Emerging Asia – moving ahead despite the headwinds

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There are several reasons why we think that emerging Asia's recovery from the pandemic will continue despite the growing worries about a US recession.

- First, our baseline view is that the US will avoid a recession and that capital spending there – which has a strong influence on Asian exports – can grow.
- Second, we see China recovering in 2023 and adding to Asian export demand.
- Third, commodity prices are likely to continue supporting several Asian economies.
- Finally, there are structural forces which will help promote investment into Asia – supply chain reconfiguration, reforms that improve the appeal to investors and infrastructure spending.

What has changed recently:

- **China**: There are more signs that the worst is over for the economy. But the economic recovery will be constrained by weak demand conditions – with small enterprises remaining under pressure, labour market conditions still parlous and the uptick in covid infections in the eastern region rattling consumers. Encouragingly, stimulus is being ramped up and there are signs that infrastructure spending will be a bright spot for the economy.
- **Monsoon rains in India continue to disappoint**: Consequently, farmers have held back on planting the summer crop. This raises the risk of a further growth slowdown and pronounced food inflation.
- **Inflation in Indonesia has breached the upper-end of the central bank's target corridor (2%–4%),** but the explicit guidance from the central bank suggests it is still not in a rush to tighten, despite burning through 8% of its reserves through spot intervention through May this year.
- **Korea is seeing a particularly pronounced slowdown in external demand**. But it is not all doom-and-gloom, as domestic demand will do more of the heavy lifting in 2H22. Watch for the upcoming inflation print that could trigger a 50bps rate hike from the BoK in mid-July.
- **Singapore's next leader to lead public consultation exercise** : The launch of the "Forward Singapore" exercise provides an opportunity for Deputy Prime Minster Lawrence Wong, the anointed successor to Prime Minister Lee to raise his profile. The policy priorities of the next generation of leaders can be gleaned from the exercise and it reinforces DPM Wong's leadership style of consensus building.
- **Thailand – a mixed performance**: Despite record-high inflation, an improving labour market and higher farm incomes are supporting domestic demand. A rapidly recovering tourism sector is giving the economy another leg-up. However, export demand is cooling, and the Bank of Thailand's accommodative monetary policy is beginning to rattle foreign investors.
- **Vietnam**: With the re-opening of borders and the easing of Covid-19 restrictions, the economy is firing on all cylinders. The key risk at hand is an over-heating of the economy that further fans inflationary pressures.

Emerging Asia – moving ahead despite the headwinds

Looking at the key determinants of emerging Asia's economic prospects – global demand for its exports, commodity prices, structural drivers and domestic demand – there is good reason to believe that the regional economies can sustain their recoveries from the pandemic despite the weakening outlook for the major economies.

1. Global demand: baseline scenario for US and China impact on Asia

In terms of demand, it is the US and China that matter most for emerging Asia, so we will focus on these two major economies. Tables 1 and 2 sketch out the channels of transmission in how each country affects Asia and the extent of dependence of GDP components on trade with each.

We think the US economy will continue to provide some demand support for Asia

We believe that US economic performance will be mediocre in the coming one to one and half years but it is likely to avoid a prolonged and broad-based contraction in output, incomes and employment – which is the more accurate definition of a recession.

First, the Conference Board's leading indicator (CLI) for the US economy fell by 0.4% in May, following a fall of similar magnitude in April. The CLI points to weakening prospects for the American economy over the next couple of quarters, but it is not at a level which predicts an outright recession.

Second, while surveys of confidence point to sharp falls in consumer and business confidence, actual spending is not falling in line with that plunge in confidence – for good reasons:

- Companies continue to maintain their spending. It is notable that capital spending has held up rather well. Orders for durable goods rose 12% y/y in May 2022 while core capital goods orders have kept rising through the last few months of financial and political turbulence – despite falls in CEO confidence. A key assumption we are making is that capital spending will be supported by strong secular forces – the unavoidable push for decarbonisation, the plethora of new technologies now reaching commercialisation stage and the need to improve labour productivity given labour shortages and rising wages.

- Moreover, firms have continued to hire workers at an impressive rate with non-farm employment up by 390,000 in May for example. Rapid expansion of payrolls has brought total employment close to pre-pandemic levels, which seems to us to be a vote of confidence in the economy.

- And that means that real consumer spending, which is volatile month to month, has grown steadily through April this year and only fell in May, even as consumer confidence was weakening. So long as labour markets remain tight, consumers will feel confident about job security while reasonably expecting that wage increases will eventually compensate for inflation. There are also signs that labour unions are gaining clout vis-à-vis employers as a result – unions have won some major political battles against big companies in recent weeks. That suggests that labour's ability to bargain for higher wages will improve in coming months, contributing to higher real wages. Moreover, with about USD2.5 trillion in excess savings on household balance sheets, consumer spending can be sustained even in the face of higher living costs.

In short, having benefited from both monetary and fiscal stimulus last year which is now being withdrawn, the US economy was bound to lose momentum this year. More so, since the benefits of the easing of the pandemic emerged last year, something that is not being repeated this year. So, it is not surprising that the oil price shock, rising inflation and the geo-political uncertainties arising from the Ukraine war would have combined with that expected loss of momentum to produce poor GDP growth numbers in the first half of this year. Thus, the weakness we are seeing now was expected but does not necessarily portend a recession – where recession is defined as a broadly based and prolonged fall in output, employment and incomes.

Table 1: Dependence on US

Indicator	China	India	Indon-esia	Malay-sia	Philippines	Singa-pore	South Korea	Thai-land	Tai-wan	Viet-nam
Exports (% of Total)	17.20	18.1	11.2	14.0	15.9	8.6	14.9	15.4	28.2	17.4
FDI (% of Total)	NA	38.5	8.2	14.0	8.7	24.7	15.1	8.8	9.4	2.2
Tourism (% of total)	NA	13.8	2.3	1.1	24.0	3.3	21.1	2.2	6.0	2.1
Portfolio Flows (% of total)	19.8	48.7	4.1	21.7	33.9	26.9	48.9	16.4	NA	NA
	Value added generated from trade with US in domestic demand components/total GDP									
Consumption	1.2	1.5	1.5	2.9	2.9	6.5	2.8	3.0	4.2	3.8
Investment	1.7	2.8	1.6	5.4	4.9	11.4	4.6	4.9	6.4	3.7
Total	2.9	4.3	3.1	8.3	7.8	17.9	7.4	7.9	10.6	7.5

Source: CEIC Data, TiVA database

As Table 1 shows, the US affects Asia through multiple channels. Previous work we have done shows that US capital spending is a far more important driver of Asian manufactured goods exports than consumer spending. If we are correct in our call that the US can avoid a broad contraction in its economy and if our intuition, that US capital spending will remain resilient, is correct, then the impact of the US on Asian exports will not be a threat to Asian growth prospects.

China is likely to be a positive driver of Asian growth as we move into 2023

Our view on China's impact on Asia is founded on the following:

As we are seeing with the recent spikes in covid infections in China's eastern region, the country will struggle to achieve zero covid. The ensuing restrictions on consumer and business activity will continue to take its toll on the economy. However, the damage caused to the economy will be mitigated by a number of factors:

- Stealth stimulus: While the leadership continues to insist that there is no need for a massive stimulus, the authorities are sneaking in stimulus through various means. The latest is the State Council's establishment of "policy-based and developmental financial instrument (PDFI)" for policy banks with an initial capital allocation of CNY300bn. This follows an earlier move to provide the same policy banks with credit lines of CNY800bn to fund infrastructure projects. Local authorities are also easing restrictions on the real estate sector to boost investment in property and stabilise the property sector. The government has also extended funding for small and medium enterprises as well as vulnerable segments of the population such as migrant workers.

- Better calibrated public health measures to contain covid: By mid-August, once the annual meetings of the leadership at Beidaihe are over, the critical political decisions would have bene made insofar as November's all-important 20th Congress of the Chinese Communist Party are concerned. After that we think that the zero-covid approach will be fine-tuned so as to be less damaging to consumer and business confidence. Once the Congress itself is over, there will be a broader easing of the pandemic measures as well.

Table 2: Dependence on China

Indicator	India	Indon-esia	Malay-sia	Philippines	Singa-pore	South Korea	Thai-land	Tai-wan	Viet-nam
Exports (% of Total)	5.80	23.50	15.50	15.50	14.80	25.30	13.70	14.70	17.40
FDI (% of Total)	0.05	10.16	3.74	1.02	2.05	3.70	7.49	1.55	9.95
Tourism (% of total)	3.11	5.92	9.35	5.90	26.74	17.60	21.94	8.06	39.61
Portfolio Flows (% of total assets)	5.53	1.33	6.86	3.46	12.57	3.39	1.23	NA	NA
	Value added generated from trade with China in domestic demand components/total GDP								
Consumption	1.8	3.1	4.2	4.2	5.3	3.6	4.7	3.9	9.0
Investment	6.3	5.5	9.7	9.8	6.4	6.3	12.6	8.4	15.1
Total	8.1	8.6	13.9	14.0	11.7	9.9	17.3	12.3	24.1

Source: CEIC Data, TiVA database

In other words, as we move into the latter part of 2022 and then into 2023, the combined impact of stealth easing and a more nuanced approach to pandemic management should remove the current constraints on the Chinese economy and allow it to rebound. That should help Asian economies. As Table 2 above shows, in terms of value-added generation, China is now more important to more Asian economies than the US.

2. **Commodity prices are likely to be supportive as well.**

Table 3 outlines our views on the commodity prices which matter for Asian economies. It shows that the outlook is broadly positive.

Table 3: Baseline Outlook: Winners and Losers from Rising Commodity Prices

Country	Commodity Outlook	Weight in GDP
Indonesia	Bullish: Coal,	2.7% of GDP
	Balanced: Coffee, Rubber, CPO, Nickel, Copper	3.9% of GDP
Malaysia	Balanced: Rubber, CPO	7.3% of GDP
Thailand	Bullish: Rice	0.7% of GDP
	Balanced: Rubber	1.1% of GDP
Vietnam	Bullish: Rice	0.9% of GDP
	Balanced: Coffee, Rubber	1.7% of GDP
The Philippines	Balanced: Copper, Nickel	0.6% of GDP
India	Bullish: Rice	0.3% of GDP

Source: Centennial Asia Advisors

3. **Structural forces bolster growth prospects as well**

A third reason to for Southeast Asia's resilience is the plethora of structural improvements in the economy which are likely to feed through to rising investment, both domestic and foreign. Reforms in the region such as the relaxation of caps on foreign investment in Indonesia and the Philippines and Indonesia's expected labour market reforms improve the prospects for more investment. Consequently, the foreign investment pipeline is looking good. Foreign investors are also drawn by the possible synergies from new trade agreements such as the Regional Comprehensive Economic Partnership. We also expect the reconfiguration of supply chains to resume now that the worst of the pandemic seems to be over. This should result is some production being relocated from China to countries such as Vietnam and Indonesia. In addition, infrastructure spending is set to revive after the disruptions caused by the pandemic.

4. **Domestic remand recovery**

It is only in recent months that the region outside China-Hong Kong has started to relax pandemic restrictions. This is unlike in the US and Europe where the relaxation started in earnest last year. The result is a wide-ranging boost to economic activity:

- Consumers are spending again as restaurants, entertainment centres and malls fully open again. Consequently, companies are hiring workers so as to service that growing demand, adding to demand.

- Tourists are also returning in force. Thailand, whose economy depends substantially on tourists, has reported 2 million tourists to date this year. But with the removal of virtually all remaining restrictions in July, they expect foreign arrivals to grow to 1.5 million a month. Since directly and indirectly, tourism contributes almost 20% of GDP, this turnaround will provide a strong uplift to Thailand's economic recovery. Similarly, other tourism-dependent economies such as Malaysia and Indonesia will also benefit.

- The opening of borders is also allowing the return of foreign workers to labour-importing economies such as Malaysia, Singapore and Thailand. This will help alleviate labour shortages in sectors as varied as plantations, manufacturing, restaurants, hotels and logistics, enabling a faster return to pre-pandemic levels of production.

- Finally, the relaxation of restrictions is helping to ease supply chain dislocations which again enables the normalisation of economic activities.

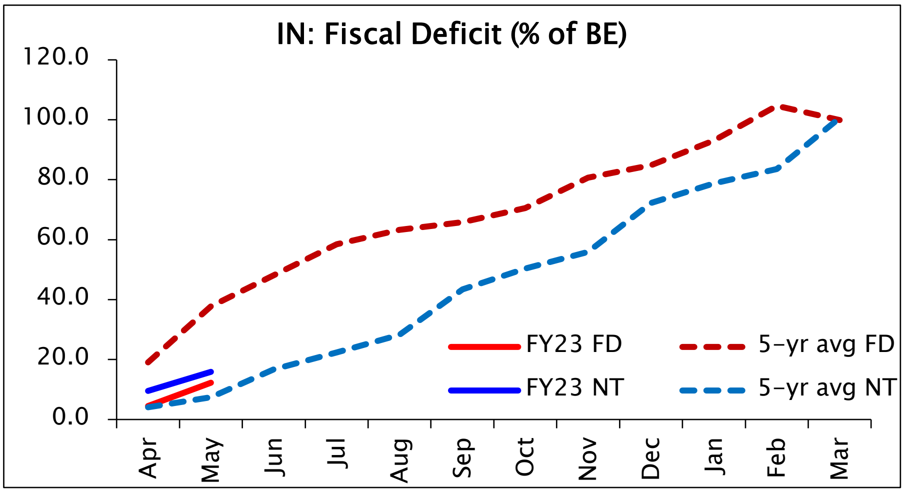
Overall, therefore, we maintain our forecasts for the region (see table at the end of this report).

Key Drivers of Asian Economies

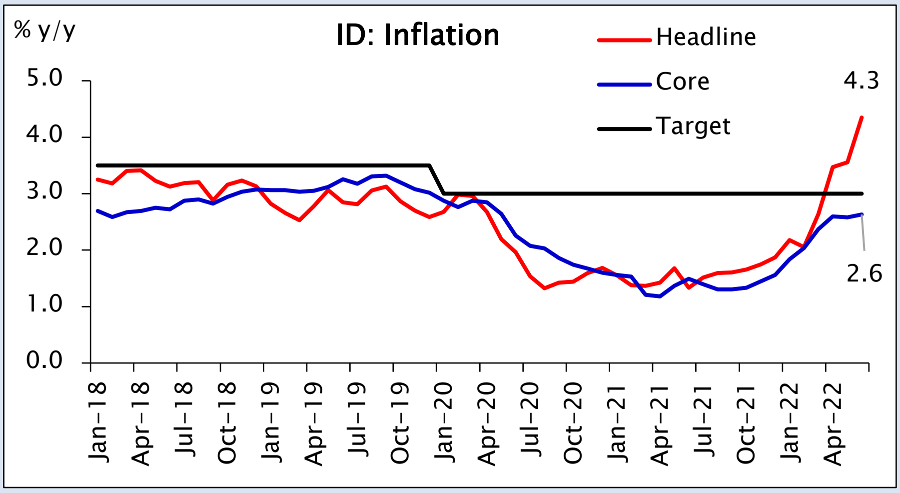
Variable	Development/Assessment
Asian political developments:	
Singapore: The next generation leadership sets out to make its mark	▪ On 28 Jun 22, Deputy Prime Minister (DPM) Lawrence Wong who has been named as successor to Prime Minister Lee Hsien Loong, launched the "Forward Singapore" exercise, a public consultation process aimed at informing policymaking which will help put his stamp on Singapore. The Forward Singapore exercise is the latest in a series of similar public consultations that have taken place over the years. **Assessment: don't expect significant policy changes** The Forward Singapore exercise does not lay out specific policy plans. It is not meant to produce economic policy changes since it is focused on Singapore's social compact and how to refresh it. Still, several takeaways can still be drawn from its launch. ▪ **First, the "6 pillars" of the Forward Singapore exercise reflect priorities similar to those of the current leadership.** Thus, it does not appear that the policy priorities of the so-called 4G (or fourth generation) leaders will diverge materially from the current orientation of policy. The 6 pillars are also very broadly defined rather than highly specific: 1) economy and jobs; 2) education and life-long learning; 3) healthcare and social support; 4) home and living environment; 5) environmental and fiscal sustainability; and 6) the Singapore identity. This raises the suspicion that the outcome will be similar to the other consultation exercises of the past decade, which barely moved the needle on substantive policies. ▪ **Second, it would therefore appear that the exercise is really meant to give Wong an opportunity to reach out to Singaporeans and establish a higher profile:** Wong projects a softer leadership approach and one based more on consensus-building. He is conscious of the changes in Singapore society which make for a more demanding electorate and seems keen to adapt the political system he will inherit to those changes. ▪ **Third, Wong used his speech to hint at areas where he might want to bring some changes**: The issues he raised were in many cases ones which trouble the average Singaporean such as the high-stakes education system which places inordinate pressure on the young; the perception of unfair privileges arising from Singapore's highly meritocratic system; a concern that social mobility is slowing; and the potential dislocations in the jobs market as a result of growing competition and new technologies. The hint seems to be that more incremental reforms will be made in these areas. But there was also a signal that change would be cautious. For example, in speaking about

Variable	Development/Assessment
	the need for higher social spending because of an ageing society and other challenges, he also noted that care had to be taken over how much tax payers would be willing to pay to fund more social safety nets. By talking about how "families, corporates and the community can complement what the Government is doing", he was reiterating current government approaches to social care.
Asian economies:	
China: Supply-side improvements facilitate growth	More signs that the worst is over ▪ **PMI rebounded**: Both the official NBS manufacturing PMI and the private sector Caixin manufacturing PMI depicted an economy returning to expansion in June for the first time in four months. The NBS PMI gained 0.6 points to reach 50.2 while Caixin PMI gained 3.6 points to reach 51.7 in Jun 22. Notably, the NBS non-manufacturing PMI surged 6.9 points to 54.7 in June, after three months of contraction. ▪ **Under-performing sectors recovering**: The construction sub-index grew 4.4 points to reach 56.6 while the services sub-index grew 7.2 points to reach 54.3 in Jun 22: clearly the under-performing sectors of the past few months have bounced back fairly vigorously. ▪ **However, small enterprises remain under pressure**: the sub-index of the PMI for small manufacturing enterprises remained in contractionary territory at 48.6 in Jun 22. The Manufacturing PMI for medium and large enterprises stood at 50.2 and 51.3 respectively in Jun 22. ▪ **Manufacturing PMI gains are mostly on the back of supply-side improvements**…: Production was able to rebound as factories resumed operations and reopened production lines. The output sub-index of the NBS survey gained 3.1 points to reach 52.8 in Jun 22 and the Caixin survey reported the strongest pace of output growth since May 21. Both NBS and Caixin manufacturing PMI reported shortened delivery times in Jun 22. ▪ **….but demand conditions continued to be weak**: The new orders sub-index of the NBS survey expanded only marginally at 50.4 in Jun 22 while the Caixin survey reported a "modest" increase in new orders. A number of firms reported "relatively subdued demand conditions" in the Caixin survey. Further, the Caixin survey reports that input inventories are increasing "fractionally", another sign that firms lack confidence in demand conditions. ▪ **Labour market conditions remained weak as well**: The employment sub-index for the manufacturing sector and the non-manufacturing sector both improved but remained in contractionary territory at 48.7 and 46.9 respectively in Jun 22. **Assessment: Stimulus is beginning to work but demand still a constraint**

Variable	Development/Assessment
	The improvement in production cannot be sustained unless domestic demand perks up. This is doubly so because the manufacturing sector lacks tailwinds from external demand unlike in previous recoveries. The new export orders sub-index of the NBS survey contracted at 49.5 in Jun 22 while Caixin reported a "modest" rise in new export orders. ▪ The good news is that the government's relentless infrastructure push is beginning to bear fruit aside from the pickup in construction: in the first five months of 2022, the National Development and Reform Commission approved 48 fixed-asset investment projects with a combined value of CNY654.2bn, a 215% surge from the same period last year. In Jun 22, local governments issued more than CNY1.9tr in debt – a historic high – mostly in the form of special purpose bonds to fund infrastructure projects. Lastly, data from China Beige Book showed that borrowing by Chinese transportation construction companies has shot up since early 2021. One in five firms in the industry issued bonds in 2Q22 while 22% took out a loan, the highest percentage for both metrics since 1Q21. ▪ The less encouraging news is that demand may remain lacklustre for some time. The uptick in covid infections in eastern regions such as Anhui has resulted in the return of restrictions and mass testing of citizens. That is bound to bear down on consumer confidence – even though the numbers remain small, the uncertainty over when there might be more lockdowns would keep citizens on edge. There are also some signs that the slowdown so far is bearing down on the finances of local governments, forcing them to cut back spending rather than boost spending to offset the weakness in private spending – for example, Caixin reported that civil servants in provinces such as Guangdong, Zhejiang and Jiangsu, are to have their annual incomes cut by 20% to 30% this year, as local governments struggle with revenues pressures. Authorities in these provinces have apparently asked local state-owned and state-backed institutions to stop paying year-end special bonuses and allowances. ▪ Given that President Xi's recent speeches have shown an unrelenting adherence to the zero covid approach for now, we suspect demand conditions will remain fragile. That means that the government will have to double up on stimulus. The State Council's decision to establish a "policy-based and developmental financial instrument (PDFI)" with an initial allocation of CNY300bn is an indication of greater policy earnestness. The funds will be used to expand the infrastructure push. We expect more such stimulus measures to be announced in coming weeks.

Variable	Development/Assessment
India: Erratic monsoon season threatens to play spoilsport	▪ **Manufacturing PMI edged down to 53.9 in Jun 22, from 54.6 in May 22.** Orders rose for the 12th straight month, but the pace of growth was down to a 9-month low, thanks in no small part to inflationary pressures. Export orders clocked robust growth, despite easing from May's 11-year high. Both input and output charge inflation slipped to a 3-month low but remained above their historical average. Employment rose for the fourth successive month. Business sentiment is still positive but it slipped to a 27-month low as virtually all respondents (95%) expect no change in output levels moving forward. <u>Erratic monsoon season could yield a subpar harvest</u> ▪ **Weekly monsoon rains were 29.6% below normal levels** in the week ending 29 Jun 22. This brought cumulative rains to a rainfall deficit of 10.2% in the same period, which is a marked deterioration from the week ending 22 Jun 22 (-0.2% below normal). Across 36 sub-divisions, 21 areas saw deficient rains of varying degree, although the IMD remains hopeful for a revival in rains moving forward as it reiterated its expectation for a normal monsoon season this year. ▪ **Planting of the Kharif crops is down 5.3% y/y as of 1 Jul 22.** In particular, the planting of rice, the main summer crop, is down 27.1% y/y, while the other crops have fared better – coarse cereals (+2.1%), pulses (+7.0%), sugar cane (-0.9%), oilseeds (-8.0%) and cotton (+3.8%). <u>No need to sound the alarm over fiscal slippage, for now</u> ▪ **The fiscal deficit stood at 12.3% of budget estimates (BE).** The realization of total spending stood at 14.8% of BE, with both capex (14.3%) and revenue spending (15.0%) making a strong start to the year. Revenue receipts were equally robust, at 16.2% of BE, led by net tax revenues (15.9% of BE).  Source: CEIC. FD = Fiscal Deficit; NT = Net Taxes.

Variable	Development/Assessment
	▪ **GST revenues for May 22 came in at INR1.45tr** (April: INR1.41tr). E-way bill generation for June is not out yet, but is expected to continue its ascendancy. ▪ **The Modi government unveiled a series of tax hikes** to shore up government coffers. First, the import duty on gold was hiked to 12.5% from 7.5% in a bid to curb the widening current account deficit from ballooning imports. Second, the government has imposed a INR6/litre and INR13/litre tax on exports of petrol and jet fuel, respectively, with effect from Jul 22, although exemptions apply for export-oriented refineries. There will also be a INR23,250/tonne tax on domestic production of crude. The authorities expect the oil tax levy to rake in INR720bn if the measures are retained till end-FY23 (i.e. March 2023), offsetting the hit from the excise duty cut that will cost around INR1tr in forgone revenues. **Assessment: Risk of fiscal slippage has diminished** ▪ **An erratic monsoon season threatens to play spoilsport**: The importance of the monsoon rains cannot be overstated, considering that close to half of Indian farms lack irrigation and are, therefore, heavily reliant on the seasonal rains. <u>The IMD's latest warning suggesting regions around the rice belt will receive average or below-average rains should sound off the alarm bells on a sub-par kharif season.</u> An erratic monsoon season, alongside dearer fertiliser and other input costs, may have convinced farmers to hold off on planting. This disconcerting trend, if sustained, will have ramifications for price stability and economic growth in 4Q22. ▪ **The probability and extent of fiscal slippage has diminished**, in large part because of the slew of taxes imposed by the authorities. By and large, these taxes and reservation of output for the domestic market resemble Indonesia's DMO structure after private refiners were importing Russian crude at a deep discount for re-export to Europe where margins are significantly higher. In that vein, the export taxes on refined petroleum would definitely hit the bottom-line of refiners. But it is also more equitable, given that private industry players have shunned away from the domestic market because of the retail price cap, leaving state refiners to operate in the local market at a deep loss. <u>We reiterate our view that the extent of fiscal slippage, if any, has diminished in both magnitude and probability</u>, given that the tax will offset a large chunk of the forgone revenues from the excise duty cut.
Indonesia: fiscal consolidation progressing,	▪ **Indonesia's manufacturing PMI dipped to 50.2 in Jun 22**, from 50.8 in May. Growth in new orders was marginal and slowest in the current 10-month growth streak. Conversely, export orders declined at the fastest

Variable	Development/Assessment
monetary policy on hold	pace in 9 months. Both input and output inflation persisted in June. There was job shedding in June, ending 5 successive months of employment growth. Business optimism dipped to a 4-month low, underpinned by expectations of economic improvement and stronger demand conditions. ▪ **The government is eyeing a budget deficit of 4.5% in 2022**, which will decline further to 2.8% in 2023 as the constitutionally-mandated 3% fiscal deficit cap kicks back in, according to estimates unveiled by finance minister Sri Mulyani. Estimates for total revenues were upgraded to IDR2.26qd for 2022 (previously IDR1.84qd) to reflect the ongoing upswing, although there will be a slight decrease to IDR2.21qd in 2023, reflecting the normalisation in commodity prices. Tax revenues will increase further to IDR1.89qd in 2023, from IDR1.78qd in 2022 (previously IDR1.51qd). Spending will also be lifted to IDR3.11qd in 2022 (previously IDR2.71qd) before declining to IDR2.73qd in 2023. According to Sri Mulyani, the heftier spending pencilled for this year stems from a tripling of the subsidy bill to IDR520tr, which will be funded by the commodity windfall. ▪ **Headline inflation quickened yet again in June (+4.3%) (May: +3.6%)**, breaching the upper-end of BI's target corridor (2%-4%). The uptick in prices were buttressed by quickening price increases in food and beverage (+8.3%), restaurants (+3.7%), transport (+5.4%) and household equipment and utilities (+4.8%). <u>Core inflation was unchanged in June at +2.6%, given that most of the price increases were concentrated in food ingredients (+9.6%) and administered prices (+5.3%).</u> Sequentially, inflation gained 0.6% m/m sa in June, following May's reprieve (+0.4%).  Source: CEIC **Assessment: Committing to fiscal consolidation entails painful trade-offs**

Variable	Development/Assessment
	▪ **With some trade-offs, achieving 3% fiscal deficit cap is do-able**: For starters, the budget proposal is unlikely to be the final draft and should undergo further changes before it is tabled during the mid-August Independence Day speech by President Jokowi. But it still offers a glimpse into the government's calculations to meet the 3% fiscal deficit cap to safeguard the credibility Indonesia has built up over years of judicious macroeconomic management under the finance ministry and the central bank. ▪ The revenue projections appear credible now that the 1% VAT hike has been pushed through since April. We are also of the view that commodity prices, with the notable exception of energy such as oil and thermal coal, are coming close to a peak as fears of a sharp growth deceleration pick up steam. This, coupled with demand destruction, will put a leash on demand for commodities, guiding prices downwards. ▪ It is the spending estimates that bears watching. Total spending in 2023 will remain unchanged at 2021 levels, following a 12% reduction from this year. The bulk of this year's supplementary spending increases stems from the bourgeoning subsidy bill, which should go into reverse next year if our assumption of falling commodity prices pans out. But it also suggests government capex will end up on the chopping block, given the ponderous spending pressures mandated by the constitution stemming from education (20% of spending) and regional transfers (>25% of spending). <u>Given the still-sizeable infrastructure gap in Indonesia, this implies a looming cutback in capex spending by the government</u>, unless the private sector is able to step up and fill the void. ▪ **The latest guidance from BI points to deferred policy normalisation**: While inflation has breached the upper-end of BI's target corridor, the latest guidance offered by senior BI officials imply that it is the trajectory of *core* inflation that will move the needle on policy tightening by the central bank. There is reason to believe reserves, which have fallen 8% ytd May 22, have extended its decline in June with no end-in-sight to the risk-off environment that have battered Asian currencies. <u>With core inflation (stripping out food and fuel) at current levels, BI is likely to kickstart the tightening cycle toward the latter half of 3Q22</u>, barring any pronounced capital outflows from Indonesia that heap excessive downward pressure on the Rupiah.

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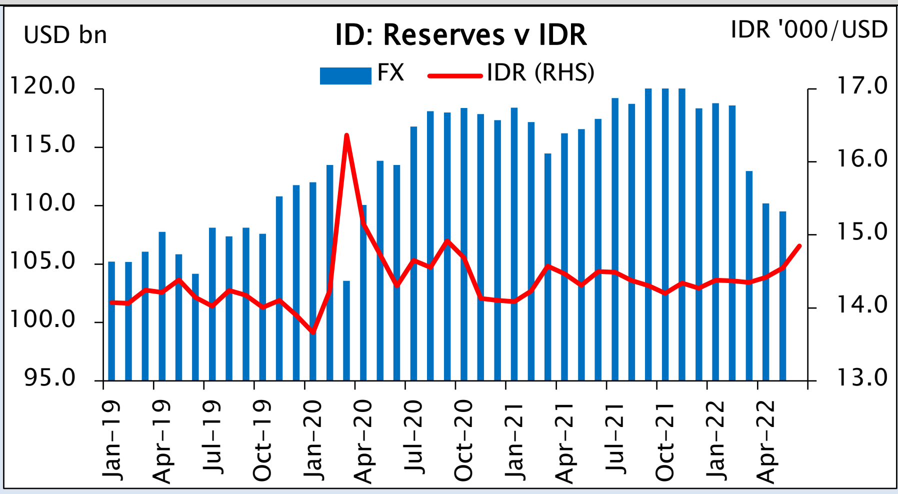
<tr><td></td><td>

Source: CEIC</td></tr>
<tr><td>South Korea: Domestic demand to make up for softening of exports in 2H22</td><td><u>External demand is softening</u>

Korea's manufacturing PMI moderated further to 51.3 in June (May: 51.8), which is the lowest since Mar 22. Growth in new orders softened because of supply shortages and heftier input costs. Export orders contracted for the 4th month running, although the rate of decline eased to the softest in the sequence. Input cost inflation quickened yet again, but factory gate inflation eased for the first time in 3 months. Employment fell again. Business optimism sagged to its lowest in 8 months.
Exports eked out a 5.4% y/y growth in June (May: +21.3%), mainly because of the protests by truckers as well as the moderation in global demand. The slowdown was evident and broad-based across the heavyweight items - semiconductors (+10.7%), autos (-2.7%), general machinery (-11.7%), petrochemicals (-0.4%) and steel products (+5.4%). Import growth also softened to +19.4% y/y in June (May: +32.0%) on the back of base effects that will become more pronounced moving into 3Q22. The trade deficit widened to USD2.5bn (May: USD1.7bn).
Industrial production rebounded 0.8% sa m/m in May 22 (April: -0.9%) and is up 7.1% y/y with the release of pent-up demand. Construction (+8.2%), the services industry (+7.5%) and manufacturing (+7.8%) have held up, despite lingering weakness in mining (-17.0%) and utilities (+0.2%). Across manufacturing, the contraction in chemicals (-1.1%), other machineries (-0.4%) and electronic components (-6.0%) were offset by the strong showing by semiconductors (+24.3%) and autos (+15.9%).

<u>Investment intentions pressured by global headwinds</u></td></tr>
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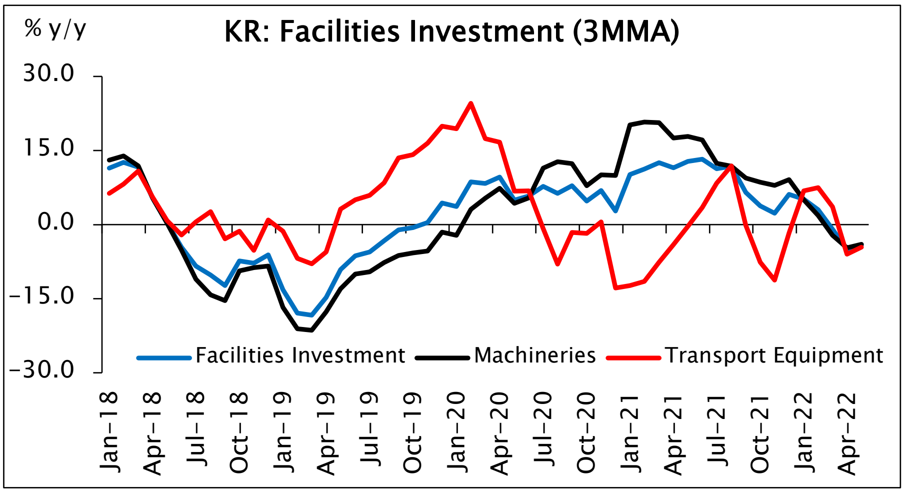
- **Core machinery orders fell 10.0% y/y in May 22 (Apr 22: +5.8%)**, led mainly by softening private sector demand (-11.2%), particularly in the electronics sector (+0.0%). The domestically-oriented core machinery orders were down 5.6% m/m sa in May, although that is still an improvement from April's -7.9%.
- **Construction orders gained 2.0% m/m sa in May 22** (April: -18.2%) and were up 18.6% y/y, with private orders leading the way (+31.1%). Both residential buildings (+17.6%) and civil engineering works (+22.5%) saw resilient growth.
- **Similarly, construction work done rose 5.9% m/m sa in May 22** (April: -0.1%) and were up 8.2% y/y, snapping out of the 3-month contractionary streak. Both building (+9.0%) and civil engineering works (+5.8%) rebounded from April's decline.
- **Facilities Investment rebounded in May (+5.1%)**, following April's 12.1% contraction. Both machineries (+4.3%) and transport equipment (+7.9%) posted growth after shrinking for 2 straight months.



Source: CEIC

- **Retail sales were up 0.7% y/y in May (April: +0.4%).** With the exception of semi-durables (+5.9%), there was a pull-back across non-durables (+0.8%), and household durables (-4.7%). Sequentially, retail sales decreased 0.1% sa m/m in May 22 (April: -0.2%), extending the ongoing contractionary streak to 3 months.

<u>Jumbo 50bps rate hike increasingly a possibility in mid-July</u>

- **The Yoon administration raised the minimum wage by 5% in 2023**, which would be unchanged from last year's hike in percentage terms. Calls by labour groups for double-digits growth in minimum wages were rebuffed by the government because of palpable fears over sparking a wage-price spiral.

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Variable	Development/Assessment
	▪ **The Bank of Korea is now open to a 50bps-rate hike in July** if the upcoming inflation print exceeds 6% (May: +5.4%) amid fears that heightened inflation expectations risk becoming entrenched, given the confluence of a tight labour market and rising fuel prices. The latest BoK survey pegged households' 1-year ahead inflation expectations at +3.9%, firming up from +3.3% in May 22. **Assessment: Recovery in domestic demand still has legs** ▪ **Exports to take a beating in the near-term**: The synchronous deceleration in global PMIs do not augur well for Korea, which is plugged into global trade, particularly in semiconductors in the electronics space. Notwithstanding the local protests that skimmed several percentage points off headline export growth, external demand will be less supportive of growth in 2H22. ▪ That aside, we are expecting domestic demand to take on the mantle of spearheading growth in the latter half of 2022 with the relaxation of Covid-19 restrictions and easing of border control measures. The elevated inflation print appears to be weighing on retail sales, although services production, which grew 7.5% y/y, is a bright spot and likely reflect the release of pent-up demand. Given the still-sizeable pile of excess household savings (~8.8% of PCE as of Apr 22), <u>the recovery in domestic demand still has legs and we continue to reiterate our full-year growth forecast of 2.5%.</u> ▪ **BoK's latest guidance opens the door to a 50bps rate hike**: As we pointed out in the previous weekly, there is considerable upside risk to terminal rates in Korea, where the inflation print has run hot for most of this year. <u>Our expectation is for inflation to come close to the upper end of the 5.5%-6% range in June</u>, given the still-elevated oil prices, robust wage growth from the tight labour market and the disbursal of the supplementary budget funds, although we also think the moderation in global demand should start to temper with CPI inflation in Korea in due course. In short, a nasty inflation surprise will spur a 50bps rate hike by the BoK per its latest guidance. If that materialises, we will upgrade our expectations for terminal rates this year to the range of 2.75%-3%.
Singapore: No signs of slowing down in the housing market	<u>Housing prices have not lost their upward momentum</u> ▪ According to flash estimates, private housing prices regained their upward momentum at +3.2% q/q in 2Q22 (1Q22: +0.7% q/q) while HDB resale flat prices continued to grow at +2.6% q/q in 2Q22 (1Q22: 2.4% q/q). ▪ Private housing prices have risen by about 18.6% since 1Q20 while HDB resale flat prices have grown approximately 24.5% since 1Q20.

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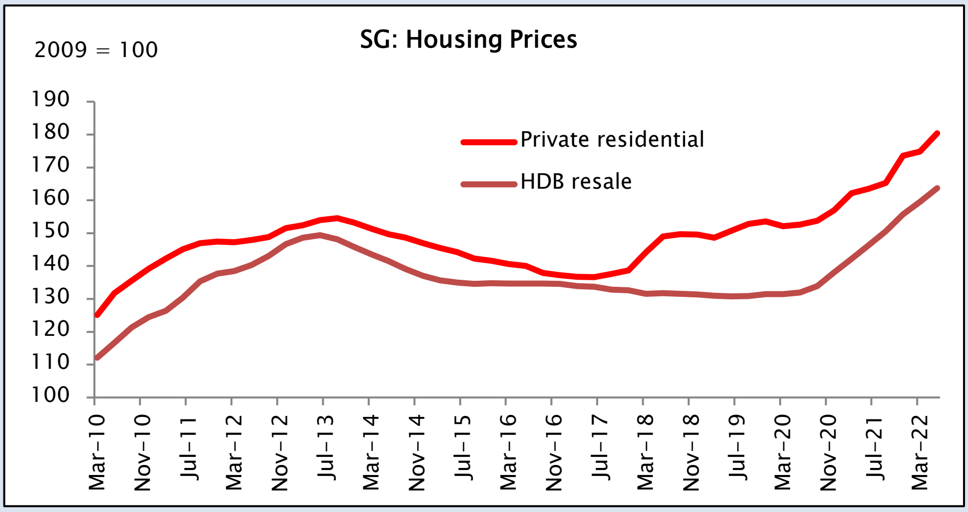
- Housing prices continue to trend upwards despite cooling measures adopted on 15 Dec 21. This could be a function of a) rising incomes amid a tight labour market and b) unwavering demand for housing as housing supply continues to be tight. According to Minister for National Development Desmond Lee, "fewer than 60%" of HDB Build-To-Order projects faced ongoing delays as of Apr 22. This pushes first-time buyers into the HDB resale market and HDB resale sellers into the private housing market, pushing up overall housing prices.



Source: CEIC

Assessment: Macroprudential measures are off the cards for now

- The authorities have maxed out on macro-prudential measures, so the authorities are likely to avoid further property cooling policies for two reasons. First, higher interest rates will serve to dampen housing prices in place of macroprudential measures. Local banks DBS, OCBC, and UOB have all raised rates on its fixed rate home loan packages with further increases to come. Second, the government will seek to dampen housing prices through supply-side increases. The government land sales (GLS) programme has increased the supply of land for residential property development in 2H22, increasing the potential yield of private residential housing units from 2,785 in 1H22 to 3,505 in 2H22, a 25.9% increase.

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<tr><td>Thailand: Signs of resilience against high inflation</td><td>

- **Despite headline inflation reaching a record high of +7.1% y/y, private consumption and investment picked up in May 22:**
  - Growth in the private consumption index (PCI) picked up to +11.3% y/y in May 22, up from +8.4% y/y in Apr 22. The consumption of semi-durables (+1.9% m/m sa) and durables (+2.1% m/m sa) returned to sequential growth. The consumption of services (+3.8% m/m sa) also grew sequentially on the back of increased tourist expenditure while the

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Variable	Development/Assessment
	consumption of non-durables contracted sequentially (-0.6% m/m sa). ▪ The private investment index (PII) grew 3.8% y/y in May 22, up from +2.0% y/y in Apr 22. Imports of capital goods, a proxy of investment in plant and equipment, reversed three months of sequential decline to grow 4.7% m/m sa in May 22. ▪ **Higher farm incomes and the improving labour market are supporting domestic demand**: agricultural prices remain elevated (May 22: +9.1% y/y; Apr 22: +10.2% y/y) and agricultural production (May 22: +11.4% y/y; Apr 22: +5.1% y/y) has grown further, spurring +21.6% y/y growth in nominal farm incomes. The impact on consumer spending is sizeable when the rural population makes up 48.6% of the total population. According to the Bank of Thailand, the labour market improved further in May 22. ▪ **Tourist arrivals are ramping up**: a hopeful sign of a stronger tourism recovery despite the shortfall of tourists from China and Russia. Tourist arrivals jumped to 521,410 in May 22, up from 293,350 in Apr 22. The Tourism and Sports Minister has gone further to estimate 1.5 million tourists per month during the high tourism season. Should tourist arrivals continue to grow exponentially, an upgrade to our GDP growth forecast is on the cards. ▪ **Export growth rebounded in May 22, but the challenge of cooling external demand remains**: exports excluding gold and petroleum-related products grew 8.6% y/y in May 22, up from +0.2% y/y in Apr 22, with improvements in growth across all the main categories of exported goods save for fishery exports. However, manufacturing PMI showed new export orders only expanding marginally in Jun 22 after three consecutive months of contraction/stagnation. The revival in domestic demand and the tourism recovery should help to support manufacturing production as external demand cools. ▪ **Supply chain disruptions continue to constrain manufacturing production, but we expect this to ease in the coming months**: manufacturing production declined by 2.1% y/y in May 22 (Apr 22: 0.0% y/y) as shortages of inputs from China held back the production of cars (-9.11% y/y), hard disk drives (-29.7% y/y) and plastic pellets (-15.6% y/y). This headwind should ease as Covid-19 lockdowns are loosened in China. **Assessment: The THB is likely to continue its downward slide** ▪ Loose monetary policy is beginning to take a toll on foreign investors. This is evidenced by net non-resident fund outflows in equities (-THB29,387mn) and bonds (-THB13,779mn) in Jun 22. Thus, we expect further depreciation pressure on the THB, mitigated only by the

Variable	Development/Assessment
	improving tourism sector. The downward slide of the THB will likely reverse in Aug 22 when we expect the first 25bps rate hike from the BOT.
Vietnam: Robust growth but there are risks of overheating	The economy is firing on all cylinders ▪ **Exports maintained a solid growth momentum**: exports grew 20.0% y/y in Jun 22 (May 22: +18.1% y/y), despite challenges of input price inflation and higher inflation in end markets. External demand from the US and Japan, Vietnam's 1st and 3rd largest export markets respectively, have held up at +29.2% y/y and +18.1% y/y respectively in Jun 22. Solid export growth momentum is poised to continue with manufacturing PMI for Jun 22 reporting the fastest pace of new export order growth in four months. ▪ In step with export growth, industrial production grew by 11.5% y/y in Jun 22 (May 22: +9.5% y/y), while manufacturing production grew by 13.1% y/y in Jun 22 (May 22: +12.1% y/y). ▪ **The tourism sector is roaring back to life**: retail sales growth in the tourism sector accelerated to +94.4% y/y YTD in Jun 22 (May 22: +34.7% y/y YTD). Foreign arrivals picked up strongly in Jun 22, growing 36.8% m/m and 32.9% y/y (1H22: +6.8% y/y). ▪ **Private consumption picked up further**: retail sales growth accelerated to +11.7% y/y YTD in Jun 22 (May 22: +9.7% y/y YTD). Breaking retail sales down into its components, retail sales of goods grew 11.3% y/y YTD in Jun 22 while retail sales of food & beverage services grew 20.9% y/y YTD in Jun 22. ▪ **With the economy firmly in the expansionary phase of the business cycle, there has been a flurry of new business activity**: the number of newly registered enterprises grew 13.6% y/y in 1H22 and exceeded 70,000 for the first time. Including enterprises returning to operation, 116,900 enterprises entered the market in 1H22, more than the 83,570 enterprises that withdrew from the market in 1H22. 2Q22 GDP growth came in at +7.7% y/y ▪ **By expenditure components**, exports led growth at +12.3% y/y in 2Q22. Final consumption grew by 7.3% y/y while gross capital formation grew 4.6% y/y in 2Q22. ▪ **By industry**, year-on-year growth in the following sectors in 2Q22 accelerated notably from the previous quarter: manufacturing (2Q22: +11.5%; 1Q22: +7.7%), wholesale and retail trade (2Q22: 8.3%; 1Q22: +3.4%), transportation and storage (2Q22: +9.4%; 1Q22: +7.0%), accommodation and food services (2Q22: +25.9%; 1Q22: -1.2%), real estate activities (2Q22: +6.1%; 1Q22: +1.9%), administrative and support services (2Q22: +16.7%; 1Q22: -3.7%) and arts and entertainment (2Q22: +14.0%; 1Q22: +2.5%).

Variable	Development/Assessment
	Assessment: Watch out for inflation risks ▪ **Inflation in Vietnam has been relatively muted…**: Concerted government action keeps inflation low. The prices of key strategic commodities are managed by the state and on 30 Jun 22 the Ministry of Finance announced plans to further cut taxes and fees on gasoline. The composition of Vietnam's CPI basket also keeps a lid on inflation – 40% of the CPI basket is attributed to food, of which Vietnam has an abundant supply. ▪ **…but the rapid economic recovery raises the risk of demand-pull inflation**: that would lift headline inflation above the State Bank of Vietnam's (SBV) target of 4%. Credit growth exemplifies the rate of aggregate demand growth – the total outstanding credit in the economy grew by 17.1% in 1H22, surpassing the SBV's target of 14% credit growth in 2022. The government's 2% interest rate support package that took effect 23 May 22 will further fuel aggregate demand growth. The package provides 2% annual interest rate subsidies for commercial bank loans to households, co-operatives, and enterprises. ▪ **The latest minimum wage hike exacerbates inflation risks**: effective 1 Jul 22, regional minimum wages will be increased by an average of 6%. Vietnamese enterprises are reporting that the minimum wage hike will raise labour costs by 10%. While minimum wage hikes are not mandatory for businesses, many will have no choice but to do so given the fierce competition for labour in the economy. ▪ **The SBV is unlikely to tighten monetary policy**: while SBV Deputy Governor Dao Minh Tu acknowledged that curbing inflation takes priority over economic growth, SBV Head of Monetary Policy Pham indicated that key interest rates will be kept constant to ensure a smooth economic recovery. Instead, the SBV will aim to lower credit growth to 11-12% to combat demand-pull inflation.

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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	6.70
India	FY21	-7.3	5.5	0.9	4.00	73.1
	FY22	8.7	5.3	-1.0	4.00	74.5
	FY23	7.0	6.3	-3.2	5.75	76.5
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	4.5	3.9	2.50	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	4.0	2.5	13.8	1.75	27.0
Hong Kong	2020	-6.1	-0.6	6.9	-	7.75
	2021	6.4	2.1	5.9	-	7.80
	2022	0.5	2.5	5.0	-	7.80
Singapore	2020	-5.4	0.0	17.6	-	1.32
	2021	7.1	4.0	17.0	-	1.35
	2022	4.4	5.4	16.1	-	1.33
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	2.50	4.20
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	4.5	-2.5	3.00	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	3.5	6.0	6.0	0.75	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	4.0	6.5	2.50	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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