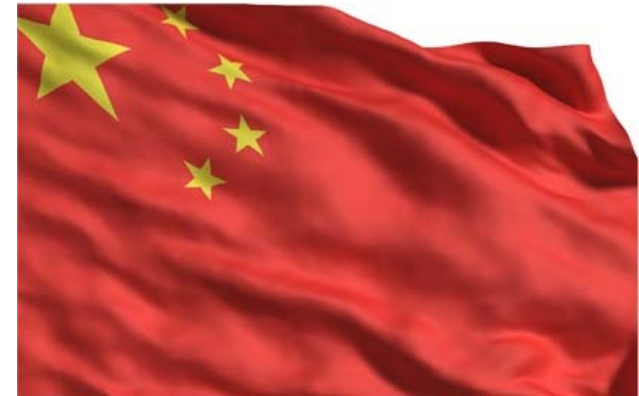




Asia Monthly Update December

US' retreat = China's rise

Amy Y. Zhuang, 14 December 2016



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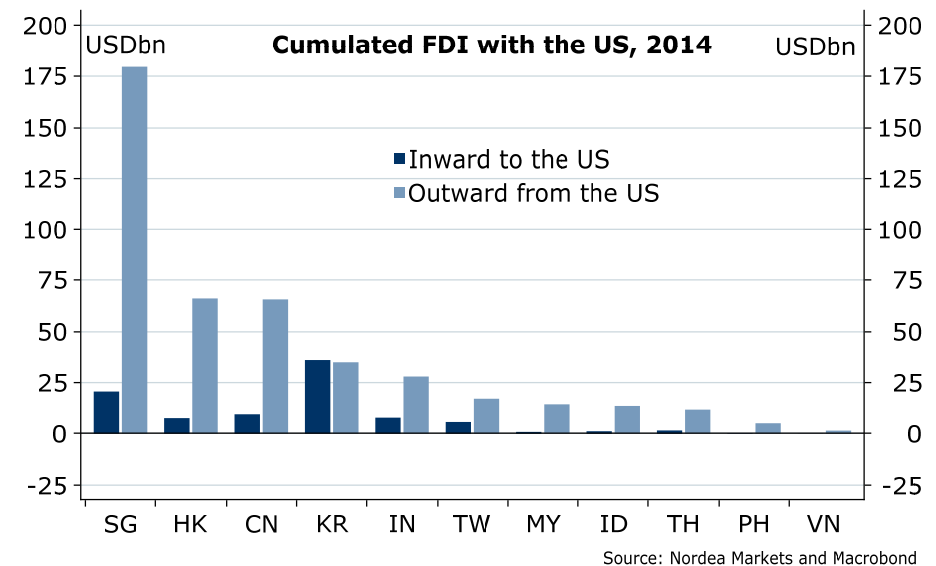
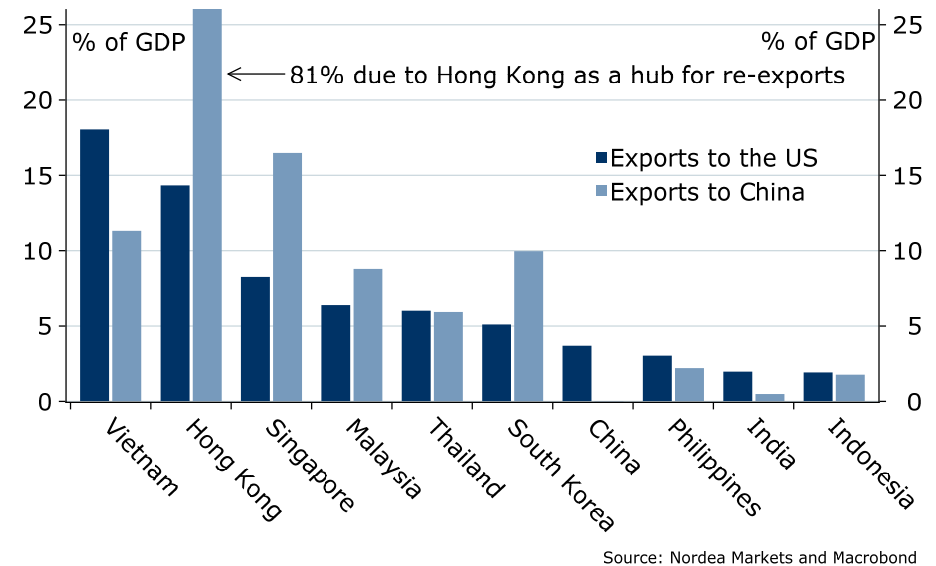
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Executive summary

- Donald Trump as the US president could pose many downside risks to the Asian economies and markets, which we covered in the previous issue of the newsletter.
- In addition, it has the possibility to accelerate a trend that is already on the way: China's rising influence in Asia.
- Rising protectionism in the US would lead most Asian countries to lose the US as a crucial export market. They would then turn their gigantic neighbour: China, which has huge domestic demand to stimulate.
- China's influence in Asia will grow in all areas ranging from foreign trade, direct investment, financial market and geopolitics.
- Asian economies will also in a higher degree focus on domestic infrastructure investment, which for most of them could boost short-term growth and long-term productivity.
- We are relatively negative on the following for 2017: SGD, KRW, TWD and MYR
- We are relatively positive on the following for 2017 : INR, PHP and THB

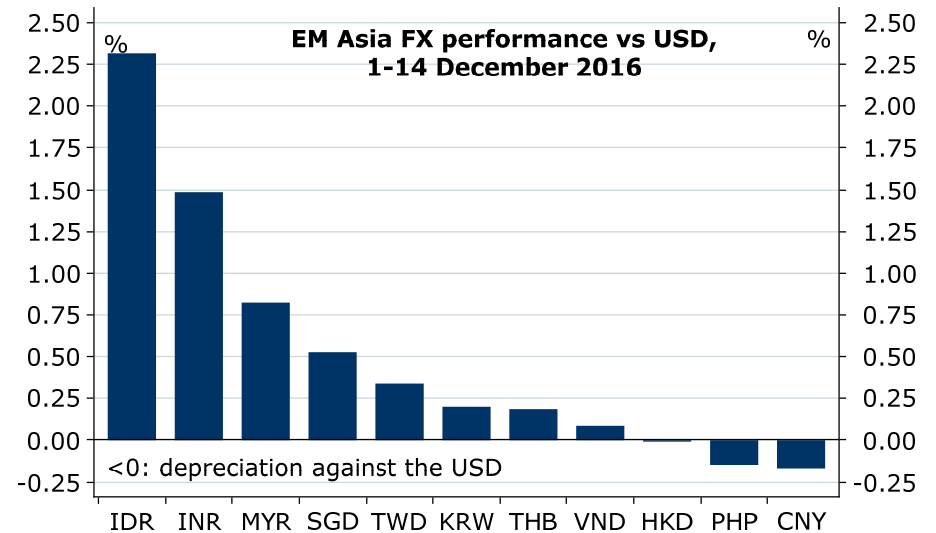
Asia: US' retreat boosts China's power

- In our previously newsletter, we have discussed the risks stemming from Trump's presidency, specifically related to trade and external debt.
- In this issue, we will look at the other side of the coin. How will US' potential retreat from Asia affect the region as it will likely give China an opportunity to increase its influence?
- China's influence has evidently risen in Asia during the past years. More Asian countries have become more sensitive to a slowdown in Chinese growth. This is due to the fact that most Asian countries exports more to China than to the US.
- Given the rising protectionism, not only in the US, Asian countries will inevitably become more inward looking and rely on domestic growth drivers. Infrastructure investment leaves a win-win situation as it will not only boost near-term growth but will enhance long-term productivity. In this perspective, Chinese direct investment will speed up in these countries, especially US capital will withdraw from the region.

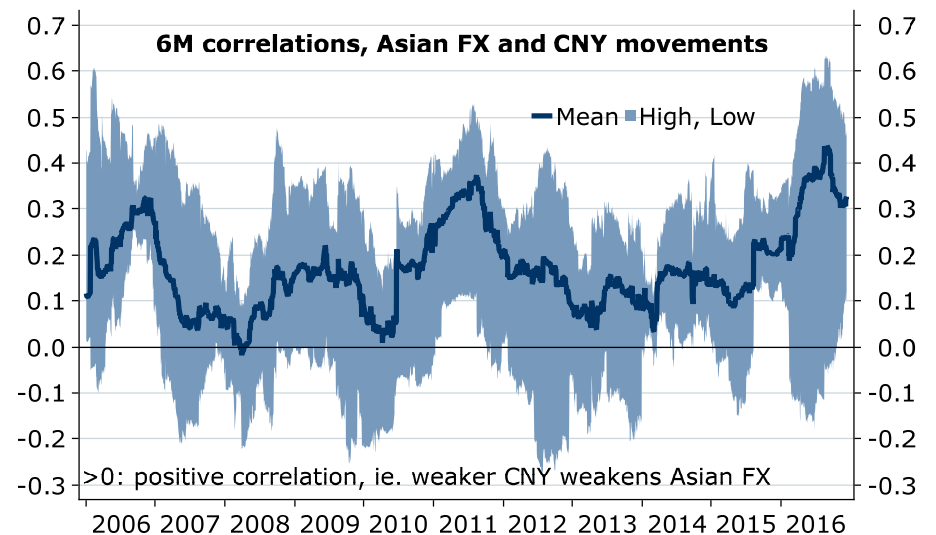


Asia FX: Look up to the Middle Kingdom

- December so far has been characterised by correction to many Asian FX, albeit the magnitude of correction varies greatly.
- In the near term, the downside risk is not over for EM FX in general. The market reaction to the Fed hike in December, Trump's inauguration in January and numerous elections in Europe next year could keep the USD high and EM FX low.
- The financial implications of Trump's rhetoric about retreating from Asia could accelerate a trend that is already on the way, that is, the Asian currencies could shift their soft peg to the yuan rather than the dollar.
- Given the large and rising trade ties within Asia, it is only a matter of time before this will happen. Beijing's effort to adopt a market-based and transparent FX regime this year is also to promote the renminbi as an anchor currency. The next step is for the Asian countries to start having their external debt denominated in the CNY rather than the USD.



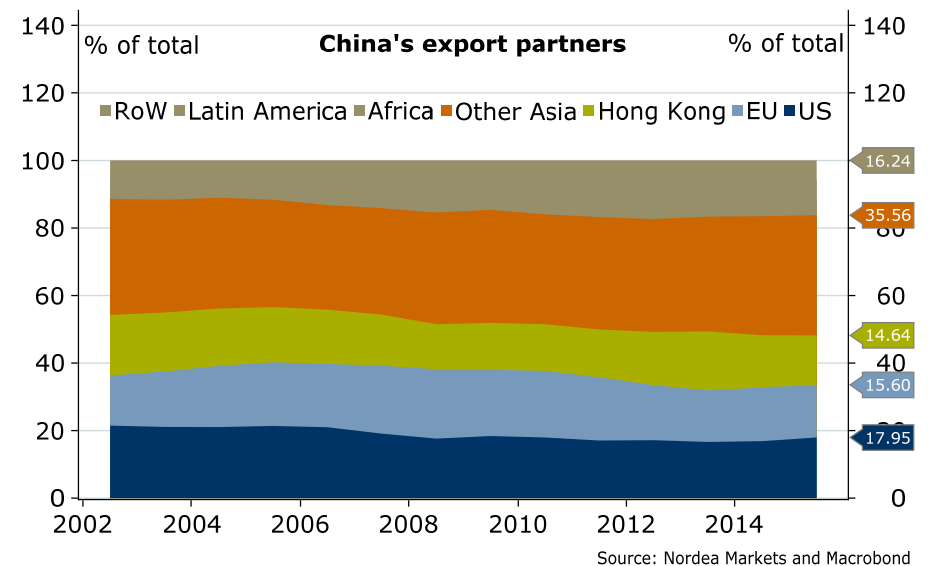
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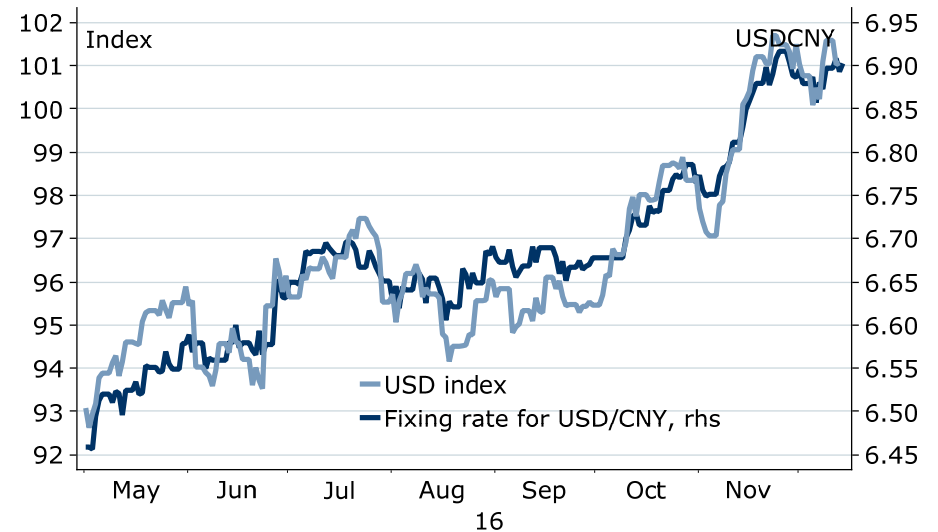
China: Uncertain times

- The improving growth momentum during the past few months is not equivalent to better fundamentals. The economy remains imbalanced with overreliance on investment and manufacturing. The structural adjustment of capacity reduction, deleveraging and, in general, a transition towards consumption and services imply lower GDP growth in the years ahead.
- Moreover, China faces risks that could trigger lower growth than we expect. One of them is Trump's assertive comments about China.
- Neither one of them would win from cooling relations. US is the largest single-country export destination for China, accounting for about a fifth of Chinese exports. Many of the Chinese goods are produced using American components and machines. Any US move to tax Chinese goods would bring retaliation and exacerbate the already stagnating global trade. As China is the center of global supply chain, this would hurt many countries and the global growth.

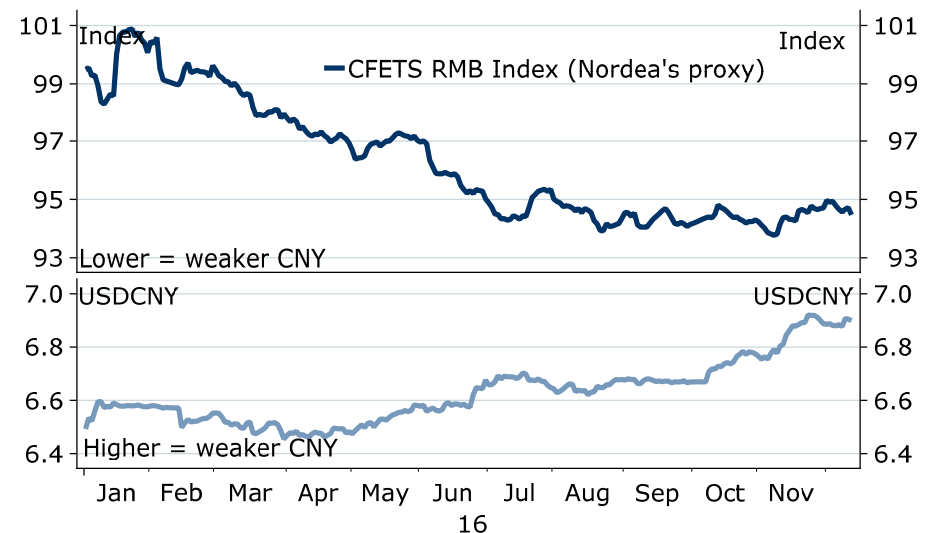


CNY: Accelerating depreciation led by the USD

- Both the CNY and CNH extended their weakness in December due to a multi-decade strong USD. This is a result of the new FX regime, where the PBoC manages the renminbi against a currency basket. When the USD strengthens against currencies in the basket, the CNY will have to weaken against the USD for the renminbi to be unchanged against the basket.
- While the depreciation has sparked concerns about capital outflows and devaluation pressure, the good news is that this regime is transparent and the daily changes in the CNY can be explained by the movements in the major currencies, especially the dollar. This is encouraging in terms of currency liberalisation in the long term.
- Due to the PBoC's tightening capital control, The risk of unmanageable capital outflows and a significant CNY devaluation is fairly small.
- Although elevated global risks could keep the USD on the strong and the CNY on the weak side in the near term, the USD/CNY seems to have overshoot fundamentals in our model. We see 6.90 as the ceiling for the USD/CNY for the coming year.



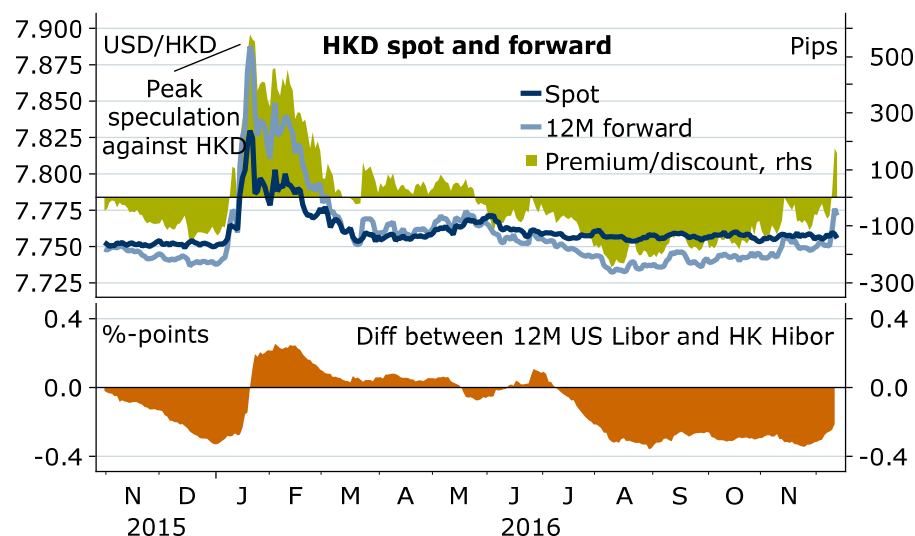
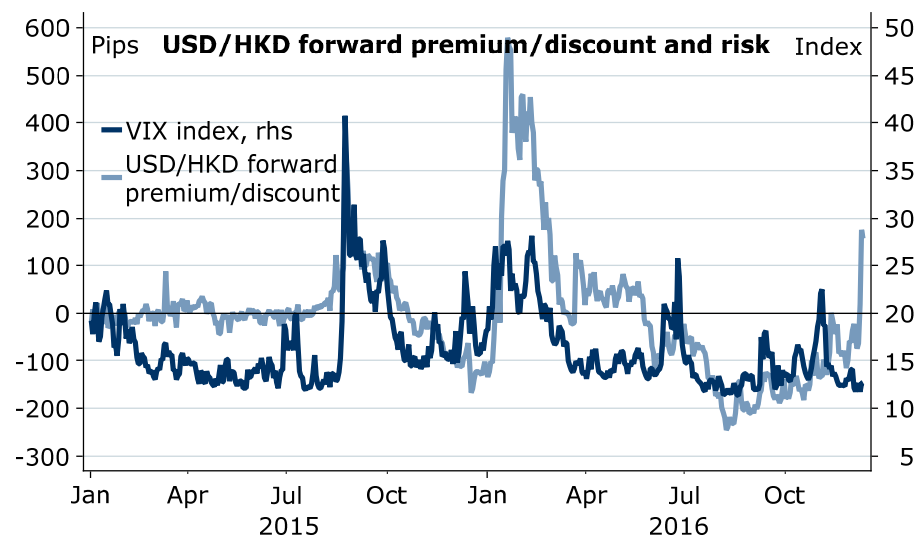
Source: Nordea Markets and Macrobond



Sources: Nordea Markets and Macrobond

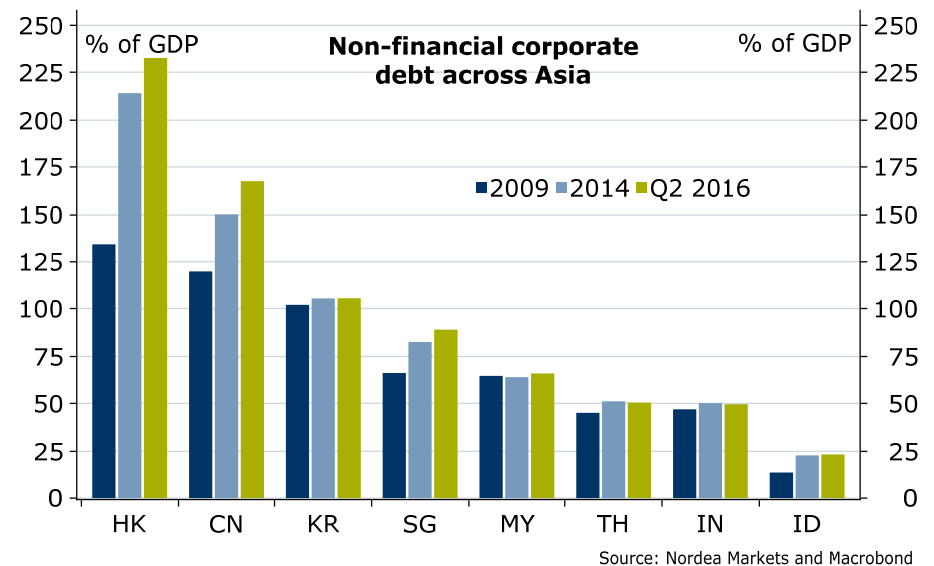
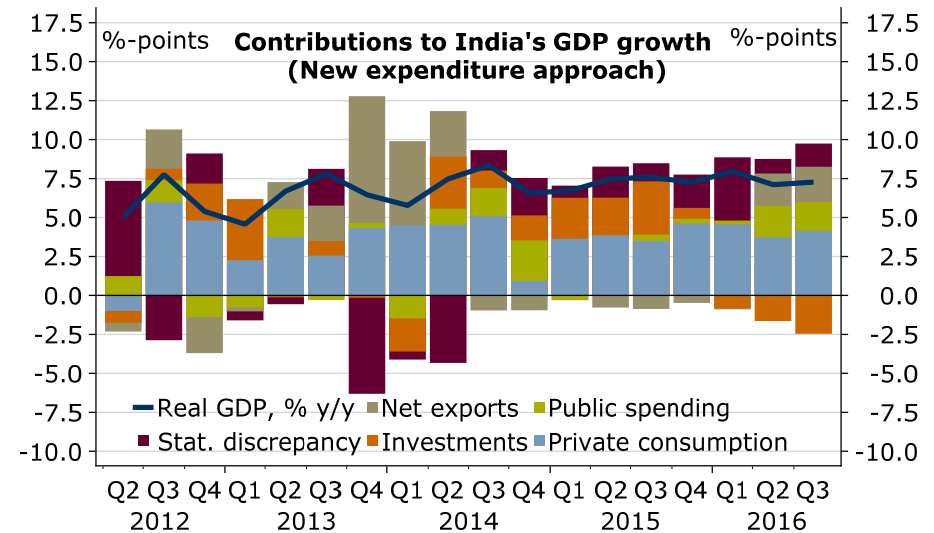
HKD: Renewed weakening pressure

- Although the spot USD/HKD has remained flat close to its strong side of the pegged band, at 7.75, the forward has returned to premium after being at a high discount for five months.
- Last time the USD/HKD forward was trading at such a premium, without the general market being in risk off mode, was in January this year, when speculation against the HKD pushed it to an eight-year low.
- The gap between Hibor and US Libor rates could narrow after the expected Fed hike on 15 December. This occurred after the Fed's last hike in December 2015.
- Even with the renewed depreciation pressure, we see a low risk that HKD peg will break in the coming year. With USD 377bn in FX reserves, the HKMA has the ability to defend the peg. It also still has the willingness as there are few alternatives to the USD peg. Any currency regime change would give too much volatility, which is undesirable amid capital outflows from EM.



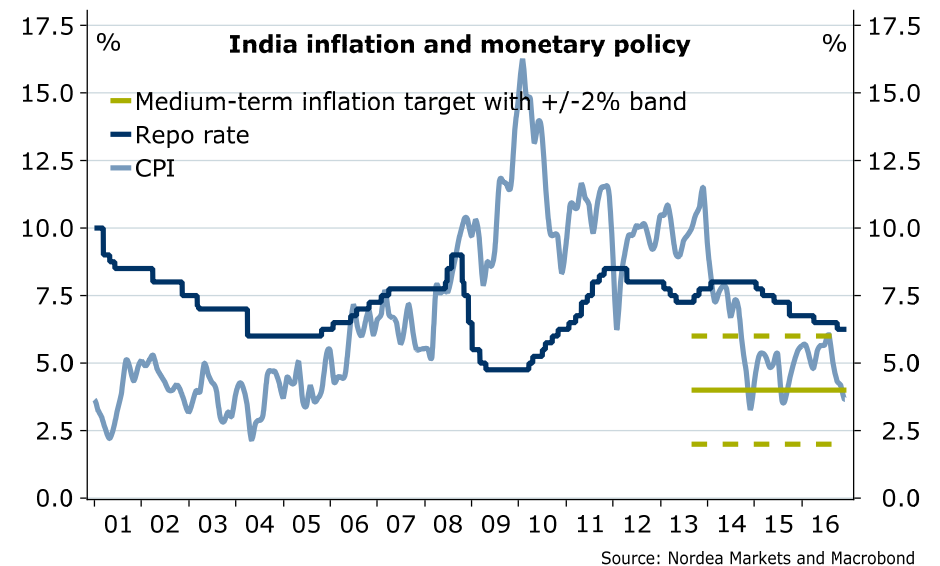
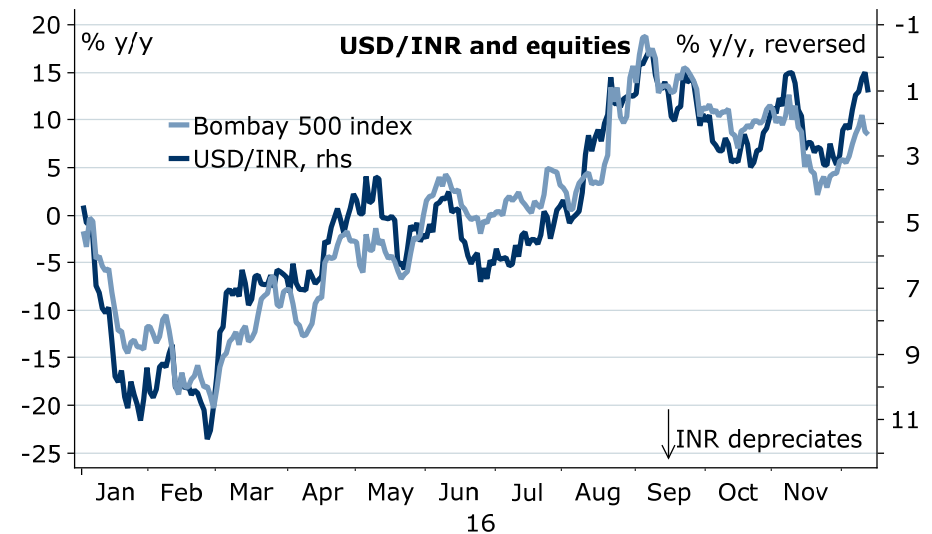
India: Key to boost investment sentiment

- India's Q3 GDP growth disappointed the market expectation, even though it showed a modest recovery from Q2. Private consumption growth remained solid, which was positive.
- It is easy to see that contracting investment was the reason behind lower-than-expected growth. With the state elections coming up next year, business sentiment has turned cautious. Among the local elections, the ones in Uttar Pradesh, slated for April-May, are the most crucial. It is the most populous state and sends 31 MPs to the upper house of parliament. A negative outcome here could seriously deter Modi's resolve to keep reforming.
- In order to boost business investment, the barrier in funding needs to be solved. India has a very low non-financial corporate debt ratio in Asia and it has stayed low for years. With NPL ratio close to 13% (official number), banks are constrained to lend. Bank loan growth is stuck at the multi-decade low of 10% y/y.



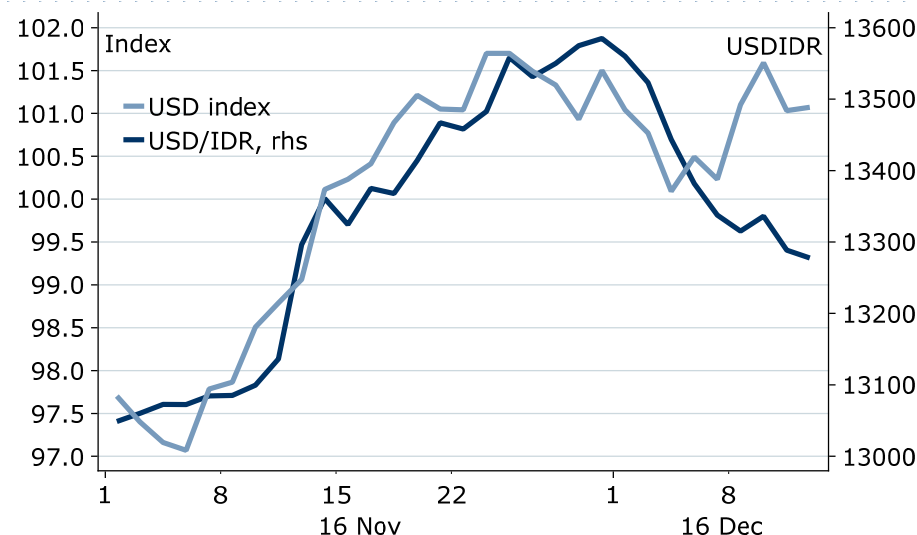
INR: Back to normal

- As we argued in the previous newsletter, the sharp weakening of the INR post-US election was overshooting, as it was partly triggered by the demonetisation announcement.
- In two weeks from late November, the INR has corrected the loss and gained about 2% vs the USD. The recovered momentum could thank the equity market.
- Now the overshoot weakness has been corrected, the INR has returned to normal. In the near term, it is still subject to the downside risk from a strong USD and other global risks. However, the INR has a good chance to outperform the EM FX due to relatively favourable domestic conditions. Any negative growth effect from the demonetisation would be temporary.
- The RBI has said in its December meeting to wait for the impacts of the demonetisation to materialise before making a policy move. So we expect no near-term rate change.

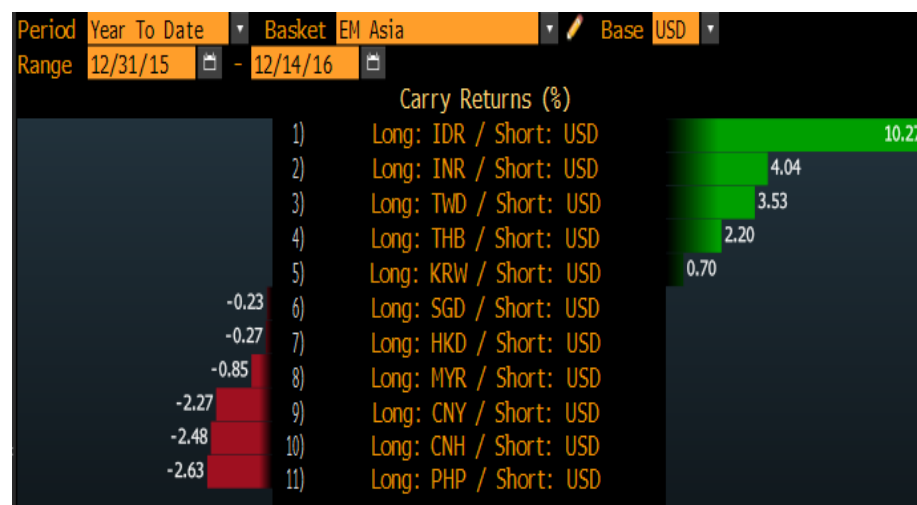


IDR: Carry protected

- The IDR has gained more than 2% against the USD so far in December as a result of post-US election correction. It outranked its Asian peers in terms of the magnitude of the gain. A major reason for this is IDR's attractive carry return, which is far higher than its regional peers.
- Thanks to relatively high interest rates, the IDR has maintained the good carry position for a long time. This has benefited the IDR in terms of inflows into the local bond market. According to finance ministry data, foreign funds bought IDR bonds for near USD 1bn in the past two weeks.
- As most EM FX, the downside risk to the IDR comes from a strong USD, especially given that it is overvalued. But we think that the attractive carry return will provide a floor for how weak the IDR can fall against the USD.
- Bank Indonesia is expected to stand by at its policy meeting this week, as inflation is climbing higher.



Source: Nordea Markets and Macrobond

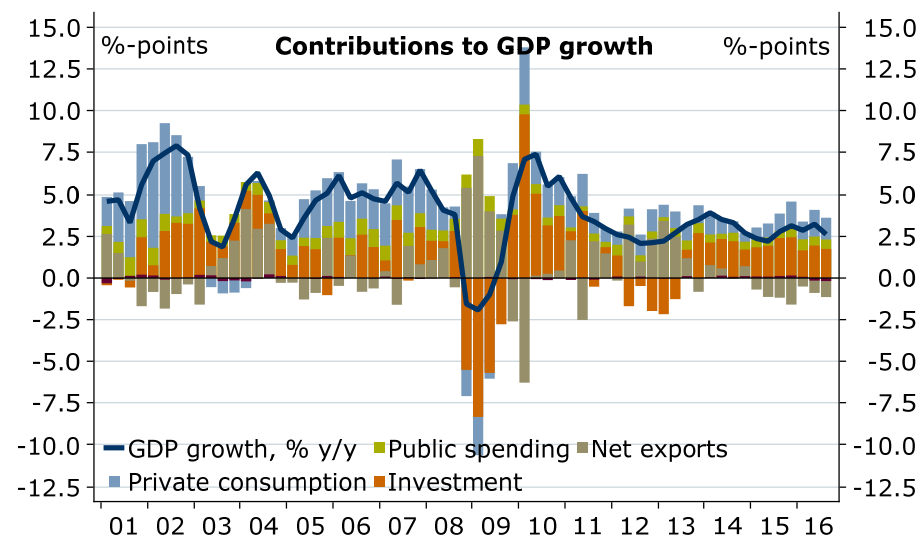


KRW: Not yet out of the scandal woods

- Last Friday South Korea's National Assembly voted overwhelmingly to impeach President Park Geun-hye over a corruption scandal. In the coming 180 days, nine judges at the country's constitutional court will decide whether the impeachment vote is valid. In the meantime, the acting President is Prime Minister Hwang.
- The final clarification of this scandal has helped pushing Korean equities further up and the KRW stronger. This is also good for restoring consumer and business confidence as Park's approval rating stood as low as 5%.
- However, the KRW is not yet out of the woods. Uncertainty remains during the impeachment legal process in coming 180 days. This will determine whether Park should resign. If so, an election must be held within 60 days.
- The scandal has not yet had material growth impacts. If the impeachment legal process goes smoothly, we expect limited harm to growth, but downside risk remains large.



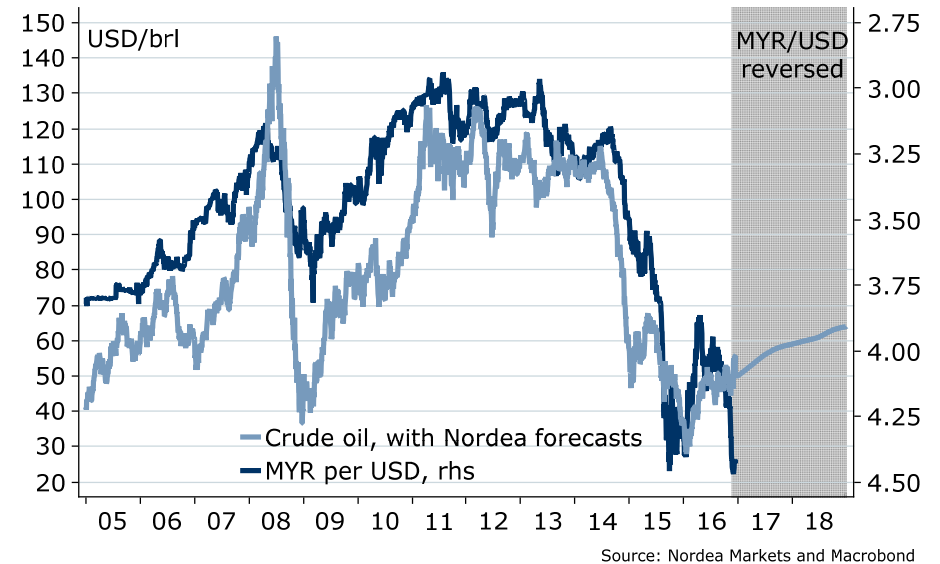
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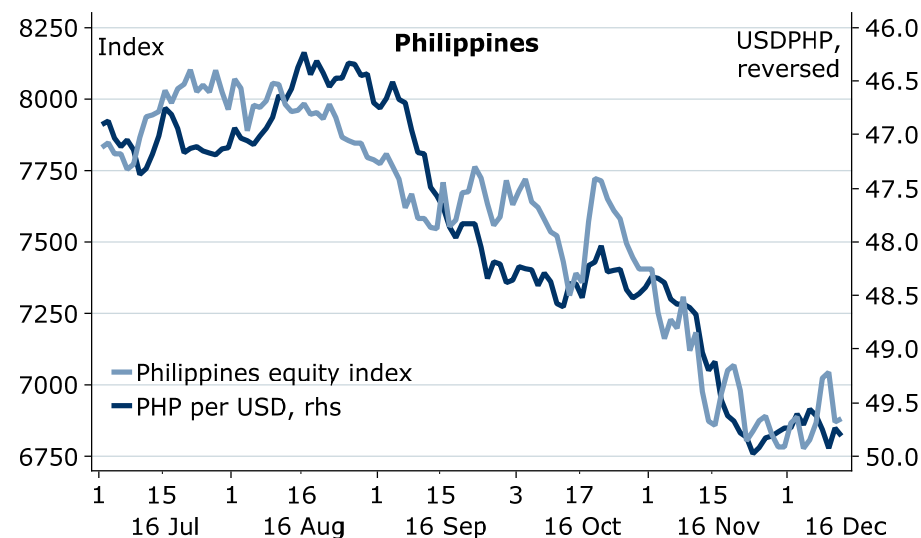
MYR: Fighting against speculation

- The OPEC meeting came and went with good news. Crude oil prices have gained nearly 20% since 29 November. But it has provide little boost to the MYR, which lost almost 7% against the USD after the US election, by far the most in Asia. It is currently trading at close to its record-weak level. In fact, the co-movement between the MYR and the oil prices have broken down as the divergence deepens.
- The limited gain in the MYR suggests that speculators are lying in wait. Foreign investors have net sold MYR assets lately. Foreign bond holdings fell by 8.3% m/m in November, the biggest drop in five years.
- Malaysia's large external debt (55% of GDP) and small FX reserves (only sufficient to cover six months of imports) makes the MYR sensitive to dollar rates, which are expected to rise.
- Unless the oil price rally continues at the current pace, the large devaluation pressure faced by the MYR will not likely ease.

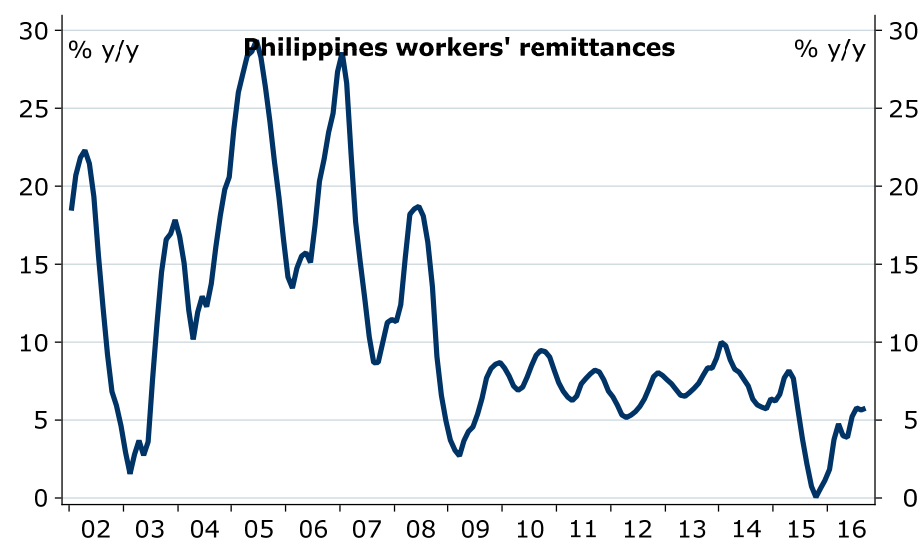


PHP: Fundamentals provide a floor

- The PHP is one of the Asian currencies, which has not seen any post-US election correction. It has remained at the weakest level in eight years, which is largely due to foreign capital leaving the local equity market.
- Continued outflows, reinforced by the expected Fed hike, pose a downside risk to the PHP. But large remittances from the 2 million Filipinos working abroad should keep net outflows in check. Better outlook for the oil and gas sector may support this trend as many overseas Filipinos work in this industry.
- In addition, President Duterte has warmed up relations to China, which is expected to bear fruit in terms of Chinese investment in the Philippines. Given the very poor infrastructure, this will boost growth in the short term and enhance productivity in the long term.
- The two countries have also signed agreement to boost tourism, which could also provide a floor for the PHP.



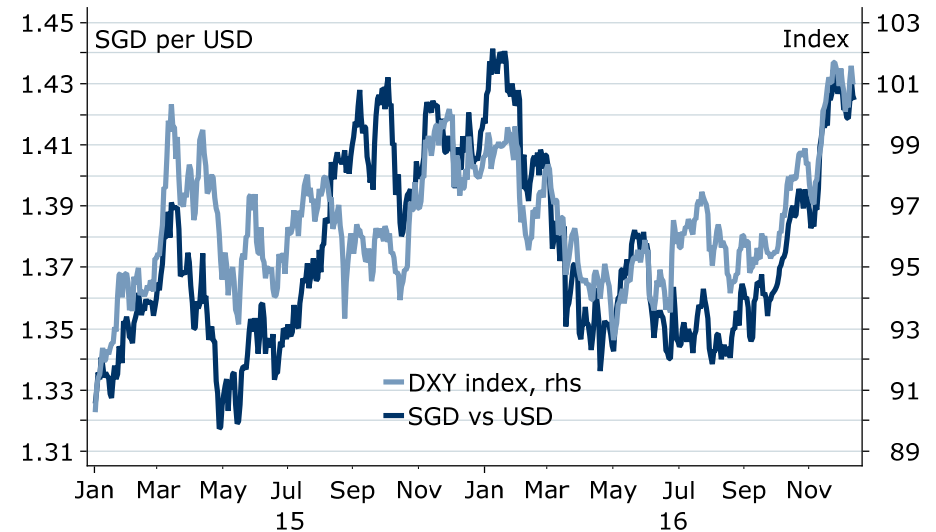
Source: Nordea Markets and Macrobond



Source: Nordea Markets and Macrobond

SGD: Stagflation risk

- The SGD is the Asian currency most sensitive to the USD. If the USD rally continues due to elevated global political risks, the SGD would be one of the most hurt Asian FX.
- Apart from the currency link, Singapore stands to lose big time if Trump takes action on his promised withdrawal from the Trans-Pacific Partnership (TPP) deal, as Singapore is highly dependent on trade and shipping activity.
- Given the close correlation between Singapore's GDP growth and global trade volumes (0.84 since 2001), it is no wonder that growth has been sluggish during the past year. In Q3, it was outside of the MAS' targeted range of 2-4%.
- This puts the MAS in a dilemma. GDP growth has poor prospect in improving in the coming quarters when inflation is climbing higher. Currently, core inflation is 1.1%, in the middle of the policy target range of 0.5-1.5%, but should oil prices continued to rise, Singapore faces a large risk of stagflation.



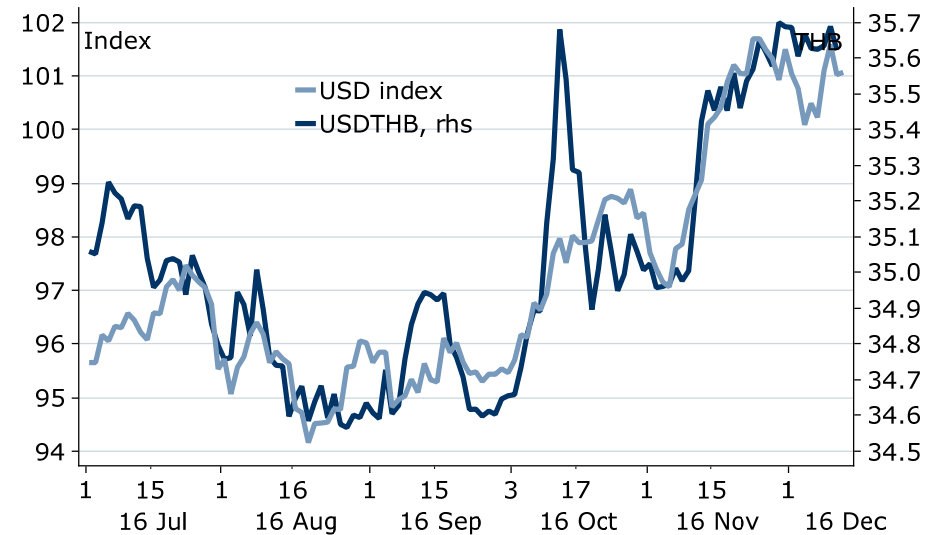
Source: Nordea Markets and Macrobond



Source: Nordea Markets and Macrobond

THB: On the right track

- Although the THB has remained elevated during the past two weeks, we look relatively positively at the THB against the USD. The lack of correction could also be due to the limited loss suffered from the Trump win.
- In the near term, given the high global risks from the market reaction to the Fed (which we expect to be fairly manageable) to political risks in the US as well as Europe, the THB will continue to face downside risk from a strong USD and general capital outflows from EM.
- However, domestic conditions are looking fairly good. The government is on the right track with its economic policies. The slightly disappointing Q3 GDP growth does not eliminate the fact that the Thai economy is recovering.
- Recently, the government approved 36 transport projects worth USD 25bn. Moreover, it initiated tax incentives to boost consumer spending. The positive growth outlook provide solid medium-term support for the THB.



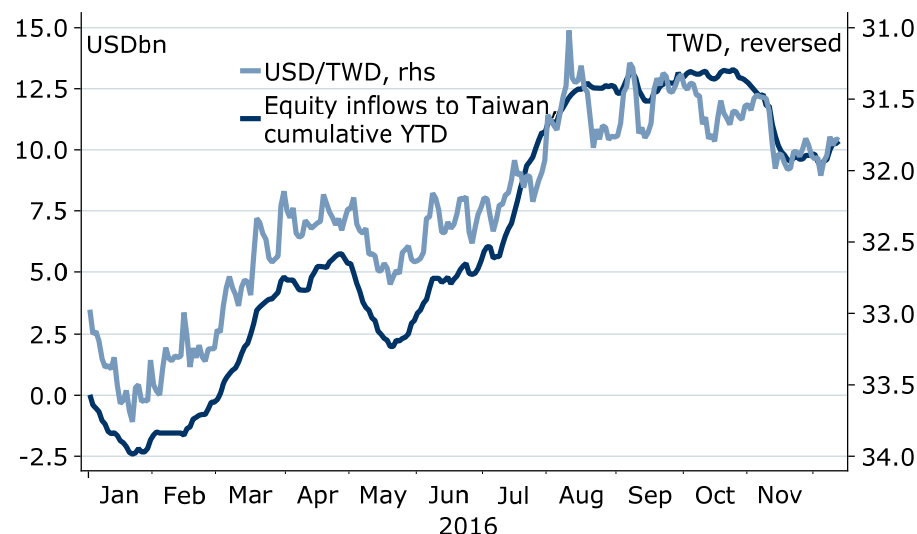
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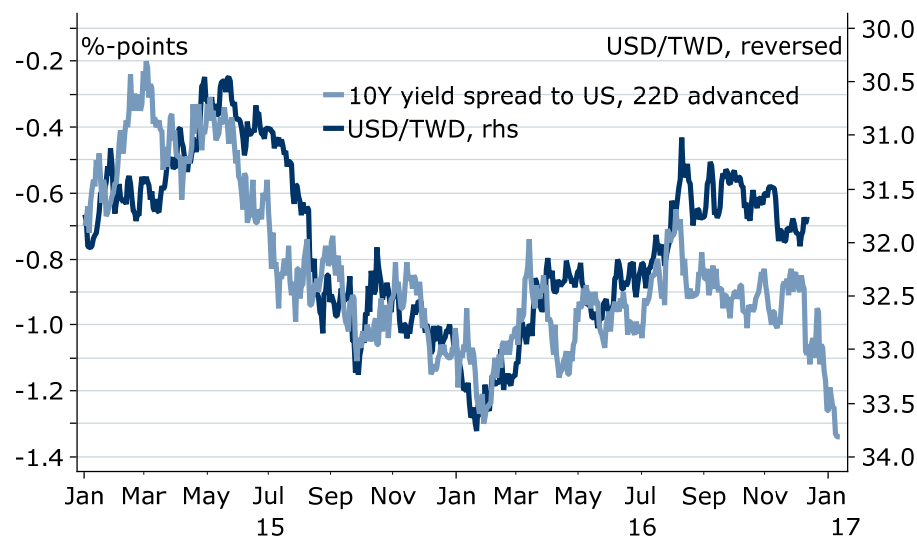
Source: Nordea Markets and Macrobond

TWD: Mostly negative forces in play

- Despite the recent inflows into the local stock market, we remain cautious on the TWD and see mostly downside risk factors in play.
- In addition to the sensitivity to a stronger USD, the expected Fed rate hike this week could further widen the yield spread to more negative and suggest more TWD weakening.
- From a macro perspective, the TWD is sensitive to rising protectionism. If momentum in China deteriorate next year as we expect, then conditions will toughen for Taiwan. If Trump takes actions on punitive tariffs on Chinese goods, it would hurt Taiwan. For instance, a large share of Chinese electronic goods use Taiwanese semiconductors. The recent export recovery to China is likely only temporary and due to the mainland's construction rebound.
- Finally, Trump has signaled to abandon the decade-long “one China policy”, which could irritate Beijing and stress the China-Taiwan relationship.



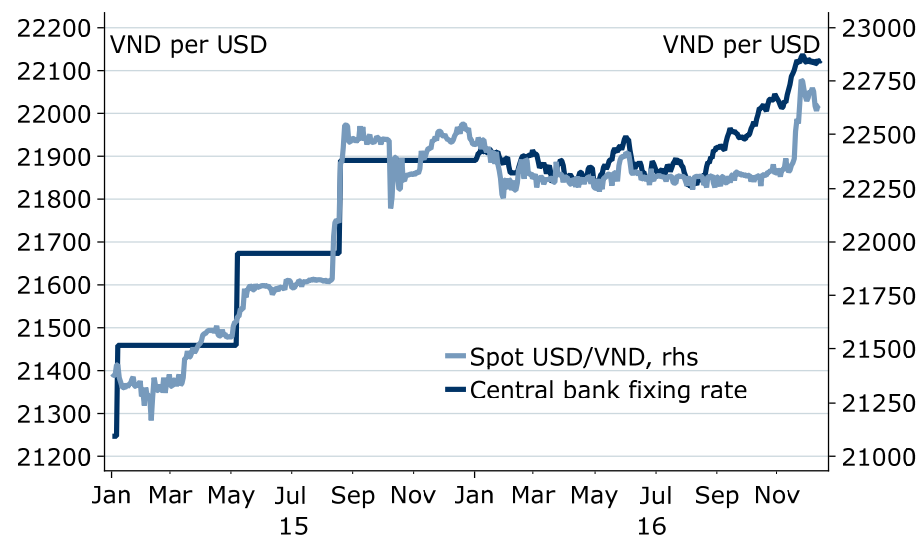
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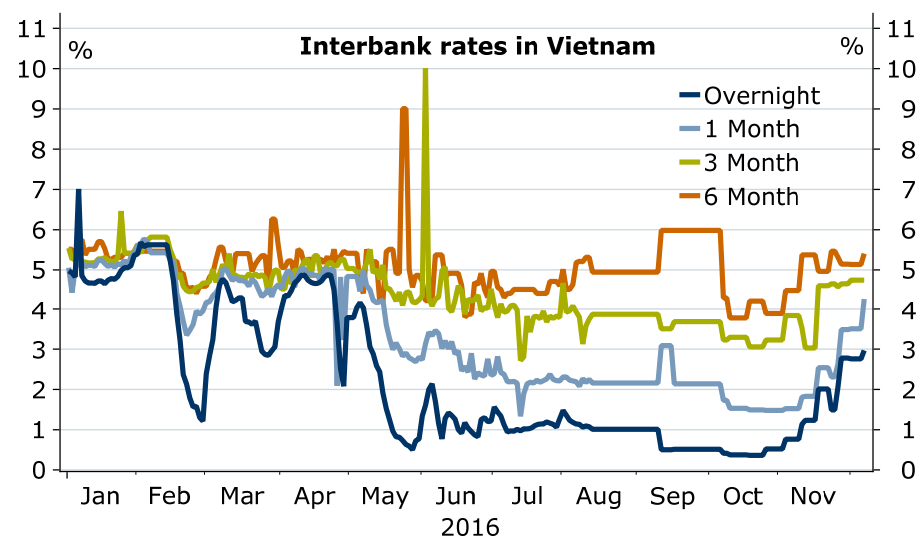
Source: Nordea Markets and Macrobond

VND: Bright long-term prospect

- The spot VND has finally caught up with the fixing rate in late November. The convergence was likely due to tighter liquidity, which was evident by sharply rising interbank rates. Moreover, year-end dollar demand is usually high as local firms need more foreign currencies to settle year-end import bills.
- Aside the current weakness, we remain positive about Vietnam and the VND in the medium term due to primarily reasons. First is the government's persistent reform efforts. There is prospect that the existing FX regulations will be relaxed to allow foreign investors to hedge their FX risks. This is a natural step in financial liberalisation after the adoption of a more market-based currency system early this year.
- Secondly, Vietnam could benefit from Trump's potential punitive trade measures against China. In that case, China could circumvent the measures by using Vietnam as a "middleman". This already applies to some steel products.



Source: Nordea Markets and Macrobond



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Nordea FX forecasts

Exchange rates vs. EUR

	14/12/2016	3M	30/06/2017	31/12/2017	31/12/2018
EUR/USD	1.06	1.05	1.10	1.10	1.15
EUR/JPY	122.62	114.40	113.40	121.00	128.80
EUR/DKK	7.44	7.45	7.45	7.45	7.45
EUR/SEK	9.75	9.60	9.40	9.00	8.80
EUR/NOK	8.96	8.90	8.70	8.50	8.50
EUR/GBP	1.35	0.83	0.82	0.82	0.80
EUR/CHF	1.08	1.10	1.12	1.13	1.15
EUR/PLN	4.43	4.40	4.30	4.20	4.10
EUR/CZK	27.02	27.00	27.00	26.75	26.50
EUR/HUF	314.11	310.00	310.00	305.00	300.00
EUR/TRY	3.71	3.50	3.30	3.10	3.00
EUR/RUB	64.71	65.10	69.30	69.30	63.25
EUR/ZAR	14.54	14.18	14.85	14.30	13.80
EUR/CNY	7.35	7.25	7.59	7.54	7.82
EUR/INR	71.93	72.45	74.80	74.80	75.90
EUR/BRL	3.55	3.47	3.63	3.58	3.57
EUR/MXN	21.59	21.00	20.90	19.80	18.40

Exchange rates vs. USD

	14/12/2016	3M	30/06/2017	31/12/2017	31/12/2018
USD/JPY	115.15	108.00	110.00	112.00	114.00
USD/DKK	6.98	7.09	6.77	6.77	6.48
USD/SEK	9.15	9.14	8.55	8.18	7.65
USD/NOK	8.42	8.48	7.91	7.73	7.39
USD/GBP	1.27	0.79	0.75	0.75	0.70
USD/CHF	1.01	1.05	1.02	1.03	1.00
USD/PLN	4.16	4.19	3.91	3.82	3.57
USD/CZK	25.37	25.71	24.55	24.32	23.04
USD/HUF	294.97	295.24	277.27	272.73	252.17
USD/TRY	3.49	3.33	3.00	2.82	2.61
USD/RUB	60.76	62.00	63.00	63.00	55.00
USD/ZAR	13.66	13.50	13.50	13.00	12.00
USD/CNY	6.91	6.90	6.90	6.85	6.80
USD/INR	67.55	69.00	68.00	68.00	66.00
USD/BRL	3.33	3.30	3.30	3.25	3.10
USD/MXN	20.27	20.00	19.00	18.00	16.00

Nordea rates forecasts

Monetary policy rates

Country	Spot	3M	30Jun17	31Dec17	31Dec18
United States	0.50	0.75	1.00	1.25	2.00
Japan	-0.10	-0.10	-0.20	-0.20	-0.30
Euro Area	-0.40	-0.40	-0.40	-0.40	-0.40
Denmark	-0.65	-0.65	-0.65	-0.65	-0.65
Sweden	-0.50	-0.60	-0.60	-0.60	0.00
Norway	0.50	0.50	0.50	0.50	0.50
United Kingdom	0.25	0.25	0.25	0.25	0.25
Switzerland	-0.75	-0.75	-0.75	-0.75	-0.75
Poland	1.50	1.50	1.50	1.50	2.00
Russia	10.00	9.50	9.00	8.00	7.00
China	4.35	4.35	4.35	4.35	4.35
India	6.25	6.25	6.25	6.00	6.00
Brazil	13.75	12.50	11.00	10.00	10.00
Czech Republic	0.05	0.05	0.05	0.05	0.05
Hungary	0.90	0.90	0.90	1.00	1.50
Turkey	8.00	9.00	9.00	8.50	7.50

3-month rates

	Spot	3M	30.06.17	31.12.17	31.12.18
United States	0.96	1.00	1.15	1.40	2.10
Euro Area	-0.32	-0.30	-0.30	-0.30	-0.30
Denmark	-0.20	-0.20	-0.20	-0.20	-0.15
Sweden	-0.61	-0.60	-0.60	-0.60	0.00
Norway	1.14	1.05	1.00	0.90	0.90
United Kingdom	0.38	0.40	0.40	0.40	0.40
Poland	1.63	1.70	1.70	1.70	2.25
Russia	10.64	10.30	9.30	8.35	8.00

10-year government

Country	Spot	3M	30.06.17	31.12.17	31.12.18
United States	2.45	2.50	2.65	2.70	3.20
Euro Area	0.32	0.05	0.15	0.45	0.80
Denmark	0.38	0.15	0.25	0.55	0.90
Sweden	0.57	0.45	0.60	1.10	1.40
Norway	1.68	1.70	1.75	2.05	2.45
United Kingdom	1.44	1.30	1.20	1.20	1.30
Poland	3.54	3.75	3.75	3.50	3.25

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