

ESSENTIAL ASIA

Surface Tension



In this issue

Differentiation in the melting pot	2
China Spotlight: Sunshine with a chance of storm	3
Korea Spotlight: Politically unscathed	4
India Spotlight: All set for an Indian summer	5
Singapore Spotlight: Great expectations	6
Malaysia Spotlight: Inflation creeps into the picture	7
Indonesia Spotlight: Stuck in the middle with you	8
Selected Indicators	9

Talking Points

- The two-way risks for the USD from Trump's policy maneuvers are increasingly leaning towards more softness.
- The calendar ahead is full of event risks globally and the jury is out on which currencies will emerge from all these relatively unscathed.
- In Asia, in the event that further softness in the USD motivates a more aggressive Fed, selected currencies will be more susceptible.

Recent Reports

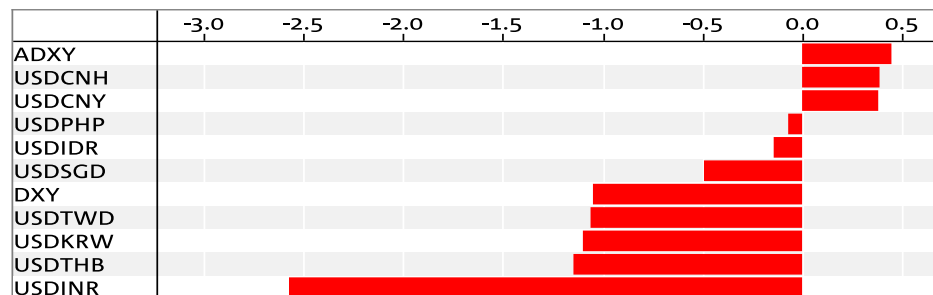
- 20 March 2017 – China Economic Update: Rise of the machines
- 15 March 2017 – Australia Economic Update: Financial stability to keep RBA at bay
- 08 March 2017 – US Economic Update: Nearly two months of Trump

Please request a copy from nab.markets.research@nab.com.au

Trade recommendations

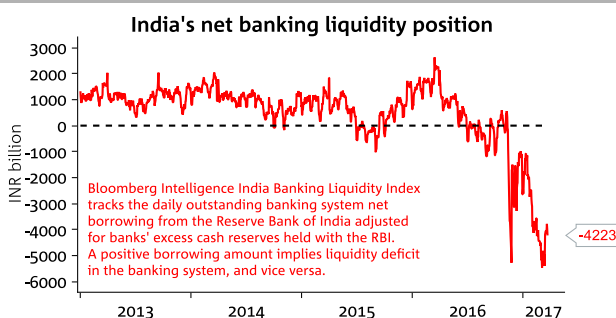
Entry Date	Currency pair	Recommendation	Opening level	Target	Stop
Nov 01	USD/KRW 6m NDF	Long	1140.15 (spot ref 1139.77)	1220	1110

Asia FX this month



Source: National Australia Bank, Bloomberg, Macrobond

Chart of the month



Source: National Australia Bank, Bloomberg, Macrobond

Asia Policy Rates

	Q1 2016	Q2 2016	Q3 2016	Q4 2016	Q1 2017	Q2 2017	Q3 2017	Q4 2017
Korea	1.50	1.25	1.25	1.25	1.00	1.00	1.00	1.00
Thailand	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
Malaysia	3.25	3.25	3.00	3.00	2.75	2.75	2.75	3.00
India	6.75	6.50	6.50	6.00	6.00	6.00	6.00	6.00
Indonesia	5.50	5.25	5.00	4.75	4.75	4.75	4.75	4.75
China	4.35	4.35	4.35	4.35	4.35	4.10	4.10	4.10

DIFFERENTIATION IN THE MELTING POT

- The two-way risks for the USD from Trump's policy maneuvers are increasingly leaning towards more softness, on the back of the latest failure to pass the Health Care bill
- The calendar ahead is full of event risks globally and the jury is out on which currencies will emerge from all these relatively unscathed
- In Asia, in the event that further softness in the USD motivates a more aggressive Fed, selected currencies will be more susceptible to deeper negative interest rate differentials with the US

The USD's softness has "strengthened", ironic as it sounds. Perhaps it is more apt to say that the USD is increasingly depicting a soft Trump environment. More evidence has emerged on that front, the latest being the failure to pass the Health Care bill, and before that, the restraining order against his executive order to ban travels from seven majority-Muslim countries. Understandably, tax policies and trade policies will come into sharper focus going forward. It is widely perceived that there is even greater urgency for Trump to start delivering his promises as the clock ticks towards his 100th day in office by end April.

We are mindful of the event risks ahead, with the UK having triggered Article 50 and Europe's forthcoming response. The prospect of China being labelled a currency manipulator grows in April with the US Treasury report potentially released. However, but then there's the Trump-Xi official meeting in Florida in early April that may motivate a delay in the Treasury report release. The other key risk event could well be the US budget blueprint in May. By then, should Trump continue to be impeded from delivering his fiscal promises, he just might find it increasingly compelling to exercise his executive powers on harsh measures on trade policies.

Renewed focus on interest rate differentials...

In the event that further softness in the USD motivates a more aggressive Fed, selected Asian currencies will be more susceptible to narrowing interest rate differentials with the US. Potentially, KRW, TWD, THB and to a lesser extent SGD are higher on the risk radar in that regard. The interest rate differentials between THB, KRW and SGD have turned negative since the middle of last year, but probably have not featured as a key factor driving these Asian currencies, as other factors like Brexit,

US elections and the Fed's benign rate hike expectations dominated.

This year, with the Trump reflation trade hitting a bump, these currencies have been appreciating strongly vs the USD. Year to date, KRW, TWD and THB have appreciated 8.5%, 6.9% and 4.0% respectively.

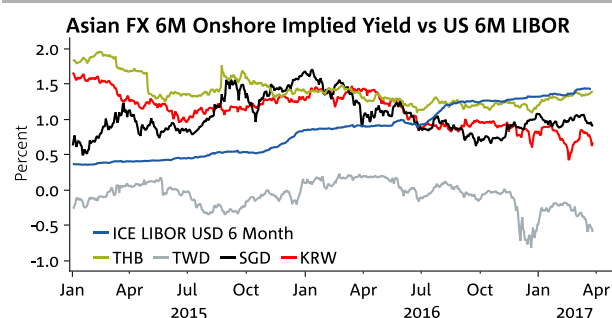
To slice the risk even further, portfolio inflows have been robust to these markets, in the equities complex for Taiwan (\$5.0bn inflows year to date) and in the debt market for Thailand (2.1bn inflows year to date). Korea has seen a whopping \$10bn worth of inflows into its local bond market and \$4.7bn into its equities market. It is probably reasonable to say that the KRW and THB will be more sensitive to shifts in interest rate expectations in the US driving flows their debt markets while the TWD may be more sensitive to shifts in global risk appetite.

The SGD may be less impacted as the macro indicators of growth and inflation suggest that the MAS may start tightening in October.

...may lead to Asian FX differentiation

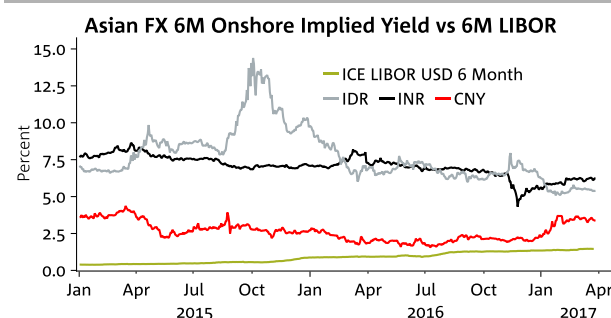
The other Asian currencies continue to hold some interest rate premium over the USD quite comfortably. Administratively, China had raised its interbank rates to slow the narrowing interest rate differentials and the Reserve Bank of India has hiked rates recently. These are, to a certain extent, pre-emptive moves to ward off speculative attacks on the local currencies. Bank Indonesia has also stopped cutting rates and is expected to hold the benchmark rate unchanged for the rest of the year. The relative attractiveness of these currencies from the carry perspective may provide a differentiated path for Asian currencies movements in the near term.

Chart 1: Negative i/r differentials may start to feature



Source: National Australia Bank, Bloomberg, Macrobond

Chart 2: Differentiation with CNY, INR, IDR



Source: National Australia Bank, Bloomberg, Macrobond

CHINA SPOTLIGHT:

Sunshine with a chance of storm

- Trump-Xi meeting in Florida may bring optimism for sunshine for bilateral relationship, yet it is advisable to brace for storm.
- The USD's ongoing softness makes it a greater challenge to label China a currency manipulator in April.
- China opportunistically seizes the window availed by the Fed's 25bp hike and a stable RMB to push through deleveraging in the domestic banking system.

No discord, no concord, no Mar-A-Lago ?

As more USD bulls abandon the arena, the remaining conviction over an aggressive US trade policy is put to the test. Arguably, the more resistance Trump faces in Congress over domestic policies of fiscal reform and healthcare, the risk that trade policy returns in sharper focus could increase measurably. A couple of risk events in the coming months could provide some clarity along these lines. On 6-7 April, the state of Sino-US political relations may be displayed through the meeting of both heads at Palm Beach Trump Summit. The venue is conducive for establishing diplomacy, but both sides have a long list of hot topics to tackle, including the Chinese currency, trade, the South China Sea, and the Korean peninsula, along with other regional and world issues. Their meeting can qualify as a success if both send a clear and strong message to pursue a constructive, not confrontational, relationship and restore a measure of stability to the bilateral relationship. Initial plans to visit Trump's residence in Mar-A-Lago appeared to have been shelved, suggesting that this trip is confined to formal discussions.

The meeting is likely to precede the semi-annual US Treasury Report, typically released in April. This is the first report under Trump administration and it appears there is increasing motivation to show that his 100 day plans still holds some clout, and that will mean naming China (potentially with Korea and Germany) a currency manipulator. There is a risk, and potentially motivation, for the US Treasury to delay the release of this report, so as not to dent the fragile balance so soon after the presidents' meeting, but yet preserve the option to do it later.

The other key risk event could well be the US budget blueprint in May. By then, should Trump continue to be impeded from delivering his fiscal promises, he just might find it increasingly compelling to exercise his executive powers on harsh measures on trade policies.

Meanwhile, the middle kingdom deleverages

The PBoC responded to the US Fed's 25bp hike in March with a 10bp hike in the reverse repo and MLF rates. Immediately after, the PBoC took the trouble to explicitly state that the higher rates do not indicate a change in monetary policy stance.

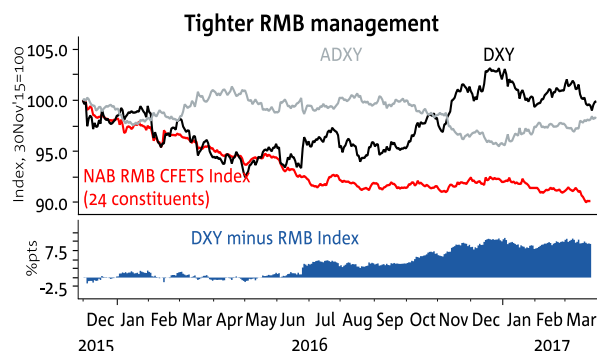
Following that, the rising theme over the past week was tighter liquidity in the domestic interbank market, to the extent that some financial institutions actually missed their interbank payments. Going ahead, as the Fed continues to adjust rate higher, we can also expect the PBoC to guide the interbank rates higher along the way. Part of the motivation for such a move (Fed has hiked 50bp since December and PBoC has only hiked MLF rates by 20bp) is to slow the narrowing interest rate differential between the US and China and consequently, mute its potential impact on CNY and capital flows.

The PBoC has, in its recent press conference during the NPC, affirmed a "prudent and neutral" policy stance for 2017. The general reluctance to hike benchmark rates comes with the heavy debt burden and slower growth prospects, but should inflation continue to push real rates into negative territory on a sustainable basis, we can see that as a sufficient trigger to adjust nominal rates higher. This is not a visible threat as yet but worth monitoring. Rising property prices may provide an added push for higher rates. The rise in February was sufficient to trigger another round of tightening, where buyers with pre-owned properties outside Beijing will have to pay at least 80% down payment for a unit in Beijing.

Surge in imports – trend or aberration ?

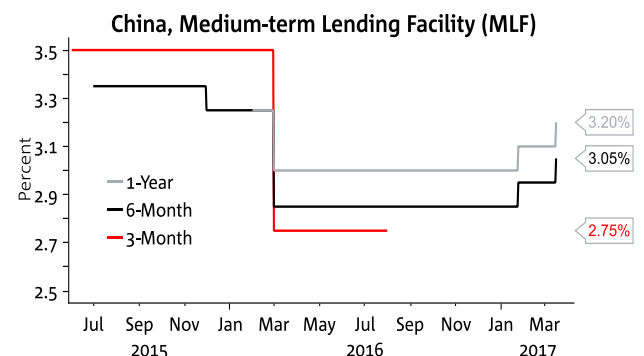
Seasonal factors notwithstanding, February exports were surprisingly low, contracting 1.3% yoy while imports surged massively with 38% growth. Overall trade went into \$9.1bn deficit. This is the first trade deficit since February 2014 and it seems the trend of import recovery is outpacing external demand for Chinese goods. While preliminary, Chinese businesses could be frontloading imports for future exports, perhaps on rising concerns with regards to border tax. If that's the case, we may see better export performance in coming months, with the caveat that the CNY does not strengthen further.

Chart 1: Tapering DXY-RMBX gap



Source: National Australia Bank, Macrobond

Chart 2: MLF rates on the rise along with US rates



Source: National Australia Bank, Bloomberg, Macrobond

KOREA SPOTLIGHT:

Politically unscathed

- President Park's impeachment paving the way for a presidential election and North Korea's missile launches failed to dent investors' sentiment for the Korean won
- The won's strength and resilience may be put to the test should the US may seek to renegotiate or even pull out from the Korea-US free trade agreement (KORUS)

An opposition party president

Koreans go to the polls on 9 May to elect a new president and given the extent of public anger against former president Park and her ruling party, the next president is likely to come from one of the main opposition parties. Recent polls suggest Moon Jae-In of the Democratic Party (DPK), who ran against Park in the 2012 presidential election, to be the front-runner. It is noteworthy that he supports engagement with North Korea and increased government spending to create more jobs.

Moon Jae-In's closest rival for the presidency is the People's Party's Ahn Cheol-soo, who is popular with conservative voters. Hong Joon-pyo, the governor of South Gyeongsang province, is set to be the candidate for Park's ruling Liberty Korea Party, but is currently in fifth place in opinion polls and has little chance of victory.

There are several immediate challenges facing the next president, including Chinese retaliation to Korea's plans to deploy a US anti-missile defence system, high levels of household debt and a rapidly ageing population.

The won has emerged unscathed

The won has continued to ignore the political fiasco and USD/KRW peaked around 1161 and fell swiftly after the impeachment was upheld on 10 March. The real effective exchange rate of the Korean won has soared most among 27 currencies of the countries in the world with highest trade volume. According to the Bank for International Settlements on 19 March, the won's real effective exchange rate as of the end of February this year was 122.34 (2010 = 100), up 3.2% from the end of last year (118.53).

The 27 major economies include the United States, Britain, Japan, and Germany as well as 19 Eurozone economies. The 14 countries whose real effective exchange rate has increased among the 27 nations were Korea (3.2%), Australia (2.6%), Sweden (2.3%), Mexico (2.2%), and Canada (2.0%).

This should help allay the emerging concerns over the prospect that the US is seeking a renegotiation of the KORUS FTA pact, after a US Trade Representative report saying that the Korea deal "coincided with a dramatic increase" in the US trade deficit with the South was released. The report noted that the total value of US goods exported to South Korea fell by \$1.2 billion, while US imports of goods from South Korea grew by more than \$13 billion.

Arguably, according to Donald Manzullo, a former congressman who served as chairman of the Foreign Relations Subcommittee on Asia and the Pacific, the KORUS FTA has brought about increases in overall US exports to the South Korea as well as better paying jobs to American workers. Specifically, the US' services trade surplus with Korea hit another record-high for 2016. When service sector exports are included, the bilateral US-Korea trade deficit drops to \$17.5 billion, revealing a more accurate picture of the trade relationship. In addition, according to the US Commerce Department, 358,000 US workers owed their jobs to exports to Korea in 2015, an increase of 87,000 jobs since 2009. The increase was most pronounced in the merchandise export sector, which added 55,000 jobs in the same time period. These trade-related jobs have the external benefits of paying higher salaries, 18% higher than other jobs on average.

Realistically, export growth to the US has paled in comparison to other major destinations like China, EU and Japan. In sum, the won's real appreciation and modest recovery in export growth to the US may be mitigating factors against harsh trade measures on Korea.

Chart 1: Portfolio inflows contributed to KRW vigour

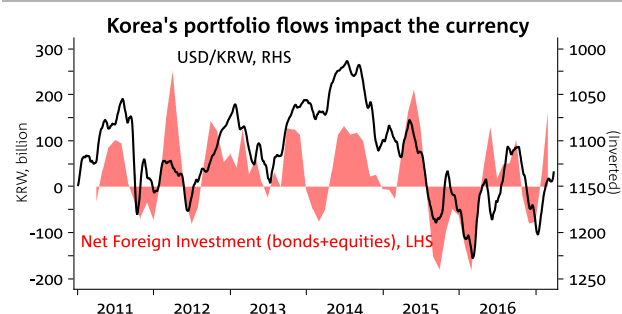
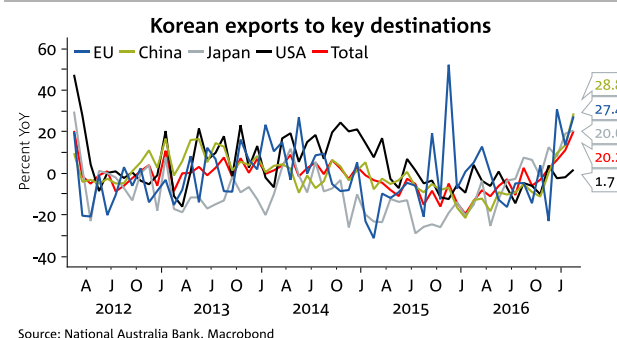


Chart 2: Exports to non-US destinations holding up



INDIA SPOTLIGHT:

All set for an Indian summer

- The BJP's strong showing in the UP elections suggests that the political backlash from the demonetization measure is quite limited.
- This is in line with data continuing to indicate that the negative economic impact is going to be transitory.
- With US rate hikes potentially a key theme for the rest of the year, the INR's high carry could make it one of the region's preferred currencies.

March has seen two major positive events for Indian financial assets that indicate that the negative impact of the demonetization measure in November is not likely to be enduring. Combined, these indicate that the medium term growth outlook is still fairly positive, especially if the political consolidation under the BJP is used to promote reforms without letting the darker side of the BJP platform run riot.

Strong economic growth, a healthy carry buffer, and an interventionist central bank that is willing to keep the USD/INR in a tight range, should all contribute towards making the INR potentially the most attractive Asian currency.

Win in Uttar Pradesh (UP) renews mandate

Prime Minister Narendra Modi's ruling Bharatiya Janata Party (BJP) surprised India watchers with a really strong showing in the regional elections in Manipur, Punjab, Uttarakhand, and Uttar Pradesh (UP), where the BJP won 325 of the 403 seats.

The wins are significant for the fact that it indicates that there is almost no political backlash from the difficult demonetization measure introduced in November 2016. This is in turn important because it sets the Modi government up for a second term, and it potentially emboldens the government in the area of reforms.

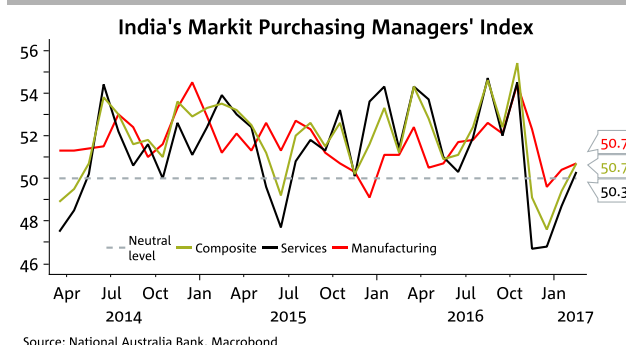
The Modi government has already demonstrated an appetite for reforms way before this latest round of elections. Besides the demonetization, which was primarily a means to increase financial inclusion, there was also the passage of legislation to streamline bankruptcy laws, and also the introduction of the Goods & Services Tax (GST), amongst others. These moves should reassure longer term investors into the stock

market. The one caveat is that Modi will need to rein in hardline elements within the BJP to avoid spooking foreign investors.

Economic picture looking fairly bright

Increasingly, the emerging economic data is suggesting that the disruption from the demonetization measure is not going to be too severe. Liquidity balances suggests that the inflow of funds into the banking sector has been quite substantial and net borrowing from the Reserve Bank of India has turned negative. The PMI for both Services and Manufacturing have rebounded strongly from December's trough and both have now crept above the neutral 50 level. This is line with other real economy data from January that also points to a rather quick rebound in economic activity.

Chart 3: PMI suggests sentiment is recovering fast



RBI might now focus on inflation

The RBI has of late started to talk about inflation and certainly the latest inflation data has come in stronger than expected. The RBI seems to be looking to manage it via a combination of tighter onshore liquidity and letting the INR appreciate somewhat. INR appreciation though will not be a reliable tool given that the real exchange rate will also be a cause of concern over competitiveness. Indeed, rumours of RBI buying of USD/INR around 65.5 suggest that the RBI's threshold of INR strength has been exhausted. Indeed, the RBI has announced that it plans to introduce a new liquidity management tool called the Standing Deposit Facility. With the RBI likely to leave the USD/INR at these lower levels, while tightening liquidity, a lower projected USD/INR trajectory is justified – we see downside risks to our forecasts for the pair at 66.50 in June and 67.50 in December 2017. The forecasts were premised on possible US-China trade tensions.

Chart 1: Banks awashed in cash

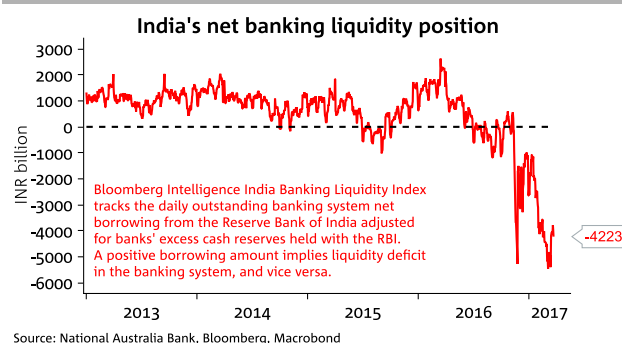
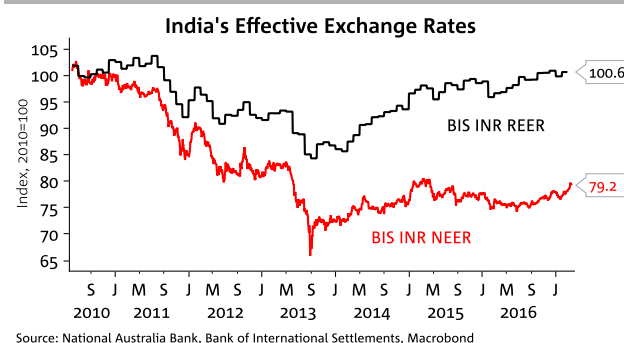


Chart 2: Growing inflation pressures on INR NEER



SINGAPORE SPOTLIGHT:

Great expectations

- Expectations for Singapore's 2017 GDP growth appear to have improved sharply due to a strongly bullish outlook on global demand.
- Although exports across the region have improved, the jobs situation has not significantly improved yet.
- The nascent improvement in the data is not likely to be sufficient to persuade the MAS to tighten in April, especially with the potential for trade tensions still looming.

The strong showing in global equity markets and improving data in both the US and China seem to have fed into expectations on Singapore's GDP growth. The Monetary Authority of Singapore (MAS) survey of professional forecasters has seen a sharp upgrade in the 2017 growth projection almost entirely on the back of a better outlook for manufacturing and exports.

The MAS though is not likely to be swayed into thinking that it has to act just yet. There is still not much inflation pressure and the jobs market still appears to be somewhat soft. Additionally, the MAS might not be as sanguine as the market is on the global risk situation given the French and German elections still to come and the Trump administration not yet on a firm footing with its policy agenda and still keeping the threat of trade tensions with China alive.

Markets croon, forecasters swoon

March's survey saw forecasters appear to have caught the exuberance of the global equity markets and raised their 2017 growth expectations from 1.5% to 2.3% largely on the back of a surge in expected growth in Manufacturing from 1.1% to 4.5%, driven largely by a rise in the expected non-oil domestic exports (NODX) growth from 0.3% to 6.1%.

The bullishness seems to be a little dubious given that the other sectors were not seen in anything approaching a similar light: expected Finance & Insurance growth rose from 1.8% to just 2.0% with Construction growth actually falling from 2.4% to just 0.3%. Expected private consumption growth meanwhile also fell from 1.5% to 1.1%.

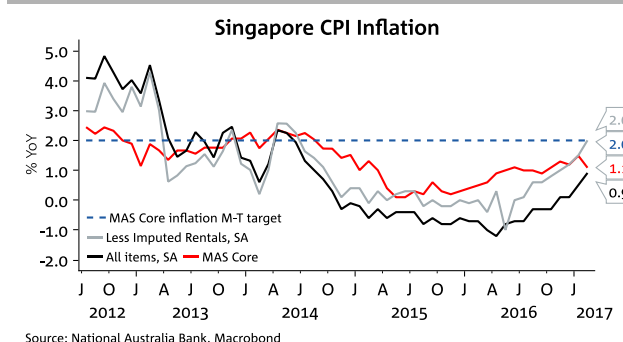
For Q1 2017, growth is expected to come in at 2.6% yoy, from 2.9% in Q4 2016. The sheer bullishness and

unevenness of the expectations suggests that some adjustments will take place in the months ahead and the MAS is likely to want to wait for things to settle down before seriously contemplating any action.

No pressure from inflation and S\$NEER

While headline inflation remains very benign, this has been largely due to deflation in sections of the CPI basket that is administered: public housing and private vehicle ownership. The MAS Core CPI has been rather robust since the middle of 2016 and the latest number as of January 2017 was 1.5%, not yet threatening the MAS' medium term target of 2.0%. This gives the MAS room to err on either side.

Chart 3: Core inflation converges on M-T target



The S\$NEER is materially above the mid-point at +0.72% but this still leaves the policy band with sufficient room to absorb any near term upside surge in the S\$NEER if there is an extended bout of USD weakness.

Reprising Yellen – watch the jobs number

Although inflation looks robust, the MAS is likely to want to take as much time as possible given that the jobs market still appears to be a little bit soft. The vacancies-to-unemployed ratio took a sharp tumble in Q4 and other indicators corroborate the picture: retrenchments remain high, resignations fell again, job placements fell sharply, and vacancies in the key white collar (PMET) segment also fell. While the employment sub-index of the PMI suggests that this weakness might pass before long (at least for manufacturing), the MAS will probably want to wait for concrete signs of stability in the jobs market before considering whether or not to shift its focus to inflation.

Chart 1: S\$NEER still near the mid-point

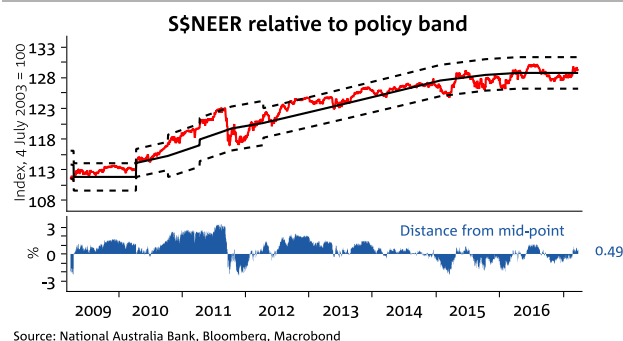
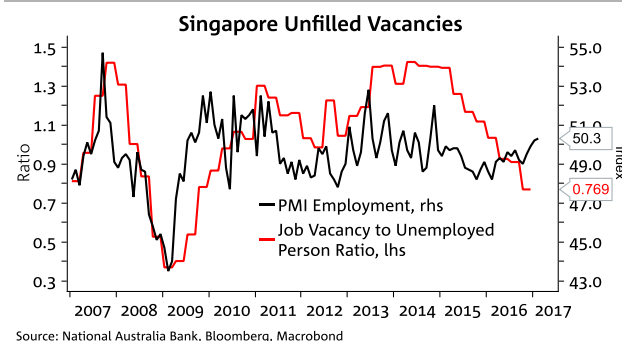


Chart 2: Job scene still soft as of Q4 2016



MALAYSIA SPOTLIGHT:

Inflation creeps into the picture

- Soft commodity prices and weak FX reserves should see MYR continue to underperform regional peers.
- Inflation has spiked up and probably removes any scope for rate cuts but will probably not trigger any hikes just yet.
- BNM has once again threatened the use of moral suasion to pressure market participants to be less bearish on the MYR

Through March, the MYR continued its underperformance relative to Asian peers. Fundamentals suggest that this is likely to continue in the months ahead, regardless of which way the USD drifts, as the central bank tries to bolster its FX reserves.

The soft commodities market looks set to be another weight on the MYR with much of the underlying rate of growth is probably already in the price. The growing doubt surrounding the viability of the Trump stimulus is only likely to deprive commodities of any meaningful upside in the immediate future.

While the economy overall remains in fairly good stead, strong domestic demand, along with flat demand for commodities, could erode the trade balance, and in turn the current account. With foreign ownership of local debt securities already fairly high, inflows cannot be counted on to negate any deterioration in the current account.

Grinding underperformance

The central bank, Bank Negara Malaysia (BNM), has not really been able to improve on the stockpile of FX reserves over the last few months as the USD surged after the US elections. With the sum of short term foreign currency sovereign debt and foreign owned local currency debt coming up to just under 140% of FX reserves as of end-2016, the MYR is vulnerable to any spikes in risk aversion that might result in a withdrawal of liquidity from Emerging Markets. Additionally, Malaysia also has the lowest level of import cover at 6.4 months, compared to an average of 13.4 months for the rest of Asia.

With uncertainty set to increase over the months ahead against the backdrop of growth and interest rate differentials moving in favour of the USD, BNM's weaker

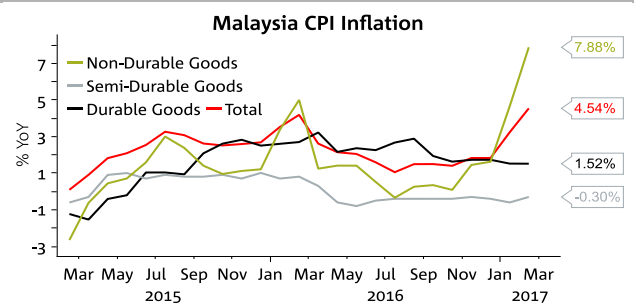
ability to smooth out volatility and support the MYR, the currency should continue to weaken against most of its Asian peers. Price action in the latter half of March though suggests that even in a weak USD environment, the MYR could weaken against key peers like the SGD, possibly due to the BNM replenishing FX reserves.

Inflation might be a fly in the ointment

Domestic demand has been fairly robust despite a sharp contraction in government spending. Chances are the rather generous 2017 federal budget had a lot to do with the strong showing in consumption and investment. While the Markit PMI has risen strongly in January and February, it still remains below 50 so there are some questions over how sustainable this surge is.

One potential issue is that headline inflation has surged in February and March. While the fact that it is largely due to food and non-durable goods, the risk is that a sustained bout of high prices could feed into second round inflation and force BNM to hike rates early.

Chart 3: Inflation could complicate things if it remains high

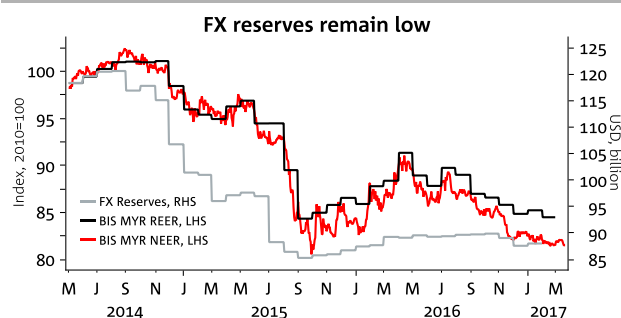


Source: National Australia Bank, Bloomberg, Macrobond

Onshore market still evolving

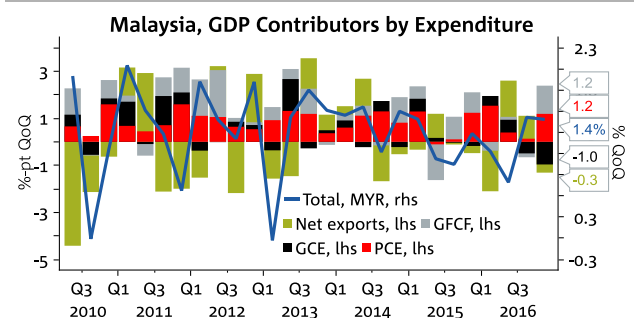
Inflation could also serve to add more downward pressure on the MYR NEER if it starts to force the REER higher. Also worth watching is BNM's continued moves to try to improve liquidity in the onshore bond and FX markets. BNM has recently said it will soon allow companies and insurers to short sell sovereign bonds so as to help them manage their interest rate exposure and inject more liquidity. On the flipside, BNM has also said that it plans to name and shame banks that have "misbehaved" in the FX markets from next year. It's not clear yet how BNM's actions will play out but the one constant likelihood remains underperformance. And this is without yet factoring in potential political uncertainty in H2.

Chart 1: MYR NEER continues to slide



Source: National Australia Bank, Macrobond

Chart 2: Domestic demand appears robust



Source: National Australia Bank, Bloomberg, Macrobond

INDONESIA SPOTLIGHT:

Stuck in the middle with you

- The USD/IDR is likely to remain one of the most stable currencies on the back of active intervention.
- Inflation is increasingly a concern but growth is likely to remain tepid with business sentiment somewhat weak.
- BI has signaled that the rate cutting cycle is over but we do not expect a hike for the rest of the year.

The IDR could be one of the attractive currencies this year given its rather generous carry buffer and interventionist central bank. In the near term, Bank Indonesia (BI) will keep the USD/IDR sticky on both sides, even though it has said that it finds the IDR undervalued at 13,300 to the USD.

There is scope for the pair to grind lower if growth starts to pick up, but this is not a central scenario given that reforms in the business environment remain superficial. Consumption though should remain strong with sentiment showing little sign of waning. This should balance out the softness in investment and keep growth on an even keel for much of the year.

Inflation though could scuttle this fine balance if it starts to climb sharply and cause a sharp widening in the positive gap between the IDR REER and IDR NEER. We expect that the combination of rising inflation and US rate hikes will eventually necessitate a rate hike by BI, but it will likely loath to do so given that growth is likely to not be exceedingly high.

Anchoring expectations

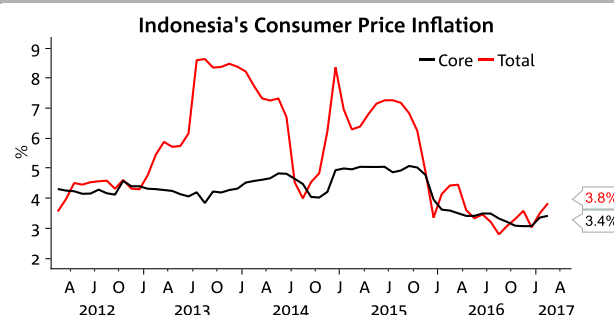
Year-to-date, the USD/IDR has ranged between 13,290 and 13,480, and since end-January it's been trapped in an even tighter 13,300-13,400 range. BI's FX reserves meanwhile has been moving opposite to the broad USD strength. Clearly, the maintenance of USD/IDR stickiness is a policy choice, and it has been executed with a very decent amount of discipline.

Inflation highlighted as a concern

BI deputy governor Mirza Adityaswara declared early in March that benchmark rates were "low enough" and sufficiently supportive for growth, also adding that keeping inflation under 4% is appearing to be a tall order. No indication was given of any inclination to

hike anytime soon and we are in concurrence given the fact that growth still seems finely balanced, with consumer sentiment very robust but investment still looking fairly anaemic.

Chart 3: Inflation appears to be bottoming



Source: National Australia Bank, Bloomberg, Macrobond

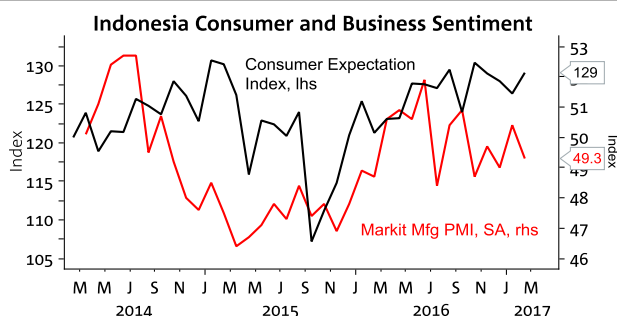
Mirza interestingly also added that GDP growth is no longer dependent on interest rates but rather on business confidence and commodity prices. Both of those factors though do not appear to be highly supportive at this point in time. Commodity prices are not likely to see significant upside. Business confidence meanwhile could improve a little if BI manages to keep the IDR and inflation under control but beyond that, structural changes are needed and therein lies the problem. Thus far, President Jokowi has yet to move on big moves like freeing up the rigid labour market and reducing red tape and bureaucracy.

A fine balance on growth

Given the absence fundamental improvement in the business environment, manufacturing and industry could remain somewhat moribund. The extended bout of political stability and the recent tax amnesty repatriation are likely to see consumption remain strong, which complicates BI's management of the IDR and inflation trajectory.

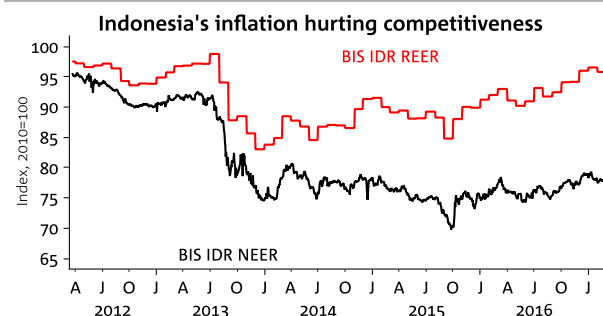
Overall, the main tool available to BI for managing the IDR will be intervention. BI's FX reserves stockpile is currently quite adequate as long as BI maintains its discipline and continues to buy dollars during periods of IDR strength.

Chart 1: Consumer sentiment stronger than business



Source: National Australia Bank, Bloomberg, Macrobond

Chart 2: Inflation eroding IDR competitiveness



Source: National Australia Bank, Macrobond

SELECTED INDICATORS

Table 1: NAB Asian FX Forecasts

	Mar 17	Jun 17	Sep 17	Dec 17	Mar 18	Jun 18	Sep 18	Dec 18		Mar 17	Jun 17	Sep 17	Dec 17	Mar 18	Jun 18	Sep 18	Dec 18
New USD/CNY	6.90	6.92	7.05	7.04	7.03	7.01	7.01	7.00	AUD/CNY	5.31	5.19	5.15	4.93	4.85	4.77	4.77	4.83
Old	7.20	7.24	7.18	7.17	7.18	7.16	7.15	7.12		5.25	5.21	5.03	5.02	4.95	4.87	4.86	4.92
New USD/IDR	13600	13800	13900	13800	13700	13600	13500	13400	AUD/IDR	10472	10350	10147	9660	9453	9248	9180	9246
Old	14000	14100	14200	14100	14000	13800	13700	13400		10220	10152	9940	9870	9660	9384	9316	9246
New USD/INR	67.5	67.8	68.5	68.3	68.1	67.9	67.8	67.7	AUD/INR	52.0	50.9	50.0	47.8	47.0	46.2	46.1	46.7
Old	69.0	69.0	68.5	68.2	68.2	68.0	67.8	67.5		50.4	49.7	48.0	47.7	47.1	46.2	46.1	46.6
New USD/KRW	1150	1200	1250	1240	1240	1220	1180	1160	AUD/KRW	886	900	913	868	856	830	802	800
Old	1250	1280	1250	1240	1240	1220	1180	1160		913	922	875	868	856	830	802	800
New USD/MYR	4.40	4.45	4.60	4.70	4.55	4.50	4.45	4.40	AUD/MYR	3.39	3.34	3.36	3.29	3.14	3.06	3.03	3.04
Old	4.65	4.75	4.85	4.85	4.80	4.75	4.68	4.60		3.39	3.42	3.40	3.40	3.31	3.23	3.18	3.17
New USD/PHP	50.3	50.5	51.0	51.0	51.0	50.8	50.6	50.4	AUD/PHP	38.7	37.9	37.2	35.7	35.2	34.5	34.4	34.8
Old	50.5	51.0	51.5	51.0	50.2	49.5	49.0	48.0		36.9	36.7	36.1	35.7	34.6	33.7	33.3	33.1
New USD/SGD	1.405	1.420	1.450	1.450	1.450	1.430	1.420	1.400	AUD/SGD	1.08	1.07	1.06	1.02	1.00	0.97	0.97	0.97
Old	1.500	1.520	1.550	1.545	1.535	1.520	1.495	1.470		1.10	1.09	1.09	1.08	1.06	1.03	1.02	1.01
New USD/THB	36.5	37.0	37.5	37.8	38.5	38.5	38.5	38.0	AUD/THB	28.1	27.8	27.4	26.5	26.6	26.2	26.2	26.2
Old	36.5	37.0	37.5	38.0	38.5	38.5	38.5	38.0		26.6	26.6	26.3	26.6	26.6	26.2	26.2	26.2
New USD/TWD	31.0	31.5	32.0	32.5	31.8	31.5	31.5	31.0	AUD/TWD	23.9	23.6	23.4	22.8	21.9	21.4	21.4	21.4
Old	33.3	33.6	33.5	33.4	33.3	33.1	33.0	33.0		24.3	24.2	23.5	23.4	23.0	22.5	22.4	22.8

Table 2: NAB Key FX Forecasts

		Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18
Australian Dollar	AUD/USD	0.77	0.75	0.73	0.70	0.69	0.68	0.68	0.69
New Zealand Dollar	NZD/USD	0.72	0.71	0.70	0.67	0.68	0.68	0.69	0.69
Japanese yen	USD/JPY	112	114	116	118	120	120	122	122
Euro	EUR/USD	1.05	1.05	1.04	1.04	1.05	1.06	1.08	1.10
British Pound	GBP/USD	1.25	1.25	1.24	1.22	1.20	1.21	1.22	1.22
Swiss Franc	USD/CHF	1.01	1.02	1.03	1.04	1.06	1.07	1.07	1.08
Canadian Dollar	USD/CAD	1.31	1.33	1.35	1.37	1.37	1.38	1.37	1.35
Chinese New Yuan	USD/CNY	6.90	6.92	7.05	7.04	7.03	7.01	7.01	7.00

Table 3: NAB Asia Macro Forecasts

	2013	2014	2015	2016	2017	2018
Hong Kong	3.1	2.7	2.4	1.6	1.6	1.6
Indonesia	5.6	5.0	4.9	5.0	5.0	5.0
Singapore	4.6	3.3	2.0	1.5	1.5	1.5
Taiwan	2.2	3.9	0.7	1.3	1.3	1.3
Thailand	2.7	0.8	5.0	4.2	4.2	4.2
Malaysia	4.7	6.0	2.6	2.7	2.7	2.7
S Korea	2.9	3.3	2.8	3.3	3.3	3.3
Philippines	7.1	6.2	5.9	6.8	6.8	6.8
Total	4.2	4.1	3.6	3.8	3.8	3.8
China	7.7	7.3	6.9	6.7	6.5	6.5
India	6.3	7.0	7.2	7.1	7.2	7.2

Table 4: NAB Key Macro Forecasts

Country/region	2013	2014	2015	2016	2017	2018
United States	1.7	2.4	2.6	1.6	2.1	2.3
Japan	2.0	0.3	1.2	1.0	0.8	0.6
Euro-zone	-0.3	1.1	1.9	1.7	1.9	1.8
United Kingdom	1.9	3.1	2.2	2.0	1.8	1.7
Emerging Asia	4.2	4.1	3.5	3.7	3.7	3.6
Latin America	2.5	0.9	-0.2	-1.2	0.1	1.9
China	7.7	7.3	6.9	6.7	6.5	6.3
Canada	2.5	2.6	0.9	1.2	1.7	2.0
Australia	2.1	2.8	2.4	2.4	2.3	2.4
New Zealand	2.2	3.4	2.5	3.2	2.9	2.5
India	6.3	7.0	7.2	7.1	7.2	7.2
Africa	5.2	5.1	3.4	1.6	2.8	3.7
Eastern Europe	2.8	2.8	3.7	2.9	3.1	3.1
Middle East	2.4	2.2	2.5	3.8	3.1	3.5
Other advanced	2.2	2.8	2.0	2.0	2.0	2.0
World	3.36	3.39	3.10	2.94	3.18	3.35

Source all tables: National Australia Bank

CONTACT DETAILS

FX Strategy, Asia

Christy Tan
Head of Markets Strategy/Research, Asia
+852 2822 5350
christy.tan@nabasia.com

Julian Wee
Senior Markets Strategist, Asia
+65 6632 8055
julian.wee@nabasia.com

Markets Research

Peter Jolly
Global Head of Research
+61 2 9237 1406
peter.jolly@nab.com.au

Group Economics

Alan Oster
Chief Economist
+61 3 8634 2927
alan_oster@national.com.au

Disclaimer: This document has been prepared by National Australia Bank Limited ABN 12 004 044 937 AFSL 230686 ("NAB"). Any advice contained in this document has been prepared without taking into account your objectives, financial situation or needs. Before acting on any advice in this document, NAB recommends that you consider whether the advice is appropriate for your circumstances. NAB recommends that you obtain and consider the relevant Product Disclosure Statement or other disclosure document, before making any decision about a product including whether to acquire or to continue to hold it. Products are issued by NAB unless otherwise specified.

So far as laws and regulatory requirements permit, NAB, its related companies, associated entities and any officer, employee, agent, adviser or contractor thereof (the "NAB Group") does not warrant or represent that the information, recommendations, opinions or conclusions contained in this document ("Information") is accurate, reliable, complete or current. The Information is indicative and prepared for information purposes only and does not purport to contain all matters relevant to any particular investment or financial instrument. The Information is not intended to be relied upon and in all cases anyone proposing to use the Information should independently verify and check its accuracy, completeness, reliability and suitability obtain appropriate professional advice. The Information is not intended to create any legal or fiduciary relationship and nothing contained in this document will be considered an invitation to engage in business, a recommendation, guidance, invitation, inducement, proposal, advice or solicitation to provide investment, financial or banking services or an invitation to engage in business or invest, buy, sell or deal in any securities or other financial instruments.

The Information is subject to change without notice, but the NAB Group shall not be under any duty to update or correct it. All statements as to future matters are not guaranteed to be accurate and any statements as to past performance do not represent future performance.

The NAB Group takes various positions and/or roles in relation to financial products and services, and (subject to NAB policies) may hold a position or act as a price-maker in the financial instruments of any company or issuer discussed within this document, or act and receive fees as an underwriter, placement agent, adviser, broker or lender to such company or issuer. The NAB Group may transact, for its own account or for the account of any client(s), the securities of or other financial instruments relating to any company or issuer described in the Information, including in a manner that is inconsistent with or contrary to the Information.

Subject to any terms implied by law and which cannot be excluded, the NAB Group shall not be liable for any errors, omissions, defects or misrepresentations in the Information (including by reasons of negligence, negligent misstatement or otherwise) or for any loss or damage (whether direct or indirect) suffered by persons who use or rely on the Information. If any law prohibits the exclusion of such liability, the NAB Group limits its liability to the re-supply of the Information, provided that such limitation is permitted by law and is fair and reasonable.

This document is intended for clients of the NAB Group only and may not be reproduced or distributed without the consent of NAB. The Information is governed by, and is to be construed in accordance with, the laws in force in the State of Victoria, Australia.

Analyst Disclaimer: The Information accurately reflects the personal views of the author(s) about the securities, issuers and other subject matters discussed, and is based upon sources reasonably believed to be reliable and accurate. The views of the author(s) do not necessarily reflect the views of the NAB Group. No part of the compensation of the author(s) was, is, or will be, directly or indirectly, related to any specific recommendations or views expressed. Research analysts responsible for this report receive compensation based upon, among other factors, the overall profitability of the Global Markets Division of NAB.

For distribution by WealthHub Securities: Where you have received this document via the nabtrade service (nabtrade), it is distributed to you by WealthHub Securities Limited ABN 83 089 718 249 AFSL No. 230704 ("WealthHub Securities"). WealthHub Securities is a Participant of the Australia Securities Exchange and a wholly owned subsidiary of National Australia Bank Limited ABN 12 004 044 937 AFSL No. 230686 ("NAB"). NAB doesn't guarantee the obligations or performance its subsidiaries, or the products or services its subsidiaries offer. Any material provided to you by WealthHub Securities will contain factual information or general advice. This factual information or general advice does not take into account your particular objectives, financial situation and needs, and a statement of advice will not be provided. WealthHub Securities will not give you any legal, tax, financial or accounting advice or any advice or recommendation regarding the suitability or profitability about your transactions. Before you make a decision about whether to acquire a financial product, you should obtain and read the Product Disclosure Statement available at nabtrade.com.au and consider the appropriateness of the information having regard to your particular circumstances. You agree that you will not solely rely on the information provided by WealthHub Securities or elsewhere on nabtrade.com.au when making investment and/or financial decisions. WealthHub Securities does not provide personal advice to online retail clients. WealthHub Securities receives commission from dealing in securities and from its authorised representatives. Introducers of business may directly share in this commission. WealthHub Securities and its associates may hold shares in the companies that it distributes research/information on.

The value of investments and future returns may rise or fall and, at times, returns may be negative. Past performance is not a guarantee of future performance. Please note, this material has not been verified by WealthHub Securities. WealthHub Securities does not make any representation or warranty as to the timeliness, reliability, accuracy or completeness of the material, nor does it accept any responsibility arising in any way for errors in, or omissions from, that material.

United Kingdom: If this document is distributed in the United Kingdom, such distribution is by National Australia Bank Limited, 88 Wood Street, London EC2V 7QQ. Registered in England BR1924. Head Office: 800 Bourke Street, Docklands, Victoria, 3008. Incorporated with limited liability in the State of Victoria, Australia. Authorised and regulated by the Australian Prudential Regulation Authority. Authorised in the UK by the Prudential Regulation Authority. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request.

USA: If this document is distributed in the United States, such distribution is by nabSecurities, LLC. This document is not intended as an offer or solicitation for the purchase or sale of any securities, financial instrument or product or to provide financial services. It is not the intention of nabSecurities to create legal relations on the basis of information provided herein.

Hong Kong: By accepting this document, you represent and warrant that you are a "professional investor" within the meaning of the definition of that term in Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571 of the Laws of Hong Kong). If you think you have received this document in error, please contact NAB at Level 27, One Pacific Place, 88 Queensway, Hong Kong Ph: +852 2826 8111

If this document is distributed in Hong Kong, such distribution is by National Australia Bank Limited, Hong Kong Branch, which is licensed by the Hong Kong Monetary Authority and registered (CE Number AAO169) under the Securities and Futures Ordinance (Cap. 571 of the Laws of Hong Kong) for Type 1 (dealing in securities) and Type 4 (advising on securities) regulated activities. Its main business address is Level 27, One Pacific Place, 88 Queensway, Hong Kong.

The contents of this document have not been reviewed by any regulatory authority in Hong Kong. If you are in any doubt about any of the contents of this document, you should obtain independent professional advice.

New Zealand: This publication has been provided for general information only. Although every effort has been made to ensure this publication is accurate the contents should not be relied upon or used as a basis for entering into any products described in this publication. To the extent that any information or recommendations in this publication constitute financial advice, they do not take into account any person's particular financial situation or goals. Bank of New Zealand strongly recommends readers seek independent legal/financial advice prior to acting in relation to any of the matters discussed in this publication. Neither Bank of New Zealand nor any person involved in this publication accepts any liability for any loss or damage whatsoever may directly or indirectly result from any advice, opinion, information, representation or omission, whether negligent or otherwise, contained in this publication. National Australia Bank Limited is not a registered bank in New Zealand.

Japan: National Australia Bank Ltd. has no licence of securities-related business in Japan. Therefore, this document is only for your information purpose and is not intended as an offer or solicitation for the purchase or sale of the securities described herein or for any other action.

Singapore: This document is distributed in Singapore to institutional investors (as defined under the Financial Advisers Regulations) only.

People's Republic of China: In the PRC, the Materials are directed solely at persons who would be constituted as (i) Qualified Domestic Institutional Investors in accordance with the applicable PRC laws and regulations promulgated by China Banking Regulatory Commission, China Securities Regulatory Commission or China Insurance Regulatory Commission or (ii) other eligible investors in accordance with the applicable PRC laws and regulations.

Further, the information on the Materials does not constitute "marketing or production and business activities in the PRC" as defined in the Administrative Measures on the Registration of Production and Operation Activities of Foreign Enterprises in the PRC promulgated by the State Administration of Industry and Commerce. This publication has been provided for general information only. NAB has no licence for securities-related, derivative or other capital market products in China.