

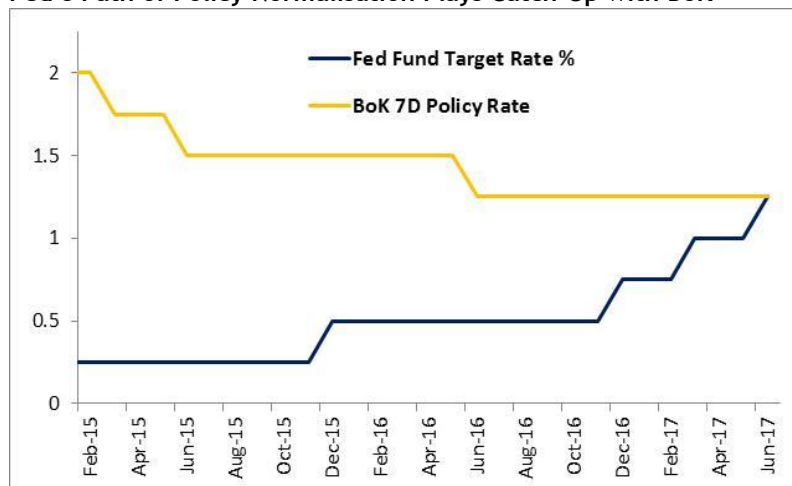
FX Insight

KRW: Retracement Risks Ahead

Focus for USDKRW this week is on BoK meeting tomorrow (13 Jul). We acknowledged that BoK Governor Lee had hinted (on 12 Jun) at the possibility of raising the benchmark rate over time. In particular he said there is a need to adjust the extent of monetary easing if economic conditions show a marked improvement. His comments came amid rising headline inflation (hovers around BoK's target of 2%), exports recovery and strong consumer sentiment (6-year high), and the BoK is expected to raise 2017 growth forecast again at the upcoming meeting.

We do not see a strong case for BoK to rush into raising rates at the upcoming meeting despite the rise in Korea's inflation towards BoK's target level of 2% level and BoK Governor Lee's hint (12 Jun) at the possibility of raising the benchmark rate over time. Though the economy may have shown signs of pick-up in momentum, we do not see any urgency for BoK to rush into premature tightening of monetary policies. Recovery in private consumption (+0.4% q/q in 1Q) continues to pale in comparison to previous quarters while inflationary pressures from the demand side are not expected to be high. The government is also in the process of hoping to push through KRW11.2tn supplementary budget to create jobs and we believe BoK is likely to coordinate with the government in keeping monetary conditions loose during this period.

Fed's Path of Policy Normalisation Plays Catch-Up with BoK



Source: Bloomberg, Maybank FX Research

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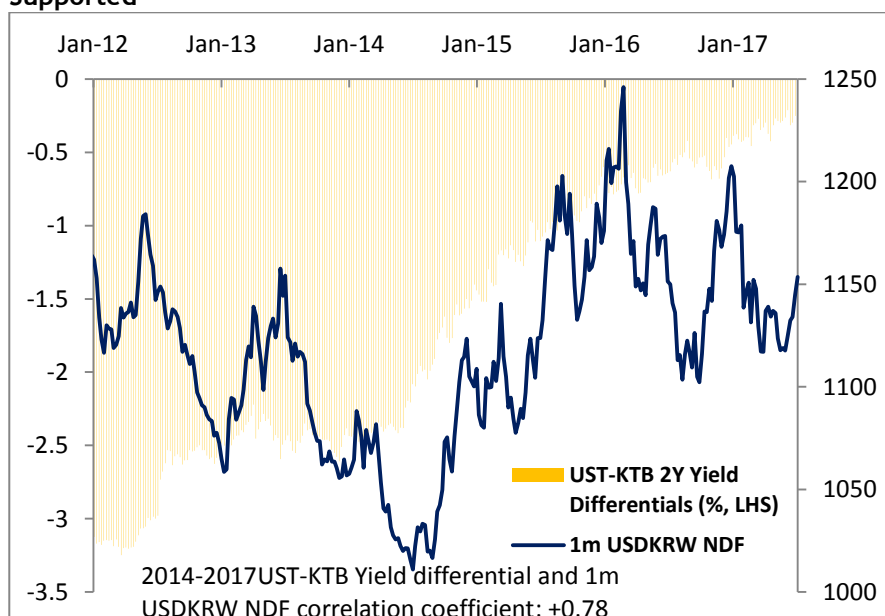
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Normalising Fed Meets Accommodative BoK

Recent FoMC meeting (15 Jun) and Fed speaks suggest that Fed is determined to normalise monetary policy. Fed is still looking for another 25bps hike and to start balance sheet unwinding this year, and possibly another 3 rate increases each year for 2018 and 2019. Contrast this against BoK which is expected to keep monetary policy accommodative for the time being should see monetary policy divergence growing and re-exert a widening of UST-KTB yields. Fed fund policy rate has now caught up with BoK at 1.25% while 2Y yield differentials between UST and KTB has narrowed from -42bps (in mid-Apr 2017) to about -25 bps (end-Jun 2017) and eventual market re-positioning for higher UST yield should see UST-KTB re-widening in favor of UST, and this should keep USDKRW broadly supported.

Potential Widening of UST-KTB Differentials to Keep USDKRW Supported



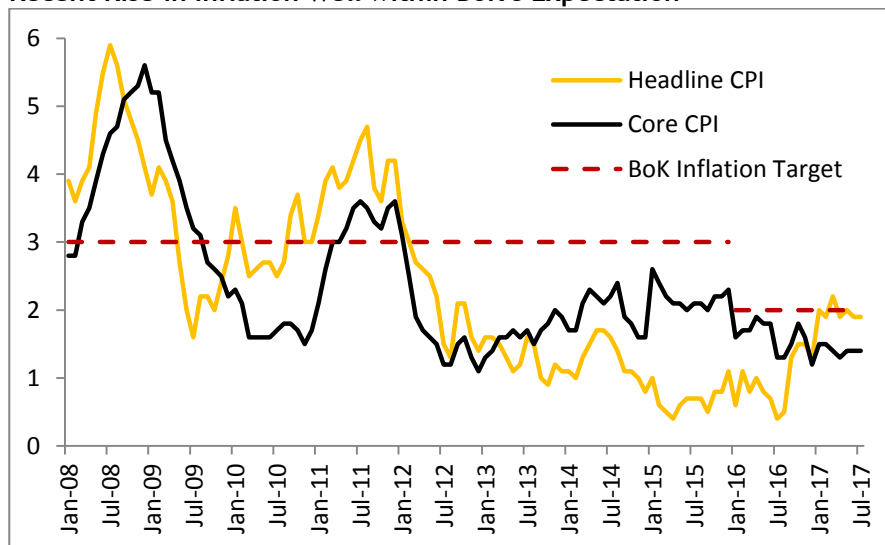
Source: Bloomberg, Maybank FX Research

Inflation Expected to Fluctuate around BoK's Target

Though headline CPI slowed in Jun (1.9% y/y vs. 2% in May), the headline inflation continues to hover around 2% this year. Recent increase was due to price jumps in fresh food and imported fuel.

The uptrend is likely to be sustained at around current levels of 2%, which is also BoK's target CPI for 2016 - 2018. This is unlikely to force the hand of BoK to tighten prematurely as inflation has been supply-side driven. Inflationary pressures from the demand side remain soft for now. Core inflation was last seen at 1.4%, and is also expected to stay in the mid-to-upper range of 1%.

Recent Rise in Inflation Well within BoK's Expectation



Source: Bloomberg, Maybank FX Research

Supplementary Budget May Support Domestic Demand But...

The government led by President Moon has submitted the KRW11.2tn supplementary budget proposal to the Assembly (7 Jun) for approval. The plan is focused on job creation (about 110,000 jobs including 71,000 jobs in the public sector), to support growth (helping domestic demand recover). This was part of Moon's election campaign and is in response to rising unemployment. Unemployed persons stood at near recent high of 1.003 million (a small decrease from 1.17 million in Apr).

But the plan is currently facing objections from the opposition, whom has taken a negative view. A majority vote in the 299-seat Assembly is required for the supplementary budget to be passed but the ruling party only holds 120 seats. Question remains if this can pass.

FX Bias Remains to Buy USDKRW on Dips

We still expect USDKRW to trade higher. Fed's determination to tighten policy should continue to see UST-KTB bond yields narrowing further and potentially lead to a widening of UST-KTB yield differentials and keep USDKRW supported while concerns about potential withdrawal of global monetary stimulus is expected to tighten financing conditions, weigh on risk sentiment and keep USDKRW supported.

Technical Thoughts - Risk of Retracement but Bias to Buy on Dips

We have been bullish on the pair (see [here](#) and [here](#)), and have been looking for 1m USDKRW NDF to trade higher towards 1155 - 1160 levels. The pair had traded a high of 1158 (6 Jul) before easing. Last seen at 1146 levels. Bullish momentum on weekly and daily chart remains intact. But momentum on daily chart shows signs of waning and stochastics on the daily chart is showing tentative signs of turning lower from near-overbought conditions. These signals suggest the **risk of retracement in the near term, possibly towards 1141 (21 DMA) or even 1131 (50 DMA).** But our bias remains to buy on dips, looking for an eventual move towards 1160 levels (50% fibo retracement of 2017 high to low). An extended move towards 1173 (61.8% fibo) should not be ruled out.

1m USDKRW NDF - Retracement Risks but Bias to Buy on Dips



Source: Bloomberg, Maybank FX Research

SGDKRW, MYRKRW - Retracement Risks Lower in the Near Term

SGDKRW is also exhibiting signs of retracing from recent gains. Cross was last seen at 830 levels. Stochastics is falling from near-overbought conditions. Next area of support seen at 822 - 825 levels before 817 (50% fibo retracement of recent up-move from Jun low to Jul high). But 50DMA shows signs of cutting 200 DMA to the upside - potential golden cross in the making - bullish signal. Bias to buy on dips.



Source: Bloomberg, Maybank FX Research

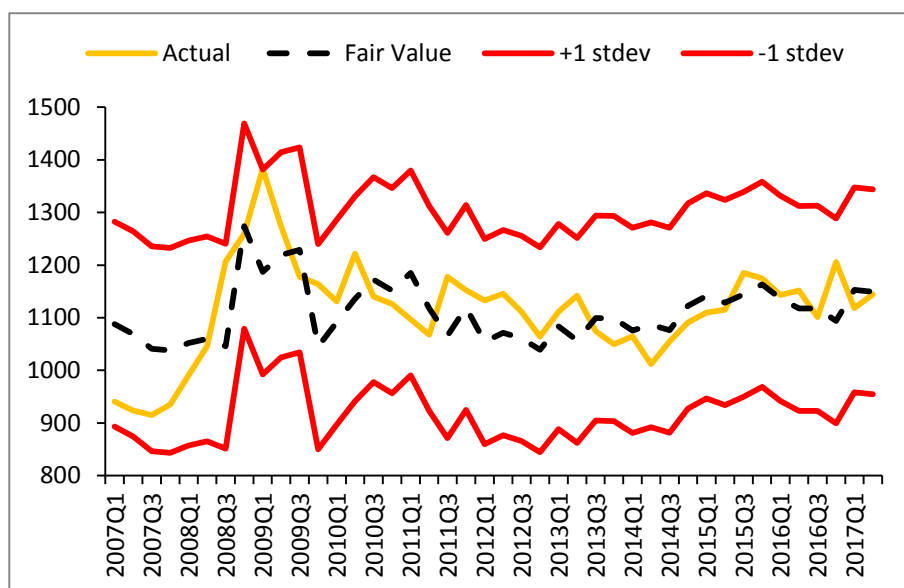
MYRKRW was last seen at 266 levels, after a 7% rally since Mar-2017. Technical signs suggest the risk of retracement from recent run-up, with support at 262. Bias to buy on dips for move higher towards 274 - 280 levels.



Source: Bloomberg, Maybank FX Research

USDKRW About Fairly Valued at 1150 Levels

Our in-house fair value model which aims to estimate the short to medium term fair value of USDKRW based on 3 cyclical factors - the differential between US and UK current account to GDP ratios; 10Y bond yield differentials between US and KTB adjusted for inflation and a reflation proxy defined as the ratio of World Equities (proxied by MSCI World Index) to World Government bonds (proxied by JP Morgan Global Aggregate Bond Index) - suggests the fair value to be around 1150 levels.



Source: EvIEWS, Bloomberg, CEIC, Maybank FX Research

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