CENTENNIAL ASIA ADVISORS
policy and strategic advisors

WEEKLY INSIGHTS
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Geo-political risks: Indo-Pacific arena heats up
Omicron variant: Mere speed bump rather than pothole in path to recovery

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Highlights from the CAA Weekly Table:

Asian economic prospects:

- **China is at a turning point:** The real estate contraction is hurting and there are signs of behavioural changes which could deepen a slowdown. The authorities are likely to shift to a more nuanced approach to the pandemic combined with carefully calibrated policy support.
- **Elsewhere economies remain on a recovery path:** India's activity indicators remain positive but there are risks to economic stability. The South Korean and Malaysian economies are performing well but might moderate a tad. The Philippines will suffer more from the the omicron variant, so its path to recovery might be slower. Indonesia's recovery remains on track but a rebound in demand could stir price pressures.

As the year begins, where does the region stand?

(A) Geo-political risks: Indo-Pacific arena heats up

China's strategic position is at risk from a pushback against its assertiveness and because it is encountering difficulties with its landmark Belt & Road Initiative (BRI).

- The US and Japan are further strengthening their defence ties as they face up to China's challenge: they will step up collaboration on military technology. Japan & Australia have deepened their defence cooperation through their new Reciprocal Access Agreement. Japan is also extending its naval build-up.
- China may have erred in pressuring Indonesia over the latter's oil exploration activities in waters claimed by China but belonging in Indonesia's exclusive economic zone. This is likely to push Indonesia into a more robust stance towards China.
- China's BRI projects may be turning out to be costlier than it had expected. Sri Lanka, where China is a major investor is pressing China to restructure its debt as its economic crisis deepens. In Pakistan, where China made its biggest BRI bets, project returns are lower than expected and debt repayments will need to be restructured. Several Chinese nationals have also been killed in terrorist incidents, adding to China's disappointment.
- China is likely to recalibrate strategy to deal with these challenges. It needs to dial down its assertiveness towards other Asian countries and will revise its BRI to be more cautious and selective in its commitments.

(B) Omicron variant: Mere speed bump rather than pothole in path to recovery

- PMI surveys show the regional economies performing well. Manufacturing is supported by improving demand. Price pressures, while diminishing somewhat, remain a risk, though.
- The omicron variant will produce a surge in infections across our region. However, if the pattern in South Africa is repeated, this surge will end fairly quickly: Our baseline scenario is for caseloads to peak later in early February before falling sharply by March.
- The economic damage is likely to be limited in duration and scale because governments are avoiding overly stringent responses, helped by rising vaccination rates. Consumers and businesses have also learnt to adapt better to surges of infections.

Key Drivers of Asian Economies

Variable	Development/Assessment
Asian economies:	
China: policy responses have to catch up with rising threats to growth and stability	Rising risks to growth and stability **For a "covid-naïve" population like China's, local transmission of Omicron spells trouble:** ▪ The first community-spread cases of Omicron were reported on Sunday in Tianjin, leading to rigorous restrictions on activity as well as tighter border controls. But there are now reports of clusters of infection in the Pearl River Delta as well, in Guangzhou and Shenzhen. As a result, limits on activity and travel have been placed. While the authorities have been careful to avoid lockdowns, there are some signs that current restrictions are beginning to cause potential difficulties to supply chains. For example, Samsung Electronics and Micron Technology have reported staff shortages at manufacturing sites in China. Truck entry into Ningbo port has also been restricted to some extent. If these effects expand, then the economic impact within China and the impact on global supply chains will worsen. ▪ **Distress in real estate still salient and spreading:** Embattled property developer Shimao Group Holdings has reportedly placed all of its real estate projects on sale, which is typically one mechanism by which financial stresses are amplified during a crisis of this nature: steep discounts worsen the cash crunch and lead counterparties' assessments of creditworthiness of these entities to be revised for the worse. ▪ **Knock-on effects of real estate stress emerging:** Local government finances are under strain and that has resulted in total compensation for their staff to be cut. Hegang city in Heilongjiang cancelled hiring plans for lower-level staff because a fiscal restructuring plan has brought "significant changes to the city's financial condition …". ▪ **The real worry – economic agents are starting to change their behaviour:** As banks become wary about the state of the economy, they are becoming more risk-averse in their lending behaviour. There are media reports to the effect that banks met the lending quotas imposed by the People's Bank of China for December by buying up low-risk financial instruments rather than by extending loans. Consumers are also becoming wary – There was an 18% y/y decline in the number of travellers over the new year long weekend, with the number of railway passengers at the lowest level since 2018. There are some straws in the wind suggesting a potential downturn, despite the slight improvement in the purchasing manager surveys – Managers of medium-size textile enterprises in Hebei, Shandong and Hubei

Variable	Development/Assessment
	provinces are reported to be starting the Lunar New Year break several weeks earlier than usual because of poor demand. <u>Is the policy response adequate?</u> The evidence of a slowdown is mainly anecdotal but if key economic agents do indeed change their behaviour and become more risk-averse, and this then feeds into lower demand, then the economy would be in trouble. This requires more aggressive policy measures than we have so far seen. ▪ **Intensity of curbs on real estate dialled back: T**he government has come out urging banks to boost property loans. According to regulators, borrowings by major property firms used to fund M&As will no longer be counted toward the Three Red Lines metrics that limit leverage. This lines up with a previously communicated plan to encourage banks to fund acquisitions by healthy developers of real estate projects belonging to distressed developers. ▪ **A push for structural reform?** The State Council has announced a pilot programme that aims to remove "institutional barriers" to the free flow of factors of production, including liberalizing restrictions on land use and supply, on restrictions on labour mobility arising from the Hukou system, and on restrictions on capital markets. **Since these measures are insufficient, China could be at an inflection point for policy:** ▪ The central government faces a tough policy quandary: containing the highly-transmissible Omicron variant will necessitate punishing curbs but such curbs would undoubtedly amplify the deceleration in economic activity that appears underway. As the political leadership prepares for the Chinese Community Party's 20th Congress in fall 2022, they are loath to give up on the zero-COVID stance that they claim as evidence of their competent governance. The only way out of the conundrum would be to adopt a more nuanced albeit still highly cautious policy towards COVID. ▪ On combating the wider effects of the real estate downturn, the policy makers are betting that their high degree of control over actors in the financial system will allow them to prevent localized stresses from morphing into a systemic problem. Thus, their response will be more of the recent moves such as getting banks to step up lending to the property sector and to fund acquisition activity. The leaders will still seek to avoid what they call the "flood irrigation" mode of easing which was used in response to the 2008 financial crisis. ▪ On reform, the latest State Council meeting likely signals a desire by the political leadership to get much-needed structural reforms moving in the lead up to the party congress this year. However, with the policymaking apparatus busy combating exigencies on multiple fronts:

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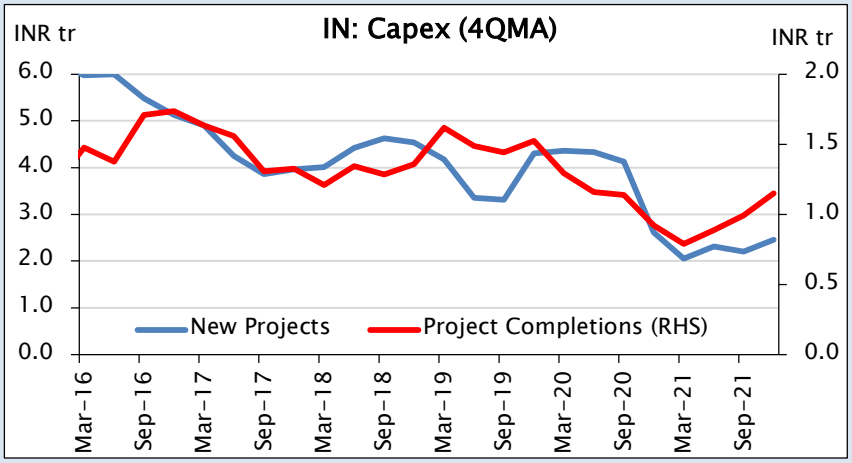
	the slowly unfolding crisis in the property sector, reining in technology companies, and the pandemic, among others, reform progress could disappoint for yet another year.
India: Dovish RBI likely to play it safe	Activity indicators largely positive ▪ **Capital spending picked up** in 4Q21 (INR2.5tr) (3Q21: INR2.3tr). Project completions also increased to INR1.5tr, from INR1.2tr in 3Q21. A key caveat, is that the state and central governments were responsible for the pipeline of new projects to the tune of INR790bn in 4Q21, so the revival in investment reflects higher public investments rather than confident private businesses stepping up capacity expansion. Similarly, the pick-up in project completions was influenced by the hasty inauguration of infrastructure projects by state governments ahead of several key state elections.  Source: CMIE ▪ **Manufacturing PMI slipped to 55.5 in Dec 21**, from the 10-month high of 57.6 in November. Despite some moderation, growth in new orders was still sharp. New export orders rose for the 6th successive month, albeit only marginally. Input inflation eased to a 3-month low but remained well above the historical average. Some manufacturers opted to pass on some of the higher cost burden to clients, culminating in output charges that rose only slightly at the slowest pace since Oct 20. Employment fell slightly because of low capacity utilisation rate. Business optimism improved from November's 17-month low but it is still below the long-run average. ▪ **Services PMI eased to a 3-month low in December** at 55.5 compared to November's 58.1. New orders were up for the 5th consecutive month, but the rate of increase softened to its lowest in 3 months. Export orders fell further because of Covid-19 restrictions, particularly in border control. Employment decreased slightly, though the vast majority of companies reported identical levels of staffing. Fuelled by

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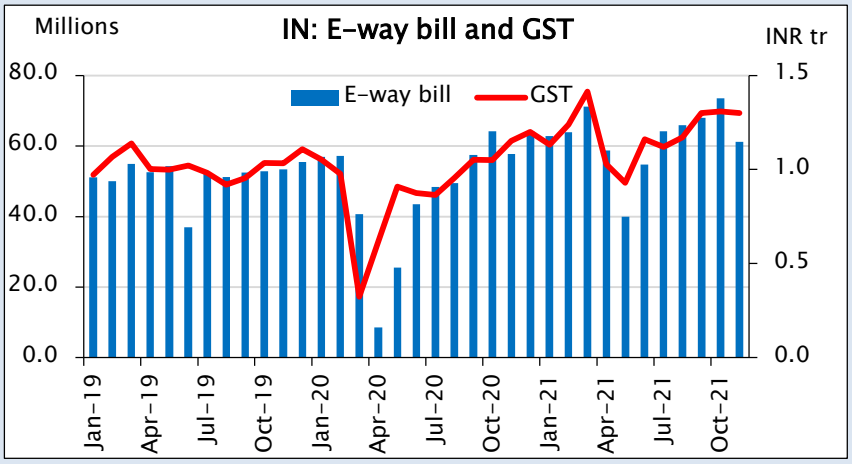
	commodity shortages, input inflation moderated to a 3-month low, although it remains sharp and above the long-run average. Given rising expenses, output charges rose, albeit at a moderate pace and the weakest since Sep 21. Business confidence leapt to a 4-month high but is subdued vis-à-vis the long-term average, with new waves of Covid-19 and inflation cited by firms as key concerns. ▪ **Non-food credit growth firmed up in Nov 21** (+7.1%), from October's +6.9% y/y. Lending extended to agriculture (+10.4%) (October: +10.2%) and services (+3.6%) (October: +2.9%) climbed further, whereas manufacturing (+3.8%) (October: +4.1%) and personal loans (+11.6%) (October: +11.7%) eased. In the services sector, wholesale (+16.1%) and retail trade (+1.7%) held up, as is the case for commercial real estate (+0.4%) and NBFCs (+5.2%). Professional services saw a slower pace of decline (-4.7%). ▪ **High-frequency indicators mixed to positive:** E-way bill generation rebounded smartly in December (71.6 million) from November's 61.2 million. Even though the latter represents a 5-month low, GST revenues actually held up at INR1.3tr in November, which is practically unchanged from October (INR1.31tr). Fuel consumption decreased 11.4% y/y in November (October: +0.7%), led by a 7.6% decline in diesel consumption (October: -5.4%) reflecting the lull from the Diwali festive season after demand hit a 7-month peak in October.  Source: CEIC <u>Stability indicators were mixed</u> ▪ **The fiscal deficit came in at 46.2% of Budget Estimates** as of November (October: 36.3% of BE). The realisation of net taxes stood at 73.5% of BE (October: 68.1%), compared to expenditures at 59.6% (October: 52.4%). Revenue expenditures (61.5%) continue to outpace the realisation of capital spending (49.4%). In y/y terms, expenditures rose

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	a mere 1.2% but this masks the divergent trends in revenue (+13.1%) and capital spending (-53.5%). Given concerns about the Omicron variant, government officials have signalled that the pace of fiscal consolidation will probably slow in the coming fiscal year. ▪ **The gross Non-Performing Asset (NPA) ratio is set to increase to 8.1%** by Sep 22, from 6.9% in the year-ago period, according to the latest estimates from the RBI's financial stability report. The medium- and severe-stress scenarios will push up the NPA ratio to 8.7% and 9.5%, respectively, though it is the public banks (PSBs) that will bear the brunt of the deterioration in asset quality – the NPA ratio will rise from 8.8% to 10.5% under the baseline scenario, or 11.0% and 11.9% under the medium and severe stress scenarios. The sector-wide Capital to Risk-weighted Assets Ratio (CRAR) will come down to 15.4% in the baseline scenario from 16.3% in Sep 21, though the medium- and severe-stress scenarios will nudge the CRAR down to 14.7% and 13.8%, respectively. ▪ **The Current Account swung back to a deficit in 3Q21** (1.3% of GDP) as import demand picked up, reversing from the current account surplus in 2Q21 (0.9% of GDP). The deterioration in the external accounts can be explained by the bourgeoning deficit in the trade in goods (-USD44.4bn) even as the services balance was unchanged (USD25.6bn). **Assessment: New variant slows monetary and fiscal policy normalisation** ▪ **Capital spending figures inflated by government projects**: The seemingly hearty projects data reflect political activism just before the political cycle turns up. Uttar Pradesh, for instances, accounted for a third (36%) of total project completions in 4Q21, which is more than triple the average. Similarly, investment announcements unveiled by the state and central government amounted to a significant share of total new projects. <u>The upshot, is that the capital spending figures are not indicative of an impending investment upcycle</u>. ▪ It could be that capacity utilisation rates are simply not at levels high enough to entice more investments to increase the economy's productive capacity. This resonates with the job shedding in manufacturing and services PMI, where utilisation rates are sub-par. Or, the election fever, starting with the Uttar Pradesh state elections across Feb-Mar 22 is feeding into regulatory uncertainty as well as questions over the Modi government's reform zeal. In any case, a lower rate of potential growth will entail a lower terminal rate for the RBI as well as raise longer-term questions over India's growth potential. ▪ **With an eye on the new variant, RBI will only start policy normalisation from April**: The latest minutes from the RBI's December MPC meeting were more of the same. MPC members were wary of choking off the

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	nascent recovery by raising rates prematurely. Our view is for the RBI to revert to a "neutral" stance and to raise the reverse repo rate in February 2022. That now seems unlikely, given the dovish credentials of the MPC members, even though the impact of the new variant, in our view, will be modest at worst. Instead, we expect the RBI to defer the first reverse repo rate hike to April 2022's MPC meeting, particularly if the new variant entails more benign prices in the interim. The tail event (20% likelihood), is for the RBI to act only in June 2022, which is unlikely now that the negative output gap is steadily shrinking. ▪ **Underspending to keep the fiscal deficit in check**: The fiscal dynamics continue to outperform relative to the historical average, considering that the government typically exhaust more than 80% of the fiscal deficit headspace by November. This boils down to the buoyant revenue mobilisation efforts as well as subdued spending by the central government, with realised capex at slightly less than half of the budget estimates with just 4 more months to go. ▪ **The big question mark lingers over the disinvestment exercise**, as the blockbuster IPO of Life Insurance Corporation, which would rake in INR900bn, as well as the mooted sales of Bharat Petroleum Corp (BPCL) are unlikely to materialise within the current fiscal year. With just INR93.3bn raised out of a disinvestment target of INR1.75tr, a gargantuan shortfall looms large. Excise tax cut on retail fuel of INR5/litre and INR10/litre on petrol and diesel, respectively, will weigh on excise duty collections at the margins, but the other revenue streams should provide a major offset – corporate taxes soared 90.4% on a ytd basis, as did income taxes (+47.3%), for instance. ▪ All in, we expect a modest fiscal slippage to the tune of 20 basis points (FY22 Budget Estimates: 6.8% of GDP), given the government's request for supplementary spending worth INR3.7tr consisting of INR3tr in cash outlays. Net tax collections will certainly overshoot, while central government expenditures will probably underwhelm relative to expectations, with most ministries disbursing less than 60% of their appropriated sums with just 4 months to go before the end of the fiscal year.
South Korea: Cyclical moderation sets in after blockbuster 2021	▪ **Manufacturing PMI rose to 51.9 in Dec 21, up from 50.9 in Nov 21.** New orders rose at the fastest rate in 3 months, on the back of buoyant domestic demand, despite falling new export orders for the first time since Sep 20 because of the Omicron variant and limited freight capacity. Employment rose after 2 months of job shedding amid expectations of growing output. Input cost inflation eased from

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	November's record but remains elevated, culminating in the sharp increases in output charges as in November. ▪ **Industrial production remains upbeat, rising 5.3% y/y in November**, up further from +4.8% in the previous month. Whereas the construction (-5.6%), electricity (+3.2%) and mining (-8.4%) sectors weakened, services industry (+5.3%), public administration (+11.1%) and manufacturing (+6.2%) edged up. Across manufacturing, chemicals (+7.0%), autos (-3.5%) and electronic components (-8.8%) improved, whereas semiconductors (+33.7%) and other machineries (+5.8%) softened from October. Sequentially, factory output rose 3.2% sa m/m, exceeding market expectations (+2.5%) and reversing from October's 2% decline. ▪ **Retail sales moderated to a still-respectable 10.0% y/y in November** following October's effervescent print (+11.3%). Whereas durables (-2.9%) were a drag, semi-durables (+14.7%) and non-durables (+!5.5%) actually firmed up. On a sa m/m basis, retail sales actually fell 0.9%, reversing from October's +0.5% m/m expansion. ▪ **Headline inflation eased to +3.7% y/y in Dec 21**, from last month's multi-year high (+3.8%). Whereas food (+6.4%), non-alcohol beverage (+4.2%), accommodation and utilities (+3.1%), household equipment (+3.9%), health (+0.3%), recreation (+0.9%), restaurants (+4.7%) and miscellaneous goods and services (+2.6%) firmed up, alcohol (+0.5%), transport (+9.9%), communication (-1.1%) eased. Clothing (+1.4%) and education (+1.1%) were unchanged. Sequentially, headline inflation moderated to +0.1% sa m/m, which is the lowest in 7 months, from November's spike (+0.8%). Core inflation rebounded 2.2% y/y, after softening to +1.9% in November. ▪ **Consumer confidence slipped to a 3-month low in December (103.9 points)** November (107.6). There was a broad-based weakness in both present (91.0) and future expectations (96.0) of living standards, as well as economic conditions (79.0, expectations: 88.0). ▪ **Exports softened to +18.3% y/y in Dec 21**, from November's +32.0% y/y. The deceleration was broad-based across semiconductors (+35.1%), general machineries (+6.2%), petrochemicals (+34.3%) and petrochemical products (+79.2%) while steel products (+49.0%) and autos (+17.3%) strengthened. Import demand remains buoyant, rising 37.4% y/y though that is down from +43.6% in November. The trade balance fell into a deficit (-USD0.6bn) for the first time in 20 months, following November's sizeable surplus (+USD3.1bn). ▪ **Housing sales shrank 10.8% m/m in November**, extending the decline from October (-7.8%). This coincided with a sharp moderation in

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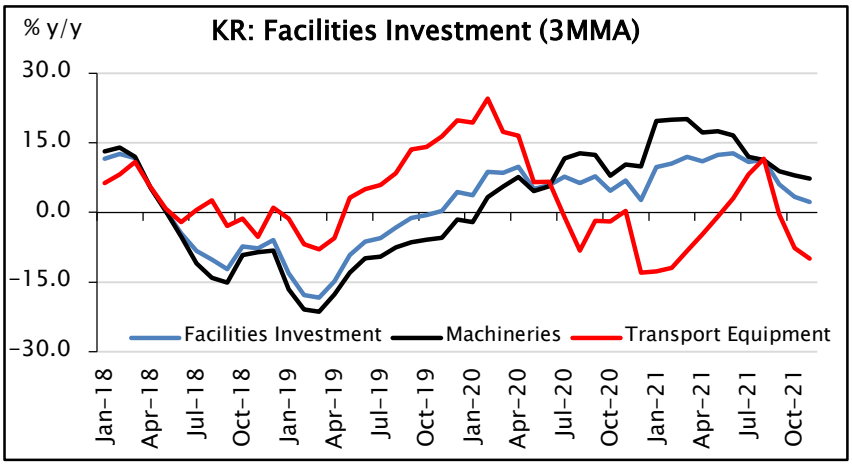
	housing prices in December (+0.5%), after rising more than 1% for every month since November 2020 as more lending curbs and rising mortgage rates by virtue of the BoK's rate hikes appear to have an effect on the red-hot housing market. ▪ **Construction work completed fell 5.6% y/y in Nov 21**, down further from -0.8% in the previous month. Whereas buildings were up 1.8% y/y, albeit from October's 2.4% expansion, this was more than offset by weakness in civil engineering (-24.5%). Meanwhile, construction orders decreased 12.5% y/y, reversing from +11.7% in October. Buildings (-20.1%) were a drag, compared to civil engineering works (+10.5%). ▪ **Facilities investments climbed 9.2% y/y in November**, up from +3.0% y/y in October. Both machineries (+10.9%) and transport equipment (+4.9%) strengthened. Sequentially, equipment investments surged 10.9% sa m/m, ending a 3-month contractionary streak.  Source: CEIC ▪ **Total machinery orders jumped 46.6% y/y in November**, up sharply from +17.3% in October, despite unfavourable base effects. Core machinery orders (i.e. less vessels) were up 27.7%, from +25.2% in the same period. Domestic core machinery orders grew 26.3% y/y, up from +18.4% in October. Sequentially, domestic core machinery orders were down 13.5% sa m/m, following a 0.1% expansion in October. **Assessment: A cyclical moderation in growth looms** ▪ **Easing supply chain bottlenecks provide a tailwind to growth**, evinced by the improving factory output figures on a sequential basis. In turn, this provides a leg up to exports, particularly that of autos and semiconductors. But the emergence of the new variant is likely to dampen external demand, as developed economies hit a speed bump in the recovery pathway. Similarly, within Korea, retail sales were

Variable	Development/Assessment
	supported by semi- and non-durables, as part of the diversion in spending away from durables with the reopening of the economy but the highly transmissible variant may put that in reverse. We do not expect a major hit to growth this year (est. +2.9%), as the impact of the new variant will likely be front-loaded in 1Q22, and high vaccination rates provide a critical bulwark to enable the easing of restrictions as early as the subsequent quarter. ▪ **Another rate hike by the BoK is imminent, given salient inflationary pressures**: The successive rate hikes by the central bank have lifted the mortgage rate (3.51%) to its highest level since July 2014, slowing the appreciation in housing prices, another key concern of the BoK. The government's fuel excise tax cut helped cool inflationary pressures somewhat, but inflation is poised to remain above the BoK's target through 2022. With the recovery likely undeterred by the new variant, we still expect the central bank to raise rates once more in 1Q22, as early as the monetary policy meeting on 14 Jan 22.
Malaysia: In fine fettle	▪ **Manufacturing PMI climbed to an 8-month high in December (52.8)** (November: 52.3). Growth in new orders also came in at a 8-month high, and new export orders returned to expansion territory at the margins. Input costs were up for the 19th month running, with the rate of inflation at a 7-month high. Thus, output charges rose at the sharpest pace since Apr 21. Border restrictions meant that firms struggled to hire foreign workers, culminating in a renewed fall in employment. Business sentiment eased slightly from November but remained strong and above the historical average. ▪ **Exports expanded 32.4% y/y in November** (October: +25.5%), the highest in 6 months. Electronics (+17.4%) led the charge, alongside chemicals (+51.3%), machineries (+19.4%) and commodities such as palm oil (+81.6%), gas (+91.1%) and petroleum and petroleum products (+84.5%). Imports were also buoyant, rising 38.0% y/y and up from +27.9% in October, thanks to still-favourable base effects. The strength in import demand was broad-based across capital (+32.1%), intermediates (+47.4%) and consumer (+22.8%) goods. The trade surplus shrank to a 4-month low in November (MYR18.9bn) having peaked in October (MYR26.3bn). ▪ **Inflation rose to a 5-month high in November (+3.3%)** (October: +2.9%). Underpinning the inflation print is food (+2.7%), non-alcohol beverages (+0.4%), accommodation and utilities (+3.4%), household equipment (+2.6%), transport (+12.7%), education (+0.1%), restaurants (+0.9%) and miscellaneous goods and services (+0.1%). Alcohol (+0.3%), clothing (-0.4%), health (+0.2%), communication (+0.0%) and recreation (+0.2%) were all unchanged from October. Sequentially,

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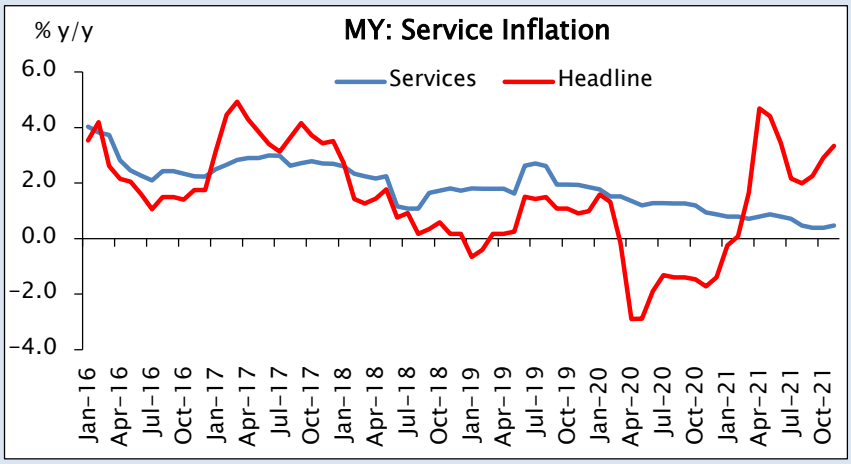
	headline inflation cooled to +0.2% sa m/m, from +0.7% in Oct 21. Core inflation grew 0.9% y/y in November, up from +0.7% in the previous month. Services inflation, another barometer for underlying price pressures, is up a mere 0.5% y/y, from +0.4% in October.



Source: CEIC

Assessment: Modest headwinds will only dampen growth slightly

- **Domestic and external demand are firing up**: The trade-oriented Malaysian economy is holding up, given the sanguine PMI print. Bear in mind that in Malaysia's context, manufacturing PMI has typically underperformed relative to GDP growth in recent years, so the upbeat PMI figures portend well for the upcoming releases on industrial production due on 10th January. The easing of supply chain bottlenecks, evinced by improving factory output in Korea and Japan will buoy Malaysian exports. Elevated commodity prices, particularly that of CPO, oil and natural gas, are a sweetener for the economy.
- **On the domestic front, hefty vaccination rates have raised the bar for a relapse into lockdowns or even harsher social distancing measures**, despite the emergence of the highly transmissible Omicron variant. In that vein, the expeditious procurement of antiviral pills by Pfizer and Merck paves the way for the transition to endemicity in light of the new variant. On the flip side, the extension of border controls and a dearth of foreign labour present as key downside risks in the near-term, but we believe they should pass by 2Q22 after the new wave of infections flame out. In short, we reaffirm our forecast for full-year growth at 6%, and we do not rule out an upside surprise to growth this year.
- **Looking under the hood, underlying price pressures remain benign:** Despite the sharp uptick in CPI inflation in recent months, underlying price pressures remain benign, going by both measures that is the core CPI and services inflation. Month-on-month CPI increase was also soft (+0.2% sa) which does not point to runaway prices. Besides, salient

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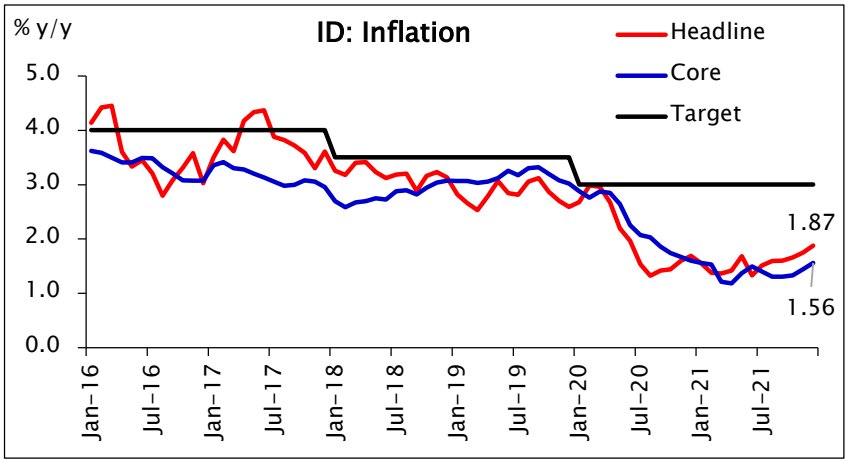
	labour market slack and a still-sizeable negative output gap will also keep wage growth and prices in check, with Bank Negara having communicated its expectations of benign core inflation. That said, we see an even split in the timing of policy normalisation by Bank Negara between May and July 2022, particularly if the recovery turns up a notch in 1Q22, despite the chills from the new variant.
Indonesia: Watch for stirring prices in 2Q22	▪ **Manufacturing PMI eased again in December (53.5)** (Nov 21: 53.9), extending the downtrend from October's all-time high. New orders eased for the second straight month, despite a rebound in export business. Employment levels were unchanged in December, as resignations balanced additional hiring to accommodation higher output. Input price inflation rose to the highest in just over 8 years, while output charges climbed more slowly in December as a result of elevated freight rates and dearer inputs. Business sentiment improved in December with hopes that demand will improve as disruptions ease. ▪ **Inflation quickened to an 18-month high in Dec 21 (+1.9%)** (Nov 21: +1.7%). More than three-quarters of the CPI basket saw rising prices – food and beverage (+3.1%), clothing (+1.5%), accommodation and utilities (+0.8%), household equipment (+2.7%), transportation (+1.6%), recreation (+1.1%) and personal care (+1.7%). Health (+1.7%), education (+1.6%) and restaurants (+2.7%) were unchanged, while info-communications and financial services slipped into deflation (-0.1%). Sequentially, headline inflation rose 0.6% m/m sa, the fastest in more than 3 years. Core inflation edged up to 1.6% y/y in December (Nov 21: +1.4%) – the highest in 11 months, although still modest.  Source: CEIC ▪ **The Jokowi administration banned coal exports for January 2022** amid reports of depleting coal stocks in domestic power plants. President Jokowi lambasted miners for failing to meet their domestic market

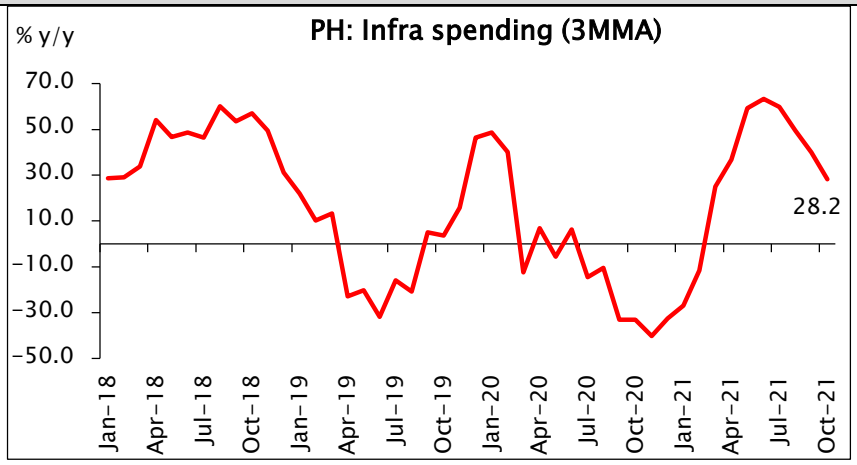
Variable	Development/Assessment
	obligations (DMO) by offloading coal at a maximum price of USD70. While the coal mining association (APBI) emphasised that 10 of its largest members will supply extra coal to state utility PLN, confusion ensued after trade minister Muhammad Lutfi failed to follow through with a meeting to review the ban. Luhut Pandjaitan, the coordinating minister for investments and maritime affairs, assured that a new formula for the DMO will be unveiled soon, which should relieve the supply crunch. APBI has proposed raising the maximum price to USD90, which was rejected by the government. Producers that have met the DMO have sought exemptions from the ban, which is purportedly under consideration. **Assessment: 3 implications from the ban on coal exports** ▪ **Watch for stirring prices in 2Q22 and further policy guidance from BI**: Risks to the inflation outlook are tilted to the upside. Unfavourable base effects should kick in soon, and the impending VAT tax hike from April will heap additional upward pressure on inflation. The new wave of Omicron infections may temper with demand pressures somewhat, but the growth pullback will be modest for reasons we detail in the long article below, which we likened to a minor speed bump, as opposed to a pothole. Anecdotal accounts from the PMI print points to intensifying input price inflation, though weak demand has curtailed the pass-through to output charges. ▪ In other words, the normalisation in demand should resume in earnest from February or March 2022 at the latest, raising the likelihood of a sharp rebound in inflation following a lull for most of 2021. The implication for policy is that BI should tighten around mid-2022 in tandem with the Fed, under the guise of keeping inflation expectations well-anchored as prices rear its ugly head. The tail risk is that inflation exceeds the upper end of BI's target (4%) in 2Q22, spurring a swift policy correction by BI to safeguard the Rupiah and keep yields under control. ▪ **Precipitous ban on coal exports – more tactical than strategic**: There are 3 implications from the abrupt ban on coal shipments. First, the ban is emblematic of haphazard policymaking in Indonesia. At the heart of the kerfuffle is the sub-par coal price (i.e. a maximum price of USD70) even though the benchmark Newcastle futures were almost triple that at the time of writing. The maximum coal price is necessitated by below-market electricity tariffs which entailed years of losses for the state utility. As such, raising electricity tariffs and supporting PLN's bottom-line would have resolved the issue, albeit at a not insignificant political cost with Covid-19 caseloads rising lately.

Variable	Development/Assessment
	▪ Instead, the precipitous ban on coal exports serves to remind investors of the tactical nature of policymaking under the current administration. Recall that a ballooning current account deficit in 2018 spurred a whole-of-the-government effort to curb imports without addressing the root cause of the issue that is the excess of investments over savings that is responsible for the external imbalances. ▪ Second, President Jokowi sought to capitalise on the incident to burnish his image as a man-of-the-people who is willing to overcome vested interests, even within his own cabinet – SOE minister Erick Thohir's brother is the president director of Adaro energy, a prominent coal mining company. Yet the move risks sparking the ire of Indonesia's key trading partners across east Asia, with Japan, China and India reliant on thermal coal from Indonesia for power generation. ▪ Last, the ban may be a short-lived affair but it will hurt export earnings. Thermal coal accounts for around 10% of Indonesian exports so the ban will squeeze January's trade balance, and could even push it into negative territory, offset slightly by the new variant's impact on the hitherto rebounding import demand. The ban should be lifted soon once coal companies contribute their share of the DMOs to replenish PLN's coal stocks.
Thailand: **Encouraging recovery, but may be short-lived**	The various components of aggregate demand performed nicely in November. On a sequential basis: ▪ **Private consumption grew +0.9% m/m sa in Nov 21**, extending its +1.6% increase in Oct 21. According to the Bank of Thailand (BOT), good vaccination progress and the gradual relaxation of Covid-19 containment measures bolstered consumption. Transfer payments from the government and improving farm incomes (Nov 21: -3.2% y/y; Oct 21: -8.0% y/y) also supported consumption. ▪ **Foreign tourist arrivals reached 100,000 in Nov 21 alone**, nearly equivalent to the number of arrivals for the first ten months of 2021. Arrivals spiked due to the removal of quarantine requirements for vaccinated tourists that took effect at the start of Nov 21. Consequently, the hotel & restaurant sub-index of the Services Production Index (SPI) ticked up in Nov 21. ▪ **Private investment grew +1.3% m/m sa in Nov 21**, reversing its -1.2% contraction in Oct 21. Sales of motor vehicles for investment purposes (+23.3%) led the increase, followed by construction materials (+1.0%), and domestic machinery sales (+0.4%). The BOT cited the recovery of demand and business confidence as factors behind the rise. ▪ **Exports excluding gold and petroleum products grew sequentially for the 3rd month at +3.2% m/m sa in Nov 21**, with all categories of manufacturing exports posting sequential increases. Improved foreign

Variable	Development/Assessment
	demand and the relaxation of containment measures which allowed for the fulfilment of pending purchase orders facilitated the increase. ▪ **Stronger domestic and external demand translated into further manufacturing output growth at +0.6% m/m sa in Nov 21**, although the pace of sequential growth slowed down (Oct 21: +2.7% m/m; Sep 21: +6.6% m/m). **Assessment: The recovery may be short-lived** ▪ Despite the encouraging recovery in November, fresh challenges have emerged that threaten to derail progress. First, the government suspended quarantine free-travel effective 22 Dec 21 in response to the rapidly spreading Omicron variant. Just as private consumption was picking up, the fresh restrictions will likely weigh on consumer confidence and bring down spending once again. The restrictions also erase the valuable gains made by the tourism sector in Nov 21. ▪ Second, the manufacturing PMI entered the contractionary zone (49.5) in Dec 21, down from 50.6 in Nov 21. New orders, including new export orders, fell, reflecting weakened demand for manufactured goods. Weakened demand also led employment in the manufacturing sector to fall at the fastest rate since Oct 21. ▪ These factors point to a slowdown or contraction in economic growth in the near-term. However, the government's stimulus measures introduced in end-Dec 21 will be sufficiently counter-cyclical. The measures include tax deductions for shoppers of up to THB30,000 per person between 1 Jan 22 and 15 Feb 22 and extended tax exemptions for large-scale investment projects until end-2022. The former is expected to generate THB42bn of spending, while the latter is expected to generate THB500bn in investment pledges for 2022.
The Philippines: a slower path to recovery	▪ **Manufacturing PMI was up fractionally to 51.8 in December** (November: 51.7). New orders quickened, though the rate of increase remains modest. But new export orders fell sharply at the quickest pace in 4 months amid tightening border restrictions. Job shedding persisted for close to 2 years, but the pace of decrease softened in December. Input cost inflation moderated to a 3-month low but output charges rose sharply as firms passed on part of the burden to clients. The future sentiment index jumped to its highest since Jan 20 as manufacturers expect a return to normality in 2022. ▪ **The Duterte administration has raised the alert level of metro Manila** to level 3 from 3-15 Jan 22 amid a sharp rise in Omicron cases. Parts of greater Manila and large swathes of Luzon were also placed on alert level 3 days later after Covid-19 caseloads hit a fresh record, outpacing the previous peak when the Delta variant was the dominant strain. Under alert level 3, intrazonal and interzonal travels are forbidden

Variable	Development/Assessment
	while retail services, such as dining-in, cinemas, personal care and tourist attractions will all be capped at 50% outdoor and 30% indoor capacity. ▪ **Credit growth continues to inch up steadily in November** (+4.0%) (October: +3.8%). By sector, credit extended to manufacturing (+6.7%), wholesale and retail trade (+1.5%) and real estate (+8.0%) quickened whereas utilities (+0.9%), transport (+27.2%) and finance and insurance (+9.0%) all slowed. Household credit saw a slower pace of decrease (-7.1%) (October: -7.4%). ▪ **Factory output held up in November (+26.5%) (October: +25.9%).** Among the heavyweight items accounting for close to two-thirds of the IIP basket, electrical equipment (+53.6%), transport equipment (-5.1%), computer and electronics products (+7.3%) and leather (+7.3%) led the charge, while food (+23.1%), textiles (+0.4%) and clothing (-11.0%) softened from October. Sequentially, factory output eased to +1.4% sa m/m, from +3.7% in October. ▪ **Headline inflation eased to its lowest in more than a year in December (+3.6%)** (November: +4.2%). Disinflation in food (+3.2%), alcohol (+6.5%), clothing (+1.8%), household equipment (+2.3%), health (+3.0%), transport (+6.1%), recreation (+0.9%) and restaurants (+3.5%) heaped downward pressure on the index. Non-alcoholic beverages (+1.6%) and education (+0.7%) were unchanged, while accommodation and utilities (+5.0%) and communication (+0.3%) edged up. Core inflation moderated to a 5-month low of +3.0% y/y in December (Nov 21: 3.3%). ▪ **President Duterte signed the PHP5.0tr-Budget 2022 into law** just before the turn of last year. The budget would adhere to the supreme court ruling that mandates a bigger share of revenues for local governments (PHP959bn), which is up by a third on an annual basis. He also extended the validity of the 2021 budget for a year (i.e. till end-2022) to address the backlog of disbursals, particularly on infrastructure outlays and subsidy funds SOEs. ▪ **Growth in infrastructure spending eased to +6.7% y/y in October**, (September: +25.1%) ending a run of double-digits expansion. YTD, infrastructure spending amounted to PHP702bn, which is still shy of the full-year target (PHP1.1tr) amid typhoon Odette as well as a diversion of funds toward spending pressures induced by Covid-19.

Variable	Development/Assessment



Source: CEIC

- **The BSP is preparing for policy normalisation post-pandemic**, but it stressed that the timing of such a move will be dependent on growth outcomes, particularly when growth prospects have improved "materially". The BSP also hinted at cuts to the reserve requirement ratios later this year, which could take place alongside the draining of excess liquidity to achieve dual purposes of trimming the RRR to single-digit by 2023 and to slow the pace of policy normalisation.

Assessment: New variant merely slows path to normalisation

- **4Q21 growth remains buoyant** but the Omicron variant could shave up to 50 basis points off full-year growth. The bevy of high-frequency figures released last week – manufacturing PMI, factory output and credit growth – is all affirmative of a meaningful rebound in 4Q21 growth. Record-high Covid-19 caseloads have spurred the authorities to tighten social distancing guidelines, which will inevitably weigh on growth in 1Q22. But the impact of the new variant, both in terms of health and growth outcomes, will be modest, thanks to a perfect confluence of the virus' transmissibility and the favourable demographic profile and natural immunity in the Philippines. There is also a not insignificant likelihood that the recovery will merely be delayed into 2Q22, with a modest hit to full-year growth.
- **Policy normalisation on track**: More benign price pressures allay concerns of excessive policy accommodation by the BSP, after the central bank green-lighted another round of advance to the government in last week under the unconventional deficit financing framework. The scheme could be renewed once more by end-1Q22 before wrapping up in June to give the central bank flexibility to mull plans for tightening in late-2022, alongside further RRR cuts to bring down the reserve requirement to single-digit (currently at 12%).

Variable	Development/Assessment
	▪ We do expect price pressures to remain elevated for the time being, no thanks to high oil prices and typhoon Odette which raises the spectre of more supply disruptions at home. As for the impact of the new variant, we do not foresee any significant delay to the timeline for normalisation, though it is still early in the year, and the emergence of more variants, especially if they are more deadly and as transmissible as Omicron, bears watching. ▪ **Infra spending could surprise on the downside:** Several factors underpin our view for infrastructure spending to play spoil-sport. First, typhoon Odette and the wet weather season held back construction and infrastructure activity in 4Q20. Second, the 45-day pre-election ban on new infrastructure spending kicks in from 25th March, which coincides with favourable weather in the first half of the year for projects to break ground. Third, the new Covid-19 restrictions will hobble the construction industry further, delivering another hit to infrastructure activity. For 2021, we peg infrastructure spending as a share of GDP to come in at around 4.5% (PHP900bn), compared to government estimates of 5.6% (PHP1.1tr). On the bright side, the law that extends the validity of disbursals for infrastructure suggest some of the spending could be back-loaded into 2022 instead.

Geo-political risks: The Indo-Pacific arena heats up

The coming year will see increased pressure on China as it suffers setbacks in two major areas where it has sought to strengthen its strategic position: First, a backlash is growing against its assertiveness in the South and East China Seas. Second, it is encountering difficulties with its Belt and Road Initiative with countries in South Asia. Unless China recalibrates its approach, it risks generating more antagonism in Southeast and East Asia while the costs of its engagement with South Asian countries may grow uncomfortably large.

China's strategic position in the region is weakening

Every action generates a reaction. China's vigorous pursuit of its interests in East and Southeast Asia allowed it to gain an advantageous position in the South China Sea. But that approach has now galvanised an increasingly sharp response from other parties in the region. If these responses intensify as we expect, then China's efforts to advance its strategic position could actually backfire.

- The US-Japan alliance, already strengthened in the past few years, is becoming more focused on countering China. Last week's meeting of defence and foreign ministers of the two nations produced several initiatives including one to collaborate on emerging military technologies, such as ways to neutralise the threat from the hypersonic missiles that China has been developing successfully and which North Korea tested recently. When US Defence Secretary Austin said the two sides would be "optimizing our alliance force posture to strengthen deterrence", there was little doubt that he was referring to threats from China primarily, and North Korea secondarily. Japan and the US also agreed on a revised five-year framework for host-nation support, which resolved the niggling issue of how much financial support Japan should provide to the US military based in Japan.

- Japan has also signed a new defence agreement with Australia, the Reciprocal Access Agreement (RAA). The RAA is a significant development as Australia becomes the only other nation aside from the US with which Japan has a treaty enabling the entry of foreign soldiers on its soil. The pact will allow for enhanced inter-operability and coordination in a military crisis. In addition, Japan also announced that it would acquire 10 new vessels for its coast guard. The RAA is also significant because cooperation between Japan and Australia is independent of the US and is clearly a hedge against the US potentially becoming disengaged from the region under a different president.

The question is how other countries in the region will respond. The Philippines has continued its slow recalibration of strategy, away from the failed one of cosying up to China in the hope that China would be more amenable on their territorial disputes. The Philippines announced last week that it would purchase two naval corvettes worth USD556 million from South Korea as part of a naval build-up to bolster its capacity to assert its presence in the waters disputed with China. We believe that this gradual shift away from China will continue, whatever the outcome of the

presidential elections in May. Even if Ferdinand Marcos Junior – who is seen as willing to accommodate Beijing – were to win, the rest of the Philippines establishment is unlikely to allow him to persist with President Duterte's anti-US and pro-China approach. Marcos Junior also lacks Duterte's visceral anti-Americanism.

China will also probably face a more truculent Indonesia. It emerged in December that China had repeatedly demanded that Indonesia cease drilling for oil in what Indonesia considers its exclusive economic zone. This followed a 4-month stand-off between Chinese and Indonesian vessels as Chinese coast guard ships shadowed Indonesian oil exploration vessels. Although the official Indonesian response has not been published, a senior parliamentarian has confirmed that Indonesia had rebuffed China firmly. It had little choice since this was the first time that China had made such an explicit claim affecting Indonesia's sovereignty rights over its maritime waters. Indonesia would also have been further miffed when China protested a joint US-Indonesian naval drill in the South China Sea last year – such exercises had been going on since 2009 but it was only last year that China issued a protest. China would be mistaken if it interpreted Jakarta's silence as a willingness to eventually accommodate Beijing – Indonesia has a long record of stoutly resisting any affront to its sovereignty. We expect Indonesia to make further efforts to assert its presence in its EEZ in the near future even if that arouses China's ire. It would not surprise us if Indonesia also sought increased military cooperation with the US and Japan as a signal to China to back off.

China's Belt & Road Initiative (BRI) faces difficulties

Away from geo-strategic and military affairs, China's key economic initiative – the Belt & Road Initiative (BRI) – is also encountering turbulence. China's large investment in Pakistan and Sri Lanka as part of its BRI has yielded it considerable influence in the region, successfully keeping India on the back foot. However, China is now beginning to realise that it has to pay a higher than expected price for this gain.

Sri Lanka is in a grave economic crisis brought on by mismanagement. As a result, Sri Lankan President Rajapaksa is pressing China for aid – a restructuring of its large debt with China and concessional access of Sri Lankan exports into China's market. While more aid would make Sri Lanka even more beholden to China, and so serve China's strategic interest, it also brings home to China that such gains come at a much higher financial cost than it bargained for.

This is even more evident in Pakistan. China has committed about USD50bn to its BRI projects in Pakistan, making that nation the biggest recipient of Beijing's largesse. However, there have been a number of setbacks and irritants have developed in the relationship.

- First, Pakistan's inability to guarantee the safety of Chinese nationals working on BRI projects in Pakistan has upset China. In July, 13 Chinese citizens were killed in a terrorist attack in Baluchistan. In August, another terrorist attack wounded a Chinese national, also in

Baluchistan. Before that, in April, a bomb that targeted the Chinese Ambassador to Pakistan missed its intended target but killed a number of Pakistanis.

- Second, Chinese officials have had a range of disagreements with Pakistani officials managing BRI projects. The Chinese Ambassador to Pakistan is reported to have berated provincial government officials for their tardiness in approving projects. Differences between China and Pakistan are also reported to have caused delays in mega projects such as the USD6.8 billion project to upgrade the Karachi-Peshawar rail link, the largest component of the BRI in Pakistan. Pakistani planners are said to be taken aback by the high cost of Chinese projects and the uneven economic impact the projects have had.

- Third, China is also realising that the financial returns from its BRI projects are not as hoped for while Pakistan is finding the financial burdens associated with some BRI projects to be excessive. In the power sector, for instance, Pakistan now has a glut of power capacity but the government is still obliged to pay Chinese firms capacity charges in line with the agreements. China has been upset that its firms are not being paid as promised and has also been surprised by the large revenues lost to pilferage because the Pakistani state is too weak to enforce its laws. If these problems persist, the Pakistani government's power sector liabilities are projected to rise to around USD9.4 billion by the end of 2023 while Chinese firms face higher losses of revenues.

Conclusion

The Indo-Pacific region will be the main arena in which the US and China compete for influence and position. In the coming year, there is likely to be continued pushback against China's assertive stance with the less powerful countries quietly stepped up their defence build-ups and strengthened ties with the US and its allies. China will need to rethink its assertive approach or lose more goodwill in the region. It will also need to find a way to reduce the higher costs and potential losses involved in its vaunted BRI projects.

Omicron variant: Mere speed bump rather than pothole in path to recovery

The release of manufacturing purchasing manager indices (PMIs) for December allow us to stake stock of how the regional economies stand as they enter the new year. The new Omicron variant appears to be making its way across large swathes of Asia, marked by a sharp rise in caseloads following a lull in 2H21. Going by the experience of South Africa, which shares a similar demographic profile with parts of emerging Asia, we believe caseloads will break new records in this region before falling as quickly. Rising vaccination rates and the expeditious rollout of booster shots in the more developed parts of Asia will also put a lid on severe illness and deaths. Our view, is that the new variant is akin to a speed bump in 1Q22, before caseloads fall sharply and enable the recovery to resume in earnest thereafter.

Where things stand – manufacturing PMIs suggest the recovery is still on track

- **Manufacturing in the majority of Asian economies expanded in Dec 21.** Singapore (55.1), Philippines (51.8), Taiwan (55.5), Malaysia (52.8), Vietnam (52.5), and South Korea (51.9) posted faster expansions. Hong Kong (50.8), India (55.5), and Indonesia (53.5) posted slower expansions, although growth in the latter two was considerable. Thailand (49.5) and Myanmar (49.0) were in the contractionary zone.

- **Stronger demand conditions and improving economic conditions were observed to have increased manufacturing output in 9 out of 12 Asian economies**. Output grew at a faster rate in Singapore, the Philippines, Taiwan, Indonesia, and Malaysia, while output growth eased in India (still sharp), Thailand (still strong), Hong Kong, and Vietnam. Output expanded for the first time since Mar 21 in the Philippines and contracted in South Korea and Myanmar. Supply-side constraints limited output in South Korea.

- **Broadly improving demand conditions can also be observed in the increase in new orders for 9 out of 12 Asian economies.** Zooming into foreign demand, new export orders expanded at a strong pace in Hong Kong, Singapore, Taiwan, and Vietnam, and reversed its previous contractions in Indonesia and Malaysia. Strong foreign demand growth was not experienced the across-the-board, however, as new export orders contracted in the Philippines, Thailand, and Myanmar, and posted little growth in India.

- **Input price inflation showed no sign of slowing down, and producers are increasingly passing on higher costs to consumers as demand recovers.** Input prices continued their rise across all Asian economies (except China) with the rate of inflation at record highs or the fastest in recent months in Hong Kong, Singapore, Indonesia, and Malaysia. Higher costs were translated into higher output prices across all Asian economies (except China) with sharp increases reported in Hong Kong, Singapore, the Philippines, Malaysia, Thailand, and South Korea.

- **Despite its economic slowdown, China's manufacturing sector has shown resilience.** Output in the public sector (indicated by the NBS PMI) recorded a faster expansion while output in the private sector (indicated by the Caixin PMI) increased at the fastest rate for a year. New orders for the public sector, however, contracted, while new orders for the private sector eased. Foreign demand was particularly subdued for both sectors. Fortunately, both input and output prices have eased in the private and public sectors, assuaging stagflation fears.

- **South Korea was particularly hard-hit by supply-side constraints in Dec 21.** First, its new export orders fell for the first time since Sep 20 due to rising Covid-19 cases globally, congestion at ports and a lack of available shipping containers. Second, the shortage of key components limited its manufacturing output for the month, sending output into the contractionary zone. The supply-side constraints it faces are particularly acute as supplier delivery times have lengthened to the greatest extent since Apr 20 and backlogs of work have increased at the fastest rate since Aug 21.

- **Business confidence remained largely positive across Asian economies as producers expect the pandemic to subside and the recovery in demand to continue into 2022.** The unpredictability of the pandemic and continued supply-chain strains remained key risks for producers.

Table 1: Manufacturing PMI for G3 and Asia

	Manufacturing PMI		New Orders	New Export Orders	Employment	Business Expectations
	Headline	Imports				
US (ISM)	58.7 (61.1)	53.8 (52.6)	Up but slower	Up but slower	Up and faster. 8-month high.	Positive but eased
US (IHS)	57.7 (58.3)		Up but slower. Softest since Jan 21.	Up. Marginal growth.	Up and faster	Positive, 13-month high.
EU	58.0 (58.4)		Up but slower. Softest since Jan 21.	Up but slower	Up and faster	Positive, 3-month high.
Japan	54.3 (54.5)		Up but slower. Above annual average.	Up but slower	Up and fastest in 4 years	Positive, 4-month low.
China (NBS)	50.3 (50.1)		Down but improving	Down and faster	Down but improving	Positive, up
China (Caixin)	50.9 (49.9)		Up but slower. Marginal growth.	Little change from Nov 21.	Down and faster. Contraction at 10-month high.	Positive, 20-month low.
Hong Kong	50.8 (52.6)		Up but slower. 2-month low.	Up, first expansion since May 21.	Down	Positive, up
	IHS	SIPMM				
Singapore	55.1 (52.0)	50.7 (50.6)	Up and faster. 5-month high.	Up and slower, but still strong historically.	Down but improving	Positive, 2-month high
Philippines	51.8 (51.7)		Up and faster. Modest growth.	Down. Contraction at 4-month high.	Down but improving. Contraction at 9-month low.	Positive, 23-month high

Taiwan	55.5 (54.9)	Up and faster. Sharp growth.	Up and faster. 5-month high.	Up but slower. 12-month low.	Positive, 4-month high
India	55.5 (57.6)	Up and faster. Sharp growth.	Up. Marginal growth.	Down from previous expansion. Marginal decline.	Positive, up from 17-month low in Nov 21, but < long-run average
Indonesia	53.5 (53.9)	Up but slower	Up from 5 consecutive months of contraction.	No change from Nov 21.	Positive, up
Malaysia	52.8 (52.3)	Up and faster. 8-month high.	Up from previous contraction.	Down from previous expansion.	Positive but eased, > long-run average
Thailand	49.5 (50.6)	Down	Down	Down and faster. Contraction at 2-month high.	Positive, 3rd highest on record
Vietnam	52.5 (52.2)	Up. Growth on-par with Nov 21 (strong)	Up and faster. 8-month high.	Up from previous contraction.	Positive, up
Korea	51.9 (50.9)	Up and faster. 3-month high.	Down, first contraction since Sep 20.	Up from previous contraction.	-
Myanmar	49.0 (46.7)	Down. Contraction at 16-month low.	-	Up from previous contraction.	Positive

Source: IHS Markit, ISM, Centennial Asia Advisors.

Omicron variant – cause for concern, not alarm

There were concerns that the new Omicron variant would leave emerging economies in a limbo, with neither the policy space nor the buy-in of the populace to enact more lockdowns or restrictions to staunch or slow the spread of the variant. A month later, it appears the fears of the new variant were overdone, and the impact of the virus will be more benign than envisaged, as we uncover and learn more about the new strain and its epidemiological traits.

- Omicron is definitely more transmissible, because of the multitude of mutations along the spike protein. This means it is able to evade antibodies to an extent, but less so for the T-cells, suggesting natural immunity cultivated from prior infection or vaccinations will not prevent infections, though it will still avert severe illness and deaths.

- One reason why the new variant is significantly less deadly is because it is more likely to infect the throat and the upper respiratory passage, as opposed to deep tissues in the lungs, where it tends to do the most damage. The current evidence suggests the new variant slashes the risk of severe illness by half or more.

- The new variant also reduces the need for hospitalisation by up to 80% by virtue of the fact that it is less severe vis-à-vis the previous dominant strain (i.e. Delta). This does not imply that hospitals will not be overwhelmed by Omicron, as the usual culprits are still at work (i.e. underlying hospital bed capacity, share of population unvaccinated etc). But it is still

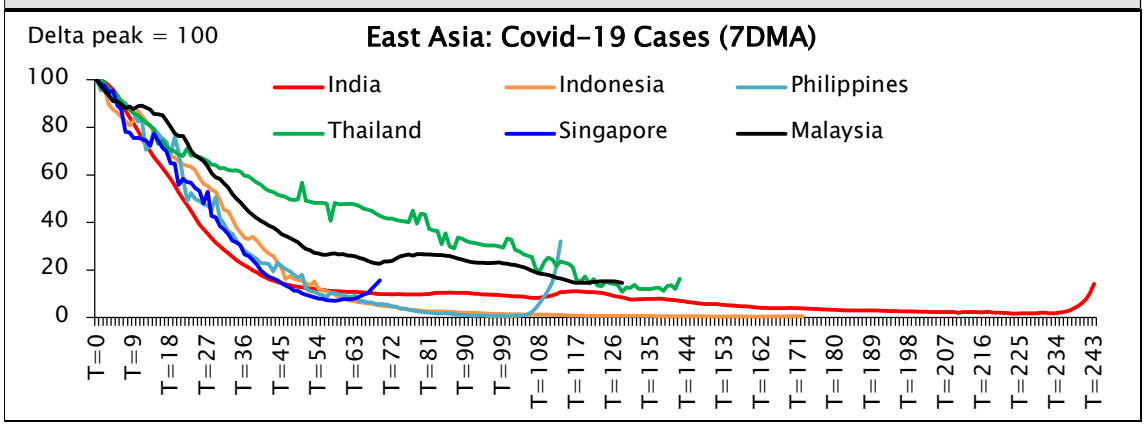
promising and suggest the variant could flame out quickly, expediting the transition to endemicity.

- In South Africa, caseloads peaked and fell in the span of a month, raising hopes of a short-lived wave of infections. Because emerging Asia share the same demographic profile with South Africa, aided further by the fact that vaccination rates are much lower in the African locomotive, this raises hopes that emerging Asia will be spared the worst compared to their harrowing experience of the Delta variant.

Turning to Asia, there is reason to be upbeat over the Omicron variant. As we mentioned in previous weeklies, economies fall into 2 categories – those with ample state capacity, and otherwise.

Chart 1

Caseloads are rebounding swiftly



Source: CEIC. Vietnam and South Korea have been omitted because there is no clear peak in Delta infections.

- Developed economies belong to the former, where vaccines were procured and administered quickly. Governments possess significant fiscal headroom to compensate workers to stay at home and slow the spread of the virus. Singapore, Thailand, Korea and Malaysia belong to this bucket of economies. Across these economies, covid caseloads were trending downwards, thanks to hefty vaccination rates while the authorities play it safe with the reopening and resumption of activity. Governments are also administering booster shots to shore up the vaccine coverage, particularly for the elderly and for those who were vaccinated early amid waning antibodies.

- Poorer and developing economies belong to the second bucket where state capacity is lacking. This pertains to India, Indonesia, the Philippines and Vietnam to a limited extent. Given the tardy roll out of vaccines, these economies managed to achieve natural immunity as the coronavirus was left to replicate and percolate across the community with vaccinations playing catch-up. This explains why caseloads across the trio have practically collapsed and been a shadow of its former self, before the introduction of the Omicron variant sent

caseloads up (see Chart 1). Vaccination rates are now at respectable levels, which affords another level of protection to the population at large.

Economic impact of Omicron will be far more modest

Governments have started to re-impose restrictions to slow the spread of the virus. Compared to their handling of the Delta strain, governments were quicker to tighten border controls that bought time for vaccinations to be stepped up and expansions of hospital capacity. Coupled with the more benign epidemiological traits of the new strain, it is not hard to see why Omicron is a mere speed bump as opposed to a pothole in the path to recovery.

- India is going by the same playbook as the Delta variant, with state governments deciding on the imposition of curfews, closures or limits on capacity for high-risk activities, depending on the local covid situation. Several states, including Delhi, Maharashtra, West Bengal and Karnataka have all brought back the curbs as infections climb exponentially.

- Malaysia has suspended the umrah pilgrimage and banned mass gatherings. Putrajaya also mandated that those aged 60 and above and those inoculated with Sinovac have to get a booster shot to maintain their vaccinated status come February 2022.

- In Indonesia, the government has elevated the alert level for Jakarta to level 2, which places limits on operating hours and operating capacity at shopping malls. Eateries and restaurants can only open till 9pm and operate at 50% capacity, while high-risk areas like parks and tourist attractions will only operate at 25% capacity.

- The Philippines has raised the alert level of Metro Manila and parts of Luzon to level 3 till mid-January 22 after Covid-19 cases quickly hit fresh records. Under alert level 3, intrazonal and interzonal travels are forbidden while retail services, such as dining-in, cinemas, personal care and tourist attractions will all be capped at 50% outdoor and 30% indoor capacity.

- Thailand opted to maintain the suspension of the travel bubble, known as the "Test and Go" waiver for quarantine, until further notice. The fate of the travel bubble, meant to revive the pivotal tourism industry, has been left in abeyance since 22 Dec 21. On the domestic front, Thailand raised the Covid-19 alert level to four, and the authorities hinted at closures and limits on high-risk activities.

- Similarly, Singapore has suspended the sales of VTL flight tickets from 23 Dec 21 till 20 Jan 22 after the first Omicron case was detected among airport staff. The authorities also opted not to ease up further on the existing restrictions, with a 5-pax cap on dining in and social gatherings. But workplaces can now operate at 50% capacity, up from 25% previously.

Where the economic impact of the new variant is concerned, we believe the hit to growth will be far more modest. We will adjust our forecasts in due course, but there is a not insignificant likelihood that the new variant merely defers the recovery into 2H22, as opposed to derailing the recovery pathway altogether, more so if symptoms are mild and the community is able to better co-exist with the virus.

- First, governments are not in a rush to lock down their economies. This boils down to the populace's fatigue with restrictions, the limited fiscal space to dole out more handouts, and the significantly lower mortality rate associated with the new strain, particularly in economies with a more favourable demographic profile.

- Second, higher vaccination rates across the region serve as a bulwark to prevent severe illness that inundates hospitals like what transpired in the Delta variant, with some even nudging the community to get their booster shots. Some governments have also procured the anti-viral pills by Pfizer and Merck, which will go a long way to undergird the revival in business and consumer confidence.

- Third, economic agents have proved to live with Covid-19 and to adapt to the disruptions induced by the restrictions. E-commerce has taken off, as did digitisation with the introduction of vaccine passports for high-risk activities. Hybrid and flexible working arrangements are now in vogue. True, contact-intensive sectors such as tourism and hospitality may remain under water for an extended period of time, but there is a silver lining to the new variant, as we suggest next.

- Last, the heightened transmissibility of the new variant suggests it may well be *the* decisive strain that accelerates the transition and path toward endemicity. Our baseline scenario is for caseloads to peak later in early-February, before falling sharply and flaming out by March, as the experience of South Africa goes to show. To be sure, this is more likely in emerging Asia where the authorities have adopted a more relaxed posture because of an inability to enforce the curbs, allowing the coronavirus to proliferate till it runs out of bodies to infect. For developed parts of Asia, the experience of the UK may be more appropriate, where caseloads have started to show signs of peaking.

CAA Table of forecasts (as of 10th January)

	Year	Growth (%)	Inflation (%)	Current Account (% of GDP)	Policy rate (%)	Currency (vs USD)
China	2020	2.3	2.5	1.9	2.25	6.53
	2021	7.8	1.4	2.4	2.25	6.45
	2022	5.5	2.0	1.3	2.25	6.55
India	2020	-7.3	5.5	0.9	4.00	73.1
	2021	9.5	5.3	-1.0	4.00	75.0
	2022	7.0	5.2	-2.0	4.40	74.5
Indonesia	2020	-2.1	1.7	-0.4	3.75	14,050
	2021	3.5	2.0	0.3	3.50	14,300
	2022	5.5	3.5	-1.0	4.00	14,000
Korea	2020	-0.9	0.5	4.6	0.50	1,085
	2021	4.0	4.0	5.0	1.00	1,180
	2022	2.9	3.1	3.9	1.75	1,150
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	1.15	27.0
Hong Kong	2020	-6.1	0.3	6.5	-	7.75
	2021	6.2	1.6	4.0	-	7.75
	2022	4.0	1.9	3.5	-	7.75
Singapore	2020	-5.4	-0.2	17.6	-	1.33
	2021	7.1	1.9	22.0	-	1.32
	2022	4.5	1.5	17.2	-	1.27
Malaysia	2020	-5.6	-1.4	4.2	1.75	4.02
	2021	3.5	2.5	4.0	1.75	4.20
	2022	6.0	2.0	3.2	2.25	4.10
Philippines	2020	-9.6	3.5	3.1	2.00	48.0
	2021	4.8	4.4	-1.2	2.00	50.5
	2022	6.5	3.8	-1.8	2.50	50.8
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	2.4	1.3	0.75	32.5
Vietnam	2020	2.8	3.2	3.7	4.00	23,080
	2021	3.0	2.5	2.2	4.00	23,300
	2022	7.0	3.5	2.5	4.50	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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