Invest ASEAN 2017 - FX Outlook

ASEAN Resilience Amid Shifting Winds

FX Research & Strategy| Global Markets
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Overview

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2. Our House View on FX Outlook
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Key Macro Questions for 2017

Key Macro Questions for 2017

How Much Will the Fed Hike?

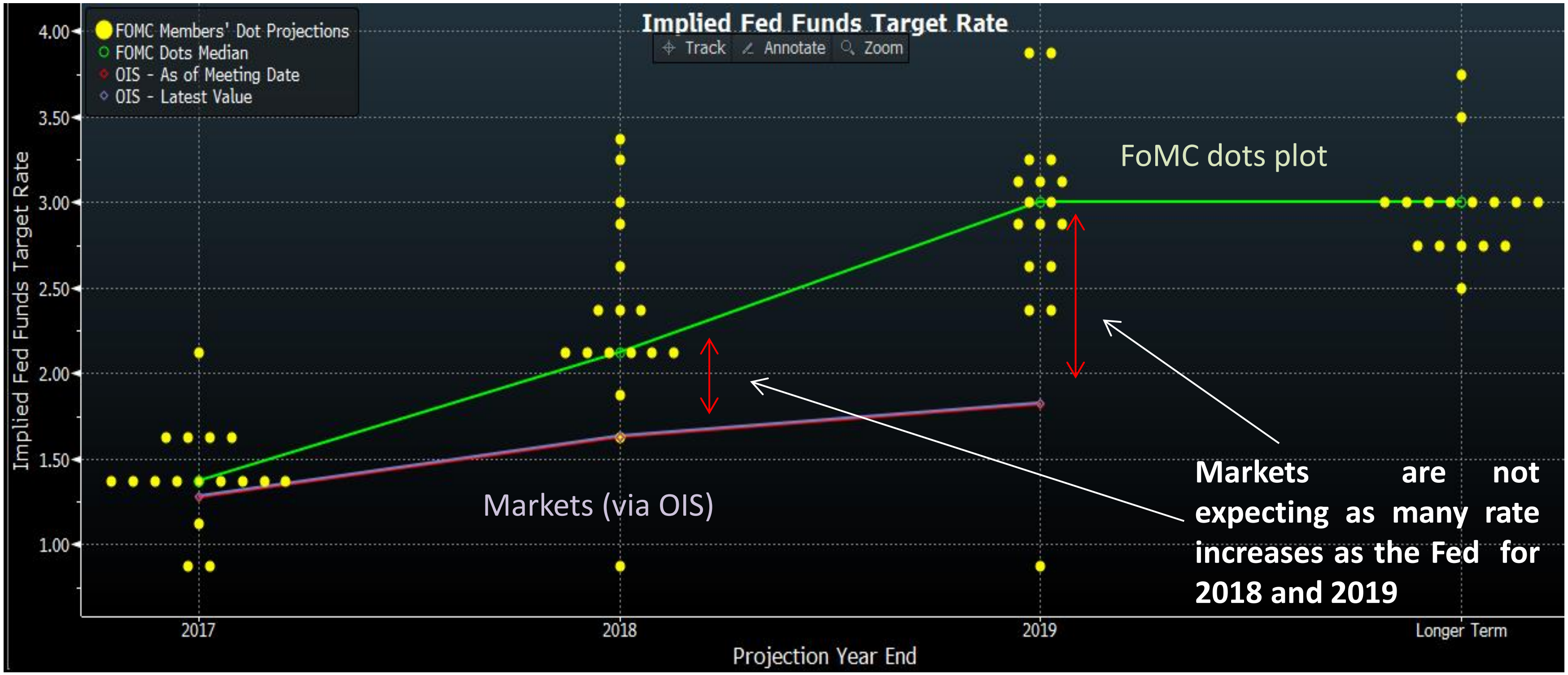
Will President Trump Deliver on Promises?

Are ASEAN FX Resilient or Vulnerable?

Other Headwind Risks?
– China, Commodity, Political Risks

How Much Will the Fed Hike?

Markets Underpricing Fed Rate Hike Trajectory beyond end-2017

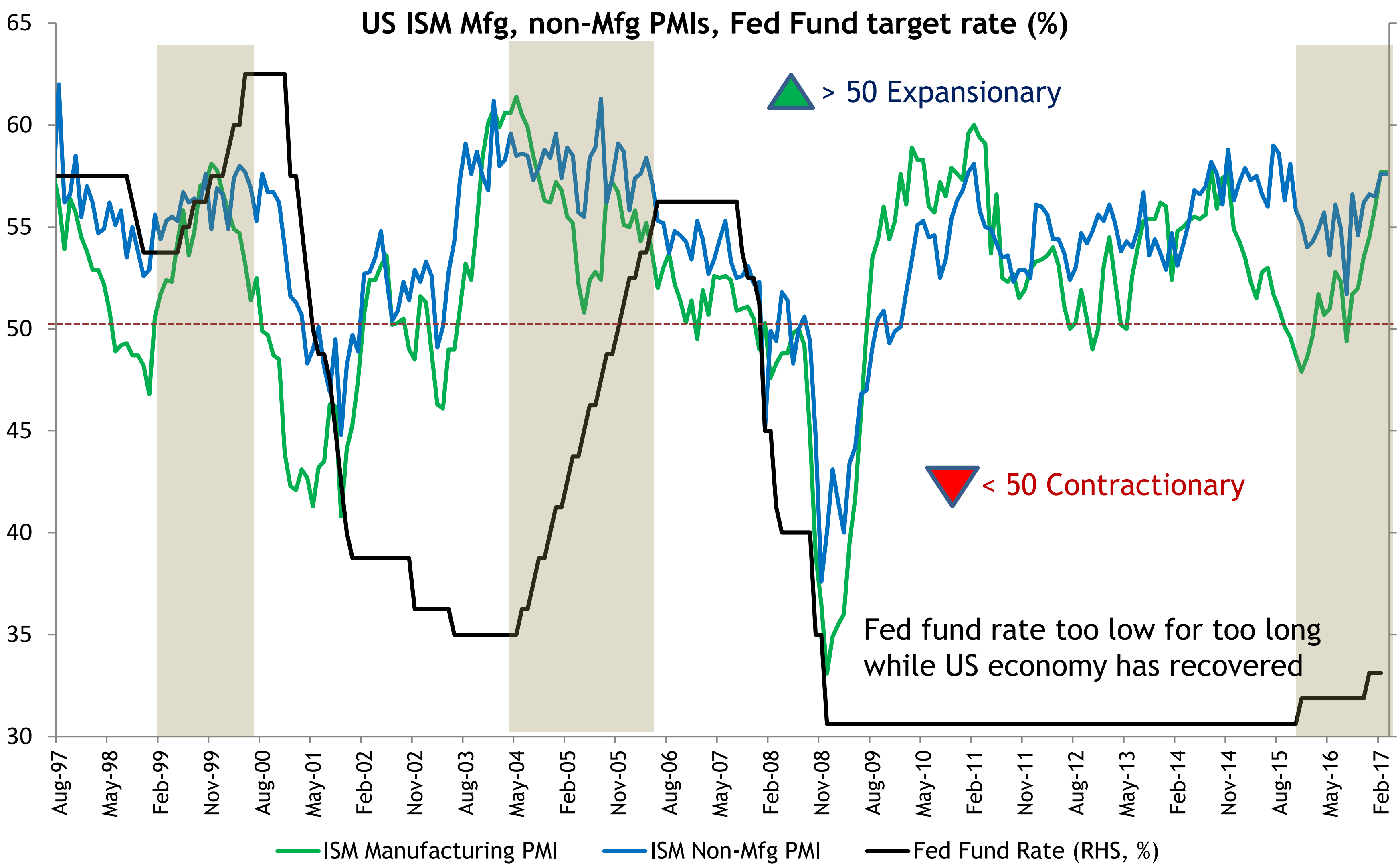


	End 2017	End 2018	End 2019
Fed (Dots Plot)	+50bps	+75	+87bps
Markets (implied from OIS)	+45bps	+52	+30bps
Markets Underpriced Fed by	5bps	23bps	57bps

Source: Bloomberg, Maybank FX Research

How Much Will the Fed Hike?

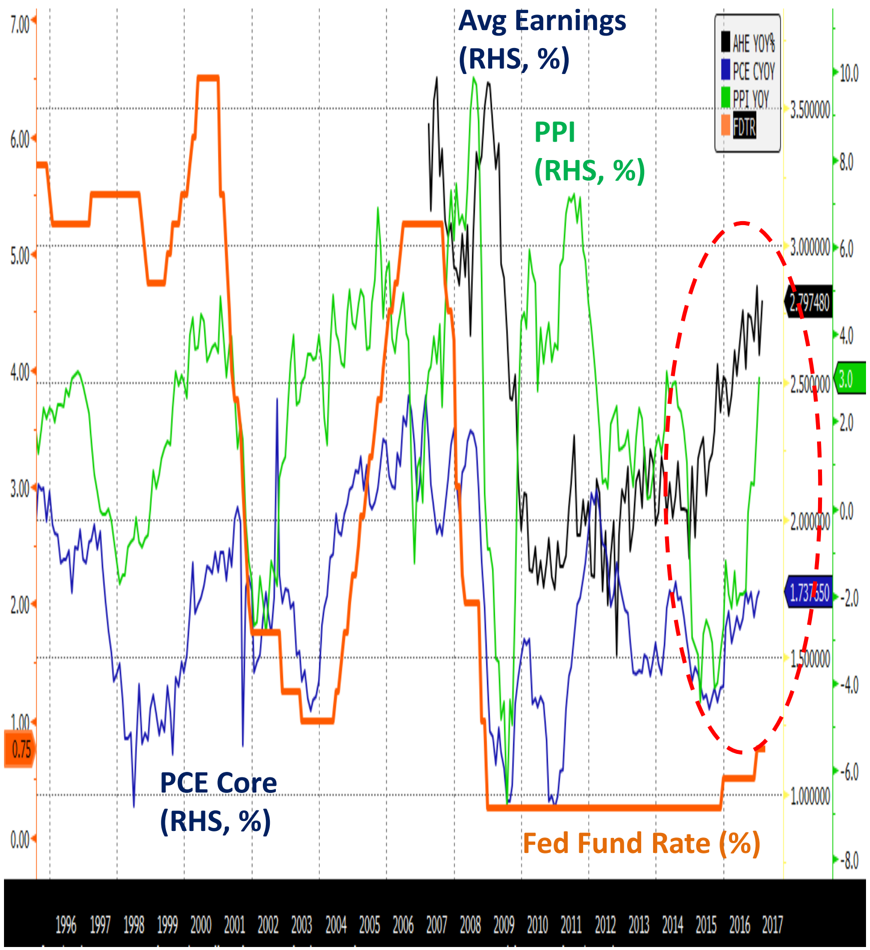
Current Episode of Rate Hike Too Tame Relative to Past Cycles



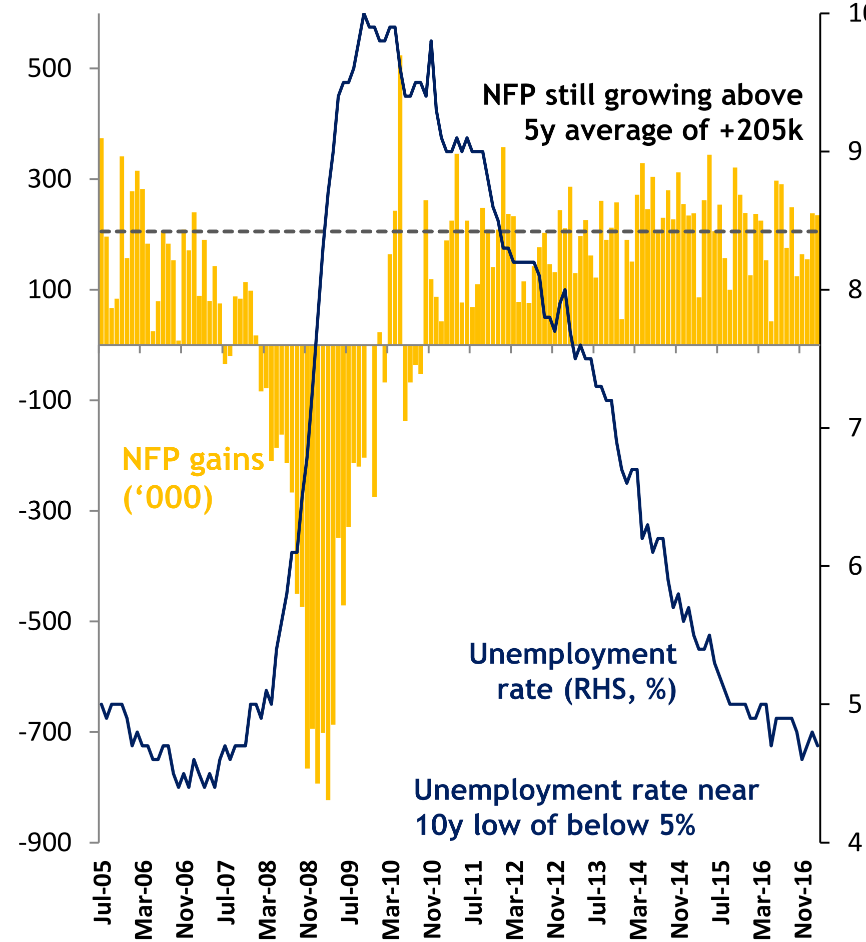
Source: Bloomberg, Maybank FX Research

Fed Is Close to Achieving Dual Mandates – Inflation & Employment

Price pressures (Wages, PCE Core, PPI) are building up while rates remain benign



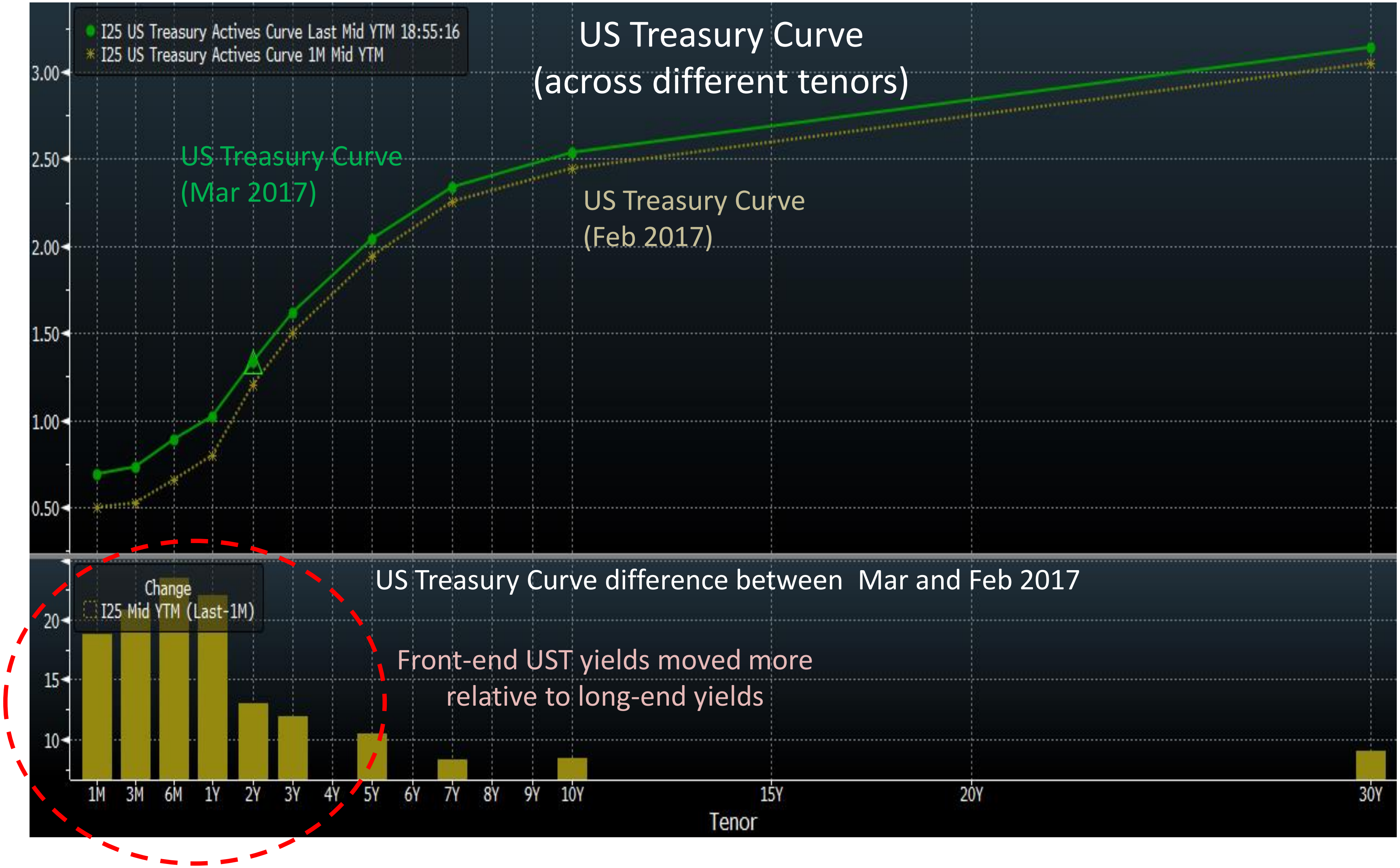
Labor market continues to tighten



Source: Bloomberg, Maybank FX Research

How Much Will the Fed Hike?

Higher Front-End UST Yields Reflects Market Expectations of Fed Rate Hike



Source: Bloomberg, Maybank FX Research

Key Macro Questions for 2017

Will President Trump Deliver on Promises?

USD Retraced On Trump Doubts, Room for More USD Upside?

Note: Pie chart on Trump Tracker as of Trump's 55th day in office as President
Source: https://trumptracker.github.io/

NAFTA and Currency Manipulator Report are Top Concerns

The Promised Laundry List (Trade Focus)

Trump's Promise	Status	Details	Implication on FX
Withdraw From Trans-Pacific Partnership	**Done**	***24 Jan 2017*** *- Trump signed an executive order to withdraw from TPP*	
Label China a "currency manipulator"	In Progress	***23 Feb 2017*** *- SOT Mnuchin - to stick to Treasury's methodological process of labelling nations as currency manipulators via a* ***report published on 15 Apr, 15 Oct every year.*** ***24 Feb 2017*** *- Trump - "I think they're grand champions at manipulation of currency"*	Some other currencies including EUR, KRW are also at risk. Focus on US trade deficit with partners; **those with extreme imbalances (such as CNY, EUR, JPY, KRW) could result in appreciation** vs. USD
Renegotiate NAFTA or withdraw from the deal under Article 2205	In Progress	***12 Mar 2017 -*** *Wilbur Ross - "New NAFTA Deal Still Being Worked Out by the Administration". Once it starts officially advising Congress, it may take longer than 90 days… "no certain date".*	CAD and MXN may come under pressure as a result of potential changes to NAFTA agreement in favor of US

SOT is the abbreviation for Secretary of Treasury*

Source: Globalnews, https://trumptracker.github.io,

Further Details on Tax Cuts, Spending Could Drive USD Higher

The Promised Laundry List (Domestic Economy Focus)

Trump's Promise	Status	Details	Implication on FX
Allow vital energy infrastructure projects, like the Keystone Pipeline, to move forward.	**Done**	*24 Jan 2017 – Trump signed executive orders to advance the construction of major pipelines.*	Little of note
Lower business tax rate from 35% to 15%. Slash the top individual income tax rate from 39.6% to 25%.	**No Action**	***9 Feb 2017** – Trump promised a "phenomenal tax overhaul".* ***23 Feb 2017** – SOT* Mnuchin tempered expectations by urging for "very significant" tax reform passed before Congress **Aug recess.*** ***28 Feb 2017** – Trump promises "big big cut".*	**Short-medium term** - Cutting corporate tax could encourage repatriation in overseas profits which could lead to **stronger USD.** **Longer-term** - More investment, hiring, stronger consumption depends on the final corporate rate.
To spend U$1 trn on infrastructure	**No Action**	**28 Feb 2017 –** Trump promises to "spend U$1trn on infrastructure" (new roads, bridges, tunnels, airports and railways), "financed through public and private capital"	More fiscal spending should lead to higher growth, faster rate increases and **stronger USD.**

SOT is the abbreviation for Secretary of Treasury*

Source: Bloomberg, Data as of 10 Mar 2017

Budget Constraints An Obstacle to Trump's Fiscal Promises

Trump – "The Money is going to come for a revved-up economy"

Which May Only Come Earliest in 2018.

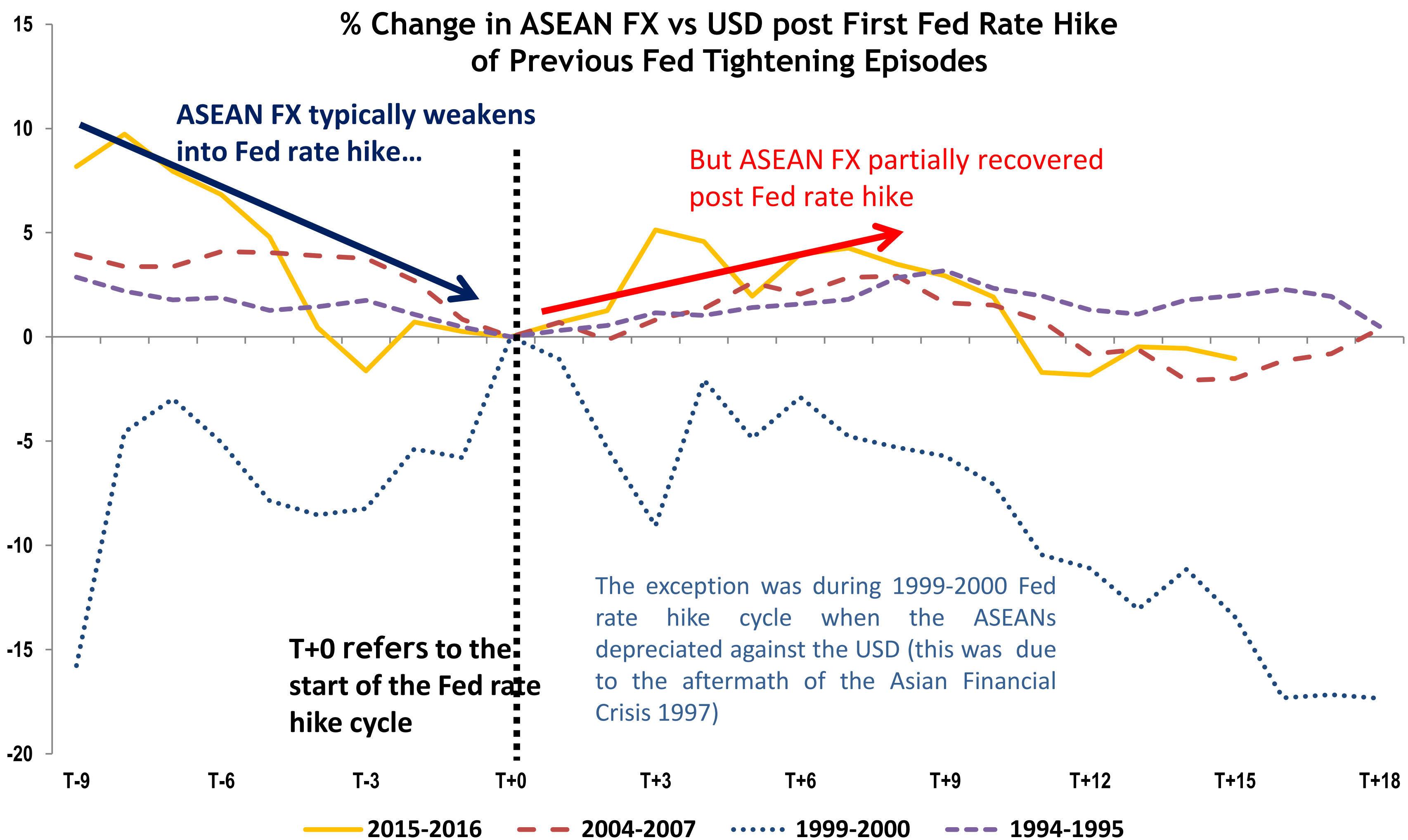
- But the Trump Administration Do Have Some Urgent Constraints – The ***US Debt Ceiling that expires on 15 Mar 2017.***
- Extraordinary Measures needed to fund government activities beyond 15 Mar (albeit temporarily estimated Aug/Sep).
- If the debt limit is not increased (above the amount established on Mar 16 2017), the Treasury will not be authorized to issue additional debt that increases the amount outstanding.
- Result is US Government Default.

Source: CBO (Federal Debt and The Statutory Limit, March 2017)

Key Macro Questions for 2017

Are ASEAN FX Resilient or Vulnerable?

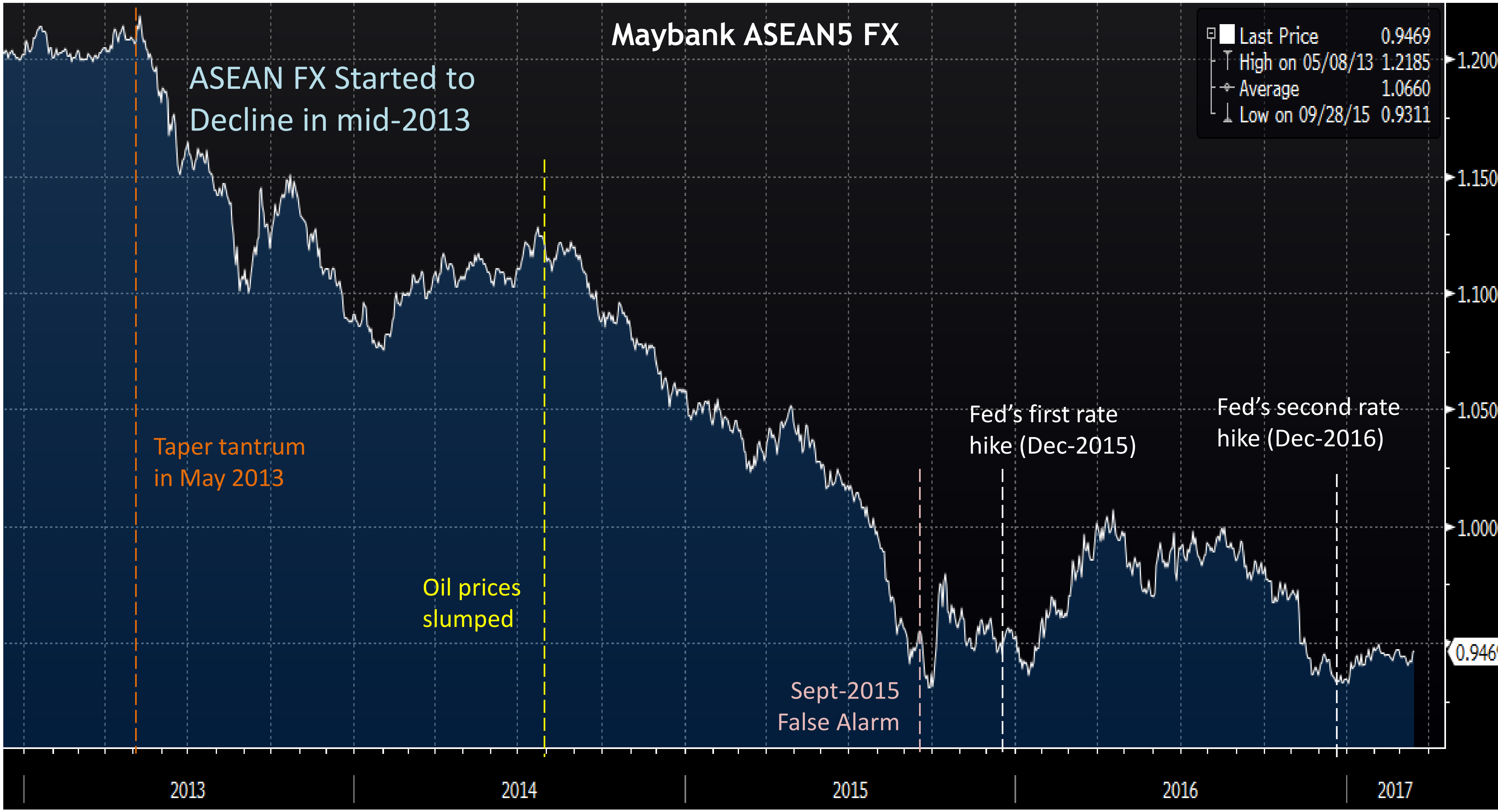
ASEAN FX Typically See Some Recovery Post Fed Rate Hikes…



Note: T+3 denotes T+3 months; ASEAN FX is comprised of SGD, MYR, IDR, THB, PHP, equally-weighted vs the USD

Source: Bloomberg, Maybank FX Research

… But Expect Intermittent Pressures on ASEAN FX in the Lead-up to Subsequent Fed Hikes



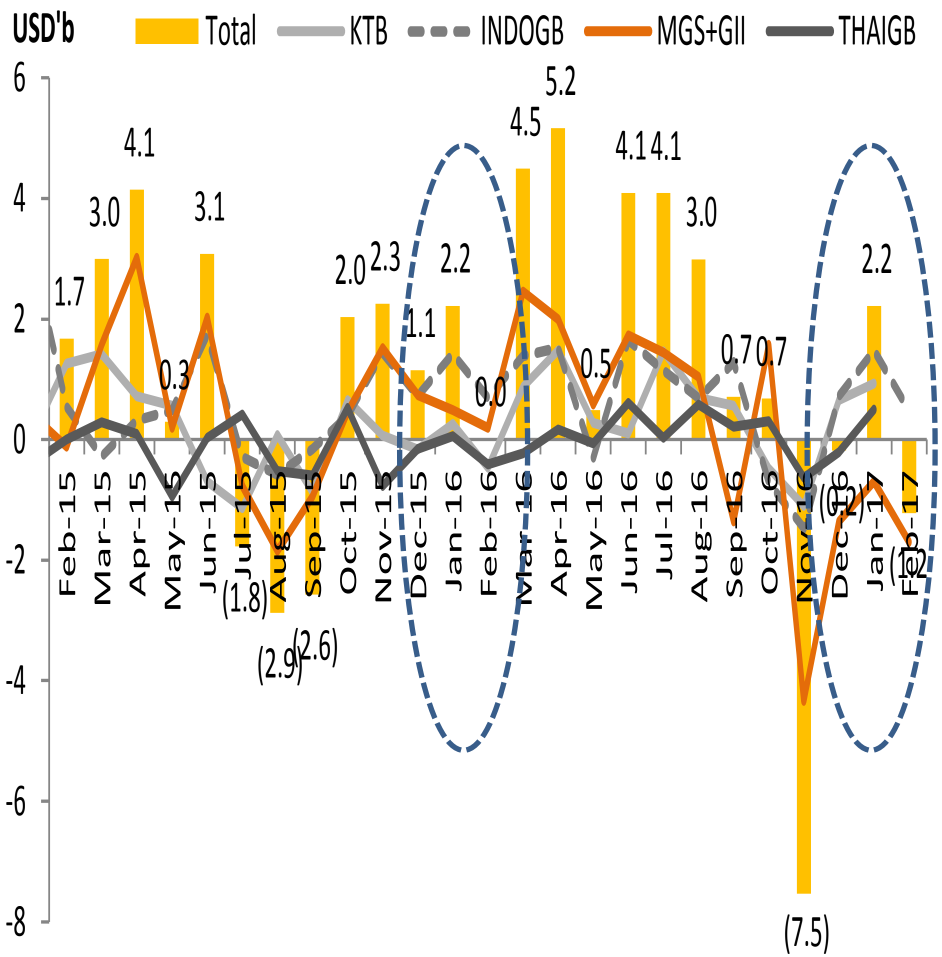
Note: Maybank ASEAN-5 FX is comprised of SGD, MYR, IDR, THB, PHP, equally-weighted vs the USD

Source: Bloomberg, Maybank FX Research

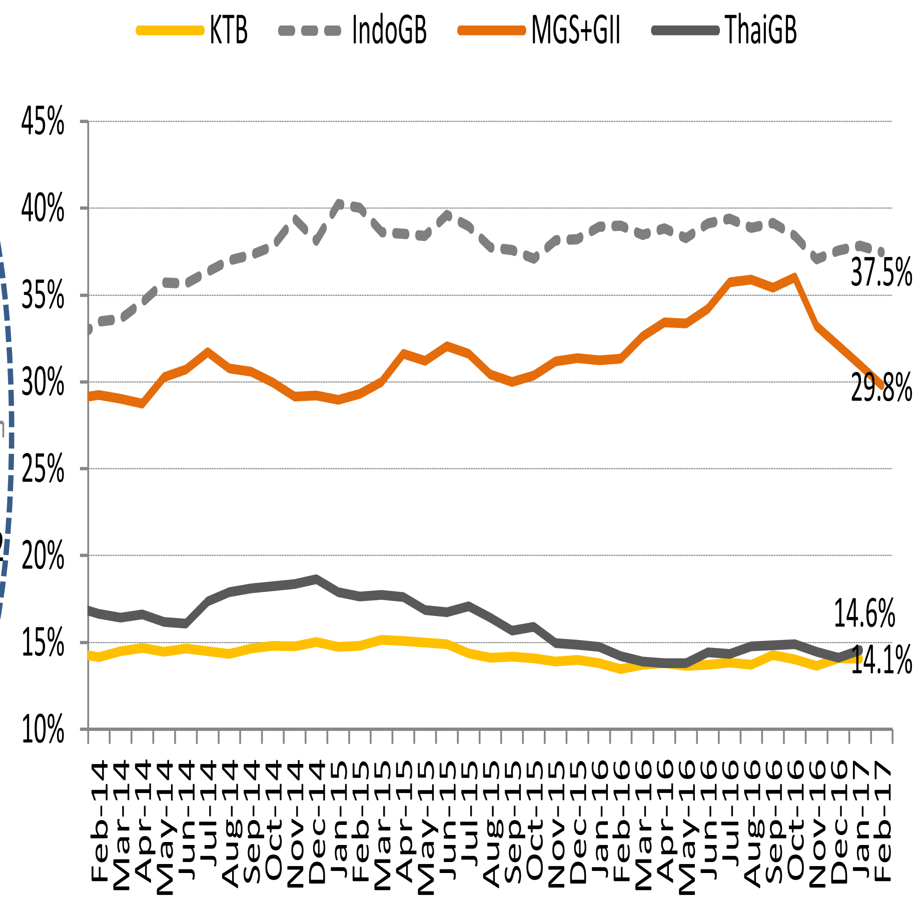
Are ASEAN FX Resilient or Vulnerable?

Bond Inflows Resume since Dec 2016 Fed Hike

Regional: Monthly Foreign Flows



Regional: Foreign Holdings (%)



Source: Maybank FI Research, Maybank FX Research

But Mixed Fortunes: IDR bonds Favored Across Most Tenors While THB Bonds Came Under Pressure

Sovereign Curves: 1-month Change Across Different Tenors

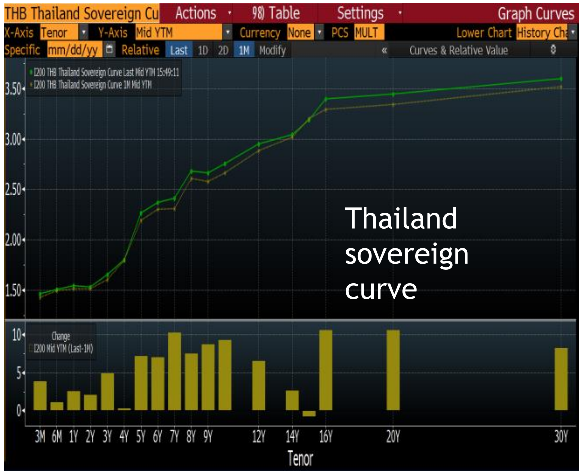
ID Bonds: Demand in the belly

SG Bonds: Mixed

MY Bonds: Selling Pressure in Front End

PH Bonds: Selling Pressure in Front End

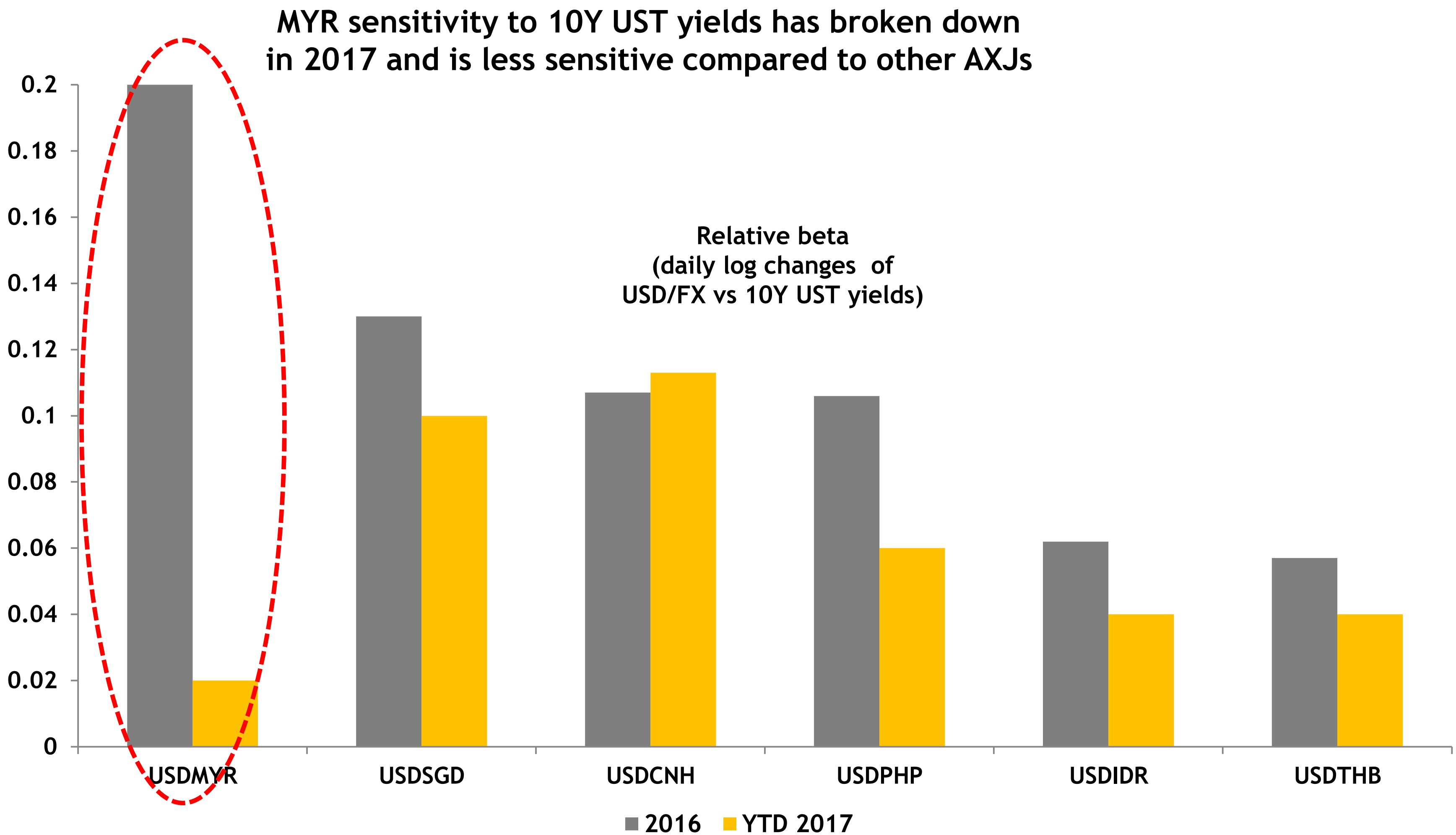
TH Bonds: Selling Pressure



IN Bonds: Short term bonds in demand

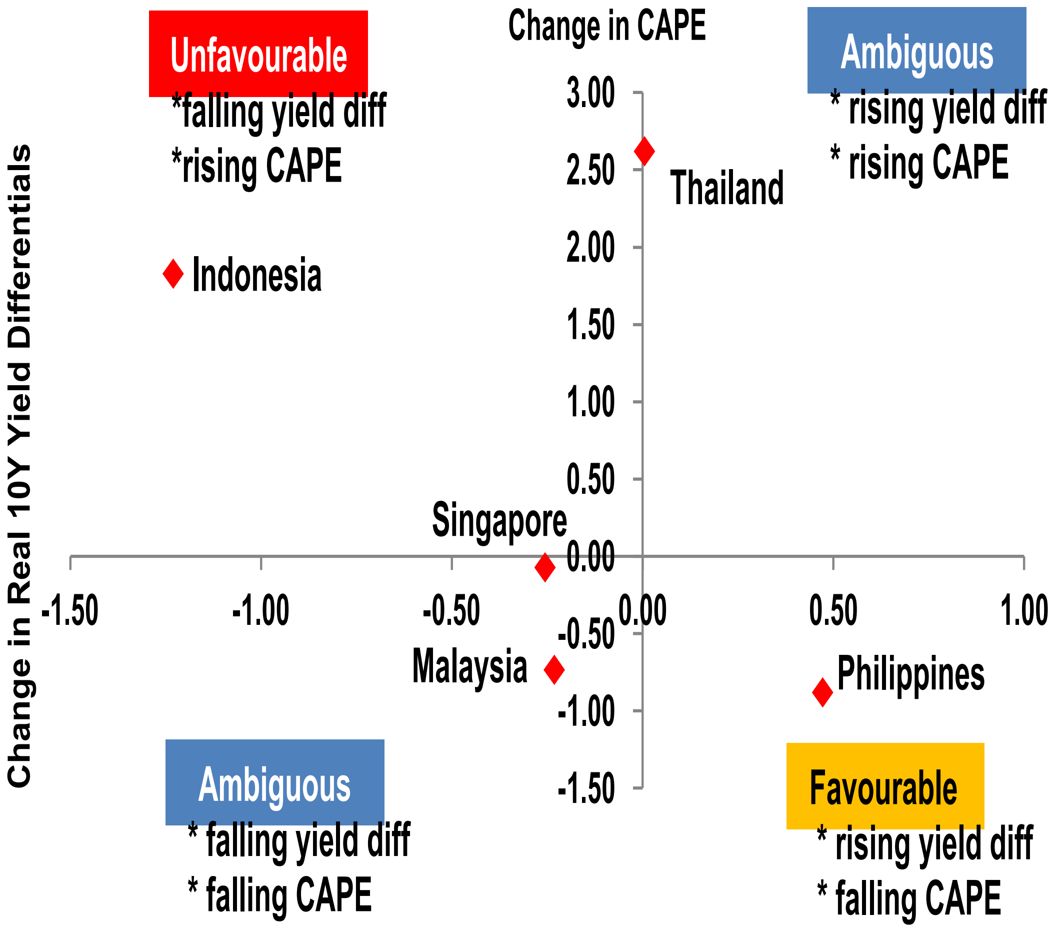
Source: Bloomberg, Maybank FX Research

USDAsians remain driven by UST yields except for USDMYR



Source: Eviews, Bloomberg, Maybank FX Research

PHP Long Term Attractiveness, on CAPE Valuation Basis

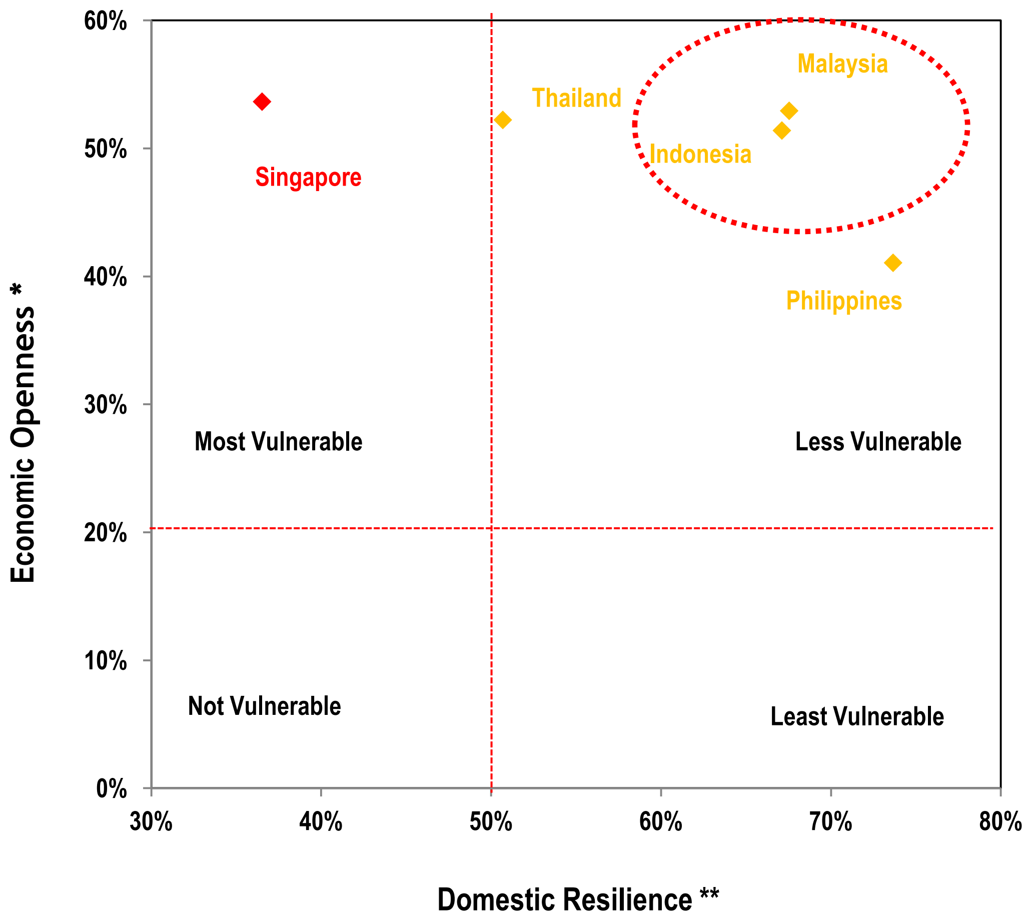


Note: Cyclical adjusted P/E ratio (CAPE) is defined as price divided by the average of 10 year earnings (both adjusted for inflation)

Source: Bloomberg, CEIC, Maybank FX Research

- From a CAPE perspective, continued portfolio inflow into ASEAN could potentially be supportive of currencies, in the longer term. But that remains questionable for now.
- **Philippines is may be attractive in the longer term** but faces near term stresses from (Duterte Risk Premium) and weakening current account balance that holds back portfolio inflows.

Most Of ASEAN FX Resilient To External Risks



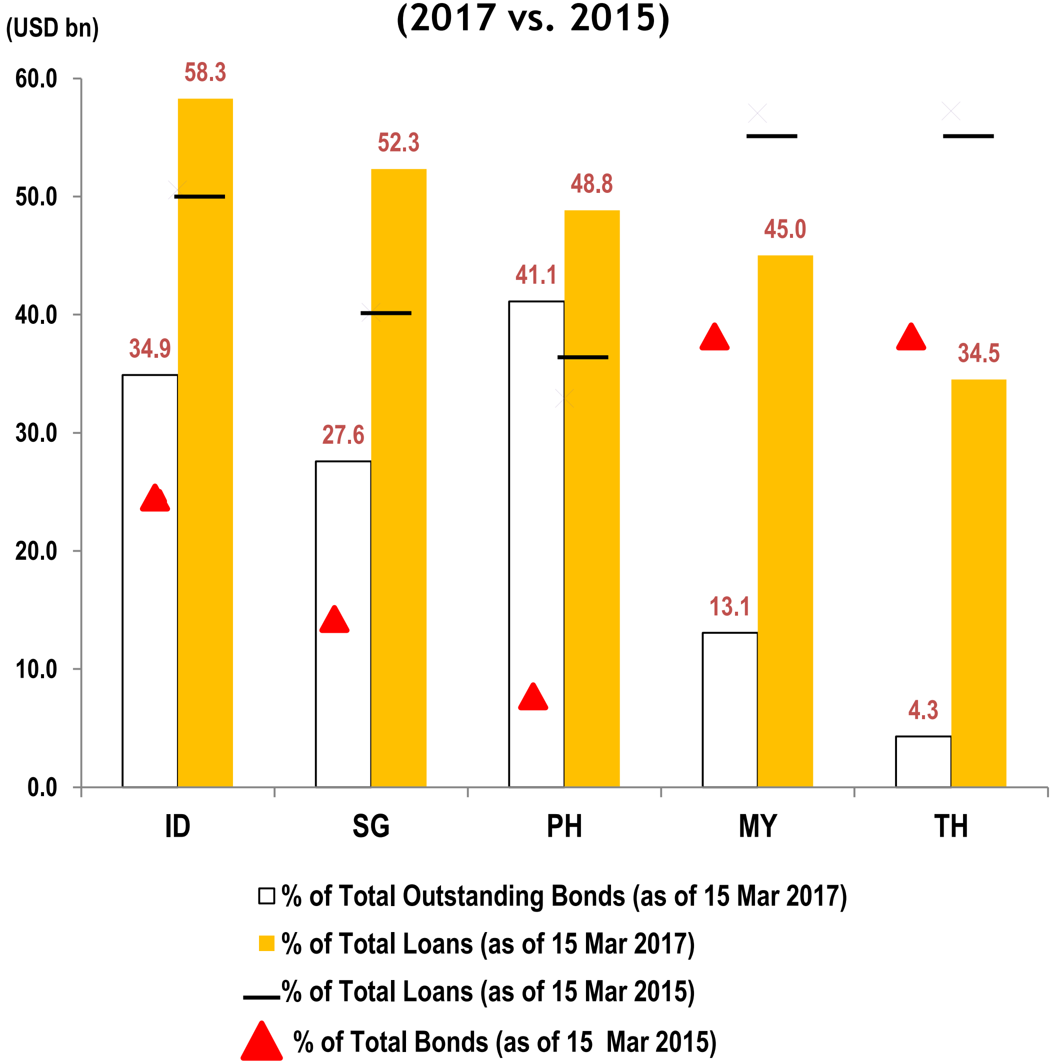
- We examine the openness of the ASEAN economies and their domestic resilience.
- On a relative basis, the SGD is likely to be bias to the downside in a more protectionist environment than its regional peers, particularly the IDR and PHP.
- **In a synchronised recovery and improved external demand scenario, we should be bullish MYR & IDR.**

Note: * Proxied by Total Trade as % of GDP
**** Proxied by Private Consumption as % of GDP**

Source: CEIC, Maybank FX Research

Downside Risks To IDR, SGD and PHP Due To Rising Exposure To USD Debt

ASEAN's Financial Exposure To The US (2017 vs. 2015)



Source: Bloomberg, Maybank FX Research

- Among ASEANs, **Indonesia, Philippines and Singapore have seen increases in their USD-denominated loans and bonds** (both corporate and government) in 2017 from 2015.
  - This suggests that both corporates and government had taken advantage of the lower US rates to finance activities
- Malaysia's and Thailand's exposure to the USD has fallen in 2017 compared to 2015.
- There are risks for these economies most exposed to the USD, namely Indonesia, Philippines and to a lesser extent Singapore (given its status as a financial hub).
- Rising US interest rates could put downside pressure on their currencies.

If Necessary, ASEAN Central Banks Can Tighten Policy

All Can But Not All Will. Depending On Inflation/Growth Risks

	Headline CPI (current period; 3MMA y/y)	Headline CPI (previous period; 3MMA y/y)	2017 Current Trend	Official Inflation Target (2017)	Inflation Drivers	2017 Growth Outlook	2017 Policy Response
Indonesia	3.45%	3.37%		3.0-5.0%	Electricity tariff adjustment		Tightening Bias
Malaysia	2.30%	1.69%		2.0-3.0%	Higher fuel prices, higher import prices, adjustment to administered prices like gas prices, electricity tariffs and sewerage charges		On Hold
Philippines	2.87%	2.59%		2.0-4.0%	Rise in commodity prices, higher import prices, firmer domestic demand		Tightening Bias
Singapore	Headline: 0.25% Core: 1.32%	Headline: 0.02% Core: 1.19%		Headline: 0.5-1.5% Core: 1-2%	Positive contributionfrom energy-related components and some administrative price increases		Tightening Bias
Thailand	1.37%	1.09%		1.0-4.0%	Rising commodity prices amid a sharper economic recovery		Tightening Bias

Source: Bloomberg, CEIC, Maybank FX Research

Key Macro Questions for 2017

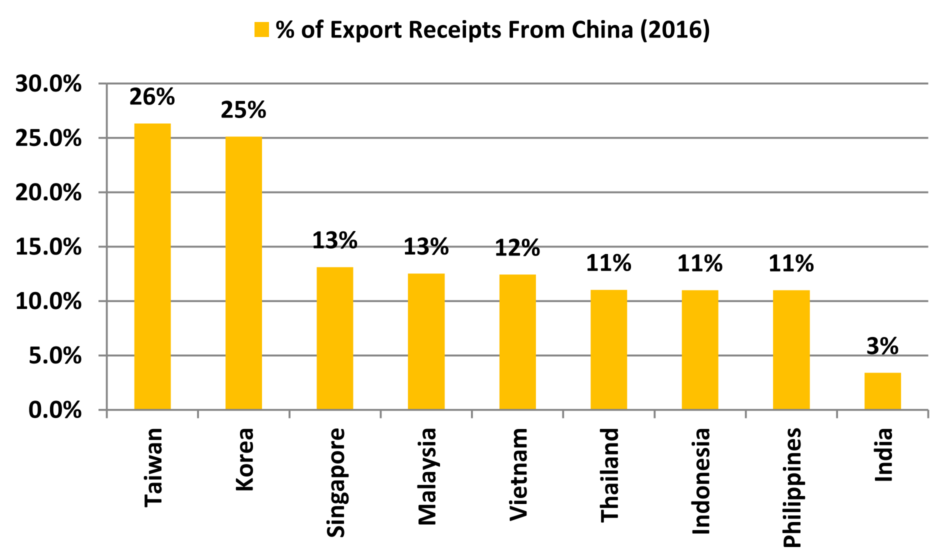
Other Headwind Risks?
– China, Commodity, Political Risks

Lower China Growth and Risks of US Trade Protectionism Weigh on Asia

China Economic Targets 2017

	2017 Target	2016 Target	2016 Actual
GDP	~6.5% or higher, if possible	6.5-7%	6.7%
Money Supply	~12%	~13%	11.3%
CPI	~3%	~3%	2%
Budget Deficit (% GDP)	3%	3%	3.80%
Urban New Employment	>11.0mn	>10mn	13.1
Urban Unemployment Rate	<4.5%	<4.5%	4.02%

Source: Bloomberg, China Daily, Maybank FX Research

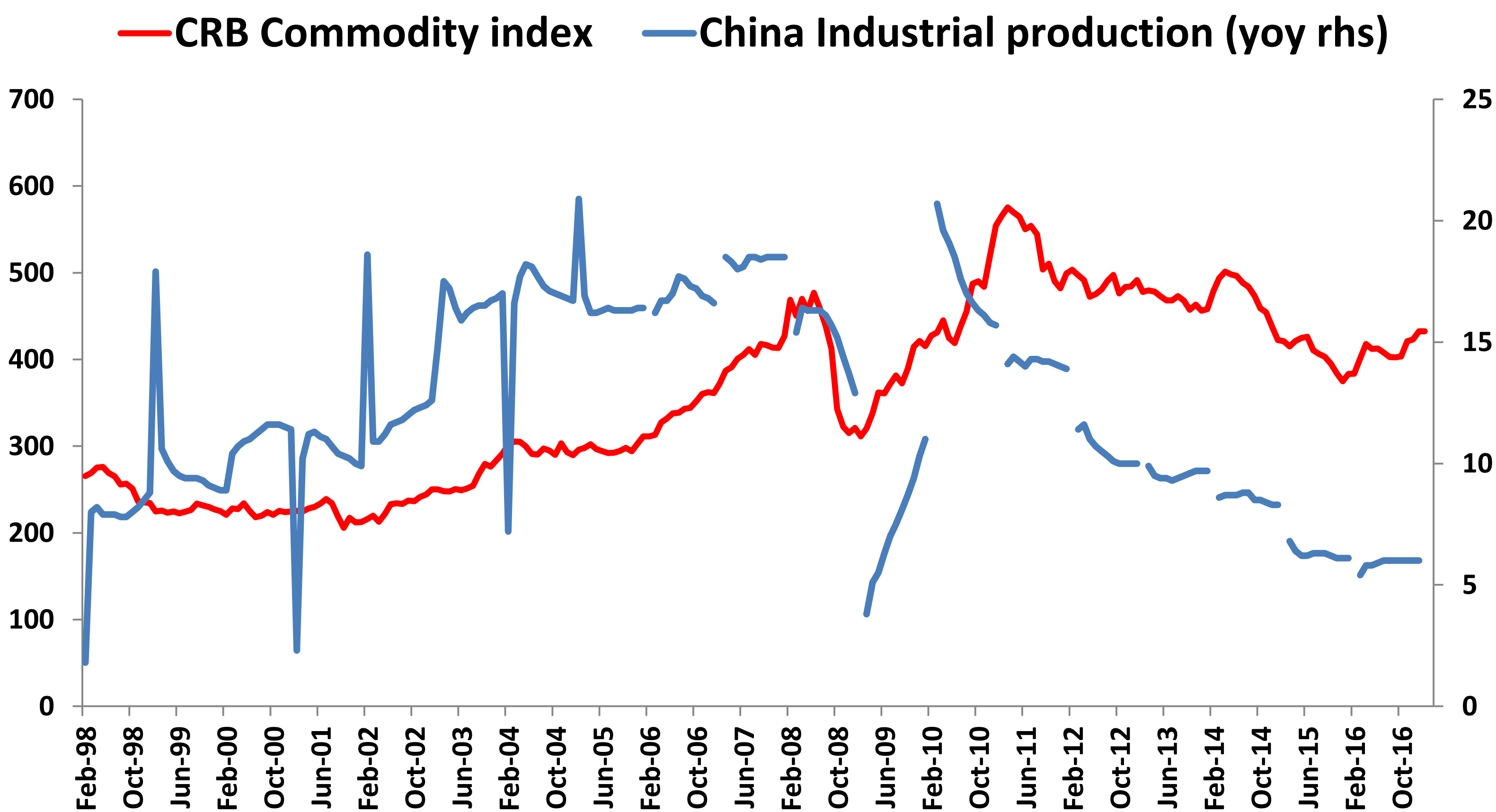


When China sneezes, the rest of the region could still catch a cold. We can expect Asian economies to be affected by slowing activity slows China as well as any trade protectionism policies including border adjustment taxes that the US implement

Source: CEIC, Maybank FX Research

China's Lower Growth Could Also Stymie The Recent Optimism in Commodities

While recent data out of China suggests stability, China has put out slower economic targets including industrial production and GDP. That should cap commodity prices and ***possibly stymie its recent run-up.***

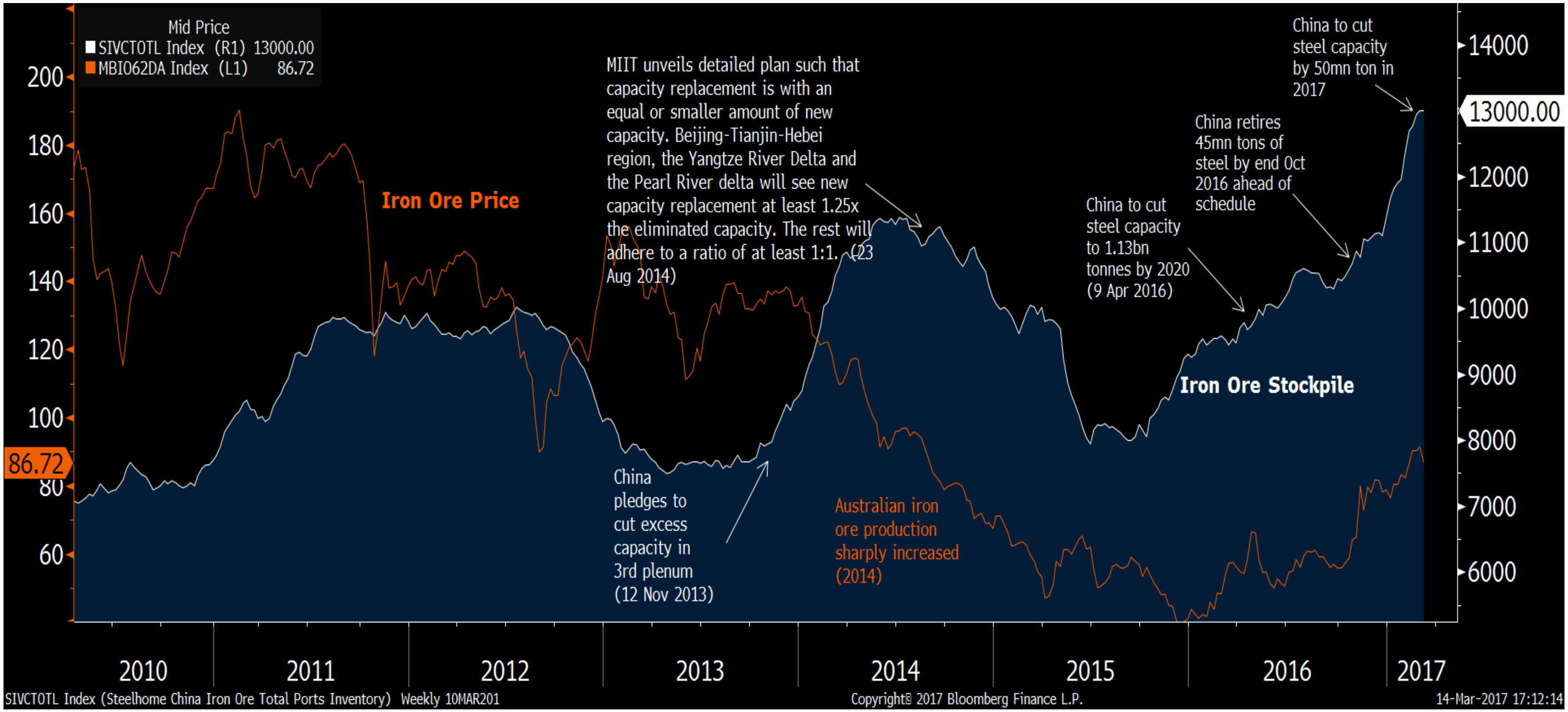


Source: Bloomberg, Maybank FX Research

Note: Gaps are seen in typically seen in China's industrial production due to seasonal factors

Iron Ore Producers See Signs of Topping, -ve AUD

Higher Iron Ore Prices Led Stock piles to multi-year highs… We see potential for correction.

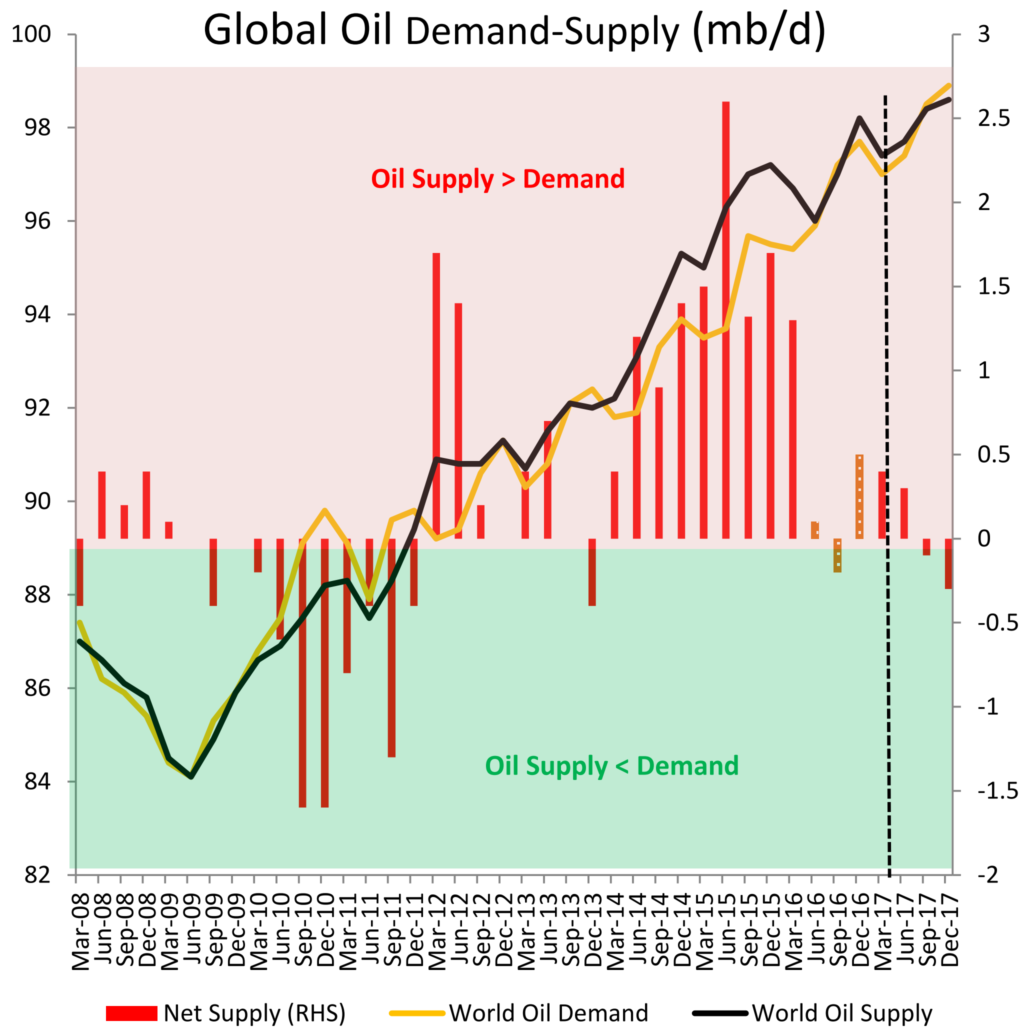


Source: Bloomberg, Maybank FX Research

"Overall, the reflationary conditions that dominated global commodity markets in 2016 **may be reaching their limits,** though positive sentiment and further steel and coal capacity cuts in China may provide further support."

Rio Tinto 2016 Strategic Report

Global Oil Supply-Demand Rebalancing Needs Time to Work Its Way



Source: Maybank FX Research

Global oil market needs time for the full impact of the big supply cuts under the output reduction agreements to be felt

Implementation of the OPEC production agreement appears in February to have maintained the solid start seen in January. For the first two months of the deal the compliance rate averaged 98% while non-OPEC countries have cut production by 37% of their commitment in the first two months of the year.

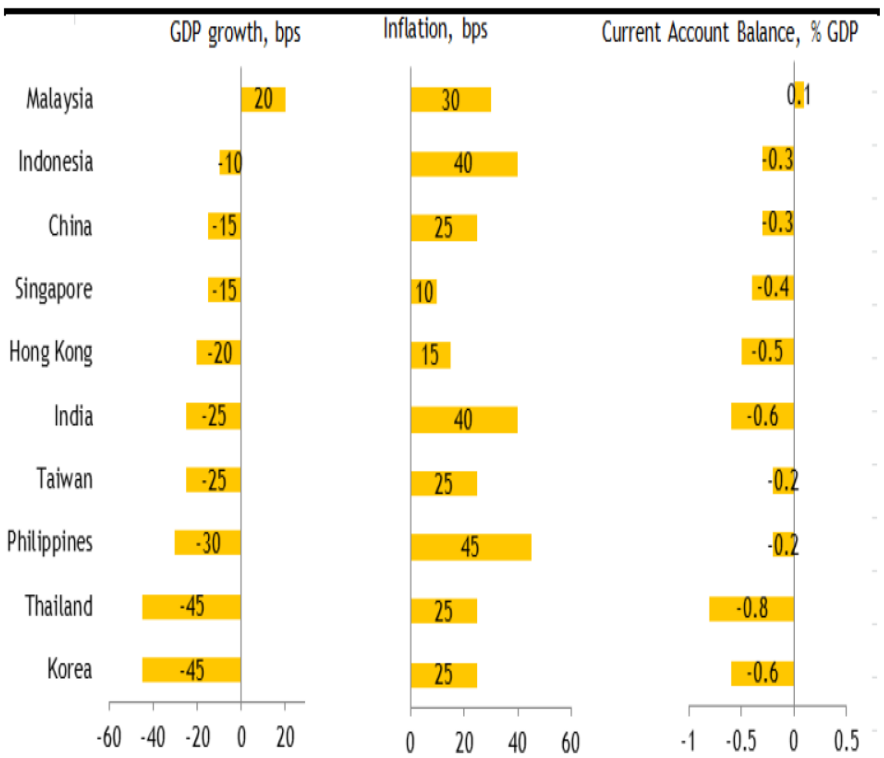
There is an implied market deficit of 0.5 mb/d for 1H17 if current production levels were maintained to June when the output deal expires

Oil Price has varying impact on Asian Currencies, Albeit All Positive

Apart from its obvious impact on economic fundamentals…

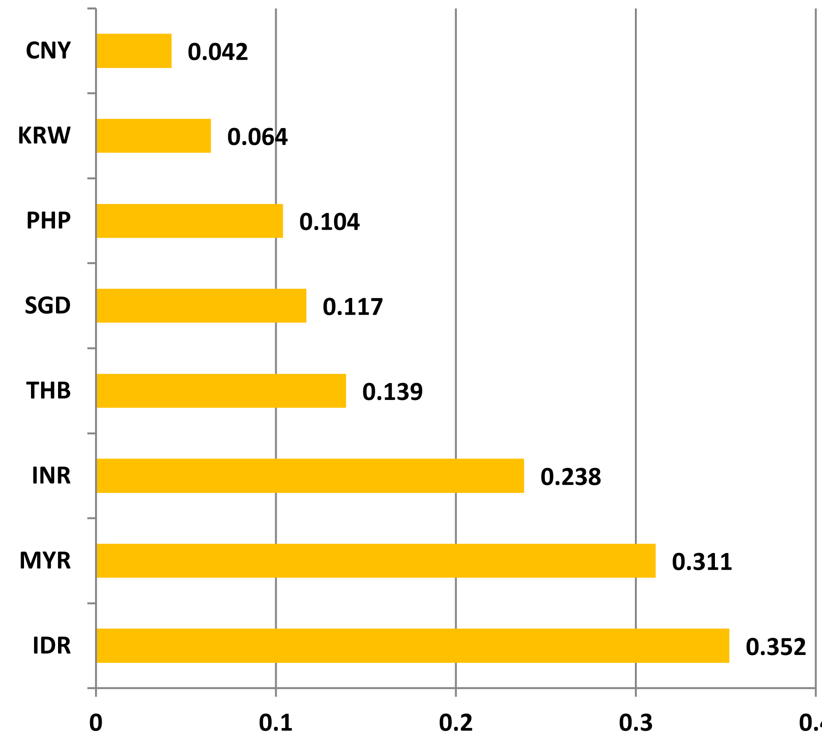
We also have to keep in mind the oil prices were a proxy of risk sentiments. Impact on FX differs slightly.

Impact of 10% Rise in Oil Prices on GDP, Inflation & Current Account



Source: Maybank Kim Eng estimates

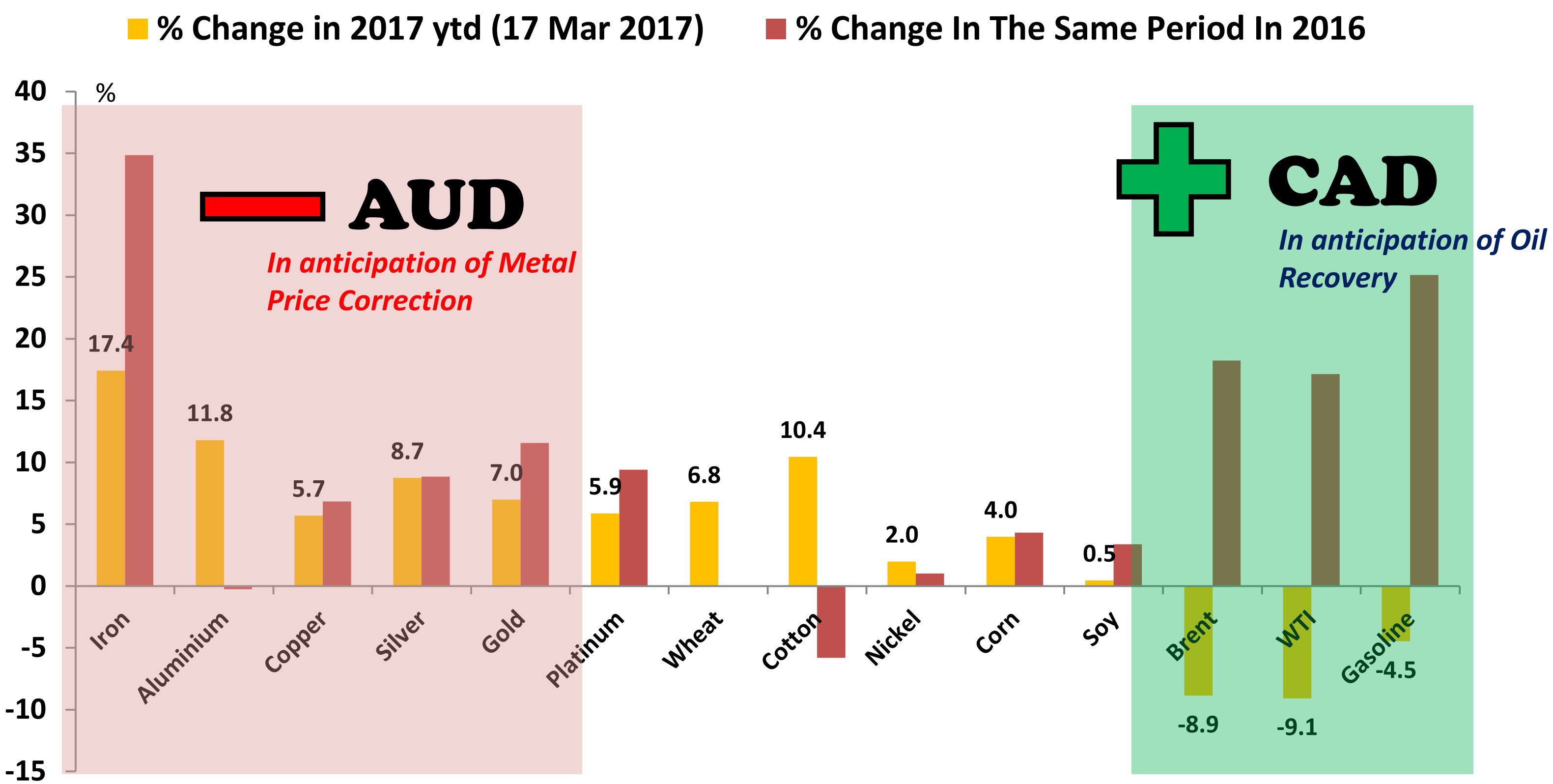
% change in currency against the USD with 1% increase in Brent



Source: Bloomberg, Maybank FX Research
Note: Sample period is 2010-2017.

Other Headwind Risks? – China, Commodity, Political Risks

Current Divergence In the Commodity Prices Allows Tactical Short AUDCAD Trade In Anticipation of Convergence



Commodity prices tend to move together. But we have been seeing some divergence since the start of the year which presents an opportunity for us to enter into a ***tactical*** cross commodity-related FX plays **as we anticipate oil prices to rebound** and **metal prices to correct lower**.

Source: Bloomberg, Maybank FX Research

Other Headwind Risks? – China, Commodity, Political Risks

Busy Political Calendar in EU/UK to Weigh on EUR & GBP

2016

2017

UK Conservative Party Conference (2-6 Oct)

UK Autumn Budget Statement (24 Nov)

Austria Presidential Re-Elections (4 Dec)

Italy Referendum on Constitutional Reforms (4 Dec)

Dutch General Elections (15 Mar)

Potential Trigger of Article-50 by UK (End-Mar 2017)

French Presidential Elections (Apr - May)

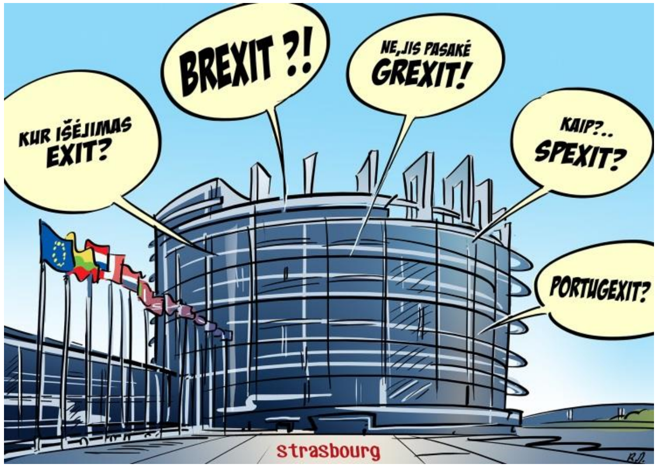
Italy Elections? (Jun 2017)

German Federal Elections (Aug – Oct 2017)

Referendum on Scottish Independence? (2017??)

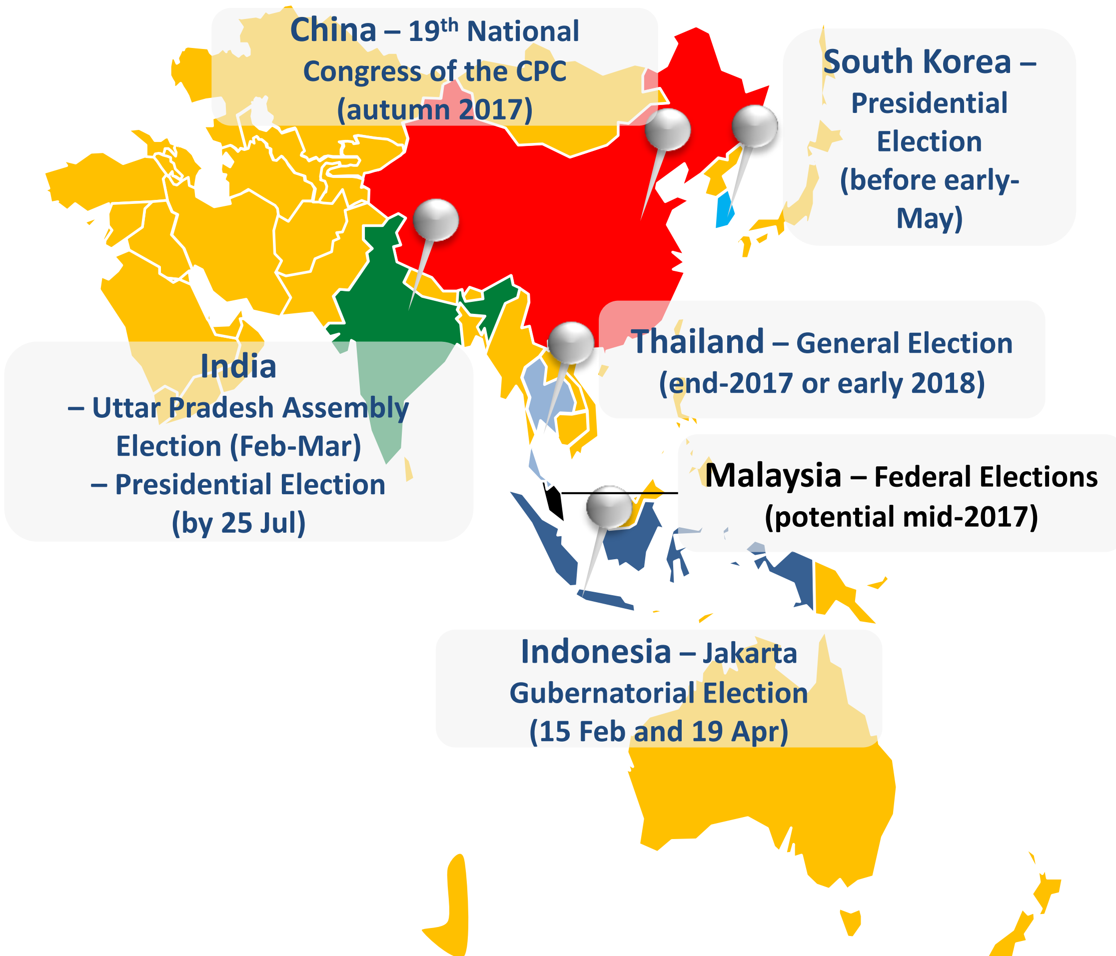
"Brexit to be very difficult messy negotiation…leaders united and ready for dirty *Brexit… talks with Switzerland show EU can be tough negotiator"*

- EU Commission President Juncker, Oct 2016



Source: Maybank FX Research

Political Events Are Typically Pressure Points for FX



Key Political Events in Asia

Thailand
- General Election *(early 2018)*

India
- Uttar Pradesh Assembly Election (*Feb – Mar*) *critical for the selection of the Presidential candidate
- Presidential Election (*must be held before 25 Jul*)

Indonesia
- Jakarta Gubernatorial Election (*15 Feb, 19 Apr*)

China
- The 19th National Congress of the CPC (*2017 autumn*) *PBoC may want to keep yuan stable nearing the event.

S. Korea
- Presidential Election before early May

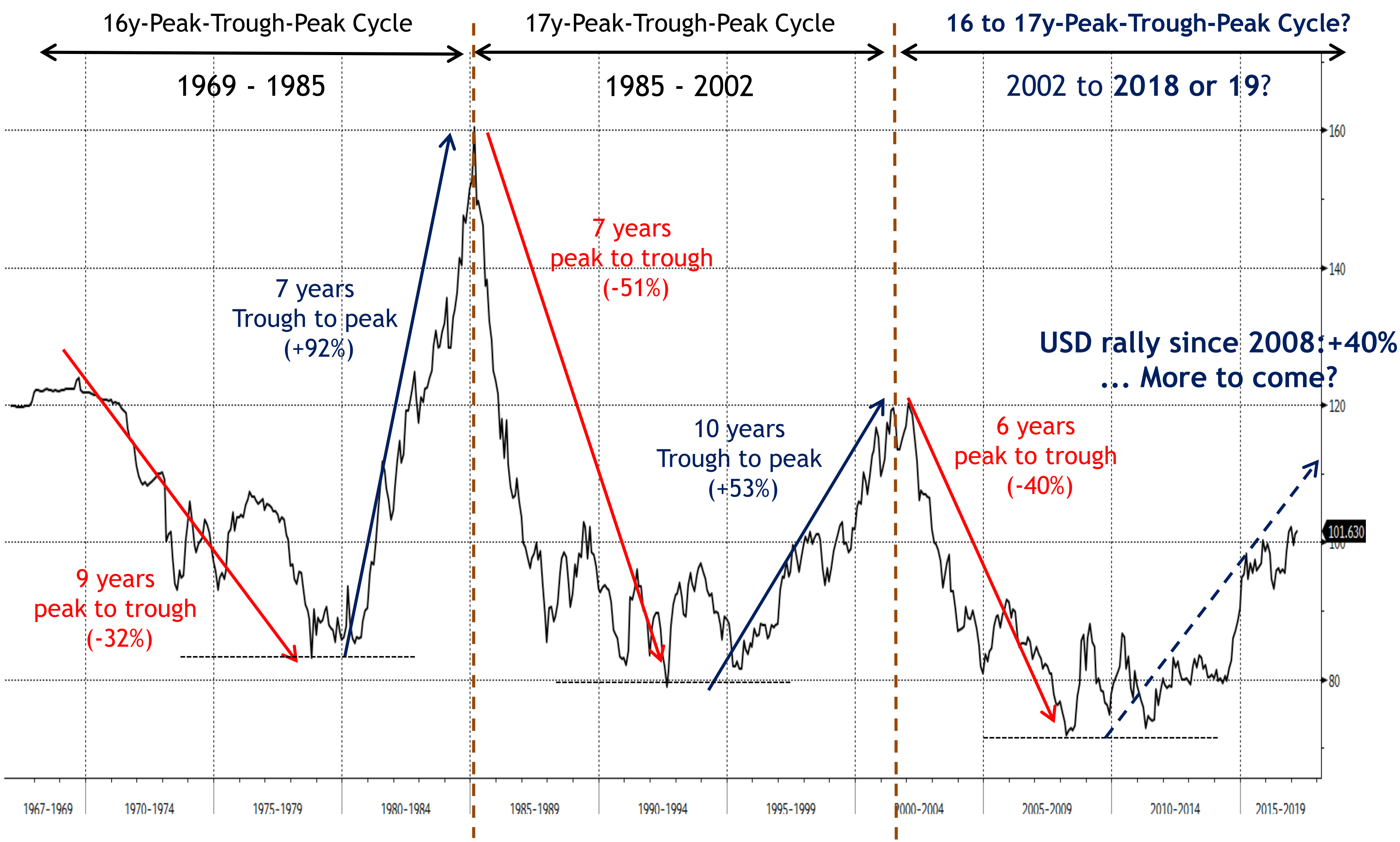
Malaysia
- Potential Federal Elections – a positive for MYR and MY assets

Note: All dates of key political events are accurate as of 28 Dec 2016.
Source: Maybank FX Research

Our House View on FX Outlook

Our House View on FX Outlook

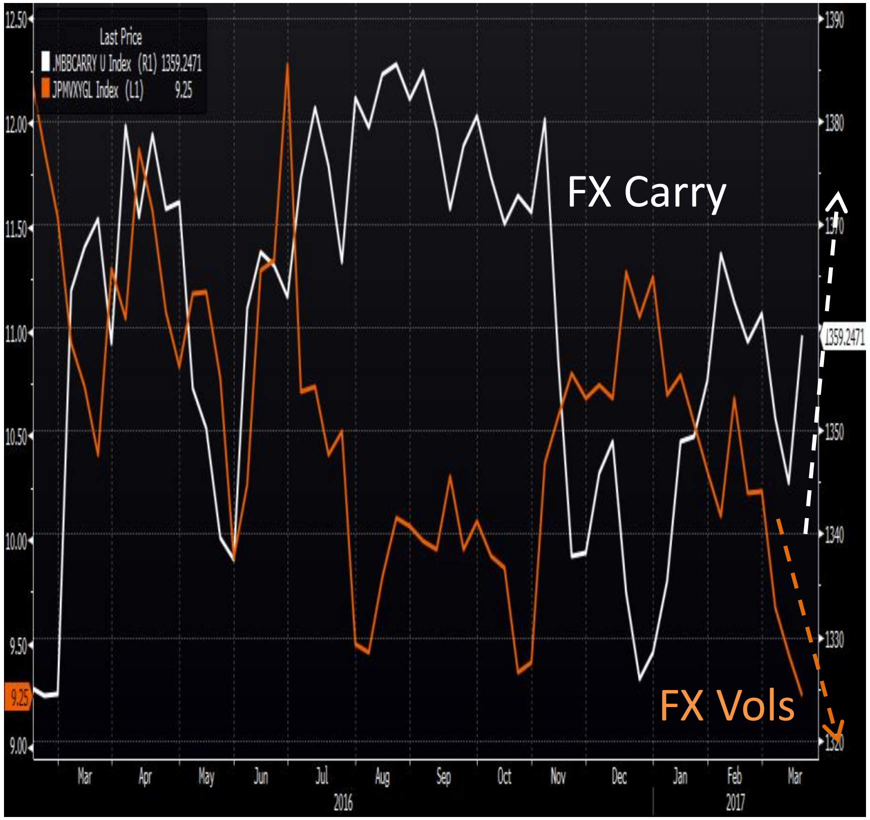
Technically, 16-17y Cycle Suggests USD Strength to Peak in 2018 (at the latest)?



Source: Bloomberg, Maybank FX Research

Carry Trades Inversely Correlated to FX Vols

FX Carry trades gain when FX vols decline



FX Carry-FX Vols Correlation Coefficient at -0.45

Note: Maybank FX Carry trade index is made up of INR, IDR, PHP, AUD, NZD, equally weighted vs. the USD

Source: Bloomberg, Maybank FX Research

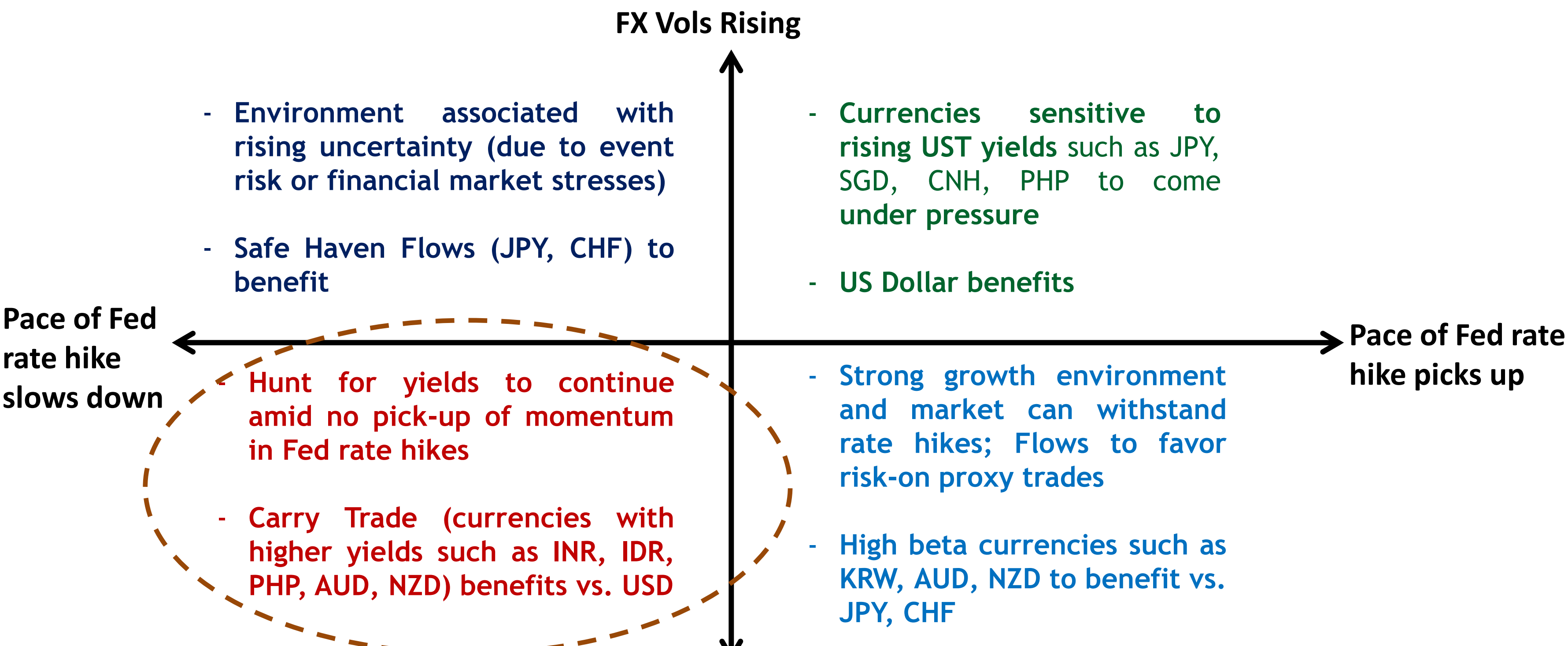
Current Environment Favors INR, IDR, PHP, AUD, NZD

Big picture:

- USD bull trend has room to run
- Fed rate hike should continue for 2017-18 – the **pace of rate hike matters more**

But in the short-medium term:

- FX is **not** a One-way Bet
- **FX vols** and **Pace of Fed rate hikes** are determinants to FX Bias



Source: Maybank FX Research

Strategic Trade Ideas

- Buy USDSGD, USDJPY on sensitivity to UST yields rising
  - Buy on dips towards 1.39-1.3950, targeting a move towards 1.4550
  - Buy on dips towards 112, 110 targeting a move towards 120

- Buy AUDSGD on dips
  - Looking for a move towards 1.10, 1.12
  - Buy levels around 1.0660 levels

- Favor long bias for IDR and THB against short JPY (Asian Central Bank RV Plays)

- Short PHPINR on diverging current account balances

- Long MYR, Short Dollar, Fundamental Undervaluation, Target 4.00, Topside 4.52.

Tactical (Short-Term) Trade Ideas

- Tactical Long GBP on smooth exit towards triggering Article-50
  - Break above 1.2450 puts next resistance at 1.2720 levels (200 DMA)
  - Support at 1.2050

- Tactical short AUD on commodity price correction
  - Looking for a move towards 0.72
  - Look for a move against CAD (Commodity Convergence).

- Long NZD
  - Vs. short USD towards 0.72
  - Vs. short SGD towards 1.0050

- Sell SGDTHB on rally towards 25; objective at 24

The House View – G7 + China

- **USD** – Remains Supported on Dips; Expect Strength to come into play leading into Fed rate hike or clarity on Trump's fiscal spending plans (if any); 98 – 103 range
- **GBP -** To Depreciate vs. USD but <u>Not a One Way Bet</u>; Brexit journey has barely just began; 1.16 Not Impossible
- **EUR - Political Risk to drive sentiment; 2-way risks between** 0.98 – 1.10
- **AUD** – Short-term Correction Seen. Medium Term – Long-term Bull. Range 0.72-0.82 (vs. USD); Bias to Buy on Dips towards 0.72.
- **NZD** – Weighed by dairy prices but yield differentials to mitigate weakness; 0.68 – 0.72 range
- **JPY** – To Weaken Towards 120-125 *first* (vs. USD)
- **CNH** – Weak vs. USD (7.10). Potential for strength vs. EUR (6.80), JPY (5.84), KRW(170)

The House View – ASEAN FX

- **SGD -** Downside Risks vs. the USD (1.4250), vs. MYR (2.95-3.20). USDSGD support at 1.3950.
- **MYR** – Fundamentally undervalued but likely to stay subdued at 4.38 – 4.48 (vs. USD)in the next 3-6months; Expect spot to reflect underlying fundamentals and appreciate past 4.00 (vs. USD) into 2018-19
- **IDR - S**hort term risk towards 13600 but **strong** fundamentals to provide support on dips, especially a potential upgrade to investment grade by S&P.
- **PHP -** Near-term pressure to the downside due to Duterte Risk premium and worsening current account balances as well as weakening financial inflows.
- **THB -** In the backdrop of more Fed rate hike this year, should see short term strength as beneficiary of synchronised recovery, but eventual gradual weakening towards the end of the year to 36.20 (vs. USD) as the General Election approaches in early 2018.

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