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The Covid Recovery Hit a Setback but Should Sustain In 2H 2021

Selena Ling
Head of Research & Strategy
+65 6530 4887
LingSSSelena@ocbc.com

Breaking Dawn in 2H 2021
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2021 started on a positive note of optimism about Covid vaccines and global growth recovery hopes. The first quarter growth momentum mostly surprised on the upside, fuelling market hopes of reflation and also speculation about potential withdrawal of monetary policy accommodation. However, the green shoots recovery story, while not derailed has definitely hit a temporary speedbump in the second quarter. This was largely due to the resurgence of global Covid cases, particularly the virus mutations including the more virulent B1617 strain, and the rapid uptick in regional economies like India, Japan, Taiwan and Malaysia. Even S'pore has seen an increase in local community Covid cases which warranted a return to Phase 2 (Heightened Alert) conditions with the attendant tightening of restrictions and work-from-home arrangements. Manufacturing Purchasing Manager Indices have also plateaued of late, suggesting that the manufacturing, especially electronics, may ease as a key growth driver in coming months.

The key difference in the storyline from a year ago is that most economies are better prepared, companies and workers know how to respond, and vaccines are available with vaccination programs underway in many countries. In fact, the OECD has just forecast global GDP growth at 5.8% yoy for 2021, before moderating to 3.3% in 2022, with the US and China leading at 6.9% and 8.5% respectively, followed by Euro-area at 4.3% and Japan at 2.6%. China is clearly a key beneficiary of the First-In-First-Out of the Covid pandemic and the economic recovery appears fairly entrenched and the Covid situation remains controlled. There have also been relatively less

global supply chain disruptions compared to this period last year with the avoidance of a global lockdown. Consequently, the policy response has been more restrained as well and market speculation of negative interest rates have also subsided compared to 2020. Global risk appetite has therefore also been supportive in 1Q21 amid ample liquidity conditions.

While inflationary concerns have come to the fore this year, most central banks' policy stance remain accommodative. But some divergence is beginning to emerge – namely the Bank of Canada has started to taper its asset purchase pace, while the Reserve Bank of New Zealand has hinted it may start to normalise interest rates in late 2022. While the US Federal Reserve members have started to signal that they may consider discussing a taper in coming meetings from the current $120 billion a month pace, they also reiterate that any taper intentions will see lots of advance warning. Moreover, they do not currently see any interest rate hikes in the next 12 months at least and continue to insist that the current bout of elevated inflation should be transitory. This is different from China who is exhibiting concern about managing commodity price inflation to control factory gate inflation, even though it is unlikely to translate to consumer price inflation for now.

However, US fiscal stimulus continues to be ramped up with the Biden administration now proposing a US$6 trillion of federal spending and a US$1.8 trillion deficit in FY2022 (amounting to 7.8% of GDP) and adding US$14.5 trillion to debt over the next decade to hit US$39.1 trillion (or 117% of GDP) by 2031. Still, the Biden administration argues that this fiscal largess, which will be partly funded by higher taxes, namely hiking the corporate tax to 28% (although he now appears to be backing off to garner bipartisan support for his budget proposal) and to close loopholes for the wealthy. His argument goes that such fiscal largesse should not burden the US economy as long as interest rates stay low (the projections are for the 10-year Treasury yield to rise from 1.4% in 2022 to 2.8% in 2028 and beyond). In addition, the Biden administration is also suggesting a global minimum corporate tax rate, of which it appears to be gaining some traction with some European countries. Of course, whether this massive US budget proposal will eventually pass is another issue. Nevertheless, the 10-year Treasury bond yield appears to be locked within a 1.55-1.75% range even though the US core PCE deflator has accelerated to 3.1% yoy (0.7% mom) in April, the highest since May 1992.

Global trade had rebounded about 10% yoy or 4% qoq in 1Q21, with exports from East Asian economies driving the bounce. Notably, trade in goods have surpassed pre-Covid levels, with Covid-related exports remaining strong amid the ongoing pandemic. UNCTAD tips global trade in goods and services to further rebound in 2Q and stay strong in 2H21 to bring the full-year growth to about 16% from the lowest point of 2020, comprising 19% for goods trade and 8% for services trade. This would mark a stronger recovery than in the last two trade recessions in 2009 and 2015, notwithstanding an uneven economic recovery, with ongoing reshoring and near-shoring trends, greater climate change awareness, and even some enduring post-Covid changes in consumption patterns.

This was in part due to the Biden administration beginning to re-engage in talks with China on trade, even as other sensitive issues like human rights and strategic competition in areas like technology remains very much in play. While Europe and Australia have also turned somewhat more hawkish on China, still geopolitical tensions have somewhat taken a backseat in 2021 to economic and Covid matters as most policymakers prioritise growth recovery.

Financial market volatility has also become more of a mainstay in the second quarter of 2021, with cryptocurrency leading the price swings of late. However, the “sell in May and go away” seasonal adage has not materialised for the equity market. Some of the cryptocurrency volatility have been attributed to official jawboning and market chatter. For instance, the Biden administration is considering reporting for cryptocurrency transactions exceeding US$10k, while China and Japanese officials have thrown water on the usage of cryptocurrency, and even Tesla has suspended acceptance of bitcoin for payments. Central bank digital currencies (CBDC), on the other hand, appear to be gaining traction with more major central banks jumping on the bandwagon. China, for example, will be key to watch given its CBDC will have to compete with other mobile payments like Alipay and WeChat Pay, but may not fundamentally transform cross-border transactions or significantly elevate the global usage of CNY. Meanwhile, growing ESG awareness and investment mandates, fund flows and product solution are likely to continue to pivot to more environmentally-friendly and sustainable options.

Looking ahead into the crystal ball of 2H21, there are a couple of milestones to watch for. First, the June FOMC and Fed chair Powell’s speech at the Jackson Hole conference will be of keen interest to see if the consideration to taper its asset purchases is within sight. Second, the battle between vaccination speed and the fight to achieve some extent of herd immunity even amid the Covid virus mutations remain very much ongoing. Third, the OPEC+ decision on output supply amid rising oil prices will be important for the commodity price complex. Last but not least, whether the nascent global recovery theme will be susceptible to the tightening of monetary policy conditions amid the growing divergence between central bank leaders and laggards on the monetary policy front. In particular, market watchers will be closely parsing to see if the BOC, RBNZ and further down the road, the BOE, PBOC and potentially even the ECB will follow in their hawkish signals or intentions going into the year-end and into 2022. Due to the low base in 2020, macro-economic data will look elevated on an on-year basis, but the sequential momentum will be key to sustaining market optimism in 2H21. In summary, despite the various hiccups, we remain confident that the economic recovery momentum will sustain in 2H21 even if the sectoral recovery remains uneven. As such, assuming that inflation and policy accommodation withdrawal remains within acceptable, risk appetite should remain conducive overall, but volatility may be here to stay.

GDP Growth Rates

% CHANGE YOY	2019	2020	2021F	2022F	2023F
US	2.2	-3.5	6.0	3.8	2.5
Eurozone	1.8	-5.8	4.3	4.3	2.0
Japan	0.3	-4.8	4.0	2.4	1.3
United Kingdom	1.4	-9.9	7.0	5.8	1.3
New Zealand	2.4	-3.0	4.1	3.3	2.9
Australia	1.9	-2.4	4.5	3.5	3.0
China	5.8	2.3	9.2	5.8	5.6
Hong Kong	-1.2	-6.1	5.6	2.5	2.0
Taiwan	3.0	3.1	3.8	2.8	2.4
Indonesia	5.0	-2.1	4.6	5.0	5.2
Malaysia	4.3	-5.6	4.0	4.3	4.5
Philippines	6.0	-9.6	4.5	7.0	6.8
Singapore	1.3	-5.4	6.0	3.0	2.0
South Korea	2.0	-1.0	4.0	3.0	2.5
Thailand	2.3	-6.1	1.8	4.0	4.0
Myanmar	6.8	3.2	-8.9	1.4	4.7
Vietnam	7.0	2.9	7.8	7.0	6.9

Source: Bloomberg, CEIC. IMF, OCBC Bank Estimates

Inflation Rates

% CHANGE YOY	2019	2020	2021F	2022F	2023F
US	1.8	1.2	2.7	2.1	2.0
Eurozone	1.6	1.0	1.8	1.4	1.5
Japan	0.5	0.0	0.1	0.8	0.8
United Kingdom	1.8	0.9	2.5	2.0	2.0
New Zealand	1.7	1.7	2.0	1.7	1.9
Australia	1.6	0.9	2.0	2.0	1.8
China	2.9	2.5	1.8	2.2	2.4
Hong Kong	2.9	0.3	1.7	2.1	2.1
Taiwan	0.6	-0.2	1.5	1.3	1.3
Indonesia	2.8	2.0	3.1	3.3	3.4
Malaysia	0.7	-1.1	1.3	1.5	1.6
Philippines	2.5	2.6	4.1	3.0	3.0
Singapore	0.6	-0.2	1.2	1.5	1.5
South Korea	0.4	0.7	1.7	1.5	1.5
Thailand	0.7	-0.8	1.2	1.2	1.0
Myanmar	8.6	6.1	5.0	5.6	6.3
Vietnam	2.8	3.2	3.2	3.8	4.0

Source: Bloomberg, CEIC. IMF, OCBC Bank Estimates

Central Bank Policy Rates

BENCHMARK RATE %	2019	2020	2021F	2022F	2023F
US Fed Funds Rate	1.50-1.75	0.00-0.25	0.00-0.25	0.00-0.25	0.50-0.75
ECB Deposit Facility Rate	-0.50	-0.50	-0.50	-0.50	-0.25
BOJ Overnight Rate	-0.10	-0.10	-0.10	-0.10	0.00
BOE Base Rate	0.75	0.10	0.10	0.25	0.50
RBNZ Cash Rate	1.00	0.25	0.25	0.50	0.75
RBA Cash Target Rate	0.75	0.10	0.10	0.10	0.50
China Loan Prime Rate (1 year)	4.15	3.85	3.85	3.85	3.85
CBRC Discount Rate	1.375	1.125	1.125	1.125	1.125
Hong Kong Base Rate	2.00	0.50	0.50	0.50	1.00
BI Reference Rate	5.00	3.50	3.50	3.75	4.00
BNM Overnight Rate	3.00	1.75	1.50	1.75	2.00
BSP Overnight Reverse Repo	4.00	2.00	2.00	2.00	2.25
Singapore 3-Month SIBOR	1.77	0.44	0.44	0.47	0.55
BOK Target Overnight Call	1.25	0.50	0.50	0.75	1.25
BOT Repurchase Rate	1.25	0.50	0.50	0.50	0.75

Source: Bloomberg, CEIC, IMF, OCBC Bank Estimates

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Prolonged "First In, First Out" Benefit

Tommy Xie Dongming
+65 6530 7256
Xied@ocbc.com

- The Chinese economy grew by a record 18.3% yoy in the first quarter of 2021 due to base effect.
- On two-year average, the Chinese economy grew by 5.0% yoy in the first quarter, below China's potential growth of 6.0%.
- Although China has not returned to pre-pandemic growth, the recovery in the first quarter was still broad based thanks to China's effective virus containment measures.

Improving domestic demand

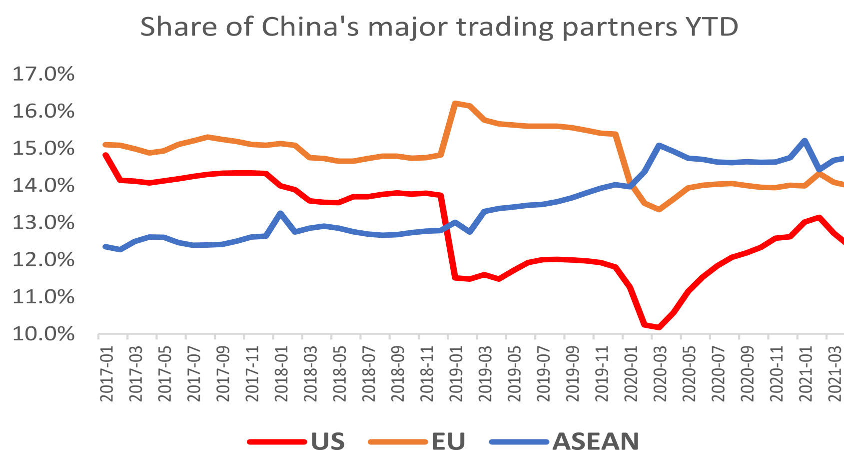
First, local consumption has been improving. China's retail sales soared by 33.9% yoy in the first quarter. After adjusting for base effect, retail sales grew by 4.2% yoy on two-year average in the first quarter, up from 3.2% yoy on two-year average in the first two months of 2021. This shows an improvement in domestic demand in March after China successfully contained a few rounds of mini- virus outbreaks before Chinese New Year holiday.

The rebound in retail sales was mainly supported by two factors. First, online sales remained resilient. E-commerce sales rose by 15.6% yoy on two-year average in the first four months, up from 15.4% yoy growth in the first quarter. Second, offline activity recovered. Revenue for catering and restaurant business in March grew by 0.9% yoy on two-year average, returning to growth for the first time since the pandemic started. China's domestic trips soared by almost 120.0% yoy to 230 million during the five-day Labor Day holiday on the back of pent-up travel demand. The number of total trips this year was 3.2% above the same period before the pandemic although domestic tourism revenue was still 23% below the same period in 2019.

Prolonged "first in, first out" benefit

Second, China's trade sector continued to enjoy the "first in, first out" benefit. China's total trade rose to US$484.9 billion in April, second highest in record after a record reading of US$486.3 billion in December 2020. China's total trade with ASEAN hit a record high of US$72.47 billion in April, reinforcing ASEAN's position as China's largest trading partners.

Chart1: ASEAN has been China's largest trading partners since 2020.



Source: Wind, OCBC

Although Covid-19 first emerged in China back in 2019, the decisive and effective containment measures have brought the country back to normal within a short timeframe and kept China largely immune from a few waves of new mutations. The latest survey conducted by a research team from York University in Canada showed that Chinese citizens' trust in their national government increased to 98%. 49% of respondents said reported increasing trust in the national government since the pandemic started while only 3% reported declining trust levels.

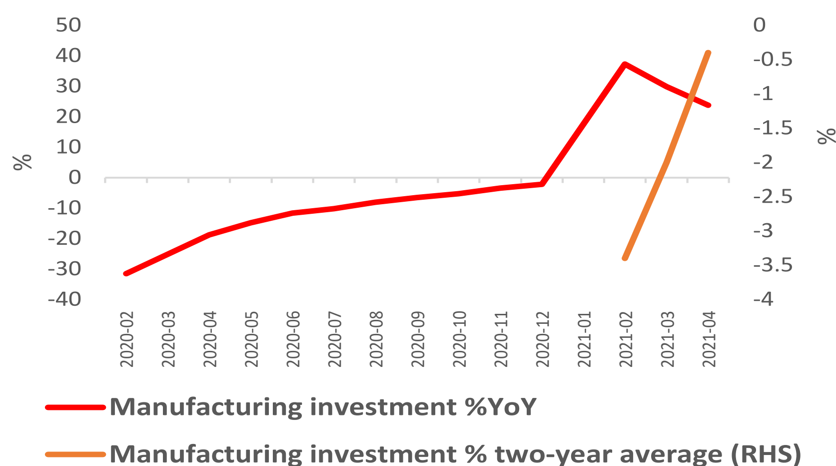
China's success in containing virus has turned the Covid crisis into an opportunity, allowing China to continue to enjoy its prolonged "first in, first out" benefit. The concept of "China exceptionalism" could become a new reaction function in the market such that when there is resurgence of virus in some parts of the world, the Chinese trade sector could benefit. As such, we expect the Chinese economy to continue to benefit from the resilient external demand when the major economies such as US and Europe reopen further in summer.

Rebound of manufacturing investment

China's manufacturing investment grew by 23.8% yoy in the first four months, 3.9% above headline growth of fixed asset investment. On a two-year average, manufacturing investment only fell by 0.4% from the same period of 2019, almost returning to its pre-pandemic level.

As China has mentioned clearly in its 14th five-year plan that it will aim to maintain the share of manufacturing in GDP to avoid the mistake of premature de-industrialization, we expect manufacturing investment to recover further in the coming months on the back of fiscal support. In addition, the resilient industrial activities, which tend to lead the manufacturing investment, will also bolster the rebound of manufacturing investment.

Chart2: The rebound of manufacturing investment



Source: Wind, OCBC

Vaccine rush to remove one economic risk in the second half

Since the May Labor holiday, China's daily inoculation has surged due to the increasing willingness to take the jab as a result of a virus resurgence driven by new B1617 variant across Asia and also the recent sporadic outbreaks in Anhui, Liaoning and Guangdong Provinces. China has administrated 620.97 million doses as of 29 May. In the last week of May, China has inoculated a record 123.7 million doses. We think China is well on track to achieve its vaccine induced herd immunity in the second half of 2021.

The vaccine rush will help remove one of the key risks for Chinese economy in the second half of 2021 when major economies such as US and Europe further open their economies after reaching herd immunity in summer.

Looking ahead, we keep our 2021 GDP forecast for China unchanged at 9.2% for three reasons. First, external demand is likely to remain supportive. Second, domestic demand is likely to improve further as offline activities are expected to rebound. Third, manufacturing investment growth is likely to accelerate, offsetting the uncertain outlook of infrastructure investment due to China's plan to lower government leverage ratio this year via clamping down on hidden debt as well as rising urgency to cool down the surging commodity prices.

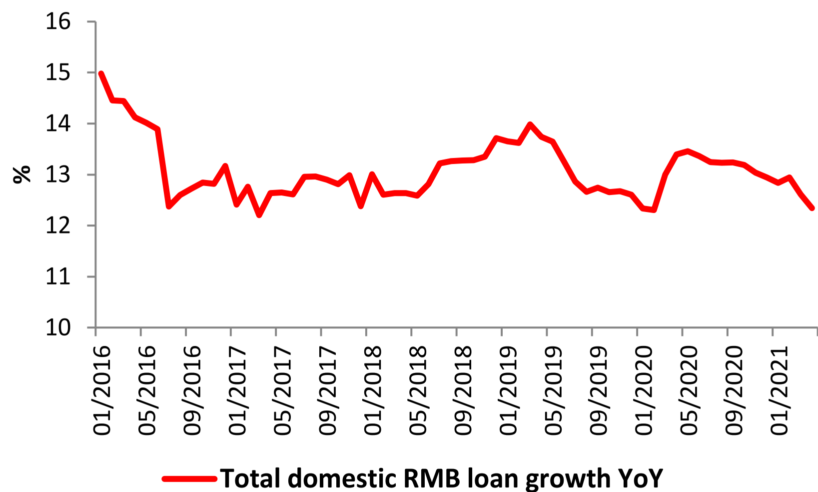
Tighter credit

China's April credit data disappointed on the downside as most indicators missed market expectation although loan demand remained resilient as evidenced by strong medium to long term loan data. The weaker-than-expected credit data in April reinforced our view that China's policy setting has entered a new era combing still-accommodative monetary policy with tighter credit policy.

The shrinking off-balance sheet lending and the sharp decline of short-term loans have demonstrated China's move towards a tighter credit policy.

We expect aggregate social financing growth to slow down further in the coming months due to tighter credit policy despite still accommodative monetary policy. However, the slope of decline is likely to be flatter given China's plan to match the growth of its social financing with nominal GDP growth.

Chart3: Aggregate social financing growth is expected to slow down further



Source: Wind, OCBC

No currency regime change

RMB continued to appreciate against the dollar in the first five months riding on dollar weakness. The recent RMB strength was not only the function of broad dollar weakness but the result of improving domestic sentiments on the back of a positive tone from recent US-China trade talks and an acceleration of China's vaccine rollout. This also sent RMB index to above 98 for the first time in more than five years.

In order to curb expectation on RMB's one-way movement, the PBoC has issued two statements regarding RMB within a week in late May. The latest statement from the meeting of China's Foreign Exchange self-regulatory framework working group reiterated RMB's two-way movement is a new normal.

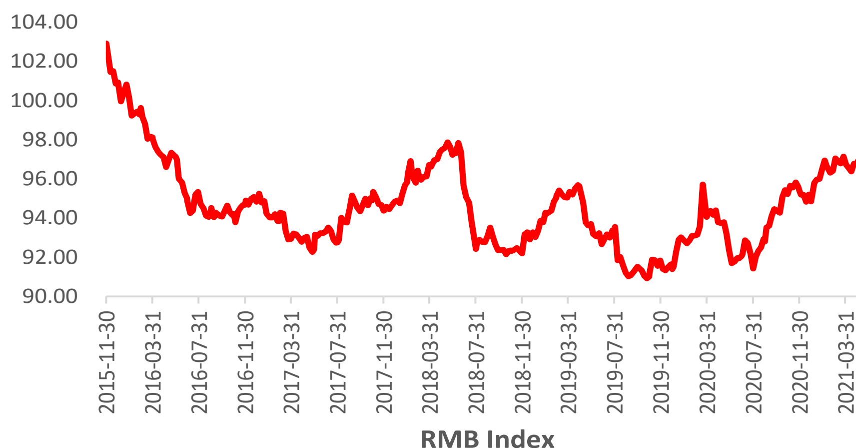
In addition, the meeting also mentioned clearly that RMB will not be used as a tool to support export via depreciation or contain imported inflation via appreciation, reinforcing our view that there is no currency regime change. Nevertheless, the embedded structural dollar weakness and the possible dividend from recent acceleration of vaccine roll out are likely to remain supportive of RMB in the medium term.

Meanwhile, PBoC announced to raise reserve requirement ratio for foreign currency deposits by 2% to 7% effective from 15 June. This is the first RRR hike for foreign currency since 2007. The excessive dollar liquidity in China's

onshore market which widened the swap points has contributed to recent RMB appreciation. We think the announcement sent a signal to the markets that there are enough tools in central bank's toolbox to curb RMB's one-way movement expectation even though PBoC has exited the direct intervention. Via narrowing the swap points, the RRR hike may have indirect impact to reset expectation on RMB's trajectory.

Given RMB index has breached the five-year range of 92-98 in late May, we will be hesitant to chase down the USDCNY in the near term. Nevertheless, the embedded structural dollar weakness and possible dividend from recent acceleration of vaccine roll out are likely to remain supportive of RMB in the medium term.

Chart4: RMB index at five-year high



Source: Wind, OCBC

Hinging on Border Reopening

Carie Li Ruofan
+852 2852 5767
Carierli@ocbcwh.com

- The economy grew at the fastest pace in 11 years by 7.9% yoy, mainly driven by the extension of fiscal stimulus and the rebound in external demand.
- Consumption and investment remained subdued despite some stabilization. On a positive note, business sentiment improved while unemployment rate may have peaked.
- Going ahead, the economy may continue to regain steam on the back of buoyant external demand and strong fiscal supports.
- Nonetheless, for the economy to show stronger recovery, we may need to see further improvement in local consumption and the revival of exports of services, both of which will hinge on the pace of vaccine rollout.
- We expect the economy may expand by 5-6% yoy on assumption that border controls will be further relaxed in 2H.

Strongest economic growth in 11 years

1Q GDP expanded at the fastest pace in 11 years by 7.9% yoy (or 5.4% qoq S.A.), ending six consecutive quarters of contraction and far better than expected. Apart from the low base effect, the strong recovery was mainly driven by external demand revival, extension of fiscal stimulus as well as improvement of local consumption and fixed investments. However, in terms of absolute levels, the headline GDP, private consumption, fixed investments and exports of services were all lower than those in the first quarter of 2019, pointing to a still incomplete economic recovery.

On a positive note, April PMI for private sector showed that business confidence rose to the highest since February 2014 and employment advanced for the third consecutive month. Due to the subsiding local infections and the resultant relaxation of social distancing measures, business sentiment appeared to have improved entering 2Q while the unemployment rate may have peaked.

External demand and fiscal supports may continue to support

Moving into the rest of 2021, the economy may continue to regain steam on the back of buoyant external demand and strong fiscal support.

On the external demand front, firstly, trade activities may remain vibrant. Specifically, exports and imports grew respectively by 30.8% yoy and 25.5% yoy during the first four months of 2021 amid the rebounding external demand, low base effect, soaring commodity prices and burgeoning regional trade activities. Hong Kong as a key re-export port has continued to benefit from the electronic supply chain diversification as the trade with Taiwan, South Korea and Vietnam continued to grow strongly while the exports and imports of electronic-related products kept surging.

Going forward, we expect internal and external demand to strengthen further owing to the extension of fiscal stimulus (e.g. in the US and China) and vaccine-induced normalcy. This may fuel further growth of Hong Kong's trade activities.

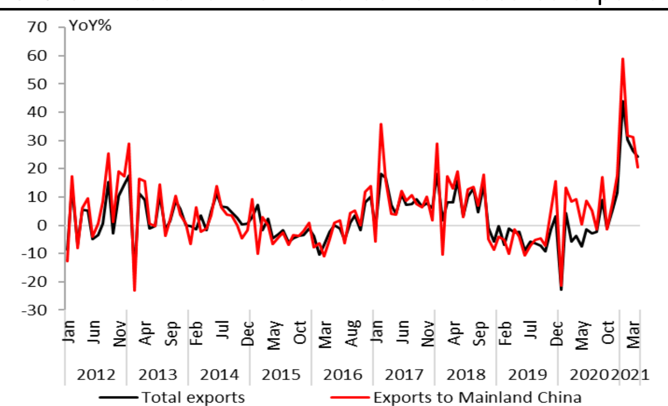
Secondly, financial activities may remain resilient. Stock market and IPO market both softened after the January frenzy due to inflation fears and concerns about the PBoC's premature tightening. That said, a large number of companies are still lining up for HK IPO thanks to the flush global liquidity, the increasingly favourable IPO rules and the largest-ever overhaul of Hang Seng Index. On top of this, we also expect the financial industry to benefit from the wealth management connect and southbound bond connect, both of which are said to be launched in July and may bring in strong investment demand from China given the rising wealth levels in the Bay Area.

On the fiscal policy front, FY2021 fiscal balance is pencilled in at another deficit of HK$101.6 billion (3.6% of GDP) after coming in at a record deficit of HK$257.6 billion (9.5% of GDP) in FY2020. This is more expansionary than expected as the 2021-22 Budget includes over HK$120 billion counter-cyclical measures to meet the immediate needs including e-consumption vouchers, a special 100% loan guarantee for the unemployed, HK$6.6 billion for jobs creation and HK$934 million for tourism. All these relief measures may help to boost local consumption, ease the downward risk on the labour market, alleviate the bad debt risk facing banks, and tide the hardest-hit sectors over.

Chart 1: Uneven economic recovery in 1Q

	1Q 2021 vs. 1Q 2020	Two-year average vs. 1Q 2019
GDP	7.90%	-5.50%
Private consumption expenditure	1.60%	-10.10%
Government consumption expenditure	6.80%	12.70%
Gross domestic fixed capital formation	4.50%	-13.10%
Exports of goods	30.20%	4.00%
Imports of goods	22.70%	-0.90%
Exports of services	-8.10%	-39.10%
Imports of services	-12.90%	-28.70%

Chart 2: Rebound in external demand boosted exports



Source: HK Census and Statistics Department, OCBCWH

Further economic recovery hinges on the border reopening

For the economy to show a stronger recovery, we may need to see further improvement in private consumption (which accounts for over 60% of total GDP) and the revival of exports of services, both of which will hinge on the pace of vaccine rollout.

On the one hand, the government has launched vaccine bubbles while private companies have provided incentives to encourage inoculation, in order to further relax the social distancing measures. On the other hand, a relatively high vaccination rate locally and externally may be required for a full and safe border re-opening.

However, as of May 31, merely 18.4% of Hong Kong's population have received at least one dose of Covid-19 vaccine. Also notable is that the vaccination pace has been uneven across the globe which may have been the reason behind the latest virus resurgence in some parts of Asia. As such, containment measures look unlikely to be relaxed in the near term, which means that the road to recovery for local economy and the hardest-hit sectors may remain bumpy. Given the uncertainties, the government kept its 2021 GDP growth forecast unchanged at 3.5%-5.5% despite the strong GDP reading for the first quarter.

Border reopening may also give some hope for the property market

The housing market has strengthened further so far this year and may remain resilient as local rates may stay low for some time given the Fed's dovish tone while the home supply may also remain scarce in the short to medium term.

Having said that, some negative factors may cap the upside of housing prices in the near term. First, housing rentals have slid for the 19th straight month in April amid the reduction in foreign workers and students as well as the elevated unemployment rate. Second, there is also some selling pressure from emigrants.

On a positive note, should Covid containment measures be relaxed to support the economic recovery, a further rebound in local demand and the return of external demand may warrant a more balanced housing market prognosis. We tip an up to 5% yoy increase in housing price index by end-2021.

On the other hand, office and commercial property markets remained under pressure. As of end-2020, the vacancy rate of private offices (11.5%) and Grade A offices (11.8%) climbed up to the highest since 2004 while that of private commercial property (retail shops) rose to a multi-year high of 11.4%.

Moving ahead, the e-consumption vouchers to be launched during summer holiday may help to revive local consumption and support the retail shop market. Border reopening may give further hopes for the non-residential property market as it could boost inbound tourism and retail sector while attracting Chinese companies to set up offices in Hong Kong for overseas expansion. However, any rebound of office property and retail property markets may be restrained respectively by the structural change in work arrangement and consumption behaviour.

In conclusion, we expect the economy to expand by 5-6% yoy on the assumption that border controls will be further relaxed in 2H.

Chart 3: Low vaccination rate in Hong Kong

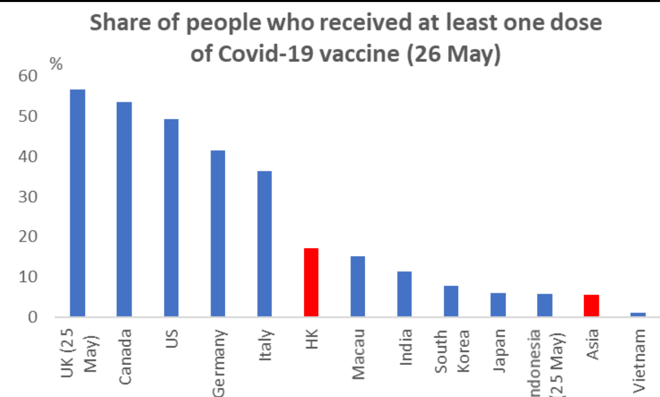
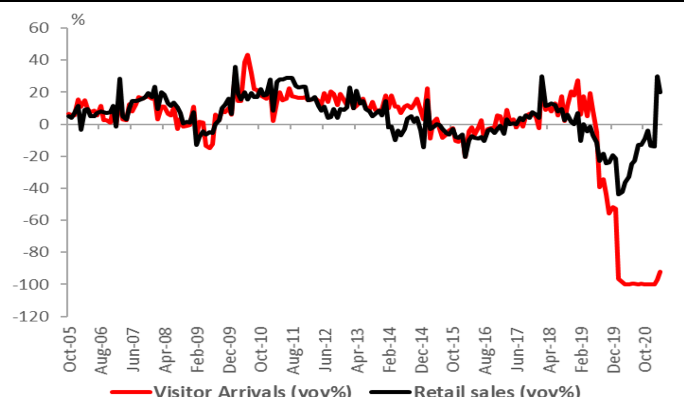


Chart 4: Retail and tourism sectors remain subdued



Source: OURWORLDDATA, HK Census and Statistics Department, Bloomberg, OCBCWH

Chart 5: Divergence between housing price and rent

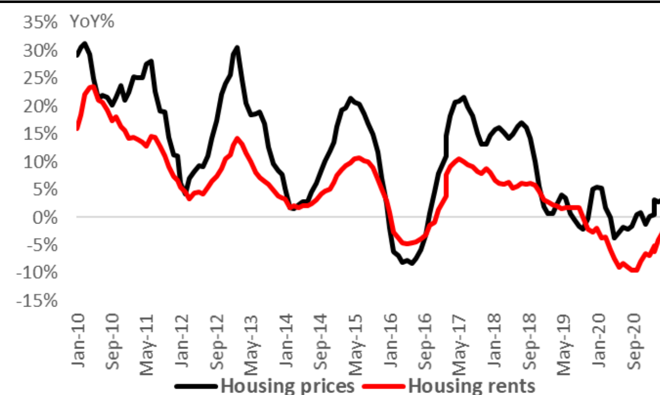
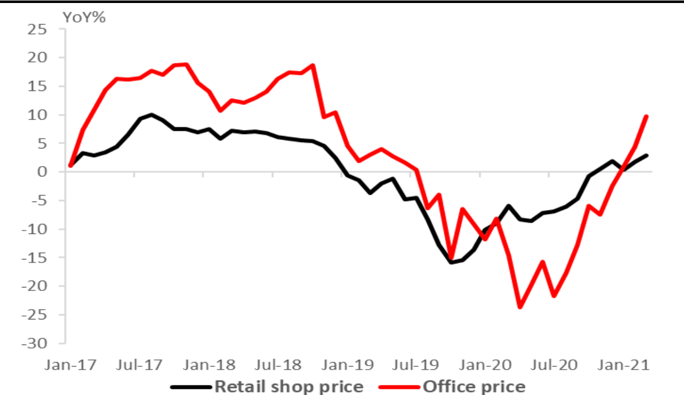


Chart 6: Commercial property price



Source: HK Rating and Valuation Department, OCBCWH

OCBC Bank

Clearing Sky

Wellian Wiranto
+65 65306818
WellianWiranto@ocbc.com

Assisted by
Ahmad Enver

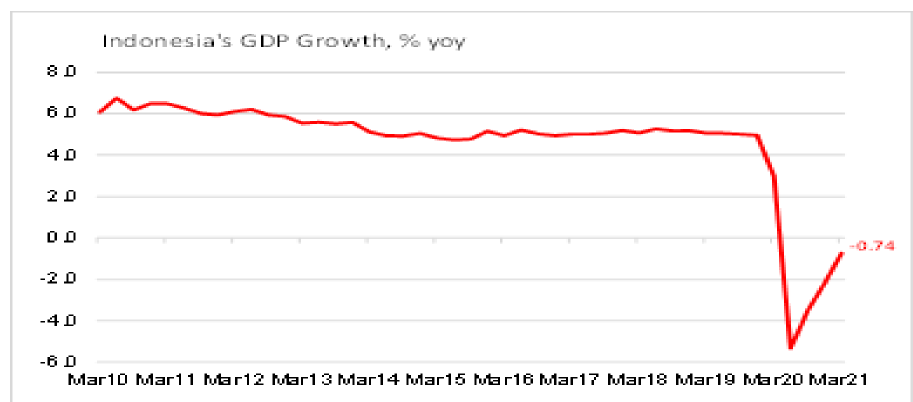
Indonesia's recovery hinges upon averting a pandemic surge

- As of now, Indonesia's GDP data remain mired in negative prints, with Q1 figure coming in at -0.74% yoy. Still, there is hope that Indonesia may start to see outright growth as soon as Q2, however, helped by base effect, and paving the way for a more substantial recovery in the second half of 2021.
- While private consumption remains broadly tepid, the momentum is heading in the right direction, with upticks in consumer confidence readings and a relative pick-up in consumer loans disbursement. No less importantly, investment activities are returning in earnest, close to breaking even in Q1 and may start to add to headline growth soon.
- However, even as the sky starts to clear, there remain rolling clouds over the distant horizon. With many of its neighbours dealing with yet more episodes of virus resurgence, the odds that Indonesia can escape unscathed are not high. If cases do pick up more markedly, confidence would be hit once more. While Bank Indonesia's most likely course of action is to stand pat for the rest of the year, any marked slowdown might prompt it to cut once again.

Positive Thinking

We have been waiting and hoping for that elusive positive yoy growth to return to Indonesia. However, one way or another, it just refuses to show up.

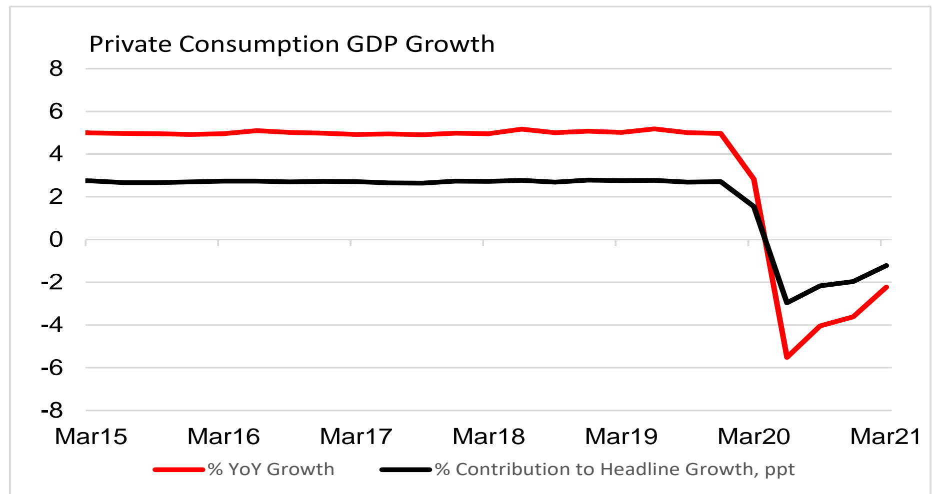
Granted that, at -0.74% yoy, the rate of growth in Q1 2021 is a lot less painful than -2.19% of the previous quarter, it has nonetheless reminded us of just how tough it is to climb out of the pandemic-induced deep slump of last year. It did come a tad short of the -0.5% and -0.65% that we and the market pencilled in, respectively.



Source: OCBC, Bloomberg.

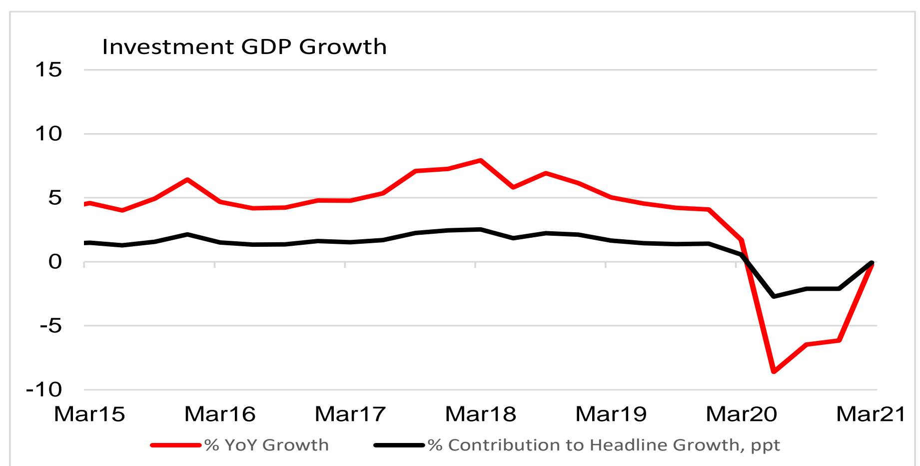
Still, despite the negative headline print, market should take note of some of the details in the data release that offer a relatively more encouraging picture for the periods ahead.

First, zooming in on the all-important private consumption. Just to be clear, it remains in contractionary territory, whether you see it from the year-on-year perspective (-2.23%) or in terms of contribution to headline growth (-1.22ppt). However, on a relative basis, things have indeed continued to start turning up more robustly from the previous quarter, contracting by less.



Source: OCBC, Bloomberg.

The momentum within the quarter matters as well. And, from the higher-frequency indicators such as consumer confidence and car sales, we could garner that although January and February were challenging, there was a palpable sense of improvement by March, with car sales surging in particular on the back of favourable tax treatment and down-payment (non)-requirement. Hence, we do see a continuation of such momentum to help the overall upturn in Q2 for private consumption, paving the way for more substantial uptick for the rest of the year.



OCBC, Bloomberg.

Elsewhere, what looks more encouraging to us is the fact that investment activities have started to improve considerably in Q1. The segment grew by -0.23% yoy, compared to -6.2% yoy in the previous quarter. To look at it from another way, it nearly added to headline growth in an outright manner, at -0.07ppt, compared to -2.1ppt in the prior quarter.

Such uptick is in concert with the investments outlay as reported by the coordinating board recently, whereby Indonesia saw a record-high investment of IDR219.7tn in Q1. Encouragingly, FDI grew by 14% to a 3-year high IDR111.7tn, with the outer-lying regions taking the bulk of it.

Already, as we highlighted here, the government has continued to signal its seriousness in elevating investments as a major driver of growth by upgrading the investment board into a full-blown ministry, although it came at the expense of effectively downgrading the research and technology portfolio.

Hence, if Indonesia can continue to capitalize on its well-known strength of demographics even while it captures new opportunities surrounding the green-energy push – by leveraging on its abundant nickel deposits, for instance – it should bode well for investment-driven growth push ahead.

Outside of consumption and investment, export activities have shown considerable recovery as well, growing at 6.7% yoy after three consecutive quarters of shrinkage. The net effect, however, has been muted by a concomitant return of growth in imports as well.

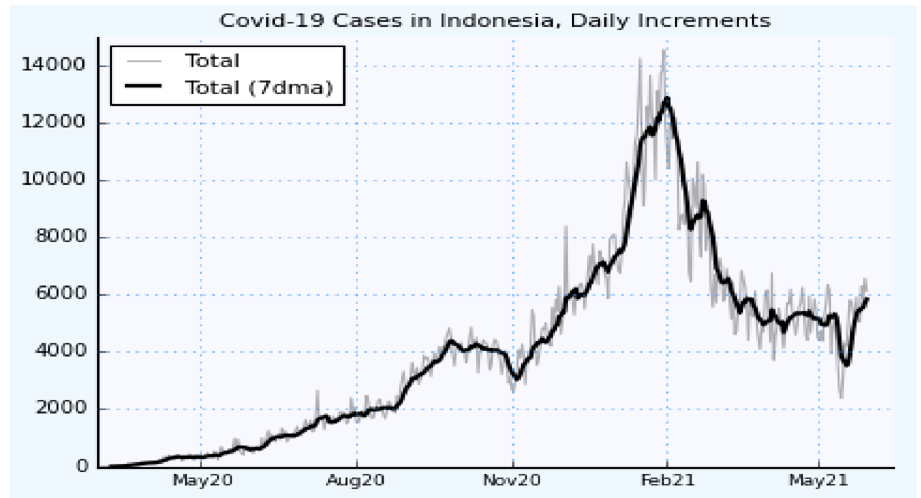
All in all, while headline growth has again languished in the negative territory in yoy terms, the fact that the momentum is moving in the right direction lends a new lease of hope that growth will return to positive zone soon.

For that, there is base effect to thank, first of all. Even if Indonesia's economy does not grow at all quarter-on-quarter in Q2, it would still be registering a yoy growth of 3.6%, purely because the dip was so sharp in Q2 last year. If the economy, however, manages to post a 3.8% qoq expansion on a non-seasonally adjusted basis, growth would come in at 7.5% yoy. Further out, partly because of the ebbing-away of the base effect, we see growth normalising to 6.0% and 5.5% in Q3 and Q4, respectively.

To be sure, while the arithmetic is on its side, the epidemic might not be as cooperative. While Indonesia's daily cases continue to remain broadly in check, the pop-ups of cases in neighbouring countries should present a clear warning that nothing can be taken for granted. Indeed, after the traditional peak travel season for Eid festivities, there remains a risk of sudden uptick in cases once again, especially now that the more transmissible variant from India appears to have made landfall in the country.

At the risk of stating the obvious, if the epidemic rears its ugly head in a big way once again, our relatively sanguine outlook will be put at risk. Indeed, we have downshifted our full year forecast from 4.9% to 4.6% partly because of such unfavourable risks.

Any substantial uptick in the number of Covid-19 cases, especially in June as the new variant plays out, will present further downside risks to our view.



Source: OCBC, Bloomberg.

Indeed, if Indonesia cannot avoid a surge in cases so much so that the nascent business and consumer confidence recovery gets nipped in the bud again and starts to weigh on growth all over again, then BI might be compelled to cut once or twice again. While that is not our baseline for now, the possibility would increase for every uptick in Covid-19 cases that we see in the coming weeks and months.

Overall, however, BI continues to see pockets of strength including in consumer expectation, retail sales, PMI reading as well as trade data. Overall, it has kept its 2021 GDP projection of 4.1-5.1%. The relative confidence that growth is recovering alright is but one reason for the decision to hold its rate unchanged. So have the circumstances surrounding the current account.

Source: OCBC, Bloomberg.

After successive quarters of staying in the rate surplus territory, Indonesia's current account dipped back into the red zone in Q1, as imports of consumption goods and raw materials started to pick up alongside economic momentum. To be sure, at USD1bn or 0.4% of GDP, the current account deficit is not a big concern in and of its own, but it does signal that the central bank would have to pay even more attention than before now in the exchange rate effect of any further rate cut.

Hence, faced with relatively little need to boost growth and an incrementally less space to do so via rate cut, it is no surprise then that BI's path of least resistance remains one of keeping the policy rate unchanged for a while to come. The central bank would contend itself with keeping the steady course, while continuing to urge the banks to pass on the rate cuts. It may also tinker around the peripheries of macroprudential policy to continue signalling its readiness to help growth.

Source: OCBC, Bloomberg.

For instance, it recently a lowering of the cap on credit card interest rate to 1.75% per month, from 2.0% previously. That should help some consumers at the margin, but not an obvious gamechanger. With loans still stuck in contraction mode, at a growth rate of -2.28% in April, BI would be banging the drum of pass-on-the-rate-cuts for a while more, it seems.

A Long Way From a Full Recovery

Carie Li Ruofan
+852 28525767
Carierli@ocbcwh.com

- Macau's GDP shrank by 0.9% yoy in 1Q, marking the ninth consecutive quarter of contraction despite the low base effect. Entering 2Q, economic data started to show a remarkable year-on-year growth amid the low base effect and a gradual recovery of tourism and gaming. However, all the data were still far below pre-pandemic levels.
- As the local epidemic remains well contained and the government rolled out a fresh round of relief measures, local consumption may rebound. The gradual rebound of Chinese investors' travelling demand may also support further recovery of Macau's two pillar industries, including inbound tourism and gaming. However, a full recovery looks far off due to the ongoing border controls, China's tightened grip on cross-border gambling and the elevated unemployment rate.
- Given the weaker-than-expected 1Q GDP and the ongoing travel restrictions, we cut our 2021 GDP growth forecast from around 65% yoy to around 50% yoy, which is about 34% lower than 2019's level. In the medium term, the economic outlook will hinge on the timing of further border reopening and the extent of China's crackdown on cross-border gambling.

Economic data has shown remarkable growth entering 2Q

1Q GDP unexpectedly shrank by 0.9% yoy, marking the ninth consecutive quarter of contraction despite the low base effect. Specifically, the growth of consumption, government expenditure, fixed investments, exports of goods and exports of other tourism services failed to offset the further decline in exports of gaming services. Worse still, consumption, fixed investment and exports of services were all lower than the levels of the same period in 2019. This indicates that the economic recovery was still sluggish, partially attributable to the virus resurgence in China during January which had impeded travel activities.

Entering 2Q, economic data has shown remarkable growth. Specifically, visitor arrivals rose for the third consecutive month, surging by 7098.8% yoy in April, led mainly by Mainland visitors that rose 6861.3% yoy as Mainland China's travel activities have resumed while Macau has relaxed the restriction measures on some Mainland visitors and all casinos since March. Likewise, the average hotel occupancy rate climbed by 45.9 percentage points to 58.5% in April, the highest since last January (81%).

During the same month, the number of hotel guests rose 550.3% yoy to 694.2k, about 60% of the level in 2019. Also, gross gaming revenue surged by 1014.4% yoy to MOP8.4 billion in April and by another 492.1% yoy to MOP10.4 billion in May.

The strong growth was mainly due to the low base

However, the significant year-on-year growth was mainly due to low base effect. In fact, the number of visitor arrivals in April was merely 23% of that in April 2019. Furthermore, gross gaming revenue in May was down 59.8% from May 2019. This indicates that both the tourism and gaming sectors are still far from full recovery amid the ongoing border control measures.

Further recovery is likely

Domestically, as the local epidemic remains well contained and the government rolled out a fresh round of relief measures, local consumption may rebound. The relief measures include four major parts. First, MOP7.235 billion cash handouts to be delivered in April. Second, MOP5.687 billion to promote local consumption during April to December. Third, MOP0.334 billion Job Skill Enhancement Scheme to take effect during May to December. Finally, tax waivers and deduction and other social welfare specified in Policy Address 2021 including healthcare voucher, education allowance, etc., which will increase the government spending by MOP1.056 billion and MOP14.9 billion respectively. The relief measures have been key to boost domestic demand and in turn help rescue the SMEs in the hardest hit sectors and retain employees.

Externally, the gradual rebound of Chinese investors' travelling demand may support further recovery of Macau's two pillar industries, including inbound tourism and gaming. Specifically, during the Labor Day Holiday, the daily average of visitor arrivals reached 33,431, up 158.2% from that during Lunar New Year and up 25.4% from that in April. Hotel occupancy rate also climbed to 83.2%, up by 34.6 percentage points from Lunar New Year. . Though the recent virus resurgence in some parts of China including Guangdong province may put a lid on a further recovery of Macau, the impact may not be long lasting given China's massive testing and rapid vaccination pace. On a more positive note, latest data out of China showed signs of improvement in the labour market and services consumption.

But a full recovery remains far off

A full recovery looks far off due to the ongoing border controls, China's tightened grip on cross-border gambling and the elevated unemployment rate.

In terms of the border controls, Macau appears to have been in no rush to extend the relaxation of travel restrictions to visitors from places other than China. The virus resurgence in some parts of Asia and the uneven vaccination rates across the globe have together made Macau more hesitant to ease the border control measures further.

Regarding China's tightened grip on cross-border gambling, the PBoC held a working conference on cracking down on the governance of cross-border gambling "fund chain". Besides, Macau's Chief Executive Ho Lat Seng stated that the government will work with the PBoC to study the feasibility of

issuing a digital currency. Ho said the introduction of a digital currency aims to improve the effectiveness in curbing money laundering, tax evasion and terrorism financing. The move sparks concern that Macau's gaming sector in particular the high-stakes gambling will take a further hit. Moving ahead, we also need to closely monitor the impact of the crackdown on money laundering on the gaming regulations and the renewal of gambling licenses.

As such, we do not expect both visitor arrivals and gaming revenue to return to their pre-pandemic levels this year.

Due to the uneven economic recovery, overall unemployment rate rose to the highest since 2010 of 3% during the three months to April. Worse still, the labour force participation rate fell to 69.6%, the lowest since mid-2007. Since the recovery of the inbound tourism and gaming sector has been slow, the improvement of labour market may be moderate as well. This may in turn constrain the upside of local consumption.

Chart 1: Gross gaming revenue remained far below

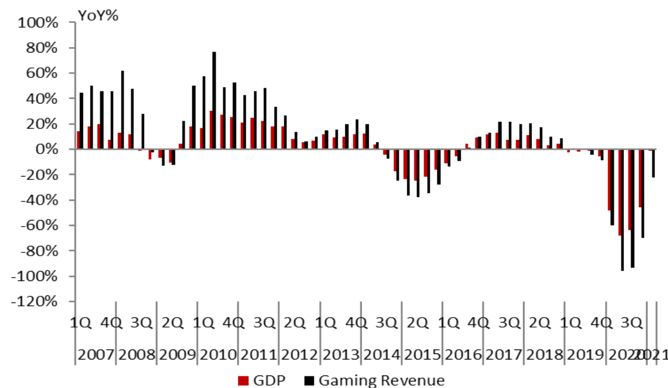
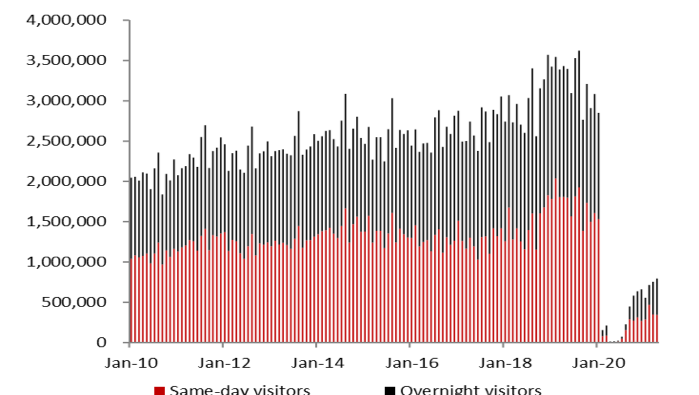


Chart 2: Visitor arrivals surged



Source: DICJ, DSEC, OCBCWH

Chart 3: Hotel occupancy rate rebounded

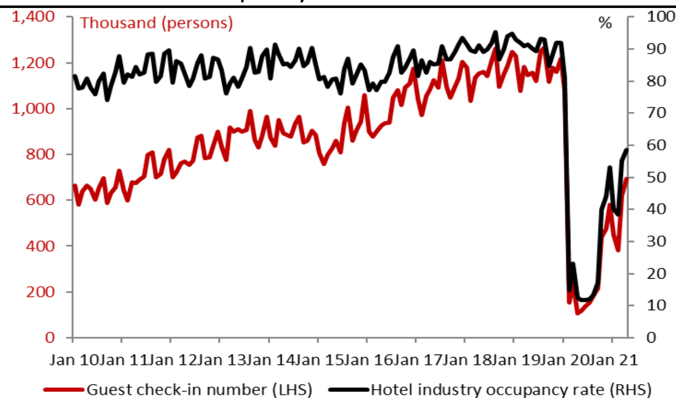
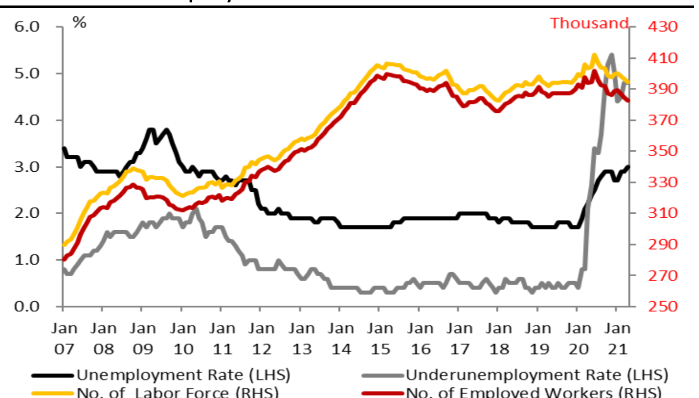


Chart 4: Unemployment rate remained elevated



Source: DSEC, OCBCWH

Housing market to see limited upside

Average housing price's year-on-year growth (+5.8%) in March returned to positive territory for the first time since last October. As the Lunar New Year effect abated, Macau's housing market regained some steam amid low interest rates and the prospect of scarce home supply. On the supply front, housing completion and construction was merely 10 units and 231 units respectively during 1Q 2021. However, we still expect the upside of the city's housing market to be capped.

First, housing demand may remain benign as Macau's two pillar industries including tourism and gaming only saw a slow recovery due to the existing border controls. Second, investment demand has been sluggish due to housing control measures and the suppressed rents amid a sharp decrease in non-resident workers and an elevated unemployment rate. Specifically, local home buyers who own more than one flat accounted for 2.47% of total local home buyers in March, the lowest since last December. Third, end-users have superseded investors as the main players in the housing market. Local first home buyers represented 85.36%of total local home buyers in March, the highest since last November.

In a nutshell, we expect average housing price to grow by up to 5% yoy by end of 2021.

Chart 5: Housing market rebounded

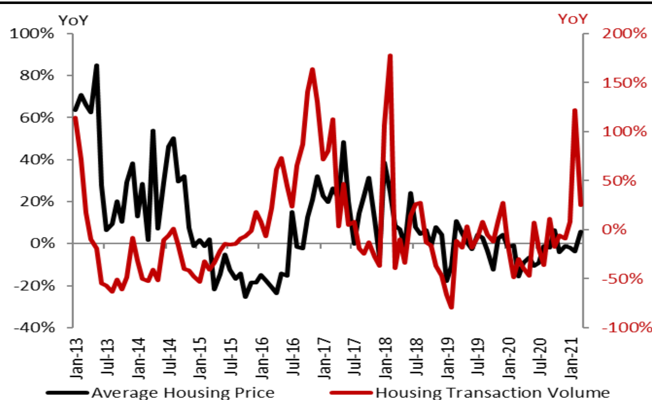
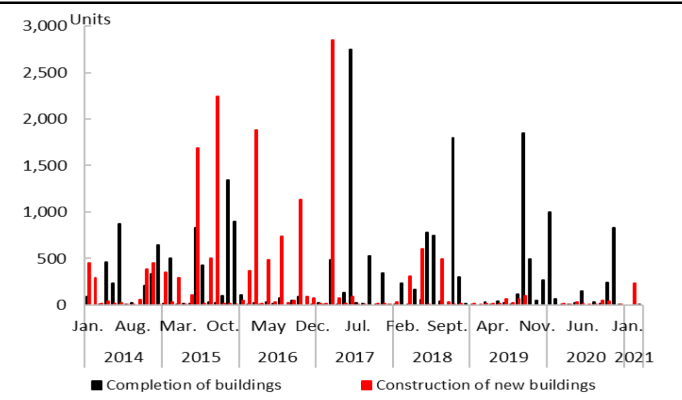


Chart 6: Housing completions dropped notably



In conclusion, we expect the internal demand, inbound tourism and gaming sector to see further recovery on the back of fresh fiscal stimulus, well-contained local epidemic and China's solid economic growth. However, all the major economic indicators may not return to the pre-pandemic levels this year. Given the weaker-than-expected 1Q GDP and the ongoing travel restrictions, we cut our 2021 GDP growth forecast from around 65% yoy to around 50% yoy, which is about 34% lower than 2019's level. In the medium term, the economic outlook will hinge on the timing of further border reopening and the extent of China's crackdown on cross-border gambling.

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A Mid-Marathon Stumble

Wellian Wiranto
+65 65306818
Wellianwiranto@ocbc.com

Malaysia's recovery is challenged by the virus resurgence

- Just as we thought Malaysia was doing a decent clip in its recovery from the Covid-19 slump, the virus resurgence hit with its full force once again. Like a marathoner with some ways to go before the finish line, the best hope now is that, despite the painful stumble, no serious harm has been done and that the economy can pick itself up again soon enough.
- With cases hitting record-highs seemingly on a daily basis, much would depend on whether the re-institution of full-scale MCO will be enough to curb the uptick. While the fact that non-essential businesses will be shut for two weeks starting June 1 will hurt the economy, there is hope that some business operations can resume thereafter, to help limit the overall damage.
- Going by that scenario, a growth of around 4.0% for the year looks increasingly likely, even if it marks a sizable downtick from our earlier expectation of 6.0%, which happens to be the bottom-end of BNM's forecast of 6.0-7.5%. In terms of policy reaction, while some fiscal support might be forthcoming, there is really no bazooka-sized ammunition left, leaving the bulk of support from BNM which has relatively more wiggle room to ease and help.

Blame it on the caveat

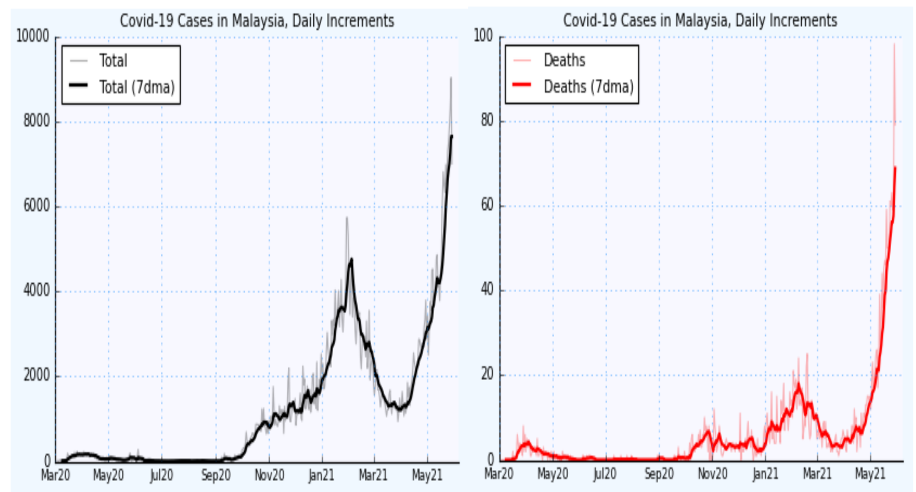
Perhaps there is a curse of celebrating too quickly after all. In our May 11th report, "*Happily Wrong*", we noted how the Q1 GDP print offered us enough encouraging signs of upticks in momentum from not only exports but private consumption for us to be confident enough to upgrade our full-year growth expectation from 5.4% to 6.0%.

Alas, events have turned – and turned dramatically – since then that made our upgrade look too starkly like counting the chickens before they hatch. The culprit came down to the virus resurgence. As we mentioned in the same report, one big caveat of concerns that we did have was the risk of an uptick in Covid-19 cases that is so sharp that the authorities would be forced to undertake a fuller lockdown that curtails business operations.

For a while, it looked like we could avoid the unfortunate scenario that was as caveated. Even though PM Muhyiddin Yassin announced a tightening of MCO measures on May 22nd, he was adamant that there would not be any closure of business because of the dire impact on businesses and the lower-income groups especially.

However, barely a week later, as the number of cases continued to breach new highs, totalling over 9000 per day at one point, the government was faced with little choice but to undertake the painful measures of shutting down most business activities.

The move came as there are increasing reports of fatalities and shortage of ICU beds so much so that doctors may soon have to choose the occupants based on their survival odds.



Source: OCBC, Bloomberg.

As it stands, the plan calls for a three-phase approach. The first phase is set to last for two weeks starting June 1, which would see much of the economy in suspension mode that will hit private consumption considerably.

The silver lining is that some manufacturing sectors can stay open although with reduced capacity of 60% of workforce. Amongst these exempted sectors is the crucial electrical and electronics segment, which contribute around 40% of Malaysia's total exports of late. Hence, fortunately, our fear of a shutdown that would hit exports badly, as we noted in our May 28th report, would not materialize fully. Helping to limit the damage would also be continued operations of the oil and gas, chemicals sectors, as well as factories which produce PPEs such as rubber gloves.

Given that the latest MCO restrictions allow for some of these crucial sectors to remain open, unlike 2020's MCO 1.0, the damage is unlikely to be as bad as the MYR2.4bn per day that was estimated. Still, compared to MCO 2.0 in early 2021, given the fact that most businesses have to be shut now versus being operational before, the damage is likely to be greater than the MYR300-400mn per day as estimated. Long story short, when it comes to gauging the exact dollar amount of damage, it remains a tricky game. This is something that the Finance Minister alluded to when he was quizzed about the potential cost of the existing round of measures, signalling that it would take some time to work out the numbers, although he suggested that the ultimate number would be lower than the 5.0-6.5% that was last talked about on May 22nd.

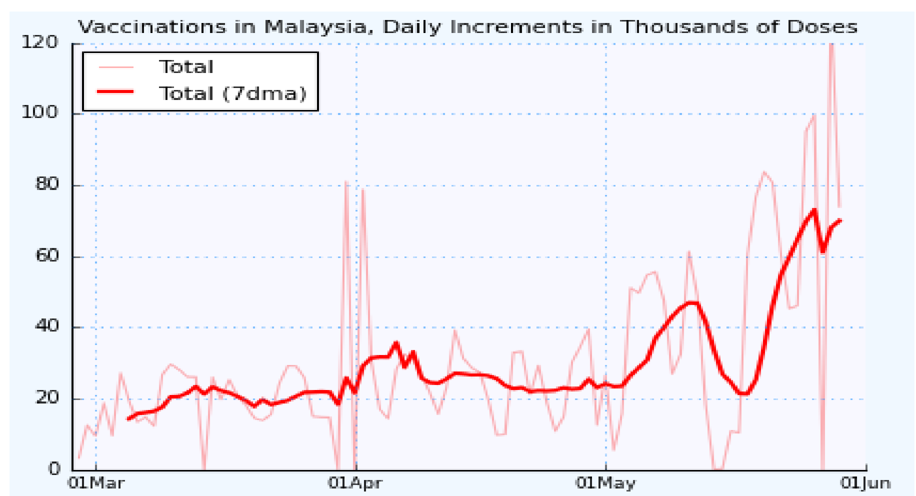
Part of the reason behind the difficulty in pencilling in the GDP forecast is the fact that the virus situation remains in a great flux, and there remains a high level of uncertainties with regard to the duration and severity of the restriction measures.

For instance, while the Phase 1 is expected to last only two weeks, to be followed by Phase 2 which would allow the reopening of a few sectors that do not involve large gatherings, the transition would be very much dependent on whether the number of cases can start to flatten in the interim. Hence, in many respects, the most important "economic data" in the next two weeks will thus be the daily Covid-19 roster of cases and fatalities, as well as updates on how the healthcare providers are coping. Nothing else would matter as much.

Going by the baseline scenario that the most stringent part of the measures, i.e. Phase 1, would only last two weeks, we see the economy shrinking by 2.5% on a sequential basis in Q2. On a year-on-year basis, growth might still appear to be relatively lofty at +15.7%. This is primarily due to the low-base effect from Q2 last year, when the bulk of the Covid-19 impact was felt such that the GDP contracted as deeply as 17.2% yoy.

Assuming that the economy has not suffered bodily damage such that it can start to inch back towards recovery in the subsequent quarters, we see growth coming in at 4% for the full year.

This would be predicated on a steady pick-up in vaccination rate, as well, that would not only help to start bolstering confidence once again but could hopefully limit the probability that the country would be hit by another unfortunate wave of resurgence once again. Hence, it is encouraging to see news flow signalling that Malaysia is procuring additional doses of vaccines, including 12.8mn Pfizer/BioNTech ones that would bring the total supply to 44.8mn, enough to cover 70% of Malaysia's population.



Source: OCBC, Bloomberg.

Given how fluid the situation is now and is likely to remain for a while to come, we would be the first one to admit that our forecasts carry a large degree of uncertainties. While it might have become more natural for us to think of downside risks given how the clear-and-present enemy of the Covid-19 resurgence has seemingly upended our best hopes time and again, we ought to allow for upside potential as well, that could come from steady

roll-out of vaccination that can help to flatten the pandemic curve and do so sustainably. Although the former scenario could well push growth even lower than what we are pencilling in, the latter will involve a sharper-than-expected return in business and consumer confidence that provide for an encouraging uplift too.

Facing such a wide range of potential scenarios, we are of the view that policymakers would likely step in only moderately, even if they would leave more room for downside considerations out of caution.

On the fiscal front, even if the government will be keen to roll out aid especially for SMEs and the low-income households that might be disproportionately hit by the shuttering of commercial operations, the room is limited. As it stands, the debt to GDP ratio is already at 58.5%, with not much leeway left from the 60% statutory limit.

This would leave the onus of support on monetary policy. While the central bank has been talking up sanguine outlooks for growth and keeping its policy rate unchanged at 1.75% as recently as the May 6th MPC meeting, the situation has obviously evolved enough for it to countenance a shift in its thinking. Hence, we see a rising probability of the central bank cutting rate on July 8th, its next scheduled meeting. Indeed, depending on whether the severe phase of MCO may be extended even further because of continued case upticks, there might well be an outside chance of the central bank stepping in out-of-cycle.

Still, despite the seeming urgency of any monetary policy support, we do not think that BNM will undertake massive rate cuts beyond 25-50bps adjustments at this stage.

Here, the fact that the global situation has shifted from what it was last year matters. Given the faster vaccine rollouts, economic recovery in the developed markets such as the US and Europe is proceeding apace, such that the era of blindly throwing in policy support no matter what of last year is no more. Indeed, whispers of tapering have started to come up again.

That change of global environment leaves increasingly little ‘air cover’ for forceful and unabated policy support for emerging economies, including Malaysia. Hence, as much as BNM would want to do all that it can to help the economy up again from the hard tumble it took and urge it along in the recovery marathon, what it can do is relatively more limited than last year, as well. All in all, the best hope now is for the existing plan to work in curbing the ongoing spread, such that, by mid-Q3, Malaysia can be on the road to recovery more forcefully once again.

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Political Unrest the Greatest Headwind

Global Treasury Research
+65 6530 8384
Treasuryresearch@ocbc.com

Assisted by Lee Liang Le

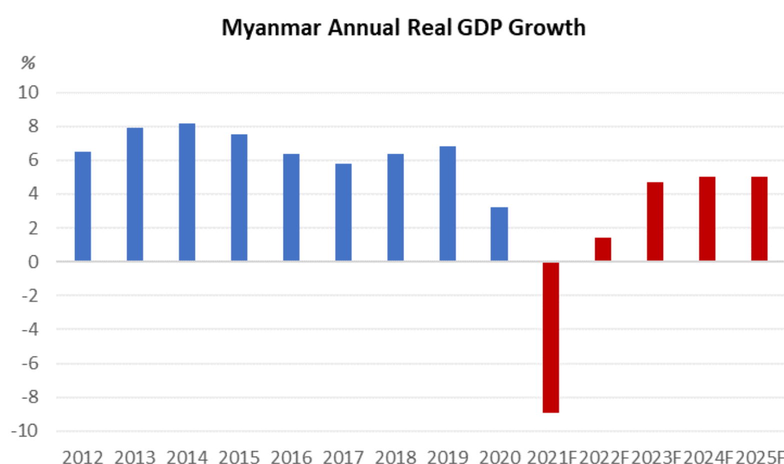
- Myanmar has been under a state of emergency since February.
- Economic conditions have deteriorated as key operations have been brought to a halt by political unrest.
- FY 2021 GDP is projected to contract 9.8% yoy, underpinned by political uncertainty and a deteriorating Covid situation.

Tumultuous first half of 2021

General Min Aung Hlaing's military government has been presiding over Myanmar since 1 February 2021. A state of emergency has since been declared and business activity has been severely disrupted by the ongoing demonstrations against the military across the country, resulting in the deterioration of Myanmar's near-term outlook.

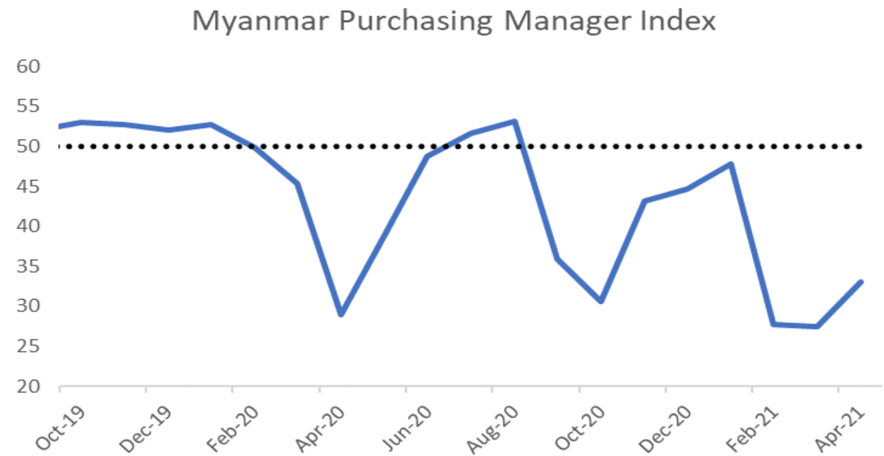
The political uncertainties have further weakened Myanmar's economy, which had already been strained following the reimposition of Covid containment measures earlier this year. Domestic and international economic activities have been severely hit as operations were disrupted by the ongoing nationwide protest, strikes and sanctions.

Meanwhile, although official data shows that new daily Covid infection levels have since returned to almost zero, this is likely a result of the slump in testing. The dual factors of political unrest and unchecked spread of the coronavirus mean that, among the ASEAN economies, Myanmar is one of the few – if not the only – expected to post an economic contraction this year. Indeed, Myanmar's economy is projected to contract 9.8% yoy this year, a stark reversal from the 5.9% yoy expansion estimated at the end of last year. Overall, the political uncertainties will likely continue to weigh on the nation's economic outlook.



Source: IMF Estimates, OCBC

Myanmar's economy hit a pause

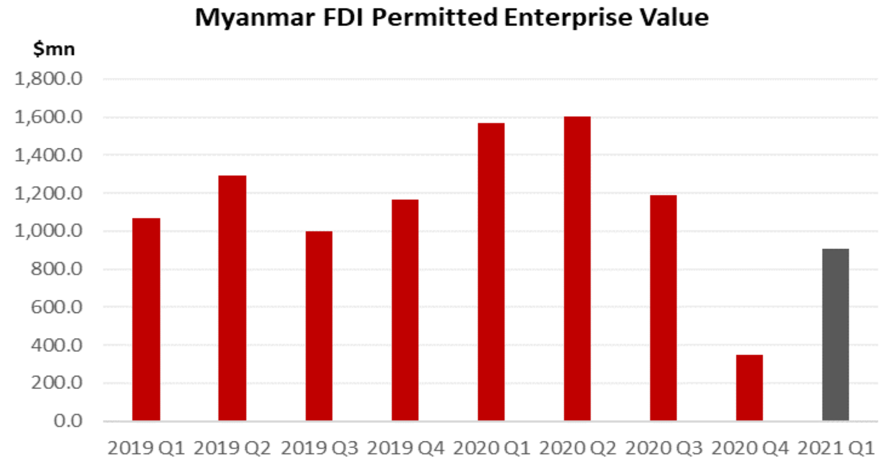


Source: Bloomberg, OCBC

Following the declaration of the state of emergency, Myanmar's manufacturing activity had reduced significantly amid factory closures and manpower shortages. Consequently, April's PMI came in at 33.0, marking the 8th consecutive month of decline underpinned by the fall in new orders and output levels amid subdued demand.

Employment has also decreased as more workers returned to their hometowns. Sharp decrease in inventory levels were reported among producers, likely due to higher cost of materials stemming from a weaker Kyat and soft consumer demand. Until the political situation has stabilised, Myanmar's manufacturing activity is likely to be constrained and the business outlook remains sombre amid the suspension of business operations. Even then, the return to growth will likely be protracted as Myanmar will also need to cope with the ongoing virus resurgence where containment measures may be in place for an extended duration amid efforts to accelerate its vaccine rollout. For the year ahead, we expect Myanmar's PMI to stay in contraction territory and a return to growth only in 2022.

Dour business outlook had impacted on FDI



Source: CEIC, OCBC

Total approved foreign direct investments (FDI) amounted to USD$1.3 billion in April which was 62.6% lower than the amount received in the same period last year (USD$3.4bn). A worsening domestic Covid-19 pandemic and political volatility had derailed foreign investors' confidence in the business outlook of Myanmar under a military-controlled government. In a joint survey conducted by the foreign chambers of commerce in Myanmar, it was noted among the companies surveyed that the military coup had contributed to a halt in their earlier plans to expand operations in the country and a reassessment of their long-term investments. Majority of the firms reported at least a 50% reduction in operations and projects, citing reasons such as interruptions to banking and payments, internet connect outages and mobility restrictions.

In the absence of any political improvement by year end, it is reported that firms may terminate all operations and possibly pull out their investments from the country altogether. Even if these projects, public and private, were not cancelled, there is still a high risk of stalling due to the lack of funds, continuation of social unrest and extended lockdown measures.

This would be disastrous for Myanmar as the nation's growth is heavily dependent on a stream of key infrastructure projects and foreign direct investment. The military government has, however, taken steps to convey its intentions to pursue a pro-business environment such as setting up private meetings with business leaders and promising to commit to all existing contracts including those approved prior to the coup. Yet, it may be insufficient to boost investors' confidence enough to retain their investments as much depends on the ability to make a smooth transition of power which is likely a tall task indeed. In consideration of this, we expect FDI inflows to remain low for the year ahead.

Tourism and hospitality industry to remain subdued

Source: CEIC, OCBC

Due to the closure of international borders and extension of the air travel restriction, Myanmar received less than 1.0 million tourists in 2020 compared to the 4.3 million registered a year before. The military coup has also led to the issuance of travel advisory against Myanmar by several countries given the risky political situation although entry restrictions into the nation is slated to expire by end of May. Meanwhile, the military government is reportedly pushing ahead with its plans to promote Chinese tours to Myanmar despite the ongoing Covid-19 pandemic. The ministry of Hotels and Tourism is said to be in talks with Chinese officials to resume tourism in accordance with Covid-19 heath regulations. The tours, however, are unlikely to be given the green light anytime soon given that Chinese officials may be wary of the possibility of a virus transmission into China following the Covid outbreak in Yunnan, which shares a border with Myanmar, in April. As such, we expect the tourism and hospitality sector to remain subdued through 2021, before a rebound in 2022 when the Covid situation has improved amid vaccine progress.

International intervention has been limited so far

Days after the military coup, the United Nations (UN) Security Council convened an emergency meeting, but there was no meaningful action. Several foreign ministers and UN have also issued statements condemning the coup. Members of ASEAN later convened a special summit with the aim to call for a ceasefire as well as to initiate a political dialogue with an eye to a peaceful resolution of the crisis. The meeting was attended by Myanmar General Min Aung Hlaing, whom have neither commented nor made commitments to ASEAN's plan publicly. Calls for an arms embargo, however, is gaining momentum within the UN General Assembly where all 193

member states will vote on the resolution if no consensus is reached. Yet, the task to get all member states on board has proven to be daunting as 9 ASEAN nations have called to remove the suspension of arms sales, postponing the vote which was slated in May. Until the differing political interests is aligned, international intervention is likely to be limited, and we expect the political situation to remain uncertain through H2 2021.

Road back to growth will be a challenge

Myanmar's near-term economic outlook is highly uncertain as any recovery will be contingent on the easing of mobility restrictions and resumption of key services. The return of trade and retainment of foreign direct investment will hinge on the domestic political situation as well as the restoration of investor confidence. A de-escalation in violent protests and a peaceful resolution, for instance, would potentially bode well for economic recovery prospects in the near future.

Meanwhile, containing the Covid resurgence will be another crucial task as we expect restriction measures to remain in place until infection levels have declined. Until then, boosting the vaccine rollout and resuming healthcare services should be the next priority.

Economy wise, we expect both fiscal and monetary policies to remain accommodative to support economic recovery, despite potential financing difficulties due to low revenue collection. Temporary restrictions on cash withdrawals imposed by the Central Bank of Myanmar to help cope with cash shortages will unlikely be lifted in the near term. This may help to alleviate stress in the financial system as business entities struggle to get back on their feet. In light of a deteriorating Covid situation and political uncertainty, Myanmar's economy is projected to contract 9.8% in 2021, with risk tilted to the downside.

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Caught Between a Rock and a Hard Place

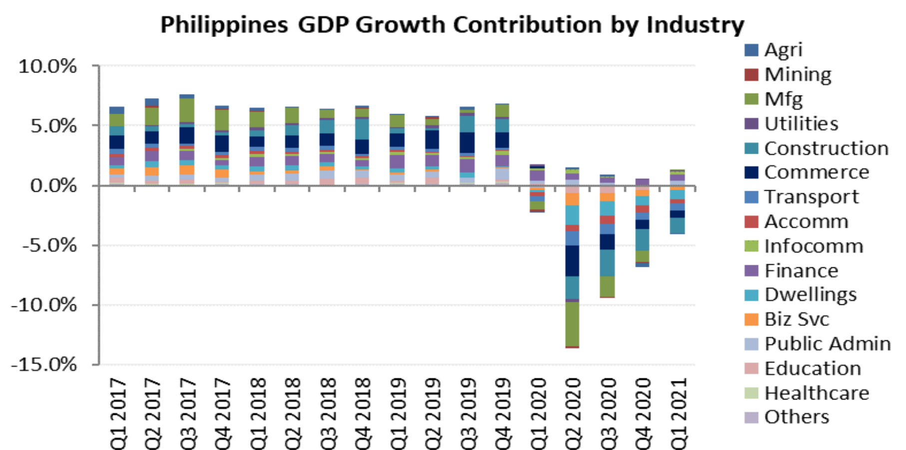
Howie Lee
+65 65301778
Howielee@ocbc.com

- GDP growth in Q1 2021 was weaker than expected, suggesting negative lingering effects on consumption even before the latest lockdown.
- Despite its relatively larger monetary buffer than regional peers, rising inflation risks mean the BSP is likely hesitant in further rate cuts.
- We downgrade Philippines' growth forecast from 7.8% yoy to 4.5% yoy, but expect the BSP to stand pat on monetary policy unless an extreme negativity materialises on growth (rate cut) or inflation (rate hike).

GDP likely to face six-month delay in returning to pre-pandemic levels.

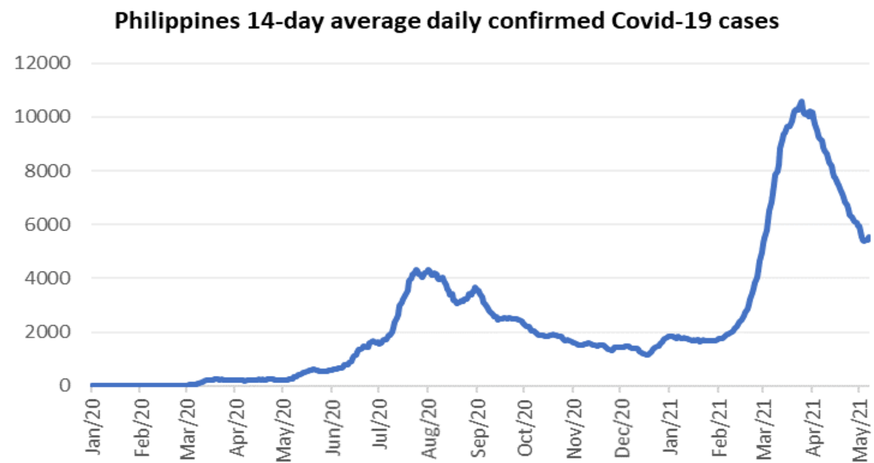
We had previously estimated in the 2021 global outlook report that the Philippines may expand 7.8% yoy this year, but with the country battling its most severe virus outbreak to-date, a downgrade in growth forecast appears well warranted. We now see the country growing only 4.5% yoy in 2021 and 7.0% yoy in 2022. This also means the economy's return to pre-pandemic levels is expected to be delayed by approximately half a year from mid-2022 to late-2022.

The Philippines economy contracted 4.2% yoy in Q1, worse than the median expectation of -3.2% yoy. In particular, we had expected private consumption to narrow the economic contraction, given the stabilisation of Covid-19 cases in the country below 2000 cases a day from Dec'20 to Mar'21. Although private consumption shrank only 4.8% yoy in Q1 2021, an improvement from the 7.8% yoy contraction in Q4 2020, we had expected the contraction to be smaller at 1.9% yoy.

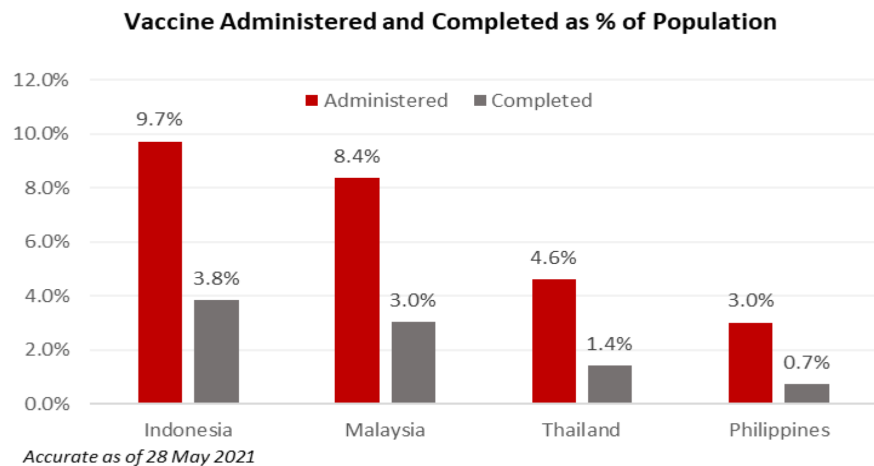


Source: CEIC, OCBC Bank

The two-month lockdown since April 2021 has succeeded in bringing the 14-day average cases down to 5500 from a high of more than 10,000 a day in April. Despite so, this is still higher than the previous peak of 4,000 a day in Aug'20 and we think the government will continue to approach reopening the economy in a highly cautious manner. We estimate that Q2 2021 GDP growth would contract about 2.4% QoQ SA, but due to the low base last year growth would still expand at a double-digit pace of 10.1% yoy. GDP in H2 2021 is hence expected to grow about 3% yoy.



Source: Bloomberg, WHO, John Hopkins University, OCBC

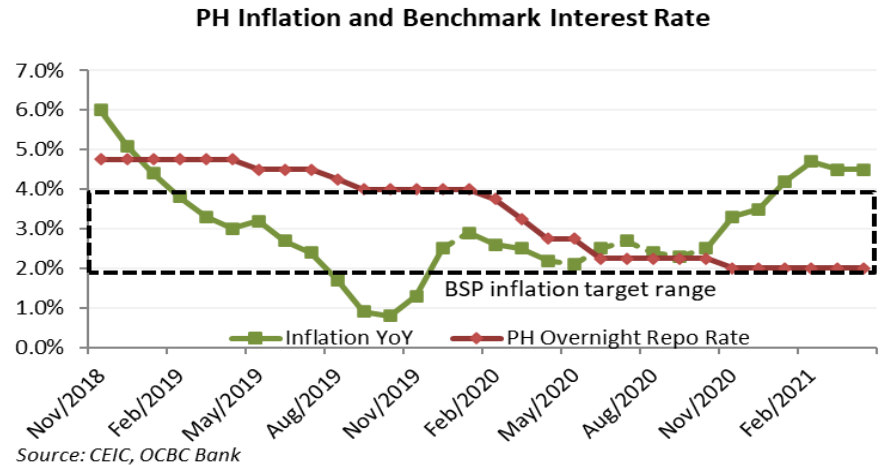


Source: Bloomberg, WHO, John Hopkins University, OCBC

Rising inflationary pressures keep BSP's hands tied.

Despite faltering growth prospects, creeping inflationary pressures could limit the extent of further monetary easing by the BSP. For the fourth consecutive month, the Philippines has posted an inflation rate of more than 4.0% yoy – the upper end of the BSP's inflation targeting framework. This comes on the back of rising commodity prices as well as the effects of a record low overnight benchmark rate of 2.00% in effect since Nov'20. Our forecast is for consumer inflation to continue trending at or above 4.0% yoy

till Jun-Oct'21, which could continue to exert pressure on policy makers to tighten monetary policy.



Source: CEIC, OCBC Bank

We expect no changes to the benchmark rate unless growth falters below 2% or consumer inflation creeps above 5% for a sustained period.

Caught between a rock and a hard place, we expect the BSP to continue holding its benchmark rate at 2.00% until an extreme negativity materialises on either growth (rate cut) or inflation (rate hike). Although we have downgraded GDP growth by more than 3 pct points, at 4.5% yoy the economic growth rate – weighed against higher inflationary pressures – is unlikely to warrant more interest rate reductions. We expect the rate cut trigger to be more pronounced if the growth outlook falls below 2% yoy.

Conversely, the necessity for tighter monetary policy will likely take focus should consumer inflation creep above 5% for a sustained period, which is unlikely based on our current forecasts.

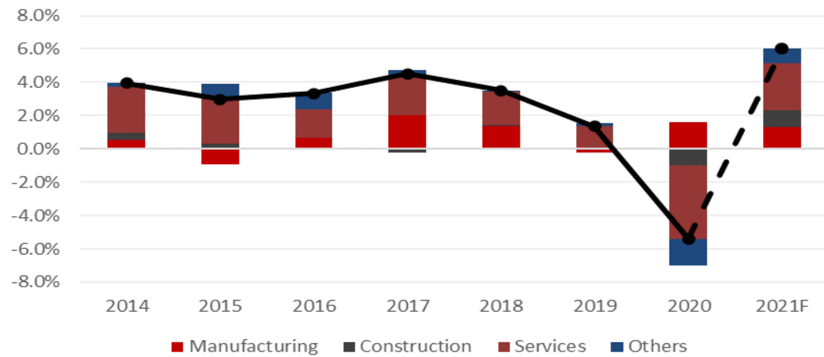
A "Fits and Starts" Recovery Indeed, But Stabilization Ahead in 2H21

Selena Ling
Head of Research & Strategy
+65 6530 4487
Lingssselena@ocbc.com

- S'pore saw better than expected GDP growth in 1Q21, but hit a speedbump in 2Q with the return to Phase 2 (Heightened Alert) conditions in May-June.
- While the government kept its 2021 GDP growth forecast of 4-6% yoy, we are hopeful that momentum should stabilise in 2H and full-year growth can still come in at 6% yoy or slightly higher.
- While the sectoral recovery remains uneven, there is still no rush to recalibrate policy settings even though headline and core CPI have ticked higher. Key to watch would be the health of the local labour market going ahead.

The Singapore economy was off to a healthy start in 1Q21, expanding a better than expected 1.3% yoy (3.1% qoq sa) which is a big upgrade from the initial flash estimate of 0.2% yoy (2.0% qoq sa). The main lift came from manufacturing which expanded a healthy 10.7% yoy, while the services sector also shrank a smaller-than-expected 0.5% yoy (compared to the earlier estimate of -1.2% yoy) aided by the finance & insurance, and information & communications and accommodation industries. However, the construction sector remained the main laggard and contracted 22.7% yoy in 2Q21, which was worse than the initial flash estimate of -20.2% yoy due to the drag from both public and private sector construction activities. On the whole, the 1Q GDP print is a remarkable turnaround from 4Q20 where the S'pore economy contracted 2.4% yoy, and marked the third straight quarter of qoq sequential growth rebound.

More importantly, the government kept its full-year 2021 GDP growth forecast unchanged at 4-6% yoy, but indicated it would review in August to assess the 2Q21 growth momentum and the status of the global/local Covid situation at that stage. This came after the April MAS monetary policy statement hint that it could exceed the upper end of its 4-6% forecast range, barring a setback to the global economy, but probably did not anticipate the recent return to Phase 2 (Heightened Alert) situation between 16 May to 14 June 2021 with the attendant tightening of restrictions, especially operating capacity limits. The latter has put a dampener on the recovery hopes for the F&B, commercial landlords, MICE, aviation and many other hospitality-related industries. Moreover, the foreign manpower crunch for the construction, marine & process industries has been exacerbated due to the recent door being closed for higher-risk countries. The recovery prospects for these impacted industries have been delayed to say the least and may continue to be mired below pre-Covid levels by the end of this year. Hence, a more uneven sectoral divergence appears inevitable for the next few quarters.



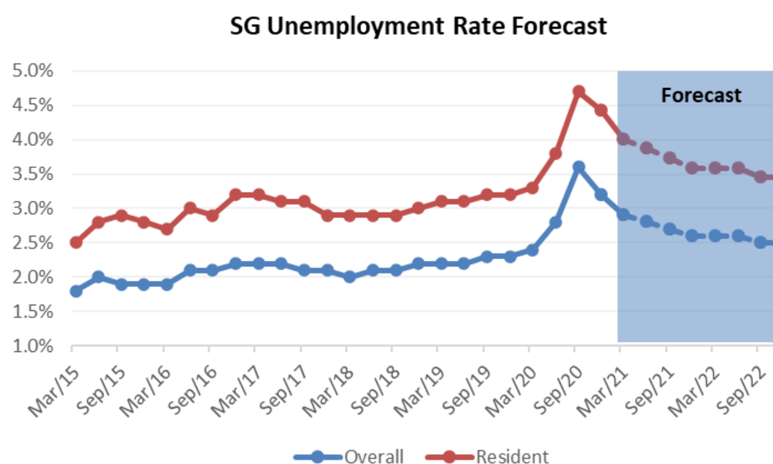
Source: CEIC, OCBC

That said, MTI remained relatively upbeat for the US, Eurozone and China, and even Asian economies including India, Japan, Malaysia, Indonesia and Thailand are expected to rebound and recover from 2020 despite the recent Covid resurgence. However, the caveat being significant downside risks amid the broader economic recovery and vaccination progress. Looking at the region, the Covid developments in Japan, India, Taiwan and Malaysia among others remain fluid and may warrant some caution in terms of potential downside growth risk and may in turn impact their consumer and import demand. Given they are also Singapore's key trading partners, this is worth monitoring in the coming months even as most countries step up and accelerate their vaccination efforts. So far, ASEAN exports have been healthy and resilient, even if domestic demand may soften if Covid restrictions are prolonged into 2H21.

Our 2021 GDP growth forecast remains around 6.0% yoy, with 5.5% yoy seen as the floor for now even after factoring in the P2(HA) setback. The 1Q21 outperformance will be accompanied by a somewhat softer 2Q21 growth print, but still likely to come in at double-digit on-year due to the 2Q20 recession trough during the Circuit Breaker period. The key question is whether the Covid situation and tightening measures get prolonged into 3Q21, both for the region and Singapore, as well as whether the manufacturing sector continues to hold up. On the trade front, Enterprise S'pore also upgraded its full-year 2021 NODX growth forecast to 1-3% yoy, mainly on the back of better-than-expected NODX growth of 9.7% yoy in 1Q21.

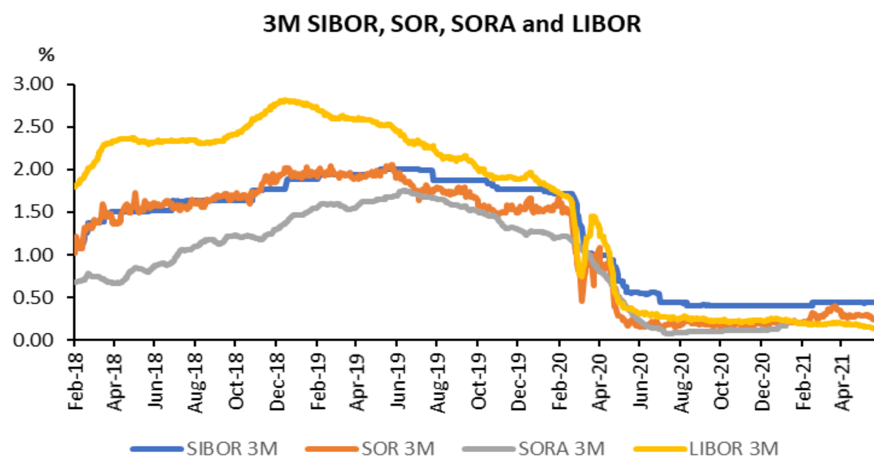
The domestic labour market, especially the unemployment rate, had stabilized towards end-2020 and into early 2021, but the risk is that it hits a speedbump. As of April 2021, the resident and citizen unemployment rates edged down to 3.9% and 4.1% respectively, with the overall unemployment rate unchanged at 2.9%. Nevertheless, the $800 million support package will go some way to help. First, there will be more wage subsidies, namely the enhanced Jobs Support Scheme which will be increased to 50% for licensed food shops & food stalls, performing arts & arts education, gyms & sports facilities, and to 30% for qualifying retail outlets, museums, art galleries & historical sites, cinema operators, family entertainment centres, and affected personal care services. Second, the Covid-19 Recovery Grant

(Temporary) will provide one-off support of $500-$700 for lower- to middle-income workers, and the Covid-19 Driver Relief Fund will give $750 per vehicle per month from 16 May to 30 June 2021. Third, there will be 0.5-1 month rental relief for SME and non-profit tenant-occupiers of commercial properties. Last but not least, repayment of tuition fee loans will be suspended for an extra 4 months until 30 September 2021, in addition to the earlier 1-year relief till 31 May 2021. What is also interesting is that this $800 million will not require an additional draw on past reserves but be funded by reallocations from development expenditure.



Source: CEIC, OCBC

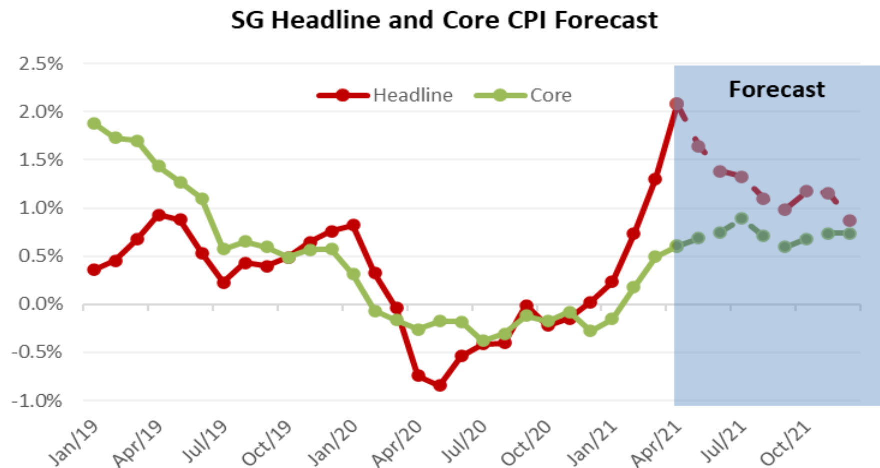
Domestic short-term interest rates have also fluctuated since the start of the year. The 3-month SIBOR stepping higher from its end-January low of 0.39875% to around 0.44% currently, whilst its SOR counterpart rose to a year-to-date high of near 40bps end-March amid hawkish MAS monetary policy meeting expectations before subsiding back to around the 22bps handle. The latter has deviated somewhat from the 3-month LIBOR which had eased to a record low of 13bps on 28 May 2021 amid the glut of cash flooding the US overnight reverse repurchase facility. The SGD liquidity situation remains sufficiently ample at this juncture. On the SORA transition, the overnight SORA has traded in a range of 0.04% to 0.39% this year.



Source: Bloomberg, OCBC

S'pore's overall bank loans growth expanded for the first time since May 2020 by 0.4% yoy in April, which also marked the highest growth seen in May last year. The improvement was led by consumer loans which grew for the third straight month by 3.4% yoy, whereas business loans contracted for the 8th straight month by 1.4% yoy. Within the consumer loan segment, the key growth driver was the housing and bridging loans which rose for the 5th straight month by 2.3% yoy, whereas softer loan demand was noted in the manufacturing, transport, storage & communication, business services industry, and financial institutions.

Domestic inflation prints have ticked higher amid the domestic growth recovery, rising commodity prices and also the increase in private transport and accommodation costs. Compared to the low base in April last year, headline and core CPI rose 2.1% yoy and 0.6% yoy. However, MAS retained its 2021 headline and core CPI forecasts at 0.5-1.5% and 0-1% yoy respectively, citing that while there is some upside external inflation risks, these pressures are anticipated to ease in the latter part of this year amid surplus oil production and persistent negative output gaps in some of our key trading partners. Meanwhile, on the domestic price front, base effects should gradually fade in the second half of 2021, and the P2(HA) tightening measures and economic uncertainties may dampen local consumer confidence and hence price pressures in the near term. Moreover, domestic wage growth is tipped to remain muted amid ongoing labour market slack, even as private transport and accommodation costs remain resilient on the back of firm demand.



Source: CEIC, OCBC

For the property market, private home prices rose 3.3% qoq in 1Q21, marking an acceleration from the 2.1% qoq growth seen in 4Q20. This was the fourth straight quarter of increases and was also the highest quarterly increase since 2Q18 amid resilient local demand and a return of foreign buying interest. Transactions for private residential properties excluding executive condominiums also rose from 2,603 units in 4Q20 to 3,493 in 1Q21, even as developers launched 3,716 uncompleted private homes for sale. However, the pipeline supply has shrunk 2.4% from end-2020 to 48,139 uncompleted units as at end-March 2021, which could keep price momentum positive in the near-term. An offsetting factor would be concern of any potential cooling measures, which so far did not materialise at the Budget 2021 beyond verbal jawboning for now.

For monetary policy, there is no rush to recalibrate current policy settings at the October MPS since core CPI remains comfortably within the 0-1% official forecast range, even as headline CPI is buoyed by low base effects and rising commodity prices. While on the global stage, we have started to see the Bank of Canada start to taper its asset purchase pace, followed by the Reserve Bank of New Zealand that signalled it could potentially hike rates in late 2022, nevertheless most Asian central banks remain cautious given the recent resurgence in Covid cases, especially with the more contagious B1617 variants. As long as lingering economic slack persists, core inflation is unlikely to surge into the latter half of 2021 and into early 2022 and this should sideline any premature monetary policy exit intentions. The recent appointment of Lawrence Wong as the new Minister of Finance is also not expected to shift the existing fiscal policy accommodation bias. Budget 2021 already pencilled in a second consecutive year of deficit spending, albeit with a more modest overall deficit of $11.01bn. However, we cannot rule out additional fiscal support measures should there be subsequent bouts of Covid resurgence that warrants a tightening of restriction measures again. For now, hopes are rising that the Phase 2 (Heightened Alert) curbs would be gradually eased if the community Covid cases remain low.

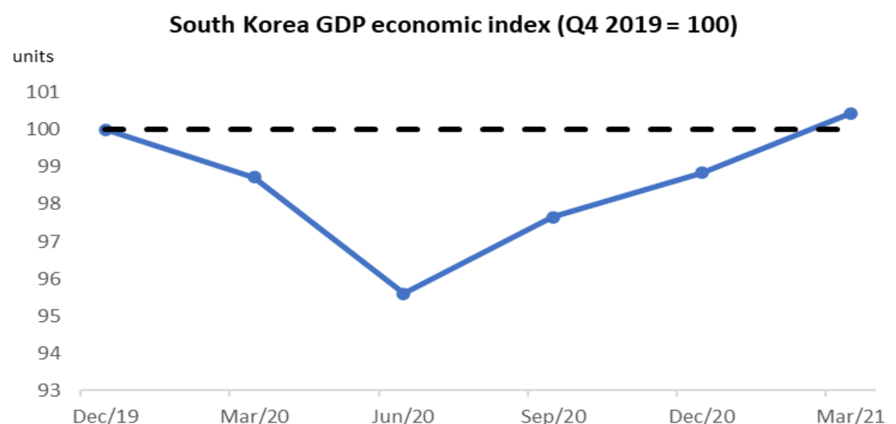
Hawkishness Warranted as Recovery Gathers Steam

Howie Lee
+65 65301778
Howielee@ocbc.com

- As widely expected, the BoK may be one of the first Asian economies to begin planning a pullback of its loose monetary policy.
- Riding on the back of China's recovery, rising global demand for chips and recent shipbuilding orders, South Korea's economic recovery is among one of the best in Asia.
- The labour market continues to send mixed signals but we expect a continued recovery as long as virus cases are kept in check.

South Korea joins chorus of central banks in withdrawing from loose monetary policy.

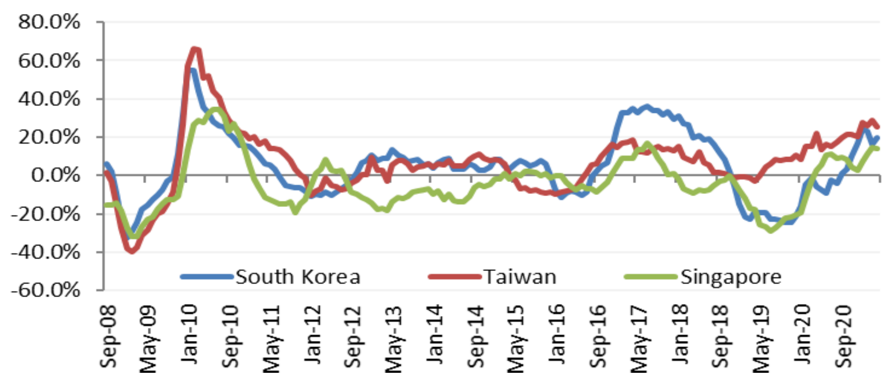
As widely expected and mentioned in our previous Global Outlook, the Bank of Korea (BoK) may be one of the first central banks in Asia to turn more hawkish on the back of improving economic fundamentals. BoK Governor Lee Ju-Yeol in the May monetary policy meeting spoke of an 'orderly exit' from its record-low interest rate, joining the likes of New Zealand, the UK, Canada and Iceland to at least hint, if not state explicitly, on intentions to withdraw from their respective ultra-loose monetary policies. South Korea was one of the best performing ex-China Asian economies in 2020, contracting only 1.0% yoy. The South Korean economy has comfortably returned to pre-pandemic levels as of last quarter and we estimate that South Korea's GDP would expand about 4.0% yoy in 2021.



Source: CEIC, Bloomberg, OCBC

Semiconductors and China lift South Korea's economic prospects.

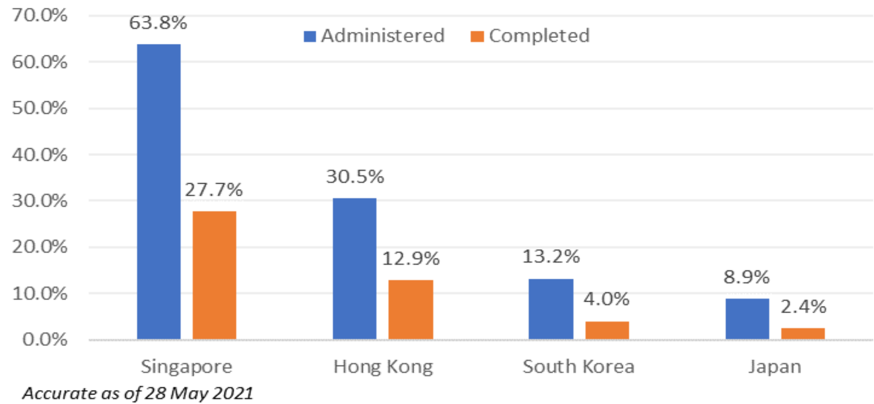
Part of South Korea's economic resurgence has been down to the pickup in global demand of electronics, particularly semiconductors. The top three electronics manufacturing economies – Singapore, South Korea and Taiwan – have all benefited from this development as they ride the cyclical trend higher. The electronics cycle appeared to have bottomed in Q3 2019 and has been on an upward swing since then. South Korea, in particular, has posted six months of double-digit growth in electronics exports on a three-month average basis. China's continued economic recovery will also continue to support South Korea's export prospects.



Source: CEIC, OCBC Bank

Efficient containment of virus boosts domestic consumption.

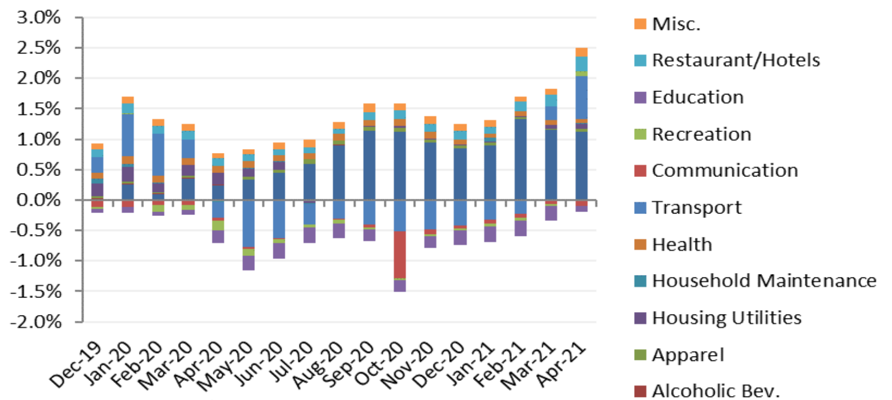
South Korea has also demonstrated its ability to keep virus cases contained. The recent spike in cases from 450 to 650 per day on a 14-day average basis lasted a month and has since been trending lower, without coming close to the 1000 cases/day peak seen in December 2020. More concerning, however, is the slow pace of vaccinations in South Korea – only 13% of the population have received at least one dose of the vaccination, compared to 64% in Singapore and 31% in Hong Kong. A quicker pace of inoculation in South Korea will put the economy on a stronger growth footing by way of boosting private consumption.



Source: Bloomberg, WHO, John Hopkins University, OCBC

Rising inflationary pressures an additional reason for BoK's hawkishness.

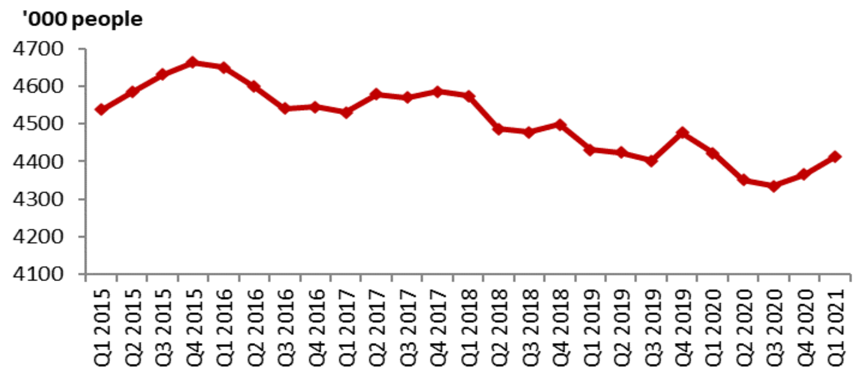
Another case for South Korea's hawkishness is the return of consumer inflation above the central bank's inflation target of 2.0% yoy. Granted, the rebound has been in large part due to the low base from a year ago, but with consumer inflation expected to continue trending above the 2% target as well as mounting inflationary pressures from rising commodity prices, the BoK is exercising prudence in planning to exit its ultra-loose monetary stance.



Source: CEIC, OCBC Bank

Labour market conditions, however, remain mixed but should improve as it catches up to export's performance.

South Korea's labour market continues to show mixed signals. The unemployment rate in Apr'21, at 3.7%, has now returned to the 5-year average. Public sector hiring, however, has been the engine of job creation. In April's data, public sector employment rose 7.4% yoy while that of the private sector increased only 1.3% yoy. The labour market remains the last piece of the puzzle for the BoK to officially embark on its rate normalization program, which we think should continue to improve on the back of strong exports and shipments of manufactured goods.



Source: CEIC, OCBC Bank

We think BoK may hike the benchmark rate as early as Q2 2022.

We expect an increase in the benchmark rate by Q2 2022. The BoK would likely want to see the unemployment rate continue to trend below the long-term average for a sustained period of time – possibly at least six months – with employment gains driven by the private sector. By this estimation, it will place the possibility of a first rate hike in the April or May meeting of 2022. We then expect two more rate hikes in 2023 to return the benchmark rate back to the pre-pandemic level of 1.25%.

OCBC Bank

The New Challenges

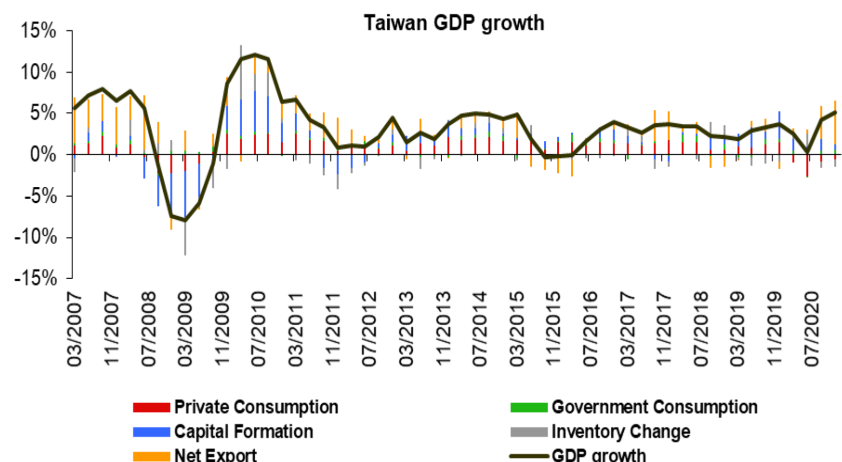
Herbert Wong
+65 6530 7256
Herberthtwong@ocbcwh.com

- Following an impressive year in 2020, Taiwan continued to record a solid growth of 8.16% for the first quarter of 2021. Thanks to the contribution of the net export growth, which contributed 4.53% yoy growth to the GDP, driven by the strong demand in tech products and machinery orders. Nevertheless, the latest spike of COVID cases is very likely to drag on domestic activities and which in turn pull down the GDP growth in near term.
- On the positive note, the US Treasury has not labelled Taiwan as currency manipulator given the lack of evidence and the "pandemic" situation, but highlighted Taiwan is still in a good position to help ease supply shortage such as semiconductors for U.S. manufacturers.
- Going ahead, the key risk of low vaccination and the new tightening of social distancing measures may continue to restrict on individual mobility and therefore having a potential impact on consumer sentiment. We lower Taiwan's growth forecast to 3.8% despite still resilient external demand.

Taiwan GDP growth expands at the fastest pace in a decade

Following an impressive 2020, Taiwan's GDP continues to record a solid grow of 8.16% yoy in 1Q21, the fastest growth since 2010. This was supported by the strong growth in domestic demand, export of goods and service and fixed investment. In particular, private final consumption grew by 2.08% yoy in 1Q2021, showing a strong growth of domestic consumption while export increased by 11.13% yoy, of which electronic parts grew 28.37% yoy.

Chart 1: Taiwan's economy grew at 3.11% in 2020



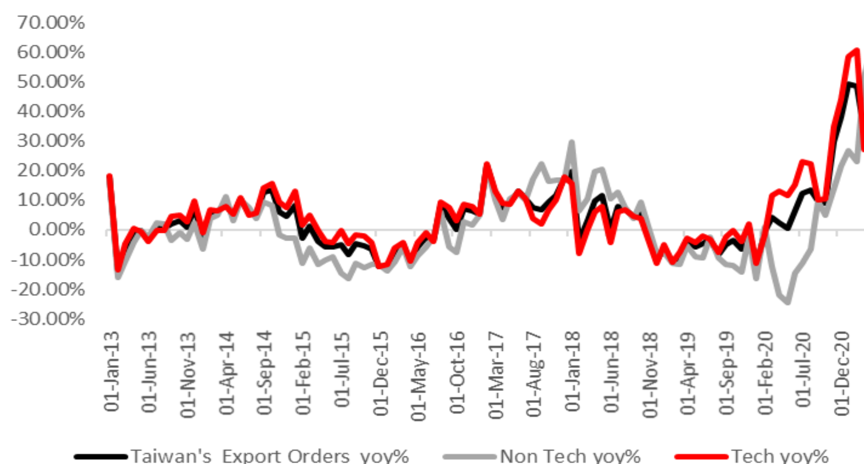
Source: National Statistics of Taiwan, OCBCWH

External demand remains supportive

Following the significant acceleration last year, Taiwan export orders have continued to grow in the recent months including 42.58% yoy (2.37% mom) in April. Tech orders remain the key driver for export orders, due to the strong foreign demand for electronic parts, ICT products and machinery orders. Tech orders printed a solid figure of 37% yoy growth in April on the back of ongoing work from home trend and global recovery in capital expenditures. In addition, non-tech orders such as Base Metals and Mineral products also grew 60.85% yoy, amid the stronger than expected growth in industrial activities all over the world.

Looking ahead, we expect Taiwan's export orders to remain strong for four reasons. **1)** Industrial activities stay positive as the end demand from global economies remain sustainable amid the massive rollout of vaccinations **2)** Robust demand for emerging technology application such as 5G, high performance computing and automotive electronics, even as the global shortage of chips drags on **3)** Work from home related tech demand **4)** US fiscal stimulus encourage enterprises to expand capex and business spending, should continue to support the growth in Taiwan's export activity.

Chart 2: Taiwan's export orders remained solid



Source: MOEA, OCBCWH

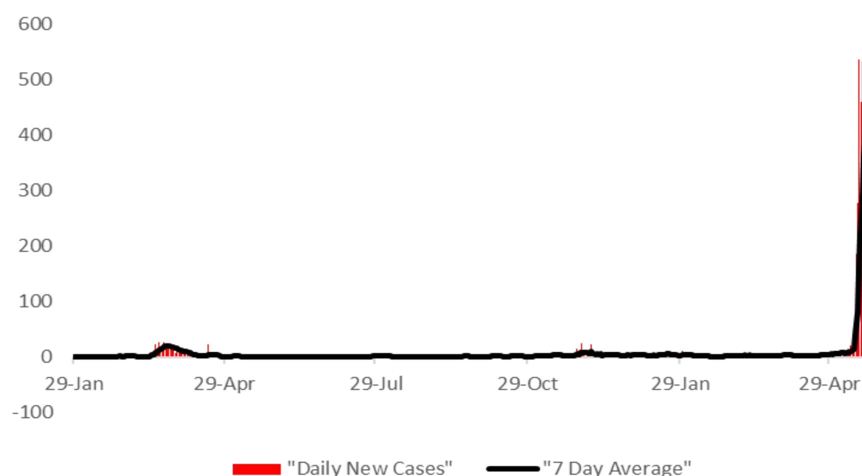
New challenge for Taiwan

As one of the only few major economies delivering growth in 2020 thanks to early success in containing virus and strong external demand, Taiwan's growth momentum may pause after the recent resurgence of virus. The latest Google mobility data declined by more than 40% from the pre-virus level as of 25 May amid stricter containment measures. The low vaccination rate with only 1.77 doses being administrated per 100 people as of 30 May suggested that it may take longer for Taiwan's domestic activity to return to normalcy.

In order to support the economy, Taiwan's Legislature Yuan approved a proposal to double the cap on special budget for Covid-19 relief measures to NT$840 billion. The additional 2% of GDP fire power is likely to offset the impact of the extension of Level 3 Covid-19 social distancing alert.

Nevertheless, we still expect the impact of the current outbreak on the pace of growth could remain substantial, ranging between 0.5% and 1% damage to the GDP growth number. As such, we lower our 2021 GDP forecast to around 3.8%.

Chart 3: COVID is surging in unvaccinated Taiwan



Source: Worldmeters, OCBCWH

Chart 4: Mobility indicator shows May were significantly declined

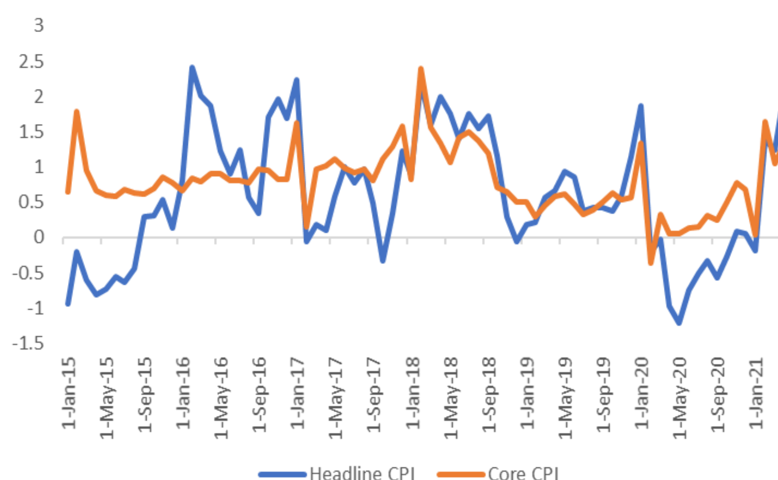
Source: Ourworlddata, Google, OCBCWH

Inflation remains controllable

In term of the CPI, headline CPI and core CPI further increase 2.09% and 1.35% yoy in Apr 21 respectively, led by a steady gain in consumer spending and service demand under a moderate recovery in general pricing environment and core CPI.

The inflation is expected to stay above 2% due to base effect and higher raw material prices. Nevertheless, the CPI is expected to moderate next quarter when the base effect tapers off. The recent outbreak of virus will also keep the inflation outlook in check. Hence, we expect the Central Bank of Taiwan to keep its interest rate unchanged at 1.125%.

Chart 5: Taiwan's consumer goods prices are picking up



Source: Bloomberg, OCBCWH

Better engagement with US

On the positive note, the US Treasury has lifted Taiwan's label as a currency manipulator given the lack of evidence, highlighting that Taiwan is still in a good position to help ease supply shortages such as in semiconductors for U.S. manufacturers. The reliance of the US on Taiwan's chip sector and enhanced engagement between the Biden Administration and Taiwan may also continue to support market sentiment in Taiwan.

To conclude, given the concerns of the recent spike in virus cases, tightening social distancing measure, we lower Taiwan's growth forecast to 3.8% despite the still-resilient external demand.

OCBC Bank

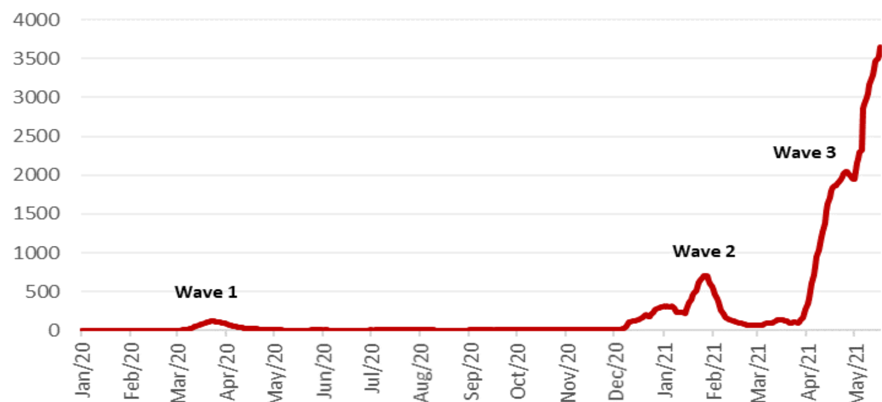
Recovery Path's Vaccination-Dependent

Howie Lee
+65 6530 1778
Howielee@ocbc.com

- Outlook for Thailand in 2021 remains weak; we downgrade our growth forecast from 3.2% to 1.8% yoy.
- With tourism revival muted and commodity prices rising, the probability of Thailand posting a current account deficit in 2021 has increased.
- Success of the 'Sandbox' tourism reopening program will depend on the pace of vaccination in Asia.
- Policymakers will likely continue to prefer targeted credit measures to revive economic growth over rate cuts or Quantitative Easing (QE) or Yield Curve Control (YCC).

Bank of Thailand outlines three paths for economic growth in 2021.

Thailand is currently experiencing its third and most severe virus wave, with the 14-day average confirmed cases at about 3600 per day – five times more than the peak of 650 seen in February. With movement restrictions reimposed across most of the country, it is little surprise that the growth outlook for Thailand has once again been revised lower. The National Economic and Social Development Council (NESDC) has downgraded its 2021 economic growth forecast for Thailand from 2.5-3.5% to 1.5-2.5% yoy.



Source: Bloomberg, WHO, John Hopkins University, OCBC

Bank of Thailand (BoT) has highlighted three paths the Thai economy may undertake in 2021 – all subjected to the pace of vaccination. The most optimistic scenario sees a GDP growth for Thailand of 2% yoy – assuming the country is able to procure and distribute 100 million doses of vaccines by year-end. Its worst-case scenario estimates a mere growth of 1.0% yoy in 2021 – assuming Thailand is unable to vaccinate its planned target of 64.6 million doses by year-end.

Scenario		Best	Base	Worst
Vaccine doses by end 2021		>100 mn	64.6 mn	<64.6 mn
Expected herd immunity		Q1 2022	Q3 2022	Q4 2022
GDP growth yoy%	2021	2.0	1.5	1.0
	2022	4.7	2.8	1.1
Tourist arrivals (millions)	2021	1.2	1.0	0.8
	2022	15	12	8.0

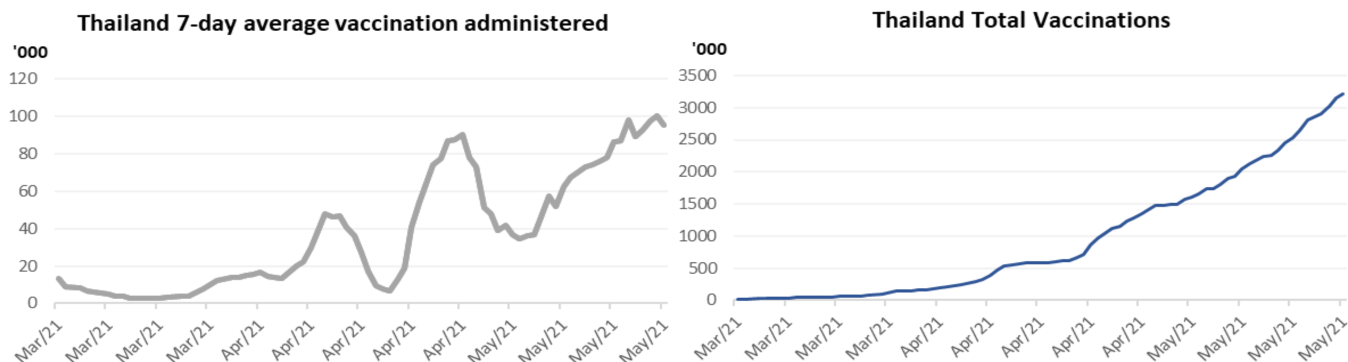
Source: Bank of Thailand, OCBC

Challenging for Thailand to administer 100 mn vaccine doses by year-end.

Thailand is currently administering about 100,000 doses of Covid-19 vaccines a day, with a total of 3.2 million doses administered to-date. Achieving 100 million doses in the next seven months requires an average pace of about 450,000 a day – 4.5x the current pace. Even the base case scenario of 64.6 million doses a day requires a pace of 285,000 a day, which means Thailand will have to almost triple its current rate of vaccination.

In addition to the pace of vaccinations required, other headwinds that Thailand continues to face in its vaccination drive includes the ability to procure (about 80 million doses so far, mostly from AstraZeneca); possible bottlenecks in shipments (most of the doses will arrive only in H2); public health concerns over the use of AstraZeneca; and healthcare manpower constraints in vaccine administering. As such, we expect the BoT's optimistic scenario of 2.0% yoy GDP growth as highly unlikely. The base case scenario of 64.6 million doses appears more plausible at this stage, although we expect additional government measures to offset potential shocks from a slow vaccination drive.

We see BoT's best case growth scenario of 2.0% yoy in 2021 as unlikely and estimate growth at about 1.8% yoy. 2022 GDP growth is estimated at 4.0% yoy on low base effects and the broad assumption that most economies would be close to achieving herd immunity.



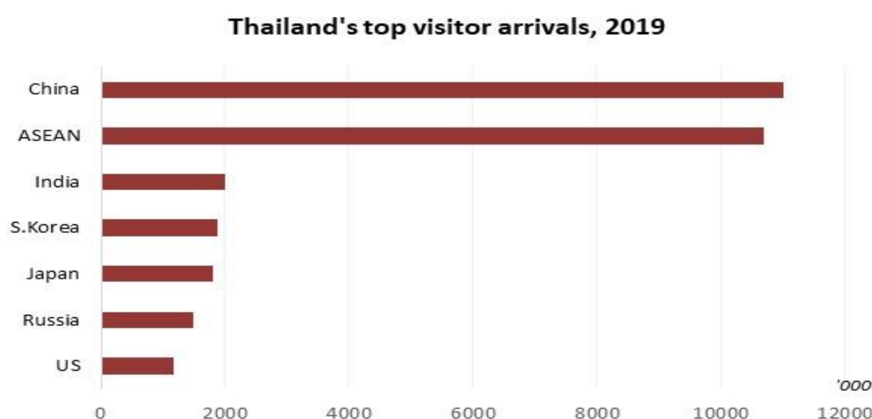
Source: Bloomberg, WHO, John Hopkins University, OCBC

'Sandbox' program dependent more on Asia's vaccination than Developed Markets (DM)

As part of Thailand's reopening plan, the government has launched a 'Sandbox' program. The scheme allows all inoculated visitors to visit Thailand without any quarantine period. Visitors will be expected to stay within the city for 7 consecutive days, after which they are free to travel to other parts of the country. This program will begin with Phuket from 1 July to 30 September, and if proven successful, will be implemented across Krabi, Phangnga, Koh Samui, Pattaya and Chiang Mai beginning Q4 2021.

The success of this project is, again, dependent on the pace of vaccination domestically and abroad. The country will require close to herd immunity to minimise the spread of the virus within the country, which as elaborated above, is only forthcoming in Q1 2022 earliest. Secondly, the pace of Asia's vaccination will be key for the 'Sandbox' program's implementation.

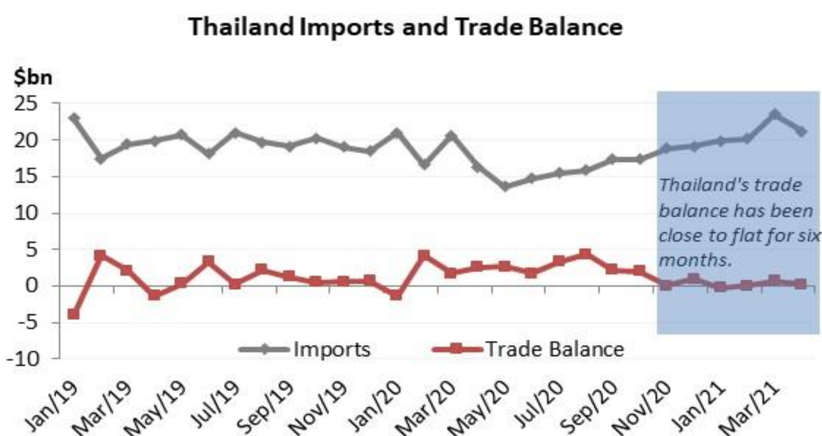
Although DM economies continue to display a quick pace of inoculation in their home countries, Asian visitors account for 80% of Thailand's visitors. In addition, DM travellers may still be apprehensive in boarding long-haul flights. We have little doubt that this program may boost tourist arrivals to the shores of Thailand, but the many uncertainties at present may see the delaying of this roadmap.



Source: CEIC, OCBC

Full year current account deficit is possible in 2021

For the fifth consecutive month, Thailand has reported a negative current account balance – a run stretching from November 2020. While exports may continue to see momentum on the back of electrical appliances and rising demand for semiconductors globally, import growth may likely overshadow the recovery in exports. While the imports of non-monetary gold have continued to surge (+135.5% yoy in Q1 2021), strong growth in ex-gold imports have also been observed. Rising commodity prices have resulted in a 27% yoy import growth of raw materials into Thailand for the first four months of 2021, while returning consumer sentiment has driven imports of consumer goods 17.7% yoy higher in the same period. We expect commodity prices to remain elevated through this year and possibly 2022, which will continue to keep the costs of imports high. Additionally, with tourism revenue not expected to recover materially until 2022, it suggests the growth in imports may continue to outpace that of exports this year and may drive Thailand into recording its first full-year current account deficit since 2013.



Source: CEIC, OCBC

Bank of Thailand to focus more on targeted relief measures than rate cuts.

Despite the third wave of virus across the country, we see a relatively low probability of the BoT implementing further rate cuts or other unconventional monetary easing measures such as yield curve control (YCC) and quantitative easing (QE). Although liquidity conditions in onshore markets have remained flush and accommodative, policymakers have stressed that large corporates have a disproportionately higher access to easy credit. BoT's focus thus is very much on ensuring the SMEs and sectors most hard-hit by the pandemic continue to have appropriate access to credit. This will be achieved by targeted relief measures, such as the modified 250bn baht soft loan program and the 100bn baht "asset warehousing" scheme, but further rate cuts and YCC/QE measures look increasingly unlikely. We therefore expect the benchmark rate to stay at 0.50% through this year and 1H 2022.

OCBC Bank

Growth Leader Once More in 2021

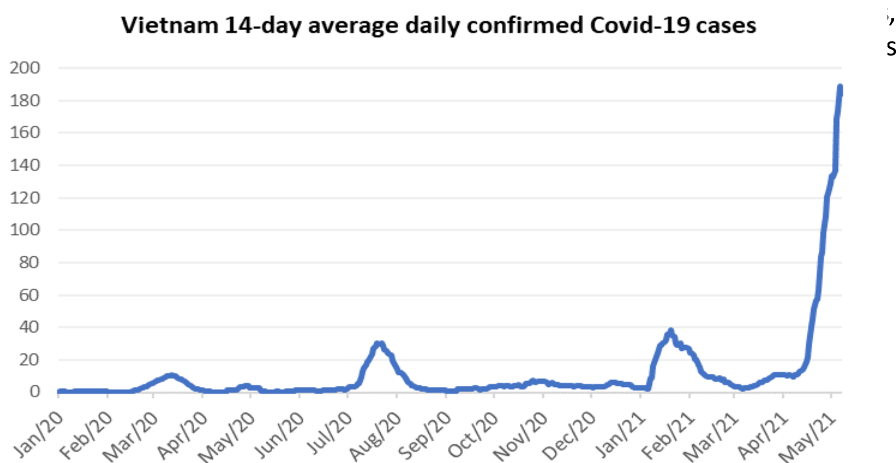
Howie Lee
+65 65301778
Howielee@ocbc.com

- We upgrade our growth forecast for Vietnam from 6.7% yoy to 7.8% yoy on the back of strong export growth and continued momentum in FDI inflows.
- Export destination diversification continues to be of paramount importance for Vietnam as it seeks to reduce export concentration risk to the US.
- Rising commodity prices are likely to send Vietnam into a negative trade balance for most of 2021.
- The negative trade balance, however, may be mitigated Vietnam begins opening its borders earlier than expected.

We upgrade our 2021 growth forecast for Vietnam from 6.7% to 7.8%.

Vietnam's economy expanded 2.9% yoy in 2020, recording one of the highest growth rates in the world amid the pandemic. The solid print reflected the nation's success in containing the coronavirus, allowing the economy to accelerate the resumption of business activities amid strong export demand from its trading partners.

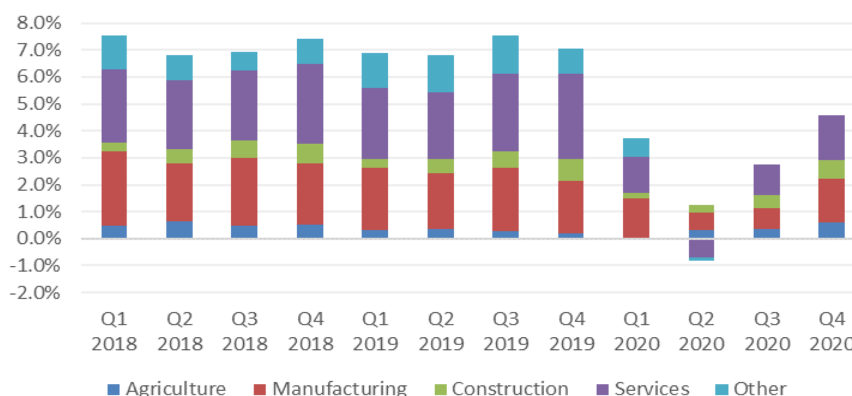
Against that backdrop, the recent Covid resurgence has been an especially acute source of concern. At an average of about 200 cases a day at the time of writing, however, this is still far less than what is observed in neighbouring countries such as Thailand (3700) and Malaysia (6600). Our base case is for local authorities to contain the virus spread as effectively as they have done in the past year and expect disruption to business activity to be minimal. Accordingly, we upgrade our growth forecast for Vietnam from 6.7% yoy to 7.8% yoy.



Source: Bloomberg, WHO, John Hopkins University, OCBC

Manufacturing sector to continue driving growth in Vietnam.

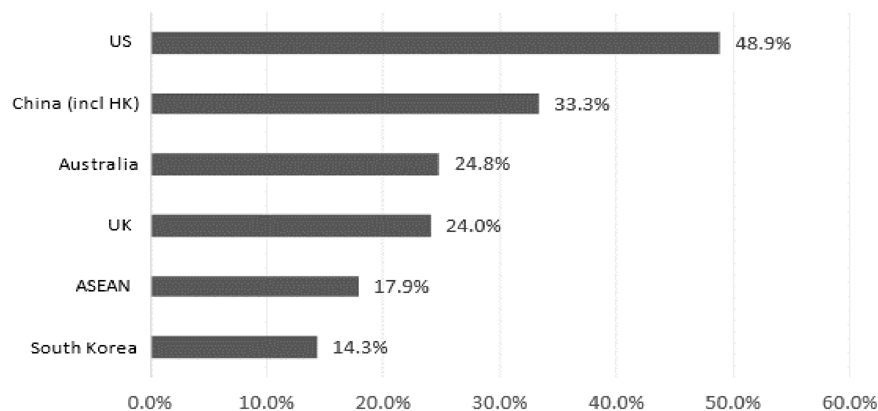
The manufacturing sector is expected to continue driving growth for Vietnam in the medium term. Although the manufacturing sector's size to GDP at 20% is only about half that of the services sector, its contribution to overall GDP growth has been approximately the same as that of the latter. Indeed, the strong continued recovery momentum in the manufacturing sector has been one of our key reasons in upgrading Vietnam's 2021 GDP growth forecast to 7.8% yoy.



Source: CEIC, OCBC

Vietnam may look at reducing export concentration risk to the US.

Exports have surged 30% yoy in the first five months of 2021, largely due to the low base from a year ago. In particular, January and April saw export growth in excess of 50% yoy. We expect this trend to moderate as we head into H2 2021 due to normalisation of base effects. Rising commodity prices, however, is likely to pressure import costs and send Vietnam into a negative trade balance for most of 2021.



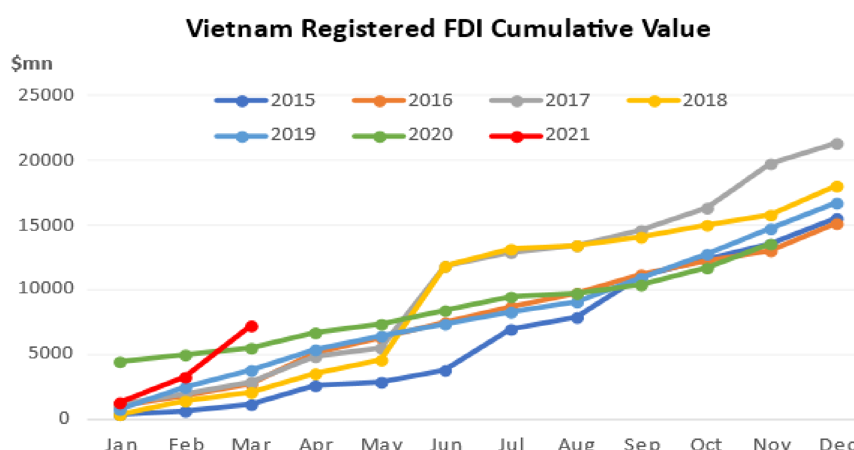
Source: Bloomberg, CEIC, OCBC

Despite the election of a new US President in Joe Biden, we do not expect the hawkish attitude of US policymakers towards Vietnam – seen as a beneficiary of the US-China trade war – to improve materially. Vietnam continues to run a high concentration risk in trade flows, with the US being its biggest trade partner at almost 30% of total exports in the past twelve months. Exports to the US in the first four months of 2021 has also surged 48.9% yoy, largely accounting for Vietnam's strong export performance year to-date. A diversification of exports destination is therefore paramount to reduce the exposure risk of Vietnam's trade with the US and to redirect trade flows regionally.

In addition to serving as an alternative manufacturing base for lower value-added goods to China, the Regional Comprehensive Economic Partnership (RCEP) should also help Vietnam strengthen its manufacturing and export of goods such as textiles and smartphones. All this is positive for Vietnam in the medium to long term.

FDI inflows in 2021 continue its strong momentum from 2020.

The uncertainty from Covid-19 appears to have hardly dampened foreign interest in the country. Registered FDI in Vietnam has recovered strongly in March 2021, touching a new cumulative high of $7.7bn.



Source: Bloomberg, CEIC, OCBC

SBV likely to turn increasingly hawkish from H2 2021, may raise benchmark rate by Q2 2022.

Due to its strong economic rebound, the continued need for loose monetary policy in Vietnam has continued to diminish. The country did not record a contraction last year and both exports as well as FDI inflows have continued to outperform year to-date. Similar to South Korea, we expect the State Bank of Vietnam (SBV) to be one of the potentially more hawkish ones in Asia/Asean. The slow pace of vaccinations and the new virus variant are headwinds to the SBV's attempt to normalise, but those challenges should likely reduce as we head deeper into H2. We see the SBV holding the key rate constant at 4.00% for the rest of 2021, but may conduct its first rate hike by 2Q 2022.

Q&A On Central Bank Digital Currency (CBDC):

Selena Ling
Head of Research & Strategy
+65 65304487
LingSSSelena@ocbc.com

What is a Central bank digital currency?

A CBDC is essentially a digital banknote, either used by individuals to pay businesses or each other (ie. a "retail CBDC") or between financial institutions to settle trade in financial markets (ie. a "wholesale" CBDC). As an electronic version of a fiat currency, it needs to have the potential to be a stable store of value, as well as be accepted as a digital payment instrument which in turn requires the cooperation of the central bank, operators, payment service providers and commercial banks.

To be acceptable to a central bank, it should not interfere or impede their policy mandate and must be interchangeable and co-exist with fiat currencies. In addition, it should be innovative, efficient, affordable and/or convenient in order to add value to existing forms of payment instruments. As it is a digital currency, security and regulatory concerns are important, as are accessibility, scalability, inter-operability, flexibility and operational resilience. From the user perspective, anonymity of payments is a bonus, but may conflict with policymakers' need for regulatory disclosures and interfere with targeted fiscal transfers.

The onset of the Covid pandemic has also accelerated the shift to e-commerce and digital payments, and cryptocurrency trading has also become more mainstream, especially with the younger crowd, while the use of cash has also waned in tandem. With the rush to digital cash, central banks also had to develop digital currency solutions, hence the growing interest in CBDCs too.

Why would central banks embark on CBDC?

Central banks are embarking to experiment in CBDC to see if it would help to achieve public good objectives, such as safeguarding public trust in money, maintaining price stability and ensuring safe and resilient payment systems and infrastructure, according to BIS. Other potential benefits include diversification in payment options, improve efficiency, facilitate cross-border payments faster and cheaper, increase financial inclusion (particularly for those who are unbanked) and possibly facilitate fiscal transfers during crisis times. CBDC could also enable real-time payment flows monitoring.

The offset of this are the user anonymity issues, the potential blurring of lines between monetary and fiscal policies, and the possible volatility in capital flows which could be destabilising. How CBDCs will change or accelerate shifts in reserve currency status is also unclear for now. But a chicken-and-egg problem that may exist is that central banks are reluctant to introduce or mandate the use of CBDCs unless there is widespread

acceptance and they are convinced of their value-add beyond that of digital currencies offered by private firms. However, without compelling real-life experiments, this is also unlikely to happen quickly.

In addition, central banks are also exploring CBDC due to the rising popularity of cryptocurrency which could impact their monetary sovereignty. That said, the Biden administration's proposal to require reporting of cryptocurrency transactions exceeding US$10k, as well as China's PBOC tightening regulation of cryptocurrency payments have doused some near-term enthusiasm for the cryptocurrency complex, as illustrated by the recent volatility in the cryptocurrency prices. Moreover, the energy consumption needs to mine cryptocurrencies have come under scrutiny due to growing ESG awareness.

A 2021 BIS survey of central banks found 86% are actively researching the potential for CBDCs, 60% are experimenting, and 14% are deploying pilot projects. Blockchain appears to be the technology widely used for the CBDC projects.

What is the current CBDC landscape?

China is leading the pack, but others are playing catch up too. China is a frontrunner in the CBDC, having been distributed in pilot projects across Shenzhen, Suzhou and Beijing. Its digital yuan project is legal tender but without interest-bearing status. Some CNY2 billion (around $300m) have been issued. Basically, the central bank disseminates the digital currency to commercial banks who in-turn passes it on to consumers, but this requires users to be registered or have an account to access. China will be handing out CNY40 million of its digital currency to Beijing citizens through a CNY200 lottery. The Beijing Winter Olympics could potentially be a testbed for wider usage of its CBDC for instance. The idea of a cross-border financial innovation expressway between Shenzhen and Hong Kong has also been proposed under a regulatory sandbox by the PBOC Shenzhen president Xing Yujing. However, PBOC deputy governor Li reiterated that the digital yuan is for domestic use and not an attempt to challenge the USD.

Elsewhere, the Bahamas and Cambodia have also had two live retail CBDC projects. Bahamas' Sand Dollar project started its pilot launch in December 2019 and was officially launched in October 2020. Issued through authorised financial institutions, residents can access the digital wallet through a mobile app or a physical payment card. For Cambodia, Project Bakong which is a DLT-based interbank payment system was officially launched in October 2020 and will support rural financial sector development and ease credit access for SMEs as well as micro enterprises. Cambodia is also experimenting with digital wallets for Cambodian workers in Malaysia to transfer funds home at lower cost.

BOJ has begun experiments for 1 year to March 2022 to focus on testing the technical feasibility of issuing, distributing and redeeming a CBDC in the first phase. The second phase will scrutinise more detailed functions such as whether to set limits on how much CBDC each entity can hold. Then there

may be a pilot program involving payment service providers and end users. However, BOJ clarified that it currently has no plan to issue CBDC.

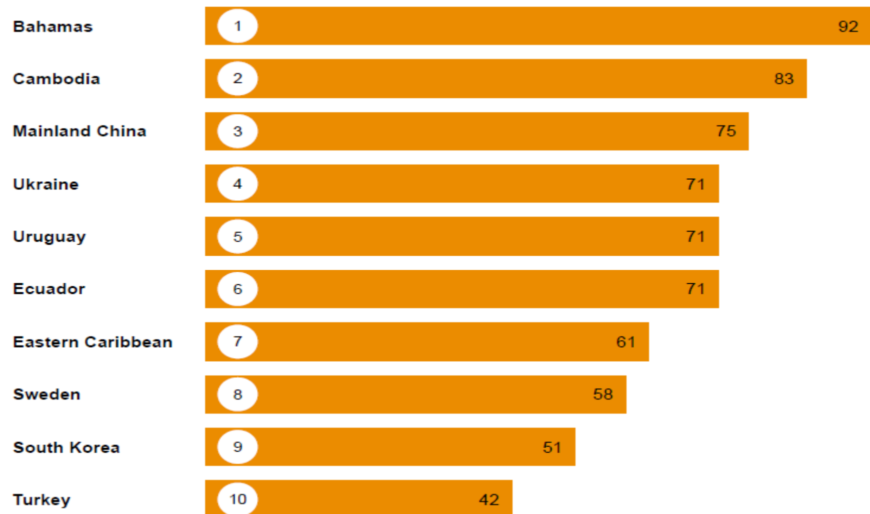
Bank of Korea also launched its 22-month pilot digital currency trial in March 2020 and presented possible revisions to the Bank of Korea Act. Even the Federal Reserve has also launched a study of CBDC with the results due to be published this summer.

Hong Kong and Thailand had previously collaborated on “Project-Inthanon-Lionrock” in 4Q19 using a Distributed Ledger Technology (DLT) solution for cross-border funds transfer by banks via CBDC tokens. China and the United Arab Emirates are also joining HKMA and BOT to use blockchain tech to facilitate cross-border, multi-currency, real-time regional payments under the “Multiple Central Bank Digital Currency Budget (m-CBDC) project. The m-CBDC Budget will likely expand to more central banks and targets a pan-Asian and even wider reach in time to come. The Bank of Thailand has also hired a German technology companies Giesecke+Devrient to develop a proof-of-concept retail CBDC project with a 3-5 year target to roll out the retail CBDC.

Meanwhile, Singapore has its own Project Ubin to explore Blockchain and DLT for clearing and settlement of payments and securities, and found that blockchain-enabled CBDC supports more complex payment flows including a decentralised liquidity savings mechanism. For wholesale CBDCs, MAS is partnering BIS Innovation Hub and the central banking community on Project Dunbar to design, develop and test new m-CBDC models for cross-border settlement. A commercial launch of a multi-currency payment system for digital currencies may also be on the cards. However, in a parliament reply, Senior Minister and Minister in charge of MAS Tharman Shanmugaratnam said that MAS is carefully studying the costs and benefits of a retail CBDC and has not made a decision on this yet.

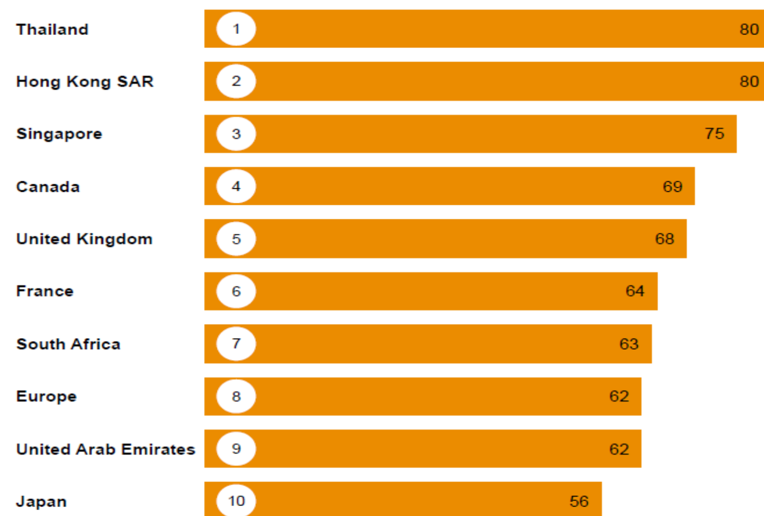
In summary, many central banks are becoming more amenable to the possibility of CBDCs and some have begun exploring and experimenting, but few are ready to issue CBDC in the near foreseeable future. Even for China, which is a frontrunner in the CBDC space, questions remain over whether the launch of a CBDC can replace the popular Alipay and WeChat Pay and if banks and the likes would support the CBDC. If China’s CBDC launch is successful, this may give other central banks more confidence to launch pilots and potentially follow suit down the road. It is not implausible that CBDCs could eventually displace private cryptocurrencies further down the road.

Top 10 – Retail CBDC projects



Source: BIS Working paper No 880, December 2020 update and PwC analysis. Rebased against an index of 100, and is dependent on the availability of data.

Top 10 – Interbank or Wholesale CBDC projects



Source: BIS Working paper No 880, December 2020 update and PwC analysis. Rebased against an index of 100, and is dependent on the availability of data.

Source: PwC CBDC Global Index

China's Digital Currency: A Defensive Rather Than Offensive Move

Tommy Xie
+65 6530 7256
Xied@ocbc.com

- China's digital currency was mainly designed to replace the narrow money or M0, which will reduce the cost of circulation of banknotes and coins.
- There are at least five features of China's digital Yuan.
- The centralised management will give China's regulator a dedicated balance between "controllable anonymity" and anti-money laundering.
- China gave new meaning to the development of digital Yuan after the recent crypto trading boom.
- The development of digital Yuan is a defensive move to catch up with the inevitable trend of global currency development.
- The convertibility between deposits in commercial banks and digital Yuan will help reinforce public confidence in the commercial banking system.

Since last year, China's central bank has rolled out its trial of digital currency project Digital Currency/Electronic Payment (DCEP) across a few selected cities. In addition, the development of digital currencies was also added into China's 14th five-year plan saying that China will steadily advance research and development of digital currencies.

As China plans to test its digital Yuan with foreign athletes and visitors during next year's Winter Olympics in Beijing, foreign interests in China's development of digital currencies continued to increase. Indeed, global media reports have zoomed in on the geopolitical aspects of the digital Yuan initiative, including on whether it is designed to challenge dollar dominance. However, that is a misreading of the digital Yuan's motivation, in our view. In this special report, we will discuss why that is the case, and touched on the drivers – both initial and subsequent ones – for the digital Yuan as well as its defining features.

Original driver for China's DCEP

China's central bank has started its own digital project called "Digital Currency Electronic Payment" (DCEP) since 2014. The development heated up in 2019 after Facebook launched its Libra project (now renamed Diem). The initiation of the project has inadvertently accelerated China's plan to issue its own digital currency. Just as there may be bubbling concerns about the impact of China's digital currency on US dollar dominance, China is also concerned about the progress of Libra as the exclusion of RMB in Libra's reserve assets may weaken RMB's position in international stage and dampen China's ambition to internationalize its currency.

Although both Libra and China's DCEP shared a similar idea of digital currency, the motivation behind is different. Libra was designed to improve financial inclusion via providing a stable currency built on a secure blockchain which creates more access to better and cheaper financial service for billions of unbanked population in the world. However, this is not the main problem statement faced by Chinese society as digital payment has been widely used in both urban and rural areas in China via the platforms like WeChat Pay and Alipay. For China's case, the DCEP was mainly designed to replace the narrow money or M0, which will reduce the cost of circulation of banknotes and coins.

Features of China's DCEP

Based on the current clues, China's planned DECP has at least five important features.

First, China's DCEP will operate in a "two-tier" issuance system with China's central bank issuing the digital currency to authorized financial institutions and the general public receiving or exchanging their digital currency from those institutions. In order to ensure there will not be any excessive supply of money, participating financial institutions will deposit 100% reserve requirement with the central bank. As such, China's DCEP will be legal tender backed 1:1 by China's sovereign currency RMB.

The adoption of two-tier issuance system has at least two benefits. First, PBoC can leverage on commercial bank's advanced IT system to help distribute the digital currency. Second, unlike the one-tier system in which central bank will issue the digital currency directly to retailers, the two-tier system will help avoid the situation that customers moved the deposits away from the commercial banks to hold central bank's digital currency due to central bank's perceived high credit rating. The two-tier system will be important to ensure financial stability.

Second, China will not pay interest to the holders of DCEP in the early stage. This suggests that DCEP will not be a competitor to bank deposits and it will mainly be an alternative payment tool. In addition, there is also no transaction fee involved.

Third, in terms of privacy issue, China's DCEP will run under the framework of "controllable anonymity". The system offers similar anonymity of physical banknotes and coins to the holders of DCEP. PBoC also said the regulator will not seek to fully control the information of the general public.

Nevertheless, China's DCEP will adhere to centralised management. This will give China's regulator a dedicated balance between "controllable anonymity" and anti-money laundering. Since the digital transactions will generate a permanent record, this will help lower the costs for KYC and AML.

Fourth, China's DCEP can be transferred offline. The payment could be made point to point even without the internet. This will make the payment more convenient as compared to the current payment system.

Fifth, on the underlying technology, there will not be any pre-determined technology path. The participating financial institutions can freely choose whether they want to use blockchain technology or traditional accounting system to distribute the digital currency. Then the digital currency will be dispersed by commercial banks through digital wallets.

New drivers for DCEP

Although Facebook's Libra was postponed after hitting regulatory roadblocks in 2019, crypto trading volume has boomed since 2020. With better understanding the digital currency following years of research and development, China also gave new meaning to the development of digital Yuan which is also part of China's supply side reform to better serve the digital China.

Based on the current development, the drivers for the development of digital Yuan have been modified to the following five areas.

First, the development of digital Yuan is a defensive move to catch up with the inevitable trend of global currency development. The rapid development of cryptocurrencies and stablecoins have sparked fears that sovereign monetary control might be diluted. The development of centralized digital Yuan will help the central bank to retain its sovereign monetary control.

Second, although the use of cash has been on the downward trend, the increase of absolute volume of cash in daily life shows that there is still room for the development of digital Yuan to reduce the reliance on cash.

Third, as the untraceable nature of banknotes and coins in transactions and payments may leave many loopholes for regulation, the controllable anonymity of digital Yuan will help safeguard financial stability via supervision.

Fourth, as the world is moving deeper into the digital economy, which will further reduce their reliance on banknotes and coins as well as traditional banking system, the convertibility between deposits in commercial banks and digital Yuan will help reinforce public confidence in commercial banking system.

Fifth, the development of digital Yuan will also help break the barrier and segregation from third party payment providers, which will help support inclusive finance.

The current role of digital Yuan is still constrained to replace M0 and domestic payment. As China's M0 accounted for less than 4% of China's total money supply, the development of digital Yuan is unlikely to be a game changer for China's financial system. It is also premature to be worried that the digital Yuan will challenge dollar dominance if it cannot even disrupt China's own financial system.

In addition, the support of digital Yuan to RMB internationalization is likely to be limited. As mentioned by the former PBoC Governor Zhou Xiaochuan, the development of RMB internationalization mainly depends on the choice of regime and policy rather than the underlying technology. As such, we think the development of digital Yuan is also not the game changer for RMB internationalization.

In conclusion, given holders of DCEP will not receive interest and financial institutions will place 100% reserve with the central bank, we think the impact of DCEP on monetary policy is limited. In the initial stage, as the DCEP will be mainly used to replace M0 and payment will be mainly restricted domestically, the impact on global financial markets is also limited.

Scattered Shots

Low vaccination rates leave Asian economies vulnerable

Wellian Wiranto
+65 6530 6818
WellianWiranto@ocbc.com

- For a while, it appears that most of Asian economies were set for a steady-as it-goes recovery this year. Even though virus cases were still ravaging major countries such as the US, UK and pockets of Europe, Asia appeared to have gotten the situation under control so much so that it was normal to talk about things getting back to normal once again.
- Alas, the table has turned considerably recently. Starting from the rampant uptick in India, the reportedly more transmissible variant spread to the neighbouring countries, resulting in record-high upticks in various places. The fact that the latest outbreaks occur right when a host of developed countries have started to turn the corner in their pandemic fights stands out too. As their economies recover and policymakers start to withdraw their support, it could have considerable ripple effects at an inopportune time.
- The divergence in fortunes has ultimately stemmed from the gap in vaccination rollouts. For instance, while the US and UK have given over 90 shots per 100 residents and that the global average is now close to 25%, the ratio stands well below that for many in Asia, with single digits in most. Hence, even as the inoculation efforts may speed up soon, it might still be a while before the effects can be felt, leaving some countries with little choice but to suffer through any new bout of resurgence with social restrictions again.

The Haves vs. Have-Nots

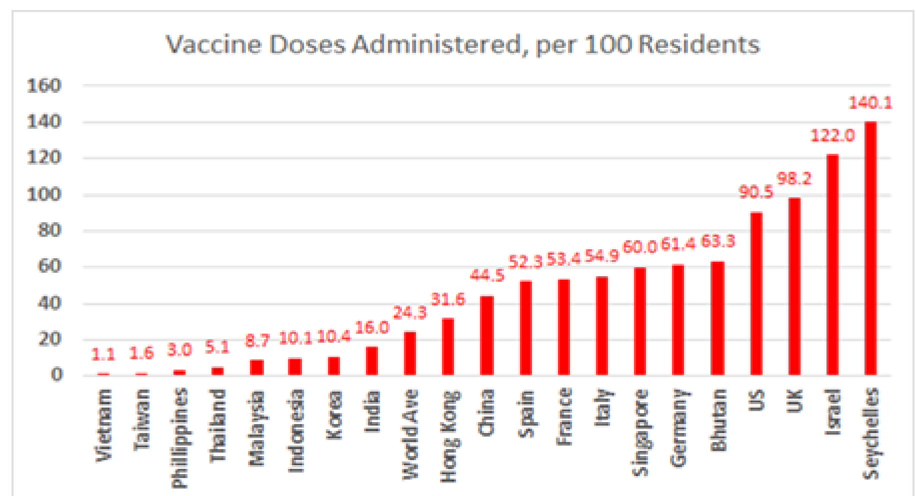
In a thematic piece in our 2021 Global Outlook in December last year, we wrote about how the economic outlook for 2021 could hinge largely upon whether either of the two major vaccine-related tail risks pans out.

On the positive end, we were holding out hope for a rapid rollout in vaccine, including easy-to-administer ones in developing countries, such that the world could see a sharp economic recovery.

On the flip side, the negative tail risk was that there might not be enough vaccines to go around. The haves of developed countries with the wherewithal to procure and distribute the vaccines would see a steady path towards immunity, such that their economies can reopen and growth can creep back up. Whereas, on the other hand, the have-nots would be stuck without enough vaccines, leaving their populations – and economies – still very much exposed to the vagaries of the pandemic.

As it turns out, both tail risks have manifested in some ways over the past half a year or so.

On the brighter side of things, among major economies, we have seen the UK and the US vaccinating their populations in earnest, accomplishing 98.2 and 90.5 shots per 100 residents, respectively. Elsewhere, even though Europe was initially lagging behind in part due to the snafu with vaccine procurement involving AstraZeneca supplies, it has since started to catch up more speedily. Italy, France, and Spain – all of which saw fearsome episodes of pandemic surge before – have successfully delivered 52-55% of shots per capita thus far.



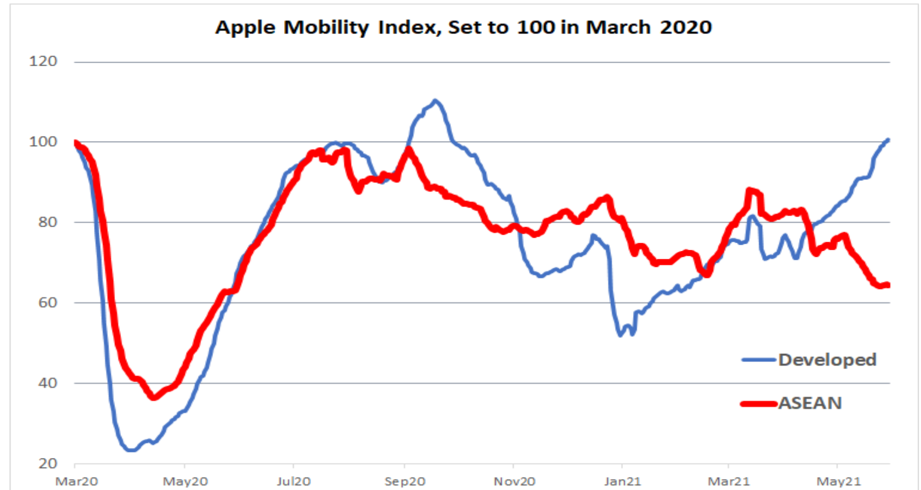
Source: OCBC, Bloomberg.

On the other hand, the vaccination rates have been largely lacklustre in Asia. While a recent ramp-up has pushed the rate up to 44.5% in China and a steady rollout has enabled Singapore to clinch the pole position regionally at 60% – to be ramped up even more with the latest push by the authorities there – most of their Asian peers have broadly been considerably behind.

There is no one singular factor to explain the slow rollout. While a country's economic standing plays a role, it may not have been the primary reason. For one, Korea and Indonesia have similar vaccination rate of around 10% per capita thus far despite the gap in their economic hefts. Indeed, the former might have been lulled into relative inaction on the inoculation front partly because it has managed to keep previous pandemic surges under control. The same complacency could partly explain the slow rollout in Taiwan as well, although geopolitical issues might have crimped its vaccine procurement drives too.

On its own, the slower rollout in Asia has already left some countries more vulnerable than others to the latest resurgence. Indeed, Malaysia, which has given just 8.7 shots per capita, has had to undertake the unpalatable decision of instituting a full lockdown of the country's economy, except for a number of essential sectors, because of the continuous uptick in cases of late.

With or without such overt lockdowns, however, it appears that people's willingness to go about their daily activities has come down in any case. Across ASEAN-6's major cities, for instance, mobility as measured by Apple has dipped to just over 60% of the pre-pandemic March 2020 level. This is in sharp contrast to some of the developed economies, where their major cities have pretty much seen a full recovery of their populations' mobility level.



Source: OCBC, Apple Mobility Index. The ASEAN reading takes a simple average of data for Jakarta, KL, Singapore, Manila, Bangkok and HCMC, while the 'Developed' reading reflects the average of NYC, London, Berlin, Paris, Madrid and Rome.

Going ahead, even as some of the authorities have to cope with the headache that is the ongoing surge, they should nonetheless be trying to procure and distribute as many shots as possible into the bare arms of their populations. To that end, it is encouraging to see that Malaysia, for instance, has reportedly secured more vaccines to be coming in over the next few months that should help it ramp up the inoculation pace. Elsewhere, Indonesia is also rolling out a private-sector initiative that has started to undertake parallel imports and distribution of vaccines alongside the official channels.

Still, the road ahead remains a rocky one. Even as the policymakers find ways to limit the economic damage, the dichotomy between the pace of recovery here and in the major economies may become increasingly stark. This could start to reflect in the expectations for interest rates and broader monetary policy support for instance.

While any rate cut by central banks here to help save the economy was largely in tandem with similar cuts by their major counterparties such as the Fed, ECB, BOE etc, this time round they would be doing so right when these 'big guys' are already inching toward withdrawal of policy support. The market, for instance, has started to pay attention to murmurs of rate hikes as soon as next year from the BOE.

On top of that, the possibility of any QE tapering or even rate hike by the Fed is going to be increasingly the elephant-in-the-room issue that could curtail the wiggle room of many central banks here.

All in all, the sequencing of it all matters. If those hawkish actions come to bear when vaccinations have picked up to considerably better levels here, then the divergence will feel less painful. If they come when we are still coping with another virus resurgence, it would be a lot more so, unfortunately.

Hong Kong: Further Financial Integration in the Greater Bay Area

Carie Li Ruofan
+852 28525767
Carieli@ocbcwh.com

- The financial integration between Hong Kong and Mainland China will take another step forward with a raft of new initiatives. Among these, market appears to have been relatively enthusiastic about southbound bond connect and wealth management connect, which will expand the direct channels for GBA investors to invest across the border.
- For the southbound bond connect, net inflows from Mainland China to Hong Kong may be muted at the early stage amid the restricted access to offshore bond market and the already attractive yield of onshore bonds. Having said that, the interests in offshore bonds may increase given the onshore investors' strong needs to diversify their portfolios.
- For the wealth management connect, we expect to see both northbound and southbound inflows given a wider range of products than those offered under the mutual recognition of funds, the attractive yield of onshore products as well as Mainland investors' strong demand for offshore products to diversify risks.
- Under a closed-loop system, should we see net inflows from Mainland China to Hong Kong under the two new connect schemes, it may help to improve CNH liquidity and boost HKD demand. However, at the initial stage, the impact may be limited as any net inflows may be moderate.
- Moving ahead, we may see further financial integration between Hong Kong and Mainland China. Apart from facilitating free flow of human resources, capital and trade across the Bay Area, the new initiatives may help accelerate the pace of RMB internationalization.

The financial integration between Hong Kong and Mainland China started in 2007 with the so-called "through train" initiative and has accelerated since 2014 as Shanghai-Hong Kong stock connect, the Mutual Recognition of Funds (MRF), Shenzhen-Hong Kong stock connect, northbound bond connect, and ETF connect have been launched sequentially.

HKMA's Chief Eddie Yu hinted that three new policies will be rolled out this year to enhance the financial integration across the Greater Bay Area. First, expanding the range of trial banks which provide services of remote bank account opening in the Greater Bay Area. Second, establishing a cross-border RMB cash pooling mechanism. Third, establishing a cross-border financial supervisory sandbox.

On top of these three policies, Yue hinted that the southbound bond connect will likely be launched in 2H 2021 while the HKMA is conducting tests for eRMB's cross border payment with the PBOC. Lately, China has also announced more details about the wealth management connect for the Greater Bay Area.

Looking forward to the two new connect schemes

Currently, China's onshore individual investors can only tap offshore market directly via stock connect schemes, Mutual Recognition of Funds (MRF) and mutual funds sold under Qualified Domestic Institutional Investor (QDII), Qualified Domestic Investment Enterprise (QDIE) and Qualified Domestic Limited Partner (QDLP). Likewise, offshore individual investors can only invest in onshore market via stock connects, MRF and mutual funds sold under Qualified Foreign Institutional Investor (QFII). For onshore institutional investors, they can only buy offshore bonds under QDII, RQDII, QDIE and QDLP.

The upcoming two new schemes will expand the direct channels for GBA investors to invest across the border. Zooming in, **for southbound bond connect,** the offshore bonds available may be limited at the early stage. As such, net inflows from Mainland China to Hong Kong may be muted at the early stage since onshore bonds are offering a relatively attractive yield. In fact, QDII quota, which has been expanded last year, has never been fully used so far. It was also reported that the net outflows under QDII were less than the net outflows under stock connects from Mainland China during the first eight months of 2020. Having said that, the interests in offshore bonds may increase given the onshore investors' strong needs to diversify their portfolio.

For wealth management connect, different from the mutual recognition of funds which only make limited variety of funds available for the investors across the border, the wealth management connect may give investors access to a wider range of investment products such as non-principal protected wealth management products and mutual funds with relatively low risks for HK and Macau eligible investors.

Given the attractive yield of onshore products like government bonds, we may see stronger northbound inflows than that under the Mutual Recognition of Funds. Southbound inflows could also be expected given the strong demand of onshore investors in the Greater Bay Area (GBA) to diversify risks with offshore investment products. More importantly, the wealth management connect is poised to be a milestone in GBA's financial integration by piloting cross-border account opening, cross-border collaboration of banks and cross-border expansion of client base.

Connect schemes' impact on Hong Kong market's liquidity

Like the stock connects and northbound bond connect, the cross-border capital flows of the southbound bond connect and the wealth management connect will be both conducted and managed by a closed-loop system with the investors opening bundled remittance and investment accounts across the border. The remittances are conducted in renminbi and the currency conversion (from CNY to HKD for southbound flows and from HKD to CNY/CNH for northbound flows) are conducted in the offshore market. With a closed-loop system, cross-border flows under the connect schemes have direct impact on the CNH and HKD market.

For HKD market, "net outflows" (e.g., northbound inflows outweighed southbound inflows) under the connect schemes does not mean "tight liquidity" unless it pushes USDHKD spot to 7.85 (the weak end of the currency peg) and prompts HKMA's intervention (results in a reduction in aggregate balance). For most of the time, net outflows from Hong Kong to Mainland China under the stock connect reduce equity-related HKD demand and therefore free up some HKD liquidity in the market. On the flip side, net inflows under the connect schemes normally increase HKD demand and add upward pressure onto HKD rates until USDHKD spot touches 7.75 (the strong end of the currency peg) and propels HKMA to sell HKD in the spot market (drives up aggregate balance).

On the other hand, for CNH market, net inflows under the connect schemes do help to improve CNH liquidity as the inflows are one of the sources of CNH liquidity.

Against this backdrop, should we see net inflows from Mainland China to Hong Kong under the two new connect schemes, it may help to improve CNH liquidity and boost HKD demand. A good example is the record net inflows under southbound stock connect during January when Hong Kong's RMB deposits rose to the highest since February 2016 and USDHKD spot fell towards the strong end of the currency peg as a result. This may in turn add some downward pressure onto USDCNH forward swap points and cap the downside of both HKD spot and front-end HKD rates.

However, at the initial stage, the impact may be limited as any net inflows under southbound bond connect are expected to be moderate. Meanwhile, the maximum net inflows for each side under wealth management connect cannot exceed the aggregate quota which is tentatively set at RMB150 billion.

Expecting further financial integration in the longer term

Moving ahead, we may see further financial integration between Hong Kong and Mainland China. Apart from facilitating free flow of human resources, capital and trade across the Bay Area, the new initiatives will likely help to gradually improve offshore RMB liquidity and in turn

accelerate the pace of RMB internationalization. However, it may not necessarily affect HKD liquidity if no currency conversion is involved

Chart 1: Channels for cross-border investment

Institutional investors to Mainland China	Stock connects, CIBM, RQFII, QFII, QFLP
Institutional investors from Mainland China	Stock connects, MRF, Mutual funds under QFII
Retail investors to Mainland China	Stock connects, MRF, Mutual funds under QDII, QDIE, QDLP
Retail investors from Mainland China	Stock connects, QDII, RQDII, QDIE, QDLP

Source: Various, HKMA, Bloomberg, OCBCWH

Chart 2: Net equity inflows to HK & RMB deposits

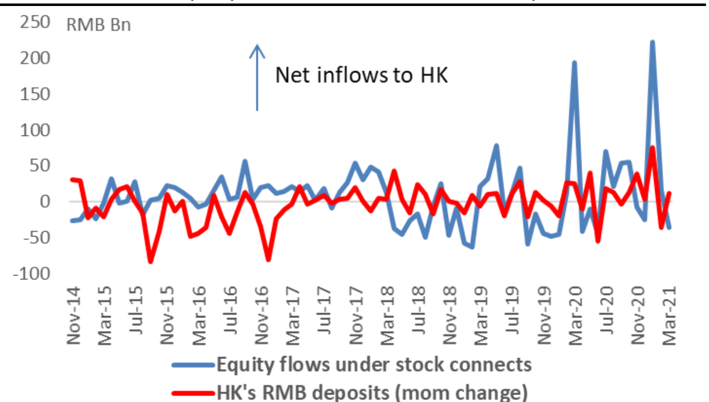
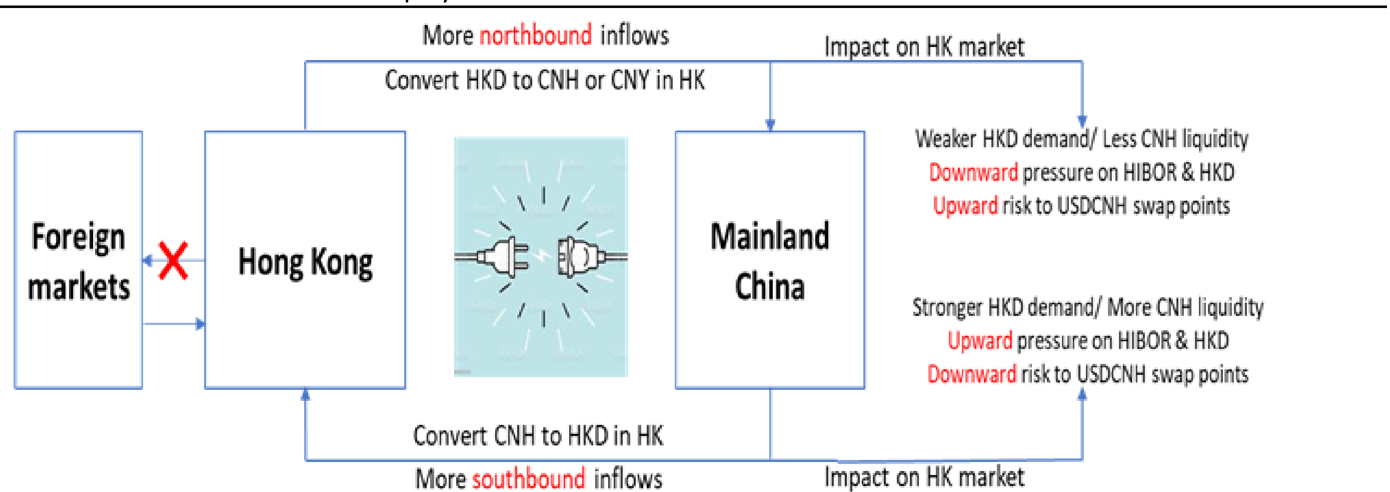
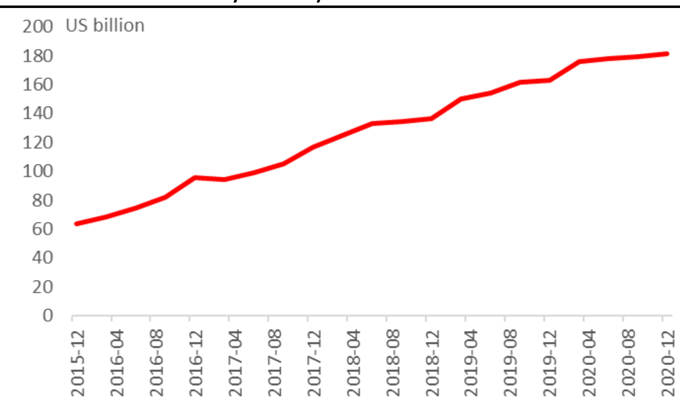


Chart 3: How does the closed-loop system work?



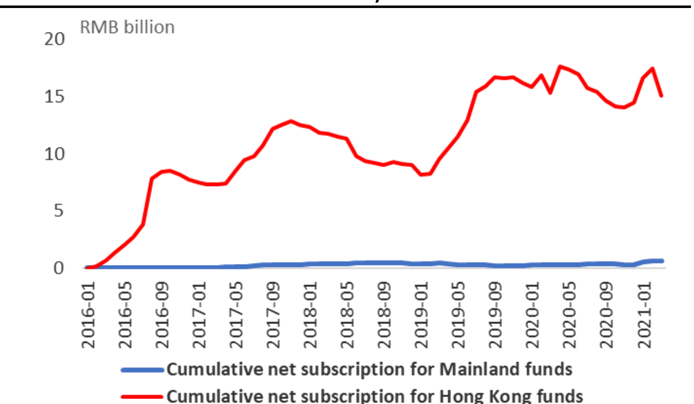
Source: OCBCWH

Chart 4: Onshore banks' offshore bond investments have increased only slowly



Source: Wind, OCBCWH

Chart 5: Onshore investors have been more interested in HK funds than the other way around under the MRF



ESG Challenges and the Proposed solutions

Howie Lee
+65 6530 1778
Howielee@ocbc.com

The growing awareness of ESG globally.

Environmental, Social and Governance (ESG) continues to dominate headlines and has grown rapidly particularly over the past half decade. Covid-19 has highlighted the increasing need for ESG and sustainability practices – among many, the need for green space in urban build-up areas, the keenness in averting future similar environmental tragedies and creating secure but sustainable jobs for employees. Increased regulatory requirements has been the main driver of growth for ESG in recent years, with more defined ESG risk management guidelines and stewardship codes across the world.

While the pace of adoption has differed across countries, the growing awareness of its importance is clearly undeniable.

The three big economies are finally aligned on climate sustainability.

2020 was a watershed moment for sustainability, as the three biggest economies have finally aligned themselves in the adoption of green movements. The US, with the appointment of Joe Biden to succeed Donald Trump, has returned to the Paris Accord. Biden's campaign also heavily centred on its Clean Energy deal, where he plans for the US to emit net zero carbon emissions by 2050. This was followed up in Q1 2021, when the President unveiled a $2.25 trillion fiscal stimulus, with green energy and decarbonization at the heart of the plan. Similarly, the European Union in 2020 presented the European Green Deal, which requires all policies to consider sustainability in their formulation. China's latest 5-year plan, among many green initiatives, seek to phase out coal and reduce carbon emissions. With the three economies in tandem over climate change and green initiatives, it provided a fillip for the rest of the world to follow suit.

ESG implications on investment and wealth management.

ESG investing, despite its overall complexity, rests on a basic principle: investing in ESG-compliant organisation should deliver higher returns over a longer investment horizon. This is premised on the idea that companies which embrace ESG values should create value for all stakeholders – ranging from employees to customers, as well as owners and the wider environment while able to navigate risks from climate change (eg: physical damage on assets, disruptions to business models). Accordingly, conducting analysis on ESG will hence focus on how these companies value add to

society and consequently, the impacts on its short and long-term performance.

ESG analysis requires a broad shift in mindset, especially for finance professionals steeped in traditional valuation models like discounted cash-flow models. Valuation of businesses should not be solely dependent on the company's near-term profitability and liquidity prospects, but consideration of long-term future trends becomes equally crucial. Conducting worst case scenario analysis, for example, should include highly disruptive change in the climate and environment that not only affects the company's profits, but determines the company's very own existence and survival.

Challenges facing ESG today.

1. **Lack of common standards and performance measurement.**

Despite the efforts by the Sustainability Accounting Standards Board (SASB) and Task Force on Climate-related Financial Disclosures (TCFD), there is still a lack of pronounced standardised guidelines that are widely adopted across the world although we have seen progress on this front through 1H2021, in part driven by the push from coalitions comprising of institutional investors and asset owners. Without a set of common metrics, investors will continue to find it challenging to attach a quantitative scoring system in ESG evaluation of companies. In the same vein, without these standards, companies will be clutching straws on ESG investments given differing frameworks and preferences across borders.

In March 2021, the World Economic Forum's International Business Council (IBC) has released a set of guidelines titled "Measuring Stakeholder Capitalism – Towards common metrics and consistent reporting of sustainable value creations" that outlines a recommended set of 21 core metrics and 34 expanded metrics to further the road towards a global harmonized reporting system. It is an attempt to condense and collate existing frameworks into a more consistent benchmark globally, and a step in the right direction in addressing the lack of common standards. The UK which has announced its intention to make TCFD-aligned disclosures mandatory, launched a public consultation on this matter in April 2021. Should this proposal go through, UK companies may need to disclose the risks they face from climate change as early as 2022.

2. **ESG understanding and adoption remains low but the market is growing fast**

ESG, SRI, impact investing – what are they and what are the differences? The plethora of acronyms have left many confused. Awareness and understanding of ESG and its role leave much room for improvement. This is especially pertinent among retail investors, who may not necessarily be governed and motivated by the same set of ESG rules surrounding institutional investors.

The long-term solution to this is actually simple, albeit philosophical. Rising investment interest in ESG should gravitate towards the idea as a core analysis process and not remain a separate “add-on” consideration. In other words, the idea of ESG investment and analysis as an afterthought should gradually diminish. Put in another way, ESG considerations should eventually evolve into another indispensable metric for consideration – in addition to discounted cash flows and credit ratings, for example. What needs to be done, however, is the acceleration of this natural process. Ideally, one way to achieve this is a critical mass uptake of ESG ratings as a key analysis process. However, we continue to see limitation in mass adoption of ESG ratings given the high divergence of ratings outcomes across ESG raters. Green, social, sustainability and sustainability-linked bond sales from governments and corporates total $442.0bn (between 1 January 2021 to 28 May 2021). While this is only a small sliver of the total bonds issued globally, issuance volume has grown exponentially, 244% higher than the same time last year.

Per Morningstar, an information service provider who tracks the asset management industry, 1Q2021 saw $185.3bn (up 17% q/q) of inflows into funds that have a sustainability objective or which uses ESG as a criteria in investment decisions, bringing total assets to ~$2 trillion. Inflows for 1Q2021 was driven by the equity asset class and Europe based funds.

3. **The quality of ESG information leaves much to be desired.**

The considerations here are two-fold. Undoubtedly, much work is being done to address this issue, ranging from the aforementioned SASB and TCDF to the Global Reporting Initiative (GRI) and the Governance and Accountability Institute (GAI). Data availability, however, remains in short supply and may even be costly. Additionally, skilled labour is also needed to populate and estimate missing data fields, especially for emerging economies.

Information noise will also be a problem that inadvertently arrives with increased data availability. Similar to the above, parsing large amounts of data requires standardised and consistent definitions and measurements. The same information also needs to be made available publicly and freely. Disparate corporate governance codes and stewardship guidelines stand in the way of achieving this goal – for example, accessing data such as executive compensation in private companies.

The solution is for a standardised agreement across nations on the necessary publications required from both the public and private sectors, similar to how IFRS and GAAP have been widely used globally for accounting standards.

Singapore's Green Plan 2030

Singapore launched its Green Plan 2030 in February 2021. Among many initiatives including the planting of a million more trees and tripling the existing cycling path network, the government also seeks to:

1. Develop Singapore into a carbon services and green finance hub in Asia and globally
2. Peaking public sector carbon emissions by 2025
3. Reduce landfill waster per capita by 20% by 2026 and 30% by 2030
4. Further bring down road tax for mass-market electric cars
5. Target 60,000 electric vehicle (EV) charging points by 2030
6. Quadruple solar energy deployment to 1.5 gigawatt-peak by 2025.

To enable these sustainability efforts, the Singapore government will be issuing SGD-denominated green bonds on several public infrastructure projects. The yields on these issuances will serve as benchmarks for the SGD green corporate bond market, especially in green yield determination. It was announced in Budget 2021 that green bonds will be issued for $19bn worth of green infrastructure projects, such as the Tuas Nexus development. We expect the bulk of these projects to be funded via green bonds. As a comparison, the total green bond issuances in the entire of ASEAN from 2016 to 2019 is USD$8.1bn (S$10.8bn) and firmly underscores Singapore's ambition to be a green finance hub. Leveraging on its position as an existing financial hub, Singapore can also look to drive capital flow towards sustainable development, including the development of green finance solutions for the region. These efforts can help to increase liquidity for green markets by further attracting more green issuers, capital and investors domestically and abroad.

Conclusion

We strongly believe that adoption of ESG on a global scale will enhance risk-adjusted return potential across investment portfolios and create investment value for all stakeholders involved. Organisations that care about its social responsibility and the environment are more likely to outperform peers that place no emphasis on ESG values. What is now needed is a broad shift in mindset across the entire investment chain – starting from governments and multi-national bodies – that create standardised guidelines for companies to follow. Ultimately, ESG analysis is about the adoption of a more forward-looking and all-encompassing approach than the traditional methods of value discounting. The first step to achieving this, is to enhance understanding of ESG across the world.

OCBC Bank

Treasury Research & Strategy

Macro Research

Selena Ling
Head of Research & Strategy
LingSSSelena@ocbc.com

Tommy Xie Dongming
Head of Greater China Research
XieD@ocbc.com

Wellian Wiranto
Malaysia & Indonesia
WellianWiranto@ocbc.com

Howie Lee
Thailand & Commodities
HowieLee@ocbc.com

Carie Li
Hong Kong & Macau
carierli@ocbcwh.com

Herbert Wong
Hong Kong & Macau
herberthtwong@ocbcwh.com

FX/Rates Strategy

Frances Cheung
Rates Strategist
FrancesCheung@ocbc.com

Terence Wu
FX Strategist
TerenceWu@ocbc.com

Credit Research

Andrew Wong
Credit Research Analyst
WongVKAM@ocbc.com

Ezien Hoo
Credit Research Analyst
EzienHoo@ocbc.com

Wong Hong Wei
Credit Research Analyst
WongHongWei@ocbc.com

Seow Zhi Qi
Credit Research Analyst
ZhiQiSeow@ocbc.com

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