QUARTERLY GLOBAL OUTLOOK

Third Quarter 2017

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Information as of 23 June 2017

GlobalEcoMktResearch@UOBgroup.com
www.uob.com.sg/research
Bloomberg: UOBR

EXECUTIVE SUMMARY
A Darker Shade Of Goldilocks

With half of 2017 now behind us, are we optimistic or pessimistic for the remaining 6 months of this year? In the true spirit of economics, we are "cautiously optimistic". The World Bank maintained its global growth forecast at 2.7% (Jun) while the IMF has a more bullish 3.5% growth expectation for 2017 (April 2017 WEO). The synchronized global revival led by (but not limited to) the developed markets including US, Europe and Japan remains intact with the outlook for Europe most promising especially after the parliamentary success of new French President Emmanuel Macron and his En Marche! Party. Expectations are that in the next five years Macron can lead the charge to reform, not just for France, but also the bigger European Union even though he still faces hurdles.

Asian economies also played their part to support the positive growth picture as they collectively drove 9.4% y/y growth in exports in the first four months of 2017, which was not too surprising as economic activities in final demand countries (mainly developed economies) continues to improve. Economic outlook for China, Asia's most important economy, is also looking up as IMF upgrades its 2017 growth forecast to 6.7% (14 Jun) notwithstanding the various challenges it is still grappling with such as the ever growing corporate leverage. That said, the stellar growth in Asian exports could moderate in 2H especially since we think that the current electronics cycle (which has been rising for 16 consecutive months) may be coming to an end. That will put Asia growth on a weaker footing in the later part of 2017, adding a shade of grey to the growth picture.

Inflation: Transitory Or Disrupted? Perhaps the most confounding part of the US economy is the US price environment. While the unemployment continues to grind lower, wage growth remains largely benign and inflation even soften in recent months. Notwithstanding certain one-off factors, the tighter labor market would eventually push wage growth higher and that should feed into higher inflation in 2H. But what if it doesn't? If inflation continues to fade amidst the tightening labor market, then perhaps some factors could be at play not just in US but also globally. We think that the sharing economy (fueled by disruptive technologies) has been subsidizing costs to gain market share/ kill off competition, and that could have suppressed the prices of major segments within the CPI/PCE (such as food services, and transport) while at the same time encouraging more of the workforce into the employment of the shared economy. The reason why companies can do that is because of funding from eager investors, and the reason for the eager investors is that money is cheap because the interest rate is low and investors want to seek higher returns, so they end up looking for the next "unicorn", perpetuating the "soft inflation-low unemployment" environment for longer with the inflation "spring" being wound even tighter and waiting to spring back with a greater vengeance. Thus, the paradoxical remedy to re-accelerate inflation could be higher interest rates soon and not later.

In our view, the Fed Reserve remains on course to hike rates once more in September and its monetary policy is likely to diverge from the rest further in 2H. It assumes higher wage growth will emerge in 2H and that the Fed also wants an adequate amount of interest rate buffer before it embarks on its next big project – balance sheet reduction (BSR). We expect the Fed to announce BSR in the Dec FOMC to be implemented in Jan 2018.

Forecasting the dollar direction is tough in 2017. We started the year full of enthusiasm for a stronger US dollar, driven by the expectations of "Trump effect". Alas, President Trump's promises of expansionary economic & fiscal policies faded in 1H, and the dollar slipped into ignominy despite the Fed Reserve remaining steadfast in its rate normalizing path. For more US dollar downside, the most direct and plausible factor will be, more disappointment in Trump and his administration. On the other hand, for US dollar upside, a sudden, unexpected improvement in the US political environment and the Congress approving some of Trump's expansionary policies

would be dollar positive but this looks like a very tall order in current circumstances. One factor that may provide a currency surprise is the planned balance sheet reduction (BSR). If the BSR is pushed earlier in 2H 2017, then that may imply a tighter than expected US monetary policy in 2017 which may lift the US dollar. Conversely, a delay in BSR could weaken the US dollar.

What are the known risk events in 3Q and beyond? There is the **German federal election** on 24 Sep 2017 (right after the Northern Hemisphere summer) but expectations are in favor of incumbent Chancellor Angela Merkel and her Christian Democratic Union/Christian Social Union (CDU/CSU), which still maintains double-digit lead over the main contender Social Democratic Party (SPD) led by Martin Schulz. In the US, the country is once again facing the **US government debt ceiling limit** this coming September and failure to raise the ceiling could result in a US sovereign default but we do not think it will happen in Trump's first year as US President. The **UK with its Brexit negotiations** and maybe another election? China is another risk but nothing is expected to happen ahead of its all-important 19th National Congress of the Communist Party of China in 4Q 2017. Beyond geo-politics, **crude oil price** could be in for another volatile period in 3Q. **North Korea** will remain an on-going issue as it remains the hotspot in Asia in terms of geo-political risk. **Terrorism incidents** are another on-going, ever widening challenge. Meanwhile, volatility in financial markets is very low so far in 2017, so low that it appears that the markets have been lulled into complacency.

Happy summer lull (or not) ahead!

ASEAN FOCUS: US Fed Balance Sheet Normalization & Impact On ASEAN FX

The FOMC released more details on its planned balance sheet reduction (BSR), still expecting to implement in a gradual manner this year but again did not specify the start date or the eventual level of the balance sheet they hope to achieve. We expect the Fed to hike rates once more in Sep before announcing BSR in the Dec FOMC to be implemented in Jan 2018.

Based on the FOMC details, we expect the Fed will run down US$180bn of UST holdings and US$120bn of MBS holdings in 2018.The UST reinvestment rate of approximately 58% in 2018 and the Fed's Balance sheet will be reduced to US$4.18 trillion by the end of 2018, further to US$3.58trn by end-2019, and US$2.98trn by end-2020. It will reach our (expected) terminal balance sheet size of US$2.53trn by 3Q-2021. An earlier than expected BSR in 2H 2017 may imply a tighter than expected US monetary policy in 2017 and that may lift the US dollar, Conversely, a delay in BSR could weaken the US dollar.

We look at market reactions in the previous episodes of similar development (i.e. 2013 "taper tantrum" and China's abrupt adjustment to its USD/CNY fixing mechanism on 11 Aug 2015) to gauge the potential impact on ASEAN markets and currencies. On the assumption of no significant changes to US fiscal/tax/trade policy and the stability of the Chinese economy, the depreciation in regional currencies against the USD would likely be well contained in the event of BSR, but some of the regional countries will be more vulnerable than others but improved fundamentals – such as real interest rates, foreign exchange reserves, in ASEAN are expected to provide buffers to risks of capital outflows. We also see room for regional central banks to raise interest rates, probably with Philippines and Indonesia starting off the rate hikes. The corrections in the ASEAN currencies will therefore unlikely be to the same extent of the 2013 "taper tantrums" in our view, particularly for the rupiah and ringgit.

CHINA IN FOCUS: Belt And Road Initiative And What It Means

The recently concluded Belt and Road Forum for International Cooperation ("BRF", held in Beijing on 14-15 May) was attended by more than 1,500 delegates from over 130 countries and some 70 international organizations, Chinese President Xi Jinping noted the need to join hands to meet the global challenges in the principle of extensive consultation, joint contribution and shared benefits. Potential beneficiaries from the B&R Initiative include: RMB internationalization, ASEAN and industries/sectors aligned towards the initiative.

ASIA FOCUS: Expected Slowdown In Asian Export Growth To Add Pressure On ADXY In 2H 2017

Recent improvement in the final demand for goods from developed countries saw China imports from the world growing at 20% y/y in the first four months of 2017 as its factories rushed to churn out the goods. Using data from satellites aiming at over 6,000 Chinese industrial sites, we found that manufacturing activities were up 7.2% y/y in the first four months of the year.

Higher imports and industrial production due to an improvement in the final demand for Asian-produced goods imply stronger demand for Asian currencies, driving up Asian FX. However, we do not think that this phenomenon will continue into the second half of 2017, especially since the current electronics cycle may be coming to an end. We expect increasing downward pressures on Asian currencies.

GMS IN FOCUS: Thailand's Eastern Economic Corridor: The Next Major Economic Zone Of ASEAN

Thailand's Eastern Economic Corridor (EEC) is the enhancement of the former Eastern Seaboard, which had been for over thirty years GMS's powerhouse for manufacturing and trade. It consists of the three Eastern provinces Rayong, Chonburi, and Chachoengsao with a combined area of 13,285 square kilometers. The EEC will see extensive infrastructure investments of USD45bn to support transport, logistics, and public utilities during the next five years. The project will be financed through a combination of government, private and PPP funding.

The EEC could be seen as part of the Chinese geo-economic doctrine for OBOR (One Belt, One Road) the trans-national connectivity project to connect China with Asia, Europe and Africa through the land corridor and the sea corridor to augment global trade and economic cooperation.

We believe that the EEC will be a major game changer promoting sustainable economic growth to pave Thailand's way out of the Middle Income Trap. The EEC will also help make transportation of goods within the region faster and more convenience, which means more business opportunities contributing to the overall welfare of the local people and the GMS expansion. However, the project may be just a small start of long-term endeavor. Here we identify that educational reforms, legal improvements, improvements on government efficiency and good governance are among the factors that are very significant both in improving competitiveness and generating domestic demand that will sustain Thailand's long-term growth.

FX STRATEGY:
FX Themes For 3Q

The themes we are focusing on this quarter include buying EUR/USD on dips for a mid-term upswing, picking up cheap hedges and fading Asian outperformance.

RATES STRATEGY:
Revising Our SG And US Rates Forecasts Lower

We have revised our rates outlook for both SG and US rates lower in recognition that most of our expected upside catalysts have not resulted in a durable positive feedback loop for yields. Downshifting the forecast curve is reasonable now that we are entering into the seasonally weak months, between May and August, for risk assets. In addition, we are not optimistic of bold policy actions taking place during the northern hemisphere summer lull. However, we continue to hold to an upside trajectory in both the SG and US rates path since the known upside yield catalysts are merely dormant rather than extinct. There are also valid concerns that valuations in the rates space are already on the dovish end of the scale when we exclude a recessionary scenario, thus room on the downside for yields may be limited from prevailing levels.

Global FX

EUR/USD: The EUR has strengthened steadily since the start of this year reflecting both positive economic momentum and broad political relief. Compared to the previous quarter, our EUR/USD projections have been revised higher. This is in part due to a less bullish US dollar. The policy divergence between the ECB and the Fed remains relevant, but we also see this divergence slowing.. The sustained US deficit and Eurozone surplus also illustrate the potential for support in the pair. That said, much of these factors have been priced in, and unless we see more aggressive ECB rhetoric, we are not convinced of too much upside in the EUR/USD from current levels. This explains the mild upward trajectory in our EUR/USD forecasts.

GBP/USD: The tone of the forthcoming negotiations will be a crucial factor in how GBP performs. In the short term, the prevailing political drama will keep the GBP soft and volatile. What matters for the GBP further out are the terms surrounding Brexit. The pursuit of a "softer" Brexit stance has given hope for some that come March 2019 there will be no cliff-like scenario on trade policy. Still, EU leaders hold all the ace cards at the negotiating table. We could get more clarity on the Brexit terms along the way, and this is likely to provide episodes of relief and upside for the GBP. However, the UK faces a long road ahead before one can get a clearer picture about its future economic direction. As such, we think rallies in the GBP would be capped by a subdued domestic economic outlook.

AUD/USD: AUD/USD has staged a modest recovery from its multi-month low in early May. Still, the pair looks poised to remain in ranges. Our current forecasts see AUD/USD trading close to current levels and possibly even lower, as ongoing low interest rates in Australia and rising interest rates in the US would suggest that the interest-rate differential between Australia and the US will continue to widen. Domestically, Australia's hands are tied on monetary and fiscal policies, and this makes it difficult to be optimistic on the AUD. In addition, concerns with the wages/employment conundrum should be particularly pertinent where considerable spare capacity still exists in labour markets .Thus, we could still see the need for easier financial conditions in Australia.

NZD/USD: The NZD has outperformed of late, rising by over 5% against the USD since early May, to become the best performing currency within the G10 space. We see that broad medium-term thrust for the NZD/USD remaining towards the upside, bearing in mind the strong growth, employment and population backdrop in New Zealand. But we suspect that given the aggressive strength over the last two months, a period of consolidation in the currency pair could be due. A lot of this good news story for New Zealand relative to Australia is already reflected in the exchange rate. New Zealand's monetary policy will also take the back seat, with the RBNZ's clear policy guidance that rates will not be changing for a long time. Additional factors such as a cooling housing market and uncertainty surrounding September's general election mean it is unlikely the RBNZ will provide any hawkish signal at this juncture. Instead, the risk is that the central bank may express greater discomfort with the strength of the NZD, lending matters a more dovish tone.

USD/JPY: After touching a 2017 high of 118.6 on 3 January, the USD/JPY has since entered a consolidation phase given the disappointment in Trump's legislative setbacks & the lack of progress in Trump's tax reform and infrastructure spending plans, leading to a broadly weaker US dollar. Despite the diminished Trump effect, we still believe the growing monetary policy divergence between the Fed Reserve (1 more hike in Sep and reduce balance sheet announcement in Dec) and BOJ to strengthen the US dollar and lift the USD/JPY pair higher albeit less aggressive than what we initially anticipated. We expect the pair to climb to 113 by mid-year and then to touch 115 by end-2017. The risk for the yen to strengthen in a risk-off environment could be due to potential geo-political events in Europe although the Korean peninsula turmoil/crisis may have a vastly different impact on the JPY depending on how involved Japan is under those circumstances.

Asian FX

USD/CNY: For the RMB, the addition of a "counter-cyclical adjustment" factor into the USD/CNY central parity mechanism – announced in late May – has further reduced the risks of a sharp depreciation of the currency. This is because the adjustment factor primary aims to counter "herd mentality" and a persistent bias towards RMB depreciation against the USD. We look for the USD/CNY to edge higher towards 6.89 by end-2017 and to 6.94 by mid-2018.

USD/SGD: As we enter the second half of 2017, we remain optimistic in the continuing growth for the electronics and precision engineering clusters. However, the double-digit growth for semiconductor production may slow into the single digits, due to base effects and a slower 2H capex growth expected in China. With no strong upside to economic growth, and inflationary pressures capped by the weaker labour market conditions, we believe that the MAS will keep the SGD NEER on the current neutral appreciation stance in the upcoming October policy meeting. The USD/SGD should continue to trend higher from current levels to end 2017 at 1.42.

USD/IDR: USD/IDR has largely hovered around 13,300 for most part of the year and we maintain our call for the pair to edge higher in 2H17. However, as we lower our US dollar trajectory, we now expect USD/IDR at 13,500 at end-3Q17 and 13,600 at end-4Q17. In addition to Indonesia's narrowing current account

deficit, the endorsement by rating agency S&P's in May to award the country an investment grade will likely contribute to more IDR stability should market volatility increases.

USD/KRW: We believe much of the positivity from strengthening exports, stabilising domestic politics and the fiscal stimulus have already been priced in. USD/KRW traded largely within 1,120-1,140 in 2Q17 and we expect the pair to end 3Q17 at 1,140 before rising to 1,150 by end-4Q17. Geopolitical risk did not have an apparent impact on the stock (KOSPI went on to hit record high in June despite the continuation of provocations from Pyongyang) and currency markets but will remain on investors' radar. Heightening tensions could potentially drive JPY/KRW up to 10.5 which we last saw in April.

USD/MYR: The Ringgit has strengthened, riding on dollar weakness in recent months, and an upswing in sentiment on the local currency. This comes amid improving macro parameters and BNM's liberalisation of bond and forex hedging requirements which took effect in May. The trend going forward could turn more volatile amid speculation that general elections could be around the corner, sizeable government bonds maturing between August and November, and more volatile crude oil prices. We still expect the Fed to deliver one more 25bps rate hike in 2H 2017 and announce the Balance Sheet Reduction at end of year. We look for USD/MYR at 4.30 by end 2017 concurrent with a firmer USD trend.

USD/THB: Capital flow and exchange rate volatility will likely increase mainly owing to external uncertainties, particularly the direction of economic and trade policies of the US, the pace of the Fed's monetary policy normalization and the political developments in advanced countries. We see broad THB depreciation against USD going forward. Currently, we expect USD/THB at 34.8 at end-3Q17.

USD/INR: Latest economic growth numbers surprised on the downside, whilst the latest inflation numbers also added to the expected dovish attitudes of the Reserve Bank of India (RBI), which had cut its projection for consumer inflation for 2017. The lowering of the Statutory Liquidity Ratio is one of the latest actions to help free up cash for banks to deploy and stimulate the economy. However, demand may not be there as the financial sector is plagued by the problem of non-performing loans as well as over-leveraged corporate sector. As such, the RBI should remain dovish and we do not rule out possible rate cuts in 2H 2017. Factoring in impending rate hikes and the uncertain outcome of the balance sheet reduction in the US, this will mean that the INR could be on a weakening path towards 67.2/USD by end 2017.

USD/VND: Against the backdrop of improving global economy, the Vietnam's economy would still face uncertainties in the direction of the US economic policies and in the monetary policy directions of major developed economies. The SBV will likely weaken the reference rate over the coming quarters to help support the economic expansion. For now, we expect VND to trade at 22,800 per USD at end-3Q17.

USD/MMK: The MMK barely budged against the dollar, appreciating by just 0.07% year-to-date (as of 21 Jun) so it clearly underperformed in 1H compared to most of its Asian peers. And the reason for MMK's sub-par performance could be due to its persistent twin deficits (of the current account and fiscal budget shortfall), more than offsetting the positive impact from the continued FDI inflows. Going forward, we are still bearish against MMK on the back of a moderate 2H rebound in US dollar as US rates are expected to be hiked further in 2H 2017 while domestically, the persistent twin deficits will also continue to weigh down on the MMK.

Global Interest Rates

Federal Reserve: After its June FOMC decision, we still believe our moderately hawkish outlook for the Fed rate trajectory in 2017 remains intact and we maintain the forecast of 3 Fed rate hikes this year (including the March & the latest June hike). Therefore, we expect one more 25bps rate hike in 2017 – this time in September FOMC – followed by a period of pause in 4Q-2017 before resuming hiking rates in 2018. We (UOB) retain our expectation that the BSR announcement may take place in the 12/13 Dec 2017 FOMC. While that development will not derail our 2017 rate hike trajectory, the potential December announcement may affect our 2018 Fed rate hike trajectory as trimming the Fed balance sheet is somewhat a 'substitute' for rate hikes, although the impact is likely more felt on the longer-end UST yields and it is difficult to quantify the magnitude at this current juncture. An earlier than expected BSR in 2H 2017 may imply a tighter than expected US monetary policy in 2017.

European Central Bank: The minor adjustment in forward guidance at the June ECB meeting marks the first step in the bias of interest rates setting. However, this does not amount to much, as the rest of the statement and press conference retained a fairly dovish bias. We think that without a strong conviction in inflation, the ECB would not risk choking off the growth that the economy has been seeing of late. Hence, doing nothing is probably the best decision at the moment. Other factors that could also interfere with the timing of ECB's exit include the Euro's strength as well as ongoing political risks.

Bank of England: The BoE was widely expected to remain cautious at its June monetary policy committee (MPC) meeting, particularly given the inconclusive election and the precarious position of the UK economy ahead of Brexit talks. Whilst it kept monetary policy unchanged, both Ian McCafferty and Michael Saunders joined Kristin Forbes in voting for a rate hike of 25 basis points. Still, BoE Governor Mark Carney provided plenty of disappointment to those who believe the three dissenters could mean a rate hike is on the horizon during his delayed Mansion House speech on 20 June. Indeed, the BoE is operating in an uncertain political climate. With ongoing risks associated with Brexit, alongside an environment of slowing growth and muted domestic inflationary pressures, we keep to our view that rates will stay on hold this year and next. There will be no meeting in July. The next meeting is scheduled for 3 August, where the central bank will also be releasing its quarterly inflation report.

Reserve Bank of Australia: We did get a sense that the RBA's June accompanying statement was incrementally more positive – from the language on the transition of the economy post the mining construction boom, to improved business conditions, rising capacity utilization, and increased business investment. But overall, there is nothing to suggest that the RBA is positioning for a near term move. Areas of focus for the RBA remain the labour market, housing and inflation. We see the RBA firmly on hold in 2017. The next monetary policy meeting is on 4 July.

Reserve Bank of New Zealand: Much of what was stated in RBNZ Governor

Graeme Wheeler's monetary policy statement in June was left unchanged from May. That said, markets likely interpreted the removal of a "neutral" stance as a relatively hawkish shift – though, in our opinion, it does not explicitly indicate a shift towards a hawkish stance. We think the RBNZ is probably very mindful about hiking prematurely, given its clear preference for a weaker currency and to avoid policy reversals, such as in 2011 and 2015. We still stick to our view that monetary policy is unlikely to change until around mid-2018.

Bank of Japan: The June BOJ decision came as no surprise as the Japanese central bank have continued to signal that loose monetary policy (including its yield curve control) will be here to stay for a awhile and the BOJ also refrained from any explicit discussion of tapering its ultra-expansionary monetary policy. And we agree that it is premature to expect the BOJ to taper its easing program anytime soon, especially in 2017 because Japan is still far away from its 2% inflation target and it is inappropriate to debate exit of monetary policy easing at this early stage, just as Kuroda highlighted in many occasions. After June's policy decision of no change, we expect status quo may likely be maintained at least in the next 6-9 months. We factor in a small probability for more BOJ policy easing in 3Q.

Asian Interest Rates

People's Bank of China: As the authorities juggle the challenges of balancing growth, reforms/deleveraging, and social stability, we see PBoC keeping its benchmark interest rates unchanged until after 4Q17, at 4.35% and 1.50%, for the 1Ylending and deposit rates, respectively. Thereafter we anticipate benchmark interest rates to be hiked starting from 1Q18. Meanwhile, upward pressure for OMO rates such as reverse repo rates and MLF rates would remain, especially as the US Fed gears up for its Sep FOMC meeting and the implementation of balance sheet reduction.

Monetary Authority of Singapore: Factoring a potential slowdown in economic growth in 2H 2017, as well as no upside surprises to our inflation forecast, we believe that the MAS will keep the SGD NEER on the current neutral appreciation stance in the upcoming October policy meeting. The tighter monetary conditions arising from the US will probably see domestic interest rates in Singapore inching higher, where we forecast the 3m SIBOR to reach 1.40% by end 2017.

Bank Indonesia: We see the sustained stability in the IDR pushing back any potential monetary tightening by BI to the first half of 2018 but the progress of monetary policy normalisation in the US including a balance-sheet reduction still points to an upward trajectory in Indonesia's policy rate going forward. For timing of monetary tightening, we will continue to watch the key indicators including domestic inflation, the exchange rate and capital flows.

Bank of Korea: Bets of monetary tightening have increased but it may be too early to start hiking interest rates at current early stage of growth recovery. Low interest rates have been blamed for the run-up in property prices, particularly in Seoul since 2015 which exacerbated the household debt situation. In South Korea, household debt has risen to more than 90% of GDP from 72.3% at the end of 2007, well ahead of the other Asian countries including Japan, Hong Kong and Singapore. In our view, a shift to monetary tightening will have to be premised on an acceleration in growth rebound while the latest round of property tightening measures fails to contain prices. While the U.S. remains firmly on a rate normalisation path, we do not expect the BOK to start to raise its interest rates until 2018. Meanwhile, we see the domestic inflation outlook being largely in line with the BOK's expectation, with our forecast at 2.0% and 2.1% in 2017 and 2018 respectively, within the BOK's target range of 1.5-2.5%.

Bank Negara Malaysia: Despite the strength in growth and relatively high inflation, Bank Negara Malaysia (BNM) continues to signal a neutral monetary stance. We think ebbing inflation pressures from oil and transportation effects coupled with potential normalisation of real GDP growth to around 4.6% in 2H 2017 (vs. 5.6% in 1Q 2017) is likely to keep policy rates unchanged at 3.00% for now.

Bank of Thailand: The Bank of Thailand (BoT) kept the policy rate unchanged at 1.50% on 24 May 2017. Looking forward, the BoT will likely keep the policy rate on hold at 1.50% through 2017 because accommodative monetary policy remains necessary given that Thailand's economic growth is still in the early stages and not yet broad-based. Moreover, headline inflation is expected to rise at a gradual pace as inflationary pressure remains weak.

Reserve Bank of India: Recent economic numbers are pointing to a slowdown in aggregate demand in India. With that, we think that this will be a strong enough case to expect incremental dovish tones from the RBI in the months ahead. As such, we will still keep to our view that there could be 2 more rate cuts for 2017 (one 25bps cut in the next 2 August meeting, and another 25bps in the final meeting of the year on 6 December).

State Bank of Vietnam: The State Bank of Vietnam (SBV) is likely to remain in easing mode, while Vietnam growth is expected to register 6.2% in 2017. Headline inflation will continue to moderate in the coming months. As a consequence, we expect the SBV will likely maintain the policy rate at 6.50% this year.

Real GDP Growth Trajectory											
y/y% change	2016	2017F	2018F	1Q17	2Q17F	3Q17F	4Q17F	1Q18F	2Q18F	3Q18F	4Q18F
China	6.7	6.7	6.6	6.9	6.7	6.7	6.6	6.6	6.6	6.6	6.6
Eurozone	1.8	1.8	1.6	1.9	1.8	1.8	1.7	1.6	1.6	1.6	1.5
Hong Kong	2.0	2.4	2.4	4.3	1.6	1.7	1.9	2.4	1.9	2.1	3.1
Indonesia	5.0	5.2	5.5	5.0	5.1	5.3	5.4	5.5	5.4	5.6	5.6
Japan	1.0	0.9	1.2	1.3	1.1	0.9	0.4	1.0	1.2	1.2	1.5
Malaysia	4.2	5.0	4.9	5.6	5.0	4.7	4.5	4.6	4.8	4.9	5.3
Philippines	6.8	6.5	6.5	6.5	6.3	6.4	6.6	6.7	6.3	6.5	6.6
India	7.5	7.2	7.6	7.1	7.0	7.4	7.3	7.5	7.6	7.4	7.6
Singapore	2.0	2.4	2.5	2.7	2.4	2.4	2.1	2.5	2.8	2.4	2.4
South Korea	2.8	2.8	2.7	2.9	2.7	2.9	2.8	2.7	2.6	2.6	2.7
Taiwan	1.5	2.1	2.0	2.3	2.2	1.9	2.0	1.8	1.9	2.0	2.3
Thailand	3.2	3.3	3.3	3.3	3.1	3.3	3.4	3.3	3.3	3.3	3.2
US (q/q SAAR)	1.6	2.5	2.5	1.2	3.5	2.5	2.8	1.0	3.5	2.5	3.0

Source: CEIC, UOB Global Economics & Markets Research

FX & INTEREST RATE OUTLOOK

		23 Jun 2017	3Q17F	4Q17F	1Q18F	2Q18F
FX OUTLOOK	USD/JPY	111.3	114	115	116	117
	EUR/USD	1.116	1.12	1.13	1.14	1.14
	GBP/USD	1.270	1.25	1.24	1.23	1.23
	AUD/USD	0.755	0.75	0.75	0.76	0.77
	NZD/USD	0.727	0.72	0.73	0.74	0.76
	USD/SGD	1.389	1.40	1.42	1.43	1.44
	USD/MYR	4.289	4.32	4.30	4.28	4.26
	USD/IDR	13,328	13,500	13,600	13,700	13,800
	USD/THB	33.97	34.8	35.0	35.3	35.5
	USD/PHP	50.31	50.6	50.9	50.9	51.0
	USD/INR	64.54	66.5	67.2	68.0	68.8
	USD/TWD	30.44	30.8	31.0	31.2	31.4
	USD/KRW	1,139	1,140	1,150	1,160	1,170
	USD/HKD	7.80	7.80	7.80	7.80	7.80
	USD/CNY	6.840	6.86	6.89	6.92	6.94
	USD/MMK	1,359.0	1,370	1,395	1,395	1,395
	USD/VND	22,725	22,800	22,900	23,000	23,100
INTEREST RATE TRENDS	US (Fed Funds Rate)	1.25	1.50	1.50	1.75	2.00
	EUR (Refinancing Rate)	0.00	0.00	0.00	0.00	0.00
	GBP (Repo Rate)	0.25	0.25	0.25	0.25	0.25
	AUD (Official Cash Rate)	1.50	1.50	1.50	1.50	1.50
	NZD (OCR)	1.75	1.75	1.75	1.75	2.00
	JPY (Policy Rate)	-0.10	-0.10	-0.10	-0.20	-0.20
	SGD (3M SIBOR)	0.99	1.25	1.40	1.50	1.70
	IDR (7-Day Reverse Repo)	4.75	4.75	4.75	5.00	5.00
	MYR (Overnight Policy Rate)	3.00	3.00	3.00	3.00	3.00
	THB (1-Day Repo)	1.50	1.50	1.50	1.75	1.75
	PHP (Overnight Reverse Repo)	3.00	3.00	3.00	3.00	3.25
	INR (Repo Rate)	6.25	6.00	5.75	5.75	5.75
	TWD (Official Discount Rate)	1.38	1.38	1.38	1.38	1.38
	KRW (Base Rate)	1.25	1.25	1.25	1.25	1.50
	HKD (Base Rate)	1.50	1.75	1.75	2.00	2.25
	CNY (1Y Benchmark Lending)	4.35	4.35	4.35	4.60	4.85
	VND (Refinancing Rate)	6.50	6.50	6.50	6.75	6.75

Source: Bloomberg, UOB Global Economics & Markets Research

ASEAN FOCUS

US Fed Balance Sheet Normalization & Impact On ASEAN FX

- The FOMC released more details on its planned balance sheet reduction (BSR), still expecting to implement in a gradual manner this year but again did not specify the start date or the eventual level of the balance sheet they hope to achieve. We expect the Fed to hike rates once more in Sep FOMC before announcing BSR in the Dec FOMC to be implemented in Jan 2018.

- Based on the FOMC details, we expect the Fed will run down US$180bn of UST holdings and US$120bn of MBS holdings in 2018.The UST reinvestment rate of approximately 58% in 2018 and the Fed's Balance sheet will be reduced to US$4.18 trillion by the end of 2018, further to US$3.58trn by end-2019, and US$2.98trn by end-2020. It will reach our (expected) terminal balance sheet size of US$2.53trn by 3Q-2021.

- An earlier than expected BSR in 2H 2017 may imply a tighter than expected US monetary policy in 2017 and that may lift the US dollar, Conversely, a delay in BSR could weaken the US dollar.

- We look at market reactions in the previous episodes of similar development (i.e. 2013 "taper tantrum" and China's abrupt adjustment to its USD/CNY fixing mechanism on 11 Aug 2015) to gauge the potential impact on ASEAN markets and currencies (In this report, ASEAN considers only the major economies and their currencies: Indonesia, Malaysia, Philippines, Singapore and Thailand).

- Within six months after the trigger event, ASEAN currencies responded negatively with average declines of 9% in "taper tantrum", and 3% in "CNY fixing mechanism" episode. However, Indonesia rupiah suffered the most, with about 20% drop during "taper tantrum". For the MYR, which was already under pressure from the 1MDB saga since early 2015, the CNY fixing change only resulted in about 6% fall. These figures provide a baseline of expected reaction as we move towards BSR.

- On the assumption of no significant changes to US fiscal/tax/trade policy and the stability of the Chinese economy, the depreciation in regional currencies against the USD would likely be well contained in the event of BSR, though this still depends on the "Mode" and "Intensity" highlighted in this article. Some of the regional countries will be more vulnerable than others but improved fundamentals – such as real interest rates, foreign exchange reserves, in ASEAN are expected to provide buffers to risks of capital outflows. We also see room for regional central banks to raise interest rates, probably with Philippines and Indonesia starting off the rate hikes. The corrections in the ASEAN currencies will therefore unlikely be to the same extent of the 2013 "taper tantrums" in our view, particularly for the rupiah and ringgit.

Overview: A Policy Path To Reduce Fed Reserve's US$4.5Trillion Balance Sheet

As widely expected, the Federal Reserve in its 13/14 June 2017 FOMC released more details on its planned balance sheet reduction (BSR) with the accompanying addendum to the Committee's Policy Normalization Principles and Plans. The Fed maintained its stance that it will implement its balance sheet normalization in a gradual manner this year but again did not specify the start date or the eventual level of the balance sheet they hope to achieve. In the post-June FOMC meeting press conference, FOMC Chairwoman Janet Yellen said she believed that additional gradual rate hikes will be appropriate over next few years while the unwind of the Fed's balance sheet will probably end a few years after process begins but she too declined to say what the final balance sheet size will be.

As we have highlighted in our earlier report ("US: Fed Reserve Contemplating Balance Sheet Normalization" dated 26

April 2017), reducing the Fed Reserve's balance sheet will be a significant change because of 3 reasons:

1. The Fed's reinvestment policy has been in place for nearly a decade (since Aug 2010),

2. The Fed has never done balance sheet reduction before, so this is uncharted territory,

3. Whether the FOMC can keep to its planned 3 rate hikes in 2018 if it starts to reduce the balance sheet in early 2018.

The Fed Reserve made the first mention in its August 2010 FOMC that it would keep constant the Federal Reserve's holdings of securities at their current level by reinvesting principal payments from agency debt and agency mortgage-backed securities in longer-term Treasury securities and that the FOMC would continue to roll over the Federal Reserve's holdings of Treasury securities as they mature. This decision of reinvesting principal payments has been maintained in every subsequent FOMC statement (as of March 2017) even as the Fed has started normalizing interest rates with three 25bps hikes so far (in Dec 2015, Dec 2016 and most recently Mar 2017) and Fed officials previously indicated that any plan to reduce its portfolio would let the bonds naturally roll off, by not reinvesting them when they mature, once its interest rate hikes were "well under way".

The general expectation is that reducing the Fed balance sheet is equivalent of tightening monetary policy and that US Treasury yields will rise. But the truth is that no one honestly know what will the impact be and how the whole reduction process will play out because this is an unprecedented event (the Fed has never done this before).

Another concern we have is whether the FOMC can keep to its planned 3 rate hikes trajectory in 2018 if it starts to reduce the balance sheet "later this year" because as New York Fed President, William Dudley (permanent voter in FOMC) pointed out on 31 March that trimming balance sheet is a 'substitute' for rate hikes and thus the Fed could 'pause' raising rates at that time and diverge from the original policy path.

Background To The Federal Reserve's Balance Sheet Growth

Prior to the Global Financial Crisis (GFC), the Federal Reserve's balance sheet for all its assets was at US$869bn (as of 8 August 2007). To combat the crisis, the Fed lowered the Fed Funds Target Rate aggressively, from the high of 5.25% (as at 7 Aug 2007) to a record low of 0-0.25% by the 16 Dec 2008 FOMC.

In addition, the Fed began large-scale asset purchases (agency debt, MBS and USTs) which greatly increased the size of the Federal Reserve's balance sheet. And as we mentioned earlier, the FOMC made the decision of reinvesting principal payments in the August 2010 FOMC and has maintained that decision every subsequent FOMC statement (as of June 2017 FOMC). The Fed's total assets peaked at US$4.5 trillion in January 2015 and it is currently hovering near the peak at US$4.476 trillion (as of 12 Jun 2017). (See Chart 1)

Path To BSR: June 2017 FOMC Details Point To Gradual Unwinding Process, How It May Look Like

In our earlier report ("US: Fed Reserve Contemplating Balance Sheet Normalization" dated 26 April 2017), we highlighted 4 possible scenarios the Fed may choose to determine the fate of its balance sheet:

1. Maintain status quo (i.e. keep reinvestment policy unchanged)

2. Partial end to reinvestment (say 50%) and allow part of the matured debt to roll off in 2018

3. End reinvestment entirely (100%) and passively allowing matured debt to roll off in 2018

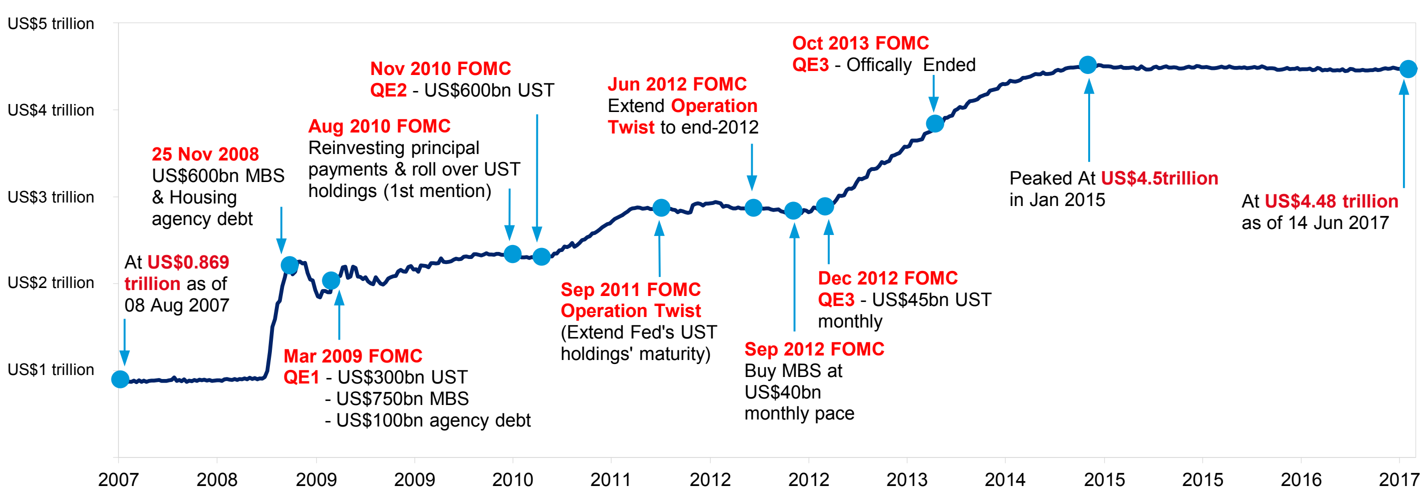
4. Actively selling of assets at a pace faster than the natural rolling over of matured debt in 2018

In terms of policy effect, scenario 1) is clearly most dovish and on the other extreme end scenario 4) is the most hawkish.

In addition, the degree of impact on USD & rates will likely be based on the **mode** and **intensity** of the reduction. In terms of mode, we are taking into account whether the reduction will be substituting some of the rate hikes or it will take place

Chart 1: How The Federal Reserve Balance Sheet Grew From US$869bn To US$4.5trillion in Less Than 10 Years.

Source: The Federal Reserve, UOB Global Economics & Markets Research (As of 20 Jun 2017)



concurrently with interest rate hikes. In terms of intensity, it will be taking into consideration of the range from magnitude of passive roll-off to active selling. For the currency effect, reducing Fed's balance sheet on the US dollar should be positive, but the magnitude of US dollar strength increases from scenario 2) to scenario 4) while in the case of scenario 1), the US dollar may weaken. A similar pattern of expectation may be drawn for UST yields as well, with UST yields higher as we move from scenario 2) to 4). That said, the currency & yield effects are further complicated by the fact that other major central banks such as the European Central Bank, the Bank of England and the Bank of Japan have embarked on their respective monetary easing programmes and expanded their balance sheets significantly as well. So the effect of reducing Fed's balance sheet on the US dollar & UST yields cannot be considered in isolation, without considering what the ECB, BOJ and BOE will do to their own balance sheets.

Chart 2: Of The 4 Selected Possibilities For BSR, The Fed Reserve Is Opting For Scenario 2 (In Red)

Source: UOB Global Economics & Markets Research (As of 20 Jun 2017)

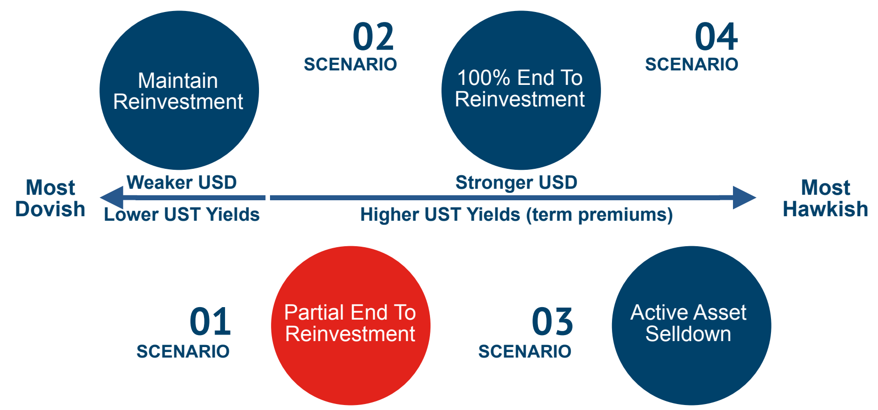


Chart 3: Fed Has US$427.5bn UST Maturing In 2018

Source: Federal Reserve, UOB Global Economics & Markets Research

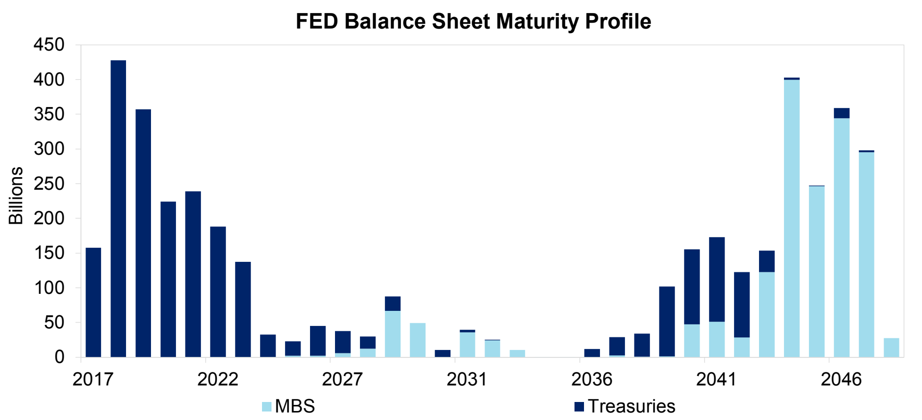
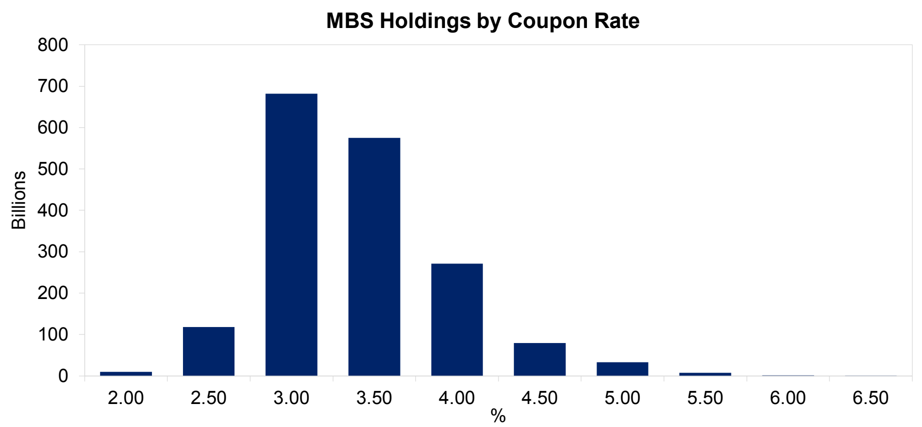


Chart 4: Fed's MBS Holdings By Coupon Rate

Source: Federal Reserve, UOB Global Economics & Markets Research



The Federal Reserve's Federal Open Market Committee (FOMC) in its June 2017 FOMC released an accompanying addendum to the Committee's Policy Normalization Principles and Plans where it spelt out how the Fed intends to reduce its balance sheet.

The Fed expects to implement its balance sheet normalization this year (without specifying when it will start the process), initially trimming reinvestments in treasury securities by US$6bn per month and mortgage backed securities by US$4bn. The cuts to reinvestment are seen expanding on a quarterly basis until it reaches US$30bn per month for US Treasuries and US$20bn per month in mortgage backed securities. It did not specify when it will terminate the balance sheet normalization process, except that it will be to "*a level appreciably below that seen in recent years but larger than before the financial crisis*" and reflects "*the banking system's demand for reserve balances and the Committee's decisions about how to implement monetary policy most efficiently and effectively in the future.*" In our view, to minimize the impact of monetary tightening, the Fed Reserve chose to reinvest a percentage of the maturing assets (scenario 2). However, doing so would also lengthen the time taken to return the balance sheet to a "neutral" state (which we estimate to be around US$2.5 trillion based on the growth rate of money supply). (Chart 2)

Looking at the maturity profile of the Fed's asset holdings, the total maturing US Treasury holding of the Fed is US$ 427.5 billion in 2018. (Chart 3) This is equivalent to close to 20% of average annual issuance in UST notes and bonds over the past 3 years. If we assume that the BSR announcement takes place in the 12/13 Dec 2017 FOMC and is implement at the start of 2018, then based on the Fed's announced schedule, it will imply that the Fed will run down US$180bn of

UST and reinvest US$247.5bn in 2018 (reinvestment rate of about 58%). And if we include the reduction of MBS holdings (by US$120bn in 2018), this means that the Fed's balance sheet will only be reduced to **US$4.18 trillion by the end of 2018**. By 1Q2019, the maximum monthly reduction caps of US$30bn (for UST) and US$20bn (for MBS) will be reached so that the annual accumulated BSR will be at the maximum of US$360bn of UST and US$240bn of MBS (i.e. reducing the Fed balance by US$600bn annually) assuming no further change to the monthly caps. Therefore, we expect the Fed's balance sheet to be lowered to US$3.58trn by end-2019, and then to US$2.98trn by end-2020. It will reach our (expected) **terminal balance sheet size of US$2.53trn by 3Q-2021.**

Our Base Case: Expect BSR announcement In 12/13 Dec 2017 FOMC & Implementation In Jan 2018, But It Is Far From Certain

After its June FOMC decision, we still believe our moderately hawkish outlook for the Fed rate trajectory in 2017 remains intact and we maintain the forecast of 3 Fed rate hikes this year (including the March & the latest June hike). Therefore, we expect one more 25bps rate hike in 2017 – this time in September FOMC – followed by a period of pause in 4Q-2017 before resuming hiking rates in 2018. We (UOB) retain our expectation that the BSR announcement may take place in the 12/13 Dec 2017 FOMC. Why December? We think that the Fed needs to build up a sufficient amount of interest rate buffer before it starts to embark of its next project – balance sheet reduction (BSR). How much buffer is deemed enough is anyone's guess but we think the Fed may be comfortable with the Fed Funds Target Rate (FFTR) to be at least 1.5% before the FOMC starts BSR. Currently, it is at 1.00-1.25%.

While a potential December BSR announcement will not derail our 2017 rate hike trajectory, it may affect our 2018 Fed rate hike trajectory. That said, a decision to change to the Fed reinvestment policy later this year is far from certain if we judge from the experience of the Fed normalizing interest rates where it was talked about/forward guided for more than 1 year (from late 2014) before delivering the first hike eventually in Dec 2015 FOMC. And then, the Fed forward guided yet another year before hiking again in Dec 2016 FOMC. Perhaps it is because of these "experiences", the US bond market reaction to the balance sheet reduction issue has been much muted. Perhaps they felt the Fed may take a longer period of guidance before delivering any action. Conversely, should the Fed provide indication that the balance sheet reduction (BSR) could take place earlier in 2H 2017, then that may imply a tighter than expected US monetary policy in 2017 and that may lift the dollar more than what we have presently projected.

Chart 5: Forecast Table On US Fed Funds Target Rate, BSR Timeline, Fed's Terminal Balance Sheet Size

Period	US Fed Funds Target	US Treasury Reduction (US$bn/3 mths)	US MBS Reduction (US$bn/3 mths)	Fed Reserve's Balance Sheet (US$trn)
2Q17	1.25	0.0	0.0	4.48
3Q17F	1.50	0.0	0.0	4.48
4Q17F	1.50	0.0	0.0	4.48
1Q18F	1.75	18.0	12.0	4.45
2Q18F	2.00	36.0	24.0	4.39
3Q18F	2.25	54.0	36.0	4.30
4Q18F	2.50	72.0	48.0	4.18
1Q19F	2.75	90.0	60.0	4.03
2Q19F	3.00	90.0	60.0	3.88
3Q19F	3.25	90.0	60.0	3.73
4Q19F	3.50	90.0	60.0	3.58
1Q20F	3.50	90.0	60.0	3.43
2Q20F	3.50	90.0	60.0	3.28
3Q20F	3.50	90.0	60.0	3.13
4Q20F	3.50	90.0	60.0	2.98
1Q21F	3.50	90.0	60.0	2.83
2Q21F	3.50	90.0	60.0	2.68
3Q21F	3.50	90.0	60.0	**2.53**
4Q21F	3.50	90.0	60.0	2.38

Source: UOB Global Economics & Markets Research (As of 20 Jun 2017)

Lessons from the Fed "Taper Tantrum" and CNY Fixing Mechanism Adjustment

How would ASEAN currencies react to the US Fed balance sheet reduction? Would this trigger a massive capital outflow from emerging economies (such as ASEAN) to US dollar assets? Or would it be just another "ho hum" development similar to the recent US Fed interest rate normalization?

We look at market reactions in the previous episodes of similar development to gauge the potential impact on ASEAN markets and currencies (In this report, ASEAN considers only the major economies and their currencies: Indonesia, Malaysia, Philippines, Singapore and Thailand).

The US Fed balance sheet reduction, when it happens, will be an unprecedented development ever since the asset purchase program or Quantitative Easing (QE) began in Nov 2008 (with US$100bn of GSE direct obligations and US$500bn in MBS). The final incarnation of asset purchase, QE3, announced in two phases (13 Sep and 12 Dec 2012), committed the US Fed to monthly purchases of US$85bn in bonds. Asset purchases under the QE3 program ended officially in Oct 2013.

However, something similar to balance sheet reduction did happen before, in what is known as the Fed "taper tantrum", which would provide a sense of how asset prices in emerging markets, especially ASEAN, could potentially respond when the "real deal" strikes in late 2017 or early 2018.

"Taper tantrum" was first set off when the then US Fed Chairman Ben Bernanke testified in Congress on 22 May 2013, that the central bank would likely start slowing—that is, "tapering"—the pace of its bond purchases later in the year. This testimony laid the groundwork for the 19 Jun 2013 press conference in which the Chairman again suggested that asset purchases might be reduced later in 2013: During the course of 2H13, US long term bond yields and US dollar exchange rate

surged in several such episodes which became collectively known as the "taper tantrum." For instance, US 10Y treasury yield jumped from 1.629% in early May 2013, to nearly 3% by early Sep 2013.

While not exactly a US Fed balance sheet reduction scenario, another event that sparked a significant EM turmoil was China's abrupt adjustment to its USD/CNY fixing mechanism on 11 Aug 2015. However, as the adjustment was initially seen as a "currency war" type of development, ASEAN currencies naturally reacted negatively, though the extent was much milder than the "taper tantrum" period, as shown in the chart.

What Is The Impact On ASEAN Currencies Once The Fed Acts?

Within six months after the trigger event, ASEAN currencies responded negatively with average declines of 9% in "taper tantrum", and 3% in "CNY fixing mechanism" episode. However, Indonesia rupiah suffered the most, with about 20% drop during "taper tantrum". For the MYR, which was already under pressure from the 1MDB saga since early 2015, the CNY fixing change only resulted in about 6% fall. These figures provide a baseline of expected reaction as we move towards US Fed balance sheet reduction.

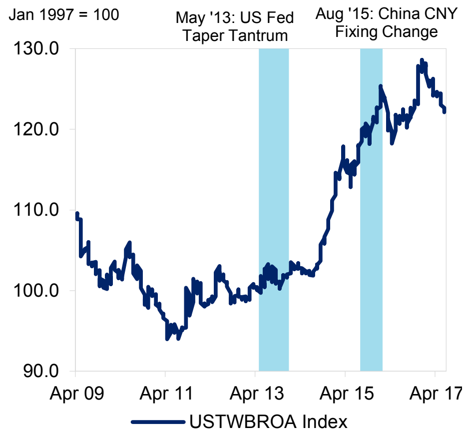
While the US dollar is expected to strengthen and improved US bond yields likely to draw capital flows away from non-dollar assets in a US Fed balance sheet reduction scenario, **we expect ASEAN currencies to cope well with only mild corrections. The extent of correction in ASEAN currencies is unlikely to be a repeat of the two earlier episodes**, and certainly not the 20% decline (in 6 months) seen in the rupiah, as economic fundamentals and sentiment/confidence towards the rupiah assets have improved vastly since 2013.

Improved Fundamentals To Cushion ASEAN Currencies

1. **Real interest rates**
   Real interest rates are generally in positive territory for most ASEAN economies, and are also ahead of real Fed funds rate. These should counter some of the impact from higher bond yields elsewhere. However, real interest rates in Malaysia and the Philippines are lower than their peers and therefore could be a point of vulnerability.

Chart 6: Broad US Dollar Index Performance
Chart 7: US 10Y Treasury Yield

Source: CEIC, Bloomberg, UOB Global Economics & Markets Research



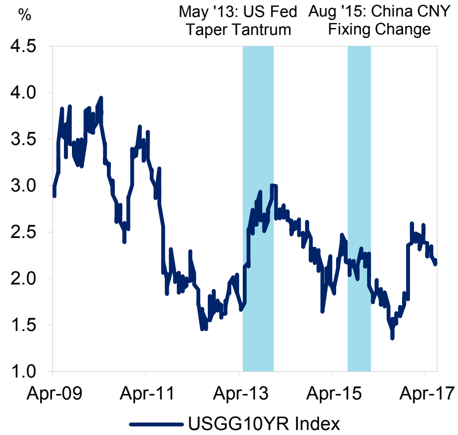


Chart 8: ASEAN: FX Performances vs. USD

Source: Bloomberg, UOB Global Economics & Markets Research

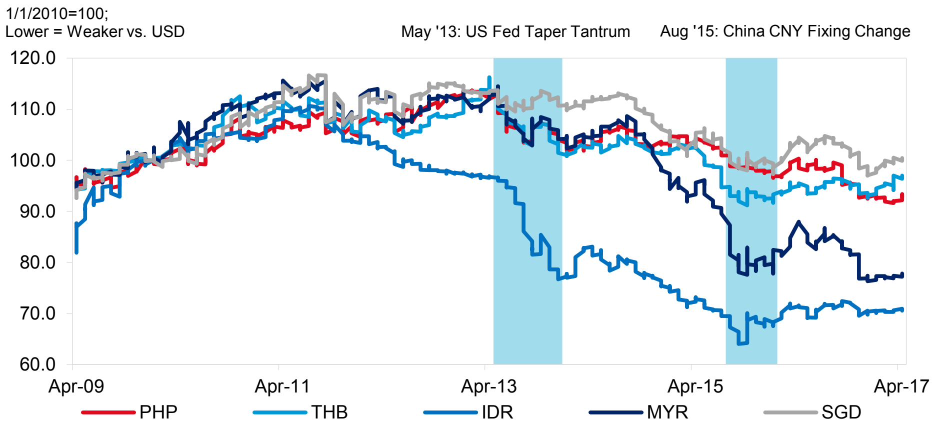
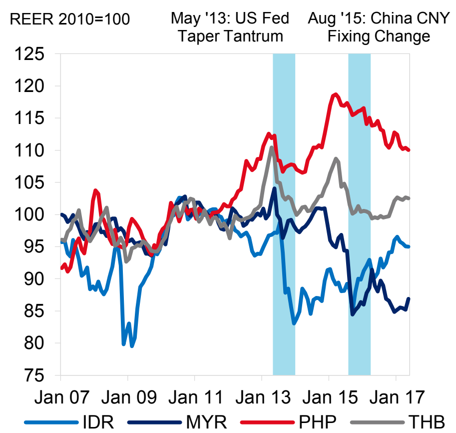


Chart 9: Asian Currencies' NEER Declining During "Taper Tantrum", With Sharp Drop In The IDR
Chart 10: REER Decline Was Also More Pronounced For IDR During "Taper Tantrum"

Source: BIS, UOB Global Economics & Markets Research



2. **Buffers Against Capital Outflows**
Most ASEAN economies have larger buffers against both capital market outflows as well as external debt exposures, as they build up their forex reserves. In an extreme – and unlikely – scenario where foreign investors pull out entirely their equity and bond investments, the most vulnerable country would be Indonesia. Even in that extreme situation, Indonesia has more than sufficient reserves to cover the capital outflows, and in this case taking up less than 2/3 of its total foreign reserves (see table).

In an even more extreme situation where total capital withdrawals by foreign investors are accompanied by repayments of all short term external debt, Malaysia would be the most vulnerable as its foreign reserves would not be sufficient to meet that demand.

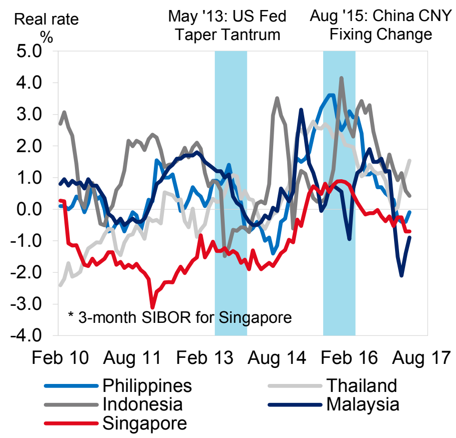
This exercise shows that, barring extreme (and unlikely) conditions mentioned earlier, ASEAN countries have sufficient forex reserves to deal with the normal capital flows, which explain the relatively calm market conditions in the region despite volatilities during the Brexit and US Presidential Election outcomes.

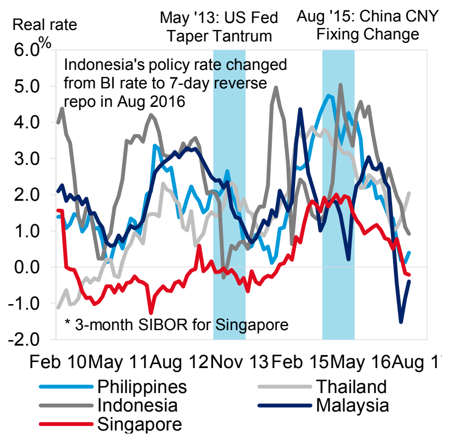
3. **Household And Corporate Debt Levels Still Benign In Asean Countries**
Household leverage has increased most noticeably in ASEAN in the aftermath of the Global Financial Crisis, driven by cheap credit and capital inflows. This has led to rapid ascent in the asset prices, and in particular the property prices in countries such as Singapore and Hong Kong to "bubble" levels. While household leverage is higher compared to earlier stress periods, we believe a measured tightening in global monetary conditions should not lead to significant fallout, since higher leverage is also in line with the improvement in household income. However, higher debt servicing costs could have a dampening effect on private consumption for economies with higher household leverage, including Malaysia and Thailand which are at around 70% of GDP according to BIS estimates.

Corporate debt trend has been more stable in ASEAN compared to the

Chart 11: ASEAN: Real Policy* Interest Rate
Chart 12: ASEAN: Real Policy* Interest Rate Premium/Discount Over Real Fed Funds Rate

Source: BIS, UOB Global Economics & Markets Research





Assessing Reserves Cover - In the Worst Scenario of Total Pullout From Foreign Equity and Bond Investors

US$ Billions	A Foreigner Net Purchases in Equities*	B Foreigner Govt Bond Holdings	C ST External Debt	D Total External Debt	E Foreign Reserves	Smaller = Better Financial Markets Reserves Cover = (A+B)/E	Smaller = Better Reserves Cover = (A+B+C)/E	Decline Against USD Brexit+4D	Decline Against USD Trump+4D
Indonesia	$24.4	$54.3	$40.6	$316.8	$121.8	65%	90%	-0.2%	-1.2%
S. Korea	$34.9	$66.7	$105.2	$380.9	$375.3	27%	55%	-1.1%	-0.8%
Malaysia	-	$35.4	$81.1	$202.6	$92.0	39%	127%	-1.3%	-1.6%
Thailand	($2.6)	$15.9	$52.8	$131.4	$172.7	8%	38%	0.0%	-1.2%
Philippines	$7.8	-	$14.5	$74.8	$80.9	10%	28%	-1.1%	-0.6%
India	$166.7	-	$82.1	$479.7	$346.3	48%	72%	-0.2%	-1.0%
Taiwan	$136.6	-	$160.0	$172.2	$437.5	31%	68%	-1.0%	-0.7%
China	-	-	$919.3	$1,416.2	$3,009.1	-	31%	-0.8%	-0.8%
Japan	$527.7	$965.1	-	$3,416.1	$1,168.9	128%	120%	3.2%	-3.2%

* Aggregation and cumulation of daily purchases and sales since data became available for each country

Colour scheme denotes the severity of the impact with green to red representing low to high impact

Source: Bloomberg, UOB Global Economics & Markets Research estimates

Chart 13: The Impact On IDR Was Accentuated By Its Return To Current Account Deficit During The "Taper Tantrums"

Source: CEIC, UOB Global Economics & Markets Research

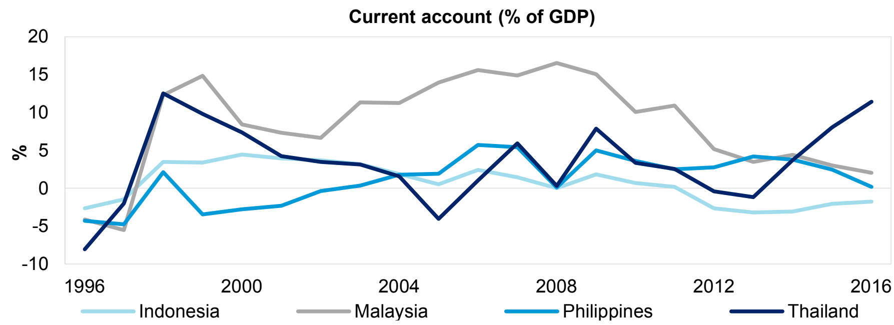
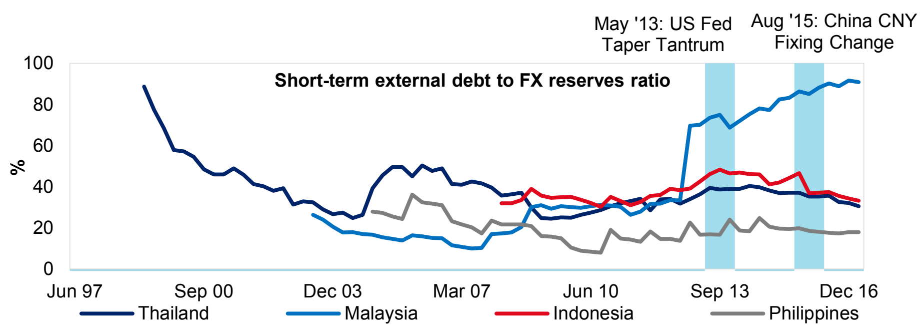


Chart 14: Short-Term External Debt/FX Reserves Trend: Malaysia More Vulnerable Than Its Peers

Source: CEIC, UOB Global Economics & Markets Research



household debt over the last decade. The sharp increase in Singapore and Hong Kong had to do with their positions as Asia's financial hub.

4. Central banks have room to tighten monetary policy, cushioning potential impact from further US monetary policy normalization

Regional central banks had been on an easing bias over the course of 2016, with central banks in Indonesia and the Philippines most aggressive in cutting rates. As US takes further actions to normalize its monetary policy and commodity prices stabilize, there will be pressure on these central banks to reverse earlier monetary easing. Given relatively low policy rates in ASEAN, there is certainly plenty of room for central banks to raise interest rates, should conditions warrant.

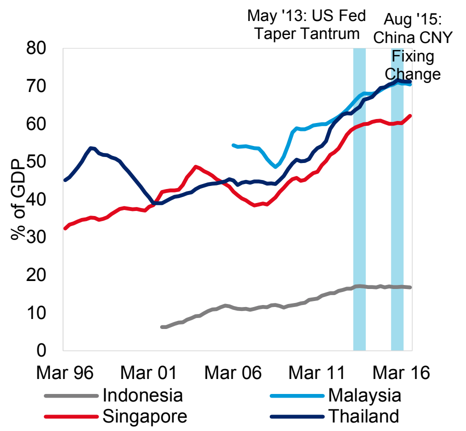
This then brings us to the question of which ASEAN central banks will be the first to raise their interest rates. Philippines is an obvious candidate to begin tightening first due to pressure from low real interest rates. Although real interest rate is higher in Indonesia compared to its regional peers, the falling trend could prompt Bank Indonesia to act as a safeguard against capital outflow risks given the relatively large exposure of its bonds and equity markets to foreign investors as compared to the size of its forex reserves. Nonetheless, we think that Malaysia could remain on hold as BNM views the inflationary pressure as transient on the back of normalizing oil prices and also given the abating financial imbalance risks.

Conclusion: ASEAN Currencies Pressured To The Downside But To Hold Well

On the assumption of no significant changes to US fiscal/tax/trade policy and the stability of the Chinese economy, we expect to see commodities prices holding steady and a slightly stronger growth outlook in Asia near-term. Any change to the above, for instance, implementation of US Border Adjustment Tax, could cause significant disruption in capital flows and hence greater adjustments in US dollar and our regional currency outlook. Barring any change to our baseline assumptions above, the depreciation in regional currencies against the USD would likely

Chart 15: Household Debt Trend In ASEAN
Chart 16: Household Debt Trend In North Asian Countries

Source: BIS, UOB Global Economics & Markets Research



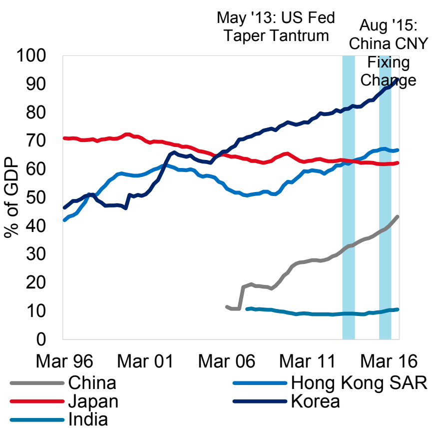
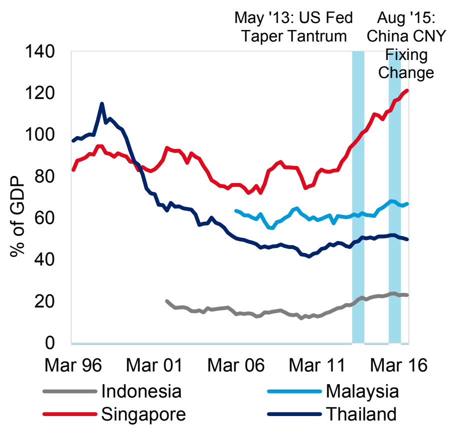


Chart 17: Corporate Debt Trend In ASEAN
Chart 18: Corporate Debt Trend In North Asian Countries

Source: BIS, UOB Global Economics & Markets Research



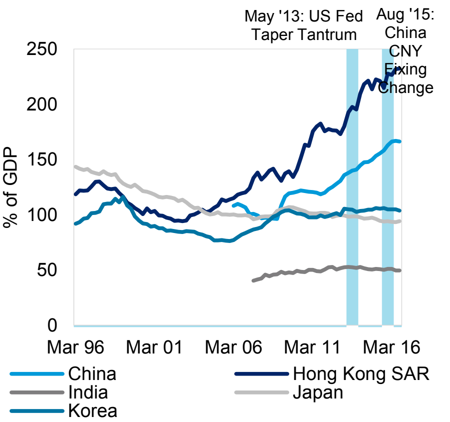
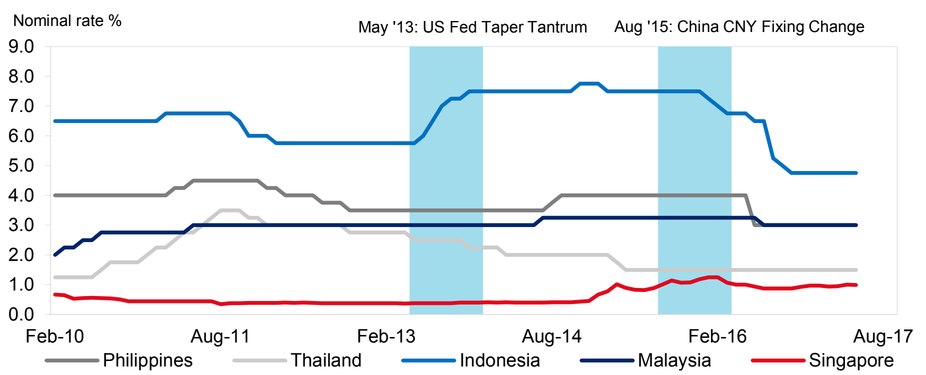


Chart 19: ASEAN: Nominal Policy* Interest Rate

Source: Bloomberg, UOB Global Economics & Markets Research



* 3-month SIBOR for Singapore
Indonesia's policy rate changed from BI rate to 7-day reverse repo in Aug 2016

be well contained in the event of BSR, though this still depends on the "Mode" and "Intensity" highlighted earlier in this article. Some of the regional countries will be more vulnerable than others but improved fundamentals – such as real interest rates, foreign exchange reserves, in ASEAN are expected to provide buffers to risks of capital outflows. The corrections in the ASEAN currencies will therefore unlikely be to the same extent of the 2013 "taper tantrums" in our view, particularly for the rupiah and ringgit.

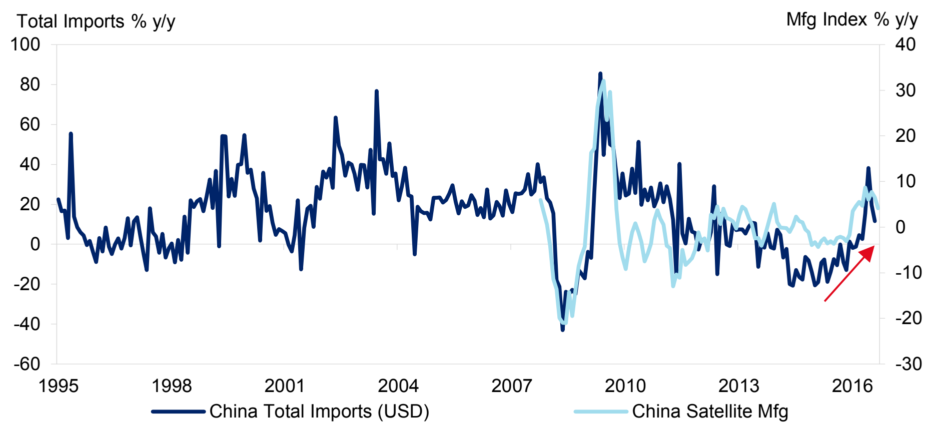
ASIA FOCUS

Expected Slowdown In Asian Export Growth To Add Pressure On ADXY In 2H2017

- Recent improvement in the final demand for goods from developed countries saw China imports from the world growing at 20% y/y in the first four months of 2017 as its factories rushed to churn out the goods.
- Using data from satellites aiming at over 6,000 Chinese industrial sites, we found that manufacturing activities were up 7.2% y/y in the first four months of the year.
- Higher imports and industrial production due to an improvement in the final demand for Asian-produced goods imply stronger demand for Asian currencies, driving up Asian FX. However, we do not think that this phenomenon will continue into the second half of 2017, especially since the current electronics cycle may be coming to an end. We expect increasing downward pressures on Asian currencies.

Exhibit A: Increase In Factory Activities Mean More Imports Of Raw Materials And Intermediate Products

Source: CEIC, Bloomberg, SpaceKnow, UOB Global Economics & Markets Research



The Revival Of Asian Exports Growth Resulted In A Strong Push For Asian Dollar Demand

After suffering from a slowdown for a full year since February 2015, the Asian [1]exports (in USD terms) engine finally started buzzing since exports growth made a bottom in February 2016 and has been climbing higher. Collectively, the selected Asian economies experienced a 9.4% y/y growth in exports in the first four months of 2017. This does not come as a surprise as economic activities in final demand countries (mainly developed economies) seem to be improving in recent months and the global factory behemoth, namely China, has been churning out more goods than ever.

Other than observing Chinese industrial production and purchasing managers' indices, we introduce a novel way to track Chinese factory activities via big data analytics applied on satellite images that are focused on over 6,000 industrial sites in the Mainland. A US company, SpaceKnow, analyses over 500,000 sqkm of land, spanning 14 years, and across 2.2 billion observations to compile the "China Satellite Manufacturing index". This index provides real-time data on factory activities and is an excellent source for now-casting China's economic health via the manufacturing sector[2].

Exhibit A shows that the increase in factory output in China since July 2016 correlates positively with Chinese imports

1 Our Asian sample size follows the component countries in the Asia dollar index and includes: China, Hong Kong, India, Indonesia, South Korea, Malaysia, the Philippines, Singapore, Taiwan, and Thailand.

2 While we acknowledge that the Chinese economy is changing towards a services-based, consumption-oriented model, we must not neglect the importance and contribution of manufacturing towards economic growth and employment creation.

from the rest of the world. In fact, while satellite images showed that production rose just 7.2% y/y in the first four months of 2017, Chinese imports from the world rose by 20.1% y/y.

Increase in final demand for Asian-produced goods mean an increase in the demand for Asian dollars to pay for the goods. Indeed, most Asian currencies had gained against the USD on a year-to-date basis (**Exhibit B**).

Here, we will not go into the intricacies of which indicator leads the other[3], but explore more on the positive correlation between the demand for Asian exports and the demand for Asian currencies.

Using the Asia Dollar Index (ADXY) as a proxy for the price of Asian currencies, we found a mildly positive relationship with Asian exports, when translated into growth rates (**Exhibit C**).

Expected Slowdown In Asian Exports To Put A Drag On ADXY In 2H2017

Looking ahead into the second half of 2017, the stellar growth in Asian exports experienced since coming out from the bottom in February 2016 may start to slowdown. This is especially since we think that the current electronics cycle[4] (which has been rising for 16 consecutive months) may be coming to an end (**Exhibit D**).

With that, Asian currencies look increasingly likely to fall out of favour and may weaken against the base, US dollar. Furthermore, any signs of hawkishness from the US Federal Reserve with respect to its monetary policies (ie: interest rate hikes, balance sheet reduction) may quicken the pace of Asian dollar weakness. The global trend of central banks marking down their inflation forecasts is yet another sign of possible slowing demand in the trade sector.

3 Though a simple Granger causality test between ADXY and Asian exports show the failure to reject the null hypothesis that "exports growth does not granger cause ADXY growth"; while we accept the null hypothesis of the vice versa. Overall, it implies that the past values of Asian exports growth data should contain information that helps to predict the future values of ADXY beyond the information contained in the past values of ADXY alone.

4 Proxied by the World semiconductor net billings

Exhibit B: Most Asian Currencies Gained Against USD Year-to-Date In 2017

Source: Bloomberg, UOB Global Economics & Markets Research

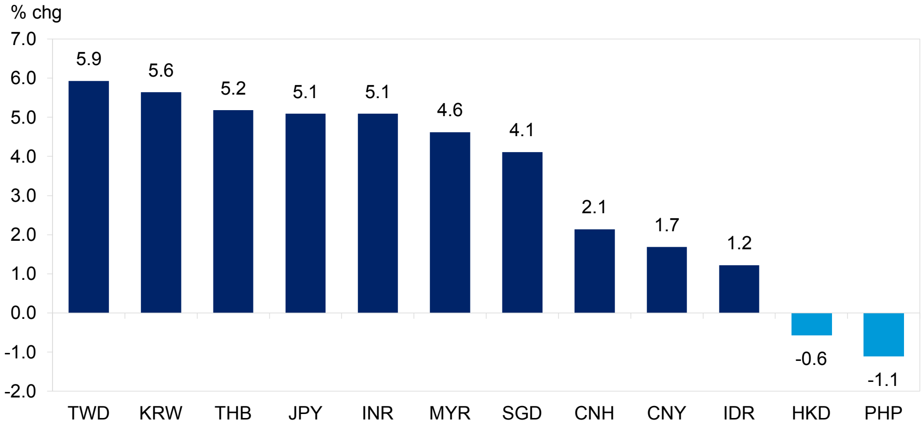


Exhibit C: Mildly Positive Correlation Between Asian Exports Growth And Asia Dollar Index

Source: CEIC, Bloomberg, UOB Global Economics & Markets Research

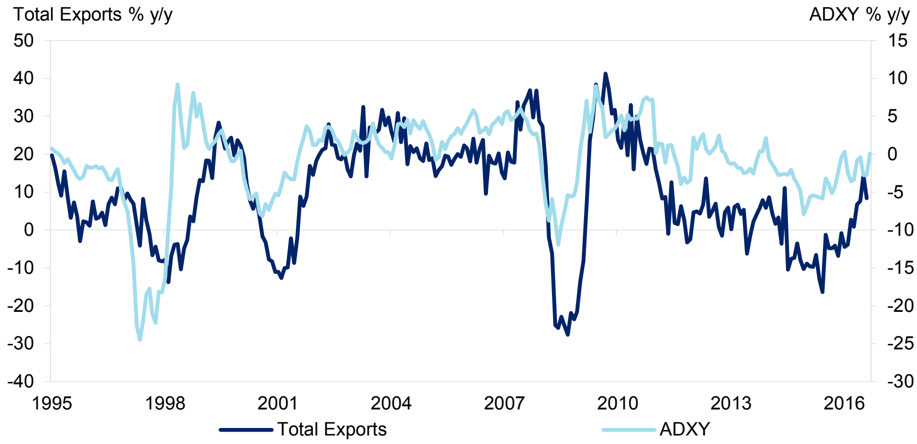
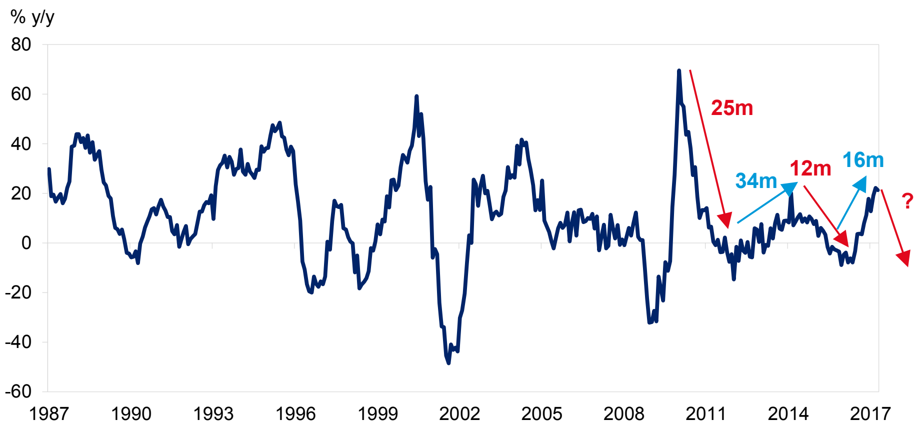


Exhibit D: Net Billings Of World Semiconductor

Source: CEIC, UOB Global Economics & Markets Research



GMS FOCUS

Thailand's Eastern Economic Corridor: The Next Major Economic Zone Of ASEAN

Thailand's Eastern Economic Corridor: The Next Major Economic Zone Of ASEAN
The Thai government has made structural reform a national agenda and has launched several important initiatives. One of the main focuses is to develop Eastern Economic Corridor (EEC) into a leading ASEAN economic zone with extensive infrastructure investments to support transport, logistics, and public utilities. It will also serve as ASEAN's sea transportation hub, which can connect with the Dawei deep-sea port in Myanmar, Sihanoukville port in Cambodia, and Vung Tau port in Vietnam.

The EEC could be seen as part of the Chinese geo-economic doctrine for OBOR (One Belt, One Road) the trans-national connectivity project to connect China with Asia, Europe and Africa through the land corridor and the sea corridor to augment global trade and economic cooperation.

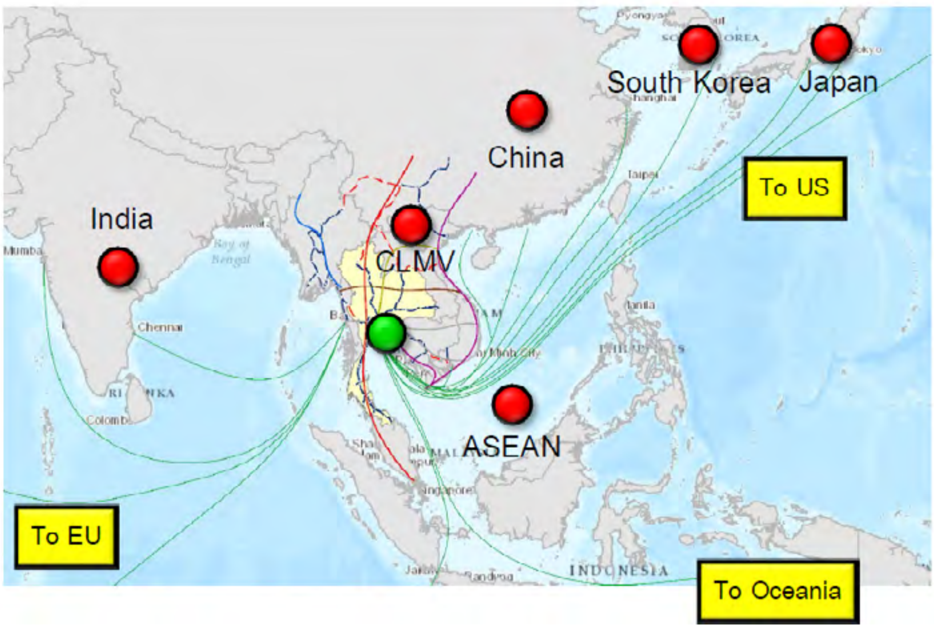
I. The EEC Development

This strategy will establish the EEC as a special economic zone across three eastern provinces – Chonburi, Rayong, and Chachoengsao – to attract investment in industries of the future. The implementation of the EEC will be based on three pillars: infrastructure upgrade, new industry development, and investment incentives and facilitation.

The EEC is designed to facilitate business operations with extensive infrastructure investments to support transport, logistics, and public utilities. Infrastructure investment in these areas includes U-Tapao International Airport, Sattahip Commercial Port, Laem Chabang Port, and Map Ta Phut Port. Other investment projects include a special highway linking Bangkok with Chon Buri, Pattaya, Map Ta Phut, Laem Chabang, and Nakhon Ratchasima, and a double-track railway, with the first section from Chachoengsao to Khlong Sip Kao and Kaeng Khoi, and the second section from Bangkok to Rayong. The Chuk Samet deep-sea port will be developed for yachts and cruise liners and will connect with other ports in the Gulf of Thailand and the Andaman Sea. The objective is to accommodate more business activities in the future.

Beyond building physical infrastructure, the EEC will promote ten target industries, which will become mechanisms for the new engine of growth. The ten target industries are divided into two categories. The first one involves the First S-Curve

Exhibit 1: EEC As ASEAN's Sea Transportation Hub



Source: MOI

Exhibit 2: Infrastructure Upgrading In The EEC

Source: TDRI

industries, that is, the five existing groups of industries in which Thailand has high potential. These industries include next-generation automotive, smart electronics, affluent medical and wellness tourism, agriculture and biotechnology, and food for the future. The second group is the New S-Curve, comprising industries for the future: robotics, aviation and logistics, biofuels and biochemicals, digital, and medical hub.

To gear Thailand towards sophisticated high-valued manufacturing, innovative manufacturing, and modern services, the Board of Investment (BOI) revised the criteria for investment promotion privileges to be based on the value added content of the project rather than on its location as in the past. The government will offer the investors in the special economic zone more corporate and personal income tax privileges, separate from the existing privileges offered by the BOI. A One Stop Service Center and a fund for competitiveness development will be set up for entrepreneurs as well.

II. The Importance Of The EEC To Growth

Thailand is in need of serious initiatives to upgrade and unlock our economic potential in the long term. Historical data indicate Thailand's failure in keeping pace with her friends into spotlight. Initially close to Thailand during 1950s, Taiwan and Korea have clearly embarked on the road to prosperity that leads them to high income status, whilst Thailand lost momentum early and stagnated at a relatively "comfortable" level of per capita income, soon to be outpaced by China. Despite the promise of the Asian Century, Thailand seems to risk being marginalized and caught in the so-called Middle Income Trap.

The government must invest to improve Thailand's long-term competitiveness, with the global economic landscape continuously evolving. Reflecting from experiences of successfully upgraded countries, well-developed and adequate infrastructure is a key necessary condition for success. By crowding in private sector's investment and enhancing labor productivity, infrastructure investment can lead to sustained productivity-driven growth that will pave Thailand's way out of the Middle Income Trap. Better transport infrastructure will propel Thailand to become the logistics hub of the Greater Mekong Sub-region (GMS).

III. The Sectoral Benefits Of The EEC

The planned economic zone integrates various modes of transportation including land (road and rail), air (airport), and water (seaports). The construction contracting and construction materials industries will be the first to reap benefits from this tremendous spending. Large contractors having prior experience handing public projects will lead the way. They could subcontract some work to smaller contractors. Businesses in the building materials industry, such as steel and cement, will also benefit from the EEC.

Additionally, the railway projects will be a catalyst for urbanization, creating new business opportunities for both the manufacturing and service sectors along the rail lines. The Thai government is prioritizing development of rail transport as it will provide great convenience but using less land and fuel than road transport, making it more environmentally friendly. It is also the least costly mode of transport. New rail systems will propel urbanization, generating a wide variety of business opportunities in transport and logistics, real estate, wholesale and retail trade and SMEs. Railway projects will create jobs, both in transport operations and related businesses. Although railway projects have high initial investment costs and low operating profits, they can be combined with property development in a so-called Transit Oriented Development (TOD) plan, which can greatly boost the value of land around the rail lines, creating more economic value.

The development of water transport infrastructure will better connect different ports to each other, and efficiently link them to other modes of transportation, reducing

Exhibit 3: Thailand's Economy Is Below Its Growth Potential

Source: NESDB, UOB Global Economics & Markets Research

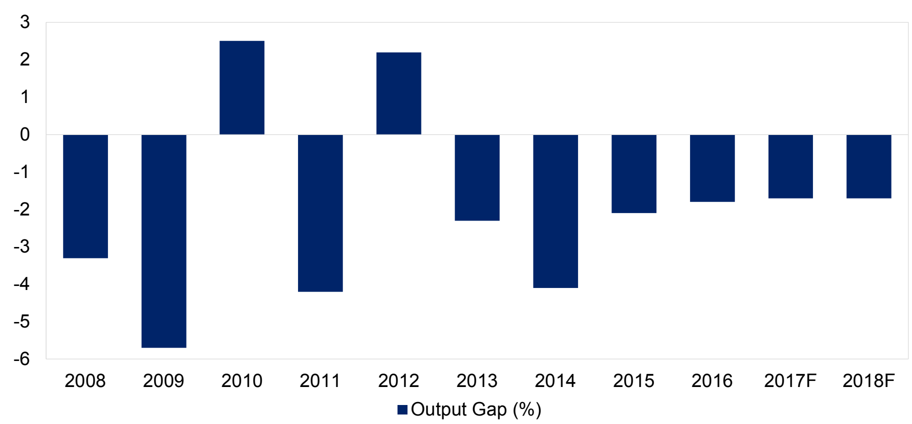
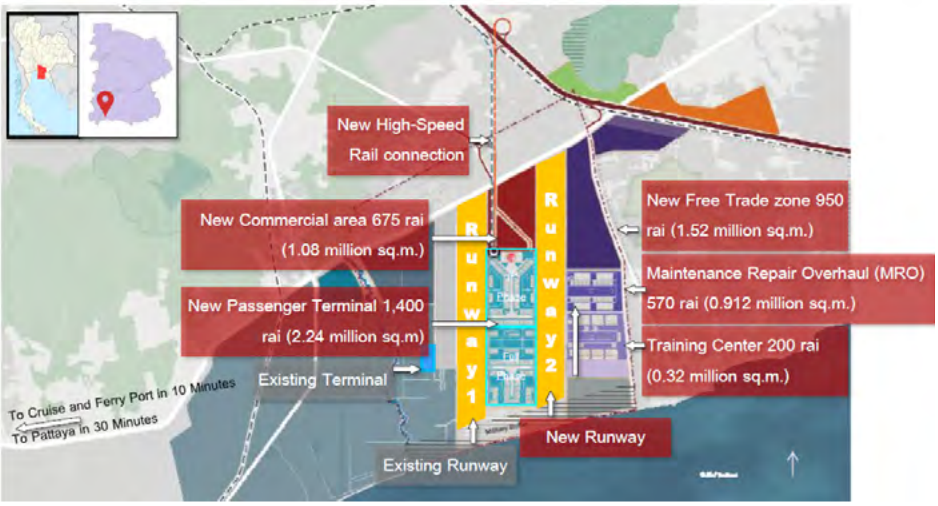


Exhibit 4: U-Tapao Airport City



Source: MOI

the cost of doing business. A plan will develop a new coastal terminal pier and the Single Rail Transfer Operator (SRTO) at Laem Chabang port, creating opportunities for other sectors in the value chain, from upstream to downstream. For instance, shipbuilding and maintenance companies will gain from more arrivals at the port. Warehouses will receive a larger volume of import and export cargo. Exporters and importers will benefit from lower operating costs and faster transportation time. Moreover, air transport projects will strengthen Thailand's airlines and boost related industries. The expansion of U-Tapao international airport will ease the transport of goods and passengers while boosting related industries. For example, contractors and providers of building materials will benefit directly during the construction period. Later, travel and leisure industries will benefit from more tourists. Aircraft catering industry will also get a boost in demand.

IV. Conclusion

The EEC is the enhancement of the former Eastern Seaboard that had been for over thirty years the region's powerhouse for manufacturing and trade. It consists of the three Eastern provinces Rayong, Chonburi, and Chachoengsao with a combined area of 13,285 square kilometers. The EEC will see investments of USD45bn during the next five years. The project will be financed through a combination of government, private and public-private partnership (PPP) funding.

The Thai government needs to increase infrastructure investment in promoting sustainable economic growth in order to pave Thailand's way out of the Middle Income Trap. Nevertheless, the EEC is not everything; it is only a necessary but not sufficient condition for success. Long-term improvements in Thailand's economic well-being also require drastic social infrastructure measures - including but not limited to educational reforms, legal improvements especially with regard to property rights and regulatory burdens for businesses, as well as improvements on government efficiency and good governance. These all-round upgrading policies will ensure Thailand a safe, undisrupted trip on the road to prosperity over the years to come.

CHINA FOCUS

Belt And Road Initiative And What It Means

Belt & Road Forum Reaffirms China's Stance On Mutual Cooperation

In the recently concluded Belt and Road Forum for International Cooperation ("BRF", held in Beijing on 14-15 May), attended by more than 1,500 delegates from over 130 countries and some 70 international organizations, Chinese President Xi Jinping noted the need to join hands to meet the global challenges in the principle of extensive consultation, joint contribution and shared benefits. Therefore the Belt and Road Initiative (B&R) will be one means to align countries' policies and integrate economic factors and resources in a global scale to create synergy to promote world peace, stability and shared development.

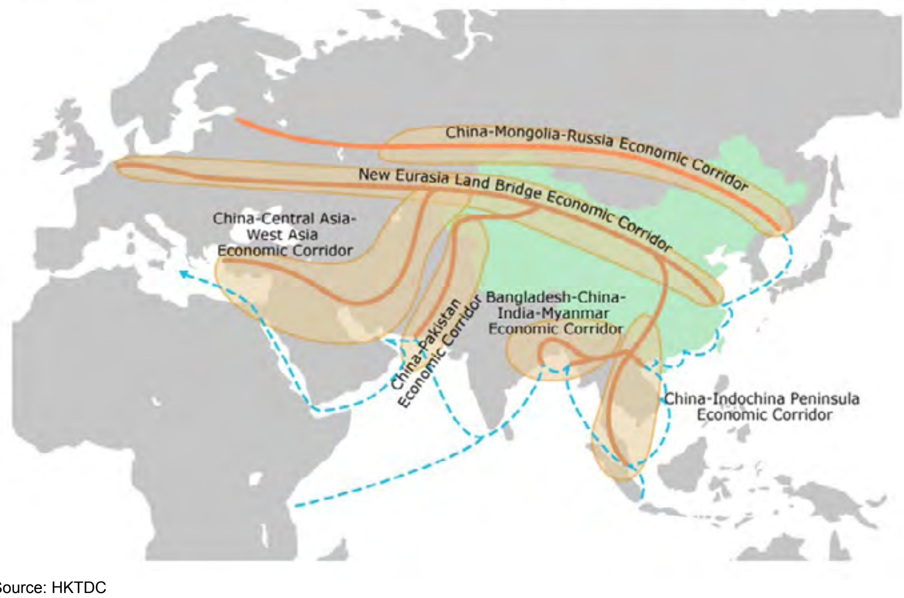
Chinese President Xi Jinping noted that Belt and Road Initiative (B&R) is about building partnership and not forming alliances, suggesting the initiative is leaning largely towards a trade/commerce approach rather than from political angle. Another contrast is the position China has taken with B&R, that is towards more open, inclusive, and globalized trade, investment, commercial, cultural, and people-to-people exchanges, compared to increasing trends towards inward looking, nationalistic, exclusionary, and populist policies adopted by some major economies. The BRF also serves as a checkpoint for the Initiative first mooted by President Xi in 2013, to gauge the successes and challenges as it moves forward. The next BRF is scheduled to be held two years later in 2019.

Size Of B&R A Force To Be Reckoned With

As seen in the table on the next page, B&R countries along with China, are an economic force to be reckoned with as its size is equivalent or even larger than some of the trade blocs. While B&R is not a trade bloc, its economic size is equivalent to that of the TPP (including US) at 40% of global GDP, though with the US' withdrawal, TPP will be just a shadow its former self. B&R countries also have access to large block of population at 4.4bn, which is the largest compared to other potential trading blocs. This means that with infrastructure especially transportation and communications network being built up, B&R will indeed present large scope of opportunities for commercial and people-to-people exchanges.

As nearly 40% of the global economy consists of emerging economies (in 2016, vs. 20% share in 1996), a more inclusive and open arrangement such as B&R, will be beneficial to their development, as that allows for greater participation of opportunities.

The Belt and Road Initiative: Six Economic Corridors Spanning Asia, Europe and Africa



Source: HKTDC

Comparison* Of B&R To RCEP And TPP

Indicator	TPP	TPP (ex US)	B&R	B&R (ex China)	RCEP	FTAAP
No. of Economies	12	11	68	67	16	21
Population	800mn	490mn	4.4bn	3.2bn	3.5bn	2.9bn
Nominal GDP (US$ tn)	27.5	9.4	22.0	12.0	22.6	43.8
% of Global GDP	40%	13%	40%	16.0	30%	60%
% Share of Global Trade	26%	15%	34%	22%	29%	50%

***B&R** (Belt & Road) is not a trade agreement and is included here for comparison purposes only.
TPP (Trans-Pacific Partnership, 12 members): The US, Japan, Malaysia, Vietnam, Singapore, Brunei, Australia, New Zealand, Canada, Mexico, Chile and Peru. US President Trump announced on 23 Jan 2017 the US' withdrawal from TPP.
RCEP (Regional Comprehensive Economic Partnership, 10+6): ASEAN's 10 members plus China, Japan, South Korea, India, Australia, and New Zealand
FTAAP (Free Trade Area of the Asia-Pacific): Currently all 21 members of APEC (the US; Australia; Brunei; Canada; Chile; China; Hong Kong, China; Indonesia; Japan; Malaysia; Mexico; New Zealand; Papua New Guinea; Peru; The Philippines; Russia; Singapore; Republic of Korea; Chinese Taipei; Thailand; and Viet Nam)

Source: IMF, World Trade Organization (WTO), Bloomberg, UOB Global Economics & Markets Research estimates

Lining Up Financing Support

Financing is at the centre of B&R Initiative and the Chinese government has announced a list at the BRF 2017 session in Beijing (see table below). Based on the figures disclosed, China will be committing at least RMB780bn at this stage. Two questions arise: what is the source of funding and whether this figure is sufficient for the B&R Initiative.

As for the source of funding, the bulk of the funding is in denominated in RMB, which means that Chinese government is eyeing greater use of the domestic currency in this project. With the Chinese central government debt ratio well below 20% of China's GDP, there is room to leverage up should there be a need to do so.

In terms of sufficiency, there is certainly much financial gap to fill as ADB estimates that Asia alone needs to spend US$1.7tn per year in infrastructure investments until 2030. As the B&R Initiative is meant to be a mutual cooperation project, financing is expected to be coming from different sources, including multilateral agencies such as AIIB, ADB, World Bank, and private sector participation.

B&R By The Numbers:

- B&R which was first unveiled in 2013 consists of 6 economic corridors and spans 68 countries representing more than 60% of the global population and around 40% of global GDP. The B&R will connect Asia, Africa, the Middle East and Europe.

- Chinese investments related to the B&R Initiative have totalled US$60bn since 2013 and set to pick up with US$600-800bn investments planned for the next five years – equivalent to US$120-130bn per year over the period. Although the amount is large, it dwarfs in comparison with Asian Development Bank's (ADB) estimates that developing Asia alone needs to spend US$1.7tn per year in infrastructure investments until 2030 of which Southeast Asia's annual requirement is US$210bn. The greatest requirements will be in the power and transport sectors. China is expected to fill a large part of the infrastructure investment gap.

- China's annual trade with countries involved in B&R is expected to exceed $2.5tn within a decade, from US$954bn in 2016 (25.7% share of China's total cross-border trade) and US$877.2bn in 2012 (25.1% share of China's total cross-border trade volume).

- Top 10 largest B&R trade partners with China (total trade): Vietnam, Thailand, Singapore, UAE, Russia, Indonesia, Philippines, India, Malaysia, Saudi Arabia.

- The investment and trade opportunities arising from the B&R Initiative will lead to economic development and jobs creation. Between 2013 to 2016, more than 180,000 local jobs were created and paid US$1.1bn in tax to local governments.

- The China-led Asian Infrastructure Investment Bank (AIIB) which was launched in early 2016 with US$100bn of initial capital, has granted US$1.7bn loans for nine projects, while the government-backed Silk Road Fund has lent about US$4bn of funds, including for a water dam project in Pakistan. Shanghai-based New Development Bank is another source of funding with US$50bn initial capital.

B&R: Dollars And Cents Announced During BRF In 2017

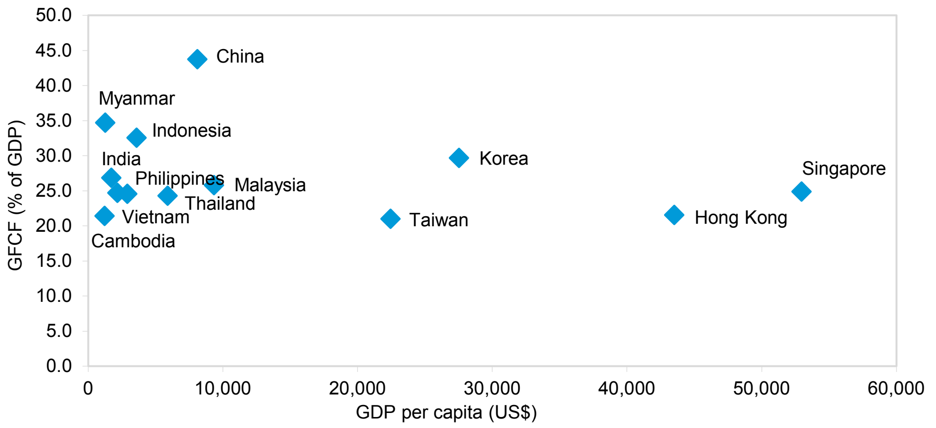
Items	Amount
Silk Road Fund (additional injection)	RMB100bn
Overseas Fund Business in RMB for promotion of RMB usage	RMB300bn
China-Russia Regional Cooperation Development Investment Fund	Initial capital RMB10bn Total size RMB100bn
China Development Bank to set up the Belt and Road Multi-currency Special Lending Scheme for Infrastructure Development	RMB 100bn equivalent
China Development Bank to set up Belt and Road Multi-currency Special Lending Scheme for Industrial Cooperation	RMB 100bn equivalent
China Development Bank to set up Belt and Road Multi-currency Special Credit Lines for Overseas Financial Institutions	RMB 50bn equivalent
Export-Import Bank of China to set up Belt and Road Multi-currency Special Lending Scheme	RMB 100bn equivalent
Export-Import Bank of China to set up Belt and Road Multi-currency Special Lending Scheme for Infrastructure Development	RMB 30bn equivalent
Chinese government to increase its assistance to the developing countries along the B&R	At least RMB 60bn over next 3 years
Chinese government to provide emergency food aid to the countries along the B&R	RMB 2bn
China to replenish the South-South Cooperation Assistance Fund	US$1bn
China to provide funding to relevant international organizations to jointly promote the implementation of international cooperation projects benefiting the countries on the B&R	US$1bn

Source: yidaiyilu.gov.cn, UOB Global Economics & Markets Research estimates

- China Development Bank has granted US$168.2bn worth of loans for more than 600 projects since the Initiative was unveiled in 2013 while Export and Import Bank of China has loaned out about US$100bn.
- China has committed to inject at least RMB780bn (US$113bn) via its state funds and banks to finance projects in the B&R Initiative. This comprises RMB100bn increase to the Silk Road Fund, increase special overseas loans by China Development Bank and Export and Import Bank of China by RMB250bn and RMB130bn respectively, and encourage Chinese banks to set up overseas funds worth about RMB300bn to help belt and road funding.

Investment as % of GDP (2016)

Note: China, Cambodia and Vietnam GFCF based on 2015 data
Source: IMF, CEIC, UOB Global Economics & Markets Research



Potential Beneficiaries Of B&R Initiative

RMB Internationalization

From trade and investment flows' perspective, increased activities in B&R would naturally lead to greater scope for RMB usage and internationalization. Of note is that the Chinese government has committed RMB300bn to Overseas Fund Business in RMB to promote the usage of RMB, according to official document.

Expanded goods and services trade ("current account" flows), financing the supply and demand gap for infrastructure investment in B&R countries coupled with increased outward direct investment (ODI) by Chinese enterprises, banks and government ("capital account" flows) are likely to provide enlarged RMB flows going forward. The share of total goods trade by B&R countries accounted for about 34% of world's total trade. B&R countries' total trade with China accounted for 25.7% share of China's total trade in 2016. China's total services trade with B&R countries reached US$122.2bn in 2016, accounting for 15.2% of China's total services trade, and 3.4% point higher than in 2015. According to one estimate, from January 2012 to September 2015, the amount of China's ODI settled in RMB increased from RMB 0.2bn to RMB 20.8bn, the latter accounting for 20% of China's total ODI as of September 2015.

ASEAN

Due to geographic proximity, historic relations, availability of resources and an emerging market, ASEAN is expected to benefit as activities pick up in B&R. This is already reflected in the top 10 trade partners' list with China, where ASEAN countries comprised of 60% of the share. In addition, under B&R, China has a range of arrangements and agreements with ASEAN, including the China-Indochina Peninsula Economic Corridor (as one of

The Global Competitiveness Index: Infrastructure Ranking (Rank/138 Countries)

	Infrastructure Ranking	Quality of Roads	Quality of Railroad	Quality of Port	Quality of Air Transport	Quality of Electricity Supply	Mobile Phone Subscriptions
Singapore	2	2	5	2	1	2	24
Malaysia	24	20	15	17	20	39	27
Russian Federation	35	123	25	72	65	62	13
China	42	39	14	43	49	56	105
Thailand	49	60	77	65	42	61	55
Indonesia	60	75	39	75	62	89	38
India	68	51	23	48	63	88	123
Brunei	78	41	na	87	84	52	85
Vietnam	79	89	52	77	86	85	40
Philippines	95	106	89	113	116	94	65
Cambodia	106	93	98	76	99	106	35
Lao PDR	108	91	na	132	100	77	131
Mongolia	110	109	69	137	124	97	93
Pakistan	116	77	53	84	91	121	130

Source: World Economic Forum, The Global Competitiveness Index Report 2016-17, UOB Global Economics & Markets Research

the 6 B&R economic corridors), China-ASEAN Free Trade Area, ASEAN and China Production Capacity Cooperation, and in areas such as maritime, port development, connectivity, tourism, health, environment, among others.

Industries/Sectors To Benefit In B&R Initiative

While it is obvious that infrastructure-related development would be the first areas to benefit from B&R, the Initiative is more than just infrastructure such as sea/land/air transport, energy, water, information communications, and pipelines. Greater flows of commercial, cultural and people-to-people exchanges will help boost demand for tourism-related industries such as F&B, hotel, recreational, and shopping, education, and healthcare.

Closer Integration Amidst A Protectionist/Anti-Globalization Environment

Amidst a rising protectionist, populist, and anti-globalization tendency in parts of the world, the B&R Initiative stands in sharp contrast as it aims to promote peaceful cooperation and common development around the world to promote efficiency in the flow of production factors and integration of markets, in order to achieve diversified, independent, balanced and sustainable development. As such, the Initiative should bring about greater level of economic activities among the participants as compared to an isolationist approach.

Key Infrastructure Projects (As of May 2017)
China-Europe Railway Express was launched in January 2017. The freight network spans 12,000 km, crossing Kazakhstan, Russia, Belarus, the EU and the UK.
China-Iran Railway freight network became operational in February 2016 where trains pass through Kazakhstan and Turkmenistan before entering Iran.
The Khorgos Gateway dry port connects Kazakhstan to China by rail.
414 km rail line between China and Laos and another more than 800 km long rail to link the Thai-Laos border of Nong Khai with Bangkok as well as Thailand's main deep-sea port in eastern Thailand.
China-funded ports and East Coast Rail Line (ECRL) will connect ports on the east and west coasts of Peninsular Malaysia
300 miles Nairobi-Mombasa railway in Africa.
China-Pakistan Economic Corridor (CPEC) consists of an estimated US$54bn worth of infrastructure projects. One of the key projects is to connect Pakistan's south-western Gwadar port with Kashgar, a city in China's north-western Xinjiang province.
The US$7.3bn Central Asia–China Gas Pipeline is a natural gas pipeline system developed as an extension of an earlier pipeline begun by the Soviets.

Source: Newswires; UOB Global Economics & Markets Research compilation

中国焦点

一带一路倡议及其意义

(This is the translated version of **China Focus: Belt And Road Initiative And What It Means** on page 23)

一带一路高峰论坛再次强调中国坚持互惠互利、共同合作

由130多个国家以及70多个国际组织的1500多名代表团成员共同参加的一带一路国际合作高峰论坛（5月14-15日于北京召开的“一带一路论坛”）于近期圆满落幕。中国国家主席习近平在论坛上指出，各方需要携起手来，本着深入磋商、合作共建和利益共享的原则共同应对国际挑战。由此可见，一带一路倡议（B&R）将能够有效协调各个国家的政策，从全球角度整合经济要素和资源，形成协同作用，推动世界和平稳定与共同发展。

中国国家主席习近平还强调，一带一路倡议（B&R）的目的是形成合作伙伴关系，而不是搞联盟。由此说明一带一路倡议会主要倾向于贸易/商业角度，而不是政治角度。相比其他某些主要经济体采取的日渐内向、民粹主义趋势、逆全球化的政策，中国在一带一路规划中对国际贸易、投资、商业、文化和民间交流则表现出了更加开放、包容的姿态。自习近平主席于2013年首次提出一带一路倡议至今，本届一带一路论坛也成为了衡量倡议执行成功与否，还面临哪些困难的一次重要检验。下一届一带一路高峰论坛计划将于两年后的2019年举行。

一带一路的规模 -不可轻视的力量

如下表所示，一带一路国家以及中国是一股不可小视的经济力量，其规模已经等同于甚至超过了某些贸易集团。尽管一带一路不是贸易集团，但其规模已经等同于TPP（包括美国），占到了全球GDP总量的40%。而在美国退出后，现有的TPP规模已大不如前。一带一路国家同时还拥有着44亿的巨大人口数量，这一数字超过了其他所有潜在的贸易集团。这也就意味着，在各项基础设施，尤其是运输和通讯网络建设完成后，一带一路将会带来巨大的商业和民间交流机会。

一带一路规划：六条经济走廊横跨亚洲、欧洲和非洲

来源：新华网 http://www.xinhuanet.com/fortune/cjzthgjj/104.htm

目前全球新兴经济体占整体国际经济的比例已高达近40%（2016年数据，1996年的规模为20%），由此可见一带一路这种更加包容、开放的规划安排将能够给参与者带来更多的机会，从而让所有参与国的经济发展都能从中受益。

资金支持

融资是一带一路倡议的核心。在2017年的北京一带一路高峰论坛上，中国政府公布了一份名单（见下表）。根据数字披露，中国在目前阶段将承诺提供不少于7800亿人民币的资金。有关这方面引起了两个问题：资金的来源是什么？这个数字是否能够满足一带一路倡议的整体需求？

关于资金来源，大部分资金将以人民币计价，也就是说中国政府计划在这个项目上大范围使用其本国货币。目前中国中央政府的负债比率远低于中国GDP的20%，因此在必要的情况下，还有一定的杠杆空间。

从能否满足需求角度看，亚洲开发银行预计，在2030年以前，仅亚洲每年在基础建设方面的投资需求就高达1.7万亿美元。因此资金方面的缺口肯定还很大。由于一

一带一路与区域全面经济伙伴关系（RCEP）及跨太平洋伙伴关系协定（TPP）的对比*

-	TPP	TPP（不含美国）	一带一路	一带一路（不含中国）	RCEP	FTAAP
经济体数量	12	11	68	67	16	21
人口数量	8亿	4.9亿	44亿	32亿	35亿	29亿
名义GDP（万亿美元）	27.5	9.4	22.0	12.0	22.6	43.8
占全球GDP比重%	40%	13%	40%	16.0	30%	60%
占全球贸易量比重%	26%	15%	34%	22%	29%	50%

*一带一路不属于贸易协定，在此仅用作比较目的。
TPP（跨太平洋伙伴关系协定，12个成员国）：美国、日本、马来西亚、越南、新加坡、文莱、澳大利亚、新西兰、加拿大、墨西哥、智利及秘鲁。美国总统特朗普于2017年1月23日宣布美国退出TPP。
RCEP（区域全面经济伙伴关系，10+6）：东盟10个成员国加中国、日本、韩国、印度、澳大利亚以及新西兰
FTAAP（亚太自由贸易区）：目前包括亚太经合组织（APEC）的全部21个成员国（美国、澳大利亚、文莱、加拿大、智利、中国、中国香港、印度尼西亚、日本、马来西亚、墨西哥、新西兰、巴布亚新几内亚、秘鲁、菲律宾、俄罗斯、新加坡、韩国、中华台北、泰国以及越南）

来源：国际货币基金组织、世界贸易组织（WTO）、彭博社、大华银行环球经济与市场研究部估计

一带一路：2017年一带一路高峰论坛上公布的资金使用情况

项目	金额
丝路基金（新增资金）	人民币1000亿元
鼓励金融机构开展人民币海外基金业务资金支持	人民币3000亿元（初步预计）
中俄区域合作发展投资基金	首期100亿元人民币；总规模人民币1000亿元
中国国家开发银行设立“一带一路”基础设施专项贷款	1000亿元等值人民币
中国国家开发银行设立“一带一路”产能合作专项贷款	1000亿元等值人民币
中国国家开发银行设立“一带一路”金融合作专项贷款	500亿元等值人民币
中国进出口银行设立“一带一路”专项贷款额度	1000亿元等值人民币
中国进出口银行设立“一带一路”基础设施专项贷款额度	300亿元等值人民币
中国政府将加大对沿线发展中国家的援助力度	未来3总体援助规模不少于600亿元人民币
中国政府将向沿线发展中国家提供紧急粮食援助	20亿元人民币
中国政府将向南南合作援助基金增资	10亿美元
中国政府向有关国际组织提供资金共同推动落实一批惠及沿线国家的国际合作项目	10亿美元

来源：https://www.yidaiyilu.gov.cn/xwzx/gnxw/13690.htm, 大华银行环球经济与市场研究部估计

带一路倡议属于共同合作项目，因此预期将有多个不同的资金来源，其中包括亚洲基础设施投资银行、亚洲开发银行、世界银行等多边机构，以及私营部门的资金参与。

数字看一带一路

- 于2013年提出的一带一路概念包含了6个经济走廊，跨越68个国家，影响全球超过60%的人口，占全球GDP总量的40%左右。一带一路将连接亚洲、非洲、中东地区以及欧洲。

- 自2013年至今，中国方面用于一带一路建设的投资累计已达到600亿美元，并将在未来五年继续投入6000-8000亿美元的资金，相当于每年投入1200-1300亿美元的规模。而这一金额相比之下还不算大，据亚洲开发银行(ADB)估计，在2017-2030年间，仅亚洲在基础设施建设方面的总投资就需要高达1.7万亿美元的资金，其中东南亚每年需要2100亿美元。而其中需求量最大的则是电力和运输行业。预计中国将承担起填补大部分基础建设投资资金缺口的重任。

- 中国与一带一路相关国家的年贸易额预计将在10年内超过2.5万亿美元，而这一数字在2016年还是9540亿美元（占中国跨境贸易总额的25.7%），在2012年则为8772亿美元（占中国跨境贸易总额的25.1%）。

- 中国的前十大一带一路贸易伙伴（总贸易额）：越南、泰国、新加坡、阿联酋、俄罗斯、印度尼西亚、菲律宾、印度、马来西亚、沙特阿拉伯。

- 一带一路建设所带来的投资和贸易机会将有效促进经济发展和就业。在2013年到2016年间，一带一路倡议累计给当地创造了180,000个就业岗位，并促成了11亿美元的当地政府税收。

- 由中国牵头的亚洲基础设施投资银行(AIIB)设立于2016年上半年，创办资本1000亿美元，截至目前已为9个项目提供了17亿美元的贷款资金。同时由政府支持的丝路基金也已贷出了约40亿美元资金，所支持的项目中包括兴建于巴基斯坦的一座水坝。总部位于上海并拥有500亿美元创办资本的金砖国家新开发银行，则是又一资金来源。

- 自2013年一带一路倡议启动以来，中国国家开发银行已为超过600个项目提供了价值1682亿美元的贷款，同时中国进出口银行则提供了约1000亿美元的贷款。

- 中国还承诺通过国家资金和银行继续注资不少于人民币7800亿元（合1130亿美元）来为一带一路倡议中的项目提供资金。这当中包括向丝路基金增资人民币1000亿元、分别向中国国家开发银行和中国进出口银行的海外特别贷款增资人民币2500亿元及1300亿元，以及出资大约人民币3000亿元鼓励中国各大银行设立海外基金帮助一带一路进行融资。

一带一路倡议的潜在受益方

人民币国际化

从贸易和投资流动的角度看，一带一路活动的日渐增加将自然而然地扩大人民币的需求和使用范围并促成其国际化的加大。值得注意的是，据官方文件显示，在一带一路倡议下，中国政府鼓励金融机构开展人民币海外基金业务资金支持达3000亿元。

日渐扩大的商品和服务贸易（“经常账户”资金流动），为一带一路国家的基础设施建设投资方面的供给和需求缺口提供融资，以及提高中国企业、银行和政府（“资本账户”资金流动）的对外直接投资（ODI）额将很可能促进人民币向海外流动。目前一带一路国家的商品贸易总额已经占到了世界贸易总额的34%左右。2016年，一带一路国家与中国的贸易总额已占到中国对外贸易总额的25.7%。中国与一带一路国家之间的服务贸易总额在2016年达到了1222亿美元，占中国服务贸易总额的15.2%，相比2015年提高3.4%。据一项估计显示，从2012年1月到2015年9月，中国以人民币结算的直接对外投资金额从2亿元猛增至208亿元，其中后者已经占到了2015年截止至9月以来中国对外投资总额的20%。

国际竞争力指数：基础设施排名（排名/138个国家）

	基础设施排名	道路质量	铁路质量	港口质量	航空运输质量	供电质量	移动电话使用情况
新加坡	2	2	5	2	1	2	24
马来西亚	24	20	15	17	20	39	27
俄罗斯联邦	35	123	25	72	65	62	13
中国	42	39	14	43	49	56	105
泰国	49	60	77	65	42	61	55
印度尼西亚	60	75	39	75	62	89	38
印度	68	51	23	48	63	88	123
文莱	78	41	na	87	84	52	85
越南	79	89	52	77	86	85	40
菲律宾	95	106	89	113	116	94	65
柬埔寨	106	93	98	76	99	106	35
老挝	108	91	na	132	100	77	131
蒙古	110	109	69	137	124	97	93
巴基斯坦	116	77	53	84	91	121	130

来源：世界经济论坛，2016-17年国际竞争力报告

东南亚国家联盟

考虑到地理位置靠近、历史渊源深远、可用资源丰富、人口红利等原因，东盟作为新兴市场预计将显著受益于日渐频繁的一带一路经济活动。从中国的前十大贸易伙伴名单上看这一点已经非常显著，目前东盟国家已经占到了名单的60%。除此之外，在一带一路倡议下，中国与东盟国家之间存在有一系列的安排与协议，其中包括中国-中南半岛经济走廊（一带一路6大经济走廊之一）、中国-东盟自由贸易区、东盟与中国产能合作，以及在海事、港口开发、互联网、旅游、医疗健康、环境等领域的合作。

能够受益于一带一路倡议的行业领域

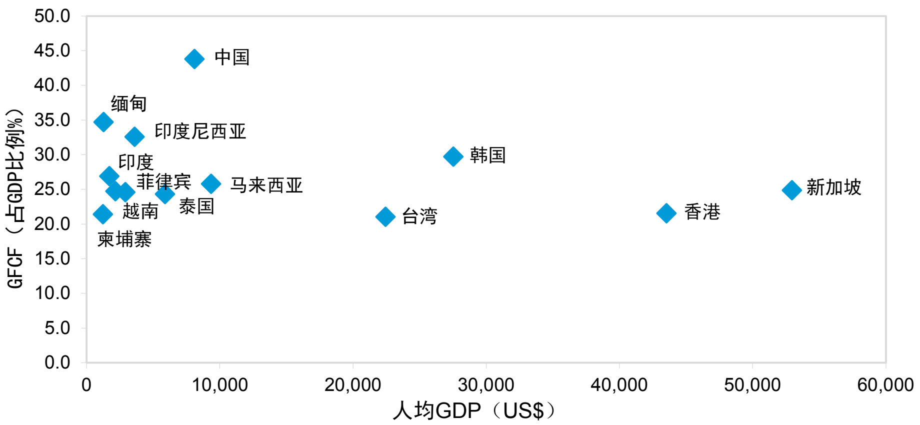
虽然最先受益于一带一路倡议的领域毫无疑问是基础设施建设相关行业，但倡议绝不仅仅局限于海洋/陆地/空中运输、能源、水利、信息通讯和管道等基础设施的建设。除此之外还将产生大量的商业、文化和民间交流，从而有效催生对餐饮、酒店、休闲、购物、教育及医疗保健等旅游及服务相关行业的需求。

在贸易保护主义/反全球化环境中力求市场融合

在当今世界部分地区贸易保护主义、民粹主义和反全球化趋势的浪潮中，一带一路倡议则孑然以促进世界和平合作和共同发展为目标，力求提高生产要素流动效率、促进市场融合，最终实现多样化、独立、平衡并且可持续的发展。由此可见，相比孤立主义模式，一带一路倡议必将带领参与各国走上经济发展活动的新台阶。

投资占GDP比例%（2016）

注释：中国、柬埔寨和越南的GFCF采用2015年数据
来源：国际货币基金组织、亚洲经济数据库、大华银行环球经济与市场研究部



主要基础设施建设项目（截止至2017年5月）

中欧铁路班列于2017年1月启动。其运输网络绵延12000km，跨越哈萨克斯坦、俄罗斯、白俄罗斯、欧盟及英国。

中国-伊朗铁路货运网络于2016年2月投入运营，列车可穿越哈萨克斯坦和土库曼斯坦进入伊朗。

中哈霍尔果斯口岸无水港可通过铁路连接哈萨克斯坦与中国。

中国与老挝之间有414km长的铁路线，同时另有一条800km长的铁路可将廊开府内的泰国-老挝边境与曼谷及位于泰国东部的泰国主要深水港相互连接。

由中国出资建立的港口和东海岸衔接铁道（ECRL）能够将马来半岛东西岸的港口相互连通

位于非洲的300英里长内罗毕-蒙巴萨岛铁路。

中国-巴基斯坦经济走廊（CPEC）包含了预计总值约540亿美元的基础设施建设项目。其中最主要的项目之一，就是连接巴基斯坦西南部的瓜达尔与中国西北部新疆自治区的喀什葛尔市。

价值73亿美元的中亚-中国天然气运输管道是在早年间苏联所建运输管道基础上延伸发展出来的天然气运输通道。

来源：道琼斯通讯社；大华银行环球经济与市场研究部汇编

FX STRATEGY
FX Themes For 3Q

Theme #1 — **Buy EUR/USD On Dips For A Mid-Term Upswing**

EUR/USD is on track to its best quarterly finish (currently +5.1% for Q2) in over six years after Macron's Presidency in the latest French elections in May soothed fears of right-wing populism taking root in continental Europe. Also supporting the up move in EUR/USD is the **outperformance of European economic data** over that of United States (see Chart 1).

Reflecting the optimism, **net speculative EUR longs rose to the highest** since May 2011 according to CFTC data as at June 13. Based on that notion alone, it is fair to say that EUR is becoming a "crowded trade". In the near term, it is likely that the extreme positioning has to moderate somewhat to inject longevity into the recovery that begun earlier this year.

In the bigger schemes of things, EUR/USD has been largely trapped in a low 1.05 – 1.15 range (see Chart 2) for the past two and half years while the European Central Bank (ECB) conducted quantitative easing (QE). Although not explicitly laid out by the ECB yet, the next policy step is clearly skewed towards removing monetary stimulus gradually. With the central bank turning incrementally hawkish, together with receding political uncertainty in the Euro-bloc, the **risk is for further EUR/USD upside from here**. Although we forecast EUR/USD at 1.1300 by end 2017, an overshoot past the 1.15 upper range bound would not be surprising. In all, we **recommend buying EUR/USD on dips towards 1.1050**.

Chart 1: EUR/USD Benefiting From Better Data In Europe Compared To US

Source: Bloomberg, UOB Global Economics & Markets Research

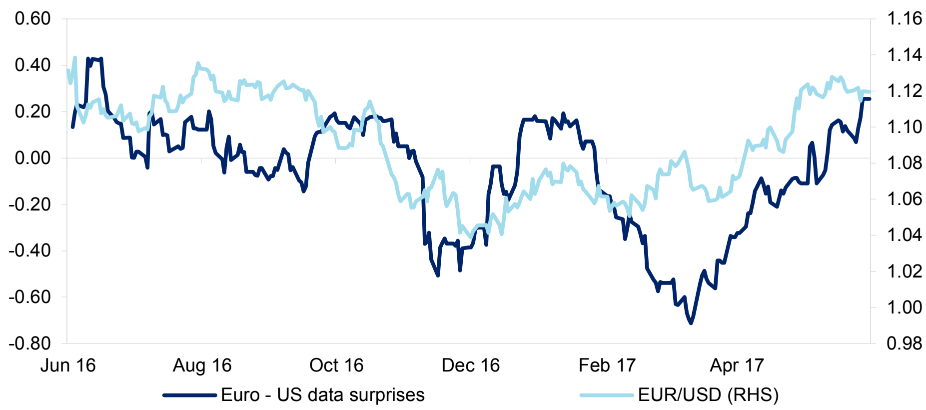
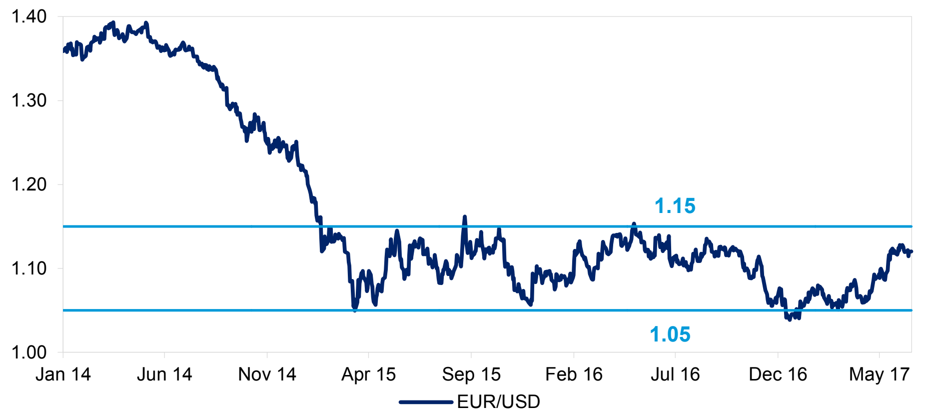


Chart 2: QE Trapped The EUR/USD In A Range

Source: Bloomberg, UOB Global Economics & Markets Research



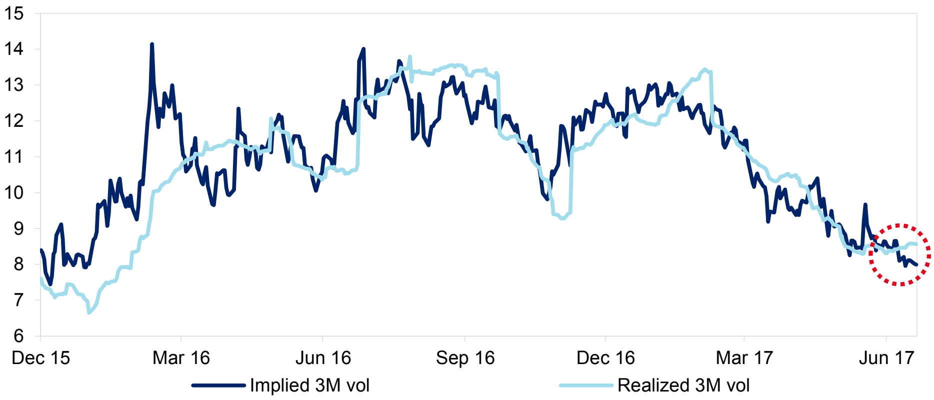
Theme #2 Picking Up Cheap Hedges

Since the start of the year, **implied volatilities for most currency pairs have been dropping precipitously**. The improving global economy, ample liquidity in the global financial markets together with well communicated monetary policies directions have all played a part in creating a backdrop of unusual calmness. Also, market participants are also increasingly complacent that selloffs are rare and often quick-reversing when it occurs.

USD/JPY is usually one of the most reactive currency pair in G-10 to adjustments in risk sentiments. Its associated 3-month implied volatility has dropped to 8%, lowest levels since December 2015 (see Chart 3). Also, the implied volatility is also trading below that of realized (also in Chart 3), thereby presenting some value here. In all, the current conditions provide a **good opportunity to construct cost-effective hedges with asymmetric pay-offs**. For example, a **3-month USD/JPY put spread** [buy 110.00 put, sell 107.50 put, same amounts] allows a maximum profit of 250 yen pips for a cost of 70 pips, or a 3.5 times return. The structure can hedge against unexpected risk aversion or sustained depreciation in the U.S dollar.

Chart 3: USD/JPY Vols Back To Dec 2015 Levels

Source: Bloomberg, UOB Global Economics & Markets Research



Theme #3 Fade Asian Outperformance – Buy USD/TWD

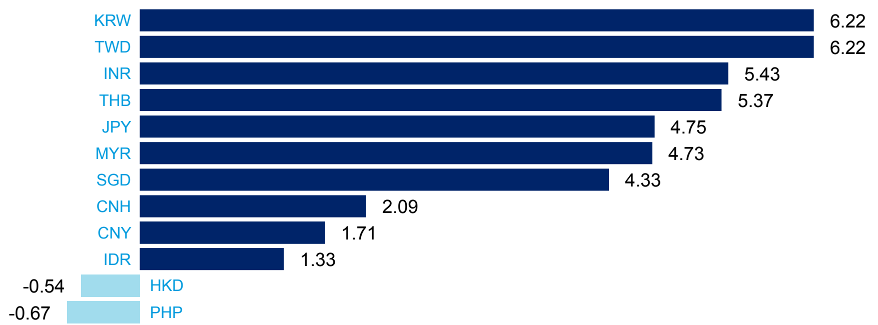
2017 has been a strong year for Asian currencies as a whole. Investors poured into the region searching for yield after the Trumpflation trade faltered. Year till date, **Asian currencies are mostly higher** (see Table 1), led by 6.2% gain in Korean Won (KRW) and Taiwan Dollar (TWD).

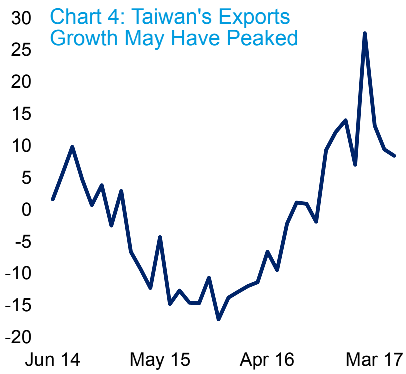
Into the second half of the year, **the pendulum may swing toward the U.S dollar** again and spur some profit taking of Asian currencies. A repricing of the currently underpriced Fed and its balance sheet reduction plan, together with progress in key policies of the Trump's administration are likely drivers for the move.

Regionally, **the strong exports growth that underscored much of Asian currencies' gains may moderate** in the second half. For one, Taiwan is most sensitive to electronics and the strong double-digits exports growth may have already peaked (see Chart 4). The gains on the currency have also started to stall. In May, the TWD failed to appreciate past the psychological 30.00 level against the USD (see Chart 5). Together with the NDF points gradually shifting to the right, the cautious tone in TWD looks set to extend into the summer months. In all, we look to **buy dips in USD/TWD at 30.25/30**, looking for a move towards 31.00 in the mid-term.

Table 1: Year Till Date Returns For Asian Currencies Against The USD

Source: Bloomberg, UOB Global Economics & Markets Research



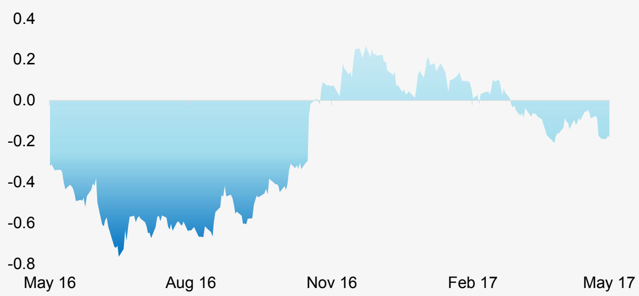


RATES STRATEGY

Revising Our SG And US Rates Forecasts Lower

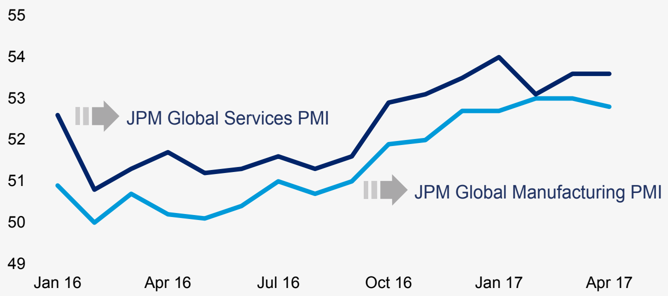
We have revised our rates outlook for both SG and US rates lower in recognition that most of our expected upside catalysts have not resulted in a durable positive feedback loop for yields. Downshifting the forecast curve is reasonable now that we are entering into the seasonally weak months, between May and August, for risk assets. In addition, we are not optimistic of bold policy actions taking place during the northern hemisphere summer lull. However, we continue to hold to an upside trajectory in both the SG and US rates path since the known upside yield catalysts are merely dormant rather than extinct. There are also valid concerns that valuations in the rates space are already on the dovish end of the scale when we exclude a recessionary scenario, thus room on the downside for yields may be limited from prevailing levels.

Lowering The Rates Bar…



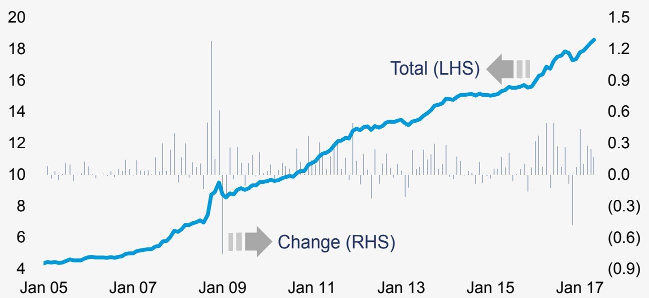
10Y UST Term Premium Back In Negative Territory

Expectations and re-pricing of fiscal stimulus in rates markets has proved to be short lived, the market's appetite for duration has been reverting back towards the days when monetary policy accommodation was the only game in town. Fresh impetus from fiscal policy is hindered by political gridlock which does not appear likely to lift anytime soon.



Global PMIs Plateau

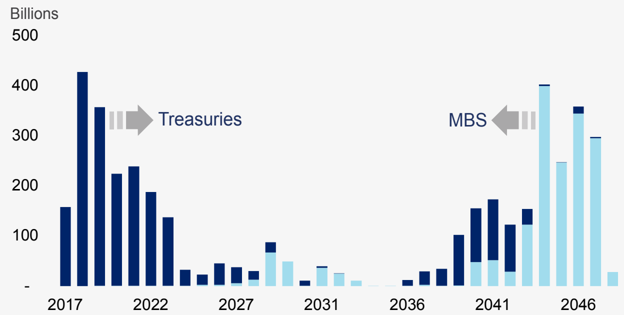
Global PMIs which have been recording gains in 2016 have slowed in 2017 which may start to feed through into slower GDP growth rates in the months ahead. A reacceleration phase in PMIs faces headwinds from China's tightening and deleveraging stance which will negatively impact on credit impulse.



Major Central Banks Balance Sheet (USD trillion)

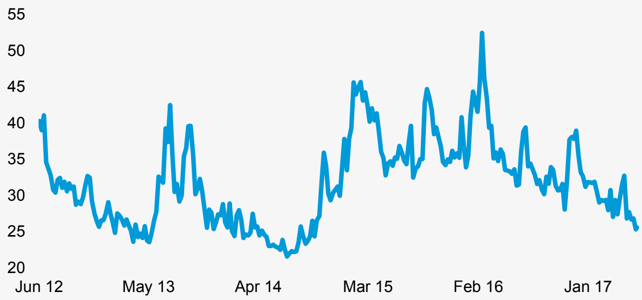
The combined balance sheet of major Central Banks (FED + ECB + BOJ + PBOC) grew by USD 1.2 trillion in 2017 to USD 18.5 trillion currently. The increase this year has been driven by ECB and BOJ, but the liquidity effects can be felt beyond national borders. Price insensitive buyers have lent support to bond prices and thereby keeping yields suppressed.

…Upside Potential Remains



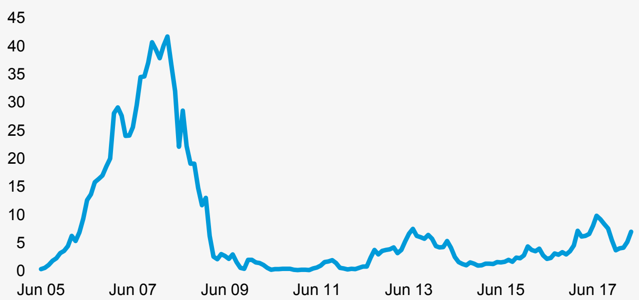
FED Balance Sheet Maturity Profile

The market's sanguine view of duration risk unlikely be a stable equilibrium because the most likely path for global central bank balance sheets going forward (2018 onwards) is towards contraction. Under appreciated risk of liquidity contraction may still come to a head when the schedule for Fed balance sheet reduction is made known.



Declining Cross Asset Volatility

Liquidity has been a very forgiving task master and a contributor to the divergence between elevated geopolitical uncertainty and declining financial asset volatility. But complacency and stretched valuations do not mix well and the eventual mean reversion process might well prove challenging to carry trades and inflows into emerging markets.



1Y Ahead US Recession Probability Remains Unlikely

The prime risk that will threaten expectations for a higher trajectory in rates is that of a recession scenario. Based on estimates from the New York FED, probability of recession 1 year ahead remains low by historical standards. However, the recession probability has been inching higher over the past 4 readings thus cannot be completely dismissed.

Source: Bloomberg, UOB Global Economics & Markets Research Estimates (As of 31 May 2017)

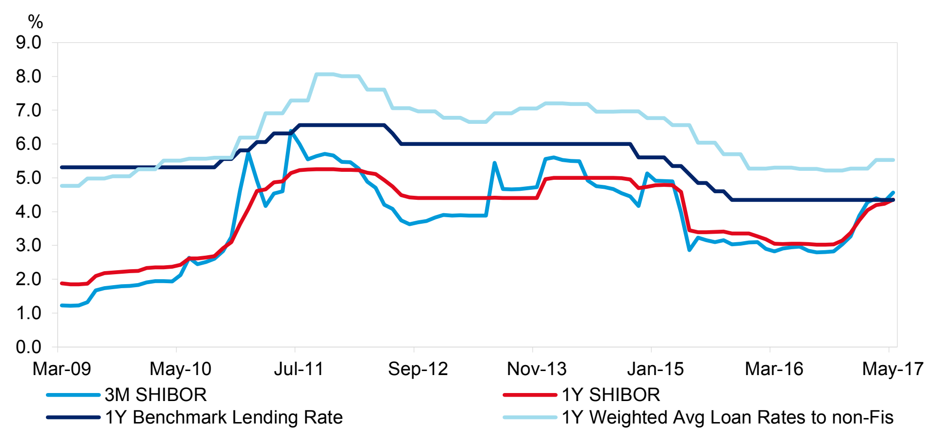
CHINA

FX & Rates	3Q17F	4Q17F	1Q18F	2Q18F
USD/CNY	6.86	6.89	6.92	6.94
CNY 1Y Benchmark Lending	4.35	4.35	4.60	4.85

Economic Indicators	2015	2016	2017F	2018F
GDP	6.9	6.7	6.6	6.5
CPI (average, y/y %)	1.4	2.0	1.5	1.4
Unemployment rate (%)	4.1	4.0	4.1	4.1
Current account (% of GDP)	2.8	1.8	1.8	1.6
Fiscal balance (% of GDP)	-3.4	-3.0	-3.5	-3.5

China: Interest Rate Trends

Source: Bloomberg, UOB Global Economics & Markets Research



Slow And Steady Into Second Half

China's 1Q17 GDP growth came in a surprisingly solid 6.9%y/y, ahead of market expectation of 6.8%. On a sequential basis, however, momentum slowed to 1.3%q/q seasonally adjusted, from 1.7% in 4Q16 and the same reading for that of 1Q16. This is the slowest 1Q in term s of q/q headline (which is generally disrupted by lunar new year holidays) since data series started in 2011. The surprisingly strong outcome for 1Q17 is primary driven by stronger performances of the secondary sector (+6.4%y/y) as well as the tertiary sector (+7.7%y/y).

Data released so far in Apr-May suggests that the pace of real economic activity remaining steady in 2Q17. Industrial production, retail sales, CPI, and external trade data have stabilized, while a sharp deceleration is seen in M2 growth, to 9.6%y/y from 10.5% in Apr as a result of tightened liquidity conditions. These suggest that 2Q17 growth pace likely to be in the region of 6.7%y/y (vs. 6.9% in 1Q17), and we expect the momentum to continue for the remainder of the year, as the Communist Party gears up for its 5-yearly Congress in the autumn. We are adjusting up our full year growth forecast for China to 6.7% (from 6.6% previously), mainly to account for the stronger outperformance in 1Q17.

However, downside risks remain that would curb growth upside, including sustainability of the recovery in external demand, and how the domestic debt and deleveraging is playing out. Property market is another top concern though price gains have been curbed somewhat by local governments taking restrictive measures.

Monetary Conditions To Stay Tight

As part of its campaign to prevent systemic risks and manage domestic leverage, PBoC is expected is expected to continue its "neutral and prudent" stance of tight liquidity condition. . It is also mindful of its role in the need to provide support for economic growth and reforms. As such, the added dimension of "macroprudential assessment" (MPA) is a critical factor in achieving these multiple and sometimes conflicting targets.

Domestic market interest rates are reflecting this tightened domestic liquidity condition. While there has been no change to interest rates at PBoC's Open Market Operations (OMO) after the US Fed FOMC meeting in Jun (unlike after the March FOMC decision), interbank interest rates have been forced march higher. It is notable that 3-month SHIBOR rates have converged to the 1Y tenure, though still short of the extreme conditions previously (such as Agri Bank IPO in Jul 2010 and the Jun/Jul 2013 episode of interbank market turbulence). While 1Y SHIBOR has exceeded the 1Y PBoC benchmark lending rate, it remains below the weighted average lending rate to non-FIs. This means that banks are still earning interest rate margin as a whole, although the pressure is certainly for the benchmark lending rate to move higher the more persistent the liquidity tightness. The authorities are likely have to juggle the challenges of balancing growth, reforms/ deleveraging, and social stability. As such, we still see PBoC keeping its benchmark interest rates unchanged until after 4Q17, at 4.35% and 1.50%, for the 1Ylending and deposit rates, respectively.

Thereafter we anticipate benchmark interest rates to be hiked starting from 1Q18. Meanwhile, upward pressure for OMO rates such as reverse repo rates and MLF rates would remain, especially as the US Fed gears up for its Sep FOMC meeting and the implementation of balance sheet reduction.

For the RMB, the addition of a "counter-cyclical adjustment" factor into the USD/CNY central parity mechanism – announced in late May – has further reduced the risks of a sharp depreciation of the currency. This is because the adjustment factor primary aims to counter "herd mentality" and a persistent bias towards RMB depreciation against the USD. This bias, left unchallenged, could create its own spiral towards ever greater depreciation expectations and result in loss of market confidence in the extreme. While the RMB rebounded after change in fixing contribution methodology, the overall bias remains towards weakening, mainly due to demand from corporates and individuals for overseas investment, travel, education, risk diversification, among others. On the other hand, the recent decision to include "A" shares into MSCI indices means that such outflows could be balanced out by institution inflows as domestic financial markets mature. We look for the USD/CNY to edge higher towards 6.89 by end-2017 and to 6.94 by mid-2018.

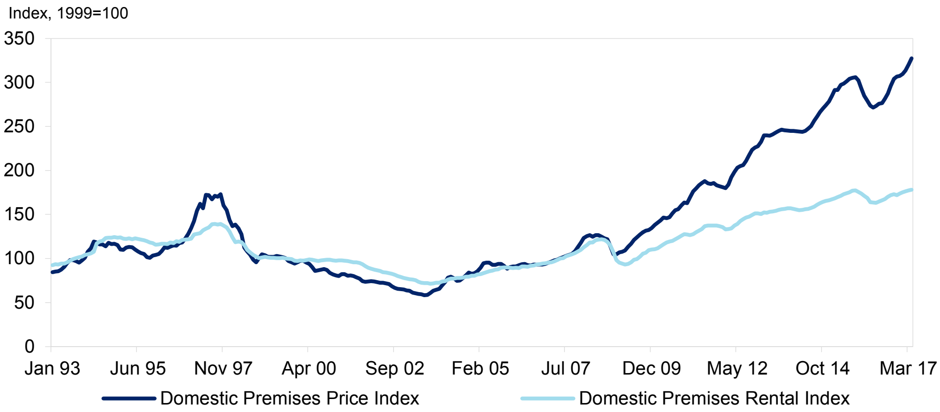
HONG KONG

FX & Rates	3Q17F	4Q17F	1Q18F	2Q18F
USD/HKD	7.80	7.80	7.80	7.80
HKD Base Rate	1.75	1.75	2.00	2.25

Economic Indicators	2015	2016	2017F	2018F
GDP	2.4	2.0	2.4	2.4
CPI (average, y/y %)	3.0	2.4	1.3	1.8
Unemployment rate (%)	3.3	3.3	3.4	3.4
Current account (% of GDP)	3.3	4.5	3.0	3.0
Fiscal balance (% of GDP)	1.9	3.3	1.2	1.0

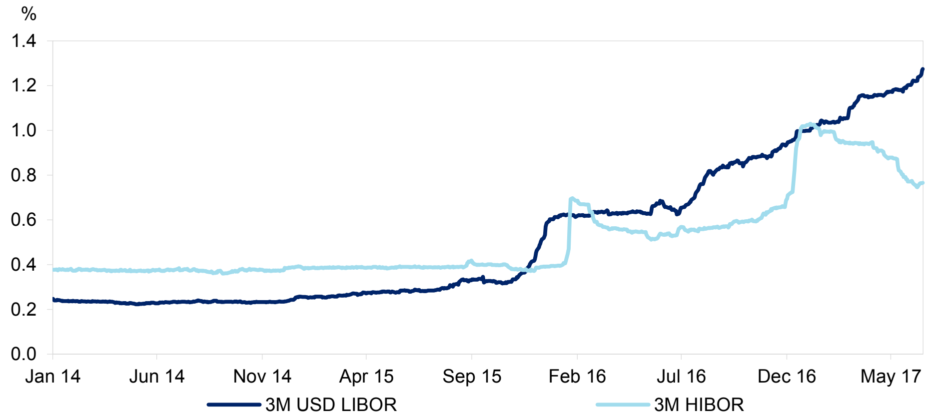
Hong Kong: Property Market

Source: CEIC, UOB Global Economics & Markets Research



HK: 3M HIBOR vs. 3M USD LIBOR

Source: Bloomberg, UOB Global Economics & Markets Research



Fastest Growth Since 2011

Hong Kong's 1Q GDP growth showed a strongest performance since 2011 at 4.3%y/y well above consensus view of 3.7% and from 3.2% growth in 4Q16. Domestic demand was the key driver and has been the case since 2H16 as property market continued to boom and consumer spending stayed steady. Domestic demand rose by 5.5%y/y, the strongest performance since 3Q11, extending the 4.6% pace in 2H16 and 0.6% in 1H16. Capital investment led the expansion with 6.4% rise in 1Q17, following 6.2% in 4Q16 and 7.2% in 3Q16.

The strong growth pace is unlikely to be sustainable as the low base effect from early 2016 would begin to dissipate from 2Q17, while property purchasers are facing increasingly tight administrative measures. as prices surge just as the new administration led by Carrie Lam is set to assume office starting 1 Jul. We tweak our full year 2017 growth forecast higher to 2.4% (from 2.0% previously), to account mainly for the outperformance in 1Q17, and growth range ahead is likely narrow to 1.7-1.9%.

Mind The Gap

In response to the US Fed FOMC rate hike in Jun, HKMA predictably raised its base rate by 25bp to 1.50%. However, HIBOR rates in general have failed to rise along its LIBOR equivalents. Not only that, HKD interest rates have in fact diverged even further largely due to flush HKD liquidity, as "risk on" mode continues to fan domestic property prices. The property index (domestic premises) has risen in double digit y/y since Jan 2017 to Apr 2017, for YTD gain of 6.5%.

This has led to HKMA to impose a series of administrative measures to curb property prices, the latest of which was on 19 May. The HKMA also warned repeatedly the risks that domestic interest rates would eventually follow USD rates higher, and along with it mortgage rates as well.

We expect the HKD Linked Exchange Rate System to remain in place for a considerable future. As such, the risks of HIBOR-LIBOR gap narrowing have risen as the two rates diverge and the HKMA base rate rises in response to the US Fed (at least another 25bps by the Sep FOMC meeting). We still think there is room for HIBOR to catch up in 2H17.

Indeed, the gap could narrow rapidly if there is a sudden shift in the current "risk on" sentiment in HK or elsewhere, or if the view on US dollar or USD interest rate turns constructive. While the HIBOR rates could stay lethargic for now, we see 3-m HIBOR to begin "normalization" and move towards 1.35% by end-2017 and to 1.95% by mid-2018.

For USD/HKD, the recent break above the 7.80 level should not be interpreted as doubts on the existing currency board arrangement. It is rather a response to excess HKD liquidity and widened interest rate gaps which favour flows into USD. Indeed, the 12-month USD/HKD outright prices have remained well within the 7.75-7.85 Convertibility Undertaking (CU). As such, a sustained move towards the top of the CU at 7.85 is likely to see HKMA selling USD/HKD.

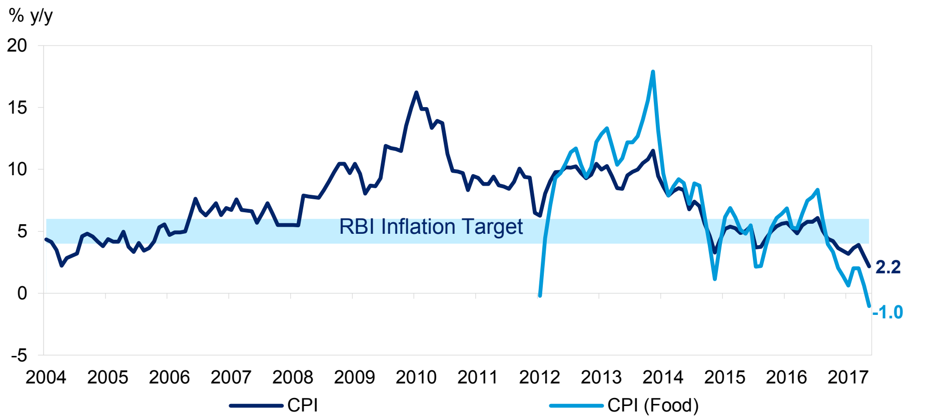
INDIA

FX & Rates	3Q17F	4Q17F	1Q18F	2Q18F
USD/INR	66.5	67.2	68.0	68.8
INR Repo Rate	6.00	5.75	5.75	5.75

Economic Indicators	2015	2016	2017F	2018F
GDP	7.5	8.0	7.2	7.6
CPI (average, y/y %)	5.9	5.0	4.3	4.5
Current account (% of GDP)	-1.1	-0.6	-0.8	-1.3
Fiscal balance (% of GDP)	-3.5	-3.7	-3.5	-3.2

Although CPI Picked Up, Its Still Considerably Low, Supporting Dovish Monetary Policy

Source: CEIC, UOB Global Economics & Markets Research



Yet Another Quarter Of Weak Economic Activity, Supporting A Dovish RBI

India's latest quarter (Jan-Mar 2017) GDP grew at a lower-than-expected pace of 6.1% y/y, culminating towards a full fiscal year GDP growth rate of 7.1%, slower than the 8.0% growth rate in FY 2015-16. Another measure of economic growth, the gross value added (GVA), was equally weak as it showed a 5.6% y/y gain, the slowest in 12 quarters.

Looking across the various sectors of the economy, what was worrisome to us was the GVA for industry slowing to 3.1% y/y in the Jan-Mar 2017 quarter, from 10.3% y/y in Jan-Mar 2016. The poor performance in industry growth rates contradicts the top-down push for the "Make in India" initiative and could spell further repercussions in the labour market going forward. Moreover, the 5.3% year-to-date gain the INR against the USD is also weakening the competitiveness of the Indian economy, especially in export-oriented manufacturing segments.

While fingers pointing to the unravelling of the negative impact from the November 2016 demonetisation exercise as responsible for the economic slowdown has been incessant, we think that there could possibly be some truth behind the reduction in demand following the ban on Rs500 and Rs1,000 currency notes. Indeed, latest GDP numbers show that private consumption in the Jan-Mar 2017 quarter slowed to a growth rate of 7.3% y/y, the slowest in 5 quarters.

With economic growth surprising on the downside, the latest inflation numbers also added to the expected dovish attitudes of the Reserve Bank of India (RBI). Latest May inflation registered 2.18% y/y, a significant drop from the 2.99% y/y in April, and well below the comfort zone of RBI's medium term 4.0% inflation target (within a +/- 2% band). It was probably in recognition of that fact that the RBI on 7 June (at its monetary policy meeting) had cut its projection for consumer inflation to 2-3.5% in April to September, down from 4.5% earlier; and to 3.5-4.5% in October to March, down from 5%. We also noted that in their statement, the RBI's tone became noticeably less hawkish as they said the risks to inflation were "evenly balanced", compared to "upside risks" to inflation during their previous statement in April.

Although the decision to keep rates unchanged during the 7 June RBI meeting was largely in line with consensus expectations (repo rate remaining at 6.25%), the central bank had used the opportunity to cut the Statutory Liquidity Ratio (SLR[1]) by 50bps to 20%, effective 24 June 2017.

1 The SLR is a mandated requirement for commercial banks under which the lenders are required to maintain in the form of government approved securities before extending credit to customers. This move will free up cash for banks to deploy, although we think that the demand may not be there, since investment declined for the first time in 12 quarters, by 2.1% y/y in the Jan-Mar 2017 quarter.

We think that the key reason for policy status quo was that the demonetisation exercise also created an excess liquidity of Rs4 trillion (US$62 billion) in the banking system. This despite efforts to drain the liquidity via the ramping up of new currency in circulation to soak up the excess liquidity, massive government spending, and the increase in the daily average overall surplus liquidity in the banking system. As such, any lowering of the interest rates could potentially reverse the liquidity draining efforts of the past months.

Going forward, the bigger problem that will add on to slower economic growth and lower inflation expectations is the problem of non-performing loans amongst banks and the over-leveraged corporate sector. We think that this will be a strong enough case to expect incremental dovish tones from the RBI in the months ahead. As such, we will still keep to our view that there could be 2 more rate cuts for 2017 (one 25bps cut in the next 2 August meeting, and another 25bps in the final meeting of the year on 6 December). We maintain our call for the INR to end 2017 at 67.2/USD, arising from expected dovishness from the RBI and impending interest rate hikes in the US.

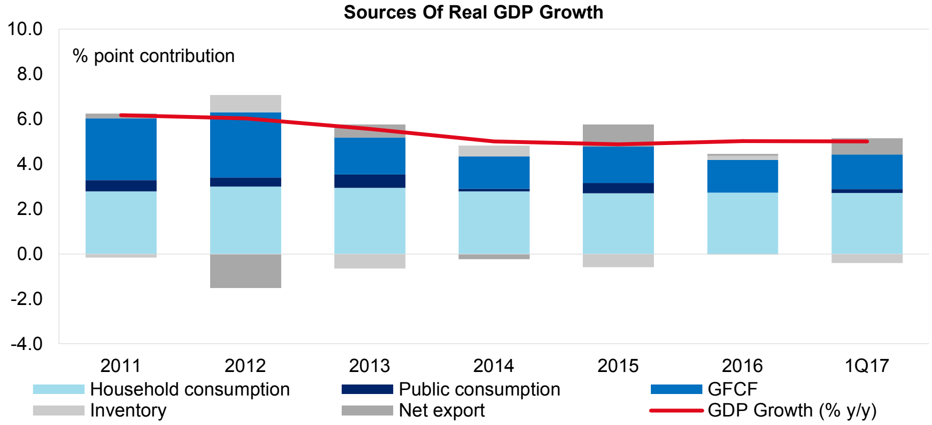
INDONESIA

FX & Rates	3Q17F	4Q17F	1Q18F	2Q18F
USD/IDR	13,500	13,600	13,700	13,800
IDR 7-Day Reverse Repo	4.75	4.75	5.00	5.00

Economic Indicators	2015	2016	2017F	2018F
GDP	4.9	5.0	5.2	5.5
CPI (average, y/y %)	6.4	3.5	4.1	4.1
Unemployment rate (%)	6.2	5.6	5.3	5.1
Current account (% of GDP)	-2.0	-1.8	-1.8	-1.7
Fiscal balance (% of GDP)	-2.6	-2.5	-2.4	-2.4

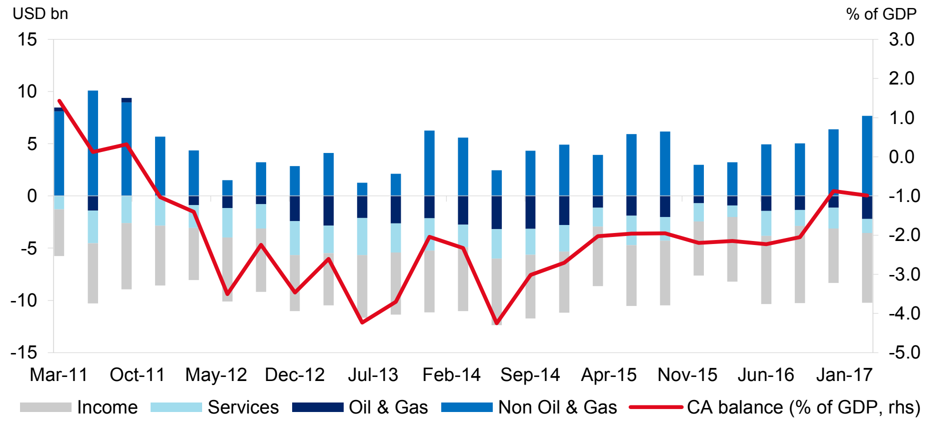
Stronger Contribution To 1Q17 Growth From Net Exports

Source: CEIC, UOB Global Economics & Markets Research



Stronger Non-Oil & Gas Surplus Not Only From Lower Imports But Stronger Exports Since 4Q16

Source: CEIC, UOB Global Economics & Markets Research



Growth To Pick Up Pace

Indonesia's GDP grew by 5.01% y/y in 1Q17, maintaining a largely stable growth path. The quarter saw stronger contribution from net exports in line with recovery in the global demand. Private consumption growth was slightly softer-than-expected, offsetting the rebound in public spending while fixed investment maintained steady growth.

We expect economic growth to pick up pace in subsequent quarters, led by export momemtum and a stable outlook for the commodities sector. Exports grew by 18.8% y/y in April-May, keeping up with the 21.1% pace in 1Q17, led by robust commodity shipments. We expect the stronger exports to continue to contribute to higher non-oil and-gas surplus, keeping the current account deficit at -1.8% this year, similar to 2016.

Furthermore, stronger government revenue also reduces the need for spending cuts in 2H17 (vs. cuts in June and August 2016) while signs of improvement in the private demand indicators, notably the consumer confidence and consumer goods imports point to stronger private demand. This should keep full-year growth on track to record 5.2% (2016: 5.0%).

Inflation Risks Are Contained

Headline inflation has continued to edge higher to 14-month high at 4.33% y/y in May due to greater pass-through of earlier electricity tariff hike and the onset of Ramadan which is expected to increase the inflationary pressure from late-May to June period. However, food prices increase in recent months has clearly eased in comparison to the earlier part of the year and in 2016. With the stability of the core inflation and moderate demand indicators, we expect the headline inflation rate to remain within Bank Indonesia's (BI) 3-5% target range for the rest of the year. Our forecast for the headline CPI to average 4.1% this year is in line with the central bank's forecast of year-end inflation at 4.36% y/y.

Neutral Policy Stance To Stay With IDR Stability

We see the sustained stability in the IDR pushing back any potential monetary tightening by BI to the first half of 2018 but the progress of monetary policy normalisation in the US including a balance-sheet reduction still points to an upward trajectory in Indonesia's policy rate going forward. For timing of monetary tightening, we will continue to watch the key indicators including domestic inflation, the exchange rate and capital flows.

We do not see further room to cut interest rate taking into account of the inflation outlook and the relaxation of the reserve requirement ratio (RRR) rules which will take effect from July. Banks will no longer need to maintain 6.50% of deposits at central banks on daily basis and only need to keep a daily minimum 5% of deposits while maintaining at least 6.5% average in a two-week period.

USD/IDR has largely hovered around 13,300 for most part of the year and we maintain our call for the pair to edge higher in 2H17. However, as we lower our US dollar trajectory, we now expect USD/IDR at 13,500 at end-3Q17 and 13,600 at end-4Q17. In addition to Indonesia's narrowing current account deficit, the endorsement by rating agency S&P's in May to award the country an investment grade will likely contribute to more IDR stability should market volatility increases.

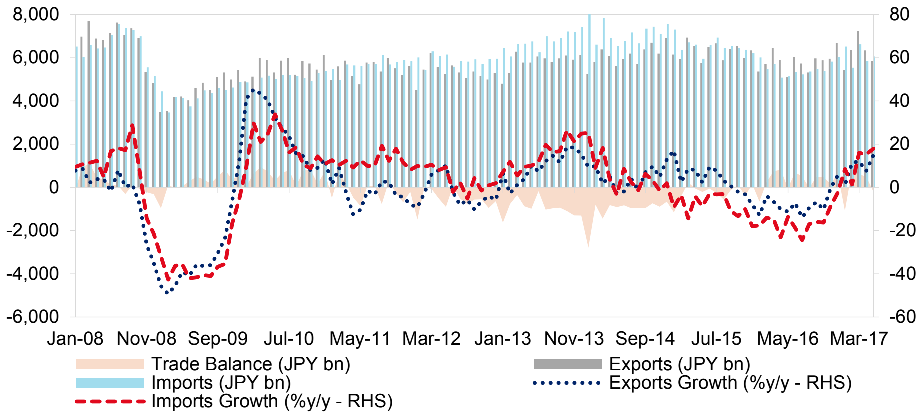
JAPAN

FX & Rates	3Q17F	4Q17F	1Q18F	2Q18F
USD/JPY	114	115	116	117
JPY Policy Rate	-0.10	-0.10	-0.20	-0.20

Economic Indicators	2015	2016	2017F	2018F
GDP	1.2	1.0	0.9	1.2
CPI (average, y/y %)	0.8	-0.1	1.0	1.9
Unemployment rate (%)	3.3	3.0	2.7	2.5
Current account (% of GDP)	3.3	3.8	3.5	4.0
Fiscal balance (% of GDP)	-5.2	-6.5	-7.0	-7.0

Japan's Trade Surplus Position Could Be In Jeopardy If Imports Continue To Surge Like In May

Source: CEIC, UOB Global Economics & Markets Research Estimates (As of 19 Jun 2017)



Expect 2017 Growth Close To 2016, Absent Wage Growth A Key Concern

Japan's 1Q 2017 GDP growth was revised lower to 1.0%q/q SAAR (down from prelim print of 2.2%q/q) while 4Q 2016 growth was unchanged at 1.4%q/q SAAR. Despite the downward revision, it was still the fifth straight quarter of sequential expansion, the longest stretch of GDP expansion in 10 years, since 2006 when Japan was under the former Prime Minister Junichiro Koizumi. Compared to the same period one year ago, the Japanese economy grew by 1.3%y/y in 1Q (down from prelim print of 1.6%y/y) while the 4Q 2016 growth was also revised slightly lower to +1.6%y/y.

External demand remained a growth pillar for Japan underpinned by robust exports but the downside came from weaker private consumption growth & inventory drag, taking its toll on 1Q growth even as investment spending saw an unexpected upward revision. The 1Q revision led by the downgrade of domestic demand reflects our on-going concern about domestic consumer weakness in Japan as highlighted in the decline in nominal and real wages in Japan despite the tighter labor market conditions with unemployment rate at a 2-decade low of 2.8% (April).

We still expect 2017 GDP growth to be at 0.9%, comparable to the growth achieved in 2016 (+1.0%) and supported by export improvement that will have positive spillover to the manufacturing sector but recent import surge (Apr and May) may dampen export's contribution to growth. The main risks ahead for Japan remains to be geo-politics, from Trump's US economic & foreign policy to European political developments & the on-going developments in the Korean Peninsula, which may hamper business investment & trade outlook. An anchor for Japan's 2017 growth may also come from public sector investment via effects of the fiscal boost from the stimulus package announced in August 2016.

Inflation remained the Achilles' heel for Japan's government and central bank policy makers. The Bank of Japan's (BOJ) CPI inflation measure (which excludes fresh food/energy/effects of 2014 sales tax hike) remains close to 0% in the latest readings. Even as the central bank kept the phrase that "inflation expectations have remained in a weakening phase", it continued with its positive outlook that Japan will achieve the 2% inflation which "will likely be at the middle of the projection period – that is around fiscal 2018". Most (including us) seriously doubt that could happen especially with the absence of any wage growth. Chances are it may be below 2% even when BOJ Governor Kuroda's term expires in April 2018.

BOJ To keep Status Quo In 2017, As 2% Price Target, Wage Growth Still Distant

The June BOJ decision came as no surprise as the Japanese central bank have continued to signal that loose monetary policy (including its yield curve control) will be here to stay for a awhile and the BOJ also refrained from any explicit discussion of tapering its ultra-expansionary monetary policy. And we agree that it is premature to expect the BOJ to taper its easing program anytime soon, especially in 2017 because Japan is still far away from its 2% inflation target and it is inappropriate to debate exit of monetary policy easing at this stage, just as Kuroda highlighted in many occasions. After June's policy decision of no change, we expect status quo may likely be maintained at least in the next 6-9 months. We factor in a very small probability for more BOJ policy easing in 3Q.

JPY Outlook – Still Expecting USD/JPY Higher, But At Less Bullish Levels

After touching a 2017 high of 118.6 on 3 January, the USD/JPY has since entered a consolidation phase given the disappointment in Trump's legislative setbacks & the lack of progress in Trump's tax reform and infrastructure spending plans, leading to a broadly weaker US dollar. Despite the diminished Trump effect, we still believe the growing monetary policy divergence between the Fed Reserve (1 more hike in Sep and reduce balance sheet announcement in Dec) and BOJ to strengthen the US dollar and lift the USD/JPY pair higher albeit less aggressive than what we initially anticipated. We expect the pair to climb to 113 by mid-year and then to touch 115 by end-2017. The risk for the yen to strengthen in a risk-off environment could be due to potential geo-political events in Europe although the Korean peninsula turmoil/crisis may have a vastly different impact on the JPY depending on how involved Japan is under those circumstances.

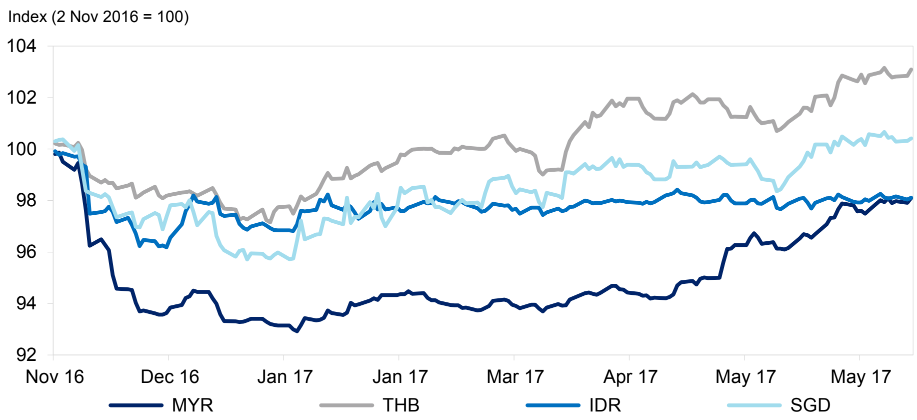
MALAYSIA

FX & Rates	3Q17F	4Q17F	1Q18F	2Q18F
USD/MYR	4.32	4.30	4.28	4.26
MYR Overnight Policy Rate	3.00	3.00	3.00	3.00

Economic Indicators	2015	2016	2017F	2018F
GDP	5.0	4.2	5.0	4.9
CPI (average, y/y %)	2.1	2.1	3.6	3.2
Unemployment rate (%)	3.1	3.5	3.4	3.3
Current account (% of GDP)	3.0	2.0	1.9	1.4
Fiscal balance (% of GDP)	-3.2	-3.1	-3.0	-2.9

Ringgit Plays Catch-Up

Source: Bloomberg, UOB Global Economics & Markets Research



Off To A Good Start

Malaysia is in a recovery mood that has transcended from stronger performance in GDP to a return of foreign portfolio flows, higher foreign reserves and stronger Ringgit.

The economy expanded 5.6% y/y in 1Q 2017, the highest quarterly growth rate in two years, thanks to higher domestic demand and broad based expansion across all key sectors. Despite concerns of sluggish consumer sentiment and effects of higher inflation, private consumption has proven more resilient than expected thanks to positive wage growth, a flexible labor force, and expanding employment. Consumer spending has also been cushioned by government support in the form of cash-handouts, reduction in EPF contribution rates and tax incentives. Business sentiment turned more upbeat in first quarter amid strengthened export orders, production activity and company earnings. Private investments accelerated alongside higher inflows of foreign direct investments. With stronger revenue buffers, both public consumption and investments gained traction.

Given the strong start, we revised upwards our real GDP growth estimate to 5.0% for 2017 (from 4.5% previously). However the growth trajectory is expected to moderate going into 2H 2017 amid expectations of normalising exports and production following the strong spurt in recent months. We think any upward bias for growth will emanate from investments. Total approved investments amounted to MYR400bn in 2015 and 2016. Financing activity has picked up amid higher loans growth and fund raised in the capital market. Construction awards grew 25% to MYR176bn in 2016. The pipeline of awards for the KL-Singapore High Speed Rail is expected to step up as construction is slated to begin in 2018.

BNM Signals Neutral Stance

Despite the strength in growth and accelerated inflation, Bank Negara Malaysia (BNM) continues to signal a neutral monetary stance and no change for policy rate. Headline inflation peaked in March and has started to show signs of decelerating. Core inflation has remained stable for most of the first half. For BNM to consider raising rates, there needs to be evidence of accelerating inflation across a broad range of goods and services due to excessive wage pressures. Another factor could be a surge in household debt that leads to higher financial imbalance risks, though household credit growth has continued to moderate and household debt to GDP eased to 88.4% in 2016 (89.1% in 2015). We do not see currency weakness as a trigger for a rate hike. However as interest rate differentials narrow, there will be pressure to raise rates but it would only be done if domestic economic conditions are strong enough to support the hike.

Ringgit Plays Catch-Up

The Ringgit has strengthened, riding on dollar weakness in recent months, and an upswing in sentiment on the local currency. This comes amid improving macro parameters and BNM's liberalisation of bond and forex hedging requirements which took effect in May. Foreign portfolio flows returned, lifting foreign reserves to a six-month high of US$98bn as at end-May. The trend going forward could turn more volatile amid speculation that general elections could be around the corner, sizeable government bonds maturing between August and November, and more volatile crude oil prices. We still expect the Fed to deliver one more 25bps rate hike in 2H 2017 and announce the Balance Sheet Reduction at end of year. We look for USD/MYR at 4.30 by end 2017 concurrent with a firmer USD trend.

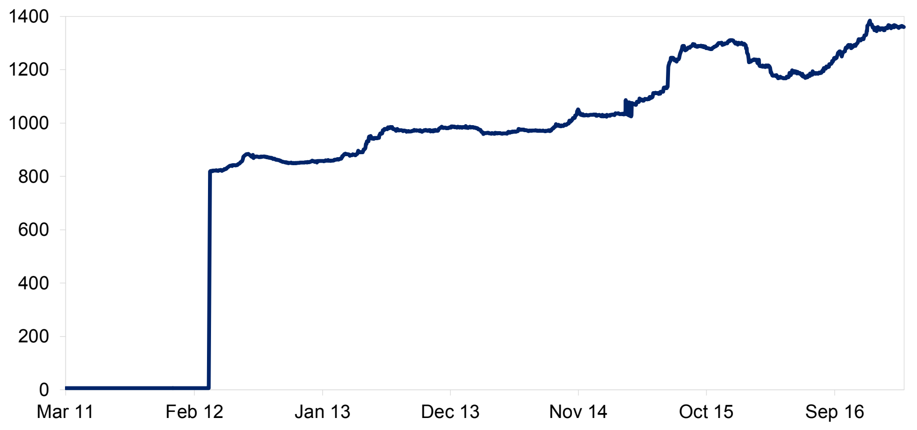
Markets have expressed some concern on higher BNM dollar borrowings via currency swaps, which rose from US$2.8bn in October last year to US$19.1bn as at April this year. BNM has been using foreign currency (FX) swaps since 2003 as one of the several tools to manage domestic liquidity. It is a widely used instrument among central banks with some having up to 50% of their reserves in FX swaps. BNM currently has less than 20% of reserves in FX swaps. Channels checks suggest there is no cap on the level of swaps. We think the pace at which BNM will unwind the FX swap position will depend on capital flows and net conversion of trade flows. The line of priority for BNM remains ensuring stability of foreign reserves.

MYANMAR

FX & Rates	3Q17F	4Q17F	1Q18F	2Q18F
USD/MMK	1,370	1,395	1,395	1,395
Economic Indicators	**2015**	**2016**	**2017F**	**2018F**
GDP	7.3	6.3	7.5	8.0
CPI (average, y/y %)	10.0	7.0	6.8	7.0
Unemployment rate (%)	4.0	4.0	4.0	4.0
Current account (% of GDP)	-5.2	-8.3	-8.1	-7.1
Fiscal balance (% of GDP)	-4.4	-4.6	-4.6	-4.6

Despite Continued FDI Inflows, The USD/MMK Is Likely To Head Weaker Towards 1,395 In 2017

Source: Bloomberg, UOB Global Economics & Markets Research



Myanmar's Growth Still To Outperform Most Of ASEAN Despite Challenges

Our view on Myanmar remains unchanged from 2Q, as the country continues to make progress on the economic front and will be one of the top growth performers among ASEAN countries, underpinned by a positive investment outlook and construction activity. In the IMF April 2017 World Economic Outlook, the IMF estimated growth in 2016 to be a softer 6.3% (lowered from 7.3% in 2015) but growth will subsequently climb above 7% in 2017 and 2018.

Investment sentiment on Myanmar remains robust as foreign direct investment (FDI) into various industries came in at US$6.87bn for the year ending at March 2017, according to the Myanmar Investment Commission (MIC). This exceeded the US$6bn target set for FY2016/2017. It is also notable that nearly half of the FDI went into telecommunication sector (47%), followed by industrial sector (17%) while the former number 1 investment sector, oil and gas sector (14%), was pushed to 3rd place, in part due to the weak oil price environment but this is also good for Myanmar as the FDI flows are diversifying to other parts of the economy beyond energy. Note that Myanmar passed a new investment law last year (20 Oct 2016) which took effect on 1 April 2017, and since April, the MIC reported it approved 22 foreign investments worth US$713 million and most of the investments were into industrial and other services sectors.

That said, Myanmar's economy continues to grapple with several challenges. Banking sector reform is on-going but needs to accelerate to complement the rapid pace of economic expansion while more resources needs to be allocated to the government to speed up policy making. And even though inflation is expected to ease further in 2017, from the recent highs in 2015, there is little scope for the central bank to let up on monetary policy so that inflation does not re-accelerate. Meanwhile, both the current account and government budget deficits remain persistent and unlikely to materially improve anytime soon. The weak and volatile natural gas price is a further negative for Myanmar, hurting both government revenue and exports value for the economy, and putting more pressure on both the current account and government budget. And the continued import growth (especially capital goods due to growing onshore infrastructure needs) is also likely to widen the current account deficit further in 2017. We will also be wary of any resurgence in ethnic conflicts, and we are mindful that Myanmar is still vulnerable to weather-related events as we are in the midst of typhoon season for Myanmar which is typically between May and October.

MMK Outlook: Contained Weakness

Contrary to our initial pessimistic assessment in March, the Myanmar currency, MMK (Kyat) has held up well against the US dollar. One key reason is that the expected broad US dollar strength did not materialize. That said, most of the Asian currencies outperformed against the USD, appreciating between 0.2% and 6% year-to-date (as of 21 Jun), except the Hong Kong dollar and the Philippine peso which weakened during this period, Based on this comparison, the MMK barely budged against the dollar, appreciating by just 0.07% year-to-date (as of 21 Jun) so it clearly underperformed in 1H compared to most of its Asian peers.

And the reason for MMK's sub-par performance could be due to its persistent twin deficits (of the current account and fiscal budget shortfall), more than offsetting the positive impact from the continued FDI inflows. Going forward, we are still bearish against MMK on the back of a moderate 2H rebound in US dollar as US rates are expected to be hiked further in Sep 2017 while domestically, the persistent twin deficits will also continue to weigh down on the MMK. Thus, 2017 is likely another year of MMK depreciation although the weakness is anticipated to be contained. We expect it to resume on a depreciation trend in 2H with the USD/MMK pair likely to be at around 1,370 by mid-2017 and then weakening further to 1,395 by end-2017 (2.2% depreciation for 2017 versus 3.5% depreciation in 2016).

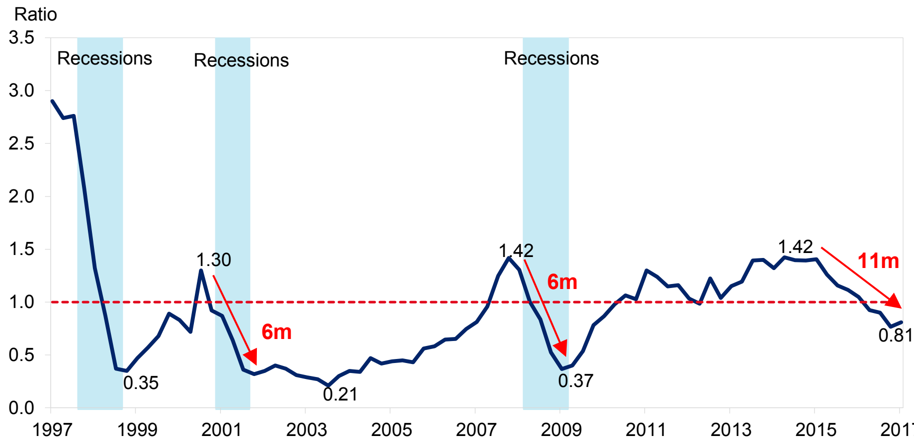
SINGAPORE

FX & Rates	3Q17F	4Q17F	1Q18F	2Q18F
USD/SGD	1.40	1.42	1.43	1.44
SGD 3M SIBOR	1.25	1.40	1.50	1.70

Economic Indicators	2015	2016	2017F	2018F
GDP	1.9	2.0	2.4	2.5
CPI (average, y/y %)	-0.5	-0.5	0.5	1.5
Unemployment rate (%)	1.9	2.2	2.3	2.5
Current account (% of GDP)	18.1	19.1	18.6	18.4
Fiscal balance (% of GDP)	0.1	1.3	1.7	1.0

Weak Labour Market As Job Vacancies to Unemployed Persons Ratio Declining For 10 Quarters

Source: CEIC, UOB Global Economics & Markets Research



Tradeable Sectors Continue To Boost Economic Growth In 1Q 2017

Singapore's 1Q 2017 GDP grew 2.7% y/y, surpassing government advance estimates of a 2.5% y/y growth rate, but slightly slower than the 2.9% y/y expansion in 4Q 2016. Nevertheless, robust performance in the tradeables sector such as the manufacturing and transport/storage sectors continued to contribute strongly to overall economic activity.

Within the manufacturing sector, strong growth was derived from both the electronics and precision engineering clusters. The strong global semiconductor demand had resulted in the production of semiconductors to grow at an on-year double digit pace over the past 13 months, at an average growth rate of 41% y/y. That spilled over positively to the precision engineering cluster, which experienced an average growth rate of 12.1% y/y over the past 8 months.

The construction sector remained weak and had contracted for the 3rd consecutive quarter already due to continued weakness in private sector construction works, while the services sector picked up some pace and grew 1.6% y/y. The faster pace of growth came from a robust pickup in the transportation and storage sector and the business services sector, while the key laggard was the accommodation & food services sector that contracted 1.9% y/y.

The pickup in GDP growth since 4Q 2016 certainly helped to boost confidence for the stakeholders in the economy. This is much needed since both consumption and investment continued to contract for the 2nd and 3rd quarter respectively in 1Q 2017. Regarding the former, it has never contracted for 2 consecutive quarters (on a y/y basis) since 1976 during a non-recessionary period. We probably had an early warning as consumption growth slowed down quite rapidly since 4Q 2015. This could have signalled a deeper, structural issue within the labour market that weakened consumer sentiments and resulted in the contraction of household consumption. The labour market remains weak as the latest 1Q 2017 job vacancy to unemployed ratio, at 0.81, is amongst the worst since the global financial crisis (30 quarters ago) and has been below parity for 4 consecutive quarters.

As we enter the second half of 2017, we remain optimistic in the continuing growth for the electronics and precision engineering clusters. However, the double-digit growth for semiconductor production may slow into the single digits, due to base effects and a slower 2H capex growth expected in China.

However, headwinds and uncertainties to growth remain due to the upcoming elections in several European countries as it may fuel further populist, anti-trade sentiments which will be a strong negative for Singapore's trade-dependent economy. Additionally, policy surprises from the new US administration could add on to the cautious consumer and business sentiments, further constraining incremental discretionary consumption and business investments.

The Singapore Trade Ministry maintained their "1% to 3%" 2017 GDP growth forecast, while adding that GDP growth may come in higher than the 2% in 2016, barring the materialization of several mentioned downside risks (such as anti-globalisation sentiments weighing on global trade and monetary tightening in China.). We are maintaining our 2017 GDP forecast of 2.4%. The 2.7% y/y growth in 1Q 2017 could be the peak on-year growth rate for 2017 and that growth rates in the next 3 quarters will be lower, although still higher than 2% y/y. With no strong upside to economic growth, and inflationary pressures capped by the weaker labour market conditions, we believe that the MAS will keep the SGD NEER on the current neutral appreciation stance in the upcoming October policy meeting. The USD/SGD should continue to trend higher from current levels to end 2017 at 1.42, while the 3m SIBOR is expected to reach 1.40%.

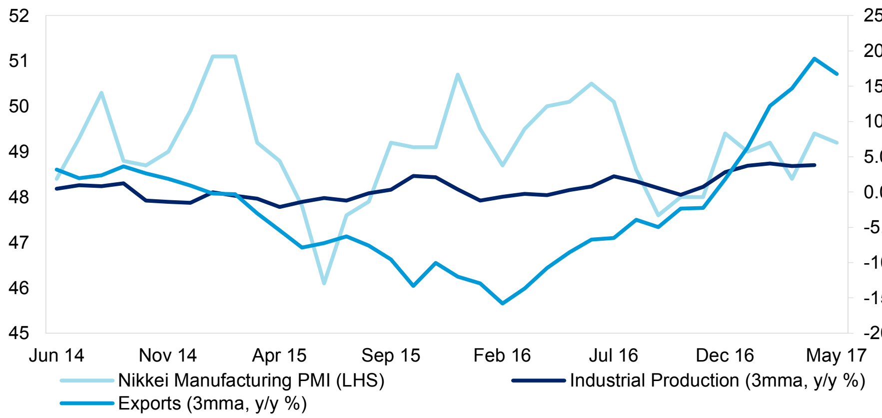
SOUTH KOREA

FX & Rates	3Q17F	4Q17F	1Q18F	2Q18F
USD/KRW	1,140	1,150	1,160	1,170
KRW Base Rate	1.25	1.25	1.25	1.50

Economic Indicators	2015	2016	2017F	2018F
GDP	2.8	2.8	2.8	2.7
CPI (average, y/y %)	0.7	1.0	2.0	2.1
Unemployment rate (%)	3.5	3.6	3.5	3.4
Current account (% of GDP)	7.7	7.0	6.0	6.0
Fiscal balance (% of GDP)	-2.1	-2.3	-2.0	-2.0

Stabilising PMI Suggests A More Moderate Export Growth Ahead

Source: CEIC, Bloomberg, UOB Global Economics & Markets Research



Further Property Cooling Measures Unlikely To Dent Growth Outlook

South Korea's revised GDP growth in 1Q17 (at 2.9% y/y) was the highest in five quarters, led by fixed investments and exports. Fixed investments growth recorded the fastest pace of expansion since 1Q10, with robust growth in both construction and facilities investments. Despite stronger exports, net exports contracted as a result of a sharp increase in imports, in particular the machinery & equipment and precision instruments which were in line with the data indicating stronger facilities investment in the semiconductor industry. There was also some recovery in private consumption in 1Q17 which is expected to extend into the second half of the year as a result of more stability in the domestic political landscape. Furthermore, the recently proposed KRW11.2 tn stimulus package (0.65% of GDP) – KRW4.2 tn to create 110,000 jobs and KRW7 tn on welfare programmes – is expected to be translated into stronger private consumption demand.

Concerns over the development of a property bubble had seen the government announcing property cooling measures in November 2016 and further tightening mortgage rules and curbs on speculative resales of homes in Seoul and parts of Busan effective from July 3. As with the measures in November, the new round of cooling measures is unlikely to dent the economic growth outlook given the targeted approach.

We now see a stronger growth rate in South Korea this year, at 2.8% which is similar to that in 2016. The key risks to growth include further tensions in the Korean peninsula, renegotiation of the Korea-U.S. FTA and a stall in the export engine from weaker demand in electronics. Semiconductor shipments had surged by 50.9% y/y in Jan-May, leading the export rebound in South Korea. The stabilising PMI readings suggest that export growth could moderate after turning in 16.3% y/y growth in Jan-May period. Another area that could have some positive impact on second half growth is the potential improvement in Korea-China relations. A thaw in relations with China had resulted in 25% drop in Chinese tourist arrivals in Jan-Apr but the strategy to shift focus to other target markets have helped to make up for some of the decline in foreign visitors so far.

Interest Rate Likely To Be Maintained For The Rest Of The Year

Bets of monetary tightening have increased but it may be too early to start hiking interest rates at current early stage of growth recovery. Low interest rates have been blamed for the run-up in property prices, particularly in Seoul since 2015 which exacerbated the household debt situation. In South Korea, household debt has risen to more than 90% of GDP from 72.3% at the end of 2007, well ahead of the other Asian countries including Japan, Hong Kong and Singapore.

In our view, a shift to monetary tightening will have to be premised on an acceleration in growth rebound while the latest round of property tightening measures fails to contain prices. While the U.S. remains firmly on a rate normalisation path, we do not expect the BOK to start to raise its interest rates until 2018. We see the domestic inflation outlook being largely in line with the BOK's expectation and will continue to fluctuate "at around the 2% level" before moderating slightly in early 2018. Overall, we expect headline inflation to average 2.0% in 2017 and 2.1% in 2018, within the BOK's target range of 1.5-2.5%.

The KRW is one of the best-performing Asian currencies YTD (as at 21 June), bagging gains of more than 5.0% against the dollar. We believe much of the positivity from strengthening exports, stabilising domestic politics and the fiscal stimulus have already been priced in. USD/KRW traded largely within 1,120-1,140 in 2Q17 and we expect the pair to end 3Q17 at 1,140 before rising to 1,150 by end-4Q17. Geopolitical risk did not have an apparent impact on the stock (KOSPI went on to hit record high in June despite the continuation of provocations from Pyongyang) and currency markets but will remain on investors' radar. Heightening tensions could potentially drive JPY/KRW up to 10.5 which we last saw in April.

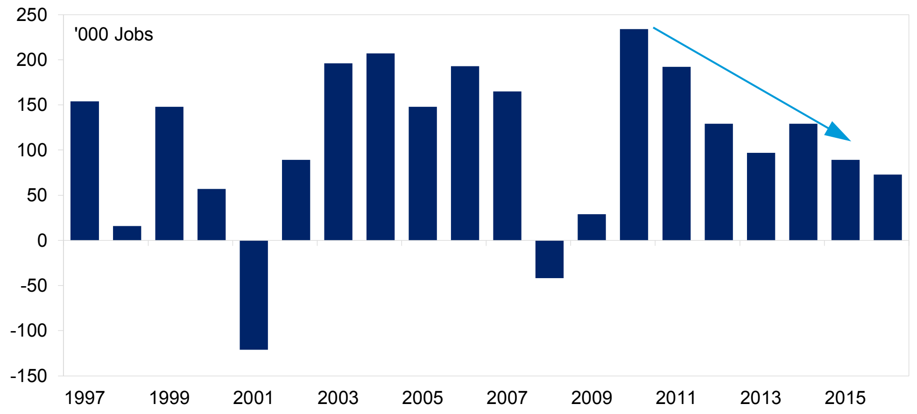
TAIWAN

FX & Rates	3Q17F	4Q17F	1Q18F	2Q18F
USD/TWD	30.8	31.0	31.2	31.4
TWD Official Discount Rate	1.38	1.38	1.38	1.38

Economic Indicators	2015	2016	2017F	2018F
GDP	0.7	1.5	2.1	2.0
CPI (average, y/y %)	-0.6	1.0	0.8	1.1
Unemployment rate (%)	3.9	3.8	3.9	3.9
Current account (% of GDP)	14.5	13.3	12.0	12.0
Fiscal balance (% of GDP)	-0.2	-0.3	-1.0	-1.2

Taiwan: Annual Job Creation

Source: CEIC, UOB Global Economics & Markets Research



Growth Pace Looks Set to Taper

Taiwan's 1Q17 real GDP grew a revised 2.6%y/y (in line with prelim estimate of 2.56%), from 2.79%in 4Q16 (slightly below preliminary estimate of 2.88%). On a seasonally adjusted basis, growth momentum remains strong, rising 3.8% annualized in 1Q17, more than doubling from the 1.4% rate in 4Q16 and pulling even compared to the annualized 3.1% in 3Q16. While the picture looks positive, we look for growth pace to soften in the second half as electronics-related activities moderate after major mobile phone launches. Official growth forecast has been raised to 3-year high, at 2.05% for this year, up from the last estimate of 1.92%. We are adjusting upward our forecast to 2.1%, from 2.0% previously.

One of the key drivers ahead for Taiwan would be the NT$890 billion (US$29.63 billion) infrastructure bill "Forward-looking Infrastructure Development Projects" that was passed by the legislature in mid-May. Under this program, the government will spend NT$890 billion over eight years on infrastructure projects around Taiwan, including new light railways, rail extension or improvement projects, green energy, water works, and digital construction projects. An estimated 40,000 to 50,000 new jobs are expected to be created under the new spending program. This is added urgency to boost income and generate employment opportunities, as the pace of job creation has been trending down for some years. In 2016, to 73,000 jobs were created, the slowest since the aftermath of Global Financial Crisis in 2009 and just half of the average annual job creation during the 2010-2015 period. The job creation momentum has also weakened compared to the pre-2008 period, when the annual change was more consistent. This means that the job market was more relatively stronger and more stable during the 2002-2007, compared to the current cycle.

While some have taken issue with elements of the bill, clearly this would be one of the few remaining policy levers available, as tourist arrivals from mainland China have fallen off sharply since the current Democratic Progressive Party (DPP) government came to power in 2016 that has seen a marked deterioration in cross straits relations.

Central Bank in Holding Pattern

As widely expected, the Central Bank of China (CBC) left its key policy rate unchanged at 6-year low of 1.375% at its scheduled quarterly meeting on 22 Jun. This is the fourth straight quarter CBC has kept its policy rate steady, after cutting interest rate exactly one year earlier at its quarterly policy meeting on 30 Jun 2016 (cumulative 50bps cut then).

Weak domestic inflationary pressures and a firmer TWD are likely to afford room for CBC to be patient, even as the US Fed is on track for its third interest rate hike at its Sep FOMC and getting ready to implement its balance sheet reduction (BSR) program.

Taiwan's headline CPI inflation rose just 0.6%y/y in May from 0.1% in April, largely due to lower fresh food and oil (commodity) prices. The firmer TWD in the first half of 2017 also helped curbed imported prices. Core CPI inflation, excluding fresh food and energy, rose 1.1%y/y in May vs. 1.0% in April. Food prices have declined for the fourth straight month to May, and more downside pressures are likely in the remainder of 2017 due to higher base last year. As we expect upside to crude oil prices is likely to be curbed below the US$60 per barrel level, this should help to keep Taiwan's inflationary trajectory at a modest pace. At nearly halfway mark for 2017, we are lowering our inflation forecast for Taiwan this year to 0.8% (from earlier forecast of 1.0%) and to 1.1% for 2018 (previous forecast 1.2%). CBC's forecast for headline inflation is at 1.07% for 2017.

As for TWD, the currency has been the best performing currency in Asia in the first half of 2017, chalking up nearly 6% gain vs. the USD, comparable to KRW. The firmer TWD has acted to curb import prices, wtih the import price index (in TWD terms) shrinking 1.9%y/y in May, the first decline since Oct 2016, while in USD terms, import price index rose nearly 6% in May. As we expect USD to remain supported, albeit with a far less bullish tone than before, we look for the TWD to grind back towards 31.00 by end-2017 from around 30.40 level in late June 2017, and towards 31.40 by mid-2018.

We maintain our call that the CBC will leave its policy rate unchanged at 1.375% through at least the rest of 2017.

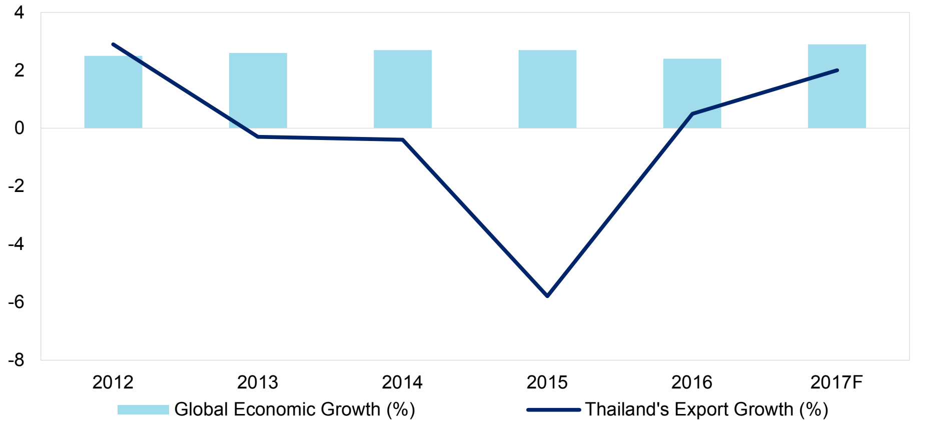
THAILAND

FX & Rates	3Q17F	4Q17F	1Q18F	2Q18F
USD/THB	34.8	35.0	35.3	35.5
THB 1-Day Repo	1.50	1.50	1.75	1.75

Economic Indicators	2015	2016	2017F	2018F
GDP	2.9	3.2	3.3	3.3
CPI (average, y/y %)	-0.9	0.2	1.5	1.8
Unemployment rate (%)	0.9	0.8	0.7	0.7
Current account (% of GDP)	8.8	10.8	7.2	6.5
Fiscal balance (% of GDP)	-2.4	-2.7	-2.7	-2.6

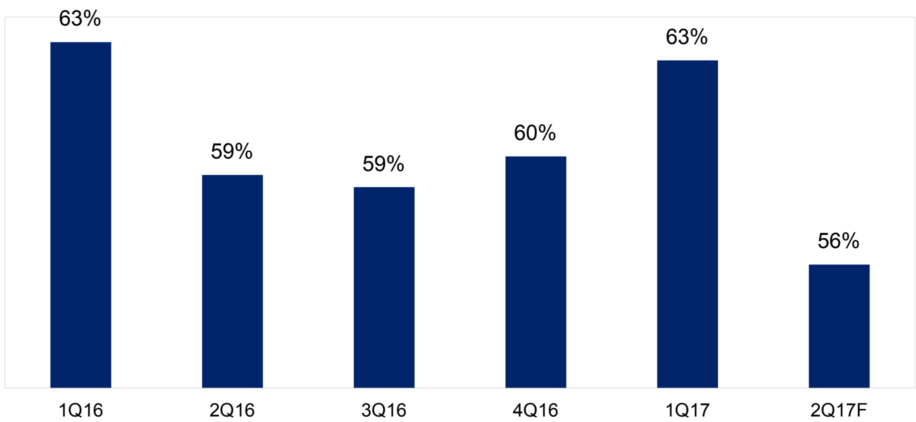
Merchandise Exports Show Incipient Signs Of Improvement

Source: IMF, MOC, UOB Global Economic Economics & Markets Research



A Low Capacity Utilization Rate Would Drag Down Future Improvements In Equipment Investment

Source: MOI, UOB Global Economic Economics & Markets Research



Gaining Momentum

The Thai economy continued to expand in the first quarter of this year. The 1Q17 GDP growth rose to 3.3% y/y versus 3.0% y/y in 4Q16. On a sequential basis, 1Q17 GDP grew by 1.3% q-o-q seasonally adjusted from 0.5% in the previous quarter, signifying some stronger momentum. Public expenditure continued to be an important driver of the economy. Export of goods exhibited a more broad-based expansion, consistent with the steady recovery of external demand. Tourism improved from the last quarter which was then affected by the government's regulation on illegal tour operators. Private consumption accelerated due to an increase in spending on durable goods, as supported by higher farm income and greater overall consumer confidence. However, private investment contracted for both construction and machinery and equipment investments.

Our growth forecast for 2017 remains unchanged at 3.3% as major infrastructure investment projects such as Eastern Economic Corridor development project, motorways, and dual-track rail routes are expected to play significant roles in driving the economy. The government will also run a 450-billion-baht budget deficit, equivalent to 2.8% of GDP, for fiscal year 2018 in order to stimulate employment and economic recovery. In addition, merchandise exports are expected to demonstrate signs of broad-based improvements in part owing to the recovery of the global economy, while tourism is expected to continue an expansion trend. Private consumption will likely gain traction, particularly for spending on durable goods and services sector. Nevertheless, private investment is expected to stabilize at a low level.

Low Inflationary Pressure

Consumer prices edged down 0.04% in May below April's 0.4%. Prices fell for the first time since March 2016 mainly due to a decrease in fresh food prices as their supply improved and a decline in domestic petroleum prices. Core inflation eased to 0.46% in May following 0.50% in April. During the latter half of the year, headline inflation is expected to gradually rise as the economy continues to expand. Core inflation is expected to stabilize mainly owing to low demand pressures, whilst public's medium-term inflation expectations remain close to the BoT's inflation target. We expect headline inflation of 1.5% on average in 2017, which is unchanged from previous quarter's forecast.

BoT Likely To Stand Pat

We reiterate our forecast that the BoT will keep the policy rate unchanged at 1.50% this year since accommodative monetary policy remains necessary given that the economic growth is still in the early stages and not yet broad-based. Moreover, headline inflation would rise at a slow pace and output gap will not close this year. With the BoT's Foreign Exchange Regulation Reform, we see a mild THB depreciation against USD amid a large degree of uncertainties on the external front, especially those pertaining to the direction of economic and trade policies of the US, the pace of the Fed's monetary policy normalization and the political developments in advanced countries. For now, we expect THB to weaken against USD towards 34.8 at end-3Q17 from around the 34.1 level currently.

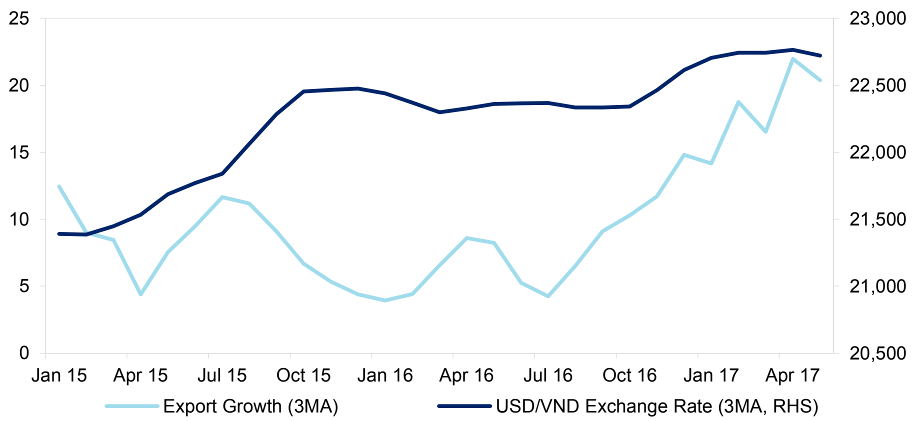
VIETNAM

FX & Rates	3Q17F	4Q17F	1Q18F	2Q18F
USD/VND	22,800	22,900	23,000	23,100
VND Refinancing Rate	6.50	6.50	6.75	6.75

Economic Indicators	2015	2016	2017F	2018F
GDP	6.7	6.2	6.2	6.5
CPI (average, y/y %)	0.6	2.6	3.5	3.2
Unemployment rate (%)	2.4	2.4	2.3	2.2
Current account (% of GDP)	1.4	1.2	1.5	1.6
Fiscal balance (% of GDP)	-5.9	-5.8	-5.9	-6.0

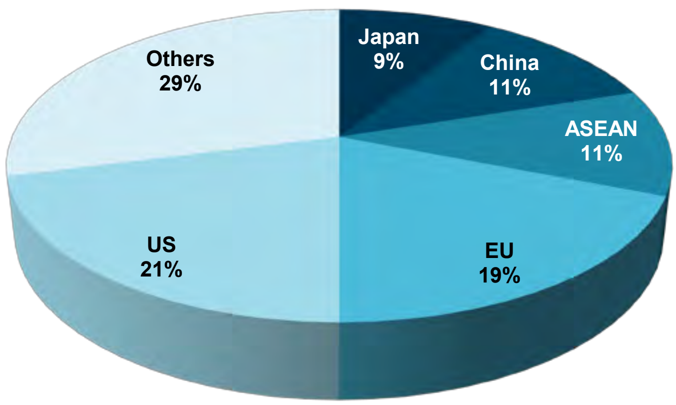
A Weaker Local Currency Would Lead To Stronger Exports For Vietnam

Source: CEIC, UOB Global Economics & Markets Research



The EU And The US Are Major Trading Partners Of Vietnam

Source: CEIC, UOB Global Economics & Markets Research



Steady Growth

Official GDP data for 1Q17 demonstrated a 5.1% increase in aggregate output. This was the slowest expansion in three years and puts in doubt the ability of the economy to meet the government's target of 6.7% growth for 2017. Agriculture remained a key area of weakness in the economy amid the worst drought in nearly a century. Output in the sector was up merely 1.4% on the year. Manufacturing however remained a standout performer in the GDP data, posting an 8.3% increase, above the 6.5% rise seen in services. Construction sector also reported slower growth of 6.5%, possibly owing to some negative spillover effects from the other sectors.

Despite a disappointing 1Q17 GDP growth of 5.1%, Vietnam's economy is expected to expand by 6.2% on the back of expansion in manufacturing exports and a sustainable rise in FDI. Manufacturing production will be boosted by the continued opening of new foreign-invested factories as a result of record FDI disbursements in 2016. Even though uncertainties in the global economy remain, particularly the monetary policy directions of major advanced economies and the US economic policy, manufacturing and exports will likely grow further with the global economic recovery and the opening up of more trade opportunities with advanced economies including the European Union through a new free trade agreement effective at the beginning of 2018. By doing this, the likelihood of TPP being cancelled will not significantly affect the economy since Vietnam still possesses different free trade agreements and bilateral agreements with other countries.

Moreover, construction will continue to benefit from high FDI disbursements to set up new factories, a strengthening housing sector, and continued high transport and energy infrastructure investments. Growth in services is projected to remain strong this year with tourist arrivals further boosted by the new e-marketing campaign launched by the government. Agriculture is expected to pick up somewhat in 2017 given the outlook for higher global food prices and assuming a return to normal weather, which will provide welcome support to private consumption and retail trade this year.

Falling Inflation

Headline inflation slowed to 3.2% in May, a nine-month low and notably lower than April's 4.3%. Core inflation, which excludes food items, energy products and commodities, came in at 1.3% in May, below the 1.5% seen in April. The slowdown in inflation was in part based on the high base last year. In the coming months, there would be downward inflationary pressures as global oil prices are expected to stabilize or edge down somewhat. We reiterate our view for headline inflation to average 3.5% this year, below the official 4% target.

SBV On Hold

We expect unchanged policy rates at 6.5% for the rest of 2017 since maintaining interest rates at low levels remain necessary to support the continuation of economic growth, while preserving financial stability. The preservation of policy space is also important given the external uncertainties. Looking ahead, we see a mild depreciation of VND against USD in line with regional currencies. For now, we expect VND to trade at 22,800 per USD at end-3Q17.

AUSTRALIA

FX & Rates	3Q17F	4Q17F	1Q18F	2Q18F
AUD/USD	0.75	0.75	0.76	0.77
AUD Offical Cash Rate	1.50	1.50	1.50	1.50

Economic Indicators	2015	2016	2017F	2018F
GDP	2.4	2.5	2.4	2.8
CPI (average, y/y %)	1.5	1.3	2.1	2.2
Unemployment rate (%)	6.1	5.7	5.8	5.8
Current account (% of GDP)	-4.7	-2.7	-1.2	-1.7
Fiscal balance (% of GDP)	-1.9	-1.5	-2.1	-1.6

Economy Still Not Quite There Yet

Australia's economic growth slowed considerably in the first quarter of 2017. Gross domestic product (GDP) expanded at a seasonally adjusted 0.3%, after rising 1.1% the final quarter of 2016. That was slightly higher than the median estimate of 0.2%. In annualized terms, GDP grew 1.7%, following a 2.4% year-over-year gain in the fourth quarter. The Australian Bureau of Statistics reported growth across 17 of the 20 industries included in the national accounts, with the strongest contribution coming from the services sector in areas such as finance, healthcare and social services. The trade sector was the biggest drag with exports down 2.6% for the quarter, led down by iron ore and coal shipments which were interrupted by bad weather in the quarter. Overall, exports lopped 0.4% of GDP. Investment in housing was also weak, down 4.4% over the quarter, falling in every state except Victoria, to record the largest quarterly slump since the depth of the GFC in 2009.

But it is not all doom and gloom in Australia: the labour market is holding up quite well and business surveys still remain strong. On the former, employment surged in May, fueled by a large uptick in full-time jobs, underscoring a strong labor recovery through the first half of 2017. In seasonally adjusted terms, overall employment rose by 42k last month, following a gain of 37.4k in April. That was the sixth increase of the past seven months. Full-time employment surged 52.1k, after declining by 11.6k the month before. Part-time jobs decreased by 10.1k in May after rising 49k the month before. The jobless rate declined unexpectedly to 5.5% from 5.7%. Workforce participation edged up to 64.9% from 64.8%.

RBA Firmly On Hold

As expected, the RBA left the overnight cash rate (OCR) unchanged at the record-low of 1.50% at its June meeting, where it has stood since August of last month. In the accompanying statement, largely unchanged from the one back in May, RBA Governor Philip Lowe concluded that "Taking account of the available information, the Board judged that holding the stance of monetary policy unchanged at this meeting would be consistent with sustainable growth in the economy and achieving the inflation target over time".

We did get a sense that the accompanying statement was incrementally more positive – from the language on the transition of the economy post the mining construction boom, to improved business conditions, rising capacity utilization, and increased business investment. But overall, there is nothing to suggest that the RBA is positioning for a near term move. Areas of focus for the RBA remain the labour market, housing and inflation. We see the RBA firmly on hold in 2017. The next monetary policy meeting is on 4 July.

Aussie To Remain Sluggish

AUD/USD has staged a modest recovery from its multi-month low in early May. Still, the pair looks poised to remain in ranges. Our current forecasts see AUD/USD trading close to current levels and possibly even lower, as ongoing low interest rates in Australia and rising interest rates in the US would suggest that the interest-rate differential between Australia and the US will continue to widen, and this will be challenging for a current account deficit country like Australia that needs to attract substantial amounts of foreign capital each year. If the interest rate gap is no longer supportive, Australian assets may need to "cheapen" to attract foreign capital via a lower AUD. Meanwhile, official policies in China to boost infrastructure investment and housing activity are likely to dominate through 2017 as the current regime seeks to present a strong economy in the lead up to the National Congress in November. Thereafter policies are likely to remain tight, weighing on Australia's exports and incomes in 2018. Domestically, Australia's hands are tied on monetary and fiscal policies, and this makes it difficult to be optimistic on the AUD. In addition, concerns with the wages/employment conundrum should be particularly pertinent where considerable spare capacity still exists in labour markets .Thus, we could still see the need for easier financial conditions in Australia.

EUROZONE

FX & Rates	3Q17F	4Q17F	1Q18F	2Q18F
EUR/USD	1.12	1.13	1.14	1.14
EUR Refinancing Rate	0.00	0.00	0.00	0.00

Economic Indicators	2015	2016	2017F	2018F
GDP	2.0	1.8	1.8	1.6
CPI (average, y/y %)	0.0	0.2	1.6	1.5
Unemployment rate (%)	10.9	10.0	9.3	8.9
Current account (% of GDP)	3.2	3.3	3.0	2.9
Fiscal balance (% of GDP)	-2.1	-1.5	-1.5	-1.4

Have Political Risks Receded?

We started 2017 with concerns surrounding European politics ahead of elections in the Netherlands, France and Germany. Much of the fear was that the march of populism across Europe would destabilize the region's economy. However, there has been a big shift in the political outlook during the past three months.

The first positive sign came in the Netherlands as the Freedom Party failed to match expected support even though it did become the second largest party in Parliament. Then, in France, National Front leader Marine Le Pen lost out to centrist Emmanuel Macron during the presidential elections. Macron later wrapped up his extraordinary string of electoral victories as his fledgling new party picked up a large majority of seats in legislative polls marred by the lowest turnout on record. Meanwhile, a weaker than expected performance for Italy's 5-Star party in the local elections on 11 June eased immediate concerns over a fresh round of instability surrounding the Italian government. And German Chancellor Angela Merkel has regained support in opinion polls and is now favourite to win the Federal Election on 24 September.

Notwithstanding these positive changes, we still remain cautious, especially given how elections can always throw up surprises. Merkel has been bedrock of political stability not only in Germany, but for the entire Eurozone. She will lose the chancellorship if Christian Democrats fail to win the majority of votes. Although the odds for such an outcome are not high, they are not completely off the table. Macron's victory was crucial in boosting confidence in the Eurozone political outlook. But the major risk, though, is that he will fail to tackle France's economic malaise and stimulate the country's economic growth as well as job creation, just like his political predecessor François Hollande. Over in Greece, following three bailouts, the country's debt burden still stands at around EUR320bn, or around 180% of its annual GDP. Of late, International Monetary Fund (IMF) chief Christine Lagarde and the Eurozone's 19 finance ministers agreed on a payout of EUR8.5bn to meet debt payments due in July and avoid another summer of Greek crisis.

Italy remains a huge pressure point. Fitch Rating downgraded Italy's sovereign debt from BBB+ to BBB in April, citing numerous the country's unsolved economic problems and mounting political risks ahead of elections. The next Italian general election is due to be held no later than 20 May 2018, that is to say no later than the last Sunday of the seventy days after the natural expiration of the current five-year parliamentary term on 15 March 2018. But beyond its political and economic problems, the biggest challenge lies in its banking sector, where Italian banks have reportedly EUR360bn in non-performing bad loans in 2016. Last but not least, in Spain, Catalonia's long-awaited and bitterly controversial referendum on independence from Spain will be finally held on 1 October, triggering yet another political and judicial showdown with Madrid.

Eurozone Economy Picks Up Pace

That said, momentum for the Eurozone economy has been building steadily over the last few quarters, with unemployment falling to its lowest since 2009. The region's GDP expanded at its fastest pace since 2015 at the start of the year, underscoring the bloc's impressive economic performance in a year many had feared would be plagued by political risks. The second official estimate was upgraded to 0.6% from 0.5% in the three months to March, following better than expected performances in France, Italy and Greece. In fact, all 19 Eurozone members registered positive growth at the start of the year. The year-on-year growth rate was increased to 1.9% from the 1.8% recorded in the previous quarter and also above the previous estimate of 1.7%. Household final consumption expenditure rose 0.3% for the quarter whilst investment rose 1.3%. There were neutral contributions from both net exports and inventories. Based on the manufacturing PMI for May (which came in at its highest in 73 months) it seems that momentum can accelerate further in the second quarter. The European Commission's Economic sentiment index is the highest in a decade reflecting increased confidence among both businesses and consumers in Europe. We now anticipate 1.8% growth for the Eurozone in 2017, followed by 1.6% in 2018.

ECB Drops Reference To Future Rate Cuts

The minor adjustment in forward guidance at the June meeting marks the first step in the bias of interest rates setting. However, this does not amount to much, as the rest of the statement and press conference retained a fairly dovish bias. We think that without a strong conviction in inflation, the ECB would not risk choking off the growth that the economy has been seeing of late. Hence, doing nothing is probably the best decision at the moment. Other factors that could also interfere with the timing of ECB's exit include the Euro's strength as well as ongoing political risks.

Euro Will Be Driven By ECB

The EUR has strengthened steadily since the start of this year (from 1.0341-lows on 3 January to 1.1296-highs on 14 June) reflecting both positive economic momentum and broad political relief. Compared to the previous quarter, our EUR/USD projections have been revised higher. This is in part due to a less bullish US dollar. The policy divergence between the ECB and the Fed remains relevant, but we also see this divergence slowing. Although rate hikes are still a distant prospect (the latest inflation forecasts by the ECB were lowered to an extent that makes it impossible for the ECB to start hiking rates any time soon), we expect the ECB to outline plans on its asset purchase programme, and in this regard, some sort of Euro-area "taper-tantrum" cannot be ruled out over the next six months. The sustained US deficit and Eurozone surplus also illustrate the potential for support in the pair. The Eurozone April current account surplus declined to EUR22.2bn from EUR35.7bn in March, although there was still a 12-month surplus of over 3.0% of GDP. Meanwhile, the US current account deficit widened to $117bn for the first quarter of 2017 from $114bn the previous quarter, although the deficit was lower than expected. That said, much of these factors have been priced in, and unless we see more aggressive ECB rhetoric, we are not convinced of too much upside in the EUR/USD from current levels. This explains the mild upward trajectory in our EUR/USD forecasts.

Summary Of ECB Policies - June Meeting

Policy Rates	**All benchmark interest rates were kept on hold** – main refinancing rate at 0.00%; marginal lending rate at 0.25%; deposit rate at -0.40%. **However, in a key change, the ECB removed language from its policy statement indicating rates could go lower in the future.** The ECB said it continued to expect interest rates "to remain at present levels for an extended period of time, and well past the horizon" of its asset-buying program, which is set to run at least through December. In previous statements, the ECB had said it expected rates "to remain at present or lower levels for an extended period of time".
QE Program	**There were no changes to the asset purchase programme.** The accompanying statement reiterated that the bond purchases are intended to run at the present rate of EUR60bn per month until the end of December 2017 and beyond if necessary. In any case, **purchases would continue until the ECB sees a sustained adjustment in inflation consistent with its inflation aim.** The ECB also repeated recent comments that the purchase programme can be increased in terms of size or duration if the outlook becomes less favourable or financial conditions become inconsistent with further progress towards a sustained adjustment in the path of inflation.
Tapering	**ECB President Mario Draghi stated that a potential tapering strategy in September was not discussed at the meeting.** He also insisted that the policy decision was unanimous, although also commenting that two Council members had made some observations surrounding policy normalization.
Staff Projections	Draghi was more optimistic surrounding the growth outlook with comments that the recovery is enjoying a stronger momentum and now growing at a faster pace than expected previously. **He also stated that the outlook was now broadly balanced, removing references to risks being tilted to the downside that have dominated over the past year.** On inflation, Draghi stated that weak inflationary pressure was due in part to low growth in wages, adding that the ECB will become more confident over a sustainable rise in inflation if there is a more robust growth outlook. **Nevertheless, he insisted that inflation developments would be crucial in determining the ECB policy moves.** 2017 / 2018 / 2019 Inflation (%) 1.5 (1.7) / 1.3 (1.6) / 1.6 (1.7) Growth (%) 1.9 (1.8) / 1.8 (1.7) / 1.7 (1.6)

	2017	2018	2019
Inflation (%)	1.5 (1.7)	1.3 (1.6)	1.6 (1.7)
Growth (%)	1.9 (1.8)	1.8 (1.7)	1.7 (1.6)

Source: Various Newswires

NEW ZEALAND

FX & Rates	3Q17F	4Q17F	1Q18F	2Q18F
NZD/USD	0.72	0.73	0.74	0.76
NZD OCR	1.75	1.75	1.75	2.00

Economic Indicators	2015	2016	2017F	2018F
GDP	3.2	3.6	3.0	2.8
CPI (average, y/y %)	0.3	0.6	1.9	2.0
Unemployment rate (%)	5.3	5.1	5.0	4.7
Current account (% of GDP)	-3.4	-2.8	-2.7	-3.0
Fiscal balance (% of GDP)	1.4	1.5	0.2	1.2

Economy Makes Tepid Rebound

The New Zealand economy grew at a slightly faster pace in the first quarter, although the expansion disappointed after a volatile end to 2016. GDP expanded at a seasonally adjusted 0.5% in the first quarter, following a 0.4% advance in the fourth quarter. Growth slowed sharply in the fourth quarter after a devastating earthquake and other seasonal influences.

The latest reading marked New Zealand's twenty-sixth consecutive quarter of expansion. By sector, agriculture grew 4.3% q/q, notching its fastest rise since the September quarter of 2014 thanks to expanding milk production. That in turn resulted in more dairy product manufacturing and delivered a boost to New Zealand's manufacturing sector, which grew 1.0%. Retail trade and accommodation rose 1.8% q/q. However, construction was down 1.0% from the previous quarter, the first contraction for the sector in a year and a half. Transport, postal and warehousing also fell 2.0%, with the statistics office pining the blame partly on lower transport support services. Total exports of goods and services dipped 0.4% due to an 11.0% fall in outbound shipments of dairy products, whilst imports rose 1.3% due to growth in inbound shipments of consumption goods and passenger cars. Household consumption grew 1.3% and fixed-asset investment rose 1.2% thanks to growth of investment in plant, machinery and equipment. In annualized terms, GDP expanded 2.5%, following a 2.7% y/y gain in the third quarter.

The Treasury expects GDP growth to average a solid 3.1% over the next five years, as the government rolls out massive infrastructure plans to support a growing population. Growth of that magnitude is expected to add 125,000 jobs through 2021, based on government estimates. Exports, construction and tourism are expected to be major catalysts behind the growth. We look for a full year growth of 3.0% this year followed by 2.8% in 2018.

RBNZ Removes Prior Neutral Tone

In its latest monetary policy meeting, the RBNZ voted to keep its official cash rate at 1.75%, unchanged since November. Diving into RBNZ Governor Graeme Wheeler's statement, much of what was stated in June was left unchanged from May. There were three notable developments though.

First, the RBNZ appears dismissive of the "lower than expected" GDP growth in the March quarter, noting that "the growth outlook remains positive, supported by accommodative monetary policy, strong population growth, and high terms of trade. Recent changes announced in Budget 2017 should support the outlook for growth". Second, the RBNZ also mentioned that the NZD has strengthened a little recently. However, although they noted that a lower NZD "would help rebalance growth", they were far less emphatically concerned about the stronger NZD than they had been in statements in recent years. Third, in May, the RBNZ said that "developments since the February monetary policy statement on balance are considered to be neutral for the stance of monetary policy." This was notably absent in June's document.

Markets likely interpreted the removal of a "neutral" stance as a relatively hawkish shift – though, in our opinion, it does not explicitly indicate a shift towards a hawkish stance. We think the RBNZ is probably very mindful about hiking prematurely, given its clear preference for a weaker currency and to avoid policy reversals, such as in 2011 and 2015. We still stick to our view that monetary policy is unlikely to change until around mid-2018.

Kiwi Supported But Gains Limited

The NZD has outperformed of late, rising by over 5% against the USD since early May, to become the best performing currency within the G10 space. Relative commodity prices between New Zealand and Australia have swung wildly, a reflection of the swings in iron ore and dairy prices. Relative pricing has moved in the NZD's favour, with dairy and other soft commodity prices recovering at a time when the hard commodities have come under some pressure.

We see that broad medium-term thrust for the NZD/USD remaining towards the upside, bearing in mind the strong growth, employment and population backdrop in New Zealand. The March quarter GDP figures were below expectations but the country's economic growth has been well above most other developed countries, including Australia, the Euro area, UK and US. But we suspect that given the aggressive strength over the last two months, a period of consolidation in the currency pair could be due. A lot of this good news story for New Zealand relative to Australia is already reflected in the exchange rate.

New Zealand's monetary policy will also take the back seat, with the RBNZ's clear policy guidance that rates will not be changing for a long time. Additional factors such as a cooling housing market and uncertainty surrounding September's general election mean it is unlikely the RBNZ will provide any hawkish signal at this juncture. Instead, the risk is that the central bank may express greater discomfort with the strength of the NZD, lending matters a more dovish tone.

UNITED KINGDOM

FX & Rates	3Q17F	4Q17F	1Q18F	2Q18F
GBP/USD	1.25	1.24	1.23	1.23
GBP Repo Rate	0.25	0.25	0.25	0.25

Economic Indicators	2015	2016	2017F	2018F
GDP	2.2	1.8	1.6	1.3
CPI (average, y/y %)	0.0	0.7	2.7	2.6
Unemployment rate (%)	5.4	4.9	4.8	5.2
Current account (% of GDP)	-4.3	-4.4	-3.2	-2.7
Fiscal balance (% of GDP)	-4.2	-2.9	-2.9	-2.5

Brexit Clock Ticks

A minority Tory government was almost unthinkable when British PM Theresa May called for a snap election in April. The expectation was for her to lead her Conservative party to a bigger majority and to govern through 2022. But it turned out, the 8 June election saw the ruling Conservative Party winning only 317 seats in the parliament, whilst their rivals, the Labour Party, secured 262. Although this leaves the Conservative Party as the largest one in the lawmaking chamber, this was less than the 326 seats required to form a majority government. May's minority government is seeking to negotiate a so-called "confidence and supply" arrangement whereby the Northern Ireland's Democratic Unionist Party (DUP) will throw their weight behind the government in key Commons votes, such as on the Queen's Speech and Budgets. Talks between the two parties have dragged on for nearly two weeks now (as of writing), and no deal has been reached.

Nonetheless, Britain finally kicked started negotiations with its European Union (EU) counterparts about leaving the bloc, after almost a year of waffling. The two chief Brexit negotiators – British Brexit Minister David Davis and the EU's Chief Negotiator Michel Barnier – said both sides sought an orderly British exit from the bloc in order to do away with uncertainty. They also agreed on priorities and a timeline for Britain's exit from the bloc. Citizens' rights, Britain's exit bill, separation issues and Northern Ireland will be addressed first. In addition, a terms-of-reference document said further talks would be held in the weeks starting on 17 July, 28 August, 18 September and 9 October.

May had entered the election vowing to regain control over immigration and British laws, accepting the risk Britain's tariff-free, regulation-light trade with its biggest market. If the EU balked at her demands, then she would walk away without a deal, she declared. However, she has been chastened by the electorate, and is now pledging to reflect a wider range of views. Senior ministers, including Chancellor of the Exchequer Philip Hammond, are already changing the tone to suggest a renewed emphasis on safeguarding jobs. Whether there's a deal or not, the final outcome, due on 29 March 2019, is as important as it now seems unpredictable.

BoE's Split Widens

The BoE was widely expected to remain cautious at its June monetary policy committee (MPC) meeting, particularly given the inconclusive election and the precarious position of the UK economy ahead of Brexit talks. Whilst it did maintain the bank rate at 0.25% and made no changes to its bond-buying programme; the vote was split, however. Both Ian McCafferty and Michael Saunders joined Kristin Forbes in voting for a rate hike of 25 basis points. Saunders' move is potentially very significant given that he is not excessively hawkish.

But BoE Governor Mark Carney provided plenty of disappointment to those who believe the three dissenters could mean a rate hike is on the horizon. At the delayed Mansion House speech on 20 June, Carney stated that now was not the time to raise interest rates given the anaemic growth rate in wages together with mixed signals on consumer spending and business investment. Carney also stated that domestic inflationary pressure was still subdued. Over the coming months, Carney wanted to see the extent to which weaker consumption growth is offset by other components of demand, whether wages begin to firm and how the economy reacts to tighter financial conditions. A key element would also be the developments surrounding expectations of households and companies during the Brexit negotiating process.

Note that periods of split votes within the MPC are not uncommon – in 2011, three members voted to raise rates, and also in 2014 and 2015, when McCafferty and his former colleague Martin Weale voted against the majority in favour of tightening policy. In fact, when the BoE regains its deputy (after hawkish Forbes leaves), we think the vote could quickly shift back towards a more wait-and-see mode. After all, the BoE is operating in an uncertain political climate. With ongoing risks associated with Brexit, alongside an environment of slowing growth and muted domestic inflationary pressures, we keep to our view that rates will stay on hold this year and next. There will be no meeting in July. The next meeting is scheduled for 3 August, where the central bank will also be releasing its quarterly inflation report.

Politics To Be The Major Catalyst Driving The Pound

With the clock already ticking towards the March 2019 deadline, as set out by the Article 50 timetable, the tone of the forthcoming negotiations will be a crucial factor in how GBP performs. The election was intended to strengthen May's hand and to provide financial markets with more confidence during the negotiation process. Instead, the hung Parliament outcome was a shock and only adds to the uncertainty, with a weak minority government an added risk. In the short term, the prevailing political drama will keep the GBP soft and volatile.

What matters for the GBP further out are the terms surrounding Brexit. The pursuit of a "softer" Brexit stance has given hope for some that come March 2019 there will be no cliff-like scenario on trade policy. Still, EU leaders hold all the ace cards at the negotiating table. The solid victory of Emmanuel Macron in France, and Angela Merkel's increased popularity in Germany has led to the closest Franco-German cooperation in years. This Macron-Merkel united front is one more reason to believe the Brexit negotiations may not go well for the UK.

We could get more clarity on the Brexit terms along the way, and this is likely to provide episodes of relief and upside for the GBP. However, the UK faces a long road ahead before one can get a clearer picture about its future economic direction. As such, we think rallies in the GBP would be capped by a subdued domestic economic outlook. This explains our downward bias in the GBP/USD throughout our forecast horizon.

The Brexit Timeline	
19 June	Negotiations begin
21 June	**The Queen's speech** Despite failure to reach a deal with the DUP, the Queen will still read out the speech during the State Opening of Parliament. This will be the first key test for May, as her position will be thrown into doubt if she loses Commons votes on her Queen's Speech agenda on June 28 and 29.
22-23 June	**European Council Summit** May will meet Angela Merkel, Emmanuel Macron and other EU leaders at the European Council summit.
26 June	**Reporting Back To EU27** One week after the start of negotiations, the commission will report back to member states and other European institutions on the progress of the talks. There is a formal reporting procedure the commission must abide by, in which it details exactly what was said and what was agreed on.
17 July	**Next Round Of Talks Begin** The second round of negotiations will begin in mid-July, after another exchange of papers.
24 September	**German Parliamentary Elections** German Chancellor Angela Merkel is standing for re-election in Germany.
01-04 October	**Conservative Party Conference** It is not yet clear if May will still be in place as party leader and prime minister by the time of the Conservative conference in Manchester.
October-December 2017	The EU hopes to have the first stage of Brexit negotiations, covering the principles of the divorce, concluded between October and December 2017.
October 2018	Barnier has said he wanted all the talks to conclude by October 2018, including discussions on transitional arrangements and the future relationship between the EU and UK.
29 March 2019	**Article 50 Deadline** Time for Brexit talks will run out in March 2019 – two years after Theresa May started the timer by triggering Article 50.

Source: Various Newswires

UNITED STATES OF AMERICA

FX & Rates	3Q17F	4Q17F	1Q18F	2Q18F
US Fed Funds Rate	1.50	1.50	1.75	2.00

Economic Indicators	2015	2016	2017F	2018F
GDP	2.6	1.6	2.5	2.5
CPI (average, y/y %)	0.1	1.3	2.1	2.5
Unemployment rate (%)	5.0	4.7	4.3	4.2
Current account (% of GDP)	-2.5	-2.5	-1.5	-1.5
Fiscal balance (% of GDP)	-2.5	-2.5	-2.9	-3.5

Growth Less Bullish, Inflation Less Certain

Despite the 1Q growth disappointment, we are still most positive on US economic growth among the G7 economies. After being revised higher to 1.2%q/q SAAR in 1Q (from just +0.7%), we expect a rebound in growth in 2Q at 3.5% although the recent batch of US economic data for April and May were lacklustre including durable goods orders, retail sales, industrial production and housing data while specific factors like declining car sales, unfortunately has been shaving off our growth optimism, bit by bit. We also factored in a longer delay (but still not a derailment) of US President Trump's reflation policies. Therefore, while we remain bullish on overall US growth, it is inevitable that we have to mark down **our growth outlook for 2017 to 2.5%** (down from 2.7% previously but still above the 1.6% recorded in 2016), still anchored by resilient US consumers, while expecting housing market & fixed capital investment to rebound but less bullish now.

And while the US economy continues to add jobs in the current very long recovery cycle, average monthly jobs creation has markedly stepped down to below -200,000 in the first 2 months of 2Q, well off the pace seen in early 2017. Still, the May numbers continued to show the US economy adding jobs every month since Oct 2010 (more than 15 million jobs in the current cycle so far) but seems to be missing the mark of excellence and may be an indication of employers' difficulty in finding suitable labor in a tight market as unemployment rate edged lower to 4.3% in May. We still expect US continue its monthly jobs creation but at a more moderate 100-150k with the occasional aberrations and rebounds.

Perhaps the most confounding part of the US economy is the US price environment. Even as the Fed Reserve acknowledged that "inflation has declined recently and, like the measure excluding food and energy prices, is running somewhat below 2 percent" but it still expects inflation "to stabilize around the [FOMC] Committee's 2 percent objective over the medium term" and FOMC Chair Janet Yellen said lower readings on inflation appear to be result of 'one-off' reductions in certain categories of prices, but she insisted that conditions still in place for inflation to rise. While the recent moderation in PCE and the core PCE could still be transitory and start moving towards 2% in 2H-2017 hopefully because of rising US wages.

If inflation continues to fade amidst the tightening labor market, then perhaps some structural/ specific factors could be at play not just in US but also globally. The rise/explosion of the sharing economy fueled by disruptive technologies and subsidizing costs (via burning cashing from eager investors) to gain market share/kill off competition, could have suppressed the prices of major segments within the CPI/PCE (such as food services, and transport) while at the same time encouraging more of the workforce into their employment. One could postulate that if the investors stop the cash burn and remove the subsidies overnight, then we may see a sudden resurgence in inflation. However, if investors (who remain flush with cash and nowhere to invest) continue to throw money at the startups in the sharing economy, then the soft inflation-low unemployment environment may still persist for longer with the inflation "spring" being wound even tighter and waiting to spring back with a greater vengeance.

Trump Policy Effect Unlikely Happening Soon But Neither Is An Impeachment Or A US Default

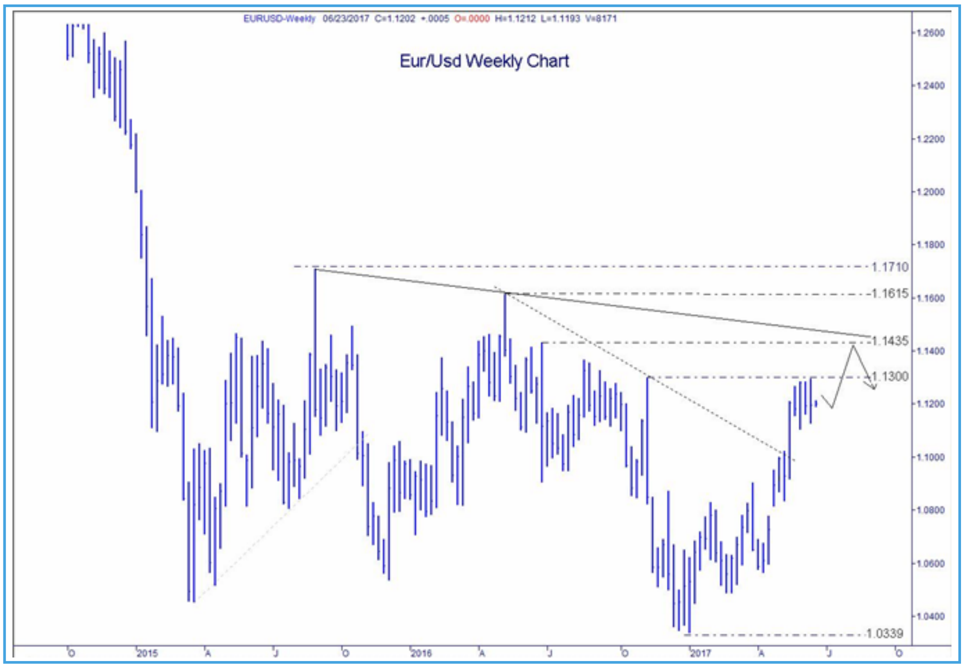
The initial optimism of the Trump's presidency has fizzled out quite remarkably as the reality of hard-bargaining politics set in and with it, the US dollar strength has been markedly sapped even as the Fed Reserve remain steadfast in its monetary policy normalizing path. One area of temporary comfort is that Trump's much feared anti-trade rhetoric and the "Border Adjustment Tax" mostly did not materialize although we remain watchful of further developments. We still expect Trump to get at least some of his tax reform and infrastructure spending proposals approved through Congress but 2017 is very unlikely and sometime in 2018 will be more realistic and will be a boost for the US economy and the real economic effect more apparent well after 2017. And while we still believe that an impeachment of President Trump is very improbable for now, noise emanating from US domestic politics will continue to distract the real economy (but not derail it). Finally, the US is once again facing the US government debt ceiling limit this coming September and failure to raise the ceiling could result in a US sovereign default. Treasury Secretary Steven Mnuchin said that US federal government will have enough cash flow to pay its bills through at least early Sep but urged lawmakers to raise the debt limit soon. Again, we think the ceiling will be raised and this will be a non-event because like in the later Obama years, the House & Senate are under Republican control but unlike Obama, Trump is a Republican president and we shudder to think his own party will play the debt ceiling roulette during his maiden year in office.

FOMC: Still On Course For 3rd Hike In 2017 But No Confirmation On BSR Timeline Yet

After its June FOMC decision, we still believe our moderately hawkish outlook for the Fed rate trajectory in 2017 remains intact and we maintain the forecast of 3 Fed rate hikes this year (including the March & the latest June hike). Therefore, we expect one more 25bps rate hike in 2017 – this time in September FOMC – followed by a period of pause in 4Q-2017 before resuming hiking rates in 2018. We retain our expectation that the BSR announcement may take place in the 12/13 Dec 2017 FOMC. While that development will not derail our 2017 rate hike trajectory, the potential December announcement may affect our 2018 Fed rate hike trajectory as trimming the Fed balance sheet is somewhat a 'substitute' for rate hikes, although the impact is likely to be felt more on the longer-end UST yields but it is difficult to quantify the magnitude at this current juncture. An earlier than expected BSR in 2H 2017 may imply a tighter than expected US monetary policy in 2017.

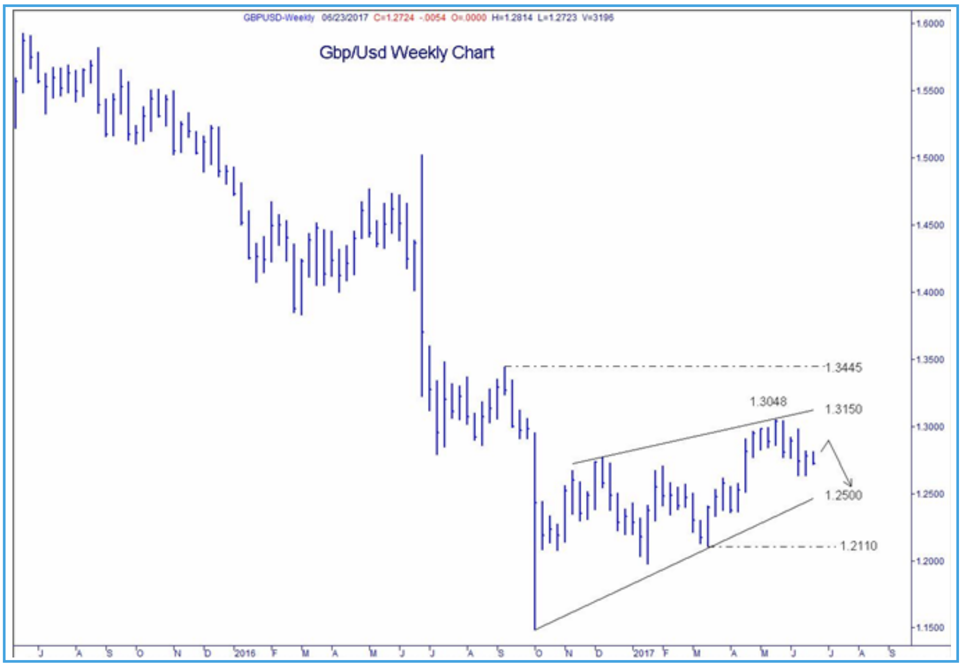
USD/SGD
1.3860

USD/SGD dipped briefly below the major rising trend-line support before rebounding quickly from a low of 1.3706. A combination of waning momentum and oversold conditions suggests that the price action is the early stages of a basing process. Further attempts to move below the trend-line support are not ruled out but any weakness is expected to encounter solid support at 1.3600. The 2016 low of 1.3313 is not expected come into the picture in the third quarter of this year. All in, USD/SGD is expected to trade sideways to higher but 1.4130 is a very strong level and is unlikely to break so easily.



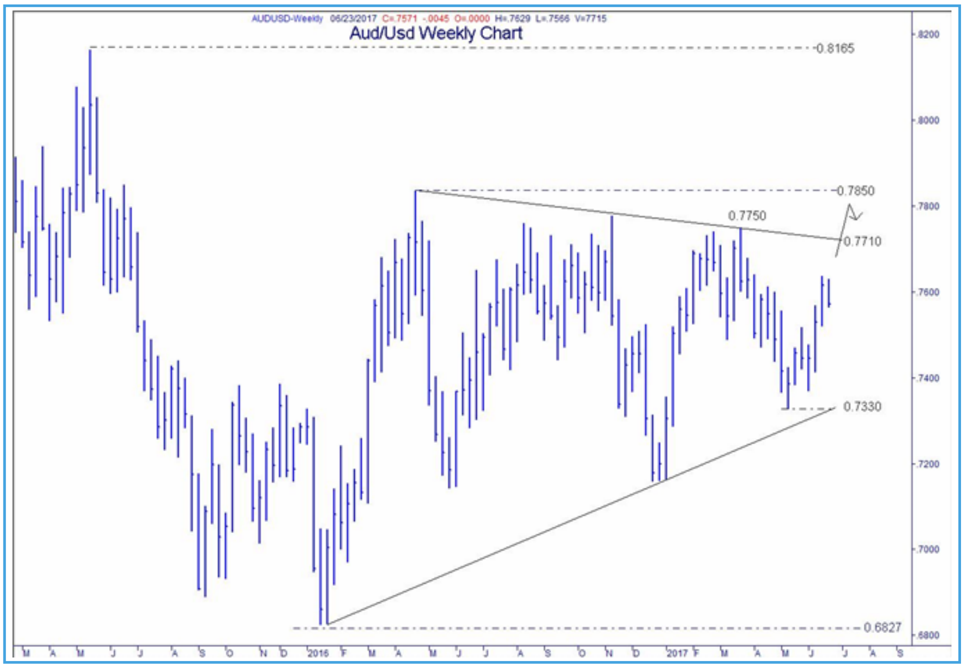
EUR/USD
1.1200

EUR/USD extended its up-move after breaking above 1.1000 but the rally was thwarted by the resistance at 1.1300. However, momentum indicators continue to suggest a higher EUR/USD in Q3 even though a sustained move above the major 1.1435 resistance seems unlikely. Overall, EUR/USD is expected to edge higher towards 1.1435 but this should be followed by a period of consolidation.



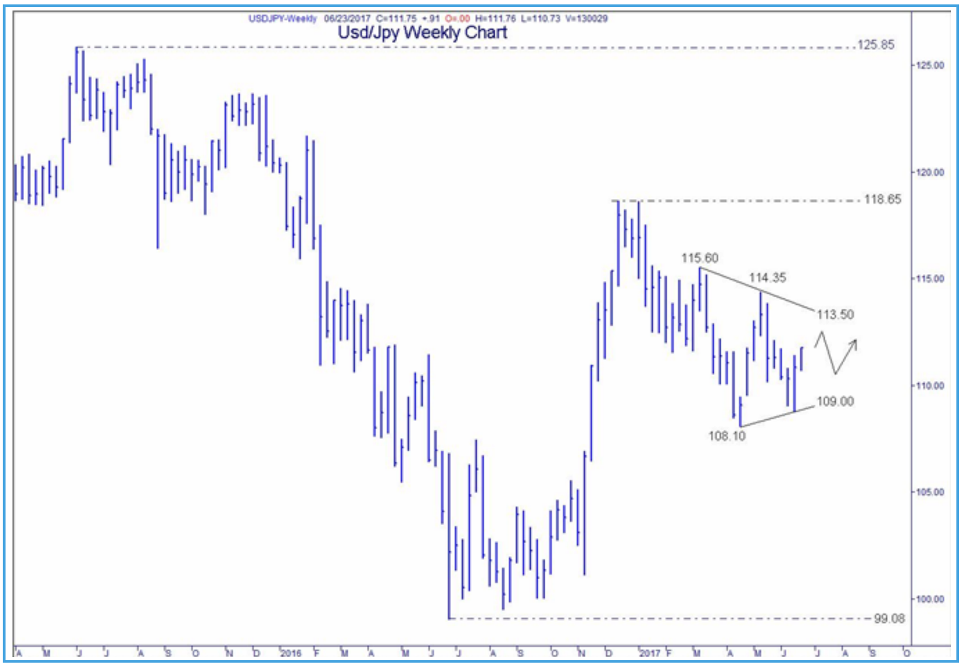
GBP/USD
1.2680

GBP/USD traded in a choppy manner in Q2, rising strongly on news UK election to hit a high of 1.3048 but the up-move was not sustained. The subsequent pull-back from the high lacks momentum even though there is scope for a probe towards the major 1.2500 support. A break below this level could lead to a rapid drop to 1.2110. On the upside, the 1.3048 peak is acting as a major resistance but the key level is closer to the 1.3150. The 1.3445 top seen in September 2016 is not expected to come into the picture in the next few months.



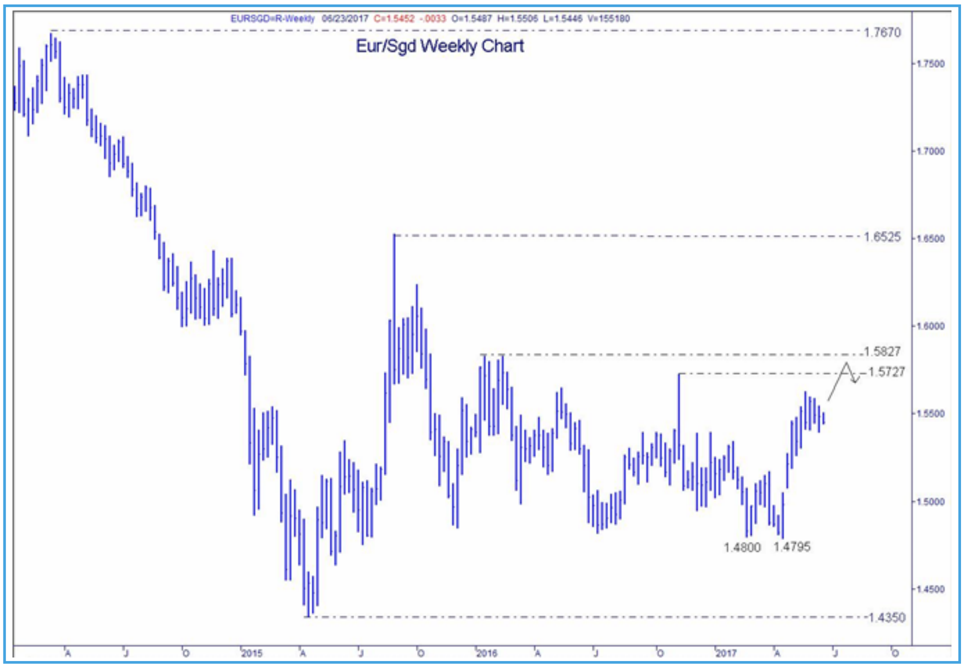
AUD/USD
0.7570

AUD/USD touched a low of 0.7330 in May, holding just above the major rising trend-line support. The rapid up-move from the low appears incomplete and further AUD strength is expected in Q3. While a move above the 0.7710 resistance would not be surprising, the major level of 0.7850 is likely out of reach. Support is at 0.7410 ahead of 0.7330 (which is acting as a very solid support).



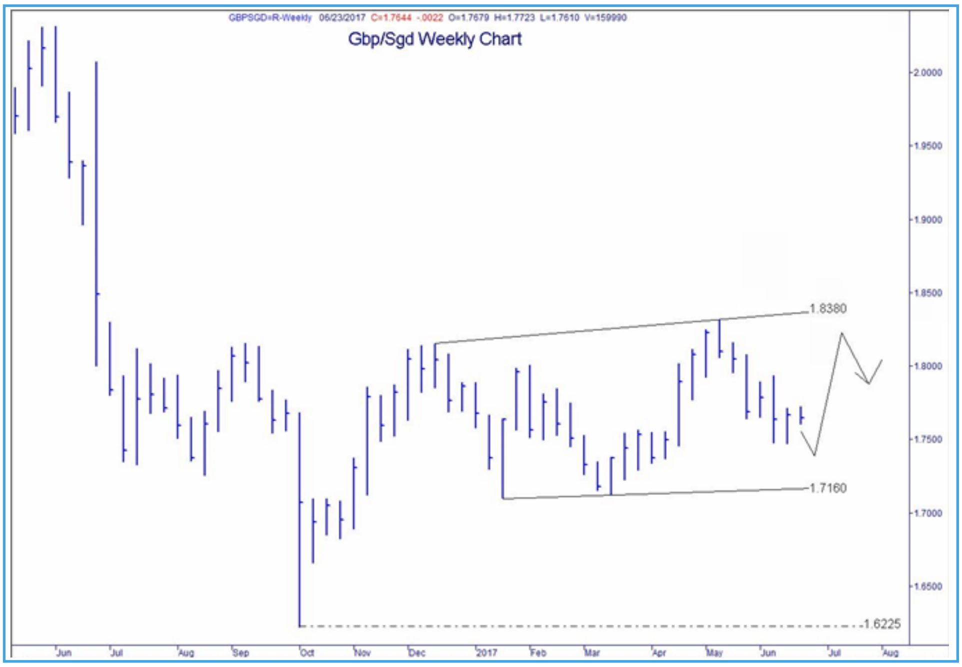
USD/JPY
111.60

USD/JPY traded in a choppy manner in Q2, dropping initially to a low of 108.10 before swinging rapidly higher to 114.35. The volatile price action has resulted in a mixed outlook and the movement is viewed as part of a broad sideway consolidation range, likely between 109.00 and 113.50. Even if there is a break-out of this range, the next support at 108.10 and resistance at 114.35 are unlikely to come under serious threat.



EUR/SGD
1.5460

EUR/SGD tested the major 1.4800 support in late April but rallied strongly after touching a low of 1.4795. While the rally appears to be running ahead of itself, there is no sign of weakness just yet and another push higher towards major resistance zone of 1.5727/1.5827 seems likely. Based on the current momentum, a sustained move above this zone is not expected. Support is at 1.5230 ahead of 1.5000. The 1.4795 is not expected to come into the picture in Q3.

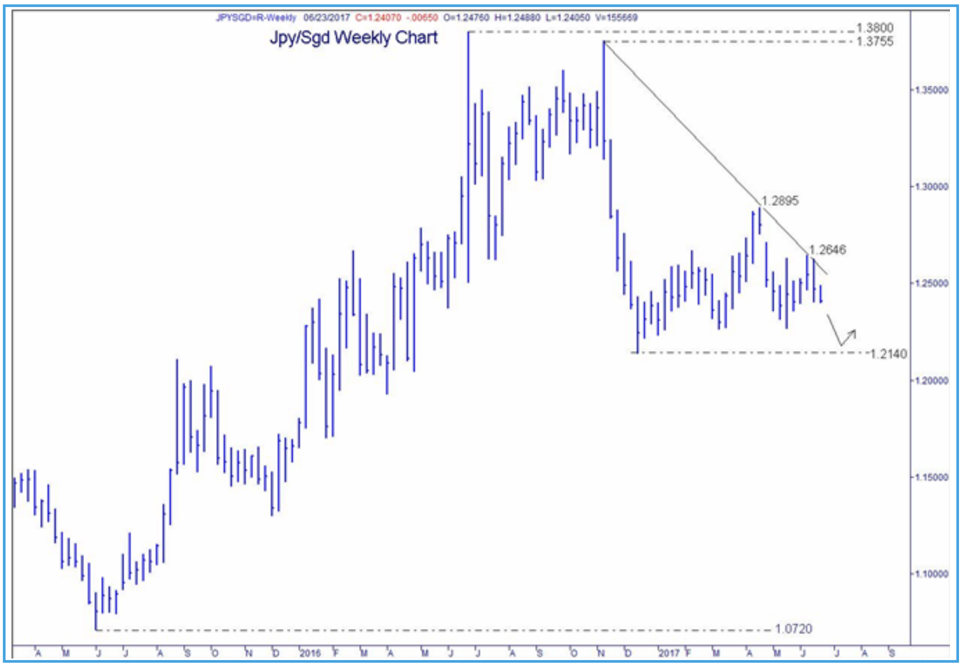


GBP/SGD
1.7660

The choppy price actions in Q1 and Q2 have resulted in a mixed outlook for GBP/SGD. The near-term direction is unclear and this pair is expected to continue to 'chop around', likely within a rather broad 1.7160/1.8380 range.

AUD/SGD
1.0520

AUD/SGD dropped sharply from a high of 1.0955 in February to a low of 1.0210 in early June. The subsequent rapid and sharp recovery from the low suggests that a bottom is in place. That said, the up-move appears to be 'corrective' in nature and a sustained break above the major resistance at 1.0825 seems unlikely. Support is at 1.0265 and based on the swift pace of the recovery, a move back below the 1.0210 low is not expected in the 3rd quarter.



JPY/SGD
1.2430

JPY/SGD surged to hit a high of 1.2895 in late April but dropped quickly from the top. While downward momentum is not that strong, the decline from the high appears to have scope to extend lower and test the major 1.2140 support. Based on the lackluster momentum at the time of writing, a sustained move below this major support is not expected. On the upside, resistance is at 1.2646 and the Q2 high of 1.2895 is not expected to be challenged in Q3.

Disclaimer

CONTACTS

Global Economics & Markets Research

Suan Teck Kin
Head of Research
(65) 6598 1796
Suan.TeckKin@UOBgroup.com

Alvin Liew
Senior Economist
(65) 6598 1797
Alvin.LiewTS@UOBgroup.com

Lee Sue Ann
Economist
(65) 6598 1792
Lee.SueAnn@UOBgroup.com

Ho Woei Chen
Economist
(65) 6598 1793
Ho.WoeiChen@UOBgroup.com

Francis Tan
Economist
(65) 6598 1791
Francis.TanTT@UOBgroup.com

Peter Chia Chih Siong
FX Strategist
(65) 6598 1754
Peter.ChiaCS@UOBgroup.com

Victor Yong Tze Chow
Interest Rate Strategist
(65) 6598 1799
Victor.YongTC@UOBgroup.com

Quek Ser Leang
Market Strategist
(65) 6598 1795
Quek.SerLeang@UOBgroup.com

Julia Goh
Senior Economist
(60)3 2776 9233
Julia.GohML@uob.com.my

Manop Udomkerdmongkol
Economist
(66)0 2343 4330
Manop.Udo@uob.co.th

United Overseas Bank Limited
Company Registration No.: 193500026Z

Head Office
80 Raffles Place
UOB Plaza
Singapore 048624
Telephone: (65) 6533 9898
Facsimile: (65) 6534 2334

www.uobgroup.com

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