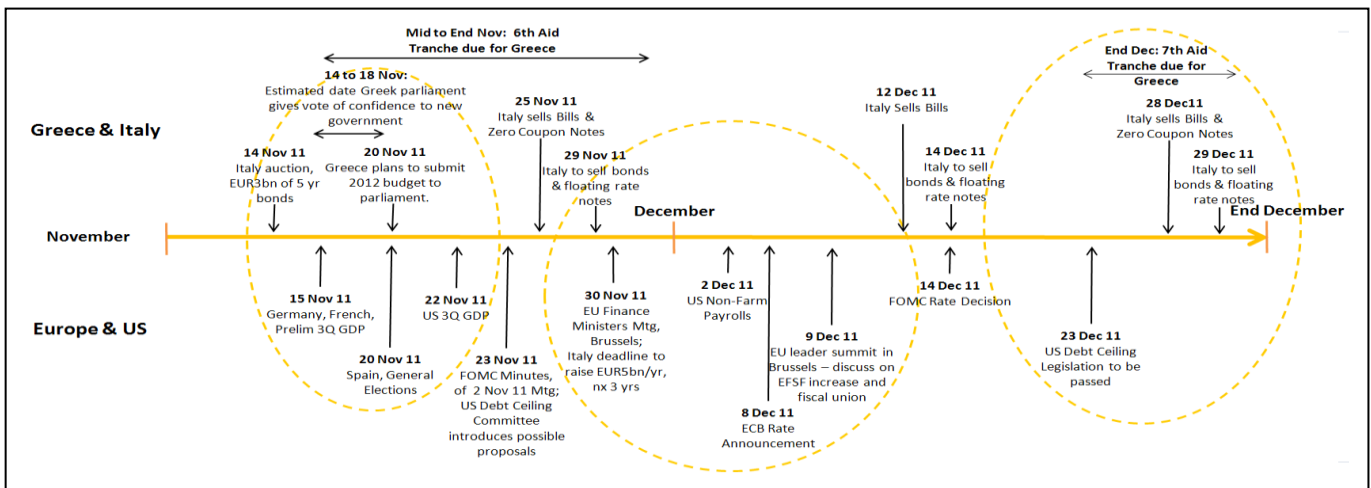


### FX: Susceptible to Clear “Unknowns” towards End 2011

#### Global Overview

- **Three main themes continue to affect the currency outlook over the next few months.**
  - First, continued focus on global economic data from US, eurozone and China, with particular concern on eurozone recession and new hints of worsening global slowdown. Although US economic indicators has since stabilized since our last monthly.
  - Second, continuation of uncertainty on adequacy of eurozone sovereign risk solutions and ‘actual’ implementation risk, rising contagion risk concerns emanating out of Greece and Italy, possibly into Spain next, has led to an increase in counterparty risk concerns and dollar funding tightening liquidity in the banking system (reflecting systemic risk buildup) as seen by rising LIBOR-OIS and the corresponding EURIBOR-OIS. Any unexpected surprises likely to come from politically motivated ‘black swan’ events exacerbating the already uncertain eurozone crisis.
  - Third, policy considerations in the developed and developing countries become more divergent and complex – with recent downside growth risks leading to dovish monetary policy bias and risk of further rate cut expectations in developed countries (i.e. ECB, BOJ, BOE, Fed, RBA), ongoing impact of fiscal austerity measures, risk of political impasse in US in end Nov and Dec with regard to the US debt ceiling resolution and speculation of further QE in developed countries (at this point higher probability out of BOE) as well as a slowdown in the speed of tightening in Asia amidst weaker global growth.



- **Euro: We hold the view that the markets will be prone to headline grabbing risk-aversion going into Nov and Dec especially with the fluid situation in Europe.** The coming months are riddled with potentially market moving political events. Some of the more significant ones include today's Italian upper chamber vote on debt reduction measures and the lower house expected to approve measures by end of the week before a new government comes in to execute the plans. This is followed by the Spanish general elections, new budgets and austerity implementation plans for Greece (as well as Italy), and US debt ceiling legislation. There are also unknowns in the pipeline. Worrisome is the notion of Italy needing a bailout due to the estimated EUR1.9tn (yes, *trillion*) of debt - way more than what the EFSF can afford at this juncture. Other risks comes out of Germany with its headline news of two tier eurozone (i.e. some countries in eurozone but not adopting euro), paving the way for countries exiting the euro. Next whether France maintains its AAA sovereign credit rating followed by the type of governments that will emerge out of Greece and Italy. A more technocratic one for both will be positive for markets with the expectations that implementation risks of fiscal austerity measures will be reduced. Finally, a key factor for the markets in our view is the ECB view on the SMP (bond buying programme) – whether it is temporary or a permanent fixture as part of the crisis solution. The official view by new ECB President Draghi thus far has been towards the temporary bias.
- **Besides that, sovereign solvency risk continues to emanate out of eurozone as concerns of contagion risk and banking system vulnerabilities remains.** Greece's inability to meet its bailout obligations was fueling risk aversion, exacerbated by after it put up the EU bailout to a referendum, only to have it called off again days later. The taboo subject of expelling members from the EU has been broached and Italy now seems to be heading down the same road as Greece, with Berlusconi being ejected from power, and bond yields rising above the purportedly unsustainable 7 percent mark. The problem is that Italy's EUR1.9tn of debt is currently too large to be bailed out, and even if it does find leadership, painful structural reforms would still have to be implemented. Italy's 7+ percent yields have caused euro zone analysts to suggest that Italy could be plodding down the same path as Greece, Ireland and Portugal. Going forward, the uptake of Italian bond auctions will be a good gauge of the market's sentiment regarding Italy.
- Notwithstanding, in the backdrop, fundamentally, we have Manufacturing, Services and Composite PMIs for the euro area steadily declining below the threshold 50 level over the recent months. There are risks going forward in 2012 that the ECB may make further cuts to policy rates as the focus seems to have shifted towards a growth downside risk bias from the usual strict inflation focus. This should weigh on the euro further down the road in 2012. **If the eurozone situation remains status quo and Italian bond yields retreat slightly due to ECB buying, we expect euro to remain around the 1.3600 to 1.3900 levels. However, we are factoring some risks of surprise events happening around the tail end 2011 to end the year at around 1.3200 by end of the year.**
- **USD:** On the US fiscal front, the risk of a US political impasse again with key dates around 23 Nov and 23 Dec, when the focus will be on the follow-through to further reduce the US fiscal debt. In the interim our view is that the dollar will see some volatility, albeit some inflows whenever global risk aversion increases and due to lack of other reserve currency alternatives. Given global economic sentiment, recent

central bank policy cuts and uncertainty out of eurozone, we are quite bullish on the USD in the interim. Although the assumption that some form of monetary stimulus and resolve on the fiscal strategy front, will ensure dollar will marginally decline by end of the year and into whole of next year.

- **We expect the Japanese economy to see a more modest recovery in 2H 2011 led by restoration of demand, however, power shortages and a US/China slowdown will continue to weigh on the Japanese economy. Deflation is expected to linger.** Japan's lower house of parliament approved Prime Minister Yoshihiko Noda's JPY12.1tn (USD155.7bn) stimulus plan to rebuild areas affected by the temblor in March and nuclear accident. Japan plans to spend about JPY19tn over the next five years on reconstruction. JPY had recently breached multi-decade lows when BOJ stepped in with a JPY7.5tn (USD96.5bn) intervention aimed in particular at aiding smaller exporters. However, JPY has been in a protracted down trend, which BOJ interventions failing to have lasting impact. In our view, fundamentally, Japan's current account surplus and low global interest rate environment means recycling by domestic exporters will be limited. In such economic conditions, we tend to see currencies appreciate in the near to medium term. As such, we expect JPY to continue to strengthen going forward but in near term hover around the 77-79 levels with possible intervention activity below 77.00.
- **RBA slashed rates by 25 basis points to 4.50 percent, the first reduction since April 2009, citing moderate growth in the Australian economy and peaking terms of trade. The central bank also lowered GDP forecasts for 2011 to 2.75 percent from 3.25 percent on sovereign debt woes and banking problems out of Europe in addition to a slowing Chinese economy.** Inflation is expected to stay within the 2 percent to 3 percent range in 2012. Despite the rate cut, the OIS curve shows that the market still anticipates RBA to cut rates by another 1 percent in the next year.
- **Overall, our view is the persistence of intense volatility for the next 3 months or so, and that the Dollar and Yen will continue to outperform regional Asian and high yielding currencies. Uncertainties in Europe, moderating US growth and a slowing China should continue to weigh on the global economic outlook as well. Spurts of risk-on in-between should venture towards a search for higher yields as intensity of capital outflows into emerging or non-reserve currencies increases. We could also see an increase in foreign exchange intervention activity over the next 6 months.**

#### Asia

- **Asia's central bank policy activities in response to global growth weakness will lead to an intensification of easing moves-particularly with BI's recent 75bps cumulative cuts in a span of less than 2 months, coinciding with the ECB and RBA rate cuts. With clear downside risks on growth taking centre stage away from inflation risks over the next 3-6 months, we expect the regional markets to remain cautious over possible further rate reductions by their respective monetary authorities while bearing in mind that once recovery starts to gain more traction, capital inflows to this part of the world could resume. We do anticipate some sort of macro-prudential measures to take place further in various forms in the regional markets.**
- Among the Asian currencies, the KRW was the worst performer in Oct and the only loser (-0.1%) against the greenback. INR gained the most vis-à-vis the dollar at +0.6% followed by THB (0.5%), tied with the PHP. SGD gained 0.4% while MYR +0.3%, the same gain for CNY as well. TWD gained 0.2% while the IDR remained flat against the greenback. **Overall, our view is that USD/Asia could consolidate from here given the fluidity of the European situation and the slow recovery in the US job markets. As we approach the year end, trading volume is also expected to be lower and thus, any significant buy/sell orders could move the Asian currencies without any material shifts in fundamentals.**
- **MYR:** Our economics team expects no change in OPR and SRR for a fairly extended period of time with Sep's MPC sending a strong signal that the central bank's monetary policy bias has shifted to supporting growth from containing inflation and/or maintaining financial stability. The team, however, opines that although the downside risk to global and local growth has increased in recent months, the Malaysian economy is not at an imminent danger of re-entering recession (Maybank IB growth forecast for 2011 stood at 4.5% this year and 3.5-4.0% next year) and inflation is under control and not likely to accelerate further (Maybank IB inflation forecast is 3.1% this year and 2.6% in 2012), implying no immediate pressures to cut OPR or SRR (currently at 3.00% and 4.00% respectively) after the previous rounds of hikes. Consequently, the Malaysia economics team sees the OPR staying at the current 3.00% throughout 2012.
- On the domestic front, much of the economic outlook has been priced in by the market, i.e. in terms of slowing growth and tapering-off of inflationary pressures and some possibility of even a rate cut whenever necessary. **Question remains on what are the key drivers for the volatile swings in the USD/MYR recently. We believe that the movement of USD/MYR will be more influenced by the global volatility rather than domestic developments (although impending general elections could be a key catalyst for the near-term movement of the pairing).** On balance, we think that the backdrop of global economic uncertainty will lead to more volatility going forward. **Despite the current global conditions, well-supported domestic economic prospects with the view that OPR could remain at 3.00% (still below the average of regional benchmark interest rates) and similarly for SRR at 4.00%, we revise our USD/MYR year-end forecast to 3.1500 from 3.2000 previously while keeping our end-2012 forecast unchanged at 3.0000 (1H 2012 forecast at 3.1000).**
- **SGD:** Faster than expected 3Q 11 at 5.9% y/y (2Q 11 at 1.0%), beating our forecast of 5.2% and consensus' 5.6% on the back of stronger than expected rebound in the manufacturing output of 13.2% (2Q 11 at -5.8%), implying that Sep's industrial figure will remain at double digit growth of around 10.2% y/y). In sequential terms, a growth of 1.3% q/q saar means that the country has managed to avert the technical recession. As expected, the MAS announced that it will continue with its policy of a modest and gradual appreciation of the S\$NEER policy band for the next 6 months, however with the expected moderation in core inflation from an expected slowdown in final demand from Singapore's major trading partners, the slope of the policy band was reduced, with no change to the width of the band and level at which it is centered. This is in line with our earlier policy view and consensus. With the policy change, our view is that the current slope of the S\$NEER will be adjusted to around 1.5% from the previous 3.0% p.a. appreciation. We think the USD/SGD in the coming months may be weighed down by the euro and US market and political-economic developments. **Given that the policy decision was in line with our expectations but in light of the fluidity in the global situation, we revise our forecast for the USD/SGD slightly to 1.2700 from 1.3100 previously before gradually fell to 1.2600 in 1H 2012 and then to 1.2500 by end 2012.**
- **CNY:** CPI (y/y) for October dipped to 5.5% in line with consensus and below last month's 6.1%. This was the third straight month in a row that inflation had declined from its peak at 6.5% in July. Noteworthy in the breakdown, food prices trimmed down to 11.9% from 13.4% in the past month and housing also fell to 4.4% from 5.1%. The lower CPI reading is in line with guidance from the National Development and Reform Commission (NDRC) that expects inflation to cool below 5% by the end of the year. Chinese regulators cite that stabilizing prices and curbing a potential property bubble remain top priority. Cooling inflationary pressures should also give Chinese leaders more leeway in their "fine tuning" of macroeconomic policy in order to maintain the balance between inflation and economic growth. We have also seen the Yuan

appreciate continuously throughout 2011. This has been one of the tools that China has been using to combat inflation as well. The fixing on the 3 Nov was the lowest for 2011 at 6.3165 and since August, there have been ten fixings strengthening the Yuan by at least 100points. Prior to Aug, the last fixing of more than 100 points was in Jan 2011. This is in accordance with a statement made by Premier Wen earlier in the year mentioning that China will "increase the flexibility of the renminbi exchange rate and **eliminate monetary conditions for inflation**". **We anticipate that inflation will continue to subside, in accordance with efforts by the NDRC stated above. We are also of the view that China will continue to appreciate the Yuan to keep imported inflation at bay. A stronger Yuan is consistent with the next five year plan to shift gears more towards domestic consumption and away from exports whilst keeping the US and their "Currency Reform for Fair Trade" act at bay.** Our USD/CNY forecast for end 2011 is 6.34, 1H12 forecast at 6.23 and end 2012 forecast at 6.11, or an appreciation of 3.8% for 2012.

- IDR:** 3Q11 real GDP growth came in slower than expected at 6.5% y/y (consensus: 6.6%) on the back of slower government expenditure and investment spending. Our Indonesia economics team forecasts growth to come in at 6.50% this year (2010 at 6.10%) while inflation to edge lower to around 4.60% from 7.00% in 2010. BI cut its benchmark rate by a cumulative 75bps over the past two months to 6.00%, citing downside risks on growth despite inflation remaining at elevated levels. On a medium-term basis, nevertheless, the USD/IDR downward move is seen to have overshot slightly from the perspective of rates differential between the USD/IDR 2Y onshore swap rates and its dollar counterpart of the same tenor. As such, we could potentially see USD/IDR to end this year at 9000, which is consistent with our current year end forecast. **Overall, bearing in mind the fluidity of the European debt saga and the snail-pace recovery in the US economy (especially its labour markets), added by the impending US debt deal issue that will resurface this month and next, we maintain our USD/IDR forecast of 9000 for end 2011. Based on the rates differential analysis above and acknowledging some lag effects, we forecast USD/IDR to edge lower to reach the 8850-8900 level by the middle of 2012 before settling in lower at 8800 by the end of next year.**
- PHP:** Inflation accelerated for two consecutive months since Sep, recording a higher than expected rate of 5.2% y/y (5.3% using 2000 prices; consensus: 5.0%) on the back of higher utility (6.5% y/y in Oct vs. 5.7% in Sep) and food (5.7% y/y in Oct vs. 5.0% in Sep) prices. BSP Governor Tetangco commented that such inflation rate was still within BSP's forecast range. He further mentioned that this will only be a one-off "blip" as it was caused by base effects and transient impact of supply disruptions due to weather disturbances. Core inflation also came in higher at 3.9% y/y (base 2000) as compared to Sep's 3.5%. The BSP Governor also highlighted that the central bank is flexible and has room to adjust policy if needed but remained comfortable with the current monetary policy settings amidst manageable inflation outlook over the policy horizon. **We read such statement as a likely outcome of rate neutral for the rest of this year and potentially some cuts in 1H 2012 should downside risks heightened.** We revise our forecast for the Philippines' economy and project that inflation would average around 5.0% for the final quarter of this year (before: 4.5%) as Oct's inflation surprised on the upside. 2011 inflation forecast was consequently revised higher to 4.9% from 4.7% previously. We maintain our view that growth could register on average 4.3% in 2H 2011 (2011 forecast at 4.2%). **Our view remains for the USD/PHP prospect to remain biased on the downside given the relatively balanced growth drivers (exports and domestic consumption) and steady monetary policy management that is consistent with the objective of achieving low and stable inflation trajectory. Although we expect such NDF ruling to affect the movement of spot USD/PHP as some short covering might increase in the near future and thus giving more support for the pairing. USD/PHP is likely to continue to be dominated by global events. On balance, we revise our USD/PHP forecast slightly lower to 43.30 by year end from 44.00 previously and then to trend lower to 42.50 by 1H 2012 before consolidating to 43.00 by end-2012.**
- THB:** Thai officials noted the extent of severity of the floods and this would undoubtedly have a negative impact on economic growth. Fin Min Thirachai estimated that the flood incidents may bring about 1-1.7%-point cut to Thai economic growth this year. The kingdom is expected to grow by 4.1% (our forecast is 3.3% but likely to be revised lower to around 2.5% to take into account the negative impacts from the flood to the overall growth trajectory). BOT Governor Prasarn said that the floods could cause the country an economic loss of THB120bn and BOT is likely to lower its growth projection on Oct 28. The 3Q 11 real GDP growth figure will be released on Nov 21. The MPC further concluded that the decision to stand pat is "appropriate in addressing upcoming inflationary pressure and supporting economic adjustments amidst heightened uncertainty in the global economy." **Given the downside growth risks going forward and our view on the prospects of no more BOT policy rate hike, we think that USD/THB should be contained in the medium-term. We revise our end 2011 USD/THB forecast slightly lower to 31.00 from 31.50 before and then to go lower to 30.25 in 1H 2012.**

## 2011 &amp; 2012 Quarterly Forecasts\*

	2011		2012		
	End Q4-11 f	End Q1-12	End Q2-12 f	End Q3-12 f	End Q4-12 f
USD/JPY	78.00	77.50	77.00	78.50	80.00
EUR/USD	1.3200	1.3000	1.2900	1.3100	1.3350
GBP/USD	1.5950	1.5900	1.5850	1.5800	1.5800
AUD/USD	1.0300	1.0250	1.0200	1.0500	1.0700
NZD/USD	0.8100	0.7950	0.7900	0.8200	0.8500
USD/SGD	1.2700	1.2650	1.2600	1.2550	1.2500
USD/MYR	3.1500	3.1400	3.1000	3.0500	3.0000
USD/IDR	9000.00	8950.00	8900.00	8850.00	8800.00
USD/THB	31.00	30.50	30.25	30.50	31.00
USD/PHP	43.30	42.80	42.50	42.80	43.00
USD/CNY	6.34	6.29	6.23	6.17	6.11
USD/HKD	7.80	7.80	7.80	7.78	7.78
USD/TWD	30.00	30.25	30.00	30.00	29.50
EUR/CNY	8.37	8.18	8.04	8.08	8.15
EUR/MYR	4.16	4.08	4.00	4.00	4.01
<b>SGD Crosses</b>	<b>End Q4-11 f</b>	<b>End Q1-12</b>	<b>End Q2-12 f</b>	<b>End Q3-12 f</b>	<b>End Q4-12 f</b>
100 JPY/SGD	1.6282	1.6323	1.6364	1.5987	1.5625
EUR/SGD	1.6764	1.6445	1.6254	1.6441	1.6688
GBP/SGD	2.0257	2.0114	1.9971	1.9829	1.9750
AUD/SGD	1.3081	1.2966	1.2852	1.3178	1.3375
NZD/SGD	1.0287	1.0057	0.9954	1.0291	1.0625
SGD/MYR	2.4803	2.4822	2.4603	2.4303	2.4000
SGD/IDR	7087	7075	7063	7052	7040
SGD/THB	24.41	24.11	24.01	24.30	24.80
SGD/PHP	34.09	33.83	33.73	34.10	34.40
SGD/CNY	4.99	4.97	4.94	4.91	4.88
SGD/HKD	6.14	6.17	6.19	6.20	6.22
SGD/TWD	23.62	23.91	23.81	23.90	23.60
<b>Other Crosses</b>	<b>End Q4-11 f</b>	<b>End Q1-12</b>	<b>End Q2-12 f</b>	<b>End Q3-12 f</b>	<b>End Q4-12 f</b>
EUR/CNY	8.37	8.18	8.04	8.08	8.15
EUR/MYR	4.16	4.08	4.00	4.00	4.01
MYR/JPY	24.76	24.68	24.84	25.74	26.67
MYR/HKD	2.48	2.48	2.52	2.55	2.59
MYR/CNY	2.01	2.00	2.01	2.02	2.04

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

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