ESSENTIAL ASIA

Appreciating Asian FX Appreciation

National Australia Bank

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- **RMB stability is expected to be restored after recent bout of volatility, even though tight CNH interbank liquidity could persist.**
- **Focus is expected to return to the Fed's policy path beyond the June hike and whether the interest rate differentials between the US and Asia will start to matter for Asian currencies.**

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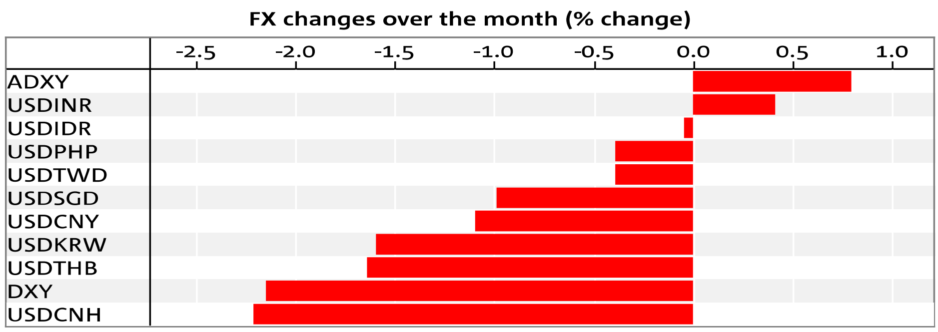
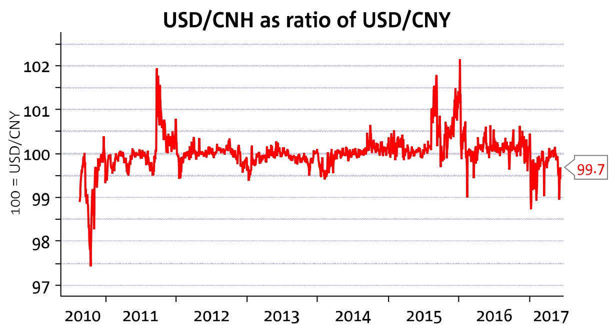
Asia FX in May



Source: National Australia Bank, Bloomberg, Macrobond

Chart of the month



Source: National Australia Bank, 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	1.25	1.25	1.25	1.25
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	3.00	3.00	3.00	3.00
India	6.75	6.50	6.50	6.25	6.25	6.25	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	4.35	4.35	4.35

Authors: Christy Tan, Head of Markets Strategy/Research, Asia   Julian Wee, Senior Markets Strategist, Asia

APPRECIATING ASIAN FX APPRECIATION

- **We expect most of our end-June Asian FX forecasts to be undershot to varying degrees, with the bigger extents in the KRW and the MYR.**
- **RMB stability is expected to be restored after recent bout of volatility, even though tight CNH interbank liquidity could persist.**
- **Focus is expected to return to the Fed's policy path beyond the June hike and whether the interest rate differentials between the US and Asia will start to matter for Asian currencies.**

Our end-June FX forecasts are looking overly bearish on Asian currencies. The divergence between these forecasts and where the currencies are at current levels are biggest in the KRW (-6.8%) and MYR (-4.3%). The persistent decline in the DXY index and the additional 3.8% slide in Q2 this year have essentially erased all the gains in the USD since US presidential elections last November. The lack of conviction in the US Federal Reserve's policy path has negated the scope for interest rate differentials with the US to matter for Asian currencies movements. On top of that, China has managed to deal with the capital outflows situation quite effectively and the risks to further RMB weakness have been mitigated. Even the Moody's downgrade of China's sovereign rating to A1 has barely dented sentiment in the Chinese financial markets. Instead, it has triggered some pre-emptive actions that resulted in a short episode of massive tightening in interbank liquidity in the CNH market. Consequently, the CNY appreciated 1.1% against the USD, and CNH rose 1.5% since Moody's downgrade.

Further RMB strength questionable

While the elusive broad USD strength may encourage Asian currencies to maintain some of the recent vigour, we do not expect further RMB strength to manifest. Our end-June USD/CNY forecast is 6.92 currently. We recognise that our forecast will be undershot, but it is premature to alter the directional trend of USD/CNY. The Fed's quantitative tightening is still a real and somewhat underpriced risk.

Concerns regarding capital flight from Asia have reduced significantly and in its latest capital flows to EM report, the Institute of International Finance (IIF) cited a brighter outlook and reduced threat of EM-DM flows (barring a more aggressive Fed), calmer flows from China and South-South investment potentially the next big thing.

Non-resident capital inflows to EMs are projected to increase by USD252 billion to USD970 billion in 2017. The IIF is looking at a notable moderation in resident outflows from China this year, helped by RMB stability. Further stability in the RMB stability is a key variable in the outflows equation for China. IIF estimated that between USD33 andUSD85 billion worth of outflows a quarter if the market still expects 2% - 3% annual depreciation in the RMB. Capital control measures may curb outflows but only partially and temporarily, as people will eventually find ways to circumvent the barriers.

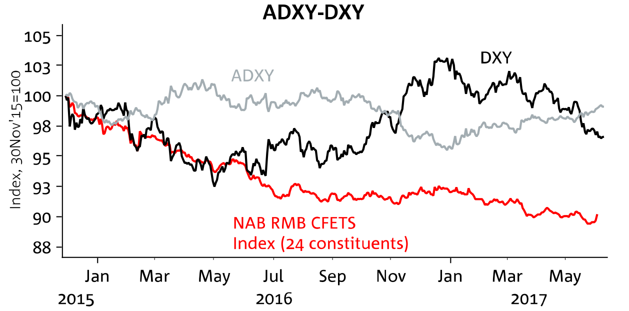
A key feature mentioned is that South-South investment is projected to make up some 5% of total cross-border investment in EMs vs 2% a decade ago. Noteworthy that China accounts for some 30% of total South-South trade. IIF cited that the key risks to the forecasts include a more aggressive Fed tightening—including rate hikes and balance sheet runoff—than is being priced in by markets. All else being equal, a USD500 billion decline in Fed Treasury holdings would be associated with a reduction of over USD50 billion in EM portfolio flows.

A more aggressive Fed could jolt the markets

Based on IIF estimates, while there may not be a strong relationship between the size of the Fed's overall balance sheet and EM portfolio flows, changes in the Fed's holdings of U.S. Treasuries do have an impact. In contrast, there is less evidence that a change in the Fed's Mortgage Backed Securities holdings would impact EM portfolio flows. IIF findings suggest that a cumulative USD65 billion decline in the Fed's UST holdings would be associated with a US$6.8 billion reduction in EM portfolio flows, similar to a 25bp increase in market expectations for the Fed funds rate two years forward. Since US$425 billion of Treasuries in the Fed's portfolio will mature in 2018, this would suggest over US$22 billion reduction in EM portfolio flows (assuming the Fed reinvests 50% of maturing Treasury securities).

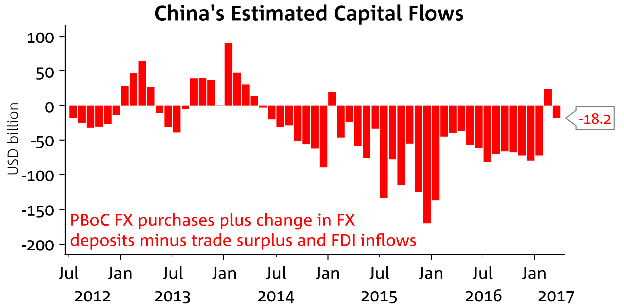
IIF also deduced that changes in the shadow Fed Funds rate have a statistically significant and economically important impact on portfolio flows to emerging markets. Broadly, a one percentage point decline in the shadow rate is associated with a US$9 billion increase in portfolio flows to EMs. Conversely, as shadow rates rise with the Fed removing liquidity from the system, portfolio flows to EMs are likely to decline on a similar order of magnitude.

Chart 1: DXY and ADXY are back at pre-Trump levels



Source: National Australia Bank, Macrobond

Chart 2: RMB stability a key anchor for capital flows



Source: National Australia Bank, Macrobond, Bloomberg

CHINA SPOTLIGHT:

Applying Heinlein's razor

- **Although the exact nature of the sharp fall in the USD/CNH remains in debate, the PBoC at least allowed it to happen at the start.**
- **Nevertheless, it is still strategically inconsistent for the PBoC to have actively engineered the move.**
- **Chances are last week was a poorly executed defensive maneuver and the PBoC appears to be back to maintaining stability in the RMB at this stronger level.**

Confusion or conspiracy?

"Never ascribe to malice that which is adequately explained by neglect." - reformulated Heinlein's razor.

The USD/CNH's sharp dip this month seems to have been due to a combination of the People's Bank of China (PBoC) declaring its intent to increase the CNY's "two-way flexibility against the USD" (24 May), a report that the PBoC was considering including a "counter-cyclical adjustment factor" (25 May), and Moody's warning that leverage will continue to rise despite government measures to rein this in (26 May). This was just a couple of days after downgrading China's sovereign rating.

Some narratives in the market have attributed indications that the CNH funding squeeze was engendered by agent banks to a backlash by the PBoC against Moody's. However, the absence of jawboning from the PBoC and the abrupt reversal of the funding squeeze is a serious problem for this narrative.

A more comprehensively consistent narrative might be that the PBoC had instructed agent banks to be prepared to push back against any surge in outflows in the CNH market. This instruction though might have been misinterpreted as an order to be proactive. Upon realizing this excessive action, the agent banks were seen withdrawing their presence in an equally abrupt manner.

Putting the moves in context

It is also worth noting that the moves over the period in question might be fairly large relative to the moribund market in the 2 months prior to the 25th of May, but in the larger context, the PBoC's belated response to the market moves does not represent a meaningful departure from the way the PBoC has been managing the RMB and therefore does not represent a change in the FX regime.

At the most extreme, the USD/CNH stretched its tether to the USD/CNY to slightly wider than 0.7% below the USD/CNY spot, beyond the +/-0.5% range that would be considered fairly usual. At the same time, the overnight CNH Hibor had spiked to a high of 42%.

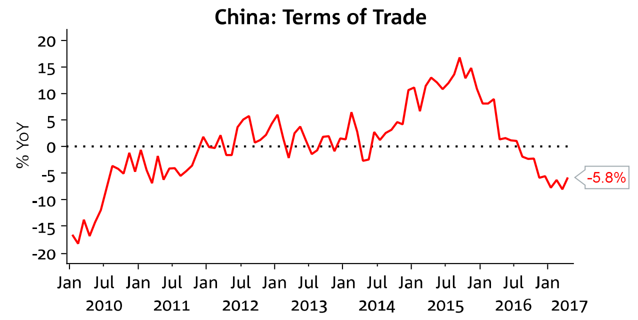
Within 2 sessions though, the USD/CNH discount was back to just 0.3% (where it remains) and the overnight CNH Hibor was back at 3.1%, before declining to the current 1.7%. The strong presence of the agent banks in the previous sessions had all but vanished.

Divining the PBoC's intent

Given the PBoC's espoused intent to keep the RMB largely stable, the medium term goal of internationalising the RMB, and the National People's Congress at the end of the year, it is hard to see why the authorities would want to rock the boat at this point by orchestrating a sharp appreciation in the RMB, especially for something petty like showing up Moody's.

Additionally, the recovery in the economy is still somewhat fragile and China's terms of trade has been on the decline for a year now.

Chart 1: Export competitiveness has eroded somewhat

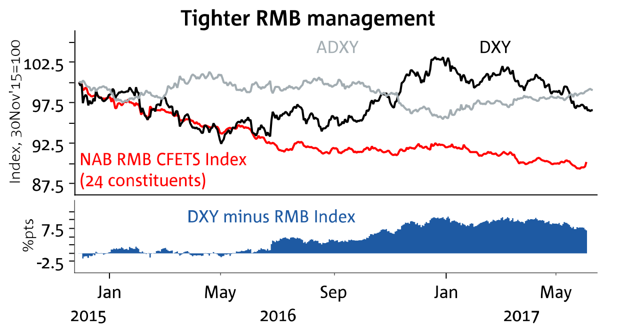


Source: National Australia Bank, Bloomberg, Macrobond

A "new normal"

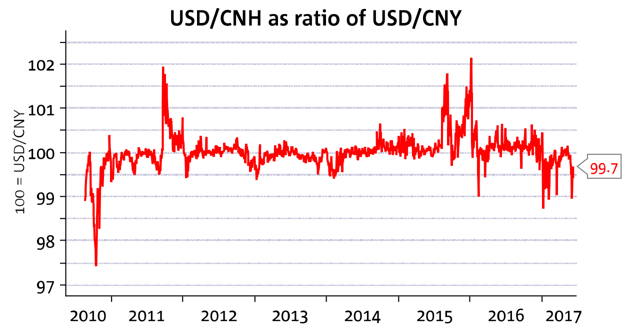
What is interesting though is that the PBoC appears to be quite comfortable with the USD/CNY rate in the vicinity of 6.80. While the CFETS index has jumped 0.9% since 24 May, it is simply back to where it was in April. The DXY meanwhile has continued to decline all through May and continues to do so. It remains to be seen how long the PBoC keeps the RMB index "stable".

Chart 2: CFETS index trajectory still "flat"



Source: National Australia Bank, Macrobond

Chart 3: USD/CNH discount back to normal range



Source: National Australia Bank, Macrobond

KOREA SPOTLIGHT:

Reassessed and Repriced

- **The Korean won has earned its top performer title with an impressive 8% gain vs the USD year to date.**
- **Some of the initial risks – North Korea threats, China FX depreciation, currency manipulator label have diminished. The risk of geopolitical tension in the Korean peninsula impacting Korean financial markets adversely, while still present, is more a shock scenario than a base case.**
- **With the additional growth support from extra stimulus, we deem it fit to revise our USD/KRW forecasts downward.**

The won claims victory vs the USD

The won has earned its top performer title with an impressive 8% gain vs the USD year to date. The KRW, along with SGD, TWD, INR, are comfortably trading stronger than the levels seen pre-US presidential election. Admittedly, there are emerging signs that the won's appreciating momentum could be waning since it briefly breached 1115 level in May but failed to move lower further. It has since recovered and pivoted around 1120 level and somewhat shrugged off the recent RMB appreciation. Interestingly, 162.0 level appears to be a very strong technical support for the CNH/KRW cross, as evidenced over the past few years as well as recently.

The lack of a convincing recovery in the USD notwithstanding, Korea has managed to shed some of the initial risks that have prompted us to adopt a more cautious outlook on the won. North Korea threats, China FX depreciation, currency manipulator label have diminished. The risk of geopolitical tension in the Korean peninsula impacting Korean financial markets adversely, while still present, has retreated to a tail risk than a base case.

BoP flows are conducive for the KRW

Portfolio flows have been persistently encouraging, particularly the appetite for Korean bonds. Understandably, while the KRW has strengthened beyond last November levels, bond yields look relatively elevated at 1.60% for the 2Y KTBs, compared with 1.4% just before the US presidential election results. Year-to-date inflows into Korean debt market totalled US$25.3bn, just shy of the US$26.9bn inflows into JGBs and dwarfing the US$8bn foreign fund inflows into the Korean equities markets.

The overall monetary policy environment is neutral for the bond market. The BoK Governor has reaffirmed that monetary policy will remain accommodative and that the BoK will not respond mechanically to US monetary policy tightening, underpinning market expectations that the policy rate will be kept unchanged at 1.25% for the rest of this year.

Concerns about Korea's external sector performance have also been laid to rest. Korean exports to key destinations have recovered strongly, specifically exports to the EU, partially offsetting the soft demand from the US.

Additional growth support from budget a possibility

Adding to the positive sentiment was President Moon's announcement in early June of plans for a supplementary budget worth KRW11.2trn (0.7% of GDP). The government's proposals include plans to spend KRW4.2trn on the creation of new jobs, largely in the public sector, as well as another 7trn won on increased welfare spending, mainly on improved childcare and more centres for the elderly. Given the likely delays in implementation, the government has estimated that the budget would boost growth by only 0.2% this year, with the remaining benefits likely to be felt in 2018.

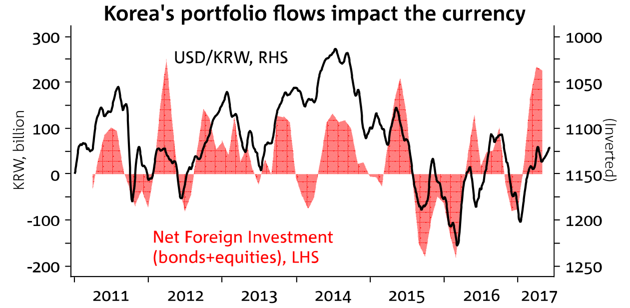
It remains unclear if the fiscal stimulus package will be approved as President Moon's Democratic Party holds just 40% of parliament seats and the main opposition Liberty Korea Party recently boycotted his choice of prime minister Lee Nak-yon. Nevertheless, the recent announcement provided some assurance that the government is still focused on growth supportive policies.

After assessing the recent development and evident reduction of negative risks to the Korean won, we deem it fit to revise our USD/KRW forecasts downward, depicting a gentler upward slope towards the end of the year.

Chart 3: USD/KRW forecasts revised

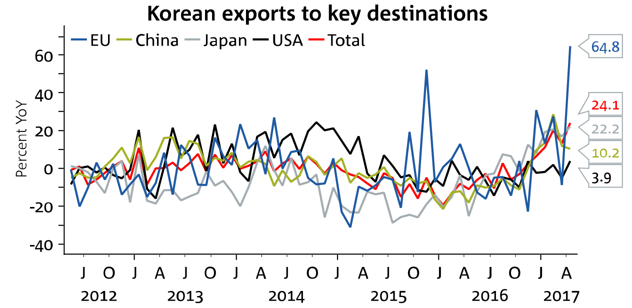
		Jun 17	Sep 17	Dec 17	Mar 18	Jun 18	Sep 18	Dec 18	Mar 19
New	USD/KRW	1135	1160	1200	1200	1180	1160	1160	1150
Old		1200	1250	1240	1240	1220	1180	1160	1150

Chart 1: Portfolio inflows contributed to KRW vigour



Source: National Australia Bank, Macrobond

Chart 2: Strong exports growth to non-US destinations



Source: National Australia Bank, Macrobond

INDIA SPOTLIGHT:

Reality bites, lightly

- **Q1 GDP growth slowed sharply due to disruptions from demonetization but RBI will likely look past this for now.**
- **April CPI inflation has undershot expectations and reduces risks of the RBI becoming even more hawkish.**
- **Partial indicators suggest that the demonetization effect will not be long lived but a rate cut later in the year is still possible.**

Sitting through the shock

The recent euphoria on Indian assets and the INR took a bit of a hit from the surprisingly weak Q1 GDP growth number. The broad weakness across investment, private consumption, and exports, suggests that there was a slightly delayed systemic disruption from the demonetization measure in November 2016.

Given that other indicators suggest the impact is likely to be fairly transitory, and that the banks are flush with cash receipts as a result of the demonetization, the Reserve Bank (RBI) is not likely to get spooked just yet. This is especially so given that core inflation remains fairly buoyant at 4.1% yoy.

The USD/INR though could retrace a bit higher as some segments of the market focus on the dip in the headline CPI inflation and the weak Q1 growth, and start to shift expectations in a dovish direction.

A dip and a bounce

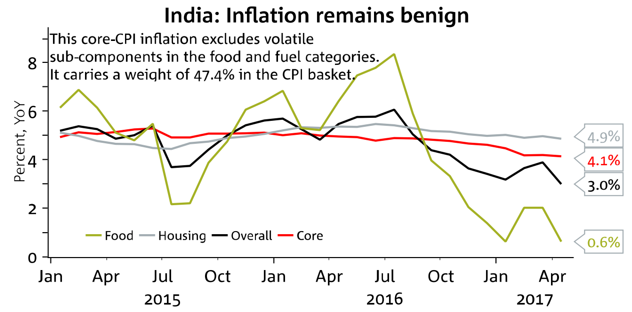
The contribution from consumption, investment and net exports all shrank but the latter two flipped into the red. This was highly unusual relative to the historical trend of both being very consistently positive. This corresponds to sharp dips in bank credit and cement growth. The latter, and production of consumer durables both fell, at least briefly, into negative year-on-year growth.

These same indicators, along with capital goods production, suggest that the dip might not endure for long. Bank credit growth rebounded to 8.3% yoy growth in March after languishing at 4% for the prior 3 months. Cement production as well as rebound, and consumer durables production growth continued to trend higher. All this suggest that the RBI is not going to react too strongly to this data and any rate cut will require more weak data.

Inflation remains an area of concern

The May inflation number slowed sharply, taking the headline number down with it to 3.0% yoy. Core inflation however, remains buoyant, albeit fairly flat, at 4.1%. Both headline inflation and core are still experiencing a low-base effect (to a lesser extent for core) which should last till the July-August period, which underpins our call for a possible late-Q3 rate but by the RBI.

Chart 3: One eye still likely to be on inflation

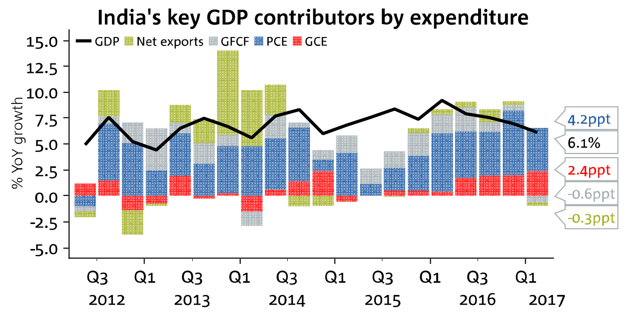


Source: National Australia Bank, Bloomberg Intelligence, Macrobond

USD/INR could retrace higher

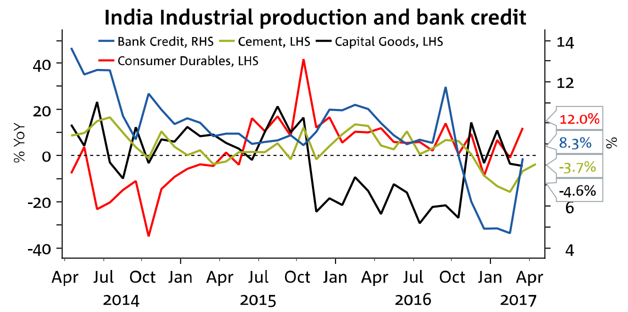
With GDP growth and inflation both disappointing, expectations regarding the attractiveness of holding the INR and INR-denominated equities should be adjusted down somewhat. The INR has been the top Asian currency since the 20th of January. While a lot of that has been on the back of the stronger than expected showing in regional elections, the generous carry and strong growth outlook are also key contributors so any paring back of those expectations should see the INR underperform for period of time. The RBI will probably not be too perturbed by a gradual upward retracement in the USD/INR.

Chart 1: Disruption from demonetization in Q1 GDP



Source: National Australia Bank, Macrobond

Chart 2: Various indicators show a rebound in Q2



Source: National Australia Bank, Macrobond

SINGAPORE SPOTLIGHT:

Inflation creeps back into the picture

- **MAS remains comfortable with current monetary policy stance as the S$NEER hovers above the mid-point.**
- **Near term growth momentum remains somewhat fragile as China's growth momentum appears to be waning.**
- **Inflation continues to creep higher towards the medium term target and will see a jump in July.**

Asymmetric tolerance

The Monetary Authority of Singapore (MAS) reaffirmed its comfort with the current monetary policy stance after the slightly unimpressive Q1 GDP growth number. Although the final Q1 the sequential number was a small negative, it still amounted to a decent 2.7% yoy and the MAS' target of 1%-3% full year growth still looks comfortably within reach.

As such, inflation might be the macro indicator that gets more attention in the months to come. For now, the S$NEER is sitting comfortably above the mid-point but given the inexorable climb in the MAS Core inflation number, one might guess that the MAS might have an asymmetric tolerance for S$NEER movement, with a likely lower threshold for depreciation.

Growth could plateau

Private consumption expenditure (GCE) and government consumption expenditure (GCE) were the drivers of the economy in Q1 2017, with both investment (GFCF) and net exports both turning negative and becoming drags on growth. Amongst the lot, GCE will probably prove to be the most consistent given that much of the spending will be related to efforts to boost capacity in the intra-city train system and to a lesser extent, the healthcare sector. PCE might have had a strong quarter but the jobs market still appears to be rather soft at the periphery, with retrenchments still hovering at a fairly high level, with total employment in manufacturing and construction still falling.

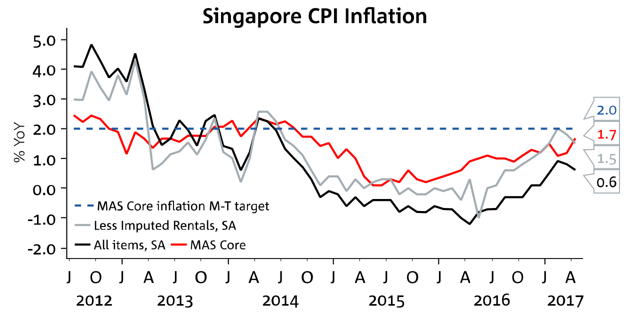
GFCF's turnaround highlights the general jitteriness in the economy, which was probably not hard to understand given the geopolitical concerns over both Europe and North Korea. With both of these having ebbed, Q2 might prove to be better for GFCF. Less so for net exports though. The likelihood that robust domestic demand will be coupled with slightly weaker demand out of China bodes ill for this component of GDP. Already, non-oil domestic exports (NODX) growth has dipped into the red after a sharp deceleration. Industrial production growth seems to have rebounded, but with China's data softening, this might prove a false start.

Ultimately though, if the sequential growth rate flattens out at zero for the rest of the year, full year growth could still come in slightly under 2%, right smack in the middle of the MAS' projected range.

Inflation will be key

This suggests that the balance of concerns for the MAS will ultimately still be inflation, which continued its upward climb in April. The MAS Core inflation skipped up in April on the back of higher oil prices, to 1.7% yoy, approaching the MAS' medium term target of 2.0%. Come July, water prices are set to be hiked 15%, part of a 2-year adjustment process to raise water prices by a total of 30%. This could imply that the MAS might elect to focus on inflation as the greater danger, rather than slow growth, especially given that fiscal policy is already in a fairly aggressively expansionary mode.

Chart 3: Core inflation converges on M-T target

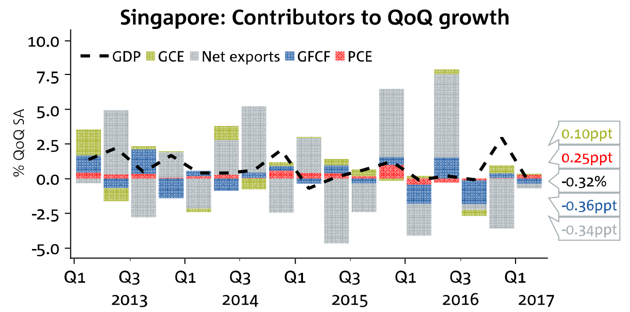


Source: National Australia Bank, Macrobond

S$NEER could be buoyed in the months to come

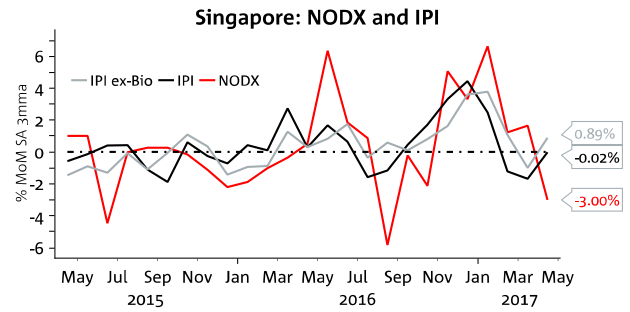
With the S$NEER sitting at just 0.3% above the mid-point of the policy band, MAS has the room to be fairly indifferent about its movements. However, given the growth-inflation dynamics, there is likely to be lower tolerance for sharp depreciation. In the near term though, the authorities should be quite comfortable with the S$NEER where it is and might just try and blunt any sharp movements on either side.

Chart 1: Total consumption drove Q1 growth



Source: National Australia Bank, Macrobond

Chart 2: Manufacturing growth likely weaker in Q2



Source: National Australia Bank, Macrobond

MALAYSIA SPOTLIGHT:

An illusory growth spurt

- **Q1 GDP growth came in artificially strong as a slew of government giveaways were handed out.**
- **Portfolio inflows into MYR assets have surged but a potential deterioration in the fiscal position could hurt the attractiveness of MYR debt.**
- **The continued weakness of the FX reserves position could be compounded by deterioration in the current account balance.**

A fragile balance

The strength of Q1 GDP growth was surprising, and was distributed across all the domestic sectors. The caveat though is that much of this resulted in a surge in imports and a large swing in net exports into negative territory.

The months of April and May saw a surge in portfolio inflows into both stocks and bonds as risk appetite returned to the markets. Bank Negara Malaysia (BNM) did take the chance to bulk up on reserves, which increased from US$95.4bn at the end of March to US$97.3bn by mid-May, even as the MYR rose 2.84% over that period, compared to the next best INR at 2.01%.

Going forward, an erosion in any one of the growth momentum, the current account position, or the government's fiscal position, or a combination, is likely to happen and we continue to be sceptical about the MYR's ability to continue to outperform regional peers.

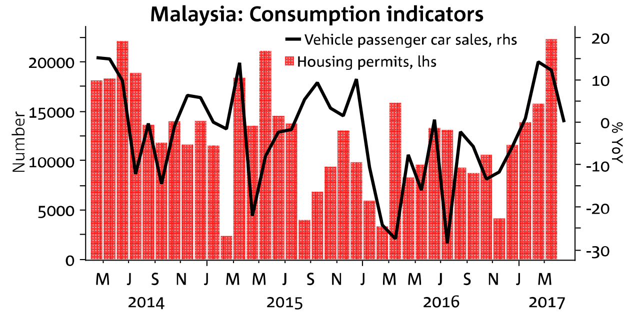
An unsustainable growth spurt

Malaysia's economy grew 5.6% yoy in Q1 2017, roundly beating expectations. This was also the case for the 1.8% qoq sa, which is more illustrative of the surge in domestic demand. The demand was spread across the domestic growth engines, with fiscal spending also contributing in equal amount.

The flipside though is that net exports fell sharply into negative territory and causing a 2.9 percentage point QoQ drag on growth. This is reflected in a fall in the current account surplus to US$5.3bn in Q1 2017 (US$6.6bn expected) from US$12.2bn in Q4 2016.

The surge in domestic demand was largely due to the generosity of the federal government's 2016-2017 budget. Specifically, there were one-time handouts to low income earners, civil servants and government retirees. Additionally, there was a relaxation in financing for affordable housing for 2017, and a reduction in the corporate tax for small and medium enterprises (SMEs), both coming into effect for 2017 and 2018. These were all announced in October 2016 so an improvement began as early as November and December.

Chart 3: Q1 buying spree evident



Source: National Australia Bank, Bloomberg, Macrobond

BNM's focus remains external

BNM's latest comments have been heavy on insouciance, with growth projections for 2017 maintained at 4.3%-4.8%, driven by domestic demand and improving exports. BNM also suggested that small and medium enterprises remained healthy and that monetary policy remains supportive.

The one area of concern for BNM remains external risk events, like the oil price, geopolitics, US interest rate shifts and general financial market uncertainty, could cause MYR volatility.

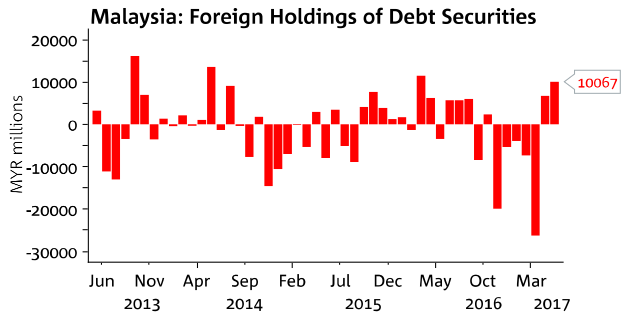
While this might be true, BNM might have downplayed the domestic risks a bit too much. Malaysia has probably the smallest fiscal space to operate amongst its Asian peers. Additionally, Malaysia's FX reserves position is also probably the weakest in Asia.

BNM might have more room to ease than some other central banks, but the risks in doing that is that it might just spur a surge in imports.

Fundamentals to the fore

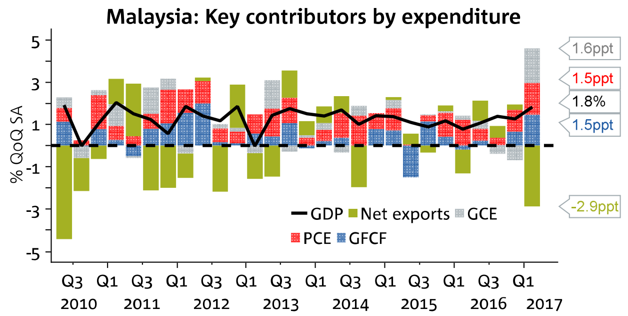
Over the rest of the year, a return of USD strength from rising interest rates differentials, coupled with further growth in risk appetite, could see the MYR lose out against regional peers. Investors are likely to prefer economies with stronger growth and fiscal fundamentals. The prospect of early elections, either late 2017 or early 2018, isn't likely to help either.

Chart 1: Little progress on FX adequacy



Source: National Australia Bank, Bloomberg, Macrobond

Chart 2: Domestic demand hitting net exports



Source: National Australia Bank, Bloomberg, Macrobond

INDONESIA SPOTLIGHT:

Catch-up upgrade

- **S&P's upgrade of Indonesia's rating did not come as a surprise, but was earlier than expected.**
- **This finally takes Indonesia's sovereign rating to Investment Grade across all ratings agencies.**
- **The upgrade is positive for both bonds and FDI but a strong acceleration in GDP growth still requires more structural reforms.**
- **Inflows may strengthen the bias for IDR strength, but will need more macro breakthroughs for USD/IDR to break below 13250 convincingly.**

Upgrade highlights reforms needs

The surprise upgrade of Indonesia's sovereign rating from BBB- to BB+ – the lowest investment grade (IG) – with a stable outlook catches S&P up with the other 2 ratings agencies.

S&P cited an improvement in the fiscal balance as a big reason for finally upgrading Indonesia but the concerns for the original delay – weak revenue collection and corporate quality – are still in place so the next upgrade might be some time away.

Tax amnesty was the trigger

S&P appears to have been persuaded by the success of the recent tax amnesty under the respected new Finance Minister Sri Mulyani Indrawati. As of March 2017, the 12-month rolling fiscal deficit had fallen to just 2.1% of GDP from as high as 3.7% of GDP as recently as June 2016, when S&P had last declined to upgrade Indonesia.

Part of the reason is due to the government's discipline with its fiscal outlays, especially after the removal of fuel subsidies. Another contributor though has been the fact that the offer of a tax amnesty saw 970,000 participants declare more than $367 billion in assets that is set to yield $11 billion in revenue for the government.

The 9-month amnesty period started in July 2016 and imposed a penalty interest of 2%-10% on individuals and companies depending on when they joined the program and whether or not they repatriated assets along with declaring funds.

Looking beyond the upgrade

It is noteworthy that the tax amnesty is a one-time event and does little to address S&P's concern about the weak revenues to GDP ratio. This is somewhat low at 12.6% as of March 2017 and has been falling since around 15.5% in 2013 and above 16% for non-high income East Asia & Pacific in 2014.

The problem with tax collections is just one of the needed structural reforms that continue to plague Indonesia. S&P is projecting Indonesia's investment to remain stuck at around 35%-36% of GDP, quite a bit below the 41.7% that non-high income East Asia & Pacific saw in 2015.

Upgrade to boost inflows, even if marginal

Although the upgrade had long been anticipated and way after the other two ratings agencies, S&P's upgrade will still burnish Indonesia's attraction to investors. Portfolio managers with highly conservative mandates (like many Japanese funds) are required to invest only in bonds that have an IG rating from all three ratings agencies. Indonesia's high yielding bonds will prove attractive in this space.

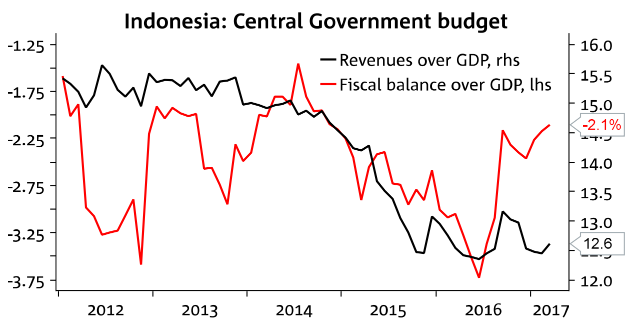
The upgrade will also help to boost Foreign Direct Investments (FDI). FDI has climbed steadily from around 0.5% of GDP in 2009 to 1.6% as of Q1 2017 but there is still more to go. This compares to around 2.4% for non-high income East Asia & Pacific as of 2015, according to World Bank data. Indonesia needs a significant amount of investment, especially in the area of infrastructure, an added assurance of the country's fiscal health will certainly support that effort.

But more macro breakthroughs needed to boost IDR

While the upgrade is likely to boost inflows somewhat, the positive impact on IDR may be limited and 13250 may hold as key USD/IDR support in the near term. We are mindful that Bank Indonesia is still inclined to accumulate reserves. The one caveat would be a surprise passage of infrastructure spending and sees real GDP growth rise beyond the 5.0%-5.5% range that many observers, including the S&P, see Indonesia trapped in.

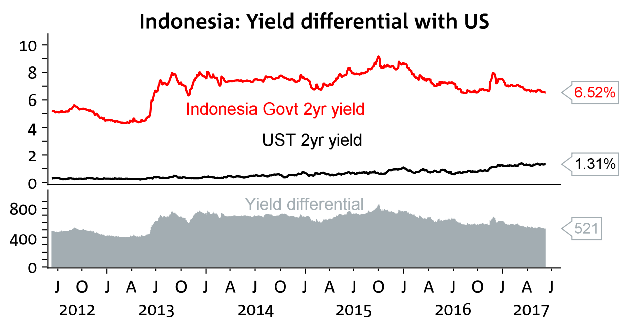
Indeed, Bank Indonesia (BI) reiterated its intent to support the continuation of structural reforms taken by the government, while cautioning that growth for 2017 is likely to be below 5.4%, as it keeps one eye on inflation risks.

Chart 1: FX reserves position has grown more robust



Source: National Australia Bank, Bloomberg, Macrobond

Chart 2: Loan approvals have waned of late



Source: National Australia Bank, Bloomberg, Macrobond

SELECTED INDICATORS

Table 1: NAB Asian FX Forecasts

	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18
USD/CNY	6.92	6.96	6.97	7.00	7.05	7.07	7.07
USD/IDR	13350	13400	13450	13450	13550	13600	13600
USD/INR	64.5	64.5	64.6	64.8	65.0	65.0	65.2
USD/KRW	1135	1160	1200	1200	1180	1160	1160
USD/MYR	4.45	4.48	4.50	4.55	4.55	4.55	4.55
USD/PHP	50.0	50.3	50.5	50.6	50.7	50.8	50.8
USD/SGD	1.42	1.43	1.44	1.44	1.44	1.45	1.45
USD/THB	34.7	34.8	35.0	35.3	35.6	35.5	35.5
USD/TWD	30.0	30.2	30.2	30.4	30.5	30.6	30.5

	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18
AUD/CNY	5.05	4.94	4.88	4.90	4.94	4.95	4.95
AUD/IDR	9746	9514	9415	9415	9485	9520	9520
AUD/INR	47.1	45.8	45.2	45.4	45.5	45.6	45.6
AUD/KRW	829	824	840	840	826	812	812
AUD/MYR	3.25	3.18	3.15	3.19	3.19	3.19	3.19
AUD/PHP	36.5	35.7	35.4	35.4	35.5	35.6	35.6
AUD/SGD	1.04	1.02	1.00	1.01	1.01	1.02	1.02
AUD/THB	25.33	24.71	24.50	24.71	24.92	24.85	24.85
AUD/TWD	21.90	21.44	21.14	21.28	21.35	21.35	21.35

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	0.70	0.70	0.70	0.70
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	1.10	1.11	1.13	1.15	1.15	1.17	1.19
British Pound	GBP/USD	1.25	1.31	1.29	1.27	1.26	1.25	1.24	1.22
Swiss Franc	USD/CHF	1.01	0.97	0.98	0.97	0.97	0.98	0.99	1.00
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	6.96	6.97	7.00	7.05	7.07	7.07

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