10 October 2017

ESSENTIAL ASIA

Politicking Policy

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Talking Points

- Politics and policy are key market focus in coming weeks.
- North Korea, China's 19th CPC and Singapore's MAS policy decision are on market radar in October, along with Fed's policy normalization thereafter.
- Asian currencies are poised for further consolidation, though a gradual Fed will continue to whet risk appetite and underpin equities markets' performance.

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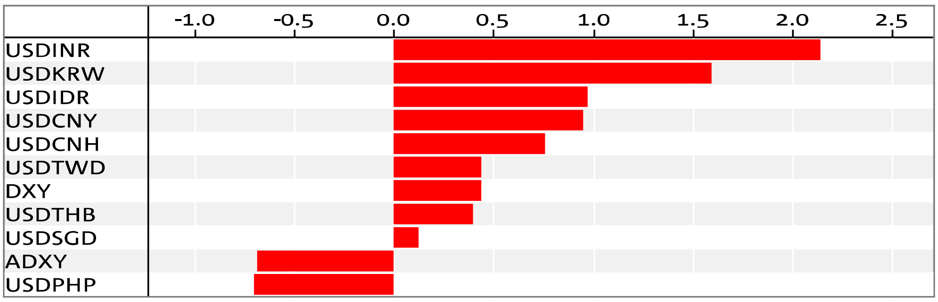
Asia FX in September

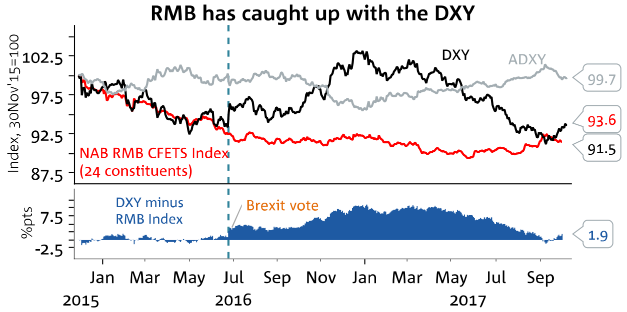
FX changes over the month (% change)



Source: National Australia Bank, Bloomberg, Macrobond

Chart of the month

RMB has caught up with the DXY



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	1.25	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	4.50	4.25	4.25
China	4.35	4.35	4.35	4.35	4.35	4.35	4.35	4.35

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POLITICKING POLICY

- **Politics and policy are key market focus in coming weeks.**
- **North Korea and China's 19th CPC are high on market radar in October, along with the US Fed's policy normalization thereafter.**
- **Asian currencies are poised for further consolidation, though a gradual Fed will continue to whet risk appetite and underpin equities markets' performance.**

Asian currencies gave up virtually all the gains accumulated since mid-August. The ADXY peaked at around 109 in early September and fell swiftly before forming a base around 107.0. Meanwhile, Asian equities started on its consolidative path right before the FOMC meeting on 21 September, but has since rebounded in October. Stretching the movements of these two indexes even further, it is evident that the taper tantrum in mid 2013 had a more pronounced and prolonged impact on Asian currencies, than it had on Asian equities.

One might recall vividly that in mid-2013, the mention by the US Fed that it was poised to scale back quantitative easing wiped off US$1.5 trillion from US Treasuries within a fortnight. However, there was very little follow through as US Treasuries yields resumed their downward path. There were a few temporary spikes in yields until the Fed actually hiked for the first time at the end of 2016. 10Y UST yield is now pretty much where they were when taper tantrum happened. That is not the case though for global yields. 10Y yields in Italy and Spain are now trading at least half of where they were during taper tantrum, when they were trading nearer to 5%. Similarly, UK and Germany 10Y yields are now trading markedly lower than 10Y USTs (965bp and 1896bp below Treasuries respectively). 10Y UST yields are now the highest among these developed markets. However, there are signs that they are moving more in sync, with the Fed slated to hike in December and the ECB tapering a matter of sooner rather than later. The sense is that while the USD is expected to strengthen along the Fed's rate hikes, there will be minimal drag on US and global growth and Asian markets are well positioned to weather the higher rates environment, providing sufficient reason to still be bullish Asian equities. Furthermore, interest rates are expected to remain quite low and this was reinforced by the Fed lowering its long term dot plot to 2.75%. Generally upbeat earnings performance in Asia are providing some additional buffer for Asian equities. China recently reported strong industrial profits which echoed the strong earnings performance that SOEs have been reporting, and observers are noting that a large part could be attributed to higher base metals prices. However, net foreign inflows have tapered in September, suggesting the boost was coming from domestic funds.

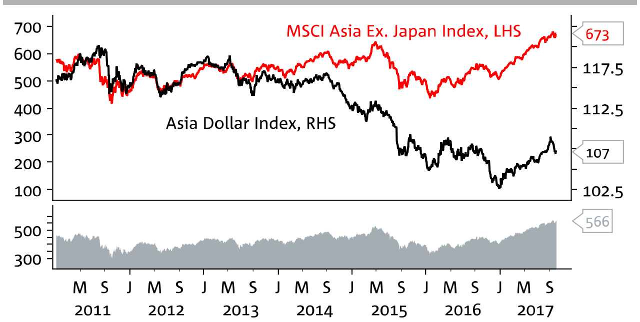
Catalonia adding to geopolitics for Asian markets

The ADXY, whilst tracking the DXY movements, has room to weaken further from here. The scope for two way risks have also widened, with the messy political situation in Europe adding to the ongoing uncertainties in the Korean peninsula. While it has been relatively quiet in North Korea, possibly as China and South Korea were away for the Golden week and Chusok holidays, no one's letting their guard down. On the contrary, US Congressional defense committees have approved shifting more than US$400 million from other accounts into missile defense programs to clear the way for more defences against North Korea. The US supercarrier Ronald Reagan powered into HK waters in early October and was expected to head to waters off the Korean peninsula for joint exercises with the South Korean navy. The FT also reported that Australia plans to fit warships with advanced air-defense technology to guard against North Korean missiles. At the same time, North Korea's U.N. ambassador accused the United States of imposing "an economic blockade" on his country and deploying nuclear assets on the Korean peninsula aimed at toppling leader Kim Jong Un. The diplomatic efforts so far have been futile and international media AP reported that officials from the South Korean Ministry of Unification visit the border town of Panmunjom on a daily basis, making calls into North Korea twice a day for the past 18 months, but no one in the north has picked up the phone.

Eyes on 19th CPC and market watchful for surprises

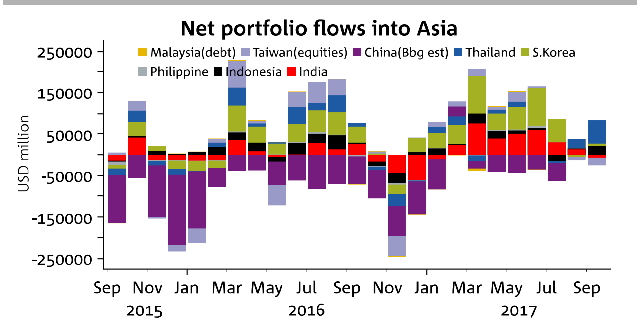
China's 19th CPC is slated to take place on 18 October. While this is widely known as a political event rather than an economic one, markets will remain watchful for surprises. The focus of the Party Congress is on "party building", with political appointments and discussions over party ideology taking centre stage. As for economic policy, President Xi will be delivering a speech on the first day of the meeting and supply-side reform are expected to be mentioned. Post Golden Week, the RMB index is expected to track the DXY while USD/CNY may reflect greater volatility.

Chart 1: Risk appetite for Asian equities prevails



Source: National Australia Bank, Macrobond

Chart 2: Smaller net inflows into Asian assets



Source: National Australia Bank, Bloomberg, Macrobond

CHINA SPOTLIGHT:

RMB regime goes retro

- **The PBoC's FX regime appears to have been reset to pre-Brexit vote; USD/CNY rebound not surprising.**
- **The government disputes S&P's downgrade and follows up with targeted RRR cuts.**
- **The 19th Communist Party National Congress on October 18th could provide signals about whether political consolidation is complete**

USD/CNY outperforms

The 2.6% rebound in the USD/CNY over the last 3 weeks of September had perplexed some in the market but for us it confirms our suspicion that the People's Bank of China (PBoC) has moved back to the FX regime it had been using before the surprise Brexit vote result in June 2016. The close tracking of the DXY by the CFETS index should be maintained until the 19th National People's Congress on October 18th and likely beyond. The Congress will be closely watched for signals of whether President Xi's consolidation of power is complete.

Downgrade defensiveness

In a somewhat belated move, S&P downgraded China's long-term sovereign rating from AA- to A+, bringing it in line with Moody's downgrade in May 2017. By and large, the main concerns were similar to what Moody's had listed. These were namely that loan growth is still continuing at too strong a pace, and that Local Government Financing Vehicle (LGFV) poses a worry.

The Chinese government disputes this reading, essentially claiming that S&P has glossed over important nuances. The market seems to agree with the government, hardly reacting to the downgrade. One reason for this is that the downgrade merely moves China to the 5th of the 11-rung Investment Grade bloc.

The war of words between China's Ministry of Finance (MoF) and S&P over the latter's decision to downgrade China's sovereign rating, seems to be turning on the differing interpretation of Local Government Financing Vehicle debt. S&P has lumped that into the total amount of debt assigned to the sovereign, but the MoF is protesting that this is "unreasonable". The government has assiduously maintained that it will not bail out LGVF debt. To be fair to S&P, this commitment has not yet been seriously tested.

In a move that should dispel fears the S&P downgrade will lead to a sharp slowdown in lending, the PBoC has delivered a targeted reserve requirement ratio (RRR) cut reminiscent of similar moves in 2014 and 2015. In a nutshell, banks will enjoy RRR cuts ranging from 0.5 to 1.5 percentage points depending on how much they lend to small enterprises, agricultural borrowers and start-ups, market segments historically ignored by the bigger, more risk averse banks. The timing of this move suggests that the authorities are still concerned about the pace of growth and are perhaps trying to head off a potential incipient slowdown, but also doing it in a sustainable way.

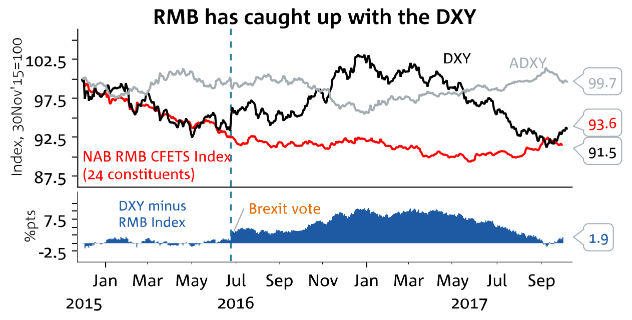
FX regime reset to pre-Brexit vote

The recent rebound in the USD/CNY corroborates our view that the PBoC views the RMB through the lens of the CFETS index and the FX regime targets the cumulative difference between the DXY and the CFETS index; the party congress is probably not central to the management of the RMB. In our view, the PBoC has returned to the FX regime that it was in place before the Brexit vote in June 2016 (see graph below). From the end of November 2015 (when the RMB entered the IMF SDR basket) to 23 June 2016, the cumulative difference ranged from -1.6ppt to +1.9ppt. From the week before the removal of the 20% reserve requirement when buying USD/CNY forwards, the cumulative difference has ranged between -1.1ppt to +1.7ppt, within the range that we had seen prior to the Brexit vote. As such, the recent surge in the USD/CNY does not really strike us as being necessarily indicative of another shift in the FX policy regime. What it does seem to indicate is that the authorities are not more committed to managing the RMB according to CFETS index and are indeed allowing more volatility in the bilateral rate (USD/CNY).

Party Congress to open Xi's second chapter

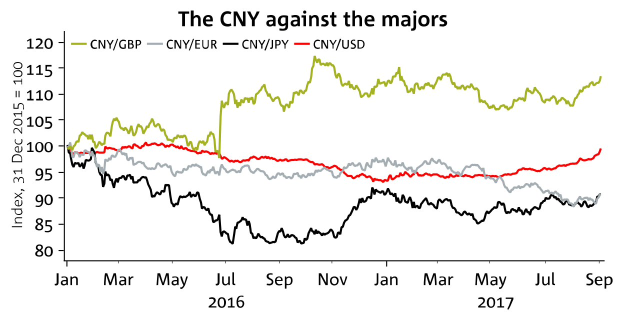
The National People's Congress on October 18th is set to reveal just how much President Xi Jinping has consolidated his power and how comfortable he feels about it. Interestingly, the South China Morning Post has cited unnamed sources as saying that Premier Li Keqiang will stay on. If this turns out to be true, it would suggest that July's ouster of Chongqing party secretary and potential rival Sun Zhengcai might be the coup de grace needed to put Xi at ease. There is some speculation that this could lead to a quickening of the pace of reforms and this could intensify the pain for the banking sector and the economy.

Chart 1: Back to pre-Brexit regime



Source: National Australia Bank, Bloomberg, Macrobond

Chart 3: CNY appreciating against the majors



Source: National Australia Bank, Macrobond

KOREA SPOTLIGHT:

Business (as good) as usual

- **South Korean financial markets have been quite resilient in the face of North Korea threats.**
- **The dent to consumer and business confidence has been mild. Macro data has been pretty robust, especially external sector performance.**
- **This may be as good as it gets and investors may get increasingly responsive to the trend of policy normalisation globally.**

Business as usual amid unusual geopolitical rumblings

USD/KRW staged a recovery from 1120 to encounter a strong resistance at 1150 in September. The persistent threats from North Korea which triggered strong sanctions from the United Nations in September managed to trigger foreign investors to switch from Korea's equity markets to the bond market. Month-to-date, foreigners net sold US$981mn worth of Korean shares, but net bought US$663mn worth of Korean debt. The dent to consumer and business confidence has been mild, with the manufacturing business survey coming off to 79 from 83. The breakdown though suggests that exporters were not in the least concerned over the geopolitical situation and it was mostly SMEs that saw a big dip in sentiment. September consumer confidence has also started to taper off, but at 107.7, is still a multi-year high. The breakdown suggests stable price and income expectations, though positive sentiment towards the economic situation has eased visibly. There are scant signs though that the escalating political tension is weighing on South Koreans' day to day activities. In other words, it's business as usual in South Korea.

Strength of macro data drowns out noisy neighbour

Final Q3 data has been encouraging, perhaps another factor drowning out the political noise from its neighbour and providing some buffer for Korean assets. September exports surprised significantly on the upside, rising 35% yoy and double the growth pace in August. Imports also beat market expectations with 21.7% yoy rise and the trade surplus ballooned to US$13.7bn. Despite the consumer backlash in China over the deployment of the THAAD missile system, exports to China rose a strong 23.4% yoy. Admittedly, there has been some impact from China's boycott of tourists to South Korea and also automobile exports, but the latter has rebounded strongly in September with a 57.6% yoy surge. Semiconductor and steel products exports were strong performers as well in September, echoing the favourable price effects that are echoed elsewhere in the region.

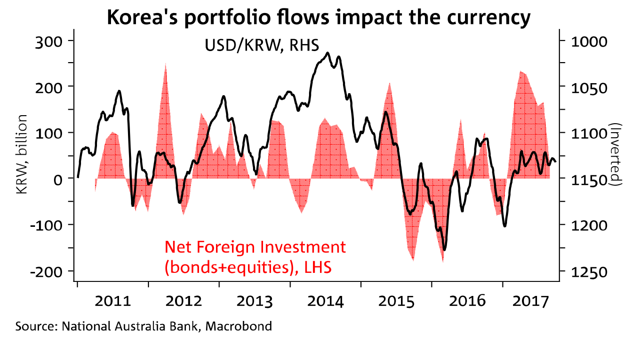
In addition, exports to the US rose 29% yoy in October, perhaps a bigger issue of contention as US President Trump has threatened to dismantle KORUS FTA. The latest development appears to be that the South Korean government has decided that the threat is substantial and can be realised at any moment in the future and hence implicitly agreed on initiating amendment negotiations on the KORUS FTA.

Geopolitical threats are still underpriced

Even though the geopolitical uncertainties have been persistently underpriced, there are signs that investors may get increasingly responsive to the firmer USD and the trend of policy normalisation globally. 10Y KTB yields have been moving up quite steadily and the divergence with the benchmark policy rate could widen further in the near term.

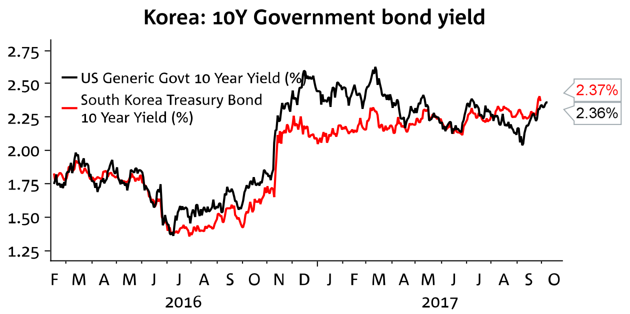
Potential negative disruptions to the Korean won will be from capital flight from the financial market instead of the current equity to debt switch by foreign investors. The trigger will be further strife in the Korean peninsula translating into shock events, and also should the KORUS talks fail in a material way. Both risks seem to be quite benign at this juncture and not a base case for many investors. In the meantime, supportive economic and monetary policy may still keep investors invested in South Korea.

Chart 3: Foreign investors stay invested in Korea



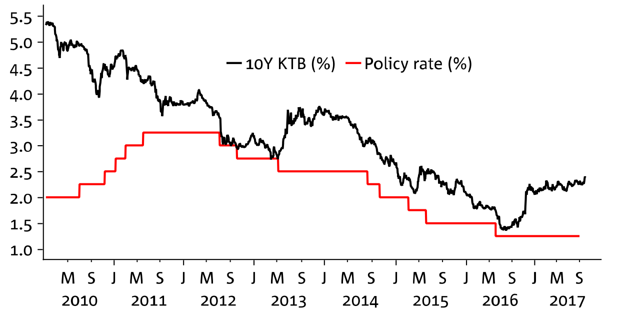
Source: National Australia Bank, Macrobond

Chart 1: Korea-US spreads may widen further



Source: National Australia Bank, Bloomberg, Macrobond

Chart 2: Widening divergence with policy rate



Source: National Australia Bank, Bloomberg, Macrobond

INDIA SPOTLIGHT:

A delicate balancing act

- **The RBI's latest policy statement cast a pall over markets as it hinted at an inevitable slowdown against the backdrop of rising inflation.**
- **The government however might be running the risk of stoking the twin fears of inflation and a fiscal deficit blowout.**
- **The risks to both INR bonds and equities are substantial; a reduction in foreign inflows could see the USD/INR move past 66.**

Fast forwarding to acceptance

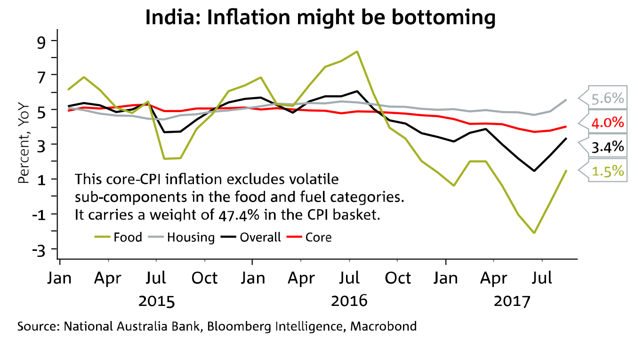
Even as the RBI maintained monetary policy in the neutral mode and kept key policy rates unchanged, the darkening of the tone in its explanatory statement was unmistakable. Headlining this would be the lowering of the growth forecast for FY2017-18 (Q2 2017-Q1 2018) from the 7.3% made in August to 6.7%. Perhaps more worrying is the slight elevation in the inflation forecast for H2 FY2017-18 from the 4.0%-4.5% made in August to 4.2%-4.6%, which signals that the prospects for further rate cuts in the near term have been curtailed somewhat. The RBI also warned that core inflation (ex-food-and-fuel) has already been exceeding projections and that the government's flirtation with the risk of fiscal slippage adds to the risk of higher than expected inflation in the months ahead.

This is a material darkening of the India story that has seen both equity and bond markets in India surge on the back of foreign inflows and ebullience of domestic investors. The danger going forward is that the government might, in its desperation to elevate the rate of GDP growth, abandon even the appearance of fiscal discipline and create a self-sustaining vicious circle of loss of confidence and reduced investment. For now, the USD/INR should merely maintain a gradual upward creep towards 66 and potentially some distance beyond that as the data continues to weaken. The government's best response would be to accept the slower growth and focus on structural reforms while maintaining some semblance of fiscal discipline at least.

A slew of spending measures

The RBI complained about 2 recent fiscal measures in particular: (1) farm loan waivers implemented by the States could exacerbate the fiscal slippages and "undermine the quality of public spending"; and (2) implementation by States of salary and allowances awards on top of what the Federal government is giving. These are both pure demand-side stimuli and will not contribute to improving the supply side situation. In particular the second measure is estimated by RBI to potential add 100 basis points to inflation over 18-24 months, plus second round effects. Besides these 2 measures, the government has also recently reduced the Goods and Services Tax (GST) on 27 items, allowed exporters to continue with exemptions and allowed small business to extended the period for small businesses to file returns.

Chart 3: Inflation is a growing constraint

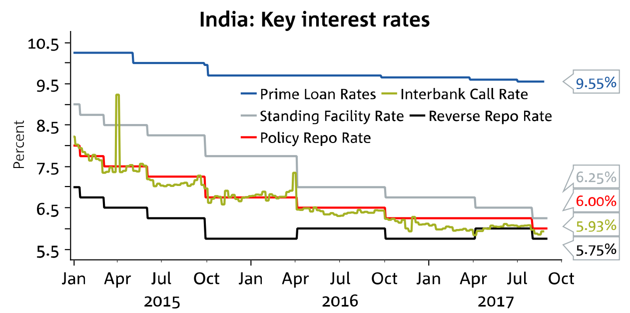


Source: National Australia Bank, Bloomberg Intelligence, Macrobond

Deficit numbers cause a surfeit of concerns

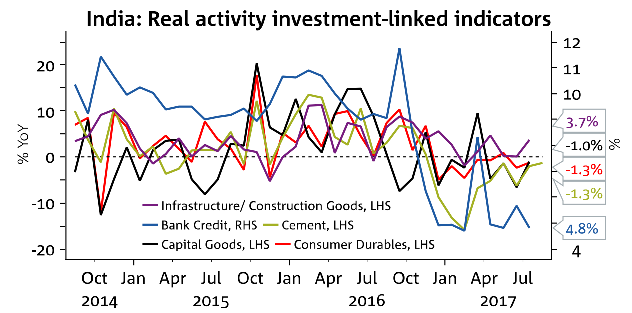
The market's concern about the government's fiscal discipline does seem to be well-founded as it was reported that the April-August deficit hit INR 5.25 trillion, 96.1% of the full fiscal year target of INR 5.47 trillion. This compares to 76.4% at the same time in the previous fiscal year. Granted that this might reflect some degree of frontloading and it is not necessarily the case the deficit target of 3.2% of GDP is a lost cause. However, concerns are justified and likely to be reflected in a bearish INR bond market.

Chart 1: Transmission mechanism still rather slow



Source: National Australia Bank, Macrobond

Chart 2: Investment indicators remain weak



Source: National Australia Bank, Macrobond

SINGAPORE SPOTLIGHT:

Signs of the times

- **As the US normalizes interest rates, MAS has more incentive to avoid unnecessary shifts in policy, especially if economic data provides no cause.**
- **Core inflation continues to hover below the medium term target while the jobs market remains soft.**
- **The likely appreciation of the USD and the CNY against the SGD in the months ahead will make it hard for the S$NEER to sustain an upward trajectory.**

No reason to rock the boat

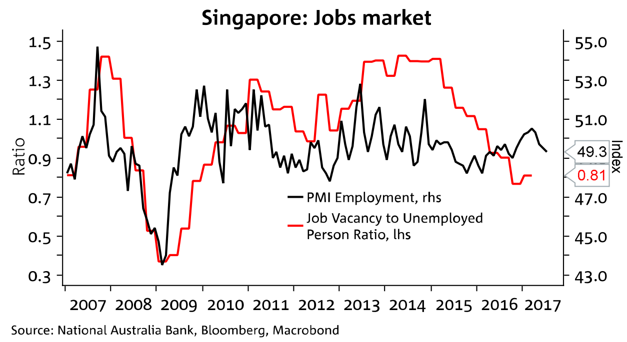
On the cusp of the Monetary Authority of Singapore (MAS) October 13 biannual monetary policy meeting, the confluence of domestic economic indicators and external conditions leaves a somewhat muddled picture of where policy needs to be. However, it might well be argued that the lack of a strong reason to move at all should be the dominating narrative and it is probably better for the MAS to keep its powder dry for now. The main uncertainty of course stems from the pace of the US Federal Reserve's normalization of its monetary policy position against the backdrop of severe hurricane damage to the growth momentum, as well the potential for fiscal stimulus. Also, the speed of market's acceptance of the inevitability of said normalization, and of the economy's ability to absorb a fairly gradual normalization, will both be key to how much USD strength is seen and how quickly it manifests. This in turn will also determine how much RMB strength comes through over the next few months. With both these currencies likely to gain against the SGD, the downside room in the S$NEER band is something MAS is likely to not allow erode too quickly. As such, maintaining the neutral bias seems like the most prudent option for now, especially with domestic indicators not providing any need to move..

Domestic data denies direction

Although the robust growth expectations, centred around very bullish expectations for both exports and manufacturing, provide room for the MAS to potentially tighten, it is not likely to outweigh the cumulative impact of other indicators, which lean away from tightening. The MAS September 2017 Survey of Professional Forecasters had 2017 GDP growth expectations unchanged from the June survey at 2.5% but the expected growth for the manufacturing sector accelerated to 6.6% from 5.0% on the expectations that non-oil domestic exports (NODX) would grow 7.4% from 5.6% in June.

Chief amongst the countervailing data though will be inflation, with the MAS Core inflation easing slightly to 1.4% yoy in August from 1.6% the previous month, and further away from the mid-term target of 2.0% yoy. Additionally, there is still evidence that the jobs market remains somewhat soft at the margin, with the job vacancy to unemployed persons ratio still stuck below 1.0 and retrenchments still remaining somewhat elevated. Lower resignation levels also indicate that the jobs market is far from tight.

Chart 3: Jobs market still soft at the margin

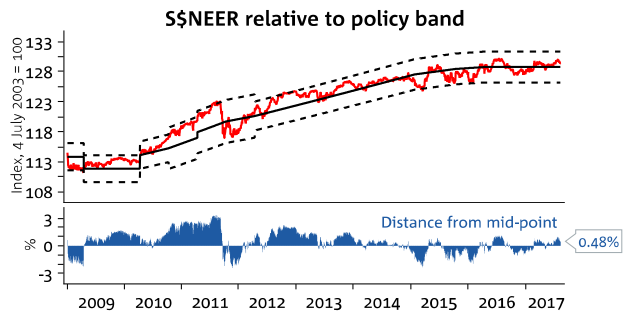


Source: National Australia Bank, Bloomberg, Macrobond

Legroom preferred

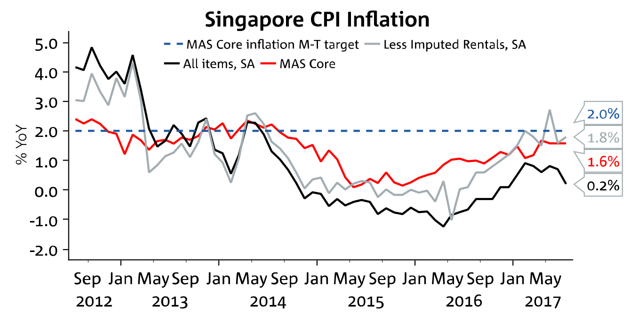
Although the S$NEER continues to hover at around 0.5%-1.0% above the mid-point, MAS might not see that legroom as superfluous given the likelihood of USD strength in the months ahead. Additionally, the People's Bank of China appears to have returned to the pre-Brexit vote FX regime of having the official RMB index track the DXY. This means that broad USD strength will also be accompanied by broad RMB strength, with both likely strengthening against the SGD and pushing the S$NEER lower; the USD and RMB jointly account for almost 40% in the S$NEER basket. With the pace of this decline in the S$NEER fairly uncertain at this juncture, the MAS will probably not want to take the risk of accelerating the erosion of that legroom by shifting to an appreciating bias in the policy band. We would peg the likelihood of a no-change decision at 80% with a 20% chance of a shift to an appreciating bias.

Chart 1: S$NEER surges in July



Source: National Australia Bank, Bloomberg, Macrobond

Chart 2: YoY growth less dependent on construction



Source: National Australia Bank, Macrobond

MALAYSIA SPOTLIGHT:

Mounting pressure in the background

- **Despite the MYR's recent strength, short term external fundamentals remain questionable as Moody's highlighted recently.**
- **BNM might be in for a difficult time as it tries to prop up growth while still defending the currency as general elections approach.**
- **With multiple threats and few buffers, it is likely that the MYR will be an underperformer in the months to come.**

USD rebound to test policy discipline

Even as Bank Negara Malaysia put on a brave face after announcing a no-change decision at its most recent policy meeting, there are signs that pressures are beginning to mount, especially with respect to the MYR. Moody's has just echoed our sentiment that Malaysia's FX reserves are uniquely low in the region; against the backdrop of a resurgent USD, this should be getting increasing scrutiny over the next few months.

The recent rebound in the MYR over the month of September, on the back of renewed portfolio inflows, might turn out to be a bit of a poisoned chalice. As US rate hike expectations start to mount and US Treasury yields start to climb, those flows could reverse across Asia and Emerging Markets (EM) and the ability of BNM to cushion the impact of those flows could determine where the MYR places on the Asian FX leaderboard.

Not much in reserve

Moody's flagged Malaysia's FX reserves status as the weakest in EM Asia, with external debt payments due this year plus total non-resident deposits over 1 year amounting to 151% of end-2016 FX reserves. Only Sri Lanka at 183% is weaker; the next weakest after Malaysia is India at 72% with Indonesia at 50%. NAB's proxy of FX reserves over a sum of short term external debt plus all MYR debt held by non-residents yields a ratio of just 0.86 compared to 1.71 for Indonesia. Even when compared on a more traditional basis like import cover, Malaysia lags at just 6 months compared around 10-11 months for most EM Asia counterparts.

As the USD starts to climb, BNM will have to be a lot more circumspect about the amount of support it can provide to the MYR. The picture on the growth side does not exactly help with the BNM either. The government's generous 2017 budget has seen a burst of both private and government consumption, with a short term dip in net exports into the red. As the fiscal stimulus starts to fade towards the end 2017, and the national election gets called in H1 2018, there is likely to be more pressure on BNM to lower interest rates. However, the MYR's carry buffer over the USD is not the widest and narrowing it will only increase the upside pressure on the USD/MYR.

Chart 3: Malaysia's in a weak position

Country	Number of months	6M Carry
China	23.7	3.8%(CNH)
Hong Kong	8.3	0.6%
India	11.8	6.1%
Indonesia	9.8	5.8%
Korea	11.0	1.0%
Malaysia	6.4	2.4%
Philippines	13.2	4.2%
Singapore	10.9	1.0%
Taiwan	22.9	-0.1%
Thailand	10.8	1.3%

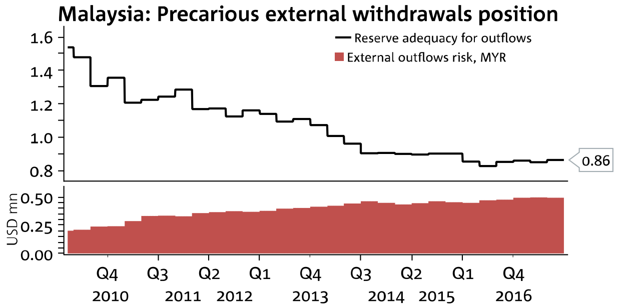
Source: National Australia Bank, CEIC

Scrambling for alternative levers

After clamping down hard on the market in non-deliverable forwards (NDF) for the MYR in November 2016, the BNM seems to be back to a similar tact again. In response to Moody's comments, BNM stated that it has other means of meeting external obligations other than FX reserves and pointed to Malaysia's positive net international investment position (NIIP) of 3.3% of GDP. Although this is true, as is the current account surplus to the tune of 2.2% of GDP, it should be noted that this is not the most relevant measure for short term flows.

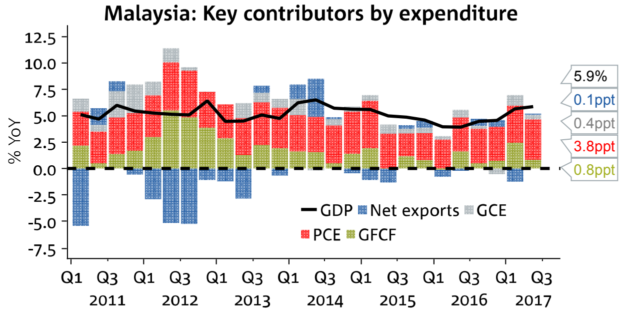
Addititonally, BNM has also reiterated its plans to name and shame banks that engage in wrongdoing in the FX market, specifically engaging in FX activity without having an underlying trade transaction. This smacks of the action in November and will only contribute to further doubts about BNM and suggests that there is some realization at BNM that it does not have the wherewithal to support the MYR in the conventional manner.

Chart 1: Little scope for sustained MYR support



Source: National Australia Bank, Macrobond

Chart 2: Domestic demand hurts net exports



Source: National Australia Bank, Bloomberg, Macrobond

INDONESIA SPOTLIGHT:

The final cut, for now…

- **After 2 successive surprise rate cuts, BI is sending out quite overtly hawkish signals as it juggles monetary stimulus with keeping the IDR stable.**
- **The economy is stymied by supply side bottlenecks and there is a limit to how much monetary stimulus can help support growth in the near term.**
- **The USD/IDR's recent upward pressure was easily contained but BI will want to be careful of the potential for prolonged broad USD strength, even if FX reserves are adequate.**

Watch out for oncoming USD traffic

Bank Indonesia's (BI) rate cutting spree appears to be at an end as Assistant Governor Dody Budi Waluyo declared that the room for further rate cuts is "not much", although he did also add that decisions remained "data dependent". BI surprised the markets with 2 consecutive 25 basis point cuts over August and September but Waluyo suggested that other tools might be employed going forward, including the currency and other liquidity measures like the reserve requirement ratio.

One thing that might have spooked BI a little but is the upward pressure on the USD/IDR as the end of September brought a boost to US rate hike expectations. The USD/IDR has been kept relatively stable in either direction against a backdrop of a gyrating USD. Chances are that BI will continue to try and maintain the USD/IDR to avoid spooking foreign investors in both domestic equity and bond markets. This might prove increasingly challenging as the USD marches higher. A healthy carry buffer could prove helpful in staving off some pressure and reduce the drain on FX reserves.

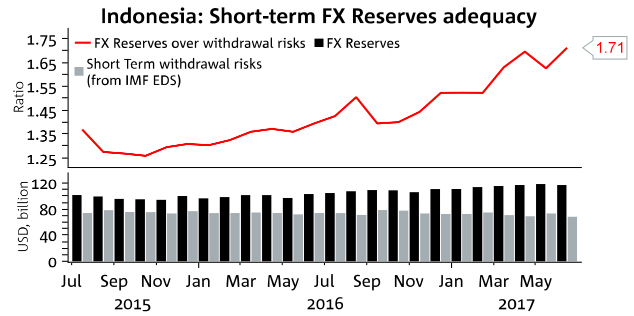
Enough in the tank for now

It has to be noted though that BI's discipline on the USD/IDR has been in both directions and it has been gradually accreting FX reserves, which amounted to USD 129.4 billion at the end of September, equivalent to 8.9 months of import cover or 8.6 months of imports plus government external debt repayments. These FX reserves are also equivalent to more than 170% of the IMF's measure of short term external liabilities. BI though seemed to be drawing its lines in the sand, saying that it foresees the USD/IDR ranging from 13,400-13,700 in 2018. Clearly it is bracing for USD strength as the interest rate normalization in the US continues and the market starts to price this in more aggressively.

Inflation could start to turn

Inflation is probably also the other (albeit likely lesser) constraint on further rate cuts. August and September saw core inflation appear to bottom around 3% yoy, with as base effects petered out and the 7-month string accelerating MoM growth in core inflation starts to tell on the YoY series. Although headline inflation slowed marginally to 3.72% yoy in September from 3.82%, this could also start to bottom as well.

Chart 3: FX reserves adequate against S-T outflows

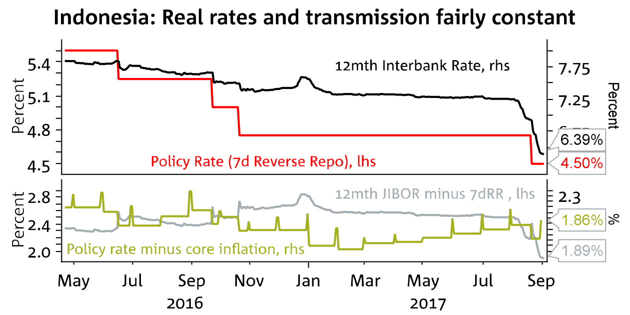


Source: National Australia Bank, IMF, Macrobond

Expectations still fairly sanguine

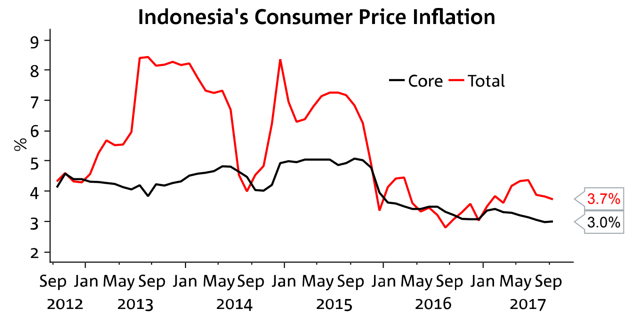
Overall, BI remains fairly sanguine about growth prospects as well as the current account and will probably opt to keep its powder dry for the time being. There is a chance that it might switch its focus to the transmission mechanism to try and push some of its previous cuts through the banking system via reserve requirement cuts, although this would also be bound to some extent by the pass-through into the currency.

Chart 1: Transmission has improved recently



Source: National Australia Bank, Bloomberg, Macrobond

Chart 2: Domestic demand doesn't need stoking



Source: National Australia Bank, Bloomberg, Macrobond

SELECTED INDICATORS

Table 1: NAB Asian FX Forecasts

	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19
USD/CNY	6.65	6.67	6.64	6.64	6.62	6.65	6.64	6.65
USD/IDR	13450	13500	13500	13480	13460	13400	13360	13350
USD/INR	65.0	65.3	65.5	65.8	65.6	65.4	65.2	65.0
USD/KRW	1160	1200	1200	1180	1160	1160	1150	1150
USD/MYR	4.25	4.40	4.35	4.35	4.35	4.30	4.25	4.20
USD/PHP	50.3	50.5	50.0	49.5	49.2	49.0	48.6	48.5
USD/SGD	1.39	1.41	1.40	1.40	1.40	1.40	1.39	1.38
USD/THB	34.1	34.5	35.0	34.6	34.5	34.5	34.4	34.3
USD/TWD	30.2	30.2	30.4	30.5	30.6	30.5	30.3	30.2

	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19
AUD/CNY	5.19	5.00	4.92	4.85	4.86	4.86	4.92	4.98
AUD/IDR	10491	10125	9990	9840	9782	9782	9886	10013
AUD/INR	50.7	49.0	48.5	48.0	47.7	47.7	48.2	48.8
AUD/KRW	905	900	888	861	847	847	851	863
AUD/MYR	3.32	3.30	3.22	3.18	3.14	3.14	3.15	3.15
AUD/PHP	39.2	37.9	37.0	36.1	35.8	35.8	36.0	36.4
AUD/SGD	1.08	1.05	1.04	1.02	1.02	1.02	1.02	1.04
AUD/THB	26.60	25.88	25.90	25.26	25.19	25.19	25.46	25.73
AUD/TWD	23.56	22.65	22.50	22.27	22.27	22.27	22.42	22.65

Table 2: NAB Key FX Forecasts

		Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19
Australian Dollar	AUD/USD	0.78	0.75	0.74	0.73	0.73	0.73	0.74	0.75
New Zealand Dollar	NZD/USD	0.72	0.70	0.69	0.69	0.70	0.70	0.71	0.72
Japanese yen	USD/JPY	112	116	118	118	118	120	120	120
Euro	EUR/USD	1.19	1.17	1.18	1.20	1.22	1.20	1.20	1.18
British Pound	GBP/USD	1.28	1.27	1.29	1.29	1.28	1.26	1.25	1.24
Swiss Franc	USD/CHF	0.97	0.97	0.97	0.96	0.98	0.98	0.98	0.98
Canadian Dollar	USD/CAD	1.27	1.30	1.31	1.32	1.33	1.34	1.35	1.34
Chinese New Yuan	USD/CNY	6.65	6.67	6.64	6.64	6.62	6.65	6.64	6.65

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

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