OCBC Global Outlook 1H25

After 2024 tailwinds, growing headwinds for 2025

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- Tariffs could be the proverbial tail that wags the dog in 2025. I tried very hard to think of how I can fit the latest viral song "APT" by Rose and Bruno Mars here, but finally surrendered. There seems to be no way that a Korean drinking game song can describe the potential challenges or market volatility that may descend in 2025, so I'll settle for "we can't be friends, but I'd like to just pretend" in Ariana Grande's song. President-elect Trump will only be inaugurated on 20 January 2025, and already his somewhat controversial and/or unorthodox policy priorities in terms of tackling inflation, immigration and the economy has both allies and non-allies anticipating the changes that will be on the cards in short order. This implies that while we have painted a balanced global macroeconomic outlook, the dispersion of potential outcomes is significantly wider. Hence, simplistic assumptions that the current post-US election euphoria playing out in financial markets (i.e., stronger USD, higher US equities and higher UST bond yields) may not sustain for the year ahead, as material assumptions would be whether or when those Trump policy shifts materialise and if the bite is as bad as the bark.

- Market players have been watching Trump's key appointments. In particular, the Treasury Secretary nomination of Scott Bessent has shone the limelight on his "3-3-3" plan – a framework to achieve 3% economic growth, trim the deficit to 3% of GDP and increase oil output by 3mn bpd. Bessent is seen by markets as a "safe hand" and also a fiscal and deficit hawk. How fiscal policy will play out in 2025 is important, but in the interim, swings in monetary policy expectations have rattled financial markets as pricing of future Fed rate cuts have been significantly pared back with some speculation that a pause may be imminent. Whether this will diminish the USD's allure and whether the S&P 500 can keep going beyond the year-end forecasts of 6,500-6,600 that many on the street are eyeing will be key questions on many investors' minds. Hence, while we are generally constructive for the year-to-date, the dark clouds are looming, and greater market volatility appears likely given major trade actions. The volume of global trade already fell 0.9% MoM in September, with import weakness in Emerging Asia ex China (-5.8% MoM), Euro Area (-0.6% MoM), and China (-0.3% MoM) whereas the US outperformed (+4.5% MoM), according to CPB.

- To recap, the global soft-landing narrative that had symptomized most of 2024 has been aided by the pivot to a global monetary policy easing cycle in 2H24 and emerging green shoots in the Chinese economy amidst sustained policy stimulus, accompanied by a rebound in the global electronics industry. For the year-to-date in 2024, many economies have seen GDP growth to be resilient if not outperforming initial expectations. One key exception is the Chinese economy which continues to require a persistent drip of support measures. However, the status quo may change soon as China may find itself in the firing line and some abrupt adjustments are probably in order for 2025. Recall that Donald Trump has threatened to levy 60% trade tariffs on Chinese exports. Trump may be able to kickstart the process once he takes office, but he is already rattling his sabre further, threatening 25% tariffs on all Mexican and Canadian goods as well as additional 10% tariffs on Chinese goods due to illegal immigrants and drug inflows across borders.

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- If the tariffs materialise and China retaliates and/or decides to export inflation to the US rather than absorb the tariff shock, this could prove inflationary for the rest of the world as well. The disinflationary trend could be disrupted and in turn the monetary policy easing space for many central banks may consequently evaporate. The current recovery momentum remains uneven, and hence market scepticism is still rife. In the interim, Chinese domestic policy support is set to continue with domestic demand the crux to mitigate external downside risks. This backdrop is likely less supportive of commodity demand into 2025.

- Outside of the US, the picture is slightly more mixed. Economic prospects in the Euro Area remain subdued, prompting the European Central Bank (ECB) to begin trimming policy rates. However, structural and cyclical factors are weighing on the 2025 growth prospects. A continued Russian-Ukraine conflict has not deterred the region's disinflation process, but upcoming German snap polls in February may point to a tough fight for the embattled Chancellor Scholz after the collapse of the coalition with the Greens and Free Democrats (FDP) in early November.

- Meanwhile, France's far-right Marine Le Pen is also threatening to bring down the minority government by year-end unless changes are made to the budget bill which needs to be passed by 21 December, amid "red lines" including a refusal to raise electricity taxes and the need to increase state pensions from January. France is also under pressure from the European Union to reduce its debt levels. French PM Michel Barnier is targeting a trimming of the French deficit from 6% of GDP to 5% through a EUR60bn squeeze. The geopolitical tilt towards the right appears to be gaining momentum whereas the economic prognosis remains under pressure amid challenging conditions.

- The UK economy has seen increasing signs of growth and inflation, aided by the Autumn Budget. While the momentum may ease into 2025, the Bank of England remains cautious and should go about easing policy rates gradually. In particular, the hike in employer National Insurance Contributions is likely to add to inflationary concerns – a CBI survey showed 6 in 10 businesses said the budget will not make the UK more attractive for investments and many were not willing to invest, expand or take a chance on new people. PM Starmer is busy defending his Labour government's controversial first budget against backlash due to plans to cut welfare spending to increase the employment rate from 74.8% to 80%. The government estimates that 9.3mn working-age adults are economically inactive (700k more than pre-Covid) and long-term illness has hit a record 2.8mn people, while one in eight young persons are not in education, employment or training.

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- The Japanese economy saw the Ishiba administration approve a JPY21.9trn economic stimulus plan to address challenges from inflation to wage growth. Meanwhile, its leading index climbed from 106.9 in August to 109.1 in September and core inflation held above the Bank of Japan's 2% target, which could keep the pressure on the central bank to continue to normalise its still-low interest rates in December. Notably, the price index excluding fresh food and energy rose by 2.3% YoY in October, accelerating from 2.1% in September. The Japanese yen's renewed weakness has also heightened import price pressures. BoJ governor Ueda had opined that "it's impossible to predict the outcome of the meeting at this point" but there is a need to "seriously" assess the impact of the currency on inflation and the economy.

- For Asia, the picture continues to be one of general resilient economic health. 3Q24 GDP growth has mostly surprised on the upside but there are external challenges that lie ahead. While the services sector was the main growth driver for the most of 2024, manufacturing growth has improved with the global supply chain recalibration and global electronics demand uptick. The recovery of visitor arrivals also continues - outbound Chinese visitor arrivals have been growing in numbers but spending patterns seem to have changed post-pandemic. There are bright spots within the ASEAN region, with inflows of foreign direct investments and wealth/portfolio money seeking greener pastures.

- The overall disinflation trajectory remains intact, but the outlook ahead has a wider tail risk. Should Trump 2.0 prove inflationary for the US economy and the global economy, the Fed's leeway to bring policy rates down to their estimated terminal or neutral rate may be shortened. While Fed rhetoric has been reticent on committing to a preset path or making assumptions about policy implications from Trump after he takes office in January 2025, the market pricing of future rate cuts has been pared back to only a half chance of another 25bp rate cut at the December FOMC and roughly 50bps cumulative cuts for the whole of 2025. We believe that market pricing of the Fed rate cut trajectory tends to be volatile and potentially over-exaggerate the possible outcomes depending on the flavour of the day (just reference the wide swings in 2024 from pricing in seven cuts to no cuts in 1H24). Nevertheless, the Fed's path remains highly data-dependent. Hence, any data surprises, whether on the inflation or labour market front, will continue to amplify in the days and months ahead. Meanwhile, note that credit market spreads remain extremely tight as too much liquidity is still chasing for yields.

- In terms of risk, geopolitics is definitely not "business as usual". The Russia-Ukraine and the Middle East conflicts are far from resolved and may be escalating in tensions recently. In fact, geopolitics had replaced inflation as the top worry for central banks and sovereign wealth funds, with 83% of respondents citing it as the main risk to global growth in the coming year and two-thirds believing a multipolar order will dominate in the next 10 years, according to a WEF Global Risks Report. While this is not necessarily a doom and gloom outlook for risk assets, nonetheless, it should warrant some defensive hedges to guard against potential tail risks as exuberant markets may be vulnerable to any significant shocks.

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- The silver lining is that 2024 has been conducive to risk-taking, the global monetary policy easing cycle has started (albeit a little later than expected) and the global soft-landing narrative has largely panned out so far. Looking out from here, whether financial markets in 2025 will continue to sustain would require substantial policy offsets to the growing headwinds. While Trump's push to reduce government bureaucracy and inefficiency, extend the 2017 Tax Cuts and Jobs Act (TCJA) promote de-regulation could generally be positive catalysts for US growth in the coming year, there could be negative offsets to US and global growth from the tariff shocks. Moreover, the tariff revenue is likely seen as necessary to help fund the USD7.75trn increase in the fiscal deficit required to fund Trump's plans estimated by the Committee for a Responsible Federal Budget. However, the key difference this time under Trump 2.0, Trump is dead serious about tariffs as part of his "Make America Great Again" strategy, throwing elevated tariffs levels with fewer institutional/tangible constraints. Conversely, retaliation is also more likely as targeted countries see less flexibility for placating him, whether through increasing purchases of US goods, onshoring some manufacturing activities in the US etc. Hence, economic pain for both sides is a very plausible scenario ahead, even though it remains uncertain whether 2025 will bear the full brunt. A realistic scenario is that the strategic de-risking, even de-coupling, narrative will continue in the years to come.

GDP Growth Rates

% Change YoY	2023	2024F	2025F	2026F
US	2.5	2.8	2.0	1.5
Eurozone	0.5	0.7	1.2	1.3
Japan	1.9	-0.3	1.0	1.0
United Kingdom	0.1	1.0	1.4	1.4
New Zealand	0.7	0.3	2.0	2.1
Australia	2.0	1.5	2.3	2.2
China	5.2	4.9	4.8	4.6
Hong Kong	3.2	2.4	2.2	2.5
Taiwan	1.4	4.2	2.8	2.4
India	7.0	8.2	6.2	6.2
Indonesia	5.0	5.0	5.1	5.2
Malaysia	3.6	5.2	4.5	4.5
Philippines	5.5	6.0	6.0	6.0
Singapore	1.1	3.6	2.7	2.5
South Korea	1.4	2.2	1.9	2.3
Thailand	1.9	2.6	3.3	3.0
Vietnam	5.1	6.5	6.2	6.2

Note: India forecasts are based on the fiscal year. FY23 is April 2022 until March 2023.
Source: Bloomberg, IMF, OCBC.

Inflation Rates

% Change YoY	2023	2024F	2025F	2026F
US	4.1	2.9	2.4	2.4
Eurozone	5.5	2.4	2.0	2.0
Japan	3.3	2.5	2.0	2.0
United Kingdom	7.4	2.5	2.5	2.1
New Zealand	5.8	2.9	2.3	2.1
Australia	5.6	2.6	3.7	2.5
China	0.2	0.4	2.4	2.3
Hong Kong	2.1	1.7	2.0	2.3
Taiwan	2.5	2.1	2.2	1.8
India	6.7	5.4	4.6	4.7
Indonesia	3.7	2.5	2.8	2.7
Malaysia	2.5	1.8	2.7	1.8
Philippines	6.0	3.2	3.0	2.5
Singapore	4.8	2.4	2.0	2.0
South Korea	3.6	2.4	2.0	2.0
Thailand	1.2	0.4	2.2	2.0
Vietnam	3.3	3.7	4.0	4.0

Note: India forecasts are based on the fiscal year. FY23 is April 2022 until March 2023.
Source: Bloomberg, IMF, OCBC.

Central Bank Policy Rates

Benchmark Rate %	Current	2025F	2026F
US Fed Funds Rate	4.50-4.75	3.25-3.50	3.25-3.50
ECB Deposit Facility Rate	3.25	2.25	2.25
BoJ Target Rate	0.25	0.85	0.85
BoE Base Rate	4.75	3.75	3.50
RBNZ Cash Rate	4.25	3.50	3.25
RBA Cash Target Rate	4.35	3.85	3.50
China Loan Prime Rate (1-year)	3.10	2.70	2.70
CBRC Discount Rate	2.00	1.75	1.75
Hong Kong Base Rate	5.00	3.75	3.75
BI Rate	6.00	5.50	5.50
BNM Overnight Rate	3.00	3.00	3.00
BSP Overnight Reverse Repo	6.00	5.50	5.50
RBI Repurchase Rate	6.50	6.00	6.00
Singapore SORA*	3.06	2.50	2.40
BOK Target Overnight Call	3.25	2.50	2.50
BOT Repurchase Rate	2.25	2.00	2.00
SBV Refinancing Rate	4.50	4.50	4.50

Source: Bloomberg, OCBC Estimates. Forecasts are as of end-calendar.
* Note: SORA is not a policy rate.

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Australia

Australia: No hurry to cut

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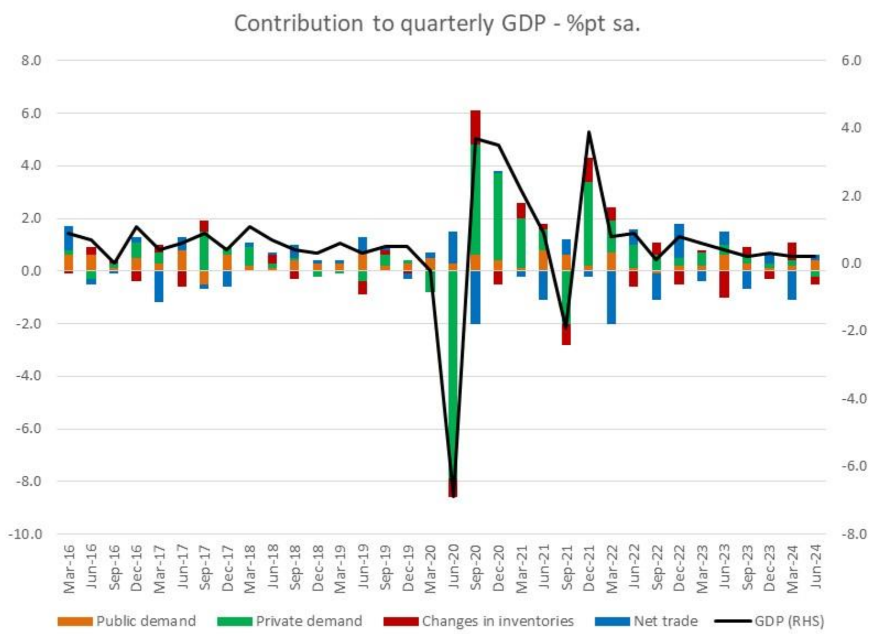
- The economic growth outlook should pick up slightly into 2025, driven by growth in domestic demand as household consumption gradually recovers while public demand is expected to continue supporting economic growth.
- Headline CPI may stay within the Reserve Bank of Australia's (RBA) target range in 1H25 but may creep higher into 2H25 when electricity rebates are scheduled to unwind. On the other hand, services inflation may decline gradually alongside an anticipated softening in labour market conditions in 2025. Housing inflation should also ease next year amid expected softening in net migration.
- We believe the RBA is not in a hurry to ease monetary policy, given a still tight labour market and sticky services inflationary pressures. Continued progress with disinflation, alongside most DM economies on an easing cycle should still provide an opportune window for RBA to ease monetary policy in 2025. Our base line is for two 25bp cuts, one in 2Q25 and one in 3Q25.

Economy may pick up slightly

The economy expanded 0.2% QoQ in 2Q24. Underlying data indicates a slight decline in aggregate demand momentum, primarily due to weaker-than-anticipated household consumption while exports (iron ore and education) fared better.



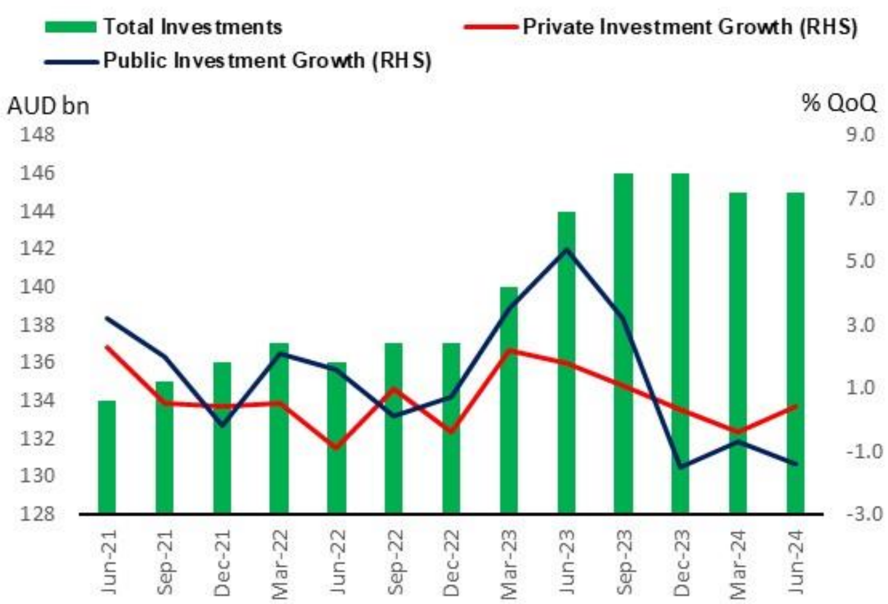
Source: Australian Bureau of Statistics, OCBC Research.

Australia

Growth in private demand was weak, while public demand remained robust, driven by the provision of increased government services and support for households, particularly in disability and aged care. Meanwhile, household consumption faced challenges from earlier declines in real disposable incomes and tight financial conditions. Dwelling investment remained sluggish due to limited new construction projects and capacity constraints affecting the backlog of work. Business investment fell in 1H24 after a strong performance in 2023, while growth in spending by tourists and international students slowed.

The economic growth outlook should pick up slightly moving into 2025, driven by growth in domestic demand as household consumption gradually recovers. Meanwhile, public demand is expected to continue supporting economic growth.

Household consumption should recover over time due to growth in real incomes as the Stage 3 tax cuts take effect, inflation eases, and the RBA lowers rates in due course. Information from the RBA's liaison program and the ABS Capital Expenditure Survey indicate that companies have scaled back their investment plans for the upcoming year due to ongoing construction cost pressures and delays in renewable energy projects. On the other hand, dwelling investment may be stronger, consistent with the increase in building approvals observed over the past year. Overall, private investment may pick up at some point in 2025, owing to a substantial pipeline of infrastructure projects, advancements in digitisation, the transition to renewable energy as well as an expected decrease in cash rate, from historically high levels.



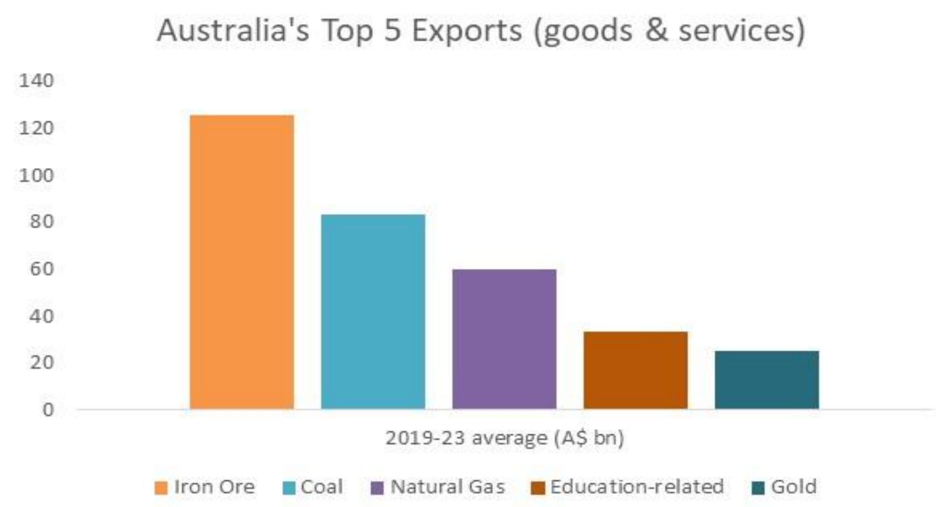
Source: Australian Bureau of Statistics, OCBC Research.

Australia

On public investments, there may be some weakness as some projects are being deferred. However, this is likely to be temporary as there is still a large pipeline of engineering work and a list of investment spendings that were announced in the 2024-25 government budget. The government is committing AUD16.5bn for new and existing projects. Some of the major ones include the North East Link motorway project, METRONET in Greater Perth and other major road and rail infrastructure across the country in NSW, Queensland, etc.

Tighter Student Visa Policy may somewhat impact growth in 2025

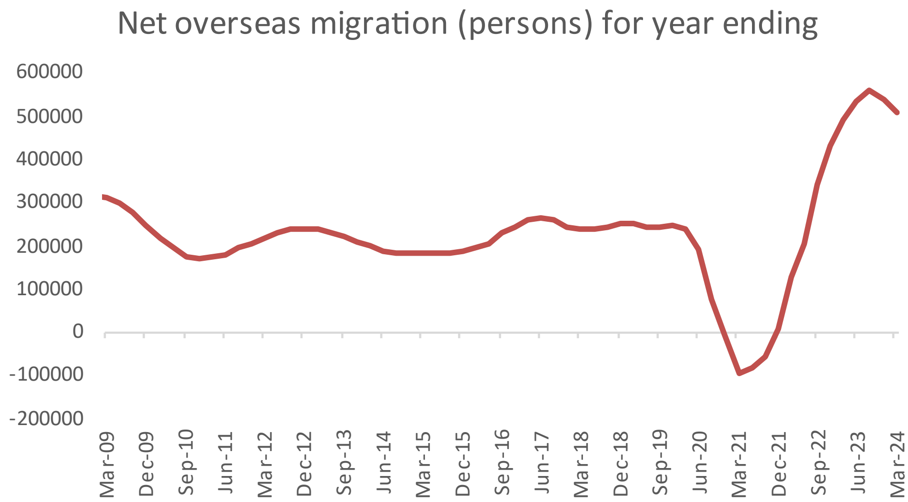
Education exports are typically a strong driver of the economy, with education exports amongst its top 5 largest earners, behind iron ore, coal and natural gas.



Source: Australian Bureau of Statistics, OCBC Research.

In 2023, international education was worth AUD47.8bn, about 2.7% of GDP. However, this may change moving forward as the tightening in student visa policies are starting to affect international student arrivals. As of 1 July, the fee for an international student visa was raised by 125% to AUD1,600 (from AUD710), while visitor visa holders and students with temporary graduate visas are banned from applying onshore for a student visa. English language requirements were also tightened earlier in March while the amount of savings required for international students to apply for a visa saw its second increase in May to AUD29,710. Home Affairs Minister Clare O'Neil said that the tightening of student visa rules was intended to restore integrity to the international education system and "create a migration system which is fairer, smaller and better able to deliver for Australia". Over the last few years post-pandemic, there was a surge in arrivals of foreign workers and students that had put pressure on the tight housing market. The government has indicated that the tightening of rules could halve its migrant intake over 2 years. There are already signs that net migration and international student arrivals are already slowing. The RBA has also factored in the impact of a tighter student visa policy on slower expected growth in net overseas migration. This in turn will reduce growth in both demand and supply in the economy from mid-2025 but there will not be a material impact on the amount of spare capacity in the economy over the medium term.

Australia



Source: Australian Bureau of Statistics, OCBC Research.

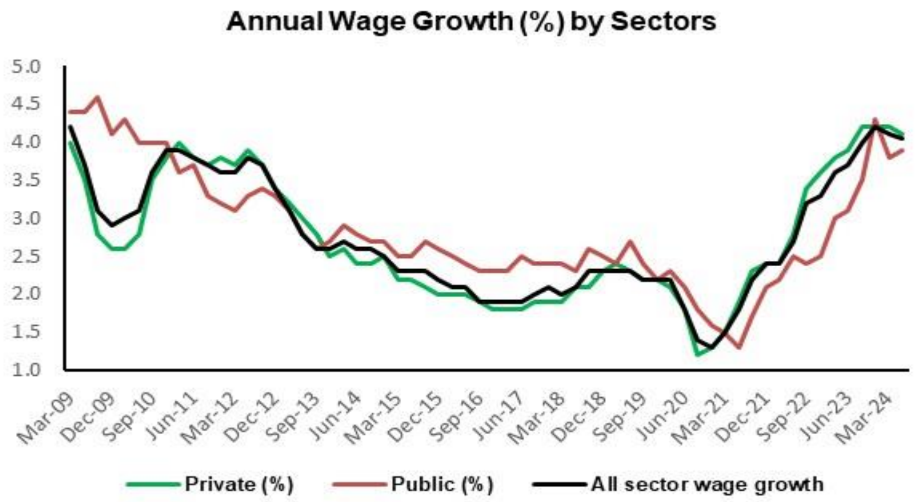
Still tight labour market, but will ease in 2025

The labour market remains tight, with the unemployment rate holding around 4.1% over the last 6 months. The employment to population ratio and participation rate have also increased to record highs, reflecting strong demand for labour. The growth in employment has been driven by the non-market sector – industries that are typically less sensitive to the business cycle, including health care and education. However, other labour market surveys – NAB employment index, ANZ job ads - suggest some normalising in labour market conditions could be on the cards moving into 1H25.

Source: Bloomberg, OCBC Research.

Australia

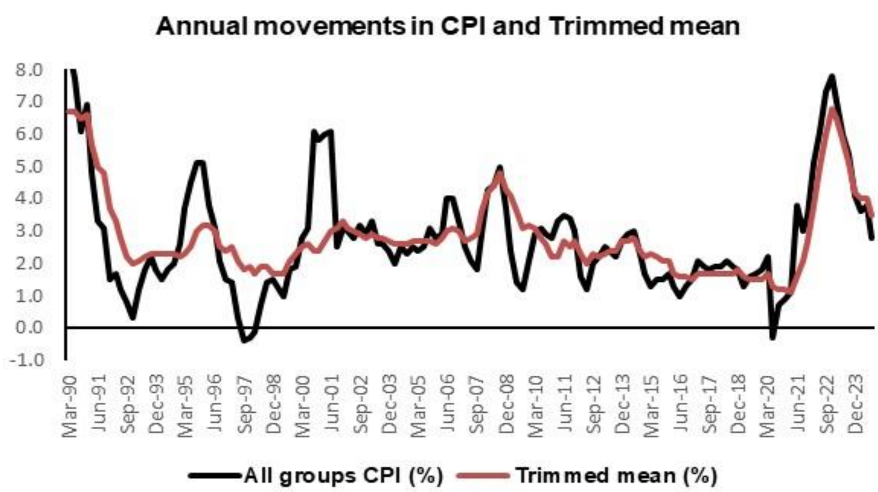
Wage growth has peaked in the current cycle and has continued to ease. 2Q24 wage growth was 4.05% YoY (versus 4.1% in 1Q24 and the peak of 4.2% in 4Q23). Easing in wage growth was more strongly observed in the private sector while public sector wages were higher, due to one-off increase in wages among public servants. Nevertheless, the trend of wage growth is expected to moderate into 2025 as labour market tightness eases. RBA has also recently lowered its projection for the wage price index to 3.2% for end-2025 (versus the previous projection of 3.5%). This adds to our conviction that RBA will calibrate monetary policy settings into 2025.



Source: Australian Bureau of Statistics, OCBC Research.

Inflation back in RBA's target range

The disinflation journey remains on track. Headline CPI came in at 2.8% YoY for 3Q24 (versus 3.8% in 2Q24). The main drivers contributing to the disinflation were first, a sharp fall in electricity costs due to Commonwealth and state government rebates; second, a decline in fuel prices; third, fall in urban transport costs (due to state government transport subsidy) and fourth, slowdown in rent inflation (due to higher Commonwealth Rent Assistance).

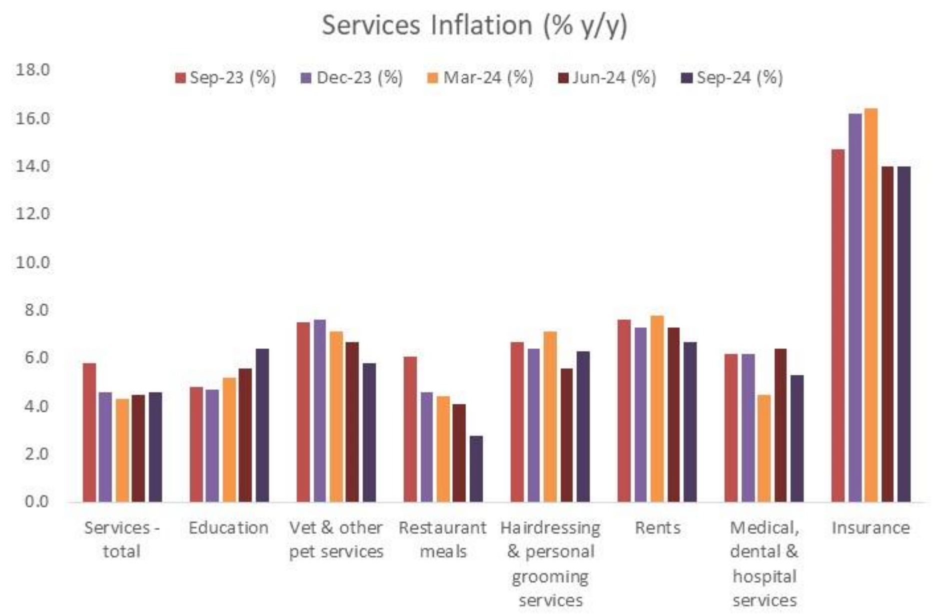


Source: Australian Bureau of Statistics, OCBC Research.

Australia

The easing in imported inflation amid normalising global supply chains last year has passed through onto domestic goods prices. The statement on monetary policy (November 2024) indicated there has been little evidence that elevated shipping costs are impacting retail prices but there have been some reports of retailers' margins being affected by shipping cost rises over the past few months.

Elsewhere, domestic market services price inflation remains elevated. Strong domestic cost pressures in both labour and non-labour inputs have continued to keep services inflation high in recent quarters. Childcare inflation also accelerated, reflecting higher operating costs.



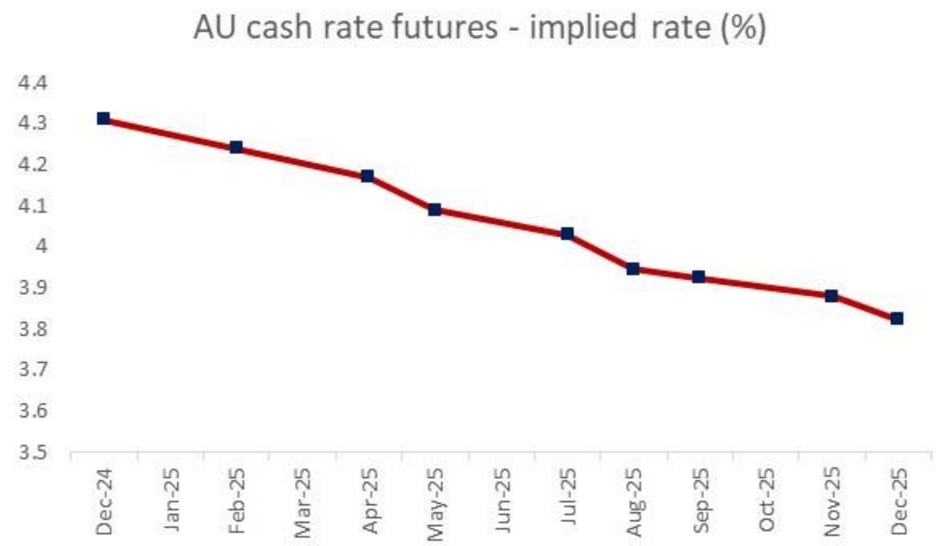
Source: Australian Bureau of Statistics, OCBC Research

RBA on track to calibrate policy settings, but likely in 1Q25

RBA kept its cash rate steady at 4.35% at the November meeting. The tone in the accompanying statement was similar to the September one, showing no indication of a pivot yet. Key highlights include first, the RBA indicated that "underlying inflation remains too high" and does not expect inflation to sustainably return to the midpoint of its target until 2026. Notably, there has been a subtle change in language, as the RBA now refers to the "midpoint" instead of simply the "target," along with a downward revision of inflation forecasts. Second, there was mention that "A range of indicators suggest that labour market conditions remain tight". Additionally, the paragraph discussing the labour market was slightly longer than in the previous statement. Third, the statement also mentioned "Sustainably returning inflation to target within a reasonable timeframe remains the Board's highest priority". This suggests that the RBA will not react hastily to the recent easing in inflation. Fourth, the statement kept the phrase "the need to remain vigilant to upside risks to inflation and the Board is not ruling anything in or out".

Australia

RBA's recent rhetoric suggests that policymakers are not in a hurry to ease policies, given a still tight labour market and sticky services inflationary pressures. Recent progress with disinflation into RBA's 2 – 3% target range also did not see any dovish shift in RBA's tone or language.



Source: Bloomberg, OCBC Research.

We are of the view that RBA is not in a hurry to ease policies, given a still tight labour market and still sticky services inflationary pressures. Continued progress with disinflation in Australia, alongside most DM economies on an easing cycle should still provide an opportune window for RBA to ease monetary policy in 2025. Our base line is for two 25bp cuts, one in 2Q and one in 3Q25. Markets implied cash rate futures as of 9 November 2024 points to a mild rate cut trajectory (total of 50bps) for RBA in 2025.

Headline CPI may stay within target range in 1H25 but may creep higher into 2H25 when electricity rebates are scheduled to unwind. On the other hand, services inflation may decline gradually alongside an anticipated softening in labour market conditions next year. Housing inflation should also ease next year amid expected softening in net migration.

Euro Area

Euro Area: Slow recovery ahead amidst political uncertainty

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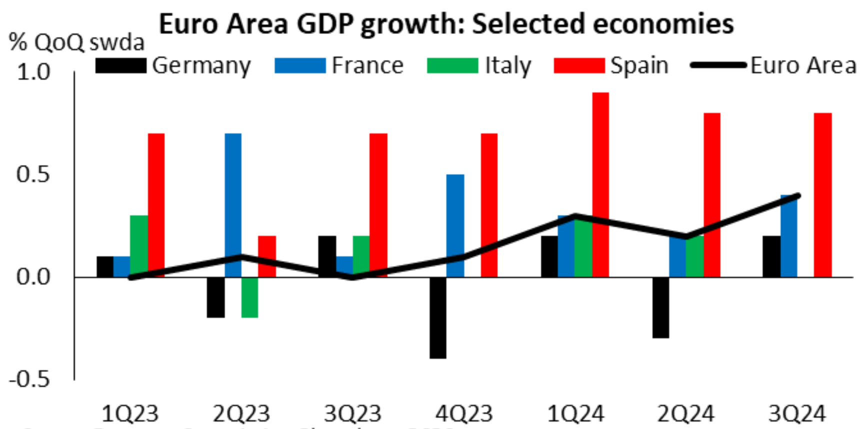
Assisted by Daryl Chan

- Stronger than expected 3Q24 GDP growth raises hopes for a stronger and more sustained economic recovery as we move into 2025. The manufacturing recovery has been delayed, but we believe that the worst has passed, and the sector will recover, albeit slowly and gradually. Domestic consumption has remained resilient and will be supported by monetary policy easing. The economy is likely to expand by 0.7% in 2024 and accelerate to 1.2% in 2025.
- There are signs that the labour market is cooling, albeit gradually. Wages will continue to remain supportive of consumption but moderate enough for inflation to continue declining towards the European Central Bank's (ECB) 2% target. Inflation may average 2.4% YoY in 2024, before subsiding further to 2.0% in 2025. As such, the ECB will continue to have room to ease monetary policy, and we see a further 25bp cut in 2024 and a total of 75bps cuts in 2025.
- Elections will remain a major topic in 1H25, as Germany is set to head to the polls after Olaf Scholz fired Finance Minister Christian Lindner, resulting in the breaking up of the SPD-Greens-FDP coalition. Whether the French government will be able to effectively pass laws also remains to be seen as the Barnier-led government remains on a shaky footing, depending on conditional support from the far-right National Rally to enact legislation.

A slow and gradual recovery

The economy rebounded in 3Q24 advance estimates to 0.4% QoQ sa (0.9% YoY), a slight pickup from 0.2% growth in 2Q24. Of the four major economies, France, Spain and Germany all showed stronger growth in 3Q24, while growth in Italy was 0% on a QoQ basis. Growth remained muted throughout 2024, with year-to-date GDP growth at 0.7% YoY through the first three quarters. Tepid growth has been dragged mainly by Germany, the Euro Area's largest economy which accounted for 24.2% of GDP as of 2023.



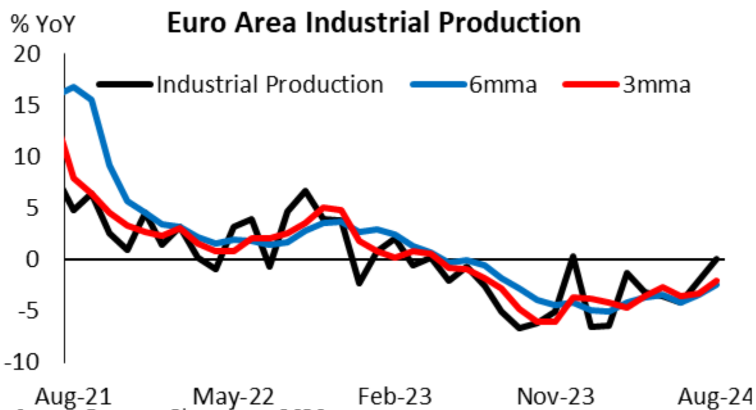
Source: European Commission, Bloomberg, OCBC.

Euro Area

The Euro Area is tipped to grow 0.7% YoY in 2024, implying a slight uptick in growth from 0.5% the year prior. Although the road to recovery has been bumpy, we anticipate a more stable economic environment moving into 2025. We expect full year growth to pick up to 1.2% YoY in 2025, on account of stronger demand and supported by a slow, gradual manufacturing recovery.

Tepid manufacturing will remain, but reaching the end of the road

The manufacturing sector remained sluggish. The recovery pace was constrained in 2H24 due to weak external and domestic demand. Industrial production contracted until August 2024, when it eked out 0.1% YoY growth. This brought year-to-August industrial production to an average -3.4% YoY.

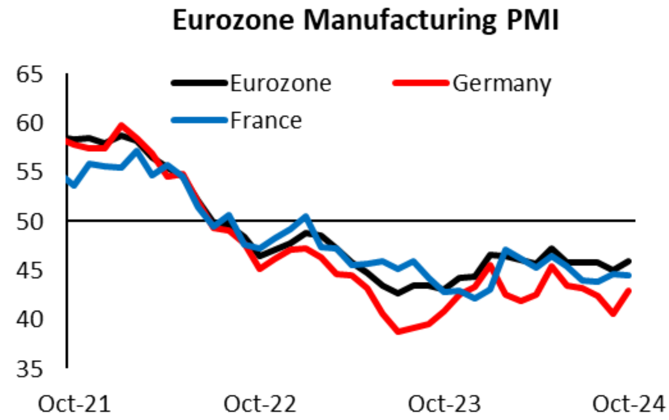


Source: Eurostat, Bloomberg, OCBC.

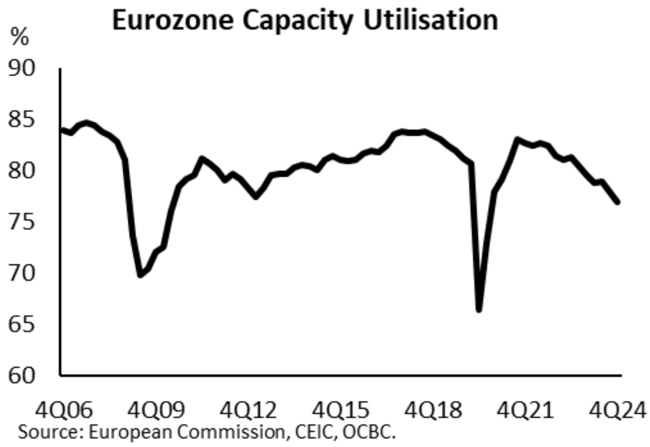
Poor industrial production has also been compounded by reports of automobile manufacturers shutting down plants due to poor sales and low-capacity utilisation. For the first time in its 87-year history, Volkswagen, the largest automobile manufacturer in the world, is set to close three factories in its home country of Germany. This unprecedented move is not isolated, as tyre maker Michelin also plans to close two plants in France, while numerous European-based carmakers such as Stellantis, Mercedes Benz, and BMW have issued profit warnings on account of weaker demand. According to the European Automobile Manufacturer's Association, the automobile industry accounts for ~7% of GDP and employs, directly and indirectly, around 13mn workers as of 2023. As such, profit warnings and factory closures highlight the challenges plaguing the automobile and by extension, the manufacturing sector in the Euro Area.

In the near term, the manufacturing recovery remains relatively subdued. Eurozone manufacturing PMI has remained below 50 for 28 consecutive months, indicating a prolonged contraction of output that has yet to recover. The European Commission sees capacity utilisation continuing to decline through 4Q24 to 76.9%, indicating that the manufacturing recovery is unlikely to start in 2024.

Euro Area

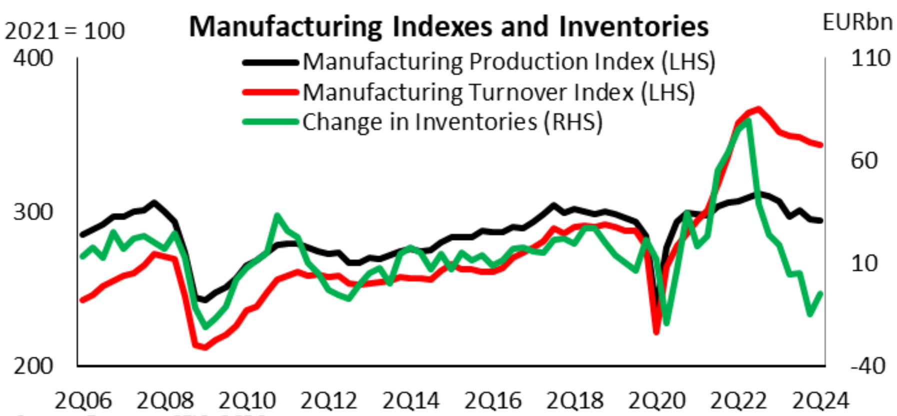


Source: S&P Global, Bloomberg, OCBC.



Source: European Commission, CEIC, OCBC.

However, we expect things to turn around in 2025 for the manufacturing sector. In the ECB's November Survey on the Access to Finance of Enterprises, Eurozone firms expect turnover to continue rising in 4Q24. This indicates some sustained demand for manufacturers. The ECB expects economic growth in 2025 to be supported by stronger exports and improving consumption on the back of rising domestic demand. With the change in inventories turning negative after the large buildup in 2021, existing supply of goods for producers are becoming scarce. We expect a normalisation of inventory change back to pre-pandemic trends ahead.



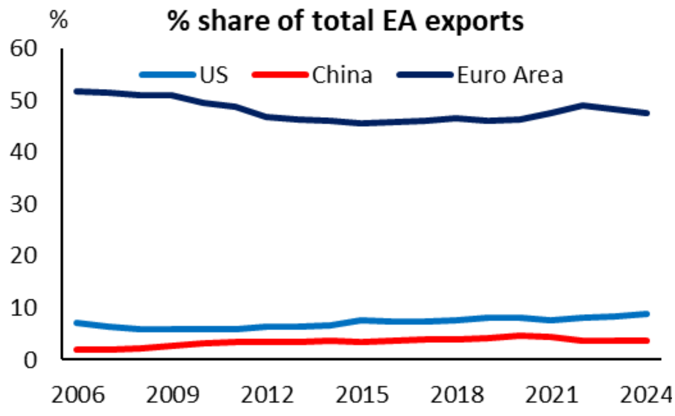
Source: Eurostat, CEIC, OCBC.

Mixed demand outlook

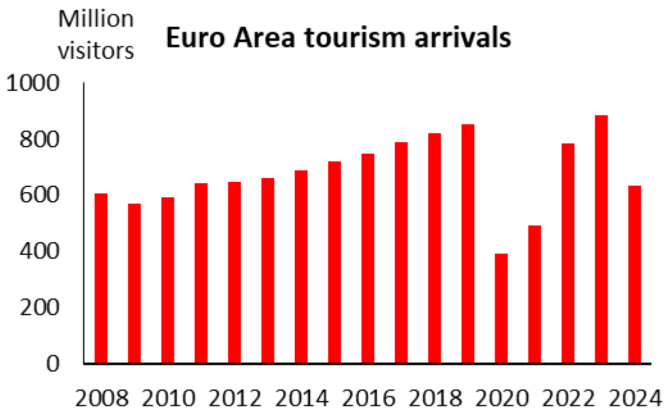
The external demand picture remains hazy, as the rising threat of protectionism looms over the Euro Area. With President-elect Donald Trump returning to the White House in January 2025, it remains to be seen if he enacts his proposed universal 10-20% tariff on all US trading partners of the US apart from China. Given that the US is the largest trading partner of the Euro Area, this is a risk that bears watching in 2025. Supplementing the hazy picture from the US is the risk of further escalation of trade tensions with China. The EU has concluded its anti-subsidy investigation into EV exports from China by imposing countervailing duties on EV imports for five years. China has opposed the ruling and launched a suit with the WTO. Further escalation could result in tit-for-tat measures imposed by China.

Euro Area

Euro Area exports to the US account for ~8% of total exports, while exports to China account for ~3.6% of total exports. While these are not small numbers, they represent a smaller share than intra-Euro Area trade, which accounts for more than 45% of total Euro Area exports. Moreover, the Euro Area is receiving rising tourist numbers - with total visitors in 2023 already up 3.3% from 2019 levels. For 2024 year-to-August, tourist arrivals are up 2.3% YoY and up 6.4% from 2019 year-to-August levels. This healthy rebound in tourism figures will be supportive of domestic demand in the Euro Area.

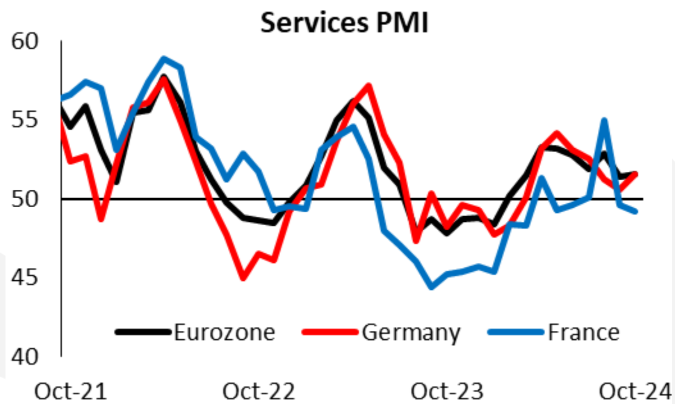


Source: Eurostat, CEIC, OCBC.

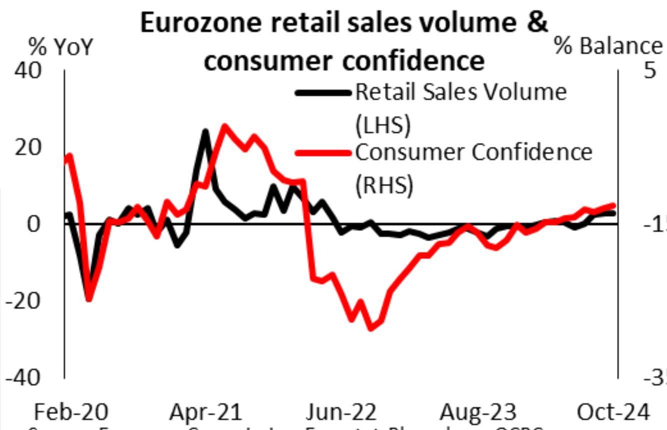


Source: Eurostat, CEIC, OCBC.

The services sector remains the bright spot in the Euro Area. The Eurozone services PMI remained steady at 51.6 in October, marking the 9th consecutive month of expansion. As the ECB continues to ease monetary policy, this has had a positive effect on Eurozone consumer confidence and retail sales. Retail sales volume growth in YoY terms has strengthened in recent times, remaining above the 2% YoY growth mark for the last three months from August to October. This has been accompanied by an uptrend in Eurozone consumer confidence, albeit still in negative territory.



Source: S&P Global, OCBC.

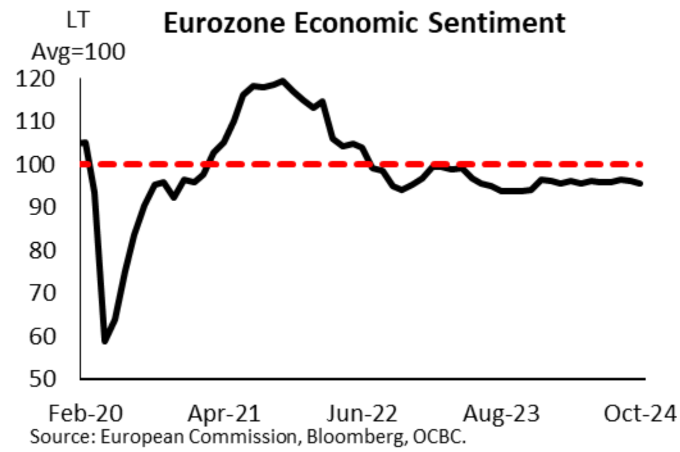


Source: European Commission, Eurostat, Bloomberg, OCBC.

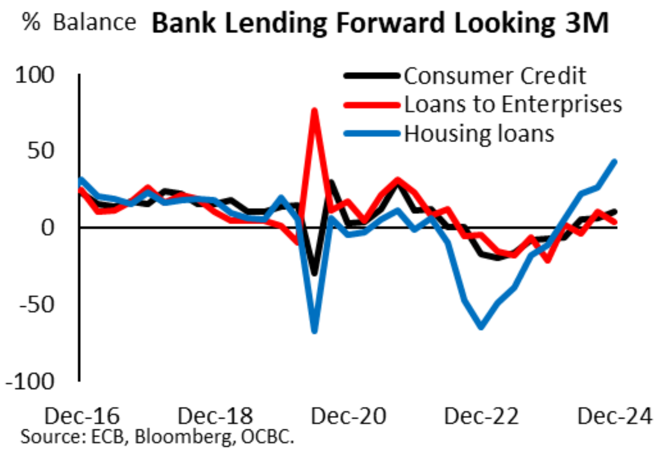
Euro Area

Overall economic sentiment remains muted at this juncture, having been below the long-term average since June 2022. Economic sentiment has struggled to rise to the long-term average, indicating persistent challenges within the overall Eurozone economy that may be structural in nature. Mario Draghi's report on European Competitiveness could help address some of these potential structural issues. The report highlights issues that have been plaguing the union and potential solutions, as well as identifying key areas for potential growth, such as renewables, the green industry and the defence sector. These changes will take time and require large support from all member countries but could bring about strong changes that will improve the Euro Area and reduce structural drags on the economy.

Meanwhile, the forward looking 3-month bank lending surveys continue to show increased demand for loans to enterprises, consumers and housing. The ECB reports that this pickup has been driven by the declining level of interest rates, while consumer credit demand was also boosted by improving consumer confidence. These further signal a strong recovery arising from the loosening of monetary policy and bodes well for the Euro Area moving forward. Hence, the short-term demand outlook remains cautious, but may improve moving forward.



Source: European Commission, Bloomberg, OCBC.



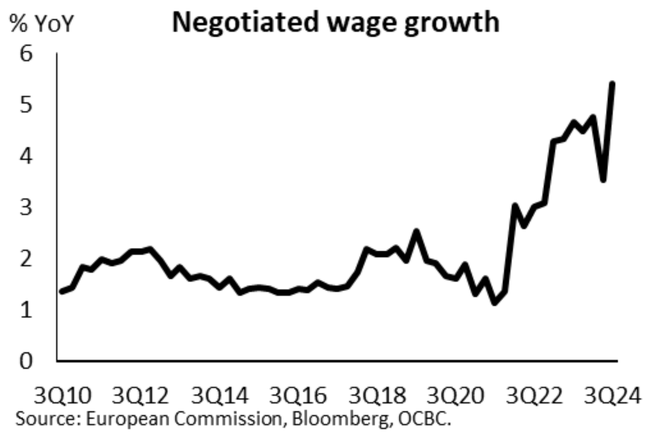
Source: ECB, Bloomberg, OCBC.

Labour market remains supportive of growth and disinflation

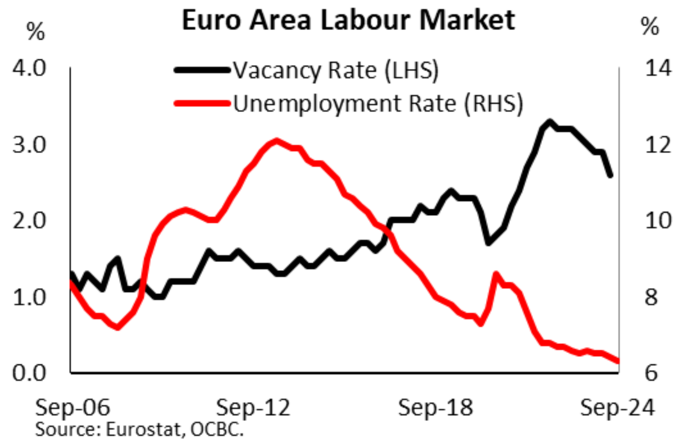
Labour market inflationary pressures are expected to ease through 2024 and into 2025, but still remain on a stable footing to support domestic consumption. The unemployment rate continues to tick downwards through 2024, indicating healthy demand for workers throughout the Euro Area. Negotiated wage growth[1] ticked up to 5.4% YoY in 3Q24, in part due to an 8.8% rise in Germany, which indicates some support for domestic consumption but potential inflationary pressures. The Bundesbank believes that wage growth has reached its peak, with Germany's largest labour union, ig Metall, striking an agreement for lower wage growth in the coming years. The agreement ensures manufacturing workers will have their salaries rise by 2% in April 2025 and 3.1% in April 2026. Although the job vacancy rate has eased slightly, the labour market is supportive of both the growth and inflation outlook.

[1] Negotiated wages are the ECB's wage growth tracker of the outcomes of collective bargaining agreements. It excludes bonuses, overtime and other individual compensation that is not linked to collective bargaining.

Euro Area

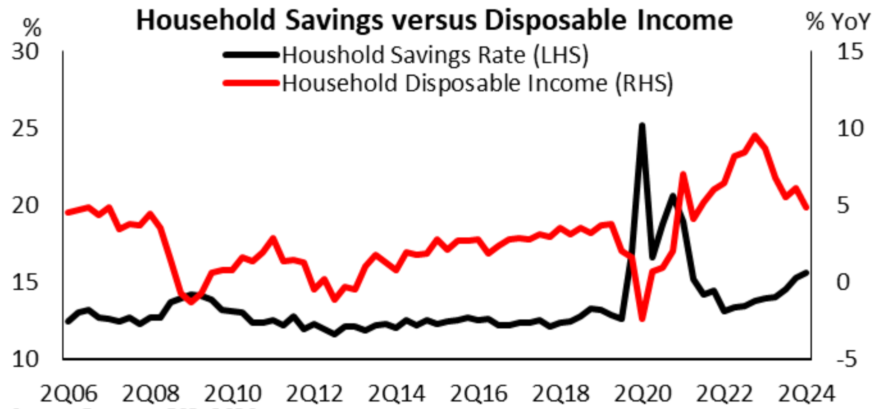


Source: European Commission, Bloomberg, OCBC.



Source: Eurostat, OCBC.

Household disposable income growth has also begun to moderate from its 2023 highs, in part due to a higher average household savings rate in the Euro Area. This will help to dampen still-strong wage growth and reduce demand-driven inflationary pressures.

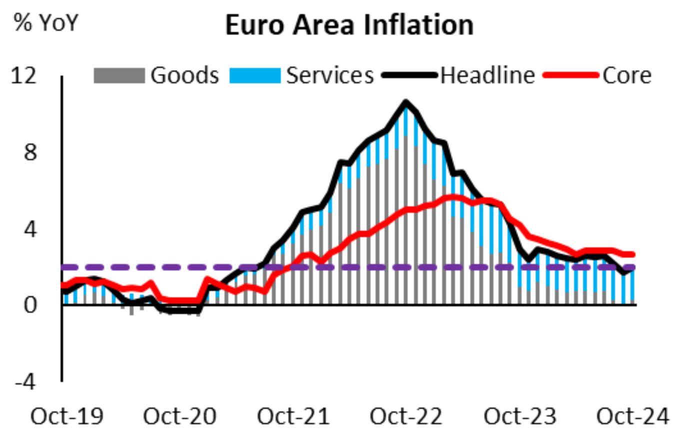


Source: Eurostat, ECB, OCBC

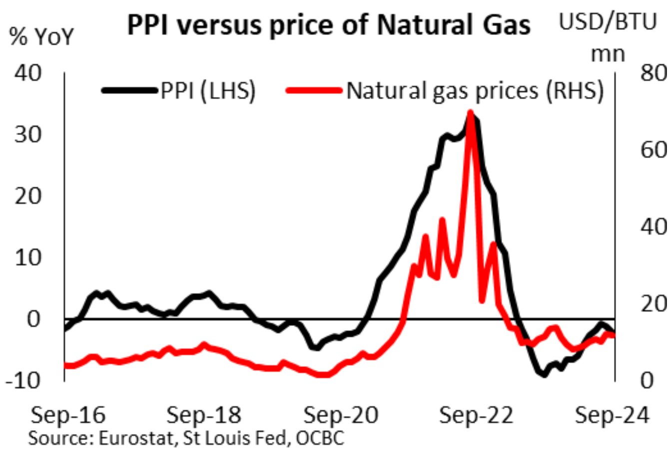
The disinflation trajectory remains intact, with the ECB recently shading down its inflation forecasts for 2025 at its 17 October monetary policy meeting. It now expects inflation to reach its 2% target “in the course of 2025” instead of “over the second half” of 2025. Headline inflation dipped below the ECB’s 2% target in September and remained at 2% in October, with year-to-October inflation averaging 2.4% YoY.

Core inflation remains sticky at 2.7% YoY as of October but remains on the downward path. The year-to-October core inflation averaged 2.9%, lower than the 5.2% in the same period last year. Supply side driven pressures that caused the sharp rise in inflation from 2023-2024 have largely eased, as oil and natural gas prices continue to moderate. Energy prices are expected to remain low, with lingering demand concerns and the looming resumption of OPEC+ oil production.

Euro Area



Source: Eurostat, CEIC, OCBC.



Source: Eurostat, St Louis Fed, OCBC

Monetary policy outlook is clear

The ECB has followed a methodical approach in its monetary policy easing cycle. It has continued to emphasise its "data-dependent, meeting by meeting" approach to monetary policy, with ECB Governor Christine Lagarde often offering little forward guidance on the pace of monetary policy easing. A new risk has emerged in monetary policy decisions, with the ECB minutes of the 17 October meeting showing that some members saw a risk of inflation undershooting the 2% target in 2025. The ECB cited 'prudent risk management' as a major motivator to cut rates, aiming to get ahead of the curve. The October cut would provide insurance against potential downside risks to inflation and support a soft-landing, while simultaneously maintain flexibility of not cutting in December if data did not merit such action. Cumulatively, the ECB has eased by 75bp this year, bringing the deposit facility rate to 3.25% as of November 2024. The ECB maintains that it "will keep policy rates sufficiently restrictive for as long as necessary". Our baseline remains for a 25bp cut at the ECB's December meeting and for a total of 75bps worth of cuts in 2025.

Political and fiscal uncertainty will persist

The French snap election results were inconclusive as no party managed to gain a clear majority to form a parliamentary majority, with the left wing New Popular Front (NFP), centrist Ensemble and far-right National Rally (RN) all roughly even. President Emmanuel Macron appointed Michel Barnier of the right-wing The Republicans (LR) party to form a minority government, with support from both the LR and Ensemble. The RN has said that they will not launch a no-confidence vote for the government and would consider each legislation on a case-by-case basis, allowing the Barnier-led government to stay in power. However, his position remains shaky, as the left-wing NFP has already launched a no-confidence vote once, which failed due to the RN not voting for it. Concessions will have to be made to the RN to ensure their support for the government. To the comfort of the wider Euro Area, Barnier has been pro-European collaboration, indicating ongoing French support for the overall European Union.

Euro Area

Rising budget deficits and the issue of fiscal consolidation will be key themes to watch moving forward in France. The 2024 budget deficit is set to widen to 6.1% of GDP, significantly higher than the government's initial estimate of 5.1% of GDP. France's current debt to GDP ratio currently stands at 112% as of 2Q24, with the European Commission expecting it to rise to 113.8% by 2025 – this far exceeds the Maastricht Treaty's mandate of a 60% debt to GDP ratio. New EU fiscal rules now require countries to keep budget deficits within 3% of GDP and gross government debt with 60% of GDP. If countries have debt exceeding these levels, they will be required to show that they are sufficiently reducing debt to the reference value 'at a satisfactory pace'. The Barnier government's first attempt at passing a budget in parliament was subject to numerous changes by opposition parties and was still voted down, highlighting the increasing political and fiscal uncertainties facing France.

The same two issues also plague the Euro Area's largest economy Germany, who is set to head to the polls in February as the Bundestag is set to hold a vote of confidence on 16 December. Chancellor Olaf Scholz of the Social Democrats (SPD) fired his Finance Minister Christian Lindner of the Free Democrats (FDP), marking an end to the traffic light coalition of the SPD, FDP and the Greens. The coalition government is set to lose the vote of confidence, which will pave the way for elections in February. While France will need to cut back spending, Germany's issue remains the opposite - it needs to spend more money.

The coalition government could not agree with regards to the debt brake enshrined in the German constitution. The debt brake limits new government debt to 0.35% of GDP, curtailing government spending that the SPD and Greens have desired to fix structural problems that they believe to have plagued the German economy. However, the FDP has been opposed to removing the debt brake, having campaigned on ensuring that it would be maintained, and that the fiscal deficit would remain controlled. The opposition Christian Democratic Union (CDU) currently leads in the polls, led by leader Friedrich Merz. While Merz has staunchly opposed any debt brake reform in the past, he had faced increasing calls from party cadres to include such plans in his campaign materials and has changed his tone on the issue. He has now signalled that he could be open to reforming the debt brake, provided that there were clear goals to achieve, such as boosting investment. Regardless of the outcome, fiscal and political uncertainties will continue to cloud the outlook of the Euro Area's two largest economies.

Japan

Japan: Gradual policy normalisation

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Assisted by Ang Hshi Qi

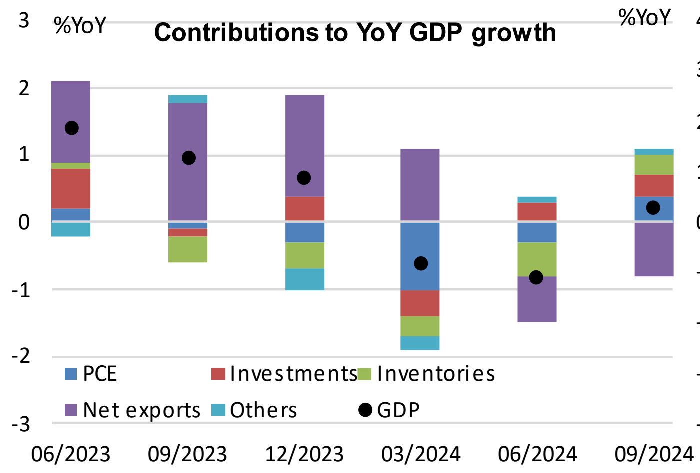
- The Japanese economy is likely to expand moderately in the quarters ahead, as private consumption recovers further upon wage increases, business fixed investment plans have stayed buoyant, while contribution from net exports may be small.
- Potential constraint on further increase in the labour force, and changing firms' wage and price setting behaviour, point to the prospects for the virtuous cycle between wage growth and inflation continuing to play out, and hence for inflation to stay sustainably around the 2% target.
- The inflation backdrop should allow the Bank of Japan to continue with monetary policy normalisation. We expect four 15bp policy rate hikes between now and end-2025.

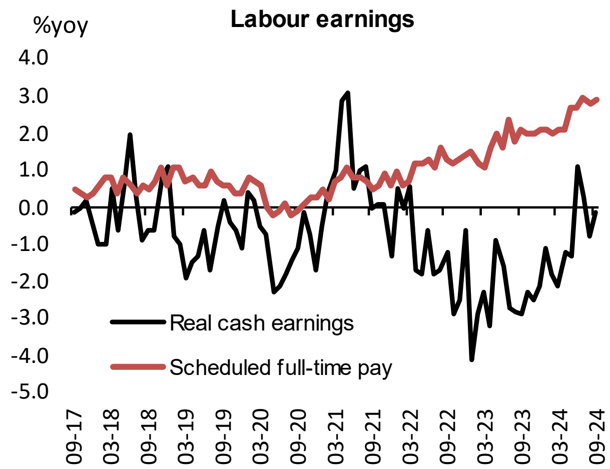
Moderate growth ahead

The Japanese economy expanded by 0.2% QoQ seasonally adjusted in 3Q24, after the 0.5% expansion in 2Q24. Consumption growth picked up for a second quarter, to +0.5% QoQ in 3Q following the +0.4% QoQ in 2Q, versus -0.3% QoQ in 1Q. The drag to overall sequential GDP growth was net exports. In year-on-year terms, GDP grew by 0.3%, after negative growth for two quarters. Private consumption, investments and change in inventories contributed positively to growth, while net exports was a drag. The respective drivers and draggers of growth were mostly in line with our expectations except inventory which has been a volatile item. Private consumption should continue to hold up, but with somewhat subdued domestic residential investment and likely minimal contribution from net exports, 4Q24 YoY growth may come in mostly flat, leading to a small contraction of 0.3% in the economy for the full year of 2024. Nevertheless, we forecast 2025 GDP growth to rebound to 1.0%, premised on further pick-up in private consumption and investment plans gaining momentum, while contributions from net exports may be small.

Private consumption is expected to increase moderately over the coming quarters, continuing to contribute to GDP growth. Real cash earnings have been hovering around zero growth in recent months, having recovered from the YoY falls which had lasted for two years. The situation may further improve as wage growth gradually catches up with price increases. Meanwhile, the government has proposed new inflation relief measures – which may require additional budget to fund, likely to be discussed at an extraordinary parliamentary session. On a net basis, these measures may help promote private consumption at the margin. Overall, private consumption is likely to hold up well. The supplementary budget of up to JPY21.9tn to support low-income households and to assist cutting-edge industries may also give a lift to GDP.

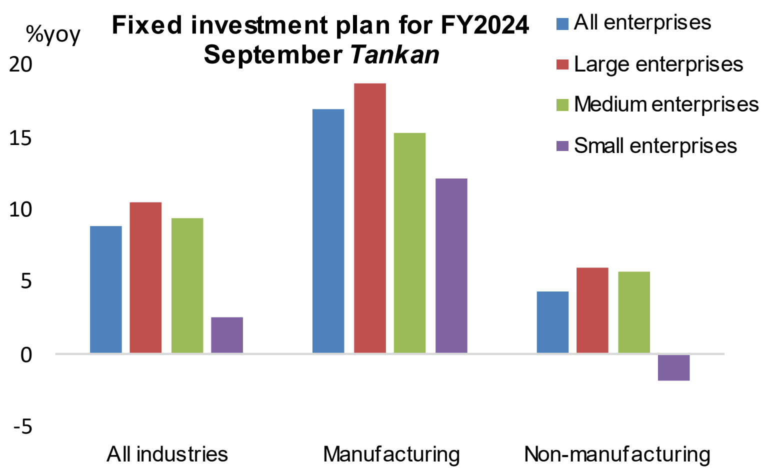
Japan





Source: Cabinet Office, Bloomberg, OCBC Research.

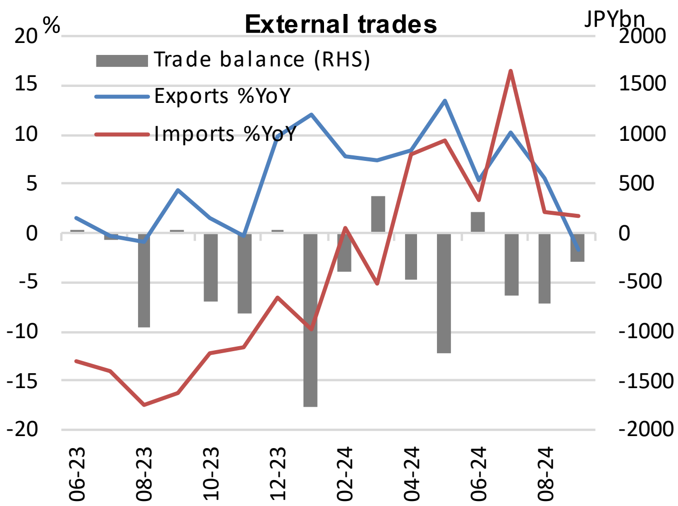
Business fixed investment has been on a moderate increasing trend. Investment plans have also become more buoyant as reflected by the latest *Tankan* survey in September, with 8.9% YoY overall growth (all enterprises, all industries) projected for FY2024. Although this projection covered up to 1Q25 only, any plans that cannot be deployed within this period may spill over onto FY2025. Bottom line is business fixed investment is expected to contribute to overall growth.

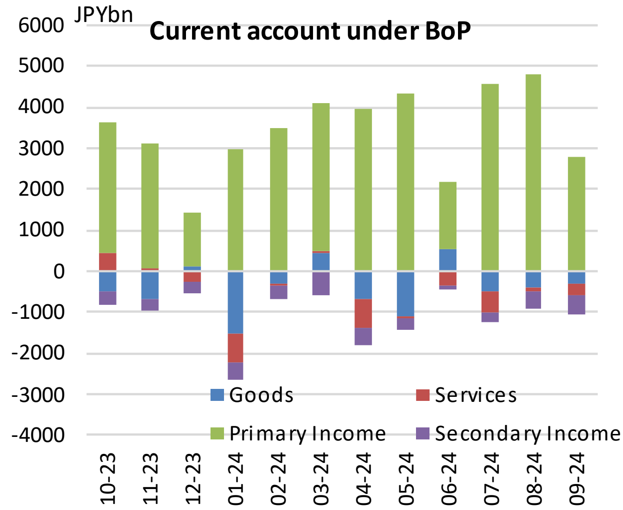


Source: Bloomberg, OCBC Research.

Export performances have been mixed across markets and items. Looking ahead, exports are likely to be supported by a recovery in global demand for IT-related goods. In terms of the broader external demand by major markets, exports to China have been relatively weak, while exports to the US have been relatively strong. The US economy may stay resilient, while our base-case is for the China economy to recover partly thanks to government stimulus measures. However, imports are also likely to hold up and potentially grow alongside domestic spending power, limiting contributions from net exports to GDP growth. The growth outlook of overseas markets remains uncertain and risks to the export outlook stem naturally from downside risks to the global growth outlook.

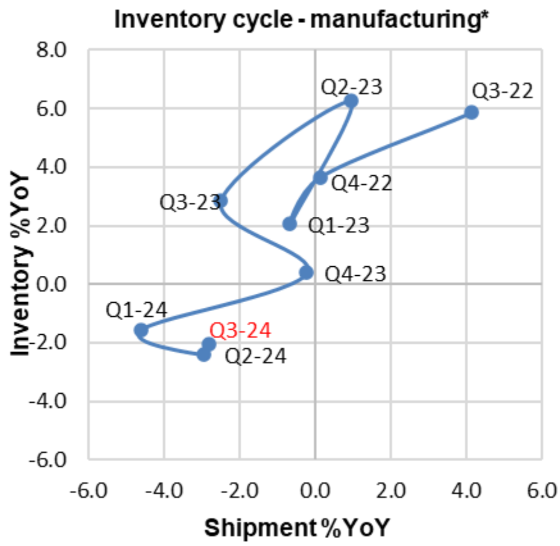
Japan





Source: CEIC, OCBC Research.

Change in inventories can be a volatile expenditure component of GDP. For Japan, on a year-on-year basis, change in private inventories contributed negatively to growth for four quarters in a row from 3Q23 through 2Q24. The positive contribution from change in inventories in 3Q24 was a surprise to us and the risk is that it may not be repeated in the next quarter. From the production side, manufacturing production shipment fell YoY for a fifth quarter, while the YoY fall in producer's inventory index lasted for three quarters. Moreover, the decline in production shipments were mostly deeper than that of the inventory index. Hence, the risk is the inventory drawdown has not been completed and there may be potentially a further drawdown or a lack of restocking.



Source: CEIC, Bloomberg, OCBC.
*Production shipment index and producer's inventory index.

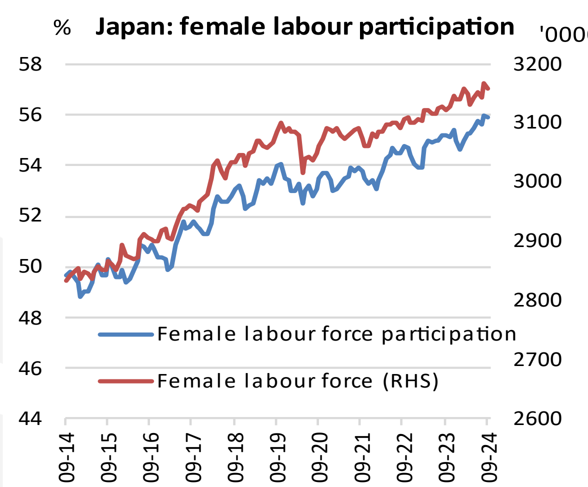
Japan

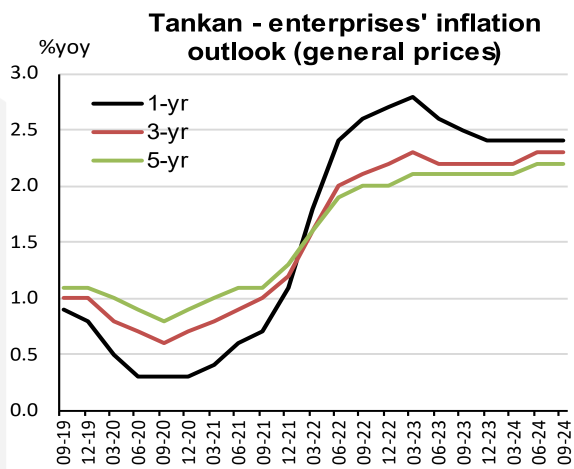
Prospect of sustained wage growth and pass-through onto prices

There was a re-acceleration in year-on-year CPI inflation in May through August. Although headline and core CPI inflation slowed in September, core core CPI inflation held steady at 2.1% YoY. Prospect is for inflation to stay sustainably around the 2% target, premised on a positive output gap and the virtuous cycle between wage and price continuing to play out as the labour market continues to tighten gradually.

The September jobless rate has edged lower to 2.4% from 2.5% prior, while the job-to-applicant ratio also edged up to 1.24 from 1.23 prior. The female labour participation rate has come a long way in that it has edged up over the past years to 55.9%. The BoJ noted in their July edition of Outlook for Economic Activity and Prices (Outlook Report), that “it will become more difficult for labor supply to increase, with labor force participation of women and seniors having advanced to a high degree thus far”. Subsequently, the October edition of the Outlook Report noted a deceleration in the pace of increase in the labour force participation of women and seniors. This development is leading to an increased tightening of the labour market and is one of the factors that helps to sustain wage growth, in our view. Already, the Japanese Trade Union Confederation is reportedly aiming for a wage hike of “over 5%” during the 2025 S*hunto* (the annual wage negotiation). Meanwhile, in the September *Tankan* survey, the diffusion index for actual employment conditions were negative as expected - meaning firms seeing employment as insufficient outnumbered firms seeing it as excessive - while the diffusion index was forecast to become more negative in the period ahead, across almost all categories of enterprises.

Firms’ price-setting behaviour is a factor that impacts the price transmission mechanism. According to *Tankan* surveys, enterprises’ short-term (1-year), medium-term (3-year) and long-term (5-year) inflation expectations have all stayed sustainably above the 2% level. There are signs that firms have been passing on higher labour costs to selling prices of services items.



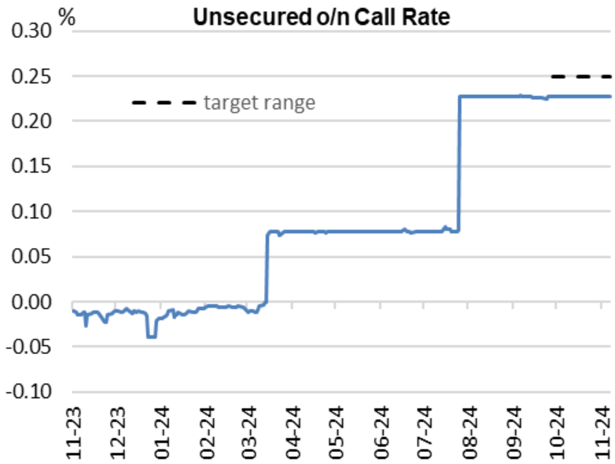


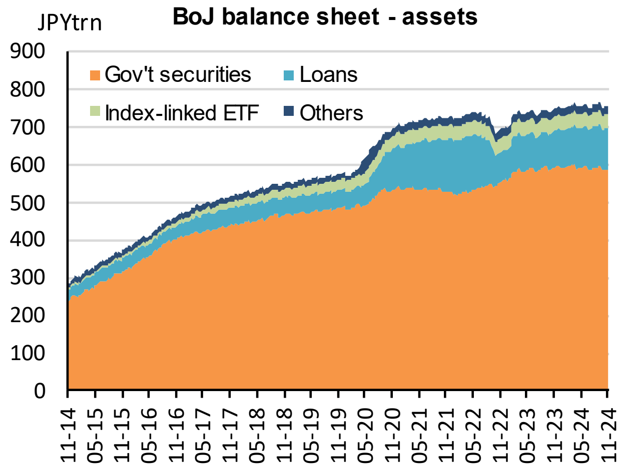
Source: Bloomberg, OCBC Research.

Japan

Monetary policy normalisation to continue

Prospects of a virtuous cycle between wage growth and inflation is continuing to play out, and hence for inflation to stay sustainably around the 2% target – this should allow the Bank of Japan to continue with monetary policy normalisation, including the ongoing slow-paced QT and additional policy rate hikes. The Bank of Japan kept its policy rate unchanged at 0.25% at the October meeting as widely expected. The overall rhetoric from the Outlook report, Ueda's press conference, and the Summary of Opinions (the meeting minutes) was mildly hawkish. Although the projected core CPI (all items less fresh food) for fiscal 2025 was revised a tad lower due to a decline in crude oil and other resource prices, the BoJ assessment remains that underlying inflation will increase gradually on an improving output gap, a tightening labour market and inflation expectations. BoJ sees "risks to economic activity are generally balanced. Risks to prices are skewed to the upside for fiscal 2025." We expect a total of four 15bp rate hikes between now and end-2025 to bring the BoJ target rate to 0.85% by end-2025.





Source: Bank of Japan, Bloomberg, OCBC Research.

United Kingdom

United Kingdom: Budget driven growth

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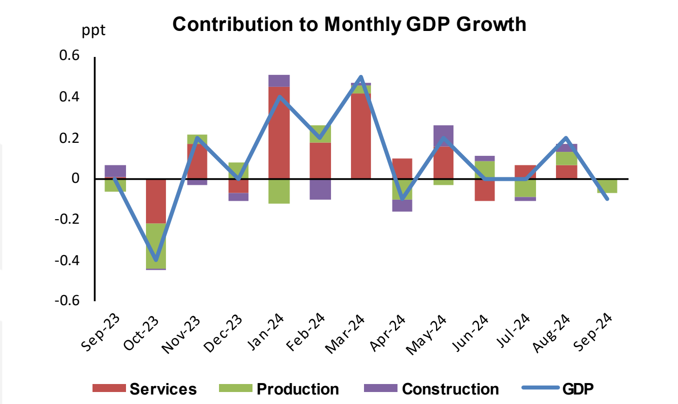
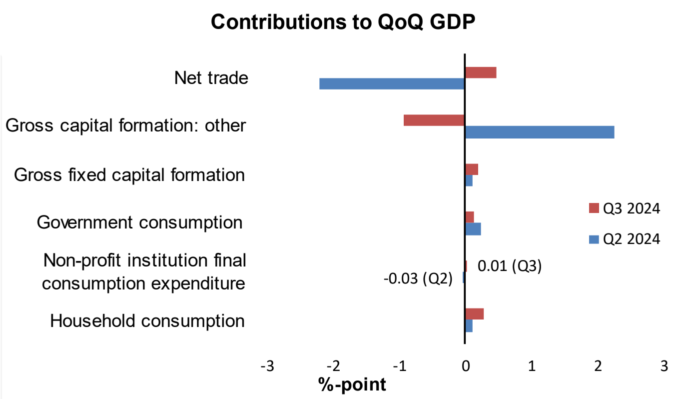
Assisted by Ang Hshi Qi

- Household consumption is likely to pick up into 1H25 on an expected National Living Wage uplift. While exports are likely to also recover gradually amid a supportive external environment, imports may also increase and hence UK's trade may remain in deficit.
- Inflation is expected to pick up, partly due to an increase in energy price cap, and partly on direct and indirect impact of budget measures.
- On balance, we see a gradual pace of rate cuts by the Bank of England (BoE). Our base-case is for a hold at the December meeting, and for one 25bp cut in each quarter in 2025.

Budget adds to improving growth momentum
The UK economy expanded by 0.1% QoQ sa in 3Q24, according to preliminary estimates. This represents the third consecutive QoQ economic expansion. The growth in 3Q24 was driven by a 0.1% QoQ sa increase in the services sector and a 0.8% increase in construction output, whereas production fell by 0.2% in the quarter with mixed performances across the manufacturing subsectors. On the expenditure side, there were increases in net trade, household spending, business investment, and government consumption in 3Q24. Net trade contributed 0.46 percentage points (pp) to overall QoQ growth in 3Q24, followed by household consumption which added 0.28pp. Household spending is starting to reflect the impact of the improvement in real incomes in the form of stronger consumer spending. Overall economic growth was partially offset by the decline in gross capital formation.

Looking ahead, we expect GDP growth to be supported by household consumption, government consumption, and continued recovery in exports. The measures announced in the Autumn Budget are expected to boost GDP for the year ahead, as the relatively front-loaded paths for government consumption and investment are likely to more than offset the impact on growth of higher taxes. Downside risks to growth are likely coming from risks to the global growth outlook and risk of interest rates staying high should inflation prove to be more persistent.



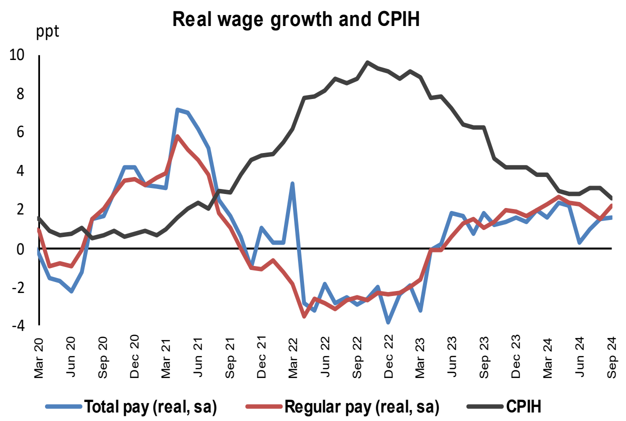


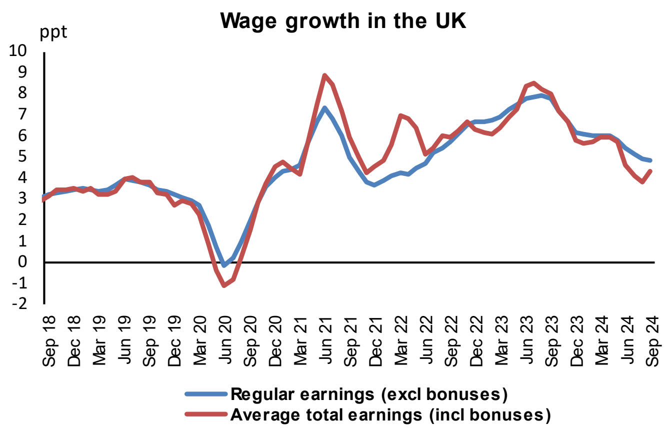
Source: ONS, Bloomberg, OCBC.

United Kingdom

Household consumption should hold up and be extended into the first half of next year, riding on real wage growth and on reduced deterioration in household balance sheets due to the lowering of interest rates. Potential downside to household spending comes from the potential increase in the household savings rate near-term before interest rates fall further.

In 3Q24, annual growth in regular earnings was 4.8% while annual growth in real terms was 1.9%. Alongside the Autumn Budget, the Government announced that it had accepted the recommendation of the Low Pay Commission regarding the 2025 National Living Wage (NLW) uplift. This means that the NLW will increase by 6.7% from April 2025, and thus a boost to annual wage growth is expected. The main rate of employee National Insurance Contributions (NICs) has already been lowered from 10% to 8% starting 6 April. These policies should translate to an increase in disposable income and purchasing power for most families, which can help drive household consumption. The impact is lasting. The BoE expects higher contributions from household consumption to GDP growth, at 1.75pp in 2025 versus an expected 0.75pp in 2024. As inflation continues to ease and real wages continue to rise, we likewise anticipate household consumption to make meaningful contributions to overall GDP growth in 1H25.





Source: ONS, Bloomberg, OCBC.

For 3Q24, the net contribution from trade to GDP was 0.46pp. This resulted from imports falling more rapidly than exports. Looking ahead, exports are likely to gradually recover amid a supportive external environment. According to the BoE's Agents' Summary of Business Conditions, contacts expect to see modest pickup in export volumes of goods at the end of the year and into 2025. However, imports are likely to pick up as well, which may still lead to an overall trade deficit.

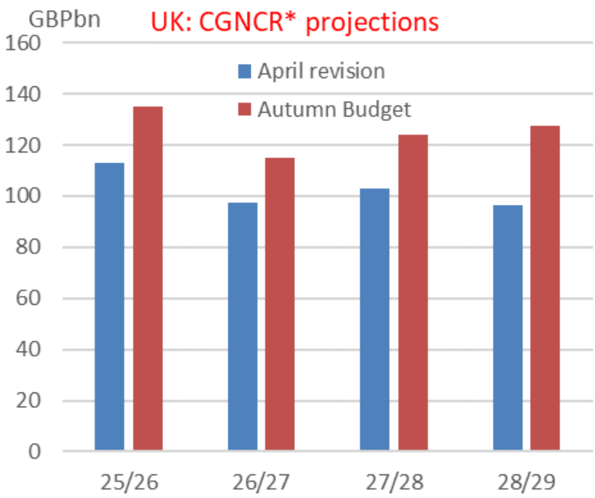
The defence and medical sectors are experiencing growth, with export growth of these items expected to continue. However, there is weak demand for exports in the automotive and construction industries, as well as for consumer goods, especially in the luxury segment. Shipping delays continue due to issues in the Red Sea, but most contacts have now largely adjusted to these challenges.

United Kingdom

Risks to strong export growth include uncertainty regarding Trump tariffs and the effectiveness of Chinese stimulus, as they may affect global trade including trade flows in and out of UK.

Implications of Autumn Budget on inflation

Fiscal spending is budgeted to increase by GBP70bn a year over the next five years. Half of the increase in spending is planned to be funded through an increase in tax and most of the rest through an increase in borrowing. The more expansionary budget may add to GDP growth for 2025, but thereafter the impact on growth may dissipate. The expansionary budget may also add to inflation. Official estimates put the impact on inflation at 0.5pp at its peak, reflecting both the indirect effects of the smaller margin of excess supply and direct impacts from the Budget measures. The inflation impact is likely to be felt more in 2025. Counteracting factors – on both the growth and inflation fronts - are potentially higher bond yields and more limited room for BoE policy rate cuts.

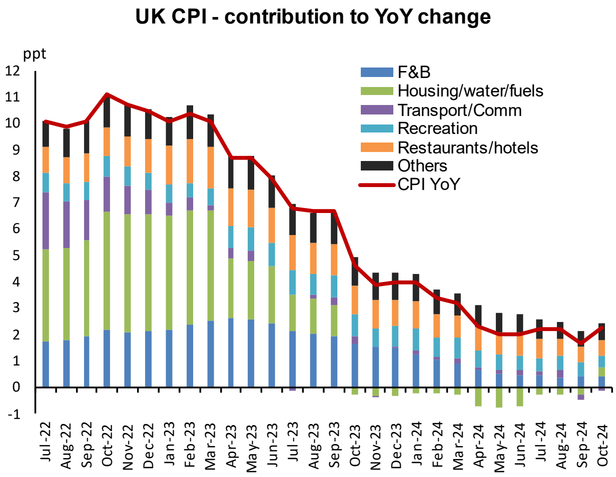


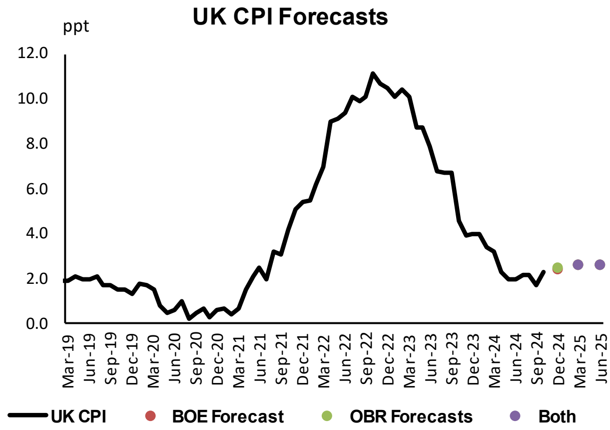
Source: DMO, OCBC Research *Central Government Net Cash Requirements

Interim acceleration in inflation

In October, headline CPI rose by 2.3% YoY, an increase from September's print of 1.7%. The acceleration was largely attributed to housing and household services, mainly because of higher electricity and gas prices. On the other hand, the largest offsetting downward contribution came from recreation and culture. Headline inflation is expected to be similarly affected in the remaining months of 4Q24 by the higher energy price cap. The Office of Gas and Electricity Markets (Ofgem)'s energy price cap is set at GBP1,717 per year for 4Q24 - this is an increase of 10% compared to the cap set for 3Q24 at GBP1,568.

United Kingdom





Source: CEIC, Bloomberg, OBR, BoE, OCBC.

Moving into 1H25, the Office for Budget Responsibility (OBR) forecasts headline inflation to rise to 2.6% YoY in each of the two quarters. The OBR based their forecasts on direct and indirect impact of the Autumn Budget measures that will lead to greater wage growth. The BoE forecasts inflation will rise to 2.6% YoY in 1H25 due to the diminished impact of reduced domestic energy costs on annual inflation, albeit it sees high uncertainty around the labour market outlook.

Wage growth has been easing over the past months and quarters. Wages (excluding bonuses) grew by an average of 4.8% YoY in the July-September 2024 period, versus 5.4% in the April-June period. While the increase in employer National Insurance contributions (NICs) may lead to a small decrease in potential supply thereby exerting an upward pressure on inflation, another risk is at the same time is that employers may curb wage growth. On balance, the low CPI print in September is unlikely to be repeated. We expect headline CPI inflation to print for most of the months in 1H25 within the range of 2.0-2.5% YoY.

Monetary policy outlook

Notwithstanding the expected pick-up in inflation from the September low level, rate cuts are still on the cards. The BoE cut its Bank Rate by 25bps to 4.75% at its November meeting with an 8-1 vote. The MPC statement cited "continued progress in disinflation, particularly as previous external shocks have abated" as the reason. The BoE judged that the current rate has remained restrictive, and if economic growth and inflation evolve as expected, "it's likely that interest rates will continue to fall gradually". Looking ahead, as the BoE has forecasted inflation to pick up towards year end and into 1H25, a "gradual approach" to removing policy restraints remains appropriate. Our base-case remains for a gradual rate cut path at the BoE. We continue to expect a hold at the December MPC meeting, and for one 25bp cut in each quarter in 2025. These expected cuts will bring the Bank Rate to 3.75% by end-2025. The risk to our expected Bank Rate trajectory is to the upside, should inflation prove more persistent.

United States

United States: Soft-landing clouded by political uncertainty

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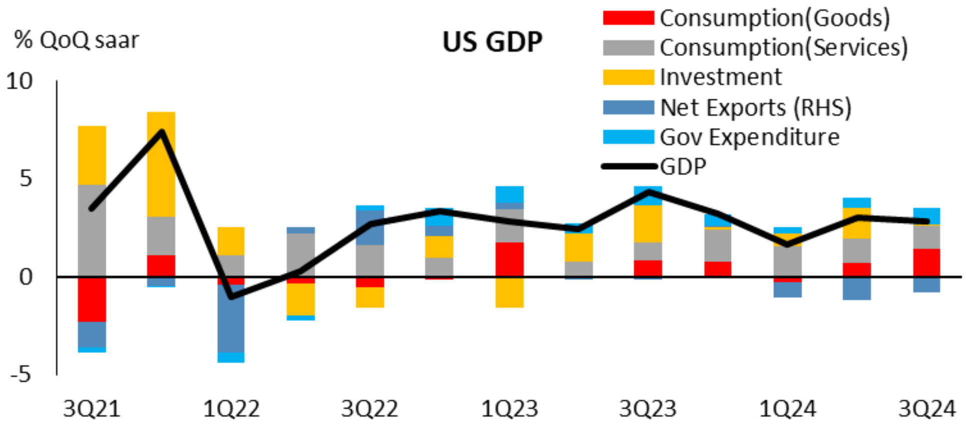
Assisted by Daryl Chan

- Economic growth has remained robust in the first three quarters of 2024, but the US economy is expected to moderate in 2025 as consumption tailwinds fade and stronger headwinds await. We expect the US economy to grow 2.8% in 2024 and ease to 2.0% in 2025.
- The disinflationary trajectory is intact, with headline PCE inflation inching closer to the Federal Reserve's 2% inflation target. Headline CPI inflation may average 2.9% YoY in 2024 before easing to 2.4% in 2025. This will allow the FOMC to gradually normalise monetary policy in the near-term, while awaiting president-elect Trump's policy shifts to materialise.
- Trump's agenda for his first 100 days in office may revolve around immigration, tariffs and the economy (through tax cuts and deregulation). While he has threatened a blanket 10-20% tariff on the whole world and more than 60% of tariffs on all Chinese imports, the timing and actual magnitude remains uncertain at this juncture. The rising fiscal deficit is another concern if Trump's electoral proposals significantly widen the deficit.

Economic resilience is the name of the game

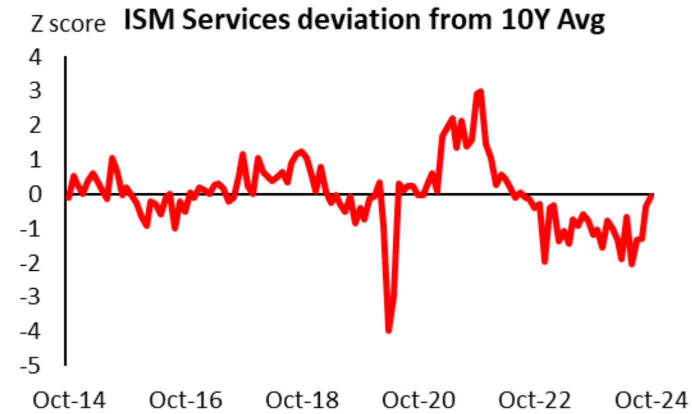
The US economy has been remarkably resilient in 2024, hence the market focus on US' economic exceptionalism as a major theme of the global economy. The US economy has outperformed its peers, with other major economies seeing tepid growth through 2024. Although 1Q24 growth was muted at 1.6% QoQ saar growth in 1Q24, the economy has since bounced back. The economy grew 3.0% QoQ saar in 2Q24 and remained relatively steady at 2.8% in 3Q24.



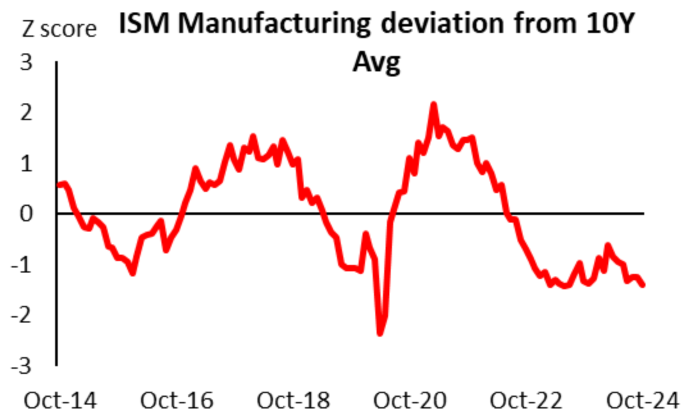
Source: BEA, Bloomberg, OCBC.

Domestic demand in 2024 has been fuelled by the services sector amidst a sluggish manufacturing sector. The services sector remained resilient in the face of an elevated interest rate environment. Services PMI remained largely above 50, indicating an expansionary sector and has seen the index rise for the last four consecutive months to hit a high of 56.0 in October (highest since July 2022). Meanwhile, the Z-score deviation shows that ISM services PMI is approaching its 10Y average value of ~56, given the October print. Compared to our 2H24 outlook, this represents a healthier services sector that is conducive for growth.

United States



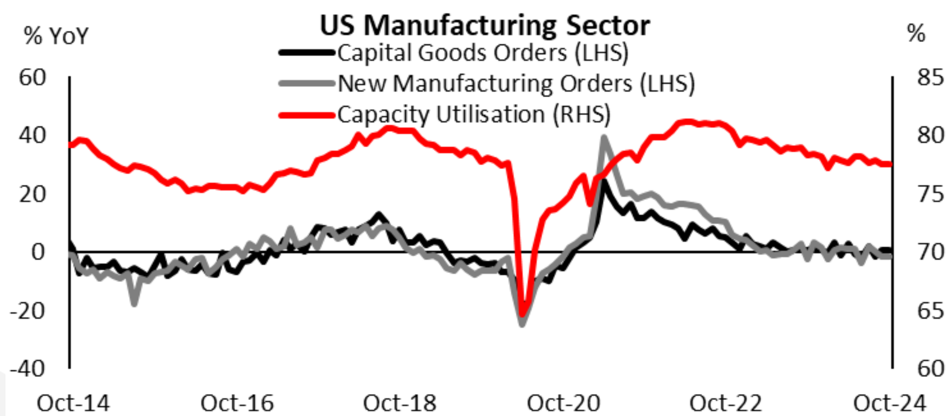
Source: ISM, OCBC.



Source: ISM, OCBC.

However, the manufacturing sector has been in limbo compared to the resilient services sector. Investment growth in manufacturing structures fell sharply to 2.2% QoQ saar in 3Q24, declining from 21.7% growth in 2Q24. Meanwhile, the manufacturing ISM contracted for seven straight months to end at 46.5 in October 2024, after a brief blip to 50.3 in March. However, it was underwater for a significantly longer period of time since November 2022 prior to March 2024, suggesting the malaise is prolonged and maybe structural. It continues to trend more than one standard deviation below its ten-year average and far below the neutral point of 50, indicating sustained weakness in the manufacturing sector.

Meanwhile, capital goods orders and new manufacturing orders growth continue to decline, indicating slowing demand. Capacity utilisation continues to trend downwards after the post-pandemic boom and is currently hovering below the pre-pandemic 5-year average of 77.8% capacity utilised.

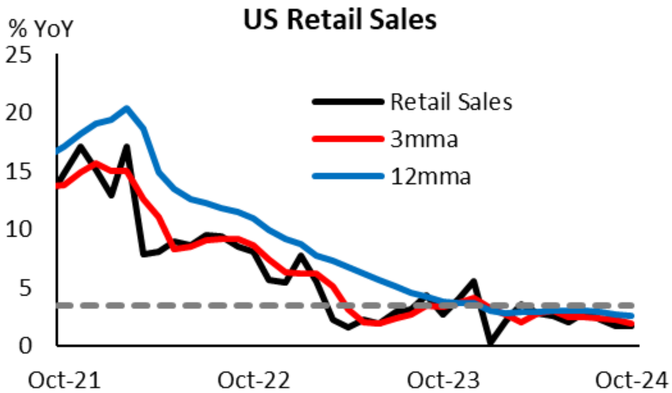


Source: Bloomberg, OCBC.

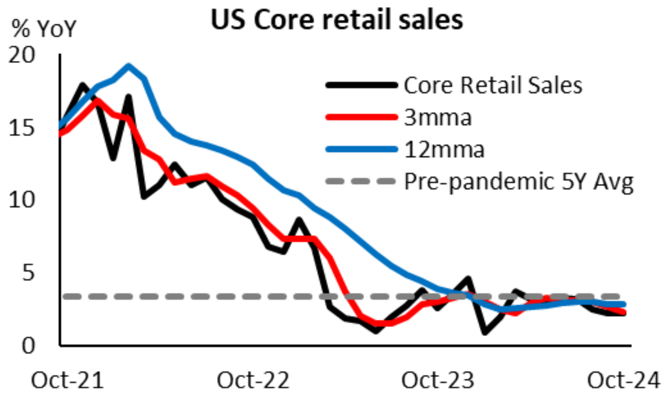
United States

We expect domestic consumption to remain the main driver of economic growth in 2025. Personal consumption expenditures, which account for ~70% of total GDP, have remained the main driver of the US economy and grew 3.7% QoQ saar in 3Q24, notwithstanding the elevated interest rate environment. Notably in 3Q24, goods consumption rebounded to expand 6.0% QoQ saar (2Q24: 3.0%) and contributed 1.4 pp to GDP growth. Services consumption eased slightly to 2.6% QoQ saar (1Q24: 2.7%), but still contributed 1.2 pp to 3Q24 growth.

Moving forward, however, we expect a moderation in consumption growth as tailwinds appear to be easing. Retail sales and core retail sales growth continue to moderate in YoY terms from post-pandemic highs and are now trending downwards and further below the pre-pandemic five-year average growth rate. Taking a 3- and 12-month moving average to smoothen out the volatility, we can see that both averages are trending below the pre-pandemic five-year averages as well, indicating a slowing in consumption.



Source: US Census Bureau, OCBC.

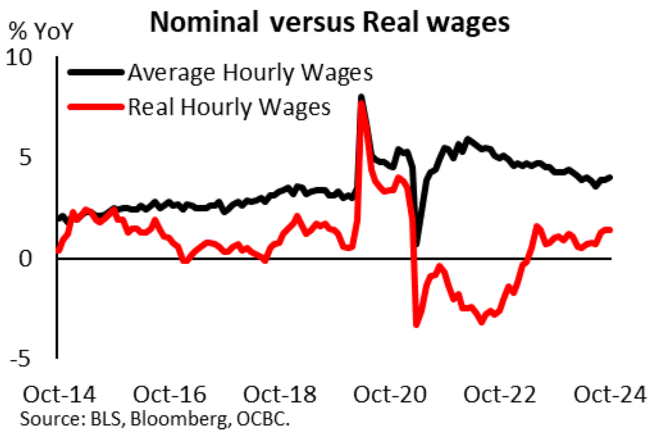


Source: US Census Bureau, OCBC.

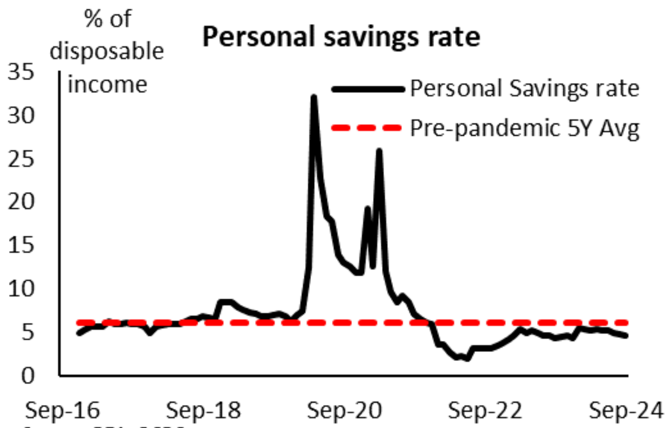
Nominal average hourly wages have remained supportive of consumption in 2024, averaging 4% YoY growth for the year-to-October. However, this remains lower than the 2H23 average growth of 4.4% YoY and has continued to ease through 2024. Meanwhile, sticky inflation has caused real hourly wages to stay relatively stable since 2H23, averaging 1% YoY growth for the year-to-October in 2024 (2H23: 1.0%).

Moving into 2025, wages are expected to continue easing as the labour market further cools, while inflation moderates slowly. This implies a moderation in real wage growth. Additionally, the personal savings rate – personal savings as a percentage of disposable income - came in at 4.6% in September 2024 and has remained steadily below the pre-pandemic five-year average of more than 6%. With the moderation in real wage growth and personal savings remaining below long-term averages, this implies a cooling consumption backdrop that heralds a moderation in economic growth.

United States



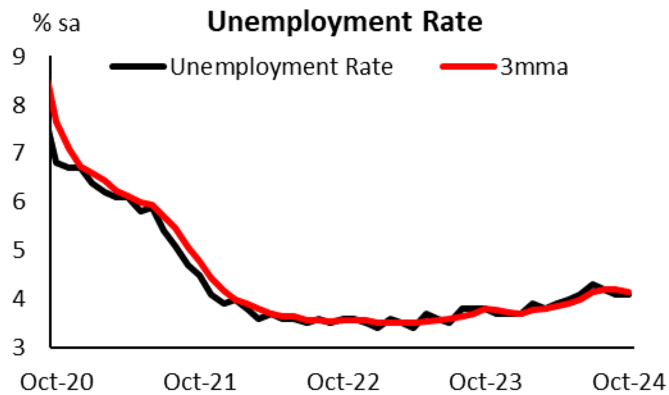
Source: BLS, Bloomberg, OCBC.



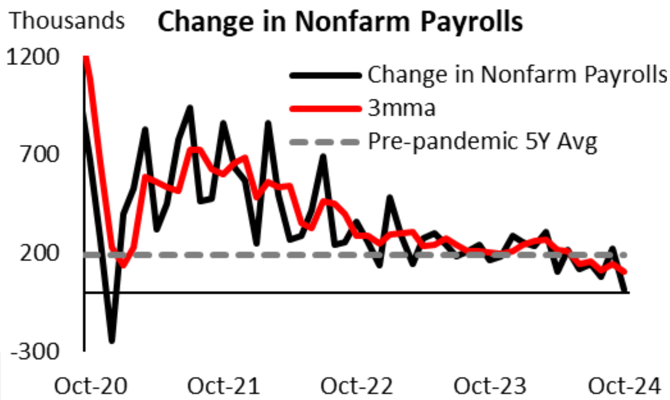
Source: BEA, OCBC.

A gradually easing labour market

The July 2024 labour market report (released in August) sent shockwaves through financial markets, when the unemployment rate unexpectedly ticked up to 4.3% in July from 4.1% in June. This July reading triggered the Sahm rule as the 3-month moving average of 4.13% exceeded the lowest 3-month moving average of 3.6% from the previous 12 months by more than 0.5 percentage points (pp). Markets were sent into a further frenzy just a few weeks later as the Bureau of Labour Statistics revised down total jobs created in the 12-months through March 2024 by 818k. This 0.5% overall downward revision was the largest since 2009. While these large downward surprises in labour market data may reignited some imminent recession fears, the subsequent strong labour market reports suggested that the labour market was cooling but still generally healthy.



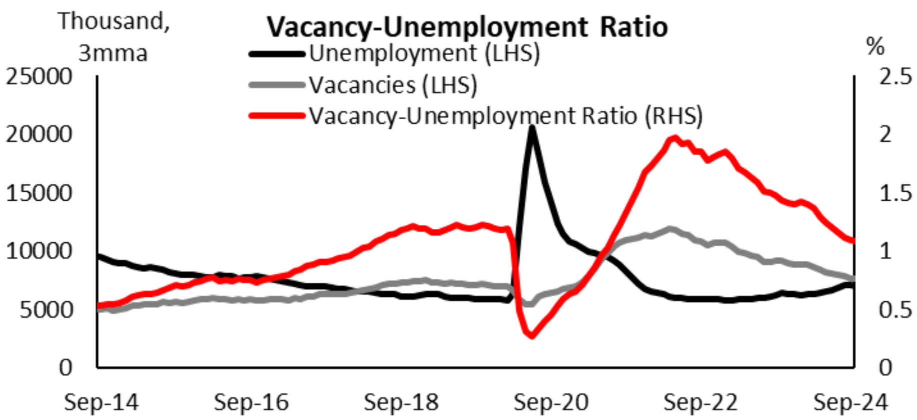
Source: BLS, OCBC.



Source: BLS, OCBC.

United States

While the labour market's monthly readings have been volatile, there is probably no need to panic at this juncture. Nonfarm payrolls (NFP) have continued to trend downwards, with October nonfarm payrolls only recording an increase of 12k, down significantly from the expected 100k increase. However, peering through the headline data, there were numerous contributing factors for the sharp decline of NFP in October. Data collection timings were impacted by Hurricanes Helene and Milton, while strikes across the airline industry eliminated 44k jobs from October nonfarm payrolls. With the worst of the hurricane season and the Boeing strike over, we believe that nonfarm payrolls should rebound above 100k in November. Similarly, the unemployment rate has since declined to 4.1% in October since the uptick in July. Looking at the vacancy-unemployment ratio, we see that it continues to converge towards pre-pandemic trends, indicating a healthy cooling and normalisation of the labour market that is conducive for the disinflation journey.



Source: BLS, OCBC.

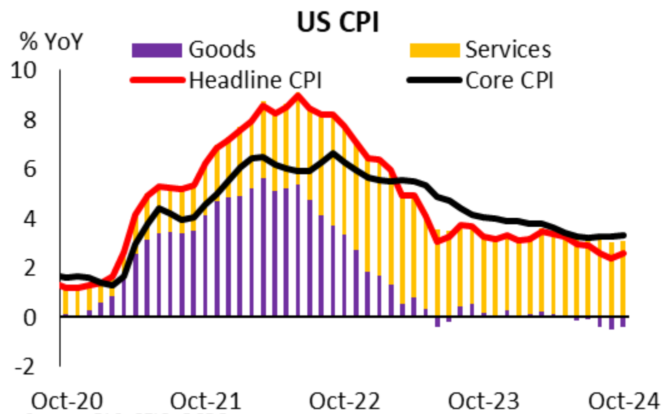
Disinflationary trajectory remains intact

Inflation has continued to trend downwards through 2024 after the stickiness shown in 1Q24, albeit there were occasional upticks in prices. Headline CPI inflation in October was one such uptick, as inflation rose to 2.6% YoY (September: 2.4%). Meanwhile, the Federal Reserve's preferred inflation gauge, core PCE has remained sticky at 2.7% YoY as of September, while headline PCE continues to inch ever so closer to the 2% target.

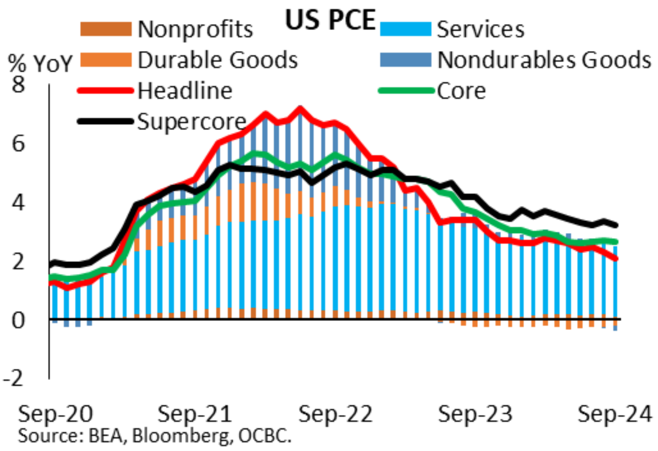
The disinflation trajectory in 2024 has been characterised by low to negative goods inflation versus sticky elevated services inflation. Goods CPI and PCE inflation have been trending near negative levels, as both durable and nondurable goods continue to show strong disinflation. In fact, as of the September PCE print, goods PCE has remained negative for six consecutive months, down from the highs of 2022.

Services inflation has shown signs of cooling, albeit remaining sticky in 2024. Services CPI came in at 4.7% YoY in October, a slight increase from the services print in September which was the lowest services reading since January 2022. Meanwhile, services PCE continues to trend lower with the September reading at 3.7% YoY, the lowest reading since May 2021.

United States



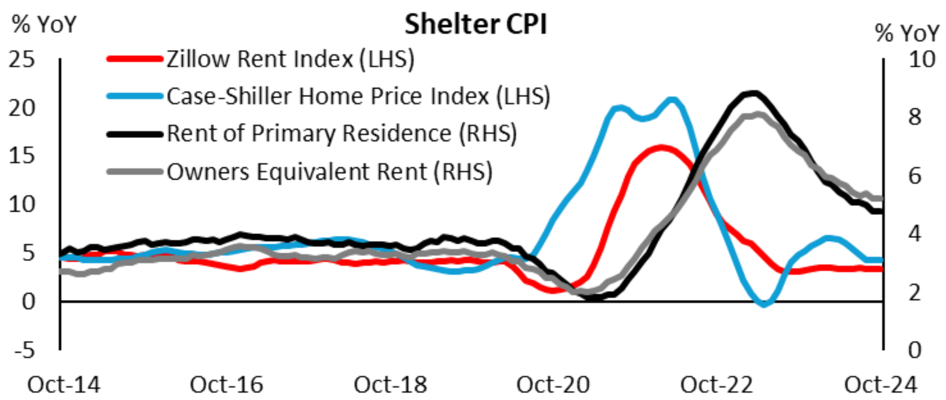
Source: BLS, CEIC, OCBC.



Source: BEA, Bloomberg, OCBC.

Shelter inflation has been a sticky component of services inflation. By weightage, shelter inflation accounts for ~36% of the inflation basket and more than 55% of total services inflation. Shelter inflation rose 4.9% YoY in October, adding 1.8pp to overall headline CPI inflation. Although still elevated, September shelter inflation has moderated from its March 2023 high of 8.2% to its lowest reading since February 2022.

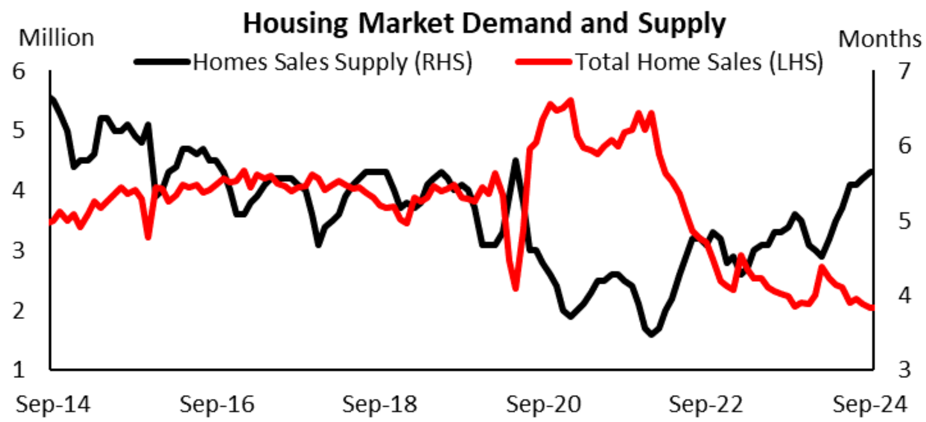
Shelter inflation can be divided into two major categories - rent of primary residence inflation (RPR) and owners equivalent rent (OER). Looking at forward looking indicators such as the Zillow Rent Index for RPR and Case-Shiller Home Price Index for OER, we see that both components of shelter inflation are past their peaks and have room to run for the disinflation trend.



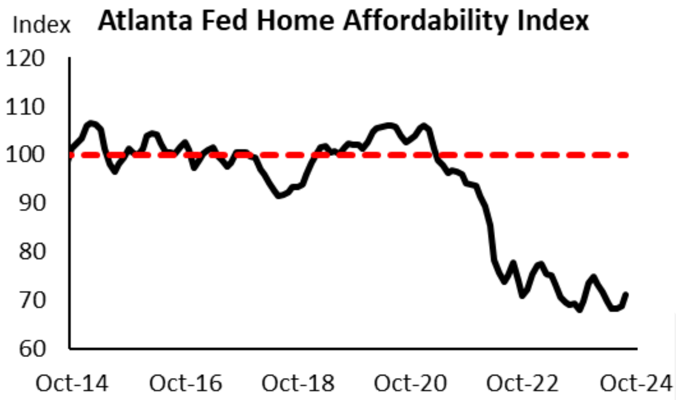
Source: Bloomberg, OCBC.

United States

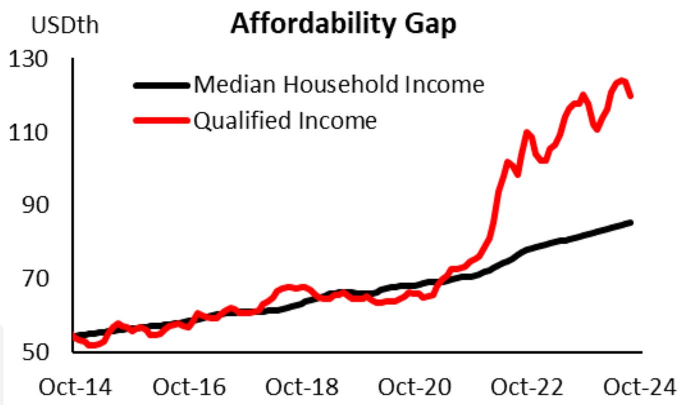
Furthermore, housing demand remains low. Total home sales continue to decline through 2024, with only 3.8mn home sales in September, the lowest reading over the past 10 years. This could be a result of the elevated mortgage rate which has reduced consumers ability to afford houses. According to the Federal Reserve Bank of Atlanta, home affordability has dropped to 71 as of August 2024, significantly below the neutral reading of 100 where the cost of the house is below the 30% share of income. This is also seen by the widening affordability gap, as the qualified income to own a house has been outpacing the rise in median household income since the pandemic. Housing supply has also rebounded post-pandemic, as months of home sales supply has increased from lows of 1.6 in Jan 2022 to the current 4.3 months as of September, nearing the approximate 5-6 months that signal a healthy housing market. As such, housing demand and supply conditions are conducive for shelter CPI to continue easing in the coming months.



Source: Bloomberg, OCBC.



Source: Federal Reserve Bank of Atlanta, OCBC. Note: Affordable = 100



Source: Federal Reserve Bank of Atlanta, OCBC.

Further room for the Fed to ease

Through 2H24, there has been a noticeable shift from inflation to the labour market. Indeed, the Federal Reserve has been paying increasing attention to the labour market since the eye-catching July labour market report. The Fed kickstarted its rate easing cycle with a 50bp cut at its 18 September meeting in a near unanimous 11-1 vote, highlighting the risks to both sides of its inflation-employment dual mandate.

United States

On the September dot-plot, the 2024 median dot showed a further 50bp of cuts this year, while the 2025 median showed a total of 100bp of cuts. This indicated a long run Fed funds rate forecast of 2.9%, slightly higher than the June estimate of 2.8%.

With a cooling labour market and the disinflationary trajectory intact, the path is open for the Federal Reserve to continue easing monetary policy. The Fed followed up its September meeting with a further 25bp cut at its 7 November meeting, with Federal Reserve Chairman Jerome Powell commenting that the US elections would have no near-term effect on monetary policy decisions.

We now expect one 25bp Fed funds rate cut each in December, January, March, 2Q25 and possibly also in 3Q25, ceteris paribus. This will bring 2024 and 2025 cumulative rate cuts to 100bp each, bringing the Fed funds rate target range to 3.25%-3.50% by end 2025. However, the road ahead is fraught with uncertainty.

Election implications on policy may be imminent

With the election of Donald Trump as President-elect and a Republican sweep of both the House of Representatives and the Senate, the Republican Party is in firm control. Trump may have a largely unhindered path to carry out his electoral promises. High up on his list will be immigration policies, tariffs and taxes.

Trump has pledged to carry out the “largest deportation in the history” of the United States, aiming to deport all immigrants within the US without legal status. According to the Pew Research Centre, as of 2022, there are around 11.0mn unauthorized immigrants living in the USA[2], which represents ~3.3% of the total American population.

If Trump were to follow through with mass deportation, this could result in the loss of ~8.3mn undocumented workers, according to the Pew Research Centre. This would have potentially significant impact on economic growth and inflation. The Peterson Institute estimates that a full deportation would raise inflation by around 3.5pp in 2026, with monetary policy implications. On economic growth, the loss of a significant number of workers will be detrimental to businesses in the form of a shrinking labour supply and poorer consumer demand. It remains to be seen as to what Trump will follow through with his mass deportation threats. As many may remember, he threatened to do the same thing in his first term in the White House. However, based on Department of Homeland Security data, repatriations were actually lower in this first term than those of the Biden administration and roughly similar to the prior Obama administration. Hence, the immigration/deportation question remains if his bark will be worse than his bite again under Trump 2.0.

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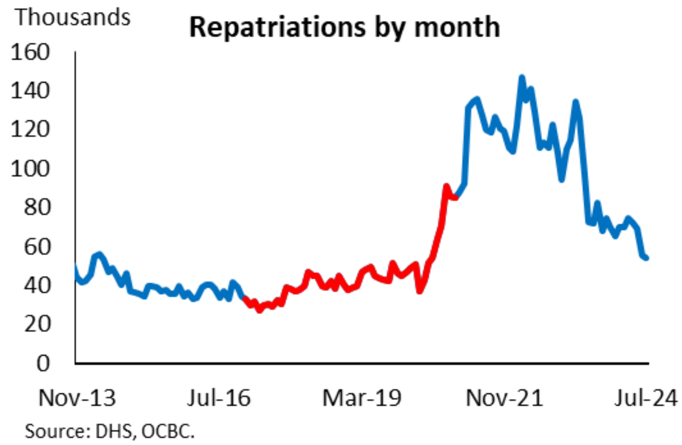
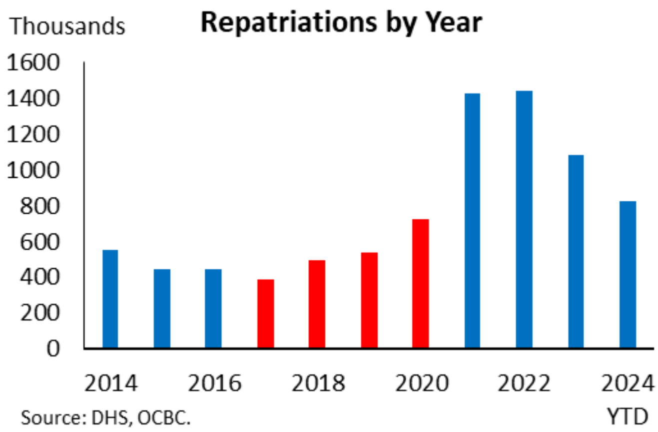
[2] Passel, J. S., & Krogstad, J. M. (2024, July 22). *What we know about unauthorized immigrants living in the U.S.* Pew Research Center. https://www.pewresearch.org/short-reads/2024/07/22/what-we-know-about-unauthorized-immigrants-living-in-the-us/

United States





Note: Blue lines represent years where Democrat's controlled the White House, Red for Republican control.

On tariffs, the threat of a flat 10-20% tariff on all US imports and 60% tariff on Chinese imports is nothing to scoff at. President-elect Trump has always been extremely vocal regarding his disdain for the large trade deficit that the US runs, aiming to narrow the deficit the US has with other countries. The main legal provisions for U.S. tariff imposition include Sections 201, 232, and 301. Sections 201 and 232 generally target specific goods, while Section 301 addresses broader actions against countries, as seen during the U.S.-China trade war in 2018. Future tariffs under a Trump 2.0 administration are likely to rely on Section 301.

The question remains; however, what President-elect Trump will actually decide to do on the tariff front. The question has multiple layers. While Trump has been consistent on his desire to implement these tariffs, it remains to be seen if he actually implements them once he takes office on 20 January 2025, or if he decides to use them as a bargaining chip to extract concessions from adversaries and allies alike. If the latter materialises, the impact may be delayed and/or muted in the near-term. Based on the 2018-2019 trade war timeline, it took about 11 months from the start of a Section 301 investigation to the initial tariffs. Even with an expedited approach, new tariffs would likely require at least 6 months, potentially impacting trade by the second half of 2025.

United States

Estimator	Tariff Policy	Change in Real GDP
Tax Foundation	10% Universal	-0.5%
American Action Forum	10% Universal	-0.16% GDP; -0.31% with retaliation
Peterson Institute for International Economics	10% Universal	10-year range, -0.36% (high) to -0.07% (final year); -0.88% to -0.24% with retaliation
Moody's	10% Universal	-1.04%, -2.82%, -3.45%, and -3.61% in years 2025-2028, with simulated retaliation
Euromonitor	10% Universal	-0.5% in 2025, -0.9% in 2026, with retaliation (derived from growth rate projections)
IMF	10% Universal	-0.4% to -0.6%, persisting at -0.4% with retaliation
Peterson Institute for International Economics	60% China	10-year range, -0.19% (high) to -0.12% (final year); -0.43% to -0.21% with retaliation
Tax Foundation	10% Universal, 60% China	-0.8%, -1.2% with retaliation
Capital Economics	10% Universal, 60% China	Up to -1.5%
EY	10% Universal, 60% China	-1.18% in 2025 and -2.34% in 2026 with retaliation (derived from growth rate projections)
Tax Foundation	20% Universal, 60% China	-1.3%, -1.7% with partial retaliation

Source: Tax Foundation.[3]

The fiscal implications of Trump's proposed policies are clear. With his intention to extend the 2017 Tax Cuts & Jobs Act and reduce corporate tax rates, tax revenue collections will be negatively impacted and only add to the overall fiscal deficit. The Committee for a Responsible Federal Budget estimates that Trump's plan could increase the fiscal deficit by around USD7.8trn in its central estimate. However, its estimates vary significantly, with a range of USD1.7-15.6trn. This reflects uncertainty in policy interpretations. The bear-steepening seen in the initial kneejerk reaction in the UST bond yield curve post-election results was to be expected.

[3] Tax Foundation review of Tom Lee, "Trump's Proposed 10 Percent Tariff: Considering the Impact"; Chief Investment Office GWM, "The Economic and Investment Implications of Higher Tariffs"; Warwick J. McKibbin, Megan, and Marcus Nolan, "The International Economic Implications of a Second Trump Presidency" Peterson Institute for International Economics; Mark Zandi, Brendan LaCerda, and Justin Begley, "The Macroeconomic Fallout of Trump's Tariff Proposals"; Aiste Bijune and Lan Ha, "US 2024 Election: Implications for the Global Economy"; International Monetary Fund, "World Economic Outlook, October 2024: A Rocky Recovery"; Paul Ashworth, "Trump's New Tariffs Would Accelerate Global Fracturing"; RBC Wealth Management, "The economic impacts of non-economic policies"; The Budget Lab, "Fiscal, Macroeconomic, and Price Estimates of Tariffs Under Both Non-Retaliation and Retaliation Scenarios"; Lydia Boussour and Gregory Daco, "2025 and beyond trade policy"; Fitch Ratings, "US-Led Tariff Hikes Under Renewed Trade War Would Reduce US/World Output."

United States

However, the uncertainties pertain to how much fiscal leeway is afforded to him, and how much tariffs can help partially fund the tax cuts. The continued proverbial "kick the can down the road" strategy for the government debt ceiling illustrates that there is no alternative (TINA) to the USD's status as a global reserve currency and the debt issue is not a problem until the market says it is a problem – ironically in an increasingly polarized world where geopolitical tensions are rife with two ongoing and prolonged conflicts between Russia-Ukraine and the Middle East, there appears to be few safe haven assets in the near-term. Gold and maybe even bitcoin (perceived by markets as a Trump play) appear to be on the ascent.

His foreign policy inclinations in his first term of government also appear to be one with no permanent allies, but transaction-driven, so more market volatility and bouts of uncertainty and de-risking appears par for the course. Nonetheless, if he is able to execute tax cuts and de-regulation for specific industries, this may prove to be a positive catalyst at least in the short-term.

At the moment, everything appears to be a toss-up, as with President-elect Trump, nothing is certain. He has shown in his previous term in office that he will do whatever he wants whenever he wants, and this term, his cabinet appointees are likely to be more supportive of him to push his agenda through.

New Trump Appointees	Position in the Administration	Background
Pete Hegseth	Secretary of Defence	Fox News host, Army Veteran
Elon Musk	Department of Government Efficiency	Owner of Tesla, X, Entrepreneur
Vivek Ramaswamy	Department of Government Efficiency	Former Presidential candidate, pharmaceutical entrepreneur
John Ratcliffe	Head of CIA	Former US Rep and Director of National Intelligence
Marco Rubio	Secretary of State	Florida Senator, former presidential candidate
Mike Waltz	National Security Advisor	Current Congressman, Army veteran
Tulsi Gabbard	Director of National Intelligence	Former US Rep, Presidential candidate, Democrat and veteran
Robert F. Kennedy Jr	Department of Health and Human Services	Former Presidential candidate, Kennedy family
Howard Lutnick	Secretary of Commerce	CEO of Cantor Fitzgerald
Scott Bessent	Treasury Secretary	CEO of Key Square Group
Pam Bondi	Attorney General	Former Attorney General of Florida

This is likely a double-edged sword for the US economy as well as financial markets - Whatever the outcome and his decisions, the outlook for the US economy remains plagued by political uncertainty, but our baseline view (our best guess for now) is for a continuation of the soft-landing narrative where growth moderates to around 2% in 2025.

China

China: Whatever it takes

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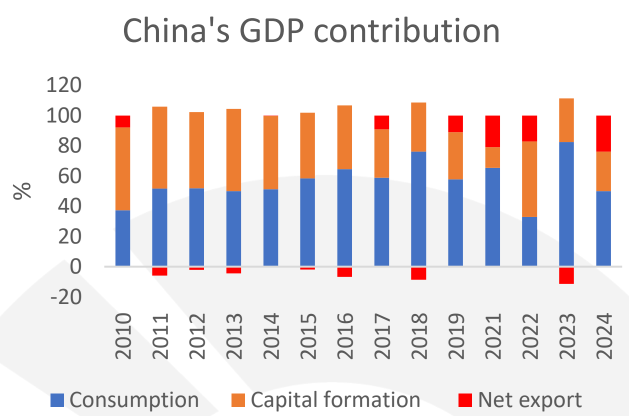
- For China's stimulus, there are four reasons this time could be different. Massive stimulus has begun to translate to an improving economic sentiment. The debt resolution is likely to be the first step in a broader fiscal stimulus.
- The impact of tariffs on growth will materialise primarily in the latter half of 2025, due to processing and implementation timelines. We expect China to intensify its fiscal stimulus efforts to mitigate the adverse effects of higher tariffs. Therefore, we maintain our 2025 GDP growth forecast at 4.8% YoY.
- China's reaction to trade war 2.0 could be different. China may export inflation this time, which may have ripple effect on the global economy.

Economic growth decelerated to 4.6% YoY in real terms in 3Q24, down from 4.7% in 2Q24. For 1Q-3Q24, the economy grew by 4.8% YoY. On a sequential basis, economic growth rebounded to 0.9% QoQ sa, up from 0.5% in 2Q24, though this growth remained below the seasonal average.

The GDP deflator contracted for the sixth consecutive quarter, though the contraction narrowed in 3Q24. As a result, nominal GDP growth stabilised, slightly rebounding from 3.97% YoY in 2Q24 to 4.04% in 3Q24.

External demand strengthened, with net exports contributing 1.1 ppts to cumulative GDP growth, up from 0.7 percentage points in 1H24. This indicates that in 2024, external demand has accounted for over 20% of China's economic growth.

<u>Chart 1:</u> External demand has accounted for over 20% of China's growth in 2024.



<u>Chart 2:</u> GDP deflator has been in negative territory for six consecutive quarters.

Source: Wind, CEIC, OCBC

China

Economic downward spiral

Economic data in 2Q24 and 3Q24 showed that the economy may be facing a potential downward spiral, driven by several root causes.

Firstly, consumer confidence is weakening, driven by stagnant income growth, negative income expectations, and a deteriorating wealth effect from both the property and equity markets. Pay cuts have significantly dampened income expectations, while declining asset values have reduced the wealth effect, further curbing consumption.

Secondly, business confidence is faltering due to concerns about local governments chasing companies for taxes, sometimes dating back decades. This uncertainty is causing many businesses to hold back on investments, exacerbating economic stagnation.

Thirdly, the government's perceived ability to manage the economy was called into question, as recent policy interventions have been largely ineffective. Compounding this was the financial strain on local governments, which have seen land sale revenues plummet by 25.4% YoY in the first eight months of 2024.

Is this time different?

In late September, the authorities unveiled supercharged stimulus measures, sending equities higher. We have covered China's stimulus on the weekly basis. The key question from investors is "is this time different?" We see four reasons why this time could be different.

Firstly, there is a shift in policy priority. It is the first time the September Politburo session was centred around economic discussions. The message from this year's Politburo meeting conveyed a heightened sense of urgency to achieve the annual growth target.

Secondly, the authorities' recognition of the interconnectedness between capital markets and economic recovery excited markets. The People's Bank of China (PBoC) adopted a "whatever it takes" approach to support equity markets.

Thirdly, other than direct stimulus, the authorities are also serious about pushing for framework changes with the focus on structural reforms, aimed at improving coordination between monetary and fiscal policies. We discuss this point in detail in our thematic below.

Fourthly, this latest package of policy measures does introduce several initiatives aimed at addressing some root causes of the downward spiral. If these tools succeed in reviving investor sentiment and reigniting animal spirits, they could deliver a positive medium-term impact on the economy.

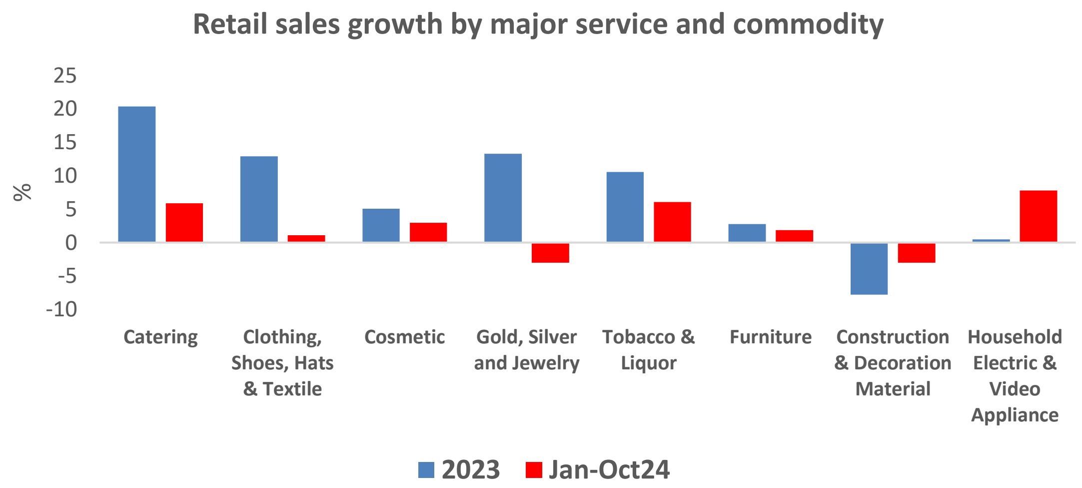
The massive stimulus has begun to translate to improving economic sentiment. Official manufacturing PMI unexpectedly rebounded to 50.1 in October from 49.8 in September, marking its return to expansionary territory for the first time in six months and defying the usual seasonal decline in October.

China

The October economic data suggests that recent easing measures are gaining traction. Resilient manufacturing and rebounding infrastructure investments offset continued declines in real estate investment. Infrastructure investment increased by 4.3% YoY during this period, a 0.2 percentage point acceleration compared to January-September, marking the first rebound since March. Policies promoting large-scale equipment upgrades yielded strong results, with equipment and tool purchases up 16.1% YoY, contributing over 60% to total investment growth and accounting for 14.8% of total fixed asset investment (FAI).

Consumption also picked up, supported by trade-in programs, the National Day holiday, and early "Double Eleven" promotions. Total retail sales grew by 4.8% YoY in October, accelerating by 1.6 percentage points from September. Trade-in policies significantly boosted sales of home appliances, automobiles, furniture, and office supplies, collectively contributing 1.2pp to overall retail sales growth.

Chart 3: Trade in programs supported retail sales growth



Source: Wind, CEIC, OCBC.

Elsewhere, the services sector saw a notable improvement, with the service production index rising 6.3% YoY in October—the fastest pace this year and a 1.2 percentage point increase from September. Incremental policies underpinned recoveries in the financial, real estate, wholesale, and retail sectors.

In terms of property, the contraction of real estate investment widened in October, driven by weak non-residential projects. Nevertheless, there are a few bright spots. Firstly, the sales area of newly built commercial housing fell by 15.8% YoY in the first ten months, improving by 1.3pp compared to January-September. Similarly, the decline in sales value narrowed by 1.8% YoY, indicating that recent policies are beginning to take effect. Secondly, medium- to long-term loans to the household sector increased by CNY110bn, CNY39.3bn higher than in the same period last year, signalling signs of a recovery in property transactions. Thirdly, the real estate service production turned positive at 0.8% YoY, the first expansion since June 2023.

China

Recent data indicates that the economy is poised to achieve growth exceeding 5% YoY in 4Q24, resulting in an estimated annual growth rate of approximately 4.9%. However, this recovery is uneven, characterized by persistently low inflation and a cautious appetite for leverage within the corporate sector. Consequently, we anticipate further policy support from the Chinese government to bolster the recovery efforts.

What's next?

During a press conference by the National People's Congress Standing Committee on 8 November, Finance Minister Lan Fo'an announced a comprehensive CNY12trn debt resolution package.

The path to resolving the CNY12trn debt includes first, raising the local government debt ceiling by CNY6trn to swap existing hidden debt over three years (2024-2026) at CNY2trn annually. Second, allocating CNY800bn per year for five years through newly issued local government special bonds to supplement government fund resources for debt resolution, cumulatively addressing CNY4trn of hidden debt. Third, extending repayment terms for CNY2trn of hidden debt related to shantytown redevelopment beyond 2028, allowing repayment according to original contract terms starting in 2029.

Within the CNY12trn debt resolution plan, only CNY6trn is regarded as incremental policy in our view, while the remaining CNY4trn reflects a repurposing of existing local government special bonds.

Overall, the amount announced aligns largely with expectations but may not meet the demands of all stakeholders. Notably, there will be no issuance of additional central government bonds or adjustments to the deficit ratio for 2024. Additionally, the debt resolution responsibility remains primarily with local governments rather than having shifted to the central government. As a result, compared to central government-led leverage increases, the chain of reaction to economic support from the local government-led resolutions may be longer.

The most immediate impact of this debt resolution plan is the reduction in interest expenses. Statutory debt carries significantly lower interest rates than hidden debt, leading to substantial savings for local governments. The Ministry of Finance projects approximately CNY600bn in savings over the next five years. Minister Lan also highlighted that this policy would alleviate debt repayment pressures, creating room for fiscal expenditures aimed at stimulating demand.

The National People's Congress press conference focused solely on debt resolution, signalling that this is likely the first step in a broader fiscal stimulus strategy. Over the next six months, additional policies are expected, including special sovereign bonds to reinforce state-owned banks' capital, special bonds for land reserves, and potential adjustments to the deficit ratio. Attention will now turn to the Central Economic Work Conference in December and the Two Sessions next year for further developments.

China

With the imminent issuance of an additional CNY2trn in local government bonds over the next two months, combined with the substantial volume of maturing Medium-Term Lending Facilities (MLFs), we anticipate that the People's Bank of China (PBoC) will implement another reserve requirement ratio (RRR) cut in November or December.

Bracing for trade war 2.0

Following Trump's victory, the offshore Chinese Yuan weakened by about 1%, while the Hang Seng Index declined by over 2% during the day. The correction in Chinese assets aligned with market expectations amid concerns over renewed tariff threats from a "Trump 2.0" administration.

What might Trump 2.0 mean for China? China faces two primary risks under a potential Trump 2.0 administration. The first is the potential revocation of its Most Favored Nation (MFN) status, which could raise average U.S. tariffs on Chinese imports to approximately 40%. The second is the possibility of an additional 20%-60% tariff on Chinese goods. However, unlike the president's unilateral power to impose tariffs, removing MFN status requires Congressional approval, meaning its implementation would depend on the political landscape in Congress.

Chart 4: The share of exports to US has declined but remains above 11%.

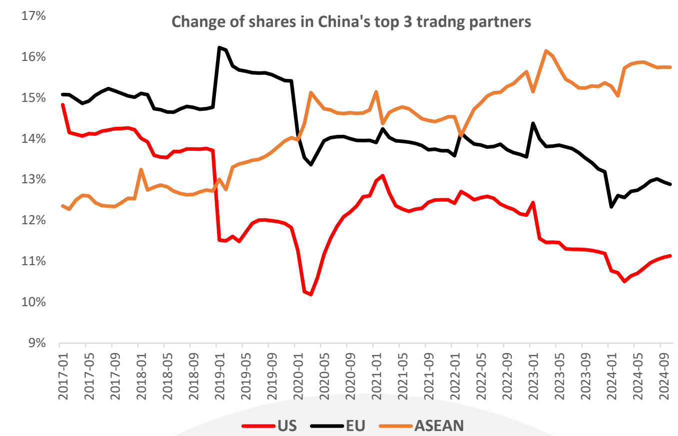


Chart 5: Labour-intensive products to the US still accounted for 20% of total exports.

Source: Wind, CEIC, OCBC.

The main legal provisions for U.S. tariff imposition include Sections 201, 232, and 301. Sections 201 and 232 generally target specific goods, while Section 301 addresses broader actions against countries, as seen during the U.S.-China trade war in 2018. Future tariffs under a Trump 2.0 administration are likely to rely on Section 301. Based on the 2018-2019 trade war timeline, it took about 11 months from the start of a Section 301 investigation to the initial tariffs. Even with an expedited approach, new tariffs would likely require at least 6 months, potentially impacting trade by the second half of 2025 if Trump assumes office in January.

China

To estimate the direct impact of potential tariff increases on China's exports to the U.S., export elasticity with respect to tariffs provides a helpful measure. Studies from the first trade war estimate China's export elasticity to tariffs at approximately -1.7 to -2.5, indicating that for every 1% increase in tariffs, China's exports to the U.S. could decline by 1.7% to 2.5%. In the worst-case scenario, an additional 60% tariff could reduce exports to roughly 10% of current levels.

Nonetheless, transshipment, or re-routing through third countries, may offset some of these impacts. Chinese scholars estimate a 40% mitigation effect from the first trade war. Given that the U.S. accounts for around 11-12% of China's total exports, the net effect on overall Chinese exports in an extreme scenario could be an approximate 7-8% decline after transshipment adjustments, translating to a potential around 1% GDP loss for China.

China's reaction: this time could be different.
When it comes to Trump's trade policies, there are both "knowns" and "unknowns." The "known" is that higher tariffs are a near certainty under his administration. The "unknowns" center around the implementation and strategic objectives of these tariffs. The key question is how Trump will implement this additional tariff, as the chosen approach will determine the timeline for its effect.

During Trade War 1.0, China adopted a "trading time for space" strategy, offering concessions to mitigate Trump's intentions. However, in Trade War 2.0, with uncertain U.S. objectives and a clear willingness to employ tariffs, this approach may no longer be effective. Instead, China may target Trump's capacity to wage a prolonged trade war, with U.S. inflation emerging as a critical vulnerability.

Recent Reuters/Ipsos poll shows inflation is the top concern for 35% of American voters during Trump's first 100 days in office, far exceeding trade and tariffs (1%). While some economists argue that tariffs have minimal inflationary impact due to currency depreciation and subsidies offsetting costs, China could exploit inflation as a pressure point.

If China actively induces inflation, it could inflict considerable economic pressure on the Trump administration. A 60% tariff that fails to significantly impact U.S. inflation would validate Trump's tariff strategy, potentially encouraging further tariff hikes and triggering a destabilising spiral.

Notably, China's Ministry of Finance announced on 15 November the removal or reduction of export tax rebates for certain goods. This policy shift could mark the beginning of a new strategy in trade wars, signalling China's willingness to adapt its approach.

We believe China's response could focus on two key areas: expanding domestic demand and reducing subsidies for overseas consumers. The competition between China and the U.S. has reached a point of no return, effectively becoming a contest of economic development models. Sustained domestic economic growth will be critical for long-term competitiveness.

China

In the near term, targeting U.S. inflation could prove to be an effective countermeasure. By exporting inflation, China could directly impact U.S. consumers and businesses, applying political and economic pressure on the Trump administration. This shift suggests that the era of subsidizing overseas consumers through fiscal tools is nearing an end.

The prevailing market consensus anticipates significant RMB depreciation during an intensified trade war, with some forecasts suggesting USDCNY could reach 8. However, RMB depreciation effectively subsidizes U.S. consumers by offsetting the inflationary effects of tariffs. This dynamic undermines the strategic value of tariffs and reduces China's leverage.

A stable RMB might better serve China's interests in Trade War 2.0 by preserving its ability to export inflation while minimizing domestic economic disruptions. However, exporting inflation would likely create global ripple effects, exacerbating challenges for other economies and heightening market volatility.

We recognise the significant risk of supply shocks stemming from President-elect Donald Trump's proposed tariffs. In October, we revised our 2025 GDP forecast for China upward to 4.8% YoY, accounting for the anticipated effects of accumulated stimulus measures. While the uncertainty surrounding the new tariffs poses challenges, we anticipate that their impact on China's growth will materialise primarily in the latter half of 2025, due to processing and implementation timelines. Consequently, the full effect of these tariffs may not be felt until 2026. We also expect China to intensify its fiscal stimulus efforts to mitigate the adverse effects of higher tariffs. Therefore, we are maintaining our 2025 GDP growth forecast for China at 4.8% YoY.

Hong Kong

Hong Kong: Interplay of headwinds and tailwinds

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- Headwinds from China's economic slowdown and the elevated interest rate environment are likely to moderate after China's stimulus package and the Fed's pivot, yet "Trump 2.0" could risk a worsening of US-China relations, and thereby dealing a blow to Hong Kong's economic recovery. Our full year GDP growth forecast for 2024 and 2025 are 2.4% YoY and 2.2% respectively, accounting for waning support from a low base. As for the labour market, we tip the overall unemployment rate at 3.0% this year and 3.1% in 2025, with the overall picture still pointing to a tight labour market.
- Approaching the end of 2024, Hong Kong dollar liquidity is likely to tighten further. Hence, there is room for HKD rates to underperform USD rates. We expect commercial banks to pause prime rate cuts in December, before slashing prime rates further by 37.5bp in 2025. 1-month and 3-month HIBORs are forecast to decline to 3.45% and 3.60% at end-June 2025, and 3.20% and 3.35% at end-December 2025 respectively.
- We expect to see some stabilisation in housing prices down the road, yet a more forceful rebound of prices will require help from banks to loosen their mortgage scrutiny, while the world economy continues on the soft-landing path. We now expect the price index to fall by 6-9% in 2024 and stay flat in 2025.

The interplay of headwinds and tailwinds

Entering 4Q24, there are a host of headwinds and tailwinds affecting economic momentum. On one hand, authorities in mainland China have unveiled a comprehensive multi-trillion-dollar stimulus package to support growth. At the same time, the Fed has kickstarted its interest rate normalisation, cutting by a total of 75bp thus far. Taken together, risk sentiment in local equity markets improved significantly, spurring an eye-popping rally. Yet, external demand continues to falter, while consumer spending remains a drag on growth. Moreover, rekindling uncertainties over the US inflation and Fed rate cut trajectory, together with concerns over US-China trade tensions, in view of US president-elect Trump's protectionist stance, present further headwinds.

Chart 1: Slowest pace of growth in five quarters

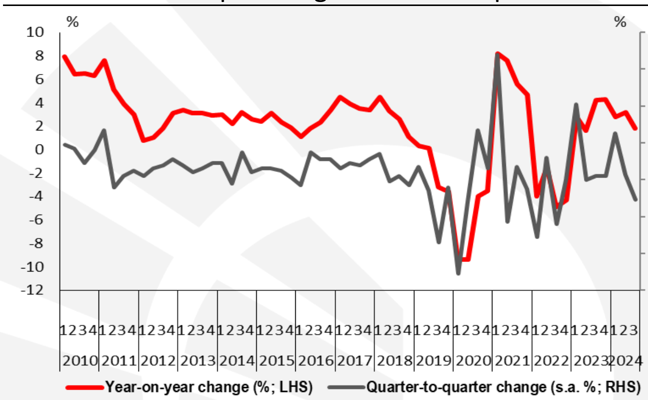
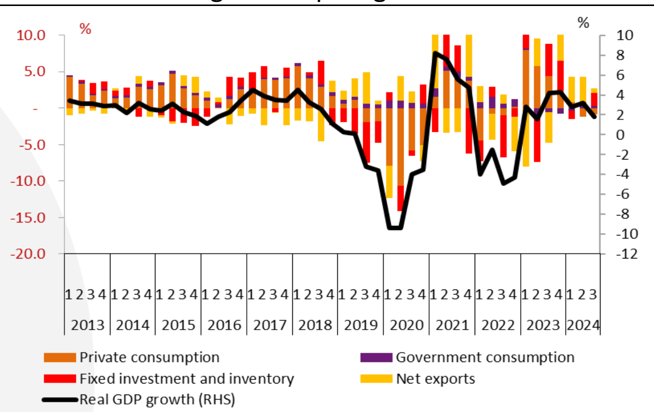


Chart 2: Weaker goods export growth



Sources: HK Census and Statistics Department, OCBC.

Hong Kong

Slowest pace of growth in five quarters

The economy grew by 1.8% YoY in 3Q24, the slowest pace in five quarters (2Q24: 3.2%; 1-3Q24: 2.6%) **(Chart 1)**. On a QoQ basis, real GDP declined by 1.1% QoQ sa (2Q: 0.3%). Growth momentum has weakened, on the back of weak goods export growth and a further contraction in domestic consumption **(Chart 2)**.

Growth in goods exports and gross fixed capital formation slowed to 4.0% YoY and 3.7% respectively (2Q24: 7.5% and 4.1%), reflecting weaker external demand and a higher base of comparison a year ago. Meanwhile, growth in private consumption expenditure contracted further by 1.3% YoY (2Q24: -1.6%), amid the weak consumption sentiment and still elevated interest rate environment. On the flip side, government expenditure and exports of services continued to grow by 2.1% YoY and 2.4% respectively (2Q24: 2.2% and 1.1%). Within the period, total visitor arrivals rose 9.6% YoY to an average of 3.8mn per month.

The near-term economic outlook remains somewhat challenging, with further signs of softening external demand. In 3Q24, growth of merchandise exports was 7.9% YoY, down from that of 12.5% in 2Q24. That said, recent stimulus measures unveiled by China and Fed rate cuts on the horizon should render some support. For one, the positive wealth effect created from the stock market rally in late September buoyed overall consumption sentiment. Total retail sales declined at a slower pace (-6.9% YoY in value terms) despite the sharp decrease in visitor arrivals after the end of the summer holidays. All in all, we keep our full year GDP growth forecast for 2024 unchanged at 2.4% YoY.

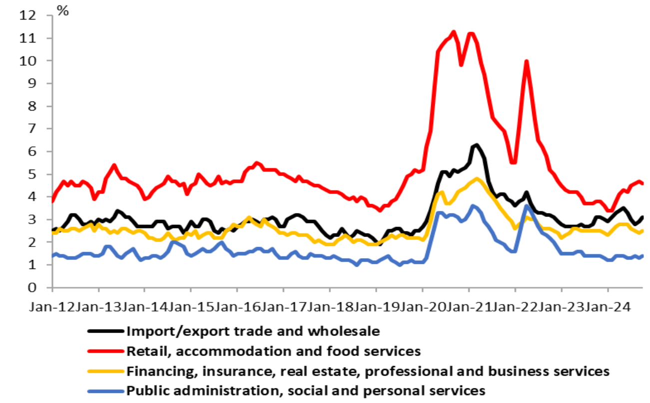
Citing increased global economic uncertainties and escalation of trade conflicts, the government revised downward its 2024 full-year growth forecast to 2.5%, from the previous range of 2.5%-3.5%. At the same time, their headline inflation forecast was lowered to 1.7% YoY from the previous estimate of 1.9%.

Labour market remained tight

The overall picture still points to a tight labour market, despite the unemployment rate in the "retail, accommodation and food services" sectors rising to their highest levels since late 2022 **(Chart 3)**. As for the other sectors, the unemployment rate fell back to early 2024 levels, reversing the uptick in 2Q24. The seasonally adjusted unemployment and underemployment rates were at 3.1% and 1.1% respectively in August-October 2024 **(Chart 4)**. We expect a further weakening of the job market in retail and trade-related sectors further down the road, albeit only mildly, and tip the overall unemployment rate at 3.0% this year and 3.1% in 2025. On a separate note, labour force growth was largely sustained, albeit at a slower pace. Compared with the recent low in mid-2022, the labour force grew by 2.2% to 3,827,900 in August-October 2024.

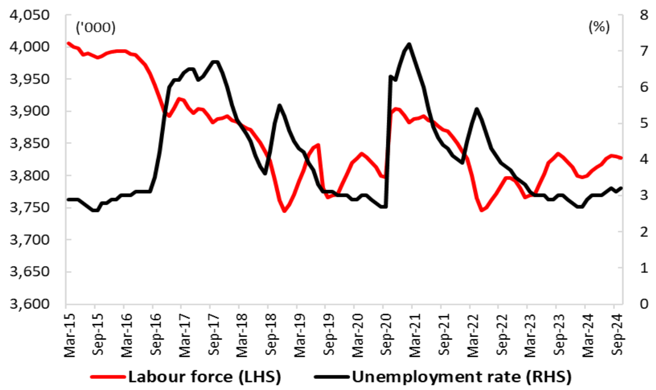
Hong Kong

Chart 3: Labour market remained tight



Sources: HK Census and Statistics Department, OCBC.

Chart 4: Growth of labour force slowed



Downbeat consumption sentiment

The retail market continues to be grappled by weak consumption sentiment and more outbound travels by residents for most of 2024. In the first nine months of 2024, total retail sales fell cumulatively by 7.6% YoY in value terms **(Chart 5)**. Consumers were considered generally more price sensitive, with retailers reporting that any increase in sales figure was due to vigorous promotions and discounts. We expect retail sales to stay weak in the next couple of months and record a mid-single digit decline for 2024. As for 2025, retail sales are expected to see a mild expansion of around 2% if positive wealth effects stemming from asset market rallies are sustained. However, if the property and stock markets failed to recover meaningfully, retail sales are forecast to fall further by low single digits.

According to the 2024 Policy address, the government will continue to support the retail and tourism industries, through organising more mega events and enabling more mainland tourists. The government also proposed to cut taxes levied on liquor to boost the "Night Economy". While the liquor tax cut and other tourism industry support measures could offer a one-off stimulus, they are unlikely to be an immediate game changer. Moreover, growth in inbound tourists may not directly translate to a surge in tourist spending, as many tourists were seen cutting back spending on big ticket items.

Other efforts made by the local government

The local government had stepped up efforts to rebrand Hong Kong in hopes of bringing in more tourists and investment. HKD1.09bn is allocated for developing an array of tourist attractions and activities in the city, including hosting monthly pyrotechnic and drone shows, while over HKD100mn would be earmarked to boost mega-event promotions over the next three years. Separately, the government would further enhance preferential tax regimes for related funds and single-family offices. To revive equity market sentiment, the government plans to introduce a treasury share buy-back regime and maintain trading operations even in severe weather, alongside other measures to boost market efficiency and liquidity. Separately, the government will also waive stamp duties payable on the transfer of REIT units and jobbing business of options market-makers.

Hong Kong

Chart 5: Retail sales still weak

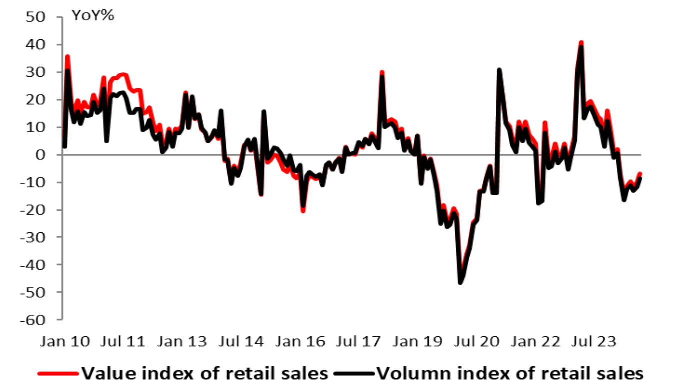
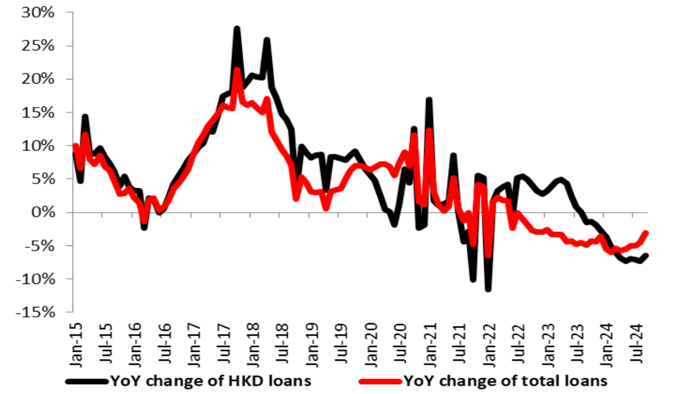


Chart 6: Decline in loan demand moderated



Sources: HK Census and Statistics Department, HKMA, OCBC.

Decline in loan demand moderated

While loan demand was consistently dented by high borrowing costs and the property market downturn, the YoY decline in total loans narrowed, with the help of a normalised base. In addition, loans to stockbrokers and loans to financial companies rose noticeably on the back of the stock market rally in September. Total loans and advances shrank by a slower pace of 3.1% YoY at end-September **(Chart 6)**, while that for loans for use in Hong Kong contracted by 4.1% YoY. Within the latter, loans to most economic sectors fell by a smaller extent. Entering 2025, loan demand should stabilise somewhat as interest rates recede, yet the recovery may be delayed given the rising uncertainties. The HKD loan-to-deposit ratio may test the recent low at 75.3% (currently at 78.36%) in 2025.

Supercharged "bull market" and IPO re-exuberance

The series of policy support measures, as well as China's stimulative measures and market-favoured corporate actions (including share buybacks, increased dividend payouts), breathed life into the battered local stock market. The Hang Seng Index staged an impressive rally in late September, bouncing by more than 30% from the trough seen in January, before paring back some gains **(Chart 7)**. Transaction volume reached a record high of HKD620bn on 8 October, up from the average daily turnover of HKD105bn in 2023.

Total funds raised by IPOs tripled in 3Q24 to HKD42.4bn **(Chart 8)**, compared with the sum of HKD13.2bn in 1H24, mostly due to a blockbuster listing in September. After such long dry spells, there was a considerable amount of pent-up fundraising and listing demand. The recent re-exuberance of the IPO market was an example of issuers capturing the window of opportunity, as policy setting turns increasingly favourable, and market sentiment improves.

Mainland authorities extended regulatory support for offshore listings of corporates, helping to ease the IPO backlog. On the other hand, risk sentiment also made a turnaround as interest rates receded and Chinese stimulus measures were unveiled. Before that, however, we had already seen stronger investor interest in late 2Q24 and early 3Q24 judging by the subscription rate, as well as improvement in post-IPO performances. Listings are expected to grow further in the coming quarters, given the solid pipeline.

Hong Kong

Chart 7: Rally in the Hang Seng Index

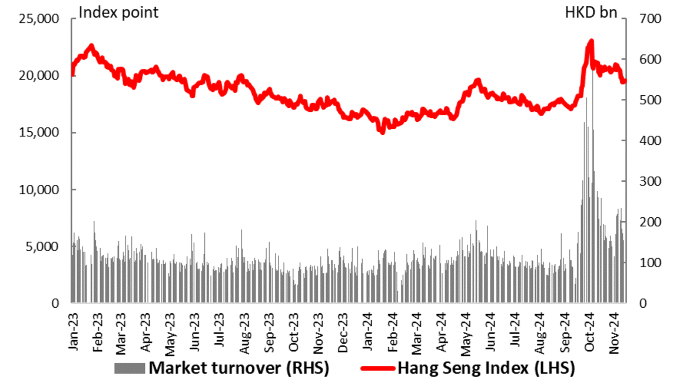
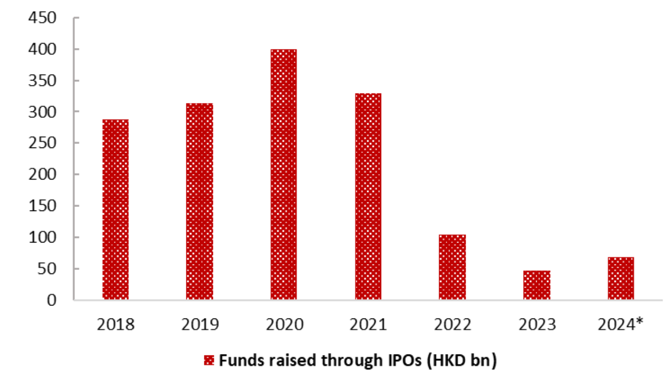


Chart 8: IPO re-exuberance



Sources: HK Rating and Valuation Department, Land Registry, HKEX, Blomberg, OCBC.
(*) Data for the first ten months of 2024.

Volatility is the name of the game

Following Trump's decisive election victory, everyone on the street had their own takes on the fortunes of Hong Kong equity market. Some downgraded their views to underweight, citing the potential risks of tariff and geopolitics, while others paraded the cheap valuation. Performance-wise, the Hang Seng Index dropped by more than 8% since the US election, cutting one third of the year-to-date gain. While the crystal ball is still murky, one thing is for sure. Markets are likely to stay highly vigilant regarding news flows coming out of the new US administration. On the China side, the bar to surprise markets continues to rise, as the authorities calibrate their policy responses. In short, there will not be any shortage of volatility in the equity market ahead.

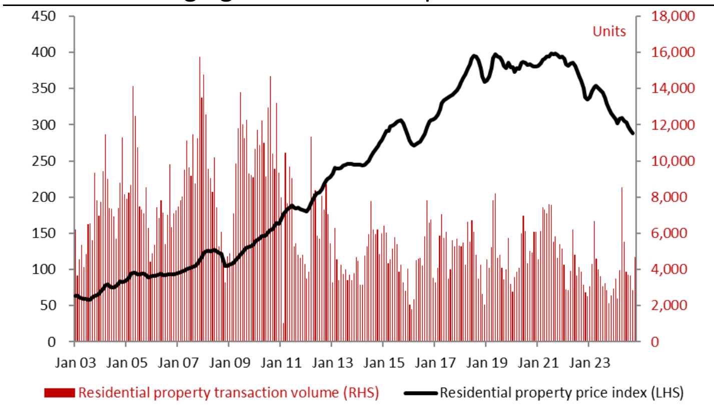
Extended slump in property prices

Housing prices and rent continued to show a diverging trend of late. The residential property price index fell by 1.7% MoM in September, the lowest level since August 2016. Meanwhile, the rental index rose by 0.1% MoM, the seventh consecutive month of growth. In the first nine months this year, the housing price index fell cumulatively by 7.5%, whereas the rental index increased by 5.4% **(Chart 9)**.

Following the September FOMC meeting, developers have increased the pace of launch of primary projects. These projects have generally been well received by the market. Total transactions rose to 4,697 cases in October, well above the monthly average of 3,408 cases in 3Q24. Nonetheless, general market sentiment remained cautious, while buyers' bargaining power stayed relatively strong in the face of abundant supply. Still, we expect to see some stabilisation in housing prices down the road, given the prime rate cut and increased housing demand from talent inflows. However, a more forceful rebound of prices will require help from banks to loosen their mortgage scrutiny, while the world economy continues on the soft-landing path. We now expect the price index to fall by 6-9% in 2024 and stay flat in 2025.

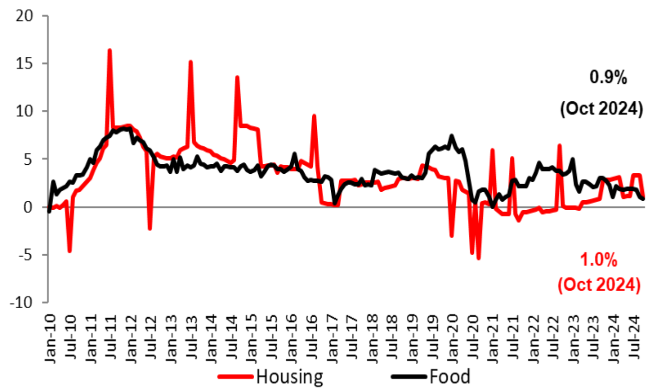
Hong Kong

Chart 9: Diverging trend between prices and rent



Sources: HK Rating and Valuation Department, Bloomberg, OCBC.

Chart 10: Inflationary pressures stayed mild



HKD rates' outperformance may be delayed

The Hong Kong Monetary Authority cut its base rate by a total of 75bps to 5%, under a pre-determined formula following the Fed rate cuts. Correspondingly, major commercial banks in Hong Kong also cut their prime rate by a total of 50bps (25bp in September and November). The higher pass-through rate at 67% (50bps cut in prime rate in response to 75bps cut in Fed fund rate) could be attributed to the subdued loan-to-deposit ratio (78.4% at end-September, the lowest since September 2017).

As we approach the end of 2024, Hong Kong dollar liquidity is likely to tighten further. Hence, there is room for HKD rate to underperform the USD rates. We expect commercial banks to pause prime rate cuts in December, before slashing prime rates further by 37.5bp in 2025. Looking ahead, when the seasonality effect wanes, if inflows into HKD assets riding on Chinese stimulus are sustained, and if HKD loan demand recovers, then our medium-term view for HKD rates to underperform USD rates on a downtrend shall materialise earlier. 1-month and 3-month HIBORs are forecast to decline to 3.45% and 3.60% at end-June 2025, and 3.20% and 3.35% at end-December 2025 respectively.

Inflationary pressures still mild

Inflationary pressure stayed mild. In the first ten months this year, composite CPI rose by an average 1.8% YoY, while underlying CPI (netting out the effect of government one-off relief measures) rose by a milder 1.0%. The pick-up in inflation in 2H24 was largely due to an end of rates concession and upward adjustments in MTR fares. Price pressures for other components remained largely tamed **(Chart 10)**. We revise downward the 2024 full year inflation forecast to 1.7% YoY, in view of receding external price pressures and weak consumption sentiment and tip the 2025 inflation forecast at 2.0% on the back of higher rent, services and utilities charges.

Hong Kong

Watch out for “Trump 2.0”

While headwinds from China’s economic slowdown and an elevated interest rate environment are likely to moderate after China’s stimulus package and the Fed’s pivot, “Trump 2.0” could risk a worsening of US-China relations, thereby dealing a blow to Hong Kong’s economic recovery. Moreover, investment sentiment is also adversely affected by heightened tension. Without a sustained recovery in the property and stock markets, consumer spending will likely remain bleak in periods ahead. Our full year growth forecast for 2024 and 2025 are pitched at 2.4% and 2.2% respectively, accounting for waning support from a low base. In 2025, the labour market is likely to stay tight, with the unemployment rate tipped at 3.1%, while inflationary pressures are expected to remain mild.

India

India: Signs of slowing growth amid sticky inflation

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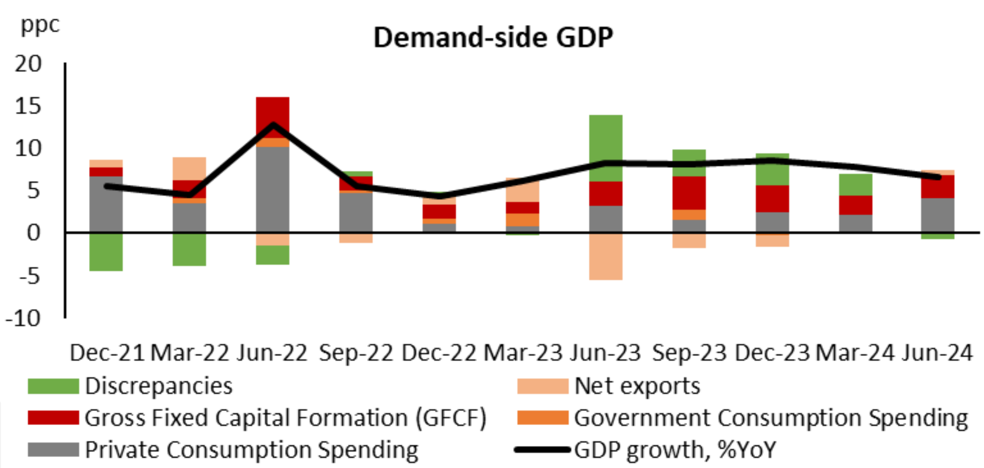
- The cyclical growth slowdown has intensified in recent months. We lower our Fiscal Year 2025 (April 2024 to March 2025) GDP growth forecast to 6.2% YoY versus 8.2% in FY24.
- Headline inflation has remained volatile due to food prices, but we expect the broader disinflation trajectory to remain intact. Our forecast is for headline CPI to average 4.6% YoY in FY25 versus 5.4% in FY24.
- We expect fewer rate cuts from the Reserve Bank of India (RBI) to the tune of a cumulative 50bps in rate cuts in 1H25 versus 75bp previously.

The macroeconomic backdrop shifted towards slowing growth and sticky inflation in 1H24. The situation was complicated by external risk factors, namely the US Presidential elections and continued tensions in the Middle East. Looking ahead into 1H25, big questions for policymakers include whether the RBI will be able to join in the regional rate cut party before it is too late and whether India's growth story will hold water even amidst the external challenges.

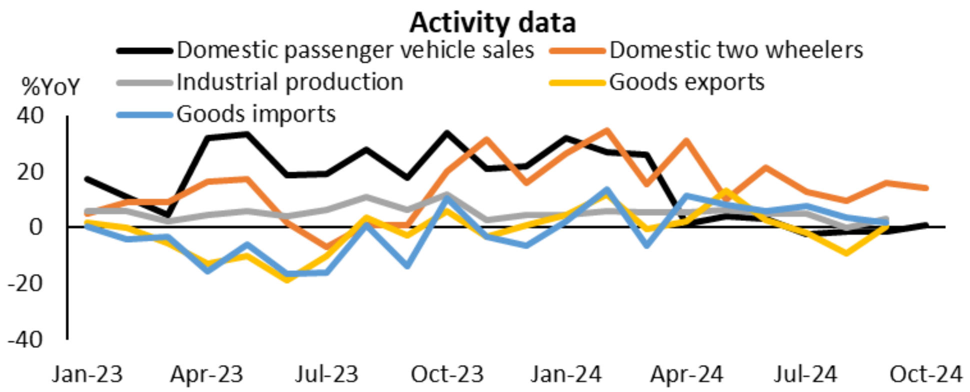
The growth picture was mixed in 2Q24. GDP growth slowed to 6.7%YoY versus 7.8% in 1Q24, while Gross Value-Added (GVA) growth picked up to 6.8% YoY versus 6.3% in 1Q24. The details of the GDP print, however, shows that much of the slowdown was driven by 'discrepancies' while the contribution of domestic demand (6.7 percentage points from 4.5pp in 1Q24) and net exports (0.7pp from 0.1pp) increased in 2Q24 from 1Q24. On the supply-side, growth in the services, agriculture and construction sectors improved in 2Q24 versus 1Q but manufacturing sector growth slowed to 7.0% YoY versus 8.9% in 1Q24.



Source: CEIC, OCBC.

India

The monthly activity data for 3Q24 showed few signs of a turnaround. Growth in the industrial production index was volatile in 3Q24 and slowed on average to 2.6% YoY versus 5.5% in 2Q24. Growth across the major sectors, i.e., mining, manufacturing and electricity also slowed during the quarter. Similarly, domestic passenger vehicle sales dropped by 1.9% YoY in 3Q24 versus 2.8% in 2Q24 and two-wheeler sales growth slowed to 12.6% YoY (2Q: 20.4%). On the external front, export growth dropped by 3.8% YoY in 3Q24 versus 5.9% in 2Q24 while import growth slowed to 4.1% YoY in 3Q24 versus 8.4% in 2Q24.

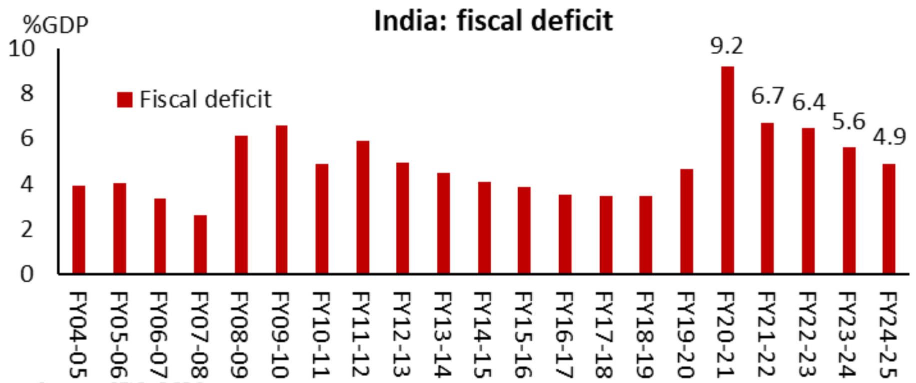


Source: CEIC, OCBC.

The data suggests that GDP growth will weaken to 6.6% YoY in 3Q24 versus 6.7% in 2Q24. We had initially expected that growth momentum would improve in 1H FY24 before weakening in 2H. However, the slowdown has come earlier than anticipated. As a result, for FY25, i.e. April 2024 until March 2025, we lower our GDP growth forecast to 6.2% YoY versus 8.2% in FY24 (previous: 7.2%). For FY26 and FY27, we maintain our GDP growth forecasts of 6.2% and 6.0%, respectively.

The government has, however, planned to increase expenditures in FY25. The details of budget FY25 suggest that expenditures will rise by 8.5% YoY from 7.3% in FY24. Capital expenditures are budgeted to rise by 17.1% YoY, similar to FY24 while revenue (or operational) expenditures will rise by 6.2% YoY (FY24: 4.6%). The consolidation is expected to be driven by higher revenue collections, budgeted to rise by 14.7% in FY25 from 10.0% in FY24. While tax revenue growth of 11.0% remains broadly in line with nominal GDP growth, non-tax revenues are expected to rise by 35.8% YoY.

India

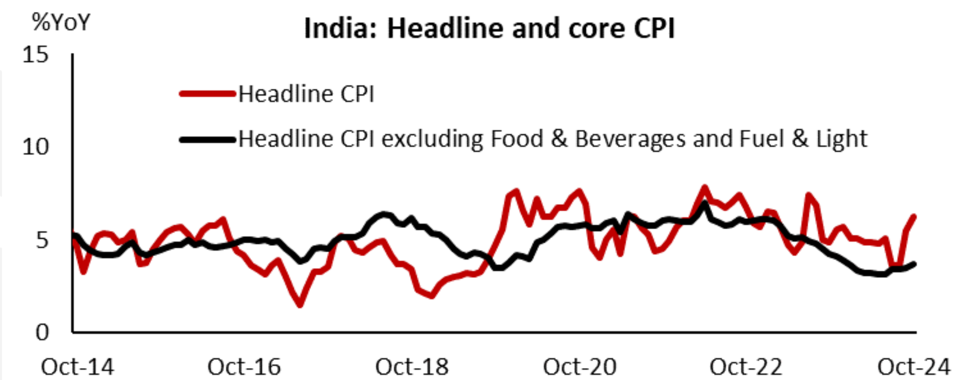


Source: CEIC, OCBC.

The fiscal deficit is forecasted to narrow to 4.9% of GDP in FY25 – a revision that was made following the May/June elections, from 5.6% in FY24. Further consolidation will be required in FY26 for the government to attain a fiscal deficit lower than 4.5% of GDP by FY26. The central government debt to GDP ratio stood at 57.8% at the end of March 2024. This, when combined with outstanding liabilities of states and union territories (UTs), suggests that public sector debt was 84.8% of GDP at end-March 2024.

With fiscal consolidation intact, the onus of inflation management rests squarely with the RBI. Unfortunately, inflationary pressures have been volatile. Headline CPI rose by 6.2% YoY in October 2024 from a low of 3.7% in July 2024, driven by volatile food item namely oils, cereals and vegetables. This was above the RBI's 2-6% headline inflation target range. The stickiness in headline inflation could persist particularly if the crop season for cereals (rice and wheat), pulses and oilseeds is underwhelming, and production becomes constrained. Retail fuel prices declined April to October 2024 as the base effects proved supportive. Electricity and LPG prices were also lower.

Core inflation, excluding food and fuel, also ticked higher to 3.7% YoY in October versus 3.5% in September. Looking ahead, we expect some disinflationary momentum to remain intact, with headline CPI averaging 4.6% YoY in FY25 versus 5.4% in FY24. For FY26 and FY27, we expect inflation to average 4.7% and 3.7%, respectively.



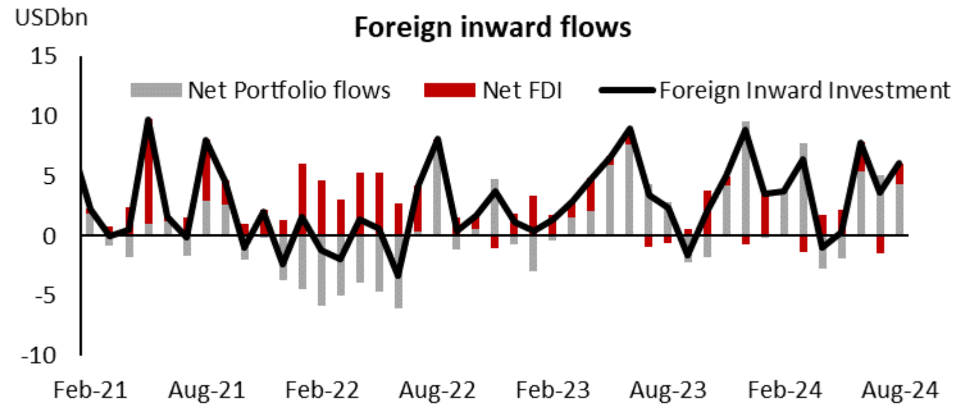
Source: CEIC, OCBC.

India

Sticky inflation makes it more difficult for the RBI to lower its policy rate in the near-term. It opened the door to rate cuts after its shifted to a “neutral stance” on 9 October, likely on account of slowing growth momentum.

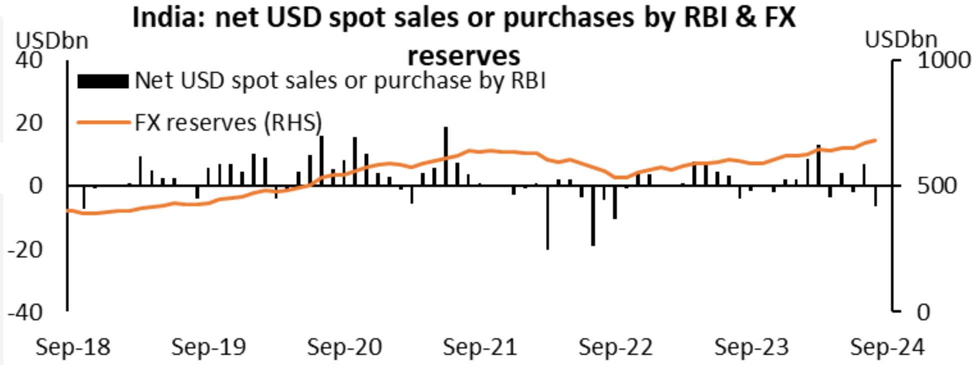
We are looking for a cumulative 50bps in rate cuts in 1H25. Once headline inflation returns to the target band, RBI will be incentivised to expedite rate cuts, given the impending inflationary pressures from US trade and tariff changes. The risk is that inflationary pressures remain sticky to a point where RBI is forced to stay on hold despite cyclically weaker growth.

Meanwhile, banking sector liquidity for the most part, with the exception of late September, was in a surplus so far in 2H24, with the RBI’s operations geared towards liquidity absorption. On the external front, the portfolio flows picture has remained robust. The impending inclusion of India into the JPMorgan GBI-EM index, Bloomberg Emerging market index from January 2025 and FTSE Russell EM bond index from September 2025 (in a phased manner) will support portfolio inflows into the country.



Source: CEIC, OCBC.

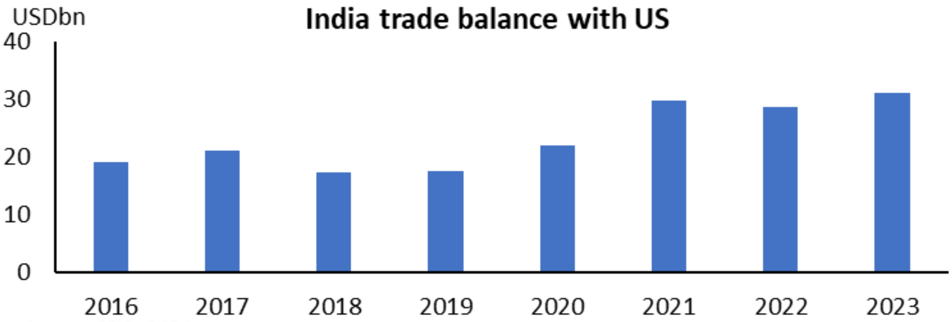
Despite the relatively robust flows picture, the currency (INR) underperformed regional peers and weakened 1.2% versus USD since July 2024 (as of 14 November). This is likely explained by net spot USD purchases by RBI during periods of heightened appreciation pressures on EM Asia FX, including INR. Concomitantly, RBI’s FX reserves war chest, as of 27 September 2024 was USD704.9bn, or 12.1 months of annualised merchandise imports according to RBI.



Source: CEIC, OCBC.

India

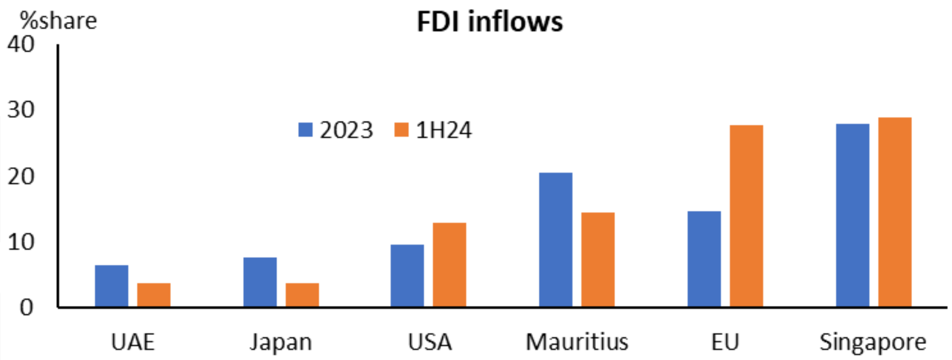
India may be resilient but not immune to US tariff policies
The US is one of India's crucial trading partners for goods and services. Specifically for goods exports, the US accounts for ~18% of total exports while the US' share of imports account for 6-7% of total imports. India has a bilateral trade surplus with the US to the tune of USD31.2bn in 2023 and USD29.6bn year-to-August 2024. Trade tensions between India and US were rife during President Trump's first term as President where he referred to India as the 'tariff king'. He withdrew General Scheme of Preferences (GSP) privileges for India's exports to the US, effective 5 June 2019, which in hindsight had a fairly limited impact on exports to the US.



Source: CEIC, OCBC.

However, the same cannot be said about the impact of higher tariffs, especially if higher tariffs are slapped on all of the US' key trading partners. We expect that India's annual GDP growth will be impacted by 0.3-0.6 percentage points (pp) from a one-time implementation of 10% and 20% tariffs on US exports, respectively. Under a scenario where tariff increases are limited to Mainland China, the impact on India's GDP will be negligible as it stands to benefit from continued supply chain diversification.

Over the medium-term, similar to the ASEAN region, India will likely benefit from continued supply-chain diversification. India's FDI base is quite well diversified - in 2023, 28% of FDI inflows were from Singapore, 20% from Mauritius, 14.5% from EU, 9.5% from US, 7.5% from Japan and 6.5% from UAE – suggesting that it is attractive for a variety for reasons and across various sectors.



Source: CEIC, OCBC.

Indonesia

Indonesia: Stable but watching risks

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- The political transition was smooth and the first steps by the new government have signalled prudent economic policy making.
- We expect GDP growth of 5.1% in 2025 versus 5% in 2024 supported by investment spending and private consumption.
- Bank Indonesia (BI) will remain vigilant of external risks and the potential impact of US tariffs. We now expect cumulative rate cuts of 50bp versus 100bp previously, taking the policy rate to 5.50% rather than 5.00%.

This year was characterised by a smooth leadership transition, which saw Prabowo Subianto take over as President from Joko Widodo. President Prabowo inherits an economy with broadly stable growth momentum, manageable inflation, modest external and fiscal deficits. Even so, President Prabowo's job will not be a bed of roses. Against a backdrop of potentially higher global trade protectionism, limitations to existing policies and a desire to push growth to above the 5% handle, the road ahead will have its fair share of challenges.

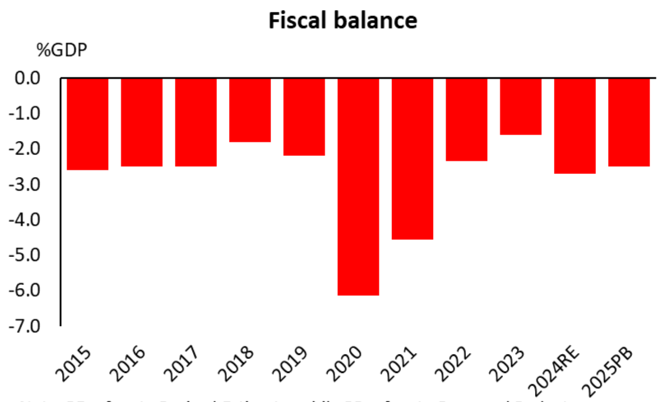
That said, the administration started on a positive note. President Prabowo's cabinet appointments have proved sound, namely re-appointing Sri Mulyani Indrawati as Finance Minister, Eric Thohir as SOE Minister and Airlangga Hartarto as Coordinating Minister for Economic Affairs. This suggests that there will be continuity for certain policies such as developing down streaming capabilities in the resources sector and building the new capital city of Ibu Kota Nusantara (IKN).

Red-White Cabinet Appointment (selected few)	
Coordinating Ministry for Political and Security Affairs	Budi Gunawan
Coordinating Ministry for Legal, Human Rights, Immigration and Corrections	Yusril Ihza Mahendra
Coordinating Ministry for Economic Affairs	Airlangga Hartarto
Coordinating Ministry for Human Development and Cultural Affairs	Pratikno
Coordinating Ministry for Infrastructure and Regional Development	Agus Harimurti Yudhoyono
Coordinating Ministry for Community Empowerment	Abdul Muhaimin Iskandar
Coordinating Ministry for Food	Zulkifli Hasan
Ministry of State Secretariat	Prasetyo Hadi
Ministry of Home Affairs	Muhammad Tito Karnavian
Ministry of Law	Supratman Andi Agtas
Ministry of Finance	Sri Mulyani Indrawati
Ministry of Industry	Agus Gumiwang Kartasasmita
Ministry of Trade	Budi Santoso
Ministry of Energy and Mineral Resources	Bahlil Lahadalia
Ministry of State-Owned Enterprises	Erick Thohir
Minister of Investment and Downstream/Head of Investment Coordinating Board	Rosan Perkasa Roeslani
Minister of Cooperatives	Budi Arie Setiadi

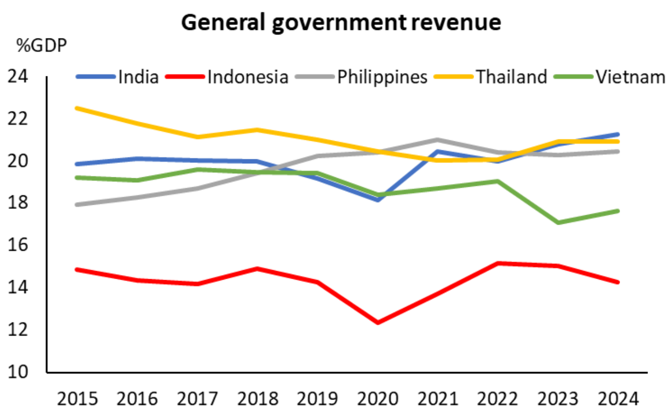
Indonesia

Following President Prabowo's victory, investor concerns were mainly related to wider fiscal deficits and possibly breaching the legal deficit limit of 3% of GDP. These fears have not materialised and in fact, Budget 2025 marks a continued sense of fiscal propriety. The government plans to narrow the deficit marginally to 2.5% of GDP from 2.7% in 2024.

Tax revenues are projected to rise by 12.3% YoY compared to the expected 3.0% in 2024, aided by stable global commodity prices and higher VAT – the tax is scheduled to be increased from 11% to 12% by January 2025. Notwithstanding, raising medium-term revenue (either through new taxes or administrative measures) will be important given Indonesia's general revenue to GDP ratio is the lowest amongst peers. It has also been broadly stable over the past decade despite various measures to boost revenues including the 2021 Tax Harmonisation Law.



Note: RE refers to Revised Estimate, while PB refers to Proposed Budget.
Source: MoF, CEIC, OCBC.



Source: IMF Fiscal Monitor Oct 2024, OCBC.

Meanwhile, the slowdown in total expenditure growth will be driven by a deceleration in operating expenses in 2025, which includes personnel spending (11.4% down from 11.7%) and interest payments (10.8% down from 13.4%). In addition, subsidy spending is projected to fall by 1.5% YoY, with non-energy subsidies budgeted to decline by 13.7%, despite a forecasted increase of 6.1% YoY in energy subsidies. This indicates that retail fuel price adjustments are unlikely for the upcoming year. However, the government has indicated plans for more targeted subsidy expenditures.

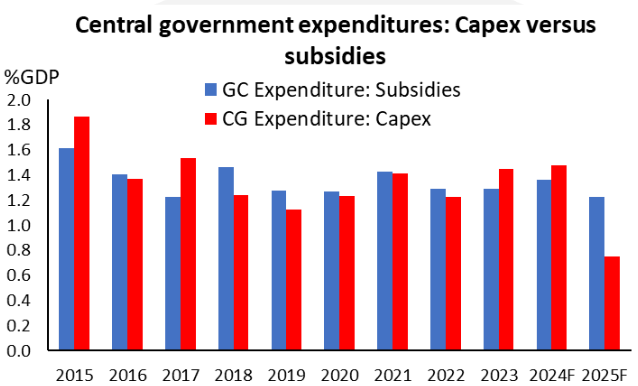
Notably, capital expenditures are also set to decline by 43.8% YoY, with infrastructure spending expected to contract by 3.9%. However, there is a shift towards social spending, with significant increases in education and healthcare budgets, including IDR71trn allocated for a 'free meal program' as part of President Prabowo Subianto's initiatives.

Indonesia

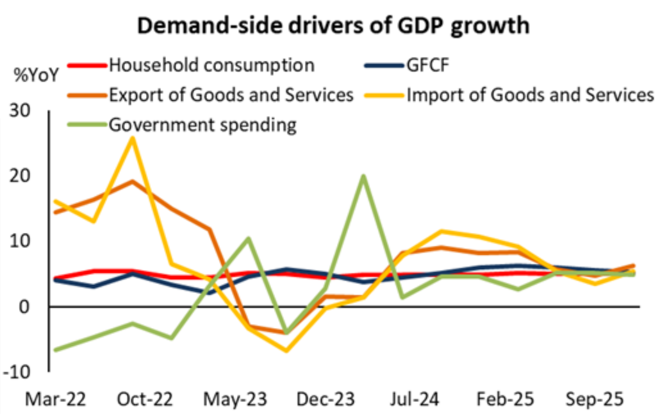
Accounts (IDRtrn)	2023	2024		2025
	Realisation	Budget	Outlook	Budget Proposal
Government Revenue and Grant	2783.9	2802.3	2802.5	2996.9
Domestic Revenue	2634.1	2766.7	2767.5	2996.3
Tax	2154.2	2309.9	2218.4	2490.9
Domestic Tax	2089.7	2235.0	2152.4	2433.5
International	64.5	74.9	66.0	57.4
Non-Tax	612.5	492.0	549.1	505.4
Grant	17.2	0.4	34.9	0.6
Government Expenditure	3121.2	3325.1	3412.2	3613.1
Central Government	2239.8	2467.5	2558.2	2693.2
Personnel	412.7	484.4	460.9	513.2
Material	432.7	407.0	436.9	342.6
Capital	303.0	247.5	338.9	190.6
Interest Payment	439.9	497.3	499.0	552.9
Subsidies	269.6	286.0	313.8	309.1
Grant	0.2	0.0	0.0	0.2
Social Assistance	156.6	157.3	153.3	152.7
Others	225.0	388.0	355.4	631.9
Regional	881.4	857.6	854.0	919.9
Government Deficit or Surplus	-337.3	-522.8	-609.7	-616.2
% GDP	-1.6	-2.3	-2.7	-2.5

The expenditure allocations in Budget 2025 may imply a shift of focus from infrastructure spending to social development, but we believe this is not necessarily the case. The current fiscal regime of conservatism necessitates a more balanced budget allocation between infrastructure and social priorities. There is room for both avenues of expenditures to be pursued but the trade-off will be rationalising fuel subsidies. Although expenditures have declined from a high of 3.6% of GDP in 2012 to 0.8% in 2023, it remains a source of expenditure inefficiencies.

For 2025, continued fiscal conservatism suggests that GDP growth will remain around the 5% handle. We forecast modestly higher growth of 5.1% versus 5.0% in 2024. The near-term outlook will be shaped by resilient domestic demand, namely stable household spending and investment spending.



Note: The 2024F and 2025F are OCBC estimates. The 2024F is based on the outlook figures, while the 2025F forecast is based on the proposed budget figures.
Source: MoF, CEIC, OCBC.

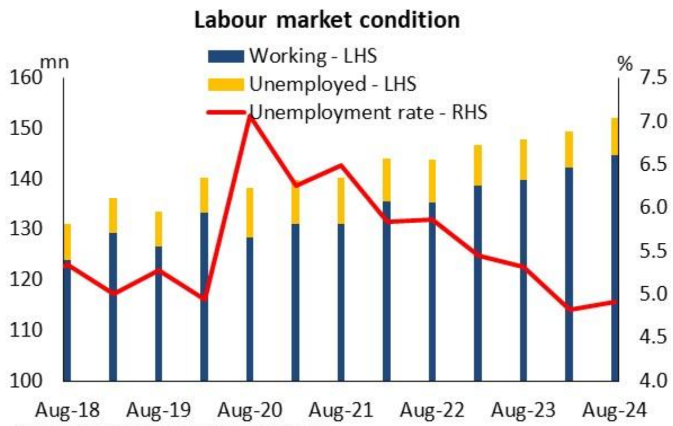


Note: 4Q24-4Q25 are based on OCBC forecast. Source: BPS, CEIC, OCBC.

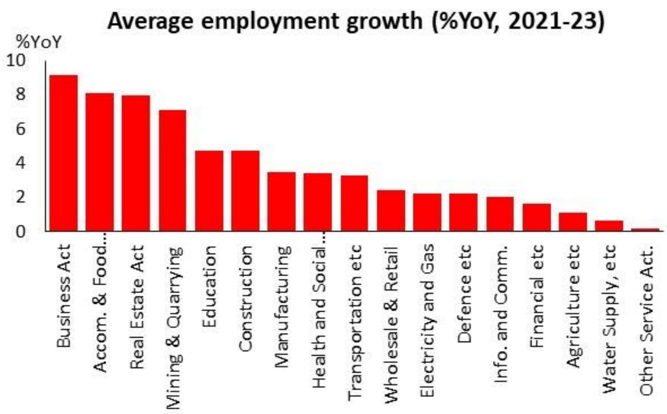
Indonesia

We expect domestic demand to contribute 4.8 percentage points (pp) to headline growth in 2025, compared to 4.7 pp in 1Q-3Q24. Specifically, stable inflation, rising real wages, and improving labour market conditions will keep private consumption robust. The unemployment rate has fallen back to pre-pandemic levels and was 4.9% in August 2024 (August 2023: 5.3%), with the share of formal employment rising to 42.1% in August 2024 compared to 40.9% in August 2023.

There was also employment growth in key sectors, including manufacturing, construction, and trade. Fiscal and monetary policies will also be supportive of household spending. BI extended looser macroprudential measures of zero downpayment on automotives and property until end-2025 while the government plans to continue to forego the sales tax on property and battery-based electric vehicles purchases[4].



Source: Statistics Indonesia, CEIC, OCBC.



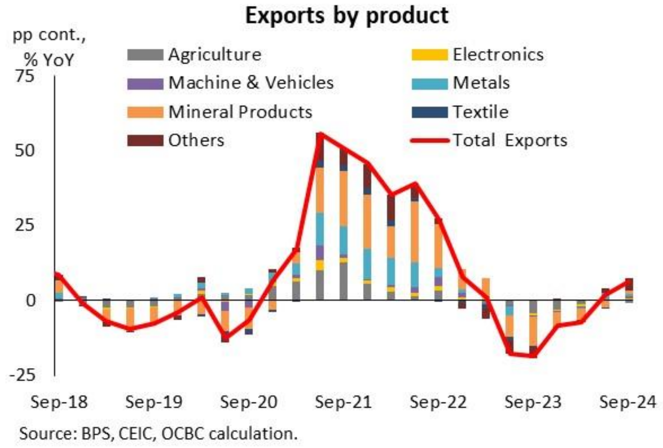
Source: Statistics Indonesia, CEIC, OCBC

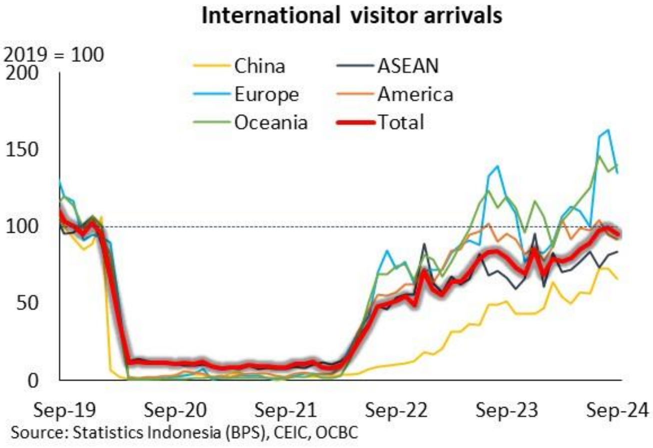
On the investment side, the extension of the corporate tax holiday policy for investment plans worth at least IDR100bn in key "pioneer" industries through to December 2025 will be supportive. These industries include, but are not limited to, upstream basic metals, oil and gas refining, economic infrastructure, and the digital economy. This initiative complements the government's ongoing efforts to boost infrastructure investments, particularly outside Java, including projects such as the new capital city of IKN and additional toll roads.

Relatively robust domestic demand will be tempered by weaker external demand. Weaker GDP growth in China and the US in 2025 will provide little support for export performance in 2025. Meanwhile, the recovery in global electronics demand will offer only a limited boost to exports given that the domestic electronics supply chain is not completely integrated into the global supply chain.

[4] The Coordinating Minister for Economic Affairs revealed on November 3, 2024, that the government plans to propose several priority incentives, including tax exemptions (PPN DTP) for electric vehicles and property, along with financing programs like People's Business Credit (KUR).

Indonesia

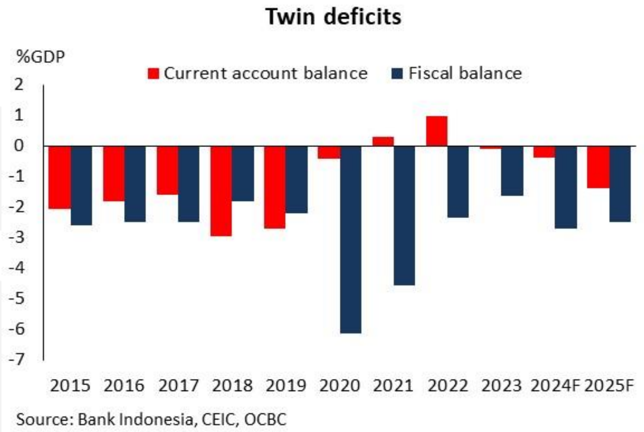


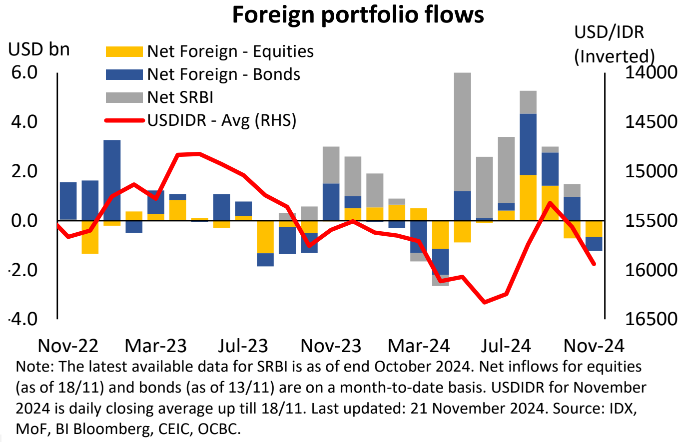


Moreover, the risks are towards the downside from potential aggressive trade policies in the US under a second Trump presidency. Under a scenario where tariffs are imposed either on China or all of the US main trading partners, we estimate that US tariffs could result in growth falling by 0.1pp to 0.5pp, depending on the tariff policy pursued (see: *Assessing the Impact of Potential Tariffs*, 4 November 2024).

The tourism sector will likely continue to recover in 2025, as has been the case in 2024. Cumulative visitor arrivals from January to September 2024 were 10.4mn, up 20.3% YoY but still 1.7mn below the 2019 level for the same period. The tourist arrivals target is 17mn in 2025, up from a targeted 10.4mn – 14.3mn in 2024. Despite better tourism inflows, we expect the current account deficit (CAD) to widen to 1.4% of GDP in 2025 from 0.6% in 2024.

'Twin deficits', i.e. deficits on the fiscal and current account, will continue into 2025. Indeed, with the CAD widening to 0.8% of GDP for 1Q-3Q24, we widened our full year 2024 CAD forecast to 0.6% of GDP from 0.4% previously. This suggests that BI will remain vigilant of capital outflow risks. Net equity and bond outflows were USD1.2bn (1-18 November) versus marginal inflows of USD0.2bn in October. Indeed, capital flows were highly volatile for most of 2024, dependent on external factors namely the timing and magnitude of US Federal Reserve rate cut expectations.

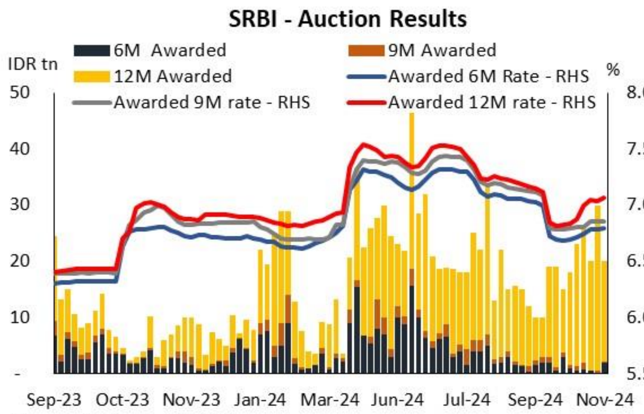




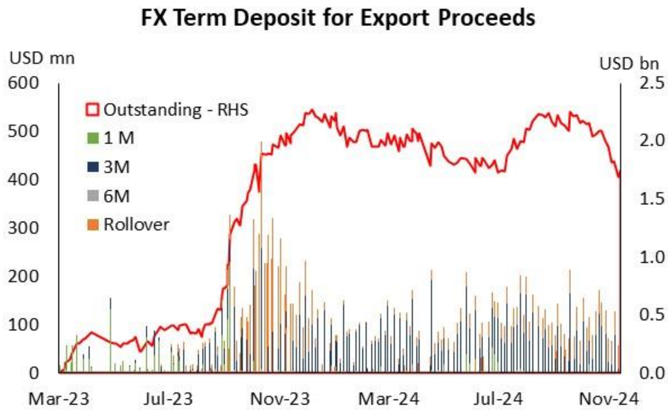
Indonesia

This volatility underlines BI's focus on attracting inflows and maintaining IDR stability. Foreign ownership of the SRBI instrument, which BI introduced in September 2023, has increased to 27% as of October 2024 while foreign ownership of government bonds, which was reduced to 14.9% in October 2024 from a peak of 41.1% in January 2018.

Policymakers will continue to tweak financial instruments to attract inflows in 2025, in our view. For instance, the government is considering extending the mandatory retention period for export earnings beyond the current three months.[5] Supporting this, BI's data shows a decline in the net outstanding balance of FX term deposits for export proceeds, which fell to USD1.7bn as of 18 November from USD2.16bn at the end of September, with most placements in the 3-month tenor.



Source: Bank Indonesia, CEIC, OCBC.



Source: Bank Indonesia, CEIC, OCBC calculation.

Meanwhile, the direct investment picture is more stable. The cumulative foreign direct investment (FDI) for January to September 2024 rose by 15.4% YoY, reaching USD43.6bn, with the basic metal industry (23.3% share) and mining (8.8%) among the largest recipients, a testament to the success in attracting investment in downstream industries. With the supply chain diversification and re-routing set to continue into 2025, we expect FDI inflows to remain strong.

That said, it is becoming increasingly clear that a significant portion of foreign investment into Indonesia originates from Chinese entities, highlighting some concentration risks. China is Indonesia's second-largest investor, contributing USD5.8bn (3.4% YoY) in 1Q–3Q24, followed by Singapore (USD14.4bn). This reliance poses challenges for Indonesia to make in-roads into the US, particularly if the Inflation-Reduction Act (IRA) remains unchanged under President-elect Trump. The IRA offers tax incentives for EV batteries, which Indonesian producers would have been eligible to obtain. However, the clause related to "foreign entities of concern"[6] means that nickel exported from Indonesia could be excluded since Chinese entities own more than 25% shares of some companies.

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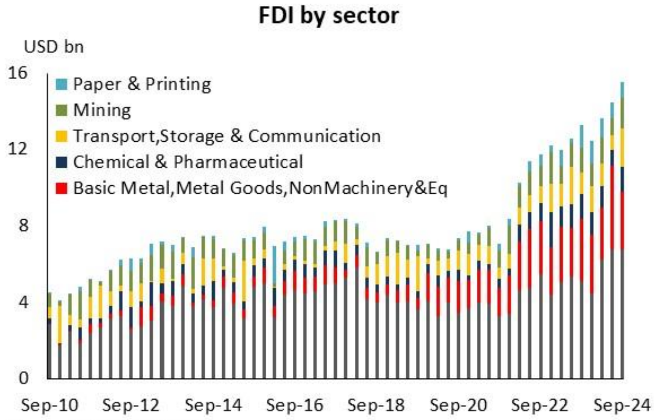
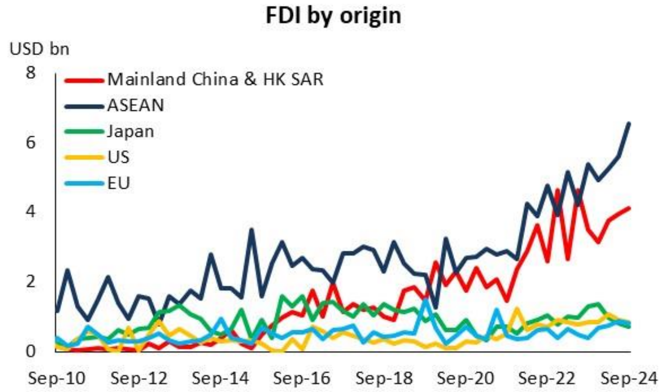
[5] The existing regulation requires natural resource exporters (i.e., mining, forestry, plantations, and fisheries) with earnings of at least USD250,000 or the equivalent to keep a minimum of 30% of their foreign exchange proceeds onshore for at least three months. This mandatory regulation was introduced in August 2023 as part of efforts to increase dollar supply.

[6] See the US Federal Register's Interpretation of Foreign Entity of Concern for more details.

Indonesia



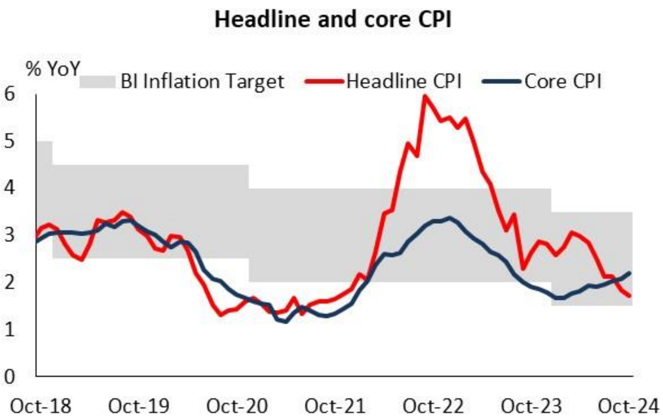
Source: BKPM, CEIC, OCBC.



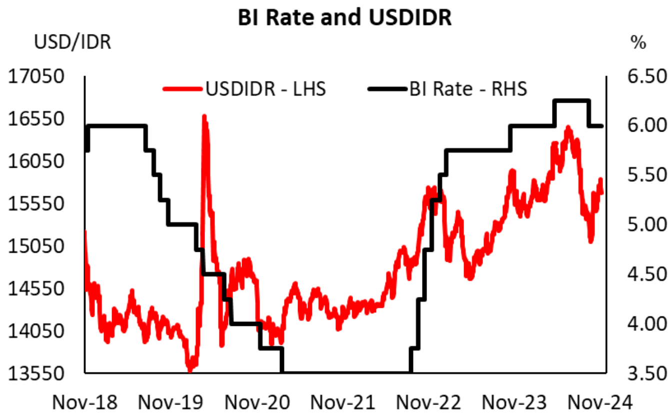
Source: BKPM (quarterly data), CEIC, OCBC.

Notwithstanding, from BI's point of view, the portfolio picture is more critical, given its direct impact on IDR stability. The room for BI to further reduce its policy rate has narrowed. We now expect BI to cut its policy rate by a cumulative 50bps, taking the rate to 5.50% rather than 5.00%. The timing will be dependent on IDR stability.

The inflation backdrop remains supportive - we forecast headline CPI to pick up slightly to 2.8% in 2025, within BI's target range of 1.5-3.5%, versus 2.5% in 2024. We expect headline inflation will likely rise in 1Q25 before easing in the subsequent quarters on account of the festive Eid season falling in March 2025.



Source: Statistics Indonesia (BPS), Bloomberg, OCBC.



Source: Bank Indonesia, Bloomberg, OCBC.

Macau

Macau: Hitting a speed bump

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- Real GDP rose by a notably slower pace of 4.7% YoY in 3Q24 (2Q24: 7.7% YoY), dragged by a moderation of services exports growth. In the first three quarters this year, the economy grew by 11.5% YoY, rebounding to around 85.9% of pre-pandemic levels in 2019.
- Growth is expected to slow further through end-2024, given tighter scrutiny over gaming activities, still-weak macroeconomic backdrop in China and the high base effect. We revise our full-year growth forecast down to 9% YoY, from the previous estimate of 11% YoY. The labour market has returned to full employment with unemployment rate falling back to 1.7%. Meanwhile, we expect full-year 2024 inflation to come in at 1.0% YoY.
- A full recovery is likely to be delayed until late 2025, assuming that outbound travel in China will fully recover by then. Even then, the pace of growth may still vary across sectors. Industries with strong links to tourism are likely to be supported, albeit seeing milder expansions, while the rest may struggle to find cyclical momentum. All in all, we expect 2025 growth to come in at 5% YoY.

Stalled path to full recovery

After experiencing a remarkable rebound in 2023, cyclical economic momentum started to falter moving into 2Q24. Multiple headwinds, such as the local authorities' more heavy-handed crackdown on gaming sector related activities, softer consumption sentiment, the persistently high interest rate environment, as well as China's lagged revival in outbound travel, have all stalled the path to a full economic recovery. In tandem, the low base effect also waned, further compressing growth. Year-on-year growth of visitor arrivals **(Chart 1)** and gross gaming revenue **(Chart 2)** both dwindled to single-digits in September and October. Adding to that, loan demand weakened, while the housing market showed little signs of bottoming out.

Chart 1: Visitor arrivals started to plateau

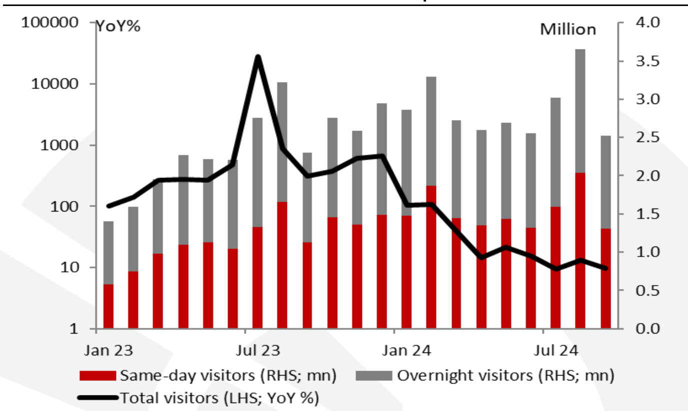
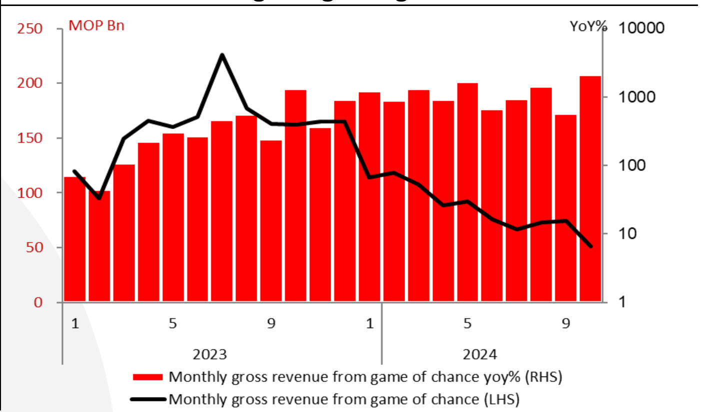


Chart 2: Growth of gross gaming revenue diminished



Sources: DSEC, DICJ, OCBC.

Macau

Chart 3: Broad based weakening of growth momentum

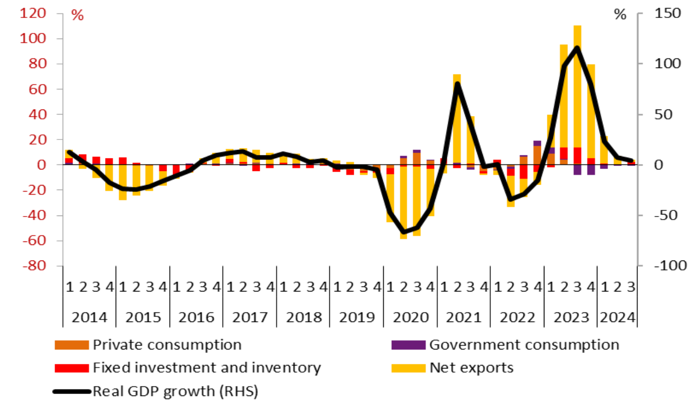
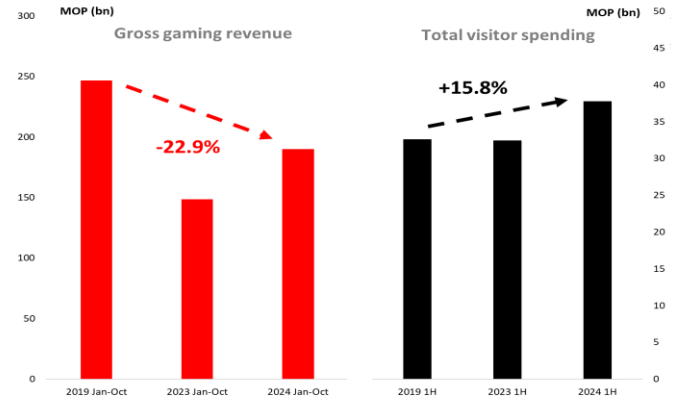


Chart 4: Uneven pace of recovery



Sources: DSEC, Macau Tourism Office, OCBC.

Growth gradually petered out

Notably, real GDP rose at a slower pace of 4.7% YoY in 3Q24 (2Q24: 7.7% YoY) **(Chart 3)**, dragged by moderating services exports growth. Both external and domestic demand expanded at a decelerated pace of 4.7% YoY and 4.6% respectively (2Q24: 17.3% and 1.0%). In the first three quarters this year, the economy grew by 11.5% YoY, rebounding to around 85.9% of pre-pandemic level in 2019.

The weakening of growth momentum was broad based. Growth of gaming services exports moderated to 11.2% YoY (2Q24: 21.5%), while exports of other tourism services declined further by 14.5% YoY (2Q24: -13.4%). Taken together, exports of services grew at a much slower pace of 1.3% YoY in 3Q24 (2Q24: 6.2%). On the domestic front, private consumption expenditure recorded modest gains at 1.9% YoY (2Q24: 4.3%), as the base of comparison normalised. Nonetheless, gross fixed capital formation growth picked up to 14.7% YoY (2Q24: 1.6%), as the private sector stepped up investment.

Revising down 2024 full year growth

Growth is likely to slow further through end-2024, given the tighter scrutiny over gaming activities, still-weak macroeconomic backdrop in China and the high base effect. We revise our full-year growth forecast down to 9% YoY, from the previous estimate of 11% YoY. We expect total gross gaming revenue to grow by 24% YoY in 2024, while full-year tourist arrivals may return to 87% of pre-pandemic levels. The labour market has returned to a full employment status with the unemployment rate falling back to 1.7%. Meanwhile, we expect full-year 2024 inflation to come in at 1.0%. Currently, total visitor spending (at MOP37.8bn) has already surpassed pre-Covid levels in 1H24, while gross gaming revenue through the first ten months of 2024 has been more than 20% below the same period in 2019 **(Chart 4)**.

Macau

A full recovery is likely to be delayed until late 2025, assuming that outbound travel in China will fully recover by then. Even then, the pace of growth may still vary across sectors. Industries with strong links to tourism are likely to be supported, albeit seeing milder expansions, while the rest may struggle to find cyclical momentum. All in all, we expect 2025 growth to come in at 5% YoY. Meanwhile, we expect 2025 unemployment and inflation rate to come in at 1.7% and 1.3% YoY respectively.

Different leader but same policy

Former judge, Sam Hou Fai was elected as the chief executive designate of the Macao Special Administrative Region. He will take office in December, succeeding Ho Iat-Seng who is stepping down for health reasons. Sam cautioned against the dominance of the gaming industry, warning about its implications on long-term development, and echoed the central government's call for economic diversification. Specifically, he was said to follow through with the "1+4" development strategy, which centred around developing Macau into a world-class Tourism and Leisure hub, while grooming four new industries (namely big health, finance and technology, as well as culture, sports and MICE).

In this regard, the government had forged ahead in the diversification drive in 2024 in collaboration with neighbouring cities or regions. Monetary authorities in Hong Kong and Macau had earlier established a bond linkage, enabling investors on both sides to trade and settle bonds. Separately, Macau had partnered with Hengqin island (neighbouring island) to promote MICE events.

Chart 5: Visitor arrivals levelling off

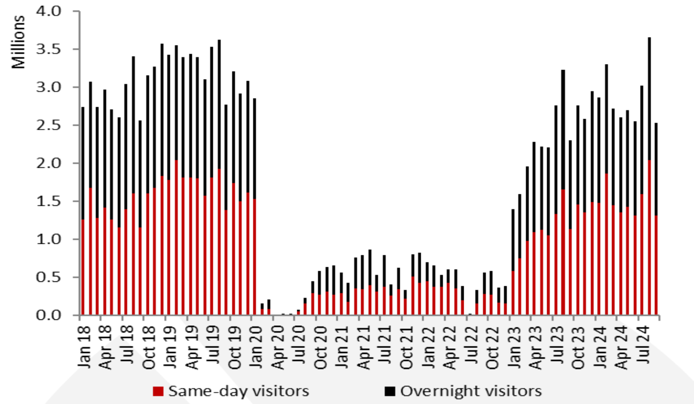
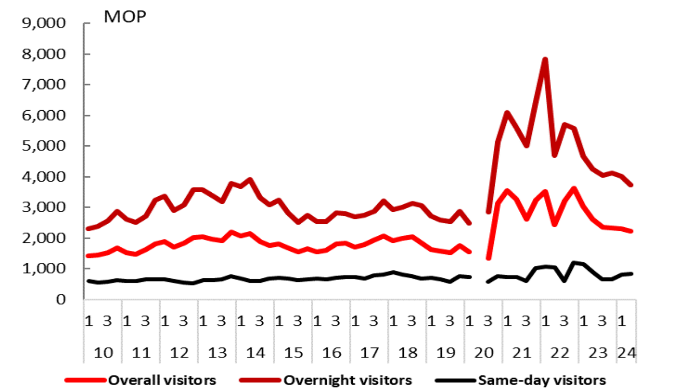


Chart 6*: Per capita spending declined further



Source: DSEC, Macau Tourism Office, OCBC.

From sharp rebound to stationary phase

Earlier this year, eight more mainland cities were added to the cities where residents can apply for Individual Visit Scheme (IVS) visas to travel to Macau and Hong Kong. However, growth of total visitor arrivals moderated, despite welcoming more eligible IVS travellers, as well as MICE travellers and concertgoers **(Chart 5)**. In the first three quarters of 2024, total visitor arrivals reached 25.9mn, returning to 85.8% of pre-Covid levels in 2019. Meanwhile, hotel occupancy rate averaged at 85.4%, below that of 90.8% in 2019.

Macau

On a separate note, per-capita spending (excluding gaming expenses) of tourists visiting Macau fell further to MOP2,223 in 2Q24, the lowest in more than three years **(Chart 6)**, possibly due to softening consumption sentiment and the still-weak CNY. In the near term, the inbound tourism sector is likely to grow at a moderated, yet still solid pace.

Chart 7: Single-digit growth in gaming revenue

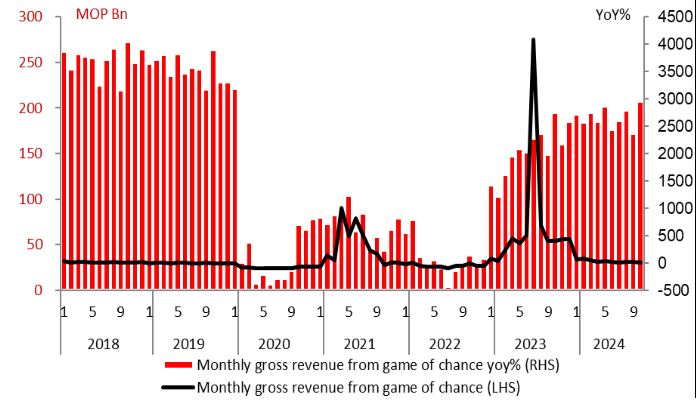
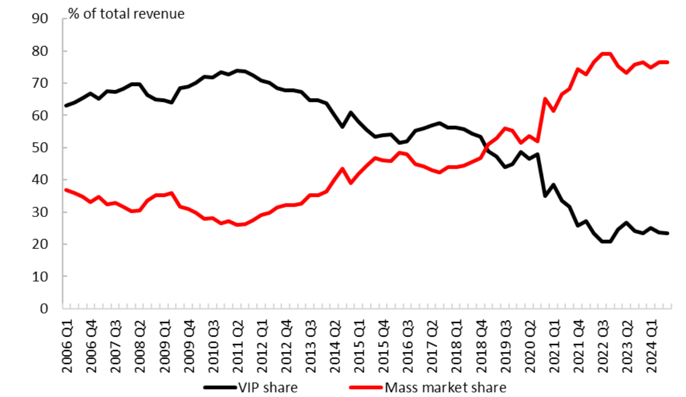


Chart 8: Share of VIP segment steadied



Sources: DSEC, DICJ, OCBC.

Gaming sector still under heat

The authorities further tightened controls on the gambling industry, criminalising "parallel/ side betting", online gambling activities and illicit money exchanges to gamblers. These moves aimed to outlaw unmonitored and cross-border gambling, stamp out capital outflows from China, as well as close loopholes for circumventing the mainland's stringent foreign exchange controls.

Gross total gaming revenue continued to refresh post-pandemic highs, though with the normalised base, year-on-year growth has returned to single-digits **(Chart 7)**. Casinos logged the highest tally of gaming revenue among the past four years in October (up by 6.6% YoY to MOP20.79bn), as foot traffic jumped during the Golden week. In the first ten months this year, the gross gaming revenue surged by 28.1% YoY, to an average of MOP19.0bn per month. Going forward, growth in gross gaming revenue should continue to slow, in light of China's lagged economic recovery and regulatory shifts. Therefore, we have revised our full year forecast down from 27% to 24%.

In 3Q24, revenue generated from the mass and premium mass segments surpassed pre-Covid levels by 7.1%, while that of the VIP segment returned to 42.1% of pre-Covid levels. It was also noted that the share of the mass market and VIP segments had steadied at around 75% and 25% respectively **(Chart 8)** after rounds of crackdowns on junket and illegal gaming related activities. We expect their share to hold at these levels under the new regulatory environment.

Macau

Back to full employment status

Since mid-2024, the overall unemployment rate stabilised at 1.7% **(Chart 9)**, back to pre-Covid levels and arguably the natural rate of unemployment. While the labour market is seemingly at full employment status, it has yet to return to 2019 levels judging by most of the key measures. The total labour force was still 6% below the mid-2020 peak despite extending a recent uptrend to 386k in 3Q24. In the gaming sector, the total employed population in 2Q24 was around 19% lower compared to the same period in 2019. Meanwhile, the vacancy rate was also notably lower at 0.9% (versus 1.5% in 2019). Similarly, the underemployment rate at 1.1% was still above 2019 levels of 0.5%. That said, given tightness in the labour market, salaries and remuneration packages remained competitive. The median employment income of total labour force and residents in the labour force hovered at record highs of MOP18,000/month and MOP20,500/month in 3Q24 **(Chart 10)**.

Chart 9: Full employment status

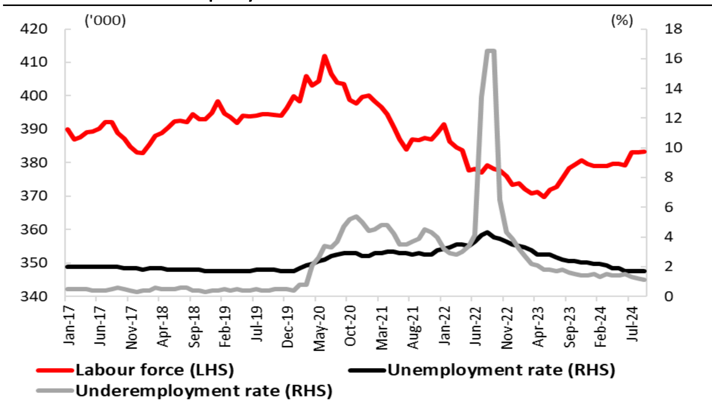
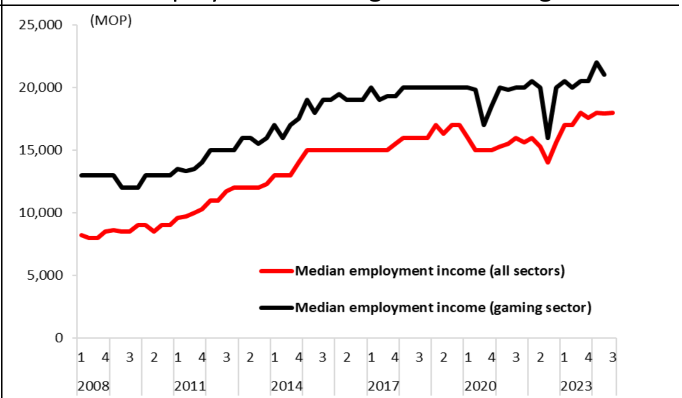


Chart 10: Employment earnings at record highs



Sources: DSEC, DICJ, OCBC.

No signs of bottoming out for housing prices

Housing prices continued its slide down the slippery road, despite the removal of all cooling measures early in 2024. Compared to recent highs, the residential property price index fell cumulatively by 20.8% in the three-months ending August 2024. On a year-to-year basis, the residential property price index dropped by 13.6% **(Chart 11)**. The local housing market continues to remain lacklustre, as property woes in the neighbouring mainland city of Zhuhai has had a negative spillover effect. We now expect housing prices to decline 7-10% YoY for 2024, taking into account the lower base in 2023, recent cuts in the prime rate and the mainland's increased housing support measures. On the other hand, the rebound in trading volumes after the removal of curbing measures appeared short-lived, as buyers stayed on the sidelines.

Macau

Chart 11: Ongoing correction in the housing prices

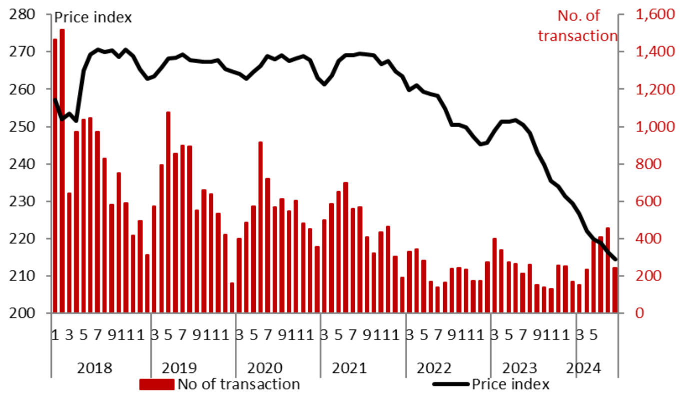
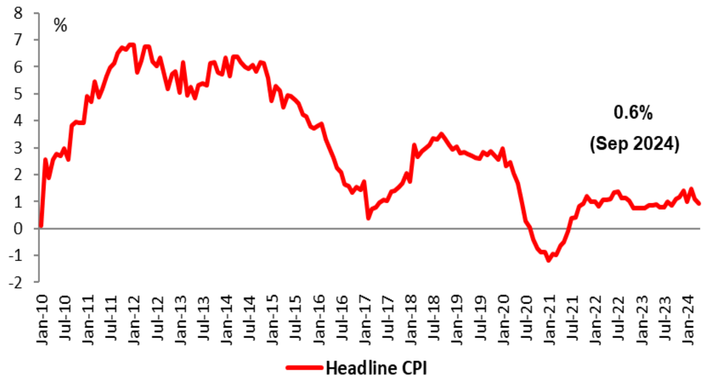


Chart 12: Inflation still low



Sources: DSEC, OCBC.

Low inflation environment persisted

The low inflation environment has persisted, with headline inflation averaging 0.9% YoY in the first nine months this year **(Chart 12)**. During this period, prices of "housing and fuels" and "food and non-alcoholic beverages" (accounting for around 34% and 28% of the CPI basket) rose mildly by 0.5% YoY and 1.3% respectively. Meanwhile, the year-on-year change of "transport" prices stayed negative, hence capping overall inflationary pressures. The cost of transport was kept low on the back of wider coverage of the Light Rapid Transit. We expect inflationary pressures to remain modest in the periods ahead, on the back of largely steady rental prices and limited import inflation.

Malaysia

Malaysia: Further strides in the right direction

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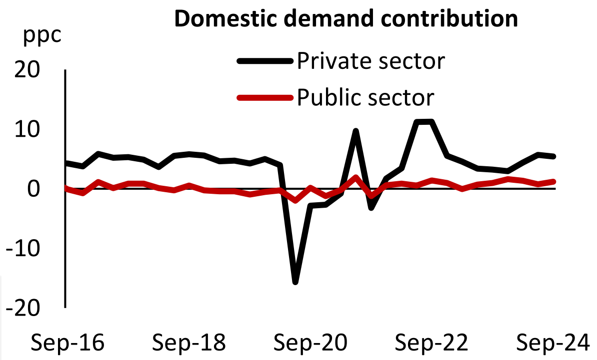
- We expect 2025 GDP growth of 4.5% YoY versus 5.2% in 2024 supported by solid investment spending and stabilising export growth.
- The inflation outcome depends on the mechanism of RON95 adjustment in mid-2025. Our baseline assumes a one-time price increase of 20-25%.
- Bank Negara Malaysia (BNM) is likely to keep its policy rate unchanged at 3.00% but will remain vigilant of second-round inflationary pressures.

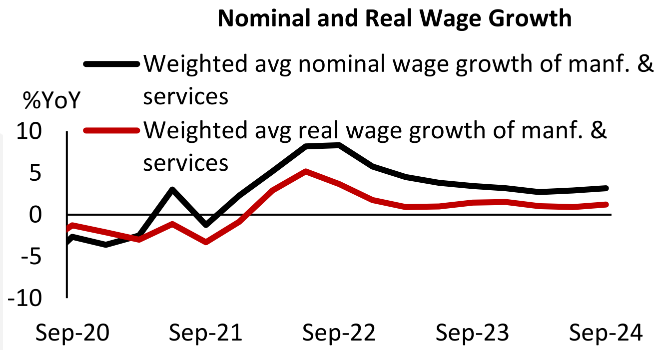
We started out 2024 more optimistic about the growth outlook given the bottoming of the global electronics downcycle and better support for domestic demand on the back of the government's medium-term development plans. Indeed, our view has panned out, with GDP growth averaging 5.1% YoY in 1Q-3Q24. Taking into account this strong outturn in 1Q-3Q24, we revise higher our 2024 GDP growth forecast to 5.2% from 5.0%. This implies GDP growth of 5.2% in 4Q24.

For GDP growth, we maintain our 2025 forecast of 4.5% YoY. Weaker household spending in 2H25 on account of higher retail fuel prices and concomitant inflationary pressures, which we discuss in the following text, will be to some extent offset by front-loading from household spending in 1H25. More fundamentally, wage growth has remained strong in nominal and real terms and will be supported by the 13.3% increase in minimum wages from February 2025 and 7-15% increase in civil servant salaries effective December 2024.

Although the government remains committed to fiscal consolidation, government expenditures are projected to increase by 3.3% in 2025 versus flat growth in 2024. In addition, the pipeline for public infrastructure spending remains solid, which will crowd-in private investment spending, as witnessed in 2024. The pipeline for initial public offerings (IPOs) also remains strong: 50 in 2025 versus 42 in 2024[7].



Source: CEIC, OCBC.

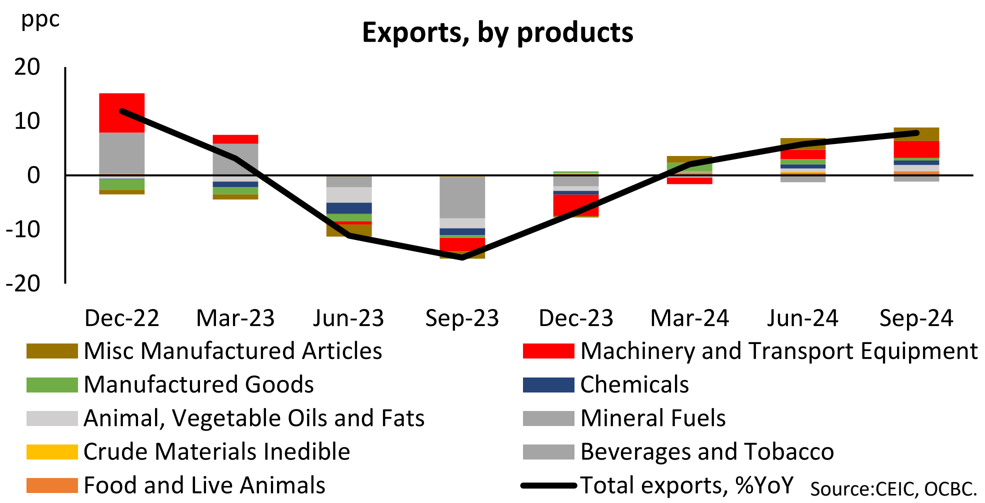


Source: CEIC, OCBC.

[7] Malaysian stock exchange eyes value-boosting plans to lure traders, 1 October 2024, The Strait Times.

Malaysia

Our baseline is for goods export growth to remain stable at 5.5% YoY in 2025 versus 2024 despite some moderation in external demand conditions, given slowing growth in the US and China. The offset will likely come from electronics export growth, which are expected to remain robust. Electronics exports accounted for over 40% of total exports for Malaysia in the past decade and rose by 1.9% YoY in 1Q-3Q24 versus -13.1% in 2023. The bulk of these electronics exports are semiconductors followed by office machines & automatic data processing equipment along with electrical machinery, appliances and parts[8].

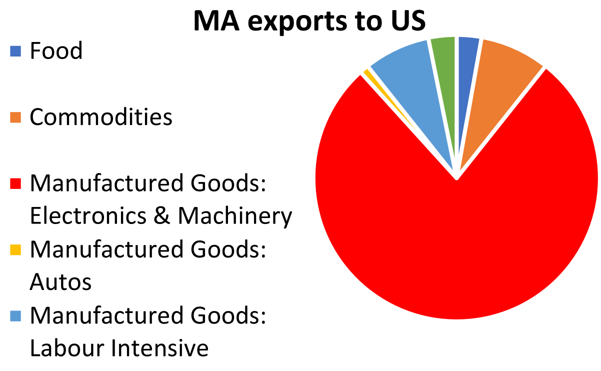


Pertinently, our baseline forecasts do not account for potential tariffs from the US, but we have estimated the impact of potential tariffs. US President-elect Donald Trump stated that he would slap China's imports into the US with a 60% tariff, and possibly 10-20% tariff rates on all other trading partners' imports. Malaysia's economic growth will be impacted to differing degrees under the two scenarios. Should the incremental tariffs stay limited to Mainland China, we expect Malaysia's GDP growth to be 0.2pp lower due the direct trade impact. Over the medium-term, however, we expect the trend of supply chain diversification to intensify, benefiting Malaysia's manufacturing sector. However, if the tariffs are slapped on Malaysia's exports to the US, growth will be weaker by 0.9pp to 1.5pp.

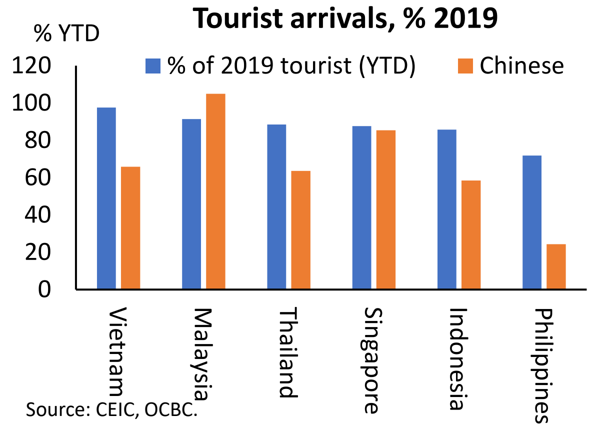
Meanwhile, the authorities are pushing for higher tourist inflows in 2025 and 2026, as a part of 'Visit Malaysia Year 2026' and 2025 ASEAN Chairmanship. While tourist arrivals are up 27% YoY to 18.4mn from January to September 2024, the growth rates are normalising compared to 160.4% YoY growth during the same period in 2023. Tourist arrivals are still likely to fall short of the government's 2024 target of 27.3mn, implying arrivals of 8.9mn in 4Q24 compared to an average 6.1mn in 1Q2-3Q24. We expect the growth rates for services exports, i.e., tourist arrivals, to normalise further in 2025 but continue to signal robust tourism prospects.

[8] The World Semiconductor Trade Statistics (WSTS) expects robust growth in the global semiconductor market of 12.5% YoY in 2025 versus 16.0% in 2024.

Malaysia



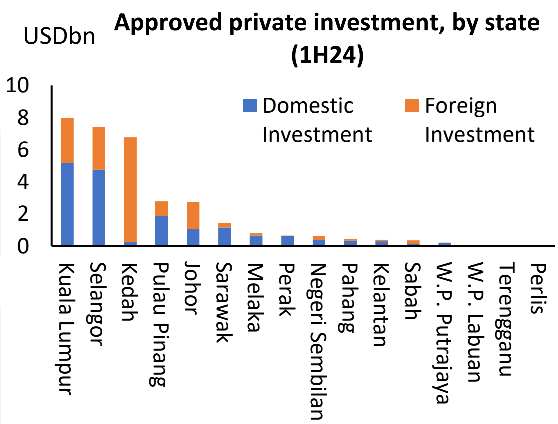
Source: CEIC, OCBC.



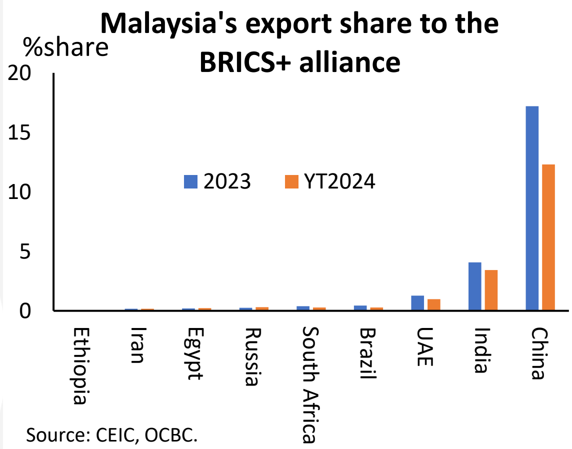
Source: CEIC, OCBC.

More fundamentally, the reform momentum remains positive. The authorities are focussed on implementing medium-term development plans including the New Industrial Master Plan (NIMP) 2030, National Semiconductor Strategy, the National Energy Transition Roadmap and the Johor-Singapore SEZ (JS-SEZ). For example, the government has introduced incentives for reinvestment under the NIMP 2030, which can benefit firms that have exhausted their reinvestment allowance. The government is also working on introducing a carbon tax targeted towards certain sectors in 2026. Our ESG analyst, Ong Shu Yi, believes that this is in preparation for the EU Carbon Border Adjustment Mechanism (CBAM), which will come into effect in 2026.

Finally, details of the JS-SEZ will be announced on 8 December 2024, capping a year that was marked by a flurry of investment and trade commitments. Indeed, approved private foreign investments into Johor remained strong in 1H24. The authorities have secured investment commitments from Germany, US, China and have signed MoU's with UAE, India and Australia. The government announced additional incentives to attract investments into the Special Financial Zone (SFZ) at Forest City in Johor, on 20 September 2024. In terms of trade, the government has signalled its intent to resume talks with the EU on the Free Trade Agreement and applied to join the BRICS alliance. Both of which, we expect will be beneficial for the diversification of export markets.



Source: MIDA, OCBC.



Source: CEIC, OCBC.

Malaysia

Budget 2025 signalled a clear intention to stick to fiscal consolidation, balancing economic priorities with political realities. The government is targeting a narrower fiscal deficit of 3.8% of GDP in 2025 from 4.3% of GDP in 2024, broadly in line with our expectations (3.5-3.8% of GDP). It is also consistent with the government's medium-term fiscal framework (MTFF) for the fiscal deficit to average 3.5% of GDP over 2025-27. Some new tax measures were introduced including the broadening of the sales and services tax base, increased excise duties for sugary products and a proposed carbon tax on the iron, steel and energy industries, starting 2026. These, according to the government, will lead to additional revenues of 0.2% of GDP.

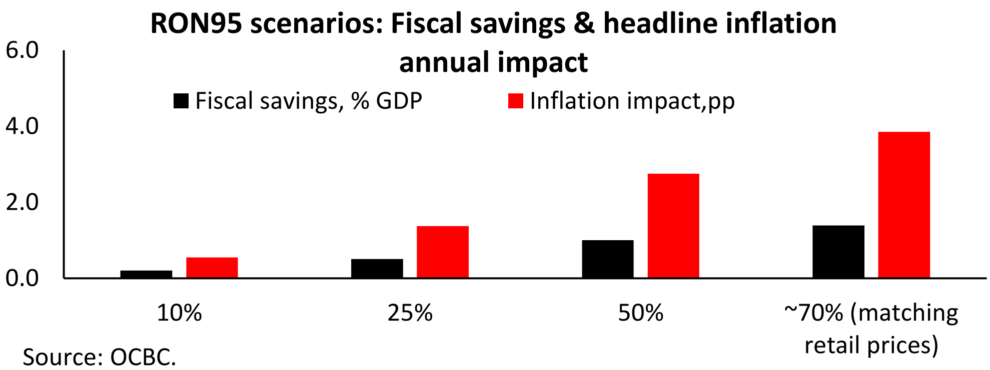
Tax measures announced in 2025		
Dividend tax	Introduction of a 2% dividend tax on certain dividend income received by individual shareholders.	AY2025
Sales tax	Sales tax rates would be increased on nonessential and imported goods, such as premium foods, although sales tax exemption would be maintained on basic food items consumed by the public.	May-25
Services tax	The scope of the service tax would be expanded to include commercial service transactions between businesses, such as fee-based financial services.	May-25
Carbon tax	Carbon Tax will be imposed on the iron, steel and energy industries.	2026
Excise duties	Increase the excise duty on specific sugar sweetened beverages. The proposed rate is an increase from MYR0.50 to MYR0.90 per litre.	Increases in phases, starting 1 Jan 2025
E-invoicing	Taxpayers with an annual turnover or revenue of more than MYR25mn and up to MYR100mn.	01-Jan-25
	All other taxpayers	01-Jul-25
Source: MoF, PwC, OCBC.		

The fiscal deficit is budgeted to reduce by 0.5% of GDP, implying that further consolidation is required. This will come from RON95 rationalisation, in our view. Our read of the budget suggests that RON95 prices could be increased by 20-25% from July 2025, leading to fiscal savings of 0.5% of GDP.

Malaysia

MYRbn	2023	2024	2025	
	Actual	Revised estimates	Budget estimates	%YoY
Central Govt Revenue	315.0	322.1	339.7	5.5
Tax Revenues	229.2	241.0	259.0	7.5
Non-Tax Revenues	85.8	81.0	80.7	-0.4
Central Govt Expenditures	406.4	406.3	419.7	3.3
Central Govt Current Expenditure	311.3	321.5	335.0	4.2
Emoluments	91.9	99.8	105.9	6.2
Net Development Expenditure	95.1	84.8	84.7	-0.2
Fiscal balance	-91.4	-84.3	-80.0	
% GDP	-5.0	-4.3	-3.8	

This will have implications for inflation in 2025. If RON95 prices are increased by 25% from July 2025, we estimate it will push average inflation higher to 2.7% YoY in 2025 versus our previous baseline of 2.1%. The caveat, however, is that the mechanism of implementation is unclear given that the subsidy removal will be targeted to a certain section of consumers.



Source: OCBC.

There are other policies, which could be inflationary including the minimum wage and civil servants' salary increases. Furthermore, there is a risk that the margin for firms could come under pressure from policies changes related to EPF contribution and foreign worker levies. The government has estimated a wider headline inflation range of 2.0-3.5% in 2025 versus 1.5-2.5% in 2024. Notably, for 2024, headline inflation has consistently surprised to the downside and based on the actual outturn of 1.8% in 1Q-3Q24, we are revising lower our inflation average to 1.8% from 1.9% for this year.

The bar for BNM to change the policy rate, however, is high. The overnight policy rate at 3.00% is similar to historical levels and the output gap will close (from being positive in 2024) given our estimates of potential growth at 4.5%. That said, BNM will remain cognisant of second-round inflationary pressures, particularly after RON95 prices are increased in July 2025 (our baseline).

Philippines

Philippines: Stabilisation

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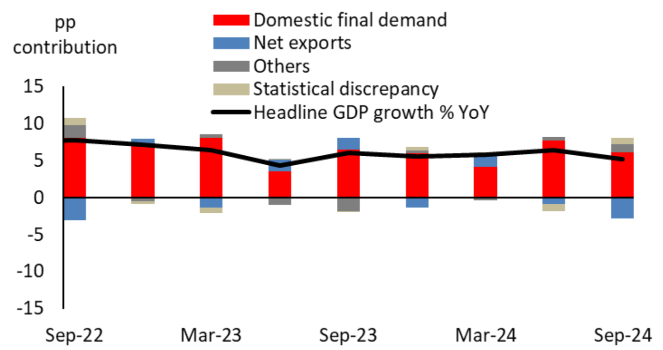
- We expect GDP growth to remain stable at 6.0% YoY in 2025 driven by stabilising household spending and higher investment spending.
- The fiscal consolidation agenda remains on track, while the mid-term elections on 12 May 2025 will be watched closely.
- With headline inflation likely to remain within Bangko Sentral ng Pilipinas (BSP) 2-4% target range, we expect BSP to continue with monetary policy easing but to a lesser degree than previously.

Stronger growth in 2024

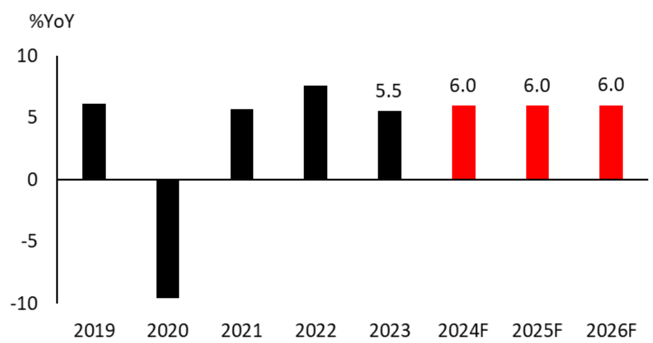
GDP growth improved to an average of 5.8% YoY in 1Q-3Q24, up from 5.5% in 2023, supported by improved exports, while domestic demand remained subdued. Within this, household spending slowed to an average of 4.8% YoY in 1Q-3Q24, down from 5.6% in 2023, reflecting the lagged impact of monetary policy tightening and volatile inflationary pressures. As a result, this more than offset higher government and investment spending. Although 3Q24 GDP growth dipped to 5.2% YoY from 6.4% in 2Q24, our house view remains for the Philippine economy to grow 6.0% YoY in 2024, which is within the government's full year target of 6-7%.

Contribution to GDP



Source: Philippine Statistics Authority, CEIC, OCBC.

GDP Growth Forecast



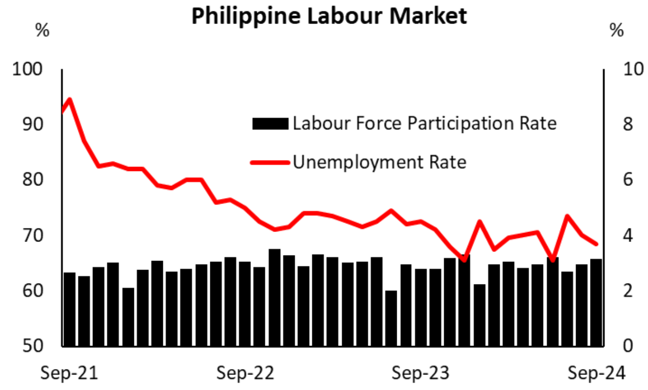
Source: Philippine Statistics Authority, CEIC, OCBC.

For 2025, we forecast a broadly stable GDP growth of 6.0% YoY, on account of stabilising household spending, higher investment spending and better export growth. Government spending growth will be slower, consistent with the authorities' medium-term fiscal consolidation agenda.

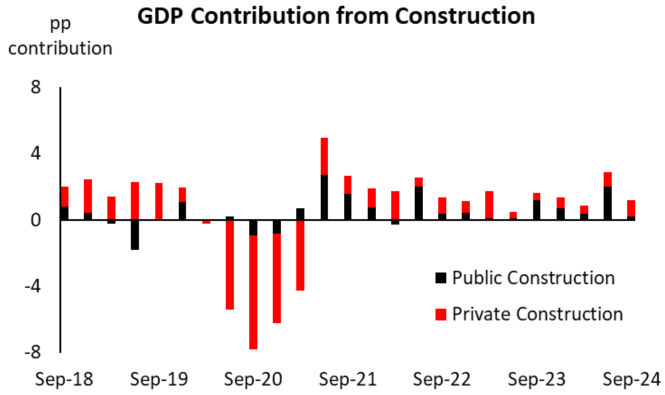
The continued recovery in household spending, which accounts for 73% of 2023 GDP and is the largest component by share, will be the backbone of growth in 2025. The signs heading into the year have shifted for the better. The unemployment rate has been declining steadily while the labour force participation remains robust at ~65%. This, alongside with easing inflationary pressures and looser monetary policy settings will bolster household spending in the coming quarters, in our view.

Philippines

Meanwhile, growth momentum in investment spending will remain strong. This will be driven by investments in the construction industry to meet the evolving needs of the country's infrastructure landscape. Public construction spending will remain robust under the government's flagship Build Better More programme[9] as private construction spending will continue to recover to pre-pandemic levels[10]. The Philippines has also experienced a spate of typhoons and super typhoons in 4Q24, and will likely result in reconstruction spending, at least through 1Q25.



Source: Philippine Statistics Authority, CEIC, OCBC.



Source: Philippine Statistics Authority, CEIC, OCBC.

The medium-term trajectory will be supported by recent reforms such as the CREATE MORE Act. The CREATE MORE Act, which is designed to make the tax incentives regime more predictable, accountable, competitive and investment friendly, will lower the corporate tax rate to 20% from 25% amongst other things (see below). Although there will be an estimated revenue loss of PHP5.9bn from 2025 to 2028 (i.e., 0.004% of projected GDP of the same period), the government expects it to be countered by higher FDI inflows in a more competitive tax environment.

[9] As of November 2024, there are 186 Infrastructure Flagship Projects. 73 projects are completed and/or are expected to be completed during the term of President Ferdinand Marcos Jr.

[10] Crismundo, K., & Esguerra, D.J. (2024, July 12). Private construction seen to return to pre-Covid level next year. Retrieved from Philippine News Agency.

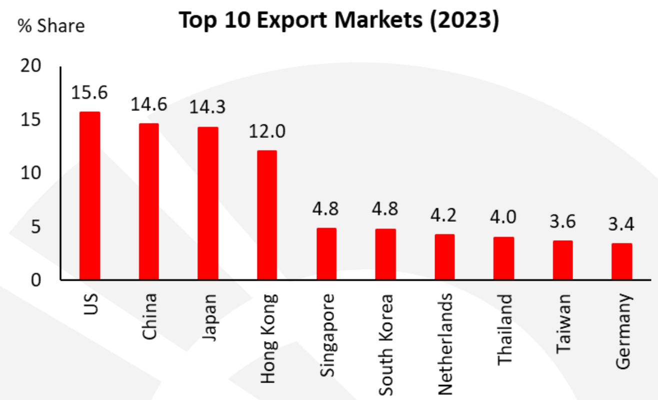
Philippines

Key Highlights of CREATE MORE Act	
1	Expands the Enhanced Deductions Regime (EDR) to provide additional relief to registered business enterprises (RBEs) by reducing the corporate income tax rate to 20% (previous: 25%)
2	Increases the additional deduction on power expenses to 100% (previous: 50%)
3	Extends the maximum duration of tax incentives to 27 years (previous: 17 years)
4	Simplifies local taxation by imposing a local tax on RBEs in lieu of all other taxes, fees and charges
5	Institutionalises the implementation of flexible work-from-home arrangements as a business model for RBEs operating inside economic zones and freeports, without jeopardising their eligibility for tax incentives
6	Raises the investment capital approval threshold to PHP15bn (previous: PHP1bn) for investment promotion agencies. Projects exceeding this amount will be reviewed by the Fiscal Incentives Review Board.

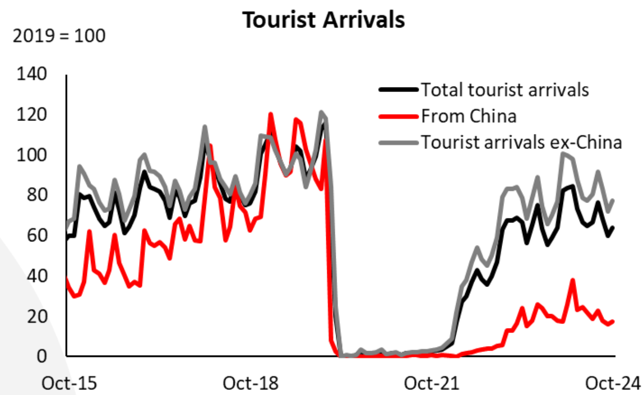
Source: Department of Finance, Philippine News Agency, Bloomberg, OCBC.

Although we forecast higher goods exports in 2025, this mainly reflects a low base from 2024 given export underperformance this year. The Semiconductor and Electronic Industries in the Philippines Foundation Inc. (SEIPI) expects higher growth of 5% in 2025 versus -10% in 2024[11]. As such, we expect goods exports to expand by 4.7% YoY versus 2.4% in 2024.

However, challenges may persist due to the rising threat of protectionism and uncertainties surrounding China's economic recovery. With President-elect Donald Trump returning in 2025, it remains to be seen if he follows through with his election promises of higher tariffs on all US trading partners. The largest export market for the Philippines remains the US, accounting for ~16% of 2023 total exports, while Mainland China accounts for ~15%. The Philippines does not have a bilateral Free Trade Agreement (FTA) with the US. Therefore, the imposition of tariffs by the US on the Philippines will negatively impact external demand.



Source: ASEANstats, OCBC.



Source: Department of Tourism, CEIC, OCBC.

[11] Miguel, J.A. (2024, October 25). Semiconductor sector sees 5% growth in 2025. Retrieved from The Manila Times.

Philippines

Meanwhile, services exports, underscored by tourist arrivals, will remain strong. However, growth rates will continue to normalise compared to years immediately following the pandemic. Total tourist arrivals are at 70.9% of 2019, as of October 2024. This is lower compared to regional peers. Meanwhile, tourist numbers for Chinese tourists remained muted. Year-to-October 2024, tourist arrivals averaged 22.7% of 2019 levels.

Disciplined fiscal policy

Meanwhile, government spending will likely be more constrained in accordance with the medium-term fiscal consolidation agenda. The fiscal report card in 2024 shows prudence in terms of better revenue growth and targeted expenditures. This was validated with a revision of its credit outlook to 'positive' from 'stable' by S&P Global Ratings on 26 November 2024, opening up the possibility of an upgrade to its sovereign rating if the government continues to make further strides in its agenda. S&P Global Ratings currently assigns the sovereign rating at BBB+.

On a 12-month rolling sum basis until September 2024, the deficit has narrowed to 5.8% of GDP from 6.2% in 2023. Both revenue and expenditure growth expanded to 16.0% YoY and 11.6% YoY in Jan-Sep 2024, respectively, up from 7.9% and 3.4% in 2023. The government is on track to achieve its fiscal target of 5.6% of GDP for 2024.

PHP bn	Program	Forecasts			
	FY24	FY25	FY26	FY27	FY28
Revenues (revised)	4269.9	4644.4	5063.2	5627.5	6249.6
% of GDP	16.1	16.2	16.2	16.6	17.0
Revenues (previous)		4583.3	4956.6	5487.7	6078.0
% of GDP		15.8	15.8	16.1	16.4
Disbursements (revised)	5754.3	6182.1	6540.1	7027.0	7621.5
% of GDP	21.7	21.5	20.9	20.7	20.7
Disbursements (previous)		6074.2	6433.5	6887.2	7449.9
% of GDP		21.0	20.5	20.2	20.1
Deficit (revised)	-1484.3	-1537.7	-1476.8	-1399.5	-1371.9
% of GDP	-5.6	-5.3	-4.7	-4.1	-3.7
Deficit (previously)		-1490.9	-1476.8	-1399.5	-1371.9
% of GDP		-5.2	-4.7	-4.1	-3.7

Source: Development Budget Coordination Committee, OCBC.

Philippines

The government has made minor recalibrations to its Medium-term Fiscal Framework for FY24-28 in anticipation of emerging domestic and global developments. Under the revised MTFF, the fiscal deficit for FY25 will be marginally widened to 5.3% of GDP versus 5.2% at its 187th DBCC meeting, while the fiscal deficit for FY26-28 will remain unchanged. This fiscal space would allow the government to mitigate some downside risks to growth as it seeks to pursue the implementation of the Philippine Development Plan 2023-2028. This will be supported by "enhanced tax administration reforms centered on digitalising the Philippine tax system and improving collection efficiency[12]", while no new taxes are expected be imposed possibly until the end of the Marcos administration in 2028, as indicated by Finance Secretary Ralph Recto.[13]

On the political front, the mid-term elections on 12 May 2025 will be a crucial juncture that set the direction for development plans for the rest of President Ferdinand Marcos Jr.'s tenure. This will be a litmus test for his popularity, following a series of public rifts between the Marcos and Duterte families. Attention will be on the 12 senate seats that are up for election. Former President Rodrigo Duterte and his sons are planning to run in the upcoming elections[14]. The senate seats are crucial as they have a sizable influence on legislation.

Inflation moving in the right direction

The biggest win for the authorities this year has been reining in inflationary pressures. Admittedly, the disinflation path has been bumpy and volatile. Headline CPI (Jan-Oct 2024) has averaged 3.3% YoY versus 6.0% in 2023, which is well within BSP's 2-4% target range. Meanwhile, core inflation (Jan-Oct 2024) slowed to an average of 3.1% YoY versus 6.6% in 2023, reflecting a moderation in domestic demand pressures. For 2024, we expect headline CPI to average 3.2% YoY, indicating slower headline CPI for the rest of year.

We expect headline inflation to average 3.0% YoY in 2025, down versus 3.2% in 2024, remaining comfortably within the BSP's 2-4% target range. Food inflation, which has been a concern for the BSP, is expected to ease due to the government's measures to lower tariffs on key agricultural products and other essential items in the energy and manufacturing sector. However, recent typhoons and weather disruptions could put upward pressure on domestic food prices. Additionally, lower energy prices should support the downtrend in inflation due to the anticipated buildup in global oil inventories. The BSP, at its 16 October meeting, forecasted risk-adjusted headline inflation[15] of 3.3% YoY in 2025, up from 3.1% in 2024.

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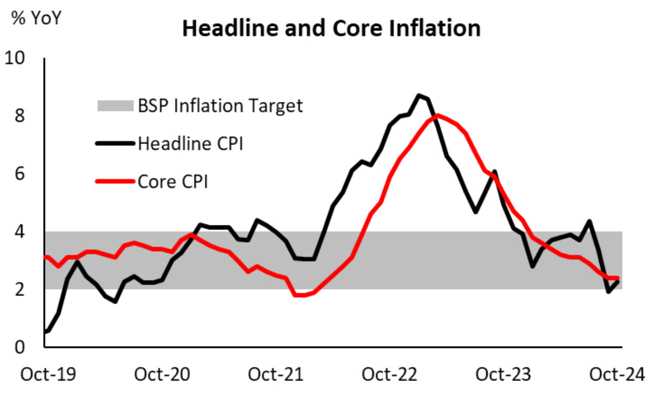
[12] DBCC JOINT STATEMENT: Review of the Medium-Term Macroeconomic Assumptions and Fiscal Program for Fiscal Years (FY) 2024 to 2028, June 27, 2024. (2024, June 27). Retrieved from National Economic and Development Authority.

[13] Cigaral, I.N.P (2024, March 25). Recto: No new taxes until end of Marcos term. Retrieved from Inquirer.net.

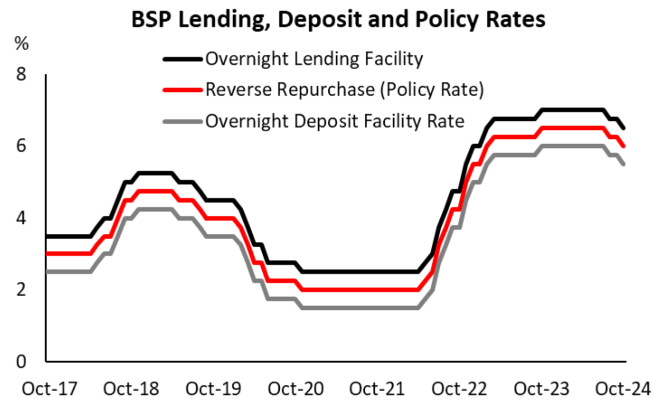
[14] Morales, N.J. (2024, June 25). Former Philippine president Duterte plans senate run in 2025, says vice president. Retrieved from Reuters.

[15] At its 16 November meeting, BSP introduced a baseline and risk adjusted forecast. However, the decision to release both set of numbers after each MPC meeting is still under discussion. The risk-adjusted forecast is determined by adding the baseline inflation forecast to the probability weighted impact of the risks (both upside and downside risks) to inflation outlook. BSP Mulls Release of 2 Inflation Forecasts as Price Pressures Persist. Manila Bulletin, 17 November 2023.

Philippines



Source: Philippine Statistics Authority, Bangko Sentral ng Pilipinas, CEIC, OCBC.

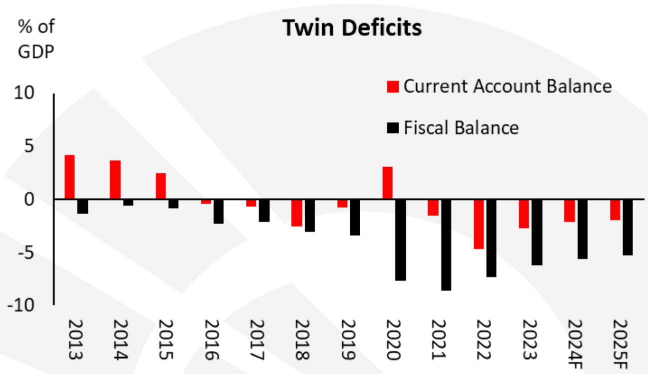


Source: Bangko Sentral ng Pilipinas, CEIC, OCBC.

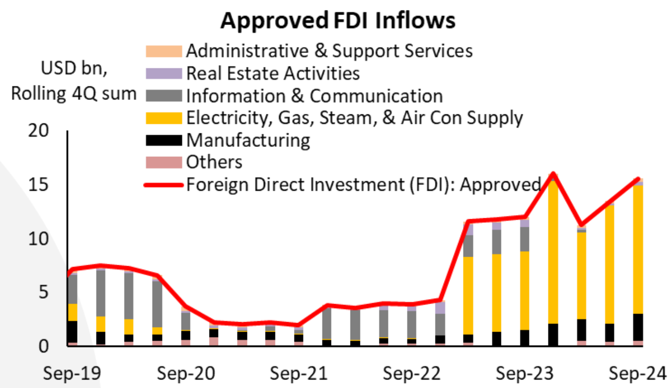
The BSP has already delivered two 25bps cuts at its August and October 2024 meeting. Lower inflationary pressures will allow the BSP to continue its monetary policy easing cycle but to a lesser degree than we had previously pencilled in. We have removed 50bps in cuts and now expect BSP to cut by a cumulative 50bps, taking the policy rate to 5.50%.

While BSP Governor Eli Remolona has noted numerous times in the past that the BSP's rate cutting cycle is dependent on domestic economic considerations, it will be hard to ignore the external backdrop particularly if trade protectionism from the US government under incoming President Trumps raises tariffs as early as 1H25.

The external backdrop will be of consequence given the existence of 'twin deficits'. The current account deficit will be stable around 2.0% of GDP in 2025 from 2.1% in 2024, by our estimates. The BSP forecasts a deficit range of 1.1% of GDP in 2025 from 1.5% in 2024[16]. The offset will come from FDI inflows. Approved FDI inflows, on a rolling four quarter sum basis, have increased by 29.4% YoY to USD15.6bn in 3Q24, up from USD12.0bn in 3Q23. Most of these inflows into the Philippines were for the 'electricity, gas, steam and air conditioning supply' and 'manufacturing' sectors.



Source: Bangko Sentral ng Pilipinas, Bureau of the Treasury, Development Budget Coordination Committee, Philippine Statistics Authority, CEIC, OCBC.



Source: Philippine Statistics Authority, CEIC, OCBC.

[16] Higher BOP Surplus for 2024 and 2025 Buoyed by Sustained Financial Flows. (2024, September 20). Retrieved from Bangko Sentral ng Pilipinas.

Singapore

Singapore: SG60 will be an important year

Selena Ling
Head of Research and Strategy
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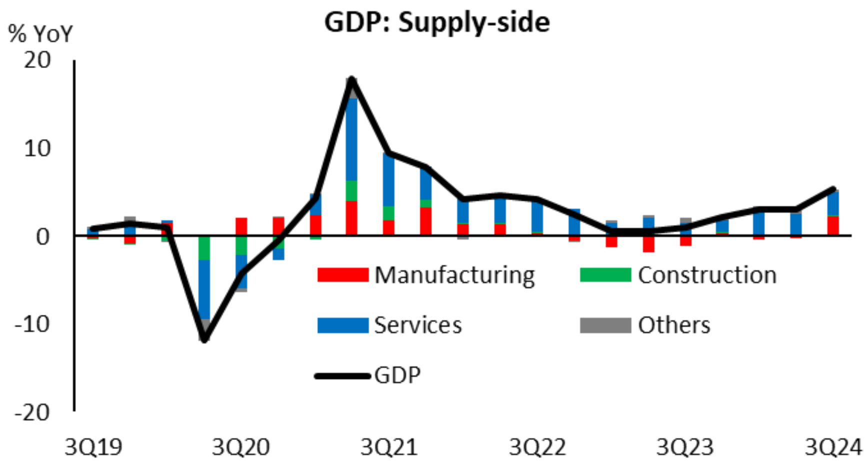
- The economy had performed better for the year-to-date in 2024, registering growth of 3.0% in 1H24. Our 4Q24 GDP growth forecast now stands at 3.1% YoY, which would bring full-year 2024 growth to 3.6% YoY given the better-than-expected 3Q24 growth. For 2025, we keep our 2.7% YoY GDP growth forecast but stay cognisant of the higher 2024 growth base as well as risks pertaining to what happens after Trump takes office on 20 January 2024.
- Inflation has cooled, as October headline and core CPI decelerated more than expected to 1.4% YoY and 2.1% respectively, down from 2.0% and 2.8% in September. For full-year 2024, we are on track to see headline and core CPI come in at 2.4% YoY and 2.7% respectively, before moderating to around 2% YoY in 2025.
- For MAS, the core inflation objective is paramount – while an easing in its policy stance is still logical given greater conviction that core inflation is headed in the right direction towards the 1.5-2.5% range in 2025, nevertheless, there is no hurry to do so given the many moving parts and external uncertainties. As such, the hurdle to any easing move in the upcoming quarterly policy review in January 2025 may remain high.

The economy had performed better for the year-to-date in 2024, registering growth of 3.0% in 1H24. The external-facing industries, particularly electronics and manufacturing, initially grappled with weak global demand and lingering geopolitical tensions. On the other hand, domestic-oriented sectors fared better, supported by healthy inflows of visitor arrivals especially with the slew of concerts in early part of the year as well as the pickup in outbound Chinese visitors with the visa-free travel from 9 February 2024. A healthy domestic labour market in turn meant resilient private consumption. Growth in services was concentrated in the finance, healthcare, and IT services.

The advance estimate for 3Q24 growth was 4.1% YoY (2.1% QoQ sa) but was subsequently revised up more than expected to 5.4% YoY (3.2% QoQ sa). This marked the strongest YoY growth since 4Q21 (7.9% YoY). The growth drivers in 3Q24 were primarily manufacturing, wholesale trade and finance & insurance sectors, aided by the electronics recovery. This brought the GDP growth for the first three quarters to 3.8% YoY, which outshone the 0.7% seen in the first three quarters last year. All three main engines of growth saw an upward revision from the 3Q24 advance estimates.

Singapore



Source: Singstat, CEIC, OCBC.

With all engines firing, the manufacturing growth was upgraded to 11% YoY in 3Q24 as anticipated, up from the advance estimate of 7.5%. This is the best manufacturing performance since 4Q21 (16.0% YoY) and was a turnaround from two consecutive quarters of contraction in 1H24, mainly aided by the recovery in electronics. Notably, green shoots have begun to emerge for the global electronics industry, which translated into a pickup in the electronics output, exports and purchasing managers index (PMI). Both construction and services sectors were similarly upgraded to 3.7% YoY and 4.0% YoY respectively, up from 3.1% and 3.3%. Notably, finance & insurance expanded 5.4% YoY, while construction grew 3.7%, boosted by the global monetary policy easing narrative as well as infrastructure projects respectively.

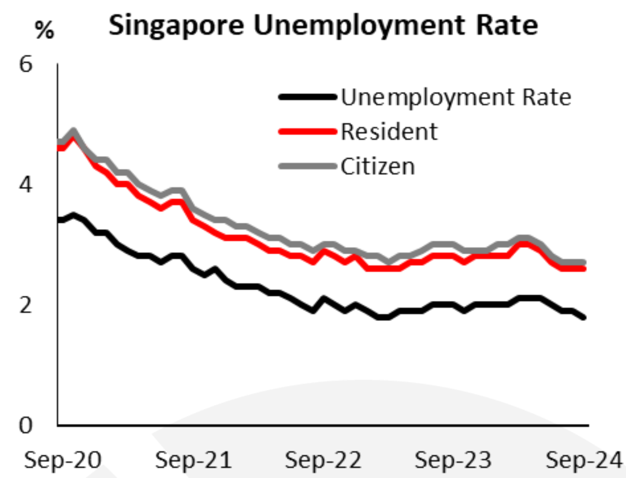
The underperformers within services were the retail trade and food and beverage services which both fell for the second straight quarter by 0.7% YoY as Singaporeans continued to travel overseas even as inbound visitor arrivals remained slower than anticipated coupled with weak tourist spending. Real estate also declined for the second consecutive quarter by 0.2% YoY, while the arts, entertainment & recreation industry also sank into the red at -4.6% YoY, reversing the 4.5% expansion seen in 2Q24 and a far cry from the 23.3% growth registered in 1Q24 amid the concert fever then.

Therefore, MTI revised up its 2024 full-year growth forecast from 2-3% to 3.5% and tips 2025 growth at 1-3% YoY. MTI cited that "on balance, Singapore's overall external demand outlook is expected to remain resilient for the rest of 2024", with the ongoing global electronics demand recovery continuing to support the manufacturing sector. Outward-facing services sectors like wholesale trade should also be supported, but tourism-related and consumer-facing sectors like accommodation, retail trade and food & beverage services industries may continue to be weigh down.

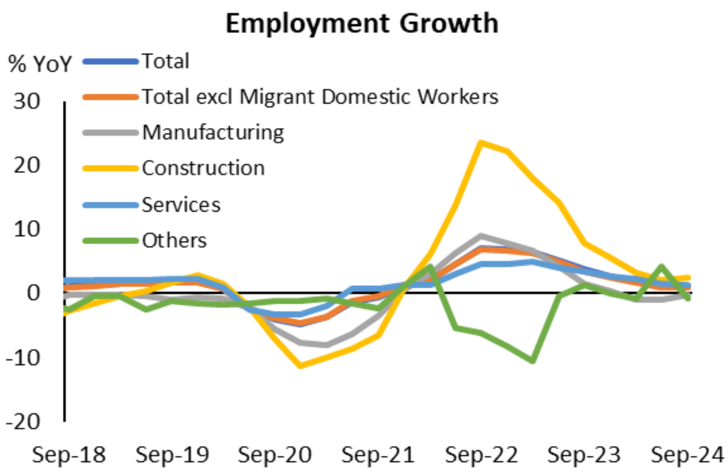
Singapore

Looking ahead, MTI expects growth in Singapore's key trading partners to ease slightly from 2024 levels, especially for the US and China, and flagged that global economic uncertainties have risen, including uncertainty over the policies of the incoming US administration, with the risks tilted to the downside. The downside risks cited included (a) a further escalation of geopolitical risks (including in the Middle East as well as trade tensions among major economies could lead to higher prices and production costs, as well as greater policy uncertainty, which in turn could weigh on global investment, trade and growth, and (b) disruptions to the global disinflation process could prompt tighter financial conditions for longer and the desynchronisation of monetary policies could trigger latent vulnerabilities in financial systems.

For the domestic labour market, the overall unemployment rate dipped to 1.8% in 3Q24 as employment accelerated from 15k in 2Q24 to 26.7k in 3Q24. Labour productivity also improved, driving overall unit labour cost down to 0.9% in 3Q24 versus 7.9% a year ago, which should be welcome music to businesses, especially SMEs that are facing elevated costs amid a challenging economic environment. Despite softening expectations, the domestic labour market has remained very resilient year-to-date, which coupled with the declining interest rate environment and still ample liquidity may have partially underpinned the recent pickup in private residential property transactions amid new launches.



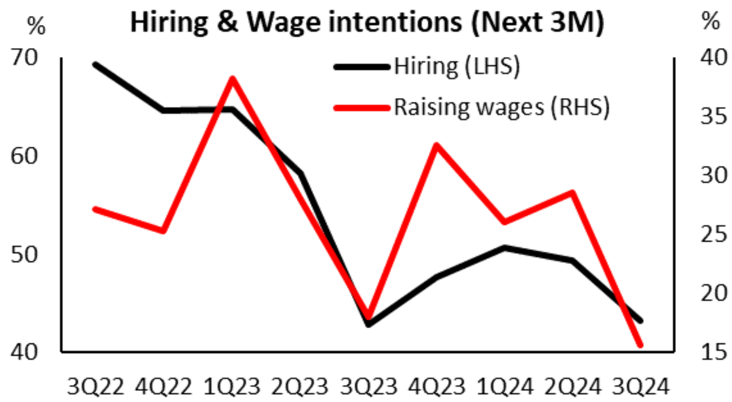
Source: MOM, CEIC, OCBC.



Source: MOM, CEIC, OCBC.

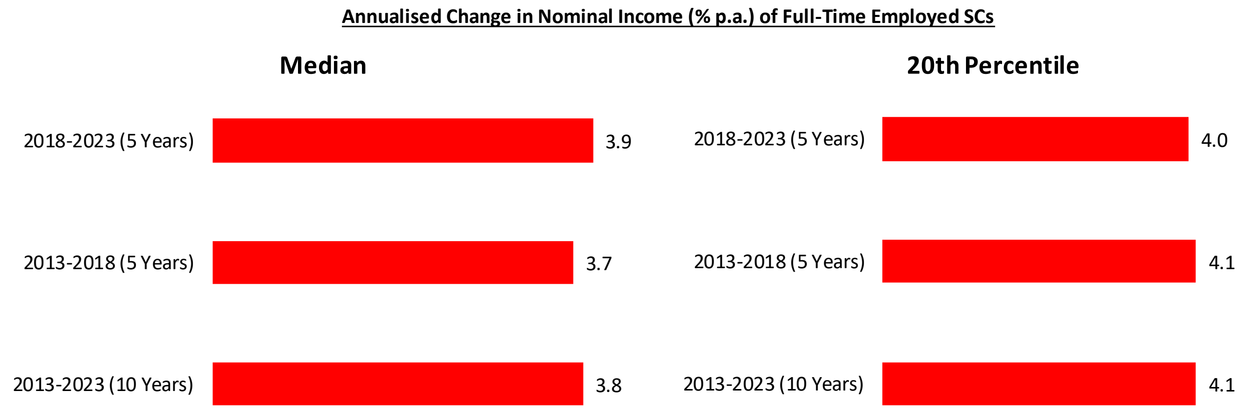
Wage growth has also moderated compared to 2023 but remained positive, supported by demand in domestic-facing industries and the expansion of the Progressive Wage Model. The easing of foreign worker restrictions also helped alleviate labour shortages in key sectors. According to MOM, the percentage of companies that plan to raise wages in 4Q24 has fallen from 28.6% three months ago to 15.6%, while hiring intentions have also cooled from 49.4% to 43.2% over the same period, citing that firms are likely to prioritise maintaining current operations over expansion or wage increases in view of global economic risks such as heightened geopolitical tensions and trade conflicts.

Singapore

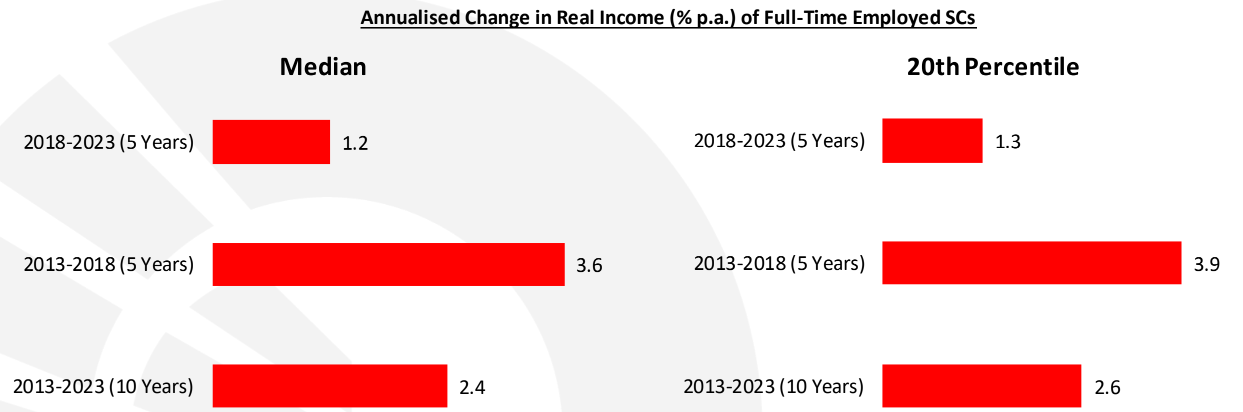


Source: MOM, CEIC, OCBC

From a longer perspective, income growth has held up at the median and 20th percentile (including WIS and related payments which mitigated the impact of Covid on lower earners), but higher inflation in recent years had eroded the real income growth gains which slowed for both the median and 20th percentile in the recent five-year period of 2018-2023.



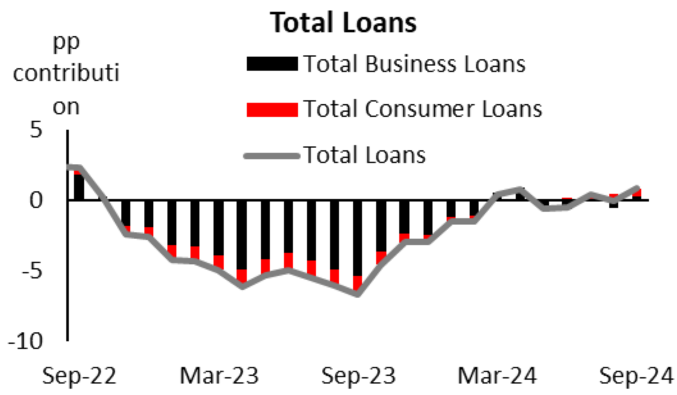
Source: Ministry of Manpower, OCBC.



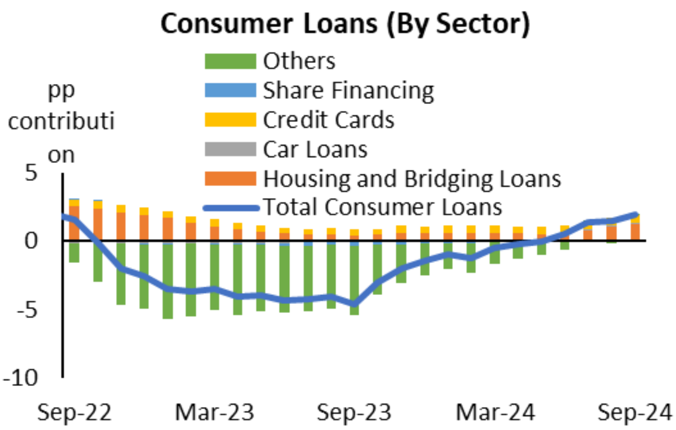
Note: Annualised change in real income growth as deflated by Consumer Price Index (CPI) for all items at 2019 prices (2019=100).
Source: Ministry of Manpower, OCBC.

Singapore

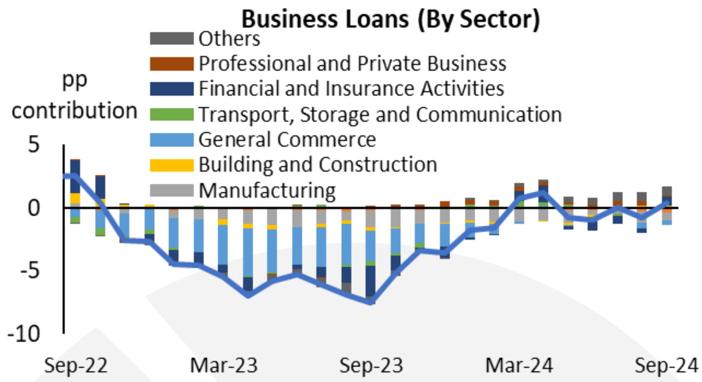
Given the myriad of external headwinds including geopolitical tensions and economic uncertainties, especially in the run-up to the US elections and bouts of market disappointment over China's recovery notwithstanding policy stimulus, Singapore's fixed asset investment also slowed to just SGD1bn (2Q24: SGD3.7bn) – this brought the first three quarters to SGD6.4bn (1-3Q23: SGD11.0bn), which barring a last-minute surge in 4Q24, may mean full-year 2024 may fall well short of the SGD12.7bn seen last year. Loans growth has turned positive in September due to an expansion in both consumer and business loans. While the pace of loans growth remains generally mild, the declining interest rate environment may nevertheless be a positive catalyst. However, this has to be weighed against the external uncertainties.



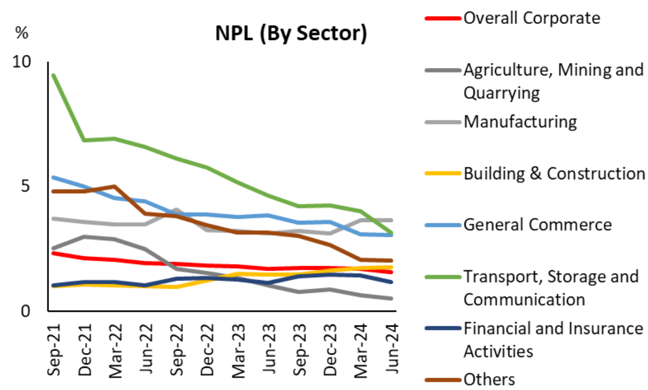
Source: MAS, CEIC, OCBC.



Source: MAS, CEIC, OCBC.



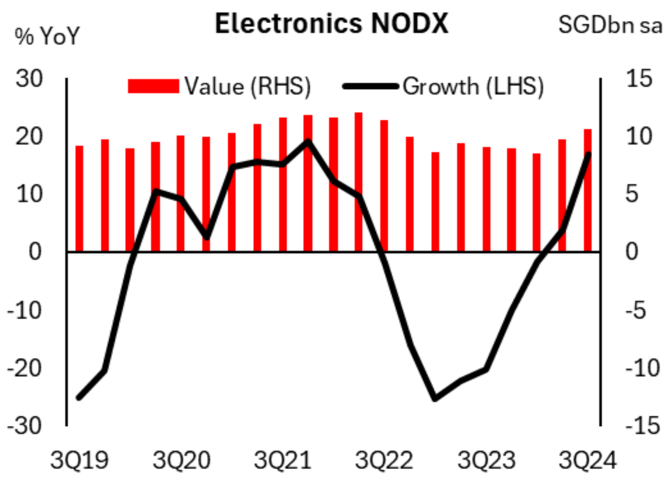
Source: MAS, CEIC, OCBC.



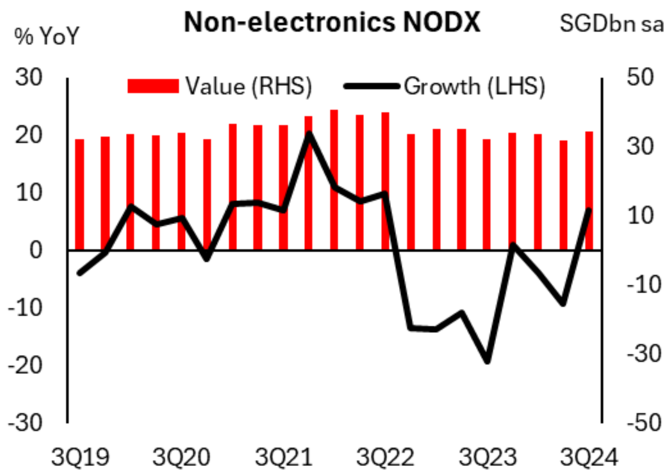
Source: MAS, CEIC, OCBC.

Singapore

Meanwhile, EnterpriseSG has trimmed its 2024 NODX growth forecast to around 1% YoY and tips 2025 NODX growth at 1-3% YoY, citing weaker-than-expected 3Q performance due to volatile pharmaceuticals and ships & boat segments and WTO's projections of faster global merchandise trade of 3% in 2025 compared to 2.7% in 2024. 3Q24 NODX had expanded 9.2% YoY, which was a rebound from 2Q24's contraction of 6.5%, as electronics exports accelerated 7.0% to mark the second consecutive quarter of growth, aided by ICs, disk media products and PCs. Meanwhile, non-electronics exports also recovered from a 9.2% YoY slump in 2Q24 to expand by 7.0% in 3Q24, with specialised machinery, non-monetary gold and food preparations are key drivers. Among the top 10 NODX markets, the biggest contributors to 3Q24 NODX growth were Malaysia (30.7%), China (12.7%) and the US (6.0%), whereas the underperformer in this group was Japan (-17.2%).



Source: DOS, OCBC



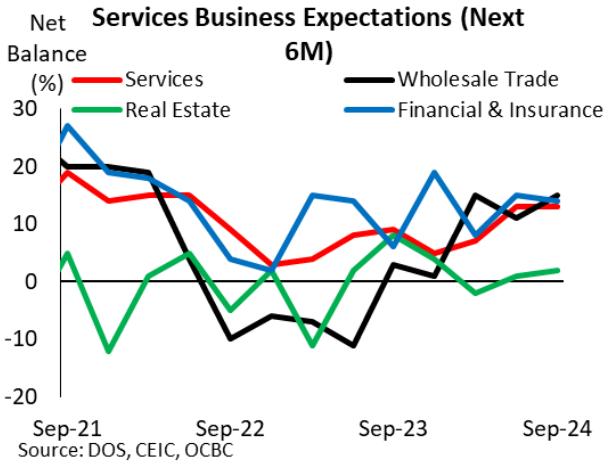
Source: DOS, OCBC

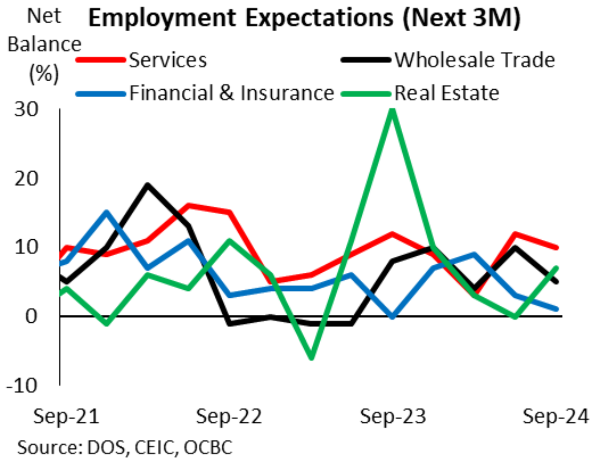
Our house view is that November-December NODX growth may only average 6.2% YoY to bring full-year 2024 NODX growth to 1%, but tip that 2025 NODX growth could improve to 3-5% due to the low base and assuming heightened uncertainties pertaining to Trump's tariffs - namely the timing and exact magnitude of the tariffs, as well as whether Singapore may be exempted due to our FTA with the US.

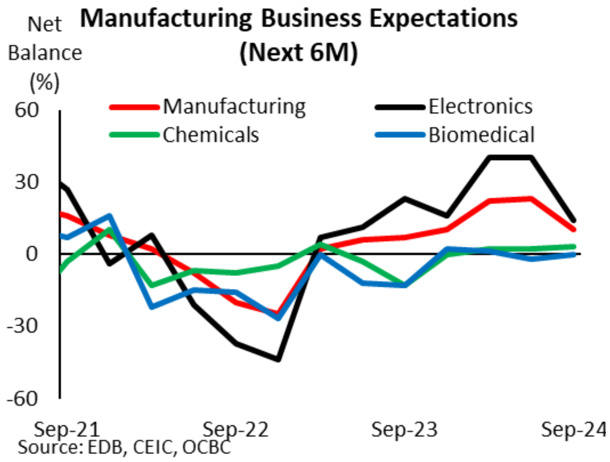
Caution ahead - with incoming US president Trump threatening punitive trade tariffs against China and potentially a universal 10-20% tariff against the rest of the world, the global trade and growth environment may turn even more challenging in 2025. The US economy is expected to moderate amid a slowdown in consumption growth in line with cooling labour market conditions, albeit investment growth may be aided by expectations of Trump's policy promises for tax cuts and de-regulation in selected industries. Meanwhile, China's growth is also tipped to moderate, albeit continued policy stimulus should cushion some of the adverse effects of tariff challenges. ASEAN may still remain resilient, aided by the upswing in global electronics demand, but is unlikely to be fully immune to any potential trade fallout if Trump carries through with his tariffs (see our report on ASEAN impact of tariffs on 30 October).

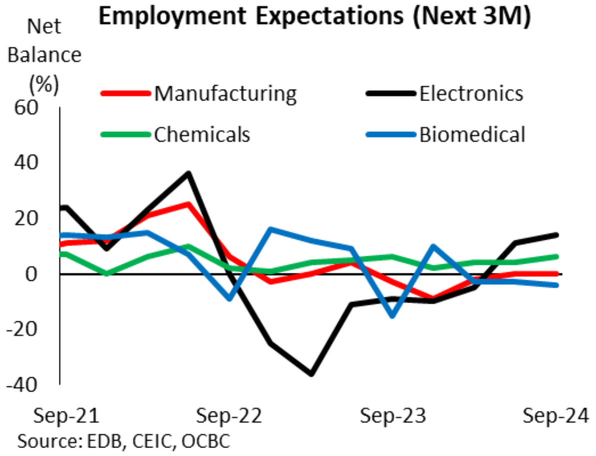
Singapore

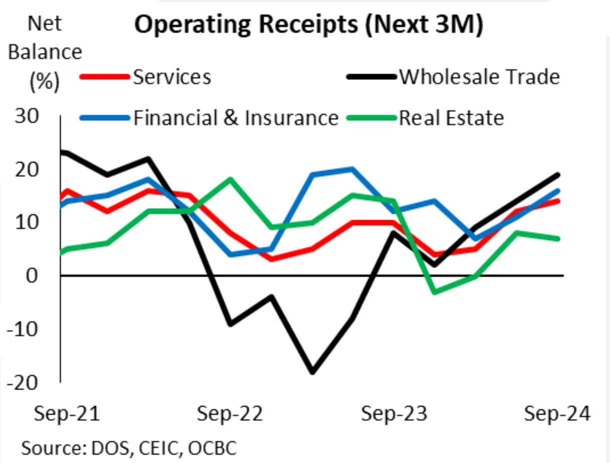
Moreover, with the recent escalation in geopolitical hotspots, namely Russia-Ukraine and the Middle East, and also Trump's push to Make America Great Again through onshoring manufacturing and strategic de-coupling from China, the potential impact on global supply chain recalibration and business capex is highly uncertain going ahead.

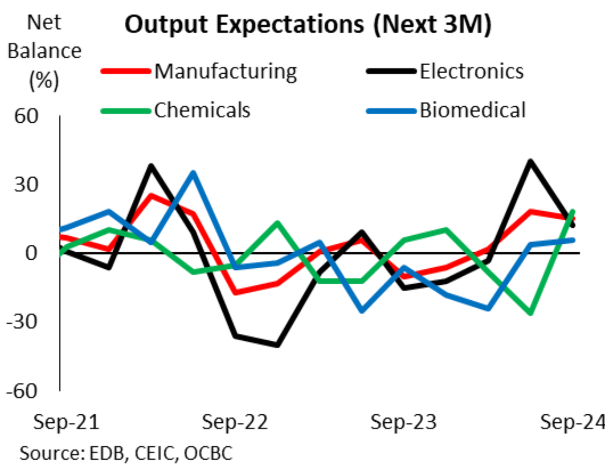










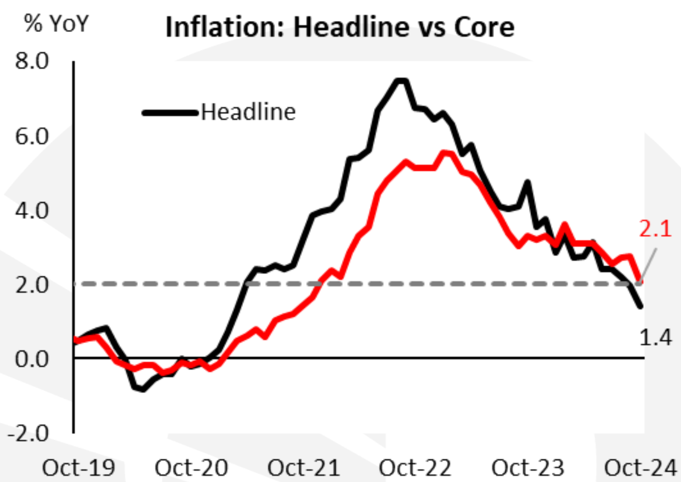


Singapore

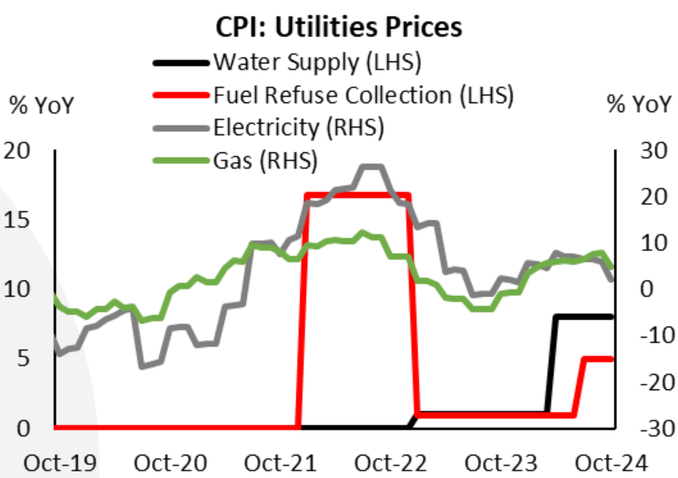
Our 4Q24 GDP growth forecast now stands at 3.1% YoY, which would bring full-year 2024 growth to 3.6% YoY given the better-than-expected 3Q24 growth. For 2025, we keep our 2.7% YoY GDP growth forecast but stay cognisant of the higher 2024 growth base as well as risks pertaining to what happens after Trump takes office on 20 January 2024. Assuming that Trump's policy shifts on tariffs, immigration and tax etc do materialise and are inflationary as anticipated, the Fed's intended rate cut trajectory could be impacted, and this could in turn complicate the 2025 growth and inflation outlook for the global economy, including Singapore. The next milestone to watch could be Budget 2025 where cost of living and job security are Singaporean's top concerns, so additional fiscal assistance could potentially be on the cards.

Inflation has cooled, as October headline and core CPI decelerated more than expected to 1.4% YoY and 2.1% respectively, down from 2.0% and 2.8% in September. This is below both the Bloomberg consensus forecast of 1.8% YoY and 2.5%, and our forecast of 2.0% and 2.5%. The October prints also marked the lowest readings since March 2021 (1.3% YoY) and December 2021 (2.0%) respectively. They also brought the year-to-date headline and core CPI average to 2.5% YoY and 2.9% respectively for the first ten months of the year, which is a significant improvement from 5.1% and 4.3% respectively in 2023. Compared to September, headline and core CPI both declined 0.3% MoM nsa.

The key contributors to the headline disinflation were accommodation (2.5% YoY versus 2.7% previously due to slower housing rent hikes) and private transport (-2.5% YoY from -2.4 as car prices declined faster) costs, while core inflation also saw a moderation in services (2.3% YoY versus 3.3% due to smaller hikes in holiday expenses and healthcare service), electricity & gas (2.5% YoY versus 6.3% due to slower increases in both electricity and gas), and retail & other goods (0.1% versus 0.8% due to cheaper clothing & footwear as well as medicines and health products) prices. Food inflation was steady at 2.6% YoY as non-cooked food and food services rose at a similar pace.



Source: Singstat, CEIC, OCBC.



Source: Singstat, CEIC, OCBC.

Singapore

MAS kept its 2024 headline and core inflation forecasts unchanged at around 2.5% YoY and 2.5-3.0% respectively before both steps down to 1.5-2.5% in 2025. MAS rhetoric remains similar – despite global energy levels being volatile recently, they remain below levels a year ago, and imported manufactured goods prices have continued to broadly decline with easing global inflation and the gradually strengthening trade-weighted S$ exchange rate. On the domestic side, unit labour costs are also projected to rise more gradually amid nominal wage growth and improving productivity. In addition, services inflation should also slow further for the remaining months. MAS also tips accommodation inflation to ease further next year, which should partly mitigate the pickup in private transport inflation amid firm car demand. MAS also reiterated that inflation risks are relatively balanced – citing that stronger than expected labour market conditions could lead to a slower easing in unit labour cost growth, while an intensification of geopolitical tensions may prompt higher commodity prices and hence imported costs, whilst on the flipside, a significant downturn in the global economy could see a greater easing of cost and price pressures.

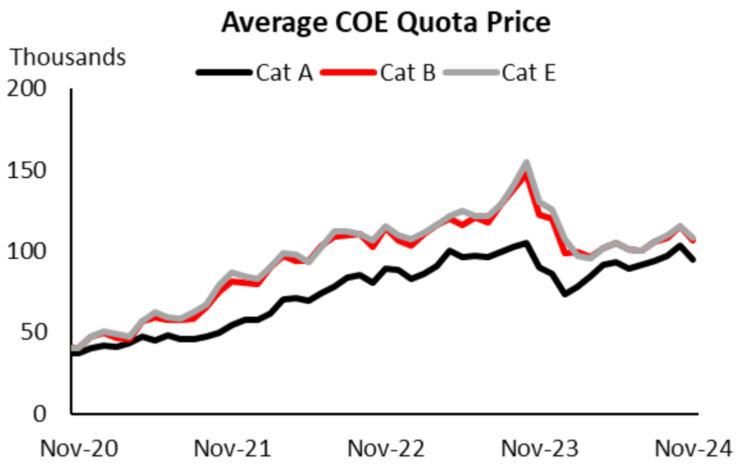
For full-year 2024, we are on track to see headline and core CPI come in at 2.4% YoY and 2.7% respectively, before moderating to around 2% YoY in 2025, which is broadly aligned with MAS forecasts. This is assuming that November-December inflation prints stay rangebound around 1.8-2.0% YoY. Incoming US president Trump has policy priorities that focus on immigration, tariffs, tax cuts etc that may be inflationary in nature. In particular, the touted 60% trade tariffs on China and a universal 10-20% tariffs on rest of the world, may usher in some retaliation if they materialise, and be inflationary in nature. If the US Federal Reserve has less flexibility to cut USD interest rates due to a second inflation bout, and there is inflation spillover to other economies, this could also limit the monetary policy easing room for other central banks, especially in Emerging Markets.

The MAS has maintained a tight S$NEER policy stance to anchor inflation expectations and ensure price stability, especially imported prices. For MAS, the core inflation objective is paramount – while an easing in its policy stance is still logical given greater conviction that core inflation is headed in the right direction towards the 1.5-2.5% range in 2025, nevertheless, there is no hurry to do so given the many moving parts and external uncertainties. Geopolitical tensions appear to have escalated of late for Russia-Ukraine and also in the Middle East, lending support to energy prices. Meanwhile, the fear factor pertaining to Trump 2.0 policies may imply that it is more prudent to wait and see rather than rush prematurely to a policy easing. As such, the hurdle to any easing move in the upcoming quarterly policy review in January 2025 may remain high.

Singapore

Fiscal policy to come to the fore in 2025?

The upcoming Budget 2025 could see a bigger fiscal impulse (since it may be the last budget in this term of government) to address cost of living issues and job security amongst others, there is no urgent need to ease the monetary policy stance in the near-term when dark inflationary clouds may be gathering. The recent momentum in private residential property sales and upward trend in COE premiums between July-October before subsiding in November also suggest that domestic appetite for big-ticket items remain resilient amid ample liquidity, low unemployment rates, and strong household balance sheets as interest rates decline.



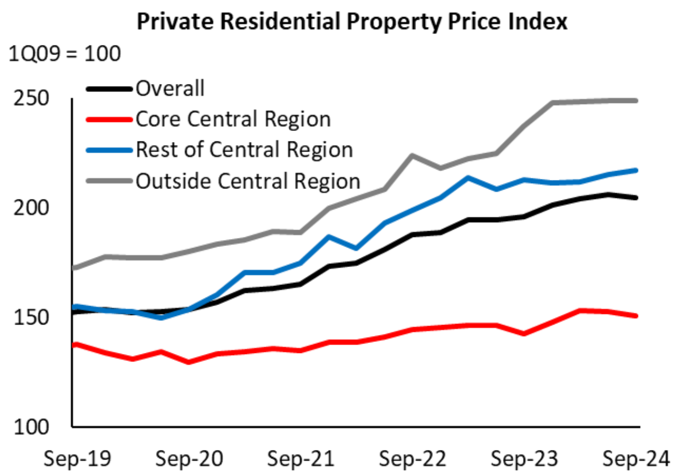
Source: LTA, OCBC.

Singapore's key policy initiatives in 2024 had included investments in green infrastructure, digital transformation, and workforce upskilling to align with the country's long-term sustainability goals. The government also expanded the Progressive Wage Model to more sectors to reduce income inequality. Looking ahead into 2025, economic strategies and jobs are among key focus areas even as Singapore continues to promote trade and multilateralism in a more dangerous world according to PM Lawrence Wong. Separately, the updated Smart Nation 2.0 policy also focuses on Artificial Intelligence (AI) and building resilience, through a SGD120mn fund for AI adoption and a new agency to tackle online bullying and other harms, as well as introduce a new Digital Infrastructure Act in 2025 to improve the resilience and security of key digital infrastructure and services. The three key goals of Smart Nation 2.0 are Trust, Growth and Community.

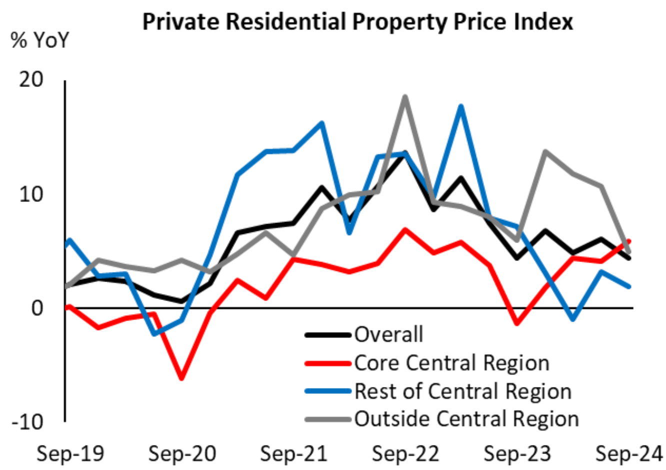
On the ESG front, EnterpriseSingapore and EDB have also launched a sustainability reporting grant (SRG) on 1 November to help companies produce their first International Sustainability Standards Board's (ISSB)-aligned sustainability report in Singapore before mandatory reporting takes effect. Under this enhanced reporting regime, Singapore-listed firms must start reporting their Scope 1 and Scope 2 greenhouse gas emissions from the financial year 2025. SMEs with revenue of less than SGD100mn, which are not required to do climate reporting but wish to prepare early, can also do so through the assistance of a new SME sustainability reporting programme launched on 1 November.

Singapore

Meanwhile, the property market outlook is a tale of two halves. Resale prices of private condos fell for the first time in 10 months by 0.5% according to flash estimates. The main drag was seen in properties in the Rest of Central Region (RCR) which fell 0.8% MoM in October, even though prices for the Core Central Region (CCR) and Outside Central Region (OCR) rose 0.5% and 1% respectively. For on-year comparison, prices for CCR, RCR and OCR rose 3.7%, 3.3% and 3.9% respectively. Transaction volumes also rose 8.1% MoM (29.1% YoY) to 1,124 units resold in October (up from 1,030 units in September) amidst the influx of new supply and as 3,225 non-landed units reached their temporary occupation permit (TOP) in 3Q24. The recent spate of new project launches appeared to have been relatively well-received amid buyer interest amidst anticipation for a gradually declining interest rate environment.



Source: URA, CEIC, OCBC.



Source: URA, CEIC, OCBC.

On the rental front, Housing Development Board (HDB) rents rose 0.5% MoM (4.6% YoY) in October, with gains in mature estates (+0.9% MoM or 5.6% YoY) outpacing non-mature estates (-0.2% MoM or 3.5% YoY). Similarly, condo rents also rose 0.5% MoM (-2.8% YoY), led by CCR (0.5% MoM) and RCR (0.8% MoM) whereas OCR was flat in October. The number of condo rental transactions, however, fell for the third straight month by 7.5% MoM (+5.3% YoY) to 5,712 units.

On balance, Singapore should be on track for 2-3% growth in 2025 (official growth forecast is 1-3%), with 1H25 likely to usher in some Trump-related uncertainties and potential market volatilities. Given that 2025 will see SG60 celebrations and likely the last Budget in the current term of government, any downside growth risks are likely to be met swiftly with a policy response even though as an open economy, the external economic uncertainties and challenges remain very real. Domestic policy issues like cost-of-living concerns and job security remain pertinent in the short-term while there is an evergreen need to positioning for new growth drivers like the green economy and AI in the medium term, especially in a multi-polar and fragmented world. This again require deft handling and a careful calibration of the policy mix.

South Korea

South Korea: More room for easing

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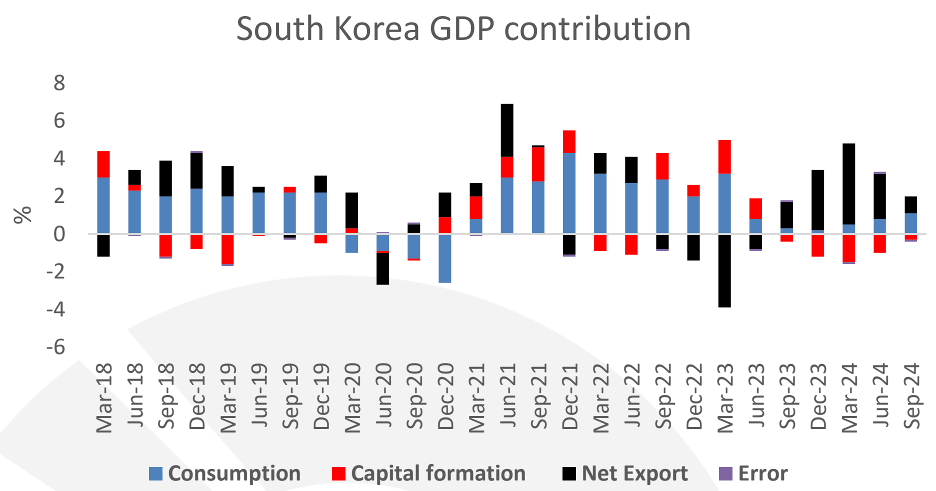
- External demand remains the primary driver of the economy in 2024. Strong facility investment contrasted with subdued retail sales and construction investment in 2024, highlighting subdued domestic demand.
- The disinflation trend remains intact, as headline inflation continues to subside below the Bank of Korea's (BoK) 2% target. As inflation appears to be tamed, the monetary policy focus has now shifted towards supporting growth, controlling household debt and the strength of the KRW.
- Delaying monetary policy normalisation could prolong the adverse effects of restrictive measures on domestic demand. We expect three more rate cuts from the BoK in 2025.

The economy expanded by a modest 0.1% QoQ (seasonally adjusted) in 3Q24, following a 0.2% QoQ contraction in 2Q24. However, this was below market expectations of 0.5% QoQ. On a YoY basis, growth moderated to 1.5% from 2.3% in 2Q24, reflecting external uncertainties and softening domestic activity.

External demand remains the primary driver of growth, although signs of easing have emerged. Net exports contributed 0.9 percentage points to the 1.5% YoY growth in 3Q24. Resilient U.S. economic performance and recovering demand from China have supported export growth.

Chart 1: Net exports have been the key driver of Korea's growth



Source: CEIC, OCBC.

South Korea

Since 2023, export outperformance has been underpinned by four key factors: Firstly, increased demand for AI semiconductors and a recovery in memory semiconductor prices have boosted exports. Secondly, demand growth in the transportation machinery sectors has fuelled Korean export growth. Automotive exports hit an all-time high of USD93.8bn in 2023, with continued strong performance in 2024 driven by U.S. demand. Ship exports, particularly high-value-added vessels such as dual-fuel and LNG carriers, have also surged. Thirdly, U.S.-China trade tensions have benefited South Korean exports of intermediate goods to the US as the tensions spurred Korean investments in U.S. manufacturing facilities. Fourthly, the global influence of Korean culture ("K-Wave") has driven robust demand for consumer goods, particularly cosmetics, with China remaining the largest market.

Despite these drivers, signs of a slowdown in export growth are evident. Headline export growth decelerated to 4.6% YoY in October from 7.5% in September, below market expectations. While semiconductor demand remained strong, exports of non-chip technologies such as handsets, computers, and display panels softened. Additionally, weaker recovery in the EU further dampened export growth. External demand's contribution to growth may moderate in the coming quarters.

Weak domestic demand

Domestically, strong facility investment driven by semiconductor manufacturing equipment demand contrasted with subdued retail sales and construction investment. Retail sales grew only 0.15% YoY in the first nine months of 2024, led by non-durable goods. Sales of durable and semi-durable goods declined by 0.96% YoY and 1.6%, respectively, with automobile and household appliance sales falling 5% and 2.7%.

Moderating inflation

Inflation continues to decline. Headline CPI eased to 1.3% YoY in October, the lowest since January 2021, down from 1.6% in September and below the central bank's medium-term target. Sequentially, CPI was flat in October, reflecting moderating goods and services inflation. Core CPI (excluding food and energy) fell to 1.8% YoY, the lowest since late 2021.

South Korea

Chart 2: Demand for durable goods and semi durable goods are weak

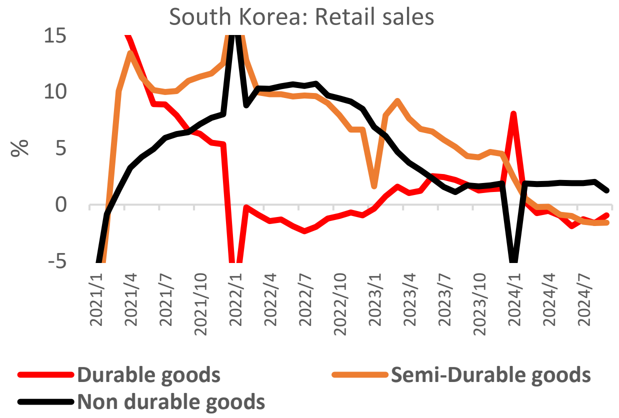
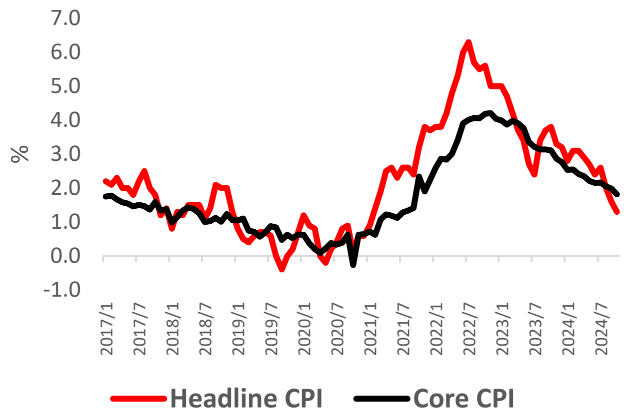


Chart 3: Disinflation trend continues



Source: Wind, CEIC, OCBC.

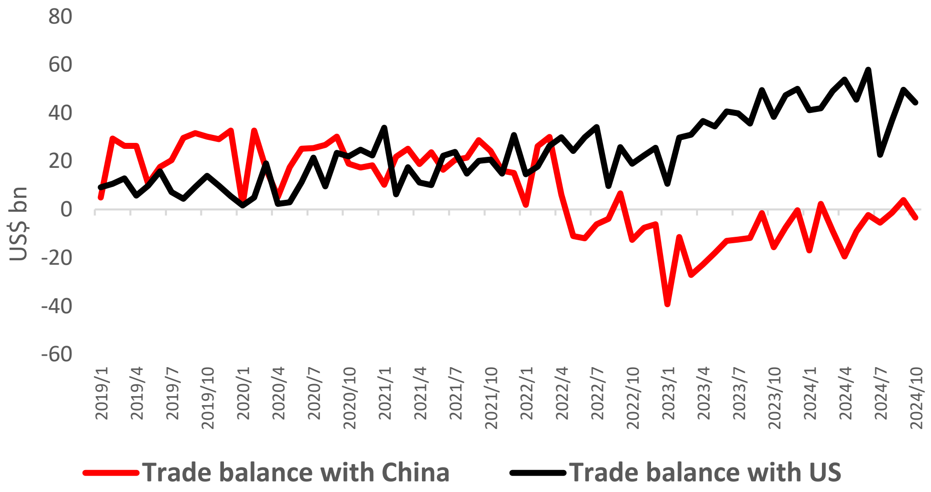
Stabilising property prices suggest the government’s efforts to control household lending have been effective. The steady decline in inflation has created room for monetary easing, prompting the Bank of Korea (BoK) to lower its benchmark interest rate by 25bp to 3.25% in October. However, BoK Governor Rhee Chang Yong has warned that currency volatility could limit further rate cuts, with the KRW down nearly 8% against the USD this year—making it the second weakest currency among core Asian economies.

Nevertheless, the recent depreciation of the KRW is primarily attributed to external factors, notably higher U.S. interest rates and uncertainties stemming from President Trump's policies. These influences lie beyond the control of Korean policymakers. Delaying monetary policy normalisation could prolong the adverse effects of restrictive measures on domestic demand. Therefore, we anticipate that the Bank of Korea (BoK) will implement three further 25bp cuts in 2025, bringing the rate closer to a neutral level of 2.5%.

We project South Korea's GDP growth to reaccelerate to 2.2% YoY in 2024 from 1.4% in 2023, driven by strong external demand. However, growth may decelerate to 1.9% YoY in 2025 as external demand weakens, partially offset by recovering domestic consumption.

South Korea

Chart 4: Changing trade landscape



Source: Wind, CEIC, OCBC.

Trump 2.0 impact

A significant risk to South Korea's outlook is its overreliance on the U.S. market. The new global trade landscape has notably reshaped major trade partnerships. Korean exports to the US have boomed, resulting in a massive trade surplus. While the trade surplus with the U.S. has helped offset competition from China, it also raises the possibility of trade sanctions if President Trump imposes broad 10-20% tariffs on global products. South Korea's exposure to U.S. trade policies presents a double-edged sword, requiring close monitoring of developments in Trump's trade strategy.

Taiwan

Taiwan: Riding the AI tailwinds

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- While advanced 3Q24 GDP expanded more than expected by 3.97% YoY, growth momentum moderated somewhat amid weak private consumption and rise in imports. On a sequential basis, real GDP growth improved from 0.29% QoQ to 1.08% QoQ in 3Q24. Our latest forecast for 2024 full-year growth is 4.21% YoY.
- We anticipate another positive performance in 2025 as AI tailwinds should persist in the near term. Our 2025 GDP growth forecast is 2.8% YoY.
- While more central banks are now embarking on an easing cycle, we expect the Central Bank of the Republic of China (CBC) to maintain its hold at 2.00% until at least 3Q25, with any subsequent rate cuts likely to be gradual.

Net exports slow in the third quarter
While advance 3Q24 GDP expanded by 3.97% YoY, growth momentum moderated somewhat amid weak private consumption and increasing imports. On a sequential basis, real GDP growth improved from 0.29% QoQ to 1.08% QoQ in 3Q24.

The main growth driver was primarily robust gross capital formation, which surged 15.27% YoY, marking the second consecutive quarter of double-digit growth. This was likely fuelled by low base effects from 2023, inventory restocking, and significant investments in AI-related sectors. Nonetheless, net exports decelerated for the second consecutive quarter, as import growth (13.33% YoY) outpaced export growth (8.67%) despite sustained demand for AI-related technology products. Meanwhile, private consumption growth weakened further, registering a mere 1.92% YoY increase – the lowest since 1Q22. While this slowdown is concerning, positive contributions from increased domestic spending, outbound tourism, and a strong stock market partially offset the decline.

Analysing the contributions to headline GDP growth, gross capital formation was the largest contributor, adding 3.67 percentage points (ppt). Private consumption and government consumption contributed 0.92 ppt and 0.53 ppt, respectively. Offsetting these positive contributions, net exports exerted a negative impact, subtracting 1.16ppt from overall growth, and representing a worsening drag compared to 2Q24.

Through the first three quarters of 2024, the economy grew by 5.18% YoY. We now expect a growth slowdown, with a projected 1.55% YoY growth in 4Q24, reflecting a high base comparison from the previous year as well as a moderation in private consumption growth. Our revised full-year 2024 growth forecast stands at 4.21% YoY (from 3.80% previously).

Taiwan

Chart 1: Net exports were negative for the second straight quarter

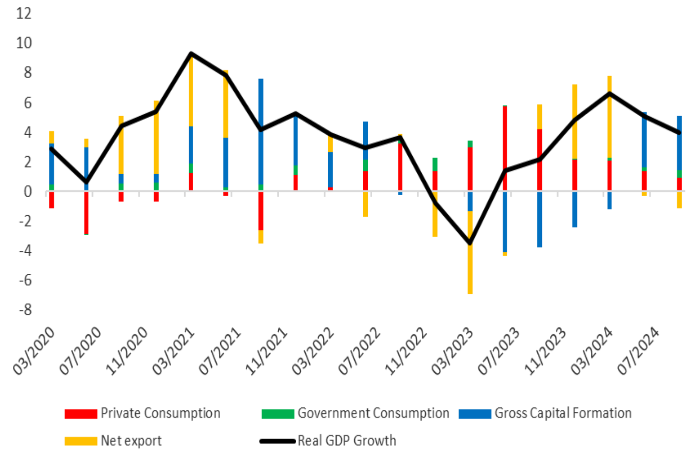


Table 1: Exports remained strong but were offset by rises in imports (Percentage Contribution, by Expenditure)

Component	2022	2023	3Q23	4Q23	1Q24	2Q24	3Q24(p)		2025F DGBAS	2025F CBC
Domestic Demand	4.24	1.17	0.50	-0.23	1.24	6.1	5.99		2.64	
-Private Expenditure	3.75	8.32	9.28	4.59	4.13	2.77	1.92		1.11	
-Public Expenditure	4.83	0.88	0.08	0.3	1.47	1.9	3.9		0.29	
-Gross Capital Formuation	4.75	-10.30	-13.18	-9.06	-4.31	14.78	15.27		1.29	
External Sector										
-Exports	1.75	-4.32	-1.41	2.86	9.22	7.65	8.67		3.25	
-Imports	4.32	-5.73	-4.62	-5.63	0.91	10.15	13.33		2.63	
Real GDP	2.59	1.31	2.15	4.83	6.63	5.06	3.97		3.26	3.08

Source: DGBAS, OCBC Research.

Chart 2: Global semiconductor sales activities remain upbeat

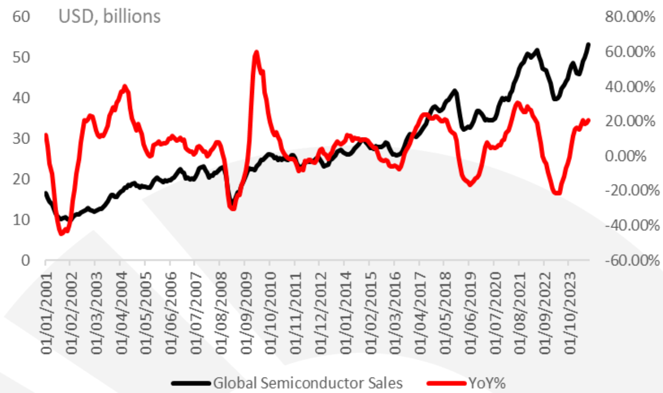
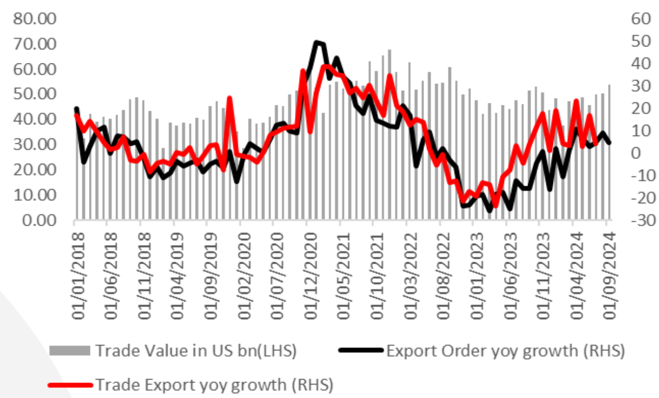


Chart 3: Exports stayed on track for its upward cycle but momentum is slowing



Taiwan

Chart 4: Domestic sales

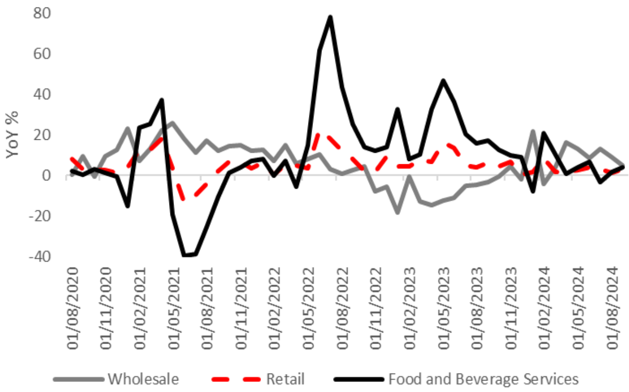
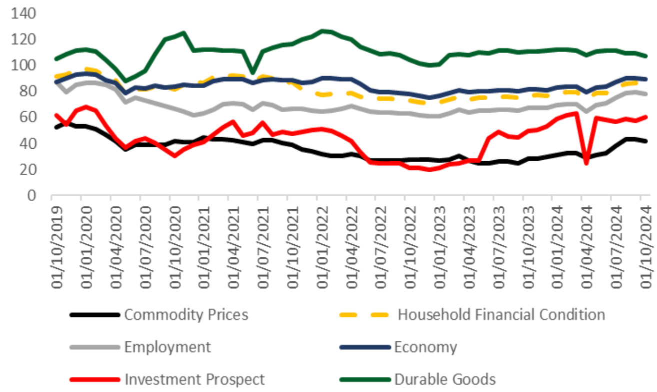


Chart 5: Consumer confidence index by component



Source: CEIC, Bloomberg, MoEA, MoF, OCBC Research.

Tailwinds in AI-related demand remain intact

The global surge in artificial intelligence (AI) has boosted tech share prices and provided a substantial tailwind for semiconductors and electronics demand. While some of the related company share prices took a bit of a breather in 3Q24, investors continue to focus their attention on the potential for momentum to pick-up in the near-term and market optimism to sustain through 2025 and beyond.

TSMC remains a major player in Taiwan's AI-driven export and investment growth. Looking at its competitors, Intel's management does not expect their leading process node (18A on track for 1H25 launch) to have a material impact until 2026+, while Samsung has also been holding off on placing orders for chipmaking equipment for its upcoming factory in Texas from ASML. This has not only enabled TSMC to solidify their leadership position as a foundry, but also to gain greater pricing power and strengthen its negotiating leverage in equipment procurement and capacity expansion over the long term. Against this backdrop, we remain optimistic that Taiwan's exports will ride this AI boom supported by their entrenched leadership role in high-end chip production.

To recall, TSMC hosted its 3Q24 earnings meeting on 17 October, beating both its 3Q & 4Q24 guidance across the board driven by significantly higher utilisation and cost improvement, particularly in 3nm and 5nm chip production. This demonstrates TSMC's ongoing efforts in cost reduction and productivity enhancement, resulting in a higher utilisation rate (UTR) and incremental revenue gains. With regards to the question of the sustainability in AI, management indicated that they maintain constant communication with their customers and believe that TSMC remains in the deepest and widest position in the AI industry. The firm is now projecting AI revenues to comprise a mid-teens percentage of total revenue in 2024 (up from a previous low-teens projection) and anticipate healthy growth in 2025, accompanied by a slightly higher capex than in 2024.

Regarding domestic demand in the Taiwanese economy, we expect consumption to remain robust, supported by positive wealth effects from equities and home price while investments should benefit from proactive reshoring policies and foreign direct investment driven by geopolitics in 2025.

Taiwan

Looking ahead to 2025, we anticipate another positive performance from the Taiwan economy as we expect AI tailwinds to persist in the near term and for Taiwan's macroeconomy to be resilient against this backdrop. We expect real GDP growth in Taiwan to be 2.80% YoY in 2025.

Chart 6: Approved inward FDI by country in USDmn

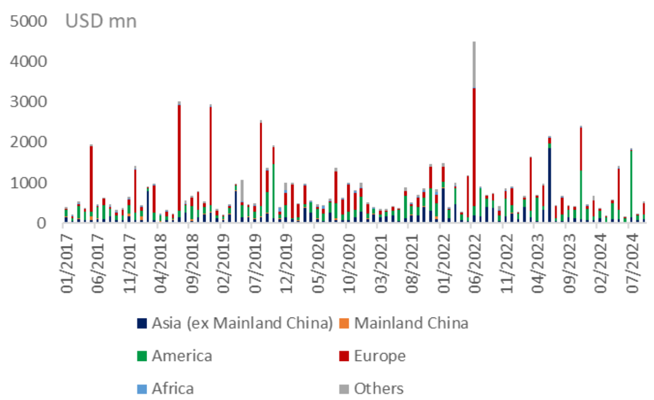
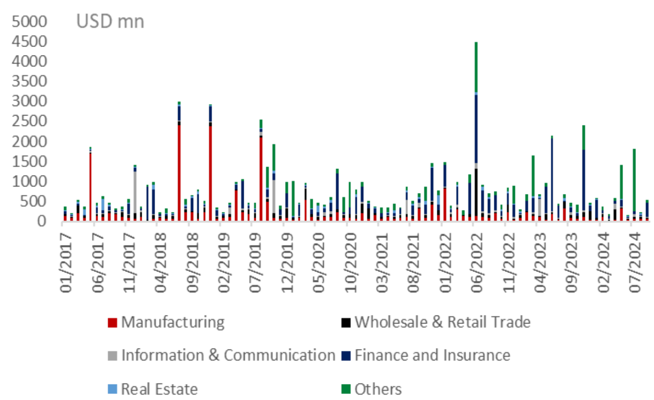


Chart 7: Approved inward FDI by sectors in USDmn



Source: CEIC, Bloomberg, OCBC Research.

CBC to be on hold till 3Q25

On 19 September, the CBC kept its benchmark discount rate at 2.0%, in line with Bloomberg's consensus and our expectation, but further adjusted selective credit control and raised reserve requirement ratios (RRRs) to cool the property market.

Given the sustained increases in residential property price, the bull run in the property market remains a concern for policymakers despite six rounds of selective credit control since 2020. With key priorities being containing housing market speculation and channelling credit resources towards non-homeowners seeking owner-occupied housing, the CBC once again enhanced the effectiveness of credit controls and reduce the flow of credit with the following measures. First, granting no grace period for first home loan for individuals who already owned a property; second, lowering the loan-to-value (LTV) ratio, from 60% to 50%, for second home loans from designated areas to nationwide ; third, lowering the LTV ratio, from 40% to 30%, on corporate entities and third housing loans; and fourth, lowering the LTV ratio cap on unsold housing unit loans from 40% to 30%.

The CBC remains optimistic about the domestic economy, citing robust 5.8% YoY economic growth in 1H24 with upside risks to growth emanating from bright prospects of AI chips persisting and the faster implementation of investments to cater to this demand into 2025. The CBC marginally upgraded its GDP growth and CPI forecasts, while slightly lowering its core CPI projections.

With core inflation now settling near the 2% target and global central banks normalising interest rates, further hikes by the CBC are unlikely. Therefore, the move in September likely represents an attempt by the central bank to fully utilise its remaining policy space, to curb gains in the property market.

Taiwan

The next and final CBC meeting for 2024 is scheduled for 19 December. While more central banks are now embarking on an easing cycle, we expect the CBC to maintain its hold at 2.00% until at least 3Q25, with any subsequent rate cuts likely to be gradual. We expect a cumulative 25bp cut for the CBC to reach 1.75% by the end of 2025.

Chart 8: CBC kept its policy rate unchanged, but raised the RRR to cool the housing market

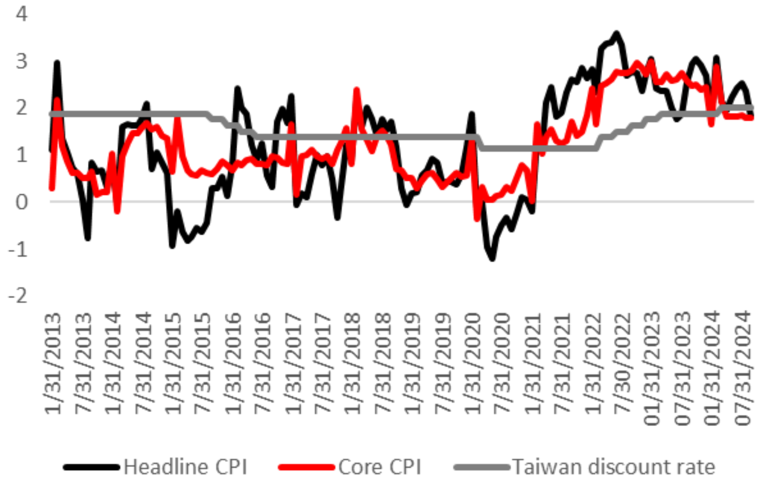


Table 2: OCBC's forecasts

OCBC's Forecast	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
USD-TWD	31.50	31.30	31.20	31.20	31.00
Taiwan Discount Rate	2.00%	2.00%	2.00%	1.88%	1.75%

Source: Bloomberg, OCBC Research.

Chart 9: Consumer price index by key product

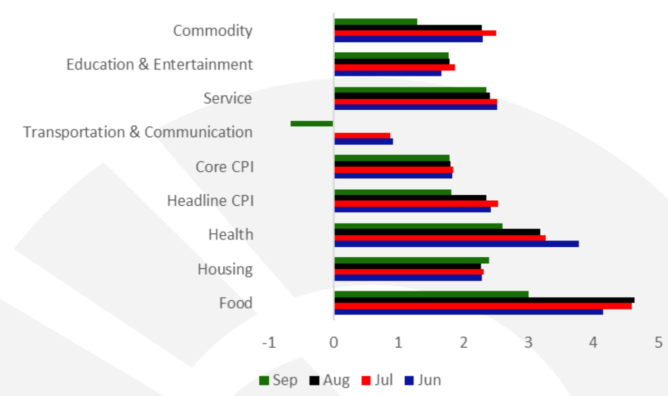
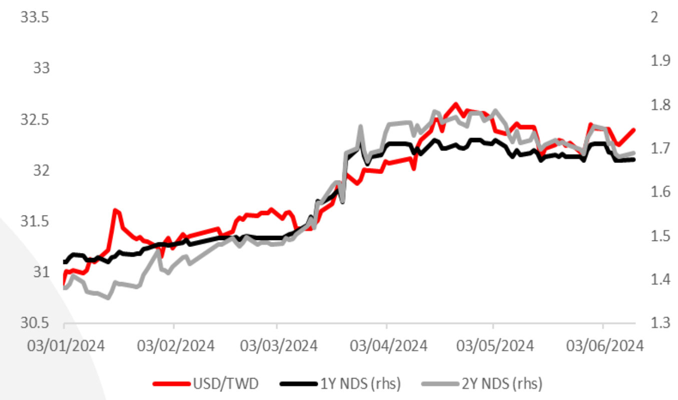


Chart 10: Taiwan's IRS rebounded to record highs



Source: DGBAS, Bloomberg, OCBC Research.

Thailand

Thailand: Weaker than regional peers

- We expect GDP growth to pick up to 3.3% in 2025 from 2.6% in 2024, supported by a stronger turnaround in household spending.
- This rebound will likely be cyclical as structural constraints such as an ageing population, elevated household debt continues to weigh on potential growth.
- We expect Bank of Thailand (BoT) to deliver a 25bp cut in 1Q25 and remain on an extended pause.

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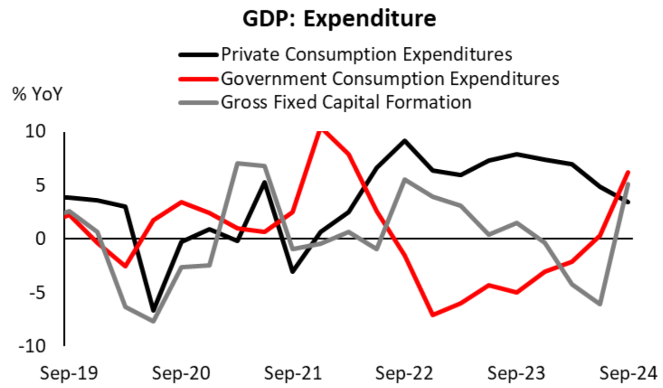
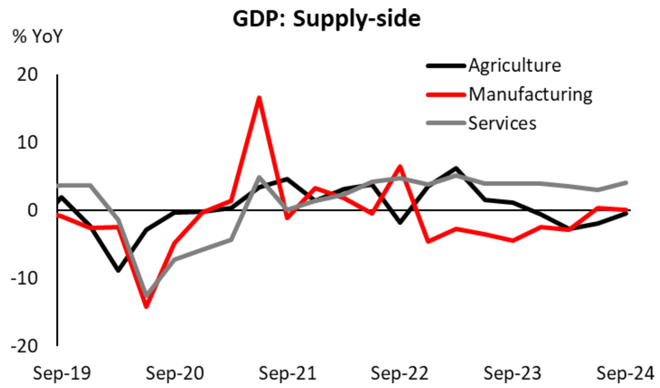
Uneven growth in 2024

The 1Q-3Q24 growth picture came in line with our expectations for a modest growth outlook. GDP growth improved to an average of 2.3% YoY in 1Q-3Q24, up from 1.9% in 2023. However, the details of the GDP print revealed that the growth drivers were limited to export growth as well as modest improvements in government spending.

Private consumption slowed to an average of 5.1% YoY in 1Q-3Q24, down from 7.1% in 2023 while investment spending declined to an average of 1.7%, down from +1.2% in 2023. The supply side reflected a similar uneven growth picture, growth in the agriculture sector contracted to -1.7% YoY in 1Q-3Q24 versus +2.1% in 2023 while the manufacturing sector growth improved to -0.8% (2023: -3.1%) in 1Q-3Q24, albeit still in contraction territory. Meanwhile, growth in the services sector eased to 3.6% YoY in 1Q-3Q24 versus 4.3% in 2023.



Source: Office of the National Economic and Social Development Council, CEIC, OCBC.



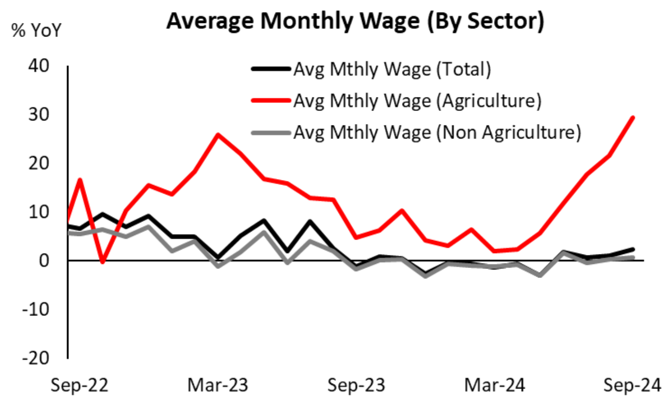
Source: Office of the National Economic and Social Development Council, CEIC, OCBC.

For 4Q24, hopes are pinned on a stronger turnaround in household spending given by the implementation of the digital wallet programme (phase 1) in late September. The first phase was launched on 25 September which targeted 14.5mn people from the vulnerable group. We expect the economy to grow 2.6% YoY in 2024, implying a pickup in 4Q24 GDP growth to 3.5%. The Ministry of Finance, NESDC and BoT expects 2024 GDP growth forecast of 2.8%, 2.6% and 2.7% respectively.

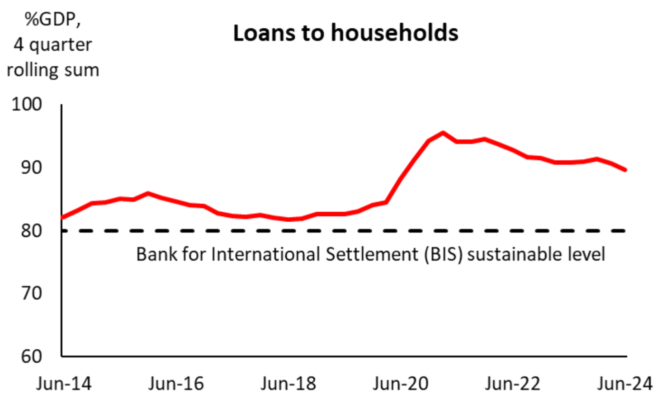
Thailand

We forecast 2025 GDP growth to pick up to 3.3% YoY. The timing of digital wallet disbursements suggests that the impact on growth will be in 4Q24 and 1H25. The details of the second and third phases of the digital wallet programme have been announced. The second phase will target economically vulnerable groups (i.e., people who are at least 60 years old) and will see the distribution of THB40bn (0.3 % of 2025 GDP) to 4mn people in January. Meanwhile, the third phase has a larger quantum and will see the distribution of THB140bn (1.2% of 2025 GDP) to 14mn people in 2Q24[17].

Beyond the impact of the digital wallet program, households are constrained by volatile wage growth and elevated household debt levels. Although agriculture wages are up 11.1% YoY in 1Q-3Q24, overall wage has been flat due to a contraction in non-agriculture wage growth. This likely remains a source of stress for households in terms of debt servicing. This could in part explain the reason behind household debt levels remaining elevated and above pre-pandemic levels.



Source: Bank of Thailand, CEIC, OCBC.



Source: Bank of Thailand, CEIC, OCBC.

Policy and political continuity will help support investment spending in 2025 from an expected contraction in 2024. Public investment spending will likely reverse course from slower disbursements in FY24 (i.e., October 2023 to April 2024) due to the late approval of budget 2024. The timely adoption of the FY25 budget and political continuity will likely lead to higher disbursements in FY25. Private investment spending could remain subdued but the increasing value of issued investment promotion certificates and the permitted construction area in industrial areas[18] suggest that momentum would be better compared to 2024.

[17] Sriring, O., Thaichareon, K., Staporncharnchai, T., & Setboonsarng, C. (2024, November 20). Thailand expects to distribute $4 bln in handouts in Q2 next year. Retrieved from Reuters.

[18] Edited Minutes of the Monetary Policy Committee Meeting (No. 5/2024) 9 and 16 October 2024, Bank of Thailand. (2024, October 30). Retrieved from Bank of Thailand.

Thailand

On the external front, the recovery of the export sector gained momentum in 3Q24. However, the outlook is subjected to risks including domestic structural headwinds[19] and concerns of oversupply[20]. Our baseline is for goods export growth to remain broadly stable at 3.8% YoY in 2025 versus 3.5% in 2024, this will be supported by stabilising growth to key trading partners such as China, ASEAN and US.

There are few crucial export sectors that face structural constraints. This includes the 'automobile and parts' sector, which accounts for 12.2% of 2023 total exports. Over the medium term, it will be crucial to raise the competitiveness of the domestic automobile industry to face stiff competition from China's automobile industry which has grown in capacity and capabilities over the years. Additionally, the domestic industry has only recently begun to diversify and integrate into the supply chain of Electric Vehicles.

HS Code	Description	% Share of Total Exports (2023)
85	Electrical machinery and equipment and parts thereof; sound recorders and reproducers; television image and sound recorders and reproducers, parts and accessories of such articles	17.6
84	Nuclear reactors, boilers, machinery and mechanical appliances; parts thereof	14.3
87	Vehicles; other than railway or tramway rolling stock, and parts and accessories thereof	12.2
40	Rubber and articles thereof	5.9
71	Natural, cultured pearls; precious, semi-precious stones; precious metals, metals clad with precious metal, and articles thereof; imitation jewellery; coin	5.2
39	Plastics and articles thereof	4.6
27	Mineral fuels, mineral oils and products of their distillation; bituminous substances; mineral waxes	3.9
8	Fruit and nuts, edible; peel of citrus fruit or melons	2.5
16	Meat, fish or crustaceans, molluscs or other aquatic invertebrates; preparations thereof	2.3
90	Optical, photographic, cinematographic, measuring, checking, medical or surgical instruments and apparatus; parts and accessories	2.0

Source: ASEANstats, OCBC.

[19] Monetary Policy Report Q1/2024. (2024, April 10). Retrieved from Bank of Thailand.
[20] Monetary Policy Report Q2/2024. (2024, April 10). Retrieved from Bank of Thailand.

Thailand

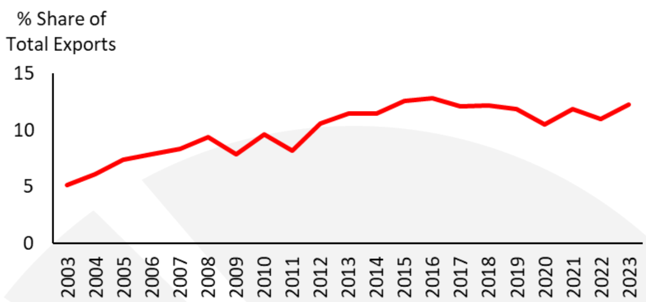
Crucially, our baseline GDP forecast does not account for potential tariffs from the US, but we have estimated the impact of potential tariffs under three different scenarios which US President-elect Donald Trump had mentioned during his campaign trail. Under scenario 1, we expect GDP growth to be 0.2pp lower than our baseline.

Assessing the Impact of Potential Tariffs on Thailand 2025 GDP Growth		
1	60% tariff is imposed on China's exports to the US	-0.2pp
2	10% tariff is imposed on all US trading partners including the ASEAN countries, along with a tariff of 60% on China's exports to the US	-0.7pp
3	20% tariff is imposed on all US trading partners including the ASEAN countries, along with a tariff of 60% on China's exports to the US	-1.1pp

Source: OCBC estimates.

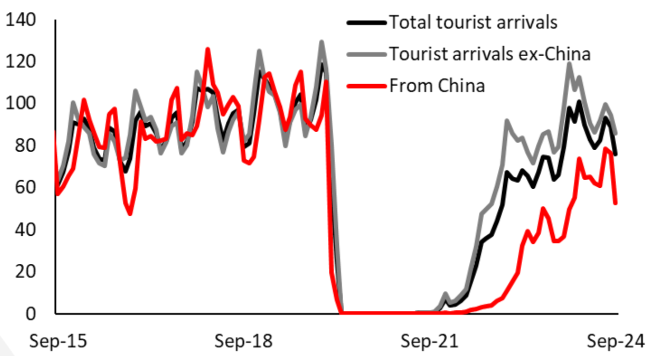
Meanwhile, the government is pushing for higher tourist inflows of 40mn tourist arrivals in 2025[21]. We expect tourism prospects to remain robust not least because of further measures boosted by domestic tourism following the Cabinet's approval for two additional holidays in 2025[22]. That said, the numbers look like they could fall short of the government's 2024 target of 36.7mn visitor arrivals. Tourist arrivals were 26.1mn from January-to-September 2024 and will need to rise by ~3mn per month on average in 4Q24 to meet the target. Nonetheless, tourist arrivals remained solid, rising 30.1% YoY in 1Q-3Q24 and this is equivalent to 87.1% of 2019 levels. Still strong tourist arrivals, better goods export growth will support the current account surplus for 2025 at 0.8% of GDP versus 0.6% of GDP in 2024.

Vehicles; other than railway or tramway rolling stock, and parts and accessories thereof



Note: HS code 87.
Source: ASEANstats, OCBC.

Tourist Arrivals



Source: Bank of Thailand, Ministry of Tourism and Sports, CEIC, OCBC.

[21] Sangwongwanich, P. (2024, October 8). Thailand Sees Tourist Arrivals at Pre-Pandemic Level Next Year. Retrieved from Bloomberg.

[22] Sangwongwanich, P., & Nguyen, A. (2024, October 8). Thailand Sets Extra Holidays to Spur Tourism-Reliant Economy. Retrieved from Bloomberg.

Thailand

Fiscal policy to support economic growth

Budget 2025 was approved during ex-PM Srettha Thavisin's tenure. Fundamentally, there were few changes to PM Paetongtarn Shinawatra's policies compared to her predecessor. Total expenditure growth is projected at 4.2% YoY. Within this, current and capital expenditure growth are budgeted to ease to 5.4% YoY and 12.5% YoY, respectively, versus 6.8% and 17.1% in the FY24 budget. Of this, the digital wallet program has been allocated THB152bn[23].

On the revenue front, revenue collections are expected to ease to 3.2% YoY, based on higher real GDP growth of 2.8-3.8% YoY in FY25 versus 2.2-3.2% in 2024. However, given the underperformance of FY24 revenues, the same revenue projections imply sharper growth of 6.2%, by our estimates. This suggests that there could be some revenue underperformance in FY25, even if GDP growth estimates match expectations. There are some new tax measures being discussed including the phase 1 of the "travelling tax" that aims to levy THB300 to foreign visitors arriving by air[24].

THBbn, unless stated	FY2020	FY2021	FY2022	FY2023	FY2024		FY2025
	Actual	Actual	Actual	Actual	Original	With supplementary budget	Budget
Revenues	2344.5	2449.7	2551.5	2665.7	2787	2797	2887
Expenditures	3168.7	3208.7	3146.2	3262.4	3480	3602	3752.7
Current	2575.9	2583.8	2516.6	2610.2	2532.8	2564.9	2704.6
Capital	367.9	428.4	416	478.2	717.7	807.6	908.2
Fiscal deficit	-824.2	-758.9	-594.8	-596.7	-693	-805	-865.7
% GDP	-5.2	-4.7	-3.5	-3.3	-3.6	-4.3	-4.4

Note: The expenditure component comprises current expenditure, capital expenditure, replenish treasury account and principal repayment.

Source: Bureau of Budget, Fiscal Policy Office, Bloomberg, Reuters, OCBC. Revenue assumption for FY24 (with supplementary budget) is based the revised deficit of THB805bn.

As such, the fiscal deficit is forecast to widen to 4.4% of GDP in FY25 from 4.3% of GDP (accounting for the supplementary budget) in FY24[25].

Persistent low inflation

The government's cost of living measures has kept prices in check. Cuts to retail diesel and electricity tariffs for an extended period have kept transport and utility inflation well-contained, while abundant produce on key food items kept food inflation low. Headline CPI (Jan-Oct 2024) has averaged 0.3% YoY versus 1.2% in 2023, below the BoT's inflation target of 1-3%. Meanwhile, core inflation (Jan-Oct 2024) slowed to an average of 0.5% YoY versus 1.3% in 2023. For 2024, we revise higher our headline CPI to 0.4% YoY, accounting for persistence of low inflation in preceding months. Nevertheless, we still expect a pickup in headline CPI for the rest of year.

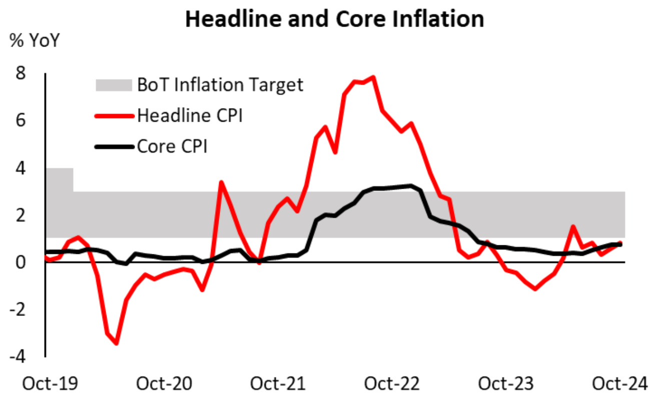
[23] Yonpiam, C. (2024, September 3). 2025 fiscal budget bill set to pass. Retrieved from Bangkok Post

[24] 'Travelling tax' to start with air travel from mid-2025. (2024, October 24). Retrieved from The Nation.

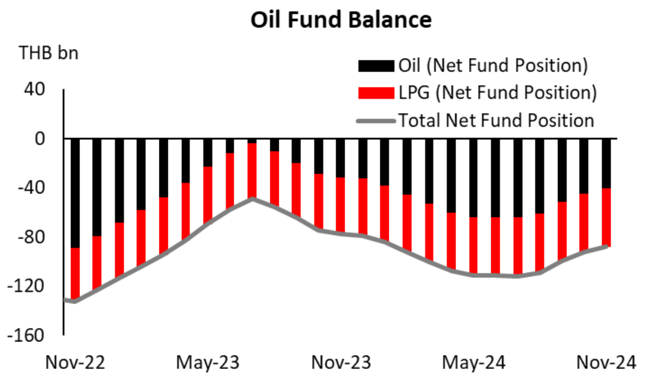
[25] 4.3% of GDP (accounting for the supplementary budget) in FY24.

Thailand

We expect headline inflation to average 2.2% YoY in 2025, up from 0.4% in 2024, comfortably within the BoT's 1-3% target range. Our baseline accounts for further upward revisions to retail fuel prices from 4Q24 onwards as well as some upward adjustments to electricity tariffs in 2025. The risk is that the government continues to bear losses on the oil fund to cross subsidise retail oil prices implying that headline inflation could remain low even next year [26].



Source: Bureau of Trade and Economic Indices, CEIC, OCBC.



Note: As of 17 November 2024.
Source: Oil Fuel Fund Office, OCBC.

From a monetary perspective, the pressure on the BoT to cut rates will unlikely be alleviated. If anything, the likely nomination of former Finance Minister Kittirat Na-Ranong as Chairman of the Board of the Bank of Thailand would increase political pressure to deliver rate cuts to support the government's goal of achieving higher economic growth. More fundamentally, tepid economic growth will allow BoT room to lower its policy rate by 25bp in 1Q25 to 2.00% but the impact of lower rates remains an open question given that the growth constraints are structural rather than cyclical.

[26] Praiwan, Y. (2024, October 17). Minister vows to keep lid on fuel and power prices. Retrieved from Bangkok Post.

Vietnam: Dealing with uncertainties

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- We expect 2025 GDP growth of 6.2% YoY versus 6.5% in 2024, but this still suggests resilience in key growth drivers such as exports and consumption.
- The economy will likely be in the firing line of US protectionism should blanket tariffs be imposed by President-elect Trump. In the interim, it will continue to benefit from supply-chain diversification and 'China +1' policies.
- The authorities will stand guard against increasingly elevated downside risks to growth and will be nimble in terms of policy support should the need arise.

Growth resilient but not immune

The economy grew 6.8% YoY in 1Q-3Q24 driven by the industrial sector, which accounts for ~29.9% of GDP, rebounded significantly, achieving 8.3% YoY growth in 1Q-3Q24. This sector alone contributed 2.5 percentage points (pp) to headline growth. Growth was also robust in the construction (7.5% YoY in 1Q-3Q24) and services (6.9% YoY) sectors, offsetting the muted performance in the agriculture sector which slowed to 3.2% YoY. We forecast full-year 2024 growth of 6.5% YoY, reflecting a modest slowdown in 4Q24 due to disruptions from natural disasters (e.g., Typhoon Yagi) and pockets of external weaknesses. Nonetheless, Vietnam will remain one of the fastest-growing economies in the region in both 2024 and 2025.

GDP Growth of Selected Sector (% YoY)	2019	2020	2021	2022	2023	1Q24	2Q24	3Q24
GDP	**7.4**	**2.9**	**2.6**	**8.1**	**5.0**	**5.9**	**7.1**	**7.4**
Agriculture, Forestry and Fishery	**2.7**	**3.0**	**3.7**	**3.5**	**3.8**	**3.4**	**3.6**	**2.6**
Industry and Construction	**8.2**	**4.4**	**3.2**	**7.9**	3.7	6.7	8.6	9.1
Industry	8.1	3.8	4.1	7.8	3.0	6.5	8.8	9.6
Manufacturing	9.6	5.0	5.4	8.2	3.6	7.2	10.4	11.4
Construction	8.5	7.1	-0.6	8.2	7.1	7.7	7.8	7.1
Services	**8.1**	**2.0**	**1.7**	**10.1**	**6.8**	**6.2**	**7.1**	**7.5**
Wholesale, Retail Sales & Motor Vehicles	9.8	5.8	0.9	10.3	8.8	7.0	7.7	8.0
Transportation & Storage	9.8	1.1	-2.9	12.3	9.2	10.5	11.5	11.1
Accommodation & Food Services Activities	9.0	-21.1	-20.1	40.9	12.2	8.7	11.1	8.8
Information & Communication	8.3	6.5	4.6	7.3	4.6	4.4	5.1	6.6
Financial, Banking & Insurance Activities	9.0	7.5	9.8	9.6	6.2	4.6	6.1	8.4
Real Estate Activities	4.5	0.9	1.3	6.2	0.1	1.8	2.4	3.9

Source: General Statistics Office (GSO), CEIC, OCBC

Vietnam

We expect a marginal slowdown in 2025 GDP growth to 6.2%. For one, some of the weaknesses observed in 4Q24 will likely persist into 1Q25 as weather disruptions have continued and the reconstruction efforts take some time to yield results. Second, growth in most key sectors will likely be stable to modestly weaker in 2025. While growth in the manufacturing sector will be supported by strong demand for electrical and electronic (E&E) products, the semiconductors industry has projected a slowdown in demand to 14% YoY in 2025 from 19% in 2024, according to Gartner[27]. This will have an impact on E&E exports. Meanwhile, the construction and the real estate sectors are expected to benefit from the expedited implementation of laws relating to land, housing and the real estate market, which took effect on 1 August 2024, rather than the initially planned implementation in 2025. However, there is anecdotal evidence to suggest that while the lull in the property and construction sectors may be bottoming[28], the improvements will take time to recover.

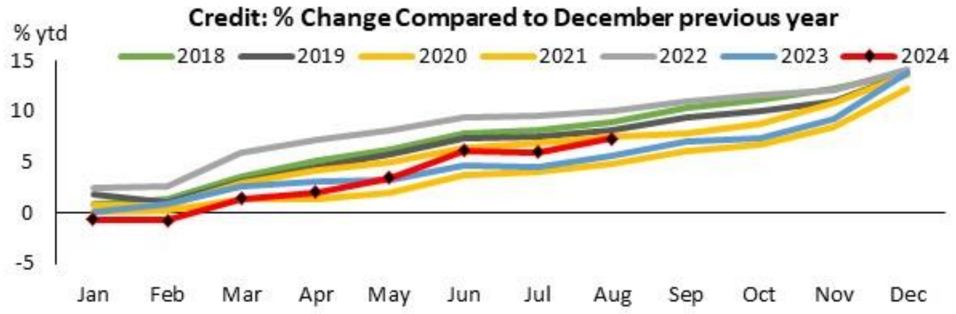
On the upside, however, growth remains supported by public infrastructure spending. The pipeline is strong including projects that will enhance the connectivity across the country. These projects include plans to complete 3,000km of highways by 2025, with Prime Minister Pham Minh Chinh calling for the acceleration of capital investment disbursement for transportation projects, expected to reach VND200trn. More recently, during a meeting with Chinese President Xi Jinping at the BRICS Summit in Russia, Prime Minister Chinh emphasized the need to expedite the development of three proposed cross-border railway lines linking Vietnam and China. These routes include a connection from China's Yunnan province to Haiphong, from Dongxing City to Haiphong, and a third from Lang Son to Hanoi. Equally significant are the efforts to enhance energy capacity. The Ministry of Planning and Investment has indicated that additional power projects are in the pipeline. Among them is a 500-megawatt project slated for completion by the end of 2024, which will supply electricity to the northern region—a critical manufacturing hub for the country.

Some Key Infrastructure Projects		
Project Title	**Investment Commitment**	**Status**
Ho Chi Minh City Urban Railway Construction Project	USD767mn	59%
Lach Huyen Infrastructure Project Port – III	USD289mn	97%
Greater Mekong Subregion Ben Luc-Long Thanh Expressway Project – Tranche 2	USD 289mn	5%
North-South Expressway Construction Project – Da Nang – Quang Ngai Section III	USD269mn	34%
Thai Binh Plant & Transmission Lines Project – IV	USD503mn	95%
Duyen Hai 2 Thermal Power Plant	USD123mn	96%
Source: Lowy Institute, OCBC.		

[27] Article by Gartner Consulting: Gartner Forecast Worldwide Semiconductor Revenue to Grow 14% in 2024, published 28 October 2024. Last accessed on 18 November 2024.
[28] Article by Hanoi Times: Promising second half 2024 outlook for Vietnamese real estate, published on 7 July 2024. Last accessed on 18 November 2024.

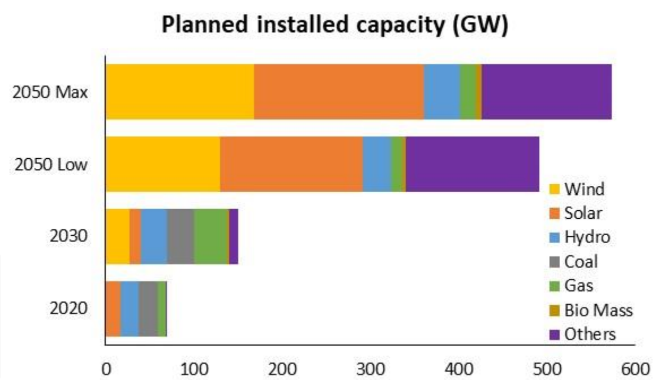
Vietnam

Meanwhile, credit growth is also likely to pick up in 2025 as increased public sector disbursements catalyse private sector demand. Loan growth was weak at the start of 2024 but has since picked up – it reached 7.4% YoY as of August compared to end of 2023, surpassing 2023's performance during the same period but trailing historical averages. Notably, credit growth was led by the 'industrial' sector at 8.7% YoY, followed by the 'trade, transportation & telecommunication' sector at 7.4%, and 'other service activities' at 7.9%. In contrast, credit to the 'agriculture, forestry & fisheries' sector lagged behind, growing at just 4.1%. According to the SBV's 4Q24 business trend survey, credit institutions expect full-year credit growth to reach 13.2% YoY, potentially falling short of the government's 15% YoY target.

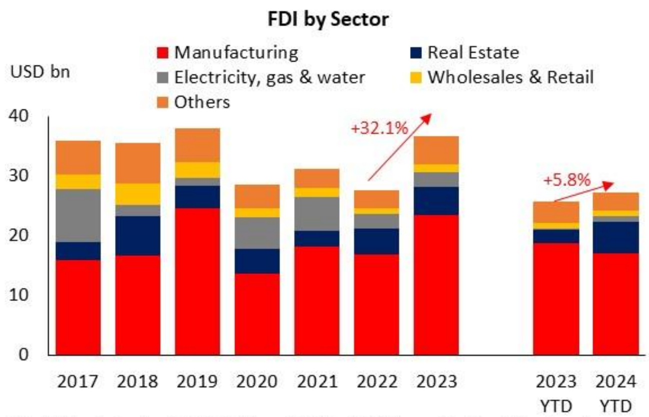


Source: State Bank of Vietnam, CEIC, OCBC.

On the external front, foreign direct investments remain strong. Several high-profile investment announcements by multinational companies in recent months underscore Vietnam's strategic role as a 'buffer' during US-China trade tensions and a key destination for supply chain diversification. These include South Korea's Hyosung Group, which plans to invest an additional USD4.0bn in data centres, high-tech industrial materials, carbon fibre manufacturing, and aviation biofuel. Similarly, ShunSin Technology Vietnam, a Foxconn subsidiary, plans to invest USD80mn in a chip manufacturing project in Bac Giang, with exports targeted to the US, EU, and Japan.



Note: Others include storage power, hydrogen, imports, etc.
Source: *Dentons LuatViet, OCBC.*



Note: Total registered capital. Latest data as of October 2024. Source: Ministry of Planning and Investment, CEIC, OCBC.

Vietnam

This suggests that the economy will continue to benefit from supply chain diversification, and we expect this to continue barring any external shocks. Realised total registered capital increased by 5.8% YoY to USD27.3bn in the January–October 2024 period. Notably, over 62% of these investments were directed towards the manufacturing sector, indicating continued expansion of future production capacity and reinforcing the sector as one of Vietnam's primary engines for growth in the near to medium term. Additionally, the government's efforts to deepen and broaden its bilateral and multilateral free trade agreements have provided better market access for exports and complement the authorities' initiatives to attract more FDI (*more in the Thematic section: Vietnam: Boon Turns to Bane?)*.

Mildly expansionary fiscal policy for 2025

The fiscal stance is expected to remain supportive of growth in 2025 compared to 2024. The budget deficit for 2025 is targeted at VND471.5trn, equivalent to 3.8% of GDP, up from the 3.6% deficit planned for 2024, according to the National Assembly's resolution on 12 November 2024. While detailed allocations are limited at the time of writing, further detail breakdowns are expected by December. Initial figures indicate a 15.6% YoY increase in state revenue to VND1,967trn and a 20.3% rise in state spending to VND2,549trn in 2025. The National Assembly also confirmed that there will be no increases in public sector salaries, pensions, social insurance benefits, or allowances for meritorious individuals in 2025.

VNDtrn	2019	2020	2021	2022	2023 (e)	2024 (p)	Jan-Sep 2024 (e)	2025(p)*
Revenue	**1553.6**	**1510.6**	**1591.4**	**1614.1**	**1620.8**	**1701.0**	**1448.2**	**1966.8**
Taxes and Fees	1391.0	1331.4	1388.2	1411.3	1464.4	1466.9	1305.1	-
Capital Revenues	157.4	174.4	186.0	195.0	150.8	227.5	142.6	-
Grants	5.1	4.8	17.2	7.8	5.5	6.6	0.5	-
Expenditure excl Principal Payment	**1526.9**	**1709.5**	**1708.1**	**2035.4**	**2035.9**	**2119.4**	**1256.3**	**2548.9**
Investment Development	421.8	576.4	540.0	663.3	739.6	677.3	320.6	790.7
Current Expenditure	1105.0	1133.1	1168.0	1223.4	1265.7	1175.7	935.7	-
Principal Payment	188.2	222.3	241.9	197.9	190.5	291.2	-	110.5
Balance	**-161.5**	**-216.4**	**-214.1**	**-421.3**	**-415.2**	**-399.4**	**-**	-471.5
Balance % GDP	*-2.1*	*-2.7*	*-2.5*	*-3.1*	*-3.5*	*-3.6*	-	-3.8

Note: e = estimate. p = planned, *based on National Assembly. Source: Ministry of Finance, CEIC, OCBC.

A key challenge will be accelerating the disbursement of public investment, particularly for critical national and local projects. As of the first nine months of 2024, state expenditure disbursement had reached only 59.3% of the budgeted amount, while revenue collections stood at 85.1%. The government aims to disburse 95% of the 2024 budget, highlighting its commitment to addressing fiscal bottlenecks and ensuring a more effective implementation of planned expenditures in 2025. We expect there will be an improvement given the efforts the government has committed to this, but we will continue to monitor progress into early 2025.

Vietnam

Inflation (largely) under control

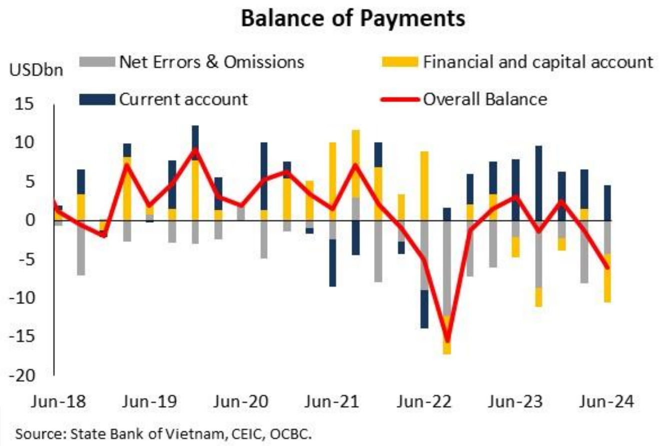
The inflation backdrop has remained volatile through 2024. Headline inflation accelerated to 2.9% YoY in October, up from 2.6% in September, with core inflation also rising to 2.7% YoY from 2.5%. This uptick was primarily driven by food and foodstuff prices, which increased by 4.4% YoY in October compared to 3.9% in September, as storms and flooding continued to disrupt supply chains. Nonetheless, the average inflation for the January–October 2024 period stood at 3.8% YoY, closely aligned with our full-year forecast of 3.7% YoY.

Looking ahead, inflation in 2025 is expected to edge up slightly to 4.0% YoY but remain below the government's 4.5% target. Contributing factors include the ongoing effects of public wage increases, stable global commodity prices, and normalised domestic food prices following India's reversal of its rice export ban. Nevertheless, upside risks persist, particularly from potential depreciation of the dong, which could adversely impact imported inflation, and the government's effectiveness in mitigating supply chain disruptions caused by natural disasters.

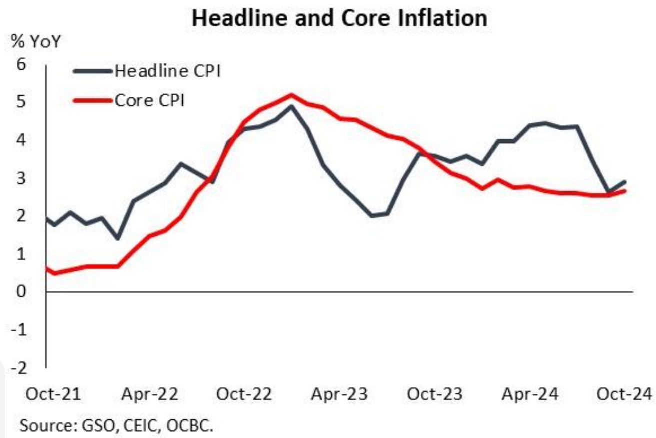
External position to remain robust

The current account surplus will likely narrow to 3.8% in 2025 from 5.0% of GDP in 2024. The latest data as of 2Q24 shows the current account surplus narrowed to 4.0% of GDP from 5.0% in 1Q24.

The main risk lies in the more volatile financial and capital account. Specifically, the financial account recorded an outflow equivalent to 5.6% of GDP in 2Q24, compared to a 1.4% surplus in 1Q24. This was driven by a widening net portfolio investment outflow, which increased to USD1.8bn in 2Q24 from USD0.5bn in 1Q24, partly due to unfavourable interest rate differentials, particularly relative to the US.



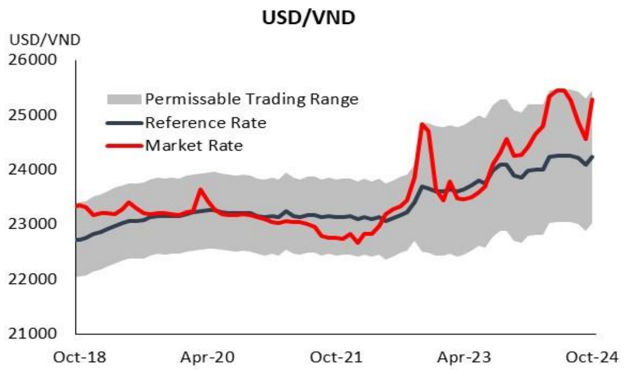
Source: State Bank of Vietnam, CEIC, OCBC.



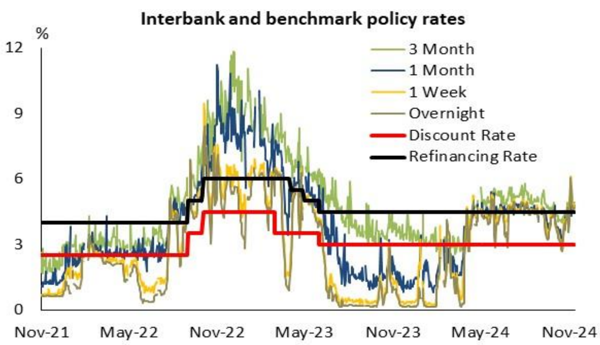
Source: GSO, CEIC, OCBC.

Vietnam

From a monetary policy perspective, strong economic momentum in 1Q-3Q24 and the projected 6.5% growth for 2024 have reduced the need for the State Bank of Vietnam (SBV) to cut its benchmark policy rate this year. Instead, recent inflationary pressures and renewed currency depreciation have likely anchored policy rates at current levels for the remainder of 2024. Looking ahead to 2025, we expect the SBV to maintain a prudent and flexible approach, carefully balancing support for economic growth as well as ensuring macroeconomic stability. Our baseline is for no changes to the policy rate. However, the risk particularly if tariffs are implemented by the US and growth is hurt (as we assess will be the case. Assessing the impact of potential tariffs), we do not rule out monetary policy support from SBV.



Source: State Bank of Vietnam, Bloomberg, CEIC, OCBC.



Note: latest data as of 12 November 2024. Source: State Bank of Vietnam, CEIC, OCBC.

Thematic Report 1

ASEAN: Assessing the impact of potential tariffs[29] [30]

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- The US elections on 5 November 2024 is set for a nailing biting finish. This has raised investor anxiety around the prospects of additional tariffs under second potential Trump presidency.
- In this piece, we outline three scenarios for tariff implementation and look at their impact on GDP growth.
- We estimate that ASEAN-6 GDP growth could fall by 0.1 percentage points (pp) to 1.3pp depending on the scenario.

The US elections on 5 November 2024 is set for a nailing biting finish. Neither Donald Trump nor Kamala Harris have held onto leads in the polls in a convincing or sustained manner. This has raised investor anxiety around the prospects of additional tariffs under a second potential Trump presidency.

The ASEAN-6 region, i.e., Indonesia, Malaysia, Philippines, Singapore, Thailand and Vietnam, have significantly benefited from the 'China +1' strategies adopted following the imposition of tariffs in 2018, during the previous Trump presidency. This makes these economies targets should Donald Trump follow through on his election promises of higher tariffs on all US trading partners. Specifically, former President Trump has said that he will consider a blanket tariff of 10-20% on almost all imports into the US, with tariffs of 60% on Chinese imports.

Scenario analysis
Below we describe three potential scenarios for tariffs imposition. Our note here is that is meant to be an illustrative exercise to provide some impacts on regional GDP growth. Our approach is simplistic and assumes a one-time shock.

Under scenario 1, we assume a 60% tariff is imposed on China's exports to the US. Under scenarios 2 and 3, tariffs are imposed on all trading partners including ASEAN along with 60% tariffs on China's exports to the US. Under scenario 2, we assume a tariff of 10% is imposed on all US trading partners including the ASEAN countries along with a tariff of 60% on China's exports to the US. Under scenario 3, a 20% tariff is imposed on US trading partners, along with a tariff of 60% on China's exports to the USA.

As mentioned above, we use a simplistic approach limited to the trade channels to determine the impact of the tariff shock on regional GDP growth. We also assume it is a one-time shock and look to examine the impact only for the year of implementation, which we assume to be 2025.

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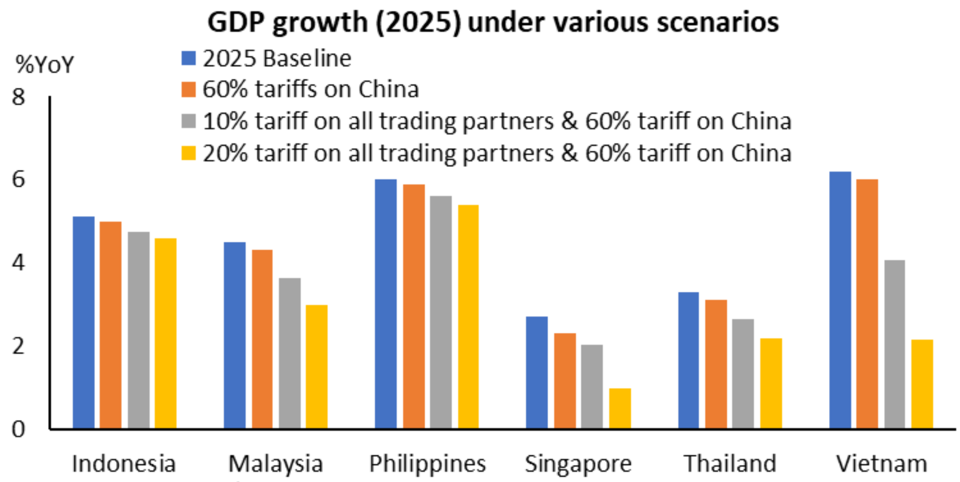
[29] In this piece, our references to China are specifically to Mainland China.
[30] This piece was completed and published on 29 October 2024.

Thematic Report 1

Our approach assumes a complete pass-through of the tariff shock onto import prices. We then estimate changes in import volumes changes based on trade elasticities calculated by a World Bank Policy Research Working Paper called *Trade Elasticities in Aggregate Models, Estimates for 191 Countries*[31]. The changes in imports are measured as a percentage of GDP and this is the decline we assume for GDP growth.

For the shock from China growth, we overlay estimates from the IMF's study on *Spillovers from China's Growth Slowdown to the Singapore Economy.* This study estimates that a 1pp decline in Chinese domestic growth will result in a cumulative decline of about 1pp of trend growth on average in ASEAN countries after five years, which is equivalent to about 0.2 percentage points per year. The study further notes that "accounting for the particularly large exposure of Singapore to Chinese final demand (relative to other ASEAN countries)" the cumulative decline in Singapore's output could be as high as 2.1 percentage points over five years. We assume the impact per annum is 0.4pp.

In terms of timing, we assume that the tariffs will be implemented and made effective in January 2025, almost immediately after the new President takes office, assuming Donald Trump wins. Our house view is that if 60% tariffs are implemented on China's exports to the US, China's GDP growth could fall by 1.0pp. This is scenario 1. Under these circumstances, GDP growth for the ASEAN-6 region could be relatively unimpacted. In fact, these economies could continue to benefit over the medium-term. However, under scenarios 2 and 3, we expect ASEAN-6 GDP growth to be lower by 0.7pp and 1.3pp, respectively, relative to our baseline.

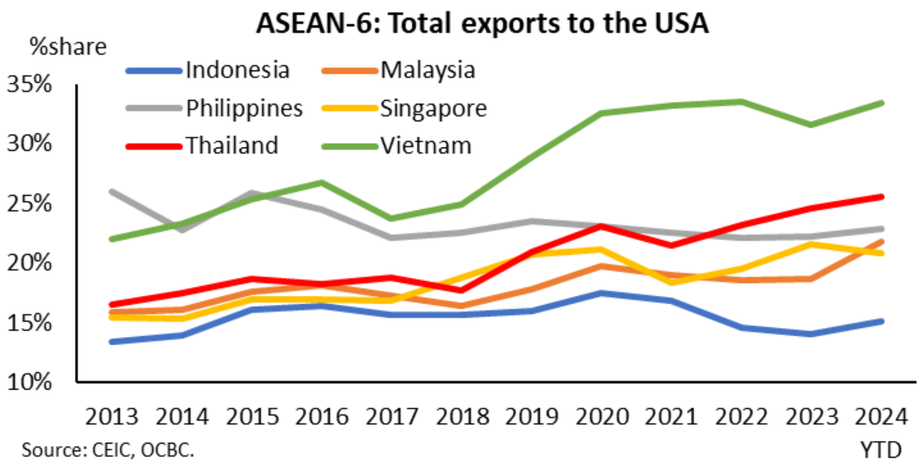


Source: CEIC, UNComtrade, OCBC.

[31] World Bank Group, Policy Research Working Paper 10490, *Trade Elasticities in Aggregate Models*, Estimates for 191 Countries. Shantayanan Devarajan, Delfin S. Go, and Sherman Robinson, June 2023.

Thematic Report 1

While total trade (exports and imports) exposure to the US is not as high as China for any of the ASEAN-6 economies, the picture becomes more nuanced looking at the breakdown of exports and imports. For almost every country in the region, with the exception of Indonesia, exports to the US (as a share of total exports) have increased over the past five years. The uptrend has become more pronounced since the pandemic.



Source: CEIC, OCBC.

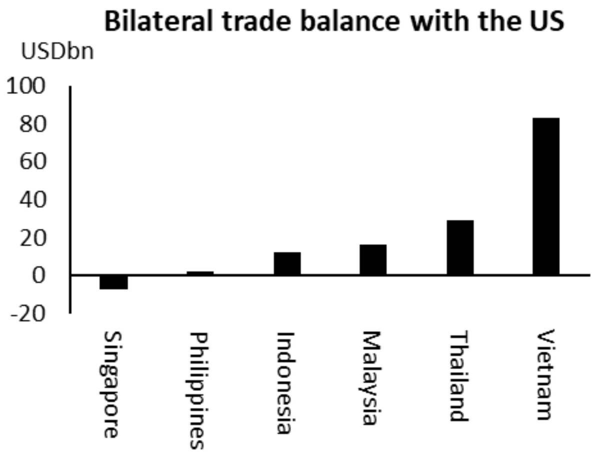
Vietnam

Vietnam will, in our view, be the most sensitive in the ASEAN-6 region to higher tariffs from the US. Vietnam's exports to the US were 27% of total exports in 2023, edging higher to 29% year-to-August 2024. Even in USD terms, Vietnam's exports earnings from the US were the highest in 2023 at USD97.0bn, more than double of Singapore's export earnings and nearly 8.5 times the earnings from Philippines exports to the US.

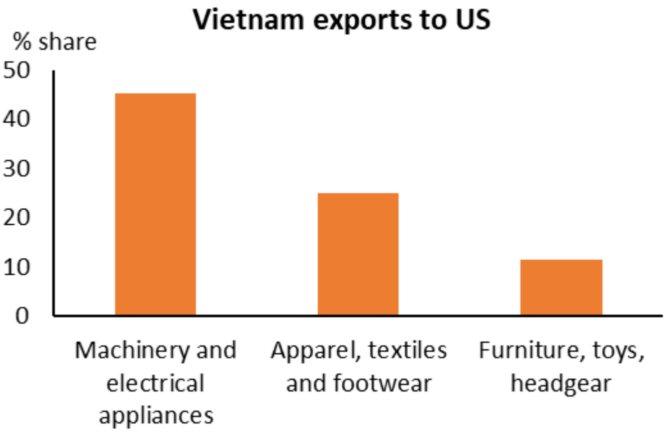
Indeed, Vietnam's bilateral trade surplus with the US was the highest in the region in 2023. These large trade surpluses are also responsible for Vietnam featuring on the US Treasury's report to Congress on the '*Macroeconomic and foreign exchange policies of major trading partners of the United States*'. In terms of products, 45.3% of Vietnam's exports to the US were machinery and electrical equipment (2022) and 36.4% of total exports were textiles, apparel, footwear, furniture and toys[32].

As one of the biggest beneficiaries of the 'China +1' policies, we expect Vietnam's GDP growth will be relatively insulated under scenario 1, where tariffs increases are limited to China, with GDP growth staying close to 6.0% in 2025 (baseline: 6.2%). Over the medium-term, Vietnam will continue to benefit from supply chain diversification. However, under scenarios 2 and 3, we expect GDP growth to be lower by 2.1pp and 4.0pp relative to our baseline. This would put GDP growth on par with rates last seen during the pandemic.

[32]We classify these as largely labour-intensive sectors in our categorisation, used for the other countries.



Source: UNComtrade, OCBC.



Source: UNComtrade, OCBC.

Singapore

Singapore's share of total exports to the US is amongst the lowest in the region and its exports to the US mainly constituted machinery, electrical equipment and optical apparatus. These accounted for ~63% of total exports to the US in 2023. However, Singapore's relatively high trade elasticity[33], according to the World Bank study we use, and exposure to China leaves it vulnerable to sharp growth slowdowns under scenarios 2 and 3. That said, Singapore's import elasticities could be over-estimated, particularly if 10-20% tariffs are imposed on all other global economies.

Singapore, however, has a bilateral Free Trade Agreement (FTA) with the US. An imposition of tariffs by US on Singapore would likely require an amendment of the US-SG FTA. Article 21.8 of the FTA cites that the agreement "*may be amended by agreement in writing by the Parties such amendment shall enter into force after the Parties have exchanged written notification certifying that they have completed necessary internal legal procedures and on such date or dates as may be agreed between them*." There remains a high degree on ambiguity on whether the FTA can be amended, and if so, what will be the timing and nature of the amendments.

With these caveats in mind, we note that for Singapore scenario 1 could be the most likely outcome. Relative to our baseline of 2.7%, under scenario 1, where 60% tariffs are imposed on China's exports to the US, we expect the impact on Singapore GDP growth to be limited to 0.4pp lower than our baseline, in line with IMF's estimates. Under scenarios 2 & 3, we estimate GDP growth could slow to 2% YoY and 1%, respectively.

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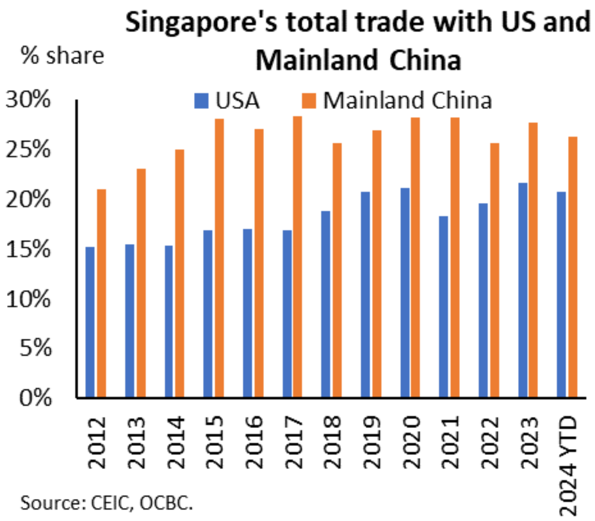
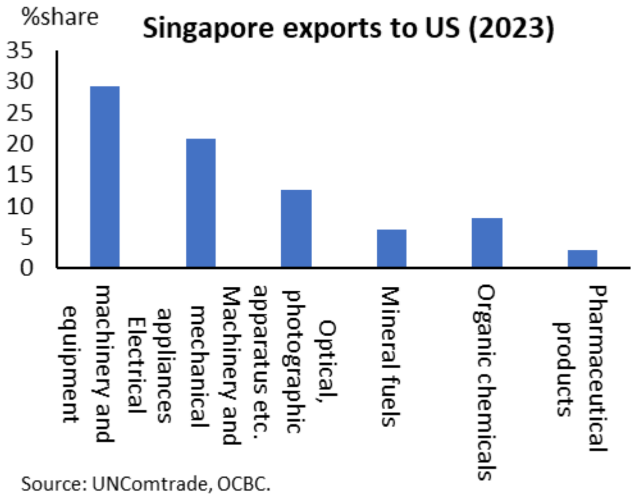
[33] The paper we refer to estimates Singapore's trade elasticity to be 1.070, higher than Malaysia (0.736), Vietnam (0.849), Indonesia (0.889), Philippines (0.783) and Thailand (0.490).

Thematic Report 1



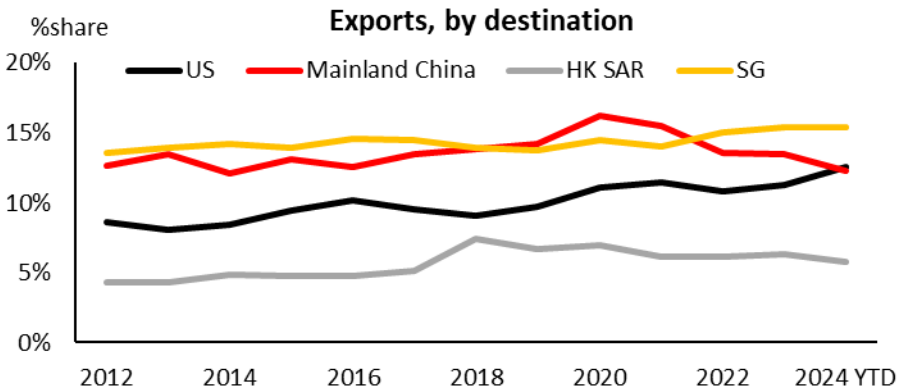
Source: CEIC, OCBC.



Source: UNComtrade, OCBC.

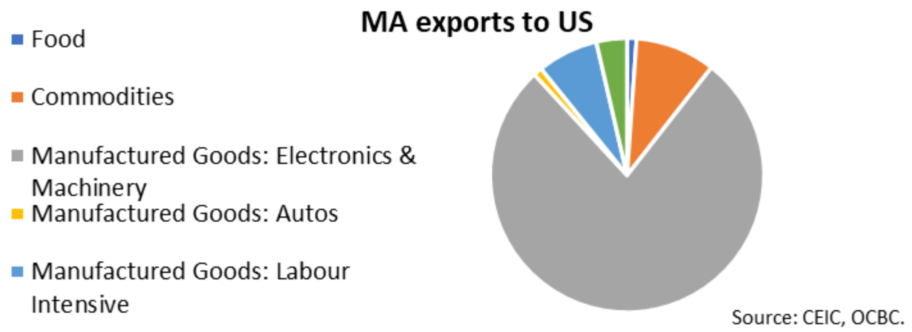
Malaysia

Malaysia's share of exports to US were higher than Mainland China's from January to August 2024. This suggests rising sensitivities to potential tariffs from the US. Malaysia's exports to the USA, however, seem quite narrow-based and mainly concentrated in the electronics and machinery sectors, which accounted for ~77% of total exports to the US (Jan-Aug 2024). Commodities exports accounted for ~8% of total exports while labour intensive exports accounted for 7.5% of total exports to the US.



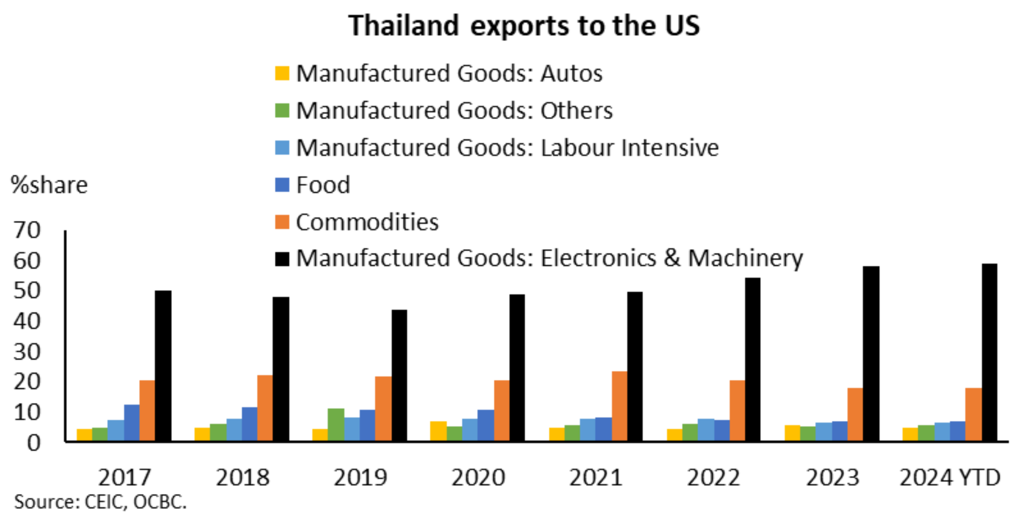
Source: CEIC, OCBC.

While we have argued that Malaysia has a well-diversified export base in terms of trading partners and products, tariffs could shave off up to 0.9pp off our baseline under scenario 2 and as much as 1.5pp under scenario 3. We expect Malaysia's growth to only be modestly impacted by 0.2pp under scenario 1. Higher tariffs on China alone will impact Malaysia via slower demand from China but there is a clear offset in terms of rising investments and further acceleration of 'China +1' policies.



Thailand

For Thailand, we estimate that GDP growth could lower by 0.7pp in 2025 under scenario 2 and 1.1pp lower under scenario 3. Under scenario 1, we expect GDP growth to be 0.2pp lower than our baseline. In terms of products, ~59% of Thai exports to the US were electronics and machinery in 2024 (January-August) followed by 17.2% of commodities and commodities-related exports including rubber, articles of iron & steel, precious metals and 7.2% of labour-intensive sectors.

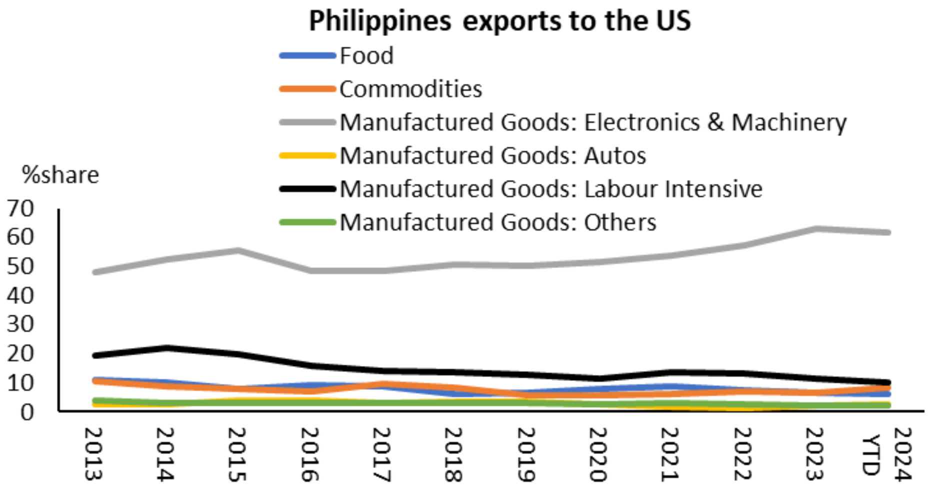


The Philippines

The largest export market for the Philippines remains the US, accounting for 16% of total exports, while Mainland China accounts for about 14%. We estimate that tariffs could shave off 0.4 to 0.6pp off headline GDP growth under scenarios 2 &3 while GDP growth could be 0.1pp lower under scenario 1. Indeed, the Philippines rate of growth was relatively unscathed in 2017-18 when US-China trade tensions began.

About 47% of exports to US were electronics & machinery followed by commodities, labour intensive and food exports. The Philippines and Indonesia are likely to be more insulated from regional peers under scenarios of external stress, given that growth engines are more domestic demand oriented. However, impact from weaker sentiment and heightened uncertainties could keep consumers and businesses on the sidelines.

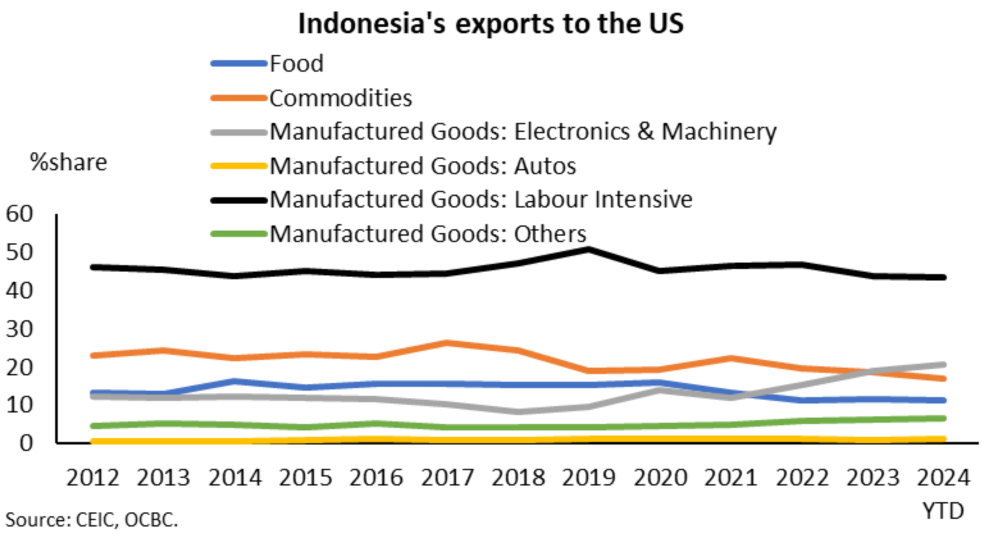
Thematic Report 1



Source: CEIC, OCBC.

Indonesia

Finally, Indonesia's exports share to the US has remained broadly unchanged at 9%-11% over the past decade to 2023. About 43% of total exports to the US from January-August 2024 were labour extensive, while about ~21% were electronics and machinery exports, followed by commodities exports including palm oil. We estimate that the impact of the tariffs under scenarios 2 & 3 could shave off 0.4-0.5pp off headline GDP growth while under scenario 1, the impact will be contained to 0.1pp.



Source: CEIC, OCBC.

The above analysis looks mainly at the growth implications from the trade channel for the ASEAN economies. Below we look at the inflationary and policy implications.

Thematic Report 1

Less clear outcomes for inflationary pressures

The consequence of broad-based tariffs, apart from lower growth, could be a build-up in inflationary pressures. These are likely to be associated with higher costs of trade exacerbated by a potential lack of domestic alternatives. Furthermore, financial market volatility and concomitant depreciation pressures on EM Asia currencies (versus USD) could further add to imported inflation pressures.

However, the offset is that global commodity prices are likely to fall especially if growth in China tumbles as under all three of our scenarios. Moreover, with GDP growth likely to slow on account of slower trade prospects, core inflation pressures could become more contained. To that end, we would say the impact on headline and core inflation under these scenarios is quite mixed and depends on the interplay for numerous external factors.

Scope for counter-cyclical policies

The role of counter-cyclical policies also cannot be negated under the above scenarios considering the extent of growth stresses. Indonesia, and to a lesser extent, Vietnam, Thailand and Singapore have some room to expand fiscal deficits to support growth. The fiscal room to manoeuvre is considerably more limited for Malaysia and the Philippines, where fiscal deficits remain larger than pre-pandemic levels.

Monetary policy will continue to remain accommodative in the Philippines, Indonesia and Thailand. There is room for the central banks to deliver a deeper rate cutting cycle than pencilled into our baseline. However, for Bank Indonesia (BI), the balancing of IDR stability and growth priorities could become harder, particularly if a risk-on scenario persists and sentiment declines. Similarly, the State Bank of Vietnam (SBV) will likely face external volatility challenges but will make room for rate cuts to support growth given the extent of the growth shock under the various scenarios.

APPENDIX: Trade categorisation & Trade elasticities

Country	OCBC classification	HS Code
Indonesia, Malaysia, Philippines, Singapore, Thailand, Vietnam	Food	1 to 14; 16 to 21
	Commodities	15; 25 to 27; 40; 68; 71 to 83
	Manufactured Goods: Electronics & Machinery	84 to 85; 90
	Manufactured Goods: Autos	86 to 89
	Manufactured Goods: Labour Intensive	41 to 67; 69 to 70; 91 to 92; 94 to 95
	Manufactured Goods: Others	22 to 24; 28 to 39; 93; 96 to 97

Country	Trade elasticities
Indonesia	0.889
Malaysia	0.736
Singapore	1.070
Thailand	0.490
Philippines	0.783
Vietnam	0.849

Source: World Bank Group, Policy Research Working Paper 10490, *Trade Elasticities in Aggregate Models*, Estimates for 191 Countries. Shantayanan Devarajan, Delfin S. Go, and Sherman Robinson, June 2023; OCBC.

Thematic Report 2

Singapore: Navigating a complex trading landscape

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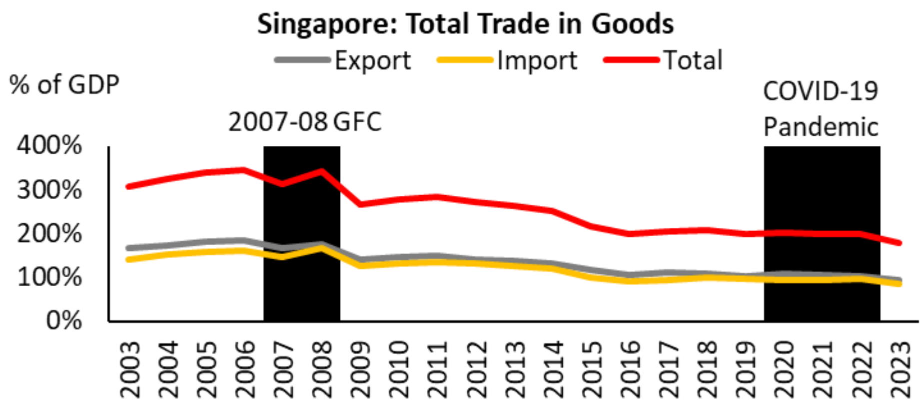
- The economy has gained momentum for the year-to-date in 2024, aided by a sharp rebound in manufacturing growth, an ongoing upswing in electronics, as well as easing global financial conditions.
- As a global trade hub, Singapore has nimbly navigated significant shifts in its trade landscape, especially after the COVID-19 pandemic. Strategies to accelerate digital adoption, embrace AI and other technologies, as well as transit to a green economy, will help position for new growth drivers.
- However, persistent trade conflicts and the prospect of slower growth in major trading partners could dampen the recovery of exports, leaving Singapore somewhat vulnerable on the growth front. Staying neutral in a polarised world and participating in Free Trade Agreements (FTAs) are key pillars in ensuing Singapore's economic relevancy. The outperformance of Singapore's services sector will provide a resilient base in the face of global headwinds.

Singapore's total trade in goods has been steadily rising, albeit slowly and gradually. Exports have risen an average of 6.4% YoY over the last 20 years, while imports growth has averaged 6.9% YoY. Singapore remains an important trading hub and the importance of trade as an economic lifeline cannot be understated for a small open economy.

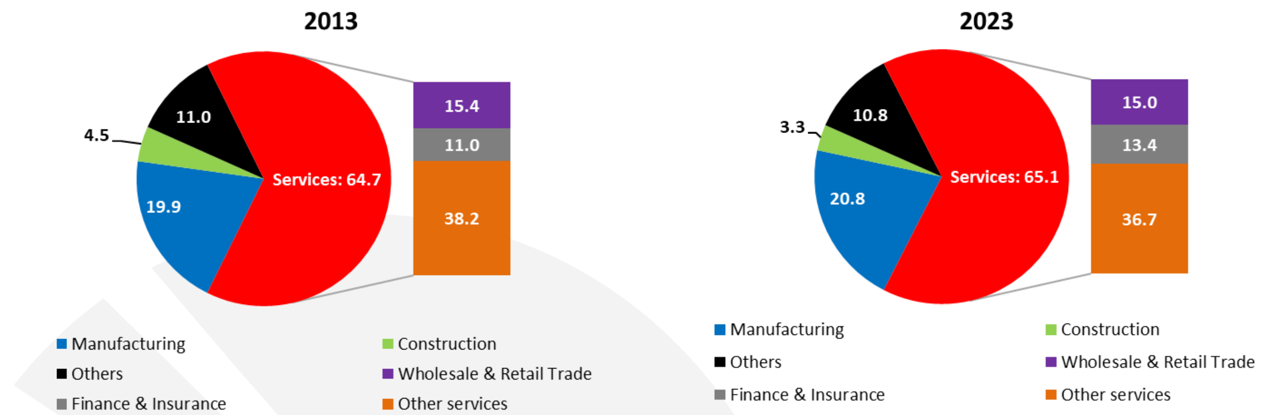
However, the nature of globalisation and global trade is changing. Shocks such as rising US-China strategic rivalry and protectionist/nationalistic measures (including onshoring, near-shoring, friend-shoring etc for economic resilience reasons) have pushed global supply chain recalibration, including the China+1 diversification, and resulted in a more fragmented and polarised landscape. Since Trump 1.0 trade tariffs on China, many multi-national companies have been shifting part of their production facilities from China to other countries including Vietnam, Mexico, Malaysia, India etc. to guard against existing and future potential tariff risks. Some have also reshored some production overseas back to US shores. Meanwhile, China has also focused on building its own domestic supply resilience and/or look for alternative markets and production supply chains.

In 2009, Singapore's total trade in goods declined as global economic growth slowed in the aftermath of the 2007-08 global financial crisis. Although, total trade in goods recovered in 2010, it stagnated between 2012 and 2014. In 2015, total trade slowed down due to falling commodity prices and weaker growth from Emerging Asian economies, particularly China. According to the WTO, lower commodity prices reduced real incomes in commodity-producing countries, leading them to import less. At the same time, the gradual shift from investment to consumption in China, along with a sharp downturn in Chinese industrial production in early 2015, reduced China's imports, including commodity producers. Moving into 2023, a combination of slower economic growth, high raw materials prices, and US-China trade tensions led to a dip in global demand for electronics and petrochemicals.



Note: Total trade in goods is derived by summing the value of exports and imports over nominal GDP (in USD). Source: ASEANstats, Monetary Authority of Singapore, Singstat, OCBC.

Singapore's total trade in goods as a percentage of GDP has been decreasing, with both imports and exports continuing to decline gradually to 84% and 95% by 2023, down from 140% and 165% in 2003. This was also mirrored in total trade growth slowing from 11.4% YoY in 2003-13 to 1.8% in 2014-23. This trend is likely due to two factors. First, a general 'slowbalisation' around the world, a result of increased tariffs, protectionism and general wariness about free versus fair trade. Second, Singapore has also increasingly shifted towards more services-oriented industries, such as finance & insurance in its aim to become a financial hub for the region and the world. The financial services industry has seen its share increase to 13.4% of GDP in 2023, up from 11% in 2013 for instance.



Source: CEIC, OCBC

Notwithstanding, the composition of trading partners and Singapore's exports are critical to understanding how the economy can weather the impending trade volatilities. In terms of total exports, Mainland China and HK SAR remain the biggest trading partners, following by Malaysia, US and EU. However, non-oil domestic exports (NODX) tell a more subtle tale. The share of NODX to the US and Mainland China were broadly similar in 2022-23; this is quite different from the 2015-19 when Mainland China was clearly the bigger NODX market. The share of NODX to HK SAR also declined to 4.7% in 2022-23 from 7.8% in 2015-19. Meanwhile, the share of NODX to Malaysia, EU and Japan have remained broadly stable.

Thematic Report 2

NODX		
Trading partner	2015-19	2022-23
US	10.5	15.6
CN	16.5	15.5
EU	10.4	10.1
MY	7.8	7.7
TW	6.2	7.1
JP	5.4	5.1
SK	4.2	5.0
HKSAR	7.8	4.7
ID	5.3	4.7
TH	4.3	4.0
Rest of the World	21.6	20.6

Note: in USD terms. Source: MAS, Singstat, CEIC, OCBC.

Exports		
Trading partner	2015-19	2022-23
Mainland China	13.4	13.1
HKSAR	11.9	10.9
MY	10.6	9.7
US	6.9	9.0
EU	8.0	7.5
ID	7.7	7.3
TW	4.2	4.6
SK	4.1	4.2
JP	4.5	4.1
TH	3.9	3.7
Rest of the World	24.9	26.0

Note: in USD terms. Source: ASEANstats, OCBC.

In terms of product mix, electronics and machinery exports have been the lion's share of exports for over two decades. Electronics integrated circuits for various uses was essentially the top item of export in 2023 followed by petroleum, turbojets and smartphones. The depth in E&E exports has evolved over the past decade. Indeed, the 3Q24 Economic Survey of Singapore noted that for electronics NODX, there is "demand from diverse markets for intermediate electronics products manufactured in Singapore as part of the intra-regional production network".

HS Code	Description	% Share of 2023 Exports	% Share of 2010 Exports
854231	Electronic integrated circuits; processors and controllers	10.2	6.1
854239	Electronic integrated circuits	7.5	11.3
999999	Other products	6.8	7.1
271019	Petroleum oils and oils from bituminous minerals	6.3	10.6
271012	Petroleum oils and oils from bituminous minerals, not containing biodiesel, not crude	5.6	0.0
854232	Electronic integrated circuits; memories	3.2	2.0
848620	Machines for the manufacture of semiconductor devices	3.1	0.1
710813	Metals; gold, semi-manufactured	2.4	1.0
851762	Communication apparatus	1.7	0.6
841191	Turbines	1.6	0.3
841112	Turbo-jets; of a thrust exceeding 25kN	1.5	0.0
210690	Food preparations; n.e.c. in item no. 2106.10	1.2	1.0
851713	Smartphones	1.1	0.0
880730	Other parts of aeroplanes, helicopters or unmanned aircraft	1.0	0.0
854129	Electrical apparatus; transistors	1.0	0.8

Note: HS 6-digit.
Source: ASEANstats, OCBC.

Thematic Report 2

Singapore's production of semiconductor chips and semiconductor manufacturing equipment account for 10% and ~20% of global production, respectively[34]. Given its broad-based applications (i.e., civilian and military) and ever-growing demand, Singapore's production and exports of electronics may continue to remain important as further investments are poured into the domestic landscape. Between 2021 and 2025, the government has committed ~SGD18bn into the semiconductor sector to foster R&D and innovation[35]. The upcoming Budget 2025, which is supposed to have four key themes including advancing economic strategies, may potentially see plans to solidify Singapore's continued growth as a global manufacturing hub, possibly including semiconductors, and boost our overall supply chain resilience.

Apart from deepening E&E capabilities, the authorities have also worked to broaden the export base. As of July 2024, Singapore has established an extensive network of 27 implemented Free Trade Agreements (FTAs). There are two of these FTAs 'pending entry into force' namely the 'Pacific Alliance – Singapore Free Trade Agreement' and 'MERCOSUR-Singapore Free Trade Agreement'. The Pacific Alliance comprises of Chile, Colombia, Mexico, Peru while MERCOSUR is a Latin American customs union that comprises Argentina, Brazil, Paraguay, and Uruguay[36]. As illustrated by the table below, these countries are important food and commodity producers cum exporters.

Export to World (2023)							
% Share	Food	Commodities	Manufactured Goods: Electronics & Machinery	Manufactured Goods: Autos	Manufactured Goods: Labour Intensive	Manufactured Goods: Others	Others
Argentina	**30.7**	25.5	2.4	12.4	1.8	22.2	5.0
Brazil	**36.8**	36.1	5.8	4.9	6.5	9.8	[redacted]
Chile	19.9	**57.3**	1.2	0.6	6.7	14.4	[redacted]
Colombia	18.1	**65.3**	2.9	1.2	3.8	8.7	0.0
Mexico	6.3	13.9	**37.8**	27.7	5.8	6.8	1.6
Paraguay	**57.4**	21.1	3.2	0.1	5.3	13.0	[redacted]
Peru	17.6	**72.9**	0.8	0.2	3.5	5.0	0.0
Uruguay	**62.2**	5.7	1.9	4.4	16.7	9.0	[redacted]

Source: UN Comtrade, OCBC.

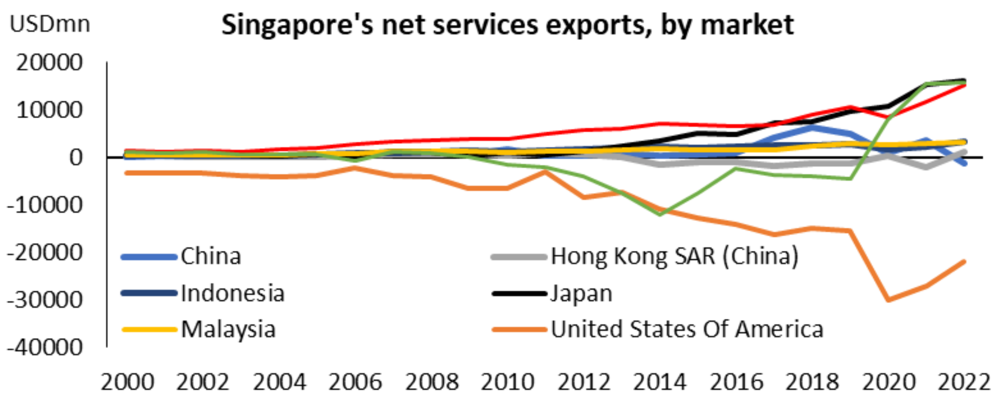
[34] What makes Singapore a prime location for semiconductor companies driving innovation. (2024, August 20). Retrieved from EDB Singapore.
[35] Medina, A.F. (2024, October 22). What Makes Singapore a Prime Location for Semiconductor Companies. Retrieved from ASEAN Briefing.
[36] All You Need to Know About Singapore's Free Trade Agreements. (2024, July). MTI.

Thematic Report 2

The FTAs allow both parties easier access into domestic markets, enjoy benefits from tariff concessions, preferential access to certain sectors, and protection of intellectual property. For Singapore, these trade linkages would boost bilateral trade activities, as well as strengthen our food supply resilience by further diversifying our supply sources.

Importantly, Singapore has an FTA with the US which might grant it some immunity ahead of impending tariff increases by the US. We estimate that if tariffs are limited to Mainland China, the impact on Singapore would be minimal. However, if the tariffs are broadened to include Singapore and other US trading partners, the impact will be more painful.

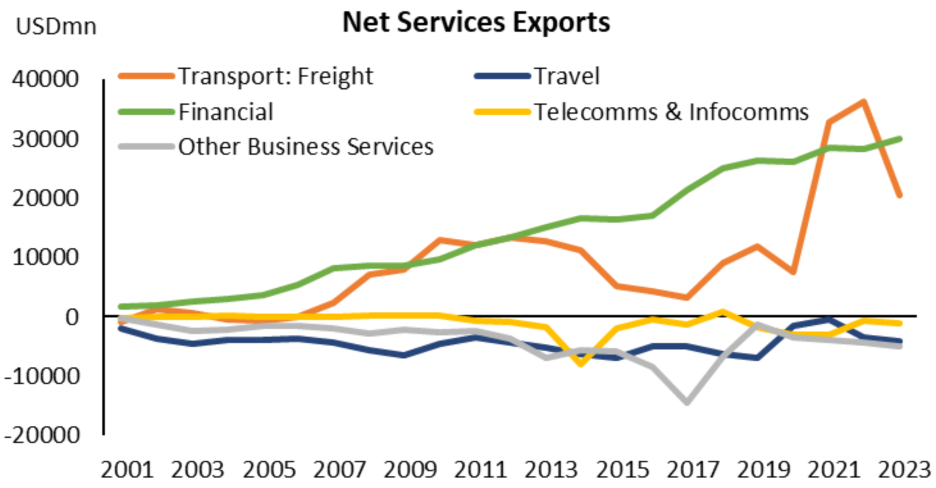
Another avenue of building trade resilience is through services exports. Singapore's services exports grew by 22.2% YoY to SGD464.0bn in 2023, up from SGD379.7bn in 2021. Our top services markets in 2022 were the EU-27, Japan, ASEAN and Australia. Singapore is net importer of services with regards to the US, however, under the current circumstances this could provide the economy with some negotiation ability should tariffs extend beyond goods exports.



Source: Singstat, OCBC

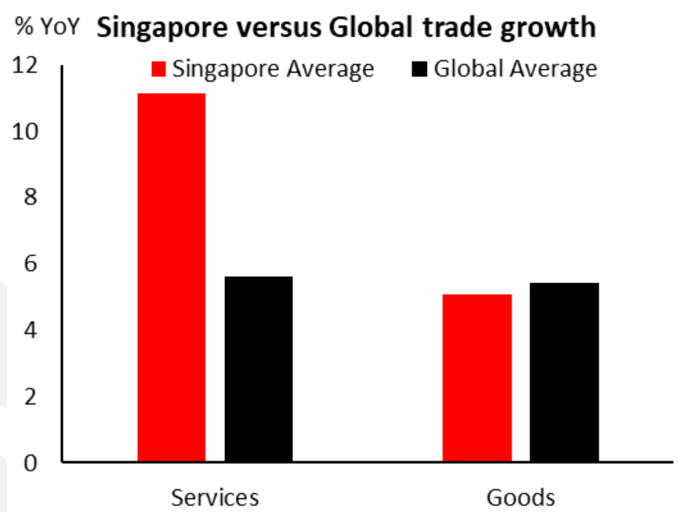
Within services, Singapore is a net export of freight and financial services. Singapore remains a major hub for MNCs and will likely remain so, providing some external resilience.

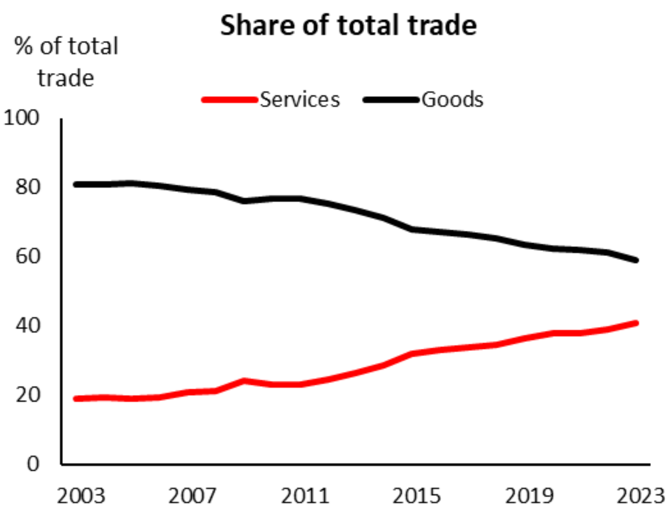
Thematic Report 2



Source: Singstat, OCBC.

Over the past two decades, however, Singapore's trade sector has remained resilient despite global headwinds. While services trade (exports plus imports) is still below goods trade (exports plus imports), growth in the services trade has notably outperformed the global average. For 2006-2023, with average growth for Singapore's services trade (exports plus imports) was 11.1% YoY versus the global average of 5.6%. Meanwhile, over the past period, average growth of Singapore's goods trade (exports plus imports) at 5.1% YoY was slightly below the global average of 5.4%. This could be a result of Singapore's lack of natural resources, which inevitably make up a large portion of worldwide goods trade. Services trade as a share of total trade of goods and services has risen over the past decade and its relative outperformance in terms of growth compared to the global average bodes well for its resilience as headwinds in the global trade sector continue to emerge.

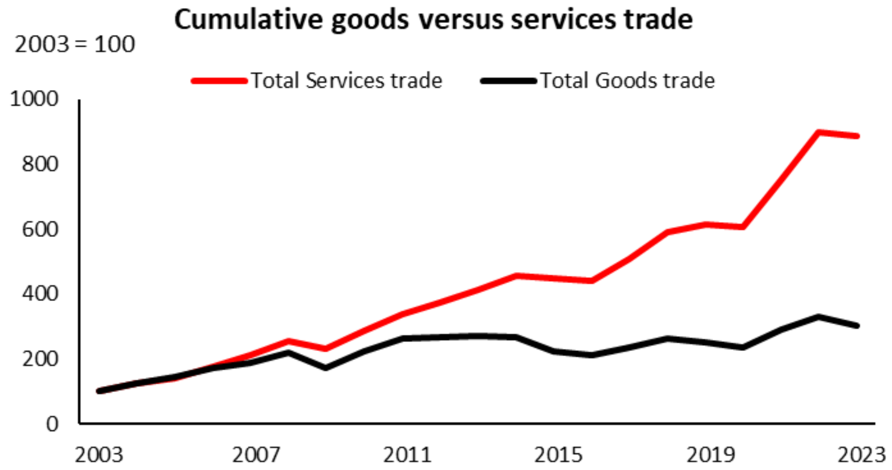




Source: Singstat, ASEANstats, MAS, WTO, OCBC. Note: Growth is averaged from 2006 to 2023.

Thematic Report 2

Total services trade, while still lower in nominal terms, has continued to outpace growth in goods trade. Services trade is growing three times faster compared to the increase in goods trade, when indexed to 2003 (i.e., 2003-100).



Source: Singstat, ASEANstats, MAS, OCBC.

Looking ahead, Singapore's service sector resilience is likely to sustain. According to the MAS October 2024 macroeconomic review, "the increased adoption of AI should also provide a tailwind for the information & communications sector as domestic firms ramp up their digitalisation plans". It also noted that "the push for digitalisation should drive demand for data and cloud services and strengthen growth of the sector. Notably, Amazon Web Services intends to spend an additional $12 billion from 2024 to 2028 on enhancing its local cloud infrastructure to cater to the growing demand for its cloud services. The company will also be launching a flagship AI programme to accelerate the adoption of AI by enterprises in Singapore."

Thematic Report 3

Vietnam: Boon turns to bane?

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- The Vietnamese economy has benefited from supply chain diversification and ‘China +1’ policies. FDI remains on an uptrend, but all is not rosy for Vietnam.
- We expect that in the ASEAN region, Vietnam will be in the firing line from President-elect Trump. Higher exports from Vietnam to the US as well as Vietnam’s close economic ties to China make it an easy target.
- The risks for Vietnam’s domestic growth profile are skewed to the downside. The authorities, we expect, will remain nimble in dealing with trade barriers.

FDI is still coming
Vietnam has been a rising star in the ASEAN region for some time, and this trend continued in 2024. High-profile investment announcements from multinational companies have continued in recent months. For example, from Samsung[37] - USD1.8bn additional investment for a new OLED manufacturing plant - and Amkor Technology[38] - USD1.6bn investment for a semiconductor assembly and testing factory. Maersk[39] announced that it had opened its first bonded warehouse in northern Vietnam – a facility where goods can be stored before paying duties or tariffs – in the Haiphong seaport region. Lego[40] also said earlier that its new USD1.3bn plant in Binh Duong was nearly complete and would come online early 2025.

This comes even as data from the Ministry of Planning and Investment showed that there were up to 2,743 new projects registered in the January-October 2024 period, representing a 5.2% YoY increase. Realised total registered capital increased by 5.8% YoY to USD27.3bn in the January–October 2024 period. Notably, over 62% of these investments are directed towards the manufacturing sector, indicating a continued expansion of future production capacity and reinforcing the sector as one of the primary engines for growth in the near to medium term. By origin, inbound FDI was led by ASEAN, followed by Mainland China & Hong Kong SAR, accounting for 29.8% and 23.9% respectively.

Electrical and Electronics (E&E) is a clear beneficiary
There are a number of reasons Vietnam is a popular FDI destination. These include a young, inexpensive, and skilled workforce, a strategic location, an established manufacturing base, strong trade relations and largely stable politics. To that end, the country’s semiconductor sector has benefited significantly from the diversification of global supply chains under the ‘China +1,’ ‘friendshoring,’ and ‘offshoring’ strategies. Additionally, ‘bamboo diplomacy’ has also played a role.

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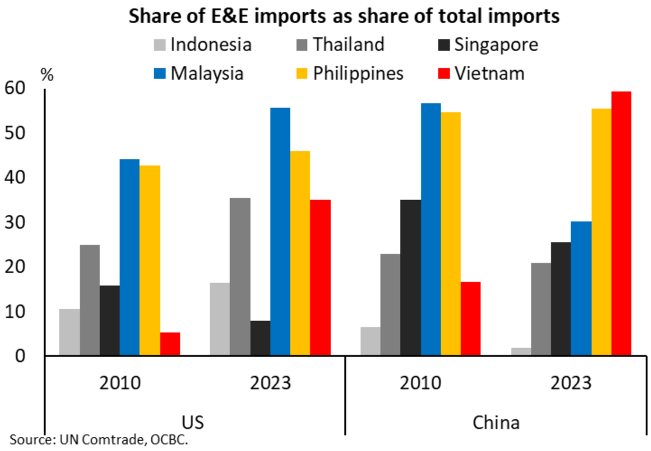
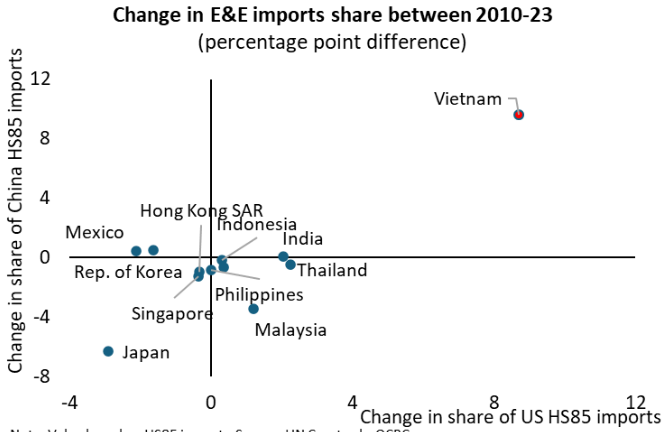
[37] Samsung invests $1.8bn in Vietnam OLED Factor, Tech in Asia (24 September 2024). Last accessed: 22 November 2024.
[38] Amkor Strengthens Investment in Vietnam, Amkor (30 June 2024). Last accessed: 24 November 2024.
[39] Maersk opens its first own-licensed bonded warehouse in north Vietnam, further enhancing its integrated customer service capabilities, Maersk (4 November 2024). Last accessed: 22 November 2023.
[40] LEGO Group nears completion of Vietnam factory, begins test run, Vietnamplus (7 November 2024). Last accessed: 22 November 2024.

Thematic Report 3

Specifically, U.S. imports of electrical and electronic (E&E) products from Vietnam have increased from USD832mn in 2010 to USD41.8bn in 2023, with its share of total imports rising from 5.2% in 2010 to 35.1% in 2023. Similarly, China's E&E imports from Vietnam rose from USD1.2bn in 2010 to USD5.4bn in 2023, with the share also increasing from 16.7% to 59.3%. More convincingly, Vietnam's deepening integration into the E&E landscapes of the world's two largest economies is evident, as it has led to market share gains since 2010, dwarfing its regional peers.



Source: UN Comtrade, OCBC.



Note: Value based on HS85 imports. Source: UN Comtrade, OCBC.

Looking ahead, the economy remains poised to capitalise on the growing demand for semiconductors, an industry that is projected to reach a revenue of USD100bn by 2050. Prime Minister Pham Minh Chinh has signed Decision 1018/QĐ-TTg dated 21 September 2024, that sets out strategy for developing Vietnam's semiconductor sector by 2030, with a vision to 2050. The strategy, known as the "C = SET + 1"(C: Chips; S: Specialised; E: Electronics; T: Talent; and +1: Vietnam), aims to position Vietnam as a secure global semiconductor supply chain destination. The industry's development will be done in three phases as shown in the table below.

Phase	Vision	Target
Phase I 2024-2030	Leverage its geopolitical and workforce advantages to attract FDI and become a prominent global semiconductor manpower hub. The strategy also aims to strengthens Vietnam's capabilities in research in all steps of the semiconductor supply chain.	To establish 100 semiconductor design firms, one manufacturing plant, and 10 packaging and testing plants. This phase also aims to develop basic capabilities in semiconductor research, design, and production, with a target of exceeding USD25bn in annual industry revenue.
Phase 2 2030-2040	To establish Vietnam as a global hub for the semiconductor and electronics industries. Aims to develop these sectors through a combination of self-reliance and FDI.	Aims to have 200 design firms, two manufacturing plants, and 15 packaging and testing plants, with industry revenue expected to surpass USD50bn annually.
Phase 3 2040-2050	To become a leading global player in the semiconductor and electronics industry, and master research and development in R&D.	Aims to have 300 design firms, three manufacturing plants, and 20 packaging plants, with revenue expected to reach over USD100bn annually.
Source: Viet Nam Government News, Vietnamplus.		

In addition, the US and Vietnam entered into a partnership in September 2023 to explore opportunities to grow and diversify the global semiconductor ecosystem under the International Technology and Innovation Fund, created by the US CHIPS Act of 2022[41]. The agreement could see Vietnam gradually moving up the semiconductor value chain beyond assembly, testing, and packaging capabilities. Indeed, we are already seeing some traction on this front (table below).

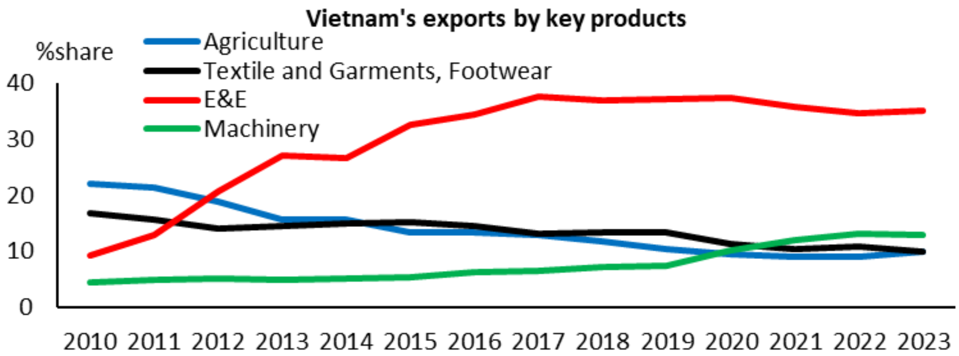
Company	Investment/planned investment details
Amkor Technology	Announced additional investment of USD1.1bn in June 2024 to bring total investment to USD1.6bn in Bac Ninh province. The production factory is planned to start trial operation in 2Q25, and official operation in 3Q25. The factory is expected to have an annual output of 3.6bn products.
Marvell Technology	Plans to set up a design centre in Ho Chi Minh City, with operations expected to begin by the end of 2024. This facility will serve as a hub for advanced semiconductor engineering, supporting the company's work in high-speed data centre optical connectivity, storage, and other critical semiconductor technologies. The company is committed to growing its workforce by 50% over the next three years.
Foxconn Singapore	USD383mn a new circuit board plant in Bac Ninh Province
Alchip Technology	Expand operations and open an office in 2024, with the goal of growing its R&D team.
Other notable investments	
Google	Weighing on setting up a “hyperscale” data centre close to Ho Chi Minh City. Expected to be ready by 2027.
Alibaba	USD1bn to build a data centre to meet various legal requirements for local data storage.
Apple	Plans to increase investment in Vietnam-based suppliers and supporting innovation projects. Apple has invested over USD15bn in Vietnam since 2019. Vietnam is Apple’s fourth leading supplier hub globally after China, Taiwan, and Japan.
Starlink	SpaceX’s Starlink plans to invest USD1.5bn in Vietnam in the near future, with the investment tied to the provision of internet services.
Maersk	Maersk opened its first licensed bonded warehouse at SLP Park, Nam Dinh Vu IP, Hai Phong province. The company aims to further expand its investment in Vietnam, with particular interest in deepwater container ports and logistics projects.
Lego	Toymaker Lego has completed 90% of its USD1.3bn plant in Binh Duong Province, with plans to launch the factory in early 2025. The trial production is expected to have an annual capacity of 30,000 tonnes.
Source: Amkor, Marvell, Maersk, Hanoi Times, Invest Vietnam, Reuters, OCBC.	

Importantly, E&E exports have increased as a share of total exports and have long overtaken sectors such as textiles and agriculture which tended to be more labour intensive. That said, there is still anecdotal evidence to suggest that FDI inflows continue to be directed to the garment and textiles industry[42].

[41] The International Technology Security and Innovation (ITSI) Fund, appropriated under the Creating Helpful Incentives to Produce Semiconductors (CHIPS) Act of 2022, provides the Department of State with $500 million — $100 million per year over five years, starting in Fiscal Year 2023 — to promote the development and adoption of secure and trustworthy telecommunications networks and ensure semiconductor supply chain security and diversification.

[42] High-tech garment groups keen to expand, *Vietnam Investment Review*, 5 August 2024.

Thematic Report 3



Source: CEIC, OCBC.

Leveraging Free Trade Agreements
With FDI inflows still going strong, and the government keen to expand physical infrastructure on roads and ports (see Vietnam country outlook), Vietnam's access to critical trading partners becomes crucial. On this front, the economy also scores well. The government has actively engaged in negotiations for bilateral and multilateral Free Trade Agreements (FTAs). As of November 2024, Vietnam has 15 active FTAs in place, with 1 already signed but not yet in effect, and 12 in progress (negotiations or under consultation).

This extensive network of FTAs has been pivotal on two fronts: providing better access for Vietnamese goods exports and mitigating the risks associated with over-reliance on any single market. Indeed, agreements such as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and the EU-Vietnam Free Trade Agreement (EVFTA) have opened new markets for Vietnamese exports, reducing dependency on the US and China.

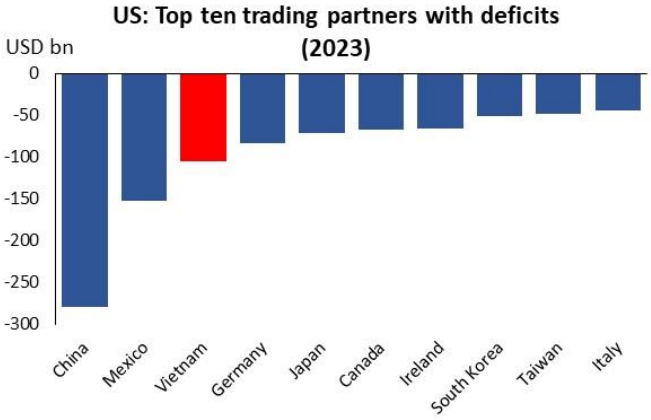
But in the firing line for tariffs?
Whether the boon of investment turns to bane under US President-elect Trump, only time will tell. But there are reasons to believe that Vietnam could be in the firing line. The US remains Vietnam's largest export market, accounting for ~30% of Vietnam's export share year-to-August 2024, followed by China at around 15%. Notably, the US runs one of its largest trade deficits with Vietnam, after China and Mexico as of 2023.

Status	FTAs
Signed and In Effect	ASEAN Free Trade Area ASEAN-Australia and New Zealand Free Trade Agreement ASEAN-Hong Kong, China Free Trade Agreement ASEAN-India Comprehensive Economic Cooperation Agreement ASEAN-Japan Comprehensive Economic Partnership ASEAN-People's Republic of China Comprehensive Economic Cooperation Agreement ASEAN-Republic of Korea Comprehensive Economic Cooperation Agreement Regional Comprehensive Economic Partnership Comprehensive and Progressive Agreement for Trans-Pacific Partnership Japan-Viet Nam Economic Partnership Agreement Republic of Korea-Viet Nam Free Trade Agreement Viet Nam-Chile Free Trade Agreement Viet Nam-Eurasian Economic Union Free Trade Agreement Viet Nam-European Union Free Trade Agreement Viet Nam-United Kingdom Free Trade Agreement
Signed but not yet in Effect	Viet Nam-Israel Free Trade Agreement
Negotiations Launched	ASEAN-Canada FTA Viet Nam-European Free Trade Association Free Trade Agreement
Proposed/Under consultation and study	ASEAN-EU Free Trade Agreement ASEAN-Eurasian Economic Union Free Trade Agreement ASEAN-Gulf Cooperation Council Free Trade Agreement ASEAN-Pakistan Free Trade Agreement Comprehensive Economic Partnership for East Asia (CEPEA/ASEAN+6) East Asia Free Trade Area (ASEAN+3) Free Trade Area of the Asia Pacific Pakistan-Viet Nam Free Trade Agreement Viet Nam-MERCOSUR Free Trade Agreement Viet Nam-Ukraine FTA
Discontinued	Trans-Pacific Partnership (TPP)

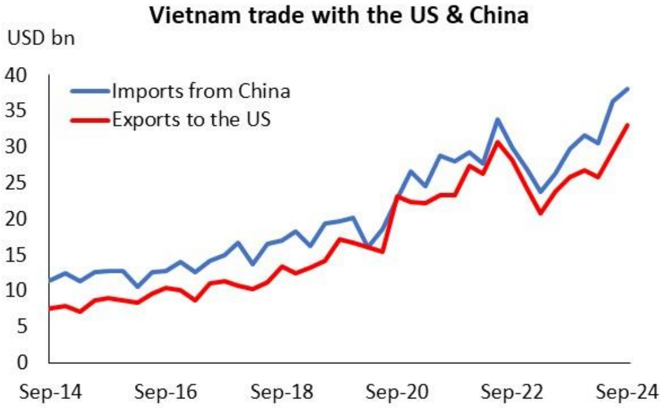
Source: Asia Regional Integration Center, Asian Development Bank. Last accessed: 21 November 2024.

Consequently, impending US trade protectionist measures under President-elect Trump which are aimed at addressing its foreign trade deficit, represent a significant risk for Vietnam's economy. In addition, there is a strong linkage between imports from China and exports to the US, highlighting Vietnam's reliance on intermediate inputs from China. This dependence increases the risk of Vietnam being perceived as a "backdoor" for Chinese goods entering the US market, which could make it more susceptible to tariffs targeting transshipment practices.

Thematic Report 3



Source: CEIC, US Census Bureau, OCBC.



Source:Vietnam Customs, CEIC, OCBC.

It remains unclear to what extent President-elect Trump will implement his campaign promises of imposing higher tariffs on US trading partners. However, in our publication *Assessing the Impact of Potential Tariffs*, 30 October 2024, we estimated that the impact on Vietnam's GDP could range from -0.2 pp to -4.0 pp below the baseline, depending on the specific trade policies enacted. Specifically, we expect that growth could fall by 0.2pp if a 60% tariff is imposed on China's exports to the US, by 2.1pp if a 10% tariff is imposed on all US trading partners in addition to a 60% tariff on China's exports to the US, and by as much as 4.0pp if a 20% tariff is imposed on all US trading partners along with a 60% tariff on China's exports to the US.

Thematic Report 4

China: Better coordination between monetary and fiscal policies

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- The direct bond trading operations by the People's Bank of China (PBoC) function as tools for base money injection and liquidity management, employing simultaneous buying and selling activities.
- The outright reverse repo operation enables the central bank to transition its medium-to-long-term liquidity framework from "reserve cuts + MLF" to a more dynamic model of "bond trading + outright reverse repo".
- With the Finance Minister announcing an increase in bond issuances in the coming years, these new tools—central bank bond trading and outright reverse repo operations—will enable the PBoC to better align monetary policy with fiscal initiatives.

Since late September, Chinese authorities have significantly ramped up stimulus measures. As we argued in our China Outlook report, there are four key reasons why this round of stimulus could yield different results. One notable factor is the focus on structural reforms, aimed at improving coordination between monetary and fiscal policies.

On the monetary front, two significant framework changes stand out: the increased emphasis on price stability in the central bank's mandate and the introduction of new tools to transition its medium-to-long-term liquidity management framework from a reliance on "RRR cuts + MLF" to a more dynamic model of "bond trading + outright reverse repos." In this special report, we will delve deeper into these new monetary tools and their implications.

The PBoC first announced the bond trading in August. The PBoC conducted open market operations with select primary dealers, purchasing short-term government bonds while selling long-term government bonds. Net bond purchases for the month totalled CNY100bn, increasing to CNY200bn in both September and October.

The PBoC's 3Q24 monetary policy report highlighted these bond trading operations as tools for base money injection and liquidity management, employing simultaneous buying and selling activities. We believe the primary objective of these interventions is to enhance capital allocation efficiency. By purchasing short-term bonds and selling long-term bonds, the PBoC aims to guide long-term government bond yields towards more reasonable levels and steepen the yield curve between short- and long-term bonds. This strategy not only supports improved market functionality but also ensures a more effective alignment of financial resources with broader economic priorities.

On 28 October, the PBoC announced that it would conduct outright reverse repo with primary dealers for up to one year.

Thematic Report 4

Difference between traditional reverse repo and outright reverse repo

In traditional collateralised reverse repo operations, primary dealers pledge bonds as collateral to the central bank in exchange for funding. While these bonds are temporarily frozen, ownership remains with the primary dealer. Conversely, in an outright reverse repo, primary dealers sell bonds to the central bank, transferring ownership directly to the central bank.

The bidding mechanisms differ notably between the two types of reverse repos. Traditional reverse repos employ a fixed-rate, quantity-based bidding approach, where the central bank sets a specific policy rate, serving both as a liquidity provision tool and a policy signal to the market. Outright reverse repos, however, use a fixed-quantity, rate-based bidding system with multiple bid levels, allowing market dynamics to determine the final rate. As such, outright reverse repos primarily function as liquidity provision tools, carrying limited policy signalling weight.

We see two implications from the introduction of the outright reverse repo.

Firstly, the recent introduction of outright reverse repo operations with maturities of up to one year enhances the central bank's liquidity management toolkit. This initiative aims to fill the gap in liquidity tools with intermediate maturities, spanning from 1 month to 1 year in addition to commonly used 7-day open market reverse repo operations and the 1-year MLF.

With the introduction of outright reverse repos expected to include maturities like 3-month and 6-month terms, the central bank seeks to improve its capacity to smooth liquidity conditions across various time frames within one year. This new tool enhances the precision of liquidity management and better addresses the concentrated MLF maturities in 4Q24, helping to ensure adequate liquidity through end-2024. In the medium term, the tool may also be utilised to replace the MLF.

Secondly, the outright reverse repo operates as a direct bond purchase, granting the central bank full ownership rather than holding bonds as collateral, as in traditional reverse repos. This ownership confers greater flexibility, enabling these bonds to be utilised within swap tools, improving upon the previous practice of using central bank bills in such operations. When combined with swap tools, outright reverse repos can temporarily support financial asset prices, positioning the central bank's innovative monetary policy tools to more effectively stabilise capital markets.

Overall, the outright reverse repo operation enables the central bank to transition its medium-to-long-term liquidity framework from "reserve cuts + MLF" to a more dynamic model of "bond trading + outright reverse repo". This shift aims to enhance coordination between monetary and fiscal policies.

Thematic Report 4

With the Finance Minister announcing a rise in bond issuances in the coming years, these new tools—central bank bond trading and outright reverse repo operations—will enable the PBoC to better align monetary policy with fiscal initiatives. This improved coordination between monetary and fiscal policies will be crucial for bolstering the Chinese economy amid growing external uncertainties.

Table 1: Impact of outright reverse repo on commercial banks' balance sheet is different from the impact of MLF

Impact of MLF on balance sheets			
Central bank		Commercial bank	
Asset	Liability	Asset	Liability
Claims on deposit bank +100	Monetary base +100	Cash +100	Liability to PBoC +100

Impact of outright repo on balance sheets			
Central bank		Commercial bank	
Asset	Liability	Asset	Liability
Bond +100	Monetary base +100	Bond -100	
		Cash +100	

Thematic Report 5

China: Resolving hidden debts

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- Despite no major LGFV defaults on public bonds to date, the underlying problem is structural, and worries have risen following a decade of robust growth, a housing boom and high infrastructure investment. The collapse of the real estate market has cut land sales revenue. Hence, LGFVs with high leverage and weak fiscal capacity are facing heavy refinancing pressures and may even be forced to deleverage.
- In the National People's Congress Standing Committee held in November, Finance Minister Lan Fo'an announced a comprehensive CNY12trn debt resolution package.
- Over the next six months, additional policies are expected, including special sovereign bonds to reinforce state-owned banks' capital, special bonds for land reserves, and potential adjustments to the deficit ratio. Attention will now turn to the Central Economic Work Conference in December and the Two Sessions next year for further developments. We think the recent meeting confirmed China's "whatever it takes" approach; however, this is not the last episode. There will be more episodes unfolding progressively in 1H25, leaving investors to speculate on what comes next in the policy series.

Central government's balance sheet will play bigger role in debt restructuring and housing market stabilisation

In the National People's Congress Standing Committee held in November, Finance Minister Lan Fo'an announced a comprehensive CNY12trn debt resolution package. We think the recent meeting confirmed the authorities' "whatever it takes" approach but this is not the last episode. There will be more episodes unfolding progressively in 1H25, leaving investors to speculate on what comes next in the policy series.

The rise of local government financing vehicles (LGFVs) in China

To understand why and how LGFVs are being burdened with local government debts, it is important to look back to the early 1990s when Beijing reformed the fiscal system that had been established since 1980.

The need for the 1994 fiscal reforms arose when the central government desired to expand the tax base and reallocate a larger share of revenue to government budget, known as the "tax-sharing system". While this reform realigned central versus local shares of fiscal revenues, it decreased local government's share of tax revenues, and the latter were prohibited from filling the funding gap by issuing bonds or directly taking loans from banks. Consequently, this created a strong incentive for local governments to set up state-owned enterprises (known as LGFVs- that allowed them to issue bonds and take out loans) and raise capital funding for public construction needed to meet government growth targets and make up for revenues redirected to the central government.

Thematic Report 5

With the popularity of local governments established LGFVs as a source of off-balance sheet financing, LGFVs started to borrow against current and future land sales revenue following the privatization of the housing market in the late 1990s and early 2000s. This strategy, also known as "Land Finance", allowed localities to fill the fiscal gap while supporting higher local investment, land and real estate values, and eventually higher GDP growth.

Chart 1: China's debt market

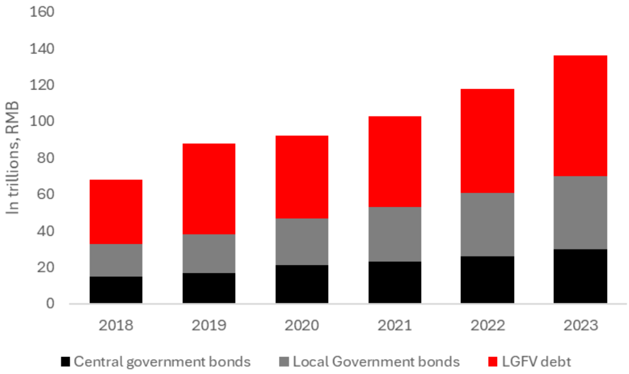
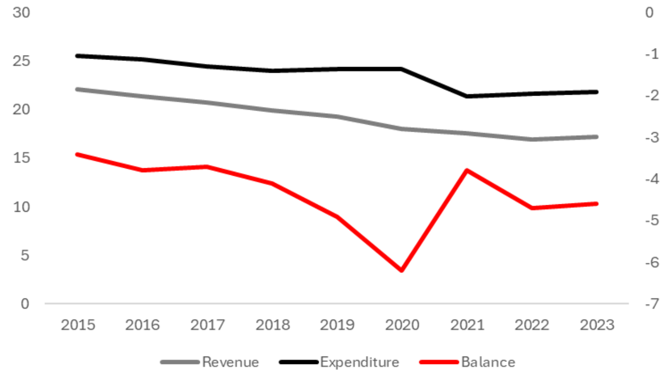


Chart 2: China's general budget in % of GDP



Source: Bloomberg, CEIC, Wind, OCBC Research.

Why have concerns rose regarding LGFV debt?

Since the massive stimulus measures in response to the Great Financial Crisis in 2008, local governments and their financing vehicles (LGFVs) have been increasing their leverage. They have used the continued rise in land values to promote local growth and provide counter-cyclical growth during economic downturns.

While these LGFVs have helped to fund infrastructure projects and drive-up higher tax revenues and regional growth, the standalone fundamentals of these LGFVs have always been weak and rarely generate sufficient returns to cover debt payments. This left many reliant on refinancing or government support to stay afloat.

Despite no major LGFV defaults on a public bond to date, the underlying problem is structural and worries have risen following a decade of robust growth, housing boom and high infrastructure investment. In light of a slowing economy and a housing market downturn that began in mid-2021, the collapse of the real estate market has cut land sales revenue Hence, LGFVs with high leverage and weak fiscal capacity are facing heavy refinancing pressure and may even be forced to deleverage.

To date, LGFVs have more than CNY60trn worth of debt and headline debt to GDP has risen from 201% in 2015 to over 300%, based on data from the People's Bank of China and National Bureau of Statistics. To some extent, a high debt burden represents a constraint to a government's fiscal firepower, hindering its ability to implement more aggressive measures and weakening the effectiveness of its support initiatives.

Thematic Report 5

Chart 3: Central government debt to GDP ratio

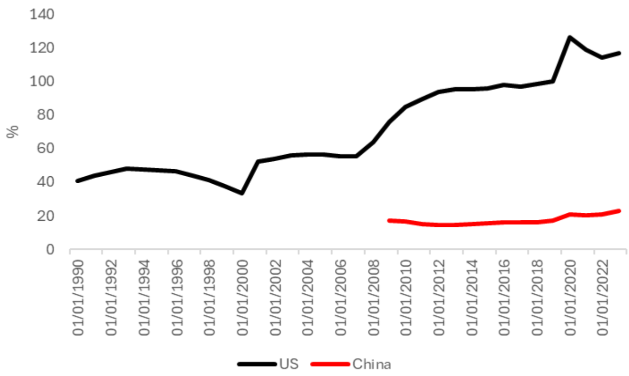
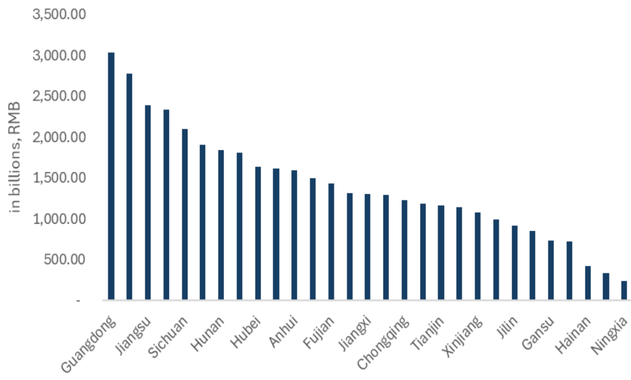


Chart 4: Local government debt limit quotas in 2023



Source: Bloomberg, CEIC, World Bank, OCBC Research.

Things that have been done in the past

Today, LGFVs continue to struggle with the legacy of off-balance sheet debt, and questions remain whether local governments can support LGFVs under growing economic pressure, wider fiscal deficits and declining land sales. With a high level of debt, we look back to what Beijing has done with a mix of fiscal and regulatory approach to contain LGFV debt since 2010.

Debt swap: A significant debt swap program totalling ~CNY12trn was initiated by the central government in 2015-18, with the goal of converting local government liabilities (including LGFVs bonds and bank loans) into government bonds. The debt swap program helps to repair local governments' balance sheets and stabilise the economy.

Debt restructuring: Zunyi Road and Bridge Construction Group Limited, an LGFV based in Zunyi City, Guizhou province has completed a restructuring plan in 2023, according to Fitch Ratings. This restructuring provided a 20-year extension on CNY15.59bn in bank loans, featuring lower interest rates and deferring principal repayments for the first 10 years. The move reduces local government’s interest burdens and prevent credit risk events.

Injection of cash-generating assets: Some LGFVs have successfully diversified their business beyond traditional infrastructure such as manufacturing, technology, and healthcare development.

The path of debt resolution

In the National People’s Congress Standing Committee held in November, Finance Minister Lan Fo’an announced a comprehensive CNY12trn debt resolution package.

The path to resolving the CNY12trn debt includes: first, raising the local government debt ceiling by CNY6trn to swap existing hidden debt over three years (2024-2026) at CNY2trn annually. Second, allocating CNY800bn per year for five years through newly issued local government special bonds to supplement government fund resources for debt resolution, cumulatively addressing CNY4trn of hidden debt. Third, extending repayment terms for CNY2trn of hidden debt related to shantytown redevelopment beyond 2028, allowing repayment according to original contract terms starting in 2029.

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Within the CNY12trn debt resolution plan, only CNY6trn is regarded as incremental policy in our view, while the remaining CNY4trn reflects a repurposing of existing local government special bonds. However, as noted during the press conference, China plans to increase the issuance size of local government special bonds next year, signalling potential incremental measures, although specific figures have yet to be confirmed.

There will be no issuance of additional central government bonds or adjustments to the deficit ratio for 2024. Additionally, the debt resolution responsibility remains primarily with local governments rather than be shifted to the central government. As a result, compared to central government-led leverage increases, the chain reaction to economic support from the local government-led resolutions may be longer.

The most immediate impact of this debt resolution plan is the reduction in interest expenses. Statutory debt carries significantly lower interest rates than hidden debt, leading to substantial savings for local governments. The Ministry of Finance projects approximately CNY600bn in savings over the next five years. Minister Lan also highlighted that this policy would alleviate debt repayment pressures, creating room for fiscal expenditures aimed at stimulating demand. The extent to which the NPC announcement will boost risk sentiments depends on how investors interpret the incremental policies and the subsequent chain reaction. Nonetheless, the announcement is expected to help reduce perceived tail risks, which could positively influence not only Chinese assets but also global assets sensitive to developments in China.

The National People’s Congress press conference focused solely on debt resolution, signalling that this is likely the first step in a broader fiscal stimulus strategy. Over the next six months, additional policies are expected, including special sovereign bonds to reinforce state-owned banks' capital, special bonds for land reserves, and potential adjustments to the deficit ratio. Attention will now turn to the Central Economic Work Conference in December and the Two Sessions next year for further developments. We think the recent meeting confirmed China’s “whatever it takes” approach, however, it is not the last episode. There will be more episodes unfolding progressively in the next half year, leaving investors to speculate on what’s next in the policy series.

With the imminent issuance of an additional CNY2trn in local government bonds in the next two months, combined with the substantial volume of maturing Medium-Term Lending Facilities (MLFs), we anticipate that the People’s Bank of China (PBoC) will implement another reserve requirement ratio (RRR) cut in November or December.

Thematic Report 6

Hong Kong: The beleaguered CRE market

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- The commercial real estate (CRE) market is currently experiencing the worst downturn since the 1990s, as evidenced by low valuations and high vacancy rates. Despite the recent economic recovery and prime rate cuts, the CRE market still shows little signs of bottoming out.
- Despite the sharper fall in prices, the market yields of commercial real estate have only been slightly above 3%. The spread between the market yield and 1-month HIBORs remains negative at around -1%, capping the room for prices to rebound.
- Looking ahead, the recovery of the CRE market is likely to be bumpy and relatively slow. The imminent US Fed fund rate/prime rate cuts should render some support to business sentiment, but it remains too early to call a bottom. With a rebound in demand still hard to come by in the short-term, in addition to the negative carry, we continued to hold a slightly bearish view on the CRE market.

Worst downturn in three decades

Grappled by the dual setbacks of oversupply and weakening demand, the commercial real estate market (CRE; offices and retail stores) is currently experiencing the worst downturn since the 1990s. The commercial property market woes have been evident from the low valuations and high vacancy rates. Compared to the recent high in late 2018, price indexes of office and retail store have declined by 40% and 34% respectively as of September 2024 **(Chart 1)**. In parallel, vacancy rates of Grade A offices have climbed to an unprecedented level of 16% in 2023 **(Chart 2)**, while that of retail stores was just shy of record highs (11.4% during the Covid-19 pandemic) at 10.3% in 2023. Despite the recent economic recovery and prime rate cuts, the CRE market still shows little signs of bottoming out.

Chart 1: Marked correction in CRE market prices

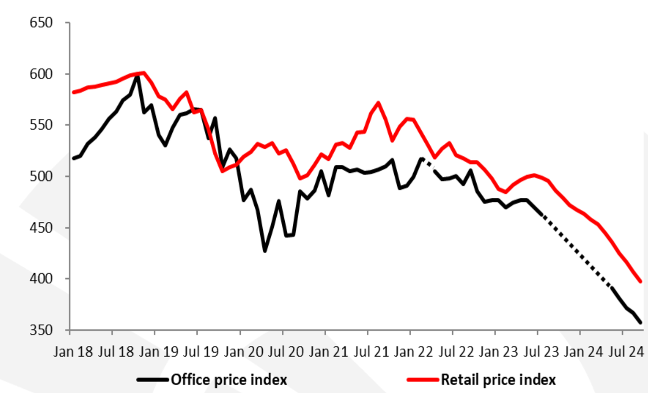
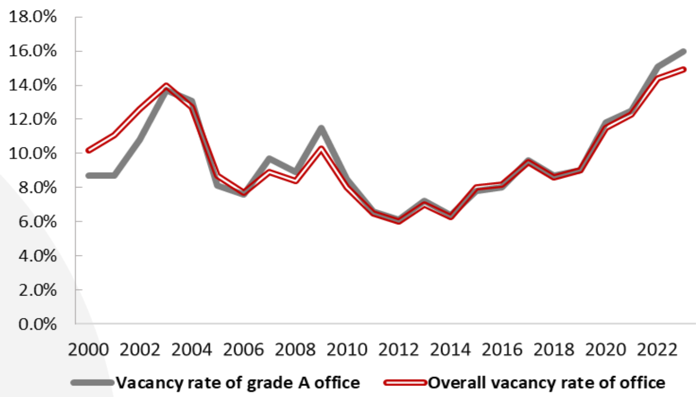


Chart 2: Vacancy rates have climbed to record highs



Sources: Hong Kong Rating and Valuation Department, OCBC.
(*) Dotted line represents months where there was insufficient data for analysis. They are for illustration purposes only and do not contain real data.

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Same-same but different
Prior to the current downturn, the CRE market in Hong Kong had undergone two major corrections, triggered by the 1997 Asian Financial Crisis and 2008 Global Financial Crisis. While the severity and duration of correction differed in each cycle, there were some common characteristics which can be observed. First and foremost, the office segment was affected more severely than retail stores, with a sharper decline in both prices and rent. Secondly, the longer the duration of correction, the higher the vacancy rate. Lastly, given that the rental index generally experienced a milder decline than the price index, the market yields inched up to levels well above the 1-month HIBOR.

This time around, the slump was caused not only by negative external economic shocks, but also a structural shift in demand for commercial spaces. By comparing various metrics **(Table 1)**, we note that the scale and severity of correction in the current cycle has exceeded that of 2008 but remains shy of that in 1997. Yet, much like 1997, the CRE market remains downbeat despite the subsequent economic recovery following the breakout from a crisis. Similar to previous patterns, prices and rents of offices saw more notable downward pressures compared to retail spaces.

Despite the sharper fall in prices, the market yields of commercial real estate have only been slightly above 3%. The spread between the market yield and 1-month HIBORs remains negative at around -1%, capping the room for prices to rebound. In the previous cycles, the spread would rise to above 4% (ranging from 4.3% to 6.3%) before bottoming out.

Table 1: Major corrections in CRE market since 1990s

	Office	Retail store
1997 Asian Financial crisis and SARS		
Peak-to-trough price correction	76%	61%
Duration	72 months	70 months
Vacancy	13.7%	10.8%
Market yield	6.8%	6.5%
2008 Global Financial Tsunami		
Peak-to-trough price correction	29%	21%
Duration	10 months	8 months
Vacancy	11.5%	8.7%
Market yield	5.2%	4.7%
2019 Social unrest and pandemic		
Peak-to-trough price correction	40%	34%
Duration*	70 months	70 months
Vacancy	16.0%	10.3%
Market yield	3.2%	3.3%

(*) as of September 2024.

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Chart 3: Various metrics for office property market

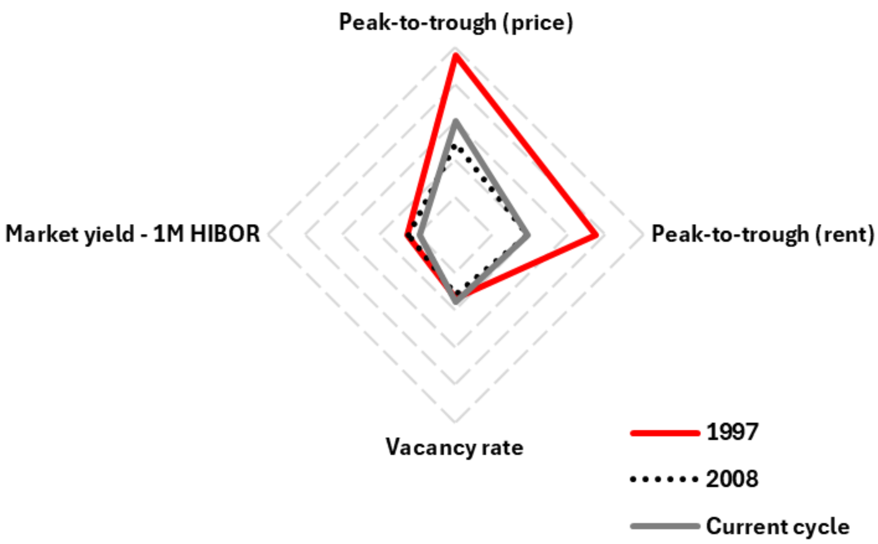
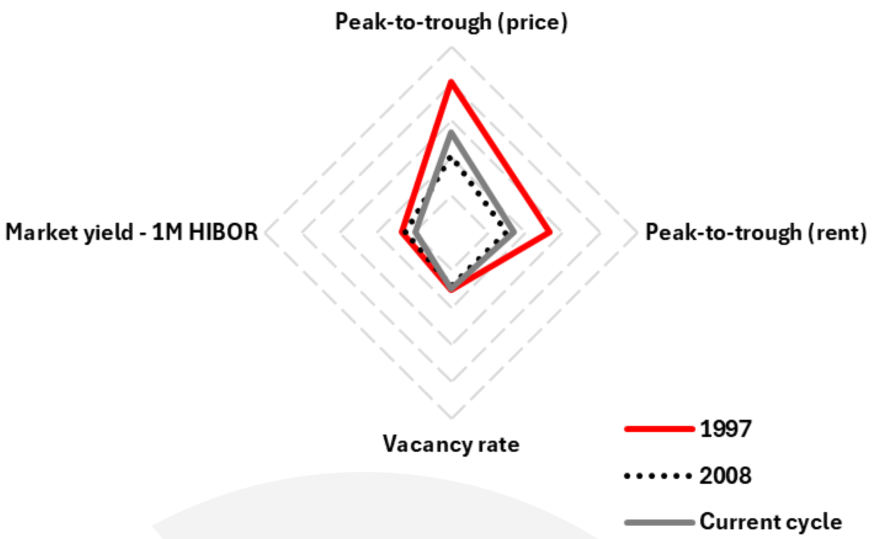


Chart 4: Various metrics for retail store property market



Unique challenges

A weak macroeconomic backdrop, a high interest rate environment, and an economic slowdown in China over the past few years have all weighed on overall business sentiment, and by extension, appetite for commercial space leasing. On top of that, both the office and retail store markets have also had their unique set of challenges.

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A fall in regional headquarters **(Chart 5)**, exodus of businesses, as well as downsizing of offices due to the shift to hybrid work mode, have slashed demand for office spaces. Despite the positive take-up of office space over the past two years, overall demand has remained subdued **(Chart 6)** as compared to supply. Facing intense competition in attracting quality tenants, landlords in both core and non-core areas chose to cut rent, leading to a 19% decrease in rents from the recent peak.

Chart 5: Fall in headquarters

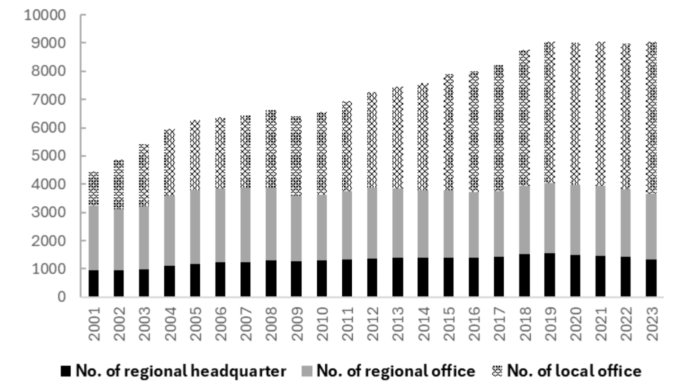


Chart 6: Subdued demand for office space

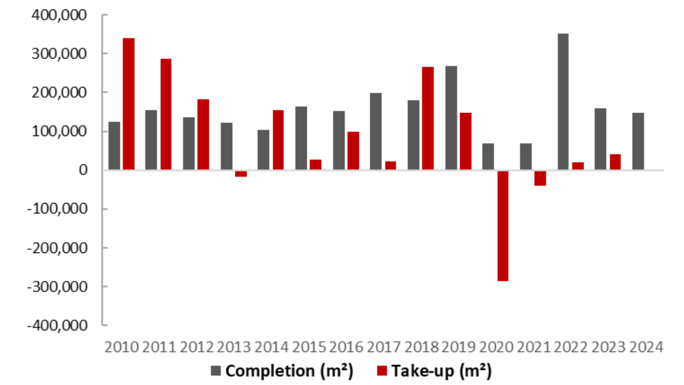
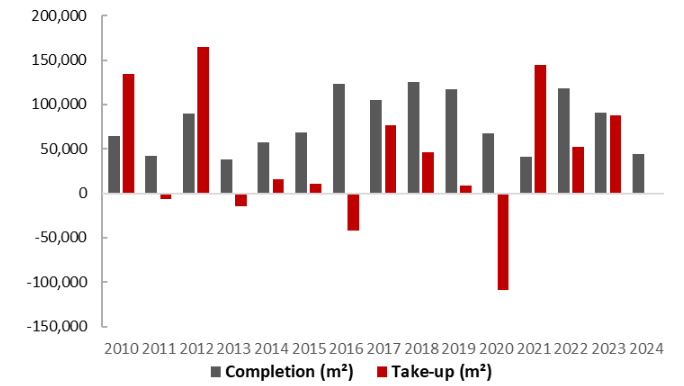


Chart 7: Weak retail sales

Chart 8: Lukewarm demand for retail store space



Sources: Hong Kong Rating and Valuation Department, OCBC.

The changing consumption patterns of inbound visitors and local residents continued to post challenges to the local retail market **(please refer to the 2H24 thematic report for more details)**. In the first nine months this year, total retail sales fell cumulatively by 7.6% YoY in value terms **(Chart 7)**, limiting upside room for retail stores' prices and rents. However, on a brighter note, vacancy rates of retail stores largely stabilised, while the supply-demand matrix was more balanced **(Chart 8)**.

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Optimistic buyers and cautious banks

While local buyers are sitting on the sidelines, Chinese firms have looked past the pessimism in the Hong Kong CRE market and have begun snapping up shopping malls and offices across Hong Kong. Reportedly, offers have been made on several large-scale local shopping malls. That said, most CRE owners are experiencing increasing cash flow strains amid high interest rates and low rental yields. Commercial banks are also increasingly reluctant to grant loans for commercial property, in light of the increased risks of credit impairment.

Too soon to call a bottom

Looking ahead, the recovery of the Hong Kong CRE market is likely to be bumpy and relatively slow. The imminent US Fed fund rate/prime rate cuts should render some support to business sentiment, but it remains too early to call the bottom. With a rebound in demand still hard to come by in the short-term, in addition to the negative carry, we continue to hold a slightly bearish view on the CRE market. Specifically, the office market is likely to trail other segments in terms of recovery amid an abundance in supply and company downsizing. The price of CRE is expected to fall further by around 5% in 2025.

Thematic Report 7

EU CBAM's influence on carbon pricing mechanisms in OCBC's key markets

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- The European Union (EU) Carbon Border Adjustment Mechanism's (CBAM) definitive regime will begin from 2026, spurring some trade partners to accelerate their decarbonisation efforts through implementing or enhancing carbon pricing mechanisms.
- China is expanding the China ETS coverage to include CBAM-exposed sectors while Indonesia and Malaysia have plans to implement a carbon tax.
- While the share of CBAM-exposed exports from OCBC's key markets to the EU is currently small, the regulatory costs may increase over time if the export volumes of CBAM-exposed products increase or when the EU CBAM coverage expands by 2030.
- Moving forward, countries may start to accelerate decarbonisation efforts to anticipate carbon border levies and reduce trade tariffs alongside meeting national climate change targets.

How does the EU CBAM work?

The EU CBAM was designed to level the playing field between the EU and third-country producers, by putting a fair price on carbon on certain imported products while phasing out free allocation of emissions allowances to the European industry.

The EU CBAM is a carbon leakage[43] instrument that functions in tandem with the EU Emissions Trading System (EU ETS), that requires EU importers to purchase CBAM certificates equivalent to the weekly average auction price of EU ETS allowances. The EU CBAM will therefore mitigate the risk of carbon leakage by equalising the price of carbon between imported and domestic products in the covered sectors. The initial phase of the EU CBAM will apply to six carbon-intensive goods that are at the most significant risk of carbon leakage: cement, iron and steel, aluminium, fertilisers, electricity and hydrogen. The EU CBAM's product scope aims to be extended to cover all EU ETS sectors by 2030.

During the EU CBAM transitional phase (2023 – 2025), importers of goods in the scope had to report their greenhouse gas emissions (GHG) embedded in their imports and did not have to buy and surrender CBAM certificates. From 2026, the EU CBAM will enter its definitive regime where EU importers will have to declare their emissions embedded in their imports and surrender the corresponding number of certificates by 31 May each year. However, if importers can prove that a carbon price has already been paid during the production of the imported goods, the corresponding amount can be deducted. This has set in motion a ripple effect and spurred trade partners to accelerate their decarbonisation efforts through implementing carbon pricing mechanisms, so that they can reduce the tariffs on the goods paid to the EU.

[43] According to the European Commission, carbon leakage refers to businesses moving their production from a country with stringent policies, to a country with laxer policies and emission constraints.

Thematic Report 7

Overall impact on OCBC's key markets

The impacts of the EU CBAM vary across OCBC's key markets of Singapore, Malaysia, Indonesia and China as some countries and industries are relatively more exposed to the EU CBAM. China, Malaysia and Indonesia are relatively more exposed to the EU CBAM than Singapore mainly due to greater iron and steel production capacities that they export to the EU. This has influenced China, Malaysia and Indonesia to accelerate the implementation or enhancement of carbon pricing policies in the respective countries in efforts to reduce CBAM tariffs. While the share of CBAM-exposed exports from those countries to the EU is currently small, the regulatory costs may increase over time if the export volumes of CBAM-exposed products increase or when the EU CBAM coverage expands by 2030.

China: Expansion of China ETS coverage to include CBAM-exposed sectors

China was the largest partner for EU imports of goods in 2023 (20.5%), followed by the United States (13.7%) and United Kingdom (7.2%). China is expected to export 868.94mn mt of CBAM-liable commodities between 2026 to 2040, 42% of which relate to iron and steel, 8% to cement and 6% aluminium, based on forecasts from S&P Global Commodity Insights. However, China's iron and steel exports to the EU account for around 1.14% of the value of China's total exports to the EU in 2023 based on data by the European Commission. Although the immediate impact on China's exports is small, the impact on China may become more significant in the long run when the scope of products under the EU CBAM expands.

As the EU CBAM is putting pressure on China's emissions-intensive sectors to decarbonise, China is expanding the China ETS sector coverage beyond the power sector to cover CBAM-exposed sectors. It will be expanded to cover cement, steel and aluminium by the end of the year for the 2025 compliance period. Upon expansion, the China ETS will cover over 60% of China's total GHG emissions. There are also plans to gradually reduce quota allocations to businesses from 2027, so that companies are incentivised to reduce their GHG emissions.

The price of China Emission Allowances has gradually increased over the years and breached the 100 CNY/t level with record high prices this year. While the China ETS expansion to CBAM-exposed sectors would help it catch up to more mature emissions trading schemes such as the EU ETS, addressing the oversupply of allowances will be important to enhance decarbonisation progress.

Thematic Report 7

Indonesia and Malaysia: Plans to implement a carbon tax

The iron and steel industries are the most CBAM-exposed industries for Indonesia and Malaysia, with growing steel production capacity in ASEAN. The value of iron and steel exports to the EU from Indonesia and Malaysia increased by 38.1% and 17.7% respectively from 2020 to 2023. Despite strong growth in value terms, the share of the value of iron and steel exports to total exports to the EU in 2023 was 4.1% and 1.4% for Indonesia and Malaysia respectively. The shares of other CBAM-exposed sectors in total exports are below 1%. Therefore, the overall impact of the EU CBAM to Malaysia and Indonesia is likely to be minimal based on the existing scope of products. However, the impact may become more significant when the scope of products under the EU CBAM expands.

To anticipate the impact from the EU CBAM, both Indonesia and Malaysia plan to implement a carbon pricing mechanism to accelerate decarbonisation in emissions-intensive sectors. Indonesia's carbon tax was previously set to be rolled out in April 2022 at a tax rate of 30,000 IDR/t for coal-fired power plants. However, this was delayed to support companies through the challenging macroeconomic environment amidst inflation and volatile energy prices at that time. The government is in the process of developing its carbon tax policy that is likely to be rolled out in 2025, to be implemented in two phases. The initial phase aims to regulate the implementation of the carbon tax for the power plant subsector, while the second phase will apply to the transportation subsector that uses fossil fuels. This is anticipated to cover around 39% of Indonesia's total GHG emissions, or around 71% of GHG emissions in Indonesia's energy sector comprising 48% from power plants and 23% from transportation. There are no further details on Indonesia's carbon tax rate or timeline.

Malaysia plans to introduce a carbon tax on iron, steel and energy industries in Malaysia by the year 2026, announced at Malaysia's Budget 2025. This can be seen as Malaysia's response to the EU CBAM and to meet its commitment towards net zero carbon emissions by 2050. However, the government has yet to set a tax rate under the carbon pricing mechanism. As there will likely be some resistance from carbon tax-liable companies, Malaysia's carbon tax could start out low to ensure that companies remain competitive and allow them to better transition. The implementation of the carbon tax could also be coupled with other government incentives to support companies in implementing decarbonisation strategies.

Thematic Report 7

Singapore: Gradual increases to its carbon tax

Singapore expects limited impact from the EU CBAM as Singapore's main exports to the EU are organic chemicals and pharmaceutical products, which are not covered under the EU CBAM's existing scope. Singapore has implemented a carbon tax since 2019 before the EU CBAM entered into effect, which started out at S\$5/tCO_2e and increased fivefold to S\$25/tCO2e in 2024. The carbon tax will be further raised to S\$45/tCO_2e in 2026 and 2027, with a view to reaching S\$50 – 80/tCO_2e by 2030. Singapore's carbon tax is applied to all facilities with annual direct GHG emissions of at least 25,000 tCO_2e. It currently covers around 80% of Singapore's GHG emissions in the manufacturing, power, waste and water sectors. Singapore has not made further changes to its carbon pricing mechanism in response to the EU CBAM, likely because the impact on Singapore's exports was assessed to be minimal and it already has a carbon tax system in place with gradual increases planned till 2030.

Ripple effect of the EU CBAM

The implementation of the EU CBAM could lead to trade tensions with trade partners that do not have equivalent carbon pricing mechanisms by 2026 or are unable to implement carbon prices that are comparable to the price levels of the EU ETS allowances. Companies may start to evaluate their supply chains, identify potential CBAM exposures, as well as educate and prepare impacted suppliers. It could also lead to countries finding new export opportunities outside of the EU for CBAM-exposed products, resulting in potential changes to global supply chains for those products. Nonetheless, the EU CBAM could be effective in accelerating decarbonisation in emissions-intensive sectors in OCBC's key markets and other Asian economies. It may also encourage greater research and development efforts in alternative products with reduced carbon content, thereby supporting the production of more sustainable products globally.

With growing attention on embodied carbon of globally traded goods and to address the risk of carbon leakage, more countries are looking to implement similar carbon border adjustment mechanisms such as the US' Clean Competition Act (CCA). In addition, the UK will be implementing a new carbon import levy from 2027 on carbon-intensive products in the iron, steel, aluminium, fertiliser, hydrogen, ceramics, glass and cement sectors. Similar to the EU CBAM's mechanism, the UK CBAM will work alongside the UK ETS to mitigate the risk of carbon leakage. Malaysia has also expressed the need to implement a CBAM of its own to level the playing field for imported goods, such that companies exporting products such as steel to Malaysia would need to pay the carbon tax.

With the EU CBAM as an opportunity to anticipate future climate-related trade measures, countries may start to accelerate decarbonisation efforts with the aim of reducing trade tariffs alongside meeting national climate targets and commitments. More countries may consider implementing carbon pricing mechanisms of their own or gradually increase existing carbon prices. Carbon pricing mechanisms are expected to first target emissions-intensive sectors including those exposed to trade-related regulations. The ripple effect of the EU CBAM could be beneficial to global decarbonisation efforts, but the challenges associated with increased costs and trade tensions need to be addressed.

Thematic Report 8

Buying time: Potential EUDR delay

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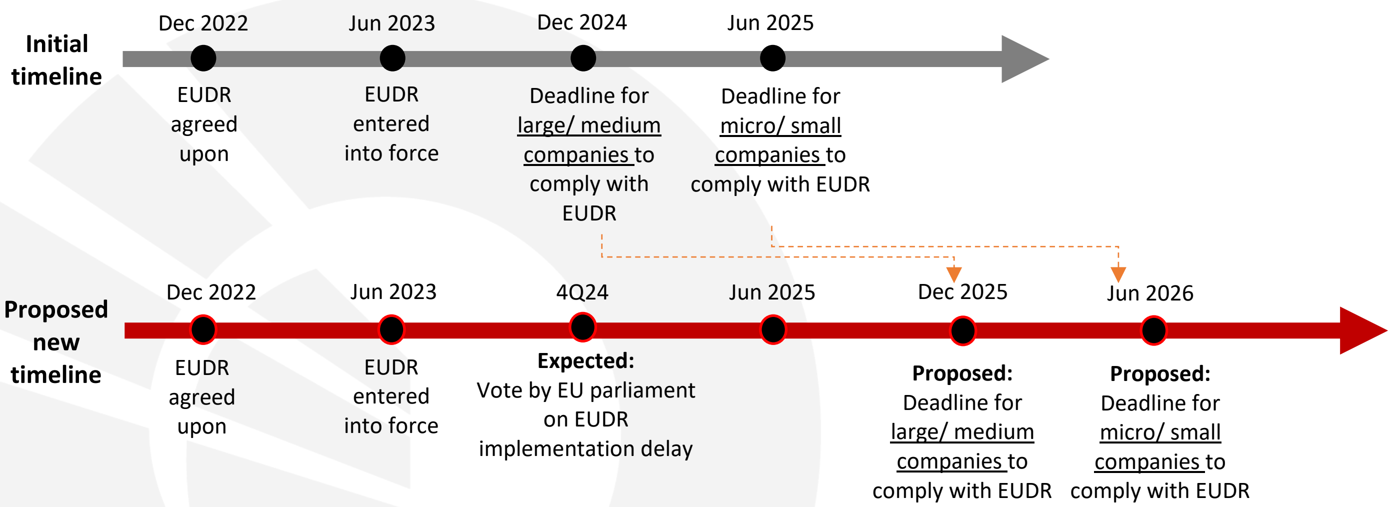
1. Introduction

The European Union Regulation on Deforestation-Free Products (EUDR), which came into effect on 29 June 2023, may have its implementation delayed by 12 months to December 2025 after repeated calls from various stakeholders. The regulation represents a significant step in the EU's broader sustainability agenda, specifically aimed at curtailing the EU's contribution to global deforestation through key agricultural imports.

Under the EUDR, companies exporting specified commodities to the EU must verify that their supply chains do not contribute to deforestation or forest degradation. The commodities included in the scope of the regulation are palm oil, cattle, soy, coffee, cocoa, timber and rubber, as well as products derived from the listed commodities e.g. beef, chocolate and furniture. In our report published on 27 November 2023 titled 'Implications of the EU's deforestation-free law for Indonesia', we analysed the EUDR and its implications for Indonesia and global supply chains. This report provides an update on EUDR developments and what to expect moving forward.

2. Proposal to delay EUDR implementation by 12 months

In response to calls from industry groups and governments globally, the European Commission proposed delaying the EUDR's implementation by a year – a proposal now endorsed by the EU Council. This amendment, pending European Parliament approval, aims to be formally adopted by co-legislators and published in the Official Journal of the EU to take effect by year-end. If approved, EUDR obligations will take effect on 30 December 2025 for large and medium companies and 30 June 2026 for micro and small enterprises. The 12-month extension provides companies more time to establish compliance systems, develop traceable supply chains and meet regulatory requirements. Stakeholders emphasise that this extension is essential, especially for small-scale producers facing challenges such as high compliance costs and complex reporting obligations.



3. Drivers of the EUDR delay

Given the concerns surrounding the implementation of the EUDR, many countries and industry groups called for the regulation to be delayed e.g. the US, European countries and ASEAN countries. The concerns include regulatory uncertainty related to the EUDR country benchmarking system, the delay in setting up the IT system for due diligence statements, and the challenges faced by small-scale farmers.

3.1 Regulatory uncertainty

The EUDR country benchmarking system will classify countries as low, standard or high risk according to the level of risk of producing commodities linked to deforestation or forest degradation. This classification aims to streamline due diligence processes for companies and guide authorities in enforcing compliance effectively. Countries assessed as low-risk will be subject to simplified due diligence processes, while high-risk countries will face the most stringent measures. The proportion of checks is performed on operators according to the country's risk level: 9% for high-risk countries, 3% for standard-risk and 1% for low-risk.

As the initial EUDR timeline of December 2024 for large and medium companies approached, the risk classification for countries was not yet finalised under the country benchmarking system. This caused concern among countries as the delay in benchmarking decisions prevents stakeholders from preparing the information required to comply with the EUDR. Additionally, there was criticism from exporting countries, including Indonesia whose Coordinating Minister for the Economy, Airlangga Hartarto, argued that the "EU has no right to be a rating agency," reflecting broader concerns that the EUDR's benchmarking system may disproportionately impact major palm oil exporters.

3.2 IT system not ready for use

The Information System is the IT system set up to ensure compliance with the EUDR, facilitating the submission and processing of due diligence statements pertaining to commodities entering the EU market. The Information System began pilot testing in December 2023, which led to stakeholders raising concerns that the Information System was inoperable with numerous functionality gaps e.g. inability to handle large data volumes, glitches, GPS inaccuracies. There was concern that the issues would not be resolved in time to meet the requirements of properly functioning supply chains. As the market was closing in on the initial timeline of Dec 2024, there was pushback from stakeholders citing that both the country benchmarking system and IT system were not yet ready for implementation. Nonetheless, the European Commission stated that "all implementation tools are technically ready" and noted that the additional 12 months would serve as a phasing-in period to allow for proper and effective implementation of the EUDR.

3.3 Challenges faced by small-scale farmers

The EUDR is expected to disproportionately impact small-scale farmers, with a growing risk that larger companies will exclude smallholders from their supply chains. Indonesia, the world's largest palm oil producer and exporter, has millions of smallholders responsible for about 35% of its palm oil production. The informal nature of agricultural supply chains, involving layers of local agents and traders, makes the EUDR particularly challenging for small-scale farmers, who often lack the resources or capabilities to comply with regulations due to lack of technical knowledge, high operational costs and complex requirements. Key challenges in integrating smallholders into sustainable supply chains include a lack of awareness, especially among independent farmers and traders, as well as unclear compliance costs and a lack of partnerships to support integration. More fundamentally, the EUDR's requirement for operators to share geolocation data for land where EU-bound commodities are produced may conflict with certain government regulations that prohibit sharing such data.

Therefore, countries like Indonesia have expressed support for the proposed delay as it provides more time to ensure proper implementation. Other than the timeline of the EUDR, Indonesia has cited concerns about the implementation rules like the country benchmarking system and is urging the EU to acknowledge locally-recognised palm oil sustainability standards (e.g. Indonesian Sustainable Palm Oil (ISPO) certificates and Roundtable on Sustainable Palm Oil (RSPO) to support smallholders in exporting to the EU.

4. What's next?

The proposed delay in the EUDR has effectively reduced near-term uncertainty while providing stakeholders with a valuable window to enhance their preparation efforts and align with the regulation's requirements. This underscores the need for a balanced approach — one that combines strong environmental commitments with equitable support systems to pave the way for an inclusive path to sustainability. Enhanced communication and regulatory clarity are crucial, as producers, exporters and governments seek consistency in the EUDR's application. The additional time also allows stakeholders, especially smallholders, to adapt to and participate in the deforestation-free supply chain. This is an opportunity for the EU, local governments and private sector partners to bolster support for smallholders by providing resources for sustainable practices and market access. Strengthened partnerships, tailored financial assistance and targeted training will be key to integrating smallholders into compliant sustainable supply chains.

Meanwhile, trading partners will closely scrutinise the country benchmarking system, expected to be finalised by June 2025 through a proposed Implementing Act, which will enable clearer risk classification and due diligence pathways for operators. Additionally, continuous comprehensive testing and training of the IT system are anticipated to address current functionality issues and ensure it is ready to handle complex compliance data.

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