OCBC GLOBAL OUTLOOK 2016

OCBC Bank

2016 Global Themes

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A key turning point has been reached. The US Federal Reserve began to execute its widely anticipated monetary policy normalization by initiating its first interest rate hike in December 2016. So far, the much-feared repeat of the "taper tantrum" has not materialized. That said, mid-December 2015 was hardly a "happening" period for financial markets, and the start of 2016 may be a more appropriate gauge to take the pulse of the global economy. So far, the first few trading days of 2016 have hardly been encouraging, starting with the turbulence in China's stock market post-a weaker than expected Caixin manufacturing PMI print.

That said, it is too easy to assume that 2016 will be a replay of the 2015 themes. For one, the US unemployment rate is already back to pre-crisis levels, and other labour market measures suggest that there is declining slack in that labour market. Second, the December median dots graph remains significantly more hawkish than what market players have priced in, and the familiar restrain of "don't fight the Fed" may gain volume as the FOMC remains true to its word and executes its second 25bp rate hike sometime in spring 2016. This is assuming the crude oil prices does not continue to head south from its current US$30+ per barrel price range and throw the Fed's core PCE inflation target further askew.

In our view, the key risks for 2016 remain namely growth and policy-centric, and largely revolving around a potentially too hawkish FOMC in the US, the ongoing deceleration in China with the attendant possibility for (unintentional?) policy mis-steps as policymakers restructure and reshape the economic model, and the persistent commodities rebalancing theme. The demand slowdown in China has significant knock on impact on regional manufacturing and trading patterns. Rather than focusing on Chinese equity market volatility, our view is that a potentially weaker CNY (whether against the USD or from a basket perspective) in particular and the China policy reaction may engender a fair amount of contagion and volatility to financial markets and currencies, especially within Asia.

Asia's growth outlook has stabilized in 2H15, and this was accompanied by an improvement in market sentiments in 4Q15. ASEAN's 3Q growth points to stronger economic momentum in Philippines and Vietnam, whilst the flash 4Q15 GDP growth estimates for Singapore also surprised on the upside, albeit lifted more by domestic services and public construction projects. The launch of the ASEAN Economic Community (AEC) on 31 December 2015 could also potentially spur intra-regional trade and in particular the liberalization of the services sector could herald the new engines of growth for the region. Other more recent initiatives like the One Belt, One Road (OBOR) and the Trans-Pacific Partnership (TPP) could also bode well for the medium-term growth prospects for the region.

However, the immediate challenges to Asia lie within our shores. So far, the manufacturing PMI cues are pointing in the right direction, albeit still somewhat lackluster and trapped in the contraction territory (<50). Those for most of Asia recently saw some improvements, especially with South Korea and Taiwan registering expansions (>50), but China's official and Caixin manufacturing PMIs continued to diverge and the underperformance of the manufacturing vis-à-vis the services PMI illustrates the two-track economy. It will be critical is to keep up the economic and policy reforms, particularly in key countries like Indonesia and Malaysia, while ramping up the infrastructure investments where fiscal space allows. Given the very benign crude oil price environment, many Asian central banks like BI will be looking for maneuver room on interest rates while allowing FX to function as an escape valve. While most central bank rhetoric still firmly lies in the camp that inflation, while currently below target, will gradually rise as the low commodity price shock fades, we do not see this transpiring in the first half of this year. Our crude oil price forecast is for WTI and Brent to crawl back to the US$50 handle by year-end, but downside price surprises may dominate in the first half of this year given Iranian supply and OPEC acquiescence. Meanwhile, geopolitical risks, particularly Middle East tensions, may continue to rear its head from time to time and should not be ignored but will not be within the scope of this outlook piece. Some key political events to take note of are Philippines presidential and general elections on 9 May, UK's potential referendum on EU membership in June, and US presidential elections on 8 November 2016.

From the asset allocation perspective, indigestion pains are just beginning with the Fed's monetary policy normalization, but the silver lining is that to-date there has been no USD liquidity situation into end-2015 after the first Fed rate hike in mid-Dec. If anything, the willingness of major central banks to provide liquidity injections and intervene to mitigate any systemic market fallouts. Does this mean that it is time to bet on the downbeaten underdogs such as commodities and high-yield bonds? Do read on. For all the Star Wars fans, may the force be with you in 2016 even as you navigate the market flux.

OCBC Asia GDP, CPI and Policy Rate Forecasts

GDP					
% chg year-on-year	2013	2014	2015F	2016F	2017F
US	1.5	2.4	2.5	2.5	2.4
Euro-zone	0.3	1.4	1.8	1.9	1.9
Japan	1.4	0.0	0.6	1.1	0.7
United Kingdom	2.2	2.9	2.4	2.3	2.2
New Zealand	1.7	3.0	2.2	2.4	2.5
Australia	2.0	2.6	2.3	2.6	3.0
China	7.7	7.3	7.0	6.7	6.2
Hong Kong	3.1	2.5	2.2	2.3	2.1
Taiwan	2.2	3.7	1.0	2.0	2.5
Indonesia	5.6	5.0	4.8	5.1	5.3
Malaysia	4.7	6.0	4.8	4.7	4.8
Philippines	7.1	6.1	5.7	6.0	6.0
Singapore	4.4	3.0	2.0	2.5	2.7
South Korea	2.9	3.3	2.6	2.9	3.0
Thailand	2.8	0.9	2.7	3.2	3.5
Vietnam	5.4	6.0	6.7	6.6	6.5

Inflation					
% chg year-on-year	2013	2014	2015F	2016F	2017F
US	1.5	1.6	0.1	1.8	2.2
Euro-zone	1.5	0.6	0.1	1.1	1.6
Japan	0.3	2.7	0.8	0.8	2.0
United Kingdom	2.6	1.5	0.1	1.3	1.9
New Zealand	1.1	1.2	0.4	1.8	2.0
Australia	2.5	2.5	1.5	2.3	2.5
China	2.6	2.0	1.4	1.6	2.0
Hong Kong	4.3	4.4	3.0	3.0	3.0
Taiwan	0.8	1.2	-0.4	1.0	1.1
Indonesia	6.4	6.4	6.7	4.5	4.6
Malaysia	2.1	3.2	2.8	3.0	3.1
Philippines	2.9	4.2	1.4	2.7	3.2
Singapore	2.4	1.0	-0.4	0.0	1.5
South Korea	1.3	1.3	0.7	1.5	2.8
Thailand	2.2	1.9	-0.9	1.4	2.0
Vietnam	6.0	1.8	0.6	2.8	4.2

Central Bank Policy Rate					
	2013	**2014**	**2015**	**2016F**	**2017F**
US Fed Funds rate	0.25%	0.25%	0.50%	1.25%	2.25%
ECB refinance rate	0.25%	0.05%	0.05%	0.05%	0.05%
BOJ overnight rate	0.10%	0.10%	0.10%	0.10%	0.10%
BOE base rate	0.50%	0.50%	0.50%	1.00%	1.50%
RBNZ cash rate	2.50%	3.50%	2.50%	2.50%	3.00%
RBA cash target rate	2.50%	2.50%	2.00%	1.75%	2.00%
China lending rate	6.00%	5.60%	4.35%	4.10%	4.10%
CBRC discount rate	1.88%	1.88%	1.75%	1.63%	1.63%
Hong Kong base rate	0.50%	0.50%	0.75%	1.50%	2.25%
BI reference rate	7.50%	7.75%	7.50%	7.00%	7.00%
BNM overnight rate	3.00%	3.25%	3.25%	3.25%	3.25%
BSP overnight reverse repo	3.50%	4.00%	4.00%	4.25%	4.50%
Singapore 3-month SIBOR	0.40%	0.46%	1.13%	2.03%	2.53%
BOK target overnight call	2.50%	2.00%	1.50%	1.50%	1.50%
BOT repurchase rate	2.25%	2.00%	1.50%	1.75%	2.00%
SBV base rate	9.00%	9.00%	9.00%	9.00%	9.00%

Source: OCBC

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CHINA

Bottom Line Thinking

The Chinese economy decelerated further to 6.9% in the first three quarters of 2015 from 7.4% in 2014 as a result of falling investment growth and weak external demand. Although China is on track to achieve its "around 7%" growth target for 2015, the underlying stress, such as excessive capacity and high corporate leverage, remains the key hurdle for Chinese economy to find a bottom in the near term. For example, China's producer prices have fallen for 45 consecutive months as of November 2015, not seen in record. The latest reading of 5.9% yoy decline clearly signalled that the excessive capacity problem is likely to persist in the foreseeable future. Given commodity prices, ranging from oil to metals, are expected to remain low at least for the next half year, we expect the restock cycle is unlikely to kick off soon, which may further weigh down on growth prospect.

Looking at the breakdown of the growth, old growth engines are clearly losing steam. Industrial production decelerated to 6.1% in the first eleven months of 2015 from 8.3% in 2014 while fixed asset investment growth slowed down to 10.2% from 15.7% in 2014 led by the collapse of real estate investment growth, which only marginally grew by 1.3% in the first eleven months down from 10.5% in 2014. One of the reasons why old growth engines are slowing down more than expected in 2015 is because China is unwilling to repeat the same mistake as it did in 2009 to over stimulate its economy. As such, a more defensive and balanced stimuli approach dominated this year under the framework of bottom line thinking. The purpose of stimulus is to buying more time to roll out more reforms rather than artificially boosting growth numbers in our view.

The change of mentality also explains why the Chinese economy failed to respond to monetary policy easing in the first half of this year even though the PBoC has accelerated its easing monetary policies since November 2014. The relatively tight fiscal policy, together with weak real effective demand as a result of excess capacity, disrupted the transmission mechanism of easing monetary policy. Looking back over the past year, China is using easing monetary policy to provide a floor for growth while fine tuning its stimulus measures via fiscal policy in reaction to the changing global environment. Since the second half of 2015, China has increasingly loosened its fiscal policy to weather the negative impact of Greek crisis as well as slower than expected global recovery.

To recall, China has rolled out a number of key fiscal measures to support the growth. First, China accelerated local government debt swap and increased the local government debt swap ceiling for 2015 to CNY3.2 trillion. Second, the State Council announced to lower the capital fund requirements for certain infrastructure projects in September. The capital fund for the construction of harbor and airport will be lowered to 25% from previously 30% while capital fund for the construction of railway, highway and urban mass transit will be lowered to 20% from 25%. The reduction of capital fund is the first time since 2009 global crisis. Third, a special financial bond program has been launched in August 2015 to support the capital needs from certain companies. Those fiscal measures are working well and are expected to supplement monetary easing to support China's around 7% growth target in 2015.

2015 is a remarkable year for all Chinese investors. The equity market rout in summer and RMB's depreciation since August have raised concerns about Chinese government's ability to manage its economic transition amid slowdown in growth. However, the unexpected volatility in capital market did not hold back China's commitment to reform and market driven pricing mechanism. 2015 is not only a year of volatility but a year of reform as well. China has realized two remarkable achievements in 2015 including full liberalization of interest rate and recognition of RMB's freely useable status by IMF.
Looking back, the bottom line thinking approach has helped China strike the balance between growth and reform. It seems to us that China is doing fine with this approach. China is able to reach its growth target while continuing to tick the box in its reform list. Looking ahead, we think the bottom line thinking approach is likely to remain the key theme in 2016.

Five goals

In the latest Central Economic Working Conference that concluded on 21 Dec, Chinese government has laid out five goals for 2016 including de-capacity, de-leverage, de-stocking of housing inventory, lower funding costs and supply side structural reform to offset weakness. The five goals, in our view, confirmed China's bottom line thinking approach. De-capacity and de-leverage, which aim to pursue a healthy sustainable growth, signal China's higher tolerance for slower growth. However, de-stocking of housing inventory via government purchase shows China's commitment to keep systemic risk in check.

Systemic risk is expected to be contained

The risk of systemic shock to global growth from China becomes more real after rising volatility in China's capital market and spread of default from private owned companies to state owned companies. Nevertheless, we believe, the systemic risk in China is still contained due to relatively healthy household sector and strong central government balance sheet. There is room for China to shift leverage ratio from high leveraged sector to low leveraged central government with the help of a more proactive fiscal policy. China plans to increase its fiscal deficit to 3% of GDP in 2016 from currently about 2% level.

Talking about leverage problem in China, China's corporate sector always draws the most attention. Although there is no official figure about China's corporate debt to GDP ratio, it is widely believed the ratio has been close to 150% according to estimation by a prestigious think tank in China. This, by any means, is a very high number. However, we would like to argue this number may not trigger any imminent crisis in China from two perspectives. First, the high corporate leverage is partially attributable to dysfunctional equity financing for the past few years due to weak sentiment. Should China move towards a registration based equity offering system and equity financing play a bigger role, the high corporate leverage is likely to be lowered. Second, China's relatively high saving ratio is likely to provide buffer to high corporate leverage, similar to Japanese experience. Japan's high saving ratio prevents Japan from credit crisis despite high government leverage.

There will be four implications for Chinese economy in 2016 under bottom line approach. First, China will not over stimulate its economy. As such, the downward trend for growth is likely to persist as a result of persistent excessive capacity issues. Second, China will guard against the systemic risk. The de-stocking of housing inventory goal and the implementation of macro prudential assessment by PBoC to broaden its supervisory on banking sector are the latest measures to help China avoid systemic risks. Third, China will continue to push through its reform to drive economic transition towards service and consumption driven economy. As such, the percentage of service sector in China's GDP is likely to increase further. Fourth, the bottom line approach also suggests that China is likely to reduce its intervention in its RMB market to allow higher volatility.

To conclude, we think the outbreak of systemic risk is not in our baseline. The economy is likely to slow further in 2016 as a result of persistent excessive capacity problem. On a positive note, the transition towards service and consumption driven economy is likely to provide buffer to China's growth. Therefore, we expect China to grow around 6.7% in 2016.

On monetary policy, given that China has completed the first step of interest rate liberalization, the move towards an interest rate corridor monetary system suggests that the room for further interest rate cut could be limited though cannot be ruled out. This is also in line with China's bottom line thinking approach. We only expect one more interest rate cut in 2016 to underpin China's recovery. RRR cut is likely to be the focus of monetary policy tool in 2016. Given China's capital outflow risk is likely to persist, RRR cut is still necessary to offset the negative impact on China's onshore liquidity. However, given onshore liquidity is still relatively flush currently, we expect three more RRR cuts in 2016.

HONG KONG

Weak Retail Sector And External Trade

HK economic growth slowed down to 2.3% yoy in 3Q 2015, down from 2.8% yoy growth in the preceding quarter. Domestic demand remained the key driver of growth. Sluggish tourist spending and lackluster external demand dragged down growth whereas offshore financing activities provided some support. Meanwhile, headline inflation was tepid and the upside risk of HK CPI inflation (2.4% in November) is expected to be limited this year given low energy prices and weak performance of the retail sector which was partly supported by tourism spending. Besides, residential property market is expected to build up risks amid the sluggish market sentiment and rate hike in US.

Weak tourism and sluggish retail sales would continue to hit the economy

The downward cycle in tourism and retail sectors remain intact due to the anti-corruption campaign in Mainland. For the first eleven months of 2015, total retail sales decreased by 3.1% yoy, indicating that business environment worsened in the retail sector amid subdued tourists spending and weak inbound tourism, as visitor arrivals fell by 0.8% yoy in January to October (+12.08% yoy in the same period of 2014). The luxury segment remained the major drag on HK retail sales, with value of sales of jewelry and watches sliding for the 14th straight month by 20.6% yoy in November.

Amid weak tourist activities and luxury consumption, unemployment rate in retail sector averaged at 4.6% in the first eleven months, which was disappointing compared with average of 4.4% in 2014. Overall, HK's labor market remained stable. Unemployment rate printed 3.3% in November while underemployment rate recorded 1.3%.

In the near term, HK retail sector is likely to be constrained by weaker tourism activities caused by a tightened visa policy and negative sentiment on Mainland parallel trade despite overall stable labor market conditions rendering support to local consumer spending. Meanwhile, the anti-corruption campaign and slowdown in the Chinese economy will continue to weigh on HK retail sector, which would translate into a negative outlook for the retail shop market in terms of rental and prices.

HK trade performance remained sluggish

Exports to major markets, including China and Japan extended the declining trend. Worse still, exports to US posted notable decline of 5.5% yoy in November, which was the third drop after rising for five straight months.

HK exports dropped 3.5% yoy to HK$ 315.3 billion in November, recording negative growth for the 7th consecutive month. Meanwhile, import growth also dropped 8.1% yoy in November. For the first eleven months of 2015, the value of total exports of goods dropped by 1.9% yoy. We expect trade growth to remain tepid in 1H 2016 due to economic headwinds from China, soft demand of major trade partners and the policy divergence between the Fed and other major central banks.

Offshore financial activities would slow in 2016

CNH depreciated by around 5.6% from July to December after PBoC reformed RMB fixing price mechanism. Demand for the CNH shrank amid RMB depreciation. RMB deposit in Hong Kong recorded RMB 864 billion in November, falling 13.9% YTD due to higher CNH volatility while total deposits in HK increased 6.0% yoy to HK$ 10,678 billion. As volatility of CNH is expected to remain high in the coming months given RMB internalization and sluggish outlook of Chinese short-term economy, we believe RMB deposits in HK would continue to decline in near term.

Mainland-related lending dipped 3.1% qoq to HK$3.38 trillion at the end of 3Q 2015 from HK$3.49 trillion at the end of 2Q. Liquidity in Mainland increased as PBoC cut interest rates in October for the 5th time in 2015 and reduced RRR from 20% to 17.5% over the first ten months, which decelerated the growth of Mainland-related lending in HK. This is because interest rate differential narrows between Mainland and HK. In addition, banks in Hong Kong are also more cautious on Mainland-related credit as the Mainland economy becomes weak.

Increase in financial integration with Mainland amid the opening up of capital account

The mutual fund recognition scheme launched on the 1st July is another key step to the liberalization of Mainland's capital account following Shanghai-Hong Kong Stock Connect. This scheme allowed funds domiciled in HK and China to be transacted in each other's market. The initial quota for the mutual fund recognition is RMB300 billion for each direction. There are around 100 HK-based and 850 Mainland funds qualified for the scheme.

The 13th Five Year Plan also claimed to have achieved convertibility of the capital account and liberalized the use of the RMB across the border. Next step could be the implementation of QDII2 which allows qualified individuals to invest in overseas directly, the launch of Shenzhen-Hong Kong Stock Connect Scheme and the expansion or even cancellation of quota limit of QFII and QDII. All these would help enhance HK's role as an intermediate to connect foreign and Mainland market. It is likely that more investment accounts would be opened in financial institutions in Hong Kong by individual investors to better manage their investment. This will benefit Hong Kong brokerages, as well as HK financial consulting agencies serving high net-worth individuals in the Mainland. Looking forward, more securities companies, fund houses and brokerages would locate their headquarters in HK to earn extra commissions and services fees, which eventually helps boost HK economy and buoy the labour market.

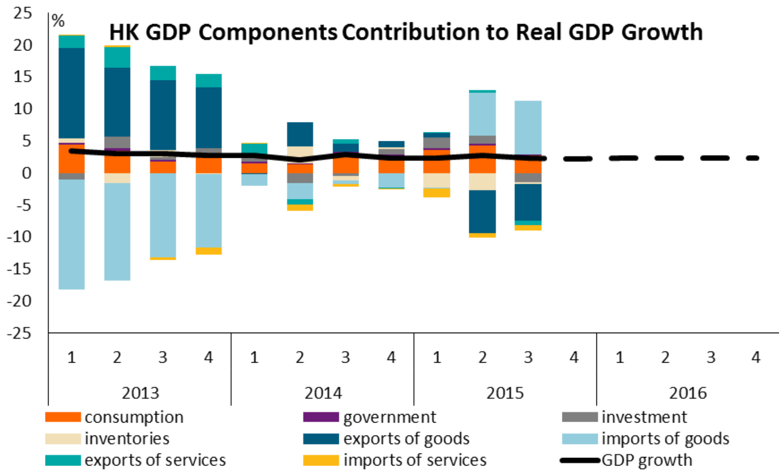
HK residential property faces risks

Though residential property market in HK remained firm on end-user demand, headwind in the market emerged. HK overall residential property price rose for the 19th straight month on monthly basis by 11.87% yoy (8.7% YTD) in October, but the growth rate has slowed down for 6 consecutive months amid the increasing supply, deteriorating market sentiment as well as the rate hike in US.

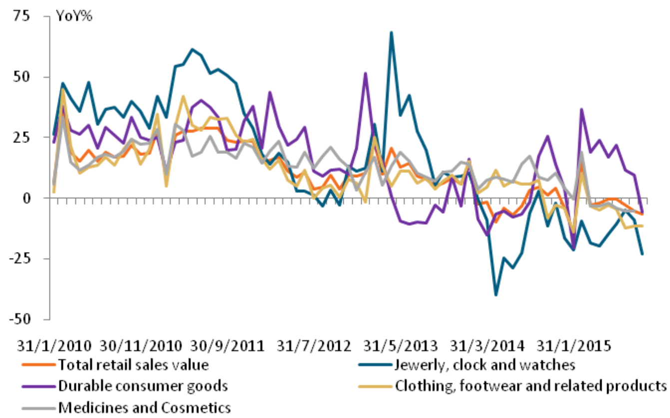
In coming years, housing supply could increase markedly. Public rental housing supply is expected to roughly average at 14,620 units for 2016-2018 compared with the average of 13,007 units in 2010-1014. The 2015 Policy Address also forecast that the private sector will produce about 14,600 flats on average each year in the next five years, representing an increase of about 30% over the past five years.

Besides, residential property transaction volume declined to average 3,390 units in 4Q from average of 5,377 units in 1H, recording year-on-year negative growth rate for the ninth consecutive month and falling 33% yoy to 4,043 units in December. We believe the sluggish economic outlook of HK and the fear of job losses amid the deteriorating retail sales will continue to side-line some home buyers.

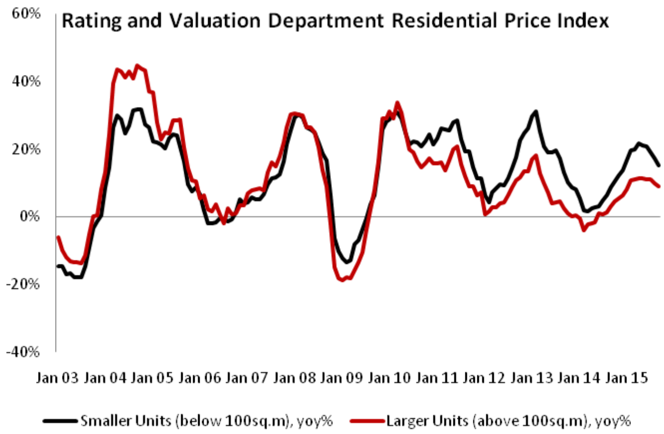
Looking forward, HKMA's mortgage rules announced in early 2015 would continue to mainly deter end-user demand for smaller ticket flats. Moreover, due to sluggish market sentiment, increasing housing supply and US rate hike, private housing price could decline around 5% by the end of 1H 2016.



Retail Sales Growth by Categories



Residential Property Price



Source: Land Registry, Census and Statistics Department.

Source: Bloomberg, OCBC Wing Hang

INDONESIA

Slowly Does It

There is a saying in Bahasa Indonesia, which goes “*Biar lambat, asal selamat*.” It roughly means “It doesn’t matter if you go slowly, as long as you get there safely.” Looking back, that appears to have been a motto that had been unwittingly adopted by the Indonesian economy throughout 2015. Growth is likely to have slowed to 4.8% for the year, just a whisker above the 4.7% rate of GDP growth printed in the post-Lehman tumults of 2009.

On one hand, given the multitude of global challenges – from the Fed and China to commodities slump – Indonesia’s growth rate last year was not a complete disaster. On the flip side of it, however, there is nevertheless an air of disappointment, in part due to the sense that, with its potential, the economy could do so much better.

For the year ahead, Indonesia can indeed do better – albeit not by much. We think growth will pick up, slightly, to 5.1% in 2016. Let’s look at some of the key reasons below.

Spend it please

One of the key reasons for the let-down in 2015 growth was the slow disbursement of government spending. In general, the take-up rate of spending by government ministries and agencies follow a certain seasonal pattern, whereby disbursement tends to be slow early on only to pick up later in the year. Last year, however, the pattern was especially exacerbated by a number of reasons.

For one, the new Jokowi government, which took over in late 2014, opted to revise the budget spending guidelines early in 2015 – a process which took about two months. At the same time, there was also a mishmash of revamp in the setup of ministries – with some mergers here and disbandment there – which meant that spending, which is already slow to start normally, was pretty much stuck in the mud for much of the first half of the year.

Now, for the year ahead, it appears that these teething problems would be much reduced. The government has learned the lessons. Crucially, it had frontloaded the tender process for its infrastructure projects, so that the construction process can proceed early in the year, rather than wait for the slow wheels of bureaucracy to turn.

Funding for infrastructure itself may be less of an issue now than before. Domestically, the riddance of large-scale fuel subsidies left money on the table for infrastructure spending. Moreover, the setting up of AIIB allows an extra international channel of funding in and of itself, and has prompted more eagerness from ‘competing’ multilateral agencies such as ADB and the World Bank to be more keen in opening up their wallets to fund infrastructure in Indonesia.

To be sure, this is not to say that infrastructure build-up in Indonesia would henceforth go on completely unimpeded. After all, big projects which involve large-scale land acquisition still have a tendency to run into issues on the ground. For example, the USD4bn, 2000-megawatt Batang power station construction in Central Java – which has long been hailed as a showcase project – ended being plagued by land acquisition problems since it began in 2011. However, in aggregate, the smaller projects should be able to proceed more smoothly in 2016 compared to the false starts of 2015. In turn, that would help to remove one of the key impediments to growth this year.

Some Help

Apart from infrastructure-led government spending, we believe the outlook is better for private consumption as well, which is long the lynchpin for overall growth.

Some of the factors weighing on consumption, including currency volatility and a slump in commodities which affect spending especially in the outer regions, will continue to be forces to be reckoned with. However, private consumption should receive some help from rate cuts by the central bank.

To be clear, we do not expect Bank Indonesia to undertake a massive round of rate cuts this year. We believe the central bank – which has already been sounding increasingly dovish – will cut rate by a total of 50bps this year, frontloaded in Q1. The presence of threat of further global risk-off environment which would upset currency volatility yet again would prevent BI from cutting more than that. While such an amount of rate cuts will not be enough to trigger any kind of consumption boom by any measure, consumption is at the point where every little bit helps.

Another source of help for the consumers for this year should come from relatively tame inflation rates. Courtesy of favourable base effect from fuel price increase from a year prior, the year-on-year inflation rates should start 2016 at a fairly low rate of 3-4% in Q1. For the rest of the year, because our team's forecast has pencilled in a higher global oil price, the inflation rate is likely to trek up. As a whole, however, we still see prices remaining fairly tame, with inflation rate averaging 4.5% for the year – which should be helpful for household consumption demand.

Conditional Optimism

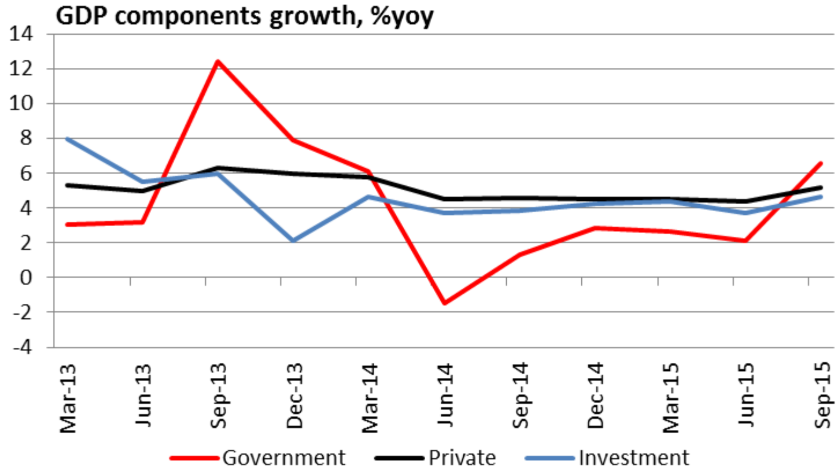
Overall, our optimism for Indonesia's economic outlook in 2016 is one that is admittedly rather provisional. While domestic factors such as faster infrastructure build-up and easier monetary policy would help, there are nevertheless potential adverse global factors that threaten to complicate things.

To start with, even though the much-dreaded event of Fed's lift-off had taken place in December last year without causing too much disturbance on global markets, the attention has now shifted to the rest of the Fed's rate hike journey. After all, as momentous as the initial hike had been, it is hardly a one-off. Just how the Fed can continue to adjust its policy rate upward, while keeping the possibility of a market rout to a minimum, will be watched keenly by Indonesia's policymakers.

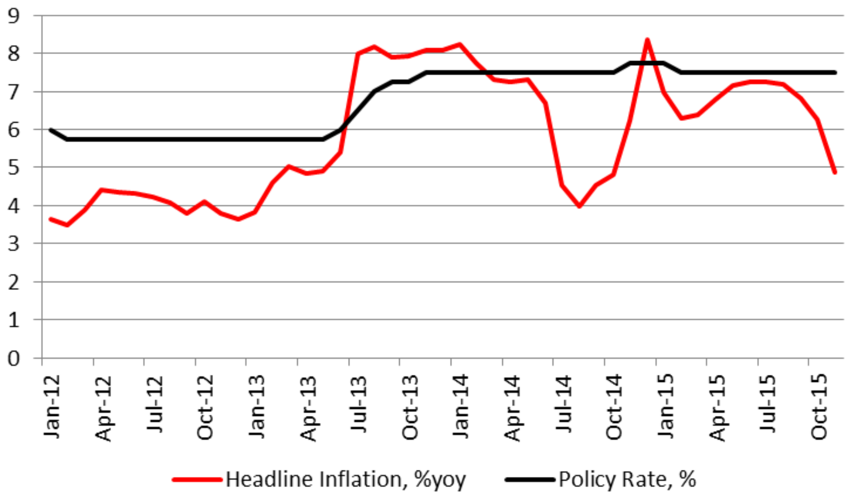
Partly because more than a third of its sovereign bonds is held by foreigners, any global market volatility has a tendency to be transmitted quickly to Indonesia via the currency market, and it remains a key risk area to look out for in 2016.

On top of that, what happens in China ranks high as well amongst global factors affecting Indonesia, not just because of direct trade linkages but also the effect on commodities.

GDP Growth



Inflation



Foreign Ownership of Bonds

Source: CEIC, Reuters, OCBC Bank

MACAU

Economic Contraction To Narrow In 2016

Macau GDP contracted for the 5th straight quarter by 24.2% yoy in 3Q 2015 due to a substantial decline in exports of services, of which exports of gaming services plunged by 37.4% yoy and exports of other tourism services dropped by 15.3% yoy. Weaker tourism and sluggish gaming sector amid global economic slowdown and China's corruption crackdown have been the main drags on the economy in 2015.

Looking forward, we expect the gaming sector to further shift its focus to the mass-market, which as a result would ease the impact of tumbling VIP revenue on gross gaming revenue. Moreover, expansion of the middle class in Asia, especially in China could also help to narrow the decline in both gaming revenue and economic growth in 2016. Additionally, the opening of more new hotels and associated entertainment facilities are expected to attract worldwide visitors, thus buoying recovery in hotel and tourism sectors and helping sustain the solid employment increase in these sectors. However, policy divergence between the Fed and major economies will result in further depreciation of major currencies. As MOP is indirectly pegged with USD, the Fed's rate hike cycle could further strengthen USD and suppress visitor spending in Macau, thus continuing to hit the retail sector.

Growth driver of gross gaming revenue shifts from VIP market to mass-market

Gross gaming revenue fell for the 19th straight month in December and slid 34.3% yoy to a five-year low of MOP230.84 billion in 2015. As gross gaming revenue stayed below MOP 20 billion for the 3rd consecutive month in August, the government was prompted to cut all budgeted current expenditure in the public sector by 5% effective from September 1st onwards to save MOP1.4 billion.

The main reason behind the slump in gross gaming revenue was the deteriorating VIP market due to China's anti-corruption campaign and global economic slowdown. Specifically, revenue from VIP tables recorded a double-digit yearly decline for the fifth straight quarter in 3Q, dipping 38.02% yoy to MOP28.99 billion. Worse still, China's restriction on offshore withdrawal amount from credit cards issued in Mainland will keep Mainland visitors farther away from VIP rooms. To avoid further loss, casino operators have either closed some VIP rooms or relocated them to the mass market. As a result, share of VIP revenue plunged to 53.3% in 3Q, compared with an average of 68.2% during 2010-2014. In this case, even though we still see downward risk on VIP revenue due to external headwinds, shrinking VIP share means that drop in VIP revenue would put less downward pressure on both gross gaming revenue and economic growth.

In contrast, revenue from mass-market dropped at a slower pace in 3Q by 30.61% yoy to MOP22.4 billion and posted the first positive monthly growth of 0.5% since 2Q 2014. Despite anti-corruption campaigns, more mainlanders from China's expanding middle class are trying their luck in mass market gambling tables. With a rebound in Mainland visitors (average yearly decline narrowed to 3% in 3Q compared with 6% in 2Q) thanks to eased visa measures effective from July 1st. Share of revenue from mass market grew further to 41.3% in 3Q from 39.3% in 2Q, compared with average of 27.5% during 2010-2014. The growth driver of gross gaming revenue is clearly shifting from VIP table to mass market table. A 7.1% growth of Mainland visitors on yearly basis during the Chinese week long National Day Holiday further proved that Macau is still attractive to Mainland tourists. Looking ahead, as casino operators plan to allocate smaller space for VIP rooms in new projects in Cotai Strip, we believe that mass market would constitute a larger share of gross gaming revenue and help narrow the decline of gaming revenue this year. However, the government has allocated less gambling tables to new casinos than requested and posted a ceiling to the annual growth of gaming tables. Also, the profitability of mass-market is much lower than that of VIP market. Therefore, we expect the gaming sector to recover at a slow and gradual pace with gross gaming revenue falling another 5% yoy in 2016. According to the Policy Address 2016, Chief Executives forecast gross gaming revenue of around MOP200 billion for the whole of 2016, showing greater pessimism.

Retail sector is expected to remain subdued in 2016

Visitor arrivals showed smaller average decline of 2.7% yoy during July to November (-3.4% yoy in 1H) thanks to increasing visitors from major tourist sources (Hong Kong, Taiwan and Japan) over the same period given the new hotels opened since late May 2015. However, per-capita spending of total visitors and Mainland tourists both contracted for the 5th straight quarter in 3Q respectively by 18% yoy and 20% yoy to MOP1,540 and MOP1,776. Also, Macau's value of retail sales dropped 7.7% yoy in 3Q to MOP 14.61 billion, recording negative growth for the fifth straight quarter. The persistent decline was attributed to slump in sales value of Leather Goods (-21% yoy), Watches, Clocks & Jewellery (-17.55% yoy), and Goods in Department Stores (-11.98% yoy) amid weaker luxury expenditure by tourists and subdued domestic demand. Clearly, increases in visitor arrivals do not necessarily translate into growth in tourist consumption. Therefore, even though the opening of new hotels equipped with various recreational facilities would attract more visitors to Macau, we expect anti-corruption campaigns on the Mainland would continue to dampen Mainland visitor spending. Prospect for further depreciation in currencies of Macau's major tourist sources (such as South Korea, Japan and Taiwan) as the Fed started to raise rate in December will also undermine the purchasing power of worldwide tourist to Macau, thus continuing to put downward pressure on the retail sector. On the other hand, despite expectation of an increase in visitors and hotel guests, hotel occupancy rate (averaged at 79.5% during January-November) might extend its yearly downtrend amid greater hotel room capacity after completion of more new hotels in 2016.

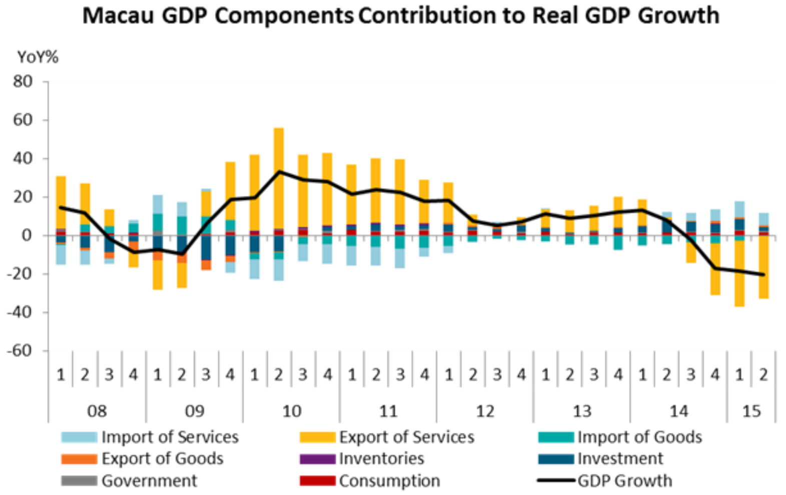
Gaming related projects will support employment

Employment in the gaming, retail, construction and hotel sectors posted YTD growth of -6.7%, 0.2%, -11.9% and 10.6% respectively in November. Meanwhile, overall unemployment rate has increased slightly to 1.9% in three months through November from 2Q's 1.8% and 1Q's 1.7%. However, as a raft of new casino and hotel projects has been launched in 2015 and will be completed within the coming 1-2 years, This would support employment in the construction and hotel sectors. Moreover, labor redundancy in the gaming sector will be mitigated by new casinos to be opened this year. Therefore, despite potential decrease in employment of the sagging retail sector, labor market is expected to remain stable in 2016.

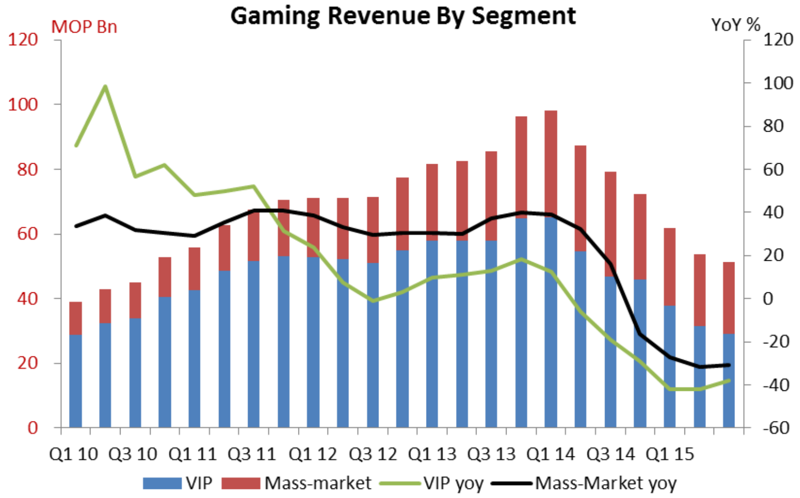
Slower wage growth to hinder recovery in housing market

Average transaction price dropped 18.5% yoy and 22.4% YTD to MOP74,771 /sq. m. in November, according to Macau Financial Bureau. Over the first ten months, total transaction volume of private housing units plunged by 25.9% yoy to 4,940 units. Both data indicates a subdued housing market sentiment. Though labor market will remain tight in 2016, we expect a broad-based slowdown in wage growth due to uncertainty of Macau's economic transition, which will side-line the potential homebuyers. Moreover, according to Housing Bureau, more social housing (2,040 units) and economic housing (4,228 units) are under construction. Policy Address 2016 also specifies increases of public housing supply (28,000 units in Zone A and over 4,000 units on five available land reserves) in the coming years. Meanwhile, 5,247 units of private units are under construction during January to October of 2015, 218.9% more than average of 1,646 units during 2010-2014. Tight supply will no longer be the main driver of Macau's housing price growth in 2016 as was in the previous years. In addition, the starting of rate hike by the Fed could push up borrowing cost in Macau, thus deterring demand for mortgage loan. Hence, we expect further downward risks to be faced by Macau’s private housing transaction volume and price.

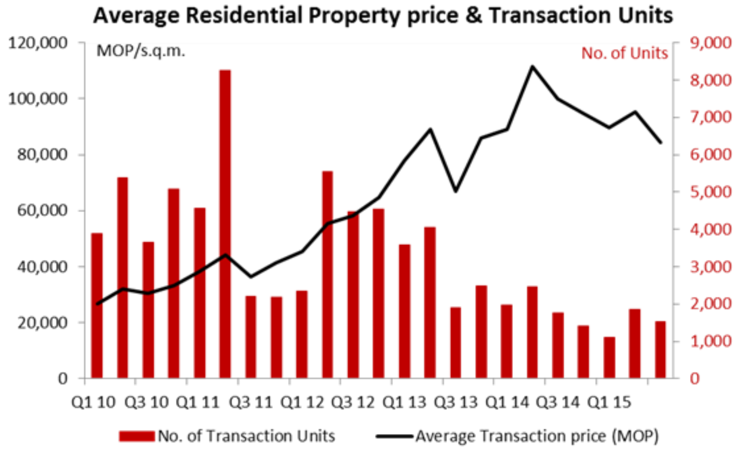
Impact of Gaming as Export of Services on Macau GDP



Macau Gaming Revenue



Macau Residential Property Market



Source: Bloomberg, OCBC Wing Hang

MALAYSIA

More Of The Same?

Things have been rough for the Malaysian economy. The fact that its currency, the Ringgit, weakened by the most among its Asian peers in many ways highlighted the challenges that Malaysia faced. Looking into 2016, we see a good chance that things would at least stabilize, even if there is always the risk that the same factors which plagued the economy in 2015 may well rear their ugly heads again.

In terms of headline growth, Malaysia will likely be printing growth rate of 4.7% yoy in 2016. That is broadly in line with what the economy is on course to achieving in 2015, which is a growth rate of 4.8%. This 'sameness' could be seen a source of comfort in and of its own, but it should be noted here that it is predicated on a number of factors going right for Malaysia – none more important than the price of oil.

It Depends on Oil

As our house view has it, oil price is on track to recover this year, with Brent back to USD55 per barrel by year-end. If that pans out, it would be a huge relief for Malaysia. After all, one of the reasons why market sentiment towards Malaysia had soured in 2015 was the sense that it is Asia's only net oil exporter, whose fiscal balance is most threatened by a drop in oil price. Hence, if oil price does recover forcefully, such concerns would dissipate.

On the flip side, however, given the reality that oil price has exhibited more of a tendency to go down and stay down in the past 18 months, we have to be cognizant of the alternative scenario, of what if it remains in the doldrums. Already, the Malaysian government appears to be preparing a Plan B for when oil price slips below its budget assumption of USD48 per barrel. Minister in the PM's office, Wahid Omar, reportedly said that the government would reconsider proposed projects expenditure if oil prieces remain at depressed levels.

If the oil-driven adjustment happens in the next few months, it is in some ways a déjà vu given that January 2015 also saw a revision of budget deficit target – from 3.0% to 3.2% of GDP – as the government found its earlier assumption of USD100 per barrel oil price simply untenable. In that round of revision, the fact that fuel subsidy was eliminated and yielded a one-time expenditure savings helped to keep the deficit revision relatively minimal.

This time round, however, things might be more complicated because there is no longer such 'easy' subsidy fat to be cut. Hence, there is a risk that – should oil price stay depressed – fiscal expenditure may have to be slashed by more than before in order to keep bond holders and rating agencies at bay. To the extent that the 2016 budget in its present state has allowed for a deficit of 3.1% of GDP – just a whisker lower than 3.2% of 2015's shortfall – leaves rather room of manoeuvre to begin with.

The same game of trying to balance between cutting deficit enough to avoid ratings downgrade and not so much as to endanger economic growth and political support would be playing out still for a while more, not least if oil price remains stubbornly low.

China and Fed

Outside of oil, two global factors which have negatively affected Malaysia are uncertainties about China's growth and its policy responses, and Fed rate path. While both factors may seem less acute this year, they are nonetheless going to be high on the watch-list of investors who look at Malaysia.

On China, as it appears, growth should be stabilizing. This should be welcome news for Malaysia, given that China is the top end-destination for its exports. However, the relatively capricious policy responses that China had pursued in 2015 meant that there is a risk, however slight, of more shocks of the same nature this year. In that regard, any currency depreciation move by China – however low the probability is – would be one of those factors that would hit Malaysia significantly.

Similarly, while the Fed's lift-off had taken place in December 2015 without too much disturbances, there is still the rest of the rate hike trajectory to go through. Given the high foreign ownership of Malaysia's sovereign bonds, any upset in global market sentiment is still going to affect the country adversely.

Domestic Factors

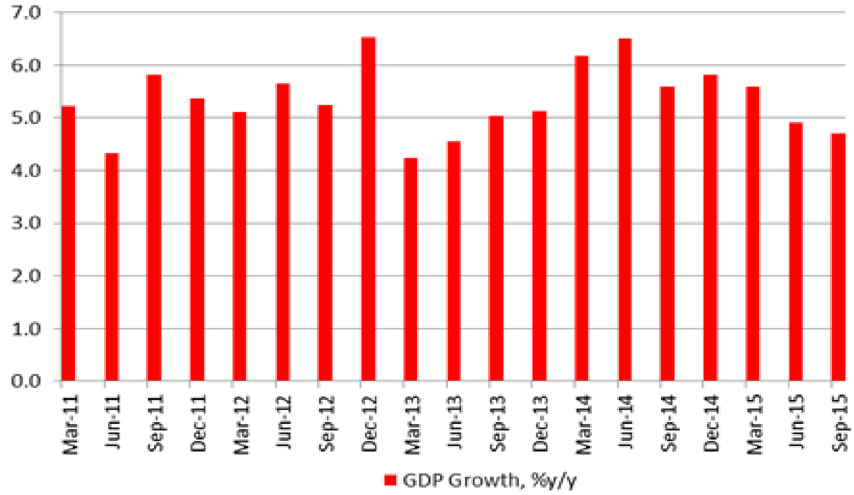
Of course, as important as the global factors highlighted above are, Malaysia's performance in 2016 will also be a function of domestic issues at the end of the day.

In that regard, there are perhaps some signs that the political situation may stabilize enough for investors to be more comfortable in the new year. Moves to consolidate power appear to be successful, even though there would likely continue to be political rumblings along the way. To add to that, recent news regarding asset sales by 1MDB, including the Edra power plant assets to China's General Nuclear Power Corp for MYR9.83bn, should also help to reduce market concerns over the matter.

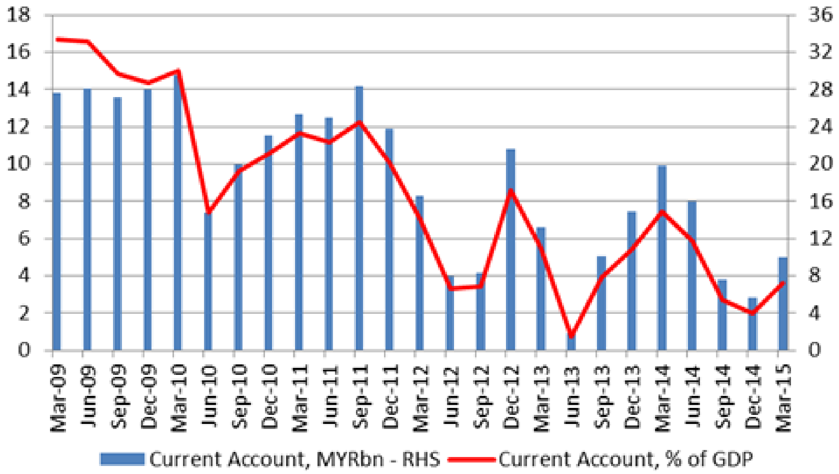
Elsewhere, one key thing that market will be looking out for this year will be the likely succession at the helm of the central bank. Having served as the Bank Negara's chief since 2000, the highly respected Governor Zeti Aziz is reportedly scheduled to step down at the end of her term in April this year. While her successful tenure shepherding Malaysia's central bank through various crises would naturally mean that she is leaving rather big shoes to fill, the strength of Bank Negara as an institution should continue to be a source of comfort for market players.

Indeed, in terms of monetary policy direction, we expect Bank Negara to remain an anchor of stability and leave its policy rate unchanged at 3.25% for the rest of the year. Even though the urge to cut rate to bolster growth is always there, we believe that the priority for the central bank will remain that of stability. If nothing else, it would want to preserve as much room for manoeuvre as possible. Should growth threaten to go below the 4-5% range that it has projected for 2016, there is every chance that it will start to nudge rates lower. Barring that, however, it would rather sit tight at the current level for a while more..

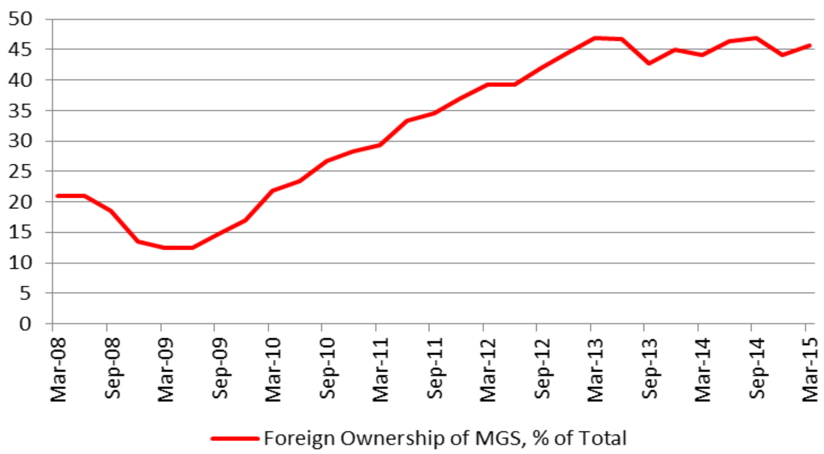
GDP Growth



Current Account



Foreign Ownership



Source: CEIC, Bloomberg, OCBC Bank

MYANMAR

A New Beginning

Myanmar reached a new milestone in its fight for liberal democracy this year when the nation's key opposition party, the National League for Democracy (NLD), scored a sweeping win in the general elections held on 8th November, attaining parliamentary majority[1]. NLD's victory symbolized a remarkable shift of power to the masses, forming the nation's first civilian-majority government since the military took the reins of the nation by force during a coup in 1962. On top of that, the NLD is led by Aung San Suu Kyi, who became a symbol of hope, courage and peaceful resistance to both the Burmese and the international community through her years of dedication to fighting for democracy in Myanmar. Her leadership would promise increased democratic reforms – that is if all goes according to plan.

The path ahead will not be easy for NLD. Being ranked as one of the least democratic nations in the world, Myanmar has plenty of room for improvement in terms of democracy. Despite the numerous reforms that took place since the election of Myanmar's first democratic government in 2010, the military still holds considerable power in the nation, having direct control over the defence, home affairs and border affairs ministries. It also has veto power over any constitutional changes, the same constitution that bars Aung San Suu Kyi from becoming president. It remains unclear how the power dynamics between NLD and the military will play out after the new government is formed in 2016, although rhetoric from the military following the election indicated a commitment to respecting the poll results. On top of that, there are concerns about NLD's inexperience in handling the nation's economy, being first-time governors.

With this backdrop, 2016 will be a pivotal year for Myanmar. Focus will be on whether the new government can bring about economic and political reforms that will kick-start Myanmar's economy. This will be no easy feat, especially amid the recent global headwinds and domestic challenges. However, we remain optimistic about Myanmar's economy. Myanmar has a huge potential for investment and we believe that if the new government delivers, the potential political stability should attract enough investment from abroad to give Myanmar's economy the boost it needs to overcome the headwinds in 2016.

A history lesson

Myanmar has progressed steadily towards democracy since 2010, when it formed its first democratic government in more than 50 years, moving away from military rule. The election was won by the Union Solidarity and Development Party (USDP) in a landslide victory and was hailed by China as a "transition to an elected government". Western leaders were more sceptical and criticized the election as neither free not fair. There were also doubts about USDP's commitment to democratic reforms since it was a pro-military party comprising of ex-military generals.

[1] Only 75% of the total parliament seats are up for grabs since 25% is reserved for the military. NLD won 77% of the 1150 total contested seats, according to data from Myanmar's elections commission, giving them a parliamentary majority even after factoring into seats reserved for the military. On the other hand, USDP won only won 10% of the seats.

Since its election in 2010, however, USDP has demonstrated its commitment by putting in place a sizable number of democratic reforms. These included releasing political prisoners, permitting peaceful demonstrations and publication of privately-owned newspapers, signing multiple ceasefire agreements with ethnic groups, and opening up its telecoms network to foreign investment. The progress has been acknowledged by the world. Western leaders – namely the US and EU – have praised the efforts and demonstrated their approval by lifting some of the sanctions on the nation, opening the path for investment from the West. Several multinational western firms like Coca-Cola and Colgate have moved into the nation since then. Meanwhile, investors from China and South-East Asia, which made up the bulk of Myanmar's FDI, also rewarded USDP's efforts by expanding their business there. As a result, total FDI from 2010 to 2014 surged, recording USD37 billion, 4.5 times the USD8.1 billion from 2005 to 2009, bolstering economic growth. Myanmar's GDP growth has increased from a mere 5.3% in 2010 to 8.5% in 2014, according to data from Focus Economics.

However, the rate of reforms seemed have lost momentum since mid-2014. Aung San Suu Kyi had personally stated during a press conference in November 2014 that reforms had "stalled" and warned the West against being "overly optimistic". Indeed, the number of reforms implemented since 2014 decreased, while the incidents of reported racial and anti-government riots rose. This was worsened by the involuntary removal of Thura Shwe Mann from his position as the president of USDP through a soft coup conducted by the military in August this year. As such, NLD's victory came at a critical period; just when Myanmar was in need of a new force to propel its progress towards liberal democracy.

Untapped growth potential

History has shown that progress in its political system towards democracy can attract huge quantities of FDI into Myanmar, boosting economic growth significantly. This is unsurprising, given the nation's appeal to investors. Once among the richest countries in South-East Asia, Myanmar is still one of the region's most natural resource-rich nations, having an abundant supply of industrial metals, precious gems, oil, and off-shore natural gas reserves. It also has a large supply of low-cost labour, which is in high-demand amid the rising wages in manufacturing hubs like China and Thailand. On top of that, it is strategically positioned between India and China to benefit from spill over effects from the two rapidly expanding economies.

Myanmar's strategic value has had hungry investors eyeing the nation for years, searching for an opportune moment to expand there. The main limiting factor that had been stopping them was Myanmar's political instability, which implied increased risk. Meanwhile, the lack of democratic infrastructure also inflicted sanctions by the West, deterring FDI from these nations due to administrative complications. This means that if Myanmar can demonstrate a commitment to democracy in its newly-formed government, more investors will be reassured to base their operations there. At the same time, Western leaders are expected to lift sanctions once they are satisfied that Myanmar has made sufficient democratic progress, opening the path for FDI from more giant multinational companies from the West.

FDI is not Myanmar's only scope for growth; trade from locally produced goods like rice can also spur growth. Myanmar was once the world's biggest exporter of rice in the early 1960s, and has the potential to return to its former glory given its abundant fertile land and water. The sector would thrive from increased FDI and organized efforts by the government to increase productivity. Available statistics showed that agriculture made up 36 percent of Myanmar's economy in 2013, so an expansion in this sector should translate to large increases in economic growth.

Elsewhere, Myanmar's new bourse, the Yangon Stock Exchange (YSX), was launched in December 2015. The stock exchange could prove to be a valuable source of finance for Myanmar's firms if it gains traction. However, there were worries that YSX would end up like its predecessor, the Myanmar Securities Exchange Centre, or counterparts in Cambodia and Laos which never took off, listing only a handful of firms. Worsening the case was the lack of necessary infrastructure and legislation for the bourse, resulting in the YSX launching with no stocks available for trade. On top of that, Myanmar Economic Bank's (MEB) majority stake in the bourse effectively meant that YSX was sanctioned by the US because of MEB's ties with the former junta. Optimists, on the other hand, maintain that Myanmar has huge economic potential which should facilitate the bourse's growth. Myanmar's deputy finance minister, Maung Maung Thein, said in 2015 that he expects the YSX to catch up with Vietnam's Ho Chi Minh Stock Exchange in just three years. It remains to be seen how the implementation of the new stock exchange will work out, especially amid the new government transition, which could delay its progress.

Escalating prices

In stark contrast with the rest of the world, Myanmar's inflation rose at an alarming rate since August 2015, driven mostly by food prices. The nation was hit by a heavy monsoon season this year, which included a heavy flood caused by the torrential rain that followed Cyclone Komen. The flood had destroyed more than one million acres of farmland, leading to spikes in prices of commodities such as rice, edible oil and sugar. Food price inflation surged at a rate of 19 percent on a yearly basis from August to October, up from 9 percent from January to July. This translated to a sharp increase in consumer prices from August onwards, with headline inflation rising to 15 percent on a yearly basis from August to October from an average of 8 percent from January to July.

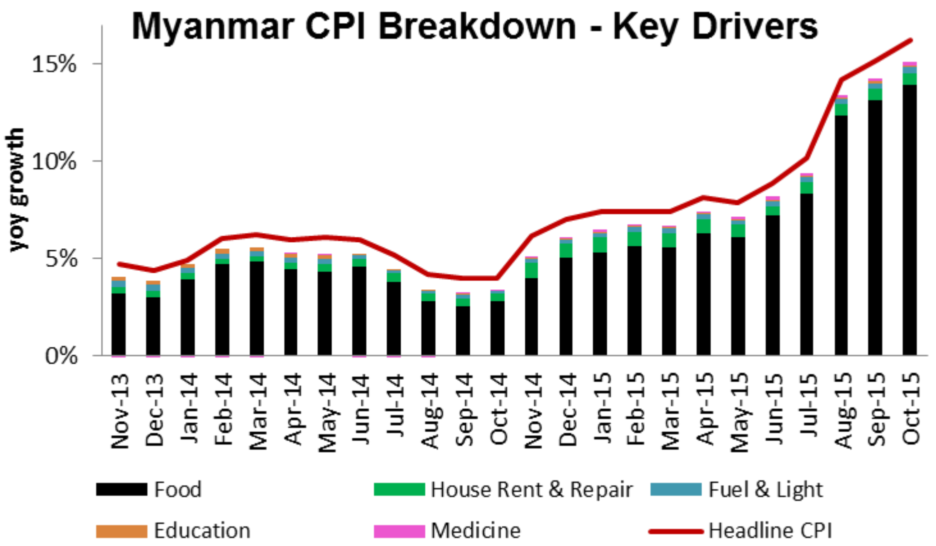
Looking forward, we expect the high inflation to gradually subside in 2016 as the country recovers from the flood, but the recovery will be slow and painful. Myanmar's central bank was only granted independence in 2013 and does not have sufficient tools to efficiently tackle the inflation. On top of that, we expect agriculture production to be hit again by La Nina in mid-2016, placing further pressure on food inflation. As mentioned in our 2H15 outlook, Myanmar also had a persistent problem of high inflation since the start of 2015, caused by more deep-rooted structural issues involving food, housing and energy. In view of these factors, we therefore forecast domestic prices to increase by 10.8% in FY2016-17.

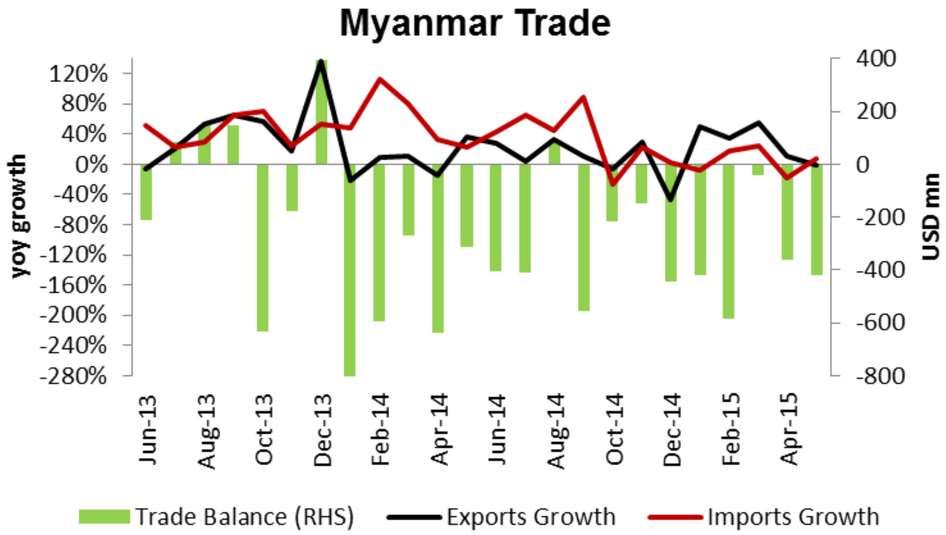
Looking forward

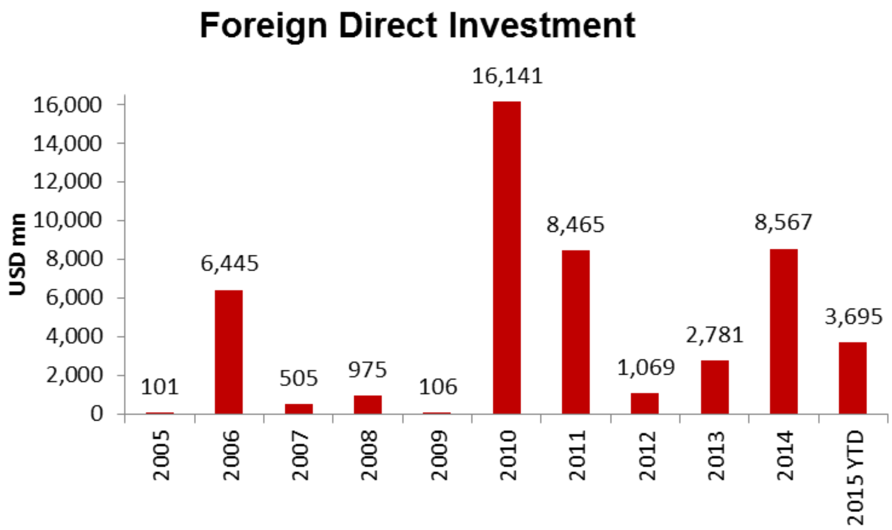
2016 will not be a smooth sailing year for Myanmar, but we remain optimistic that Myanmar will be able to keep up the healthy growth rate it has been logging for the past two years.

Plenty of headwinds exist for the Myanmar economy in 2016. The global economic slowdown and declining global trade will hurt exports in the coming months. FDI is also expected to decrease amidst the oil glut and China's slowdown. Domestically, the effects from the floods in August 2015 are expected to persist into early 2016, while La Nina poses a further drag to agriculture production in mid-2016. High consumer prices, especially food prices, will also dampen consumer sentiments.

Despite this, we remain optimistic about Myanmar's economy in 2016, with FDI being the key driver for growth. We expect FDI to surge as investors' optimism is renewed after the election of the new government, although this is hinging on a successful power transfer. Better economic prints from neighboring India should provide a further boost to growth, while the new stock exchange could pave the way to the development of a Burmese capital market. Furthermore, we expect the oil glut to pass in 2H16, reducing some of the pressure on the economy. Overall, the economic outlook for Myanmar in 2016 seems promising and we project FY2016-17 GDP growth to print a healthy 8.4%.







Source: CEIC, Bloomberg, OCBC Bank

SINGAPORE

Singapore: Beyond SG50

What a ride in 2015.
2015 shaped up to be a memorable year for Singapore, and this encompassed the passing of Mr Lee Kuan Yew, the SG50 celebrations, as well as the general elections where the incumbent party took an overwhelming majority. On the economic front, what was notable were the twice monetary policy easing by the MAS, the avoidance of a technical recession in 3Q15, as well as the latest 4Q15 GDP growth flash estimates which came in better than anticipated to end the year close to the 2% target. Even then, the full year 2015 growth of 2.1% marks a moderation from the 2.9% growth registered in 2014, and is the slowest since 2009.

How will 2016 shape up?
The external economy has been of little aid to the Singapore economy last year. Even the unprecedented two-time monetary policy easing in January and October 2015 was no salve to the beleaguered manufacturing sector. Essentially China's growth sustained growth deceleration took its toll - dampening regional trade and whipsawing regional financial markets. Singapore's manufacturing shrank a disastrous 4.8% (based on the 4Q15 flash estimates), the worst performance since 2001. In contrast, the other two pillars of services (especially financial services and wholesale & retail trade) did most of the heavy-lifting.

Growth may still be rangebound around 2-3%
Headline GDP growth may not deviate from the 2+% yoy range in the near-term. We expect that manufacturing may continue to be handicapped and potentially shrink 0.2% yoy in 1Q16 and constrain overall GDP growth to 2.4% yoy. Recent leading indicators suggest no newfound optimism in the near-term. The latest SME business surveys suggest greater caution for the first half of this year. Bank loans data in Nov15 also pointed to business loans declining on-year for the third straight month. Our full-year 2016 GDP growth forecast remains at 2-3%, which is at the upper end of the official 1-3% forecast. The economic spillover and market contagion effects from a sustained deceleration in China, coupled with market suspicions over the CNY policy, will likely continue to impart volatility to Asian market including Singapore.

Headline inflation may turn positive in 2H16, with core inflation also a tad higher
Headline CPI prints may stay deflationary in 1H16 but edge back to positive territory before the year is out. That said, headline CPI inflation may stay flat on-year in 2016 amid subdued crude oil prices and sustained domestic asset price deflation. Private residential housing prices, having fallen for nine straight quarters, may not be able to resist the downward draw of gravity as official rhetoric continues to hint that cooling measures will remain in the near-term. On the private road transport side, the COE supply should keep COE premiums under pressure as well. The bugbear - the pass-through from the tight labour market into the broader cost environment - has also been fairly limited to-date. The only CPI basket components that would positively drive inflation into the positive territory are likely to be food (due to La Nina), healthcare and education costs.

Policy settings to be steered with an eye on medium-term stability

At this juncture, it is premature to call for a third monetary policy easing, given that growth and inflation settings have not deviated significantly from policymakers' expectations. One unknown is whither the CNY policy direction which could have a profound effect on Asian currencies' bearing this year. The 3-month SIBOR has been relatively stable post-Oct15 MPS, but the SOR have tracked higher. Both are now back to their respective Nov08 levels and the risks still lie to the upside, albeit it may not be a straight upward trajectory, just like in 2015. Our end-16 forecasts are for the two to test the 2% handle by year-end.

SGS bonds will see $15b maturity in 2016 amid longer-dated supply pipeline

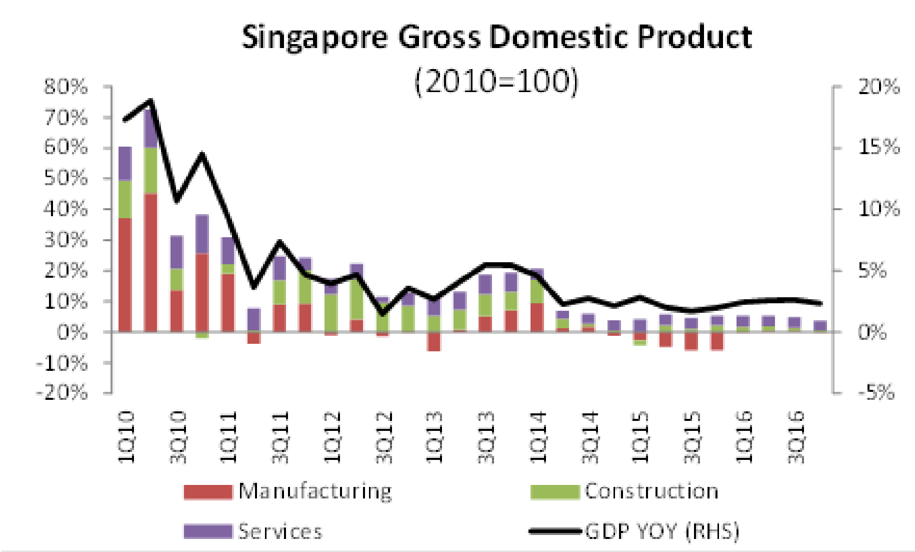
2016 SGS issuance calendar will kick off with the 5-year re-opening on 1 Feb, with the announcement on 20 Jan and auction on 27 Jan. There is a total of $15b SGS bonds maturing this year, comprising of $7.3b 5-year bonds in April and $7.7b 15-year bonds in Sep. Nevertheless, the 2016 SGS bond issuance calendar comprises of a new 30-year is March, a new 10-year in June and a new 20-year in August.

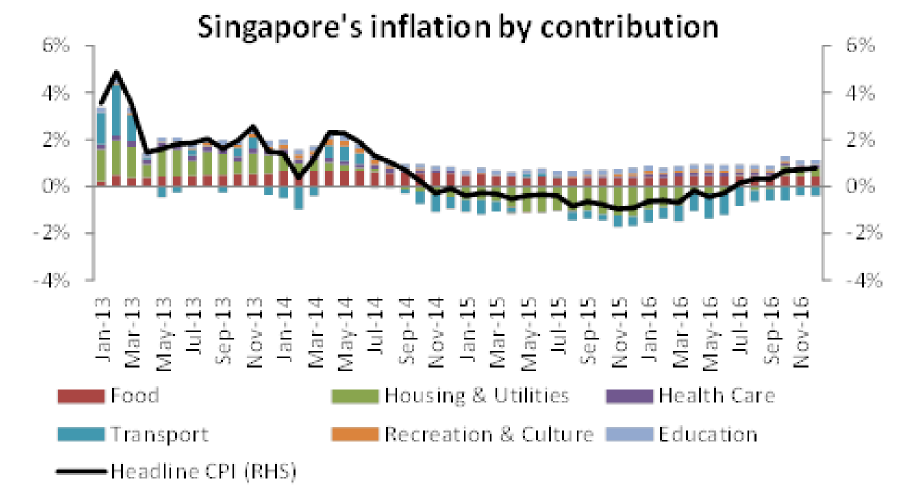
Accommodative FY16Budget may not steal thunder from FutureEconomy Committee recommendations due end-2016

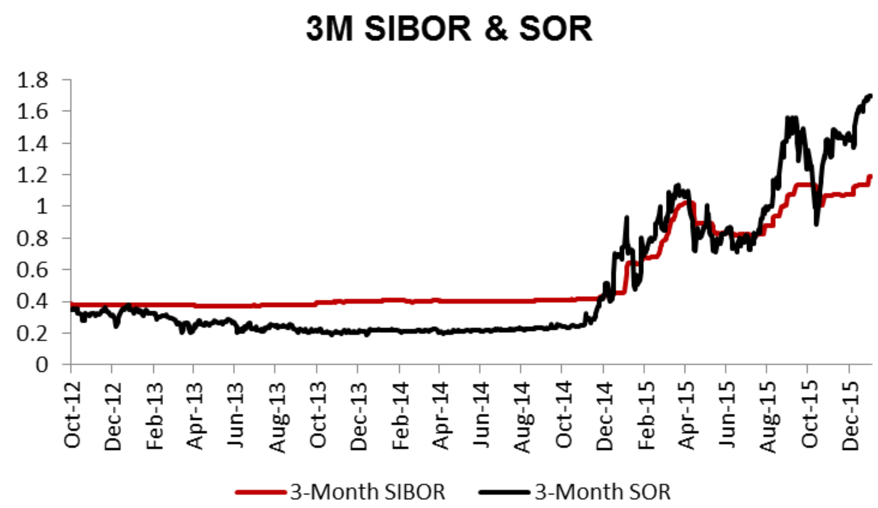
The FY16 Budget will be delivered on 24 March. Given the new term of government, a more neutral to slightly accommodative FY16 Budget may be in order, while maintaining its fiscal prudence philosophy. The three key things to watch are: (a) the conservative official 2016 growth forecast of 1-3% suggests that an aggressively fiscal stance may not be forthcoming? (b) an infrastructure investment focus will imply sustained public construction projects which could provide a stabilising growth force as seen in the 4Q15 flash GDP growth data? (c) will the earlier deferment of foreign worker levy hikes be extended or reinstated? On balance, we suspect any major policy shifts may be left to the FutureEconomy Committee who will finish its work by end-2016.

Unemployment rate to stay low, but labour market conditions to ease in 2016

The overall seasonally adjusted unemployment rate was unchanged at 2% in Sep15. However, the unemployment rate for both residents and citizens had risen for the second straight quarter in 3Q15 to 3.0% and 3.1% respectively amid softer economic conditions. While employment expanded in 3Q15 by 12,600, the pace was significantly slower than a year ago (+33,400), and layoffs actually rose across the board. The number of job vacancies to unemployed persons also declined from 121 per 100 job seekers in Jun15 to 116 openings in Sep15, which is back to levels seen in Jun13. Looking ahead, the employment gains may hover around 15,000-20,000 in 2016, mainly supported by the services industries, especially the community, social & personal services, whereas manufacturing employment is likely to continue to shrink. With professionals, managers, executives & technicians (PMETs) representing 70% of all residents laid off in 3Q15, this may be one area of continued policy focus going forward amid the economic restructuring.







Source: Bloomberg, OCBC Bank

TAIWAN

Another Challenging Year

2015 was deemed to be a challenge year for Taiwan amid China's slowdown and heightening financial market volatility due to global policy divergence. The Taiwanese economy unfortunately entered a technical recession after its seasonally adjusted annualized sequential quarter-on-quarter growth contracted by 4.5% and 1.2% respectively in 2Q and 3Q. Although Taiwan is unlikely to slip into a recession in 2015, its economic growth is expected to end 2015 with around 1% growth, lowest since 2009. Meanwhile, the Taiwanese economy also underperforms its Asian peers such as South Korea and Singapore, due to higher exposure to China.

The slowdown of Taiwanese economy in 2015 was mainly attributable to three factors, in our view; including weak external demand as a result of China slowdown and slower than expected global recovery, insufficient government reaction and weak domestic demand due to sluggish wage growth.

The Taiwanese economy grew by 1.33% on average in the first three quarters, down from last year's 3.9%, mainly dragged down by external demand with net export bringing the growth down by 0.35% on average in the first three quarters. The negative contribution of net export to Taiwan's growth this year is mainly the result of weaker Chinese growth and falling commodity prices. The high concentration of Taiwan's exports to mainland China, which accounting for about 38% of total exports in the first eleven months of 2015, makes Taiwan extremely vulnerable to China risk. Meanwhile, the high percentage of electronic products in Taiwan's exports also makes Taiwan's economy sensitive to the global growth. Despite the solid recovery of US, the weak recovery in emerging market due to sharp fall of commodity prices led to the weaker demand for electronic products, which in turn dampened the growth prospects.

Unlike South Korea, which announced a couple of stimulus measures from 2Q amid weaker than expected global recovery, the Taiwanese government has failed to roll out significant stimulus to boost the economy. As such, government spending dragged the growth down by 0.13% in the first three quarters. Nevertheless, two stimulus programs, including the bringing forward of implementation of productivity 4.0 program to October and NT$5bn short term consumption stimulus to boost purchase of energy efficient home appliances and domestic travel from November, are likely to bring some supports to the growth. However, given the small size of stimulus (less than 0.04% of GDP) due to tight government budget, we think the stimulus is unlikely to be a game changer for Taiwan's growth outlook in 2016.

In addition to weak external demand and government spending, domestic consumption also lost steam in the second half of 2015 after growing steadily in the first half. Private consumption grew by 3.64% in the first half, adding average 2% to economic growth in the first half. However, private consumption decelerated sharply in 3Q to only 0.5%, lowest since 2Q 2009 due to concerns about global slowdown and sluggish wage growth.

Looking ahead, given external demand has been the key driver to Taiwan's growth since 2000s, the fate of Taiwan's economic growth will largely rely on the development of global economy. Although the global growth is expected to recover modestly in 2016 according to consensus forecast, the uncertainty remains due to Fed tightening cycle and persistent China slowdown. As such, the recent pickup in export orders may not lead to straightforward conclusion that Taiwanese economy is likely to bottom out soon though it should add some positive sentiment to the economy. Overall, we do expect Taiwan's economy to reaccelerate to about 2% in 2016 from this year's sub 1%, however, the output gap is likely to remain due to still uncertain external demand.

Our modest recovery scenario should also be underpinned by supportive monetary policy despite lagging fiscal policy due to tight government budget. Taiwan's central bank has cut its benchmark interest rate twice in September and December after keeping its rate intact in the past four years, less affected by Fed's decision to increase its benchmark interest rate. Unlike some emerging economies which may find themselves difficult to balance between economic slowdown and risk of capital outflows amid Fed tightening cycle, we believe Taiwan's monetary policy is likely to decouple from Fed's policy due to its high current account surplus. The double digit current account surplus as percentage of GDP ratio will provide cushion to Taiwan's central bank to run its monetary policy independently. Having said that, the central bank is unlikely to run its interest rate policy too aggressively as mentioned by its governor Perng as the impact of latest rate cuts in September and December will take effect with time lag. As such, we only expect one more interest rate cut to support Taiwan's economic recovery in 2016.

2016 could be another challenging year for Taiwan and its economy is likely to face three key risks including China slowdown, political risk and marginalization by regional trade pact. First, as we mentioned above, Taiwan's high export dependency on China is likely to delay Taiwan's recovery should Chinese economy slow down more than expected in 2016. Second, the presidential and legislative elections on 16 Jan 2016 are another event risk for Taiwan's growth in 2016. The latest poll shows that opposition DPP's Presidential candidate is likely to win the race by wide margin, however, the key focus will be on the Legislative Yuan election, which poll also shows that the ruling KMT is likely to lose the majority for the first time in Taiwan's history. Should DPP win both Presidential and Legislative elections, the concern about the cross strait tension is likely to re-surface. This may undermine confidence in Taiwan's near term investment and growth prospect. Third, Taiwan has not joined the first round negotiation in two most important regional trade pacts including TPP and RCEP. However, given its high dependency on the global value chain, Taiwan may have no choice but join the negotiation to maintain its export competitive. However, the local protest against important of certain meat products such as US beef and the cross strait relationship with mainland China are likely to be the key hurdles for Taiwan to join any regional trade pact.

THAILAND

Weighing The Scales

A glass filled with water

One popular litmus test for gauging optimism is one's description of a glass half-filled with water. Recognizing the presence of water rather than the void, scientists argue, signals one's ability to see the silver lining in a gloomy cloud.

Perhaps, the same analogy can be said for Thailand's economic performance for the large part of 2015. For those who prefer to fixate on the 'half-empty' portion of the economy, it takes no effort to cherry-pick the signs that hint for an anemic growth pattern. For the optimists however, the likely 2.7 – 2.9 percent economic growth for the whole of 2015 is an undeniable fact that Thailand's GDP had accelerated from a tepid 0.9 percent print seen last year. After-all, it can be argued that the slowdown in exports in Thailand is a symptom felt by every Southeast Asian economy given the Chinese economic slowdown and low oil prices.

To be fair however, the pessimists have a point. They have pointed out the pitfalls that may plague Thailand's long-term economic growth. Their arguments are multi-faceted, but not without grounds, which include the rather alarming increase in household debt levels, flagging consumer expenditure patterns, and most importantly, Thailand's rather precarious social-political arena. On this, the former Bank of Thailand (BOT) governor Prasarn Trairatvorakul commented rather aptly that "Thailand's political situation is my first concern and from my five years in the job, this is a major issue for the country"[2]

Going back to the analogy of the half-filled glass, we note that both camps do have their own points. There is then a key difference that draws the defining line: the optimists cheer for the strength seen in the year. The pessimists however, adopt a relatively longer time horizon paradigm, and to their disappointment, frown on the uneven road ahead that only appropriate policies can mitigate.

What's in the paradigm of the pessimist?

For this, we have the cautious to thank in highlighting the possible pitfalls Thailand may face. We point out three key aspects that would likely require attention in 2016.

First off, Thailand being an open economy which has its exports accounting for more than 50% of gross domestic product, has been largely affected by the fall in total trade across Asia. Statistically, total trade in Asia[3] has contracted by 14.0% (in value terms) in Sept 2015, the deepest plunge since 2009 during the Global Financial Crisis. As such, trade growth in Thailand has been invariably affected especially by the sudden

[2] Erich Parpart from The Nation Multimedia: *Political situation a concern: Prasarn*, Sept 2015 http://www.nationmultimedia.com/business/Political-situation-a-concern-Prasarn-30269660.html

[3] Asia total trade calculation includes the totaling of trade (USD terms) in China, India, Indonesia, Hong Kong, Japan, S. Korea, Malaysia, Philippines, Singapore, Taiwan, Thailand and Vietnam.

slowdown in commodity prices and relatively weaker growth prospect across Asia.

The reality of things, increasingly realized even by bullish market-watchers, is the fact global economic standing is not as kosher as what many would have hoped; the US Federal Reserve finally hiked its Fed fund rate despite the relatively poorer global growth outlook, while elsewhere, Chinese growth prospect remains in the doldrums given its export falling for the fifth month in November. Still in Europe, growth is heavily reliant on accommodative measures, especially those recently achieved from lower interest rate and the extension of the quantitative easing programme. In short, global growth in 2016, while likely to be slightly rosier compared to the previous year, will likely still see a slight limp. Of this, Thailand's economic health may well suffer negative spillovers, a similar phenomenon that policy-makers know so well.

Secondly on a similar note, the higher Fed rates seen at its latest FOMC meeting would be something policy-makers would need to pay close attention to. At least, with the 1998 Asian Financial Crisis still fresh in memory, the risk of fund outflows and the resultant damage in confidence is a lesson so well learnt. Of this, policy-makers in Asia, especially Thailand, would need to reckon with increasing rate differentials as it widens on higher Fed fund rate into 2016. Should the rate differential widen considerably into 2016, investors' yield-seeking behavior may fund outflows from Thailand. In huge volumes, the fund outflows would be detrimental to macroeconomic stability through a possible colossal depreciation in the Thai Baht, and in turn, affecting business and consumer confidence.

Putting it all together, the third and final aspect would be the exacerbation of fundamental cracks that are specifically associated with Thailand. On this, we focus primarily on Thailand's ballooning household debt levels, now estimated at over 80% of GDP at end 2015. The tenets of economics would spell the same consequence to its readers on this: increasing household debts levels is simply a borrowing from future generations to feed current consumer spending.

Thus, the high household debt levels seen today would (1) mean that current generation are already paying in terms of reduced consumption due to past consumption patterns and (2) imply that the current generation, in order to maintain consumption patterns, would need to accumulate more liability thus raising growth concerns for future generation. In short, the high household debt is a clear threat to macro-economic stability.

Should we reference history, we do have the first car purchase scheme to blame for this phenomenon back when this populist scheme ran between Oct 2011 and Dec 2012. This scheme had invariably encouraged consumers, then able to obtain credit at attractive conditions, to purchase their vehicles. Since then, household debt levels sky-rocketed – private sector debt rose from 124% to almost 160% between 2010 and 2014, according to the World Bank. Household debt also risen from around 60% to 85% of GDP between 2010 and 2015.

All-in-all, the mix of a possible weak external environment at least in 1H16, rate differentials, and the high indebtedness of its households then present policy-makers a rather uncomfortable mix of factors in policy-consideration. A common (and favored) tool by central bankers would be to reduce its domestic interest rates, BOT rate in Thailand's case, to stimulate growth and inflationary pressures. But with all policies, this move is a double-edged sword, an edge more likely damaging in Thailand's case as it not only widens the rate differential, but also spurs consumers to incur more debts simply on attractive domestic interest rates.

Twin policy approach is the key

With the precarious path Bank of Thailand has to take, the road is at the very least, adequately lit with the potential pitfalls. Of these, one likely policy mishap would be the lowering of interest rates to support economic growth, knowing that this move would only aggravate debt accumulation and encourage fund outflows.

For that matter, we have elaborated at length in our *November note – Rate cuts are a thing of the past*. We noted that much of official rhetoric has pointed towards the use of two key tools in the coming year: (1) fiscal stimulus measures and (2) a weaker Thai Baht to encourage better trade balance prints and provide delight to tourists hoping for a holiday-break.

From the fiscal perspective, market-watchers are already encouraged from a generous government expenditure plan of THB3.8bn approved back in September 2015 for infrastructure spending, thus supporting growth and job creation. Elsewhere, targeted aid to farmers would be a positive boost to consumer spending, specifically with the cabinet's recent approval of THB13bn in Nov 2015 to help rubber farmers, as well as about THB35bn (US$1bn) to aid rice farmers. It does not end there, especially with the government's plan to spend the US$2.25 billion raised in Thailand's 4G auction to fund infrastructure projects and aid the needy.

Elsewhere, the official rhetoric by the Finance Ministry to employ a weaker Thai Baht to support Thailand's external environment would be a welcomed sight. The Baht has already printed its weakest since the global financial crisis back in 2008, a signal by the ministry for a greater threshold for a weaker currency. A weak currency in theory will support economic growth in numerous ways; a cheaper baht renders domestic exports to be relatively cheaper in the eyes of its foreign trade partner while making imports dearer thus improving trade balance. Elsewhere, Thailand's attraction as a tourist spot will be greatly enhanced from the increased affordability by holiday-goers. Though not as an immediate result, the improved trade balance and increased tourist spending will also be key drivers for a healthier economic outlook, thus injecting positive spillovers in Thailand's industries and benefiting income growth and consumer spending.

With this twin-engine policy arsenal, policy-makers can bolster economic growth into 2016 while discouraging further debt accumulation by its domestic market. But more may still be needed to bolster these initiatives. Chief of our concern will be the possible ailing tourism market, where the air-safety downgrades from both International Civil Aviation Organization and US Federal Aviation Administration would have dented international confidence. Elsewhere, Thailand's classification as a source, transit and destination country for human trafficking by the United Nation Inter-agency Project (UNIAP) has human right activists and international leaders frowning. It is up to Prime Minister Prayuth Chan-ocha and his colleagues to tackle this issue and convince the world otherwise.

Last stop: Politics

There is one more crucial element Thai authorities would need to assure its international community – the assurance of democracy in Thailand. Critics have frequently pointed against the lack of democracy, the take-over by the military general and now Prime Minister Prayuth Chan-ocha, and the forced retention of individuals accused of disrupting the peace and order of Thailand.

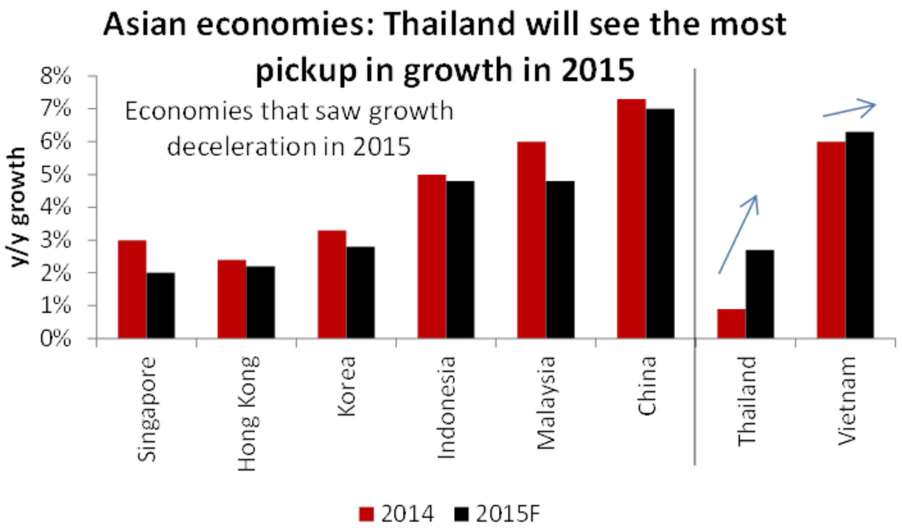
These critics, though not without grounds in their views, may be too quick to have forgotten that the military take-over was achieved in a bloodless manner. Also unlike other coups, the take-over is with the permission of the King Bhumibol Adulyadej himself. Through the take-over, the efficacy of the newly found government was clearly seen through the ridding of bloody demonstrations, economic crippling disorder and the establishment of healthier consumer and investor confidence in the country.

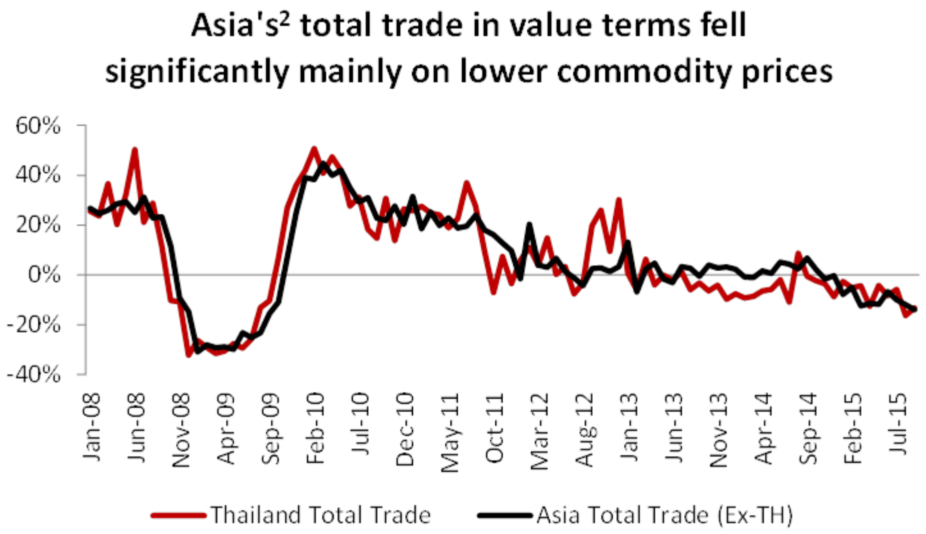
But dwelling back to democracy, elections are likely to be held, at the earliest, in the July 2017, according to the Prime Minister, thus postponing the previous timeline of 2016 given the acrimonious rejection of the newly proposed constitution. A new constitution is slated to be released on 29 January 2016, according to the Constitution Drafting Committee, but that will still be subjected to a referendum, and if passed, time is needed to enact laws and organize an election.

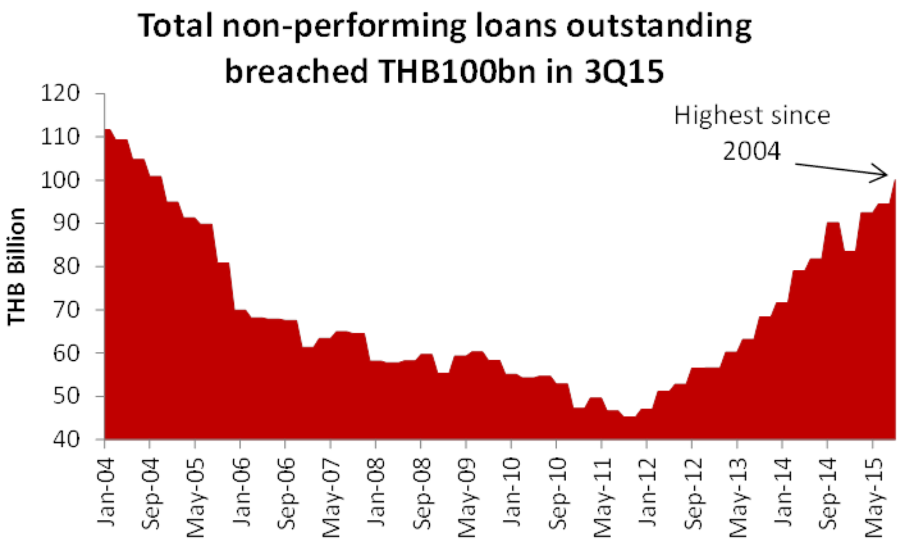
Growth, inflation, and policy rates

The pitfalls have been highlighted, and the path is set. It is up to the policy-makers to steer the ship in the right direction in lifting international confidence and bolster economic strength. It is in Thailand's prudent policies that we continue to eye the glass as half-full, going back to the analogy we first introduced. On this, we are highly encouraged by the presence of government fiscal plans to bolster economic growth, and the clear rhetoric of using foreign exchange tools to stimulate growth in its external environment.

As such, we remain firm on our outlook for Thailand to print a respectable 3.2% growth from 2015, led by a strong comeback in export growth and government expenditure, while capital formation is expected to print at a healthy pace similar to 2015's. The drag however, may be seen private consumption as Thai households balance spending with their relative indebtedness. Elsewhere, inflation is likely to print higher to 1.4% on-year as oil prices recover into 2H16 together with higher food prices on weather extremities. Lastly, we look for the Bank of Thailand to inject a 25bps rate hike in 2H16 to an eventual 1.75% as part of its macroprudential move in response to the higher US rate environment then.







Source: Bloomberg, OCBC Bank

VIETNAM

Up And Coming

2015 was a good year for Vietnam. The export-reliant South-East Asian nation has proven to be resilient, growing at its fastest pace since 2010 despite deteriorating global economic conditions. Vietnam's cumulative GDP growth as of 3Q15 printed 6.5 percent year-on-year, up from 5.6 percent in the same quarter last year and the highest since 2010, indicating a recovery from the 2012 recession. An analysis of the underlying data indicates that the stellar performance was largely driven by strong foreign-direct investments (FDI) into the export-oriented manufacturing sector, while the services sector also supported growth by expanding moderately. Elsewhere, the recent oil glut caused inflation rate to fall to record low levels, although not posing a significant deflation risk to the economy. In fact, the low prices were actually beneficial to the economy by supporting private consumption. Meanwhile, trade balance recorded its first negative print since 2011 as imports expanded faster than exports. Although the trade deficit was not sufficient pose a significant risk to the country's balance of payment, it still acted as a drag to economic growth. Overall, we expect Vietnam's growth to remain strong into 2016 on the back of more foreign investment attracted by recent free trade agreements, particularly the Trans-Pacific Partnership (TPP), and strong private consumption.

Manufacturing steals the show again

The manufacturing sector has once again carried Vietnam to new heights in 2015, this time even in spite of a global economic slowdown and trade decline. An industrial breakdown of the GDP by Vietnam's general statistics office found that the manufacturing sector expanded by a record 10.2 percent in November 2015, up from 8.6 percent in the same period in 2014. Meanwhile, the industrial production index (IPI) data also supported the case, with the manufacturing sector registering an average of 13 percent growth in the first eleven months of 2014, up from 10 percent across the same period in 2014.

Like in the past two years, the manufacturing sector's stellar performance in 2015 was led by external investment. FDI into the nation's export-oriented manufacturing sector has surged since 2013, generating an average of US$10.5 billion newly registered capital from 2013 to 2014, three times the amount received in 2011-2012. This resulted in a corresponding expansion in Vietnam's manufacturing sector since 2013, which grew at a yearly pace of 7.4 percent and 8.5 percent in 2013 and 2014 respectively, up from a meager 4.5 percent in 2012. Vietnam is on its way to attaining its highest FDI print on record in 2015, according the nation's Planning and Investment Minister Bui Quang Vinh. Total FDI in the first eleven months of 2015 generated US$13.6 billion of newly registered capital, while the number of projects rose by 30 percent from the same period in 2014. Out of this, the manufacturing sector attracted the most investment, accounting for 64 percent of total registered capital.

We expect to see a further acceleration of FDI into Vietnam's manufacturing sector in 2016. Vietnam remains as one of the top manufacturing hubs in the region, with its competitively low wages, strategic geographical location and political stability. The low wages, in particular, will grow to be increasingly appealing as the average

Chinese income continues to rise. China's mean wage had been growing at an average of 13 percent per year since 2000, and this trend is expected to continue in line with the country's ambitious goal of doubling its 2010 GDP by 2020. As of 2014, the average daily income in the manufacturing sector in China stood at US$23.00, in contrast with Vietnam's US$8.51. Also adding to Vietnam's appeal are its new trade agreements, eased business regulations and tax reforms that will facilitate doing business in the country. Meanwhile, China's economic restructuring to emphasize more on its tertiary industry had resulted in a slowdown in its manufacturing industry in 2H15 that will further redirect FDI into Vietnam, away from the current global manufacturing hub. Together, these factors should lead to a significant boost in Vietnam's FDI in the coming years that will be beneficial to economic growth.

Regarding Vietnam's other sectors, growth in the services sector continued to be outshined by manufacturing's stellar performance in 3Q15, remaining largely unchanged from the 1H15 print at 6.2 percent year-on-year. Within the sector, the best performer was the total retail sales of consumer goods and services, which grew by 9.8 percent year-on-year after factoring in price changes, led by stronger trade. Tourism proved to be a drag amid the slowing global economy, with the total number of tourists declining since the start of 2015. Elsewhere, the agriculture, fishery and forestry sector continued its long-term growth trend of about 2 percent per year.

Building new ties

Vietnam has been actively expanding its network of trading and investment partners since it set out to be the next manufacturing hub. In 2015 alone, the nation sealed 3 major free trade agreements (FTA), with Korea, the newly formed Eurasian Economic Union (EEU), and the European Union. The trade agreement with EU was the European bloc's first FTA with a developing country, and not only reduced tariffs and taxes, but also opened up various industries in Vietnam, like financial services and telecom, to European investors. The trade agreement with EEU was also a monumental one, marking the union's first ever trade agreement with a third party. Meanwhile, Vietnam has more trade agreements in line for 2016, including the Trans-Pacific Partnership (TPP) and ASEAN Economic Community (AEC). There are especially high hopes for the TPP, given that it is dubbed the biggest trade agreement in history. Studies have found that Vietnam is one of the nations that will benefit the most from the deal because of its high reliance on exports and low-wage labor force. In particular, Vietnam's apparel manufacturing sector will grow as TPP nations switch to investing and buying from it, while the seafood industry will also benefit from increased demand from US and Japan. A study done by the World Bank in 2015 concluded that over the next 20 years, TPP alone could grow GDP by 8 percent, real exports by 17 percent, and capital stock by 12 percent. As such, the host of new trade agreements has added to the positive sentiment towards Vietnam's FDI and export growth over the next few years.

More dong cuts as Fed takes off

Vietnam devalued the dong again in 2H15, in line with our expectations. Shortly after China's surprise devaluation of the yuan in August, the nation had responded by widening the dong's trading band from 1 percent to 3 percent and lowering the official mid-point rate by 0.99 percent to 21,980 dong per dollar. This reaction was largely interpreted as a bid to mitigate the impact of a weaker yuan. The nation's trade balance has been worsening since the start of this year, recording a deficit in 10 out of 11 months in 2015. The biggest share of the trade deficit belongs to China, so a corresponding devaluation of the dong was needed prevent a flood of China imports into Vietnam that would worsen the trade balance. Meanwhile, the devaluation would also help by "protecting the competitiveness of Vietnamese goods", according to the statement released by the State Bank of Vietnam (SBV), allowing Vietnam maintain its position as an alternative low-cost manufacturing hub to China.

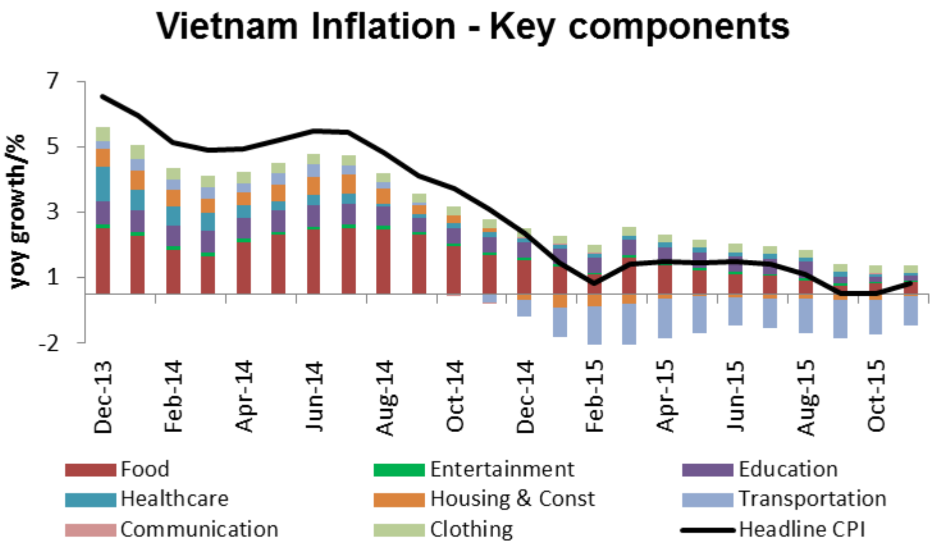
We expect further devaluations from the SBV in 2016 given the macro environment. The US Federal Reserve is poised for more rate increases in 2016, albeit at a gradual pace, after finally lifting off in December 2015. This means upside pressure for the dollar and in turn the dong, which is pegged to the dollar. Elsewhere, China's move towards a market-driven exchange rate is expected to lead to a further depreciation of the renminbi in 2016. Given SBV's inclination towards "protecting the competitiveness of Vietnamese goods" by devaluating the dong, we expect them to conduct similar measures again in the 2016 macro environment.

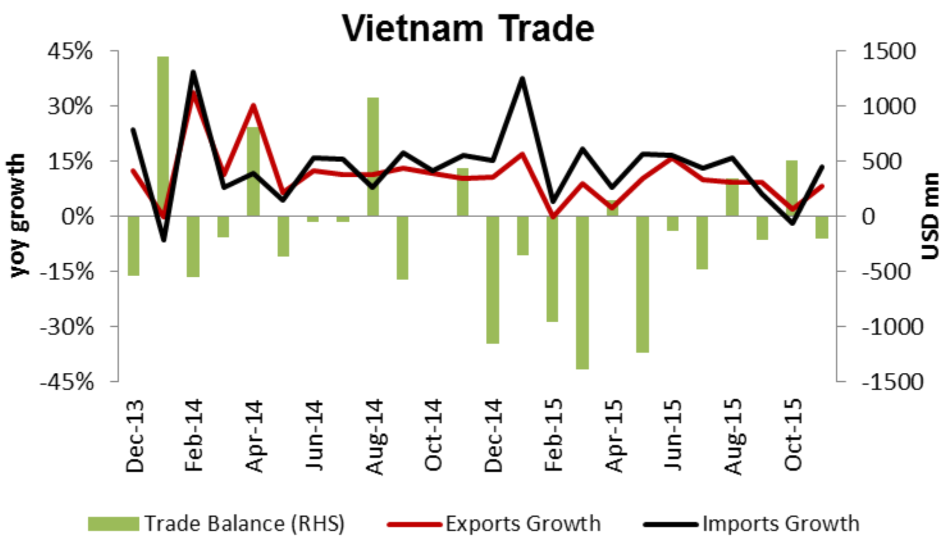
Inflation to pick up in 2016

Headline inflation reached record low levels in 2015, printing at an average of 0.6 percent over the first 11 months of 2015, with September and October even recording flat growth. This is a stark contrast from the 20 percent yearly inflation Vietnam was experiencing just four years ago, and also far from the country's inflation target of 5 percent. The low inflation was brought on by the recent oil glut which sent oil prices spiraling down close to levels last seen during the 2008 financial crisis, leading to lower electricity costs and gasoline price cuts that caused transportation costs to fall by an average of 12.1 percent over the first 11 months of 2015. With the other components of CPI printing marginally above 0, falling transportation costs accounted for the bulk of the deflationary effect on prices. Accordingly, core inflation, which excludes food and energy prices, continued to register a relatively healthier annual growth rate of about 2.1 percent. Unlike the other economies that are hugely dependent on oil, the low inflation has actually been beneficial to Vietnam by encouraging private consumption. Estimation by the Asian Development Board (ADB) puts annual private consumption growth at a solid 8.9 percent in 3Q15.

We expect headline inflation to average at 0.6 percent in 2015, before picking up to 3.0 percent next year. Deflationary effect from the low energy prices will ease towards 2H16 as the oil glut passes, while private consumption supported by strong credit and money supply growth continues to push prices higher. Elsewhere, further devaluations of the dong will also encourage inflation growth through higher import prices.

Overall, the outlook for Vietnam is 2016 is promising. The new trade agreements, particularly the TPP, will bring a batch of new investors that will boost FDI to even higher levels. Manufacturing will remain the main driver for growth as the country continues to leverage on its low wages to attract FDI into the sector. Regarding this aspect, however, Vietnam needs to be careful of becoming over reliant on foreign investment for growth since it increases the nation's exposure to global economic fluctuations. Elsewhere, the El Nino and La Nina effect may prove to be detrimental to the health of the agricultural sector. All in all, we are optimistic that Vietnam be able to keep up the strong performance from 2015 into the next year, with economic growth printing at a solid 6.6 percent.





Source: CEIC, Bloomberg, OCBC Bank

HONG KONG SPECIAL

HK Residential Property Market Enters Correction Period

HKMA prudential measures on properties

HKMA's mortgage rules announced in late February and early March 2015 had lowered maximum Loan-to-Value (LTV) ratio from 70% to 60% for self-use residential properties with value below HK$7 million. In addition, the rules lowered maximum debt servicing ratio (DSR) from 50% to 40% as well as maximum stressed DSR from 60% to 50%. At the same time, the Hong Kong Mortgage Corporate tightened eligibility criteria for mortgage insurance applications. The rules intended to deter investment demand further in the property market. Developers have reacted with rebates and by allowing provision of second mortgage to buyers. Property prices rose during the 1H, mainly led by active transaction in the primary market. Due to tightened mortgage insurance policies, transactions of residential properties that were under HK$4 million were active in 1Q. Following which, the nature of transactions changed from first-time home buyers to upgraders during 2H 2015 and transactions of properties from HK$5 million to HK$10 million caught up in 2Q.

HK residential property price growth decelerated though price remained high

Though HK overall residential property price rose for the eighteenth straight month on a monthly basis, by 14.87% yoy (9.91% YTD, 0.2% mom) in September, the growth rate slowed down notably amid the increasing supply and depressed market sentiment.

For small units (below 100 sq.m), the price growth decelerated for the fifth straight month, slowing down from 21.8% yoy in April to 15.15% yoy (10.11% YTD) in September. Among small units, growth in price of flats from 40 sq.m to 70 sq.m had slowed since April from 22.7% yoy (HK$ 107,552 per sq.m) to 15.05% yoy (HK$ 109,972 per sq.m, 10.05% YTD) in September. Price of flats from 70 sq.m to 100 sq.m also grew at a slower place since May from 15.32% yoy (HK$ 129,040 per sq.m) to 12.49% yoy (HK$ 132,758 per sq.m, 8.82% YTD) in September. Compared with smaller units, price growth of large units (above 100 sq.m) fell at a slower pace from 11.51% yoy to 9.05% yoy (6.56% YTD) during April to September.

Analyzed by region, residential property prices also saw broad-based deceleration. Specifically, in September, Kowloon residential properties rose at the slowest pace in the past 13 months by 6.83% yoy (HK$ 122,767 per sq.m, 1.39% YTD). As for Hong Kong Island, the price growth fell notably for the fourth consecutive month in September to 11.87% yoy (HK$ 152,714 per sq.m, 8.52% YTD), compared to the 21.92% yoy (HK$ 154,362 per sq.m) in May. In New Territories, residential property price growth plunged markedly to 10.51% yoy (HK$ 95,465 per sq.m, 4.01% YTD) in September, compared with the 20.47% yoy (HK$ 98,324 per sq.m) in first eight months.

Though residential property price decelerated regarding all regions and all sizes, prices remained at a high. Given subdued sentiment and external headwinds, still-high housing prices are therefore expected to have more room for further decline.

Overall transaction volume dropped in 2H amid sluggish market sentiment. Residential property transaction volume dropped markedly to a 19-month low of 3300 units in October from 4263 units in September. The headline figure remained at low levels compared with the average of 5,377 units in 1H and recorded a year-on-year negative growth rate for seven consecutive months by falling 47% yoy in October. By segment, the decrease in volume was mainly recorded for flats valued from HKD 5 million to 10 million, dropping to average 1,812 units in 3Q from average 2,363 units in 2Q. Share of flats by this category also dipped from 46% to 40%. Meanwhile, transaction volume for flats below HKD 3 million continued contracting for the eighth consecutive month on yearly basis from 601 units (-21% yoy) in March to 379 units (-60% yoy) in October while transaction volume for flats above HKD 10 million rolled down to 390 units (-64% yoy) in October from 929 units (-29.5% yoy) in July. Broad-based tumble in residential property transaction pointed directly to a subdued housing market sentiment.

As the decline in value of HK total retail sales widened significantly from 5.3% yoy to 6.4% yoy in September due to weak inbound tourism and a shift of tourist spending pattern amid the tightened visa policy and Chinese economic slowdown, we believe that the sluggish economic outlook of HK, recent turmoil in HK stock market and the fear of lay off amid the deteriorating retail sales will further dampen market sentiment and make investors stay aside from the market.

Downward risk on residential property market is building up with increasing supply

In the longer term beyond 2015, housing supply is expected to increase substantially. According to forecast from the Housing Authority, a total of 77,100 public rental housing units will be completed in the five years from 2014 to 2018. Since 23,300 units are scheduled for completion in 2015-16, public rental housing could roughly average at 14,620 units for 2016-2018, up from the average of 13,007 units in 2010-1014.

In terms of private housing, the 2015 Policy Address reported that the housing supply projection of first-hand private residential property market for the coming three to four years is approximately 74,000 units, which is the highest on record. Private housing developers only completed an average of about 11,400 flats each year over the past five years. The 2015 Policy Address also forecasted that the private sector will produce about 14,600 flats on average each year in the next five years, representing an increase of about 30%. More supply of private housing would therefore add downward pressure to housing prices, especially given that market sentiment is expected to remain subdued amid tight mortgage rules, worries about economic outlook, and higher borrowing costs amid upcoming rate hike by Fed.

In fact, HK housing starts of private residential properties during the first 9 months of 2015 totaled 13,946 units, 252% higher than that of the same period last year. Based on the average housing starts, average supply of private residential units during 2017 to 2018 could be around 12,511 units, higher than the five-year average of around 11,397 units in 2010 to 2014. Moreover, there will be less completion of public housing (11,300 units) and subsidized flat completions (3,000 units) in 2016-2017 according to the housing authority, compared with the average 15,900 units for public housing and 4,250 units for subsidized flat during 2017 to 2018. Therefore, we believe private housing developers will seize the opportunity to accelerate the construction in the rest of 2015, so as to increase supply in 2016 before demand shrinks amid higher borrowing cost and more supply of public and subsidized housing in later years. In all, we expect private housing price would face further downward pressure in 2016.

Growth of residential property market could fall notably while rental growth may drop faster in 2016

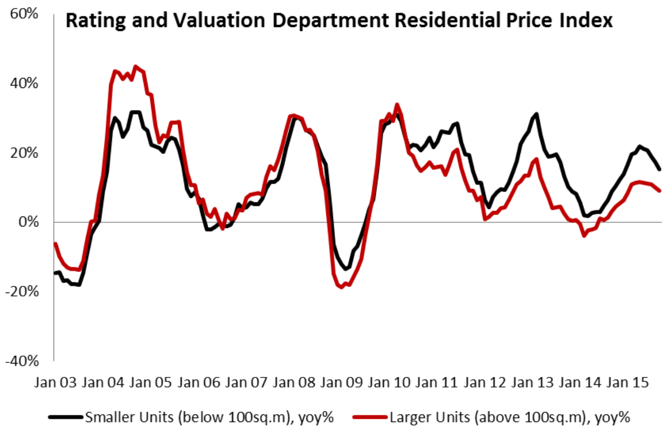
Looking forward, we expect residential property prices, which grew 14.87% yoy (9.91% YTD) in September, to keep rising in early 2016. But the growth would slow markedly due to sluggish market sentiment which is expected to sustain into 2016 as the weakening HK retail sales and softening trade activity could exacerbate the fear of layoff. Also, the increase in supply combined with higher borrowing cost amid an expected Fed liftoff would mean that the residential property market will encounter more downward risk over the next 3-5 years. Therefore, we expect private residential property price to continue to decline around 5% by the end of 1H 2016 and around 10% for the whole of 2016. Furthermore, we believe rental growth for private house (8.72% yoy, 6.5% YTD in September) which also fell for the third consecutive month would drop faster than housing prices in 1H 2016 as homeowners are reluctant to sell their house during the correction of property market and instead rent their houses with concessions given the sluggish market sentiment.

Table 1. HK Residential Housing Supply

Year	Public Housing Completions	Subsidized Sales Flat Completions	Private Domestic Completions	Total
2011	11,186	0	9,450	20,636
2012	13,114	0	10,150	23,264
2013	14,057	0	8,254	22,311
2014	9,938	0	15,700	25,638
2015 (F)	23,300*	0	13,290 ^	36,590
2016 (F)	11,300*	3,000*	20,000 ^	34,300
2017 (F)	19,000*	4,200*	13,333 ^	36,533
2018 (F)	12,800*	4,300*	13,333 ^	30,433
2019 (F)	9,200*	6,100 *	13,333 ^	28,633
2020 (F)	22,133*	13,233*	23,400 ^	58,767

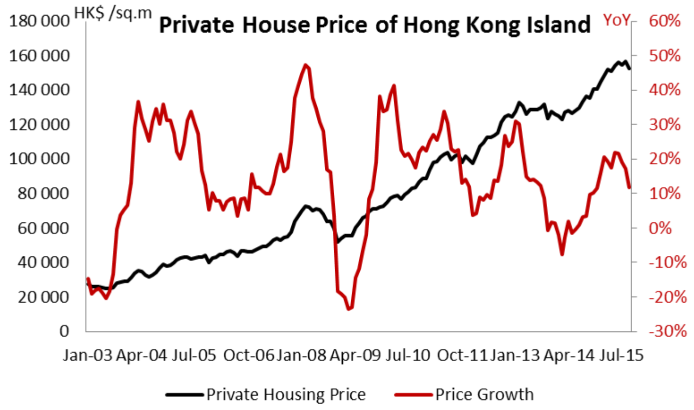
* Forecasts by Housing Authority ^ Latest government forecasts

Figure 1. Residential Price and Trend



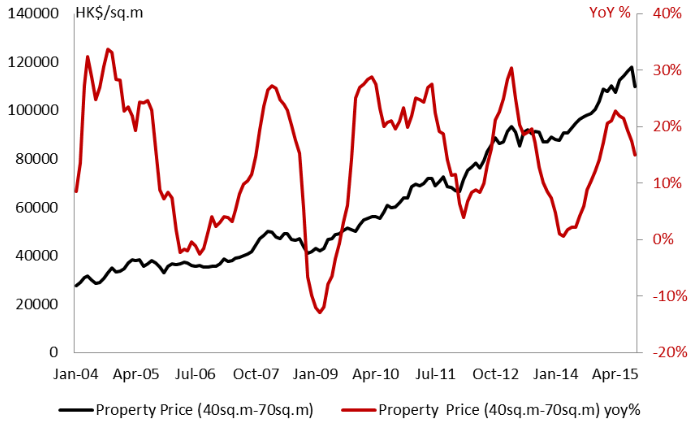
Source: Rating and Valuation Department, Land Registry

Figure 2. Residential Price by Region



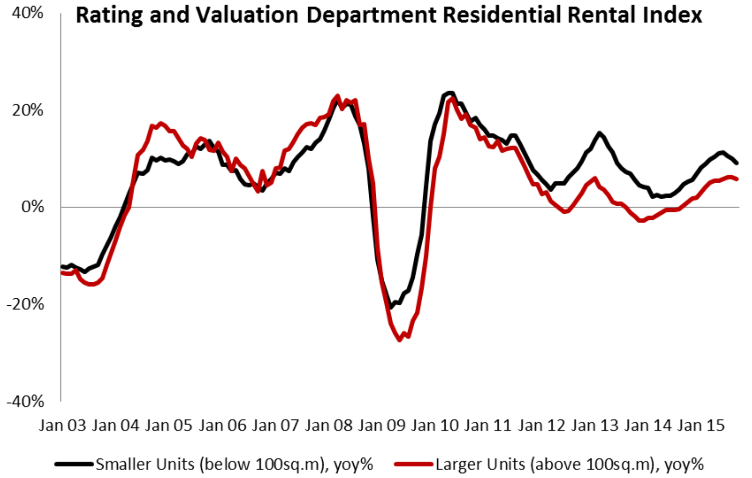
Source: Rating and Valuation Department

Figure 3. Residential Price by Size



Source: Rating and Valuation Department

Figure 4. Residential Rental



Source: Rating and Valuation Department

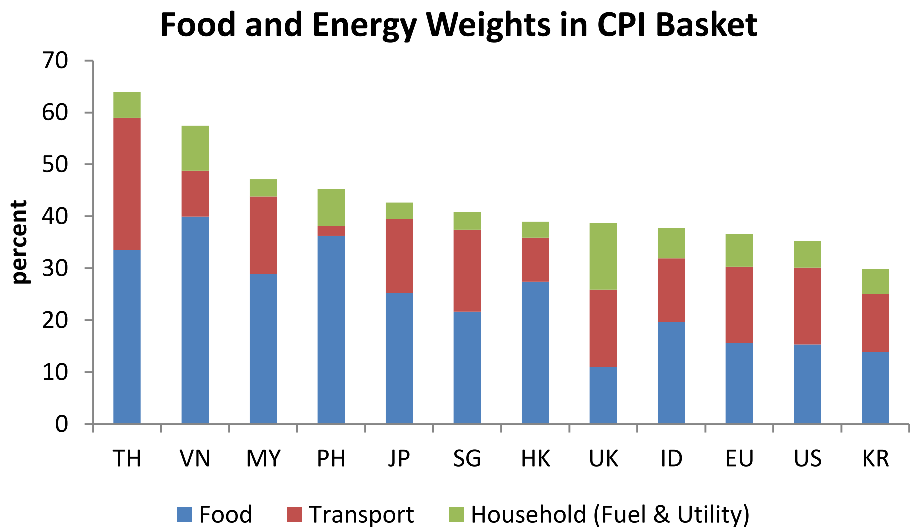
INFLATION

The Conflicting Force Between Energy and Food

It's not going to last

The inflation outlook has been at the forefront of concerns for many in the last year, owing to the plunge in oil prices to its sub-$40 per barrel handle in the fourth quarter last year. Central banks in particular, especially those belonging to the Asian and European economies, have been citing low inflation pressures and pale external environment as key reasons for accommodative monetary policies.

As we step into the new year, analysts and market-watchers would all know for certain that low inflation pressures in the previous year serves as a low-base effect for price growth prints in 2016. The commodities in question would actually be isolated to agriculture and energy, where prices have been largely pressured down on ample supply reasons. Needless to say, higher food and energy prices, should it occur into 2016, would have spill-over effects to a wide-range of inflation components especially Fuel & Utilities, Transport, Recreation, and Services.

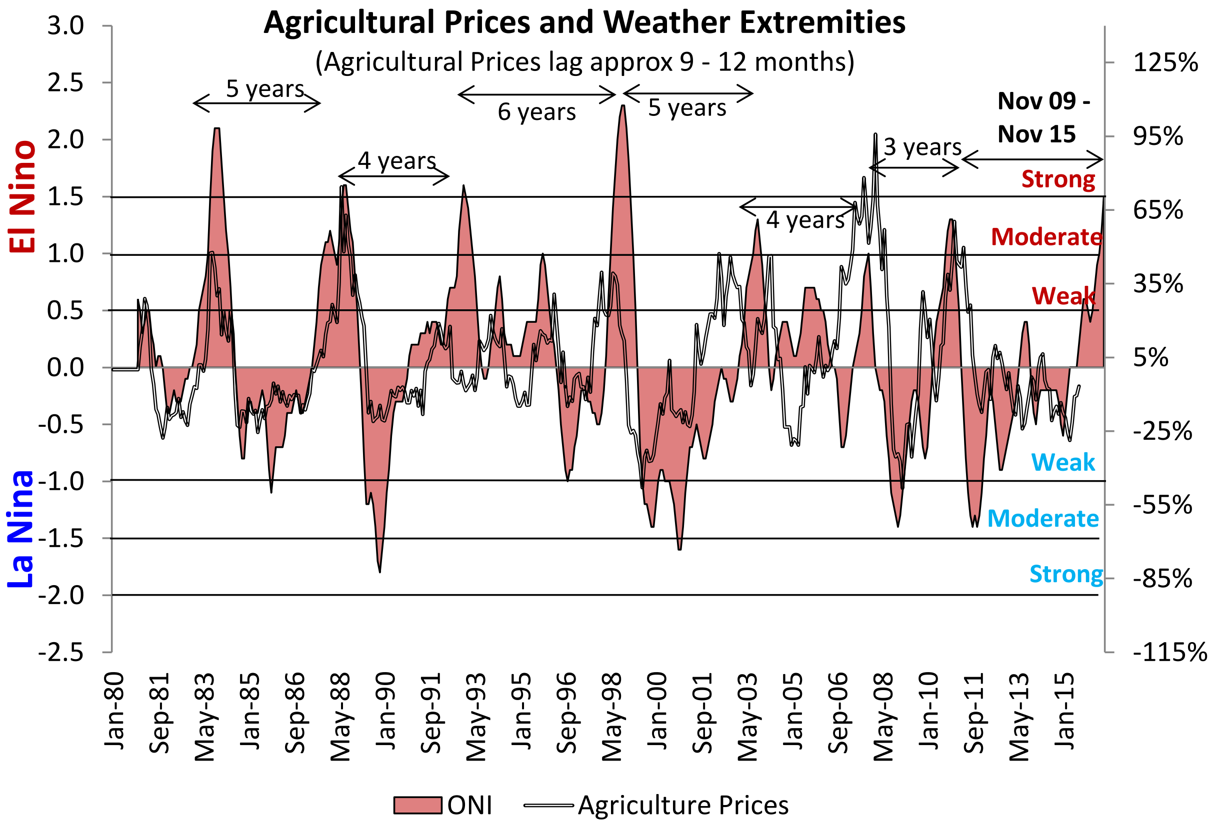


Source: CEIC, OCBC Bank

The crux of the matter is, overall inflation pressures have tremendous upside potential in 2016. The culprits of this phenomenon are likely higher food and inflation, exacerbated by the high weightage given to these components in the inflation basket across Asian economies. Of this, while we had enjoyed low prices in 2015, it likely isn't going to last as we usher in the new year.

Food – The double whammy effect

Agriculture harvest has been largely affected by Mother Nature and her fancies, at least between 3 to six years interval. In this, we are referring to the El Nino phenomenon, commonly associated with wet winters across southeastern US and hotter weathers in large parts of South East Asia. Truth be told, El Nino has visited, announced by the National Oceanic and Atmosphere Administration (NOAA) back in the second quarter of 2015. Comfortingly, the seasonal patterns of the El Nino have preserved, with the severity of it peaking in November 2015, though our models point for agricultural prices (measured by our basket of grains, rice, crude palm oil and sugar) to peak in the nine months to come.



Source: National Oceanic and Atmosphere Administration (NOAA), Bloomberg, OCBC Bank

More importantly, the death of El Nino (expected to be around February/March 2016) comes the birth of La Nina. La Nina is described as a counterpart to El Nino and is said to bring heavy rains to South East Asia, wetter-than-normal conditions in Africa, while triggering lower-than-normal rain precipitation in Southern US. But for agricultural producers alike, weather extremities like this would only mean unfavorable climate for crops, thus likely affecting harvests once again when La Nina takes root likely as soon as 2Q16. For consumers then, the poor harvest would only mean that the base of relatively low food prices would wane as we approach the second half of 2016.

Crude - The lifeblood of the world

The second commodity in question is crude oil prices, now that the sticky liquid is priced at its 8-year low below its $40 per barrel mark. Throughout the year 2015, crude oil prices have been largely pressured, led by a multi-faceted kaleidoscope of factors including the lifting of the Iranian oil export ban, growth concerns led by the volatility in the Chinese markets, and the exacerbation of over-supply issues as OPEC refuses to taper production to rebalance the oil markets.

Unlike agricultural prices which have a strong inclination to climb further into 2016, oil prices at this juncture, is still exhibiting bearish signals. We observe that the net non-commercial positions reported by the US Commodity Futures Trading Commission (CFTC) had eventually fallen in tandem with lower oil prices. Elsewhere, bullish calls for crude oil have been largely muted as the United States is poised to lift its 40 year-old crude oil ban.

Still, we are still firm believers of the rebalancing story into 2016, especially as crude oil supplies from non-OPEC sources remain pressured on low prices. On this, we look for US oil production to fall to (at least) 8.8 million barrels per day (mbpd), down from a 9.2 mbpd seen in late 2015. Furthermore, market estimates show that energy companies in the US are likely to engage another 20% capital expenditure cut in 2016, similar to the rate of cuts seen in 2015 according to company guidance. Elsewhere, crude oil demand still appears steady especially with higher crude oil import volume seen in Europe and China (likely on the affordable prices) on year-on-year basis. Still, let's not avoid the fact the crude oil is a growth-related commodity, where it naturally flourishes on positive global growth winds. Putting these together, the rebalancing story appears to be underway into 2016. Translating this into price, it may well be said that the sticky liquid will likely be priced higher, though much of the increases may likely be isolated in the second half of 2016.

In this, we need to account for the low base effect once again, given that oil prices were largely lower especially in the second half of 2015. Coupled with relatively higher oil prices expected in 2H16, the base effect of low oil prices will rapidly fade. Higher oil prices have far-reaching implications for consumer prices in Asian economies, especially as it is tied closely to gasoline prices, as well as household energy consumption.

Being ahead of the curve

It is important to have far-sighted paradigm, especially during this period of economic uncertainty. Even as market-watchers place inflation-related risk far down on the list of concerns that they may have, we however are increasingly concerned over it.

The risk of inflation, likely to be concentrated largely in 2H16, will have policy implications for Asian economies. This would likely mean tighter monetary policies as they combat dearer food and energy prices. The risk of such will likely be magnified in Asian economies such as Thailand, Vietnam, Malaysia and Philippines, where food and energy components make up a huge part of their CPI basket.

The inflation outlook has been at the forefront of concerns for many in the last year. For this matter, it can be said that the inflation outlook will still be at the forefront of concerns in 2016, but on significantly higher inflationary pressures as we approach the second half of 2016.

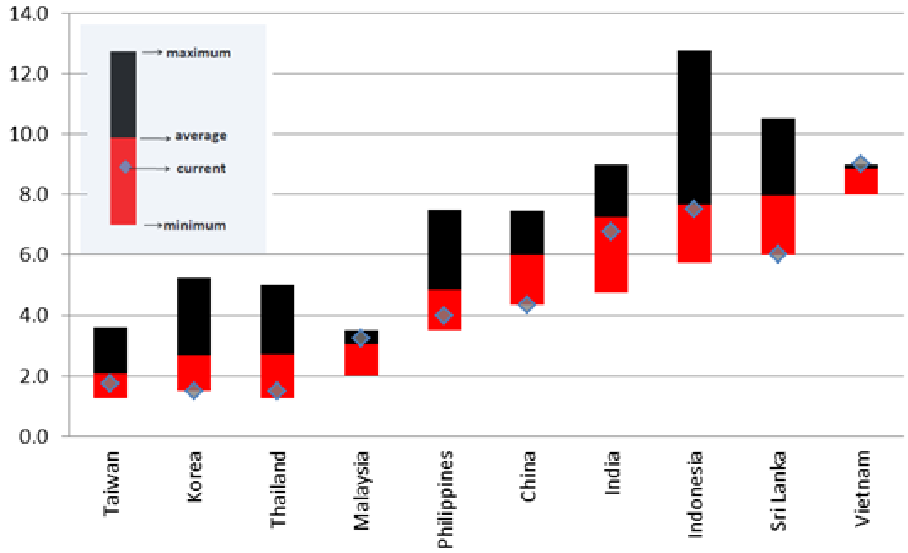
INDONESIA SPECIAL

Why Is Indonesia's Rate So High?

As we have highlighted in our 2016 outlook piece, Indonesia's central bank is on the cusp of bringing its policy rate lower. That is a cyclical thing, however. Structurally speaking, Indonesia's policy rate level – which ultimately sets the tone for other interest rates in the economy – has been high and may remain so for a while more. We discuss why that is the case, and venture into a look at what can push it lower on an enduring basis.

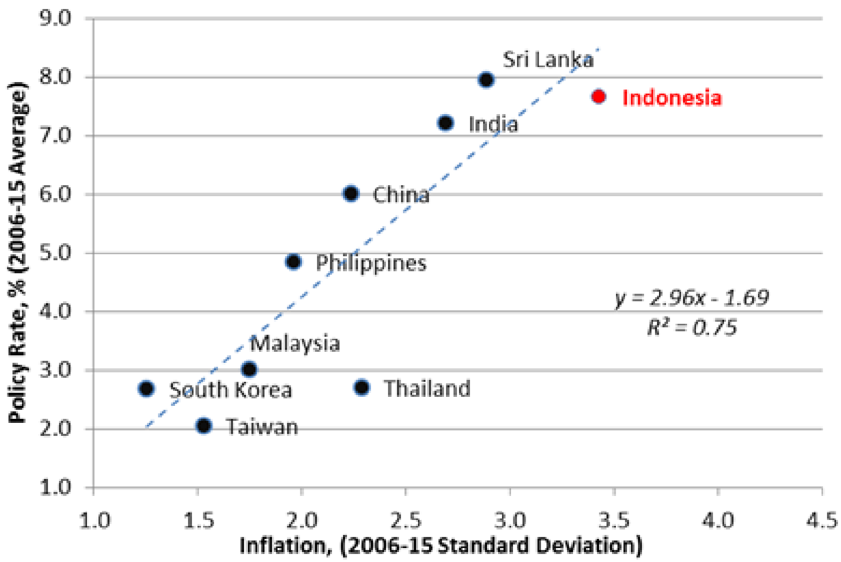
To begin with, consider this. Indonesia's policy rate ranks as one of the highest in Asia. That is not just a recent phenomenon, as Bank Indonesia has kept rate lofty at 7.5% amid concerns about current account deficit and currency rumblings of the past year or two. In fact, over the past ten years, that has been the case, ranking third just behind Sri Lanka and Vietnam in Asia, for instance. Indeed, if we go by the maximum level, the highest point at which policy rate has reached in the past decade, Indonesia would have been the top.

Policy Rate Range (2006-2015), %



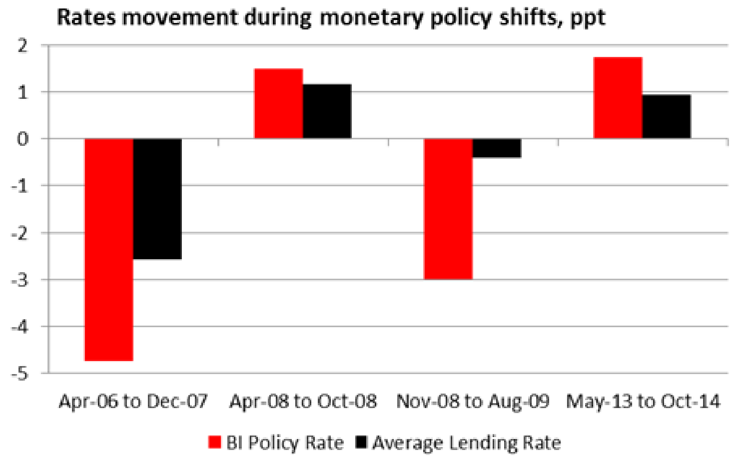
The fact that Indonesia's rate is at a high level has become a sore point of contention among policymakers lately. Vice President Jusuf Kalla, for one, has been vocal in pointing out that the Indonesian economy risks losing to its peers because businesses experience the heaviest interest rate burden in the region. Among other things, he mentioned that Bank Indonesia should stop using the Fed rate hike as an excuse for not cutting rate.

To that end, it is worth noting that even though the proximate cause for BI's cautiousness in slashing its policy rate a lot lower is indeed the uncertainty about how global markets could be rocked by Fed's actions, it is by no means the only factor of consideration. To have its policy rate go much lower towards the level of regional peers – such as the 4-5% level that Philippines has been – Indonesia needs to tackle one of the root causes of it, which is inflation variability.



When we look into the determinants of policy rate level in Asia over the past ten years, one of the key factors is just how prone the inflation rates are to large changes. What we found is that, the higher the standard deviation of inflation is, the higher the policy rate tends to be too. Indeed, Indonesia's inflation rates have the highest tendency to deviate. This makes it more necessary for policy rates to not only go up, but also stay at a relatively high level to anchor inflation.

The effect of structurally tight policy rate environment has been further compounded by the fact that there appears to be a tendency for lending rates by the banking sector to 'discount' any cuts in policy rates. Between April 2006 and December 2007, policy rates were cut by nearly 5 percentage points. However, banks trimmed their lending rates on average by about half that amount. They were even more conservative in passing on the rate cuts when policy rates came down by 3ppt between November 2008 and August 2009. Lending rates went down by less than half a percentage point over the period. (On the flip side, they appear more ready to hike their lending rates when policy rates go up).



While there can be a multitude of reasons for the banking sector's reluctance to pass on rate cuts more readily – including nonperforming loan concerns and perhaps a lack of competitiveness in the sector as a whole – the worry that policy rate cuts may be reversed quickly would have played a role, as well. After all, it is easy to tell your banking clients that rates are lower but considerably harder to inform them that their interest payments would have to go up again. Hence, there is an inherent incentive for banks to go slow on rate cuts.

Hence, just as the variability of inflation contributes to the high policy rate environment, the very variability of policy rate itself may have inadvertently added to the stickily high lending rates of the banking sector as well. Hence, to fundamentally resolve the issue of structurally high interest rate environment in Indonesia, it appears that reducing the tendency for inflation to yo-yo would be more important than the jaw-jaw of talking about the need to cut rates.

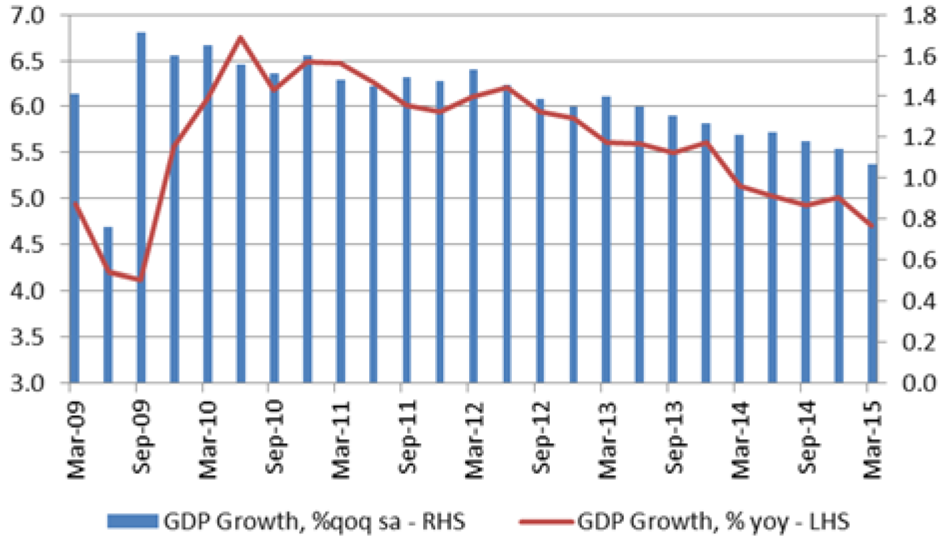
In turn, if we look back into the episodes of inflation jumps – and troughs thereafter – over the past ten years, they are more often than not linked with fuel price shocks. Indeed, with the exception of mid-2010 period when food prices climbed, each time year-on-year headline inflation registers prints of above 6%, it has come courtesy of large fuel price adjustments due to sudden subsidy cuts

Now, even though subsidies have been dropped for most fuel categories, the reality is that prices are still maintained at sticky levels rather than floating alongside actual market fluctuations.

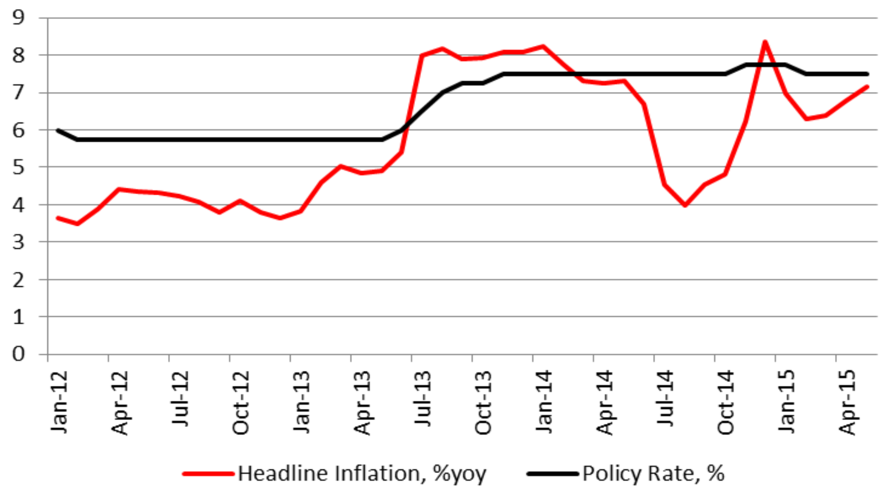
For one, the most popular Grade-88 fuel which was previously subsidized had been priced at IDR7400/lt since March 2015 despite the fluctuations in global oil price. While there is a move scheduled this month – with prices to be cut by around 4% reportedly - the generally static price hides the danger of sudden huge adjustment again akin to the situation under the subsidy regime. This hidden risk would be especially acute if oil price does indeed rebound later this year as our house view has it.

Overall, even though outright fuel subsidy has been largely dismantled, it appears that the fuel price adjustment process is not transparent and reflective enough yet to dismiss the risk of contributing to sudden inflation jump once more. If prices at the pump are not allowed to adjust gradually together with fluctuations in global oil price, the scenario whereby they would have to be adjusted out of the blue, bringing inflation spikes and thus sudden policy rate increase remains a distinct possibility. In short, it will get a lot harder to have lower interest rates on a structural basis in Indonesia if that turns out to be the case

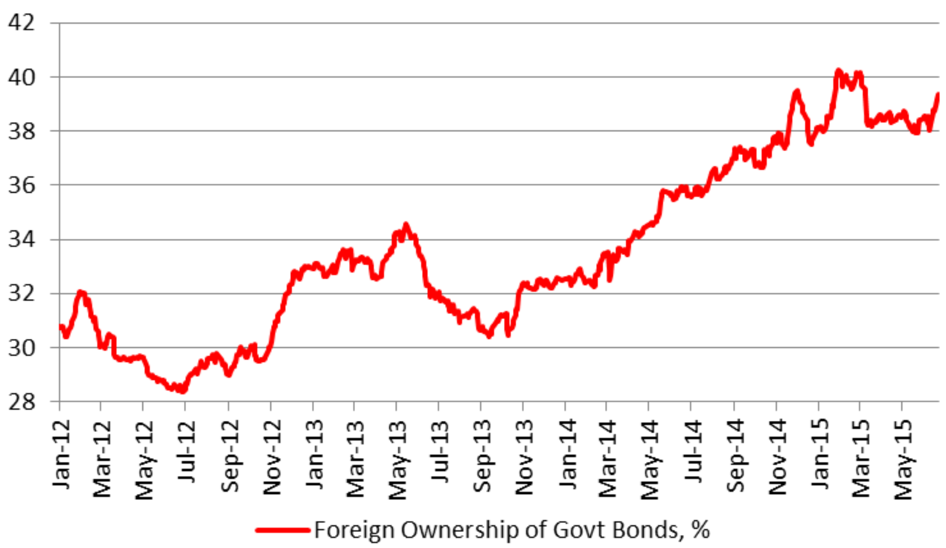
GDP Growth



Inflation



Foreign Ownership of Bonds



RMB A NEW ERA

RMB A New Era

The USDCNY ended 2015 at 6.4937 in the onshore market and 6.5697 in the offshore market, marking around 4.6% and 5.5% depreciation against the dollar respectively in two markets, the worst performance since 1994. With 5% depreciation being nothing compared to China's peers in EM as well as major currencies such as Euro and commodity currencies; it still marks a new era for investors who have been used to RMB's gradual pace of appreciation. The reason behind RMB's fast annual depreciation against the dollar since 1994 was because of concerns about rising capital account outflows despite China's record high trade surplus. In our view, RMB's depreciation in 2015 was mainly driven by changes of sentiment.

RMB's status as an anchor of stability for the past two decades was mainly the result of tight government control. After successfully weathering through two major financial crises in 1997 and 2008, the Chinese government established a mighty image that no investors dare to challenge PBoC, even despite persistent speculation on China's hard landing scenario. However, this mighty image came into question in 2015 after a failed government intervention in its stock market. The move towards a market driven fixing and pricing system opened Pandora box during the turmoil and completely turned sentiments around against RMB amid the slowdown in Chinese growth and equity market rout. The sentiment driven depreciation made it increasingly difficult to forecast RMB in 2016.

Looking ahead, in order to forecast RMB, three factors have to be taken into account including market sentiment, fundamentals and the government's willingness to intervene. Sentiment can be judged based on CNY-CNH spread as well as forex purchase data while fundamentals would mostly depend on China's balance of payment position.

Let's zoom into the government willingness. China's reluctance to intervene both in the onshore and offshore RMB market in December was probably attributable to two factors. First, China has a higher tolerance for the CNY-CNH spread. With further opening of China's onshore market to offshore reserve managers, the CNY-CNH spread is no longer the hurdle for RMB to be defined as freely usable currency by IMF. As such, China is not in urgency to close the gap between onshore and offshore market. Since September 2015, Chinese regulators have started to pay more attention in order to clamp down on cross border arbitrage activities. The latest news that several foreign banks have been suspended for transacting cross border RMB business in late December following the 0.3% penalty margin implemented from September suggests China's commitment to stop banks from taking advantage of the system. However, the clampdown on arbitrage may also cause the gap to remain. Second and most importantly, despite RMB's depreciation against the dollar, RMB still appreciated against its basket currencies in 2015. According to the latest CFETs RMB index, RMB appreciated by 0.94% in 2015. The still appreciating RMB index was likely to give China room to wait and see. Looking ahead, we expect RMB to remain under pressure in the beginning of the year due to rising dollar demand from retail investors driven by shift of asset allocation strategy after 50K foreign currency purchase quota is filled. In the medium term, we think it will be increasingly important to track the change of RMB index. The latest clues we received from China's central bank is that China will continue to keep its currency stable at a reasonable level and China will look at RMB value from perspective of basket currency value. As such, our best estimate is that the key change for RMB policy this year is that China will likely keep RMB stable against its basket currency rather than dollar. Unfortunately, the PBoC did not give quantified guidance on the range of RMB index. Based on our current estimation, we think 98-102 is likely to be reasonable level for the RMB index. We expect the upside for USDCNY is around 6.70 inferred from current projection of RMB index.

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