Maybank

Macro | FX Research & Strategy

Global

FX Monthly

2023, Issue 7: "Peak Rate Hike" Phase

What Has Changed This Month?

- We have lowered our forecasts for the USDJPY as the BOJ decision to raise the cap on the YCC to 1.00% together with the likelihood of Fed rates peaking soon (with the potential of cuts next year) is likely to lead to narrower rate differentials, providing a boost to the JPY. Additionally, we have also adjusted our USDTHB forecast downwards given the possibility that the formation of a government together with the increasing return of tourists could give a lift to the THB.

Our Strategies and Views

- The Fed and ECB have started to be less committed to future hikes and leaned more towards data dependency as headline inflations slow more discernibly but core measures still threaten. Separately, the BOE looks set to possibly hike by 25bps instead of 50bps as inflation in the UK moderates. BoJ sprung a surprise by announcing a tweak of its monetary policy framework with the cap of +0.5% on 10y JGB yield seen as more of a reference rather than a hard cap. 10y yield is now allowed to move within -0.5% to +1.0%. More speculative plays on the JGBs and BoJ reaction function (ad-hoc bond purchases) could continue to keep the USDJPY supported. Slow rise in the JGB yields could potentially create modest pressure on the yields of bonds in other parts of the world. USD may continue to remain supported on dips as result, not helped the least by the BOJ operations that tend to fan USDJPY higher.

- China's Jul Politburo confirmed what many had already suspected - no big bang stimulus. Even so, markets warmly welcomed government's recognition of key economic issues (lack of confidence, youth unemployment, local government debt risks, property slump) and hopes on a gradual recovery return. Recovery will take time and yuan's appreciation will be bumpy, albeit supported by the PBoC via strong daily yuan fixes and the adjustment of the cross-border financing parameter.

- The SGDNEER has been exceptionally firm and has tested the 2.00% upper limit of the band since the early-mid Jul in the latest bout of USD weakness. Further attempts at higher SGDNEER should necessitate MAS intervention and we see an opportunity to sell the SGDNEER on rally, with the SGDNEER trading at 1.82% at time of writing.

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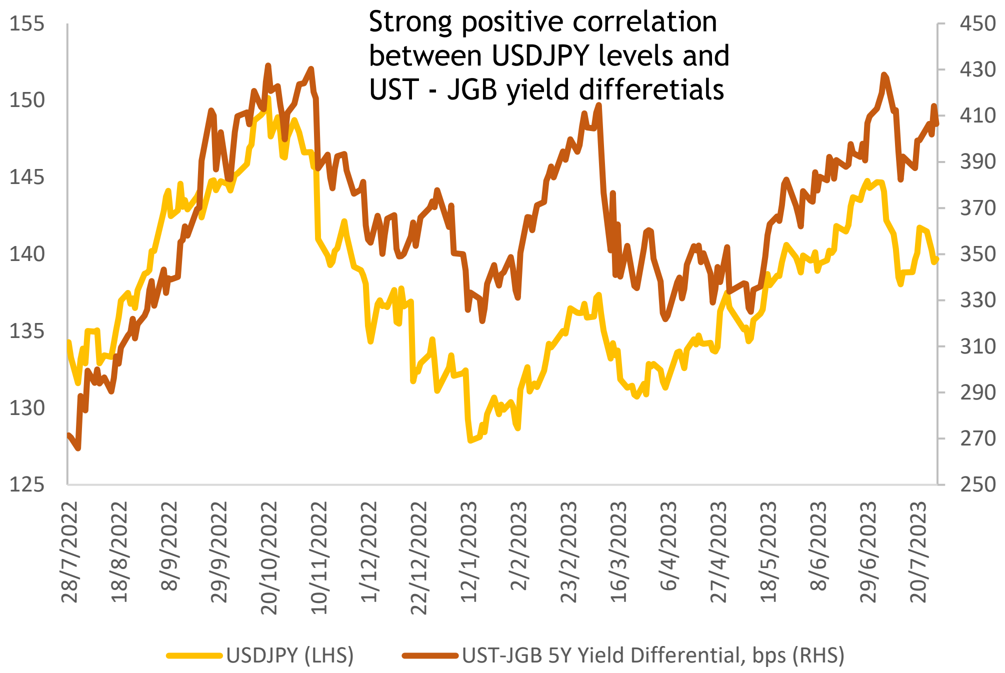
Top 3 Currency Plays for Aug

Sell SGDNEER on Rally
Sell USDJPY on Rally
Sell USDIDR on rally

Key Events for the Month Ahead

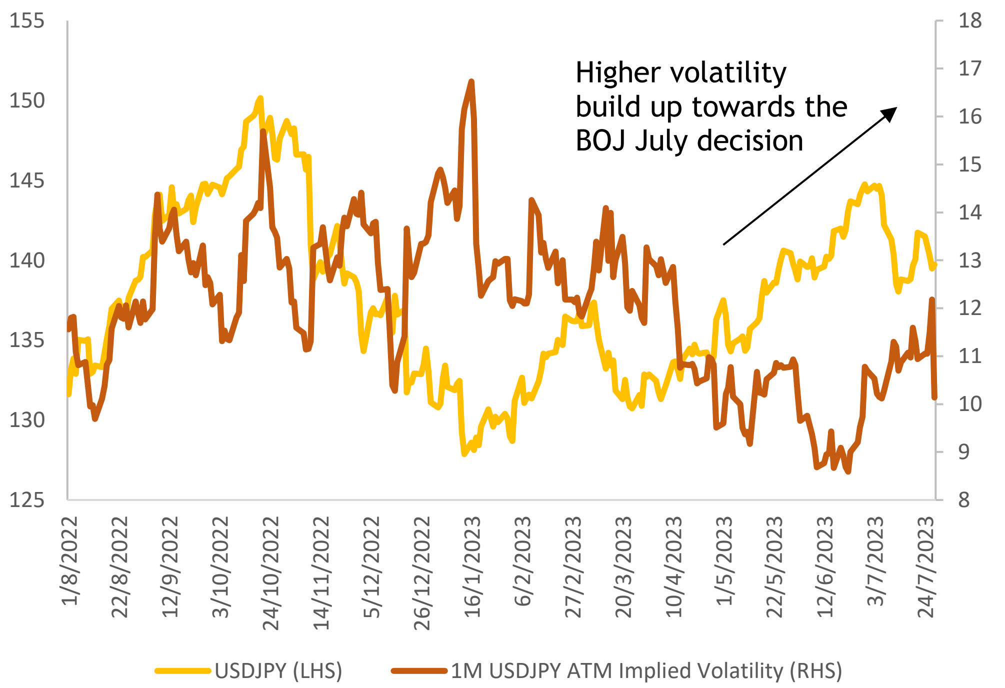
Date	Event
24-26 Aug	Jackson Hole Economic Symposium

JPY on Stronger Appreciation Path With YCC Change as UST - JGB Yields Differential to Narrow



Source: Bloomberg, Maybank GM FX Strategy & Research

Risks of Higher Volatility But BOJ Does Not Look Comfortable with Excessive Speculation on Yields



Source: Bloomberg, Maybank GM FX Strategy & Research

G7 Global Overview

USD: FOMC's "Data Dependent" Phase

Forecast	3Q 2023	4Q 2023	1Q 2024	2Q 2024
USD Index	102.65 (103.51)	101.94 (102.71)	100.30 (101.27)	98.61 (99.32)

Previous Forecasts in Parentheses

- **Motivation for the FX View:** The DXY index trended lower in the early part of July on the back of expectations that the Fed will see a pause following a PCE coming in lower than expected and a softer NFP. With a slower quarterly pace, the 25bps Jul hike would significantly raise the likelihood of a 4Q move much harder as there is some likelihood that there could be some cooling of inflation by then, reducing the probability the Fed would undertake a second hike. Our economists are expecting no more hikes. But we do note that the view could change as the current turning point risk environment would highly depend on inflation (and growth) outcomes.

- Our DXY forecasts are revised lower largely because of our upwards revisions to the JPY given the pricing-in of the likely policy tightening shift out of BOJ. We still expect USD to remain supported in 3Q as its carry vis-a-vis other currencies still remains with some softness in 4Q as the markets price in some cooling of inflation in the end of 2023.

- Last few months we highlighted that USD strength could be a bit stretched and there could be room for the USD to come off from current levels into Jun and July. That had panned out although we are pricing in a slightly more gradual depreciation for the USD further into the year, largely in the tail end of 2023 and 1Q 2024.

- **Growth and Inflation Outlook:** 2Q US real GDP rose 2.4% (vs. 2.0% prior), much higher than the consensus (1.8%). Final sales to domestic purchasers — which includes only the less volatile components of consumption, business fixed investment, and residential investment moderated to 2.3%, vs. 3.5% in 1Q. Consumer spending slowed sharply to 1.6% (vs. 4.2% in 1Q), contributing 1.1% point to headline GDP. Spending on services slowed slightly but still grew a respectable 2.1%. But durable-goods spending, a better predictor of recessions, grew a tepid 0.4% (vs. 16.3% prior). With excess savings dwindling and student debt repayments resuming in October, we expect consumer spending to cool even further in the months ahead. Non-residential fixed investment grew a robust 7.7%, driven by strong growth in structures and equipment, contributing 1.0 ppt to GDP. Fiscal support for initiatives to increase US semiconductor manufacturing capacity is likely supporting investment growth in these categories.

- The GDP report provides more optimism about prospects of a soft landing. While interest-rate sensitive categories, such as residential investment and consumption of durable goods, continue to be tepid, other categories are boosting growth, likely driven by demand generated by the Biden administration's industrial policy.

- The June personal consumption expenditures price index rose 0.2% last month from May. YoY, PCE deflator increased 3% — the slowest pace in more than two years. Core PCE price index rose 4.1% from year ago, down from 4.6%. The gain in inflation-adjusted spending led by strong truck sales. The core PCE price index also rose 0.2% from the prior month and was up 4.1% from June 2022. Consumer spending, adjusted for inflation, increased 0.4% in June — the most since January.

- NFP rose 209k in June, less than expectations and jobn gains over the past 2 months were revised lower. The unemployment rate fell to 3.6%.

- The US labour market still looks resilient but the latest labour data prints seem supportive of a slowdown in the actual labour market conditions which could be less optimistic than the initial headline data suggests.

- **Monetary Policy Forecast:** FOMC meeting on 25-26 July 2023 saw Fed raised the target fed funds rate (FFR) range by +25bps to a 22-year high of 5.25%-5.50% as widely expected.

- Aside from the FFR decision, and the tweak in the description on the pace of economic expansion to "moderate" from "modest", the latest FOMC statement did not change from the previous statement released after 13- 14 June 2023 FOMC meeting.

- In particular, FOMC statement implies Fed keeps the door open for further rate hike, given that its current "dot plot" signals additional +50bps hikes in 2H 2023. With the +25bps hike done at the 25-26 June 2023 FOMC meeting, the "dot plot" implies another +25bps increase at one of the remaining three FOMC meetings of this year i.e. 19-20 Sep; 31 Oct - 1 Nov; and 12-13 Dec.

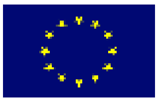
- As of 27 July 2023, futures market is pricing in 80%-20% split between pause and another +25bps hike at the 19-20 Sep 2023 FOMC. For the 31 Oct – 1 Nov 2023 FOMC meeting, the odds are 68.7% for pause and 28.5% for +25bps hike to 5.50%-5.75%. The probability of pause remains the highest for the final FOMC meeting of this year on 12-13 Dec at 62.5% vs 26.1% for another +25bps hike. Overall, market is broadly betting the Fed rate hike cycle has ended with the latest +25bps hike.

- Between now and the next FOMC meeting (19-20 Sep 2023), and in relation to Fed's policy mandates on inflation and employment, there will be two rounds of inflation and job market data releases respectively. To note, latest inflation number showed US inflation rate eased to +3.0% YoY in June 2023 – the lowest since Mar 2021. But that did not stop Fed from rehiking FFR at the 25-26 July 2023 FOMC meet after the pause at 13-14 June 2023 FOMC meet amid the still tight job market conditions.

- We will also be keeping an eye on the Federal Reserve Bank of Kansas' annual Jackson Hole conference next month (24-26 Aug 2023) to see whether Fed will provide stronger and clearer signal about FFR direction. Maintain our call of no more FFR hike for the rest of the year… but it will be a "fluid" forecast We maintained our view of FFR staying at the current 5.25%-5.50% level for the rest of the year, to be followed by a total of -200bps cuts in 2024. Admittedly, this is a "fluid" forecast, subject to how inflation and job market data pan out - as well as on the narratives by Fed's senior officials - between now and the remaining FOMC meetings for this year.

- **Key domestic events and issues to watch in Aug:** S&P Global US Manuf PMI, ISM Manuf (1 Aug), Factory Orders, Durable Goods Orders (3 & 27 Aug), FOMC Minutes (17, Aug), ADP (2 Aug) Trade Balance (8 Aug), NFP (4 Aug), June CPI (10 Aug), Empire Manuf (15 Aug), Retail Sales (15 Aug), Initial jobless claims (24 Aug), GDP (30 Aug), Core PCE 30 Aug), PCE deflator (31 Aug), FOMC (21 Sep).

- **Technical Outlook:** DXY Index was last seen at 102.00 level. Resistance is seen around 102.00 before the next at 102.50/102.70 region. Support around 101.40 (21-dma). There could be more two-way price action for the greenback with support around 101.10.



EUR: Emphasis on Data Dependence

Forecast	3Q 2023	4Q 2023	1Q 2024	2Q 2024
EURUSD	1.0800 (--)	1.0900 (--)	1.1100 (--)	1.1300 (--)

No Change from Previous Forecasts

- **Motivation for the FX View: We maintain our EURUSD forecasts even as the ECB shifts to a less hawkish position, with a greater emphasis on data dependence.** Economic data from the Eurozone has improved, with advance estimates of 2Q23 GDP showing that growth has returned to the Eurozone and that headline inflation has moderated. At the same time, core inflation remains sticky at elevated levels and as such the future of ECB hikes remains in the balance. We think that the EUR will continue on our expected trajectory against the USD, given that the Fed is likely closer to the end of its tightening cycle and pressures on the EUR from EU-US yield differentials could abate. While there remains uncertainty over the actual growth and inflation outturns globally and for the Eurozone, we stay convicted on our EUR forecasts over the next four quarters.

- Germany narrowly avoided a recession in 2Q23 with GDP growth basically flat. This should be taken positively at the margin, although flat growth is no reason to cheer. Even though the next ECB decision looks to be more finely balanced as Lagarde retreated from a very hawkish position, we still believe that the European Central Bank (ECB) is the central bank that is least likely to finish tightening its monetary policy, and this could have a positive impact on the sentiment towards the EUR.

- Furthermore, we anticipate that economic growth in the European Union (EU) and globally will slow down without significant deterioration, potentially supported by China's recovery. If the ECB eventually decides to pause its interest rate hikes later this year, it could be seen as a positive development for the EUR sentiment, as long as the decision is motivated by a desire to control inflation and doesn't lead to a significant decline in growth. It's important to note that this is not our main expectation, but if such a pause occurs, it could be seen as bullish for the EUR, indicating the ECB's commitment to maintaining a balance between inflation control and economic growth.

- This scenario becomes more plausible if other central banks, like the Fed, also reach the end of their tightening cycles and if Europe's energy situation remains stable while the labor market remains resilient. Overall, we maintain an optimistic view of the EUR's prospects in the medium term, and this is reflected in our expectation for a higher EURUSD exchange rate even as the ECB has retreated from its earlier unequivocally hawkish position.

- The economic landscape for the Eurozone continues to be mixed, as services activity remains robust, while manufacturing sector continues to contract. We think that while there could be potential tailwinds from China’s recovery, this could possibly take a longer time to play out. We do see possible upsides for the EU as easing energy prices and supply issues from 2022 should provide support for the economy, however the rollback of state-backed support initiatives could offset the boost that these developments could provide for economic growth. The EU’s largest economy, Germany, has narrowly avoided a continued recession, although growth remains flat and this could continue to weigh on sentiment for the EU and the EUR. At the very least, the Eurozone as a whole returning to growth should be taken as a positive for the EUR.

- A warmer winter, slower drawdown in gas inventory have made all the difference for the European economy, limiting the decline of the EUR. Germany plans to reach 70.7mn tonnes per year of LNG import capacity by 2030 which would lift the country to the world’s fourth largest LNG import capacity. This comes after Russia completely halted gas supply to Germany after the Nordstream pipeline was sabotaged. Germany then rushed to install floating storage and regasification units in order to import gas. According to energy analysts, Europe is on track to completely fill its gas storage toward the end of Oct 2023. Asian demand for LNG has remained muted and as such Europe is expected to be the final destination for the majority of flexible LNG cargos. Looking forward, analysts predict that Europe’s gas inventories will end Mar 2024 around half full, which would be enough for Europe to endure the coldest of the last 30 winters. Stronger energy resilience could mean that the European stronghold would be less vulnerable to energy supply shocks and that bodes well for the EUR.

- **Risk(s) to our View:** The war in Ukraine is still ongoing and an end is nowhere in sight. Any further escalations of this war, although unlikely, present a key risk to our view for a stronger EUR. We expect peace to continue to be hard to achieve as Ukraine has retained its hard stance against Russia. We also expect most sanctions to remain, and this could continue to weigh on the Eurozone trade balance. This could then in turn weigh on the EUR.

- Also on the Ukrainian war-front, Russia has backed out of the Black Sea Grain initiative that allowed Ukraine to export grain via its ports in the south of the country. Russia looks unlikely to reverse its decision after turning its back on the deal on 17 Jul and could result in a price in global wheat prices which could in turn affect inflation in the Eurozone. In addition, this development represents a potential escalation in the conflict, and while there has been no immediate impact on the EUR, we keenly observe further developments on this front.

- Energy risks while lowered, still linger and a resumption of an energy crisis theme could weigh heavily on the EUR. Asian demand for LNG has remained muted thus far, and if this demand should pick up, then Europe will be competing for a limited supply of flexible LNG cargos. Europe is currently projected to attract almost 75% of global flexible LNG supply. This is the key assumption that drives analysts' estimates that Europe will survive the next winter. Should this situation change, then the EUR could once again face some challenging headwinds.

- The EUR also faces risks of ECB overtightening, which could lead to a destabilization of financial markets and a potential slowdown in the Eurozone economy. While the ECB has shown a hawkish tilt in recent months and signaled a willingness to raise interest rates to combat rising inflation, the potential for renewed financial instability remains a concern. While concerns over the viability of European banks have alleviated, continued tightening of monetary policy could once again call the viability of banks into question. However we recognize that the ECB has thus far handled the issues of combating inflation and maintaining banking and financial sector stability fairly well. As such, we think that this risk remains under control for now.

- The fall of Silicon Valley Bank, Signature Bank and the subsequent acquisition of Credit Suisse by UBS have called financial sector stability to question. The viability of European banks, such as Deutsche Bank, have also been similarly called to question and tested by markets. The EUR had weakened in the episodes of fear caused by Credit Suisse and Deutsche. While the fears seem to have eased and remain controlled now, the return of Europe-specific financial sector stability concerns are likely to weigh on the EUR once again.

- Eurozone growth prospects could drastically worsen if China's recovery does not materialize. This narrative is looking increasingly likely and if Eurozone economic data continues to deteriorate, then the ECB could be less convinced about tightening, especially if there is an accompanying pullback in price levels. Overall, this would be negative for the EUR from both a poorer growth standpoint and from the lack of support from the central bank.

- **Growth and Inflation Outlook:** Eurozone growth prospects have been lifted by the fall in natural gas prices that could potentially lower inflation and lift GDP. In addition, Europe also stands to benefit from China's reopening and recovery, although a sharper uptick in global demand recovery could have implications on commodity prices that may affect Europe's gas outlook. However, the ECB has also recognized that downside risks to growth exist given existing narratives about the slower than expected.

- Advance 2Q23 Eurozone GDP growth printed at +0.3% SA QoQ (exp: 0.2%; prev: -0.1%) and +0.6% SA YoY (exp: 0.5%; prev: 1.1%). The Eurozone has exited recessionary territory and once again headed into a growth environment as Ireland in particular experienced bumper growth in the second quarter of the year. Growth in Germany was flat QoQ, while Frace experienced a +0.5% QoQ expansion. While this should not be taken too positively, the Eurozone has by advance estimates emerged from a recession, which should be positive for the EUR at the margin.

- Most advanced economies, including the Eurozone, are seeing contractions in manufacturing activity implied by PMIs, although services PMI remain firmly in expansionary territory. This trend continued through Jul as prelim PMI numbers showed that services remained in expansion at 51.1 (exp: 51.6; prev: 52.0), while manufacturing stayed in contractionary territory at 42.7 (exp: 43.5; prev: 43.4). Note that PMIs are deteriorating and if services should dip into contractionary territory, it could foreshadow slower Eurozone growth prospects in the future as activity declines.

- Meanwhile, Eurozone continues to see a rather stable unemployment rate of 6.5% in Apr (exp: 6.5%; prev: 6.6%). Tight labour market conditions seem to be supportive of household spending and the services sector. Jul Core CPI inflation printed at 5.5% YoY (exp: 5.4%; prev: 5.5%), while headline inflation moderated to 5.3% YoY (exp: 5.3%; prev: 5.5%. While the latest inflation print is rather mixed, given that core remains sticky and elevated and headline has moderated, we think that the former is likely to be a concern for the ECB, which has emphasized its focus on data moving forward. We do however recognize that there are a few more data releases ahead of their next decision in Sep.

- **Monetary Policy Forecast:** On 27 Jul, the ECB raised rates by 25bps to take the deposit facility rate to 3.75%, marginal lending facility to 4.50% and main refinancing rate to 4.25%. There was a marked departure from the ECB and Lagarde's unequivocally hawkish position on inflation and an absence of previous language such as "inflation remained far too high for too long" and that the ECB was not pausing as it had yet to reach the terminal rate. Instead, there was a new emphasis on data dependence, although Lagarde did add that the ECB was still focused on combating inflation. Lagarde also suggested that the ECB could hold on raising rates at the upcoming Sep meeting and hike at a later date and said that the GDP growth figures for the Eurozone were encouraging. The approach of holding on rates for one meeting and hiking later is similar to the Fed's approach, and it remains entirely possible that the ECB takes this approach given their public acknowledgement of monetary policy transmission lags.

- The Jun ECB meeting minutes showed that the governing council remained unequivocally hawkish and explicitly mentioned that successive rate hikes in Jun and Jul were necessary "at a minimum" to return inflation to target. The ECB has since delivered on both hikes and struck a less hawkish tone at their latest meeting with an emphasis on data dependence. We look out for the next release of ECB meeting minutes for further clues on the deliberations behind the Jul policy meeting. It appears preliminarily that there could be an increasing divide between the hawks and doves in the governing council of the ECB on the future path of inflation and accordingly the future path of ECB policy. Earlier the governing council also recognized the reinforcing effect of a wage-profit-price spiral and that signs of this were emerging in the Eurozone.

- For the rest of 2023, current OIS implied pricing is for a terminal deposit facility rate of 3.80%, with the market implying that the ECB could be done with one more hike. A pause would not necessarily be negative for the EUR as long as growth does not deteriorate significantly and inflation is en-route towards the 2% target. Given that the ECB's core inflation projection is 4.6% for 2023, and core inflation still remains sticky with the latest print at 5.5%, there is still a disparity between what the market is pricing in and what the ECB is expecting. Should the ECB actually deliver on expected rate hikes, we should see further gains for the EUR.

- **Latest Fiscal and External Balance Outlook**: The Eurozone current account improved to a €9.1b surplus in May (prev: €3.8b). Current account deficit amounted to 0.4% of Euro area GDP or €49b in 12 months to May 2023, compared with a surplus of €161b (1.3% of euro area GDP) one year earlier.

- **Key domestic events and issues to watch in Aug:** EC Jul Final Mfg PMI, Unemployment Rate (1 Aug), EC Jul Final Services/Composite PMI , EC Jun PPI (3 Aug), EC Retail Sales (4 Aug), EC Sentix Investor Confidence (7 Aug), ECB Economic Bulletin (10 Aug), EC ZEW Survey (15 Aug), EC 2QP GDP (16 Aug), EC Jun Industrial Production (16 Aug), EC Trade Balance (17 Aug), EC Jul CPI Final (18 Aug), ECB Current Account (22 Aug), EC Aug Prelim PMI (23 Aug), EC Consumer Confidence (23 Aug), EC Jul Money Supply (28 Aug), EC Economic/Industrial/Consumer /Services Confidence (30 Aug), EC Aug Prelim CPI (31 Aug), EC Jul Unemployment (31 Aug).

- **Technical Outlook:** EURUSD traded at 1.099 levels at time of writing. EURUSD has retreated from overbought levels and is now neutral on RSI, stochastics and momentum. Support remains at 1.0950 and 1.09 level, while resistance is at 1.10 and 1.1050 levels. We see a possible broader trading range of 1.07 to 1.13 will likely hold, with the Jul high of 1.1276 a key resistance level further on the upside to watch.

GBP: Smaller BOE Hike Likely

Forecast	3Q 2023	4Q 2023	1Q 2024	2Q 2024
GBPUSD	1.2700 (--)	1.2400 (--)	1.2400 (--)	1.2300 (1.2600)

Previous Forecasts in Parentheses

- **Motivation for the FX View: We revise our GBPUSD forecasts lower for 2Q2024 to 1.23 on the belief that the GBP will gradually weaken due to the structural issues and grim economic prospects that are facing the UK. We retain our other forecasts given our expectation that the GBP should still remain fairly supported in the near term as the BOE looks likely to hike by at least 25bps.** In addition, the UK's medium-term prospects still look grim, given the existence of price pressures, labour market shortages and an ailing economy, all structural problems inherited from Brexit. Should inflation continue to remain sticky, the policy space for the BOE to hike rates will be narrower in the face of a recession. We still believe that the cable is fundamentally overvalued at levels above 1.24. Based on this, we see the opportunity to fade rallies in the cable, although this could take a longer time to play out given that BOE hikes will be supportive.

- **Risk(s) to our View:** While we remain bearish on the GBP at current levels, we are also cognizant of two-way risks for the outlook. UK data has largely come in more positive than expected, although we feel that tailwinds from previous positive data prints and the Northern Ireland protocol are largely over and done with. Moreover, the Sunak administration's credibility that they have attained thus far could provide some support to the economy and help offset the negative effects of Brexit-related structural problems. Overall, while the downside risks are significant, it is important to keep in mind that there are still potential upside factors that could impact the cable.

- Governor Bailey has also acknowledged that the UK is in a wage-price spiral is also rather worrying. Core inflation had also re-accelerated earlier and this could potentially portend stagflation. While the BOE hikes should support the GBP at the margin, bad inflation or out of control inflation should be seen as a factor that is overall negative for the GBP. On balance, the risk is tilted towards GBP weakness, since stagflation fears could potentially weigh heavily on the GBP.

- The UK is in a tough position in no small part due to Brexit and the resulting protracted negotiations that have yet to be resolved. A positive resolution to any of these unresolved issues is likely to provide some support for the GBP. These issues are of paramount economic importance to the UK, but are ultimately politically daunting for the Sunak administration to deal with. The NI deal has passed the UK parliament and this has provided some tailwinds for the GBP. However, ultimately, the UK faces structural issues such as a labour shortage and poorer economic prospects from losing the common Euro market arising from Brexit. While no resolution for these issues remain in sight, Sunak's administration continues to gain more credibility for itself as it works on these issues. Should some further concessions be obtained from the EU, we do see the risk for a stronger GBP than we had previously projected.

- The fall of Silicon Valley Bank, Signature Bank and the subsequent acquisition of Credit Suisse by UBS have called financial sector stability to question. The viability of European banks, such as Deutsche Bank, have also been similarly called to question and tested by markets.

Given the geographical proximity and the close ties of the UK banking system to the Euro banking system, the GBP weakened in the episodes of fear caused by Credit Suisse and Deutsche. While the fears seem to have eased and remain controlled at this point in time, the return of Europe-specific financial sector stability concerns are likely to weigh on the GBP once again.

- Although the BOE's tightening thus far has been seen as an appropriate response to inflationary pressures that remain elevated and stubborn, there also exists a risk that the BOE overtightens. This could worsen the UK's already difficult economic situation, given that Brexit-related structural problems such as a shortage of skilled labour and disrupted supply chains have contributed to the UK's weak economic performance in recent years. When overlaid with potential credit tightening issues that could arise in times of financial sector turmoil e.g. if banks were to refuse to lend to one another, an overtightening while appropriate in terms of dealing with inflation, could potentially drive the UK into a recession, which would eventually weigh on the GBP. The BOE therefore has to strike a tricky balance between raising rates to combat inflation and providing economic support e.g. through liquidity provided via their various facilities. In addition, Governor Bailey has already publicly admitted that the UK is in a wage-price spiral, and should this eventually lead to stagflation, there could be further problems for the UK and for the GBP down the line.

- **Growth and Inflation Outlook:** UK Monthly GDP in May came in at -0.1% MoM (exp: -0.3%; prev: 0.2%) and 0.0% on a rolling 3-month basis (exp: 0.1%; prev: 0.1%). Current consensus forecast suggests GDP growth to come in at +0.2% YoY (prev: +0.2% YoY) for the UK in 2023. In addition, there are still significant downside risks for the UK economy – it may struggle to recover from current challenges such as the lingering impact of COVID-19, supply chain disruptions, and slowing global demand in addition to facing the structural issues such as labour market shortages and loss of the common market that have come with Brexit. The balance of probability is still tilted in favour of a UK recession, with the implied likelihood of a UK recession over the next 12 months is at 54.5% (prev: 52.5%). The BOE has also upgraded growth forecasts for the UK to 0.25% in 2023 and 0.75% in 2024 and 2025. This is in stark contrast to their previously anticipated recession forecasts of about -1.50% in 2023 and -1.00% in 2024. That said, the BOE also recognizes two-way risks for growth amid the current uncertainty in the global economy.

- On the inflation front, core CPI inflation moderated to +6.9% YoY in Jun (exp: +7.1%; prev: +7.1%), while headline CPI inflation was cooler than expected at +7.9% YoY (exp: +8.2%; prev: +8.7%). Price pressures look to have alleviated and the BOE expects full year CPI inflation at 5.00% in 2023 and closer to the target at 2.25% in 2024. This is predicated on a fall in energy prices, as the BOE recognizes that food prices should continue to rise. Inflation is expected to return to the BOE's preferred target of 2% only in 4Q2024. Inflation has been kept sticky also in part due to a labour shortage in the UK that is keeping wage cost pressures strong. Consensus estimates for CPI inflation in the UK are at 7.5% in 2023 and 3.0% in 2024, higher than the BOE expects.

- **Monetary Policy Forecast:** The BOE surprised and delivered a 50bps rate hike (vote split: 7 hike, 2 maintain) in the last meeting on 22 Jun, bringing the policy rate to 5.00%. The 3 Aug meeting looks to be finely balanced with a roughly 30% chance of a 50bps hike although we think that with recent inflation prints coming off we will see a smaller 25bps hike. OIS implied is suggesting a terminal rate of around 5.75% for the BOE at this point, although we think that it could be wiser to adopt a meeting to meeting approach for BOE meetings. Should inflation indeed fall off in the second half of the year as the BOE suggests, the terminal rate could turn out to be lower than the market is pricing at the moment. We think that the BOE is in a difficult spot and has declined to provide forward guidance to provide itself with some flexibility. Unresolved problems from Brexit could pose more troubles for the BOE in the future. The BOE is also cognizant of the risk of overtightening at this point of time, given the prevailing concerns of an overtightening in the Eurozone area.

- **Latest Fiscal and External Balance Outlook:** PM Rishi Sunak has signaled his intentions to reduce the UK's national debt and cut inflation as priorities for 2023. He also added that he wishes he could implement tax cuts, but understands that it is practically impossible with the current level and persistency of inflation. Chancellor Jeremy Hunt is already under pressure from UK conservative MPs to show a path to lower taxes, which many believe is the easiest way to stave off a recession. However, inflation is not the only thing preventing tax cuts. If taxes are cut and government spending is to remain the same, then the government must finance the spending. The most expedient way to do this would be to increase government debt. However, this goes directly against the PM's intentions to reduce the UK's national debt. It remains to be seen how Chancellor Hunt plans to deal with this problem, with independent fiscal watchdog the Office for Budget Responsibility noting that there would be less headroom for the March budget, given weak productivity and labour market issues that have damaged the UK's economic prospects. The UK's budget deficit in 2022 stood at £125 billion, roughly 5.4% of GDP. Meanwhile, the current account deficit stood at -4.24% of GDP or about £100 billion. Chancellor Hunt's 15 March budget was spun as one that was pro-growth and pro-families by offering giveaways to both corporates (investment subsidies) and families (childcare and energy). However, there was a glaring absence of tax cuts, given the current inflationary environment that the UK is in. This was one of the thinnest margins for a UK budget after having relaxed fiscal rules in November, leaving himself with £6.5b to spare in contrast to the average cushion of £25.6b over the last 13 years. This leaves the UK with a small buffer against a crisis against the current backdrop of fear over financial stability, and puts the UK in a precarious position should a serious shock to the economy occur.

- UK May Trade Balance widened to a deficit of -£6.6b (exp: -£2.2b; prev: -£2.5b). The trade balance worsened as the goods deficit widened as exports declined by -2.6% to an 11-month low and imports rose by 3.1%. . The trade deficit reinforces the difficulty that the UK is facing in terms of slowing global demand and underscores the importance of access to the EU common market.

- **Key domestic events and issues to watch in Aug:** S&P Jul Final Mfg PMI, Jul Nationwide House Price Index (1 Aug), S&P Jul Services/Composite PMI, BOE Policy Decision (3 Aug), S&P Construction PMI (4 Aug), RICS House Price Balance (10 Aug), Jun Monthly GDP, Jun Industrial/Manufacturing Production, Jun Trade Balance, 2Q Prelim GDP (11 Aug), Jobless Claims, Avg Weekly Earnings, Jun ILO Unemployment (15 Aug), Jul CPI/RPI/PPI (16 Aug), GFK Consumer Confidence Aug, Jul Retail Sales (18 Aug), Aug Rightmove House prices (21 Aug), Public Sector Finances (22 Aug), Aug Prelim PMIs (23 Aug), Nationwide house Price Index (28 Aug to 3 Sep), BRC Shop Price Index (29 Aug), Jul Mortgage Approvals (30 Aug) and Aug Lloyds Business Barometer (31 Aug).

- Technical Outlook: GBPUSD last trades at around 1.2830 levels at time of writing ahead of the 3 Aug BOE decision. Support is at 1.27 and 1.2570 (100 dma), with 1.230 (200dma) a further support to the downside. Resistance is at 1.29 and 1.30 figures (psychological) and 1.3140 (Jul-high) as another key level to watch.

AUD: Holding our Optimism on China

Forecast	3Q 2023	4Q 2023	1Q 2024	2Q 2024
AUDUSD	0.65 (--)	0.68 (--)	0.70 (--)	0.70 (--)

No Change from Previous Forecasts

- **Motivation for the FX View:** We hold our view that AUDUSD could potentially head towards the 0.70-figure as (1) monetary policy tightening cycles around the world (Fed, ECB, BoC, RBNZ, RBA, etc) come close to an end which should reduce policy uncertainties, (2) potential for RBA to retain hawkish stance even if it extends its pause on 1 Aug and (3) as China starts to act to support growth at home that could boost Australia's net exports of goods and services to China. The first sector that China wants to address first is property which is typically positive for the AUD given that it is a industry that requires intensive use of Australia's base metals. While China is not likely to inject significant amount of liquidity for property developers to build more estates, even modest measures to stabilize the real estate sector there could be positive for sentiments in mainland China and potentially revive consumer/investors confidence.

- **Key risks to our view:** China's growth continues to deteriorate, dragged by waning growth momentum seen in some parts of the world. A US recovery ahead of the rest of the world could also strengthen the USD against AUD. A fall in consumer spending due to the cumulative impact of tightening and a concomitant deterioration in its labour market conditions could see RBA lean dovish sooner than expected and spur more AUD depreciation.

- **Growth and Inflation Outlook:** Inflation for the year through Jun 2023 came in at 6.0%y/y, just a tad under RBA's inflation forecast of 6¼% as indicated in the SoMP that was released in May. While the headline inflation as well as underlying inflation had eased more than expected due to lower automotive fuel prices, slower increase in prices of food, furniture, appliances and clothes, **most worrying was the strong services inflation that rose to more than two-decade high of 6.3%** and these include rents, restaurant meals, holiday travel and insurance.

- Unemployment rate remains low at 3.5% for Jun. That is expectly where the RBA had projected it to be in its May SoMP. The Reserve Bank continues to project the jobless rate to rise to 4% by year end and then to 4.5% by end 2024. That would still be below where the jobless rate will be pre-pandemic. Strength of the economy lies in its services sector still and strong wages were a reason for fanning services inflation higher.

- NAB business confidence for 2Q was seen to be less negative at -3 vs. orevuiys -4. Some improvement in business confidence could be alluded to pause as signaled by RBA in Aug. Given the hikes that came after, business confidence may not be able to see a sustained improvement.

- Home loans have been on the rise, up 4.8%m/m in May vs. previous -1.0% (revised higher). That also correspond to the recent rebound in home prices. The recovery in the home prices was also alluded to the anticipation for RBA to end its tightening cycle. An imbalance of supply and demand is also a key reason for home prices to rise. It is unclear if the rise in home prices could sustain as mortgage rates remain very high and more supply of homes have come on stream due to the recent rebound in prices.

- **Monetary Policy Forecast:** We look for RBA to keep cash target rate unchanged at 4.10% for the rest of the year. RBA held cash target rate unchanged at 4.10% on 1 Aug, in line with our expectations which was against the consensus. Our view for RBA to keep policy settings unchanged was based on the fact that household spending had softened on both annual and sequential pace in Jun at 2.4%y/y and -1.7%m/m respectively. This comes as the household saving ratio plunged to just 3.7% for 2Q from 4.4%. This compares to the 23.6% household saving ratio seen in Jun 2020. At 3.7%, it is lower than pre-pandemic 2019 levels. Australian households have run down their excess savings and are now saving much less than before due to higher interest rates and elevated inflation. Prelim. Services PMI for Jul also fell to 48.0 rom 50.3, underscoring weakening demand conditions that **just might not have shown up on the inflation metrics** yet. The unexpected slide in retail sales for Jun (-0.8%m/m) adds to the picture of weaker spending. In our view, even though this was a hawkish pause, this is likely the last live decision as we look for household spending to weaken further. We look for the RBA to keep cash target rate unchanged at 4.10% for the rest of the year.

- **Latest External Balance Outlook:** As of last available data, current account surplus was recorded at +1.4% of GDP for 1Q 2023, widening a tad from the previous 1.13%. Over the same period, Australia recorded a AUD12.3bn of current account surplus vs. previous A$11.7bn in 4Q

2022, buoyed by the stronger surplus in goods and services trade balances. Trade surplus widened a tad to AUD11.8bn from previous AUD10.5bn due to strong exports of gold and energy. Exports overall rose 4% on the month while imports rose 2%. Warmer trade ties with China and the resumption of trade with the world number 2 economy on certain commodities such as timbre (in May) could continue to keep the Australia's trade account healthy.

- **Fiscal Outlook:** Australia is projected to turn in a sliver of a surplus of $4.2bn for Budget FY2022-2023 (that ends Jun 2023). This would be the first surplus in 15 years but Treasurer Jim Chalmers also flagged that a deficit of $13.9bn is expected for FY23-24.

- **Key domestic events and issues to watch:** Jul Mfg PMI, Jul investor loan, home loans, Jun Building approvals, private sector houses RBA policy decision [1 Aug]; Jul Services PMI, Jun trade, retail sales ex inflation 2Q [3 Aug]; RBA SoMP [4 Aug]; Jul ANZ-Indeed job adv [7 Aug], Jul CBA household spending, Westpac consumer confidence, Jul NAB business confidence, NAB business conditions [8 Aug]; Consumer inflation expectation [10 Aug]; RBA Minutes, Wage price index for 2Q [15 Aug]; Jul labour report [17 Aug], Jul CPI [30 Aug].

- **Technical Outlook:** AUDUSD remains in a whipsaw. Key support is seen around 0.6620 before the next at 0.6560. Momentum indicators are mixed pric action may remain within 0.66-0.69 but we remain biased to accumulate on dips. Look for a break of the 0.6890-resistsance for a break-out higher (ascending triangle).

NZD: RBNZ To Hold OCR at 5.5% for the Rest of 2023

Forecast	3Q 2023	4Q 2023	1Q 2024	2Q 2024
NZDUSD	**0.63**	**0.63**	**0.65**	**0.65**
	(--)	(0.65)	(0.67)	(0.67)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** We maintain our NZDUSD trajectory but lower our 12-month forecast towards 0.65, taking into account the sharper-than-expected pullback in the second half of Jul. On net, we look for a likely modest and gradual recovery for China which should lend modest support to New Zealand's exports. We are wary that current restrictive monetary policy may curb property/construction exuberance within the next half of the year. With RBNZ already done, further support from policy for the NZD would be limited. We continue to expect the gradual USD decline to provide modest lift to the NZDUSD pairing as the US economy continues to slow under the pressure of the restrictive monetary policy.

- **Growth and Inflation Outlook**: Economic growth remains soft with consumer confidence on a shaky uptrend. Consumer confidence eased a tad to 83.7 in Jul from 85.5 in Jun, albeit still retaining a gradual uptrend. Mfg PMI remains in contraction for Jun at 47.5 vs. pervious 58.9 while performance services index eased to 50.1 in Jun vs. previous 53.3. That said, total card spending quickened to 6.6%y/y in Jun from previous 4.3%. Looking at the month-on-month pace, card spending rose +1.3% vs. prev. -2.1%. The rebound in spending was across most components with non retail industries spending up +2.8% (vs. prev. -1.3%) and the retail spending was up +1.0% (v. prev. -0.7%). Spending on services grew +1.4% vs. +0.4%. Interestingly, spending on vehicles (ex fuel) was up +2.4% vs. prev. +0.3%. Consumption in durables also rose +0.5%. Total core retail was flat at +0.0% and these are made of apparel (+2.0%), durables (+0.5%) and consumables (+0.2%). Regardless of the expansions, slight pullback in consumer confidence suggests that this report may show some weakness for Jul and unlikely to pose a threat to RBNZ's policy trajectory.

- 2Q CPI eased to 6.0%y/y from 6.7% in 1Q. The quarterly pace also slowed less than expected to 1.1% from previous 1.2%. Tradeable inflation quickened to +0.8%q/q from previous 0.7% while non tradeable eased to 1.3%q/q from previous 1.7%. The pullback in non-tradeable inflation also underscores weaker domestic demand. While the prints were firmer than median estimates, the disinflation progress is largely intact. Regardless, the bumpy route of disinflation could continue to keep the RBNZ watchful.

- **Monetary Policy Forecast:** RBNZ kept OCR unchanged at 5.50% in Jul and this was well telegraphed to be the peak in this cycle. We bear in mind that RBNZ expects inflation to come within the 1-3% target by 3Q 2024 and the latest inflation prints, whilst a tad firmer than expectations, continue to suggest that price pressure continues to ease. On the other hand, monetary policy settings have been deemed restrictive enough to curb demand and price pressure and to some extent, the central bank could be concerned about growth. The central bank noted that the mortgage rates on outstanding loans have increased by around 200bps from early 2022 and average mortgage rates are expected to reach around 6% in early 2024. The central bank also noted that there are pockets of stress emerging but early indicators suggest that the increase in stressed lending in the coming months should be modest. So with that, we can expect domestic demand could be reined in and RBNZ is likely to keep the OCR unchanged at 5.50% for the rest of the year.

- **External Balance and Fiscal Outlook:** Recall that NZ current account could remain in deficit. Current account deficit narrowed to -NZD5.22bn in 1Q vs. NZD10.1bn in the quarter prior. Services balance have started to swing into surplus and could rise further into 2Q amid the influx of migrants and tourist arrivals. However, goods trade could remain in deficit due to weak external demand, cushioned eventually by China's recovery.

- **The Treasury projects a return to fiscal surplus in 2025/2026, delayed by one year.** New Zealand now expects the economy to avoid recession, looks for a budget deficit of NZ7.6bn in 2023-2024. GDP growth is expected to be around 1% for this FY23/24 and 3.2% in FY22/23. Net debt to peak at 22% of GDP in 2023-2024. The budget includes an extension pf 20 hours Early Childhood Eductation to include 2y olds, abolition of $5 prescription co-payment, subsidies for children to take public transport and $71bn of infrastructure spending. The budget was seen more expansionary than expected, funded by more borrowing. This could boost discretionary spending slightly.

- **Key domestic events and issues to watch:** Jun Building Premits [1 Aug]; 2Q unemployment rate [2 aug]; Jul Card spending, 2Y inflation [9 Aug]; Jul food prices [11 Aug];RBNZ Policy Decision [16 Aug]; Jul Trade [21 Aug], 2Q retail sales ex inflation [23 Aug].

- **Technical Outlook:** NZDUSD was last seen around 0.6210 levels this morning. The recent low has formed a rising trend line that acts as a support for the NZDUSD. Risks could be tilting to the upside. Rebounds of the NZDUSD to meet resistance at 0.6232. Preference remains to buy the NZDUSD on dips.

CAD: Downside Pressure for Now

Forecast	3Q 2023	4Q 2023	1Q 2024	2Q 2024
USDCAD	1.33 (--)	1.31 (--)	1.30 (--)	1.30 (--)

No Change to Previous Forecasts

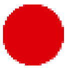
- **Motivation for the FX View:** We remain on track on our forecasts. We hold our view for USDCAD to grind lower over the next twelve months. Within the next few weeks, USDCAD may remain in sideway trades, awaiting signs of softening demand externally and domestically. A hawkish BoC could probably limit USDCAD forays below 1.34. At this point, a data-dependent Fed and a market that is largely calling the Fed bluff on its final hike (based on the Jun dot plot) could mean that the risks are skewed slightly to the upside for the USD leg, especially if US data continues to surprise to the upside. Regardless, we expect the cumulative Fed rate hikes to eventually work their way through the economy. Data thus far suggests a soft landing is very plausible for both the US and Canada (strong labour market, resilient business sentiment, albeit private consumption show signs of weakening). As such, a gentle slowdown for the US as well as the Canadian economy remains the base case scenario and that should provide the conditions for USDCAD to ease towards 1.30.

- Risks to our view is that the growth divergence between the US and Canada widens in favour of the former. That could bring the USDCAD substantially higher. A more severe slowdown in global growth slowdown alongside an absence of demand recovery in China could also strengthen the USD against most other currencies in the world, including the pro-cyclical CAD.

- **Growth and Inflation Outlook:** CFIB business barometer for Canada was relatively unchanged 54.2 for Jul vs. previous 54.1. Firms are still expecting to adjust prices by an average of 3.3%. Wages on average are expected to be adjusted by 2.9%. Amongst the ones surveyed, 19.5% of them intend to increase staff and 17% intend to reduce. Shortage of skilled labour remains the top limitations on sales/production. The BoC takes into account these business surveys and could continue to keep a hawkish stance for a while.
- Apart from the business survey, there are signs of softening in activity including retail sales which grew by a slower 0.2%m/m vs. previous +1.0%. Unemployment rate also rose to 5.4% with the hourly wage rate for permanent employees slowing to 3.9%y/y from previous 5.1% (a sharper deceleration than the median estimate of 4.6%). Net hire for Jun was strong at 59.9K. So there are signs that supply and demand conditions are coming to balance based on the Jun labour report.
- Inflation outlook remains a tad uncertain given business barometer survey for Jun. But CPI eased to 0.1%m/m (non. S.adj) from previous 0.4%. year-on-year, CPI slowed to 2.8%y/y from previous 3.4%. Core inflation was a tad more elevated around 3.8% (average of median and trim) for Jun, relatively steady from the month prior. Next few inflation prints would remain in focus but BoC is more likely to care about other growth indicators as well as restrictive monetary policy, weakening global growth should start to hurt spending/investment/employment.
- **Monetary Policy Forecast:** BoC raised the policy rate by 25bps to 5.00% on 12 Jul. We were calling for the Bank of Canada to pause but the central bank was too concerned with persistent underlying inflation pressures and firms were intending to raise prices still. Based on the CFIB, this picture does not seem to change but there are signs that spending has started to slow. Businesses should start to be more conservative on raising prices or wages and that should show up in the Aug CFIB business barometer. While the inflation target is not yet achieved, there is certainly progress. Consumption may look strong based on the recent retail sales print at 1.1%m/m but that was for Apr. The CFIB business survey seems to suggest that demand conditions might have softened already. We are thus of the view that will not need to hike any more this year.
- **Latest External Balance Outlook:** As of last available data, Canada's current account balance was at a deficit of -U$14.2bn for 1Q23, wider than the -U$6.6bn deficit for 3Q. Trade balance may remain under pressure as energy prices continue to remain lacklustre and that could reduce amount of oil export receipts.
- The new Federal budget presented on 28 Mar showed an increase of C$43bn of new net costs over six years with a focus on improving health-care and fund clean-technology subsidies. Canada records C$6.44 deficit in the first ten months of FY2022-2023. However, the budget 2023 no longer shows a projection towards a balanced budget by 2028. Fiscal is still pretty much expansionary with overall balance at -1.5% of GDP for FY2022-2023, albeit still narrower than the -3.24% of GDP for the prior fiscal year.

- **Key domestic events and issues to watch:** S&P Mfg PMI [1 Aug], labour market report [4 Aug], Int'l trade [8 Aug], CPI [15 Aug], housing starts [16 Aug], retail sales [23 Aug], CFIB Business Barometer for Aug [31 Aug].

- **Technical Outlook:** USDCAD is resisted by the 21-dma at 1.3278 and we cannot rule out further move higher towards 1.3420 (51-dma). Stochastics are rising from oversold conditions. MACD is still turning more bullish. Support around 1.3160 before the 1.30-figure. Labour market remains tight with unemployment rate steady at 5.0%y/y in Apr. Canada added a net 41.4k jobs in Apr vs. +34.7K previously. Hourly wages steadied at 5.2%y/y, more than the expected 4.8%. Participation rate was unchanged at 65.6%.



JPY: Faster Rate of Appreciation With YCC Change

Forecast	3Q 2023	4Q 2023	1Q 2024	2Q 2024
USDJPY	**138** (145)	**136** (142)	**132** (140)	**125** (133)

Previous Forecasts in Parentheses

- **Motivation for the FX View:** We are revising our USDJPY forecast downwards as we now see that the JPY is on a stronger appreciation path following the BOJ's move. We believe the recent decision by the BOJ to effectively raise the YCC cap to 1.00% but still keep the +/- 0.5% band is likely to be a precursor to an eventual abolishment of YCC. We see that could come in 2Q 2024, when they should also complete their broad-perspective review and do not expect any other moves by them in the interim. In the coming months, the climb in JGB yields together with a peaking of Fed rates is likely to give more support for the JPY (note: rate differentials has been the major driving factor of the currency movement). However, we do feel the BOJ's move represents more of an attempt to fine-tune their monetary policy tools as they intend to eventually scrap a policy, which has created many issues for them. It was unlikely to have been driven by expectations of a significant economic improvement as their forecasts do not imply that they see inflation sustainably picking up over the medium to long term. Henceforth, we do not expect the BOJ to undertake any other policy changes aside YCC abolishment (e.g. they may not scrap the NIRP). JPY appreciation we think may only be seen more discernibly in September onwards after the FOMC once the Fed tone implies a pause.

- **Growth and Inflation Outlook:** The 1Q GDP second reading saw quite an upward revision to 2.7% QoQ from an initial 1.6% QoQ. The revised reading was much higher than the market estimate at 1.9% QoQ. The main driver behind the higher reading was the much larger contributions from private inventory investment. However, scrutinizing the details, we see that inventory of work in progress grew sharply in the second reading. The inventory of work in progress in the initial GDP reading was actually estimated through ARIMA modeling whilst in the second reading, calculation was done on the basis of using financial statements statistics of corporations by industry. As this kind of represented a calculation methodology difference, we do not see this contributing component as to shifting our judgement on the economic situation. Meanwhile, private capex also played some part (though to a lesser extent) in the revision. This does strengthen our view that capex could play a substantial part in driving growth forward. Capital spending itself rose by an astounding at 11.0% YoY (est. 6.0% YoY and 4Q 2022. 7.7% YoY). Overall, we continue to see strong economic recovering throughout the rest of this year.

- Inflation for June continued to come out strongly with the headline number at 3.3% YoY (May. 3.2% YoY) whilst the core number was at 3.3% YoY (May. 3.2% YoY) and the core core number at 4.2% YoY (May. 4.3% YoY). On a yearly basis, food and general services was the major contributor to the inflation numbers. On a monthly basis, compared to May, electricity charges were a major contributor after the 7 electricity companies had raised their prices. As it stands, inflation still appears to be quite supply side driven than it is demand. Labour cash earnings which had been higher in May at 2.5% YoY (Apr. 0.8% YoY) is as a whole still not clearly indicating an upward trend. Given the emphasis the BOJ places on the need for wage pick-up and demand driven inflation, it is challenging to see the economic situation providing much of a case for further BOJ tightening beyond the lifting of the YCC.

- High frequency indicators such as Jul (P) Jibun Bank PMI mfg fell further into contraction at 49.4 (June. 49.8). The new orders index and stock of items purchased index pushed down the headline number. The weakness in the PMI mfg could be seen as a reflection of a weakening in the global goods trade and a downturn in the China economy. The services PMI also declined slightly to 53.9 (June. 54.0). Given that it still remains in expansion territory, we are not too concerned about the reading and that there continues to be strong activity in that sector with the reopening of the economy since the end of the pandemic. Gradually though, the services PMI may eventually stagnate and even fall more discernibly as the effects of the economic reopening wanes. Overall, the indicators in our view highlight the fragility of the economy and does little in supporting the economic case for a BOJ long term tightening.

- Retail sales in June turned to a decline at -0.4% MoM (May. 1.4% MoM). The fall can be seen as a reflection that the reopening boost to the economy is gradually waning away and that retail sales could slow going forward. The earlier mentioned PMI services number which showed a slowdown implies also that consumption of services is losing momentum. We therefore expect that retail sales growth can risk stagnating from here which would only lower the possibility of greater demand pressures feeding into inflation. This in turn too weakens the BOJ's economic case for long term tightening.

- **Monetary Policy Forecast:** The BOJ surprised the market by adjusting the YCC at its recent meeting. They will essentially now be capping the JGB 10y yield at 1.00% through conducting purchases but at the same time, they will retain the +/- 0.5% band as a reference. BOJ Governor

Kazuo Ueda appears to have justified the move on the basis that the current YCC arrangement is mainly orientated to managing yields on the downside price scenario but less so on the upside. In particular, he labelled it a technical change on how BOJ conducts operations. The BOJ itself is still not expecting that long term rates would rise to 1.00% and they have so far been careful in preventing excessive volatility, speculation and a quick run up to 1.00% especially with their surprise announcement of undertaking an unscheduled bond-purchase operation.

- The BOJ as a whole still did sound rather dovish and Ueda constantly avoided trying to paint the move as a tightening. They actually see that near-term high inflation could decelerate given "waning of the effects of a pass-through to consumer prices of cost increases led by a rise in import prices". Subsequently, they expect the rate of increase to "accelerate again moderately" due to the output gap improvement, rising inflation expectations and wage growth. Overall, their own core inflation forecasts was raised for fiscal 2023 to 2.5% (prior. 1.8%) but it was lowered for fiscal 2024 to 1.9% (prior. 2.0%) and kept at 1.6% for fiscal 2025. This gives us an impression that the BOJ does not yet expect inflation to sustainably pick-up in the medium to long term. Therefore, we get the idea that the BOJ may still see that the economic case for tightening is not strong at this point yet. Instead, the recent YCC move could actually be seen as a recognition of the issues that is associated with continuing to keep this YCC policy. Given this, we think that this recent move could be a precursor to the eventual abolishment of YCC, which may occur in 2Q 2024 when their broad-perspective review should also be done by.

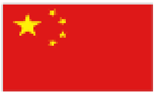
- We are not expecting that the BOJ would undertake any other policy actions aside the abolishment of YCC. This is simply because as mentioned, we do not see that the BOJ is under the impression that inflation is going to sustainably pick-up given their forecasts. Hence, for now, an exit out of the negative interest rate policy is not on our cards. Quantitative tightening is also not on the table for us.

- We are not expecting that the JPY would see strong appreciation movements in August just yet. Instead, it may more likely come in September after the next FOMC, when the Fed could imply more of a pause in rates. A concurrent peaking in US rates (and eventual cuts in 2024) together with a climb in JGB yields should lead the JPY stronger overtime.

- **Latest External Balance Outlook:** The country saw a turnaround to a trade surplus in June at 43.0bn yen (May. -1.37tn yen) as imports fell sharply at -12.9% YoY whilst exports came out positive at 1.5% YoY. This was the first time in 23 months that the trade balance had also seen a surplus. Exports to Asia ex-China, US and the EU grew on real terms but those to China saw a contraction. This comes as little surprise given the persistent sluggishness in China's economy. There was also interestingly a sharp rise in exports of semiconductors and other electronic parts. It would be key to watch if the semiconductor cycle is bottoming out and whether there could be a rebound. Overall, the numbers do actually highlight some possibility for upside in exports as China's economy should eventually show a more discernible recovery by year end and the potential for a pick-up in semiconductor sales. A continued pick-up in exports can help support to push the trade balance further into surplus and provide a boost the currency. As a note, the JPY had in some sense been weighed down by a trade deficit over the last year or so.

- **Key domestic events and issues to watch:** June (P) leading index and coincident index (7 Aug), June cash earnings (8 Aug), June household spending (8 Aug), June BOP CA balance (8 Aug), Jul bank lending (8 Aug), Jul eco watchers survey (8 Aug), Jul (P) machine tool orders (9 Aug), Jul PPI (10 Aug), 2Q (P) GDP (15 Aug), Jun capacity utilization (15 Aug), Jul nationwide/Tokyo dept sales (16 – 22 Aug), Jul trade data (17 Aug), June core machine orders (17 Aug), Jul CPI (18 Aug), Aug (P) Jibun Bank PMIs (23 Aug), Aug Tokyo CPI (25 Aug), Jul PPI services (25 Aug), Jul jobs data (29 Aug), Aug consumer confidence index (30 Aug), Jul retail sales (31 Aug), Jul (P) IP (31 Aug) and Jul housing starts (31 Aug).

- **Technical Outlook:** Near term, pair could move further up. Resistance is at 142.51 (FI retracement of 61.8% from Jan 2023 low to Oct 2022 high) and 145.00 (psychological level). Support is at 137.59 (100-dma) and 135.00.



RMB: Politburo Bought Some Time, But Not Much More

Forecast	3Q 2023	4Q 2023	1Q 2024	2Q 2024
USDCNY	7.15 (--)	7.10 (--)	6.95 (--)	7.00 (--)
USDCNH	7.15 (--)	7.10 (--)	6.95 (--)	7.00 (--)

No Change to Previous Forecasts

- **Motivation for the FX View:** We keep our forecast trajectory for USDCNY and USDCNH unchanged, expecting both onshore and offshore paring to gradually drift lower. We assume (1) that the Fed is at the end of its tightening cycle (or at most one hike away from it), (2) global growth will slowdown gradually (with minimal growth differential between the rest of the world with the US), (3) effective economic supports for China could be announced soon, as indicated from the Politburo.
- Yuan has been supported by the PBoC via the daily USDCNY reference rate fixes, cross-border financing parameter adjustments as well as some extent of jawboning. The recent recovery of the yuan was both a reflection of peak pessimism as well as some optimism that the government has a a sustsainable growth plan for China. The politburo meeting at the end of Jul managed to buy time for its "powerful and targeted" growth measures to take shape. However, markets cannot wait too long now. Early indicators (traffic data, SME confidence index, housing sales by floor space, total mortgage loans) are already showing signs of further economic weakness for Jul. We still hold a glass half full view of a gradual economic recovery. Any measures to ensure growth stabilization at this point and a slight pick up in confidence could be positive for yuan and lift it back towards the 7-figure against the USD especially with tightening cycles coming to an end for many central banks in the backdrop. Between now and then, USDCNH and USDCNY could remain supported on dips.
- **Growth and Inflation Outlook:**
  - **Politburo Meeting Readout:**

    Property. Politburo acknowledged that there is a deficient of demand. For decades, stimulating the property sector was one of the fastest way to boost the economy and this was done via liquidity injections for developers to start projects and the concomitant boom created the positive wealth effect for consumption. So a prolonged slump in properties for the past few years (due to a harsh combination of Covid lockdowns, three red lines -regulatory debt ratio) removed one source of exuberance and animal spirits in the economy. The key phrase that was removed in the readout is that "houses are for living, not for speculation". **What to expect:** <u>removal of restrictions to purchase</u>

homes in tier-one and tier two cities (reducing downpayments/mortgage rates).

Local government Debt Risks. The slump in the property sales had led to a lack of land sales which are a significant source of revenue for local governments. The flailing economy had hurt revenue collection in general and Covid lockdowns were expensive for the local governments. The politburo promised "a basket of plans" to resolve the debt risks (estimated to be around $9trn). **What to expect:** debt restructuring via debt-for-equity swaps or extending bank loans with reduced interest rates and deferring principal repayments (done for LGFVs before), simply bailouts.

Support for Private Sector. After a rather punishing three years, the Politburo endorsed "standardised, healthy and sustainable development" of china's internet platform operators. Earlier this month, there was a 31-point action plan to support the country's private sector. Main message was to treat private sector the same as SOEs. The Mayor of Beijing Yin Yong had also assured CEOs of Alibaba and Xiaomi that Big Tech firms would help propel Beijing to become a "global technology centre" by 2025 (SCMP). More recently (28 Jul), PBoC Deputy Governor Zhang Qingsong had urged the financial sector to help fund technology research and M&A deals in order to support the private sector growth. *Apart from bank loans, insurance and pension funds are encouraged to invest in venture capital vehicles, unlisted startups are supported by regulators to issue bonds for fund raising and the potential creation of a platform for HY bonds to meet the fund-raising needs of SMEs (BBG).* NDRC announced (on 24 Jul) that projects in some key subsectors with clear investment return mechanisms and good investment return levels will be selected for private sector participation. These key sectors include **transportation, water conservancy, clean energy, new infrastructure, advanced manufacturing and modern agriculture**. FIs will be encouraged to finance such projects. **Key reason for private sector revival is the fact that SMEs and self-employed contributed 60% of total GDP, 50% of tax income, 79% of job creation and 68% of exports based on OECD data as of 2020.**

Household Consumption. China had not abandoned its plans for "consumption-led" recovery and continued to emphasize that this is the main thrust of growth. Quite a number of measures were announced to boost the autos(EVs). On top of that, FIs were encouraged to promote lending for households to purchase electronic products and household goods. The politburo also wants to promote tourism, sports, entertainment and culture (Reuters). **What to watch:** It is hard to see households having the confidence to borrow at all in such an economic climate. **General observations (especially during Covid) suggest that direct cash handouts to households is the most effective way to boost consumption. However, apart from e-CNY lotteries for the sake of testing the digital payment system and to promote its use, the Chinese government is not willing to provide handouts.**

- We still look for a consumption-led recovery over the next six months. The politburo has emphasized on the importance of private consumption as a main thrust of growth and also acknowledged that there is a lack of confidence now with a serious issue of high youth unemployment. To address youth unemployment, recall that the Ministry of Human Resources and Social Security is said to have launched a six-month campaign from Jul to boost youth employment. The authorities will provide career guidance, skills training, job referrals and internship opportunities during the campaign. Focus will be employment in advanced manufacturing, modern services and other fields. National Bureau of Statistics had flagged that the situation of youth unemployment could get worse before it gets better. Afterall, hiring can only happen after all of the political bureau's pledges of property sector stabilization, getting business confidence, consumer confidence back up in private sector need to come to fruition in some ways. All activity data, credit data should see some form of improvement in the next six months.

- Exports fell -12.4%y/y vs. previous -7.1%. Imports also fell -6.8%y/y vs. prev. -4.5%. Trade balance widened a tad to $70.62bn. External demand is deteriorating while the current weakness in domestic demand keeps its goods balance in surplus. This may not last should the Chinese government finds success in ensuring a recovery in consumption and we can expect China's trade surplus to narrow.

- **Monetary Policy Forecast:** Our China economist looks for PBoC to ease monetary policy further only after yuan is no longer under persistent downside pressure. Thus far, PBoC has been managing the yuan via a few ways including the daily USDCNY reference rate, the raising of the cross-border financing parameter from 1.25 to 1.5 that allows corporates and FIs to borrow from more from overseas as well as some extent of verbal intervention (e.g politburo did mention that the yuan will be kept stable). Yuan has managed to strengthen against the USD as a result on the back of some optimism that the government is finally coming up with a sustainable plan to boost growth. Monetary policy support may come but only after most central banks are more comfortable to signal the end of their respective tightening cycles.

- **Latest Fiscal and External Balance Outlook:** The Two sessions had revealed that the fiscal deficit (general public deficit) is seen at 3.0% of GDP for 2023. MOF has plans to issue CNY3.16trn in general sovereign bonds in 2023, CNY510bn more than 2022. However, the quota for general bonds to be sold by local government was kept unchanged at CNY720bn. Total income from taxes and fees are projected to be 6.7% more at CNY21.7trn this year vs. 2022 but expenditure on public services (healthcare, eduation, defense and internal security) is also expected to be raised 5.6%. Consolidated General Public Budget is expected to be a 4.47% deficit of GDP. Total budget deficit is around 7.4% of GDP.

- **What to Watch:** Local government debt risks are in focus now. Authorities in China may issue special bonds for refinancing purpose to swap local hidden debt. FIs may extend or renegotiate terms of the debt with the borrowers to optimize the maturity structure and lower their interest payment burden.

- **Key domestic events and issues to watch:** Caixin Mfg PMi [1 Aug], Caixin Services PMI [3 Aug], Foreign Reserves, trade [7 Aug], aggregate financing, money supply, new yuan loans [9-15 Aug], CPI, PPI [9 Aug];

FDI [11-18 Aug]; 1Y MLF [15 Aug]; retail sales, FAI ex rural, industrial production, FX Net settlement on behalf of clients, surveyed jobless rate [15 Aug]; 1Y, 5Y LPR [21 Aug]; industrial profits [27 Aug]; Mfg, Non-Mfg PMI [31 Aug].

- **Technical Analysis:** This pair has risen higher within the 6.83-7.00 range, not establishing any trend line at this point. Weekly chart suggests some bullish bias for this pair with resistance seen around 6.98 and then at 7.0250. Support at 6.8302 before 6.7550. 21-wma has made a death cross with the 50-wma and could be en-route towards the 200-wma. Technical indicators are still rather mixed and we look for more two-way moves for this pairing.

KRW: Potential to Outperform

Forecast	3Q 2023	4Q 2023	1Q 2024	2Q 2024
USDKRW	1300 (--)	1280 (--)	1270 (--)	1250 (--)

No Change from Previous Forecasts

- **Motivations for the FX View: We maintain our forecasts for USDKRW on the expectation of a possible bottoming in the chip cycle which will be supportive of a positive KRW trajectory.** China's recovery has hitherto flattered to deceive, and we think that this means China's reopening and the expected benefit to the KRW could take longer to play out. We earlier noted that there were nascent signs of an improvement in export numbers for Korea and the latest optimism and hype over Artificial Intelligence (AI) should bode well for future demand for chips. Graphic processing units (GPUs) that are used heavily for the purposes of AI-related computations require memory chips that Korean companies such as Samsung and SK Hynix specialize in producing. We therefore maintain the expected downward trajectory of the KRW against the USD.

- South Korea has also been earmarked on the watch list for inclusion in the FTSE Russell World Government Bond Index, which should be further supportive of the KRW. The Korean government is also making a strong push for this to happen and market watchers think there is a 50% chance that this could happen by Sep 2023. We watch developments on this front closely as the expected inflows from benchmark investors should drive the KRW stronger.

- The BOK had earlier paused on its tightening and has provided hawkish forward guidance for its future actions, should data warrant a rate hike. On the whole, should price pressures moderate from current levels, growth slow down but not tank and central banks end their tightening cycles, the global macro environment would be positive for the KRW moving forward.

- We think it is possible that China's reopening sets in albeit at a slower than previously anticipated pace. Given China's close trade linkages and geographical proximity to Korea, we expect the KRW to be one of the largest beneficiaries of China's reopening when it happens.

- USDKRW has largely trended lower in Jul from highs of around 1316.50 levels at the start of the month and now trades at around 1274.55 levels. Asian FX in general have been performing well this month as the USD retreats on peak Fed rate bets. KRW in particular has been an outperformer and has strengthened more than 3% in Jul on expectations of more stimulus from China. We think that the KRW could continue to outperform,

- **Risks to our View:** KRW's traditionally high-beta to global chip demand and global equity performance means that it is inclined to see amplified swings from geopolitical developments. While this is positive in the context of China's reopening, developing tensions between US and China could leave Korea stuck between a rock and a hard place. Korea is a US ally, but it has shown in refusing to join the US-led protectionist chip-bloc against China that it does not want to offend China. Indeed, it could well be the case that Korea cannot afford to offend China. We see a potential drag on the KRW if tensions continue to escalate and Korea is forced to pick a side.

- We also note potential tensions with China, North Korea as risk triggers. Recall that China-Korea relations deteriorated in 3Q 2016 over US-Korea alliance decision to deploy US Terminal High Altitude Area Defense (THAAD) anti-missile system to defend against North Korea missile threat. President Yoon had earlier indicated plans to buy an additional THAAD system. This may be a concern for KRW if it induces risks of retaliation from China. But we also note some recent efforts from Yoon to avoid antagonizing China. Meanwhile, inter-Korean tensions are also in play as North Korea ramps up missile tests in recent weeks. South Korean president Yoon has warned of "overwhelming" response if North Korea attempts any nuclear action. Meanwhile, KRW also continues to be exposed to swings in broader geopolitical risks. E.g., Biden's warning of China potentially making a move on Taiwan on a "much faster timeline" than previously thought, continued aggressive Russian strikes in Ukraine etc., and could continue to cap sentiment recovery.

- Global growth concerns remain a persistent drag on high-beta/pro-cyclical KRW. Global growth slowed in 2022 to 3.2% and is expected to remain at below-trend rates in 2023 and 2024. The OECD believes the Ukraine war to be the main cause for the moderation in growth recovery post-Covid and cost of living issues continue to persist globally. Global growth is projected to come in at 2.6% in 2023 and 2.9% in 2024. Further downside risks about the global growth and inflation outlook could weigh heavily on high-beta/pro-cyclical currencies like the KRW. Issues that potentially could lead to such a situation are the recent surprise OPEC+ production cuts, an escalation of tensions between Russia and the West, or the return of banking turmoil on a wider scale.

- Korea's energy importer status also means that there is a serious risk to inflation running rampant if oil prices spike once again. OPEC once again cut production early in Jun, with total cuts of 3.6m barrels per day (bpd) or 3.6% of global demand on the cards. Saudi Arabia has telegraphed production cuts to 9m bpd in Jul from around 10m bpd in May. Analysts suspect that oil may once again rise to >$100/bbl and this could weigh heavily on global recovery as the costs of doing business rise. In such an environment, there would be a two-fold drag on the KRW via high inflation rates and poorer growth prospects. This risk has recently been reduced as energy prices have moderated of late, although an uptick in prices could happen quickly, especially if OPEC continues to cut production.

- **Growth and Inflation Outlook:** South Korea's real GDP grew at +2.6% YoY in 2022. Latest consensus forecasts see growth in 2023 at 1.4% and 2024 at 2.3%. The main reason for below-trend growth continues to be a drag in exports which is expected to contract -0.8% YoY in real terms. 1Q23 preliminary GDP figures showed that the Korean economy likely grew by +0.9% YoY (exp: 0.8%; prev: 0.8%) and +0.3% SA QoQ (exp: 0.3%; prev: 0.3%).

- In May, the BOK revised its real GDP growth projections downwards to 1.4% in 2023 (prev: 1.6%) and 2.3% in 2024 (prev: 2.4%). BOK is expecting challenging headwinds from global economic sluggishness and interest rate hikes, but expect the economy to pick up in 2H2023 as external conditions improve, in particular as China's anticipated reopening comes into play. Officials recognize that uncertainty remains high. The South Korean government (Finance Ministry) has been mulling cutting their GDP forecasts, but for now this remains at 1.6% for 2023. This move has been mentioned by both Finance Minister Choo as well as other unnamed Finance Ministry officials.

- South Korea's Jun exports contracted by more than expected at -6.0% YoY (exp: -3.6%; prev: -15.4%), while imports contracted by -11.7% (exp: -10.1%; prev: - 14.0%). The Jun trade balance was in a US$1.13b surplus (exp: US$1.50b; prev: -US$2.2b). The trade balance turning into a surplus from a deficit is in line with our view of a possible bottoming of trade flows in line with the expected chip and semi -conductor cycle and as the latest hype on artificial intelligence could also possibly spur demand.

- The latest 20-day trade figures however, suggest that global demand could continue to remain weak as exports in 20-days to 21-Jul fell -15.2% YoY (prev: 5.3%), while imports fell -28.0% YoY (prev: -11.2%).

- South Korea's unemployment rate in Jun came in at 2.6% (exp: 2.6%; prev: 2.5%), indicating that the labour market continues to be resilient and remains healthy. Meanwhile, Jun Industrial Production came in at -5.6% YoY (exp: -5.5%; prev: -7.6%), showing a decline in manufacturing activity that was in line with the BOK's downward growth revisions. On an SA MoM basis, Jun Industrial Production fell -1.0% % (exp: -0.9%; prev: 3.0%).

- On inflation, BOK expects CPI inflation to rise by 3.5% in 2023 (prev: 3.5%) and 2.5% in 2024 (prev: 2.6%). Core inflation is expected to be above the previous forecast at 3.3% (prev: 3.0%). The expected moderation in headline price pressures is due to easing pressures from both an increased supply and reduced demand. However, this forecast was predicated on lower crude oil prices, which has thus far played out to expectations. Core inflation is expected to decrease at a slower than previously anticipated pace due to an increase in services demand, a tight labour market, and the lagged pass-through of accumulated cost pressures. In terms of actual outturns, Jun headline CPI inflation cooled to +2.7% YoY (exp: 2.8%; prev: 3.3%), while Jun core CPI inflation re-accelerated to +4.1% YoY (prev: 3.9%).

- **Monetary Policy Forecast:** The Bank of Korea (BOK) maintained its policy rate at 3.50% on 13 Jul in line with market consensus. This follows similar pauses in May, Apr and Feb, on the back of two 25bps rate increases in Nov and Jan. The latest language accompanying the Jul hold continues on the trend of a hawkish hold, with BOK recognizing that while inflation has slowed, they are expecting it to pick up again to around the 3% level and remain above their target for a considerable time and they remain focused on ensuring price stability. We expect them to retain the hawkish hold approach at their upcoming 24 Aug meeting and think that this is the base case scenario moving forward unless there is a surprise shock to future inflation prints, which currently looks unlikely.

- **Latest Fiscal & External Balance Outlook:** Fitch maintained Korea's rating at AA- (outlook stable) in Sep, citing robust external finances and resilient macroeconomic performance versus geopolitical risks related to North Korea and structural challenges from an ageing population. The new administration has proposed a fiscal rule of 3% of GDP managed deficit (consolidated balance minus social security surplus) and 60% of GDP debt limit, which implies incremental fiscal discipline, though its passage is uncertain. Fitch forecasts a deficit decline to 1.2% of GDP in 2023 alongside lower expenditure. Debt-to-GDP ratio could rise marginally from an estimated 49.5% in 2022 to 51.5% by 2025. Actual fiscal outturns for 2022 showed a surplus of 0.2% of GDP (versus an expected deficit of -2.7%). While this remains a positive for the KRW at the margin, consensus estimates are expecting a fiscal deficit of -1.2% in 2023 and -0.7% in 2024.

- South Korea's trade balance in Jun came in at a -US$1.3b surplus, improving on the -US$2.1b deficit in May. Should chip demand eventually pick up, the trade balance should improve and this should provide a significant tailwind for the KRW. However, there are signs that China's reopening effects could be delayed and this could weigh on the trade outlook for South Korea. In addition, the US has continued to be hawkish on China in terms of rolling out chip measures, which could also dampen the outlook for chips and exports for South Korea, which would be negative for the KRW.

- **Key domestic data and events to watch in Aug:** Jul Trade, S&P Global Mfg PMI (1 Aug), Jul CPI (2 Aug), Jul Foreign Reserves (3 Aug), BoP Goods/Current Account Balance (8 Aug), Jul Unemployment (9 Aug), Bank Lending to Households (9 Aug to 16 Aug), Jun Money Supply (11 Aug), Jul Import/Export Price Indices (17 Aug), 20-Day Import/Exports (21 Aug), Business Survey, Short Term External Debt (23 Aug), Jul PPI , BOK Policy Decision (24 Aug), Retail Sales (24 Aug to 31 Aug), Industrial Production (31 Aug).

- **Technical Outlook:** USDKRW last traded at 1272.81 levels. Momentum, stochastics and RSI are all at neutral levels. We see key upside resistance at 1350 and support at 1250 levels. Breakouts to the bottom are to be supported by 1200 and resisted at the top by 1400 psychological levels.

SGD: Technical Recession Avoided

Forecast	3Q 2023	4Q 2023	1Q 2024	2Q 2024
USDSGD	1.3350	1.3250	1.3250	1.3150
	(--)	(--)	(--)	(--)

No Change from Previous Forecasts

- **Motivation for the FX View: We maintain our USDSGD forecasts even as Singapore has narrowly avoided a technical recession. The SGDNEER has remained firm above the mid-point of the policy band and has consistently looked to push the 2.00% (our assumption of upper end of policy band) mark. The SGD in general has held up well amid market fluctuations and swings between periods of USD strength and weakness and we expect this to continue.** Our assessment is that MAS is likely to stand pat in October, and the continued appreciating stance (assumed to be +1.5% p.a.) in the SGDNEER should provide plenty of support for the SGD and result over time in a lower USDSGD. We also see the off-chance that China's reopening comes in stronger on a delayed basis and this could also provide a boost for the SGD.

- On 14 April, MAS stood pat and left policy settings (slope, centre and width) unchanged. This is the first stand pat after a series of five tightening moves that began in October 2021. This decision goes against our expectations for a tightening via a re-centre upwards, given that core inflation remained well above MAS' comfort levels. In our view, this was largely due to MAS' inflation outlook being more sanguine and expectations for growth being more pessimistic than we had expected.

- The trajectory for a lower USDSGD remains intact and is in line with our view that China's reopening could eventually come in, albeit at a delayed basis. In addition, should the narrative that the Fed is coming to an end of its tightening cycle come to fruition, the SGD should also find some support despite a lack of MAS tightening. While MAS stood pat, the current policy stance still implies a +1.5% appreciation in the SGDNEER against its trade-weighted constituents, which will also provide support for the SGD against the USD. Given that Singapore's robust macroeconomic fundamentals such as a persistent current account surplus, strong governing institutions and pro-growth policies remain intact and are fundamentally unchanged, we remain convicted on our positive medium-term view on the SGD.

- We earlier thought that there was a risk that the Fed remains hawkish after a pause and this has materialized. The risk now is that global growth slows down, and price pressures remain strong, which should be overall favourable for the USD in the long term. We think that the SGD NEER will continue to remain resilient. We saw SGD NEER trade firmer in Jul and test the 2.00% band limit during the latest bout of USD weakness. Further attempts at testing the upper limit of the band could necessitate MAS intervention which should imply a lower SGDNEER.

- The fundamentals for the SGD have not materially changed – robust macro fundamentals in Singapore such as ample fiscal space, current account surpluses, healthy labour market and political stability etc. will continue to impart SGD some "safe-haven" appeal, which is likely to be reflected in SGD resilience in the future. Indeed since 14 Apr, the SGD continues to display signs of resilience against most other currencies on both a bilateral and trade-weighted basis. However, we also see the Fed coming to an end of the tightening cycle and are looking for the USD to weaken gradually through the year as the market pares back on USD assets. In addition, we expect China's reopening effects to be beneficial for Asian currencies and specifically for the SGD, with its close trade linkages to China.

- **Risks to our View:** There is a chance that global growth prospects could deteriorate further and that China's anticipated reopening effects do not live up to expectations. In such a scenario, it would be difficult for Singapore as a small country that is highly dependent on trade to escape a recession. We would therefore expect that in such a scenario, the SGD could underperform, and any SGD weakness could be further exacerbated should MAS decide to support growth by easing the current appreciating policy stance via moving to a zero appreciation path. For now this is not our baseline scenario and we do not expect MAS to ease to move to a zero appreciation path in a sudden move and expect easing, if any, to be gradual and measured.

- **Growth and Inflation Outlook:** On growth, 2Q2023 advance estimates showed that the Singapore economy grew by +0.3% SA QoQ (exp: -0.2%; prev: -0.4%) and by +0.7% YoY (exp: 0.5%; prev: 0.4%), narrowly avoiding a technical recession. MTI has forecast growth at 0.5% to 2.5% in 2023, with expectations for growth to be around the mid-point of the range, on the back of a stronger economic recovery in China. Our economists maintain their full-year GDP growth forecast at +0.8% YoY, which is at the lower end of MTI's forecast range. Manufacturing is expected to remain tepid in 2H2023 due to weak external demand and services may remain supported by consumer-facing segments with the tourism recovery.

- The manufacturing contraction continued in Jun, albeit at a shallower pace,as Jun Industrial Production came in at -4.9% YoY (exp: -6.0%; prev: -10.5%). In SA MoM terms, Industrial Production rose by 5.0% (exp: 4.1%; prev: -3.6%) reversing two months of declines. Nevertheless, all sectors saw YoY declines, with the exception of transport engineering.

- On inflation, MAS lowered its forecasts for both core CPI (2.5% to 3.0% YoY; prev: 2.5% to 3.5%) and headline CPI (4.5% to 5.5% YoY; prev: 5.5% to 6.5% YoY). MAS recognized both upside and downside risks exist to inflation and central bank chief Ravi Menon has said that the central bank will not pivot to a growth supportive stance as it remains vigilant of the risks that upside shocks to inflation could cause price pressures to be more persistent than expected, even as the forecasts for inflation are lowered.

- Jun CPI inflation prints indeed showed a moderation in headline CPI inflation at 4.5% YoY (exp: 4.4%; prev: 5.1%) and core CPI inflation at 4.2% YoY (exp: 4.2%; prev: 4.7%). However, it is important to note that core inflation eased on the back of softer food and services costs due to favourable based effects. The easing in headline inflation was due to a fall in private transport and lower core inflation. Core inflation still rose by +0.2% MoM (prev: 0.1%) and headline by +0.5% MoM (prev: 0.3%) and prices remain above MAS' comfort zone. Our economists maintain their 2023 forecasts for headline inflation at +5.1% YoY and core inflation at +4.3% YoY. Price pressures are expected to moderate further in 2H2023 as energy and food prices remain lower than 2022 highs, supply chain frictions ease and a stronger SGDNEER caps imported prices. Nevertheless, possible upside risks to inflation remain as adverse weather conditions and food protectionism amid the ongoing Russian-Ukrainian war could cause an increase to global food and energy prices.

- Jun Unemployment was stable at 1.9% on a SA basis (exp: 1.9%; prev: 1.9%). Unemployment has remained stable in Singapore and with jobs and employment an important indicator for the government, it is likely that policies will remain friendly for the labour market.

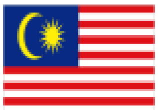
- **Monetary Policy Forecast:** The poorer than expected growth outlook and the balance of risks skewed to easing of inflationary pressures likely influenced MAS' decision to stand pat rather than to tighten further. We note that MAS used "sufficiently tight" to describe the current policy stance in addition to their usual use of the word "appropriate". We think this could be a possible hint to their policy leaning in October. **Given the current outlook for growth and inflation, we think it is likely that MAS will be biased towards a stand pat in Oct as long as MAS' core inflation is on their projected trajectory.** However, we would not rule out a tightening in Oct should MAS' core inflation projections change materially if upside imported inflation risks materialize. The base case for MAS to stand pat however, remains intact.

- This latest decision was in line with the narrative that the Fed and other central banks around the world are coming to an end of the tightening cycle. Should global inflation trends indeed show a significant deceleration in core inflation prices, we then think that the case for MAS standing pat in Oct should further strengthen. However, we also note that MAS highlighted upside risks to inflation and specifically cited commodity price shocks. Thus far the earlier OPEC surprise production cut has resulted in a somewhat sustained increase in oil prices. We need to monitor this space as any easing in energy prices could provide some support for the MAS narrative that inflation will come off later into the year. We would like to highlight that core inflation prints in many advanced economies in the world remain elevated and persistent despite a moderation in headline inflation and our economists are not as certain that MAS' core inflation, which is slightly different in that it excludes accommodation and private transport and as such includes energy, will come off later in 2023.

- **Latest Fiscal Outlook:** Budget 2023 came out in Feb and mainly provided more social support amid rising costs of living and the hike in GST. A deficit is still expected albeit at a relatively low level of 0.1% of GDP or SGD0.4bn.
- A large SGD3bn top-up was done for the GST Assurance Package (AP) to SGD9.6bn. This is in light of the likelihood that a 2% GST hike would raise about SGD3.5bn annually. Cash payouts of various sorts were adjusted or introduced including an increase in the cash component of the AP by between SGD300 and SGD650, CVC vouchers to be raised SGD100 to SGD300 in 2024, etc. The permanent GST voucher (GSTV) scheme for eligible Singaporeans was also raised, which brings total spending for this to SGD1.7bn from 2024 onwards. In addition to all this, the Enterprise Financing Scheme, which include the 70% government risk-share for trade loans and support for domestic construction projects via project loans, will be extended for another year until end March 2024.
- On the revenue side, Singapore is looking to implement the Pillar 2-global minimum tax from 2025, via introduction of a Domestic Top-Up Tax, which will top up the MNE groups' effective tax rate in Singapore to 15%. This part of a broader international movement by other countries including the EU, UK and Switzerland to implement Pillar 2 in phrases starting from 2024.
- The FY2022 deficit meanwhile was smaller than projected at 0.3% of GDP or SGD2bn (vs initial projections of 0.5% of GDP or SGD3bn). Draw on reserves was also lower than initial estimations at SGD3.1bn (vs expectations of SGD6bn). The overall drawdown from past reserves from FY2020 to FY2022 totaled SGD40bn, much less than the initial SGD52bn sought by the government for the President's agreement. As a whole, there was little to note for the SGD from the FY2023 budget, given that Singapore's overall fiscal health remains sound and it does not need to borrow to spend.
- **External Balance Outlook:** Jun NODX declined at a steeper pace as it plunged -15.5% YoY (exp: -15.6%; prev: -14.8%) and rose by 5.4% Sa MoM (exp: -3.6%; prev: -14.6%). Electronics Exports fell -15.9% YoY (prev: -27.2%). These releases remain reflective of the moderation in global demand and the overall tapering of economic growth prospects in Singapore and abroad. Preliminarily our economists have seen some recovery of non-oil exports to China and Hong Kong, potentially hinting at some signs of recovery in demand in Greater China and supporting the narrative for China's reopening. Our economists maintain their 2023 NODX forecast at -9% to -6% (1H23: -14.8%) on the expectation that there could be a recovery in 2H23 although external demand is expected to remain weak relative to the years of roaring trade. Singapore's Current Account balance for 1Q2023 is at 18.52% of GDP (4Q2022: 19.3%). Singapore's current account has remained in a structural surplus and short term (quarterly) fluctuations are not expected to have a material impact on the SGD.
- **Key domestic events and issues to watch in Aug:** Jul Purchasing Managers Index, Electronics Sector Index (2 Aug), S&P Global PMI (3 Aug), Jun Retail Sales (4 Aug), Jul Foreign Reserves (7 Aug), COE Bidding

(10 Aug), Jul Electronics Exports and NODX (17 Aug), 2Q Final GDP (21 Aug to 25 Aug), Jul CPI, COE Bidding (23 Aug), Jul Industrial Production (25 Aug), Jul Money Supply (31 Aug).

- **Technical Outlook:** USDSGD last traded around 1.3310 levels. We see supports for USDSGD at the 1.33 figure, while resistances are at the 1.34 figure. Stochastics are flagging oversold conditions while RSI is neutral. We see two-way risks for the pair moving forward. USDSGD is likely to keep within a wider 1.32 to 1.38 range.



MYR: Aligned for a Gradual Turnaround

Forecast	3Q 2023	4Q 2023	1Q 2024	2Q 2024
USDMYR	4.60 (--)	4.50 (--)	4.35 (--)	4.20 (--)

No Change from Previous Forecasts

- **Motivation for the FX View:** We keep our MYR forecasts unchanged for now. The MYR trade weighted BIS Index has fallen around 2.8% ytd but more recently has actually risen around 0.8% mtd. USDMYR has fallen around 2.8% and reached a low of 4.4972 on 31 Jul 2023. It edged higher in Jul as the Fed rate hike peak phase builds up since the June FOMC and in the run up to the Jul FOMC as well as US data which suggests a better growth/inflation scenario compared to a few months ago. In addition, CNY support on the back of the Politburo meeting and China stimulus related factors has helped support regional currencies including the MYR. Recent upward momentum in global commodity prices (i.e. crude oil, palm oil) due to signs the market is tightening, with estimates that crude demand is running at a record clip just as OPEC+ cuts back production. West Texas Intermediate held above $80 a barrel after a run of five weekly gains that lifted prices to the highest since April. The US crude benchmark has rallied almost 14% this month, putting it on course for the biggest advance since Jan 2022. It's the best performance for Jul in almost two decades.

- In addition, domestically, part of the lackluster demand for MYR assets has partially abated as the Malaysian government lays out in detail its first long term economic blueprint, Madani economic narrative (MEN), which provides a framework to build a better Malaysia. There may be lingering concerns about the completion of the upcoming state elections in mid Aug but our economists had highlighted that the impact on the economy and MYR from the could be minimal. Our economists baseline scenario or assumption is that the outcome of these state elections will broadly mirror the results of the Parliament seats contested in these states at the 15th General Election back in Nov 2022 i.e. PH/BN will keep the multiracial states Selangor, Penang and Negri Sembilan while PN/PAS will retain the Malay heartland/belt states of Kedah, Kelantan and Terengganu. What is more – and most - important is that after the conclusion of the state elections, the PM, his Cabinet and the Federal Government is likely to focus on policy making and implementation of economic and institutional reforms given that there is over four years to go before the next general election.

- Overall, balance of payments data had highlighted concerns about net FDI being significantly lower than historical standards. Net portfolio flows have remained positive with some renewed interest into Malaysia's bond and equity market. In Jul, foreign net buying saw RM$281mn in end Jul with total foreign net buying for Jul coming in at RM1.4bn – reversing 10 straight months of selling. In essence, there has been a confluence of positive factors, i.e. Fed's end of tightening cycle, firmer crude oil and CPO palm oil prices in recent weeks and more recently a return of foreign buying in Malaysian equities (possibly due to value emergence and fund rotation activities). Amidst all these, the current account balance (trade drivers) remains a pillar of support.

- The global situation which looks unfavourable over the past 1H 2023 are not expected to keep persisting until year end as had panned out recently. The Fed could also eventually soften its stance closer towards year-end as inflation gradually falls. China we believe would show more discernible level of recovery over the tail end of 2023 and we factor in some significant level of targeted stimulus to help the economy and that should give a boost to commodities' prices eventually. Domestically, the state elections may conclude by 3Q 2023 and thereafter if the results lend credence to extended stability of the current government could see positive effects on both cold (FDI) and hot (equity+ bond) portfolio flows and coupled with eventual Fed pause and softer USD expectatons may lead exporters starting to sell their USD holdings from export proceeds, which may have grown. All these are possible scenarios which may materialize in 2H 2023 and we are already factoring it into our MYR forecasts.

- We are also mindful of risks that could result in our expectations not panning out. This include US data staying strong for too long with inflationary pressure concerns emerging again and China's consumption failing to pick-up. For now, we remain confident that these risks would not materialize at a serious level.

- **Growth and Inflation Outlook:** Maintain our full-year 2023 forecast of +4.5% (1Q 2023: +5.6% YoY) i.e. moderation from the +8.7% surge last year that was boosted by full economic opening. The outlook reflects high base effect on 2Q 2023 and 3Q 2023 growth following real GDP growth surges to +8.8% YoY in 2Q 2022 and +14.1% YoY in 3Q 2022, plus the impact of the aforementioned high inflation-interest rate environment on domestic demand growth (2023E: +5.6%; 2022: +9.2%) - notably in terms of slower growth of private consumption (2023E: +6.1%; 2022: +11.2%) and some denting of private investment expansion (2023E: +5.0%; 2022: +7.2%). At the same time, public consumption growth is projected to ease (2023E: +3.2%; 2022: +4.5%) amid slightly lower Federal Government's operating expenditure (2023E: MYR289.1b, -1.2%; 2022: +MYR292.7b, +26.4%).

- Public investment is expected to buck the trend (2023E: +7.3%; 2022: +5.3%), partly reflecting higher Federal Government's gross development expenditure (2023E: MYR97b, +35.5%; 2022: MYR71.6b,

+11.4%), on top of the progress in the on-going major infrastructure projects.

- Meanwhile, after two years of double-digit growth, we ae forecasting low single - digit growth in goods and services exports (2023E: +2.5%; 2022: +14.5%) and imports (2023E: +2.0%; 2022: +15.9%), reflecting base effect as well as global economy, electronics industry and commodity price downturns, impacting commodity and manufacturing segments - notwithstanding the positive effect of tourism and travel rebounds on services part - of the external trade.

- Consequently, the above dynamics in the demand side of the economy result in especially the deceleration in the growth of services (2023: +5.5%; 2022: +10.9%) and manufacturing (2023: +3.5%; 2022: +8.1%) and the pickup in construction (2023: +7.0%; 2022: +5.0%), alongside relatively faster agriculture (2023: +1.2%; 2022: +0.1%) and slower mining (2023: +1.5%; 2022: +2.6%).

- Headline inflation rate eased further to +2.4% YoY in Jun 2023 (May 2023: +2.8% YoY; 6M2023: +3.3% YoY; 2022: +3.3%) – the lowest since Apr 2022, as transport inflation was flat at +0.0 YoY (May 2023: +1.0% YoY; 6M2023: +2.2% YoY; 2022: +4.7%) mainly on base effect. Food & non-alcoholic beverages (FNAB) price increase slowed to +4.7% YoY (May 2023: +5.9% YoY; 6M2023: +6.3% YoY; 2022: +5.8%) while non-food inflation decelerated further (Jun 2023: +1.2% YoY; May 2023: +1.3% YoY). MoM, headline CPI was up by +0.2% (May 2023: +0.2%).

- Headline inflation rate ex-fuel prices also eased to +2.8% YoY (May 2023: +3.3% YoY: 6M2023: +3.6% YoY; 2022: +3.2%) and encouragingly, core inflation slowed to +3.1% YoY (May 2023: +3.5% YoY; 6M2023: +3.6% YoY; 2022: +3.0%). Services inflation was also on downward trend (Jun 2023: +3.2% YoY; May 2023: +3.6% YoY) but remains elevated amid lingering pent up discretionary spending and services demand from economic opening plus cost pressures e.g. restaurants & hotels; recreation services & culture; furniture, household equipment & routine household maintenance.

- Maintain our 2023 inflation forecast at +3.0% as we expect monthly inflation rate to stay sub-3% YoY for the rest of the year, mainly on base effect. However, inflation risk remains biased to the upside amid the fluid policy on price subsidies and controls. The Government has started to implement targeted subsidies, beginning with electricity at the start of this year whereby subsidy is given only to domestic (household) and lowvoltage users vs non-domestic (industrial, commercial) and medium/high voltage users. This was followed by the exclusion of very high-income households from electricity subsidies at the start of 2H2023 i.e. those with monthly electricity consumption excess of 1,500kWh. Next is the implementation of targeted fuel subsidy, potentially next year that will also end the “benefits” to the high-income households.

- Following the decision by the BNM’s Monetary Policy Committee (MPC) meeting on 5-6 Jul 2023 to keep the Overnight Policy Rate (OPR) at 3.00%, we expect OPR to stay at this “slightly accommodative” level in 2H2023;

- **Monetary Policy Forecast:** Following the decision by the BNM's Monetary Policy Committee (MPC) meeting on 5-6 July 2023 to keep the Overnight Policy Rate (OPR) at 3.00%, we expect OPR to stay at this "slightly accommodative" level - as per BNM's description – for the rest of the year, with expectations of continued moderation in inflation. BNM also removed the assessment that "inflation risk is tilted to the upside", as well as its full-year inflation rate forecast range of 2.8%-3.8% that suggest forecast review is underway with the likelihood of the number now coming in at the lower end/half of that forecast range. This is based on four takeaways from BNM's latest Monetary Policy Statement (MPS) issued after the above-mentioned MPC i.e.

- Cautious global economic outlook as BNM changed its view on China, acknowledging "slowing recovery post-economic re-opening in recent months" vs "stronger-than-expected rebound" in the previous MPS in May 2023, while the MPS line on the downside risks to global economic outlook now adds "slower major economies".

- Constructive domestic economic outlook. Domestic economic growth slowed in recent months as exports are dragged by slower external demand. But for the remainder of this year, the economy will be driven by resilient domestic demand, as favourable labour market conditions – especially in the domesticoriented sectors – underpinned consumer spending, plus rebounds in tourist arrivals, thus tourism-related activities, on top of progress in multi-year infrastructure projects supporting investment activity.

- Expectations of continued moderation in inflation in 2H 2023 after the downtrend so far this year. In particular, BNM removed the assessment that "inflation risk is tilted to the upside", as well as its full-year inflation rate forecast range of 2.8%-3.8% that suggest forecast review is underway with the likelihood of the number now coming in at the lower end/half of that forecast range.

- MPS also added that BNM's MPC sees limited risk of future financial imbalances, compared with previous statement about the need to ensure monetary policy stance is appropriate to prevent the risk of future financial imbalances. Assuming the "financial imbalances risk" refers to the Ringgit situation and amid the outlook of further US Fed's interest rate hikes, we view that BNM feels its recent statement (by the Financial Market Committee or FMC on 27 June 2023) on Ringgit and FX market intervention is sufficient and effective in stabilising Ringgit i.e. not reaching and breaching 4.70 vs USD.

- **Fiscal Outlook:** The much anticipated re-tabled Federal Budget was released on the 24 Feb 2023 with the budget deficit seen to be at a narrower -5.0% of GDP (versus -5.5% of GDP in the original proposal) although it is still higher than -3.0 - -4.0% of GDP seen pre-pandemic. There still appeared a commitment to fiscal consolidation as the target to reduce the fiscal deficit to -3.2% of GDP by 2025 was set. The budget focused on introducing more "progressive and redistributive" tax measures through taxing higher income groups more and cutting the rate for the middle income. At the same time, there are attempts to strengthen governance in public spending through a tabling of the Government Procurement Act (GPA). However, our in-house economists noted the lack of details of sustainable revenue enhancing measures with the reintroduction of GST not appearing high on the government agenda. Fuel subsidy is also to stay in place with no specific mention of a targeted scheme being implemented in the coming year.

- Regarding corporations, the government is looking to adopt the Global Minimum Effective Tax rate of 15% in 2023 via the implementation of the Qualified Domestic Minimum Top Up Tax. This would put the country in line with its participation in the GLOBE Model rules (Pillar 2) initiative and inclusive framework on BEPS. There would also be lower Micro, Small and Medium Enterprises' (MSME) income tax rate of 15% for the first RM150,000 of taxable compared to RM100,000 proposed in the previous 2023 budget.

- On account of lower oil prices, the overall petroleum revenue is projected to drop by -20.9% to RM65.2bn and account for 22.4% of total revenue compared to 28.0% of total revenue in the prior year. Petronas would be contributing a lower level of dividends at RM40bn compared to RM50bn in the prior year.

- Fuel subsidies are to stay in place with no specific mention of any targeted scheme being implemented in the coming year. Our in-house economists have noted that past episodes of adjustment in fuel subsidies during periods of high crude oil prices did happen after key elections are out of the way. The country would be seeing six state elections later in the year.

- Government domestic debt is projected to stay just below 60% of GDP by end 2023, which compared to 57.7% as of end-2022. This still keeps it below the debt ceiling of 65% of GDP. Total government debt meanwhile is projected to rise to 62% of GDP by end 2023 from 60.4% of GDP as of end 2022. If the MTFF assumptions for 2023 – 2025 are realized, our in-house economists forecast that the government total debt should be at 62.8% of GDP in 2025 whilst the domestic debt level would be just over 60% of GDP in 2024 – 2025. As a note, government domestic debt as a percentage of GDP has been trending upwards since 2018 – 2019. However, we also do note the occurrence of the pandemic in the last couple of years which generally hurt the financial position of governments globally. Government debt service charge to revenue ratio has also been on upward trend for the last 10 years or so and will be at 15.9% in 2023, which is above the 15% international best practice threshold.

- **Addressing Structural Challenges via Madani Economy:** The Government identified nine major structural challenges facing the Malaysian economy i.e. deterioration in governance; economy becoming domestically-driven; low labour share of income; low median and mean wages; low female labour force participation rate; rising national debt; declining investment share of GDP; falling competitiveness; and inequality.

- In addressing these challenges, MADANI Economy aims to 1) "raise the ceiling" for the country by leveraging on inherent strengths to be a leading Asian economy by becoming a competitive and world class investment destination; promoting digital and innovation-led industries; positioning as global leader in Islamic finance; developing global champions among the micro, small and medium enterprises (MSMEs); achieving economic security and sustainability; and 2) “raise the floor” for the people by means of respectable jobs; decent standard of living; equality and inclusivity; improving basic infrastructure and public services, underpinned by access to quality education and healthcare services; enhancing social protection i.e. social security system and safety nets.

- MADANI Economy sets medium-term targets (10 years) anchored on global benchmarks for the positioning and ranking of the Malaysian economy, competitiveness, quality of life, labour inclusiveness, corruption, and fiscal sustainability.

- Among the key medium-term macroeconomic results expected under MADANI economy are 1) real GDP growth of 5.5%-6.0% p.a. over the next 10 years vs current run rate or “business as usual” (BAU) growth of 4.0%- 5.0%; 2) raise employees share of GDP to 45% in 10 years time (2021: 35.1%; 2022: 32.4%; 2025E: 40%); and 3) budget deficit to GDP ratio of 3% or less 10 years from now (2023E: 5.0%; Medium Term Fiscal Framework 2023E2025E average: 4.1%).

- Prime Minister’s speech at the launch of MADANI Economy also mentioned several major infrastructure projects that are pending, thus confirming these projects will be implemented i.e. MRT3; Penang LRT; Johor Bahru Bus Rapid Transit (BRT); Penang and Subang airport expansions. There are also incentives, initiatives and allocations targeted for MSMEs, startups, and sectors/industries like technology (electronics, datacentres), resource-based (downstream oil & gas and rubber), tourism and affordable housing.

- Hitting the ground running on execution in 2H 2023. The Government is hitting the ground running on implementation of MADANI economy. Underscoring this, MADANI Economy launch on the morning of 27 July 2023 was followed by the unveiling Phase 1 of the National Energy Transition Roadmap (NETR) in the afternoon by the Economy Ministry and the Ministry of Natural Resources, Environment and Climate Change. NETR Part 1 will be followed by NETR Part 2 and the National Industrial Master Plan (NIMP) 2030 by end-Aug 2023; mid-term review of the 12th Malaysia Plan (12MP, 2021-2025) at the special Parliament session on 11-19 Sep 2023; Budget 2024 on 13 Oct 2023; and Fiscal Responsibility Act and Government Procurement Act by end-2023.

- **External Balance Outlook:** June 2023 and 2Q 2023 saw exports fell -14.1% YoY and -11.1% YoY (May 2023: -0.9% YoY; 1Q 2023: +3.0% YoY); imports down -18.9% YoY and -11.5% YoY (May 2023: -3.7% YoY; 1Q 2023: +3.4% YoY). Trade surplus rose monthly (June 2023: +RM25.8b; May 2023: +RM15.7b), but shrank quarterly (2Q 2023: -8.8% YoY to +RM54.1b; 1Q 2023: +1.2% YoY to RM64.4b), suggesting net external demand was a drag on last quarter’s GDP growth.

- **Key domestic events and issues to watch:** S&P Global PMI MFG (1 Aug), Jul Foreign reserves (7 and 22 Aug), June Manufacturing sales, May IP (8 Aug), June Trade data (18 Aug) and June CPI (25 Aug).

- **Technical Outlook**: USDMYR has been pressing on the 50-dma at around 4.5050. Break there could open the way towards 4.3870. We see downside risks to this pair. Resistance at 4.5820.

IDR: Gradual Appreciation

Forecast	3Q 2023	4Q 2023	1Q 2024	2Q 2024
USDIDR	15,000 (-)	14,900 (-)	14,700 (-)	14,600 (-)

No Change from Previous Forecasts

- **Motivation for the FX View:** The USDIDR has spent most of July hovering around the 15,000 level after the pair had fallen earlier in the month as the DXY strength came off. We are keeping to our expectations in seeing a gradual decline of the USDIDR as UST yields may also only see a steady downward move too. The latter occurring amid the increasing likelihood that the Fed could be hitting peak rates soon before engaging in a pause for a while. A more pronounced move downwards in the pair would likely occur once it becomes clear that the Fed has pivots and Bank Indonesia (BI) then cuts rates, which raises the appeal of the IGBs, giving a boost to the IDR.

- **Growth and Inflation Outlook:** Our in-house economists continue to maintain their GDP forecasts at 5.00% YoY for 2023 as they expect domestic demand to remain steady in addition to seeing some boost from election-related spending in 2H 2023. Additionally, President Jokowi declared 28 – 30 June as collective Eid leave to create a 5-day weekend which could encourage travel and consumption and provide support to the economy. Meanwhile, exports could see some slump in the coming months given lower commodity prices compared to the prior year. However, the trade balance should still be in surplus due to lower global oil prices, which should at least prevent it from weighing negatively on the GDP growth.

- Headline inflation in June continue to keep easing downwards and surprised on the downside at 2.58% YoY (est. 2.64% YoY and May. 2.66% YoY). The lower number itself was driven partially by an easing in food prices due to the government maintaining adequate food stocks and aside the higher base in 2022 given the Ukraine conflict. Lower transportation costs also played a part in guiding the inflation number lower as it hit a 10-month low of 10.2% YoY (May. 10.6% YoY) given falling gasoline costs. Both prices of Pertamina Dex and Pertamax RON 92 fell -9.2% MoM and -6.8% MoM. The core number meanwhile itself also slowed below estimates to 3.52% YoY (est. 3.62% YoY and May. 4.00% YoY). As it stands now, both the headline and core numbers are within Bank Indonesia's (BI) target range. Despite this positive development related to easing inflation, we think that BI is unlikely to cut rates so soon given they would want to avoid hurting the IDR as other global central banks could keep rates at elevated levels for a while.

- Retail sales in June rebounded from a decline in May (due to calendar effect of Eid falling earlier this year), climbing by 8.05% YoY (May. -4.5% YoY). Meanwhile, the June consumer confidence index was slightly lower at 127.1 (May. 128.3). Despite the fall, the number itself is still elevated. The strength of both the retail sales and consumer confidence index numbers reflect that consumption can remain robust this year and provide support to the economy to stay on sound footing.

- **Monetary Policy Forecast:** BI unsurprisingly held rates at 5.75% at their latest June policy meeting as they look to provide support to the IDR as other DM central banks are likely to keep rates at an elevated level. They also maintained their GDP growth forecast at 4.5% - 5.3%. They continued to sound optimistic on the external balance as they kept their current account forecast at -0.4% to 0.4% of GDP. They see that the 2Q current account balance recording surplus although it would likely shrink due to falling commodity prices. Regarding inflation, they expect it to remain within the target range of 2 – 4% for the rest of 2023 and for it to average 1.5% - 3.0% in 2024. Going forward, our in-house economists expect BI to keep rates on hold for the rest of 2023 given their focus is on ensuring IDR stability. Their base case is also for the first cut to come in 1Q 2024 when the Fed eases too. However, they do note that BI may have the leeway to cut rates in 4Q 2023 if Fed ends its tightening cycle after September.

- **Latest Fiscal Outlook:** The country reported a budget surplus in end June of IDR152.3tn. Revenues jumped by 5.4% YoY whilst expenditure only rose by 0.9 YoY. The government now sees the 2023 budget deficit coming out at 2.28% of GDP, compared to their initial forecast of 2.84% of GDP amid an upward revision in the revenue outlook. Indonesia's improving fiscal position is providing more support to IGBs as supply is limited. Consequently, this is also giving a boost to the IDR. Meanwhile, for the 2024 budget draft, parliament has approved a key target budget deficit of around 2.16 – 2.64% of GDP. The target continues to reflect the strong fiscal discipline exercised by the government, which in turns supports sentiment towards the IDR.

- **Latest External Balance Outlook:** The country continued to resiliently maintain a trade surplus at $3.46bn for the month of June. However, the underlying numbers continued to reflect the worsening trade situation for Indonesia, which itself is in line with weakening global trade trends. Exports itself plunged by -21.18% YoY (est. -17.80% YoY) amid weaker commodity prices compared to last year and setbacks in China's economic recovery. Imports however also fell sharply by -18.35% YoY (est. -4.20% YoY) which was due to a broad based decline across the categories given lower demand in the economy. Our in-house economists still see that Indonesia can maintain a trade surplus even as exports fall given that imports would also decline concurrently due to lower oil prices. The maintenance of this surplus should continue to give support to the IDR.

- Foreign reserves continued to slide donwards for the month of June at $137.50 (May. $139.29bn) as the IDR continues to come under pressure from the uncertain global environment. The level of foreign resrves is now getting closer to the level of the low of 2022 in October of that year at $130.20bn. However, the central bank's reserve could get some boost down the road from the Indonesian government new rule on export proceeds (talked about more below).

- Indonesia introduced a new FX proceeds rule that would take effect from 1 Aug. The new rule requires that exporter with exporters with proceeds of at least $250,000 or its equivalent to keep 30% of export earnings onshore for at least 3 months. The rule though would only apply to the natural resource sector – mining, plantations, forestry and fisheries. There is no mandated conversion required but the regulation does allow the government to require it in times of crisis. We see only limited impact from the rule on the currency at this point. Exporters may not be incentivized to undertake conversion given that the rates for the BI USD term deposits stand much better than the IDR deposit rates. Furthermore, commodity prices of key exports such as coal and palm oil have fallen sharply from the 2022 levels, which reduces the amount of available proceeds. However, we also do note that the increase in the central bank's reserve can support IDR stability. Indonesia's Coordinating Minister of Economic Affairs Airlangga Hartarto has stated that the amount of proceeds that could be kept onshore may amount to $60bn a year.

- There was a moderate level of net inflow into Indonesia Government Securities (IGBs) which was at $0.46bn month to date until 21 July 2023. The flow though over the month was mixed, which is probably reflective of the uncertainty over the extent the Fed hiking cycle would still have to go and how long they would subsequently pause for at elevated rates. Flows were net negative earlier in the month before turning positive later. Going forward, we are not expecting stronger inflows into IGBs until possibly towards year end 2023 or into 2024 when the Fed starts to pivot and BI could possibly cut. Meanwhile, on the equities side, sentiment appears to be much stronger. Net foreign inflow is at $0.36bn month to date up until 26 July 2023, which is the strongest level of monthly inflow since April. Equity market players appear possibly to be more optimistic that BI would have to cut soon and hence, they may be looking to position earlier compared to their bond counterparts. We are expecting equity inflows could be volatile in the months to come given the uncertainty in the global economy.

- FDI for 1Q 2023 flatlined at $5.1bn (4Q 2023. $5.1bn) although it did represent a 20.2% YoY increase. The Investment Minister had noted that the manufacturing sector especially to the metal industry was the top ranked area to attract FDI. This may be a reflection of the result of the government's effort to strongly develop more-value added natural resources activities such as downstream processing of the raw materials. For now, we are still expecting that the level of FDI should at least remain stable in 2023 as the government continues to keep pushing ahead with attracting FDI into the downstream commodities area.

- **Key domestic events and issues to watch**: Jul CPI (1 Aug), Jul foreign reserves (7 Aug), 2Q GD (7 Aug), Jul consumer confidence (8 Aug), Jul trade data (15 Aug), Jul local auto sales (15 – 21 Aug), 2Q BOP CA balance (22 Aug) and BI policy decision (24 Aug).

- **Technical Outlook:** Pair is likely to hover around 15,000 in the near term as markets continue to assess when Fed rates are going to peak. Resistance is at 15222 (200-dma) and 15309 (FI retracement of 61.8% from May 2023 low to Dec 2022 high). Support is at 15008 (100-dma) and 14823 (FI retracement of 61.8% from Feb 2022 low to Dec 2022)

PHP: Strength Limited Amid Twin Deficit

Forecast	3Q 2023	4Q 2023	1Q 2024	2Q 2024
USDPHP	55.50 (-)	55.00 (-)	54.50 (-)	53.00 (-)

No Change from Previous Forecasts

- **Motivation for the FX View:** The USDPHP has seen some decline in line with the pullback in the USD. However, the fall though has lagged other ASEAN peers such as the MYR or the THB. This is not much of a surprise given that the USDPHP is likely to see more limited downward movements this year. Whilst the external environment can turn more favourable with some greenback strength coming off, the country's twin deficit position is going to be a limiting factor for the PHP appreciation. A continued hawkish stance by the BSP is likely to give some support to the currency but would not suffice enough to strengthen it further. We therefore stick to our forecasts which reflects this view of a gradual move down in the USDPHP.

- **Growth and Inflation Outlook:** 1Q 2023 GDP growth eased although it stayed above expectations at 6.4% YoY (4Q 2022. 7.1% YoY and est. 6.1% YoY) as external demand slumped. A slower global economy and world trade resulted in exports and imports of goods slowing whilst exports and imports of services stalled. However, domestic demand did pick up to 7.2% YoY (4Q 2022. 5.5% YoY) which help keep the overall growth number high. This came on top of stronger gross fixed capital formation and government consumption even as private consumption moderated. All economic sectors also saw expansion this quarter with the exception of mining which declined due to a fall in coal mining. Our in-house economists are overall maintaining their 2023 growth forecast at 5.5% as they expect further slowdown ahead domestic demand is weighed down by elevated inflation, interest rates and a slowing global economy resulting in sluggish external demand.

- High frequency indicators such as the S&P Global Mfg PMI released in June showed a decline to 50.9 (May. 52.2). The prior month had shown an increase in the index but the June number now affirms a downward trend in manufacturing activity is intact. This decline though is in line with a weakening in the global goods trade this year and we continue to expect that the mfg can risk seeing further falls for the rest of 2023, which in turn would weigh on the economy.

- Headline inflation though still remains elevated with domestic economic activity as a whole remaining firm. However, it was quite a fall as the number in June stood at 5.4% YoY (May. 6.1% YoY). The fall was driven by a deceleration in the food & non-alcoholic beverages category and a decline in transport costs. Core inflation at the same time is also still very elevated despite a slowdown at 7.4% YoY (May. 7.7% YoY). Our economists see that headline inflation should hit within BSP's target range of 2.0 – 4.0% by 4Q 2023 and maintain their forecast at 5.5% YoY for 2023. They do also see inflation risks are skewed to the upside given the El Nino weather conditions and the potential nationwide minimum wage hike. Therefore, the inflation situation is unlikely to allow the BSP to cut so soon as they continue to provide support to the PHP, which in itself is a factor in weakening inflation pressures.

- **Monetary Policy Forecast:** BSP held rates at 6.25% in the prior May meeting whilst there was no policy decision in June. The next would be on the 17 August 2023. Governor Eli Remolona has expressed a hawkish tone as he said it is still too "premature" to talk about a rate cut and that they are "worried" about the upside risks to inflation stemming from El Nino and the potential nationwide minimum wage hike. He would further go on to even say that they are actually "contemplating whether to hike or not to hike". The new governor's comments in its own right continues to give support to the PHP from a carry perspective, assuring investors that a sufficiently enticing rate differential would stay intact. For now, our in-house economists are expecting the BSP to stay on hold at 6.25% for the rest of 2023.

- **Latest Fiscal Outlook:** June budget balance swung further into deficit at -PHP225.4bn (Apr. PHP122.2bn) as revenue shrank by -7.91% YoY whilst spending only was a bit lower compared to year back at -2.59% YoY. From Jan – June, the budget was in deficit was at PHP551.7bn, which is lower compared to the same period last year at PHP674.2bn (though that was a period when the economy was just barely emerging out of the pandemic). Fiscal pressures are likely to keep persisting amid an high budget spending, which in turn would be a factor that weighs on the PHP and limits its strengthening going forward.

- **External Balance Outlook:** May trade balance was slightly narrower at -$4.4bn (Apr. -$4.5bn) but still in a deficit regardless. Exports managed to notch in a gain surprisingly at 1.9% YoY (est. -15.0% YoY) whilst the imports decline lower than estimates though at -8.8% YoY (est. -16.6% YoY). Our in-house economists have set their 2023 export and import forecasts at 3.0% YoY and 2.3% YoY respectively with expectations that the global economic and trade environment could be quite subdued. Their full year estimate for trade deficit is at -$59bn. The continued persistent trade deficit makes up the one of the component of the twin deficit condition for the country that would keep weighing on the PHP and limit its strengthening even amid a more favourable external environment.

- OFWR growth in May slowed and missed estimates at 2.8% YoY (est. 4.5% YoY and Apr. 3.7% YoY). There were slower repatriations from major countries that include the US, Canada, Europe (ex-UK) and Singapore. Our economists continue to hold their forecast of OFWR at 3.0% YoY for

2023 as global composite PMI continues to stay above 50.0. They also believe OFWR would remain resilient even during economic weakness as the past two downturns have shown that OFWs sustained their repatriations home to support their families during tough economic periods. Continued growth in OFWR should provide some support to the PHP although other factors such as twin deficit and the Fed and BSP rate paths are to be bigger drivers.

- Bonds saw foreign net inflow of $0.45bn for the three month ended 31 May. The inflow could have been driven by expectations then of DM central banks coming to an end with their tightening cycle and hence, pushing investors to position into high yielders. However, this data is dated and it is likely that there could have been some outflows in June when there were concerns that DM central banks may not actually be quite done with rate hikes. After June, increasing expectations again of the Fed tightening cycle ending soon could have induced some inflows. We expect that inflows could pick up going forward as Fed rates are likely to peak. This in turn should give support to the PHP although the mentioned earlier persistent budget deficit is still going to limit the extent of the appetite for bonds.

- Meanwhile, equities saw a net foreign inflow of $0.63bn as of 28 July 2023 as the PSEi has been seeing quite a rally this month given strong sentiment towards global equities from the US to China. Going forward, although there would be volatility in the global equity markets given the continued uncertainty and the risks of corrections, we still expect equities around the world to trend up amid the increasing likelihood of an economic soft landing and an eventual end to the Fed rate tightening cycle. Hence, equity inflows whilst it may be choppy in coming months could still likely to overall be positive in 2H 2023 and give support to the PHP.

- FX defensive buffers was slightly weaker in June as foreign reserves fell to $99.8bn (Apr. $100.6bn) as the PHP came under pressure during that month. For the rest of this year, foreign reserve levels could risk being drained amid the uncertain global environment.

- **Key domestic events and issues to watch**: Jul CPI (4 Aug), Jul foreign reserves (5 – 10 Aug), June trade data (8 Aug), 2Q agriculture output (9 Aug), June unemployment rate (9 Aug), 2Q GDP (10 Aug), June OFWR (14 – 18 Aug), BSP policy decision (17 Aug), Jul BOP overall (25 Aug) and Jul bank lending (28 – 31 Aug).

- **Technical Outlook**: Pair likely to remain around 54.00 – 55.00 near term. Resistance is at 55.33 (100-dma) and 55.81 (200-dma). Support is at around 54.45 (FI retracement of 50% from Dec 2021 low to Oct 2022 high) and 53.38 (FI retracement of 61.8% from Dec 2021 low to Oct 2022 high)

THB: Bumpy Road But Positive

Forecast	3Q 2023	4Q 2023	1Q 2024	2Q 2024
USDTHB	33.75 (35.70)	33.00 (35.25)	32.50 (34.80)	32.00 (34.50)

Previous Forecasts in Parentheses

- **Motivation for the FX View:** After a period being much of an underperformer for the first half of this year, the THB has seen quite substantial appreciation in the month of July. This occurred amid pulling back of USD strength, increased hope of a formation of a new Thai government and downward movements in the USD-CNH. Going forward, we see that developments are likely to work more in favour of the THB. With Fed rates peaking and a hold looking more likely, upward movement for the USD is likely to be more limited even if the greenback may still be supported on dips in the interim. The overall trend in the next year is for the greenback strength to gradually chip away. On the political front, there may still be uncertainty but we remain confident that a government can eventually be formed and the impasse would not drag on for too long. This should help give further support to the THB. We also expect the BOT to hike rates by 25bps in August, which would give near term support for the currency. Meanwhile, even though we are not expecting China to roll out big stimulus, we still believe that were be a more discernible pick-up in growth for the country towards year-end and a higher outflow of tourists. This should be a huge boost for the THB. Consequently, we feel our previous forecasts for the USDTHB had been too pessimistic and therefore, we are revising it lower.

- **Growth and Inflation Outlook:** Our economists have downgraded the forecast from 4.0% YoY to 3.8% YoY for 2023 as they see that the domestic outlook is somewhat dimmed given the anticipated post-election boost in fiscal spending and business spending may not materialize. Additionally, export growth looks likely to be weak this year due to weaker global goods trade situation even as tourism recovery may buoy the services portion. The Finance Ministry themselves have also trimmed their 2023 growth forecast to 3.5% YoY from 3.6% YoY. The downgraded growth outlook we think is unlikely to hold back the BOT's hawkish rhetoric as they stay vigilant of upside risks to inflation. However, the BOT's immense lag in the global rate hike cycle means that THB has not anyway been receiving much support from a carry perspective.

- More importantly, the continued return of tourists would be the a crucial factor in ensuring the THB can be on an appreciation path as it plays a key part in boosting the current account position even as the goods trade weakens.

- June headline inflation fell further close towards static level although it was still better than expectations at 0.23% YoY (est. 0.00% YoY and

May. 0.53% YoY). Lower food and energy prices amid the high base last year resulted in the lower inflation prints. Core inflation eased further to 1.32% YoY (est. 1.40% YoY and May. 1.55% YoY). June actually marked the second month in a row that inflation has fallen below the BOT's target range of 1-3%. Regardless, BOT's retains a hawkish rhetoric with upside risks of inflation in 2H 2023 especially with the continued return of tourists. Lower inflation is certainly helping real rates to be higher but on the other hand, as mentioned the BOT lagging well behind the rest of the world in the rate hiking cycle means the THB is likely to continue not getting much support from a carry perspective.

- **Monetary Policy Forecast:** The BOT continues to hold a hawkish rhetoric as they remain wary of upside risks to inflation going forward especially with the return of more tourists. The Governor has also been emphasizing that monetary policy would be focus more on the outlook than current data. Concerns around financial stability and the need to build policy space could also be other driving factors for the BOT expressing this hawkish tone. Our expectations is for the BOT to hike by 25bps on 2 August to bring the benchmark rate to 2.25%. From a currency perspective, it is hard to see that the THB would be sustainably impacted much by another hike given that the BOT has already been lagging the rest of the world quite significantly in the tightening cycle. There may be some knee jerk upward move in the THB but it may not hold up if the BOT does not strongly imply a series of more rate hikes.

- Foreign reserves as of 21 Jul was at $221.7bn as it generally rose compared to a month back as pressure was relieved on the THB with the USD strength pulling back and downward movements in the USD-CNH. There could be some stabilization or some gradual increases in the level of foreign reserves in the coming months as further USD upside is likely limited with Fed rates peaking in addition to the return of more tourists and China's economy possibly showing more discernible levels of recovery as we get closer to year end.

- **Latest Fiscal Outlook:** The political situation in the country continues to remain fluid as Pita Limjaroenrat has been unsuccessfully in his first vote to become Prime Minister (PM) while lawmakers blocked a second vote. Initially, parliament was awaiting clarity from the constitutional court on whether it was constitution for lawmakers to block Pita to be nominated for the PM post the second time. However, parliament is now going to still go ahead with a vote on the 4 August. Thai media has though also reported that the court itself would be meeting on 3 August to determine whether to accept the case on the constitutionality of blocking Pita's second vote. If they do accept the case, the court can order parliament ot postpone the 4 August vote until a ruling from it is issued. Pita has already said that he would give way to Pheu Thai to form the government should he fail. However, the general nature of his words do risk the possibility that the impasse could keep dragging on if he continuously persists on trying to be PM. Adding to the complexity of the situation, Thaksin is also slated to return to Thailand on 10 August with some speculating that Pheu Thai may have compromised with the conservative establishment to allow Thaksin to return. Move Forward are fearful that Pheu Thai is putting the pursuit of power ahead of principle and may abandon Move Forward in order to win conservative support to form the government. Pheu Thai on its part has said that for now, the coalition will stick with its original members and try to win more support. As it stands, Pheu Thai's PM candidate is Srettha Thavisin, a real estate tycoon. Despite the challenging situation, we remain confident in believing that a government can be formed in time and the impasse should not drag on for too long. This should give a boost for the THB as the political uncertainty has likely been limiting the extent of the currency's strengthening near term.

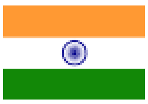
- **Latest External Balance Outlook:** June trade balance saw a larger surplus at $2.0bn (May. $0.055bn) as both exports and imports sharply fell by -5.9% YoY and -9.6% YoY respectively. The BOP CA balance though swung into surplus at $1.4bn (May. -$2.8bn). The surplus in the goods trade may have helped contributed to the CA surplus but the underlying numbers also do highlight weakness in the global goods trade given the contraction in overall trade value. Services trade though is likely to pick up further with the return of tourists and give a bigger boost to Thailand's external position going forward. Resultantly, this would provide support for the THB.

- From a portfolio perspective, equity saw an outflow month to date up to 27 July of -$0.4bn. This could be a reflection of the anxiety regarding the political situation. However, equity inflows should pick-up once there is a resolution. Bonds meanwhile saw a net inflow of $0.9bn month to date until 27 July, which could be due to investors now increasingly moving into EM bonds in anticipation of peaking Fed rates and possibly hoping to benefit from currency appreciation and eventually falling yields.

- **FDI performance would continue to be watch closely in 2023.** FDI for 1Q 2023 was at $2.0bn (4Q 2022. $1.5bn). It is challenging to see if FDI can pick up more strongly this year given Thailand has been facing increasing competition for neighboring peers for FDI with the country manufacturing wages being the second highest in ASEAN after Malaysia.

- **Key domestic events and issues to watch**: Jul S&P Global mfg PMI (2 Aug), BOT policy decision (2 Aug), Jul business sentiment index (2 Aug), Jul CPI (7 Aug), Jul consumer confidence (7 – 15 Aug), Jul car sales (18 – 24 Aug), 2Q GDP (21 Aug), Jul customs trade data (23 – 28 Aug), Jul ISIC mfg production index (25 – 30 Aug), Jul ISIC capacity utilization (28 – 30 Aug), Jul BOP CA and overall balance (31 Aug) and Jul trade data (31 Aug)

- **Technical Outlook:** We lean downward bias on the pair. Support is at 33.60 (FI retracement of 76.4% from Feb 2022 low to Sept 2022 high) and 33.00. Resistance is at 34.86 (200-dma) and 35.52 (FI retracement of 50.0% from Jan 2023 low to Oct 2022 high).



INR: Resilient in Sweet Spot

Forecast	3Q 2022	4Q 2022	1Q 2023	2Q 2023

USDINR	82.00 (--)	81.50 (--)	81.00 (--)	81.00 (--)

No Change from Previous Forecasts

- **Motivation for the FX View: We maintain our USDINR forecasts based on the belief that the INR is likely to strengthen gradually against the USD and that the RBI highly prefers a more stable USDINR exchange rate. USDINR remains one of the more stable pairs as the RBI sticks to its preferred approach of leaning against the wind to allow for orderly conditions in the FX market.**

- On FX intervention, we think that it is likely RBI sticks to its approach of "leaning against the wind" to enable orderly conditions in the FX market. India relies heavily on capital flows to fund its current account deficit and this opens the Indian FX market to large and lumpy flows which then generate bouts of volatility. The RBI steps in to then cushion this volatility and broadly means that they accumulate reserves in times of USD weakness and expend reserves in times of USD strength. As expected, this has played out with India's foreign reserves falling in May amid USD strength but rose in early to mid-Jun amid USD weakness. RBI has added about US$32b in reserves YTD, while its USD forward book has gained about US$10b in the first four months of 2023.

- India's external position has also improved as its current account deficit has narrowed to around 2.0% of GDP in 1Q23, from 2.2% of GDP in 4Q22, and compared to 3.7% of GDP in 3Q22. This is due to a combination of commodity prices coming off and a resurgent post-pandemic export of Indian services. Net services exports in FY23 were close to US$150b versus FY22's US$110b. All in all, this has provided the INR with some support as it remains resilient.

- We think the INR should trend lower over the next four quarters as economic fundamentals remain robust. GDP growth has been healthy, inflation has meaningfully abated and the current account deficit has improved. That said, RBI's approach of leaning against the wind should keep USDINR within a controlled range and we should see an increase in India's FX reserves over this period. We also caution that RBI's approach makes it tricky to profit from a long INR position.

- **Growth and Inflation Outlook:** India's 1Q23 GDP re-accelerated to 6.1% YoY (exp: 5.0%; prev: 4.5%) surging ahead of expectations. Annual Estimate for 2023 GDP is at +7.2% YoY (exp: 7.0%) and the re-acceleration in GDP implies that the undershoot of the level of GDP from pre-pandemic potential trend has narrowed to about 5%. The positive surprise was largely due to stronger Indian exports and a continued emphasis on public investment by the government.

- CPI inflation has largely abated in India as food prices meaningfully undershoot expectations and core inflation has moderated despite remaining sticky in 2022. Although the latest Jun CPI inflation print came in at 4.81% (prev: 4.25%), core inflation has been relatively stable at 5.12% (prev: 5.11%). %). The recent uptick in headline inflation was due mainly to an increase in food prices. All things considered, despite the recent acceleration in headline CPI inflation, the inflation situation in India thus looks to be under control, as opposed to the situation that several other countries are facing where core price pressures have picked up noticeably.

- Industrial Production in May came in higher than expected at +5.2% YoY (exp: 5.0%; prev: 4.5%) as mining activities surged 6.4% YoY (prev: 5.1%) and factory activity rose 5.7% YoY (prev: 4.9%). Electricity production rebounded to 0.9% YoY (prev: -1.1%). Overall, the increase in output looks to provide a positive impetus for India's GDP growth.

- **Monetary Policy Forecast:** In essence, the RBI is in a sweet spot given that growth is healthy and inflation looks to be under control. Broad consensus expects that the RBI will be on a prolonged pause and the bigger question is if there will be a change in its stance of "withdrawal of accommodation" to "neutral". We feel that given that upside risks to inflation still exist e.g. oil/commodity price shocks and El Nino affecting food prices, the RBI may decline to be too optimistic in its outlook. We look for RBI to maintain their policy rate at the upcoming August meeting, and perhaps for it to refer to the positives while retaining some flexibility to react to any changes to the growth/inflation outlook. They may soften their stance, but not as materially as some might expect. Moreover, while US yields have risen over the past couple of months, Indian yields have fallen about 30bps over the same period which implies that real monetary conditions are normalizing more slowly and are more accommodative than pre-pandemic levels. Our base case is therefore for the RBI to hold their policy rate steady, but be hawkish in terms of the language that accompanies the policy statement.

- **Latest Fiscal and External Balance Outlook:** India's FY23 budget remains an expansionary one with expenditures estimated to be at US$560b and revenues at US$530b. The fiscal deficit however is expected to fall to 5.9% of GDP (prev: 6.4%). The budget looks to lend economic support through favourable income tax structures, an increase in government capital spending and a push toward job growth and support for agricultural and adjacent sectors.

- India's trade balance stood in a deficit of -US$267.7b on an NSA basis in May. However, as earlier mentioned the current account deficit narrowed meaningfully in 1Q23 to around 2% of GDP (-US$67b). India's external position looks to have improved and as we have earlier asserted this should continue to provide support for the INR.

- **Key domestic events and issues to watch in Aug:** Jul S&P Mfg PMI (1 Aug), Jul S&P Services/Composite PMI (3 Aug), RBI Policy Decision (10 Aug), Jun Industrial Production (11 Aug), Jul Trade Balance (12 Aug to 15 Aug), Jul Exports/Imports, Jul CPI, Jul Wholesale Prices (14 Aug), Jul Fiscal Deficit, 2Q GDP (31 Aug).

- **Technical Analysis:** 1M USDINR NDF last traded at 82.30 with stochastics at oversold levels, while RSI remains neutral. Momentum looks to be neutral. Support is at 81.50 (fibo), while resistance is at 82.30 (200dma) and 83.00 (psychological).

VND: Looking Up

Forecast	3Q 2023	4Q 2023	1Q 2024	2Q 2024
USDVND	23,500 (--)	23,400 (--)	23,300 (--)	23,200 (--)

No Change to Previous Forecasts

- **Motivation for the FX View:** We keep the USDVND forecasts trajectory unchanged. Moves of the pair have been muted for much of the past month. Equity markets remained on the rise with the HCM Index up around 9% (1-31 Jul). Investors appear assured by the the government's growth measures including aggressive interest rate cuts, launching a VND15trn credit package for forestry, fishery businesses, cutting VATs and a surge of realized state investment in infrastructure to support the economic recovery in the face of a slowing global economy. For the first half of the month, Vietnam experienced net equity outflow of up to $111.92mn before reversing higher in the second half of the month. While portfolio flows remain rather volatile, FDI inflows remains healthy with average pace of around $1.7bn realized FDIs seen for the first seven months this year, cushioning the VND. We continue to look for the USDVND to soften towards 23200 over the next 12 months as most central banks end their respective tightening cycles while global growth slows gradually. Potential for a gradual China recovery, release of key electronic products may even generate an export recovery for Vietnam into the 4Q of the year and that is positive for VND.

- **Key risks to this view** is for a reacceleration of inflation in the US that could inject more uncertainties on Fed's policy trajectory or contagion from corporate defaults that could weigh on domestics assets and concomitantly, the VND. However risks ofa systemic crisis seem to have reduced recently. Our equity analysts noted that suspended projects have been allowed to resume and developers may see better cashflow from here.

- **Growth and Inflation Outlook:** Our economist maintains GDP forecast at 4% for 2023 and 6% for 2024**, expecting a moderate export recovery potentially in 4Q.** Jul saw the strongest growth of computers & electronics up +32%y/y, vs -3.5% in Jun. On the other hand, telephones & components fell -18.4% vs. -8.8% in Jun but this could reverse especially with new product releases (Samsung) expected in the second half of the year. Retail sales picked up pace to 7.1%y/y from previous 6.5%. This corresponds to the rise in foreign visitor arrivals with arrivals from mainland china already at 44.3% of pre-pandemic levels as of Jul and could potentially continue to remain on the uptrend.

- With regards to the real estate, the HCMC Real Estate association urged the immediate allocation of funds to the real estate sector to drive economic growth, noting weak demand, lack of cash flow, declining liquidity and insolvency for real estate businesses (The Saigon Times).

There are observations that projects that have been suspended were allowed to continue and that could mean developers are now facing better cashflow. Risks of a further deterioration in the real estate sector or any systemic crisis seem to be fading on that front.

- Vietnam continued to strengthen trade relations with multiple nations. Vietanm forged an FTA with Israel (25 Jul), came to an agreement with Malaysia to increase bilateral trades to $18bn by 2025 from $14.8bn as of 2022. There will also be more cooperation in digital economy, defense and security. Separately, US Treasury Yellen and SBV Head Nguyen Thi Hong had also agreed to streamline trade and intertwine their FIs to boost bilateral economic relationship. These could mean that the FDI flow could continue.

- Our economist maintained Inflation forecasts at 2.8% in 2023 and 3.5% in 2024, expecting food & food services to ease on base effects while deflation in transport should narrow in coming months

- **Monetary Policy Forecast:** There have been calls from PM Pham Minh Chinh for the SBV to lower average rates and direct credit to production and other growth sectors, pointing out that the credit growth in 1H was low and commercial lending interest rates are high and businesses encountered challenges in credit access. In response to that, SBV Deputy Governor Dao Minh Tu told the press that the central bank may lower interest rates with commercial banks in order to ease credit conditions for businesses if conditions allow. Our economist noted that this suggests caution on the part of SBV. We concur. SBV could lower deposit rate by another 25bps in 3Q which would take the total reduction to 150bps. There would be no further change to refinancing and discount rates that have been lowered by 150bps this year.

- Thus far, VND has reacted calmly as Fed's less hawkish language (over the past few quarters) had allowed a more benign US interest rate environment for SBV to ease without jeopardizing the stability fo the VND too much. That said, we cannot rule out a tail risk of a reacceleration of inflation in the US that could generate a tad more volatility.

- **Latest Fiscal and External Balance Outlook:** Current account flipped into surplus of around $6.5mn for 1Q 2023 vs. the deficit of $-1.0n in 4Q 2022. Our economist looks for a potential recovery in exports in 4Q.

- As for fiscal, the state budget revenue is expected to be around VND1.62 quadrillion ($68.5bn), up 0.4% from 2022 and state budget expenditure at VND2.07 quadrillion, a 16.3% increase from 2022. State budget deficit to come in around VND455.5trn which would be 4.42% of GDP. Central budget deficit will amount to VND430.5trn (4.18% of GDP), local budget deicit at VND25trn (0.24% of GDP).

- **Key domestic events and issues to watch:** Aug CPI, Industrial production, Trade are due 25-31 Aug.

FX Forecasts

	End Q3-23	End Q4-23	End Q1-24	End Q2-24
USD/JPY	138.00	136.00	132.00	125.00
EUR/USD	1.0800	1.0900	1.1100	1.1300
GBP/USD	1.2700	1.2400	1.2400	1.2300
AUD/USD	0.6500	0.6800	0.7000	0.7000
NZD/USD	0.6300	0.6500	0.6700	0.6700
USD/CAD	1.3300	1.3100	1.3000	1.3000
USD/SGD	1.3350	1.3250	1.3250	1.3150
USD/MYR	4.6000	4.5000	4.3500	4.2000
USD/IDR	15000	14900	14700	14600
USD/THB	33.75	33.00	32.50	32.00
USD/PHP	55.50	55.00	54.50	53.00
USD/CNY	7.15	7.10	6.95	7.00
USD/CNH	7.15	7.10	6.95	7.00
USD/HKD	7.82	7.80	7.79	7.78
USD/TWD	31.25	30.50	30.25	30.00
USD/KRW	1300	1280	1270	1250
USD/INR	82.00	81.50	81.00	81.00
USD/VND	23500	23400	23300	23200
DXY Index	102.65	101.94	100.30	98.61
	End Q3-23	End Q4-23	End Q1-24	End Q2-24
SGD/MYR	3.45	3.40	3.28	3.19
JPY/SGD	0.97	0.97	1.00	1.05
EUR/SGD	1.44	1.44	1.47	1.49
GBP/SGD	1.70	1.64	1.64	1.62
AUD/SGD	0.87	0.90	0.93	0.92
NZD/SGD	0.84	0.86	0.89	0.88
CAD/SGD	1.00	1.01	1.02	1.01
SGD/IDR	11236	11245	11094	11103
SGD/THB	25.28	24.91	24.53	24.33
SGD/PHP	41.57	41.51	41.13	40.30
SGD/CNY	5.36	5.36	5.25	5.32
SGD/HKD	5.86	5.89	5.88	5.92
SGD/TWD	23.41	23.02	22.83	22.81
SGD/KRW	974	966	958	951
SGD/INR	61.42	61.51	61.13	61.60
SGD/VND	17603	17660	17585	17643
	End Q3-23	End Q4-23	End Q1-24	End Q2-24
JPY/MYR	3.33	3.31	3.30	3.36
EUR/MYR	4.97	4.91	4.83	4.75
GBP/MYR	5.84	5.58	5.39	5.17
AUD/MYR	2.99	3.06	3.05	2.94
NZD/MYR	2.90	2.93	2.91	2.81
CAD/MYR	3.46	3.44	3.35	3.23
MYR/IDR	3261	3311	3379	3476
MYR/THB	7.34	7.33	7.47	7.62
MYR/PHP	12.07	12.22	12.53	12.62
MYR/CNY	1.55	1.58	1.60	1.67
MYR/HKD	1.70	1.73	1.79	1.85
MYR/TWD	6.79	6.78	6.95	7.14
MYR/KRW	283	284	292	298
MYR/INR	17.83	18.11	18.62	19.29
MYR/VND	5109	5200	5356	5524

Source: Maybank FX Research and Strategy as of 1 August 2023.
*These forecasts are meant to be indicative of FX trends and not meant to be point forecasts.

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