Global Macro Department – Indonesia (UNDERWEIGHT)

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Analysts

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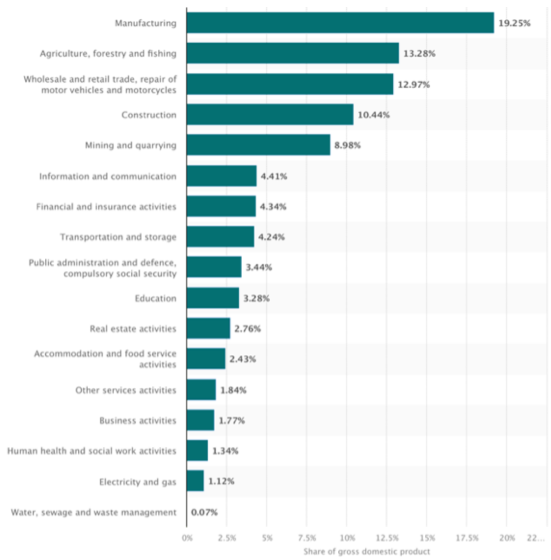
Basic Information

Real GDP (in 2021, USD)	1.186 T
M2 (Oct 2022, USD)	529.031 B
CPI (Nov 2022)	112.85
PPI (Nov 2022)	113.02
Consumer Con. (Nov 2022)	119.1
Currency	IDR

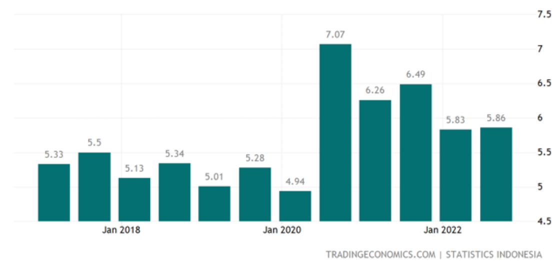
Chart info

Figure 1: Breakdown of GDP



Source: Statista

Figure 2: Unemployment Rate



Source: Trading Economics

Figure 3: Nominal GDP Growth (YoY)

Overview of Indonesia's Economy

With over 275 million people, Indonesia is the world's fourth-most populous country and the most populous Muslim-majority country. Its population growth, however, is decreasing, due to a lessening birth rate (2.24 births per woman) and a negative net migration rate (-0.0375% of population).

As seen in Figure 1, Indonesia's GDP per sector comprises 40% in wholesale and retail trade, as well as other services, 38.7% in manufacturing, construction, mining and quarrying, and finally 14% in agriculture, forestry and fishing. Each sector is significant to the country's key economic indicators, each employing 49%, 22.4%, and 28% of the workforce respectively.

Headline inflation has the respective larger weightages: 25% in food, drinks and tobacco, 20.4% in housing, water, electricity and household fuel, and 12.4% in transportation. The rest of the categories are each less than 10% each of the CPI. Food is a large percentage of the chosen goods-and-services basket, leading to inflation that is variable to climate changes and crop levels.

Similarly, its exports are highly dependent on seasonality and climate. Indonesia is a big exporter, with its most important export commodities in oil and gas, minerals, crude palm oil, electrical appliances and rubber products, exporting mostly to China ($32.6B), United States ($19.6B), Japan ($14.4B), Singapore ($12.6B), and India ($11B). On the other hand, the it imports predominantly are petroleum products, telephones, and aviation products, mostly from China ($40.8B), Singapore ($14.8B), Japan ($9.24B), Thailand ($7.76B), and United States ($7.59B). Indonesian Rupiah (IDR), has a credit rating of BBB, and thus is not a safe haven currency. Its demand and supply would be based on speculation and transactions.

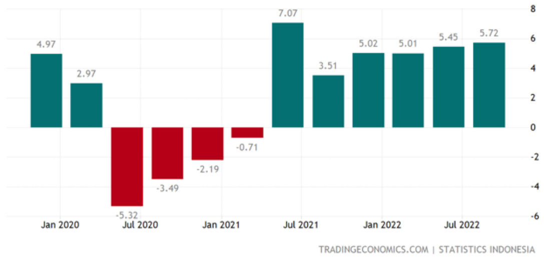
Summary of events in the past 6 months

Recovery from Covid-19

- Unemployment rate is approaching its pre-COVID average, at 5.86% in Q3 of 2022, as seen in Figure 2.
- Both nominal and real GDP growths have recovered as well, and is steadily increasing, as seen in Figure 3 and 4.
- Although consumer confidence increased sharply over the ease of Covid-19 measures, it has a trend of weakening from May to November, as depicted in Figure 5.

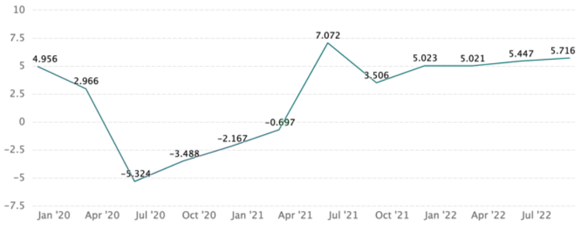
Rising Inflation

- Indonesia's inflation rate has increased from an average of approximately 2% in 2021 to YoY rates as high as 5.95% in September, as seen in Figure 6.
- Although the rate is higher than its past, this remains lower than other ASEAN counterparts, and has not been steadily increasing. Inflation in Indonesia has subsequently decreased



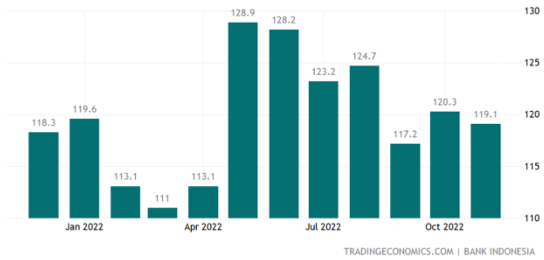
Source: Trading Economics

Figure 4: Real GDP Growth (YoY)



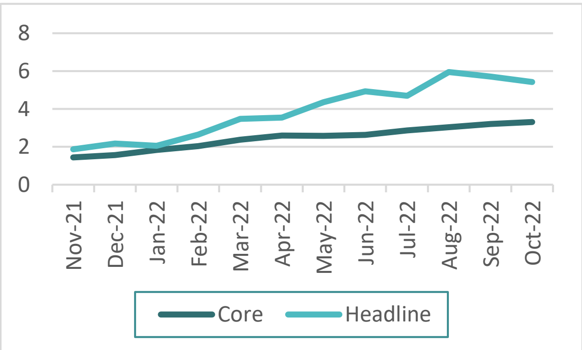
Source: MacroTrends

Figure 5: Consumer Confidence Index



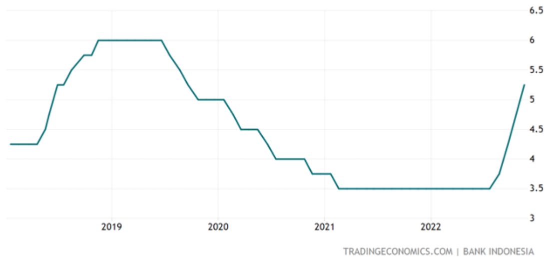
Source: Trading Economics

Figure 6: Indonesia's Inflation Rates



Source: Trading Economics and Macro Trends

Figure 7: Benchmark Rates



Source: Trading Economics

Figure 8: CPO Futures Daily Chart

to 5.42% in November, slightly lower than the market consensus of 5.5%.

- Additionally, while its headline inflation remains above the target of 2-4%, its core inflation has been within this range, as seen in the same figure.

<u>Interest Rate Hikes</u>

- To combat the rising inflation, Bank Indonesia rose its 7-Day Reverse Repo Rate, its benchmark interest rate, in Q3 and Q4. This is depicted in Figure 7.
- August: 3.5% to 3.75%
- September: 3.75% to 4.25%
- October: 4.25% to 4.75%
- Meanwhile, it also raised the deposit facility and lending facility rates to 4.50% and 6.00% respectively.

<u>Palm Oil Levy Waiver</u>

- On 28 April, Indonesia started a three-week palm-oil export ban aimed at controlling domestic cooking oil prices, exacerbated by increasing crude palm oil (CPO) prices as seen in Figure 8.
- After a worldwide decrease in prices, farmers felt an additional squeeze in profitability paired with the lowered demand for palm fruits due to the ban. On 23 May, the ban was hence ended. The ban also caused a problematic inventory glut.
- When crude palm oil prices continued to drop globally in mid-July, the government begun an export levy waiver until the end of the month.
- This was extended in August, and then until the end of October, and finally until the end of the year, unless CPO futures broke $800 per tonne, which it currently shows no signs of doing.

<u>Petrol Subsidy Cuts</u>

- Previous government subsidies kept inflation lower, but tripled in 2022 from its original budget, rising to 502 trillion rupiah (USD 34 billion). This was triggered by rising global prices of oil and gas.
- As such, the government cut its subsidies on fuel, causing fuel prices to hike by 30%. The price of gasoline grew from 51 cents to 67 cents per litre and that of diesel fuel grew from 35 cents to 46 cents.
- The government instead is providing 150,000 rupiah (US$10) cash handouts to cushion the impact of the fuel-price increase on 20.6 million poor families until the year-end. The total cost of the handouts will be 12.4 trillion rupiah, which will be reallocated from the budget for energy subsidies.
- In response to the higher fuel prices, students and labour unions have rallied through October against this decision.

<u>Updates on Relocation of Capital City</u>

- The relocation of the capital from Jakarta to Nusantara has been slated since 2019, due to Jakarta's overcrowding, pollution and sinking due to the over-extraction of groundwater.

Source: Trading View

- The project to build the city from scratch was put on pause during the Covid-19 period, and now that President Joko Widodo's term is coming to an end in 2024, he is still aggressively courting international investors to finance 80% of the project's US$34 billion estimated budget.
- Insiders claim that more than three years after the first announcement, not a single foreign entity, state-backed or private, has signed a legally binding agreement to support the project. The persons claimed that while some prospective investors have signed letters of intent, there is no firm commitment to pay.

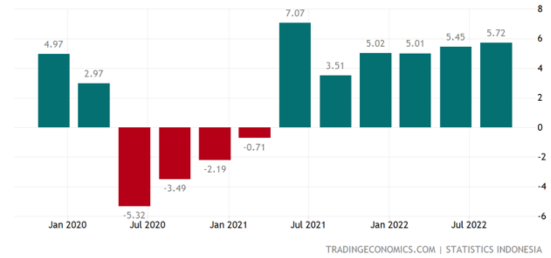
<u>New Criminal Code Banning Sex Outside Marriage</u>

- On 6 December, the parliament passed the law banning sex outside marriage with a punishment of up to one year in jail. The new criminal code will also ban insulting the president or state institutions, spreading views counter to the state ideology, and staging protests without notification.
- This new criminal code is said to be slated in 3 years, and will affect not just citizens but also foreign residents and visitors. Currently, Indonesia bans adultery but not premarital sex.

<u>New Long-Term Residency Visa Scheme in the Works</u>

- To bolster its capital flows and tourism market, Indonesia has teased about a new long-term residency visa scheme, which will attract foreign investments into property.
- Details have yet to be revealed, but so far it has been shared that there will be a minimum requirement of USD30,000 in bank deposits and a temporary tax holiday on overseas income, an incentive similar to those shared by Thailand and Malaysia.
- The scheme aims to attract rich foreigners, boosting foreign investment, capital flows, and tourism into the country.
- Rolled out this year, the similar "second home" programme Malaysia has successfully attracted 42,000 foreigners, a third of them from mainland China and Hong Kong, according to data compiled by Juwai IQI.

Figure 9: Nominal GDP Growth (YoY)

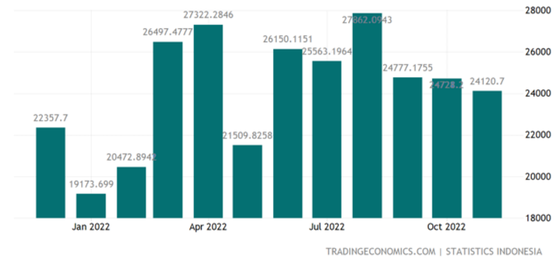


Source: Trading Economics

Figure 10: Net Exports (in million USD)

Source: Trading Economics

Figure 11: Exports (in million USD) – 1 Year



Source: Trading Economics

Figure 12: CPO Futures Daily Chart

Source: Trading View

Figure 13: Indonesian Coal Index Futures Daily Chart

Source: Trading View

Macro Trend 1 - Growth on the Coat Tails of Increased Exports

Indonesia's GDP rate is expected to be 5.4% in 2022 and by 5.0% in 2023, according to a report by the Asian Development Bank (ADB) released in September. This is seen in Figure 9. Its net exports has also increased slightly over the months as in Figure 10.

Taking the increase in net exports as a percentage of the increase in GDP, net-export growth made up a total of 43.0% of 2022's GDP growth so far.

Overall, however, Indonesia's GDP growth in the following year is expected to be lower than its other South East Asian counterparts. The factors that have accelerated the growth of exports, such as high commodity prices and tourism boosts, are predominantly in the short-run, or are not significant enough to push Indonesia's growth beyond that of other countries.

<u>Commodities Exports Propelling GDP growth</u>
Indonesia is the world's biggest exporter of thermal coal, palm oil, and refined tin and a major seller of nickel-based steel, copper, rubber, and other resources.

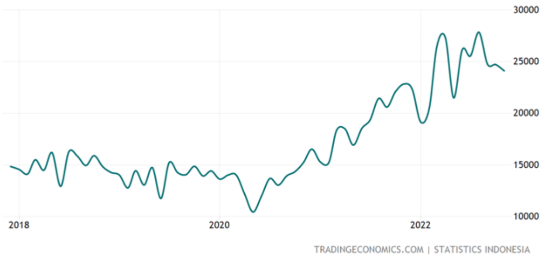
As seen in Figure 11, Indonesia's exports have been rising rapidly in the face of increasing global commodity prices and demand, alongside policies such as "resource downstreaming", as seen in Figure 11. "Resource downstreaming" involved the ban on exports of nickel ore in 2020, attracting investment into processing facilities. This caused sharp rises in the higher value nickel-based steel shipments. Overall, Indonesia's exports could hit a record US$280 billion this year.

However, this export boom may be short-lived. Commodity prices are rising less rapidly than they were earlier in the year. Palm oil futures, for example, are trading far below Q2 prices, as seen in Figure 12. It is true that coal, another core commodity, is still expected to rise in price due to the energy crises in Europe exacerbated by cold winters and the oil shortage from the Russian-Ukraine war, paired with increasing electricity demand as the globe restarts its economic activity. However, after hitting record highs and losing its speed of increase as seen in Figure 13, the price of coal will likely not rise as dramatically as it has earlier in the year. Furthermore, the rise will likely be in the short-term, due to environmental concerns.

Furthermore, it is important to note that the government instated significant export bans on coal and palm oil in January and June respectively. This explains the dips in export revenue in those months in Figure 11, which may augment the positive trend depicted in the graph. If we disregard the significant dips at the start and middle of 2022, the rate of the rise in net exports appears to be consistent with previous years, as seen in Figure 14.

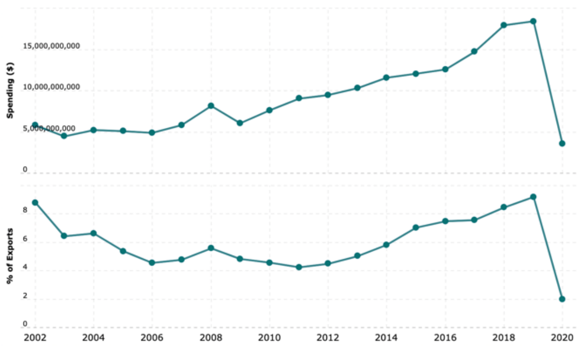
In addition, Indonesia has shown many times that it is willing to ban specific exports for the sake of the domestic majority whom are more affected by prices, even if it causes inefficiency or deadweight loss in the market. Past bans have been signals of power to directors of Indonesia's large domestic companies. Especially in today's

Figure 14: Exports (in million USD) – 5 Years



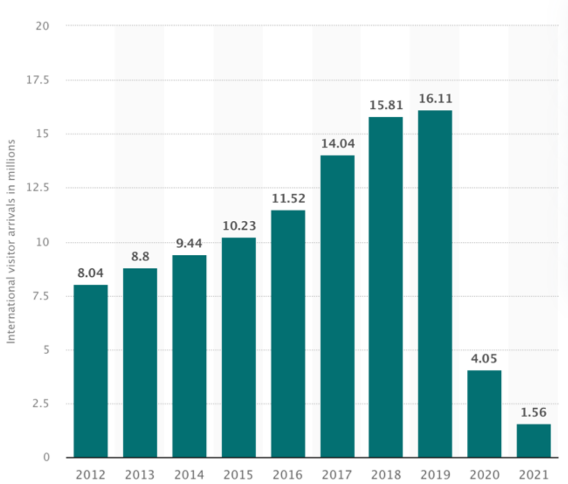
Source: Trading Economics

Figure 15: Tourist Spending and its Percentage of Total Exports



Source: Macro Trends

Figure 16: Visitor Arrivals (in millions)



Source: Statista

inflationary climate and rising low-income discontentment, it is possible that such a ban may occur. More of such bans may thus dampen future trade. For example, in October, president Joko Widodo said that a tin export ban may be on its way.

As such, even though rising commodity prices are amplifying net export growth and thus economic growth, it appears that this will not be significant in the following months as we enter 2023.

Tourism Sector Continues Growing... for Now?

Tourism took a huge hit in 2020 and 2021 – seeing an 80.8% decline in tourist spending and a nearly 75% drop in visitors from 2019 to 2020, as depicted in Figures 15 and 16. It has significantly recovered this year, whereby the Indonesian National Statistics Bureau recorded over 470,000 foreign tourist arrivals in the country – the highest number since the easing of Covid-19 restrictions in October last year.

Nonetheless, with the new criminal code implicating not just foreign residents but also tourists, the scare tactics ruin the image of certain tourist destinations like Bali, and will likely lead to impairments on these numbers. The new law may hence hinder Indonesia's tourism going forward.

While it is true that the difficulty in execution of the law should act as a safety net for potential visitors since the new laws will be limited by who could report them such as a parent, spouse or child of suspected offenders, the new law will still disturb the reputation of Indonesia as a travel location and may make tourists feel unsafe. Maulana Yusran, deputy chief of Indonesia's tourism industry board, said the new code was "totally counter-productive" at a time when the economy and tourism were starting to recover from the pandemic. Phil Robertson, the Deputy Asia Director at Human Rights Watch tweeted that the new laws will "blow up Bali's tourism".

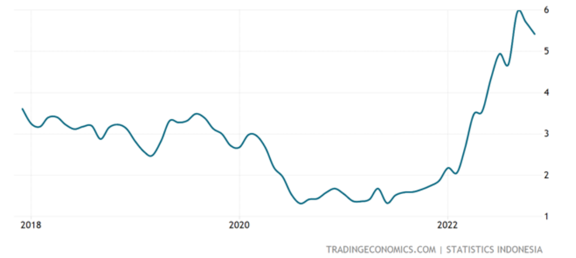
Additional Revenue from Foreign Visitors in the Long-Term

Besides recovery from Covid-19, Indonesia has another large reason for increased export revenue from visitors: its new long-term residency visa scheme. With the domestic issues occurring in China and Hong Kong – including but not exclusive to the strict Zero-Covid policy and increased government intervention and pressure onto the wealthy in China, as well as the numerous protests and reduced business confidence in Hong Kong, many of the rich have been migrating to other countries. Indonesia, alongside countries such as Thailand and Malaysia, have implemented or have plans to implement easier immigration rules in order to attract these people into their country. This is likely to bolster tourist and visitor revenue in Indonesia.

Beyond that, the scheme will help boost capital flows and government tax income. Although the scheme hints at a temporary tax holiday, long-term residents that bring their work and income into the country should make a large boost in tax revenue, if the scheme is able to attract these wealthy business people.

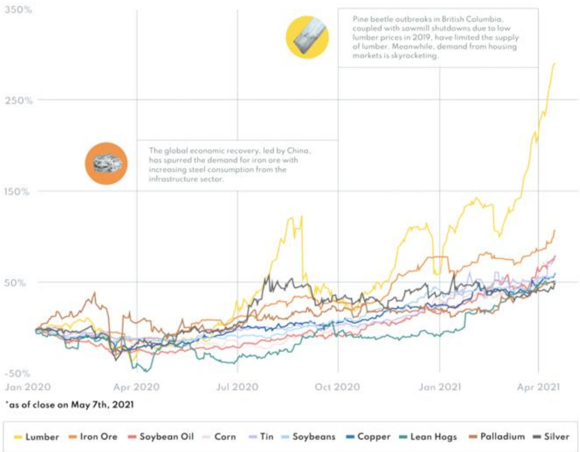
However, this scheme is expected to be carried out only later in 2023, and will take time for people to decide to relocate into Indonesia. Thus, its benefits will not be felt significantly during the next year.

Figure 17: Inflation Rate



Source: Trading Economics

Figure 18: Changes in Individual Global Commodity Prices (in %)



Source: Bhutada, Visual Capitalist

Figure 19: THB/IDR Daily Chart

Source: Trading View

Figure 20: JPY/IDR Daily Chart

Source: Trading Economics

Macro Trend 2 - Inflation, inflation, inflation

As discussed earlier, inflation has increased significantly to 5.42% in November as shown in Figure 17, significantly past their 2-4% target range. This is from a collection cost-push, demand-pull, and imported inflation. Indonesia has responded by increasing their rate hikes, but inflation still remains high.

Demand-pull Inflation

The easing of Covid-19 restrictions has led to an greater domestic demand in comparison to 2021. Although business processes are opening up as well, they were not opening up quickly enough to meet the rise in household consumption.

Another large factor is imported inflation. Naturally, this is was caused by the increasing global commodity prices as seen in Figure 18, as well as the depreciation of IDR.

Imported Inflation

Even with the current increase in exports increasing transactional demand, IDR has been depreciating against many of Indonesia's major trade partners, as seen in Figures 19 to 21.

When the IDR depreciates against the currencies of major import partners such as Japan, Thailand and the United States, import prices from these countries are relatively more expensive. Although some demand should be transferred to other countries through the substitution effect, it will only be a small portion of Indonesia's demand for imports, as trade agreements take time to carry out. Diversifying their trade portfolio by increasing imports from countries of which currencies have not appreciated excessively against the IDR may be why Indonesia has recently ratified new trade pacts with countries like China and South Korea.

Response: Rate Hikes

Indonesia has raised its key interest rate, called the BI 7-Day Reverse Repo Rate, by a total of 125 basis points in the second half of 2022. The changes can be seen in Figure 22.

This hike represents a pre-emptive and forward-looking measure to mitigate the risks posed by rising core inflation, and inflation expectations caused by higher non-subsidized fuel prices and a build-up of inflationary pressures on volatile food products. They do this also with the aim to strengthen rupiah exchange to maintain its fundamental value amid persistently elevated global financial market uncertainty, and stronger domestic economic growth momentum.

Indonesia was behind in its response, whereby rising rate hikes from the federal government had already lead to significant capital outflows due to more attractive US yields. As such, IDR continued depreciating against the dollar.

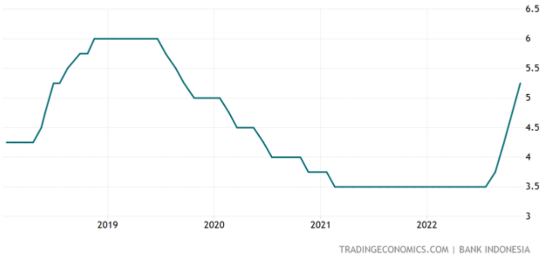
Economic Impacts

High inflation and high interest rates dampen economic growth in many ways. The depreciation of IDR, however, may not be as harmful in Indonesia's case.

Figure 21: USD/IDR Daily Chart

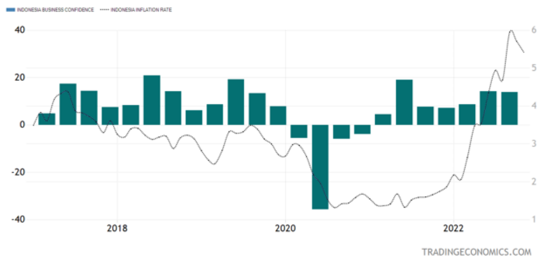
Source: Trading View

Figure 22: Benchmark Rates



Source: Trading Economics

Figure 23: Business Confidence and Inflation Rate

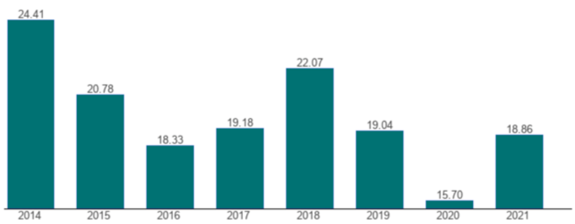


Source: Trading Economics

Figure 24: Net Exports (in million USD)

Source: Trading Economics

Figure 25: Imports as Percentage of GDP



Source: Trading Economics

Inflation not only worsens consumer and business confidence (as shown in Figure 23, which graphs monthly business confidence with the country's YoY inflation rate – indicating a negative relationship between the two), lowering consumption and investment, it also decreases the efficiency of economic allocation. This is because the fast erosion of money's value will reduce its role as a unit of account. Companies are less able to use it to properly gauge demand and supply factors.

However, Indonesia has a stable and persistent trade balance surplus (meaning positive net exports, as seen in Figure 24), meaning that the weakening of the IDR has less implications on imported inflation. In fact, imports was less than 19% of GDP in 2021, as in Figure 25.

With Indonesia's status as a cheap and affordable trading partner and travel destination, it appears that the export demand is net price elastic, meaning that the weaker IDR may even bolster export revenue. Given the recent increase of commodity trade and tourism, it appears that the depreciation of the IDR has not greatly harmed the country's economic growth.

<u>Social Impacts</u>

It is hard to determine the precise impacts of currency devaluation on the poor, but both inflation and interest rates are detrimental to the socioeconomic context of a country.

The depreciation of IDR has both positive and negative impacts on society and individuals, depending on which groups import more and which export more, as well as their overall flow of capital. On one hand, 2017 study has shown that the poor consume relatively more items that are internationally tradeable, compared to the higher-income households who consume relatively more non-tradeables such as education and personal services, thus leading to higher cost-of-living increases for the poor. On the other, Indonesia's lower-income groups predominantly work in their commodity industries, which have benefited and flourished with a weakened IDR.

As for inflation, the high inflation has direct social implications, in the sense that the erosion of purchasing power will disproportionately affect households with lower income.

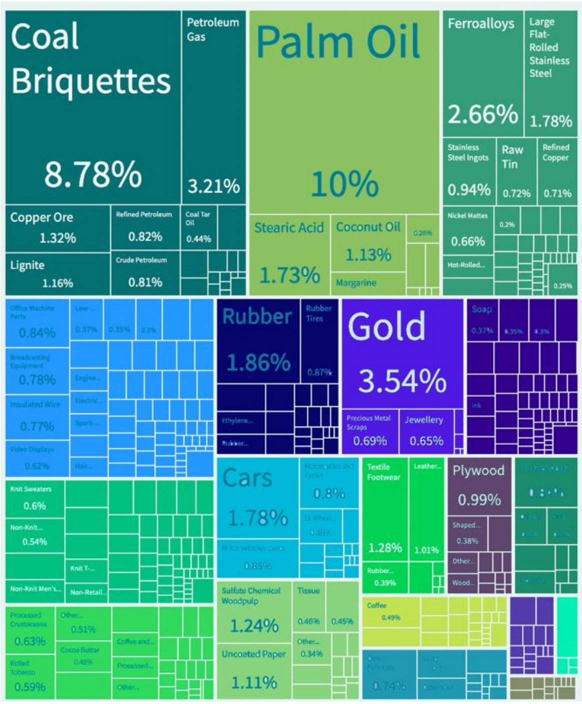
Higher interest rates on the other hand, will not directly affect the lower income, as their low credit ratings prevent them from borrowing in the first place. Instead, it indirectly affects them by influencing businesses and their growth, leading to impacts not just through the trickle-down effect, but also on unemployment.

In this way, a government must keep both high interest and inflation in check.

Figure 26: CPO Futures Daily Chart

Source: Trading View

Figure 27: Export Breakdown



Source: OEC World

Macro Trend 3 – Policy Intervention: A Balancing Act

Indonesia has always participated in drastic intervention into specific markets, from export bans to large subsidies. Recently, the government has and will continue to tackle microeconomic markets, particularly of those with greater impacts to the lower-income, either because these markets are necessities or hire large amounts of blue-collar workers. In the face of the increasing political unrest and socioeconomic inequality exacerbated by the inflation, the government has taken on more microeconomic measures targeted to lower income groups.

Still, with development projects still in the works and Joko Widodo's term ending, it is likely that the government will need to perform a juggling act between short-term poverty-related interventions and long-term development plans.

Overall, both seem to indicate that the government will favour keeping interest rates low over keeping inflation rates low.

The direct social impacts of high inflation are to be mitigated by market-based intervention and income-oriented subsidies that target the most poor in the country. These come in the form of a palm oil levy waiver and petrol subsidy reallocations.

<u>Palm Oil Levy Waiver</u>

Indonesia announced on 31 October its extension of the waiving a palm oil export levy until the end of the year, unless the palm oil reference price breaks $800 per tonnes. The waiver was initially due to expire at the end of October.

This is to protect the farmers and local businesses, who would have faced sudden and large drops in Crude Palm Oil prices within a single year, as seen in Figure 26.

Palm oil is the largest export product of Indonesia in terms of export revenue as seen in Figure 27. The levy waiver will make it more affordable to buyers and more profitable to sellers, thus increasing export and economic growth.

<u>Petrol Subsidy Cuts</u>

Concerned about the fiscal burden from subsidies, more than 70% of which goes to the middle and upper classes, the government decided to increase fuel prices in early September and instead, divert some funds to targeted social assistance programmes.

It is worth noting that this will affect freight transportation costs. This will in turn affect businesses, and push costs of production higher. Exports will also be affected, as container ships to and from Indonesia would need to refuel, causing an increase in transportation cost for companies overseas.

Overall, based on these two policies, we can expect that the government will begin targeting the growth in markets that will help its lower income groups, as opposed to harsh measures to decrease inflation.

Possible Political Issues

While these policies are progressive, meaning that they generally benefit the lower income more than the higher income, both of them do not protect the middle-income group. The palm-oil levy waiver helps farmers and the richer business leaders, but awards far less benefits to the middle income, who now have to pay more for the lesser domestic supply of palm oil. The petrol-subsidy cuts will hurt the middle income who will not have handouts reallocated to them, but will feel the squeeze in their consumption power. In this way, these policies only help with treating inflation for the poor, and not the middle-class.

Some might opine that this could lead to a political issue that will force the government to start treating inflation on a macro and micro scale, for example through raising interest rates further. Indeed, there have been numerous protests by students and trade unions about the above policies and about inflation in general. However, it is unlikely that these protests hold sway in the political sphere. For one, the protests are not supported by major political parties, indicating that they are unlikely to transform into wider discontent against the government. Additionally, president Joko Widodo's government is supported by seven out of the nine parties in parliament, altogether controlling 82% of parliamentary seats. This largely eliminates the risk of government instability. As such, these protests and complaints are unlikely to hold sway in government policy.

On the flip side, Indonesia seems to be focusing on development projects, and as such has reason to keep rates low. Jokowi has directed his cabinet to prioritise permits strategically significant projects, in order to finish existing infrastructure projects by 2024, when he steps down from presidency. An example of this is the relocation of its capital city.

Updates on Relocation of Capital City

It is claimed that there has been no concrete commitment with regards to overseas financing of the project to relocate Jakarta to Nusantra. “Foreign investors are super cautious as the project is still at the initial stage,” said Dedi Dinarto, lead Indonesia analyst at strategic business advisory firm Global Counsel. Years of delays due to the Covid-19 pandemic have left potential backers hesitant to commit to the passion project of a president who will be out of office long before a new city could ever be completed.

Nonetheless, given the political support and physical necessity for the idea, the plan is likely to still proceed; the issue is with regards to how fast and how ambitious it can be.

As such, the government has funded the initial developments of the capital in a bid to increase investor confidence in the project. Considering that Jokowi has only 18 months left in his final term, it makes sense that he would want to gather domestic capital to fund for the early stages of the project, in order to gain momentum and attract foreign investment to ensure the completion of the project and the impartment of his legacy. Hence, it is in his interest to keep interest rates low, promote borrowing, and not limit private investment. This is one of the reasons Indonesia’s interest rates may not be hiked as severely as its counterparts’.

Figure 28: USD/IDR Daily Chart (EMAs)

Source: Trading View

Figure 29: USD/IDR Daily Chart (Trade Details)

Source: Trading View

Trade Idea: Long USD/IDR

<u>Narrative</u>

Although more interest rate hikes that follow the Fed's are anticipated in the upcoming year, the IDR is ultimately expected to depreciate against the USD.

The IDR had depreciated extensively against the USD due to Bank Indonesia (BI) coming in late with its rate hikes. This caused significant rate differentials with the US, where the Federal Reserve aggressively tightened their policy.

<u>Catalysts</u>

Although BI may increase their benchmark rates again during the upcoming year in order to prevent excessive speculatory action, it is worth noting that a slow and controlled depreciation of the IDR is not as harmful to Indonesia's particular economy, as shared earlier. Even with the Fed slowing down their rate hikes, it is likely that Indonesia will not increase its rates to catch up to the United States as it wishes to promote domestic investments, as discussed in macro trend 3.

As such, increasing or continued rate differentials will increase speculative demand for USD in exchange for IDR, causing IDR's depreciation against the USD.

Although net exports is flourishing currently, it is unlikely that it will continue growing into the next year, as discussed in macro trend 1. As such, transaction demand for the IDR will not dampen its depreciation against the USD.

<u>Technicals</u>

The graph indicates that after the golden crosses during April, the 20-day EMA has remained above the 50-day EMA, which stays above the 100-day EMA, as seen in Figure 28. Alongside the fundamental analysis above, we expect a continued bullish momentum that can be capitalised on through this trade idea.

Taking today's price to approximate the entry, and support and resistance lines with the middle of September as the approximate date to cash in, we arrive at our trade values below. This uses Figure 29.

Trade
Entry: 15400
Take profit: 16358
Stop loss: 14815
Risk-reward ratio: 1.64

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Analysts

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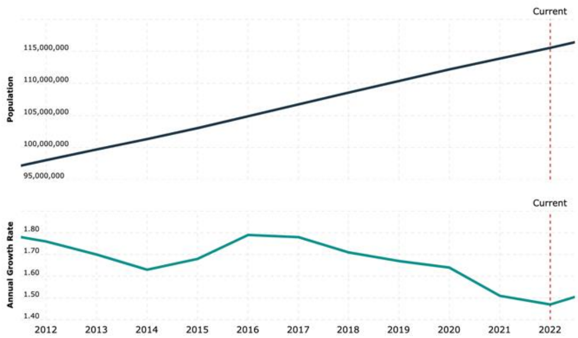
Basic Information

Real GDP (in 2021, USD)	394.1B
M2 (Oct 2022, USD)	256.479 B
CPI (Nov 2022)	119
PPI (Oct 2022)	99.4
Consumer Con. (Aug 2022)	-12.9
Currency	PHP

Chart info

Figure 1: Population and Annual Growth

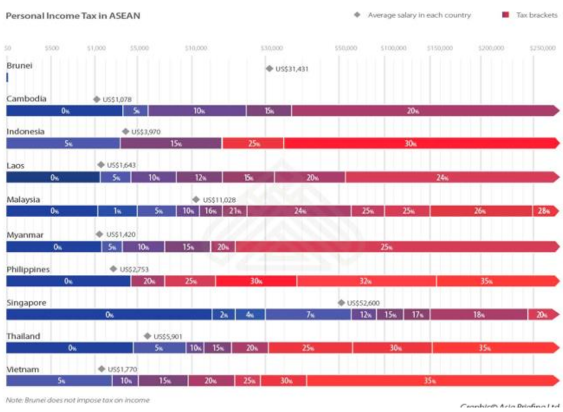


Source: Macro Trends

Figure 2: Net Exports

Source: Trading Economics

Figure 3: Comparison of Income Tax Systems



Source: Asia Briefing Ltd

Overview of the Philippines' Economy

The Philippines is a developing market and a recently industrialised nation whose economy is shifting from one that is concentrated on agriculture to one that focused on services and manufacturing. It is a founding member of the East Asia Summit, the Asia-Pacific Economic Cooperation conference, ASEAN, the World Trade Organization, and the United Nations. Its nominal GDP contribution in September consisted of 78.8% private consumption, 25.7% investment, and 15.0% public consumption.

A significant number of its citizens work overseas, and remit parts of their income to their families. While this does not increase the GDP, it does bolster its GNI, which has led to a general trend of GNI being greater than GDP each year. As such, the country is often in a capital account surplus, and reversely often in a current account deficit.

An island country with a variety of natural resources, the Philippines is home to 113 million people, significant biodiversity, and raw materials. Like other developing countries, however, the Philippines has a positive but decreasing population growth, amounting to 1.3% in 2021 as depicted in Figure 1.

The Philippines headline inflation comprise these main weightages: 38.3% in food and non-alcoholic beverages, 22% in housing, water, electricity, gas and other fuels, and 8.1% in transportation. This is a relatively high weightage on variable factors such as food, and possibly electricity and gas – but the breakdown makes it difficult to determine.

The country's fiscal budget tends to be in a deficit, as shown in Figure 2. Nonetheless, its government debt to GDP ratio is improving, and was 62.1% of GDP at end of 2022 Q2 with PHP 12.89 Trillion in debt. It has one of the highest and most progressive tax rates in South East Asia, ranging from 0% to 35% as seen in Figure 3 and 4.

Summary of events in the past 6 months

<u>Rapid but Reduced Economic Growth</u>

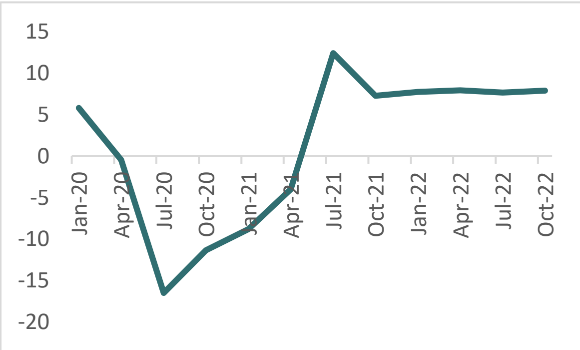
- Slowing slightly from the 8.2% growth in Q1, Philippines' GDP grew by 7.4% in Q2, falling short of market forecasts. The economy has reported a stable and rapid economic growth following this, meeting its growth goal of 6.5 - 7.5%, far exceeding 2021's 5.6% expansion.
- Real GDP growth has increased past pre-pandemic levels (as seen in Figure 5), reaching a 7.884% YoY growth in September, as seen in Figure 4.
- Decreasing unemployment rate, as seen in Figure 6: 4.5% in October 2022, an all-time record low
- Timely changes in COVID-related policies, such as easing alert levels, removing tourism restrictions, and accelerated vaccine rollout, helped increase economic activities. The level of growth signifies a bounce back from the Covid-19 economic

Figure 4: Income Tax System

Taxable Income Band (PHP)	Tax Rates
1 to 250,000	0%
250,001 to 400,000	20%
400,001 to 800,000	25%
800,001 to 2,000,000	30%
2,000,001 to 8,000,000	32%
8,000,001 +	35%

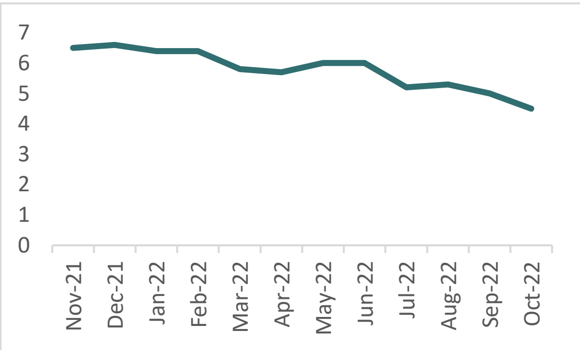
Source: HSBC

Figure 5: Real GDP (YoY)



Source: CEIC Data

Figure 6: Unemployment Rate



Source: Trading Economics

Figure 7: Inflation Rate

Source: Trading Economics

Figure 8: Interest Rates

Source: Trading Economics

downturn after the government removed nearly all its restrictions, thus allowing business activities to resume.

<u>Widening Trade Balance</u>

- Widened sharply from September to October, as seen in Figure 2: trade gap soared to USD 46.64 billion from USD 28.59 billion in the same period during 2021
- This was likely bloated due to rising commodity prices.

<u>Rising Inflation</u>

- Inflation soared far beyond targets, increasing rapidly until 8% in November, as depicted in Figure 7.

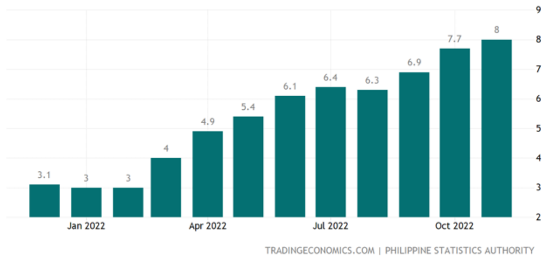
<u>Interest Rate Hikes</u>

- The central bank has raised interest rates very boldly in the second half of the year, as depicted in Figure 8.
- May: 2% to 2.25%
- June: 2.25% to 2.5%
- July: 2.5% to 3.25%
- August: 3.25% to 3.75%
- September: 3.75% to 4.25%
- November: 4.25% to 5%
- December: 5% to 5.5%

<u>Storms and Monsoons</u>

- Seasonal rainy period during Q3 to Q4, with the notable storms listed below.
- September: Typhoon Noru
    - The National Disaster Risk Reduction and Management Council (NDRRMC) of the Philippines reported at least USD6.18 million in infrastructural damages and USD62.5 million in agricultural damages, totalling to US$68.7 million.
    - 40 people have been reported dead following the typhoon, another 5 remain missing.
    - 67 ports and 84 flights were suspended on the September 14th.
- October: Storm wreaked havoc in the villages of in South Philippines, with at least 45 dead.
    - Authorities have said that 185,000 people across the country have been affected by the storm, with more than 8,000 people made temporarily homeless

Figure 9: Inflation Rate

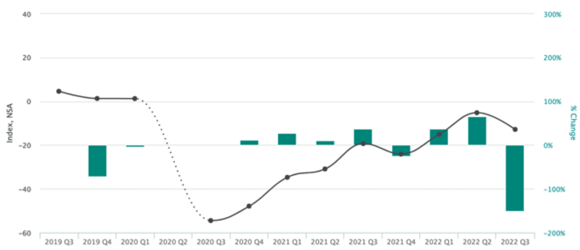


Source: Trading Economics

Figure 10: USD/PHP Daily Chart

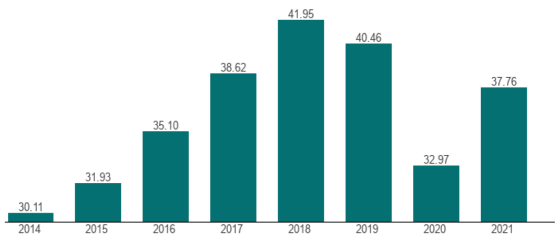
Source: Trading View

Figure 11: Consumer Confidence



Source: Trading Economics

Figure 12: Imports as Percentage of GDP



Source: The Global Economy

Figure 13: Net Exports

Source: Trading Economics

Macro Trend 1 - Peso Plummets, Interest Rates Soar

We can expect significant interest rate hikes for the first two quarters of 2023, with greater attempts to dampen the inflation rate and depreciation of the Philippine Peso (PHP).

<u>Peso Breaks its Trend of Depreciation</u>

This rise in inflation as seen in Figure 9 is exacerbated by the weakening of the PHP. The peso has been depreciating against the dollar since Q2 of 2021, but the process has sped up since Q2 of 2022, when the Fed began to raise interest rates significantly to combat their own domestic inflation rate. This is depicted in Figure 10.

There are some level of benefits to the depreciation, although it appears that its effects are net negative. Besides a potential increase in exports, the wages of Overseas Filipino Workers which are paid in other currencies like the USD are now worth more in PHP. This could increase gross national income, which is highly dependent on remittances from abroad. This will have income effects on the consumption of the family members receiving this remittance. Although consumer confidence has increased since 2021, it has begun to decrease in Q3 of 2022, as seen in Figure 11. Thus, multiplier effect from the increase in overseas funds funnelled into the economy will not be as large, due to a lower marginal propensity to consume. As such, the impacts on GDP may not be that significant.

Furthermore, the Philippines relies heavily on its imports, importing many of its staples such as fuel, and capital goods such as office appliances. Philippines' imports made up 37.76% of their GDP in 2021, as in Figure 12. As such, a weakening of the PHP which causes imports to be relatively more expensive may lead to significant imported inflation in the Philippines. The country has had a constant trade deficit as seen in Figure 13, indicating that it imports more than it exports. This shows that the negative cost impacts of the depreciation due to greater relative import prices likely outweigh its positive demand impacts on export revenue.

<u>Monetary Policy</u>

The Philippine central bank has raised rates a total of six times this year, with two 75-basis point increases in July and November, marking a cumulative hike of 350 basis points, as seen in Figure 14. The governor of the central bank has delivered on its 50 basis point rise on 15 December.

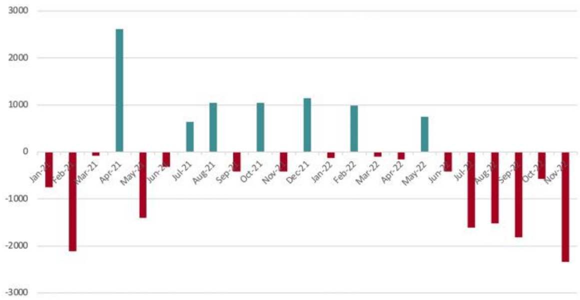
We can expect that rates will continue to rise. A central bank representative had said that they were prepared to take all necessary policy action to bring inflation toward a target-consistent path over the medium term and deliver on its "primary mandate of price stability".

They also mentioned that they have been actively intervening in the Forex market, protecting the Peso against the strengthening US dollar. Given their increasingly negative balance of payments as shown in Figure 15, it appears that they are selling their FX reserves of other currencies and buying back their own in the market, to promote the demand for and thus the appreciation of the PHP.

Figure 14: Benchmark Interest Rates

Source: Trading Economics

Figure 15: Balance of Payments



Source: Business World Online

USD/PHP reached an all-time high on 3 October, at 59.0, and has been slowly depreciating since.

Impacts on Economy

Interest rates pose the benefits of mitigating inflation and reducing rate differentials with the US, but still have detriments and side effects.

Consumer loans had begun increasing in March after 4 quarterly decreases, but we can expect that loans that bolster consumption will begin decreasing once more. The higher costs of borrowing impedes business projects who will now have lower net present values. Less projects will be carried out. The reduction of consumer and investment expenditure indicate that aggregate demand in the economy will decrease. This suits the goals of the contractionary monetary policy: to reduce inflation.

Increasing interest rates also reduces the rate differentials between the Philippines and other countries – most notably the US that has been engaging in significant rate hikes, thus minimising speculative demand that promotes the depreciation of the PHP.

However, there are side effects. Reduced investments have longer-term impacts, and may leave a hole in capital development. There is always a time lag in economic policy, even if monetary policy is the fastest to take effect. In that way, if the Philippines overdo the rate hikes, they may usher in a recession or a period of much slower growth.

On the other hand, forex intervention to appreciate PHP requires the use of FX reserves to buy back PHP, hence increasing the demand for it in the market. A PHP appreciation with important importers will help reduce imported inflation.

The potential issue lies with the running down of FX reserves. If investors think that the multiple balance of payments deficits are unsustainable, then they will expect that reserves may run out and the central bank is forced to let its currency depreciate. This can lead to capital flight, which will be extremely harmful to the Philippines' economy as it requires significant development to prop up its long-term growth.

Having said that, the central bank appears to have sufficient reserves to defend its currency. Another YSD 30 billion in FX reserves can be used to defend the peso before concern over the stockpile's adequacy emerges, head of Asia research at Australia & New Zealand Banking Group (ANZ) in Singapore wrote in the last week of October. BSP has used up about USD 12 billion to intervene in the FX market this year, ANZ estimated. Still, while they will continue to conduct foreign exchange policy, with the grave risks of running down their reserves, they have will likely have to engage in interest rate hikes as well.

As such, the Philippines' government has to find other ways to boost the country's development and investor confidence.

Macro Trend 2 - Marcos Jr's Policy Bias

Marcos Jr's dovish foreign policy bias has garnered the wrath of some Pinoy citizens, but it is likely that this bias will persist. It seems likely that the Marcos Jr administration will be promoting foreign investment and tackling inflation through large rate hikes to boost the country's development and protect the lower income, even if it angers the nationalist protestors.

Dovish Foreign Policy Bias

Marcos Jr appears to have a dovish foreign policy bias that promotes greater globalisation and foreign investment into the Philippines.

In the September UN General Assembly, Marcos called for stronger cooperation on the grounds of climate change, agriculture and food security. In his appeal for help with regards to Philippines' food industry, he touted his government's efforts in attaining food self-sufficiency and security.

At a forum hosted by NYSE, he stated that he "can't see PH's future without the US". He also invited more American businessman to do business in PH, indicating a policy shift from his predecessor Duterte, who favoured China over the US.

To encourage foreign and domestic investment, the administration has rolled out policies that further opened the Philippine economy, such as lowered corporate income tax rates and rationalised fiscal incentives. They have reduced minimum paid-up capital requirements for foreign retailers and foreign start-ups bringing in advanced new technology, and have allowed for full foreign ownership of companies providing public services such as telecommunications, shipping, air carriers, railways, subways, airports and toll roads.

He also announced aims to create a "friendship" with China, and also reopened discussions about loan agreements for the three railway projects previously awarded to Chinese firms that were scrapped in May.

Overall, we can expect more negotiations for projects with other countries in the future, and more dovish policies to encourage foreign direct investment.

Political Unrest and the Steps to Mitigate it

However, the new bias has led to some disenchantment by the Filipino citizens.

The speech and the new foreign-facing policies from Marcos Jr have been paired with a protest outside the UN Headquarters from Filipinos living in the US, over 'Marcos for "selling out" the Philippines to foreign investors. Organizers claim that this event "only aims to deceive attendees about the success of his economic agenda, which, rather than enriching Filipinos, has caused inflation and food prices to skyrocket to record highs and pushed more households into poverty."' The appeal to China has also been met with disapproval from some, given the tensions regarding the South China Sea.

There have also been other catalysts of political unrest. Percival Mabasa, a radio broadcaster often critical of former President Rodrigo

Duterte was assassinated. This has sparked protests regarding press freedom. The Committee to Protect Journalists, based in New York, in 2021 ranked the Philippines 13th on its global impunity index.

Protestors also went out on the streets on the date 50 years after Martial Law was imposed, vowing to "'Never Forget' Marcos Era Abuses". Some accuse Marcos Jr of not fully acknowledging the brutality of his father's reign.

Protests have affected the Philippines from Duterte's and Marcos Sr's times, due to implications on consumer and investor confidence.

Nonetheless, Marcos Jr still appears to be the people's favourite, and the legitimacy of his government is not being questioned. Marcos Jr has recently received relatively high approval ratings from his people, graded on September. The poll showed that citizens believed that Marcos and his administration were doing well in "calamity response" (78%) and "controlling the spread of COVID-19" (78%), but not in terms of "poverty reduction" (39%) and "control of inflation" (31%).

Although Filipinos may be upset by an excessive focus on foreign direct investment, the realities of the Philippines have and will force Marcos Jr's hand. With already one of South East Asia's highest tax rates but a constant government budget deficit, the government needs to find other ways to aid in reducing the incidence of poverty and increasing productivity. As such, we can expect that Marcos Jr and administration will have to cater to foreign investors and businesses in order to speed up the development of the country. This can be seen in the new corporate income tax reforms.

In addition, we can expect that Marcos and administration will also focus on the segments that have less approval ratings, namely poverty and inflation, in the upcoming months. This will be done through contractionary policies as listed above, alongside progressive policies that distribute income and policies that will revitalise sectors that have higher poverty incidence, like agriculture.

In this way, Marcos Jr can counter the issues caused by the hikes in interest rates by attracting foreign investment, alongside addressing his citizens' dissent by showing that he is raising rates and dampening inflation.

Figure 15: USD/PHP Daily Chart (Entry and EMAs)

Source: Trading View

Figure 16: Daily USD/PHP – Take Profit and Stop Loss

Source: Trading View

Trade Idea: Short USD/PHP

As explained in macro trend 1, Philippines is a country that is detrimentally affected by depreciation of its currency. This is due to significant impacts on imported inflation.

Moreover, the need to increase rates and dampen inflation goes beyond economic reasons, but political as well. As in macro trend 2, Marcos Jr will likely want to carry out policy that lowers inflation in order to improve approval ratings. The high inflation also worsens inequality and poverty, as the drastically lower spending power affects income and savings of the lower-income groups more significantly than those of the higher-income groups. As such, it is in Marcos Jr's administration's interest to carry out contractionary monetary policy, and pressure the central bank to raise rates to lessen the rise of inflation. The government will instead appeal to foreign investment to fund development. The BSP governor has vowed to match any move by the Fed in the coming months and maintain a 100 bps differential with the Fed fund target rate. We can expect that interest rates hikes to continue into the next year, so long as inflation remains excessively high. The rate hikes decrease rate differentials, reducing speculatory behaviour that sped up the depreciation of the PHP.

The Fed's rate hikes have also slowed down, lessening the rate differential even more. These factors have led to a slight appreciation of the PHP past 3 October. This trade idea rides on the assumption that this appreciation will continue in the short term as BSP raises rates to lessen the rate differential and tackle inflationary pressures.

<u>Technicals</u>

In Figure 15, the 20-day EMA has recently crossed 50-day EMA, indicating that a bearish outbreak is occurring.

Technical analysis suggests an entry point at approximately 55.50 if it breaks the first support line in Figure 15, at approximately mid-January. Figure 16 suggests that one should take profit at 50.42 and have a stop loss at 57.32 as they go closer to the long-term resistance and support lines, taking the approximate trade timing to be a year later.

Trade
Entry: 55.50
Take profit: 50.42
Stop Loss: 57.32
Risk-reward ratio: 2.79

Disclaimer

NUS INVESTMENT SOCIETY

Global Macro Department – Singapore (OVERWEIGHT)

Date: 15th December 2022

Analysts

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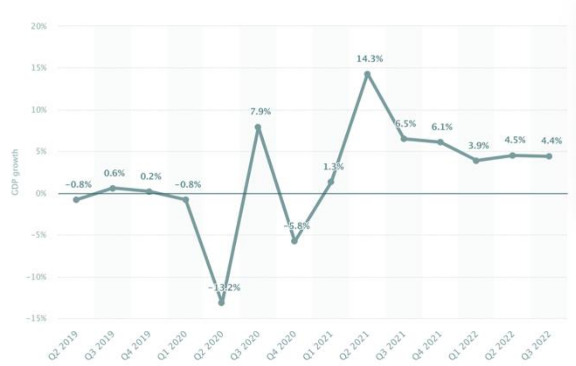
Basic Information

Real GDP (USD)	397Bn
M2 (SGD)	745Bn
CPI	109.9
PPI	115.3
Straits Times Index (SGD)	3,225.45
USD/SGD	1.3534

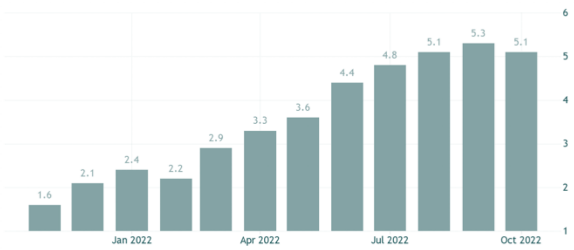
Chart info

Figure 1: Real QoQ GDP Growth (%) from 2019 2Q-2022 3Q



Source: Statista

Figure 2: MoM Core Inflation (%) from November 2021-October 2022



Source: Trading Economics

Overview of Sector

Singapore is a highly-developed and open economy whose trade GDP is largely dependent on its levels of trade with the rest of the world. It has one of the world's highest per-capita GDP in terms of purchasing power parity. Manufacturing goods continue to stay as the largest component comprising its GDP (22.3%) and exports.

This year, Singapore's growth has stagnated along with the rest of the world as global demand weakens following central banks' rate hikes. Inflation has been buoyed by post-pandemic supply-chain disruptions; MAS CPI-All Items Inflation for 2022 is expected to come in at 5.0-6.0%, while Core Inflation is project to reach 3.0-4.0%. Despite this, SGD has remained strong relative to USD, projected to end the year as the only developed currency to beat the dollar.

Summary of events in the past 6 months

Growth moderates in line with weakening global demand

- Persistent high inflation and tighter financial conditions in the global economy have dampened domestic private consumption and investment.
- Softening in external demand saw manufacturing output and financial services weaken in the third quarter, as well as a downturn in the electronics industry which has been weighing on externally-oriented Asian economies such as Singapore.
- The drag on economic activities is likely to intensify in the quarters ahead as internal and external growth factors accumulate across the global economy. MAS expects growth in Singapore's major trading partners to slow to below trend but stay positive in 2023.
- A silver lining is that domestic-oriented and travel-related sectors are expected to be sustained by continuous expansions. This is underpinned by strong household balance sheets and robust wage incomes as pandemic restrictions are relaxed locally and abroad.

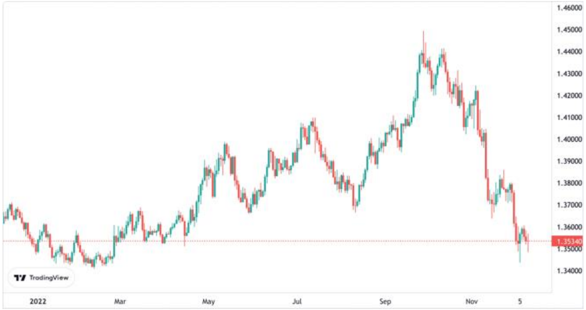
Higher inflation amidst post-pandemic supply chain bottlenecks

- Continuous high imported inflation buoys core inflation, as cost pressures accumulated along domestic and global supply chains continue to pass through to consumer prices.
- Businesses have faced high utility and raw material costs as contracts are renewed, while tight domestic labour market supports strong wage increases.
- However, CPI in October has fallen from its recent high of 110.3 in September to 109.9. Continued hawkish policy from the Federal Reserve as well as MAS is calming markets' qualms over persistent inflationary pressures.

Currency strengthens against the US dollar

- MAS SGDNEER readjustments over the months, including the raising of the policy band's midpoint and slope, have allowed the SGD to garner some safe haven flows.

Figure 3: USD/SGD from December 2021-December 2022



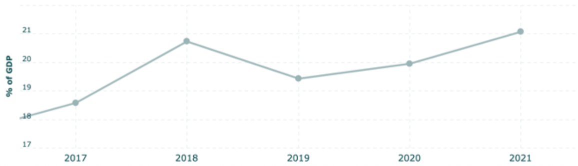
Source: Trading View

- SGD has been generally rising against USD since late September, as the Federal Reserve's hawkish policy has allowed inflation concerns in the U.S. to ease, and MAS' willingness to perform off-cycle rate hikes has reassured investors of their commitment to beating inflation.
- The currency remains sensitive to its major trading partners' policy decisions. Recently, the relaxation of China's Covid-Zero policy saw SGD rise further against the USD.

<u>MAS tightens SGDNEER in response to inflationary concerns</u>

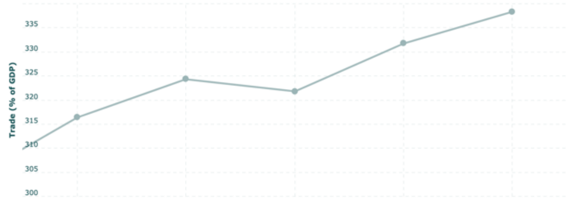
- MAS raised the midpoint of the SGDNEER policy band in October, making no changes to the slope or width of the band. This is the fourth tightening since October 2021.
- The central bank has expressed that they will continue to monitor global and domestic economic developments closely, amid heightened uncertainty on both the inflation and growth fronts.
- Future decisions will also depend on the Federal Reserve's rate hike decisions, given that the US is one of Singapore's largest trading partners. As the Feds continue their hawkish policy, MAS will likely have to follow suit.

Figure 4: Manufacturing Output (% of GDP) from 2017-2021



Source: Macro Trends

Figure 5: Trade-to-GDP (% of GDP) from 2017-2021)



Source: Macro Trends

Figure 6: All-Items Inflation Rate (%) from December 2021-October 2022

Source: Trading Economics

Figure 7: USD/SGD from December 2021-December 2022

Source: Trading View

Figure 8: Year-to-Date Currency Returns of Singapore Dollar Relative to Other Currencies

Economic Outlook Contingent on Global Developments

This year, Singapore's exports have weakened in line with weaker global demand. The Eurozone economy has been heading into recession as it struggles with an energy crisis. The crisis is caused by Russia cutting its gas supplies by over 80% this year. Prices of electricity and gas have risen as much as 15-fold since early last year, severely affecting households and businesses. As a result, the Eurozone's burgeoning trade deficit has bled into Singapore's growth outlook, where the former is a major trading partner with the latter.

Furthermore, China's struggles to bring down its number of Covid-19 cases have likewise caused Singapore's outlook to weaken. President Xi's Covid-Zero policy following an outbreak of the Omicron variant has caused the economy's growth outlook to weaken and its unemployment rate hit a record high in May this year. China being another one of its major trading partners, Singapore's export volumes have likewise been affected.

The weaker external demand is somewhat mitigated by a strong recovery in the tourism industry, which has in turn boosted travel- and aviation-related sectors. The real value-added of air transport and arts, entertainment and recreation segments growths of 5.5% and 6.8% YoY respectively over the same period. The professional services sector (3Q: 8.3% YoY) was likewise boosted by the reopening of regional and global borders.

The government has also been diligently pushing vaccination programs for its residents, resulting in 81% of the population having the minimum vaccination protection by the end of November. The government is steering the economy toward endemic living with the Covid virus, ensuring the appropriate public health measures are in place to counter the virus and protect the vulnerable.

In 2023, growth rates in most major economies are expected to moderate from 2022 levels as global supply chain disruptions continue to be exacerbated by the Russian-Ukraine war, albeit to a lesser extent. Singapore's outward-facing sectors, such as its semiconductors, machinery & systems, and wholesale trade, are hence expected to decline in line with these global developments.

<u>Breakdown of growth in 2022 by sector</u>

Growth in Singapore's manufacturing sector slowed down reaching 0.8% YoY in 3Q (2Q: 5.6% YoY). This trend continued to be supported by expansions in the transport engineering, general manufacturing and precision engineering sectors. The electronics, chemicals and biomedical manufacturing sectors declined in tandem with weaker global demand.

The construction sector grew by 7.8% YoY in 3Q (2Q: 4.8% YoY), boosted by expansions in both public and private sector construction output. Wholesale trade grew by 5.4% YoY in 3Q (2Q: 1.6% YoY), fuelled by expansions in the machinery, equipment & supplies, and fuels & chemicals segments. Retail trade expanded by 8.9% YoY in 3Q (2Q: 12.3% YoY), driven by growth in non-motor vehicle sales. The trend prevailed against the backdrop of a fall in motor vehicle sales volume as the government reduced COE quotas.

Source: Tiger Brokers

The finance & insurance sector fell by 0.4% YoY (2Q: 2.4% YoY) as the banking segment weakened following a fall in net fees & commissions income.

Elevated but moderating inflationary pressures

Singapore's all-items inflation rate is predicted to reach around 6% in 2022, while core inflation is expected to average around 4%. This reflects the higher cost of living due following the rebound of domestic and global demand post-Covid, as well as the cost pressures exerted from global supply chain disruptions.

In 2023, all-items inflation is expected to average around 5.5%-6.5%, while core inflation is expected to stay around 3.5%-4.5%. These predictions come on the back of the increase in the goods & services tax (GST), which is stated to increase from 7% to 8% in 2023 and 8% to 9% in 2024, as the government increases tax revenue to meet growing healthcare expenditures since the pandemic.

In October, Singapore's core inflation eased for the first time in eight months, rising 5.1% YoY (E: 5.3% YoY, P: 5.3%). The moderation was caused by smaller increases in the prices of electricity and gas, retail, and other goods and services. The figure may likely allow the central bank to shift some of their focus away from beating inflation towards targeting lower growth.

SGD Strength Sees Currency Outperform

The SGD has been largely influenced by US dollar movements this year as the backdrop of global inflationary pressures have cast a spotlight on the Federal Reserve's rate policy decisions. The steady ascent of the greenback in the first three quarters of this year saw most currencies, including the SGD, weaken against it. As seen in Figure 7, USDSGD hit its 2022-high of 1.4492 at the end of September.

Regional safe haven currency

Despite the downward trend however, the SGD continually outperformed its Southeast Asian peers. This was largely due to investors' perception of it as a regional safe haven currency. Using Figure 8, we see how the year-to-date currency returns of the SGD outstrips its G10 and Asian currency peers.

Despite its steady decline in the first part of the year, investors continued to long SGD due to Singapore's strong economic fundamentals, including its high foreign reserves and strong current account surplus. The Monetary Authority of Singapore's persistent and well-purposed moves in targeting inflationary pressures throughout the years also serves to maintain the economy's relative competitiveness in the region.

In the latter quarter of the year, signs of US inflation finally cooling has boosted the case for the Federal Reserve to ease off on its hawkish policy. The US dollar index has seen a steady downward trend since late October, fuelled recently by the release of November Federal Reserve meeting minutes that suggested most policymakers were favouring the slowdown of further rate hikes. Against the US dollar, SGD has been outperforming consistently.

Stronger SGD boosted by USD bears

An incremental market bets for a dovish tilt from the Federal Reserve at its year-end or early-2023 meeting have caused the bulk of the greenback's softening towards end-October. Amidst this move and the continued global uncertainties (such as China's struggle in achieving its Covid-zero policy and the Russian-Ukraine war), the SGD has been seen to strengthen significantly on the back of its robust macro fundamentals.

The re-centering of SGDNEER in October also gave the currency a decisive boost, given that the currency was likely testing the upper bound of the policy band prior to the central bank's move.

Further SGD strength driven by USD weakness may be limited by sticky US core price pressures. Markets will need to monitor US market data closely in the coming weeks leading up to the next FOMC meeting on 13-14 December.

Source: Trading View

Trade Idea: Short USDSGD

<u>Narrative</u>

Throughout the year, SGD has been outperforming its peers as it acts as a safe haven for regional flows.

As mentioned, this is due to its sound economic fundamentals as seen through its strong trade surplus and ample foreign reserves. Hence, investors should look to long SGDNEER on dips.

<u>Catalysts</u>

The recent weakening of the US dollar arises from signs of moderating inflation in the US, as well as the Federal Reserve's statement regarding members' intentions to slow down the pace of future rate hikes. Bias on USDSGD hence remains bearish as the SGD is likely set to gain against the USD. The currency pair will allow investors to factor in both trends in the two currencies.

<u>Technicals</u>

For USDSGD, momentum on daily charts stays bearish, while RSI hovers around oversold conditions. Support is currently at 1.3438 (December low), before 1.3404 (2022 low). Resistance levels are at 1.3685 (23.6% Fibonacci retracement from September high to December low), followed by 1.3839 (38.2% Fibonacci retracement level).

<u>Trade</u>

Entry: 1.3534
Take Profit: 1.3400
Stop Loss: 1.3685
Risk-Reward Ratio: 1.13

Disclaimer

![NUS Investment Society]

Global Macro Department – Malaysia (OVERWEIGHT) Date: 15th December 2022

Analysts

Fiona Xiao Jingyi
Global Macro Analyst
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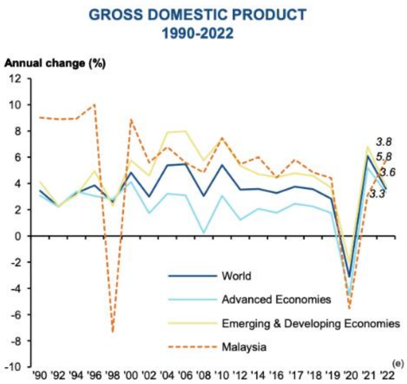
Basic Information

Real GDP (USD)	372.7Bn
M2 (MYR)	73.4Bn
CPI	123.7
PPI	119.2
FBMKLCI (MYR)	1,476.46
USD/MYR	4.4010

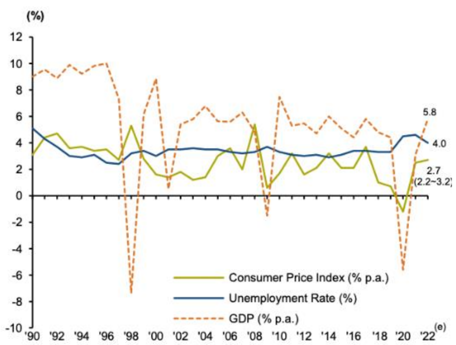
Chart info

Figure 1: Malaysia's Real GDP from 1990-2022



Source: Malaysia Economic Planning Unit

Figure 2: Malaysia's GDP, CPI, and Unemployment Rate from 1990-2022



Source: Malaysia Economic Planning Unit

Overview of Sector

Malaysia is among the world's most open economies, with its trade-to-GDP ratio averaging around 130% over the past 12 years. Exports hence play a significant role in its economy's growth and job creation, with around 40% of jobs in the economy linked to export activities. It has also been a leading exporter of electrical appliances such as integrated circuits ($65Bn) following the diversification of its economy away from one initially agriculture and commodity-driven to one now largely manufacturing and service-based. Other significant components of its exports include refined petroleum ($15.9Bn), palm oil ($10.6Bn), and semiconductor devices ($8.67Bn).

Income inequality in Malaysia remains high relative to its East Asian peers, exacerbated by the Covid-19 pandemic. In July 2020, the national poverty line was revised such that 5.6% of total households are currently living in absolute poverty. The government is targeting the bottom 40% of the population which remains particularly vulnerable to economic shocks and changes in the cost of living.

Summary of events in the past 6 months

Stronger growth underpinned by domestic demand

- The Malaysian economy grew consecutively in the second and third quarters, driven by endemicity and policy measures enacted by the government.
- Strong domestic demand was accounted for by improvements in the labour market, while exports continuesd to be supported by strong global demand for electrical and electronic products.
- The relaxation of border restrictions post-Covid saw inbound tourism fuel higher growth as well.

Inflation pressures remain elevated

- Cost-push and supply-driven inflationary pressures saw Malaysia's YoY inflation rate increase by 4.5% in Q3.
- A decline in housing inflation pushed the annual inflation rate down to 4.0% in October 2022 (E: 3.9%, P: 4.5%), achieving the lowest print since June of this year.
- However, core consumer prices rose by the steepest gain in record in October. This was largely driven by higher prices of furnishing and household maintenance, as well as prices of repair and maintenance of personal transport.
- Headline inflation is expected to remain elevated but moderate in Q4, averaging around 3.3% this year as the higher inflation in Q3 caused by the discount on electricity bill wears off in Q4.

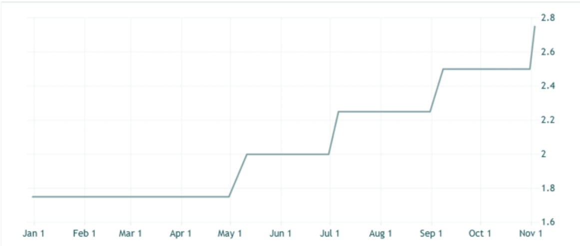
A weakening currency against the US Dollar

- The Malaysian ringgit fell by 4.9% against the USD in Q3 2022, in line with other regional currencies (which depreciated by an average of 5.5%).
- This is mainly driven by the strengthening of the USD amidst tightening by the Federal Reserve, as well as higher investor risk aversion as global growth takes a hit.

Figure 3: USD/MYR from December 2021-December 2022

Source: Trading View

Figure 4: Overnight Interest Rate (%) from January 2022-November 2022



Source: Trading View

<u>Central bank rate hikes</u>

- The central bank has raised their overnight policy by 25-bps each for four consecutive hikes this year.
- They have stated that these moves were pre-emptive in nature, so as to manage the risk of excessive post-pandemic demand on prices.
- Further rate moves will depend on their monitoring of the global inflation environment.

<u>Hung parliament</u>

- The 2022 Malaysian General Election resulted in a hung parliament for the first time in the country's history.
- The king appointed Anwar Ibrahim, the chairman of Pakatan Harapan, as Prime Minister. Markets view the appointments as a hopeful sign that the Malaysian government will no longer be bogged down by corruption.

Figure 5: USD/MYR from December 2021-December 2022

Source: Trading View

Figure 6: USD/MYR from October 2022-December 2022

Source: Trading View

Ringgit Halts its Steady Descent

This year, a hawkish Federal Reserve amidst global inflationary pressures and growth concerns has caused the USD to strengthen against most of the world's currencies, including the Malaysian ringgit. In September, MYR reached its lowest levels since the Asian Financial Crisis.

<u>Ringgit's declines steadily on the back of US dollar strength</u>

MYR weakness this year has been largely due to exogenous factors, most notably the rise in USD strength and US treasury yields following Fed hawkishness.

The weakness in CNH throughout the year as China battled with its economy's slowdown amidst its rising Covid-19 cases has also contributed to the ringgit's downward trend. President Xi's Covid-Zero policy saw the country close its borders, causing its growth outlook to falter and its unemployment to rise. Being Malaysia's largest trading partner, this has greatly affected the economy's growth and its currency strength. As shown in Figure 5, USDMYR reached a peak of 4.7480 on 4 November 2022 on the back of heightened global inflation concerns and uncertainty surrounding the national election's results.

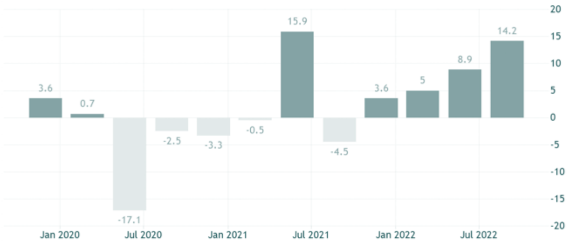
<u>A recent trend reversal</u>

The ringgit has been a key beneficiary of broader USD weakness in the past month. Signs of US inflation finally cooling has boosted the case for the Federal Reserve to ease off on its hawkish policy. This has been corroborated by the November FoMC meeting minutes, which showed that policymakers are in agreement on implementing a cooldown of future rate hikes.

Additionally, there has been a recent trend reversal in the CNY's performance, as the government has recently issued new guidelines showing an ease in its Covid-Zero policy. The relaxation of pandemic restrictions have boosted markets' confidence in the economy, which as bled into the performance of the ringgit as an extension of this movement. Political clarity following the election results is another major factor that has contributed to relief for the MYR. The 2022 Malaysian General Election was held on 19 November, resulting in a hung parliament for the first time in Malaysian history.

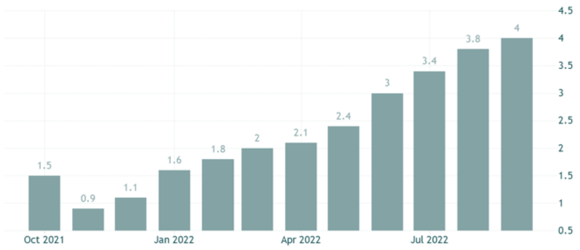
Perikatan Nasional swept the north-western and east coastal states of Peninsular Malaysia in a landslide win; Pakatan Harapan retained a plurality of seats in the Dewan Rakyat with a reduced share; Barisan Nasional lost most of its seats to Perikatan Nasional. The king eventually appointed Anwar Ibrahim, the chairman of Pakatan Harapan, as Prime Minister. Initial qualms in the market over the unprecedented election result was calmed after the appointment, with investors seeing Anwar as a symbol for reduced state corruption. These changes hence contributed to the ringgit's recent rebound as well. The trend reversal since early November is shown in Figure 6, as USD/MYR has seen a steady decline.

Figure 7: Real QoQ GDP Growth (%) from 2019 4Q-2022 3Q



Source: Trading Economics

Figure 8: MoM Core Inflation (%) from October 2021-October 2022



Source: Trading Economics

Strengthening Demand amidst Elevated Inflation

Stronger growth underpinned by domestic demand

The Malaysian economy grew at 14.2% in Q3 2022, up from 8.9% in Q2. This was largely due to endemicity as well as policy measures enacted by the government.

Strong domestic demand was enabled by improvements in labour market and income conditions. Exports also continued to be supported by strong demand for electrical and electronic products. By sector, services and manufacturing sectors continued to act as the main drivers of growth. Moreover, the relaxing of border restrictions post-Covid saw inbound tourism fuel higher growth as well. The economy had likewise grown in the second quarter, the movement driven by strong wholesale and retail trade, a robust motor vehicle segment, as well as an acceleration in the retail segment. August MoM seasonally-adjusted growth came in at 3.1%, up from -1.6% in July.

Inflation pressures remain elevated

Continual cost-push and supply-driven inflationary pressures saw Malaysia's YoY inflation rate increase by 4.5% in Q3. The primary contributors of this movement where the Food and Restaurants & Hotels groups, which increased by 7.0% and 6.4% respectively.

On the other hand, there are signs of inflationary pressures moderating. Annual inflation rate fell to 4.0% in October 2022 (E: 3.9%, P: 4.5%), achieving the lowest print since June of this year. The slowdown in inflation is largely due to a sharp decline in housing inflation (1.5% in October vs 4.4% in September). However, core consumer prices, which exclude the volatile prices of fresh food and administered prices, rose 4.1% in October, which was the steepest gain in record. This was largely driven by higher prices of furnishing and household maintenance, as well as prices of repair and maintenance of personal transport.

Headline inflation is likewise expected to moderate in Q4, despite remaining elevated. It is expected to average at 3.3% this year, as the discount on electricity bill which contributed to higher inflation in Q3 will likely wear off in Q4. However, core inflation is likely to stay elevated as demand continues to improve in a high-cost environment.

The Bank Negara Malaysia (BNM) has raised their overnight policy by 25-bps each for four consecutive hikes this year, such that the policy rate now stands at 2.75%. The central bank has stated that these moves were designed to pre-emptively manage the risk of excessive demand on prices. This is in line with their recalibration of monetary policy that balances both the risks of domestic inflation and sustainable growth. To avoid allowing inflationary pressures to become entrenched, the government will need to continue showing commitment to beating inflation through future rate hikes.

Source: Trading View

Trade Idea: Short USDMYR

<u>Catalysts</u>

The conclusion of the general elections and the appointment of Anwar Ibrahim as the new prime minister of Malaysia instilled confidence amongst investors.

On the other hand, the recent signs of moderation in US inflation and the Federal Reserve's indications of a slowdown in future rate hikes have caused USD to fall against most currencies around the world.

The Chinese government's relaxation of their stringent Covid-zero policy has likewise boosted market sentiment, boosting MYR along with CNY.

Despite the ringgit's broad weakness this year, its recent climb is a good opportunity for investors seeking to express their view of a weakening USD.

<u>Technicals</u>

For USDMYR, momentum on daily charts is bullish, while RSI moderates from oversold conditions. Support is currently at 4.3623 (December low), before 4.1903 (50 DMA). Resistance levels are at 4.4534 (23.6% Fibonacci retracement from November high to December low), followed by 4.5098 (38.2% Fibonacci retracement level).

<u>Trade</u>

Short USDMYR on signs of breakout lower past the 4.36-support level.

Entry: 4.3600

Take Profit: 4.1920

Stop Loss: 4.4534

Risk-Reward Ratio: 1.80

Disclaimer

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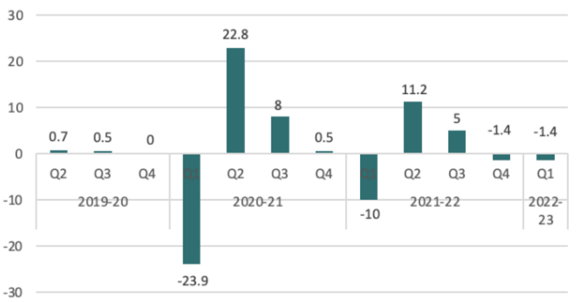
Basic Information

GDP	US$3173.40 bn
CPI Inflation (October 2022)	6.77%
Unemployment Rate	8%
Trade Deficit (October 2022)	US$26.91 bn
Interest Rate (Repo)	6.25%

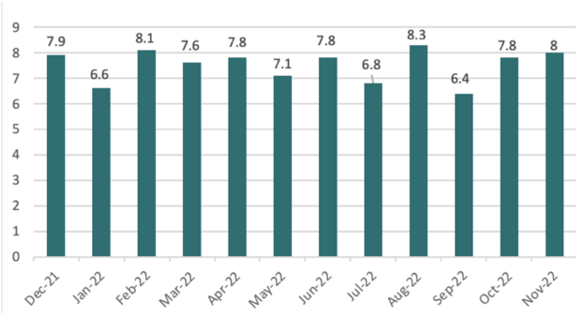
Chart info

Figure 1: India's QoQ GDP growth rate



Source: Trading Economics

Figure 2: India's Unemployment Rate



Source: Trading Economics

Figure 3: Consumer Confidence Indices

Source: RBI

Overview of India

- With a population of 1.4 Billion, India is the 5th largest economy in the world and the 3rd largest in PPP terms. Driven by strong domestic demand, the Indian economy has shown resilience in the face of the deteriorating global economic outlook and is projected to grow at 6.8-7.1% in FY22-23. Personal consumption expenditure contributes approximately 60% to the GDP, Investment expenditure contributes 30%, government expenditure 11%, exports 21% and imports -23%. The service sector plays a dominant role in the economy, contributing 56% to the GDP. India benefits from a strong demographic dividend. In 2020, there were about 900 million people (67%) in the working age group (15-64 years). This figure is expected to reach a billion by 2030. India's main exports include refined IT and BPO services, refined petroleum products, and engineering goods and its main imports include crude and petroleum, machinery, electronic goods, and gold. The Reserve Bank of India (RBI) maintains a Flexible Inflation Targeting Framework (FITF), which involves setting an inflation target every 5 years. Presently, the FITF has set an upper tolerance limit of 6% and a lower tolerance limit of 2% for retail inflation.

Summary of events in the past 6 months

<u>RBI maintains its hawkish stance</u>

- The Reserve Bank of India's Monetary Policy Committee (MPC) has raised its policy repo rate by 225 basis points since May to 6.25% as retail inflation stubbornly remained above RBI's upper tolerance band of 6% until subsiding to a 11 month low of 5.88% in November.

<u>Credit growth remains strong</u>

- Bank credit growth rose to a decade high 17.94% YoY in October on the back of strong demand from the retail segment (housing, vehicles, and credit card loans) during the festive season. Credit to service sector also showed strong growth, increasing to 22.5% YoY in October 2022 as compared to 2.8% a year ago. However, deposits grew at a much slower rate of 9.62%.

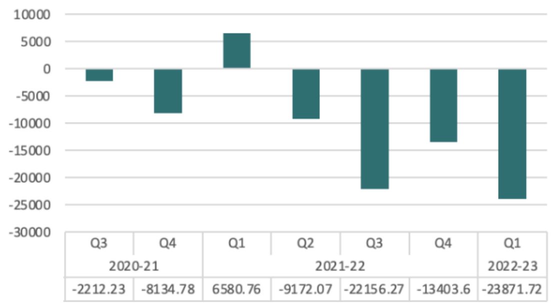
<u>Housing sales touch new highs</u>

- Housing sales in the top 7 Indian cities are projected to exceed a record 360,000 in 2022. Sales in January-September 2022 stood at nearly 273,000 units, already surpassing the full year sales for 2019. The sales remained strong despite the average property prices appreciating by 6% YoY in Q3 2022 – the highest in the past seven years.

<u>India turns to Russian Oil</u>

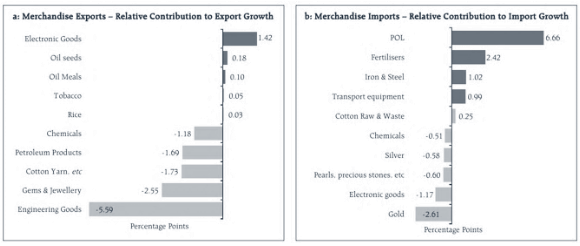
- Russia overtook Saudi Arabia and Iraq to became India's largest crude oil supplier, providing 24.8% of its crude oil imports, up from 0.2% in February before Russia invaded Ukraine. India has leveraged the G7 price cap on Russian crude oil to get oil at deeply

Figure 4: India's Current Account Balance (Millions of USD)



Source: Trading Economics

Figure 5: Drivers of Trade Growth: October 2022 vs October 2021



Source: RBI

discounted rates and to diversify its crude oil supply outside the West Asian region.

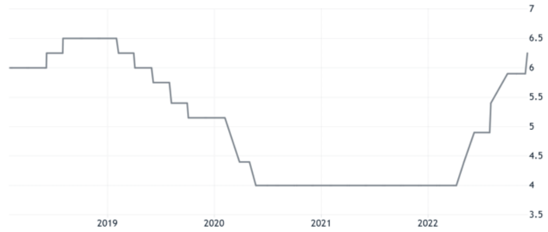
Trade Deficit Widens

- India's trade deficit widened to $26.91 billion in October 2022 as exports contracted by 19.4% MoM to $29.78 billion. This is the sharpest MoM decline in exports since April 2020. While exports grew at a healthy rate of 12.55% during April – October, they were outpaced by the growth in imports, which stood at 33.12%.

Tax collection on path to exceed Budget estimates

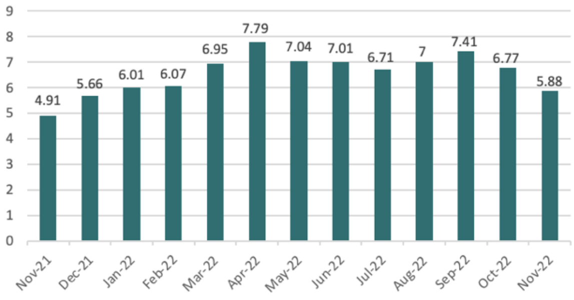
- The Ministry of Finance projects a total tax collection of Rs 31.5 Trillion in FY22-23, exceeding the Rs 27.50 Trillion estimate made in the Union Budget.
- Gross Direct Tax collection jumped by 31% in the April-November period as compared to the previous year. This includes a 41% increase in personal income tax and a 22% increase in corporate tax collection.
- Indirect tax collection is projected at Rs 14 Trillion, slightly higher than the Budget estimate of Rs 13.30 Trillion.

Figure 6: RBI's Repo Rate



Source: Trading Economics

Figure 7: India's CPI inflation

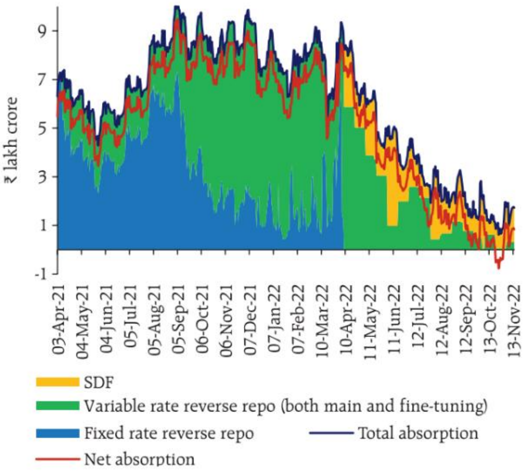


Source: Trading Economics

Figure 8: INRUSD chart

Source: Yahoo Finance

Figure 9: Liquidity Conditions



Source: RBI

Monetary Policy: Withdrawal of Accommodation

Inflation eases, but remains a tad bit too high

The retail inflation for October 2022(see Figure 7), aided by a higher base effect of nearly 226 bps, stood at 6.77%, down from 7.41% in September. In the food and beverages sub-group, inflation softened in edible oils, fruits, vegetables, pulses and sugar in October but was partially offset by a surge in inflation in cereals, meat, milk, and spices. Fuel and light inflation decreased from 10.4% in September to 9.9% in October, primarily due to favourable base effects. LPG and kerosene inflation slowed down for the third month in a row, while electricity prices remained in deflation. Meanwhile, core inflation was steady at 6%.

In November, the retail inflation subsided to 5.88%, under the RBI's upper tolerance bad of 6%. Like October, inflation in November was helped by moderating food prices and a favourable base effect. While the inflation outlook has improved, it still remains higher than the RBI's target of 4%.

Accordingly, the RBI hiked its policy repo rate by 35 bps to 6.25% in early December. This was the fifth consecutive rate hike made by the RBI this year, and was a smaller one than the three previous consecutive 50 bps hikes. With the rate of inflation coming down, the RBI is expected to make an even smaller cut of 25 bps in February 2023 given that no upside risks to global inflation materialize.

Rupee Weakness affecting RBI decisions

The weakening Indian Rupee (see figure 8) was also a major contributor to India's high rate of inflation as it made imports pricier. With the RBI raising rates slower than the Fed and the market risk appetite declining, the INR fell approximately 9.54% against the USD in 2022. This development was particularly troublesome for India, a nation which imports nearly 85% of its oil and 50% of its gas requirements. Therefore, RBI's interest rate decisions are also determined by the need to manage its currency in order to curtail imported inflation on essential goods.

In 2022, the knock-on effects of the worsening global economic outlook dampened the demand for Indian exports. On the other hand, rising domestic consumption and economic growth resulted in higher imports, particularly of raw material, capital goods, and intermediate products. As a result, India's merchandise trade deficit widened to US$ 26.9 billion in October 2022 as compared to US$19.7 billion in October 2021. This widening trade deficit is likely to hurt the rupee and influence the monetary policy decisions of the RBI.

RBI has also intervened directly in the foreign exchange market, spending nearly $24 billion in this fiscal year to defend the rupee. Apart from that, it has also carried out buy-sell swaps.

Limited Efficacy

RBI's efficacy in controlling inflation remains limited. Owing to the low per-capita income in the country, food and beverages constitute an enormous 45.86% share in India's CPI basket. The prices of these goods are primarily driven by supply side factors, and are being increasingly affected by the disruptions in rainfall patterns caused by climate change. Moreover, with a large proportion of people in the rural areas still preferring to hold cash, the currency-deposit ratio of the country remains high. This further reduces the efficacy of the monetary policy of the RBI.

Due to the dominant effect that volatile food prices have had on inflation in India, the RBI has refrained from raising rates at the pace at which other major central banks, particularly the Fed, have.

Moreover, the MPC is increasingly cautious in making further hikes due to the lag with which monetary policy operates. It feels the need to properly gauge the effect its rate hikes are having on inflation as it fears that increasing the interest rates beyond what it required to bring down inflation within its tolerance bands will dampen economic growth.
In conclusion, with inflation subsiding and growth and unemployment becoming a priority, the RBI is likely to end its hawkish stance after making a small terminal rate hike in February.

Tightening Financial Conditions

Banking system liquidity drying up

The surplus liquidity conditions have moderated (see figure 9) on account of RBI's monetary tightening coupled with higher festive season currency demand, GST and other tax related outflows, forex market operations and robust credit demand. The liquidity briefly fell to a deficit in the second half of October, but returned to a surplus as government spending picked up in the beginning of November. With FPI flows returning and deposit growth showing signs of an uptick, pressure on liquidity are expected to ease, which will enable banks to fund the strong growth in credit.

The depletion of liquidity briefly pushed the weighted average call rate (WACR) above the RBI's Marginal Standing Facility rate. This also had a pass on effect on other money market rates. In tandem, rates in the collateralized segment also increased, with the market repo rate trading, on an average, 2 to 4 bps above the policy repo rate in late October.

With the RBI keeping the interest rates high and the demand for credit remaining strong, liquidity is likely to remain tight. This will lead to high short term interest rates for a sustained period of time. Moreover, the need to manage banking system liquidity while keeping imported inflation under control have compelled the RBI to do Buy-Sell swaps, which has put downward pressure on the rupee forward premiums.

Bond Yields track movements in US Treasuries

The benchmark 10-year US treasury yield exceeded 4% in the second part of October, increasing to 4.24 percent, its highest level since 2008. This put pressure on the 10-year G-sec yield. The yield on the 10-year US Treasury bond subsequently decreased, especially after the publication of a lower-than-expected CPI inflation figure, with a corresponding effect on the yields on domestic bonds. From a peak of 7.51 percent on October 21 to 7.29 percent on November 14, 2022, the yield on the 10-year G-sec in India dipped. Across the curve, G-sec yields generally softened.

Corporate Yield Spreads widen

Corporate Bond yield increase and spreads widen across the ratings and tenor spectrum. This increase has been particularly large for AAA 1-year bonds because of the pass-on from the higher money market

Figure 10: Rates and Spreads

Instrument	Interest Rates (per cent)			Spread (bps) (Over Corresponding Risk-free Rate)		
	Sept 15 -Oct 13, 2022	Oct 14 -Nov 11, 2022	Variation (in bps)	Sept 15 -Oct 13, 2022	Oct 14 -Nov 11, 2022	Variation (in bps)
1	2	3	(4 = 3-2)	5	6	(7 = 6-5)
Corporate Bonds						
(i) AAA (1-year)	7.01	7.77	76	14	83	69
(ii) AAA (3-year)	7.75	7.87	12	47	46	-1
(iii) AAA (5-year)	7.7	7.94	24	23	42	19
(iv) AA (3-year)	8.5	8.60	10	122	120	-2
(v) BBB- (3-year)	12.15	12.25	10	487	485	-2

Note: Yields and spreads are computed as monthly averages.

Source: RBI and Bloomberg

rates. Increase in supply of corporate bonds as borrowers shifted to rupee denominated debt amidst tightening global financial conditions and a rallying US Dollar also contributed to the rise in credit risk premiums.

Fund raising through corporate bond issuance jumped to Rs. 836.90 Billion in September, the highest in the current financial year, but subsequently declined to Rs. 346.99 Billion in October amidst higher interest rates.

<u>Equity Markets remain resilient</u>

The Domestic equity markets recorded a strong bounce back in November as global risk sentiments improved and Foreign Portfolio Investors (FPIs) turned net buyers. Moreover, strong earnings in the financial sector improved the market sentiment. However, these strong earnings may be temporary as banks are raising deposit rates to mobilise funds to finance their lending activity, thus reducing their net interest margin.

The BSE Sensex increased by 5.8% in October, with the BSE Bankex registered a gain of 7.3%, the highest among all sectoral indices. The equity market continued to grow in November, sustained by strong PMI and GST collections. Markets rallied further following the release of a lower than expected CPI data in the United States. The Sensex grew by 3.54% in November, reaching an all-time high of 63,284.19 on 1st December 2022.

While economic growth remains strong, the returns on equities may be limited due to the sky high valuations. Valued at a PE ratio of about 23.5, the SENSEX remains more expensive than other emerging market indices as well as its own long term average.

Falling Forward Premiums

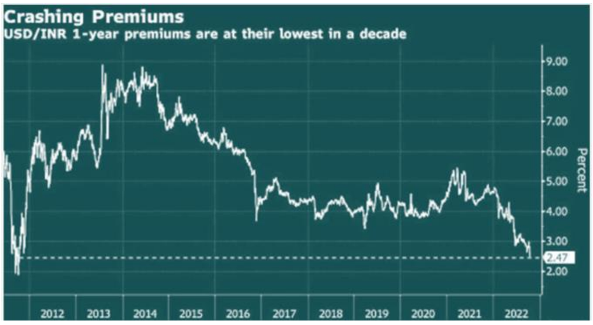
<u>USDINR forward premiums hit a decade low</u>

As US treasury yields surged with the Federal Reserve aggressively hiking interest rates, the 1-year USD/INR implied yields have fallen from 4.67% in the beginning of the year to nearly 1.70%, the lowest since 2011. The Fed raising the interest rates by 150 bps more than the RBI has been the key driver behind this fall. The 1-year rupee Overnight Index Swaps also declined by about 30 bps in November as the improved inflation outlook in India reduced market's expectations of the RBI's terminal rate.

The RBI's activity in the forward market has also contributed to the fall in premiums. As the banking system liquidity declined during year, even falling to a deficit for the first time in 40 months in October on account of advanced tax outflows, the RBI engaged in Buy-Sell swaps to inject liquidity in the system while trying to keep the imported inflation under control. Under the Buy-Sell swaps, the RBI sells the rupee in the spot market while buying them in the forward market, thus causing a fall in the forward premiums.

The falling forward premiums have reduced the attractiveness of rupee carry trade, contributing to the depreciation of the INR in the spot market.

Figure 11: USD/INR 1 year forward premiums (data till 17th October 2022)



Source: Bloomberg

Importers begin the hedge beyond the short term

The fall in forward premiums bode well for importers as it reduces their hedging costs, thus encouraging them to hedge for a longer time period, typically 5-6 months. When the premiums lingered between 3.00-4.00%, importers were typically reluctant to hedge for more than two months.

On the other hand, exporters are less enticed to hedge as it reduces the return they receive on selling dollars. Banks are advising exporters to hedge only 15-20% of their dollar exposure as compared to 40-60% in normal times. With exporters hedging less, there is a fall in supply of dollars in the forward market. This makes the rupee particularly vulnerable to episodes of risk aversion.

A Positive Feedback Loop

With hedging becoming unattractive and the INR being in a freefall against the dollar, exporters began holding off their dollar sales in the hope of windfall profits from an even stronger dollar.

This creates a positive feedback loop wherein reduced exports leads to a widening current account deficit, which leads to a further depreciation in the rupee, thus creating expectations for a further fall in the rupee and encouraging exporters to further hold off their sales.

Figure 12: USDINR Daily Chart

Source: Tradingview

Trade Idea: Long USDINR

<u>Narrative</u>

The mismatch between the weak external and the strong domestic demand in India is likely to result in a weak rupee. Strength in the manufacturing sector is likely to keep imports elevated. After falling sharply in September, India's Manufacturing PMI has shown steady growth, which will increase the demand for raw material and capital goods. . On the other hand, India's worsening global economic outlook is likely to take a toll on its exports.

Furthermore, with inflation easing in India, the RBI is likely to slow down its hikes as it shifts focus on growth, with the terminal repo rate projected to be 6.5% in February 2023. The ensuing lower interest rate differentials, along with a short supply of dollars in the USDINR forward markets with exporters unwilling to hedge make carry trade unattractive and put downward pressure on the rupee. Moreover, while the equity markets have exhibited healthy growth, the momentum of this growth has slowed down over the past few weeks. After being net buyers for 2 months, FIIs are pulling their funds out as the SENSEX trades at a P/E ratio of nearly 23.55, which is higher than the PE ratios of other EMs as well as its own long term average.

Additionally, with the CAD widening and global trade growth slowing down, the organic flow of dollars will reduce, leading to borrowers scrambling for them in order to service their dollar denominated debt. This is likely to push the USD further up.

<u>Technicals</u>

As seen in the chart, the pair has shown consistent upward movement but for a bearish run in early November. The MACD signals a strong bullish trend as the MACD line recently crossed the signal line from below and moved above the zero line. The stochastic oscillator also signals an upwards trend, with the %K line moving above the %D line. We suggest entering the trade at the support level of 82.26. The take profit has been set at 83.28, near the pair's all time high and the stop-loss is at 81.70, which is the next major support level.

Entry: 82.2600
Take Profit: 83.2800

Stop Loss: 81.7000
Risk Reward Ratio: 1.82

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