Oct 31, 2017

Maybank

FX Monthly

2017, Issue 10: Upside Risk from US Tax Reform Developments

What Has Changed This Month?

- We are revising EUR, NZD, AUD forecasts weaker whilst revising KRW, IDR and THB stronger. Given latest positive developments in the US tax reforms timeline, we have revised 1H 2018 forecasts to reflect an earlier than expected USD strength. The USD DXY forecast has been adjusted higher in 1Q 2018 and lower in 2Q 2018 accordingly as a result of the combined changes above on the index.

Our Strategies

- There is risk that US fiscal impulse may come earlier than expected. A scenario where US tax reforms sees material progress and Fed composition skews to the hawkish-spectrum (if Taylor gets appointed as Fed Chair), US rates and USD could be subjected to upside pressure. But we caution against excessive optimism on US tax reforms. Nonetheless, US activity remains positive despite hurricane disruptions. The Sep FoMC meeting suggests that the Fed remains determined to tighten monetary policy as planned, with balance sheet reduction commencing in Oct and dots plot indicating 4 more hikes between now and end-2018. **Our house view remains for a 25bps rate hike, likely in Dec 2017.**
- Our call for EUR to correct lower towards 1.16 – 1.17 levels were met. Looking ahead for the **next few weeks, we expect EUR to consolidate around 1.14 - 1.18 range with bias to the downside** as EUR runs out of catalysts for upside pressures to return in the near term amid ongoing political uncertainty in Europe, potential USD positive drivers (potentially more material progress with US tax reforms and a more hawkish Fed), ECB policy normalisation already in the price and seasonality trend pointing to EUR weakness for 4Q. That said we maintain our **positive outlook on the EUR in the medium term** on sustained signs of economic recovery broadening in Europe and ECB gradual policy normalisation to play catch-up with the Fed in 2H 2018.
- Global policy unwinding continues to take shape at differing pace. **We maintain our view of EUR long vs. JPY, on the basis of monetary policy divergence between ECB and BoJ.** We see strong case for **BoE to raise rates by 25bps at Nov-2017 meeting and this should lend some support to GBP**. But GBP upside could fade as slowing growth momentum and ongoing *Brexit* uncertainties weigh.
- Our call for NZD to trade lower towards 0.6820 was met. We maintain our bearish outlook on NZD on the back of government policy uncertainty relating to immigration, trade and RBNZ mandate but caution for the risk of technical rebound in the near term, given that most negativities have been in the price and is oversold on technical indicators.
- Amongst AXJs, we are bearish on THB due to a range of factors including political risk in 2H 2018. We remain bias to **stay long MYR, on a strategic basis.** We are cautious on INR on the back of twin deficits amid slowing growth momentum. On a relative basis, we favour long PHP short THB and INR.
- **Risk to our outlook:** Any delay in Fed's timeline of normalising monetary policies is likely to impact on asset allocation in ASEAN. At the same time, the low interest rate environment for longer could spur a further re-weighting of equities and re-ignite foreign interest in ASEAN equities. Furthermore our view of global synchronised recovery story should further support inflows into ASEAN selectively. **Given continued momentum in the global recovery, we remain positive on open economy currencies such as SGD, KRW and TWD.**

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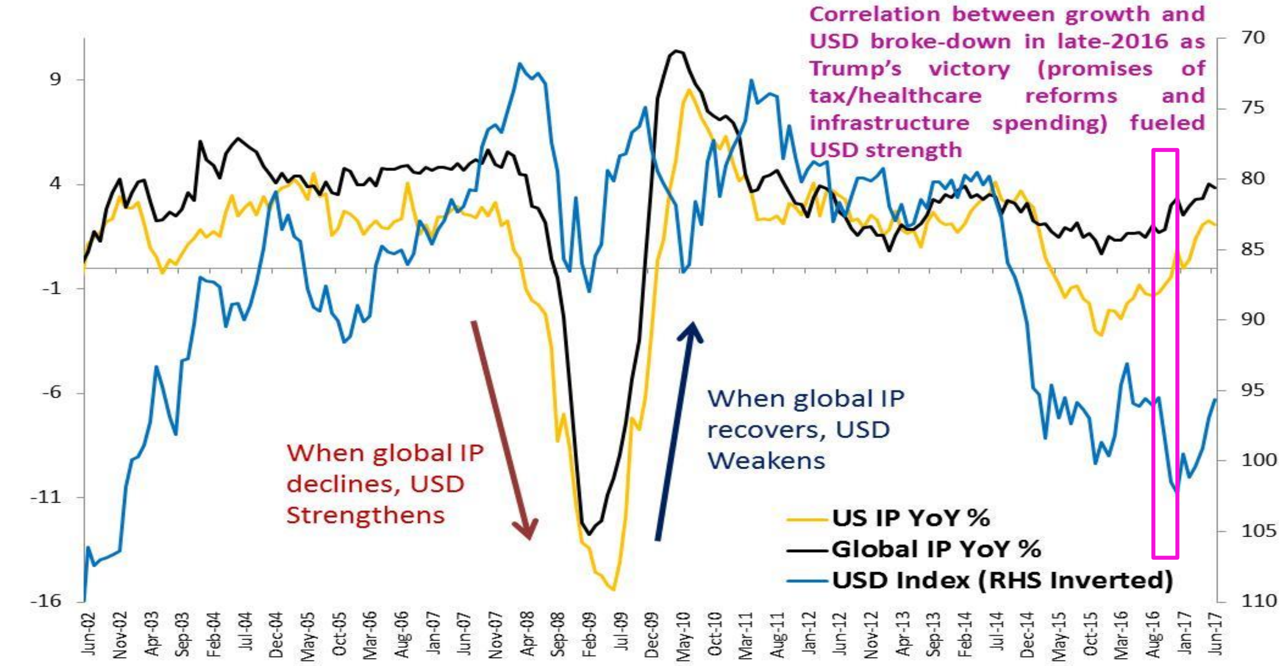
SEE PAGE 61 FOR IMPORTANT DISCLOSURES.

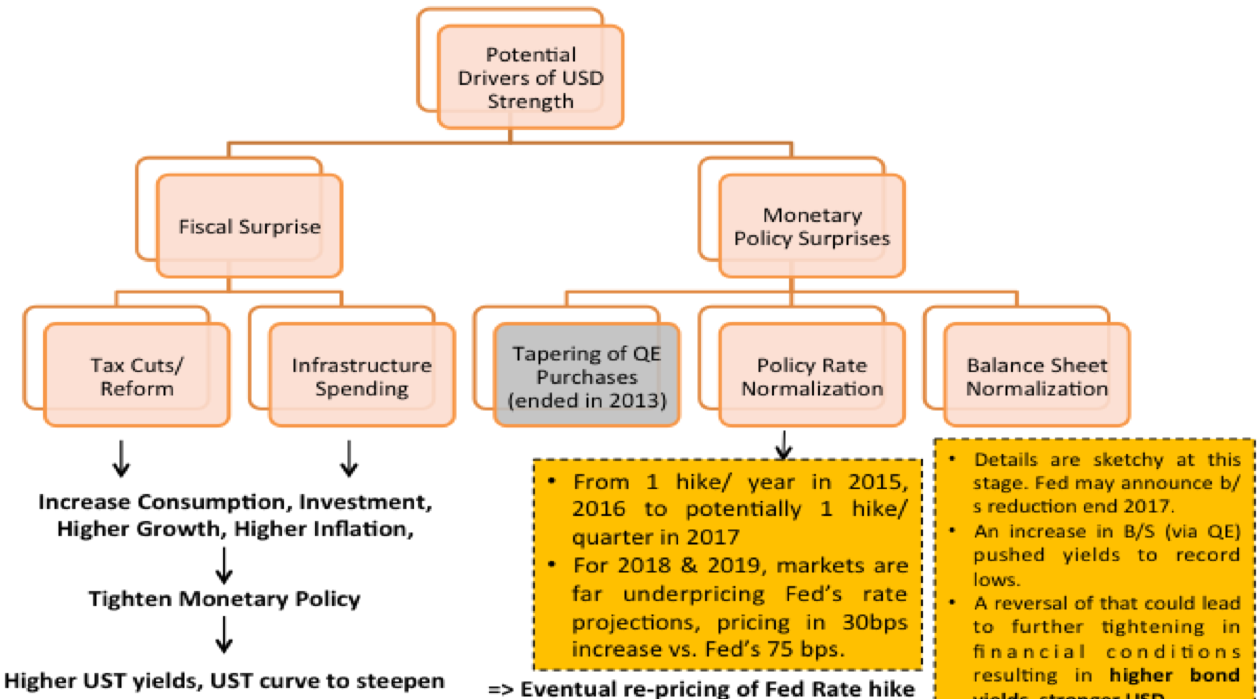
So What?

USD is a Countercyclical Play: Suffers When Global Growth is Well..



Source: Bloomberg, Maybank FX Research & Strategy

Where Can USD Strength Come From?



Source: Maybank FX Research

G7 Global Overview

USD: Tax Reform Progress Raises Upside Risk

Forecast	4Q 2017	1Q 2018	2Q 2018	3Q 2018
USD Index	94.78 (93.34)	94.78 (93.11)	93.81 (94.04)	92.80 (92.34)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** We expect at least one more rate hike in 2017, more likely in Dec now followed by the announcement of the start of balance sheet reduction possibly as early as Sep 2017. We do caution that additional repricing of a surprise balance sheet reduction over the course of the year could continue to see UST yields higher in particular Treasuries 2y and below, and see USD strength (buy the rumor) in the lead-up to FOMC meetings. The DXY forecasts saw slight upward revisions due to our downward revisions to the key G7 currencies such as the EUR in the near term. ***We continue to expect USD to rebound in 4Q this year and early next year with occasional swings within a tight range in the interim by around 5% or so. At current levels, long USD positions vis-à-vis G7 currencies, in particular the euro is beginning to look attractive from a tactical perspective. But medium term, we still expect USD advantage to be eroded by eventual gradual stronger growth trends in rest of the world and assist USD reversion towards fair value but at slower pace compared to the past.***

- The July FOMC statement plus the latest probabilities of Fed's rate hike in the next three remaining FOMC meeting this year derived from the fed fund futures suggests the third rate hike is unlikely to happen at 1 Nov 2017 FOMC meetings given the above-99% probability of no change, although the odds of a hike at the final FOMC meeting of the year on 12-13 Dec 2017 is now at around 84%.

- We continue to expect domestic data and a repricing of the future stance of monetary policy to support the USD. But recent positive US tax reform developments taking a slight turn for the better (materialising possibly as early as in the 1Q 2018) and trade policies as well as softer inflation pressures to support a strong US reflation view, we do not expect the Dollar to appreciate as strongly as expected in 4Q 2017 as we had expected earlier this year. During this phase and around FOMC announcements, we believe the USD could be mildly supported at times given potential concerns about Fed changes in FFR guidance on hikes and around the .

- **While the DXY has fallen more than 10% since the start of the year, technical signs are emerging to suggest a bottoming could be in place.** Domestically the focus is on Trump's appointment of Fed Chair and Vice Chair – which is expected to be announced before Trump leaves for Asia on 3 Nov. The nominees-list has been narrowed down to Taylor, Powell and/or Yellen. Taylor's appointment for either Fed Chair or Vice-Chair is supportive for UST yields and firmer USD. He also seems to receive more support for the role of Fed Chair according to show-of-hands straw polls among GOP Senators when asked by Trump (24 Oct). Going by Taylor-rule estimate (core PCE at 1.3% and unemployment rate at 4.2%, neutral real rate at 2%, NAIRU at 4.6%), nominal rate should already be at 3.3%. The current Fed fund rate of 1.25% (upper bound) is way below Taylor-rule estimate. That may suggest a potentially more hawkish Fed going forward, if we see a Taylor Fed Chair relying solely on the rule for deliberation (highly unlikely but a good estimate of concern for now).

- US earnings releases could be key also in affecting the risk driven USD. Outside of US, the ECB meeting (26 Oct) and ongoing political stress in Spain may also play a part in supporting the USD. Market expects some form of announcement with respect to tapering QE from its current pace of EUR60bn per month. Street consensus is now for reduced purchase amount of EUR30bn for a period of between 6 and 9 months, starting from Jan 2018. Our base case is for ECB to phase in slower purchase of EUR40bn per month for 6 months period before a gradual reduction to EUR20bn per month for next 6 months. Our base case option should see ECB maintaining a considerable degree of monetary accommodation (of about EUR360bn for 2018 vs. EUR780bn for 2017) for inflation dynamics to become durable and self-sustainable. Delay in announcing QE tapering or a much larger purchase amount (than expectation) is deemed as dovish and should weigh on the EUR while a much smaller purchase of say EUR20bn per month will be a hawkish surprise and may be positive for the EUR.

- The dollar index rose 2% in Oct and more recently have been supported by data showing the US economy grew more than expected in the third quarter. The dollar is up nearly 4% from its September lows, although it remains down on the year.

- The latest GDP data showed that it expanded at a 3% annual rate in 3Q against consensus of 2.7% gain. The stronger-than-expected 3Q GDP is likely to support markets expectations that it will bolster the case for the Fed to raise rates at a faster pace in coming months. More recently, the dollar received a boost after Republicans overcame internal divisions to adopt a budget that sets the stage for a rewrite of the U.S. tax system which could likely boost the US economy and push the Fed to tighten monetary policy at a faster rate. Market participants are also watching the selection process for the next Fed Chair. Externally, the ECB Draghi's recent comments that the bank's bond-buying program could be extended beyond September 2018, had sent the the euro falling against the dollar.

- **Growth and Inflation Outlook:** The latest print of the 3Q GDP came in at a 3% annualized rate (est. 2.6%) following a 3.1% gain in 2Q. Private consumption, biggest part of the economy, grew 2.4% (est. 2.1%) after 3.3% in 2Q while business fixed investment rose 1.5%, adding 0.25 ppt to growth; spending on nonresidential structures fell, equipment and intellectual property gained, residential dropped. Trade and inventories added a combined 1.14 ppt to growth.

- NFP in Sep fell 33k (expected 80k) due the hurricane having a net effect. There was no significant impact on unemployment rate. Average hourly earnings rose by 0.1% m/m (expected 0.3%).

- Sep headline CPI rose 0.5% m/m (expected 0.6%) while the core CPI inflation came in at 0.1% m/m (expected 0.2%).The Commerce department consumer inflation measure is running below the Fed's2% target with a 1.4% y/y gain in the past year. Overall the trend in core inflation has been softening in recent months but is likely to rise. Headline inflation measures could remain elevated for several months as the data more fully incorporate the fallout from Harvey and Irma. The Fed's preferred PCE measure has not managed to sustainably meet or exceed the 2% target.

- US retail sales rose 1.6% in Sep as result of rebuilding efforts in the wake of Harvey and Irma. The increase was most evident in autos and building materials.

- **Monetary Policy Forecast:** No change in fed funds rate i.e. 1.00%-1.25%. Fed maintains its guidance of three rate hikes this year and announces the start of balance sheet reduction next month, in line with our expectations of another +25bps rate hike this year and commencement of balance sheet reduction in 4Q 2017.

- Fed will kick off balance sheet reduction in Oct 2017. The plan was earlier unveiled at the 13-14 June 2017 FOMC meeting i.e. reducing the securities holdings in the balance sheet by gradually decreasing the reinvestment of principal payments from matured securities. Currently, Fed fully reinvests proceeds from matured securities, keeping its balance sheet size around USD4.5tr since Sep 2014 following the end of QE Taper.

- The initial size of balance sheet reduction will be USD10b per month (i.e. USD6b in US Treasury and USD4b in agency debt and mortgage-backed securities), and raised by +USD10b every three months (i.e. +USD6b in US Treasury and +USD4b in agency debt and mortgage-backed securities) over a 12-month period until the process reached USD50b per month (i.e. USD30b in US Treasury and USD20b in agency debt and mortgage-backed securities), which Fed expects to be the maximum pace of monthly balance sheet reduction for a gradual and predictable balance sheet normalization process. Fed also added that any amount of maturing US Treasury, agency debt and mortgage-backed securities that are in excess of the monthly reduction size will be re-invested.

- FOMC's median interest rate forecast at end-2017 remains at 1.375% (mid-point of 1.25%-1.50%), and there is no change to the projection of 2.125% (mid-point of 2.00%-2.25%) at end-2018, indicating the guidance for +75bps hikes per annum or three +25bps increases per year for 2017- 2018 is intact. The only tweak is for end-2019 i.e. down to 2.75% (midpoint for 2.50%-3.00%) from 3.00% (mid-point for 2.75%-3.25%), indicating two instead of three rate hikes in 2019 (Fig 8). Fed fund futures market indicates no rate hike at the next FOMC meeting (30 Oct – 1 Nov 2017) and the probability of hike at the 12-13 Dec 2017 FOMC jumped to 63.7% from 50% the day before.

- Fed acknowledges the short term effect from Hurricanes Harvey, Irma and Maria, but sees no material impact on the medium term outlook. In fact, Fed raised its expected 4Q 2017 YoY real GDP growth to 2.4% from 2.2% back in June 2017, maintained the 2.1% YoY forecast for 4Q 2018, and bumped up the projection for 4Q 2019 to 2.0% from 1.9% previously. It also maintained the 4.3% unemployment rate for 4Q 2017, and cut slightly the Figures for 4Q 2018 and 4Q 2019 to 4.1% vs 4.2% previously. Notwithstanding the subdued inflation rate this year (July 2017: 1.4%; 2017 YTD: 1.7%), Fed keeps its faith in inflation rate moving towards its implicit target of 2% over the next couple of years i.e. from 1.6% in 4Q 2017 (unchanged from June 2017 projection) to 1.9% in 4Q 2018 (revised marginally from 2.0% previously) and 2.0% in 4Q 2019 (unchanged).

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

- Focus is also on whether House GOP will adopt the budget passed by Senate (expected to be sometime this week). Progress here could potentially pave the way for US tax reform plans by end-year (Trump-imposed deadline). Building on this momentum, this could lead to fresh hopes for other Trump's promises – healthcare reforms, infrastructure spending – to come back into focus (though a bit too optimistic at this stage). Lower tax rates for corporates and individuals could spur companies to invest more, household discretionary spending could increase and economic growth may rise further. These could result in faster than expected pick-up in inflation and lead to tighter monetary policies (rate hikes in addition to Fed balance sheet unwinding) next year. A combo of fiscal and monetary impulses can support the dollar – a potential bigger positive risk for the medium term not priced in by markets.

- **Key domestic events and issues to watch in Nov 2017:** Key US events: ISM Manufacturing (1 Nov); Factory Orders (3 Nov); Durable Goods Orders (3 and 22 Nov); Trade Balance (3 Nov); NFP (3 Nov); CPI (13 Oct); Retail Sales (13 Oct); GDP 3Q (27 Oct); PCE Deflator (30 Oct), Housing Starts (17 Nov); FOMC Meeting (2 Nov); FOMC Meeting Minutes of 1 Nov (23 Nov).

- **Technical Outlook:** Our call in last month's FX Outlook for DXY rebound to extend materialized. DXY rose to 3-month high of 95.15 (27 Oct). We also shared in FX Flash (dated 25 Oct) that technical signs are emerging to suggest a bottoming could be in place. DXY was last seen at 94.70 levels. Price action suggests the potential of a classic textbook inverse Head (H) and Shoulders (S) pattern with H at 91-levels, S1 at 92.6 and S2 at 92.80 levels. Neckline is seen at 94-levels (also the 23.6% fibo retracement of 2017 high to low). This pattern is usually formed after a downtrend. The reversal of its downtrend is only confirmed until a breakout from its neckline. It remains early to tell that this will pan out to be a bullish reversal pattern from its downtrend. But looking at other indicators including momentum and stochastics on weekly and daily charts, the bias is mild bullish. On the monthly chart bearish momentum shows tentative signs of waning while stochastics is showing signs of turning higher from near-oversold levels. We reckon a key area of resistance to watch is the neckline at 94 – 94.30 levels. Sustained price action above this neckline should see upside gather momentum and the complete reversal of the inverse H&S should see the pair higher towards 97-levels. Failure to push through decisively will nullify this pattern. Support at 92.90 (50 DMA), 91 levels

EUR: Near Term Risks Skewed to the Downside

Forecast	4Q 2017	1Q 2018	2Q 2018	3Q 2018
EURUSD	**1.1700** (1.2000)	**1.1700** (1.2000)	**1.1800** (--)	**1.2000** (1.2100)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** Our tactical call for EUR to correct lower towards 1.1680 was more than met. The currency traded at a low of 1.1575 (27 Oct). In our last FX Monthly, we cautioned for the risk of deeper correction due to the aftermath of German election results, risk of Catalonian crisis escalating and markets coming to terms with ECB policy normalisation (buy on rumor, sell on fact). Looking ahead for the next few weeks, we expect EUR to consolidate around 1.14 – 1.18 range with bias to the downside as EUR is running out of catalysts for upside pressures to return in the near term amid ongoing political uncertainty in Europe, potential USD positive drivers (potentially more material progress with US tax reforms and a more hawkish Fed), ECB policy normalisation already in the price and seasonality trend pointing to EUR weakness for 4Q. Given recent developments, we lowered EUR forecasts for 4Q 2017 and 1Q 2018 but kept 2H 2018 forecast around 1.20 on expectations that Euro-area inflation to re-accelerate leading to market re-pricing in ECB rate hike expectations. This remains consistent with our **strategic call for positive outlook on EUR in the medium term.**
- ECB's decision (26 Oct) on reduced asset purchase amount of EUR30bn for period of 9 months starting Jan-2018 was largely within market expectations. But the **decision to keep the Asset Purchase Program (APP) open-ended and to keep rates at current level well past end of QE is interpreted as dovish**. We believe ECB's Draghi was attempting to avoid a taper tantrum that could derail financial markets as ECB strives to ensure that financing conditions remain easy. ECB decision was premised upon its assessment that there is not yet

convincing evidence of a dynamic pick-up in core inflation pressures. It also maintained optionality in reiterating that it is prepared to increase the size and duration of QE if needed. In fact, the ECB projects inflation to fall from 1.5% this year to 1.2% in 2018 (due to energy prices) before rising only to 1.5% in 2019. The projection is below ECB's inflation mandate of near and under 2%. Any expectation for rate hike is now pushed back to 2019. **ECB policy normalisation is now priced in and we expect forward guidance to remain little changed for the next few meetings** unless inflation or growth surprised to the upside, which may then subject EUR to upside risks.

- Recent political developments in Spain may potentially have wider implication for the Euro-area. While it remains uncertain how Spanish politics will evolve but one thing that seems worrisome is the recent rise in support for right-wing parties in Europe: AfD party (far-right) becoming the third largest party in German Bundestag, Austria's new coalition government leans to the right, Catalan crisis which sees the risk of breakaway from Spain (raises fear of civil unrest and may depress investor sentiment) and recent Czech's election which saw the new government leaning to the far-right. Even Italy's rich Lombardy and Veneto regions voted for more autonomy in the past weeks with Sicily likely to follow suit. Not forgetting Italy is expected to call for General election in coming months (no later than May-2018 and election uncertainty is another driver that could weigh on EUR). Risk of **return to populism policies could undermine the stability of the Euro-club, pose risks to financial markets and weigh on the EUR**.

- Our medium term positive outlook on EUR remains intact on sustained signs of economic recovery broadening in Europe (supported by private consumption, business sentiment, construction investment and export recovery) and that ECB is on gradual path towards policy normalisation (as underlying inflation remains subdued for now). We continue to caution that the risk of Italian election being announced (which has to be held by mid-2018) may usher in some downside risk on the EUR. But into 2H-2018, we see further EUR upside towards 1.20 – 1.21 levels as ECB policy normalisation may play catch-up with Fed's policy normalisation (resulting in narrowing of EU-UST yield differentials in favor of EUR).

- **Growth and Inflation Outlook:** Euro-area recovery continues with 17 quarters of growth while unemployment fell to 9-year low of 9.1%. 2Q GDP growth accelerated to 0.6% q/q (vs. 0.5% in 1Q). On y/y basis, GDP growth rose to 2.3% (vs. 1.9% in 1Q). This is the best level in 5 years. **Forward looking surveys also suggest that activity levels remains robust for the Euro-area but German PMIs suggests the risk of moderating momentum and this could have implication on 4Q GDP data rather than 3Q data.** Also of note is preliminary composite PMI for Oct saw a divergence between manufacturing and services. Prelim Manufacturing PMI rose to 58.6 in Oct (vs. 58.1 in Sep) while prelim services PMI slipped to 54.9 (vs. 55.8 in Sep). That said overall PMI data still suggest activity expansion. ECB's recent assessment (26 Oct) is that (1) private consumption is underpinned by rising employment, which is benefiting from past labour market reforms, and by increasing household wealth; (2) upswing in business investment continues to benefit from very favourable financing conditions and improvements in corporate profitability; (3) Construction investment has also strengthened; (4) broad-based global recovery is supporting Euro-area exports.

- In the last quarterly assessment report (7 Sep), **ECB revised 2017 growth to 2.2% (vs. 1.9%), which would be the fastest rate of growth since the 3% growth seen in 2007 before GFC.** Growth is broad-based and 6 million jobs were created since 2013. The ECB kept 2018 and 2019 growth forecast unchanged at 1.8% and 1.7%, respectively. **The next ECB quarterly assessment report will be available on 14 Dec.**

- **Euro-area inflation held stable at 1.5% y/y in Sep** while Core inflation (ex food and oil prices) also held steady at 1.1% in Sep. These data came in below expectations due to weak inflation in France, Spain and Germany. Inflation pick-up has remained gradual and well below ECB's policy mandate to maintain inflation rate below but close to 2%. Current level of inflation confirms Draghi's point that core inflation has yet to see a meaningful recovery. A stronger EUR (more than 6% rally in the EURUSD since late-Jun and more than 15% gains YTD to Sep high) could also weigh on imported prices (imported consumer products account for around 15% of industrial goods in the Euro-area) and result in negative feedback loop to core inflation.

- In the last quarterly assessment report (7 Sep), the **ECB kept inflation forecast unchanged at 1.5% for 2017** but lowered inflation forecast due to currency strength for 2018 and 2019 to 1.2% (from 1.3%) and 1.5% (vs. 1.6%), respectively. Our inflation forecast shows headline inflation may reach a high of 1.5% in 3Q (still below ECB's "around 2%" target) before easing off towards 1.2% in 4Q 2017 and then gradually pick up again for 2018 and 2019.

- **Monetary Policy Forecast:** We **do not expect any changes to ECB's recent decision at its upcoming on 14 Dec** (also the last meeting of the year). At the last meeting on 26 Oct, benchmark rates (MRO at 0%; marginal lending facility at 0.25% and Deposit rate at -0.4%) were left unchanged as expected. The Governing Council (GC) continues to expect **rates to remain at current levels for an extended period of time well past the end of the QE program**. **Asset purchase program will be extended for another 9 months to Sep-2018 at a reduced purchase amount of EUR30bn** (down from current pace of EUR60bn which will run till Dec-2017) starting Jan-2018. The GC left the **asset purchase program open-ended** – it can extend APP beyond Sep-2018 or increase the size of APP if the GC sees financial conditions inconsistent with further progress towards a sustained adjustment in the path of inflation of if outlook becomes less favourable.

- ECB explained that the decisions were taken to preserve the very favourable financing conditions that are still required for a sustained return of inflation towards levels that are below but close to 2%. The recalibration of APP reflects growing confidence in the gradual convergence of inflation rates towards ECB's inflation target, owing to robust and broad-based economic expansion, uptick on underlying inflation and continued pass-through of policy measures to financing conditions of the real economy. However ECB also said that **domestic**

price pressures are still muted and the economic and inflation outlook remain conditional on continued support from monetary policy. Hence ample degree of monetary stimulus remains necessary for inflation pressures to build up.

- **Latest Fiscal and External Balance Outlook:** Euro area's current account surplus widened to EUR33.3bn in Aug (from EUR25.1bn in Jul) on jump in surpluses for services and a smaller deficit in secondary income. Current account surplus to GDP inched higher slightly to 3.1% (vs. 3.0%) for 12-month period ending Aug 2017.

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

- **Key domestic events and issues to watch:** Oct Mfg PMI (2 Nov); Oct Services PMI, Sep PPI (6 Nov); Sep retail sales (7 Nov); Sep IP, Nov ZEW, 3Q GDP (14 Nov); Sep trade (15 Nov); Oct CPI (16 Nov); Sep current account (17 Nov); Nov consumer confidence (22 Nov); flash PMIs for Nov, ECB Minutes (23 Nov); Nov CPI estimate (30 Nov).

- **Technical Outlook:** EUR continued to correct lower, consistent with our caution for downside may have more to run (as of last FX Monthly). EUR was last seen at 1.1640 levels. Bearish momentum on weekly and daily charts remains intact. A head and shoulders pattern (bearish reversal) appears to be in the making. Sustained price action below 1.1670 levels (neckline support of H&S) may suggest further downside towards 1.1420 (38.2% fibo retracement of 2017 low to high), 1.1250 (200 DMA). Resistance at 1.17, 1.1850 (50 DMA).

GBP: Will Carney/BoE Cry Wolf?

Forecast	4Q 2017	1Q 2018	2Q 2018	3Q 2018
GBPUSD	1.3200 (--)	1.3200 (--)	1.3400 (--)	1.3600 (--)

No Change to Previous Forecasts

- **Motivation for the FX View**: GBP could **stay supported in the near term** on the back of expectations for BoE to raise rates soon but we expect **some of this GBP strength to fade** as slowing growth momentum and ongoing Brexit uncertainties should counter GBP strength. This suggests a **"buy on rumor, sell on fact" play leading into BoE MPC meeting on 2 Nov**. Upside could re-visit 1.3340 - 1.3420 in the near term but runway further upside may be limited and bias to fade this move tactically for GBP to return back towards 1.3050 - 1.32 levels, owing to delay in Brexit negotiations and growth momentum decelerating). The risk here is BoE sounds more hawkish than expected. This may lend strength to GBP. Hence we would pay extra attention to BoE/ Governor Carney's tone and language – if he cries wolf (decision to keep rates unchanged), GBP may be poised for further downside.

- We see a **strong case for 25bps rate hike to 0.5%, possibly as early as its next meeting on 2 Nov**. This is due to (1) inflation still stubbornly above BoE's 2% threshold and is testing the 3% levels (more than 5-year high now); (2) 3Q growth surprising to the upside (though we don't see the growth number as fantastic - momentum continues to decelerate and is below its long term average) and (3) tight labour market (unemployment rate at 4.5% is more than 40 year low). We do not see the rate hike (if any) as the start of a tightening cycle and is likely to be one and an extended pause as BoE is constrained due to ongoing *Brexit* uncertainties, decelerating wage growth and economic growth momentum. We expect the BoE to strike a balance between arresting inflation and making sure they do not derail growth momentum.

- **However we caution that the risk of BoE/Carney "crying wolf" could disappoint markets and send GBP down sharply.** BoE MPC and Governor Carney have somewhat been preparing markets for an imminent hike via their various comments. Probability implied from OIS for next rate hike on 2 Nov stands at 90% (vs. around 70% end-Sep). We caution that market disappointment could hurt BoE's credibility and depress GBP possibly towards 1.30 levels and beyond.

- **Progress on Brexit negotiations with EU is likely to be delayed.** First topics for EU-UK discussion – citizens' rights, UK financial obligations and border in Northern Ireland remain unsatisfactory (according to EU27) for discussions to move onto the second phase of trade negotiations. We now look for some hopes of progress in Dec-2017. Material progress on negotiations can support GBP.

- We maintain our medium term (18 - 20month) bias that GBP could trade higher from current levels towards 1.38 – 1.44 as GBP is perceived to be undervalued from both historical and fundamentals perspective (our BEER model puts GBP at 1.40). The 20% or so depreciation (from Jun to Oct 2016) should help the UK economy to rebalance and grow sustainably over time - current account deficit should narrow, exports should become more competitive and tourism and education receipts should pick up further. We believe UK should be able to manage the exit, transform itself into a global marketplace and continue to attract capital (longer-term). Past experience of UK leaving the ERM back in 1992 saw a period of consolidation (for a few years) at historical lows for GBP, before the eventual move higher in the following years, where GBP TWI traded above 100-levels in 1998 (from the lows of 80 in 1993-1996) due to buoyant demand fueled by rapid growth of wealth, credit and money. If history is a guide (assuming UK manages the transition well and takes the opportunity to correct its imbalances), its currency may start climbing higher.

- **Growth and Inflation Outlook:** GDP surprised to the upside for 3Q (+0.4% q/q vs. +0.3% expected vs +0.3% in 2Q), supported by manufacturing and services sector (accounts for nearly 80% of GDP) while construction sector weighs. On y/y terms, 3Q GDP held steady at 1.5%. While upside surprise should clear the hurdle for BoE to raise rates in Nov, growth momentum continues to decelerate and is below its long term average. Already for 1H, GDP has seen a notable slowdown driven by lower household spending and business investments. We caution that decelerating real wages will further crimp household budget and weigh on growth while potential delay in Brexit negotiations should see uncertainty persisting and weigh on business investments.

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

- **UK inflation continued to print higher, hitting its highest level in more than 5 years in Sep, due to increases in transport and food prices.** On y/y terms, Sep headline CPI rose to 3% (vs. 2.9% in Aug). The pick-up in inflation is squeezing household budget as wage growth is relatively unchanged at 2.2%. State pension payments from Apr-2018 is expected to rise by a rate equal to Sep's CPI rate or earnings growth or 2.5%, whichever is the greatest. RPI and input PPI were also seen rising to its recent highs for Sep. Inflation is expected to stay above BoE's inflation target of 2% for longer than expected but we do not expect price pressures to stay above 3% for extended period as seasonal effects from travel (Easter holiday) and fuel prices ease while GBP stabilization after the sharp depreciation (post EU referendum in 2016) should stabilize import price pressures.

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

- **Monetary Policy Forecast:** We see a **strong case for 25bps rate hike to 0.5%, possibly as early as its next meeting on 2 Nov**. This is due to inflation still stubbornly above BoE's 2% threshold and is testing the 3% levels (we believe to be BoE's upper threshold). BoE Carney appears to have been quietly preparing markets for rate hike soon in his recent comments: (On 13 Oct), he said it may be appropriate to raise interest rates in coming months as BoE seeks to control inflation as Brexit process continues. He also added that UK may be running out of spare capacity as more people in UK are working than ever before and tolerance for having inflation over targets in year 2 and 3 of the *Brexit* process has diminished; (on 29 Sep) he said rates would rise so long as there was not a sudden and unexpected deterioration in economic data. Recent release of 3Q GDP (better than expected) should firm up expectation of a rate hike as early as 2 Nov. Probability implied from OIS for next rate hike stands at 90%. Though we expect BoE to raise rates as soon as 2 Nov meeting, we do not see it as the start of a tightening cycle (likely to be one and extended pause) as BoE is constrained due to ongoing *Brexit* uncertainties and decelerating wage growth. BoE is expected to strike a balance between arresting inflation and making sure they do not derail growth momentum.

- At the last MPC meeting (14 Sep), BoE kept rate unchanged (MPC voted 7 -2) at 0.25% and maintained the stock of QE at GBP435b (unanimous vote from MPC). Accompanying statement saw the MPC striking a hawkish chord saying *"some withdrawal of monetary stimulus was likely to be appropriate over the coming months in order to return inflation sustainably to target"*. MPC also reiterated a warning from its Aug MPC meeting that *monetary policy could need to be tightened "by a somewhat greater extent" than market rates imply.*

- On the Aug Quarterly Inflation Report (or QIR), there were downward revisions to its macro assessment – economic growth from 1.9% to 1.7% for 2017 and from 1.7% to 1.6% for 2018.

- **Latest Fiscal and External Balance Outlook:** UK's current account deficit to GDP for 2016 was revised to its widest level in history at -5.9% of GDP. It was previously thought to be -4.4% of GDP. This reflects changes in Office for National Statistics estimates of flows of cross-border investment income rather than trade transactions. 2Q 2017 current account deficit stood at -4.6% of GDP (vs. -3.9% of GDP in 1Q). Foreign inflow of capital is needed to fund the deficit. But if Brexit uncertainty persists for longer, slowdown in foreign inflows could worsen the situation and the GBP could be punished.

- While public sector borrowing so far for the 2017-18 fiscal year has been running lower than projected by the Office of Budget Responsibility, productivity growth has also been much weaker. A downgrade to future productivity growth forecast will imply a hit to public finances. Eyes are on the November Budget – if Chancellor Hammond unveils a worse outlook for public finances. On 22 Sep, **Moody's cut UK rating by 1 notch to Aa2** from Aa1, citing reasons relating to weaker public finances and fiscal pressures will be exacerbated by erosion of UK's medium term economic strength (due to UK leaving EU single market and customs union).

- **Key domestic events and issues to watch:** Oct Mfg PMI (1 Nov); BoE MPC meeting decision, Oct Construction PMI (2 Nov); Oct services PMI (3 Nov); Sep IP, construction output, trade (9 Nov); Oct CPI, PPI, RPI (14 Nov); Sep jobs report (15 Nov); Oct retail sales (16 Nov), Hammond's Autumn statement to parliament (Budget) on 22 Nov; 3Q prelim GDP (28 Nov); Nov GfK consumer confidence (30 Nov).

- **Technical Outlook:** Our call downside play on the GBP worked well for the past few weeks. GBP traded to low of 1.3027 (6 Oct). Last seen at 1.3190. Momentum indicators are not consistent for weekly and daily charts. On daily, bearish momentum shows signs of waning while weekly indicator suggests bearish momentum could be building. We expect GBP to consolidate in range of 1.30 – 1.3340.

AUD: Narrowing Yield Differentials to Weigh

Forecast	4Q 2017	1Q 2018	2Q 2018	3Q 2018
AUDUSD	0.77 (0.78)	0.79 (0.80)	0.81 (--)	0.83 (--)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** AUD's decline moderated, from -1.7% in Sep to -1% for the month of Oct (at time of writing) as decline in iron ore prices in Sep stabilized in Oct. Downside surprise to 3Q inflation validated market expectation for no RBA monetary policy shifts in the foreseeable future (up to Aug-2018) further weighed on the AUD. We shared last month that AUD decline in Oct is unlikely to go beyond 0.7650 support. The low was seen at 0.7626 (27 Oct). Looking ahead, **AUD may fall further within 0.74 - 0.78 range** on (1) **narrowing AU-US yield differentials** (owing to monetary policy divergence between RBA and Fed) lowers the allure of AUD; (2) **slight risk of political uncertainty** after High Court ruled that Deputy PM Barnaby is ineligible for Deputy PM resulting in PM Turnbull's government losing the 1-seat majority; (3) China's **iron ore demand could potentially drop into Winter months** and (4) **seasonality trend points to weaker AUD in Nov-Dec**. We calibrate 4Q 2017 and 1Q 2018 forecast slightly lower to account for the recent development abovementioned.

- AU-UST 10Y yield differentials have been narrowing since start of Oct from about +50bps to +33bps (26 Oct). We caution that a potentially hawkish Fed (if Taylor gets appointed and US tax reform plans gain further traction resulting in expectation for US growth and inflation to pick up) vs. neutral RBA (not expected to move till sometime in 2H 2018 as wage growth remains soft and household debt concerns) could suppress AU-UST differentials further possibly towards sub-20bps and weigh on the AUD.

- We flagged out in the last issue of our FX Monthly that China's clampdown on steel production could weigh on iron ore demand and result in softer iron ore prices. But it turned out to be a flight to quality as China demanded for higher grade material from overseas. The import of iron ore surged above 100-million metric tons in Sep. Decline in iron ore prices in Sep somewhat stabilized at around the $60 - $62 level/tonne (Iron ore delivered to Qingdao China 62% Fer).

- There is some uncertainty on the political front after Australia High Court ruled that Deputy PM Barnaby is ineligible to sit in parliament due to his dual citizenship. This resulted in PM Turnbull's coalition government losing its 1-seat majority. **Though there are some uncertainties, we do not expect this to be a big negative** for AUD as Independent Cathy McGowan has issued a statement confirming her support for the coalition government in the form of supply and confidence agreement and that a by-election to be held in New England (former deputy PM's seat) on 2 Dec is likely to return to Deputy PM Barnaby (he is now eligible to run as he has denounced his dual citizenship). Recent opinion polls showed that he remains favored candidate. We do acknowledge that the government will sit through 27 – 30 Nov sittings without a 1-seat majority and that may pose some downside risks on the AUD in the near term.

- **Upside risk to our bias in Nov:** Synchronous recovery in global growth if sustained should support risk sentiment and cyclical proxy plays such as AUD; iron ore prices if surprised to the upside or return of USD weakness on the back of stalled progress with US tax reforms could support the AUD.

- **Growth and Inflation Outlook: GDP growth rebounded to 0.8% q/q in 2Q** (vs. +0.3% in 1Q). Public sector was the main contributor with strong gains from public consumption and investment. Private consumption and business investment rose moderately while housing remains flat. On y/y basis, GDP growth remains unchanged at +1.8% for 2Q. Looking out RBA expects economic growth to continue to recover as drag from falling mining investments come to an end and the ramp-up in resource exports continue. Outlook for non-mining investment has improved and reported business conditions are at high level. RBA expects growth to average around 3% over the next few years. This will be slightly faster than the current estimate of trend growth and should lead to a gradual decline in employment rate, and pick-up in wages growth.

- **Inflation picked up pace to +0.6 q/q in 3Q**, from 0.2% in 2Q. The increase was due to electricity and tobacco prices while sharper declines in prices of vegetables and petrol weighed. **Despite the rebound in headline CPI, it fell short of market expectation** of +0.8% q/q and weighed on the AUD. Tradable inflation fell in 3Q (-0.3% q/q) while non-tradable inflation rose (+1% q/q), in part due to tobacco and electricity prices. That said non-tradable inflation is now near 4-year high of 3.2% y/y. Treasury Secretary John Fraser told parliament that he remains confident wage growth will eventually accelerate as unemployment falls but he stressed that it will take some time. He added that wage growth will accelerate as cyclical constraints that have weighed on the economy recede. The RBA had revised its headline inflation higher in its last Statement on Monetary Policy from 1½-2½ % for year ended Jun 2018 that was seen in May this year to 1¾-2¾%.

- **Monetary Policy Forecast:** We continue to hold our view that RBA is likely to keep cash rate on hold at 1.5% at its upcoming meeting (7 Nov) and for the next few meetings, as wage growth remains subdued. While there has been plenty of comparison between Canada and

Australia, Canada has seen a faster pace of real wage recovery than Australia. The stage of economic recovery is not comparable between two countries although RBA has been sounding optimistic. With household debt at 190% of disposable income, a rise in rates could affect household consumption in an environment of low wage growth.

- Markets expectation for first rate hike to come in 2H 2018, with probability for Aug-2018 at 56% (implied from OIS) while we think RBA may potentially move as early as May-2018. RBA expects Australia growth to average around 3% over the next few years and this will be slightly faster than the current estimate of trend growth and should lead to a gradual decline in employment rate, and pick-up in wages growth. This would tip RBA to possibly raise rate as early as in May-2018. Our recent study which takes into account monetary transmission lags and time take for current and forecasted inflation to reach RBA inflation median target shows that RBA is slightly behind the curve in tightening. A combination of faster pick-up in wage growth, Australia inflation reaching its median target of 2.5% (range is 2 – 3%), steady economic growth in Australia, firmer commodity (base metals) prices amid synchronous recovery in global economy including China should lead to RBA tightening interest rate in due course.

- At its last meeting (3 Oct), RBA kept cash rate unchanged at 1.5% as widely expected. RBA continued to highlight low wage growth and inflation, as well as a growth in housing debt. RBA has also mentioned that the strong AUD is 'weighing on the outlook for output and employment'. Nonetheless, there were some small reasons for optimism, including the fact that 'growth in borrowing by investors has slowed a little recently'. RBA also highlighted that 'in Sydney, where prices have increased significantly, there have been further signs that conditions are easing'. On unemployment, there was a mention of a 'rise in labour force participation'. On growth, there was also an additional mention of a 'large pipeline of infrastructure investment' and that 'capacity utilisation has risen'.

- **Latest Fiscal and External Balance Outlook:** Australia's current account deficit widened to A$9.56 billion (s.a.) in 2Q. Lower export commodity prices for key exports of iron ore and coal were largely responsible for widening deficits. Current account to deficit stands at -2.1% of GDP.

- The 2017-18 budget deficit is A$29.4bn and projected to return to a surplus of A$7.4bn by 2020-21. Economic assumptions include inflation at 2% this year, real GDP of 2.75%. Total revenue is expected to be A$444.4bn, up from A$412.1bn in 2016-17. Net debt is projected to peak at 19.8% of GDP in 2018-19. Infrastructure spending will amount A$75bn from 2017-18 to 2026-27. The budget managed to help the government avert a loss of its AAA rating by S&P. That said, Australia still has a negative credit rating outlook as its deficits run the risk of being persistent for several years with little improvement if the government is not able to implement more forceful fiscal policy decision.

- **Key domestic events and issues to watch:** Oct commodity index (1 Nov); Sep building approvals (2 Nov); 3Q retail sales (3 Nov); RBA cash rate meeting (7 Nov); Oct NAB Business Confidence (14 Nov); Nov

Westpac Consumer confidence, 3Q wage price (15 Nov); Oct Employment change (16 Nov); Oct private sector credit, new home sales, building approvals (30 Nov).

- **Technical Outlook:** AUD drifted lower in Oct, in line with our caution for downside risks (in our last FX monthly). AUD was last seen at 0.7670 levels. Bearish momentum on weekly and daily chart remains intact. Downside pressure may persist. Support at 0.7630 (61.8% fibo retracement of May low to Sep high) before 0.7520 (76.4% fibo). Look for opportunities to buy on dips. Resistance at 0.7730 (50% fibo), 0.7820 (38.2% fibo).

NZD: Bearish Outlook but Caution for Temporary Bounce

Forecast	4Q 2017	1Q 2018	2Q 2018	3Q 2018
NZDUSD	0.6800 (0.7300)	0.6800 (0.7400)	0.7100 (0.7500)	0.7200 (0.7600)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** We **maintain our bearish outlook on NZD** on the back of government policy uncertainty relating to immigration, trade and RBNZ mandate. The recent change in government led by Labour and NZ First coalition supported by Green party on supply and confidence agreement is likely to be more inward looking and is expected to focus on a nationalist agenda. **We see downside risks to NZ growth forecast, business confidence, disruption to foreign capital inflows, rising likelihood of low policy rates for longer and potentially an interest to pursue a more competitive currency. We revised NZD forecasts broadly lower over the forecast horizon, taking into account the above considerations.**

- **NZ election results surprised markets.** National party with the most votes at 56 seats (out of 120 seat parliament) has lost to second placed Labour party with 46 seats but managed to form a coalition government with NZ First party (9 seats) and support from Green party (8 seats) on confidence and supply agreement. Together with the smaller parties, Labour managed 63 seat majority. We had shared that such a coalition implies an inward looking, nationalist-focused agenda. New policies may be less positive on immigration, trade and foreign investments. This would have negative impact on housing, foreign inflows and growth.

- **RBNZ Independence at Risk?** The new government will "review and reform" 1989 the Reserve Bank Act (no further details and timeline was given) and is possible that RBNZ mandate could be subject to changes. Labour party has previously proposed **the addition of full employment to the RBNZ's existing mandate of price stability and that monetary policy be decided by a committee rather than the governor as a lone decision maker.** We see risk that RBNZ's independence is potentially at risk as Labour and Green party have a history of commenting on RBNZ policy decision. The **new government is expected to extend its influence over the appointment of new RBNZ governor (Mar-2018) and RBNZ policy mandate relating to monetary and exchange rate management, resulting in greater room for lower rates or low rates for longer and a weaker currency. New NZ Finance Minister Robertson (Labour party) already said that reforming the RBNZ monetary policy mandate could potentially result in lower interest rates (28 Oct).**

- Taking stock of the past month, our **call for NZD to trade lower beyond 0.70 levels and towards 0.6820** (May low, complete text-book decline of head & shoulders pattern) **on coalition government formation involving Labour, Green and NZ First materialised.** NZD met both our downside objectives; traded fresh 5-month low of 0.6918 levels (27 Oct) and was last seen at 0.6840 levels. **Short-term, we do not rule out temporary bounces towards 0.70 levels**, given that most of the negatives have been in the price. But uncertainty on policies could have wider repercussions beyond the short term, which led us to lower our NZD forecasts. We also see room for AUDNZD to extend gains towards 1.1460 levels.

- **Growth and Inflation Outlook:** According to last available RBNZ MPS (dated 10 Aug), NZ economy is expected to continue growing at an average of 3.1% over the next 4 years. This projection assumes that economic activity is supported by tourism, immigration (strong population growth), consumer spending, high terms of trade and fiscal stimulus (as highlighted in Budget 2017) amid still-accommodative monetary policies. Going forward, **we expect the risk to growth forecast is skewed to the downside**. A new **coalition government led by Labour and NZ First as well as Green party (on supply and confidence agreement) is likely to be more inward looking and focused on nationalist-focused agenda,** bringing upon **fear of policy discontinuity in particular to immigration and trade.** New policies may be less positive on immigration, trade and foreign investments. This would have negative impact on housing, foreign inflows and growth.

  - On immigration, Labour has promised to reduce net immigration by up to 30,000 per year (that's nearly half of the annual net migration of 72,400 in the Jul 2017 year) while NZ First party had previously campaigned to reduce net migration to around 10,000 per year.

  - On trade, Labour party's leader and PM Jacinda Ardern had already made her stance that she wants a renegotiation of the TPP and other FTAs (with China and Korea) to clamp down on sales of property and farms to foreign buyers.

  - On minimum wages, the new government has agreed to increase the minimum wages to NZ$20/ hour by 2020, from current levels of NZ$15.75. PM Jacinda had previously said she would start with a slight increase (about 4.8%) to NZ$16.50 by Apr-2018.

- 2Q GDP rose 0.8% q/q (vs. +0.6% in 1Q), largely due to one-off boost from tourism (British and Irish Lions rugby tour and World Masters' Games) and rebound in agriculture and transport. Export of good &

services surged 5.2%, led by strong diary shipments while construction activity fell for a second straight quarter. On y/y basis, GDP remained unchanged at 2.5% in 2Q 2017. It is **less clear if growth momentum will extend into 3Q as business and consumer confidence fell in Sep while services and manufacturing PMIs eased in Sep. 3Q GDP report is scheduled for release on 21 Dec.**

- **NZ inflation picks up pace in 3Q (+0.5% m/m vs. 0% in 2Q). On y/y basis, 3Q inflation quickened to 1.9% (vs. 1.7% in 2Q).** The increase was due to food prices and housing costs. Non-tradable inflation picked up in 3Q (+0.7% m/m vs. +0.2% in 2Q) owing to increases on land taxes, rents and cost of building new houses. On y/y basis, non-tradable prices increased to 2.6% - the most since 2Q 2014. 3Q Tradable prices also rose to +0.2% m/m (vs. -0.2% in 2Q), helped by increases in vegetable prices though cheaper fuel and airfares offset partially.

- **RBNZ expects headline inflation to decline in coming quarters** as effects of higher fuel and food prices wears off. Outlook for tradables inflation remains soft while non-tradables inflation remains moderate. Longer term inflation expectations remain well anchored at around 2%. We see risk that potential fiscal impulse and proposed minimum wage increase could support consumer spending and result in faster pick-up in inflation.

- **Monetary Policy Forecast:** The new government will "review and reform" 1989 the Reserve Bank Act (no further details and timeline was given) and it is possible that RBNZ mandate could be subject to changes. Labour party has previously proposed **the addition of full employment to the RBNZ's existing mandate of price stability and that monetary policy be decided by a committee rather than the governor as a lone decision maker.** Recall that **PM Ardern had previously looked for unemployment rate to fall towards 4% (from its current levels of 4.8%).** NZ First party leader Peters had previously proposed adopting a Singapore-style monetary policy so that the central bank can directly control and devalue the NZD (to add, he is an advocate of a more competitive currency given NZ's status as an export-dependent nation) but **Peters conceded that he did not manage to secure this as part of the coalition agreement**. Acting governor Grant Spencer's term runs out by Mar-2018. Focus will be on the next appointment for RBNZ governor as that will have wider implication for policy bias. We see risk that RBNZ's independence is potentially at risk as Labour and Green party have a history of commenting on RBNZ policy decision. The **new government is expected to extend its influence over the appointment of new RBNZ governor and RBNZ policy mandate relating to monetary and exchange rate management, resulting in greater room for lower rates or low rates for longer and a weaker currency. New NZ Finance Minister Robertson (Labour party) already said that reforming the RBNZ monetary policy mandate could potentially result in lower interest rates (28 Oct).**

- For the upcoming meeting (9 Nov), we do not expect the current RBNZ Acting Governor to waver and expect the **RBNZ to keep OCR on hold at record low of 1.75%.** Accompanying monetary policy statement is likely to remain "neutral" and flag the risks of slowing growth momentum and core inflation in coming quarters. RBNZ should also welcome the recent 3.2% decline in NZ TWI from above 76-levels to 73.90 levels (as of writing). Grant Spencer has taken over Graeme Wheeler (effectively 27 Sep) as acting Governor for 6 months before he goes into retirement. This 6-month period should see monetary policy remain status quo till Mar-2018 unless inflation overshoots upper band of target range of 3% (not our base case scenario).

- At the last RBNZ meeting (28 Sep), RBNZ kept OCR on hold at record low of 1.75%. Accompanying statement acknowledged the rebound in 2Q GDP following relative weakness in previous two quarters and expects growth to maintain its current pace going forward supported by accommodative monetary policy, strong population growth (we are sceptical given the potential change in government policy towards immigration), high terms of trade and fiscal stimulus. The trade-weighted exchange rate has eased slightly since the August Statement. A lower New Zealand dollar would help to increase tradables inflation and deliver more balanced growth. House price inflation continues to moderate due to loan-to-value ratio restrictions, affordability constraints, and a tightening in credit conditions. This moderation is expected to continue, although there remains a risk of resurgence in prices given population growth and resource constraints in the construction sector. Monetary policy will remain accommodative for a considerable period. Numerous uncertainties remain and policy may need to adjust accordingly

- **Latest Fiscal and External Balance Outlook:** The new government is expected to usher in expansionary fiscal policies while National party's initial plan to raise tax thresholds, increase accommodation payments and tax credits will be abandoned. It is unclear at this stage how much Labour is planning to use the budget surplus (which National party spent the past 9 years returning the budget from deficit to surplus), but plans as highlighted in the coalition agreement – spending for health & education, new infrastructure projects (regional rail) could be sizeable. And NZ will need foreign capital to operate. If new policies are not business-friendly, inflow of capital could be disrupted and NZ will have to rely on domestically-raised capital sources.

- NZ reported a better than expected budget surplus in the 2016/17 year. OBEGAL (for the year ending Jun-2017) rose to NZ$4.069bn from an earlier forecast of NZ$3.706bn.

- 2Q current account deficit narrowed to NZ$7.49bn or -2.8% of GDP (vs. -3.1% in 1Q). The improvement was due to Foreign sports fans travelling to NZ for World Masters Games (Apr) and British and Irish Lions rugby team (Jun).

- **Key domestic events and issues to watch:** 3Q unemployment rate, wages (1 Nov);Oct QV house prices (2 Nov); RBNZ meeting (9 Nov); Oct card spending (10 Nov); Oct food prices (13 Nov); 3Q Retail sales (14 Nov); Nov consumer confidence (16 Nov); Oct Mfg PMI (17 Nov); 3Q PPI (17 Nov); Oct Services PMI (20 Nov); Oct Migration (22 Nov); Oct trade (24 Nov); Oct building permits, Nov Business Confidence (30 Nov). GDT trade auctions take place on 7 and 21 Nov.

Technical Outlook: Our long-standing bias for NZD to trade lower towards head & shoulders bearish reversal objective at 0.6820 was met. Pair was last seen at 0.6850 levels. Downtrend remains intact as indicated by weekly and daily momentum. Next support at 0.67, 0.6520 levels. However we cautioned for rebound risks towards 0.6990 level in the near term - falling wedge pattern appears to be forming (bullish reversal) while Stochastics is also in oversold conditions. Bias to lean against strength.

JPY: Watching UST Moves For Further Downside

Forecast	4Q 2017	1Q 2018	2Q 2018	3Q 2018
USDJPY	115 (--)	117 (115)	115 (117)	116 (--)

Previous forecasts in parenthesis

- **Motivation for the FX View:** The USDJPY climbed to a three-month high of 114.45 (on 27 Oct) in Oct amid the surge in UST yields and firmer USD. The potential for tax reforms by end-1Q 2018, the possibility of a more hawkish Fed (with the upcoming appointment of a new Fed Chair) and softer EUR on ECB's dovish taper lifted the USD and UST yields higher. At the same time, the landslide victory by PM Abe's ruling coalition in the Oct snap polls put Abenomics, particularly the BOJ's ongoing powerful easing measures, back in centre-stage, and suggesting no change in economic policy ahead. Together, these factors have weighed on the JPY, particularly the widening UST-JGB yield differentials. So far in Oct, the JPY has declined by 1.0% against the USD. This made the JPY the second worst performing currency among the currencies we track. Year-to-date though, the JPY has gained about 2.9% against the USD year-to-date. We expect these gains to dissipate towards the end of the year. We maintain our bearish call on the JPY.

- Given the recent developments, it is not surprising that market is now positioning for even further JPY weakness ahead. Recent CFTC data showed that net short-JPY positions have increased in the week of 24 Oct. Market has increased its short-JPY positions to 176934 contracts (vs. 156296 the previous week) and its long-JPY bets to 60077 contracts (vs. 55010 in the week before), resulting in an increase of 116857 net short-JPY contracts in the week of 24 Oct vs. 101286 in the week of 17 Oct. This reflected the market's bias for further JPY weakness ahead, particularly on expectations of further widening in UST-JGB yield differentials. The rise in UST yields with JGB holding steady around current levels at the very least should favour further net short-JPY bets ahead. This suggests the potential for further upside to the USDJPY in remainder of 2017 and 2018.

- With PM Abe firmly back in the helm and the likely re-appointment of Kuroda to the BOJ governorship, no changes to the BOJ's ultra-loose monetary policy are expected. With inflation still a ways off the BOJ's 2% target, continuation of the easing policy is expected. This is in contrast to some of its G7 peers who have begun to unwind their QE policies. The dissent by new board member Goushi Kataoka, who had argued against the BOJ's inflation overshooting commitment, preferring instead for additional easing, points to an easing bias than towards tapering/unwinding. He also called for the BOJ to target the 15-year JGB yield instead. Governor Kuroda is not in favour of additional easing measures though he has constantly reiterated that the central bank will keep its powerful easing for as long as required to get inflation back up to the 2% target. This ongoing powerful easing measures and yield curve control should see 10Y JGB yield hovering around the zero percent levels, widening the UST-JGB yield differentials and keeping the USDJPY elevated, possibly towards 117 by end-1Q 2018.

- Despite the dissent from Kataoka, further easing measures remains unlikely for now. It would be hard to justify further easing measures when the economy is on a steady recovery path. Still, should inflation fail to gain traction going into 2018, we cannot discount the BOJ unleashing even more easing measures to lift inflation towards the BOJ's 2% target. These easing measures could include cutting interest rate further to -0.3% (from -0.1% currently) and increasing asset purchases of ETFs and J-REITs and other instruments to JPY10tn and JPY6tn.

- A possible headwind that could weigh on the USDJPY is geopolitical risk especially arising from North Korea or the disappointment over global reflation trades. Safe-haven plays arising from geopolitical tensions over North Korea or the lack of global reflation could crimp foreign demand for Japanese equities and weigh on the USDJPY. This has not panned out so far in Oct with foreign investors purchasing USD24.53bn in equities from 1-20 Oct (latest data available). This is in contrast to the USD39.76bn in equities sold off for the whole of 2016. The positive sentiments have allowed the Nikkei 225 index to hit a new multi-year high at 22012 as at 30 Oct.

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

- We retain our USDJPY forecast, projecting the pair to end-2017 at 115. Thereafter, US tax reforms in 1Q 2018 should be supportive of the USD and the USDJPY, lifting the pair to the 117-levels. Some moderation in USD strength is expected after the strong showing in 1Q with the pair easing slightly to 115 by end-2Q before re-accelerating to 116 by end-3Q.

- **Growth and Inflation Outlook:** The economy has been expanding for sixth straight quarters. Growth momentum is likely to remain on an acceleration path ahead with the government seeking to implement a JPY2tn spending package by end-2017 when it gets returned to power after the election. Confidence in the economy was reflected in the 3Q Tankan survey result where sentiments of big manufacturers have risen to the highest level since Sep 2007 (3Q: 22 vs. 2Q: 17). Core machine orders rebounded by 4.4% y/y in Aug after declining in the previous two months, while industrial production climbed 5.3% in Aug from 4.7% in Jul. Healthy external demand is also supportive of the economy with exports rising by double-digits for the past three months (Sep: 14.1% y/y vs. Aug: 18.1%). Imports too have been expanding at a double-digit pace, rising 12.0% in Sep from 15.2% in Aug. Given the strong economic so far in the first three months of the year, the BOJ has upgraded its growth forecast to 1.9% for 2017 from 1.8% previously, while keeping its outlook for 2018 and 2019 unchanged at 1.4% and 0.7% respectively.

- Headline CPI rose 0.7% y/y in Sep, the same pace as in Aug and in line with market expectations. Core inflation (headline CPI less fresh food) also rose by 0.7% in Sep (Aug & Cons.: 0.7%). Core-core inflation (headline CPI less fresh food, energy) climbed 0.2% y/y in Sep (Aug & Cons.: 0.2%). For 3Q, headline and core inflation were each up by 0.6% from a year ago, an improvement over 2Q's 0.4%. Similarly, core-core inflation rose by 0.2% y/y in 3Q compared to 0% in 2Q. Though inflation is picking up, it is doing so modestly. This slow progress on the inflationary front can be attributed to the lack of any significant pick-up in wage growth (with growth in base wages, i.e. excluding OT and bonuses, hovering just around the 0.5% for the past few months). This is despite the improved domestic economic conditions, including the tightening labour market. The persistently low inflationary environment suggests that the powerful easing by the BOJ will continue for the foreseeable future as long as the 2% inflation target is not achieved. In a nod to reality, the BOJ adjusted its core inflation forecast lower to 0.8% and 1.4% for FY2017 and FY2018 respectively from 1.1% and 1.5% previously.

- **Monetary Policy Forecast:** The BOJ left its policy unchanged at 30-31 Oct meeting as expected. Its policy balance (short-term) rate was kept at -0.1% and 10Y JGB yield target at around 0%. The pace of asset purchase was maintained even though this measure is no longer central to its "QQE with Yield Curve Control" regime. Once again, board member Goushi Kataoka dissented, arguing for additional easing measures to achieve the 2% inflation target and for the BOJ to target the 15Y JGB yield to remain at less than 0.2%. As we had previously cautioned, the dissent by Kataoka could be laying the ground for even more easing measures should inflation fail to gain traction. That said, it would appear that there is no turning back from the ultra-loose monetary policy for the foreseeable future. This is in contrast to its G7 peers, who are either considering (ECB and BOE) or already withdrawing monetary stimulus (Fed and Bank of Canada), amplifying the divergence in monetary policy.

- We are doubtful at the point of writing that additional easing measures will be forthcoming given that the economy continues to expand healthily and labour market slack has tightened. Nevertheless, we cannot rule out such moves completely. In an environment of muted inflation, the central bank could be prompted into action, unleashing even more easing measures to lift inflation towards the BOJ's 2% target. These easing measures could include cutting interest rate further to -0.3% (from -0.1% currently) or even surprise with a change in regime.

- The BOJ could face complications in its future policy decision making as a consequence of the government planned postponement of its goal of achieving a primary balance/surplus by 2020 as set out in the ruling party's election manifesto. This delay in fiscal consolidation complicates matter for the BOJ as its policy depresses the government's borrowing cost and removes an incentive for the government to eliminate its debt as quickly as possible. Still, it is unlikely that the BOJ will change its policy stance given that its policy board is now stacked with doves. Nevertheless, the call for an unwinding of BOJ asset purchases could intensify and there could be increasing pressure to deal with its own tapering sooner than it would like. Any moves that hint of tapering is likely to increase uncertainty, leading to a sell-off in domestic equities and increased JGB purchases, and weigh on the USDJPY.

- **Latest Fiscal and External Balance Outlook:** To offset the negative impact of the consumption sales tax hike, PM Abe has ordered the Finance Ministry to come up with a spending package to be implemented by year-end. Financing for the new spending package would come from the revenues generated from the sales tax hike. The JPY2tn spending package should include expenditure for expanding access to education and cutting waiting times at child-care centres. Further details are expected before the end of the year. This is a shift away from the previous pledge of using the revenues from the sales tax hike to reduce the fiscal deficit. More importantly, the time-line for eliminating the fiscal deficit is now in limbo after PM Abe's LDP dropped the long-held goal of curbing the fiscal deficit by 2020. This increases the risk of a credit-rating downgrade ahead.

- The current account (CA) surplus widened mildly in Aug. The CA surplus rose to JPY2.38tn in Aug from JPY2.32tn in Jul, underpinned by a modest rebound in the goods and services surplus (Aug: JPY338.8bn vs. Jul: JPY329.30bn) and primary income account surplus (Aug: JPY2.24tn vs. Jul: JPY2.15tn) offsetting the increase in the secondary income deficit of JPY197tn in Aug (from Jul's JPY156.30bn deficit). The financial account surplus widened in Aug to JPY1.92tn from JPY0.85tn in Jul on the back of an improvement in the other investment account (Aug: +JPY2.45tn vs. Jul: -JPY7.07tn). Consequently, the overall balance of payments (BoP) surplus widened for the first time in four months to JPY3.85tn from JPY1.71tn in Jul.

- **Key domestic events and issues to watch:** On the political front, Shinzo Abe is to be voted in as Prime Minister on 1 Nov during a special Diet session. Thereafter he will announce his cabinet line-up, which should be largely changed from the one before the election.

Preliminary GDP print for 3Q will be released on 15 Nov. Although there is no BOJ meeting in Nov, minutes of the 20-21 meeting and summary of opinions at 30-31 Oct meeting will be released on 6 and 9 Nov respectively. BOJ speaks to note include governor Kuroda's speech in Nagoya and Zurich on 6 and 14 Nov respectively, and chief economic speak at conference. JGB auctions in Nov: 10-year (1 Nov), 30-year (9 Nov), 5-year (14 Nov), 1-year (15 Nov) and 20-year (16 Nov).

- **Technical Outlook:** Our bias for upside play towards 114.50 (as mentioned in last issue of FX Monthly) was nearly met. USDJPY traded high of 114.45 (27 Oct) before turning lower. Last seen at 113.10 levels. Short term chart suggests some downside risks ahead. Key support at 112.90. Break below this exposes the pair towards 111.60 (200 DMA) – 112 area of support. But we observed that golden cross pattern could be in the making – 50DMA about to cut 200 DMA to the upside. This is a bullish signal. Bias to buy on dips. Resistance at 114.50, 115.90 (76.4% fibo retracement of 2017 high to low).

CNY: Xi's "New Era", Power centralization

Forecast	4Q 2017	1Q 2018	2Q 2018	3Q 2018
USDCNY	6.60 (--)	6.65 (6.60)	6.60 (6.65)	6.60 (--)
USDCNH	6.60 (--)	6.65 (6.60)	6.60 (6.65)	6.60 (--)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** USDCNY remained within the range of a 6.56 to 6.69 in the month of Oct, as the twice-a-decade National Congress wraps up and sets the stage for China's growth. The USDCNY started Oct on a firm footing on the back of a firmer USD (owing to progress with US tax reforms and an inclination to a more hawkish leaning Fed chair). However, the Yuan subsequently strengthened in mid-month as investors awaited the 19th National Congress that sets the stage for the ruling party's mandate on growth. The pair settled higher towards the end of the Oct as the strength in the US took effect on the CNY. Moving forward, we expect the USD strength to continue into the start of Nov at around 6.65 to 6.67 levels as Trump's visit to China takes place (3 Nov). We also look to a centralization of power of Xi Jinping that could potentially implicate markets with policies which seems easier to pass with the new Politburo Standing Committee (PSC). Growth is likely to be slow and gradual, as the mandate set by Xi focuses on high-quality growth rather than a rapid growth model. We see potential CNY strength towards 6.60 levels going in to the end of Nov as investors await the China's Economic Work Conference taking place in Dec.

- The 19th National Congress of the Communist Party (十九大) wraps up with Xi's Politburo Standing Politburo Committee members as stated below. The lineup of the PSC members released signaled a centralization of power as President Xi tightens his grips with his key appointments.

PSC	Members	Description
General Secretary	Xi Jinping, 64	Assumed position in 2013
Premier	Li Keqiang, 62	Holds many different views with Xi
Chairman, NPC	Li Zhanshu, 67	Xi's close advisor, Chief of staff, least political experience
Chairman, CPPCC	Wang Yang, 62	Pro-democracy, liberal, key liaison to US
Central Secretariat?	Wang Huinin, 62	Xi's close advisor, political theorist & foreign policy guru
Secretary, CCDI	Zhao Leji, 60	Trusted figure who oversaw overhaul of CCP personnel
Executive Vice Premier	Han Zheng, 63	Ex-CCP shanghai secretary, transformed Shanghai

- Apart from Xi himself and Premier Li Keqiang, the other 5 members are seen as new, key figures whom supports Xi's current mandate; which increases the speed for reform as political barriers are likely isolated. We also see Xi to be likely to stay in power above his term in 2022, due to the absence of an obvious heir. The succession process usually includes members eligible by age into the PSC. However, the current lineup indicates none being eligible for party general secretary/presidency for 2022, which suggests Xi's potential for continuing his term after 2022.

- Xi's speech during the Congress declared a "New Era", showing that he aims on reforms to come in a manner that bears comparison to Deng Xiaoping and Mao Zedong eras. Main points of his mandate includes a plan through 2050 that focuses on (1) SOE reform, (2) Environmental protection and Poverty reduction, (3) Pushing forward the Belt and Road Initiative (BRI), (4) Shift towards High-quality growth, (5) Strong Military. Implications may not be clear until policy priorities are set at the Economic Work Conference in Dec.

- As Xi moved away from China's rapid growth model, China sets growth targets fairly constant at 6.5% as they focus to a gradual deleveraging of the economy. Moving through a gradual deleveraging, China is hoping to avoid the all famous "Minsky Moment" debt cycle with capacity cuts and leverage control, which may unfortunately curb growth.

- China's Ministry of Finance has also kick started plans to issue USD sovereign bonds worth USD2b. This bond issuance indicates the country's move to further open the financial sector to global investors, while also getting international financing to support the development of China's real economy. The sovereign bond sales offshore in Hong Kong helps promote connectivity between both financial markets. The MoF priced the 5-year USD notes 15bps over US treasuries, while the 10 year notes priced at 25bps above. The offering on 26 Oct saw the demand climbing to 11 times the offering size; suggesting foreign investor's strong appetite for China exposure.

- On the commodities front, we could potentially see an Iron ore price correction as regulation on property markets started to take effect. Property prices have increased less compared to previous months' figures. Combined with the recent clampdown on air pollution, which saw small miners being forced to upgrade production process or face permanent closure, we see several factors that could further suppress iron ore prices, and hence limiting growth in the manufacturing sector.

- With all that being said, Nov seems to be an important month for the Chinese economy. As plans and reforms are being struck out after the National Congress, we could potentially see how the markets and economy react to Xi's vision through the subsequent few months to the year. The emphasis of quality will definitely implicate economic data and market sentiment in the coming month. However, the implications and noises are unlikely to persist through 2018 as reforms start to take effect and reflect on the real economy. We expect CNY strength to be capped for the month of Nov, but with the possibility of outperforming on data surprises.

- Our monthly Maybank vulnerability score (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) showed unchanged value for China of 5.3 (with 1 being the best and 9 being the worst).

- **Growth and inflation outlook**: 3Q GDP rose 6.8% y/y in 3Q in line with expectations (2Q: 6.9%). Change from 2Q is mainly due to fall in real estate and construction activities, while we see an increase in financial services and IT sectors. Moving forward, growth could be potentially subdued with economic reform and financial deleveraging. The credit market is likely to face a headwind in Nov, but should gradually improve through to 2018. Hence, growth could potentially stall in the near-term. However, we expect growth to continue at 6.5% levels, in line with the current's government 3 year growth target.

- CPI came in line with expectation at 1.6% y/y (2Q 1.8%), mainly dragged down by a fall in food prices, while being supported higher with increases in health service prices. PPI increased higher than expected at 6.9% y/y (2Q 6.3%), with the rise coming from smelting and pressing of ferrous metal and non-ferrous metal, paper industry, and nonferrous metals mining. Sep property prices show 44 out of 70 cities showing increases, compared to Aug data of 46. There could potentially be a lid on upward price pressures and inflation amid a slowdown in domestic demand growth with weaker property prices, which too will affect commodity prices

- Industrial production climbed 6.6% y/y in Sep, the same pace as in Aug. Retail sales rose 10.3% y/y, an improvement over Aug's 10.1%. Urban FAI though moderated slightly, rising by 7.5% y/y YTD in Sep, down from Aug's 7.8%. Sep industrial profits rose y/y to 27.7% (previous 24%). All indicators underscored resilience in the economy as capacity cuts and environmental efforts intensifies lifted prices.

- Manufacturing PMI fell from previous month's 5-year high. Mfg PMI fell to 51.6 from 52.4, while non-mfg PMI declined to 54.3 from 55.4. The decrease in PMI is likely a result from the economy's transition away from a rapid growth-at-all-cost model to a more high quality growth model, along with China's pledge to keep pollution control measures.

- **Monetary Policy Forecast:** We expect PBoC to keep monetary policy "prudent and neutral", and continue to focus on influencing funding rates by managing RMB supply. On RMB policy, it is clear that PBoC will continue to be cautious and pragmatic to pursue relative stability via the use of its daily fixing mechanism which has been rather successful in guiding and managing FX. However, the 19th national congress has shown that PBoC is unlikely to widen the trading band of +/-2%.

- The PBoC is likely to see a more hawkish stance as growth and inflation has shown to be stable in 3Q. With the recent RRR (Reserve Requirement Ratio) cut, which was not a shift in monetary policy but a structural adjustment aimed to encourage commercial banks on credit support, it would be possible to see upside to lending rates which would tighter policy.

- **Latest Fiscal and External Balance Outlook:** Fiscal revenue in China rose 13.3% y/y to CNY1.271trn in Sep. PBOC had stated that China will coordinate fiscal and monetary policy. With the new PSC in place, we will likely see a more supply-side structure, by allowing tax breaks to ease funding cost in real economy. So while real rates could rise and PBOC can continue to tighten, the government may be able to offset the rise in funding cost by offering tax breaks. The fiscal deficit could rise in the nearer term as expansionary fiscal policy is enacted in order to offset monetary tightening policies.

- FX reserves increased higher than expected to US$3108.5b (prior US$3091.5b), likely due to the weaker USD and strength in the CNY. Trade balance decreased to US$28.47b (prior US$41.99b) with imports of energy and food consumables rising faster than exports.

- Key domestic events and issues to watch: Caixin PMI (1 Nov); FX Reserves (7 Nov); Trade balance, FDI (8 Nov); CPI, PPI (9 Nov), Money supply, Aggregate financing (10 Nov); retail sales, IP (14 Nov); Mfg and Non-mfg PMI (30 Nov).

- **Technical Outlook:** Daily chart shows bullish momentum but waning, while weekly chart shows bearish conditions intact. Stochastics for both daily and weekly charts is at overbought conditions. Resistance remains around 6.7165 (50% fibo retracement of Jan high to Sep low), 6.7000 levels (100WMAs). Support is around 6.5720 (23.6% fibo). All technical signals suggest that risk is to the downside (in line with our 4Q expectations). A breakthrough of key support at 6.60 (50 DMA) could however develop further downside pressure towards next support at 6.5720 levels.

KRW: Supported on Rate Hike Bets and Robust Trade

Forecast	4Q 2017	1Q 2018	2Q 2018	3Q 2018
USDKRW	1142 (1160)	1140 (--)	1130 (1140)	1120 (1130)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** We see **room for KRW to strengthen** in coming weeks as **geopolitical tensions eased**, **BoK rate hike bets returned** while **synchronised global recovery continues to support robust trade growth**. Solid headline GDP for 3Q (and possibly 2017 growth to meet BoK's upgraded forecast), inflation testing BoK's target of 2%, BoK Governor Lee's comments that BoK can consider rate hike if recovery is solid, close to potential growth rate and CPI approaches target as well as recent BoK MPC vote shift at 19 Oct meeting (1 dissenter) should pile up market expectation for 25bps rate hike possibly as early as at its upcoming meeting (30 Nov). Market expectation for BoK rate hike soon should see KRW supported. However we think it may be too early to jump the gun (our base case remains for BoK to stay on hold). Market disappointment with BoK could see KRW gains unwind. We **expect a range of 1110 - 1145 for the next few weeks**. In light of recent market development - expectation for BoK rate hike, exports benefiting from continued and synchronised global recovery as well as geopolitical tensions easing - we calibrate our USDKRW forecast lower for end-year but maintain it above current spot on expectations for moderate USD strength into year-end (Fed rate hike, progress on US tax reforms and potentially the risk of a more hawkish Fed).

- **Our base case remains for BoK to remain on hold at 1.25% at the upcoming meeting** (which is also the last MPC meeting for the year).

  - Though inflation has risen to BoK's target, the **inflationary pressures from the demand side are not high**. Core inflation remains around 1.6% levels. The jump in headline CPI comes from seasonal factors - heavy rain, summer heatwave and recent incident relating to contaminated eggs.

  - While growth for 3Q picked up, **headline GDP was mainly driven by exports, business investment and private consumption on the other hand slipped from previous quarter.** Furthermore BoK Lee told parliament (23 Oct) that *"need time to assess if current trend of economic recovery continues"*. **We think it may be too soon to jump the gun on raising rates this year,** especially when preliminary GDP could even be subjected to revisions. **We maintain our call for BoK to raise rates by 25bps in 1Q 2018.**

- Exogenous factors such as Trump's appointment of Fed Chair and Vice Chair in coming weeks as well as US tax reforms progressing positively may also have impact on UST yields and on USDKRW. A more hawkish appointment (i.e. Taylor), material progress with US tax reforms, higher growth and inflationary pressures in US as well as the risk of tighter monetary policies could surprise USD shorts and translate into USD strength. Furthermore seasonal trends favor firmer USDKRW in Nov (USDKRW rose in past 7 out of 10 Novembers). Risk of on-off escalation of geopolitical tensions should also keep the pair supported on dips. Trump's visit to S.Korea early-Nov is expected to focus on North Korea and US-Korea FTA (KORUS). Previously, Trump has criticized the KORUS for its large trade deficit with S.Korea and have asked for renegotiation or risk termination again. We see potential risk for renegotiation but do not expect the KORUS to be terminated. On North Korea, Watch out for re-escalation of geopolitical tensions (i.e. retaliatory launch of missiles from North Korea) on any harsh remarks from Trump. This may see short term spikes in USDKRW. But we do not expect geopolitical tensions to escalate into an armed conflict.

- **Downside Risks to our Outlook**: Synchronised global recovery, on the other hand, has continued to boost S.Korea's exports (+35% y/y in Sep). This is the 9th back to back month of double-digit growth and is in its longest stretch of robust expansion since 2011. A **continuation of this trend could pose downside risks to our forecast. We caution that a break below 1110 may subject our forecast to revisions**.

- **Our monthly Maybank Vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for S.Korea improved modestly to 6.2 (vs. 6.3 prior), owing to relative improvement in bond yields.

- **Growth and Inflation Outlook: 3Q preliminary GDP surprised to the upside** (+1.4% q/q vs. +0.9% Expected vs. +0.6% prior), owing to the sharp rise in exports (which accounts for about 40% of GDP) and government spending (believed to be effects of the KRW11tn supplementary budget). Weighing on GDP is Gross capital formation (-0.5% q/q vs. +2.6% in 2Q). On y/y terms, 3Q GDP rose to 3.6% (vs. 3% expected vs. 2.7% in 2Q). Sequential growth rate at 1.4% is the fastest in 7 years. BoK official said that 2017 GDP can grow 3% (in line with BoK's recently revised figure) even if 4Q growth is negative and that private consumption is showing gradual recovery. He did however caution that 4Q export growth may slow on fewer work days. On China's economic retaliation against S.Korea's deployment of THAAD via reduced inbound tourism, closure of Lotte's supermarket outlets in China, reduced sale of Hyundai vehicles in China, etc has resulted in S.Korea's 2017 economic growth to be shaved off by about 0.4ppts. This may potentially wear off overtime into 2018.

- **BoK raised 2017 GDP growth forecast to 3%, from 2.8%** for the third time this year (19 Oct). The central bank attributed the upward revision to continued improvement in exports and increased capital expenditure. It said private consumption has recovered moderately and will likely pick up pace as the government implements more economic stimulus to boost spending. With Trump visiting S.Korea in early Nov as part of his Asia trip, some focus will be placed on US-Korea FTA (KORUS) as Trump has criticized the KORUS for its large trade deficit with S.Korea and have asked for renegotiation or risk termination again. We see potential risk for renegotiation but do not expect the KORUS to be terminated. Larger emphasis will also be placed on North Korea. Watch out for re-escalation of geopolitical tensions (i.e. retaliatory launch of missiles from North Korea) on any harsh remarks from Trump. This may see short term spikes in USDKRW.

- AT the last MPC meeting (19 Oct), BoK raised inflation forecast to 2%, from 1.9% previously. **Headline inflation eased from 5-year high of 2.6% y/y in Aug to 2.1% y/y in Sep.** Food and non-alcoholic beverages as well as utility cost remain the main drivers of headline inflation. Core inflation slipped to 1.6% y/y in Sep (vs. 1.8% in Aug) and is expected to stay in the mid-to-upper range of 1% into 2018.

- **Monetary Policy Forecast**: We see risk of BoK raising rates by 25bps to 1.5% at the next meeting on 30 Nov, given the reacceleration in growth momentum and inflation hovering around BoK's 2% target. BoK Governor Lee's comments - BoK can consider rate hike if recovery is solid (close to potential growth rate) and recent BoK MPC vote shift (1 dissenter) do suggest some risks of rate hike as early as in Nov. **However our base case remains for BoK to remain on hold at 1.25% at the upcoming meeting** (which is also the last MPC meeting for the year). Though inflation has risen to BoK's target, the **inflationary pressures from the demand side are not high**. Core inflation remains around 1.6% levels. The jump in headline CPI comes from seasonal factors – heavy rain, summer heatwave and recent incident relating to contaminated eggs. While growth for 3Q picked up, **headline GDP was mainly driven by exports, business investment and private consumption slipped from previously quarter.** Furthermore BoK Lee told parliament (23 Oct) that *"need time to assess if current trend of economic recovery continues"*. We think it may be too soon to jump the gun on raising rates this year. **We maintain our call for BoK to raise rates by 25bps in 1Q 2018.**

- **Latest Fiscal and External Balance Outlook:** Current account surplus widened to $6.06bn in Aug, compared with $5.03bn in Aug-2016. The improvement was due to semiconductor exports and the surplus is the 66^{th} consecutive month. Goods account surplus widened to 9.31bn in Aug from 6.94bn in Aug-2016 while services deficit worsened to $2.33bn in Aug (vs. 1.5bn in Aug-2016). Decreasing inbound Chinese travellers amid rising outbound travellers contributed to the widening of the deficit.

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

- **Key domestic events and issues to watch:** S. Korea releases Oct CPI, exports, PMI (11 Nov); Oct FX reserves, Sep current account balance (3 Nov); Oct export, import price index (13 Nov); Oct unemployment rate (15 Nov); Oct PPI (20 Nov); 20 Days Exports for Nov (21 Nov); Oct IP, BoK MPC meeting decision (30 Nov).

- **Technical Outlook:** USDKRW traded lower for the month of Oct. Last seen at 1120 levels. Bearish momentum on monthly and weekly chart remains intact. Key support at 1110 (2017 low). Break below this puts next support at 1090 (Sep-2016 low). Resistance at 1135 levels (50, 100, 200 DMAs). Risk skewed to the downside.

SGD: Higher UST Yields to Weigh

Forecast	4Q 2017	1Q 2018	2Q 2018	3Q 2018
USDSGD	1.3700 (1.3500)	1.3750 (1.3550)	1.3650 (--)	1.3700 (--)

Previous forecasts in parenthesis

- **Motivation for the FX View:** USDSGD has been on the grind higher in Oct, touching a near three-month high of 1.3714 on 27 Oct. Since then the pair eased off from that high to hover around the 1.36-levels currently. Powering the pair higher are the prospects of higher UST yields rate hikes on the potential for tax reforms by end-1Q 2018, the possibility of a more hawkish Fed (with the upcoming appointment of a new Fed Chair) and softer EUR on ECB's dovish taper. This bounce in UST yields in Oct weighed on the SGD, which dipped by 0.4% against the USD month-to-date. This dip though did not make a significant dent on the overall strength of the SGD so far this year. The SGD has gained 6.1% against the USD year-to-date, the second best performing currency in ASEAN.

- The resilience of the SGD so far this year is attributable to the lack of Trump reflation trades and the healthy macroeconomic fundamentals of the economy led by the synchronized recovery in exports in the region. These have played a part in dampening aggressive upside in the USDSGD. In addition, the government's mildly expansionary fiscal policy, which together with still accommodative monetary policy, its triple-A status and persistent balance of payments surpluses, have also been supportive of the SGD and have capped overly aggressive climb in the USDSGD.

- To date, the ongoing synchronized recovery in exports in the region, and the historically low volatility environment as reflected in the equity and FX volatility indices have spurred greater flows into emerging market assets, including those in Singapore. This should be supportive of the SGD. Risk to this is that episodes of global risk-off could re-emerge, spurring a sell-off in regional equity assets, including Singapore, and weigh on the SGD, posing upside risk to the USDSGD.

- However, recent developments have weighed on the SGD. The progress made on tax reforms in the US in particular amid strong US data has reignited global reflation trades. In addition, the decision by

MAS to maintain its neutral policy has provided little impetus for a higher SGD. As we had previously cautioned in our previous Monthlies, our underlying assumption remains for the USDSGD to be supported in the next three-six months, underpinned by rising UST yields. UST yields should continue to climb higher given on US tax reforms expectations, steady US economic growth, the Fed normalization of its USD4.5tn balance sheet beginning in Oct and expectations of even more rate hikes in 2018 (we expect at least 2 rate hikes in 2018).

- We are now looking for the global reflation trade to come in 1Q 2018 instead of 2H given the progress made so far on tax reforms in the US. As we are observing currently, there is a re-pricing of US reflation trades with UST yields rising in anticipation. Aside from USD moves, the rise in UST yields is likely also to have a significant impact on the USDSGD, given that the USDSGD is one of the most sensitive currency pair to moves in 10Y UST yields. This rise in UST yields is likely to narrow the yield differentials between the UST and SGS (assuming no change in SGS yields) and result in outflow of funds back to the US, lifting USD and support the USDSGD higher.

- As our previous forecast built in a MAS adjustment in Oct that would mitigate USD strength in 4Q 2017, we had tweaked our USDSGD forecast accordingly. In the absence of any monetary policy impulse, we now expect the SGD to fall more aggressively against the USD to 1.37 by end-2017 and then climb higher to 1.3750 by end-1Q 2018 on US tax reforms kicking in. The MAS tightening move at its Apr 2018 meeting should provide the SGD with a lift and weigh on the USDSGD even as market re-prices US reflation trades. We expect the pair to moderate to 1.3650 in 2Q 2018 rebounding to 1.37-levels by end-3Q.

- **Singapore's monthly Maybank Vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) was improved to 4.2 from 4.3. This should be supportive of the intrinsic value of the SGD. Our model shows that the SGD NEER at 0.86% above the mid-point implied at 1.3732. Upper bound is implied at 1.3459 while lower bound is now at 1.4004.

Growth and Inflation Outlook: Advanced estimates for 3Q 2017 showed the economy accelerating sharply by 6.3% (4.6% y/y) q/q seasonally-adjusted (sa) annualised from 2.4% (2.9% y/y) in 2Q. This was the fastest pace of the economy has expanded since 4Q 2016 (12.3%). Driving growth in 3Q was manufacturing, which accelerated 23.1% q/q sa annualised (2Q: 3.2%). Manufacturing drivers have broadened beyond electronics to include precision engineering and biomedical manufacturing. Services growth however did not match its previous pace, expanding by just 1.5% in 3Q compared to 3.3% in 2Q. Construction remained a drag on growth, contracting by 9.2% q/q sa annualised (2Q: 2.4%). Despite its lackluster performance in 3Q, our economic team expects services to contribute a greater proportion to growth as the recovery broadens to more domestic-oriented sectors and manufacturing cools off. Consequently, they have upgraded their full-year growth outlook to 3.2% (from 3.0%) for 2017 and 2.5% (from 2.4%) for 2018. For now, MTI maintains its 2-3% forecast range for 2017 but our economic team expects an upside revision to 3.0-3.5% in mid-Nov when the finalized 3Q17 GDP is released as growth has been averaging 3.3% in the first three quarters. For 2018, MTI and MAS are guiding for steady growth albeit at a slower pace compared to 2017. The team expects MTI to release a 1.5-3.5% forecast range for 2018 as a start in Nov.

- Headline inflation continues its slow grind higher, still hovering below the 1.0%. Headline inflation rose by 0.4% y/y in Sep, unchanged from the Aug's pace, weighed by private transport costs. Core inflation (headline inflation less accommodation and private transport costs) picked up to 1.5% y/y (Aug: 1.4%), lifted by services inflation. Year-to-date, headline and core inflation have averaged 0.6% and 1.5% y/y. Our economic team expects inflationary pressure to creep higher in 2018 after likely coming in lower than expected in 2017. There are downside risks to the team's 2017 headline inflation forecast of 0.9%. Its forecast of 1.6% for core inflation for 2017 remains. For 2018, the team expects headline and core inflation to rise to 1.2% and 1.7% respectively, driven by the cyclical economic recovery and rising services and commodity prices, as well as higher transport cost following the government's zero growth plan for all vehicles starting in Feb 2018. MAS expects core inflation to come in around 1.5% this year and then to average 1-2% in 2018. Headline inflation is expected at 0.5% in 2017 and then hover in the 0-1% range in 2018 on the back of higher housing costs.

- Consequently, the MAS has adjusted its inflation forecast to a point estimate of around 1.5% (mid-point of its earlier 1-2% forecast range) for core inflation and 0.5% (lower bound of its 0.5-1.5% range) for headline inflation. Our economic team is looking for core and headline inflation to come in at 1.6% and 0.9% respectively for 2017. MAS expects both external and domestic factors to keep inflationary pressures modest in 2018. "(I)mported inflation is likely to rise mildly, as global demand improves amid ample supply in key commodity markets", while economy-wide cost pressures should remain relatively restrained as wage pressures are unlikely to accelerate in the near term given that the slack that had previously accumulated will take time to be fully absorbed and other non-labor costs such as commercial and retail rents stay subdued. MAS is forecasting core and headline inflation to average 1%-2% and 0%-1% respectively in 2018. Our team is more hawkish on inflation, expecting inflation at the upper ranges of the official forecasts.

- **Monetary Policy Forecast:** MAS maintained its neutral policy, i.e. the zero appreciation path of the SGD NEER, at its 13 Oct bi-annual meeting in line with consensus expectations. MAS also kept the width and center of the policy band unchanged as well. This though was contrary to our house call for the MAS to shift to a 'slight appreciation bias'. The decision to keep policy intact was motivated by the absence of (1) any sharp domestic growth momentum (MAS expects the economy "to expand at a steady, but slightly slower, pace in 2018 compared to 2017") and (2) inflationary pressures (where "core inflation is expected to trend towards but average slightly below 2%" in the medium term). Despite the MAS move to keep the current neutral policy in place for a while longer, our Taylor Rule estimates for the SGD NEER continues to show that the SGD NEER is expected to strengthen ahead. SGD NEER is expected end 2017 at around 126.86 and then to 128.43 by end 2018. The implied USDSGD forecasts corresponding to the SGD NEER estimates range from 1.3415 - 1.3580. Based on our analysis, normalizing policy by shifting to a 'slight appreciation bias' remains appropriate. We now expect such a move to take place at the MAS' Apr 2018 meeting.

- Note that MAS chief Ravi Menon had warned against complacency even as inflation remained well below the historical average. The MAS remains on watch against inflation but "as long as inflation remains benign, the currency policy stance has been appropriate". Though the forward guidance that the policy stance remained appropriate for an extended period was fuzzy in the MAS statement, Menon commented that "it will be hard to extrapolate from here how long more that extended period will be". Nevertheless, this does not distract from the fact that growth has recovered strongly and that policy will have to be normalized.

- The USDSGD has come off from its near two-month high at 1.3714 (27 Oct) but could re-test that level in coming weeks. Pair is currently seen around 1.36-levels. The swing in the USDSGD has seen the 3-month SOR (3MSOR) touch a 2017 high of 1.023% on 25 Aug before coming off to hover around the 0.94% levels at the point of writing. The 3-month SIBOR (3MSIBOR) remains elevated and was last seen around the 1.126% levels. The still modest rise in rates suggests that the rise in mortgage rates remains on the slow grind higher. Deposit rates (for 12-month fixed) have also not risen since end-Jan but has remained at 0.33%. This continues to suggest that risks related to interest rate increases affecting financial and economic stability, particularly in interest rate- and property-related sectors, seems limited for now, though the risk could be rising.

- Upward pressure on domestic rates remain with Fed balance sheet reduction starting in Oct and a further Fed rate hike penciled in for Dec. US 3MLIBOR continues on its upward trajectory and is currently hovering around 1.3625%-levels at the point of writing, just off the 8-year and 2017 high of 1.3626% on 18 Oct. Ample liquidity has so far kept domestic rates from tracking the US 3MLIBOR higher though, allowing domestic rates to continue with its rather slow grind higher. For now, we expect the 3MSIBOR and 3MSOR edge higher to 1.46% and 1.24% respectively by end-2017. For next year, we expect the rates to accelerate to end 2018 at 1.87% and 1.65% respectively.

- **Latest Fiscal and External Balance Outlook:** The government's operating revenue rose to SGD18.96bn in 2Q17 from SGD16.60bn in 1Q17, while its operating and development expending slipped to SGD10.86bn and SGD4.36bn in 3Q to SGD17.74bn and SGD5.25bn in 2Q. This resulted in a budget surplus of SGD3.73bn in 3Q after a deficit of SGD6.39bn in 2Q. With the economy poised to expand at the upper bound of the government's 2-3% growth forecast range this year, there could be further upside to tax collection this year. This should provide more fiscal room for the government to spend and support the economy in 2018.

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

- **Key domestic events and issues to watch:** Final estimates for 3Q17 GDP will be released sometime 20-24 Nov.

- **Technical Outlook:** USDSGD traded higher in line with our caution for rebound risk. High was seen at 1.3714 (27 Oct) before easing lower; last seen at 1.3610 levels. Bullish momentum on daily chart appears to be waning while stochastics is falling from near-overbought conditions. Short term pressures could emerge for now. Support at 1.3550 (50 DMA), 1.3480. Resistance at 1.3720 (previous high). Bullish momentum on weekly chart, supports the case to buy on dips towards 1.3510 for a move back towards 1.3750, 1.38 objectives.

MYR: Trade Flows to Remain Supportive

Forecast	4Q 2017	1Q 2018	2Q 2018	3Q 2018
USDMYR	4.2500 (--)	4.2750 (--)	4.2000 (--)	4.1500 (--)

No Change from Previous Forecasts

- **Motivation for the FX View:** We remain positive on the Ringgit outlook given support for fundamentals remain intact as data released over the first two months of 2Q such as industrial production, retail trade and trade data remain positive. Besides, BNM initiatives to broaden and deepen the onshore financial markets remain intact and help to shore up confidence. We interpret these steps as positive development and expect foreign investors' confidence to gradually return. Thus far foreign investors interest in Malaysian equities and bonds, which have picked up the past few months has tapered into Oct with subdued portfolio capital flows so far in Oct 2017. Foreigners are net sellers of Malaysian equities so far this month (1-19 Oct 2017) at –MYR0.2b (vs Sep 217: –MYR0.7b). Meanwhile, our Fixed Income Research team does not expect foreign flows in the Malaysian bond market this month to be as vibrant as the +MYR9.3b net buy in Sept 2017, with the "worst case scenario" being a flat month (Oct 2017 data will be out by the end of first week of Nov 2017). Another

MYR19.7b worth of Government bonds will mature in 4Q 2017 i.e. MYR12.2b MGS and MYR7.5b GII, although we believe the risk of maturity-driven foreign selling in the domestic bond market has reduced as exemplified by the net foreign buying last month despite the maturity of MYR12.6b MGS.

- External reserves are well supported by trade flows so far this year amid stronger export growth (Jan-Aug 2017: +22.0%; Jan-Aug 2016: +1.0% YoY) and larger trade surplus (Jan-Aug 2017: +16.0% YoY to +MYR60.8b; JanAug 2016: +2.3% YoY; +MYR52.5b). We expect full-year 2017 trade surplus of +MYR90.2b or the equivalent of USD21.3b at current exchange rate.

- Trade flows still supportive of the MYR thus far. Export and import growth stayed robust in Aug 2017 at +21.5% YoY (July 2017: +30.9% YoY) at +22.6% YoY (July 2017: +21.8% YoY). Trade surplus widened +14.4% YoY to +MYR9.9b (July 2017: +MYR8.0b). Global manufacturing PMI, US ISM new orders index and intermediate goods imports point to firm external demand amid mixed signal on domestic demand as consumption goods imports surged while capital goods imports lagged. External demand firm with positive outlook. In Jul-Aug 2017, growth in export and import values picked up to +25.9% YoY (2Q 2017: +20.5% YoY) and +22.2% YoY (2Q 2017: +19.0% YoY), while trade surplus widened by +67% YoY (2Q 2017: +35% YoY). The bigger trade surplus suggests “net exports” or “net external demand” component of GDP will remain growth-accretive in 3Q 2017 (2Q 2017: +1.4% YoY; 1Q 2017: -14.5% YoY).

- Given improved investors’ sentiment, well-managed expectation for Fed rate hike given pricing in of forward guidance this year, less dependence on oil for revenue, and MYR being fundamentally and historically undervalued, we see scope for Ringgit to play catch up with regional peers and extend its gains towards 4.25 levels (vs the USD) for 4Q, before some strength in the USD early next year potentially supporting the pair at around 4.2750 in 1Q 2018. Our forecasts already reflect our concern that there could be some risk of delayed tightening by the Fed and further delays in a US fiscal stimulus and tax reforms.

- We reiterate our **long-standing bias that the Ringgit remains fundamentally undervalued.** Our fair value estimate (which takes into account interest rate differential, inflation differential, current account differential and reflation variables) puts USDMYR at 3.70 levels. We had previously said that Ringgit weakness was temporary and was not a reflection of underlying fundamentals (which remain intact). We believe stability is gradually returning to Ringgit as political/ contingent liability risk subsides, fiscal consolidation gains traction, oil prices continue to stabilize and uncertainty subsides. Solid underlying fundamentals and policies, backed by domestic demand, re-calibrated supportive budget (on a lower oil price assumption suggests flexibility in the fiscal space), relative stability in oil prices though some downside pressure exists, relative attractive yields in the MGS, stabilizing FX reserves to retained imports & short-term debt, accommodative monetary conditions (to support businesses) remain intact and should provide an anchor for MYR stability once short-term noises subside. We believe USDMYR range of 4.20-4.40 is likely to remain relatively sustained for 2017 and early 2018 before moving to a 4.05-4.20 range in the second half of 2018.

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

- Total gross external reserves rose +USD0.3b to USD100.8b at mid-Sep 2017 (end-Aug 2017: USD100.5b) amid signs of portfolio capital inflows given MYR gain so far this month. Current reserves level is also adequate to deal with potential capital flow risk based on its ratio to IMF's Assessment of Reserve Adequacy (ARA) metric of 115%.

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

- Headline inflation rate in Aug 2017 rose to +3.7% YoY (Jul 2017: +3.2% YoY) while core inflation moderated to +2.4% YoY (Jul 2017: +2.6% YoY). For Jan-Aug 2017, headline inflation rate was +3.9% YoY (Jan-

Aug 2016: +2.3% YoY) and core inflation rate was +2.5% YoY (Jan-Aug 2016: +2.7% YoY). Maintain our full-year 2017 inflation rate forecast at 3.5%-4.0% (2016: +2.1%) and view that there will be no change in OPR this year.

- After four consecutive months of deceleration, headline inflation rate picked up to +3.7% YoY in Aug 2017 (Jul 2017: +3.2% YoY; Maybank-KE: +3.3% YoY; Consensus: +3.4% YoY). The higher headline inflation was mainly contributed by "Food & Non-Alcoholic Beverages" and "Transport". Meanwhile, core inflation rate which excludes volatile food and energy prices as well as price-controlled/price-subsidised components of the CPI, including fuel prices) remained contained (Aug 2017: +2.4% YoY; Jul 2017: +2.6% YoY). Compared with Jul 2017, headline inflation rose +0.9% MoM (Jul 2017: -0.1% MoM) while core inflation was up by +0.3% MoM (Jul 2017: +0.2% MoM).

- Inflation in Sep 2017 accelerated to +4.3% YoY (Aug 2017: +3.7% YoY) while core inflation stable at +2.4% YoY (Aug 2017: +2.4% YoY). Similarly in Jan-Sep 2017, inflation faster at +4.0% YoY (Jan-Sep 2016: +2.2% YoY) while core inflation steady at +2.5% YoY (Jan-Sep 2016: +2.6% YoY). Adjust 2017 and 2018 forecasts to +4.0% (3.5%-4.0% previously) and 2.5%- 3.0% (2.0%-2.5% previously) on higher crude oil price assumption.

- Headline inflation rate picked up to +4.3% YoY in Sep 2017 (Aug 2017: +3.7% YoY), contributed mainly by higher costs of "Transport" (Sep 2017: +15.8% YoY; Aug 2017: +11.7% YoY) and "Food & Non-Alcoholic Beverages" (Sep 2017: +4.6% YoY; Aug 2017: +4.3% YoY). Meanwhile, core inflation rate, which excludes volatile food and energy prices as well as price-controlled/price-subsidised components of the CPI, including fuel prices) remained stable (Sep 2017: +2.4% YoY; Aug 2017: +2.4% YoY). For Jan-Sep 2017 period, headline inflation rate was +4.0% YoY (Jan-Sep 2016: +2.2% YoY) while core inflation rate was +2.5% YoY (Jan-Sep 2016: +2.6% YoY).

- Our economics team maintains their view that monthly inflation rate has peaked in Mar 2017 despite the recent fuel price-driven pick up in inflation amid the advance in global crude oil prices. Assuming global crude oil prices stay around current level for the rest of the year, we estimated that monthly inflation rates will average +4.3% YoY in Oct 2017 and +3.5% YoY in NovDec 2017, keeping quarterly inflation rate at +3.8% YoY this quarter, the same as last quarter. Consequently, we see headline inflation this year coming in at the upper end of our forecast range of 3.5%-4.0% (official 2017: 3.0%-4.0%; 2017YTD: +4.0%; 2016: +2.1%). With our revised assumption that crude oil price will average higher at USD52.5/bbl in 2017 (USD51.8/bbl previously) and USD55/bbl in 2018 (USD52.5/bbl previously), we adjust 2017 and 2018 headline inflation rate forecasts to +4.0% and to 2.5%-3.0% (2.0%-2.5% previously).

- OPR to stay at 3.00% this year. Overnight Policy Rate (OPR) will be kept at 3.00% p.a. at the final BNM's Monetary Policy Committee (MPC) meeting of this year on 9 Nov 2017. We see little motivation for BNM to alter current monetary policy stance amid current favourable macro conditions as per the faster economic growth this year which is accompanied by stable core inflation – suggesting "demand-pull" and "wage-driven" inflationary pressures are contained, improved MYR, sustained current account surplus and rising external reserves amid gradual monetary policy normalization by US Fed. At this juncture, we priced in a modest +25bps OPR hike in 2H 2018.

- **Monetary Policy Forecast:** BNM kept the Overnight Policy Rate (OPR) at 3.00% after its MPC meeting on 6-7 Sep 2017. Monetary Policy Statement (MPS) continues to reflect BNM outlook of better-than-expected growth this year with moderating inflation. Maintained our view that OPR will stay at 3.00% at the final MPC meeting for the year on 8-9 Nov 2017, followed by a modest +25bps hike in 2018.

- Similar to the previous MPC meeting, the Monetary Policy Statement (MPS) indicated that BNM expect this year's real GDP growth to come in better than expected amid the synchronized and entrenched strengthening of global economic growth that lifted global trade, hence Malaysia's exports. This is on top of the favourable factors underpinning consumption and investment that support domestic demand, namely improving incomes and labour markets conditions, new and ongoing infrastructure projects, and sustained capital investment by firms in the manufacturing and services sectors. Current official 2017 real GDP growth forecast is a range of +4.3% to +4.8%, and we expect this to be revised upward to above +5.0% when Budget 2018 is tabled at the Parliament on 27 Oct 2017, together with the release of the Government projection for 2018. Our 2017 and 2018 real GDP growth forecasts are +5.5% and +5.1% respectively (1H 2017: +5.7%; 2016: +4.2%).

- At the same time, BNM maintained its view that headline inflation will moderate for the rest of 2017 (Jan-Jul 2017: +4.0% YoY; 2016: +2.1%), reflecting the waning effect of "cost-push" factors, while core inflation will be sustained by robust domestic demand but remain contained (Jan- Jul 2017: +2.5% YoY; 2016: +2.5%).

- No change in our view of OPR staying at 3.00% this year. Overall, we see BNM is comfortable to keep the current monetary policy stance unchanged this year amid positive growth momentum, receding inflationary pressures and the stabilisation and strengthening of MYR. Additional motivation to maintain OPR at current level is the uncertainties to the outlook coming mainly from political and policy developments in the major economies as well as geopolitical risk.

- **Latest Fiscal and External Balance Outlook:** Budget 2018 balances between maintaining fiscal discipline; addressing current socio-economic issues such as cost of living, affordable housing, equality and inclusivity; as well as preparing economy, businesses and people for the future.

- Following the +5.7% real GDP growth in 1H 2017, the official growth forecast for 2017 is raised to 5.2%-5.7% from 4.3%-4.8% previously. The 5%-plus growth is expected to continue in 2018 at 5.0%-5.5%. 2017 budget deficit aim remains at -3.0% of GDP and achievable, followed by 2018 target of -2.8% of GDP, continuing fiscal consolidation since 2010.

- 5%-plus real growth in 2017 to be sustained in 2018.Following the pick up in real GDP growth to +5.7% in 1H 2017 from +4.2% in 2016, the official growth forecast for 2017 is revised higher to 5.2%-5.7% from 4.3%-4.8% previously. This 5%-plus growth is expected to be sustained in 2018 at 5.0%-5.5%. To note, the Ministry of Finance's Economic Report 2017/2018 gives real GDP values for 2017 and 2018 of MYR1,168.4b and MYR1,228.8b respectively, meaning real GDP point growth forecasts of +5.4% this year and +5.2% next year. **This is in line with our current forecasts of +5.5% this year and +5.1% next year.** We are keeping our forecasts. To note, 3Q 2017 GDP numbers is scheduled to be released on 17 Nov 2017.

- Budget 2018 is broadly in line with Maybank Economics team preview note ("Balancing Short-Term Populism & Long-Term Agenda",4 Oct 2017) as the allocations, incentives and measures have that mix of the "now" and the "future". The "now" of Budget 2018 is about tackling on-going issues and concerns among the peoplesuch ascost of living, affordable housing, equality and inclusivity.There are over MYR12b to boost disposable incomes for the bottom 40% (B40) and the middle 40%(M40) income groups, which include the continuation of BR1M, the surprise 2ppts cut in personal income tax rate and various other financial assistances for specific target groups as per our expectations. This is complemented by around MYR9.0b-MYR9.5b to address cost of living issue. Meanwhile, MYR2.2b is allocated to complete and construct 385,000 units of affordable homes under various programmes, while the step-up financing scheme introduced in Budget 2017 for purchase of affordable housing build by PR1MA is expanded to include private housing developers.

- Another notable aspect of Budget 2018 is the focus on equality and inclusivity, especially to raise women labour force participation rate, investing in future generation's education, supporting minority groups and addressing income/wealth gap. Budget 2018 also addresses long-term issues such as raising contribution of productivity to growth and labour productivity, reducing dependence on foreign workers, and "future-proofing" businesses and people. Measures include tax incentives, funding and grants for companies and businesses to automate and adopt "Industry 4.0" technologies, and support the necessary human capital development and investment, namely MYR4.9b allocation to implement the TVET Malaysia Masterplan.

- Budget 2018 also focus on future growth drivers given the allocations and incentives that benefit and promote SMEs, Tourism, "Digital Economy", Financial Services (specifically for the development of capital market and venture capital industry) and Principal Hub.

- Infrastructure remains a key feature, and the emphasis on the "now" and the "future" is reflected by the reiteration on multi-year multi-billion Ringgit major transport infrastructure projects that are balanced with MYR14.0b allocations to improve existing basic, social(healthcare, education)and rural infrastructure.

- **Key domestic events and issues to watch:** BNM policy decision (9 Nov); Trade data (3 Nov); FX reserves (7, 22 Nov); Industrial Production (9 Nov); CPI (22 Nov); Nikkei Malaysia PMI (1 Nov).

- **Technical Outlook:** Our call for mild rebound risks (in last month's FX Outlook) saw USDMYR traded a high of 4.2440 (27 Oct). Last seen at 4.2280 levels. Mild bullish momentum shows signs of waning while stochastics shows tentative signs of turning lower from near overbought conditions. Pair may drift lower. Next support at 4.20, 4.18 levels. Resistance at 4.2590 (100 DMA).

IDR: Fading Carry Trades Weighs

Forecast	4Q 2017	1Q 2018	2Q 2018	3Q 2018
USDIDR	13600 (--)	13700 (13600)	13600 (13700)	13600 (13650)

Previous forecasts in parenthesis

- **Motivation for the FX View:** The IDR has been on downswing since touching a 2017 high of 13126 levels on 11 Sep. This downside pressure on the IDR can be attributed to the unwinding of IDR carry trades on prospects of higher UST yields on the back of developments in the US. These included the potential for corporate tax cuts in the US to come in by end-1Q 2018, the possibility of a more hawkish Fed (with the upcoming appointment of a new Fed Chair) and softer EUR on ECB's dovish taper. At the same time, the BI's two 25bp cut to its benchmark policy rate has put domestic yields under pressure as well. Consequently, the IDR has fallen to a new 2017 low of 13651 on 27 Oct though it has since rebounded slightly to hover below the 13600-levels at the point of writing. So far in Oct, the IDR has weakened by 0.75% against the USD, making the second worst performer in ASEAN after the Philippines. We remain bearish IDR for the next three to nine months.

- Macro-fundamentals in Indonesia remain healthy. Domestically, the current account deficit (CAD) is poised to improve though some deterioration is expected in the near term as the government embarks on infrastructure building, while economic reforms are ongoing. BI expects CAD to average 1.91% of GDP in 2H, and this together with 1H CAD at 1.5%, full-year CAD should come in at 1.7% of GDP. It is also important to note that the CAD can be attributed to capital goods import for infrastructure building, which should eventually lift potential growth higher. These have helped to keep the IDR supported amid external headwinds. Though real GDP is currently hovering around the 5% levels so far, but is expected to accelerate in 2018, aided in part by the two rate cuts by BI so far this year. In addition, the 15 reform/stimulus packages introduced so far that should help to cut red tape and liberalize rules that have been a drag on the economy. The government's infrastructure push should also be supportive of growth ahead.

- The steps taken by the government under the watchful eyes of Finance Minister Sri Mulyani to rein in the budget deficit should also be supportive of the IDR. Unlike the previous year where the focus was on raising revenue, efforts this year are on cutting unnecessary expenditure. Reducing waste and using resources more efficiently should provide the government in 2017 to push forward its ambitious USD400bn infrastructure building programme. This should not only lift potential growth but the IDR as well.

- We caution that there could be some slowdown in inflows to Indonesian debt, though not necessarily a complete reversal of flows. So far, the historically low volatility environment as reflected in the equity and FX volatility indices has spurred greater flows into emerging market assets, including those in Indonesia. Year-to-date to Sep, foreign investors have purchased USD10.1bn in Indonesian debt compared to the USD7.65bn purchased for the whole of 2016. The unwinding of carry trades should put foreign holdings of debt under pressure. So far in Oct, foreign funds have sold off USD1.05bn in debt. Further sell-off is likely as carry trades wane and this should weigh on the IDR ahead.

- The move away from the IDR as a carry trade is likely to persist given the narrowing yield differentials between UST and Indonesian debt. This should weigh on Indonesia assets and the IDR in the quarters ahead. Already the IDR has generated volatility-adjusted carry trade returns of -1.5% in Oct, the second consecutive month of decline. In addition, there are other risks to our IDR outlook, including the potential disruption to global trade from restrictive trade policy in the US that could moderate the synchronized export recovery in the region. These risks are likely to diminish the attractiveness of the IDR carry trade and could potentially spur a sell-off in Indonesian assets. Note though that interest in Indonesian debt could re-ignite given Indonesia's strong fundamentals currently as and when carry trade resumes. This should be supportive of the IDR.

- We expect more moderate inflows into Indonesian debt consequently, especially after the recent policy rate cut by the BI. At the same time, UST yields have started to spike on the back of a confluence of factors, namely expectations of more Fed rate hike (we are expecting at least two more hikes in 2018) and optimism over the progress of tax reforms in the US. This jump in UST yields have increased the risk to emerging market, including Indonesia, that domestic rates will have to rise in tandem to prevent portfolio outflows.

- There have been talks swirling that S&P is looking to upgrade Indonesia's credit rating status. Coordinating Minister for Maritime Affairs Luhut Pandjaitan suggested that S&P was planning to lift the credit rating to BBB from BBB- currently sometime next year. FinMin Sri Mulyani suggested that this optimism could be due to the progress Indonesia has made on economic reforms, including paring its twin deficits – the fiscal and current account. An upgrade by S&P would be positive for the IDR as it should lead to a repricing of Indonesia assets, spurring greater inflows. We however do not expect a credit rating upgrade anytime soon with any such move to come on in the latter part of 2018.

- Given the recent market developments, we now expect US reflation trades to kick in early than expected in 1Q 2018 instead of 2H 2018. This suggests supported UST yields and USD that should lift USDIDR higher by end-1Q 2018 to 13700 from 13600 at end-2017. Thereafter BI is poised to hike its benchmark rate by end-2Q 2018 as expected by our economic team and this should be supportive of the IDR. The USDIDR is projected to come in at 13600 by end-2Q and hover at those levels in 3Q.

- **Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for Indonesia was again unchanged at 5.2. This should be supportive of the intrinsic value of the IDR.

- **Growth and Inflation Outlook:** 3Q17 GDP is expected to be released sometime in early Nov. BI is upbeat about domestic economic prospects, led by improvement in household consumption and improvement in government spending. Despite car and motorcycle sales declining in Sep (by -5.7% and 1.7% y/y respectively in Sep), car and motorcycle sales remained robust in the three months ending Sep, expanding by 7.3% and 18.1% y/y. External demand remains healthy as the synchronized recovery in exports in the region continues. At the same time, imports accelerated in Sep, rising 13.13% y/y in Sep after moderating to 9.08% in Aug, signaling some pick up in consumption and investment spending. Meanwhile, the cyclical economic recovery in the region is boosting demand for exports. Exports continue to expand at a double-digit pace of 15.6% y/y in Sep, though this was a slowdown from Aug's 19.41%. Key driver of growth ahead remains President Jokowi's USD400bn infrastructure program that should not only bolster growth in the near term but also potential growth. The government has pledged to disburse the state budget in 4Q 2017 to ensure growth remains strong through year-end. Moreover, the two rate cuts by BI this year should be supportive of growth as well. This optimism in the economy has led BI governor Agus Martowardojo to project growth to come in at 5.1-5.2% in 2H 2017 compared to 5.01% in 1H. BI expects 2017 growth to remain within its 5.0-5.4% forecast range for the full-year before accelerating to 5.1-5.5% in 2018. Our economic team is not as sanguine even as they expect the government's fiscal push to drive growth for the rest of the year and into 2018, penciling full-year growth to come in at 5.07% for 2017. The team expects growth to accelerate to 5.30% for 2018.

- Headline inflation has remained below the 4.0% levels for three straight months. Headline inflation rose by a more moderate 3.72% y/y in Sep compared to 3.82% y/y in Aug. This could be attributed to lower food prices (up 1.04% y/y in Sep vs. 1.51% in Aug), the continued slippages in housing and health costs (Sep: 5.58% and 3.25% vs. Aug: 5.66% and 3.43% respectively) and lower transport cost (Sep: 4.71% y/y vs. Aug: 4.89%). Core inflation dipped to the 2% levels for the first time since inflation data was rebased. Core inflation accelerated by 3.00% in Sep from 2.98% in Aug. Our economic team expects inflationary pressures to be tamed for the rest of 2017. Food prices should remain benign, helped not only by the government's readiness to import food supplies but by good weather as well. Just as important, the government is halting moves to increase petrol, fuel, gas and power tariffs until the end of the year that should help to restrain price pressures. The team expects headline and core inflation to average 3.86% and 3.18% in 2017 respectively, which is in line with BI's projection for headline inflation of 3.0-5.0% for 2017. For 2018, the team is looking for a slightly easing in consumer prices with headline and core inflation averaging 3.79% and 3.11% for the full-year.

- **Monetary Policy Forecast:** After cutting its benchmark 7-day reverse repo rate twice by 25bp each time at its previous two meetings, BI hit the pause button and left its policy rate unchanged at 4.25% at its 19 Oct policy meeting. At the same time, the deposit and lending facility rates were held steady at 3.50% and 5.00% respectively. This meant that the interest rate corridor was maintained at 75bp on either side of the policy rate. The BI decision was not unexpected. Despite subtle pressures from the President, the governor Agus Martowardojo had said that further moves by the central bank would be data-dependent. With growth expecting to come in within the BI's 5.0-5.4% estimate amid benign inflation (expected to stay below 4% for the remainder of 2017), there is little need for further monetary impulse. Instead, focus will be to maintain macroeconomic stability as well as IDR stability given likely external pressures ahead (from possible Fed rate moves in Dec, US tax reforms etc.).

- With two more policy meetings left for the rest of the year, we think that further moves by BI will be data-dependent, particularly inflation and growth data. Should credit growth remain lackluster and fail to pick up towards its 10-year (2007-2016) average of 19%, the risk of further rate adjustments by BI rises. Still, we think that the central bank will be patient and allow the two previous rate cuts to work their way into the economy as well as to gauge their effectiveness on credit growth. In addition, we think that BI may have to tread with care as external risk may intensify especially with G7 central banks on a tightening bias. This suggests that the room for further rate cut could be limited for the rest of the year. Our economic team does not expect any further rate cut this year.

- Aside from rate cuts, we cannot discount the possibility that BI turn its focus on macro-prudential policies as well to lower lending cost and boosting growth. Already BI has announced that it would allow commercial banks to include holdings of corporate bonds as part of loan-to-funding ratio as well as relaxation of financing-to-funding ratio, allowing more lending room to banks. Further macro-prudential measures will be rolled out by the central bank "soon".

- **Latest Fiscal and External Balance Outlook:** The parliament has approved the government's 2018 budget proposals on 25 Oct. The 2018 budget targets growth of 5.4% - the highest in 5 years. To achieve this growth target, the government intends to push spending as reflected in the record government spending of IDR1455.5tn. The 2018 budget aims for total expenditure of IDR2220.7tn vs. revenue of IDR1804.7tn. Even then, the budget short-fall is expected at 2.19% of GDP in 2018, lower than this year's projected deficit of 2.67% of GDP. This is more optimistic than our economic team's projection of -2.5% of GDP. Other assumptions approved by parliament include inflation at 3.5% and the exchange rate at 13400 per USD.

- The current account deficit (CAD) is expected to come in at 1.6% of GDP in 3Q 2017 compared to the 1.96% recorded in 2Q. The narrower deficit is likely due to the improvement in the goods and services surplus. Note that this surplus was at USD2.48bn in 2Q. For the full-year, the BI does not expect the CAD to exceed 2% of GDP in 2017. Our economic team now expects the CAD to widen even more to 1.50% of GDP from 1.38% previously. The team continues to expect greater import of capital goods to support the government's infrastructure program to underpin the CAD in 2017.

- **Key domestic events and issues to watch**: 3Q 2017 GDP will be released sometime 6-7 Nov. BI policy meeting begins on 15 Nov with the policy decision to be released on 16 Nov.

- **Technical Outlook:** USDIDR was last seen at 13550 levels. Bullish momentum on weekly and daily chart shows signs of waning while stochastics is falling from overbought conditions. Pair may face some downside pressure. Next support at 13530 (23.6% fibo retracement of Sep low to Oct high, 21 DMA), 13450 (38.2% fibo). Resistance at 13590, 13650 (recent high).

PHP: Weighed By External And Domestic Headwinds

Forecast	4Q 2017	1Q 2018	2Q 2018	3Q 2018
USDPHP	52.00 (--)	52.00 (--)	51.80 (--)	51.50 (--)

No Change to Previous Forecasts

- **Motivation for the FX View:** The PHP is once again the worst performing currency in ASEAN with the PHP declining by 1.6% against the USD in Oct. This move from best performer in ASEAN in Sep to the worst in Oct is largely due to both domestic and external factors. Externally, USD and UST yields found support from the potential for corporate tax cuts in the US to come in by end-1Q 2018, the possibility of a more hawkish Fed (with the upcoming appointment of a new Fed Chair) and softer EUR on ECB's dovish taper, which in turn weighed on the PHP. Domestically, question marks have started to pop up regarding the passage of the tax reform bill in the Philippines Senate. Comments by two senators seem to point to a delay in the passage of the tax reform bill till next year. The lack of progress on this front weighs on investor sentiments and hence the PHP. In addition, PHP faces downside risk from deteriorating current account. Together, these factors should be supportive of narrowing yield differentials between the UST and Philippine debt that should keep the USDPHP supported above the 51-levels for the rest of the year and into 2018. However, expectations of two 25bp rate hikes by the BSP in

2Q and 3Q 2018 should provide the PHP with a lift in those two quarters. Nevertheless, we remain bearish on the PHP in the next three-to-six months.

- The outlook for global rates to tick higher remains intact for the next three-to-six months as the advanced economies tighten policy, particularly in the US. The Fed remains on the tightening bias (one more hike in Dec and at least two more in 2018) and has started the process of unwinding its balance sheet. At the same time, US tax reforms and the re-emergence of US reflation trades could now kick-in earlier in 1Q 2018 instead of 2H, which should be supportive of UST yields and USD. We expect UST yields to remain elevated consequently and the narrowing yield differentials between the UST and Philippines sovereign bond could exacerbate portfolio outflows. With the USDPHP among the most sensitive to UST yields, rallies in UST yields should lift the USDPHP higher and possibly towards the 52-handle by end-2017 and into 1Q 2018.
- Market had been optimistic regarding the tax reforms introduced by the government. Though the Philippine Senate's version of tax reforms differs from the one passed by the House, both versions offer cuts to personal income tax and raise excise tax on fuel, new cars and sugary drinks with the differences coming from the threshold for exemption from income tax for the former, and the amount of tax for the latter. The other glaring difference is that the House tax bill is expected to generate PHP82bn in annual revenues, half of the projected PHP162bn originally proposed by the Department of Finance, while the Senate's version would raise at least PHP130bn. The differences though can be reconciled once the Senate passes its version of the tax reform bill. Passage and implementation of tax reforms would have provided a further lift to investor confidence and spur both portfolio and FDI inflows, keeping the PHP supported.
- The sticking point now is that the Senate could delay debating the bill till next year given its packed agenda for the remaining session in Nov-Dec. Passage of the bill is likely then in 1Q 2018 when the Senate session resumes on 15 Jan. Delay in the passage of the bill by the Senate could hold up funding for the government's ambitious PHP8tn infrastructure programme that includes new roads, railways, bridges and airports. The lack of progress should weigh on investor sentiments and lead to some pullback in portfolio flows into Philippine assets. Already foreign investors have purchased just USD1.9mn in equities so far in Oct compared to the USD569.87mn purchased in Sep. This moderation in foreign portfolio inflows should weigh on the PHP.
- Also underpinning PHP weakness is the deteriorating current account. Latest data showed a shortfall of USD0.23bn or 0.2% of GDP in 1H 2017. The BSP expects the current account to slip into its first deficit in 15 years of USD0.60bn in 2017 and this suggests the short-fall will extend into 2H. The delay in the passage of the tax reform bill as well as the deteriorating current account is likely to encourage greater short net-PHP bets, which are supportive of the USDPHP. We continue to look for the USDPHP to remain elevated at the 52-levels in 4Q 2017 and 1Q 2018.

- Monetary tightening in 2017 is unlikely given that growth is still expanding at a healthy above-6% pace and inflation manageable and well-within the central bank's comfort zone of 2-4%. Our economic team notes that manageable inflation outlook should allow the central bank to maintain its current accommodative policy to support domestic growth momentum for a while longer. The absence of monetary action by the BSP this year should keep the USDPHP supported above the 51-handle in 2017. Going into 2018 though, the central bank should be on a tightening bias as inflation is expected to accelerate as the economy continues to outperform and as the tax reform bill comes into effect (possibly by the latter part of 1Q 2018). Our team is looking for two 25bp rate hikes in 2018, possibly in 2Q and 3Q, which should be supportive of the PHP. This could help the USDPHP to taper off to 51.80 and 51.50 by end-2Q and end-3Q 2018 respectively.

- Despite the slowdown in portfolio inflows, we expect the pace to pick up again once the tax reform bill is passed in 1Q 2018. Continuing inflows into the Philippines equity market should be supportive of the PHP. Our expectations are premised on the favourable valuations in the stock market after the sell-off in the equity market between Aug 2016 and Mar 2017. According to our estimates using the Cyclical Adjusted P/E (CAPE) ratio, equities are now relatively cheaper (as reflected by estimated P/E ratios minus their 5-year average P/E ratios) compared to its peers and this could attract even greater foreign inflows. We are already seeing greater inflows into Philippine equities with foreign investors having purchased USD1.07bn year-to-date compared to just USD83.39mn for the whole of 2016. Further inflows should go some way to mitigate some of the downside risks to the PHP and weigh on the USDPHP.

- We maintain our forecast for the USDPHP to head higher towards the 52-handle by end-4Q 2017 and to hover around that level by end-1Q 2018. Thereafter the USDPHP is expected to ease off to around 51.80 and 51.50 by end-2Q and -3Q 2018 on stronger domestic economic fundamentals and the two BSP rate hikes.

- Our monthly **Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, deteriorated to 4.9 from 4.8. This should weigh on the intrinsic value of the PHP.

- **Growth and Inflation Outlook:** The growth momentum seen in 2Q is expected to continue into 3Q and beyond supported by consumer and government spending. 2H 2017 pace of growth should be similar to 1H. Our economic team expects consumer spending to remain resilient in 2H 2017, supported by favorable demographics and job market conditions, sustained by overseas remittances. Overseas remittances average 5.4% in the Jan-Aug period, an improvement over the 2.8% decline for the whole of 2016. They also expect some acceleration in consumer spending towards the end of the year ahead of the possible tax hike should the proposed tax reform is passed before year-end. Should there be any delay in the passage of the tax reform bill by the Senate that results in a delay in implementing new infrastructure projects, our team expects growth to come in at the lower end of the government's 6.5-7.5% growth forecast for 2017. Support for growth is also likely to come from the synchronized recovery in exports in the region. So far this year, exports have increased by 13.3% y/y, while imports are up 8.2%, suggesting healthy external and domestic demand. Our economic team maintains their 2017 and 2018 growth projection at 6.4% and 6.5% respectively.

- Headline inflation accelerated for the third straight month in Sep, rising by 3.4% y/y from 3.1% in Aug. The main culprit was higher food prices, housing cost and transport, which were up by 3.6%, 3.8% and 4.8% y/y respectively in Sep from Aug's 3.5%, 2.8% and 4.4%. Core inflation (headline inflation less selected food items and energy prices) also accelerated, climbing by 3.3% y/y in Sep from 3.0% in Aug. For the Jan-Sep period, headline and core inflation averaged 3.1% and 2.9% y/y respectively. Our economic team expects base effects from relatively higher inflation rate towards end 2016 to limit upside to inflation in 2017, and maintains its 2017 and 2018 headline inflation forecast at 3.0% and 3.5% respectively. Our team sees upside risks to inflation on transitory impact of the proposed tax reform program and adjustments in transportation fares, though improvement in productivity should likely temper the impact on inflation over the medium term. For now, the BSP remains comfortable with inflation, maintaining its 2017 and 2018 inflation forecast at 3.2%, well-within its inflation target range of 2-4%. It has however revised upward its 2019 inflation forecast to 3.2% from 3.1%.

- **Monetary Policy Forecast:** There was no policy meeting in Oct. At its last meeting in Sep, the BSP left its key policy rate – the overnight reverse repurchase rate – unchanged at 3.0%. The overnight lending rate and overnight deposit rate were also left unchanged at 3.5% and 2.5% respectively, leaving the interest rate corridor symmetrical on either side of the policy rate by 50bp. The BSP has maintained the status quo since it moved to an interest rate corridor framework on 3 Jun 2016. The reserve requirement ratio (RRR) was also kept steady at 20%. It does not appear likely that any rate hike is in the cards for the remainder of the year. BSP governor Nestor Espenilla suggested that contained domestic inflation does not support the need for a rate hike, and the BSP need not automatically follow rate hike moves by major central banks, including the Fed. Any moves by the BSP would be data-dependent. Our economic team does not expect any moves by the BSP for the rest of the year given manageable inflation. The team though expects the BSP begin its tightening cycle in 2018 with two 25bp rate hikes penciled-in in 2018.

- **Latest Fiscal and External Balance Outlook:** The government fiscal balance returned to a deficit of PHP36.89bn in Sep from Aug's surplus of PHP28.81bn. Expenditure rose to PHP237.0bn in Sep from Aug's PHP201.6bn, while revenue moderated to PHP200.09bn in Sep from PHP230.41bn in Aug. For the Jan-Sep period, the fiscal deficit was at PHP213.1bn and looks unlikely to hit the level seen for the whole of 2016 at PHP353.42bn. The Finance Secretary was reported to have reiterated the government's plans to keep its budget deficit ceiling of 3% of GDP. This is even though the tax reform bill under consideration in Congress may not yield sufficient revenue to help fund massive infrastructure plan. So unless revenues can be increased or the ceiling raised, the government may have to cut its prized infrastructure programme to meet its budget deficit ceiling.

- For only the second time in 2017, there was a surplus in the balance of payments (BoP). After three straight months of deficits, the BoP saw a surplus of USD23.7mn in Sep. Detailed breakdown of the components of the BoP is unavailable at the point of writing. The deficit for the Jan-Sep period was USD1.37bn, wider than the USD0.42bn deficit for the whole of 2016. As for the current account, latest data showed the current account registered a shortfall of USD0.23bn or 0.2% of GDP in 1H 2017. The BSP continues to expect "a modest BoP shortfall for the year" of USD500mn (-0.2% of GDP), though this was an increased from 2016's –USD400mn (-0.1% of GDP). The current account is projected to record a deficit of USD600mn - its first deficit in 15 years.
- **Key domestic events and issues to watch:** BSP policy decision will be released on 9 Nov. 3Q 2017 GDP is on tap on 16 Nov. The Senate will take up deliberation on the first of five tax reform bills when it resumes its session on 13 Nov.
- **Technical Outlook:** USDPHP traded higher for the month of Oct. Last seen at 51.60 levels. Bullish momentum on daily chart shows signs of waning while stochastics is turning lower from overbought conditions. Pair could pull back towards 51.30 levels (23.6% fibo retracement of 2017 low to high), 50.90 (38.2% fibo). Resistance at 51.90 (recent high).

THB: Supported By Persistent Current Account Surplus

Forecast	4Q 2017	1Q 2018	2Q 2018	3Q 2018
USDTHB	33.50 (34.00)	34.00 (--)	33.70 (34.30)	34.00 (34.80)

Previous forecasts in parenthesis

- **Motivation for the FX View:** THB remains the best performing currency in ASEAN against the USD in Oct and in 2017 so far. The THB gained 0.34% against the USD in Oct, while it was up 8.23% against the USD so far this year. The resilience of the THB can be attributable to its strong current account position amid political calm so far this year. While up-to-date current account prints are not available, the most recent data showed the current account still in surplus in Aug. This strength in the THB was partially mitigated by the outflows from equities and debt in Oct amid higher UST yields on the potential for corporate tax cuts in the US to come in by end-1Q 2018, the possibility of a more hawkish Fed (with the upcoming appointment of a new Fed Chair) and softer EUR on ECB's dovish taper. At the same time, gains in the THB have been capped by the BoT intervention to offset THB strength as evident in the record foreign reserves of

USD199.30bn in Sep. This explains the modest gains in the THB against the USD in Oct. Given the strong current account position, we are now less bearish on the THB.

- As we had written previously, we do not expect the THB to dip aggressively because of its strong current account position. Thailand is only one of the few ASEAN economies enjoying not only current account surpluses but double-digit surpluses as well. Recent data showed the current account surplus at 10.6% of GDP for 2Q 2017. This persistent current account surplus (since 1Q 2014) should continue to put the spotlight on the THB vis-à-vis its regional peers (with the exception of Singapore) and backstop the THB against any aggressive moves to push it lower. On a monthly basis, the current account surplus widened to THB154.90bn in Aug compared to THB93.28bn in Jul. This persistent and strong current account surplus is expected to continue given that private consumption remains soft and the take-off in infrastructure spending has been gradual. The current account surplus should be positive for investor sentiment, and mitigate downside risks to the THB, helping to keep the USDTHB supported within 33-34 levels ahead.

- Also supportive of the investment climate is the current political calm in the kingdom. The year-long mourning period for HM the late King Bhumibol had helped to keep political tensions at bay for now. The pushing back of the general elections to Nov 2018 instead of the 1H 2018 should extend the political calm for a while longer. This is because the law limiting political discourse remains in-force and would be lifted only once the election schedule is announced. This announcement is expected in Jun 2018 when the organic laws governing the elections have been passed. Thus, simmering tensions could resurface in the run-up to the general elections in Nov 2018. The current political calm should provide the impetus for an economic growth recovery and investment inflows, keeping the THB supported around the 33-levels for now.

- The narrowing real yield differentials between 10Y UST and the Thai government bond has lowered the real return from investing in Thai debt and is spurring outflows from Thai government debt in search of higher returns elsewhere. Recent data showed real 10Y Thai bond yield at 1.43% in Sep vs. 2.0% in Aug, while US real bond yield rose to around 0.4% vs. Aug's 0.2%. This is reflected in the sell-off of USD551.5mn in Thai debt so far in Oct compared to the THB2.5bn purchased for the whole of Sep. This sell-off in debt together with the sell-off in equities of USD208.3mn weighed on the THB.

- With the BoT holding steady on monetary policy and the US rates on the upmove, we can expect the 10Y US-Thai debt yield differentials to narrow. The yield differential is expected to narrow even more as we expect US reflation trades to re-emerge in 1Q 2018. These moves could lift UST yields and support the USD even further. This in turn should keep the USDTHB supported going into 2018. Similarly, other major G7 central banks are either tightening or on the verge of tightening monetary policy and higher returns elsewhere could spur further outflows from Thai assets and weigh on the THB.

- We have tweaked our forecast for the USDTHB to reflect the relative strength of the THB so far. We now expect the USDTHB to end-2017 at 33.50 before bouncing higher to the 34-handle by end-1Q 2018 on the re-emergence of reflation trades. Thereafter, the moderation in USD strength by end-2Q 2018 should allow the USDTHB to ease off to hover around the 33.70 levels. Once the election date is announced, simmering political tensions should break into the open, weighing on investor sentiments and lift the USDTHB back to the 34-handle by end-3Q 2018.

- **Our Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for Thailand deteriorated to 4.4 from 4.1. This should weigh on the intrinsic value of the THB.

- **Growth and Inflation Outlook:** GDP data for 3Q set for release on 20 Nov should reflect the ongoing recovery in the economy. Growth has been accelerating since 4Q 2016 with 2Q GDP coming in at 3.7% y/y – the strongest pace of growth since 1Q 2013. The central bank's optimism about the economy is reflected in its strong outlook for growth in both 2017 and 2018. It expects the economy to expand by 3.8% for both 2017 and 2018, powered by external demand (tourism and exports) and gradual pick-up in domestic demand. Our economic team is as sanguine about the economy as the BoT. The team believes that the synchronized export recovery in the region should continue to support both export demand and growth. Already exports and imports have gained 8.5% and 15.5% y/y in the Jan-Aug period, highlighting the export-led recovery and the pick-up in domestic demand. In addition, the government's infrastructure push, including transport networks and the Eastern Economic Corridor should lift government spending further and also private investment. Our economic team expects full-year growth to come in at 3.8% and 4.0% in 2017 and 2018 respectively.

- Headline inflation rose 0.86% in Sep, accelerating from Aug's 0.32%, marking the third straight month of positive inflation. Keeping consumer prices elevated were food, housing and transport cost, which climbed by 0.06%, 1.07% and 2.25% y/y respectively in Sep from -0.92%, 0.57% and 2.1% in Aug. Also driving prices higher was the implementation of sin taxes on sugary drinks, cigarettes and most alcoholic drinks effective 16 Sep that lifted tobacco and alcoholic beverages prices higher – up 2.06% y/y in Sep vs. 0.11% in Aug. Core inflation also rose at a faster pace of 0.53% in Sep vs. 0.46% y/y in Aug. For the first nine months of the year, headline inflation continues to average 0.6% y/y, well below the BoT's target of 1-4%. Despite the lack of traction in inflation so far, our economic team expects inflationary pressures to return later this year on the back of low base effects, higher energy/fuel prices, improving domestic demand amid a weaker THB. This should allow inflation to average 1.0% in 2017 and 1.6% in 2018. The BoT is less sanguine with regards to inflation and expects headline inflation to average 0.6% and 1.2% in 2017 and 2018 respectively. The central bank expects modest increases in inflation ahead attributable to a domestic demand recovery, excise tax increase and regulation on immigrant workers that could affect wages.

- **Monetary Policy Forecast:** The BoT has not adjusted its benchmark policy rate – the one-day repo rate – for the past 19 months. The central bank has maintained the status quo and kept the policy rate steady at 1.50%. The last time the BoT moved on policy rate was during the Great Financial Crisis in 2009 when the rate was lowered to a historic low of 1.25% to support growth and maintain financial stability. The current environment of economic recovery amid a modest inflationary environment has enabled the BoT to keep its policy rate at current levels. Even pressure from the government and the IMF for policy easing has failed to move the BoT decision was a rebuff of the recent government pressure on the central bank. Instead the BoT believes that a rate cut could increase financial stability risks.

- **Latest Fiscal and External Balance Outlook:** The excise tax on alcohol and cigarettes has been increased effective 16 Sep. The tax on alcohol will rise by up to THB30/bottle, while beer will rise by THB0.50/can and THB2.66/bottle. Tax on imported wine will increase by THB110/bottle. Cigarettes will see increases of THB2 to THB15/pack. According to the Ministry of Finance Director-General Somchai Poolsavadi said that exercises tax revenue will increase by 2% under the new regime, generating about THB12bn in tax revenue. At the same time, the cabinet has approved an investment budget worth a combined THB2tn for 55 state enterprises in FY2018 on 26 Sep, a marked increase from THB580bn in FY2017. Infrastructure and logistics projects will receive the bulk of the investment budget of THB796bn of the total investment. Projects earmarked in the investment budget include the expansion of a natural gas pipeline (worth THB28.8b); expansion of Suvarnabhumi airport (worth THB18.1b); the Orange Line (eastern section) connecting Thailand Cultural Centre with Min Buri (worth THB19.1b); and the Red Line (Bang Sue-Rangsit) (worth THB17.8b).

- The current account surplus re-widened to THB154.90bn in Aug from THB93.28bn in Jul. This widening of the surplus could be attributed to the larger trade surplus achieved in Aug of THB1133.06bn compared to just THB45.36bn in Jul. Details on the financial account are currently not available, but the surplus in the overall balance of payments (BoP) of THB189.16bn in Aug (vs. THB78.03bn in Jul) suggests that the financial account could have recorded a larger surplus in Aug compared to Jul.

- **Key domestic events and issues to watch:** BoT meets on 8 Nov to decide on monetary policy. 3Q 2017 GDP estimates will be released on 20 Nov.

- **Technical Outlook:** USDTHB was last seen at 33.23 levels. Mild bullish momentum on weekly chart remains intact. Resistance at 33.35 (trend channel resistance). Break above this puts next resistance at 33.77. Support at 33 levels. We continue to monitor if bearish trend channel formed since start of the year is at risk of losing relevance.

INR: Midst of Stabilisation

Forecast	4Q 2017	1Q 2018	2Q 2018	3Q 2018
USDINR	65.00 (63.00)	66.00 (64.50)	64.50 (66.00)	65.00 (--)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** We've seen a considerable recovery of India's economy in Oct as most key data outperformed. The USDINR started the month on a relatively high note at around 65.60 levels as lagging data and growth uncertainty looms in the India economy. However, the INR has regained strength as key data released over the month boosts investor's sentiment on the economy. The USDINR is currently trading at around 65.00 levels. Moving ahead, we forecast certain strength in the INR to cap the USD upside coming into the remaining months of the year.

- We see that the widespread popularity of Prime Minister Narendra Modi is largely intact as the demonetization and GST reforms policies are increasingly seen to be of a success. The crackdown of corruption, to terrorism, to proper tax collection systems has improved investor's sentiment in the previous month. PM Modi has mentioned that "GST is giving India a new business culture and consumers will be biggest beneficiary of the new tax regime". An increase in business growth is likely to add to job creation, which is the main concern for the increasing populist nature of citizens.

- Although we believe that the BJP's NDA Coalition is likely to stay in power on the back of the popularity of PM Modi and prudent policies, we note that even with the scheme of events taking place, political pressure still weighs on the current ruling party as upcoming State elections tin 2017 of Himachal Pradesh and Gujarat concluding in Dec likely calls into question the policies of the current party. Himachal Pradesh is currently ruled by the India National Congress (a.k.a. "Congress"), the center-left political party of India; while Gujarat is currently ruled by the BJP, India's center-right ruling party. We should expect both parties to be re-elected into their current states. However, we should not rule out Congress's possible victory in Gujarat. A Congress victory in Gujarat, although still insufficient to unseat the NDA, could still potentially pose some risk towards the NDA. Polling dates are to be held on Nov 9 for both states, while poll counting will be concluded on Dec 18.

- The recent Bank Recapitalization plan in order to kick-start growth and private investments seem to be supportive of the INR. This comes as banks have recently been withering on potential losses from bad credit, which would deplete the bank's equity (shareholder's stake); with their equity levels already close to regulatory minimum. With that, bank-credit growth has slump as their capacity for new loans are almost exhausted. The Indian Government, which has majority stakes in 21 lenders, hence offered a plan to aid ailing banks of around 1.45trn rupees (USD21bn) to the banks. However, it is important to note that the recapitalization is based on government bond issue funding. Surprisingly, these bonds are expected to be bought back by the banks that were recapitalized themselves. This definitely calls into question the thoughts of financial engineering, by changing the structure of holdings by the banks to improve growth. These banks will now hold government securities in lieu of equity capital. This means money flows to the government, whom will in turn buy shares in these banks, essentially recapitalizing them. We carefully consider the success of this plan in boosting credit growth as the banks are still sitting on huge potential loan losses.

- Apart from the election polls for 2 states in India, the month of Nov proves relatively quiet from India's economy. Although growth has slowed since the start of the year, we would expect several reforms to partially improve, from GST improvements to the cleaning up of bad debts in state's banks; thereby shaping a more conducive environment to spur further foreign investments, finding some support for the INR.

- **Our Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) improved 4.6 (vs. 4.8) due to GDP and inflation.

- **Growth and Inflation Outlook:** As previously mentioned, the rushed demonetization bank notes in the economy and implementation of GST system may hinder the growth trajectory of India's economy. However, we might see growth turning a better corner as the several indicators shows economic activity picking up. IP (Aug) increased for the 2nd time to 4.3% y/y from 1.2% in Jul, exceeding estimates of 2.6%. The jump comes largely from increase in manufacturing of furniture and computer electronics. Manufacturing PMI remained at 51.2 (any reading above 50 indicates overall positive sentiment from purchasing managers). This signals that the real economy has somewhat adjusted to the GST system that was implemented. Svc PMI also rose to 50.7 (prev 47.5). We should expect further stabilization of the real economy in the remaining months of the year.

- CPI decreased slightly to 3.28% y/y (exp. 3.53%, prev 3.36%), mainly dragged by food and beverage prices which rose only 1.76% y/y compared to 1.96% y/y in the previous month. The CPI still lingers below the 4%-medium term target but nevertheless leaves some room for RBI to cut rates.

- **Monetary Policy Forecast:** RBI decided to keep its policy repo rates unchanged for Oct at 6%. This decision signaled that most members of the Monetary Policy Committee (MPC) accords to meet inflation targets as a much higher priority, rather than bolstering economic growth. This decision comes after RBI delivered a 25bps rate cut on 2 Aug. Most of the MPC members noted that inflation prints have come off while investment growth remains weak. RBI sets monetary policies on the basis of CPI within the 2% top 6% range (median 4%). We expect the MPC's plan to reinvigorate investment activity through improving business environment, recapitalizing public sector banks, and formalizing the economy; instead of pursuing expansionary monetary policies. Hence, we expect that the RBI is unlikely to cut rates further this year

- **Latest Fiscal and External Balance Outlook:** The recent decision to recapitalize banks seems likely to weigh on the fiscal deficit of India. However, we note that the recapitalization plan is unlikely to increase the deficit (as assumed by the government) as the recapitalization is based on issuing bonds to funding. However, there might be other effects on the fiscal deficit such as increased interest payments by the government to the bonds issued. This could potentially drag on the fiscal deficit on the longer term.
- Current account deficit has widened to -$14.3bn in 2Q2017, from -$3.4bn in 1Q2017. On the other hand, the financial account in 2Q2017 has recorded even greater inflows of direct investment ($7.24bn vs $5.00bn previously) and portfolio investment ($12.45bn vs $10.80bn previously), leading to overall financial account surplus increasing from $3.0bn to $14.0bn. We also see a net increase of foreign purchases of local equities of USD295.6mn month to date and USD2421.3mn of local bonds month to date. Stronger financial inflows are likely to close the deficit gap, as global investors add India's debt into their portfolios.
- Trade balance data showed better than expected deficit at -$8984.3 (est. -S11700, prev. -$11644). Exports grew 25.7% y/y (est. 10.3%), and imports decreased 18.1% y/y (est. 21%). We would expect the weaker INR and increased production to drive exports ahead.
- **Key domestic events and issues to watch:** Mfg PMI (1 Nov); Svcs and Comp PMI (3 Nov); IP, Trade bal (10 Nov); CPI (13 Nov); Wholesale price (14 Nov); 3Q GVA, 3Q GDP, Fiscal Deficit (30 Nov).
- **Technical outlook:** Daily and weekly chart on the 1m USDINR NDF both showed signs of bullish momentum waning, and stochastics shows tentative signs of turning lower. We could possibly see a downward trend channel forming on the daily chart, with key support level at 64.70 (100 DMA). A breakthrough of this level could potentially see the NDF going lower towards next support at 63.75 (2017 lows). Current support remains at 64.94 (23.6% fibo retracement of Jan high to Jul low), 64.70 (100DMA). Resistance at 65.67 (38.2% fibo).

VND: Stable

Forecast	4Q 2017	1Q 2018	2Q 2018	3Q 2018
USDVND	22760 (--)	22730 (--)	22780 (--)	22700 (--)

No Change to Previous Forecast

- **Motivation for the FX View:** USDVND has remained stable in recent months and we might not see a lot of volatility in the USDVND for the rest of the year. Deputy Head of SBV Nguyen Hoang Minh has said that remittances are forecast to rise 10% to $5.5bn this year, and will 'help keep the currency stable'. He also said SBV sees 'no pressure on the dong to drop against the dollar at the end of the year'. For the month ahead we expect USDVND to remain confined to 22710 – 22740 range.

- On Oct 23rd the prime minister, Nguyen Xuan Phuc, officially set a real GDP growth target 6.5-6.7% in 2018, little changed from this year's goal of 6.7%. Inflation is also expected to accelerate at 4% on average. We see the country to rely on tourism and stake sales at SOE for economic growth. Together with rising oil prices, the USDVND can be seen to remain consolidated around current levels.

- High public debt may result in some downside risk for Vietnam, though recent growth figures are encouraging and may mean that the government will feel less pressured to stimulate the economy through fiscal policy. While inflation remains relatively well-managed and subdued, previous expansionary policies that have taken place may have already taken effect on the economy. FDI inflows and continued trade surplus will certainly help to support the VND.

- **Growth and Inflation Outlook:** Mfg PMI grew to 53.3 (Sep) from 51.8 (Aug). The significant jump shows the highest reading since April 2017. Output rose and new order both rose to April's high, which resulted in the significant increase in the PMI. Coupled with indicators of a rise in output and new orders, they signal a positive sentiment for growth. Industrial production also showed a significant increase to 17% y/y (prev. 13.2%). The rise follows increases in manufacturing, mining & quarrying, and electricity; likely supported by higher crude prices. If this continues, we could possibly see more sustained growth figures towards the government's median 6.7% target (current 3Q GDP at 6.4%).

- In this environment and with plenty of FTAs in the pipeline, Vietnam may continue to attract foreign investors for its infrastructure development. Trade surplus for Oct was at +$900mn, much higher than expected of $699mn. The figure was however lower than the prior month's revised figure of +$1101mn (revised upward from +$400mn). However, overall trade volume is still experiencing double digit growth; exports (+20.7%) y/y and imports (+22% y/y). We see the high levels of trade surplus to be supported by stable FDI levels at $17,629.9mn and lower domestic sector levels at -$16,401.9mn.

- In the meantime, Vietnam has been seeing double digit growth in visitor arrivals. Tourism in Vietnam jumped 24.7% y/y to 1.024mn (prev. year 0.8mn). Comparing the year to date values, tourism jumped 32.8% for the first 10 months of 2017 compared to preceding year's period. Cumulative retail sales also rose 10.7% y/y in Oct, vs prior 10.5% y/y; this was mainly driven by rise in Tourism and hotel/restaurant sales.

- Oct CPI turned out lower than expected at 2.98% y/y (est. 3.1% y/y), compared to previous month data of 3.4% y/y. This comes in line in keeping inflation target below 5% (note that Vietnam has a poor track record at managing inflation, thus it would be prudent to balance between inflation and growth). We expect inflation to accelerate for the remainder of 2017 on the back of stronger economic activity and currency weakness.

- PM Nguyen Xuan Phuc has recently urged all government agencies, ministries and localities "to have more drastic efforts and solutions" to meet the growth rate of 6.7% for 2017. In order to do that, the economy must grow by at least 7.42%.That has been the reason why rates has been cut over the past few month. As highlighted by our Macro Strategist, the focus on China-style point target, set at 6.7% for 2017, via pushing credit growth (already at +20%) could risk worsening NPL problems and weaken bank balance sheet. Therefore, we expect overall growth to be underpinned by private consumption and tourism, while government spending is expected to decrease as government focuses on SOE reforms.

- **Monetary Policy Forecast:** On 28th Oct, SBV cut its deposit rate cap to 5.5% from 6% to support lending growth. This move is an effort to "support economic growth and revive lending", which could help the government meet 12-14% credit growth target. Policy interest rate remains at 6.25% from Jul's cut, while rediscount, refinance, and repurchase rate remained at 4.5%, 6.5%, and 9% respectively. The absence of USD strength was able to cap inflation and allowing more room for the central bank to boost credit growth at home. We also recall that the National Assembly passed a resolution on 21 Jun that allows bad debt to be bought and transferred with special bonds into bad debt at market prices under the guidance of the SBV. These rate cuts might be also one that could ease up credit conditions so that the resolution on NPL could be more easily executed. In the meantime, the cut in policy rates have triggered commercial banks to lower its deposit rates to retain their Net Interest Margin (NIMs). With USD on the stronger note, USDVND could turn lower, remaining supportive for conducive for foreign investment. Hence, we expect that SBV be unlikely to cut rates further to keep tabs on inflation.

- **Latest Fiscal and External Balance Outlook:** Vietnam's fiscal position is likely to remain in consolidation mode. This view comes on the back of possible tax breaks for ASEAN imports, ambitious infrastructure plans, and growing welfare costs. 3Q budget deficit stands at -61,545bn dong, higher than 2Q deficit of -19,465bn dong. In the remaining year, the government's target to stick to their 6.7% economic growth will likely continue to limit reduction in the budget deficit. However, we might see economic growth, healthy consumption, increased tourism, and indirect taxes to boost government revenue.

- Finance Minister Dinh Tien Dung assured previously that the government continues to aim for balanced budget in the long run. The state budget collection met 63% of the annual target this year (Jan-Aug data).

- Vietnam set a lower budget deficit of 3.38% of GDP for 2017 from previously 3.50%. 2016-18 public debt (including government debt, debt guaranteed by government, municipal debt) is capped at 65% of GDP. ADB has warned that public debt has reached this 65% limit.

2016-18 government debt is set at no more than 54% of GDP while foreign debt is set at no more than 50% of GDP.

- The government has an ongoing effort to divest VND67trn from SOE in the years leading to 2020. Key use of the capital is to develop important infrastructure projects like the Long Thanh International airport, along with the recent plans to build the Chrey Thom Bridge that will connect the southern province of An Giang in Vietnam to Cambodia's Kandal province. This is meant to promote bilateral trade and bring about more economic benefits for those communities along the border areas though a time frame was lacking.
- Current account recorded a deficit of USD0.27bn (latest data available), just as we have expected, improving from a deficit of USD1.17bn from the previous quarter. This data comes from strong trading of goods in surplus of USD1.37bn. Financial account also recorded net inflow of USD2.74bn, largely driven up by direct investments.
- **Key Domestic Events and Issues to Watch:** PMI Mfg (1 Nov); Domestic vehicle sales (6-13 Nov); CPI (24 Nov); Trade bal, Retail sales, IP (25-30 Nov)

FX Forecasts

	End Q4-17	End Q1-18	End Q2-18	End Q3-18	End Q4-18	End Q1-19
USD/JPY	115	117	115	116	116	118
EUR/USD	1.1700	1.1700	1.1800	1.2000	1.2100	1.1600
GBP/USD	1.3200	1.3200	1.3400	1.3600	1.3800	1.4000
AUD/USD	0.7700	0.7900	0.8100	0.8300	0.8500	0.8500
NZD/USD	0.6800	0.6800	0.7100	0.7200	0.7200	0.7200
USD/SGD	1.3700	1.3750	1.3650	1.3700	1.3700	1.3750
USD/MYR	4.2500	4.2750	4.2000	4.1500	4.0500	4.0000
USD/IDR	13600	13700	13600	13600	13500	13300
USD/THB	33.50	34.00	33.70	34.00	34.50	35.00
USD/PHP	52.00	52.00	51.80	51.50	51.00	51.00
USD/CNY	6.60	6.65	6.60	6.60	6.55	6.50
USD/HKD	7.80	7.80	7.80	7.80	7.80	7.80
USD/TWD	30.20	30.40	30.30	30.10	30.00	30.00
USD/KRW	1142	1140	1130	1120	1120	1110
USD/INR	65.00	66.00	64.50	65.00	65.00	64.00
USD/VND	22760	22730	22780	22700	22500	22400
DXY Index	94.78	94.78	93.81	92.80	92.10	94.49
SGD Crosses	End Q4-17	End Q1-18	End Q2-18	End Q3-18	End Q4-18	End Q1-19
100 JPY/SGD	1.1913	1.1752	1.1870	1.1810	1.1810	1.1653
EUR/SGD	1.6029	1.6088	1.6107	1.6440	1.6577	1.5950
GBP/SGD	1.8084	1.8150	1.8291	1.8632	1.8906	1.9250
AUD/SGD	1.0549	1.0863	1.1057	1.1371	1.1645	1.1688
NZD/SGD	0.9316	0.9350	0.9692	0.9864	0.9864	0.9900
SGD/MYR	3.1022	3.1091	3.0769	3.0292	2.9562	2.9091
SGD/IDR	9927	9964	9963	9927	9854	9673
SGD/THB	24.45	24.73	24.69	24.82	25.18	25.45
SGD/PHP	37.96	37.82	37.95	37.59	37.23	37.09
SGD/CNY	4.82	4.84	4.84	4.82	4.78	4.73
SGD/HKD	5.69	5.67	5.71	5.69	5.69	5.67
SGD/TWD	22.04	22.11	22.20	21.97	21.90	21.82
SGD/KRW	834	829	828	818	818	807
SGD/INR	47.45	48.00	47.25	47.45	47.45	46.55
MYR Crosses	End Q4-17	End Q1-18	End Q2-18	End Q3-18	End Q4-18	End Q1-19
EUR/MYR	4.97	5.00	4.96	4.98	4.90	4.64
JPY/MYR	3.70	3.65	3.65	3.58	3.49	3.39
MYR/HKD	1.84	1.82	1.86	1.88	1.93	1.95
MYR/CNY	1.55	1.56	1.57	1.59	1.62	1.63
GBP/MYR	5.61	5.64	5.63	5.64	5.59	5.60
AUD/MYR	3.27	3.38	3.40	3.44	3.44	3.40
NZD/MYR	2.89	2.91	2.98	2.99	2.92	2.88
MYR/IDR	3200.00	3204.68	3238.10	3277.11	3333.33	3325.00
MYR/INR	15.29	15.44	15.36	15.66	16.05	16.00

Source: Maybank FX Research as of 31 Oct 2017

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

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