to derail policymaking by Prayut's coalition. The unfair advantage that the Junta-coalition has in government (i.e., the presence of the 250-member senate which was chosen by the Junta) should allow them to push through most pro-growth policies. Over time, if reforms are credibly delivered, market confidence should improve.

- **Growth and Inflation Outlook:** 2Q GDP growth (+2.3%y/y vs. +2.8% in 1Q) had eased to a 5-year low as domestic demand dampened further, adding to concerns over the sharp decline in exports (-6.1%). The slump in exports was due to weakness in both goods (-5.8%) and services (-7%). Economic indicators had shown a slight improvement in July from the previous month on the back of an uptick in private consumption, public spending and visitor arrivals. Nonetheless, external demand conditions remained weak, with customs exports seen contracting by -4.0%y/y in Aug. Manufacturing production contracted by -4.40%y/y in Aug, extending the -3.32% decline in Jul. Consumer and business sentiments also continued to soften.

- Despite the above, our Economist team notes that there could be some positivity going forward associated with recovering tourist arrivals after a year-long slump (led by Chinese tourists), as well as a pick-up in FDI interest (applications surged 109% in 1H 2019). Indeed, Thailand's Aug tourist arrivals numbers showed that total arrivals picked up by +7.4%y/y (vs. +4.7% in Jul), the strongest pace since Dec 18. Chinese tourists (+19%) had made a strong comeback. BoT forecasts for 2019 and 2020 GDP growth are 2.8% and 3.3%, respectively.

- Headline inflation declined sharply to +0.5% in Aug (vs. +1% in Jul), mainly on the back of energy prices (-5.2% vs. -3.3% in Jul), which declined at the steepest rate in 3 years as oil prices edged below $60 per barrel in Aug. Food inflation also softened to a 4-month low of +2.6% in Aug (vs. +3.5% in Jul), as softer prices of vegetables & fruits offset the spike in rice & cereal prices. Core inflation (excluding food & energy) inched up slightly to +0.5% (vs. +0.4% in Jul). BoT now expects headline inflation to come in at +0.8% (vs. +1% previously), below their target range of 1-4%. Our Economist team holds a similar view, and forecasts inflation at +0.9% in 2020, as slowing domestic demand will likely keep inflation muted. The US-China trade war could intensify deflationary pressures on cheaper imported products from China.

- **Monetary Policy Forecast:** At its 25 Sep policy meeting, BoT kept its policy rate unchanged at 1.5%, in an unanimous board decision. The decision was based on the committee's view that the current monetary policy stance was accommodative for continued economic growth, and should support the rise of headline inflation towards the target. Officials pledged to continue monitoring THB's strength, and may potentially implement more measures to rein it in, if needed. Our Economist team is expecting another 25bps cut to 1.25% in 4Q (either on 6 Nov or 18 Dec), as the easing wave continues around the region, downside risks to growth persist, and THB continues to outperform.

- Financial stability risks remain a concern. DPM Somkid also tried to downplay the role of interest rates in propping up growth, arguing that confidence channels are more important. These factors could mean that extent of further cuts from current 1.5% level could be limited. As more DM and Asian central banks continue to ease, relative yield differentials could be maintained in Thailand's favour, which would in turn support the THB.

- **Latest Fiscal and External Balance Outlook:** After debating by the lower house in this month, the draft Budget Bill is expected to see its second and third readings in December, before it is forwarded to the senators for consideration. For now, the government plans to spend around US$32.5bn in 2H to help stabilize the economy. Total FY2020 expenditure is expected to come in around THB3.2tn, with revenues projected at THB2.73tn. This will lead to a budget deficit of

THB469bn, or around 2.6% of GDP. Meanwhile, to anchor growth above 3%, an interim stimulus package of around THB316bn has been announced, including soft loans to be provided by state banks, additional cash handouts to welfare card holders for two months, and subsidies for rice planting costs.

- The customs trade surplus was significantly larger in Aug (US$2.1bn vs. US$110mn in Jul). Customs exports had declined by -4.00% (vs. +3.82% prior), as softness was observed among exports in both agricultural (rice & rubber) and industrial (vehicles & parts) products. However, imports saw an even larger decline, by -14.62% (vs. +0.74% in Jul), mainly due to the plunge in raw materials & intermediate products. We note that exports performance continued to be supported by gold (+378%). Excluding gold, exports would have fallen by a sharper -9.8%. While overall outlook remains challenging, our Economist team expects exports to improve slightly in the coming months, mainly due to low base effects starting Sep and frontloading of exports prior to the upcoming tariff hikes. Current account for the full year could come in at 5-6% of GDP or higher.

- **Key domestic events and issues to watch:** Sep PMI (1 Oct); Sep CPI (1 Oct); Sep Consumer Confidence (10 Oct); Sep Car Sales (18-23 Oct); Sep Customs Trade (21 Oct); BoT Benchmark Interest Rate (25 Sep); Sep Manufacturing Production (30-31 Oct); BoP (31 Oct).

- **Technical Outlook:** Levels last seen at 30.575. Momentum indicators on the daily charts show a modest bullish bias, while stochastics are in near-overbought conditions. We see chance of ranged movement for the pair in the interim, perhaps between 30.40 and 30.70. Resistance at 30.70 (50 DMA), then 31.00 (38.2% Fibonacci retracement from May high to Sep low). Support at 30.40 (longer-term 23.6% fibo retracement from 2009 high to 2013 low), then 30.00.

INR: Ratchets Up Stimulus

Forecast	4Q 2019	1Q 2020	2Q 2020	3Q 2020
USDINR	70.00 (--)	69.00 (--)	68.50 (--)	68.00 (--)

No change from previous forecasts

- **Motivation for the FX View:** Equities rallied after the government surprised with a $20bn tax cut announced on 20 Sep. Corporate tax will pay only 22% on their income from 1 Apr 2019 vs. 30% previously. That basically puts India's corporate income tax level to be lower than the average in Asia, below Malaysia but still above Vietnam. New companies that are established from 1 Oct will only pay 15% tax and an effective rate of 17.01% (similar to Singapore). In addition, Finance Minister Sitharaman also lowered GST on certain hotel and catering services and levy on passenger vehicles, with effect from 1st Oct. The goal is to vie for a bigger share of trade divestment flows that have benefitted regional economies as a result of the US-China trade-war.

- The government has been rolling out policies to support growth and to attract foreign investors. In Aug, the government eased the rules for foreign direct investment in retail, manufacturing and coal mining in a bid to lift growth. Limits on investment in commercial coal mining and contract manufacturing were also abolished. Local sourcing norms eased for FDI in single-brand retail companies who are also now allowed to set up online sales prior to opening of brick and mortar stores. Easing FDI restrictions may allow foreign investors such as Apple to sell products more easily to India's large consumer base.

- As we write, the USDINR is 1 rupee off our 3Q forecast at 70. Further monetary policy rate adjustments cannot be ruled out as activity remains weak and we can expect USDINR to remain around 70 as potential for economic recovery and equity-related inflow could depress this pair while the potential of further conflicts with Pakistan could still provide the USDINR some support on dips. The geopolitical tensions were heightened after PM Modi abolished the Article 370 that allows Kashmir to enjoy a status of autonomy. He also ordered a military mobilization into the disputed region, shutdown telecommunications and internet, arrested political leaders along with a curfew for the 8 million populations. Risk of geopolitical escalation with Pakistan could still swing the USDINR higher.

- **Growth and Inflation Outlook:** Industrial production picked up pace to 4.3%y/y from previous 2.0%y/y buoyed by stronger output from mining and manufacturing while growth in the electricity softened. The breakdown of the report also revealed a strong demand for intermediate goods.

- PMI-mfg for Aug deteriorated to 52.5 from previous 52.1. The prolonged trade tariffs in place and protectionist measures imposed have also started to affect India, not helped the least by US decision to remove the beneficial trade status for India's exports on 5 Jun. Exports growth have shrunk in Sep and even pending orders based on the RBI forecast have fallen. Trade deficit steadied around $13.4bn as imports fell by a steeper -13.5%y/y vs. previous -10.4%, another reflection of the soft domestic demand.

- Activity numbers suggest that growth in 3Q may not be as bad as 2Q. GDP came in at 5.0%y/y vs. 5.8% in the quarter prior, vindicating RBI's unconventional and larger-than-expected 35bps rate cut earlier in Aug. The release was way lower than consensus at 5.7%. GVA slowed to 4.9%y/y from previous 5.7%. Based on the breakdown of India's gross value added growth, the slowdown was rather broad-based with the exception of financial services/real estate and construction. The release raises expectations of more rate cuts.

- Inflation edged higher to 3.21%y/y from previous 3.15%, buoyed by the acceleration of food inflation. WPI steadied around 1.08%y/y for Aug, a sign of narrowing margins and weaker pricing power. Looking forward, monsoon rainfall level is now in surplus and that could alleviate some food inflation and keep inflation in the lower bound of 4% (+/-2%) target.

- **Monetary Policy Forecast:** We see a risk of RBI persevering with its easing cycle that started from its first meeting for the year in Feb with another 25bps cut. The improvement in activity for Jul may gain traction with the recent announcement of the corporate income tax cuts and the WALR (weighted average lending rate) only dropped by around 29bps over the recent easing cycle of Feb-Jun, not including the impact of the latest 35bps cut in Jul. In other words, the 75bps cut that the RBI provided for the repo rate and the reverse repo rate translated to just 29bps reduction in the WALR, underscoring poor transmission of the monetary policy. As such, the RBI may find itself needing to ease deeper in order to lower lending rates for private sector, in conjunction with structural reforms such as the merger of the 27 public sector banks into 12 entities announced on 30 Aug as well as the recapitalization of the PSBs that were announced earlier in FinMin Sitharaman's first budget since her appointment that could improve transmission mechanism of the monetary policy as well as credit growth.

- In the minutes of the Aug meeting, Governor Das emphasized on the central bank's focus to "fill output gaps" and that India is in a cyclical slowdown, not structural. He also explained that RBI had delivered an unconventional 35bps cut because "the standard 25bps cut may not be adequate" and "50bps cut" could be excessive given the fact that RBI already had 3 back to back cut this year that were "pre-emptive" already. All of the MPC members had looked for rate cuts in the last meeting but only 4 out of the 6 members voted for a 35bps cut. Most of the members were more concerned about growth.

- **Latest Fiscal and External Balance Outlook:** The record INR1.76trn transfer of the RBI dividends to the government could help MOF to roll out its fiscal stimulus package. With regards to FY20 budget deficit, Sitharaman had projected the fiscal deficit to be around 3.3% of GDP in Jul but the corporate tax cuts could raise this to around 4% of GDP in 2019-2020.

- As of last available data, current account for 1Q 2019 narrowed to $4.63bn from previous $17.74bn (not out yet). Trade deficit of goods for Aug steadied around $13.45bn. Trade deficit for 3Q has been rather steady. Higher oil prices may increase the import bill and widen the current account deficit.

- **Key domestic events and issues to watch:** Aug fiscal deficit is due 30th Sep, Mfg PMI is due on 1st Oct, RBI meets on 1,3,4 Oct, decision on the 4th; Aug industrial production on 11th; WPI and CPI are due on the 14th; trade data is due on the 15th; Sep fiscal deficit is due on 31st.

- **Technical Analyses:** The 1M USDINR NDF was last seen around 70.97. MACD is mild bearish bias and stochastics are in oversold condition. Strong support is seen around 70.60 before the next at 70.10. Resistance at 70.12 before 71.75.

VND: Eye The US Treasury FX Report In Oct

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

No change from previous forecasts

- **Motivation for the FX View:** USDVND did not move much at all for the whole of Sep as we have suspected and we keep the USDVND forecast for 4Q at 23200. Not even the surprise cut by the State Bank of Vietnam nudged the dong much. USDVND merely drifted to a high of 23224 before coming back towards the 23200-level where it hovers as we write. For this month ahead, we eye the FX report that the US Treasury typically publishes every Apr and Oct.

- **Vietnam was included in the US Treasury's watch-list for currency manipulation in May as it had met two of its three thresholds for the three criteria including a bilateral goods trade with the United States that exceeds $20bn and a current account surplus above 2% of GDP based on the 4 quarters through Dec 2018.**

- **Ahead of the Oct report,** we see a risk that Vietnam would meet all three thresholds to be labelled as a currency manipulator. In the past 4 quarters through Jun 2019, Vietnam had a net FX purchase for 7 out of 12 months, above the threshold of 6 out of 12months. However, a potential "get out of jail card" is IMF's recent assessment (a metric also used by the US Treasury) that Vietnam's "reserves are still less than needed in the context of the managed exchange rate regime". This assessment was published in July this year. Its bilateral trade surplus with the United States had already crossed the $20bn threshold for the first half of this year and monthly goods surplus has been rising. Its current account surplus for the 4 rolling quarters through Jun 2019 also projects to be above 2% of GDP.

- We recall US Trade Representative Lighthizer call for Vietnam to cut its trade surplus with the US and to increase market access for foreigners. Ahead of the next FX report that is typically released in Oct, Vietnam seems to have ensured that the VND is stable against the USD even during bouts of weakness experienced by the regional currencies (with the exception of THB). Vietnam's exclusion of Huawei network hardware for its mobile carriers (citing network safety) also underscores how much Vietnam values its alliance with the US. We continue to hold the view that SBV would ensure minimal weakness in the VND against the USD to avoid being labelled as a currency manipulator.

- In addition, PM Nguyen Xuan Phuc seems rather keen to reduce the goods surplus with the US. Just today (26 Sep),Vietnam is expected to import 5mn tons of LNG by 2025 and annual imports is expected to increase to 10mn tons by 2030, according to Tran Tuan Anh. Vietnam has embarked on a $5bn LNG project that would include an import terminal and gas-fired power plant so as to import US fuel into the country. The promise came in Jun by the government amid pressure from the White House to narrow the trade surplus. The US-based Energy Capital Vietnam has led a consortium that includes Korea gas to sign a MOU to develop the project.

- Solid growth momentum and external demand is still the story for Vietnam and the VND is poised to remain steady. USDVND could remain at current levels. We see potential for VND to remain resilient against the USD as Vietnam comes under pressure to open up its market access to foreigners. With Vietnam still under the US Treasury watch list for currency manipulation, VND turned out to be one of the most resilient currencies in the region as we have forewarned in the last issue of the FX Monthly. Exports to the US have been in double digit growth and Vietnam just clocked the highest trade surplus with the US ever seen at almost $5bn. Outperformance of the VND is due not just to the trade. Supply chain diversion away from China continues to contribute to the surge in FDI inflows into its manufacturing sector and kept the VND steady.

- VND's competitiveness against its trading partner improved in Sep as regional currencies strengthened against the USD while VND was relatively unchanged. Our estimate of the VND trade weighted index (TWI) rose to 65.40 from previous 65.5, a -0.22% depreciation on the trade-weighted basis. In an environment of trade truce however, we anticipate the recovery in the VND to lag that of the region and the competitiveness of the VND could be clawed back.

- **Growth and Inflation Outlook:** PMI-mfg deteriorated to 51.4 from previous 52.6 and Markit's report highlighted the slower demand, new orders and production due to the US-China trade war. Operating conditions were said to have worsened for investment goods producers.

- 3Q GDP quickened to 7.31%y/y from previous 6.71%, well above the consensus of 6.70%.The headline was driven by broad-based expansion in the industry & construction sector while services remained robust. Our economist upgraded growth forecast to 7.0% for 2019 and 6.6% for 2020 from 6.8% and 6.5% respectively. Breakdown suggests that the industry and construction accelerated to 10%y/y in 3Q vs. 9.1% in the quarter prior, underpinned by the acceleration in manufacturing +11.7% vs. previous 10.9%.

- Industrial production softened only a tad to 10.4%y/y in Sep vs. previous 10.5%, underpinned by stronger manufacturing. Retail sales picked up pace to 12.4%y/y in Sep from previous 11.7% in tandem with the surge in tourist arrivals in the month.
- Exports growth doubled in Sep from 4.5%y/y in Aug to 9.0%. Imports also accelerated to 15.6%y/y from previous 7.5%. Trade surplus narrowed to $500mn from previous $1700mn. As of last available data, trade surplus with the US continues to surge to record high of $4.99bn from previous $4.25bn.
- Recall that the US trade representative Lighthizer urged Vietnam to cut trade surplus with the US and to open its markets to more US goods and services. In response, Deputy Spokesperson Vietnam Foreign Ministry Nguyen Phuong Tra aid that Vietnam has “made multiple efforts” to increase imports of US products and to improve the investment and business environment for US firms. Vietnam is on the watch-list of the US Treasury for currency manipulation and could mean less depreciation likely for the VND vs. the USD over the next few months as the country wants to avoid being labelled as a currency manipulator.
- Headline inflation eased to 1.98%y/y from previous 2.3% in Aug. weighed by the sharper fall in transport costs (-2.65%y/y vs. prev. -0.62%) and slower rise in house/construction materials (+2.72%y/y vs. prev. 2.80%), medical products/healthcare (+8.83%y/y vs. prev. +8.88%), culture/sports/entertainment (+1.63%y/y vs. prev. 1.66%) and education (+4.65%y/y vs. prev. +6.60%). Softer price pressures in these subcomponents offsets the slight acceleration in food/foodstuffs (+1.81%y/y vs. prev. 1.70%)
- **Monetary Policy Forecast:** Our Economist does not look for any further easing for 2019-2020 as further easing could raise credit risk concerns. The SBV uses “credit growth targeting” as its main monetary policy tool and the credit growth target is maintained at 14%. As for the VND, we see upside risks to the currency as Vietnam continues to benefit from manufacturing and trade diversion flows and FDI that resulted from the US-China trade conflicts though that uptrend could be dampened by recent comments coming out of the USTR office. VND could stand to strengthen further from a stronger demand out of China as China is likely to increase monetary stimulus to support growth momentum and that could in turn increase the demand for Vietnam’s exports. We still expect FDI inflows to continue because of the trade agreement/diversions and that could cushion the effects of the decline in external demand.
- **Latest Fiscal and External Balance Outlook:** As of last available data, current account surplus was at U$-107bn in 2Q.
- **Key Domestic Events and Issues to Watch:** Domestic vehicle sales in 6th-13th Oct; Oct CPI, trade numbers, retail sales and IP are due 25th-31st Oct.

FX Forecasts

	End Q4-19	End Q1-20	End Q2-20	End Q3-20
USD/JPY	105	106	106	105.5
EUR/USD	1.1100	1.1150	1.1200	1.1250
GBP/USD	1.2400	1.2500	1.2600	1.2800
AUD/USD	0.6800	0.6900	0.7000	0.7100
NZD/USD	0.6400	0.6600	0.6600	0.6800
USD/SGD	1.3950	1.3900	1.3800	1.3700
USD/MYR	4.2500	4.2200	4.1800	4.1500
USD/IDR	14,200	14,100	14,050	14,000
USD/THB	30.60	30.40	30.20	30.00
USD/PHP	52.50	52.00	51.50	51.00
USD/CNY	7.20	7.18	7.15	7.10
USD/HKD	7.80	7.80	7.80	7.80
USD/TWD	30.90	30.60	30.50	30.50
USD/KRW	1200	1185	1170	1160
USD/INR	70.00	69.50	68.50	70.00
USD/VND	23,200	23,100	23,000	23,000
DXY Index	97.62	97.17	96.69	96.30
SGD Crosses	End Q4-19	End Q1-20	End Q2-20	End Q3-20
SGD/MYR	3.0466	3.0360	3.0290	3.0292
SGD/IDR	10179	10144	10181	10219
SGD/THB	21.94	21.87	21.88	21.90
SGD/PHP	37.63	37.41	37.32	37.23
SGD/CNY	5.16	5.17	5.18	5.18
SGD/HKD	5.59	5.61	5.65	5.69
SGD/TWD	22.15	22.01	22.10	22.26
SGD/KRW	860	853	848	847
SGD/INR	50.18	50.00	49.64	51.09
MYR Crosses	End Q4-19	End Q1-20	End Q2-20	End Q3-20
EUR/MYR	4.72	4.71	4.68	4.67
JPY/MYR	4.05	3.98	3.94	3.93
MYR/HKD	1.84	1.85	1.87	1.88
MYR/CNY	1.69	1.70	1.71	1.71
GBP/MYR	5.27	5.28	5.27	5.31
AUD/MYR	2.89	2.91	2.93	2.95
NZD/MYR	2.72	2.79	2.76	2.82
MYR/IDR	3341	3341	3361	3373
MYR/INR	16.47	16.47	16.39	16.87
MYR/KRW	282	281	280	280
MYR/PHP	12.35	12.32	12.32	12.29
CNY/MYR	0.5903	0.5877	0.5846	0.5845

Source: Maybank FX Research as of 30 Sep 2019.
*These forecasts are meant to be indicative of FX trends and not meant to be point forecasts.

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