Maybank

# FX Monthly

# 2016, Issue X: Uneven USD Strength and Yield Curves in Focus

Macro | FX Research

Global

## Key themes[1]

- First, US Fed timeline for eventual future rate hike still remains data dependent but has heightened following recent official comments by Fed officials. US growth recovery remains on track even as enhanced volatile market activity remains likely. Still expect USD to be mildly positive as we hold our call for a hike in 4Q 2016. *Brexit volatility, Fed rate hike expectations and US elections (i.e. non baseline Trump win) remains key triggers for risk aversion and further dollar support.*

- Second, *even though the dateline for achieving Japan's 2% inflation target is now open-ended, we expect the BOJ to push back this dateline to FY2018.* BOJ have scrapped its target for the average maturity of its government bond holdings and forward guidance has been strengthened, with the BOJ stating asset purchases will continue until inflation is stable above 2%, making it clear that exit won't happen immediately if they hit 2%. BOJ kept the benchmark rate unchanged at -0.1% and have stated that the JPY 80trn annual monetary base target will now fluctuate in the short term in order to shape the slope of yield curve. *As well, the 10-year bond yield is targeted around 0%. BOJ policy announcement on 1 Nov is likely to be a non-event. Market focus will remain on the steeper curve in Japan and the divergence in monetary policy with the US and possibly the EU.*

- Third, *rising market expectation for potential extension of QE beyond Mar 2017*, US Presidential Elections (outcome uncertainty), rising expectation for Fed to raise rates (leading to USD strength) as well as potential political contagion risks arising out of upcoming Italian Referendum (4th Dec), elections in Netherlands, France, Germany (in 2017) and hard stance adopted by Britain and Euro-area leaders on Britain exit could keep the EUR under pressure.

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

- *In light of upcoming FoMC meetings and US Presidential Elections (8 Nov), risk proxies may come under pressure while FX volatility is expected to rise amid choppy trading ahead. We expect broad USD strength against most currencies including KRW, SGD. Carry plays may not be as attractive in the meantime. On UST curve, 2s10s steepened to nearly 100bps (from 83bps in end-Sep). 10Y UST yield is now at 4-month high of 1.86%. This coincides with headline growth and inflation showing signs of bottoming. We think further upticks could support further steepening and may lead to further upside for usdjpy, in the medium term. Given EU contagion risks, we continue to favor selling EUR and GBP on rallies.*

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

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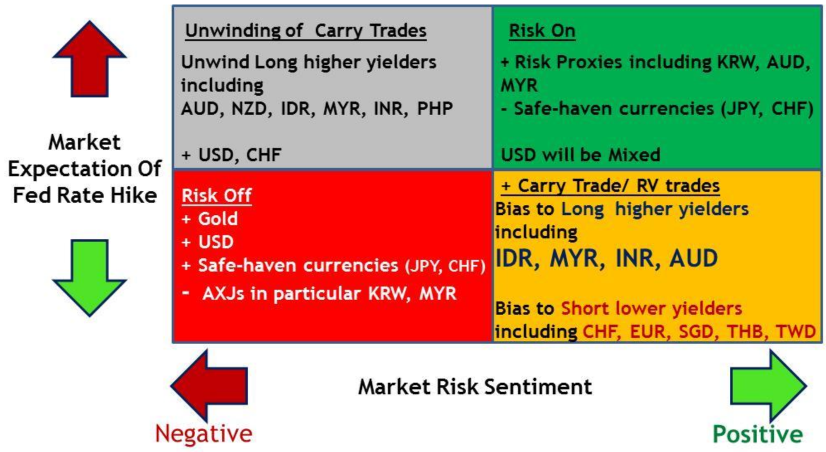
## So what?




| | 2015 | 1Q- 3Q 2016 | 4Q 2016 | 2017 Outlook? |
|---|---|---|---|---|
| Global Growth | IMF, ADB downgrades | Growth 'not hot not cold' | Lesser Downgrades from IMF, ADB | Potential Signs of Stabilisation in 2H 17 |
| Inflation | Subdued globally; Only US showed signs of pick up in end-2015 | Subdued globally; but inflation in US managed to stabilize 1 – 1.5% | China, Europe started to show signs of uptick in headline inflation; US inflation holding up above 1.5% | Inflation shows signs of further pick up via the headline (base effects and pick-up in commodity prices) |
| US Rate Hike Expectation | First Fed rate Hike in 10 years | No rate hike | Rising expectation for rate hike in Dec | MBB Expects 1 – 2 rate hike expectation vs. Markets' expectation for less than 1 hike |
| Commodity/ Oil Prices | Decline to more than 10Y low of $30/bbl | Stabilised around $43 (1Q-3Q avg) | Stabilised at higher average of $50/bbl | Potentially Moving Higher into $50 – $60 Range |
| | | | | |
| **Impact on FX** | USD strength against most currencies | USD Strength Eased; Carry trade returns (hunt for yield) | USD strength returning; UST yield steepening | Expect further steepening of UST yield curve; **Markets underpricing of rate hikes could lead to further USD strength ahead** |

- The **FX GamePlan Grid** above assumes all major central banks except US remain on accommodative monetary policy (low rates for longer); global growth outlook remains subdued/below-trend growth and that markets remain driven by US Fed rate hike expectation and risk sentiment. We think that assumption and environment remains and has not changed for the past few months.
- **Macro Themes:** Global growth remains anemic (lethargic global business investment outlook), inflation risks remains minimal, bond market yield curve steepening (or is it a bubble), central banks (except US) still easing, global QE levels at record high, tighter regulation and lower global credit multipliers, widening credit spread divergence between EM and DM and rising asset market volatility - are unprecedented. We have not seen a congruence of these in history since under the current global financial architecture. Question is when some of these will unravel.
- We see an eventual re-pricing of fear for Trump victory that could heighten volatility and trigger further risk aversion that would lead to dollar and yen strength. We stick to our view that Fed is likely to raise

target rate in Dec 2016 and possible volatility going into the Nov FOMC. There was also news report of Congress passing a stopgap funding bull that expires on 9 Dec, raising the risk of a potential government shutdown in Dec, a week before the FoMC is scheduled to meet. We anticipate occasional potential shifts towards the top left quadrant from the bottom right (yellow quadrant) in the 2by2 grid shown above as we proceed ahead to Dec FOMC and slightly beyond.

- **Major Currencies:** Expect USD to see modest strength but not by the magnitude we have seen last year. Risk aversion and re-pricing of Fed hike expectation could support the USD. GBP to remain bearish bias, weighed by political/Brexit uncertainty, risk of BoP crisis and BoE easing. EUR is trying find its equilibrium level now (although it is still far away from our fair value of 1.20) but is likely to be weighed down by medium to long term concerns of EU contagion risks (arising out of Brexit), European banking sector stress (Italian banking sector and Deutsche Bank) and ongoing risk of ECB easing. Higher yielding and good quality sovereign bonds benefit in low global rates environment, given AAA rating. Near-bottom commodity prices, stronger iron ore prices and weaker domestic financial sector profits which reduce the risk of an easing, also protect the downside for AUD. NZD continues to be weighed by expectation for RBNZ monetary easing and macro-prudential policies but recent upswing in dairy prices and tourism sector growth has delayed the move in the near term. Yield differentials in favor of Kiwi could mitigate some of the negativity. Occasional safe-haven flows and its trade surplus could limit weakness in the JPY. Carry currencies and EM Asia FX such as IDR, MYR etc and NZD and AUD most vulnerable to higher volatility. Any further rise in volatility could provide more support to safe haven currencies such as USD and JPY. Overall, monetary policy in G7 excluding the US, have been ineffective and reliance on fiscal policy to boost the environment is likely to be a protracted process.
- **AXJs:** We continue to expect some weakness in the MYR in the short term but expected to see gains amid fund inflow, supported oil prices and positive risk appetite into Asia for now. Domestic and external headwinds continue to weigh on the SGD. Government spending and quasi-safe haven inflows though should be supportive. Risks of further MAS easing cannot be ruled out but is not our base case. SGD should remain weak. The improving economic fundamentals and introduction of reforms and economic liberalization (including the Indonesian tax amnesty law) should continue to generate positive sentiments and encourage greater FDI and portfolio inflows into Indonesia. These should be IDR-positive. The Philippines economy should outperform its regional peers but concerns about the government's extra-judicial killings, policy flip-flops and the president's unpredictable temperament could weigh on the PHP for the next 12 month. Risks from regional geopolitical tensions arising from the South China Sea claims could undermine the Philippines economy. We remain bearish on the PHP. Elsewhere, high yield, strong growth, recent policy reforms underpin the INR. We are wary of GST implementation uncertainties.
- We still see potential inflows into AXJs as markets search for higher yielding plays amid a near-zero rate environment (in the developed world). In the medium term, we favor IDR and INR.
- Risks to our view are faster and larger than expected US Fed rate hikes, sharp deterioration in China's growth, crude supply overhang that could drag on oil price and a risk of underpricing a Donald Trump Win. Any Fed signaling that is seen as overly hawkish and significant spike in global FX volatility could unravel some of the inflows we have already seen into Asia. Overall in the table shown above, as long as

there are less economic growth downgrades, some signs of global inflation, rising expectation and eventual Fed rate hike and if oil remains somewhat stabilized around $50/bbl, then we will expect USD strength to return in 4Q 2016 and UST yield steepening to appear.

# G7 Global Overview

## USD: Strength Remains Sustained But Uneven

| Forecast | 4Q 2016 | 1Q 2017 | 2Q 2017 | 3Q 2017 |
|---|---|---|---|---|
| USD Index | 98.69 (98.39) | 97.89 (96.79) | 99.56 (99.56) | 98.07 (98.07) |

*Previous Forecast in Parenthesis*

- **Motivation for the FX View:** We expect at least one rate hike in 4Q 2016, more likely in Dec after the US Presidential elections. We do caution that additional repricing of a surprise Fed hike earlier in Nov (due to market complacency over Fed rate hike trajectory) could continue to see UST yields higher in particular Treasuries 2y and below, and see **USD strength (buy the rumor) in the lead-up to the FOMC** meetings. At the same time, post Brexit search for FX equilibrium and surprise Fed hikes may lead to lower risk sentiment and rising risk premiums, before it affects global consumption, investment growth and then the real economy. During this transition phase and around FOMC announcements, we believe the **USD could still be mildly supported**.
- As long as there are less economic growth downgrades by supranationals and the market, some signs of global inflation emerging, rising expectation and eventual Fed rate hike and if oil remains somewhat stabilized around $50/bbl, then we will expect USD strength to be sustained in 4Q 2016 and UST yield steepening to appear more entrenched.
- Recent economic data including factory orders, durable goods, ISM manufacturing, existing and new home sales, retail sales, have remained generally firm on average. Labor market is at or near full employment and inflation progressing towards Fed's medium term objective of 2%. Within the context of Fed's mandates of "maximum employment and stable prices", we think the trends in key indicators appear to be supportive of the Fed's decision and market expectation on US interest rate policy tightening, namely data on job market conditions (unemployment rate, non-farm payrolls), inflation indicators (personal consumption expenditure or PCE deflator, wage growth), and economic growth and activity (real GDP, purchasing managers index or PMI) during 2015 and so far in 2016.
- However, we think any moves on the dollar is conditional on upcoming FOMC statements, Fed speaks and projections. So the Nov statement remains relevant and we expect the Fed to acknowledge that recent economic data remains relatively resilient, continues to reiterate gradual and cautious pace of tightening.
- **Growth and Inflation Outlook:** The advanced reading on GDP figures announced on 28 Oct, showed that the US economic growth picked up in the third quarter after an uninspiring first half of the year as a build

in inventories and a soybean-related jump in exports helped cushion softer household spending. The 2.9% annualized increase in GDP follows a 1.4% gain in 2Q (consensus: 2.6%). Consumer spending rose a less-than-projected 2.1 percent. Nonetheless, the data is in line with the recent views of Fed officials that the economy is making slow and steady progress. At the same time, solid employment and steady income gains are a sturdy base for households to continue in the role as the economy's main driver of growth, a contrast with the drag from business investment.

- In the Sep FOMC, the Fed's projection of the US growth outlook was less upbeat for 2016 and the US GDP 2016 growth *f*orecast is now expected at 1.7-1.9% (from 1.9-2.0% in June) while 2017 & 2018 growth forecasts are unchanged at 1.9-2.2% and 1.8-2.1% respectively. The Fed provided its first forecast for 2019 GDP growth at 1.7-2.0% while the longer run growth was revised a tad lower to 1.7-2.0% (from 1.8-2.0%).
- The 2016 unemployment rate was revised up slightly to 4.7-4.9% (from 4.6-4.8%) while 2017 is kept unchanged and 2018 is revised lower to 4.4-4.7% (from 4.4-4.8%). The longer run unemployment rate remains unchanged at 4.7-5.0%.
- The Fed's view of headline PCE inflation was revised lower for 2016-2018 in the latest Sep projections while the core PCE inflation forecasts remained mostly intact, except for 2017 which is revised lower to 1.7-1.9% (from 1.7-2.0%).
- Inflation indicators are heading in the right direction as per the guidance in FOMC statement. The PCE deflator-Fed's preferred measure of inflation -is still below Fed's preferred 2% level. However, it is at higher level this year averaging +0.9% in Jan-July 2016, compared with last year's average of +0.4%. This is consistent with one particular recurring line in the FOMC statements i.e. low inflation in the near term but rising to 2% over the longer run. Fed's outlook of inflation rate uptrend in the medium term is supported by the trend in wage growth, which averaged +2.3% in Jan-Aug 2016 vs in +1.5% 2015. The 28 October 3Q GDP report also showed price pressures remain limited. A measure of inflation, which is tied to consumer spending and strips out food and energy costs, climbed at a 1.7% annualized pace.
- **Monetary Policy Forecast:** Fed kept the target fed funds rate (FFR) at 0.25%-0.50% for the fifth consecutive FOMC meeting this year after the 25bps hike at the 15-16 Dec 2015's FOMC meeting. We are pricing in a 25bps hike at this year's final FOMC meeting on 13-14 Dec 2016 i.e. after US Presidential Election.
- Despite the recent rate hike rhetoric by its senior officials, US Fed kept the target fed funds rate (FFR) at 0.25%-0.50% **for the sixth consecutive FOMC meeting this year after the 25bps hike at the 15-16 Dec 2015 FOMC meeting. Maintain our view since mid-year of Fed doing a replay of 2015 i.e. +25bps hike at this year's final FOMC meeting on 13-14 Dec 2016. We see a the rate trajectory in 2017 to see another move in the middle to 3Q of next year.**
- The tone of the latest FOMC statement is little changed from the previous statement issued after the 26-27 July FOMC meeting i.e. labour market "continue to strengthen"(vs "strengthened" previously); economic activity "picked up from modest pace"(vs "expanding moderately" previously); household spending "growing strongly"(same as previously); business investment "remained soft" ("soft" previously); inflation "continues to run below the Committee's 2% longer-run objective(same as previously); and "the Committee

continues to closely monitor inflation indicators and global economic and financial developments" (same as previously). However, the Fed stated that "near-term risks to the economic outlook *appear roughly balanced*", which is slightly more "hawkish" than "near term risks to the economic outlook *have diminished*" previously.

- Fed also updated its median fed fund rate forecasts i.e. it lowered the forecasts for end-2016, end-2017 and end-2018 to 0.625%, 1.125% and 1.875% from 0.875%, 1.625% and 2.375% previously. It also introduced the end-2019 forecast at 2.875%. Meanwhile, the fed fund rate's "terminal level" is lowered to 2.875% from 3.00% previously.
- Overall, the internal fed fund rate projections indicate Fed is guiding for a +25bps hike this year, with the pace of interest rate hike rising to +50bps in 2017, +75bps in 2018 and +100bps in 2019.
- Our view since mid-2016 that Fed will do a replay of 2015 is panning out i.e. another year of single 25bps hike at the final FOMC meeting of this year on 13-14 Dec 2016, given the above-mentioned change in the fed fund rate forecast for end-2016 to 0.625% from 0.875%. This is exactly the same as what happened at the 16-17 Sep 2015 FOMC when the median forecast was cut to 0.375% form 0.625%, leading to the fed fund rate to be hiked at the 15-16Dec 2015 FOMC to 0.25%-0.50% (simple average or mid-point of 0.375%) from 0%-0.25%. **The FOMC meeting on 1-2 Nov 2016 is too close to the US Presidential Election on 8 Nov 2016, and we noted that since the 1990s, Fed tends to not make any move on its benchmark interest rate at its November FOMC meeting in the Presidential election years.** Meanwhile, we are currently pricing in a +50bps hike in fed fund rate next year.
- **Latest Fiscal and External Balance Outlook:** Fiscal sustainability risk continues to weigh on the outlook and may emerge after the Nov 2016 presidential election. In the long term, an improved US economy and manufacturing sector, US shale oil and gas production may improve the US current account leading to dollar support but this is likely to be long drawn and may probably begin only in 2017/2018.
- **Key domestic events and issues to watch in Oct 2016:** Key US events: ISM Manufacturing Sep (1 Nov) (expected: 51.7); Factory Orders (3 Nov); Durable Goods (3, 23 Nov); NFP (4 Nov); FOMC Meeting (2-3 Nov); Retail Sales (15 Nov); CPI (17 Nov); GDP 3Q (29 Nov); PCE Core (30 Nov). Fed Lockhar (4 Nov); Fischer (5 Nov); Evans (8, 9 Nov); Kashkari (10 Nov); Williams and Bullard (11 Nov); Lacker ( 15 Nov); Bullard (18 Nov); Fed Minutes of Nov 1-2 FOMC meeting on 24 Nov.
- **Technical Outlook:** October turned out to be a one way ride higher for the USD index, rising from 95.50 levels to a high of 98.85 levels, at time of writing. The move was in line with our bias to buy on dips. Daily technical do suggest some moderation of recent gains in the days ahead; and we do not rule out a pull back towards 97.60 (21 DMA). Underlying momentum on weekly chart remains bullish bias. We still favor staying long. Interim resistance at 99.10 (week high) before 99.80 (Feb high). Support at 98-levels (76.4% fibo retracement of 2016 high to low), 97.50, 96.80 (61.8% fibo).

## EUR: Eyes on Inflation Data

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

*Previous Forecast in Parenthesis*

- **Motivation for the FX View:** We expect EUR to stay under pressure, given an environment of rising market expectation for potential extension of QE beyond Mar 2017, US Presidential Elections (outcome uncertainty to favor USD longs), rising expectation for Fed to raise rates (leading to USD strength) as well as potential political contagion risks arising out of upcoming Italian Referendum (4$^{th}$ Dec) and hard stance adopted by Britain and Euro-area leaders on Britain exit.

- We do not rule out a move lower towards 1.0780 over the coming weeks but do not expect a free fall beyond 1.06 support. ECB's decision is not cast in iron, and will not be anytime soon as the next meeting is only scheduled on 8$^{th}$ Dec. We believe the Governing Council's decision is highly dependent on upcoming price-related data, in particular core inflation (17 Nov and 30 Nov). We expect FX volatility to pick up and trading in the EUR to be increasingly volatile but confined to a lower range of 1.07 – 1.12 (from 1.10 – 1.14 previously).

- Our FX forecasts are left unchanged for now and are based on our assumptions that the ECB will maintain status quo on its QE program. We do however see a risk that ECB may extend QE program beyond Mar 2017, given recent comments made by ECB Draghi that core inflation has yet to see convincing upward trend and he noted that rising headline inflation was merely a reflection of rising energy prices. So if core inflation data continues to point to a subdued outlook, we think the case for QE extension could strengthen. And we will review our forecasts lower accordingly then. As of now, we still expect inflation to pick up further into end of the year.

- The perception of tough talks ahead between European and Britain's leaders over the latter's exit from the Euro-club could weigh on EUR, on a medium term basis. Judging from PM May and her Ministers' Brexit stance so far, it appears that Britain do not accept compromise especially on the freedom of movement of labor but want access to EU single market (i.e. trade freely). If EU allows such a waiver, other European countries will be looking for opportunities to break away from the Euro-bloc and this may trigger political contagion and undermine the future of the Euro-club. And in a year (2017) where many European countries are holding Elections (Netherlands in Mar, France in Apr, Germany in Aug-Oct), as well as Italy referendum on Constitution Reforms (4 Dec 2016), we expect the European leaders to stand even firmer in their belief for 4 freedoms (freedom of movement of goods, people, services and capital over borders) to avoid Far-Right parties stoking anti-EU sentiment leading to risk of "Leave EU" referendums (if held) could undermine the future of the Euro-club, create noises, heighten the level of market uncertainty, and weigh on the EUR.

- In our last monthly, we said that EUR/USD is likely to stay confined within 1.10 – 1.14 range over the next few weeks and expect moderate USD strength in the run up to US Presidential Elections and next FoMC meeting to weigh on EUR in the later part of Oct. This has materialized. But it was the recent ECB meeting (20 Oct) which fueled market expectation and hopes for QE extension in Dec ECB meeting that forced EUR to break below 1.10 support.

- **Risk to EUR Direction:** Should core inflation data pick up further above 1% region, we expect markets to unwind their EUR shorts. This could see a rebound back towards 1.10 – 1.12 range.

- **Growth and Inflation Outlook:** According to latest survey from Bloomberg, the economy of Euro-area is expected to expand +0.3% q/q in 3Q. Data is expected to be released after the publication of this report. Manufacturing PMI for the region strengthened in Sep (52.6 vs. 51.7 in Aug). Order-inventory balance increased to the highest level since 2010; this is typically a good leading indicator and suggests that Manufacturing PMI is expected to increase in the months ahead. Services PMI was a touch softer (52.2 in Sep vs. 52.8 in Aug). Nevertheless it remains in expansionary territories.

- To recap, 2Q Euro area growth grew by +0.3% q/q (vs. +0.6% in 1Q). Household final consumption expenditure had a positive contribution to GDP growth (+0.1 percentage points), while the contribution from gross fixed capital formation was neutral. The contribution of the external balance to GDP growth was positive, while the contribution of changes in inventories was negative. On y/y terms, 2Q GDP grew 1.6% (vs. +1.7% previous print).

- In ECB staff assessment of macroeconomic projections (8 Sep), 2016 GDP forecast was revised marginally higher to 1.7% (from 1.6% in Jun's projection) but revised lower to 1.6% (from 1.7% previously) for 2017 and 2018. Economic recovery is expected to remain moderate, supported by domestic demand amid accommodative monetary and supportive fiscal policies. The ECB expects private consumption to grow strongly in 2016 and remain resilient as outlook for nominal disposable income stays positive and consumer confidence remains well above historical averages. The next set of ECB forecasts will be available at the Dec ECB meeting.

- Impact of *Brexit* is expected to affect the Euro-area economy, via multiple channels including trade, financial, sentiment, etc.

  (1) UK PM Theresa May's mention of trigger of Article 50 before end Mar 2017 poses another risk to the EU. Judging from PM May and her Ministers' Brexit stance so far, it appears that they do not accept compromise especially on the freedom of movement of labor but want access to EU single market (i.e. trade freely). If EU allows such a waiver, other European countries will be looking for opportunities to break away from the Euro-bloc and this may trigger political contagion and undermine the future of the Euro-

club. And in a year (2017) where many European countries are holding Elections (Netherlands in Mar, France in Apr, Germany in Aug-Oct), as well as Italy referendum on Constitution Reforms (4 Dec 2016), we expect the European leaders to stand even firmer in their belief for 4 freedoms (freedom of movement of goods, people, services and capital over borders) to avoid Far-Right parties stoking anti-EU sentiment. German Chancellor Merkel reiterated (5 Oct) that full access to EU market requires accepting the 4 freedoms of the European Union and exempting the UK would create an "extremely difficult" precedent.

(2) From a trade perspective, UK represents 37% of EU's total trade and a number of European countries ran trade surpluses (i.e. exports more than imports) to the UK. Disruption to trade flow will have impact on growth prospects for the EU region.

- **Euro-area inflation** increased 0.4% in Sep, from +0.2% y/y in Aug. This is the fastest pace of increase since late 2014. Energy prices fell by smaller magnitude at 3% in Sep (vs. -5.6% in Aug). while inflation is slowly showing signs of rising, it remains well below ECB's objective of 2%. ECB's Draghi had also said that the uptick on headline CPI was mainly a reflection of continued increase in energy inflation. Core inflation remains subdued at +0.8% in Sep (unchanged from prior month).

- On inflation expectations, the ECB continues to project 2016 inflation at +0.2% (unchanged from Jun projection); reduced 2017 inflation marginally to 1.2% (from 1.3% in Jun projection) and kept 2018 inflation projection unchanged at 1.6%. ECB expects inflation to start picking up towards end-2016 due to fading effects of the previous large decline in oil prices (base effects). On the basis of the oil price futures curve, the contribution of HICP energy inflation to headline inflation is expected to swing from -0.6 percentage point in 2016 to around +0.1 to 0.2 percentage point in 2017 and 2018, thereby contributing 0.7 percentage point to the pick-up in headline inflation between 2016 and 2017. ECB also expects core inflation to rise as economic slack slowly fades. Improvements in labour market conditions, as reflected in a notable decline in the unemployment rate, are expected to bolster a gradual pick-up in wage growth over the projection horizon.

- Monetary Policy Forecast: There is no ECB meeting scheduled in Nov; the **next as well as the last one for the year is scheduled on 8th Dec.** This meeting will be **closely watched for potential announcement of change or continuation in monetary policy stance**. ECB's Draghi had said that **decisions in Dec meeting will convey what the ECB will do in the coming months**. Recall back in the Sep ECB meeting, ECB has tasked the relevant committees to evaluate options to ensure its QE program does not face bond scarcity problem. **A potential extension of QE program beyond Mar 2017 (if it happens), will very likely bring about other tweaks to its bond purchase parameters** which include increasing issuer limits from 33% or eliminate the floor rule (yield > deposit rate) or allow for deviations in ECB capital key requirements. The reason for making those tweaks stems from shrinking pool of eligible bonds for ECB to purchase.

- We think **ECB's doors remain open for any possibility** – extension of QE program beyond Mar 2017 or maintaining status quo to its current QE program. The fact that Draghi mentioned that the recent rise in headline inflation was mainly due to energy prices and that there is no sign of convincing upward trend in core inflation suggests that the **chance of a QE extension could be higher**. After all one of the main mandates of ECB is to ensure price stability (this is defined as y/y increase for the Euro-area of below but close to 2%). Risk is if core inflation starts picking up in the coming 2 months to above 1%, then we could see the ECB on status quo.

- **We expect heightened level of FX volatility around the ECB meeting and give more attention to core inflation and wages data in the coming weeks.**

- At the last ECB meeting (20 Oct), ECB maintained status quo on monetary policy - main refi at 0%, marginal lending rate at 0.25% and deposit rate at -0.4%. On non-standard monetary policy measures, ECB maintained the current pace of monthly asset purchases at EUR80bn and is intended to run until the end of Mar 2017, or beyond, if necessary, and in any case until the Governing Council sees a sustained adjustment in the path of inflation consistent with its inflation aim. At the press conference, ECB President Mario Draghi said there were **no discussion of tapering of bond purchases** and **extension of QE beyond Mar 2017**. ECB Draghi added that "it's quite clear that our decisions in Dec will tell (markets) what we do in the coming months (referring to its current QE program). On tapering of bond purchases, he did explain that QE is not forever but added that "my perception is that a sudden stop is not in anybody's mind". Clearly the fears of early tapering were overstated at this point of time.

- **Latest Fiscal and External Balance Outlook:** The government deficit ratio is projected to decline to 1.5% in 2017, from 2.1% of GDP in 2015. Projected government debt ratio is projected to decline gradually to 88.4% in 2017, from 91.5% of GDP in 2015.

- Euro area current account surplus widened to EUR29.7bn in Aug (up from EUR21bn in Jul), on seasonally adjusted basis. The rise was due to primary income which more than offset the decline in secondary income. Current account surplus is at a 3-month high. Current account surplus stood at 3% to GDP.

- **Key domestic events and issues to watch:** Sep PPI (4 Nov); Sep IP (14 Nov); Nov ZEW Survey Expectations (15 Nov); Euro-area 3Q preliminary GDP (15 Nov); Oct CPI (17 Nov); Nov Prelim PMI (23 Nov); CPI estimates for Nov (30 Nov).

- **Technical Outlook:** EUR broke out of its triangle consolidation pattern and traded a low of 1.0851 (25 Oct), in line with our bias to lean against strength. But the low was more than our expectations. Pair was last seen at 1.0920 levels. Daily momentum and stochastics are showing signs of rebound, possibly towards 1.0970, 1.1030 levels in the near term. Underlying momentum remains bearish bias. We favor selling on rallies. Next support at 1.0850 before 1.0780 (76.4% fibo retracement of Dec low to 2016 high).

## GBP: Rebound Risks but Bearish Bias Remains

| Forecast | 4Q 2016 | 1Q 2017 | 2Q 2017 | 3Q 2017 |
|---|---|---|---|---|
| GBP/USD | 1.2300 (1.2600) | 1.1600 (1.2700) | 1.1800 (1.2400) | 1.2300 (1.2800) |

*Previous Forecast in Parenthesis*

- **Motivation for the FX View**: We are revising lower our FX forecast for GBP over the forecast horizon, due to expectations for tough talks ahead between EU and UK. While **one can argue that the bearishness is in the price, we do not disagree and do think that GBP could be due for technical rebound soon**. This however does not suggest that the worse is over as much uncertainty remains and trigger of Article 50 has yet to take place (though UK PM Theresa May indicated it will be invoked before end-Mar 2017).

- Just by looking at the EU/UK calendar for the year ahead is daunting enough. The next 12 months is littered with many political events including Autumn Budget statement from UK Chancellor Philip Hammond (23 Nov) – though there are market chatters that he is considering axing the annual Autumn Statement and focus on tax and spending decision on the Spring Budget instead, Italy referendum on Constitutional Reforms and Austria Presidential re-elections (4 Dec), Netherlands General Elections (15 Mar 2017), potential trigger of Article-50 by UK (by end-Mar 2017), French Presidential Elections (Apr – May 2017), German Federal Elections (Aug – Oct 2017).

- With many major elections lined up in Europe next year, we expect European leaders to stand even firmer in their belief for 4 freedoms (freedom of movement of goods, services, people and capital over borders) to avoid Far-Right parties stoking anti-EU sentiment leading to risk of "Leave EU" referendums (if held) could undermine the future of the Euro-club. German Chancellor Merkel had said that free access to EU single market requires acceptance of the 4 freedoms. For now, UK do not seem to show any hint of compromise especially on the freedom of movement of labor but want access to EU single market (i.e. trade freely). Nevertheless we note that such stances do change overtime. Moreover formal EU-UK talks are only expected to begin on the trigger of Article-50.

- Upon the trigger of Article-50, UK will have up to 2 years to negotiate new terms with EU, and we do not expect talks to conclude before end-2017, given that EU leaders are expected to be pre-occupied with elections at home and pre-formal talks suggest some sort of deadlock, for now. EU Commission Juncker had said that "Brexit to be very difficult messy negotiation…leaders united and ready for dirty Brexit… talks with Switzerland show EU can be tough negotiator".

- This period should continue to see heightened levels of FX volatility for GBP, and we do not rule out further swings. History has shown that

GBP can depreciate by nearly 30% during the Global Financial Crisis in 2008, and out of the past 12 years, GBP has fallen (peak to trough in the year) in 8 of them.

- Overall, we maintain our bearish bias on the outlook of UK economy and the GBP over the medium term horizon (6-9 months), as much uncertainty remains over the timing of trigger of Article-50, exit plan/ strategies the incumbent government has in place and the medium term repercussion of all these on UK's outlook and prospects (in terms of trade relationships, London's status as financial hub, investment/portfolio flows and job creation).
- But on a shorter term perspective (2-4 weeks), daily momentum and stochastics indicators do provide some mild signs of rebound (but these signs appear weak at this stage). Rebound may take GBP towards 1.2430 (23.6% fibo retracement of Sep high to interim lows of 1.2120). A move towards 1.2630 should not be ruled out.
- **Growth and Inflation Outlook:** Recently released 3Q GDP preliminary estimate surprised expectations (+0.5% q/q vs. +0.3% consensus). Services sector provided the support while manufacturing, construction and agriculture shrank. This is the 15$^{th}$ straight quarters on expansion and is in line with the average q/q growth over the prior year. Note that the current estimate was based on only 44% of the data required for the final estimate and is subject to further revision next month. Elsewhere Manufacturing, construction and services PMI continued to surprise to the upside. In a surprise move, Nissan has announced new investment plans – to build new car models (Qashqai and X-Trail) for its Sunderland factory, safeguarding more than 7000 jobs. It was previously feared that Nissan may move production to France.
- Looking out, our concerns of medium term growth outlook remains as trigger of Article-50 has yet to take place (although the timetable has been advised by PM Theresa May that it should take place before end Mar 2017. But the issue is with the uncertainty in terms of trade, investment flows/decisions, jobs, relocation of HQs away from UK, if London maintains its status as Financial Hub, etc. These concerns could translate into further weakness in the exchange rate.
- In Jul, the IMF has cut UK growth outlook for 2016 and 2017 by -0.2 ppts and -0.9 ppts, to 1.7% and 1.3% respectively. IMF noted that the referendum will damage short-term growth prospects via lower confidence and investment but factored in favorable trade terms into its forecasts. Increase in uncertainty is projected to weaken domestic demand significantly.
- Headline inflation jumped to 1% y/y in Sep (from 0.6% in Aug). This is the highest level since late-2014. Rise was due to clothing and footwear as well as restaurants and hotels components. The sharp rise in inflation was well flagged out, given that large decline in GBP exchange rate is expected to exert upside pressure on prices (via the import price channel), given UK imports more than it exports. This should erode the purchasing power of the UK consumer and weigh on growth, over time. BoE's Carney said MPC discussed earlier that GBP depreciation was going to lead to inflation around 2.5% over 2-3 years

of the forecast horizon (in his testimony to House of Lords Economics Committee 25/Oct). Core inflation also increased to 1.5% in Sep (from 1.3% in Aug).

- **Monetary Policy Forecast:** We expect BoE to keep monetary policy status quo at its next meeting on 3 Nov, given that the performance of the economy held up, much better than expected amid rising inflationary pressures. The latter is expected to rise further amid a sharply weakened currency. Further monetary easing could exacerbate the inflationary situation. We expect BoE to conserve its monetary policy toolbox for use at a later stage when need arises.

- At recent public speaks including testimony to House of Lords Economic Affairs Committee, BoE Carney defended its QE program, including the purchase of corporate bonds. He clarified that the GBP slump had less to do with monetary policy but more to do with announcement of the timetable of Article 50 and market perception of how discussions on Brexit may unfold. **Carney added that BoE is not a targeter of exchange rate but a target of inflation. But that does not mean that the BoE is indifferent to the level of the exchange rate. "It does matter, ultimately for inflation and over the course of 2 to 3 years out, and so it matters to the conduct of monetary policy.** He also added that BoE would tolerate higher inflation that its formal target, if necessary in order to avoid rising unemployment.

- At the last MPC meeting (15 Sep), BoE MPC kept rate unchanged at 0.25% and APP at GBP435bn/month, as expected. On forward guidance, BoE maintained their easing bias, saying that another cut is only likely if August outlook is confirmed. On MPC meeting (4 Aug), BoE unleashed a broad-based package of easing measures (more than we and consensus expected): (1) policy rate was cut by 25bps to 0.25% (this was the first cut in 7 years); (2) GILT purchases of GBP60bn over 6months; (3) Corporate bond purchases of GBP10bn over 1.5 years; (4) Term Funding Scheme (TFS) of GBP100bn for 4Y at close to bank rate (to help with transmission mechanism).

- **Latest Fiscal and External Balance Outlook:** UK's public finances worsened in Sep; public sector borrowing was GBP1.2bn higher at GBP10.6bn in Sep, from a year earlier, due to fall in income from corporate tax receipts. The Office for National Statistics said it was the first fall in corporation tax revenues seen in the month of September since 2009.The growth in VAT receipts was the slowest for the month of September since 2012.

- UK's current account deficit widened to -5.9% of GDP in 2Q, (from -5.7% of GDP). This could potentially narrow due to the drop in GBP resulting in higher demand for UK exports, outweighing the higher prices of imports.

- **Key domestic events and issues to watch:** Oct PMI (1 Nov); BoE meeting (3 Nov) – expected to maintain monetary policy status quo; Oct CPI, PPI (15 Nov); Sep jobs report (16 Nov); Oct retail sales (17 Nov) and 3Q prelim GDP (25 Nov).

- **Technical Outlook:** GBP traded lower for the month of Oct amid announcement of timetable of Trigger of Article-50 and market chatters of "fat finger"-related flash crash. GBP was last seen at 1.22 levels. From monthly and weekly charts, momentum and stochastics continue to indicate a bearish bias, with support levels possibly at 1.2120 levels (recent lows) before 1.1920 (123.6% fibo projection of 2001 low to 2007 high), 1.0830 (138.2% fibo). Resistance on the longer-term chart now stands at 1.3680 (low in 2001 and 2008). From a shorter term perspective, daily momentum and stochastics indicators do provide some mild signs of rebound (but these signs appear weak at this stage). Rebound may take GBP towards 1.2430 (23.6% fibo retracement of Sep high to interim lows of 1.2120). A move towards 1.2630 should not be ruled out.

## AUD: Bulls Waiting For Cue

| Forecast | 4Q 2016 | 1Q 2017 | 2Q 2017 | 3Q 2017 |
|---|---|---|---|---|
| **AUD/USD** | 0.7600<br>(--) | 0.7800<br>(--) | 0.7500<br>(--) | 0.7800<br>(--) |

*No Change To Previous Forecasts*

- **Motivation for the FX View:** The 0.7850-resistance still caps the AUDUSD amid Fed hike expectations at the end of the year. The range of 0.74-0.78 could hold for much of this quarter. Beyond the near-term, our view on the AUD is broadly unchanged as we continue to expect the currency to remain resilient, albeit sensitive to the Fed. The few underpinnings that we highlighted in the past few months still hold. One, iron ore prices could be looking at a medium term bottoming. While that is unlikely to give a material boost to the iron ore prices and AUD, the major part of the decline in iron ore prices is likely to already be in the price of AUD. Two, we are still in a world of subdued growth and low inflation which suggests that yield hunting will still dominate notwithstanding episodes of carry trade unwinding in times of Fed hike expectations (like now) or risk-off. In that respect, AUD is still likely to be in favour given its room for further rate cut that should boost the allure of its government bonds both in terms of yields and price gains. Third, its AAA-rating, albeit at risk, give comfort to those who seek that rare commodity.

- AUD bond markets correct with 5Y-20Y yields gaining 20-30bp since a month ago (last checked on 26 Oct). The sell-off started since 4 Oct after RBA Governor chaired his first policy rate meeting as Governor. Statement was rather neutral with emphasis that "*inflation remains below most central banks' targets*", "*measures of household and business sentiment remain above average*", labour market conditions are still uneven, "*growth in rents is the slowest for some decades*". Taken together, we see room for easing as the central bank projects stability and even further correction in the housing market and labour market conditions are still far from robust as full-time hires continue to give way to part-time hires. Still, the recent rise in retail sales, mild appreciation in AUD TWI, lack of deterioration in the inflation prints suggest that a cut may be better timed in May 2017.

- **Growth and Inflation Outlook:** Retail sales seemed to have shown slight improvement, led by a rise in consumer confidence from 99.1 in Jul to 102.4 in Oct. Even so, that still has to translate private consumption. Confidence level is not only improving amongst consumers, the Sep report of the quarterly NAB survey (released in Oct) also noted slight improvement in the business confidence levels. Capex is expected to rise significantly along with hiring intentions into the next year. Capacity utilization rate has also rose from Aug low for manufacturing, construction and services. These leading indicators may be heartening but private investment is still lacking and growth of retail sales are still near multi-year low, lacking the traction of a broad-based recovery.

- The picture is also uncertain for the labour market conditions. Although the jobless rate is around "*½ a percentage point or a bit more above full employment*", full-time hires have been giving way to part-time hires and the details underscore the spare capacity that belie the healthy looking headline jobless rate. So while there has been some growth in hiring, the picture is mixed and RBA is likely to keep its door open for easing in the future.

- 3Q inflation had rebounded by +0.4%q/q from -0.2%, buoyed by higher costs in food, transport and housing. Year-on year, inflation slowed to 1.0% from previous 1.3%. The trimmed mean version surprised with a firmer than expected print of 0.5%q/q vs. previous 0.2%. With demand still deficient and AUD rather elevated, inflation outlook is likely to remain benign.

- **Monetary Policy Forecast:** New Governor Philip Lowe has confirmed that RBA will stick to the 2-3% inflation target. "Both the Reserve Bank and the government agree that a flexible medium term inflation target is the appropriate framework for achieving medium-term price stability", "allowing for natural short-run variation in inflation over the economic cycle". The statement also highlighted "financial stability" as one of its broad objectives. This suggests that RBA may not be so pressured to lower policy rate in order to nudge inflation back within the 2-3%.

- In the past easing policy decisions, AUD has been emphasized as a great source of uncertainty and could impact inflation as well as the growth momentum of increasingly important services exports. As RBA gradually shaves cash target rate to fresh record lows, we anticipate every additional moves will be carefully timed to juggle the few public priorities including providing necessary monetary support for consumption and investment, guarding against a strong AUD that could derail the economic restructuring process as well as weak inflation prints that could entrench the inflationary expectations. With TWI still near year lows, we see little impetus for a move in Nov and anticipate the next move to be in May, a seasonally weak month for the AUD.

- **Latest Fiscal and External Balance Outlook:** For the first time in history, Australia issued a 30year bond on 11 Oct and raised A$7.6bn from investors with bids totaling almost twice the amount. The issuance underscores the allure of AUD bonds. Post elections, Treasurer Scott Morrison announced changes to the superannuation system on 15 Sep. The A$500,000 lifetime non-concessional cap is removed. Rather, people will be able to make both concessional and non-concessional contribution up to a cap of A$1.6mn in their super retirement account, subject to a yearly cap of A$100,000 on non-concessional contribution. This would cost the budget A$550mn in revenue over the next four years.

- To recall, the budget deficit presented in May for 2016 is expected to be A$37bn. The deficit is projected to exist for the next four years and should narrow to A$6.0bn by the financial year 2019-2020. The government expects to raise tax on tobacco and commit a record A$50bn in infrastructure investment between 2013-14 and 2019-20 for roads, rail, airports and dams. Fiscal deficit is estimated to be around -2.2% of GDP for 2016-2017 before gradually narrowing towards -0.1% by 2019-20. Real GDP is estimated to be 2.5% this year before accelerating to 3% for the next 3 subsequent fiscal years. One of the key plans is the Ten Year Enterprise Tax Plan meant to boost new investment, create and support jobs ad increase real wages. The Plan will see lower tax rates for small businesses first before progressively extending cuts to all companies by 2026-27. For personal tax, the government will also lift the tax threshold on the middle tax bracket to prevent average full time wage earners from moving into the second top tax bracket. This could serve to boost consumption in the long run.

- Current account deficit came in at a narrower -A$15.5bn for 2Q versus previous –A$14.9bn in 1Q (which was revised a lot lower). Worth noting is that the imports of general merchandise and capital goods have been on a decline. The latter underscores the lack of investment that belies the narrower current account deficit recently.

- **Key domestic events and issues to watch:** RBA decides on cash target rate on the 1st. Building approval is due on the 2nd. Trade on the 3rd followed by retail sales on the 4th. Statement on Monetary Policy is due on the 4th. NAB business surveys are due on the 8th. Minutes of the Sep meeting is due on the 15th. Labour report is due on the 17th. Building approvals are due on the 30th.

- **Technical Outlook:** As we approach the end of the month, AUDUSD is making an attempt to breakout of its downward sloping trend channel that has formed since 2012/2013. The elements are in place for a bullish correction including RBA's easing bias (albeit reluctant) that can still lure demand for Australian bonds, its AAA rated that can provide downside protection in times of risk-off, potential upside risk to inflation that typically benefits the AUD base on historical prices. Even if the current upmove is a technical correction, we anticipate that a 38.2% fibonnaci retracement of the 2011-high to 2016-low is needed to attract meaningful bearish attempts. The 21-month moving average is seen as a strong support at 0.7450. Hence, *we like to long AUD against the USD towards 0.8450. Stoploss below 0.74. Spot ref. at 0.7650 which should give us a decent risk-reward ratio of around*

*2.8.*We see potential dips in the near-term as opportunities to buy into.

## NZD: Gearing for a Rate Cut

| Forecast | 4Q 2016 | 1Q 2017 | 2Q 2017 | 3Q 2017 |
|---|---|---|---|---|
| **NZD/USD** | 0.7000<br>(--) | 0.7300<br>(--) | 0.7200<br>(--) | 0.7500<br>(--) |

*Previous Forecast in Parenthesis*

- **Motivation for the FX View:** Our bias to sell NZD on rallies (in our last monthly outlook) remains intact. We expect NZD to trade in a lower range of 0.69 – 0.73 (vs. 0.71 – 0.74 previously) over the next few weeks. A combination of drivers including expectations for RBNZ rate cut, and USD strength (in light of US Presidential Elections outcome uncertainty and rising expectation for Fed to raise rates) are expected to weigh on the NZD. But given relative yield differentials in the g7 space, and much of the rate cut has been priced in (about 84% as implied from OIS), we see NZD downside limited towards 0.69 – 0.70 levels.

- We now expect the RBNZ to cut OCR by 25bps to record lows of 1.75% at its 10 Nov meeting. While 3Q headline inflation did beat expectation slightly, overall price pressures remain benign at more than 16-year lows and have yet to show meaningful signs of picking up. Taking cues from RBNZ guidance (that further easing is required) and RBNZ Assistant Governor McDermott (that RBNZ prefers to move rates with quarterly MPS). We believe a cut at the upcoming meeting (which is also the last for the year before RBNZ meets again in Feb 2017) is timely.

- **Risks to our outlook:** We observed that markets are already pricing in 84% chance of a 25bps rate cut at the Nov RBNZ meeting. We caution that a RBNZ no-move could see NZD shorts unwinding and this could lead to Kiwi strength. We will be watching the MPS closely for guidance on RBNZ easing bias. If words such as “further easing is required” is removed or tweaked, markets may interpret it as RBNZ is done easing. This could pose immediate upside risk to NZD.

- **Growth and Inflation Outlook:** Sep leading surveys are pointing to some divergence between Manufacturing and services sector. Manufacturing PMI expanded at a faster pace in Sep, rising to 8-month high of 57.4 (vs. 55.2 in Aug). The production gauge gained to near 2-year high of 61.3 while employment index rebounded from 4-year low in Aug. On the other hand, services PMI grew at slowest pace in 22 months, falling to 54.1 in Sep (vs. 57.9 prior). That said services PMI remain in expansionary territory and one softer data point doesn’t make a trend. Putting both manufacturing and services PMI survey together, they still point to an expansion. Activity Outlook and Business Confidence also rose in Sep, to levels not seen since Jul 2014 and Apr 2015, respectively. These data suggest that 3Q GDP (due for release on 15 Dec) could continue to show another quarter of strong growth, following 2Q GDP growth of 3.6% y/y. Looking ahead, domestic growth is expected to remain supported by strong net immigration, construction activity, tourist spending, and accommodative monetary policy.

- Headline inflation came in slightly above expectations in 3Q, but remains softer than in 2Q. (3Q CPI at +0.2% vs. 0% Expected vs. +0.4% prior m/m). The rise was due to higher housing-related costs and vegetable prices. On y/y terms, CPI fell to +0.2% (vs. +0.4% in 2Q). This is the **8th consecutive quarter below the lower bound of RBNZ's inflation target range of 1-3%.** Tradables inflation was flat q/q (-2.1% y/y; negative since 2012) while non-tradable inflation rose slightly by +0.3% q/q. The outlook for low inflation is expected to persist for longer. Subdued global environment continues to dampen inflationary pressures in NZ. This is especially so as spare capacity contributed to the decline in commodity prices and strong NZD exchange rate translated into lower import prices, suppressing tradables inflation, and weigh on headline inflation. RBNZ cautioned there remains a risk of further declines in expectations stemming from persistent low inflation.

- **Monetary Policy Forecast:** Judging from guidance from RBNZ MPS statement in Sep, Assistant Governor McDermott's recent comments (10 Oct), and recent 3Q inflation print, **we expect RBNZ to lower OCR by 25bps to record lows of 1.75% at its next meeting on 10th Nov.** This is also RBNZ's final meeting of 2016 and the next time RBNZ meets for policy decision is in 9 Feb 2017. While 3Q headline inflation did beat expectation slightly, overall price pressures remain benign if we strip out the housing component (related to rental). Headline inflation remains at more than 16-year lows and have yet to show meaningful signs of picking up. RBNZ had previously said that further easing is required and given that inflation did not increase beyond RBNZ's expectation, we think a cut is warranted at the next meeting. Furthermore RBNZ had said that **RBNZ prefers to move rates with quarterly MPS to enable better communication of stance. The upcoming meeting in Nov will see a release of the quarterly MPS.** He added that *"Interest rates are at multi-decade lows, and our current projections and assumptions indicate further policy easing will be required to ensure that future inflation settles near the middle of the target range"*.

- Markets are now pricing in about 84% chance of a 25bps cut to OCR in the Nov meeting. This is up from 73% chance seen last month.

- At the last RBNZ meeting on 22 Sep, RBNZ kept OCR on hold at 2%, as expected. RBNZ again noted "The trade-weighted exchange rate is higher than assumed in the August Statement. Although this may partly reflect improved export prices, the high exchange rate continues to place pressure on the export and import-competing sectors and, together with low global inflation, is causing negative inflation in the tradables sector. A decline in the exchange rate is needed.". RBNZ reiterated that "Monetary policy will continue to be accommodative. Our current projections and assumptions indicate that further policy easing will be required to ensure that future inflation settles near the middle of the target range."

- **Latest Fiscal and External Balance Outlook:** 2Q current account swung back into deficit of NZD945mil (vs. NZD1.184bn revised surplus in 1Q) or -2.9% of GDP. Record spending by New Zealanders overseas was cited as the main reason behind the surprise deficit. NZ's net external debt position increased to NZD141.6bn (about 56.3% of GDP).

- NZ reported an operating surplus of 1.8bn for the year to June, boosted by a surge in taxes from a growing economy and high immigration. This is the second straight budget surplus. Finance Minister Bill English suggested the possibility of tax cuts in next year's budget.

- **Key domestic events and issues to watch:** 3Q Labor report (2 Nov); RBNZ meeting (10 Nov); 3Q Retail Sales (15 Nov); trade (25 Nov). GDT auctions on 1 and 15 Nov.

- **Technical Outlook**: NZD fell for the month of Oct, in line with our call last month on rising wedge formation (typical bearish reversal) on the weekly chart. Pair traded a low of 0.7035. Last seen at 0.7140 levels. Weekly momentum remains bearish bias. Bias remains to lean against strength. Support at 0.7070 (upward sloping trend-line support from the lows in Jan and Jun). Break below the support paves the way for a move towards 0.6980 (200DMA). Resistance at 0.7240 50 DMA).

## JPY: Eyes On BOJ's Next Move

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

*Previous Forecast in Parenthesis*

- **Motivation for the FX View:** The bounce in the USDJPY so far has come, not as a result of domestic policy responses to the weakness in the Japanese economy. Instead, the USDJPY's climb higher has been underpinned by the steepening of the UST yield curve as market re-price Fed rate hike expectations. This in turn has bolstered the USD and hence lifted the USDJPY. Not surprisingly, the JPY has fallen by 2.8% against the USD so far in Oct. Nevertheless, further upside appears capped with market still long-JPY. This pullback in the JPY could not offset the gains the JPY has made so far this year. Year-to-date, the JPY remains the best performing currency among the Asians and majors, rising 15.4% against the USD.

- Recent CFTC data showed that speculators are still net long-JPY but their position has been reduced since the week of 11 Oct to week of 25 Oct. Such bets were cut to 44595 contracts by 25 Oct from 68695 contracts at the beginning of the month. The paring of net long JPY positions reflects expectations of some dollar strength ahead. Since the start of the year, net long-JPY positions have been favored compared to previous years where bets have been net short-JPY. Still as market re-price Fed rate hike expectations and UST yields continue their climb higher, these net long-JPY bets should be pared even further. Until then, these speculative bets should supportive of the JPY and cap the rise in the USDJPY.

- For this policy meeting (31 Oct-1 Nov), we do not expect the BOJ to add to its easing measures so soon after its shift to a new policy. Instead, we expect the BOJ to move only in Dec to maximize the impact of policy by timing it with the Fed's expect rate hike in Dec. The additional measures that the central bank could put in place include cutting the interest rate to -0.3% from -0.1% currently and increasing asset purchases of ETFs and J-REITs and other instruments to JPY10tn from JPY6tn previously. As well, the dateline for achieving the 2% inflation target could be pushed back further to FY2018. Still, the lack of action by the BOJ is likely to be countered by the market remained focus on the steepening UST yield curve and the concomitant rise in the USD, and this should keep the pair supported ahead.
- The lack of BOJ action aside, USDJPY upside is also likely to be capped to a certain extent by its persistent current account (CA) surpluses we have previously written about. In the first eight months of the year, the surplus was JPY14.50tn, on track at least to match or exceed last year's surplus of JPY16.41tn. There has been a current account surplus since 1996.
- We expect the divergence in monetary policy between Japan and the other advanced economies, particularly the US, to weigh on the JPY. The expected rate hike by the Fed in Dec together with the additional easing measures by the BOJ in Dec should help to keep the USDJPY supported ahead. However, a pull-back in the USDJPY is possible on back of risk aversion (on concerns about global growth and possible oil price pullback). Together, these should keep the USDJPY hovering around the 105-106 levels in the next 6-12 months. Moreover, the persistent current account as discussed above should also cap USDJPY upside.
- We maintain our forecast for the USDJPY to end 2016 at 105. Modest Fed rate hike expectations in 2017 should help keep the USDJPY elevated around the 105-levels by end-3Q17. Nevertheless, we caution that should UST yields continue to steepen ahead, the USDJPY may bounce beyond the 105-106 levels. In such a scenario, we could expect the USDJPY to climb towards the 108-levels by year-end.
- **Growth and Inflation Outlook:** The economic picture remains mixed in 3Q and no marked improvement in the economy is expected. On the bright side, industrial production and core machinery orders showed gains, expanding by 0.9% in Sep and 11.6% y/y in Aug respectively. Year-to-date though, industrial production and core machinery orders fell by 1.1% and 6.3% y/y respectively. External demand also remains a drag. Exports slipped for the 12th straight month in Sep, falling by 6.9% y/y vs. Aug's -9.6% on the back of lower shipments of automobiles, steel and semiconductors. Imports slipped 16.3% y/y in Sep – the 21st straight drop – from -17.2% in Sep due to the y/y drop in oil and gas prices. The trade surplus however widened to JPY408.3bn – the first surplus in two months – vs. a deficit of JPY19.2bn in Aug. The government and BOJ expect export to remain lackluster given weak global demand and relative strength of the JPY. Hopes are pinned on the supplementary budget of JPY4.52tn for FY2016 to bolster the economy but are likely to underwhelm given the small fiscal impulse expected from it. The recovery ahead is likely

to be modest, a view highlighted by the Cabinet report on the economy for Sep.

- Anchoring inflationary expectations continue to remain a challenge to the BOJ. Recent inflation print showed that inflation once again failed to gain traction despite some gains in global oil prices. Headline inflation fell for the sixth consecutive month in Sep by 0.6% y/y (Aug: -0.6%), while core inflation (headline less fresh food) slipped further by 0.6% y/y in Sep from -0.5% in Aug. Even the favored gauge of the BOJ – 'core core' inflation (headline inflation less fresh food and energy prices) – has been on the downtrend after initially manifesting signs that consumer prices could be picking up. 'Core core' inflation rose by just 0.2% y/y in Sep, moderating from +0.4% in Aug. Given the lack of inflationary traction, the BOJ is likely to postpone achieving its 2% inflation target from this current fiscal year to beyond FY 2018.
- **Monetary Policy Forecast:** The shift in policy framework to QQE with Yield Curve Control at the BOJ's Sep policy meeting focuses policy now on achieving a "normal" yield curve by controlling both the short- and longer-terms interest rates. The monetary base expansion – the tour-de-force of BOJ's policy from the start – is no longer the target of monetary policy though the BOJ expects the pace of JGB purchased to be "more or less in line with the current pace … of JPY80tn". As well, the average maturity target of JGB holdings has been scrapped. The new "twist" to the BOJ policy framework includes measures to ensure that the 10-year yield stays around the 0% region through purchases of JGBs, conducting fixed-rate purchase operations (i.e. outright purchases of JGBs with yields the BOJ designates) and fixed-rate funds-supplying operations for a period of up to 10-years (from 1 year currently).
- Despite expectations to the contrary, we believe that there is room for the BOJ to add to its easing measures ahead. We however do not expect any move at its next policy meeting on 31 Oct-1 Nov, though a slight risk remains that the BOJ could surprise. More likely than not, we expect a move to take place in Dec to maximize the impact of policy by timing it with Fed's move in Dec. Possible additional measures that the BOJ could put in place include a rate cut to -0.3% from -0.1% currently, asset purchases of ETFs and J-REITs and other instruments could be possibly increased to JPY10tn from JPY6tn currently. As well, the dateline for achieving the 2% inflation target could be pushed back further to FY2018.
- **Latest Fiscal and External Balance Outlook:** The second supplementary budget for the current fiscal year ending March put forward by the government of PM Abe has been approved by both houses of the Diet. The supplementary budget plan of JPY4.52tn could be implemented as soon as the middle of Nov as a result. As we had written previously, JPY713.7bn will be used to enhance welfare measures including supporting childcare and distributing cash to low-income earners to boost consumer spending. Another JPY1.41tn will be set aside for infrastructure improvement to attract foreign tourists to Japan and promote agricultural exports. The government also intends to increase low-interest government loans – zaito – by JPY1.5tn to bring forward the launch of the high-speed maglev train services between Tokyo and Osaka from 2045 and another JPY828bn to accelerate construction of shinkansen bullet train lines on other routes. However, the boost to the economy is expected to be limited. Some estimates suggest that the budget would only provide a 0.1-0.25ppt boost to the economy in 2016 and 2017.

- The current account (CA) surplus widened for the second consecutive month to JPY2.00tn in Aug from JPY1.94tn in Jul and JPY0.98tn in Jun. Contributing to the widening CA surplus was once again the larger surplus in the primary income account of JPY1.99tn compared to JPY1.69tn in Jul. This surplus reinforced the more moderate surplus the goods and services sub-account of JPY0.19tn (Jul: 0.39tn). The financial account surplus narrowed to JPY2.92tn in Aug from Jul's JPY3.67tn due to large deficit in the other investment segment of JPY3.08tn (Jul: +0.55tn). Consequently, the overall balance of payments surplus narrowed to JPY0.93tn in Aug from JPY7.35tn in Jul.
- **Key domestic events and issues to watch:** BOJ meets on 31 Oct-1 Nov to decide on policy, the second last meeting of the year, followed by the governor's presser later in the afternoon. At the same time, the BOJ's outlook report will be released. BOJ minutes for the 20-21 Sep meeting will be released on 7 Nov and this will be followed by the summary opinions at the 31 Oct-1 Nov meeting on 10 Nov. We also have BOJ governor Kuroda speaking in Nagoya on 14 Nov morning, followed by a press conference in the afternoon. 3Q16 GDP is on tap on 14 Nov. JGB auctions in Nov: 10-year (8 Nov), 30-year (10 Nov), 5-year (15 Nov), 20-year (17 Nov) and 1-year (16 Nov).
- **Technical Outlook:** Our call for USDJPY to go higher (in our last monthly outlook) towards 104 was validated. Pair traded higher and was last seen at 104.90 levels. Weekly momentum and stochastics are still indicating a bullish bias. We reiterate our bias to stay long in the pair for a move towards 108 levels. Support at 103.70 (21 DMA), 102.40 (50 DMA). We do not rule out pullbacks within the next month; so long 100 – 101.50 holds; our long bias for further upside remains intact.

## CNY: Not The End of the Slide, Not Even Close

| Forecast | 4Q 2016 | 1Q 2017 | 2Q 2017 | 3Q 2017 |
|---|---|---|---|---|
| USD/CNY | 6.80 (6.67) | 6.82 (6.65) | 6.86 (6.70) | 6.84 (6.70) |
| USDCNH | 6.80 (6.67) | 6.82 (6.65) | 6.86 (6.72) | 6.84 (6.70) |

*Previous Forecast In Parenthesis*

- **Motivation for the FX View:** USDCNH keeps making fresh year highs for most of Oct ever since onshore markets returned from the Golden Week holidays. In contrast, USDCNH vols are at year lows. But this is not a uniquely-China phenomenon. The USD upmove is hardly done at this point given that the expected Fed hike is only to occur more than six weeks away. In between, we still have the US elections to watch. The lack of volatility suggests that FX players have come to terms with the fact that monetary policy divergence of the PBoC vis-à-vis the Fed should place only temporary pressure on the CNY and CNH unless Fed signals aggressive tightening. The relative calm in the markets allow more room for PBoC to allow CNY to be more market-determined against the USD. The CNY TWI might see some slippage moving forward as vols drift lower. However, we sense that PBoC is past the half-way mark in letting out the depreciation pressure from the CNY given the fact that REER has corrected 7% from Dec 2015 highs.

- We estimate that the TWI will need to correct a further 4% and that should happen sooner (within the first half of 2017 rather than later). We make these estimates in a backdrop of a series of events as we move into 2017. We see potential for USD to strengthen though post Fed hike might provide some relief. EUR-negative events may also boost the USDCNH trajectory potentially towards the 7-figure at some point though we watch the 6.8-figure at this point as it would be a firm resistance to break. Should the 6.8-figure break without excess volatility and capital outflows, China may move on to next phase of capital outflows.

- Capital outflow is still a main concern as more Chinese nationals seek returns overseas. The government encourages domestic investors to head overseas to diversify their assets. We also want to keep in mind that China has been garnering interest in its domestic financial markets. The recent opening up of the China interbank bond market (CIBM) to a wider array of institutional investors has seen more reforms that are done in the right direction. PBoC has recently permitted CDS trading so as to offer investors a form of insurance against corporate bond defaults. The year has seen more cases of defaults compare to 2015 which could lead to a better pricing of credit risk. In addition, the allowance of CDS trading also signals that the government would allow more defaults to happen since investors are now able to insure themselves from a default event. That has lifted the 5Y CDS from its recent lows. The National Association of Financial Market Institutional Investors also intends to increase the requirements for bond issuance including a clause to require immediate repayment if a company's owner changes or if a firm sells its main income-earning business. Debt-limit metrics and cross-default triggers are also likely to be included in future requirements which should lift the quality of the massive bond markets and attract foreign interest in its interbank bond market.

- **Our monthly Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) showed the score for China has deteriorated marginally to 5.4 from previous 5.3 (with 1 being the best and 9 being the worst) due to a weaker score for inflation relative to Asian peers.

- **Growth and inflation outlook:** Leading indicators like the NBS PMI-mfg steadied around 50.4 for Sep. The breakdown of the NBS PMI-mfg shows that only large firms are registering expansion whilst those of small and medium enterprises continue to indicate contracting output. Large enterprises registered expanding new orders but contractions for small and medium firms. A look at Caixin PMI-mfg saw marginal deterioration to 52.0 from previous 52.1 with output and total new orders expanding marginally. Inflationary pressures appeared to intensify during Sep, according to the report by Markit. In the meantime, PBoC is still pumping liquidity with aggregate financing surging to CNY1.72trn with total loans seeing another strong month of CNY1.26trn. A total of CNY552mn of loan was provided via SLF. A total of CNY275nn of MLF was provided in Sep. Sep was also a month of strong OMO injections, around CNY871.6bn done. That is however, slowly reversing out as CNY679.6bn OMO was drained so far for Oct (as of 27 Oct).

- Managing growth stability, yuan stability and deleveraging with stability is a challenging juggling task. While 3Q GDP came in as expected at 6.7%y/y, steady from the previous quarter, the industrial production growth for Sep slowed unexpectedly to 6.1% from previous 6.3%. Industrial profits also decelerated to 7.7%y/y from previous 19.5% as favourable base effects fades. We note that non-over capacity sectors seeing a contraction in profits. According to a statement released by the NBS, inventory has been reduced along with leverage levels. However, the statistics bureau also noted that domestic and oversea demands are still weak and urges industries to move up the value chain and guard against corporate debt risk.

- The cooling measures on property market will have pretty far reaching impact and spillover effects on other sectors. Efforts to cut overcapacity in steel and coal will also weigh. Deleveraging will continue to cap growth. However, due to the fiscal stimulus recently, the short-term target growth of 6.5-7.0% should be secured for 2016. Retail sales quickened to 10.7% from 10.6%, on stronger accommodation/catering subcomponent and cosmetics sales. Cosmetic sales should continue to see a recovery after China lowered taxes on cosmetics and skincare. Urban FAI also saw mild improvement to 8.2%y/y from previous 8.1%y/y. Investment growth in tertiary industry softened a tad to 11.1%y/y from previous 11.2%.

- Inflation quickened to 1.9%y/y from previous 1.9%. PPI also made the first return to a positive print of 0.1%y/y for Sep since Feb 2012. Price pressure seems to be inching higher on both counts and the room for easing is gradually narrowing.

- **Monetary Policy Forecast:** We stick to our view that PBoC will use pledged supplementary lending, medium term lending facility and standing lending facility to supply credit to the targeted sectors that require more liquidity support. However, we note that PBoC has been keeping onshore liquidity rather tight as inflation creeps higher. Broad based RRR cuts may risk generating flows to assets that are prone to bubbles (real estate in the tier-one property sectors), undo deleveraging efforts in the economy and increase downside pressure on the CNY. The government has been implementing cooling property measures and these measures could have spillover effects on other sectors of the economy, even the services sector.

- Sep saw plenty of liquidity boosts via the OMO but ¾ of the liquidity injection has been drained in Oct so far. China also provided around CNY 275mn of medium term lending facility vs Aug's CNY289mn. However, China seems to have stopped recently, keeping the liquidity conditions onshore pretty tight. The 7-day repo rate was last seen around 2.8% after spiking past 3%. We anticipate rates to remain elevated. For the past month, the China sovereign curve continues to bull flatten with a small rise on the front end and the longer end. 5Y is down more than 10bps, 7Y down more than 8bps, and 30Y down more than 7ps. the 3M. There has been continuous speculation that PBoC has engineered a flattened yield curve to discourage arbitrage activities.

- **Latest Fiscal and External Balance Outlook:** The IMF estimates that China's 'augmented' fiscal deficit is running at around 10% of GDP. Growth of government expenditure is still likely to head higher as the government works to pump prime the economy with infrastructure investment. In addition, local government has been accumulating a lot of off-balance sheet debt in order to finance infrastructure investment. The recent tax overhaul which moves construction, property, finance and consumer service sectors under the value-added structure could mean less revenue for the local governments. The central government plans to increase budget deficit to redistribute the VAT revenue back to provinces. Small businesses with less than CNY500,000 in annual sales will drop to 3% from 5%.

- Current account surplus widened to U$59.4bn from previous U$39.3bn in the quarter prior. The outflow via its capital accounts was much lower at -U$30mn vs the previous -U$112.2mn amid capital account controls. The latest release of BOP for 2Q 2016 show that there has been capital outflow via trade credit, loan, deposit and currency in the period. There was inflow via the pension and insurance channel. Existing capital control and a lack of aggressive fed tightening suggest that outflows should be manageable. We anticipate capital controls could be relaxed soon should China allow more CNY to become more market determined.

- **Key domestic events and issues to watch:** Caixin PMI-mfg is due on 1 Nov along with Oct NBS PMI-mfg and non-mfg. Foreign reserves is scheduled for release on the 7th. Trade is due on the 8th. CPI and PPI on the 9th. Liquidity prints are due anytime from 10th-15th. Activity data is due on 14th. Property prices are eyed on the 18$^{th}$. We also like to watch industrial profits due on the 27th.

- **Technical Outlook:** USDCNH has breached all-time highs and remained lofty around the 6.78-figure, as we write. It is almost as if the CNH has come a full circle. Nearing unchartered territories now, this pair still has some upside room towards 6.8370, the 123.6% Fibonacci extension of the 2016 downmove, before the next at 6.88. Support is seen around 6.6870.

## KRW: Hit by A Tale of Two Presidents

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

*No Change from Previous Forecast*

- **Motivation for the FX View:** We expect USDKRW to remain supported, on expectations of softer risk sentiment arising out of suspense in the lead-up to US Presidential Elections (8 Nov) and ongoing problems at home including the recent scandal involving S. Korean President Park. But a potential relief rally on risk proxies (given our assumption for Clinton win) may see a temporary pullback in USDKRW. That said we expect the pullback to be shallow and expect a drift higher towards end-Nov as focus on FoMC (in Dec) comes into focus amid ongoing downside pressures on domestic growth (due to Samsung discontinuation of Galaxy Note 7, labor strikes by local carmakers, job losses as a result of ongoing corporate restructuring in Shipping and Shipbuilding industries). While these domestic negativities may already have been priced in, to some extent, we think the recent scandal involving President Park could further weigh on investors' confidence (as scandal reignited concerns over transparency, government mismanagement and problems with graft) and exert further depreciation pressures on the KRW, for now.

- Recent media reports of S.Korea President Park's office as well as homes and offices of senior advisers being raided by Prosecutors could weigh on investor sentiment, heightened political risks and put downside pressure on the currency in the weeks ahead. This was due to allegations that a close friend (Choi Soon-sil) had wielded influence on state affairs despite not holding any official position in the government. It was reported that she exerted regular influence over President Park's decision making between Dec 2012 and Mar 2014, and issues range from Seoul's policy towards North Korea to the appointment of Presidential staff and government posts; used her personal relationship with President Park to raise funds from a business lobby group for 2 foundations she controls. Ms Choi had so far denied intervening in state affairs but had indicated that she did received presidential documents. President Park made a rare apology (25 Oct) in a nationally televised address that she consulted Choi on certain documents.

- As of writing, several top aides of the President, including senior Presidential secretary for civil affairs (Woo Byung-woo), and President Park's 3 other senior secretaries have stepped down. The Prime Minister is expected to be replaced soon (according local news agency Yonhap). With only 1 year to go in her tenure, President Park's approval rating has also plunged to record lows with more than 40% of those surveyed saying the President should step down. The Blue House has given no indication that President Park is considering resignation (she has only asked her top aides to resign so far). If she resigned, the Prime Minister will take over and the country is expected to hold a mandatory election within 60 days. The ruling party, Saenuri Party said it would seek a coalition government in which the parliament would have the powers to appoint cabinet ministers. This scandal reignited concerns over transparency, government mismanagement and problems with graft, and is expected weigh on investors' confidence for now. As of now, the case is pending investigation and we do not want to jump too conclusion, hence keeping our FX forecasts unchanged. We do however caution for heighten volatility in FX and possibly some weakness in KRW for now.

- We expect BoK to keep policy rate on hold at record low of 1.25%, at its upcoming meeting on 11 Nov for the fifth consecutive time despite slower growth expectation. Moreover household debt has been rising, doubling the amount since end-2006. As of Jun 2016, S. Korea's household debt stood at US$1.1tn or 90% of GDP. Cutting rate could risk exacerbating the debt situation at home.

- We expect choppy trading in USDKRW over the next few weeks, potentially testing as high as 1155 levels, or even 1170 levels due to US Presidential Outcome uncertainty, and domestic issues (recent scandal involving President Park) before easing towards 1110-1120 support. Towards end-Nov,or early-Dec, we see USD strength returning in the lead up to US FoMC in Dec and a move towards 1140 levels should not be ruled out.

- Given that the risk events have already been built into our forecast projection over the horizon and are now panning out, we are keeping our forecasts unchanged. But we could potentially review our FX forecasts higher, depending on how the recent scandal pans out. The case is currently under investigation and we do not want to jump to conclusion so soon without further details. We do however caution that spikes beyond our forecast levels within the quarter should not be ruled out.

- **Our monthly Maybank Vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for S.Korea deteriorated slightly to 6.2 (from 6.1 in previous month), due to inflation.

- **Growth and Inflation Outlook:** 3Q GDP came in weaker than previous quarter. On q/q terms, 3Q GDP grew 0.7% (vs. +0.8% in 2Q). This is the 4th consecutive quarters that growth stayed under 1%. On y/y terms, 3Q GDP was 2.7% (vs. 3.3% prior). The softness was due to weak manufacturing activity caused by Samsung Galaxy Note 7 discontinuation and partial strikes by local carmakers (Hyundai and Kia Motors). Samsung estimated that the discontinuation would cut its operating profit by $5.3tn from the start of Jun 2016 to Mar 2017 while Hyundai Motor estimated that the past 4 months of labor unrest had cost the company about $2.6tn in lost production. Given these as well as government led-corporate restructuring plans on troubled industries such as Shipping and Shipbuilding (including Hanjin Shipping bankruptcy) leading to jobs losses, we continue to expect growth momentum for 2H to slow.

- Sep headline inflation accelerated to 1.2% y/y (vs. 0.4% in Aug). This was due to sharp increase in food prices which were affected by abnormally hot weather this summer. Price of fresh produce including vegatables jumped 20.5%, the highest y/y growth since Feb 2011. While this may be one-off, the government has warned that kimjang (kimchi making season) is coming in Nov and this may keep food prices supported overall. Core inflation firmed (+1.3% y/y vs. 1.1% prior) but was lower than expectations of +1.4%.

- **Monetary Policy Forecast**: We expect BoK to keep policy rate on hold at record low of 1.25%, at its upcoming meeting on 11 Nov for the fifth consecutive time. While growth may seem a touch softer, it was largely due to issues at Samsung, strikes at local carmakers (which lasted for months and is now settled) and corporate restructuring (shipping and ship-builders), rate cut will do little to help. Moreover household debt has been rising, doubling the amount since end-2006. As of Jun 2016, S. Korea's household debt stood at US$1.1tn or 90% of GDP. Cutting rate could risk exacerbating the debt situation at home.

- At the previous meeting on 13 Oct, BoK kept policy rate on hold at record low of 1.25% for the fourth consecutive time, as expected. BoK remained positive in its assessment on its domestic activities noting that domestic demand activities appear to have continued their improvements, driven largely by investment in construction; employment to population ratio was slightly higher. However it judges that the uncertainties surrounding the growth path is high in light of economic conditions domestically and abroad. BoK also slightly lowered Korea's growth forecast for 2017.

- **Latest Fiscal and External Balance Outlook:** Current account surplus narrowed to the lowest level in 4 months to US$5.51bn in Aug (from 8.67bn in Jul and record levels of $12.17bn in Jun), due to sharp narrowing of surplus in goods account while service balance deficit narrowed and primary account surplus widened.

- Fiscal deficit for 2017 is expected to improve to 1.7% of GDP, from deficit of 2.3% of GDP this year (expected). Next year's budget will focus on creating more jobs (but did not give a specific number) and increasing spending for health, welfare and labor. The government plans to reduce deficit to 1% of GDP by 2020. Sovereign debt will stand at 40.4% of GDP in 2017, compared with 40.1% this year.

- **Key domestic events and issues to watch:** S. Korea releases Oct trade data and CPI (1 Nov), BoK meets (11 Nov) and Oct IP (30 Nov).

- **Technical Outlook:** USDKRW continued to trade higher. For the month of Oct, KRW has lost over 5% vs. the USD. Last seen at 1141 levels. Weekly, daily momentum indicators remain mild bullish bias but daily stochastics suggests the pair is nearing overbought conditions. We do not rule out a move towards 1155 (200 DMA). We do however caution that a decisive weekly close above could point to further upside – 1170 levels (50% fibo). Support seen at 1130 (23.60% fibo retracement of 2016 high to low) before 1117 (50 DMA).

## SGD: Policy Bias And Domestic Concerns Weigh

| Forecast | 4Q 2016 | 1Q 2017 | 2Q 2017 | 3Q 2017 |
|---|---|---|---|---|
| **USDSGD** | 1.4050 (1.3750) | 1.4100 (1.3800) | 1.4150 (1.3850) | 1.4000 (1.3850) |

*Previous Forecast in Parenthesis*

- **Motivation for the FX View:** Post-MAS, the USDSGD has been broadly on the climb higher towards the 1.40-handle. The pair has been the worst performing currency among the ASEAN currencies within the past month. Month-to-date, the SGD has fallen by nearly 2.2% against the USD and much of this downside pressure on the SGD can be attributed to the policy bias of the MAS, re-pricing of Fed rate hike expectations and the subdued outlook for the domestic economy. As well, the pair has been broadly tracking the USDJPY, given the strong correlation of the USDSGD to the USDJPY. The recent slide in the SGD has not completely erased its gains against the USD so far this year. Year-to-date, the SGD is still up 1.8% against the USD, though this was down from the 4% gain seen in the Jan-Sep period.
- We continue to expect the USDSGD to grind higher for the rest of the year, albeit at a more aggressive pace than we had previously anticipated. The USD rally in Oct so far on the back of a re-pricing of an imminent Fed fund rate hike, the rise in the USDJPY as well as concerns about domestic growth have led to a re-positioning in the SGD. Though detailed breakdown of foreign portfolio flows is not available, an examination of government debt yields in Oct showed that yields have broadly risen across the curve by 4.8-16.8bp except for the 2Y and 5Y, which slipped 3.9bp and 1.0bp respectively. The climb in yields suggested that demand for government debt by foreign funds has come-off, reflecting not only lackluster global conditions but domestic weakness as well.
- Domestically, many challenges persist for the next year or two. The ongoing economic restructuring of the economy and property curbs are still likely to constrain growth ahead, while the lackluster global environment should weigh on export-oriented industries. The softer labor market should reflect these weak domestic conditions. Already the overall and resident unemployment rate has increased to 2.1% and 3.0% respectively in 2Q from 1.9% and 2.7% in 1Q. It is in this unfavorable environment that Deputy PM (DPM) Tharman warned that growth could be below the normal 2-3% for the next few years. Both he and Minister for Trade and Industry (Trade) Lim Hng Kiang have suggested that growth could come in at the lower half of the 1-2% forecast range. This was further reiterated by the MAS in its recent Macroeconomic Review (MR) report.
- We however are not expecting a protracted economic recession to take place, though we cannot discount the possibility of a technical recession (i.e. two consecutive quarters of q/q saar negative growth). A similar view was articulated by Minister Lim that the government was not expecting "an outright recession" though "the possibility that the economy will experience some quarters of negative growth on a quarter-on-quarter basis". The government stood ready to support the economy with a range of contingency measures. This should keep the

economy on track to still expand for the whole of 2016. Thus, while the USDSGD could climb higher, we expect topside in the pair to be capped for now.

- On the monetary front, forward guidance by the MAS suggested that the neutral policy stance is likely to be maintained beyond the Apr 2017 meeting. Accommodative policy should help close the output gap while maintain price stability. Economic concerns as described above are best dealt with using fiscal and other policies rather than monetary policy. Any further adjustment to monetary policy though is thus likely to be data-dependent. Maintaining the neutral policy should allow the SGD NEER to hover at the lower half of the policy band, suggesting that further weakness in the SGD can be expected ahead.
- Nevertheless, expansionary fiscal policy, accommodative monetary policy as well as its triple-A status and persistent balance of payments surpluses should continue to backstop the USDSGD and moderate the pair's climb higher. These though are unlikely to offset completely the current policy bias, concerns about domestic growth, the impact of an imminent hike in the Fed fund rate and further easing moves by BOJ. We should continue to see the pair edge higher towards 1.4050 by end-2016. The pair should continue its climb higher in 2017 even though expectations are for modest Fed rate hikes ahead. Further upticks should see the pair end 2017 at close to 1.4200.
- **Our monthly Maybank Vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for Singapore was again unchanged at 4.3 as there were no changes to its risk profile. This should be supportive of the intrinsic value of the SGD. Our model shows that the SGD NEER was last seen 0.99% below the mid-point implied at 1.3775. Upper bound is implied at 1.3497 while lower bound is now at 1.4053.
- **Growth and Inflation Outlook:** The economy underperformed in 3Q16, expanding by just 0.6% y/y vs. 2.0% in 2Q, dragged down by a contraction in manufacturing (-1.1% y/y) and services (-0.1%). On a q/q SAAR basis, real GDP contracted by 4.1% in 3Q compared to a marginal expansion of 0.2% in 2Q. The weak advanced estimates for 3Q suggested that growth is likely to moderate in 2H from 1H's 2.0%. More importantly, the 3Q print reinforced Deputy PM Tharman's expectations for growth to come in in at the lower half of the 1-2% forecast range in 2016. However, there appears to be some light at the end of the tunnel from the external front. Even though Sep NODX data fell by 1.3% y/y (Aug: +2.2%) while imports slipped a steeper 6.2% y/y (Aug: -1.2%), 3Q trade surplus widened to SGD18.0bn (2Q: 17.1bn) implying that net external demand was less of a drag on 3Q growth than implied in the advanced estimates. Similarly, the better-than-expected 6.7% y/y increase in industrial production in Sep on the back of healthy pharmaceuticals and electronics output brings manufacturing output to 1.3% in 3Q – stronger than the -1.1% recorded in the advanced GDP estimates. These better-than-expected prints in 3Q could mean an upward revision to the advanced estimates, barring any revisions to the other components of GDP, particularly services.
- Still, the risk of a technical recession is not insignificant. The services sector remains under pressure from a possible slowdown in tourist arrivals and wholesale trade due to slower global growth/demand, and slower financial services on the back of financial markets volatility. Still, a further cyclical slowdown in the economy is likely to

be met with a response from the government. The Minister for Trade and Industry (Trade) Lim Hng Kiang said in Parliament that "depending on the nature and severity of the downturn, the Government is prepared to consider introducing a range of contingency measures, which could include broad-based as well as sector-specific measures". Already, the government is mulling measures to help the marine and offshore engineering sector affected by the low oil prices and slower global growth as announced by Minister of Trade and Industry (Industry) S Iswaran on 31 Oct 2016. Given these developments, our economic team continues to expect growth to come in at 1.8% for both 2016 and 2017, more sanguine than MAS' expectations for growth to come in at the lower end of the 1-2% forecast range in 2016 and then climb only slightly higher in 2017.

- CPI data for Sep suggests that deflationary pressures have bottomed. Headline inflation fell by just 0.2% y/y in Sep (Aug: -0.3%) - the smallest decline in consumer prices since Dec 2014. Core inflation moderated marginally to 0.9% y/y (Aug: +1.0%). The MAS outlook for both headline and core inflation remains unchanged. Imported inflation is still expected to remain muted as are domestic cost pressures. Factors including increasing slack in the labour market that should cap wage growth, and expected moderation in increases in services inflation (including healthcare and education) should keep domestic cost pressures muted. As well, the subdued economic growth environment will constrain the extent of cost pass-through. MAS forecast headline and core inflation to come in around -0.5% and 1.0% respectively in 2016. For 2017, the ascent of core inflation will be gradual to 1-2%, while headline inflation should return to positive territory at 0.5-1.5%. Our economic team maintains its full-year headline and core inflation at -0.4% and +1.0% respectively for 2016, and +1.0% and +1.5% respectively for 2017.

- **Monetary Policy Forecast:** As expected by consensus and ourselves, the MAS maintained its neutral policy stance – that is, the slope of the SGDNEER was kept at zero percent – that has been in place since the Apr meeting. As well, the width of the policy band and the level at which the SGDNEER is centred were also left unchanged. The two easing moves by the MAS since 2015 had appeared to lower the hurdle for an adjustment. However, the Oct monetary policy statement now suggested otherwise.

- MAS' forward guidance that the neutral policy will be maintained for an "extended period" to facilitate the closing of the output gap and ensure medium term price stability suggests that the hurdle for further easing remains high. The neutral policy was necessary to provide "some flexibility for the S$NEER to accommodate the near-term weakness in inflation and growth". With policy already accommodative, any policy adjustments will be data-dependent. An intermeeting move remains available to the MAS though but will be undertaken only if the macroeconomic environment deteriorates materially. Thus, our reading of the MR suggests that the neutral policy stance could continue beyond the Apr 2017 monetary policy meeting with the SGD NEER likely to hover at the lower half of the policy band ahead.

- In the past month, the USDSGD has been on the bounce back above the 1.38 levels from the 1.36 levels but this has not resulted in large swings to domestic interest rates. In fact, domestic interest rates continue its gentle slide lower. The 3-month SIBOR (3MSIBOR) had initially slid lower from 0.8732% at the beginning of the month to 0.8704% but has since rebounded back to the 0.8732% levels at the point of writing. The 3-month SOR (3MSOR) has started to inch marginally higher to 0.6321% currently from 0.6223% at the start of the month. Year-to-date, the 3MSIBOR and 3MSOR have fallen by more than 30% and 60% respectively from their Jan high of 1.254% and 1.7624% respectively. The modest rise in rates suggests that the rise in mortgage rates is unlikely to be significant for now. Deposit rates (for 12-month fixed) have not risen since end-Jan and remains at around 0.35% currently. This continues to suggest that risks related to interest rate increases affecting financial and economic stability, particularly in interest rate- and property-related sectors, seems limited for now.

- The recent re-pricing of a Fed rate hike risk in 2017 suggests that upward pressure on domestic rates remains gradual. US 3MLIBOR continues to edge higher in Sep from 0.8579% on 3 Oct to 0.8812% at the point of writing. Ample liquidity has so far kept domestic rates from tracking the US 3MLIBOR higher. Still, with US rate hike trajectory on a gradual plane, domestic rates should continue on its slow grind higher. We expect the 3MSIBOR and 3MSOR to end 2016 and 2017 at 1.31% and 1.04% and 2.37 and 2.10% respectively.
- **Latest Fiscal and External Balance Outlook:** The current account surplus widened to SGD20.85bn in 2Q 2016 from SGD18.85bn in 1Q. The larger current account surplus could be attributed to the larger surplus in the goods and services account of SGD27.63bn (1Q: SGD24.45bn) that offset the increase in the primary balance account deficit of SGD6.78bn (1Q: -SGD5.60bn). The financial account surplus narrowed to USD15.78bn (1Q: SGD26.90bn) as portfolio inflows (2Q: USD25.04bn) and smaller 'others' segment (2Q: SGD26.22bn) that offset the larger outflow of direct and financial derivative investment (2Q: -SGD14.68bn and –SGD9.80bn respectively). The overall balance of payments returned to a surplus of SGD4.76nm in 2Q 2016 compared to SGD8.72bn in 1Q.
- **Key domestic events and issues to watch:** Final 3Q 2016 GDP will be released sometime on 21-25 Nov.
- **Technical Outlook:** Our call (in our last monthly outlook) for USDSGD to go higher towards 1.39 was validated. Pair traded as high as 1.3964 (27 Oct) and was last seen at 1.3940 levels. Weekly momentum continues to indicate a bullish bias though stochastics suggests the pair is in overbought conditions. Big level at 1.3950 (23.6% fibo retracement of 2014 run-up to 2016 high) awaits. A decisive close above this level puts next resistance at 1.41, 1.44-handle. Meantime pullback can re-visit 1.38 levels. Bias remains to accumulate on dips. Golden cross on daily chart typically suggest a bullish signal.

## MYR: Vulnerable To Event Risks

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

*No Change from Previous Forecast*

- **Motivation for the FX View:** Over the past 1 month, MYR has generally weakened by around 1.8% against the dollar, as oil prices fell on average to below $50/bbl recently, and the USD mildly stronger overall despite negligible domestic idiosyncratic risks.
- USDMYR traded as high as 4.22 (17 Oct). It has broken the 3.98-4.15 range we called for, over the past few months. We still think it should be capped at 4.20/4.25 unless there are Fed and US election surprises leading to a strong dollar scenario. And we think this weakness could still persist in the short term but solid underlying fundamentals and policies {backed by domestic demand, re-calibrated supportive budget (on a lower oil price assumption suggests flexibility in the fiscal space), relative stability in oil prices though some downside pressure exists, relative attractive yields in the MGS, stabilizing ratio of FX reserves to retained imports & short-term debt, accommodative monetary conditions to support businesses} remain intact and should provide an anchor for MYR stability once short-term noises subsided.
- We note that **oil prices may face some downside pressure in the near term as refiners have already finished stocking for the summer (now to Oct) season. On the big picture, oil supply-demand is projected by EIA to rebalance further over the next 1 year. Oil surplus supply is also winding down due to the lack of capex in the last 18 months while seasonal demand for winter in 4Q should see oil prices picking up.** We still expect oil prices to see support around $40-45/bbl. Hence it is **not our baseline scenario to see MYR suffer another round of high-single digit rout** (in 3Q 2015 – end-2015).
- We do expect to see broad but modest USD strength into 4Q 2016, as we head into US Presidential Elections in Nov (which will typically see USD strength in the lead-up and post-Elections). Some post-*Brexit* uncertainty (on timing of trigger of Article 50, trade talk negotiations with EU and other trade partners) is also expected to weigh on sentiment and keep the USD modestly supported. Risk of potential Fed rate hike in Dec 2016 (now our base case scenario) could also see a firmer USD in the lead up to the Dec meeting. While all the above factors (Presidential Elections, *Brexit uncertainty and Fed rate hike)* may keep the USD supported, investors' hunt for attractive yields could continue to see inflows into local bond markets and counteract to support the MYR, mitigating the upside pressure in the pair. As long as oil does not see further declines below $45/bbl, we should see MYR still somewhat supported.
- We continue to caution for USDMYR to trade in wide ranges. 4.20/4.25 should keep the lid on USDMYR (assuming that oil prices do not fall further). **We maintain our FX forecasts over the forecast horizon as some dollar retracements at end Dec remains possible following the actual rate hike and some bond positioning in 1Q 2017 could be positive for the MYR.**

- **Our fair value estimate (which takes into account interest rate differential, inflation differential, current account differential and reflation variables) puts USDMYR at 3.55 levels.** We had previously said that Ringgit weakness was temporary and was not a reflection of underlying fundamentals (which remain intact). We still expect to see some stability returning to Ringgit as political/contingent liability risk subsides, fiscal consolidation/reforms gains traction, oil prices stabilize and uncertainty and likelihood of Fed rate hike subsides for the next 6 months.
- Between end-Aug 2016 and end-Sep 2016, external reserves rose from USD97.5b to USD97.7b.This was despite foreign net selling in the equity markets, suggesting sustained foreign flows in the debt markets and trade /current account surplus. Latest tally is equivalent to 8.4 months of retained imports and 1.2 times of short-term external debt.
- Foreigners were net sellers of Malaysian equities totaling –MYR0.3b in Sep 2016 versus +MYR1.6b net buying in Aug 2016. Data on net foreign flows in for Sep2016 is not available yet. In Aug 2016, a significant development in the local debt market was the inclusion of the Malaysian Government Investment Issues (GII) into the GBI-EM Global Diversified Index, which should lead to increased visibility of GII among global EM bond investors with potential purchases in the future.
- Suggesting better trend in foreign flows into the debt market compared with the equity market, the International Institute of Finance (IIF) reported that the net inflows of portfolio capital into the emerging market (EM) increased to +USD25.3b in Sep 2016 from +USD22.7b in Aug 2016, driven by the higher net inflows of +USD18.4b (Aug 2016: +USD12.5b) into EM debt markets as net inflows into EM equity markets slowed to +USD6.9b (Aug 2016: +USD10.2b).
- According to IIF, the larger net inflows into EM debt markets reflect continued hunt for yields in the face of the zero-bound to negative interest rates across the developed markets, while expectations of US Federal Reserve prepping for a rate hike despite the inaction at the 20-21 Sep 2016 FOMC weighed on the EM equity market flows.
- Meanwhile, fundamental flows is intact, especially as Malaysia's trade surplus widened to +MYR8.5b in Aug 2016 after slumping to +MYR1.9b in July 2016, easing the on-and-off concern about the sustainability of the trade and current account surpluses.
- **Our monthly Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for Malaysia remained largely unchanged at 5.1 in Oct from last month but it saw improvements in inflation and some deterioration in PE valuation.
- **Growth and Inflation Outlook:** No change in our 2016 and 2017 growth forecasts of +4.1% and +4.5% for now as we closely monitor key domestic indicators and developments in major economies. Our Economics team sees no change in our 2016 full-year forecast of +4.1% (1H 2016: +4.1%), implying growth is expected to hover at just over +4.0% in 2H 2016. The projection for 2017 also remains at +4.5%.
- At this juncture, we need to keep a close tab on key high frequency domestic data, namely the monthly economic indicators such as the indices on industrial production and distributive trade, external trade, money and banking statistics, as well as major commodity output and prices. In addition, our eyes are also on the economic

trends as well as policy and political developments in the major economies i.e. US, Europe (including UK), China, Japan.

- Index of leading economic indicators rebounded +0.2% YoY in Aug2016 (July 2016: -2.5% YoY) -first YoY growth since Oct 2016. Together with earlier released data like industrial production index and imports of capital and consumption goods, the numbers for July-Aug 2016 suggest GDP growth slowdown since 2Q 2015 have stabilized at least in 2H 2016.
- The index of leading economic indicators leads GDP growth by one quarter. On this basis, we estimated that "forwarded" index of leading economic indicators contracted by a smaller-1.2% YoY in 3Q 2016 (2Q 2016: -2.0% YoY) and grew +0.2% in early-4Q 2016, suggesting the downward pressure on quarterly real GDP growth since 2Q 2015 is easing in 3Q-4Q 2016. Our 2016 full-year real GDP growth forecast of +4.1% implies the economy is expected to stabilize 2H 2016 after the +4.1% expansion in 1H 2016.
- Other recently released data are also supportive of the above view. Industrial production index -comprising of manufacturing, mining and electricity output that makes up 35% of GDP –picked up to +4.5% YoY inJuly-Aug 2017 compared with +3.7% YoY in 2Q 2016. Imports of consumption and capital goods –a proxy for domestic demand –rose +17.2% YoY in July-Aug 2016, up from +10.1% YoY in 2Q 2016. Meanwhile, the retail trade index -which is highly correlated with real private consumption growththat makes up 55% of GDP point to sustained momentum in consumer spending as it grew by +7.5% YoY in July-Aug (2Q 2016: +7.4% YoY).
- **Headline inflation rate** in Sep 2016 remained at +1.5% YoY (Aug 2016: +1.5% YoY). Core inflation eased slightly to +2.1% YoY (Aug 2016: +2.2% YoY). YTD 2016 inflation and core inflation are +2.2% YoY and +2.6% YoY respectively. No change in our 2016 and 2017 inflation rate forecasts of 2.0%-2.5% for both years.
- Inflation rate rose by lower than expected at +1.5% YoY in Sep 2016 (Aug 2016: +1.5% YoY; Maybank-KE: +1.7% YoY; Consensus: +1.8% YoY),while core inflation rate (excluding volatile and price-controlled/price-subsidised components of the CPI) eased to +2.1% YoY (Aug2016: +2.2% YoY). The continued sub-2% headline CPI was mainly influenced by the moderate rise in "Food and Non-Alcoholic Beverages" and continued decline in "Transport" costs. Compared with Aug 2016, headline inflation rate declined -0.3% MoM but core inflation was up by +0.1% MoM. Year-to-date, headline and core inflation rates were +2.2% YoY and +2.6% YoY respectively.
- Headline CPI in 3Q 2016 has gone down to +1.3% YoY from +3.4% YoY in 1Q 2016 and +1.9% YoY in 2Q 2016, while core CPI in 3Q 2016 was relatively stable at +2.1% YoY (1Q 2016: +3.6% YoY; 2Q 2016: +2.2% YoY).This was partly due to the base effect from GST implementation in Apr 2015, adjustments in administered prices and muted external inflationary pressures specially from the low global crude oil prices. This is further supported by slower domestic economic growth in 4Q 2016, expected at the lower end of +4.0-4.5% YoY range. Hence, we see moderate headline CPI for 4Q 2016at the lower end of the +1.5% to +2.0% YoY range.
- We maintain our 2016 full-year inflation rate forecast at 2.0%-2.5%, with expectation that inflation to be at the lower end of the forecast range on moderate domestic and external inflationary pressures. The range forecast reflect factors such as the volatile currency and commodity prices –especially crude oil prices; weather and seasonal

effects on food-related commodity and food prices e.g. surge in world raw sugar prices impacting domestic sugar prices; scheduled reviews and the still-pending decisions on “administered prices” like gas and electricity tariffs and Indah Water sewerage charges; cost impact of specific domestic labour market policies, such as the hike in levy on foreign workers effective 18Mar 2016 (Peninsula Malaysia for now) and the Minimum Wage increase on 1 July 2016; and extension of the Price Control & Anti-Profiteering Act to 31 Dec 2016 from 30 Jun 2016, which helps to reduce the risk of excessive price hikes, although pass-through of cost increases and price increases could be more prevalent next year.

- **Monetary Policy Forecast:** As we expected, BNM maintained the Overnight Policy Rate (OPR) at 3.00% in Sep after the 25bps cut in Jul 2016. The Statutory Reserve Requirement (SRR) was also unchanged at 3.50%. The tone of the Monetary Policy Statement (MPS) is still “dovish” in our opinion, implying BNM is “risk-aware”, “data-dependent” and “event-driven”. Therefore, we maintain our OPR forecast of 2.75%-3.00% for end-2016 and end-2017.
- Although BNM expects Malaysia’s real GDP to be within the official forecast of 4.0%-4.5% for this year and to remain on steady growth path in 2017, supported by domestic demand, namely consumer spending and investment in infrastructure, manufacturing and services, the Monetary Policy Statement (MPS) is still “dovish” in our opinion as BNM sees downside risk to global economic growth, while global markets are vulnerable to setbacks and changes in sentiments. In addition, domestic inflation this year will be at the lower end of its 2%-3% forecast and to remain relatively stable in 2017.
- The still “dovish” tone of MPS implies to us that BNM is being “risk-aware, data-dependent and event-driven” amid the downside risks to global economy and markets, uncertainty over monetary policy shifts in major economies, and unresolved issues post-EU Referendum in the UK. Therefore, we maintain our OPR forecast of 2.75%-3.00% for end-2016 and end-2017, meaning we are not ruling out the possibility of another 25bps cut in the OPR. The next MPC on 22-23 Nov 2016 will be the last for this year, and is one month after the tabling of the 2017 Budget on 21 Oct 2016 and two weeks after the US Presidential Election on 8 Nov 2016.
- Our Economists are also pricing in the **possibility of another 25bps cut over the next 6 – 12 months,** but **do not expect rapid-fire OPR cuts over the next few meetings as BNM turns “risk aware”, “data-dependent” and “event-driven”.**
- **Latest Fiscal and External Balance Outlook:** Themed “Accelerating Growth, Ensuring Fiscal Prudence, Enhancing Wellbeing of People”, Budget 2017 maintains commitment to fiscal discipline and consolidation; supports domestic demand via corporate income tax rate cut, incentives for tourism, SMEs, exports and digital economy, and infrastructure investment; and focuses on the wellbeing of the low-and middle-income groups by addressing the issues of inclusivity, equality, cost of living and affordable housing.
- Budget deficit target for 2017 is set at -3.0% of GDP, sustaining the policy of fiscal consolidation since 2010. This year’s aim of -3.1% of GDP is maintained and achievable. Based on monthly data, we estimated budget deficit in Jan-Aug 2016 was -3.9% of GDP as the deficit of -5.6% of GDP in 1H 2016 turned into an estimated surplus of +1.2% of GDP in July-Aug 2016.

- This is in line with our expectation as per our Budget 2017 Preview note (Expected the "expected", 7 Oct 2016) and reflects commitment to achieve near-balanced budget by 2020. The average crude oil price assumption (based on Brent crude) used for Budget 2016 was revised lower to USD30-35/bbl on 28 Jan 2016 from USD48/bbl back in Oct 2015. **Currently, the Government is expecting it to be USD40/bbl.** Year-to-date, crude oil price averaged USD42.5/bbl. Better than expected crude oil price mitigates the downside to oil-related revenue.
- Concern over GST revenue was tied to the sharp slowdown in the immediate post-GST consumer spending and as 1H 2016 GST revenue totaled MYR17.2b against the full-year target of MYR38.5b (revised marginally from the target of MYR39b previously). However, post-GST consumer spending showed quicker than expected recovery i.e. since 4Q 2015 and the rebound is sustained into 3Q 2016, based on the Retail Trade Index which is highly correlated with real private consumption growth. Furthermore, the number of GST-registered companies is rising steadily i.e. 423,920 at end-Sep 2016 (end-2014: 300,811; 1 Apr 2015: 362,748; end-Sep 2015: 390,378; end-2015: 400,519). Consequently, the full-year GST revenue target is on track given the year-to-date collection of almost MYR30b as at 19 Oct 2016.
- In an environment of sluggish global economy and weak world trade, hence external demand, Budget 2017 is supportive of domestic demand with the "conditional" or "performance-based" reduction in corporate income tax rate and specific incentives to promote tourism industry, SMEs, exports and digital economy. At the same time, Budget 2017 sustains the momentum in infrastructure spending.
- The economy is therefore expected to grow by 4%-5% in 2017 (2016E: 4%-4.5%), underpinned by firmer domestic demand growth (2017E: +4.9%; 2016E: +4.7%) that outpaces the rebound in net external demand (2017E: +1.9%; 2016E: -4.7%). The growth in domestic demand is supported by private sector expenditure (2017E: +6.2%; 2016E: +5.9%) on pick up in private consumption (2017E: +6.3%; 2016E: +6.1%) and private investment (2017E: +5.8%; 2016E: +5.3%) amid sustained public sector expenditure (2017E: +0.6%; 2016E: +0.8%) given the continued modest growth in public consumption (2017E: +0.4%; 2016E: +0.2%) and public investment (2017E: +1.1%; 2016E: +1.7%).
- The issues of inclusive growth and equality are addressed in Budget 2017 via measures targeted for the wellbeing of the low-and middle-income groups. These include measures to boost their disposable income via increases in BR1M, financial assistances and social safety nets as well as additional personal income tax reliefs; a new financing scheme for the purchases of low-cost and affordable houses to allow home ownership that generate wealth and equity; and higher budget allocations for education& training; affirmative programmes, guarantees and micro-credit schemes to support and promote upward socio-economic mobility through entrepreneurships and business startups; as well as for healthcare and basic infrastructure.
- The main takeaway from the latest October external trade statistics is that net exports remained a drag on GDP growth during 3Q 2016. Based on the July-Aug 2016 data, trade surplus was valued at +MYR10.4b, down -15.6% compared with +MYR12.3n recorded in the first two months of 2Q 2016 and -16.9% lower than +MYR12.5b in July-Aug 2015. To recap, trade surplus in 2Q 2016 fell -25.4% QoQ and -12.3% YoY, and as a result, net external demand component of real GDP shrank -5.1% QoQ and -7.0% YoY. Despite the contraction in net

external demand, real GDP grew by +2.3% QoQ and +4.0% YoY, thanks to the +4.4% QoQ and +6.3% YoY in domestic demand. Growth in imports of capital and consumption goods strengthened to +17.2% YoY in July-Aug 2016 vs +10.1% YoY in 2Q 2016 and +12.5% YoY in 3Q 2015, suggesting firming up in domestic demand in 3Q 2016.

- Malaysia's current account surplus narrowed in 2Q 2016 to MYR1.9b or +0.6% of GDP (1Q 2016: +MYR5.0b or 1.7% of GDP) on smaller goods account surplus and wider income account deficit but as we calculated the score on a relative basis, the improvement suggests that other current account in Asia fared worse than Malaysia. Our economics team full-year forecast for the current account is +MYR24.3b or 2.0% of GDP.
- **Key domestic events and issues to watch:** Trade data (4 Nov); FX reserves (4 Nov); CPI Inflation (23 Nov), GDP 3Q (11 Nov); Industrial Production (11 Nov), BNM Policy Meeting (23 Nov); Current Account Balance (11 Nov); Palm Oil production (10 Nov), Issuance of 10 yr bonds (Nov), Issuance of 7yr Islamic bonds (Nov).
- **Technical Outlook:** USDMYR continued to trade higher in the past month. Last seen at 4.2000 levels. Bullish momentum on weekly chart remains intact while stochastics is entering into overbought conditions. Key resistance at 4.21-4.22 levels (61.8% fibo retracement of 2016 high to low). We caution that a break above this (on weekly close) puts next resistance at 4.30 (76.4% fibo). Support at 4.14 (50% fibo), 4.1160 (50 DMA).

## IDR: Still Resilient

| Forecast | 4Q 2016 | 1Q 2017 | 2Q 2017 | 3Q 2017 |
|---|---|---|---|---|
| **USDIDR** | 12950 (--) | 12500 (--) | 12800 (--) | 12600 (--) |

*No Change From Previous Forecast*

- **Motivation for the FX View:** The IDR has remained resilient in the face of dollar strength. So far in Oct, the IDR, together with the PHP, has been the best performer not only in ASEAN but also among the Asia-Pacific currencies (as tracked by Bloomberg). The IDR has gained just 0.35% against the dollar since the start of the month, but this gain was more than sufficient for the IDR to claim the top spot with the PHP. Year-to-date, the IDR is also the best performer among the ASEANs and among the Asia-Pacific currencies ex-Japan, up 6.0% against the dollar. In Oct so far, the USDIDR has been hovering in a tight range within 12990-13090. This resilience can be attributable to a confluence of positive factors that continue to bolster investor confidence in the economy, spurring long-IDR bets. This was once again manifested in the forward points that suggested further downside to the USDIDR in the 1-month, 3-month and 12-month ahead.
- The main confidence booster for the IDR has been the tax amnesty program. The first phase of the program, which had an initial slow start, can be deemed a success with an estimated IDR4500tn declared by the end of Sep. This has resulted in tax revenues of IDR97.2tn that

should help with the fill the revenue gap in the state budget. The repatriation of funds in Jul-mid Oct period has amounted to IDR142.77tn and this has helped to offset portfolio outflows. This together with a more realistic state budget for both 2016 and 2017 (driven by FinMin Sri Mulyani) has helped to restore foreign investor confidence in the government and its reform process, and kept the IDR supported so far.

- In addition, the reform process has been moving forward slowly but surely with 13 stimulus packages introduced by the Jokowi administration to date and the 14th (relating to e-commerce) to be announced any day. These reform packages aimed to cut red tape,liberalize rules that have been a drag on investment and growth, and support specific growth industries. As well, fiscal spending of more than USD400bn for infrastructure projects is in the works to build ports, roads and railways. Together, these efforts should continue to support domestic demand, particularly private consumption, and encourage private investment ahead, all of which are IDR-positive.
- This optimism over the tax amnesty program together with the more realistic assumptions for the state budget as well as the ongoing reform of the economy bodes well for the economy and its reform/restructuring process. This puts the economy in good stead to receive an upgrade in its sovereign credit in the next 6-12 months. This is even though S&P – the only major credit rating agencies not to move Indonesia to investment grade – has recently said that Indonesia may not get an upgrade in its sovereign credit rating at its annual review at the end of the year. S&P remained concerned about rising bad debts (from stresses in the corporate sector) and risks to the growth outlook as well as material headwinds in the corporate and banking sectors. These comments may have poured cold water somewhat on these re-rating expectations, but we nevertheless believe that the economy remains on track for a credit rating upgrade. The potentiality of such an event should weigh on the USDIDR going into 2017.
- The structural reforms have so far encouraged FDI inflows. FDI rose by 7.8% y/y in 3Q – the same pace as in 2Q, which is supportive of the IDR. This is in contrast to the recent outflow of portfolio investment. So far in Oct, foreign funds have unwounded their holdings of Indonesia assets, selling USD108.45mn of equities, though this was a moderation from Sep's USD249.77mn sell-off. At the same time, foreign funds also removed IDR12.08tn from their outstanding holdings of Indonesian government debt so far in Oct as compared to the addition of IDR16.89tn in Sep. This was likely due to expectations of a rise in UST yields, thereby narrowing yield differentials between Indonesian and US government debt and resulting in a sell-off in Indonesian government debt. Nevertheless, inflows into Indonesia remains positive with USD2.52bn still vested in equities. Similarly, foreign investors have added IDR114.38tn to their outstanding holdings of debt as well. These inflows should remain supportive of the IDR.
- Our house expectations of a Fed fund rate hike in Dec and then twice more in Jun and Dec 2017 should continue to weigh on the IDR. Still, we do not expect Fed actions to be sufficient to outweigh the increasing optimism in the Indonesian economy, particularly the expected success of the tax amnesty program, the economic transformation of the economy and the push for infrastructure building. We maintain our USDIDR outlook for the pair to remain below the 13000-figure for the foreseeable future. The pair is

expected to end the year at 12950 and continue to move lower to within 12500-12850 in 2017 as it adjusts to the Fed's rate adjustments. We remain positive on the IDR.

- **Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for Indonesia improved to 5.4 from 5.6 in the previous month due to an improvement in yield risks. This should supportive of the intrinsic value of the IDR.
- **Growth and Inflation Outlook:** The economy is expected to come in weaker in 3Q than the 5.18% recorded in 2Q; but is expected to rebound in 4Q. Aside from private consumption, which remains the mainstay of the economy, the government's fiscal boost is likely to be supportive of growth in 4Q as well. According to FinMin Sri Mulyani, accelerated government spending in 3Q will likely bolster growth in 4Q. This should allow the economy to expand by 5.0% in 2016 as expected by the FinMin. Still, private consumption could moderate as reflected in the consumer expectations index, which came in at a more moderate 110 in Sep from 113.3 and 114.2 in Aug and Jul. More concretely, motor vehicle sales have slowed in Sep to +5.1% y/y (from +8.9% in Aug), while motorcycle sales contracted by the fastest pace since 2Q 2015 in 3Q (3Q: -15.7% y/y vs. 2Q: -7.1%).
- At the same time, support from external demand remains unlikely. Exports and imports contracted by 5.4% and 3.9% y/y respectively in 3Q, though this was a moderation from 2Q's -8.7% and -8.5% respectively. This moderation suggests that external demand might be at a trough and could be poised for an uptick ahead. Given these development, BI expects the economy to expand at the lower end of its 4.9-5.3% forecast range for 2016, while the FinMin is looking for 5% growth. Our economic team is projecting for 2016 growth of 5.09%. As for 2017, our economic team is expecting GDP growth to come in at 5.10% in 2017, not dissimilar to 2016, and in line with the government's growth assumption used in the 2017 state budget of 5.1%.
- Inflation rebounded mildly in Sep, rising by 3.07% y/y from 2.79% in Aug. This was likely due to the rebound in food prices (up 6.20% y/y in Sep vs. 5.14% in Aug) as well as the more moderate decrease in transport cost (Sep: -1.35% y/y vs. Aug: -1.93%). Core inflation however continued to ease, rising by 3.21% y/y in Sep compared to 3.32% in Aug. Given that inflationary expectations remain well-anchored, BI now expects inflation to come in at the lower bound of its 3-5% forecast range in 2016. As well, the continuing strength and stability in the IDR as well as government policies to slow the pace of prices increases (e.g. by giving subsidy for school fees) should moderate the rise in consumer price. Our economic team maintains its headline inflation at 3.52% in 2016, which is at the lower end of BI's headline inflation projection of 3-5% for 2016. Core is still expected to come in at 3.40% in 2016.
- **Monetary Policy Forecast:** The BI followed up its Sep policy cut with another 25bp cut in Oct – the second consecutive cut in a row. This brought the 7-day reverse repo (RR) rate to 4.75%. The deposit and lending facility rates were also reduced by 25bp to 4.0% and 5.50% respectively (effective 21 Oct) to maintain the symmetrical 75bp corridor on either side of the policy rate. The front-loading of cuts ahead of the imminent Fed rate adjustment expected in Dec was driven by BI's expectations of more moderate economic growth for 2016 as growth in 2H is likely not as strong as previously expected. With fiscal policy likely to be limited by the adjustment the

government is making to its spending in 2H, further easing of monetary policy would fill the gap left by fiscal policy and be supportive of growth in 2017. More importantly and likely the focus of policy going forward is credit growth and the impact the cuts have on it. To date, the transmission mechanism to lending has been weak with credit growth constrained by rising non-performing loans (3.2% in Aug). By cutting rates, BI hopes that it would encourage banks to pass on the savings from a rate cut to borrowers, thus spurring credit demand and domestic demand.

- ***With these moves so far, our economic team expects BI to remain on hold at the last two meetings of the year. Our economic team expects any rate cut to come only 2017, most likely sometime in 1Q***. Still, a further rate cut to further front-load monetary stimulus before the US Fed fund rate hike in Dec cannot be ruled out. Even BI appears to be signaling that there is room for the 7-day RR rate to move lower. However such moves are likely to be data-dependent with focus particularly on the stability in the IDR, sustainable current account deficit and the commodity price recovery as emphasized by the central bank governor. Given that the Fed is expected to continue with its rate normalization in 2017, albeit at a more gradual pace, the room for BI to move may be limited ahead. We however do not discount the possibility of further rate cuts in 2017 at this time.
- **Latest Fiscal and External Balance Outlook:** The Parliament's budget committee has approved the macro assumptions for 2017 state budget submitted by the government. The 2017 macro assumptions included GDP growth at 5.1%, inflation at 4% and the exchange rate at IDR13300 per USD. Indonesian crude price is projected at USD45/bbl and oil lifting at 815000bpd. Other budget assumptions that were approved included a budget deficit target of 2.41% of GDP with tax revenue at IDR1.271.7tn and excise revenue at IDR191.2tn. Central government spending is expected at IDR1.315.5tn. The proposal now goes to the Parliament for approval.
- The current account deficit (CAD) narrowed moderately to USD4.68bn in 2Q 2016 or 2.0% of GDP compared to USD4.76bn (2.2% of GDP) in 2Q. The narrower deficit was attributable to a larger goods and services surplus of USD1.7bn (1Q: USD1.6bn) and lower-than-expected deficit in the income account, which came in at USD6.4bn vs. 1Q's USD6.3bn. The overall balance of payments returned to a surplus of USD2.2bn in 2Q after slipping into a deficit of USD0.3bn in 1Q on the back of a wide surplus in the financial account, which more than offset the CAD. Our economic team continues to expect the 2016 CAD to come in at 2.2% of GDP on the back of lower CAD in 1H 2016, in line with the BI expectations for the CAD to be lower than 2.5% of GDP in 2016. For 2017, our economic team is penciling a larger deficit of 2.4% of GDP.
- **Key domestic events and issues to watch**: 3Q16 GDP is expected to be released sometime 5-7 Nov. BI meets to decide on policy on 16 Nov.
- **Technical Outlook:** USDIDR traded a subdued range of 12940 – 13090 over the past few weeks. Weekly momentum is not providing a clear bias for now. Expect range-bound trade 12900 – 13200.

## PHP: Duterte Risk Premium Still At Play

| Forecast | 4Q 2016 | 1Q 2017 | 2Q 2017 | 3Q 2017 |
|---|---|---|---|---|
| USDPHP | 49.00 (--) | 48.50 (--) | 49.50 (--) | 49.00 (--) |

*No Change From Previous Forecast*

- **Motivation for the FX View:** After suffering a 4.0% drop on the back of concerns emanating from the unpredictable temperament of President Duterte, the PHP has regained some lost ground against the USD. The claw-back in the losses could have been due to market concerns that the sell-off in the equity markets had been overdone. Nevertheless, the PHP did not managed to completely claw back its Sep losses. Instead, it managed gains of just 0.35% against the USD in Oct so far, though this was still an outperformance compared to the rest of its regional peers (except for the IDR) – all which has fallen against the USD in the month.
- Still, the weakness in the PHP is likely to stay extended for a variety of reasons. Not least among them is because of ongoing market positioning for an imminent Fed rate hike at the end of the year. Expectations of a Fed rate hike are lifting UST yields and this should narrow the yield differentials between the Philippine and UST debt, possibly sparking a capital outflow. Just as important, increasing concerns about the government's extra-judicial killings, policy flip-flops and the president's unpredictable temperament continues to weigh on the PHP. Finally, equity valuation remains stretched with current P/E ratios above their 5-year averages.
- Taken together, these factors should continue to weigh on investor sentiments. Consequently, foreign investors have extended their sell-off of Philippine equities into Oct. So far in Oct, they have sold slightly over USD81.1mn in equities, though this was a moderation from the USD273.40mn sold for the whole of Sep. At the same, rise in the sovereign yield curve so far in Oct suggested a sell-off in Philippine government debt. While a detailed breakdown by origins of the investor is not available, we can nevertheless infer from this that foreign investors were also part of the sell-off. Yields have climbed higher by 1.20-35.45bp across the curve except for 3 and 6 months. These outflows together with the softer overseas remittances should keep the USDPHP supported above the 48-handle ahead.
- These headwinds have continued to cloud its healthy economic fundamentals, including its growth outperformance and persistent balance of payments surpluses. A combination of healthy private and public infrastructure spending is expected to keep growth intact going into 2017. The government intends to progressively increase infrastructure spending from 5% of GDP in 2016 until it hits 7% by the end of its six-year term in 2022, which should be a significant fiscal impulse for the economy. As well, continued robust domestic demand on the back of healthy overseas remittances should allow the economy to expand by at least 7% in 2016. However, the healthy economic fundamentals will remain in the background until investor concerns regarding the political noise are resolved.

- With risks still to the upside, we expect the USDPHP to stay elevated into 2017 underpinned by Fed fund rate hike risks and ongoing concerns about the "un-statesman"-like behavior of the president. We maintain our year-end forecast for the USDPHP at 49.00 as the Fed rate hike resumes in Dec. Further expectations of rate hike by the Fed in 2017 and the unlikely resolution to the extra-judicial killings and the continuing unpredictability of the president's temperament could see the pair headed even higher in 2017. We still look for the pair to climb higher towards 49.50 by the end of 2Q 2017 before easing off slightly at 49.00 at end-3Q.
- Our monthly **Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, has improved to 4.6 from 4.7. This was due to an improvement in its reserves risk. This should be supportive of the intrinsic value of the PHP.
- **Growth and Inflation Outlook:** The Duterte administration is optimistic about growth in 3Q, expecting the economy to expand by at least 7% underpinned by infrastructure spending. This is in contrast to market expectations for the growth momentum to decelerate in 3Q after having expanded by 6.9% and 7.0% respectively in 1Q and 2Q. This is because market does not expect the impact from accelerated infrastructure spending to be felt immediately but likely in 4Q only. Still, this downward slide is not likely to be prolonged as a combination of healthy private and public infrastructure spending should bolster growth in 4Q. Infrastructure spending amounting to 5% of GDP this year should keep growth supported.
- In addition, the import growth of 14.4% y/y in the first eight months of the year signals that both consumer and capital spending will continue to support domestic growth ahead. This should help to offset any slowdown in remittances resulting from slower growth in the G3 and oil-producing Middle Eastern economies as well as the continuing weakness in external demand. For the first eight months of the year, remittances have risen by just 4.6% y/y vs. 6.6% in the same period last year. Moreover, the weakness in the PHP could go some ways in lifting export demand but is unlikely to be a panacea for its export woes. Year-to-date to Aug, exports have contracted by 7.8% y/y, extending the losses recorded last year (2015: -5.3%).
- Headline inflation accelerated to 2.3% y/y in Sep from 1.8% in Aug due to a pick-up in food prices (Sep: 3.1% vs. Aug: 2.4%) and the continuing rebound in housing and transport costs (Sep: 0.9% and 0.2% y/y respectively vs. Aug: +0.2% and +0.1%). In the first nine-months of the year, inflation averaged 1.6%, coming in below the 2-4% inflation target range of the BSP and could be attributed to low global oil prices. With oil prices expected to stabilize around the USD45/bbl ahead, inflationary pressures should re-emerge and guide headline inflation back within the BSP target of 2-4%. The BSP expects inflation to average 1.7% in 2016 given the weak inflationary pressures so far this year.
- While we do not expect inflation to rise significantly in 2016, it could be a different story in 2017. Inflation could be set to accelerate due to upside risks from El Nino/La Nina weather phenomenon as well as PHP weakness. As well, the higher excise tax on petroleum products expected in 2017, leading to the corresponding rise in transport cost and higher electricity charges, should stoke inflation ahead. This was reflected in the BSP inflation outlook for 2017 where headline inflation is projected to accelerate to 2.9% before easing to 2.6% in 2018.

- **Monetary Policy Forecast:** There were no surprises from the BSP when it kept its policy rate unchanged at 3.0% at its 22 Sep meeting. Manageable inflation and still robust economic activity were the key motivators for the BSP to maintain the status quo. It also kept its overnight lending rate and overnight deposit rate unchanged at 3.5% and 2.5% respectively, maintaining the symmetrical 50bp corridor on either side of the policy rate. We continue to expect the BSP to stay on course and keep its policy rate steady for the rest of the year as economic growth should remain healthy, and more importantly, inflation is expected to come in below the 2-4% target range in 2016. There had been expectations earlier that the BSP could adjust the banks' required reserve ratio (RRR) to not only ensure adequate liquidity in the system but also to spur credit growth. But BSP governor Tetangco has since poured cold water on this, saying that there was no need to adjust the RRR as liquidity remain adequate and money supply non-inflationary.
- **Latest Fiscal and External Balance Outlook:** The budget flipped into a surplus of PHP32.61bn - only the second time in 2016 that the budget has been in surplus and the first surplus after three consecutive months of deficits. The surplus was due to the recovery in revenue, which jumped to PHP209.57bn in Aug from PHP170.25bn in Jul. Nevertheless, the overall budget position remains in deficit at PHP138.38bn year-to-date in Oct compared to PHP121.69bn for the whole of 2015. The larger budget deficit so far though is still off the PHP388.9bn deficit targeted for the full-year as part of government spending plan to spur economic growth.
- The overall balance of payments (BoP) surplus narrowed sharply to USD117mn in Sep from USD682mn in Aug. Still, this was the seventh consecutive month that the BoP has been in surplus this year. For the first nine months of the year, the surplus was USD1.65bn, within reach of the USD2bn surplus target set by the BSP for 2016. Accounting for the narrower surplus was likely due to a moderation in fund inflows amid uncertainties surrounding the timing of the next Fed rate hike at that time, as well as slower overseas remittances. Net USD deposits from the national government and gains from the central bank's foreign exchange operations as well as strong receipts from the business process outsourcing (BPO) and tourism receipts helped to sustain the surplus.
- **Key domestic events and issues to watch:** BSP meets to decide on monetary policy on 10 Nov, while 3Q16 GDP is on tap on 17 Nov.
- **Technical Outlook:** USDPHP continued to trade higher, above the 48-handle. Last seen at 48.45 levels. Bullish momentum on weekly chart remains intact though showing some signs of waning while stochastics is entering overbought conditions. Resistance at 48.70. Break above could see a move higher towards 49. Support at 48, 47.50 levels.

## THB: Uncertainties Ahead

| Forecast | 4Q 2016 | 1Q 2017 | 2Q 2017 | 3Q 2017 |
|---|---|---|---|---|
| **USDTHB** | 35.20 (34.70) | 35.50 (35.00) | 35.80 (35.20) | 36.00 (35.50) |

***Previous Forecast in Parenthesis***

- **Motivation for the FX View:** The THB did not find any relief in Oct as it remain pressured down, first on concerns about HM King Bhumibol's health and then on concerns about the royal succession and political stability after the king's passing. These concerns sent foreign investor fleeing Thai assets and helped to push the THB lower, while ignoring the still healthy macroeconomic fundamentals. So far in Oct, the THB has fallen by 0.7% against the dollar – the worst performer in the region after the SGD. Year-to-date though; the THB has managed to eke some gains against the USD, rising by 3.3% against the USD so far.
- In the days prior to that fateful day, market had been rocked with uncertainty over the king's health and the royal succession, leading to investor angst and a sell-off in Thai assets. The sell-off continued with the passing of the king on concerns about the royal succession and political stability. Foreign investors likely took this opportunity as well to take profit given the rich valuations of the equity market. Like the Philippines, equity valuations are stretched with current P/E ratios above their 5-year averages. As a result, foreign investors have sold off THB14.66bn and THB8.37bn in equities and government debt so far in Oct. These outflows have weighed on the THB.
- The relative calm and political stability so far as the public focus their energy on mourning the only king that most Thai has ever known and the junta's recognition of Crown Prince Maha Vajiralongkorn's as heir to the throne has helped to stabilized the THB. This has allowed the USDTHB to return to hover around the 35-levels. Also capping the THB's fall was probably the against-the-wind activities by the central bank to curb USDTHB volatility.
- Beyond political concerns, the domestic macroeconomic environment remains favorable to the THB. A combination of accommodative monetary policy and expansionary fiscal policy has helped the Thai economy to rebound from its subpar growth performance in 2015 to around 3% in 1H16. The boost from the planned THB1.8tn infrastructure programme embarked by the government should help to lift consumer spending, mitigating the weaknesses in exports. The lift from government spending, infrastructure expenditure and consumer spending could push growth higher in both 2016 and 2017.
- Expansionary fiscal policy aside, monetary policy remains accommodative as well with the policy rate at near historical lows at 1.5%. Further rate cuts are unlikely for the rest of the year, barring unforeseen risks to the economy. Rate cuts though would not solve the kingdom's export woes and is unlikely to be effective in spurring further lending or investment activities given the level of household debt (2Q: 4.36%) and non-performing loans (3Q: 2.89% vs. 2Q: 2.72%). In addition, the central bank believes that fiscal policy should take the lead in bolstering the economy, while accommodative monetary policy should play a complementary and supportive role. Just as importantly, the central bank would like to keep its ammunition dry

for even more adverse shocks to the economy like a disorderly Brexit or China hard landing (all not our base case).

- Just as important, once concerns about the royal succession have dissipated and calm and political stability returns, foreign capital should continue to flow back into the kingdom. Despite the outflows so far in Oct, foreign investors have remained vested in Thai assets. Year-to-date though, they have purchased THB117.82bn and THB394.84bn of equities and government debt. Continuing inflow of foreign portfolio investment should thus be supportive of the THB.
- External challenges are likely to keep the USDTHB supported above 35.00 levels ahead, particularly the re-pricing of an imminent US Fed rate hike, concerns about the outcome of the US presidential election as well as post-Brexit developments. The increasing risk of a US Fed fund rate hike in Dec could see yield differentials between Thai government debt and UST narrow, resulting in a reallocation of assets out of Thailand and back to the US. This should lead to upside pressure on the USDTHB. We could see similar consequences in the lead up to the US presidential election as a "President Trump" could increase market volatility and uncertainty, resulting in safe-havens flows and sparking another round of outflows from riskier Thai assets. In addition, Brexit concerns could spark another round of risk haven flows. Altogether, these risks should weigh on the THB.
- These developments together with residual concerns over the royal succession could keep the THB weakness intact for some time, even if there is some retracement in the near term. This together with dollar strength on expectations of a US Fed fund rate hike by the end of the year should keep the pair elevated above the 35-handle for the rest of the year and into 2017. Given these developments, we now expect USDTHB forecast to end 2016 at 35.20. Thereafter, expectations of further rate hikes in 2017 should keep the pair elevated with the pair eventually climbing higher to the 36-figure by end-3Q.
- **Our Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for Thailand has deteriorated slightly to 4.3 from 4.2 previously. This was due to an increase in inflation risk. This should weigh on the intrinsic value of the THB.
- **Growth and Inflation Outlook:** Economic activity is likely to moderate ahead as a result of the year-long mourning period for the late HM King Bhumibol. BoT governor Veerathai suggested as much in his recent speech as the entertainment and recreation industries could post slower growth as spending slows following the government's call to avoid "joyful events". This is in contrast to the Federation of Thai Industries which expects the economy to be unaffected by the mourning period as the drop in demand in the entertainment and recreation industries is expected to be offset by gains in other sectors including garments.
- To mitigate the expected slowdown in economic activities, the government is likely to introduce further fiscal measures and accelerate government spending. Already, the government has approved a THB18.8bn budget to support villages across the kingdom to help raise living standards and boost the economy. The program will kick off in Nov and last till Jan 2017. Still, there are doubts whether this program and others like this would be able to lift growth in 2016. More likely than not, the impact is likely to be felt in 2017. Furthermore, the roll-out of large construction and infrastructure projects that would be more effective in stimulating the economy is likely to be felt only in 2017.

- Still, the government expects its spending as well as tourism to be the main engines of growth for the economy. Supporting the government's optimism is its upward revision to its export projection, which it expects to contract by just 0.5% in 2016 vs. previous estimates for a 1.9% decline. This improvement though is likely to be offset somewhat by the dip in tourist arrivals in 2016 (33.3m vs. previous estimates of 33.8m). Given these developments, the government maintains its 2016 GDP growth estimates at 3.3%. For 2017, the outlook is unlikely to be dissimilar to 2016 with growth estimated to come in at 3.4%. The government's growth forecast is marginally more optimistic than the BoT's 3.2% for both 2016 and 2017. Our economic team continues to expect stronger growth underpinned by infrastructure spending. Real GDP is expected to come in at an above-consensus 4.0% this year before accelerating to 5.0% in 2017.
- Headline inflation continued to accelerate for the second consecutive months, rising by 0.38% y/y in Sep from 0.29% in Aug and 0.1% in Jul. This was the sixth straight month that headline inflation has been in positive territory. The climb in headline inflation was due to the more moderate decline in transport cost, which contracted by 0.6% in Sep vs. Aug's -1.4%, and this was attributable to the smaller decline in energy prices. Given the mild uptick in inflation so far, headline inflation averaged just 0.02% in the first nine months of the year but is notable as it was the first positive print in 21 months. Given the weak consumer prices to date, the Ministry of Commerce expects headline inflation to average 0-1% in 2016, while the BoT maintains its 2016 inflation forecast of 0.3%. Our economic team continues to expect a loftier inflation outcome in 2016 because of a low base effect, improving domestic demand, the impact of the drought on raw food prices, firmer oil prices and weak THB. The team is looking for headline inflation to average 2.0% in 2016.
- **Monetary Policy Forecast:** The BoT has not adjusted its key rate since 29 Apr 2015 with the policy rate held steady at 1.50%. The last time the policy rate was even lower at 1.25% was during the Great Financial Crisis in 2009-10. The rate has been held at near historical lows and monetary policy remains accommodative, thus making it unnecessary for the BoT to adjust the policy rate for the rest of the year. However, this does not preclude the BoT from adjusting rates should event risks (e.g. China hard-landing, hard Brexit etc. – all not our base case) materialize. For now though, risks to economic growth have risen with the passing of HM King Bhumibol and the year-long mourning period but this is likely to be temporary. With monetary policy already accommodative, any additional stimulus should come from the fiscal side. Further rate cuts is also unlikely to spur lending or credit growth given the level of household debt (2Q: 4.36%) and non-performing loans (3Q: 2.89% vs. 2Q: 2.72%). Moreover, the concomitant weakness in the THB from a rate cut is unlikely to be a panacea for the kingdom's export woes. As well, refraining from further policy action for now would allow the central bank to keep its ammunition dry for black swan events.
- **Latest Fiscal and External Balance Outlook:** Despite the fragile economic recovery so far, the government's revenue collection exceeded expectations. According to the Finance Ministry, the revenue collection for FY2016 that ended in Sep was 2.7% above target to THB2.39tn. However, this was due to a one-off event, namely the contribution from the 4G mobile-license auctions.
- The current account surplus widened further to THB132.14bn in Aug from THB124.77bn in Jul. The wider surplus could be mainly attributed to the larger trade surplus of THB95.02bn (Jul:

THB88.23bn). The surplus in the primary and secondary income account rose slightly to THB37.12bn from THB16.57bn in Jul. The overall balance of payments (BoP) surplus widened to THB65.06bn in Aug from Jul's THB0.40bn.

- **Key domestic events and issues to watch:** BoT meets on 9 Nov to decide on monetary policy. GDP for 3Q16 is due on 21 Nov.
- **Technical Outlook:** USDTHB traded as high as 35.90 in early Oct but eased into the month's end. Last seen at 35 levels. Weekly momentum continues to indicate a mild bullish bias. We expect the pair to trade within the downward sloping trend channel (formed since Oct 2015), with the upper bound resistance at 35.30. Break above that could see a move towards 35.60 (50% fibo retracement of Oct 2015 high to Sep 2016 low) before 35.84 (61.8% fibo). Support at 34.50 (double bottom in Aug-Sep).

## INR: Resilient

| Forecast | 4Q 2016 | 1Q 2017 | 2Q 2017 | 3Q 2017 |
|---|---|---|---|---|
| USD/INR | 67.00<br>(68.00) | 66.00<br>(--) | 68.00<br>(--) | 66.00<br>(--) |

*Previous Forecast in Parenthesis*

- **Motivation for the FX View:** The MPC voted unanimously to lower repo rate to 6.25% from 6.50% on 4 Oct. As we have noted, markets were not caught off guard by the move. Rupee remained largely range-bound against the USD for the rest of the month even as the greenback saw considerable strength against most Asian currencies this month. The rupee has indeed displayed its resilience, so much so that we see the need to shift our year-end forecast a bit lower to 67-figure from previous 68.00. We consider that the current USD upmove has not ended and so we still see some risk that the USDINR could head towards the 67-figure. Looking forward, we see risk of another cut in Dec as lower pulse prices cap inflation into the rest of the FY2016. That should be positive for growth and rupee.
- Just a recap on the GST. The GST Council, the government is racing against time to get the GST implemented by Apr 2017. The GST Council had decided that businesses in the Northeastern and hill states with annual turnover below Rs. 10lakh would be exempted. The threshold for the rest of India would be an annual turnover of Rs. 20lakh. Finance Minister Jaitley said that the actual GST rates should be decided by the **GST Council at the meeting that takes place 3-4 Nov**. India Panel is considering 12% and 18% as standard GST rates. A Technology company SAP and industry body Assocham launched a knowledge-sharing resource centre to help companies in their adjustments to the GST system. This would aid the industry in terms of the IT infrastructure and possibly pricing strategies and supply chain structure. Beyond its implementation, we anticipate that the near-term impacts of GST to be sharp, albeit transient, rise in prices next year. Medium term impacts are still uncertain even though there has been much optimism about it simplifying the tax system to avoid double taxation, spurring better supply mobility across inter-state borders that could eventually boost India's GDP level by 1-2%.

- USDINR should remain somewhat steady for the rest of the year amid decisive reform progression with regards to GST implementation, deepening the corporate bond market and positive carry of the rupee for yield hungry environment to offset the strength of the USD. We anticipate the USD20bn outflows (from the FCNFR (B) redemptions) that the RBI has estimated to happen in the rest of the year but we are also comforted by the fact that the central bank has probably amassed a substantial of USD363bn of FX reserves as of Jun.
- Our **Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for India saw slight deterioration from 4.3 (with 1 being the best score and 9 being the worst) due to a poorer score for yield after RBI cut policy rates.
- **Growth and Inflation Outlook:** Factory output is still not seeing recovery with a -0.7%y/y decline in Aug vs. previous -2.5%. in Jul from the previous growth of 2.0%. Looking forward, the RBI industrial outlook survey for the second quarter of FY2016-2017 shows softening in demand condition compared to the quarter prior. However overall business sentiments for the next quarter (3Q) remain unchanged. Businesses are optimistic about production, capacity utilization and financial environment though still concerned about the rise in cost of raw material that would keep profit margin unchanged. However, that has still not translated into output. We await the next industrial production numbers.
- Food inflation brought the headline CPI down from 5.05%y/y to 4.31% for Sep. Wholesale prices softened to 3.57%y/y from previous 3.74%y/y, weighed by lower price pressures on food articles, non-food articles and minerals. With the government ensuring that food essentials like pulses and sugar are at the current price, CPI may be able to remain near the inflation target of 4%. The government's commitment to the inflation target of 4% (+/-2%) for the next five years could also help anchor inflation target.
- **Monetary Policy Forecast:** The Reserve Bank of India will make its next rate decision in Dec. There has been significant efforts to ensure the availability of food necessities like sugar and pulses such that food prices continue to remain at current level to allow room for the MPC to lower policy rates by another 25bps. As such the risk of another cut in Dec exists as a continuous effort to crowd in private investment. Insofar, RBI has assured that there will be credit support for the banks as banks struggle to bring down their non-performing loans. In addition, we also take into account the impact of GST that is due to come into effect next Apr which could see a sharp, albeit temporary, spike in price pressures.
- **Latest Fiscal and External Balance Outlook:** PM Modi has declared that the presentation of the Union Budget will be brought forward to Jan instead of the usual end-Feb next year. He plans to accelerate the projects in the pipeline. Foreign investors sold USD450.3mn of equities and USD839.6mn of bonds for the month as of 28 Oct. Sources said that the government may ease certain restrictions in selected sectors such as the information and broadcasting sector for foreign direct investment.
- India's fiscal targets were held steady at 3.5% for FY16/17. The government highlighted "Transform India" that is meant to boost domestic demand, continue the pace of economic reforms and policy initiatives. There was also focus and budget allocation for agriculture and farmers' welfare - Irrigation projects will be sped up, a dedicated Long Term Irrigation Fund will be created as well as programme for sustainable management of ground water resources. There is also a

substantial amount allocated to education and health care, as well as infrastructure and investment. Total expenditure projected to be INR19780bn – INR14280bn of which is non-plan and INR5500bn is plan. The plan and non-plan classification will be scrapped in the next fiscal year. The plans outlined should work to improve inflation expectations via the supply side measures whilst boosting rural demand.

- The current account deficit remained steady at $0.3bn in the quarter ending Jun. Trade deficit was lower at U$23.8bn vs. previous U$24.8bn. Capital account saw a stronger surplus. Portfolio investment recorded a net inflow of U$2.1bn due to strong equity demand.
- **Key domestic events and issues to watch:** GST council meets on 3-4$^{th}$ Nov to set the tax revenue. Oct PMI-mfg is due on the 1$^{st}$. Trade is due anytime within 10-15th. CPI is due on the 13$^{th}$ followed by WPI, trade at 14$^{th}$. 3Q GDP is due on 30$^{th}$.
- **Technical Outlook:** 1M NDF remains stuck within the 66-67 range. Momentum indicators signal bearish tendencies for this pair on the monthly chart and support is seen around 66.25 before the next at 64.90. That said, downmove may be a grind ahead of Fed hike in Dec. Barrier is seen around 67.50. We need a breakout of the 66-67 range before a trend can be seen.

## VND: Still Vulnerable To USD Strength

| Forecast | 4Q 2016 | 1Q 2017 | 2Q 2017 | 3Q 2017 |
|---|---|---|---|---|
| **USD/VND** | 22500 (--) | 22400 (--) | 22650 (--) | 22500 (--) |

*No Change From Previous Forecast*

- **Motivation for the FX View:** USDVND jolted into action in Oct, after 4 months of little movements. The pair jumped towards the 22350-level on 25 Oct before easing to levels around 22320 at last sight. VND has been mainly underpinned by strong FDI inflows and trade surplus but these supports could be ebbing. The amount of FDI inflow for Jan-Oct shrank -1.3%y/y while trade balance dipped into deficit in Oct, the second negative print for this year. Still, PMI-mfg prints for Oct suggests that this could be a dip rather than a persistent decline as new export orders are meant to have risen in the month. Potential for a rate cut, as urged by the Prime Minister leaves VND vulnerable towards 22500 by year-end and our forecast assumes Japan fires enough monetary and fiscal stimulus to keep USDJPY largely within 100-110 for the rest of the year.
- Vietnam's apparel, footwear, agro-forestry and seafood industry are meant to get the boost from the Trans Pacific Partnership. However, we are cautious of the fate of TPP since both US Presidential Candidates are not supportive of the pact to differing extent. Vietnam has delayed the vote to ratify the pact until next year. To be sure, Vuoong Duc Anh, a negotiator of the TPP has indicated that the terms of the pact cannot be renegotiated. That could be a primary reason why FDI inflows have slowed significantly in recent months.

The FDI flows shrank -1.3%y/y for Jan-Oct from triple digit growth seen in the earlier part of the year.

- **Growth and Inflation Outlook:** PMI-mfg rose to 52.9 in Sep from previous 52.2. Markit reported an acceleration in new orders, output and purchasing activity from Aug. The rate of job creation also rose. Output prices were raised for the first time since May. While this seems to describe a stronger manufacturing sector, recent data seems to indicate that domestic demand softened in Oct. Industrial production slowed to 6.0%y/y from 7.6% with manufacturing output sharply lower at 5.5%y/y vs. previous 11.7%. Retail sales also softened to 9.3%y/y for the first ten months from 9.5%y/y growth for the first nine months. Recently, PM Nguyen Xuan Phuc has urged ministries, sectors and localities to accelerate the disbursement of public investment capital and promoting exports to ensure a growth rate of 6.3-6.5% for 2016. 4Q growth has to reach 7.3%. That said, he also stressed on the need for macro-economic stability and keeping inflation within 5%. He urged credit reform, supporting enterprises in accessing capital and *lowering interest rates*. In that respect, the government specified plans to impose tax on the purchase of second residential properties to curb speculation.

- In the meantime, exports growth accelerated to 7.2%y/y in Jan-Oct from previous 6.7% in Jan-Sep, slightly higher than expected. Imports growth also quickened to 2.1%y/y for the first ten months from 1.3% in the first nine months. Trade deficit came in at U$200mn. Trade remains a strong focus for the government. Vietnam has recently committed to more tariff cuts for quite a number of products out of China, fulfilling its part in the ASEAN-China FTA. In return, China has also promised to do the same for Vietnamese goods. That should raise the trade volume between the two nations but it is premature to estimate the net impact on Vietnam's current account. CPI rose to 4.09%y/y from previous 3.34%, on the back of higher housing/construction materials, medical products/healthcare and education.

- **Monetary Policy Forecast:** SBV has not moved policy rates for a while and room for easing is becoming smaller given the persistent rise in inflation. However, PM Nguyen Xuan Phuc has urged SBV to lower interest rates and reform credits in order to attain the goal of 7.3% growth for 4Q. The Central Institute for Economic Management had projected a growth of around 7.19% that could place full-year growth at 6.33%. We see a slight risk of SBV easing rates (currently base rate at 9.0%, refinancing rate at 6.5% and discount rate at 4.5%) in order to nudge the growth engine a little by boosting domestic spending. That would take its credit growth towards its annual target of 18-20% from the current 11.81% as of 20 Oct. FX-wise, USDVND has been rather stable except for the recent upmove. Broad yuan weakness, USD strength would mean that the USDVND is still vulnerable to the upside. In addition, exports growth is still weak. Lean FX reserves-import ratio of barely above 2 would mean that any external shocks in the FX space could force SBV to devalue the dong, notwithstanding the ample USD supply onshore. Should USD remain on the upmove, expect USDVND reference rate to be fixed higher and that should guide the USDVND towards our 22500 forecast by the end of the year.

- **Latest Fiscal and External Balance Outlook:** Vietnam is running out of fiscal room to boost growth. The Ministry of Finance revised the fiscal deficit significantly higher to 6.6% of GDP in 2014 and 6.1% for 2015. We see upside risk as MOF has just proposed to lower existing tax rates for SMEs from 20% to 17% so as to encourage companies to engage in productive investment. Separately, the government plans to divest VND67trn from SOE in the years leading to 2020. Key use of the capital is to develop important infrastructure projects like the Long Thanh International airport.

- We still watch the Japanese yen as Vietnam's external debt/GDP stood at 41.5% as of end 2015. Strong relationship with Japan suggests that JPY-denominated debt could be at least 30% of total debt (as reported by our Vietnamese analysts) and a stronger JPY could weaken Vietnam's debt position. That said, given the threat of BOJ intervention and potential monetary and fiscal stimulus, we expect USDJPY to remain within 100-110 for the rest of this year. That should in turn alleviate pressure on Vietnam's debt.
- Growth of exports remains positive for the past ten months at around 7.2%y/y and the Markit report of PMI-mfg for Oct shows a rise in new export orders growth. Current account recorded a surplus of USD2.24bn in 2Q (latest data available), narrowing from the U$2.63bn seen in 1Q on the back of smaller net trade surplus of goods and wider net trade deficit of services. External demand and current account demand may continue to lend some support to the dong.
- **Key Domestic Events and Issues to Watch:** PMI-mfg is due on the 1st. CPI is due on the 24th. Trade balance, retail sales, industrial production within 25-30th.

## FX Forecasts

| | End Q4-16 | End Q1-17 | End Q2-17 | End Q3-17 | End Q4-17 |
|---|---|---|---|---|---|
| USD/JPY | 105 | 103 | 106 | 105 | 107 |
| EUR/USD | 1.1000 | 1.1200 | 1.0900 | 1.1000 | 1.0800 |
| GBP/USD | 1.2300 | 1.1600 | 1.1800 | 1.2300 | 1.2400 |
| AUD/USD | 0.7600 | 0.7800 | 0.7500 | 0.7800 | 0.7600 |
| NZD/USD | 0.7000 | 0.7300 | 0.7200 | 0.7500 | 0.7300 |
| USD/SGD | 1.4050 | 1.4100 | 1.4150 | 1.4000 | 1.4100 |
| USD/MYR | 4.1000 | 4.0000 | 4.1000 | 3.9500 | 4.1000 |
| USD/IDR | 12950 | 12500 | 12800 | 12600 | 12850 |
| USD/THB | 35.20 | 35.50 | 35.80 | 36.00 | 36.30 |
| USD/PHP | 49.00 | 48.50 | 49.50 | 49.00 | 50.00 |
| USD/CNY | 6.80 | 6.82 | 6.86 | 6.84 | 6.83 |
| USD/HKD | 7.80 | 7.80 | 7.80 | 7.80 | 7.80 |
| USD/TWD | 32.40 | 32.80 | 32.80 | 32.80 | 32.80 |
| USD/KRW | 1130 | 1100 | 1130 | 1100 | 1120 |
| USD/INR | 67.00 | 66.00 | 68.00 | 66.00 | 67.00 |
| USD/VND | 22500 | 22400 | 22650 | 22500 | 22650 |
| DXY Index | 98.69 | 97.89 | 99.56 | 98.07 | 99.33 |
| **SGD Crosses** | **End Q4-16** | **End Q1-17** | **End Q2-17** | **End Q3-17** | **End Q4-17** |
| 100 JPY/SGD | 1.3381 | 1.3689 | 1.3349 | 1.3333 | 1.3178 |
| EUR/SGD | 1.5455 | 1.5792 | 1.5424 | 1.5400 | 1.5228 |
| GBP/SGD | 1.7282 | 1.6356 | 1.6697 | 1.7220 | 1.7484 |
| AUD/SGD | 1.0678 | 1.0998 | 1.0613 | 1.0920 | 1.0716 |
| NZD/SGD | 0.9835 | 1.0293 | 1.0188 | 1.0500 | 1.0293 |
| SGD/MYR | 2.9181 | 2.8369 | 2.8975 | 2.8214 | 2.9078 |
| SGD/IDR | 9217 | 8865 | 9046 | 9000 | 9113 |
| SGD/THB | 25.05 | 25.18 | 25.30 | 25.71 | 25.74 |
| SGD/PHP | 34.88 | 34.40 | 34.98 | 35.00 | 35.46 |
| SGD/CNY | 4.84 | 4.84 | 4.85 | 4.89 | 4.84 |
| SGD/HKD | 5.55 | 5.53 | 5.51 | 5.57 | 5.53 |
| SGD/TWD | 23.06 | 23.26 | 23.18 | 23.43 | 23.26 |
| SGD/KRW | 804 | 780 | 799 | 786 | 794 |
| SGD/INR | 47.69 | 46.81 | 48.06 | 47.14 | 47.52 |
| **MYR Crosses** | **End Q4-16** | **End Q1-17** | **End Q2-17** | **End Q3-17** | **End Q4-17** |
| EUR/MYR | 4.51 | 4.48 | 4.47 | 4.35 | 4.43 |
| JPY/MYR | 3.90 | 3.88 | 3.87 | 3.76 | 3.83 |
| MYR/HKD | 1.90 | 1.95 | 1.90 | 1.97 | 1.90 |
| MYR/CNY | 1.66 | 1.71 | 1.67 | 1.73 | 1.67 |
| GBP/MYR | 5.04 | 4.64 | 4.84 | 4.86 | 5.08 |
| AUD/MYR | 3.12 | 3.12 | 3.08 | 3.08 | 3.12 |
| NZD/MYR | 2.87 | 2.92 | 2.95 | 2.96 | 2.99 |
| MYR/IDR | 3158.54 | 3125.00 | 3121.95 | 3189.87 | 3134.15 |
| MYR/INR | 16.34 | 16.50 | 16.59 | 16.71 | 16.34 |
| MYR/KRW | 275.61 | 275.00 | 275.61 | 278.48 | 273.17 |
| MYR/PHP | 11.95 | 12.13 | 12.07 | 12.41 | 12.20 |

Source: Maybank FX Research as at 31 October 2016

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

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