CENTENNIAL ASIA ADVISORS
policy and strategic advisors

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Russia-Ukraine war: India caught in a geostrategic bind
Thailand: Fall of Prayut government could presage wider instability

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Russia-Ukraine war: India caught in a geostrategic bind

- India is the biggest loser in the Russia-Ukraine war from an economic and geostrategic standpoint. India's reliance on Russian arms and historically warm relations explain Delhi's pushback against calls to take a stand on the war.
- Near-term, a rapture in the Russo-Indian symbiotic relationship is not likely. India needs more time to diversify away from Russian arms. The premise of importing Russian crude at a discount is a further sweetener. Russia, acutely aware of its reliance and lop-sided relationship with China, will be keen to keep India onside to balance against China as well.
- On the economic front, there may be small positives from soaring commodity prices. Booming wheat exports represent a small positive in the grand scheme of things.
- But the fertiliser subsidy bill looks set to climb as potash prices surge. There is limited room to cut fuel taxes, leaving consumers to feel the pinch. And a widening import bill looks set to follow, entailing a deterioration in the external accounts.

Thailand: Fall of Prayut government could presage wider instability

- There are two threats to Thai political stability. One is the infighting within the establishment, which could precipitate early elections. The other is a surge in protest activity as anti-establishment forces renew their push for fundamental social and political reforms.
- There is pressure for early elections because of the instability of the coalition government. The opposition is machinating to topple the government in the coming months. Premier Prayut will seek to complete his term which officially ends in Mar 23 by offering compromises to his opponents.
- The risk of deeper, longer-term political instabilities arises from the deep fault lines in Thai society that the ruling establishment has avoided addressing. Instead, it has doubled up on repression, which raises the risk of bottled-up resentments eventually exploding into crisis.

Highlights from the CAA Weekly Table:

- **China**: As the threats to economic growth and financial stability grow, it is concerning that the policy tools do not seem to be as effective as before.
- **South Korea**: The discernible loss of momentum in manufacturing and investment activity in February can only be partly explained by base effects. Consumer activity is unsteady.
- **Indonesia**: Underlying economic indicators are improving, with business confidence at an 8-month high. But inflationary pressures are mounting.
- **Thailand**: Economic momentum flagged in February as we had expected. Tourist arrivals are only edging up slowly, putting our expectation of a tourism-fuelled recovery at risk.
- **Malaysia**: The central bank remained confident about recovery, buoyed by the tech cycle, resumption of travel, improving labour market conditions and continued policy support
- **Philippines**: Upbeat high-frequency activity indicators affirm our view for a strong economic showing this year.

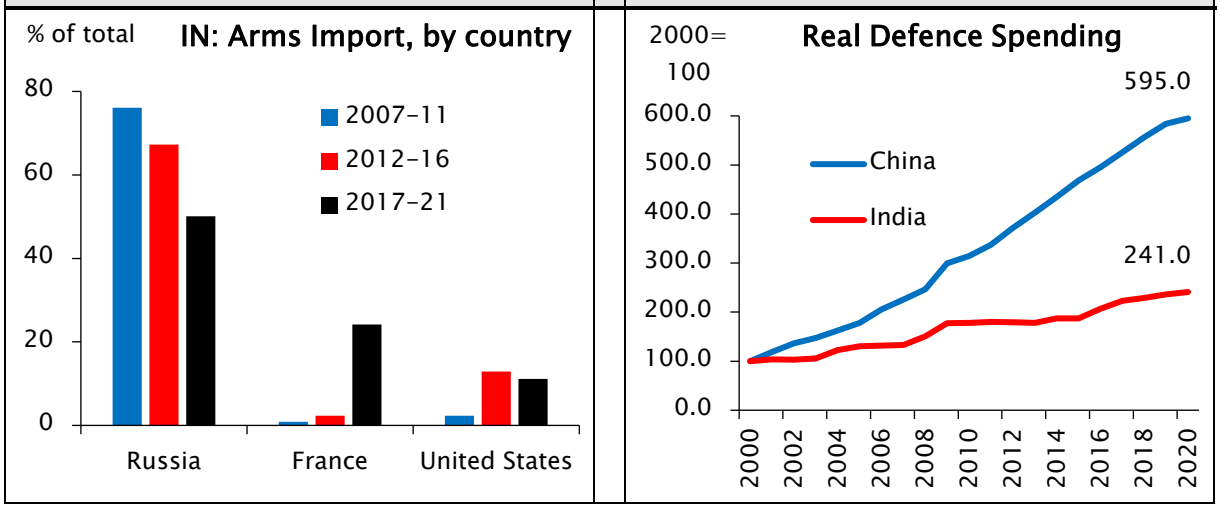
Russia-Ukraine war: India is the biggest loser

Among large countries, India could be the biggest loser from the Russia-Ukraine war. Its dependence on Russia for arms exposes its geostrategic vulnerability and limited room for manoeuvre. Unwilling and unable to criticise Russia, its relationship with the US and allies has become awkward. In economic terms, the gains are limited and the harm is significant – mounting oil prices more than offset gains such as buoyant demand for its wheat exports. Compounding this is its limited policy space as inflation turns up and global interest rates normalise.

India is caught in a geostrategic bind

Since the outbreak of hostilities in Ukraine, India has had to fend off pressure from the US and allies to adopt a tougher line against Russia's invasion.

Chart 1	Chart 2
Chipping away at dominance of Russian arms	Outgunned by China



Source: CEIC, Stockholm International Peace Research Institute (SIPRI)

Despite its growing concerns about China and despite Russia's relative decline as a source of the high-tech weaponry it needs to contain China, India's leaders had been slow to switch to American and other western sources of arms. Reluctant to give up on the Treaty of Peace, Friendship and Cooperation that it signed with Russia in August 1971, India has continued to rely on Russia. In 2020, it committed to acquire 21 Russian-made MIG-29 fighter jets. More recently, Russia commenced delivery of the highly-advanced S-400 surface-to-air missile to India in late-2021, even in the face of American threats of sanctions for doing so. India's political elite valued Russia's support against its US-backed rival Pakistan in the December 1971 war and never forgave the US for threatening to intervene to prevent India's defeat of Pakistan in that war. Consequently, India is painfully reliant on Russian arms. Even after declining somewhat, Russia's share of India's arms imports has still averaged 50% in the 5-year period through 2021. Second-placed France does not even come close at 25%, followed by the US (11.2%) (See Chart 1).

Thus, no matter how much pressure the US and its allies may exert on India, it cannot afford to lose Russia as a critical source of arms. Not only has India maintained its strategic ties with Russia and refused to vote against Russia in the United Nations, it is also importing Russian crude oil at a discount, helping Russia to offset the impact of Western sanctions.

Since the outbreak of border clashes along the Sino-Indian border in recent years, there has been a newfound sense of urgency in Delhi to step up its military modernisation. India's defence spending, in real terms, is still far short of what China managed to muster (Chart 2). China's superior economic performance has generated the resources to enable it to raise defence spending far faster than India. Unless India dramatically improves its economic growth, this hard power asymmetry can only worsen.

Worse still for India, its dependence on Russia could become a strategic weakness. The extensive sanctions imposed by the US and Europe on Russia will leave Russia tethered to and increasingly dependent on China for military, diplomatic and economic support. At some point, Indian defence planners will have to consider the risk that Beijing could wield this outsized influence to press Russia into limiting or suspending arms exports to India. Russia, acutely aware of its lop-sided dependence on China, will be keen to keep India onside to balance against China as well. But the longer-term trend of growing Chinese sway and leverage in Sino-Russian relations is unmistakable.

For now and the near future, expect India to stand firm on its neutrality and to resist pressure from the West to take a more robust stance against Russia. But, given that its main strategic threat is from China, India will have to shift towards a closer relationship with the security framework that the US, Japan and allies are constructing in the Indo-Pacific, centred around the Quad. How it executes such as shift will be a challenge that it will struggle with for many years.

No good options on the economic fallout from the war

The gyrations in commodity prices stem from the virtual cessation of trade either because of sanctions or disruption to exports being shipped from Black Sea ports. Prices of wheat, oil, edible oils and fertiliser – which Russia is a major producer of – have been soaring in the aftermath of the outbreak of the Russia-Ukraine war. For India, there are some small positives, but the economy is still a net loser from the surging commodity prices.

Booming wheat exports a small positive in the grand scheme of things

The war has thrown a wrench into the works, given that the Black Sea region accounts for a third of global wheat exports. Ukrainian farmers have held back on fertiliser usage because of skyrocketing costs, compounded further by fuel shortages. Estimates vary, but Ukraine's winter crop harvest may decline by 15%-50% as a result of the war as lower-than-desired usage of fertilisers hamper yields and crop output.

Having amassed gargantuan inventories of wheat following successive years of bumper harvests, India looks set to benefit, having exported 6.12 million tonnes of wheat in 2021. The wheat harvest is slated to climb further to 111.3 million tonnes in 2022, from last year's 109.6 million tonnes. Traders point out that India is likely to export 4 million tonnes of wheat in 1H22. Where the data is available, wheat exports have more than tripled on an annual basis in January 2022 to USD305mn. But it still pales in comparison to net oil imports in absolute terms, particularly now that oil prices are in triple digits.

A bystander in the face of soaring fertiliser costs

The sanctions on Russia have throttled outbound trade, sending fertiliser costs up. Russia is a major producer of potash, phosphate and nitrogen containing fertilisers – major crop and soil nutrients. Ukraine has also banned exports of fertilisers in the aftermath of the invasion by Russia to divert whatever that is left of supplies inwards. India typically relies on shipments to the tune of 4-5 million tonnes of potash imports every year, of which a third is derived from Belarus and Russia.

Policymakers in India have stepped up efforts to procure supplies elsewhere, such as Canada (1.2 million tonnes of Potash), Israel (600,000 tonnes) and Jordan (300,000 tonnes) to offset the shortage left by Russia and Belarus. This assumes precedence ahead of India's kharif sowing season which coincides with the monsoon season around the middle of the year. While it is unclear if the procurement effort is adequate to meet domestic requirements, the fertiliser subsidy bill (FY23e: INR1.05tr), which has replaced fuel subsidies in magnitude, is likely to balloon above and beyond what the authorities budgeted for in Budget FY23.

Limited room to cut fuel taxes, leaving consumers to feel the pinch

One option that governments across the globe have turned to is to shoulder some of the hit from rising oil prices, either by imposing fuel subsidies or cutting fuel excise taxes to absorb some of the cost burden from more expensive fuel. This option is not available to the Modi government, however. Retail fuel prices were unchanged from December 2021 when the electoral cycle turned up, while Brent prices were practically unrecognisable compared to last year. Bear in mind that the Modi government raised fuel excise taxes to leverage on the collapse of oil prices in 2014 and most recently in 2020 when the pandemic gutted demand for aviation fuel. Consequently, oil excise revenues have doubled between FY16 to FY21, coming in at INR3.7tr in FY21 (Chart 3).

The Fed's hawkish turn and outbreak of the Russian-Ukraine war led to bouts of risk aversion in markets. The depressed valuations scuttled the listing of LIC, which was supposed to deliver around INR650bn in disinvestment receipts. To fill the gaping hole left by LIC, the government had to dip into the small savings funds to ensure FY22's fiscal deficit comes in at the budgeted 6.9% of GDP. Even if the war were to come to an end, the Fed's aggressive rate hike cycle is likely to leave battered and butchered markets in its wake, raising more questions on the valuations for LIC's IPO and the revenues the authorities were eyeing in the first place. In turn, this meant

that there simply is no room for the authorities to cut fuel excise taxes so as not to jeopardise the fiscal math.

Import bill set to climb, widening external imbalances

Another corollary of rising oil prices is that it translates into a heftier import bill, all else being equal. It does not help that India sources foreign crude imports for 85% of its demand requirement, leaving it vulnerable to oil price swings. And it does not appear to be the case that the imposition of excise taxes has lessened the oil intensity of the economy, probably because of the fact that there exist few substitutes for oil as a factor of production in the transportation and power sector. India has also moved to scope up Russian oil at a discount, purchasing at least 13 million barrels of Russian crude, compared to about 16 million barrels for all of 2021.

Chart 3

Fuel excise revenues have risen considerably

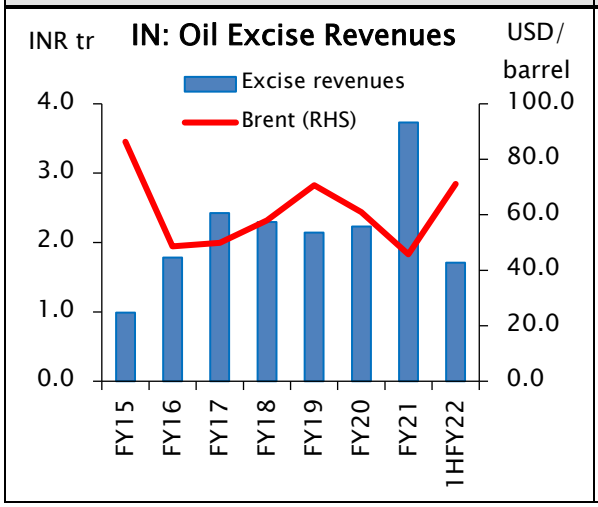
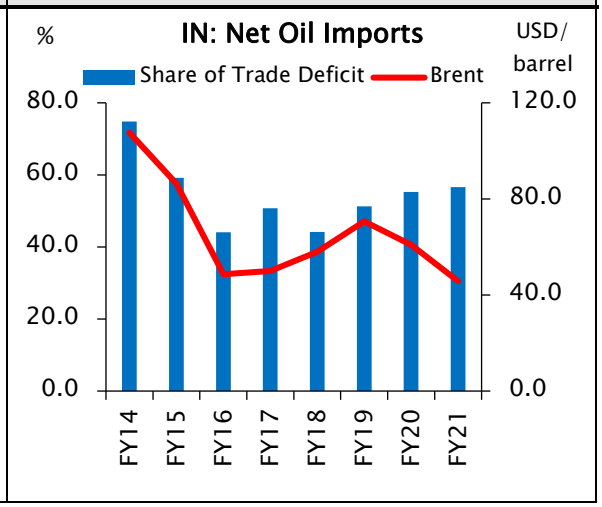


Chart 4

A widening import bill loom



Source: CEIC

Net oil imports typically explain half of the trade deficit India racks up on a monthly basis, though this figure used to be significantly higher prior to the rise of US shale (Chart 4). Over the last 2 fiscal years, the lockdown-induced import compression kept the trade deficit in check, which more than made up for the collapse in oil imports as a result of both lower prices and lukewarm economic activity. Nevertheless, the rising price of Brent will inevitably entail a widening of the Current Account imbalance, which roared to life with a vengeance in 4Q21 (2.7% of GDP).

Bottom line: No good options for India to deal with diplomatic and economic blowback

In essence, there is simply no good option for India to deal with the pushback and pressure for it to align itself more closely with the US and Europe in signalling a more aggressive stance against Russia's war in Ukraine. On the economic calculus of the war, India is a net loser, despite the modest windfall from wheat exports.

Thailand: Fall of Prayut government could presage wider instability

There are two threats to Thai political stability. The immediate threat is that Prime Minister Prayut Chan-ocha's coalition government could fall apart because of infighting. The greater danger is that this intra-elite squabble allows long-suppressed anti-establishment forces to exploit the government's disarray and mount renewed protests.

Growing challenges to Prayut's longevity, deepened by infighting within the ruling coalition

To survive, Prime Minister Prayut has to deflect three major challenges, just one of which would be enough to cause his fall:

- First, the opposition plans to submit a motion of no-confidence against Prayut once parliament re-opens on 22 May 22. The opposition only needs a simple majority in the House of Representatives to pass a no-confidence vote.

- Second, the opposition will seek a constitutional court ruling on the tenure of Prayut's premiership in Aug 22. How long Prayut can remain as prime minister is a source of controversy. The constitution limits prime ministers to only two four-year terms. Prayut's critics say that his term ends in Aug 22 because he first became Thailand's leader in 2014 as head of the National Council for Peace and Order (NCPO, the official name for the military junta that Prayut led to oust the previous, democratically-elected government. Prayut's supporters disagree with this interpretation but are themselves divided as to whether Prayut's term began in 2017 when the present constitution was promulgated or in 2019 when Prayut officially became prime minister following a general election. Should the constitutional court rule in favour of Prayut's critics, he will have to step down as prime minister, which would trigger the dissolution of his administration.

- Third, the opposition will attempt to vote down the government's national budget bill for FY23 which will be tabled in parliament in Aug 22. Because it involves fiscal matters this is considered a confidence bill. If the Prayut government cannot secure the simple majority needed to pass such a bill, it would warrant the resignation of the prime minister and the fall of his government.

On paper, the coalition government should easily defeat no-confidence motions and get its critical fiscal bills through parliament. The military-backed PPRP which is the core of Prayut's parliamentary position is in coalition with the Bhumjaithai Party, the Democrat Party and a clutch of tiny parties with just a few parliamentarians each. This coalition alliance has a majority of 257 MPs in the 487-member House of Representatives while the opposition only has 212 MPs. However, Prayut cannot be confident of the loyalty of all the coalition's parliamentarians.

- First, his government is unpopular. A National Institute of Development Administration (NIDA) poll in Feb 22 found that close to 60% of respondents believed Prime Minister Prayut Chan-

o-cha should call for early elections "as soon as possible". As Tables 1 and 2 show, voters have become disillusioned with Prayut and the PPRP, the core component of his coalition government.

Table 1: Who do you support to become the next prime minster?

%	Candidate	Party
13.4	Pita Limjaroenrat	Move Forward Party
12.7	Prayut Chan-o-cha	Palang Pracharath Party
12.5	Paetongtarn Shinawatra	Pheu Thai Party
8.2	Khunying Sudarat Keyuraphan	Thai Sang Thai Party
7.0	Pol Gen Seripisut Temiyavet	Thai Liberal Party
5.6	Other candidates	
3.6	Not interested in who becomes prime minister	
2.8	Korn Chatikavanij	Kla Party
2.6	Jurin Laksanawisit	Democrat Party

NIDA poll: Mar 22

Table 2: Which political party do you support?

%	Party
28.9	Do not support any party
25.9	Pheu Thai Party
16.2	Move Forward Party
8.0	Democrat Party
7.0	Palang Pracharath Party
2.3	Thai Liberal Party
2.2	Thai Sang Thai Party

Source: NIDA poll: Mar 22

- Second, this growing unpopularity makes key coalition partners keen to dissociate themselves from Prayut well before the general elections due after March 2023. The government's humiliating defeat in a recent vote for the chairmanship of the parliamentary committee scrutinising two election laws shows this lack of loyalty. Coalition MPs were supposed to vote for the PPRP-nominee Paiboon Nittitawan. However, at the last minute and without informing the coalition, a Bhumjaithai MP nominated deputy health minister and deputy leader of the Democrat Party Satit Pitutacha as chairman. Several ministers from the Democrat Party and the Bhumjaithai Party broke ranks to vote for Satit who went on to win by one vote.

- Third, the clutch of tiny parties that were pressed into joining the coalition cannot be trusted to continue being loyal. This unwieldy coalition was put together by the controversial political operative, Thammanat Prompao, who used to be secretary-general of PPRP. But his faction of 21 MPs was expelled from the PPRP in Feb 22 after he was accused of engineering a no-confidence vote against Prayut's government in Sep 21. Thammanat has become a sworn enemy of Prayut who is also said to have fallen out with his long time mentor in the military and now deputy prime minister Prawit Wongsuwan who is reportedly still allied with

Thammanat. Thammanat has been seen wining and dining MPs from the micro coalition parties recently and could potentially win them over against Prayut. Prayut has steadfastly refused Thammanat's key demand of two cabinet seats in return for its support.

In short, there is a growing risk that the Prayut government will fall, precipitating a general election about a year ahead of its time. Prayut is keen to avoid this – he wants to show that he was capable of completing a full term in office, which is not something that many Thai governments have been able to do. He is also determined to play host to the Asia-Pacific Economic Cooperation (APEC) summit to be held in Thailand in Nov 22. He may still find a way to hang onto power, through compromising with the Thammanat faction, for instance. But he has lost considerable moral authority and will stumble on as a weak leader.

The more fundamental threat: Prayut's failure to resolve the deep divisions in the country.

Political instability on a much larger scale might be looming on the horizon. Thailand has been wracked by instability since around the middle of 2004. The establishment forces that Prayut represents – the monarchy, the military factions, the conservatives in the bureaucracy and judiciary as well as well-placed business families – have refused to tackle the deep social divisions that are at the root of this instability. Instead, they have doubled down on repression of the expressions of dissent, bottling up these resentments and creating a potentially explosive political crisis in future.

The year 2020 saw widespread student protests across Thailand. They demanded structural change in the country's political system, namely a reduction in the power of the military to determine state affairs and reforms to the monarchy. Their demands were aimed at ushering in greater democracy. The Thai youth were galvanised to do so after the dissolution of the Future Forward Party (FFP) by the constitutional court in Feb 20 made them feel like democracy was regressing in the country. The FFP was the younger generation's favourite political party in the 2019 elections. It was the platform through which they could make their voices heard and have their hopes advanced.

The students' protests were nothing but explosive. Between July and December 2020, there were an estimated 385 protests in 62 provinces by 112 groups. The students' protests took on a feature that was highly provocative to the ruling establishment – for the first time, the monarchy was directly and publicly challenged, breaking a longstanding taboo in Thai society about criticising the monarch. The student protest that particularly shook Thailand was the United Front of Thammasat and Demonstration (UFTD) on 10 Aug 20 that issued a 10-point demand for royal reforms. It was the most direct challenge to the monarchy Thailand in recent times.

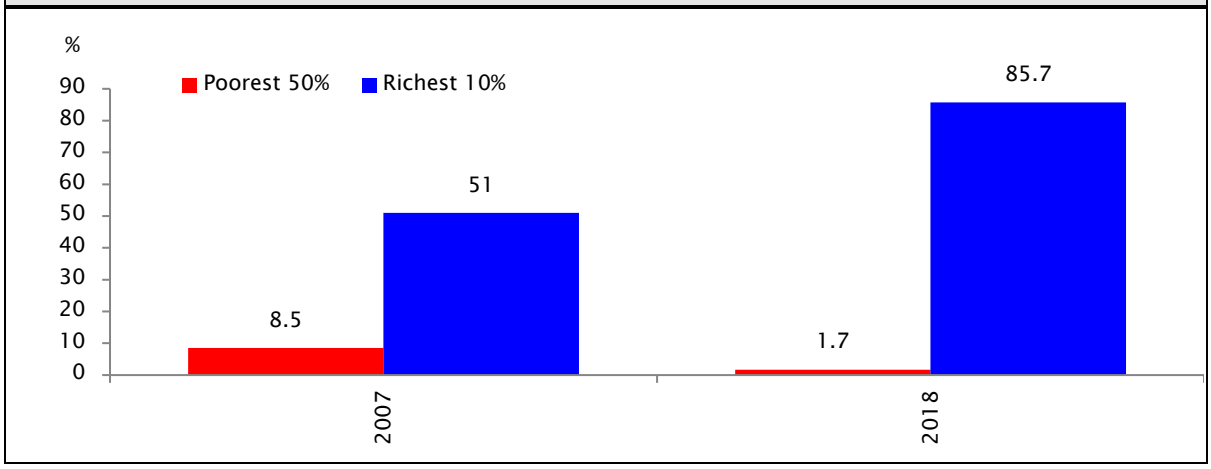
However, the students' demands fell on deaf ears. Instead of engaging with the youth, the military fell back on repression. It cracked down harshly on protests with water cannons and arrests of student protest leaders. The royal palace also remained silent. <u>We see this as a source of political instability in the long run</u>.

In the absence of change and their political demands completely unmet, the youth are bound to resume their acts of civil disobedience. All that is needed to ignite fresh protests is a trigger event such as an outrageous act of repression. We also think that the political instability to come will be protracted as the demands of the younger generation are difficult to resolve. First, an institution as entrenched as the monarchy will be resistant to change. Second, it is not likely that the military will relinquish its powers of intervention in politics. The latter can be understood in terms of the military's vested interests and the role that it perceives it has as the "guardian" of the state and the nation.

Fundamental misunderstandings between the Thai youth and members of the establishment will only make things more difficult. Student protestors emphasise that their fight is for the equality of all Thais and that they wish to reform, not abolish the monarchy. Members of the establishment, however, view student protestors as "nation-haters" that resist all institutions, norms, and culture. At the height of the student protests, Former Army Chief General Apirat Kongsompong, Deputy Secretary to the Royal Office, said: "Infection with COVID-19 can be healed, but *rok chang chat* [hate-the-nation sickness] cannot."

Chart 1: Wealth Inequality in Thailand

The % of wealth held by the poorest 50% and the richest 10% of Thais



Source: 2018 Credit Suisse Global Wealth Report

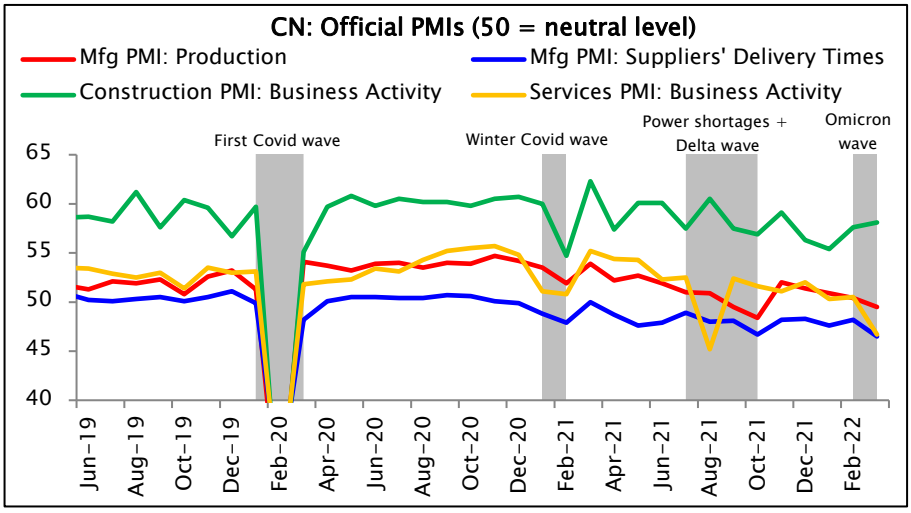
Apart from the unmet demands of the younger generation, there are also older grievances that plague Thai society. The grievances of the rural and urban lower class under the banner of the "Red Shirts" that concerned the distribution of economic gains were never properly addressed – they were only repressed and beat back like the demands of the student protestors. Their grievances are just as salient today. Thailand ranks first globally in wealth inequality according to the 2018 Credit Suisse Global Wealth Report (Chart 1). The 2020 World Bank report on poverty in Thailand showed that even in the absence of economic crises, the absolute number of people living in poverty in Thailand increased from 4.85 million to more than 6.7 million between 2015-2018. Many members of the rural and urban lower class currently live in a state of precarity, that is the possibility of falling back into poverty any time. In a similar vein, the middle class is

dissatisfied with the inequality of opportunities. Small and productive enterprises are being crowded out by large corporations that potentially benefit from cronyism.

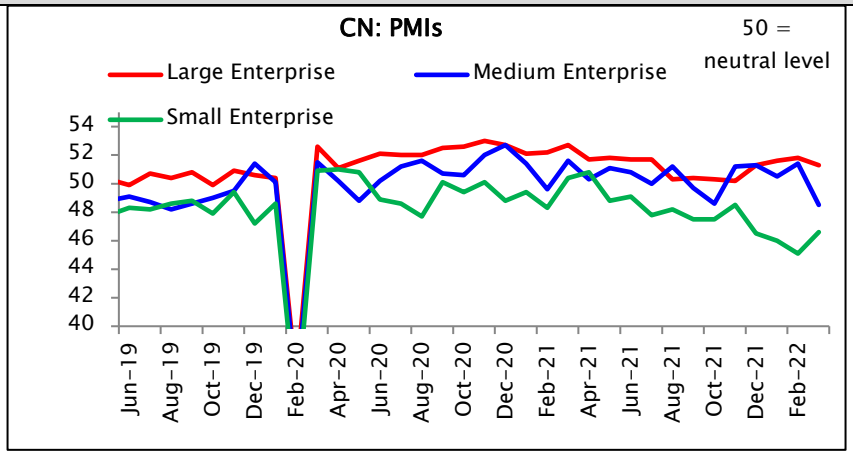
If these grievances rise to the fore and coalesce with the demands of the younger generation (perhaps into a shared resistance against the prerogatives of the Thai elite), it will not only contribute to longer-term political instability but intensify it.

As such, even if short-term political instability is averted, we see that political instability on a much larger scale looms on the horizon. This is the result of the deep fault lines that run through Thai society that have yet to be resolved.

Key Drivers of Asian Economies

Variable	Development/Assessment
Asian economies:	
China: Efficacy of policy toolkit in question	**Supply-side of economy under pressure despite policymakers' efforts to preserve production capacity**: ▪ The official manufacturing PMI contracted for the first time since the initial COVID-19 wave in 2020 that prompted national lockdowns, with the headline reading coming in at 49.5 in March, down from 50.2 previously. The rolling lockdowns of the past month took a toll on production which fell to 49.5 in March from 50.4 in February. The suppliers' delivery times sub-index, a proxy for supply bottlenecks, fell to its lowest level since the start of the pandemic, another sign of COVID-19 related disruptions to output (see Chart below).  Source: CEIC, Centennial Asia Advisors ▪ **Both domestic and external demand contracted,** as evinced by similar (1.8-1.9 ppt) declines in the new orders and new export orders indices. On the domestic front, beneficial spillovers from the ongoing infrastructure buildout may be overshadowed by the deep-set malaise in the consumer and property-related sectors while externally, geopolitical ructions may be weighing on orders from abroad. ▪ **Larger hit to services activity was seen in March** of roughly similar magnitude and speed to Oct-November last year when a wave of Delta outbreaks spurred lockdowns in northern China (see Chart above). ▪ **Construction activity picked up, but by less-than-expected**: The recovery in the PMI for construction activity that began in January lost steam, inching up only slightly to 58.1 in March from 57.6 in February. In contrast, the gauge saw a sharper rebound out of the winter COVID-19 wave-induced slump in 2020 (see Chart above).

Variable	Development/Assessment



Source: CEIC, Centennial Asia Advisors

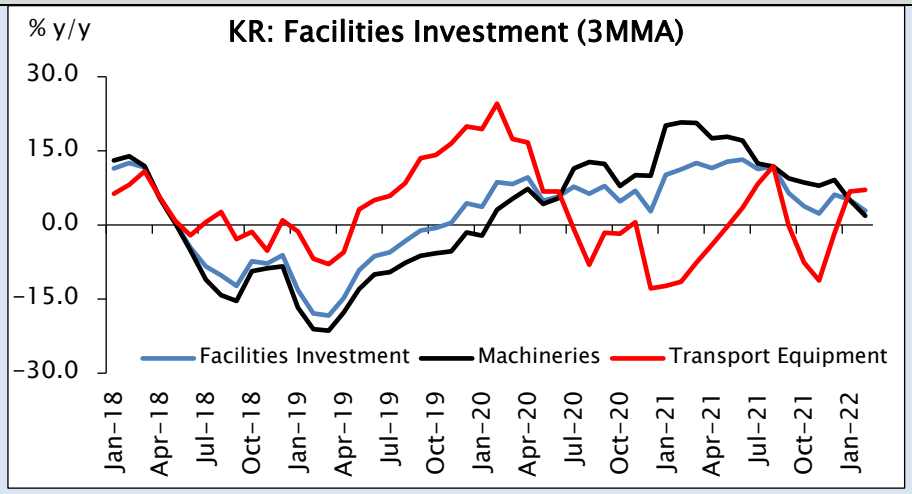
- **Small enterprises in bad shape despite credit support; negative read-across to capex:** The PMI sub-index for small enterprises that are responsible for 60% of GDP and 80% of employment rebounded in March from its weakest reading since the start of the pandemic (see Chart above). Further improvement is likely to be capped given that the concurrent drop in the PMI sub-index for medium enterprises to its weakest level since the first COVID-19 wave in 2020.

Assessment: Can policy easing arrest the downward spiral in confidence?

- The current "dynamic zero-COVID" posture is likely to be maintained until after the Party Congress late this year given the political stakes, as Xi makes his bid for an unprecedented third term whilst receiving an unusual degree of pushback behind the scenes on the policies he has promulgated since the start of the pandemic e.g. zero-COVID and the sweeping crackdowns on technology companies, the private and real estate sectors that has hurt business sentiment.
- Our assumption is therefore that the government regains control of the Omicron wave by end-2Q22, such that the immediate damage to growth is confined to the second quarter, but lingering restrictions on mobility and sporadic lockdowns weigh on activity thereafter.
- This raises downside risks for Chinese GDP growth and the orderly functioning of global supply chains, though it may not signal an upside risk to inflation given the associated negative demand shocks.
- The pressure on policymakers to ramp up policy support for the economy will grow. However, the uncertain efficacy of the policy toolkit could restrain or blunt the impact of the stimulus on growth.
- The weaker-than-expected construction PMI outcome in March raises questions of whether rolling and/or sporadic lockdowns in the coming months could prevent the required offsetting response from infrastructure spending from being realized.

Variable	Development/Assessment
	▪ To this end, we call attention to the striking gap between the PMI sub-indices for large and small enterprises that opened up over 2021 – despite the People's Bank of China's efforts to direct credit to small firms via "inclusive loans" and window guidance, or instructions to the state banks to raise lending to a particular sector of the economy. With business confidence among small firms' impaired, manufacturing fixed asset investment is unlikely to come to the economy's rescue. Nor is consumption, given the *cumulative* impact of zero-COVID policies on incomes, employment and confidence – and a supply-side heavy policy mix that is skewed towards supporting businesses.
South Korea: Slight loss of momentum in February	▪ **Manufacturing PMI declined to 51.2 in March** (February: 53.8), ending a 4-month improvement streak. New orders rose for the 18th successive month, but the rate of increase was the joint-softest, and geopolitical tensions weighed on export orders, which fell sharply. Input prices firmed up at the fastest pace in 3 months, and output charges rose markedly. Job shedding continued, albeit at a softer rate. Business optimism remains robust, but eased from February. ▪ **Factory output growth held steady in February (+4.3%)**. Construction (-4.7%), mining (-11.3%) and services (+3.8%) decelerated, while public administration (+5.1%), electricity (+10.2%) and manufacturing (+6.2%) ticked up, with the electronics (+9.5%) and semicon (+31.3%) sectors being particular bright spots. Sequentially, factory output slipped 0.2% m/m sa, following a 0.3% decrease in January. ▪ **Core machinery orders plunged 15.2% y/y in February**, marking the first contraction since end-2020 amid unfavourable base effects. A desultory showing by the private sector (-16.2%) weighed on orders. Sequentially, core orders fell 6.2% m/m, up from -26.0% in January. ▪ **Facilities investment rose 2.1% y/y in February**, up from +0.1% in January. Machineries (+2.1%) and transport equipment (+2.4%) remain soft, however. Sequentially, facilities investment decreased 5.7% m/m sa, ending a 3-month growth streak.

Variable	Development/Assessment



Source: CEIC

- **Retail sales moderated to +1.6% y/y in February** (January: +0.4%) – the slowest since late-2020 as unfavourable base effects kick in. Notably, durables (+6.7%), particularly household durable goods (+7.9%), was the only bright spot, offset by the sharp deceleration in semi- (+5.2%) and non-durables (-2.4%). Sequentially, retail sales posted a mere 0.1% m/m expansion (January: -2.1%).
- **Export growth remains resilient in March (+18.2%)** (February: +20.6%). Semiconductors (+38.0%) went from strength to strength, more than offsetting the slowdown in autos (-9.7%) and petrochemicals (+14.8%). General machineries (+3.0%) and petroleum products (+90.1%) picked up as well. Imports firmed up in March (+27.9%), and the hefty fuel prices have kept the trade balance under pressure (-USD140mn).

Assessment: Growth momentum slows a tad

- **Manufacturing production cooled in January as headwinds swirl:** There was a discernible loss of momentum in manufacturing and investment activity in February. While part of it can be ascribed to base effects when the economy was in the early-stage of the growth cycle in 1H21, the Korean economy is likely to run into headwinds from the negative spillovers as a result of geopolitical tensions. For one, the economy has racked up trade deficits in 3 out of 4 months. While the secular strength in the tech sector will continue to buttress the economy, base effects moving forward entail a cyclical moderation in the growth momentum as the economy nears the late-stage of the growth cycle, and domestic consumption has to do more of the heavy lifting this year.
- **Consumption looks wobbly:** While Covid-19 caseloads have finally peaked, mobility trends remain way below their pandemic-era highs, suggesting large swathes of the population have yet to come to terms with living with the Coronavirus. The lunar new year festive season did

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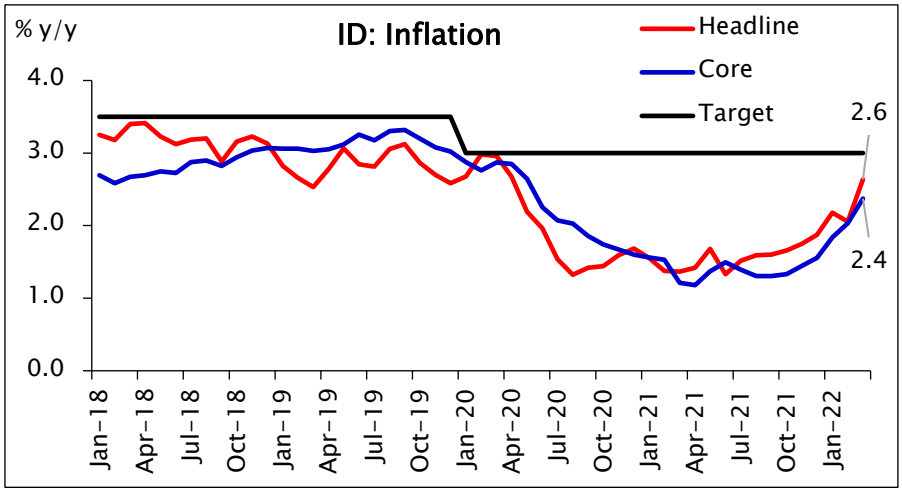
	no favours for retail sales either, given the sluggish sequential momentum. The hope is that as caseloads continue their descent, the ensuing revival in consumer confidence and spending will gin up the economy, despite the bearish impact posed by sky-high fuel prices.
Indonesia: Inflation will continue trending up in 2H22	▪ **Manufacturing PMI ticked up to 51.3 in March** (February: 51.2). New orders grew, albeit at the slowest pace in 7 months. Export orders also slowed because of shipping constraints. Employment rose because of higher production requirements, but the pace was marginal and the fastest in almost 3 years. Input and output inflation quickened in March. Business confidence remained positive, with the level of optimism jumping to a 8-month high. ▪ **Headline inflation quickened to a 2-year high in March (+2.6%)** (February: +2.1%). Following a period of stasis, prices are jumping across every component of the CPI basket – food and beverage (+3.6%), transportation (+2.4%), personal care (+4.4%), accommodation and utilities (+1.8%), clothing (+2.0%) and household equipment (+3.8%) all continued their ascent. Info-comm and financial service (-0.2%) and education (+1.7%) were unchanged. Core inflation also firmed up to a 22-month high (+2.4%) as unfavourable base effects play out further in 2H22.  Source: CEIC **Assessment: Indonesia is not spared ill-effects of heady commodity prices** ▪ Indonesia is a net beneficiary of higher commodity prices, particularly that of hydrocarbons and nickel, despite the rather muted PMI print for March. On the flip side, its economy is unlikely to emerge unscathed from the episodic surges in commodity prices, rendered more salient by the inflation print. Unfavourable base effects are likely to play out further in 2H22, which will imminently push inflation above 3% as the VAT tax hike kicks in from April. Looming upward price adjustments

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	to the subsidised retail fuel and LPG, hinted by coordinating minister Luhut, will fan inflationary pressures further. ▪ That said, we continue to hew to our view for Bank Indonesia to keep rates unchanged till 3Q22, as the central bank will probably point to the still-fragile recovery and negative output gap as reasons to keep monetary conditions accommodative.
Thailand: Inflationary pressures a drag on domestic demand	Weaker growth outcome, as we expected: ▪ Previously, we downgraded our 2022 growth forecast for Thailand from 4.7% to 4.0%. We expected sharper inflation to create a drag on domestic demand. The latest high-frequency data for Feb 22 reflects our view: ▪ Households cut back on their spending in Feb 22. The private consumption index contracted -0.6% m/m sa in Feb 22, extending the -0.4% m/m sa contraction in Jan 22. Declines in private consumption were partly mitigated by rising farm incomes (Feb 22: +9.0% y/y; Jan 22: +5.5% y/y) and cash transfers from the government. ▪ Private investment also fell in Feb 22, most likely because businesses struggled with tighter margins and were less confident to invest. The private investment index contracted -0.9% m/m sa in Feb 22, extending the -0.7% m/m sa contraction in Jan 22. Real imports of capital goods, another proxy for private investment, also contracted by -4.3% m/m sa in Feb 22. ▪ The government has announced a "10-point plan" to manage rising costs. We do not expect it to reverse the drags on domestic demand. We hold this view because government aid is mostly targeted to state welfare card holders and lower income households and price subsidies are only slated to last for a few months. ▪ Meanwhile, exports and government spending continue to support growth: exports maintained a strong growth momentum of +16.0% y/ in Feb 22, up from +7.9% y/y in Jan 22. The government's current expenditure grew +3.4% y/y and its capital expenditure grew +19.2% y/y in Feb 22. **Assessment: BOT remains cautious, tourist arrivals bear watching** ▪ The BOT's latest monetary policy meeting on 30 Mar 22 showed a determination to keep rates accommodative. The monetary policy committee voted unanimously to maintain the policy rate at 0.50%. Expectations that inflation will subside in early-2023 and the need to facilitate a sustained recovery amid subdued domestic demand informed the BOT's decision. This entails hot money outflows as central banks in the region move to raise rates. ▪ Foreign tourist arrivals bear watching in the coming months. It edged up in Feb 22 after the resumption of the Test & Go scheme, but it is

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	nowhere near the levels required for the expected >5 million tourists in 2022. Disappointing tourist arrival figures could cause another downgrade to our GDP growth forecast.
Malaysia: Central bank still on track to hike OPR in 2H22	▪ **Manufacturing PMI slipped to 49.6 in March** (February: 50.9), the first time it fell into contractionary territory in 7 months. Both new orders and export orders contracted at a faster rate. Input inflation firmed up for the first time in 3 months and was marked overall, while output inflation was the highest since April 2021. Job shedding continued, albeit only slightly in March. Business optimism waned to its lowest since October 2021, mainly because of concerns of higher cost pressures. Highlights from the BNM Annual Report ▪ **Real GDP growth to range 5.3%-6.3% in 2022**, led primarily by private consumption (+9.0%) and investments (+5.3%). The tech cycle, resumption of travel, improving labour market conditions and policy support will all shore up the economy this year. ▪ **Headline inflation will average between 2.2%-3.2% in 2022**. Core inflation will also average 2%-3%, snapping out of a multi-year disinflationary streak, as commodity price shocks and disruptions to supply-chain and global trade all entail a higher cost of production for firms. ▪ **The negative output gap will narrow to around 4% of GDP in 2022**, compared to 6% in 2021, as actual output exceeds that of potential (2022e: 3%-4%). ▪ **The Current Account surplus is expected to widen to 4.2%-4.7% of GDP** (2021: 3.5% of GDP), thanks to the positive terms-of-trade shock in the goods trade from surging commodity prices. ▪ **BNM affirmed its hawkish tilt,** signalling that the extent of policy support should be in line with the "expected improvement in economic conditions" as price pressures become more salient. At the same time, policy adjustments will be made in a "measured and gradual manner". This represents a break from March's MPC statement, when there was no change to the policy guidance. **Assessment: Nothing to suggest change to the status quo till 2H22** ▪ Bank Negara's annual report sheds clarity on the parameters that bear watching for the first sign of the policy normalisation post-pandemic. Our view is that the report does not convince us otherwise that BNM will hike the OPR in May. Considering that the 1Q22 GDP print will only be out in mid-May *after* the MPC meeting, we think BNM will play it safe and keep rates unchanged. What could wrongfoot markets is if

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	inflation turns up sharply in Malaysia, sharpening the policy dilemmas against the backdrop of a still-sizeable negative output gap and forcing BNM to tighten prematurely.
The Philippines: the recovery is intact	▪ **Manufacturing PMI leapt to a multi-year high in March (53.2)** (February: 52.8). New orders expanded at the joint-fastest pace since July 2019, but export orders whipsawed and contracted in March. Both input and output inflation quickened to a record-high, amid stirring supply-side cost pressures. Employment fell again in March, again because of resignations and a cost rationalisation exercise by firms. Firms remained strongly positive regarding the outlook for output in the year-ahead period. ▪ **Credit growth continues to firm up in Feb 22 (+8.8%)** (Jan 22: +8.6%). Loans for production inched up further (+9.7%), underpinned primarily by wholesale and retail trade (+5.7%), information and communication (+33.3%) and construction (+8.0%). Conversely, lending extended to manufacturing (+11.0%), utilities (+0.4%), real estate (+16.0%), finance and insurance (+13.2%) and transportation and storage (+8.9%) softened a touch. Consumer loans rose for the first time first time in 14 months (+0.9%). ▪ **The budget deficit widened to PHP106bn in February** (Jan 22: PHP23.4bn). Total revenues slipped 3.3% y/y, because of a 2.6% decrease in tax revenue mop-up. Expenditures were equally sluggish (-5.2%) to make way for the ballooning disbursements to local government units (+29.2%). Ytd, the fiscal deficit came in at 0.7% of GDP, compared to the full-year cap of 7.7%. ▪ **Infrastructure spending as a share of GDP rebounded to pre-pandemic levels** in 2021 (4.6%) (2020: 3.8%) (see Chart below, blue bars). Transfers, which include subsidies, equity releases to government corporations and fund transfers to local governments, jumped to 1.4% of GDP, from 1.1% in 2020. For this year, the outgoing Duterte administration is eyeing infrastructure spending of 5.3% of GDP.

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	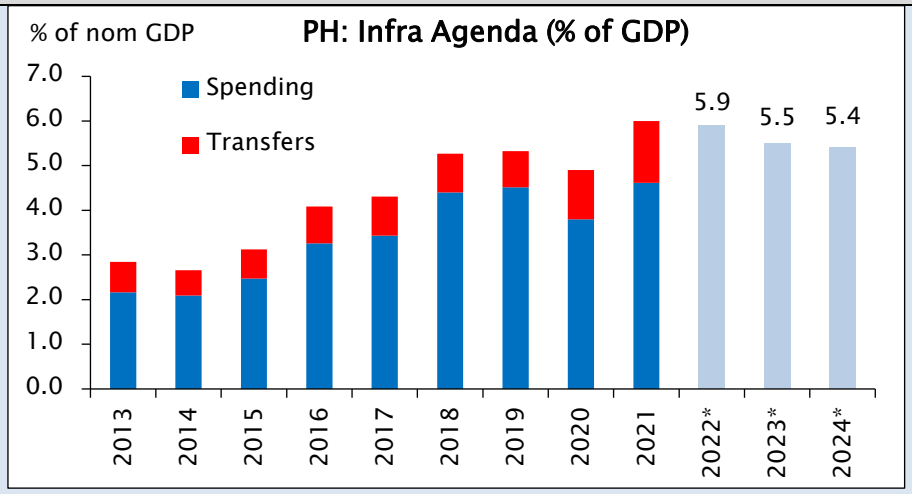 Source: CEIC. *Figures for 2022-2024 are all estimates from the medium-term assumptions by the economic managers. **Assessment: Growth story remains intact** ▪ **Solid growth in 1H22**: The slew of high-frequency activity indicators affirms our view for a strong showing by the Philippine economy in 1H22, on the back of the easing restrictions and the release of pent-up demand, at least during the initial period of the reopening trade. Fiscal policy is set to remain strongly accommodative, even as the authorities are eyeing a more conservative policy stance to shore up public finances, evinced by the spike in infrastructure spending as a share of GDP in 2021. The greater allocation of revenues to local governments represents a double-edged sword, depending on the spending efficiency of LGUs. ▪ **Watch for inflation**: CPI Inflation is due for release on 5th April, and we do expect inflation to come in close to the upper end of the target corridor, primarily because of the incessant fuel price hikes as global oil prices continue trading in triple digits. Record-high input and output inflation, according to the PMI print, is cold comfort for the dovish and growth-obsessed central bank, which remains adamant over hiking only in 2H22. In the near-term, inflation is likely to breach the CPI's target corridor in 2Q22 as the normalisation in demand meets simmering cost pressures from freight rates, oil prices and a weak Peso.

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	Year	Growth (%)	Inflation (%)	Current Account (% of GDP)	Policy rate (%)	Currency (vs USD)
China	2020	2.3	0.1	1.9	2.95	6.53
	2021	8.1	1.8	2.8	2.95	6.36
	2022	3.2	2.3	2.2	2.65	6.40
India	2020	-7.3	5.5	0.9	4.00	73.1
	2021	8.8	5.3	-1.0	4.00	74.5
	2022	7.0	5.6	-2.0	4.70	76.0
Indonesia	2020	-2.1	1.7	-0.4	3.75	14,050
	2021	3.7	2.0	0.3	3.50	14,300
	2022	5.3	3.8	-0.8	4.00	14,200
Korea	2020	-0.9	0.5	4.6	0.50	1,085
	2021	4.0	4.0	5.0	1.00	1,188
	2022	2.5	3.5	3.9	2.00	1,250
Taiwan	2020	3.1	-0.2	14.1	1.125	28.0
	2021	6.1	3.0	14.6	1.125	27.5
	2022	3.8	2.2	13.8	1.50	27.0
Hong Kong	2020	-6.1	-0.6	6.9	-	7.75
	2021	6.4	2.1	5.9	-	7.80
	2022	1.5	3.0	5.0	-	7.80
Singapore	2020	-5.4	0.0	17.6	-	1.32
	2021	7.1	4.0	17.0	-	1.35
	2022	5.4	3.3	16.1	-	1.31
Malaysia	2020	-5.6	-1.4	4.2	1.75	4.02
	2021	3.1	2.5	4.0	1.75	4.18
	2022	6.0	2.8	3.7	2.25	4.10
Philippines	2020	-9.6	3.5	3.1	2.00	48.0
	2021	5.6	4.4	-1.8	2.00	50.9
	2022	6.8	4.1	-2.5	2.50	52.0
Thailand	2020	-6.1	-0.8	3.5	0.50	30.0
	2021	1.0	1.5	0.3	0.50	33.0
	2022	4.0	2.5	6.0	0.50	31.0
Vietnam	2020	2.8	3.2	3.7	4.00	23,080
	2021	3.0	2.5	5.5	4.00	23,300
	2022	7.0	2.0	6.5	3.50	23,050

Source: Centennial Asia Advisors. Forecasts for India are on the basis of the fiscal year ending March. Figures in parentheses refer to previous forecast. Figures in red indicate a downgrade; green signal an upgrade.

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