OCBC GLOBAL OUTLOOK 2H17

OCBC Bank

2H17 Global Themes

Monday, July 03, 2017

In the first half of 2017, the global economy has seen economic green shoots blooming and financial markets generally weathering geopolitical risks relatively well. Since US president Trump's inauguration, the escalation of North Korean tensions, Dutch elections, French presidential and parliamentary elections, UK's triggering of Article 50 as well as the unfortunate hung parliament outcome in its recent snap elections have come to pass, but the risk assets have generally performed well for the year-to-date. Some of the bullish signs have been Argentina's sale of US$2.75b of 100-year bonds for 7.917% yield, joining Mexico, Ireland and UK in the century bond club, whiles a record US$14.5 billion of perpetual bonds have been issued in Asia ex-Japan in 1H17 including fixed-for-life and FWD's zero-coupon USD non-call 5 perpetual bonds.

The global growth engine continues to hum along smoothly, but 2H17 may also herald some potential summer storms. There are remaining risks, not least the German elections, concerns about risks in Italy's banking system and ongoing Brexit negotiations with a weakened PM May administration. Closer to home, investors remain undecided if Malaysia will call general elections later this year or in early 2018, and if Fitch would also upgrade Indonesia's sovereign credit rating following S&P's recent upgrade to investment grade, even as China's hard landing risks subsides. The key question in our minds are market players becoming immune to geopolitical speedbumps or is the global search for yield essentially in the last dance before the ball ends, now that the US Federal Reserve (FOMC) has clearly articulated its intentions for normalizing its balance sheet before the year is out, in addition to its anticipated third rate hike later this year and another 3-4 rate hikes in 2018? The USD swoon may be nearing an end if the FOMC leads the pack in paring its balance sheets later this year. If the USD starts to base-build and gain traction into 2018, then the capital inflows into Emerging Markets (EM), including Asia, may falter going ahead, especially if the economic surprises fail to sustain and excite on the upside.

What has been a surprise is that inflation has failed to rear its ugly head. If anything, the recent crude oil price slump has thrown a spanner into reflationary hopes, even though OPEC producers had agreed to extend their production cuts. According to EIA data, weekly US crude stockpiles peaked at a record 535.5 million barrels for the week ended 31 March, and US oil production had climbed above 9.3 million barrels a day to its highest since August 2015. This came as US president Trump touted "energy dominance" and pulled out from the Paris Agreement on Climate Change. With crude oil price failing to make further headway after touching US$54 per barrel for WTI and having retraced back below US$45 handle in late June, the base effects for inflation prints are also likely to begin to stabilize and should ally some of the initial concerns that key central banks had fallen behind the curve in monetary policy normalization.

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Our core view at the start of 2017 (as per our earlier "OCBC Global Outlook 2017") was that Asian interest rates would not rise as fast as USD rates as Asian policymakers are likely to tread a delicate balance between supporting domestic growth and finding policy space amid externally-driven pressures on currencies and interest rates. We continue to see MAS, BI, BNM, and BOT etc to remain on hold for the foreseeable future, cautious about the balance sheet unwinding plans of the G3 central banks, namely FOMC, ECB and BOE going into 2018, which could potentially upend the happy state of affairs in 1H17 which saw healthy capital inflows into EM and Asia. ECB's Draghi recently commented that "the central bank can accompany the recovery by adjusting the parameters of its policy instruments – not in order to tighten the policy stance, but to keep it broadly unchanged", leading market-watchers to regard that ECB could be ready to reduce its bond-buying program at a later stage. Elsewhere, BOE's Carney warned that "some removal of monetary stimulus is likely to become necessary if the trade-off facing the MPC continues to lessen and the policy decision accordingly becomes more conventional", while BOC's Poloz also opined that "certainly we need to be at least considering that whole situation now that the excess capacity is being used up steadily". The gradual withdrawal of monetary policy accommodation over time is likely to portend the tightening USD liquidity conditions globally and this is an additional challenge for Asian central banks going forward.

Trump's fading of his earlier anti-globalisation and anti-trade bluster had also come as a relief to markets. Amid the political uncertainties surrounding the investigations into Russia's role in last year's election, the economic priorities have largely been waylaid. His healthcare reform has been postponed and the tax reform timing and scale remains hanging in the balance, albeit we think that the latter is one deliverable he has to execute before the mid-term elections. Essentially, disappointment on his controversial policy convictions had allowed market players to price out Trump-related noise and focus on the FOMC. Consequently, portfolio capital flows have returned to Emerging Markets (EM) including Asia, and IDR- and MYR-denominated assets have been among the outperformers for the year to date after seeing significant volatility in 2016. Even the sovereign rating downgrades for China and Hong Kong have not proved to have lasting effects. Meanwhile, the MSCI's inclusion of China's 222 A-shares into its benchmark index from 2018 marked an important step for China's capital market to integrate with the global financial market. The recent introduction of a counter-cyclical factor in late May to the RMB fixing mechanism has helped to alleviate some pressure of a vicious cycle of depreciation expectations. Admittedly, many China-related uncertainties linger, among them being the upcoming 19th National Party Congress, continued deleveraging and financial supervision tightening, RMB outlook and capital outflows.

Surprisingly, the US withdrawal from the Trans-Pacific Partnership (TPP) did not totally sink the proposal. The remaining 11 TPP countries have affirmed their intention to move forward without the US (which would have accounted for 60% of the trade agreement's GDP), with a November 2017 target deadline set for a roadmap of next steps. Note that Malaysia and Vietnam are somewhat hesitant on a TPP-minus-US agreement, while Mexico, Canada and Japan are also wary of potentially antagonizing Washington according to a Forbes report. So far, Japan and New Zealand are the only two countries to have ratified the TPP so far. US Trade Representative Robert Lighthizer has reiterated that America will only seek bilateral trade deals rather than multilateral agreements, which is underpinned by its "America first" philosophy. As such, the TPP's "gold standard" of environmental sustainability and labor rules, digital trade standards, data-privacy rules and cyber-security emphasis are at stake.

Other regional trade initiatives also take time to come to fruition, so hopes of near-term regional trade fixes may prove elusive in the near-term. Meanwhile, the "Road and Belt Initiative" continues to generate market interest, with about US$126b (+36% yoy) of contracts signed in 2015 according to the China International Contracts Association, the economic implications and spillovers for the rest of Asia likely remains a more medium-term theme. Similarly, the Regional Comprehensive Economic Partnership (RCEP), would see its 19th round of negotiations in Hyderabad in July since talks began in November 2012, aims to cover liberalization of goods, services, investments, economic and technical cooperation, competition and intellectual property rights for the 16 countries which account for over a quarter of the global economy (estimated at more than USD75 trillion), but may not conclude this year due to difficult negotiations.

In summary, central bank intentions have trumped geopolitical anxieties in the short-term, but we are surprised at how far the risk assets, particularly equity and credit markets, have rallied in the 1H17 with softer inflation, oil prices and lower bond yields even though global growth momentum remains healthy and G3 withdrawal of monetary policy accommodation is likely to materialize in the months ahead. We remain constructive on Asian economies on a macro-economic perspective, but cautious about how far the unwinding of Trump trades had taken the USD-Asian FX and rates complex and it could prove an uphill task to sustain expectations going ahead, so market corrections could be in the pipeline, albeit we are not looking for any hard binary-type of outcomes.

OCBC Asia GDP, CPI and Policy Rate Forecasts

GDP					
% chg year-on-year	**2014**	**2015**	**2016**	**2017F**	**2018F**
US	2.4	2.6	1.6	2.2	2.3
Euro-zone	1.2	2.0	1.8	1.8	1.6
Japan	0.3	1.1	1.0	1.3	1.0
United Kingdom	3.1	2.2	1.8	1.6	1.3
New Zealand	2.8	3.2	3.6	3.0	2.8
Australia	2.8	2.4	2.5	2.3	2.8
China	7.3	6.9	6.7	6.5	6.2
Hong Kong	2.8	2.4	2.0	2.2	2.5
Taiwan	4.0	0.7	1.5	2.1	2.2
Indonesia	5.0	4.9	5.0	5.0	5.4
Malaysia	6.0	5.0	4.2	4.9	4.2
Philippines	6.2	6.1	6.9	6.5	6.5
Singapore	3.3	2.0	2.0	2.5	2.5
South Korea	3.3	2.8	2.8	2.6	2.6
Thailand	0.8	2.9	3.2	3.5	3.5
Vietnam	6.0	6.7	6.2	6.4	6.5

Inflation					
% chg year-on-year	**2014**	**2015**	**2016**	**2017F**	**2018F**
US	1.6	0.1	1.3	2.3	2.2
Euro-zone	0.4	0.0	0.2	1.6	1.5
Japan	2.7	0.8	-0.1	0.6	0.8
United Kingdom	1.5	0.0	0.7	2.7	2.6
New Zealand	1.2	0.3	0.6	1.9	2.0
Australia	2.5	1.5	1.3	2.1	2.2
China	2.0	1.4	2.0	1.7	2.0
Hong Kong	4.4	3.0	2.4	2.0	2.5
Taiwan	1.2	-0.3	1.4	1.4	1.5
Indonesia	6.4	6.4	3.5	4.3	4.4
Malaysia	3.2	2.1	2.1	2.9	2.6
Philippines	4.2	1.4	1.8	3.3	3.3
Singapore	1.0	-0.5	-0.5	1.0	1.2
South Korea	1.3	0.7	1.3	2.1	2.5
Thailand	1.9	-0.9	0.2	0.8	1.8
Vietnam	1.8	0.6	4.7	4.0	4.0

Central Bank Policy Rate (%)					
	2014	**2015**	**2016**	**2017F**	**2018F**
US Fed Funds rate	0.25	0.50	0.75	1.50	2.25
ECB refinance rate	0.05	0.05	0.00	0.00	0.00
BOJ policy rate	0.10	0.00	-0.10	-0.10	-0.10
BOE base rate	0.50	0.50	0.25	0.25	0.50
RBNZ cash rate	3.50	2.50	1.75	1.75	2.00
RBA cash target rate	2.50	2.00	1.50	1.50	1.50
China 1yr lending rate	5.60	4.35	4.35	4.35	4.35
Hong Kong base rate	0.50	0.75	1.00	1.75	2.50
CBRC discount rate	1.88	1.63	1.38	1.38	1.63
BI rate*	7.75	7.50	6.50	4.75	5.00
BNM overnight rate	3.23	3.05	3.00	3.00	3.25
BSP overnight reverse repo	4.00	4.00	3.00	3.00	3.25
Singapore 3-month SIBOR	0.46	1.19	0.97	1.25	1.55
BOK target overnight call	2.00	1.50	1.25	1.25	1.50
BOT repurchase rate	2.00	1.50	1.50	1.50	1.75
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

Solid Growth To Create Room For Further Reform

Solid growth to create room for further reform
The Chinese economy kicked off 2017 with a stronger growth, reaccelerating to 6.9% yoy in the first quarter from 2016's 6.7% thanks to a low base. Despite a strong start, the Chinese government lowered its 2017 growth target to around 6.5% from the previous 6.5%-7%. This creates more room for China's policy makers to pursue their agenda of keeping systematic risks in check.

De-leverage tops policy priority
China has been fighting its high leverage problem since 2013, which led to liquidity crunch in June 2013. However, the effect was not so encouraging with China's corporate leverage having continued to climb in the past few years as most of the efforts have been diluted by all kinds of financial arbitrage in the name of financial innovation. As such, the focus this year has been shifted from a simple corporate de-leveraging to stemming the root problem of leverage in the financial system, which was also accompanied by the increasing anti-corruption campaign in the financial sector.

The current financial de-leverage has been mainly driven by two tools including monetary policy and regulatory tightening. Since Feb 2017, PBoC has shown tighter bias after it hiked its reverse repo rate twice in the money market although it has kept its benchmark lending rate unchanged. From late March, China's banking regulator CBRC also joined the campaign to tighten its grip on financial leverage via announcing more than nine regulatory statements to force banks to conduct a thorough investigation on their exposure to shadow banking activity.

China's capital market became the unintended victim of the recent wave of monetary tightening and regulatory tightening. China's equity market underperformed the region with A-share barely gaining in the first half while most equity markets achieved double digit return. In addition, China's bond market was also sold off with 10-year government bond yields rose from a low 3.25% in March to above 3.5% as of end of June.

Financial de-leverage taking effect
Despite the rising volatility, the latest financial data in May showed encouraging results that China's financial de-leverage have started to take effect. First, funding demand is moving back to on-balance sheet from off-balance sheet. For example, China's new Yuan loan growth beat market expectation in May and exceeded aggregate social financing. Entrusted loans, which is an off-balance sheet financing component, fell by the record of CNY24 billion in May.

M2 growth is another indicator of China's de-leveraging efforts. M2 growth decelerated to 9.6% yoy, below 10% for the first time in history. According to PBoC, the entire lending chain has been shortened significantly in May as a result of China's deleveraging. M2 from the financial sector only grew by 0.7% while M2 from non-financial sector grew steadily by 10.5%. The lower M2 growth is likely to be the new normal going forwards.

Growth momentum remains steady

China's yield curve inverted recently, sparking concerns about potential policy induced risk. However, the latest growth data pointed towards solid growth momentum. Indeed, both property tightening and financial de-leveraging are taking effect. For example, Investment in real estate decelerated to 8.8% in the first five months, down from 9.3% while property sales also slowed down to 18.6% in May from 20.1% in April due to tightening property measures.

However, the negative spillover effect from tightening policies has largely been balanced by steady private sentiment and improving manufacturing outlook. Private investment remains stable expanding by 6.8% in the first five months. Manufacturing production remained relatively stable at 6.9% yoy. In addition, fixed asset investment in manufacturing accelerated to 5.1% in the first five months. The stable private investment, together with improving manufacturing activities, shows that the recent economic recovery is genuine and the momentum is likely to last longer than initially expected.

Capital outflow risk subsidised

China's FX reserve rebounded for four consecutive months from Feb to May, mainly due to favourable valuation effect due to weaker than expected dollar. The capital flow picture has been largely balance in the past few months thanks to capital control measures as well as improving RMB outlook.

China recently fine-tuned its RMB fixing mechanism with the introduction of a counter cyclical factor. We think this is a positive move for RMB to break the asymmetrical depreciation pressures. We expect the USDCNY to stay in the range of 6.8-6.9 for the second half on the back of murky dollar outlook.

In addition, MSCI's decision to include China's A-share into its benchmark index and the launch of bond connect program is likely to attract more portfolio inflows. Meanwhile, China's Ministry of Commerce is going to launch the revised foreign investment list soon to encourage more foreign direct investment into the country. Altogether, we think capital outflow risk is likely to be contained in 2017.

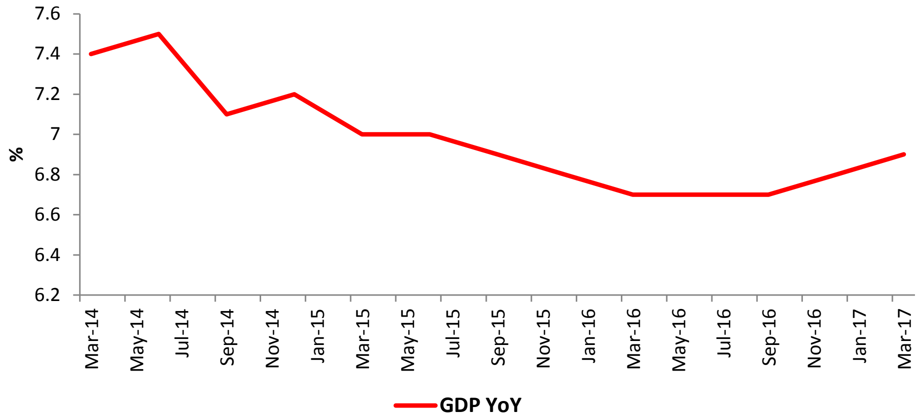
Growth may have peaked in 1Q

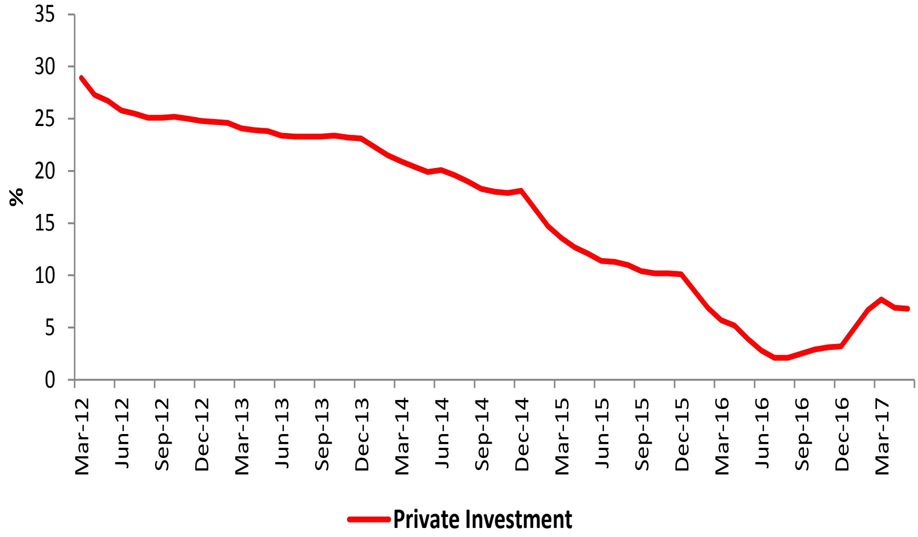
Despite positive developments in China, we are keeping to our view that economic growth has peaked in 1Q. We still expect growth to slow in the coming quarters for two reasons. Firstly, the higher funding costs in the money market will be partially passed on to the real economy and slowing growth. Secondly, the tug of war between driving financial de-leveraging efforts and simultaneously ensuring financial stability will continue. This may lead to periodic volatility in both capital markets and the real economy. Despite possible volatility, we upgrade China's 2017 GDP forecast to 6.5% from 6.4%.

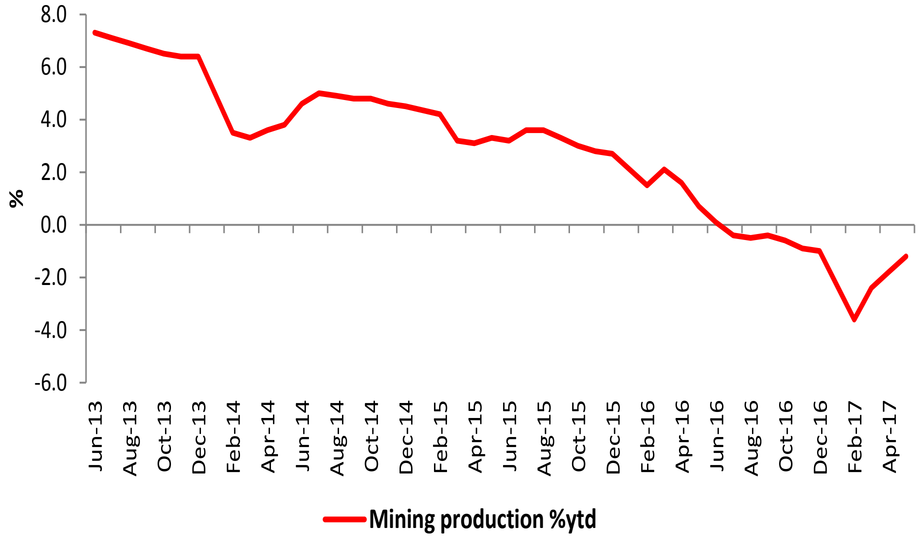
Watch for policy risk

Since June, both PBoC and CBRC has shown signs of policy flexibility. For example, PBoC injected liquidity to smooth out the liquidity fluctuation via both MLF and reverse repo while CBRC may give some banks more flexible deadline for the self-regulatory check. As such, we see low probability of a policy induced financial crisis.

Bonds and equities of Chinese conglomerates such as Wanda and Fosun had recently sold-off after news reported that China's banking regulator had asked some lenders to check their risk exposure to these conglomerates. This shows that sentiment remains fragile and concerns about political risk and regulatory tightening remain high, in the leading to the leadership reshuffle in the 19th Party Congress later this year. Therefore, we expect markets to remain sensitive to any policy risk.







Source: OCBC Bank, Bloomberg

HONG KONG

A Tightening Integration With China

GDP growth surprised on the upside and accelerated to print a 4.3% growth yoy in 1Q 2017, the fastest pace since 2Q 2011. Economic growth for 2016 was revised up to 2.0% yoy. The rosy performance was due to resilient private consumption (+3.7% yoy), strong government expenditure (+3.7% yoy), investments (+18% yoy), strong exports (+9.2% yoy) and private sector investments into building and construction (+5.3% yoy). A low base effect also contributed to the better-than-expected growth in GDP. Due to the waning base effect and an expected deceleration of China's growth, we expect HK's economic growth to have peaked in 1Q and to slow down gradually in the coming quarters. For 2017, our forecast on GDP growth remains unchanged at 2.2% yoy.

Housing boom may not last

HK's housing frenzy has been the talk of town for the first half of this year. It also contributed to the strong economic growth in 1Q. Since the government implemented new cooling measures from last November, the secondary market was tamed briefly with total housing transactions retreating on a monthly basis for two consecutive months. However, as the banking system is flushed with liquidity, banks were allowed to reduce mortgage rates aggressively in a bid to gain market share. Developers offering mortgages with high loan-to-value ratio to buyers had also dampened the negative impact of property cooling measures, thus foiling regulators attempts to tame the market. Furthermore, Mainland developers' aggressive purchase of HK land at high premiums had encouraged home sellers and developers to raise selling prices. This in turn led to a panic buying spree. Concurrently, new home supply increased at a slow pace earlier this year. As a result, housing transactions rose to the highest level since last September in April. Meanwhile, overall housing prices index refreshed its record high for the sixth straight month in April and edged up by 19.8% yoy.

With the HKMA increasingly concerned over banks' credit exposure resulting from the housing frenzy, new cooling measures were announced on May 12 and May 19. The new wave of housing cooling measures implemented by the HKMA is unlikely to have an adverse impact on the primary market. Large developers (which are outside HKMA's regulatory purview) will still have adequate capital to continue making loans to potential buyers. In contrast, the secondary/resale market which tends to be bank debt reliant may take a hit as new measures propel banks to increase the mortgage spread on HIBOR-based loans while Fed's rate hike may also push banks to lift Prime Rate by end of this year. Therefore, total housing transactions is likely to shrink further, after decreasing 18.8% mom to 5,732 deals in May. Factoring in increasing new home supply and China's slowdown, we expect the growth of home prices to decelerate in 2H. If this is the case, HK's housing market will lend less support to GDP growth.

Benefit from improved external demand

In addition to the housing frenzy, strong performance of the trade sector has been a contributor to economic growth since 4Q 2016. Total exports grew by 9.4% yoy during the first four months. External demand had improved on the back of global recovery with shipments to Mainland China and India sustaining their solid growth. Exports to the US though retreated by 1.9% yoy in April.

As Trump's administration encounters difficulties in pushing ahead with its' fiscal stimulus plans, trade demand from the US may not expand fast enough, thus lending little support to HK's exports. Nonetheless, the lowered possibility of a stronger HKD (amid the muted greenback performance) may mitigate some downward risks on exports. We expect resilience in exports to persist, thereby supporting economic growth in the coming quarters. Imports edged up 9.8% yoy during the first four months amid higher commodity prices. As commodity markets retreated on concerns over lower demand from China, the resultant deceleration in imports growth may help to narrow HK's trade deficit.

A moderate recovery of tourism activities

Though the revival of tourism activities could bolster economic growth, the support may be limited as the recovery is likely to be moderate. March retail sales numbers showed an end in the downward trajectory over the past two years and in April, retail sales continued to grow by 0.1%. This was mainly driven by the increase in the sales value of clothing, footwear, jewelry and watches. As such, we believe that the retail sector's revival was attributed to low base effect and the rebound in visitor arrivals from Mainland China (Mainland visitors increased by 3.3% yoy during the first four months). In comparison, the sales value of goods in supermarkets (-0.6% yoy) and consumer durable goods (-12.8% yoy) decreased in April. Sales from these segments are driven more by domestic spending patterns. We think the decline in both segments reflects households' preferences for online shopping and the decline in sales of durable goods was partially due to removal of full exemptions from first-time registration tax for electric cars. Even though retail sales are starting from a low base effect, we only expect low single-digit growth in retail sales this year. Nevertheless, retail shop property market is likely to rebound after tumbling for about a year.

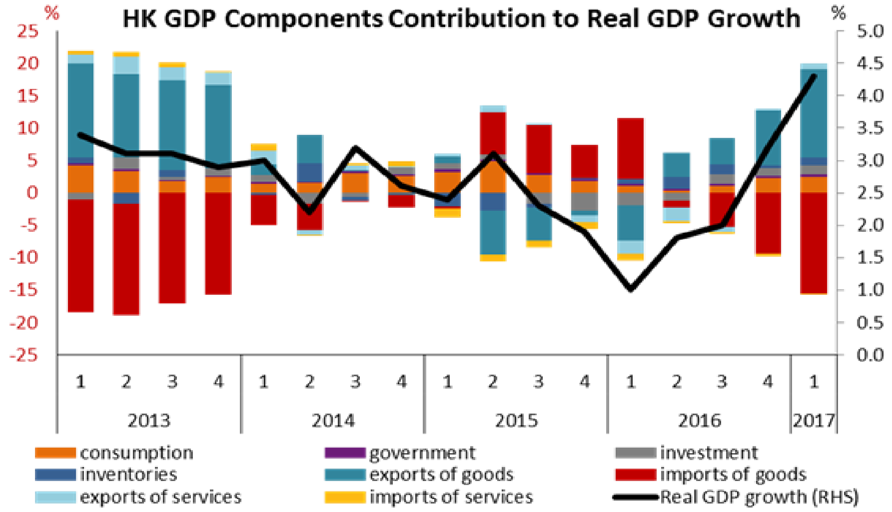
A tightening financial integration with China

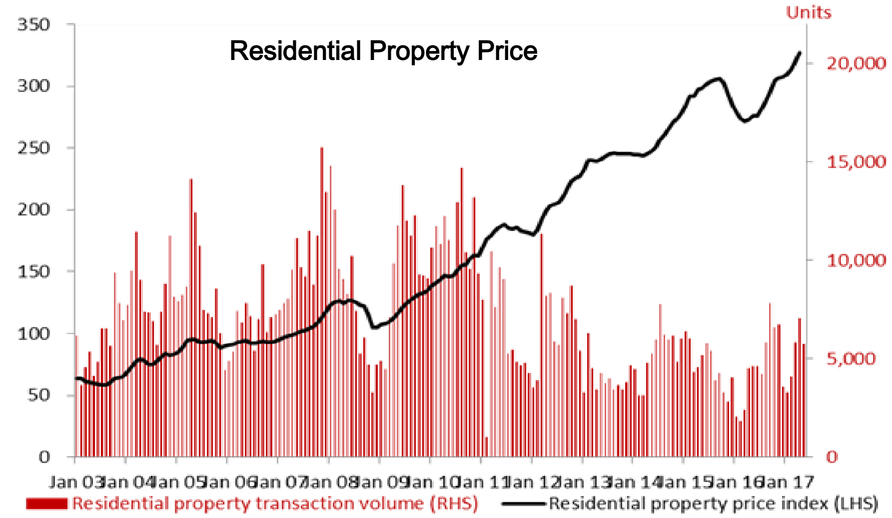
Apart from the tourism sector, the financial sector has also benefited significantly from Mainland China. Due to tight onshore liquidity and crackdown on the overuse of leverage, there was a huge demand for offshore loans from Mainland companies. This has pushed loans for use outside of HK (+14.9% yoy in April) to register double-digit annual growth for the third consecutive month. Simultaneously, increased trade activities and the housing boom have boosted growth in loans for use in HK (+12% yoy in April). Therefore, total loans and advances (+12.9% yoy in April) have also increased for thirteen consecutive months. However, amid HKMA's new cooling measures from May, we expect prospective homebuyers to borrow from developers rather than banks, in turn undermining banks' mortgage businesses. The likelihood of a moderate correction in housing markets could also slow banks' mortgage business. In contrast, strong exports may underpin the growth of loans to finance visible trade (+8.5% yoy). Overall, we expect to see loans to Mainland companies increasing as PBOC will likely retain its tightening bias and the country's deleveraging campaign may continue for the rest of 2017. Still, policy risks linger as media reported that China's authorities have curbed offshore financing of property developers since 2Q.

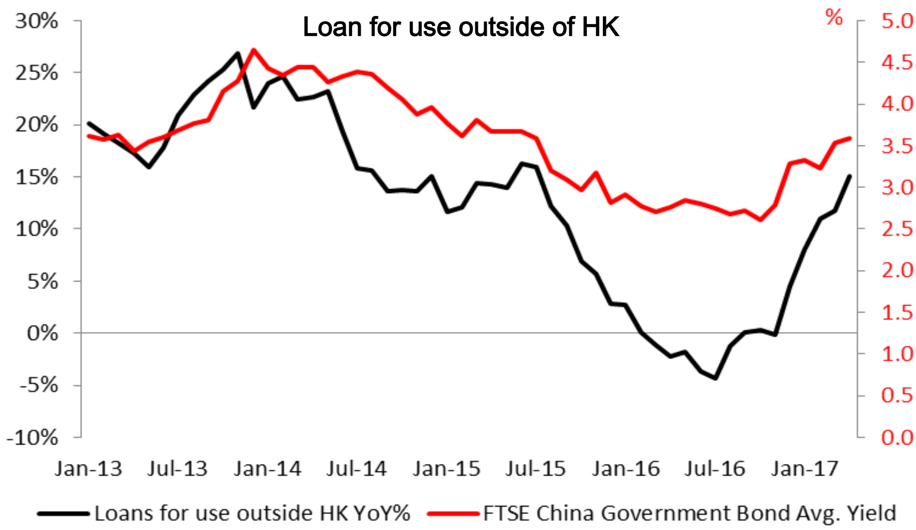
Following the launch of two stock connects which continued to encourage capital flows into HK's stock market, the PBOC officially approved the bond connect between HK and Mainland China. Should bond connect bring capital inflows into the onshore market, the PBOC may consider loosening its capital controls in the medium term, given lower outflow pressure and a more stable RMB. Due to the improving RMB outlook as well as loosening policy on cross border RMB payment under the current account, we expect RMB deposits to stabilize, after we saw in April that deposits had increase for the first time in seven months.

With Hong Kong increasingly being linked to China in various aspects, Moody's downgraded Hong Kong's ratings to Aa2 from Aa1 and revised the outlook to "Stable" from "Negative", following its' downgrade of China's sovereign rating. Nevertheless, we believe that the downgrade will have a limited impact on Hong Kong issuers and investor sentiment as Aa2 stable is still a solid rating. The HK government's sizable fiscal reserve and resilient economic fundamentals will also help to weather the impact of the downgrade. Though loan quantum in connection with Mainland businesses have been increasing, credit risks are well contained given HKMA's stringent regulation. China's crackdown on leverage means that debt risks will not heighten or hit HK's credit profile in the short to medium term.

In the long term, the development of "Greater Bay Area" will create more business opportunities for HK, allowing it to continue serving as a financial center and a platform for Mainland companies to go global.







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

INDONESIA

Humming Along

If it's not broken, why fix it? That seems to be the spirit that is guiding Bank Indonesia's monetary policy decision over the past few months, and it looks set to remain so for the rest of the year from the current vantage point. Thus far, BI has kept its 7-day reverse repo policy rate unchanged at 4.75%, and our sense is that it will remain stuck at the same level for the rest of this year.

To understand why there is such an apparent inertia, it is easiest to think of it less as a result of casual indifference, and more of an active consideration balancing two equal but opposing forces.

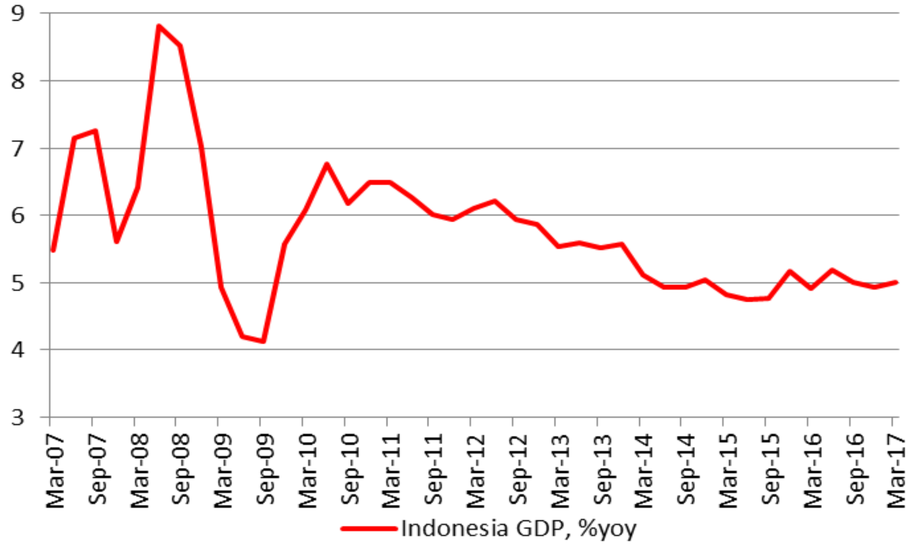
First, as alluded to at the start, a number of factors keep BI from easing its monetary policy. The most in-your-face one has to be the recent uptick in inflation. May saw headline prices picking up by 4.33% yoy, when it was below 3% just half a year back. This wave has been driven by a motley crew of adjustments in electricity prices, dearer airline tickets, petrol and cigarettes. Around the Ramadan fasting month, we are likely to see further uptick in food- and transport-driven prices for the next few prints. While the one-off and seasonal factors are hardly a reason to freak out over more generalized inflation risks, they would nonetheless minimize the chances of a rate cut in the near term.

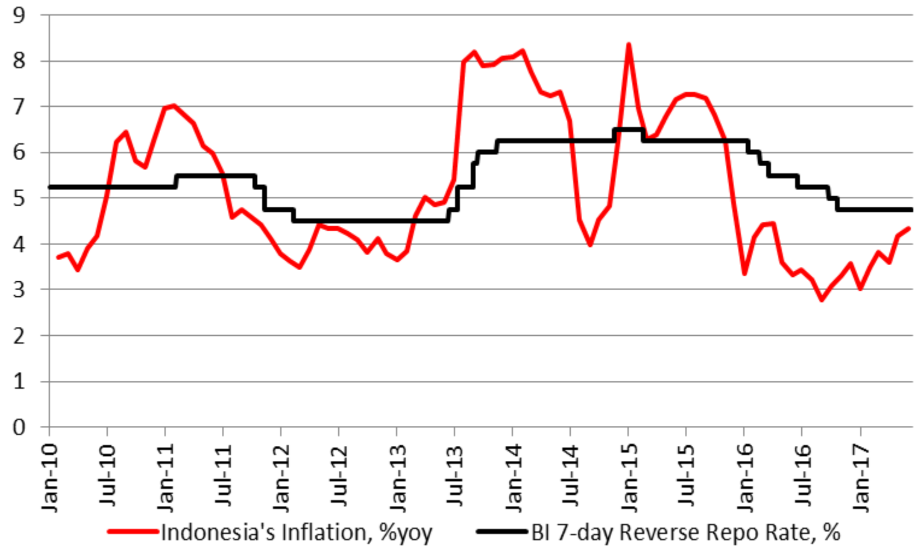
Meanwhile, while Q1 GDP growth was not much to write home about at 5.01%yoy – a barely noticeable uptick from 4.94% of the previous quarter – the momentum remains positive enough for the central bank to refrain from easing. This is especially so given that there appears to be relatively low chances of a fiscal pullback by the government, unlike the same period last year. Indeed, we think growth will still be around 5.2% for the whole of this year.

On the flip side, there is not much impetus for the central bank to nudge its policy rate upward. For one, as mentioned earlier, even as inflation remains something to look out for, there is little sign that price upticks are spreading broadly enough to warrant a classic monetary policy reaction just yet. On top of that, Rupiah has also been trading around a comfortably narrow range, which means BI is unlikely to intervene forcefully to support the currency via rate hikes.

This relatively dormant situation, of course, remains in large part a function of external factors, as well. Every now and then, we saw a whiff of risk aversion because of a roster of captivating developments in the US domestic politics. Thus far, this has translated more into USD weakness – which is, narrowly defined, a boon to EM currencies including Rupiah. To be sure, in what remains a rapidly evolving situation, BI is probably not alone in being cognizant that, if the risk aversion deepens further, EM currencies may well come under pressure as well. However, the likelihood of BI having to tighten primarily to stabilize its currency remains low at this point.

For now, the lack of compelling reasons to hike rate, or to ease it, will keep BI on hold. Overall, steady rates look to us to remain the path of least resistance for now.





Source: OCBC Bank, Bloomberg

S. KOREA

Fiscal Policies To Support Growth

South Korea kicked the year off on rocky grounds. Towards the end of 2016, the political arena was in shambles given investigations on alleged corruption and eventual impeachment of then-president Park Guen-hye. Not only did her leadership threaten both domestic and foreign confidence in Korea's growth prospect, it also failed to curb rising unemployment levels and rising household debts. With Moon Jae-in, recently elected in May as Korea's new president, much work needs to be done to repair the damage and re-assure the international community.

New president, new hope
At the very least, the inauguration of Moon has clearly removed political uncertainties, while recent strong fund inflows suggest the recovery in international confidence. Elsewhere, the better external environment seen across Asia has also benefited Korea, and the outperformance of its exports printed thus far should provide further growth lift beyond the official 2.6% growth outlook.

Still, it is not a bed of roses. Despite the improvement in Korea's economic outlook, recent developments in its geopolitical space are especially worrying if it exacerbates further. At least for now, further provocations by North Korea has not been seen after its last missile test (the last missiles were on 8th June – four surface-to-ship cruise missiles). Of note, the easing concerns over North Korea should give more breathing space for Moon to negotiate between its two key economic partners: US and China; the US had long wanted S. Korea to deploy the Terminal High Altitude Area Defense (THAAD) in response to North Korea's military threat, while China openly opposed this move. More importantly, the easing tensions also suggest limited military intervention, a scenario that clearly preserves peace and the multitude of lives in the surrounding countries.

Comfortingly, Moon's approach to the North-South Korean tensions is one of pro-engagement. A critic of ex-president Park Guen-hye's approach in dealing with the north, Moon calls for a "two-step" approach with talks hoping to lead towards "economic-unification" and ultimately "political and military unification". Moreover, with Moon-led Korea's foreign agenda with North Korea, market-watchers were also quick to point out the possibility of South Korea taking the lead in negotiating the nuclear issue. In these, he has also pointed out three stages in which he would hopes to achieve a nuclear-free Korean Peninsula: (1) for North Korea to not engage in any further nuclear provocations, (2) prevent North Korea from advancing its nuclear capability further and (3) eventually see North Korea in completely scrapping its nuclear program.

Delving into market fundamentals
In a nutshell, there is upside risk to Bank of Korea's current 2.6% growth outlook with BOK governor Lee Ju-yeol commenting that growth *"is showing signs of faster-than-expected growth on improving exports and investments. I think we can revise the growth outlook upward in July".*

Lee's optimism is not unfounded. Korea's growth engines have been firing nicely for some time now, led by the improving external environment and recovering fund inflows into Korea's equity and bond spaces. Notably, Korea's export environment (which accounted for 35.5% of GDP in the twelve months into 1Q17) grew to its 5-year high in April earlier this year. Empirically, in the first 20 days of June, total outbound shipments surged 24.4% yoy, up from May's 13.4% print, led by exports to Japan (+22.2%) and China (+7.4%). The improving trade numbers also coincided with the improving industrial production prints and consumer sentiments, suggesting that the positive spillover effects from a rosier trade environment are already seen in the industrial and consumer spaces as well.

Coupled with the improvement in domestic confidence, seen from the rising consumer sentiment index, the strong fund inflows also illustrate the ongoing optimism seen from the international community. Empirically, net-inflows into Korea's bond space in the first five months of 2017 was the highest since 5M13, while equity inflows over the same period are already 70% of total inflows seen in 2016. In a nutshell, the record highs in the fund inflows during January to May 2017 suggest strong investor confidence, despite the ongoing political tensions in the Korean peninsula.

However, inflation is likely to stay benign into 2H17, led by weakening oil prices of late. Empirically, CPI has risen to its 2.0% handle in May 2017, from a trough of 0.4% in July 2016. Though we remain bullish on oil prices into 2H17 (OCBC Commodity outlook: WTI $55/bbl, Brent $57/bbl at year-end), the uptick in oil prices will likely be gradual and contingent on crude oil's rebalancing act into 2018. At the same time, sustained sluggishness seen in consumer expenditure should continue to limit demand-pull pressures on overall inflation rate.

Areas of concern

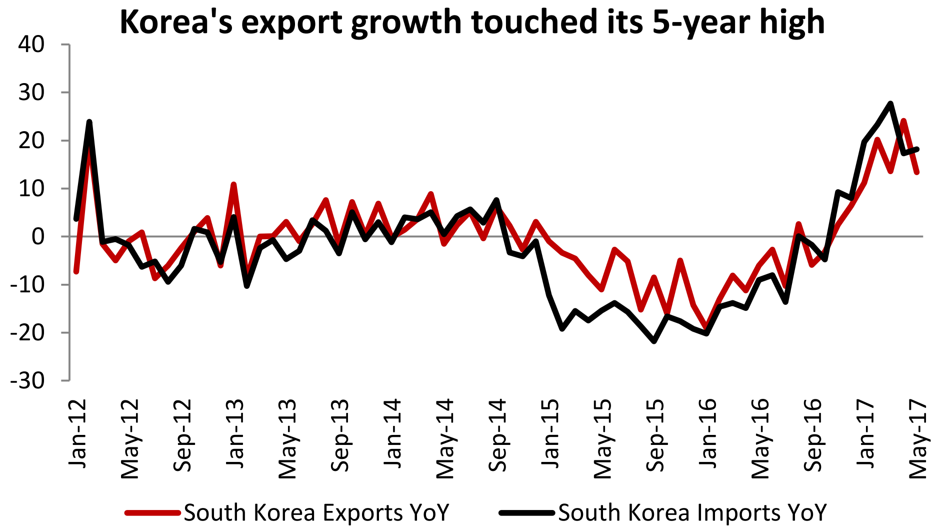
Aside from the geopolitical issues at the backdrop, tell-tale signs of economic risk can still be observed. Namely, we remain watchful over Korea's labour environment, especially given the falling income levels, weakening employment demand in Korea's key manufacturing sectors, and rising household debt levels.

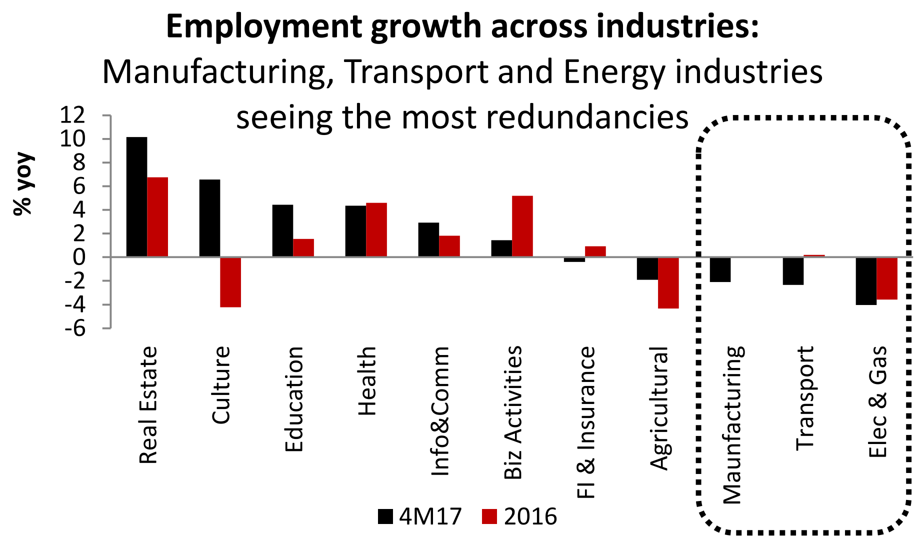
To elaborate, the falling average income levels and elevated unemployment levels should be discussed jointly. Empirically, South Korea's household income growth has decelerated considerably to a mere 0.84% in March 2017, down from June 2010's peak of 8.1%. Elsewhere, high youth (defined as people aged 15 – 29) unemployment rate at 9.3% remains disconcerting, with President Moon citing this as a "jobs crisis" that is causing a gap in wages and wealth. Delving deeper, industries including manufacturing, transport and energy are seeing the most labour redundancies in the first four months of 2017, suggesting that low energy prices and challenging business conditions in Korea's chaebols space may give rise to further growth risk if left unchecked. Should we digesting these indicators, it is of no surprise that Korea's household are increasingly weighed down by debt, in which household loans grew to 11.1% yoy in March 2017, up from 5.2% at the end of 2012.

Policy rate and growth outlook

Given the negligible inflation risk and high household debt, we look for the Bank of Korea to keep its benchmark rate unchanged at 1.25% for the rest of the year. Moreover, Moon's proposed infrastructure spending of an extra KRW11.2 trillion to create an additional 810,000 jobs should well suffice in providing growth support for the year. Moreover, Moon has also pledged a 7% increase in government spending in 2018, up from 2017's 3.5% in a bid to support growth and overall sentiment.

Should we consider the growth drivers (and drags) holistically, we opine that Korea's growth outlook remains favourable into 2H17 barring a quick exacerbation in geopolitical tensions. With the likelihood for trade and fund inflows to further support growth and sentiment, Korea's growth print is likely to average above 2.6% comfortably. Elsewhere, should Moon's proposed fiscal aid plays its part to create the much needed jobs, it should spark further uplifts in overall consumer spending.





Source: OCBC Bank, CEIC, Bloomberg

MACAU

The Recovery Story To Be Continued

GDP growth accelerated and marked 10.3% growth yoy in 1Q 2017, recording the fastest growth since 1Q 2014. Growth in the gaming and tourism sectors remained the key force driving the recovery of the gambling hub. Specifically, exports of gaming services and those of other tourism services edged up 11.3% and 20.9% on a yearly basis respectively. Meanwhile, a pick-up in external demand fuelled a revival of exports of goods (+9.7% yoy) which have declined over the past five consecutive quarters. Moreover, on the back of fiscal stimulus, government consumption and public investment grew by 4.8% yoy and 75.3% yoy respectively. In comparison, private investment rose by a mere 1% yoy as only one mega project is scheduled to be completed this year. On the other hand, a stable labour market and festive seasonal spending helped to reverse the decline of private consumption from -0.5% yoy in 4Q 2016 to 1.6% yoy. Nonetheless, growth remained subdued relative to its historical average level due to stagnant wage growth. Looking ahead, the gaming and tourism sectors are likely to gain traction at a moderate rate as lowered expectations of a strong MOP may offset the impact of China's slowdown and policy risks. Besides, fiscal stimulus may continue to provide an impetus for GDP growth and help to ease the impact of slowing private investment. Exports of goods are also likely to remain resilient given improved external demand. With the strong growth of gaming revenue in the second quarter, Macau's growth is expected to peak in 2Q 2017? and slow down gradually in the coming quarters. We revise our forecast for Macau's growth for 2017 from 3% - 5% yoy to 8% yoy approximately.

Continuous recovery of the two crucial sectors

Macau's attractiveness as a tourist spot is limited given that only one mega project is scheduled to be completed in 2017. Nevertheless, due to the global recovery, visitors from Taiwan, Japan and South Korea continue to be attracted to Macau. Meanwhile, China's economic stabilization and its political issues with Taiwan and South Korea have translated into Mainland tourists' higher preference for Macau and Hong Kong as their travel destinations. Furthermore, a combination of hotel promotions and the effect of public holidays have lent support to the tourism and gaming sectors. As a result, total visitor arrivals rose significantly by 6.9% yoy over the first four months.

However, due to the relatively low betting amount of casual gamblers, the mass-market segment did not contribute much to the robust growth of gross gaming revenue (GGR). Share of mass-market revenue in GGR dropped to a two-year low at 39% in 1Q 2017. On the contrary, amid China's stabilization and housing boom as well as the extension of credits by junket operators, high-rollers returned to the VIP gambling rooms. Therefore, this has been the major force driving the remarkable gain of 15.8% yoy in GGR over the first five months. Revenue from the VIP segment made up 56% of GGR in 1Q 2017, as compared to the quarterly average of 54% in 2015 and 2016. In this case, we expect that a likely slowdown in growth of VIP revenue may hinder the rebound of the gaming sector. As the deleveraging campaign and the housing market correction has undermined China's growth momentum, China's economic growth might have been decelerating from 2Q onwards.

As a result, VIP gambling demand from Mainlanders is likely to shrink due to the lower wealth effect. Furthermore, as the government has been striving to crack down on money laundering, we expect this lingering policy risk and the spill-over effect of China's slowdown to limit the upside of the VIP segment.

On the other hand, the mass-market segment is also facing some headwinds. Firstly, the high costs associated with visiting Macau, such as transportation and accommodation costs, may deter tourists from revisiting the gambling hub. Secondly, as there are hardly any public holidays during June to September, the effect of festive holidays on demand will likely abate. Thirdly, the regulation of checking the identities of Chinese UnionPay cardholders before they withdraw money at ATMs could possibly reduce leisure gambling demand. Nevertheless, the blow of high visiting costs and the abating seasonal effects may be softened by lower expectations of a stronger MOP. Therefore, we believe that both tourism activities and the mass-market segment of the gaming sector could sustain their growth into 2H, albeit at a moderate pace.

Based on the rosy performance of both the tourism sector and the gaming sector, we revised our forecast for GGR growth from 5%-7% yoy to about 12% yoy for 2017.

Retail sector and retail shop market to pick up growth traction

Due to the revival of tourism activities, retail sales value rose significantly by 12% yoy in 1Q. The low base effect also contributed to the gain in retail sales. Specifically, watches, clocks and jewelry (+23.2% yoy), adults' clothing (+10% yoy) as well as leather goods (18.6% yoy) showed notable growth in their sales value. As seen, these categories registered double-digit annual growth in sales volume. This is due to lowered expectations of a stronger MOP, the attractiveness of new hotels and China's stabilization, all of which supports tourist expenditure (+16.6% yoy in 1Q). Furthermore, the government's subsidy scheme for the elimination of two-stroke motorcycles drove sales value and volume of motorcycles, parts and accessories up by 49.6% yoy and 43% yoy respectively. However, the sales value of motor vehicles (-7.8% yoy) and communication equipment (-6.1% yoy) dropped, which signals muted local spending on durable goods amid stagnant wage growth.

Nevertheless, given a low base effect, we expect the annual growth of retail sales to accelerate and print around 20% in 2Q. As a result, retail shops prices (+32.8% yoy over the first four months) may rebound at a fast pace after declining for five consecutive years.

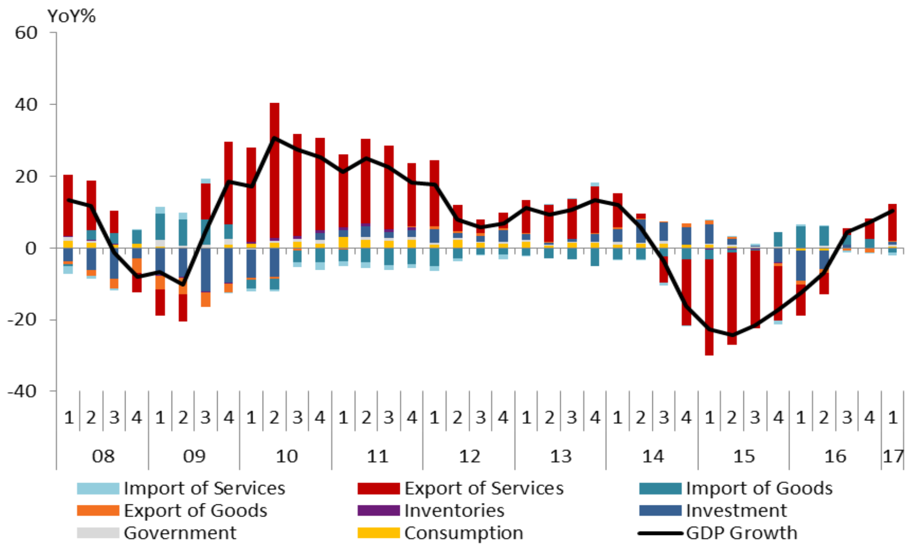
Housing prices to retreat from current level in 2H

Housing transactions grew for the 14th consecutive month in April, though at a slower pace by 3.3% yoy to 1080 deals. Meanwhile, approved new mortgage loans rose by 19% yoy to MOP3.36 billion, while housing prices rose by 21.7% yoy to MOP95,817 per square meter. As such, we believe that the housing market is improving as a result of solid economic recovery and low borrowing costs. However, average home prices have dropped by 7.7% so far this year.

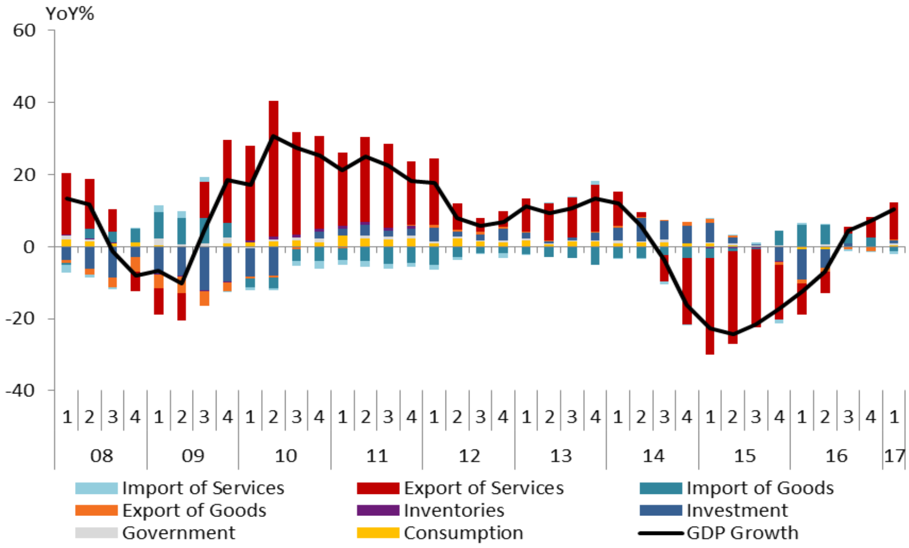
Moving forward, despite a stable labor market, housing demand may be constrained by stagnant income growth and an expected Prime Rate hike later this year. Furthermore, the government required banks to lower the loan-to-value ratio cap for non-first-home buyers in early May, which is expected to hit demand. Elsewhere, housing supply and housing completion was up **297% and 28%,** (verifying with carie) respectively over the first four months. Therefore, a housing boom is unlikely despite the gradual economic recovery.

Nevertheless, a mere 25 bps increase in the Prime Rate may not have a significant impact on the housing market. Also, slight upward risks have to be taken into consideration as the reclamation of undeveloped plots of land may hinder the growth of new housing supply. A stronger-than-expected economic recovery on the back of the gaming sector's resilience in 1H 2017 could also underpin higher housing demand. Still, we expect housing prices to retreat to approximately MOP85,000 per square meter by end of this year.

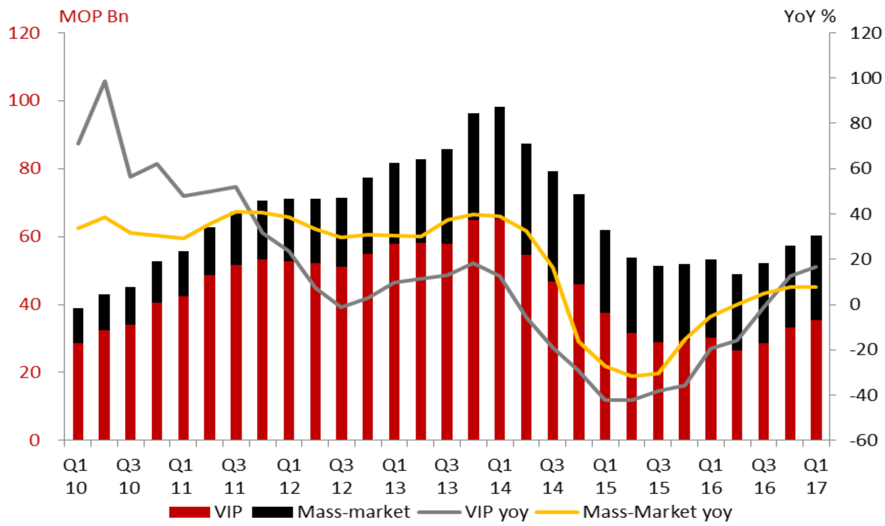
Impact of Gaming as Export of Services on Macau GDP



Macau Gaming Revenue By Segment



Macau Residential Property Market



Source: DSEC, DICJ, OCBC Bank

MALAYSIA

A Pleasant Surprise

The year began with a world that was preoccupied with concerns about how the rise of protectionist politics in the developed world would impede global trade flows. Looking through that prism of concern, we thought that 2017 would likely be a rather tough year for an export-dependent country like Malaysia. Fortunately, as it turns out, such dejected despair has not been warranted.

While the archetypal protectionist-in-chief, President Donald Trump of US, did assume power with all the threatening blusters about slapping tariffs on this country and building a beautiful wall along the border with that country, thus far, the bark has been worse than the bite. Instead of falling off the cliff as some might have feared, global trade flows actually picked up rather encouragingly.

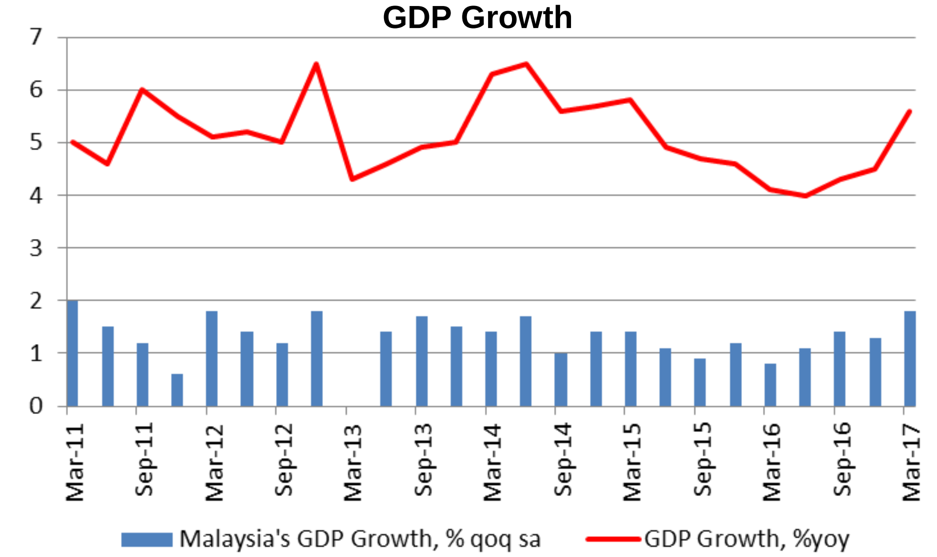
Against this backdrop, instead of being dragged down by a massive global trade slowdown, Malaysia's economy was in fact boosted by the pleasant surprise of robust trade flows. Indeed, exports grew strongly in the first quarter of the year, by an average of 21.4% yoy per month. The strong momentum appears to have some tailwinds to it still, with April's print coming in at a still-commendable 20.6%yoy.

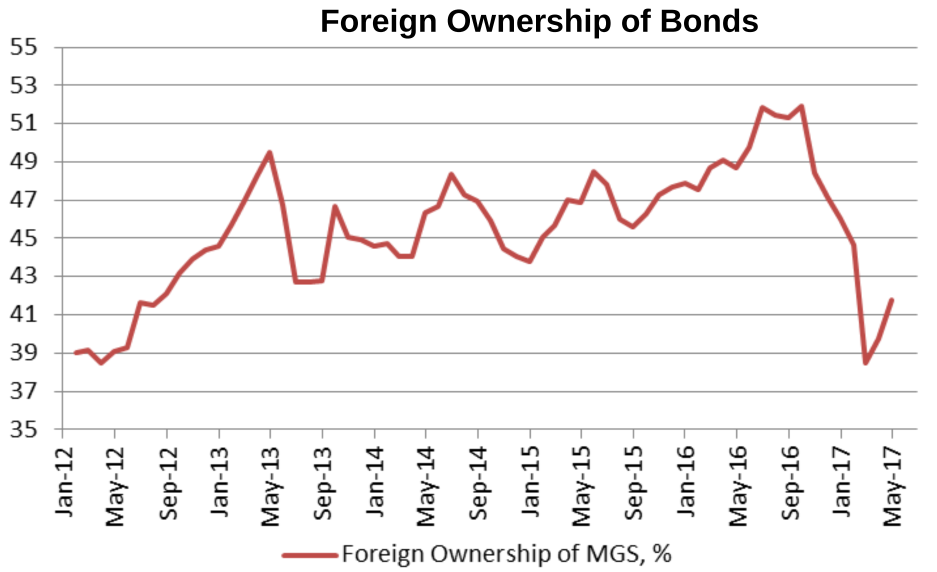
Looking at the components, the strong exports appear to have been driven by good demand for Malaysia's manufactured goods, including semiconductor devices. Meanwhile, recovery in both the prices and demand volume for commodities such as crude oil, LNG and rubber has also contributed to the encouraging upturn.

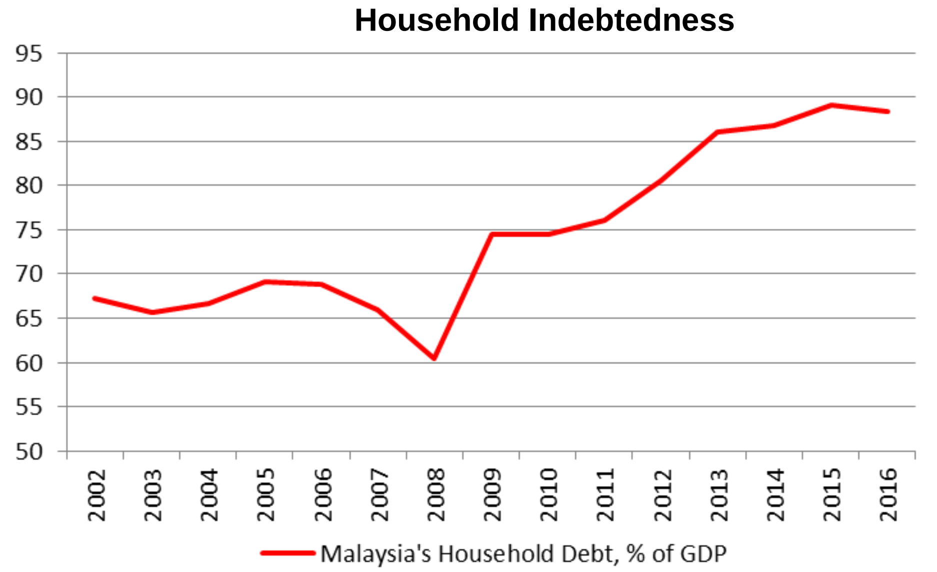
Moreover, help from external factors aside, the economy has also received a fillip from domestic consumption. For instance, private investment grew by 12.9%yoy in Q1 compared to 4.9%yoy in the previous quarter. On top of that, private consumption continued to power on. It grew by 6.6%yoy in Q1 this year, compared to 6.1%yoy in Q4 2016. As Bank Negara put it in a recent Monetary Policy Statement, "Growth will be mainly driven by domestic demand amid continued wage and employment growth, and the implementation of new and on-going investment projects."

Against this backdrop and the fact that Q1's growth print of 5.6%yoy was superbly high, our earlier expectation of 4.2%yoy GDP growth for the whole of 2017 looks untenably conservative. While there remains some risks that whatever fears of protectionism that we had earlier this year may yet pop up as an unpleasant surprise, a baseline expectation that global trade will still proceed apace in the second half looks to be a rational one at this point. Hence, we upgrade our outlook for Malaysia's GDP growth to 4.8% for the whole of this year.

When it comes to monetary policy, we still hold the view that Bank Negara is most likely going to keep its policy rate unchanged at 3.0% for the rest of the year. An improvement in the growth outlook removes the need to inject further stimulus, while a stabilizing inflation trajectory chips away market talks about having to hike rates to battle price pressures.







Source: OCBC Bank, Bloomberg

MYANMAR

A Waiting Game

The 2H 2017 Global Outlook will be a good opportunity to take stock on the economic performance of the National League of Democracy's (NLD) first full year in governance, and ask what can be achieved next. In the past, we have projected optimism for the Myanmar growth story based on some notable victories on the policy front. The lifting of the US sanctions, restoration into the Generalised System of Preferences (GSP) scheme and the passing of the new Myanmar Investment Law are all achievements in their own right. Unfortunately, these victories have yet to translate into a meaningful improvement in terms of economic data. Looking forward, however, we do believe that the conditions for growth are more favourable now than a year ago.

The urge to compare

The Myanmar economy has been on a broad slowdown since 2013. The slide continued into 2016. Data from the International Monetary Fund (IMF) showed that GDP grew 6.3%, a full percentage point lower than the previous year. Value of exports, in USD terms, were about 10% lower than in 2015. Interestingly, despite the lifting of US sanctions and the restoration into the GSP scheme, there was no improvement in the trade and foreign direct investment (FDI) figures between Myanmar and the US. Actual data proved to be a wet blanket on the optimism when these changes were first announced.

FDI, while it hit the government's target of US$6bn, were reliant on large, once-off investment projects. On a monthly basis, there are no signs of a sustained momentum in FDI inflows. It appears that many foreign investors are somewhat disappointed by the slow pace of economic reforms, and remain hesitant to commit. The ongoing interest to invest in Myanmar may still be present, but much of the exuberance appears to have evaporated.

Naturally, there will be an urge to compare the performance against the previous year, and give the NLD government a bad scorecard on economic management. However, this would be a hasty conclusion, not least for two reasons. For one, much of the poor performance can be attributed to inclement weather and weak external environment – none of which is directly under the government's control. More importantly, it should be recognised that the NLD government represented a structural break in the political and economic landscape. Direct comparisons across structural breaks are limited in value.

Ready for a lift off?

Some quarters of the government rationalised the underwhelming economic performance by taking the position that stabilisation, not growth, was the economic priority in the first year. If so, the next question will be whether the economy is ready for a lift off in this financial year. In this respect, we note that the external environment facing Myanmar has become more benign since the start of the year. This should augur well for the export sector, and provide the foundation for higher growth.

Growth in four out of Myanmar's top five export destinations have either picked up or consolidated at higher levels in 2017. These countries accounted for around 60% of total exports. Thus, there may be a noticeable uplift in export performance alongside the higher growth in Myanmar's export partners.

The European Union (EU) and Japan are Myanmar's fourth and fifth largest export partners, accounting for around 7.4% and 4.8% of total exports respectively. We note that their manufacturing sectors are expanding at an accelerating pace in 2017, underlying a general sense of health in the economy. Trade with these economies primarily focus on garments and clothing. With garment exports accounting for almost 10% of export revenue in Myanmar, any uptick in imports by the EU and Japan will give a meaningful uplift to total export revenues this year. In the longer term, the government is putting in effort to promote light manufacturing through income tax benefits. Moreover, these industries should also benefit from the broad drive towards improving infrastructure and energy production.

India, the third largest export destination, has also seen its growth rates settle at levels higher compared to 2015 and 2016. The main exports to India are legumes and their derivative products. Thus, Indian growth may catalyse a pick-up in agricultural exports on the demand side. On the supply side, the recovery of the agricultural sector from the floods should consolidate in 2017, after being unexpectedly slow in 2016. Taken together, the prospects for the agricultural sector may have brightened.

Over in China, economic momentum remains strong despite the deleveraging efforts, providing underlying support for the demand for natural gas from Myanmar. Based on estimates from the Ministry of Electric Power and Energy's data, natural gas production in the four main offshore fields has remained stable since 2014. New production activity in the Badamyar project should keep overall output supported over the next few years. Price dynamics for natural gas have also turned favourable. Average natural gas prices stand at US$3.11 per MMBtu year-to-date, compared to US$2.55 per MMBtu in 2016, and US$2.63 per MMBtu in 2015. Barring unexpected shocks in production or global energy markets, export revenue from natural gas should trend higher in the upcoming years.

An additional fillip from the energy sector may come from the Myanmar-China oil pipeline. The first tankers unloaded crude oil to be transported through the pipeline in May this year. The domestic economy will benefit from the improved access to crude oil supplies for energy production. More importantly, it provides an alternative source of tax revenue for the government, as it extracts transport tariffs and other forms of taxes on the oil that eventually flows to China's Yunnan province. This will contribute to growing tax revenues and a more comfortable fiscal position.

What to look out for next?

We expect continued reform on the policy front, with the new Myanmar Companies Law to be enacted in the second half of the year. This law will prove to be a major upgrade to the existing Myanmar Companies Act, which is filled with archaic clauses that are incompatible to the modern world. Amongst the many changes, we highlight two areas of importance.

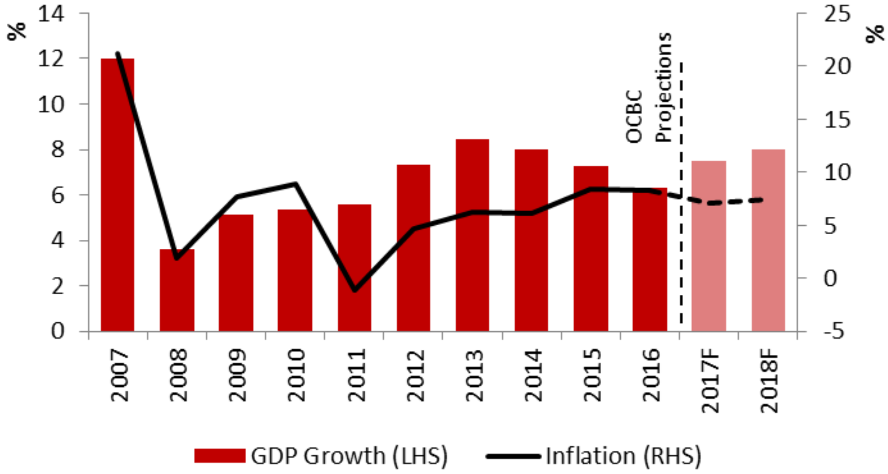
From a foreign corporate's perspective, what is arguably most important is the change in definition of a "foreign company". In the previous Myanmar Companies Act, a company is classified as "foreign" as long as a *single share* is owned by a foreigner. The draft version of the new law allows for a "foreign company" to be defined as any company where foreigners have "an ownership interest of more than the prescribed ownership amount". The threshold level has not been fixed, but numbers being bandied about range from 35% to 50%. Another possibility is to have differing thresholds for companies involved in different industries. By extension, so long as foreign ownership does not exceed the said threshold, then the company will be considered a "Myanmar company". The implications of this should not be underestimated. Foreign corporates may now be involved in a full swath of business activities, including those which were shut out from them previously, if they keep ownership interest below the threshold. Clearly, this expands the options available to foreign corporates.

New changes to the regulations relating to local companies should also add vibrancy to the economy. Corporate structures of local enterprises will become more flexible with the introduction of single-shareholder and single-director companies. Procedural requirements for enterprises, such as annual general meetings and financial statements, have also simplified. These changes should reduce the regulatory burdens on small local enterprises, contributing to a more vibrant SME scene.

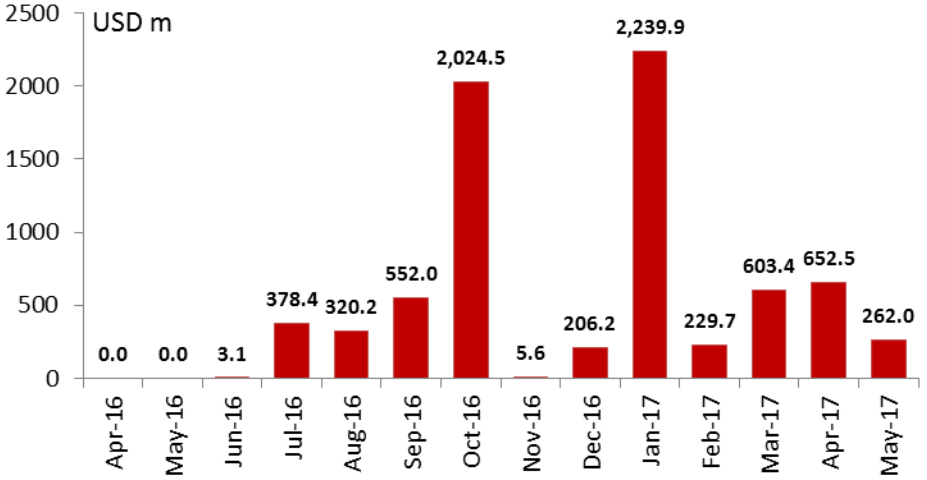
Conclusion: A waiting game

The Myanmar story is one of patience as much as optimism and growth. Myanmar's potential is plain to see, but the economic indicators have not matched up. Promising frontier economies can fizzle out as quickly as its initial hype once investors give up. Good governance and consistent policy implementation are critical in maintaining confidence. We believe that these best practices have not been overlooked. Myanmar will still be afforded time, but eventually the data will have to deliver for Myanmar to experience the next significant leg up.

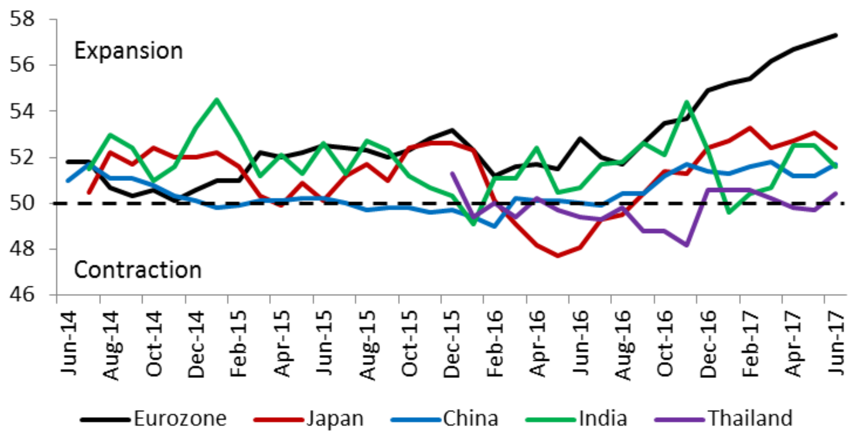
GDP growth and inflation projected to trend upwards



Permitted foreign investment under new administration



Mfg PMIs of major export partners picking up



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

PHILIPPINES

BSP: To Hike Or Not To Hike?

The US interest rate hike cycle has just seen its third hike in six months, and the fourth hike overall in June 2017. While the Federal Reserve moves into the mid-cycle phase, main Asian central banks, except for the PBoC, are either decidedly neutral or tending towards an easing bias. One central bank, the Bangko Sentral ng Pilipinas (BSP), might be ready to buck the trend in 2017. The official stance is still neutral, with the BSP opting to push back market expectations for a hike in order to win more time to monitor developments in growth and inflation indicators. In this thematic piece, we assess the chances of the BSP pencilling a rate hike by the end of the year.

Optimism over the Philippines' economic growth over the next few years will be predicated on the success of "Dutertenomics", a US$180bn infrastructure investment plan. However, early signs have not been fully positive. First quarter GDP growth stood at 6.4%. This is a notch lower compared to the 6.9% and 6.6% printed in the first and last quarters of 2016. While the slowdown appears to be broad-based across most components of GDP, the main laggard was government spending. Government spending in the first quarter was essentially flat. This came as a surprise for a government which has committed to the "build, build, build" promise. A possible interpretation is that the government is facing difficulty pushing through infrastructure spending. Indeed, a recent tax reform package aimed at raising revenue to fund Dutertenomics has stalled in Congress.

However, looking beyond the slowdown in government spending, key sectors of the economy are faring well. Manufacturing output growth picked up considerably to 7.5% yoy, while the services sector grew at 6.8% yoy. By the BSP's own admission, the "prospects of domestic economic activity continue to be firm". With the rest of the economy streaming along just fine, it appears that the slide in first quarter GDP growth could be attributed to the slowdown in government spending. We expect this to be a transitory weakness, not least because President Duterte has repeatedly reminded his colleagues that he has promises that need to be kept. Moreover, the tax reform plan should undergo further discussion when the Congress next meets in July. Given President Duterte's supermajority in both houses of Congress and the popular support enjoyed by the President, the delay in passing the tax reform legislation should be overcome quickly. Headline GDP growth figures should recover once government spending reverts back to norm.

China is a concern that is holding Asian central banks back from tightening. With financial deleveraging as a government policy objective, an engineered slowdown in the Chinese economy is expected. In turn, this will add pressure to Asian exports.

For the BSP, the China factor is perhaps less acute. While China (including Hong Kong) is the largest export destination, it is offset by a sizable proportion of exports heading to Japan and the US. A legitimate concern could have been raised in the early months of 2017, where protectionist sentiments were emanating from the US.

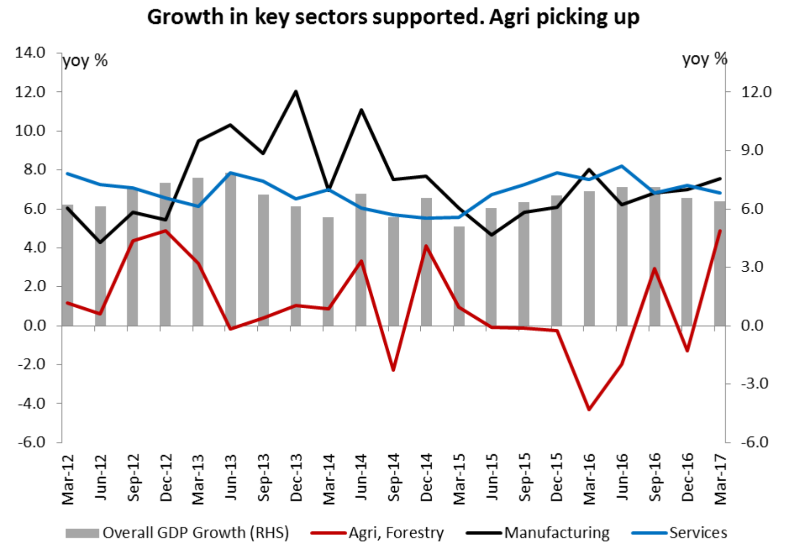
However, this episode appears to be largely forgotten by now. Indeed, under a sanguine global growth environment, export performance has been strong, averaging 15.2% yoy growth in the first four months of 2017.

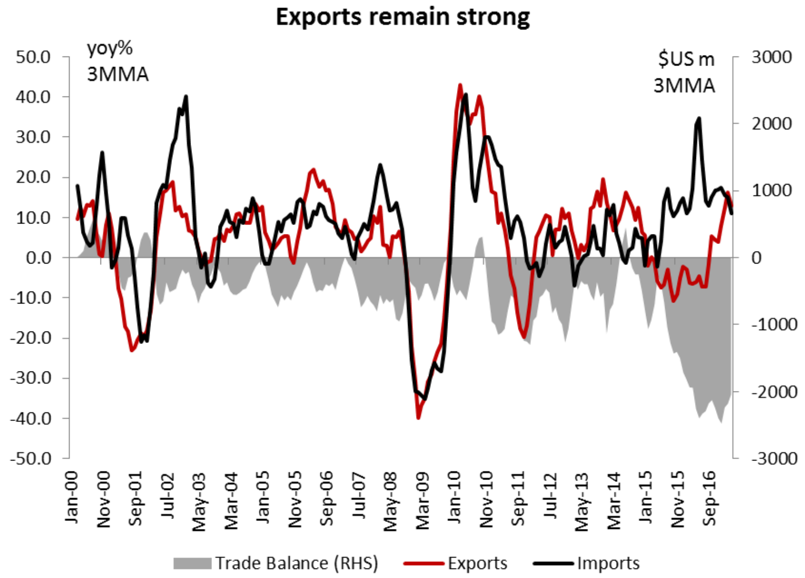
The comparatively weak peso may also give exports an additional boost. Since the start of 2017, emerging Asian currencies have largely appreciated by 2.5-5.5%. The peso was the notable laggard, remaining largely flat. This should contribute to the overall competitiveness of Philippine exports, especially when compared to similar products in the region. Thus, barring an unexpected deterioration of global economic outlook, or a re-emergence of protectionist sentiments in the US, we expect Philippine exports to perform strongly heading into the second half of the year.

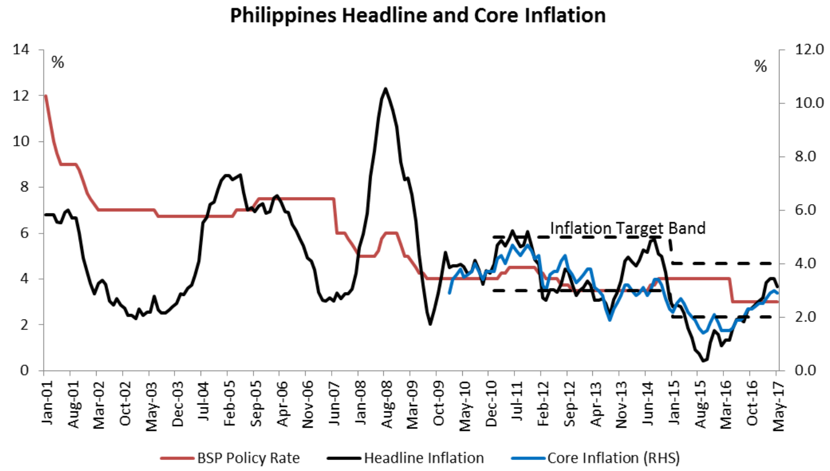
Perhaps the most important factor for the BSP to consider is the inflation outlook. Indeed, the headline inflation rates have eased towards 3.0% after hitting a high of 3.44% in March 2017, while core inflation rates have remained stable between 2.9-3.0%. This is safely within the BSP's target inflation band of 2-4%. Leading BSP officials are also guiding markets to expect a further slide in inflation rate in the 3rd quarter, towards the lower end of the target range. This is perhaps not surprising given that the base effect due to depressed commodity prices in 2015 have largely run its course.

Beyond the third quarter, the inflation outlook is likely to turn up again. Depending on when the proposed tax reforms will eventually take effect, currently expected to be in early 2018, there might be upward price pressures again. Price changes in fuel and automobiles due to increased taxes will result in a once-off increase in inflation. The increased consumer spending power as a result of the lowered income taxes may, instead, result in a more sustained upward price pressure if it translates to materially higher consumption growth. Furthermore, with the initiation of the infrastructure projects may again lead to upward price pressures in the short term.

We believe that the slowdown in growth is largely transitory, and can be easily reversed when government spending picks up. Upward price pressures may also manifest upon the implementation of the tax reforms, expected to be in early 2018, and when the building of the infrastructure projects hits full swing. However, a disappointing first quarter growth rate, coupled with fading inflation prints since hitting a high of 3.44% have cast a pall on rate hike expectations. Overall, we continue to expect that the economic conditions in Philippines are almost ripe for a rate hike by the BSP, which in our view, would likely come in early 2018.







Source: Bloomberg, OCBC Bank

SINGAPORE

Pickup Underway, But Largely Manufacturing-Driven

The 1Q17 GDP growth surprised on the upside, prompting more upbeat full-year growth expectations. MTI now indicates that full-year growth could be in the higher end of its official 1-3% forecast range. The uplift came on the back of stronger than expected manufacturing growth, mostly predicated on the electronics upswing, as well as accompanied by a rebound in regional economic and trade activities. The MAS also kept its monetary policy stance static in mid-April, with the slope of the Singapore dollar nominal effective exchange policy band at zero percent with no change to the width of the policy band or the level at which it was centered. MAS cited that the neutral policy stance was assessed to be appropriate for an extended period and to ensure medium-term price stability given the subdued outlook for growth and inflation. Notably, the lack of demand-driven inflationary pressures meant that MAS core inflation is envisaged to rise gradually on the back of higher global oil prices, but average slightly below 2% over the medium term.

At this juncture, Singapore's economic assessment remains steady, albeit still uneven. Domestic growth could see some deceleration into 2H17, but given the better-than-expected 1Q16 growth, there is greater confidence that full-year growth would be in the higher 2% range. The external economic environment has improved, with the upgrades to global growth forecasts and the fading of geopolitical risks arising from the earlier Dutch and French elections, and anti-globalisation/trade concerns from a Trump presidency. The growth outlook for the Chinese economy has also stabilized even as lingering concerns remain over deleveraging, the RMB and capital outflows. With the firming business sentiments especially in the Eurozone, particularly Germany, capital expenditure may improve. While some risks like North Korean tensions, German elections, and the FOMC's tapering of its balance sheet may still pose headwinds into the rest of this year, nevertheless, the local business and consumer sentiments look relatively resilient compared to the start of the year.

Our house call for 2017 GDP growth to be 2.5%, with headline and core CPI inflation forecasts at 1.0% and 1.6% respectively, vis-à-vis the 0.5-1.5% and 1-2% official inflation forecast ranges. The MAS professional forecasters survey for June has upgraded the full-year growth forecast to 2.5% but trimmed the headline CPI, 3-month SIBOR and USDSGD forecasts to 0.9%, 1.3% and 1.41 respectively. For 2018, the consensus forecasts stand at 2.5% (GDP), 1.4% (headline CPI) and 1.7% (core CPI).

The unemployment rate may creep up gradually to 2.5%, from the current 2.3% in 1Q17, but the slack in the labour market is unlikely to deteriorate significantly given that the foreign worker measures are still intact and certain sectors like Education, Healthcare, Community, Social and Personal Services, and Information & Communications (ICT) are still growing and hiring. Wage growth is likely to taper from 2016's 3.1%, down from +4.9% in 2015, even as MAS tips that the employment outlook for this year is not expected to be significantly different from last year. This is because the private sector, especially the Small and Medium-Size Enterprises (SMEs) remain under pressure from elevated business costs and manpower constraints. Manpower Minister Lim Swee Say also reiterated the need for a leaner workforce, innovation and higher productivity to maintain Singapore' competitiveness. With a slowdown in resident wage growth from 3.7% last year to around 3% this year, productivity growth may improve from 1% in 2016 to 1.5-2% this year.

Singapore's manufacturing sector is likely to see some modest moderation in the months ahead. The manufacturing PMI has retraced for the second consecutive month from a 26-month high of 51.2 in March 2017 to 50.8 (still in expansion territory), even though the electronics PMI remained healthy at 52.4 in May which marked the highest reading since October 2014. The key outperformer which was the electronics cluster had seen output expanding by a robust 36.9% yoy in the first five months of this year, and in turn the precision engineering cluster also benefited with 19.5% yoy growth. However, the transport engineering cluster remains weighed down (-11.8% yoy) by the marine & offshore engineering segment amid weak rig-building activities and soft demand for oilfield & gasfield equipment. The biomedical manufacturing cluster is also down 13.9% yoy for the first five months of 2017 due to weak pharmaceuticals segment (-32.6% yoy).

The uneven manufacturing recovery trajectory is unlikely to deviate significantly for the remainder of this year. While the electronics upswing should sustain, particularly with several smartphone model launches, the relatively narrow growth driver for the current manufacturing is unlikely to prompt a near-term upgrade of growth prospects going out to 2018, particularly when factoring in the external risks from a 2H17 deceleration in China's growth pace due to ongoing deleveraging efforts and regulatory tightening, as well as uncertainty ahead of the 19th Party Congress.

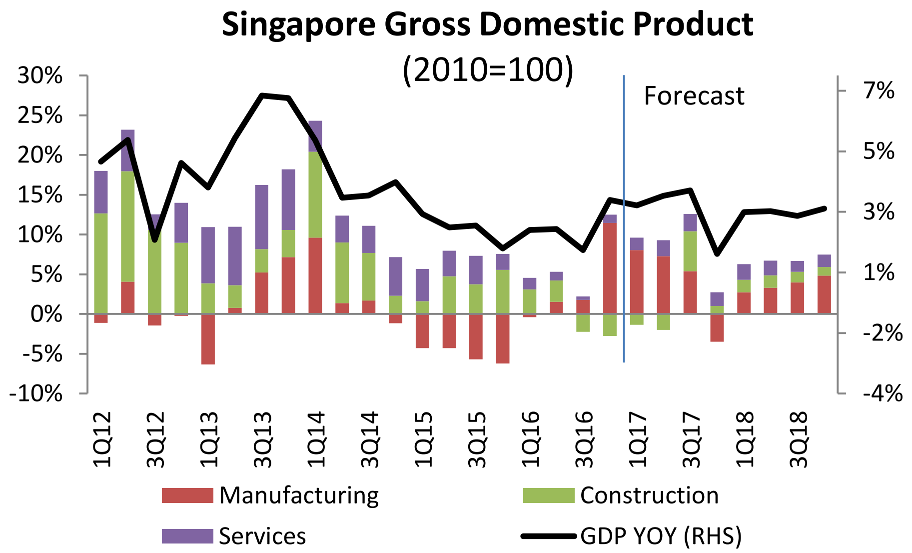
The Nikkei Singapore whole economy PMI has made a remarkable recovery from the cycle low of 49.4 in April 2016 to a high of 52.6 in April this year before softening slightly to 51.4 in May 2017. The 2016 average whole economy PMI print was 51.6. So far, 2Q17 data cues have been supportive, with retail sales beating expectations to grow 2.6% yoy (+1.6% mom sa) in April and retail sales excluding autos expanding 4.9% yoy (March: +0.5% yoy). That said, we do not anticipate that private consumption growth will rebound sharply amid modest wage growth and higher headline inflation. Conversely, the softening in the domestic labour market is also very mild, with employment conditions showing tentative signs of having troughed in financial services and the Oil & Gas sectors.

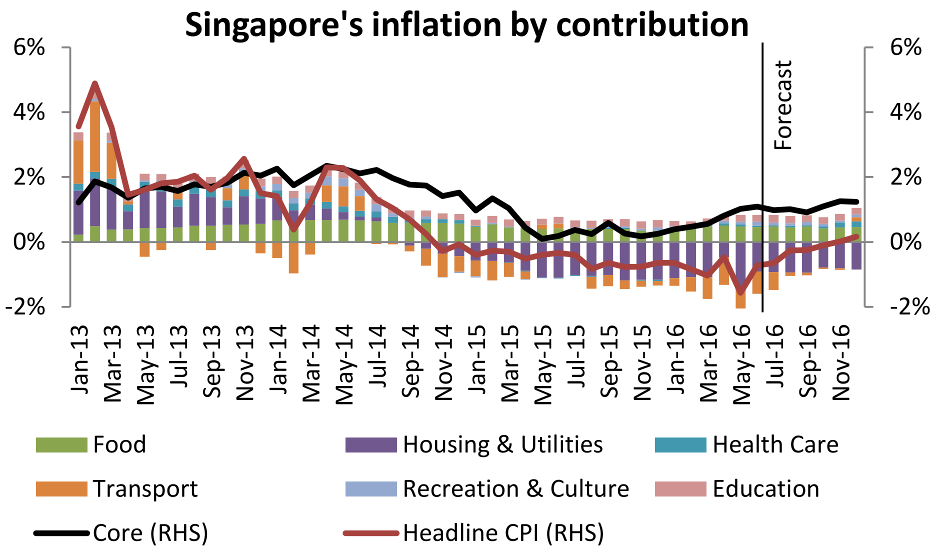
Interest in the private residential property sector has also picked up in 2Q17, with sales of more than 1,000 units a month for March to May 2017 after the government relaxed some cooling measures including the sellers' stamp duty. The low mortgage rates should also continue to be supportive of residential sales and mortgage servicing. En-bloc sales have also made a comeback as well. Co-working office demand could also help support rentals for CBD fringes, especially with the growth of fintechs and start-ups. However, retail rentals may remain under pressure in the interim amid a very lackluster retail scene, as brick-and-mortar shops are increasingly pressured by e-commerce channels. As such, construction activity is likely to continue to be led by the pipeline of public construction projects which have been accelerated and will sustain support for the next few quarters.

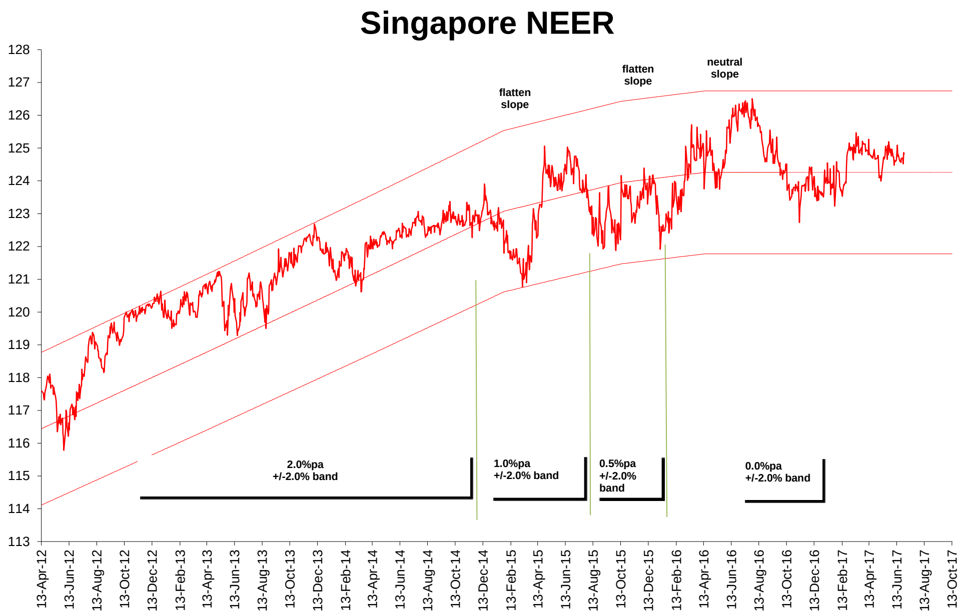
Monetary policy settings are unlikely to be tweaked for now. The official view on inflation has been very benign, attributing the pick up to higher energy costs and administrative price hikes rather than generalized demand-induced price pressures. The direct first-round impact of the 30% water price hike will add about 0.1% points to headline and core inflation this year. Still, the soft labour market may constrain firms from passing on rising business costs to end-consumers. MAS estimates that almost half of the cumulative impact from past policy easing moves since January 2015 will continue to filter through to the economy, which coupled with the current neutral monetary policy stance will help keep the level of output close to the economy's potential and ensure medium-term price stability. We expect that the MAS will maintain its neutral policy settings at the October 2017 policy review as well. With the recent retracement in global crude oil prices, there is no impetus for policymakers to turn overtly hawkish anytime soon, even with the US Federal Reserve (FOMC) still anticipating a third 25 basis point (bps) hike and to begin tapering its balance sheet later this year. The FY18 Budget announcement is also only due in April 2018.

Domestic short-term interest rates have diverged from USD Libor rates and the tear between SIBOR and SOR may also persist for longer. After the FOMC hiked its Fed Funds Target Rate by 25bps for the second time at the June meeting and articulated its plans to begin tapering its balance sheet later this year (possibly starting by September 2016 beginning with UST and agency/MBS at US$6b and US$4b monthly with quarterly step-ups to reach US$30b and US$20b per month over 12 months), the 3-month LIBOR has hit a high of 1.29%. While the 3-month SIBOR was more stable at 0.99%, the 3-month SOR has declined to 0.70% as of 23 June (down from a recent high of 1.03% on 29 December 2016) as market players attempt to prefund the tightening in USD liquidity, especially with the month/quarter/half-year end funding requirements coming up in end-June. **We are retaining our year-end 3-month SIBOR forecast at 1.25%, but the 1.35% 3-month SOR forecast looks susceptible to downside risk.**

Bank loans growth have accelerated to +7.0% yoy in April, the highest since November 2014 and a sharp turnaround from the -2.7% yoy trough seen in June last year. This brought total bank loans growth in the first four months of 2017 to 5.4% yoy. With the improvement in business loans growth and resilient consumer loans growth, total bank loans may expand by 7% yoy for 2017. Business loans have expanded by five straight months, supported by general commerce, transport/storage/communication, business services and financial institutions segments. Consumer loans also remained healthy due to sustained housing/bridging loans. Singapore banks are likely to benefit should domestic interest rates pick up even if they continue to lag its US counterparts amid the FOMC's monetary policy normalization.







Source: Bloomberg, OCBC Bank

TAIWAN

A Tepid Recovery

The recovery of Taiwan's economy continued in the first quarter of 2017 on the back of improving global demand. Although the economic growth decelerated slightly to 2.6% yoy in 1Q2017 from 2.88% yoy in 4Q2016, the positive contribution from net export, first in two years, shows that growth outlook is likely to be more promising in 2017 as compared to 2016.

Investment led recovery

To recap, this round of economic recovery in Taiwan started from the second half of 2016 mainly driven by investment as the rising demand for electronics lifted private machinery investment. Total capital formation grew by 5.2% in the second half of 2016 and the strong investment spree continued in the first quarter of 2017 with capital formation increased by 4.1%. As Apple is expected to launch its major product iPhone 8 this year, we expect Taiwan's electronics exporters to benefit from this, which should continue to support private investment. Meanwhile, public investment may start to pick up driven by government stimulus measures. The US$29 billion stimulus package announced in late March is likely to help Taiwan weather the global uncertainty. The infrastructure plan, which will be spread over next eight years, may help revive the weak government investment. As such, we expect capital formation growth to stay around 3% in the next two quarters.

More supports from export

The contribution of net export to the growth finally turned positive in the first quarter after two-year's drag on the growth. Net export grew by 3.8% in the first quarter thanks to strong demand for electronics and correction in commodity prices. The abating protection risks from Trump administration alleviated concerns on potential shock to Taiwan's export. However, the contribution from export to the growth is unlikely to be significant as the strong export of electronics is likely to be partially offset by the weak service export due to falling visitor arrivals. Taiwan's visitor arrivals fell by 7% yoy in the first five months of 2017 mainly the result of plunge of arrivals from mainland China, which fell by 41.5%, due to souring cross straits relationship.

Tepid private consumption despite positive wealth effect

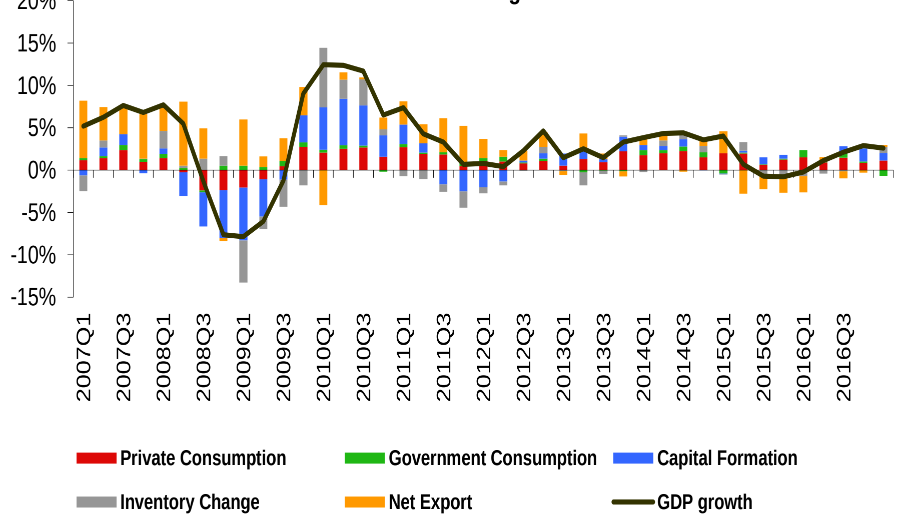
Private consumption remains relatively stable, growing by 1.95% in the first quarter, below still below long term average. The private consumption was mainly supported by improving job market as well as the wealth effect from stronger equity market and Taiwan dollar. The unemployment rate fell to 3.79% in May after seasonal adjusted from the high of 3.96% in the middle of 2016. In addition, Taiwan's equity market has gone up by about 12% in the first half of 2017 while Taiwan dollar strengthened against the dollar to around 30.50 from 32.3 in the beginning of 2017. However, interesting to note that Taiwan's consumer confidence remains sluggish despite those positive developments. This was probably due to the uncertainty arising from the pension reform. President Tsai has pushed ahead with pension reform to cut the payment to public sector retires despite strong opposition from pensioners in order to prevent the system from collapsing. The move is likely to have near term impact on the consumer sentiment, which may slow the spending by the elderly consumers.

Looking ahead, we expect Taiwan's economic recovery to be driven by investment and export although consumption is unlikely to give Taiwan extra boost. We expect Taiwan's growth to reaccelerate to about 2.1% in 2017 from 1.5% in 2016.

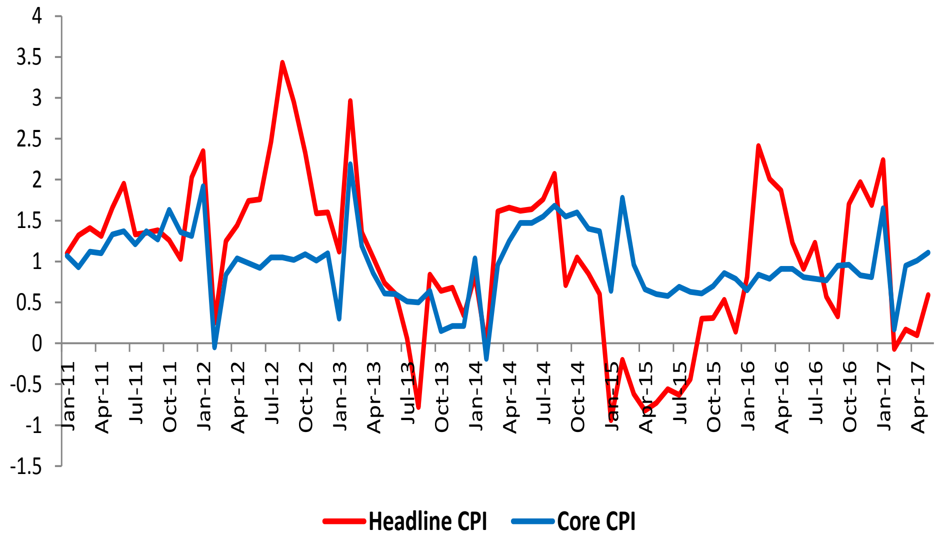
Inflation remains muted despite improving growth outlook. The CPI only grew by average 0.6% in the first five months due to the decline of food prices and contained import inflation as a result of stronger Taiwan dollar. In addition, the unwinding of Trump's reflation trade also contributed to sluggish headline numbers. The core CPI excluding fruits, vegetables and energy grew by average 0.97%, also below the target. Given weak commodity prices as well as return of global disinflationary pressure, we expect inflation to remain subdued in 2017. As such, we revised down our CPI forecast for Taiwan to 0.9%.

As a result of weak inflationary pressure, Taiwan's central bank kept its benchmark interest rate unchanged at 1.375% in June for the fourth consecutive meeting. The central bank suggests that the current low interest rate level is appropriate given the growth and real interest rate dynamics. We expect the central bank to hold on for the rest of the year due to muted inflation.

Taiwan GDP growth



Taiwan CPI



Taiwan healthy external environment

Source: OCBC Bank, Bloomberg

THAILAND

It's Stability That Matters

A rising tide lifts all boats, but surely not all boats in an equal scale. For those which holes are plugged and buoyancy assured should evidently be better off than those without. Such can be said for Thailand's economy, seen from a vote of confidence from international investors whom continued to pour in funds into the first six months of this year. The influx of international holiday-makers also suggests similar sentiments, seen from the rapidly growing tourist arrivals numbers in the first five months of this year. Elsewhere, domestic consumer and business confidence sentiments have continued to print in optimistic territories. Piecing these jigsaw pieces together, there is only one reason for such a phenomenon: it is stability that drives confidence.

Stability comes in many aspects, namely from the economic, societal and political point of view. Empirically, these aspects have seen marked improvement since the 2013/4 social unrest, and should sustain at least for the remainder of the year.

It is a best of both worlds, really!

To start off, economic growth is expected to accelerate for the third consecutive year in 2017 should official growth estimate of 3.6 percent come to pass. Should growth print as expected, it also marks growth pace comfortably above its 5-year average of 2.7 percent. Importantly, growth is underpinned by strong fundamentals in both domestic and external environments: the junta planned to reinvigorate economic growth with some $40 billion invested across 20 major infrastructure projects by 2022. Moreover in recent announcements, the junta voiced its aim to expand fiscal spending by THB190 billion in fiscal year 2017 alone to provide the necessary growth lift.

Moreover, other domestic growth pillars including private consumption (+3.2% yoy, fastest growth pace since 2Q16) and tourism arrivals (+3.2% and generated THB1.05 trillion in 5M17) have been providing an excellent fundamental backdrop for future growth sustainability. Elsewhere, export growth has recovered significantly from its 2016 levels; exports grew an encouraging 8.5% in April, and averaged 5.7% in the first four months of 2017 (fastest average growth print since 4M11 at +25.7%). Across sectors, mining exports led by higher crude oil prices grew 96.4% in the first four months of 2017, while recovering agriculture prices led other respective exports higher as well.

Celebrating political and societal stability

However, the environment that eventually underpins economic growth and international confidence has to be one built upon political and societal stability. Factually, there remain concerns over potential exogenous events that could threaten Thailand's attractiveness as a destination for investors and tourists. As early as 2013/4 was the social unrest and military coup that eventually ensued, while recent cases of the Erawan shrine bombing, Zika outbreaks and national mourning over the passing of Thailand's beloved King Bhumibol Adulyadej had market-watchers doubting Thailand's growth prospects. However, investments and tourist arrivals continued to pour in, a sign of confidence that these events would have little negative impact on Thailand's economic strength in the long run.

Eventually, data do not lie, and statistics pointing to the strong influx of tourist arrivals into the first five months of 2017 suggests that tourism will continue to play a significant role in underpinning growth. Statistically, international tourist arrivals rose 4.6% in May from a year earlier, with revenues up a whopping 6.9% as a result. Moreover, the number of foreign tourists stood at 2.59 million in May, led by visitors from China, Malaysia, India, Russia and the United States, generating revenue of 125 billion baht ($3.67 billion). The strong influx of tourism is important, especially to Thailand, as tourism receipts account for 12% of gross domestic product (GDP). Elsewhere, fund inflows into Thailand also suggest a similar picture, where international investors flocked an accumulated $297.4 million and $3.7 billion of equity and bond funds, respectively, from January to mid-June 2017.

The same positive sentiment can also be felt domestically. Despite the bouts of pessimism seen in 2014 and 2015, a gradual improvement in sentiment is reflected in both consumers and businesses to-date. Across industries, manufacturing-related industries such as electronics, as well as oil-related industries including petroleum and chemicals were amongst the top gainers in sentiments. Moreover, consumer economic confidence is markedly higher in the four months leading to May 2017 when compared to the same period last year, indicative of the growth in consumer spending year-to-date. Finally, as a sign of sustained economic resilience, Thailand’s net-imports of capital goods continued to grow into 1Q17 (+6.3% yoy), suggesting that capital inflows and rosier manufacturing climate necessitated the demand of capital goods.

Areas of improvement

Though it is relatively optimistic at this juncture, there remains areas of concern even within Thailand itself. On the top of our list is the household debt levels, but more pressing perhaps, are the emerging deteriorating signs in debt serviceability in SMEs enterprises. Moreover, the sudden and rather unexpected downtick in inflation pressures to deflation territories is quite disconcerting as well, especially if it persists into 2H17. Finally, we note that there will be eventual elections (likely in 2019 or beyond) which may rock the political stability being enjoyed currently.

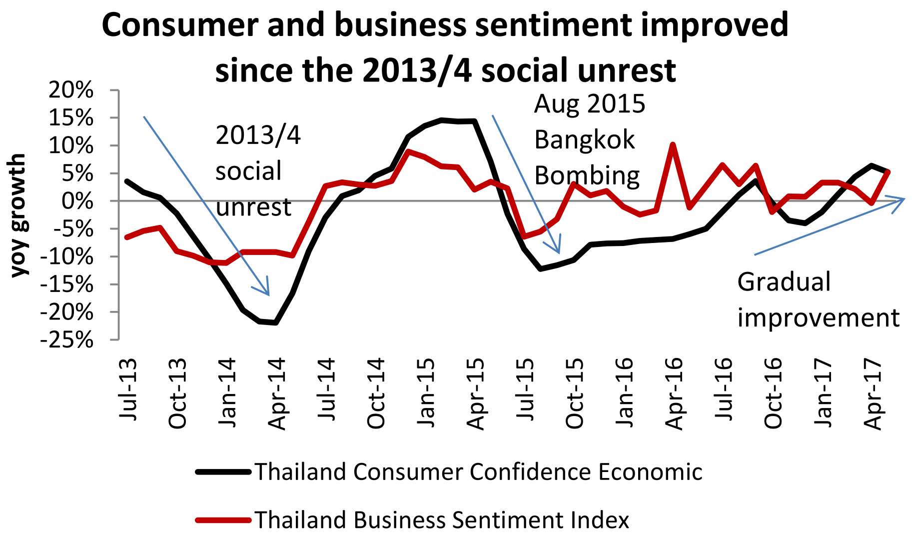
Delving into economic indicators, the mix of a strong Thai Baht, climbing household debt levels and deterioration signs in debt serviceability in SMEs enterprises may limit Bank of Thailand’s policy space. Specifically, policy-makers have voiced their concern over the relatively stronger Baht as a potential drag to tourism arrivals and trade balance. As illustrated in our previous paragraphs, the strong fund inflows and tourist arrivals are signs of international confidence, and the surge in confidence naturally give rise to a stronger domestic currency as well. To that end, the Bank of Thailand had recently rolled out FX relaxation measures, specifically to allow Thais with assets of at least THB50 million to directly invest in overseas securities amongst other measures. Still, THB strength is sustained despite the measures, which give rise to questions if more measures are needed to limit further strengthening into end 2017.

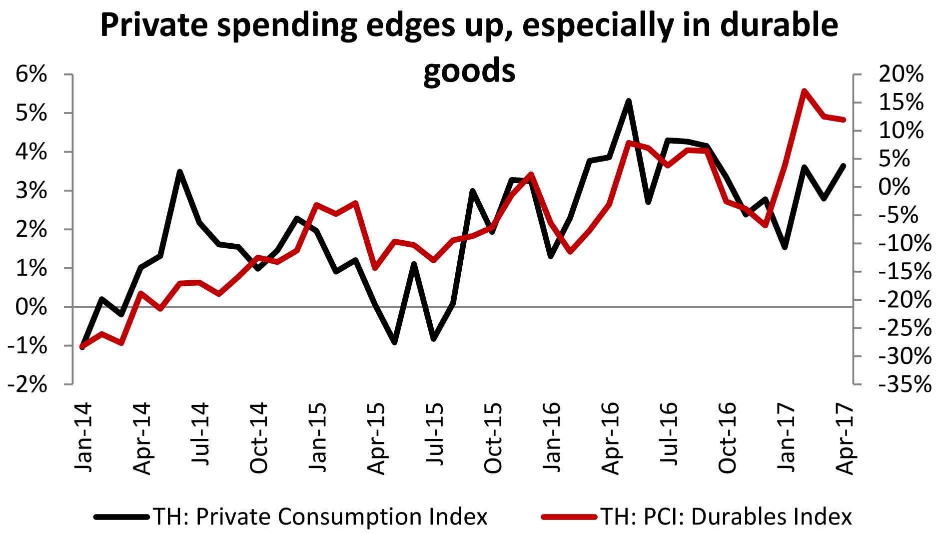
Elsewhere, we opine that elections will likely not take place before 2019, given Aug 2016’s public approval for the junta-drafted referendum, thus cementing the military’s presence in the government. Moreover, the king’s intervention to the constitution draft earlier this year had possibly rubber-stamped the junta’s justification to extend the election timeline. To that end, election will eventually come, and may serve to inject short-term bouts of risk aversion when nearing the event. Thus, should we go back one full circle, the political stability currently seen, which is clearly underpinning the ongoing optimistic environment, may well unwind international confidence should the same stability be threatened into 2019.

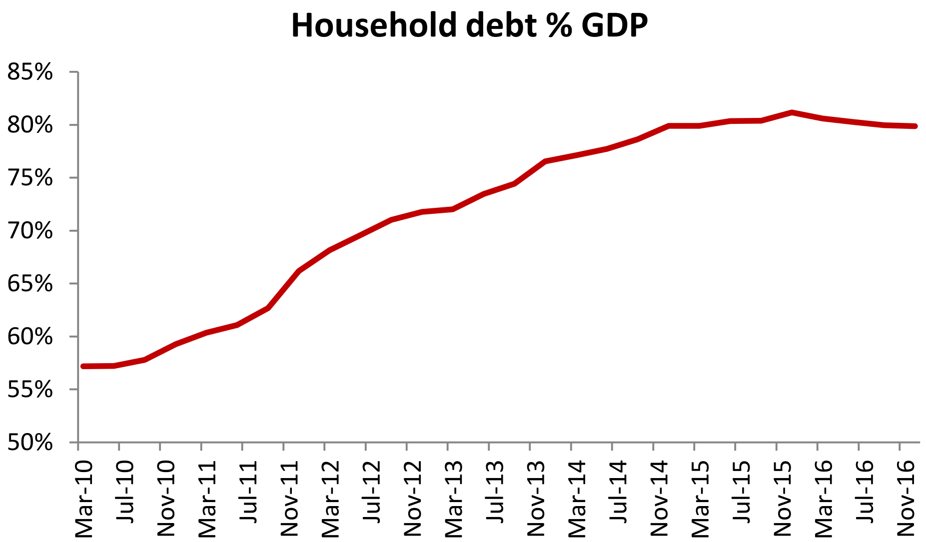
The strengths clearly outweigh the risks

Thailand’s economy is not without faults. The climbing household debt levels and rising non-performing loans have been frequently cited as key risks to growth. Moreover, the recent THB strength may eventually drag tourism arrivals and limit the trade surplus currently enjoyed. Deflationary environment, should it persist, may also give rise to spending reluctance by consumers which could eventually limit growth into 2017.

Still, the strengths clearly outweigh the risks: we remain especially optimistic on Thailand's economic growth given the remarkable progress in the first half of this year. Thailand has tided through well despite the multiple exogenous events as discussed above, and yet tourism arrivals and fund flows remained strong. Should the stability seen to-date remains soundly in place, we expect economic growth to print 3.6% yoy in 2017, clocking its third year of growth acceleration. Although deflation was seen of late, we opine that it is likely transitory, and domestic price growth should turn positive into year-end. With the ongoing debt issues amid an uncomfortable strong THB, we expect Bank of Thailand to stay pat at 1.50% for the rest of the year.







Source: OCBC Bank, CEIC, Bloomberg

VIETNAM

Playing Catch-Up

Vietnam is off to a bad start in 2017. First quarter GDP growth registered 5.1%, which is considerably weak even for the seasonally slow quarter. The sectors that drove growth saw a rotation in the first quarter. Construction, which outperformed in 2016, took a breather. Primary industries, having suffered poor weather and unfavourable price dynamics last year, started to show increased activity with the improvement in the commodity complex. Meanwhile, the services sector maintained its stable performance, supported by growing tourist arrivals.

However, we are not overly concerned with this slowdown. We believe it could be attributed, in part, to the withdrawal of the Samsung Note 7, a once-off factor that tripped the export sector. Given that Samsung affiliates account for 22.7% of Vietnam's large export sector, the fortunes of the economy is closely tied to the success of Samsung and its smartphones. By the government's own estimates, the unprecedented recall of the entire Note 7 product line cost the country close to US$1bn in potential export revenue.

The government has an official growth target of 6.7%. To achieve this, Vietnam will have to play catch-up in the second half of the year. Stripping out once-off factors, the fundamentals remain in place for faster growth. We remain positive on the outlook for three intertwined aspects of the Vietnamese economy, the export sector, tourism and foreign direct investment (FDI).

Export sector: Latching on to the global smartphone cycle
Being so dependent on one company of its exports is clearly a doubled-edged sword. Having being stung by the Note 7 fiasco, Vietnam now appears poised to ride on Samsung's subsequent comeback with the successful launch of the S8 smartphone. According to the company, S8 pre-sales numbers outpaced even the previously best-selling S7. With Vietnam accounting for 50% of global S8 production, the export sector should be supported going forward. Further ahead, expectations are also high for the upcoming announcement of the next iteration in the Note series. Another successful launch will no doubt provide the additional boost for export growth.

Indicators also suggest that the export sector is well positioned for a strong the second half of the year. May 2017 export growth registered a 19.7% yoy growth. Manufacturing output in the first quarter also rose 9.3% yoy. In the larger scheme of things, the second half of 2017 is expected to be a significant one as a new smartphone cycle appears to be underway. Key manufacturers are expected to make landmark improvements to their devices, with pent-up demand from largely captive consumers waiting to purchase. It is, therefore, crucial that Vietnam is moving beyond just Samsung devices, and emerging as a key cog in the global smartphone production chain. Production facilities for new component parts, such as OLED displays, are also being extended. The output from these facilities will eventually be supplied to a range of smartphone manufacturers, including Apple. This generates greater stability for the export sector by reducing the reliance on specific product lines. Thus, we expect these intermediate suppliers to grow in importance and take up a greater share of exports.

Tourism: From strength to strength

After a flat 2015, tourism arrivals spiked 26.0% in 2016. The growth trend has accelerated into 2017, with tourist arrivals in the first five months of 2017 growing 29.6% compared to the same period last year. In turn, the strong momentum in tourist arrivals provided underlying support for the 6.4% service sector growth in the first quarter. In the longer term, a sustained stream of tourists should also provide a strong impetus to further develop local infrastructure.

Despite the stellar rates of growth, the Vietnam National Administration of Tourism (VNAT) has continued to invest heavily in its promotional campaigns. It followed up the “Why Vietnam” campaign in December 2016 with a series of road-shows in China in May 2017. We believe that targeting Chinese tourists is a sound strategy, considering that China accounts for almost 30% of all tourist arrivals in 2017, and is the largest source country of tourists by far.

We note also that Vietnam’s tourism potential has not been fully exploited. Many of the tourists still keep to the well-established cities and sites. Many more areas, such as the central province of Nghe An, remain relatively off the beaten track with insufficient exposure and infrastructure to draw in more tourists. Notably, VNAT is exploring spiritual tourism as the next growth driver, drawing on its rich heritage of some 40,000 possible sites in the form of temples, pagodas and religious monuments. These efforts should refocus attention to the less developed provinces, and create fresh experiences for new and returning tourists in the long term.

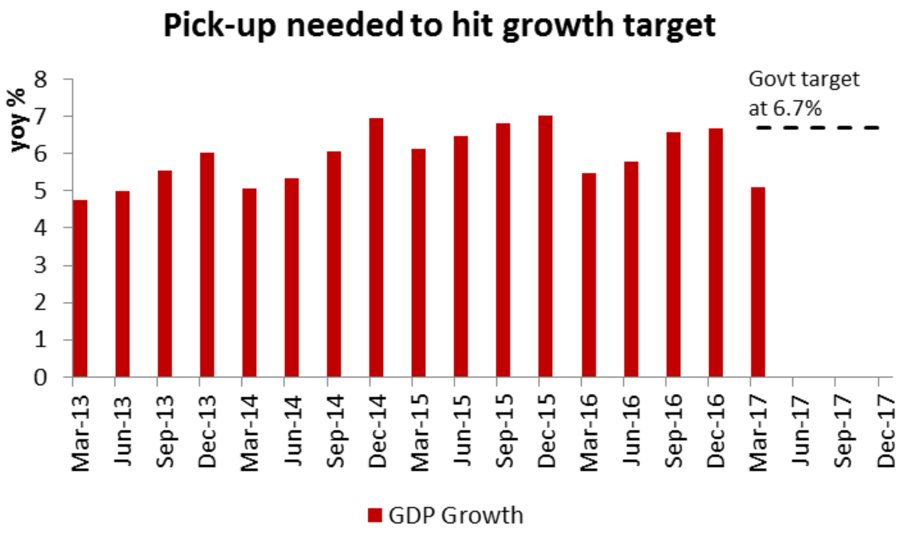
FDI: Continuing to build momentum despite disappointment

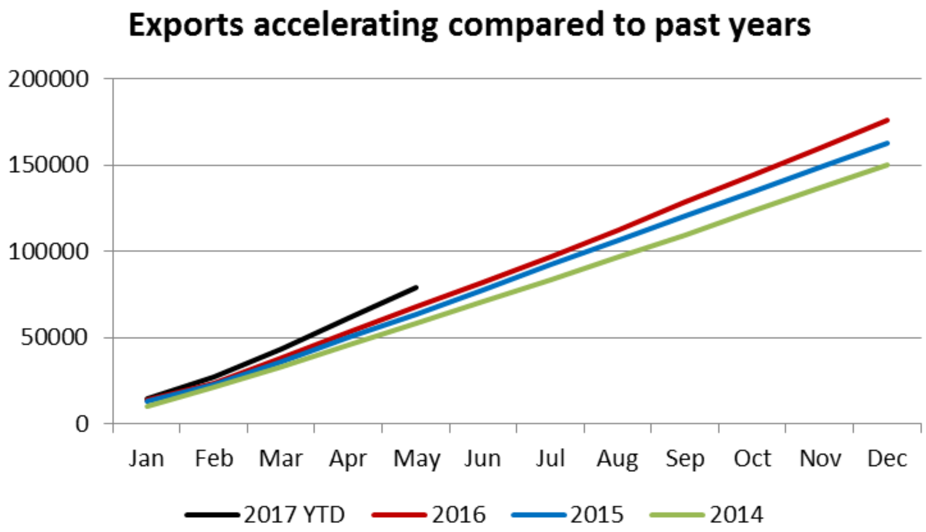
Due, in part, to the growing presence of smartphone component producers and booming tourist arrivals, FDI inflows into Vietnam reached new highs in 2016. The momentum has not slowed down, with Ministry of Planning and Investment data showing that FDI has grown 41% yoy in the first five months of 2017. Moreover, this inflow has been broad-based, with investment going into areas like the F&B and infrastructure industries. There were concerns in some quarters over the collapse of the Trans-Pacific Partnership (TPP) will lead to a decrease in interest in Vietnam. However, this pessimistic view was not reflected in actual data. The TPP would probably have given Vietnam an additional fillip in foreign investment, but FDI flows remained steady even without it. Barring further trade tensions emanating from the US, we expect the strong momentum of FDI flows to continue into 2018 on two counts.

Firstly, it is not difficult to notice that Vietnam’s niche as a stable and price-competitive manufacturing destination is sufficiently attractive in its own right. Even without the TPP, Vietnam remains well connected to the global trade system, with 16 Free Trade Agreements in place with different partners. Expectations are also high for the EU-Vietnam Free Trade Agreement (EVFTA), which is expected to take effect in 2018, to bring an additional boost to garment exports. Secondly, ongoing business reforms help ensure that it is easier to conduct business in the country. Vietnam has steadily climbed the World Bank’s Doing Business rankings, coming in at 82 of 190 countries in 2017, compared to 91 among 189 countries last year. So long as the export sector is robust, and the business environment benign, Vietnam should remain attractive to foreign investors.

Conclusion: Time for catch-up

Although Vietnam has started the year poorly, we believe that the foundations are set right for it to see catch-up growth in the second half. Strong performance from the recent Samsung product launches, high consumer expectations for upcoming smartphones and a strong pent-up demand should provide support to Vietnam’s export sector. Moreover, an active VNAT has continued to invest efforts in prolonging the tourism boom. Continued good execution and performance in these sectors should inspire confidence in terms of foreign investment. Taken together, we believe these sectors will be the main growth drivers for the Vietnamese economy in the second half of 2017. We expect overall GDP growth to come close to, but fall just short of, the government’s official target of 6.7%.





Source: General Statistics Office of Vietnam, Bloomberg, OCBC

ASEAN SPECIAL

One Belt, One Road in ASEAN: For what it's worth

In May 2017, China held the Belt and Road Forum for International Cooperation (BRF), the first international summit drawing heads of states and representatives from various countries together under China's One Belt, One Road (OBOR) initiative. ASEAN, with the exception of Brunei, was well represented, with seven heads of state and two ministers representing ASEAN countries.

ASEAN is thought to be a vital cog in the 21st Century Maritime Silk Road arm of the OBOR initiative. The setting under which the Chinese President Xi Jinping chose in 2013 to announce the 21st Century Maritime Silk Road, during a visit to Indonesia, was telling of ASEAN's importance. Indeed, given the relative underdeveloped state of the infrastructure in the region, ASEAN is also envisioned to be a prime beneficiary to the initiative's aim to promote infrastructural connectivity and development.

Almost four years since the OBOR initiative is first introduced, how have the ASEAN countries benefited? The answer is surprisingly difficult to pin down. This is, in part, due to the overall lack of clarity of the OBOR initiative in terms of its overall extent and the form of Chinese involvement. Concrete financial commitment takes the form of the US$40b Silk Road Fund, from which no investments were made in this region. It is also not clear if the China-backed Asian Infrastructure Investment Bank (AIIB) is part of the OBOR initiative. Meanwhile, funding from China EximBank and China Development Bank seemed to be fuelling most projects in the ASEAN countries. Furthermore, the OBOR initiative appears to be used rather loosely by Chinese officials to justify any sort of Chinese interest in infrastructure projects. Not only the Chinese officials are guilty of this, but local officials also seem to be increasingly creative in finding ways to invoke the OBOR initiative to attract Chinese funding to their local projects.

The net result is a convoluted situation where are large number of projects are mentioned along the same breath as the OBOR initiative. In this thematic piece, we attempt to review the infrastructure projects in ASEAN countries may see increased Chinese involvement under the OBOR initiative. The objective is to inject some clarity on extent of its presence in ASEAN, and to obtain a sense of how ASEAN may benefit. As it turns out, the OBOR initiative has been linked to almost every key infrastructure project in the region. This underlies the immense potential of the OBOR initiative – the potential to either jumpstart a new infrastructure development cycle, or to fail rather spectacularly amidst heightened expectations.

Thailand

The main OBOR-related projects in Thailand are the Thailand-China railway and the Eastern Economic Corridor. Of these, the railway is in a more advanced stage of progress, with construction expected to commence this year. The first part of the railway, costing US$5.15b, will link Bangkok to Nakhon Ratchasima. Chinese support coming from China EximBank will cover for funds used for technical systems, with the remaining costs to be raised by Thailand. The second part of the railway will link Nakhon Ratchasima to the Thailand-Laos border city of Nong Khai, from which it will join the Laos-China railway leading up to Vientiane and Kunming. Further phases under consideration involve a southeastern extension to Rayong, and an eventual link to Kuala Lumpur and Singapore.

This project is considered strategically important for both Thailand and China. For China, Thailand's location at the centre of mainland Southeast Asia makes it significant piece in the Pan-Asia Railway Network linking Singapore and Kunming. Thus, the Bangkok-Nong Khai stages are arguably central to the overall success of the Road arm of OBOR initiative. From Thailand's perspective, this railway forms part of a broader strategic infrastructure policy aimed at boosting the domestic economy.

The second project is Eastern Economic Corridor, which is aiming to reinvent the southeastern provinces of Rayong, Chachoengsao and Chonburi into a manufacturing and services hub for the ASEAN region. This total project cost is expected at US$43b. Official Chinese involvement in the project is not yet obvious. The link from Bangkok to Rayong as part of the Thailand-China railway is also only at a proposal stage. However, local officials are enthusiastically linking the project to the OBOR initiative, and attempting to attract greater Chinese involvement.

Indonesia

The landmark project between Indonesia and China under the OBOR initiative is the Jakarta-Bandung high speed railway, costing US$5.2b. Financial support for the project is obtained through pre-agreed loans from the China Development Bank. This project holds particular significance for China as the contract was awarded to a Chinese consortium over a competing Japanese bidder. This railway will also be the first outside China to be built completely to Chinese high-speed rail standards. Thus, it has the potential to become a showcase project for Chinese companies bidding for other high-speed rail projects around the world. However, whether this project actually makes sense for Indonesia is a matter of greater debate, considering that the high-speed rail technologies may not be fully exploited due to the relatively short length of the railway line.

Apart from the Jakarta-Bandung railway, Indonesian President Jokowi is also keen to invoke the OBOR initiative to invite Chinese involvement in other key infrastructure projects in North Sumatra, North Sulawesi and North Kalimantan. In general, the projects at North Sumatra and North Sulawesi seek to improve local rail and road networks, and to upgrade seaport and airport facilities in the region. The North Kalimantan project involves mainly energy generation. However, these projects are still at an early stage, and the extent of actual Chinese involvement is unclear.

Malaysia

Malaysia has been a vocal supporter of the OBOR initiative, with partnerships in place for new railways, industrial parks and educational institutes. The most significant of these projects is the US$13.1b East Coast Rail Link, which will be financed through soft loans from China EximBank. The key port of Klang on the western seaboard will be linked to the population centres on eastern coast of Peninsular Malaysia through this project. This is expected to allow a faster and more efficient movement of goods and resources, thereby driving greater economic activity in the relatively undeveloped states of Trengganu and Kelantan.

In China's calculations, the East Coast Rail Link provides an overland link between the Indian Ocean and the South China Sea. Goods bound for China can potentially be unloaded at Port Klang, and reloaded at Kuantan to carry on the journey, after being carried overland through the East Coast Rail Link. A port at Kuantan is undergoing expansion under a partnership with Chinese private sector companies for this purpose. This provides a strategic alternative to shipping China-bound goods through the narrow Straits of Malacca and Singapore. For Malaysia, the benefits lie in leveraging on this relationship to develop a vibrant trading hub to rival Singapore.

Myanmar

Myanmar participation to the OBOR initiative takes the form of the Myanmar-China natural gas and oil pipelines, linking Kyaukphyu at the Bay of Bengal to Kunming. The natural gas pipeline has been in operation since 2013, bringing natural gas from the Shwe offshore gas field into western China. The oil pipeline also carried its first shipment of oil in March 2017. The oil pipeline allows China to transport oil from the Bay of Bengal to China, bypassing potential flashpoints at the Straits of Malacca and South China Sea. This alternative source of oil and gas supply contributes to a more robust network of fuel supplies into China.

The two pipelines also provide for the energy needs of inland Myanmar, with key off-stations along the pipeline supplying fuel to power stations driving urban centres like Mandalay. Furthermore, the gas pipeline served as a conduit for a long term contract to supply gas to China, thereby allowing Myanmar to receive a constant inflow of gas revenues Similarly, upon the activation of the oil pipeline, Myanmar will generate tax revenue through various port and transportation taxes.

Other ASEAN countries

The Laos-China railway will eventually form a segment between Bangkok and Kunming. This US$5.8b project is currently undergoing construction, with approximately 70% of the funding coming from the China EximBank. Given the relative underdeveloped Laos economy, the economic viability of this railway is somewhat tenuous both parties, at least until the Thailand-China railway is fully operational. Nevertheless, the ability to link Vientiane to other rural population centres in Laos may provide the required impetus for the rural centres to develop economically through trade and tourism.

The Philippines bears hope that the Chinese may contribute financially to their “Dutertenomics” infrastructure plans. It appears that Davao City will be the main beneficiary to the OBOR initiative, with Chinese interest already evident in the Davao port and airport improvement projects, and the Davao City Expressway.

Conclusion: Play the long game

In reality, almost all main infrastructure projects, in both advanced and conceptual stages, forwarded by the ASEAN countries have been associated with the OBOR initiative in one form or another. This reflects the all-encompassing scope of the OBOR initiative, and its amorphous nature at the same time. It appears that the OBOR initiative remains more of a long term vision, rather than a program that can be operationalized and executed. Therein lays the inherent contradiction that faces the ASEAN countries. On one hand, the OBOR initiative represents a great opportunity for the ASEAN countries to obtain help in realizing their grand infrastructure plans. Yet, there is a possibility of failure amidst heightened expectations, not least due to the uncertainty surrounding the nature of Chinese involvement.

We believe that the ASEAN countries stand to gain from the success of the OBOR initiative. To that end, the partnering ASEAN countries and China may need to work towards a clearer framing of the scope of the OBOR initiative, and the sort of projects that it should be involved with. Together with this definition of scope, there should also be better institutionalization of the support provided. One possible way this could be achieved is to have a single body to manage the OBOR initiative and provide the financial support. Such changes should provide a more transparent platform from which the ASEAN countries can engage with the OBOR initiative, thus improving the overall chances of success.

CHINA SPECIAL

The Greater Bay Area: From “Bringing In” to “Going Out“

Apart from “Xiong’an New Area”, “Greater Bay Area” has been another hot topic lately. The Greater Bay Area covers 11 well-developed cities in South China, which most have been well known by the global investors.

What is “Greater Bay Area”?

In fact, the concept of “Greater Bay Area” first surfaced in the report “Study on the Action Plan for the Bay Area of the Pearl River Estuary” in 2011 and was briefly mentioned in the “13th Five-year Plan”. However, it was not until Premier Li Keqiang stressed the concept in his annual work report for 2017 and reiterated the central government’s plan to develop a “Greater Bay Area” did the market start to pay attention to it.

At this juncture, the new development plan still lacks of details. The Guangdong Development and Reform Commission director He Ningka suggested the area’s development to involve six areas including 1) strengthening internal infrastructure networks to enhance interaction; 2) spur innovation; 3) consolidating trade relations and external infrastructure networks to support “One Belt, One Road” initiative; 4) fostering an industrial value chain with shared interests; 5) building a financial center and 6) creating high-quality, environmentally friendly cities.

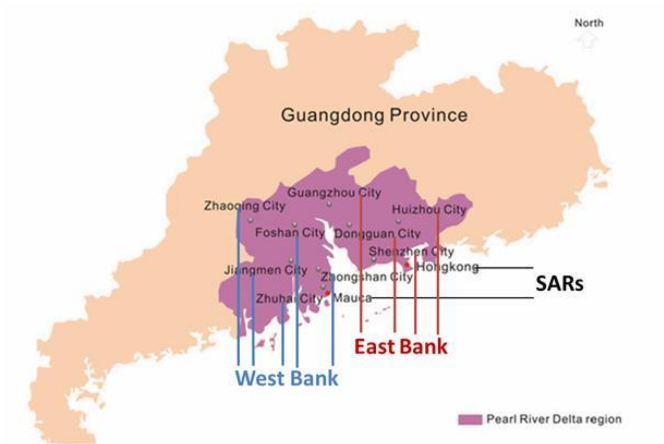


Figure 1. Greater Bay Area Map

An upgrade version of the "Pearl River Delta"

The Greater Bay Area will cover nine cities in Guangdong (Shenzhen, Guangzhou, Zhuhai, Foshan, Zhongshan, Huizhou, Dongguan, Jiangmen, Zhaoqing) and two special administrative regions (SAR) Hong Kong and Macau, exactly the same as those included in the Pearl River Delta. As such, people are confused about the difference between the two concepts. We conclude three major purposes of the central government to give a new title to the delta.

First and foremost, the delta needs a new development plan to serve as the country's gateway for Chinese companies to expand overseas as its traditional manufacturing industry is faltering. The concept of the "Pearl River Delta" emerged firstly in 1994. At that time, manufacturers in Hong Kong and Macau increasingly relocated their factories to the Pearl River Delta due to the delta's geographical advantages and lower labor costs. In addition, as a bridge connecting Mainland China and the world, Hong Kong has brought the delta trillions of dollars of foreign direct investment. The concept of the "Pearl River Delta" reflected the area's "Bringing in" (引進來) strategy to boost its economic growth. For the past decades, the demographic dividend has enabled the Pearl River Delta to become China's manufacturing and export hub. With less than 1% of China's territory and 4.3% of China's population (Figure 2), the delta's (excluding HK and Macau) GDP at about USD1 trillion represented 9.1% of China's GDP. The GDP of the delta (excluding HK and Macau) grew by 8.3% yoy in 2016, outpacing that of Guangdong (7.5% yoy) and China (6.7% yoy) (Figure 3). Besides, a fifth of China's total foreign direct investment went to the nine Mainland cities of the delta in 2015. Furthermore, in the Pearl River Delta (including HK and Macau), the container throughput amounted to over 70 million TEU (Figure 4) while exports and imports totaled USD1.8 trillion in 2015.

However, the delta is facing challenges as its demographic dividend faded. Rapid increase in the labor costs together with the aging problem has propelled manufacturers to move their factories to the inner-city or Southeast Asia. More notably, according to the Economist, the net inflow of migrants into Guangdong has nearly halved since 2008 to 600,000 in 2016. Against this backdrop, the central government needs a new plan to help sustain the delta's growth. If labor forces can be freely floating among the 11 cities, the impact of the area's aging problem would be eased.

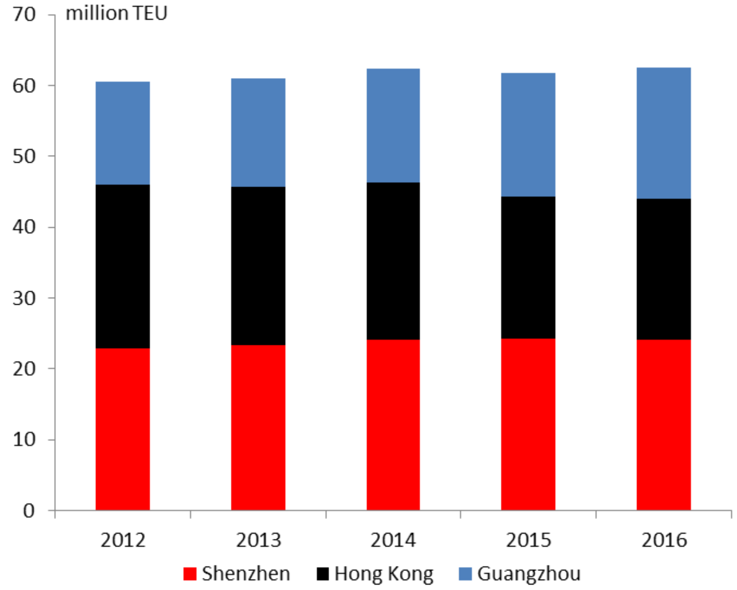
Figure 2. Land area and population

Cities	Land area (sq. km)	Population (mn)
Guangzhou	7,434	13.5
Shenzhen	1,953	11.38
Zhuhai	1,688	1.63
Foshan	3,848	7.43
Huizhou	11,158	4.76
Dongguan	2,465	8.25
Zhongshan	1,800	3.21
Jiangmen	9,541	4.52
Zhaoqing	14,856	4.06
Total	52,943	55.53

Figure 3. Growth, industrial production and other key indicators

2016	GDP growth	Industrial production	Fixed asset investment	Retail sales	Gov Revenue
China	6.7%	6.0%	8.1%	10.4%	4.8%
Guangdong	7.5%	6.7%	10.0%	10.2%	10.3%
PRD	8.3%	6.7%	11.3%	10.1%	10.7%

Figure 4. Container throughput of major ports of Pearl River Delta



Second, the development of the Greater Bay Area is expected to lead an industrial upgrade across the country. In the meantime, industrial upgrade in the delta will also help to mitigate the impact of the diminishing demographical dividend as advanced manufacturing and high-tech industry is less labor-intensive. In fact, the delta has witnessed successful industrial upgrade, which allowed the area to recover soon after the Global Financial Crisis with its GDP growth far outpacing Guangdong's and China's since 2013 (Figure 5). Previously, the east bank (led by Shenzhen and Guangzhou) of the delta was famous for on electronics and IT products while the west (led by Zhuhai, Foshan and Zhongshan) for household appliance products. Based on this, the east and west part of the Greater Bay Area will specify in advanced IT industries and advanced equipment manufacturing respectively. Over the past decade, several private companies founded in Guangdong have shifted their focuses on to high-tech or advanced manufacturing and stood out in the globe as a result (Figure 6). The number of high-tech companies in delta increased by 78.8% to 18,880 and is expected to rise to 23,000 in 2017. Production of advanced manufacturing and high tech industries accounted for 54.9% and 32.5% of total production in delta respectively in 2016. During the same year, the number of invention patent applications increased by more than 50%. What is more, government investment in science and technology in the delta jumped 88% yoy in 2016.

Figure 5. GDP Growth

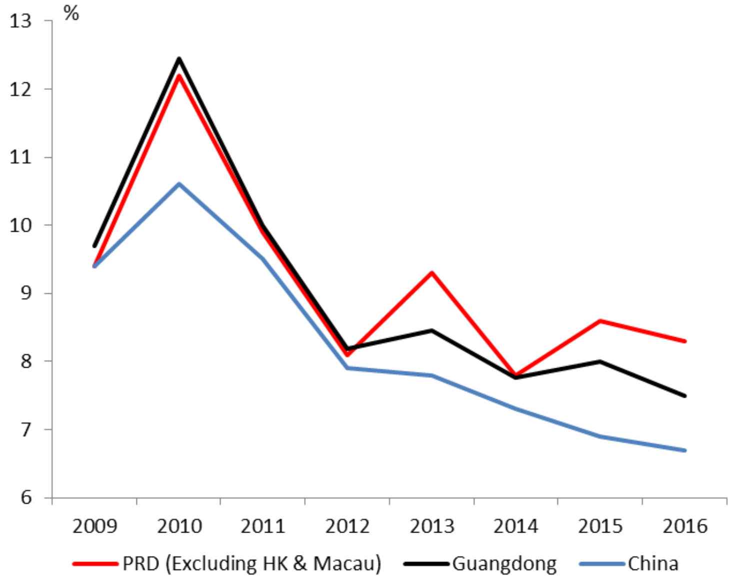


Figure 6. Famous names in Pearl River Delta

	Big Names
Shenzhen	• Huawei--now the largest telecommunications equipment manufacturer in the world and a global smart phone brand • BYD--best known for its electric cars and buses.
Zhuhai	Gree
Huizhou	TCL
Foshan	Midea (acquisition of Toshiba's white goods department backed by local state investment from the PRD.)
Dongguan	OPPO Electronics and Vivo have captured top market positions in China – the world's largest market – from Huawei, Samsung and Apple

Third, the new development plan will serve as an example for the whole country to recalibrate the economic growth model from a reliance on exports towards domestic consumption and services. According to the Economist, exports as a share of Guangdong's industrial output fell from 38% in 2000 to 27% in 2015. The delta's decreasing competitiveness against the Southeast Asia, the subdued external demand since Global Financial Crisis and the rise of trade protectionism together have made the region's exports weaker than before. Therefore, factories in the delta have been rearranging logistics and supply chains to redirect exports to the growing domestic market. By integrating the cities that focus on high-tech industry, advanced manufacturing, financial services and tourism services respectively, the Greater Bay Area could better serve the diversified and huge internal demand. Also, the rapid expansion of middle-class in China makes the new plan more promising.

Fourth, the central government aims to develop a city cluster which could be comparable to the world's rival Bay areas in San Francisco, London, New York, Sydney and Tokyo (together account for nearly 60% of global GDP). Under the new plan, four leading cities including Hong Kong, Macau, Shenzhen and Guangzhou will stand out to lead the development. Specifically, Hong Kong will continue to play its role as a financial center and a platform for Mainland companies to go global. Macau together with its neighbor city Hengqin will build an international gaming and tourism hub. Meanwhile, Shenzhen will build on its innovation and technology capabilities (R&D to GDP ratio was over 4% for Shenzhen, nearly doubling that for China and Singapore) while Guangzhou will lead as an advanced manufacturing and modern services center. Furthermore, Guangzhou, as the previous starting point of the "Silk Road", may lead the delta to support the "One Belt One Road" initiative. Here, the central government is applying the "Going out" strategy (走出去) to the future development of the delta.

Strong infrastructure in the Greater Bay to support the Belt & Road Initiative

With respect to the infrastructure, Hong Kong International Airport, Guangzhou Baiyun International Airport and Shenzhen Bao'an International Airport, combined with Macau Airport, Huizhou Airport and Zhuhai Airport could provide air transport services for the bay area and even the whole region in South China. On the other hand, there are several railways connecting Guangzhou and Beijing, Guangzhou and Sichuan Kuming as well as Beijing and Hong Kong Kowloon. In the near future, it is also possible that the Pearl River Delta will be linked to Southeast Asian countries by road. These together with three large ports in Hong Kong, Guangzhou and Shenzhen means that the strong infrastructure is more than able to support the expected increase in trade of goods and direct investments between China and the countries involved in the Belt and Road initiative (Minister of the Ministry of Commence, Zhong Shan, estimated that over the next five years, China will import USD2 trillion of goods from the countries involved in the "One Belt One Road" (OBOR) initiative while overseas investments will exceed USD750 billion).

Hong Kong's role in the Greater Bay

The latest report from McKinsey shows that the financial gap for infrastructure in Asian is as big as US$21 trillion for the next 15 years. Getting financing right is the key success factor to infrastructure investment under Belt and Road initiative. Hong Kong, as the major international financial center, is clearly able to play a role. Meanwhile, Hong Kong could share its expertise in financial services, professional services, high value-added shipping services, tourism services, and convention and exhibition services with the countries involved in the "One Belt One Road" initiative. In addition, as the Belt and Road initiative is expected to facilitate the development of RMB as a funding and investment currency. This could help to expand the offshore yuan market and therefore bolster the development of CNH businesses in Hong Kong.

In addition to financing, Hong Kong's strong research capability and large talent pool thanks to high quality world class tertiary education will also help the area to excel. The recent success of DJI, the Shenzhen based world's largest drone-maker, set a strong and convincing example how Hong Kong could cooperate with mainland cities such as Shenzhen. Without the support from the R&D lab at Hong Kong Science and Technology Park, DJI probably may not grow so fast. The heathy ecosystem between Shenzhen and Hong Kong is helping facilitate growth.

Challenges remain

Nevertheless, challenges remain for the development of the Greater Bay Area. The differences in the political, economic and legal system across the border suggest that the development path of the Greater Bay area is likely to be different from other Bay areas in the world. For example, under the "One Country Two System", some law enforcement issues emerged when the governments across the border proposed to adopt a joint Hong Kong-mainland checkpoint for the express rail link connecting Hong Kong with mainland cities. In addition, the heightening social tension in Hong Kong may also hinder the integration of the 11 cities.

Despite challenges, the government commitment to the development of the Greater Bay area is promising. Hong Kong leader Leung Chun-ying led a major delegation to six mainland cities as part of the "Greater Bay Area" plan during April 19- April 21. After that, Hong Kong's government will submit its proposal to the National Development and Reform Commission (NDRC) by June. The NDRC will then complete the blueprint for the State Council's approval at the end of the year, which may provide more clues about the new plan. The Hong Kong and Shenzhen governments' plan to develop an Innovation and Technology

Park in the Look Ma Chau Loop reinforce government's strong support for the area.

Conclusion

All in all, the "Greater Bay Area" is more like an upgrade version of the "Pearl River Delta", reflecting a change in the area's economic development strategy from "Bringing in" to a "Going out". With the new development plan, the delta may be able to overcome the challenge of the waning demographic dividend; lead the industrial upgrade and economic transition in China; compete with the world's rival Bay areas; and facilitate the Belt and Road initiative. However, various challenges, including the differences and tension between Hong Kong and Mainland China, are likely to hinder the implementation of the new plan, which need to be addressed by strong government commitment.

A Likely Correction

Housing frenzy since last year has contributed to the economic growth and the resultant significant increase in stamp duty led to notable growth in fiscal revenue. However, it also heightened social anxiety as even a small flat of 30 square meters are unaffordable to a majority of residents.

For the first half of this year, a stable labor market, persistently low borrowing costs, strong demand from Mainland investors and slow increase in new home supply have together boosted the housing market. As a result, housing transactions rose to the highest level since last September in April. Meanwhile, overall housing prices index refreshed its record high for the sixth straight month in April and edged up significantly by 19.8% yoy. However, we believe that increasing supply, higher interest rates and China's slowdown could be factors leading to a moderate correction in the housing market in 2H. For 2017 as a whole, we expect home prices to increase by 0% to 5%.

Life is all about buying a home

For most of the residents in Hong Kong, buying a house is the priority of their life. However, this is getting more and more difficult. According to Hong Kong Housing Department, around 25,400 public housing units will be offered in 2017-2018, a 25% decrease from 33,800 units in 2016-2017, a third record low in 10 years. As at end-March 2017, the average waiting time for general applicants was 4.6 years. This forces low to medium income households to rent private homes or buy smaller flats. Banks cutting mortgage rates and developers offering mortgages with high loan to value ratio have encouraged more lower to medium income households to enter the market. On the other hand, parents who have paid down their mortgage increasingly offered their property as collateral to borrow money for home purchases for their children. Furthermore, Mainland visitors who are eager to diversify their investment portfolio and hedge against RMB risks have rushed to HK to buy homes, especially given that home prices in the first tier cities have caught up with that in HK.

For either own-use or investment, home purchases seem to be a must for Chinese people. Therefore, even though the government announced its plan to curb purchases of multiple flats under single agreement from April, the new home supply freed up by the new measure was still well absorbed by the pent-up demand.

On supply front, tight home supply (housing completions fell by 66% yoy to 329 units in the first two months) and a stable labor market have fueled the housing boom. Furthermore, as developers including those from Mainland China have aggressively purchased lands (one third of the available lands were purchased by Mainland Companies in 2016) and pushed up the land prices. This propelled developers and home sellers to lift selling prices. With home prices increasing, panic buying spree emerged and helped to sustain the housing boom.

New cooling measures to have limited impact

To reduce the increasing credit risks faced by banks amid the housing frenzy, the HKMA announced its plan on May 12 to tighten lending to developers. Nevertheless, as large developers who dominate the property market are rich in capita and show relatively low mortgage to equity ratio (only a few of banks fail to hold below the upper limit of 5% set by the HKMA), they are not much affected by the tightening. Therefore, mortgages offered by developers will continue to help prospective buyers to enter the primary market in coming months.

On May 19, the HKMA stepped up effort and announced to require all banks to lower the loan-to-value ratio cap by 10 percentage points for residential mortgage loans involving borrowers with one or more pre-existing mortgage loans and those who earn the majority of their income outside HK. Furthermore, the risk weight floor on all new mortgages was lifted from 15% to 25% for all banks following an Internal Ratings Based (IRB) approach. For the primary market, these measures may have limited impact as the involving prospective buyers could simply turn to developers for mortgages. The strong demand for the new projects launched right after the announcement of these measures just reinforces our point of view.

In the secondary market, the lowering of cap on the loan-to-value ratio may tame local and foreign speculative demand. In addition, as new measures prompted banks to gradually narrow the mortgage spread on HIBOR-based loans (some have raised the rates from HIBOR plus 1.3% to HIBOR plus 1.4%), second-hand home buyers who rely on bank lending will take an immediate hit. Taken together, we expect the measures implemented lately will tame secondary market transaction volumes in the near term, whereas barely affect the transaction volumes in the primary market or the overall housing prices.

Still, the next round of housing correction is approaching

Even without the new wave of cooling measures, we believe that the housing market is already approaching its cycle peak as the supporting factors are abating. On supply front, new home supply is set to grow rapidly. Specifically, housing completions rose by 401.9% yoy in March, ending the decrease trend over the previous two months. Also. housing starts rose by 53.8% yoy in March.

With regard to demand, it is likely to be dampened by factors other than the new cooling measures. Firstly, a stable RMB, a slowdown in China and a tightening liquidity condition in the onshore market, may together shrink the demand from Mainland investors. Secondly, Chinese authorities have deterred developers from issuing dollar bonds in offshore market and have blocked all possible channels for developers to raise capital in the onshore market. Therefore, Mainland developers may become less aggressive in purchasing HK lands in the near term. This point of view is reinforced by the fact that only one Mainland company out of nine companies bid for the most expensive land for commercial use in HK in May. Finally, the resultant decrease in capital flows from Mainland china and the expected rate hikes by Fed will likely prompt banks to raise the prime rate late this year. In a nutshell, we expect that housing market is bracing for a moderate correction in 2H with housing transaction shrinking and housing prices growth decelerating gradually.

When and how will banks raise rates?

Though we are calling for a correction in the housing market in 2H, we believe that the correction could be rather moderate, based on our forecast on gradual and mild hikes in lending and deposit rates starting from late this year.

Since the beginning of this year, the spread between 1-month USD LIBOR and 1-month HIBOR has edged up continuously and reached its highest level at 79 bps since late 2008. However, there are little signs of capital outflows with the banking system remaining flushed with liquidity. Market speculation on a widening gap between HIBOR and USD LIBOR has kept the HKD swap points near a nine-year low. Nevertheless, as the Fed is set to raise rates by one more time in 2H and plans to trim the balance sheet this year, we expect capital to rotate from global market back to the US gradually and push up the HIBOR.

As a result, adjustment to the Prime Rate seems inevitable for HK banks.

Looking back to 2001-2003 period, the downward adjustment made by HK's banking system to the Prime Rate was smaller than the magnitude for rate cuts by the Fed. This left HK banks some room to delay raising the Prime Rate after the Fed started its rate hike cycle in June 2004. Similarly, after the Global Financial Crisis, the Fed cut rates from 5.25% to 0.25%, 75 basis points lower than its previous low at 1%. By comparison, HK banks merely reduced the Prime Rate from 8% to its historical low of 5%. As a result, banks have some leeway (75 basis points) to delay the adjustment of the Prime Rate. However, after two rate hikes by the Fed so far this year, the room for further delay is diminishing. As we expected the Fed to lift rates by one more time in 2H, a Prime Rate hike may be inevitable.

Nevertheless, for the past two rate hike cycles during 1999-2000 and 2004-2006 respectively, HK banks lifted Prime Rate by fewer times than the Fed. Therefore, HK banks may still lag the US hikes in the current rate hike cycle.

On the other hand, liquidity in HK's banking system is more abundant now than during the previous two rate hike cycles. As at the end of May, banking system's aggregate balance and outstanding exchange fund bills and notes totaled about USD157.2 billion, 1120% and 704% higher than the same period in 1999 and 2008 respectively. The amount also outweighed the estimated capital inflows of USD130 billion since 2008. Though the Fed is likely to raise rate by one more time and reduce its balance sheet this year, any capital outflows could be controllable. Therefore, banks will unlikely lift Prime Rates at faster pace and in large magnitudes.

In conclusion, though it is inevitable for banks to raise the Prime Rate this year, we expect banks to move forward with a marginal 25 basis-point increase before or after the Fed's third rate hike this year. Thereafter, the pace of adjustment to the Prime Rate could be gradual and moderate, which means that the housing market may not take a hard hit as a result.

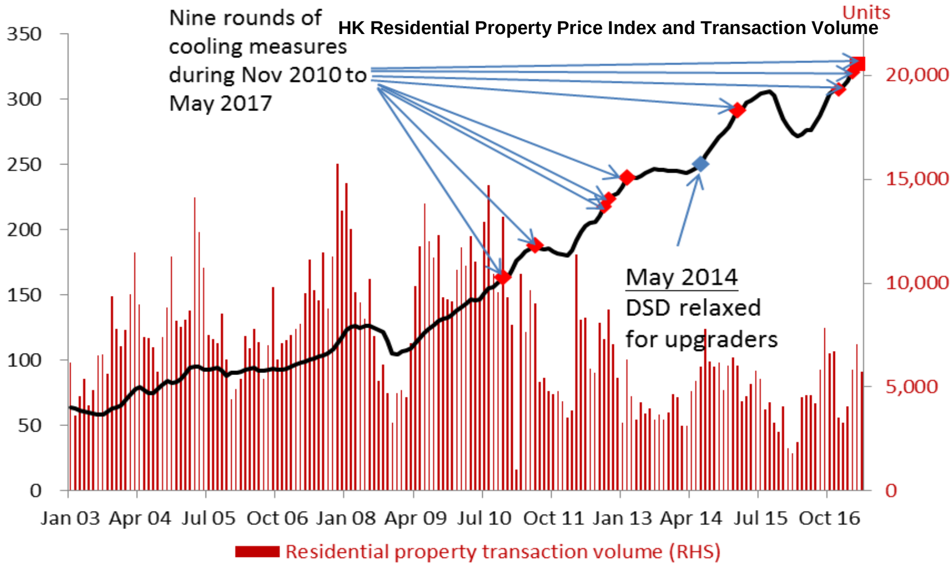
Housing market correction to be moderate

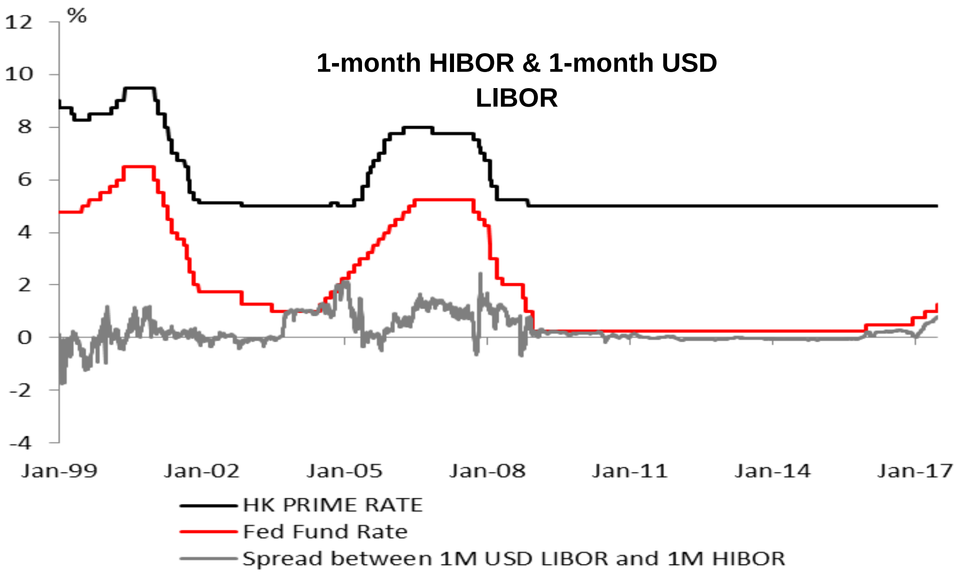
Though the new wave of cooling measures are unlikely to hit overall housing prices or reduce the secondary market's transaction volumes in the long term, it combined with other unfavorable factor may lead to a correction in the housing market. This means that transaction volumes will shrink while annual growth of housing prices will decelerate. Nevertheless, for the second half of this year, given a stable labor market, a bullish stock market and the still low borrowing costs after lifting 25 bps, we expect the housing correction to be moderate. Therefore, our forecast on growth of housing prices for 2017 remained at 0%-5% unchanged.

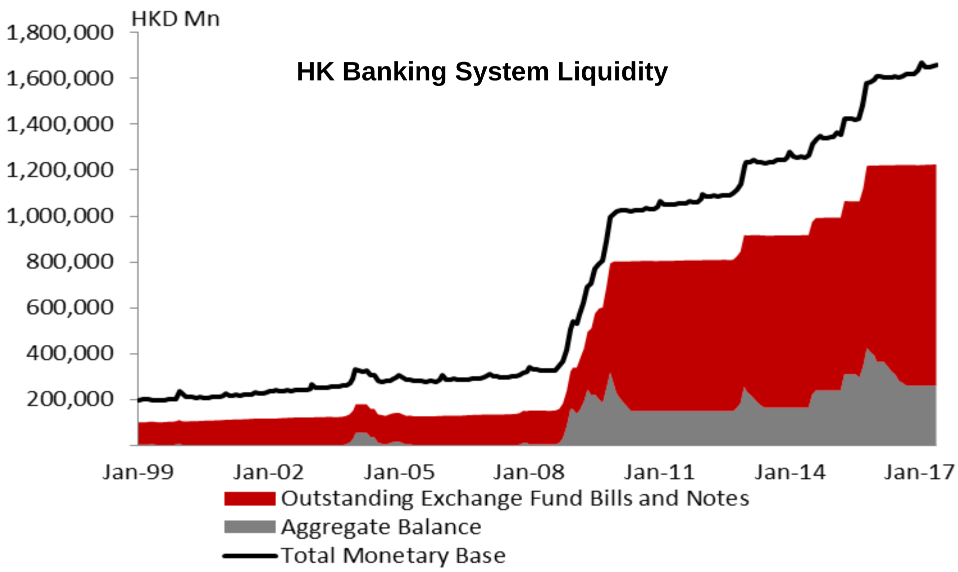
In the longer term, when borrowing costs increase substantially as compared to the current level, developers' 'financial support' may no longer be able to shield the primary market from the impact of cooling measures. Though fewer down payments are required if buyers borrow from developers, mortgage rates required by developers will be at least two percentage points above the rates charged by banks. As such, even if developers are financially able to offer mortgages, higher rates may still deter prospective buyers. Hence, should the Fed's accelerate its rate hike pace on the back of fiscal stimulus or further improvement in economic fundamentals, the resultant increase in mortgage rates will likely suppress housing demand in both primary and secondary markets. On supply front, an expected supply of 96,000 units in the coming 3 to 4 years according to the Transport and Housing Bureau may also drag on housing prices.

Nevertheless, collapse in housing market is unlikely in the longer term as investment demand may remain solid. On one hand, though homebuyers increasingly relied on developers' lending, for new home purchases, mortgages offered by developers accounted for less than 20% of total new mortgages approved. Therefore, the reduction in primary housing demand amid higher interest rates is unlikely to cause any collapse in the housing market.

On the other hand, strong demand from high-net-worth individuals will continue to underpin the long-term upward trend of housing market. According to The Wealth Report 2017 by Knight Frank Property Consultants Co, Ltd, the number of individuals with US$30 million or more in net assets, defined as UHNWIs, in HK amounted to 4,080 in 2016, ranking third in the world and first in Asia. Given the high return of property investment (Hang Seng Index rose merely by 10% while overall housing prices index soared by 227% from end of 2006 to end of 2016), local wealthy residents will highly likely continue to invest in housing market. Notably, the UHNWIs in Hong Kong own 3.3 homes on average. Long-term increase in housing prices could help to enlarge the base of high-net-worth individuals and in turn provide more impetus for housing market. Furthermore, this group of wealthy residents will offer financial support to their children for home purchases. Finally, according to the report issued by the Shenzhen Real Estate Research Center in 2010, the home-ownership rate in Shenzhen was even lower at 33.6%, indicating huge speculative demand in Shenzhen's housing market. As Shenzhen's housing prices have been catching up with HK's, the speculative demand may spill over to HK and add upward pressure to the housing market in the long term. Therefore, due to huge speculative demand from the wealthy minority, housing market is not likely to collapse until next financial crisis.







Source: Land Registry, Rating and Valuation Department, Bloomberg, HKMA

INDONESIA SPECIAL

Better Late Than Never

After what was a long wait, S&P finally upgraded Indonesia to investment grade rating in May this year.

When it refrained from upgrading Indonesia in the last few rounds of review, the reasons S&P gave were multi-fold, ranging from somewhat understandable non-performing loans risk in the banking sector to the more quixotic talks about GDP per capita level.

When the ratings agency finally saw the light and upgraded Indonesia from BBB- to BB+ and hence into investment grade, however, the motivation seems to be straightforward enough.

In its own words, the upgrade is said to be reflecting its "assessment of reduced risks to Indonesia's fiscal metrics." It added that "The government's new focus on realistic budgeting has lowered the risks that budget deficits will widen significantly when government revenue disappoints."

These seem to be code-words for "we like the way the Finance Ministry is run now" and should be seen as kudos to Sri Mulyani Indrawati.

After taking over the finance portfolio in the middle of last year, she executed a reality check on the 2016 budget. Among the tough decisions she had to make was to undertake a fairly sharp pullback of government spending halfway through the budget year, as revenue shortfall threatened to force the overall deficit too close to the legally mandated 3% of GDP level for comfort. The decision for H2 2016 austerity dampened overall GDP growth significantly, bringing about tail effects on government spending that still bore imprints in Q1 2017's relatively lacklustre 5.01%yoy growth.

For 2017's budget, however, the chances of having to execute another sharp U-turn on government spending policy have been reduced by imbuing it with reality checks. Rather than over-promising only to under-deliver, we half-joked that she had learned the importance of doing the reverse from her time leading a bureaucratic behemoth of World Bank.

It is that spirit of being upfront and realistic, we believe, that has ultimately won over the hitherto skeptics at S&P.

Having an all-around investment grade from the three major rating agencies matters more than just the practical ease of not having to remember whose grade stands at which side of the divide anymore. It also would potentially open up Indonesia to a broader – and stickier – base of investors, including funds that could not invest in the country before because of investment grade provisions in their mandates. It would also help to bolster the government's efforts in improving the appeal of Indonesian assets to previously untapped groups of investors. This includes retail investors in major developed markets. For its recent initiative to sell its first dollar-denominated bonds to US retail investors by registering with the SEC, for example, the upgrade is helpful to say the least.

Going forward, the good thing is that the story of upgrades is not over yet. Not so much from the relatively shy S&P, but from its competitors, Moody's and Fitch ratings. These two have not only upgraded Indonesia into investment grade territory more than 5 years ago, they both now have an active positive outlook in their assessments. Our sense is that there are enough reasons for them to move Indonesia further up in the scale of investment grade this year, particularly if Sri Mulyani and her team manage to continue keeping the budget in shape in the coming months.

Overall, while there will be those who worry that S&P's upgrade may take away the impetus for the government to undertake further reforms, we think that concern is overblown. If anything else, celebratory atmosphere aside, it appears that there is enough realization that this upgrade has been hard-won and but a milestone in a long journey.

Having gone through tough decisions such as cutting away oil subsidy that was a parasitic leach on scarce government resources, to the undertaking of an ambitious and largely successful tax amnesty program, the next phase will be to fundamentally reshape Indonesia's tax base that remains too narrow. With the tax law changes supposedly ranking among the high priority agenda in the nation's parliament, may this upgrade be a reminder to the country's lawmakers of the importance in engaging less of distracting politics and more of important economics.

NORTH KOREA SPECIAL

Tread With Care. Please.

A war of words

The geopolitical tensions between North Korea and the world's major powers have been mind-boggling and particularly concerning at times. Being the world's only hereditary Marxist monarchic government, its supreme leader Kim Jong-un has been seen to prefer a massive show of arms to illustrate North Korea's military strength. Elucidating his power were numerous missile tests since the beginning of this year (twelve launches this year, and possibly counting), coupled a show of armaments and weaponry during "The Day of the Sun" which commemorates the birth anniversary of Kim Il-sung, founder and "eternal president" of North Korea. With the booming commentaries which repeated "Peace is guaranteed by our arms" during the celebrations, these massive display of military strength likely serves as a premonitory message to its rivals: They possess the capability to retaliate or even engage a pre-emptive strike if necessary.

At least for now, it is merely a war of words. From a national security point of view, the political need to quickly defuse North Korean aggression is emotionally appealing. Yet no quick resolution methods seem to be available. Rhetorically, US vice-president Mike Pence has mentioned that "all options (are) on the table", adding to the multitude of other geopolitical tensions already present. In response to the intensified friction, North Korean Kim reportedly expressed "the conviction… to send a bigger 'gift package' to the Yankees" amid plans to develop a new ballistic missile with precision guidance system. Japan, a close proximity to North Korea, has also voiced that North Korea "is a grave threat to (Japan)… We strongly condemn such acts." The only peace-maker is heard from China, given official comments that China "will absolutely not permit war or chaos on the peninsula," and for good reasons.

Options are (very) limited

China's call for peace in the peninsula is understandable. A pre-emptive strike on North Korea is likely viewed to be a reckless endeavour by many international leaders. Any military intervention would clearly mete collateral damage in Japan (Tokyo is just across the Sea of Japan), S. Korea (Seoul is merely a few miles from the DMZ) and China (the Chinese city of Changbai is one of the closest regions to the North Korean nuclear test site at Punggye-ri, and a stone throw away from North Korea's Hyesan city). With little doubt, the mix of close geographical proximity and vast effects of nuclear damage would endanger millions of lives, let alone desecrate whole economies. Of course, there is also little certainty if Pyongyang may order its own pre-emptive nuclear strike as well.

If military intervention is frown upon, the only tools left on the table would be stacking more trade sanctions against North Korea, and in hope to engage Pyongyang in negotiations. To that end, the ongoing US-led trade sanctions against North Korea are arguably ineffective in dissuading the Korean's missile launch efforts. The sanctions have been hurting North Korea's domestic economy; 40% of the population, or about 24 million people, live below the international poverty line. This is in contrast with South Korea's 15% of its population below the same poverty line, and just slightly higher than sub-Saharan Africa's 46% poverty line level. North Korea, despite being surrounded by many developed economies, still relies on international aid to feed its citizens. Standard of living is stunted with the lack of proper infrastructure, with electric power sporadic and unreliable. Yet, the sanctions, which hurt N. Korea's domestic economy, may not rob Kim of his lunch; the young Kim has reportedly inherited as much as $4.0 billion from his father, and may have kept GBP2.7 billion in overseas bank accounts.[1] As such, the sanctions against North Korea has invariably damaged its economy, but has left its leader relatively unscathed.

Even if sanctions could be effective, China is seen to be the only nation that has the biggest leverage on N. Korea's interest. Being its sole ally, China accounts for 85% of North Korea's foreign trade in 2016 and supplies the North with food and oil supply. Statistically, Sino-Korea trade has steadily increased over the last years. Trade between these two countries has grown ten-fold between 2000 and 2015, and peaked at $6.86 billion in 2014. Still, Chinese interests are starkly different from that of the US; China has historically opposed harsh international sanctions on North Korea, likely in hope to prevent the regime's collapse and trigger a refugee influx into its neighbours. Moreover, from a national security point of view, it may also be in Chinese interest to preserve North Korea as a geographical buffer, in turn also keeping US troops away from its borders. Given the close trade relationship and similar political goals, China has remained to be the sole line of communication into North Korea.

This communication medium however, is slowly breaking down, much to the dismay of market-watchers. In a clear turn of direction, China is slowly disengaging its support for its Northern ally in the latest support for additional financial penalties during a UN Security Council meeting. Moreover, in a likely first of many steps, China also suspending the imports of North Korean coal for the rest of 2017, a move that should hurt the north tremendously given that coal accounts up to 40% of North Korea's export to China. Referring to China and the US jointly in a single statement, the North Koreans condemned the moves to be "a bare expression of high-handed and arbitrary act in pursuit of their own interest trampling upon international justice", and adding that it "will not flinch from the road to build up nuclear forces".

Reunification could be the only sustainable resolution

With sanctions proven to be self-defeating and inter-regional communications turning deficient, market-watchers invariably turn to South Korea (and its new found president Moon Jae-in) in hopes that its recent wooing efforts to be effective in dialing down international tensions.

Arguably, Moon's new administration may see more headway in achieving a grander sense of peace as compared to Park Guen-hye's previous government. In Moon's presidential campaign leading to his election victory, he has visibly advocated support for the "Sunshine Policy", an effort introduced by the Millennium Democratic Party under the then-President Kim Dae-jung, to "actively pursue reconciliation and cooperation" with North Korea, and eventually "achieve peaceful reunification one day". Under the newly coined "Moonshine Policy", Moon is proposing to restart the Kaesong Industrial Complex, which opened back in 2004 in North Korea to employ North Koreans in making goods for South Korean firms. Elsewhere, Moon has openly availed himself to visiting North Korea itself in hopes to engage in open dialogues with Kim himself.

Supporters of the Moonshine policy highlights that a reunification would allow the South access to the North's demographic strength (the North has a significantly younger population), an estimated influx of 17 million workers (on top of South's 36 million), as well as an entrée into the North's reserve of rare earths (estimated at about $10 trillion in value, 20 times more than in the South). Moreover, the reunification could serve to reduce both Korea's interstate war risks, and hopefully de-escalate further military aggression into the future. Into the long run, should the North sees clear benefit from economic partnership with the South, the incentive to de-nuclearise as a pre-requisite for further talks could well be

[1] The Telegraph, *Kim Jong-un 'cannot sleep' because of North Korea's poverty*, 4th June 2017

more effective versus the current senseless battering of sanctions against N. Korea's citizens.

In the long run, reunification will likely be a win-win scenario for both Koreas and international powers. But in the meantime, the tools to prevent degradation into nuclear are limited, and sanctions proved ineffective. In the absence of a reunification option for now, all eyes will likely be on China to utilize its trade leverage on Kim. Military actions, though may have catastrophic effects on global growth and political stability, could unfortunately the only solution should all talks break down.

US SPECIAL

Will The Trump-et Continue To Blow?

"This is more work than my previous life. I thought it would be easier."
US President Donald Trump's personal management of an international conglomerate, drawing in US$10 billion worth of revenue a year is certainly highly laudable. The scale of his previous work simply pales in comparison to the responsibilities of leading the biggest economy in the world with annual GDP of over US$18 trillion; not to mention the management of a myriad of other social, environmental, and political concerns on a global scale. Currently flooding the headlines and public agenda, US President Donald Trump is tied up in a scuffle on his alleged ties with Russia throughout the 2016 US Presidential Elections. With investigations ongoing, whiffs on impeachment have begun to surface, especially after Comey's public testimony in Congress. Nonetheless, waving the impeachment wand ahead of the midterm elections in November 2016 creates a web of considerations that would impact both the midterm elections and the prospects of impeachment.

At present, only the Democratic Representative of Texas, Al Green, who thundered in the House "The President must be impeached!", has actually begun drafting articles of impeachment and formally made a call for proceedings to take place. Nonetheless, despite the Democrats' disdain of President Trump's dramatics, leaders of the blue still warned members to avoid hastily taking action as they should not "be perceived as an effort to nullify the election by other means". On the other side of Congress, the Republican representatives remained unsurprisingly quiet, with the exception of 2 House Republicans who broke the deafening silence by co-sponsoring the Democratic bill to investigate Russia's role in the 2016 elections. Shifting the focus to public sentiments, a poll conducted by POLITICO/Morning Consult, revealed that 43% of voters want Congress to begin impeachment proceedings. In addition, 71% of self-identified Democratic voters would like to see Congress begin the impeachment process, while 76% of self-identified GOP voters do not believe that Congress should begin impeachment proceedings.

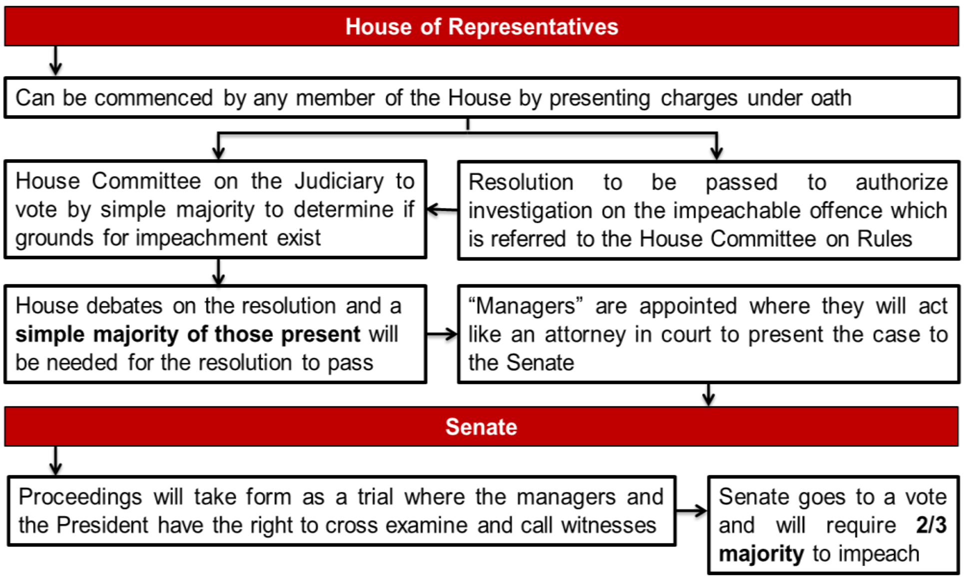
Let's have a blast from the past

Numerous possible reasons for impeachment surfaced since the beginning of Trump's Presidential term. Some reasons filling the headlines recently would include: (1) the potentially unjustified firing of ex-FBI chief Comey (currently investigated by special counsel Mueller), (2) alleged ties with Russia, and (3) possible perjury on his "100 percent" willingness to go under oath to disprove Comey's testimonial. Note that when President Trump testified under oath 10 years ago in a deposition, he was forced to confess to 30 different lies. To add on to the list, former Secretary of Labour under the Clinton Administration, Robert Reich, has also called out the following offences that could be used as grounds for impeachment. Such offences include, (1) violating his Oath of Office after he accused President Obama of wiretapping him, (2) accepting money from foreign governments through steering diplomatic delegations to Trump properties, and (3) attempting to ban residents from Muslim-majority countries from entering US, violating their First Amendment rights. Separately, the Attorney General of Maryland

(and Washington, along with 200 Democrats from the House and Senate have filed lawsuits against President Trump. These lawsuits allege that he violated the Emoluments Clause. Whether any of these allegations would stick could be anyone's guess, but would it be entirely earthshaking to see the list lengthen even further?

Flipping through the history books did show some worrying similarities between the past impeachment scandals and the present situation. Historically, only 3 US Presidents have had a brush with the impeachment guillotine. The most recent would be President Bill Clinton, who lied under oath while testifying for his sexual-harassment case – causing him to be slapped with perjury and abuse of power charges where he was acquitted in the Senate. Looking further back, we have the infamous Watergate scandal during President Richard Nixon's term. A few impeachment attempts were made but failed to pass through the House Committee on the Judiciary. A domino effect ensued after Nixon fired the Watergate prosecutor, which led to the departure of the Attorney General and Deputy Attorney General. This incident was henceforth recorded in the history books as the "Saturday Night Massacre". This sparked a multitude of calls for impeachment, which culminated into the eventual resignation of President Nixon. Lastly, more than a century ago, President Andrew Johnson found himself face to face with impeachment articles that centered on his unconstitutional firing of the Secretary of War which was acquitted in the Senate. It is worth mentioning that none of the Democrats voted to have Clinton or Johnson impeached.

So, would one go about it?
To successfully impeach a President, articles of impeachment would have to pass through the House of Representatives with a simple majority, and be voted through the Senate with a two-third majority.

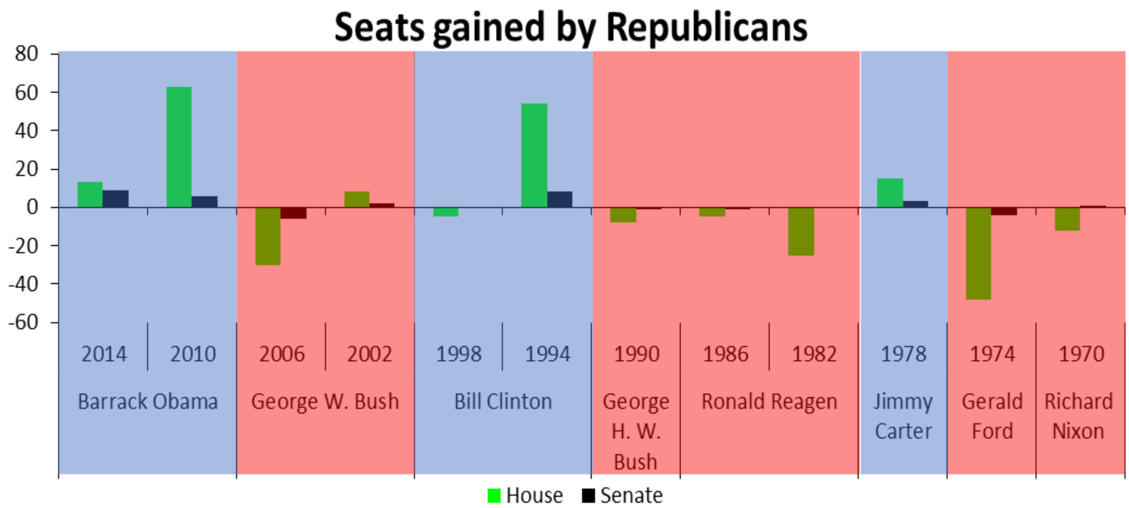


At face value, it may seem apparent that with the Republicans controlling a simple majority in the House Committee on Rules, the House Committee on the Judiciary, the House of Representatives, and the Senate, any possible case of impeachment would be dead on arrival of any Committee. However, with the midterm elections coming up in a year's time, where the House of Representatives and the Senate could see a reshuffling of power, there is an added layer of complexity that could turn the tides against President Trump.

Ok then…. what about the midterm election?
Typically, the midterm election serves as a progress report on the President's party progress when all 435 seats in the House of Representatives and 33 out of the 100 Senate seats will be up for grabs. Analyzing data from the past century (1910 – 2014), we can see that the President's party almost always loses seats. When a Republican President is in power, the Republican Party loses an average of 29 seats in the

House of Representatives and 4 seats in the Senate. On the flip side, when a Democratic President is in power, the Democratic Party loses an average of 33 seats in the House of Representatives and 4 seats in the Senate. Naturally, disgruntled and frustrated voters are more likely to vote than those who are contented and satisfied. Hence, the President's party almost always loses.

Interestingly, during the midterm elections after impeachment scandals were on the table, Clinton, Nixon, and Johnson's respective parties gained 5, -48, 20 seats in the House of Representatives and 0, -4, 0 seats in the Senate. Multiple hypotheses have emerged seeking to explain the counterintuitive results from Clinton's and Johnson's presidency. This would include the fact that Clinton was actually enjoying record high job approval ratings at around 75% over his entire term and that a majority of voters were actually against the impeachment of the President. In Andrew Johnson's case, the surprising results were likely on the back of Democratic southern confederate states, which were readmitted to the Union. Hence, should impeachment be on the table within the next 2 years, the midterm elections after Richard Nixon's resignation would be provide a better point of reference to examine its impact on the upcoming elections next year.



Source: OCBC Bank, US House of Representatives, US Senate

For the Democrats to single-handedly impeach President Trump, they would need to win at least 24 seats in the House of Representatives and at least 14 seats in the Senate from the 2018 midterm elections. In a nutshell, we have established 2 possible cases that can be studied to ascertain possible outcomes of the midterm elections.

1) **President Trump continues to stay in his seat during the midterms**: Using the average seats lost and gained over the past century when a Republican President is in power, the Republicans could potentially lose around 29 seats in the House of Representatives and roughly 4 seats in the Senate.

2) **Presidential seat finds itself a new seat warmer:** A possible measure would be to use the number of seats lost following Nixon's resignation, which would imply that the Republicans could then possibly lose roughly 48 seats in the House of Representatives and around 4 seats in the Senate.

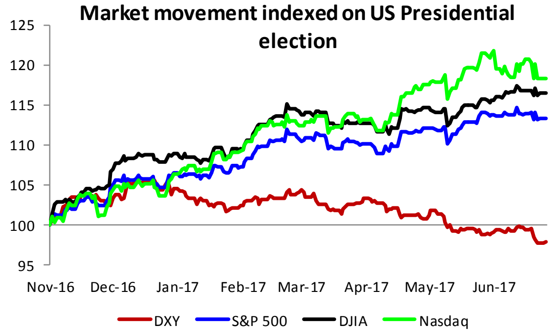
Regardless, the Democrats will only be able to obtain the majority required in the House of Representatives to move forward the impeachment motion to the Senate, but would fail to achieve the two-third majority in the Senate to remove President Trump from office. Without a two-third majority in the Senate, the Republicans still have a considerable amount of power to influence impeachment.

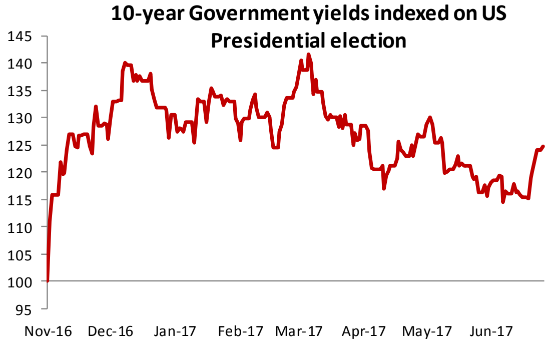
Does this mean that President Trump would get to serve out his entire 4 year term?

It is definitely hard to say for sure, but our stance would lean slightly towards a "Yes". The tricky issue here is that as we move towards the midterm elections, we can expect Republican Representatives and Senators to start sweating their pants with regards to their job security based on the fact that the President's party almost always loses seats. To add fuel to fire, the Trump-et still blowing, and more Republican Representatives and Senators may begin to feel the heat. This could spell trouble for President Trump as the Republicans could begin questioning if it is more beneficial to rip off the band-aid and place a more conservative Mike Pence at the helm. By doing so, the party can aim to repair its image ahead of the midterm elections rather than potentially losing a considerable amount of seats in the midterms. However, it is definitely highly debatable if the jitters from the Republicans will be sufficient to turn the tides against President Trump. Nonetheless, it is important to note that among the 33 seats up for election in the Senate, 23 of them are already held by Democrats, 8 by Republicans, and 2 by Independents. Hence, even in the scenario most favourable to the Democrats, where they would not only retain all their seats, but would win all the seats from the Republicans and the Independents, they would still fall short of 4 votes in the Senate to impeach. Therefore, this would imply that the Democrats alone would never be able to impeach President Trump by 2018. With the 2020 US Presidential Elections in consideration, should the Republicans have intentions to impeach Trump, a likely strategy that the Republicans could partake in would be to impeach Trump right after the next midterm elections. This would allow them to lose lesser seats in the upcoming midterms, and to also obtain a longer lead time in order for Mike Pence to restore public faith in a Republic President, and the Republican party.

Let's dig into the numbers

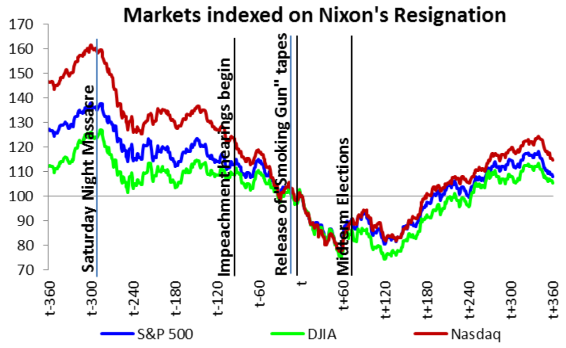
We have seen the US Dollar index (DXY) grew by as much as 5.6% since President Trump's win in the election on the back of his campaign promises, but completely unwinding itself by today. To date, the DXY has fallen by around 2.2%. On the other side of the coin, we have the S&P 500, Dow Jones Industrial Average (DJIA), and Nasdaq still hovering near record high levels as they have risen by 13%, 16%, and 18% respectively since the elections. Currently, these strong gains in the equity markets could likely still be supported by generally robust US-centric economic recovery, rosier corporate earnings as well as a rosier economic outlook on the back of the Trump trade. 10 year treasury yields have risen as high as 2.63% before gradually tapering down to current levels of 2.32%. This likely exhibited a spike in risk-on sentiments from the Trump trade before market watchers begin questioning if President Trump's promised expansionary fiscal policies will come to fruition. Hypothetically speaking, should the DXY and 10-year treasury yield be indicative of a gradual but complete unwinding of the Trump trade, it could represent a potential storm brewing in the shadows, especially in the equity markets.





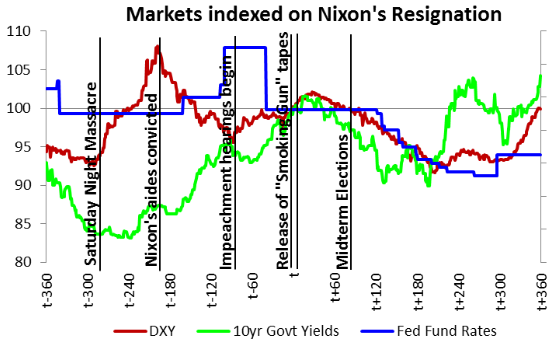
Source: OCBC Bank, Bloomberg

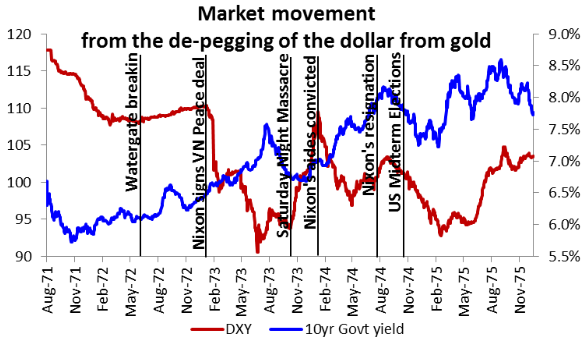
Should we come to face to face with a serious consideration of a Trump impeachment scenario, a possible point of reference to foresee how the markets would react would be to examine how did investors move the markets during Nixon's resignation.



Source: OCBC Bank, Bloomberg

Despite numerous impeachment calls that failed to make it past the House Committee on the Judiciary, impeachment was only seriously on the table after a landslide of impeachment calls following the “Saturday Night Massacre”. From the “Saturday Night Massacre” to the recovery that began around the midterm elections, the S&P 500, DJIA, and NASDAQ have fallen by 44%, 41%, and 51% respectively over the span of 1 year. To put things to perspective, during the Lehman Crisis that was triggered in September 2008, markets plunged until March 2009, where the S&P 500, DJIA, and NASDAQ fell by 43%, 39%, and 41%. This could mean that a Trump impeachment scenario could potentially spell a market downturn worse than the subprime mortgage crisis. However, it is important to note that the economy was not a bed of roses before Nixon’s impeachment fiasco. Stagflation was prevalent with unemployment levels registering around 5 – 6% while having average inflation levels of 7.7%. The backdrop of a poor economy could have added additional downward pressure in the equity markets. Additionally, it is also crucial to know that Nixon was responsible de-pegging the US dollar away from the gold standard, which could likely explain the high inflation levels.





Source: OCBC Bank, Bloomberg

From the conviction of Nixon’s aides to his resignation, US 10 year treasury yields soared by from 7.0% to 7.9% while the DXY have fallen by 5.2% from 107.1 to 101.6. Although the soar in treasury yields were likely on the back of the rising inflation, the weakening dollar story was probably a result of risk-off sentiments stemming from the entire Watergate fiasco that lasted for over 2 years. A Trump impeachment scenario might spell a similar story. However, prior to impeachment proceedings, the Fed Fund Rates were as high as 13% due to inflationary concerns, coincidentally providing the FOMC plenty of policy space to spur the market in an event of a downturn. In fact, the FOMC was able to cut rates from 13% to 9.25% prior to Nixon’s resignation, and gradually tapered rates down to 5.25%. Even though we would likely continue to see further hikes down the road to arrive at 3% by 2020, there could be some macro-policy space limitations in comparison to 1974. Hence, should the tail end risk of a Trump impeachment occur, the FOMC may find themselves with limited power to quickly nurse the economy and the markets.

In a nutshell…

With the midterm elections coming in just over a year's time, it is indeed hard to determine whether President Trump's days in the oval office will be numbered. However, should push come to shove, we can be relatively sure that the rapid unwinding of the Trump trade could result in a sharp downturn in the markets. Nonetheless, even if impeachment never reaches the doorsteps of the Senate, or even the House, it would not be surprising to see President Trump spending a considerable amount of his time fencing off allegations, and lesser of his time pushing forward his campaign promises that are already facing substantial resistance even among his own party. Just a quick recap, some of the policies or plans that are still in the workshop would include, his tax reform plan, his state budget proposal, the reinstallation of the Glass-Steagall act. Not forgetting his promises that have yet to see the light of the day since his inauguration which includes establishing tariffs to discourage companies to relocate, the $1 trillion infrastructure plan and his almighty Mexican border wall. In addition, it is important to note that the recent downgrade of US' 2017 GDP growth rate from 2.3% to 2.1% by the IMF, was attributed to the removing of the assumption that Trump's tax cuts and fiscal spending plans would boost growth. With more obstacles beginning to pile up on his shrinking plate, it could only be a matter of time before it all spills over.

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