GLOBAL MID-YEAR OUTLOOK 2016

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2H 2016 Global Themes

Friday, July 08, 2016

At the start of 2016, we warned that the key risks for 2016 remain namely growth and policy-centric ones. What a volatile first half of 2016 it has been – first the Chinese equity markets had a bumpy start, this was quickly followed by a wishy-washy US Federal Reserve who kept talking about policy normalization but also backtracked on China growth slowdown and Brexit fears, and of course, the actual surprise outcome of the Brexit referendum on 24 June itself. The Brexit-induced political crisis in the Eurozone will take time to play out, even though the economic impact on global growth is estimated to be fairly modest. However, the key channel of contagion has been financial in the short-term rather than economic in the medium term.

The silver lining, if you were hunting for one, is that global policy accommodation has been unprecedented, especially in the utilization of unconventional policies. The more global growth prospects soften, the more monetary and fiscal policy will be on tap. So far, the Bank of Japan has joined the European Central Bank in venturing into negative deposit rate territory. Still, the continued supply of liquidity, whether through bond purchase programs and/or actual term liquidity injections, have benefited asset more than actual business credit growth or headline GDP growth. This combination has led many to question on the efficacy of monetary policy as interest rates approach the zero bound. With many of the G7 sovereign bond yields already testing record lows, if not outright negative yields, obviously we do not live in a normalized world. In fact, the thinking is increasingly focusing on fiscal policy and structural and economic reforms to make a difference from the protracted period of sluggish growth since the Global Financial Crisis.

The only certainty looking ahead appears to be more anticipated market volatility and economic uncertainties for the second half of the year. Looking into a rather murky post-Brexit crystal glass at this juncture, the overwhelming suspicion is that the global growth will again disappoint, China will continue to meander along a modestly downward sloping GDP growth trajectory and currency regime, and the search for yield will continue as long as the "low-for-longer" interest rate environment and liquidity-on-tap environment persists.

The biggest market disappointment has been the US Federal Reserve. The key motto here is to clearly watch what they do and not what they say. Policymakers are being confounded by mixed economic prints and event risks. Note the June FOMC minutes sounded another cautious tone amid the mixed data points, as "almost all participants judged that the surprisingly weak May employment report increased their uncertainty about the outlook for the labour market…even so, many remarked that they were reluctant to change their outlook materially based on one economic data release". Overall, "most participants judged that, in the absence of significant economic or financial shocks, raising the target range for the federal funds rate would be appropriate", albeit "some other participants were uncertain whether economic conditions would soon warrant an increase" in the Fed Funds rate. On inflation, they "viewed the firming in some measures of core inflation, the evidence that wage growth was picking up". On Brexit risks, most participants noted it "could generate financial market turbulence that could adversely affect domestic economic performance". Our view is that the split in the FOMC members' economic assessment will likely keep them on hold in the near-term (ie. through summer), especially given Brexit risks have materialized to a certain extent, and that at best one rate hike will occur at the end of the year. So whilst the FOMC credibility has been materially dented, nevertheless, the sustained dovish slant in the other major central banks continues to ensure policy divergence for now.

For Asia, China's policy risks remain predominant. While growth appeared to have stabilized in China, whether the current momentum can be sustained remains another question altogether. Within Asia, the Philippines and Indonesia look better poised to ride out the external turbulence and market headwinds, whereas Singapore continues to lag behind in absolute growth rates due to a combination of domestic challenges like a high cost base and foreign manpower constraints amid the ongoing economic restructuring. To bank on a China recovery in the near-term remains a bit of a stretch for now, so additional firepower from the policy front would be necessary to support Asian ex-China growth and credit conditions in the interim. Domestic consumption and business confidence remains key in the current choppy macro-environment. So stay tuned for now.

OCBC Asia GDP, CPI and Policy Rate Forecasts

GDP					
% chg year-on-year	**2014**	**2015**	**2016F**	**2017F**	**2018F**
US	2.4	2.4	1.7	1.8	2.0
Euro-zone	0.9	1.7	1.5	1.6	1.6
Japan	0.0	0.6	0.5	0.7	0.6
United Kingdom	2.9	2.3	1.3	0.0	1.5
New Zealand	3.0	3.0	2.5	2.5	2.5
Australia	2.7	2.5	2.9	2.9	3.1
China	7.3	6.9	6.6	6.2	5.8
Hong Kong	2.7	2.4	1.1	1.8	2.5
Taiwan	3.9	0.6	0.9	2.0	2.5
Indonesia	5.0	4.8	5.2	5.2	5.4
Malaysia	6.0	5.0	4.3	4.7	4.9
Philippines	6.1	5.7	6.0	6.0	6.0
Singapore	3.3	2.0	1.8	2.0	2.3
South Korea	3.3	2.6	2.6	2.8	2.9
Thailand	0.8	2.8	3.2	3.5	3.5
Vietnam	6.0	6.7	6.4	6.5	6.7

Inflation					
% chg year-on-year	**2014**	**2015**	**2016F**	**2017F**	**2018F**
US	1.6	0.1	1.3	2.3	2.2
Euro-zone	0.4	0.0	0.3	1.4	1.6
Japan	2.7	0.8	0.0	0.9	1.2
United Kingdom	1.5	0.0	0.7	1.7	1.9
New Zealand	1.2	0.3	0.8	1.8	2.1
Australia	2.5	1.5	1.3	2.1	2.2
China	2.0	1.4	2.2	2.5	2.8
Hong Kong	4.4	3.0	2.2	2.3	2.3
Taiwan	1.2	-0.3	1.2	1.5	1.8
Indonesia	6.4	6.4	4.8	4.6	4.4
Malaysia	3.2	2.1	2.8	3.1	3.0
Philippines	4.2	1.4	2.0	3.0	3.3
Singapore	1.0	-0.5	-0.4	1.0	1.5
South Korea	1.3	1.3	1.1	1.8	2.0
Thailand	1.9	-0.9	0.4	2.0	2.3
Vietnam	1.8	0.6	2.5	4.2	4.5

Central Bank Policy Rate					
	2014	**2015**	**2016F**	**2017F**	**2018F**
US Fed Funds rate	0.25%	0.50%	0.75%	1.25%	2.00%
ECB deposit rate	-0.20%	-0.30%	-0.50%	-0.50%	-0.50%
BOJ overnight rate	0.10%	0.00%	-0.30%	-0.30%	-0.20%
BOE base rate	0.50%	0.50%	0.10%	0.10%	0.25%
RBNZ cash rate	3.50%	2.50%	2.25%	2.00%	2.25%
RBA cash target rate	2.50%	2.00%	1.50%	1.75%	2.00%
China lending rate	5.60%	4.35%	4.35%	4.10%	4.10%
CBRC discount rate	1.88%	1.75%	1.25%	1.25%	1.25%
Hong Kong base rate	0.50%	0.75%	1.00%	1.50%	2.25%
BI reference rate	7.75%	7.50%	5.00%*	4.75%*	4.5%*
BNM overnight rate	3.25%	3.25%	3.25%	3.00%	3.00%
BSP overnight reverse repo	4.00%	4.00%	2.75%	3.00%	3.25%
Singapore 3-month SIBOR	0.46%	1.13%	1.05%	1.20%	1.80%
BOK target overnight call	2.00%	1.50%	1.00%	1.50%	1.75%
BOT repurchase rate	2.00%	1.50%	1.50%	1.75%	2.00%
SBV base rate	9.00%	9.00%	9.00%	9.00%	9.00%

*Denotes the new policy rate of 7-day reverse repo rate, effective August 2016

Source: OCBC

Contents

CHINA

Brace For Impact

China kicked off 2016 with a tough start after RMB volatility spiked to record high in January following the quick depreciation of RMB fixing. In reaction to the panic sale of RMB, PBoC intervened in both onshore and offshore market aggressively. The mop-up of RMB liquidity in early January resulted in the man-made liquidity crunch in the offshore market but managed to turn fortune around after the intervention. The stabilized RMB in late January albeit at the expense of China's RMB internationalization and capital account liberalization helped calm the sentiment down and market shifted focus back to economic fundamentals.

China's growth decelerated to 6.7% in 1Q from 6.9% in 2015, but in line with market expectation. The stabilization of the economy in 1Q was mainly attributable to three factors including favourable global environment, stable RMB and supportive domestic monetary and fiscal policies.

Externally, global sentiment improved in March and April after the G20 meeting in Shanghai in late Feb, following more easing measures from ECB and BOJ as well as dovish comments from Fed Chairwoman Yellen. The recovery of global sentiment also spilled into China's financial markets, which in turn helped curb excessive bearish sentiment.

The panic about the disorderly RMB depreciation has diminished significantly after PBoC guided markets to trade RMB with reference to a currency basket. Since early March, China has been following the new fixing mechanism closely and markets gradually adapted to the new fixing mechanism. This then eventually contained concerns over any big one-time devaluation. A more predictable currency policy is important for exporters and importers, which partially contributed to the recovery of China's trade albeit still not stable in the past few months.

Domestically, the Chinese economy also benefited from more expansionary monetary policy and proactive fiscal policy. China's aggregate social financing hit an all-time quarterly high of CNY6.53 trillion in 1Q, signalling expansionary credit policy even as China kept its benchmark interest rate unchanged. Meanwhile, infrastructure investment re-accelerated to 19.6% in 1Q from 17.2% in 2015 on the back of fiscal support.

Challenges remain

Despite encouraging growth data in 1Q, challenges still exist given the poor private investment trend as well as weaker-than-expected global recovery. China's fixed asset investment by private sector decelerated further to only 3.9% yoy in the first five months, down from 10.1% yoy in 2015. This signals caution in the private sector, in anticipation of a slowdown in Chinese economy. As a result of weak private investment, fixed asset investment slowed down to 16-year low of 9.6% yoy in the first five months. Should private investment fail to pick up from here, we think it may weigh down the GDP growth in 2Q. We expect China's growth to slow down to about 6.5% in 2Q.

The impact of Brexit is manageable for now

The Brexit decision made by British people shocked the global market. The drama has been far from over as market focus will shift to when the UK is going to invoke the Article 50 and how long the negotiation between the UK and EU will take. Uncertainty is expected to last for at least three months until we have clearer picture about who is going to take over David Cameron as the new Prime Minister in October. Nevertheless, we think the impact on China is limited for now as the bilateral trade between UK and China only accounted for 2% of China's total trade.

However, RMB felt the first wave of the Brexit shock with the USDCNY spiking to around 6.65 following the event. The break of 6.60 handle may fuel fresh concern about RMB's depreciation. In aggregate, as the recent RMB weakness is not a China-specific event, corporate's expectation about RMB's two-way movement has not been derailed yet. We think PBoC may step in to keep volatility in check. As such, we do not expect another round of one-time devaluation. The net sale of foreign exchange under the current account turned positive at US$4.8 billion for the first time since July 2015, signaling more balanced demand and supply. As such, we see low risk of disorderly capital outflows in the second half should China continue to follow its fixing mechanism.

Systemic risk is likely to be contained

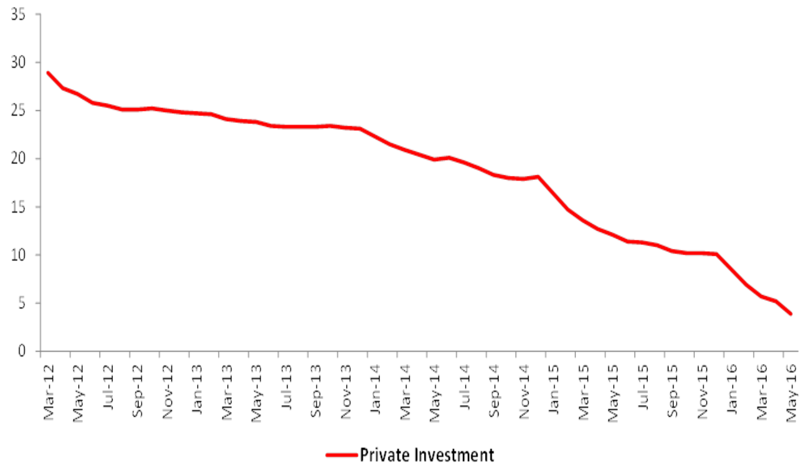
A hard landing is not in our baseline scenario for the next two years as we think China still has enough buffers to protect itself from systemic risks. The upgrade to macro prudential assessment is likely to keep financial risk in check. The fact that China's deposit growth remains steady shows that confidence in China's banking sector has not been eroded by the recent rise in credit events as well as deteriorating asset quality. Meanwhile, money markets have been stable since last year after PBoC used the combination of three innovative measures including SLF, MLF and PSL to manage short end liquidity, less affected by the equity and currency market volatility. As such, we do not expect any imminent banking crisis in China.

Looking ahead, we expect China's monetary and fiscal policies to remain supportive, in particular, after taking local government debt swap program and upcoming debt for equity swap program into account. On monetary policy front, easing expectation has swung left and right after the authoritative person's article in May. Overall speaking, we think the chance of further interest rate cut is low despite Brexit event for three reasons. First, China's short end money market rate has been stable. Hence, there is no urgency for China to cut interest rate to boost sentiment unless we see another round of equity market turmoil. Second, China has enough alternative measures to express easing monetary policy. The latest three non-traditional measures including SLF, MLF and PSL, are preferred measures at the current stage to interest rate cut. Third, an interest rate cut may have negative impact on still fragile RMB sentiment. As such, we see no interest rate cut for the rest of year. However, the chance of reserve requirement ratio cut cannot be ruled out under the prudent monetary policy. We expect one more RRR cut in 3Q to offset the impact of capital outflows.

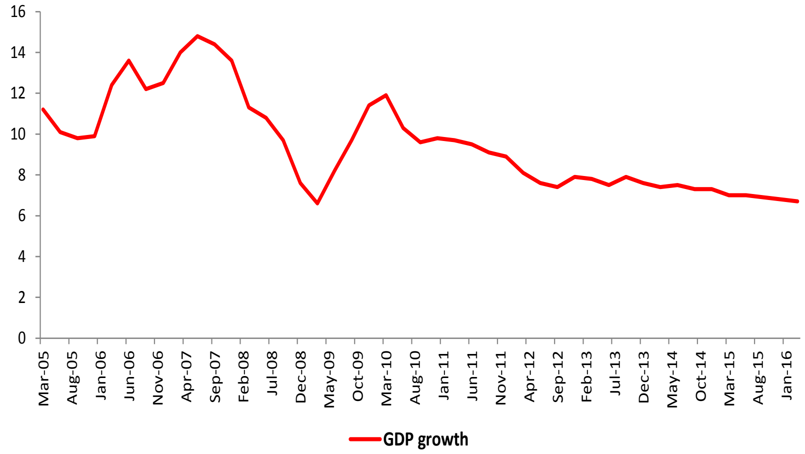
Compared to prudent monetary policy, we think fiscal policy is likely to play a more active role in the second half to stimulate the growth. China has raised the fiscal deficit target to 3% of GDP for 2016; we expect the actual fiscal deficit target to exceed 3% as a result of rising infrastructure investments and change of tax regime from business tax to value added tax.

To conclude, we expect China to achieve its 6.5%-7% target for 2016. How fast China will grow will depend on two key parameters including the external environment and private sector participation. Given private investment remains weak, we revise our GDP forecast for China down slightly to 6.6% from previously expected 6.7%.

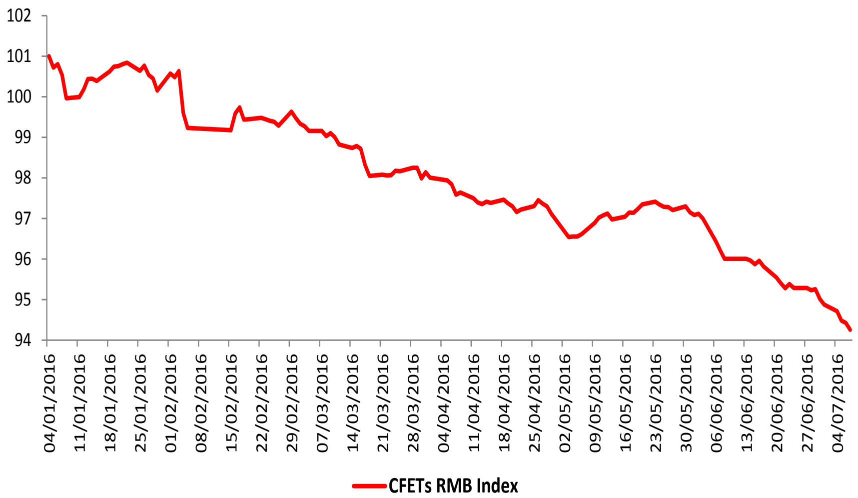
China's Private Investment



China's GDP Growth



CFETS Index



Source: Bloomberg, CEIC, OCBC

HONG KONG

Gloomy Economic Outlook

HK's GDP shrank by 0.4% qoq (+0.8% yoy) in 1Q, the first contraction since 2014 amid weak retail and trade sectors, cautious business spending and sluggish local consumer demand. A combination of fewer visitors and tepid tourist expenditure further dragged retail sales in April, in turn prompting the employers in this sector to increase retrenchments. Also, sluggish trade growth resulted in high unemployment rate in the trade and wholesale sector. Consequently, unemployment rate in HK held at an over two-year high of 3.4% in April. Elsewhere, the continuous drop in housing prices and consistently low borrowing costs have brought some potential home buyers back to the market, bringing transaction volume up in April.

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

Downward cycle in both the tourism and retail sector are still present due to a combination of fewer tourists, tepid tourist spending as well as cautious local consumer sentiment. Total value of retail sales fell for the 14th straight month in April, down by 7.5% yoy to HK$ 35.2 billion. The retail sector remains in doldrums amid weak inbound tourism and subdued tourists spending. The luxury segment has been the major drag on HK retail sales, with the sales value of jewellery and watches sliding for the 19th straight month by 16.6% yoy in April.

Due to the gloomy prospect for Hong Kong's retail sector, HK retail property market may tumble further even as retail shop rentals and prices fell by 1.3% yoy and 7.8% yoy respectively in March. More rental concession by landlords and higher vacancy rates in core business district could also be expected.

Amid weak tourist activities and luxury consumption, unemployment rate in the retail sector rose to 5.3% in April. This was disappointing as compared to an average of 4.4% in 2014. This is because business performance in retail sales was lacklustre amid shrinking tourist spending. In the near term, HK retail sector is likely to be constrained by weak inbound tourism activities amid Chinese economic downturn and external uncertainties, in turn weighing down employment in this sector. Overall, HK's labor market may worsen further with unemployment rate expected to rise to 3.5% over 2016.

Trade remained lacklustre and fake trade invoicing increased

Exports to major markets, including China, US and Japan continued to decline. This may reinforce the sluggish trading activities of Hong Kong.

Total exports value declined for the 12th consecutive month albeit at a slower pace, falling by 2.3% yoy in April due to weak external demand. Meanwhile, fall of imports value (HK$ 316.3 billion) also narrowed to 4.5% yoy in April, improving the trade deficit to HK$31 billion. Looking ahead, though the U.K. and Germany merely took up 1.5% and 1.9% respectively of HK's overseas shipments, demand across the globe may be dampened amid the heightened uncertainty of global recovery after Brexit. As a result, Hong Kong's exports are likely to remain subdued this year. Notably, exports to Mainland China slipped by 4.8% yoy, whereas imports from HK reported by China's customs jumped significantly by 203.5% yoy. The prominent mismatch in data prints points out that pressure of capital outflow from the onshore market is still alive.

Offshore financial activities dipped amid increasing RMB volatility in 2016
Offshore RMB deposits shrank further by 24.3 yoy for the 8th straight month to the lowest level (RMB 723 billion) since August 2013 in April as raising expectation on Fed's summer rate hikes pushed USDCNH up by 0.4% during the same month. On a monthly basis, RMB deposits dipped 4.8% after the previous drop of 5.5%. Interestingly, recent deprecation of the RMB has been orderly and the PBOC managed market expectation well via its new fixing mechanism. Nonetheless, since the RMB exchange rate would rest more on the basket of currencies than on the USD, the PBoC seemed to become more tolerant about RMB depreciation. Moving forward, the potential inclusion of the Korean Won to the basket and the impact of Brexit may further increase the volatility of the RMB, and as a result, dent market sentiment of the currency. As such, we believe RMB deposits may continue to decline moderately in coming months.

Loans for use outside HK dipped slightly by 0.5% mom (-2.2% yoy), indicating that demand for Mainland related loan remained soft in China given lower onshore borrowing cost and banks' increasing cautiousness of Chinese borrowers after the series of credit events. All-in-all, Hong Kong's restrained loan growth can be attributed to (a) rising defaults and moral hazard issues in China's bond market and thus souring sentiment, (b) deterioration of credit quality in China's enterprises due to its economic slowdown, (c) narrowing of offshore and onshore lending rates.

Increasing need for financial integration with Mainland
The mutual fund recognition scheme launched on the 1st July in 2015 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. Also, Shenzhen-Hong Kong Stock Connect is on the schedule and could be implemented in 2H 2016.

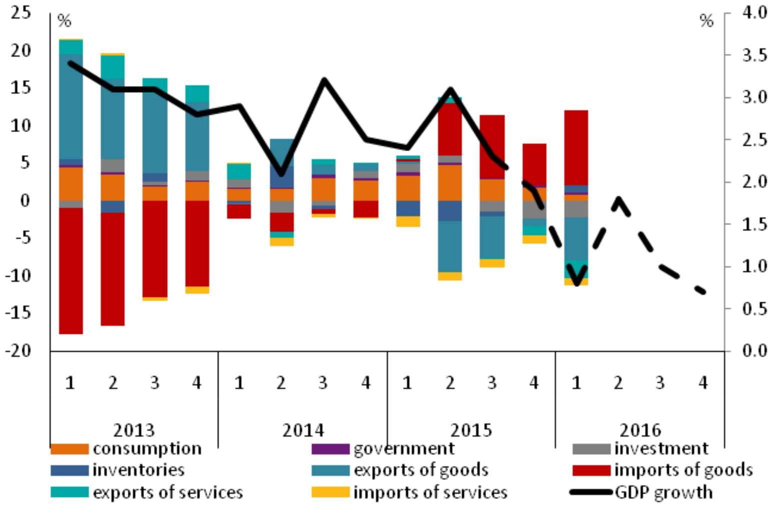
At present, QFII & RQFII are not offering enough quotas. There is no transparent quota system and it is not easy to apply for quota. In the future, there exists hope for removal of quota system, and thus, removing the need to open accounts in onshore market and the use of counterparty's dealer (foreign dealer). In addition, the One Belt One Road plan can bring in RMB investment as governments and other long-term investors can benefit from huge earning opportunities in the emerging markets while reduce short-term risks. Besides, OBOR plan will increase use of RMB for trading activities. All these would help enhance HK's role as an intermediate to connect foreign and Mainland market.

HK residential property market remained clouded
Lower housing prices (-8.2% yoy in Apr) and low borrowing costs drove housing transaction volumes up by 2% mom to 4,586 units in May. However, as compared to the same month last year, housing transaction activities remained subdued. The bleak economic outlook due to China's slowdown and tame external demand may put pressure on employers to increase retrenchments or slow wage growth, thereby hurting investor sentiment. On a positive note, as the Brexit may translate into delays in rate hikes by the Fed, the borrowing cost in Hong Kong is more unlikely to tick up this year, leaving room for the city's property market to see a more gradual correction.

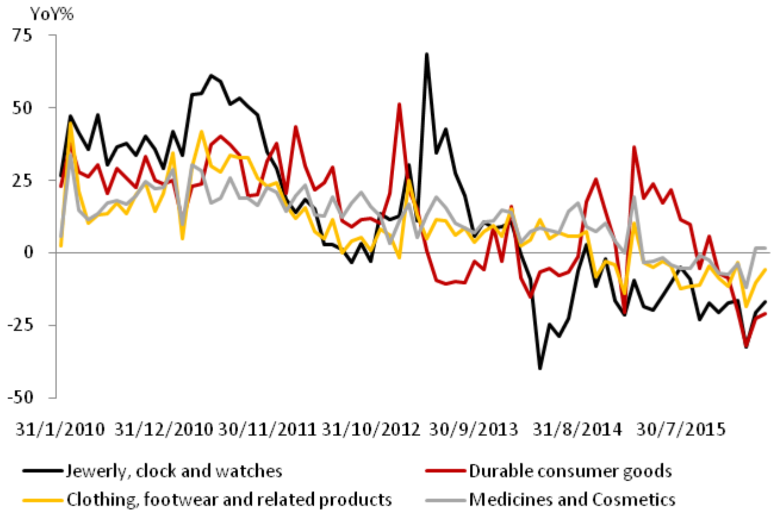
On the supply front, HK private residential housing starts increased 12.15% yoy in 1Q. Figure indicates that the housing supply in private sector could grow at a solid pace over next two to three years. Based on the average housing starts figures, average supply of private residential units during 2016 to 2018 could reach around 17,913 units, higher than the five-year average of around 11,397 units over 2010 to 2014.

Moving forward, we expect dimmer economic outlook coupled with a volatile stock market, especially after Brexit, will continue to dent investor sentiment despite recent rebound in transaction volume driven by lower prices and low borrowing cost. The increasing supply may also translate into additional downward risks to the housing prices, which may drop by around 20% yoy by end of 2016.

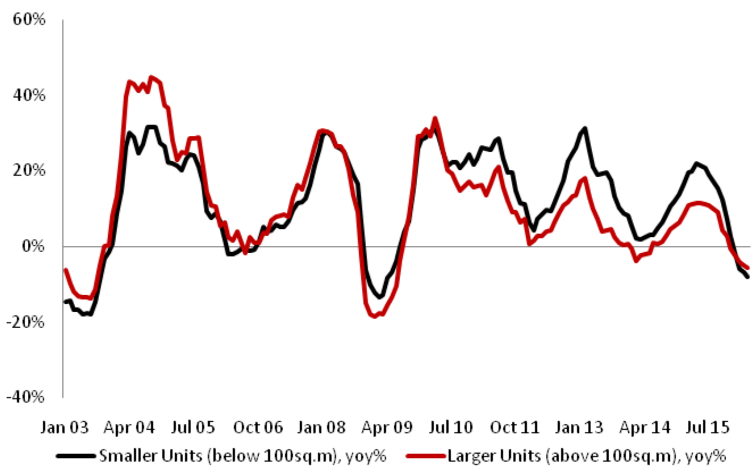
Hong Kong GDP Growth



Retail Sales Growth by Categories



Residential Property Price



Source: Land Registry, Census and Statistics Department.

INDONESIA

Monetary Push

At the start of this year, after we peered into the crystal ball and thought about the outlook for the Indonesian economy in 2016, we wrote that, "For the year ahead, Indonesia can indeed do better – albeit not by much."

Halfway into the year, it appears that the above characterization has been holding up. For one, the year was off to a rather uninspiring start, with GDP clocking growth of just 4.92% yoy, falling back below 5% again after peering above it in the previous quarter. Lackluster growth in household consumption and investment activities were the key drags on overall GDP growth at that time.

It appears that the relatively weak momentum has extended into the second quarter. In its latest monetary policy statement, for instance, Bank Indonesia suggested that, while Q2 GDP should be an improvement from Q1, it is likely to still be softer than expected. The fact that it sees Q2 growth at 4.9-5.0% yoy signals that, even if Q2 does offer higher growth rate compared to Q1, it is unlikely to be more than just second decimal point type of improvement and that growth may be unable still to break the 5% barrier.

The sense that economic growth remains 'stuck' has prompted the central bank to give it another push. Indeed, having cut its policy rate by three times successively in the first quarter of the year, BI has reached for easing again on June 17th, by slashing its policy rate by another 25bps. Its existing 12-month policy rate was cut from 6.75% to 6.50%, while the 7-day reverse repo rate – which is slated to be the new benchmark rate come August – was also trimmed from 5.50% to now 5.25%.

By re-engaging in monetary policy easing, the central bank is hoping to inject new fervour into the banking sector, in terms of passing on the lower rates and boosting credit growth more – and thus helping to juice up the economic growth more significantly. Tellingly, in the latest monetary policy statement, BI noted that "transmission via credit channel is not yet optimal."

Having picked up speed somewhat in the first quarter, there are some signs that credit growth momentum has weakened again. The latest April loans growth stood at 8.0% yoy, a dip compared to the 8.7% yoy the month before, for instance. The stubbornly slow credit disbursement proved too much for BI to stomach and re-energized the easing bias.

Our sense is that the central bank is not quite done yet with rate cuts, with at least one more rate cut for the year to bring the new benchmark rate of the 7-day reverse repo to 5.0%.

Timing will all depend on how the global factors play out once more. Our sense is that BI remains worried that the Fed may still hike rate in July. If that were to happen against a market that is not expecting it, then any resurgence in USD because of that would obviously make it rather tricky for Bank Indonesia to continue the course of easing. Hence, BI may wait until August when things look clearer to cut rate again.

In case it cannot enjoy the space to cut policy rate because of global factors, we believe that BI will nevertheless continue to signal an easing bias to further prod the banking sector in extending credit more. It has already talked about broadening today's loosening of macro-prudential measures to vehicle financing, for instance. There is also a potential slashing of reserve requirement ratio that it can utilize.

All in all, we see a central bank that is determined to play its part in giving the domestic economic momentum more push, enough for us to be confident in our fairly sanguine growth outlook for Indonesia. Moreover, with the long-deliberated Tax Amnesty Law now passed by the parliament, the potential flow of funds could help to push growth up to 5.2% into year-end.

The fact that BI feels that it has to act repeatedly in utilizing monetary policy to boost growth also betrays the fact that fiscal policy has limited space to do so.

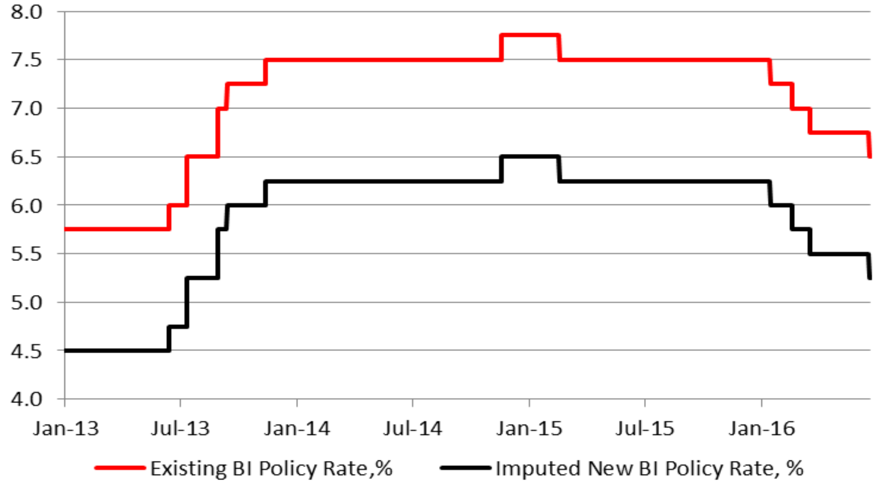
On that front, it pays to remember that Indonesia has a legal limit of 3% when it comes to how much fiscal deficit the government can run as a proportion of GDP. While even with an upward revision, the fiscal deficit this year should be around 2.5% of GDP, the sensitivity of deficit to low tax revenue intake would make the government cautious in terms of expenditure as well.

So far, the government is banking on the hope that the tax amnesty policy could bring in extra revenue that will be enough to cover any potential shortfall in tax intake. While figures vary, the government itself has talked about anticipating over IDR100tn worth of additional revenue from the policy.

The central bank's estimate is perhaps more realistic, seeing an additional tax revenue of IDR53.4tn and adding 0.3 percentage point to the GDP growth rate. The question of whether these estimates turned out to be close enough to reality would have to wait for the actual uptake of the amnesty measure that is something to look forward to in H2 this year.

GDP Growth

Policy Rate



Loans Growth

Source: Bloomberg, CEIC, OCBC

MACAU

The Worst May Be Over

Macau's GDP contracted for the seventh straight quarter in 1Q, falling by 13.3% yoy due to continuous decline in gaming revenue, slowdown in investment, as well as weak domestic and visitor consumption. Looking ahead, the expected sustained recovery in the gaming and tourism sector, will continue to support government expenditure and boost private expenditure.. All in all, this is likely to offset slackening domestic demand and subdued visitor expenditure. However, as it looks to us that the gaming business is unable to return to the past glory days, adding that tourists and local consumption may continue to take a hit, we revise our GDP forecast for 2016 down to around 2-3% from 5.0%.

Moving forward, eyes will be on whether the increase in overnight visitors is able to sustain and translate into growth of low-end gamblers, in turn underpinning a further pick-up in the gaming sector. Even with recovery in the tourism activities, weak tourist expenditure and sluggish local consumer sentiment are expected to further dampen the retail sector. Fortunately, the city's labour market is likely to remain strong thanks to the mismatch between huge demand from tourism-related businesses and the tight labour supply. Nevertheless, uncertainty over the economic transition may propel employers to slow wage growth, which will hurt domestic sentiment and add downward pressure to the housing market as well as the economic growth.

The gaming sector is getting over its worst time

Gross gaming revenue declined consecutively for two years, dropping 9.6% yoy in May to MOP18.39 billion. On a positive note, the stabilization of gaming revenue confirms that the gaming sector has bottomed out.

In the first quarter, gaming revenue declined at its slowest pace since 4Q 2014. Due to the relentless anti-corruption campaign of China, loss of high rollers prompted casino operators to shift their focus to the mass-market segment. VIP tables have been partially reconfigured to serve mass-market gamblers. As the string of hotel openings has bolstered a gradual recovery of the tourism sector, it supports the new business strategies of the casino operators. Consequently, the share of mass-market revenue rose to 40.8% in 1Q 2016, as compared to the average of 32.8% during 2012-2015.

Looking ahead, the gaming sector may be able to benefit further from more new hotel, casino and theme park openings in the next 1-2 years, which are expected to lure more overnight visitors and casual gamblers. However, while the worst is over for the gaming sector, the sector still suffers from government caps on gaming tables growth at 3% till 2023. Also, despite an expanding mass-market segment, the lower profitability of mass-market tables, as compared to that of VIP tables amid lower minimum betting amount, sees the gaming sector unable to return to the past glory days. As such, though we expect gross gaming revenue to decrease at a slower pace in 2016 from last year, it may still fall 4%-5%.

Increasing overnight visitors with tighter purse strings

The hotel industry sees prevailing room rate cuts as hotels are struggling to maintain their market shares after new hotel openings since last May. Increasingly favourable room rates lured more the overnight visitors from major sources (including Mainland China), which increased for the 9^{th} straight month (+5.6% yoy) in April. Due to the structural change of the inbound tourists, total visitor arrivals decreased marginally by 0.3% yoy over the first four months. Into 2H, upcoming data prints of visitor arrivals should be closely monitored to confirm whether Macau's appeal to a wider range of visitors is able to sustain, thereby bolstering the pick-up in tourism activities. Still, the overnight visitors should keep its growth pace, especially after a fresh wave of new hotel projects completed.

Despite signs of recovery in the tourism sector, visitor expenditure remained lacklustre. Specifically, due to a stronger MOP, global economic slowdown and China's anti-corruption campaign, per-capita spending of total visitors and Mainland tourists both shrank for the 7th straight quarter in 1Q, down respectively by 14% yoy and 18% yoy. Adding cautious local consumer sentiment, Macau's total value of retail sales dropped at a faster pace by 11.2% yoy in 1Q. The seven straight months of decline was attributed to slump in sales value of Watches, Clocks & Jewellery, Goods in Department Stores and Leather Goods, all of which accounted for 47% of total retail sales. Also, the prospects of slower wage growth may dent local consumer sentiment. Therefore, retail sales are expected to take a further hit and dampen labour demand in the sector.

Elsewhere, in spite of continuous solid gain in overnight visitors and hotel guests, hotel occupancy rate continued to drop albeit at a slower rate to 79% in April amid oversupply. Looking forward, as more new hotels are scheduled to be completed in the coming two years, the resulting increase in hotel rooms will cap the hotel occupancy rate at 80%.

Labour market to sustain its strength

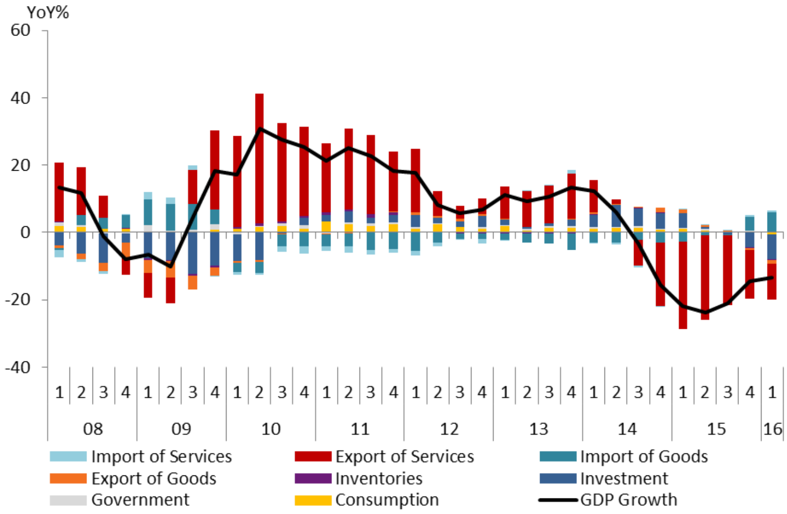
Unemployment rate held steady at 1.9% in April, reinforcing a stable labour market in Macau. As it gets clearer that the gaming sector has already bottomed out, the employment in this sector registered robust gains (+ 3.1% YTD). In contrast, despite the continuous growth in overnight visitors, employment in hotels, restaurants and similar activities were down 0.3% YTD. Additionally, delays in the completion of some hotel and casino projects have also resulted in layoffs (-6.7% YTD) in the construction sector. However, we still believe that after the completion of a fresh wave of new hotels and casinos in the coming 1-2 years, employment in the hotel, construction and gaming sectors will increase. Elsewhere, the outlook of the retail and wholesale sector's employment (-6.3% YTD) remains clouded by soft tourist spending and the resulting slump in retail sales. In conclusion, we expect that the jobless rate will remain stable below 2.0% this year.

Housing market is still searching for its bottom

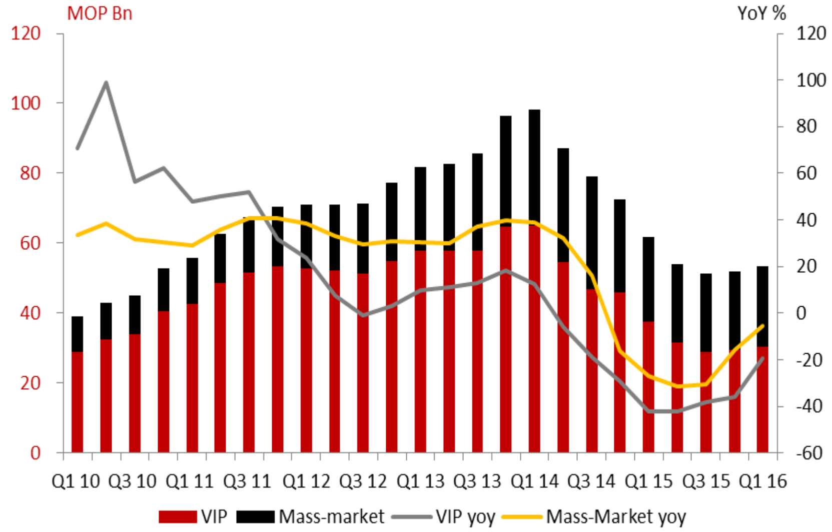
Recent signs of the gaming sector's bottoming out and rebound in tourism activities have underpinned housing market sentiment. Additionally, sellers' willingness to slash prices drove the average transaction price down by 34.6% in 1Q from the peak in 2Q 2014. Lower housing prices and low borrowing costs as a result have attracted some end-users of smaller units. As such, housing transaction volume sustained its rebound in 1Q despite slimmer demand for the high-end flats, up by 9.1% yoy to 1215 units. However, the increased transaction volume did not translate into higher demand for new residential mortgage loans (RML), which dropped in 7 out of the past 8 months and was down by 35% yoy in April. Fears of steep increase in borrowing cost amid Fed's tightening may be the main reason behind homebuyers' persistent cautiousness of mortgage loans.

Looking ahead, though increasing labour demand from new hotels and casinos will likely to attract more non-local residents to work in Macau, this group of labour tend to reside outside the city, providing little support to Macau's housing market. Slower wage growth is also expected to dent housing market demand. Coupled with increasing supply in coming 1-2 years, housing prices (-23.6% yoy to MOP 78,745/sq.m in April) are expected to drop 10% yoy by end of this year.

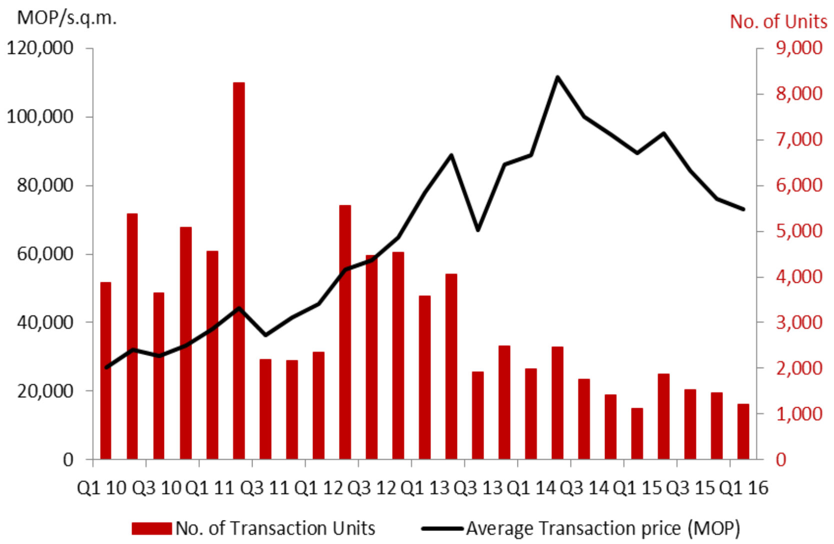
Impact of Gaming as Export of Services on Macau GDP



Macau Gaming Revenue



Macau Residential Property Market



Source: DSEC, DICJ

MALAYSIA

Hanging In There

The year did not start on that friendly a note for the Malaysian economy.

One of its largest trading partners, China, appeared to be struggling to keep its economy on an even keel. While that fear soon ebbed enough for some semblance of stability to return, it had nonetheless led to concerns about Malaysia's export prospects and its currency stability as well in the early months of the year.

Meanwhile, the price of oil appeared to be dropping precipitously, affecting market perception of the sustainability of Malaysia's current account surplus as well as its fiscal situation. All these occurred right when domestic political situation was also hardly conducive for sentiment, with 1MDB-related news flow dominating headlines.

Against such an inopportune backdrop, it is notable then that – despite all that – the Malaysian economy was still, effectively, hanging in there. For one, while Q1's GDP growth of 4.2% yoy was indeed the lowest print since mid-2009, it nevertheless was better than expected.

In other words, it could have been worse. What turned out to be saving grace was a number of factors. To begin with, as mentioned earlier, the fear about China's hard landing did subside by early March. No less importantly, a revision to 2016 budget that the government undertook in January began to make a more realistic assumption of oil price and prioritized spending enough to counter market concerns about the country's fiscal sustainability.

Still, as much as the economy has avoided the deepest pitfalls, it remains an unfortunate reality that the underlying growth momentum remains rather weak.

Looking into the details of the Q1 GDP data, for instance, the challenging nature of eking out growth amid a tough environment is most evident in the external sector. The exports component of GDP showed a 0.5% yoy contraction in Q1, for instance, compared to an already-challenged 0.6% growth in the previous quarter. Commodities slowdown continued to be deadweight to the economy, even as exports of manufactured goods tried to keep the whole thing above water. As a result, despite a fairly steady growth in imports, the net exports registered a 12.4% yoy slump that hurts the overall growth print.

Tellingly, the balance of payments data that was released today as well paints a similar story. Current account receipts for Q1 slumped to MYR5bn, compared to over 11bn the quarter before. As a proportion of GDP, this stood at a relatively thin surplus of 1.7%.

These are some sobering numbers to be sure, but it is important to note that there remain crucial pockets of resilience in the economy. In particular, private consumption continues to stage a robust recovery from last year's post-GST slump. In year-on-year terms, household consumption grew by 5.3% in Q1, at a healthy clip that is comparable to Q4's 4.9%. BNM highlighted support for this sector coming from continued wage and employment growth. At a time when external trade, especially on the commodities front, remains too much like fair-weather friends, the fact that domestic consumption has been a more dependable source of growth will not escape the attention of the central bank.

Hence, given the resilience of the private spending, it is not too surprising to see BNM remaining relatively sanguine about Malaysia's growth prospects. The new governor, Muhammad Ibrahim, for one was quoted as saying today that the economy remains on track to expand by 4.0-4.5% this year, something that we agree as we keep to our 4.4% forecast.

His words of confidence have been backed by action, as well, thus far. In what was his inaugural meeting as BNM's governor on May 19th, he led the MPC members in keeping the overnight policy rate unchanged at 3.25%.

Bank Negara's decision was anchored by a palpable conviction that – despite what casual observers might think given various headlines about the country – the underlying economic fundamentals remain strong. Hence, more than having to consider whether there is space to ease or not, the central bank appears to think that there is not much of a need to ease to begin with.

Tellingly, the wording in a portion of the latest monetary policy statement marks an important shift as well. In particular, we are referring to the segment regarding private consumption. Whereas "private consumption is expected to moderate" back on March 9th, "private consumption is expected to expand further" in today's statement. The fact that civil service pay is due to be increased soon is likely to be one of the factors BNM has in mind.

The conspicuous absence of alarm regarding growth prospects is also evident in how BNM describes the global outlook. Importantly, the central bank points out that the "Volatility in the international financial markets has receded and investor sentiments have improved," even if it adds that the calm is "susceptible to policy and market developments."

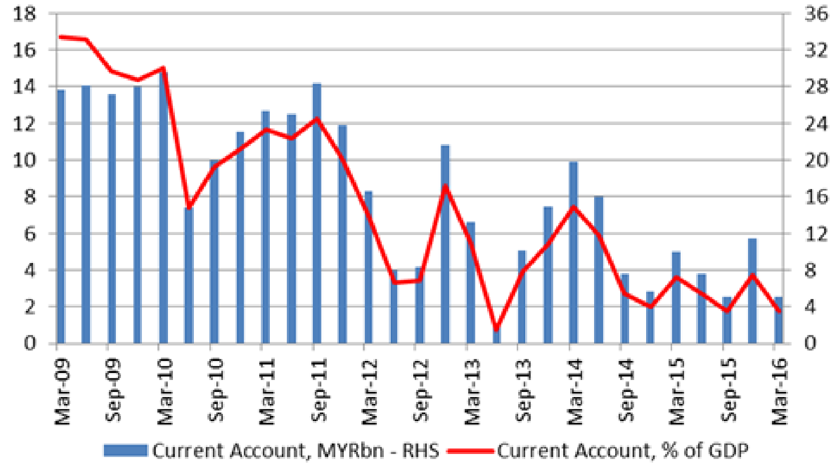
As we mentioned before, looking at how BNM looks at the world is important. Given its comfort about domestic growth drivers, the only way in which it would turn more cautious about growth outlook and thus become more dovish and inch towards rate cuts would be if its views of the global growth prospects darken considerably. We do not get the sense that is happening at all from the statement.

Hence, when it comes to Malaysia, any dovish expectation that some corners of the market are harbouring will face disappointment. Unless export numbers deteriorate massively, or the much-touted domestic consumption uptick gets derailed somehow, here is a central bank that will most likely hold at 3.25% for the rest of the year.

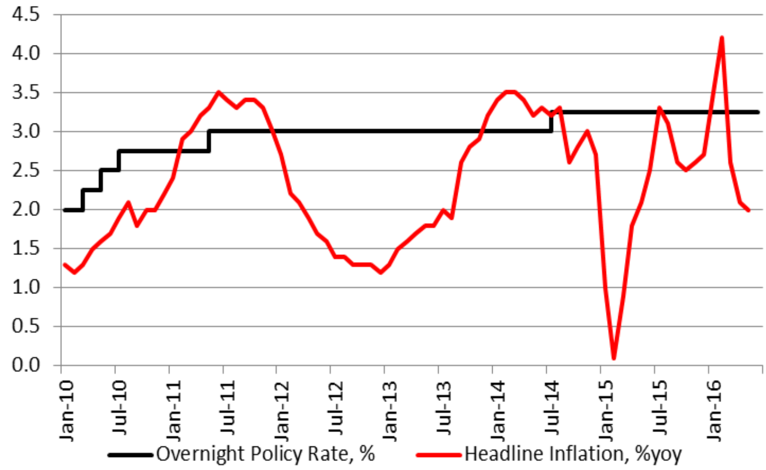
In short, as long as the economy is hanging in there, the policy rate will be, as well.

GDP Growth

Current Account



Overnight Policy Rate and Inflation



Source: Bloomberg, CEIC, OCBC

MYANMAR

Stabilization In Progress

Thus far, 2016 has been a year of rapid transition and change for Myanmar. Following the landslide election victory by the National League of Democracy (NLD) in November 2015, the new government has settled in well, and democratic transition in Myanmar has continued apace. With strong backing from the people, the NLD government is well positioned to deepen the much-needed reforms to bring progress to the country.

With great potential and the new government in place, we continue to be optimistic about the economic outlook of Myanmar. Annual GDP growth in 2015 came in at a relatively low 7% due to the floods in July 2015. However, we continue to expect Myanmar to grow at a rate of 8% to 8.5% in the medium term.

Stabilising political scene sets the stage for economic development
Htin Kyaw, a trusted aide of Aung San Suu Kyi, assumed office as the President of Myanmar in 1 April 2016, officially ushering in the new democratic government. Ms Suu Kyi remains central in charting Myanmar's course as its State Counsellor and Foreign Minister. Meanwhile, the Constitution retains the military's presence in the Myanmar's politics by guaranteeing it 25% of all parliamentary seats in the Union parliament and three ministerial positions in the Cabinet. This lingering influence of the military has been cited as cause of concern. However, it is worth noting that the military is not in the position to block any legislation that does not amount to a constitutional change. Indeed, it appears that the military's biggest scope of influence is through its participation in the parliamentary committees that advise on specific policy areas. Even so, they will have to convince other committee members, most of whom will invariably be democratically-elected parliamentarians. Thus, the NLD government has significant scope in passing the legislations supporting administrative and policy reforms, especially in areas relating to the business and economy of Myanmar.

Transport infrastructure and tourism: Two drivers of the services sector
Since Myanmar took the initial steps to open up its economy in 2011, the services sector has seen the most rapid growth. As a percentage of GDP, the services sector grew from 36.7% in 2011 to 40.7% in 2015 respectively. Moving forward, the transportation and tourism industries are expected to drive the services sector. However, the two industries will be in focus for very different reasons.

The call to focus more on the transportation industry is predicated on the currently poor state of transportation infrastructure, and the resultant tendency to cause bottlenecks that hamper the growth of other industries. The new NLD government recognizes the lack of transportation infrastructure, ranging from railways to ports, will hamper the prospects of Myanmar's economic growth. Moving forward, as the government invests more in its transport infrastructure, more opportunities should arise for corporates to be involved in this space.

In reality, great attention has already been placed on transportation infrastructure. In February 2016, a consortium consisting of JGC Corporation, Yongnam Holdings and Changi Airports International overcame another regulatory hurdle in its project to build the new Hanthawaddy International Airport when it formalized a framework agreement to with the Department of Civil Aviation (DCA).

When completed in 2022, the airport will be the main gateway for the Yangon metropolitan area. Meanwhile, plans to upgrade the existing Yangon International Airport and Mandalay International Airport are also in place. Once these developments are completed, the scope for supporting industries like aircraft maintenance, food catering and fueling services will be immense.

Another potential growth area is the maritime ports of Myanmar. The main Yangon port is essentially unchanged since colonial times, and will struggle to support the accelerating economic growth in Myanmar. The single terminal within the port is dated and prone to congestion. It took emergency measures, such as 24-hour port operation, to clear a backlog accumulated in May 2016. In addition, supporting infrastructure like storage and logistics are also inadequate. Moving forward, it is likely that there will be strong determination from the new government to bring meaningful improvement to this area.

On the other hand, tourism continues to be a bright spot. Tourist arrivals have skyrocketed in recent years. Since 2011, the number of tourist arrivals grew by 41.8% per annum to reach 4.68m visitors in 2015. The Ministry of Hotels and Tourism expects 6m visitors to arrive in 2016. This forecast is likely to be achieved given the post-election political stability. Moreover, a 30-day visa-free travel agreement between Singapore and Myanmar will take effect on December 2016. Following the agreement, Jetstar also announced that the frequency of flights to Yangon will be increased. These changes will further spur business and recreational travel between the two countries.

Tourists are also spending more in Myanmar. Growth in total expenditure by tourists outpaced arrival figures, growing 52.9% per annum since 2011. Tourist spending amounted to over US$2.1b in 2015, making up approximately 3.3% of Myanmar's GDP. With the current growth trends in tourist arrivals and per tourist expenditures, tourism is likely to contribute much more significantly to Myanmar's GDP. In the medium term, we expect tourism to contribute about 5-6% of GDP.

While significant in itself, the true value of tourism to the economy lies in its ability to generate positive externalities in the economy. With the growth of the tourism industry comes the development of supporting industries. A case in point is the construction industry. In recent years, the increase in the number of hotel rooms has not kept pace with tourist arrivals. Consequently, the relative shortage of hotel rooms has resulted in the development and construction of newer and larger hotels in Myanmar, especially in the Yangon metropolitan area. Apart from construction, industries like food and beverage, entertainment and hospitality may also enjoy the spillover effects of the increase in tourists.

Formidable challenges remain

In May 2016, the U.S. sanctions on Myanmar were renewed with changes that amounted to easing in some respects. It is now easier for U.S. nationals to conduct day-to-day business transactions, such as transportation of goods and banking through local banks. Six companies were also removed from the Specially Designated Nationals (SDN) List. U.S.-nationals are not permitted to have business dealings with persons or entities on the SDN List. While these are steps in the right direction, major impediments remain. The SDN list runs more than 900 pages long, covering the majority of Myanmar's largest businesses.

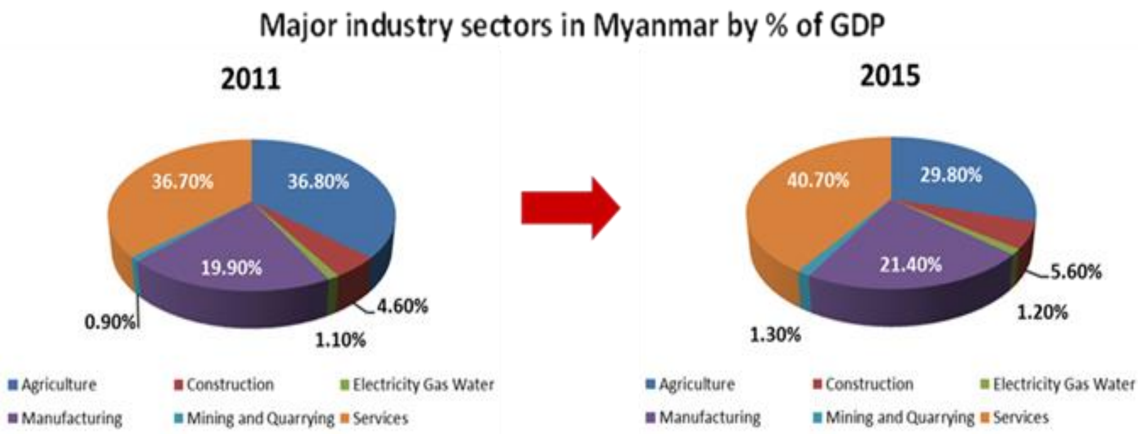
The argument that Myanmar will still progress well in spite of the sanctions is not without justification. Nevertheless, having the potential of deeper U.S.-Myanmar business ties hampered by the sanctions is a wasted opportunity. Although major U.S. companies, such as General Motors and Coca-Cola have pledged to establish operations in Myanmar, the overall presence of U.S. companies in the Myanmar's economy is still limited. Bilateral trade between the Myanmar and the U.S. is also insignificant. From a commercial perspective, Myanmar should benefit from a greater U.S. involvement in its quest to jumpstart the economy and reintegrate into the global business environment.

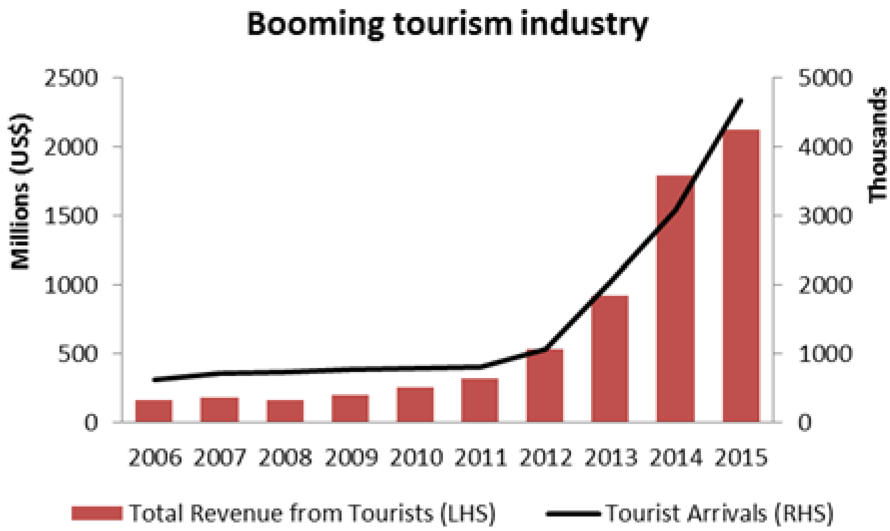
In addition, the sheer scale of the task facing the NLD government should also not be underestimated. Frictions in the transition process remain to be surfaced and be addressed, especially in the different administrative arms and agencies of government. These will take time to be surfaced and addressed. A case in point is the Myanmar Investment Commission (MIC), the agency that grants approvals for foreign investment into Myanmar. The previous commission, consisting of members appointed by the ex-President Thein Sein, saw their tenure expire in March following the inauguration of the new government. However, the new commission was only appointed in early June. In the meantime, potential investments totaling US$2.3 billion were delayed. Moreover, approvals granted by the previous MIC to a hospital project and a port extension were reversed. These frictions will undoubtedly create some anxiety among the business community. However, we expect that these issues will be alleviated over time as the new government settles into its role.

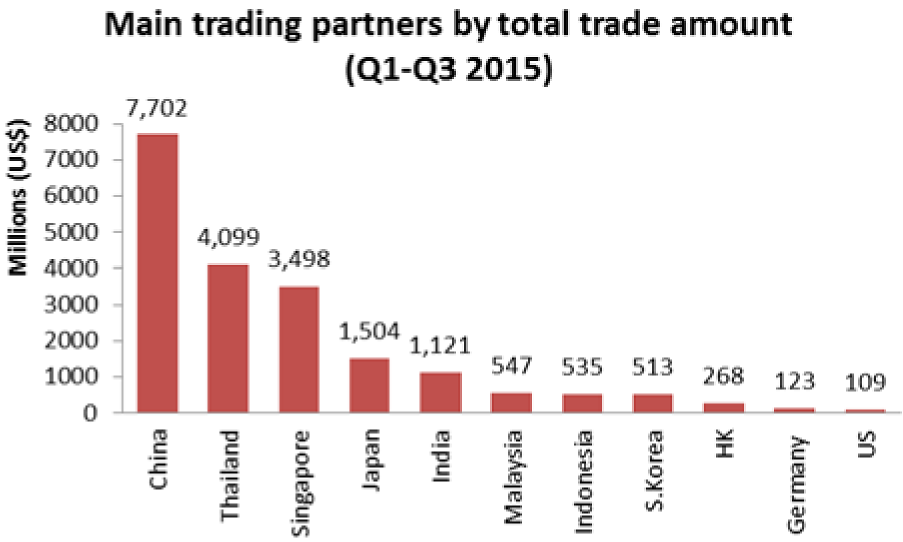
Cautious optimism on the continued progress of Myanmar

Expecting an overnight improvement in Myanmar's business and economic outlook would be unrealistic. As the euphoria of the election victory subsides, the new NLD government settles into the daily grind of governance. Inevitably, challenges will continue to arise in the transition process. However, with the strong mandate that the new NLD government possesses, it will be afforded the time to address them in due course.

We urge patience when it comes to Myanmar. Undoubtedly, Myanmar has the building blocks of a thriving economy. However, formidable challenges remain in the short term. We continue to be cautiously optimistic over Myanmar, expecting it to achieve growth rates of 8% to 8.5% per annum in the medium term.







Source: Bloomberg, CEIC, OCBC

SINGAPORE

Staying The Course In 2H16

Another challenging first half for the economy
Given the global growth headwinds, Singapore's first quarter GDP growth turned out to be a lackluster +0.2% qoq saar (+1.8% yoy), but just avoided an on-quarter contraction. As a testament to the deflationary forces prevailing globally, the MAS also adopted at its April 2016 monetary policy review a neutral slope for the SGD NEER, which was last seen during the post-GFC, citing that inflation had been generally undershooting expectations and core inflation is likely to average slightly below 2% due to an extended period of globally low inflation. Manufacturing and export growth remained in the doldrums, partly due to disparate trends of China's insourcing of intermediate goods and services and US' re-shoring trends, in addition to sluggish global demand.

Downside risks to the 2016 GDP growth forecast persist
The official 2016 growth forecast remains at 1-3%, but downside risks prevail and suggest that a 1-2% range is more plausible. As such, we expect the official growth forecast to be narrowed to 1-2% yoy at a later stage. Note that external demand remains very weak, notwithstanding the recent May NODX blip (+11.6% yoy). After a very weak NODX performance (-9.0% yoy) in 1Q16, IE Singapore had also pared its full-year NODX growth forecast from 0-2% to -5% to -3%, as total trade forecast is anticipated to contract -8% to -6% this year. Given the ongoing China slowdown story and a potentially acrimonious US presidential elections coming up in November this year, the various trade initiatives like the Trans-Pacific Partnership may not gain much traction in the interim. Our NODX growth forecast remains at -4.4% yoy, which would mark a 4th year of contraction and further deterioration from 2015's 0.1% decline.

But barring downside risks, growth expectations may be bottoming
Latest MAS Professional Forecasters Survey shows a slight downgrade in 2016 growth forecast from 1.9% three months ago to 1.8%, the NODX forecast to -2.1%, and CPI to -0.4%. Our growth forecast remains at 1.8%. The silver linings are the public infrastructure spending which is holding up the public construction activity pipeline, coupled with the recovery in visitor arrivals and sustained growth in financial and business services in the interim. That said, 2Q16 GDP growth could still shrink quarter-on-quarter, and the possibility of a technical recession materializing by 3Q16 remains.

Headline inflation continued to stay in negative territory in 2016
Headline CPI prints, which have already marked the longest slump on record, are expected to stay negative throughout 2016, but MAS core inflation remains solidly in positive territory for now despite reduced tightness in the labour market. Global crude oil prices have crept higher over 1H16 but the US$50 handle remains a key resistance. Given that crude oil prices averaged around US$45 in 2H15, oil-related prices could start seeing a positive contribution to headline inflation if current levels are sustained. The latest MAS Professional Forecasters Survey saw the street downgrade the headline inflation forecasts for 2016 to -0.4% (previously -0.2% three months ago) but kept the MAS core inflation forecast unchanged at +0.8%. Our house forecast for both headline and MAS core inflation remains at -0.4% and +1.0% yoy respectively.

Business sentiments remain cautious heading into 2H16

The latest business surveys suggest slightly less bearish sentiments across manufacturers and services firms for the second half of the year, but few domestic catalysts rise to the top of the mind in the near-term. Even MAS warned in the Macroeconomic Review that corporate margins could come under further strain in the near term amid the weak external demand conditions and sluggish domestic growth environment. Note total bank loans had already fallen for 7 consecutive months in April, overtaking the Nov1999-Apr2000 period as the longest duration whereby loans growth fell year-on-year. Notably, business loans could continue to decline due to the drag from general commerce and the marine & offshore industry. This suggested that private sector business sentiments remain very cautious at this juncture. Consumer bank loans, however, continued to expand year-to-date, supported by housing/bridging loans. The recent easing of auto loan measures may also mean more support for consumer loans, albeit it remains a small segment (just 3%) of the consumer loan market. Our forecast is for bank loans growth to shrink 0.2% yoy for 2016.

Policy settings to remain accommodative with the challenging external economic environment

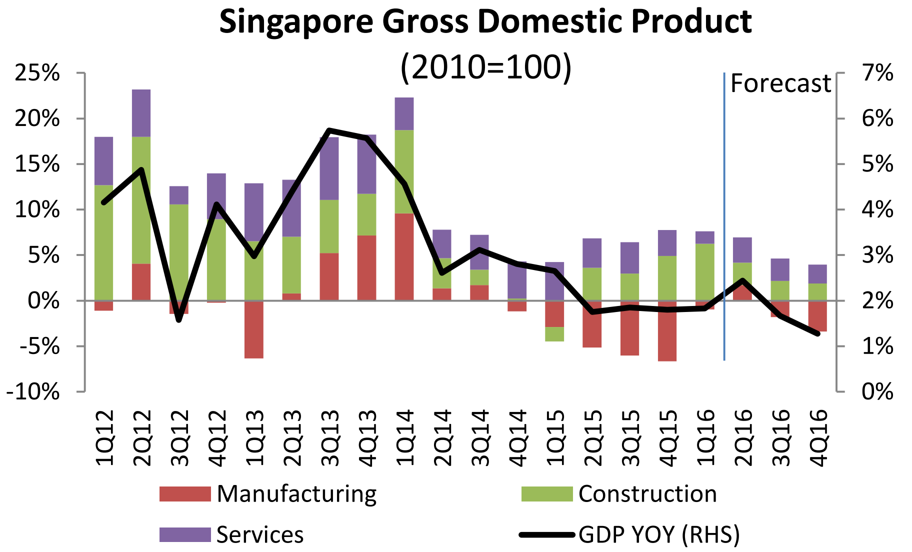
The 3-month SIBOR has been very stable since April around the 1% handle, while the 3-month SOR has also treaded lower and is nearing its year-to-date low of 0.81% as a more dovish FOMC weighed on the broad USD sentiment. The key question is if we will see a replay of the 2015 pattern where 2H saw greater interest rate volatility. The majority of FOMC members are still pencilling in one to two rate hikes this year, albeit market pricing is currently discounting even that probability. Our year-end forecasts for the 3-month SIBOR and SOR have been updated to 1.05% and 0.9% respectively. SGS bonds should remain supported in a relatively stable interest rate environment. In terms of longer-dated SGS bond issuance, there is only a new 20-year SGS bond for auction on 1 August.

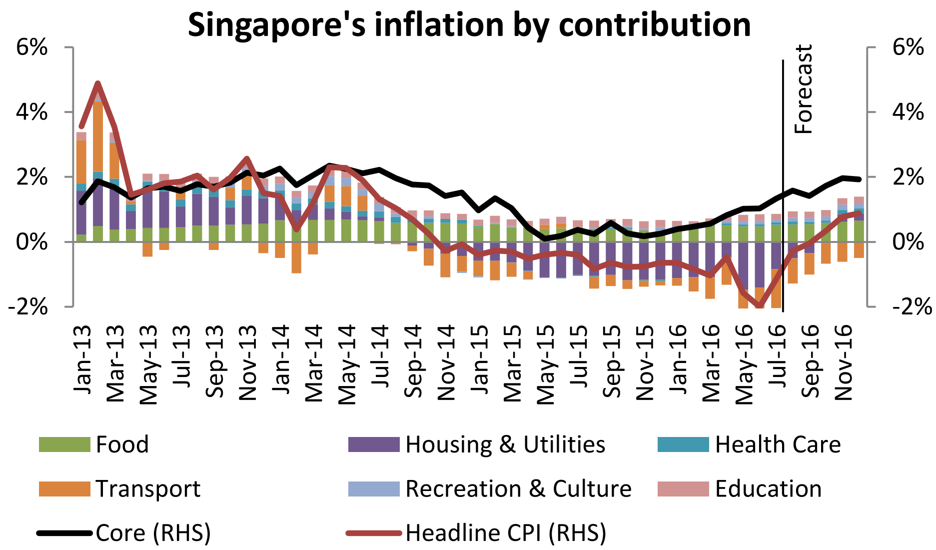
Labour market conditions should continue to soften, but the unemployment rate will remain low

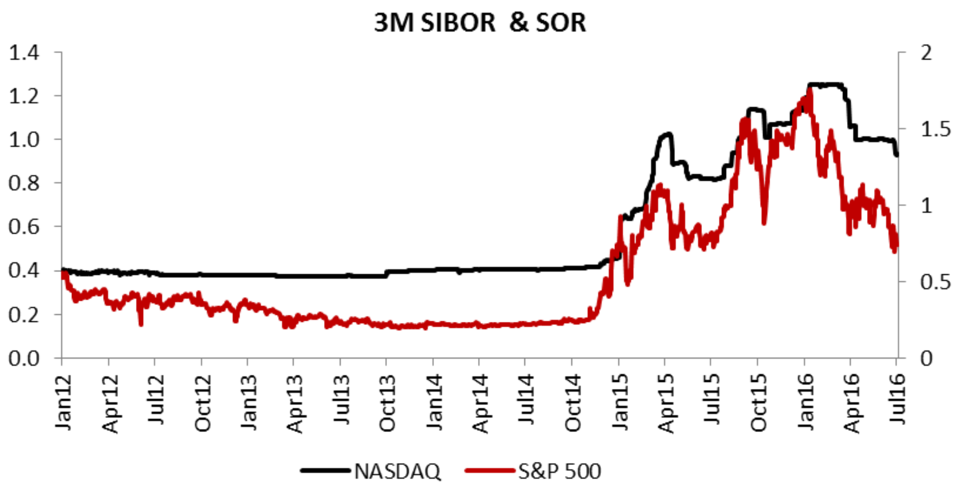
The overall unemployment rate was unchanged at 1.9% in 1Q15. However, the decline in resident and citizen unemployment rate was largely attributable to a lower labour force participation rate among youths aged 15-24. Redundancies, which stood at 4,600 in 1Q16, is lower than the 5,370 registered in 4Q15, but is nevertheless still the highest since at least 1Q12. Going forward, we expect that layoffs may potentially pick up amid a more cautious business outlook and ongoing economic-cum-business restructuring, particularly given the business consolidation in some sectors like manufacturing and retail trade. The unemployment rate may average around 2.1% for the full year of 2016. Wage growth, on the other hand, should moderate from 2015 but remained positive due to the negative headline inflation print. Resident wage growth is tipped to be 2.5-3% this year versus 3.5% in 2015.

Fiscal policy still has room to step up, but may be more a 2017 story

The Committee for Future Economy (CFE), which is supposed to prepare for longer-term challenges and structural changes in the Singapore economy, is due to release its recommendations at the year-end. This follows the earlier Economic Review Committee in 2001 and the Economic Strategies Committee in 2009. The adoption and implementation of the CFE recommendations are likely to materialize only in 2017, possibly accentuated by the FY17 Budget announcement in early 2017. The FY16 Budget had projected an overall surplus of $3.4 billion (equivalent to 0.8% of GDP), compared to a $4.9 billion (1.2% of GDP) in FY2015, but was estimated to mildly expansionary. The FY17 Budget would mark the second year of the new government and has scope to be more supportive of the Singapore economy should growth and inflation conditions deteriorate further from here and a further boost to the restructuring efforts are required.







Source: Bloomberg, CEIC, OCBC

TAIWAN

Muddling Through Global Uncertainty

Taiwan's economic growth contracted by 0.68% yoy in the first quarter of 2016, down for three consecutive quarters. The contraction was mainly attributable to two factors including weaker than expected external demand as well as sluggish investment.

External shock

Among the entire GDP component, external demand has been the main drag for the past few quarters. Net export fell by 29.19% yoy in 1Q, dragging down growth by 2.29% in 1Q and overshadowing 1.59% contribution from domestic demand. The external shock to Taiwan's GDP was mainly the result of uncertain global situation as well as the slowdown in China's growth. Taiwan's export growth fell by 10.5% yoy in the first five months, but in line with the decline trend in the region due to sluggish global recovery. In addition, the slowdown in Chinese economic growth as well as China's economic restructuring also weighed down Taiwan's export prospect. The historical data shows that Taiwan's export growth has been positively correlated with China's import growth. The further decline of China's import hurt by excessive capacity also negatively impact Taiwan's export growth.

Limited fiscal room for counter cyclical stimulus

In addition to the decline in net export growth, capital formation also fell by 0.5% in 1Q 2016 due to budget constraints after expanding by three straight quarters. Taiwan has been running a fiscal deficit for many years. Compared with its neighbouring competitor South Korea, there is limited room for Taiwan to roll out a big stimulus to boost public investment to counter cyclical slowdown. South Korea plans to announce a 20 trillion won stimulus package to support growth following the unexpected Brexit results while the room for Taiwan seems to be limited given the fiscal constraint.

Consumption remains steady

Private consumption remains steady, growing by 2.19% despite weaker job market. However, looking ahead, the outlook of private consumption remains murky due to the both cyclical slowdown and structural shock. Cyclically, Taiwan's job market deteriorated further due to uncertain external environment. Unemployment rate rose to 3.87% while nominal wages posted negative growth. Structurally, the aging problem is expected to kick in. According to the latest estimation, Taiwan's working population peaked in 2015 and is expected to shrink by an average of 180K every year from 2016. This may structurally impact Taiwan's consumption behaviour.

Muted inflationary pressure

Taiwan's CPI re-accelerated in the first quarter from the contraction of 0.3% in 2015 on the back of a recovery of oil prices and higher food prices due to extreme weather. CPI grew 1.7% on average in 1Q but slowed to an average of 1.3% in 2Q. However, the negative output gap continued to suppress the inflationary pressure. Given that the upside risk for oil price in the second half is likely to be capped, Taiwan's CPI is expected to hover around 1% assuming no shock to food prices.

More easing still possible

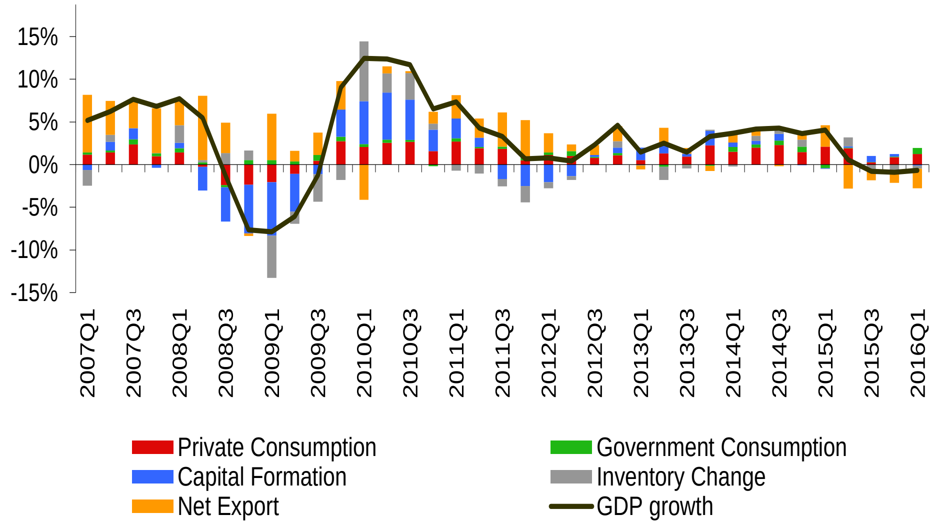
Taiwan's central bank has entered the easing cycle since September 2015 to support growth. Benchmark interest rate has been cut by four times from 1.75% to 1.375% due to sluggish economic outlook and modest inflationary pressure. CBC became the first central bank in the region to cut interest rate following the unexpected result of Brexit as pre-emptive measures to stabilize the market sentiment. However, as mentioned by CBC Governor Peng that monetary policy is very loose now and cannot be overly used.

Despite year-on-year contraction, Taiwan's economy may have found the bottom in 3Q 2015. The economy expanded by annualized 3.14% quarter-on-quarter seasonally adjusted in 1Q 2016. Given the favourable base effect, we expect the yoy economic growth to go back to positive territory in the second half of the year. As such, the need for additional monetary easing may start to taper. The future policy path may be data dependant. We expect one more interest rate cut in September before CBC ends its the current easing cycle.

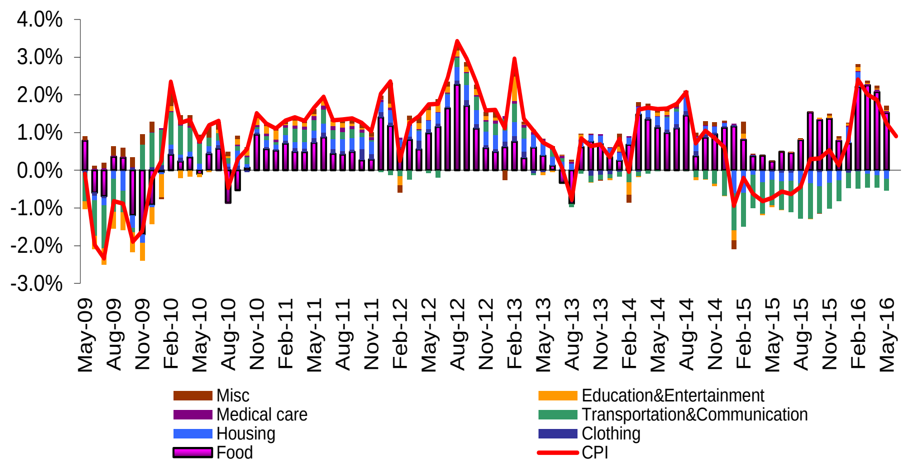
On the currency front, Taiwan dollar has surprisingly held up well in the first half of the year in the form of both spot and effective exchange rate, unaffected by monetary easing and RMB weakness thanks to tight management by the central bank. Taiwan dollar has appreciated against RMB by more than 4.5% year to date. The delay of Fed tightening may lend some supports to Taiwan dollar. However, we doubt the current strength will last in the second half. We think the recent rate cut may eventually press the currency downward and the USDTWD is expected to test 32.50 again.

To conclude, although Taiwan's economy is projected to return to positive in the second half, the economy is likely to underperform as a result of uncertain external environment following the Brexit shock as well as the drag by the slowdown in China. We downgrade our GDP forecast for 2016 to 0.9%.

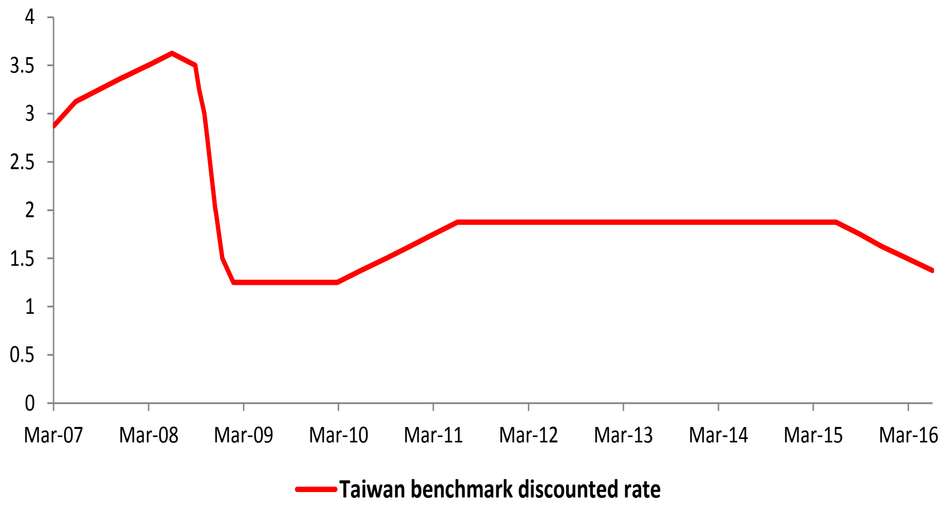
Taiwan GDP Growth



Taiwan CPI



Taiwan Benchmark rate



Source: Bloomberg, CEIC, OCBC

THAILAND

Why Is The Land Of Smiles Frowning?

Choose Thailand as a holiday destination, and you will not be disappointed. This Asian country is home to an extremely vibrant history and gorgeous landscapes, endless opportunities for bargain shopping in the famous Chatuchak Weekend Market, and most importantly, a deeply religious culture that is entirely unique to this nation. Aptly coined as being the Land of Smiles, for one holiday trip that offers so much, any tourist would be beaming from cheek to cheek.

Arguably, the same may well be said for a Thai citizen on the streets. According to Bloomberg Misery Index in 2015 and 2016, Thailand has retained its bottom place (meaning being the happiest economy) given low unemployment and inflation levels. In addition, the peace that ensued after the military takeover has also likely lifted both consumer and business confidence, seen from the uptick in both indices in 2015. Afterall, the Thai people would pride themselves as being part of a Teflon economy, where economic growth at this stage is expected to accelerate further from 2015's levels even in the face of a lackluster external environment.

Smile turning to a frown

Moving into the second quarter of 2016, this said smile is slowly turning into a frown. Much has changed since the start of this year; Thailand's consumer confidence has fallen to its 8-month low in May, a tell-tale sign that economic challenges are gradually crippling sentiments. Although unemployment levels remains at a coveted 1.0% as of April 2016, the labor participation rate suggests an entirely different tale. Empirically, the participation rate has fallen to its record low to 68.5%, suggesting that a significant part of its population that are supposed to be economically active (typically refers to ages 16 to 64), plays no part in contributing labor and growth to the economy.

In addition, further investigations show that the agriculture sector, still accounting for about 40% of total labor force, has seen a sizable fall in employment levels, suggesting that the recent drought and consequential poor harvests have left farmers idle. Thailand has long served as one of the world's key producers of rice, and the water shortages seen since last year have hit nearly a third of Thailand, particularly in the rice-producing provinces. This had left farmers no choice but to plant only one rice crop in the year, versus the norm of three rice crops during water-abundant periods. Translating this into economic prints, the growth in the agricultural sector saw a 1.5% contraction in 1Q16, while farmers' income reportedly fell by 7%. Moreover, the sudden realization of unemployment amid the need to tide through the dry season had probably contributed to higher household debt levels as well.

More stark however is the sustained deterioration of Thailand's economic fundamentals, led by the still lackluster external environment. Empirically, exports in dollar terms had contracted for 13 straight months till January this year, before resuming its decline again (-8.0% yoy) in April. Elsewhere, imports as a signal of falling oil prices and tapering consumer demand also resulted in its 10^{th} straight month of contraction. Should we observe the industry sentiment prints across Thailand's key sectors, we can see that confidence levels in machinery, electronics, petroleum and automobile have remained in the doldrums since the start of year (as well when compared on the year-on-year basis). To exemplify matters, these industries make up Thailand's key export sectors, with chemical & petroleum constituting 11% of total exports (down from 14% back in 2013), electronics, machinery & equipment at 24%, while automobile stands at a strong 14%.

Further economic uncertainty may also be seen from the current post-Brexit environment. Noting that Thailand's key economic drag has stemmed from the deterioration of trade numbers, the lack of policy direction by the European officials after 23rd June's awkward divorce would certainly bring about undesirable risk-off ripples into Asia, including Thailand. Just focusing on the trade numbers, it may be seen as a cup half-full, given that Thailand's percentage of total trade with the EU has fallen from almost 20% back in 1991 to a current 8.9% in May 2016. Still, EU is Thailand's 4th largest trade partner, after China, Japan and the US, suggesting the first direct impact to Thailand from the Brexit fallout may come from worsening trade numbers.

Last but not least, as we approach the upcoming August referendum, much concerns surrounding this issue has naturally surfaced. According to a poll made by Suan Dusit Poll, the top concerns surrounding the political issues includes the fear of political division (84.7%), its detrimental effects to economic growth (81.5%) and presence of corruption within the political arena (76.2%). Their concerns are not without grounds given the many years of political divide amid past violence seen as a result. Elsewhere, political arrests made ever since the junta took over had picked up over the last year, especially as open criticisms over the upcoming referendum is deemed illegal. To exacerbate matters, even the sale of "Vote No" t-shirts, deem as propaganda against the vote for the referendum this August, constitutes a 10-year prison sentence.

A sturdy ship in rough waters

At the very least, much of the policy in place is aiding economic growth. The government's aim to pursue large-scale infrastructure projects investment, namely the ambitious earmark of THB1.6 - THB1.9 trillion worth of transportation projects is a strong driver to cushion the lackluster external environment. Elsewhere on the monetary policy front, Thailand's benchmark interest rate at 1.50% remains highly accommodative, while the central bank's reluctance to cut interest rates further signals its priority to keep imbalances in check. Moreover, the peace that ensued with the junta government in place has aided international confidence and encouraged tourist arrivals which contributed a healthy THB708bn (+17.3%yoy) of tourism revenue in the first five months of 2016.

Moreover, Thailand's economic make-up remains favorable to overall growth, a key reason as to why growth is able to accelerate into 2017 despite the various political and economic challenges. Encouragingly, its huge domestic consumer base private consumption still accounts for over 50% of gross domestic product, thus enabling consumer demand to provide an effective cushion against the dull external environment. In addition, the Land of Smiles should remain an attractive avenue for foreign investment, with Gross Fixed Capital Formation accounting for a quarter of GDP, especially with the cabinet's approval to double tax breaks for private investors.

Still, while much has been done to spur growth, one key exogenous factor faced by the policy makers has little mitigating solutions: weak export growth seen since 2015 have dragged the already stagnant manufacturing sector. Empirically, Thailand's manufacturing sector is a significant component of growth and contributes close to 30% of overall GDP. This same sector however, was the worst performing non-agriculture sector, printing a worrying 0.33% contraction in 1Q16. Still, do note that a lackluster manufacturing sector is not isolated to Thailand itself; the weak oil prices amid sustained slowdown in Chinese import demand (contracted for 19 consecutive months now) have led overall lower trade value.

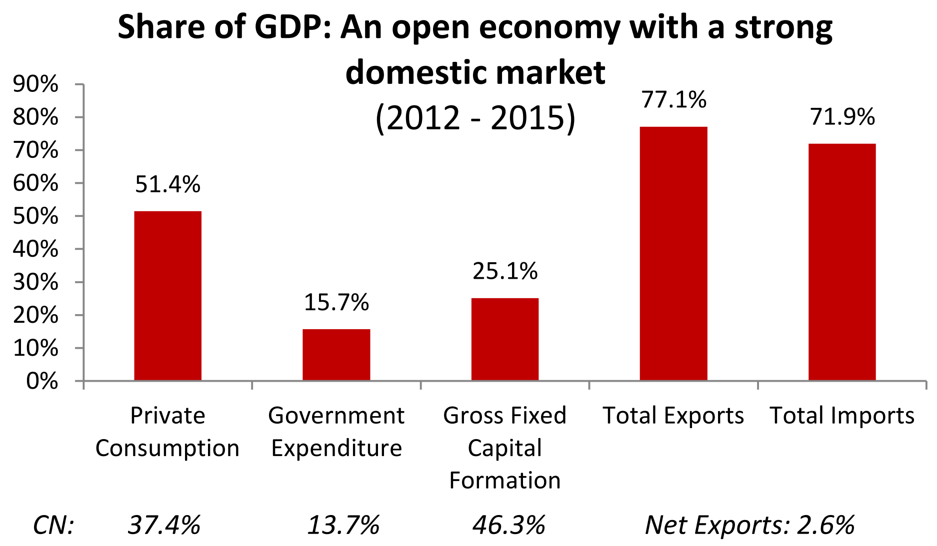
Time will tell…

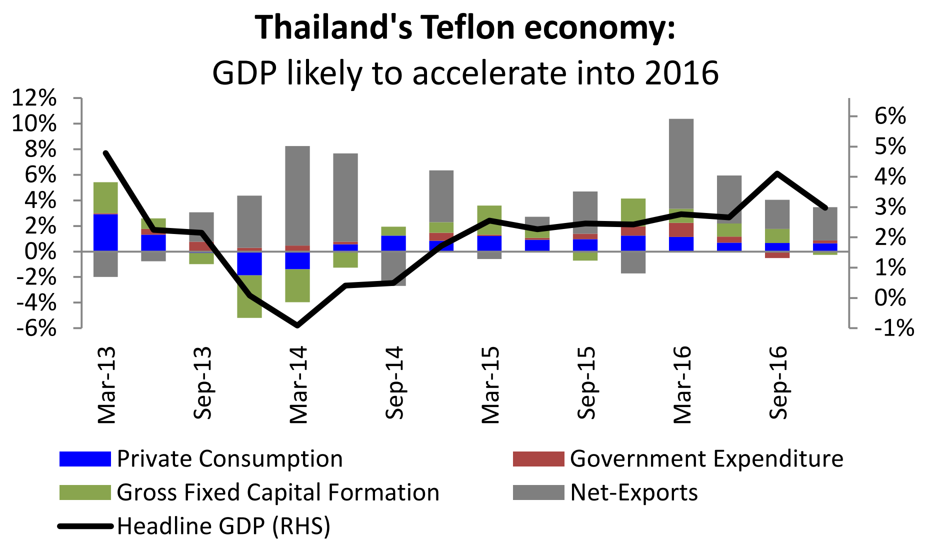
It is the mix of appropriate monetary governance, societal peace and more importantly, the ambitious disbursement of public expenditure that would give economic growth the much needed support. At least on paper, Thailand's ability to print above 3.0% growth this year (vs 2.8% in 2015) with the help of state spending and growing tourism revenue would bolster both domestic and international confidence.

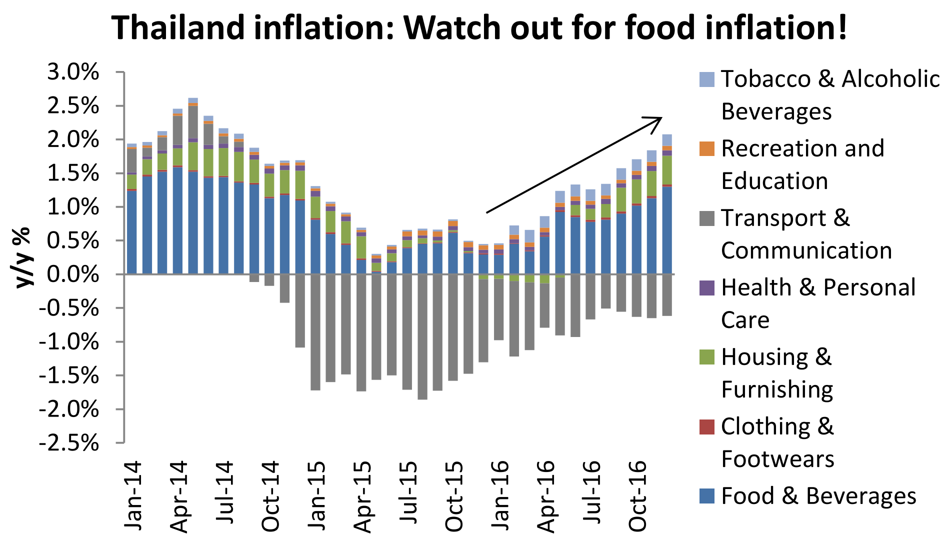
Still, the Thai people may likely see little glee in the prints, given the ballooning indebtedness seen since 2013 with the rollout of the car buying scheme, exacerbated by the falling income in both the manufacturing and agricultural sectors. Elsewhere, pockets of unhappiness may also surface as we near the August referendum, especially with the curb on open debate and criticism over the referendum outcome itself. The risk of political uncertainty and prolonged military rule may be possible Post-August as well, as Prime Minister Prayuth Chan-ocha is expected to order another constitution draft to be drafted by the Constitution Drafting Committee (CDC) should the upcoming referendum be voted down.

So far our discussion has focused largely on the nation's economic prospect and societal happiness. Beyond that, while we worry over the Brexit's influence on Thailand's economic growth, we are comforted by Thailand's strong growth fundamentals and its falling reliance on EU trade. Barring an extreme risk-off scenario from the Brexit fallout, we keep our growth forecast for 2016 at 3.2%, while inflation to turn positive to average 0.4% this year. With this growth potential, we expect the Bank of Thailand to prefer to keep economic imbalances in check by adhering to its 1.50% interest rate handle for the entire year.

At the very least, PM Prayuth's "Return Happiness" campaign back in 2015 has worked wonders. Given the choice of political instability and bloodshed versus the pick-up in both domestic and international confidence, it is no wonder that Prayuth's "Return Happiness" song topped the Thai radio chart briefly in 2015. Still, the challenge is to keep the happiness of the people on the table, a reality that is appearing increasingly arduous as we approach the August referendum.







Source: Bloomberg, CEIC, OCBC

VIETNAM

Paving The Way For A Brighter Future

The first half of the year came as a shock to Vietnam with its cumulative GDP growth as of 1Q 2015 slowing to 5.46%, marking the first slowdown in economic growth since 2014. However, even with the slowdown, the up-and-coming South East Asian nation continues to show strength and resilience, with its industrial/construction sector continuing to grow at 6.72% year-on-year, while service sector growth headlined at 6.13% for the same period. Deeper analysis of the underlying data also indicates that the dip in economic growth was mainly a result of disappointing agricultural output that was severally hit by unfavourable weather conditions. Rice production derived from the Mekong Delta, reportedly dropped by 6.2%, pulling overall agricultural production down by 2.69% year-on-year, a surprise for a sector that averaged a consistent 2% growth ever since 2014. Elsewhere, inflation picked up from last year's lows as concerns over the oil glut subsided with crude prices steadily climbing back up to US$50per barrel. Given that 2016's official inflation target still remains set at 5%, it remains to be seen if rising healthcare and education prices will bring back fears of an overheating economy or allow the economy to settle below its target. On the whole, we continue to expect Vietnam's growth to remain strong in the second half of 2016 on the back of greater foreign investments, particularly from its greater economic partnerships from its trading partners.

More good things to come

In tandem with its notable economic growth, 1H 2016 has seen manufacturing and industrial production heading towards new highs as foreign investments continue to drive economic development despite a volatile global environment. A breakdown of Vietnam's industrial production by the country's general statistics office found that the country averaged a 6.67% year-on-year growth in 1Q 2016, beating other regional developed economies such as Singapore and South Korea that posted an average of 2.63% and -0.17% respectively for the same periods.

For the second half of 2016, we continue to expect the trend of accelerating FDI to support manufacturing especially given the nation's proactive stance to greater economic integration. Vietnam's leap into the global economic landscape has also garnered World Bank support which had recently extended US$150 million worth of loans to (1) maintain economic stability through strengthening financial sector governance and fiscal management, (2) create a more transparent, efficient and accountable public sector, and (3) improve business environment. The World Bank also believes that Vietnam has the potential for greater growth and prosperity. Hence, as Vietnam continues its process of socio-economic reforms, the foundation for sustainable growth is expected to strengthen exponentially.

Furthermore, let's not forget the many Free Trade Agreements (FTA) that Vietnam had established in the recent 5-years, the biggest being the Trans-Pacific Partnership (TPP). Leveraging on these FTAs, the potential for Vietnam's manufacturing growth extends itself both in the medium and long term, ensuring sustainable levels of growth as more inflows from partner countries look towards ASEAN to facilitate their operations. Coupled with its low cost of labour and production, the contention for Vietnam to be an alternative to China as the next "factory of Asia" is certainly supported. Against the backdrop of the Chinese economic slowdown and its shift towards a more service-oriented economy, Vietnam is positioned to "pick up the slack" in manufacturing within the global economy. With May's Purchasing Managers Index (PMI) climbing further to 52.7, the highest in a year, business conditions in 2016 have clearly shown signs of improvement, signalling an expansionary manufacturing sector.

In addition, as reported by the Japanese Ministry of Economy, Trade and Industry, 1,500 Japanese businesses have already been reported to be operating in the Vietnam as of May 2016, while a total of 3,000 projects with a total registered capital of over US$39 billion being invested in the economy. With Japan being the country's largest official development assistance (ODA) provider, this number is expected to skyrocket as the two nations continue to enhance collaboration through infrastructure development, education and training. Moreover, during the recent 25th World Economic Forum on ASEAN, Vietnam's efforts for economic integration were also recognized, with Malaysia pledging to boost trade and investment through the Vietnam – Malaysia action programme. As such, with Vietnam's industrial production continuing to be in the limelight of global growth, we also expect manufacturing to not only improve but to accelerate in the medium term.

A trade deficit: but not to worry

Meanwhile, Vietnam's trade balance continues to register a surplus, coming in at US$1.36 billion year-to-date as total exports (US$67.7 billion) overtook imports (US$66.3 billion). The surplus came on the back of accelerating export growth, as exports deriving from the domestic sector reached a high of +6.8% year-on-year in May itself. Among its trading partners, export growth to China rose by 16.5% year-on-year, while exports to the United States saw an uptick of 14.9% for the same period as well. However, despite improving export prints, Vietnam's Ministry of Industry and Trade (MoIT) continues to anticipate an overall trade deficit at the end of 2016.

In line with MoIT's forecast, we also expect Vietnam's trade balance to snap into a deficit at the end of 2016 due to the loss in export competitiveness. Despite having close trading ties with China, the Middle Kingdom still remains one of Vietnam's close competitors when it comes to the global export space. Within the first five months of 2016, the Chinese Yuan has already depreciated by 5% on a nominal effective exchange rate basis (OCBC calculations) and is expected to fall further as China continues to move its exchange rate towards a market-driven system. Moreover, with the expectation that the dollar is expected to climb at the end of the year due to the Fed's lift off, pressures amount for the Yuan to depreciate further into 2H 2016. With the risk of a weakening Yuan, Vietnamese firms face greater pressures to remain competitive.

On the other hand, total imports are expected to increase both in the near and medium term as Vietnam continues to forge closer ties with its trading and investment partners. Specifically, with the active expansion and development of Vietnam's manufacturing sector, demand for imported machinery and materials for infrastructure development would certainly be expected to climb in tandem. Furthermore, healthier domestic consumption also provides another reason for imports to rise. As reported by the General Statistics Office of Vietnam, retail sales in May grew by 9.1% on the back of greater trade and service growth.

Nonetheless, a trade deficit does not necessary spell doom and gloom for Vietnam. On the contrary, as imports are focused on materials used for future development, import growth would likely moderate once Vietnam establishes its position as a global manufacturer. Meanwhile, export competitiveness should also improve as MoIT continues to devise measures for tackling business obstacles and improving production capacity.

Inflation: On its way back up

Elsewhere, headline inflation printed an average of 1.6% in the first half of 2016, picking itself up from 2015's lows. Notably, since November 2015's CPI print of 0.34%, domestic prices have been steadily increasing, reaching 2.28% in May. The rise in CPI was brought about mainly due to sharp spikes in medical and healthcare prices, which surged from 1.73% in February to 26.8% year-on-year in May.

Overall prices were also pushed up by the food component, which were largely affected by supply-side shocks that came in the form of severe droughts. Interestingly, on a year-on-year basis, transportation prices remained in deflationary territory as the effects of the oil glut continued to weigh on electricity and gasoline prices. However, the drag is likely to abate as prices of the sticky liquid had already begun to rally in recent months, even crossing US$50 per barrel. From further observation of the monthly inflation figures, transport prices have already returned to inflationary territory, registering a 2.39% month-on-month growth in May. Accordingly, core inflation, which excludes food and energy prices, continued to remain relatively unchanged, printing an average of 1.78% for the first five months of 2016.

Looking ahead, we continue to expect headline inflation to pick to 3.3% in the second half of 2016 as the effects of rallying energy prices trickle down to pull transport prices back up. Also, with the arrival of the La Nina in September this year, it is unlikely that Vietnam's agricultural sector will recover from the droughts which plagued the sector in the first half of the year, thus providing additional upside risks for domestic prices.

A new political era

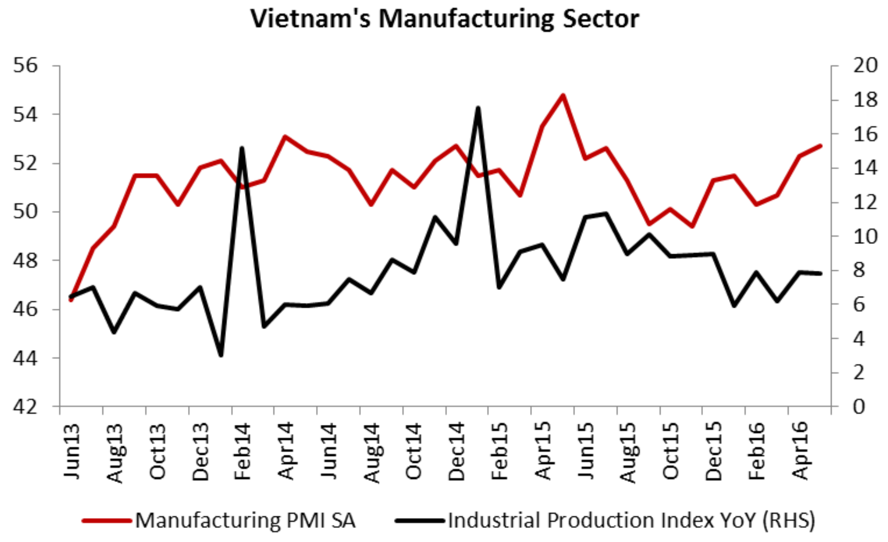
Taking a step back from the country's economic health, Vietnam's parliament had also recently completed reshuffling its leadership, turning the page onto a new political era. Though the cabinet sees twenty one new faces, several key figures from the previous pro-business administration remained. These include finance minister Dinh Tien Dung, deputy premiers Vu Duc Dam and Pham Binh Minh, who is also foreign minister.

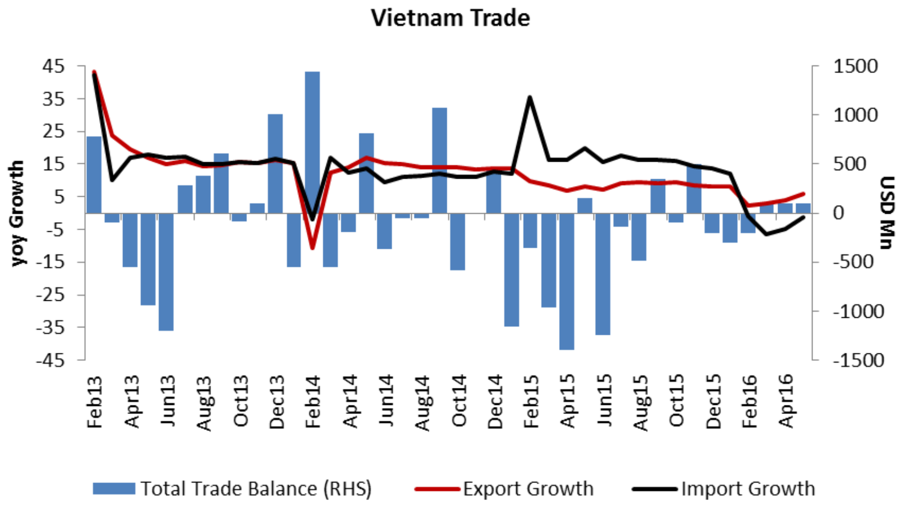
More importantly, the new Prime Minster was also sworn in. Former Deputy Prime Minster, Nguyen Xuan Phuc dominated the national assembly, clinching 90% of the total votes, replacing two-term Nguyen Tan Dung. Other than Phuc, three new deputy prime ministers were also voted in, including former Supreme Court judge Troung Hoa Binh and former chief of the Communist Party's economic committee, Voung Dinh Hue.

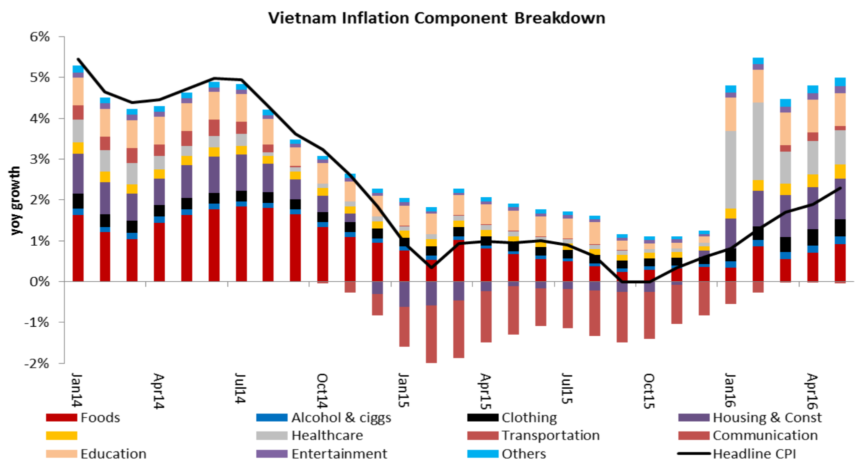
Nevertheless, despite a reshuffle of the country's key decision makers, we expect Vietnam's economic and foreign policy to remain focused on economic reformation and global integration. Already the South-East Asian nation recently hosted United States President Obama on his tenth trip to Asia, strengthening ties between the two nations. Economic, trade and security issues were the main themes of the visit as both countries continue to partner with each other on the TPP. Moreover, as China continues to expand into the South China Sea, it remains to be seen how the new Vietnamese administration would tackle matters over national sovereignty, especially since China is one of Vietnam's top trading partners.

A rosier second half

All in all, the outlook of Vietnam in the second half of 2016 continues to look promising. As the nation continues to build economic ties with the rest of the world, trade and investments are expected to boost growth in the near and medium term. Manufacturing will continue to remain the key driver for growth, with Vietnam leveraging on its low cost of labour and production while also strengthening the overall competitiveness of its export industry. Meanwhile, agricultural production is expected to remain in the doldrums as the bad weather from an impending La Nina is likely to devastate crops in the second half of 2016. However, the support comes in the form of rising crude oil prices as well, which may help to keep domestic inflation above deflationary levels for the rest of the year. In totality, we expect Vietnam's growth to tip at 6.4% at the end of the year, on the back of investment and manufacturing growth.







Source: Bloomberg, CEIC, OCBC

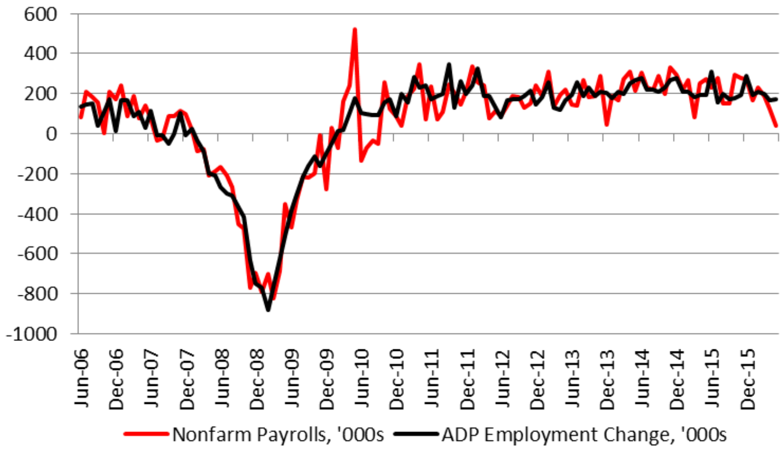
US THEMATIC

Conflicting Signals On The Labour Market

Fed chairwoman Janet Yellen might have used Brexit referendum uncertainties as one of the many excuses not to push for a rate hike on the June 16th FOMC meeting. However, it does appear that the most important reason behind the hesitation is none other than the hugely disappointing nonfarm payrolls print from May that was released just weeks before the meeting.

Against expectation that the US economy would create 160,000 jobs, actual data disappointed with a tepid 38,000 increase. The upset in the official payrolls data also contrasted sharply with the steady-as-she-goes trajectory suggested by the numbers compiled privately by ADP.

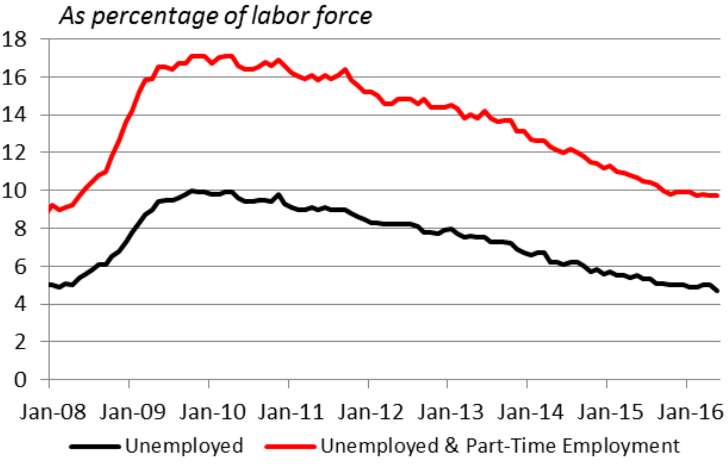
Given the scale and suddenness of the downside surprise, there is of course the chance that the May NFP figure is but an aberration and that the numbers thereafter would bounce back up nicely enough. Such a scenario is not without precedent. NFP data of December 2013 saw a sharp shortfall – at 45,000 compared to 291,000 the month before – but recovered to 187,000 the month after. Similarly, March 2015 saw a quick dip to 84,000 in between months of jobs prints above 200,000.



Source: Bloomberg, OCBC.

This history of occasional month-to-month seesaws aside, it pays to note also that the NFP print comes with a wide margin of error of 100,000 on either side. This means that, the 38,000 number from May could well actually be saying that the actual jobs created for the month could be anywhere between -62,000 to 138,000.

All in all, it is a number that has to be taken with a pinch of salt. Market and policymakers alike would therefore have to wait for the June number to ascertain whether the May figure is a one-off outlier or a harbinger of something more sinister about the US employment outlook. Tellingly, in her June 21st testimony before the Senate Banking Committee, Yellen said that "It is important not to overreact to one or two reports, and several other timely indicators of labour market conditions still look favourable."



Source: Bloomberg, OCBC.

Indeed, if we look at the US unemployment rate, it is striking that the figure was at 4.7% in May, the lowest rate since mid-2007. Meanwhile, a broader unemployment rate which takes into account not only those who cannot find jobs, but also Americans who could only find part-time work even if they want full-time roles, tells a similar encouraging story. The so-called U6 unemployment rate printed 9.7% in May, staying at its lowest rate since before Lehman Crisis.

The fact that the unemployment figures dipped even as nonfarm payrolls data came out poorly for the month is largely due to a drop in labor force participation rate. Given that fewer people are in the workforce actively looking for a job, the unemployment rates can still go down even with more lackluster jobs creation.

Source: Bloomberg, OCBC.

The same cannot be said, however, if a significant number of people are no longer in workforce because they are so utterly dejected from failing to succeed at job searching that they stop doing so altogether – and thus drop out from the participation rate statistics.

This is especially tricky at the turn of cycles. If the economy recovers well enough for more jobs to be created, those who have previously given up now feel encouraged enough to step back into the search process, they would thus contribute to the labor force participation rate pick up once more. In turn, that may well lead to an uptick in unemployment rate, even though the economy is actually picking up steam.

The difficulty in knowing for sure whether the metrics you are looking at when making decisions are truly reflective of the state of the economy is a tricky one. It is as if you are flying a plane through rough weather over treacherously mountainous terrain, right when you have doubts about whether the flight instruments in your cockpit are telling you the right things or not.

Arguably, having done its lift-off in December last year with an idea that more hikes will be carried out into 2016 only to face China's market jitters early in the year and Brexit volatility at the end of Q2, the Fed should already be cautious in carrying out its plan for further tightening. Add to that the unknowns about how the domestic labor market truly is coping and it makes sense then that the policymakers would adopt an even more gingerly stance and be extra careful in raising rates until they have a better sense of the outlook ahead.

CHINA THEMATIC

Capital Account Liberalization And RMB Internationalization Amid RMB Volatility

Back in mid-2015, PBoC mentioned in its RMB Internationalization report published on 11 June 2015 that China will further push two-way capital account liberalization including deepening the outflow channels such as QDII2 program to allow individual to invest in the offshore market. One year after the publication of report, PBoC has failed to deliver those reforms. Instead, China unwound some previous opening measures and shut down most of outflow channels in reaction to the currency turmoil following the fixing mechanism reform on 11 August 2015. For example, China suspended bond repo transaction by offshore Yuan clearing and participating banks that participating in the onshore interbank bond market in November 2015, five months after PBoC launched the new initiative in early June to push on Yuan usage.

The “stop-go” approach drew concern that China may prolong its timeline for capital account liberalization even though RMB has been admitted to the SDR basket currency. This, together with the concern about RMB depreciation has hindered the development of offshore RMB market since late 2015. Offshore RMB deposits in Hong Kong fell to CNY723 billion in April from the peak of CNY1 trillion in December 2014. In addition to Hong Kong, offshore RMB deposits have declined across the major offshore RMB centers including Singapore and Taiwan. Meanwhile, the usage of Yuan in international trade settlement and payment also declined. Based on our estimation, total China’s goods trade denominated in RMB fell to about 16% in April, down significantly from an average 25% in 2015. RMB’s ranking as global payment currency also fell by one position to six, accounting for about 1.9% of global shares as of June 2016.

Coupled with the shrinking liquidity pool in the offshore market, the development of RMB denominated assets also stalled. The issuance of dim sum bond tumbled in the first quarter of 2016 due to concerns about RMB exchange rate as well as falling funding costs in the onshore market but subsequently recovered in May and June after number of default cases in the onshore market increased in April.

In order to reboot the engine of RMB Internationalization, China has sped up the capital account liberalization reform since the beginning of the year under the guideline of “attracting inflows and controlling outflows” as shown on the table below.

All the measures listed above served two purposes in our view including attracting capital inflows to mitigate the capital outflows and further open onshore RMB denominated assets to promote RMB Internationalization. The results have yet to be seen. Nevertheless, it is clear that policy direction is likely to remain unchanged to attract more inflows.

How about outflows?

Since the beginning of the year, we have heard various rumors that China may restrict the foreign currency purchase by individuals but all have been denied by China’s currency regulators. So far, US$50K quota is still the main channel for individuals to move capital out of country. Corporates are still able to purchase foreign currency for trade and investment settlement backed by genuine documents. Nevertheless, talking to people on the ground, it is indeed that China has tightened the grip on outflows especially for large amount of outward payment above US$50 million.

China has not talked about two-way since late 2015 until recently when PBoC published its 2015 annual report in late June 2016. The PBoC reiterated that it plans to roll out the trial of QDII2 to allow individual to invest in the offshore market though there is no details about timetable. However, given the unexpected Brexit referendum event, the risk for China to postpone the QDII2 cannot be ruled out amid renewed concerns about RMB depreciation.

Looking ahead, the Brexit event has complicated China's plan for capital account liberalization. We think China may continue its lopsided capital account liberalization focusing on attracting capital inflows. The latest news that China suspended the purchase of foreign currency for overseas direct investment by partnership companies financed by individuals after the Brexit event shows that China remain cautious about the capital outflows. As such, we think China may postpone its reform plan for capital outflows until clearer picture from this Brexit drama.

In terms of RMB Internationalization, it is undeniable that the initiative has been dampened by the uncertain outlook about RMB and tighter capital account control. Nevertheless, given China has speeded up its reform to open both interbank FX and bond markets, we think RMB Internationalization may find alternative engine and we expect foreign ownership of China's bond is likely to go up.

	Reforms	Implications
Feb-16	China opened its onshore interbank bond market to most foreign investors	The move is likely to attract more capital inflows given low foreign ownership of Chinese bonds.
May-16	China announced to implement new macro prudential management of cross border financing.	All China incorporated enterprises (excluding government funding vehicles and real estate company) and financial institutions are allowed to borrow RMB or foreign currency from offshore market under new foreign debt limit in place of existing foreign debt quota.
May-16	China gave the green light to first batch of offshore participating banks to enter China's onshore interbank FX market.	In the longer run, the open of onshore FX market will provide more effective hedging tools to those offshore players, who are able to access to onshore capital markets. This will make RMB assets more appealing to offshore players.
May-16	PBoC published detailed guidance on investment in China's onshore interbank bond market by offshore financial institutions.	There will be no quota limit for qualified offshore financial institutions. China also eased repatriation rules. We do not expect the recent RMB volatility to hinder interests from medium to long term investors.
Jun-16	China announced to allocate CNY250 billion RQFII quota to the US	The CNY250 billion RQFII quota is the second largest after Hong Kong. Together with the setup of RMB clearing and settlement in the US, it will help promote the use of RMB in bilateral trade and investment between US and China.
Jun-16	China's currency regulator SAFE released regulation 16 to ease the sale of foreign currency receivable from foreign debt.	The companies are allowed to sell their foreign currency receivable from foreign debt at their own willingness. Given the offshore all-in cost remains low compared to onshore RMB cost, companies may have incentive to bring in the foreign debt to swap their existing RMB loan.

HONG KONG THEMATIC

HKD Pegged To Hold

HKD's strengthened in 2015
HKD kept triggering the Strong-side Convertibility Undertaking in 2015 due to the robust stock market in first half of 2015 and the sudden depreciation of RMB after the reform of USDCNY fixing mechanism in the second half. This propelled the HKMA to sell HKD to defend the linked exchange rate system, in turn piling up its foreign exchange reserve to a historical high.

Impact of China's slowdown on HK becomes prominent
In 2015, trade with Mainland China took up 51% of HK's total trade. Though visitors from Mainland decreased, its share in total visitors to HK remained high at 75% during the first four months of 2016. Closer economic and financial inter-connection with the Mainland China makes the impact of China's slowdown on HK more prominent.

Since the beginning of 2016, a plunge of China's stock market and the further depreciation of the RMB have raised market concerns on China's hard-landing. Such concerns indirectly pushed the HK dollar down to the weaker side. On one hand, China's Securities Regulatory Commission postponed the expiration of shares sale ban by major shareholders, prompting the investors to sell the H-share instead. As a result, the demand for HKD shrank.

On the other hand, in order to ease the concern of RMB depreciation and narrow the spread between CNH and CNY, Chinese officials intervened in the offshore RMB market via crackdown on the short selling of CNH. This propelled investors to sell off the HKD instead, betting on an abandoning of HKD's peg against USD.

Increasing concerns on the de-peg risk of the HKD
Given that HK connects more closely to the Mainland China in terms of economy, the Fed's rate hike and China's economic slowdown have together weighed on HK's growth, which witnessed the first contraction since 2Q 2014 in the first quarter. This underpins the speculation on the de-pegging of HKD against the USD and builds up downward risks for the HK dollar. On Jan 21st, USD/HKD surged to the highest level since 2007, reaching 7.8295, while the USDHKD 12 month outright forward prices jumped to 7.9002, implying the heightened expectation on de-peg risk.

Nevertheless, the de-pegging of HKD against the USD is unlikely at this junction for three reasons. First, Hong Kong Monetary Authority (HKMA) reiterated that they have no intention to abandon the linked exchange rate system. The HKMA raised its interest rate for the first time since 2006 on 17 December 2015, one day after the Fed hiked its interest rate, showing its determination to maintain the HK dollar's 32-year-old peg to the US dollar. Second, maintaining the current linked exchange rate system instead of de-pegging and re-pegging to the RMB, which has yet been freely traded, is perceived as the best way to sustain the stability of Hong Kong's financial system, especially given the heightened market volatility after Brexit. Third, HK's foreign exchange reserve remained near an all-time high of USD360.8 billion in April, equivalent to 1.75 times the monetary base and over 7 times the currency in circulation one of the highest levels across the globe. In this case, even if the HK dollar leans to the weaker side and touches 7.8500, abundant foreign exchange reserve will allow HKMA to maintain the peg. Moreover, aggregate balance and outstanding exchange fund bill and notes together amounted to USD157 billion in May, which is enough to cover a potential outflow of the hot money (accumulated to USD130 billion since 2008).

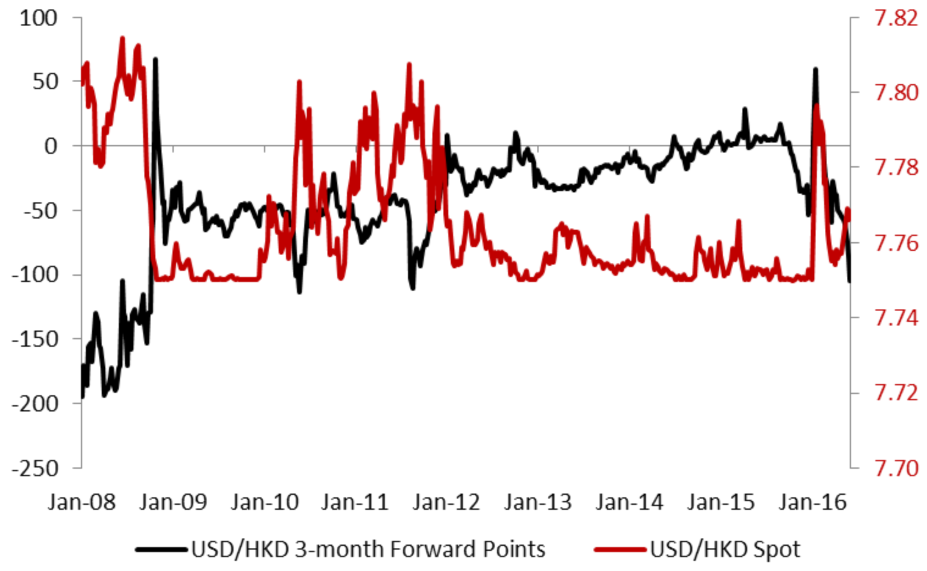
HIBOR may not spike this year

Looking ahead, poor economic outlook and correction in the property market may result in a lag of increase in HK's prime and deposit rates as compared to US rate hikes, in turn leading to capital outflow and a softer HKD. Moreover, the Brexit is likely to translate into capital exodus from the Britain-based or exposed companies in Hong Kong. As such, some may worry about a steep rise in HIBOR.

Date back to early this year, the weakness in the HKD and the resulted capital exodus did push the 3-month HIBOR to a seven-year high of 0.697% on 25th January. However, after the PBOC introduced CFETS index and managed the market expectation on the RMB, both HKD and HIBOR stabilized. Moreover, global headwinds and the heightened uncertainty of global outlook after Brexit are likely to further slow the pace of rate hikes by the Fed. This will translate into more moderate capital outflow from Hong Kong, thereby posing less upward pressure on the HIBOR. Moreover, the HKMA has introduced discount window system after the Asian financial crisis. On the back of such system, even if capital outflow results in tighter liquidity, the banks can borrow Hong Kong dollar funds overnight from the HKMA through repurchase agreements at base rate for the first 50% of exchange fund paper held by the bank. As such, the HIBOR may be able to stabilize below the base rate (0.75% currently) and will not surge unreasonably like what happened during Asian financial crisis.

As the HKMA follows the Fed's step to raise rates, adding that the HKD inherits the safe haven nature of the USD, we believe that the appeal of HKD-denominated assets may be resilient, especially given the increasing risk-off stances. Therefore, we see little chance for the HIBOR to surge beyond expectation, indicating that property crisis is also unlikely.

USD/HKD Spot, USD/HKD 3-month Forward Points

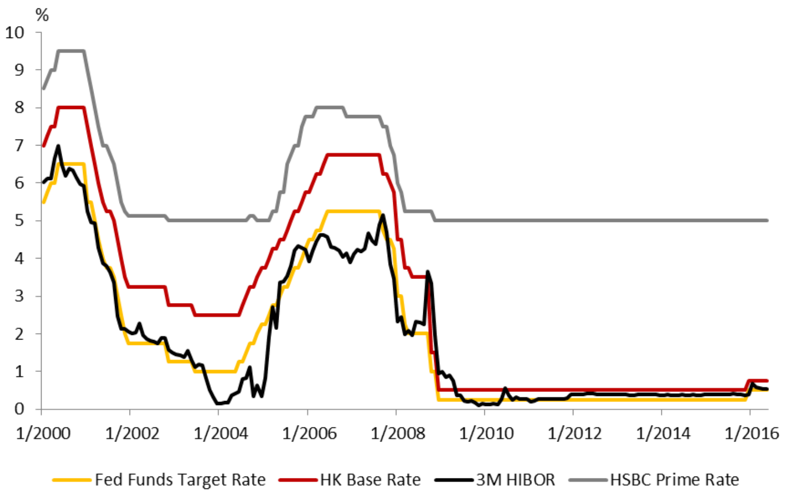


Source: Bloomberg, HKMA

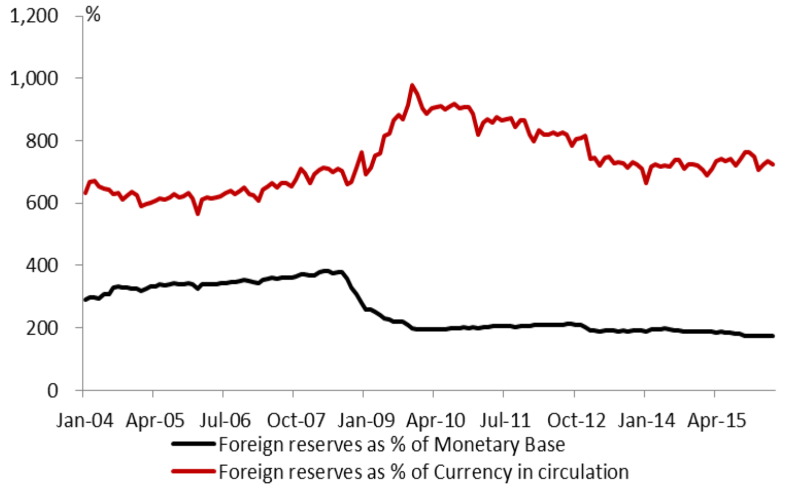
Outlook of the HKD

In conclusion, we expect that the HKMA will continue to maintain the linked exchange rate system. In this case, as increase in lending and deposits rates in Hong Kong tends to lag the Fed's rate hikes for nearly 9 months based on historical data, capital flow out of the former British colony is inevitable. However, the Fed's rate hike pace is more likely to slow down amid the broad-based impact of the Brexit. Instead, capital exodus may mainly result from the bleak outlook of the U.K.-based or -exposed companies in Hong Kong. As such, the HKD will be relatively weak as compared to last year. On the other hand, the increasing safe-haven demand and the mounting downward pressures on the RMB amid the market cautiousness of risky assets after Brexit are expected to bolster the demand for the HKD and limit the downside of the HKD in the near term. As such, USD/HKD is expected to be capped at 7.7700 this year.

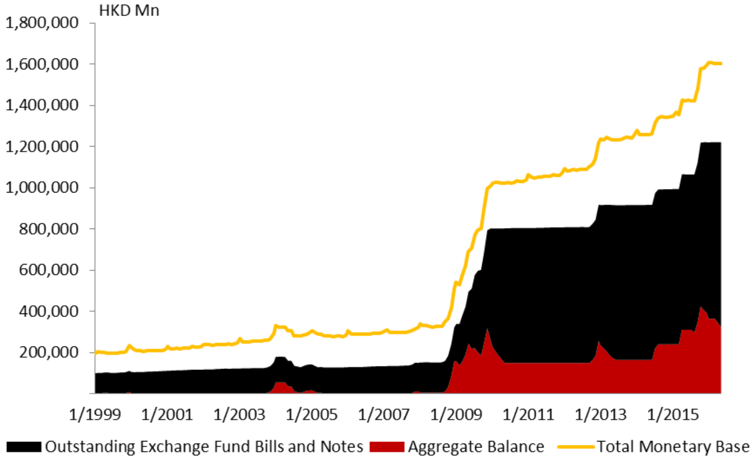
HKD Rates v.s. USD Rate



HKMA Foreign Exchange Reserve



HKMA Monetary Base



Source: Bloomberg, HKMA

SINGAPORE THEMATIC

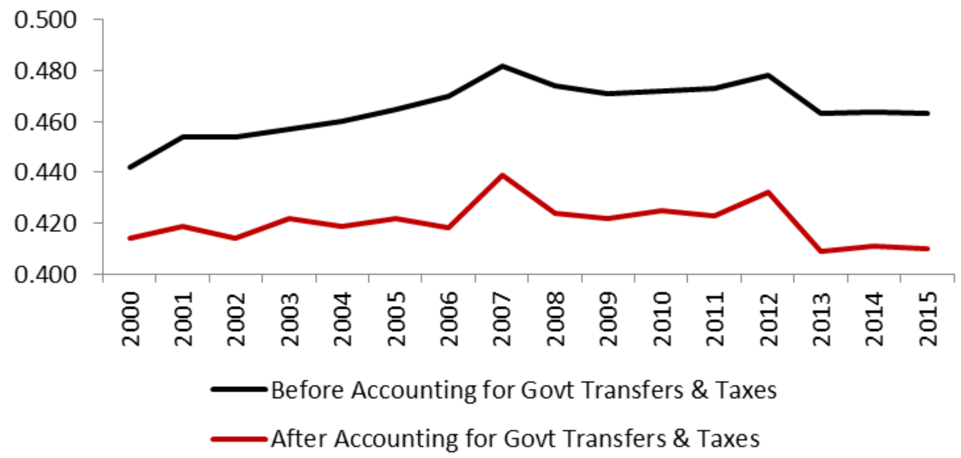
Going Beyond Income Inequality?

Proactive fiscal policy measures have taken effect since 2012

Since 2000, Singapore's GINI coefficient, after accounting for government taxes and transfers, peaked at a high of 0.439 in 2007, before tapering down for a couple of years. It then spiked again to 0.432 in 2012, which was likely attributed to lagging real wage growth. This probably underscored the urgency to improve the labour productivity thrust so as to improve the labour market's real wage growth and its share of the economy.

Given the more recent redistributive slant in Singapore's Budgetary and other fiscal policies, the Gini coefficient have stabilised and even improved since 2012, especially if government transfers and taxes are taken into account. To a certain extent, this came amid a whole host of measures to tackle not only the financial aspects of the income inequality issue, but also the socioeconomic aspects like education, healthcare and job up-skilling opportunities notwithstanding the sluggish economic growth and a tight labour market.

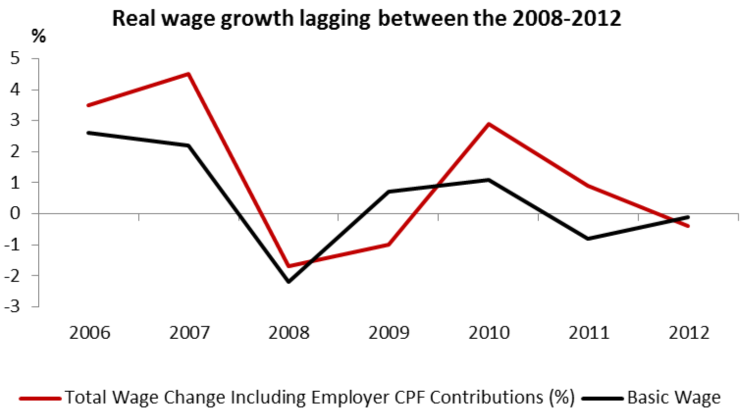
Singapore's Gini coefficient is lower after accounting for goverment transfers and taxes



Source: CEIC

Measuring income inequality beyond the GINI coefficient?

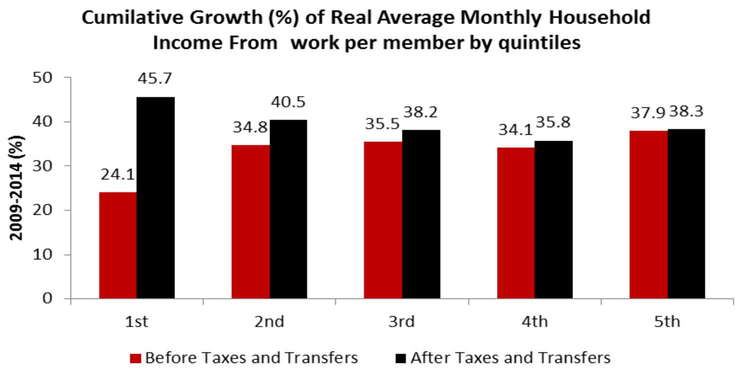
Like in many other countries, the GINI coefficient is used as a main indicator to represent the income distribution of the country's residents. However, simply looking at the coefficient at face value does not allow for a full analysis. Singapore has a somewhat different approach to using fiscal policy to tackle such issues – this includes having a lower overall tax burden and very targeted subsidies for the low income households which have been increasing over time. The overall GINI coefficient also does not offer a breakdown of real income growth within the different income groups.

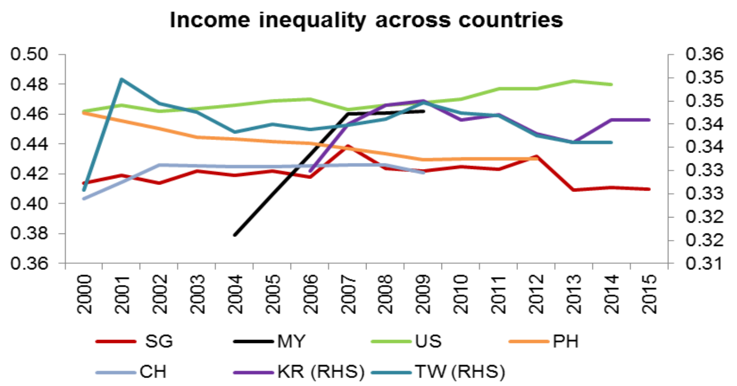


Source: SingStats, OCBC

Important role of taxes and transfers in Singapore's fiscal objectives

Over 2000-2015, despite slower wage growth within the bottom quintile before accounting for taxes and transfers, average monthly household income growth skyrockets once taxes and transfers are taken into consideration. In addition, when comparing across countries, IMF statistics show that Singapore's income growth after taxes and transfers among lower income households is also considerably higher than other countries, with cumulative income growth for households in the lowest 20% coming in at 37.1% as opposed to the US' growth of -8.2% and UK's growth of 2.8%. Moreover, if we compare Singapore's after tax GINI coefficient across similar economies, income redistribution policies also play a fairly significant part in reducing Singapore's income inequality to that below most of these countries.

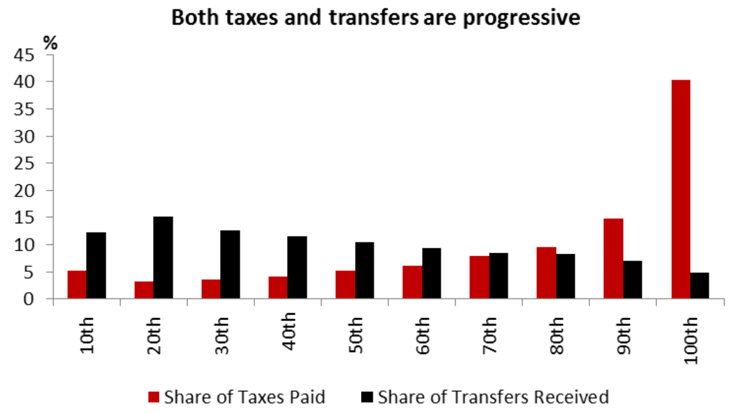




Source: World Bank, CEIC, MOF, OCBC

Supplementing work income for the low-income workers

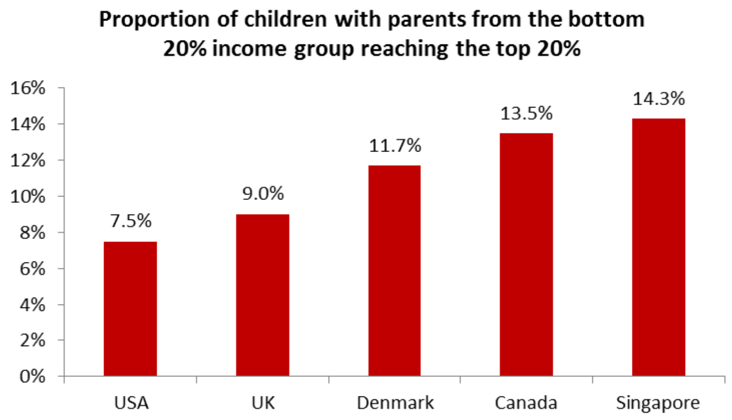
Since 2007, the government has introduced many schemes that aimed to supplement the income and retirement savings of low-wage workers. The Workfare Income Scheme is an example, encouraging eligible workers to continue working by enhancing their net income through cash payments and CPF contributions. In addition, with the permanent implementation of the GST voucher scheme in 2012, P20 households are able to partially offset tax expenses as well. Coupled with a progressive tax system that places a greater tax burden on the rich, Singapore is able to tweak income distribution to ensure that the lower-income households are not left behind.



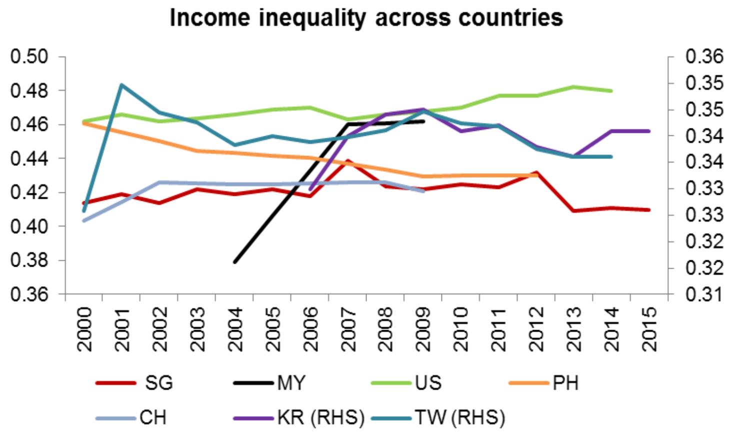
Source: MOF, OCBC

A holistic approach to promoting intergenerational income mobility

Apart from redistributive fiscal policy inclinations, even the education policies promote intergenerational income mobility. In a study done by the Ministry of Finance, Singapore has the highest percentage of children born to parents in the bottom 20% of incomes making it to the top 20%, compared to other developed economies. Singapore's focus on engendering intergenerational income mobility extends to schemes such as the Workfare Training Support Scheme and dedicated agencies such as the Workforce Development Agency (WDA). As such, the combination of targeted manpower and education policies help Singapore to achieve a more flexible income structure, allowing for movement between quintiles and hopefully a more stable and equitable income distribution in the medium term.



Source: MOF, OCBC



Source: CEIC, OCBC

The household balance sheet offers another perspective

Singapore's household balance sheet shows that overall net worth has been increasing since 2010, with growth driven by both financial and residential property assets. CPF contributions, which are a form of compulsory savings, would be included in the calculation of financial assets. At the same time, Singaporean's overall liabilities seem to have stabilized over the past 3-years.

	2010	2011	2012	2013	2014	2015
Household Net Worth (SGD Trillions)	**1.19**	**1.27**	**1.38**	**1.43**	**1.47**	**1.52**
Assets	**1.40**	**1.51**	**1.64**	**1.71**	**1.76**	**1.82**
Financial Assets	0.71	0.75	0.83	0.89	0.94	0.99
Residential Property Assets	0.69	0.76	0.81	0.83	0.82	0.84
Liabilities	**0.21**	**0.24**	**0.26**	**0.28**	**0.29**	**0.30**
Mortgage Loans	0.16	0.17	0.19	0.21	0.22	0.22
Personal Loans	0.05	0.06	0.07	0.07	0.08	0.08

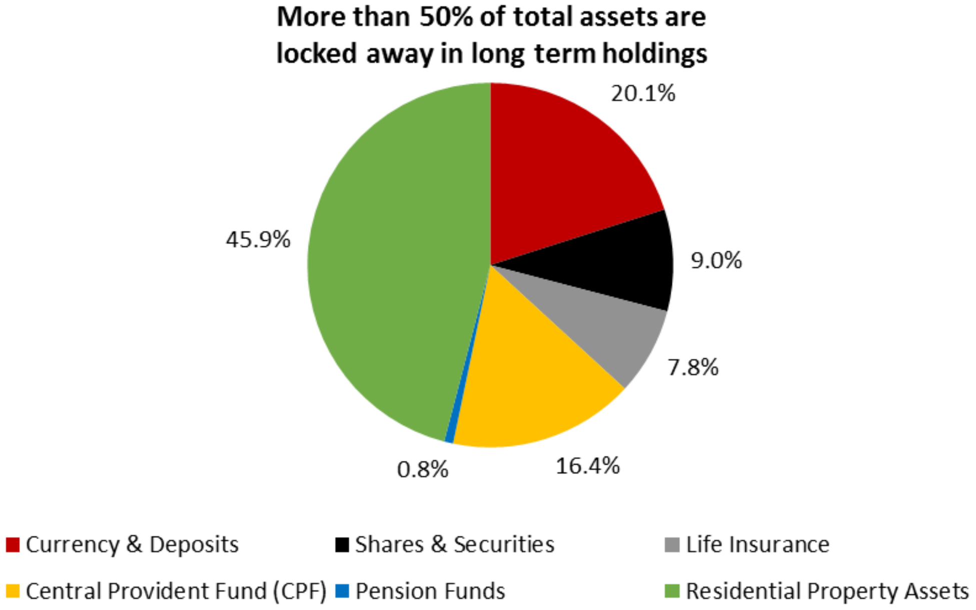
Figures may not add up due to rounding.

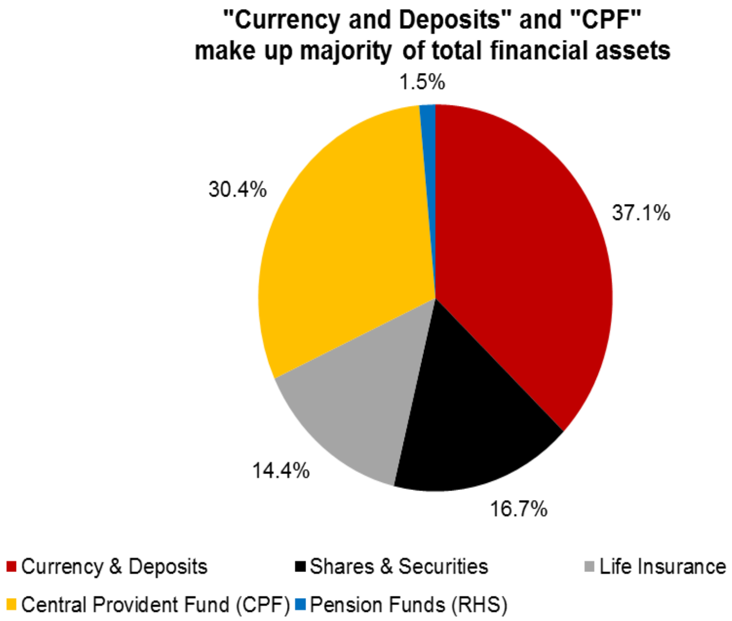
Source: Singstats, OCBC

The full breakdown is attached in appendix A

Under "Financial Assets", the items "Currency and Deposits" and "CPF" account for the majority of total financial assets. These two components are highly correlated to income growth because (1) "Currency and Deposits" comprise of traditional banking saving deposits, and (2) "CPF" is considered a compulsory saving policy which is a function of a worker's total wages.

More than half of Singaporean assets either comprise of long term holdings or residential assets. For example, CPF holdings and residential assets are not easily withdrawn or cashed out and cannot be used for everyday purchases. In addition, life insurance plans and investment funds are typically held over a medium to long term tenure (more than 5 years). Therefore, after discounting the long term illiquid assets, liquid assets in the household balance sheet account for 35% of total wealth in 2015, but total liabilities amounting to only 20% of total wealth, this could partly explain why the impression of Singaporeans being "asset rich but cash poor" came about. Residential property asset valuations are also vulnerable to property cycles and cooling measures.





Source: Singstats, OCBC

The Singapore household balance sheet may not fully capture the holding of overseas financial and property assets.[1] This exclusion could mean the household balance sheet is likely an understatement of total wealth inequality, with the dispersion possibly higher than it actually is given that the SGD strength and low domestic interest rate environment has led many Singaporeans to look overseas in their search for yield. From the leverage perspective, increased exposure to foreign debt may also imply greater exposure to foreign exchange rate and interest rate risks.

Stabilizing the GINI coefficient is only the first step?

The income gap between Singapore's rich and poor has narrowed only after redistribution policies spearheaded by the government. Given the ageing demographics and increasingly globalized household

[1] Singapore Department of Statistics, Quarterly Household Sector Balance Sheet, October 2012

balance sheets, other forms of addressing inequality issues may grow in importance. For instance, equality in other aspects outside of income like health and education may be interesting to study, but this will be for future discussion.

Appendix A: Singapore's complete household balance sheet

	2010	2011	2012	2013	2014	2015
Household Net Worth (SGD Trillions)	**1.19**	**1.27**	**1.38**	**1.43**	**1.47**	**1.52**
Assets	**1.40**	**1.51**	**1.64**	**1.71**	**1.76**	**1.82**
Financial Assets	0.71	0.75	0.83	0.89	0.94	0.99
Currency & Deposits	0.25	0.27	0.30	0.32	0.34	0.37
Shares & Securities	0.16	0.15	0.16	0.17	0.17	0.16
Listed Shares	0.08	0.07	0.09	0.09	0.09	0.08
Unlisted Shares	0.04	0.04	0.03	0.03	0.03	0.04
Unit Trusts & Investment Funds	0.04	0.04	0.04	0.05	0.05	0.05
Life Insurance	0.11	0.11	0.12	0.12	0.14	0.14
Central Provident Fund (CPF)	0.19	0.21	0.23	0.25	0.28	0.30
Pension Funds	0.01	0.01	0.01	0.01	0.01	0.01
Residential Property Assets	0.69	0.76	0.81	0.83	0.82	0.84
Public Housing	0.35	0.39	0.42	0.41	0.39	0.40
Private Housing	0.34	0.37	0.40	0.42	0.42	0.44
Liabilities	**0.21**	**0.24**	**0.26**	**0.28**	**0.29**	**0.30**
Mortgage Loans	0.16	0.17	0.19	0.21	0.22	0.22
Financial Institutions	0.12	0.13	0.15	0.17	0.18	0.19
Housing & Development Board (HDB)	0.04	0.04	0.04	0.04	0.04	0.04
Personal Loans	0.05	0.06	0.07	0.07	0.08	0.08
Motor Vehicle	0.02	0.01	0.01	0.01	0.01	0.01
Credit/ Charge Cards	0.01	0.01	0.01	0.01	0.01	0.01
Others	0.03	0.04	0.05	0.05	0.06	0.06

Figures may not add up due to rounding.

Source: Singstats, OCBC

COMMODITY SPECIAL

Absence Of A Supercycle

The old supercycle

As recently as December 2015, major newswires were having headlines including “Don’t mourn the death of the commodities super-cycle”, and “Is the Commodities Super-cycle really at an end?”. Others however are saying that the supercycle is a pause, rather than an end. Should we be interested in the death of the commodity supercycle, or more importantly, why should we be interested?

Should history be of reference, investors who have missed the previous commodity supercycle back in the late 1990s to the fall of Lehman in 2008/9 had effectively squandered their chance to ride the rally in oil (+1,062%), gold (+646%), copper (+487%), corn (+240%). The gains had in fact effectively overshadowed those of developed market equities (+139%), emerging market equities (+418.8%), US HY bonds (+88.5%), US IG bonds (+40.4%) and for the interest of property investors, global property prices (+208.5%). As such, just by merely observing the returns, any investor (and speculator for that matter) would want to see such substantial gains in their portfolio should the chance arise again, should a commodities ‘super’ cycle be around the corner.

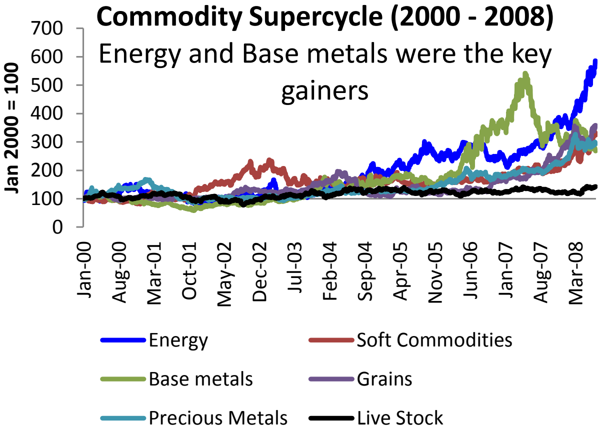
Why so super?

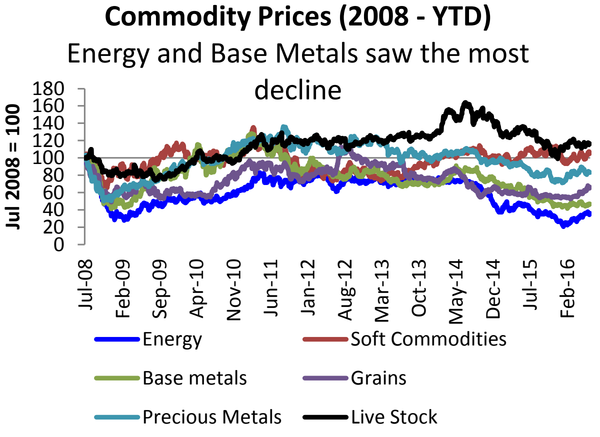
To aid our discussion, it is important to define the commodity classes, as well as the term “cycle”. Commodities comprise of six main groups: Energy accounting for the most in the Thomson Reuters CRB Commodities Index, followed by Base Metals, Precious Metals, Agriculture and Grains. Elsewhere, a cycle refers to the upward movement of commodity prices for a long time period, followed by a downward movement of commodity prices. The cycle thus continues, hopefully with another upturn of prices when prices bottom.

Despite the likelihood that commodity prices may likely not match its stellar performance back in the last decade, it does not mean that one should take a negative view on future prices. For one, soft commodities and grains had rallied substantially due to its classification as defensive in nature, while also benefiting from the harsh weather conditions meted out by El Nino.

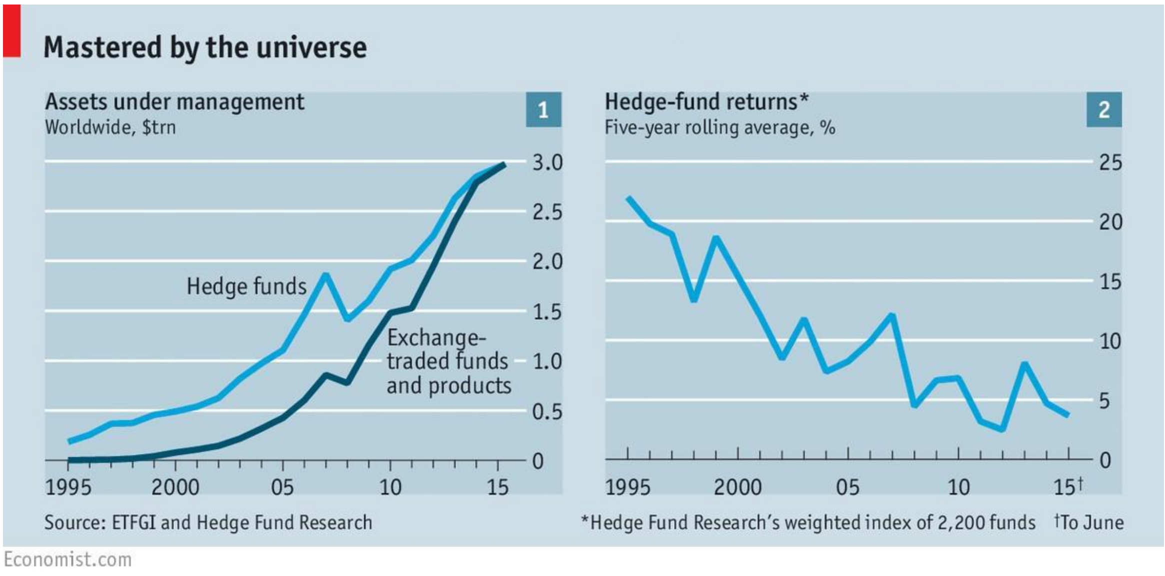
However, prices belonging to energy and base metals had fallen substantially given renewed global growth headwinds and slowdown in Chinese imports demand. Statistically, since July 2008, crude oil prices tumbled 63.9%, though most of the decline was seen back since late 2014. Base metals, related to crude oil as a growth-linked commodity, also suffered a sizable 34.3% fall over the same period of time. Gold also lost some of its appeal, falling by 16.9%. Curiously enough, these are the same commodity classes that racked the most gains during the commodities supercycle, and therefore begs the question if these commodity classes have fallen substantially enough to pose for another upward cycle.

Should history be of reference, an upward cycle should occur not only in the presence of an immediate down cycle, but also in tandem with other exogenous drivers. Looking back to the last decade, many pieces had fallen in place to stimulate the commodities supercycle:





1. **The Maturing Commodities Market**
Arguably, the commodities market was less mature fifteen years ago. The world before the introduction of the Exchange Traded Fund (ETFs) then, required high net-worth individuals to trade with traditional hedge funds. ETFs however, are basically low-cost funds that track commodity prices (on top of other indices and asset classes). Thus, the blossoming of the Exchange Traded Fund (ETFs) allowed the influx of investors to tap on a market that is previously obscure to them.



2. **Role of Emerging Markets**
Some may argue that the rise of the emerging markets, especially China, is the key driver of the commodities supercycle. According to the International Monetary Fund (IMF), China contributed almost all of the increase in the world consumption of tin and nickel during 2002 - 2005. In addition, the Middle Kingdom demanded more than net world's consumption growth of lead and zinc. Finally, a sizable contribution of around 50% was seen in the demand of aluminium and copper as well. Elsewhere in the oil markets, passenger car sales in China reportedly increased more than fivefold during 2001 – 2007. All-in-all, the industrialisation and urbanisation seen in China over the last decade boosted demand for fuel-based electricity such as crude oil and coal.

3. **Population and Technological Boom**
The last decade has also seen the technological boom, which resulted in the introduction of the Silicon Valley, and accelerated the pace of globalisation via the creation of the World Wide Web (WWW) as early as 1989 which gained prominence till today. Elsewhere, the innovation of mobile

and media devices ranging from digital cameras, MP3 players, and camera phones to smartphones also played its role in the demand for commodities. The rapid increase in population growth in emerging nations, empirically even outpacing those of the developed ones, would also contribute to the demand of commodities as overall consumption increases.

Table 5.3. Consumption of Industrial Metals and Oil
(Consumption expressed as real annual percent change; contributions to growth in percent)

	1993–2002			2002–05[1]		
	World consumption growth	Contribution to growth of: China	Contribution to growth of: Other major emerging markets[2]	World consumption growth	Contribution to growth of: China	Contribution to growth of: Other major emerging markets[2]
Metal						
Aluminum	3.8	38	9	7.6	48	9
Copper	3.5	43	15	3.8	51	41
Lead	3.0	42	15	4.3	110	–7
Nickel	4.4	12	–11	3.6	87	–11
Steel	3.4	38	11	9.2	54	8
Tin	1.3	34	16	8.1	86	2
Zinc	3.4	42	10	3.8	113	7
Oil	1.5	21	18	2.2	30	7
		1993–2000		2002–05		
			(In percent)			
Memorandum items:						
World GDP growth		3.5		4.8		
China's share in world GDP		10		13		
China's industrial production growth		10.5		16.2		

Sources: International Energy Agency; International Iron and Steel Institute, *Steel Statistical Yearbook* (various issues); World Bureau of Metal Statistics, *World Metal Statistics Yearbook* (various issues); and IMF staff calculations.
[1]The sample is selected to match the recent period of rising real metal prices. Due to limited data availability, figures for steel are over the period 2002–04.
[2]Brazil, India, Mexico, and Russia. Due to missing data for 2005, Russia is not included in the group for oil.

Maybe not so super

With the supercycle effectively coming to an end, the recent commodity plunge had well sparked some interest in a new upward cycle in commodity prices. Having the factors in mind, one should re-evaluate on the presence of these factors in current times to substantiate another 'supercycle'.

Fundamentally, many of the drivers are well absent at this juncture. Global population growth rate has also slowed to 1.2% in 2013, down from 1.7% seen back in 1990. Importantly as well, we are now faced with the slowdown of China's growth to an estimate of 6.7% (2016) and 6.2% (2017), amid an observable slowdown in its import growth.

Still, the question begets if another form of a technological boom equivalent to the magnitude of that in the last decade may bring about the anticipated rise of commodity prices. The concept of driverless cars, space exploration and inhabitation of the moon, and the rise of robotics may be the next technological horizon for the next decade. Needless to say, the recovery in global growth in the key economies would also spur the pickup of commodity prices.

But before that happens, a natural cycle of a pickup in commodity prices should occur, given the low prices already seen from the plunge in the last years. It may not as super as the one seen in the last decade, but could still warrant interest in the eyes of the market as price appreciation takes form.

FUND FLOWS UPDATE

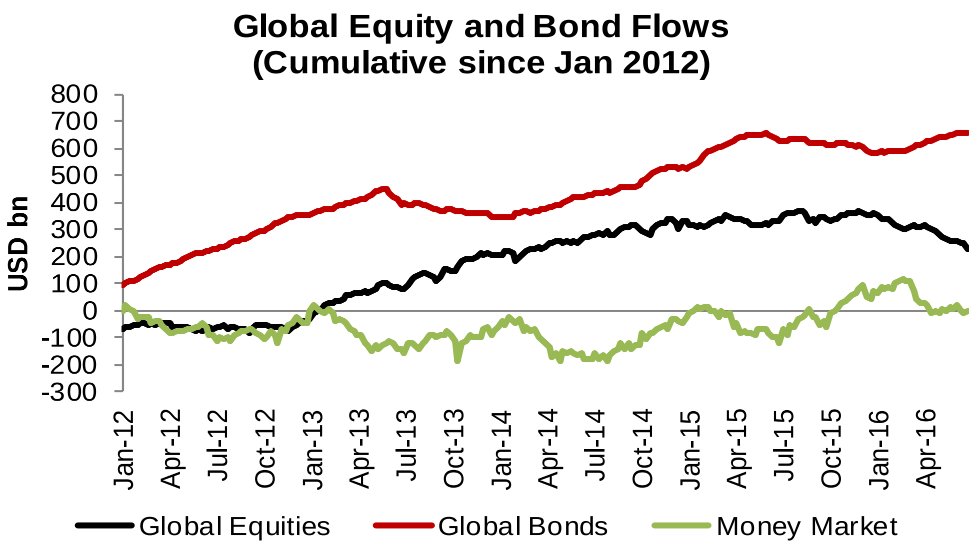
1H 2016 Global Fund Flows Review

Highlights

Global risk appetite through the first half of 2016 demonstrated much risk aversion as seen from the divergence between global equity and bond flows. China's economic slowdown coupled with constant fears over the Brexit Referendum led to investors pulling funds out of equity funds as total flows printed a net of $133.6bn worth of redemptions. In contrast, total net flows for 2014 and 2015 came in at +$129.2bn and +$27.9bn respectively. In tandem with global risk aversion, investors flocked to credit as capital inflows into global bond funds came in $75.5bn. Meanwhile, flows within the money market in the first half of 2016 reversed 2015's gains to post $78.5bn worth of outflows, led primarily by outflows from North America (Total YTD flows: -$56.1bn).

In the DM space, equity flows from all regions dived into negative territory in 1H2016 with total net outflows coming in at $123.4bn. Of note, total DM-equity outflows were led by North America (Total YTD flows: -$82.5bn) as equity outflows from the US dragged total flows down within the region (Total YTD flows: -$80.2bn). Elsewhere, concerns over Europe's economic recovery coupled with Brexit fears weighed heavily on Europe in 1H2016 as the region also posted net outflows (Total YTD flows: -$40.5bn). Risk appetite clearly abated as 2015 ended the year with $152.7bn worth of net inflows. On the flip side, DM-bond funds enjoyed fresh money through the year (Total YTD flows: +$71.1bn). In particular, the North American region saw flows totalling up to $72.4bn, likely due to investors fleeing to safe haven US treasuries.

With China's economic slowdown and the equity rout in start of the year, EM-Asian equity markets (Total YTD flows: -$9.72bn) pulled total EM-equity funds down into the red. As such, total outflows from EM-equity funds came in at $10.3bn. On the other hand, total flows within the EM-bond space closed the first half of the year within inflow territory (Total YTD flows: +$4.4bn) as all EM-regions resurfaced back from 2015's outflow print.

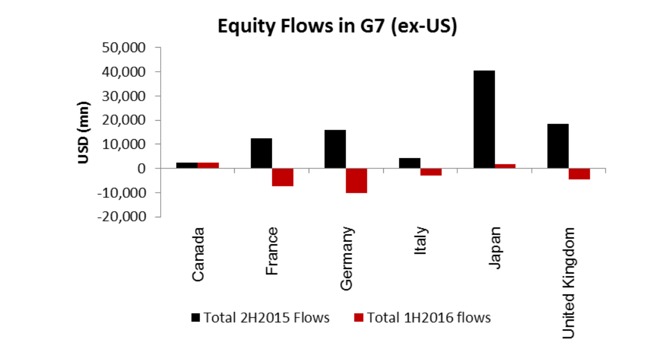


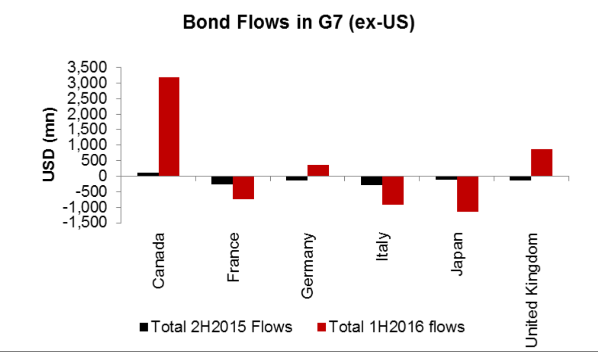
Source: EPFR, OCBC Bank

G7 Fund Flows

Despite healthy employment numbers, the constant slew of disappointing data prints such as June's non-farm payrolls figure and a lower than expected GDP growth in 1Q, led to concerns over US economic growth in the first half of 2016. These concerns also worsened as events such as the Brexit and the Brussels bombings sent investors into a flight for safety. As Fed Chair Yellen caveated in her recent statement, "an important question is whether the US economy could continue to make progress amid fairly considerable global bumpiness". In addition, on top of economic concerns, a lacklustre 1Q16 corporate earnings season also placed the US status of a "safe-haven in times of market stress into question" under question. Mirroring these concerns, equity flows from the US totalled $80.2bn worth of redemptions in the first half of 2016. Elsewhere, with the theme of the Brexit hanging over Europe in the first half of the year, G7-Europe posted net outflows. France, Germany, Italy and United Kingdom registered total year-to-date outflows of $7.4bn, $10.1bn, $3.0bn and $4.5bn respectively. Meanwhile, as crude oil prices climbed back to US$50 per barrel, Canadian equity markets saw relief, enjoying $2.5bn worth of new money. Nevertheless, this was still not enough to cushion overall outflows as total G7-equity flows closed 1H2016 in negative territory (Total YTD: -$101bn).

On the other hand, total G7-bond flows for 1H2016 posted $66.0bn worth of net inflows. Inflows were led primarily by flows into the United States as investors likely flocked to save havens through the year (Total YTD flows: +$64.4bn). Conversely, total net inflows were weighed down by European and Japanese debt markets as negative interest rates steered investors away. Accordingly, France and Italy bond funds saw a year-to-date net outflow of $753.4mn and $916mn respectively while Japanese debt markets registered a net flow of -$1.2bn



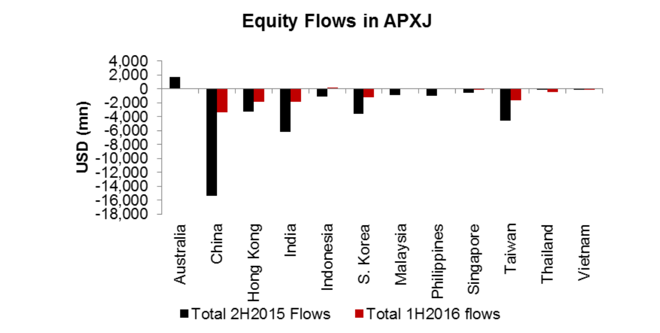


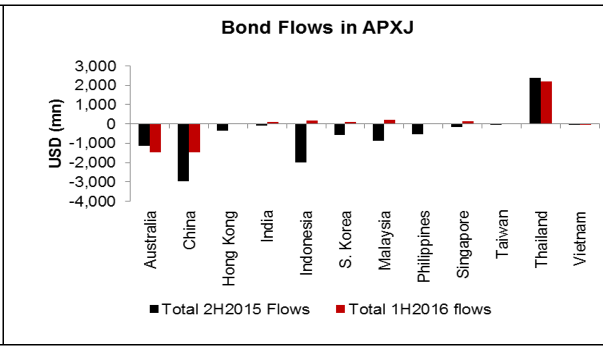
Source: EPFR, OCBC Bank

APXJ Fund Flows

China's equity market has had its fair share of shocks in 1H2016. Firstly with the equity market rout in the beginning of the year and second with MSCI's delay of the inclusion of China's A-share into its international stock benchmark, Chinese equity markets saw $3.4bn worth of capital redemptions. To make matters worse, sentiments with regard to the Middle Kingdom remained under pressure as concerns over its economic slowdown continue to sour risk appetite. As mentioned by the "authoritative person" earlier in May, China's recovery is likely to be L-shaped and last more than 2-years. Elsewhere in its bond markets, defaults by SOEs such as the Sichuan Coal Industry Group and Dongbei Special Steel saw investors turn more cautious on Chinese names. The increased number of credit events in the onshore market this year is likely to have dampened offshore investors' demand for the offshore bonds, especially those issued by Chinese companies which are struggling with overcapacity. As such, $1.5bn worth of outflows was felt by the Middle Kingdom in the first half of the year.

Meanwhile, equity flows from the rest of APXJ remained weak in 1H2016 as majority of the regions remained in negative territory. These include Hong Kong (-$1.92bn), India (-$1.9bn), South Korea (-$1.3bn), Singapore (-$10.4mn), Taiwan (-$1.7bn), Thailand (-$511.2mn) and Vietnam (-$52.2mn). Notably, Indonesian (+$207.4mn) and Malaysian (+$94.9mn) equity funds saw year-to-date flows post net inflows despite ending 2015 in the red. Flows into Indonesian and Malaysian debt markets also reflected a reversal of flows as both regions posted $176.2mn and $208.7mn worth of capital inflows respectively. On top of these regions, Thailand was the biggest APXJ recipient of money, enjoying $2.2bn worth of capital inflow.

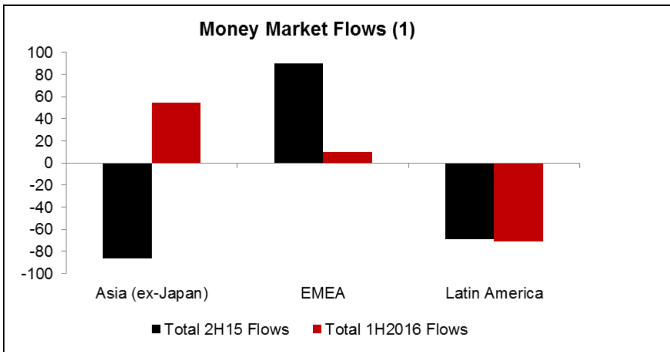


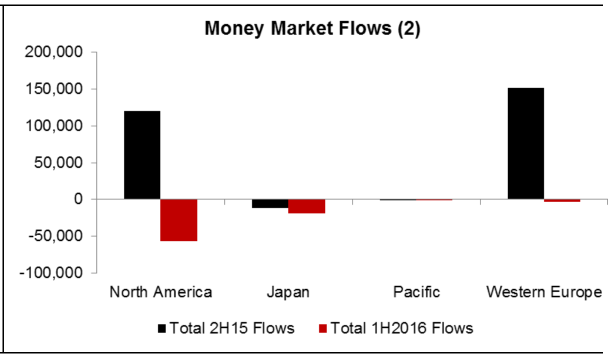


Source: EPFR, OCBC Bank

Money Market

Even as global markets showed risk aversion in the first half of the year, money was still being put to work as money market flows registered a net outflow of $78.5bn. Notably, flows from North America snapped back from 2015's high (Total 2015 flows: +$35.2) to post $56.1bn worth of capital outflows as the Fed continued to send dovish signals whilst constantly downgrading its rate hike expectation. Apart from North America, Brexit fears also hung over Western Europe, with the region seeing capital being pulled out as the region posted $2.9bn worth of outflows, a marked difference as compared to 2015's net inflow total of $43.9bn. Elsewhere in the east, Japan also saw net outflows in the first half of the year (Total YTD flows: $19.3bn), likely due to BOJ's decision to cut its policy rate to -0.10%.





Source: EPFR, OCBC Bank

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