CENTENNIAL ASIA ADVISORS
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WEEKLY INSIGHTS
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India: Looking Beyond Budget FY23
Singapore Budget Preview: Pivoting away from crisis management

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What has changed?

Global economy: Key commodity prices are up because of political tensions and supply bottlenecks. Central banks, fearing unanchored inflationary expectations, might tighten monetary policy pre-emptively.

Asian economies:

- Chinese policy makers, now more worried about growth prospects, are likely to resort to innovative tools to stimulate the economy. That makes us more optimistic about growth this year but untested new tools could pose risks as well.
- India's recovery lost steam recently but this is temporary. The central bank is likely to begin policy normalisation in April. Bank Indonesia, however, may hold off policy action. Similarly, we do not see the Philippines central bank normalising monetary policy just yet. There is more data to show Malaysia and Vietnam poised to deliver upside economic outcomes.

India: Looking Beyond Budget FY23

Now that the dust has settled on Budget 2022-23, it is timely to take stock of the broader implications of the budget statement. We outline 5 macro implications from Budget FY23.

- First, the increase in capex is less impressive after accounting for special factors. The assumption that massive public spending will crowd in private investments is questionable. In fact, rising global interest rates and a normalisation in household savings, alongside more government dissaving entail higher yields. Thus, the bond market is poised for indigestion, given the deluge of borrowings at a delicate time when financial conditions are tightening.
- Furthermore, the dearth of details on a credible fiscal consolidation plan raises the risk of fiscal dominance by compromising the RBI's reaction function.
- Last, the reform agenda seems to have hit a wall, with little in the way of further tax reforms, measures to ease India's inclusion in bond indices, and a fading drive.

Singapore Budget Preview: Pivoting away from crisis management

- The government has clearly signalled the likely revenue measures in the budget to be announced on 18th February, so there will be few surprises there: The GST rate will be hiked from 7% to 9%, carbon prices will be raised in stages and a very modest form of wealth tax will be announced.
- The government will also offer substantial support measures to help the lower-income groups weather the impact of higher GST rates.
- But, given the policy makers' determination to bring the budget back to balance, it will be a conservative budget with a slightly contractionary fiscal impulse. Given the strong growth prospects for the economy, that would be appropriate.
- It also appears to us that the government is keen to pivot away from two years of crisis management so as to focus more on structural challenges faced by the economy. More measures to help businesses to scale up and move up the value chain by adopting new technologies are likely as are schemes to to retrofit the city-state's infrastructure for "greener" growth.

Key Drivers of Asian Economies

<table>
<tr><th>Variable</th><th>Development/Assessment</th></tr>
<tr><td colspan="2">Global economy and impact on Asia</td></tr>
<tr><td>One thing certain in an uncertain world – higher inflation expectations</td><td><u>Tensions over Ukraine have facilitated a spike in oil prices</u>
▪ Brent crude oil prices have surged from USD77per barrel at the end of 2021 to around USD96 today, up around 25%. Problems with supply have played a role in lifting prices but a stronger reason is the rising risk premium because of the Ukraine military stand-off. The market is pricing in the risk that Russia would cut off gas supplies to Europe in the event of outright conflict in Ukraine, triggering off a knock-on rise in oil prices as well.
▪ But, since petrol pump prices move fairly quickly in response to higher crude prices, consumers' inflation expectations tend to be disproportionately influenced by oil prices, especially in places such as the United States. If the current tensions in Ukraine do turn into an outright military clash, the chances are that oil prices will spike higher and destabilise inflation expectations further.
<u>Other factors are also adding to inflation fears</u>
▪ Beyond oil, other commodities are also seeing upward price pressures. One reason is lower inventory buffers – stocks of commodities as varied as copper, aluminium and arabica coffee have fallen to multi-year lows. This has supported spikes in their prices.
▪ Supply chain difficulties are also contributing to shortages and price increases. The surge in covid-19 inflections has reduced the availability of workers in many economies. Strikes such as the one by workers at a Finnish forestry group have caused paper shortages and could lead to more price increases. Political disturbances over government measures to control the pandemic have also led to temporary supply chain disruptions, as we saw recently with the blockade by protestors of the bridge linking the US and Canada.
Assessment: sustained inflationary pressures not the base case for Asia
▪ For inflation to take off, we would need higher inflation expectations to be sustained enough to feed into wages as well as into services prices. After all, services prices account for the bulk of most developed countries' consumer price index baskets. That is not the base case yet – it is not clear how the Ukraine stand-off will end while it is also reasonable to believe that supply chain dislocations will gradually ease.
▪ However, the risks are rising. Global consumer price inflation as measured by Moody's Analytics has doubled in the past six months, from 6.3% in August 2021 to 13.5% last month. While the rise in inflation has been less marked in Asia, central banks here will be watching to see if inflation expectations are at risk of becoming</td></tr>
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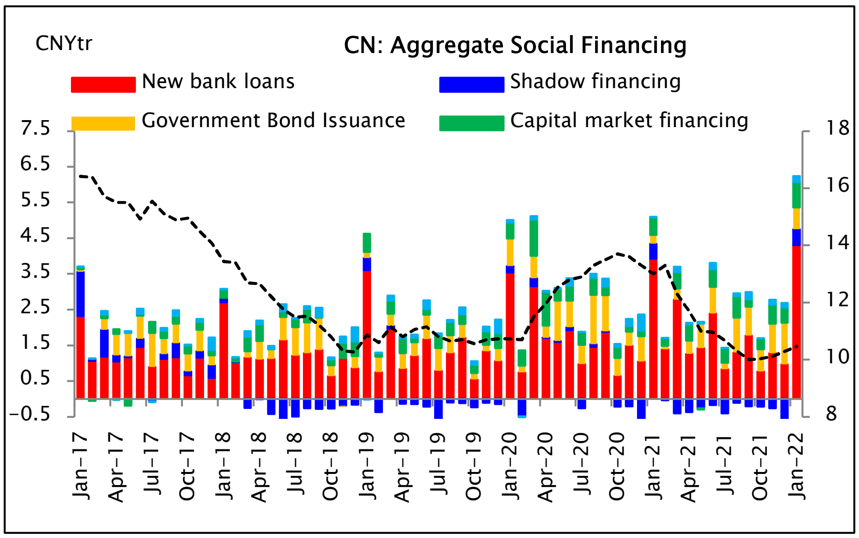
<tr><th>Variable</th><th>Development/Assessment</th></tr>
<tr><td></td><td>unanchored. If that risk rises, we might see more central banks tightening policy in pre-emptive moves to stall inflation.</td></tr>
<tr><td colspan="2">Asian economies</td></tr>
<tr><td>China:
Incrementally more optimistic on GDP growth in 2022</td><td><u>Policy easing is underway and helping to stabilise the economy</u>
Outstanding credit growth continued to strengthen in January to 10.5% y/y, primarily supported by a significant acceleration in bank loans (see Chart below; red bar) which stood out despite January being a seasonally strong month for bank lending. It is notable that even shadow financing, which the authorities have tried hard to reduce, has turned positive for the first time in 12 months. We expect credit growth to be supported in particular by increased local government special bond financing going forward.


Source: CEIC, Centennial Asia Advisors
Note: Stacked bars show flow contribution to stock credit growth
Housing policies more flexible: The maximum down payment for second-time homebuyers in Fuzhou, Fujian has been reportedly lowered to 40%, with similar changes observed in many third and fourth-tier cities. The Securities Daily, a major Chinese financial newspaper, reported that a number of commercial banks have accelerated home loan issuance.
New measures to contain downside risks in the real sector: China's "big four" asset management companies were urged to participate in the restructuring of defaulted property firms e.g., Shimao and Evergrande by buying property projects and distressed debt. The government also further adjusted rules to make it easier for property developers to access cash from pre-sales held in escrow accounts.
<u>However, growing risks point to policy makers stepping up support efforts</u></td></tr>
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Variable	Development/Assessment
	▪ **Hong Kong's covid situation out of control – a warning to China**: A senior official from the Chinese Center for Disease Control and Prevention told Chinese media that, since China has no effective way to prevent large-scale transmission from imported strains of the virus, the country will not ease its stringent policies for now. In Hong Kong, despite a similar though less rigorous commitment to China's "dynamic clearing" approach to the pandemic, infections have surged out of control. Chief Executive Carrie Lam admitted today that the surge had "…overwhelmed the city's capacity of handling". The crisis in Hong Kong reminds Chinese policy makers of the risks that China faces – they will have little choice but to employ punishingly restrictive measures to curb even small outbreaks of infections – even at the cost of disrupting supply chains and damaging economic activity. ▪ **The employment situation is another downside risk that shapes policy**: The National Development and Reform Commission reported that increasing employment for university graduates will be a priority this year. Youth unemployment remains high – of those aged 16 to 24, 14.3% were unemployed as of December while for those aged 20 to 24, the rate has remained higher than 20%. It looks like despondent young job seekers are giving up on the labour market. A survey by a Chinese employment service platform revealed that only 56.9% of the class of 2021 chose to take a full-time job after graduating from universities, compared with 75.8% in 2020. Many are taking up free-lance work or choosing not to work so that they can prepare for the highly competitive civil service examinations. With 10.76 million graduating from local universities this year, 1.67 million more than last year, the need to prevent the young from becoming disaffected in a politically sensitive year is growing. **Assessment: Innovative policies to stimulate growth** <u>Watch out for new policy tools</u> Both the People's Bank of China (PBOC) and the National Development & Reform Commission (NDRC) have recently issued reports hinting at innovative policy approaches. ▪ It is clear from these reports that Chinese leaders appreciate the growing threat to the economy. But it is equally clear that they remain determined not to fall into the trap that caught their predecessors, of rushing into massive stimulus programmes which created severe imbalances such as the travails in real estate and high debt that they are cleaning up now. Hence the need for new tools that have potency but which do not create imbalances. ▪ The NDRC released a policy document that signalled policies to cultivate "new types of consumption" to create jobs.

Variable	Development/Assessment
	▪ On its part, the PBOC ruled out aggressive monetary easing and rebuffed advice that support measures would fail without substantial measures to boost the property sector. But its latest Monetary Policy Review acknowledged the triple pressures on the economy (demand contraction, supply shock, and weakening expectations) and the pressing need to stabilize growth in the run-up to the 20th Party Congress. This was a clear indication that more priority will placed on protecting economic growth. The report went on to promise that the PBOC would "open monetary the policy toolbox wider", while emphasising the implementation of newly stablished lending facilities that have been introduced in the past year. One area of expansion is likely to be "inclusive financing support facilities". It is estimated that the CNY374bn of inclusive loan credit support provided to commercial banks encouraged them to extend CNY1.05tr worth of inclusive loans. Thus, an expansion of this facility could drive credit growth quite powerfully. ▪ The PBOC's monetary policy report also repeated the political leadership's frequent exhortations to "better meeting the reasonable housing needs" of the people. This hints at another tool of stimulus – higher public spending to support the government's new urbanisation approach which includes a massive effort to clear urban slums and create new urban agglomerations. <u>The net effect – better than expected economic growth</u> ▪ China's growth trajectory this year lies hinges on two opposing forces: the deep-seated, lingering headwinds to the economy on one hand, and cyclical policy easing on the other. We had previously laid out our base-case scenario: the economy will struggle despite moderate policy easing measures given that a) private consumption is depressed and unlikely to revive without a concerted lifting of COVID-19 restrictions and/or direct income transfers to households as stimulus; b) infrastructure spending will not offset negative spillovers arising from the continued downward pressure on real estate; c) another round of tax and fee cuts does little to lift manufacturing investment given weak domestic demand. ▪ The policy signals above, however, have led us to turn incrementally more positive on Chinese growth this year. While we continue to believe that consumption will remain very weak, the combination of new financing tools mentioned above, infrastructure spending, tax and fee cuts, and rising global demand for capital goods could catalyse a moderate acceleration in manufacturing investment. Stealth easing of property-related policies, as outlined above plus ramping up

<table>
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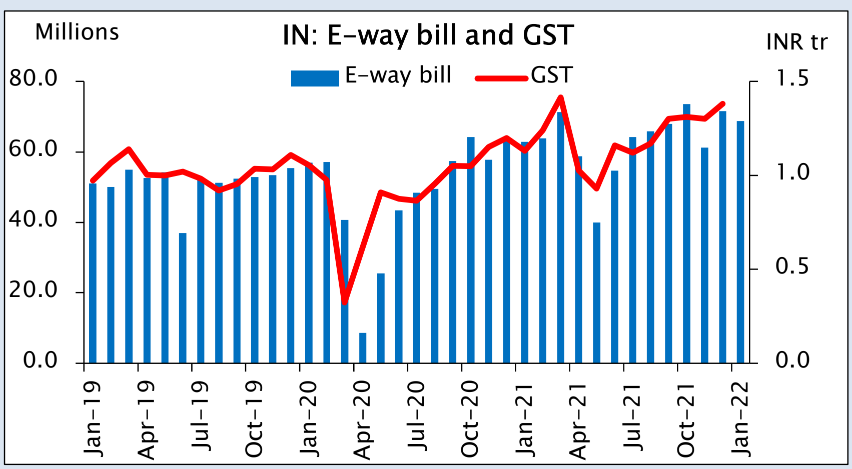
<tr><td></td><td>construction of social housing in line with its "common prosperity" agenda can also be expected.
▪ The risk is that resorting to innovative but untested policy tools could produce unintended consequences or encounter unforeseen snags in implementation and how they are appreciated by economic agents. If that risk can be contained, a considerable boost to growth can be expected.</td></tr>
<tr><td>India: Talk of RBI falling behind the curve is overdone</td><td><u>The recovery is losing steam</u>
▪ Industrial production rose at the slowest pace in 10 months in December (+0.4%) (November: +1.3%). Manufacturing contracted (–0.1%), while electricity firmed up (+2.8%) and mining (+2.6%) eased to its weakest since March 2021. The deceleration was broad-based across primary (+2.8%), capital (–4.6%), intermediates (+0.3%), construction (+1.7%) and consumer non-durables (–0.6%). Only consumer durables quickened (–2.7%), albeit remaining in the red.
▪ Fuel consumption growth also slowed, declining 0.2% y/y in January, although that is up from –0.4% in December. Diesel consumption, which is a key barometer of economic activity, fell 6.4% y/y, flipping from a 1.6% expansion in December.
▪ Auto sales sank 18.8% y/y in January, compared to a 10.7% y/y decline in December. Whereas two-wheeler sales fell at a faster clip (–21.1%; December: –10.8%), passenger vehicle sales, a proxy for urban demand, improved for the 4th successive month with a 8.1% contraction (December: –13.3%).
▪ E-way bill generation (an indicator of business activity) has been pegged at 68.8 million for January 2022, which is down from 71.6 million in December 2021.


Source: CEIC
<u>Central bank defied calls for monetary tightening</u></td></tr>
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Variable	Development/Assessment
	▪ **Defying market expectations, the RBI kept rates unchanged** in its February monetary policy meeting. The benchmark repo and reverse repo rates were retained at 4% and 3.35%, respectively, alongside an "accommodative" policy stance, despite growing clamour for a hike to the latter to narrow the interest rate corridor. Aside from a soft patch in 1Q22 because of the Omicron variant, the RBI expects FY23 growth to moderate to 7.8%, from a projected 9.5% in FY22. Underpinning the RBI's dovish stance is its inflation forecast, which will ease to 4.5% in FY23, from 5.3% in FY22, with 4.9% in 2Q22, 5.0% in 3Q22, 4.0% in 4Q22 and 4.2% in 1Q23. The MPC reiterated the need to keep conditions accommodative to revive growth on a durable basis, citing weak private consumption. **Assessment: No, the RBI is not falling behind the curve, yet** ▪ **Momentum eased in January amid Omicron-induced soft patch**: The slowdown in January, evinced by the sluggish fuel consumption and auto sales, can be ascribed to two factors – a soft patch induced by the new variant as mobility restrictions were re-introduced, albeit to a limited extent vis-à-vis previous lockdowns, as well as elevated oil prices that probably curtailed demand. As such, industrial production is likely to take a hit in January, but the effect will be modest, given that caseloads have already peaked and are now on a descent. The same can be said for 1Q22's GDP print, as we think Omicron's impact will be capped at 0.5 percentage points of GDP growth. ▪ **One has to go beyond inflation to predict the trajectory for rates**: The RBI's decision to stand pat is aligned with our baseline scenario, where we assigned a 70% probability for rates to be unchanged in February. For starters, the central bank remains dovish, given that 4 out of the 6 MPC members hail from the government, suggesting that the RBI will want to go slow on normalisation. ▪ Second, the pass-through from higher oil prices has been muted because of political considerations ahead of the imminent Uttar Pradesh state elections as state producers kept retail prices unchanged, which amounts to an implicit subsidy. Third, all indications suggest the growth momentum is easing a tad post-Diwali as the cyclical bounce peters out. This chimes with the RBI's growth forecast (7.8%), which is more pessimistic than the government's estimate in Budget 2023 (8%-8.5%). Last and most importantly, the labour force participation rate (January: 39.9%) remains below pre-pandemic levels (February 2020: 42.6%), which tempers with wage and price pressures even as growth normalises. ▪ Moving forward, we expect the RBI to commence the normalisation of monetary policy from April, with a 15-20 bps hike to the reverse repo

Variable	Development/Assessment
	rate, alongside a pivot toward a "neutral" stance. By then, the economy should be in better position, and there will also be more clarity on the borrowing plans by the government, which appeared to have been factored into the RBI's calculation amid soaring yields. A hike to the benchmark repo rate will only follow in 2H22, once the interest rate corridor is narrowed to 25bps, compared to 65bps at present. ▪ **But, the measured pace in policy normalisation is not without its risks.** <u>Supply-side factors that influence inflation are largely out of the RBI's hands, such as food and oil prices.</u> The monsoon season and the distribution of rainfall will have a huge bearing on crop output, food prices and farm incomes. A dry season will most certainly push prices up as shortages becomes salient. On the latter, the benchmark Brent crude has flirted with USD95 per barrel amid surging geopolitical tensions and expectations of limited spare capacity. By March, when the election fever abates, the impact of higher oil prices on the CPI print should become apparent, particularly if the standoff between Russia and Ukraine takes a turn for the worse.
Indonesia: BI appears keen to test markets	<u>Omicron an immaterial threat to growth in the near-term</u> ▪ **The government is tightening mobility restrictions in 4 regions** – the greater Jakarta, Bandung, Yogyakarta and Bali. The tougher curbs reduce the hours of operation for an array of commercial venues and imposes capacity limits for public transportation (75%), restaurants (60%), places of worship (50%) and bars and nightclubs (35%). Malls can only operate till 9pm at 50% capacity while offices can only operate at full capacity if 75% of the personnel are fully vaccinated. ▪ **The economy grew 5.0% y/y in 4Q21,** rebounding from last quarter's soft patch (+3.5%) when Covid-19 caseloads were on the up-and-up. Household spending gained 3.6% y/y (3Q21: +1.0%), with food and beverage ex-restaurants (+3.2%), health (+3.0%), transportation (+5.3%) and durables (+3.1%) being bright spots. Clothing (+1.2%), restaurants (+2.8%) and miscellaneous items (+2.8%) were stronger but remains sluggish. Government spending clocked a robust 5.2% y/y growth, as did exports (+29.8%) and imports (+29.6%). Last, GFCF rose 4.5% y/y (3Q21: +3.4%), with equipment (+13.5%) leading the charge whereas residential (+2.5%) and vehicle investments (+3.6%) lost steam. On a seasonally adjusted basis, the economy expanded briskly (+3.0% q/q), reversing 3Q21's decline (-1.1%). For 2021 as a whole, the economy grew 3.7% y/y, led by GCE (+4.2%) and GFCF (+3.8%) while PCE rose 2.0% and is still around 0.7% below pre-pandemic levels. ▪ **Consumer confidence stabilised in January (119.6),** having added 1.3 points following a 0.2 point drop in December. The present sentiment

Variable	Development/Assessment
	index gained 1 point, coming in at 100.9 points in January while the future expectations index gained a larger 1.5 points, ending at 138.3 points in the same period. Policy outlook: BI appears keen to test the waters by deferring tightening ▪ **Bank Indonesia held the benchmark rate at 3.5%**, which was in line with the market consensus. The global recovery remains firm, despite the recent flare up in caseloads that appears to be subsiding. Growth projections for Indonesia were unchanged (4.7%-5.5%) amid rising infections and deaths. BI also retained its forecast for the current account deficit, at 1.1%-1.9%, adding that strong FDI inflows will shore up the external accounts. On inflation, BI reiterated its belief that price pressures will remain contained within the 2%-4% target corridor in 2022. Governor Perry's latest policy guidance suggests BI will only prepare for policy tightening in 3Q22 once price pressures firm up substantially, despite recent murmurs of an aggressive rate tightening cycle by the Fed. ▪ **Lawmakers are preparing to revise the law** as a workaround for the legal hurdles standing in the way of the cherished Omnibus bill labour reforms. Reports suggest the proposed revision will empower the central government to override, or at least influence regulations emanating from local and regional governments, a move that failed to bear fruit in the past over concerns that it runs into the principle of regional autonomy. Coordinating economics minister Airlangga expects the legal revision to be done prior to the G20 summit in November. ▪ **The second tax amnesty has raked in IDR1.2tr in the first week of February**, with the participation of more than 11,000 errant taxpayers and declarations of IDR11.5tr in the program. The amnesty will last till June, and though the ytd collection appears meagre vis-à-vis the first amnesty totalling IDR135tr in revenues from declarations of IDR4.8qd, the authorities are eyeing a better tax effort this year by leveraging on the Automatic Exchange of Information (AEOI) which it signed up to in 2018. An extradition treaty with Singapore, which emerged out of the leaders' retreat and has to be ratified in parliament, is icing for the cake if it adds to the credibility and efficiency of tax administration in Indonesia. Assessment: Can BI surprise markets by holding rates steady till 3Q22? ▪ **Growth set to remain robust this year, despite Omicron headwinds**: The 4Q21 GDP print is in line with our expectations, and the resilience of mobility trends suggests economic agents are not overly concerned by the Omicron variant, which is already flaming out in India and the

Variable	Development/Assessment
	Philippines, which shares a similar demographic and epidemiological profile with Indonesia insofar as Covid-19 is concerned. Growth is likely to take a modest hit in 1Q22 as restrictions are tightened to slow the spread of Covid-19. ▪ Nevertheless, there remains room for PCE and GFCF to play catch-up in 2022, after previous restrictions dampened the recovery, with government spending being the only game in town. Our forecast for 2022, which is unchanged at +5.5%, hinges on an enduring revival in consumer and business confidence. The reopening of borders in 2H22 for the G20 summit – the MotoGP competition in March is unlikely to move the needle on tourism, given the current flare-up in cases – and quickening momentum behind the infra agenda alongside the move up the value-chain in smelters and refining capacity will add to the growth impetus further. More headway on revising the law to undo the legal roadblocks standing in the way of the omnibus bill will also be a positive for the economy. ▪ **Can BI surprise markets by standing pat in 2Q22?** Despite indications pointing to an aggressive rate hiking cycle in the US, BI's policy guidance continues to chafe against market expectations which are pencilling at least 2 rate hikes, starting from 2Q22. Our view is for BI to hike rates ahead of the Fed to preserve rate differentials with the US and shore up the perpetually fragile Rupiah. ▪ Yet the latest policy guidance suggests, to us, that BI may prefer to stand pat in 2Q22, even as inflation is set to pick up materially, because of stirring oil prices which has breached past USD95 at the time of writing (although it is negated by the retail price cap), as well as the 1% VAT tax hike from April. BI could write off the latter as a one-off increase and argue that it will not set off a wage-price spiral, which may be true if the recovery remains fragile but that no longer appears to be the case following the upbeat 4Q21 GDP print. ▪ The most acute pressure point lies in 10y-yields, and the exodus of portfolio investors has not fed into a significant uptick in long-term yields. Foreign ownership of government securities stabilised at 19.0% in January, while yields have ticked up recently, but remains low by Indonesia's standards (see Chart below). In turn, this is probably giving BI the confidence to stand pat in the face of the Fed's aggressive tightening efforts, aided further by the front-loading of the RRR hikes as an offset against the FOMC's first hike in March.

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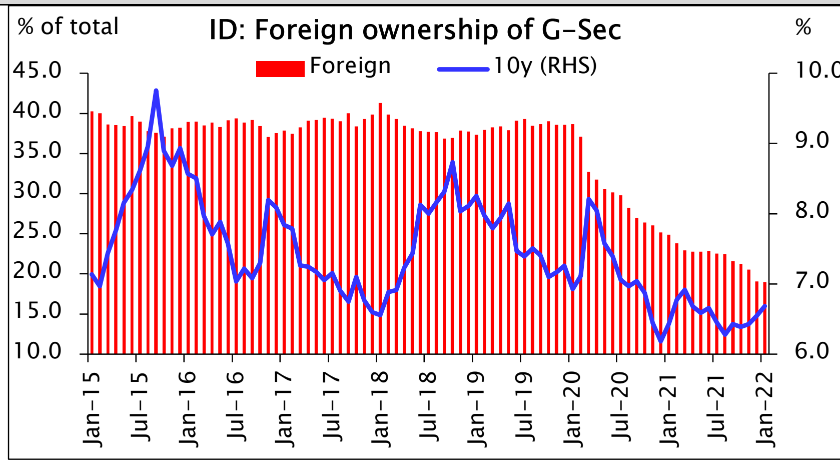

Source: CEIC

As such, we now re-calibrate our probabilities and the timing of BI's rate hikes. <u>We assign a 60% probability chance for a 25bps increase in the benchmark rate in the 21st July monetary policy meeting</u>, with the balance split between a hike in May or June. What could upend the probability distribution lies in 1) the inflation print, particularly if the rebound in domestic demand feed into runaway prices that exceed 4%, BI's upper limit of the target corridor in 1H22, and 2) a massive depreciation of the IDR if the Fed wrongfoots markets, say, with a 50bps rate hike.
A more benign fiscal outlook works in BI's favour: Assuming the authorities do not backtrack on the VAT tax hike this year, a fiscal deficit of 4%-4.2% (2021: 4.65%) appears imminently achievable, barring another negative shock to growth that necessitates fiscal pump priming. <u>In fact, a lower fiscal deficit would allow the government to take the economy off life support, and to temper with BI's primary debt purchases</u> which stand at IDR3.6tr as of 8 Feb 22 out of a projected IDR224tr.
In our view, portfolio investors have voted with their feet in part because BI's primary purchases have distorted price discovery. A trimmer fiscal deficit would be a step in the right direction in terms of taking the pressure off BI to step up debt purchases to keep yields under control. But it still remains to be seen as to how and whether BI can extricate itself from the business of financing public spending without roiling bond yields.

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<tr><td>Malaysia: recovery is intact with possible upside</td><td>

GDP growth rebounded 3.6% y/y in 4Q21, following a 4.5% contraction in 3Q21. This brought full-year GDP growth to 3.1%, which undershot our forecast of 3.5% and is a reversal from 2020 (-5.6%). Government spending decelerated (+4.3%), while household spending (+3.7%) rebounded and GFCF improved (-3.3%) following 3Q21's double-digits

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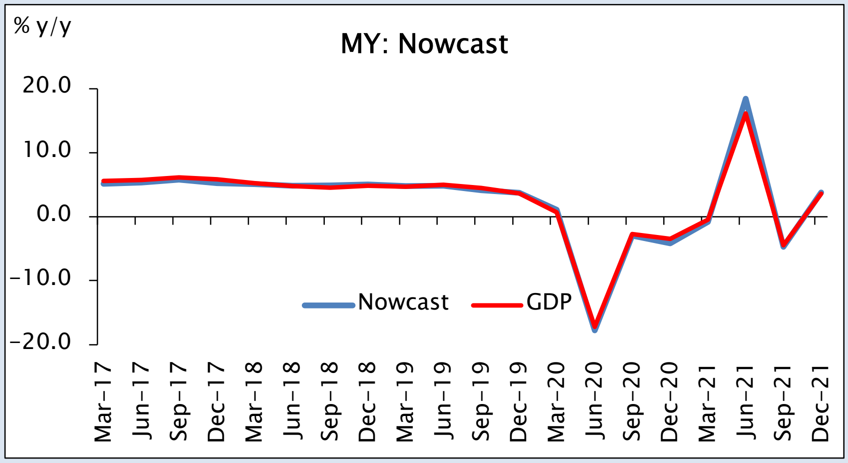
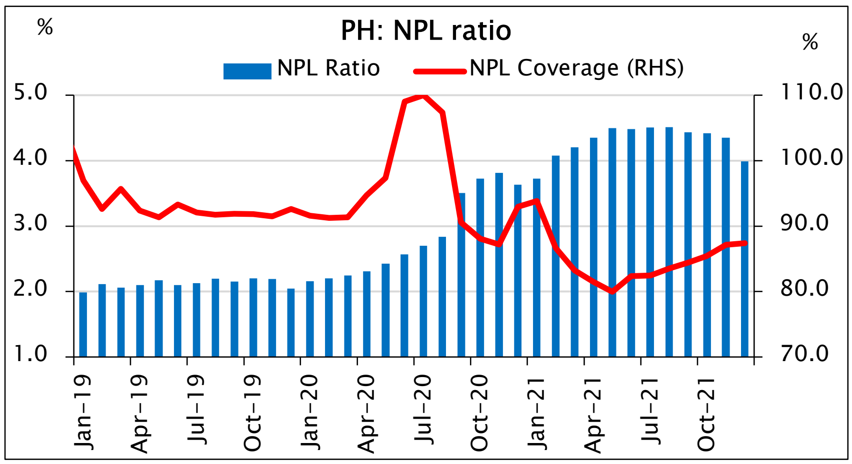
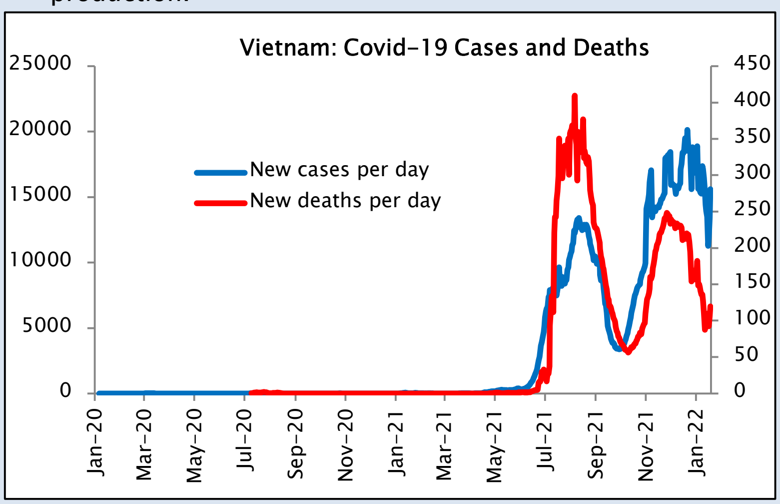
Variable	Development/Assessment
	contraction (-10.8%). Exports (+13.3%) and imports (+14.6%) firmed up from 3Q21 as well. Residential (-15.5%) and machinery investments (+16.4%) quickened, whereas other investments slowed (-3.1%). On a sequential basis, GDP clocked a swift rebound in 4Q21 (+6.6% q/q), following the 3.6% decrease in 3Q21.  Source: CEIC ▪ **The volume of services expanded 3.0% y/y**, reversing 3Q21's decline (-7.5%). The distributive sector grew a paltry 2.2% after last quarter's 12.1% decrease, marked by a weak showing across distributive trade (+1.4%) and food and beverages (+2.2%) whereas accommodation surged 46.6%, having plummeted in 2021. Business services and finance remains in the red, albeit marginally (-0.1%), as the improvement in finance (+1.4%), real estate (-13.4%) and miscellaneous services (-3.9%) failed to offset the deceleration in insurance (+11.2%). Information and communications (+8.0%), transport and storage (+12.2%) and other services (-0.4%) all perked up from 3Q21. ▪ **Industrial production moderated to +5.8% y/y in December,** from +9.4% in November. The deceleration was broad-based across manufacturing (+8.4%), electricity (+3.7%) and mining (-2.5%). Across sectors of manufacturing, electrical and electronic products was the only component that firmed up (+18.2%), while every other subsector eased - food and beverage (+10.3%), wood and paper products (+6.5%), non-metallic minerals and basic metals (+5.3%), transport equipment (+1.3%), textiles (+4.2%) and petroleum and chemicals (+2.1%). On a seasonally adjusted m/m basis, factory output slipped 0.7% in December (November: +3.0%), mimicking the manufacturing print (-0.9%; November: +2.9%) and ending a 4-month expansionary streak.

Variable	Development/Assessment
	▪ **Manufacturing sales softened slightly to +15.5% y/y in December**, from +18.8% in November. Electrical and electronic products (+18.4%) held up, while other subsectors eased to respectable levels – wood and furniture (+10.0%), hydrocarbons and rubber (+19.9%), transport equipment (+1.4%), basic metals and mineral products (+7.2%), textiles (+6.9%) and food and beverage (+19.0%). ▪ **Wholesale and retail trade gained 3.5% y/y in December**, down from +6.5% in November. Wholesale trade slowed (+4.1%), as did retail trade (+3.5%) and auto sales (+1.5%). ▪ **Construction work done fell 12.9% y/y in 4Q21**, up from -21.0% in 3Q21. Residential buildings (-18.2%), civil engineering (-20.3%), commercial buildings (-7.1%) and special trade activities (+22.5%) all firmed up. ▪ **The unemployment rate slipped further to 4.2% in December** – the lowest since the outbreak of the pandemic. The labour force participation rate rose to a multi-year high (69.0%), as more workers in their prime age found jobs. **Assessment: An upside surprise remains likely** ▪ The 4Q21 GDP print falls within expectations, thanks to the sprightly manufacturing and export-oriented sectors which provide a strong offset against domestic woes, particularly in the contact-intensive services and construction sector. With global demand set to remain strong while bottlenecks are easing, exports will remain supportive of growth, albeit to a more limited extent vis-à-vis what transpired in 2021. What will really move the needle on growth hinges on a stronger recovery in domestic demand and the services sector, which is still 4 percentage points below pre-pandemic level. For 2022, our above-consensus growth forecast (6%) hinges on the normalisation of domestic demand as private consumption assumes the mantle of driving growth from the trade sector.
The Philippines: Deterioration in asset quality remains modest	▪ **Industrial production decelerated to +18.6% y/y in December**, a 9-month low (November: +27.2%). Among the heavyweight items, food (+33.9%), textiles (+19.5%), electrical equipment (+58.1%), apparel (-8.5%) and leather products (+6.2%) firmed up, computer and electronic products (+11.1%) and transport equipment (-10.4%) moderated. Sequentially, factory output decreased 3.6% sa m/m, ending a 4-month sequence of growth. ▪ **The unemployment rate was up a smidgen in December (+6.6%)** from November's multi-year low of 6.5%. The labour force participation rate saw a material uptick (65.1%; November: 64.2%), alongside a decline in

Variable	Development/Assessment
	the underemployment rate (14.7%; November: 16.7%), as the rebound is in full swing. ▪ **The NPL ratio edged down to 4.0% in December** (November: 4.3%), which is the lowest since January 2021. Similarly, the NPL coverage ratio, which accounts for loss provisioning by banks, ticked up to 87.4%, from 87.1% in November. In absolute terms, NPLs peaked in August and is trending down, suggesting the falling NPL ratio is not fuelled purely by credit growth (i.e. a greater denominator). In another indication that the worst has passed, the BSP's rediscount facility, which serves as a backstop for the financial system, was left untouched by lenders, suggesting liquidity and monetary conditions remain easy.  Source: CEIC **Assessment: Easing prices gives BSP room to defer normalisation to 2H22** ▪ Inflationary pressures are set to ease, giving more wriggle room for the BSP to keep conditions accommodative of growth. The authorities have greenlighted more imports of fish (60,000 MT) to address an expected shortfall of around 119,000 MT in 1Q22, while the DoF is pressing for an extension of an executive order expanding pork imports, another key pressure point in food prices after local supplies were decimated by the African Swine Fever from 2019. Electricity tariff rates are set to come down 1.2% in February, according to Meralco, the utility firm. ▪ Conversely, rising oil prices, the prospect of a weakening Peso, and a tightening labour market represents key upside risks to the inflation outlook, although the authorities are likely to unveil relief measures in terms of implicit fuel subsidies if global oil prices were to remain above USD95 per barrel. For 2022, we expect inflation to average 3.8%, down from 4.5% the year before. As for the BSP, which is set to hold its first monetary policy meeting of the year on 17th February, <u>the central bank is unlikely to shake up the status quo.</u>

Variable	Development/Assessment
	▪ Our expectations is for the BSP to move only in 2H22 to rein in imbalances and keep inflation expectations well-anchored. Besides, the falling NPL ratio, which is short of the 6% the BSP predicted earlier, suggests the economy will be able to stomach the rate hikes without a corresponding deterioration in asset quality spurred by the higher cost of borrowing.
Vietnam: **A confluence of growth drivers**	After the drastic fall in economic activity in 3Q21 – when the country went into lockdown and GDP growth fell to -6.2% y/y – the economy has recovered. ▪ In 4Q21, GDP resumed growth at +5.2% y/y. By sector, agriculture, forestry, and fishery grew at +3.2% y/y in 4Q21, up from +1.0% in 3Q21; industry and construction grew +5.6%, up from -5.0%; services grew +5.4%, up from -9.3%. ▪ Industrial production recorded its third month of growth since the downturn at +2.4% y/y in Jan 22, down from +8.7% y/y in Dec 21. The manufacturing sector specifically grew +2.8% y/y in Jan 22, down from +10.9% in Dec 21. ▪ Retail sales notched its first month of growth in 5 months at +1.3% y/y YTD in Jan 22, up from -3.8% y/y YTD in Dec 21. However, only retail sales of goods recovered (+4.4%). Tourism (-35.7%) and accommodation & F&B (-12.0%) contracted further in Jan 22. ▪ Inflation remains stable at +1.9% y/y in Jan 22, up slightly from +1.8% y/y in Dec 21. Food prices were softer in Jan 22 while transport inflation remained strong on high oil prices. **Assessment: A confluence of forces will drive 6-8% GDP growth in 2022** ▪ **Vietnam's latest free trade agreements (FTAs) will drive strong growth in exports.** These FTAs include the Vietnam-EU Free Trade Agreement (EVFTA) that came into force Aug 20 and the Regional Comprehensive Economic Partnership (RCEP) that came into force Jan 22. The EVFTA demonstrates the efficacy of FTAs in driving export growth – Vietnam's exports to the EU rose by 14% y/y in the first 8 months of 2021. Agricultural exports in particular will benefit from the latest FTAs as it is traditionally dependent on the Chinese market, a fact that did not play out well for Vietnam during the pandemic when border closures frequently disrupted agricultural exports to China. ▪ **Foreign investment is also recovering, attracted by Vietnam's FTAs and its low costs:** Actual disbursements of foreign direct investment rose 6.8% y/y in January. ▪ **Government policies to move Vietnam up the value-chain will also drive growth in the manufacturing sector.** The overarching policy is the National High-Tech Development Program 2030, introduced in 2021. It aims to increase the share of high-tech products in manufactured

Variable	Development/Assessment
	exports to 60% and for there to be 500 manufacturing firms and 200 agricultural firms that use high-tech applications by 2030. How this will lead to growth in the manufacturing sector is the two channels of: (1) increasing the value-added of the manufacturing sector as more businesses upgrade their products (2) increasing the output of the manufacturing sector as new high-tech producers enter the industry. This growth trajectory is already taking shape – post-lockdown, investment boards in the Southern provinces have been stating that priority would be given to projects with advanced technology over labour-intensive ones. ▪ **The development of the digital economy is another growth driver**. It stands to raise growth in the e-commerce, fintech, ed-tech, logistics, and media sectors. There is huge room for growth – sectors related to the digital economy currently only contribute to 8.2% of GDP; the government plans to raise this to 30% by 2030 under the National Programme on Digital Transformation. Strong investor interest in Vietnam's digital economy sectors also demonstrate its strong growth potential. Investment in Vietnam's technology start-ups reached a record high of USD1.3bn in 2021, and the value of M&A transactions in the technology sector doubled in the first 10 months of 2021 as compared to the whole of 2020. According to the e-Conomy SEA 2021 report by Google, Temasek and Bain & Co., Vietnam's digital economy is projected to grow +29% by 2025 to reach a value of USD57bn. ▪ **The rebound in tourism, expected to start by April, is another positive.** In Jan 22, Vietnam began resuming commercial flights from 8 countries (China, Japan, South Korea, Thailand, Singapore, Laos, Cambodia and the US), with more countries slated to be added to the list. Most recently, the government pledged to "fully re-open" the country to tourism by no later than end-Apr 22, bringing forward the deadline from Jun 22. Tourism has been at a standstill since the start of the pandemic so its recovery – from an extremely low base – will contribute strongly in percentage-point terms to GDP growth in 2022. ▪ **Both fiscal and monetary policy remain accommodative.** In Jan 22, a VND350tr (USD15.4bn) Socio-Economic Development and Recovery Program was announced that includes a VAT tax reduction from 10% to 8%, reduced loan interest rates by at least 0.5-1% for 2 years, and VND170tr worth of spending on infrastructure spending. This will support growth in 2022 and reduce the risk of economic scarring. ▪ **Could pandemic-related risks curtail the recovery?** Overall, the threat of further disruptions to economic activity in Vietnam has diminished – but it has not disappeared entirely. The rapid roll-out of vaccinations has boosted the share of Vietnam's population fully vaccinated against

Variable	Development/Assessment
	Covid-19 to 73% today. So, although caseloads have exceeded that of the lockdown period, the ratio of new deaths to new cases has fallen. The government also plans to inoculate all people aged 18 and above with their third shot by 1Q22. This will allow Vietnam to take full advantage of its growth drivers to achieve a projected GDP growth rate of 6-8% in 2022. ▪ However, it will take a while before supply-side dislocations are entirely removed as constraints on growth. In the latest purchasing manager survey, respondents noted that problems with shipping and other disruptions caused by the pandemic had caused suppliers' delivery times to lengthen. Vendor performance deteriorated markedly though at a pace that was less pronounced than at the peak of such dislocations in September last year. In addition, migrant workers were returning only slowly to industrial zones from their Lunar New Year breaks - Vietnamese media reported that electronics and garment factories were only able to get back 70-80% of workers which slowed production.  Source: Our World in Data

India: Looking Beyond Budget FY23

Now that the dust has settled on Budget 2022-23, it is timely to take stock of the longer term implications of the budget statement. We outline 5 macro implications from Budget FY23. The increase in capital spending touted by the government is less flattering after accounting for one-offs and spending by SOEs. In turn, the bond market is poised for indigestion, given the deluge of borrowings. It is also far from clear that the massive capital spending can actually crowd in private investments, as postulated by the finance minister. Furthermore, the dearth of details on a credible fiscal consolidation plan fans the risk of fiscal dominance. As for the reform agenda, it appears the impetus for change has hit a wall ahead of looming state elections. Details of the budget are outlined below in Table 1.

Table 1: Draft Budget 2022/23 (INR trillions)

	2019-20 Actuals	2020-21 Actuals	2021-22 Revised Budget	2022-23 Draft Budget	(+/-) % y/y*
Revenue receipts (1)	16.84	16.34	20.79	22.04	+6.0
(of which)					
Net Tax revenue (2)	13.57	14.26	17.65	19.35	+9.6
Non-Tax revenue	3.27	2.08	3.14	2.70	-14.1
Total Expenditure (3)	26.86	35.10	37.70	39.45	+4.6
(of which)					
Revenue Expenditure	23.51	30.84	31.67	31.95	+0.9
Capital Expenditure (4)	3.36	4.26	6.03	7.50	+24.5
Interest Payment (5)	6.12	6.80	8.14	9.41	+15.6
Subsidy Disbursement (6)	2.28	7.08	4.33	3.18	-26.6
Govt Contribution to National Savings	-12.69	-22.44	-21.94	-24.11	+9.9
Budget Surplus(+)/Deficit(-)	(-)9.33	(-)18.18	(-)15.91	(-)16.61	*
as % of GDP	4.6%	9.2%	6.9%	6.4%	-
Assumptions					
Nominal GDP Growth	6.2%	-1.4%	17.2%	11.1%	
Real GDP Growth	3.7%	-6.6%	9.2%	8%-8.5%	
Inflation	4.8%	5.5%	6.0%	2.9%	
Tax-to-GDP ratio	9.9%	10.3%	10.9%	10.6%	

Source: Government of India, Centennial Asia Advisors. Note that calculations may not add up due to rounding.
*Year-on-year % change applies only to 2021-22 Revised Budget and 2022-2023 Draft Budget.
**FY23 Growth projections were taken from the Economic Survey. Nominal GDP growth is pegged at 11.1%.

First, the capex push is less flattering than what the headline figures suggest

There was much ado over what the Modi government argued to be a gargantuan effort via a capex push to crowd in private investments and spark a virtuous growth cycle, instead of relying on additional relief measures to keep the economy afloat. Our calculations suggest the capex push is more modest-than-envisaged, although it is still supportive of growth.

- According to the budget, central government capex spending is set to rise 24.5% y/y in FY23, following a 41.4% increase in FY22 under the revised estimates. However, the capex figure is distorted by the one-off injections (~INR520bn) to settle the liabilities of Air India, the national carrier that was privatised and offloaded to Tata. Netting off the Air India injections, and central government capex would increase 36.2% y/y, which would be the quickest in more than a decade (Chart 1).

- Besides central government capex, another key source of capital spending lies with SOEs, otherwise known as Public Sector Undertakings (PSUs). This segment of capex is set to decline 6.6% y/y, reversing a 5.2% increase from the revised estimates for FY22. Bringing the two together, and the combined government capex is poised to increase 15.8% y/y in FY23, down a tad from +16.7% in FY22RE.

- There is also an effort by the Modi government to augment capital spending through state governments by hiking the capital component of state grants to INR3.2tr in FY23, from INR2.4tr in FY22RE. This is on top of a long-term interest free loan to state governments worth INR1tr to bolster capex spending.

- As a share of GDP, total capex spending by the central government will edge up slightly to an estimated 4.7% in FY23, from 4.5% in FY22RE. Putting it all together, the capex push is a positive for growth, but one should not get carried away. As Chart 2 goes to show, the increase in capex spending by the central government masks the steadily decreasing share of off-budget capex devolution to SOEs. Suffice to say, the headline capex figures in FY23 were puffed up, which concealed the decrease in off-budget spending by SOEs.

Chart 1

Flattering capex push...

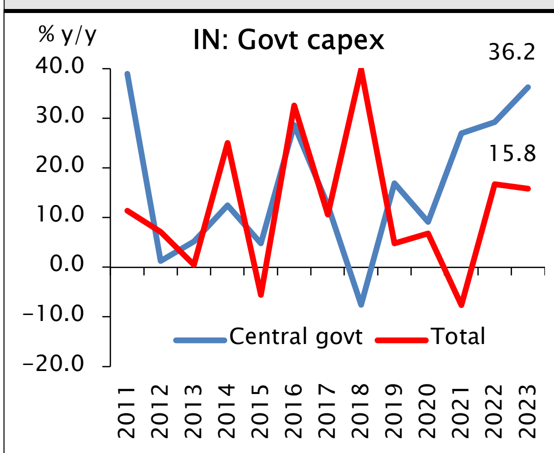
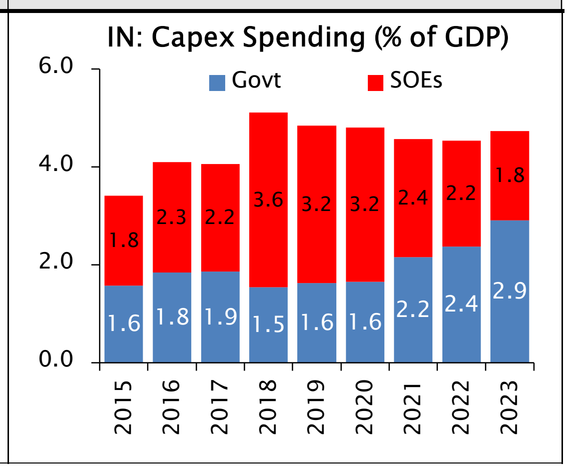


Chart 2

...masks the compositional shift in spending



Source: CEIC. 2022 figures refer to revised estimates, 2023 figures refer to budget estimates.

Second, a reckoning looms for bond markets

The government's fiscal deficit projections wrong-footed markets and sparked a sell-off in the bond market. At a time when financial conditions are tightening, the deluge of borrowings will test the ability of the RBI to manage an orderly evolution of bond yields, as governor Das alluded to repeatedly in media interviews and press releases.

Chart 3

Net borrowings have been sticky…

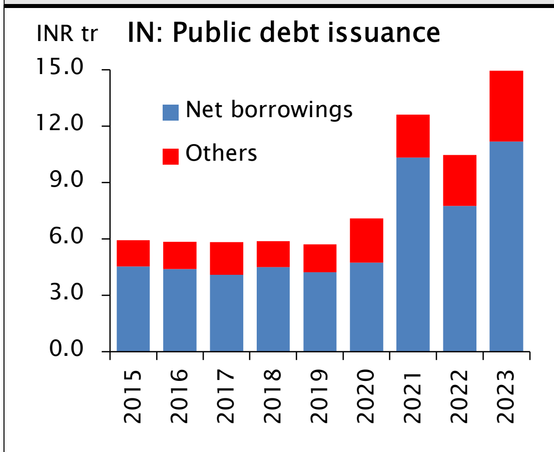
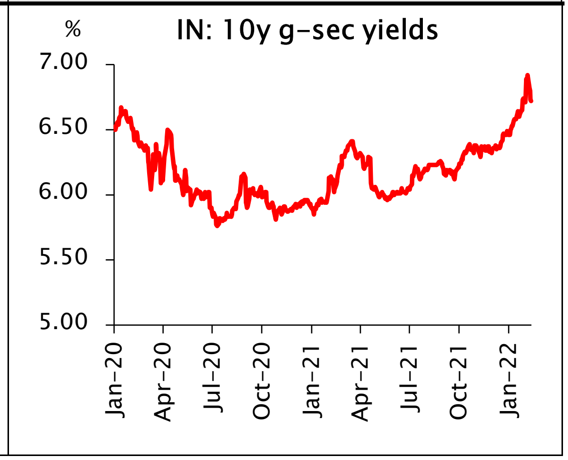


Chart 4

…pushing yields upwards



Source: CEIC. 2022 figures refer to revised estimates, 2023 figures refer to budget estimates.

- The fiscal deficit is programmed to ease to a still-elevated 6.4% in FY23, from the upwardly-revised 6.9% in FY22 under the revised estimates. Whereas market participants were expecting a fiscal deficit of around 6%, we were projecting a deficit of 6.3%-6.5%, in part because of our belief that the government wants to mount a sizeable push for growth post-pandemic, with perverse implications for the conduct of monetary policy, as we elaborate next. The conservative nominal GDP growth estimate also fed into the arithmetic behind the tabulation of the fiscal deficit.

- Gross borrowings are pegged at a record INR14.95tr in FY23 (FY22RE: INR10.47tr). Accounting for repayments and net borrowings would still come in at an elevated INR11.19tr, which is down from INR7.76tr in FY22RE (Chart 3). Note that this estimate already incorporates the INR1.2tr of bond switch by the government with the RBI in end-January, which includes INR636bn for bonds maturing in FY23. This estimate is STILL subject to downside risk, given the conservative budgeting in small savings (INR4.25tr; FY22RE: INR5.9tr) and cash drawdown (INR7.51bn; FY22RE: INR1.74tr).

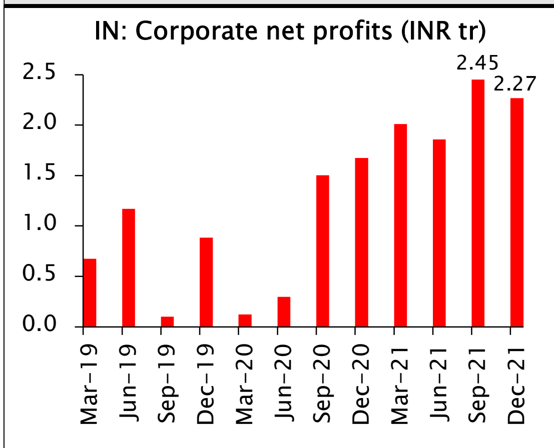
- Our view is that yields will easily cross 7%, particularly if there is a nasty inflation surprise in the offing, either because of surging oil prices or a sub-par monsoon season. Despite the latest bond switch, the bond market is slated for indigestion, in light of the sharp increase in net borrowings, which is a touch below the record-high from FY21 (INR11.5tr) when the economy was ravaged by the pandemic. The benchmark 10y yield flirted with crossing the 7%-resistance level on 4th February (Chart 4), before easing a tad and coming down further after the RBI's inaction, citing its benign inflation projection.

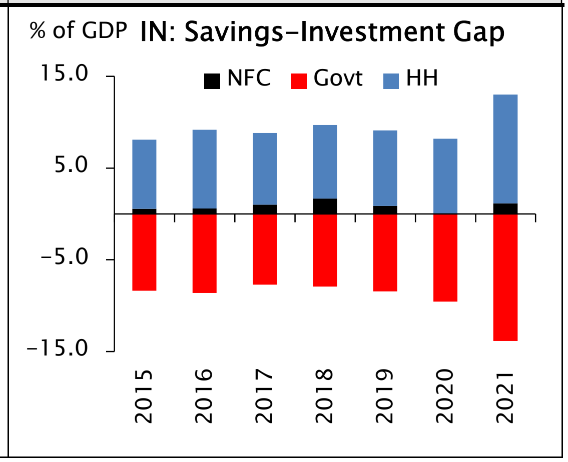
- A dearth of initiatives to support India's inclusion in bond indices, which would have sparked inflows of around USD30bn by various estimates, removes another layer of support for government bonds, while tightening global financial conditions will seriously test the RBI's ability to manage bond market angst amid narrowing yield differentials with the US.

Third, the fiscal profligacy may actually *crowd out* private investments

Finance Minister Sitharaman's argument for raising capex spending was to crowd in private investments as legacy issues pertaining to banking sector stress are resolved and India's cost competitiveness vis-à-vis China becomes apparent. At a time of rising interest rates, the deluge of borrowings by the government may actually crowd out private investments at the margins by pushing up borrowing costs further.

Chart 5	Chart 6
There remains ample dry powder	Widening current account deficit





Source: CEIC. NFC = Non-Financial Corporates.

- For starters, there remains ample dry powder. Preliminary estimates suggest net corporate profits edged down to INR2.27tr in 4Q21, from last quarter's record-high (INR2.45tr), although a quarter of listed companies have yet to release their financial statements, which should lift the final figure (Chart 7). Net sales climbed to INR23.3tr, which is offset by a slight increase in total expenses (INR21.74tr). The net profit margin edged down to a still-elevated 9.4%, from 10.1% in 3Q21. In short, funding is not an issue for the corporate sector.

- The pandemic and the ensuing lockdowns curtailed import demand, culminating in current account surpluses for the Indian economy in calendar year 2020, which is a rare sight, to say the least. From a savings-investment standpoint, household savings rose to 22.2% in FY21, which offset government dissaving (-6.8%) and falling savings rate by corporates (10.1%) (Chart 8). Factoring in investments by households and private corporates (public corporate investments are assumed to fall under the government's purview, and is therefore subsumed within government investments), and the savings-investment balance falls into a marginal deficit in FY21.

- With the household savings rate set to normalise to pre-pandemic levels, the government's expansive spending plans has the potential to crowd out private investments, particularly if the corporate capex cycle turns up in 2H22. In this scenario, the transmission mechanism is via yields, as the economy has to rely on foreign financing to plug the savings-investment gap. With global interest rates on the ascendancy, higher yields translate into a heftier cost of borrowing, dampening the highly-anticipated revival of investments.

Fourth, the shadow of fiscal dominance looms large

The elevated fiscal deficit is fanning the risk of fiscal dominance, where the conduct of monetary policy is subordinated to government spending. Put in another way, the central bank's reaction function is compromised as keeping borrowing costs low trumps the inflation-fighting mandate. This is also complicated by the sizeable OMOs by the RBI, accompanied by recent evolutions in the conduct of monetary policy, specifically that of QE to keep long-term borrowing costs low.

Chart 7

Debt burden continues on its upward march

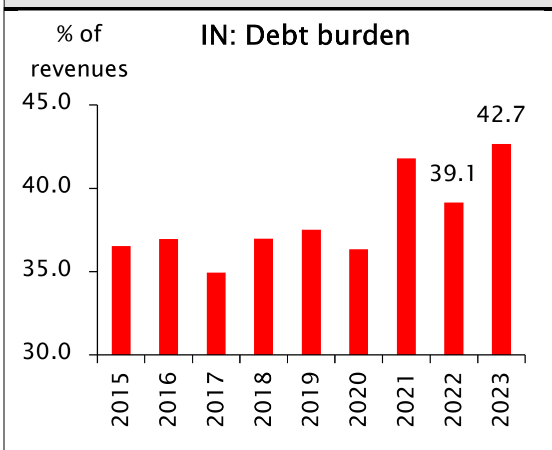
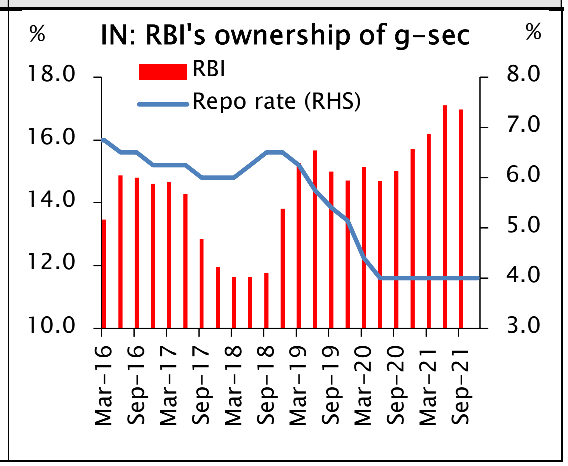


Chart 8

Ballooning balance-sheet from OMO and QE



Source: CEIC. 2022 figures refer to revised estimates, 2023 figures refer to budget estimates.

- It does not help that there was no clarity on a credible medium-term fiscal consolidation plan, in a departure from the past, as the authorities cited the need for "fiscal flexibility" till the pandemic and its ill-effects flame out. In the Economic Survey, the authorities are eyeing a fiscal deficit of 4.5% of GDP by FY26, which is exceedingly ambitious, given the dearth of further tax reforms. Bear in mind that the next Lok Sabha elections are due in first half of 2024, so any significant fiscal adjustments will only take place afterwards.

- In Budget FY23, the debt burden, or interest payments as a share of revenues, are set to rebound to 42.7% (FY22RE: 39.1%) (Chart 7) – the last time the debt burden was higher was back in FY04. Interest payments are a function of two factors: yields, or the cost of borrowing, and the quantum of debt. With interest payments taking up more than four-tenths of total revenues, it is easy to see how this complicates the nominally independent RBI's monetary policy decisions, given its dual mandate on price and financial stability.

- The RBI's balance sheet has ballooned from open market operations as well as the QE program which has since been discontinued late last year as a first step toward normalisation. According to the latest data, the central bank's ownership of government securities has swelled to 17% as of Sep 21 (Chart 8). Against the backdrop of a hawkish Fed and the deluge of bond issuance by the government, it is unclear how the RBI can tread the delicate path and strike a balance between keeping yields under control, while normalising monetary policy.

- The RBI is now in a pickle. In the latest MPC meeting, the RBI's decision to stand pat caught market participants by surprise, feeding into murmurs that the central bank chose not to raise rates to nudge yields down. To date in FY22, the RBI has purchased around INR2.1tr in government bonds via OMOs, but that trend changed starting from 4Q21 as the RBI sought to drain excess liquidity in the economy. More OMOs may be inevitable to relieve the bond market indigestion. Meanwhile, calls for the RBI to raise the benchmark rate will only grow with many labelling the recent pause as evidence that the central bank is falling behind the curve.

Last, the reform impetus has hit a wall

As a signal of the government's intent, the Budget has achieved the bare minimum of turbocharging growth with the capex push. For all that was said and done, it is the omissions from the Budget that are unsettling.

- **The reform impetus has clearly hit a wall**, with no mention of the once-vaunted farm reforms after the year-long protest from farmers in a sign of rare and wilful resistance. Tellingly, the Economic Survey omitted the farm reforms from its own list of supply side reforms at the end of Chapter 1. Our view is that the reform impetus has given way to the electoral cycle with the imminent Uttar Pradesh elections, followed by the Gujarat elections at the end of the year. As the incumbent at both the federal and state level, the opposition is ready to pounce on any signs of weakness by the BJP. Barring further structural reforms, it is hard to see how the economy can achieve growth upwards of 8% once the post-pandemic bounce peters out.

- **The absence of measures to pave the way for India's inclusion in bond indices** represents a missed opportunity of sorts. Specifically, there was no mention of changes to capital gains tax for India bonds that are pertinent for its inclusion in bond indices. The matter is unlikely to be taken up in the Budget session of Parliament after the Finance Bill is already tabled in the legislature. Another corollary of the hefty deficits, at a time when the global financial conditions are tightening, is that yields will easily breach the 7%-mark, given the deluge of borrowings which is just a touch lower than the towering INR15tr (FY22: INR10.5tr). The onus now falls on the RBI to manage bond market angst and indigestion, as well as to ensure what it commonly terms the "orderly evolution" of yields and financial conditions as the recovery perks up and slack within the economy diminishes.

- **Related to the previous point is the dearth of further tax reforms**, as the authorities rely on better tax administration, by improving the ease of tax compliance and clamping down on tax evasion to rein in the fiscal deficit moving forward. These measures will certainly be positive for revenues, but they probably will not move the needle in terms of broadening the tax base following the blockbuster GST reform in July 2017.

- **There is clearly a whiff of populism in the air**, as the Modi government drags its feet on food and fertiliser subsidy rationalisation, after having deregulated the retail fuel market. Now that fuel subsidies have been trimmed to a fraction of what it used to be, any further cuts to the subsidy bill will have to come from either spending on food or subsidy procurement. Whether the authorities can muster the political will to do so remains to be seen, given that food subsidies are linked to the procurement of rice and wheat by FCI at MSP prices, while fertiliser subsidies are dependent on global prices of the aforementioned inputs.

- **The momentum behind privatisation has lagged the rhetoric** dating to the previous budget, when finance minister Sitharaman unveiled plans to privatise 2 of 12 state-owned lenders to shake up the economy and reduce the presence of the state to a "bare minimum". A year later, the finance ministry has yet to make any headway on the privatisation effort, having failed to even identify the bank to be offloaded to the private sector. All mention of privatisation has been reduced to a whisper in Budget FY23, and this is also apparent in the disinvestment receipts, which has been slashed to INR780bn in FY22 (previously INR1.75tr) and INR650bn in FY23. The government bailout of Vodafone Idea with gross debts of INR1.95tr adds to the confusion over the role of the state as rhetoric has gotten far ahead of what is transpiring on the ground.

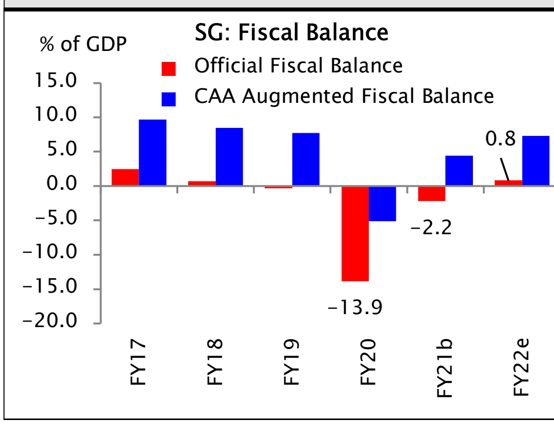
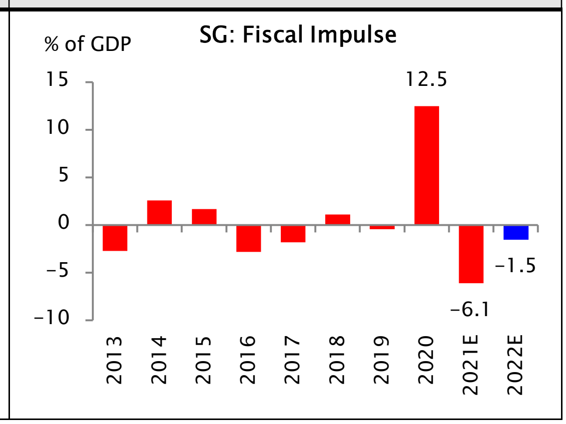
Singapore Budget 2022: Pivoting from crisis management to tackling secular challenges

Budget 2022 will be delivered by Finance Minister Lawrence Wong on 18th February. The budget is set against a robust macroeconomic backdrop: we expect GDP growth to reach 5.4% this year powered by exports and strengthening private domestic demand – considerably above the economy's potential growth rate of 2.7%, leading the output gap to turn positive in the second half of 2022.

- Historically, fiscal policy has acted countercyclically to the output gap; we expect a small official budget surplus (0.8% of GDP) this year which will impart a negative fiscal impulse to the economy.

- The Goods and Services Tax will be hiked by 2 percentage points, as the government bolsters its ability to meet structurally rising expenditures.

- Finally, the budget will pivot away from crisis management e.g. keeping firms afloat to refocus on preparing the economy and workforce for secular challenges, such as labour market dislocation arising from technological change.

Chart 1	Chart 2
	

Source: Budget 2021 documents, Centennial Asia Advisors

1. Enhanced revenue-raising measures to meet structurally rising expenditures

Despite stronger-than-expected operating revenues – derived from the robust performance of the economy over the past 12-14 months – that will feed through to a significantly smaller-than-expected FY21 deficit (SGD4.5bn or 0.9% of GDP vs. a budgeted 2.2% of GDP), revenue-raising measures are expected to be beefed up to meet structurally rising expenditures from demographic-related and climate change pressures.

The Finance Minister said recently that the planned 2 percentage point Goods and Services Tax hike will take place "more likely sooner than later" in the targeted 2022-25 timeframe. **The GST hike will take place this year,** in our view, as fiscal consolidation – a stated goal of the government after a cumulative fiscal deficit of SGD59bn in FY20-21 – can begin earlier, while a 2023 hike could be viewed by the political leadership as too close to the next General Election due in 2025.

- The GST hike will meaningfully add to the inflationary risks that are building in the economy. The extent of pass-through of GST hikes to output prices will be relatively high in the current environment of strong demand and good pricing power, while a GST tax hike would also allow firms to raise prices opportunistically. Although the hard economic data may not show it yet, non-tradeable goods and services prices seem to be rising faster – food and beverage operators raised prices after the Chinese New Year holiday while providers of services such as barbers have also put up their charges. Since there was little consumer resistance, businesses might feel encouraged to use the excuse of a higher GST rate to improve their profit margins.

- Our sense is that there is already some concern on the ground over inflation. The government has hinted that an upsized Assurance Package would be introduced to mitigate the resulting cost of living increases for lower- and middle-income households. However, this might actually feed into inflation risks: businesses would know that consumers with spending power boosted by government support would be more willing to accept price rises. There is, therefore, a material risk that inflation expectations will rise markedly after the GST hike and that could feed through to a greater risk of higher inflation as wage contracts are renegotiated over time.

We also expect a small property-related wealth tax. The Finance Minister has said that any wealth tax should ideally minimise its impact on Singapore's competitiveness and target immobile forms of wealth – a preference that favours property versus financial wealth. The tax could come in the form of a capital gains tax on the sale of private property assets, or larger stamp duties on the purchase of residential properties.

Carbon taxes will be meaningfully ramped up – albeit in a tiered manner to allow businesses time to adjust to them – and broadened to cover a wider base of producers.

Finally, the government may also review its existing set of tax incentives for MNCs following the OECD's landmark agreement in October 2021 to establish a global minimum corporate income tax (CIT) of 15%. This would meaningfully bolster Singapore's medium-term fiscal picture, in our view, given the hefty tax incentives and tax holidays it gives to foreign companies.

2. Fiscal policy will act countercyclically to the positive output gap

Targeted assistance for sectors still struggling with COVID-19 e.g. air transport, accommodation will continue, but stimulus will otherwise continue to be withdrawn, which, alongside enhanced revenue-raising measures, should lead to a slight official budget surplus of roughly SGD3-5bn (0.6-1% of GDP). However, as Singapore's budget accounting does not take account of important revenue elements, a fuller picture of the fiscal balance and therefore of the net effect of the budget on the economy can only be gleaned through making adjustments to the official budget. Our augmented CAA fiscal balance corrects for this by incorporating a) revenue from land sales and, in lieu of the Net Investment Returns Contribution (NIRC), b) the estimated cash return from the government's Past Reserves. With these adjustments, we believe the fiscal surplus will be closer to 7% of GDP (Chart 1).

Our projections for the official budget balance would imply a negative fiscal impulse to the tune of 1.5% of GDP (Chart 2).

3. Refocusing on long-term development objectives in an incremental fashion

As the economy leaves the pandemic behind it, longer-term development challenges such as the aging population, climate change, the need to raise productivity among local enterprises and help workers cope with the threat of dislocation by technological change – will return to the fore, necessitating a policy response from the government.

- The previous budget boosted funding for long-standing schemes that help businesses defray the costs of adopting new technologies such as 5G and artificial intelligence and hiring digital-ready talent.

- To help local companies scale up, Budget 2021 also pencilled out a greater role for the government to provide capital to high-growth firms, SMEs and large local enterprises.

- Budget 2021 also presented several initiatives in support of the Singapore Green Plan 2030 which seeks to retrofit the city-state's infrastructure for "greener" growth, such as encouraging the usage of electric vehicles. On the funding side, the government had announced that it would begin to issue green bonds. The upcoming Budget should provide greater clarity on these plans.

We expect Budget 2021 to announce incremental tweaks and enhancements to policies along these major thrusts.

Disclosures

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