October 31, 2018

Maybank

FX Monthly

2018, Issue 10: US Politics Takes Centre-Stage in Nov

What Has Changed This Month?

- We revised our currencies forecast to reflect our view of USD strength to remain supported into 1Q 2019 due to growth and policy divergence in favour of US. Near term USD support remains on US-China trade tensions, idiosyncratic factors in EU, UK.
- **But** the USD trajectory profile for 2Q-3Q 2019 remains skewed to the downside to factor in slowing divergence between US and world growth due to US growth peaking and the Fed slowing its pace of policy normalisation, resulting in a window of opportunity for selected AXJs to recover lost ground.
- The EUR trajectory profile over the forecast horizon was revised lower to account for slowing growth momentum in Euro-area and new elements of political uncertainty in Europe. In particular recent news of German Chancellor Angela Merkel stepping down (as party leader in Dec-2018 and Chancellor in 2021) and a lack of visibility on strong succession plans in Germany poses risk to the Euro-area continuity. The latter may potentially change the political landscape in Europe and this warrants a revision lower in EUR forecasts.

Our Strategies

- Post mid-term US elections and in the run-up to G20 meeting on 30 Nov-1 Dec (where Trump and XI are scheduled to meet), may provide a window of opportunity for selected AXJs, including CNH, SGD, KRW, AUD and NZD to recover on hopes of a trade compromise.
- On a broader term perspective, we no longer favour accumulating EUR on dips due to potential change in the political landscape in Europe after Chancellor Merkel announced to step down. Near term, we do not rule out rebound risks if Italy backs off from its 2.4% budget deficit target and reach a compromise with EU or if EU-UK progresses towards a successful Brexit summit (supposedly scheduled in mid-Nov depending on situation). Externally, the potential for USD to ease off recent highs in the near term (1-3 weeks horizon) possibly due to US mid-term elections, falling yields could help to provide some support for EUR. We look for a range of 1.12 – 1.16 range in the weeks ahead.
- Stretched positioning suggests that certain currencies could be vulnerable to short squeezes including AUD and NZD, albeit within broader downtrends.
- Further signals from the BSP on extending the tightening cycle that reinforces the central bank's credibility should keep the PHP supported.

Analysts

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

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

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

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

Top 3 Currency Plays for November

Chance for USDAXJs to fall in the lead up to G20 but bias to buy USD/AXJs on dips

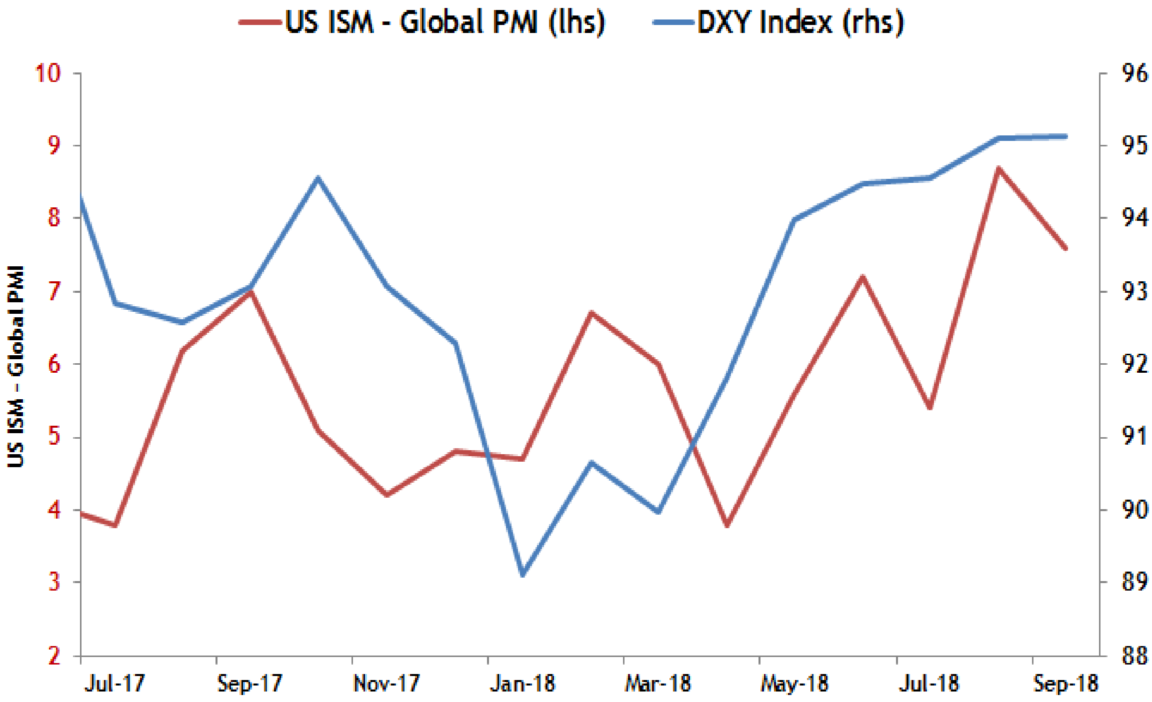
Long AUDSGD

Short USDPHP

Key Events for the Month Ahead

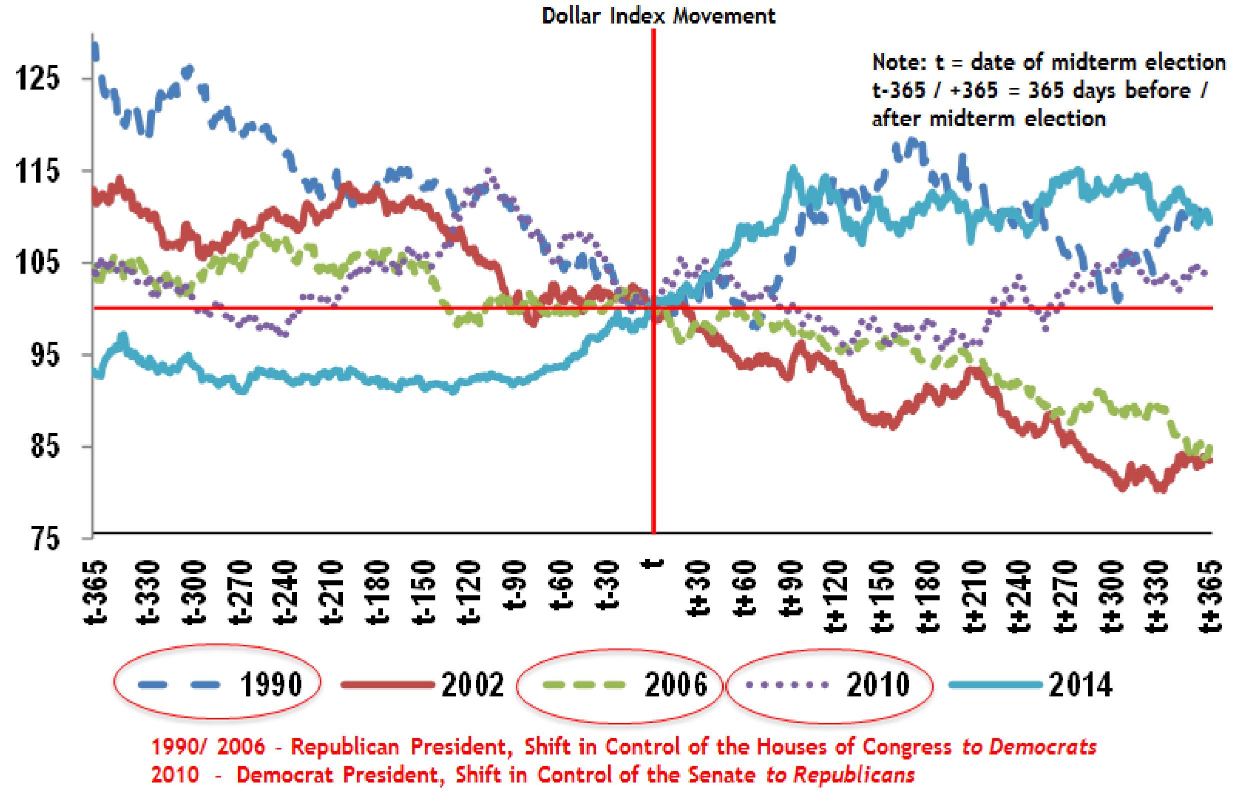
Date	Event
4 Nov	US sanction on Iran
6 Nov	US Mid-Term Elections
7 Nov	Yuan bills issuance in HK
Mid-Nov	Potential of extraordinary Brexit Summit
30 Nov - 1 Dec	G20 Summit Bueno Aires, with focus on Trump-Xi meeting on the sidelines

USD Tend to Rise when US-World Growth Divergence Widens in Favor of the US. Risk is USD Strength May Wane when US Growth Peaks



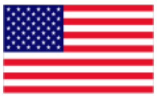
Source: Bloomberg, Maybank FX Research & Strategy
Note: Rising US ISM - Global PMI spread indicates increasing divergence between the US growth vs. the Rest of the World

Past Episodes of Post US Mid-Term Elections Yield No Conclusive Direction for DXY



Source: Bloomberg, Maybank FX Research & Strategy

G7 Global Overview



USD: Awaiting US Mid-Term Election and Trump-Xi Meeting Outcomes as US Growth Concerns Emerge

Forecast	4Q 2018	1Q 2019	2Q 2019	3Q 2019
USD Index	96.96 (94.15)	98.66 (93.52)	95.82 (92.69)	94,00 (90.58)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** We continue to see some support for the USD to be sustained into early 2019 on the back of expectations of rate hikes and momentum from the fiscal support, before USD softness setting in 2Q 2019 as speculative USD longs are at risk of unwinding and fatigue sets in for USD bulls as EM risk premiums look overstretched. Near term USD support remains on trade tensions, idiosyncratic factors in EU, UK. In the short immediate time frame USD could decline this week as speculative players stopped adding to USD longs, but will not see sharp drops as it continues to be supported by real money managers adding to strategic longs.

- In 2019, a few scenarios could start weighing on the USD in from 2Q-3Q 2019. The key factors supporting a sell USD on rally are (i) the FED is near its end of tightening, (ii) US economy peaking soon, and (iii) US twin deficits in focus as treasury sees a surge in borrowing. **However, towards the end of 2019, our baseline builds in some expectations of heightened concerns about weaker global and US growth intensifying thus leading to some level of global risk off, supporting the USD somewhat.**

- The dollar index forecasts have risen slightly due to adjustment we have made on the euro. ***We revised lower the euro trajectory profile due to new elements of political uncertainty (Merkel's leadership nearing an end pose risk to Euro-group leadership succession, Italian budget impasse at risk of taking longer to resolve, Brexit uncertainty), expectations of ECB-Fed policy convergence to come later and euro-area growth momentum slowing (but recession is not our base-line scenario).***

- In November 2018, two major event outcomes will have some ramifications on policy and thus on asset markets. If we do see a scenario of a divided Congress, the impact on 2019 fiscal deadlines and the issue of raising the debt limit, which will have to happen in July or August 2019, will add to market volatility. The last time markets saw such a situation around those deadlines was in 2011 and 2013, when there was a divided Congress and a divided government.

- Overall, the impact on markets is likely to be small, especially relative to other factors. But to the extent that the base case of divided Congress suggests slightly weaker fiscal stimulus and growth, and little reason to expect friendlier trade policy, we could see slight downside risk to Treasury yields and the dollar, all else equal. Since a divided Congress is the consensus view, some of this may be priced in, but probably not all of it. In contrast, Republican control of both chambers would imply slightly higher growth expectations on more fiscal stimulus and reduced regulatory risk, which could see yields and the dollar as well as equity indices rise. The other event in Nov is the Trump-Xi meeting in end Nov. A further escalation of the trade war in the run up and post meeting could lead to further USD strength.

- Another driver which is more fundamental is related to the current rate hike cycle. The Fed started normalizing monetary policy since 2015 and YTD the Fed has raised rates on 8 occasions of 25bps each (well-spread over 33 months or so). Going by Fed's forward guidance, there are probably another 5 more rate hikes penciled in for the next 27 months or so. This underscores our take that Fed normalisation is more than mid-way through and is probably approaching its end game soon (some time into 2019). It is also likely that the Fed may soon give an update on balance sheet normalisation (an announcement for an end-date could weigh on rates and USD). For other majors, policy normalisation are still in their early stages (ECB, BoE) or may not have begun for most including RBA, RBNZ. We emphasize that policy divergence between the Fed and other DMs should slow and policy convergence could well be a thematic to position for into 2019. This should add to USD weakness.

- Generally, the USD was mildy stronger in Oct. on the back of US data outperformance, escalation of US-China trade tensions. But we stress that some degree of differentiation is needed when interpreting USD strength. DXY (or dollar index), commonly referred as the dollar proxy rose 1.2% in Oct and this was largely due softness in the EUR and GBP (both made up nearly 70% of the DXY) as JPY remains largely rangebound. This can be attributed to worsening situation on the Italy budget and concerns about a Brexit deal concluding. However the same cannot be said for USD vs. Asian FX which the USD has continued to trade near recent highs amid lingering concerns of trade tensions re-escalating and spill-over risk from the sell-off in BATS FX (Brazilian Real, Argentine Peso, Turkish Lira and South African Rand) which sparked fears of contagion. Higher UST yields in the lead up to upcoming FoMC meetings may be an additional factor (tightening monetary conditions) keeping the USD strength broadly supported as long as markets price-in continued rate hike concerns on Asian economies and businesses.

- Continued fear of Fed picking up pace of tightening could lead to higher rates and keep USD supported in the interim. However any dovish guidance from Fed in Dec may see USD strength and UST yield taper off. This should provide a breather for risk assets and high-beta FX. However, if activity slows or labor market conditions weaken, we believe the Fed would be more likely to delay its normalization plans even if higher import prices boost short-term inflation outcomes. A more serious escalation that threatens the US recovery could lead to a pause in balance sheet normalization, though it is far too early to draw any such conclusion. For now, the committee sees fiscal stimulus as providing solid momentum in domestic activity, as well as a significant buffer against external shocks; for now we retain our view that the Fed will hike its policy rate one more time this year and potentially only 1-2 times next year depending on the fundamentals.

- We believe broader term shifts were already underway to support the case for broad USD downtrend, including (1) US tax reforms and its wider implication on deficit, debt and the USD; (2) reserve diversification away from the USD; (3) USD countercyclical play; (4) USD downtrend cycle.

- Synchronous global economic recovery, led by US, EU remains intact and it may be too soon to judge if recent inflation upticks could gather pace sustainably to warrant a shift for faster pace of rate hikes. As such we maintain our bias for broad USD downtrend and look for opportunities on USD upticks to fade into. We believe that a slightly faster pace of tightening amid healthy economic growth outlook and optimistic corporate earnings outlook should not derail the growth momentum or USD down-trend. That said the interim risk-off sentiment could remain as markets adjust from a period of policy certainty under Yellen's era to a period of policy uncertainty under a new leadership (Powell) and under the Trump administration.

- **Growth and Inflation Outlook:** US real GDP increased 4.2% y/y in 2Q 2018, the same rate of increase as in the "second" estimate. The updated estimates reflected more consumer spending on goods, more investment by state and local governments, and less spending on imports, which are a subtraction in the calculation of GDP. These upward revisions were offset by less inventory investment.
- The U.S. economy expanded at a 3.5% pace in 3Q as consumer expenditure rose, businesses restocked inventories and governments boosted spending, marking the strongest back-to-back quarters of growth since 2014. The GDP YoY gained compared with the 3.3% consensus
- Consumer spending, unexpectedly accelerated to a 4% increase while the 0.8% gain in nonresidential business investment was the weakest in almost two years. In two volatile categories, inventories provided the biggest contribution since early 2015, while the drag from trade was the largest in 33 years. Government spending rose by the most since 2016.
- Headline US inflation was below estimates in Sep as used-car costs fell and housing rents cooled, signaling that price gains may remain close to where Fed has estimated amid an outlook for continued gradual interest-rate hikes. Excluding volatile food and energy costs, the core consumer price index rose 2.2% in Sep from a year earlier, the same pace as in Aug and less than the 2.3% consensus The broader CPI slowed to a 2.3% annual gain, the least since Feb, compared with forecasts for 2.4%.
- The inflation figures partly reflect a 3% monthly decline in prices for used cars and trucks, the biggest drop in 15 years. While the dollar and 10-year Treasury yields initially fell after the report, Fed officials will have two more months of price figures in hand before their Dec meeting at which they are projected to raise interest rates for a fourth time this year amid solid economic growth and consumer spending, boosted by tax cuts. The core CPI rose 0.1% in Sep from the prior month, compared with the consensus for a 0.2% gain.

- **Monetary Policy Forecast: We maintain our outlook that further progress toward the Fed's mandate will keep the FOMC on a path of gradual policy normalization. We expect the next 25bp increase in the target funds rate to occur one more time in Dec with a total of 4** hikes this year. Fed funds rate (FFR) was raised by +25bps to 1.50%-1.75% at the first FOMC meeting chaired by Jerome Powell in March 2018. Our baseline view is for a further 75bps hike in 2019.

- The Fed raised the target range for the federal funds rate by 25bp, to 2.0-2.25%, as widely expected. The FOMC continues to have a positive view of the effects of fiscal policy on economic activity and the US economy's ability to withstand shocks. The Sep statement continued to describe the economy as "strong."

- In the updated set of economic projections, the committee raised its 2018 growth forecast and the estimate of the long-run funds rate to 3.0%, from 2.875%. The remainder of the outlook remained largely unchanged and, as a result, there was no change in the median policy path. The committee expects the median funds rate to rise to 2.4% in 2018, 3.1% in 2019, and 3.4% in 2020. Twelve of 16 committee members see the outlook as consistent with another hike before year-end.

- The FOMC also removed the language that said monetary policy "remains accommodative" thus somewhat confirming that members expect monetary policy to become restrictive over time. Economic projections for 2021 include growth slowing to potential and a rise in the unemployment rate to 3.7% from 3.5%.

- During the press conference, Chairman Powell indicated that the Fed will likely have to conduct policy more on feel and less on a model-based forecast which in our view could leave room for timing inconsistencies if policy lags take some time to feed into the economy. Markets interpreted Chairman Powell's comments as somewhat dovish but Powell's dismissal of the language change as meaningful, and focused instead on how the Fed views the economy after the initial gains of fiscal stimulus. The Fed sees growth in 2021 decelerating to the long run level and it shows the unemployment rate increasing in 2021. Overall, more Fed officials targets for rates was lower for 2020, but the median did not change suggesting a not too positive picture beyond 2020.

- **Latest Fiscal and External Balance Outlook:** The "Tax Cuts and Jobs Act" (TCJA) was signed into law on Dec 22, 2017. Although the tax policy left out many controversial overhauls that have been put forth, the final reconciled bill between the House and the Senate still saw major reforms including corporate tax cuts to 21% from 35% and one-time tax repatriate of earnings and profits at 15.5% and 8% for reinvestments (further details are outlined in Appendix 1 at the end of this report). These tax reforms will have implications on broader economy, politics and the US Dollar.

- Briefly on the economic front, the TCJA is expected to increase US GDP by 0.8% in 2018, reduce marginal tax rates and increase personal consumption. Output and aggregate demand will be lifted, hence boosting government revenue, according to Tax Policy Center's (TPC) analysis on macroeconomic effects of tax reforms.

- On the tax reforms' implications on FX, it is not as clear cut. The one-time repatriation could lead to demand for USD. In the current episode that is unfolding, tax reforms is expected to widen US budget deficit to -5.4% of GDP (vs. -3.4% currently) while debt to GDP will rise to 97.5% of GDP (vs. 75% of GDP currently), according to Congressional Budget Office (CBO) estimates.

- And if history is of any guide, the current period of tax reforms (widening budget deficit and rising debt to GDP) is akin to expansionary fiscal policies and like previous periods, the USD should weaken.

- **Key domestic events and issues to watch in Nov 2018:** ISM Mfg (1 Nov); Trade Balance (2 Nov); FOMC (9 Nov); FOMC meeting minutes (30 Nov); Factory orders and Durable Goods Orders (2, 21 Nov), NFP (2 Nov); Housing Starts (20 Nov); CPI (14 Nov); Retail Sales (15 Nov); GDP 3Q S (28 Nov); Core PCE (28 Nov); PCE Deflator (29 Nov). President Xi & Trump meeting (30 Nov-1 Dec).

- **Technical Outlook:** Our call (in last month's FX Outlook) for DXY to rebound on the back of bullish signals developing (bullish divergence and falling wedge pattern). But the rebound exceeded our expectations of 95.70 resistance. DXY was last seen at 97 levels. Bullish momentum on weekly, daily remains intact but stochastics is running into overbought conditions. Key resistance at 97 levels (interim double top) remains. A monthly close above 97 would nullify our near term bias for USD pullback and put the focus on 97.8 levels (61.8% fibo retracement of 2017 high to 2018 low) as next resistance. However failure to push above decisively would see USD ease lower. Support then seen at 96 (50% fibo) and 95.80 (21 DMA). An extension of the potential double-top reversal move lower towards 95 levels should then not be ruled out.

EUR: Unnerved by Political Risks

Forecast	4Q 2018	1Q 2019	2Q 2019	3Q 2019
EURUSD	1.1400 (1.1800)	1.1100 (1.1900)	1.1400 (1.2000)	1.1600 (1.2200)

Previous Forecast in Parenthesis

- **Motivation for the FX View: We revised lower the euro trajectory profile over the forecast horizon,** due to slowing growth momentum in Euro-area and new elements of political uncertainty in Europe. In particular recent news of German Chancellor Angela Merkel stepping down (as party leader in Dec-2018 and Chancellor in 2021) and a lack of visibility on strong succession plans in Germany poses risk to the

Euro-area continuity. The **latter may potentially change the political landscape in Europe and this warrants a revision lower in EUR forecasts.** We will continue to monitor if there is a clear and strong leadership after Merkel and we do not rule out further revisions in our EUR forecast ahead. 1Q EUR forecast was revised lower with a kink to account for the potential of extended delay in finding a resolution on Italian budget, rising risk of hard Brexit, growth momentum slowing (but recession is not our base-line scenario) and negative EU-UST yield differentials to persist further into 1Q.

- EUR's downside (on a broader term perspective) looks increasingly vulnerable after the break of 1.14-handle, and this can be attributed to (1) renewed political uncertainty in Germany and possibly Euro-area leadership after Merkel was said to step down as CDU party head); (2) Italy budget impasse (took longer than expected to resolve; (3) slowing momentum in Euro-area PMIs; (4) moderating growth momentum in Germany owing to drag from auto production in Germany; (5) ongoing uncertainty with Brexit amid an environment of negative yield differential (10Y EU-UST differentials at record -270bps). We think those factors highlighted above could still pose a drag on EUR but we do not rule out the risk of near term rebound, as some of these negatives appear to have been baked into the price. It would take new and additional negative shocks to see a continuation of the downtrend. In contrast, we think the rebound risk is possible especially if Italy backs off from its 2.4% budget deficit target and reach a compromise with EU or if EU-UK progresses towards a successful Brexit summit (supposedly scheduled in mid-Nov depending on situation). Externally, the potential for USD to ease off recent highs in the near term (1-3 weeks horizon) possibly due to US mid-term elections, falling yields could help to provide some support for EUR. We look for a range of 1.12 – 1.16 range in the weeks ahead.

- **Political Developments Remain Fluid and downside risks likely to be front-loaded over 4Q 2018 to 1Q 2019:** According to Bloomberg news (29 Oct), German Chancellor Merkel will <u>quit as leader of her party CDU at the party convention in Dec-2018</u>, after suffering a historic defeat at the Hesse state election. And she is <u>not seeking another term as a Chancellor</u> in the Bundestag (Federal Elections) in 2021 (supposedly the Federal election will be held no later than 24th Oct 2021). **Markel is a veteran in coalition politics and is perceived as the major driving force in keeping Euro-group intact.** We turn cautious in European politics (in particular due to lack of strong succession planning) and question the continuity of the Euro-club. **Absence of a credible leader or succession planning to lead German government may undermine the Euro-club and the EUR.** As of writing, Friedrich Merz (long-time critic of Merkel, ex-politician, German lawyer) is said to be preparing to launch a political comeback for CDU party head.
    - According to local media, Merz was most well-known for seeking to reduce complex issues to simple terms. In 2004, he called for a tax system where a family could calculate wheat they owed on the back of a beer coaster - amounting to 12% income tax with fixed rate of deduction per household member.

Elsewhere, the European Commission has rejected Italy's 2019 draft budget plans and had requested Italy to cut structural deficit by 0.6% of GDP rather than increase it by 0.8ppts (budget deficit proposed by Italy was -2.4% of GDP). EU officials feared that Italy's public debt (currently at 131% of GDP) may increase further. Italy coalition government has made known their intent of refusing to budge. Longer than expected time taken to resolve this may unnerve credit markets and weigh on EUR but a compromise could support EUR.

- We **retain a *mildly* constructive outlook on the EUR in the medium term, with 3Q forecast of 1.16 (still above current spot of 1.1350)** on a combination of factors including: (1) monetary policy convergence possibly towards the middle of next year (ECB-Fed policy divergence likely to slow as Fed normalisation likely to have been priced in while markets start to price in ECB normalisation); (2) expectations that political/leadership and budget concerns in Germany and Italy will play out after 1Q 2019; (5) expectation of progress between EU-UK with brexit negotiations after Mar-2019. On the latter, we argue that a smoother and more predictable exit for UK should serve to mitigate uncertainty associated with business investments even for European companies and this should support the EUR. **That said we remove the bias "to accumulate on dips, reflecting our caution on the potential change in political landscape. We will re-assess after the National Conference in Dec-2018.**

- **Growth and Inflation Outlook: Euro-area growth slowed to +0.2% q/q in 3Q, down from +0.4% in 2Q. This is the slowest pace in more than 4 years.** Slower pace of Italy growth (3Q GDP slowed to zero), sluggish pace of growth in France (expanded less than expected) and hit on German automakers (which some including the ECB argued was a one-off factor) were the main drags. **Latest prelim PMIs for Oct suggests that growth momentum continues to moderate.** Manufacturing and services PMI slipped in Euro-area, including Germany and France. ZEW survey expectation slumped 2018 low of -24.7. These data may suggest that 4Q growth further moderated.

- The latest ECB macroeconomic projection in Sep 2018 report shows that projections for 2018 and 2019 growth have been revised lower to 2% (vs. 2.1% in Jun's projection) and 1.8% (vs. 1.9% in Jun's projection), respectively. 2020 growth projection remains unchanged at 1.7%. Though ECB forecasts showed that growth will ease slightly faster than previously anticipated, Draghi said that the underlying strength of the economy is solid enough to cope with global risks. He added that downside risks are going to be mitigated by the improvement in the labor market and rising wages. Looking out, the ECB still expects growth to remain stable over the next few quarters, in line with elevated levels of business and consumer sentiment though real GDP is projected to trend gradually lower towards 1.7% in 2020 as tailwind gradually fades.

- **ECB's inflation profile for the Eurozone remains flat at 1.7% for forecast horizon from 2018 - 2020**. Uncertainty around inflation outlook is receding and the ECB expects core inflation to pick up towards the end of 2018 and thereafter to increase gradually.

- **Headline Euro-area CPI picked up pace to 2.1% in Sep (vs. 2% in Aug), in line with our expectation. Electricity and gas prices were the main contributors. Core CPI held steady at 0.9% and could accelerate in Oct as cuts to education costs in Italy (implemented last year) drops out of the annual comparison.** We reiterate that current level of inflation has already topped ECB's sub-2% target and has validated our long-standing call for inflation to rise amid ECB's accommodative monetary policy stance, higher energy prices and wage growth (negotiated wages rose to 2.2% y/y in 2Q from 1.7% in 1Q and is expected to rise further as wage agreements often last 2 years or more).

- **Monetary Policy Forecast: There is no ECB Governing Council meeting scheduled for Nov. The next meeting is scheduled on 13 Dec.** We expect ECB to **confirm the end to QE at this meeting. Currently, the asset purchase program is proceeding at monthly pace of €15 billion between Oct and Dec (a reduction from €30 billion). The ECB is also expected to keep rates unchanged** (Policy rates (Main Refinancing operations, deposit facility and marginal lending facility hold at 0%, -0.4% and 0.25%, respectively) **till Autumn 2019 (around Oct-Nov), as guided by ECB President Draghi but we continue to see risk that the ECB may need to move earlier than expected** (relative to ECB's timeline) should (1) inflation data, in particular core CPI continues to surprise to the upside while (2) growth and activity data continues to hold up. With global oil production unlikely to see further increases, oil prices could still stay supported and higher energy prices have already tipped Euro-area inflation to overshoot ECB's inflation target of under-2%. Headline CPI was last at 2.1 % y/y (Sep). A weaker currency (YTD decline of 10% at one point vs. USD) could result in higher prices via the **import price channel**. This should add on to further upside pressure for Euro-area CPI. **We do not rule out the possibility that ECB could proceed with baby steps to normalize deposit rate first** (currently at -0.4%) at some stage.

  - Recall that *Austrian central bank Governor Nowotny said (23 Sep) he would welcome moving the ECB's deposit rate towards -0.2% from current -0.4%. Other ECB heavyweights including Coeure and Praet said there the ECB would need to start clarifying the likely path of its interest rates beyond its first rate hike;*

  - *In a testimony to the European Parliament's Economic and Monetary Affairs Committee in Brussels (24 Sep), Draghi described acceleration in underlying inflation in the euro zone as "relatively vigorous" and expressed confidence that a pick-up in wage growth would continue.*

- At the last ECB meeting (25 Oct), ECB's Draghi acknowledged weaker momentum in the Euro area economy, pointing to drag from auto production in Germany but he maintained his optimism that developments since Sep were not sufficient to warrant a change in baseline scenario. There were concerns from the floor on Italy's budget but Draghi expressed confidence that a resolution will be reached. Draghi (Italian nationality) has also told Italy government to ‘reduce the tone and don’t question the constitutional framework of the EUR’ as well as to reduce the bond spreads.

- **Latest Fiscal and External Balance Outlook:** Euro area’s current account surplus widened to EUR24bn in Aug, from EUR19bn in Jul. This was due to increase in visible trade surplus while services trade surplus fell but by a smaller magnitude. Current account surplus to GDP was last seen at 3.3%, for the 12-months to Aug. ECB expects current account surplus to narrow further to 2.8% of GDP in 2019.

- The EA19 government deficit narrowed to -0.9% of GDP in end-2017 (vs. -1% of GDP in 3Q). This is the narrowest level since 2008. Breakdown showed German government recorded +1.3% surplus of GDP while deficits were seen for France, Italy and Spain at -2.6%, -2.3% and -3.1 of GDP, respectively. Government debt to GDP also declined to 86.7% as of end-2017 (vs. 89% at end-2016).

- **Key domestic events and issues to watch:** Oct Mfg PMI (2 Nov); Oct services PMI, Sep PPI (6 Nov); Sep retail sales (7 Nov); ZEW survey expectations (13 Nov); Sep IP, 3Q GDP, employment (14 Nov); Sep trade (15 Nov): Oct CPI (16 Nov); Sep current account, construction output (19 Nov); Nov consumer confidence (22 Nov); Nov prelim PMIs (23 Nov); Oct unemployment rate, Nov CPI estimates (30 Nov).

- **Technical Outlook:** Our call (in last month’s FX Monthly) for EUR to retrace lower towards 1.15 was more than met. EUR traded a low of 1.1336 (26 Oct). Last seen at 1.1350 levels. Bearish momentum on daily chart shows tentative signs of waning while stochastics shows signs of turning around from oversold conditions. A corrective rebound from current levels towards 1.15 (21 DMA), 1.1590 (50, 100 DMAs) 1.1620 could be on the cards in the next 1-3 weeks but question remains over its sustainability of the rebound. Support at 1.13 (2018 low). A decisive break below that should see a resumption of the downtrend seen from start of the year, towards 1.12. A completion of the bearish head & shoulders pattern should then see the pair tests 1.08, 1.05 levels.

GBP: A Tale of *Deal or No Deal Brexit*

Forecast	4Q 2018	1Q 2019	2Q 2019	3Q 2019
GBPUSD	**1.3000** (1.3200)	**1.2800** (1.3000)	**1.3200** (1.3400)	**1.3400** (1.3500)

Previous Forecast in Parenthesis

- **Motivation for the FX View**: GBP remains primarily driven by the fluid nature of the progress on brexit development. Domestically, PM May continues to face challenges on her brexit plan while externally, EU-UK negotiation continues to run into issues concerning Irish borders. The extraordinary EU summit that was supposed to be scheduled in mid-Nov remains an uncertainty. This remains dependent on EU-UK brexit negotiation. A go-ahead at the eleventh hour (our base case for Brexit deal) will suggest material progression being made and this could negate GBP bearish pressure and expose asymmetric upside risks, given stretched GBP short positioning. Rebound spikes towards 1.29 – 1.30 not ruled out. Elsewhere we see interim support at 1.2750, 1.2660 levels. We caution that GBP downside will increasingly be more vulnerable on prolonged time taken to resolve Brexit differences. A scenario of *no-deal Brexit* may see 1.2660-support being taken out.

- We further lowered GBP forecasts for the next 2 quarters, to take into account persistent uncertainties on Brexit in the near term. 1Q 2018 forecast was kinked lower than 4Q 2018 to account for uncertainties (and possibly downside pressure on GBP; higher vols) in the lead up to Brexit day (29-Mar 2019). Barring these short-term nuances driven by Brexit, we continue to retain our cautious optimism on GBP's outlook, on the basis that UK will manage an orderly Brexit. (our base case remains for UK to strike a deal with EU at the eleventh hour while PM May remains in power and the cabinet divide narrows). We argue that any positive progress towards an agreement on Brexit could result in further unwinding of GBP shorts. **To be sure, future trade deal need not be negotiated before UK formally exits on 29 Mar 2019; only the separation agreement needs to be negotiated before 29th Mar 2019 to avoid a disorderly exit.**

- **Downside Risks to Our Outlook:** (1) no-deal brexit (akin to hard brexit scenario) concerns if re-emerged will dampen confidence on GBP bulls; (2) Delay in finalising a deal heightens uncertainty (raises fears of disorderly brexit), dampen investor/business confidence and expose GBP to further vulnerabilities; (3) growing divide within PM May's cabinet and conservative leading to PM May's leadership being challenged is also another source of volatility for GBP; (4) slowing economic momentum including deceleration in wage growth, PMIs, IP will weigh on GBP.

- Into the medium term, we maintain our bias that GBP could trade higher. GBP is perceived to be undervalued from both historical and fundamentals perspective (our BEER model puts GBP at 1.40 – 1.45). The 20% or so depreciation in the Brexit-aftermath (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 hold to our belief that UK should be able to manage the exit, transform itself into a global marketplace and continue to attract capital (longer-term).

    - 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: 2Q GDP rebounded to +0.4% q/q (vs. +0.2% in 1Q).** The rebound was attributed to the construction and services sectors (strongest quarterly expansion since end-2016 and accounts for nearly 80% of UK economy) thanks to hot weather following the cold snap in 1Q (which weighed on growth and activity). It was reported that the Office for National Statistics (ONS) lowered UK economic growth to 1.2% for 2018 due to larger than expected hit from last winter's snow. Activity data was a mixed bag - manufacturing PMI rose in Sep while services and construction PMI moderated; industrial and manufacturing accelerated but retail sales slipped from prior month. We expect growth momentum for 3Q to remain steady. 3Q GDP advanced estimates will be released on 9 Nov.

- The next quarterly MPS (to be released on 1 Nov) will be closely scrutinized for any downgrade in growth projection (especially after ONS lowered GDP projection for 2018. In the last Quarterly Inflation report (2 Aug), BoE MPC **expects GDP to grow by around 1.75% per year on average over the forecast period**. Net trade and business investment could continue to support UK activity while consumption grows in line with the subdued pace of real incomes. The MPC continues to judge that the UK economy currently has a very limited degree of slack. Unemployment is low (5.2%) and is projected to fall a little further. In the MPC's central projection, therefore, a small margin of excess demand emerges by late 2019 and this could feed through into higher growth in domestic costs than has been seen over recent years.

- **UK headline inflation eased from 6-month high of 2.7% in Aug to 2.4% in Sep.** The decline was due to lower prices for food and non-alcoholic drinks. Core inflation slipped to +1.9% (vs. +2.1% in Aug). The fall in inflation was welcomed to some extent as wage squeeze eases. Wage growth (ex-bonus) picked up pace to 3.1% (vs. 2.9% prior month). Planned cap on standard variable tariffs for gas and electricity is expected to take some pressure of rising prices in the meantime but we caution that any sustained wage growth and further rise in oil prices may still keep prices somewhat supported.

- **Monetary Policy Forecast: The next BoE MPC meeting is scheduled for 1 Nov. We expect BoE to keep policy rate unchanged at 0.75% for the rest of 2018** (the last MPC meeting is scheduled on 20 Dec). Monetary policy stance is likely to remain status quo for as long as over the next 6 -9 months before the next rate hike as uncertainty over Brexit **takes precedence over policy normalisation. Softer inflation profile is also another reason for the lack of urgency to tighten further at this point. OIS implied suggests the next rate hike could take place in Aug-2019 at the earliest (51.3% probability).** BoE's forward guidance shows another 2 hikes expected to end-2020. We remain watchful of inflationary pressures as tight labor market can further generate domestic price pressures. Sustained rebound in CPI towards 3% again could change our view on BoE policy status quo (to front-load rate hikes). The size of BoE balance sheet (GBP435bn) is also expected to stay unchanged until policy rate reached 1.5% (this was discussed and agreed at the Jun BoE MPC meeting). The policy rate was last raised by 25bps at the Aug meeting.

- There was no MPC meeting scheduled for Oct. The last BoE meeting on 13 Sep, MPC voted 9-0 to keep policy rate unchanged at 0.75%, as widely expected. MPC flagged “greater uncertainty” around Brexit negotiations but raised forecast for UK economic growth to 0.5% for 3Q (up from 0.4%) on potentially higher consumer spending over warm summer. Carney shared in a cabinet meeting (13 Sep) that the impact of no-deal Brexit could be as catastrophic as the 2008-09 GFC. According to media reports, Carney “painted a bleak economic picture of unemployment reaching double figures in percentage terms, house prices falling by 25-35% over three years, and transport links with the EU, including air travel and the Eurostar, stalling”.

- **Latest Fiscal and External Balance Outlook** UK’s current account deficit widened to -3.9% of GDP for 2Q (vs. -3.4% of GDP in 1Q). Deterioration was due to widening of trade deficit. The Office of Budget Responsibility has projected current account deficit to be about -4.4% of GDP in 2021, rather than -2% of GDP initially forecasted in Mar 2017. Foreign inflow of capital is needed to fund the deficit. But if Brexit uncertainty takes a turn for the worse or persists for longer, investor/business sentiment can be adversely impacted. Slowdown in foreign inflows could worsen the situation and the GBP could come under pressure as a result.

- UK budget deficit narrowed more than expected in Sep while August deficit was also revised lower. For the first 6 months of 2018-19 financial year, the budget deficit stood at GBP19.9bn, down by about 35% from the previous year and was at the narrowest at this stage of the year since 2002. Progress suggests the Chancellor Hammond is on course to undershoot the forecast deficit of 1.8% of GDP. Ultimately Hammond is targeting a budget surplus by mid-2020s, in order to cut national debt as a share of GDP, which he says, is too high to easily support a big rise in public spending during a future deep recession. In the recent Budget announcement (29 Oct), Chancellor Hammond pledged extra cash for National Health services, Ministry of Defence and brought forward an earlier than planned income tax cut (in the way of an increase in personal tax-free allowance to GBP12,500, tax break when higher income tax rate threshold rises in Apr-2019). He also earmarked GBP500mio for no-brexit contingency preparation and introduced a digital services tax, targeted at tech giants such as Facebook, Netflix and Google. In sum, he said that the eight years of cuts to public services (so-called austerity measures) are now coming to an end - but only if UK secures a Brexit deal.

- **Key domestic events and issues to watch:** Oct Mfg PMI, BoE MPC policy decision, Quarterly Inflation Report (1 Nov); Oct construction PMI (2 Nov); Oct services PMI (5 Nov); Oct house prices (7 Nov); Sep trade, IP, construction output, 3Q GDP (9 Nov); Sep labor market report (13 Nov); Oct CPI, PPI, RPI (14 Nov); Oct retail sales (15 Nov); Oct public finances (21 Nov); Nov consumer confidence (30 Nov).

- **Technical Outlook:** GBP traded lower for the month of Oct, in line with our call in the last FX Monthly but the extension of the decline was outside our expectations. Pair was last seen at 1.2710 levels. Bullish momentum on weekly chart is waning while stochastics has turned lower. On the daily chart, bearish momentum on daily chart remains intact though stochastics is in oversold conditions. Risk of further pullback not ruled out but likely to be limited towards support at 1.2660 (2018 low). Break below this would nullify our bias and puts 1.25 in focus. Resistance at 1.2780 (upward sloping trend-line support from the low of 2017 and 2018), 1.29 and 1.30 levels.

AUD: Short Term Rebound Plausible

Forecast	4Q 2018	1Q 2019	2Q 2019	3Q 2019
AUDUSD	0.71 (--)	0.68 (0.69)	0.70 (0.68)	0.72 (0.70)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** The path of least resistance has been down for the AUD for a while now. However, hawkish Fed, the spike in the UST 10y yield, more headlines on US-China that culminates to RMB weakness seem to have less effect on the AUD in recent weeks. Into Nov, we see a potential for AUD to make a rebound. Net short AUD position reduced modestly in the past two weeks. We do not want to rule out a rebound towards the 0.72-figure and a break-out there would violate the trend channel that this pair has been trading in for most part of this year. Support area is seen around 0.68-0.70. Into the first quarter of 2019, we see risk of AUDUSD heading towards 0.68 as Fed remains on the tightening path whilst RBA is unmoved. Some recovery is expected into 2Q as the US economy is expected to peak.

- The political turmoil in Australia did not have much impact on the AUD as the government is still expected to pursue somewhat expansionary fiscal policy into 2019 ahead of the elections that should come by May save for some tweaks in personal income and housing policy. In any case, the rebound in the commodity prices could allow room for the government to do so. US growth outlook, fiscal and foreign policy has a slightly more significant impact on the AUD. To be sure, Australia's hiring momentum is robust, private consumption is firm, private investment has been strong, and capacity utilization rates are high. However, US-China trade war dampens global trade. AUD is one of the most sensitive currencies to the trade war and we reckon a huge part of the trade war is in the price. Upshot is that Australia is one of the top trading partners of China (6^{th} largest in terms of 2017 total trade), upcoming tariff cut that China has planned could cushion some of its impact. At home, the decline in its real estate market could crimp on private consumption, not helped the least by the rise in the mortgage rates. So whilst the economy is robust, slower global growth and trade, softening property market could translate to negative wealth effect and further limit the impetus to move rates. With AUD already down so much for the year, positioning matters. Net short positioning for the AUD is at still near

3.5 year lows according to data from CFTC and this could still render AUD vulnerable to short squeezes. However, the broad trend is still to the downside and we look for AUD to end the year at around 0.71.

- **Growth and Inflation Outlook:**
  - From the last available data, 2Q GDP came in above the expected at 0.9% q/q, just a tad softer than the previous 1.1% (which was revised higher). Consumption maintained its pace with household consumption picking up pace in 2Q to 0.4%q/q from previous 0.6%, offsetting the deceleration in government expenditure to 0.2%q/q from 0.3%. With AUD not making much recovery yet, expect that to continue to support net exports subcomponent. We are not particularly bullish on the household consumption given tightening financial conditions and low wage growth that could crimp on disposable income. The rise in the money market rates prompted some major local lenders to raise their mortgage rates recently. However, inflation is still benign enough to support household consumption.

  - **As of last release, CPI** quickened to 2.1%y/y in 2Q from previous 1.9%. The average of the trimmed mean and median was at 1.9%. Seasonally adjusted, the headline actually firmed to 2.2%y/y from previous 2.0%. Food inflation softened in the quarter but this was outweighed by the acceleration in transportation, recreation and education. Looking at the breakdown for goods and services, the CPI for goods seem to be on the uptick, possibly buoyed by the rise in energy prices as well as the cheaper AUD. With the drought affecting the agriculture output of the country, there could also be some upside risks to food inflation. Upside surprise in the next data could flush out some AUD shorts.

- **Monetary Policy Forecast:** We continue to expect RBA to keep cash target rates unchanged and we see an increasing possibility of the central bank standing pat throughout 2019. With the CPI still close to the lower bound of the 2-3% inflation target and plenty of uncertainty in the horizon amid the current trade war, there is very little motivation for the central bank to move rates at this point. RBA published a study on wage growth puzzles and technology which has monetary policy implication. It finds that *the increasing impact of digital technology is certainly not the only factor that may be leading to increased competition in product markets and greater employer resistance to cost – including wage cost – pressures, but the anecdotal evidence suggest it is an important and growing one*. With consumption likely to remain subdued, inflation pressure could remain tempered. That could offset price pressure from a cheaper AUD.

- We note that RBA seems to be comfortable with the AUD at this point and even stated its expectations for terms of trade to "stay at a relatively high level". That said, RBA Lowe had said that the next move is still likely a hike rather than a cut and that somewhat protects the downside for the AUD. However, that rate hike might not come at all as wage growth remains subdued and as mortgage rates creep higher, leaving less room for RBA to lift rates in the near future.

- **Latest Fiscal and External Balance Outlook:** The Federal budget could continue to remain supported by the strong rebound in the commodity prices. Budget deficit for 2018-19 was reported to be A$10.1bn by the new Treasurer Josh Frydenberg vs the projected A$14.5bn. In response, S&P upgraded its negative watch on Australia to stable, affirming the AAA rating of the sovereign. S&P is confident that Australia's budget would return to surplus and a property crash is less likely. The government projects a surplus of A$2.2bn in 2019-20, in line with market expectation. The outstanding Australian government debt is projected to be at A$533bn by the end of June this year and at A$561bn at the end of Jun next year. Thus net debt is forecast to peak at 18.6% of GDP in 2017-18.

- **Key domestic events and issues to watch:** 3Q CPI on 31st Oct; trade data on 1st Nov; 3Q PPI and Sep retail sales on 2nd Nov; MI inflation gauge on 5th; RBA meeting on 6th; SomP, home loans on 9th; NAB business survey for Oct on 13th; Wage price index for 3Q on 14th; Westpac consumer confidence for Nov on 14th; labour report on the 15th; Minutes of the RBA meeting on the 20th; 3Q Capex on 29th.

- **Technical Outlook:** AUDUSD last printed 0.71, bouncing from a low of 0.7021 made on 21 Oct. This pair is still firmly within the trend channel and widening yield differentials suggest that this pair could head towards the 0.70 by the end of the year. Stretched short positioning suggests that AUDUSD could be vulnerable to short squeezes in the short-term and we still eye the 0.72-figure for an indication of the break out. Support at 0.69/70. Momentum is lacking. So the path of least resistance is southbound still.

NZD: Bearish Bias Remains But Mild Rebound Likely

Forecast	4Q 2018	1Q 2019	2Q 2019	3Q 2019
NZDUSD	**0.6500** (--)	**0.6400** (0.6700)	**0.6600** (0.7000)	**0.6800** (0.7200)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** We maintain a bearish take on NZD amid growing monetary policy divergence (between Fed and RBNZ), with 10Y yield differentials at -55bps, forward leading indicators pointing to potential slippage in activity momentum for 3Q, softer dairy outlook (Fonterra revised milk prices lower to between $6.25 - $6.5, from previous forecast of $6.75), ongoing trade tensions between US and China and US equity sell-off (a drag on risk sentiment). We revised our 2019 forecast lower, penciling in more weakness for 1Q

2019 to account for the risk of UST yield overshooting and the risk of US-China trade tensions re-escalating. Nonetheless we kept the upward sloping trajectory for NZD intact on the basis that US-NZ growth differentials slow in favor of NZ (US growth potentially to peak) and negative yield differential between NZ-UST to slow as Fed inches closer towards end of policy normalisation.

- While NZD bearish bias remains intact, we do not rule out rebound risks (1 -3 weeks horizon), amid NZD net short positioning at record high. We continue to hold to our view, articulated in the last FX Monthly that NZD may have formed an interim base around 0.64 – 0.65 levels and a recovery in risk sentiment may force stale NZD shorts to unwind, resulting in rebound pressure towards 0.66, 0.67 in the short term. A case for potential USD softness in the near term due to US mid-term elections (6 Nov) or supported sentiment arising out of Trump-Xi meeting (30 Nov) may also help NZD to recovery lost ground. Slower pace of UST increase may help to narrow the negative yield differential and provide some support for NZD.

- **Growth and Inflation Outlook:** The most recent quarterly MPS (9th Aug) noted that growth over the medium term is expected to recover in 2019 (towards 3.5% RBNZ projection), supported by fiscal stimulus (government's Families Package), export growth and monetary stimulus.

- **While 2Q GDP silenced critics, we are cautious of 3Q growth as services and manufacturing activity suggest a deceleration** while **trade deficit widened amid slump in dairy exports**. Though business confidence rebounded in Sep, from 10Y lows, the level remains soft (at -38.3 from the low of -50.3). Taken together these forward leading indicators may suggest a deceleration in growth momentum for 3Q.

    – **NZ GDP picked up pace in 2Q, rising to** +1% q/q (vs. 0.5% in 1Q vs. 0.8% expected). This is the fastest rate of expansion in 2 years. On y/y basis, growth accelerated to 2.8% in 2Q from 2.6% in 1Q. Growth was broad-based with 15 out of 16 industries recording higher production. Mining sector was the outlier; fell by most in 30 years after an unplanned shutdown disrupted gas production. Services sector led growth, in particular retail trade and accommodation, wholesale trade, and transport industries were stronger backed by a combination of increased household spending and strong international spending.

- On inflation outlook, **MPC projected a delayed return in inflation to RBNZ's target range mid-point to 1Q 2021** (from late 2020 as projected in May MPS). RBNZ expects CPI to increase in 2019, supported by non-tradables inflation while tradables inflation is expected to increase (amid fuel excise duties) but remain below its historical average.

- **Headline CPI surprised to the upside, picking up pace to 0.9% q/q in 3Q (vs. 0.4% in 2Q). On y/y basis, 3Q CPI accelerated to 1.9% (vs. 1.5% in 2Q).** The rise was due to higher gasoline prices, house construction prices, land taxes and food prices. Headline CPI now comes close to the middle of RBNZ's inflation target range of 1 – 3%.

Our internal projection also shows inflation possibly rising towards RBNZ's median target of 2% in early 2019. RBNZ quarterly survey of inflation expectation for 3Q also showed a modest rise to 2.04% y/y. Inflation expectations tend to have implication on inflation, OCR and the NZD. PPI rose further in 2Q (input up 1% vs. 0.6%; output up 0.9% vs. 0.2% q/q). This is the 9th consecutive quarters of gains amid rise in fuel prices. 3Q PPI to be released on 19th Nov.

- **Monetary Policy Forecast:** RBNZ MPC policy decision in due on 8th Nov - this is also the last for the year before RBNZ next meet on 13th Feb 2019. **We expect RBNZ to retain the slightly dovish rhetoric unchanged and keep OCR on hold at 1.75%** amid signs of moderation in global activity, sluggish business confidence, cautious inflation outlook, ongoing trade war concerns between US and China. The Quarterly MPS will be released as well – focus on any upward revisions to growth and inflation given that recent data surprised to the upside but is likely that RBNZ Governor Orr may choose to look past the transitory jump in 2Q GDP and 3Q inflation as the former was considered a lagged data as compared to business confidence, activity and survey indicators while the latter was probably due to one-off factors such as fuel taxes (3.5ct per litre nationwide increase was introduced on 30 Sep). RBNZ is likely to reiterate its caution that the next move could be a cut instead of a hike but we do not subscribe to the "cut" bias as growth, activity and inflation outlook remain promising and do not warrant a rate cut. In fact the latest jump in inflation suggests the odds of rate cut should pare back and we expect inflation to pick up, owing to fiscal impulse, higher prices via import price channel given the depreciation in NZD, higher oil prices and minimum wage increases. **Our expectation is still for a rate hike in 2H 2019, about 1 year earlier than RBNZ's projection of end-2020.**

- At the last MPC meeting (27 Sep), RBNZ MPC kept OCR unchanged at 1.75% as widely expected and RBNZ continued to retain its dovish tilt. **RBNZ Governor Orr reiterated that OCR is expected to be kept at current levels through 2019 and into 2020… the direction of the next OCR move could be up or down… pledge to keep OCR at an expansionary level for a considerable period to contribute to maximizing sustainable employment, and maintaining low and stable inflation.** As expected, RBNZ acknowledged that 2Q GDP growth was stronger than anticipated but downside risks to growth outlook remain. Accompanying statement also noted that "*robust global economic growth and a lower New Zealand dollar exchange rate is expected to support demand for our exports. Global inflationary pressure is expected to rise, but remain modest. Trade tensions remain in some major economies, increasing the risk that ongoing increases in trade barriers could undermine global growth. Domestically, ongoing spending and investment, by both households and government, is expected to support growth.*

- **Latest Fiscal and External Balance Outlook:** NZ current account deficit widened to -3.3% if GDP for the year through Jun 2018 (vs. -3% in 1Q vs. -2.9% expected). This is the widest level in 3 years and this was due to increase in primary income deficit. However on seasonally adjusted terms, 2Q current account deficit was narrower than in 1Q, due to rising exports of goods and services.

- NZ government surplus is projected to be $3.1bn this year rising to $7.3bn by 2020/21. Finance Minister Grant Robertson also shared that net debt at $62.5bn is relatively low compared to international trends and at 22.1% of GDP. It is projected to fall to 20.8% of GDP for the full year and 20% of GDP over the next 5 years.

- **Key domestic events and issues to watch:** Oct house prices (1 Nov); Oct consumer confidence (2 Nov); 3Q labor report including wages (7 Nov); RBNZ meeting (8 Nov); Oct card spending (9 Nov); Oct food prices (13 Nov); Oct Mfg PMI (16 Nov); Oct services PMI (19 Nov); 3Q PPI (19 Nov); Oct net migration (22 Nov); 3Q retail sales (26 Nov); Oct trade (27 Nov); Nov business confidence (29 Nov); Nov consumer confidence, Oct building permits (30 Nov).

- **Technical Outlook:** NZD has fallen by more than 13% from the highs early this year above 0.73-handle to a low of 0.6425 (early-Oct). While the NZD remains firmly within the downward sloping trend channel and the bias remains bearish as shown on momentum indicators, there are signs that a bottoming may be in place. Weekly chart shows a bullish divergence in the making with lower lows for NZD but higher lows are showing up on MACD histogram. Stochastics is also in oversold conditions and is showing tentative signs of turning. We hold to our view, previously articulated in the last Monthly outlook that an interim base may be forming around 0.64-0.65 levels. We do not rule out rebound risks in the short term towards 0.6580 (50 DMA), 0.6680 (100 DMA). Support at 0.6460 (76.4% fibo retracement of 2015 low to 2017 high) before 0.6430 (2018 low). A decisive push beyond this support risk nullifies the interim bottom call and could open way for further downside towards 0.6360, 0.6130 (2015 low).

JPY: Safe-Haven Demand Remains In Play

Forecast	4Q 2018	1Q 2019	2Q 2019	3Q 2019
USDJPY	112 (--)	113 (112)	108 (111)	106 (110)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** JPY has outperformed its G10 peers in Oct after being the worst performer against the USD in Sep. The JPY had rebounded from its decline of 2.35% against the USD in Sep to gain around 1.30% in Oct to date. Unlike in Sep, the main driver of JPY movements in Oct was not widening yield differentials between 10Y UST and JGB bonds. Instead, global risk aversion from the sell-off in global equities has spurred demand for safe-haven proxy plays including the JPY.

- We have adjusted our profile for USDJPY trajectory for 2019. External factors will largely drive the USDJPY trajectory in 2019. We now expect USDJPY to pick-up in 1Q 2019 to reflect our expectations of a Fed rate hike and peak in US growth that should keep yield differentials between 10Y UST and JGB widening. Thereafter, slowing US growth and a potential for a temporary pause in Fed rate hike could weigh on UST yields and drag the USDJPY lower in 2Q and 3Q. Concerns over global growth going into 2020 could lead to a re-rating of risk conditions and spur increase demand for safe-haven assets, weighing on the USDJPY by end-4Q 2019.

- Domestically, some concerns over the local elections in Apr 2019 and Upper House elections scheduled in Jul 2019, together with the possible referendum to amend the pacifist constitution could create some political instability in 2H 2019, which could in turn lead to safe-haven demand for the JPY. Implementation of the consumption sales tax hike in Oct 2019 and concerns of its impact on domestic consumption and overall growth could also add downside pressure on the USDJPY in 2H 2019.

- Our BEER fair value model which takes into account differentials in REER, terms of trade, GDP per capita and interest rate; net foreign assets (as % of GDP); ratio of total trade to GDP; productivity; and government consumption, estimates USDJPY at 109. This estimate suggests that the current level of the USDJPY is fundamentally undervalued by about 3.5% and this suggests some room for the JPY to appreciate towards our fair value estimate.

- However, gains in the JPY in Nov are likely to be gradual given that market appears to be positioning for further weakness in the JPY in the near term. Still, recently released CFTC data showed investors have continued to pare both their long and short bets on the JPY as of the week of 23 Oct. Their short-JPY bets were reduced to 122,726 contracts from 113,717 as of the week of 16 Oct, and their long-JPY bets were cut to 29,922 contracts from 30,096 over the same period.

- A re-escalation of Sino-US trade tensions in itself may not spur traditional safe-haven proxy plays like the JPY as Japan is also vulnerable to any fall-out from the trade disruption between the two world's largest economies. On the flip-side though, Japan and US are set to begin talks on automobiles and farm goods. While this should remove the threat of tariffs on Japanese goods during the talks, trade negotiations are unlike to be smooth and tension-free. Trump bluster and threat of US tariffs should trade talks falter could weigh on the JPY.

- USDJPY could also come under upside pressure from the widening of yield differentials between 10Y UST and JGB. Even if 10Y JGB yield is allowed to fluctuate in a wider range, 10Y UST yield is still expected to climb more rapidly by comparison on Fed rate hike expectations and increasing supply of bonds to finance the US government's budgetary requirements. This could keep the USDJPY supported in Nov.

- Thus, while downside pressure on the USDJPY remains intact, the move lower should be measured in Nov as discussed above. We continue to expect risk aversion and intensification of the concomitant sell-off in equity market towards the end of the year to weigh on the USDJPY towards the 112-levels by end-2018. Thereafter, we expect the pair to edge higher to the 113-levels in 1Q 2019 on Fed rate hike and peaking of US growth expectations before easing off in 2Q and 3Q to around 108 and 106 respectively on a possible pause in Fed rate hikes and slowdown in US growth.

- **Growth and Inflation Outlook:** Economic growth momentum is likely to persist into 2H 2018. Final GDP print for 2Q 2018 had shown the economy expanding at the fastest pace since 1Q 2017 at +0.7% q/q sa. Private sector orders for machinery (ex-volatile vessels and electricity) remained healthy, rising 12.6% y/y in Aug compared to +13.9% in Jul. Industrial production though moderated to 0.2% y/y in Aug vs. Jul's 2.2%. In addition, the government's planned extra budget of nearly JPY1tn for disaster relief and rebuilding efforts, in addition to the FY2017 supplementary spending package of around JPY2tn, as well as preparations in the run-up to the 2020 Olympics in Tokyo should bolster economic growth for the whole of 2018 and into 2019. Nevertheless, the BOJ in its latest economic outlook report was less sanguine regarding the economy. The BOJ sees FY2018 economic risks skewed to the downside compared to balanced risks for the economy in its previous outlook. The BOJ now expects full-year growth to come in around 1.4% in FY2018, slightly lower than the previous 1.5%. For FY2019 and FY2020, growth is expected to expand by 0.8% for both years.

- Core inflation (headline less fresh food) edged higher again, rising by 1.0% y/y in Sep – the highest it has been since Mar 2015. The rise in core inflation was attributed to higher energy prices, which rose 8.1% y/y. Still, the rise in core inflation is only half of the pace targeted by the BOJ, highlighted the challenges the central banks in spurring price momentum. Headline inflation though moderated slightly to 1.2% y/y in Sep from Aug's +1.3%, while core-core inflation (headline less fresh food and energy) was up by +0.4% y/y in Sep, the same pace as in Aug. While further oil price increases should help keep the price momentum going, it is higher wages, according to BOJ Governor Kuroda, that is needed to drive inflation towards 2%. Until then, any talk of normalisation remains premature. We expect the BOJ to continue its pursuit of its ultra-loose monetary policy until its 2% inflation target is achieved. Still, the lack of traction has led the BOJ to downgrade its inflation outlook for 2018, expecting core inflation to now average 0.9% vs. 1.1% previously. FY2019 and FY2020 core inflation is forecast to come in lower as well at 1.4% and 1.5% (excluding the effects of the consumption tax hike) respectively compared to its previous forecast of 1.5% and 1.6%.

- **Monetary Policy Forecast:** As expected, the BOJ unsurprisingly left its monetary policy unchanged at its 30-31 Oct meeting. The policy balance rate was maintained at -0.1% and the 10-year JGB yield target at around zero percent. Yield of 10Y JGB though have been on the rise as market test the upper limits of the range that the 10-year bond yield is allowed to fluctuate. BOJ operations though are likely to be used to cap too rapid climb in the yield and to maintain an orderly pace of advance in the 10Y yield. The 10Y JGB yield has hovered above the 0.10%-levels since. At the same time, the BOJ kept its forward guidance – its pledge to keep interest rates “very low” for the time being – unchanged as well.

- **Latest Fiscal and External Balance Outlook:** The government will be seeking approval for a supplementary budget to provide relief for a recent spate of natural disasters during the extraordinary session of the Diet which began on 24 Oct. The budget which included additional spending of JPY936bn is to reconstruct areas that have been devastated by natural disasters. Of this spending, JPY503bn will be targeting at restoration work stemming from heavy rains in Jul, JPY119bn for the Hokkaido earthquake and JPY105bn for the typhoon and quake in Osaka. Meanwhile, the government is also planning countermeasures by the end of the year to prevent the planned consumption tax hike in Oct 2019 from having a negative impact on the economy. The measures are likely to include tax breaks and subsidies for purchases of cars and homes, and will be compiled into the government’s draft budget for FY2019 beginning in Apr.

- After rising to JPY2.01tn in Jul, the current account (CA) surplus narrowed slightly to JPY1.84tn in Aug, weighed by the larger deficit in the goods and services account (JPY0.23tn) and smaller surplus in the income accounts (both primary and secondary). The financial account slipped back to a deficit of JPY1.91tn in Aug from a surplus of JPY0.83tn in Jul, bolstered by an increase in direction investment abroad of JPY1.35tn (vs. JPY1.13tn in Jul) and other investment overseas of JPY0.33tn (vs. Jul’s -JPY5.28tn). The overall balance of payments (BoP) slipped into a mild deficit of JPY75.21tn in Aug vs. Jul’s surplus of JPY2.83tn.

- **Key domestic events and issues to watch:** Key data release this month is preliminary 3Q18 GDP on 14 Nov. We have BOJ minutes of Sep policy meeting and summary of opinions of 31 Nov meeting on 5 and 8 Nov respectively. We also have BOJ Governor Kuroda speaking at Nagoya and Tokyo on 5 and 19 Nov respectively, and board member Funo speaking in Kochi on 7 Nov. JGB auctions in Nov: 10-year (1 Nov), 30-year (13 Nov), 5-year (15 Nov), 1-year (19 Nov) and 20-year (20 Nov).

- **Technical Outlook:** USDJPY partially retraced Oct’s losses into month-end as we speak. Pair was last seen at 113.25 levels. Daily momentum and stochastics indicators suggest the risk of near term upside towards 113.50, 113.80 levels. But weekly chart suggests the risk of pullback. Bearish divergence is potentially forming on the weekly charts, with higher highs seen for USDJPY in Jul and Oct-2018 but lower highs in the MACD (Price and Indicator divergence). This suggests there is waning upside momentum and may signal a reversal may come into play. Bias to lean against strength. Key support level to watch at 111.60. A decisive close below the key support on weekly basis could open way for further downside towards 110.26 (50 DMA). A break above 114.55 (2018 high) on the upside will nullify the bias.

RMB: Watching the 7

Forecast	4Q 2018	1Q 2019	2Q 2019	3Q 2019
USDCNY	6.95 (6.72)	7.05 (6.65)	6.95 (6.62)	6.92 (6.60)
USDCNH	6.95 (6.72)	7.05 (6.65)	6.95 (6.62)	6.92 (6.60)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** Nov is a rather pivotal month for the RMB. This will be the month that will test our base case assumption that the US mid-term elections is the most important trigger for the US to further re-escalate its trade war with China. While we are not looking for any resolution between the two nations, we expect the US to refrain from escalating trade war further. Divergence in monetary policy and growth could continue to weigh on the RMB vs. the USD. It is increasingly plausible for China to cut RRR almost every quarter in the next year as the economy continues to face challenges in the external environment and as deleveraging efforts that clamps down on shadow financing credit growth continue to bite. That underpins our projection for USDCNY to head towards 7.05 in 1Q next year. In the meantime, RMB stability is still important and that could mean weakness is slow and gradual. The currency has depreciated 11% from its 2018 highs against the USD and around 5% against the trade-weighted basket. A sharp depreciation could undermine other priorities.
  Should the US growth show further signs of peaking in the coming months, we look for some chance that USDCNY could head a tad lower. That said, we do not rule out fresh highs before now and mid-Nov and so eyes are still on the prized 7. As ECB prepares the market for further monetary normalization. Some convergence between the US and the rest of the DMs could see USD drifting lower and the USDCNH would take the lead from there. We look for USDCNY to head lower towards 6.92 by 3Q 2019, adjusted higher to take into account recent developments, divergence in monetary policy and underlying concerns that the US and China diplomatic ties could deteriorate further.
- As China's current account surpluses thin on rising services imports, the authorities strive to woo foreign institutional investors to its capital markets. MSCI had started to include A-shares in Apr and Aug this year but news broke that the index compiler could significantly increase the weight of the A-shares from next year and also including some smaller tech stocks. FTSE Russell follows suit with a decision pending on the inclusion of A-shares. This comes ahead of the Shanghai-London Stock Connect that is supposed to be launched in Dec this year. Foreign holdings of China Government Bonds have been on the rise. So we are unlikely to see a deliberate FX policy for yuan weakness as that could increase the opaqueness and uncertainty for investors. For big trends, USDCNY and USDCNH could still take the cue from the USD.

Growth and inflation outlook: Industrial production softened to 5.8%y/y from previous 6.1%, weighed by fall in the output from manufacturing that outweighs the contribution from power supply and mining. While industrial activity continues to soften, retail sales and fixed asset investment firmed a tad. With an overhaul of a personal income tax in the works and the State Council urging more government bond financing for infrastructure, expect further support for consumption and investment in anticipation of further impact from the trade war. Purchasing managers are increasingly cautious with the last PMI-mfg released at the 50-level from NBS. Caixin PMI-mfg came in also at the 50-figure.

Retail sales rose to 9.2%y/y for Sep from previous 9.0%. New yuan loans undershot expectations at CNY1.28trn vs. the expected CNY1.4trn. Aggregate financing surpassed expectations with a print of CNY2.21trn for Sep with an inclusion of a new item - special loan government bond issuance. Without the item, growth of aggregate financing actually slowed to 9.7%y/y from previous 10.1%. Industrial profits from private companies remains on a double digit decline, down -25.6%y/y though headline was a milder growth of 4.1%y/y from previous 9.2%.

- Inflationary pressure rose in Sep on the back of acceleration in many of the food subcomponents. However, the non-food subcomponent (that includes clothing, healthcare, transportation and communication, education culture and entertainment and residence) slowed to 1.7%. Services also slowed to 2.1%y/y from previous 2.7%, possibly dampened by slower domestic demand.

  Monetary Policy Forecast: A RRR cut may be needed to boost support for enterprise just before the 10% tariff on Chinese imports in the US is raised to 25%. Expect equity to also need some liquidity boost then but we do expect retail sales and investment to eventually see some improvement into 2019 just as external balance is likely to show the true impact of the trade war.

  PBoC ramped up liquidity injections to bring the open market operation rates lower. Deleveraging may not be a key priority now but the central bank is unlikely to repeat the 2009 debt binge. PBoC should continue to keep average-weighted OMO rate between 3.15-3.30%. 12M USDCNH forward points remain elevated above 700pips whilst that of onshore 12M forward slipped back into negative at last sight, 91.50pips.

  Latest Fiscal and External Balance Outlook: China had set out a target earlier this year, to reduce its budget deficit target from 3% of GDP to 2.6%, lower than speculated 2.9%. However, with the plentitude of fiscal measures undertaken recently, the budget deficit to GDP ratio could rise as China cushions growth in the face of a trade war. This is especially in light of only modest growth expected for this year.

- **Key domestic events and issues to watch:** NBS PMI and Caixin PMI due on 31st of Oct and 1st Nov respectively; BoP current account 3Q on 5th; FX Reserves on the 7th; trade data on the 8th; inflation on the 9th; money supply, new yuan loans, aggregate financing on 10-15th; activity data on the 14th; new home prices on the 15th; FX net settlement (clients) on the 19th; industrial profits on the 27th; G20 Summit of the leaders 30th;

- **Technical Outlook:** USDCNH retains a bias to the upside, last seen around 6.9650. This pair could remain guided by the 21-dma. Resistance is at the 7-figure. We do not want to rule out a pullback in Nov given the overbought condition that stochastics flag. Support at 6.92.

KRW: Chance for Gains; BoK Rate Hike Expected

Forecast	4Q 2018	1Q 2019	2Q 2019	3Q 2019
USDKRW	1130 (1110)	1150 (1100)	1130 (1090)	1110 (1080)

Previous Forecasts in Parenthesis

- **Motivation for the FX View: We see recovery space for KRW in the 1- 3 weeks horizon, for USDKRW to head lower towards 1121, 1110 levels,** playing on BoK rate hike expectations, targeted stimulus to support economy and jobs, potential USD and UST yield softness in the interim and feel-good factor in the lead up to Trump-Xi meeting in Mexico later in Nov. But caution remains in the wind as trade tensions could risk escalating and global equity sell-off may extend. These risk factors may be the stumbling blocks for KRW to extend any gains beyond 1110. We suggest playing the range of 1110 – 1150 for the month of Nov. USDKRW also tracks USDCNH closely. Further strong upmove in USDCNH beyond 7 may result in panic and this could see USDKRW overshoot our upper bound estimate of 1150, towards 1160.

- We revised USDKRW forecasts higher, with more upside priced in for 1Q 2019 due to the risk of UST yield overshooting amid Fed normalisation, US-China trade tensions re-escalating, USDCNY to test above 7-levels. We maintain the forecast trajectory for USD to ease into 2Q, 3Q 2019 on expectations the Fed-BoK policy divergence could slow as markets reprice the end of Fed normalisation and the risk of US growth peaking.

- We expect BoK to hike 25bps at the 30th Nov meeting, on the back of rising headline CPI (+1.9% in Sep), the presence of 2 dissenters at the last BoK MPC meeting, rising risk of capital outflows (2Y UST-KTB yield differential was last seen at +85bps vs. par early-2018 and about -40bps on average for 2017 while Fed-BoK policy rate differential has widened to +75bps from +50bps), and attempt to control runaway housing prices in Seoul. Though pace of economic growth may have slowed for 3Q and job market remains sluggish, we believe the more appropriate policy to address these issues is the planned fiscal stimulus, targeted to help to support consumers and business investments and boost employment.

- **Growth and Inflation Outlook: South Korea’s economic growth for 3Q was below expectation (+0.6% q/q vs. +0.8% expansion) but was steady when compared to 2Q growth (on sequential terms).** On y/y terms, growth expanded at 2% (vs. 2.8% in 2Q). While exports supported growth, the sharp pullback in investments, in particular facilities and construction investment were the main drags. While growth rate for 1H 2018 was +2.8%, S.Korea runs the risk of not meeting BoK's reduced 2018 FY growth projection to +2.7% (from 2.8%). BoK had cut GDP projection on 3 occasions this year from 3%, citing external risks. 3Q GDP report also showed that household consumption was modestly softer (added 1.2ppts to GDP growth, down from 1.3 ppts), partly due to sluggish job market. But we expect some improvement going forward as the government is introducing fiscal stimulus by way of fuel tax cut to ease burden on consumers and businesses as well as tax incentives and financial support for SMEs, This should help to sput job creation.

- **Inflation jumped to 1.9% in Sep from +1.4% y/y in Aug due to hot weather affecting agri-products and an end to previous cut in utilities** (government's social welfare policies resulting in the reduction of utility bill for Jul-Aug (amid summer heatwave).). **Core CPI rose to +1.2%** (vs. 0.9% in Aug). For the year, BoK expects inflation at 1.6%.

- **Monetary Policy Forecast**: We expect a 25bps rate hike at the next meeting on 30 Nov, to take policy rate to 1.75%, from 1.5%. Headline inflation in now running close to 2% target and we believe true inflation (defined as excluding the so-called "administered prices", which is controlled by the government for policy purposes and it applies to 30 service items including utilities and government subsidized welfare sectors such as medicine, education, etc.) is well above 2% (2Q seen at 2.2%). Even core inflation has shown a pick up. Though pace of economic growth may have slowed for 3Q, we believe the planned fiscal stimuli should help to support consumers and business investments. Though job market remains sluggish, the more appropriate policy to boost employment should be fiscal policy - which is now being implemented. In addition widening yield differential between US and Korea risks seeing further capital outflow. 2Y UST-KTB yield differential was last seen at +85bps vs. par early-2018 and about -40bps on average for 2017 while Fed-BoK policy rate differential has widened to +75bps from +50bps. Further widening in yield differentials in favor of US may trigger capital outflow and result in KRW depreciation. A potential BoK rate hike could stem the differential from further widening. The issue of widen rate differential was first brought up in Sep when BoK is said to monitor the US-Korea rate gap with more caution. The **presence of 2 dissenter is also significant for BoK policy decision.** At the 12 Jul, 31 Aug BoK MPC meetings, Lee Il-Houng, a distinguished Economist was the lone dissenter in the 7-member board. At the last meeting on 18 Oct, Koh Seung Beom joined Lee as the 2 dissenters (first time this year) on policy rate decision.

- At the last MPC meeting on 18th Oct, BoK MPC voted 5-2 to keep policy rate on hold at 1.5%. The previous meeting in Aug saw a vote of 6-1 to keep policy rate unchanged. The decision to keep rate on hold was aimed at supporting the economy and to address record high household debt issue. Accompanying statement said that "we will adjust the level of accommodation by monitoring growth and inflation… and will pay attention to trade with key partners, monetary policies of major central banks and geopolitical risks". But the policy meeting was interpreted as a hawkish hold as BoK Governor Lee sent a strong signal that it is time to focus on financial stability more than before as financial imbalances are increasing. President Moon's government is also said to be asking BoK to consider rate increase as easy monetary policy is contributing to rising house prices in Seoul.

- **Latest Fiscal and External Balance Outlook:** Current account surplus for Aug was seen at $8.44bn, modestly lower than $8.79bn in Jul but the surplus continued to extend its run for the longest on record at 78 months. Goods account surplus rose sharply on the back of rising global demand for Korea-made semi-conductors while services account remain in deficit due to outbound travel during Summer vacation period.

- Korea's national debt is projected to reach KRW700tn this year (38.6% of GDP) and to rise to KRW740tn next year. The level remains relatively low vs. other major developed economies.

- **Key domestic events and issues to watch:** S. Korea releases Oct exports, Mfg PMI, CPI (1 Nov); Oct FX reserves (5 Nov); Sep current account (6 Nov); Oct unemployment rate (14 Nov); Oct PPI (20 Nov); 3Q short term external debt (22 Nov); Nov consumer confidence (27 Nov); Oct IP, BoK meeting (30 Nov).

- **Technical Outlook:** USDKRW traded higher for the month of Oct. Last seen at 1140 levels. Bullish momentum on monthly, weekly and daily chart remains intact. Next resistance seen at 1150 (50% fibo retracement of 2016 high to 2018 low), 1160 before 1172 (61.8% fibo). Support seen at 1127 (38.2% fibo), 1110 levels. Bias to buy dips.

SGD: Risks Are To The Downside Near Term

Forecast	4Q 2018	1Q 2019	2Q 2019	3Q 2019
USDSGD	1.3850 (1.3650)	1.4000 (1.3650)	1.3900 (1.3600)	1.3800 (1.3550)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** The USDSGD remains on the backfoot in Oct even after from its new 2018 high of 1.3873-levels hit on 9 Oct. MAS move to remove accommodation further from policy provided the impetus for the pair to move lower and has helped to keep the pair's current move higher a slow grind. Still, the global sell-off in equities amid valuation concerns and escalating Sino-US trade war concerns is keeping the pair elevated above the 1.38-levels. We do not expect much relief to the pair on this front as that the risks to pair remain to the upside due to our house view for a firmer USDCNH going into reflect the changes to the USDCNH. We now expect the pair to remain lofty above the 1.38-level over the forecast horizon, but maintain our trajectory for the USDSGD to ease off gradually by end-2019.

- The USDSGD faces downside pressure from the expected weakness in the yuan amid a slowdown in economic growth and economic disruptions from escalating Sino-US trade war concerns. A softer yuan is expected to be a drag on the SGD given the strong trade and financial links between China and the US, and more importantly, the use of the SGD as a proxy-play for the CNY.

- Similarly, political uncertainty in the Germany and the vacuum in EU leadership with Merkel's eventual exit from the political arena as well as concerns about Italy's commitment to the economic goals of the Eurozone should weigh on the EUR. This should keep the EUR from accelerating at more rapid pace in 2019, particularly in the next six months. This in turn should weigh on the SGD given the negative correlation between the EURUSD and the USDSGD. A softer EURUSD should be supportive of the USDSGD. Thereafter, monetary policy convergence between the ECB and Fed should be supportive of the EUR, providing the SGD will a lift.

- Underscoring the SGD is its still healthy domestic fundamentals. The healthy budget surpluses of the past few years provide fiscal space for the government to accelerate its infrastructure programme, including development of Changi Airport Terminal 5 and the redevelopment and rejuvenation of the Jurong Lake District, should it become necessary. Pump-priming by the government could mitigate any economic slowdown resulting from economic disruptions due to the Sino-US trade war. Aside from the country's ample fiscal space, its triple-A status and persistent high balance of payments surpluses are also supportive of the SGD. These should provide incentive for investors to remain invested in Singapore assets, including the SGD. Taken together, the healthy macroeconomic fundamentals should keep the SGD supported and could keep the USDSGD on its gradual downward trajectory going into 2019.

- At the same time, we cannot rule out the possibility of the MAS tightening policy further at its Apr 2019 meeting. The MAS had highlighted at its Macroeconomic Review the improvement in the labour market, higher oil and water costs, and increases in public transport costs should put upside pressure on core inflation in the coming quarters. Further upticks in core inflation above the 2% level could lead the MAS to tighten policy even further to remove policy accommodation. This should provide upside impetus to the USDSGD in the lead-up to the Apr meeting. We are likely to see a relatively stronger SGD from 2Q 2019 onwards.

- Given the changes to our USDCNH outlook, together with the added weakness of the EUR, we now expect the USDSGD to continue to gyrate around the 1.3850-levels until the end of the year. We expect Fed fund rate hikes in 1Q and negative eurozone developments to lift the USDSGD higher to 1.40 by end-1Q 2018 before easing off to 1.39 and 1.38 by end-2Q and -3Q respectively.

- **Growth and Inflation Outlook:** Not unexpectedly, the economy expanded at a more moderate pace in 3Q 2018, coming at +2.6% y/y in the advanced estimates vs. +4.1% in 2Q – the softest pace in six quarters. Weighing on GDP growth was manufacturing, which lost momentum after two years of acceleration. Manufacturing slowed to +4.5% y/y in 3Q compared to +10.6% in 2Q mainly on the back of softer electronics. Construction remained a drag on the economy, contracting by 3.1% though this was much slower pace of decline than the -4.2% in 2Q. Services though maintained its growth momentum, expanding by 2.9% y/y in 3Q, a similar pace as in 2Q.

- MAS in its latest Macroeconomic Review expects the services sector to play a bigger role in supporting the economy. MTI expects GDP growth to come in within the upper half of its 2.5-3.5% forecast range for 2018. Our economic team expects the economy to be negatively impacted by the escalating Sino-US trade war, particularly by the tariffs on half of the China-US trade that will be hiked to 25% on 1 Jan 2019. This is likely to impact manufacturing, resulting in low single digit growth for the rest of 2018 and into 2019. Similarly for services as trade dependent sectors get impacted by lower trade volumes. A strong SGD relative to its regional peers may also hurt tourism and retail spending. Consequently, our economic team has lowered their 2018 and 2019 growth forecasts to 3.4% (from 3.5% previously) and 2.2% (from 2.7% previously) respectively.

- Headline inflation rose 0.7% y/y in Sep, unchanged from Aug, helped by the softer decline in accommodation (-2.5%) and private road transport cost (-0.1%). Meanwhile, core inflation (headline inflation less private road transport and accommodation costs) slowed to +1.8% y/y (Aug: +1.9%), underpinned by a moderation in retail inflation due to softer clothing and footwear prices and a steeper decline in recreation and entertainment goods and telecommunication equipment.

- The MAS appears concerned about rising core inflation in the recent months and remains hawkish in its inflation outlook. Its hawkish outlook is premised on the labour market slack having been absorbed that should provide the impetus to domestic price pressure towards end-2018 and into 2019. Amid sustained economic growth and improving labour market conditions, the MAS expects core inflation to edge up to around 2% for the rest of 2018 underpinned by higher oil prices. For the full-year, it expects core inflation to average 1.5-2% in 2018 and then to 1.5-2.5% in 2019. In contrast, our economic team is less sanguine, expecting escalating Sino-US trade war to put downside risks to inflation and growth in 2019. The team expects headline and core inflation to come in at +0.6% and +1.7% respectively in 2018 before accelerating to 1.2% and 1.8% respectively in 2019

- **Monetary Policy Forecast**: The MAS further tightened monetary policy at its semi-annual policy meeting on 12 Oct. The MAS increased "slightly" the slope of the SGD NEER policy band, while keeping the level at which the band is centred and the width of the policy band unchanged. In the absence of information from the MAS, we have assumed the "slight" steepening of the slope of the SGD NEER to entail an adjustment of 0.25% p.a., smaller than the 0.75% p.a. we had assumed for the Apr 2018 move. This brings the total steepening of the slope to 1% p.a. thus far. This should allow for a stronger SGD on a trade-weighted basis to mitigate the expected the climb in core inflation in 2019 and anchor inflationary expectations.

- The move comes after MAS expects output to keep slightly above potential and core inflation to "experience modest but continuing pressures" on account of higher global oil and food prices. We had expected the MAS to maintain the status quo due to downside risk from global trade disruption and its deflationary impact on the economy. MAS though is more optimistic, expecting the global economic environment to be resilient, expecting "a small, positive output gap … to persist into 2019" instead. In its recent Macroeconomic Review, the MAS expects growth to be enduring aided by the services sector even as global uncertainties such as Sino-US trade war rises. For now, we cannot rule out the possibility of the MAS tightening policy further at its Apr 2019 meeting. The MAS had also highlighted at its Macroeconomic Review the improvement in the labour market, higher oil and water costs, and increases in public transport costs should put upside pressure on core inflation in the coming quarters. Further upticks in core inflation above the 2% level could lead the MAS to tighten policy even further to remove policy accommodation.

- The USDSGD traded to a new 2018 at 1.3873 on 9 Oct but has since eased from that level to hover around the 1.38-handle at the point of writing amid a global equity sell-off that has weighed on the USD. Pair is currently sideways within the 1.3720-1.3850 range currently. Softer USDSGD though has not translated into slower increases in domestic interest rates. The 3-month SOR (3MSOR) has decelerated from the 1.654% levels at the start of Oct to around 1.646%-levels at the point of writing. On the other hand, 3-month SIBOR (3MSIBOR) has climbed to a new 10-year high of 1.646% on 26 Oct as domestic liquidity tightened. Both the 3-month SOR and 3-month SIBOR should remain elevated as the withdrawal of monetary stimulus in the advanced economies continues. We are now gradually seeing mortgage rates to the climb in domestic rates. Deposit rates (for 12-month fixed) also continues to edge higher, climbing 2bp to 0.40%-levels on 3 Sep. This suggests that risks related to interest rate increases affecting financial and economic stability, particularly in interest rate- and property-related sectors, remain on the gradual uptick.

- USD 3MLIBOR has climbed to a new 2018 high at 2.52% on 26 Oct. Fed balance sheet reduction is playing a part in draining liquidity from the system and this has resulted in the recent moves higher in domestic rates vis-à-vis the USD 3MLIBOR. We expect the 3MSIBOR and 3MSOR to edge higher to 2.08% and 1.96% respectively by end-4Q 2018. For 1Q 2019, we are penciling the 3MSIBOR and 3MSOR to come in at 2.03% and 1.91% respectively.

- **Latest Fiscal and External Balance Outlook:** Tax revenue collected by the government picked up slightly in Jul after slowing in May. Tax revenue collected in Jul was at SGD5.7bn compared to SGD5.5bn. This slightly improved tax revenue collected was due to the pick-up in corporate income tax collected of SGD1.9bn vs. SGD1.8bn in Jun, as well as the SGD1.0bn (vs. -SGD0.34bn in Jul) collected under "other taxes".

- The current account (CA) surplus widened to SGD22.83bn in 2Q 2018 compared to SGD20.5bn in 1Q. As a percentage of GDP, the CA surplus rose to 20% in 2Q vs. 18.4% in 1Q. The wider CA surplus was largely attributable to the increase in the goods and services surplus of SGD29.38bn in 2Q vs. 1Q's SGD27.66bn. The financial and capital deficit narrowed to SGD14.10bn in 2Q from SGD15.32bn in 1Q due to the larger direct investment inflows of SGD13.70bn (1Q: +SGD8.5bn) and smaller outflows of SGD18.41bn (1Q: -SGD26.62bn) from the "other investment" segment. Consequently, the overall balance of payments (BoP) surplus widened to SGD7.8bn in 2Q vs. SGD6.8bn in 1Q.

- **Key domestic events and issues to watch:** Focus in Nov will be on final GDP print for 3Q18 that will be released sometime 19-23 Nov and also inflation print on 23 Nov.

- **Technical Outlook:** USDSGD traded higher for the month of Oct, with fresh-2018 high of 1.3873 being printed. Pair was last seen at 1.3860 levels. Bullish bias remains intact with price action likely to respect the mild upward sloping trend channel. Resistance at 1.3890 (upper bound of the trend channel). Break above that puts next resistance at 1.3960 (61.8% fibo retracement of 2017 high to 2018 low). Support at 1.3780 (50% fibo), and 1.3700 (100 DMA, lower bound of trend channel). Favor trading the range of 1.3700 – 1.3950.

MYR: Weighed by Fiscal Concerns

Forecast	4Q 2018	1Q 2018	2Q 2019	3Q 2019
USDMYR	4.1800 (4.1200)	4.2000 (4.1000)	4.1200 (4.0800)	4.1200 (4.0800)

Previous Forecast in Parenthesis

- **Motivation for the FX View: Motivation for the FX View:** In line with most other regional currencies, the MYR weakened against the USD by around another 1% in the month of Oct (similar rate of depreciation in Sep). It reached a high of 4.1807 on 30 Oct 2018, due largely to external uncertainties from the escalation of trade war and its concomitant CNY weakness as well as some loss from MYR carry relative to other regional FX as markets in part also price in some domestic risk premium on MYR assets. The decline in the MYR could potentially in part be supported by Brent crude oil price moving lower and below $80/bbl. At the same time, crude palm oil production and prices seem to be falling as well the past year, potentially contributing to the MYR.

- The risk of a possible global trade war re-escalating, coupled with continuing Fed policy normalisation and repatriation of corporate earnings, may further add to USD tightness. In that base scenario, riskier and commodity currencies are likely to remain vulnerable.

Further out, we continue to anticipate more USD underperformance on the back of a further flattening of the UST yield curve, concerns about the deteriorating US twin deficits and long USD positioning becoming a bit overstretched.

- In addition, our economics team sees rising likelihood that the BNM could keep rates on hold until 2019 to support domestic demand especially consumer spending. This is happening in an environment where regional central banks are tightening more to keep pace with the hikes in US policy.

- As such taking into consideration both domestic and external factors, we now have a slower pace of MYR appreciation vis-à-vis the dollar, consistent with our USD weakness view in the medium term. On the domestic front in the short term, a weak MYR bias coupled with USD strength will likely persist, before some element of certainty comes from the Budget 2019 in Nov. Overall in the short term, domestic policy uncertainty risk may still somewhat weigh on the MYR despite solid fundamentals. Recent market concerns about the revised higher budget deficit and concerns about its impact on the bond market and concerns about potential ratings outlook revisions could play a part in weighing on the MYR. Near term, we do not rule out retracement risks. In the next 3 months or so, the pair could potentially reach 4.20-4.25 range if factors remain the same and the US dollar support remains amid trade war, EM concerns and domestic factors remaining the same. But any highly positive post budget announcements could potentially see it fall to 4.15.

- Nonetheless, MYR fundamentals remain well anchored by sustained current account surplus, rising FX reserves to retained imports & short-term debt, sustained growth pick-up backed by consumption, investment and exports as well as higher oil prices. We maintain our lower USDMYR forecast trajectory beyond 2018 on efforts taken by the new government to improve governance, transparency and accountability. However, we acknowledge there could still be some uncertainty over the next few years as the new government navigates the new political environment and foreign investors still remain somewhat cautious for now. Domestically some concerns about a pullout in some of the investment projects from the previous administration may have inadvertently affected sentiment in the short term, although our medium term view remains supportive of the currency.

- External reserves fell by –USD0.2b to USD102.8b as at mid-Oct 2018 (endSept 2018: USD103.0b) – the lowest level this year and since Dec 2017 amid the –MYR1.2b (-USD0.3b) net foreign selling of Malaysian equities so far in Oct 2018. The latest tally is 7.3 months of retained imports, 0.9 times of total short-term external debt and 11% above IMF's estimate of adequate reserves level of USD92.5b.

- Foreign net selling of Malaysian equities returns this month at –MYR1.2b in 1-19 Oct 2018 after the sustained foreign net selling in May-Aug 2018 was briefly punctuated by a +MYR0.1b net buy in Sep 2018, mainly reflecting the global impact of tech-related Wall Street sell off.

- Foreigners were –MYR3.0b net sellers of Malaysian bonds in Sep 2018 (Aug 2018: -MYR2.4b). For Oct 2018, there is the potential of maturity-related foreign net selling (instead of re-investment) by foreign investors as MYR3b worth of MGS and MYR7.5b worth of GII expire this month.

- Downside to reserves more from bond-related flows The downside to external reserves from equity-related portfolio capital outflow is limited in our view as the –MYR9.9b net foreign selling of Malaysian equities so far this year have reversed 93% of last year's +MYR10.6b net foreign buying. In fact, since 2010 up to last week, cumulative net foreign selling was –MYR39.5b, reversing 91% of the +MYR43.5b cumulative net foreign buying.

- We see the risk to external reserves from portfolio capital flows to emanate from the bond market. From Jan 2010 up to Sep 2018, cumulative net foreign selling of Malaysian bonds was –MYR49.8b, reversing only 30% of the +MYR165b cumulative net foreign buying. Granted that 54% of total foreign holdings of Malaysian government bonds are the "more sticky" investors like foreign central banks, sovereign funds, pension funds and insurance companies, 44% are "less sticky" investors, namely foreign fund managers and banks.

- Aside from risk sentiment towards emerging market bonds, a key domestic factor to watch is the reaction of investors and rating agencies to the upcoming Budget 2019 to be tabled on 2 Nov 2018. This follows the 11th Malaysia Plan (11MP) Mid-Term Review last week that saw the revision in budget deficit forecast for 2020 to -3.0% of GDP from the original 11MP's forecast of -0.6% of GDP, implying risk of above-3% budget deficit to GDP ratio in 2018-2019 amid policy shifts under the new PH Government and legacy issue from previous administration e.g. tax revenue loss from scrapping GST and bringing back SST; fuel subsidy; MYR35b outstanding tax refunds. To recap, Budget 2018 tabled in Oct 2017 targeted budget deficit of -2.8% of GDP (2017: -3.0% of GDP).

- **Growth and Inflation Outlook:** Our economics team expects economic growth to moderate to 4.8% this year (2017: 5.9%), mainly reflecting the impact of the measures and policies of the new Pakatan Harapan (PH) Government announced so far. The zero-rating of GST between June-Aug 2018 and its abolition in Sep 2018 as well as the fuel price stabilisation programme until end-2018 are expected to boost consumer spending growth. However, the impact of these measures on Government revenues and spending amid the commitment to achieve the Budget 2018's deficit target of -2.8% of GDP will result in prudent Government spending. Meanwhile, review of major infrastructure projects could pose some risk to investment outlook. Our full-year growth forecast implies moderation in quarterly growth in 2Q-4Q 2018 after the 5.4% expansion in 1Q 2018.

- We maintain our view of Malaysia's real GDP growth at +4.8% in both 2018 and 2019 (2017: +5.9%). BNM in Aug 2018 also indicated that it expects this year's real GDP growth to be around +5.0% vs its Mar 2018's projection of between +5.5% and +6.0%. Recent 11 Malaysia Plan (11MP) mid-term review also revised lower the targeted growth for 2018-2020 period to 4.5-5.5% p.a. as the targeted growth for 2016-2020 period is now revised down to 4.5-5.5% p.a. vs. the original target of 5.0-6.0% p.a.

- Other than the external risks such as trade tension between US and its major trading partners as well as China's growth slowdown, current main issue on the domestic front is details and clarity of Government policies. A key policy event to watch in the tabling of Budget 2019 on 2 Nov 2018 amid question on whether Malaysia can maintain its budget deficit consolidation since 2010 given the reversals in previous Government's fiscal reform measures (i.e. introduction GST, fuel subsidy abolition).

- BNM sounds more cautious on growth. Global growth momentum is showing signs of slowing amid downside risks to domestic growth from trade tensions, prolonged weakness in the mining and agriculture sectors, impact on public sector spending as Government embarks on reprioritisation of expenditure, as well some domestic policy uncertainty.

- Unofficially, the official growth forecast for 2018 have been lowered to "around 5%" from 5.5%-6.0% previously. The downward revision will be confirmed when Budget 2019 is tabled on 2 Nov 2018.

- Meanwhile, BNM is less dovish in inflation now as it expects inflation to edge upwards going forward and into 2019 as the effect of 0% GST is transitory and lapses toward end-2019. In previous MPS, inflation was expected to turn negative in some months and remain low in 1H 2019 before trending upwards. To note, inflation rate was sub-1% YoY in June 2018 (+0.8% YoY) and July 2018 (+0.9% YoY) reflecting the consumption tax holiday impact in June-Aug 2018.

- Inflation rate remained zero-bound for the fourth straight month at +0.3% YoY in Sep 2018 (Aug 2018: +0.2% YoY) despite the end of the 0% GST period (Jun-Aug 2018) and the start of Sales Tax & Services Tax (SST) on 1 Sep 2018. Year-to-date inflation rate is +1.2% YoY. Maintain our 2018 and 2019 inflation rate forecasts of 1.0%-1.5% and 2.0%-2.5% respectively.

- Headline inflation stayed sub-1.0% YoY in Sep 2018 on slower increases or declines in the prices of goods and services despite the end of the "consumption tax holiday" period of June-Aug 2018 when GST rate was zerorised from 6% and SST was enforced on 1 Sep 2018. Nevertheless, core CPI is back in positive territory as it rose +0.3% YoY last month, after two consecutive months of "deflation" (Aug 2018: -0.2% YoY; Jul 2018: -0.2% YoY).

- The initial impact of SST implementation on headline inflation is modest as businesses partially absorb the tax e.g. no hike yet in cigarette prices despite the 10% sales tax; extended price promotions by auto companies. Nevertheless, we expect inflation rate to creep higher going forward as businesses will start passing on the tax to consumers especially as inventories are replenished with goods that are subjected to SST.

- Both headline and core inflation rates in Jan-Sep 2018 were subdued at +1.2% YoY and +1.0% YoY respectively. Together with factors such as the increase in minimum wage next year and the expected change in current "blanket" fuel subsidy to a "targeted and quota-based" system next year, we maintain our 2018 and 2019 headline inflation rate forecasts at 1.0%-1.5% and 2.0-2.5% respectively.
- **Monetary Policy Forecast:** BNM kept the OPR unchanged at its Monetary Policy Committee (MPC) meeting on 4-5 Sep 2018 i.e. no change in OPR for the fourth successive MPC meeting. The accompanying Monetary Policy Statement (MPS) indicates BNM expects inflation to edge upwards going forward and into 2019 as the transitory effect of 0% GST period in June-Aug 2018 lapses. The economic growth and inflation outlook supports our view of no change in BNM's current Overnight Policy Rate (OPR) level of 3.25% until end-2019 after the +25bps hike at the Monetary Policy Committee (MPC) meeting on 25 Jan 2018.
- Furthermore, unless the US Fed turns very aggressive on its interest rate hikes vs the current guidance, there is currently "positive carry" in terms of the differences between Malaysia and US interest rates and between domestic interest rate and inflation rate which should not necessitate further interest rate hike this year. Malaysia is also ahead of the curve marginally in normalizing its interest rate i.e. since 2011, as the current OPR is just 25bps short of the pre-GFC peak of 3.50%. But relative to other currencies in the region, the positive carry allure of MYR assets has fallen slightly.
- Furthermore, post-GFC, BNM's monetary policy objective also includes financial stability. Under current environment of US-led rising global interest rates and volatility in Emerging Market's capital and FX markets, interest rate policy plays a role in managing capital flows and currencies, further underlining our view of no change in OPR.
- **Latest Fiscal and External Balance Outlook:** We expect 2019 budget deficit to remain above-3% of GDP at -3.5%, but down from our estimate of -3.7% in 2018, on impact of net consumption tax revenue loss from GST abolition and its replacement by SST, the MYR35.25b tax refunds and unbudgeted costs such as 1MDB debt servicing. Market will be looking for details on how to bring the deficit back to -3% of GDP by 2020 as targeted under the 11th Malaysia Plan (2016-2020) Mid-Term Review.
- Expect above-3% budget deficit to GDP ratios in 2018 and 2019 of -3.7% and -3.5% respectively, mainly as the net consumption tax revenue loss from GST abolition and its replacement by SST, the MYR35.25b tax refunds and unbudgeted costs such as 1MDB debt servicing cause current budget balance (revenue minus operating expenditure) to register deficit for the first time since 1987. The Government is committed to fiscal consolidation as the 11th Malaysia Plan Mid Term Review (11MP MTR) set the 2020's budget deficit target of -3.0% of GDP.
- No major new taxes such as capital gains, inheritance and carbon taxes in Budget 2019 as the Tax System Review Panel tasked with tax system reforms is only "operational" last month and is expected to

submit its recommendations only in mid-2019. Furthermore, 11MP MTR specifically mentioned higher contributions of indirect taxes and non-tax revenue. Amid the expected lack of changes in income taxes, our eyes are on “SSTs” i.e. adjustments in Sales Tax, Services Tax and Sin Tax as well as introduction of Soda Tax, and on non-tax revenues e.g. PETRONAS dividend, asset sales and monetization, 1MDB-related “recoveries”. We are sticking our neck out and take the view that the MYR35.25b tax refunds will be settled by next year instead of over the next few years.

- Meanwhile, Government spending will be consolidated and controlled via measures such as zero-based budgeting; open tender and competitive biddings for procurements and projects; change in fuel price subsidy to a “targeted with quota” system; and debt restructuring/refinancing to reduce debt servicing cost (especially 1MDB borrowings).

- Budget 2019 can be expected to kickstart and roll out initiatives and targets on affordable housing under 11MP MTR and the National Housing Policy 2.0. With the focus on affordable housing and despite the ongoing issue of property oversupplies, we do not see any relaxation of macro prudential measures on the property sector. Fiscal incentives in Budget 2019 will mainly focus on SMEs, productivity and technology adoption, in view of the 11MP MTR targets to raise SMEs shares of GDP and exports, and increase productivity contribution to economic growth via technology adoption. The importance of technology adoption is underscored by the launch of the National Policy on Industry 4.0 on 31 Oct 2018.

- **Key domestic events and issues to watch:** Trade data (5 Nov); FX reserves (7 & 22 Nov); Industrial Production (9 Nov); CPI (23 Nov), BNM Policy Meeting (8 Nov), GDP 3Q (16 Nov).

- **Technical Outlook:** USDMYR continued to trade one-way higher for the month of Oct. Last seen at 4.1830 levels. Bullish momentum on weekly and daily chart remains intact but shows signs of waning while stochastics is in overbought conditions. Uptrend still intact but gains could slow given stretched technical conditions. A move towards 4.20 should not be ruled out. Support at 4.1770 (50% fibo retracement of 2017 high to 2018 low), 4.1580 (21 DMA), 4.12 levels.

IDR: Softness To Persist

Forecast	4Q 2018	1Q 2019	2Q 2019	3Q 2019
USDIDR	15250 (14600)	15300 (14500)	15200 (14300)	15100 (14200)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** The USDIDR continues to underperform most of its regional peers in Oct. The USDIDR has traded beyond the psychological 15000-levels, climbing to a multi-year high of 15284 on 9 Oct- a level not seen since Jul 1998 during the Asian Financial Crisis. This move higher comes amid a global equity rout and the re-escalation of trade tensions. We are now of the view that risks to the IDR remains to the downside and could persist into 2019 as the global equity sell-off could continue for some time. Consequently, we expect the pair to remain elevated above the 15000-levels over the forecast horizon. Market perception of the IDR has not yet changed; it remains vulnerable to global rates adjustments due to its twin deficits and high foreign ownership of government bonds. It also does not help that the pair is likely to come under further upside pressure from a weaker yuan and EUR over the forecast horizon.

- This perception of Indonesian vulnerability and expectations for further IDR weakness is manifested in the reduction in foreign holdings of government debt so far this year. Year-to-date in 2018, foreign investors have purchased USD1.66bn in government debt, nearly USD10.41bn less than the total amount purchased for the whole of 2017. This has resulted in the foreign holdings of government debt falling from 41% of total outstanding government debt at end-Jan to around 37% as at end Sep. This suggests that there remains substantial foreign ownership of Indonesian government debt that could be unwound should market angst continue. Further unwinding of foreign ownership should put upside pressure on the USDIDR.

- In addition, the BI's defence of the IDR and bond yields has continued to whittle away its foreign exchange reserves. This is likely to also reduce market confidence on concerns that further reserves could be burned up should volatility in the IDR and yields continue to increase, especially as there is no end to the Fed's tightening cycle as yet. Since Feb, the BI has spent over USD17bn in to curb volatility in the IDR and bond yields. While foreign reserves remain relatively healthy at above USD100bn at USD114.85bn in Sep, they are down from their 2018 peak of USD131.98bn. Further drainage of the reserve buffers increases perception of the vulnerability of the IDR to external risks.

- Aside from further US Fed fund rate hikes in 2019, there is also the potential for ECB policy normalisation to begin in 2H 2019 on sustained price and wage growth pressure, and stable growth. Monetary policy convergence between US and ECB should prove constructive for EU assets and spur a re-balancing of portfolio flows back into the EU. This could lead to another round of capital outflow from emerging Asian assets, including those from Indonesia. There is thus room for further unwinding of foreign holdings of government debt, which could put upside pressure on the USDIDR in the lead-up to the ECB move.

- We now expect the impact of the measures introduced by BI and the government to show significant results only in 2019. Some of the BI and government measures introduced recently, includes domestic non-deliverable forwards, overnight index swaps, interest-rate swaps, tariffs to curb imports to reduce conspicuous consumption, delay in some infrastructure projects to reduce imports, use of biodiesel as alternative to crude oil, and promotion of tourism, should help to curb excesses in the current account and stabilize the IDR.

- At the same time, plans are underway to offer incentives to encourage exporters to convert their foreign-denominated earnings into IDR. According to BI, less than 15% of exporter earnings are converted into IDR in 1H 2018. The government is seeking to have at least 50% of export earnings kept onshore for at least 6-months. Greater conversion into the IDR could help provide the IDR with a buffer and some stabilisation. In addition, the government is considering waiving taxes to lure capital back into Indonesia, including VAT for service exports, luxury or income taxes for sales of middle-upscale properties. Minimum investment eligible for tax holiday could also be lowered from IDR500bn currently to spur greater capital inflows.

- Going into 2019, market volatility could increase as the 17 Apr Presidential and general elections draw closer. Currently, the opinion polls point to strong support for Jokowi but things can change from now till Apr next year. Signs of waning support for Jokowi could shake market confidence and keep the USDIDR elevated. Our house view is for a Jokowi to win at this juncture, which should ease upside pressure on the USDIDR post-elections.

- In 2019, it is likely that BI will not move on its policy rate by the same quantum as they have to date. BI has hiked its policy rate by 150bp since May to curb IDR weakness. We are expecting only a further 50bp hike by BI in 2019, probably front-loaded in 1H. Still, should volatility in the IDR increase due to ECB policy normalisation, BI is likely to step-in and adjust its policy rate as necessary. This should provide support for the IDR and keep the USDIDR on a gradual downward trajectory in 2019.

- We have revised our USDIDR outlook for the forecast horizon to reflect our expectations of further portfolio outflows from Indonesian assets. We look for the USDIDR to hover around the 15250-levels by end-2018. We then expect further Fed rate hike in 1Q and the lead-up to the 17 Apr 2019 Presidential and general elections to generate greater volatility in the IDR, pushing the pair higher to 15300 by end-1Q 2019 and then coming off gradually to 15200 by end-2Q as the government measures to curb the twin deficits begin to show results before hovering around the 15100-levels in 2H 2019. We continue to expect the USDIDR to be on a downward trajectory in 2019, albeit more gradually.

- **Growth and Inflation Outlook:** Real GDP growth is likely to come in slower than 2Q's 5.27%. Government efforts to date to curb IDR weakness and contain the current account deficit as well as BI's 150bp hike in its benchmark rate are likely to impact growth negatively. In particular, the measure to hold back some import-heavy infrastructure projects and to curb imports of luxury consumer goods could stem investment and consumption expenditure. These though do not suggest that government support for growth has waned. We believe government expenditure should continue to be supportive of growth, including spending ahead of the presidential and general elections in Apr 2019 and reconstruction efforts following the recent devastating earthquake and tsunami. While higher interest rates are likely to dampen private spending to some extent, macroprudential measures, especially for home buyers, could mitigate some of this risk. This should allow the economy to expand by 5.13-5.25% in 3Q and 5.1-5.23% in 4Q respectively, bringing full-year economic growth to 5.14-5.21% for 2018. The government sees downside risks to its 5.3% forecast for 2019 though on account of the measures to curb the current account deficit, while BI expects full-year growth to come in at 5-5.4%. As a consequence of the measures to curb imports and softer IDR, our economic team now expects growth to come in at a more moderate 5.18% in 2018 compared to 5.21% previously. The team also expects the impact of the curbs to manifest more intently in 2019 to bring full-year growth lower to 5.14% in 2019 vs. 5.31% previously.

- Headline inflation rose by a more moderate 2.88% y/y in Sep from Aug's 3.20%, weighed by softer food prices (up by just 3.75% vs. Aug's 4.90%) and transport costs (Sep: 1.74% vs. Aug: 1.80%). Core inflation also edged lower, coming in around 2.82% y/y in Sep compared to Aug's 2.90%. The government's move to curb imports and the current account deficit should help temper imported inflation. The 7.5% tariff on around 900 consumer goods should reduce demand for imported goods and put downside pressure on inflationary pressures. Consequently, our economic team has revised lower its headline and core inflation to 3.18% and 2.77% respectively for 2018 from 3.36% and 2.86% previously. The BI continues to target inflation to come in within 2.5 and 4.5% in 2018.

- **Monetary Policy Forecast:** There was no surprises at the BI's policy meeting on 22-23 Oct. After hiking its 7-day reverse repurchase rate by a cumulative 150bps so far this year to 5.75%, the BI took a break and paused hiking rate. The deposit and lending facility rates similarly left unchanged at 5.00% and 6.50% respectively, keeping the interest rate corridor at 75bp on either side of the policy rate. The pause though does not diverge from the governor's strategy of keeping policy "pre-emptive, front loading, and ahead of the curve" in order to maintain macroeconomic and financial system stability. Instead, it allows the central bank to observe the impact of its previous rate hikes on the domestic economy and the IDR and to save its ammunition for when the Fed hikes again in Dec. We look for the BI to hike the policy rate by 25bp to 6.00% at its last meeting of the year in in Dec.

- The BI also announced that the domestic non-deliverable IDR forwards (DNDF) will be effective on 1 Nov. The DNDF is another avenue for market participants to hedge their foreign currency exposure. Currently, onshore players are not allowed to quote offshore NDFs though offshore NDFs are used quite blatantly still. The aim of the DNDF is to shift demand for hedging onshore and to further deepen the domestic financial system. Some features of the proposed are (1) banks are prohibited to carry out domestic NDF transactions against the MYR and THB given existing swap agreements between the three economies; (2) there must be underlying transactions such as trade in goods and services, investments or bank loans among others; (3) the amount and period of a DNDF transactions must not exceed the amount and period of the underlying transaction; and (4) contract settlement is in IDR based on the BI's spot USD rate – the JISDOR.

There are still very little details as to the framework or how the DNDF will be operationalized. But for the DNDF to be effective alternative hedging instrument, the authorities may have to enforce a complete ban on domestic financial institutions quoting the offshore NDF for clients.

- **Latest Fiscal and External Balance Outlook:** The fiscal gap for 2018 might be lower than 2% of GDP in 2018 according to FinMin Sri Mulyani, coming in well below the 2.19% target set in the state budget assumption. She expects the deficit to reach 1.83-2.04% of GDP this year as revenue generation from tax is expected to rise. The Finance Ministry expected a 17.4% increase in tax revenue. In the first nine-months of the year, the budget deficit is at IDR200.2tn (or 1.35% of GDP) on the back of revenues of IDR1312.3tn and expenditure of IDR1512.6tn.

- The current account deficit (CAD) is expected to widen further in 3Q 2018 from 2Q's USD8.03bn (equivalent to 3.04% of GDP). This expected widening in CAD in 3Q is attributable to the ballooning trade deficit in Jul and Aug. In 3Q, the trade deficit is at USD2.72bn, larger than 2Q's deficit of USD1.37bn. BI expects the CAD in 3Q to remain above 3.0% but not to exceed 3.5% of GDP. BI also expects the CAD to fall in 4Q, helped by the measures introduced by the government to stem imports, including imposing a tax of 7.5% on select products to curb capital and consumer goods imports, accelerate the use of biodiesel fuel to cut the import of oil, and push for import substitution whenever possible. BI expects the CAD to come in below 3.0% of GDP in 2018 and to for it to fall to 2.5% of GDP in 2019. As a result of the expected higher CAD in 3Q, our economic team has revised higher its CAD projection for 2018 to 2.9% of GDP from 2.70% previously. The team's projection for the CAD in 2019 remains at 2.50% of GDP.

- **Key domestic events and issues to watch**: BI policy meeting on 14-15 Nov will be keenly watched. Also in focus is GDP for 3Q18 on 5 Nov.

- **Technical Outlook:** USDIDR continued to trade higher for the 5th consecutive month. Last seen at 15220 levels. Bullish momentum on monthly, weekly chart remains intact but there are tentative signs that momentum may be waning. Stochastics is in overbought conditions. Resistance at 15284 (Oct high). Failure to push beyond that level may see the pair ease, possibly towards 15200 (21 DMA), 14980 (50 DMA).

PHP: Eyes Remain On BSP

Forecast	4Q 2018	1Q 2019	2Q 2019	3Q 2019
USDPHP	53.50 (--)	54.20 (54.00)	54.00 (53.90)	53.80 (53.70)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** The PHP has been the best performing Asian currency against the USD in Oct, gaining 0.9% month-to-date. The BSP's two back-to-back 50bp rate hikes helped to put the central bank back on track in its fight to anchor inflationary expectations and restored its credibility. The cumulative rate hike of 150bp to bring the policy rate to 4.50% since May and hints that the central bank will do all that is necessary to rein in prices (we expect another 50bp rate hike by end-2018) have since allayed market reinforced the central bank's creditability and help pushed the USDPHP back below the 54-levels to around 53.50 at the point of writing. We however do not expect USDPHP moves lower to go unabated. Firmer USDCNH, continuing sell-off in global equities, Fed rate hike expectations and still relatively positive US growth is likely to keep the USD supported and be supportive of the USDPHP as well in the next three months.

- Further downside moves could be limited by the continued sell-off in Philippine equities by foreign investors. Foreign investors have so far sold USD206.5mn in equities in Oct, tracking the global equity sell-off as well as on ongoing concerns over inflation (including the negative impact from the devastation wrought by Typhoon Mangkhut), a still hawkish BSP and simmering trade war concerns. Year-to-date, foreign investors have sold off USD1.78bn in equities. This sell-off could continue given global equity valuation and trade war concerns.

- The sell-off in the equity market could persist for a while longer on Fed rate hike concerns. Still, our analysis using the Cyclical Adjusted P/E (CAPE) ratio model suggests that domestic equities appears relatively cheap (as reflected by the estimated P/E ratios minus their 10-year average P/E ratios) compared to its regional peers. This is especially so given the expected relative strong economic performance this year. Greater inflows into equities in 2019 once risk appetite improves should weigh on the USDPHP and allow the pair to ease in 2019.

- USDPHP is also likely to remain supported around current levels given that economic fundamentals remain soft. The trade balance remains in a deficit, still hovering above the USD3bn mark still. At the same time, overseas remittances has softened again, averaging just +2.5% y/y in the first eight months of the year vs. 2017's +4.3%. In addition, the current account deficit should have widened to over 3.0% of GDP even more on elevated oil prices (in value terms) given that Philippines is an oil-importing economy. The government's ambitious infrastructure building programme is likely to keep the current account in deficit in 2018 and possibly into 2019 as well. Further deterioration in the current account deficit should be supportive of the USDPHP.

- **USDPHP should remain elevated in 1Q 2019. Aside from possible Fed rate hike and peaking of US economic growth that could keep USD supported, some political uncertainties could manifest in the lead up to the general elections on 13 May 2019. This election will see 12 seats in the Senate and all seats in the House of Representatives as well as all regional, provincial, city and municipal positions up for grabs**. Should the opposition win a majority of the seats in both Houses of Congress, they could effectively block the parliamentary agenda of President Duterte who would be mid-way through his one-term in office. The uncertainty in the lead-up to the elections could force investors to sit on the side-lines until clarity in the political environment emerges. Until then, we could see the USDPHP come under stress in the lead-up to the elections with the pair possibly climbing back above the 54-handle by end-1Q 2019 before easing off as political clarity emerges.

- The 50bp rate hike in 4Q we are penciling in should weigh on the USDPHP and mitigate upside pressures from a softer CNH and counter partially the expected Fed rate hike and escalating Sino-US trade tensions. We look for the USDPHP to end-4Q 2018 at 53.50. Rising political risk as elections for the House of Representative and half of the Senate approach as well as Fed rate hike and peaking of US growth should lift the USDPHP even higher back above the 54.00-levels to 54.20 by end-1Q 2019. Thereafter, the expected temporary pause in Fed rate hike and moderation in US growth that should see a softer USD strength together with the return of domestic political certainty should see the USDPHP ease to 54-handle and 53.80 by end-2Q and end-3Q respectively.

- **Growth and Inflation Outlook:** Economic growth is likely to moderate for the rest of the year but still outperform its regional peers. Remittances have slowed in the two months of 3Q (Jul and Aug), up by just +2.1% y/y compared to 2Q's +15.1%. Exports though rebounded from its 1.3% decline in 2Q, rising +1.7% in Jul & Aug combined. This suggests that growth remains supported in 3Q. Our economic team maintains its 2018 and 2019 growth forecasts at 6.3% and 6.5% respectively. This though is less sanguine than the government's 6.5-6.9% growth projection for 2018.

- Headline inflation rate (base year = 2012) accelerated by +6.7% y/y in Sep vs. +6.4% in Aug. Sep's inflation is the highest since the +7.2% posted in Feb 2009 (base year = 2006). The uptick in inflation could be attributed to the impact of the Tax Reform for Acceleration and Inclusion (TRAIN) Act measures, higher costs of food & non-alcoholic beverages (FNAB), and transport. The pick-up in core inflation (CPI excluding selected food items as well as energy prices) was also sustained in Sep, up +4.7% y/y vs. 4.8% y/y in Aug. Our economic team expects inflationary pressures to persist on additional factors like the impact of natural disasters (Typhoons Mangkhut & Yuta) and upside risks from crude oil prices. Consequently, they have revised upwards their 2018 and 2019 inflation forecast again. The team now expects 2018 and 2019 inflation to average +5.5% and +4.8% respectively from +5.2% and +4.3% previously. By comparison, the BSP is looking for inflation to average +5.2% and +4.3% in 2018 and 2019 respectively.

- **Monetary Policy Forecast:** There was no BSP meeting in Oct with the next policy decision due on 15 Nov. So far, the BSP hiked its benchmark overnight borrowing rate by a cumulative 150bp move in since May this year to 4.50%. These hikes so far mark the most aggressive tightening by the BSP since 2000. The BSP left the interest rate corridor intact with the overnight lending rate and overnight deposit rate both raised by 50bp accordingly to 5.00% and 4.00% respectively. The interest rate corridor remained symmetrical on either side of the policy rate by 50bp. The pressure to be more aggressive on rates was because of "persistent signs of sustained and broadening price pressures" as inflation has outpaced the upper bound of the central bank's target range of 2-4% for this year and next.

- As we had articulated in our last monthly, the current BSP tightening cycle has yet to reach its end. The BSP governor himself has reiterated that there is the need to do more for at least the next policy meeting (i.e. in Nov). However, he hinted that the rate hike would be more modest to anchor inflationary expectations and dependent on data, particularly the impact of recent measures on inflation. Our economics team is more hawkish on this front. It believes that it may be necessary to hike the policy rate by another 100bp within the next six months to curb inflationary pressures. The team is looking for another 50bp rate hike to come by the end of 2018.

- **Latest Fiscal and External Balance Outlook:** The fiscal deficit widened to PHP378.2bn in the first nine months of the year as spending continued to outstrip revenues. Expenditure Nevertheless, the deficit is still below the nine-month deficit target of 396.6bn. Still, the deficit is inching closer to the full-year target of PHP523.7bn for 2018. The deficit stands currently at 72% of the 2018 deficit ceiling for the whole year.

- The current account deficit ballooned in 2Q 2018 to USD2.93bn (or equivalent to 3.56% of GDP) compared to a deficit of USD0.16bn (or equivalent to 0.2% of GDP) in 1Q. It is likely that the current account deficit for the whole of 2018 will overshoot the BSP's projection of a deficit of USD3.1bn (-0.9% of GDP) for 2018. The wider deficit was primarily driven by the deficit in the goods and services account which ballooned to USD10.1bn in 2Q from 1Q's -USD7.38bn. The deficit though should not be a cause for concern according to BSP Assistant Governor Restituto Cruz. This is because the underlying trends suggest that the deficit was due to the increased demand for capital goods in the past three years as the economy expanded.

- **Key domestic events and issues to watch:** In focus in Nov is BSP meeting on 15 Nov. Before that, 3Q18 GDP on 8 Nov will be eyed.

- **Technical Outlook:** USDPHP turned lower for the month of Oct, in line with our call for a bearish reversal. We shared that bullish momentum showed signs of waning while rising wedge appeared to be forming (typically associated with a bearish reversal). Pair was last seen at 53.5 levels. Further decline towards 53.33 (23.6% fibo retracement of 2017 low to 2018 high), 52.90 (200 DMA), 52.64 (38.2% fibo) likely. 21 DMA cuts 50 DMA to the downside – another short term bearish signal. Resistance at 53.9 (21, 50 DMAs), 54.45 (2018 high). Bias to lean against strength.

THB: Outflows & Politics Weigh

Forecast	4Q 2018	1Q 2019	2Q 2019	3Q 2019
USDTHB	33.00 (32.80)	33.80 (33.00)	33.50 (32.60)	33.00 (32.60)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** The THB has gone from being among the most resilient currency in ASEAN to being the worst performing currency against the USD in Oct. The THB has depreciated by 2.8% against the USD so far in Oct. Unlike in Sep, net foreign outflows from Thai assets weighed on the THB in Oct, tracking global concerns over valuations, escalating Sino-US trade war and softer global growth expectations. The lack of clarity on the monetary policy front is adding to some establishment of short-THB positions vs long USD in the near term, which is supportive of the pair. It also did not help that softer yuan is putting upside pressure on the USDHB as well.

- So far in Oct, foreign investors have sold off USD1.95bn in equities compared Sep's sell-off of USD0.24bn. In contrast, they had purchased USD1.14bn in debt in Oct to date. The net foreign portfolio outflow in Oct puts upside pressure on the USDTHB. Aside from global risk-on sentiments, domestic profit-taking activities due to investors' belief that the economy is facing domestic structural headwinds, including hollowing out of industries, ageing demographics and rising leverage is reinforcing the equity market rout. We do not think that these structural issues can be resolved overnight and these concerns will thus continue to weigh on Thai equities and in turn on the THB. At the same time, there could be some re-allocation of assets away from Thailand in 4Q as political uncertainty re-emerges in the run-up to the general elections expected early 2019. We could thus the USDTHB remain supported in Nov and into 2019.

- Mitigating the upside pressure on the USDTHB from the equity sell-off is the still healthy economic fundamentals including healthy growth momentum, return of foreign interest in Thai debt, the increasing expectations of policy normalisation by the BoT. In addition, the possible shift of manufacturing away from China to Thailand could also be positive for the THB. In addition, persistent current account surpluses (around 9% of GDP in 2Q) remain supportive of the THB. In addition, we are looking for a pick-up in private investment to drive the next phase of growth and the THB higher. Our optimism arises from the high correlation between private investment and trade for Thailand. Meanwhile, the government's push to accelerate infrastructure projects, especially the USD47bn Eastern Economic Corridor project ahead of general elections expected in Feb 2019 could also deliver upside surprises to domestic demand, growth and weigh on the USDTHB.

- While there are some concerns currently in the market that the BoT might not normalise policy this year, we are not in this camp. We continue to see less need for extremely accommodative monetary policy given the strong economic fundamentals currently. We expect the BoT to start the ball rolling on policy normalisation by removing some of the current accommodation in policy. Policy normalisation sooner rather than later would provide the BoT with policy space to response to any external shocks. Growth accelerating back towards potential with a concomitant pick-up in inflation highlights the case for a rate hike. We expect a rate adjustment of 25bp to come at the BoT's Dec policy meeting. A policy normalisation would be positive for the THB.

- However, we do not expect unabated THB strength in the next three-six months. This is because we believe that political risk could re-emerge in the coming months and weigh on the THB. The organic laws related to the election of MPs and appointment of Senators have been endorsed by HM King Vajiralongkorn and the ban on political activities have been partially lifted to allow for the parties to organize and elect their party leaders. It is beginning to look very likely that the general elections will take place on 24 Feb 2019. So far the moves towards the general elections have been supportive of risk sentiments and weigh on the USDTHB. However as we noted previously, the political temperature could rise as election fever catches towards the end of the year and into 2019. This should keep investors on the sidelines until political uncertainty dissipates. Such political concerns are likely to put upside pressure on the USDTHB in the next six months.

- Our base scenario is for the general elections to proceed as planned on 24 Feb 2019. We believe that a majority government by a single party is unlikely given the new Constitution. A fractious parliament made up of smaller parties is likely with the Senate dominated by 250 members appointed by the military junta. This should allow the military to retain influence in the government as no single party will be able to command a majority. More likely than not, PM Prayuth should remain as PM as a result. We do not expect any change in economic policy direction and for the BoT to begin policy normalisation in 4Q 2018. Some initial volatility is expected in the aftermath of the election but we expect the THB to stabilise and continue on its appreciation path thereafter.

- Given our expectations of the continued net foreign portfolio outflows, softer yuan, Fed rate hike and the run-up to the Thai general elections, we have tweaked our USDTHB outlook and now expect the pair to end 2018 at 33.00 vs. our previous forecast of 32.80. Further Fed moves in 1Q and expectations of peaking US growth together with political uncertainty post-election could lead the USDTHB higher to 33.80 (from 33.00 previously) by end-1Q 2019. Thereafter, clarity in the political situation and easing political tensions, and the expected fall-off in US growth should weigh on the pair in 2Q and 3Q 2019 with the pair seen around 33.50 and 33.00 (vs. 32.60 both quarters previously) respectively by end-2Q and -3Q.

- **Growth and Inflation Outlook:** Growth momentum is unlikely to let up in Thailand. Though the economy had moderated slightly in 2Q to +4.6% vs. 1Q's pace of +4.9% we believe the economic recovery has legs. Government spending, especially ahead of the general elections expected early next year, together with planned infrastructure building projects including transport networks and the Eastern Economic Corridor development project should attract FDI and continue to bolster growth. We continue to expect the export-led recovery to spark a revival in private investment that should sustain growth in 2018, given the high correlation between export recoveries and machinery & equipment investments for Thailand. Even a rate hike of 25bp at the end of the year is unlikely to derail growth momentum as monetary policy should still remain accommodative. Our economic team is penciling full-year growth of 4.5% for 2018, while BoT is expecting real GDP growth to come in at 4.4%. The Finance Ministry maintains its growth projection at 4.5% in 2018.

- Headline inflation rose by 1.33% y/y in Sep, moderating from Aug's +1.62% y/y. The moderating force in Sep's inflation print was food prices, which rose a more moderate +0.35% y/y in Sep compared to +0.77% in Aug. Firmer energy cost did not translate into higher transport cost, which rose by 3.86% in Sep – the same pace as in Aug. Core inflation (headline inflation excl. raw food and energy) though rose by 0.8% y/y in Sep from +0.75% y/y in Aug. The Commerce Ministry now expects headline inflation to average 1.25% in 2018 compared to its earlier projection of 1.2%. Our economic team maintains their 2018 inflation projection at 1.3%.

- **Monetary Policy Forecast:** The BoT has left its one-day repurchased rate unchanged at 1.50% since Jun 2015. The last time the policy rate was even lower was during the Great Financial Crisis in 2009 at 1.25%. There does not seem to be any sense of urgency in the BoT to normalise policy, in contrast to its ASEAN peers who have already begun the process of policy normalisation. This is because the BoT has the policy space to be patient given its persistent current account surplus (9.8% of GDP in 2Q 2018) and strong foreign exchange reserves of USD205bn.

- Nevertheless, the accommodative bias of the central bank nearing its end-point with the BoT Governor Veerathai Santiprabhob expounding on 20 Aug that "there was less need for an extremely accommodative stance since the recovery in the economy is clearer" as saying. Since then, concerns over escalating Sino-US trade war and softer global growth that was blamed for the 5.5% decline in exports in Sep have made it unlikely that the BoT will move on its policy rate in Nov. Still, the overall growth outlook for the Thai economy remains sanguine and that as growth accelerates back towards potential, there could be a concomitant pick-up in inflation. Accordingly, our economic team continues to look for the BoT to normalise sooner rather than later to provide it with policy space. We now expect a 25bp rate adjustment to take place either at its Dec policy meeting.

- **Latest Fiscal and External Balance Outlook:** The Finance Ministry expects the budget deficit to narrow as a percentage of GDP by 2020 as the targeted budget gap is expected to remain around THB450bn even as the economy expands. Implementation of strict fiscal discipline should contain the budget shortfall in 2020. The government expects the budget deficit starting in 1 Oct 2019 to average 2.6% of GDP.

- The current account surplus ballooned in Sep, rising to USD2.37bn compared to USD0.75bn in Aug. This rise in the current account surplus can be attributed to the larger trade and income accounts surpluses of USD1.96bn and USD0.41bn (Aug: USD0.60bn & USD0.15bn) respectively. Nevertheless, the overall balance of payments recorded a larger surplus of USD1.04bn in Sep vs. USD0.19bn in Aug. Details for the financial account are lacking at the point of writing, continued portfolio outflows remain likely.

- **Key domestic events and issues to watch:** BoT meeting on 14 Nov will be eyed for clues on hints of policy normalisation. At the same time, markets will be watching 3Q18 GDP print for signs of further strengthening of the economy.

- **Technical Outlook:** USDTHB traded higher for the month of Oct. Move higher was consistent with our caution for "near term risks skewed to the upside". But magnitude of the move exceeded our target of 33 levels. Pair was last seen at 32.27 levels. Bullish momentum on daily chart remains intact though stochastics is rising into overbought conditions. Upside may be limited towards 33.50, 33.61. Support at 33 levels. A decisive break below 33 may see the pair test lower towards 32.70 – 32.80.

INR: Weighed

Forecast	4Q 2018	1Q 2019	2Q 2019	3Q 2019
USDINR	73.50 (--)	75.00 (74.50)	73.00 (68.20)	73.50 (--)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** USDINR made a retracement in an environment of lower crude brent price. However, the conflict between the RBI and the government has seen the USDINR take a U-turn since. We had expected INR to have a moment to recover in an environment of more benign crude but that window of opportunity was taken away by RBI and the government. There was supposed to be a meeting between RBI Governor Patel and Finance Minister Jaitley next Tue (6 Nov) but fresh from the press, at the time of writing, was news that the government had already invoked a "never-used" Section 7 (that empowers the government to give instructions to the governor to act on certain issues that the state considers to be in the public interest) on the RBI and there are unconfirmed rumors of RBI Patel resigning.

- The demand for bonds had rebounded amid softer crude and upside surprise in the OMO purchase announced by the RBI in Nov. In addition, the CPI print has come off and base effects could ensure that inflation headlines could remain rather stable in the next few months. Trade deficit narrowed substantially due to the sharper slowdown in the imports growth. However, with the rift between the RBI and the government and as long as the outlook for crude oil price remains bullish, it is hard for the rupee to manage a complete reversal.

- Part of the rupee's plight is RBI's indifference to its weakness relative to its counterpart in BI, underscored by the refusal to raise policy rates in Oct although the monetary policy stance is changed to "calibrated tightening". Notwithstanding some leaning against the wind activities, it is also rather widely perceived that the rupee is largely driven by market forces and pull-backs could be substantial. On the other hand, the government has been taking up the load of improving trade balances. So far, there has been mentions of plans for free trade agreement with China, tariffs raised on 19 products and possibly more import curbs on other plastics and steel items. So in an environment of softer crude price, INR could still have chance to strengthen before a move back into its USDINR uptrend into the Fed hike in Dec.
- **Growth and Inflation Outlook:** Industrial production slowed less than expected to 4.3%y/y from previous 6.5% (expected at 3.8%). The contraction in mining and deceleration in manufacturing was slightly offset by the acceleration in the electricity output. Capital goods rebounded this month though output of infrastructure and construction as well as consumer durable goods slowed. Growth is rather uneven. PMI-mfg rose to 52.2 vs. the previous 51.7 with firmer gains reported in new orders, output and employment. We recall that RBI forecast of order books also came off a bit more for 3Q and that could suggest a limit to how much output will accelerate.

- Sep CPI softened further to 3.8%y/y from previous 3.69% as the fuel and light subcomponent eases, offsetting the tick higher in food inflation. Into the rest of the year, expect headlines to be tempered by high base effect seen in the last quarter of 2017.

- Trade deficit narrowed substantially to around U$14bn in Sep, as imports growth slowed considerably while exports recorded a contraction. The US China trade war comes as an opportunity for India to strengthen its ties with China in the hope of boosting exports to the latter. The US is also keen to strengthen trade relationship. So even as rupee could be hurt by sentiments in the region, the trade war between the US and China is not that negative. However, a crude surge could certainly hurt India, as a twin deficit economy. That explains the change in the monetary policy stance to "calibrated tightening".

- **Monetary Policy Forecast:** RBI sent mixed signals by standing pat on 5 Oct. INR weakened as a result but was thereafter saved by the fall in brent crude price. We do not think the next hike would come as easy as the ones so far. Our view is that RBI is unlikely to raise cost of financing for the sake of defending the rupee as that could risk dampening consumption and investment. This is especially so in light of recent development that saw the default of debt payments by Infrastructure Leasing & Financial Services Ltd that triggered concerns that other non-bank financial companies could have similar challenges coping with rising yields. In addition, current data and latest RBI industrial survey suggests manufacturing growth and industrial activity are already subdued and could remain so in the next few months.

- Managing inflation is still the mandate of the RBI and recent inflation prints have softened. That should take the pressure off the central bank to raise rates further after this one. In fact, the central bank had lowered the inflation outlook to 3.9-4.5% for 2H of FY19 from 4.8% previously. That is in line with our view and our caution (stated in our previous FX Monthly) that for the next few months, favourable base effects could temper the CPI headline and allow RBI and the government some time to work on the non-performing loans.

- Separately, RBI has been increasingly vocal about increasing its autonomy so as to regulate the state-run lender. RBI Patel and FinMin Jaitley is slated to meet next Tue (6 Nov).

- **Latest Fiscal and External Balance Outlook:** The outlook of brent crude is still bullish even though there has been a correction. Thus, India's current account is still at risk of further deterioration. Finance Minister announced that the fiscal deficit for FY17 is poised to come in at 3.5%, well above the 3.2% projected as tax collections following the implementation of GST was lower than expected. The RBI also released a report on the states budget, reporting that the consolidated gross fiscal deficit overshot the budget estimates in 2017-18 due to shortfalls in own tax revenues and higher revenue expenditure. For the coming year, the government estimates fiscal deficit to improve to 3.3%.

- **Key domestic events and issues to watch:** PMI-mfg on 1st Nov; FinMin meets RBI Governor on the 6th; Oct CPI and Aug IP on 12th; WPI on 14th; trade on 15th; GDP on 3Q.

- **Technical outlook:** 1M NDF remains rather biased to the upside, last seen around 74.30. Momentum is increasingly bullish for this pair. Next key level is 75. Support at 71.84.

VND: Resilient

Forecast	4Q 2018	1Q 2019	2Q 2019	3Q 2019
USDVND	23300 (23000)	23200 (22900)	23100 (22800)	23100 (--)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** The VND has been surprisingly resilient to the yuan weakness that we have seen thus far. Net external surplus, portfolio (U$420mn of equity-related inflows (mtd)) and foreign direct investment inflows have been supportive of the currency. On the other hand, fresh highs of USDCNH could keep USDVND elevated at around where it is right now (23340) between now and mid of Nov. Into 2019, expect USDVND to edge higher towards 23500 as Fed continues on its tightening path before potentially coming off as US growth peaks.

- The RMB still matters and it is primarily affected by the China-trade war. Despite the fact that this could be all about protecting the US intellectual property rights and its lead in technology, a lot of "China bashing" is also likely meant to be for Trump's domestic audience ahead of mid-term elections. Beyond 6 Nov, the political motivation is past and the next political event (US Presidential Election) is two years away. We do not think that trade war could still dominate much of the headlines beyond the US mid-term elections and less talk on it could simply see RMB appreciate in a more benign USD environment.

- **Growth and Inflation Outlook:** Exports slowed a tad to 14.2%y/y for the first 10 months vs. 15.4% in the first 9 months. Imports also maintained its pace at 11.8%y/y. As a result, trade surplus widened to U$100mn. CPI eased to 3.89%y/y from previous 3.98% Retail sales steadied at 11.4%.

- With price pressure still benign, we see less need for a rate hike. The government could continue to use policies and administration to keep prices in check. The legislature targets a cap of 4% for CPI and ADP recently revised its forecast for Vietnam's inflation higher to 4%, citing inflationary pressures that stem from the weakening VND, rise in international oil and food prices. Insofar, it is also likely that Vietnam has defended the VND in order to ensure that inflation pressure does not tick higher. That could lead to a vicious circle. As such, USDVND is still seen at 23340.

- **Monetary Policy Forecast:** We hold the view that SBV is unlikely to move policy rates. As other central banks in the region hiked rates to buffer against further currency weakness that threatens their inflation outlook, there seem to be some speculation that SBV could do the same. However, the recent inflation data for Vietnam suggest that price pressures are still in control and are unlikely to dampen consumption. As such, SBV should be less motivated to hike rates.

Furthermore, FDI has slowed since Jul this year. With a trade war still on between the US and China, we do not think it is a favourable environment to raise cost of financing for businesses. As such, we hold our view that policy rates are unlikely to change for the rest of the year.

- In terms of NEER, VND remained on a strengthening path against its regional peers. This was probably due to the depreciation in the heavily weighted RMB that was not matched by the VND. In terms of NEER, VND has gained significant competitiveness compared to its trading partners from a year ago and that could buffer Vietnam's exports in a trade war environment.

- **Latest Fiscal and External Balance Outlook:** The Ministry of Planning and Investment forecasts 2018 state budget deficit at VND204trn, equivalent to 3.67% of GDP. 2019 budget deficit is expected to improve to 3.6% of GDP. Vietnam's fiscal position is likely to remain in consolidation mode as fiscal deficit ratio remains above the 3%-level. The government needs to fund state budget deficit of VND 206.15trn and pay principal loans of CNY157.13trn this year. The government aims to reduce budget deficit to 3.5% of GDP by 2020. Fitch has lowered Vietnam's 2018-19 budget deficit forecasts to 4.2% in 2019 and 4.4% in 2018 vs. previous estimate of 4.4% and 4.6% respectively.

- Current account surplus narrowed to U$1.24bn in 3Q from the previous U$4.3bn. Net trade surplus of goods slipped to U$3.0bn from previous U$5.2bn. The competitive dong could keep the current account in surplus. Financial account surplus narrowed to U$2.295bn. Overall balance of payments records a surplus and could support the VND.
- **Key Domestic Events and Issues to Watch:** PMI Mfg on the 1st; domestic vehicle sales in 6th-13th; CPI, trade numbers, retail sales and IP are due 25th-30th Sep.

FX Forecasts

	End Q4-18	End Q1-19	End Q2-19	End Q3-19
USD/JPY	112	113	108	106
EUR/USD	1.1400	1.1100	1.1400	1.1600
GBP/USD	1.3000	1.2800	1.3200	1.3400
AUD/USD	0.7100	0.6800	0.7000	0.7200
NZD/USD	0.6500	0.6400	0.6600	0.6800
USD/SGD	1.3850	1.4000	1.3900	1.3800
USD/MYR	4.18	4.20	4.12	4.12
USD/IDR	15250	15300	15200	15100
USD/THB	33.00	33.80	33.50	33.00
USD/PHP	53.50	54.20	54.00	53.80
USD/CNY	6.95	7.05	6.95	6.92
USD/HKD	7.85	7.80	7.80	7.80
USD/TWD	30.90	31.20	30.80	30.60
USD/KRW	1130	1150	1130	1110
USD/INR	73.50	75.00	73.00	72.50
USD/VND	23300	23500	23200	23100
DXY Index	96.96	98.66	95.82	94.00
SGD Crosses	End Q4-18	End Q1-19	End Q2-19	End Q3-19
SGD/MYR	3.0181	3.0000	2.9640	2.9855
SGD/IDR	11011	10929	10935	10942
SGD/THB	23.83	24.14	24.10	23.91
SGD/PHP	38.63	38.71	38.85	38.99
SGD/CNY	5.02	5.04	5.00	5.01
SGD/HKD	5.67	5.57	5.61	5.65
SGD/TWD	22.31	22.29	22.16	22.17
SGD/KRW	816	821	813	804
SGD/INR	53.07	53.57	52.52	52.54
MYR Crosses	End Q4-18	End Q1-19	End Q2-19	End Q3-19
EUR/MYR	4.77	4.66	4.70	4.78
JPY/MYR	3.73	3.72	3.81	3.89
MYR/HKD	1.88	1.86	1.89	1.89
MYR/CNY	1.66	1.68	1.69	1.68
GBP/MYR	5.43	5.38	5.44	5.52
AUD/MYR	2.97	2.86	2.88	2.97
NZD/MYR	2.72	2.69	2.72	2.80
MYR/IDR	3648	3643	3689	3665
MYR/INR	17.58	17.86	17.72	17.60
MYR/KRW	270.33	273.81	274.27	269.42
MYR/PHP	12.80	12.90	13.11	13.06
CNY/MYR	0.6014	0.5957	0.5928	0.5954

Source: Maybank FX Research as of 31 October 2018

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

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