

OCBC Asia Outlook 2012

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At the cusp of 2012, the global economy looks set to decelerate further

The European sovereign debt crisis has snowballed through additional stresses on not only the peripheral economies like Greece, Ireland and Portugal, but the infection appears to have spread to the core economies like France, Belgium and even Germany. At the root of the problem is one of high sovereign indebtedness, complacency over growth and economic competitiveness, vulnerable banking systems, and political wrangling that has increasingly clouded and impeded policy decisions. Fiscal austerity coupled with a lack of growth competitiveness necessitates worsening debt ratios in the near-term before the medicine can take effect. Even recent coordinated major central bank moves to extend USD swap lines at cheaper funding costs are perceived as band-aids to the real problems. Market confidence remains cued to the resolve of Germany and ECB to do more. Hence the prognosis for global growth has to be tempered with a dose of reality, and we see things probably getting worse in H1 before it hopefully gets better in H2.

The US economy stabilized in late 2011, but could see a fiscal drag in 2012

Given the impasse facing the US super-committee which had the task of finding another US\$1.2 trillion deficit cuts in order to avoid automatic budgetary cuts from kicking in from 2013, the overall fiscal environment will likely remain less than conducive in 2012. Given that US presidential elections are due in November 2012, the probability of growing policy deadlock cannot be ruled out. Meanwhile, the labor market remains stagnant, and the wage income picture still challenging for American consumers. Throw in the potential contagion spillover from Europe, and while we are not calling for a double-dip recession for the US economy at this juncture, sub-par and anemic growth looks like the most likely outcome. This also implies that Fed policy accommodation, through very low interest rates, and even the possibility of QE3 after the conclusion of Operation Twist, could remain the linchpin supporting the US economy in the near-term.

Spillover contagion effects to slowing Asia

The charts below illustrate the extent of economic and financial interconnectivity that Asia-Pacific economies have with Europe and the US in terms of trade and foreign claims by nationality of reporting banks. IMF estimates that a global downturn could impact Asia-Pacific growth by 1.5-4% relative to baseline in the absence of policy responses if EU growth falls 3.5% below current baseline for 2 years leading to 1% slowdown in US during the same period. If anything, the previous 2009-2009 global financial crisis had highlighted the macro-financial vulnerabilities inherent in Emerging Markets (EM), including Asia. The potential for any shock transmission cannot be discounted at this juncture. Asia-Pacific excluding Japan received US\$32.1bn in equity and US\$20.3b bond inflows since the start of 2010. Any global risk aversion bout puts EM and Asian markets under considerable market pressure, as seen in the recent September period of deleveraging. This adverse feedback loop could have potentially systemic consequences that require prompt policy actions. In addition, the Chinese economy is also facing challenges of GDP growth and property

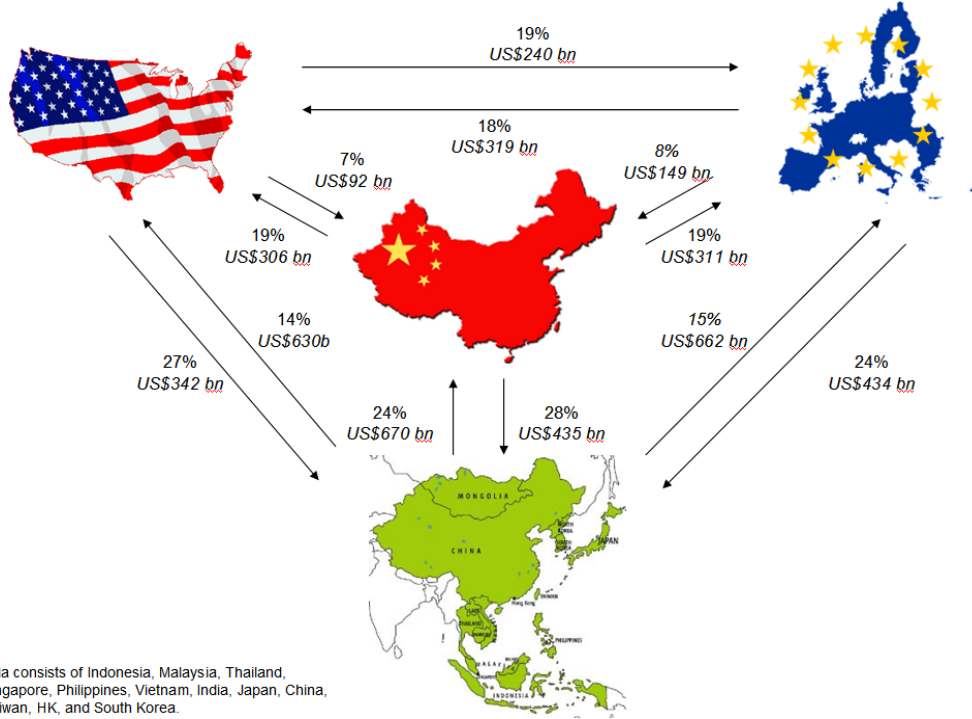
market slowdown and shadow banking issues. Therefore, Asian policymakers will have to tread cautiously between the downside growth risks and still elevated inflation trade-off, with China being the case in point. While selected Asian central banks like BI, BOT, MAS and RBA have begun easing monetary policy, others like BNM, BOK and BSP have preferred to adopt a wait-and-see attitude. Note the ADB had already called for Asia's policymakers must consider financial, monetary, and fiscal tools to cope with a potentially prolonged global crisis and a slow subsequent recovery. These include contingencies to safeguard financial stability and ensure sufficient credit is available locally, and monetary policy must remain flexible while exchange rate coordination would avoid competitive devaluations. In addition, fiscal stimuli may be applied gradually and judiciously where needed while avoiding budgetary strain. This sounds like prudent advice sailing into 2012 choppy waters.

Table 1: IMF outlook for the European economies for 2012

	Real GDP Growth			
	2009	2010	2011	2012
Europe ¹	-4.6	2.4	2.3	1.8
Advanced European economies ¹	-4.1	1.7	1.6	1.3
Emerging European economies ¹	-6.0	4.4	4.4	3.4
European Union ¹	-4.2	1.8	1.7	1.4
Euro area	-4.3	1.8	1.6	1.1
Austria	-3.9	2.1	3.3	1.6
Belgium	-2.7	2.1	2.4	1.5
Cyprus	-1.7	1.0	0.0	1.0
Estonia	-13.9	3.1	6.5	4.0
Finland	-8.2	3.6	3.5	2.2
France	-2.6	1.4	1.7	1.4
Germany	-5.1	3.6	2.7	1.3
Greece	-2.3	-4.4	-5.0	-2.0
Ireland	-7.0	-0.4	0.4	1.5
Italy	-5.2	1.3	0.6	0.3
Luxembourg	-3.6	3.5	3.6	2.7
Malta	-3.3	3.1	2.4	2.2
Netherlands	-3.5	1.6	1.6	1.3
Portugal	-2.5	1.3	-2.2	-1.8
Slovak Republic	-4.8	4.0	3.3	3.3
Slovenia	-8.1	1.2	1.9	2.0
Spain	-3.7	-0.1	0.8	1.1

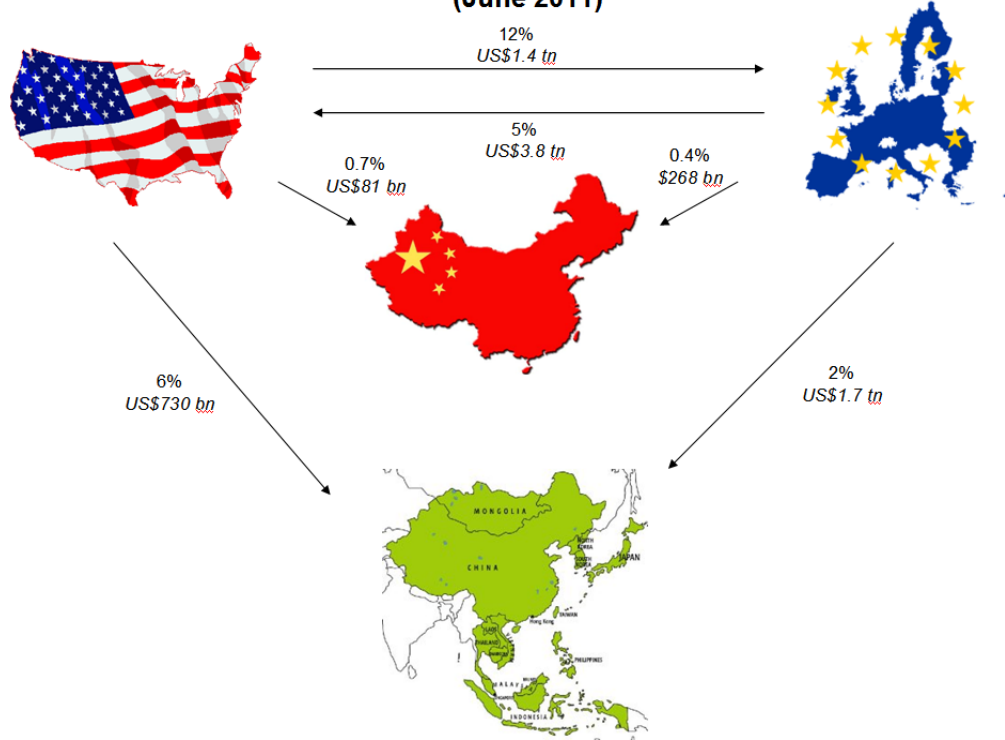
Source: IMF

Chart 1: Economic linkages through trade as a % of total trade (2010)



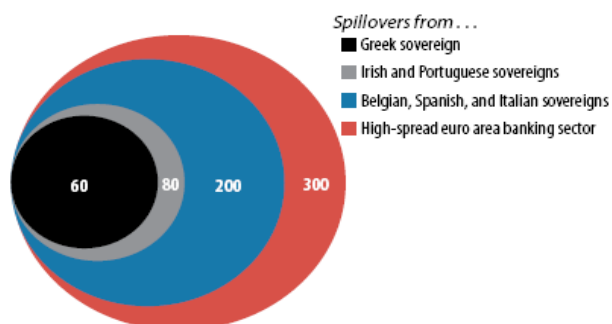
Source: CEIC, OCBC, Google Pictures

Chart 2: Financial linkages through total foreign claims by reporting country (June 2011)



Source: BIS, OCBC, Google Pictures

Chart 3: IMF's estimate of hat European banks may need up to €300b recapitalisation



Source: IMF staff estimates.

Note: The size of the circles is proportional to the size of the spillover. Includes banking systems in 20 European Union countries. The high-spread euro area countries are Belgium, Greece, Ireland, Italy, Portugal, and Spain. Figures are rounded to the nearest 10 billion euros.

Table 2: 2012 Forecast

	Adverse Baseline	
US	1.0	1.7
EuroZone	-1.0	0.5
Japan	1.0	1.7
UK	-0.5	0.5
Australia	1.5	2.5
New Zealand	0.7	2.3
China	7.0	8.5
Hong Kong	0.0	3.0
Taiwan	1.0	2.5
Singapore	1.0	3.0
South Korea	1.0	2.1
Malaysia	2.1	3.8
Indonesia	4.0	5.3
Thailand	1.6	3.8
Philippines	3.0	3.7
Vietnam	3.3	4.5

Source: OCBC

Table 3: Key Economic Indicators Forecast

	Q1 2012 F	Q2 2012 F	Q3 2012 F	Q4 2012 F	2011 F	2012 F
China						
GDP	8.10	8.20	8.80	8.90	9.20	8.50
CPI	4.00	3.30	2.30	2.60	5.50	3.00
1-year Deposit Rate	3.50	3.50	3.50	3.50	3.50	3.50
Hong Kong						
GDP	1.40	3.90	2.00	4.50	5.00	3.00
CPI	5.10	4.10	3.30	3.00	5.20	3.90
Indonesia						
GDP	5.00	5.00	5.40	5.60	6.40	5.30
CPI	5.50	5.80	6.20	6.50	5.50	6.10
BI Rate	6.00	6.00	6.00	6.00	6.00	6.00
Malaysia						
GDP	3.00	3.50	4.20	4.60	4.90	3.80
CPI	3.00	2.90	2.90	2.80	3.30	2.90
Overnight Policy Rate	2.75	2.75	2.75	2.75	3.00	2.75
Philippines						
GDP	3.50	4.20	4.30	2.80	4.00	3.70
CPI	4.30	4.10	4.10	4.00	4.80	4.10
Reverse Repo Rate	4.50	4.25	4.25	4.25	4.50	4.25
Singapore						
GDP	2.50	3.50	3.00	2.90	5.20	3.00
CPI	2.90	3.20	2.80	3.50	5.10	3.10
3-m SIBOR	0.40	0.43	0.46	0.49	0.38	0.49
Taiwan						
GDP	0.80	1.90	3.10	4.20	4.60	2.50
CPI	0.80	0.80	1.30	1.20	1.40	1.00
Discount Rate	1.88	1.88	1.88	1.88	1.88	1.88
Thailand						
GDP	-2.00	2.00	4.00	11.40	1.50	3.80
CPI	3.90	3.50	3.70	3.70	4.10	3.70
Benchmark Interest Rate	2.75	2.75	2.75	2.75	3.25	2.75
Vietnam						
GDP	4.20	4.30	4.40	5.10	5.80	4.50
CPI	17.20	12.70	11.10	11.60	18.70	13.00
Prime Lending Rate	9.00	10.00	10.50	11.00	9.00	11.00

Source: OCBC

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Weathering the storm amid rising challenges

As we mentioned in our global outlook, the global economy is likely to slow next year due to the deepening Eurozone debt problem. Not only has this increased the risk of a hard landing in the Chinese economy in 2012 but it has also led to increasingly high anticipation of China's role in acting as a global savior. While a hard landing in China will probably derail the still solid Asian growth, we expect the Chinese economy to continue posting a relatively strong expansion in 2012.

Slowing but no hard landing

As we mentioned in our late October report <reassessing China's macro risk>, we see a low probability of a hard landing in China next year as the economy is set to manage the risk exposures faced by its banking system. Nevertheless, the Chinese economy is unlikely to escape the negative impact from a possible recession in Eurozone given that Europe is still China's largest trading partner. China's official PMI fell below the neutral 50 mark for the first time since February 2009, to 49 in November. This suggests the negative impact of Eurozone debt crisis coupled with China's previous credit tightening measures on Chinese economy have taken effect. We expect the Chinese economic growth to slow further to about 8.5% yoy in 2012, weighed by weaker exports growth and a bleaker investment outlook.

View on policy reactions remains divided

While the market seems to have reached a consensus on a slower growth in China, the view on the possible policy reactions remains divided. China announced to lower its reserve requirement ratio (RRR) by 50 bps on 30 November, following 12 consecutive hikes since Dec 2008, marking the official start of monetary policy "fine-tuning". The cut was the result of a slower money growth and less capital inflows. Given capital inflows into China may remain weak in the beginning of next year, we expect China to cut the RRR four more times in 2012.

No full relaxation of monetary policy is expected

That said, the adjustment of the RRR does not mean a full relaxation of monetary policy. We don't expect China to launch a second fiscal stimulus package and fully relax its monetary policy even if global economy head towards recession. That is because the excessively aggressive fiscal and monetary policies could lead to huge inflationary pressures, as experienced in 2010 and 2011, which may outweigh the benefit of short-term boost to the economy. Additionally, it may also dilute China's current effort to control the housing bubble. As such, we expect China to rely more on the RRR rather than using its interest rate tool to fine tune its monetary policy. We expect interest rate to remain intact for the best part of 2012.

On broad expectations, we still expect a prudent monetary policy next year. Although we don't expect China to introduce a second massive fiscal stimulus package, we do expect China to run a proactive fiscal policy via tax incentive. It is imperative to note that China's transformation clearly needs a more active involvement of the private sector and a proactive fiscal policy via tax incentive is likely to be the most effective tool to support China's SMEs as well as other private companies.

Price pressure to moderate in 2012

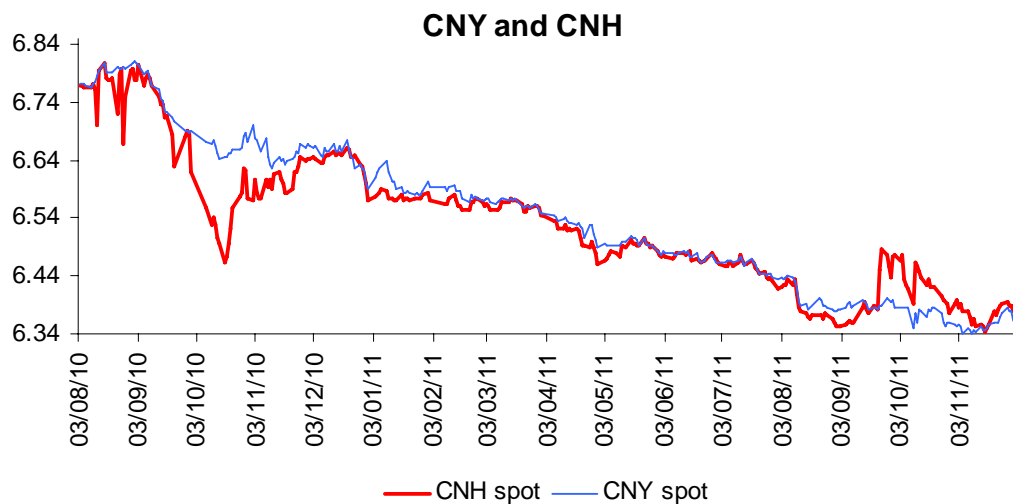
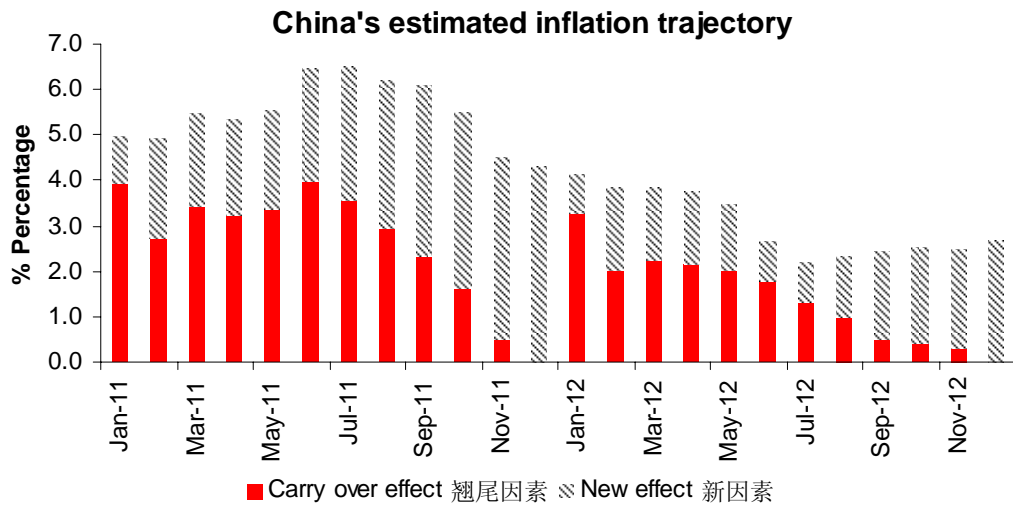
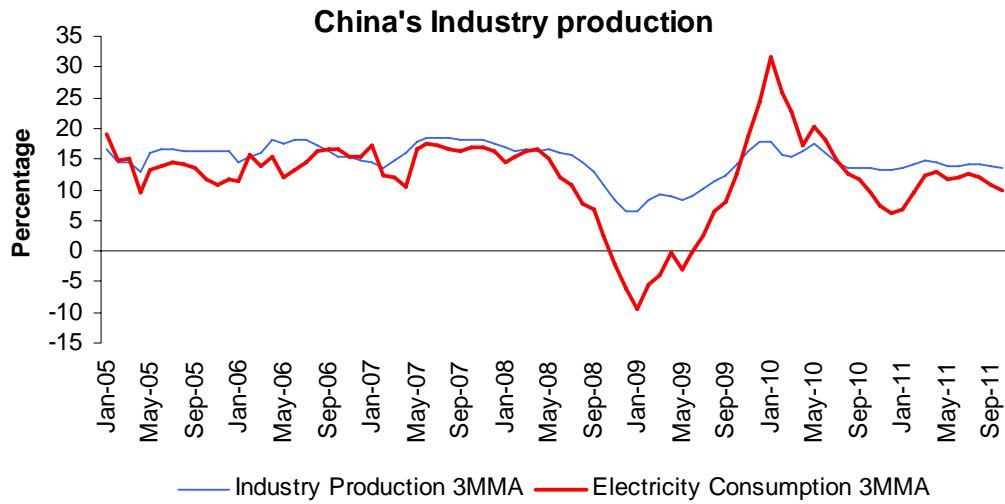
Price pressure is likely to moderate gradually next year due to the high base effects and easing commodity prices and food prices amid growing concerns on global slowdown. China's real interest rate may remain negative in Q1 2012, as headline CPI is still likely to average above 4%. However, we expect the negative real interest rate to be corrected in Q2 2012 as inflation is projected to fall below 3.5% in the period. With the help of base effect, we expect China's inflation to ease to 3% yoy in 2012, sharply down from estimated 5.5% in 2011.

Pace of RMB appreciation may slow

On the currency front, we expect RMB's gradual appreciation trend to remain intact. However, the pace of appreciation could slow next year due to the declining fundamental support. China's trade surplus is likely to shrink substantially next year as China's export is likely to be hit by a slower global growth while import may remain supported by the resilient domestic demand. Meanwhile, China may also receive less capital inflows given the rising binary expectations on RMB's two-way movement. Therefore, we expect RMB appreciation pace to slow to about 3% per annum next year.

Risks

Our baseline scenario suggests that risk exposure faced by China's banking system is manageable barring a full blowout in China's property market. China's property market has reached the turning point with nationwide property prices reported to fall slightly in October. Although we do not expect a freefall in property prices, as we think Chinese investors have a strong holding power with low leverage ratio, a significant decline in property prices cannot be totally ruled out. Should property prices fall more than 40% nationwide, we expect China's banking system to face stress, which in turn may lead the growth to break below the threshold line of 8%.



Source: CEIC, OCBC

Walking on thin ice

Hong Kong's economic growth slowed to 4.30% yoy in Q3 2011, down from 5.29% yoy in Q2 2011. On a sequential basis, the economy managed to avoid a technical recession growing marginally by 0.1% qoq sa after shrinking by 0.4% qoq sa in Q2 2011. Despite the slowdown, the economy continued to outperform most of Asian economies in Q3 supported by strong private consumption and fixed investment with private consumption and capital formation growth at 8.82% yoy and 10.24% yoy respectively in real term. Nevertheless, coupled with a relatively high base effect, a weak external demand has weighed on Hong Kong's growth in Q3 amid the worsening Eurozone debt crisis.

The lingering Eurozone debt crisis is likely to continue weighing on growth prospect in 2012 as the economy is likely to be further dragged down by possible de-stocking. We expect Hong Kong's growth to slip to 2.9% yoy in 2012, sharply lower than the anticipated 5% for 2011.

Growth is likely to be dragged down by weak external demand

Given that Hong Kong has the highest export to GDP ratio (230% in 2011) in Asia, the economy is extremely vulnerable to external shocks, especially those that originated from the developed economies. A slowing growth in Mainland China is also likely to weigh on Hong Kong's economy, considering that bulk of the service trades has been mainly driven by Mainland China's growth. Note that exports of services have grown steadily in the past decade, to about 22% of total exports in 2011 from about 17% in 2000. As a small and open economy, we expect the Hong Kong economy to slow rather markedly in the first half of next year, led by both a continuation of de-stocking and the weak external demand.

Private consumption to offset the external shock

Nevertheless, domestic demand may continue to provide a buffer to downside risk from external demand in 2012. The solid growth in investment seen in Q3 2011 was the result of increasing investment by private enterprises and infrastructure related spending. The construction sector may remain supportive of growth in the new year.

Private consumption is likely to be the major driver of Hong Kong's growth next year thanks to a low interest rate environment and tight labor market. Hong Kong's interest rate will remain low in 2012 following the path of the US interest rate after the US Fed had reassured to keep interest rate low until 2013. The low interest rate environment is likely to continue to spur consumption growth. On the job market front, Hong Kong's seasonal adjusted unemployment rate dropped to 3.3% in October from 4.0% in end-2010. We expect the labor market to remain relatively tight in 2012, which may provide another support to private consumption. This combination of an accommodative monetary conditions and a relatively tight labor market is also likely to limit the negative wealth effect from a declining stock market. As such, on average, we expect private consumption to grow 3.5% yoy in 2012.

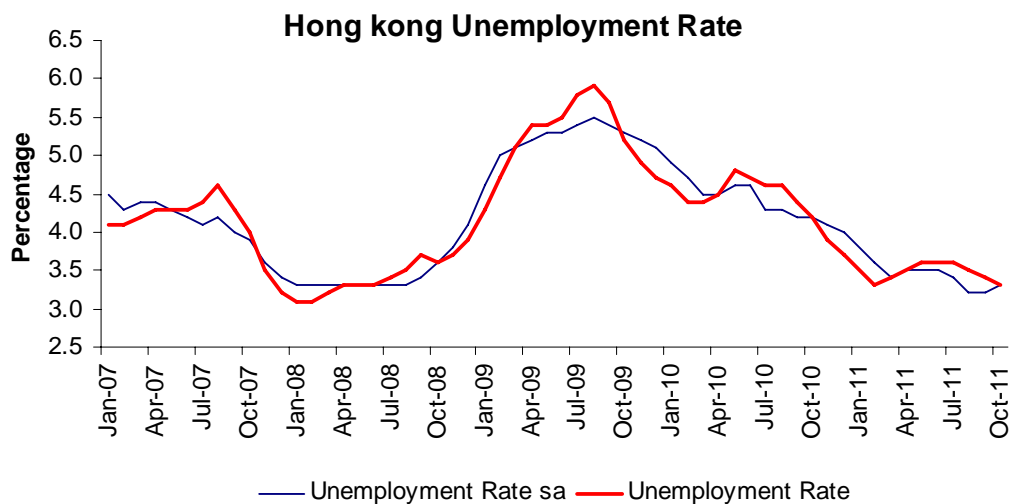
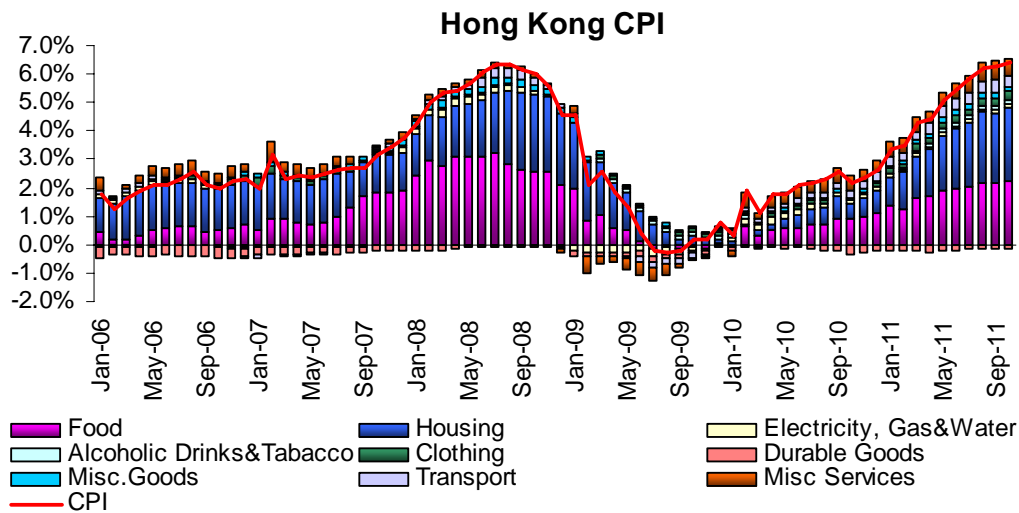
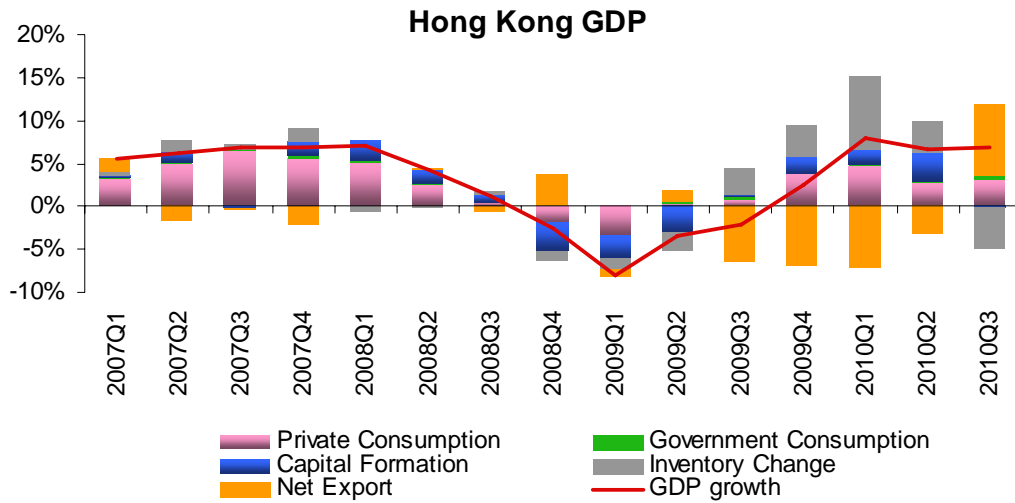
The still solid support from private consumption is likely to mean that a full recession is not in the picture in our base line scenario. Currently, we forecast Hong Kong economy to grow 2.9% yoy in 2012, down from an estimated 5% yoy growth in 2011.

Inflation nearly peaked and will trend down gradually next year

On inflation, Hong Kong's underlying inflation (after netting out effects of government one-off measures) was unchanged at 6.4% yoy in October, suggesting that inflation is likely to have peaked. While the strong underlying inflation has been mainly driven by food and housing prices, price pressure is likely to be alleviated amid softening commodity prices next year. Nevertheless, housing prices may remain sticky on the back of a low interest rate environment, and this may in turn lead to only a slow decline in both underlying inflation and headline inflation. Therefore, we expect inflation to slow marginally to about 3.9% in 2012.

Risks

The high exposure of Hong Kong's economy to Mainland China is a double-edged sword. Although a hard landing in Mainland China is not in our baseline scenario, we cannot totally rule out a sharp decline in China's growth next year. Should Chinese growth head towards a hard landing next year, Hong Kong economy could slip into another recession in 2012.



Source: CEIC, OCBC

A temporary glitch

Medium-term fundamentals strongly intact

We remain bullish on the medium-term fundamentals of the economy, and continue to expect that the economy will post an average 6.5-7% growth over the next 5-10 years. Going into 2012, all indications remain positive for the growth outlook, especially noting clear signs that a robust domestic demand prevails. Nevertheless, Indonesia is not isolated from the extended soft patch in the global economy, particularly considering the negative impacts from softening commodity prices. We forecast Indonesia's GDP growth to slide to 5.3% yoy in 2012, below its medium-term trend.

Strong outlook for investment growth to sustain

Investment growth has consistently come in strong throughout 2001, with an average of about 8% expected for the year. Loan growth is expected to reach 25% yoy in 2011 and likely to remain strong even if may moderate to about 20% in 2012. More importantly, we have continued to see robust import growth data, particularly in the capital goods component, which suggest that the longer-term investment projects in Indonesia were largely isolated from the turmoil in the financial markets during the period. This is clearly an encouraging note for a country that is in the midst of a complete overhaul of its infrastructure. As it is, total foreign direct investment (FDI) has continued to tick higher and set to reach about USD 17bn in 2011 and about USD 20bn in 2012. We are also optimistic that further growth is likely, particularly considering that Indonesia is on the verge of getting an investment credit rating upgrade, a move now likely to be seen early in 2012. Given that an investment credit rating tends to be followed with a surge in FDI inflows, we look for massive upgrades in both the physical and technological infrastructure that have been consistently quoted as the country's current shortcomings.

Expect some moderation in private consumption growth

Private consumption growth is also likely to remain decent at about 4-4.5% yoy range in 2012. Various indicators have continued to paint a positive outlook into 2012, with the latest retail sales index growth recorded at 31% yoy, consumer confidence index at record-high levels and local car sales registering 20% yoy expansion in the year-to-date up to October 2011. A combination of a somewhat stronger local currency, stock market gains and growth of the middle-income class have provided the underlying support to private consumption growth. Yet, as mentioned above, falling commodity export earnings will directly affect domestic demand and prolonged instability in the financial markets may also dampen domestic sentiment leading to some moderation in growth in 2012.

Room for fiscal stimulus

A quick look on fiscal spending pattern still suggests of a low efficiency in fiscal management as Government spending typically gets offloaded near the year-end, presumably in less impactful projects. As such, we note that government spending has consistently come in below budget throughout 2011, with growth likely to come in below 1%. Yet, this also essentially means that from the fiscal policy perspective,

the government has some room to implement another round of fiscal stimulus to help boost the economy, similar to the 2008-09 episode, given the fact that Indonesia's estimated 1.5% fiscal deficit/GDP ratio stands among the lowest in the region.

Inflation may inch higher in 2012

We forecast inflation to average 6.1% yoy, above the BI's target range of 3.5-5.5% range. Money supply growth remains strong in excess of 15% yoy, and this is likely to be sustained given that credit growth remains robust as well. While food inflation has been well contained in 2011, we expect upward pressures in food prices driven by the supply disruption caused by recent flooding in the region. Rice, which makes up about 5% of CPI basket, has seen gradual increase in prices since the second half of this year. Additionally, the government has also signalled its intent to revise electricity prices higher by about 10% in Q2 2012, while the issue of fuel subsidy removal may continue to lurk in the background despite formally excluded from Budget 2012.

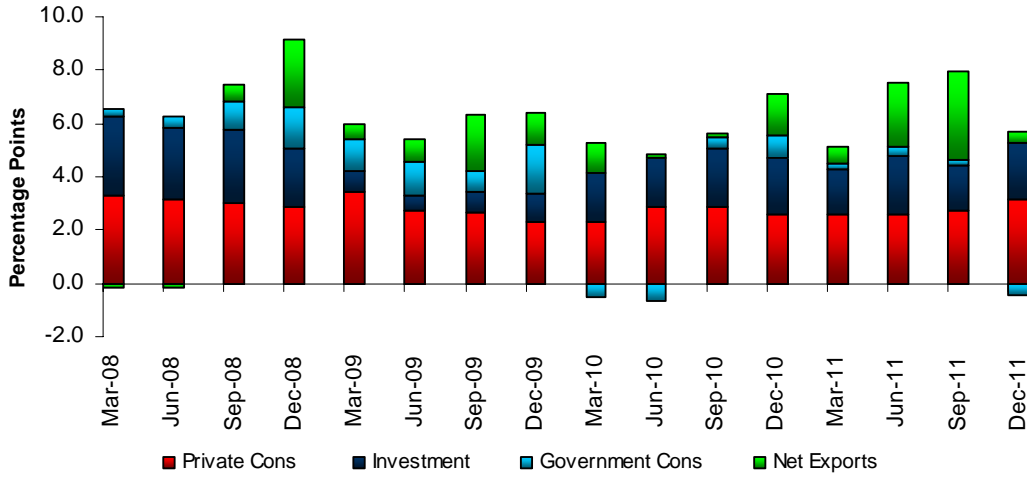
BI may take a more cautious approach

In response to a slowing growth momentum in 2012, the BI has delivered a total of 75bps rate cuts in October and November 2011, and has continued to signal that it is open to trim its interest rate further. We expect the BI to be more cautious and likely to hold its interest rate constant throughout 2012. By moving further to close the gap between the policy and market interest rates, the central bank risks triggering a loss in confidence that may weigh on the Rupiah, a weakening of which would only exacerbate the domestic inflation problem. As it is, we think that the BI would resort to spur domestic growth by moral suasion, considering that the real problem has been the persistently high prime lending rates among Indonesia's commercial banks.

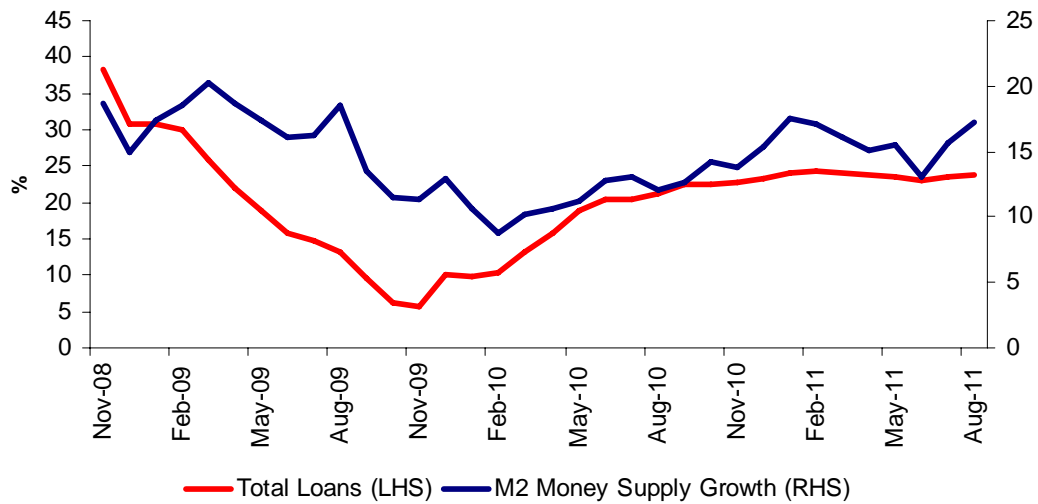
Risk of massive capital outflows sustains

Given the still significant amount of foreign ownership in the local currency government bond market, we are cautious that foreign investors may look to safe haven bids if there is another bout of risk aversion. This is especially given the fact that the bond market has appeared excessively rich since 2010, amidst the massive foreign inflows. We have consistently pointed out is the fact that yields for 10-year government bonds have fallen below the long-term inflation trend even in period that had seen the VIX index spiking significantly. BI has been actively intervening in the bond market since late 2011, but as it is, we note that while Indonesia's USD 115bn FX reserves are still sizable, as a proportion of GDP or total external debt, it remains to be among the lowest in the region.

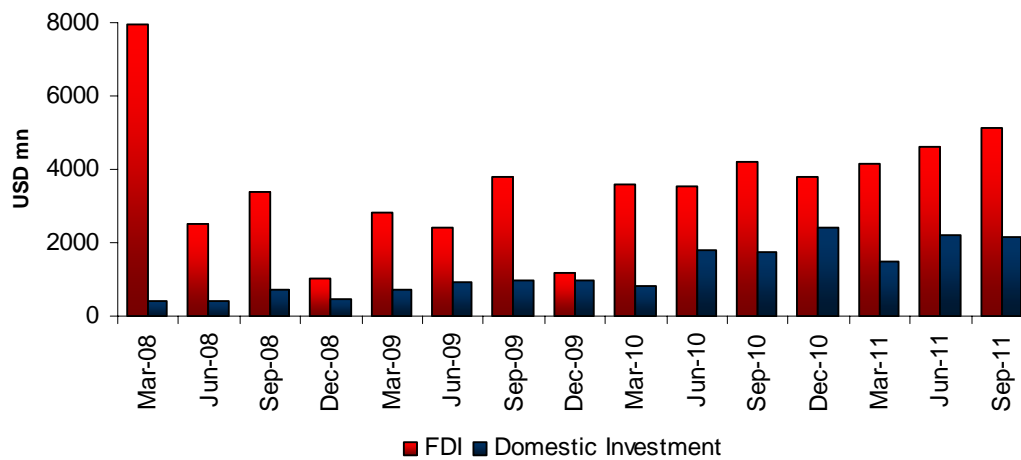
Indonesia - Growth Drivers



Loans & Money Supply Growth



Investment in Indonesia



Source: CEIC, OCBC

High fiscal spending to sustain

Broadly supportive domestic demand in 2011

Given the extended soft patch in the global economy, 2012 is going to be a challenging year for the Malaysian economy despite its otherwise strong domestic demand performance in 2011. To start with, as we had previously expected for 2011, fiscal spending played a huge part in providing a boost to the overall economy, witnessed by the multi-year high 21.8% yoy growth seen in fiscal spending in Q3. This has not taken into account the indirect impact from fiscal spending on private investment and household consumption, which averaged modest expansion of 5.2% and 6.8% yoy respectively in 2011. The momentum seen in private investment growth has been sustained well throughout the year, hardly surprising if we consider the fact that the government has kicked off its Economic Transformation Plan. Note that net Foreign Direct Investment (FDI) has returned to the positive territory in H1 2011 for the first time since H1 2008.

Strong fiscal expenditure to sustain

We expect fiscal expenditure to remain broadly supportive to the economy in 2012, especially considering the possibility that the government may call for an early election. In Budget 2012, the government has highlighted a two-prong approach to boost the corporate sector and bolster household spending. In attempting to spur further private investment growth, the government has provided new funding schemes for SMEs, liberalized several service sub-sectors as well as taking up joint venture programs to develop the rural areas. The decision to maintain the current subsidy system, meanwhile, would urge more spending among households. As it is, a double-digit fiscal expenditure growth looms even as the government aims for a smaller budget deficit target of 4.7% of GDP.

Slowing exports growth will be a drag

Yet, the impact from an extended slow patch in the global economy will be quite significant in 2012 and recent rhetoric from the government has clearly indicated increasing concerns on this front. Note that total exports to the Eurozone alone represent about 10.5% of Malaysia's GDP in 2010. Exports growth remains a dominant factor that leads overall economic growth and given its high dependence on exports, domestic economic activities are likely to remain weighed in line with declining export earnings. On a sequential basis, signs of moderation in Malaysia's export growth have been rather prevalent in H2 2011. While the total value of commodity exports might have returned to pre-2008 crisis levels, the dominant reason has been the surge in commodity prices, particularly in H1 2011. Otherwise, from the volume angle, the marked drop in shipments of major commodities like crude oil and palm oil suggest that the economy will not escape the adverse impact from further softening of global growth momentum. Note that about 60% of Malaysia's total labour force is employed in the manufacturing sector, about 70% of which are export-oriented. A further slowdown in global demand would only exacerbate the worsening employment conditions in the domestic manufacturing sector, which has seen a surge in the number of retrenched workers in H2 2011.

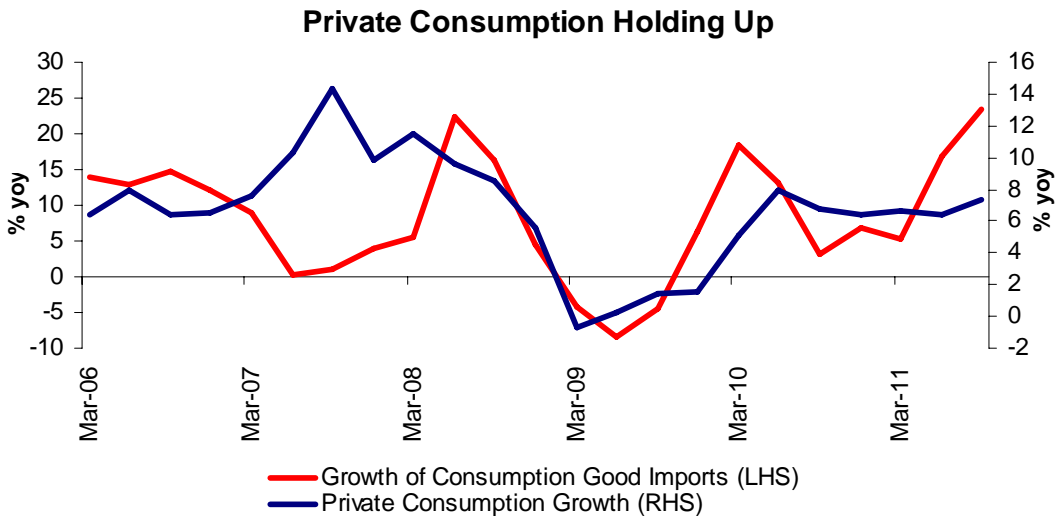
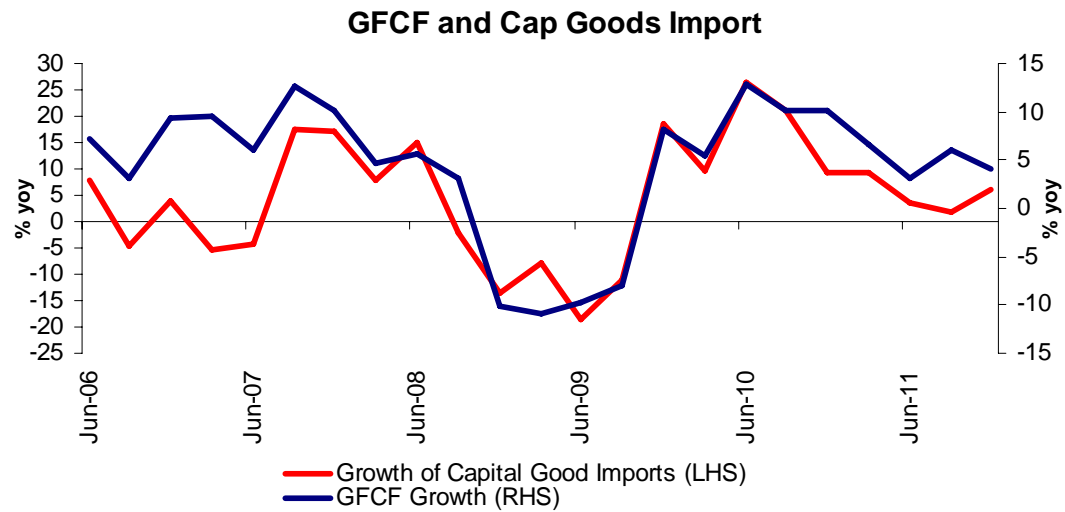
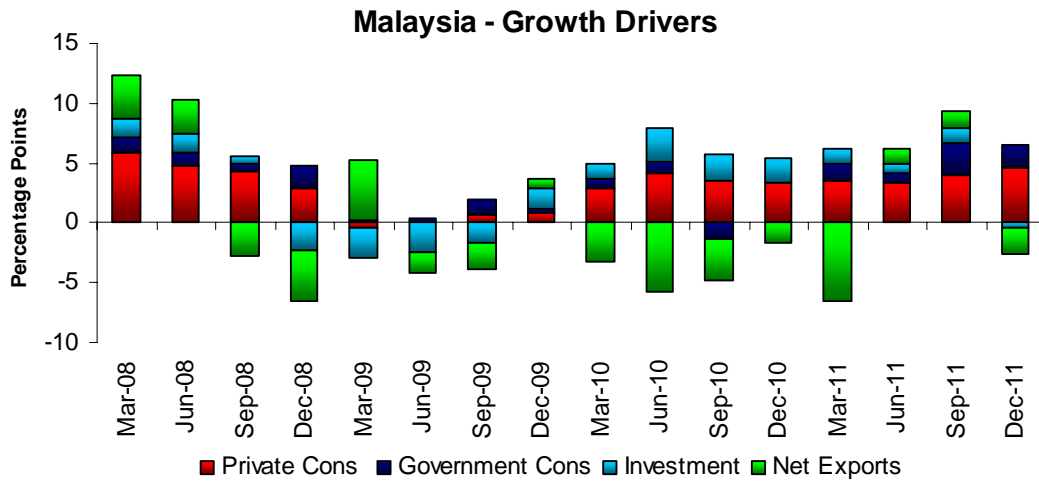
A moderation in investment growth is a concern

The most worrying sign has been the marked moderation seen in capital goods import growth, which may indicate slowing investment growth ahead. Net FDI has reversed back to the negative in Q3 2011 and may remain weighed by the lingering uncertainties in the global economy, at least for the first half of 2012. Again, it is important to note that about 30% of total FDI inflows into Malaysia in 2010 originated from the Eurozone. The anticipated financial market volatility and a weakening bias in the MYR that are likely to kick off 2011 may lead to further softening of domestic sentiment, prompting businesses to hold back bulk of their investment plans until the global economy regains a stronger footing. As such, we expect private investment growth to slow towards 3-4% in 2012.

BNM may loosen its monetary policy

On the inflation front, we expect CPI growth to average 2.9% yoy in 2012, slightly lower than the projected 3.3% yoy for 2011. Current inflationary trend suggests that inflation has peaked in mid-2011 and a moderation in domestic demand means even less pressure from the demand side in 2012. Barring another global oil price shock, the government is unlikely to make significant (if any) changes to its administered prices for 2012, easing concerns stemming from supply side pressures for now. The implication on monetary policy perspective is clear to us and while the BNM has stayed neutral in recent time, the authorities will not hesitate to lower its benchmark interest rates if growth momentum were to soften further. It is imperative to note that given Malaysia's region-high fiscal deficit position, the government may not be in the best position to pump-prime the economy, leaving the BNM with most of the brunt. The BNM has previously stated that they will adjust their policies to ensure both price stability and sustainable growth in the future, and we take it as an indication of a possible rate cut in early 2012.

Overall, we see Malaysia chalking a decent 3.8% yoy expansion in 2011, lower than our projected 4.9% yoy growth for 2011. Amidst the lingering uncertainties in the global economy, we continue to see some downside risks to our forecasts.



Source: CEIC, OCBC

Global growth is key

Hard pressed to meet official GDP target in 2011

Growth is likely to remain lackluster in 2012, we expect the economy to grow at a tepid 3.7% as weak exports and investment growth are likely to sustain, while inflation is expected to be tame at 4.1%. Following the disappointing 3.2% yoy growth recorded in Q3 2011, overall 2011 growth is likely to come in at 4.0% yoy, falling short of the official forecast of 4.5-5.5%. This poor performance was largely attributed to the fall in exports to key trading partners as well as the production shortfall from Typhoon Nesat and Nalgae. We expect these factors to continue weighing growth prospect in 2012, particularly as the adverse second-round impacts from the typhoons are likely to linger till mid-2012.

Global growth is the key

The double digit contraction in exports seen in 3Q11 continued to signal Philippines' dependency on external demand. According to the Semiconductor and Electronics Industries (Seipi), Philippines' electronic exports are not likely to recover until 1Q12, and we think that there is a possibility for exports growth to stay soft up until H2 2012. Another marked drag to the economy came from the construction sector, which also saw a double-digit contraction in Q3 2011, as stricter project reviews for public construction projects and lower government spending had limited construction performance for the best part of 2011. We expect these stricter standards to limit construction performance for the next year.

That said, Philippines' vibrant service sector may limit further slowdown in growth. Within the top 2 subcomponents in services, we expect 9.5% yoy growth in financial intermediation, nearing its pre-Lehman crisis level, while wholesale & trade is likely to grow by a decent 6.7% yoy. The contribution by the service component may also be boosted by increased public administration and defense spending by the government, such as the salary increases and pension benefits for the National Police Organization that will be in place in 2012. Notably, the contribution by public administration and defense had already grown 5.4% in 3Q11 due to the release of the third tranche of the government salary standardization law and pay hike for the police force.

Investment growth is the missing key

We note that Philippines would need to improve its productivity in order to sustain a growth rate above 5%. While we applaud the government's efforts in its implementation of public investment and public-private partnership (PPP) programs, the quality of urban and rural infrastructure such as roads, ports and airports serves as a constraint to growth, and is made worse by the recent twin typhoons that had damaged bridges and road sections in Ilocos, Cagayan, Central Luzon and Cordillera.

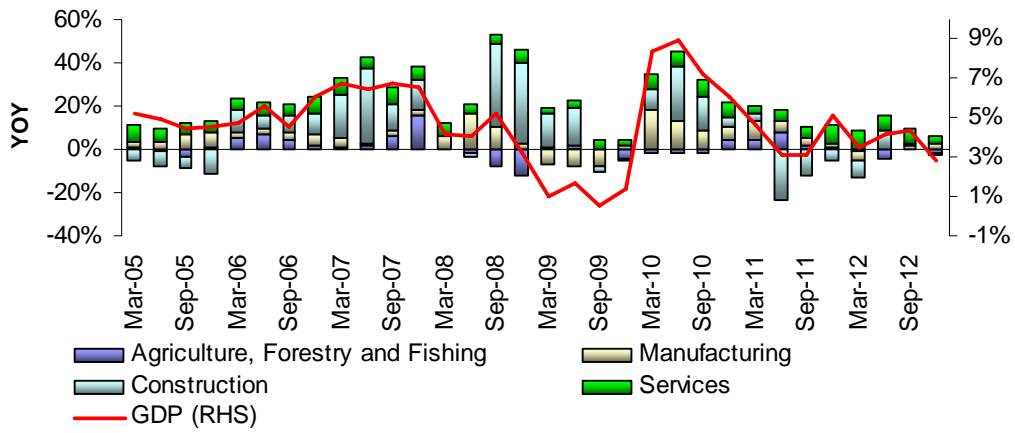
At this juncture, any significant boost to infrastructure development from foreign investors is likely to be limited, especially considering that we are pessimistic that Philippines is going to get a credit rating upgrade anytime soon, given its domestic

structure deficiencies. Despite bullish comments from the authorities, the Philippines would need to improve its fiscal standing as well as reducing its debt levels before an investment credit rating is granted. Fiscal deficit is likely to come in at least 3.0% of GDP (P300b – P350b) in 2012, given the rebuilding expenditure from the damages done by the twin typhoons and lower revenue collections due to the growth slowdown. Furthermore, the high debt-to-GDP ratio of 52.4% as of 2010 remains a concern as high debt levels may translate into credit weakness as it stifles the country's capacity to implement a financial stimulus should the need arises.

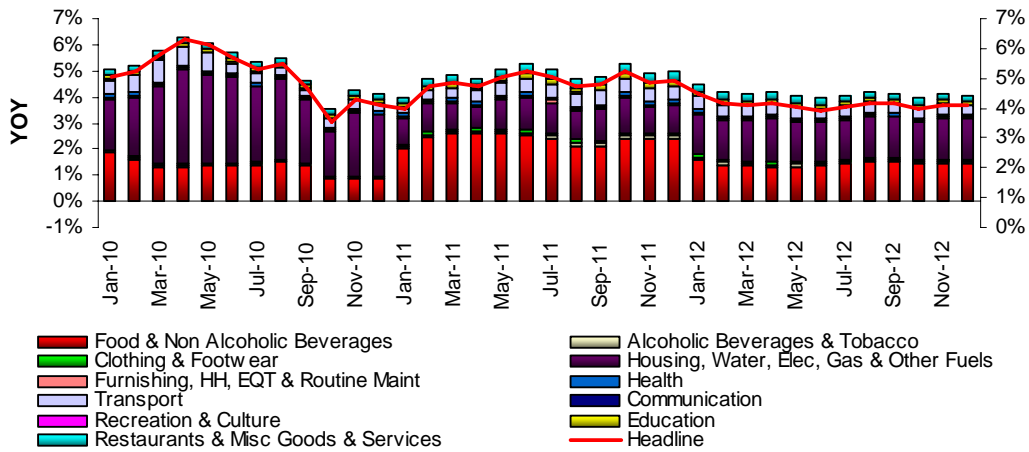
BSP likely to shift towards a more accommodative stance

In its latest monetary policy meeting on 1 Dec BSP commented that the global economic outlook is becoming significantly more uncertain while external demand is likely to weaken in the coming months. The reluctance to cut its benchmark rate signals its priority in keeping inflation in check. However, BSP had also hinted at subsequent rate cuts for next year should inflationary pressures prove to be temporary, and we expect a In view of the lower-than-expected 3Q11 GDP growth which suggests a slowing growth momentum into 2012, tame inflationary trend and global uncertainty in 2012, we believe that BSP will be accommodative towards growth.

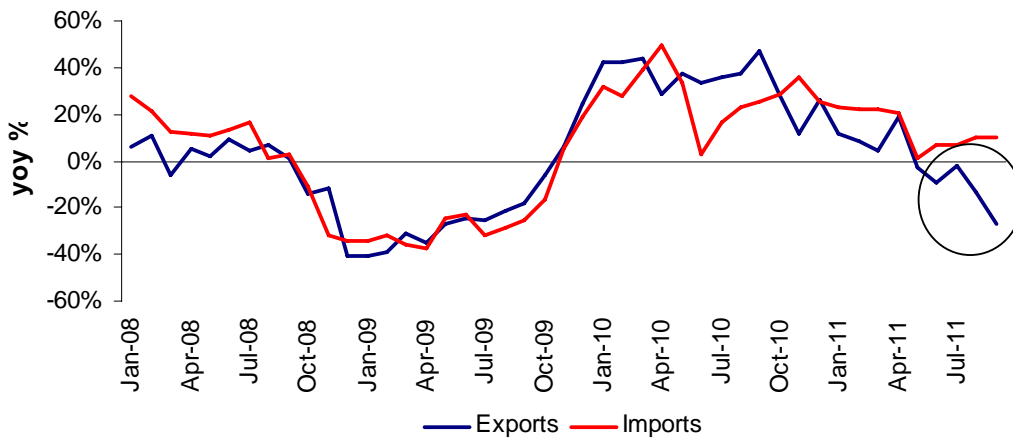
Philippines GDP to moderate to 3.7% in 2012



Philippines CPI



Philippines Exports Suffer in 3Q11



Source: CEIC, OCBC

2012 outlook to sink to 1-3%

Singapore's 2011 growth of around 5% yoy is likely assured.

Q3 2011 GDP growth was revised marginally higher from the earlier flash estimates of 5.9% yoy (+2.0% qoq saar) to 6.1% yoy (+1.9% qoq), led by manufacturing (+13.2% yoy) especially biomedical, services (+3.6%) and constructions (+0.4%). This suggests that full-year forecast of 5.2% yoy for 2011 is achievable. That said, there was very little cheer in the Q4 2011 and 2012 outlook as the global growth environment has turned distinctly more bearish in the face of sovereign debt problems, fiscal austerity and bank recapitalization and deleveraging challenges.

Domestically, services and construction momentum has decelerated, while manufacturing activity remained hampered by ongoing electronics industry weakness and a likely payback within the biomedical sector in Q4 2011. Within services, the main drags coming from wholesale & retail trade, transport & storage, hotels & restaurants, and other services industries. This probably reflects the more cautious consumer sentiment domestically and also the global economic moderation coming to bear on global trade momentum

Looking ahead, 2012 may see choppy growth momentum, especially in H1.

Deteriorating external macroeconomic conditions, coupled with given the risk-on/risk-off environment driven by Europe headline risk, imply that the going will likely get tougher in the early part of 2012. In addition stagnant US GDP growth and fiscal retrenchment contributing to recession risks in Europe, the Chinese economy is also decelerating. Key risks to Singapore's growth trajectory are as follows:

- a) Manufacturing growth may remain subdued as biomedical sector activity potentially retracts and electronics remains depressed. While the semiconductor book-to-bill ratio appears to have troughed at 0.71 in September and stabilized at 0.74 in October, prospects for improvement in demand conditions in the developed economies remain dim in the near-term. Meanwhile, MTI had warned that support from domestic biomedical sector due to increased production of active pharmaceutical ingredients and biologics will only be modest. The November manufacturing PMI had contracted for the fifth straight month, deteriorating further from 49.5 in Oct to 48.7 and reflecting a further decline in new orders and new export orders. The electronics PMI also softened from 52.1 to 50.7 over the same period, reflecting a decline in new orders as well.
- b) Financial intermediation activity is expected to moderate and the sentiment-sensitive segments are expected to perform poorly. Hence a moderation in the financial services momentum is in order. Should the European policymakers and leaders fail to deliver a comprehensive and aggressive package of measures to combat the persistent sovereign debt crisis, the prognosis is not good and the global economy may have to brace for another replay of the 2008-09 financial crisis. This is potentially a double-edged sword for Asian financial centres like Hong Kong and Singapore, where some diversion of funds towards Asia may be offset by the deleveraging activity of European banks. For instance,

the ADB is already preparing for a surge in demand for its trade-finance program to fill persistent market gaps as some major European banks are retrenching from the business.

- c) Tourism-related services have benefited from rising visitor arrivals from the region since the two Integrated Resorts opened, but may find it more challenging going forward in the face of slowing GDP growth within the key Asia and more cautious consumer spending patterns amidst the global uncertainties (see chart 2). Our 2012 GDP growth forecast for the top 3 visitor markets, namely China, Indonesia and Malaysia are 8.5% yoy, 5.3% and 3.8% respectively.

The official 2012 growth forecast of 1-3% looks reasonable to us.

Our 2012 GDP growth forecast is 3% yoy, but the risk is for growth to undershoot should there be a global recession or full-blown financial crisis in the developed economies. The domestic composite leading index has been contracting for three consecutive quarters this year and shrank 2.9% qoq in Q3, signaling a slowdown ahead, but we are not penciling in a double-dip recession for the US or a hard landing scenario for China at this juncture. As it is, a 3% yoy handle in 2012 already implies a technical recession is likely on the cards (see table 1 and chart 1).

CPI inflation has peaked in Q3 2011 and will retreat to more reasonable levels.

CPI headline inflation is likely to moderate from 5.5% yoy in Q3 to 4.5% in Q4, bringing full-year CPI to 5.0%, before easing further to 3.1% in 2012 amid the economic deceleration and softening in demand conditions. MAS forecasts 2012 CPI inflation forecast to be 2.5-3.5% yoy. Our assessment is that should growth-inflation dynamics continue to tilt towards further downside risks in Q1 2012, a further easing in the SGD NEER monetary policy cannot be ruled out.

Labor market dynamics to turn more cautious in 2012.

The domestic labour market should remain more resilient in 2012, barring a further deterioration in business activity. The unemployment rate stood at a low 2% in Q3 2011, but is biased higher given the pullback in corporate hiring intentions. NTUC is already tracking the number of workers who might be retrenched. Wage expectations are also expected to be scaled back to more modest levels e.g. 0-2% yoy. However, we do not expect large-scale retrenchments at this juncture, and also that the foreign worker tightness is unlikely to be lifted in the interim.

SGD interest rates could tilt higher in 2012, but remain subdued overall.

The 3-month SIBOR fixing stood at 0.38% as of 6 Dec. We do not expect any short-term spikes in the SIBOR rates, barring any financial crisis-type risks in the Eurozone, but could see some modest pressure kicking in ahead of the year-end. Given the major central banks - Fed, ECB, BOC, BOE, BOJ, SNB have extended their swap lines which were previously due to expire 1 Aug 2012 and cut the pricing of existing USD liquidity swaps from OIS+100bps to OIS+50bps, and also created temporary contingency bilateral swap lines to provide non-USD funding should market conditions so warrant till 1 Feb 2013, this should partly ease USD liquidity concerns. Bank loans growth have slowed for the first time since Oct 2009 from a record 31.1% yoy in Sep to 29.8% in Oct, as both business and consumer loans growth eased. We tip 2012 bank loans growth to average about 10% yoy, down from this year's forecasted 25% yoy growth. Our 3-month SIBOR average forecast remains at 0.45% for 2012.

FY2012 Budget has the potential to be more stimulative to mitigate downside growth risks

PM Lee has warned that 1-3% growth may be the norm and more layoffs loom in 2012, with unions expecting at least 20% higher retrenchments than in 2010. Given this rapidly softening economic backdrop and increased policy concern about the labour market, we suspect that more policy aid to help workers weather through this coming storm may be in store. The FY11 budget was dubbed a “grow and share” package, and penciled in a very modest surplus of \$0.08m. However, the FY12 budget position may revert back to a deficit given the need to boost spending in key areas in order to achieve and sustain real wage increases through productivity improvements, which would require upgrading the quality of workers and jobs. Special transfers may also continue to play a role in helping to mitigate the income divide and the potential fallout that lower-income and lower-skilled workers may face should there be rising retrenchments due to the deteriorating economy. In particular, Workfare may be enhanced to supplement wages and ensure that the lower-income workers and their families enjoy access to education, housing, healthcare and transport.

Table 1: Singapore’s 2012 GDP growth forecast

	GDP Growth (yoy)	GDO growth (qoq saar)	Manufacturing Growth (yoy)	Construction Growth (yoy)	Services Growth (yoy)
1Q12	2.5%	18.8%	2.4%	2.6%	2.2%
2Q12	3.5%	-1.8%	5.7%	2.9%	2.7%
3Q12	3.0%	-0.6%	2.5%	2.5%	3.1%
4Q12	2.9%	-3.2%	0.8%	2.1%	3.4%
2012	3.0%	-	2.9%	2.5%	2.9%

Table 2: Singapore’s interest rate forecast for 2012

SGD Interest Rates	2012 Q1	2012 Q2	2012 Q3	2012 Q4
1-month SIBOR	0.30%	0.32%	0.34%	0.36%
1M SOR	0.30%	0.33%	0.36%	0.39%
2-month SIBOR	0.36%	0.38%	0.40%	0.42%
3-month SIBOR	0.40%	0.43%	0.46%	0.49%
3M SOR	0.42%	0.45%	0.48%	0.51%
6-month SIBOR	0.48%	0.52%	0.55%	0.60%
6M SOR	0.43%	0.46%	0.49%	0.52%
12-month SIBOR	0.63%	0.66%	0.69%	0.72%
2-year swap rate	0.55%	0.60%	0.65%	0.70%
5-year swap rate	1.15%	1.20%	1.25%	1.35%
10-year swap rate	1.90%	1.95%	2.00%	2.10%
15-year swap rate	2.53%	2.55%	2.58%	2.60%
20-year swap rate	2.60%	2.64%	2.68%	2.70%

Source: MTI, OCBC

Chart 1: Singapore's GDP growth to peter out in 2012

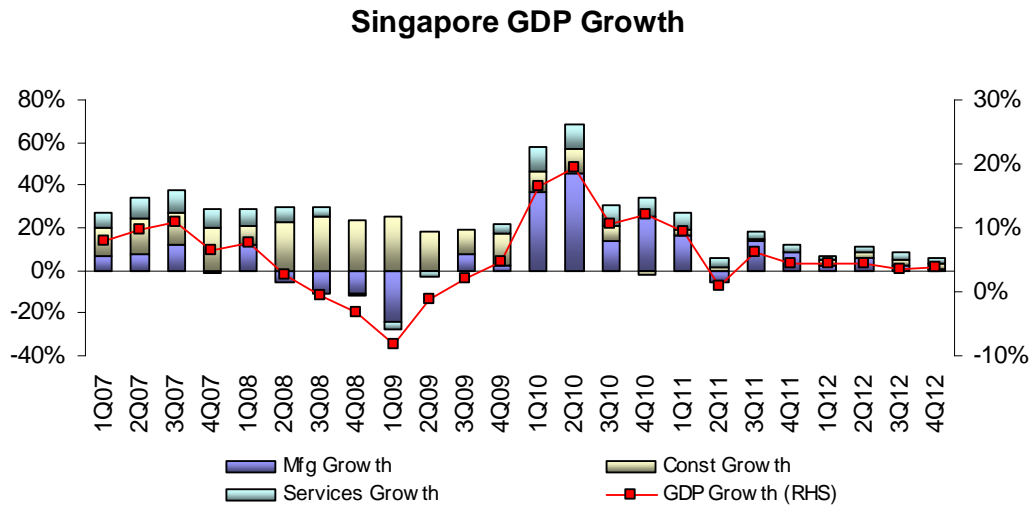
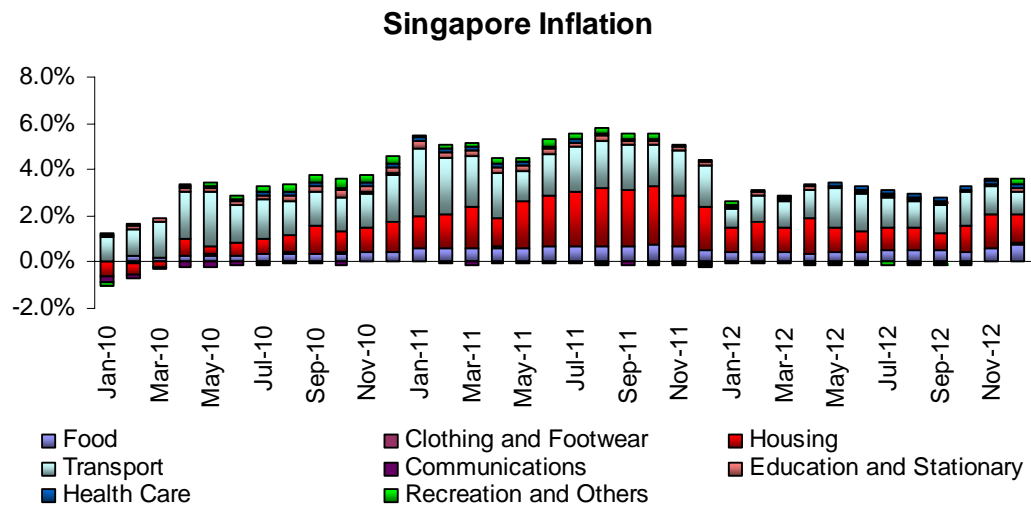
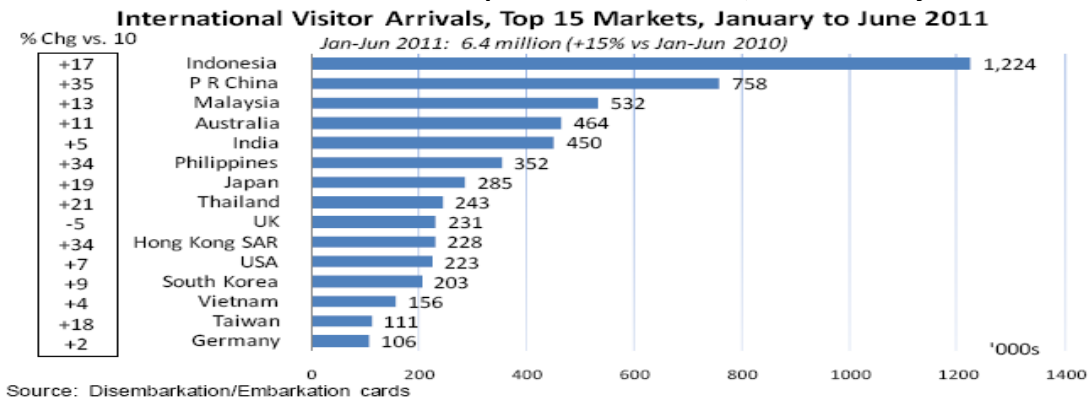


Chart 2: Singapore's inflation trajectory to subside in 2012



Source: CEIC, OCBC

Chart 3: Tourism markets dependent on Indonesia, China & Malaysia



Watching out for endogenous risks

Taiwan's economic growth slowed to 3.42% yoy in Q3 2011, down from 5.57% yoy in H1 2011. This also meant a -0.15% qoq seasonally adjusted growth in the period, representing the first contraction on a sequential basis since Q1 2009. While a technical recession may not be avoided given a likely second straight negative sequential growth in Q4 2011, amid a deepening Euro zone debt crisis, any significant recovery in 2012 is still unlikely at this juncture. We expect economic growth to slow further in 2012 as the economy is unlikely to find strong support from its external demand amid a deteriorating global outlook.

Capital formation stalled despite external demand remaining supportive

Taiwan kicked off 2011 with a stellar growth momentum carried over from 2010 and the economy was well supported by both domestic demand and external demand in H2 2011. Despite a high base effect, a 5.57% yoy growth in H1 2011 means that Taiwan had outperformed two other Asian tigers including Singapore and South Korea. However, the domestic demand lost its growth momentum in Q3 dragging the economy down by 0.44%, leaving external demand to be the sole driver.

The key factor that contributed to a stalling domestic demand in Q3 2011 was the weak capital formation growth despite the steady expansion that was still witnessed in both private and government consumption. Taiwan's business index slipped materially in August due to the increased uncertainties in global economy, leading to a lower capital expenditure in Q3. The sharp decline in machinery imports in Q3 continued to paint a weak outlook in capital formation growth going into 2012. The shrinking capex investment in H2 2011 may bring more downside risks for 2012.

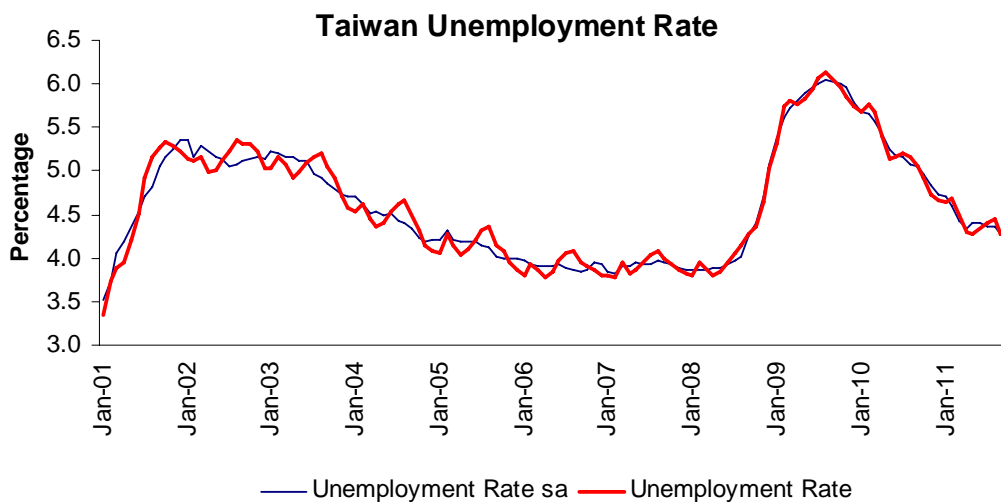
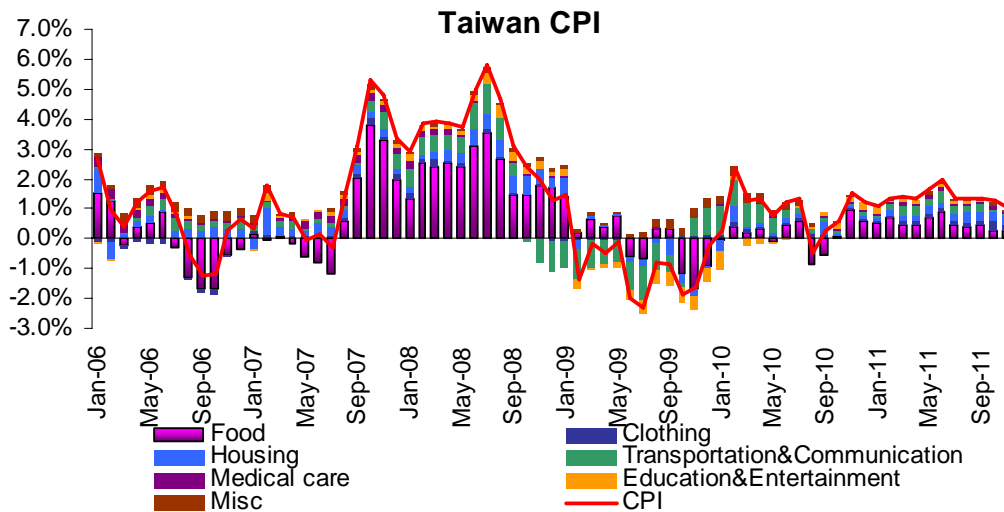
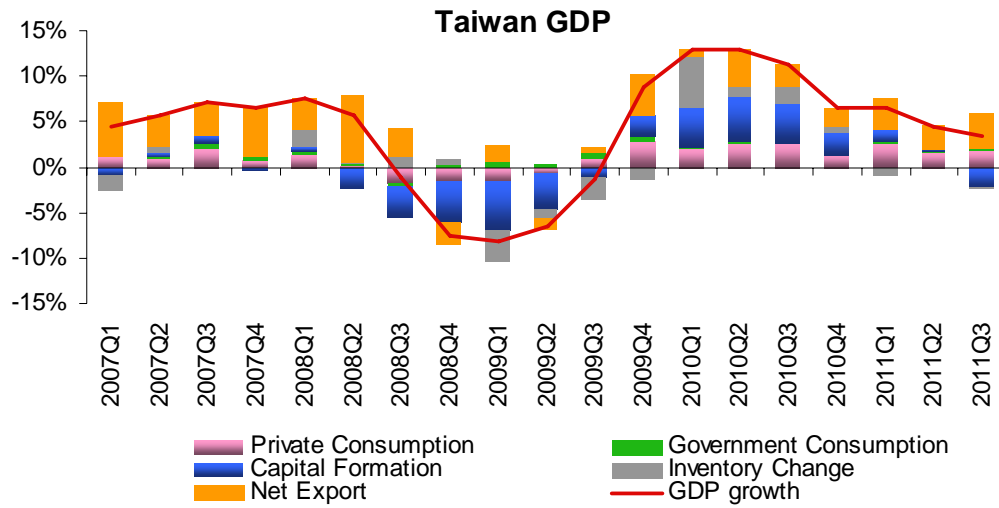
Nonetheless, the lackluster private investment growth could be partially offset by an increase in foreign direct investment. Although the early effects of the Economic Cooperation Framework Agreement (ECFA) with Mainland China were less impressive than expected, we expect Taiwan to benefit more from the ECFA next year as a gateway to Mainland China for global investors. Meanwhile the latest investment agreement with Japan signed in September also marked a starting point to attract more foreign investments into Taiwan.

Private consumption to provide some buffer

We expect private consumption to remain resilient in 2012 thanks to the stable job market and the still positive wealth effect from the property market. Taiwan's unemployment rate has declined steadily from 4.67% in 2010 to 4.28% in September 2011. Additionally, Taiwan's tourism market is likely to be supported further by influx of Chinese tourists, providing another layer of support to the domestic economy. That said, despite providing a buffer, private consumption cannot help the overall economy from slowing down in 2012, amidst the significant drag from a steep fall in external demand and an uncertain outlook in fixed investment. In our baseline scenario, Taiwan's economic growth is likely to slow to 3% yoy in 2012.

Risks

Although we don't expect Taiwan to fall into full recession in 2012, there are increasing tail risks in our view due to two main reasons, namely a heightened political risk and less spending power of the government. The close race between the ruling Kuomintang Party and the opposition party for 2012 President Election creates many uncertainties on the ties between Mainland China and Taiwan. Taiwan's economic growth prospect and structure could face reshuffle should opposition party win the election in 2012, leading to potential short term volatility in growth and market sentiment. Meanwhile, after running a persistent fiscal deficit for the past four years, Taiwan's government debt to GDP ratio is fast approaching the legal limit. This leaves the government less room to prime pump the economy via a proactive fiscal policy should global growth continue to sour.



Source: CEIC, OCBC

Recovery Efforts to Bolster Growth

Set to rebound in 2012

Prospect of the Thai economy in 2012 depends as much on the state of the global economy as the extent of recovery efforts in the aftermath of the disastrous floods that have gripped the nation since late Q3 2011. Following what is anticipated to be a dismal 1.5% yoy 2011 GDP growth in 2011, we look for the Thai economy to rebound in 2012. While the overall impact from the floods is not completely known as yet and the adverse effects may sustain well into Q1 2012, the initial recovery efforts are likely to see a spike in both private and public sector expenditure, especially with the government fully committed to help revive the country's growth momentum. We, however, expect the pace of absorption to be slow, given that some major companies may not fully resume their production until Q2 2012. Coupled with a slowing external demand, we expect the lagged impact from the recovery efforts to spur a still below trend 3.8% yoy GDP growth in 2012, but a decent performance in any case.

Contraction in major industries still likely in early 2012

From the industry perspective, the manufacturing sector remained as the top driver of growth in Q3 2011, with its 1.3 percentage point contribution and close to a 40% yoy expansion in the period. This was hardly surprising given that exports still recorded a robust 12.5% yoy growth in the same period. Yet, business sentiment index has plunged to multi-year low in Q4, deeply in the bearish territory, and likely to remain weighed until Q2 2012 or until there are signs that the global economy is on a stronger footing. Note that while we look for exports growth to recover in Q1 2012 from an anticipated -15% yoy in Q4 2011, we still expect a contraction in exports of about 5-7% to kick off 2012. Other major industries are also likely to see a stronger rebound only in Q2 2012, with automobiles production likely to return to normal towards end-H1 2012. Meanwhile, agriculture products may also continue to see a 5-10% contraction in output in early 2012, with rice production alone estimated to have declined by about 20-25% in Q4 2011. The total economic cost from the floods is still largely an unknown at this juncture, but we estimate the direct impact alone to be about USD 10-15bn or as much as 3-5% of nominal GDP.

A cautious sentiment to limit private consumption growth

The spill over impact on private consumption and new investment is likely to be pronounced, especially considering that even in Q3, private sector contribution remained below its potential trend. While the 3.4% private consumption growth in Q3 means that it has inched up closer to its medium-term trend, it should be noted that fiscal spending has continued to outpace the private sector. After a rather strong improvement in Q2 and Q3, consumer confidence index is likely to slide back towards the 2011-lows, driven by the negative wealth impact from the floods and the selloff seen in the financial markets. A somewhat cautious sentiment is likely to sustain well into 2012, keeping private consumption growth in check, although the low base effects are likely to mean that it may inch higher to about 5-5.5% in 2012.

Fiscal expenditure to be the main support

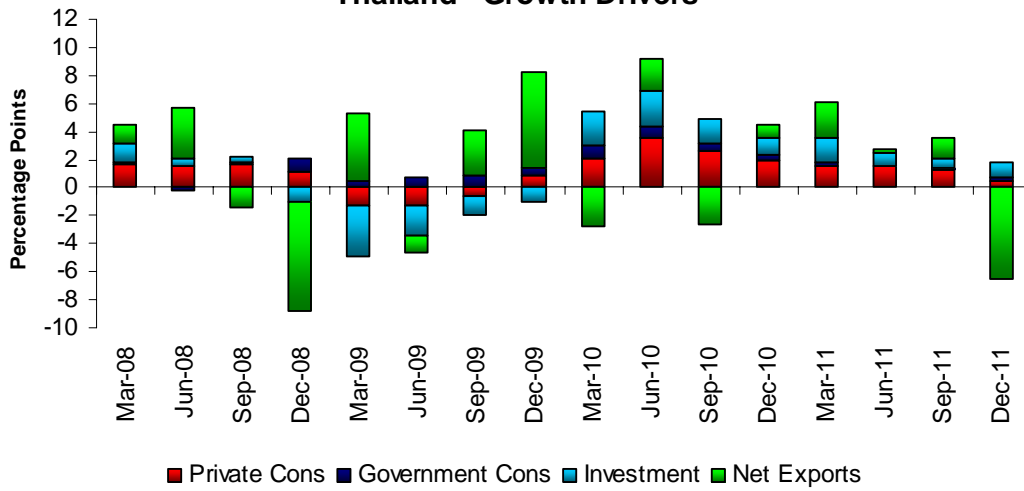
By and large, however, we expect fiscal expenditure to be the main support of the economy. We expect fiscal expenditure to grow by about 7-8% in 2012, just a tad lower than the pace of growth seen in the aftermath of the 2008 Lehman collapse. While the 2011 elections went by rather smoothly, the deeply entrenched urban-rural divide remains a prevalent threat that is likely to spur the current populist government to continue maintaining its promised high fiscal spending in the coming years. Note that even before the floods hit, the newly elected Thai government has already signalled its intent to keep an expansionary fiscal policy through the implementation of its populist policies, including the likes of the rice buyback scheme. Given that its fiscal deficit is currently estimated at about 3.5% of GDP, the Thai government has some fiscal room to consider extra pump-priming should the global economic growth continue to sour going forward. We expect fiscal deficit close to about 5% of GDP in 2012.

BOT to frontload its monetary policy loosening

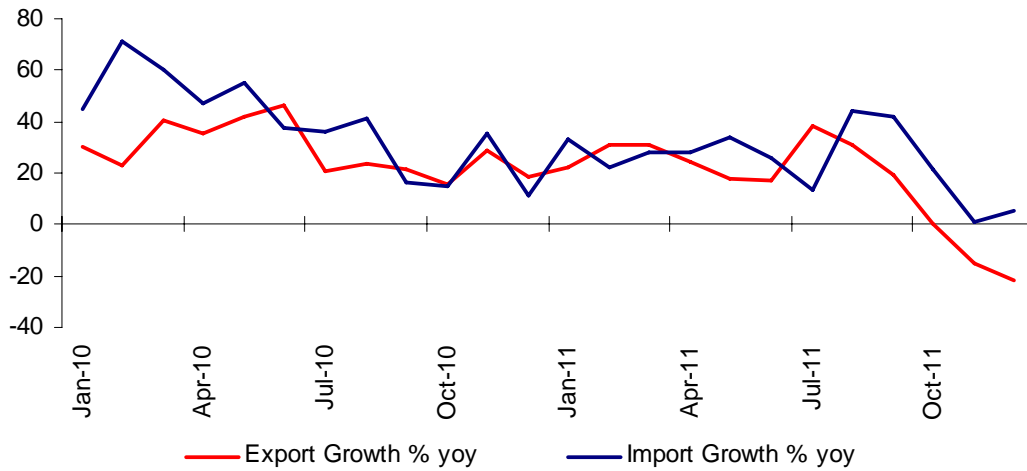
On inflation, core inflationary pressures will be fairly supported by the string of expansionary policies adopted by the government. Core inflation is unlikely to dip anytime soon and the government's new minimum wage policy would only exaggerate the matter. On this front though, the actual implementation of this new wage policy is set to be delayed now that the economy is struggling to get back on full speed, and we do not rule out the government delaying it further. Essentially, we don't expect inflationary pressures surging significantly in 2012, despite earlier concerns over the impact from a wage-price spiral on inflationary expectations. Indeed, while still emphasizing on the longer-term inflationary trend, the BOT has recently toned down its rhetoric on inflationary pressures for 2012. The BOT has delivered a 25bps rate cut in late November 2011 and indicated room for further rate cuts in early 2012. Given our view that a full resumption of production is unlikely to kick-off up until we are well in 2012, another 50bps rate cuts are imminent in H1 2012.

Overall, we are set to see the Thai economy rebounding in 2012 to chalk a 3.8% yoy expansion, well above the 1.5% yoy anticipated for 2011. While the risk of a renewed political tension is likely to persist in Thailand, the more crucial factor to watch out for will be the extent and pace of the recovery efforts. A slowing external demand, however, poses the potential hurdle that may trigger a marked delay in private sector's reinvestment activities.

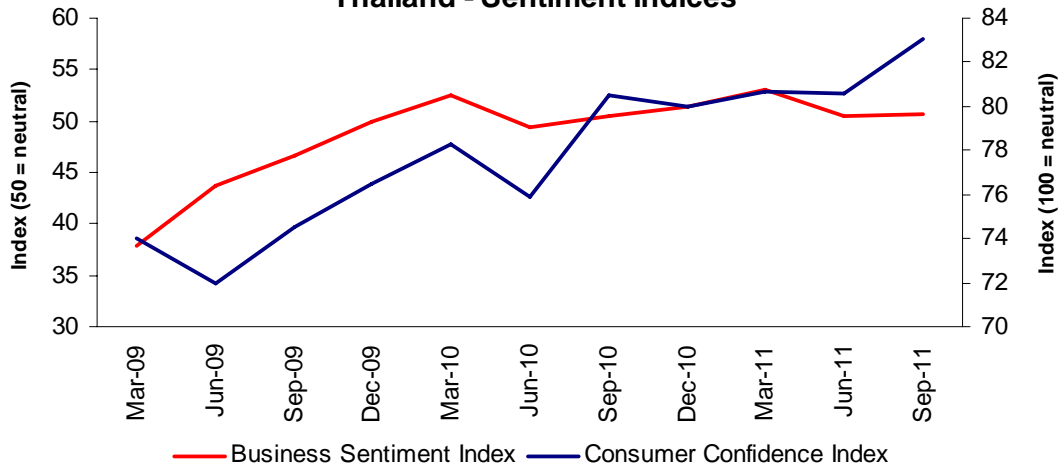
Thailand - Growth Drivers



Thailand: Trend in Export Growth



Thailand - Sentiment Indices



Source: CEIC, OCBC

New Year, Same Problems

A new year, same problems

The problems of high inflation and persistent deficits in both the trade and fiscal accounts that have been plaguing Vietnam in recent years will most probably remain prevalent in 2012. Inflation, at an excessively high 18.7% yoy far outweighs the 5.8% yoy GDP growth anticipated for 2011. Meanwhile, total trade deficit in 2011 is expected to possibly exceed \$10 billion, or about 80% of its FX reserves, while budget deficit is estimated at 2.4% of GDP. Given downside risks to global growth in 2012, not only will Vietnam's economic growth continue to moderate but we also expect the twin deficit problem to sustain in the economy. On broad expectations, we expect the economy to chalk a 4.5% yoy expansion in 2012, lower than the official projection at 6.0-6.5%, while CPI may only ease to 13% yoy, above the official forecast of 10%.

Problems magnified by policy trilemma

Just like in 2011, Vietnam will face a choice in choosing between growth, inflation and trade deficit, and may be forced to give up at least one of them if they seek improvements in others. Managing inflationary pressures may stifle growth, while any efforts to improve trade deficit via a devaluation of currency may stoke inflationary pressures. This trilemma has led to policy inconsistencies, which often yield ineffective results that eroded official credibility.

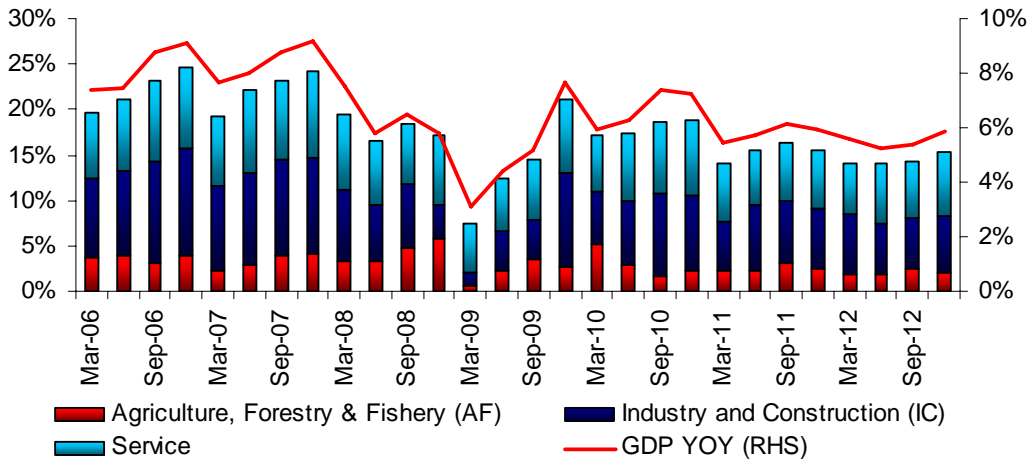
Going forward, we believe that Vietnam's top priority will be to tame inflation at the expense of growth, and the authorities may do this by raising the prime lending rate by at least another 200bps. Note that SBV had already hiked its refinancing rate to 15% from 9% and its discount rate to 13% from 7% in 2011 while keeping its prime lending rate unchanged. We also expect a possible devaluation of the VND at a similar pace in recent years to help reduce its trade deficit. Nonetheless, we think that these moves are insufficient to rectify the issues as they do not solve the core structural problems that had been dominant in the economy and the lack of structural reforms are apparent.

Reform plans in place but effectiveness remains in question

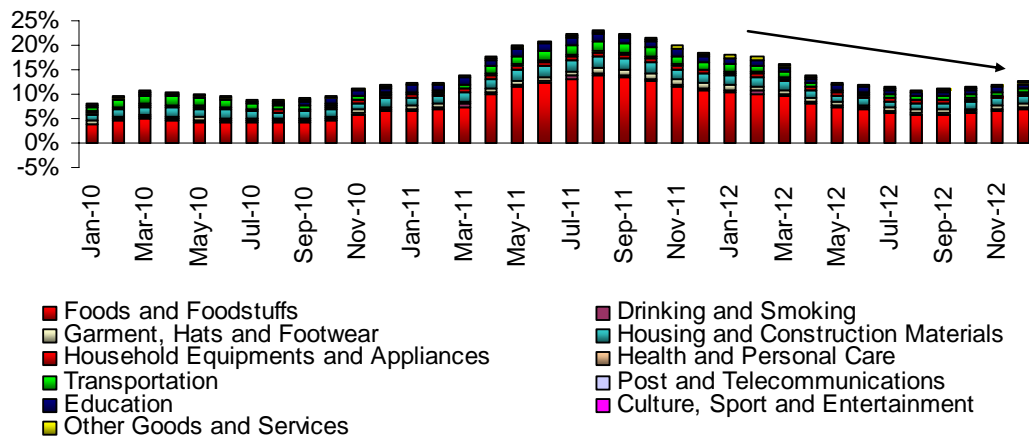
The authorities are aware of the structural shortcomings that have been weighing on the economy and have proposed a series of reforms to ensure greater stability in the medium-term. Key to the reform is the attempt to shift the current economic model away from the reliance on cheap labor and capital by focusing on three areas: banks, public spending and state-owned enterprises (SOEs). Firstly, in a clear effort to conform to stricter standards of corporate governance, the government is planning to separate ownership and management in SOEs while pushing these SOEs to shrink their holdings in non-core businesses. Additionally, to boost public coffers, a string of privatization of SOEs is on the cards, especially in industries like seafood, textiles and coffee. Next, in an attempt to enhance efficiency in the banking industry, the SBD aims to have 15 "big" banks by 2015 that make up about 80% of the local market. Lastly, we believe that SBV may embark on another round of de-dollarisation to boost confidence on the Dong.

While the need to improve transparency and official credibility is vital in restoring public confidence, the transparency and efficacy of these reforms remain questionable. Any immediate boost to growth maybe limited, especially since there is likely to be a sizeable lag before we can witness the positive impact from these reforms. In any case, domestic confidence remains mired in a mix of high inflation and falling export earnings. Despite the anticipated privatization of several SOEs, we expect little increase in foreign direct investment into Vietnam, leaving little reasons to suggest that growth will pick up in 2012.

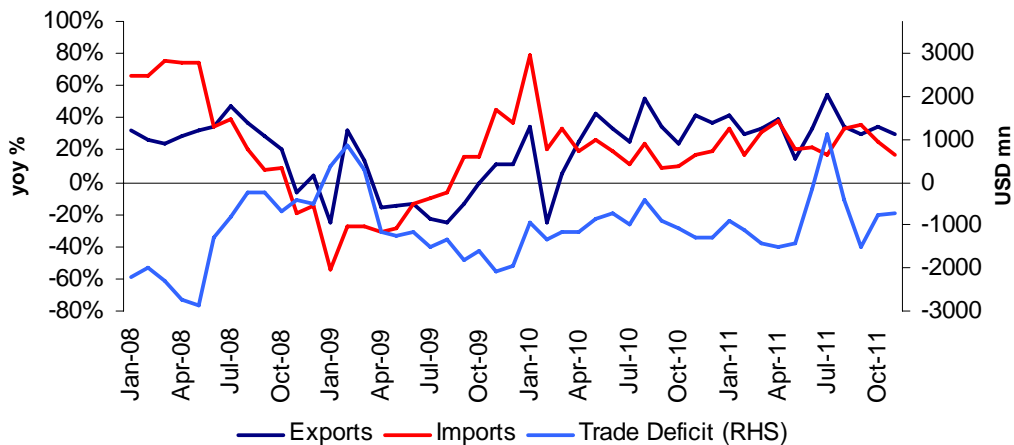
Growth is expected to ease to 4.5% in 2012



Vietnam Inflation to moderate to 13% next year



Vietnam's consistent trade deficit



Source: CEIC, OCBC

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