Essential Asia: Shifting Gears

A macro strategist's view on Asian economies and markets

National Australia Bank

13 November 2015

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Talking points

- The gears have shifted higher in November for the US and the USD, with strong non-farm payrolls stoking more confidence in a December Fed hike.
- Meanwhile, it's the reverse for the rest of emerging Asia, where the engines of growth remain stuck in low gear and the only thing on the acceleration pedal is policy easing.
- We are neutral in our FX recommendations in the Asian currencies space, but may refuel on trades that reflect policy and growth differentiation.

In this issue

Recent reports

- China's Economic Update, 12 November 2015
- China's Economy at a Glance, 11 November 2015
- NAB's World on Two Pages, 11 November 2015

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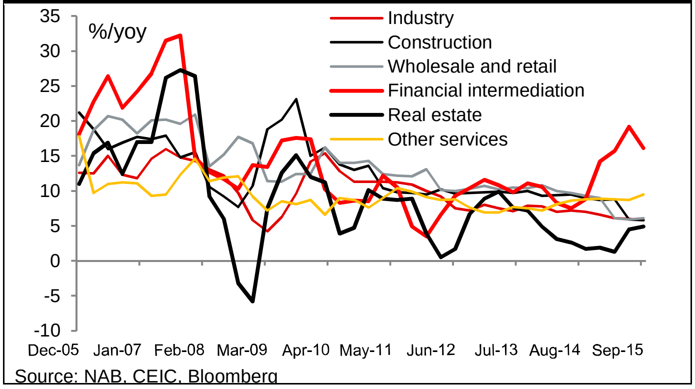
Trade recommendation

Entry Date	Recommendation	Opening level	Target	Stop
5 Nov	Short NZD/USD	0.661	0.620	0.670
30 Oct	Long AUD/JPY	85.95	91.50	86.30

Chart of the month – China's financial services sector held up in Q3 despite stockmarket crash



Source: NAB, CEIC, Bloomberg

Policy Rates

	Q4 2014	Q1 2015	Q2 2015	Q3 2015	Q4 2015	Q1 2016	Q2 2016	Q3 2016	Q4 2016
Korea	2.00	1.75	1.50	1.50	1.50	1.50	1.75	1.75	2.00
Thailand	2.00	1.75	1.50	1.50	1.50	1.50	1.50	1.75	2.00
Malaysia	3.25	3.25	3.25	3.25	3.25	3.50	3.75	3.75	3.75
India	8.00	7.50	7.25	7.25	6.75	6.75	6.75	6.50	6.25
Indonesia	7.75	7.50	7.50	7.50	7.50	7.75	7.75	7.75	7.75
China	5.60	5.35	4.85	4.60	4.35	4.10	3.85	3.85	3.85

Asian FX Forecasts

	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17
USD/CNY	6.40	6.50	6.60	6.65	6.70	6.72	6.75	6.80
USD/IDR	13500	13800	14000	14000	14100	14500	14500	14500
USD/INR	65.5	65.5	66.0	66.0	66.5	66.0	65.5	65.0
USD/KRW	1200	1220	1250	1250	1250	1200	1200	1180
USD/MYR	4.20	4.25	4.30	4.35	4.40	4.40	4.40	4.38
USD/PHP	46.2	46.5	47.0	47.5	48.0	48.0	47.5	47.5
USD/SGD	1.42	1.44	1.46	1.47	1.48	1.47	1.46	1.45
USD/THB	36.0	36.5	37.0	37.0	37.0	37.0	36.5	36.5
USD/TWD	33.0	33.5	34.0	34.5	34.8	35.0	35.0	34.8

	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17
AUD/CNY	4.48	4.42	4.55	4.66	4.69	4.77	4.86	4.96
AUD/IDR	9450	9384	9660	9800	9870	10295	10440	10585
AUD/INR	45.9	44.5	45.5	46.2	46.6	46.9	47.2	47.5
AUD/KRW	840	830	863	875	875	852	864	861
AUD/MYR	2.94	2.89	2.97	3.05	3.08	3.12	3.17	3.20
AUD/PHP	32.3	31.6	32.4	33.3	33.6	34.1	34.2	34.7
AUD/SGD	0.99	0.98	1.01	1.03	1.04	1.04	1.05	1.06
AUD/THB	25.20	24.82	25.53	25.90	25.90	26.27	26.28	26.65
AUD/TWD	23.10	22.78	23.46	24.15	24.36	24.85	25.20	25.40

Shifting Gears

- **The gears have shifted higher in November for the US and USD, with strong non-farm payroll and stoking more confidence of a December Fed hike.**
- **Meanwhile, it is the reverse for the rest of emerging Asia, where the engines of growth remain stuck in low gears and the only thing on the acceleration pedal is policy easing.**
- **We are neutral in our FX recommendations in the Asian currencies space, but may refuel on trades that reflect policy and growth differentiation.**

The USD shifted to higher gear

The USD index shifted into a higher gear in November to touch 99.0 (DXY) after a brief period of consolidation just below 97.0 at the end of October. The price action has reflected an undecided market dealing with slower China growth and the somewhat unconvincing recovery in commodity prices.

The European Central Bank (ECB) ruffled more Euro bears' feathers (or should I say "hair") on 22 October with its dovish language during the press conference. The EUR tumbled a notch and China's PBoC took the opportunity that very weekend to cut rates by 25bp and remove the deposit rate ceiling. Following that, the expectations of a December Fed rate hike was restored convincingly after a strong showing in nonfarm payrolls. Our G10 FX strategists aptly sumit up that the way the central bank stars are currently aligning, with the ECB broadly expected to ease on 3 December and the BoE not joining the Fed in the rate hike camp (potentially not before 2017) points to further USD gains ahead. But it also begs the question of how long before Fed officials will be crowing that the USD is an issue and needs to be watched? Until that point arrives we assume the Fed raises the target range of the Fed funds rate by 25bps to +0.25% to 0.5% on 16 December. We believe the Fed will want to impart a view that future hikes will be gradual and will use the dot points to this end as a messaging device (more details in the Global FX Strategist, 9 November).

Asia stays stuck in low gear

Asia's economic prospects, on the other hand, stay in an uninspiring low gear. The OECD was the latest to join the others like the IMF, ADB and World Bank in revising down its global growth forecasts. In its half yearly Economic Outlook, the OECD forecasts the world economy to grow 2.9% this year and 3.3% next, revised down from 3.0/3.6% in September on emerging market weakness, Russia and Brazil in recession and China soft.

The current economic environment suggests that growth differentiation will sustain the policy differentiation and will be reflected in currency movements. Consequently, portfolio flows are at risk of retracting (Chart 1). The influencing factors for various policy decisions include the speed of economic recoveries, the inflation situation and conditions in respective financial and foreign exchange markets.

The US Federal Reserve is pushing cautiously ahead with monetary policy normalization. The ECB and the Bank of Japan are on the other hand maintaining their respective expanded asset purchase programme and quantitative and qualitative monetary easing policies, while the People's Bank of China has also expanded its accommodative monetary policy stance in response to its domestic economic slowdown and financial market unrest.

Among 20 other economies belonging to the G20 or the OECD, nine held their policy interest rates steady between April and September 2015, while another nine countries cut theirs and two raised them.

Hikers vs cutters and what's priced in

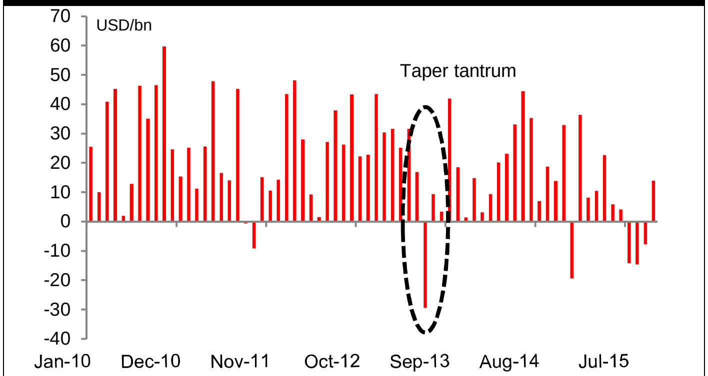
In Asia, taking into consideration our current assumption of a December Fed hike and a gradual hiking policy path in 2016, our assessment on Asia policy rates in 2016 are as such.

The hikers – Korea (+50bp), Thailand (+50bp), Malaysia (+50bp), Indonesia (+25bp).

The cutters – India (-50bp), China (-50bp).

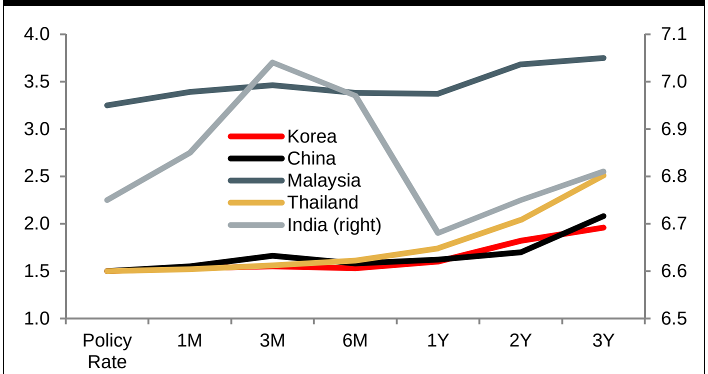
As for the currency impact of future policy decisions, we continue to expect Fed hikes and the withdrawal of liquidity and capital flows from Asia to be the overwhelming backdrop for our firmer USD/Asian FX forecasts. Most of the market implied policy rates in Asia are pricing in more easing in the next six months before some normalisation in twelve months' time (Chart 2). This may change swiftly but at this point we expect a stronger preference for USD strength in the next three to six months, until Asia starts to hike and narrow the policy differentiation.

Chart 1: Unconvincing return of portfolio flows



Source: NAB, IIF

Chart 2: Market implied policy rates (%)



Source: NAB, Bloomberg

China Spotlight: Mission (hills) accomplished

- **NAB's products and markets team spent a weekend in China's Mission Hills and it seems fitting to relate China's recent accomplishment as analogous to a golf game.**
- **The 13th five year plan discussion has concluded and the key message on growth in the next five years is that policy makers will accept slower growth, but not much slower. 6.5% GDP growth is representative of President Xi's "moderately prosperous" society.**
- **After five rate cuts this year, broad direction suggests more policy easing ahead, but we may be done with rate cuts for the rest of this year.**
- **The outcome of the SDR entry mission should be disclosed by the end of November. The CNY may get increasingly more aligned with growth and policy guidance after that.**

Growth on undulating grounds

Recent macro data performance has merely affirmed China's slower growth prospects. The manufacturing PMIs, both by Caixin and the official release, has stayed below 50, IP growth has been hovering around 6% and property prices have not recovered convincingly. Fading profits, extensive overcapacity and high real interest rates are negative influences denting China's business investment. In addition, fixed-asset investment growth slowed to 10.9% in the first eight months of 2015, down from 15.7% in 2014. Within that, manufacturing sector investment has slowed more sharply. The overall outlook is downcast, even though Q3 GDP came in modestly higher than expectations at 6.9%.

Interestingly, the stockmarket crash did not dent the financial services sector as much as most had expected (Chart 3). The financial intermediary component within China's GDP registered a slower growth of 16.1% yoy in 3Q from the peak of 19.2% in 2Q. That was not exactly cataclysmic nor does it fully reflect the extent of the stockmarket rout, but probably showed some impact of the government's backstop measures and intervention.

In addition, there were some indication of strong regional performances. For instance, Beijing and Shanghai both got boosts from financial services, which surged 19% and 27% respectively, while technology saw double-digit jumps in both provincial-level municipalities. That helped offset an overall growth slowdown in both provinces. But there were some surprise packets on the services front too. Jilin province in the industrial north reported a 22% surge in the value-added of financial services, even higher than the national level of 17%. Output in Guangdong, the biggest regional economy and one of China's manufacturing heartlands, saw a pickup to 7.9% in the third quarter. Officials there attributed the strength to having a relatively developed services sector, as its population of 107 million makes it a massive consumer market.

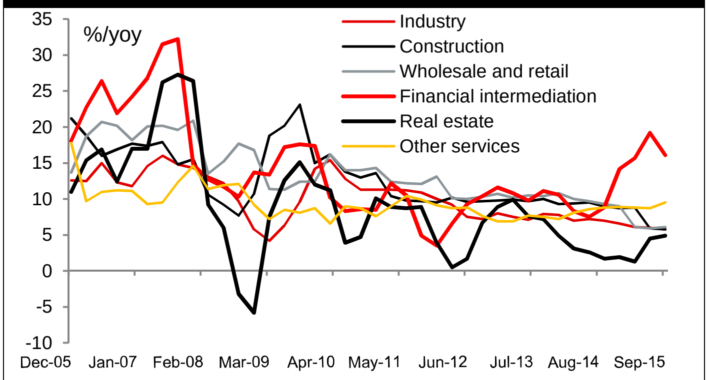
The longest drive to 2020

The 13th five-year economic plan maps out the growth roadmap for 2016-2020 and the key message on growth in the next five years is that policy makers will accept slower growth, but not much slower. Annual growth should be no less than 6.5% in the next 5 years to realize the goal to double 2010 gross domestic product and per capita income by 2020, according to President Xi.

The Chinese government also announced the abolishment of the one-child policy, as part of President Xi Jinping's five-year blueprint for transition to a "moderately prosperous society." Three main rationales were cited for the move, namely the long lag time before any new born becomes a productive force, resistance by young couples to have kids/more than one kid with affordability as the key issue cited, and the lack of response to the previous relaxation. China's population is expected to peak at 1.41 billion in 2025, and the total in 2050 will be much lower than it is today, according to Zhang Juwei, director of the Institute of Population and Labor Economics at the Chinese Academy of Social Sciences.

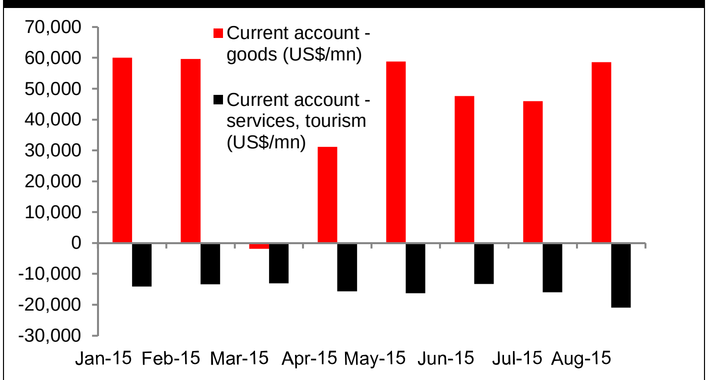
Some of the key messages include that China will push forward stocks and bond issuance system reform, develop a transparent, healthy capital market and deepen the fiscal, tax system reforms. There was also commitment to gradually remove quota limits for inbound and outbound investment over the next five years. And not to be excluded, the ruling Communist Party says it plans to make RMB a freely tradable and freely usable currency by the end of 2020. This includes a move to switch to a "negative list" in foreign exchange regulation during the five-year plan, which would allow companies to do whatever is not explicitly prohibited.

Chart 3: Financial services decline not as drastic as expected



Source: NAB, CEIC

Chart 4: Services deficits may be a source of concern for CNY



Source: NAB, CEIC

Nearest to pin, but no hole in one

China's policy is likely to be dominated by the twin agendas of cementing the CNY's reserve currency status by further liberalizing the currency, and the slightly longer term goal of liberalizing its capital account. China is on the green and very near the entry into the IMF SDR basket, with the outcome possibly announced on 30 November. We believe that even after entering the IMF SDR basket, making sure that the CNY continues to fulfil the "freely usable" requirement will be of paramount importance. There is a good chance that the authorities will follow-up on the adjustment to the fixing mechanism of the USD/CNY's by widening the current existing 2% band to 3%, with a view to eventually removing those limits entirely. Indeed, the IMF's most recent Article IV mentions the widening of the band as an important part of the currency liberalization process. A more sustainable FX regime will be one where intervention efforts are reduced and is a path that China will likely embark on once again.

The short game – orderly is a tall order

The big question is can China maintain an orderly realization of yuan convertibility? The hope is that free cross-border capital flows will improve the efficiency of capital allocation. Given fears about instability in the financial system, it seems unlikely that China's markets will be completely open to large-scale volatile portfolio flows on such a short time horizon. Thus, the short game will involve the PBoC intervening in USD/CNH in the near term, to ensure that the spread between CNY and CNH does not overly widen and limit arbitraging opportunities. Note that the spread has been widening in recent weeks, triggering heavy intervention in USD/CNH (chart 7). Signs of heavy intervention have showed up in PBoC data on CNY forwards. The PBoC and local banks' onshore CNY forwards holdings rose to US$67.9bn in August, more than five times the average in the first seven months of the year. Consequently, FX reserves have fallen nearly USD 180 billion in 3Q alone to USD 3.5 trillion. We would repeat that arguably, the more stable the CNY in the near term, the greater the risk of a bigger shift next year. Potentially, another step like devaluation similar to August 11 cannot be totally ruled out.

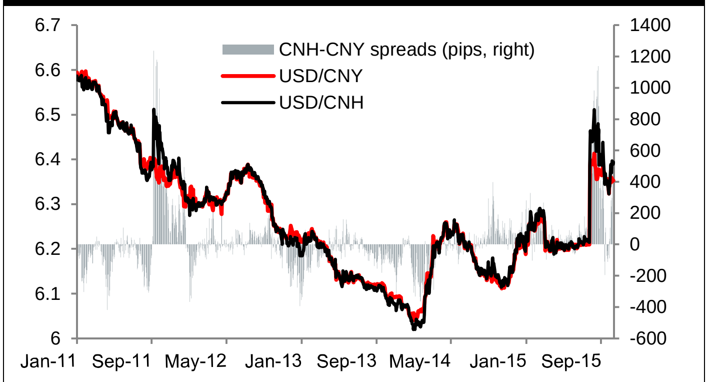
Policy wind direction – tailwind for doves

China delivered another rate cut on October 23, bringing the benchmark one year lending rate to 4.35%. The move was somewhat expected and together with the 50bp RRR cut across all financial institutions, is expected to release about CNY1.0tn worth of liquidity. At the same time, the PBoC lifted the last hurdle to interest rate liberalisation by removing the ceiling on deposit rate. This is a milestone but its overall impact may be mitigated by the fact that banks are still cautious about lending and hence are not expected to aggressively lift deposit rates to lure deposits. Furthermore, the central bank was quick to disemminate the message that although banks are now given free rein, it will not hesitate to discipline those that use high interest rates to attract deposits or disrupt the market.

After five rate cuts this year and bringing the key policy rate down by 100bp collectively, we expect the PBoC to take a pause for the rest of the year. Our China economist Gerard Burg is of the view that China may cut again next year, but at a more moderate pace with two cuts in the first half of 2016. Gerard has downgraded China's 2016 GDP forecast to 6.7% from 6.9% and is cognizant that downside risks persist. Understandably, the PBoC is keen to get the Finance Ministry to push more fiscal measures in the months ahead. Local newswires quoted Chinese central bank adviser Huang Yiping as saying that the country's fiscal policy also has room for easing as the government debt-to-GDP ratio is <50%. He also warned that current deflation pressure is large and worth paying attention to.

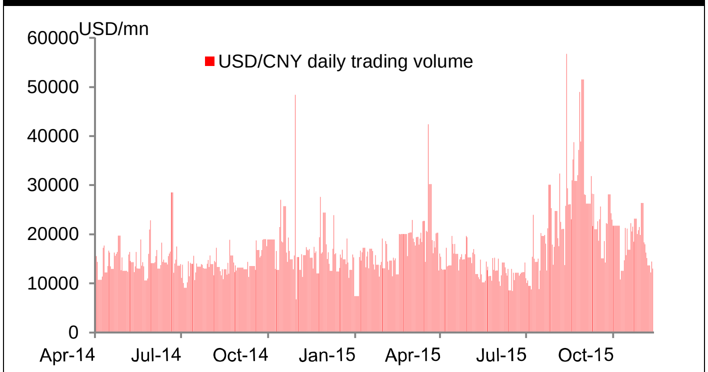
Elswhere and somewhat a prelude to fiscal spending, debt market activities in China have been picking up. This is a direct consequence of more conviction towards gradual Fed hike prospects as well as a continued policy easing stance in China. Local governments are taking the opportunity of a more conducive environment and also some remaining appetite before the end of the year to raise funds, and these include Ningxia, Tianjin, Guangdong, Shanxi and Henan. There are also reports suggesting that another expansion of the local government bond swap program to RMB 3.8-4.0 trillion for 2015 could be in the offing; in August the government had expanded it to RMB 3.2 trillion. Offshore issuances are also picking up, with British Columbia and South Korea looking to issue Panda bonds.

Chart 7: PBoC uncomfortable with wide CNY/CNH spreads



Source: NAB, CEIC, Bloomberg

Chart 8: USD/CNY trading volume picked up after August deval



Source: NAB, CEIC, Bloomberg

Korea Spotlight: Bottoming out

- **Korea's economic profile is looking better. There are hopes that Korea may be the first Asian economy to stop slowing and recover.**
- **Our economists have removed the rate cut call this year and we now expect Korea to start hiking rates next year.**
- **In the meantime, USD/KRW is still biased for higher levels within a 1100-1200 range, with China's growth and CNY as dominant external influences along with an upward-biased USD/JPY.**

Two sides to a coin

The Korean authorities are of the view that US interest rate hikes will proceed in line with the US economic recovery and are not expected to adversely impact the Korean economy. However, they are acutely aware of the KRW's sensitivity to Fed rate hike expectations and the prospect of increased capital outflows from emerging markets. Hence, at the last economic review meeting hosted by Bank of Korea, Governor Lee that was joined by academics and also industry players, where the participants emphasized the need to strengthen financial market soundness going ahead.

In addition, there is also increasing focus on getting Korean exporters to adjust to China's new growth strategy. China's transition to a slower growth trend will have a prolonged impact on Korea's exports and it is important for Korean exporters to be attuned with China's industrial development. Korean policymakers were urged to focus policy measures on increasing medium to long term growth potential rather than raising short term growth.

Forward thinking – No more cuts needed

In light of recent developments, we are inclined to think that the Bank of Korea may no longer need to cut policy rates, but will look to adjust its inflation target lower for 2016-2018 from 2.5-3.5% currently. The BoK projectthat inflation may recover next year but at a modest pace of 1.6% in H1 and 1.8% in H2 2016. However, the BoK's trend forecast for core CPI (excluding food and energy) is a recalibration lower to 1.8% in H1 and 1.7% in H2 2016 from 2.5% in H2 2015.

According to the BoK, looking at the future price path, there is a mix of both upside risks from a potential recovery in international oil prices or drought-related spikes in agricultural prices, and downside risks from China-led commodity price declines or stronger global USD trends. Our economists have removed the rate cut call for the rest of this year and are projecting two rate hikes next year.

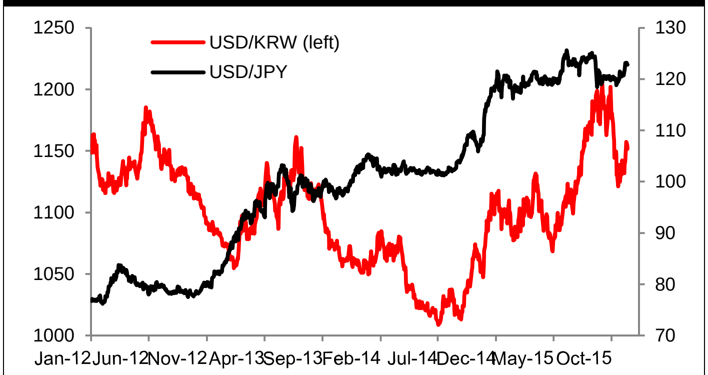
Modest revival in risk appetite may cushion KRW

Consumer sentiment and an appetite for riskier assets looks be reviving. convincingly. Korea's economic performance rebounded in 3Q, as GDP surprised on the upside at 2.6% yoy. The overall performance was underpinned by strong consumption demand, offsetting lacklustre external trade growth. The upbeat trend in consumer spending has persisted, with the apparent 21% increase in retail sales of 22 major retailers during the two week Black Friday shopping festival in October.

Consequently, rate cut expectations were pared, reflected in the jump in 3Y bond yields from their historical low of 1.57% on 30 September to 1.84% on 10 November. The lure of investing in the CNY in Korea has also faltered, as indicated by the fall in CNY deposits to USD 7.2 billion from USD 9.4 billion in October.

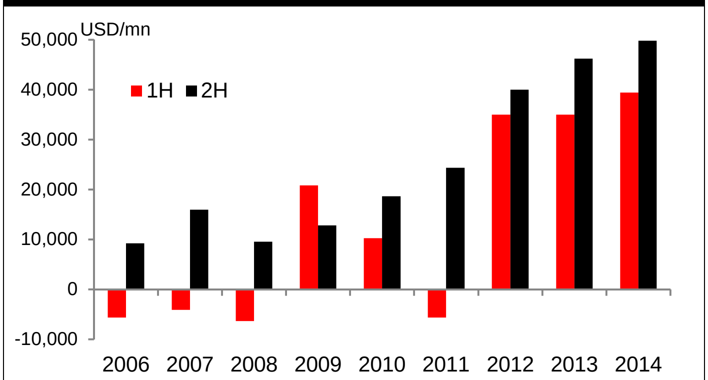
Admittedly, the recovery in risk appetite is still looking rather tentative as FX deposit data bucked the recent declines and rose for the first time in 6mths to USD 63.4 billion. BoK attributed the rise in USD savings to USD 49.45 billion to an increase in trade bills deposits by corporates. Overall, FX deposits data is not a sufficient indicator of recovering domestic risk appetite. In addition, portfolio flows have not returned convincingly, but we think the other domestic positives may provide some buffer against significant USD/KRW upside from here. USD/KRW has been trading below 1150 level since bottoming out from a low of 1120.6 on 19 October. The pair managed to gap convincingly higher above 1150 after the stronger than expected US non-farm payroll data in early November. Further upside toward the 1200 level may beckon in the near term due to external influences. However, beyond that, the climb may be more gradual, provided more domestic positives kick in more prominently.

Chart 5: USD/KRW starting to track firmer USD/JPY



Source: NAB, CEIC, Bloomberg

Chart 6: Firmer current account surplus performance in H2



Source: NAB, Bloomberg, Asian bonds online

India Spotlight:
Carry-trade to support INR?

- **The Indian rupee has seen a volatile month but is now close to its September lows against the USD.**
- **The RBI has strongly suggested that interest rate cuts have been suspended for the time being.**
- **A return of the carry-trade environment should see the INR benefit relative to its Asian counterparts.**

RBI hints that it's done, for now at least

After the 50bps rate cut in November, and a total of 125bps worth of cuts this year, RBI governor Raghuram Rajan seems to be signalling that the central bank is done with rate cuts for the time being, saying that inflation has to be brought under control. The government's chief economics minister Arvind Subramaniam seems to be putting aside erstwhle disagreements with Rajan and suggesting that expansionary fiscal policy is in place to take up the slack.

It is quite likely that this announcement partly takes into consideration the renewed potential of the U.S. Federal Reserves effecting a first rate hike in December 2015. While the INR's fundamentals are much improved relative to 2013, the RBI might still be worried that market sentiment still considers the INR to be highly vulnerable to higher U.S. interest rates. The USD/INR is likely to be supported over the rest of 2015 till the Federal Reserves effects its 'liftoff', but a hefty carry should enable it to outperform its Asian and EM peers.

A cessation of further monetary easing could see (at least temporary) a reduction in new inflows into the bond market. Inflows into the equity markets will depend on economic data and whether or not the government pushes forward with reforms like the Goods and Services Tax.

Further easing still justified but that can wait

With the policy rate at 6.75%and the real interest rate still at around 2.5%, there remains scope for further easing, especially with domestic credit growth having decelerated significantly since 2014. Q2 GDP growth had also decelerated, with investment spending lagging the 7% headline number, at just 4.9% y/y growth. Business confidence is also proving fragile and has been on the slide since the decisive election results in 2014.

However, it is probably fairly prudent for the RBI to hold off on further cuts for now, and let the cum-ulative effect of the easing in the past months filter through the economy. This is especially so given that the INR is still seen as being particularly vulnerable to a narrowing differential with the USD.

There are some cyclical signals that look positive enough to buy the RBI some breathing room, like industrial production, which accelerated in September to 6.4% y/y from 4.2% in August. Inflation is also providing some cause for caution, having risen to 4.4% y/y in September from 3.7% August. Governor Rajan's specific mention of the need to control inflation could be an allusion to this data point.

INR's interest rate buffer should help

Two key developments over October and early November should benefit the INR over the multi-month timeframe. The first being the sharply increased expectations of an earlier interest rate lift-off in the U.S. on the back of comments by Federal Reserve Chair Janet Yellen, and a very strong nonfarm payrolls number. There is a good chance that this could see markets revisit the carry trade theme and this should benefit the high-carry INR.

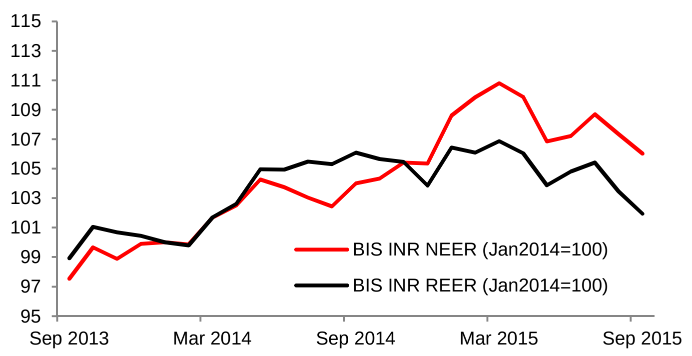
The second development is the rather strong hint provided by Rajan that rate cuts might be suspended for the time being. This should help reduce the rate of erosion of the INR's interest rate buffer, which will prove attractive should the carry trade strategy take hold.

Reform jitters likely temporary

Early November also saw the INR sold off somewhat on the back of the ruling coalition's heavy loss in state elections in Bihar. It is feared that the government will be stymied in its attempt to gain a grip on the Upper House of the national legislature and the government's reform agenda will be undermined. While this could indeed slow down reforms somewhat, it is unlikely to completely halt or reverse the reform process.

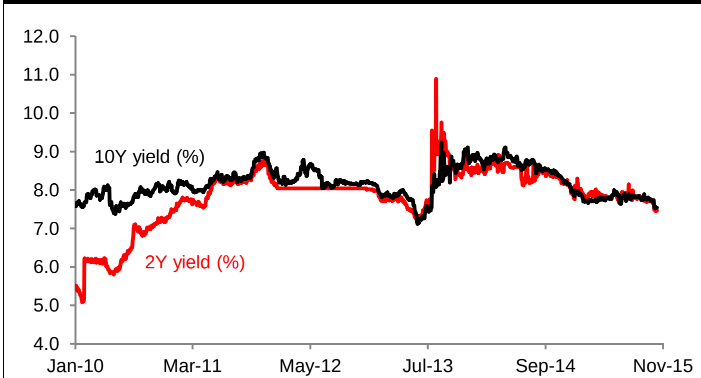
Markets are likely to also pay heed to growth and on that front, there are some signs that the cyclical momentum isn't that weak and fiscal and monetary stimulus are likely to help boost momentum in the months to come.

Chart 9: Trade-weighted INR has weakened



Source: NAB, CEIC

Chart 10: 10-2 gap could widen again as cuts end



Source: NAB, CEIC, Bloomberg

Singapore Spotlight: SGD caught in USD current

- **The MAS opted for a mild monetary easing at its October 2015 monetary policy meeting.**
- **Arguably there is little slack in the economy at this juncture and economic growth appears to be stabilizing.**
- **There is room within the S$NEER policy band for more SGD weakness amidst broad USD strength.**

Data improves as MAS remains sanguine

Data releases in October suggests that Singapore's economy might be seeing some degree of stabilization, which might partly explain the MAS' rather mild easing move at its October 2015 meeting.

Table 1: Macro indicators suggest economy stabilizing

	IP	CPI	PMI	NODX
Actual	-4.8%	-0.6%	48.9	0.3%
BBG consensus	**-4.5%**	**-0.6%**	48.9	-3.9%
Previous	--7.0%	-0.8%	48.6	-8.4%

S$NEER pace of appreciation reduced "slightly"

At its 14 October monetary policy meeting, the second of its scheduled biannual meetings for 2015, the Monetary Authoritiy of Singapore maintained its policy stance of gradual appreciation of the S$NEER policy band, although it did reduce slightly the pace of appreciation, saying that the "measured adjustment" balances both support for growth in 2016 and price stability over the medium term.

The MAS maintained its 2015 growth outlook at 2.0-2.5%, citing robustness in domestic demand as a counterweight to weak external demand. It said risks are tilted towards the downside but broadly similar growth is expected for 2016.

The MAS was also rather sanguine on inflation, expecting core inflation for 2015 at around 0.5% with overall inflation for 2015 at -0.5% on the back of lower car and housing prices.

Economic data supports MAS adjustment

The biggest economic news in October was probably that the economy narrrowly avoided a technical recession, at least going by advance Q3 GDP estimates. These suggested that the economy grew 0.1% q/q SAAR, after 2Q's 2.5% fall. The growth in Q3 was largely fueled by the services sector, in line with the medium term trend.

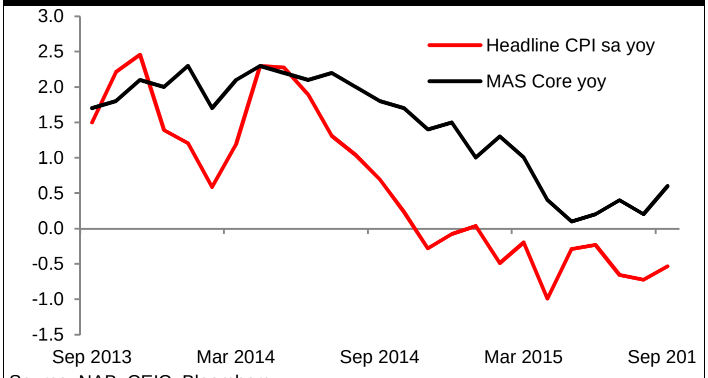
At the end of the day, the 2.0-2.5% growth expected for 2015 and 2016 is actually quite a healthy rate for a developed economy that has enjoyed fairly healthy growth over the last 4-5 years. With unemployment running at close to 2% and immigration policy still rather tight, it is quite understandable that the MAS preferred to be cautious about stimulating the economy.

Monthly data broadly suggest that economic activity might have bottomed in Q3. NODX for September saw its first positive y/y number in 3 months on the back of a strong seasonaly adjusted m/m number. Retail sales ex-autos for August saw strong growth as well, especially on a m/m basis. Headline inflation remained negative in September, but more importantly, the MAS' measure of core inflation appears to be starting to climb on a y/y basis. This could have been the most significant factor in dissuading the MAS from adopting a looser monetary stance on the S$NEER.

USD/SGD has more headroom

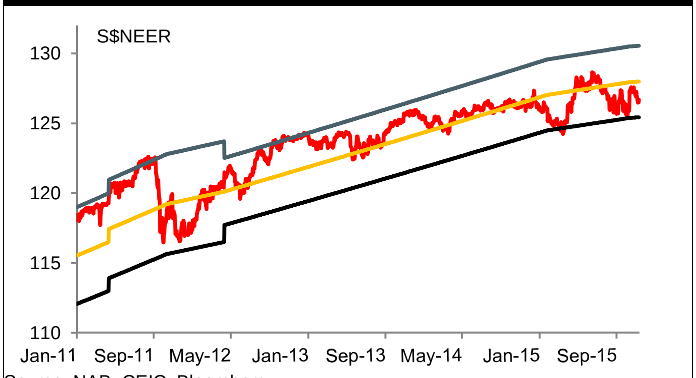
The modest reductions in the pace of appreciation of the S$NEER policy slope in both January and October, along with the rebound in the S$NEER over the last month or so, will provide some buffer for more weakening. This is key given that with the broad USD likely to strengthen again, the SGD should weaken against both the USD and CNY – both of these account for around 30% of the NEER basket.

Chart 12: Muted adjustment on rising MAS core inflation



Source: NAB, CEIC, Bloomberg

Chart 13: S$NEER traded in lower half of band



Source: NAB, CEIC, Bloomberg

Selected Indicators

Table 1: NAB Key FX Forecasts

		Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17
Australian Dollar	AUD/USD	0.70	0.68	0.69	0.70	0.70	0.71	0.72
New Zealand Dollar	NZD/USD	0.62	0.60	0.60	0.61	0.62	0.63	0.64
Japanese yen	USD/JPY	121	122	123	124	125	127	126
Euro	EUR/USD	1.10	1.10	1.10	1.08	1.07	1.07	1.08
British Pound	GBP/USD	1.52	1.51	1.48	1.45	1.44	1.43	1.42
Swiss Franc	USD/CHF	0.97	1.00	1.02	1.05	1.07	1.06	1.06
Canadian Dollar	USD/CAD	1.34	1.38	1.37	1.36	1.37	1.35	1.32
Chinese New Yuan	USD/CNY	6.40	6.50	6.60	6.65	6.70	6.72	6.75

Table 2: NAB Asia Macro Forecasts

Average annual growth in GDP (%)				
	2013	**2014**	**2015**	**2016**
Hong Kong	3.1	2.5	2.4	2.6
Indonesia	5.6	5.0	4.6	4.5
Singapore	4.4	2.9	2.2	3.3
Taiwan	2.2	3.8	2.1	2.8
Thailand	2.8	0.9	2.9	3.8
Malaysia	4.7	6.0	6.7	4.9
S Korea	2.9	3.3	2.2	2.5
Philippines	7.1	6.1	5.4	5.7
Total	**4.2**	**4.0**	**3.6**	**3.8**

Table 3: NAB Key Macro Forecasts

Country/region	2011	2012	2013	2014	2015	2016
			% change			
United States	1.6	2.2	2.2	2.4	2.5	2.5
Japan	-0.4	1.7	1.6	-0.1	0.7	1.2
Euro-zone	1.7	-0.7	-0.3	0.9	1.3	1.7
United Kingdom	1.6	0.7	1.7	3.0	2.6	2.4
Emerging Asia	4.4	5.4	6.4	7.4	8.4	9.4
Latin America	4.9	2.5	2.5	0.9	0.1	1.1
Canada	3.0	1.9	2.0	2.4	1.0	2.0
Australia	2.7	3.6	2.1	2.7	2.3	2.7
New Zealand	1.8	2.4	2.2	3.3	2.4	1.9
Africa	7.7	6.8	6.4	7.1	7.4	7.5
Eastern Europe	5.4	1.4	2.9	2.8	2.9	2.8
Middle East	3.9	4.8	2.4	2.7	2.8	2.5
Other advanced	3.3	2.0	2.2	2.8	2.9	2.7
World	4.37	3.51	3.35	3.32	3.11	3.25

Source all tables: National Australia Bank

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