Market Strategy

Essential Asia: Interest in Interest

A macro strategist's view on Asian economies and markets

National Australia Bank

21 December 2015

Talking points

- With the U.S. Federal Reserve embarking on a path to rate normalization, the focus in Asia is likely to shift to which economies are best placed to cope.
- Asia is likely to see slowing but decent 6% growth; its healthy current account balances and strong FX reserves positions though should enable the impact of outflows to be contained.
- The relative growth and inflation outlooks put India ahead of the pack on both fronts, in addition to the INR's very healthy positive carry over the USD.
- We updated our 2016 Asian FX forecasts and also added a focus piece on Taiwan elections.

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Recent reports

- Asia Dashboard, 14 December 2015
- China Economic Update, 11 December 2015
- India GDP & Policy Update, 7 December 2015

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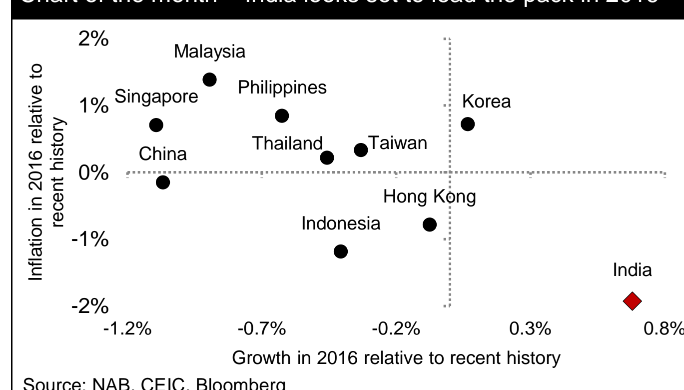
Chart of the month – India looks set to lead the pack in 2016



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

	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17
USD/CNY	6.50	6.60	6.65	6.70	6.72	6.75	6.80	6.80
USD/IDR	13800	14000	14000	14100	14500	14500	14500	14500
USD/INR	67.0	66.5	66.5	66.0	66.0	65.5	65.0	64.0
USD/KRW	1220	1250	1250	1250	1200	1200	1180	1150
USD/MYR	4.30	4.30	4.35	4.40	4.40	4.40	4.38	4.35
USD/PHP	48.0	49.0	47.5	48.0	48.0	47.5	47.0	46.5
USD/SGD	1.44	1.45	1.47	1.48	1.47	1.46	1.45	1.45
USD/THB	36.5	37.0	37.5	38.0	37.5	37.5	37.5	37.5
USD/TWD	33.5	34.0	34.5	34.8	35.0	35.0	34.8	34.5

	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17
AUD/CNY	4.42	4.55	4.66	4.69	4.77	4.86	4.96	4.96
AUD/IDR	9384	9660	9800	9870	10295	10440	10585	10585
AUD/INR	45.6	45.9	46.6	46.2	46.9	47.2	47.5	46.7
AUD/KRW	830	863	875	875	852	864	861	840
AUD/MYR	2.92	2.97	3.05	3.08	3.12	3.17	3.20	3.18
AUD/PHP	32.6	33.8	33.3	33.6	34.1	34.2	34.3	33.9
AUD/SGD	0.98	1.00	1.03	1.04	1.04	1.05	1.06	1.06
AUD/THB	24.82	25.53	26.25	26.60	26.63	27.00	27.38	27.38
AUD/TWD	22.78	23.46	24.15	24.36	24.85	25.20	25.40	25.19

Asian Value – A Leader Emerges

- **With U.S. interest rates on the rise, the focus for Asia is likely to shift to the relative ability to cope.**
- **Asia is likely to see slowing but decent 6% growth; healthy current account balances and strong FX reserves keep the impact of outflows contained.**
- **The relative growth and inflation outlooks put the INR ahead of the pack in terms of the value it offers relative to its Asian counterparts.**

The USD shifted to higher gear

Even as the DXY took a sharp tumble in December, the ADXY fell rather steeply as well, highlighting a divergence between EM and DM currencies that in turn points to the dominance of risk aversion as U.S. interest rates start rising. This risk aversion is also likely to see the market attempt to be more discerning about the various Asian economies and markets.

Not as divergent as it might seem

On the surface, Asia's ability to cope with higher U.S. rates tends to be viewed as rather varied. While the IMF still sees EM Asia growing by more than 6% in 2015, there is also quite a considerable spread in the expected growth rates across the entire region.

A closer look at the key variables of growth and inflation though suggests that the market impact might not be that disparate. In terms of the other factors as well, the regional generally has the wherewithal to deal with outflows.

Growth slowing across the region

What is not so divergent, however, is the fact that many of EM Asia's economies' projected growth rates (according to market expectations) represent a slowdown relative to the average growth rates over the 2012-2014 period.

A big part of this is undoubtedly due to the spillover from China's slowdown. Addditionally, this latest economic recovery in the developed world, especially in the U.S., has been notable for seeing a much bigger rise in demand for services rather than manufactured goods – the latter has traditionally been Asia's means of benefitting from a global recovery.

Only India is expected to see a meaningful acceleration in its growth rate in 2016, at 0.7 percentage points over its recent historical average. Korea is the only other economy expected to see an acceleration in growth, but of just 0.1 percentage points.

The rest of the region is expected to see a deceleration of as much as 1.1 percentage points (for China and Singapore). Singapore's deceleration though should not be seen as that big of a concern given that growth is still relatively strong.

Inflation also expected to be higher

Market expectations also point to a rise in 2016's inflation rates relative to the 2012-2014 averages. Part of this is due to base effects, especially in energy prices – the price of oil in 2016 is unlikely to see the sharp down moves witnessed in 2015, thereby removing a major source of downward pressure on inflation.

India is expected to enjoy the greatest amount of disinflation relative to its 2012-2014 average, of around 1.9 percentage points. Indonesia is second at 1.2 percentage points.

This spread over the inflation rates relative to recent history also leads to differing scope for supportive monetary policy to be employed. This in turn will have an impact on expectations regarding domestic financial assets and in turn portfolio flows.

Economic strength impacts FX outlooks

India therefore comes out tops in both growth and inflation, with the latter clearly allowing for more rate cuts in 2016. NAB's India economist John Sharma expects another 50bps worth of cuts sometime in the year. The current account deficit has shrunk to a very manageable 1.3% of GDP and the authorities have increased FX reserves to a level that covers a very adequate nine months' worth of imports. The INR's rather healthy carry over the USD should prove attractive. We see the USD/INR remaining relatively stable at 66, outperforming its Asian counterparts

The CNY, on the other hand, is expected to be one of the weaker ones in 2016, bringing the SGD along with it. Weak growth expectations should feed through into less favorable portfolio flows, especially for equities.

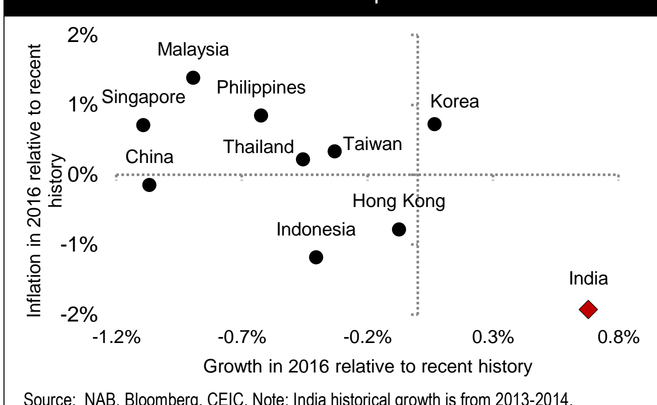
Korea might need to follow the U.S. rate hikes given the inflation outlook but recent official comments suggest that hikes will be delayed as much possible. The thin carry over the USD means the KRW is fairly vulnerable to higher US rates, especially with the USD/JPY rate still looking fairly buoyant.

Table 1: External fundamentals to contain impact of outflows

	Current Account to GDP	Import cover (mth)	6M Carry	GDP (2016,IMF)	Inflation (2016,IMF)
China	2.7%	24.2	4.7% (CNH) 8.7% (CNY)	6.3%	1.8%
HK	2.4%	7.8	0.5%	2.7%	3.0%
India	-1.3%	9.5	6.6%	7.5%	5.5%
Indonesia	-2.5%	7.6	10.6%	5.1%	5.4%
Korea	7.1%	5.8	1.9%	3.2%	1.8%
Malaysia	2.8%	13.0	3.9%	4.5%	3.8%
Philippines	4.0%	9.6	1.5%	6.3%	3.4%
Singapore	23.7%	20.9	0.4%	2.9%	1.8%
Taiwan	13.7%	20.9	0.4%	2.6%	1.0%
Thailand	6.1%	8.5	2.5%	3.2%	1.5%

Source: NAB, IMF, Bloomberg.

Chart 2: India stands out from the pack



Source: NAB, Bloomberg, CEIC. Note: India historical growth is from 2013-2014.

China Spotlight: SDR-Slowdown, Debt, Reserves

- **China is officially a member in the IMF SDR basket with a nearly 11% weight.**
- **USD/CNY traded higher in December and this trend looks set to persist in 2016.**
- **The CNY-CNH gap has widened as market conviction in a more market oriented currency took firmer hold.**
- **We think 2016 will be quite eventful for China and lack of orientation in global financial markets will keep policymakers busy.**
- **The headwinds to growth may reduce, but China will find that a bottom is still some distance away.**

Slowdown momentum may ease

Recent macro data performance continues to dance to a slow tune, but some hopes of recovery seem to be emerging if one looks closer. While manufacturing PMI fell to a three year low of 49.6, the Caixin PMI rose to a five month high of 48.6. Arguably, the Caixin PMI may be a closer indicator to overall growth performance as it tends to focus on smaller and medium-sized companies as compared to the official PMI. Furthermore, the improvement in the Caixin PMI was partly driven by a pick up in export orders and an improvement in the output component. Elsewhere, exports data has continued to disappoint while inflation showed a mild recovery and could be paving the way for a more convincing price recovery next year. Overall, there may be more conviction that the pace of China's growth slowdown has been arrested and that it will be a soft landing.

Debt cloud overhang

The Fed's rate hike cycle, however gradual, brings China's external debt issues to the forefront in 2016. The debt servicing burden will further increase if higher rates are accompanied by a firmer USD trend. As for the real USD demand for debt repayment, the BIS has just released a report on EM USD debt and data as of end 2Q 2015 indicated that China has USD17.3tn worth of non-financial corporate debt (in various currencies), but the USD share is only 5% or USD0.9tn. This contributes to the bulk of the USD1.18tn worth of USD debt and which includes that held by non-bank financial entities, non-financial corporations, governments, household and international organisations.

If that's an accurate reflection of the corporate borrowing situation, then expectations of significant USD demand as corporates deleverage may persist for some time. Furthermore, hedging demand will likely persist going forward. And there is no clear indication of the maturity profile of the bulk of USD debt in the form of USD bond issuances/loans by non-bank financial institutions, so that leaves room for more guesswork about upcoming USD requirements as the Fed proceeds with its hiking cycle.

Reserves a reservoir, not a river

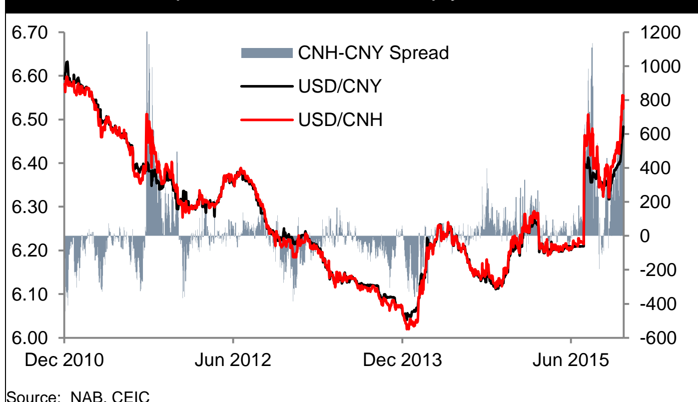
Heavy intervention is probably a thing of the past. The PBoC has to allow CNY to be more market-oriented and heavy intervention is not sustainable. After having drawn down nearly half a trillion dollars intervening in the currency market this year (in addition to other non-price interventions, for instance cutting offshore funding from onshore), market watchers are probably right in thinking that the central bank will not be as heavy-handed as it was before the SDR entry decision.

However, we are sensing that the recent price actions and corresponding "inaction" by the PBoC could be the real start of an FX regime shift. This could mean that the CNY/CNH gap may be allowed to stay wide or even widen further from here, as a precursor to further FX liberalisation. This does not mean the PBoC will stop intervening totally, but from time to time it will be conducting smoothing operations when market movements onshore threatens to become disorderly. In other words, the authorities may be more inclined to allow greater volatility in the offshore CNH market while still managing the onshore CNY movements.

With USD/CNH now trading above 6.50, the peaks last seen after 11 August devaluation, our view about the FX regime shift is being tested. We can categorise the recent USD buyers into a few groups:

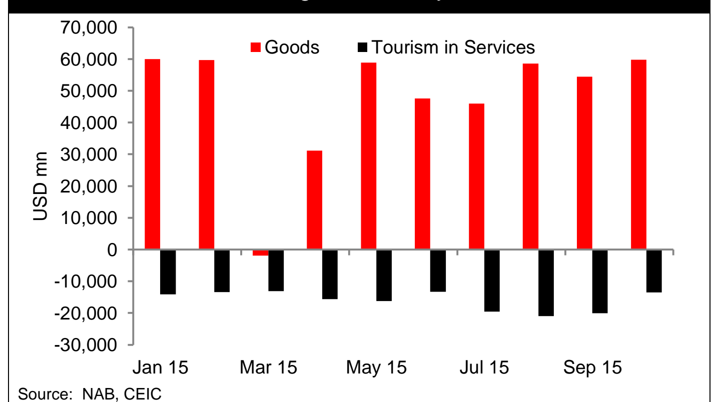
1) corporates who are buying USDs to repay debt/ hedge their exposure in the forward curve;
2) corporates who are buying USD/CNY onshore and selling USD/CNH offshore;
3) equities investors who utilise the HK-SH stock connect to chalk up FX gains; and
4) Others who anticipate corporates continuing to buy USDs to repay debt or hedge exposures.

Chart 3: CNH spread has widened sharply



Source: NAB, CEIC

Chart 4: CNY could be weighed down by Services deficit in CA



Source: NAB, CEIC

Accordingly, 12M CNH forward points have climbed higher to around 2000 points, indicating expectations for about 3.0% depreciation in the next twelve months, which is still rather contained and not exactly a crisis scenario. It is also reasonable to expect the forward points to stay elevated above 1500.

Weaker, from position of strength

On balance, we believe that the CNY will stay on a consolidative path in 2016, from a position of strength. Global demand recovery staying patchy is not likely to be a major deterrent for the CNY to regain some export competitiveness. Chart 7 below shows that China's export performance has been adversely affected by the CNY's strength on a REER basis.

The challenge, is to manage the decline in an orderly manner. A PBoC official mentioned recently in local media that China has in the past few years taken into account yuan appreciation when setting policies. Current financial and forex market fluctuations offer a chance for stress testing yuan internationalization. Recent rhetoric from the Chinese authorities suggest that Beijing recognises the depreciation pressure and saw it as important to assure that there is no basis for long term yuan devaluation. PBoC Deputy Governor Yi Gang said foreign exchange reforms aimed at building a market-oriented regime without government intervention, or a "clean float", will continue, but it needs a transitional period. The "managed float" regime will be maintained in the meantime.

More reforms from the new SDR member

China is officially the new member in the SDR club, alongside the existing four (USD, EUR, GBP, JPY) with the currency assigned a 10.9% weight.. As mentioned in our Asia Dashboard reports titled Time for the RMB to grow up (24 November) and New kid on the SDR bloc (1 December) we believe that with the RMB's admission into the IMF's SDR basket, China's government would have achieved a longstanding strategic goal and give the authorities a free hand let the currency drift according to market forces.

Along those lines, the authorities have also announced that the China Foreign Exchange Trade System (CFETS) will now be releasing an internally calculated variant of the trade-weighted index for the RMB that will "better capture the competitiveness of a country's goods and services, and better enable the exchange rate to adjust import, export, investment activities and the balance of payments position."

The CFETS RMB index (see below) are heavily weighted in the majors of the USD, EUR and JPY, but is also adapted to the specific nature of China's trading landscape, devoting 17.5% to the HKD, AUD and MYR. In total, these six currencies dominate the basket with 80% of the total weight. Given that the HKD is pegged to the USD, the latter can be seen as accounting for almost 33%.

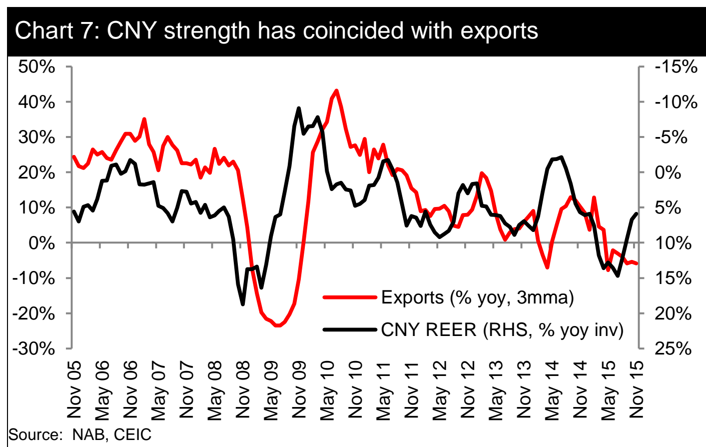
Table 1: CFETS RMB Index Weights

USD	26.40%	RUB	4.36%
EUR	21.39%	GBP	3.86%
JPY	14.68%	SGD	3.82%
HKD	6.55%	THB	3.33%
AUD	6.27%	CAD	2.53%
MYR	4.67%	CHF	1.51%
Sum of above six	**80.0%**	NZD	0.65%

Source: NAB, CFETS

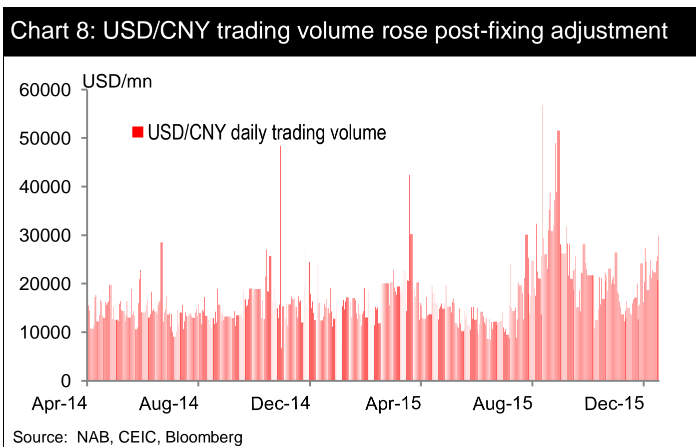
The shift in focus is likely to lead to a higher degree of volatility in the USD/CNY rate. Given that capital outflows from China continue to dominate and the EUR and JPY look set to remain weak against the USD, the move probably allows for a higher USD/CNY in the near term. For more on the CFETS RMB index, please refer to the *Asia Dashboard: RMB policy shapeshifts* of 14 December.

Chart 7: CNY strength has coincided with exports



Source: NAB, CEIC

Chart 8: USD/CNY trading volume rose post-fixing adjustment



Source: NAB, CEIC, Bloomberg

Korea Spotlight: Dovish Signal Renewed

- **Bank of Korea is expected to keep policy rates unchanged in coming months and may not immediately follow the Fed's rate hikes.**
- **The authorities are concerned about financial market uncertainties and continued disinflationary pressure from lower oil prices.**
- **In the meantime, USD/KRW is now closer to 1200 and a break above looks probably in light of weaker CNY and regional currencies.**

Neutral with a tinge of dovishness

The Bank of Korea left the benchmark rate unchanged at 1.5% in December, but post meeting comments were more dovish. BoK Governor Lee highlighted the disinflationary pressure stemming from the unexpected drop in oil prices, exerting downward pressure on the central bank's 1.7% inflation forecast for 2016. He also added that the expcted upcoming Fed rate hike would not immediately lead to interest rate rise in Korea, but said that the biggest risk from Fed rate increase could be financial market uncertainties. The policy statement also echoed his concerns with regards to exports weakness: Looking at the Korean economy, although domestic demand activities have sustained their paces of recovery, driven by consumption, the trend of declining exports has persisted while the improvement in economic agents' sentiments has been inadequate. The Board forecasts that the domestic economy will continue its recovery going forward, centering around domestic demand activities, but in view of external economic conditions judges the uncertainties surrounding the growth path to be high.

Consumer price inflation rose from 0.9% the month before to 1.0% in November, due mainly to a narrowing of the scale of decline in petroleum product prices and to expansions in the range of services seeing fee increases. Core inflation excluding agricultural and petroleum product prices also rose to 2.4%, from 2.3% in October. Looking ahead the central bank board forecasts that inflation will continue at a low level, due mainly to the effects of the low oil prices.

Modest revival in risk appetite may cushion KRW

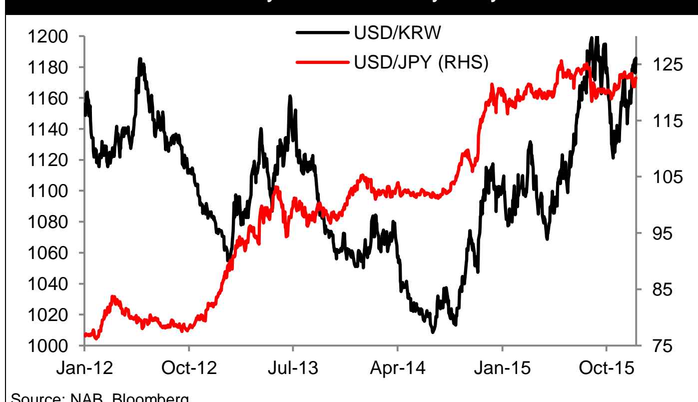
USD/KRW finally broke above 1180.0 in December, as renewed weakness in CNY after China's entry into the IMF SDR basket provided an added impetus. The BoK's dovish signals also reaffirmed market views that any policy tightening is likely to be later rather than sooner. We think that the KRW will continue to track the weaker trend in CNY and regional currencies, though the lower oil prices could provide some reprieve for Korea's current account performance.

Taking a step forward in FX Liberalisation

South Korea is seeking to allow local brokerages and insurers to engage in foreign exchange (FX) transactions starting in late February. The finance ministry said it will revise the country's Foreign Exchange Transaction Act to remove many restrictions, which will expand the scope of the financial market and create more business opportunities. In the past, only large commercial banks were allowed to engage in FX business, although non-financial companies were allowed restricted access in certain cases. This kind of practice had drawn flak for hindering growth and undermining the country's overall competitiveness.

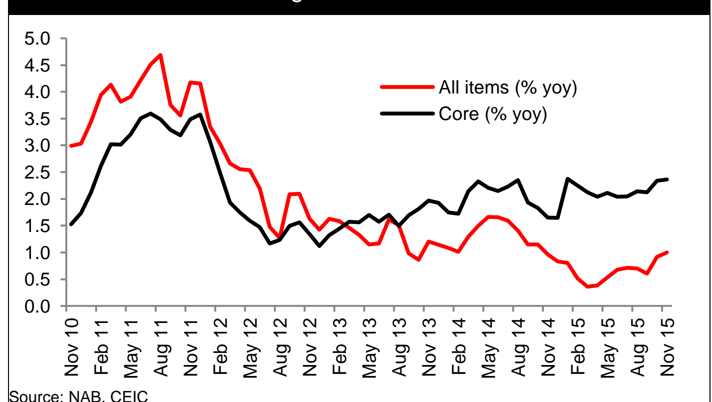
He said while restrictions will be lifted, the government will strengthen oversight to ensure that securities and insurance companies do not abuse the changes or engage in transactions that exposes them to excessive risks. The official said firms that engage in foreign exchange transactions will be subject to regulations roughly on par with those implemented on banks. In regards to banks that may lose some of their business, the ministry pointed out that a larger foreign exchange market will eventually benefit big institutions.

Chart 5: USD/KRW likely to remain buoyed by USD/JPY



Source: NAB, Bloomberg

Chart 6: Inflation bottoming out at low level



Source: NAB, CEIC

India Spotlight: Positives Increase for INR

- **A healthy positive carry and potentially strong portfolio flows into Indian bonds and equities, means that the INR could be one of the outperformers in EM Asia in 2016.**
- **Growth momentum looks set to remain strong, with domestic growth engines revving up nicely.**
- **If early passage of reforms like the GST in April 2016 starts to look likely, increased portfolio inflows could be induced.**

India's fundamentals most positive in Asia

India's growth and inflation for 2016 place it at front of the pack in Asia. NAB's India economist John Sharma expects another 50bps worth of cuts sometime in the year. With the current account deficit having shrunk to a very manageable 1.3% of GDP, India is no longer "fragile" like it was in 2013. We expect the INR's rather healthy carry to see the USD/INR remaining relatively stable at 66 for 2016, outperforming its Asian counterparts

Domestic demand to drive growth

3Q 2015 saw strong growth of 7.4% yoy which keeps the Jan-Sep 2015 growth rate at 7.3% yoy. This is by some distance the strongest growth rate in Asia and is likely to be sustained through much of 2016. Private consumption grew 6.8% yoy and contributed 3.8ppts to the growth rate with GFCF, which grew 6.8% yoy, chipping in with another 2.1ppt to the growth rate. Inventory growth contributed only 0.1ppt to growth. Net exports remained weak and contributed only 0.7ppt to growth.

Industrial production of capital goods and consumer durables was up 13.8% and 11.8% yoy respectively in 3Q, with the former also seeing strong qoq growth of 13.2%. Looking ahead, modelling by NAB Economics using leading indicators suggest an improvement in the coming quarters. Industrial production is expected to pick up, and grow by 7% in yoy terms by the June quarter, 2016. This will, of course, depend on progress made in reducing supply bottlenecks and reform measures such as the Goods and Services Tax (GST).

The strong momentum is supportive of NAB's outlook for GDP growth of 7.5% in 2015 and 7.6% in 2016. The 7th Pay Commission is proposing a 23.55% increase in wages and allowances for government employees; this has the potential to raise future consumption expenditure. However, the view is also for the economy to be aided by another 50 basis points of rate cuts in 2016.

Higher INR interest rates to provide buffer

The 50 basis point rate in October, along with the robust growth momentum, will probably give the RBI the room to maintain stable rates for the next few months at least and following "lift-off" by the U.S. Federal Reserve.

The INR enjoys the second largest carry in EM Asia behind only the Indonesian Rupiah but India has significantly healthier fundamentals than Indonesia so the high carry is likely to be much more meaningful for the INR than the rupiah.

GST could provide an extra boost

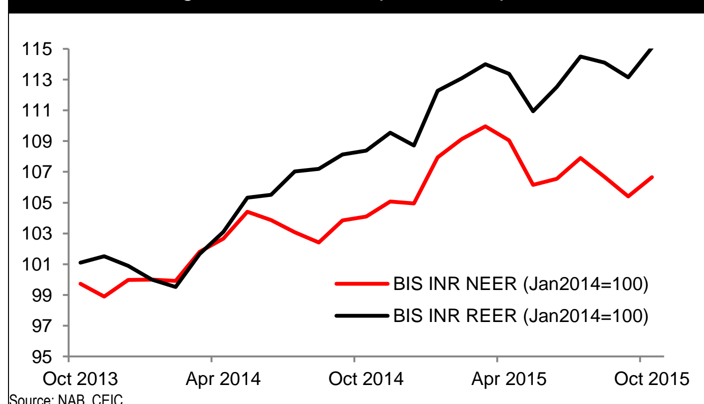
While negotiations are still underway and continue to look difficult, the government has put together a proposal that seems to tick all the boxes required by the opposition in the legislature. The proposal is for a standard rate of 17-18%, which is above the 15.0-15.5% revenue-neutral rate, but below rates of around 20-27% that were feared might raise inflation. The GST is expected to both reduce the tax burden on goods that consumers currently face, estimated at 25-30% at the moment. It should also bode well for the fiscal deficit. This could in turn reduce the size of issuance in the months to come.

Fed "lift-off" could shift focus to INR

The start of the U.S. normalization of interest rates could shift the spotlight to the INR . The strong growth momentum in itself should see Indian equities remain relatively attractive. Indian bonds should also remain relatively resilient given that the reduced risk of GST-linked inflation maintains the likelihood that the RBI could still ease rates in the later part of 2016.

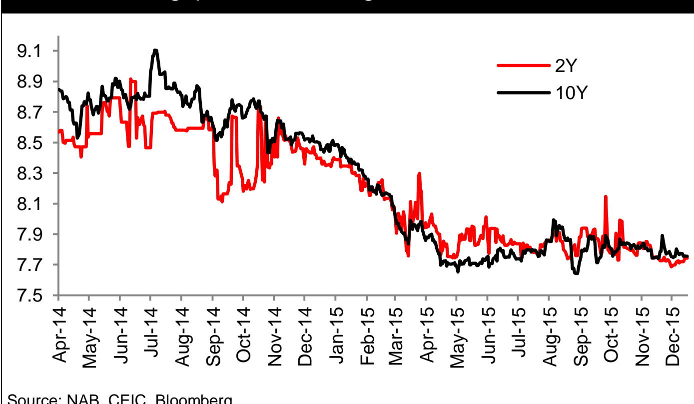
Portfolio inflows are therefore likely to remain relatively strong vis-à-vis other EM Asia counterparts; this is definitely something to keep an eye on.

Chart 9: INR might continue to outperform its peers



Source: NAB, CEIC

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



Source: NAB, CEIC, Bloomberg

Singapore Spotlight: Going with the Flow

- **Singapore barely avoided a technical recession in Q3 2015 on the back of the services sector but growth remains fragile.**
- **External factors are likely to continue to be the dominant determinants for the SGD, especially the USD and CNY.**
- **Monetary policy is likely to remain broadly unchanged given that the economy is running at full capacity.**

2016 growth expected to slow, but still robust

Economic data continues to point to some increasing stability in economic activity but the economy does still remain somewhat soft. A technical recession was avoided in Q3, but only just, with the economy growing just 0.1% qoq SAAR – fine margins indeed.

Table 1: Economy stabilizing but still fragile

	IP	Core CPI	PMI	NODX
Actual	-5.4%	0.3%	49.2	-0.5%
BBG consensus	**-5.3%**	**0.6%**	49.0	-3.0%
Previous	-4.8%	0.6%	48.9	0.3%

Expectations for 2016 though remain fairly robust. The December 2015 MAS Survey of Professional Forecasters yielded median GDP growth expectations of 2.2% for 2016 and inflation expectations of 0.5% and 1.0% for headline and core respectively for 2016. Services, especially finance, is expected to lead growth, with manufacturing set to underperform significantly. Private consumption is also expected to remain robust and grow by 2.8% in 2016.

S$NEER has room to slip lower within the band

By our estimation, the S$NEER has drifted up towards the centre of the band and is now around 0.2-0.3% below it – a large part of the reason for that undoubtedly is the weakening of the RMB since the IMF announced its inclusion into the SDR basket on 30 November 2015.

The MAS survey also indicated an expectation that the USD/SGD rate will head towards 1.47 in 2016, in line with NAB's view of a 1.48 target on the pair towards the end of 2016 on the back of broad USD strength, especially against EM Asia currencies.

With the SGD likely to weaken along with most other Asian currencies, the S$NEER is likely to remain comfortably within the lower half of the policy band. Given that the S$NEER is probably close to the mid-point at this time, there will likely be enough downside room to allow the MAS to keep its policy stance unchanged.

MAS might not need to adjust policy band

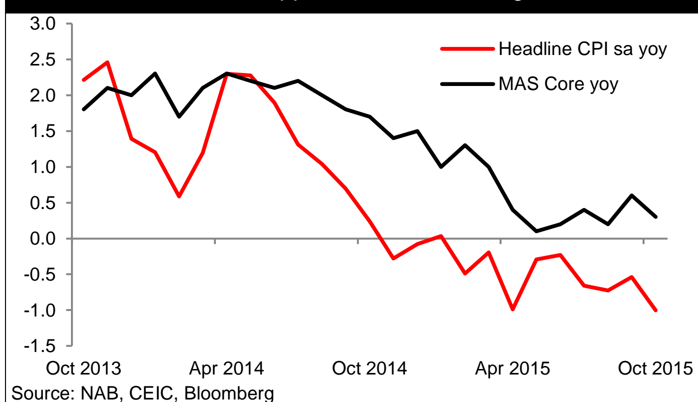
The SGD is unlikely to underperform its regional peers so there should be enough room within the existing policy band to allow for that move without the MAS needing to adjust the band. This is especially so given that the RMB looks likely to keep depreciating against the USD through 2016 as well.

While benign inflation does provide some room for the MAS to lower the policy band should the S$NEER approach the floor of the band, there are quite a few other factors to hold them back. For one, growth is still pretty healthy, especially in the context of sustained healthy growth over the last 4-5 years. Furthermore, the unemployment rate remains a very low 2.1% and immigration policy remains rather tight at the moment. Additionally, fiscal policy is currently already in an expansionary state so it really is quite hard to justify adding on a significant amount of monetary stimulus.

Policy risks to the SGD

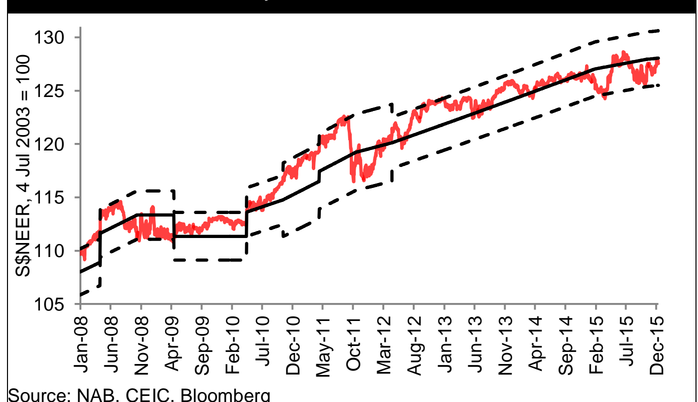
One interesting potential event that might disrupt this narrative would be a relaxation of the restrictions on labour imports. This would open up the way for the economy too absorb more stimulus and the authorities might gradually shift towards this since there has not been any overt reversal of the medium term population growth projection. Any sudden weakness in growth could accelerate this and prompt the authorities to also pull the monetary policy lever as well.

Chart 12: Core inflation appears to be bottoming



Source: NAB, CEIC, Bloomberg

Chart 13: S$NEER likely to remain in lower half of band



Source: NAB, CEIC, Bloomberg

Asian Elections 2016: Taiwan General Election

- **Taiwan elects a new president on 16 Jan next year. The USD/TWD has trended lower in the month after each of the last 5 elections but the stock market has been less consistent.**

When: Friday 16 January 2016, polling stations open from 8am to 4pm.

What: Election for the 14th President, Vice President and members of the 9th Legislative Yuan.

Each presidential candidate has a vice-presidential running mate on the same ticket, to be elected using the first-past-the-post system. Due to the two-term limits in the Constitution, incumbent president Ma Ying-jeou cannot seek re-election. This will be the sixth direct election of the presidential and vice-presidential by citizens of Taiwan, as these officers were previously indirectly elected by the National Assembly prior to 1996.

In a separate set of ballots, the 113 seats in the Legislative Yuan are elected by two methods: 73 are elected in geographical constituency using the first-past-the-post system, 6 are elected from two 3-member Taiwanese aboriginal constituencies using the single non-transferable vote system. The remaining 34 are elected by closed list proportional representation in a single nationwide constituency which will include at least half of these seats (17) for females.

All three presidential candidates announced their respective running mates in November 2015. For the first time in Republic of China electoral history, no vice presidential candidate shares a party affiliation with any presidential candidate.

Candidate	Party	Running Mate (Party)
Tsai Ing-wen	Democratic Progressive Party	Chen Chien-jen (Independent)
Eric Chu	Kuomintang	Wang Ju-hsuan (Independent)
James Soong	People First Party	Hsu Hsin-ying (Minkuotang)

2012 Election results		
President and VP candidates	**Votes**	**% votes**
Ma Ying Jeou and Wu Den Yih	6,891,139	51.60%
Tsai Ing-wen and Su Jia Chyuan	6,093,578	45.63%
James Soong and Lin Ruey Shiung	369,588	2.77%

Source: Central Election Commission

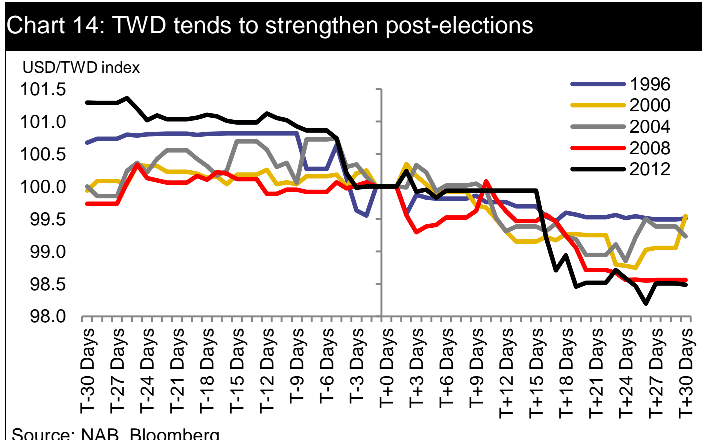
The Kuomintang party appeared to have improved its chances in the 2016 presidential elections by replacing deputy legislative speaker Hung Hsiu-chu with party chairman Eric Chu. The change took place just three months before the elections, after it became evident that Hung's strong "one-China" ideology was very unpopular not only with the masses, but even within the party itself.

However, opinion polls are still favoring DPP presidential candidate Tsai Ing-wen. She has adopted a more centrist position than her predecessor Chen Shui-bian, who served two terms from 2000-2008. According to observers, Tsai has taken a more subdued approach to cross-straits relations and vowed to maintain the "status quo" under the current constitutional framework of the Republic of China and seek continuity in the relationship with Beijing. She has focused her campaign on domestic factors and avoided the "independence clause" in the party charter and instead uses "Revolution of Taiwan's Future[1]" – that Taiwan is already an independent state - as a signal that she did not intend to make cross-straits relations a major factor in her campaign.

For the past five presidential elections, USD/TWD has traded lower 30 days after polling day. Admittedly, there was a spike post polling days of 2000 and 2004, after the victory of DPP candidate Chen Shui-bian, but it was brief and swiftly followed by over 20 days of declines. In 2012 as well when President Ma Ying-jeou was re-elected, USD/TWD registered a small spike right after the onshore FX market re-opened, only to consolidate before the week-long Lunar New Year holiday from 23 to 27 January. Depreciation in USD/TWD followed through post holiday and the extent of depreciation in USD/TWD exceeded the past election episodes. To a large extent, the outcome was very much expected, so the decline in USD/TWD was probably a reflection of reduction in perceived risk after polling day.

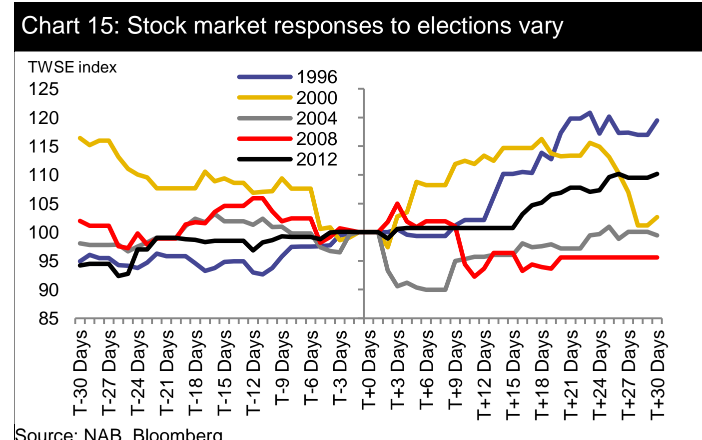
[1] http://www.taiwandc.org/nws-9920.htm

Chart 14: TWD tends to strengthen post-elections



Source: NAB, Bloomberg

Chart 15: Stock market responses to elections vary



Source: NAB, 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	0.61	0.61	0.61	0.60	0.60	0.61
Japanese yen	USD/JPY	121	122	123	124	125	127	126
Euro	EUR/USD	1.06	1.05	1.05	1.06	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	1.40	1.47	1.47	1.46	1.46	1.44	1.43
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

Global growth forecasts % change yoy							
Country/region	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
United States	1.6	2.2	1.5	2.4	2.5	2.4	2.3
Japan	-0.4	1.7	1.6	-0.1	0.6	1.1	0.9
Euro-zone	1.7	-0.8	-0.2	0.9	1.4	1.7	1.9
United Kingdom	2.0	1.2	2.2	2.9	2.4	2.3	2.2
Emerging Asia	4.4	4.6	4.2	4.0	3.7	3.8	4.1
Latin America	4.9	2.5	2.6	0.9	-0.2	1.1	1.6
China	9.3	7.8	7.7	7.3	6.9	6.7	6.5
Canada	3.0	1.9	2.0	2.4	1.0	1.7	1.8
Australia	2.7	3.5	2.0	2.6	2.4	2.7	3.0
New Zealand	1.8	2.4	2.3	3.3	2.2	1.8	2.0
India	7.9	4.9	6.4	7.1	7.5	7.6	7.4
Africa	5.4	4.4	5.2	5.0	3.8	4.3	4.0
Eastern Europe	5.4	1.4	2.9	2.8	3.0	2.9	2.6
Middle East	3.9	4.8	2.4	2.7	2.7	2.5	2.5
Other advanced	3.3	2.0	2.2	2.8	2.3	2.4	2.6
World	4.39	3.38	3.27	3.30	2.99	3.18	3.32

Source all tables: National Australia Bank

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