OCBC GLOBAL OUTLOOK 2018

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2018 Global Themes

Tuesday, December 19, 2017

Moving from geopolitical risks and black swans to grey rhinos.
Both traditional assets (equities and bonds) as well as alternative investments (just look at the phenomenal price ascent of Bitcoin) testify to the risk-on investor sentiments and the conducive global liquidity situation. The happy combination of improving growth with subdued inflation suggest that companies are better positioned compared to previous years. CEOs have become surprisingly optimistic, with 51% very positive about longer-term growth prospects, according to a PWC survey. There was no shortage of headline risks - for instance, North Korea just fired an intercontinental ballistic missile after two months of relative quiet, but this did not deter financial risk appetite significantly. As the year draws to a close, it is stark how the absence of headline risks in Eurozone (apart from Brexit negotiations which continue to drag on), investors prefer to zoom in on US tax reforms which are seen as icing on the cake for the US economy.

Asia's growth year-to-date in 2017 has mostly surprised on the upside
With the external demand improvement, manufacturing and trade momentum has picked up across Asia. Consequently, GDP growth has mostly surprised on the upside for 3Q17, with the key exceptions of Indonesia and India. Beyond the short-term, Asia's main challenges are managing demographic ageing trends and economic reforms. Going forward, while the IMF's revised global GDP growth forecasts suggest a benign and stable economic growth picture into 2018, there some grey rhinos (which are not random surprises as opposed to black swans, but the obvious dangers which we could potentially ignore to our own peril) which we have to keep an eye on.

The grey rhinos in financial markets
The Bank of International Settlements (BIS) has warned of stretched market valuations. However, with liquidity conditions still abundant, the fear factor still remains low. That said, finding value is increasingly challenging. As investors have an innate fear of missing out (FOMO), the current investor preference is still to buy any dips. However, the global monetary policy normalisation bandwagon has just recruited a few more members – the Bank of Korea (BOK) just hiked rates for the first time since 2011, and Bank Negara Malaysia (BNM) has started to sound hawkish. Asian asset markets and FX have been key beneficiaries of the risk-on and capital inflows. If investors reassess carry prospects, there may be room for caution. Other risks include macro-prudential measures and tighter regulation. Manufacturing momentum may also be due for a pause. Malaysia and Thailand are also holding general elections in 2018, which could see some markets adopt a temporary "wait-and-see" attitude to capex spending and hiring.

Inflation may come back
The US unemployment rate remained at 4.1% (lowest since Dec 2000) in November. However, the wage growth remained subdued at 2.4% yoy (YTD: 2.6%), core inflation at 1.7% yoy (YTD: 1.9%) and 3Q17 core PCE at 1.3% qoq.

Hence the US Federal Reserve has been cautious about hiking interest rates and tapering its balance sheet. While muted global commodity prices have also helped to keep global inflation tame, the inflation picture is gradually changing. Global oil prices have recovered substantially this year. IMF tips average annual oil prices of US$50.2/bbl in 2018 versus US$50.3/bbl in 2017. Our house view is more bullish at US$65/bbl for WTI and US$70/bbl for Brent by end-2018, up from US$55 and US$60/bbl respectively at end-2017. OPEC's production cut agreement has definitely helped in the demand-supply rebalancing. Note the implementation of the US tax reform bill may have a muted impact on a relatively strong US economy but risks forcing wage inflation to a tipping point.

Global liquidity may peak soon

The Fed will shrink its balance sheet by US$300 billion in the first year from Oct 2017 to Sep 2018. However, the ECB will continue to expand its balance sheet till September 2018 albeit at a slower pace of EUR30 billion per month. One may ask why is there a sudden urgency to normalise monetary policy? Well, financial conditions have been loose for a prolonged period, and volatility has been suppressed by excessive liquidity, but is that sustainable going ahead? Policymakers now see near-term risks are broadly balanced, with a greater policy focus on build-up of some financial stability risks. In particular, there appears to be pockets of vulnerability due to credit growth and balance sheet weakness and therefore, policy adjustments (part of "normalisation") are prudent in line with evolving macroeconomic picture. Should inflation pick up faster than expected, then policy normalisation could also be more hawkish than assumed by market players. With Jay Powell assuming Fed chair from Yellen, and a compositional tilt in the Fed board of governors, the gradualist approach to policy normalisation could also be affected.

Geopolitical risks will likely remain speed bumps

As US president Trump faces midterm elections in 2018, an event risk is if he loses the House to Democrats who in turn could open the way to kick-start an impeachment process. As a diversion tactic, US-China trade tensions could notch higher in 2018. Note that the US continued to deny China "market economy" status recently. Over in Europe, Italian elections are due by May and could see another hung parliament, albeit financial markets are not unduly perturbed at this juncture. In Asia, escalating tensions over North Korea remains a distinct if binary risk for now. With Singapore assuming the Asean chair in 2018, the advancement on the agenda on digital economy and trade facilitation would be key to watch as well, in addition to on-going RCEP and TPP-1 efforts.

China's economic transition still bears watching

While GDP growth clearly illustrates a soft economic landing for China, there remains substantial policy mis-step risks. Post-19th NPC, the focus on financial deleveraging and environmental policies ironically imply downside risks to growth. Financial de-leveraging is a long haul project for China. However, should China try to shorten the duration of battle too aggressively, it may create the growth shock to China and the region. As such, we suggest investors should pay careful attention to China's de-leveraging process, which could be source of the market volatility in 2018.

Benign macroeconomic fundamentals masks a choppy market ride for 2018

In summary, the global and regional growth prospects look stable, almost benign, but the converse is probably true for asset markets given the latter has had a very good run in 2017. With the monetary policy environment normalising, possibly faster than earlier assumed as inflation picks up, there could be some healthy corrections if not a time of reckoning for the "low for longer" mind-set that has dominated since 2007-08. So be prepared for a higher market volatility environment. Bond markets in particular, look potentially susceptible in 2018.

OCBC Asia GDP, CPI and Policy Rate Forecasts

GDP					
% chg year-on-year	2015	2016	2017F	2018F	2019F
US	2.6	1.6	2.2	2.5	2.1
Euro-zone	2.0	1.8	2.3	2.0	1.7
Japan	1.1	1.0	1.5	1.2	1.0
United Kingdom	2.2	1.8	1.5	1.4	1.6
New Zealand	3.2	3.6	2.7	3.0	2.7
Australia	2.4	2.5	2.3	2.8	2.9
China	6.9	6.7	6.8	6.5	6.3
Hong Kong	2.4	2.0	3.6	2.9	2.6
Taiwan	0.7	1.5	2.6	2.5	2.5
Indonesia	4.9	5.0	5.1	5.3	5.5
Malaysia	5.0	4.2	5.5	5.0	5.0
Philippines	6.1	6.9	6.6	6.6	6.7
Singapore	2.0	2.0	3.4	3.0	3.0
South Korea	2.8	2.8	3.5	3.0	3.0
Thailand	2.9	3.2	3.9	3.5	3.5
Vietnam	6.7	6.2	6.3	6.4	6.5

Inflation					
% chg year-on-year	2015	2016	2017F	2018F	2019F
US	0.1	1.3	2.1	2.1	2.2
Euro-zone	0.0	0.2	1.5	1.5	1.6
Japan	0.8	-0.1	0.5	0.8	1.0
United Kingdom	0.0	0.7	2.7	2.5	2.1
New Zealand	0.3	0.6	1.9	1.9	1.9
Australia	1.5	1.3	2.0	2.2	2.3
China	1.4	2.0	1.6	2.0	2.4
Hong Kong	3.0	2.4	1.5	2.0	2.4
Taiwan	-0.3	1.4	0.6	1.5	1.7
Indonesia	6.4	3.5	3.9	3.8	3.5
Malaysia	2.1	2.1	3.8	3.3	3.0
Philippines	1.4	1.8	3.2	3.4	3.4
Singapore	-0.5	-0.5	0.6	0.8	1.5
South Korea	0.7	1.3	1.9	2.0	2.3
Thailand	-0.9	0.2	0.7	1.4	1.6
Vietnam	0.6	4.7	4.5	5.5	4.1

Central Bank Policy Rate (%)					
	2015	**2016**	**2017F**	**2018F**	**2019F**
US Fed Funds rate	0.50	0.75	1.50	2.25	2.50
ECB refinance rate	0.05	0.00	0.00	0.00	0.25
BOJ policy rate	0.00	-0.10	-0.10	-0.10	0.00
BOE base rate	0.50	0.25	0.50	0.75	1.00
RBNZ cash rate	2.50	1.75	1.75	2.00	2.50
RBA cash target rate	2.00	1.50	1.50	1.75	2.25
China 1yr lending rate	4.35	4.35	4.35	4.35	4.35
Hong Kong base rate	0.75	1.00	1.75	2.50	2.75
CBRC discount rate	1.63	1.38	1.38	1.63	1.88
BI rate*	7.50	6.50	4.25	4.50	5.00
BNM overnight rate	3.05	3.00	3.00	3.25	3.75
BSP overnight reverse repo	4.00	3.00	3.00	3.50	4.00
Singapore 3-month SIBOR	1.19	0.97	1.25	1.55	1.95
BOK target overnight call	1.50	1.25	1.50	1.75	2.25
BOT repurchase rate	1.50	1.50	1.50	1.75	2.00
SBV base rate	9.00	9.00	9.00	9.00	9.00

* Indonesia changed to 7 day repo from 3Q16.

Source: OCBC Bank

Contents

CHINA

No Fatigue of Financial De-leveraging

The Chinese economy's GDP growth surprised the market on the upside in 2017, reaccelerating to 6.9% in the first three quarters from 6.7% in 2016, well above government's target of around 6.5% growth. The stronger than expected growth in 2017 was mainly attributable to two factors in our view, including supportive external demand and ongoing economic transformation from an investment driven economy to consumption economy. Those two positive elements helped to shrug off the negative impact of financial de-leveraging on the economy.

China's exports of goods under its balance of payments increased by 10.3% yoy in the first three quarters after the decline of 7.15% in 2016. As such, China's manufacturing sectors expanded for 16 consecutive months since August 2016 with the latest November PMI at 51.8. The upbeat manufacturing outlook also led to more investments in manufacturing sectors as well as increasing manufacturing output. Meanwhile, the imports of electronic integrated circuit increased by 13.8% yoy in the first eleven month of 2017, reversing the 0.3% year-on-year decline in 2016. Putting China's imports of electronic integrated circuit together with exports of electronic product data reported by Malaysia and Taiwan, it shows a synchronised recovery story in the region benefiting from the improving global demand for electronic products. This also signalled that the upward trend of global business cycle is likely to continue into 2018, which may be still supportive of China's exports next year.

Domestically, private consumption also continued to play an increasing role in China's growth. Private consumption's share to GDP growth has increased to 64.5% in the first three quarters of 2017 from 44.9% in 2010 while capital formation's share to GDP growth fell to 32.8% from 66.3% in the same period. The rising share of consumption is the key reason why China's economy has been more resilient than initially expected.

No imminent debt crisis

Both rating agencies Moody's and S&P had earlier downgraded China's sovereign credit rating citing debt concerns. Although on the aggregate level, China's total debt to GDP ratio is still lower than that in most advanced economy, the rapid increase of corporate debt to GDP ratio, which stood close to 170% at the end of 2016, is pretty alarming. As we mentioned in a separate report about China's to-do lists in 2018, we think de-leveraging efforts, especially corporate de-leveraging, will be one of the key focus in 2018. Nevertheless, we still see a low probability of imminent debt crisis in the next two years as the unique feature that more than half of corporate debt is owed by SOEs will give China some room for policy manoeuvring.

In addition, the PBoC also raised the medium term lending facility rate three times in February, April and December to remind investors that China will not lower the guard against the leverage.

As a result of financial de-leverage, China's broad money supply (M2) growth decelerated significantly to a low of 8.8% in October from 11.3% in 2016. Nevertheless, the growth of aggregate social financing remained largely stable in 2017, hovering around 13%. The widening gap between aggregate social financing growth and M2 growth tell market two stories. First, China's financial deleverage started to take effect but with lagging effect on the real economy. The sharp decline of M2 in 2017 is the result of financial de-leverage in our view as banks started to reduce their reliance on wholesale funding. Second, this also shows that China is facing the so called credit intensity problem, meaning that the same amount of credit generates less GDP growth. The increasing credit intensity suggests China will have to work harder to contain financial risk.

Although China's commitment to financial de-leverage is good for long term sustainable growth, the near-term shock to the market and economy has emerged. China's risk free interest rate shot up in 2017 due to concerns about financial tightening with 10-year government bond yield spiked to around 4% from around 3.06% in 2016. The rising volatility in China's bond market has led to the sharp decline of debt financing driving the funding demand back to bank's on-balance sheet lending as well as off-balance sheet trust loan. The surge of China's risk free interest rate may gradually weigh on growth outlook in 2018.

Will China follow Fed in rate hike cycle?

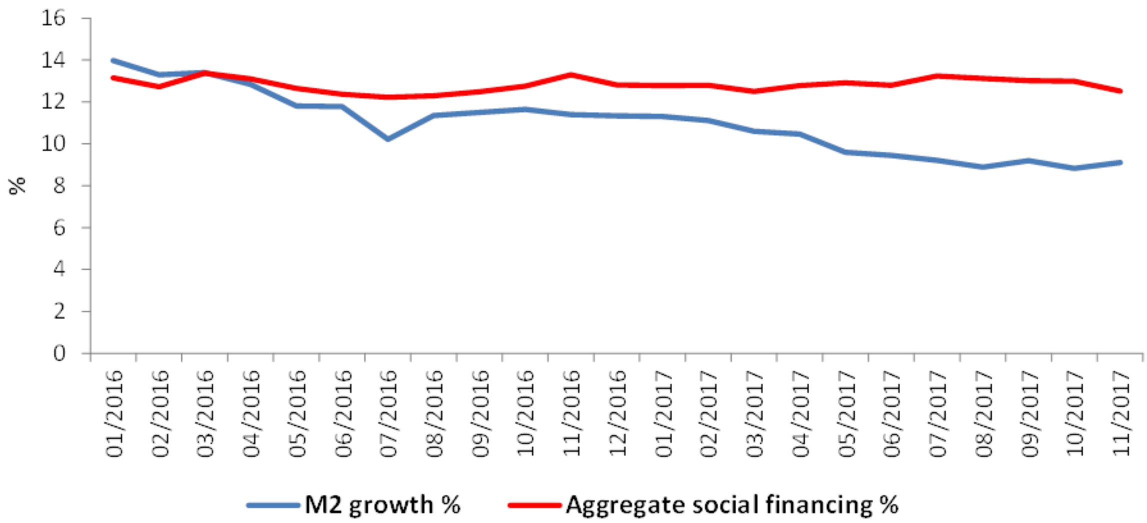
Same as most economies in the world, China's benchmark interest rates are also near the multi-decade lows. This could also be one of the reasons fuelling leverage activities. Meanwhile, South Korea has become the first major Asian economy to start its monetary policy normalization process and Malaysia is expected to follow suit in 2018. Will China also hike its interest rate to intensify its battle against the high leverage?

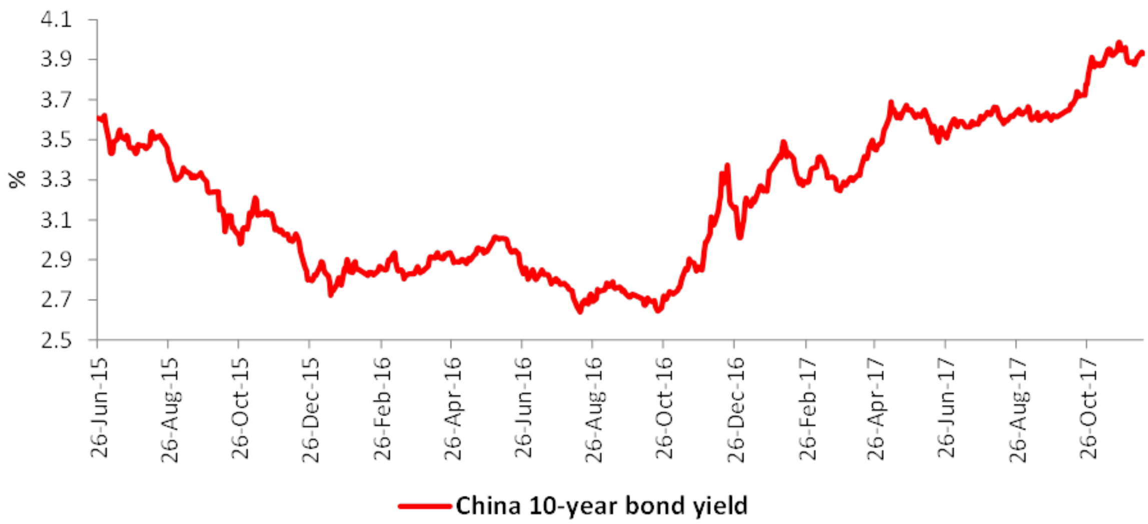
We think China may hike its interest rate in 2018 but not in form of the benchmark interest rate. China's central bank has expanded its monetary policy tools in the past few years with multiple interest rate tools in its toolbox. We think the high debt level is the key hurdle for China to hike its benchmark interest rate next year. Instead, China may consider continuing to adjust its money market rates higher to further press banks to deleverage while keeping the pressure away from the real economy.

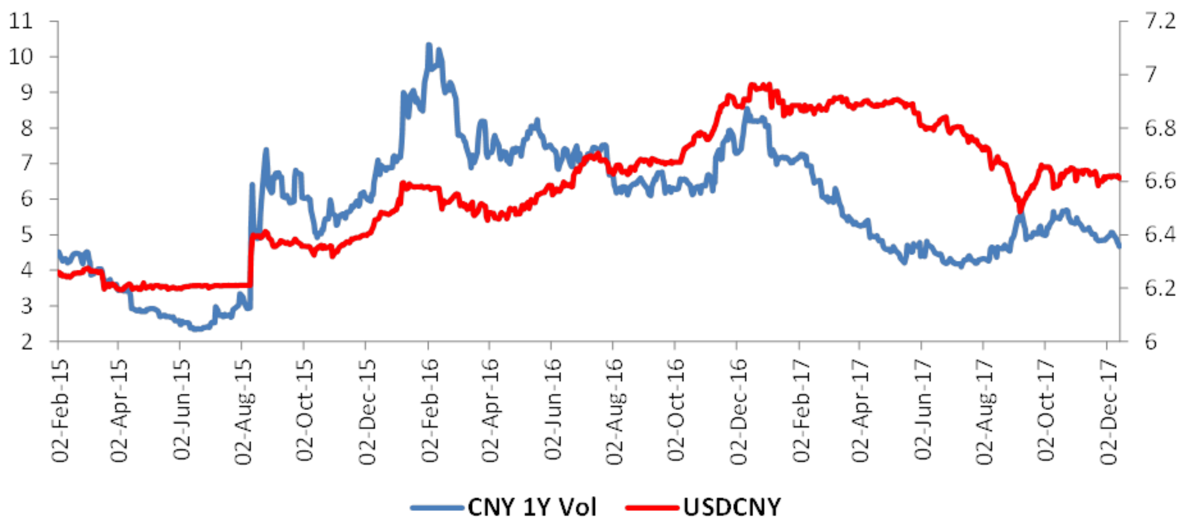
To conclude, although we expect external demand to remain supportive in 2018, we think the recent de-leverage policy together with environmental protection measures will weigh down growth outlook in 2018. Nevertheless, we expect the slowdown to be at a gradual and manageable pace in our base case scenario. As such, we expect China's growth to slow slightly to 6.5% in 2018 from estimated 6.8% in 2017.

Having said that, financial de-leverage is a long haul project for China. However, should China try to shorten the duration of battle too aggressively, it may create the growth shock to China and the region. China shows no sign of fatigue in financial de-leverage. Since November, China has unveiled two drafted rules including one on asset management products and one on bank's liquidity supervision. The asset management products rule aims to break the implicit guarantee while new liquidity ratios introduced by China's banking regulator are designed to contain liquidity risk. Although both rules propose the grace period to the market, it may still lead to an unwinding of assets should the market be concerned that the grace period is not long enough. As such, we think global investors should pay careful attention to China's de-leveraging process, which could be source of the market volatility.

Last but not least, we expect RMB to take a backseat in 2018. The introduction of the counter cyclical factor in May 2017 was clearly a game changer to RMB as it helped the PBoC take some discretionary power back for daily fixing setting. As China is likely to concentrate on financial de-leverage in 2018, we expect China to hold on any major currency reform next year. As such, with the help of the counter cyclical factor, we expect RMB to be the function of broad dollar movement in 2018. We expect the USDCNY to be traded in the range between 6.5-6.9 in 2018.







Source: OCBC Bank, Bloomberg

HONG KONG

Benefiting from Global Recovery

As the low base effects faded, GDP growth peaked in 1Q 2017 and slowed down gradually in the aftermath. However, the pace of deceleration has been much softer than we previously expected. The economy's rosy performance was mainly driven by global recovery, solid labour market and domestic fiscal stimulus.

Externally, improved external demand has continued to underpin Asia's exports, including HK's overseas shipments. Better-than-expected growth of China in the second half of 2017 has supported the recovery of tourism sector. Also, Mainland companies shifting their funding demand to the overseas market and the financing needs associated with the Belt and Road initiative together have supported HK's financial sector.

Internally, sizeable fiscal reserves allowed the government to sustain growth in public investment and spending. Furthermore, domestic consumption has remained resilient given a solid labour market and wealth effect from both stock market and property market. Therefore, we have revised our GDP forecast to 3.6% yoy for 2017.

External supports may sustain

Against the backdrop of global recovery, HK's exports have expanded for nine consecutive months in October and were up by 8.5% yoy over the first ten months of 2017. Specifically, exports to the Mainland China, Japan, Taiwan and Vietnam all have increased consecutively since February 2017. By commodity, exports and imports of electrical machinery, apparatus and appliances, and electrical parts have risen for 19 and 20 consecutive months respectively. Meanwhile, China's imports and Southeast Asia's exports of similar commodity expanded substantially. The entire electronic value chain and the manufacturing activities in Asia may continue to benefit from global recovery. Therefore, we expect Asia's exports to remain supported in the near term. Robust trade activities (total exports of goods jumped by 5.5% yoy in 3Q 2017) are expected to fuel further economic growth in the coming year. Therefore, trade and cargo flows may also sustain the vibrancy.

On the other hand, despite the deleveraging campaign and environmental policy, China's growth slowed down at a much milder pace than we previously expected in the second half of 2017. As a result, HK's tourism sector recovered gradually with visitor arrivals increasing by 2.2% yoy over the first nine months of 2017 (mainland visitors rose by 2.5% yoy). During the same period, retail sales rebounded by 0.9% yoy after sliding consecutively in the past three years. Therefore, growth in exports of services accelerated to 3.7% yoy in 3Q 2017 from 2.6% in 2Q 2017.

Furthermore, loans for use outside of HK expanded for the eleventh straight month in October 2017. Given concerns about China's intensifying de-leveraging campaign and year-end effect, onshore liquidity got tighter. Adding on strong financing needs associated with the Belt and Road Initiative and loosened policy on overseas financing of Mainland companies, we expect growth of loans for use outside of HK to stabilize in coming months. Elsewhere, the Belt and Road Initiative and the upcoming launch of cross-border investment schemes like ETF connect will help to enhance Hong Kong's role as the largest offshore Renminbi centre. Apart from financial services, Hong Kong's economy will be able to benefit further from the Belt and Road Initiative by exporting professional services, high value- added shipping services, tourism services, and convention and exhibition services to the countries along the new silk road.

Domestic consumption and public investment held up well

Domestic consumption (+6.7% yoy in 3Q 2017) has strengthened amid a solid labour market and wealth effect from the rising stock market and housing market. On the one hand, unemployment rate decreased to its lowest since early 1998 at 3.0% yoy for the three months through October 2017, as recovery across major sectors boosted hiring sentiments. Meanwhile, real indices of payroll have increased for 10 straight quarters and were up by 1.7% yoy in 2Q 2017. On the other hand, Hang Seng Index and secondary housing price index rose by more than 30% and 11.4% respectively as compared to end of 2016. Moving forward, the labour market is set to remain tight and wage growth is likely to pick up pace on domestic growth. As such, domestic consumption is expected to hold up well in the coming quarters.

In terms of public spending and investment, it remained strong on the back of a sizeable fiscal reserve (HK$935.7 billion for 2016/17, the highest in nine years). Over the first eleven months of 2017, the value of housing transactions totalled HK$504.4 billion, reaching its highest level since 2010. This signals that the stamp duty from housing transactions could continue to be substantial for the fiscal year of 2017/18. Furthermore, the proceeds from land sales reached HK$90.682 billion during April 2017 to November 2017 after registering HK$109.5 billion in the preceding fiscal year. As such, for the year of 2018, we expect public spending (+4.1% yoy in 3Q 2017) and investment (public investment in building and construction rose by 12.3% yoy) to remain vigorous.

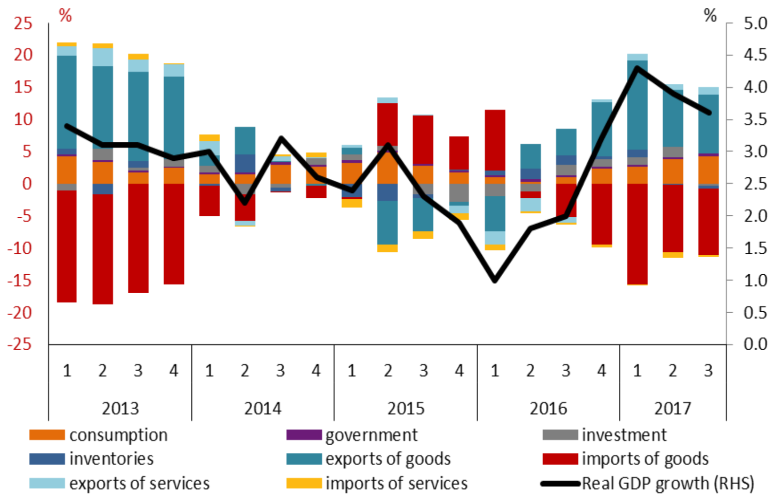
Elsewhere, the ultra-low interest rates and global recovery have encouraged companies to borrow. As a result, total loans and advances have marked nine months of double-digit annual growth. However, robust loan growth did not translate into higher corporate spending. Due to global uncertainties, corporate seemed reluctant to increase spending as expenditure on machinery, equipment and intellectual property products fell by 6% yoy in 3Q 2017 after a 4.7% yoy gain in 2Q 2017. Property developers also slowed down new home constructions amid fears of housing correction. Private investment in building and construction merely rose by 0.5% yoy in 3Q 2017 (versus a 4.8% increase in the previous quarter). Moving forward, should inflationary risks intensify and prompt more central banks to tighten their monetary policy, the resultant increase in borrowing costs may further curb private investment. On a positive note, new government proposes to implement a two-tier corporate tax system, which hopefully can encourage small to medium-sized enterprises as well as the start-ups to increase spending and push wage growth.

Looking forward to the new growth engine

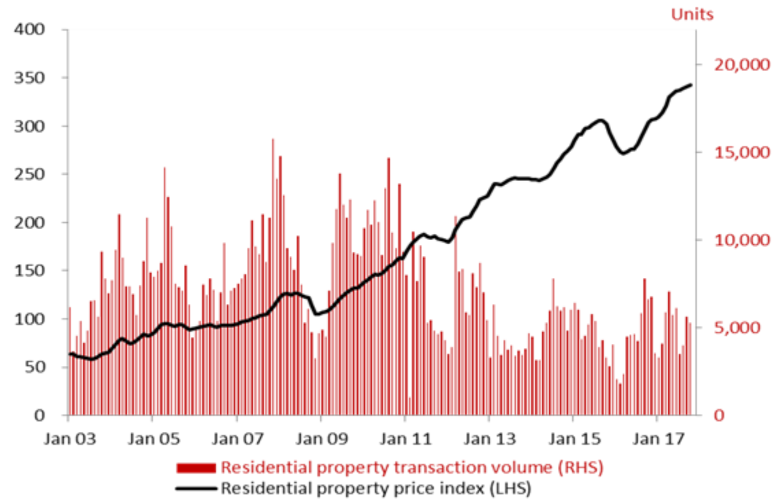
The new government places great emphasis on the innovation and technology industry, in an effort to diversify HK's economy. The proposed tax reduction for and the additional investment in the innovation and technology industry may boost the industry's growth. Meanwhile, the government aims to promote innovation and technology development by participating in the development of the Greater Bay Area. As China is also aiming to optimize the industrial structure according to the 13th Five-Year plan, we believe that Hong Kong's strong research capability and large talent pool will facilitate its co-operation with Mainland China in terms of innovation and technology. This will in turn buoy growth of the Greater Bay Area.

All in all, we expect external factors to continue supporting export of goods and tourism recovery. Tight labour market and fiscal stimulus will also keep private consumption as well as government spending and investment elevated respectively. Therefore, despite unfavourable base effect in 4Q, we have revised our GDP growth forecast to 3.6% yoy for 2017. This will be the strongest growth since 2011. In the coming years, economic growth is likely to sustain albeit at a slower pace due to high base effect. We will also continue to monitor external uncertainties including the rise of protectionism, which will hit trade activities, and global monetary tightening, which may curb private investment. We expect GDP to expand by 2.9% yoy in 2018.

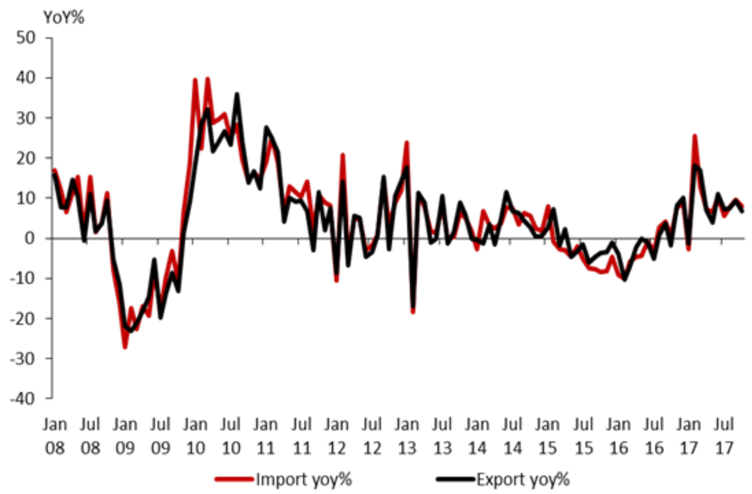
Hong Kong GDP Growth



Residential Property Price & Transaction



HK Trade Activities



Source: Census and Statistics Department, Land Registry, Rating and Valuation Department

INDONESIA

Platform for Growth

2017 proved to be a largely benign year for Asia, with key economies printing better than expected growth rates amidst an improvement in their external trade sector, domestic consumption, or both. However, this favourable environment appeared to pass Indonesia by. Third quarter GDP growth came in at 5.06%, marginally higher than the 5.01% in the first and second quarters. While this is a strong number in absolute terms, it failed to excite observers, who expected much more from the largest economy in Southeast Asia. 2018, on the other hand, promises to be more optimistic. We take this opportunity to take stock of a rather flat year for Indonesia, and gauge whether the platform for growth is well-established for 2018.

Insipid outcomes looking for catalysts

Overall growth data has been essentially straightjacketed between 5.0% and 5.1% yoy, with shifts largely confined to the second decimal place. Hardly much reason to be overly agitated about moves either way. In a similar way, the largest component of GDP, private consumption, has seen its growth rate bounded by 4.9% and 5.0%. Growth in government spending and investment were also nothing to shout home about. External trade, however, had a stellar year. Export growth this year averaged 18.5% yoy, undoubtedly buoyed by a secular improvement in global economic growth. However, this was matched by a 16.0% yoy improvement in imports. Overall, this limited external trade's contribution to overall GDP growth.

In the midst of these uninspiring outcomes, we note a shift in sentiments. A read of the government's 2018 budget plan reveals that the GDP growth estimate is set at 5.4%. First reactions suggest that this figure is some distance higher than recent outcomes, and may be a tad too optimistic, However, the respected Finance Minister Sri Mulyani has called the plan "neither too optimistic nor pessimistic". This begs us to examine the basis of the government's confidence. To hit this growth target in 2018, private consumption growth will have to break through its recent cap of 5.0%, and investment growth will have to pick up strongly. At this point, the prospects for both look bright, and they may be the required catalysts to bring GDP growth to a higher level.

That private consumption growth is still so anaemic is somewhat curious. We note that a number of leading indicators for household spending have been picking up consistently across 2016 and 2017. For example, the Consumer Confidence Index has been trending higher since recording a low of 97.5 in September 2015, and reached a recent high at 123.8 in September 2017. New consumer loan approvals have also bottomed at the start of 2017, and picked up as the year progressed. Lower borrowing costs, as the two rate cuts by Bank Indonesia (BI) gets transmitted through the commercial banks, should also provide support for consumer credit. In addition, muted price pressures have also helped consumers retain their purchasing power. Therefore, the preconditions for an acceleration of private consumption appear to be in place. The wait for consumers to loosen their purse strings further may not be much longer

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On the investment front, we note that government support for public infrastructure projects have been strong. Putting the money where their mouth is, the infrastructure budget for 2018 will be raised to IDR404t, which is 4.2% higher than the IDR387.7t allocated in 2017. General investment climate has also improved, with the government taking steps to reduce red tape and making it easier for private investors to obtain different licenses and approvals. This should provide the encouragement for private sector to step up their investment activities. In reality, nascent results in this front may already be visible in third quarter growth figures, with investment growth coming in at 7.11% yoy, significantly higher than the 4-5% range it was residing in previously. This should set the platform for continued growth in the fourth quarter, and into 2018.
Taken together, we expect upticks in domestic consumption and investment growth to be the catalysts in pushing overall GDP growth to a higher plane.

Muted price pressures may make BI's position difficult
As in most economies, the inflation in Indonesia remains muted. After hitting a high of 4.37% yoy in June, headline inflation has moderated to 3.58% yoy in October, closing in on the lower bound of BI's tolerance range. Similarly, core inflation stands at 3.07% yoy, near historical lows. Looking forward, looser monetary policy following BI's two surprise cuts may provide some support for price levels. However, it remains difficult to see a structural impetus for markedly stronger inflationary pressures at this point.

The BI held rates constant for most of 2017, before surprising the markets with two cuts in August and September. It has since reverted to a holding stance. Moderating inflationary pressures will give justification for the BI if it chooses to cut rates further, but official willingness to re-engage an easing bias seemed to be missing. Official rhetoric from BI leaders in successive speeches since the September cut has been that the current policy rate, at 4.25%, is sufficient to keep inflation within the target band, and that the space for further cuts are limited. Moving forward, expect the BI to use alternative tools, such as macro-prudential and liquidity measures, to support the economy. Indeed, Governor Agus Martowardojo has recently extended the looser reserve requirements to Islamic banks and non-IDR deposits, and hinted further easing of reserve requirements in 2018.

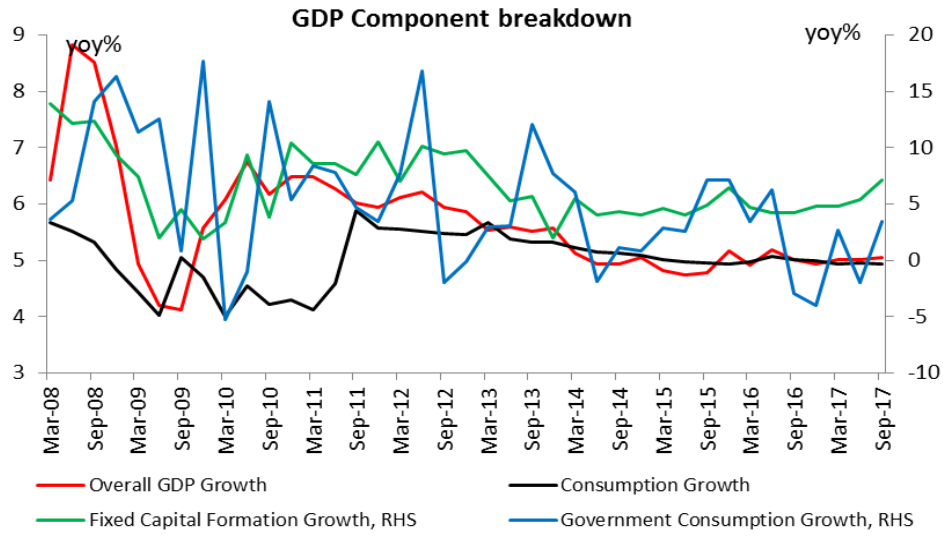
In line with official rhetoric, we expect the BI to remain on hold in December, and also into the first quarter of 2018. Real long-end interest rates in Indonesia remains in the middle of its range, leaving little impetus for the BI for cut further in the near term. However, the picture may get hazier as the year progresses, especially if the domestic and external conditions diverge.

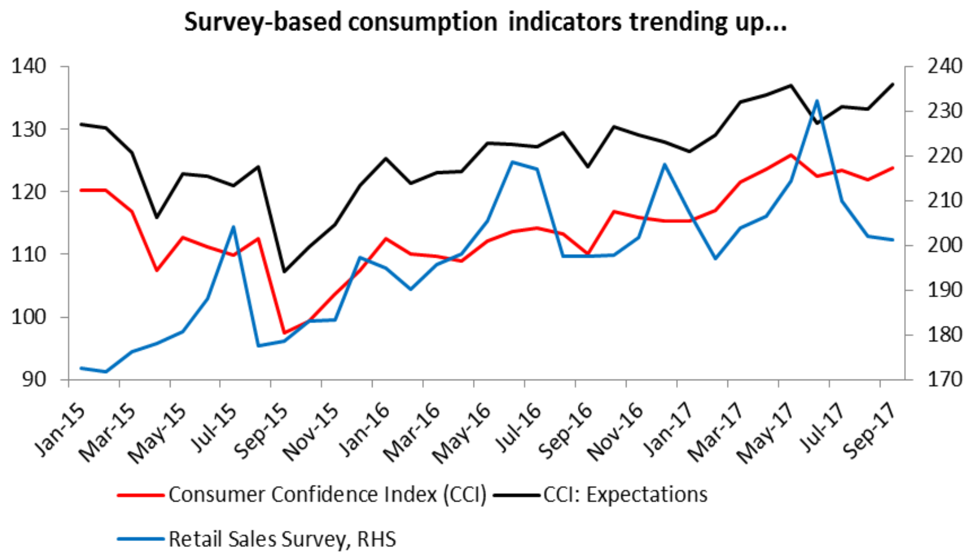
From the domestic perspective, we note that certain quarters of the establishment appear to favour a still lower policy rate. Persistently muted inflation will provides the ammunition to call for further cuts. It remains to be seen whether attempts to lift overall growth will be effective. If indicators of economic activity do not pick up early in 2018, a situation where the BI is subtly pressured to cut further might arise.

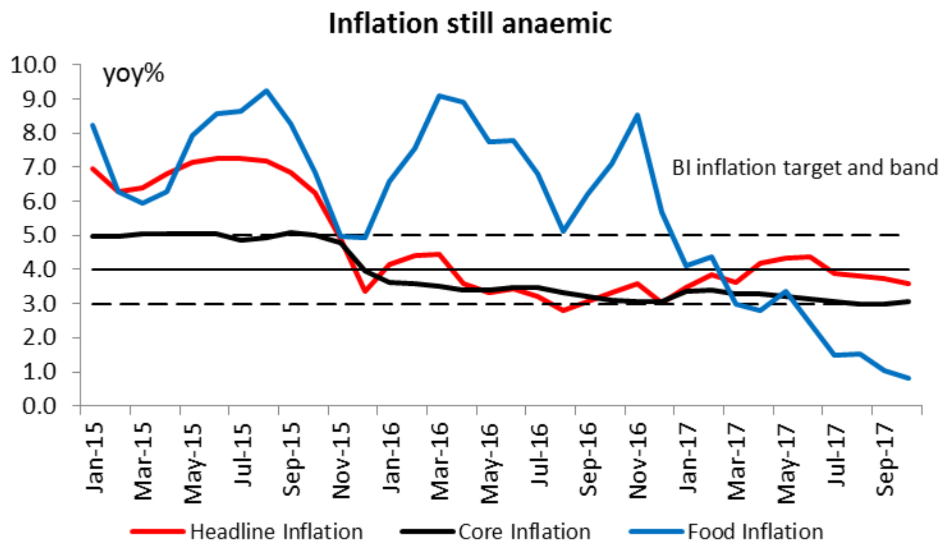
On the other hand, the global monetary environment may undergo a shift next year, with major central banks stepping up the reduction of their monetary accommodation, or even switching to outright tightening. Asian central banks may be forced to follow suit. The Bank of Korea has already made the first move, with a 25 bps hike in November. The Bank Negara Malaysia (BNM) has also hinted at a rate hike with the subtle comment that it is "reviewing the current degree of monetary accommodation". Couple that with established hawkish expectations for the Bangko Sentral ng Pilipinas (BSP), a round of monetary policy tightening in Asia may be seen in 2018. Thus, the BI may be pressured to follow suit, though we expect pressures on this front to pick up mostly in the second half. On the balance, we believe the policy rate may end 2018 higher at 4.50%.

Conclusion

Indonesia has been the relative laggard in terms of economic growth this year. However, we remain cautiously optimistic about its ability to average a 5.3% yoy growth for 2018, a tad lower than the government's 5.4% target. For this to take place, we need private consumption growth and investment growth to come in higher. At this stage, we believe the preconditions for these indicators to pick up are present. On the other hand, without structural impetus for significantly higher price pressures, we expect inflation to muddle along near current levels, averaging 3.8% for 2018.







Source: Bloomberg, OCBC Bank

KOREA

Fiscal Policies to Support Growth

Geopolitics risks cloud healthy fundamentals

On the surface, Korea's fundamentals appear to be rosy and nice. According to the latest growth print, South Korea's economy grew at its fastest pace since 2010 in 3Q17, led by strong exports and the government's supplementary budget. Growth expanded by 3.6% y/y (+1.4% q/q sa), surprising market expectations for a 3.0% growth (OCBC est: +3.1% y/y). Accounting for 3Q17 growth, Korea's economy has grown an average of 3.1% in the first nine months of this year, a tat higher than BOK's recent growth upgrade to full-year's growth of 3.0% in its last October MPC meeting.

Notably, Korea's external environment has been a key support to overall growth. Export growth has constantly been in the double-digit growth print for the most of the year, with Nov's exports printing a relatively strong 9.6% on-year growth. The uptick in external demand has been supported by overseas demand for semiconductors, steel and petrochemical products. Elsewhere, government expenditure grew 4.6% y/y in 3Q17, the fastest pace since 1Q16 while private investment growth sustained at double-digit zone (+10.1%). With the favourable indicators of late, it is of no surprise that Korea is the first Asian economy that triggered a rate hike at its latest meeting.

Barring any further escalation in geopolitical tensions in the Korean Peninsula, we had upgraded our 2017 growth outlook to 3.5% (up from 3.0%) in November. The upgraded growth outlook is underpinned by the strong performance in the first three quarters of 2017 and a relatively lower base in 4Q16 (GDP grew at 2.4% in 4Q16, slowest since 2Q15). Growth is likely to be supported by the ongoing expansion in Korea's external environment, which in turn is expected to inject positive spillover effects into Korea's manufacturing and employment space.

There's a time and tide for everything

Despite the upgrade in growth outlook, we remain relatively cautious looking into 2018. Against other Asian economies, S. Korea (and arguably Japan as well) may have pronounced geopolitical risks into the next year. Geopolitical aggression especially from North Korea has remain to be one of market-watchers' key concerns this year, which has dampened economic confidence and dissuaded portfolio inflows at least in the first 10 months of the year.

Geopolitical risks have continued to take its toll. The late recovery of Korea's manufacturing Purchasing Managers Index (PMI) across key Asian markets to above 50.0 suggests that Korea's manufacturing environment remains to be a laggard across most Asian economies. In addition, Bank of Korea's forward-looking Business Confidence Indicator (BSI) for the manufacturing sector fell to 79.0 in October, down from 83.0. As a result, the indicator now sits further below the critical 100.0 point threshold, suggesting that the majority of businesses still remain pessimistic despite the uptick in export growth.

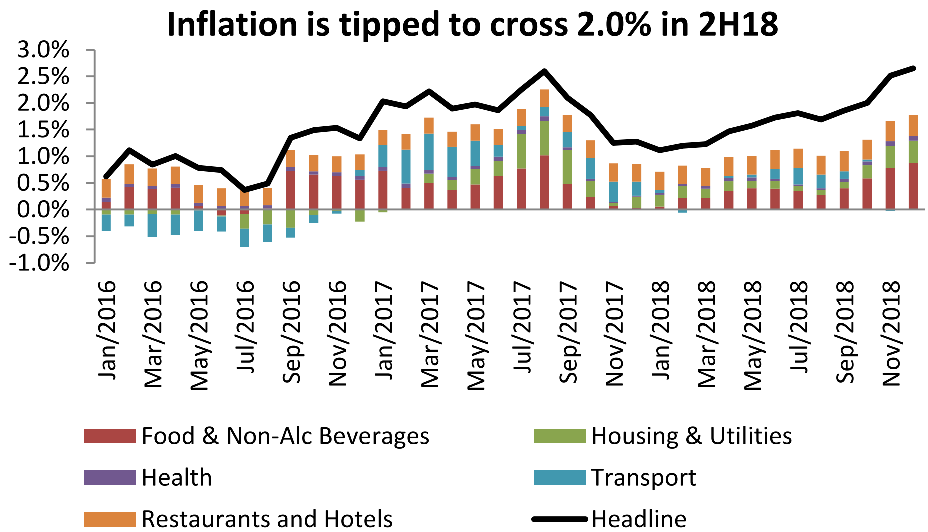
Even so, despite the strong external environment seen of late, export growth has slowed from its double-digit growth print in November (although it remains relatively strong at 9.6% y/y). The strong export momentum this year would serve as a high base for subsequent export momentum as well, which could see headline growth taper into 2018. The high base effect would also be felt for industrial production as well, noting that October's IP print has been rather disappointing at -5.9% y/y.

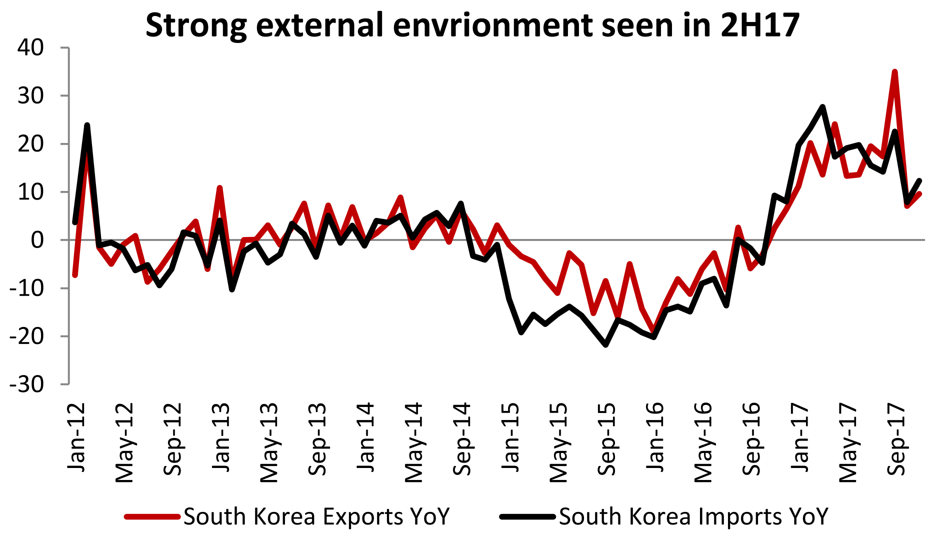
Domestically, it is not all hunky dory as well; household debt remain to be one of market-watchers' key concerns as well. On the surface, Korea's household consumption continued to accelerate to 2.5% in 3Q17, the highest growth print in a year. However, the rise in domestic consumption also coincided with a continued rise in Korea's household indebtedness which rose to record high of KRW1,419 trillion (or US$1.3 trillion) in 3Q17. On this issue, Bank of Korea identified the government's easing of regulatory measures on housing loans since 2014 as the main reason behind the rising indebtedness. High household debt introduces two key risks into 2018: (1) it could potentially stifle future household spending and (2) could present relative policy paralysis for policy-makers; a rate hike may further burden household debt serviceability while a rate cut could persuade households to chock up more unnecessary debt to finance consumption.

Of course, fiscal policy will be key in supporting economic growth into next year. According to plan, Korean President Moon Jae-in's administration plans to increase spending by an average of 5.8% y/y over the next five year. More importantly, a total of KRW429 trillion ($380 billion) of expenditure is planned into 2018 to boost welfare benefits and raise the number and quality of jobs, according to the 2018 Budget. In fact, the budget proposal is 7.1% more compared to the initial plan for this year, and the biggest jump in spending since 2009. Despite the rise in spending, fiscal deficit is also expected to be around 2.0% while government debt is to stay manageable at around 40% of GDP over the next five years.

It pays to be cautiously optimistic

We admit that we were not huge fans of the recent BOK rate hike decision in late November. We agree that growth fundamentals have indeed improved; the positive growth in external demand has also gradually transmitted into benefitting Korea's domestic economy. While we still keep to our 2017 growth outlook at 3.5% (we previously upgraded growth from 3.0% on 26th Oct), the decision to hike rates further cements our view for growth to moderate into 2018. Korea would have to contend with a (1) relatively higher growth base, (2) a relatively tighter monetary environment, (3) potentially sustained geopolitical uncertainty and (4) high household debts into the next year. Accounting for these factors, we pencil Korea's 2018 growth to print 3.0%, while inflationary pressures are estimated to stay tame at ~2.0% into next year.





Source: OCBC Bank, CEIC, Bloomberg

MACAU

Moderate Growth for Coming Years

What a rosy year for the gambling hub! China's resilient economic growth has helped to encourage the return of genuine VIP demand. Junket operators continued to offer credit extensions to the high rollers, in turn further fuelling growth in VIP revenue. Therefore, the VIP segment remained the main contributor to gaming growth so far in 2017. On the other hand, tourism momentum sustained on the back of Asia's recovery. However, the relatively low betting amount of leisure gamblers resulted in a rather benign growth in mass-market revenue. In the longer term, we doubt the sustainability of VIP revenue growth as the segment is vulnerable to both policy risk and liquidity risk. Liquidity risk may intensify with more central banks to tighten the monetary policy in the coming years. Despite that, we remain optimistic about gaming sector's outlook as mass-market segment will likely further benefit from Asia's recovery and the expansion of China's middle-class, given upcoming completion of Hong Kong-Zhuhai-Macau Bridge and a slew of new project openings in years ahead. Nonetheless, gaming growth driven by mass-market improvement is likely to be less robust than that fuelled by VIP demand. All in all, we have revised our GDP growth forecast to 8%-10% for 2017. For 2018, our GDP growth forecast is 7% as economy growth may moderate gradually in coming years.

Wary of the unsustainability of VIP revenue growth

Gross gaming revenue expanded by 21.8% yoy in 3Q 2017, a tad slower than a 21.9% yoy increase in the previous quarter. VIP segment remained the main driver of the gaming sector's growth with its revenue surging by 35% yoy in 3Q 2017 and its share rallying to 57.74% (the highest level since 1Q 2015). The return of VIP demand was mainly driven by China's resilient economic growth and junket operators' credit extensions. This reinforces that the impact of China's anti-corruption campaign has been waning. We expect VIP growth to remain robust in the near term.

However, Macau regulators plan to start tightening the standards for junket-related business in January 2018 when they review applications for new and renewed licenses. In a longer term, policy risks regarding anti-money laundering will remain to threaten the sustainability of VIP growth. Also, high rollers' increasing demand fuelled by credit may render the VIP segment vulnerable to liquidity risk in the run-up to global monetary tightening. Therefore, we remain wary of the unsustainability of VIP revenue growth.

Long-term gaming growth may hinge on the mass-market segment

Mass-market revenue grew at a softer pace by 6.7% yoy in 3Q 2017 and its share in total gaming revenue dipped to 37.45% (the lowest level since 1Q 2015). In 3Q 2017, the mass-market segment took a brief hit as two typhoons scared tourists away from the gambling hub. After that, the number of visitor arrivals increased by 11.6% yoy during the golden week and continue to grow post-holiday. Therefore, the return of leisure gamblers have lent supports to the mass-market segment in October 2017. Still, the relatively low betting amount of leisure gamblers has capped the growth in mass-market revenue. As the government has capped growth in gaming tables, this also constrains the growth in mass-market segment. More notably, though tourism activities sustained the momentum, the sector showed limited upside due to three reasons. First, tourists might have refrained from revisiting amid high accommodation costs and high transportation costs. Second, as the opening date of a mega project is rescheduled from 2H 2017 to 1Q 2018 due to bad weather, the incentive for re-visitation waned. Tourists from Hong Kong and Taiwan decreased for the sixth and fifth consecutive month by 9.4% yoy and 2.1% yoy respectively in October 2017. Besides, hotels guests from Hong Kong and Taiwan decreased for the fourth and third consecutive month by 29.4% and 1.4% respectively on a yearly basis in October 2017. As such, moderate improvement in tourism has not lent much support to the mass-market segment. Still, given the rosy picture painted by the gaming sector, we have adjusted our forecast on gaming revenue growth to 19% for 2017.

As VIP growth is likely to be unsustainable, we expect long-term gaming growth to hinge more on the mass-market segment. Moving forward to the coming years, with the completion of Hong Kong-Zhuhai-Macau Bridge and the opening of new mega entertainment projects, tourism sector and the mass-market segment are expected to benefit from Asia's growth and China's expanding middle-class. Still, gaming growth led by mass-market segment may be slower than that driven by high rollers. Adding to a high base effect, we opine that gaming revenue growth will decelerate to 10%-15% yoy in 2018.

Retail sector to improve albeit at a slow pace

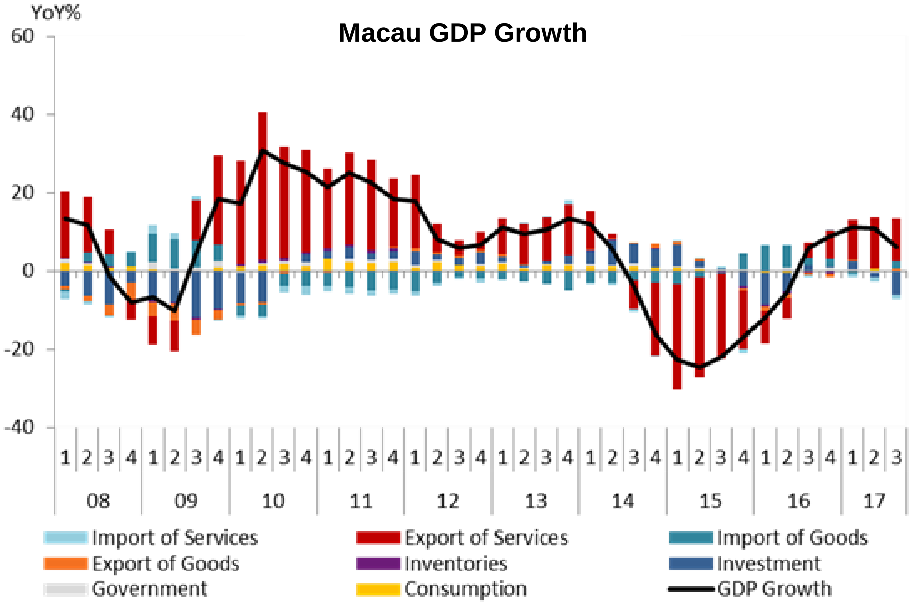
Retail sales rose for the fourth consecutive quarter and edged up at its strongest pace since 4Q 2013 by 14.9% yoy in 3Q 2017. This is mainly led by the five consecutive quarters of annual growth in total visitor spending (+8.8% yoy in 3Q 2017). Specifically, sales of goods in department stores, luxury goods, adults' clothing increased by 17.3% yoy, 16.6% yoy and 20.4% respectively. Growth in per-capita spending of visitors from Taiwan, Japan and Hong Kong returned to positive territory and printed 2.1% yoy, 10.4% yoy and 1.5% yoy respectively. Also, per-capita spending of visitors from Mainland China increased for the fifth straight month by 4.6% yoy. Asia's resilient growth may continue to support Macau's tourism and retail sector in 2018. However, retail sector's growth may moderate due to high base effect.

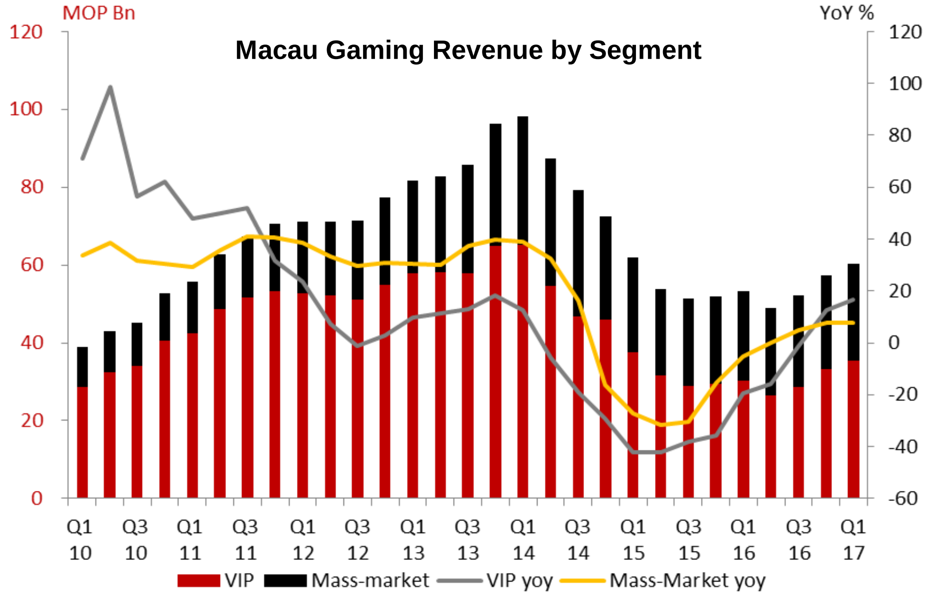
Housing market to remain stable

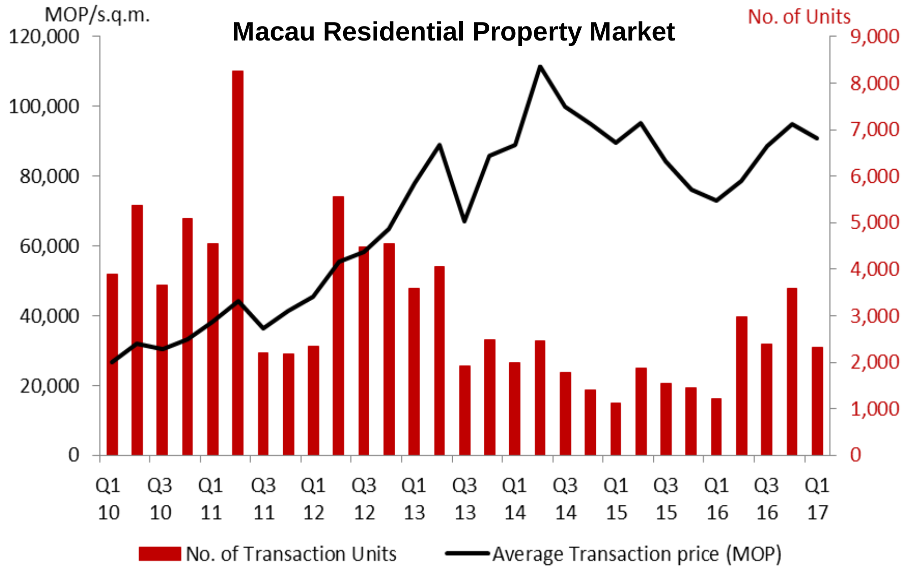
Housing transactions and approved new mortgage loans both dropped for the second consecutive month in September 2017 and were down by 24.3% yoy and 47.5% yoy to 665 deals and MOP2.81 billion respectively. A quite housing market was due to new cooling measures and tepid investment sentiment following two typhoons. However, due to high new home prices, average housing prices rose by 6% mom or 22.9% yoy to MOP100,487/sq. m..

Moving forward, we note that housing completions surged by 1205% yoy during the first nine months of 2017. With more new home projects launched successively from late September 2017 onwards, we expect to see a rebound in housing transactions in the primary market, supported by stable labour market and rosy performance of domestic economy. In comparison, cooling measures and prospects for higher rates may continue to curb secondary housing demand. Therefore, average housing price is expected to oscillate around MOP100,000 per square meter in the near term.

In the longer term, new home supply is unlikely to grow substantially as housing starts slid by 16% yoy during the first nine months of 2017 after falling by 6% yoy in 2016. Also, public housing will remain in short supply in the coming years. Specifically, the government plans to build around 9,500 public housing units in the short-to-medium term, 3,100 fewer than that proposed in 2016. Therefore, despite higher rates which could weigh down demand, housing market may still be able to grow moderately (against the backdrop of gaming recovery and a stable labour market) in the coming years. With regard to the leasing market, fewer non-local workers chose to reside in Macau. This results in lower housing rentals. Upon the completion of Hong Kong-Zhuhai-Macau Bridge, we expect improvement in transport infrastructure will help to attract some immigrants to live in Macau and in turn pose renewed upward pressure to the housing rentals in the longer term.







Source: DSEC, DICJ

MALAYSIA

The Need to Stay Vigilant

Economic momentum has improved in the first three quarters of 2017. Recent growth data in 3Q17 surprised higher at 6.2% y/y (+1.8% q/qsa) versus market expectations at 5.7% y/y (+1.1% q/qsa). This marks Malaysia's fastest year-on-year growth since 2Q14, suggesting that growth stays underpinned by the pickup in global trade activities which consequently added positive spill-over effects into its domestic environment. This is seen especially in the thriving manufacturing sector, which subsequently led to a relatively tighter labour market and higher wages. Given the strong performance in the third quarter, growth is likely to come close to the upper range of the official projection of between 5.2 – 5.7% this year. The pick-up in economic activities did not come without higher inflationary pressures; domestic prices continued to rise into 4Q17, underpinned by increases in transport cost as well as higher prices for food and non-alcoholic beverages. Moreover, the uptick in domestic demand is evident to-date, and will likely drive demand-pull inflation higher into the rest of 2017. As such, headline inflation will also likely average at the upper-end of the official forecast range of 3 – 4% for this year.

Three key factors: Crude oil, trade activities and domestic demand

Into 2018, Malaysia's economic prospect should continue to gain traction as it benefits from a favourable external environment. Meanwhile, Malaysia's status as a net-exporter of crude oil will also provide the needed impetus for growth especially on higher oil prices into 2018. Elsewhere, the recent 2018 Budget passed on 27th October has been seen as expansionary for growth and domestic consumption.

According to the World Trade Organisation (WTO), growth in global merchandise trade volume was upgraded to 3.6% for 2017 (up from a mere 2.4%), although trade growth could moderate slightly lower to 3.2%. Malaysia, including many of its peers in Asia, will stand to benefit on sustained trade growth for the next year given its reliance on trade (total trade accounts for 139% of Malaysia's GDP). As seen since the latter part of 2017, the stronger trade environment has resulted in a positive spill-over effect into Malaysia's domestic environment, including manufacturing, consumption and investment spending. This transmission effect from trade to Malaysia's domestic economy should sustain into 2018 as global trade growth stays buoyant; a relatively healthier labour market and better business conditions should lift both domestic demand and investment spending into the next year.

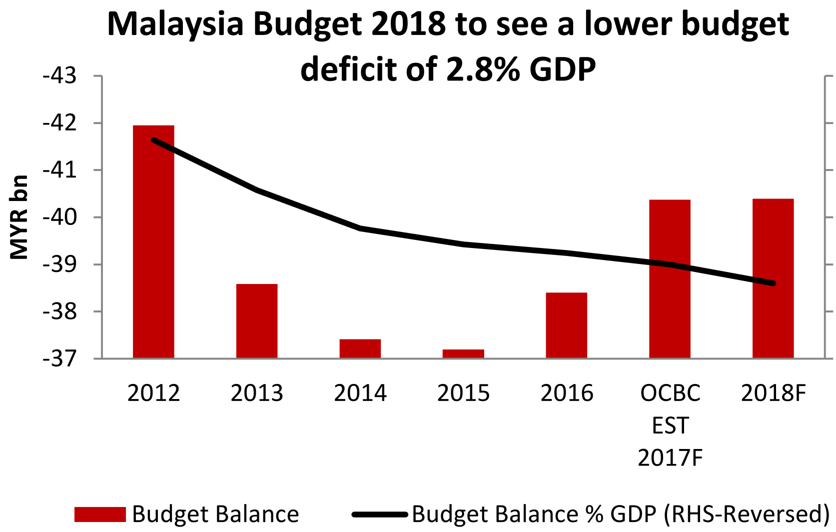
In the same vein, further growth traction to be seen into the next year would also spur risk-taking behaviour and benefit growth-related commodities especially crude oil. The first-order effect from rising oil prices has already been observed in the widening current account surplus, which has cascaded down to stronger energy-related industries & its equities, government revenue receipts and wages in related fields. Note that crude oil and related mineral fuel trade accounts for the second largest export group in Malaysia, with a value of MYR123.3bn (or 13.6% of total exports) in the past twelve months since Sept 2017. Moreover, the manufacturing of petroleum and its related mining activities accounted for over 18% of GDP back in 2011, before fading to around 15% in recent quarters given lower oil prices. As such, in the light of higher oil prices to-date, Malaysia's total trade surplus has grown by a strong 16.4% in the first nine months of this year over the same period last year. With higher crude oil prices seen to-date, Malaysia's growth prospect should invariably improve given its status as a net-exporter of crude oil.

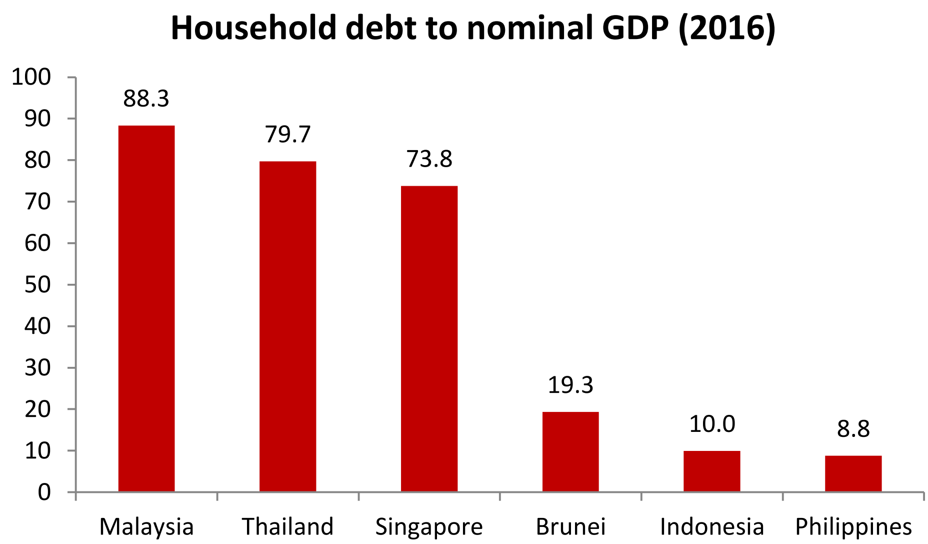
To further prop economic growth into 2018, the 2018 Budget announced on 27th October is seen to be expansionary for economic growth while keeping fiscally prudent. Budget 2018 boasts a record high allocation of MYR280.2bn (up from MYR260bn in 2017) while budget deficit is slated to narrow further to 2.8% as a percentage of GDP. A total of MYR234.2bn (83.5% of total budget) will be allocated towards operating expenses, while MYR46.1bn will be dedicated to development expenditure. Boosting domestic consumption appears to be one of the key goals of the budget, noting the GST relief to specific sectors as well as an income tax reduction for income bracket between MYR20,001 to MYR70,000. Elsewhere, infrastructure pipeline seen from the allocation of MYR6.7bn into eight projects, expenditure to improve the quality of education (MYR16.4bn) and the building/improvement of schools into the years ahead should continue to support growth into 2018.

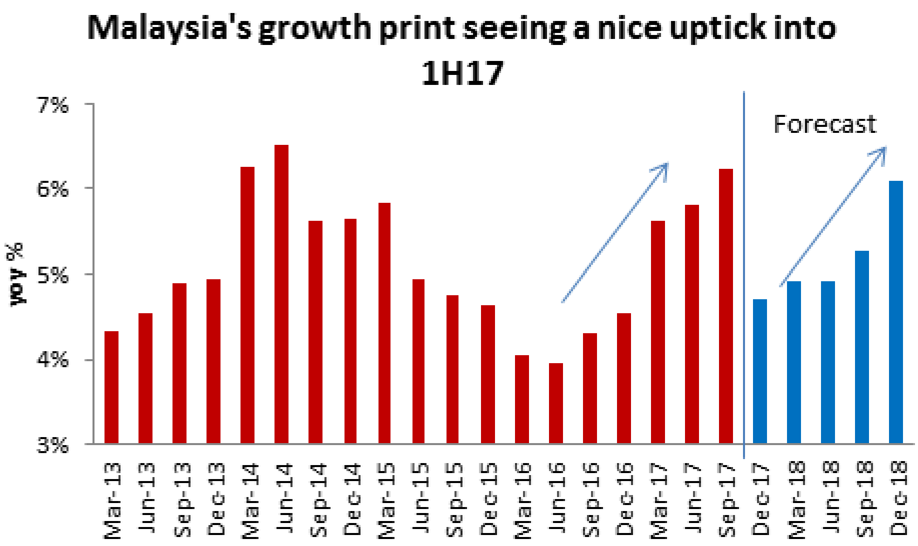
Still susceptible to risk nonetheless

Even with clear signs of growth into the next year, the economy is still susceptible to external shocks such as a global growth slowdown or geopolitical tensions. On the domestic front, Malaysia could face rising political noise ahead of its general election in 2018, while policy-makers would need to contend with the sizable household debt levels. With inflation pressures pacing relatively faster vis-à-vis its Asian peers, Malaysia would need to stay vigilant on any early signs for a faster-than-expected surge in inflation into 2018.

All-in-all, while we pencil GDP to moderate slightly to 5.0% into 2018, we opine that Malaysia's growth fundamentals appear solid on the back of improving global fundamentals and higher oil prices. Economic growth will like stay supported by further traction seen in private consumption, investment spending and trade into 2018, while the fiscal spending backdrop seen from the recent Budget should add to bolster both consumer and investor confidence into the next year. Still, higher inflationary pressures could be a natural by-product when both demand-pull (driven by stronger domestic demand) and supply-push (higher oil and food prices) forces concurrently tune higher into the year. As such, further monitoring on how domestic prices may evolve into 2018 is warranted. In the same vein, with Bank Negara Malaysia (BNM) commenting its "flexibility to adjust the degree of monetary policy accommodativeness", we read the recent statement to be gearing up market expectation for a start of a rate hike cycle into 2018.







Source: CEIC, OCBC Bank

MYANMAR

Looking Past Distractions

In the 2H 2017 Global Outlook, we called the Myanmar story a waiting game, where performance will eventually catch up with economic potential. However, half a year on, the situation seems more challenging for Myanmar. Ethnic conflict in the Rakhine State has become a mainstay in global newswires, and its sustained nature threatens to overshadow progress in economic management and national governance. In this edition of the Myanmar outlook, we hope to re-establish visibility on other areas where there have been positive developments.

Nevertheless, in the current environment, a piece on Myanmar would be incomplete without a comment on the situation in Rakhine State. Undoubtedly, the situation is difficult and unfortunate. However, the issues on the ground are long-standing, and will not be solved in the near term. Initiatives are being implemented, but they will have to be afforded the time to take effect. A complete resolution of the issues may be some years away. Therefore, for investors, it may be pertinent to look through these distractions, and focus on the immediate economic opportunities that Myanmar presents. Indeed, while it may not solve the fundamental problems, better economic outcomes may alleviate the livelihoods of many in the region. If investors wait till all issues are resolved before looking seriously at Myanmar again, the opportunities would have been lost by then.

Foreign direct investment (FDI) flows still positive despite distractions

A key concern for many Myanmar observers is the foreign direct investments (FDI) it receives. Naturally, the worry is that FDI will dry up as the problems in Rakhine State hog media attention. There are signs of a fading off of FDI, with the value of permitted investments steadily falling since June 2017. However, on a broader perspective, total FDI fiscal year-to-date (from April 2017 onwards) has been very strong, recording US$4.12b. This is 30.6% higher than the total received in the same period over the previous fiscal year, and more than two-thirds of the target FDI this year.

The largest foreign investors this fiscal year are Singapore and China. These countries' interest in Myanmar is longstanding, and has sustained through periods of political issues. We believe that corporates from these countries will continue to focus on Myanmar's long-term economic potential, rather than ethnic issues in the Rakhine State. Moreover, we find that the majority of foreign investment is flowing into the Yangon region, which is relatively unscathed by ethnic issues.

Interestingly, despite the negative headlines from primarily Western media channels, foreign investments coming from the five largest Western foreign investors (the UK, Netherlands, USA, France and Canada), have been strong this fiscal year. They account for 20.2% of all permitted FDI this fiscal year, compared to just 1.6% in the previous fiscal year. We also note that foreign investment from the United States amounting to US$122.79m was approved in July 2017. This is significant as it is the first instance of foreign investment from the United States captured in official data since the economic sanctions were lifted in September 2016.

Apart from looking at the FDI figures at a broad level, ongoing efforts are made on the ground to improve the investment climate for foreigners. For one, IE Singapore has signed a Memorandum of Understanding (MOU) with the Myanmar Investment Commission (MIC) to allow Singaporean corporates to deepen their collaboration with local companies in selected industries, such as urban and housing solutions, utilities, transport and logistics, and manufacturing. These initiatives continue to benefit both Singaporean and local corporates, allowing for expansion and transference of knowledge.

The Japanese International Corporation Agency (JICA) will also be extending credit to local small-medium enterprises (SMEs), continuing the initiative it started last year. Interestingly, JICA chose to work with the Myanmar Economic Bank, and dispense its funds through a network of local banks. The local banks may select the beneficiary SMEs based on their own internal considerations. This serves a dual purpose, with SMEs benefiting from the JICA funds, while the local banks deepening their expertise in lending and credit management.

Strong FDI flows and initiatives taken by international organizations to engage Myanmar are heartening. They signal the continued confidence that the international business community has in Myanmar. The gradual improvement of the investment and economic climate has also been recognized internationally, with the World Bank awarding Myanmar the Star Reformer Award at the Global Investment Competitiveness Forum. This underlies the government's continued efforts to make Myanmar more attractive to foreign investors.

Legislative improvements continue apace

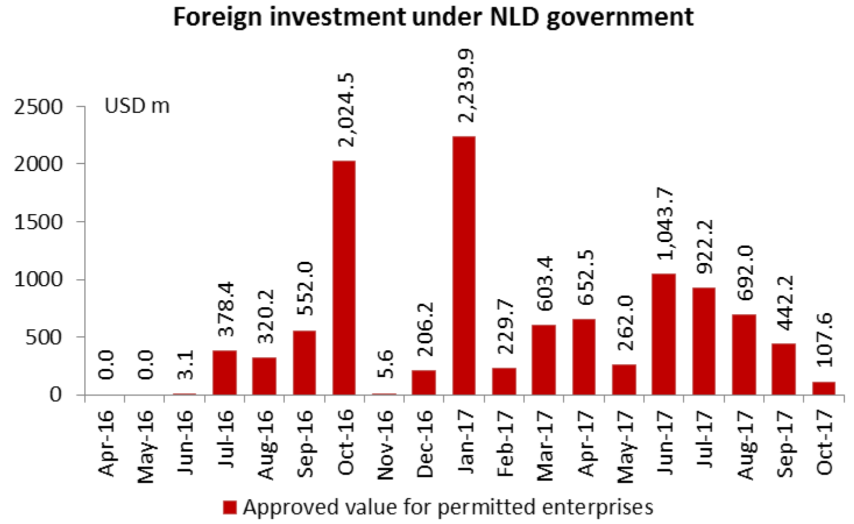
The Myanmar Investment Law enacted last year was a main reason why Myanmar was awarded the award. Since then, the momentum for legislative improvements has continued to pick up. As we highlighted in the previous articles, the next major change will come from the Myanmar Companies Law. As of 7 December 2017, the revised version of the legislation has obtained approval from both Houses of Parliament. The last steps will be for the President to sign the bill into law, and for the government to announce an effective date. The key change to take note is the change in definition of a "Myanmar company", which will allow foreigners to take an ownership share of up to 35%. This would allow foreign corporates to enter industries previously reserved for "Myanmar companies", and to enjoy similar benefits as local corporates. Industries that may present new opportunities for foreign corporates under this new legislation include industrial equipment and pharmaceuticals.

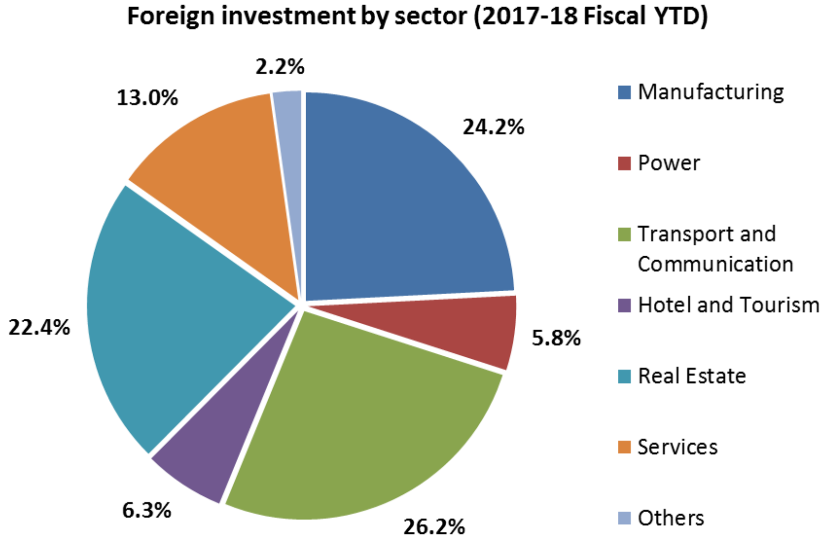
Apart from this the landmark companies law, many other legislation are in various stages of amendment to bring them closer to international norms and to better support the growing economy. In this front, the tourism sector may see some changes in the upcoming year, with the proposed Tourism Law Bill published for public consultation earlier this year. The tourism industry has been an area of focus for both the government and foreign investors. 6.4% of total permitted FDI this calendar year went to the hotel and tourism sector. The proposed law will strengthen the regulations that support the development of eco-tourism and allow the formation of tourism promotion boards at different levels to oversee the marketing of tourism at national and state levels. Moreover, it may also make provisions for an industry inspector, to ensure that tourism businesses operate in accordance to regulations. These proposed changes should increase the attractiveness of Myanmar as a tourist destination, and also provide assurances of good practice in the industry.

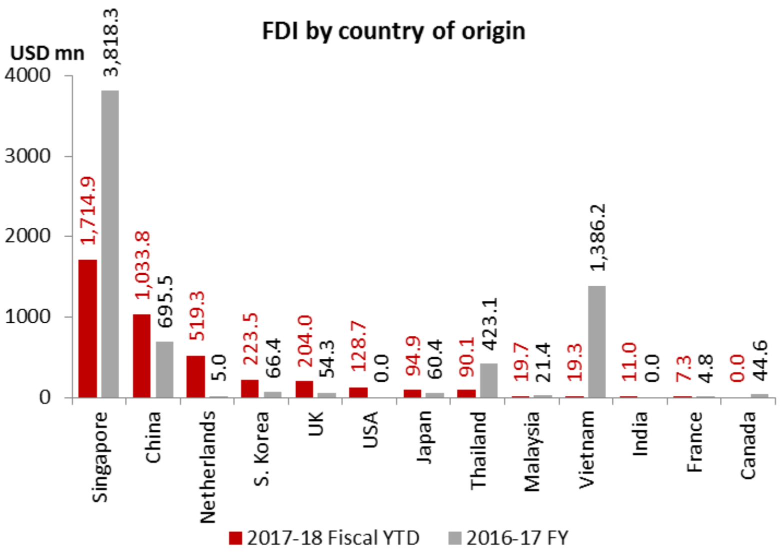
Intellectual property protection has generally been a problem in emerging economies. Acknowledging this fact, the government has also introduced the proposed Industrial Design Rights Bill for public consultation. The proposed bill will accord more protection for the rights of designers and creators, and will help Myanmar move towards international conventions in the intellectual property space. Currently, the level of intellectual protection in Myanmar is low, and the proposed bill may become the platform on which more legislation in this area will be built.

Conclusion

Ethnic issues in the Rakhine State may have hogged the media headlines and heaped pressure on the government this year. Meanwhile, astute foreign corporates has continued to invest in Myanmar even as the media made the ethnic issues sound bleaker. The progress in making Myanmar a better economy to invest in has been taking place away from the spotlight, with the government doing its part to smooth out the legislative support and other roadblocks to investment. Overall, it may be wiser to look pass the distractions to focus on the progress taking place.







Source: Directorate of Investment and Company Administration (DICA), OCBC

PHILIPPINES

Current Account Deficit Not a Worry

In our 2H17 paper, we discussed the likelihood of the Bangko Sentral ng Pilipinas (BSP) pencilling in a rate hike by end-2017. Shifting our lens onto 2018, while we retain our view that BSP might hike its overnight reverse repurchase (RRP) facility in early-2018, we also want to highlight the widening current account (CA) deficit of late, as well as reasons why this factor might not stand in the way for an upbeat Philippines economy next year.

The archipelago's trade deficit stands at $2.85bn, the widest since at least 1980. Furthermore, President Duterte's $180bn infrastructure led to robust demand for imports of raw materials. Therefore, the BSP is estimating the country's first CA deficit in 15 years. As a result, the peso responded negatively and left some market participants concerned. However, it is important to note that given the current state of development in the Philippine economy, a CA deficit is not unusual. Particularly, fast-growing, emerging economies have CA deficits as they import capital goods and raw materials to support growth. Indeed, if the CA deficit is broken down, capital goods makes most of the increase in imports. This situation is likely positive in the long run.

Growth still looks to be on track

As we turned to economic indicators to substantiate Espenilla's claim, we observed that Philippines' gross domestic product (GDP) managed to surprise higher at 6.9% from a forecast of 6.5% in 3Q, clocking its highest print in the last 4 quarters. Chiefly, we observed that the faster-than-expected growth was a result of strong exports and the manufacturing sector. Digging into the figures, year-to-date export and import growth stood at 12.2% and 7.4%, exceeding official targets. Meanwhile, the surge in exports this year largely was on the expense of a fast weakening peso, falling by around 5.8% y/y in nominal terms against the dollar year-to-date. On the manufacturing front, PMI numbers also spiked in October, paving the way nicely for Philippines to end the Q4 season strong, on the back of faster growth in new orders and output.

Meanwhile, balance of trade has picked up since 2016, albeit still trending in the negative territory, with imports for capital goods being a large contributing factor. Nevertheless, the benefits of a weaker peso could still prove beneficial for the population. Filipino workers offshore largely benefit from the effects of a depreciating home currency. As such, since remittances are a key component of the nation, a depreciating peso allows for a nominally larger amount of remittance, denominated in peso terms to flow into the economy. This could in turn provide a temporary lift to the economy through increased consumption.

Inflation readings aligned nicely with the National Government's target

Shifting our lens onto yet another key economic indicator - inflation, we witnessed that headline inflation stood pat in Q3 at 3.1%, steady for three consecutive quarters including 1Q17. Moving forward into Q4, inflation could be poised to pick up, with September (3.4%) and October (3.5%) readings already showing signs of increasing price pressures. Particularly, the marginally higher but still benign print into Q4 was due to Non-food items like higher utility prices (Housing, Water, Electricity and Gas), but pared by lower pressures from transport services. We are thus looking for Philippines' overall 2017 inflation reading to range between 3.0% and 3.2%, well within the National Government's (NG) announced target range of 2-4%.

Looking forward into 2018, inflationary pressures might continue to pick up, albeit at a slower pace compared to 2016-2017. Overall, we pencil in a 3.4% headline inflation for 2018, slightly above the 3.2% estimated in 2017. This is because the chief contributors to the upward pressure – a depreciating peso, tight labour market, and high capacity utilisation may taper into 2018.

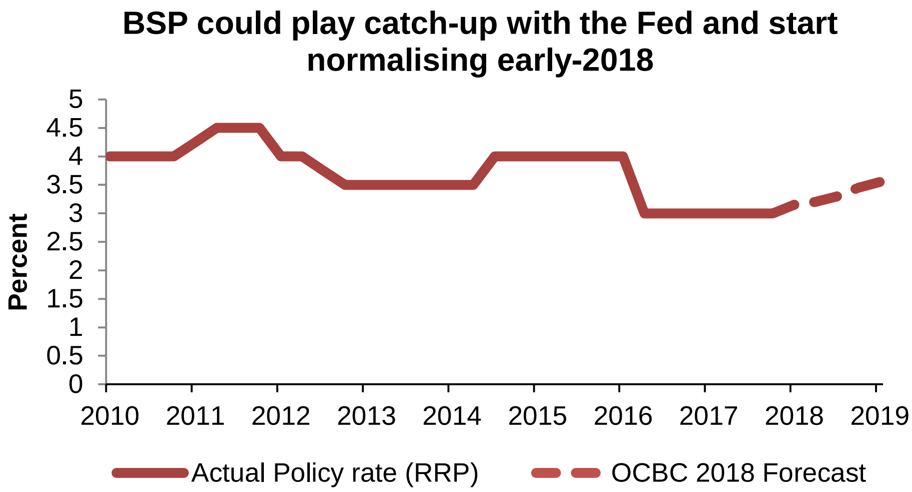
Upgrade of Philippines sovereign credit rating

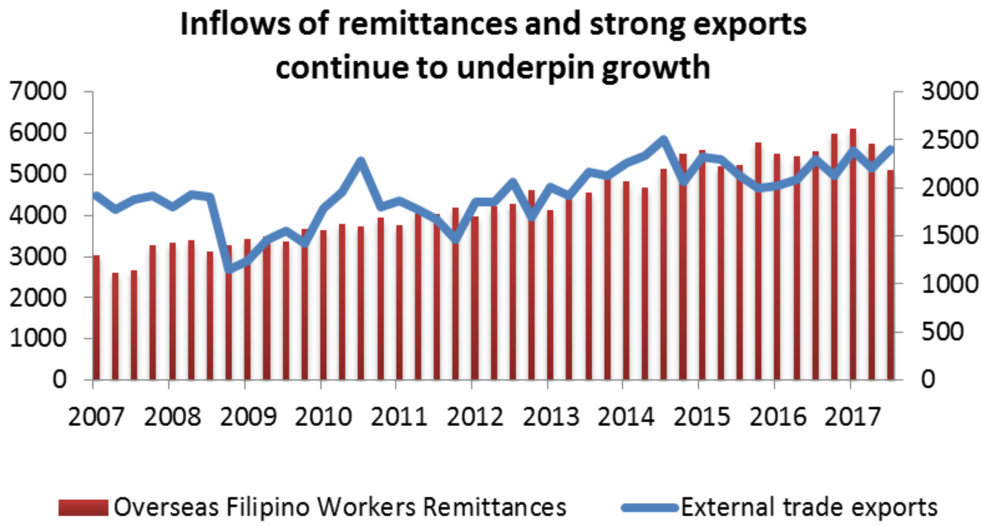
In addition to the healthy economic indicators discussed thus far, a recent upgrade by rating agency Fitch in Philippines' credit sovereign rating to BBB further affirmed the relatively sanguine outlook, with the peso gaining around 0.4% post-announcement. Fitch opined that the economy's "strong and consistent macroeconomic performances" was the impetus for the rating upgrade, and also forecasts GDP growth at 6.8%, similar to our view that growth would likely come in at the lower range of Duterte's economic team forecast of 6.5% - 7.5%. Furthermore, Fitch was also comforted by the NG's fiscal plans, which initial phrase was estimated to contribute 0.5% - 0.8% of GDP in the form of additional revenue in 2018.

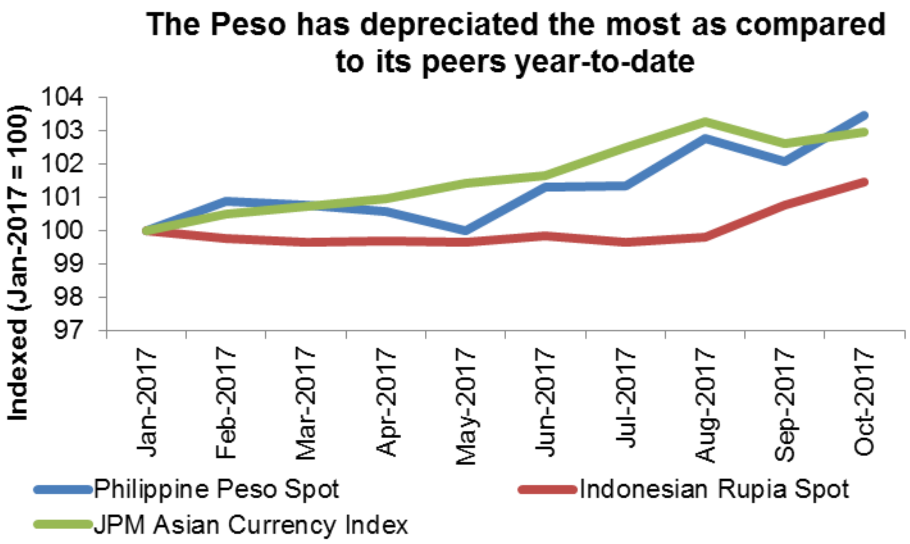
Impetus for the Philippine economy into 2018

In view of the macroeconomic factors discussed, and the stance of Fitch, we believe that fundamental drivers like inflows of remittances would continue supporting private consumption and household spending. Furthermore, the business process outsourcing (BPO) sector could remain supported by positive US growth prospects.

On the other hand, the key risks facing Philippines are also the familiar ones. A possible Chinese slowdown may upset trade growth, and possibly affect the funding efforts of some infrastructure projects. However, we believe that the CA deficit is not a source of concern. We think GDP growth should remain healthy in 2018 and come in at the lower end of the official forecast target of 6.5% - 7.5%.







Source: Bloomberg, OCBC

SINGAPORE

More Balanced Growth in 2018

A stellar manufacturing performance has lifted 2017 GDP growth

2017 started with the uptick in manufacturing, namely in electronics, particularly in semiconductors in response to the improved global demand. As the year progressed and headline geopolitical risks (such as the North Korean tensions, French and German elections and US president Trump's anti-trade campaign promises) subsided, domestic confidence also improved. For 3Q17, GDP growth was revised up to 5.2% yoy, which prompted the official full-year growth forecast to be upgraded from the previous 2-3% to 3-3.5%. Our house forecast for 2018 GDP growth is slightly more sanguine at 2-4% yoy, versus the anticipated 3.4% yoy for this year, amid broadening domestic growth drivers beyond manufacturing.

2018 growth picture looks stable and steady

With a fairly benign global and regional growth picture, should one still be cautious about the 2018 outlook at this juncture? Manufacturing momentum could taper given the less favourable base effects after a stellar performance year-to-date in 2017. The same applies to the cyclical uplift in non-oil domestic exports (NODX) which could ease to around 4% yoy in 2018. Externally-oriented sectors like wholesale trade, transportation and storage should still sustain, amid supportive trade and resilient trade growth in China and Asean markets. Certainly, the services sector remains uneven, with financial and tourism-related services likely to lead, while real estate and retail trade looks more tentative. Construction and offshore marine sectors could see less of a drag next year, especially with $1.4 billion of public construction contracts being brought forward for the former.

Domestic sentiments have improved, with services overtaking manufacturing

Both manufacturing and services confidence have improved, with the latter overtaking the former since 2H17 according to the business expectations survey. Similarly, the Purchasing Managers Indices (PMIs) for the Singapore whole economy has hit a record high and exceeds that of the manufacturing and electronics PMIs in the latest readings. These broadening of business confidence has translated into hiring intentions and aided in the stabilization of the domestic labour market. Labour demand should be supportive in 2018 amid the benign macroeconomic environment. Existing redundancy drags from the construction and offshore marine sectors should also ease. The overall unemployment rate should remain stable around the 2% handle. There is little impetus for short-term wage inflation in the pipeline at this juncture.

Productivity growth picture is improving, largely driven by manufacturing

Productivity growth has improved by leaps and bounds for manufacturing, aided by the cyclical recovery. However, the construction and particularly services sectors have to play catch-up. There are no easy answers here, but the Committee for Future Economy (CFE) recommendations point to Industry Transformation Maps (ITMs) as a model for building capabilities, tapping on industry synergies and tackling the needs of each sector. Meanwhile, there is a need for productivity growth to keep pace with real wage growth which is expected to accelerate slightly from the 3.7% yoy seen in June 2017 to around 4% yoy in 2018.

Be watchful for inflation

The domestic inflation trajectory remains contained for now. External inflation sources also generally remain benign, despite the uptick in global crude oil prices. There are no broad-based increases in demand-led price pressures. Although headline consumer price index (CPI) inflation is tipped to accelerate from 0.6% yoy in 2017 to 0.8% yoy in 2018, MAS core inflation is the key to watch. We anticipate MAS core inflation to remain stable at 1.6% in 2017 and 1.5% in 2016, which reinforces policymakers' rhetoric that there is no urgency to tweak its neutral monetary policy stance for now. Nevertheless, the window remains open for MAS to adjust its policy stance in 2018 (either April or October) even if core inflation remains stable in the 1-2% range for 2018, namely because monetary policy operates with a long time lag and policymakers prefer to be pre-emptive rather than reactive. That said, the move should be seen as a normalisation of sorts to adjust the neutral SGD NEER policy band to a modest appreciation slope which is likely to be at a more gradual gradient than pre-GFC (ie. <2% appreciation p.a.). Moreover, the potential announcement and implementation of a GST (Goods and Services Tax) hike could inject some volatility into the headline CPI prints.

Is there a need to raise taxes for fiscal prudence?

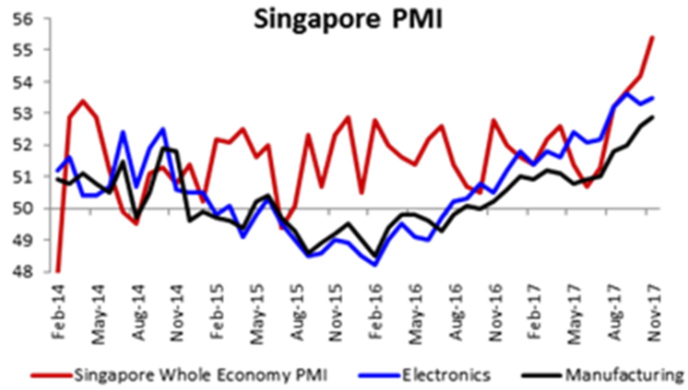
PM Lee suggested recently that Singapore will need to raise taxes to fund growing expenditure on healthcare as well as infrastructure. Some market speculation is that the impending tax change could take the form of GST hikes since it has been a decade since the last adjustment. There is some rationale behind this speculation – Corporate Income Tax (CIT), Personal Income Tax (PIT) and GST accounted for 26.4%, 18.9% and 13.0% respectively of total tax receipts. Since the US tax reform efforts are targeting to cut its corporate tax rate from 35% to 20%, it may not make economic sense for Singapore to be raising CIT at this juncture. Similarly, the highest PIT brackets had been adjusted not so long ago (albeit it may still make sense in the medium term to ensure income inequality does not widen unsustainably), so GST may look like a viable candidate, especially since Singapore's 7% GST is relatively low compared to regional economies. This of course assumes that expenditure growth trends cannot be curbed (albeit we recognise that overall government spending is still relatively low at 18% of GDP), the Net Investment Income (NII) contributions have hit some maximum threshold at 50% of expected long-term investment returns, and the timing is right to adjust taxes without compromising global competitiveness.

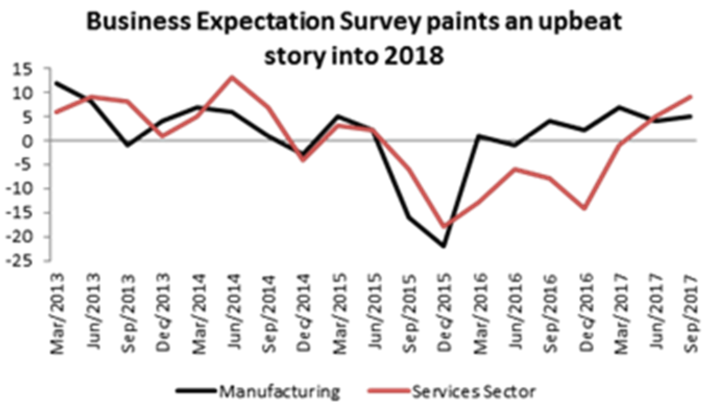
All revenue options are on the table

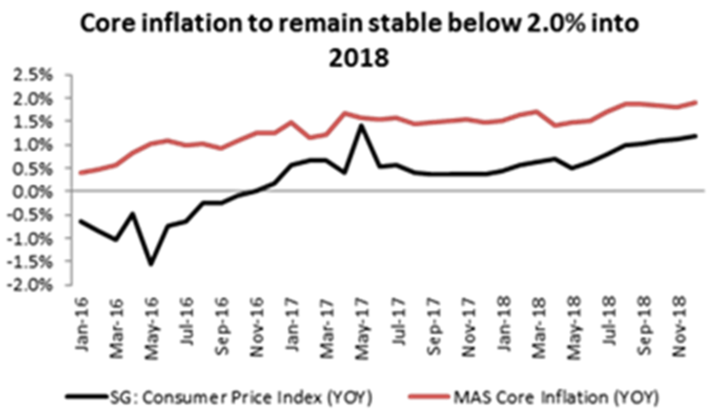
Besides CIT, PIT and GST, there are other feasible revenue options like asset taxes (contributing 7.8% of total tax receipts), stamp duties (7.4%), customs and excise duties (5.1%), betting tax (4.7%), motor vehicle tax (3.7%) etc. So a combination of tax tweaks is plausible. Given the ageing demographics and increasing household wealth, especially financial assets and property, it could possibly make sense to bring back the estate duty. Even for the GST discussion, the low-lying fruit would be to tax e-commerce transactions first and foremost, before hiking the GST rate whether by 1% or 2% increments in a phased in manner.

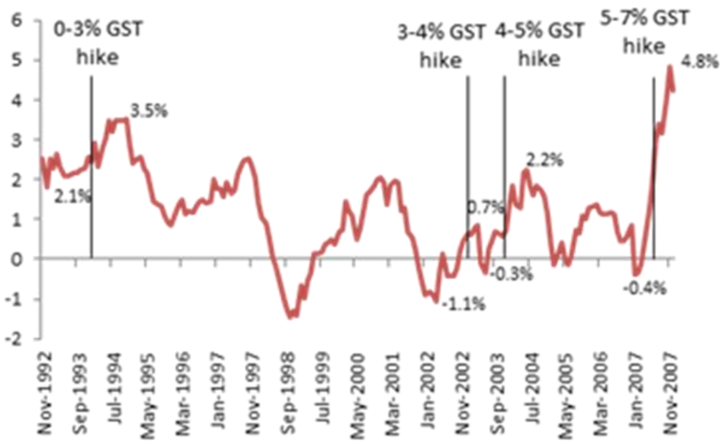
What could pose a headwind to the benign 2018 growth picture?

If the 2017 Budget does introduce tax changes (possibly a GST hike), coupled with monetary policy adjustment in a rising global interest rate environment, this could pose a potential double-whammy for domestic SMEs who are still struggling with high business cost, tight manpower and economic restructuring.









Source: Bloomberg, OCBC

TAIWAN

Warm on the Outside but Cold on the Inside

The Taiwanese economy recovered further in 2017 with the economic growth accelerated to average 2.67% yoy in the first three quarters of 2017 from 1.4% yoy in 2016. The economy is expected to expand by 2.6% in 2017, well above the initial target of 2% estimated by government and market in early 2017. The stronger than expected growth was mainly supported by improving external demand as global trade continued to expand at a rapid pace undisrupted by US President Trump's trade protectionism tone. In particular, Taiwan's export has benefited from the surging global demand for electronic products since the second half of 2017. The real net export grew by a remarkable 64.7% yoy in the third quarter. For the first three quarters, the real net export grew by 24.8% yoy, contributing to more than half of Taiwan's GDP growth in the same period.

As compared to the strong external demand, private consumption remained lacklustre. Private consumption grew by average 2.18% yoy in the first three quarters of 2017, down slightly from 2.32% in 2016, despite solid job market. Taiwan's unemployment rate after seasonally adjusted slipped to a low of 3.7% in October 2017, lowest since Feb 2000. The lacklustre private consumption was probably the result of challenging relationship between mainland China and Tsai administration. The sharp decline of visitor arrivals from mainland China, which fell by 40.06% in the first half of 2017, may weigh down on domestic consumption.

New Southbound policy

On the positive note, Tsai administration's new southbound policy to deepen its economic, cultural and political relationship with Southeast Asia and South Asia starts to bear the fruit. Visitor Arrivals from ASEAN is expected to hit record high in 2017. The official data showed that visitors from Southeast Asia reached 1.644 million in the first ten months of 2017, up by 34% yoy. Although the inflow is still not large enough to offset the decline of visitors from mainland China, it helps build buffer to Taiwan's tourism industries as well as private consumption.

Meanwhile, Taiwan's total trade with ASEAN 6 including Singapore, Philippines, Indonesia, Thailand, Malaysia and Vietnam rose by 14.8% yoy in the first eleven months to US$80.6 billion after the decline of 2.5% in 2016. In addition, Taiwan's outward direct investment in ASEAN 6 in the first ten months of 2017 surged by 77% yoy to US$2.655 billion.

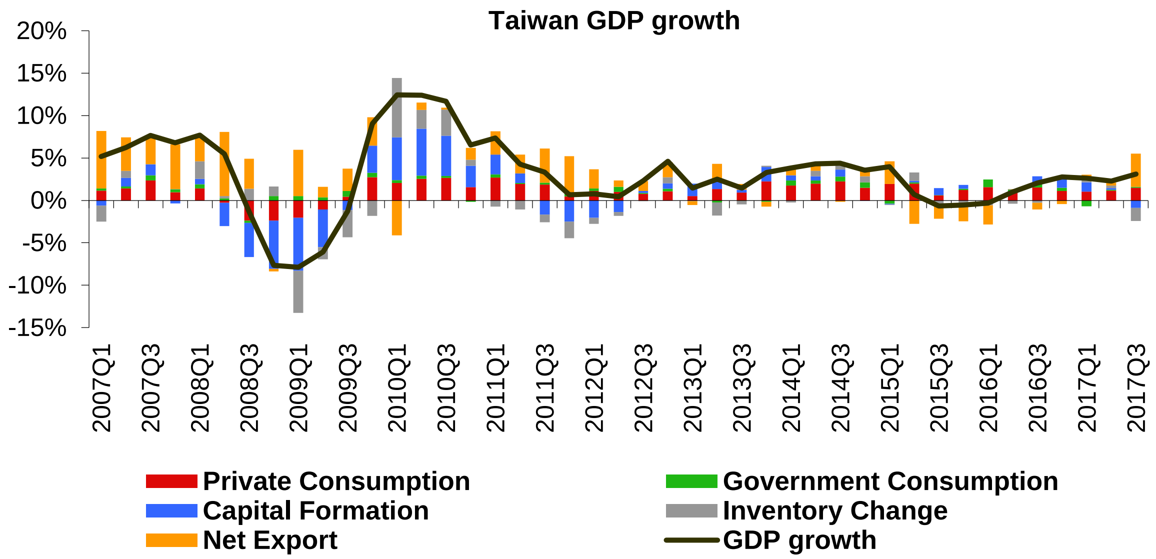
Despite competition from China's Belt and Road initiative, Tsai's new southbound policy, which focused on soft elements, may still find its own stage in Southeast Asia as well as South Asia. This may help Taiwan reduce its economic reliance on China in the longer run.

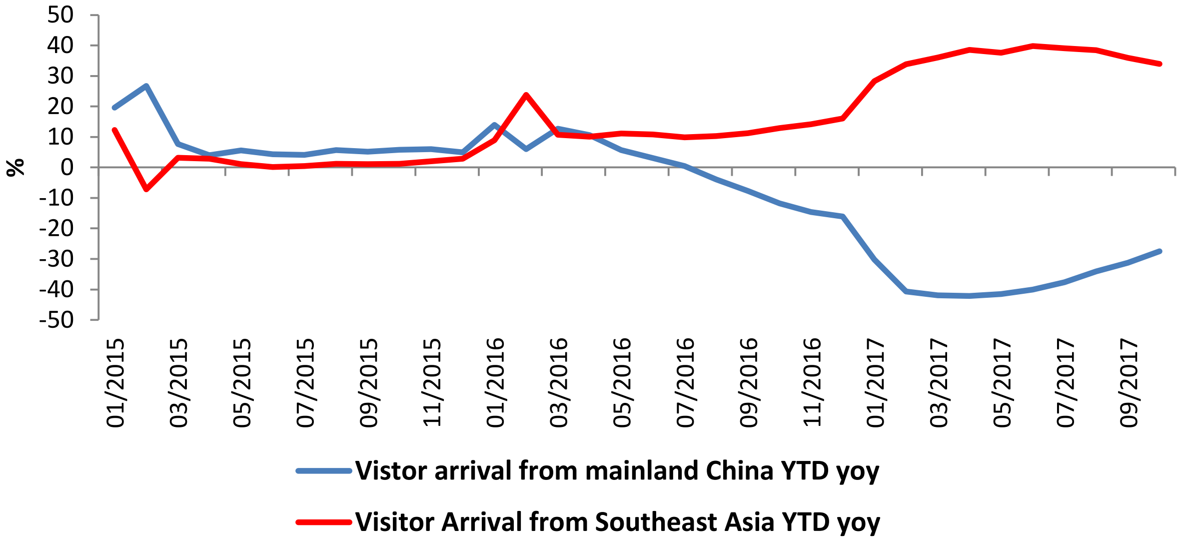
Looking ahead, we expect Taiwan's growth to soften slightly in 2018 to about 2.5% as the support from external demand is likely to fade due to high base in 2017. However, we expect consumption and capital formation growth to pick up in 2018 due to supportive fiscal policies. Taiwan has officially launched the Forward looking Infrastructure Development Program to build new generation of infrastructure including railway projects, water environments, green energy, digital infrastructure, urban and rural projects, child care facilities, food safety and human resource infrastructure to boost employment. The program will be funded with a special budget over the four years and the first batch of NT$107.1 billion will span from September 2017 to end of 2018.

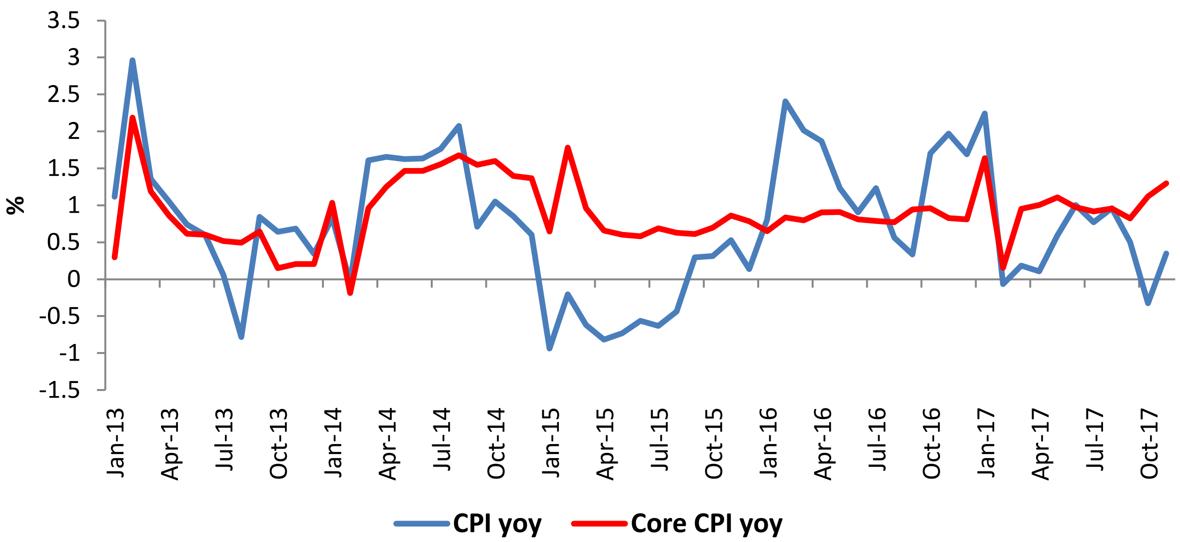
In addition, Taiwan's public sector workers including civil servant, public school teachers and military personnel will receive 3% pay raise in 2018 after a freeze of more than six years. Meanwhile, employees from the State Owned Enterprises are expected to receive similar pay raise. The scheduled pay hike will boost government consumption and private consumption.

Time for monetary policy normalization

Taiwan's headline inflation moderated further to average 0.57% in the first eleven months of 2017 from 1.4% in 2016 due to the decline of food prices, which fell by average 0.36% year to date. However, core CPI excluding fruits, vegetables and energy accelerated to average 1% in the first eleven month, up from 0.83% in 2016. As wage growth is likely to pick up in 2018, we expect Taiwan's core inflation to trend higher further, which will be the catalyst for Taiwan's central bank to start its policy normalization. Nevertheless, as the current central bank governor Perng Fai Nan's term ends in February, the change of leadership is likely to slightly postpone the normalization process. As such, we expect that the first rate hike may not come until the second half of 2018.







Source: CEIC, OCBC Bank

THAILAND

All Pistons Firing Nicely

Economic sentiment has improved since the onset of the junta's rule in the last three years. Both consumer confidence and business sentiments have seen marked improvement since the 2014 military take-over by the current Prime Minister Prayut Chan-o-cha. Recent data suggested that growth is broadening as headline growth printed an encouraging 4.3% y/y, clocking its fastest growth print since 1Q13, led by the acceleration in private consumption, private investment, exports and government expenditure. Elsewhere, tourism arrivals continues to grow at 5.2% y/y in the first nine months of 2017 even in the face of a relatively high base year. All-in-all, the improvement in its external environment amid a strong tourism base have given the much needed positive spill-over benefits to the domestic economy, especially seen in Thailand's manufacturing output, private investment and consumer spending.

In line with the strong growth prints seen of late, we opine that overall growth will meet the official target of 3.9% in 2017. Into 2018, the Macroeconomic Strategy and Planning Office penciled a realistic 3.6 – 4.6% growth, citing the expectations for global growth and trade activities to remain on track. Furthermore, Thailand's domestic environment is also expected to stay underpinned by the acceleration by both private and public investments, household income conditions and manufacturing activities. Elsewhere, while inflation is likely to only average a tepid 0.7% this year, CPI growth into 2018 is likely to edge higher and eventually fall within the range of Bank of Thailand's 1 – 4% target.

It's all about how global growth

Like many Asian economies, Thailand's growth trajectory is determined by how global growth may perform into 2018. As of today, there are clear indications that suggest the uptick in domestic activity has benefited largely from the relatively stronger external prints. Similarly to how 2017 has grown, we look for four economic drivers for Thailand's economy into 2018: Manufacturing, Public Spending, Private Investment and Domestic Consumption.

First off, the continued expansion of global trade activities will directly benefit Thailand's manufacturing space. The manufacturing sector accounts for a sizable 28% of GDP, many of which are export-oriented in nature. Importantly, some slack in manufacturing growth has been absorbed into 2H17, as manufacture exporters are busy depleting inventories rather than producing new ones. As such, industrial production has grown for three consecutive months into Sept 2017, while the manufacturing capacity utilization rate has grown sizably to 63.6% in the same month, up from January's 59.9%. In the same vein, exports clocked its 12th consecutive month of positive growth into Oct 2017, underpinned especially by strong Chinese demand which grew double digit over the same period. Given the improvement in global growth and trade activities, the growth in Thailand's manufacturing space would be a key pillar of growth for Thailand.

Secondly, public investment growth has been a pillar of growth in 2017, which is expected to play its part in supporting growth next year as well. Despite public investment being relatively slower in 2017, investment activity is expected to tick higher given the increased capital budget framework under the annual budget and state-owned enterprise's budget by 21.8% and 45.7%, respectively.

This is in addition to the ambitious infrastructure spending pipeline into 2017 and 2018. It is expected that there will be a total of 12 projects with a total budget of THB452.4 billion in 2017. Into 2018, another THB233.4 billion worth of projects has been budgeted into 2018.

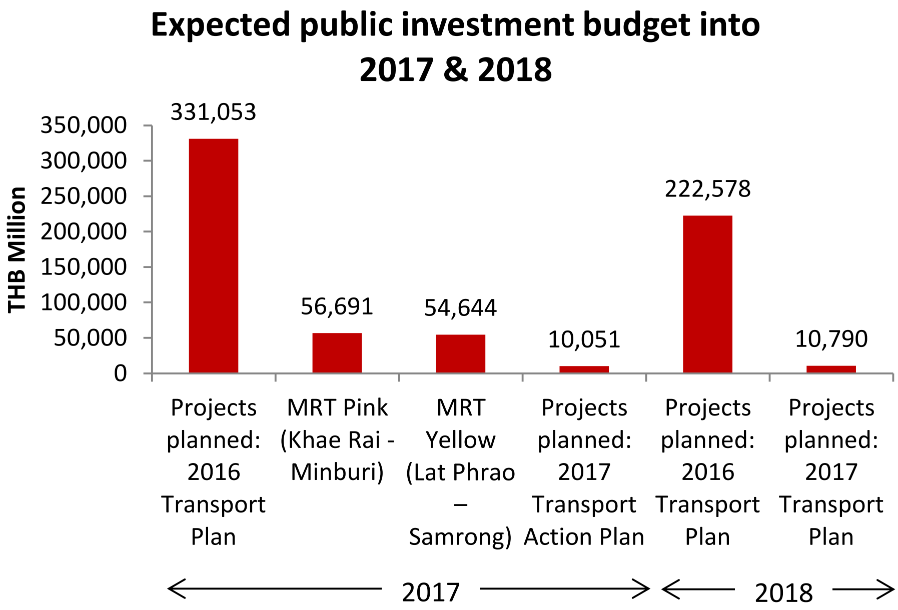
Thirdly, private investment growth is expected to tune higher into the next year. Relatedly to the excess capacity seen in Thailand's manufacturing space, private investment growth has also been relatively flat in 1H17 before edging gradually higher into 2H17. With the expected improvement in Thailand's manufacturing space into 2018, investment growth is expected to grow in tandem. Moreover, the government also expects the ambitious public investment pipeline to also spur and attract further private investment demand as well.

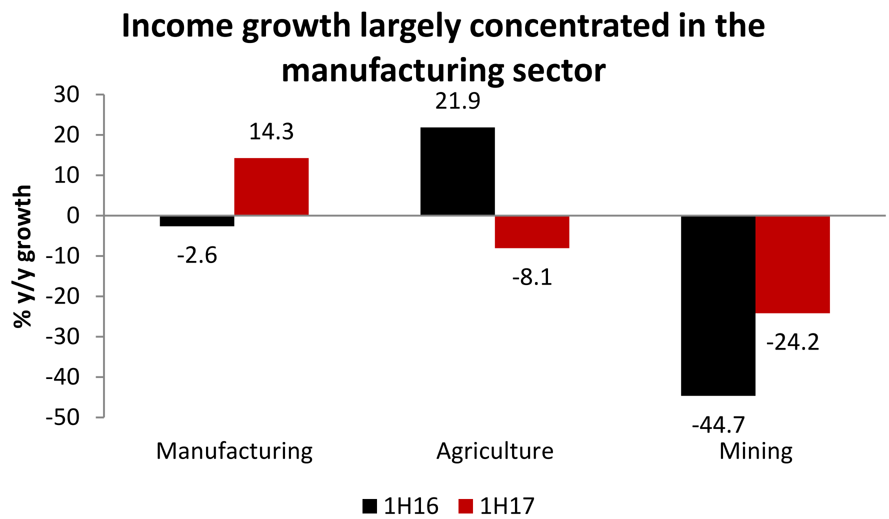
Fourthly, private consumption which accounts for over 50% of GDP will also support overall growth. Private consumption growth has grown steadily since the start of 2017, suggesting that the improving global backdrop has led to stronger consumer confidence and higher income. Thailand's labour market remains relatively tight with unemployment at 1.3% as of October 2017. Elsewhere, persons earning between THB15,001 – 30,000 per month in the whole economy surged 5.8% in 2Q17, versus the lower income bracket of below THB1,500/month which contracted 2.3% over the same period. Moreover, the increase in income levels is concentrated in the export-oriented manufacturing sector, although agriculture and mining income continued to fall on low commodity prices.

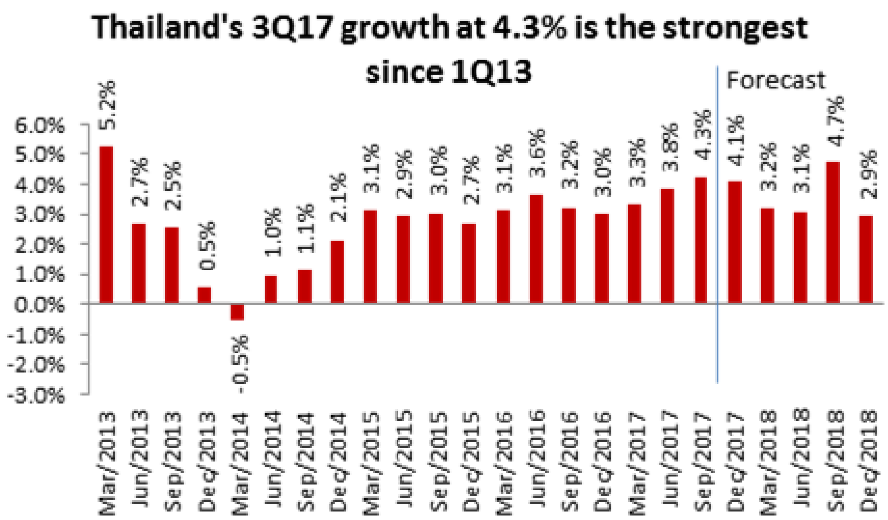
Watch for political noise and higher rates

So far our discussion has been tuned towards praising the Thai economy. Indeed, the growth traction seen in 2017 should continue to play out as its economy benefits from the uptick in global trade activities. However, Thailand's election risk and potentially higher rates into 2018 cannot be ignored; Thailand's relatively polarized society, as well as potential drag on both domestic and international confidence must be addressed as the political noise gets louder into November 2018. Moreover, in the face of higher global rates especially in developed economies, Thai policy-makers will find themselves between keeping domestic rates accommodative and risk fund outflows, versus matching higher rates and risk dampening economic growth. Thailand has one of the highest household debt as a % of GDP in South East Asia, which does limit Bank of Thailand's monetary policy space into 2018 should global growth unexpectedly turn south.

In a nutshell, while we look for GDP to print a strong 3.9% in 2017, there could be some moderation in growth potentially to 3.5% into the next year. Thailand ultimately faces a strong base year in 2H17, especially seen in manufacturing, exports, and tourism arrivals. Elsewhere, inflation risk still appear almost non-existential, with CPI growth pencilled to grow to beyond 1.0% only in 2Q18 and stay at around its 1.0% level to average CPI at 1.4% for the year ahead. With global rates inching higher into 2018, we reckon Thai policy-makers to eventually hike its benchmark rate once in 2H18 to play catch-up.







Source: CEIC, OCBC Bank

VIETNAM

Growth Momentum Continues into 2018

Vietnam had a weak start in 2017. First quarter real GDP growth registered 5.1%, lower than readings in previous two years as compared on a yoy basis. The economy accelerated in the second quarter, growing 6.2%. The increase from first quarter is largely due to strong performance in industrial and services sectors. As we closely monitor the incoming data, Vietnam is poised for a likely acceleration in GDP growth through 2H2017. Vietnam GDP for the year of 2017 is expected to grow by 6.6%, short of government target of 6.7%. Nonetheless, we believe the underlying growth momentum remains strong, aided by sound economic fundamentals such as strong manufacturing activity, increasing FDI, robust domestic demand and strong export demand. Meanwhile, service sector maintained strong performance, supported by growing tourist arrivals. Overall, we expect GDP growth for 2018 to come in at 6.5%.

Robust external demand supports further export growth

Vietnam's export performance is expected to remain strong with continued support from new foreign-invested factories and an upturn in commodity prices. Despite the country's heavy dependence on imported capital goods and intermediate products for manufacturing activities, a rebound in export growth has pulled the trade balance further up into surplus; up to November 2017 trade surplus registered a year high at US$2.76bn. As a result, the current account surplus as percentage of GDP is expected to expand 1.1% by the end of 2017 and 2.7% in 2018.

A free trade agreement with the European Union that will come into effect in January 2018 will also provide momentum for further export growth. EU is Vietnam's second biggest export market, worth $30.72bn in 2016, and its fourth largest source of import, worth $10bn in 2016. Machinery and appliances accounted for 50.1% of Vietnam's exports to the EU, followed by telecommunications equipment comprising 33.5%, footwear and hats 12.1%, and textiles 10.4%. Vietnam's imports from the EU included machinery and appliances (27.4% of the total), chemicals (17.8%) and manufactured goods (11.3%). Under this agreement, Vietnam will eliminate 65% of its import duties on EU products with the remainder lifted over the following 10 years. Similarly, the EU will eliminate duties on 71% of products and lift others over a course of 7 years. The agreement will boost trade flows between Vietnam and EU in various aspects. As a result, we expect the manufacturing and textile industries to remain supported in 2018.

Foreign Direct Investment continues to build momentum

FDI inflows into Vietnam hit a record high of $15.8bn in 2016. Supported by stable domestic environment and robust external demand, FDI inflows remained strong in 2017. Vietnam received an estimated $14.2bn in FDI in the first 10 months of this year, up 11.8 percent from the same period in 2016, according to the Ministry of Planning and Investment. The manufacturing and processing industry received the most foreign funding as of October, followed by the real estate sector. With mobile phone parts and other electronics accounting for almost a third of the total exports, Vietnam has played an important role in the electronics industry and continues to attract investment from mobile products manufacturers. A recent development is that Samsung announced to build a new smartphone factory worth $3bn in Vietnam. This announcement comes only a month after Samsung Electronics revealed plans to build a $560mn factory in HCMC, where it intends to make TVs, washing machines and air conditioners. We expect FDI inflows into manufacturing industry, especially electronic industry, to remain robust in 2018.

In our last Global Outlook, we have identified two factors that contributed to the strong FDI in Vietnam. The two factors remain valid and continue to build momentum in FDI through 2018. Firstly, Vietnam's increasing networks of free trade agreements are enhancing investment opportunities. With 16 Free Trade Agreement in place with different partners, Vietnam remains well connected to the global trade system. In addition, the EU-Vietnam Free Trade Agreement that will come into effect in Jan 2018 will bring further boost to export growth. Secondly, ongoing business reforms help ensure it is easier to conduct business in the country. With greater access to credit and improvement in taxation, Vietnam moved up 14 places to rank 68 among 190 countries in the World Bank's Doing Business 2018 ranking, compared to 82 among 190 countries in 2017. So long as export sector is robust, and business environment is conducive, Vietnam remains attractive to foreign investors.

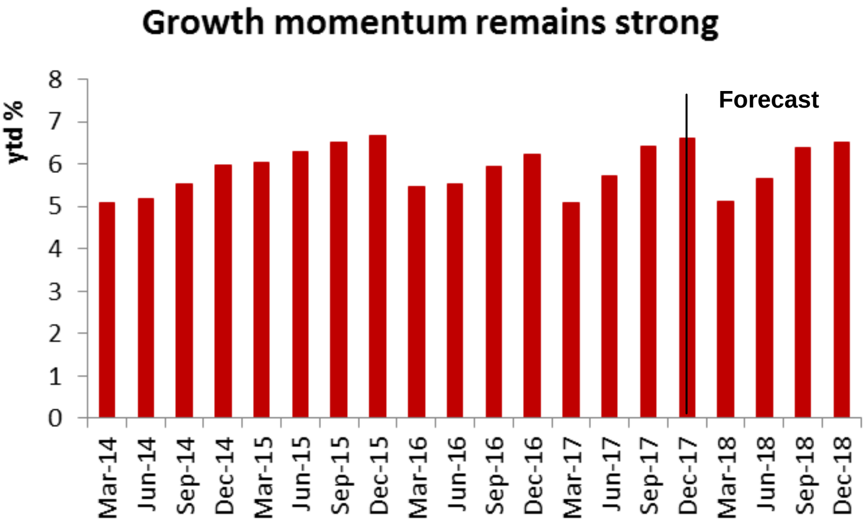
Rising inflation continues into 2018

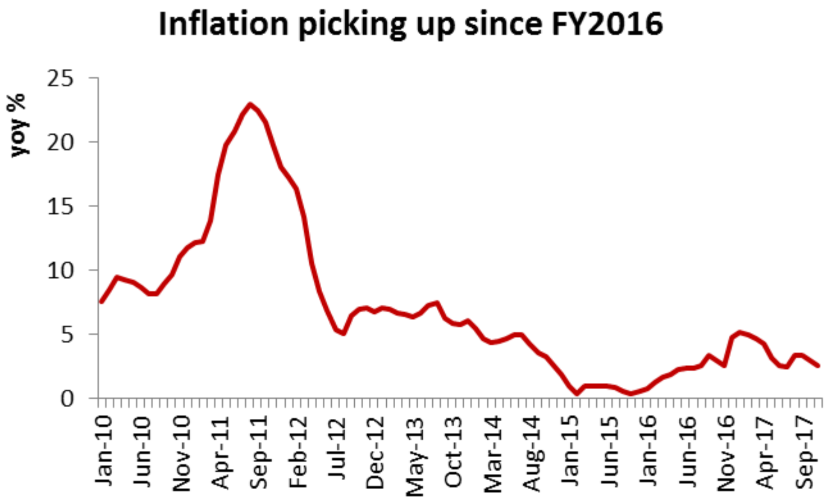
As growth accelerates, inflation is also picking up. Though headline inflation has decelerated over the years from a high of 22.42% in 2011, it has now recovered from historical lows in 2016. Vietnam's consumer price index (CPI) in November went 2.62% yoy, as reported by the General Statistics Office (GSO). The mix of stronger supply-side price inputs in oil-related transport price and administered price hikes in healthcare and education will continue to push inflation higher into 2018. Increase in petrol price contributed to the rise in transport price as the Ministry of Industry and Trade has increased the price of petroleum by 1.5% and 2.4% on Nov 4th and Nov 20th respectively. Health service price hikes in major provinces like Quang Ninh, Quang Tri and Bac Lieu and higher tuitions fees in Quang Ninh and Bac Lieu will continue to provide momentum for CPI growth. Major cities like Ho Chi Minh and Hanoi also saw administrative price increases. This will exert additional upward pressure on inflation.

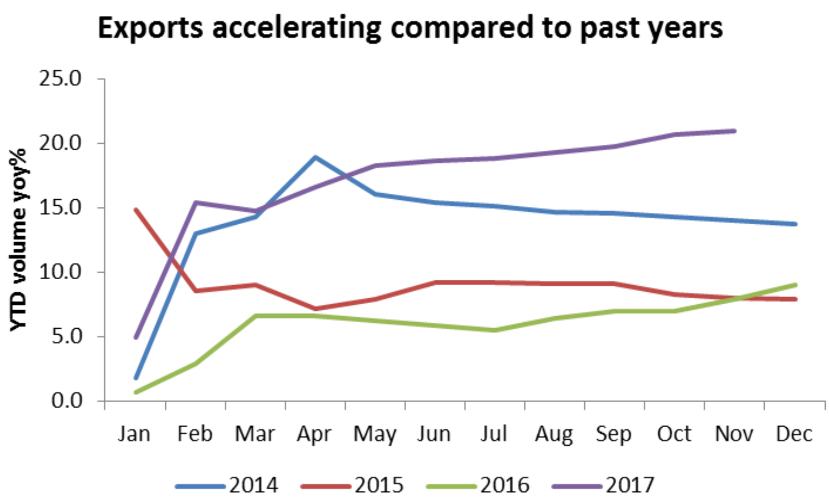
In addition, the National Wage Council announced a 6.5% increase in minimum wage that will take effect in 2018. Under the new rule, the minimum wage in the country stands at $121-175 per month, a 6.5% increase from the original level. However, the move was opposed by textile and apparel industries. As these companies are labour intensive, a rise in the minimal wage will severely affect their profit. In this year as a whole, average inflation is expected to come in at 4.5% and 5.5% in 2018.

Conclusion

In conclusion, we believe the growth momentum to remain strong moving into 2018. GDP in Vietnam is expected to grow at 6.5% in 2018, underpinned by strong export outlook and continued FDI. Inflationary pressure remains intact as driven by increased administrative fees and improved minimum wage.







Source: Bloomberg, CEIC, OCBC Bank

GLOBAL SPECIAL

Have the Markets Underestimated Inflation Risk?

Although the global economy has been recovering since 2012, global inflation remains sluggish. It seems that the fundamental principles of macroeconomics have been challenged, with major central banks even describing this phenomenon as a “mystery”. Will global inflation restore to normal levels in 2018? Where can we find it? Before answering these questions, it would be better to understand the causes behind this interesting phenomenon.

The debates regarding “abnormally” low-inflation have not come up with answers yet. However, we would like to provide some possible explanations below, including the impact of globalization and technology change.

Globalization is to blame

The development of globalization has accelerated since the early 1990s. The frequent cross-border trades among different economies have induced drastic changes on the labour market and the goods market. In addition to the growing importance of emerging market in international trade, the business environment of markets and industries has been more competitive.

Globalization, with more “transparent” information flow, has lowered trade barriers, allowing domestic products to access the foreign market. It has also led to an increase in the volume of imports. With closer substitutes from abroad available in domestic markets, firms have less scope to increase the prices even if domestic demand rises. Inflationary pressure has been undermined by moderate price adjustments.

In addition to price, the slower wage growth could be another consequence of globalization. Firms have more flexibility to reallocate their resources to invest in different markets, aiming for cost minimization due to rising labour mobility. Therefore, the wage growth has slugged even if the labour market remains tight. As labour costs are suppressed and consumption is curbed by weak wage growth, inflation refuses to edge higher.

Technological advancements may be another reason

Technological development has been another driver of weak inflation. With the rapid technological advancements, simple and duplicated tasks can be performed by machines and robots solely. According to the research conducted by the Bureau of Labour Statistics Employment Projections (BLS) of US, it is expected that there will be more than 700,000 jobs loss in US manufacturing sector, replaced by automation, over the next decade. The removal of a middle man due to technology change keeps prices low while fears about job replacement by automation suppresses wage growth.

Can China be the source of global inflation?

Although China's CPI remained sluggish at sub 2%, China's PPI has picked up significantly since the second half of 2016. This was driven by a low base effect and rising raw material prices. The PPI touched a high of 6.9% in September and October. Given the positive correlation between China's PPI and US CPI, the question is whether the spike of China's PPI will eventually be passed onto the US.

We doubt so as the current higher PPI was mainly driven by supply side factors as a result of China's de capacity campaign and environmental protection. Without the pickup of demand, we think the spillover effect of higher China PPI to the rest of the world is unlikely to be significant. As such, we do not expect China to be the source of global inflation at the current juncture.

Chart 1: Positive correlation between China & US PPI

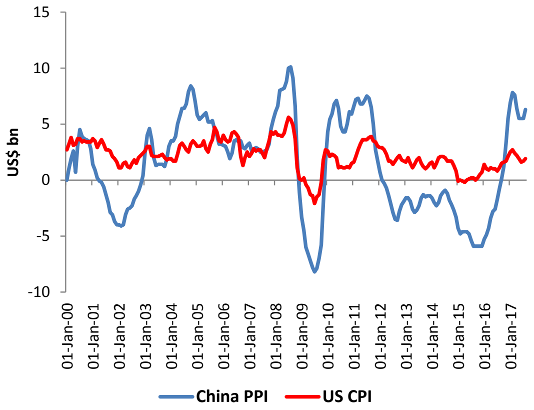
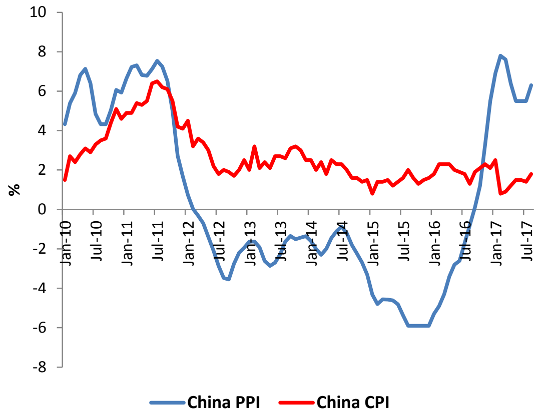


Chart 2: China's high PPI failed to boost CPI



Source: Bloomberg, OCBC

Markets may underestimate inflation risk in 2018

Having said that, we think markets could have been too complacent and may underestimate inflation risk next year. Although the structural changes such as globalization and technology change as mentioned may continue to weigh down inflation expectation, we would like to highlight a potential inflation shock in 2018, stemming from rising oil prices (pushing headline inflation higher) and the US tax reform (pushing core inflation higher).

Headline Inflation to edge higher

Decline in commodity prices, especially in that of energy has been the major culprit, weighing on headline inflation. Global oil prices have slipped persistently since April 2011. The price of WTI crude oil dropped to $37/bbl on average in early 2016 from around $106/bbl in May 2011. However, recent data suggests that the downtrend in oil prices has started to reverse. As OPEC is set to extend its production cuts until 2018, along with Asian and European demand likely to hold up well, it is expected that the oil market rebalancing will speed up.

Elsewhere, the manufacturing sector has continued to forge ahead with significant improvements, further reducing excess supply. The JPMorgan Manufacturing PMI has increased consecutively for 4 months in October and hit its highest level since May 2011. As a result, commodity prices have picked up significantly since early 2016.

Outlook of core Inflation remains mixed

Compared to headline inflation, core inflation is much more complicated as it excludes energy prices or food prices or both. Productivity improvement, wage growth and demand are the essential factors in boosting core inflation.

Technological developments may be a drag on core inflation recovery. On one hand, global productivity has been substantially enhanced by technological progress. On the other, technology has suppressed wage growth and reduced labour demand, especially in the manufacturing sector. This in turn pushes down underlying inflationary pressure. However, as room for companies to streamline the process gets limited due to huge investments in automation, the impact of technology on wage growth may start to ease.

Meanwhile, we think the potential impact of the US tax reform cannot be ruled out. Both House and Senate have passed their own version of the tax bill. The probability of eventual passage of tax reform by end of the year is high. As such, we may see a weird combination that the fiscal stimulus may be launched when the US economy operates above potential growth. According to IMF estimations, the US economy's negative output gap has been closed in 2017 and the positive output gap is expected to widen in the next few years. The combination of fiscal stimulus amid an upward sloping business cycle suggests that demand is likely to be boosted next year, which may eventually push up prices.

Chart 3: Headline inflation and oil prices

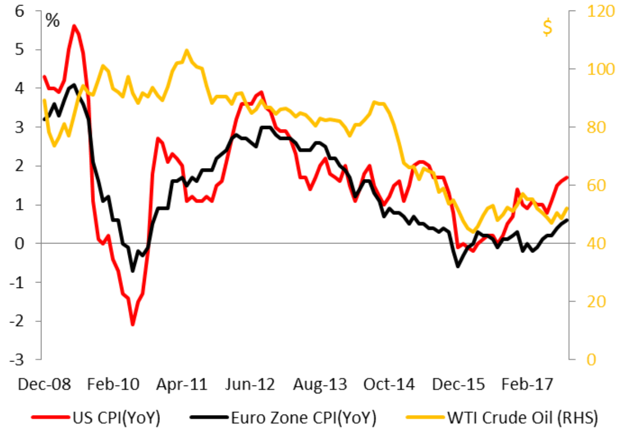
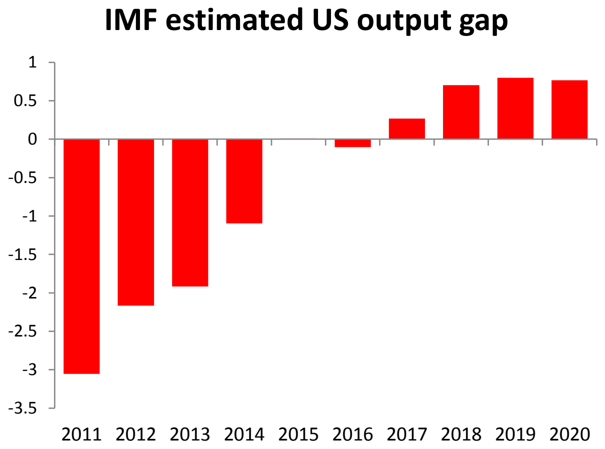


Chart 4: US output gap has been closed



Source: Bloomberg, IMF, OCBC

All in all, the rebound of commodity prices and the US tax reform may be the source where inflation can be found. However, without sustainable improvements in productivity and wage growth, long-term inflationary risks will still remain contained.

CHINA SPECIAL

China's To-do List and its Implications

Since the conclusion of China's 19th Party Congress in late October 2017, most China watchers have agreed that President Xi Jinping has been the most powerful Chinese leader since Deng Xiaoping. We do not share the concerns that the centralization of power may be the hurdle for reform. Instead, we expect Xi administration to roll out more reforms over the next 12 months to capitalize on President Xi's rising political capital as well as favourable macro backdrop.

Other than the ongoing anti-corruption campaign, from an economic perspective, meaningful efforts are expected to be made in four areas including financial de-leverage, environmental protection, ongoing economic transformation and further openness. In this article, we will discuss those four areas as well as their implications.

I. Financial de-leveraging

Both rating agency Moody's and S&P downgraded China's credit rating in 2017 citing debt concerns. Although we do not expect any imminent debt crisis in the next two years as more than half China's corporate debt were owed by state owned enterprises, which gives China room to manoeuvre, de-leverage is likely to be most important target for Chinese government in the next few years to secure a long-term sustainable growth.

Among all, the de-leveraging efforts in SOE sectors have topped policy priority after China's corporate debt to GDP ratio has risen to an alarming level of close to 170% by end of 2016. Premier Li has put de-leverage as the most important task in his 2017 Government Work Report back in March. Meanwhile, China further stepped up its commitment to reduce corporate debt in the State Council meeting in August. China has set up an alert line mechanism for debt ratios of different overly leveraged sectors and put a strict control in investments out of SOE's main business.

Nevertheless, those measures are unlikely to solve the problem without addressing the root problems, such as China's implicit guarantee which has distorted credit risk, a regulatory gap which led SOE to increase their leverage to arbitrage interest rate differentials as well as less developed direct financing channels. We think China will gradually move towards addressing those root problems in the next 12 months.

The most notable change of regulation recently was probably PBoC's drafted rules announced in mid-November to control risks in asset management industry. One of the most important aims of this new regulation is to break the implicit guarantee. This is likely to further differentiate good quality names from bad quality name. Investors will gradually learn to how to more accurately price credit risk, which will prevent the weaker credit name from borrowing excessively. This will help contain leverage.

In addition, China's State Asset Supervision and Administration Commission (SASAC) unveiled news rules in late November to tighten regulation on SOE's participation in public private partnership (PPP). Under the new rule, the SOEs should set quota for investing in PPP projects. In addition, the accumulative net spending in PPP should not exceed 50% of SOE's net assets reported in the previous year. Leverage ratio should not increase due to participation in PPP. The standardization of PPP will help prevent SOEs from adding leverage to become the conduit to channel money from banks to local government projects for the positive interest rate carry.

Implications of financial de-leveraging

Looking ahead, we think China is more determined than ever to lower leverage. Although China may grant a longer grace period for financial institutions to be ready for the eventual break of implicit guarantee, the trend of de-leverage is irreversible in our view. Since 19th Party Congress, volatility has returned to China's domestic bond market due to concerns about negative impact of financial regulation. We have seen unwind of credit bonds as asset managers are preparing for the new regulation. As such, we expect China's interest rate may remain elevated and volatility in China's capital market, in particular bond market to stay in 2018.

II. Environmental protection

As more Chinese people have been lifted out of poverty after rapid economic growth in the past few decades, the demand for quality of growth rather than speed of growth has increased significantly in China. President Xi Jinping has already shared the concept of "beautiful China" in his first speech as President. And environmental considerations have been added to official performance evaluations. China has stepped up its protracted battle against the pollution after the appointment of the new environment minister in June 2017. Meanwhile, in his 19th Party Congress speech, President Xi Jinping used the word "Green" 15 times in total. This signals that environmental protection is no longer talk only. As such, we expect China will continue its battle to clean up polluted air, water and soil.

Implications of environmental protection

In the longer run, the heightened environmental protection measures are important to improve citizen's quality of life, which in turn will help build a harmonious society. However, in the near term, we see two possible impacts. First, the measures may lead to higher volatility in commodity prices. Second, it may weigh down growth outlook. The environmental protection ministry together with local governments has shut down huge number of factories and companies which failed to comply with the environmental regulation. This resulted in the sudden decline of raw material supply, which in turn drove up the prices, although the demand picture remains unclear. The supply side factor driven commodity price volatility may continue into 2018. In addition, it may also knock some growth off GDP growth in the second half of 2017. The latest effort to fight pollution is one of the reasons why we expect China's growth to slow down in the second half of 2017.

III. Moving towards a consumption driven economy

The Chinese economy has benefitted from the economic transformation. The increasing share of consumption in GDP helped China build buffer to counter external shocks. We think China will continue to boost domestic consumption in the next five years. One of the key initiatives is likely to boost imports. President Xi has mentioned in May that China will host its first import exhibition in November 2018 to attract more foreign companies to sell their products to vast Chinese market. Meanwhile, China's Ministry of Finance also just announced to lower import tariff on 187 consumer goods, effective from 1 Dec. The average tax rate has been lowered to 7.7% from 17.3%.

Implications of the ongoing economic transformation

The recent reduction of import tariffs is expected to boost demand for foreign consumer goods. It also shows that China is ready to further open to the global economy to act as a true global leader to contribute towards the global recovery. This should be good news for regional economy as it supports the global business cycle going into 2018. In addition, the move will also be used to press domestic Chinese producers to move up the value chain to meet global competition.

In the longer run, the boost in consumption means that the stronger imports may further narrow China's current account surplus. This could further create room for RMB's two-way volatility.

IV. Further openness

In the past few years, China has gradually removed the restriction on foreign banks' operation in China. In March, China's banking regulator announced foreign banks are no longer required to gain prior approval from the CBRC for Treasury bond underwriting, wealth advisory and most custody businesses to simplify administrative procedures.

The openness accelerated after 19th Party Congress. In early November, China's People's Daily published an article written by Vice Premier Wang Yang, who is expected to take a bigger role next year, to advocate further opening. In addition, China also announced to gradually remove cap for foreign investment in China's financial sector. First, the investment cap in onshore securities ventures by foreign firms will be increased to 51% from previously 49%. And the cap will be abolished three years after the new rules take effect. Second, the maximum 20% equity stake cap in a Chinese bank for a single foreign investor and 25% for all for foreign investors will be scrapped. Third, foreign ownership cap in insurance companies will be increased to 51% in three years and will be removed in five years.

Implications of further openness

China's commitment to further openness shows that China stands ready to lead the next phase of globalisation and fill the gap as the US pulls away and turns more insular. In addition to allow more foreign participation in China's key sector such as the financial sector, China will also continue to contribute to the development of the region. President Xi has officially added China's Belt and Road Initiative to his 19th Party Congress speech. By filling the infrastructure gap under the Belt and Road Initiative, China will help to integrate isolated developing economies into the global system. Meanwhile, the reduction in transportation costs as a result of the infrastructure support will also underpin the trade flows in the region.

To conclude, we believe China will step up its reform push. We expect China to unveil its long to-do lists in 2018. Among all, financial de-leverage, environmental protection, ongoing economic transformation and further opening are four areas topping policy maker's mind.

On the positive side, China will contribute to the next phase of globalization via filling the infrastructure gap and boosting import demand for global consumer goods. However, on the negative side, some of reforms may weigh down the near term growth and create volatility in China's interest rate market as well as commodity markets. However, those volatility is unlikely to deter China's reform push as China presently has higher tolerance for slower growth.

HONG KONG SPECIAL

Upside Risks on Local Rates

Though the HKMA has closely followed the Fed to lift base rates since the Fed started its rate hike cycle in Dec 2015, local interest rates refused to tick up. As a result, the interest rate differential between HKD and USD widened to its largest level since 2008 and pushed HKD down towards the weak end of its trading band. Ultra-low interest rates also continued to underpin investment sentiment in the housing market. Housing price index has refreshed its record high consecutively for a year in October 2017. Nevertheless, risks on local interest rates have tilted to the upside amid a raft of IPOs, HKMA's additional exchange fund bills issuance and rising expectations on Fed's Dec rate hike. The resultant narrowing of yield differential may ease some downward pressure on the HKD. On the other hand, a higher HIBOR may prompt banks to lift the prime rate for the first time since 2006. Apart from the secondary housing market which has been hit by the increased HIBOR and new cooling measures, the primary housing market may also find it hard to hold up well as developers' loans with reference to prime rate will become less attractive should banks adjust local interest rates.

Mounting upward risks on HIBOR

Since the Fed started its rate hike cycle in Dec 2015 and raised rates for four times, HIBOR remained mired amid ample liquidity with 1-month HIBOR staying persistently below 1% since 2008. However, in the second half of 2017, HIBOR ticked up gradually due to two major reasons. First, HKMA issued additional exchange fund bills respectively on Aug 9 and Sep 19. As a result, aggregate balance, a gauge of interbank liquidity, fell notably from HK$260 billion to HK$180 billion. Second, a raft of heated IPOs including Zhongan, China Literature, Razer and Yixin locked up liquidity successively. Though the IPO money returned to the market in mid-November 2017, HIBOR remained elevated given year-end effect and the Fed's Dec rate hike. As such, the 1-month HIBOR and 3-month HIBOR have reached our year-end 2017 target of 1.05% and 1.21% respectively.

Moving forward to the year of 2018, whether the uptrend of HIBOR will persist is open to question given three uncertainties, including (1) Trump's tax reform, (2) the tipping point of global liquidity and (3) domestic liquidity condition. At this juncture, we still see upward risks on the HIBOR in the coming years.

Firstly, we believe GOP is likely to carry out the reform plan in 1Q 2018. As such, fiscal stimulus is likely to boost wage growth and inflation, against the backdrop of a strengthening economy and a tightening labour market. This will support the Fed to raise rates at least three times in 2018, regardless of the future composition of the US Federal Reserve Board of Governors, and in turn pile upward risks on the HIBOR.

Secondly, even if the Fed is tightening its monetary policy, other central banks may not rush to follow suit. For example, ECB is going to continue its QE plan at least until Sep 2018 while BOJ is unlikely to shrink its QQE size or raise rates in the near term. However, a combination of Trump's tax reform, oil rally and tight labour market condition may push up inflation. Therefore, global liquidity will likely reach its tipping point in the coming years. As such, heightening concerns about global monetary tightening may trigger capital outflows from emerging markets and therefore push up HIBOR.

Finally, domestic liquidity condition is likely to improve after year-end effect abates and the impact of Fed's Dec rate hike is priced in. The main reasons include relatively ample aggregate balance and strong equity inflows from China. Aggregate balance totalled HK$180 billion as at the end of October 2017, much stronger than HK$3.23 billion as at the end of September 2004 when the latest prime rate hike cycle started. Besides, southbound equity flows under the two stock connects amounted to RMB51.5 billion in November 2017, the strongest level since September 2016. However, any correction in HIBOR is likely to be limited. On the one hand, high loan-to-deposit ratio (80.2% in October 2017, an over two-year high) due to huge funding needs of local and Mainland companies will add upward pressure to HIBOR. On the other hand, any large IPOs could lock up liquidity and limit the downside of HIBOR.

All in all, we believe that after year-end, HIBOR may subside a bit amid still flush liquidity and strong equity inflows from China. However, upward risks on HIBOR remain intact in 2018 as we expect the Fed to hike at least three times in 2018 and other major central banks to follow suit gradually. Furthermore, the surge in the loan-to-deposit ratio and large IPOs may keep HIBOR elevated. Therefore, we expect one-month and three-month HIBORs to reach 1.4% and 1.7% respectively by end of 2018. With HIBOR's uptrend to suppress bank mortgage's net interest margin, banks will face higher pressure to lift the prime rate in 2018.

Housing market growth to moderate

After the new government refrained from announcing additional cooling measures in the 2018 Policy Address, the secondary housing market showed signs of improved investment sentiment recently. A land for residential use was sold at a record-high premium in November 2017. This also exerted some spill-over effect to the secondary housing market. However, we still believe that the moderation of secondary housing growth will remain roughly intact due to several reasons.

First, prospects for higher interest rates may add to cooling measures in taming secondary housing demand which relies heavily on bank loans. The October approved new mortgage loans fell on a yearly basis for the second consecutive month and dropped by 15.2% yoy. Second, a slew of new home projects launched so far in 2017 might have reduced investment demand in the secondary market. Third, increasing supply of subsidized flats may help to distract some demand for smaller flats from private housing market. Fourth, some less affluent homebuyers may wait and see if increasing private home supply could take down housing prices. In the near term, we expect growth of secondary housing prices index to moderate and housing transactions (dropped for the fifth consecutive month in November 2017) to remain tepid. Nevertheless, the correction may be capped by a still solid labour market as well as the wealth effect from stock market. Therefore, secondary prices index (+11.4% YTD in October 2017) is expected to grow by 10% approximately in 2017 as a whole.

With regard to the primary market, it has been less sensitive to cooling measures and the HIBOR's movement. This is due to a slew of sweeteners including mortgages with high loan-to-value ratio offered by property developers. As a result, despite a relatively quiet secondary market, resilient in the primary market has allowed the whole housing market to remain buoyant. However, we note that the oversubscription of new home projects fell to about 5 times lately from over 25 times in the first three quarters of 2017. As property developers continued to raise prices, the prices of new homes have become less acceptable to prospective homebuyers. Should HIBOR continue to tick up and prompt banks in HK to adjust the prime rate for the first time since 2006, developers' provision of mortgages, which is based on prime rate, will become less attractive. On the other hand, global monetary tightening could probably lead to a correction in the stock market and in turn reduce wealth effect from the stock market. This will also potentially hit the investment demand in the housing market. Therefore, even with a stable labour market and a resilient economy, the housing market may slow down in the coming year. Besides, the secondary home prices index is expected to increase merely by 0%-3% in 2018.

Still, a housing market collapse is unlikely in the longer term

Annual growth of households has remained at or above 2.5% yoy since 1Q 2015 while the vacancy rate of private flats reduced notably from 4.9% in 2008 to 3.8% in 2016. Housing stock per household living in private sector also decreased to 0.86 in 2016 from 2008's 0.89. This reflects an imbalance between supply and demand which may not be simply reversed by additional supply.

On the other hand, due to eight rounds of cooling measures carried out by the HKMA, the loan-to-value ratio of residential mortgages was lowered to 49.1% in October 2017 from 68.9% in September 2002. Moreover, according to the HKMA, homebuyers' debt servicing ratio (monthly debt repayment as a percentage of monthly income) also dipped to 34% from 40% in 2010. This means that the risk of high leverage in housing market is well contained, especially against the backdrop of a solid labour market and economic recovery.

HKD is likely to see two-way volatility

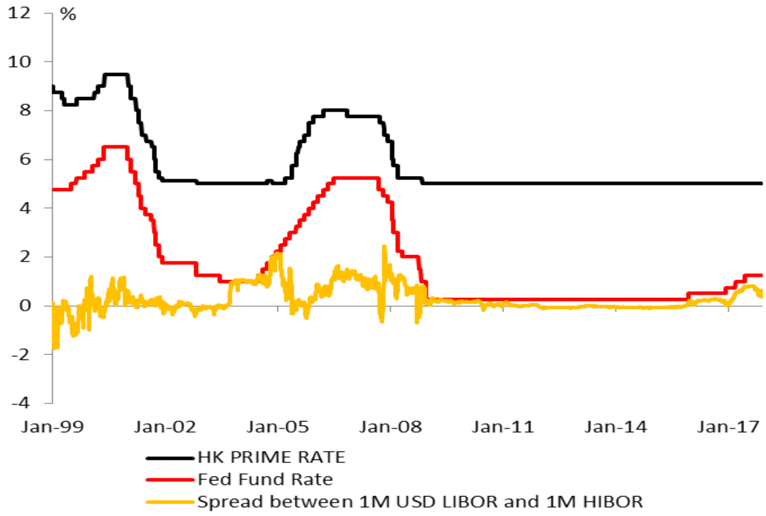
As HIBOR continued to lag LIBOR, the huge interest rate differential between HKD and USD induced carry trade opportunities (selling HKD for higher-yielding USD) and pushed HKD down towards the weak end of its trading band. However, in the second half of 2017, a raft of factors have pushed up the HIBOR with one-month HIBOR topping 1% for the first time since 2008 in late November.

Given mounting upward risks on the HIBOR, interest rate gap between the USD and the HKD might have peaked. A narrowing interest rate gap will likely damp carry trade which shorts HKD for higher-yielding greenback. Therefore, we see little possibility of USD/HKD breaking its recent peak around 7.83 even with a broad USD strength.

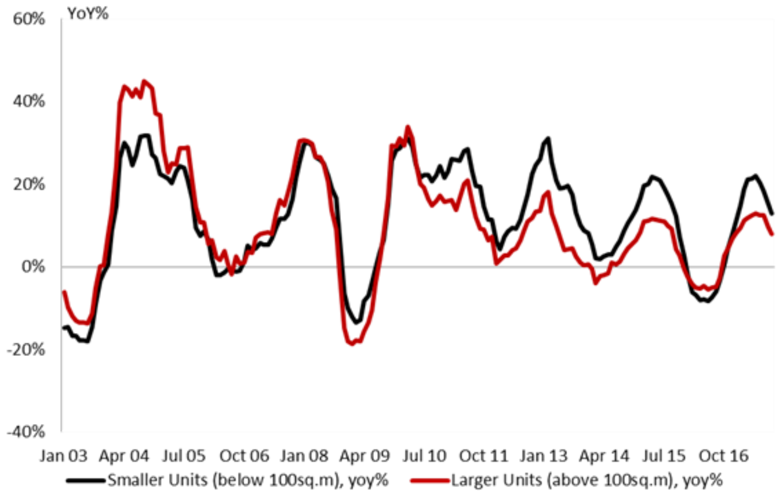
Nevertheless, much upside on the HKD is also unseen. In the near term, without any signs of capital outflows, relatively flush interbank liquidity will prevent yield differential from narrowing rapidly and substantially. This means that the HKD's downward pressure from yield differential will not fade away immediately.

In the longer term, should global liquidity reach a tipping point in late 2018, it will probably lead to a rotation of capital from emerging markets to developers markets. If this is the case, the interest rate gap may narrow further and ease the impact of yield differentials on the HKD. Still, any upside on HKD will be capped by the selloff of HKD assets. Therefore, instead of moving towards the stronger end of its trading band, HKD is likely to see two-way volatility, probably in the range of 7.7900-7.8300 against the greenback.

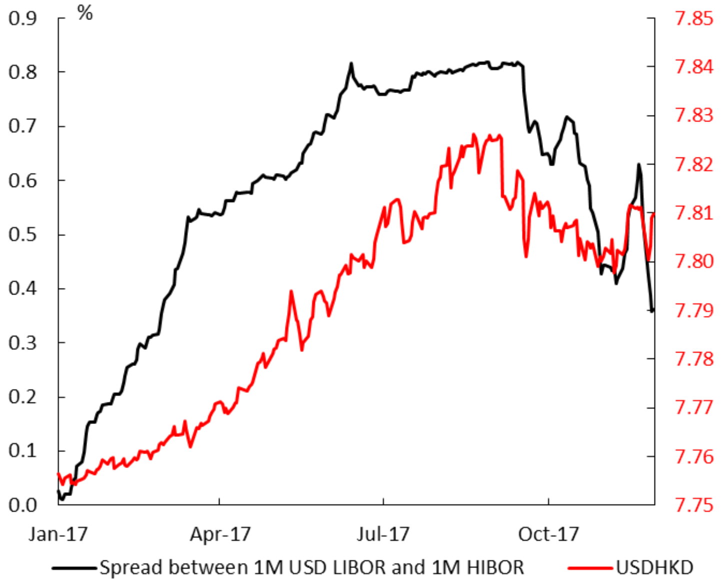
HK Local Interest Rates and US Interest Rates



HK Residential Property Price Index



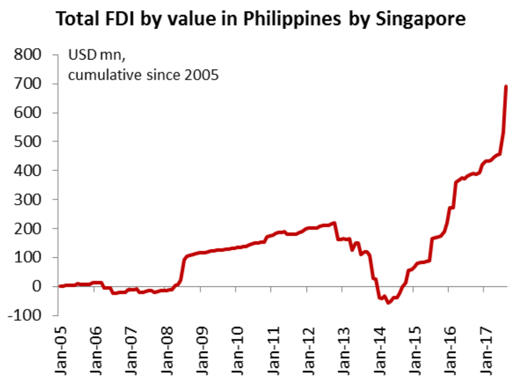
HKD and Interest Rate Differential

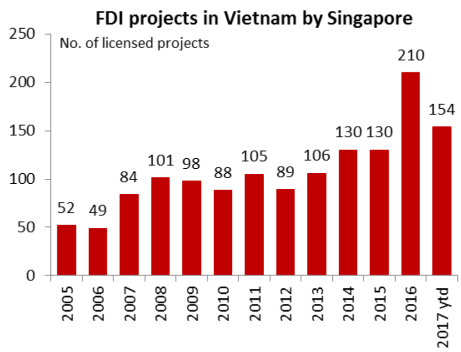


Source: HK Rating and Valuation Department, Bloomberg

Roads Less Travelled

Successful Singaporean corporates often have an outward-looking disposition, always looking for expansion opportunities in the region after the foothold at home is well-established. Policymakers, through the Budget and other initiatives, have also been encouraging Singaporean corporates to regionalize and expand their business footprint to leverage on opportunities elsewhere and build capabilities and competitiveness. Therefore, it is not difficult to spot a Singaporean presence in the regional markets, especially in the more developed economies like Indonesia, Malaysia and Thailand. These economies are well traversed by Singapore corporates, and business opportunities in these regions are probably also well-understood. The next two largest destinations for Singaporean corporates in the region, Philippines and Vietnam, also see sizable investments. A number of pioneering Singaporean corporates are already active in these countries. In the 2015, direct investment by Singaporean corporates in Philippines and Vietnam totalled S$5.8bn and S$5.4bn respectively.





Source: Bloomberg, General Statistics Office of Vietnam, OCBC

However, it is also true that these countries do not immediately come to mind when Singaporean corporates are considering an overseas expansion. Comparatively, Myanmar, at sixth place, arguably enjoyed more attention than the Philippines and Vietnam This thematic piece attempts to put the spotlight on these less well-known destinations.

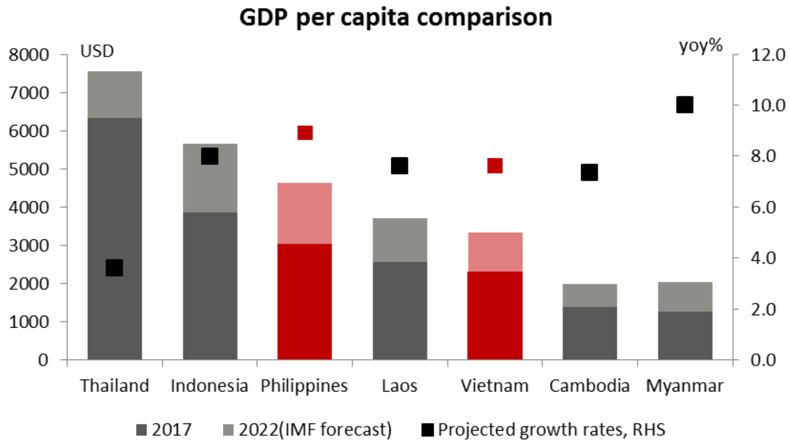
Current political climate is supportive of foreign investment

Corporates doing business in emerging economies often have to consider the political climate, rather than a calculation based on pure economics. Much is the same for Philippines and Vietnam. Both countries can be considered welcoming of foreign investment, and have attempted to improve laws to make investment more accessible.

Traditionally, the Philippine government has been open to foreign investment. Over the years, it has introduced a range of incentives and reduced the hidden cost of business by tackling graft and corruption. The prevailing belief appears to be that the push for growth should be led by the private sector, with the government limited to a supporting role, and not being explicitly involved in the economy. The government's grip on selected sectors, such as banking and finance, telecommunications and transportation, is also being increasingly loosened in a liberalization drive. These developments give the private sector, and also foreign players, more room to develop. In Vietnam, the new Law on Investment and Law on Enterprise were attempts to improve the investment climate for foreigners, underscoring a welcoming posture for foreign investment. These laws seek to liberalize ownership limits in selected industries, shorten registration procedures and provide tax incentives to selected industries.

Strong economic fundamentals supporting consumption

The current socio-economic profile and developmental trajectory of these countries favour increased consumption, especially of aspirational products. While absolute GDP per capita is still relatively low in both countries (US$3022 for Philippines and US$2306 for Vietnam), it is poised to grow at 8.9% per annum for the Philippines and 7.6% per annum for Vietnam over the next 5 years.



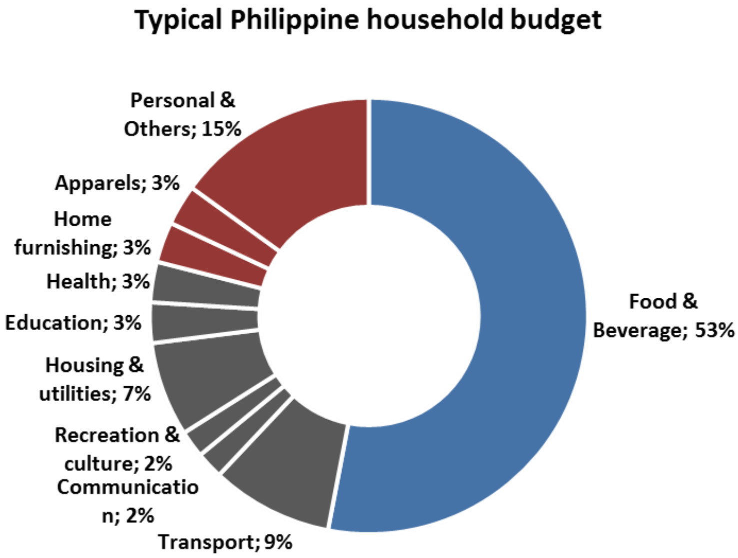
Source: Bloomberg, IMF, OCBC

Singaporean corporates looking to enter the Philippines will also benefit from its demographic advantage. With a population of 106 million, second only to Indonesia in the region, the Filipino population is still growing at 1.6% per annum. Moreover, with almost 8% of all Filipinos working abroad, the flow of remittances (totalling almost US$30b a year) provides a steady base for domestic consumption. Similarly, Vietnam enjoys a large population of around 92 million, growing at 1.1% per annum. With a median age of 30, Vietnam provides the access to a large group of consumers who are coming of age and experiencing strong income growth.

These characteristics point a developmental trajectory that should see increasing urbanization, an emerging middle class and a resilient domestic consumption sector. Indeed, domestic consumption accounts for more than two-thirds of total GDP in both the countries. Therefore, there may be potential for the fashion and fast retail subsectors to see out-sized growth. The opportunity for foreign corporates would be to introduce a brand which will be cultivated, and eventually accepted, as a premium brand. This brand can then be positioned as an upper-middle to high-end aspirational item that may experience greater sales as incomes grow. Typical marketing strategies for such products that have proven to be effective include the use of celebrity endorsement and visual advertising methods. However, a downside would be the higher cost of entry for newcomers, who will need to overcome the initial informational disadvantage.

Another industry that may benefit from the socio-economic structure of Philippines and Vietnam is the food and beverage (F&B) industry. F&B spending makes up a considerable portion of household budgets in both countries. The preferences for F&B often evolve as incomes grow, moving towards better quality and higher margin foodstuff. An increasing acceptance of convenience foods amongst the working youth, and a rising demand for health-orientated food products are new trends within the F&B

industry. These developments create the openings required for new players to fill. In this space, Singaporean corporates have a natural advantage given their reputation for good quality, especially in Vietnam.



Sources: IE Singapore, OCBC

Openness to trade and Free Trade Agreements (FTAs)
In addition to robust domestic demand, both countries enjoy the added advantage of being very much plugged into the global trade cycle. Foreign trade has been embraced as part of economic liberalisation, with both countries being key partners in ASEAN's economic integration initiatives. Both countries also actively seek to create a network of FTAs with their major trading partners. A case in point is the EU-Vietnam FTA, which is expected to take effect from 2018.

This creates additional opportunities for manufacturing, as the end-products do not just flow to the local market, but can also flow to other global consumer centres. More importantly, it allows corporates to take advantage of the unique features of the Filipino and Vietnamese economies to fulfil a part of the global supply chain. Basic manufacturing, such as food processing and apparel production, continues to be attractive given the strong agricultural base and low labour costs in both countries. However, they also have unique features that give rise to selected pockets of strength in higher value-added processes.

The youthful Filipino workforce benefits from being highly proficient in English. This quality, coupled with a strong education system, allows the Filipino workforce to be easily trainable in technical skills. This is already evident within the Filipino diaspora, which have a reputation as quality technicians, professionals and managers. Leveraging on this strength, the Philippines is a large player in Business Process Outsourcing (BPO) sector, using its bilingual workforce to provide support for multinational firms.

Meanwhile, Vietnam has established itself as an alternative to more expensive economies like Thailand and China in basic manufacturing. For example, the textile and garment industries can take advantage of the low cost of labour to reduce production costs, and the final products can be easily exported given the network of FTAs. Higher up in the value chain, Vietnam has also developed a niche in supplying specific components of the consumer electronics, with Samsung being a major player in this space.

It is also important to note the alternatives to the main cities of Manila, Ho Chi Minh City and Hanoi. Undoubtedly, these cities and their surroundings are natural industrial centres. However, opportunities exist in second-tier cities and regions, with the added advantages of having a larger pool of untapped labour markets and lower costs. An example of a new region not to be overlooked is Davao, the largest city in the Mindanao island group. It has a large pool of untapped labour force that may be attractive to labour-intensive industries.

Country-specific intricacies need to be considered

From a macro perspective, the Philippines and Vietnam may be attractive markets to enter. However, idiosyncratic features in each economy need to be considered and well-understood as well. Some of these features will be fleshed out here, but it is by no means exhaustive.

From a personal perspective, newcomers to these markets will have to manage entrenched local interests. The Philippines may be a difficult market to penetrate as a group of families controls a significant proportion of the economy. This implies that having a strong local partnership will be critical to unlocking the market and achieving success. Moreover, newcomers working in joint ventures with local companies may also have to negotiate complicated ownership structures and hierarchical chains of command. In Vietnam, the complicated and unfamiliar political setup may trip up many newcomers.

Notwithstanding the difficulties at an inter-personal level, corporates, especially those in the manufacturing sector, may also want to take note of the significant infrastructural issues in both countries. Given the geographical feature of the Philippines, road connections are consequently less efficient. Airports and seaports are essential to the movement of goods, but they remain relatively underdeveloped in many parts of the country. Similarly, infrastructure links in Vietnam, outside of the urban centres of Ho Chi Minh City and Hanoi, are not well maintained.

Conclusion

Singaporean corporates are structurally limited by the small local market size. Expanding into the region may be the only way for them to maintain a consistent growth trajectory. In this context, government support for overseas expansion has been strong over the years, and many corporates have benefited in the process.

In addition to heading to the more well-trodden markets in the region, it might be an advantage for Singaporean corporates to explore other potential markets like the Philippines and Vietnam. The political climate and economic profile remain supportive of foreign investment. Both countries have youthful populations which are experiencing strong income growth, and are well-connected in the global trade network. These attributes favour the manufacturing industry and the high-end consumer industry.

COMMODITIES SPECIAL

Commodity Prices and Asia's Growth

Stronger economic growth and continued gains in commodity prices are helping to drive up commodity exporters' economic growth prospect into 2018. Most developing economies in Asia including Malaysia, Indonesia and Thailand rely extensively on commodity prices to improve trade balances, which in turn supports overall economic growth. On the other spectrum, developed Asian economies with a relatively stronger manufacturing industry would likely remain as price-takers, and the uptick in commodity prices could potentially raise cost of production and narrow profit-margins.

With global growth likely to stay on track, a steeper inflationary environment due to stronger commodity prices would have mixed effects on Asian economies. As growth picks up, higher demand for growth-related commodities would mean relatively pricier food and energy prices. This would in turn benefit especially commodity-exporters. This paper serves to identify the economies that stand to benefit the most in next-year's commodity boom. However, for economies that does have a huge manufacturing base, the sustained healthy risk appetite and search for yield behaviour could well be sufficient to give these economies the needed support into 2018.

Methodology and Findings

Given our call for higher commodity prices into 2018, economies that rely on commodities for a sizable portion of their exports would invariably see positive spill-over effects from higher commodity prices to headline growth. Our study spans across eight different Asian economies including China, Hong Kong, Indonesia, Japan, Korea, Malaysia, Singapore and Thailand, and delves into their respective reliance on commodities and/or finished products as key export products. Our findings suggest that higher commodity prices have far-reaching implications especially on Malaysia, Indonesia and Thailand across various economic indicators including trade, confidence, employment, inflation and currencies.

For the purpose of this study, we ploughed through the Asian economies trade statistics organised via the United Nation's Standard International Trade Classification (SITC) method. Chiefly, the UN's SITC method compartmentalises export products via nine different (and rather complex) sub-categories, which we further simply into four key products: (1) Food, Live Animals & Edible Oils, (2) Crude & Processed Energy, (3) Raw Materials including Base Metals, Wood, Rubber, Clay etc and (4) Manufactured Goods including Semi-Conductors, Machinery, Transport, Chemicals and other miscellaneous products. Through these categorisation, we establish the economies which are net-exporters (or net-importers) of these said categories, and as a percentage of total trade to gauge their relative size and reliance on these commodities/products for trade and headline growth.

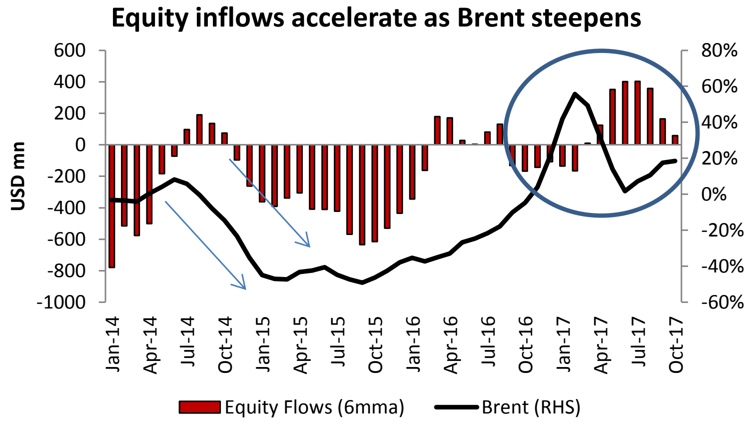
Our findings show that Malaysia, Indonesia and Thailand remain key commodity exporters in Asia, accounting for a sizable positive net-export as a percentage of total trade. Across the time period between 2015 and 2017 year-to-date, Indonesia tops all other Asian exporters in commodity exports, with net-exports of Food, Live Animals & Edible Oils (agriculture) accounting for 6% of total trade, Energy at 3.3%, and Raw Materials at 1.9%. Malaysia remains to be net-exporters of energy and agriculture as well, with Energy accounting for 2.6% of total trade while agriculture made-up 1.7%. Thailand on the other hand, has limited natural energy resources and relies on imports for its energy use. However, agriculture and raw materials remain to its key commodity exports.

On the flipside, developed Asian economies and China remained key manufacturing hubs. In turn, they rely on raw materials as input products for fabrication and construction of manufactured goods which include electronics, biomedical products, construction materials, machinery and transport equipment. These economies (save for China which arguably still retains its status as a price-maker given its sheer manufacturing size) are likely price-takers of raw materials, and naturally aligned themselves to be net commodity importers. The positive side of things perhaps, stem from the recent uptick in trade activities, which in-turn lifts both commodity prices as well as demand for manufactured goods. Regardless, while China, Korea and Japan top the charts for net-exports of manufactured goods, they do rely heavily on other raw commodity imports including energy and agriculture, which in turn could potentially squeeze profit-margin and intensify cost-push inflation into their respective economy.

Case Study: Malaysia’s energy exports to lift growth

Take Malaysia for instance: being the only net-exporter of crude oil in Asia, the price per barrel has substantial implications for Malaysia’s economic growth. As early as 2016, the slump in crude oil price has led Malaysia’s finance ministry to downgrade its growth outlook for the second time in two years. The reverse can be said to be true; higher crude oil prices should conversely support Malaysia’s growth. Thus, rising crude oil prices is supportive of Malaysia’s growth prospect into 2018. The first-order of things includes benefiting Malaysia’s balance of payment accounts, empirically seen in widening trade surpluses and stronger investor appetite. This cascades down to benefiting energy-related industries & its equities, government revenue receipts, and eventually wages in related fields.

In the same vein, stronger consumer and investor confidence will likely follow suit when Malaysia’s growth prospects brightens, which in turn benefits Malaysia’s capital flows and energy-related equities. To-date the Kuala Lumpur Composite Index (KLCI) has rallied by as much as 4.7% in the first ten months of 2017 against the same period last year. Similarly, net portfolio inflows made by foreign institutional and retail investors printed a strong US$2.2 billion in the first ten months of 2017, up from a mere US$491.8 million in the same period last year. The uncanny resemblance crude oil prices have with foreign portfolio flows strongly suggests that higher crude oil prices have supported Malaysia’s equity market as well.



Source: Bursa Malaysia Berhad, Bloomberg, OCBC Bank

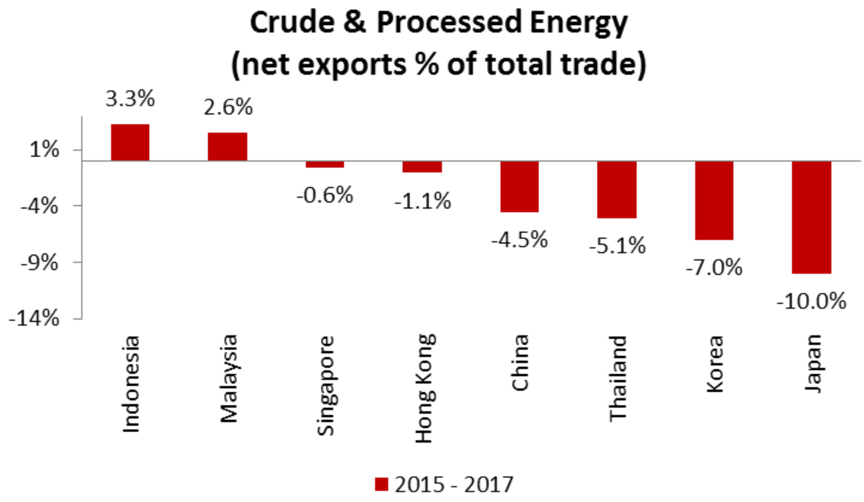
The government's fiscal standing also stands to benefit from higher oil prices. Although oil revenue as a percentage of total government revenue has fallen significantly from 41% back in 2009, it still contributes a relatively sizable sum of 14.6% in 2016 (estimated to be 13.8% in 2017). Encouragingly, the introduction of Malaysia's Goods and Service Tax (GST) and continued expenditure prudency in the last years has kept overall budget deficit below 4.0% of GDP. In the light of stronger oil prices and potentially higher dividend payout by Petronas, the finance ministry has pencilled a healthier budget deficit at 2.8% of GDP.

Tying all these together, the stronger growth prospects underpinned by robust trade, capital flows and healthier fiscal standing will eventually lead the ringgit higher. Empirically, the ringgit has trended in tandem with oil prices, given the closely knitted relationship crude oil has with the Malaysian economy. Referencing back to the tenets of economics, the uptick in oil prices and the positive spill-over effects it has on trade, confidence and fiscal standing are key ingredients for a dearer ringgit going forward.

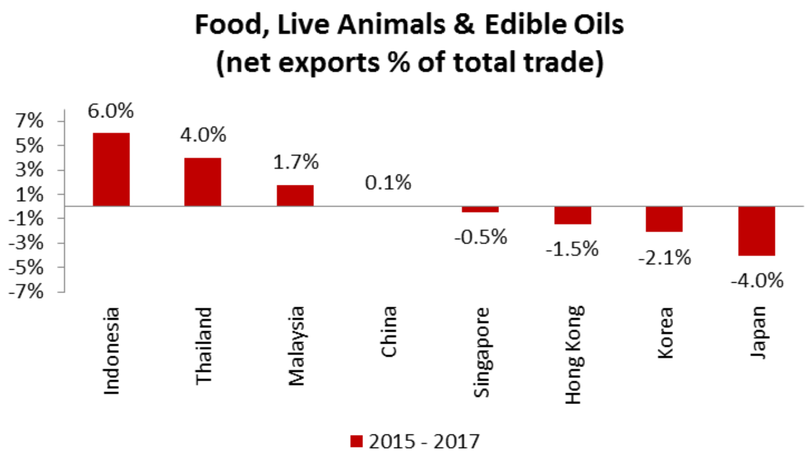
It's a double-edged sword

We have to be clear on what is driving commodity prices into 2018. Higher commodity prices are likely to be underpinned by the improving global economic outlook and relatively rosy trade activities then. The uptick in export demand should invariably lift both growth-related commodity prices including base metals and energy (and palm oil given its bio-diesel component), as well as giving the much needed positive spill-over effects into Asia's manufacturing industries. As a matter of fact, industrial production prints and manufacturing Purchasing Managers Indices (PMIs) across key Asian economies have remained in expansionary territories, which provide the backdrop for Asia to start 2018 on a stellar note.

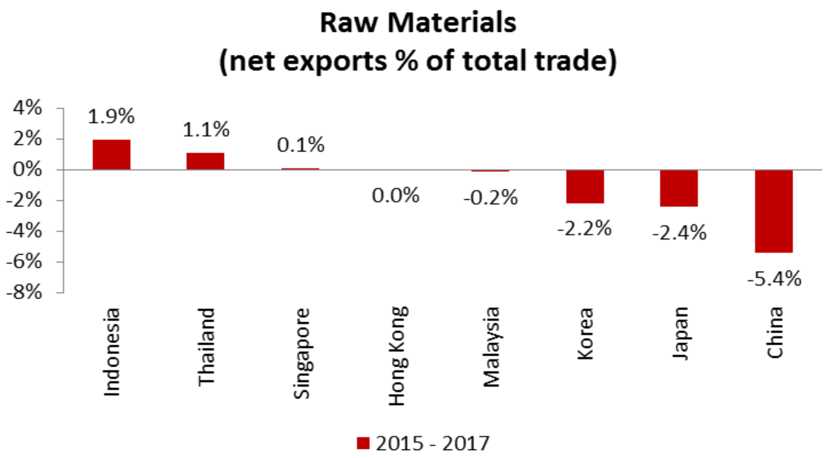
However, the mix of higher inflationary pressures and higher interest rates into 2018 may eventually dull risk appetite and taper potential growth. For commodity exporters, while they will gleefully see wider trade balances as commodity prices rise, the backlash from higher prices of finished goods will eventually be seen. The reverse can be said to be true for Asian economies which rely on manufactured goods; higher commodity prices would seep into inflationary prints as a first-order condition effect, though the uptick in demand for manufactured goods should eventually inject positive returns for both firms and headline GDP growth.



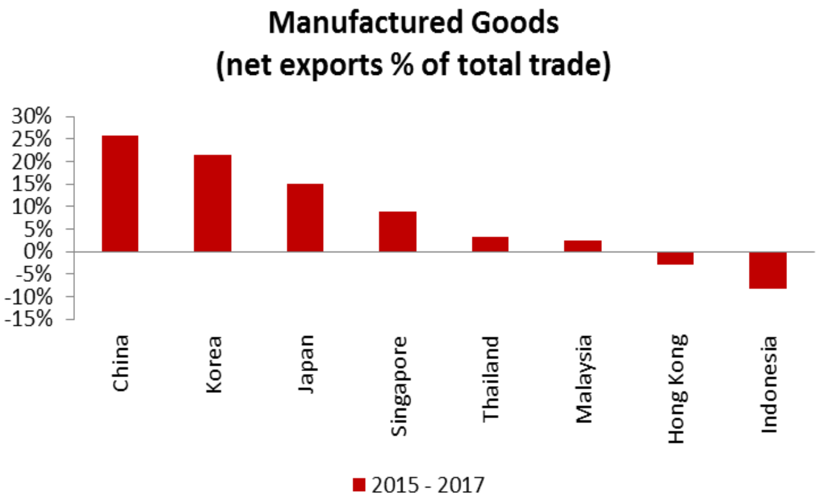
Crude & Processed Energy
(net exports % of total trade)
3.3%
2.6%
-0.6%
-1.1%
-4.5%
-5.1%
-7.0%
-10.0%
1%
-4%
-9%
-14%
Indonesia
Malaysia
Singapore
Hong Kong
China
Thailand
Korea
Japan
2015 - 2017



Food, Live Animals & Edible Oils
(net exports % of total trade)
6.0%
4.0%
1.7%
0.1%
-0.5%
-1.5%
-2.1%
-4.0%
7%
5%
3%
1%
-1%
-3%
-5%
-7%
Indonesia
Thailand
Malaysia
China
Singapore
Hong Kong
Korea
Japan
2015 - 2017



Raw Materials
(net exports % of total trade)
1.9%
1.1%
0.1%
0.0%
-0.2%
-2.2%
-2.4%
-5.4%
4%
2%
0%
-2%
-4%
-6%
-8%
Indonesia
Thailand
Singapore
Hong Kong
Malaysia
Korea
Japan
China
2015 - 2017



Source: CEIC, OCBC

TECHNOLOGY SPECIAL

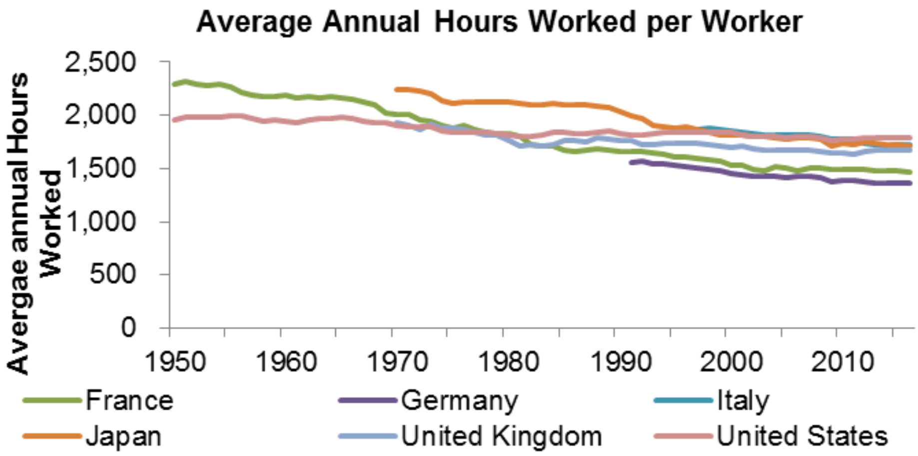
Act Fast, Artificial Intelligence is Here To Stay

The traditional levers of economic progress - 1) capital investment and 2) labour are no longer able to sustain the growth in GDP enjoyed in previous decades in most developed economies. With the recent convergence of technology, economies are entering a new era where Artificial Intelligence (AI) has the potential to overcome the physical limitations of capital and labour and open up new sources of value and growth. Of late, communities, businesses, and even governments are concerned on how they can capitalise on AI, and if their comparative advantage is threatened by AI disruption. They are looking to AI capabilities which can allow them to outperform their peers, improve productivity, and even enhance the quality of their goods and services.

If it aint unbroken, why fix it?

Many jobs that used to exist a century and a half ago no longer exist today. To illustrate, in 1870, almost 50% of US' workers were in the agricultural sector, supplying food to the country. Fast forward today, agriculture employs shy of 2% of the nation's workers, with the surprising fact being that American food production outstrips domestic demand. We can thus see how technological innovations like the self-driving tractors we see today, has improved the productivity of the sector and subsequently improved standards of living.

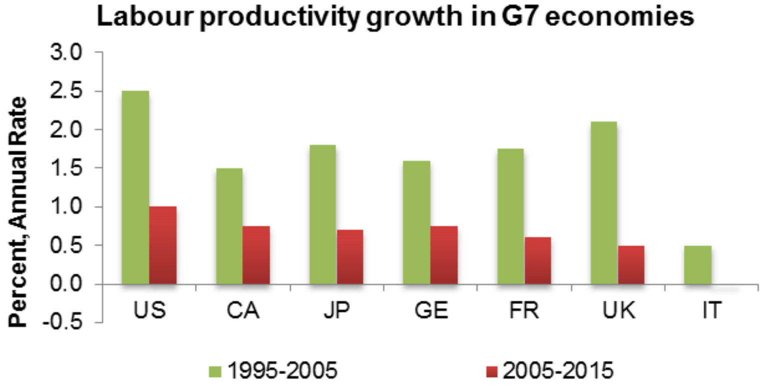
Generally, technology improves productivity by reducing the amount of hours required to generate a unit of output. The labour productivity improvements normally result in increases in average wages, and thus lowering the number of work hours for the worker. Empirically, over the last 65 years, a large part of developed economies experienced average annual hour worked per worker decline by a significant amount.



Source: OECD Stat

Enter the 2nd stage of the industrial revolution

Indeed, technology is one of the key forces of the growth in productivity. Particularly, there is empirical evidence that industrial robotic automation singlehandedly increased labour productivity growth by 0.36% across 17 economies between 1993 and 2007.



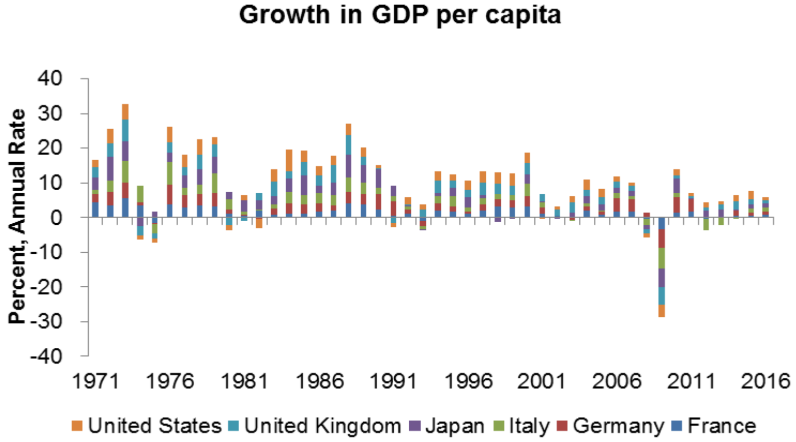
Source: Conference Board, Total Economy Database, CEA calculations

There has also been a stark fall in the potential of a rise in capital investment, combined with labour to effect the rate of growth currently experienced (World GDP growth steadily declining since peak of 5.4% since 2011). As such, both developing and developed economies may have to leverage on the capabilities of A.I to overcome these incumbent limitations, and to explore new avenues of growth.

Additionally, leaders and policy makers should look to AI as a game changer, rather than temporary hype in the market. A.I's presence is stronger now than ever before. The Inxx Global Robotics & Artificial Intelligence Thematic Index, designed to track the performance of companies listed in developed markets that are expected to benefit from the increased adoption of robotics and Artificial Intelligence have seen a more than 50% year-to-date change. A close benchmark, the Nasdaq, which composition is heavily weighted towards information technology companies only grew by more than 20% year-to-date. This increased inflow of funds and interest in investors in A.I and robotics has seemingly grown since 2010.

Implications on GDP

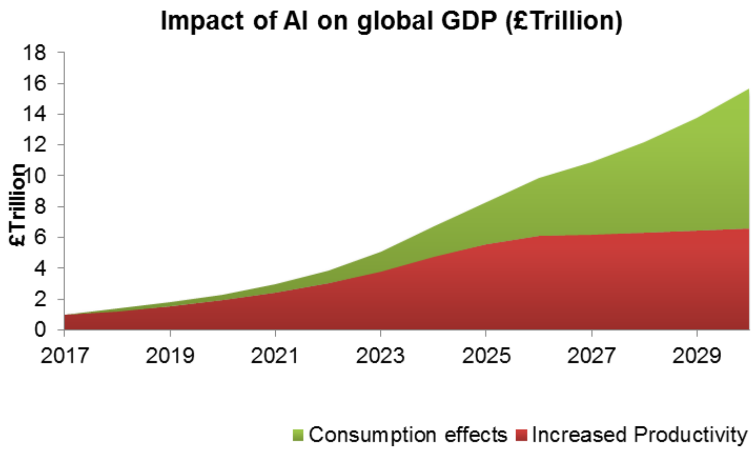
Shifting our lens onto GDP prints instead, we observed that G4 GDP growth rates have been steadily falling for the past two decades. Thus, we feel that Artificial Intelligence can offer the developed economies fuel to improve productivity and streamline processes to once again drive economic growth higher.



Source: OECD Stat

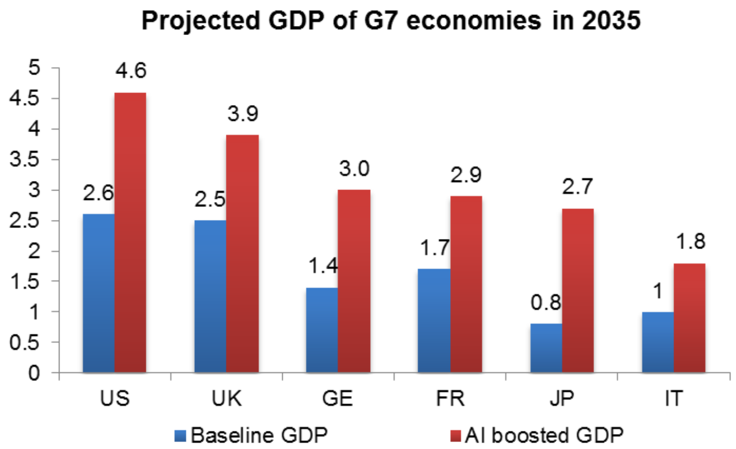
To have a closer glimpse at AI's estimated effect on global GDP as well as GDP in developed economies, we took a dive into various white papers from the likes of PWC, Accenture (Why Artificial Intelligence is the Future of Growth, 2017), and frontier economics. We found their methodology to be interesting and to have considered many aspects of modeling. As such, we have been able to present these effects as seen below.

AI's modeled impact on GDP



Source: PwC Analysis

The first paper we delved into was a research report by PWC (Sizing the Prize, 2017). To estimate the potential and impact of AI, their team sourced for input from their database of customers, as well as functional and sector advisors within the firm. Many insights were drawn from the extensive research but we choose to focus mostly on the potential impact on AI on GDP, dividing the impact into consumption (demand-side) and productivity (supply-side) effects. On the data front, we saw that enhancements in productivity of labour were slated to take up more than 55% of overall GDP improvement from AI from 2017 to 2030. As seen from the curve above, as new technology is slowly taken up and implemented by mainstream consumers, there will be an uptick in demand, thus burgeoning the proportion of impact from product advancements. Additionally, as impacts from increased productivity start to taper off from 2025 onwards, demand-side effects would have the lion's share of the impact of AI on GDP, hitting around an estimated of 58% by 2030.



Source: Accenture, Frontier Economics

In another paper, collaboration by Accenture and Frontier Economics helped us understand the impacts of AI on 12 developed economies, of which we choose to present the largest 6. These 12 developed markets, which contribute more than half of the world's output aided us in realising that AI had the capabilities to double annual GDP rates, providing a solution to the slowing growth rates of late. To model the economic potential of AI on these various economies, a baseline and expected economic growth factoring the impacts of AI was included. Furthermore, a buffer till 2035 was used in the analysis to take into account the time for the impacts of AI to filter through. Clearly, AI's modelled economic benefit on the US is the largest at 4.6% by 2035. Also, Germany and Japan's effected GDP change are stellar as well, having a doubled and tripled GDP respectively. Elsewhere, the projected effects on GDP were also done on more laggard economies such as Italy (80%), Spain (47%) and Belgium (69%), albeit a dull effect. This is due to the mismatch of technological advancement and public investment in these laggard economies.

These estimates also allow us to see how quick these regions can double in size with the help of Artificial Intelligence. Particularly for Japan, the baseline effect (no AI intervention) would mean around 80 years for its economy to double in size. However, with AI, it is estimated that Japan GDP could double in a mere 25 years. The US is even quicker in this aspect, boasting a doubling in size is just 10 -15 years' time with the help of AI intervention.

What do all these mean for the AI scene onshore?

Notwithstanding AI's potential implications for the US and other developed markets, the Asia Pacific region also boasts a great environment for robust growth and is well placed to embrace robots and AI in the workforce. In recent years, the limelight has been falling on AI, emerging to be the top agenda of many countries including Japan and China. Looking at data trends, there is a multitude of AI research being carried out in these countries as they continuously see the hatching of several deep learning-focused start-ups amid a surge in demand from regional businesses for services powered by technology.

The case for Singapore is no different. Prospects for the country's tech sector are robust. Supported by the government's consistent investments into the sector, the country has developed a strong research foundation which will in turn serve to augment Singapore's competitive edge. Under the auspices of the National Research Foundation (NRF), AI.SG, an initiative introduced in May 2017 dedicated to advancing AI, is slated to receive $150 million of funding over the next five years for industry research. Moreover, Singapore is attracting leading AI talents given its status as a cosmopolitan society and strong state backing for technology research. This will continue to drive reforms that will promote higher efficiency in the country's tech sector. As Singapore forges ahead on its Smart Nation journey, this technology will definitely play a key role.

Recently, service robots introduced by Park Avenue Rochester Hotel in Singapore in June last year could be the first of many to spur Artificial Intelligence take up in Singapore , two A.I robots named "Techi" would try on the roles of bellboy and housekeeping. Additionally, the shortage in labour in the Hospitality industry, aggravated by its traditionally manpower intensive nature has placed a constraint to growth. Hence, with the help of the two Techi which cost $100,000 each, will be able to accomplish an equivalent amount of duties to four full-time staff in a year. Notwithstanding the rise in A.I infiltration in Singapore, the concept of robot taking up duties in Hotels has also thrived offshore, with one Hotel in south-west Japan already fulfilling almost all of their labour needs with robots since Jul-2015.

Most notably, the recent opening of Changi Airport's Terminal 4 grants us a potential glimpse of the near future. The terminal boasts of state-of-the-art technology that makes use of facial recognition technology to enhance the automated lanes currently being used at existing terminals which use thumbprints. Further, FinTech is increasingly becoming more involved with the Singaporean landscape for real economic value as the country seizes technology like blockchain. The city-state's central bank, Monetary Authority of Singapore, is also encouraging more FinTech experimentation via a regulatory sandbox to enable promising innovation testing in the market with minimum red tape. Banks have also seized opportunities by collaborating and investing in FinTech companies. For instance, OCBC launched an AI-capable chatbot with the ability to answer questions on home and renovation loans early this year. The bank has also launched a robo-advisor that can guide clients in their investment journey. With the latest developments, AI is poised to revolutionise many aspects of human life, ranging from FinTech to healthcare, hospitality as well as transportation and communication. Taking into consideration the accelerated rate of adoption, it is thus best that more countries ride the wave of AI, lest they be left behind.

Conclusion

Reacting with haste to the uptick of impact of Artificial Intelligence will pose a significant challenge to both corporates and governments. Notably, the transformation of AI in the workplace has begun, changing the types of jobs available and the skills required for workers to be equipped with. Sustained engagement amongst policy experts, governments and the public would play a pivotal role in moving countries forward, and pushing boundaries for productivity to improve further.

With AI in full swing in the foreseeable future, market leaders seen today could be struggling to stay relevant or may even disappear forever if their response to AI is laggard. As such, the full potential of AI is in doing things never done before, instead of an absolute automation or improvement of current capabilities. Therefore, business leaders must react quickly and leverage on AI, as it could spur businesses much further than what the world could imagine.

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