OCBC Global Outlook 2H24

Playing the Long Game for 2H24

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- The global soft-landing narrative has taken root for 2024 even as the real economic sectors grapple with the persistent effects of past monetary policy tightening. The World Bank has upgraded its 2024 global growth forecast from 2.4% projected in January 2024 to 2.6%, largely attributable to the bright spot that is the US economy. Indeed, resilient US growth has kept risk sentiments largely afloat in the first half of 2024. Upside economic data surprises out of the US in 1Q24 led to a pushback in Fed Fund rate cut expectations from the mid-2024 that was earlier anticipated. However, the more recent 2Q24 data prints have been softening, but were insufficient to warrant that the Fed pull the trigger yet. The upcoming US election in November will be key to watch, with significant implications for trade, tax, immigration and other key policies at risk. Recall that Donald Trump has threatened to levy 60% trade tariffs on China and 10% for rest of the world, renew his tax cuts and clamp down on immigration again. More recently, the Biden administration has also implemented tariff hikes across strategic sectors such as steel and aluminium, semiconductors, electric vehicles, batteries, critical minerals, solar cells, ship-to-shore cranes and medical products with an aim of encouraging China to eliminate unfair trade practices regarding technology transfer, intellectual property and innovation.

- Outside of the US, the picture was slightly more mixed. Economic prospects in the Euro area started to look more upbeat in 1Q24 with 0.4% YoY sa (0.3% QoQ sa) GDP growth, aided by the pickup in external demand. Notably the ZEW survey expectations for June also surged from 47.0 in May to 51.3, the strongest since July 2021, but the composite PMI unexpectedly slipped from 52.2 in May to 50.8 in June, weighed down by Germany and France. Germany's industrial sector could take longer to recover, while France's snap elections may have contributed to some near-term uncertainties. There are two upcoming elections to watch - UK will go to the polls on 4 July with polls suggesting that Labour's Keir Starmer will put an end to 14 years of Tory rule, while France's two-round vote culminating on 7 July may also unveil a hung parliament with far-right Le Pen's National Rally and the left-wing New Popular Front. That said, the UK economy has likely turned a corner and should see growth accelerate into 2025.

- The Japanese economy has sputtered with 1Q24 GDP growth contracting 1.8% on an annualised basis as both consumers and companies cut back on spending and inventory buildup. Personal consumption shrank 0.7%, registering the fourth quarter of declines, while business spending also fell 0.4%, albeit partly due to one-off factors like the New Year's Day earthquake and an auto certification scandal. Second quarter growth is expected to rebound, ahead of the ruling party's next leadership contest in September. Notably, there are one-off tax rebates starting from June, healthy annual wage negotiations and increased tourism aided by the weak JPY, which should support the economic picture. The Bank of Japan has begun to normalise monetary policy and Governor Ueda continues to keep the door open for a further rate hike in July, depending on data and information on the economy, inflation and financial conditions.

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- Moreover, the BOJ also announced their intent to trim bond purchases but deferred the details to the 31 July board meeting. This guessing game is clearly taking a toll on the JPY which is being penalised for its wide yield differentials with the US. Increased verbal jawboning as the USDJPY approaches key levels is likely to continue. Japan has spent a record JPY9.8 trillion to intervene in the currency market this year, but to little avail and has drawn the attention of the US Treasury Department who again added Japan to its FX "monitoring" list for the first time since June 2023. Japan, joins China, Germany, Malaysia, Singapore, Taiwan and Vietnam, although it noted that Japan is transparent with respect to foreign exchange operations and regularly publishes its foreign exchange interventions each month.

- China's economic recovery remains uneven. The property sector slump has worsened after the initial euphoria from the announcement of greater policy support in mid-May. The RMB has been under pressure, again due to US-CH yield differentials, but the RMB daily fixing rate has been maintained around 7.1, with a daily trading limit of 2%, making the vicinity of 7.25 a line in the sand for the onshore RMB spot rate. With the PBoC prioritizing currency stability over combating deflation, it may buy time for market pessimism to subside while waiting for the US Fed to cut rates. With the PBoC also contemplating the future framework of monetary policy in China, the potential change in the main policy rate could have wider implications and present challenges in policy communication and short-term volatility. Market watchers are also watching for more policy announcements in the run up to the third plenum in July. Our house forecast for China's 2024 GDP growth remains at 5%, but the risks is that the road ahead remains bumpy both domestically and externally.

- For Asia, the picture remains one of general resilient economic health, but varies across different economies and sectors. The good news is that 1Q24 GDP growth have mostly surprised to the upside but face different challenges ahead. Services demand has largely been conducive for growth given relatively tight labour markets and the recovery of visitor arrivals. The scorecard for manufacturing, especially electronics including semiconductors, has been more divergent due to whether there is exposure to the AI-related boom and/or are beneficiaries of the China+1 diversification strategy. India has also been touted as the next big economy to watch given growth is still likely to clock in around the 7% handle for 2024-2025, assuming that PM Modi maintains his reform agenda.

- The great disinflation trajectory remains intact, but the last mile journey has been bumpy and tricky to navigate. Hence the reticence of the US Federal Reserve to cut rates – as illustrated by the latest June dot plot which had shaved down the number of cuts from three to just one, but the scatter plot suggests that balance is more finely calibrated between 4 members opting for no cuts, 7 members calling for one cut and 8 members calling for 2 cuts. That said, the median Fed forecasts see the core PCE inflation gauge higher at 2.8% (previously 2.6% in March) for 2024 and 2.3% (previously 2.2%) for 2025, requiring the Fed Funds rate forecast to also be adjusted higher to 5.1% (previously 4.6%) and 4.1% (previously 3.9%), respectively. Fed's Kashkari suggested that "getting all the way back to 2% is going to take a little bit more time", possibly a year or two, while Goolsbee also opined that the central bank can cut with more inflation reports like May.

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Undeterred, the current Fed Funds pricing still leans closer to two cuts of 25bps each this year, likely starting in September. This is also consistent with our house view.

- The ECB has pared its deposit rate by 25bps to 3.75% in June, but recent upticks in inflation may mean the ECB will shy away from back-to-back cuts and pause at the July meeting. The Bank of England's tone has evolved as well, with the May meeting suggesting the decision not to cut rates was "finely balanced" even as it kept its policy rate unchanged at a 16-year high of 5.25%. With BOE Governor Bailey opining that it was good news that inflation is back to its 2% target for the first time in nearly three years, markets are pricing in the possibility of an August cut. Meanwhile, the Swiss National Bank has already cut borrowing costs for a second straight meeting and sees inflation subsiding to just 1% in 2026.

- The standout in terms of the anticipated global monetary policy easing cycle is the BOJ. The BOJ is the latecomer and has barely exited the negative interest rate policy (NIRP) and may continue on its monetary policy normalisation path in the coming months and quarters ahead, when the rest of the world is now shifting into an easing cycle. The bulk of the other Asian central banks are mostly angling to ease monetary policy but may only be hesitating due to pressures on the currency and bond markets from the Fed's high-for-longer interest rate mindset. Once the Fed embarks on its first rate cut, more developing economies may feel emboldened to also ease their monetary policy settings. This is likely to be the case even if major central banks potentially step up on Quantitative Tightening to bring down their ballooned balance sheet sizes.

- In terms of risk, geopolitics remain front and centre. Apart from the Russia-Ukraine and Israel-Hamas conflicts that have not been resolved, there remains various hotspots that market watchers are concerned about including the Taiwan Straits, China-Philippines and others. In addition, there are worries about growing fragmentation, especially for key strategic sectors like electric vehicles (EVs). China and the EU have recently agreed to hold initial talks over the EV tariffs that the latter was planning to implement in July, but whether this will be successful or degenerate into a tit-for-tat retaliation remains to be seen. China is already taking pre-emptive steps including an anti-dumping investigation into European brandy in January, as well as pork (with Spain likely to feel the most pain as China was the second-largest export market last year, but also Denmark and the Netherlands), and possibly also wine (with France also being the largest European exporter of wine to China), cars (with Germany and Slovakia possibly at risk), and even dairy products. With the China+1 diversification strategy taking greater prominence, there is also concerns if the incoming new US administration undertakes a tougher stance on China and targets what it perceives as proxy conduits for Chinese exports, then the landscape could become even more complicated to say the least. At this juncture, it is not only the non-Chinese corporates who are diversifying into Asia/ASEAN, but also the Chinese corporates who are increasingly shifting to tap into these markets to potentially kill two birds with one stone – seek alternative markets in a polarised world and/or leverage on less sensitive production locations in anticipation of an escalation of tariffs on China.

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- The silver lining is that with the Taiwanese, Indonesian and Indian elections out of the way, their respective immediate election-related uncertainties have subsided and investor focus now turns to policy and implementation risks. For instance, Taiwan remains one risk to watch, while incoming Indonesian president-elect Prabowo has caused some market consternation with his free lunch program that may prompt the fiscal deficit to rise. This type of fiscal largesse may not be uniquely an emerging market problem as the US budget deficit could well swell if Trump and/or Republicans win the presidential/Congressional election and pursue more tax cuts. The higher trade tariffs and tighter immigrant controls would also impact inflation and manpower costs, albeit with the implications falling more in 2025 than December this year. Given the high level of uncertainties attached to this binary outcome, 2H24 looks like a sweet spot at least where risk appetite is concerned.

- This gives rise to another critical question – are financial markets already priced to near-perfection? The S&P500 has eked out multiple fresh highs this year despite the high-for-longer interest rate environment. VIX, currently below the 14 handle, also remains below the 1- and 5-year historical averages. The 10-year US Treasury bond yield has fluctuated in a wide range between 3.8%-4.7% year-to-date but considering that the market pricing for Fed rate cuts have shrunk from 6-7 cuts of 25bps at the start of the year to now less than 2 cuts, it is still very well-behaved at the current 4.25%. In the currency markets, the king USD remains underpinned by the Fed's pause mode even as the US' economic exceptionalism is starting to fade. Until the Fed succumbs to rate cuts, the yield differentials are overwhelmingly in favour of the USD. Moreover, in periods with bouts of heightened geopolitical uncertainties, the safe haven qualities of the USD kicks in as well – just look at gold prices as a reference.

- Meanwhile, credit market spreads have ground in this year amid the ongoing search for yield as recessionary risks subside. The key exception being China and the implosion of many high-yield Chinese property names in the USD market. Looking ahead, credit dispersion is likely to pick up as the cumulative effects of past monetary policy tightening is still playing out in the economic and corporate space, and also depending on the maturity walls.

- On balance, after the last few years of constant surprises on the economic, policy, pandemic and geopolitical fronts, it may not be the risks front and centre on our risk assessments that we have been wary of, but the curveballs that come from left fields that stump financial markets and throw all our models and predictions into disarray. Even if we cannot accurately predict the trigger, the outcome may still warrant being nimble and not putting too many eggs into one basket, especially if it is a mainstream consensus view that appears to be completely logical at this point in time. Good luck and may the odds be ever in your favour.

GDP Growth Rates

% Change YoY	2023	2024F	2025F	2026F
Global	3.2	3.2	3.2	3.2
US	2.5	2.4	1.5	1.5
Eurozone	0.5	1.0	1.3	1.3
Japan	1.9	0.7	1.0	1.0
United Kingdom	0.1	0.5	1.0	1.3
New Zealand	0.7	0.8	2.2	2.7
Australia	2.0	1.5	2.0	2.1
China	5.2	5.0	4.6	4.6
Hong Kong	3.2	2.3	2.2	2.6
Taiwan	1.4	3.8	2.5	2.4
India	8.2	7.2	6.2	6.0
Indonesia	5.0	4.8	5.1	5.2
Malaysia	3.6	4.2	4.5	4.5
Philippines	5.5	6.0	6.0	6.0
Singapore	1.1	2.3	2.7	2.5
South Korea	1.4	2.2	2.3	2.3
Thailand	1.9	2.8	3.3	3.0
Vietnam	5.1	6.0	6.2	6.2

Note: India forecasts are based on the fiscal year.
Source: Bloomberg, IMF, OCBC.

Inflation Rates

% Change YoY	2023	2024F	2025F	2026F
Global	6.8	5.9	4.5	3.7
US	4.1	2.7	2.3	2.2
Eurozone	5.5	2.7	2.2	2.1
Japan	3.3	2.3	1.9	1.9
United Kingdom	7.4	2.4	2.3	1.5
New Zealand	5.8	3.2	2.2	2.0
Australia	5.6	3.4	2.8	2.5
China	0.2	0.5	2.4	2.3
Hong Kong	2.1	2.3	2.8	2.5
Taiwan	2.5	2.1	2.2	1.8
India	5.4	3.7	4.5	3.7
Indonesia	3.7	3.1	2.8	2.7
Malaysia	2.5	2.5	2.3	2.3
Philippines	6.0	3.9	3.0	2.5
Singapore	4.8	2.8	2.0	2.0
South Korea	3.6	2.4	2.0	2.0
Thailand	1.2	1.2	2.2	2.0
Vietnam	3.3	4.3	4.0	4.0

Note: India forecasts are based on the fiscal year.
Source: Bloomberg, IMF, OCBC.

Central Bank Policy Rates

BENCHMARK RATE %	Current	2024F	2025F	2026F
US Fed Funds Rate	5.25-5.50	4.75-5.00	3.50-3.75	3.25-3.50
ECB Deposit Facility Rate	3.75	3.25	2.50	2.25
BOJ Target Rate	0.0-0.1	0.2-0.3	0.4-0.5	0.5-0.6
BOE Base Rate	5.25	4.75	3.75	3.25
RBNZ Cash Rate	5.50	5.25	4.50	4.00
RBA Cash Target Rate	4.35	4.10	3.60	3.35
China Loan Prime Rate (1-year)	3.45	3.25	3.25	3.25
CBRC Discount Rate	2.00	2.00	1.75	1.75
Hong Kong Base Rate	5.75	5.25	4.00	3.75
BI 7D Reverse Repo Rate	6.25	5.75	5.00	5.00
BNM Overnight Rate	3.00	3.00	3.00	3.00
BSP Overnight Reverse Repo	6.50	6.00	5.00	5.00
RBI Repurchase Rate	6.50	6.25	5.75	5.75
Singapore SORA	3.60	3.25	2.60	2.50
BOK Target Overnight Call	3.50	3.00	2.50	2.50
BOT Repurchase Rate	2.50	2.50	2.50	2.50

Source: Bloomberg, OCBC Estimates. Forecasts are as of end-calendar.

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United States: Normalisation Underway

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- Growth is expected to slow in 2H24 after a remarkable 2023 as consumption tailwinds wane. The US economy started 1Q24 on a softer note than anticipated at 1.3% QoQ annualized compared to 4Q23's 1.6%, as personal consumption moderated from 2.5% to 2.0% over the same period. While recessionary risks have ebbed and 2024 growth may reach 2.4%, the high interest rate environment and is likely to weigh on domestic demand going out into 2025.
- The labour market may be weaker than what the headline data suggests with constant downward revisions, while normalizing vacancy/unemployment ratio also indicates gradual loosening. Sticky inflation for the past few months led by services upswing is set to ease as shelter and financial services inflation subside gradually in 2H24. One key risk to watch includes the US presidential elections in November 2024 as geopolitics, especially in relation to China given Trump's advocacy for 60% tariffs on China and 10% for the rest of the world, as well as fiscal and immigration implications.
- Barring new shocks to energy markets and/or supply chains, easing incoming inflation and the labour market rebalancing should provide the constructive statistical mix the data-dependent Fed is looking for. We still see the window for the Fed to cut up to twice this year starting from the September FOMC.

Growth momentum is slowing
The US economy has exhibited remarkable resilience at the start of 2024, with upside data surprises that contributed to the Fed's shift to delay its monetary policy easing cycle. Recession risks have ebbed and the US economy is tipped to grow 2.4% YoY in 2024, similar to the 2023 pace. That said, it is noteworthy that a handful of 1Q24 data succumbed to downward revisions and fresh releases in 2Q24 have come in softer.

For instance, the 2nd reading for 1Q24 real GDP growth came in at 1.3% QoQ annualised, downwardly revised from the initial estimate of 1.6% and a marked step down from 3.4% in 4Q23. The sectoral composition was uneven, with downward revisions made to goods consumption (-1.9% vs -0.4% prior), while services spending remained robust and only saw a slight revision down to 3.9% from 4.0% prior. Upward revisions were made to non-residential fixed investment (6.0% vs 5.3% prior), residential investment (15.4% vs 13.9% prior) and government spending (1.3% vs 1.2% prior). Services consumption remained the primary driver, adding 1.8ppts to growth, while goods consumption reversed to become a drag (-0.4ppts).

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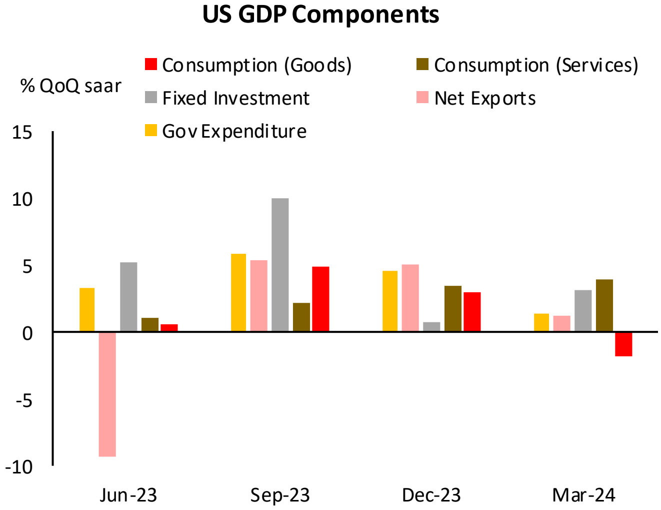
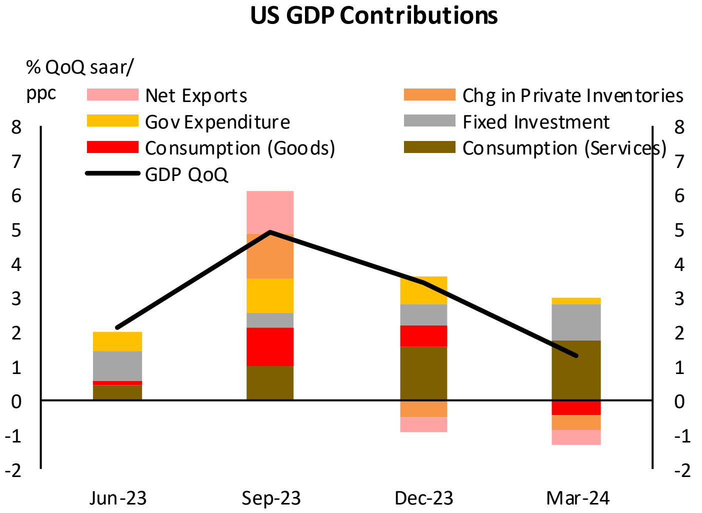


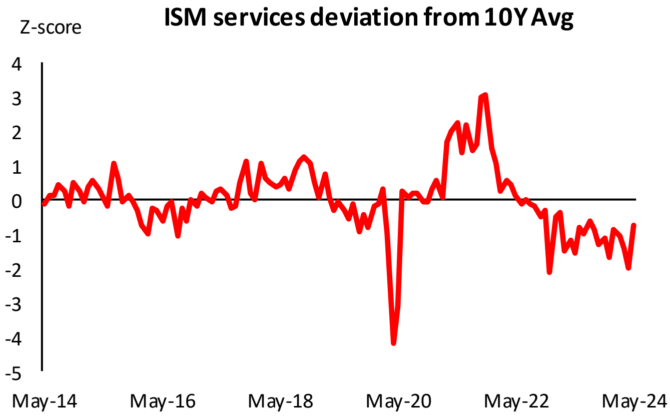
Source: BEA, CEIC, OCBC.



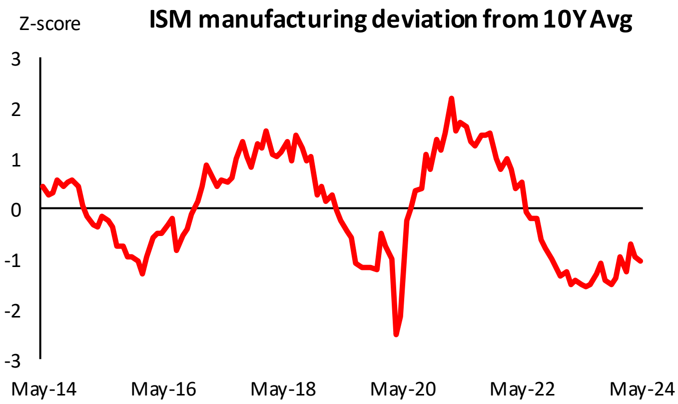
Source: Bloomberg, OCBC.

Consumption tailwinds are set to normalise further

Heading into 2H24, we anticipate a further tightening of consumer purse strings on services spending, with goods spending already losing some steam. Leading indicators are already signalling this trend, with the 10-year averages for manufacturing and services ISM pointing to domestic activity at historically subdued levels.



Source: ISM, OCBC.



Source: ISM, OCBC.

Other consumer spending metrics are also showing signs of softening. Headline retail sales growth declined by 0.2% MoM in Apr and came in below expectations in May at 0.1% MoM (consensus: 0.3%). The caveat is that retail sales data is subject to substantial monthly variability and backwards revisions, so taking the 3-month and 12-month moving averages paints a clearer picture of an ongoing normalisation story taking place in consumer spending. Since the start of 2024, 3- and 12-month moving averages for both headline and core retail sales growth have been stabilising between 0.0-0.4% MoM, similar to the pre-pandemic range.

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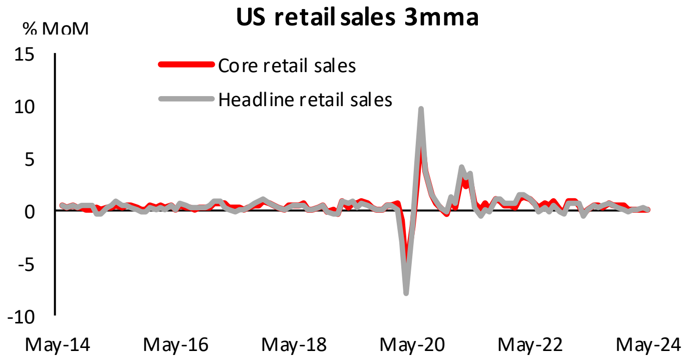
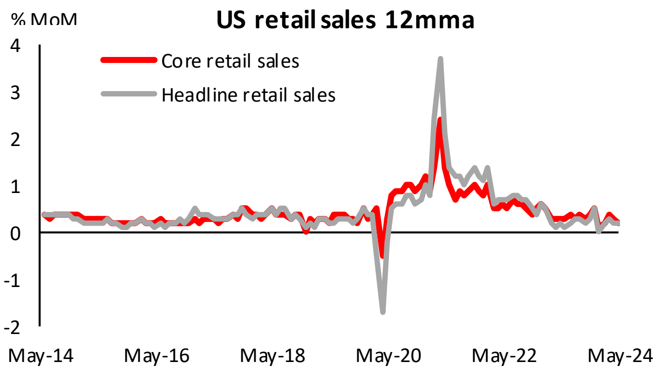
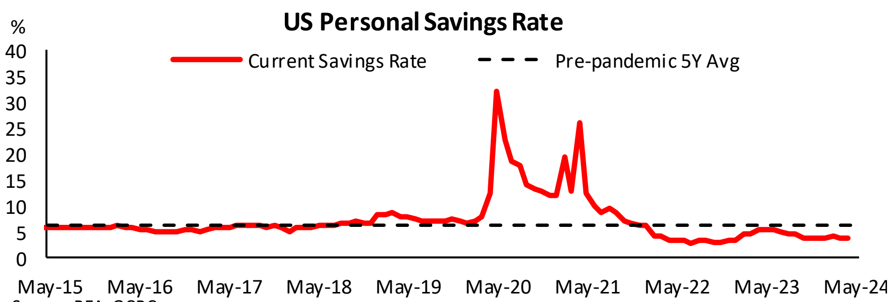


Source: CEIC, OCBC.



Source: CEIC, OCBC.

Crucially, key consumption tailwinds including real wage growth and ample household savings have begun to fade. Although nominal disposable incomes grew by 4.2% YoY in 1Q24, real income growth lagged at 1.6% YoY (4Q23: 3.8%), implying stickier inflation has eroded some household purchasing power. The savings rate — personal savings as a percentage of disposable incomes, is also on a downward trend, standing at 3.6% in April, from 4.1% in January and 5.2% in April 2023. The confluence of a cooling labour market, slower wage growth and stickier inflation will likely set the stage for consumption to ease further into 2024.



Source: BEA, OCBC.

Consumer sentiment surveys still show a relatively upbeat consumer environment at this juncture. The University of Michigan consumer sentiment index averaged at 76.3 in Jan-May 2024, well above the 63.3 recorded over the same period in 2023. The conference board consumer confidence indicator also rebounded strongly in May to 102.0 from 97.5 in April.

However, in addition to stepping down gradually since March 2024, a peek under the headline reveals a considerable gap in sentiment between income levels. Sentiment amongst top income earners have outstripped middle- and bottom-income groups, possibly explained by the equities rally[1] which drove confidence mostly for top earners via higher asset prices. The main implication of such a divergence would be that consumer confidence may not be broad based, and that a consumption pull-back is likely to begin with lower income earners more sensitive to labour market cooling and stickier inflation.

[1] Eliza Winger, Bloomberg Economics, Why Consumer Confidence is Fragile

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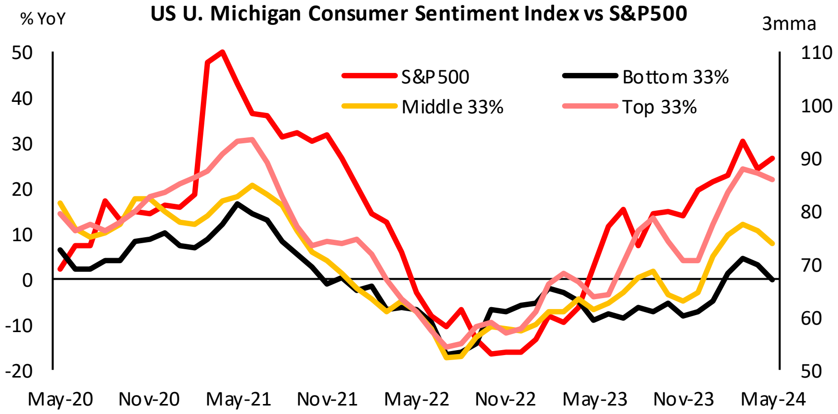
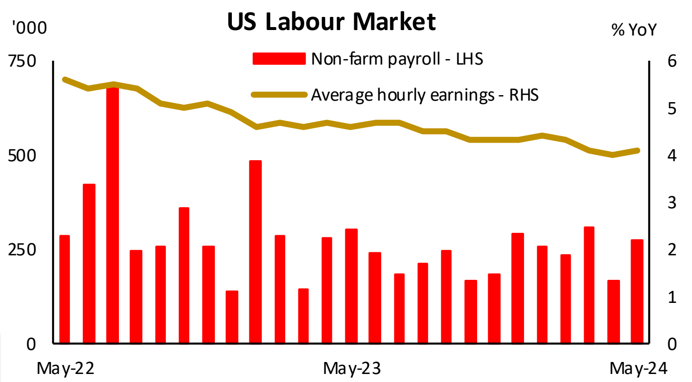


Source: Bloomberg, U. Mich, OCBC.

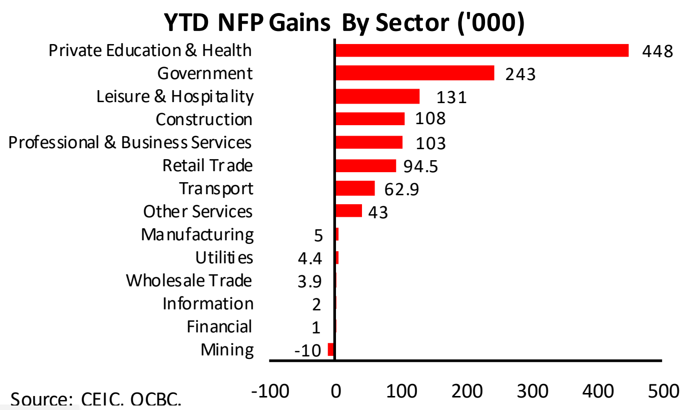
Healthy labour market rebalancing

Employment has remained resilient with a steady stream of upside surprises to payroll figures in 1Q24. However, continuous downward revisions and mixed signals between strength and softness in various employment surveys implies that underlying job growth is weaker than what headline data might suggest. It is also possible that some degree of labour hoarding is holding the labour market as employers are wary of having to replace talent if they lay off staff in the near-term.

Markets were met with another blockbuster nonfarm payrolls (NFP) report in May with 272k new jobs added from 165k in April, exceeding consensus expectations of a 180k increase by a longshot. Average hourly wage had also risen slightly to 4.1% YoY (April: 4.0%). However, we again see downward revisions to prior data, with a total -15k shaved off past 2 months of headline NFP gains. Furthermore, gains were once more led by non-cyclical sectors, namely health services, government and leisure and hospitality, a trend which we have observed repeatedly year-to-date.



Source: CEIC. OCBC.



Source: CEIC. OCBC.

Additionally, the latest BLS household survey was rather cautionary. Employment fell briskly by -408k (April: +25k) and the growth of full-time jobs fell back into contraction to -625k, reversing the 949k gain in April. Unemployment had also risen from 3.9% to 4.0%. Signals of a cooling labour market can be found in leading data as well, with hiring intentions mostly trending down along with active and new job ads. Our take is that the labour market is headed towards a healthy rebalancing,

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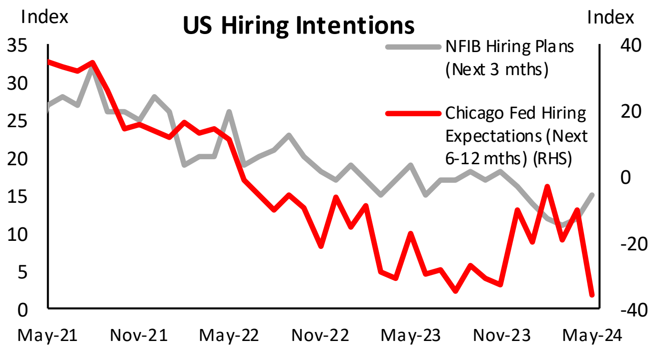
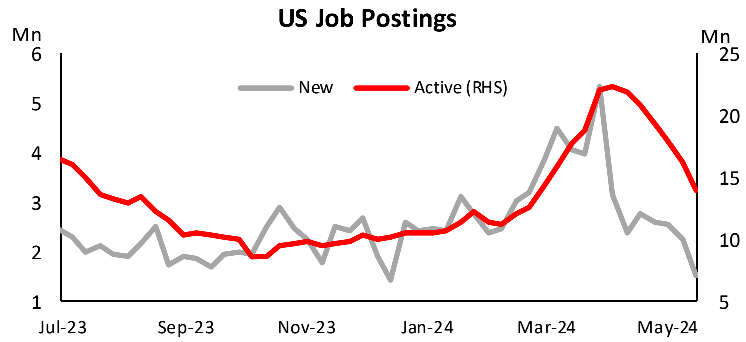
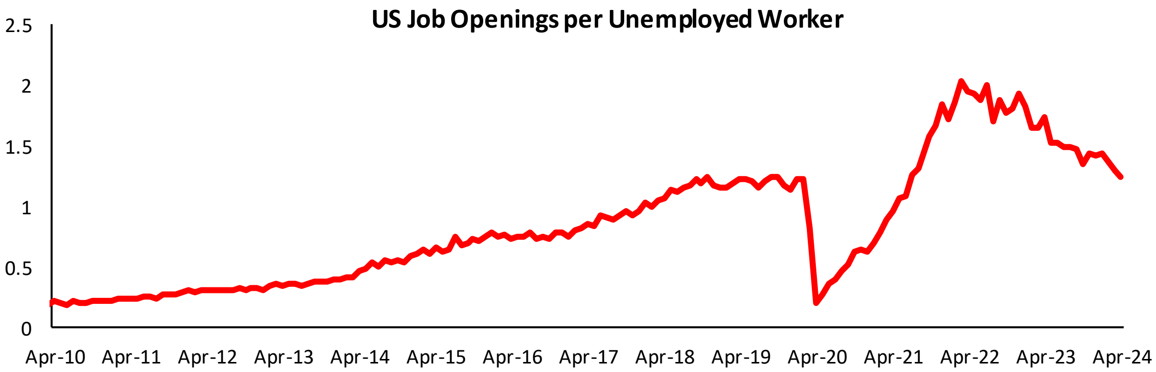
particularly with the ratio of vacancies to unemployed workers gradually moving back to 2019 levels.



Source: Chicago Fed, NFIB, OCBC.



Source: CEIC, OCBC.



Source: BLS, OCBC.

Disinflation is on track, but the last mile is tricky.

The disinflation momentum is largely intact despite several upside surprises to inflation data in 1Q24, with stubborn prices stemming mostly from core services categories. Inflation prints have clearly exhibited cooling, with the May core CPI weakening to 3.4% YoY from 3.6% YoY in April, marking the slowest pace since April 2021. Core CPI also eased to 0.2% MoM in May from a 0.3% MoM increase in April and core goods continued with its 12th consecutive month of deflation (excluding a blip in February 24). Core services eased to 0.2% MoM, far below the year-to-date average of 0.5%.

On contributions, however, core services still delivered the largest upside, adding 3.2ppts to annual headline CPI. Core PCE – the Fed's preferred inflation gauge, held steady at 2.8% YoY in April and eased only slightly over the month to 0.2% MoM (March: 0.3% MoM), mostly due to services inflation which added 2.7ppts to the annual figure.

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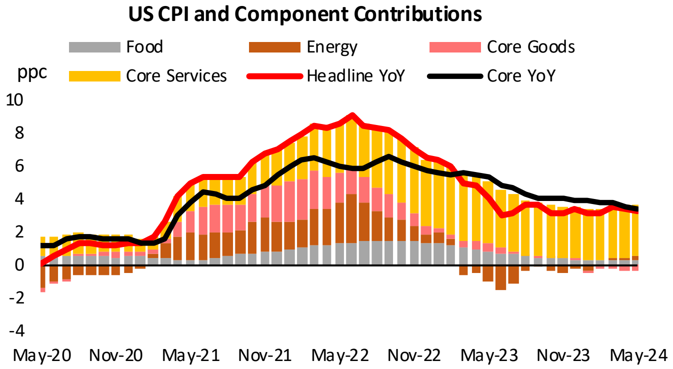
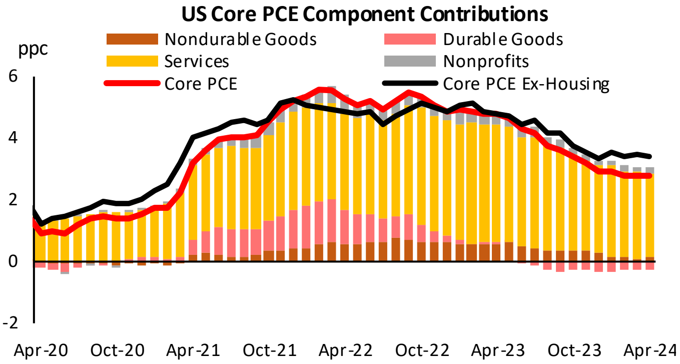


Source: Bloomberg, OCBC.

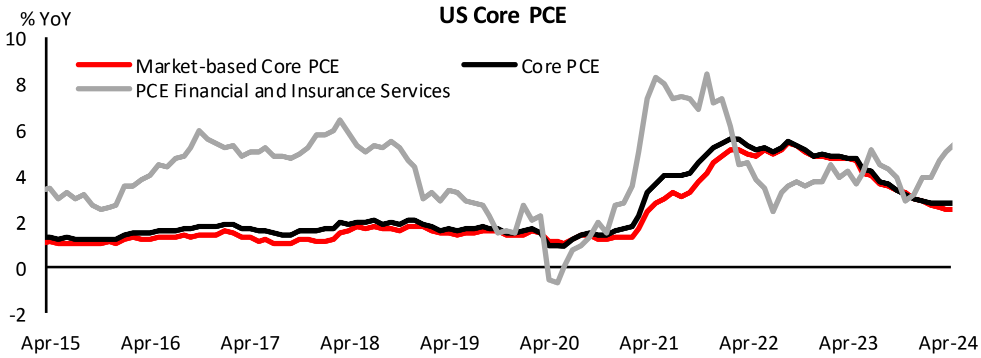


Source: Bloomberg, OCBC.

A deeper dive into the recent upswing in headline services components bears interesting insights.

Financial and insurance services rose the fastest within the PCE services category in Apr at 0.8% MoM, in line with the 1Q24 average. Most if not all the spending from financial and insurance services are 'imputed expenditures' which the BEA describes as "services furnished without payment"[2], i.e. where transactions are implicit and values are estimated, instead of directly measured.

Taking the BEA's "market based" PCE price index, which excludes imputed spending, we can observe actual out-of-pocket expenditures slowing but offset by rises in imputed categories.



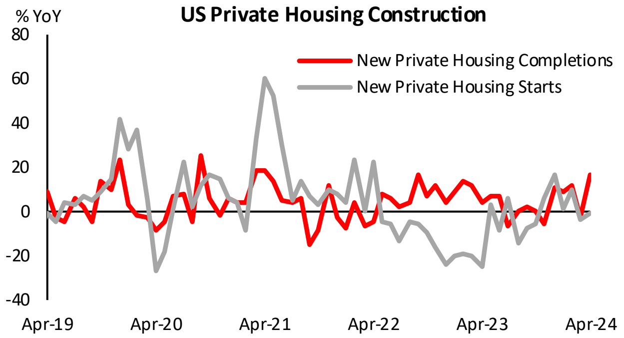
Source: BEA, OCBC.

Another source for sticky services in 1Q24 had been shelter, which rose 5.4% YoY (0.4% MoM) in May and added 1.9ppts to annual headline CPI. Although still at historically elevated levels, shelter inflation has moderated meaningfully from the high of 8.2% YoY in March 2023 with further room to ease. The current high mortgage rate environment has plausibly deterred existing homeowners from moving to new accommodation, while potential homebuyers may choose to rent instead in the interim.

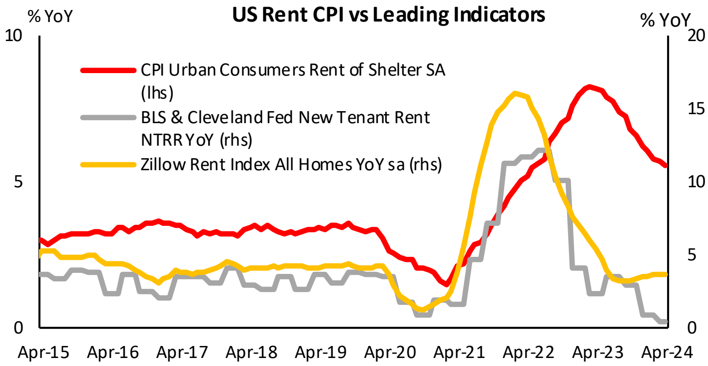
[2] What is the "market-based" PCE price index?, BEA, 6 December 2005.

United States

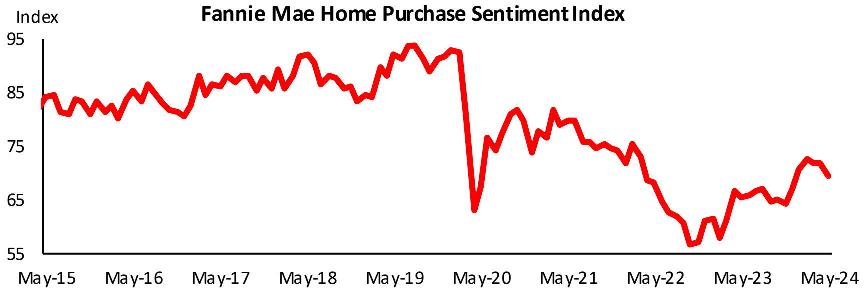
Housing inflation is set to dampen from more constructive supply conditions, with housing starts rebounding from the past year and completions 25% faster than in 2019 and 16% faster than in 2021-2022. On rents, we observe a marked slowdown since the post-pandemic jump, with leading indicators showing growth rates slowing to even below the pre-pandemic pace. Disinflationary momentum may also be picking up on the demand side, with homebuyers demonstrating signs of pullback given elevated mortgage rates. Homebuying sentiment is weakening, with the Fannie Mae Home Purchase Sentiment Index down to 69.4 in May (April: 71.9) and only 14% of consumers indicating a conducive purchasing environment (March: 20%).



Source: Bloomberg,



Source: Bloomberg, BLS, Zillow, OCBC.



Source: Bloomberg, OCBC.

The Fed is biding its time

Although the June FOMC dot plot showed Fed officials only expecting 1 cut in 2024 (from 3 cuts prior), Powell cautioned against reading the dot-plot scenarios as a definitive plan. He added that 15 of the 19 members backed either 1 or 2 cuts and that either option was "plausible". The accompanying FOMC statement also revealed a slight shift in tone on disinflation ("modest progress toward the Committee's 2% inflation objective" vs. "a lack of further progress"), and Powell's press conference highlighted that labour markets saw a "gradual moving toward better balance".

All-in-all, the trend of strong headline prints accompanied by softer underlying momentum will continue in 2H24. GDP growth may reach up to 2.4% this year, similar to 2023, notwithstanding a gradual moderation in 2H24. Barring new shocks to energy markets and/or supply chains, easing incoming inflation and a labour market rebalancing will provide the window for the data-dependent Fed to cut up to two times this year.

Euro Area

Euro Area: Green Shoots Amid Geopolitical Uncertainties

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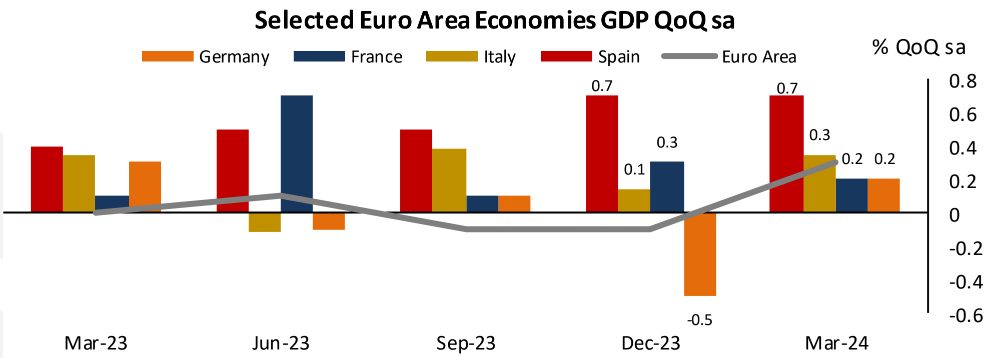
Assisted by
Hanif Ibrahim

- Stronger than expected 1Q24 growth has lifted 2024 growth prospects amid improving domestic and external demand. Domestic consumption is set to be the key driver as a tight labour market aids steady wage growth and a recovery in household incomes and is accompanied by waning inflationary pressures and monetary policy easing. The Euro Area is expected to expand 1.0% this year and accelerate further into 2025.
- Economic recovery is underway, albeit from a low base with the stagnation in 4Q23. Inflation is also expected to decline towards target by 2H25. This has given European Central Bank (ECB) the confidence to start cutting interest rates in June 2024. Our baseline continues to project 50bps of rate cuts in 2H24 despite the non-committal rate cut path and the ECB's increased inflation expectations in 2024 and 2025.
- The recent European Parliament elections, which were held from 6-9 June, saw right-wing gains and has contributed to some near-term uncertainties. While the European People's Party (EPP) won the majority with 189 of the 720 seats, the European Conservatives and Reformists Group (ECR) has gained 21 seats from the last election to 83 seats. France's Macron has called for a snap election amid heightened cost of living concerns.

Growth is on a rebound trajectory
The Euro Area staged a recovery in early 2024 as real GDP growth picked up 0.3% QoQ sa from -0.1% in 4Q23, beating market expectations of 0.2% and registering the fastest quarterly expansion since 3Q22. This marked an exit from a technical recession amid a challenging 2023, where activity was weak, and consumption restrained by the outpacing of inflation vis-à-vis labour income gains, in addition to the persistent fall-out from the Russia-Ukraine war.

The outlook has turned slightly more positive, with Germany and France recording firmer-than-expected expansions and southern Europe, namely Italy and Spain, leading the major economies on stronger growth. We expect the bloc's GDP growth to improve to 1.0% YoY in 2024, with a pickup in 2H24 owing to a gradual recovery in manufacturing and improved demand conditions.



Source: Eurostat, OCBC.

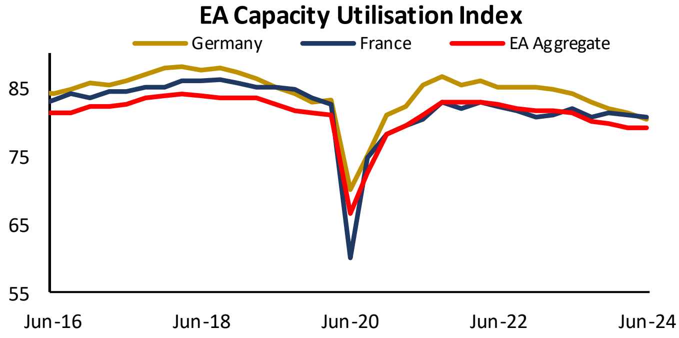
The outpacing of growth in southern Europe is likely to continue for the rest of 2024, given the post-pandemic tourism boost in the south and a slower

Euro Area

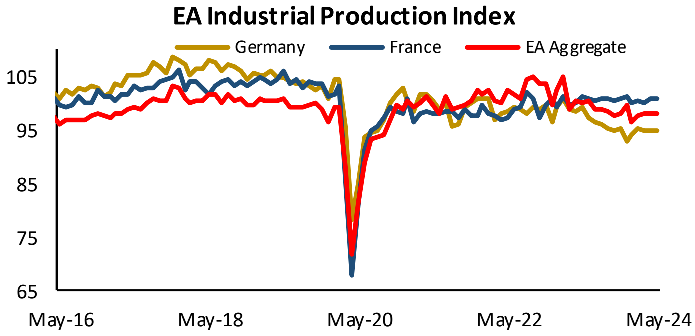
manufacturing recovery in the north. The EU Commission expects all Euro Area economies to return to expansion this year, as highlighted in its 2024 Spring Economic Forecast.

Manufacturing has room to run

Domestic activity remains lacklustre in the bloc's heavyweights - Germany and France, with factories still operating below normal capacity utilisation rates. Incoming data for 2Q24 has been mixed - Germany's industrial production in April fell by -0.1% MoM (Machr: -0.4%), weighed down by weak output in intermediate goods and construction. France, meanwhile, recorded an expansion of 0.5% MoM (March: -0.2%), the fastest in 5 months and driven by machinery and equipment manufacturing.

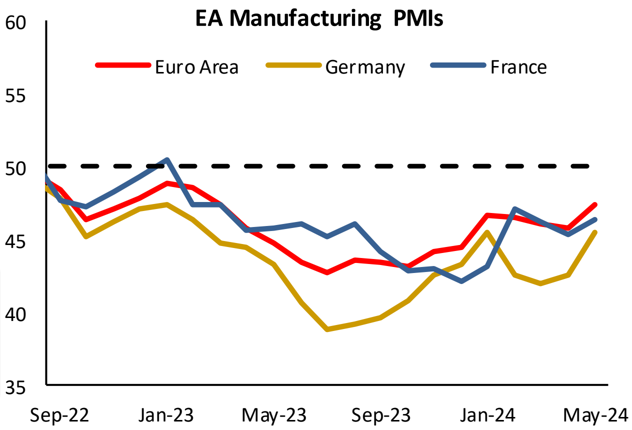


Source: Eurostat, OCBC.

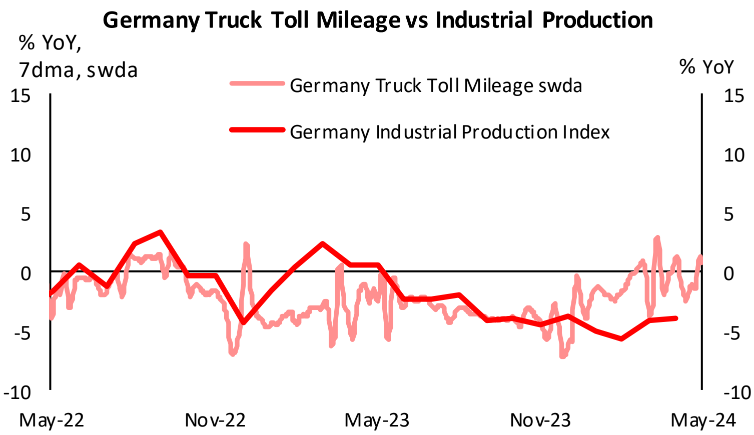


Source: Eurostat, OCBC.

A gradual, albeit tepid, recovery is already underway for manufacturing, with momentum for France looking firmer than Germany. Manufacturing PMIs for France, Germany and the Eurozone aggregate all posted improvements in May (though still below the 50-point threshold) while leading data suggests a German industrial production rebound is on the cards.



Source: Bloomberg, OCBC.

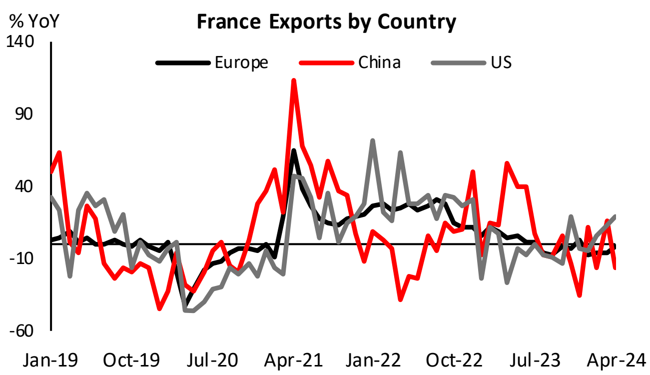


Source: Bloomberg, CEIC, OCBC.

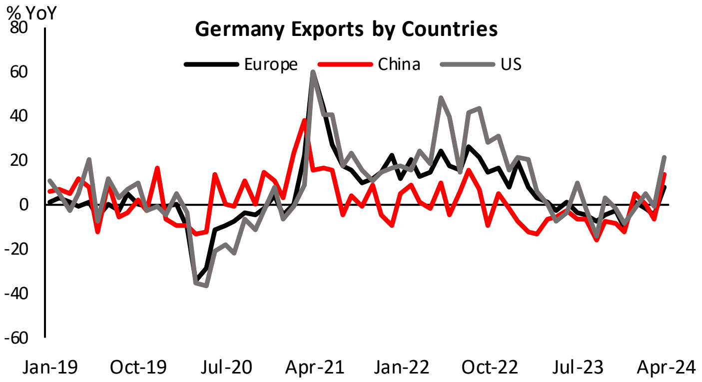
Euro Area

To be bolstered by external demand

Additionally, with still resilient growth in the US and relatively stable growth in China, external demand may improve for Euro Area industrial activity in the near-term. We already observe favourable movements for the external sector, with German export growth picking up to 12.3% YoY in April (15-month high) and French exports up by 9.5% YoY (a 10-month high). Furthermore, a sustained rebound in domestic activity within continental Europe would also bode well for intra-EU trade.



Source: CEIC, OCBC.

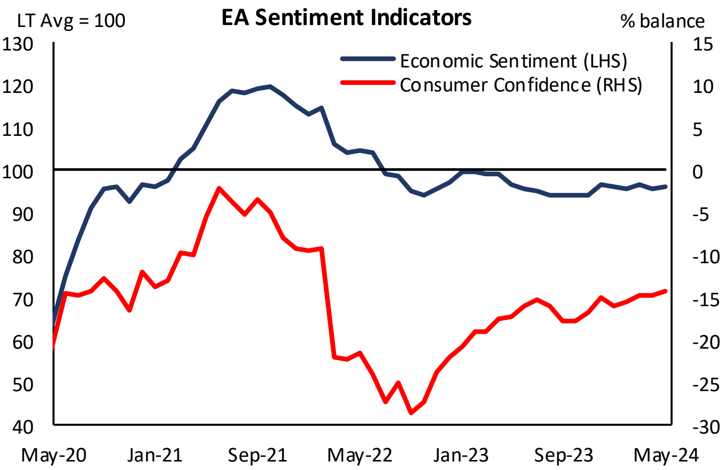


Source: CEIC, OCBC.

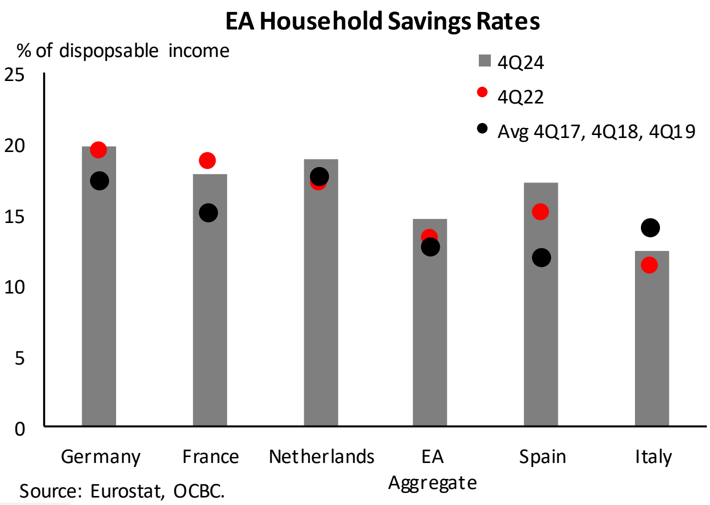
Anticipating a consumption rebound

Prospects for a post-pandemic rebound in private consumption have been dampened thus far by the concomitant climb of the household savings rate – currently running at above historical averages. Factors including the sharp rise in household deposit rates (owing to elevated policy rates) and fragility in consumer sentiment (from war-induced shocks and inflationary episodes of 2023) which have dampened consumption and constrained the bloc's recovery.

Looking ahead, the unwinding of past shocks should lead to improved confidence, and the gradual easing of policy rates this cycle should reverse the accumulation of household savings further into 2024.



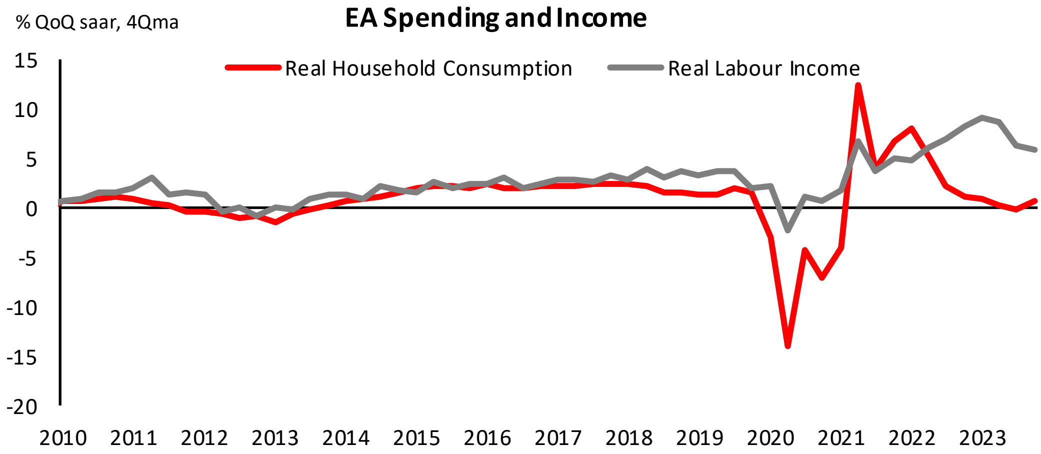
Source: Bloomberg, OCBC.



Source: Eurostat, OCBC.

Euro Area

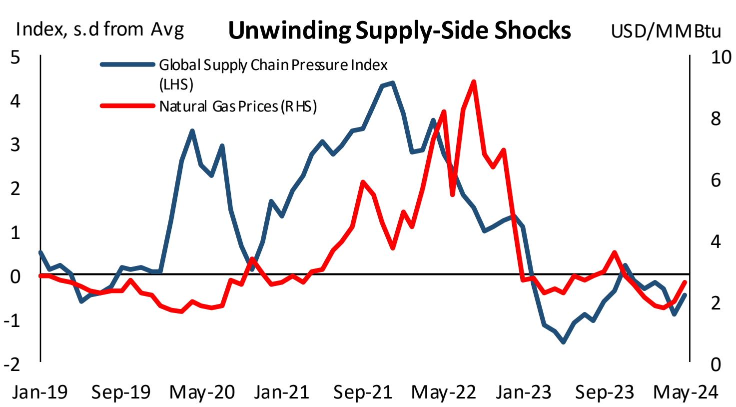
A gradual easing of price pressures, coupled with steady nominal wage growth, would be supportive of real incomes and constructive for the consumption outlook. Compensation per employee rose 5.1% YoY in 1Q24 (4Q23: 4.9%), while negotiated wage is up 4.7% YoY (4Q23: 4.5%).



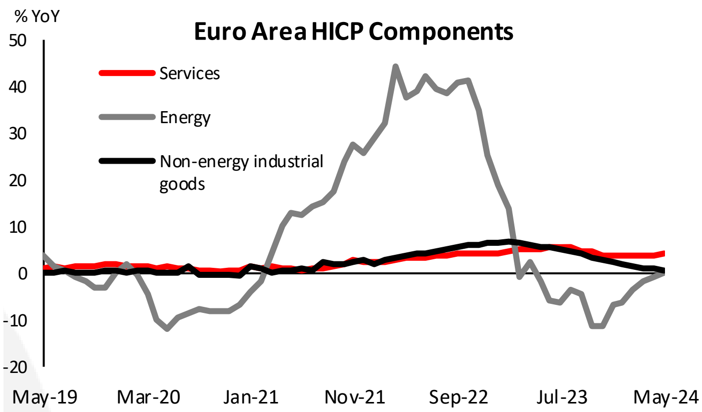
Source: Eurostat, OCBC.

Wage-inflation dynamics are manageable

Normalisation of supply-side shocks implies further easing will be contingent on core services disinflation. Core inflation reaccelerated in May at 2.9% YoY (April: 2.7%) but the overall downward trend is intact as its average of 3.0% for the first 5 months of 2024 remains a sharp step down from the 4.6% average in 2H23. The ECB was undeterred by the upside surprise in May HICP and delivered a 25bps cut at its June MPC. Barring fresh commodity price spikes or a rapid surge in wages, inflation is poised to move to around 2.5% as per latest ECB and European Commission forecasts.



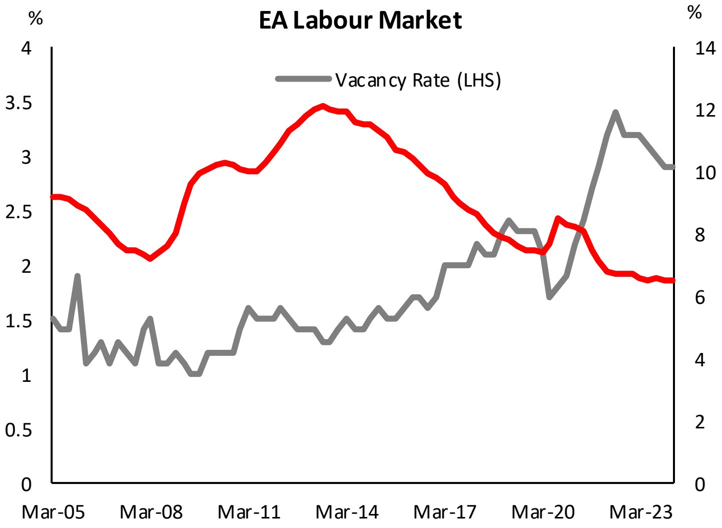
Source: Eurostat, OCBC.



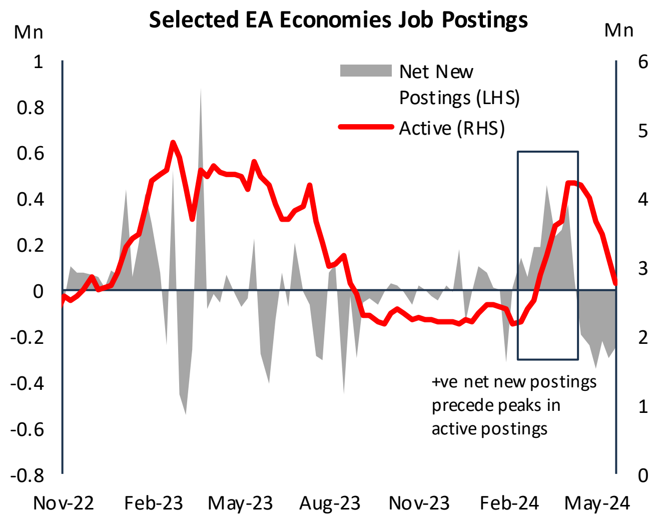
Source: Eurostat, OCBC.

With the disinflation progress on track, wage growth should not reaccelerate as workers temper pay demands. Although unemployment remains at historic lows, there are some signs that labour market tightness is past its peak with vacancies falling and job openings slowing down. Labour markets are expected to ease but remain solid enough to support real incomes and household spending amid slower inflation.

Euro Area



Source: Eurostat, OCBC.



Source: CEIC, OCBC. Selected economies incl. FR, GE, IT. SP.

Easing cycle is underway

The ECB initiated its easing cycle with a 25bps cut at the June MPC, consistent with prior communications. The press release highlighted that inflation is expected to "fluctuate around current levels" for the rest of 2024 and is "expected to decline towards our (ECB) target" by 2025. That said, Lagarde mentioned in her Q&A that the council will keep its restrictive stance "as long as necessary to bring inflation to 2% in a timely manner" and maintain its "meeting-by-meeting approach". The ECB has thus stopped short of committing to a particular rate path.

Our assessment of an incoming cooling of labour markets and fading energy price volatility would mean inflation and wage dynamics will be conducive for ECB confidence to carry on with easing. Our baseline remains for a cumulative 50bps in cuts for 2H24.

Near-term uncertainties post-European Parliament elections

The recent European Parliament elections, which were held from 6-9 June, saw right-wing gains and has contributed to some near-term uncertainties. While the European People's Party (EPP) won the majority with 189 of the 720 seats, the European Conservatives and Reformists Group (ECR) has gained 21 seats from the last election to 83 seats. France's Macron has called for a snap election on 9 June amid heightened cost of living concerns. The far-right National Rally is currently leading in the French polls although it does not have a majority. This has raised concerns of a potential hung parliament ahead of the two-round vote on 30 June and 7 July. According to the Economist, current polling trends suggest the likeliest outcome looks to be a hung parliament with either the hard right of hard left in a position to try and form a government. This in turn could see an attempt to reverse much of the economic agenda Mr Macron has pursued since 2017. Whatever the outcome, France may be in for some instability.

United Kingdom

United Kingdom: Watching Wages

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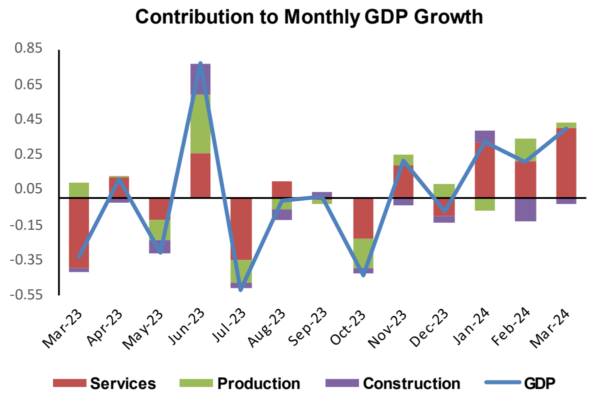
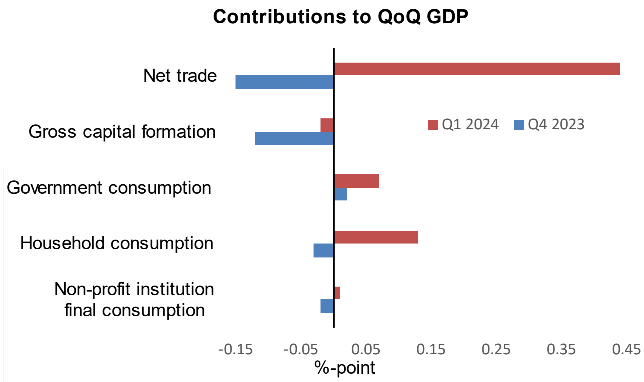
- GDP growth in 2H24 will be supported by household consumption, mirroring solid real wage growth, and gradual improvements in exports.
- Inflation is expected to hover around low levels, amid a combination of counteracting factors including lower energy price caps, resilient household spending and a potential pick-up in tourism spending.
- A benign inflation environment will allow the BoE to start cutting the policy rate. Our base-case is for a total of 50bps of cuts by end 2024, which still leaves the monetary policy environment restrictive.

Improving growth momentum
The economy expanded by 0.6% QoQ sa in 1Q24, according to preliminary estimates, after two consecutive quarter-on-quarter contractions. The services sector, which grew by 0.7%, contributed the most to 1Q24 GDP growth while the production sector expanded by 0.8%. This more than offset weaker construction output (- 0.9%), reflecting a decline in new work, and repair and maintenance. The extreme wet weather in February could have impacted the construction sector by delaying completion of projects.

On the expenditure side, net trade contributed 0.44%-point to overall QoQ growth in 1Q24, followed by household consumption which added 0.13%-point. Within household spending, the largest contributions to growth came from housing, water and fuels, recreation and culture, and restaurants and hotels.

Looking ahead, we expect GDP growth to be supported by household consumption, amid strong real wage growth, and better exports on gradual improvements in external demand. The downside to growth comes from risks to the global growth outlook and risk of persistently high interest rates.





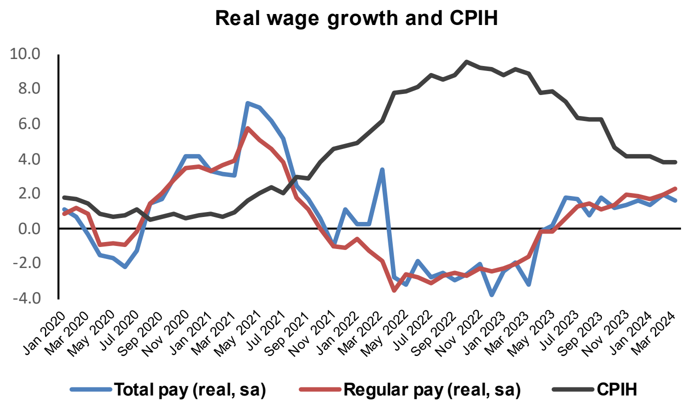
Source: ONS, OCBC

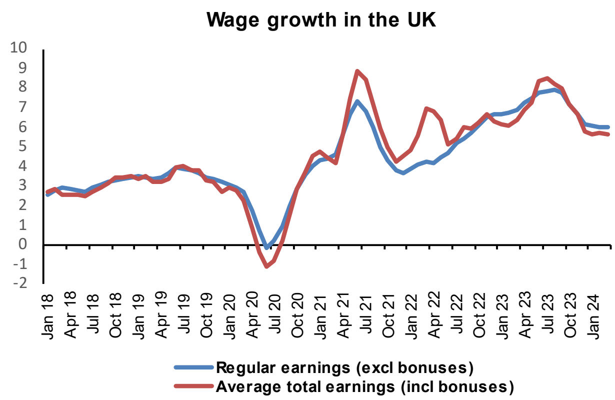
The recent improvements in household consumption are likely to hold up and extend into 2H24, riding on real wage growth. In 1Q24, annual growth in regular earnings was 6% while annual growth in real terms was 2%. The 2024 National

United Kingdom

Living Wage (NLW), which came into effect in April 2024, also saw a 10% increase in cash terms over the 2023 NLW.

In May, BoE has forecasted that annual wage growth would likely remain around 5.25% by the end of the year. This comes at a time when the government has cut taxes again. The main rate of employee National Insurance Contributions (NICs) was lowered from 10% to 8% starting from 6 April, as announced in the Spring Budget 2024. This translates to an increase in disposable income and purchasing power for most families, which can help drive household consumption. As inflation continues to ease and real wages continue to rise, we anticipate that the contribution of household consumption to overall GDP growth will increase in 2H24.





Source: ONS, Bloomberg, OCBC

For 1Q24, the net contribution from trade to GDP resulted from imports falling more rapidly than exports. Looking ahead, exports are likely to gradually recover amid a supportive external environment. According to BoE's *Agents' Summary of Business Conditions*, contacts expected to see modest positive growth in export volumes during 2H24 and expect the growth in the value of export services to continue. By markets, the Eurozone, United States and Developing Asia were the three largest trading partners of the UK.

	% of Total Trade in 2023	% of UK Exports in 2023	% of UK Imports in 2023
Eurozone	45.69	41.73	47.99
United States	11.9	15.28	9.93
Developing Asia	11.9	8.64	13.79

For the Eurozone, we expect the bloc's economy to expand by 1.0% in 2024, with a pick-up in growth in 2H24. Likewise, this is likely to translate into greater demand for UK exports in the second half. Cars topped UK's total goods exports by value (and top those to the Eurozone) in the 12 months to March 2024 as the demand for cars has traditionally been pro-cyclical. Should our expectation for inflation to ease over the coming months in the Eurozone pan out, there will be a further recovery in consumer confidence in the region, supporting the demand for products such as cars.

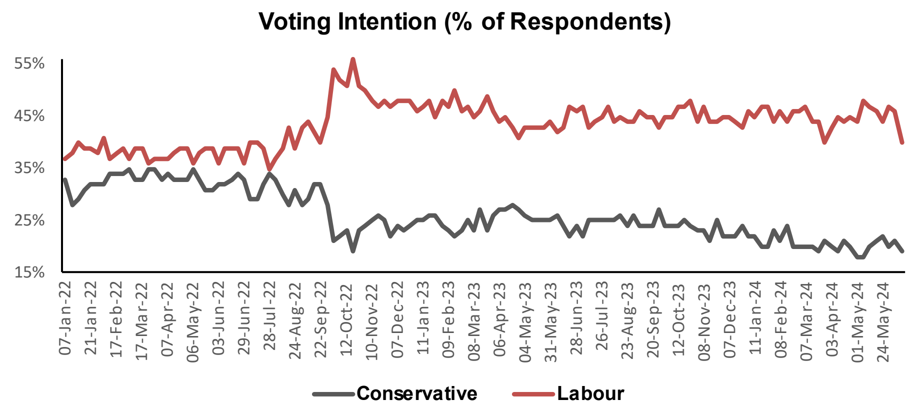
United Kingdom

Meanwhile, large-scale sporting events in the region such as the Paris Olympics and Euro 2024 taking place in 3Q24 could also lead to tourism spillover effect for the UK. There has also been a rise in air travel demand in the summer months, credited to the Eras Tour taking place in Europe, including 15 shows across the UK across 3 months. The tour is likely to drive domestic tourism and boost domestic spending while also giving a boost to UK's tourism sector as fans across Europe and the US fly in for a chance to watch their favourite act.

Regarding other major exports markets, we expect the US economy to grow by 2.4% this year, and the Asian economies we monitor shall also exhibit decent growth on the basis of resilient domestic demand, recovery of the tourism sector and the prospect of China growth stabilising. As these markets collectively account for almost a quarter of UK's total exports in 2023, stable growth in these regions may similarly lend support to UK exports.

Assumption of policy continuity

When voters in the UK head to polls on 4th July, the economy will be one of the key issues at the top of their minds. According to a YouGov poll from June 2024, 52% of surveyed voters had picked the state of the UK economy as one of the top three "most important issues facing the country". The amount of concern on the economy is not surprising given that the UK had just emerged from a technical recession in 2023. It is hence even less surprising that promises to reignite growth have been a hot topic in the general election campaign for the two leading parties, Labour and Conservative.



Source: YouGov, OCBC

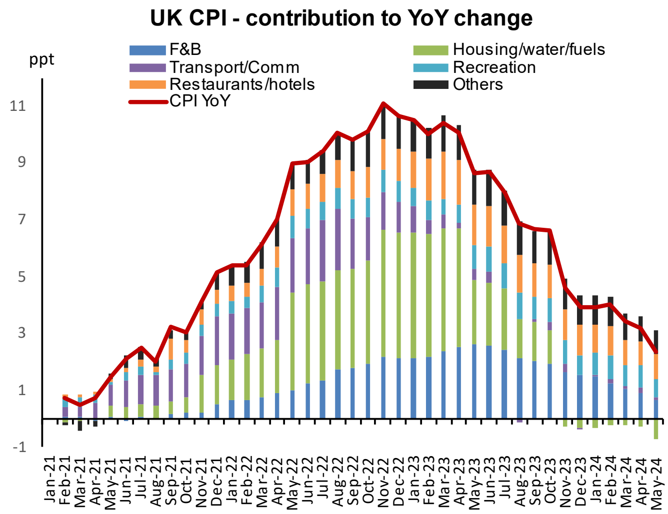
The Labour party, led by Keir Starmer, is currently leading in surveys, and has campaigned on the promise to make UK the fastest growing G7 economy. For context, the OECD forecasted UK to be the worst performing G7 economy in 2024 on the premise of high interest rates and restrictive fiscal policies that are likely to hinder medium to long term growth. The UK has also lagged other G7 nations since the pandemic. Sunak, on the other hand, has called for the snap election hoping "to build on the progress" his party has made, which can loosely be interpreted as the improvements in Q1 growth and falling inflation, among other things.

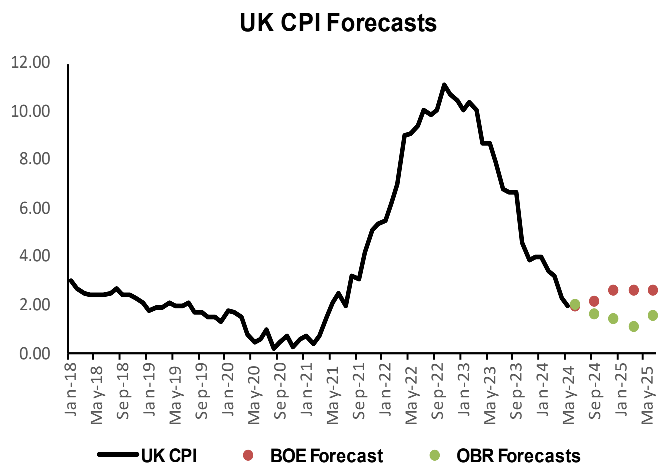
United Kingdom

Our assumption is that there will be policy continuity, including in terms of fiscal policy. Total financing needs for fiscal year 2024-25 has been revised upward to GBP277.7bn in the April update, from an earlier estimate of GBP265.3bn, as a net result of measures including reduction in rates of NICs, reform of non-domicile regime, introduction of new taxes and other revenue raising measures. Over the medium-term, the target for fiscal consolidation is likely to remain in place.

Inflation to hover at low levels

In May, CPI rose by 2.0%YoY, the slowest since September 2021. The deceleration was largely attributed to falling gas and electricity prices under Office of Gas and Electricity Markets (Ofgem) energy price cap. This trend is likely to continue, given that Ofgem's energy price cap is set to fall further by an average of 7% in 3Q24, compared to 2Q24.





Source: CEIC, Bloomberg, OBR, BoE, OCBC

As we approach 2H24, the Office for Budget Responsibility (OBR) forecasts headline inflation to ease to 1.645% YoY in 3Q24 and further to 1.445% in 4Q24. OBR based their forecasts on lowered energy prices, the continuation of the freeze in fuel duty for another 12 months as announced at this year's Spring Budget and increasing space capacity in the economy. The BoE, however, forecasts inflation will pick up again in the 2H, reasoning that energy price inflation is likely to be less negative due to base effects.

Services CPI inflation is sticky at current levels, having eased marginally in the recent couple of months, printing 5.7%YoY in May. Forward looking indicators including prices components under PMI surveys point towards softer services CPI inflation in the period ahead. Counteracting this would be wage growth. Wages makes up a significant portion of the service industry's costs. Wages (excluding bonuses) grew by an annual 6% on average in 1Q24 and the living wage hike effective April this year was 9.8%. On balance, service inflation is still likely to ease in the coming months, but at a slow pace.

United Kingdom

GBP and BoE outlook

Our base-case is for the BoE to deliver two 25bp policy rate cuts this year, one in 3Q24 and one in 4Q24. After these expected policy rate cuts, the monetary environment will still be restrictive.

We maintain a modest upward trajectory for GBP. Though BoE may soon cut rates in August, we do not expect aggressive rate cuts within this year and still expect BoE to keep monetary policy restrictive overall as inflationary pressures remain.

Additionally, a combination of positive factors including resilient UK demand amid a strong labour market may keep GBP supported on dips. However, there are risks to our outlook, including the possibility of an aggressive rate cut cycle, a faster slowdown in UK economic growth, worse-than-expected public finances, or a surge in energy prices due to geopolitics.

Singapore

Singapore: A Time of Transition

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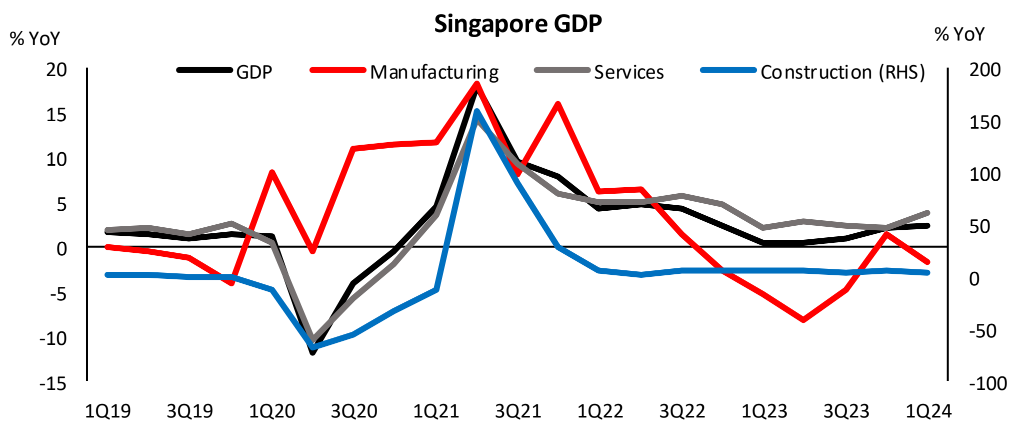
- The economy grew by 2.7% YoY in 1Q24 and is on track for full-year growth of around 2% for 2024. The key risks are the external demand environment, especially the manufacturing and electronics recovery, as well as geopolitical tensions.
- MAS is currently on pause mode. Given that core inflation will only step down more significantly in 4Q24, MAS may keep S$NEER policy settings unchanged at the July meeting and likely the October meeting as well.
- Hiring intentions remain relatively stable, which suggest that any uptick in unemployment rates should be well-controlled.

The economy grew by 2.7% YoY in 1Q24, an improvement over the 2.2% seen in 4Q23. However, sequentially, it was a very muted 0.1% QoQ seasonally adjusted pickup from the previous quarter. From a sectoral perspective, manufacturing remained on the backburner with an 18% YoY contraction, weighed down by the biomedical, electronics and general manufacturing clusters amid an uncertain external demand environment. In contrast, the construction sector extended the 5.2% YoY expansion in 4Q23 to chalk up 4.1% YoY in 1Q24, as the pickup in public construction activities more than offset the private sector slowdown. Over in the services sector, growth momentum was led by the finance & insurance (amid a surge in banking and fund management activities), transportation & storage sector (particularly the air and water transport segments), and wholesale trade sectors. The information & communications, accommodation (due to the strong recovery in international visitor arrivals) and the retail sectors also grew in 1Q24. Notably, the total number of air passengers handled at Changi Airport in 1Q24 has exceeded its pre-Covid level, while the container throughput and sea cargo handled at Singapore's ports also improved.



Source: Singstat, OCBC

With 1Q24 off to a good start, there was no change to the official 2024 growth forecast of 1-3% YoY or our house forecast of around 2% YoY. The MTI outlook also sounded a tad more upbeat, citing stronger-than-expected 1Q24 GDP growth in both the US and China. More importantly, MTI still expects manufacturing and trade-related sectors to gradually pickup over the course of the year, aided by the electronics industry recovery due to support from demand for semiconductors

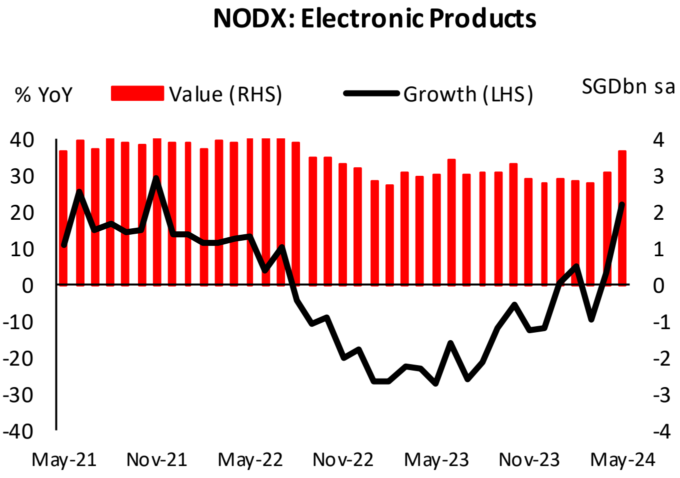
Singapore

including end-markets for smartphones, PCs and AI, which in turn should have positive spinoffs into the precision engineering, machinery, equipment & supplies segments of the wholesale trade sector. In addition, the capacity expansions into sustainable aviation fuel will also benefit the chemicals cluster. In the services sector, while the domestic labour market is tipped to cool modestly, the stronger-than-expected air travel and tourism-related demand for accommodation and other consumer-facing goods and services should be beneficial also to the banking payments channels. The anticipated global monetary policy easing cycle should also support the banking and fund management fees and commissions.

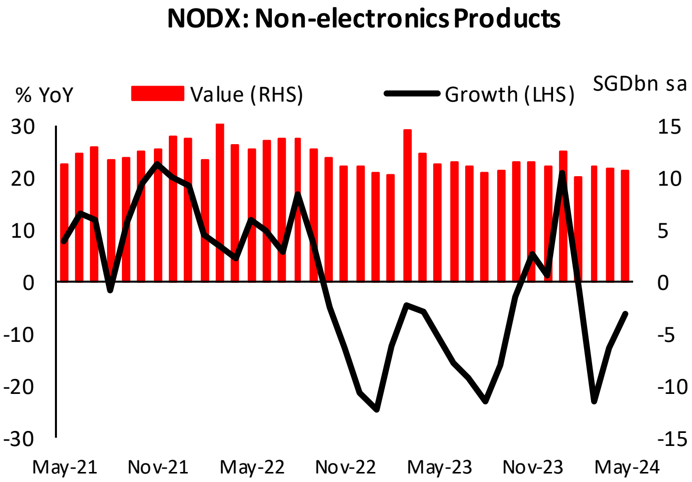
While the usual caveat of downside risks applies, the litany of risks has also evolved somewhat from the statement three months ago which centred around geopolitics, lagged effects of monetary policy tightening and idiosyncratic cost shocks (e.g. adverse weather events). At this juncture, apart from geopolitics which remain front and centre on the risk horizon, the other two cited downside risks were disruptions to global disinflation leading to a high-for-longer interest rate environment and vulnerabilities in emerging markets due to the wide desynchronisation of monetary policy cycles with developed markets contributing to volatility of capital flows and currency fluctuations.

The official 2024 total trade and NODX growth forecasts by Enterprise Singapore were both also maintained at 4-6% YoY, but with downside risks for the NODX forecast which could come in at the lower range of 4-6% due to the weaker-than-expected 1Q24 performance at -3.4% YoY (4Q23: -3.4%). Notwithstanding this, there will be anticipated NODX support from the electronics recovery in 2H24, aided by consumer devices and AI servers, whilst the total trade outlook is cautiously optimistic following higher expected oil prices. Supporting factors included the forecast improvement of global semiconductor revenue at 17.4% YoY in 2024 (versus 2023's -11.7%) by Gartner, as well as the IMF and WTO's 2024 forecast of global growth and global merchandise trade at 3.2% and 2.6% respectively. Our NODX prognosis is that things should gradually improve in 2H24 on the back of an improvement in the electronics sector and if China's GDP growth stabilises. Given that NODX has declined by 4.0% YoY year-to-May, the full-year performance may come in at the lower end of our 2024 NODX forecast of 4-6%.

Singapore

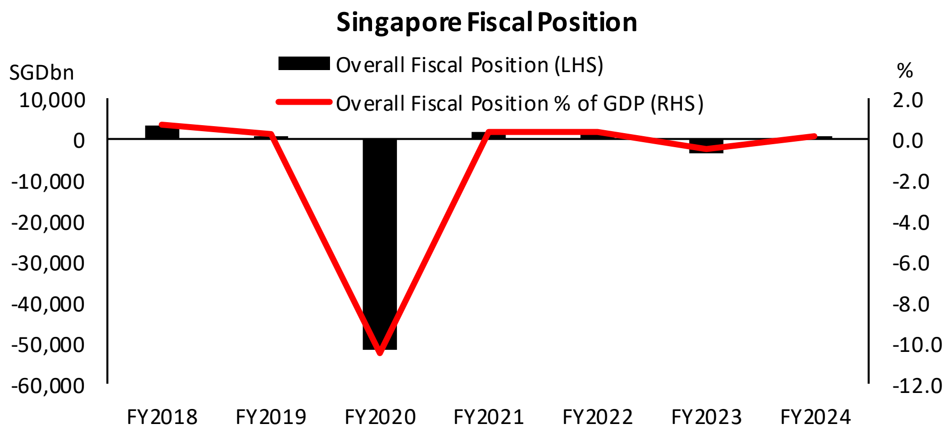


Source: DOS, OCBC



Source: DOS, OCBC

For fiscal policy, the FY2023 fiscal outturn was a slightly bigger deficit of S$3.6bn (0.5% of GDP) despite buoyant corporate income tax due partly to the S$7.5bn top up to the Majulah Package Fund. Budget 2024 unveiled a roughly balanced budget with a modest surplus of S$0.8bn (0.1% of GDP). Managing costs for households and businesses received much airtime while not forgetting the need for longer-term economic priorities in a violent, fragmented and messy world. Enhancements to the Assurance Package costing S$1.9bn, S$1.3bn for the Enterprise Support Package, and a S$2bn top up to the National Productivity Fund were some of the key thrusts announced in Budget 2024. While there is a clear 2-3% growth target set for the next decade, Budget 2024 was a S$131bn plan to build a shared future together rather than targeting "growth at all costs".



Source: MOF, OCBC. Note: FY2024 reflects MOF estimates

Budget 2024 also pushed ahead with the BEPS2.0 Pillar 2, with an implementation target date set for January 2025. The roadmap for implementation will include the Domestic Top-up Tax as well as Income Inclusion and Undertaxed Profits Rules.

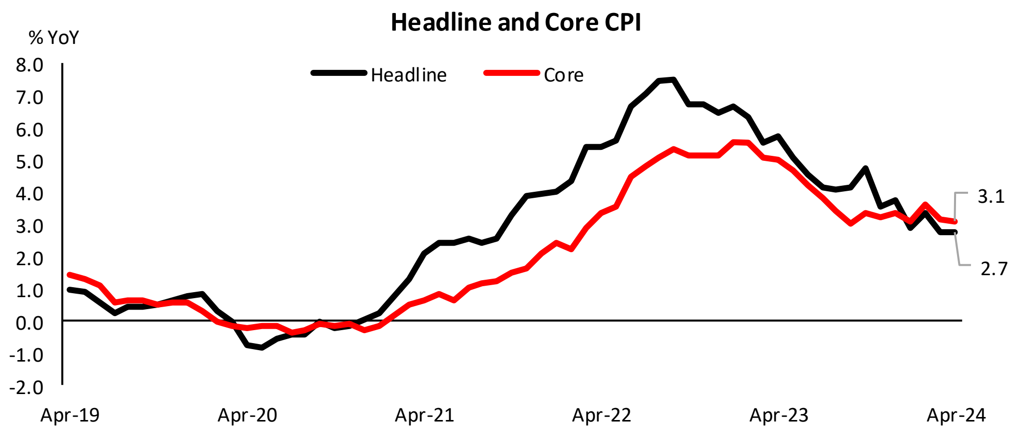
Singapore

BEPS2.0 Pillar 2	
Tax/Rule	**Key Details**
Income Inclusion Rule (IIR)	Domestic Top-up Tax (DTT): Overseas profits of MNEs parented in Singapore subject to a minimum effective tax rate (METR) of 15%.
Domestic Top-up Tax (DTT)	Singapore profits of MNEs operating in the country will also be subject to the 15% METR.
Undertax Profits Rule (UTPR)	For subsidiaries of MNEs where home country of the parent company does not apply its own IIR, additional tax will be imposed on outbound payments of the subsidiary. UTPR to be considered at a later time.

Source: Ministry of Finance, Budget 2024

For monetary policy, MAS is currently on pause mode. With the switch to quarterly meetings, the decision was to keep the S$NEER policy settings unchanged at both the January and April reviews this year. The domestic labour market remains resilient, but employment growth had cooled to 9.8k in 1Q24, down from 11.6k in 4Q24 and 106.2k for full-year 2023. Headline CPI rose a more subdued 3.0% YoY in 1Q24, compared to 4.0% in 4Q23.

In the latest prints, headline inflation reaccelerated to 3.1% YoY (0.7% MoM nsa) in May, up from 2.7% YoY where it had been for both March and April 2024. This marked the highest YoY print since 3.4% YoY in February, and was largely due to higher private transport inflation, as prices of cars and motorcycles rose and petrol prices also increased at a faster pace. Other segments like recreation & culture (5.0% YoY, mainly supported by holiday expenses which rose 6.3%) and healthcare (4.8% YoY, mainly driven by hospital services, health insurance and outpatient services) remained important drivers of headline inflation. Food inflation, on the other hand, was unchanged at 2.8% amid stable food services inflation, whereas accommodation costs also eased slightly to 3.4% YoY as housing rents moderated its pace of increase. Within the food category, food excluding food serving services have eased to 0.8% YoY in May (compared to January-May average of 1.5% YoY), but food serving services is still running at 3.8% YoY (similar to the 3.9% for January-May).



Source: Singstat, OCBC

Core CPI in May was unchanged at 3.1% YoY for the third straight month, bringing the first five months to 3.2% YoY. Compared to April 2024, core CPI rose a muted

Singapore

0.1% MoM. On balance, the higher services inflation (due to more expensive holiday expenses and also a smaller fall in airfares) was offset by lower electricity & gas (6.9% YoY versus 7.6% previously given a smaller increase in electricity price) and retail & other goods inflation (1.5% YoY versus 1.6% previously amid a slower increase in personal effects and alcoholic beverages & tobacco).

There is no change to the official 2024 headline and core inflation forecasts of 2.5-3.5%. MAS-MTI's view remains that imported intermediate and final manufactured goods have also continued on a broad decline and the gradually strengthening S$ trade-weighted exchange rate will temper imported inflation in the coming months. Meanwhile, the cooling domestic labour market conditions should weigh on unit labour costs, albeit businesses are likely to continue to pass on earlier cumulative cost increases to consumer prices at a reduced pace. Therefore, MAS core inflation is still tipped to gradually moderate over the course of the year and step down more discernibly in 4Q24. In addition, private road transport inflation is likely to benefit from the larger COE supply, while accommodation inflation will also see greater rental housing supply improve. There is also no change to the two-sided inflation risks perceived – upside price risks from fresh geopolitical shocks, adverse weather events and further supply chain disruptions on global energy, commodity and shipping costs, as well as stronger-than-expected domestic labour demand prompting a re-acceleration in wage growth. Conversely, if the global soft-landing scenario does not pan out, the risk is for a greater easing of cost and price pressures.

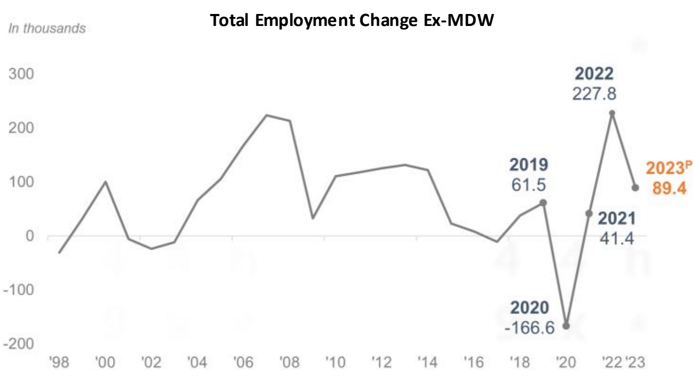
At this juncture, the last mile disinflation trajectory remains somewhat bumpy but is not unique to Singapore. With headline and core inflation running at 3.0% and 3.2% YoY respectively, there is room for both to step down below the 3% handle in coming months to average 2.8% and 3.0% for the full-year 2024. Major central banks are also data-dependent and watching the inflation developments closely and prioritizing inflation compared to growth, which appears to be relatively stable for now. For instance, the ECB and SNB have started to cut its policy rates, whilst the BOE is sending dovish signals, and others like the US Fed is still in wait-and-see mode but pencilling in one cut this year followed by four cuts in 2025 and another four cuts in 2026 according to the recent dots plot. For the MAS, the bar to further monetary policy tightening is relatively high, while the time for an easing may also be some time away given the downward sticky core inflation prints. Our baseline view is no change to MAS' monetary policy stance for the July meeting and likely the October meeting as well.

Singapore's labour market remains very stable despite expectations that it will cool modestly for the rest of 2024. Total employment cooled in 4Q23 but still marked its 9th consecutive quarter of expansion at 8,400. Resident employment growth was focus in domestic-related services like Health & Social Services and Public Administration & Education, while festive season in 4Q also gave a boost to seasonal hiring. The overall unemployment rate remained low and stable at 2.0% (resident: 2.8% and citizen: 2.9%). Retrenchments also moderated from 4,110 in 3Q23 to 3,200 in 4Q23. This brought the full-year 2023 retrenchments to more than double the record-low of 6,440 in 2023 to 14,320, largely attributable to business reorganisation or restructuring. More importantly, the re-entry rates for those

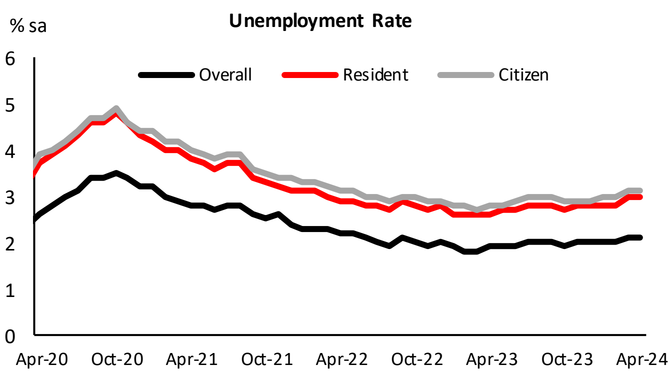
Singapore

retrenched suggest that a majority find new employment within six months ie not a structural long-term unemployment issue.

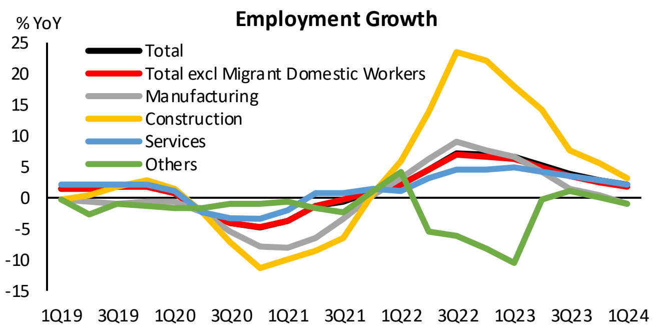
Looking ahead, employers' intention to hire remain stable, with 47.7% intending to hire in the next three months (previously 42.8%) and the intention to raise wages also rose to 32.6% (previously 18.0%). This suggests that GDP growth prospects and in turn labour demand conditions should remain supported this year, despite challenging external headwinds from a high-for-longer global interest rate environment and a soft Chinese economy in addition to geopolitics. While the anticipated domestic labour market cooling has been well-telegraphed, a sharp surge in retrenchments or the unemployment rate is not expected, and any uptick should be well-controlled.



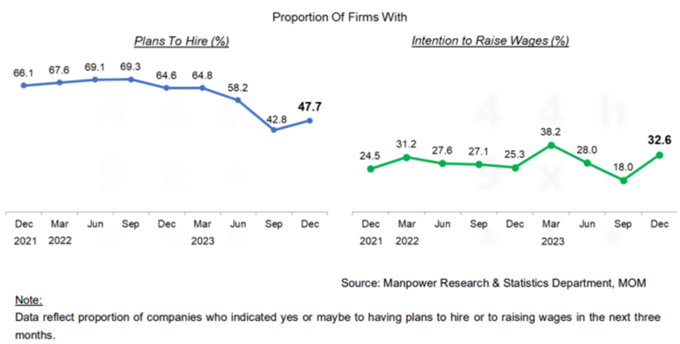
Source: MOM.



Source: MOM, CEIC, OCBC



Source: MOM, CEIC, OCBC

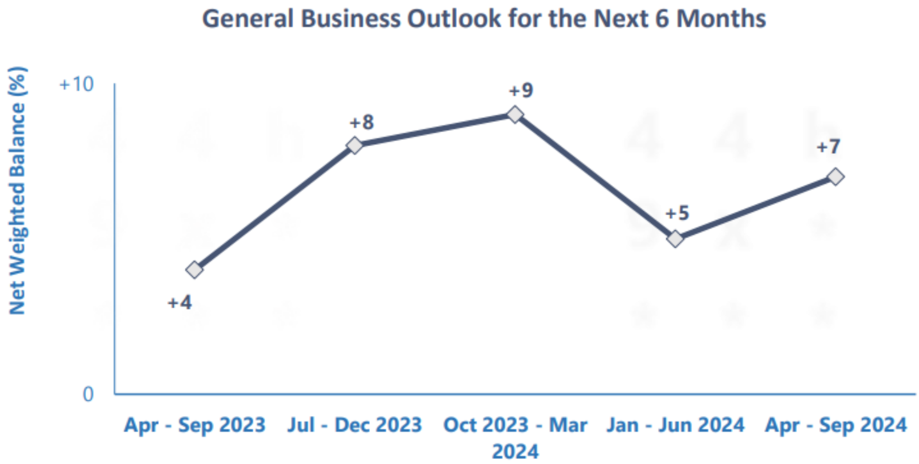


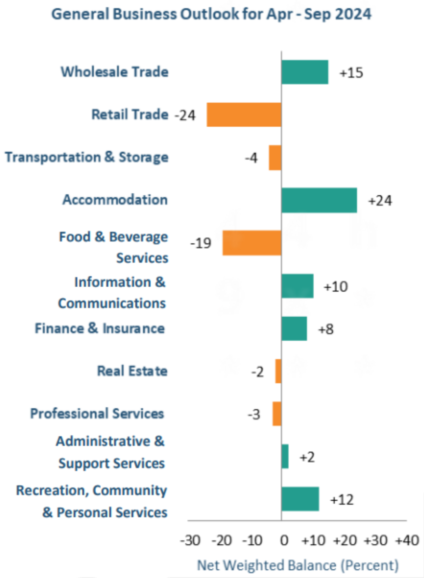
Source: MOM.

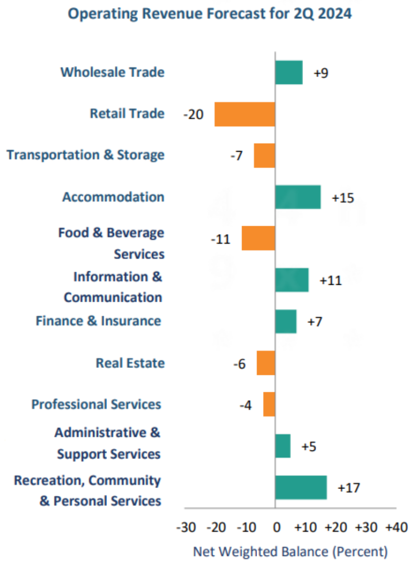
The latest business expectations survey suggests that a net 7% of services firms tip a more upbeat business outlook for the six months from April – September 2024, which is up from 5% three months ago. Within services, the most positive firms were in Accommodation (+24% due to expected increased occupancy rates amid the various MICE events and the F1 in September), Wholesale Trade (+15% amid anticipated higher demand for AI-related computers), Recreation, Community & Personal Services (+12%, attributable to an anticipated uptick in foreign patients and new childcare centre openings) and Information & Communications (+10%). In contrast, the most bearish services industries were in Retail Trade (-24%) and Food & Beverage Services (-19%) given fewer festive periods compared to the last six months as well as possible post-concert fatigue.

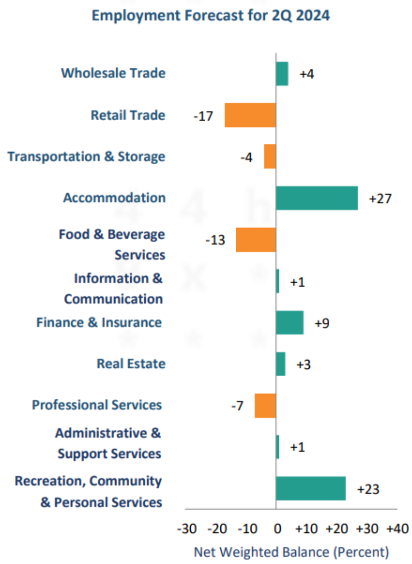
Singapore

In terms of hiring intentions, a net 3% of services firms plan to increase headcount, led by the Accommodation (+27% amid improved expectations of leisure and business travellers) and Recreation, Community & Personal Services (+23% given higher demand by healthcare and childcare services).









For the manufacturing firms, a net 25% anticipate business prospects to improve in the next six months despite the challenging geopolitical headwinds. The optimism was led by the electronics cluster (+40%), namely the semiconductors (+46%) as well as the other electronics modules & components (+26%), whereas the mood for infocomms & consumer electronics (0%) and computer peripherals & data storage (+3%) was more subdued. Specifically, the improved demand in consumer electronics devices and AI-server demand is tipped to boost demand for memory, storage and networking chips. Outside of electronics, the transport engineering cluster (+18%) was again buoyed by the marine & offshore engineering (+31%), followed by the aerospace (+12%) industries, whereas the biomedical manufacturing (+1%) remained very cautious, especially for the pharmaceuticals (+2%) and medical technology (0%). The latter suggested that the recent

Singapore

biomedical/pharmaceutical weakness seen in the March industrial production data may persist in the near-term.

The manufacturing cluster is also unlikely to be the key driver of job creation in the next two quarters as hiring intentions is very weak at -2%. In particular, the employment numbers is being weighed down by electronics (-5%), biomedical (-3%) and general manufacturing industries (-9% given high operating cost concerns). Interestingly, the new order book is mainly driven by direct export orders for electronics (+18% versus local sales of -10%), whereas the reverse is true for biomedical (-25% versus local sales of -2%). Among the top challenges faced by manufacturing firms to obtain export orders in 2Q24, the top two limiting factors cited were international price competition and external conditions such as geopolitical tensions and inflationary pressures. Fascinatingly, the high interest rate environment does not feature prominently. In addition, 52% of manufacturers plan to invest in plant and machinery over the 12-month period from April 2024 to March 2025, with 40% tipping a similar or higher capital expenditure, mostly to replace equipment or install new production technology.

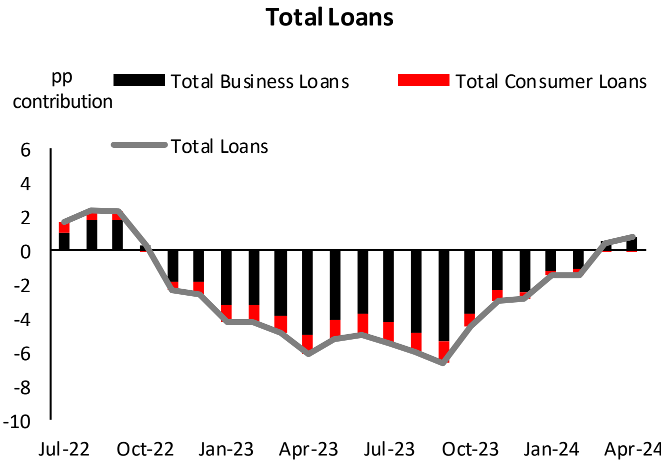
Singapore

Industry	General Business Outlook for for April – September 2024 compared with January – March 2024			
	Net Weighted Balance	Up	Same	Down
Electronics	+40	42	56	2
Semiconductors	+46	48	50	2
Computer Peripherals & Data Storage	+3	3	97	0
Infocomms & Consumer Electronics	0	0	100	0
Other Electronic Modules & Components	+26	35	56	9
Chemicals	+2	4	94	2
Petroleum	0	0	100	0
Petrochemicals	-3	0	97	3
Specialties	0	2	96	2
Other Chemicals	+24	24	76	0
Biomedical Manufacturing	+1	1	99	0
Pharmaceuticals	+2	2	98	0
Medical Technology	0	0	100	0
Precision Engineering	+10	14	82	4
Machinery & Systems	+10	11	88	1
Precision Modules & Components	+9	24	61	15
Transport Engineering	+18	18	82	0
Marine & Offshore Engineering	+31	32	67	1
Aerospace	+12	12	88	0
Land	0	0	100	0
General Manufacturing Industries	+10	25	60	15
Food, Beverages & Tobacco	+33	37	59	4
Printing	-68	0	32	68
Miscellaneous	-7	14	65	21
Total All Industries	+22	25	72	3

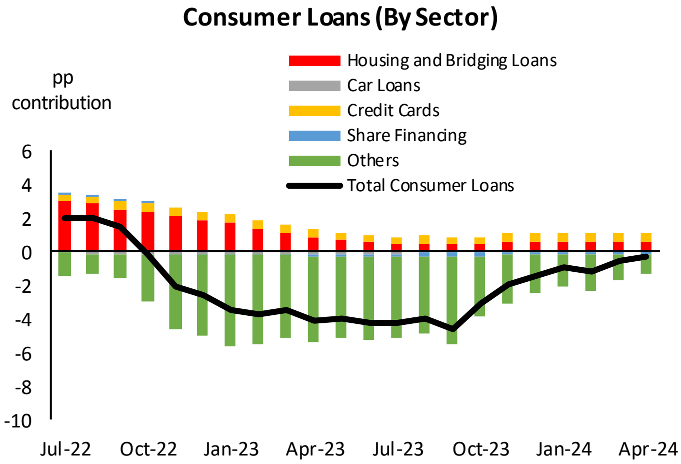
Source: MoM, Singstat, EDB

Singapore

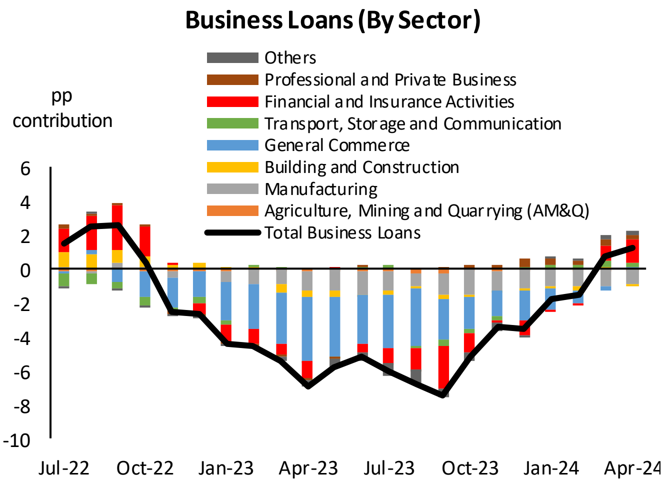
Singapore's loan growth has been muted for the year to date but is generally in line with the overall GDP growth. Business loans have been steadily improving despite the external economic and geopolitical uncertainties whilst consumer loans saw a more tepid performance. The domestic interest rate environment will continue to take the cue from the global interest rate trajectory and MAS' monetary policy stance to contain imported inflation. Meanwhile, the property market has been weighed down by the various cooling measures, with the ABSD hitting the CCR properties harder.



Source: MAS, CEIC, OCBC



Source: MAS, CEIC, OCBC



Source: MAS, CEIC, OCBC

On balance, Singapore's economy is on track for 2% growth in 2024 with 2H24 likely to usher in a gradual recovery in the manufacturing and trade-oriented sectors. The political transition to a new Prime Minister also proceeded smoothly on 15 May 2024. However, as an open economy, the external economic uncertainties and challenges remain very real. Domestic policy issues like cost-of-living concerns and managing the manpower situation in the short-term while positioning for new growth drivers like the green economy and AI in the medium term would mean a careful calibration of policy mix.

Australia

Australia: Sluggish Growth; Sticky Inflation

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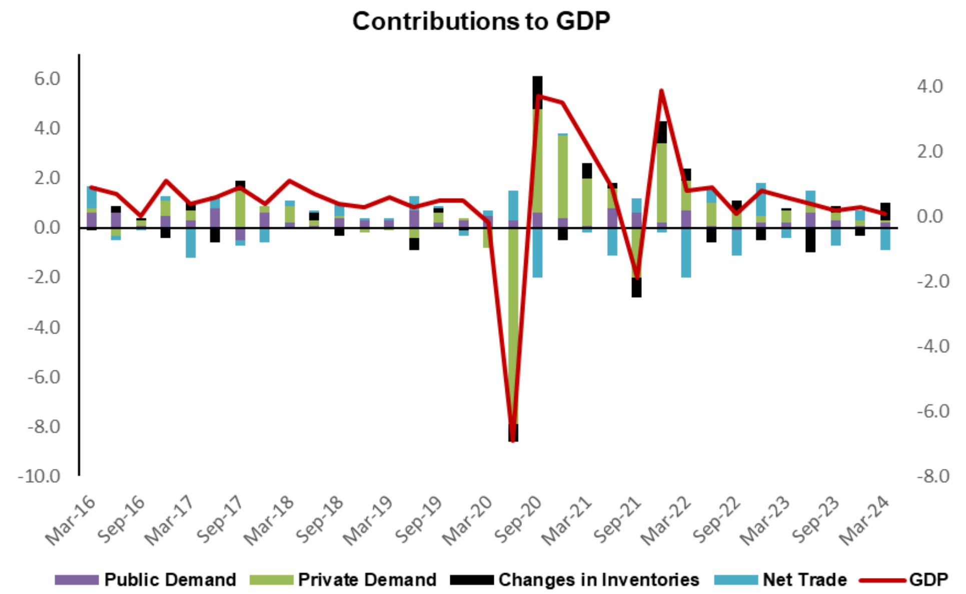
- Economic growth outlook is likely to remain subdued for 2H24 as earlier increases of interest rates by 425bps continue to bite. Households have reduced their spending and saved less.
- Growth may pick up modestly towards the later part of the year when household spending gradually recovers. This can happen when RBA lowers rates while stage 3 tax cuts and higher minimum wage kicks in.
- RBA is expected to be on hold for just a little longer, given sticky inflation and still-tight labour market. However, we do look for one 25bps cut later this year as the disinflation trend remains on track.

Economy posted sluggish headline growth

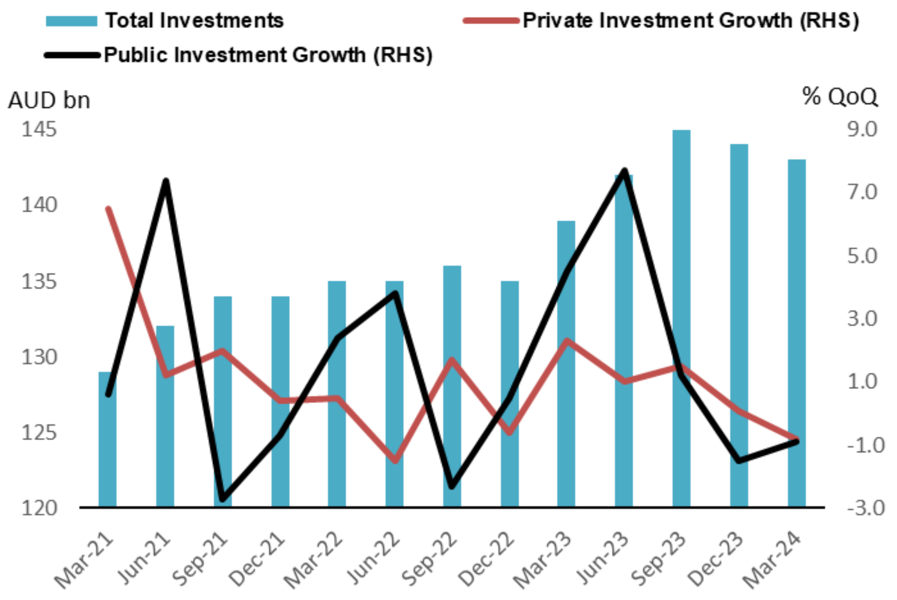
The economy grew just 0.1% QoQ SA in 1Q, slowing down from 0.3% in 4Q23. Excluding pandemic related distortions, this is the weakest economic growth since 1992.



Source: Australian Bureau of Statistics, OCBC

The main drags were investment spending, in both the public and private sectors, and net trade. Specifically, investments in the public sector fell for two consecutive quarters as several education projects were completed while work on health projects slowed. Major transport infrastructure projects are also nearing completion. Business investments grew strongly over the last 18 months and fell for the first time since 2Q20. Non-dwelling construction led the decline as work on mining projects fell while engineering construction also fell due to reduced work on O&G projects. Dwelling construction also fell as building approvals slowed and the property market saw subdued activity. Nonetheless, the level of business and public investments remains at high levels.

Australia



Source: Australian Bureau of Statistics, OCBC

The drag from these components more than offset household consumption and a build-up in inventories. Household spending picked up pace in 1Q24 driven by expenditures on essential services, including electricity and gas. Spending on one-off events such as Taylor Swift, Pink and the Australian Grand Prix contributed to the overall rise in household spending. Australia's accommodation, catering, and arts and recreation industries also benefited from these events.

Meanwhile, government spending rose due to increase in spending by the Commonwealth on social assistance benefits to households, including health programs through Medicare and the Pharmaceutical Benefits Scheme, we well as energy bill relief by some state governments.

Subdued in 2H24 but modest improvement not ruled out

Economic growth outlook is likely to remain subdued for 2H24 as earlier increases of interest rates by a cumulative 425bps continues to bite. Households have reduced their spending and saved less. Household savings to income ratio fell to 0.9% in 1Q24, from 1.6%. That said, growth may pick up modestly towards the latter part of the year when household spending gradually recovers. This can happen when the RBA lowers its policy rates and stage 3 tax cuts kicks in. Minimum wage will also rise by 3.75% from 1 July, helping to ease cost of living pressures.

Australia

Stage 3 tax cuts to support consumption

From 1 July onwards, the government's stage 3 income tax cut will come into effect. Australian individual taxpayers who earned above A$18,200 per year, will receive a tax cut. The change aims to redistribute tax savings much more widely, delivering a larger tax cut for 11mn low-and-middle-income taxpayers and a smaller tax cut for 1.8mn high income taxpayers.

The key features include:

- Those in bracket 2 (earning between A$18,201 – A$45,000) will see a cut in income tax rate to 16%, from 19%, saving $804 for those on taxable income of A$45,000;
- Those in bracket 3 will see a cut in income tax rate to 30%, from 32.5%;
- Those in bracket 4 will see higher threshold of A$135,000 being applied, instead of original A$120,000;
- Those in bracket 5 will see higher threshold of A$190,000 being applied, instead of original A$180,000.

Bracket	Income Range		Marginal Tax Rate		Tax Payable	
	Previously	1st July 2024	Previously	1st July 2024	Previously	1st July 2024
1	$0-$18,200	$0-$18,200	0%	0%	NIL	NIL
2	$18,201-$45,000	$18,201-$45,000	19%	16%	19% of excess over $18,200	16% of excess over $18,201
3	$45,001-$120,000	45,001-$135,000	32.50%	30%	$5092 + 32.5% of excess over $45,000	$4,288 + 30% ofexcess over $45,000
4	$120,001-$180,000	$135,001-$190,000	37%	37%	$29,467 + 37% of excess over $120,000	$31,288 + 37% of excess over $135,000
5	$180,001	$190,001	45%	45%	$51,667 + 45% of excess over $180,000	$51,638 + 45% of excess over $190,000

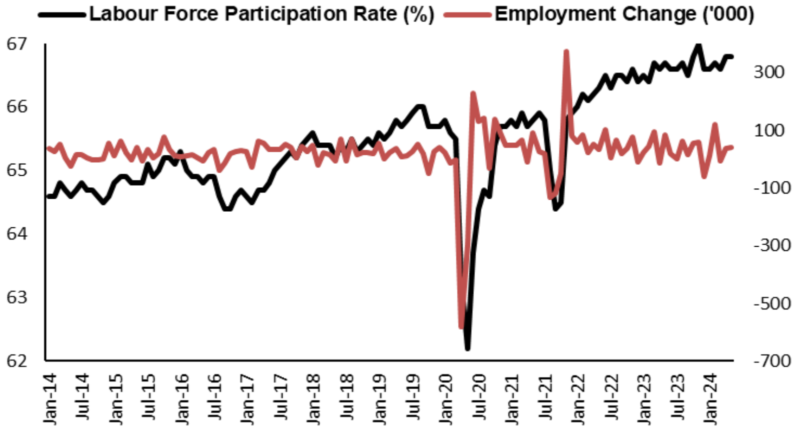
Source: Australian Treasury, Taxation Office, OCBC

In addition, medicare levy of 2% on taxable income is not payable by those on low incomes (earning less than A$26,000 or less). The levy increases gradually, and the full 2 percent levy is paid by anyone earning more than $32,500.

Tight labour market shows signs of easing

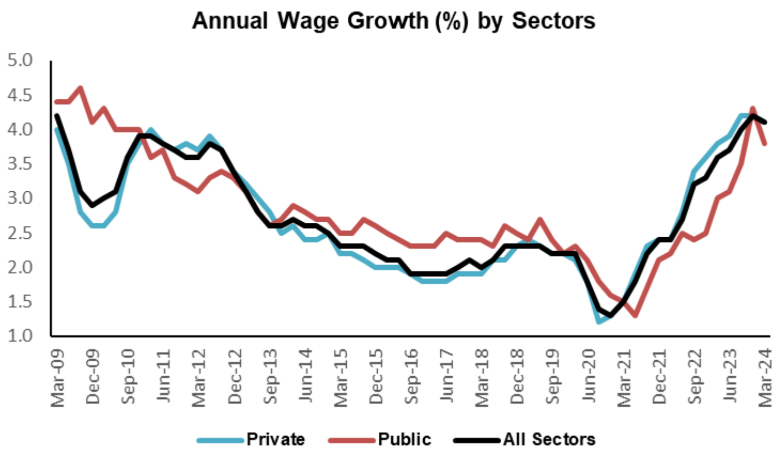
The labour market remains tight, although there are signs of it easing modestly. Unemployment rate rose to 4.1% in April, but from multi-decade lows. Employment was still growing. For January-April 2024, employment rose by +165.5k vs. +139.6k compared to the same period in 2023. The participation rate is also near a record high of 66.7% (as of April 2024) due to increased female and older workers joining the work force.

Australia



Source: Australian Bureau of Statistics, OCBC

Meanwhile, wage growth may have peaked in current cycle. 1Q24 wage growth slowed to 4.1% YoY, from 15-year high of 4.2% in 4Q23. Both public and private sector wage growth showed signs of moderation for 1Q24, and this should alleviate concerns of a price-wage spiral and reinforce our view that the RBA remains on track to lower rates in the later part of the year.



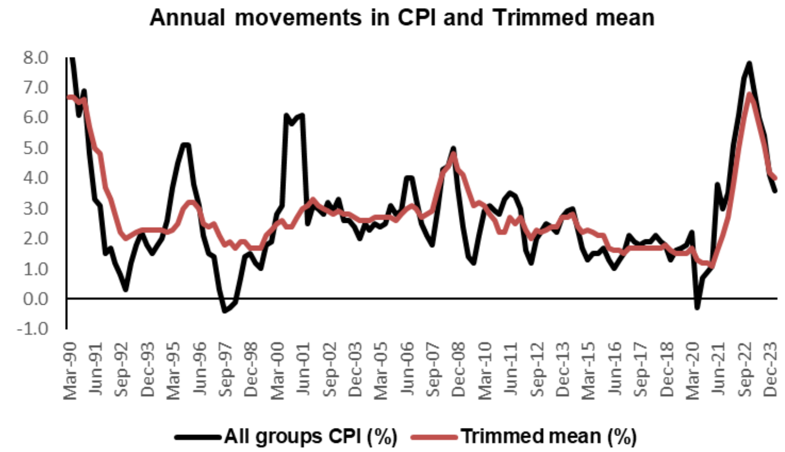
Source: Australian Bureau of Statistics, OCBC

Disinflation underway but progress looks bumpy

Meanwhile, inflation eased for the fifth consecutive quarter in 1Q24, from a peak of 7.8% in 4Q22. 1Q24 CPI was 3.6% YoY, lower than the 4.1% in 4Q23. The trimmed mean annual inflation of 4.0% in 1Q24, was also lower compared to 4.2% in 4Q23. Inflation for tradable goods slowed, as some imported goods like footwear, furniture and household appliances were cheaper a year prior.

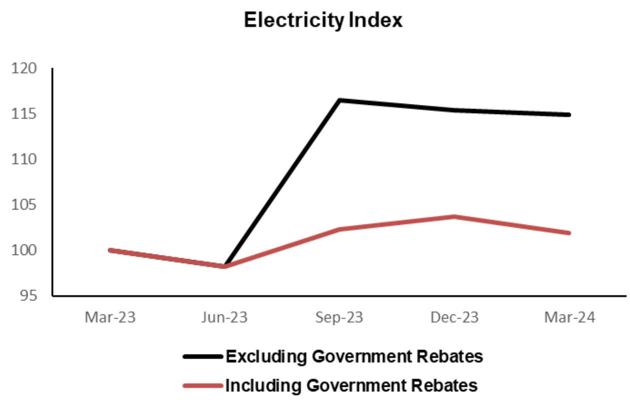
Elsewhere, education fees recorded the largest increase in 12 years, which was driven by all education levels including higher primary, secondary school and tertiary fees. Insurance prices also posted its highest annual rise since 2001, as higher reinsurance, natural disaster and claims costs continue to drive higher premiums for house, home contents and motor vehicle insurance.

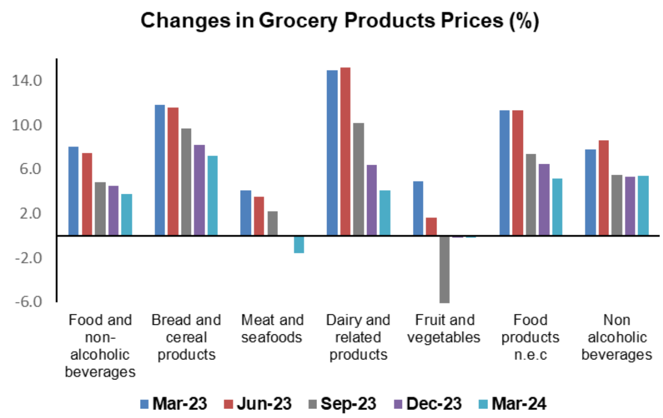
Australia



Source: Australian Bureau of Statistics, OCBC

Electricity prices fell by 1.7% QoQ in 1Q24 (+1.4% QoQ in 4Q23). The introduction of the Energy Bill Relief Fund rebates from July 2023 have moderated the increase in electricity bills for households. Electricity prices have risen by 3.9% since 2Q23. Excluding the Energy Bill Relief Fund rebates, prices would have increased by 17.0% over this period. Food inflation also eased for the 5th consecutive quarter to 3.8% YoY in 1Q24, down from 4.5% in 4Q23.



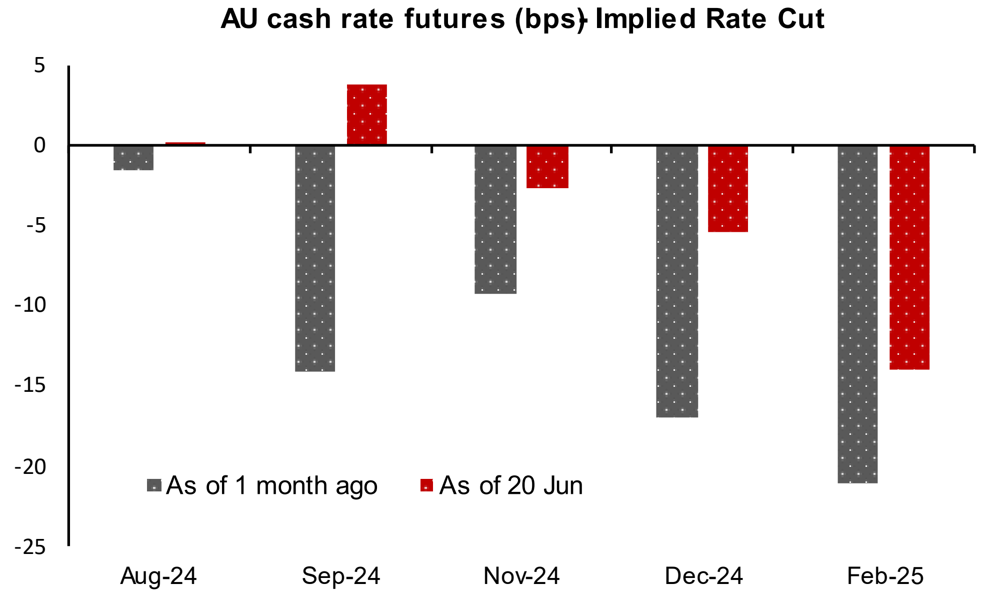


Source: Australian Bureau of Statistics, OCBC

Timing of first cut is deferred but not derailed

Despite the progress in disinflation, the pace has started to slow in recent quarters and CPI remains well above of RBA's target range of 2-3%. Monthly CPI came in even hotter-than-expected at 3.6% YoY in April, up from 3.5% in March 2024. Significant price increases were seen in housing (+4.9%), food and non-alcoholic beverages (+3.8%), alcohol and tobacco (+6.5%) as well as transport (+4.2%) components. CPI excluding volatile items and holiday travel was 4.1% YoY in April. The recent bumpy progress on the CPI path even led to market chatters of the RBA considering cash rate hikes. At time of writing (19 June), the cash rate futures implied no rate cut or hike for 2024.

Australia



Source: Bloomberg, OCBC

Unless inflation surprises significantly to the upside, we do not think a hike is warranted. However, we do expect the RBA to be on hold for a little longer, given sticky inflation and still-tight labour market conditions. Recent releases of RBA minutes also noted that inflation risks had risen somewhat and there are risks that CPI stays above target for longer. RBA also said that returning inflation to target remains the highest priority. Furthermore, RBA Governor Bullock stressed that monetary policy is restrictive.

We still expect one 25bps cut from RBA later this year. Economic growth has already slowed to a crawl in 1Q24 as the high cost of living and elevated interest rate burden weighed on household spending. Governor Bullock also indicated that the RBA will be ready to ease if economic growth is much weaker. She also added that the labour market is easing on several measures. Overall, the disinflation path should remain on track. Moderation in wage growth should arrest concerns of a price-wage spiral and reinforce our view that the RBA remains on track to lower rates in the later part of the year.

Japan

Japan: Virtuous Inflation-Wage Cycle

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Assisted by
Ang Yen Chi

- The economy is likely to expand moderately in the quarters ahead, as private consumption gradually recovers with wage increases, business fixed investment plans stay buoyant, and assuming that external demand remains supportive.
- Expected increases in imports, potential further inventory destocking or a lack of inventory build-up, and a slow start in 1Q24 are factors that would mean slower GDP growth this year versus 2023.
- Prospects for a virtuous cycle being formed between wage growth and inflation, with inflation staying sustainably around the 2% target, shall allow the Bank of Japan to gradually move away from an ultra-loose monetary setting via both interest rate and balance sheet policies.

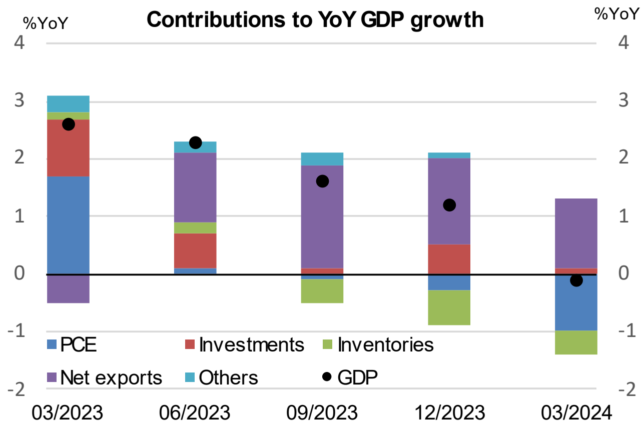
Moderate growth ahead

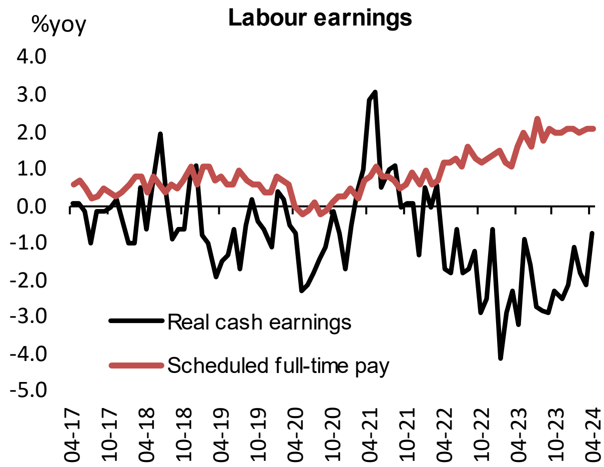
The economy shrank by 0.5% QoQ sa in 1Q24, dragged mainly by the falls in private consumption (which deducted 0.4%points from GDP growth) and net exports (which deducted 0.4%points from GDP growth), while changes in inventory added 0.3% points to seasonally adjusted sequential growth. In year-on-year terms, GDP shrank by 0.1%, marking the first contraction in 12 quarters. Net exports continued to contribute positively to YoY growth, as imports fell more rapidly.

The Japanese economy is likely to expand moderately in the quarters ahead, as private consumption gradually recovers with wage increases, business fixed investment plans stay buoyant, and on the assumption that external demand remains supportive. Expected increases in imports, potential further inventory destocking or a lack of build-up, and a slow start in 1Q24 are factors that would mean slower growth this year versus 2023. We forecast 2024 GDP growth at 0.7%, after the 1.9% expansion in 2023.

Private consumption has been weighed down by inflation, falling in YoY terms for three consecutive quarters, with real cash earnings YoY having stayed in negative territory for an extended period. Nevertheless, the YoY drop in real cash earnings has been on a broad narrowing trend. The situation may further improve in the periods ahead as wage growth catches up with price increases. In addition, cuts in taxes including income tax and inhabitant tax shall also support private consumption more broadly. On balance, private consumption is expected to increase moderately for the remaining quarters of the year.

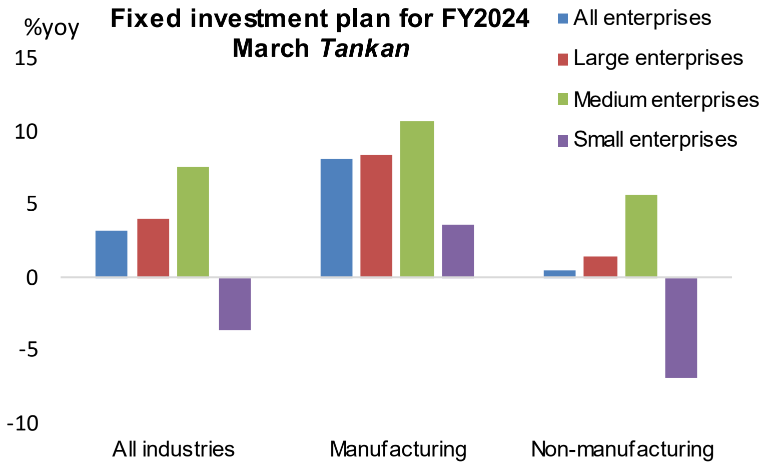
Japan





Source: Cabinet Office, Bloomberg, OCBC

Business fixed investment plans have stayed buoyant as reflected by the latest *Tankan* survey, with 3.3% YoY overall growth (all enterprises, all industries) projected for FY2024. This is led by plans in the manufacturing sector, which targets fixed investment growth at 8.2% YoY. Weakness is seen at the investment plans by small enterprises in the non-manufacturing sector. Past investments had fallen short of plans and therefore we do not automatically assume these plans will be deployed in full in our GDP estimates. Still, business fixed investment is expected to contribute to overall growth.



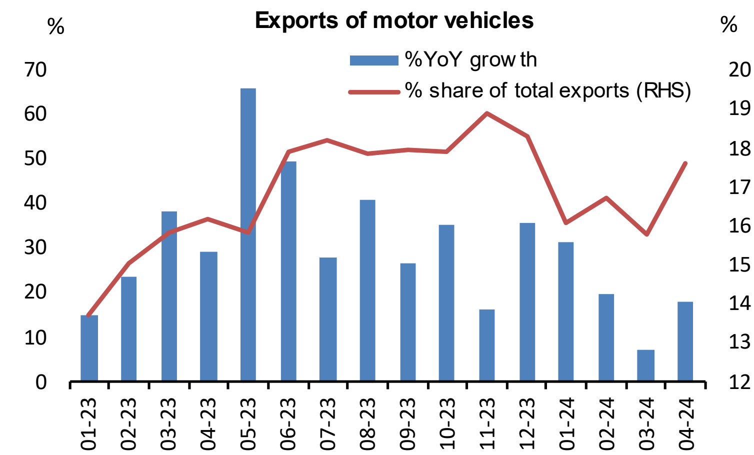
Source: Bloomberg, OCBC

Exports are expected to recover in the periods ahead. The recent sequential setback was partly due to the suspension of production and shipment at some automakers. Incidents involved some suspension starting in December, followed by investigation into certification applications for certain vehicles. Exports of motor vehicles slowed to 7.1%YoY in February, while growth in January and March at 19.8%YoY and 17.8%YoY respectively were still lower than those in earlier months. Nevertheless, this likely represents a temporary factor and we assume the impact will dissipate beyond 2Q24.

Japan

In terms of the broader external demand by major markets, the US economy has stayed resilient despite some softening of data of late, while our base-case is for the China economy to continue to recover partly thanks to government measures. Inbound tourism is expected to persist, but receipts may not experience the rapid growth seen in the quarters after reopening, on a high base of comparison.

Meanwhile, imports are also likely to stabilise and potentially grow alongside domestic spending power, hence limiting contributions from net exports to GDP growth. If the soft-landing narrative for other major economies do not materialise as expected, then there is a risk to our expectation that Japanese exports will benefit.

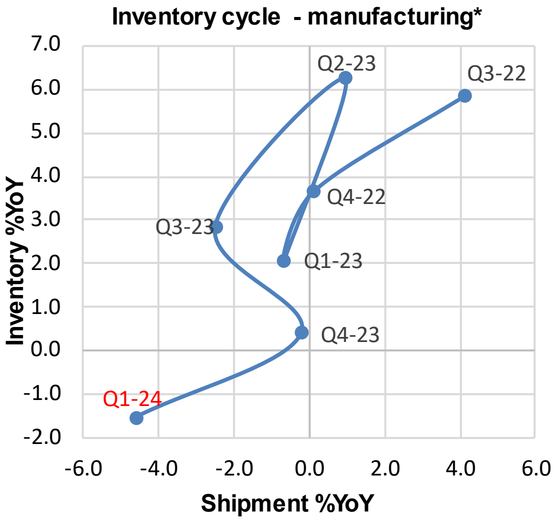


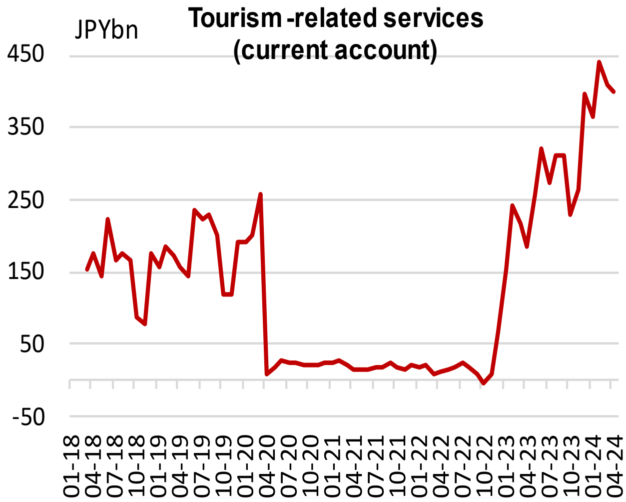
Source: CEIC, OCBC

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 three quarters in a row, from 3Q23 through 1Q24. Private inventories were still growing in 3Q23 and 4Q23, but the stock-building slowed from a year ago and hence the negative contributions to YoY GDP growth. In 1Q24, the situation differed in that there was outright destocking. Overall GDP shrank by 0.2%YoY in 1Q24 and change in private inventory alone deducted 0.6% points from growth.

From production side statistics, manufacturing production shipment fell YoY for a third quarter, while a YoY fall in producer's inventory index was seen only in 1Q24. Hence, the risk to our GDP growth outlook is further inventory drawdown or a lack of restocking before a pick-up in exports growth is evident.

Japan





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

Virtuous cycle between inflation and wage growth
CPI inflation has been decelerating in year-on-year terms from the peak seen in December 2022, but has nevertheless stayed above 2% across headline, core and core core readings. CPI inflation in YoY terms is likely to stay above or near the 2% mark for the remaining months of the year amid spillovers from wage growth. We expect 2024 CPI inflation at 2.3%.

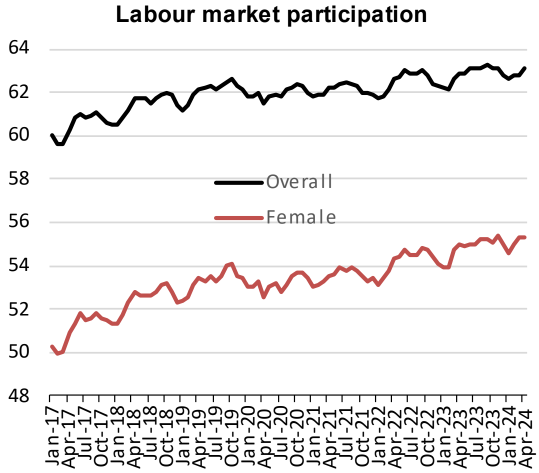
Shunto – the annual spring labour-management wage negotiation - results showed average wage increase at 5.17% vs 3.67% last year, and that for small companies (with <300 employees) was also decent at 4.66% vs 3.35% last year. April cash earnings accelerated to 2.1%YoY, while the March's number was revised upward to 1.0% from 0.6% prior. Data in the months ahead should gradually reflect what was suggested by the *Shunto* results. Meanwhile, overall labour participation rate has been rising steadily from below 60% in early 2017 to the latest 63.1%, and female labour participation rose from below 50% to the latest 55.3%. Room for further increase is more limited at these levels, which should contribute to labour market tightness and help sustain wage growth.

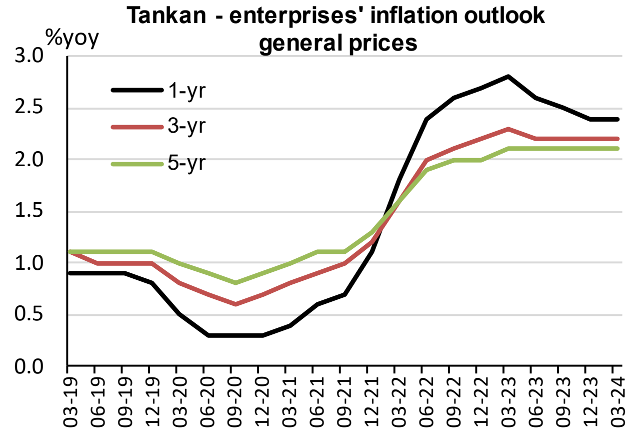
The transmission from wage growth back to general price levels is not straightforward. According to a recent BoJ study *Recent Developments in the Linkage between Wages and Prices, May 2024*, "moves to reflect wage increase in output prices are gradually spreading". BoJ researchers examined those CPI items with a low ratio of import costs to total costs, those with a high ratio of labour costs to total costs, and those which are of low volatilities - these items are not particularly susceptible to import prices but instead are relatively more responsive to changes in wages. The observation of the study was that "the contributions of the wage factors [to the increase in CPI] has been increasing gradually". This is an encouraging sign that a virtuous cycle between inflation and wage growth may be forming.

Firms' price-setting behaviour is another factor impacting the price transmission mechanism. According to *Tankan* surveys, enterprises' medium (3-year) to long-

Japan

term (5-year) inflation expectations have been stable at around/above the 2% level since 3Q22. This suggest that it is more likely that sustainable inflation will be achieved.

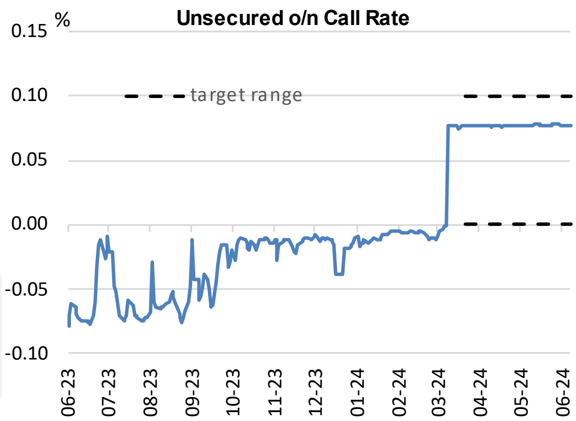


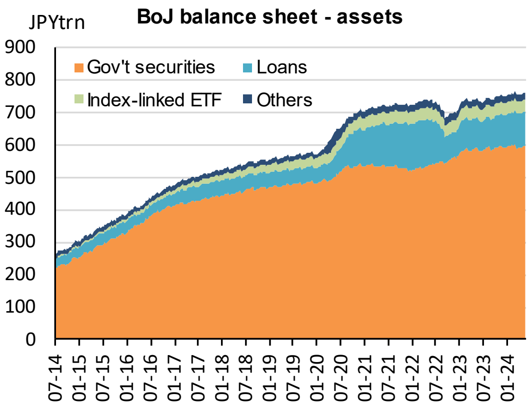


Source: *Tankan*, Bloomberg, CEIC, OCBC

Gradual monetary policy normalisation

Prospect is for a virtuous cycle being formed between wage growth and inflation, and hence for inflation to stay sustainably around the 2% target. This should allow the Bank of Japan to gradually move away from an ultra-loose monetary policy. We expect the BoJ target rate to be raised to 0.2-0.3% by year-end. In terms of balance sheet policy, passive quantitative tightening (QT) is also likely to be underway starting sometime in Q3. The Bank of Japan's balance sheet stood at JPY76.1trn as at end May, comprising mainly government securities at JPY597trn. We expect the BoJ would reduce monthly purchase target to JPY4-5trn, from the previous guidance of JPY6trn, while the actual purchases can even be lower depending on market conditions.





Source: Bank of Japan, Bloomberg, OCBC

South Korea

South Korea: Growth Rebound

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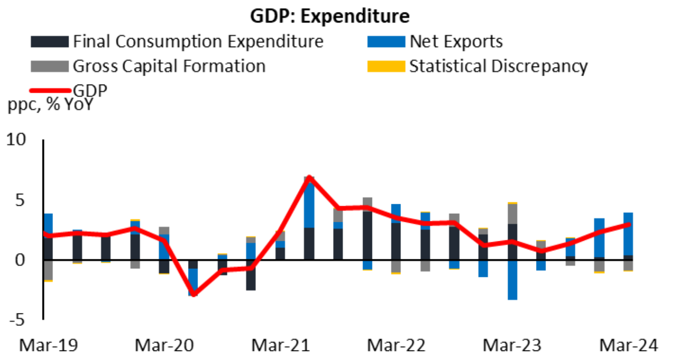
Assisted by
Hanif Ibrahim

- We expect growth to accelerate to 2.2% YoY and 2.3% YoY in 2024 and 2025, respectively, following some stabilisation in 2023.
- The outlook for the manufacturing sector is largely positive, in line with our house view for a recovery of the global electronics downcycle in 2H24.
- Easing CPI and improving growth outlook opens the door for rate cuts later this year. Our base case is for two 25bp cuts in 2024.

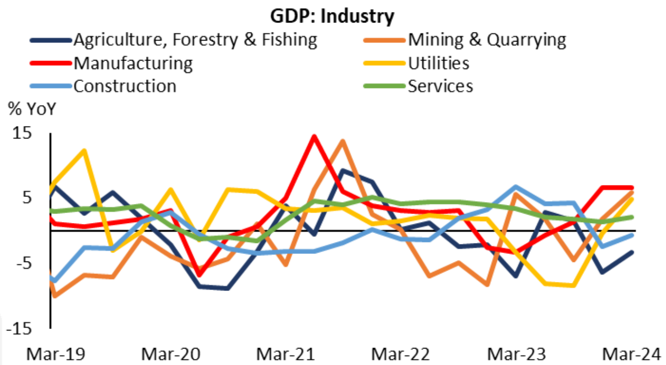
Recovery is well underway

We expect growth to accelerate to 2.2% YoY and 2.3% in 2024 and 2025, respectively, following some stabilisation in 2023 at 1.4%. Our expectations for growth are reinforced by the ongoing notable recovery in exports, partly reflecting stronger-than-anticipated growth in the US economy (which is South Korea's second largest trading partner accounting for 18.3% of total exports in 2023) and growing demand for advanced semiconductors. Meanwhile, domestic demand improvements are also underway, albeit at a more gradual pace.

The start to 2024 was strong. GDP growth accelerated meaningfully to 3.4% YoY (1.3% QoQ sa) in 1Q24 from 2.2% (0.6% QoQ sa) in 4Q23, fuelled by robust exports growth and more measured improvements in domestic demand. These factors more than compensated for the weakness in government spending, aligning with post-pandemic fiscal consolidation. Meanwhile, investment growth shifted from a 1.6% YoY contraction in 4Q23 to a growth of 0.5% in 1Q24, highlighting some improvement in public sector investment. This offset the sluggish recovery in construction investment amid uncertainty over real estate project financing and ongoing high interest rates environment.



Source: The Bank of Korea, CEIC, OCBC



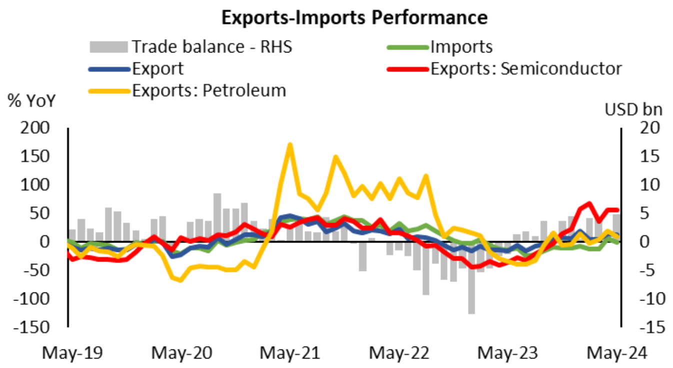
Note: Utilities = Electricity, Gas & Water Supply. Source: The Bank of Korea, CEIC, OCBC

The weakness in construction investment also reflected in the supply side, with the construction sector growth of -0.7% YoY in 1Q24 from -2.4% in 4Q23. Similar weakness was observed in the agriculture, forestry, and fishing sector (-3.4% YoY in 1Q24 from -6.4% in 4Q23). Meanwhile, other key sectors recorded positive growth, let by manufacturing (6.6%), mining & quarrying (5.9%), utilities (4.8%), and services (2.1%).

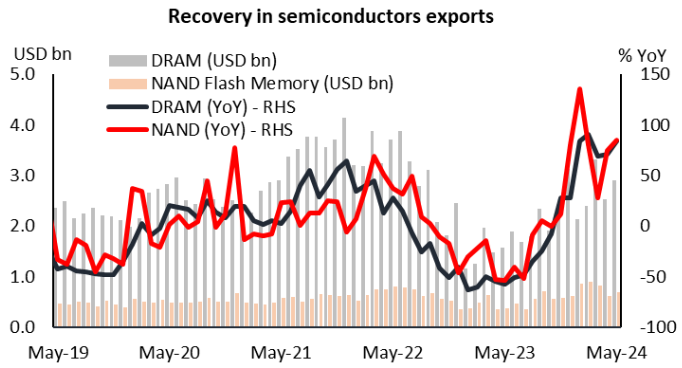
South Korea

With multiple export tailwinds
The outlook for the manufacturing sector is largely positive, in line with our view for a bottoming of the global electronics downcycle by 1H24. Indeed, rising global demand for semiconductors has taken shape, demonstrated by the significant uptick in the semiconductor shipments, reaching 52.5% YoY in the first five months of 2024, compared to a 39.5% contraction in the same period of 2023. Semiconductors accounted for ~15.6% of South Korea’s total exports in 2023.

Exports of NAND flash memory and dynamic random-access memory (DRAM) has picked up dramatically in recent months, and the trend is likely to remain robust with the rise of artificial intelligence (AI), autonomous driving, IoT technologies. In addition, semiconductor inventories have continued to be drawn down as well, declining to -33.7% YoY in April, a clear reversal of the inventory buildup in 2023 which peaked at 66.0% in Apr 2023. Considering South Korea's significant contribution to global supply chains for semiconductors, burgeoning semiconductor and overall electronics exports is expected to lift many boats.



Source: Korea Customs Service, CEIC, OCBC.

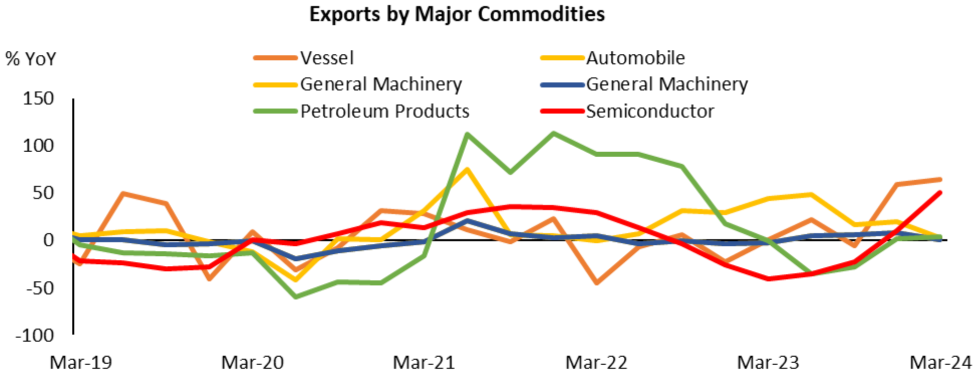


Source: CEIC, OCBC.

Looking ahead, solid global chips demand is expected to hold up for the rest of 2024 and is expected to keep South Korea’s overall exports on a positive growth trajectory. In May, the World Semiconductor Trade Statistics (WSTS)[3] raised its 2024 growth forecast for the global semiconductor market to 16.0% YoY from 13.1% YoY in its prior estimate, for which the memory sector is expected to expand 76.8% YoY. Likewise, market research firm TrendForce lifted its demand forecasts for memory chips, with DRAM and NAND bit growth revised up to 16.7% YoY (16.3% prior) and 14.1% YoY (13.9% prior) respectively. With memory chips constituting ~30% of net semiconductor exports, the runway is clear for chips exports to take off.

[3] 2024 Forecast: Strong Recovery Expected, WSTS Semiconductor Market Forecast Spring 2024, 4 June 2024.

South Korea



Source: Ministry of Trade, Industry and Energy, CEIC, OCBC

Beyond the electronics outperformance, strong growth momentum is also visible in other export categories:

- Automobile export value exceeded all-time highs in both April and May, exceeding the USD6bn threshold every month this year*. Rising optimism on EV and hybrid vehicle demand prompted the trade ministry to raise its automobile export target in 2024 to USD100bn from USD98.4bn previously.

- Exports of vessels grew by 108.4% YoY in May, recording a 10th consecutive month of expansion. Month-to-date May saw vessel exports also growing 18.8% YoY. We foresee ship builders maintaining a steady growth profile with US sanctions on Chinese vessel exports and demand for LNG tankers. The White House trade office has announced investigations on unfair trade practices by Chinese ship builders in April. South Korean builders from the likes of Samsung HI and HD Hyundai have announced their largest single orders in history in recent months for LNG vessels.

The improving trade outlook is expected to widen the current account (CA) surplus, with the BOK estimating that the CA surplus will reach USD52bn in 2024 and USD59bn in 2025, compared to USD35.5bn in 2023. Indeed, the cumulative current account balance for January to April reached USD16.5bn – a stark contrast to the USD7.3bn deficit during the same period last year.

On the domestic side, private consumption, which accounts for almost half of the economy, is projected to remain broadly stable to mirror the 1.8% growth in 2023. Rising household income and improved labour conditions, coupled with easing inflation, should keep household spending supported. That said, the pace of recovery is likely to be more gradual, as high interest rates on loans and still elevated household debt and interest repayments would likely limit the extent of the pickup in consumption.

* save for the month of Feb due to lunar new year.

South Korea

Property finance risks set to ease

Real estate distress and project finance (PF) risks, closely watched by the BOK in 2022-23, is expected to subside with the government taking active steps to avert a property crisis. Major financial institutions' exposure to real estate project finance steadily increased in 1H24, with the loan balance up ~70% since end 2023. Financial companies' delinquencies are also at elevated levels, following the default of Legoland in 2H22.

Key Real Estate PF Policies	Specific Measures
Raise standards for assessing project viability	Financial companies allowed to assess viability by considering land mortgage loans and debt guarantees in addition to PF and bridge loans.
	Strengthen the viability evaluation system by assessing risks at each project stage
	Raise viability rankings from 3 (satisfactory, average, and at risk of deterioration) to 4 (satisfactory, average, in need of attention, and potentially insolvent)
	FSC to lead in creating and inspecting standards for effective project finance oversight
Ensure funding for viable projects	Increase PF guarantees for viable projects from KRW25tr to KRW30tr to support transition from bridge loans to conventional PF term loans
	Provide additional funding for viable projects including for construction
Encourage restructuring & liquidation of unviable projects	Projects requesting for a maturity extension for the second time or more subject to higher thresholds in securing consent from the real estate project finance lenders' consortium
	When a maturity extension is granted, from now on, overdue interest payments will have to be paid in principle.
	Banks and insurers to provide syndicated loans worth KRW1tr (potential to raise up to KRWW5tr)
	KAMCO funding of KRW400bn for KFCC and savings banks
Minimising contagion risks	Temporary 'normal' classification of funds used by FIs to provide additional funding to distressed projects
	Executives/employees of Fis protected from legal liability for potential losses arising from syndicated loan provision/sales related to PF projects

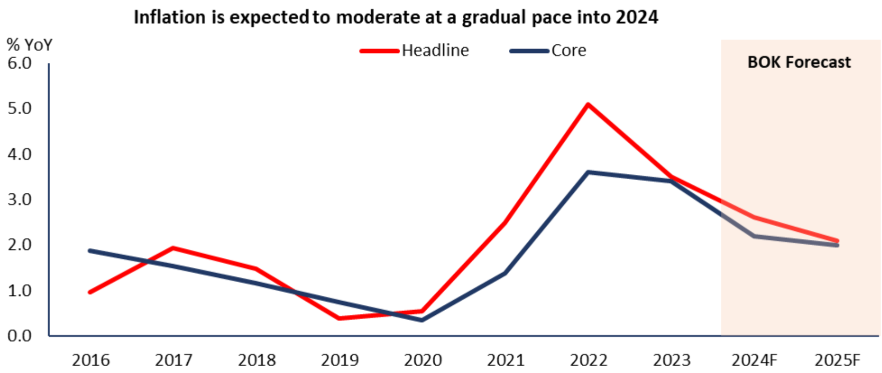
Source: FSC, OCBC.

Measures unveiled by the Financial Services Commission (FSC) on 13 May seeks to facilitate an "orderly soft landing" in the real estate project finance market and minimise contagion risks from distressed projects. The strategy is broad, simultaneously aiming to provide funding support for financially viable development projects and pushing for the restructuring/liquidation of those deemed unviable. While forced liquidation of real estate assets from non-viable projects may shake up sector intermittently in 2H24, state intervention should help to rebuild health and restore confidence in the real estate PF market, thus managing risks of a broader spillover. With real estate PF risks expected to become more manageable, the BOK has greater optionality in setting monetary policy based on its assessment of inflation progress towards its 2% target.

Contained inflation opens room for BOK easing

Price pressures have largely eased in 1H24, with headline CPI slowing to a 10-month low of 2.7% YoY in May. This brings the year-to-May inflation to an average of 3.0%, compared to 3.4% in 4Q23. The lower inflation reflects a broad-based slowdown in price pressures, notably in utilities, while food inflation remains somewhat elevated.

South Korea



Source: Statistics Korea, Bank of Korea (August Forecast), CEIC, OCBC.

Looking ahead, easing in international energy and agricultural products prices is expected to keep the disinflationary trend intact and support CPI moderation towards the BOK's 2% inflation target. In line with this, the BOK forecasts headline and core inflation to be at 2.6% and 2.2% in 2024, respectively, down from 3.6% and 3.4% in 2023. However, the disinflation is expected to be gradual, with heightened geopolitical risks and a volatile exchange rate posing as upside risks.

In terms of monetary policy, easing inflation and an improving growth outlook is constructive for a Goldilocks scenario for the BOK, opening the door for rate cuts later this year. The BOK commented in June that they continue to expect CPI to gradually slow down as projected, but further monitoring is needed due to uncertainty. We maintain our base case of two 25bp cuts for the BOK in 2024.

India: The Going Will Be Tougher

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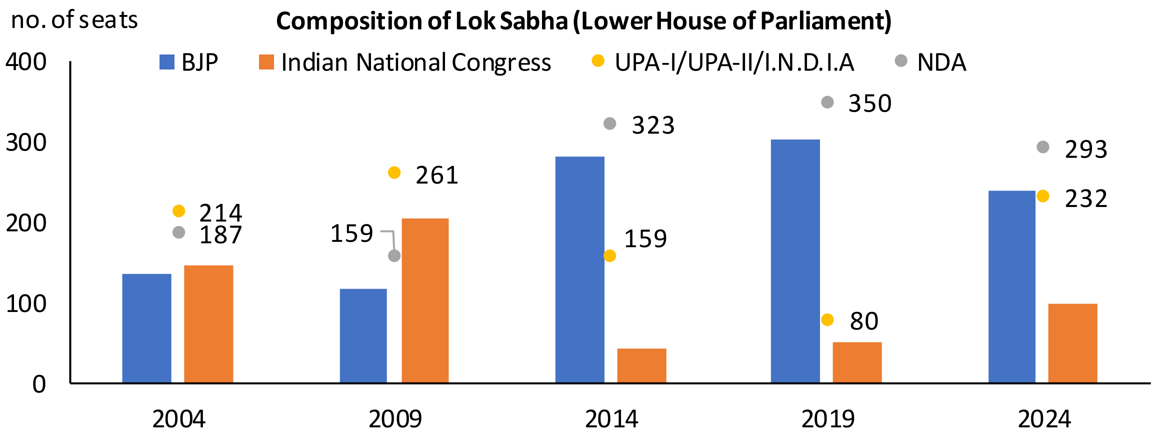
- PM Narendra Modi will get a third term in office, but not without a reality check. The return of coalition politics will rein in the BJP's economic reform agenda.
- We expect the incoming government will stick to low hanging fruits such as a focus on infrastructure spending and digitalisation. Our GDP growth forecasts for FY25, FY26 and FY27 are 7.2%, 6.2% and 6.0%, respectively versus 8.2% in FY24.
- We expect RBI to cut its policy rate by a cumulative 75bp, in gradual, calibrated cuts from CY4Q24 through to CY2Q25.

A Changed Political Landscape

It is a historic third term for Narendra Modi as the Prime Minister of India, but it is not without a political reality check. The BJP won its lowest number of seats in the Lower House at 240, falling short of the single party majority of a minimum of 272 seats, that it had claimed in the 2014 & 2019 elections. The National Democratic Alliance (NDA), of which the BJP is the biggest party, will remain in power for a third term with support from its regional allies with a total of 53 seats.



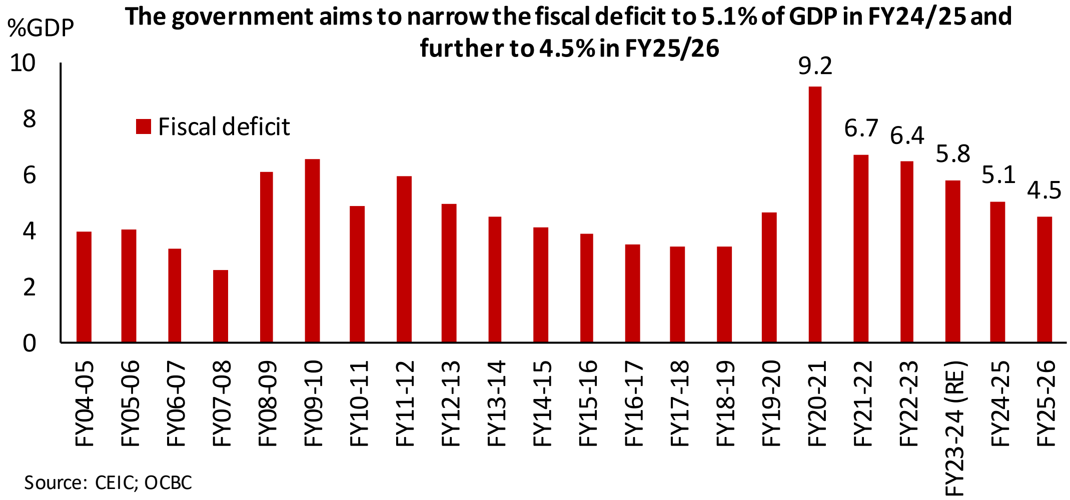
Source: Inter-Parliamentary Union; OCBC.

Coalition politics will come with its own set of challenges and compromises, as historical precedence in the Indian context has shown. India's governments were largely coalitions through the 1990's. There will be an increased resistance to tougher, unpopular economic reforms. However, the government is likely to remain focused on infrastructure development and enhancing the ease of doing business.

India

Budget FY24-25: The First Litmus Test of Policy Direction

The incoming government's first order of business, given cabinet formation has been completed, will be to table the FY24-25 Budget (year ending March 2025). In the interim budget, tabled in February 2024, the government aimed to narrow the fiscal deficit to 5.1% of GDP from 5.8% in the revised estimate of FY23-24. RBI's bumper dividend transfer of INR2.1trn (0.7% of GDP) versus market expectations of INR1trn (0.3% of GDP) could help further narrow the deficit further.



Source: CEIC; OCBC

Nonetheless, **the direction of the FY24-25 budget will likely set the tone of PM Modi's third term.** Steady tax revenue collection growth of 12% YoY (slightly higher than our nominal GDP growth assumption of 10% YoY), a similar pace of growth for non-tax revenue, contained operational expenditures of 6.0% YoY (versus 8.3% in FY2014-19 and 12.2% in FY2020-24) with capex rising ~13% will, by our estimates, allow the government to reach its fiscal deficit target of 4.5% of GDP by FY2025-26.

This implies that the government will have to be steadfast with its focus on fiscal consolidation with little room to manoeuvre on the fiscal side. Sustained efforts to plug tax revenue loopholes and continuous administrative improvements will likely help keep revenue collections strong. That said, additional tax reforms are still necessary underscored by the need that tax revenue growth has to surpass nominal GDP growth for fiscal consolidation to stay on track. By the same token, the government does not have a large amount of wiggle room to placate voters considering fiscal spending will likely need to be closely monitored, particularly if capex objectives are to be met.

Continue with Low Hanging Fruits

Attendant to broader fiscal consolidation, we expect the incoming administration to remain focused on economic priorities, that will not be met by significant political opposition. These include infrastructure development and digitalisation.

Infrastructure development: The Modi administration has been instrumental in supporting the infrastructure development drive. Since 2014, the length of railway tracks has increased 10% (as of 2022) while the length of national highways has

India

increased 60% (as of 2023). Bolstering infrastructure for roads, railways, ports, and airports will be met with limited political resistance given its far reaching benefits and positive externalities. Progress on projects which are currently underway will continue. Given PM Modi's regional coalition partners are from Andhra Pradesh and Bihar, we would not be surprised if national mega projects are announced within these states in coming years.

Some key infrastructure projects currently underway
Roads & Bridges
Delhi-Vadodara Eight-Lane Expressway Project (NH-148N)
Bhiwani-Jind-Karnal Two Laning Road Project (NH-709A)
Jaisingh-Nagar-Madhya Pradesh Chhattisgarh Border Road Project
Tirunelveli-Sengottai-Kollam Four Laning Road Project (TNRSP-Phase II)
Airports
Noida (Jewar) International Greenfield Airport Project
Mopa International Airport Project
Shimoga Airport Project
Mysore Airport Runway Expansion Project
Coimbatore Airport Expansion Project
Railways
Jammu-Udhampur-Katra-Qazigund-Baramulla Railway Line
Ahmedabad-Rajkot Railway Electrification Project
Redevelopment of Mumbai Central Railway Station Project
Ports & Shipping
Vizhinjam International Container Transhipment Terminal Project
Khandaleru Creek North-South Industrial Cluster Road Project
Kochi Water Metro Project
Diamond Harbour Container Terminal Project at Kolkata Port
Sources: National Infrastructure Pipeline; India Infrastructure Monitor; OCBC.

Digitalisation: A feather in PM Modi's cap has been creating a conducive environment for rapid digitalisation and adoption of new technologies. While these plans were in place prior to PM Modi's taking office, his government has maintained a steadfastness in implementation and adoption, which we expect will continue into his third term.

The introduction of Aadhar cards, provided by the Unique Identification Authority of India (UIDAI), has helped target subsidy rationalisation and cash payments reducing the scope of leakages. The rapid adoption of Unified Payments Interface (UPI) has been a game changer for India's digital payment platforms paving the way for a cashless payment across all economic strata. The ubiquitous presence of mobile users in India has catalysed UPI.

The next steps will be in terms of honing digital capabilities in the fields of education, gen-AI adoption, innovative cloud technology. These will be more

India

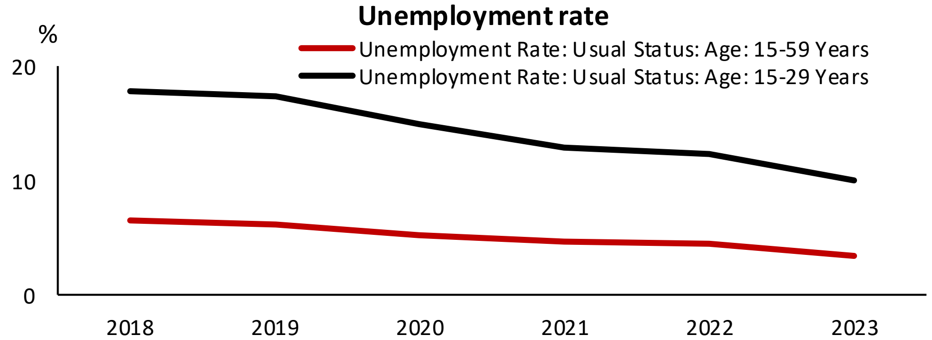
challenging but again the political capital will likely sustain given the positive impact of past reforms in these efforts.

But there Could Be a Realignment of Priorities

The election outcome clearly showed that on-the-ground concerns need to be actively addressed. **The first one of which is unemployment.** More public sector schemes to promote employment and alleviate cost of living burdens through more targeted cash handouts cannot be ruled out given the upcoming state elections of Haryana and Maharashtra as BJP fared poorly in both these states during the general elections.

Tougher National Reforms Will Be Less Forthcoming

While the unemployment rate has been declining, anecdotal evidence shows that unemployment among the youth is elevated. Resolving this issue will not be a straightforward process and maybe complicated by the penchant of coalition governments to dole out cyclical solutions rather than address structural constraints. Some such measures include a stricter implementation of the 2020 National Education Policy to ensure better learning outcomes and processes/programs to establish stronger linkages between education outcomes and job market requirements.



Source: CEIC, OCBC.

Economic reforms that require more political capital such as fine-tuning Goods & Service Tax exemptions (including petroleum, alcohol, real estate) and further rationalising subsidies may, however, be put on the back burner. Similarly, the ability of the incoming government to press ahead with agriculture reforms (after the 2020 agriculture reforms were withdrawn) will be difficult.

PM Modi's focus on bolstering manufacturing sector has become sharper in recent years. These include measures such as the government production-linked incentives scheme[4] and large subsidies to foreign investors to set up shop in India. While these programs have helped bolster the manufacturing sector, we see some risks that these could be de-prioritised. Nonetheless, the risks for schemes such as PLI will mainly come ahead of its expiration dates.

[4] Production Linked Incentive (PLI) Schemes for 14 key sectors have been announced in with an outlay of INR1.97 lakh crore (over US$26 billion) to enhance India's manufacturing capabilities and exports. The scheme was first introduced in 2020 and expanded in subsequent years.

India

An Eye on State Dynamics

While the purview of the state is clearly demarcated by the Constitution of India, centre-state collaboration could become more tenuous. There are now numerous states for which the ruling state party differs from the party of representation at the centre. Importantly, Maharashtra and Haryana go to the polls later this year, further testing the BJP-led coalition.

State/Union territory	Ruling State Party	Seats at Centre
Andhra Pradesh	Telegu Desam Party	Telegu Desam Party
Arunachal Pradesh	Bharatiya Janata Party	Bharatiya Janata Party
Assam	Bharatiya Janata Party	Bharatiya Janata Party
Bihar	Janata Dal (United)	BJP/JDU
Chhattisgarh	Bharatiya Janata Party	Bharatiya Janata Party
Delhi	**Aam Aadmi Party**	**Bharatiya Janata Party**
Goa	**Bharatiya Janata Party**	**Bharatiya Janata Party/Congress (INDIA alliance)**
Gujarat	Bharatiya Janata Party	Bharatiya Janata Party
Haryana	**Bharatiya Janata Party**	**Bharatiya Janata Party/Congress (INDIA alliance)**
Himachal Pradesh	**Indian National Congress**	**Bharatiya Janata Party**
Jharkhand	**Jharkhand Mukti Morcha**	**Bharatiya Janata Party**
Karnataka	**Indian National Congress**	**Bharatiya Janata Party**
Kerala	**Communist Party of India (Marxist)**	**Indian National Congress (INDIA alliance)**
Madhya Pradesh	Bharatiya Janata Party	Bharatiya Janata Party
Maharashtra	**Shiv Sena**	**Indian National Congress (INDIA alliance)**
Manipur	**Bharatiya Janata Party**	**Indian National Congress (INDIA alliance)**
Meghalaya	**National People's Party**	**Indian National Congress (INDIA alliance)**
Mizoram	Zoram People's Movement	Zoram People's Movement
Nagaland	**Nationalist Democratic Progressive Party**	**Indian National Congress (INDIA alliance)**
Odisha	Bharatiya Janata Party	Bharatiya Janata Party
Punjab	**Aam Aadmi Party**	**Indian National Congress (INDIA alliance)**
Rajasthan	Bharatiya Janata Party	Bharatiya Janata Party
Sikkim	Sikkim Krantikari Morcha	Sikkim Krantikari Morcha
Tamil Nadu	Dravida Munnetra Kazhagam	Dravida Munnetra Kazhagam
Telangana	**Indian National Congress**	**Bharatiya Janata Party/Congress (INDIA alliance)**
Tripura	Bharatiya Janata Party	Bharatiya Janata Party
Uttar Pradesh	**Bharatiya Janata Party**	**Samajwadi Party (INDIA Alliance)**
Uttarakhand	Bharatiya Janata Party	Bharatiya Janata Party
West Bengal	All India Trinamool Congress	All India Trinamool Congress

Source: OneIndia; OCBC.

GDP Growth to Be Sustained

Taken together, we expect GDP to remain solid in the coming years, albeit moderating from 8.2% YoY in FY24. Our GDP growth forecasts for FY25, FY26 and FY27 are 7.2%, 6.2% and 6.0%, respectively. This assumes that there will be continued fiscal consolidation, but this will be more passive assuming continued benefits from past reforms such as GST and a contained operating expenditure profile. We expect infrastructure spending will continue, supported by private sector investments, as political stability ensues, and policy priorities are clarified. Meanwhile, export improvements will likely remain modest over the medium-term.

India

RBI To Remain Steadfast

This will keep the current balance in a deficit while inflationary pressures remain volatile. Admittedly, headline inflation has been easing back to within RBI's 2-6% inflation target range over a sustained period, but the disinflation trajectory has been bumpy.

RBI will look for an opportunity to start easing its policy rate in the October-December 2024 quarter, in our view. By this time, we expect inflationary pressures would have eased further and the US Federal Reserve may have embarked on its easing cycle. We expect RBI to cut its policy rate by a cumulative 75bp in gradual, calibrated cuts from CY4Q24 through to CY2Q25.

China

China: More Support Needed

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- The latest May activity data indicated a further weakening in the real estate market despite greater official support for the sector. Domestic demand is improving but uncertainties remain. Manufacturing has been the standout sector in 1H24, reflecting strong external demand. We expect this will continue to support growth in 2H24.
- On the one hand, weak credit and money supply coupled with sluggish inflation argue for additional monetary policy support. On the other hand, the near-term preference to maintain exchange rate stability could limit the role of interest rate policy. However, we still expect the People's Bank of China (PBoC) to cut interest rates and the reserve requirement ratio in 2H24.
- It is possible for China to achieve its growth target this year even without a meaningful recovery of the property market on the back of resilient external demand and targeted domestic demand policies. Our forecast for GDP growth of 5% in 2024 remains unchanged.

GDP growth exceeded expectations in 1Q24 to grow by 5.3% YoY, accompanied by sequential QoQ sa growth of 1.6%. This robust expansion was underpinned by several key factors including resilient industrial activities, strong service consumption, and a rebound in external demand.

Despite the better-than-expected 1Q24 outturn, the government stepped up its support for growth. During the politburo meeting in late April, top leaders reiterated their commitment to utilize interest rates and reserve requirement ratios to bolster the real economy and alleviate funding costs. To us, this suggests that there is potential for further rate cuts. The meeting also explicitly highlighted the need for coordinated research and implementation of policy measures to manage existing housing stock.

More property easings

Following the April politburo meeting, on 17 May, various ministries unveiled what are currently the strongest supports for the property market, focusing on four key areas: increased financial support for home buyers, additional financial support for developers, measures to reduce housing inventory through state acquisition, and repurposing existing land holdings to aid developers in recycling capital.

Firstly, on financial support for home buyers, the PBoC announced that the nationwide downpayment ratio will be lowered to 15% for first-time home buyers and 25% for those with existing loans, down from the previous 20% and 30%, respectively. Meanwhile, the floor for mortgage rates will be removed. Previously, the floor for first-time mortgage rates was the Loan Prime Rate (LPR) minus 20 basis points (bps), and for second home mortgages, it was LPR plus 20bps. In addition, the interest rate for provident fund loans will be reduced by 25bps. For example, the interest rate for first-time provident fund loans will decrease from 3.1% to 2.85%.

China

Secondly, the "white list" measure continues to be a key support mechanism from commercial banks for property projects. PBoC issued CNY935bn in loans to "white list" projects since January this year.

Thirdly, the PBoC will establish a new refinancing tool to support public housing projects. This facility will provide CNY300bn at an interest rate of 1.75% with a term of one year, extendable up to four times. The PBoC will refinance 60% of the loan principal, potentially generating bank loans of up to CNY500bn. This tool aims to facilitate the state acquisition of unsold properties. Local state-owned enterprises, selected by city governments, will act as the acquiring entities, managing the properties in a market-oriented manner.

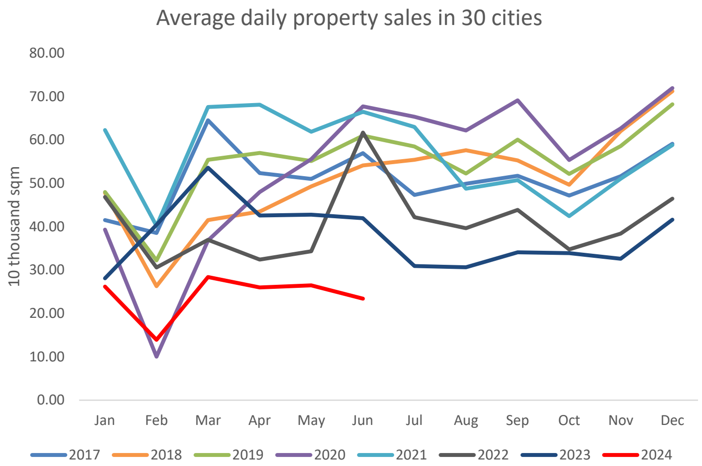
Fourthly, for undeveloped or partially developed land that has not yet been completed, appropriate measures will be implemented to address and revitalize these assets through methods such as government reclamation or repurchase. The reclaimed or purchased land will be designated for constructing affordable housing and public service facilities, thereby improving the supporting infrastructure for surrounding residential areas. For land used in affordable housing projects, funding support can be provided through local government special bonds. The policy also stipulates that local governments must operate within its financial means, carefully balancing project revenues and expenditures to avoid increasing hidden government debt risks.

Property: still no light at the end of tunnel

The equity market rebounded initially but the excitement faded towards the end of May as investors remain cautious about the impact of fewer real estate policies. Divided opinions on real estate policies in the market primarily stem from the intermittent effect of policy relaxation on real estate sales in major cities since 2022. The latest data from May indicated a further weakening in China's real estate market, with property price corrections deepening. It may take some time for demand and supply to reach a new equilibrium.

China

Chart 1: High frequency data showed that property transactions failed to pick up despite easing policies.



Mixed external versus domestic demand

Meanwhile, holiday spending has rebounded year-to-date in 2024. According to data released by the Ministry of Culture and Tourism, a total of 110 million trips were made during the latest Dragon Boat Festival long weekend in June, marking a 6.3% YoY increase. Additionally, total domestic travel spending grew by 8.1% YoY, reaching 40.35 billion yuan.

Despite some initial indications of recovery, recent inflation and credit data continue to reflect an uncertain outlook for domestic demand. Headline CPI only grew by 0.3% YoY in May. Meanwhile, May M1 and M2 growth slowed to record lows. M2 growth decelerated to 7% YoY in May from 7.2% YoY in April, while the contraction in M1 growth deepened to 4.2% YoY in May from 1.4% YoY previously. The gap between M2 and M1 widened further.

On the bright side, external demand remains supportive. Goods exports grew by 7.6% YoY in May, surpassing market expectations, while imports increased by a less-than-expected 1.8% YoY. The stronger-than-expected export growth aligns with resilient global manufacturing activities, as demand from China's main trading partners improved across the board. Notably, exports to ASEAN accelerated to 22.51% YoY in May, while exports to the US turned positive, rising by 3.6% YoY. We expect export growth to remain strong in the coming months.

Manufacturing has been a standout sector in 1H24, reflecting strong external demand. The rising global demand for Chinese products, coupled with the global economic soft landing, highlights the increasing competitiveness and appeal of Chinese products resulting from industrial upgrades. Current production trends indicate a shift towards high-tech, smart, and green manufacturing. Overall, we believe external demand is expected to remain the key driver to growth in 2H24.

China

Filling the gap

The government is pushing for equipment upgrades and trade-ins of consumer goods given the softening property market. By stimulating consumption in bulk items like home appliances and automobiles, this initiative enhances the likelihood of reaching the 2024 growth target without relying heavily on the property market.

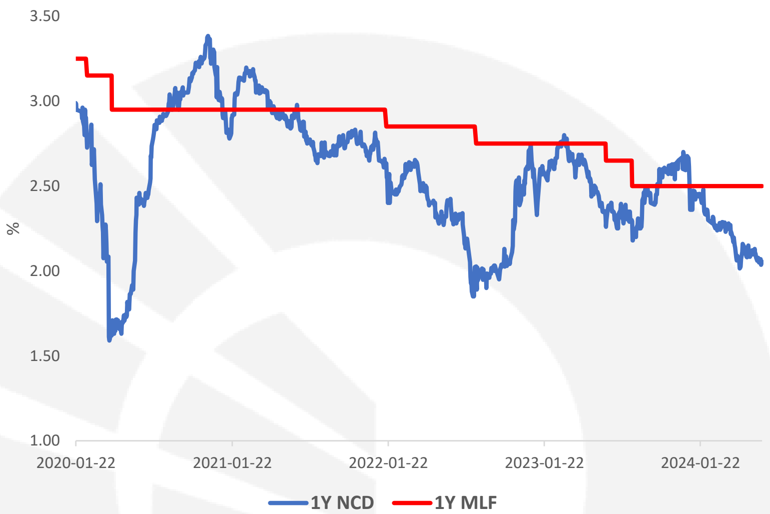
The equipment upgrade and trade-in of consumer goods are not a panacea for solving China's structural problems. However, they serve as short-term solutions that can buy China more time to rebalance its economy. Historical evidence supports the effectiveness of these measures, as seen in the previous round of trade-in programs for household appliances.

For instance, the pilot project that began in June 2009 and expanded nationwide in April 2011 resulted in a direct consumption surge of 342 billion yuan, thanks to a cumulative subsidy of 30 billion yuan allocated by the central government based on the data from Commerce Ministry. This demonstrates an encouraging multiplier effect. Based on that multiplier effect, it shows that for every CNY100bn subsidy, consumption of home appliances may expand by CNY800-900bn. This accounts for more than 1.5% of total retail sales and may help offset the decline in property-related transactions.

More monetary policy support is expected

The deceleration in China's money supply and the recent shift in demand for both central bank-engineered tools such as PSL and MLF, driven by relatively high funding costs compared to market-traded rates, underscores the dilemma facing the PBoC. In recent months, the PBoC's balance sheet has contracted from its peak, reflecting weak demand for MLF and redemptions for PSL, which could further hinder the expansion of the monetary base. Against a backdrop of increasing propensity for fixed deposits, the slowing creation of the monetary base may delay China's timeline for reflation.

Chart 2: Market traded rate is much lower than the policy rate



China

The weak credit and money supply data, along with the recent reduction in the central bank's balance sheet, may indicate a potential pressure for the PBoC to further lower its policy rate.

Nevertheless, the PBoC currently appears to favour exchange rate stability over interest rate adjustments. Although the current low inflation rate supports the case for further interest rate cuts in China, concerns about the impact of such cuts on exchange rate stability limit the central bank's ability to adjust interest rates.

This may delay the timeline to roll out more monetary stimulus. However, we still expect China to lower its benchmark Loan Prime Rate by another 20bps this year as well as the reduction of RRR by 50bps to fight the deflation risk.

To summarize, we think it is possible for China to achieve its growth target this year even without a meaningful recovery of the property market on the back of resilient external demand and policies geared towards supporting domestic demand. Our forecast for 5% growth in 2024 remains unchanged. Nevertheless, it is still too early for China to lower its guard. We expect PBOC to deliver more interest rate cuts and RRR cuts in 2H24 to support growth and offset the drag from the property market.

Hong Kong

Hong Kong: From Reactive to Proactive

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- To counter the economic slowdown and revive market sentiment, the authorities had shifted from a reactive policy response to a proactive one.
- The gloom in the housing market has eased since the removal of cooling measures, yet it did not seem to signal a decisive turnaround in sentiment.
- On a multi-month horizon, we expect HKD rates to underperform USD rates on a downward move on expected inflows. Our base-case is a 12.5bps cut in prime rate in 4Q24, with the risk of no cut should the Fed stall on monetary policy easing.
- Growth is likely to remain patchy and uneven, with the external demand staying relatively firm. Our full year growth forecast for 2024 is 2.3% YoY.

Policy response has turned more proactive

The weakness in domestic demand can no longer be masked by the low base effect as of mid-2024. The "higher for longer" interest rate setting is exacting its toll on local consumption and investments, putting persistent downside pressure on economic growth. This is exacerbated by a re-emergence of labour market softness and a lacklustre property market.

To counter the economic slowdown and revive market sentiment, the authorities shifted from a reactive policy response to a proactive one. Cooling measures related to the housing sector were scrapped, while a slew of measures have been put forward to woo back tourists and reinforce Hong Kong's status as financial centre.

Chart 1: Favourable base effect waned

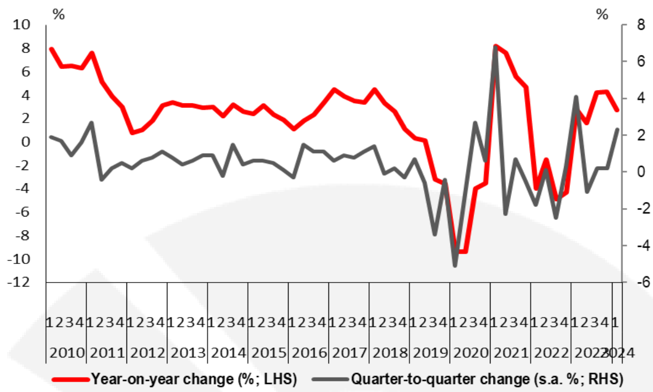
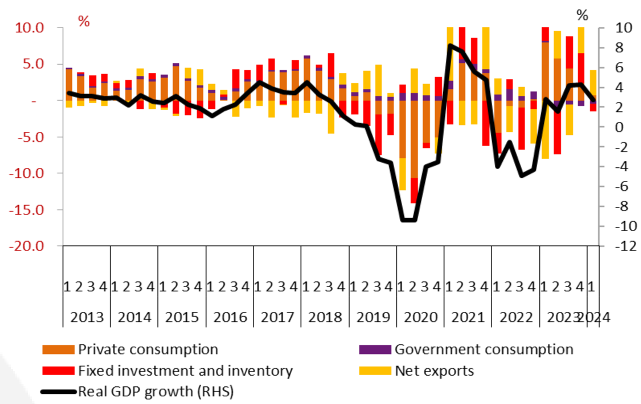


Chart 2: Domestic demand weakened



Sources: HK Census and Statistics Department, OCBC

Weakening domestic demand

Real GDP grew by 2.7% YoY in 1Q24, compared to 4.3% YoY in 4Q23 (***Chart 1***). On a seasonally adjusted basis, real GDP rose by 2.3% QoQ, accelerating from 0.2% QoQ in 4Q23. Growth became increasingly unbalanced, as external demand remained resilient in 1Q24, while domestic demand weakened notably (***Chart 2***). The government maintained its full-year GDP growth forecast at 2.5%-3.5%, citing the potential positive impact from various government initiatives and a further revival of inbound tourism.

Hong Kong

Breaking it down, exports of services continued to be the key growth driver. Exports of services grew at a brisk pace of 8.4% YoY in 1Q24 (4Q23: +21.2% YoY), as visitor arrivals jumped by 154% YoY to 11.2 million. Meanwhile, goods exports registered growth of 6.8% YoY as external demand remained resilient, although a very low base of comparison also played a part.

On the flip side, private consumption expenditure expanded by a much slower 1.0% YoY (4Q: +3.5% YoY), amid weak local consumption sentiment and more outbound travel. The pace of growth for gross domestic fixed capital formation also decelerated notably to 0.3% YoY (4Q: +17.5% YoY), similar to government consumption expenditure which fell by 3.0%YoY (4Q: -5.2% YoY) amidst fiscal consolidation.

Cracks are emerging in the labour market

The unemployment rates in most sectors have edged up lately, while the overall unemployment rate had been kept at a relatively low level of 3.0% in the three-months ending April 2024 (***Chart 3***). Specifically, unemployment rates in "retail, accommodation and food services" and "import/export trade and wholesale" sectors rose the most with both up by 0.7 percentage points. Further softening of the labour market is likely to weigh on domestic demand, and the unemployment rate has more room to climb later this year. We forecast the overall unemployment rate at 3.1% for this year.

Chart 3: Labour market softened

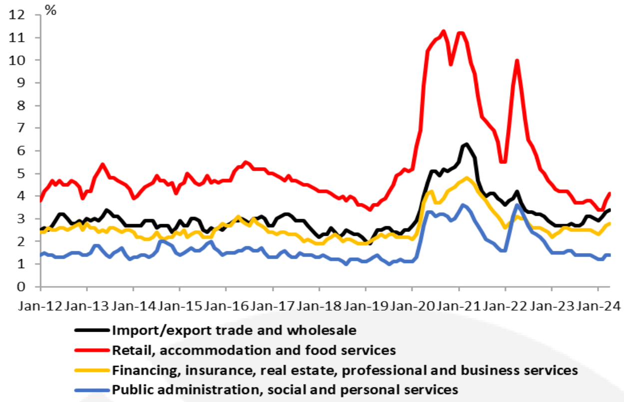
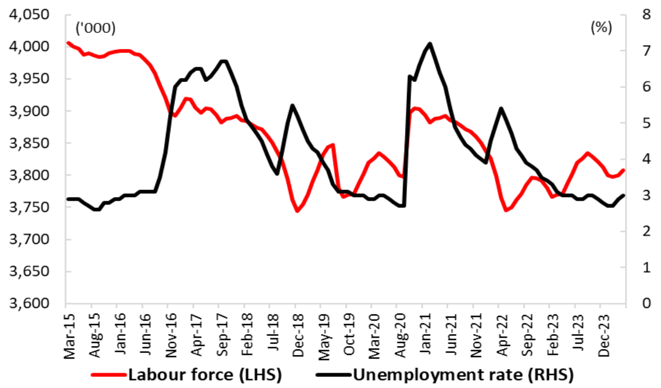


Chart 4: Labour force



Sources: HK Census and Statistics Department, OCBC

Meanwhile, the labour force grew by 62,600 to 3,807,800 in February-April 2024 compared with the recent low in mid-2022, supported by schemes to attract talent and increase labour importation. (Chart 4). In parallel, total employed persons increased considerably by 142,700 to 3,694,100 against the recent lows, hence keeping the labour market on the tight side.

Hong Kong

All savings and no lending
Still elevated time deposit rates at local banks have reduced the incentive to move money out of banks or invest elsewhere. As a result, Hong Kong dollar CASA ratio for licensed banks stayed at a subdued level since late 2023 (***Chart 5***), pushing banks' cost of funding even higher. The share of time deposits to total HKD deposit in licensed banks rose substantially from 31.3% at end-2021 to 56.5% as of end-April 2024.

On the other hand, loan demand was hard hit by the persistently high borrowing rate, lacklustre asset market performance and the growing macro uncertainties. Total loans and advances shrank by 2.0% from end-2023 to end-April (Chart 6), while that for loans for use in HK contracted by 1.2%. Within the latter, loans to most economic sectors fell. In particular, loans to stockbrokers and loans to financial concerns saw the most notable declines of 10.4% and 7.5% respectively.

A silver lining can still be found
The high interest rate environment was blamed for the broad-based slowdown of the economy, yet a silver lining can be found. Considerable inflows had been recorded from the Mainland as investors rushed to benefit from higher rates. Retail banks had to extend their operating hours to accommodate the increasing demand from mainland clients. Total Renminbi deposit in local licensed banks rose to 1.1 trillion at end-April 2024 (Chart 7), the highest level since January 2022. Meanwhile, Southbound Wealth Management Connect sales reached a record high of RMB 22.3 billion in April (Chart 8), following the enhancement to the Wealth Management Connect.

Chart 5: HKD CASA ratio kept at subdued level

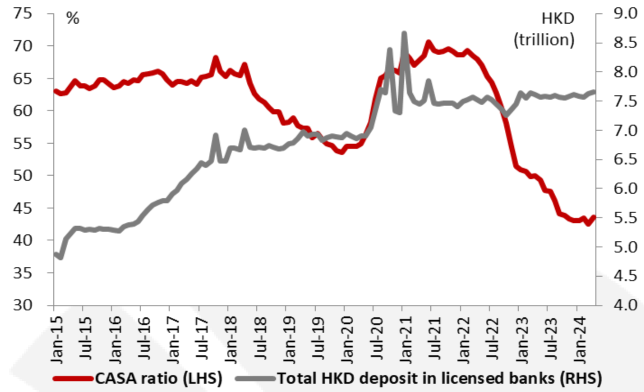
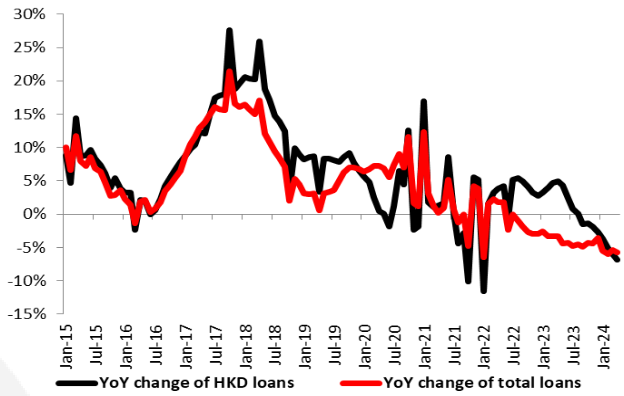


Chart 6: Loan demand hard hit



Sources: HKMA, OCBC

Hong Kong

Chart 7: Renminbi deposit grew notably

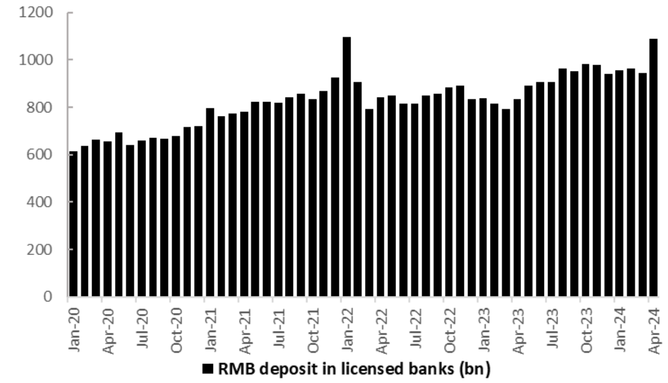
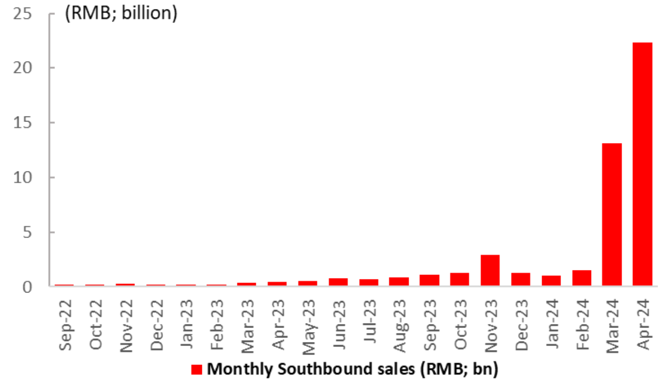


Chart 8: Southbound Wealth Connect sales surged



Sources: HKMA, PBoC, OCBC

Regulatory green shoots emerging

Reviewing the recent policy announcements (***Table 1***), including Wealth Connect 2.0, expansion of Stock Connect and encouraging leading enterprise to list in Hong Kong, we believe that top management has taken a proactive approach in aiming to re-establish Hong Kong's role as an international financial centre and IPO hub. Efforts were also made to promote coordinated development and mutual market access of mainland and Hong Kong's capital markets.

Key enhancements to the Wealth Connect, namely expansion of the scope of participants, raising the investment quota (from RMB 1 mn to RMB 3 mn) and widening of the eligibility of investment products, are expected to provide new momentum for the wealth management sector. Separately, mainland authorities' regulatory support for offshore listings of corporates could help bring back the once vibrant IPO market, after years of dry spell.

Table 1: Recent policy announcements

Date of announcement	***Measures***
Jan 24	➢ ***"Triple** Connectivity, **Triple Convenience"*** ○ *Expanding the list of collateral for HKMA's RMB liquidity facility to RMB bond issued onshore by China's MoF and policy banks* ○ *Opening up onshore repo market for institutional investors with access to China Interbank Bond Market* ○ *Enhancement to Cross-boundary Wealth Connect scheme in the GBA* ○ *Promoting collaboration on cross-boundary credit referencing* ○ *Expanding e-CNY pilot scheme in Hong Kong*
Apr 24	➢ **Expansion of Stock Connect** ○ *Expanding the scope of eligible ETFs* ○ *Incorporating real estate investment trust* ○ *Inclusion of yuan-denominated stocks into southbound trading* ➢ **Enhancement to mutual recognition of funds** ○ *Relaxing sales restrictions for recognised HK funds in the Mainland** ➢ **Supporting listing of leading Mainland companies in Hong Kong**

Sources: HKMA, PBoC, CSRC, OCBC

(*) Content adapted from consultation paper by the China Securities Regulatory Commission (CRSC).

Hong Kong

From "policy speculation" to "policy execution"
The series of policy support measures, as well as China's stimulative measures and market-favoured corporate actions (including share buyback, increased dividend payout) breathed life into the battered local stock market. The Hang Seng Index has staged an impressive rally since mid-April, bouncing by more than 30% from the trough seen in January (***Chart 9***). Some IPOs were met with strong market response, with an oversubscription rate of above 10 times.

Businesses and corporates also rushed to take advantage of the visible improvement in risk sentiment and favourable policy signals, by issuing convertible bonds to raise funds. Yet the "policy speculation" related optimism gradually morphed into concerns over "policy execution". Market participants probably need to see some concrete results before gaining more confidence in the traction around recent reforms.

Local government efforts have stepped up
The local government also stepped-up efforts to rebrand Hong Kong with the hope to bring in more tourists and investments. HK$1.09bn will be allocated for developing an array of tourist attractions and activities in the city, including hosting monthly pyrotechnic and drone shows, while over HK$100mn would be earmarked to boost mega-event promotion over the next three years.

Separately, the government will further enhance the preferential tax regimes for related funds and single-family offices. To revive equity market sentiment, the government is looking to introduce a treasury share buy-back regime and maintain trading operation under severe weather conditions, alongside other measures to boost market efficiency and liquidity. The government will also waive stamp duties payable on the transfer of REIT units etc.

Chart 9: Rally in Hang Seng Index

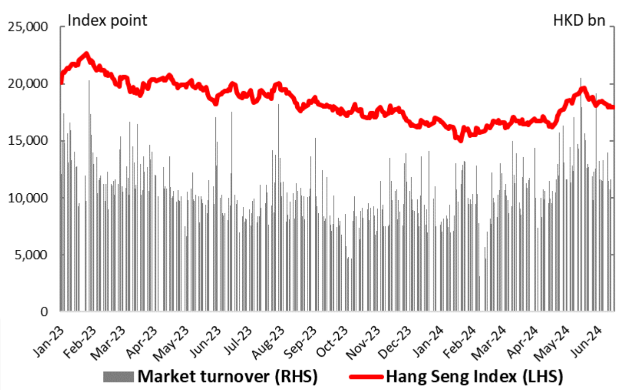
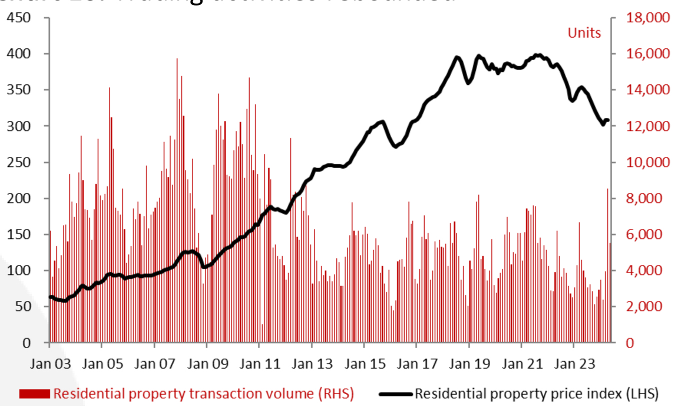


Chart 10: Trading activities rebounded



Sources: HK Rating and Valuation Department, Land Registry, HKMA, Blomberg, OCBC

Hong Kong

All "spicy measures" were scrapped
To arrest the decline in housing prices, all demand-side measures for residential properties (including Special Stamp Duties, Buyers' Stamp Duties and New Residential Stamp Duties) were lifted in February this year, while mortgage rules were further relaxed (loan-to-value ratio adjusted to 70% for all self-occupied residential properties valued at HK$30 million or below). Trading activities in the residential property market saw notable rebound in the following months. Average monthly transactions rose to 6,023 cases in March-May 2024, significantly above that of 3,584 in 2023 and 2,926 in January-February 2024 (Chart 10). Anecdotal evidence suggests that the share of non-local buyers is around 40-50% of the total.

Short lived rebound
The gloom in the housing market eased somewhat since the removal of curbs, yet it did not signal a decisive turnaround of sentiment. The official residential property price index extended the month-on-month gain in April, though at a slower pace of 0.3% (+1.8% MoM in March). In the first four months this year, the housing price dropped cumulatively by 0.8%. Other high frequency market data suggested that rebound in housing prices was short lived and all its gains have been completely erased lately. Sentiment turned south again due to tightened mortgage policies, competitive pricing strategy for newly launched projects and elevated mortgage rates.

Local commercial banks had quietly tightened mortgage policies, including reducing cash rebates, increasing scrutiny of mortgage applications and raising mortgage rates on specific type of residential units, over concerns of asset quality deterioration during the property market down cycle. On the other hand, developers have accelerated the launch of new projects, with some offering additional incentives on top of existing concessions. As a result, we have revised downward the full year 2024 forecast for housing prices. We now expect the price index to fall by 3-6% this year. That said, the increased housing demand from talent inflows and the rally in rental prices should still render some support to the overall sentiment (***Chart 11***).

Chart 11: Diverging trend between price and rent

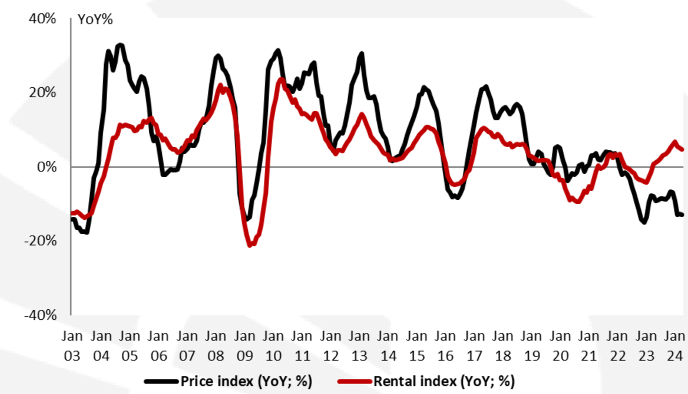
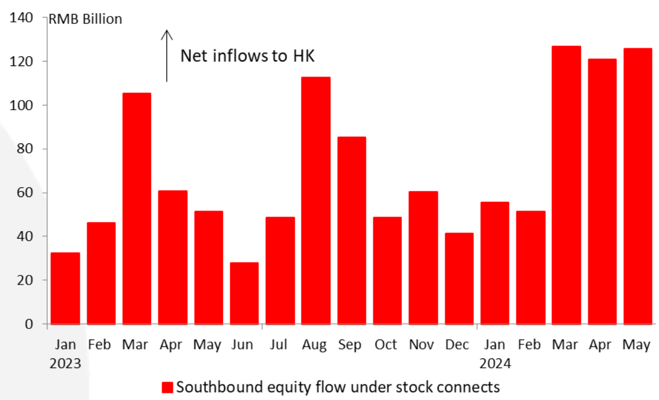


Chart 12: Southbound flows above 120 billion mark



Sources: HK Rating and Valuation Department, Bloomberg, OCBC

Hong Kong

HKD rates outperforming USD rates

Near term HKD liquidity is likely to stay relatively tight in the front-end, against the backdrop of ongoing dividend payouts and more fund-raising activities, as well as the approaching quarter-end. However, such tightness is not expected to last, given the lukewarm IPO market and low HKD loan-to-deposit ratio (82.12% at end-April). Meanwhile, the Fed is widely expected to start cutting rates in 2H24. On a multi-month horizon, we expect HKD rates to underperform USD rates on a downward move of expected inflows. For one, Southbound Stock Connect flows have been persistent, staying above the RMB120bn mark for the past three months (***Chart 12***).

Our base-case is for a 12.5bps cut in the prime rate in 4Q24, with the risk of no cut should the Fed stall on monetary easing. The pass-through from Fed's rate decision onto Hong Kong commercial banks' prime rate is usually higher in a rate cut cycle than in a hike cycle, based on our observations of historical trends. Meanwhile, factors such as cost of funding, deposit bases, loan demand, liquidity situation and economic climate also contribute to such decisions. In this case, we expect the pass-through to be around 25%, i.e. 50bp cut in Fed fund rate vs. 12.5bp cut in HKD prime rate, given the limited rate hikes (87.5bps) in the last tightening cycle.

Inflationary pressure is likely to stay mild

Inflationary pressure stayed low, with CPI rising by an average 1.7% in the first four months this year (2.1% in 2023). Over the same period, underlying CPI (after removing the effects of all government's one-off relief measures) rose by a milder 1.0%. Breaking it down, most of the components saw milder price pressures entering 2024, except for housing inflation which rose by 3.1% YoY in March, the highest level since 2022, before paring somewhat in April due to the provision of rates concession. Overall inflationary pressure is likely to stay mild in the near term. We have revised downward the full year inflation forecast from 2.5% to 2.3%, in view of the receding external price pressure and weak consumption sentiment.

Growth forecast is also revised downward

Sluggish domestic demand conditions and delayed Fed rate cut expectations, together with a further softening of labour and housing market conditions, make for a dim economic growth outlook. That said, with green shoots emerging on the regulatory front, we expect some stabilisation of sentiment in the asset markets. Growth is likely to remain patchy and uneven, with the external demand staying relatively firm, barring abrupt slowdowns in China or global economy. Our full year growth forecast for 2024 is 2.3%, down from the original forecast of 2.5%.

Macau

Macau: Cyclical Optimism Sustained

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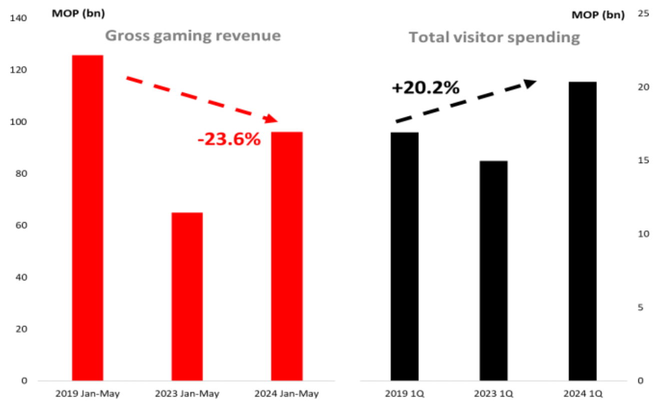
- The economy is set to recoup all the declines during the pandemic, as cyclical momentum stayed strong.
- While the near-term economic outlook is rosy, the optimism is mostly cyclical rather than structural. Industries with weak links to inbound tourism and gaming sectors have been impacted by high interest rates.
- The economy is expected to return to its pre-Covid size later this year. We stick to our earlier growth forecast of 16% in 2024.

Closer to a full recovery

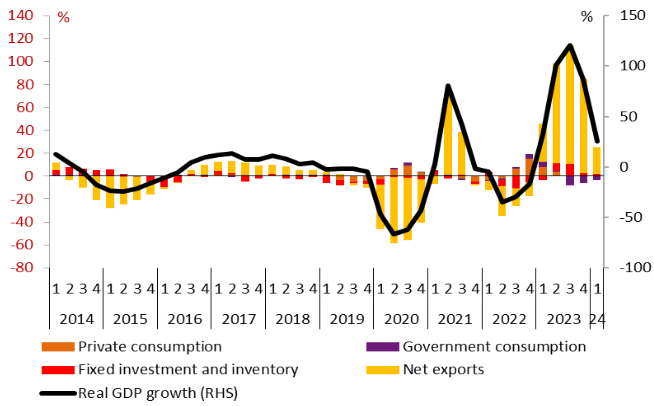
The economy is set to recoup all the declines from the pandemic, as cyclical momentum remains strong. Total tourism spending and gross gaming revenues, which represent the total receipts of the two key economic pillars, surged by 35.9% YoY (in 1Q24) and 47.9% YoY (Jan-May 2024), respectively. As a result of the uninterrupted rally in the last few quarters, the former has exceeded the 2019 level by 20.2%, while the latter reached 77.3% of the 2019 level (***Chart 1***). At the same time, most of the macroeconomic indicators continued to be on the fast track towards a full recovery. The labour market is only a step away from full employment, and median monthly employment earnings have reached a record high.

Chart 1: Tourism receipt and gaming revenue surged



Sources: DSEC, DICJ, OCBC

Chart 2: Real GDP rose sharply against higher base



Macau

Chart 3: Visitor arrivals saw sharp yearly gain

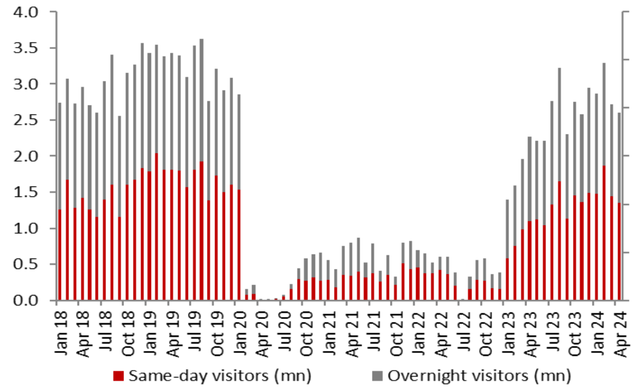
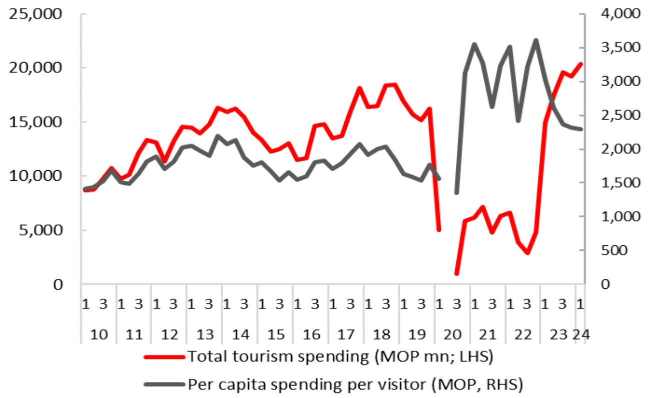


Chart 4*: Total tourism spending surpassed 2019 level



Sources: DSEC, Macau Tourism Office, OCBC

Note (*): The survey data is not available for the second quarter of 2020.

Both domestic and external demand expanded further

Underpinned by the stellar growth in services exports, real GDP rose sharply by 25.7% YoY in 1Q24 (***Chart 2***), against the higher base last year (4Q 2023: +86.4% YoY). Yet comparing to the same period in 2019, Macau's economy still shrank by 12.8%. During the quarter, both external and domestic demand expanded further, recording year-on-year increases of 61.0% and 3.4% respectively.

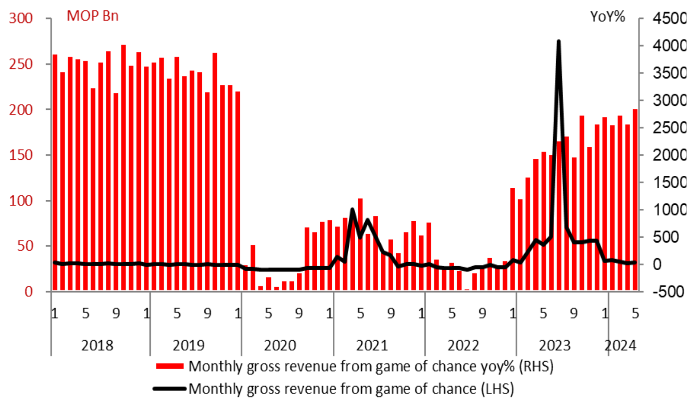
Exports of services grew by 30.3% YoY in 1Q24, as visitor arrivals jumped by 79.4% YoY to 8.9 million (***Chart 3***). Specifically, exports of gaming services and other tourism services surged by 62.7% YoY and 14.8% YoY respectively. Meanwhile, domestic demand also contributed to growth, with private consumption expenditure and gross fixed capital formation recording solid year-on-year gains of 10.9% and 13.0% respectively. Growth in investments were led by the private sector as casinos operators stepped up investments. Construction and equipment investment by private sector rose by 10.4% YoY and 28.5% YoY respectively. Separately, public consumption expenditure declined further by 20.7% YoY in 1Q24 amid the conclusion of Covid period relief measures.

Non-gaming investment forming a virtuous cycle

Thanks to the coordinated efforts of the government and businesses, the economy had transitioned into a Las Vegas-style entertainment hub and wooed back nearly all the tourists. Macau's total visitor arrivals reached 11.5 million in the first four months this year, returning to 83.2% of the pre-Covid level in 2019. In parallel, the total tourism spending in 1Q24 also exceeded the 2019 level by as much as 20.2%, with the sharp increase in tourist arrivals more than offsetting the slump in per capita spending. Per-capita spending (excluding gaming expenses) of tourists fell to MOP2,293 in 1Q24, the lowest in more than three years (***Chart 4***), possibly due to visitors' preference of more frequent rather than longer stays.

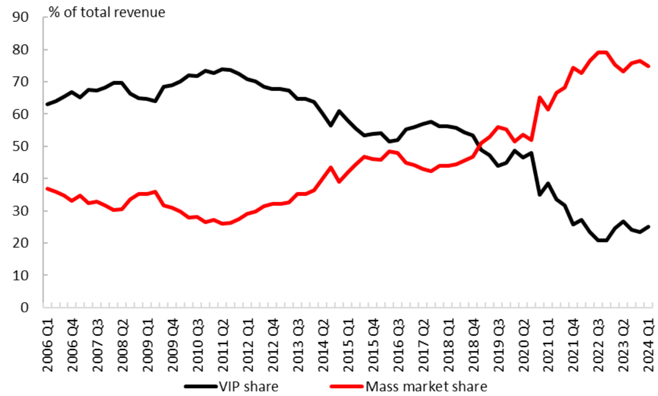
Macau

Chart 5: Gross gaming sector continued its uptrend



Sources: DSEC, DICJ, OCBC

Chart 6: Share of VIP segment steadied



The clause requiring a 20% increase in concessionaires' investment commitments on non-gaming amenities (originally at MOP108.7 billion for six concessionaires over the course of 10 years) was triggered, as gross gaming revenue hit MOP$180 billion in 2023.

Aside from enriching hospitality offerings at their respective hotels and entertainment venues, casino operators had made multi-year plans with the government to revitalise tourist attractions and host mega-sized events. Such investments are forming a virtuous circle, where the gaming and non-gaming tourism sectors are fuelling the growth and prosperity of one another.

Share of VIP gaming segment has steadied

Gross total gaming revenue grew further, as revenue originating from mass and premium mass segments reached new highs. Gross gaming revenue surged by 47.9% YoY from January-May 2024, to an average of MOP19.2 billion per month (***Chart 5***). In May alone, the gaming revenue returned to 77.8% of 2019 level. Revenue generated from mass and premium mass segments surpassed the pre-Covid level by 10.3% in 1Q24, while that of VIP segment returned to 38.6%.

The recovery story in gaming sector was mass and premium mass segment led, as stated in our previous report. However, the pace of growth for the VIP segment has picked up lately. The share of the VIP segment has steadied and even bounced back somewhat (***Chart 6***), despite the crackdown from Mainland authorities on illegal money exchanges and loan sharks. Their prevalence was considered an important factor contributing to the exponential growth of the VIP segment over the past few decades. This showed that the VIP segment may be finding some success, tapping into overseas high-roller market, and adapting to the new regulatory environment.

Tighter labour market

In line with the ongoing recovery, the labour market has continued to tighten, while employment earnings have reached record highs. In February-April 2024, the overall unemployment rate declined further to 1.9% (***Chart 7***), just shy of the pre-pandemic level at 1.7%. In parallel, the median employment income rose to the record high of MOP18,000/month in 1Q24, as majority of the economic sectors saw higher median employment income (***Chart 8***).

Macau

As the labour market is approaching full employment status, domestic consumption will stay supported. However, the labour force has started to plateau of late. Total labour force hovered near 3790k-3820k since late 2023, while participation rate of local residents has edged down slightly.

Chart 7: Labour market tightened

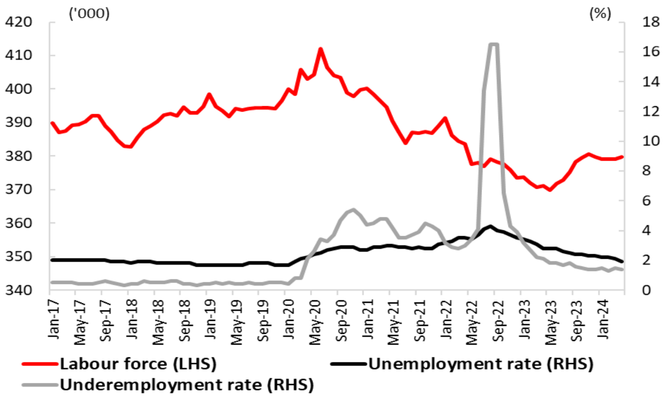
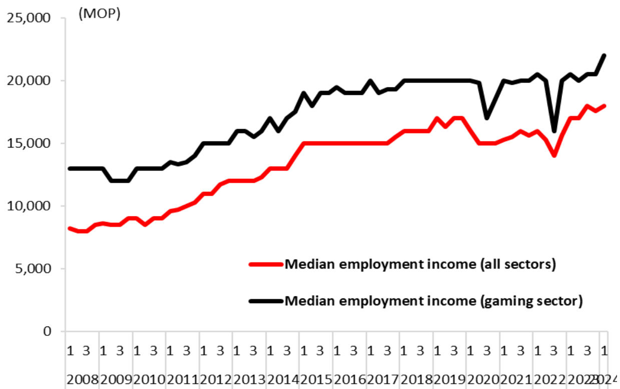


Chart 8: Employment earning reached record high



Sources: DSEC, Macau Labour Affair Bureau, OCBC

Pessimism prevailed despite the removal of cooling measures

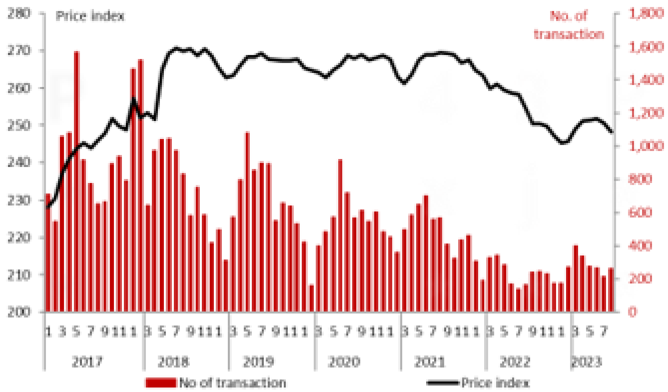
The government lifted all housing cooling measures in April this year in response to the ongoing correction in the housing prices. These measures include special stamp duties (for all non-resident buyers, properties resold within 24 months and buyers with at least two properties), stress test requirements and raising the upper limit on mortgage-to-value ratio. The government hopes to rejuvenate the housing market by easing curbs on home purchases. Yet, the government is expected to employ other supply side measures to maintain the stability of the housing market, including adjusting the supply of public housing and land.

Home prices fell by a faster pace in April, despite the removal of property market cooling measures. The residential property price index dropped by 11.6% YoY in three-month ending April 2024 (***Chart 9***). Comparing with the high in 2018, the housing price has fallen a cumulative 18.0%. Trading activities stayed at a subdued level, amid a lacklustre housing market. However, average rental prices bounced by 0.7% QoQ in 1Q24, as housing demand stemming from foreign workers continued to grow.

Sentiment in the local housing market remains fragile as mortgage rates are elevated by historical standards (***Chart 10***). Buyers generally prefer to stay on the sidelines before any rate cuts materialise. We now forecast the year-on-year decline in housing price to be 4-8% for 2024.

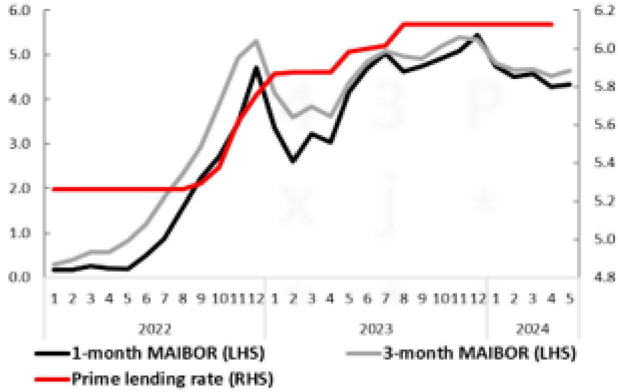
Macau

Chart 9: Ongoing correction in the housing prices



Sources: DSEC, Monetary Authority of Macau, OCBC

Chart 10: Interest rates elevated



Mild uptick in inflationary pressure

Price pressure remained moderate despite a mild uptick. Headline inflation averaged 1.1% from January-April 2024, above 0.9% in 2023 (***Chart 11***), as the YoY change of the largest component of CPI, i.e., "housing and fuels" returned to positive zone (averaging at 0.2%). Separately, the increase in costs of "food and non-alcoholic beverage" (averaging at 1.6%) slowed, while that of "miscellaneous goods and services" and "recreation and culture" accelerated notably (averaging at 2.4% and 6.2% respectively). We expect the inflationary pressure to remain modest in the periods ahead, on the back of largely steady rental prices and limited import inflation. Our forecast for the inflation rate is 1.1% in 2024.

Cyclical optimism and structural frustration

While the near-term economic outlook appears rosy, the optimism is mostly cyclical rather than structural. The post-pandemic economic rebound was solid but uneven. Industries with weak links to inbound tourism and gaming sectors are challenged by the high interest rate environment (***Chart 12***) and intensified competition from neighbouring cities. Economic diversification failed to gain much momentum while development bottlenecks (such as lack of qualified workforce and insufficient transport infrastructure) remain unresolved. Furthermore, due to its over-reliance on China market, any further economic slowdown in China would have a spillover effect onto Macau's economy.

Returning to its pre-Covid size

Based on the current trajectory, the economy is expected to return to its pre-Covid size later this year. We stick to our earlier growth forecast at 16% YoY in 2024. This assumes that the pace of recovery for inbound tourism and the gaming sectors holds steady, offsetting the weakness in other sectors. We expect the total gross gaming revenue to grow by 33% YoY this year, while full-year tourist arrival may return to 89% of pre-pandemic level. The labour market is likely to return to full employment, with the unemployment rate falling back to 1.8% by year-end.

Macau

Chart 11: Price pressure saw mild uptick

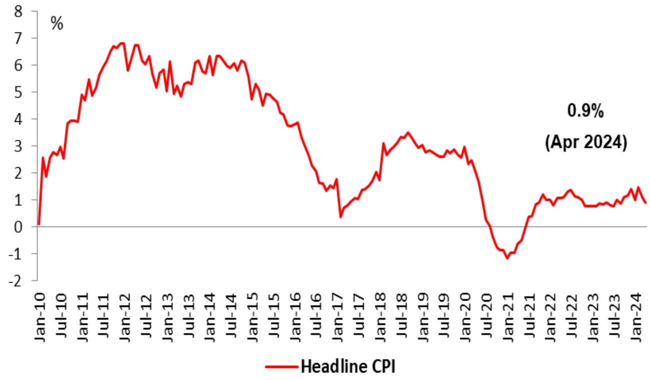
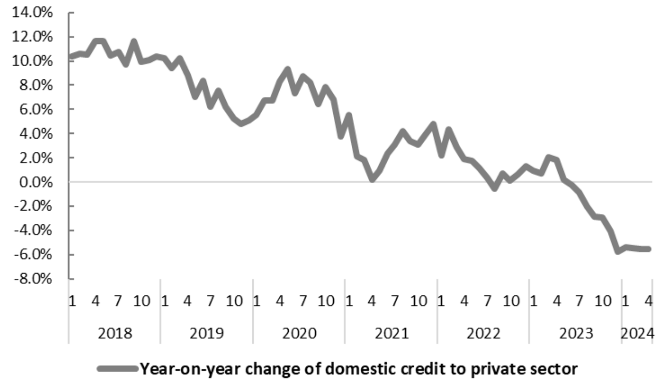


Chart 12: Loans to private sector dropped



Sources: DSEC, Macau Monetary Authority, OCBC

Taiwan: On Track for Solid Growth

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- GDP growth was +6.56% YoY in 1Q24, while sequential growth momentum remained positive at 0.27% QoQ SA.
- Recent high frequency data continues to show that export shipments and order levels is consistent with an export-driven production recovery and our full-year 2024 GDP growth forecast of 3.80% YoY.
- We reiterate our call for the CBC to extend its rate pause at 2.00% for the rest of the 2024, with rate cuts likely to begin in 1Q25.

Momentum stayed positive

The economy expanded by +6.56% YoY in 1Q24 (OCBC forecast: 6.15% vs. BBG consensus: 6.0%), helped by the low base comparison and improved external demand conditions. Growth momentum remained positive, with sequential GDP growth rising by 0.27% QoQ SA (4Q23: 2.34%).

The robust headline growth was again underpinned by private consumption (+ 2.26 ppts to headline growth) and net exports (+5.49 ppts). While private consumption (+4.45% YoY) continues to stay robust supported by higher spending on services despite the already high base, the export recovery only began in 4Q23 following a year of contraction. Shipments of goods and services rose for the second consecutive quarter by +10.21% YoY, following a +3.72% YoY growth in 4Q23, with the latest boost from AI-related tech demand. Meanwhile, the tourism sector recovery stayed on track. In addition, government expenditure was modestly higher (+1.15% YoY, +0.16 ppts) in 1Q24, building on a previous high base.

By contrast, gross capital formation (-4.88% YoY, -1.35 ppts) extended its fifth consecutive contraction on a quarterly basis due to the higher interest rate environment, global uncertainties arising from the rising cross-strait tensions and the Middle East situation.

The recent high frequency data continues to show that export shipments and order level are on track for further improvements. This suggests that the upbeat economic growth in 1Q24 is likely to extend into the remaining quarters of 2024. As such, we expect a continuation of an export driven production recovery supporting our latest 2024 GDP forecast of 3.8% from 3.5% previously.

Taiwan

Chart 1: Private Consumption and Net Exports Were Again the Key Growth Drivers

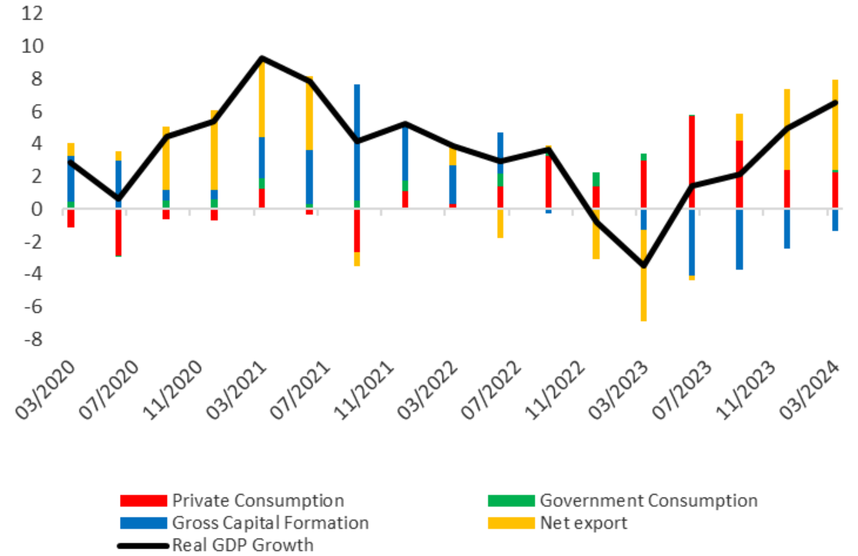


Table 1: Growth Momentum Stays Positive in 1Q24 (Percentage Contribution, by Expenditure)

Component	2021	2022	2023	1Q23	2Q23	3Q23	4Q23	1Q24(p)		2024F	2024F
										DGBAS	CBC
Domestic Demand	5.24	4.24	1.17	2.45	1.87	0.50	-0.23	1.2		3.27	
-Private Expenditure	-0.35	3.75	8.32	6.41	12.94	9.28	4.59	4.45		2.64	
-Public Expenditure	3.69	4.83	0.88	3.59	0.3	0.08	0.3	1.15		2.68	
-Gross Capital Formuation	17.26	4.75	-10.30	-4.70	-13.82	-13.18	-9.06	-4.88		2.72	
External Sector											
-Exports	17.27	1.75	-4.32	-11.86	-7.75	-1.41	2.86	9.11		5.90	
-Imports	18.06	4.32	-5.73	-4.79	-9.03	-4.62	-5.63	0.84		6.24	
Real GDP	6.53	2.59	1.31	-3.49	1.41	2.15	4.83	6.56		3.43	3.22

Source: DGBAS, OCBC

Chart 2: Global Semiconductor Sales Activities Stay Upbeat

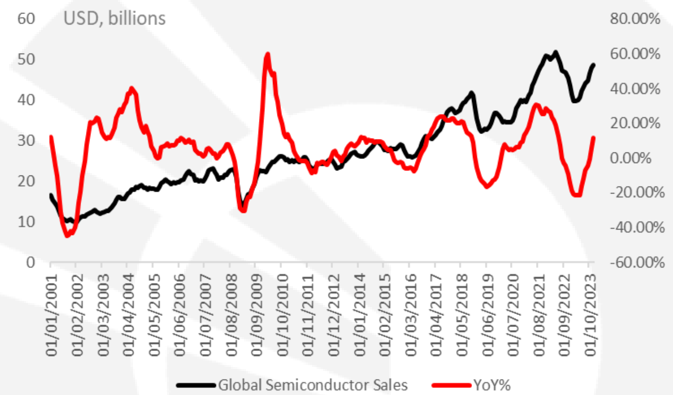
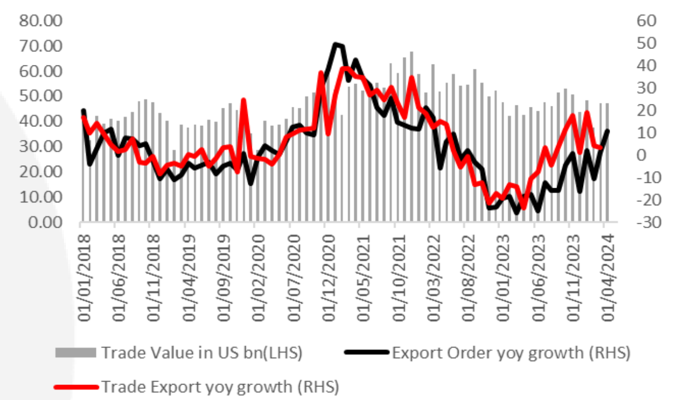


Chart 3: Taiwan's Export Stays on Tracks for its Upward Cycle



Taiwan

Chart 4: Domestic Sales

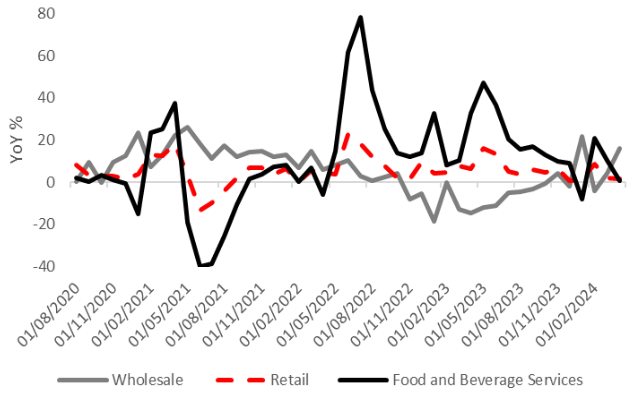
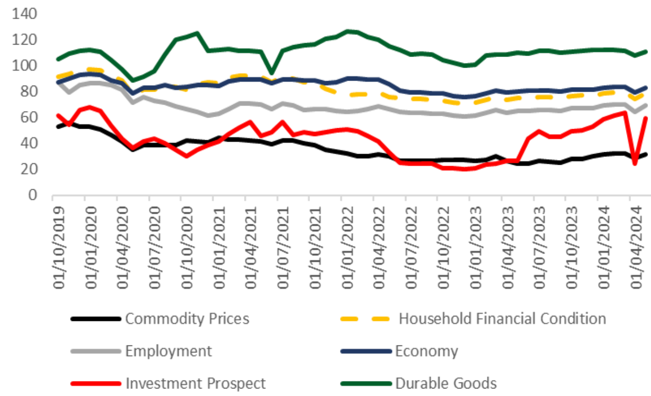


Chart 5: Consumer Confidence Index by Component



Source: CEIC, Bloomberg, MoEA, MoF, OCBC

High tech expectations meet high earnings

Based on the recent earnings calls from the semiconductor industry, AI-related tailwinds have continued to cushion the top line for those with relevant exposures, in many cases offsetting the declines felt from other end-markets that have yet to see substantial recovery from their cyclical lows.

In the meantime, TSMC has revised its forecast on its April's earnings call for the global semiconductor market, excluding memory, to a 10% growth this year. The company's management highlighted the following reasons for the change: **1/**traditional server demand remains subdued as investment focus shifts towards AI; **2/**smartphone platforms have shown signs of recovery, albeit at a gradual pace; **3/** PC demand has bottomed out, although the recovery is progressing slowly; and **4/** automotive segment is expected to see inventory corrections throughout 2024.

That said, we believe Taiwan and Korea remain the main beneficiaries of the recovery in the semiconductor conductor sector in the Asian region, given the substantial backlog of orders in AI chips.

Interest rates currently on hold, but RRR hikes may be on the cards

Following a surprise 25bp hike at its March meeting, the CBC kept the benchmark discount rate at 2.0% but tightened household credit measures and raised the reserve requirement ratios (RRRs) to cool property market.

The RRR will be increased by 0.25 percentage points to 5.75%, reaching the highest level since 2008, starting 1st July. This marks the third increase in banks' RRR in the current tightening cycle, following the previous increases at the June and September meetings in 2022. The CBC Governor commented that the 25bp RRR hike is expected to result in a reduction of approximately NT$120bn in bank liquidity.

Given the sustained increases in housing prices, the CBC further tightened the Loan-to-value (LTV) ratio cap for second home loan in designated areas to 60% from 70%. This applies to Taipei, New Taipei City, Tainan, Taoyuan, Taichung, and Kaohsiung, as well as Hsinchu County and city, effective on 14 June 2024. According to the press release, this arrangement will help enhance credit flows and risk

Taiwan

management for banks, achieve healthy housing markets, and promote financial stability.

The outcome is in line with our expectations, given the impact of electricity tariff hikes had been contained in April and May. In the first five months of 2024, Taiwan's headline inflation rate averaged at 2.24% YoY and the core inflation rate was 2.06% YoY, resuming its decelerating trend from 2.90% and 2.44% in 4Q23 respectively, and indicating limited transmission into broader price pressures.

Looking ahead, we reiterate our call for the CBC to keep its policy rate unchanged at 2.00% for the rest of the 2024, with rate cuts expected to begin in 1Q25.

Chart 6: CBC surprised with a 12.5bps hike in March

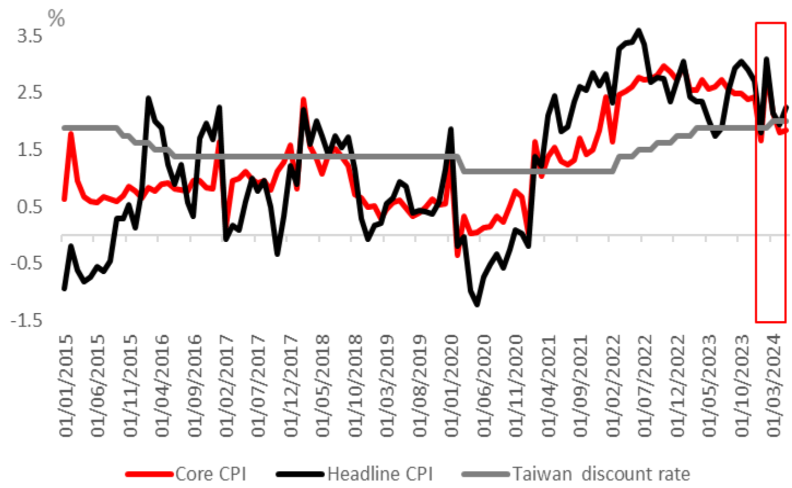


Table 2: OCBC's Forecasts

OCBC's Forecast	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25
USD-TWD	32.2	32.1	31.85	31.75	31.6
Taiwan Discount Rate	2.00%	2.00%	2.00%	1.88%	1.88%

Source: Bloomberg, OCBC

Chart 7: Consumer Price Index by Key Product

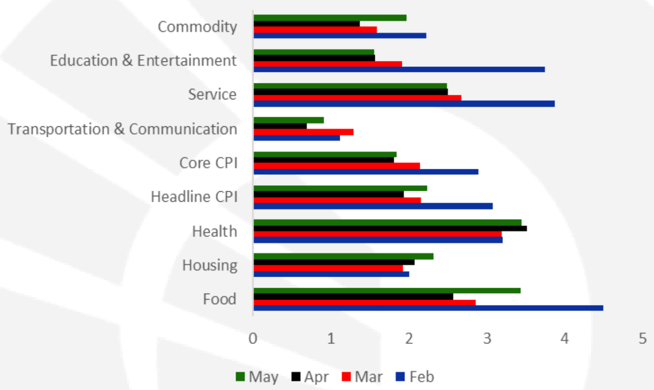
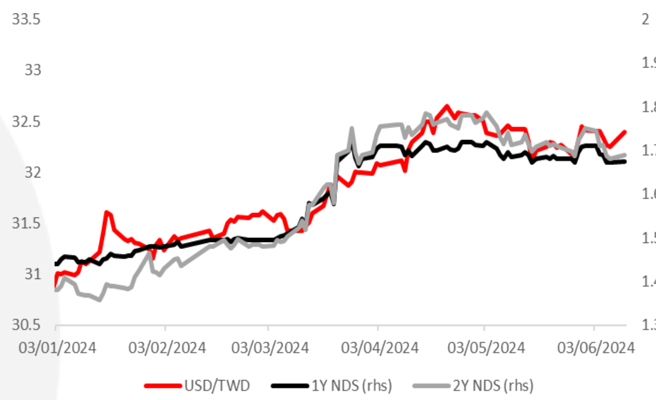


Chart 8: Taiwan's IRS jumped in early March



Source: DGBAS, Bloomberg, OCBC

Indonesia

Indonesia: Coping With Changes

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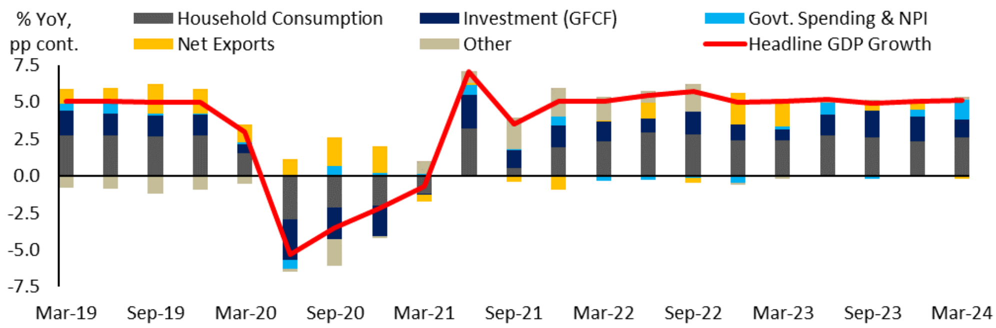
- A modest cyclical slowdown is slated for 2H24 after robust 1Q24 growth of 5.1% YoY, taking 2024 GDP growth to 4.8% before rising to 5.1% in 2025.
- President-elect Prabowo is likely to adopt more expansionary fiscal policies in the coming years, focused on social and infrastructure development.
- Bank Indonesia (BI) will remain focused on mitigating IDR depreciation pressures in the near-term. We forecast 50bp in rate cuts in 4Q24 followed by 75bp in 2025, once the US Federal Reserve has begun its rate cutting cycle.

Resilient growth in 1H24

1Q24 GDP growth rose by 5.1% YoY versus 5.0% in 2023 supported by election related expenditures and tourism. Government spending and non-profit institutions (NPI) contributed 1.4 percentage points (pp) to the 1Q24 GDP growth, significantly higher than 0.5pp in 4Q23 and 0.4pp in 2019 (the previous election year). A more normalised contribution from these components is likely to have resulted in 1Q24 GDP growth of 4.8% YoY. Meanwhile, growth in public sector capex slowed to 17.8% YoY in 1Q24 versus 34.4% in 4Q23 but was resilient nonetheless.

Significant election boost unlikely to sustain in the coming quarters

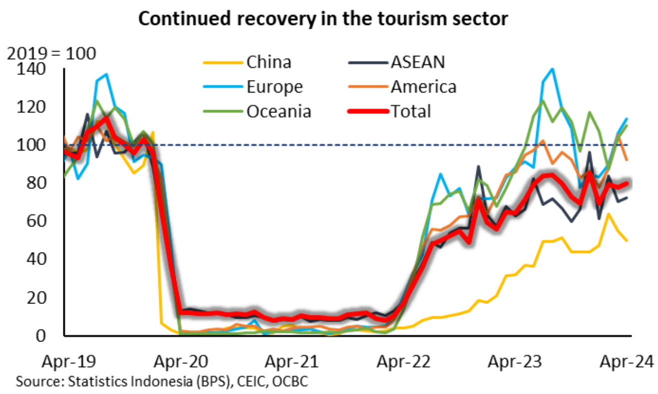


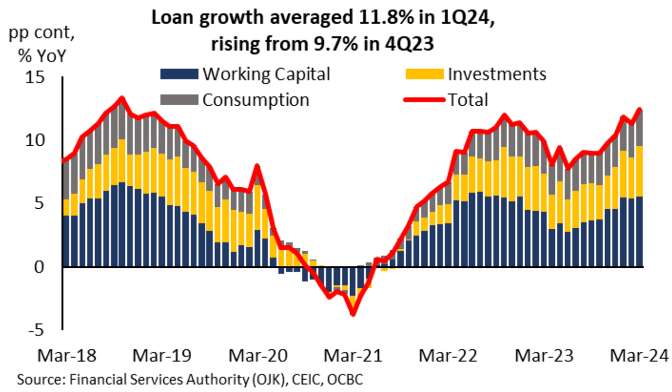
Note: Other refers to combined value of change in inventories and statistical discrepancies.
Source: Statistics Indonesia (BPS), CEIC, OCBC.

Notwithstanding, the tourism sector recovered further in 1H24. While year-to-May tourist arrivals of 4.1mn remain about 1 million below the 2019 level in the same period (24.9% YoY rise). Tourist arrivals from Europe and Oceania are above 2019 levels. In addition, credit demand has remained solid, a testament that BI's multi-pronged approach[5] to policy making is working. Commercial bank loan growth was 12.2% YoY in May 2024 driven by broad-based growth across investments, working capital and consumption loans.

[5] Holding a hawkish bias to support the currency (IDR) while simultaneously easing macroprudential measures to bolster loan growth.

Indonesia

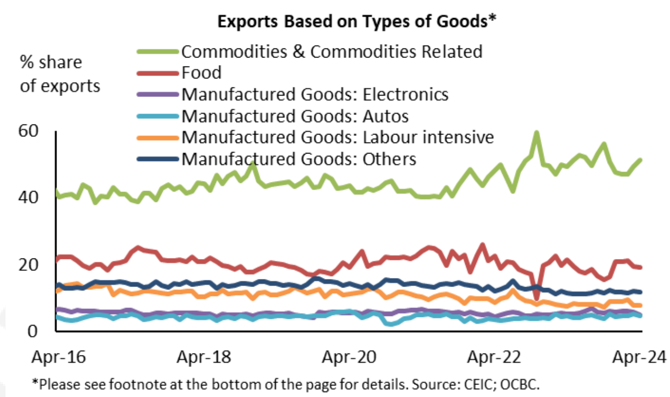


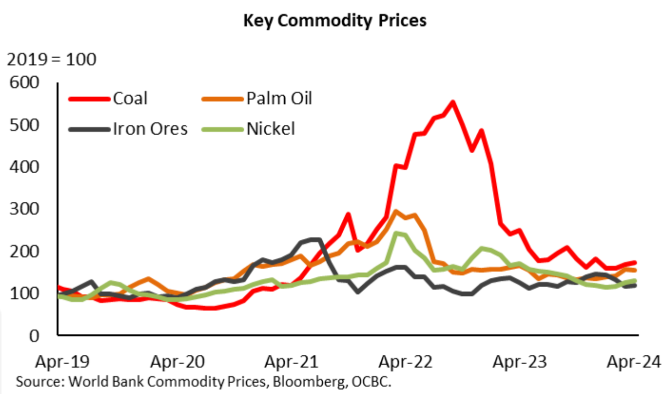


But some payback due in 2H24

The impact of better credit growth on real investment spending has, however, been muted. Investment spending slowed for a second consecutive quarter to 3.8% YoY in 1Q24 versus 5.0% in 4Q23 and 5.8% in 3Q23. We expect this will be the case for the rest of the year, as private sector investors wait on the sidelines for some clarity on global central bank moves and its implications for the local currency (IDR). In addition, commodity tailwinds are fading, and this has historically been a drag on investment spending.

The lion's share of Indonesia's exports are commodities hence, the recovery in the global electronics demand will have a limited boost to exports. By contrast, weakening prices of coal, palm oil and key minerals such as nickel and iron, will have a disproportionate impact on export growth especially when external demand remains volatile. Admittedly, export growth in April and May 2024, averaging +2.3% YoY versus -7.1% in 1Q24, has shown some improvements. It remains to be seen if these can be sustained for the rest of 2024.





Importantly, the Presidential election concluded in one round, and relatively lower spending for regional elections scheduled in November 2024, implies that the boost to growth from the elections will wane in the coming quarters. As such, we continue to expect GDP growth to moderate slightly to 4.8% YoY in 2024 from 5.0% in 2023. This is within BI's GDP growth forecast range of 4.7-5.2% for this year.

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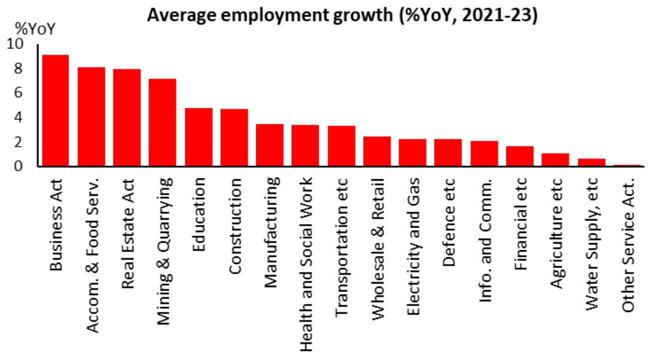
Still strong medium-term growth
The modest slowdown in 2H24, by our forecasts, is more cyclical than structural. We expect GDP growth to accelerate to 5.1% in 2025 buoyed by expansionary fiscal policies, resilient household spending and a normalisation in investment spending and exports following a period of commodity price adjustments.

The support to private consumption, which accounts for over 53% of GDP, will remains robust**,** buoyed by stable inflation, rising real wages, and improving labour market conditions. Employment growth was recorded in all major sectors while average and minimum wages have risen in both nominal and real terms in recent years. In addition, a rising middle class will help support consumption expenditures.



Source: Statistics Indonesia, CEIC, OCBC

Source: Ministry of Manpower, Statistics Indonesia, CEIC, OCBC.

This will be complemented by government support to growth, which is set to expand in the coming years. After some years of a contractionary fiscal stance, largely due to revenue windfalls from higher commodity prices, expenditures are set to rise under the incoming President Prabowo Subianto. The free food program, which targets more than 82 million students, is expected to cost IDR120trn in its first year of implementation. Once the program reaches full scale in 2029, the scheme will cost IDR460trn/year (~2.2% of 2023 GDP).

This program along with a continued focus on capex and infrastructure development necessitates wider fiscal deficits over the medium-term. Spending on National Strategic Projects (PSNs) remains a focus. The government is targeting the completion of 41 PSNs worth IDR554tn this year, with 189 projects having been completed since 2016. Currently, 44 projects are still in the construction stage[6] and construction of these projects will remain a priority for the incoming administration. While most of these projects are funded from a mix of on-budget and off-budget sources, the capex budget has remained strong in recent years, and we expect this will remain the case under Prabowo Subianto.

[6] Indonesia Targets Completion of 41 national Strategic Projects in 2024, Antara News, 14 May 2024.

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Selected PSN Projects	Details	Investment (IDR trn)	Status
Balikpapan – Samarinda Toll Road	99.4km toll road located in Balikpapan, East Kalimantan	8.5	Completed
Serang - Panimbang Toll Road	83.6km toll road located in Serang, Banten	9.9	Partial Operation
Pekanbaru - Kandis - Dumai	135km toll road part of the Trans Sumatra toll	16.2	Completed
Probolinggo – Banyuwangi Toll Road	170.4km toll road located in Java	21.1	In construction *(Expected operation: N.A)*
Pekanbaru - Bangkinang - Payakumbuh - Bukittinggi	185km toll road part of the Trans Sumatra toll	28.7	In construction *(Expected operation: 2025)*
Kuala Tanjung International Hub Port	Port development estimated to increase container volume flows to 12.5mn TEUSs in 2039. Located in Kuala Tanjung, North Sumatra	30	Partial Operation
Patimban Port	Construction of a port with a container terminal with an estimated capacity of 75mn TEUs. Located in Patimban, Subang, West Java	43.2	Partial Operation
Morowali Smelter	Construction of Morowali Smelter located in Central Sulawesi	32.4	Completed
Konawe Smelter	Construction of Konawe smelter on an area of 351 Ha, located in South Sulawesi	13.4	Completed

Source: Komite Percepatan Penyediaan Infrastruktur Prioritas (KPPIP), OCBC.

Matched with fiscal vigilance

Higher expenditures on development priorities are likely to be matched with some subsidy rationalisation and tax reforms over the medium-term. This is assuming that the fiscal deficit will be maintained under the 3% of GDP legal ceiling but will be hitting close to the limit in the coming years.

Subsidy expenditures averaged 1.3% of GDP in 2022-24, with energy subsidies accounting for 36.7% of the total. There is scope to adjust retail diesel and petrol prices higher to better reflect market prices. Encouragingly, the incoming administration has suggested that these discussions are ongoing[7].

Furthermore, revenue reforms remain in the pipeline. The 1% increase in the VAT in 2022 from 10% to 11% is estimated to have generated an incremental 60.8trn (0.2-0.3% of GDP) in revenues[8]. Similar incremental revenues are likely from a further increase in the VAT rate to 12%; this is mandated by law to happen by January 2025.

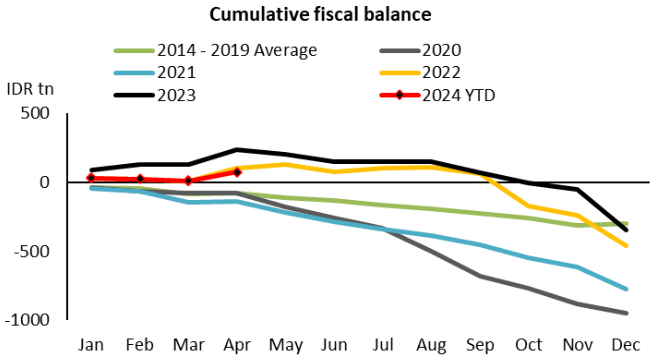
Beyond this, President-elect Prabowo plans to carve out a state revenue agency under the purview of the President and raise the state revenue to GDP ratio to 23%. Assuming tax revenue collection growth of 10% YoY from 2025-2029, broadly in line with nominal GDP growth, the tax to GDP ratio will rise from 10.3% in 2023

[7] Indonesia's Next Leader Targets Energy Subsidies in First Move, Bloomberg, 15 February 2024.
[8] The VAT to increase by 12%: What Will Happen Next Year?, Cekindo, 4 April 2024.

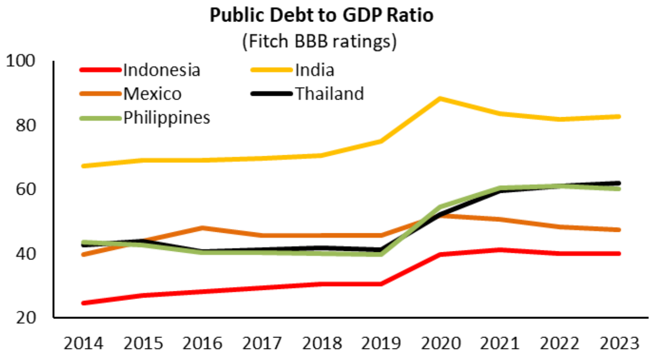
to 11.0% in 2029. This suggests that for further increases to tax revenue to GDP ratio, tax buoyancy needs to increase along with new sources of revenue.

2024 fiscal deficit target is on track

Meanwhile, the government seems on track to achieving its fiscal deficit target of 2.3% of GDP. The cumulative surplus in the first four months of 2024, reached IDR75.7trn (0.3% of GDP), similar to the 2022 outcomes when commodity prices supported the fiscal position. The fiscal deficit stood at 1.5% of GDP on a 12-month rolling sum basis until April 2024. There are, however, signs that revenue collection is slowing - tax and non-tax revenue contracted by 7.6% YoY and 38% YoY in April, respectively. Moreover, with commodity tailwinds fading, we expect revenue growth to slow relative to 2023.



Note: 2023 Numbers based on unaudited figures. Source: Ministry of Finance, CEIC, OCBC.



Source: Focus Economics, OCBC.

On the expenditure front, spending growth has been broadly stable, mirroring past years. Current spending dropping 8.5% YoY in April, reflecting a reversal in election-related spending, while capital expenditure rose 22.0% as the focus on expediting infrastructure and development spending sustains.

The 2025 Budget will be announced in August 2024 and will be keenly watched. The Budget Framework (KEM & PPKF 2025) has pegged the fiscal deficit to be within the range of '2.45% - 2.82% of GDP'. The revenue growth assumptions are broadly similar to Budget 2024 with expenditure growth expected to accelerate to as high as 15.2% of the GDP versus 14.6% expected for 2024.

Notwithstanding, the debt to GDP ratio will remain around 38-39% of GDP. This is well above pre-pandemic levels of 30% of GDP but significantly lower than the mandated debt ceiling of 60% of GDP[9]. While credit ratings have been sceptical of fiscal plans under the incoming government, Indonesia's debt to GDP is below regional peers of a similar credit profile mitigating credit rating changes in the near-term.

[9] Law No 17 of 2003 on State Finance.

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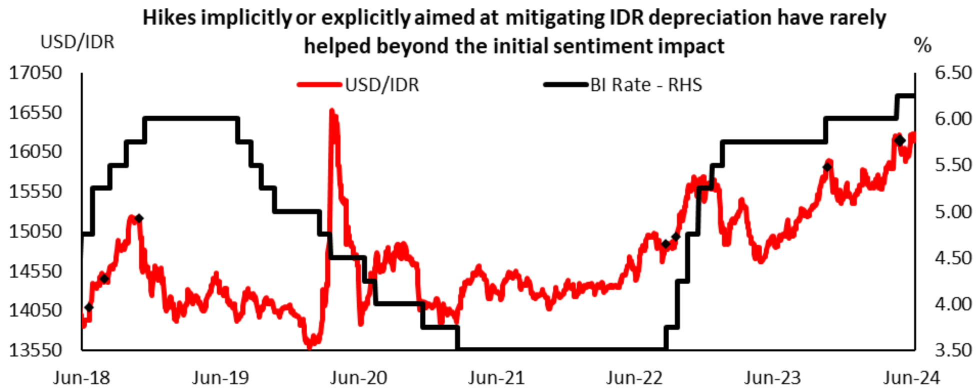
Fiscal Position (% of GDP)	2023 realisation (unaudited)	2024 Budget	2025	
			Lower bound	Upper bound
Government Revenue and Grant	13.2	12.3	12.1	12.4
Tax revenues	10.3	10.1	10.1	10.3
Non-Tax Revenues	2.9	2.2	2.1	2.1
Grants	0.1	0.0	0.0	0.0
Government Expenditure	14.9	14.6	14.6	15.2
Central Government	10.7	10.8	10.9	11.2
Regional Transfer	4.2	3.8	3.7	4.0
Primary balance	0.5	-0.1	-0.3	-0.6
Budget Deficit	-1.6	-2.3	-2.5	-2.8
Debt ratio	39.0	38.3	38.0	38.7

Source: Ministry of Finance, OCBC.

Bank Indonesia to tread water

With fiscal policy set to become more expansionary, monetary policy will continue to tread water. BI explicitly targets the USD/IDR exchange rate, necessitating close ties to the US interest moves and the external backdrop. This implies that rupiah stability will continue to dominate BI's near-term reaction function. Indeed, in a bid to support the currency (IDR), BI hiked its policy rate by 25bp each at its October 2023 and April 2024 meetings. The impact, of which BI maintains, helped mitigate IDR depreciation.



Source: Bank Indoneisa, Bloomberg, OCBC.

However, we believe that BI is hitting its limits on further policy rate increases taking into account the domestic economy and inflation. Since adopting the 7-day reverse repo rate in 2016, i.e. the current BI rate, the policy rate of 6.25% is at its highest. It was previously at this nominal level from September to December 2015.

But the difference is that the policy rate has been moving higher even as inflation has been moving lower. Year-to-May headline CPI averaged 2.8% YoY, versus 4.6% in 4Q23, mainly due to lower food and transportation inflation. Looking ahead, our forecast is for headline inflation to average 3.1% in 2024 (2023: 3.7%) before easing further to 2.8% in 2025, well within BI's 1.5-3.5% target range. This essentially implies

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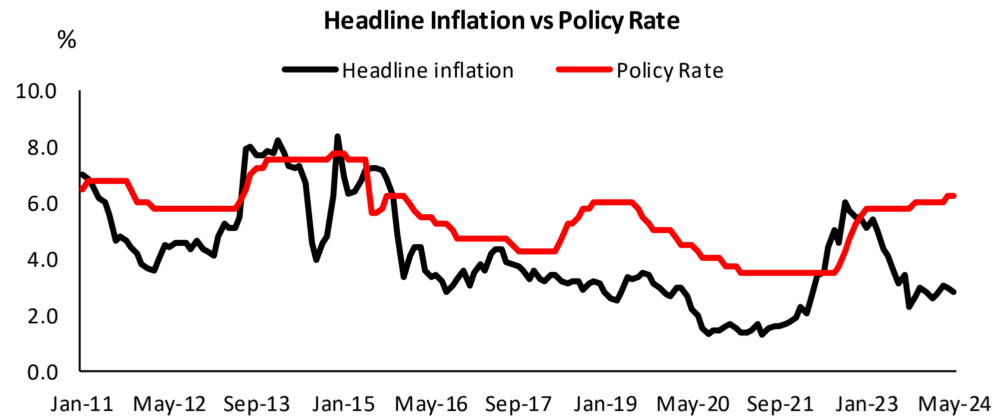
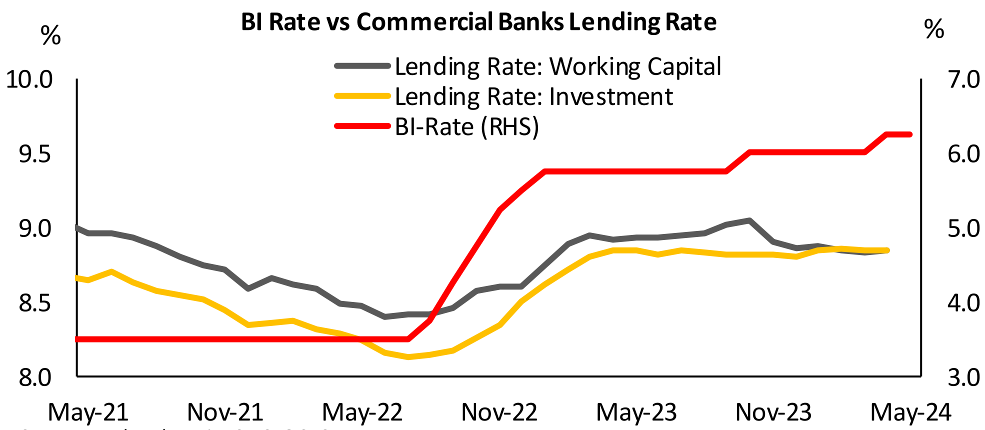
that real rates are highly positive at more than 3 percentage points versus 2.25 percentage points in 2018-19.



Source: Statistics Indonesia, Bank Indonesia, CEIC, OCBC.

Admittedly, the transmission of rate hikes onto the banking system has been less clear for the last two hikes in October 2023 and April 2024. Deposit rates have moved somewhat higher on account of BI's October 2023 and April 2024 hikes, but lending rates have been flat. Mixed signals on policy transmission poses risks for BI down the line when monetary policy objectives reorient towards become more growth or inflation focussed.



Source: Bank Indonesia, CEIC, OCBC.

Finally, while a modest cyclical slowdown in 2H24 creates room for BI to lower its policy rate since we expect growth to pick up in 2025 and over the medium-term. This will also provide BI with some policy room to raise rates to navigate stronger economic conditions in the coming years.

Importantly, BI has over the past year adopted a multi-pronged approach to policy. BI maintains IDR stability via rate hikes and 'triple intervention' mechanisms while loosening macroprudential conditions simultaneously. Loan-to-financing ratios for property and vehicles are brought down to 0% while banks have been consistently incentivised to increase lending to priority sectors via targeted reserve requirement ratio reductions.

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BI will necessarily need to wait for the US Federal Reserve before embarking on a rate cutting cycle, in order to maintain favourable interest rate differentials. Moreover, the current account deficit (CAD) is forecasted to widen to 0.4% of GDP in 2024 from -0.1% in 2023, by our estimates. BI forecasts a range of -0.1% to -0.9% of GDP. The financing of the CAD will remain supported by foreign direct investments, which are projected to remain strong in coming years, while portfolio flows are likely to remain volatile.

Taken together and given our house view for the US Federal Reserve to cut its policy rate by a cumulative 50bp starting in 3Q24, we expect BI to follow suit from 4Q24. We forecast a cumulative 50bps in late 2024 and 75bps in 2025.

Vietnam: Recovering Slowly

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- Despite the soft start to 2024, we expect GDP growth to pick up to 6.0% YoY this year and 6.2% in 2025, from 5.0% in 2023, driven by a gradual recovery in investments, exports and broader domestic demand.
- The State Bank of Vietnam (SBV) will have to deal with near-term currency depreciation pressures, elevated inflation but also weak credit growth.
- We expect a cumulative 50bp in rate cuts from SBV in late 2H24, however, the risks are for a delay if external conditions remain unconducive.

Details show some resilience in 1Q24

Although 1Q24 GDP growth slowed to 5.7% YoY versus 6.7% in 4Q23, we remain positive on the growth outlook for the remainder of 2024. Our forecast is for growth to accelerate to 6.0% YoY in 2024 and 6.2% in 2025, from 5.0% in 2023. Indeed, a closer look at the 1Q24 GDP print suggests growth in the manufacturing and services sectors were resilient at 7.0% YoY and 6.1% YoY, respectively, albeit slowing from 8.0% and 7.3% in 4Q23.

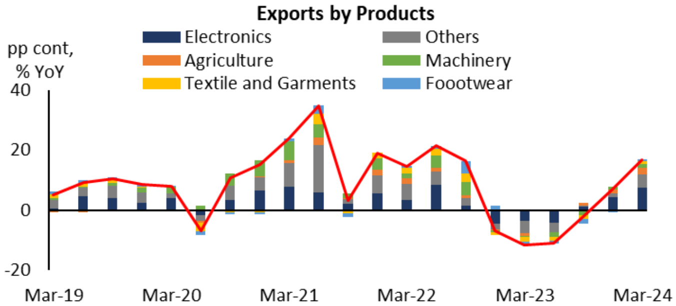
GDP Growth of Selected Sector (% YoY)	2019	2020	2021	2022	2023	1Q23	2Q23	3Q23	4Q23	1Q24
GDP	**7.4**	**2.9**	**2.6**	**8.1**	**5.0**	**3.4**	**4.2**	**5.5**	**6.7**	**5.7**
Agriculture, Forestry and Fishery	**2.7**	**3.0**	**3.7**	**3.5**	**3.8**	**2.9**	**3.8**	**4.3**	**4.1**	**3.0**
Industry and Construction	**8.2**	**4.4**	**3.2**	**7.9**	**3.7**	**-0.3**	**2.0**	**5.2**	**7.4**	**6.3**
Industry	8.1	3.8	4.1	7.8	3.0	-0.7	0.9	4.5	6.9	6.2
Manufacturing	9.6	5.0	5.4	8.2	3.6	-0.4	0.5	5.6	8.0	7.0
Construction	8.5	7.1	-0.6	8.2	7.1	1.9	7.2	8.0	9.3	6.8
Services	**8.1**	**2.0**	**1.7**	**10.1**	**6.8**	**6.9**	**6.6**	**6.4**	**7.3**	**6.1**
Wholesale, Retail Sales & Motor Vehic.	9.8	5.8	0.9	10.3	8.8	8.0	8.6	8.7	9.9	6.9
Transportation & Storage	9.8	1.1	-2.9	12.3	9.2	6.9	10.0	9.7	10.0	10.6
Accommodation & Food Ser. Act.	9.0	-21.1	-20.1	40.9	12.2	22.9	9.4	9.4	8.9	8.3

Source: General Statistics Office, CEIC, OCBC.

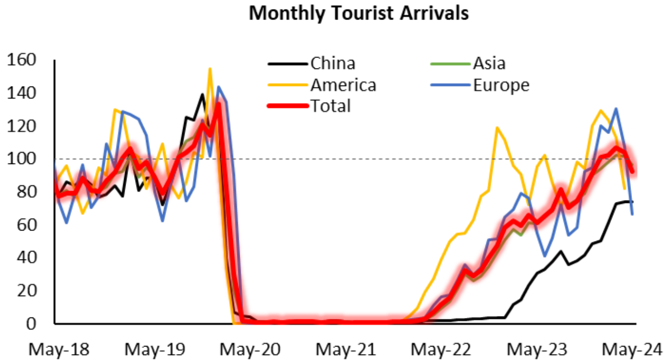
The relative resilience of these sectors underscores better electronics exports growth. These exports, which accounted for ~33% of 2023 exports, increased by 22.6% YoY in 1Q24 versus 13.0% in 4Q23. The strong momentum has been sustained into 2Q24, with the April-May electronics exports rising 28.4% YoY.

Similarly, inbound tourist arrivals for January-to-May were 7.6mn, a 164.9% YoY increase and above pre-pandemic levels, when 7.3mn tourists visited Vietnam during the same period in 2019.

Vietnam



Note: Agriculture: Fishery products, rice, coffee, fruits and vegetables, rubber, pepper, cashew nuts, tea, animal fodder and animal fodder materials, & fertilizers. Electronics: Comp, Electrical Product, SpareParts and Components Thereof, Telephones, Mobile Phones and Parts Thereof, & Still Image, Video Cameras and Parts Thereof. Source: Vietnam Customs, CEIC, OCBC.

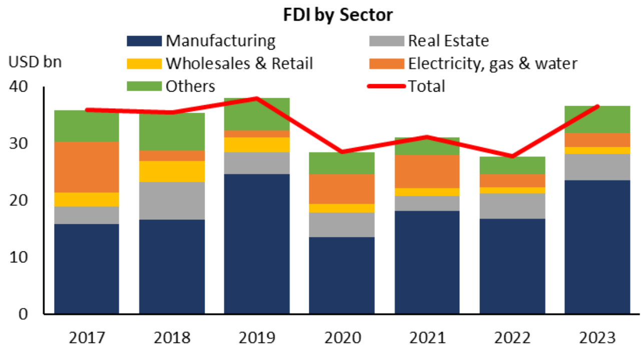


Source: General Statistics Office (GSO), CEIC, OCBC.

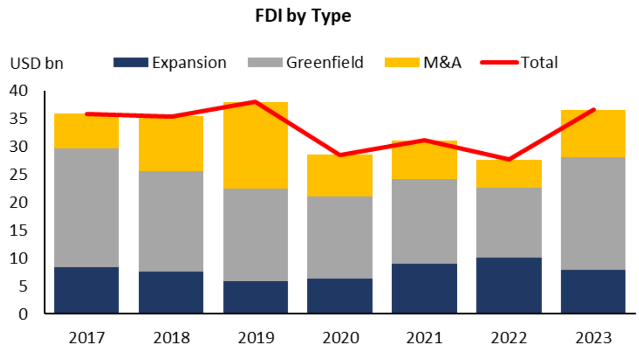
Dividends expected in 2H24

Admittedly, construction sector growth was weaker at 6.8% YoY versus 9.3% in 4Q23. There are, however, signs that this will pick up in the coming quarters underscored by higher development spending in 1Q24 and support from FDI inflows into the sector.

Indeed, incoming FDI trends remain robust. Total registered FDI rose by 13.2% YoY, reaching USD6.2bn in 1Q24, with greenfield investments growing at a robust pace of 57.9% YoY (USD4.8bn) versus 87% in 4Q23. In addition, there was a substantial injection into existing projects and M&A activities, reaching USD 934.6mn and USD 466mn in 1Q24, respectively. The manufacturing industry was the key primary recipient of FDI, reaching USD3.9bn, with greenfield investments into the sector having risen by 29.7% YoY (USD3.0bn) in 1Q24.



Note: Total registered capital. Source: Ministry of Planning and Investment, CEIC, OCBC.



Note: Total registered capital. Source: Ministry of Planning and Investment, CEIC, OCBC.

The government also aims to welcome 17-18 million international arrivals in 2024, matching pre-pandemic levels, with total revenue targeted to reach VND840tn (USD34.2bn). Indeed, the liberalization of visa policies[10] since 2023 has supported the tourism sector and other allied economic activities, such as transportation, accommodation, and catering.

Finally, the bottoming of the global electronics export downcycle by 1H24, in accordance with our house view, will allow for a more sustainable recovery of

[10] Vietnam grants e-visas for citizens of all countries and territories with 90-day stay duration and valid for multiple entry effective 15 August 2023 - Resolution 127/NQ-CP.

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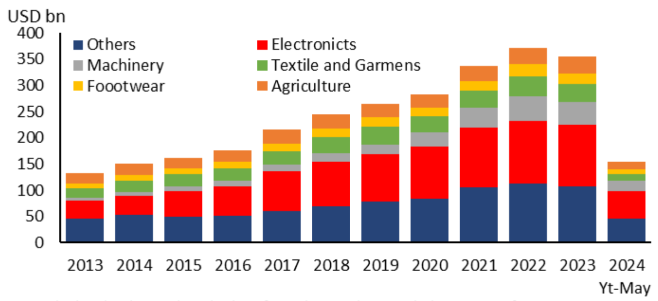
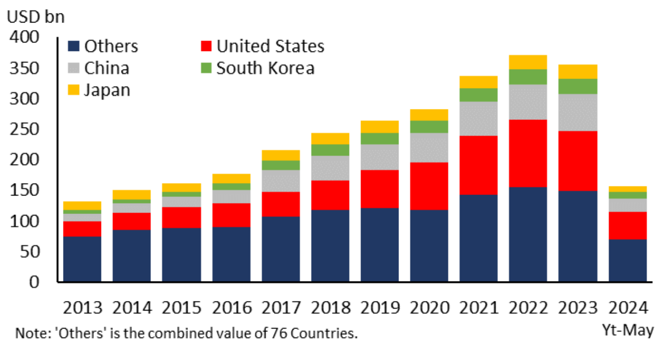
Vietnam's electronics exports. Resilient, albeit slowing, growth in key trading partners such as US, China, and Japan, which account for 27.4%, 17.3% and 6.6% of Vietnam's exports in 2023, respectively, will also remain supportive of growth. Indeed, there are incipient signs of continued resilience in the manufacturing and export sectors. The purchasing manager index (PMI) remained in expansionary territory in April-May, with industrial production (IP) growth rising to an average 7.2% in April-May vs 5.2% in 1Q24.

Exports by Products



Note: 'Others' is the combined value of 28 other products, including means of transportation, parts & accessories, iron & steel, and chemical products, Iron & steel, and Chemicals products.
Source: Vietnam Customs, CEIC, OCBC.

Exports by Destination



Note: 'Others' is the combined value of 76 Countries.
Source: Vietnam Customs, CEIC, OCBC.

Solid medium-term prospects

Beyond this year, the economy's growth prospects are robust. We forecast an average 6.0% YoY of GDP growth in 2025-26 based on strong FDI prospects, a resilient labour market, a focus on infrastructure development and the authorities' focus on better governance.

Vietnam is ranked among the top few economies considered attractive by foreign investors and receives the bulk of its inflows from Singapore, Japan, Mainland China & Hong Kong SAR, and South Korea. A recent survey by the Japan External Trade Organization (JETRO) published in May 2024 placed Vietnam at the top of the list regarding future business expansion destinations in the region, beating China, India, Indonesia, and Thailand.

Importantly, the authorities have actively engaged in negotiating Free-Trade-Agreements (FTAs) to allow for better market access for the country's exports. As of May 2024, Vietnam has 15 active FTAs in place with various countries.

Vietnam Free Trade Agreement		
No	FTA	Status
1	ASEAN Free Trade Area	Signed and In Effect
2	ASEAN-Australia and New Zealand Free Trade Agreement	Signed and In Effect
3	ASEAN-Hong Kong, China Free Trade Agreement	Signed and In Effect
4	ASEAN-India Comprehensive Economic Cooperation Agreement	Signed and In Effect
5	ASEAN-Japan Comprehensive Economic Partnership	Signed and In Effect
6	ASEAN-People's Republic of China Comprehensive Economic Cooperation Agreement	Signed and In Effect
7	ASEAN-Republic of Korea Comprehensive Economic Cooperation Agreement	Signed and In Effect
8	Comprehensive and Progressive Agreement for Trans-Pacific Partnership	Signed and In Effect
9	Japan-Viet Nam Economic Partnership Agreement	Signed and In Effect
10	Regional Comprehensive Economic Partnership	Signed and In Effect

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11	Republic of Korea-Viet Nam Free Trade Agreement	Signed and In Effect
12	Viet Nam-Chile Free Trade Agreement	Signed and In Effect
13	Viet Nam-Eurasian Economic Union Free Trade Agreement	Signed and In Effect
14	Viet Nam-European Union Free Trade Agreement	Signed and In Effect
15	Viet Nam-United Kingdom Free Trade Agreement	Signed and In Effect
16	Viet Nam-Israel Free Trade Agreement	Signed but not yet In Effect
17	ASEAN-EU Free Trade Agreement	Proposed/Under consultation and study
18	ASEAN-Eurasian Economic Union Free Trade Agreement	Proposed/Under consultation and study
19	ASEAN-Gulf Cooperation Council Free Trade Agreement	Proposed/Under consultation and study
20	ASEAN-Pakistan Free Trade Agreement	Proposed/Under consultation and study
21	East Asia Free Trade Area (ASEAN+3)	Proposed/Under consultation and study
22	Free Trade Area of the Asia Pacific	Proposed/Under consultation and study
23	Pakistan-Viet Nam Free Trade Agreement	Proposed/Under consultation and study
24	Comprehensive Economic Partnership for East Asia (CEPEA/ASEAN+6)	Proposed/Under consultation and study
25	Viet Nam-MERCOSUR Free Trade Agreement	Proposed/Under consultation and study
26	Viet Nam-Ukraine FTA	Proposed/Under consultation and study

Source: Asia Regional Integration Center, OCBC.

Domestically, the focus remains on infrastructure development. There are 34 major projects, and 86 nationally important component projects, focusing on transportation in 46 provinces and cities. These include five railway projects, and two airports, and the rest are road projects such as highways and ring roads around Hanoi, and Ho Chi Minh City[11].

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	USD289mn	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.

Complementing these efforts is the resilient labour market. Wage growth has been relatively strong, and the unemployment rate has declined from the peak of the pandemic. Moreover, the labour force is relatively young and well educated allowing the economy to take advantage of the demographic dividend.

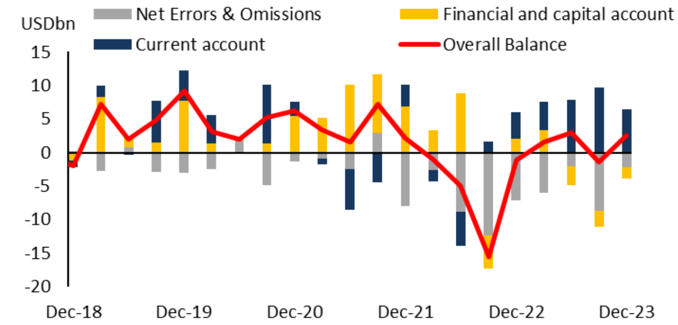
[11] Vietnam Gov't earmarks US$27 billion for public investment in 2024, Hanoi Times, 16 February 2024.

Vietnam

An eye on external vulnerabilities

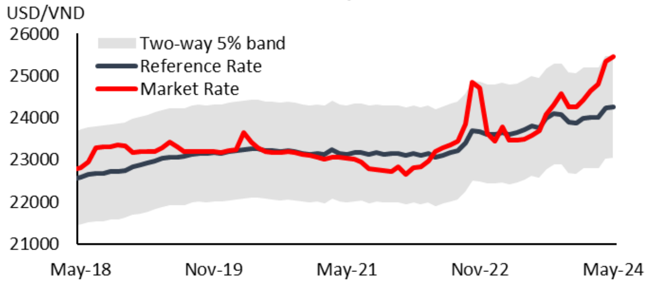
Despite the strong fundamentals, there are some near-term vulnerabilities particularly on the external front. Although the trade surplus has sustained at USD7.9bn from January-May 2024, it is narrower than USD10.2bn in the same period of 2023. Stronger domestic demand amidst a recovery in the export sector is likely to imply a narrower current account surplus of 5.0% of GDP in 2024 versus 6.6% of GDP in 2023.

Balance of Payments



Source: State Bank of Vietnam, CEIC, OCBC.

USD strength, among other factors, has put the dong under pressure



Note: The two-way 5% band around reference rate set by SBV. Source: State Bank of Vietnam, Bloomberg, CEIC, OCBC.

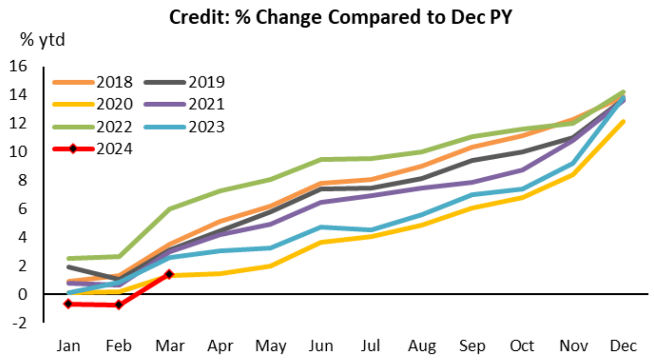
Moreover, portfolio outflows persist due to unfavourable interest rate differentials particularly to the US. The financial account registered a deficit of 0.8% of GDP in 2023 from a surplus of 2.3% in 2022, as a widened deficit in the 'other investment' (-5.1% of GDP from -1.8%) and 'portfolio investment' (-0.3% from 0.4%) accounts to offset the larger 'direct investment' surplus (4.5% from 3.7%).

SBV's FX reserves rose to USD93.3bn, equivalent to 3.3 months of imports, by the end of 2023 from USD87.1bn in 2022. This has allowed SBV some room to stabilise the currency (VND) amid recent depreciation pressures, when the USD/VND rate reached the top of the flexible FX trading band of +5% around the central rate. SBV also increased money market rates, with the reverse repo rate rising to 4.5% in May, in a bid to attract inflows and stabilize the VND.

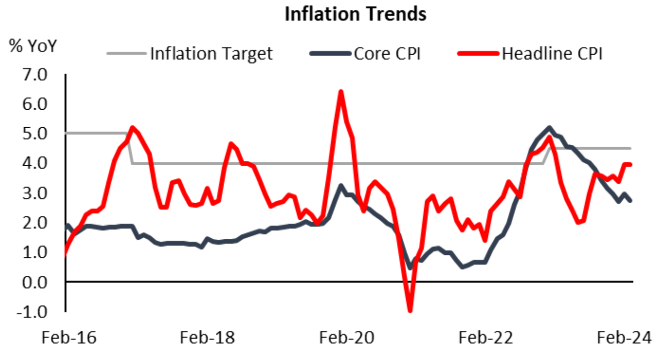
Credit growth is weak

Domestically, SBV's challenge is tackling low credit growth. Year-to-March credit growth was muted at 1.4%, the lowest in the past few years, and a far cry from the annual target of 15% growth. This is likely driven by tighter scrutiny around loan disbursements following the challenges emanating from Saigon Joint Stock Commercial Bank (SCB).

Vietnam



Source: State Bank of Vietnam, CEIC, OCBC.



Source: General Statistics Office, CEIC, OCBC.

Inflation is rising

In addition, inflationary pressures have picked up in recent months, with May inflation rising by 4.4% YoY. This brings the January-to-May CPI to an average of 4.0%, up from 3.5% in 4Q23. Food inflation continues to be the key contributor to overall inflation, with extreme weather events keeping food prices elevated and posing an upside risk. Meanwhile, core CPI was more stable, averaging 2.8% in the first five months of 2024 versus 4.2% in 2023. Looking ahead, we expect the headline CPI to average 4.3% in 2024, up from 3.3% in 2023 but remain within the SBV's 4-4.5% inflation target range.

SBV's dilemma is therefore to navigate a volatile external backdrop and elevated inflationary pressures, while trying to prop up credit growth. Our expectations are for a cumulative 50bp in rate cuts from SBV likely in 2H24. Following rate cuts from the US Federal Reserve, we expect SBV will have room to become more growth focussed allowing for lower policy rates. The risk, however, is that VND depreciation pressures sustain limiting SBV's room to manoeuvre.

Fiscal policy to remain neutral

Meanwhile, the fiscal stance is expected to remain relatively neutral in 2024 compared to 2023. Government expenditure (excluding principal payments) was broadly flat in 2023 but is budgeted to increase by 4.1% YoY in 2024[12].

Similarly, revenue collections were estimated to rise by 5% YoY in 2024 versus 0.4% in 2023. These seem achievable considering nominal GDP growth of 10.2% in 2024, by our estimates. As a result, the fiscal deficit is expected to narrow to 3.6% of GDP in 2024 from an estimated deficit of 4.1% of GDP in 2023.

[12] Vietnam has extended the reduced environmental tax on fuel until the end of 2024. The tax rates are currently lower at VND2,000 per litre for gasoline, VND600 for kerosene, and VND1,000 for diesel, fuel oil, lubricant, and aeroplane fuel. After the extension ends, the tax rates will revert to the previous levels of VND4,000 per litre for gasoline, VND1,000 for kerosene, VND2,000 for diesel, fuel oil, and lubricant, and VND3,000 for aeroplane fuel.

Vietnam

VND tn	2021	2022 (e)	2023 (e)	2024 (p)	% YoY	2022 (e)	2023 (e)	2024 (p)
Revenue	**1591.4**	**1614.1**	**1620.8**	**1701.0**		**1.4**	**0.4**	**5.0**
Taxes and Fees	1388.2	1411.3	1464.4	1466.9		1.7	3.8	0.2
Capital Revenues	186.0	195.0	150.8	227.5		4.8	-22.6	50.8
Grants	17.2	7.8	5.5	6.6		-54.6	-29.5	19.5
Expenditure excl Principal Payment	**1708.1**	**2035.4**	**2035.9**	**2119.4**		**19.2**	**0.0**	**4.1**
Investment Development	540.0	663.3	739.6	677.3		22.8	11.5	-8.4
Current Expenditure	1168.0	1223.4	1265.7	1384.2		4.7	3.5	9.4
Principal Payment	241.9	197.9	190.5	291.2		-18.2	-3.7	52.8
Balance % GDP	***-2.5***	***-4.4***	***-4.1***	***-3.6***				

Note: e = estimate. p = planned. Source: Ministry of Finance, CEIC, OCBC.

Malaysia: Holding Its Own

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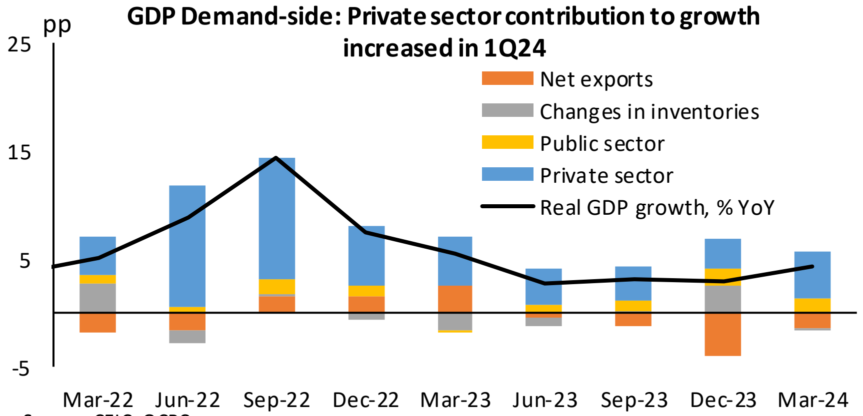
- We continue to expect modestly better growth of 4.2% YoY in 2024 versus 3.6% in 2023 buoyed by resilient domestic demand.
- Gradual implementation is underway of medium-term plans aimed at fiscal consolidation, attracting FDIs, enhancing growth and development.
- We maintain our 2024 average inflation forecast of 2.5% YoY, which will likely allow Bank Negara Malaysia (BNM) to keep its policy rate unchanged in 2024.

Stronger in 1H24

1Q24 GDP growth picked up to 4.2% YoY versus 2.9% in 4Q23, supported by broad based improvements in private consumption, government spending, investments, and exports. The private sector did most of the heavy lifting in 1Q24 contributing 4.4 percentage points (pp) to headline GDP growth versus 2.9pp in 4Q23. Public sector contribution was reduced to 1.3pp versus 1.6pp in 4Q23 while net export contribution was less negative at -1.4pp versus -4.0pp in 4Q23. Similarly, growth in manufacturing, services and construction sectors improved in 1Q24 versus 4Q23, while agriculture output was more volatile.

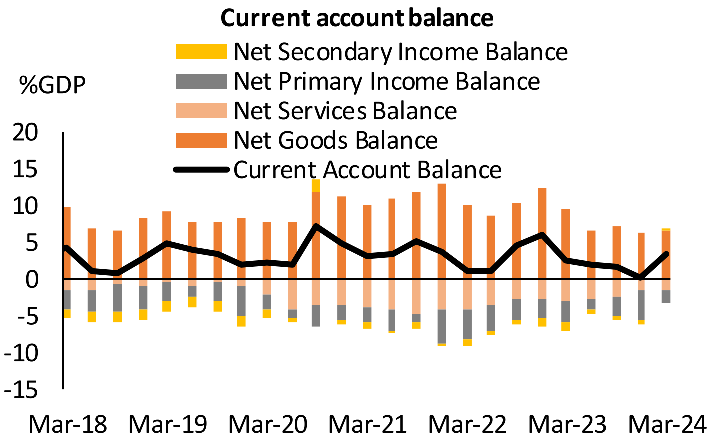


Source: CEIC, OCBC.

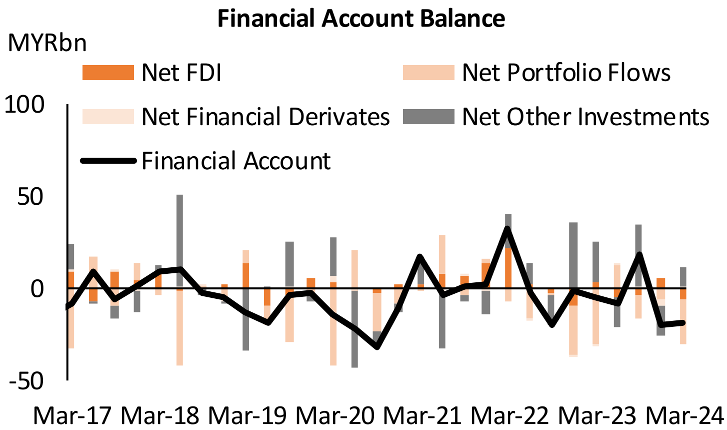
Encouragingly, the external account also stabilised. The current account surplus widened to MYR16.2bn (3.3% of GDP) in 1Q24 from MYR0.9bn (0.2%) in 4Q23. The secondary income account flipped to a surplus of MYR0.3bn from a deficit of MYR2.2bn in 4Q23 while the primary income deficit narrowed to MYR8.8bn from MYR20.3bn in 4Q23. The goods balance recorded a modestly higher surplus (MYR32bn from MYR30.8bn in 4Q23) while services deficit narrowed only slightly (MYR7.3bn from MYR7.4bn). Our forecast is for the current account surplus to be 2.5% of GDP in 2024 versus 2.4% of GDP in 2023, supported by a narrower contraction in goods export growth and stable tourism inflows.

Malaysia

The capital and financial account deficit narrowed marginally to MYR18.7bn from MYR20.1bn in 4Q23. Net FDI recorded outflows of MYR6bn, more than reversing inflows of MYR5.2bn in 4Q23. Net portfolio outflows rose to MYR23.7bn from MYR6.0bn in 4Q23 while the net financial derivates and other investments accounts shifted to surpluses from deficits in 4Q23.



Source: CEIC, OCBC.



Source: CEIC, OCBC.

With some traction on medium-term plans

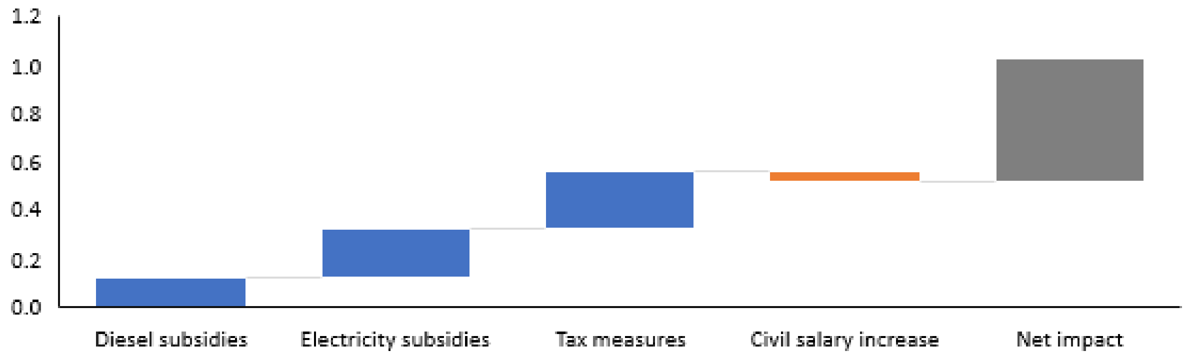
The government followed through on its plan to implement targeted fuel subsidy rationalisation. This is in line with our view, as stated in our 1H24 outlook. Diesel subsidies were removed for Peninsular Malaysia, starting 10 June, while RON95 prices remain fixed.

The government has estimated that the fiscal savings will be MYR4bn per annum. This is in addition to electricity subsidy rationalisation, estimated to save a similar MYR4bn per annum, and higher tax revenue collections of MYR4.5bn. Civil servant salaries will rise by more than 13% from December 2024, which will add MYR10bn to annual expenditures.

On balance, we estimate the measures will reduce the fiscal deficit by 0.5% of GDP for this year. The government aims to narrow the fiscal deficit to 4.3% of GDP in 2024 from 5.0% in 2023, which we still deem as within reach, given mandatory e-invoicing becomes into effect from 1 August 2024.

Malaysia

Impact on 2024 fiscal deficit from measures announced so far



Next focus is Budget 2025

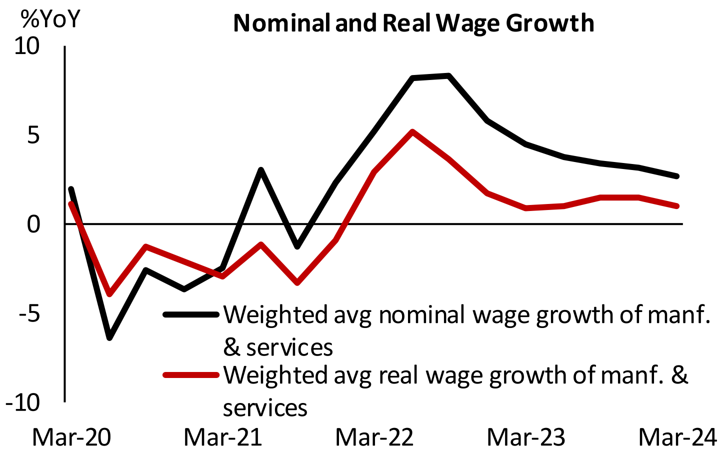
The government aims to narrow the fiscal deficit to 3.0% of GDP over the medium-term, with the deficit over 2024-26 averaging 3.5% of GDP. This implies that further tax reforms will need to be implemented to broaden the tax base along with incremental expenditure rationalisation. The sharp increase in emolument payments from the 13% increase in civil servant salaries will need to be more than offset by RON95 rationalisation.

The big question for the 2025 budget, likely to be tabled in October 2024 using historical precedence as a guide, is whether the Goods & Services Tax (GST) will be re-introduced. It is too early to say, in our view, but the government has not ruled out this option. The government will likely need to lay the groundwork for the re-introduction of GST based on inflation outcomes from subsidy rationalisation and progress on containing cost of living pressures. Beyond this, tax administrative improvements will continue in line with the Medium-Term Revenue Strategy.

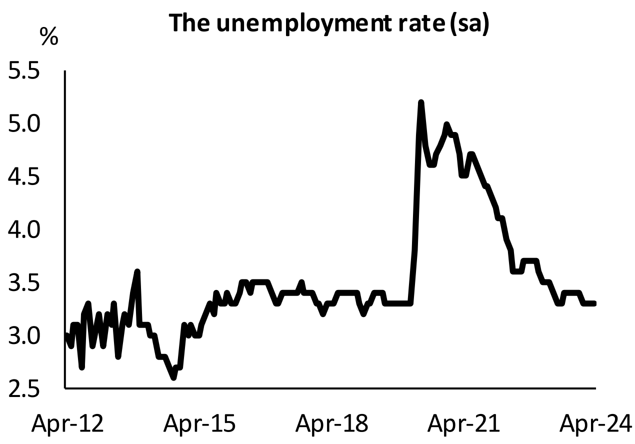
Re-alignments to support near-term growth

The restructuring of the Employee Provident Fund (EPF) accounts to a three-tiered system from a two-tiered system came into effect on 11 May 2024. The introduction of the 'flexible account', at 10% of the total EPF allocation per account, allows members to withdraw money at any time. Between 11 May and 31 August, members are allowed a one-time transfer. The maximum amount depends on the initial balance. EPF has estimated MYR25bn in transfers to 'account flexible' during this period.

Malaysia



Source: CEIC, OCBC.



Source: CEIC, OCBC.

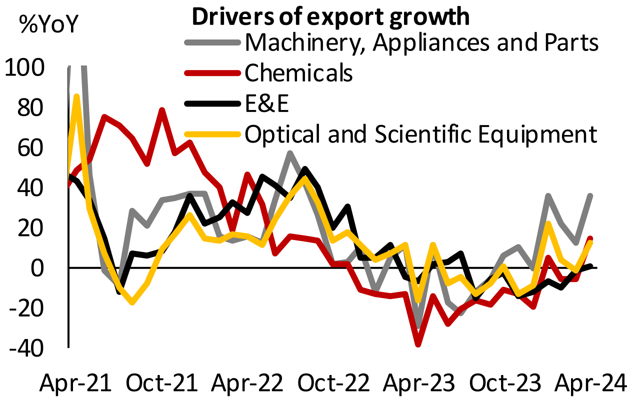
The exact amount that will be spent on consumption expenditures will be less, in our view. While some support to household spending may be required amid ongoing broader fiscal policy changes, the labour markets are in a stronger position compared to 2020-22, when the previous rounds of EPF withdrawals were allowed. Wage growth remains resilient in nominal and real terms, albeit lower compared to 2023, while the unemployment rate is lower at 3.3% in April 2024 versus a peak of 5.2% in May 2020.

With an eye on sentiment support

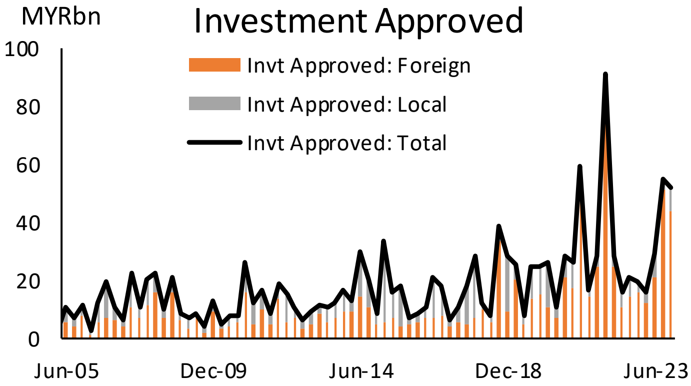
Beyond some near-term buffer for household spending from this EPF account restructuring, the government has been fastidious in terms of prioritizing public infrastructure development, seeking out foreign inflows and supporting sentiment by mitigating MYR depreciation pressures. Specifically, on the latter, the Financial Markets Committee (FMC) introduced measures in late February to contain MYR depreciation including actively involving government linked companies (GLCs) and government linked investment companies (GLICs) in repatriation and conversion of foreign investments into MYR and calibrated outward FDI and portfolio outflows.

Meanwhile, public infrastructure projects continue along with increased FDI commitments into Malaysia likely to support medium-term growth. The bottoming out of the global electronics downcycle, along with resilient growth in the US and EU, will help support exports. The upshot is that growth momentum will improve in 2Q24 and into 2H24, supporting our 2024 GDP growth forecast of 4.2%.

Malaysia



Source: CEIC, OCBC



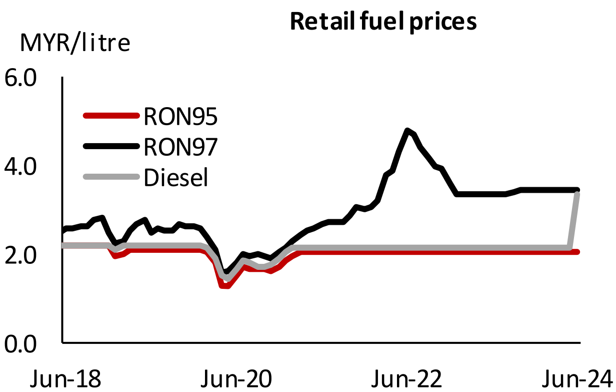
Source: CEIC, Malaysian Investment Development Authority, OCBC.

BNM to watch inflation

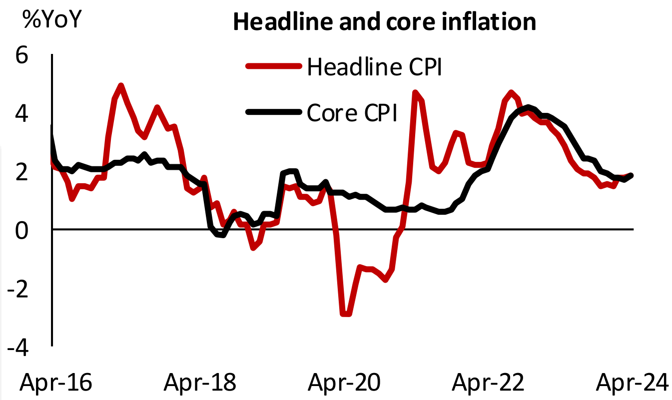
Against this solid growth backdrop, inflation will be volatile. The 55.8% increase in diesel prices will lead to higher inflationary pressures in the coming months. Our forecast is for headline inflation to average 2.9% YoY from June-December 2024, peaking in 4Q24.

For full year 2024, we continue to expect headline inflation to average 2.5% YoY in 2024 versus 1.7% from Jan-April 2024. This is within BNM's estimates of headline inflation at 2.0-3.5% range. BNM will assess the need for hikes based on the persistent and pervasiveness of inflation pressures, and particularly the second-round impact of higher prices.

That said, BNM has rarely reacted to changes in inflation caused by supply shocks such as the food price shocks in 2006-07 or the introduction and subsequent removal of the GST. As such, we expect BNM to be on prolonged pause through 2024 and 2025. But the balance of risks around this call will vary depending on incoming data.



Source: CEIC, OCBC.



Source: CEIC, OCBC.

Thailand: Higher Growth But At A Cost?

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- We expect higher 2024 GDP growth of 2.8% YoY in 2024 versus 1.9% in 2023 supported by tourism and government policies to boost consumption.
- Inflationary pressures are set to accelerate in the coming month, to average 1.2% YoY in 2024. This is similar to 2023 and within BOT's 1-3% target range.
- We see no urgency for the Bank of Thailand to adjust monetary policy despite political pressures. We see BOT on hold for the rest of 2024.

Weak growth continued in 1Q24

GDP growth slowed further to 1.5% YoY in 1Q24 versus 1.7% in 4Q23. Government spending, constrained by the delayed approval of the FY2024 fiscal budget, remained in contraction (-2.1% YoY in 1Q24 versus -4.6% in 2023). The drag from the public sector worsened to -2.1 percentage points (pp) from -1.5pp in 4Q23. The private sector contribution to growth was fairly resilient at 4.6pp versus 5.0pp in 4Q23.

Meanwhile, net exports contribution turned negative in 1Q24, mostly due to weakness in goods exports. Goods exports declined by 2.0% YoY in 1Q24 from -2.8% in 2023. Tourism, i.e., services exports remained a bright spot, rising by 24.8% YoY in 1Q24 versus 14.9% in 4Q23.

With the path forward looking more promising

The trajectory for tourist arrivals looks solid for the rest of this year. Tourist arrivals reached 30.4% of 2019 levels year-to-April in 2024, showing a strong rebound in arrivals from China as well as other countries including India and Russia. The government has actively supported the tourism sector by easing of visa rules[13], extending operating hours of entertainment venues, and rolling out of incentives for organisers to hold events[14].

Goods exports are likely to pick up as our house view is for a bottoming of the global electronics export downcycle by 1H24. Electronics exports account for 11.6% of total exports (customs basis) in 2023 and have shown some signs of improvement year-to-April (12.9% YoY versus -3.7% in 2023)[15]. In addition, agriculture exports may be supported by higher rice[16] and durian exports to China.

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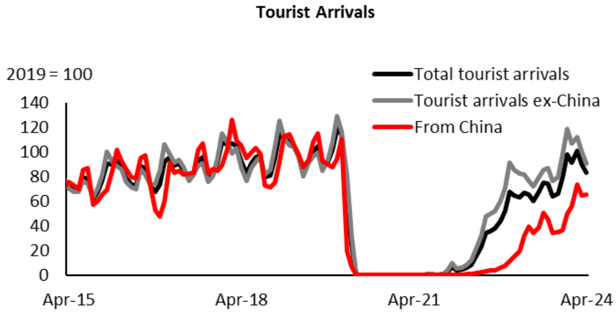
[13] Yuvejwattana, S. (2024, May 28). Thai Cabinet Approves Easing Visa Rules to Boost Tourism: PM. Retrieved from Bloomberg.
[14] Sangwongwanich, P. (2024, June 05). Thai BOI Offers Incentives for Events, Sports to Boost Tourism. Retrieved from Bloomberg.
[15] Our classification for food includes 'cereal', 'preparation of meat fish', 'sugar & confectionery'; commodities include 'mineral fuel oil wax', 'rubber & articles thereof', 'pearl, precious stones & metals'; manufactured goods: electronics include 'electrical machinery & equipment'; manufactured goods: autos include 'vehicle', 'aircraft'; manufactured goods: labour intensive include 'Knitted, Crocheted, Clothing Access', 'Man-Made Staple Fibres', 'Footwear'; manufacture goods: others include 'nuclear reactors, machinery', 'plastics & articles thereof', 'organic chemical'.
[16] Thailand's rice exports jump 32 pct in January-May. (2024, June 10). Retrieved from Xinhua.

Thailand

Note: See details in footnote 16.
Source: Ministry of Commerce, CEIC, OCBC



Source: CEIC, OCBC

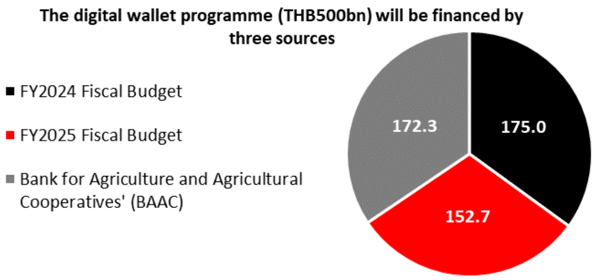
Most importantly, the drag from government spending is set to fade. The FY2024 budget (that started in October 2023 until September 2024) received royal endorsement in late April, paving the way for higher government spending. A supplementary budget of THB122bn (0.7% of est. nominal 2024 GDP)[17] for FY2024 will further support growth provided disbursements are expedited within the stipulated timeframe[18].

Finally, the digital wallet program is set for implementation in 4Q24. The wallet is expected to cost THB500bn (2.7% of est. nominal 2024 GDP). Almost 76% of the country's 60mn people will get money via a digital wallet application. The program targets adults earning no more than THB70,000/month and have less than THB500,000 in their bank accounts. The money is available for spending over two quarters. The program will be financed through a combination of on-budget and off-budget sources.

The Ministry of Finance estimates that growth will be boosted by 1.2-1.8pp in 2025. Our 2025 GDP growth forecast is 3.3% YoY but does not account for the impact of the digital wallet program. We will review our forecast once the program is ready for implementation. For 2024, we forecast GDP growth of 2.8% YoY, implying an increase to 3.3% YoY in 2Q-4Q24 from 1.5% in 1Q24.

Progress on Digital Wallet Scheme	
1Q24	Gather data, suggestions, and implementation plans.
2Q24	Finalise details, criteria, and sources of fund.
	Table to the Cabinet for approval.
3Q24	Registration opens for merchants and citizens who wishes to participate in the scheme.
4Q23	Transfer of THB10,000 to digital wallets of participating citizens

Source: Bank of Thailand, Announcement by the Ministry of Finance on 10 April 2024



Note: A supplementary budget for an additional THB122bn to boost the FY2024 fiscal budget is in discussion and will be sent to the cabinet for approval on 2 July, before being tabled to the House of Representatives. If the bill is passed, this could change the composition of the funding sources.
Source: Royal Thai Government, The Nation, OCBC

[17] OCBC estimates.
[18] Chantanusornsiri, W. (2024, February 27). Fiscal 2024 budget disbursement expedited. Retrieved from Bangkok Post.

Thailand

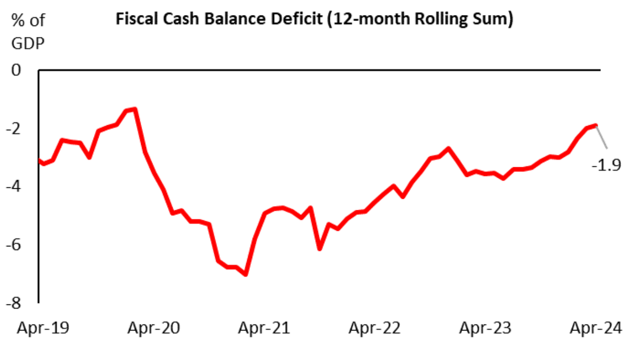
Fiscal costs are set to rise

The government's support measures are expensive, and it has accordingly adjusted its medium-term budget plan higher. The fiscal deficits from FY2024 until FY2028 are noticeably higher, with the biggest adjustment for FY2024. The FY2024 fiscal deficit has been widened to THB805bn (-4.3% of GDP) from the previously approved fiscal deficit of THB693bn (-3.6% of GDP).

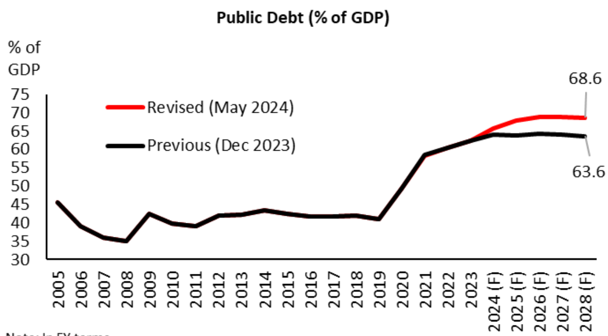
THB bn	Forecasts				
	FY24	FY25	FY26	FY27	FY28
Net Revenue (Revised)	2797.0	2887.0	3040.0	3204.0	3394.0
Total Expenditures (Revised)	3602.0	3753.0	3743.0	3897.0	4077.0
Fiscal deficit (Revised)	-805.0	-865.7	-703.0	-693.0	-683.0
% GDP	-4.3	-4.5	-3.5	-3.3	-3.1
Fiscal deficit (Previous)	-693.0	-865.7	-703.0	-693.0	-683.0
% GDP	-3.6	-4.4	-3.4	-3.2	-3.0

Source: Cabinet Meeting Notes, Fiscal Policy Office, OCBC

This implies that spending for the May-September period, needs to be increased by 47.7% YoY to achieve this deficit target. Expenditure growth fell by 12.5% YoY in October 2023-April 2024, following the delayed approval of the FY2024 fiscal budget[19], while revenue growth was negligible (i.e., 0%) during the same period. As a result, the fiscal cash balance deficit has narrowed to 1.9% of GDP on a 12-month sum basis until April 2024 from 3.3% of GDP for FY2023.



Source: Fiscal Policy Office, CEIC, OCBC



Note: In FY terms.
Source: Public Debt Management Office, CEIC, OCBC

There is a good chance that some of these expenditures, if unspent, are rolled over into budget FY2025. For now, the FY2025-28 deficit is pegged at 3.1% of GDP versus 3.0% of GDP, previously. Consequently, the public debt profile will be higher by almost 5 percentage points of GDP, reaching at 68.6% of GDP by FY2028. While this is below the debt ceiling of 70% of GDP, it is still much higher than the pre-pandemic levels.

Quasi-fiscal support, via off-budget measures, have also led to higher public debt risks. The oil fuel fund[20] deficit significantly widened to THB63.8bn (as of week ending 2 June) after narrowing to THB3.9bn in July 2023. The government has recently lifted retail diesel prices to curb losses to the oil fuel fund, but the extent

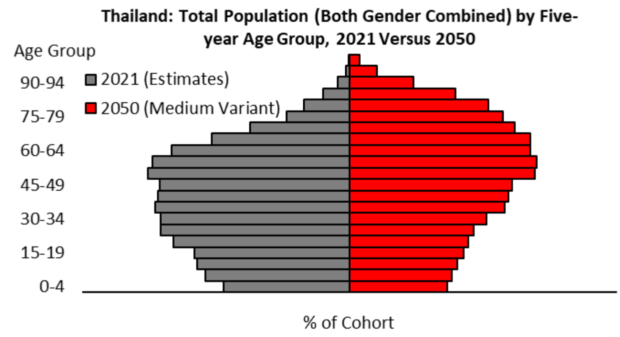
[19] Organisation for Economic Co-operation and Development. (2021). OECD Journal on Budgeting, Volume 2020 Issue 3, OECD Publishing, Paris.
[20] A cross subsidy fund adopted to manage retail energy costs.

Thailand

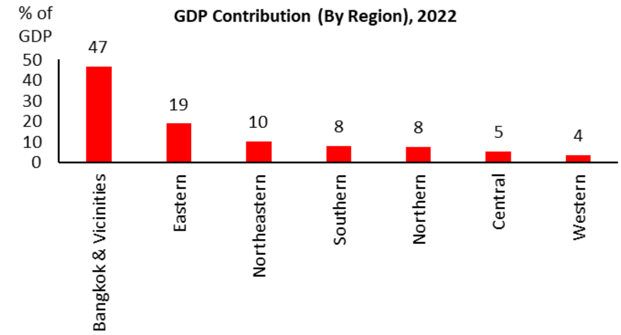
of the losses is large. In fact, the Fiscal Policy Office also noted that it had failed to meet its revenue target in the first four months of FY2024 due to fuel subsidies[21].

Largely skirting structural constraints

The focus of government policies has been to boost consumption spending and support the tourism sector. However, given the structural constraints within the Thai economy, there needs to be a rebalancing of expenditure priorities, in our view. The structural constraints include a rapidly ageing population, which will need fiscal assistance over the medium-term to support pensions and healthcare costs; re-orienting economic activities across the country as Bangkok and vicinities remain the largest contributors to growth; focussing on providing incentives provided to the electronics export sector to allow it to move into the latest technologies for AI and semiconductors.



Source: United Nations Department of Economic and Social Affairs, OCBC



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

Finally, reducing political uncertainty to foster a more conducive climate for investments. Indeed, political uncertainties linger as there are cases filed against PM Srettha Thavisin, former PM Thaksin Shinawatra, and the Move Forward party. The outcomes of these cases will have political and economic implications.

	Charges	Hearing Dates
PM Srettha Thavisin	Allegations of ethical violations over cabinet appointment	18 June 2024
Move Forward Party	Allegations of violating charter over efforts to amend the *lese majeste law*	18 June 2024
Ex-PM Thaksin Shinawatra	Allegations of royal defamation case and computer crime	18 June 2024 (official indictment)

Source: Bloomberg, Reuters, Bangkok Post

[21] Govt blames fuel subsidies for missing its revenue target by 8.8 billion baht. (2024, March 11). Retrieved from The Nation.

Thailand

Inflation will remain subdued

Fiscal/quasi-fiscal policies have also played a role in keeping inflationary pressures subdued. Headline CPI averaged -0.1% YoY from Jan-May 2024 (2023: 1.2%) driven by government policies cutting retail diesel and electricity tariffs for an extended period. Notwithstanding, underlying inflationary pressures were also subdued with core CPI easing to 0.4% from Jan-May 2024 versus 1.3% in 2023.

BOT, however, is clear that this is not demand deficiency but rather supply-side factors driving inflation lower[22]. BOT forecasts headline inflation at 0.6% in 2024, lower than our forecast of 1.2%. While we see some downside risks to our forecast, we expect further upward revisions to diesel and petrol prices in the coming months.

BOT holds firm despite political pressure

BOT's view of higher inflation and better growth in the coming months, has led it to keep its policy rate unchanged at 2.50% in 1H24. This is despite significant political pressure to reduce the policy rate. At any rate, the public dissonance between the BOT and government has hurt Thai assets, including the currency (THB) and equity markets.

The political pressure on the BOT is unlikely to subside. If anything, as the BOT doubles down on its stance, the government could get more insistent on rate cuts. This could continue to weigh on sentiment, even as the current account surplus narrows. Although the current account surplus increased to 2.3% of GDP in 1Q24 (2023: 1.4% of GDP), we expect the current account surplus to narrow to 0.6% of GDP for full year 2024, as stronger goods imports more than offsets strong tourism inflows and the recovery in goods exports.

[22] Edited Minutes of the Monetary Policy Committee Meeting (No. 2/2024) 5 and 10 April 2024, Bank of Thailand. (2024, April 24). Retrieved from Bank of Thailand.

Philippines

Philippines: Ready to Ease

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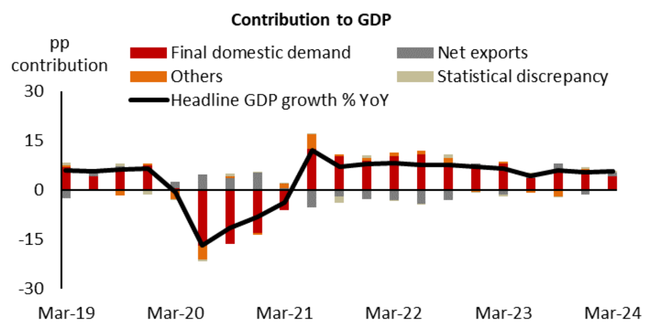
- GDP growth is expected to improve to 6.0% YoY in 2024 versus 5.5% in 2023 supported by better investment and export growth.
- The disinflation process remains underway while 'twin deficits' on the current account and fiscal balance will narrow relative to 2023 levels.
- Bangko Sentral ng Pilipinas (BSP) is ready to ease, and we expect it to cut its policy rate by a cumulative 50bp in 4Q24 and 100bp in 2025.

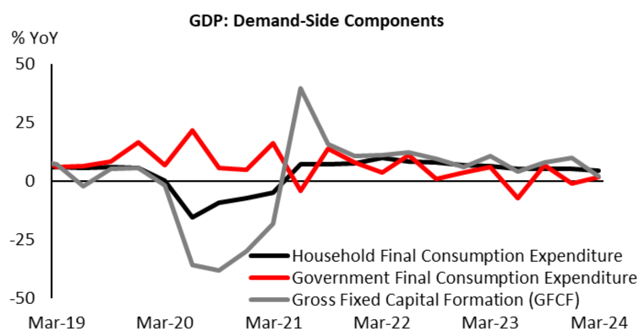
Growth improved in 1Q24

GDP growth improved to 5.7% YoY in 1Q24 versus 5.5% in 4Q24, supported by improved exports while domestic demand remained subdued. The contribution of net exports shifted to +1.2 percentage points (pp) from -1.4pp in 4Q23 as export rose by 7.5% YoY versus -2.5% in 4Q23, supported by higher electronics exports.

The contribution of domestic final demand eased to 4.2pp in 1Q24 from 6.0pp in 4Q23 as household and investment spending slowed relative to 4Q23. Household consumption eased to 4.6% YoY in 1Q24 from 5.6% in 2023, reflecting the lagged impact of monetary policy tightening and elevated inflationary pressures. Similarly, investment spending was also likely impacted by higher interest rates. These more than offset modest improvements in government spending (1.7% YoY versus -1.0% in 4Q23.



Source: Philippine Statistics Authority, CEIC, OCBC



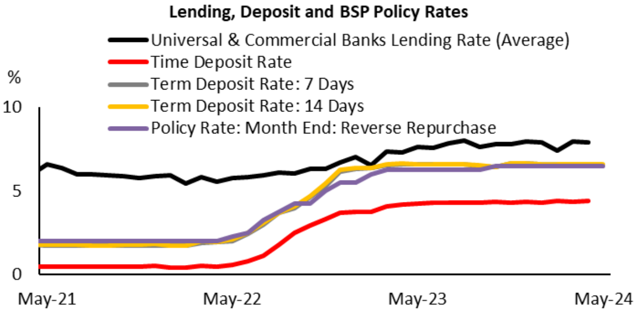
Source: Philippine Statistics Authority, CEIC, OCBC

Need for policy support

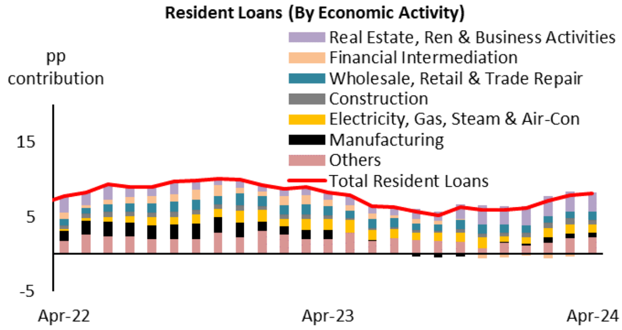
The 1Q24 growth picture underscores the need for looser monetary and fiscal policies to boost domestic demand. Lower policy interest rates, easing inflationary pressures and further progress on the government's structural reform agenda, will help bolster household and investment spending in the coming quarters, in our view.

We expect BSP will lower its policy rate by 50bp in 4Q24 and 100bp in 2025 to support credit growth. If anything, BSP seems more inclined to bring forward rate cuts (more details below). The government, meanwhile, has allowed for a more gradual path of fiscal consolidation, specifically boosting expenditures in the near-term to support economic growth momentum.

Philippines

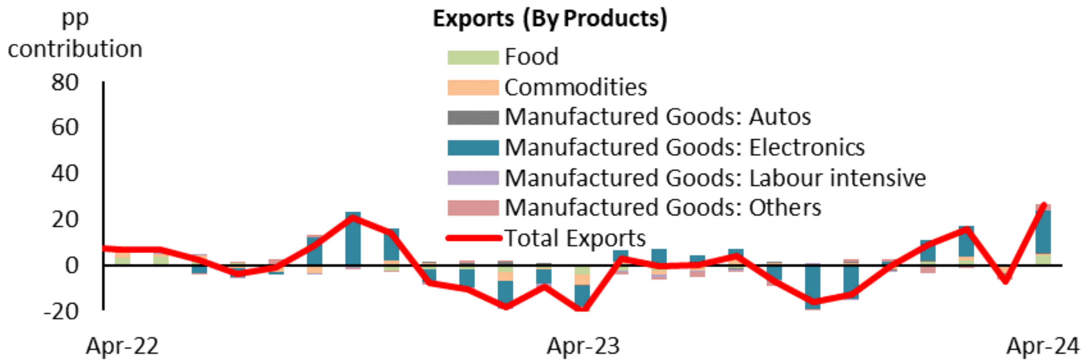


Source: Bangko Sentral ng Pilipinas, CEIC, OCBC



Source: Bangko Sentral ng Pilipinas, CEIC, OCBC

Importantly, the pick-up in electronics export growth will be sustained by a bottoming out in the global electronics cycle by 1H24, in line with our house view[23]. The Semiconductors and Electronics Industries in the Philippines Foundation Inc. (SEIPI) revised its outlook to "modest" growth in electronics exports versus its previous expectation of flat growth[24]. Meanwhile, other services exports such as Business Processing Outsourcing (BPO) is also expected to remain resilient[25].



Note: See details in footnote 24.
Source: Philippine Statistics Authority, CEIC, OCBC

Medium-term prospects remain intact

We expect GDP growth of 6% to be sustained across the forecast horizon (2024-2026). This will be supported by a focus on public infrastructure development, a realignment of FDI priorities and solid household spending prospects.

1. Focus on Public Infrastructure Spending

A key driver of economic growth over the past fifteen years has been investment spending, excluding the pandemic period, which has increased to 23.3% of GDP in 2023 versus 19.9% in 2010. This has been supported by the private and public sectors and we expect that this will continue over the medium-term.

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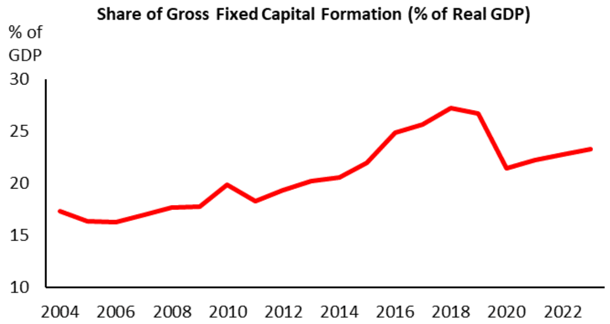
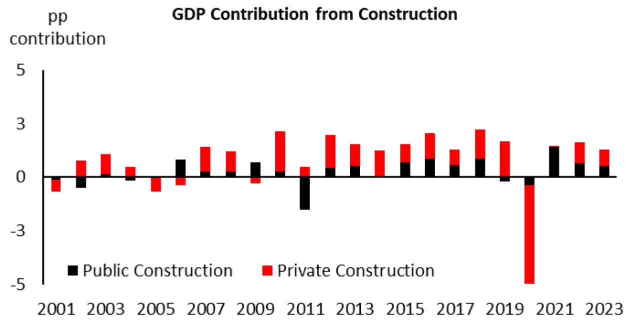
[23] Our classification for food includes 'fruits & vegetable, 'coconut', 'coconut oil'; commodities include 'copper meal', 'gold'; manufactured goods: autos include 'machinery & transport equipment'; manufactured goods: electronics include 'components or devices (semi conductors)', 'electronic data processing'; manufactured goods: labour intensive include 'garments', 'travel goods & handbags'; manufacture goods: others include 'chemicals'.
[24] Monzon, A.M. (2024, April 11). PH electronics exports now see modest growth this 2024. Retrieved from Inquirer.
[25] Campos, O.V. (2023, November 27). BPO industry expected to grow 7% in 2024. Retrieved from Manila Standard.

Philippines

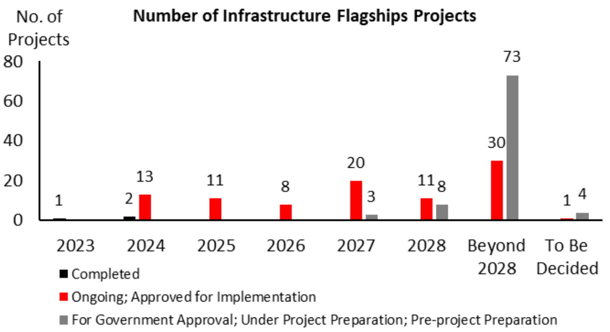


Source: Philippine Statistics Authority, CEIC, OCBC

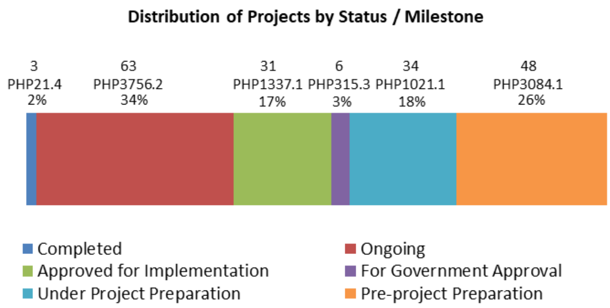


Source: Philippine Statistics Authority, CEIC, OCBC

Public infrastructure spending is expected to remain strong at (more than) 5.5% of GDP from 2024-2028, under the revised medium-term fiscal framework (MTFF). As of 31 March 2024, 34% of the flagship infrastructure projects are ongoing, while 17% are approved for implementation. There are currently 185 Infrastructure Flagship Projects with an indicative cost of PHP9.5tn. This suggests that pipeline spending on these projects remain solid and supportive of growth.



Source: National Economic and Development Authority, OCBC



Source: National Economic and Development Authority, OCBC

Simultaneously, the government will continue with its fiscal consolidation agenda albeit at a slower pace than previously projected. Under the revised MTFF from March 2024, the medium-term deficit will decline more gradually and be pegged at a higher level of 3.7% of GDP in 2028 versus 3.0% of GDP, previously. The recalibration would allow the government the fiscal space to support the implementation of its priorities aligned with the Philippine Development Plan 2023-2028 [26] and reflects a combination of lower revenue collections and higher expenditure until 2026. Beyond this, revenues and expenditures are lower compared to the previous plans.

[26] JOINT STATEMENT OF THE DBCC ON THE REVIEW OF THE MEDIUM-TERM MACROECONOMIC ASSUMPTIONS AND FISCAL PROGRAM FOR FY 2023 TO 2028. (2024, April 24). Retrieved from National Economic and Development Authority.

Philippines

PHP bn	Forecasts				
	FY24	FY25	FY26	FY27	FY28
Revenues (revised)	4269.9	4583.3	4956.6	5487.7	6078.0
% of GDP	16.1	15.8	15.8	16.1	16.4
Revenues (previous)	4235.3	4699.2	5283.4	5903.9	6622.2
% of GDP	15.5	15.7	16.1	16.5	16.9
Disbursements (revised)	5754.3	6074.2	6433.5	6887.2	7449.9
% of GDP	21.7	21.0	20.5	20.2	20.1
Disbursements (previous)	5630.0	5925.8	6428.8	7049.5	7797.1
% of GDP	20.6	19.8	19.6	19.7	19.9
Deficit (revised)	-1484.3	-1490.9	-1476.8	-1399.5	-1371.9
% of GDP	-5.6	-5.2	-4.7	-4.1	-3.7
Deficit (previously)	-1394.7	-1226.5	-1145.4	-1145.6	-1174.9
% of GDP	-5.1	-4.1	-3.5	-3.2	-3.0

Source: Development Budget Coordination Committee, OCBC

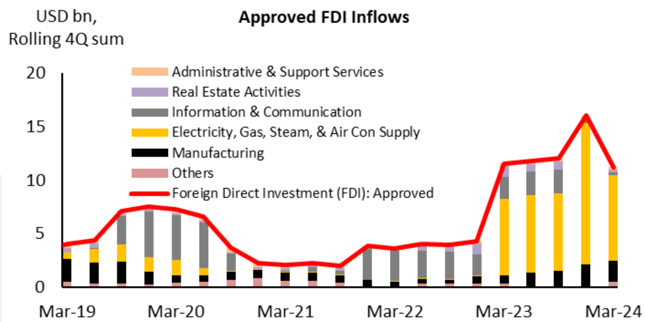
Notwithstanding, the government will still continue with crucial tax reforms required to broaden the tax base over the medium term, while continuing with "enhanced tax administration reforms focused on modernizing and upgrading the efficiency of the Philippine tax system." Consequently, the public debt profile will be higher at 55.9% of GDP by FY2028 versus 51.1% of GDP, previously.

2. Realignment of FDI priorities

Although FDI inflows declined by 2.9% YoY to USD11.2bn (on a rolling 4Q sum) in 1Q24 versus USD16.0bn in 4Q23, the government is realigning its geopolitical priorities to woo FDI from the US and Germany[27], even as tensions with China undermine FDI inflows from there. This will allow the economy to benefit from ongoing global supply chain adjustments. More fundamentally, relaxation of restrictive FDI provisions in key economic sectors[28] [29] will help support inflows and broaden the FDI base.

Act	Sectors impacted	Effective Date
Public Service Act	Railways, airports, expressways, and telecommunications are now open to 100% foreign ownership from 40%, previously. Some sectors remain restricted	01-Apr-23
Retail Trade Liberalisation Act	Lowering the paid-up capital requirement for foreign retail enterprises and other purposes.	21-Jan-22
Foreign Investment Act	Allows international investors to set up and wholly own domestic enterprises, including micro and small enterprises	04-Mar-22
Renewable Energy Act	Foreign investors can now hold 100 percent equity in the exploration, development, and utilization of solar, wind, hydro, and ocean or tidal energy resources.	08-Dec-22

Source: Philippines Government, IMF, World Bank, OCBC



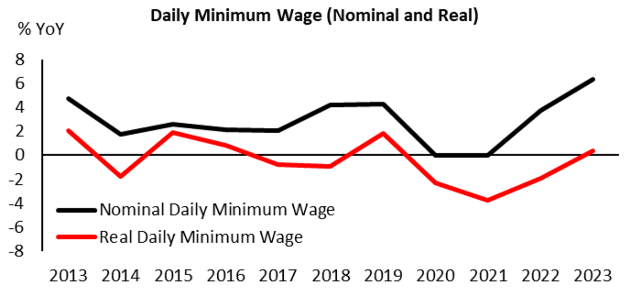
Source: Philippine Statistics Authority, CEIC, OCBC

[27] Morales, N.J. (2024, March 13). Philippines get US$5 billion in investment pledges from German, US companies. Retrieved from Reuters.
[28] Porcalla, D. (2024, March 21). Economic Cha-cha gets final House OK. Retrieved from The Philippine Star.
[29] Note: The following public utilities have foreign ownership limited to 40%: electricity distribution; electricity transmission; seaports; water pipeline & sewage; public utility vehicles.

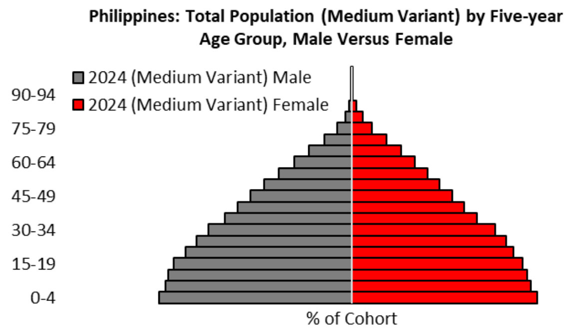
Philippines

3. Household Spending to Remain Supported

Finally, private consumption, which accounts for close to 75% of GDP, is fundamentally supported by still-resilient labour market conditions, lower unemployment rates, better wage growth and stronger overseas remittances. Moreover, economic growth will continue to benefit from the demographic dividend given the low median age and young labour force.



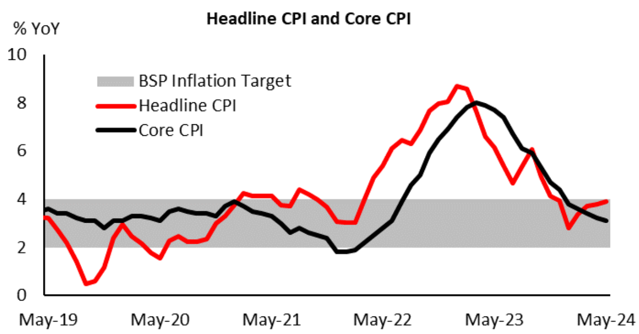
Note: The nominal daily minimum wage is derived by averaging the nominal daily wages of workers in non-agricultural, plantation, and non-polantation sectors.
Source: National Wages and Productivity Commission, CEIC, OCBC



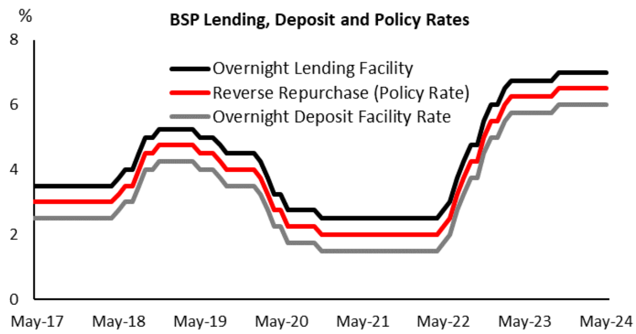
Source: United Nations Department of Economic and Social Affairs, OCBC

Inflation moving in the right direction…

Inflationary pressures, which have been a bugbear for BSP since 2023, has shown signs of consistent easing. While the disinflation process has been bumpy and volatile, headline CPI (Jan-May 2024) has averaged 3.5% YoY versus 6.0% in 2023. This is within BSP's 2-4% target range. Similarly, core inflation averaged 3.4% YoY versus 6.6% in 2023, mirroring some moderation in domestic demand pressures.



Source: Philippine Statistics Authority, CEIC, OCBC



Source: Bangko Sentral ng Pilipinas, CEIC, OCBC

Looking ahead, the government's decision to extend lower tariffs for key agricultural and energy products until 2028 to improve food and energy security[30] as well as lower oil prices will likely continue to support the disinflation process. For 2024, we expect headline CPI to average 3.9% YoY from 6.0% in 2023. This implies a slight pickup in inflationary pressures of 4.1% YoY for Jun-Dec 2024, breaching the top end of BSP's 2-4% target range in some months.

[30] NEDA Board approves Comprehensive Tariff Program calibrating current tariff rates until 2028 to lower prices of goods. (2024, June 5). Retrieved from Philippine Information Agency.

Philippines

BSP has wiggle room to ease rates
Our baseline forecast is for BSP to cut its policy rate by a cumulative 50bp starting in 4Q24 followed by a cumulative 100bp in 2025. The risk, however, is that the timeline could be brought forward depending on inflation outcomes. BSP Governor Eli Remolona has signalled that cuts to the policy rate could be delivered in 3Q24. At that point, the BSP will have the June and July headline CPI prints to better assess the disinflation trend.

However, BSP will need to stomach and handle a weaker currency (PHP). Since the BSP alluded to a timeline for rate cuts, the currency has underperformed regional peers. While our forecast is for the current account deficit to narrow to 2.1% of GDP, above BSP's 1.3% forecast, from 2.6% in 2023, the persistence of 'twin deficits' on the current account and fiscal fronts, implies that BSP will remain vigilant of capital outflow vulnerabilities.

Myanmar

Myanmar: Conflict Constrained

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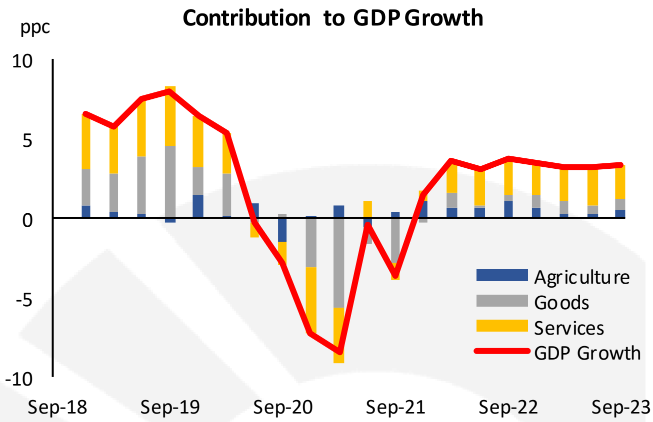
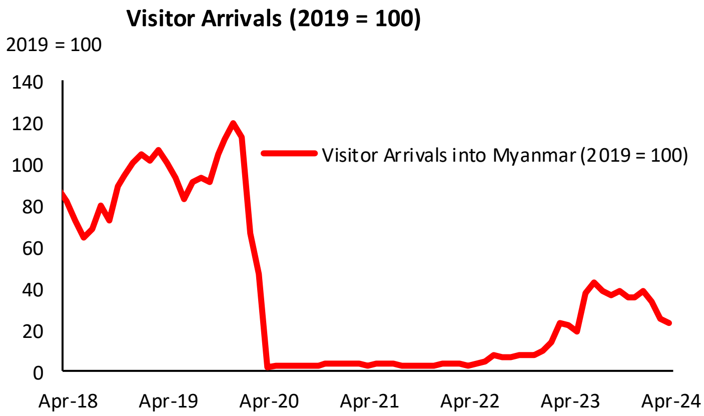
- Economic growth remains under significant pressure from heightened political and security risks, broadly disrupting growth engines including tourism, agriculture and manufacturing.
- Despite better remittance inflows, conflict induced disruptions on supply-chains and overland trade routes have restrained goods exports significantly to widen the overall current account deficit.
- The conflict is also extracting its toll on domestic prices. Headline inflation is projected to remain elevated in FY24 and Myanmar faces fresh kyat depreciation risks.

Economic growth has come under significant pressure following the pandemic and heightened political risks. Indeed, the conflict intensity index[31] suggests that the level of conflict remains high. GDP growth was estimated to be 1% YoY in FY23 by the World Bank, still 10% below pre-pandemic levels. More importantly, GDP growth is expected to remain around a similar 1.0-1.5% range in FY24 and FY25[32].

The drag on growth has been and is likely to remain fairly broad-based. The agriculture sector is constrained by disruptions to overland trade routes given conflicts near the border, with 33.0% of agricultural exports to Thailand, China and India transported via land, according to the World Bank. Manufacturing production continues to be held back by power shortages and supply-chain disruptions with firms across all sectors set to continue operating at lower capacities this year. Tourism, a major engine of pre-pandemic growth (~4.0% of GDP in 2019), has shown few signs of recovery. Tourist arrivals are 23% of 2019 levels as of April 2024.



Source: CEIC, OCBC

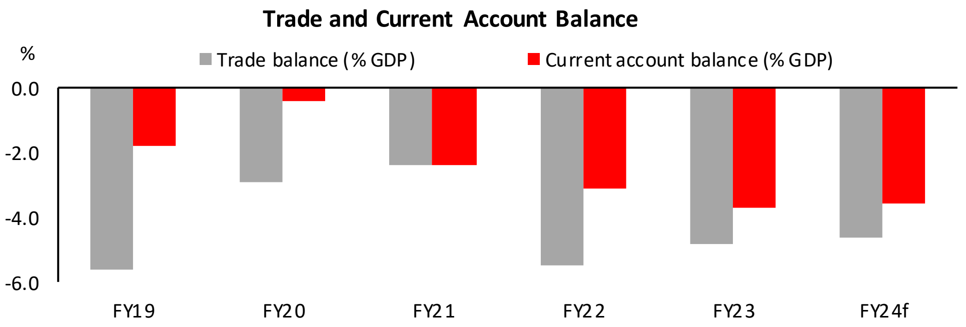


Source: CEIC, OCBC

[31] Conflict Intensity Index refers to the geometric mean of events and fatalities using data from the Armed Conflict Location and Event Data Project (ACLED)
[32] Official sources have pegged real GDP growth higher at around 3.3% YoY for FY2022-23, i.e., year ending March 2023. For the purpose of our publication, we use World Bank estimates.

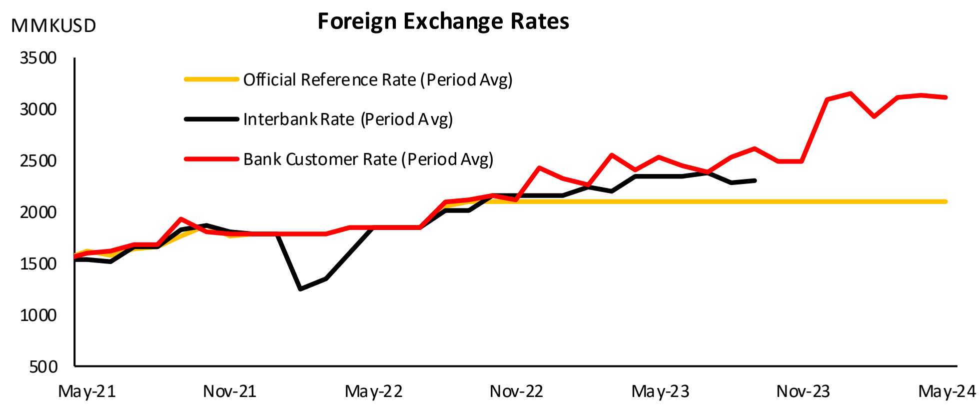
Myanmar

However, weaker tourism reciepts and weakening export growth are more than offseting better remittance inflows. The government's introduction of conscription in April[33] is likely to worsen labour shortages in agriculture and garments and reduce remittances, thus weighing on goods and services exports. As such, the trade and current accounts are expected to remain in large deficits of close to 5% of GDP in FY24 and FY25, from 5.5% in FY22-23, as per World Bank estimates.



Source: World Bank.

The conflict is also extracting its toll on domestic prices. Headline inflation is projected to remain elevated in FY24 at around 18.0% YoY, versus 26.5% in FY23. Food and transportation costs have been high. Following a brief stabilisation between December 2023 and January 2024, the parallel-market exchange rate for MMK versus USD reached all time lows of 4300 in early June, depreciating ~20% since end 2023. CBM initiated a substantial reported drawdown of USD88mn in foreign reserves from mid-February to March[34] in an attempt to mitigate kyat depreciation pressures. The CBM also increased the required reserve ratio (RRR) by 25 basis points to 3.75% in May and raised the interest rate on excess cash reserves by 20bp to 3.8%. The implications of these moves have been fairly contained.



Source: CEIC, OCBC.

[33] The SAC revived the Military Service Law on 10 February 2024, with recruitments beginning in April 2024.
[34] Central Bank of Myanmar sells more millions in foreign currency market, Eleven Myanmar, 5 Mar 24

Myanmar

A wider fiscal deficit is on the cards, with revenue collection moderating further from FY22 levels. Total revenue is set to moderate further to reflect a diminishing firm and household tax base. Authorities have also planned to raise outlays across broad spending categories including defence, electricity generation, transport and agriculture. The fiscal deficit came in at 3.3% of GDP in FY22, and estimates[35] expect the FY23 and FY24 deficit to widen markedly to 5.7% and 6.1% respectively.

The upshot remains that economic growth potential is constrained by political uncertainties, while inflationary pressures remain elevated with currency depreciation pressures likely persisting.

[35] World Bank estimates

Thematic Report 1

The 2024 US Presidential Elections

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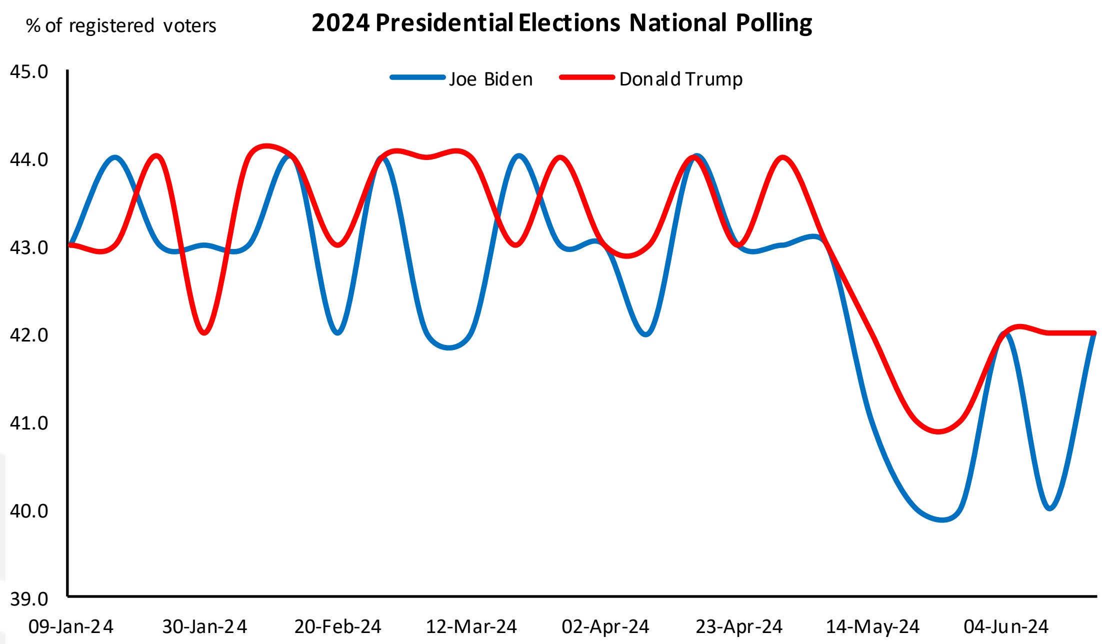
- With the race still neck-to-neck, it is still too close to call the November outcome at this juncture. Swing states are leaning Trump, while Biden's electability has room to recover should inflation continue to normalise and feed into lower inflation expectations.
- A larger fiscal deficit and higher government debt is on the cards either way. With both Trump and Biden having signalled that they are not keen on entitlement reform, and the US is therefore set for larger budget deficits with either candidate in office.
- While short-term market volatility may be expected around the election cycle, asset class performance will likely still be influenced by the overall growth, inflation, and monetary policy backdrop.

The 2024 US Presidential race has shaped up to be a rematch between incumbent President Joe Biden and former President Donald Trump, since the conclusion of Super Tuesday Republican primaries on 6 March. Polling data has since continued to fluctuate within a narrow range.

Each candidate is dealing with their own set of challenges. Former President Trump faces a slew of legal battles and is falling behind on campaign finances. Meanwhile, President Biden's re-election chances continue to be weighed down by weak sentiment on the economy and domestic tensions (protests at universities). At this juncture, the election outcome is likely still too close to call.



Source: YouGov, OCBC.

Thematic Report 1

Setting Up for a Nail-Biting Finish

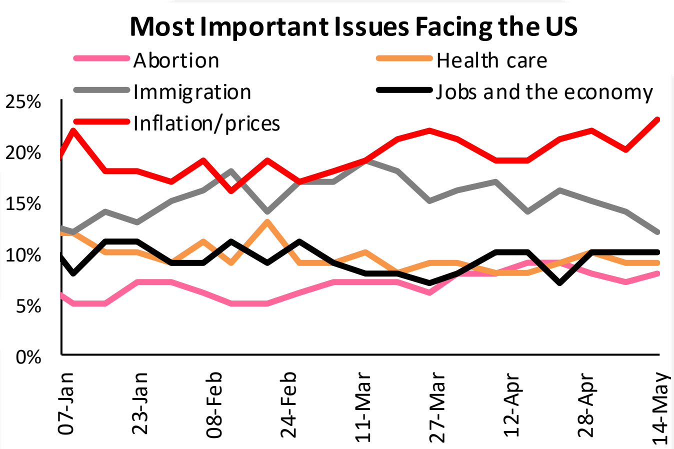
Swing states leaning Trump. Presently, Trump holds the upper hand in 5 out of 6 key swing states. The Economist/YouGov surveys on 14 May indicate 57% of registered voters 'strongly or somewhat disapproving' of Biden's job performance, versus 40% 'strongly or somewhat approving'.

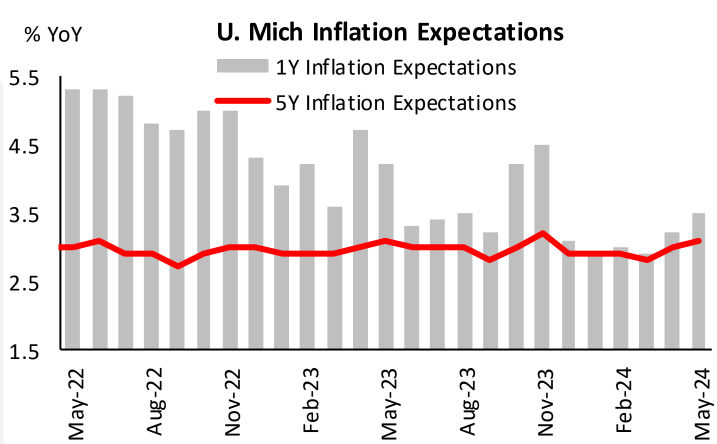
Assessing campaign issues that may sway swing state electorates, inflation and prices held strong as the 'most important issue facing the US', according to YouGov at 23%. This was followed by immigration at 12% and healthcare at 9%. Former President Trump holds a more definitive immigration stance with promises to bring back Title 42. However, the lack of an Affordable Care Act (Obamacare) alternative despite Republican's "repeal and replace" rhetoric leaves little room roughly 40 million Americans insured directly by or benefitting from ACA-related coverage unsure of prospects under a future Trump Presidency.

Swing State	Electoral College Votes	2016	2020	Polling
Arizona	11	**Trump (48.1%)** Clinton (44.6%)	Trump (49.1%) **Biden (49.4%)**	**Trump** leads by 7%
Georgia	16	**Trump (50.4%)** Clinton (45.3%)	Trump (49.2%) **Biden (49.5%)**	**Trump** leads by 6%
Michigan	15	**Trump (47.3%)** Clinton (47.0%)	Trump (47.8%) **Biden (50.6%)**	**Trump** leads by 7%
Nevada	6	Trump (45.5%) **Clinton (47.9%)**	Trump (47.7%) **Biden (50.1%)**	**Trump** leads by 12%
Pennsylvania	19	**Trump (48.2%)** Clinton (47.5%)	Trump (47.7%) **Biden (50.1%)**	**Trump** leads by 3%
Wisconsin	10	**Trump (47.2%)** Clinton (46.5%)	Trump (48.8%) **Biden (49.5%)**	**Biden** leads by 2%

Source: Bloomberg, OCBC. Polling by NYT/Sienna College on 28 Apr-9 May.

A soft- or no-landing growth narrative may be constructive for Democrats. Biden's electability has room to recover should inflation continue to normalise and feed into lower inflation expectations. As the electorate typically attributes the state of the economy to the incumbent president and his party, it is possible that Biden's electability could improve should a soft-landing scenario (i.e., slowing growth without a recession) materialise. Indeed, this remains our base case as we expect headline inflation to ease to 2.7% YoY in 2024 (2023: 4.1%) and growth remaining sturdy at around 2.4% YoY (2023: 2.5%).



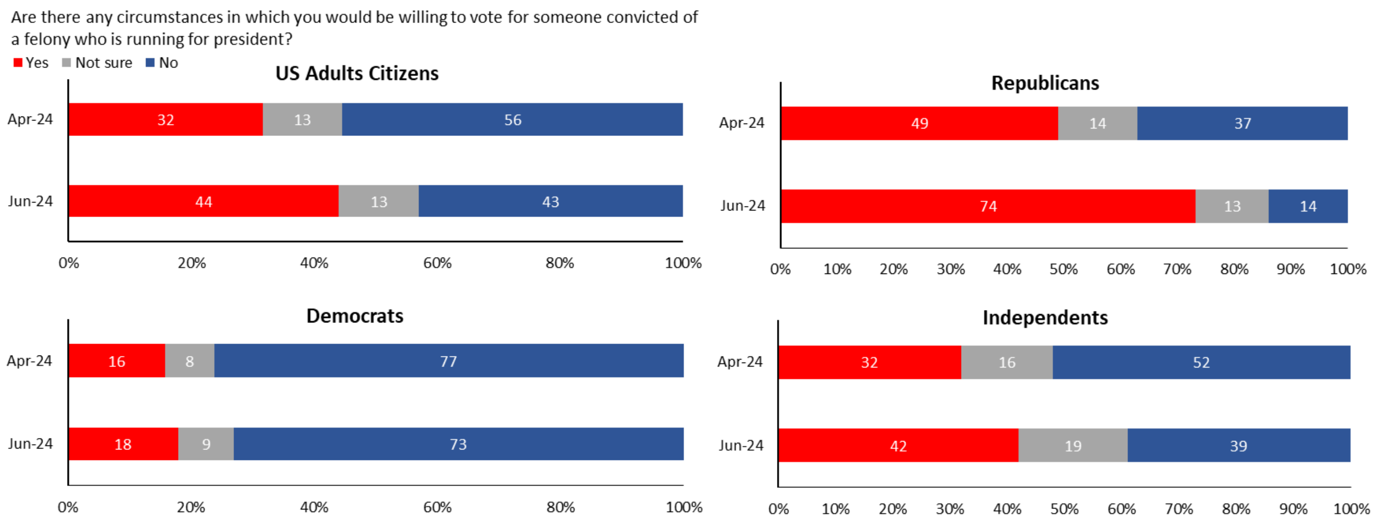


Source: YouGov, U. Michigan, Bloomberg

Thematic Report 1

Trump's legal challenges may not move the needle significantly before November. Trump remains mired in a slew of legal challenges (>90 felony counts involving 2 state courts and 2 Federal districts) and has been found guilty on all 34 counts of falsifying business records in the hush-money case. Sentencing for said case is due 11 July and any of his trials could lead to a criminal conviction and jail time. Nevertheless, Trump could still legally run for office as the constitution does not procedurally void his presidential eligibility, with minimal dent to his support amongst Republicans.

Surveys from YouGov[36] on 31 May – 3 June showed that more Republicans and independents say they would vote for a convicted felon than in April. Furthermore, the Trump campaign reportedly raised US$52mn in the 24-hours post his guilty verdict. All is to say that criminal convictions before the elections are unlikely to dent his popularity as his team will seek to leverage on his legal challenges to galvanise support. Trump has vowed to appeal his guilty verdict in New York, while his election interference case in Georgia and obstruction of justice case in Florida do not have scheduled trial dates. His election interference case with the Washington federal court is pending a Supreme Court on whether he has immunity from prosecution as a former president.



Source: YouGov, OCBC.

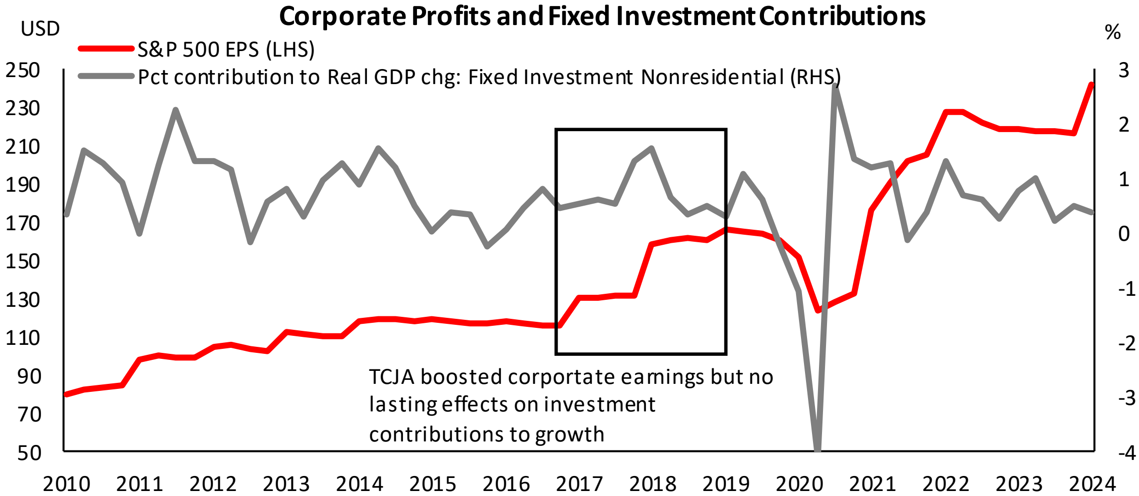
Handling of the conflict in Gaza may hurt Biden in key demographics. Biden's handling of the conflict in Gaza and recent campus protests has shored up support for the growing 'non-committed' movement, popular amongst Arab-Americans and college-educated youths who traditionally lean Democratic. With continuously failed calls for a ceasefire (at the time of writing), it is possible for the movement to gain enough steam to materially hurt Biden's chances in November. This is particularly relevant with regards to Biden's performance in Michigan, a key swing state where the movement has gained momentum, owing to its sizeable Middle Eastern diaspora.

36 After the Trump verdict, most Republicans say they're OK with having a criminal as president, YouGov, 5 June 2024.

Thematic Report 1

Macro Implications

First, a larger fiscal deficit and higher government debt is on the cards either way. A second Trump administration would seek to make the 2017 Tax Cuts and Jobs Act (TCJA i.e. Trump tax cuts), set to expire in 2025, permanent. Estimates by the Congressional Budget Office show the TCJA potentially costing the federal government US$2trn by 2027, while evidence of a transmission from lower corporate taxes to real investment spending and GDP growth remains uncertain.



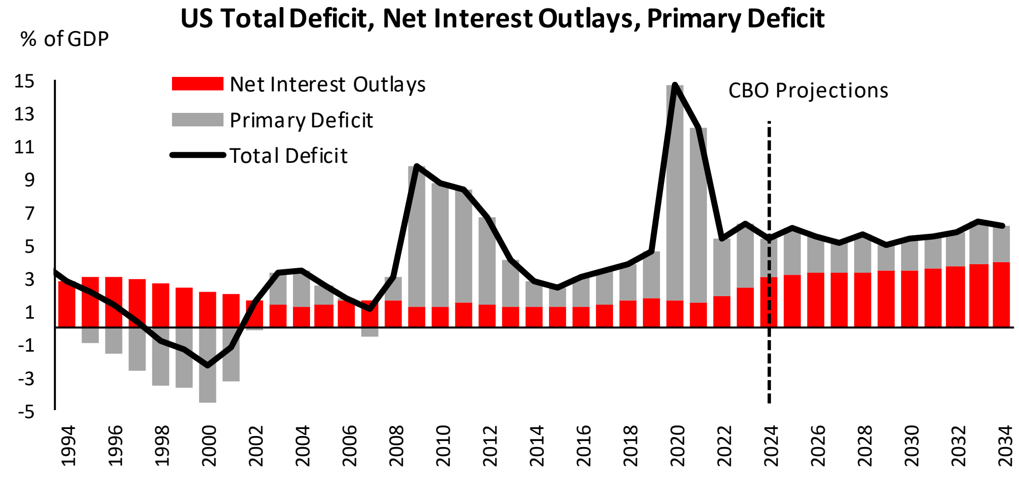
Source: Bloomberg, NBER, OCBC.

Meanwhile, while Biden could propose another round of tax hikes on wealth, fiscal spending due to the IRA is projected to reach US$386bn over 10 years from 2022-2031. Current deficit projections from the CBO show the federal budget deficit increasing from US$1.5trn in 2024 to US$2.6trn by 2034 or rising from 5.6% of GDP to 6.1%. The projections would be substantially above the 50-year average of 3.8%.

Even if the primary deficit stabilises at around 2% of GDP as growth picks up in 2026 to bolster receipts, elevated interest outlays are set to keep the total deficit wider. With both Trump and Biden having signalled that they are not keen on entitlement reform, and the US is therefore set for larger budget deficits with either candidate in office.

Watching the debt clock, the CBO projects federal debt held by the public to increase from 99% of GDP in 2024 to 116% by 2034. Trump in January promised to pay off the US$34trn national debt but has yet to specify how. Federal debt held by the public grew by US$7.2trn during Trump's term and his administration approved ~US$8.4trn of new borrowing over ten years. Biden's latest budget proposal for 2025 claims that the debt-GDP ratio would be managed at around 105% by 2034, via higher taxes on wealth and corporates but was not passed by Congress.

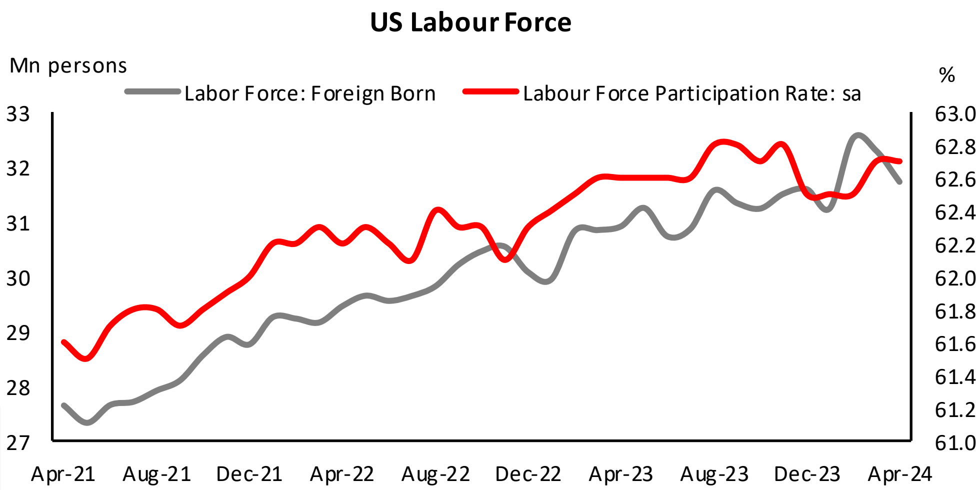
Thematic Report 1



Source: CBO, OCBC

Tighter immigration policy may slowdown the pace of labour market loosening. Recent cooling of the US labour market was partly aided by the expansion of the labour force via rising immigrant participation. The above trend payroll growth of ~270k per month in 1Q24 came with concurrent slowdowns in wage growth, likely a consequence of increased labour supply from foreign-born workers.

Trump's plans to reinstate Title 42 may cause labour markets to re-tighten, especially for immigration reliant sectors including food services, construction, and accommodation. The net effects on inflation, however, could be offset by plans to expand fossil-fuel production and removal of environmental regulations which would relieve pressures on energy prices and increase supply capabilities.



Source: CEIC, OCBC.

ESG considerations and the renewables sector expansion take a backseat with Trump at the helm. A Trump presidency would result in a reversion of US energy policies to fossil fuels, consequently undoing progress made via the Inflation Reduction Act's (IRA) renewables capacity building.

Thematic Report 1

While Trump may not be able to roll back on the law unilaterally, but he can hinder its implementation such as by holding back grants and incentives for clean energy deployment. Trump has vowed to reverse regulations imposed on the fossil fuel industry and expand US oil production, including construction of the Keystone Pipeline, expediting drilling permits on federal land and opening additional areas for production.

Environmental regulation rollbacks under Trump

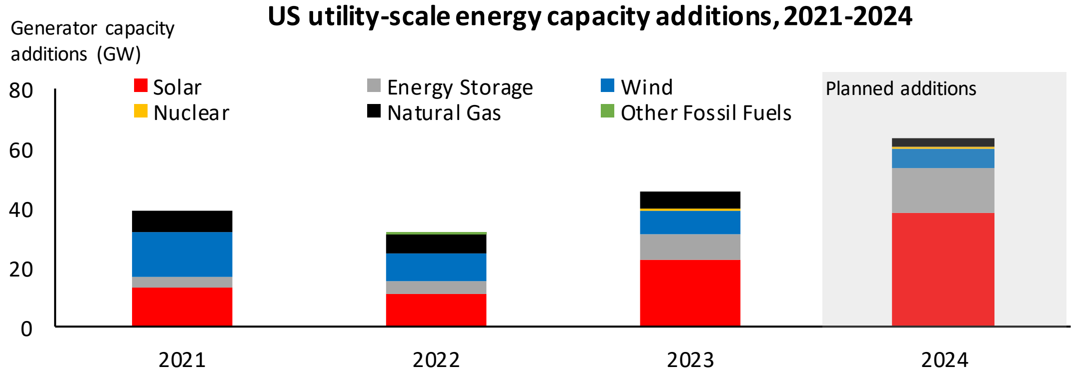
Segment	Completed	Incomplete*	Total
Air pollution and emissions	28	2	30
Drilling and extraction	12	7	19
Infrastructure and planning	14	0	14
Animals	15	1	16
Water pollution	8	1	9
Toxic substances and safety	9	1	10
Other	12	2	14
All	98	14	112

Source: NYT. *Note: As of Jan 2021.

The ESG U-turn will have implications for the global decarbonisation progress. Trump said in December 2023 that if he were re-elected, all climate reparation payments will be cancelled, and he will seek to clawback any payments made by the Biden administration. This includes reneging on a US$3bn US pledge to the Green Climate Fund meant to help developing countries reduce emissions and adapt to the impacts of climate change. Trump followed through with his promise to withdraw from the Paris Agreement in 2020 and Biden pushed for reinstatement in 2021.

Unsurprisingly, Biden's ESG scorecard is much better with renewables and energy storage dominating utility-scale generation sources under his term. A Biden victory is set to continue some degree of policy continuity and he will continue to tread carefully between restraining China's influence in the renewables supply chains, without damaging his own energy transition agenda.

US utility-scale energy capacity additions, 2021-2024



Source: World Resources Institute, OCBC.

US-China Trade Relations: Different Approaches

Both candidates have espoused protectionism, which will remain a prominent feature in US geoeconomic strategy moving forward.

Irrespective of the November outcome, both candidates have made clear their plans to actively support and shield industries critical to reinvigorating US manufacturing and protecting national security. In February, the Trump campaign floated the idea of imposing tariffs of up to 60% on Chinese imports and up to 10% on imports from other countries. The Biden administration followed up in May with announcements of tariffs on ~US$18bn of goods imports from China, primarily targeting EV inputs including Chinese-made lithium-ion batteries.

Prior to this, licenses to export certain semiconductors by Qualcomm and Intel to Huawei were revoked on national security grounds. Furthermore, the intervention on US Steel and failed negotiations to include EU carmakers in the IRA has underscored President Biden's motivation to stick to these policies.

Date	Tariff Announcements	Administration
Jul-18	US announces additional $200bn in Chinese imports, and an additional $300bn after that	Trump
Jul-18	US reaffirms plans to impose tariffs on all Chinese imports (roughly $500bn).	
Aug-18	US threatens a 10% tariff on $200bn of Chinese goods if China retaliates for the previous 10% tariff, and that would extend to an additional $200bn of goods.	
May-19	US announces it will raise tariffs on $200bn of imports from China from 10% to 25%, with threats to impose an additional 25% on $325bn of goods.	
Jul-19	US again threatens additional tariffs on Chinese imports if China further retaliates, increasing threats from levies on $200bn and another $200bn to $200bn and $300bn.	
Aug-19	US announces 10% tariff on $300bn Chinese goods lowered from the previously announced 25% on $325bn.	
Aug-19	US announces the 25% tariff on $250bn of Chinese goods would increase to 30 percent (postponed indefinitely)	
Feb-20	US reduces tariffs on $120bn of Chinese goods by half to 7.5% and China reduces tariffs on approximately $75bn of US goods in half to 2.5% and 5%.	
Mar-21	Five Chinese companies including Huawei are backlisted by US telecom regulator	Biden
Apr-21	US Senate Foreign Relations Committee approves the Strategic Competition Act of 2021, signalling bipartisan consensus on China Strategy	
Jun-21	Biden expands Trump-era ban on American investment into Chinese firms	
Jun-21	US Senate passes the Innovation and Competition Act of 2021 to compete with China on technology	
Jun-21	US bans imports of solar panel material from Xinjiang	
Nov-21	US blacklists Chinese quantum computing companies	
Oct-22	US Department of Commerce implements new export controls on advanced computing and semiconductors to China.	
Aug-23	Biden Issues Executive Order Restricting US Investments in Chinese Tech.	
Oct-23	US Further Tightens Export Controls of Advanced Chips to China	
Mar-24	US House of Representatives Passes Bill to Ban TikTok	
Apr-24	Biden administration calls for tripling tariff rate on Chinese steel and aluminium imports.	
Apr-24	Joe Biden Signs Bill that will Force ByteDance to Divest from TikTok Following Senate Approval.	
May-24	US Set to Increase Tariffs on Chinese EVs, Solar Panels, Semiconductors, and More Following Review of Section 301 Tariffs.	

Source: Taxfoundation.org, China Briefing. Note: List is non-exhaustive

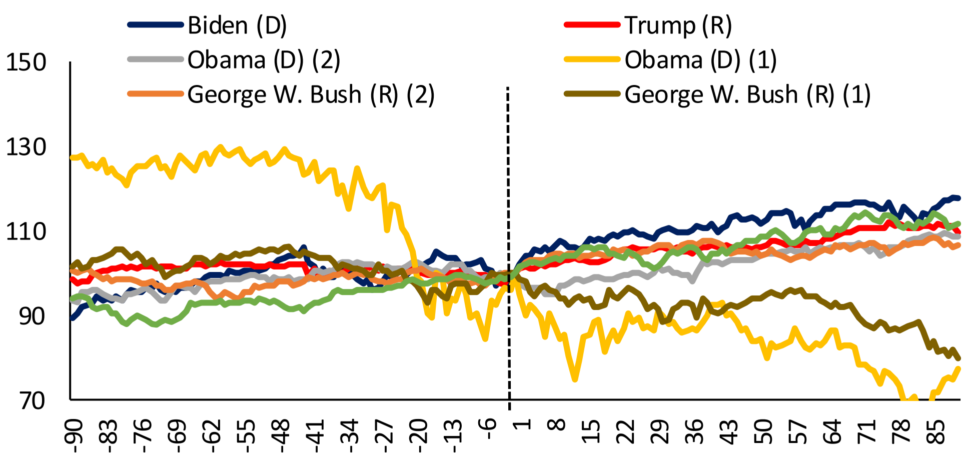
That said, it is noteworthy that Biden's tariffs have been more precise, and that he is more consultative on trade relations with China. While Trump applied blanket tariffs on Chinese imports, Biden's tariff strategy targets technologies with military applications (e.g. advanced semiconductors) and sectors crucial to his industrial policy agenda (e.g. EVs).

Biden and Xi agreed to advance cooperation in certain areas including international crime and AI-security risks at San Francisco in November 2023, which was followed up with visits to China by Yellen and Blinken in April 2024. Thus, while de-risking and fragmentation themes may be a mainstay regardless of the November outcome, the trade war could be marginally cooler under Biden.

Market Performance

While short-term market volatility may be expected around the election cycle, asset class performance will likely still be influenced by the overall growth, inflation, and monetary policy backdrop. We observe mostly positive movements for the S&P500 in the 3-months pre- and post-election for the past 7 cycles. The exceptions are bear markets during the 2008 GFC for Obama 2008 and 9/11 attacks for Bush 2001. A Trump victory may lead sentiment higher bolstered by the expectation that corporate tax rates will remain low. A Biden win may exert pockets of pressure on stocks, should tax hikes feature more prominently on the Biden agenda later in the campaign.

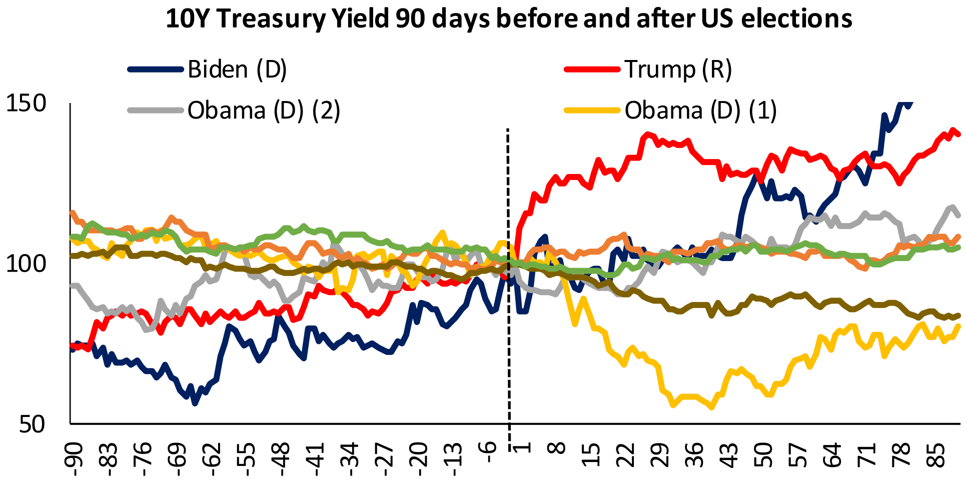
S&P performance 90 days before and after US elections



Source: Bloomberg, OCBC.

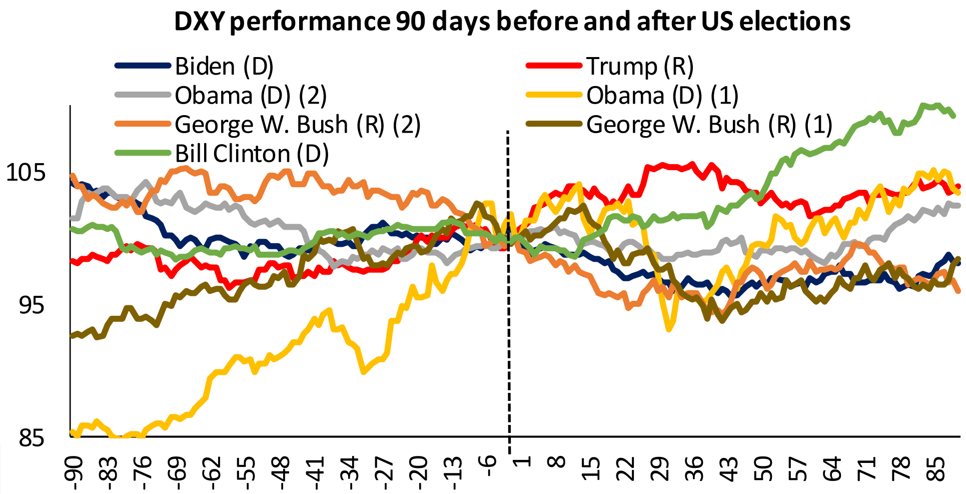
Yields on the UST 10Y rose noticeably sharply following Trump's win in 2016, which coincided with the beginning of the Fed's hiking cycle. Yields started around 1.80% before the election and reached just shy of 2.60% in mid-December. Trump's political messaging on tighter immigration, increased trade protectionism and tax cuts is similar to that in 2016, implying that drivers for higher yields via inflation expectations and term premium channels may be present this time round. That said, our view is that wider fiscal deficits are on the cards for both candidates.

Thematic Report 1



Source: Bloomberg, OCBC.

USD strength continues to be strung along by the US exceptionalism narrative though recent activity and inflation data showed signs of that fading. During past election cycles, the DXY index staged the 2nd strongest rally for Trump 2016 (after Clinton 1996) possibly supported by weakening of trading partner's currencies due to protectionist rhetoric. EURUSD pushed nearly 3% lower in the 3 months after Trump's win. While trade fragmentation is in play for both candidates this time round, Biden's more consultative approach vis-à-vis Trump's broad-stroke strategy to tariffs means higher FX vols are more likely with Trump, which would be dollar positive.



Source: Bloomberg, OCBC.

Thematic Report 1

Bottom Line

With the race still neck-in-neck, it is still too close to call the November outcome at this juncture. Nonetheless, markets have begun positioning for a "what-if Trump" scenario as geopolitical risk premiums have emerged in certain asset classes (see FX Thoughts: Gold Bulls to Mind the Pullback). Increased protectionism is on the cards either way, but a Biden win may see lower market volatility on policy continuity.

The clearest risk for a Trump victory to us is the U-turn on US energy policy. Rolling back the IRA will stall or reverse progress in renewable and EV-related capacity expansion. We maintain our near-term growth and inflation outlook for now, acknowledging that it assumes some degree of policy continuity.

US Forecasts

Real GDP (%YoY)			Headline CPI (% YoY)			FFTR Upper (%)			
2023	2024	2025	2023	2024	2025	Current	2Q24	3Q24	4Q24
2.5	2.4	1.5	4.1	2.7	2.3	5.5	5.5	5.25	5.00

Key US Election Events

Month/Date		Event
Jun	27	CNN Presidential debate
Jul	15 - 19	Republican National Convention (Milwaukee, WI)
Aug	19 - 23	Democratic National Convention (Chicago, IL)
Sep	10	ABC News Presidential Debate
Nov	05	US General Elections
Dec	10	Deadline to resolve election discrepancies
	17	Electoral College casts votes
Jan-25	06	Congress counts electoral votes
	20	Inauguration Day

Source: Bloomberg, OCBC. Note: VP Debate dates TBC.

2024 Presidential Elections Policy Position Matrix

	Fiscal Policy	Energy and ESG	Industrial Policy	Immigration	Social security
Domestic	Trump • Make 2017 TCJA permanent. • Lower CTR and IIT, floated reducing CIT from 21% to 15%.	Trump • Rollback clean energy tax credit and subsidies for EVs and renewables • Build Keystone pipeline and expand US oil & gas and coal production.	Trump • Rollback clean energy tax credit and subsidies for EVs and renewables • Build Keystone pipeline and expand US oil & gas and coal production.	Trump • Reinstate Title 42 and heavy clampdown on illegal immigration via support for Dept of Homeland Security. • Alluded to the reinstatement of family separations.	Trump • Leave social security system unchanged, campaigned on supporting current outlays via raising oil production.
	Biden • Allow TCJA provisions to expire in end-2025. • Raise CIT and IIT, proposed raising CTR from 21% to 28%.	Biden • Policy continuity in clean energy, expand clean energy tax credits beyond solar and wind to include hydro, geothermal, waste energy.	Biden • Continued focus on attracting manufacturing investment back into US, supported by trade protectionism on key sectors (EVs, renewables).	Biden • Subtle clampdown on illegal immigration due to polling and fiscal pressures from accommodating irregular immigration in urban areas.	Biden • Continued focus on attracting manufacturing investment back into US, supported by trade protectionism on key sectors (EVs, renewables).

	Trade / China		EU/NATO	MENA	APAC
Foreign	Trump • Proposing 10% levy on almost all imported foreign goods. • Urge Congress to pass legislation to give presidential authority to impose reciprocal tariffs.	Trump • Proposing 60% tariffs on imports from China. • Ban Chinese companies from owning US infrastructure. • Eliminate China's MFN status. • Continued support for Taiwan given strong Republican Party backing.	Trump • Stress that US support for NATO will be contingent on NATO partners meeting defence spending requirements of 2% of GDP. • Limit further aid to Ukraine, push for Russia-Ukraine negotiations to end the conflict which may include territorial concessions by Ukraine.	Trump • Supports Israel's military action (though he has been critical of some of Israel's tactics). • Purse the Abraham Accords and push for normalization of relations between Israel and GCC allies. • Increase pressure on Iran and oppose further progress on the 2015 Iranian nuclear deal.	Trump • Engagement with allies may be contingent on increased national defence spending commitments. • May pressure allies to pay more for US troop presence.
	Biden • Continue to de-risk supply chains but protectionism targeted to sectors crucial to industrial policy agenda to reshore manufacturing (steel, EVs, renewables) and national security (high-tech semiconductors).	Biden • Continued high-tech export curbs and scrutiny of Chinese tech companies by regulators. • Maintain close engagement with Taiwan but will seek to maintain open lines of communication with China.	Biden • Continued rhetorical support for Ukraine but possible reductions in aid due to deadlock in the conflict.	Biden • Continued push for a two-state solution and push for negotiations between Israel and Hamas. • Push for normalization of relations between Israel and the GCC.	Biden • Deepen engagement with SK, JP and AU and strengthen AUKUS and 'Quad' defence partnerships.

Source: Various research reports.

Thematic Report 2

Five Questions On Asset Class Performance Into 2H24

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- US stocks and gold markets both hit an all-time high in May, but are now undergoing a healthy consolidation in our view. While central banks remain cautious on easing monetary policy, leading economic indicators continue to improve globally, and recession risks appear low for most developed economies, particularly for the United State.
- In Asia, China and Hong Kong stocks have surged in 1H24 after spending three years in the doldrums. Following a combination of better-than-expected macro prospects, an impactful policy put, fund rotation, and cheap valuation relative to the US and Japanese stock, the MSCI China has risen over ~10% over the past two months and is nearly ~25% since its tough in mid-January.
- So, what's next from here? Below, we address some questions investors may have in mind.

Goldilocks Returns? Macro overview at a glance
Market expectations regarding the US Federal Reserve rate cutting cycle have essentially done a round-trip since our 1H24global outlook report in November 2023. While the market initially priced in only about two 25bps rate cuts in 2024 and moved to nearly six cuts early this year, this expectation has now retreated to fewer than two cuts.

Macroeconomic data in May across the globe have been surprisingly strong, following a sluggish April. Manufacturing sector activity indicators improved across the US, UK, Eurozone, and Japan, while their service sector PMIs remained in expansionary territory, led by the US. However, a second read on US Q1 GDP was revised down from 1.6% to 1.3%, while the ISM manufacturing stayed below 50 for 18 out of the past 19 months. Additionally, the job market in the US continues to exhibit signs of softening, which is positive for the inflation front. The overall picture suggests continued healthy growth in the US, as reflected in the Federal Reserve's latest Beige Book and the Atlanta Fed's GDP Nowcast estimate of 1.8% growth for 2Q24.

With growing confidence and fading recession fears in economic growth, we believe a window for a 'Goldilocks' outcome to support risk assets in the coming months. Technical indicators (for example?), particularly in the US and Europe, remain supportive, exhibiting strong momentum and low volatility for which markets?.

On the risk outlook, we remain cautious on:
1/Geopolitical Tensions. Ongoing conflicts between Russia-Ukraine and Israel-Hamas, Houthi attacks in the Red Sea (leading to cargo diversions around the Cape of Good Hope) and increased military drills in the Taiwan Straits.

2/US Elections. In the run-up to the November US presidential elections, the Biden administration has already slapped tariffs ranging from 25% to 100% on items like steel, aluminium and lithium batteries, semiconductors, solar cells, and electric vehicles. While the new tariffs will have a limited impact on Chinese goods imports (estimated at ~4.2% of total US imports from China), the persistent de-risking measures could have more widespread implications for intermediary manufacturing/exporting economies in Asia/ASEAN who play an integral role in the regional supply chains. Note Trump has threatened 60% tariffs for China and 10% on the rest of the world if he wins in November. That said, the FOMC is still likely to trim interest rates later this year given softening inflation and growth momentum, even though the ECB has started cutting earlier in June.

What are the key calls given moderate growth, disinflation and expected rate cuts?

Government Bonds/DM Rates: Our economists expect a broad array of central bank policy rates to be lowered over the course of the next 12 months, and this will be a supportive backdrop for government bonds, even if major central banks' balance sheets continue to shrink.

We expect government bond yields to move lower across the DM markets. In US, cooling inflation and the assumed loss of US economic exceptionalism should see 10-year yields trading around 4.05% by year-end. In Eurozone, we expect European core rates to decline as we continue to expect a total of 75bps of rate cuts this year, while Gilts yields should fall across the term structure under our views of a total of 50bps cut expected for this year. As for Australia, our long-held view has been that the RBA would be among the last major central banks to start the easing cycle. 1Q24 CPI had surprised to the upside across headline, trimmed mean and weighted median. Sticky sequential inflation may further delay the timing of the first rate cut. We now expect one 25bp cut in the OCR this year, instead of two cuts.

Asian local rates: Bond yields should head down, supported by USTs and benign Asian inflation. In Credit, valuations are expensive as spreads approach historic tight, but solid macro backdrop (Korea, Indonesia, and India), plus China policy action should support credit market outlook.

Asian Equities: Dollar strength could be a headwind for Asian equities, and we expect volatility to pick up into the event of US election, especially if US-China geopolitical tension increases. Elsewhere, earnings delivery and policy effectiveness will be another focus.

FX: Given USD's yield advantage and US exceptionalism narrative, USD may continue to stay supported until US data starts to show more signs of softening or when Fed's hawkish rhetoric softens. While we expect the USD to trend slightly lower towards year-end as the Fed is already done tightening and should embark on rate cut cycle in due course, a higher premium priced for US election could be a tailwind for the dollar strength. In this scenario, we expect USD strength could remain relatively resilient against funding currencies, and modestly against EM. We like GBP, AUD, CNY/CNH and Asian currencies should face pressure if USD strength and US election risks feed through. We expect DXY end the year at 103.00.

Thematic Report 2

China turnaround?

Following a combination of better-than-expected macro prospects, an impactful policy put, fund rotation, and cheap valuation relative to the US and Japanese stock, MSCI China is up over ~10% over the past two months and nearly ~25% since its tough in mid-January.

Equity performance relies on strong economic and corporate fundamentals, but the current economic climate presents challenges for sustained performance in equities. China's 1Q24 real GDP growth came in at 5.3%, remaining on track for the government's target of "around 5%", underpinned by resilient industrial activities, strong service consumption, and a rebound in external demand despite a deep correction in the housing market. While the announcement of property policy stimulus in mid-May was a positive step, market attention is now shifted to the implementation and policy effectiveness. To date, fundamentals of the property sector remained largely weak as housing starts and sales value were 78% and 85% below from their respective peaks as of April, reflecting a still moribund backdrop.

There are still plenty of challenges in terms of policy execution. For instance, consumer and household behaviours could be considerably different compared to the previous cycle, given a lower marriages and childbirth ratio compared to a decade ago. Meanwhile, price setting and pace of execution presents significant challenges for local governments, whether through purchasing new home from developers or existing homes via the trade-in program. Steep discounts could exacerbate the current downturn, while setting well prices above market could create financing challenges for local governments.

While the focus on house price stabilization is the right strategy towards mitigating downside risks in the sector, a failure to follow through with effective measures will likely disappoint the market again and unwind the recent rally. That said, we expect some consolidation after the recent run-up in the near term but remain constructive over the medium to long term given a further stabilisation in earnings revision trends and strong determination from policymakers to set a floor in the property market.

Looking ahead, we believe the sustainability of the rallies in China and Hong Kong equities will hinge on **1) US-China Geopolitical Dynamics** and **2) Domestic Policy Effectiveness**. More measures are expected to be released if house sales data stay weak and price expectations remain uncertain, especially in the run up to the 3rd Plenum meeting of the 20th CPC Central Committee held in July. On US-China tensions, the recent announcement of EV tariffs by the US did not have a sizeable negative impact on China and Hong Kong stock markets. To be clear, we think the scope of these tariff is relatively narrow, affecting only around $18 billion worth of China's exports to the US, which constitutes 4.2% of China's total exports to the US. This contrasts starkly with the initial rounds of the trade war in 2018, when the Trump Administration imposed tariffs on $50 billion worth of products, subsequently expanding to an additional $200 billion in 2019. Overall, the current situation appears to reflect a more balanced approach from Biden Administration to trade tensions, likely influenced by upcoming elections. We expect volatility to pick up into the US election as tariff war could intensify if Trump wins.

Thematic Report 2

A bottom has likely been set for the global semiconductor cycle, but how strong will be the recovery?

Following a mild drawdown in April, the S&P 500 has resumed its upward trajectory, surpassing the 5,250 marks with bulk of the gains concentrated in the mega-cap technology companies, given the ongoing enthusiasm surrounding the Generative AI.

While the explosion of Generative-AI enthusiasm continues to fuel the current equity bull market, 1Q24 results from the semiconductor industry remain largely mixed, outside of AI. For 1Q24 in aggregate, we see declining QoQ results within most of the end-market universe driven by a sharp decline in the consumer and automotive segments. This reflects end broad based demand weakness and lingering inventory burn. Notwithstanding, AI-related tailwinds have continued to cushion the top line for those with relevant exposure, in many cases offsetting the declines from other end markets.

Put another way, Nvidia delivered another set of strong results with continued robust growth in data centre revenues. Notably, management commentary pointed to sustained demand in Hopper [37] despite the imminent launch of Blackwell product. Meanwhile, there has been a diversification beyond traditional CSPs into a multitude of startups, sovereign entities, and verticals. Nvidia's CEO, Jensen Huang, also unveiled at Computex 2024 that the company is planning to upgrade its AI accelerators annually and a next- generation platform called Rubin (following ultra- Blackwell in 2025) will go live in 2026. We believe the AI tailwinds will remain positive into 2025 and beyond given the strong fundamentals and financial execution from the company.

Beyond the near-term reports/guides, we remain optimistic on the AI trend favours big technology companies. We remain bullish on Asian AI beneficiaries and the memory segment within the semiconductors space given the substantial backlog of orders in AI chips. We expect tech hardware, South Korea, and Taiwan growth outlooks to be more resilient in the event of high for longer rates and a strong dollar environment.

How high can gold go?

Gold prices have rallied significantly and hit an all-time high in May. The rally of late has been largely driven by a rising prospects of rate cuts, high physical demand in China, strong interest by central bank for gold holdings, and geopolitical concerns. While we had expected a pullback in gold prices in mid-April, we saw gold snap back up above the USD 2,400/oz level.

The Developed Market central easing cycle is broadening as ECB and BoC started to cut rates in June. Despite the market progressively pricing fewer Fed rate cuts this year, the prospect of lower US interest rates and the hedge value against negative geopolitical shocks have pushed gold prices significantly higher. To some extent, global geopolitical tensions have escalated significantly since the beginning of

[37] Hopper is a graphics processing unit (GPU) microarchitecture developed by Nvidia. It is designed for datacenters and is parallel to Ada Lovelace. It is the latest generation of the line of products formerly branded as Nvidia Tesla and since rebranded as Nvidia Data Center GPUs.

Thematic Report 2

October, raising concerns on multiple fronts. The ongoing war in Ukraine continues to cast a shadow while tensions between China and Taiwan remain a risk. In addition, concerns about US fiscal sustainability, coupled with potential risks arising from the upcoming election cycle (mainly in the US), have also fuelled gold buying. Aside from the macro and geopolitical factors, there are also structural shifts in demand for central banks to diversify their reserves away from the US dollar. To illustrate, EM central banks including China, Turkey, India, Egypt, Qatar, and Jordan all have significantly increased their gold purchases following US sanctions against Russia. On a country level, China stands out as the main driving force, with its gold holdings reaching 2,265 tonnes as of March 2024, representing approximately 5% of its international reserves.

At the same time, retail demand in China has been increasing, given concerns over economic stability and performance in the property sector, and deposit rates remain low. CNY depreciation concerns could have also boosted retail buying for currency and inflation hedge.

Overall, positioning looks crowded, but we think gold prices will likely trend higher in 2H24 following a near-term consolidation as metal remains a role in portfolio diversifier and an attractive hedge against geopolitical risks. We also expect more traditional ETF holdings to increase once the Fed starts to cut rates later this year, which could be the catalyst for the next tailwind. In our view, gold price can trade to USD 2,445/oz by December 2024.

Thematic Report 3

Silver: Constructive Outlook amid Market Dynamics and Low-Carbon Push

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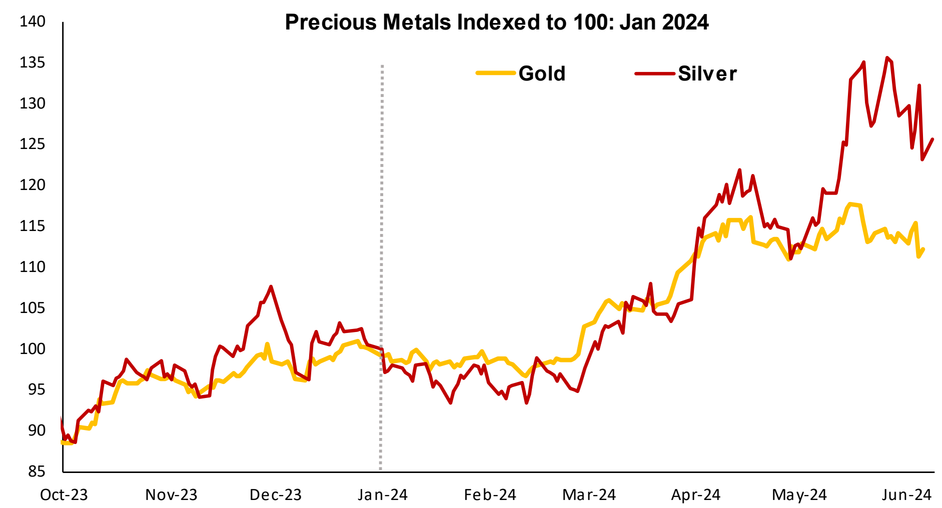
- The parabolic rise of silver (>30% YTD at one point in May) may have caught many by surprise. The medium-term outlook is constructive due to industrial demand prospects and ongoing supply deficits. Demand prospects is promising, given the green transition and how silver has its place for industrial use.
- Silver's thermal and electrical conductivity properties make it an important industrial metal for some clean energy technologies. With a global push towards a low-carbon future, silver demand is expected to increase in tandem with strong growth expected in the solar sector amid a supply deficit.
- The near-term outlook can vary somewhat due to its volatile nature and that it is also driven by market and macro dynamics, including interest rate cycles, global growth outlook and geopolitics. In the interim, silver may consolidate, taking cues from moves in gold prices. Meanwhile, long position in silver looks stretched at current levels. Unwinding of stretched longs can add downward pressure on silver prices. Our bias is to buy dips.

Precious metals shimmer



Source: Bloomberg, OCBC

The prices of precious metals, including gold, silver have risen sharply this year. The rise can be attributed to various reasons including prospects of central banks easing monetary policies, geopolitical concerns, supply and demand dynamics. While gold may have stolen the limelight early in the year for printing fresh highs on multiple occasions, the parabolic rise in silver prices has somewhat caught markets' attention lately.

Silver prices rose more than 30% to more than $32/oz in mid-May 2024, a level not seen since 2012. Apart from the fundamentals driving the price of silver, gold's sharp rise is likely to have spilled over to silver and subsequently, exacerbated by short unwinding in silver positions.

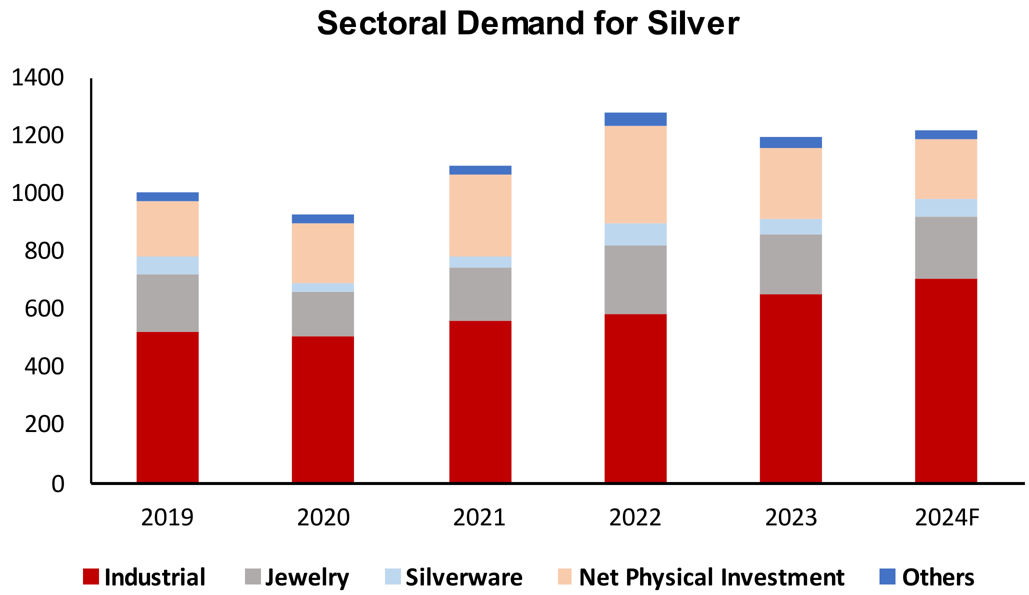
Thematic Report 3

We explore some of the underlying factors, in particular the demand and supply aspects that may underpin the outlook on silver.

Demand dynamics favourable

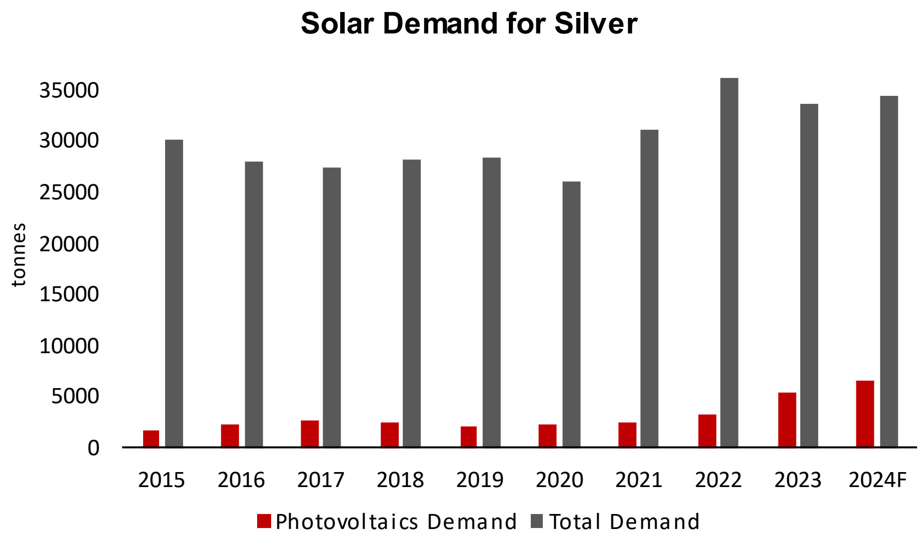
According to the Silver Institute[38], global silver demand may reach 1.2 billion ounces in 2024 from continued growth in industrial end-uses, as well as jewellery and silverware demand. Presently, around 55% of silver consumption falls under industrial usage. As silver has the highest electrical and thermal conductivity of all metals, it has important industrial use in electronic products, including green technologies such as solar photovoltaic (PV) cells and EV batteries.

Strong growth in the solar sector is expected to be a key driver for silver demand, with much of the growth expected to come from China as the global leader in solar PV installations. This comes as more countries are striving towards achieving net-zero emissions. In addition, a clear text on the transition away from fossil fuels was agreed upon at COP28 in Dubai, putting stronger international pressure on countries to adopt low-carbon measures to reduce greenhouse gas emissions.



Source: Metals Focus, The Silver Institute, OCBC

[38] World Silver Survey 2024. Silver Institute. April 2024.

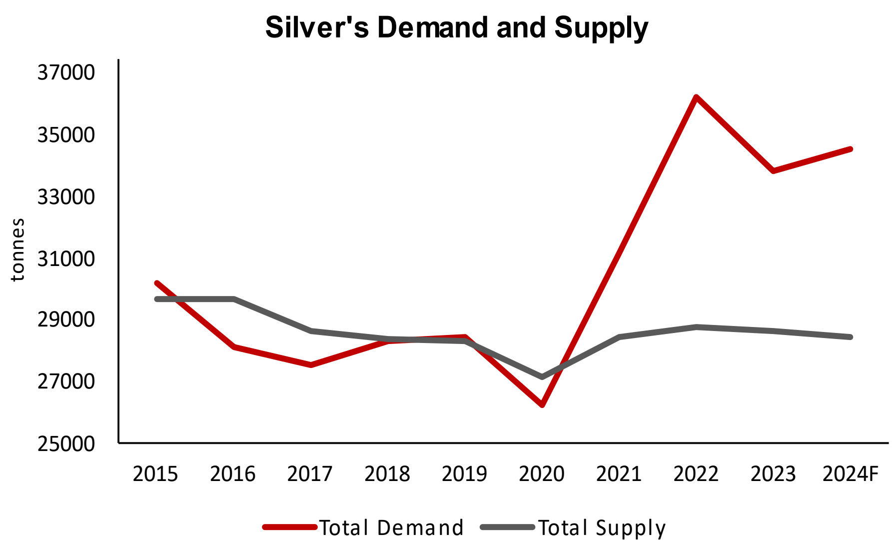


Source: World Silver Survey 2024, OCBC

Silver supply is facing a structural shortage

High silver demand is also putting a strain on its supply as primary silver mines are scarce with around 80% of silver supply coming from by-products of lead, zinc, copper and gold production[38]. By-product silver output is estimated to decrease as community and government disputes have resulted in some mine closures in South America in 2023. Notable examples include a 4-month-long strike at a Mexican gold-silver mine in 2023 after workers went on a strike over disagreements regarding profits and contract breaches and a 3-year strike at a silver mine in Idaho in 2017 due to accusations of unfair labour practices, causing silver production to fall by 77% YoY in 2017 and 80% in 2018.

Over the past few years, there has also been a decrease in new silver discoveries and a decline in ore grades, leading to production levels falling by nearly 8.2% between 2015 and 2023.



Source: Silver Institute, OCBC

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In the long-term, the solar sector is estimated to deplete between 85 – 98% of global silver reserves by 2050[39]. As global silver supply is forecast to decrease by 1%, the silver market may remain in a deficit of 215.3mn ounces this year[38].

Additionally, the recycling of silver, which involves recovering silver from solar PV panels, has not been able to fully compensate for the supply deficit. While recycling today accounts for around 18% of silver supply[38], it is severely limited by factors such as the availability of scrap material and the cost-effectiveness of recycling processes, especially for the small amounts found in complicated electronics such as televisions. Regardless, at the current pace of contribution of recycled silver to the overall supply, it is unlikely to keep pace with the increasing demand.

Silver's role in enabling the green transition

Global policies and regulations are increasingly promoting the implementation of low-carbon strategies to transition away from fossil fuels towards achieving national climate goals. Some technologies and infrastructure that enable the transition to a low-carbon future, including renewable energy technologies and EVs, are heavily reliant on critical minerals such as silver. Silver may also play an important role in novel low-carbon technologies such as carbon capture and storage (CCS). University College London researchers are exploring the use of silver in making CCS technologies more cost-effective, by utilising silver's stability at high temperatures in innovative membranes that separate carbon dioxide from other gases before carbon dioxide can be stored[40]. Therefore, silver's properties position it as a key player in the transition to a low-carbon economy. However, the industry is also exploring cheaper alternatives like copper although there are uncertainties surrounding lower reliability and performance.

Managing the impacts of silver mining

Silver production is associated with mining-related impacts on the environment and communities e.g. water pollution and habitat destruction. There are net-zero and sustainability initiatives progressing across the mining sector as they seek to build more responsible portfolios to attract global investors.

Major miners are working on areas such as community development, waste and water management, as well as emissions reduction[41]. Increasing the usage of recycled silver is one way to reduce both emissions and the need to produce new metals, to ensure the long-term capacity of solar PV production. The adoption of new and innovative technologies to reduce emissions in mining operations can also support more sustainable production of silver in the long run.

Understanding silver's market characteristics

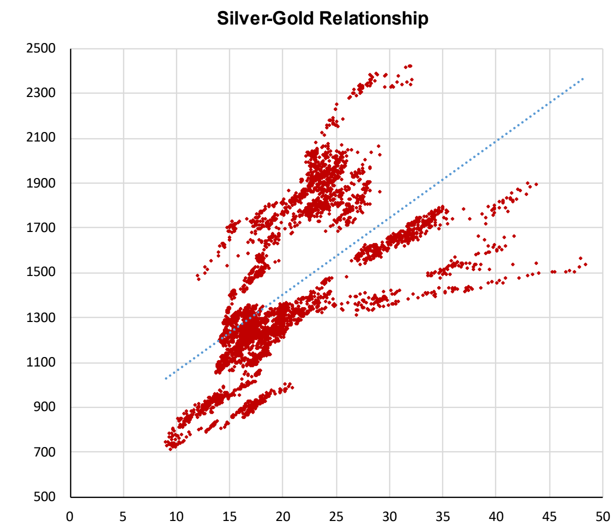
As highlighted, silver exhibits the characteristics of a precious metal and is also an industrial metal. Silver shares similarities with copper as both metals possess comparable properties. Copper, for instance, is the second most conductive metal after silver, and they are often present in the same products or used

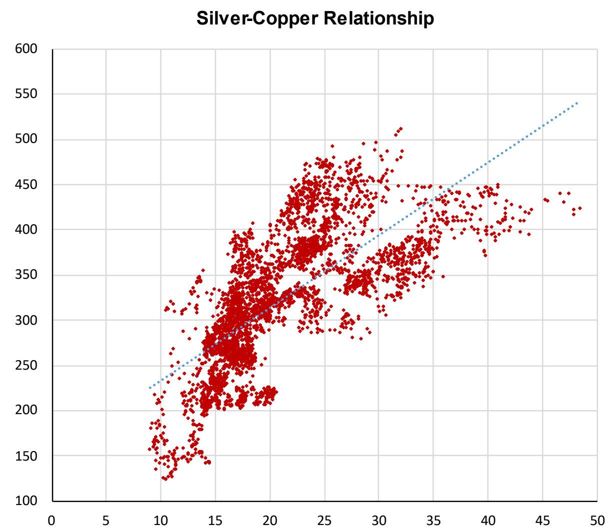
[39] Hallam, B., Kim, M., Zhang, Y., Wang, L., Lennon, A., Verlinden, P., Altermatt, P. P., & Dias, P. R. (2022). The silver learning curve for photovoltaics and projected silver demand for net-zero emissions by 2050. Progress in Photovoltaics: Research and Applications, 31(6), 598–606.
[40] UCL. (2022, December 6). Could silver help us tackle climate change?
[41] EY. (2022, November 11). How silver miners can build long-term competitiveness.

interchangeably. As such, prices of copper and silver can at times be highly correlated. According to the Silver Institute, more than 50% of silver is used for industrial purposes and so in a way, prices of silver can be sensitive to global economic cycle.

Gold and silver are classified as precious metals. According to World Gold Council data, approximately 48% of gold went to jewellery fabrication over the last 5 years while about 23% of silver went into creation of jewellery and silverware over the same period[42]. Further breakdown shows 23% of silver demand was for net physical investment while 29% of gold demand was for investment, including physical bar, medal coin, etc. In terms of broader market dynamics, silver and gold are influenced by similar factors, including inflation, interest rates, sentiments, geopolitical tensions, etc. As a result, changes in these factors tend to impact both metals in a similar manner, though the magnitude can vary. In summary, gold and silver prices tend to display a strong positive correlation over the years.

This unique dual or hybrid characteristic of silver can be seen with its strong proxy relationship with gold (precious) and copper (industrial).



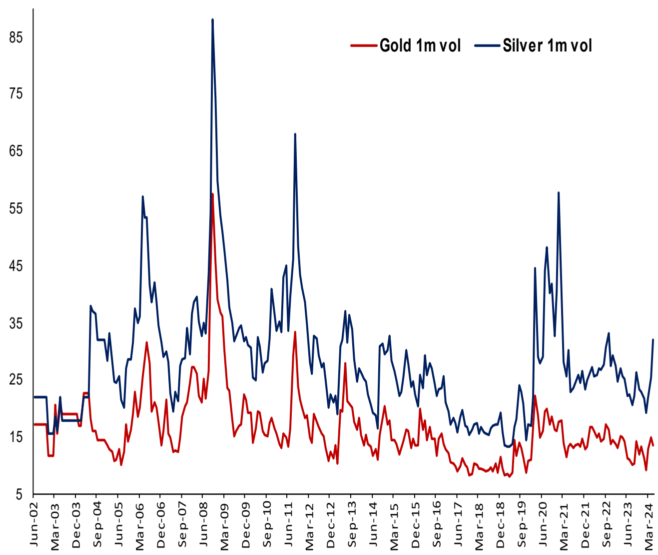


Source: Bloomberg (daily data from 2008 – 2024), OCBC

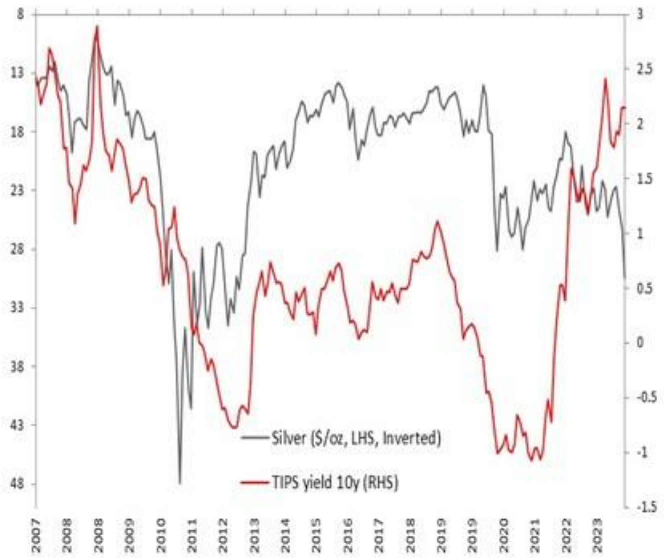
In the world of precious metals, not all volatility is the same. The volatility in silver prices tend to be much higher than gold. And this can be attributed to the differences in the demand profile of silver and gold. As we have indicated above, silver is largely demanded for industrial uses and as such, can be susceptible to swings in economic cycles. But the industrial demand for gold is fairly limited and is less affected by economic downcycles.

[42] Gold demand trends full year 2023. World Gold Council. (2024, January 31).

Silver volatility higher than gold volatility



Eventual decline in real yields should further support price of silver



Source: Bloomberg, OCBC

Outlook: Constructive medium term but mind the volatility

The medium-term outlook of silver is constructive due to industrial demand prospects and ongoing supply deficits. Demand prospects are promising, given the green transition and how silver has its place for industrial use. Global silver demand is projected to reach 1.2 billion ounces in 2024[38] from continued growth in industrial end-uses, especially for solar panels, EVs and 5G technology.

To meet renewable energy goals, annual silver demand from this segment could eventually hit 500 million ounces by 2050. Solar alone could account for nearly half of total silver demand by mid-century. Silver is also increasingly in demand for EVs, given its conductivity and efficiency for electrical transmission. Battery electric vehicles can contain up to twice as much silver as internal combustion engine vehicles[38]. The Silver Institute forecasts automotive industry demand growing from around 90 million ounces today to nearly 200 million ounces by 2030. That would represent over 15% of total silver demand. Charging infrastructure for EVs is another area that will significantly increase silver requirements in the coming years. 5G communications technology is also likely to more than double silver demand from around 8 million ounces today to 23 million ounces by 2030[43].

One risk to monitor is supply trends and technology advancement. While silver is well known for its superior conductivity, making it amongst the best for both heat and electricity and hence widely used in applications that require efficient wiring, circuitry, thermal conduction, one cannot ignore that ongoing research and potential advancement in technology may avail alternative metal or material that may well challenge silver's status and its value.

[43] Silver to play a critical role in 5G Technologies. The Silver Institute. (2020, March)

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Near-term outlook can vary somewhat due to its volatile nature and that it is also driven by market and macro dynamics, including interest rate cycles, global growth outlook and geopolitics. Our house view expects the Fed to begin its rate cut cycle in 3Q 2024 and we pencilled in a total of 50bps cut for 2024 and another 125bps cut for 2025. Silver prices can strengthen when real rates correct lower. This can happen when Fed embarks on rate cut cycle. Apart from the Fed, other DM central banks, including ECB, SNB and BoC have started their easing cycle and are expected to continue to ease going forward. Collectively, this should boost the appeal of precious metals, including gold and silver. Moreover, precious metals' risk-off hedge (safe haven proxy) against geopolitical risks and as a portfolio diversifier should continue to play up more dominantly, in driving up gold prices, which in turn should have some spillover effects on the prices of silver.

Silver Technical: Bullish though RSI near overbought

Source: Bloomberg (Monthly chart), OCBC

Silver (XAG) rose sharply especially over the last couple of months. Last at 29.55 levels (as of 24 Jun), underlying momentum as seen on monthly and weekly charts remain bullish though RSI is seen near overbought conditions. On the monthly chart, XAG has broken out of its downward sloping trendline resistance and has continued to trade higher on consecutive months. There is room for further upside from a medium-term time frame. Immediate resistance at 30.50 levels, 32.50 (May high). Breakout puts next resistance at 35.22 (61.8% fibo retracement of 2011 high to 2020 low), 40.80 (76.4% fibo). Buy dips preferred.

However, in the near term, the risk of pullback is not ruled out as bearish divergence appears to be developing on the daily RSI chart (not shown here). Support has been seen at 28.73 (the low in the recent pullback), 28.40 levels. Our bullish view would be at risk of being nullified if silver declines past 25. We would re-assess our view if this scenario plays out.

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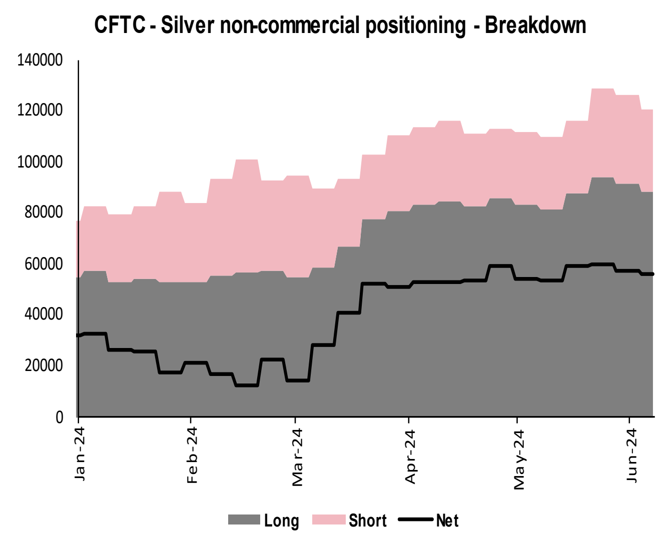
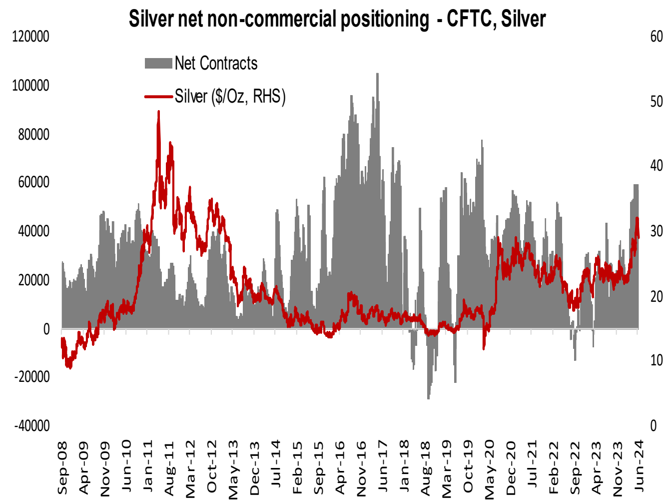
Market Positioning
According to The Commitments of Traders (COT) report published by CFTC, short positions in silver rose during Jan – Feb 2024, as net longs fell to low of 12,425 contracts. The subsequent unwinding of short positioning and fresh longs being put on saw net longs rose since March. Concomitantly, the prices of silver started to rise, and even rose at a faster pace over April-June period.

Given the sharp rise in long silver positions, and prices of silver in a short span of time, there may be risk of a corrective pullback in the near term, and this can weigh on prices of silver. But net longs are not high by historical standards. While gold prices have already printed fresh highs on multiple occasions this year, silver prices have yet to test its all-time high. Without sounding overly complacent, we see room for silver prices to test higher in the medium term.

Silver shorts picked up in early parts of the year as net longs fell. Subsequent short covering took place



Silver net longs rose but not high by historical standards



Source: CFTC as of 28 May 2024, Bloomberg, OCBC

Thematic Report 4

Commodities: Crude Oil Prices To Be Supported In 2H24

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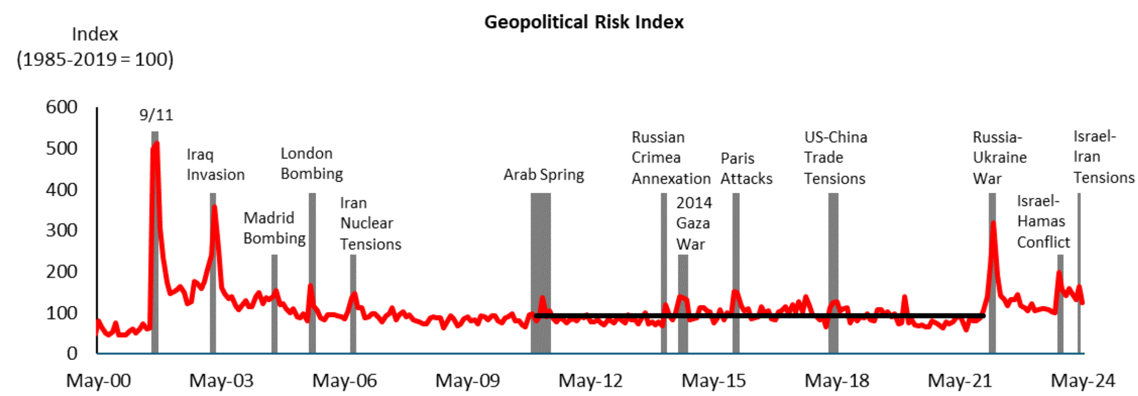
- Crude oil prices have come under downward pressure in May. The pull back was driven by softer macro sentiment and subsiding fears of a broader regional conflict in the Middle East.
- For 2H24, the fundamental outlook for crude oil remains constructive. By our projections, the crude oil market may experience a sharp supply deficit in 3Q24 before narrowing in 4Q24.
- Notwithstanding, we expect a ceiling in oil prices. OPEC surplus crude oil production capacity, if deployed, should prevent Brent oil prices from rallying past USD92/bbl, in our view.

Geopolitical tensions across the world have notably picked up. In addition to the ongoing Russia-Ukrainian war, we have seen the outbreak of conflict in the Middle East. These geopolitical noises have been supportive of higher oil prices in 1H24 as Brent increased by more than 19% YTD on 12 April 2024 (Israel-Iran tensions) to reach a six-month high of USD92.2/bbl respectively.

Since then, Brent gains have pared back following a de-escalation in Israel-Iran tensions. Due to a lack of geopolitical risk premium and softer macro sentiment, oil prices have come under downward pressure in recent weeks. Both WTI and Brent oil prices have been trading range bound around USD78/bbl and USD83/bbl levels respectively[44].

Looking ahead, we believe the fundamental outlook for crude oil remains constructive in 2H24. For 2H24, our forecast is for WTI and Brent oil prices to average USD80/bbl and USD86/bbl versus USD78.7/bbl and USD83.3/bbl in Year-to-21 June[45], respectively.



Source: Economic Policy Uncertainty; Constructed by Dario Caldara and Matteo Iacoviello (2017), OCBC

[44] We derive this information by averaging the daily closing prices from 1 May 2024 to 21 June 2024.
[45] We derive this information by averaging the daily closing prices from 29 December 2023 to 21 June 2024.

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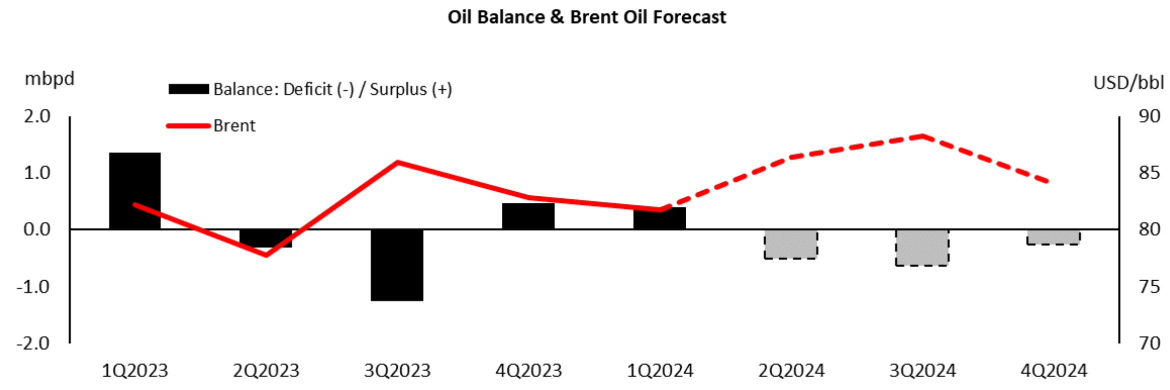
Central to this thesis is our expectations that the crude oil market may remain in a supply deficit through 2024, if OPEC+ decides to keep its current output reduction for the rest of the year[46 47]. Our projections show that the crude oil market may experience a sharp supply deficit in 3Q24 due to strong oil demand (related to increased transportation activities) and the extension of OPEC+ output reduction through September 2024, before narrowing in 4Q24.

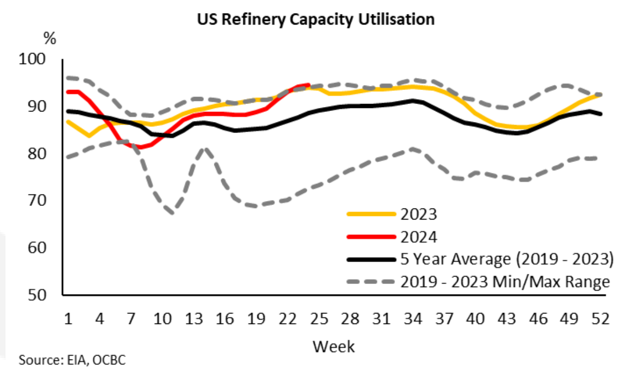


Source: EIA, IEA, OPEC, Bloomberg, OCBC estimates

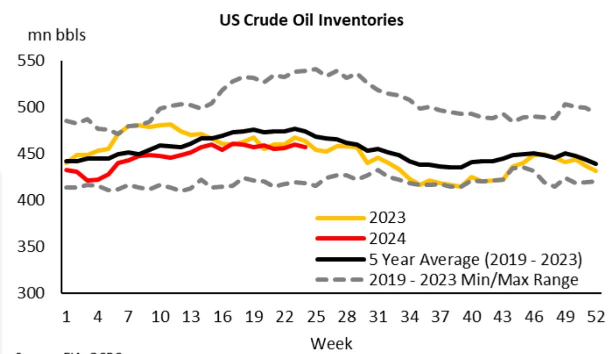
Increased transportation activities should support oil prices

Heading deeper into the summer driving season, oil demand is expected to pick up. The summer driving season in the northern hemisphere should provide higher demand for transportation fuel as summer air travel and road mobility increase.

The current picture remains encouraging. Crude oil demand from US refineries has returned to seasonal norms. Refinery utilisation rates have accelerated to 94.6%[48] as refiners sought to process more crude oil to meet potential consumer demand for refinery products. Meanwhile, US crude oil and fuel inventories (i.e., gasoline and distillate) remain below 2019 – 2023 seasonal range, implying robust demand for transportation fuel during the summer driving season.



Source: EIA, OCBC

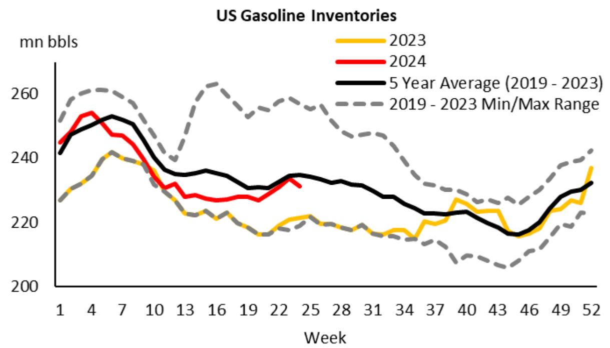


Source: EIA, OCBC

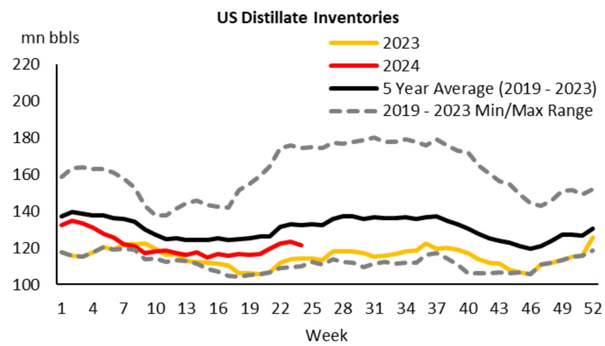
[46] Organization of the Petroleum Exporting Countries. (2024, June 2). Saudi Arabia, Russia, Iraq, the United Arab Emirates, Kuwait, Kazakhstan, Algeria, and Oman met in person in Riyadh on the sidelines of the 37th OPEC and non-OPEC Ministerial Meeting (ONOMM) [Press release]. Retrieved from OPEC.
[47] Organization of the Petroleum Exporting Countries. (2024, June 2). 37th OPEC and non-OPEC Ministerial Meeting [Press release]. Retrieved from OPEC.
[48] This information is based on a 4-week rolling average for the week ending 14 June.

However, gains may be limited due to slowing US growth momentum
Our analysis reveals a robust and positive correlation between US economic growth and global oil demand growth. We have recently revised our house forecast for US GDP growth in 2024, raising it to 2.4% YoY from the previous estimate of 1.5%.

Consequently, we adjust our forecast for global oil demand growth upward, reflecting a higher level of demand-side resilience that we might have previously unaccounted for, albeit still decelerating from 2023.



Source: EIA, OCBC



Source: EIA, OCBC

OPEC+ needs to continue curbing supply at its current rate
The US comfortably produced 13.2mbpd of crude oil in May 2024, surpassing both Russia and Saudia Arabia[49]. Its pole position as the leading producer of crude oil is expected to be solidified in the near-term as Russia, Saudi Arabia, and other OPEC+ members continue to implement production cuts in an effort to stabilise crude oil prices.

According to EIA, the growth in global supply of petroleum and other liquids in 2024 and 2025 will primarily be driven by growing crude production in the Americas region (i.e., US, Guyana, Canada, and Brazil). The EIA highlighted that this growth would partially offset the voluntary production cuts implemented by OPEC+ member countries in 2024[50].

Taken together with our view of moderating global oil demand, we believe strong production growth outside of OPEC+ could potentially lead to a buildup of global oil inventories in 2H24, if the current output reduction was not maintained for the rest of the year. Therefore, our expectations are for OPEC+ member countries to continue curbing its supply output at its current rate, in view of "supporting the stability and balance of oil markets."

[49] According to EIA Short-Term Energy Outlook, Russia and Saudia Arabia are producing 9.2mbpd and 9.1mbpd of crude oil in May 2024, respectively.
[50] Hill, S. (2024, March 14). Four countries could account for most near-term petroleum liquids supply growth. Retrieved from US Energy Information Administration.

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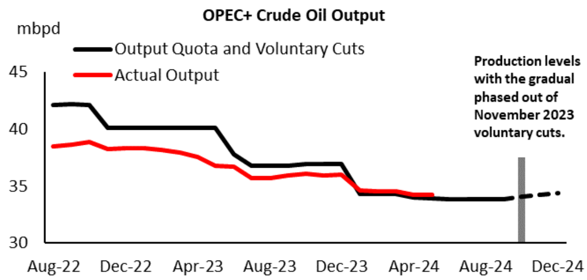
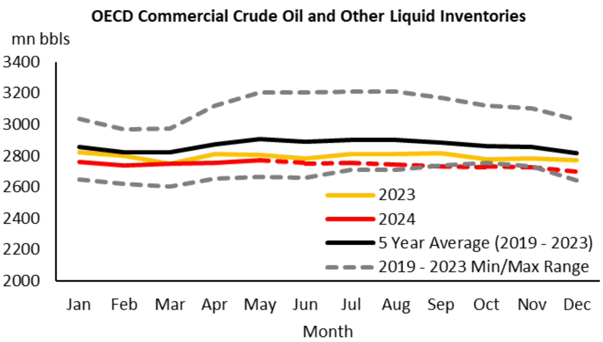


Note: Angola left OPEC effective 1 Jan 2024; OPEC shared that the gradual phasing out of its November 2023 voluntary cuts is data dependent (i.e., the increase can be paused or reversed subject to market conditions).
Source: Platts OPEC+ survey by S&P Global Commodity Insights, OPEC, OCBC



Source: EIA, OCBC

OECD oil inventories to stay below seasonal average through 2024
The curbing of crude oil supply seems to have yielded positive results as global oil inventories remain tight relative to 2023. Between January and May 2024, OECD oil inventories remain below the lower end of the 2019 - 2023 seasonal range: inventories averaged 2754 mn bbls versus 2795 mn bbls compared with the same period in 2023. According to EIA's forecast, inventories are expected to remain tight for the rest of 2024. A tighter oil inventories for the rest of 2024 will limit downside price potential for oil prices. We expect tighter oil inventories to keep the global oil markets well supported in 2H24.

Subdued volatility
According to our estimates, factoring in the latest OPEC+ extensions for the rest of the year, the supply deficit in the global oil market for 1H24 would average 0.1mbpd, and remain at a supply deficit of about 0.4mbpd in 2H24. This trajectory is contingent on OPEC+ extending its additional voluntary cuts of 2.2mbpd for the remaining months of 2024. We retain our optimism that the crude oil market, driven by a 2H24 supply deficit, will provide firm support for oil prices to remain elevated in 2H24.

We expect volatility in crude oil prices to remain subdued. Despite de-escalation in Israel-Iran tensions, tensions remained heightened in the Middle East. In particular, we see any potential short-term supply disruption to be temporary due to the available spare crude oil capacity from OPEC. According to EIA, OPEC surplus crude oil production capacity stood at 4.4mbpd (14.1% of OPEC crude oil production capacity) in May. If OPEC members choose to deploy its spare crude oil capacity, this should prevent tailwinds from Brent oil prices to rally past USD92/bbl level[51], in our view.

[51] We derive this information by establishing the highest price from 29 December 2023 to 21 June 2024.

Thematic Report 5

China's Policy Dilemma

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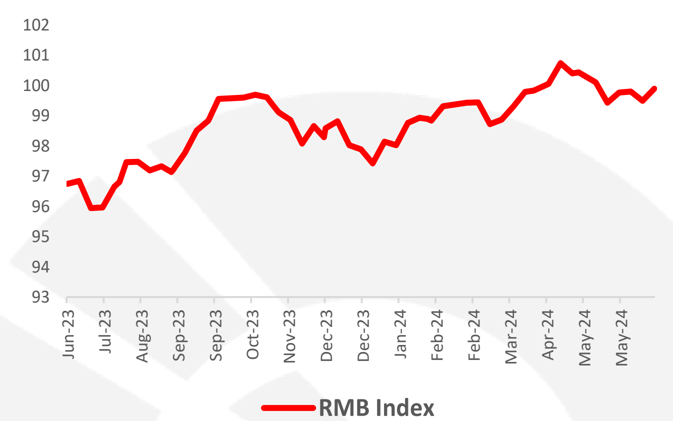
- The unusual stability of the RMB exchange rate reflects a preference of monetary policy in maintaining exchange rate stability over interest rate adjustments.
- Prioritizing exchange rate stability could delay China's recovery from deflation.
- This dilemma suggests that the pressure on the RMB to depreciate will persist for some time.

Although the renminbi (RMB) has depreciated against the US dollar this year, its decline has been less pronounced compared to other Asian currencies. Amid the rebound of the US dollar index in 2024, the RMB has appreciated against a basket of currencies.

However, this counter-trend rise of the RMB under a strong US dollar is not due to fundamental economic improvements but largely intensified counter-cyclical measures. Since August 2023, there has been a persistent divergence between the projected daily RMB fixing and the actual daily fixing. Since the beginning of 2024, the RMB daily fixing rate has been maintained at around 7.1, with a daily trading limit of 2%, making the vicinity of 7.25 a "hard cap" for the onshore RMB spot rate.

US-China yield differentials have become a new parameter in this depreciation cycle compared to the 2015-16 episode of RMB depreciation. This year, as expectations for a Federal Reserve rate cut have been continuously pushed back, the interest rate differential between China and the US has widened further, making the RMB a funding currency, similar to the JPY.

Chart 1: RMB appreciated against a basket of currency



Source: Wind, OCBC.

Chart 2: Since August 2023, RMB fixing has deviated from the implied fixing

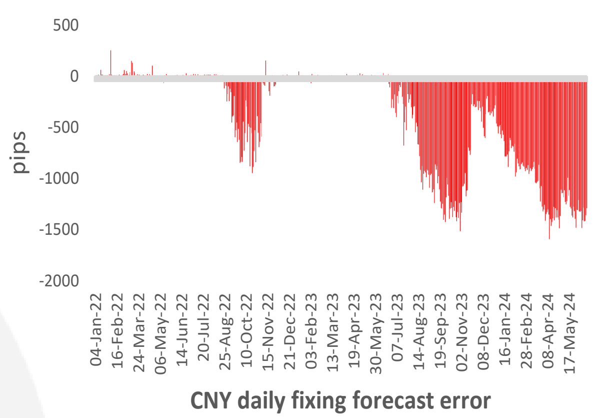


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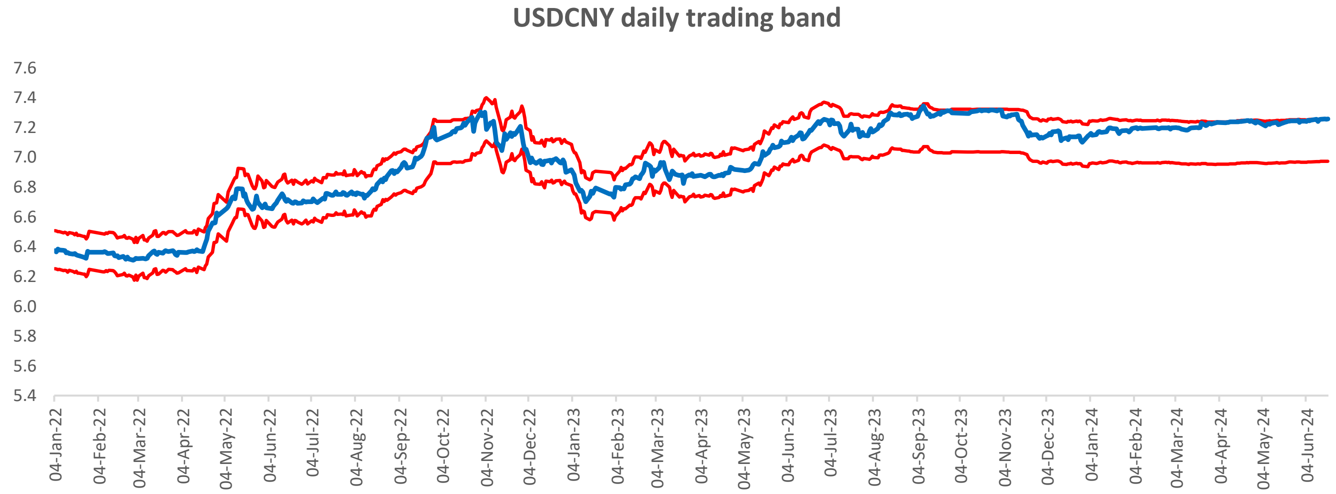
Chart 3: The vicinity of 7.25 is a "hard cap" for the onshore RMB spot rate due to stable RMB daily fixing



Source: Wind, OCBC.

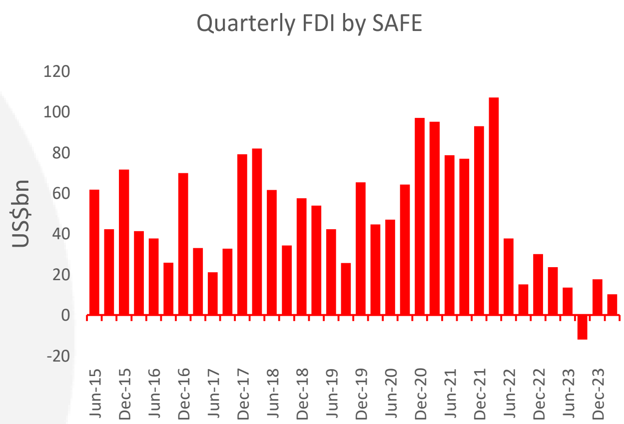
Additionally, the persistent US-China yield differential has exacerbated the deterioration of fundamentals. Since the onset of the pandemic, the surplus in the basic balance (current account + net direct investment account) has shown a trend of decline, which accelerated after the Ukraine war and the US Fed's rate hikes. Data from 1Q24 indicates that although China's merchandise trade surplus remains substantial, the service trade deficit has widened, and increases in outflows from income and current transfers have led to a further narrowing of the current account surplus.

In terms of foreign direct investment (FDI), despite relatively stable figures from the Ministry of Commerce, net FDI under the balance of payments has remained low, narrowing to US$10.3bn in 1Q24, just one-tenth of US$107.2bn in 1Q22 before the US Fed's rate hiking cycle commenced. Overall, the basic balance surplus is expected to remain low, which may further dampen expectations of any RMB recovery.

Chart 4: China's basic balance as % of GDP shrank

Source: Wind, OCBC

Chart 5: FDI under Balance of Payment fell notably



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As the cycle of weakening fundamentals extends, expectations within the domestic corporate and household sectors have begun to fluctuate. In April, the foreign exchange settlement and sales deficit, reflecting the supply-demand relationship in the foreign exchange market, expanded to its highest level since 2016.

The willingness to sell foreign exchange dropped to 58%, while the desire to purchase foreign exchange rose to 70%. This significant gap indicates rising expectations of RMB depreciation, with market participants preferring to hold foreign currency. Additionally, domestic foreign exchange deposits have continued to rise. Since domestic households hold a relatively small proportion of foreign currency assets, shifts in sentiment have made the RMB more vulnerable.

Buying time

The unusual stability of the RMB exchange rate reflects a monetary policy preference towards maintaining exchange rate stability over interest rate adjustments.

The stable daily RMB fixing serves to buy time for two things: declining market pessimism around China and the strong US dollar. Firstly, the authorities are trying to buy time to allow for a decline in market pessimism through the introduction of more stimulus policies, thereby improving expectations for the RMB. Secondly, the authorities hope that the US dollar will retreat once the Fed begins its rate-cutting cycle.

However, current market developments are not in the Chinese economy's favour. After the introduction of real estate easing policies in May, the market rebound has been short-lived, and the market is still in the phase of bottom-seeking. Additionally, the unexpected resilience of the US economy has led the Fed to continually adjust its rate-cut expectations, extending the strong US dollar cycle.

In the short term, the central bank may have to continue maintaining the stability of the central parity rate. This stability provides an anchor for Asian currencies, which is positive. However, every policy has its costs, and the greatest cost here is the constraint on China's monetary policy independence. Between interest rates and exchange rates, the PBoC currently appears to be prioritizing exchange rate stability. Although the current low inflation rate supports further interest rate cuts, concerns about the impact of such cuts on exchange rate stability constrain the central bank's interest rate policy. As the timing of the Federal Reserve's rate cuts is pushed back, if PBoC continues to prioritize exchange rate stability, domestic monetary policy could be excessively influenced by external factors for an extended period, leading to a loss of proactive macroeconomic control.

Deflation and RMB exchange rate stability are becoming a dilemma for monetary policy. Prioritizing exchange rate stability could delay the recovery from deflation. Conversely, aggressive monetary easing could amplify depreciation pressure on the RMB, intensifying financial market volatility. This dilemma suggests that the pressure on the RMB to depreciate will persist for some time. Whether the USD/CNY will break below 7.3 in 2H24 largely depends on policy attitudes.

Thematic Report 6

Gauging ASEAN-China FDI Flows

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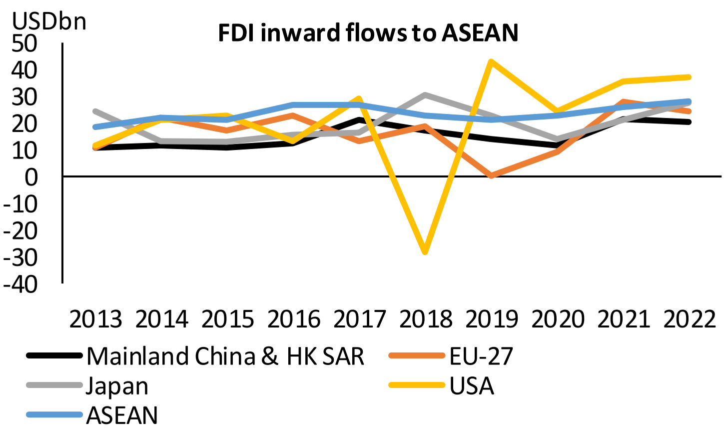
- The ASEAN-6 region has benefited from a diversification of global and regional supply chain as well as the adoption of 'China+1' strategies.
- FDI inflows from Mainland China and HK SAR into the region have risen, with manufacturing and certain services receiving the bulk of inflows.
- Importantly, the region is primed for further FDI inflows as it further integrates into global supply chains and carves out stronger global position for itself.

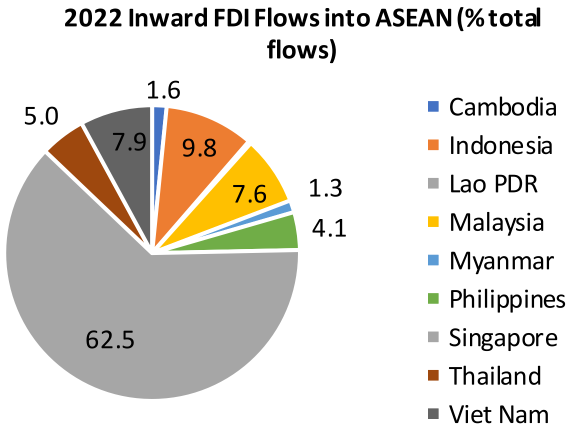
Current State of Play

FDI inflows into the ASEAN-6 economies of Indonesia, Malaysia, Philippines, Thailand, Singapore and Vietnam have been gaining traction and rose to USD236bn in 2023 compared to annual average of USD190bn in 2020-22[52].

FDI inflows into the ASEAN region were the highest from the USA, Japan, EU and Mainland China & HK SAR (2022[53]). This was underpinned by global factors such as a diversification of global and regional supply chain as well as the adoption of 'China+1', 'friend-shoring', 'offshoring' and related strategies. Strong domestic reform momentum and improving macroeconomic fundamentals are adding to the attractiveness of the region.



Source: ASEAN Secretariat; OCBC.



Source: ASEAN Secretariat; OCBC.

Within the ASEAN-6 region, Singapore received the bulk of the inflows in 2022. Among the remaining economies, Indonesia was the biggest recipient of inflows, followed by Vietnam, the Philippines, Malaysia and Thailand. Most FDI inflows were directed towards the 'manufacturing' and 'financial and insurance' sectors. The transportation, construction and wholesale sectors also received a decent share of FDI inflows.

[52] We sum the FDI inflows over the three years and divide by the number of years to smooth out pandemic related disruptions.
[53] The breakdown of FDI inflows by country and sector are only available until 2022.

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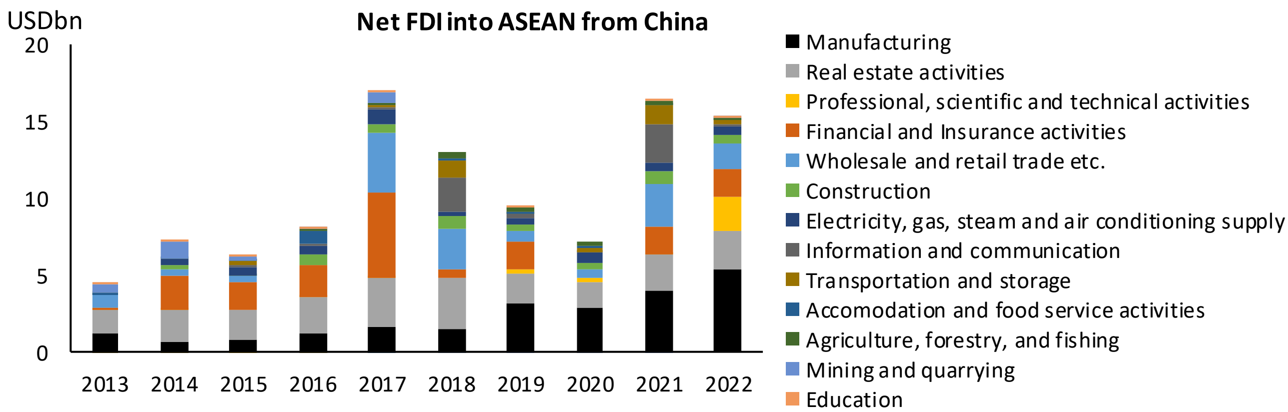
ASEAN-China Connections Run Deep

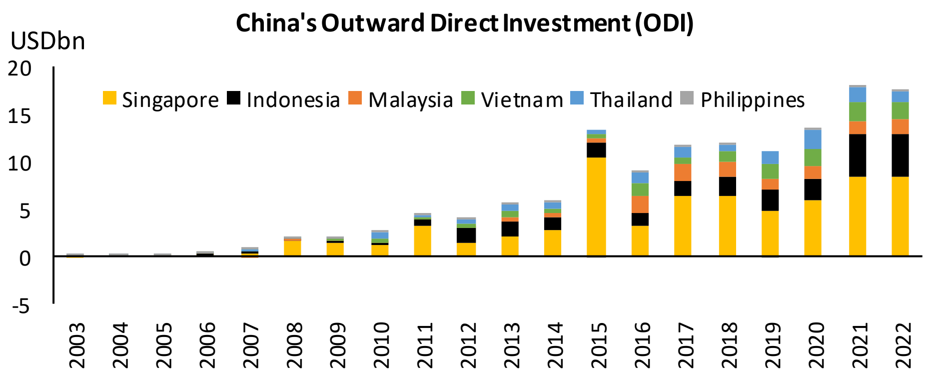
While the US remains the largest FDI investor in the region, supply chain diversification was expedited by US-China geopolitical tensions and pandemic related disruptions. This supported increased FDI inflows from other countries, with flows from China being closely regarded as bellwether of the ongoing changes.

To that end, FDI inflows from China into the region were sharply reduced during 2020 due to the pandemic but have since picked up sharply. Importantly, the nature of FDI inflows into ASEAN from China has evolved over the past decade, diversifying from infrastructure into electronics, resources, and food industries. More broadly, the manufacturing, wholesale & retail trade, finance and insurance, real estate and professional services sectors have witnessed higher FDI inflows from China.



Source: ASEAN Secretariat; OCBC.

According to China's Outward Direct Investment (ODI) flows, Singapore has traditionally been the largest beneficiary of FDI from China. This reflects Singapore's position as a financial hub, with strong synergies in the manufacturing, real estate, and services sectors. After Singapore, China's ODI goes to Indonesia, Malaysia, Vietnam, and Thailand. China's ODI into Indonesia increased noticeably, accounting for almost a third of ODI to the region in 2022. By contrast, the Philippines has not benefited as much from Chinese investments. This is not entirely surprising given geopolitical tensions between the two countries have taken a turn for the worse over the past year.



Source: CEIC; OCBC.

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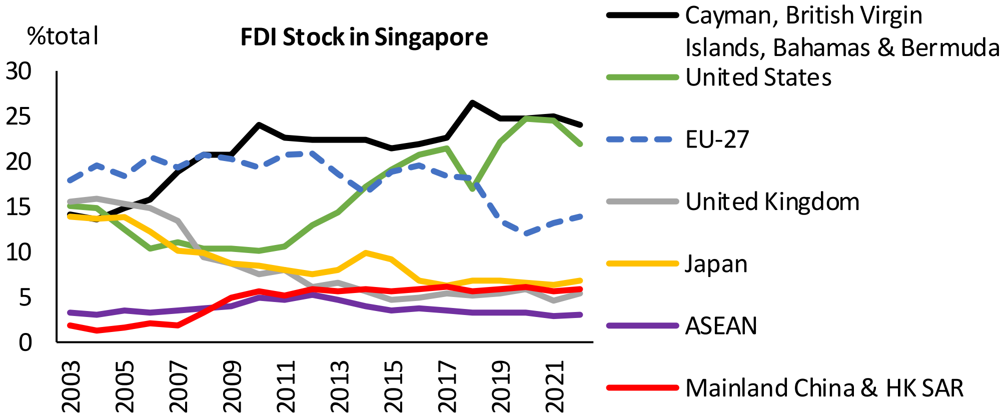
Singapore: While Mainland China and HK SAR are not the biggest sources of FDI's into Singapore, its share has risen in recent years. The stock of FDI from these locations stood at USD113.2bn as of end-2022, more than doubling from USD51.9bn in 2015.



Source: CEIC; SingStat; OCBC.

By sectors, the finance and insurance sector has seen the biggest uptick over this period, followed by the wholesale & retail sectors. Investments into these sectors can be corroborated by anecdotal evidence, which show that banking, finance and digitalisation[54] investments from China into Singapore picked up.

Source: SingStat; OCBC.

[54] Chinese companies set up in Singapore to hedge against geopolitical risk, Financial Times, 29 November 2022.

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Homegrown names in China's technology industry such as Alibaba, Tencent, ByteDance have set up regional offices in Singapore. Other Chinese technology companies with a presence in Singapore include Trip.com, iQiyi, Huawei Cloud, Yitu etc. Importantly, investments are coming from many important hubs in China. According to Enterprise Singapore, there were over 400 Shanghai companies in Singapore, as of end-2022[55]. In addition, the New International Land-Sea Trade Corridor (ILSTC), a crucial trade and logistics passage set up jointly by China's western provinces and Singapore, has seen significant traction in recent years. There is also anecdotal evidence to suggest higher wealth flows into Singapore from China including property purchases[56].

Sector	Project	Year	Description
Infrastructure	China-Singapore (Chongqing) Demonstration Initiative on Strategic Connectivity (CCI)	2015	Over USD17bn in cross-border deals (led by Singapore banks) have been signed. CCI cross-border financial services help drive the New International Land-Sea Trade Corridor (ILSTC) a trade and logistics passage. This was jointly built by Singapore and provincial-level regions of western China. (Chongqing is the corridor's operational center).
	Bayfront Infrastructure Management	2021	AIIB announced that it was committing US$60 million to Bayfront Infrastructure Management's (Bayfront) debut issuance of infrastructure asset-backed securities (IABS).
	Keppel Asia Infrastructure Fund	2020	AIIB approved a US$100 million investment as a commitment to the Keppel Asia Infrastructure Fund with co-investment rights for another US$50 million.
			AIIB announced that it would invest a further US$100 million, again with co-investments up to US$50 million, in the Keppel Data Centre Fund II, LP (KDCF II), a closed-end PE vehicle managed by Alpha Investment Partners Ltd (Alpha), a wholly owned subsidiary of Keppel Capital.
E-commerce	Tencent investment into SEA Group	2014-17	Tencent participated in five rounds of funding to Sea, investing a total of US$268 million.
	Alibaba investment into Lazada	2016	Alibaba initially acquired a 51% stake in Lazada. In 2017, it added another USD1bn to its investment increasing its stake to 83%. In 2018, Alibaba added another USD2bn, doubling its investment to USD4bn.
Digital Banking	Greenland Financial Holdings	2020	Greenland Financial Holdings Group Co. Ltd (Greenland), a subsidiary of the Greenland Group (Hong Kong), led a consortium on its successful application for a digital wholesale bank (DWB) license in Singapore (one of 4 licenses granted).
	Ant Digital Bank	2022	Ant Group soft-launched ANEXT Bank, a digital wholesale bank in Singapore following MAS approval for the bank to launch.
Blockchain/Crypto	Binance Asia Services	2021	Binance Asia Services, the Singapore arm of major cryptocurrency exchange Binance (China), announced that they planned to acquire a stake in a local private securities exchange, Hg Exchange (HGX)
Digitalisation	Baidu & AMI	2018	Baidu teamed up with Asia Mobility Industries (AMI) to launch a new Singapore-based mobility venture fund, called "Apollo Southeast Asia."

[55] Shanghai eyes Singapore as it chases foreign investments amid slowing economy, Business Times, 30 January 2024.
[56] Rich mainland Chinese snap up luxury homes in Singapore despite tax hikes, Reuters, 6 October 2022.

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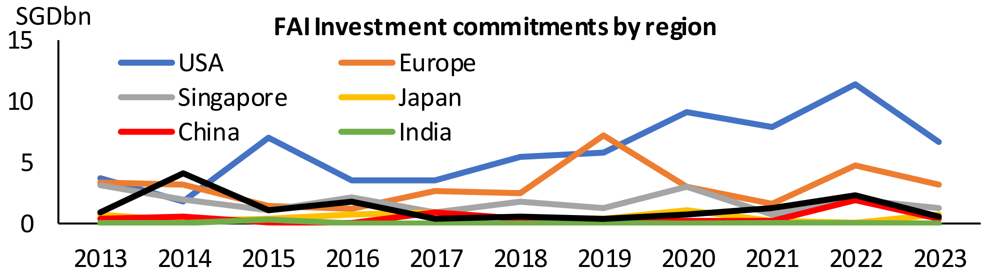
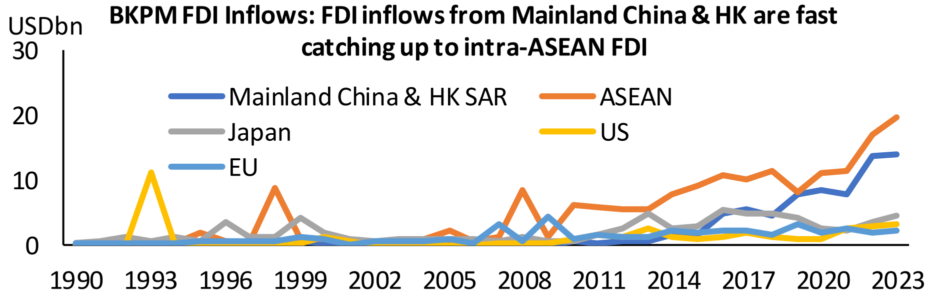
Looking ahead, FDI investment commitments, proxied by Fixed Asset Investments, from China into Singapore slowed in 2023 after a pickup in 2022, likely reflecting a subdued global economic growth backdrop and domestic growth challenges in China. While inflows may slow, the intent to deepen relations between the two countries is clear. The Singapore-China Economic Partnership Conference on 1 February 2024 culminated in both countries signing three MoU's and a visa waiver to increase people mobility between the two countries was introduced from February 2024.



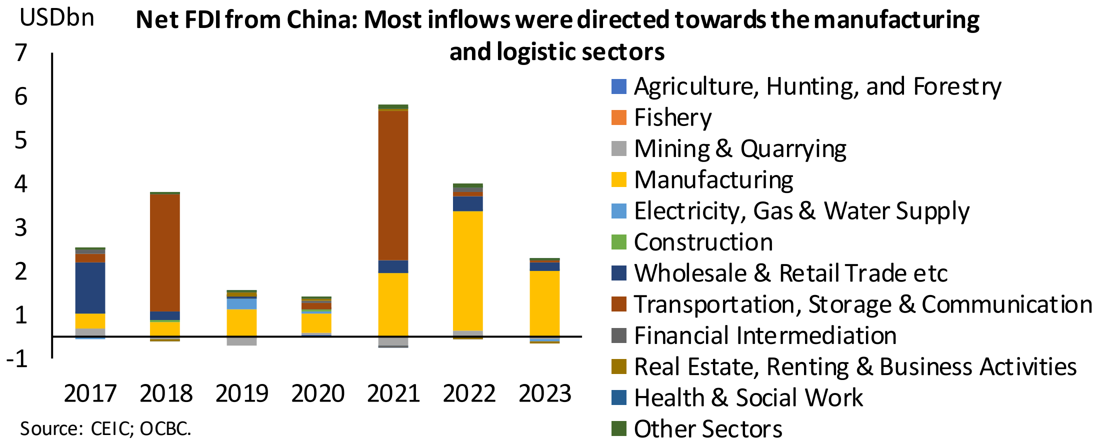
Source: EDB; OCBC.

Indonesia: China has become the one of the top contributors to FDI inflows in Indonesia. Although FDI inflows from Japan and the US have been picking up in recent years, it is dwarfed by inflows from Mainland China & HK SAR. Indeed, BKPM data showed that FDI inflows from Mainland China and HK SAR remained solid in 1Q24, rising to USD3.8bn from USD3.1bn in 4Q23.



Source: CEIC; OCBC.

Net FDI inflows from China have been mainly directed towards the manufacturing sector, increasingly consistently over the past decade. Net FDI inflows were resilient in the 'transportation, storage & communication' and 'wholesale & retail trade; repair of motor vehicle, motorcycles; household goods' sectors.



Source: CEIC; OCBC.

The country remains attractive as an FDI destination for China's investments. China pledged USD21.7bn in new investments into Indonesia in September 2023. Prior to this, Presidents Xi Jinping and Joko Widodo had committed to USD44.9bn in July 2023. The deeper collaboration between Indonesia and China was also underscored by the intent to foster the 'two countries, twin parks' model. On the China side, the park is set up in the Yuanhong Investment Zone while on the Indonesia side, it includes the Bintan Industrial Estate, the Aviarna Industrial Estate and the Grand Batang City. Business fairs held in February and May 2023 saw deals worth USD9bn being discussed across sectors such as aquatic production and fishing & processing.

The announcements by Chinese corporations of expansion into Indonesia have continued into 2024. The Batam Island Authority in Indonesia officially inaugurated the direct shipping route from Batuampar Port to Guangzhou and Shenzhen, China on 31 March 2024 to facilitate trade between the two countries. FDI commitments were enhanced in the nickel, furniture and medical equipment sectors. The authorities are also looking to broaden the FDI commitments beyond the mineral resources sector into agriculture. Indonesia is planning to collaborate with China on rice farming in Central Kalimantan. It also plans to collaborate on curly chilli, garlic, durian and seaweed[57].

Malaysia: Foreign capital investment approvals, a proxy for approved FDI, has been picking up into Malaysia. The source of the inflows has become more diverse in recent years, underscoring the broadening role of Malaysia in regional and global supply chains. Inflows from EU, other ASEAN countries, US, Japan and China have improved in recent years.

Specifically for 2023, approved investments were the highest from major EU countries, followed by the US and Mainland China & HK SAR. FDI inflows from Mainland China & HK SAR rose to USD3.4bn in 2023 from USD3.3bn in 2022, tripling from 2013 levels.

[57] Indonesia plans food production collaboration with China, targeting self-sufficiency, Indonesia Business Post, 25 April 2024.

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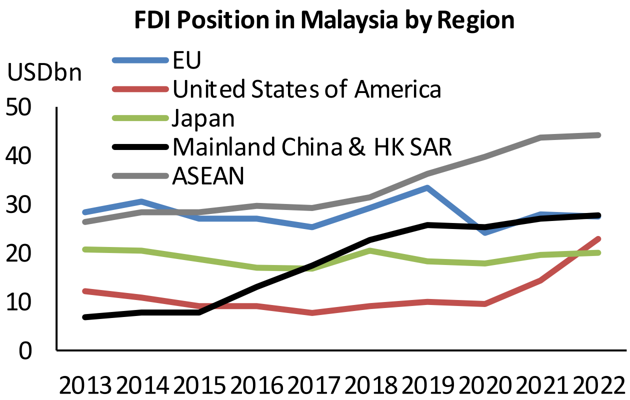
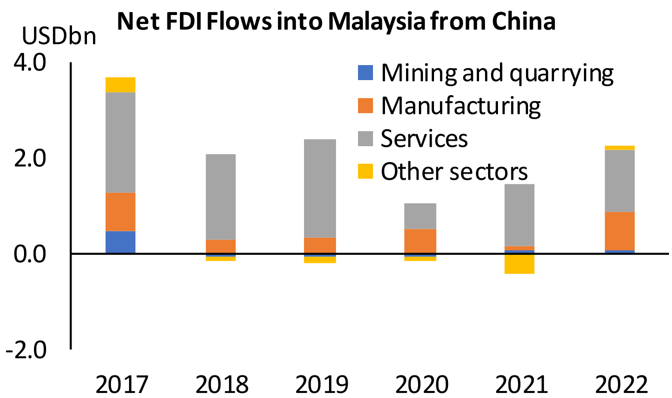
The FDI position (i.e., stock of FDI inflows) of Mainland China & HK SAR was second in 2022; the ASEAN region was in the top spot. Meanwhile, net FDI inflows were highest in the services and manufacturing sectors, implying that these sectors have been major recipients of inflows.



Source: Department of Statistics, Malaysia; OCBC.



Source: Department of Statistics, Malaysia; OCBC.

Data compiled by *American Enterprise Institute and the Heritage Foundation*[58] show that the bulk of investment from China has been directed towards the energy, technology and transportation sectors. Moreover, Chinese firms pledged around MYR170bn in investments into Malaysia in April 2023, with 19 MoU's signed, followed by commitments of MYR198.4bn in September 2023. These suggest that there is a strong pipeline of FDI commitments from China into Malaysia. Further commitments are likely to be made at the Malaysia-China Summit 2024, on 17-19 December 2024.

USDmn	Agriculture	Chemicals	Energy	Finance	Logistics	Metals	Other	Real Estate	Technology	Tourism	Transport	Utilities
2008			1150								680	
2009												
2010			770			1250		140				
2011			830			1140		1000				330
2012			200				1480	1750			130	
2013			720			980	190	1370			1900	
2014			1570				200	200				
2015		180	5360					1190	370		830	
2016		300	340			290		680		1890	500	160
2017	280	100	620	120		1660		280		550	340	
2018			140					1190	440	130	2120	140
2019			250			310	590	610			2500	
2020			320				140	110			100	
2021							300					
2022				100		310	940		320		1260	
2023			690		790				790		1270	

Source: The American Enterprise Institute and The Heritage Foundation; OCBC.

[58] The China Global Investment Tracker is published by the American Enterprise Institute and the Heritage Foundation. The China Global Investment Tracker is the only comprehensive public data set covering the country's outbound investment and construction, which are documented both separately and together. It includes 4300 large transactions across metals, real estate, agriculture, technology, and other sectors (plus 370 troubled transactions). The full set, with the amount, Chinese parent company, host country, and sector, is available for public use with the proper citation. The tracker is published by the American Enterprise Institute.

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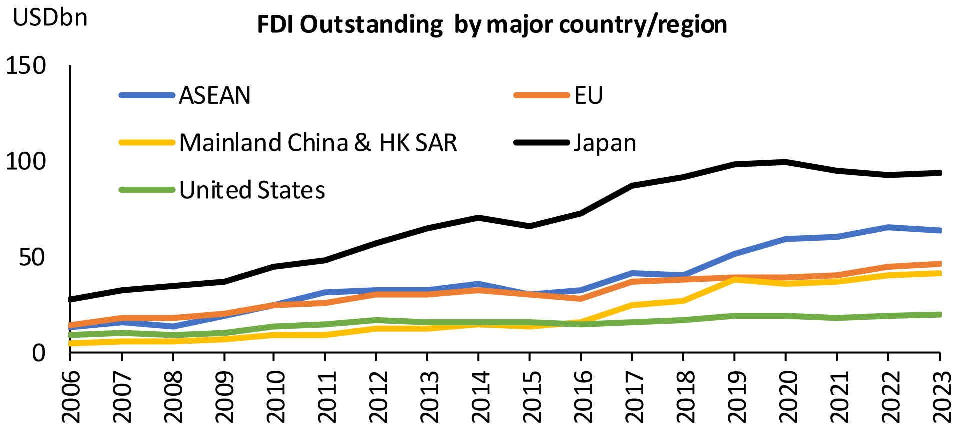
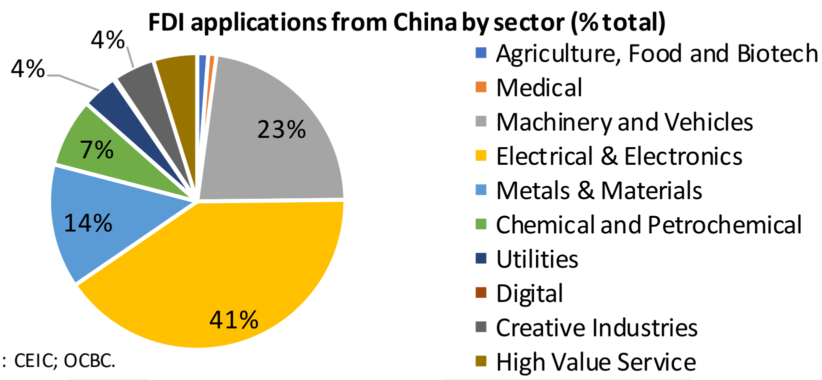
Thailand: China and Thailand share a long-standing relationship. China was one Thailand's largest trading partners in 2023 (second after the US not accounting for intra-ASEAN trade). Similarly, FDI outstanding from Mainland China and HK SAR is among the larger contributors, by country. FDI application approvals in 2023 were higher from Mainland China and HK SAR compared to other bigger countries.



Source: CEIC; OCBC.

More than 75% of FDI applications in 2023 from Mainland China & HK SAR were in the 'machinery and vehicles', 'electrical and electronics' and 'metals & materials' sectors. In recent years, the electronics sector received ~40% of total FDI applications. The 'machinery' and 'metals' sectors have gained some traction along with the chemicals and services sectors. Inflows into the auto sector have also been strong as Chinese companies look to tap into Thailand's already well-developed automotive supply chain and enhance new-energy vehicle (NEV) capabilities.



Source: CEIC; OCBC.

Furthermore, logistics and infrastructure projects under the Belt and Road Initiative continue, including the China-Thailand Railway and China-Laos-Thailand Connectivity Development Corridor. Indeed, data from the American Enterprise Institute and the Heritage Foundation shows that the majority of investments from China have been directed towards the transportation sector. There have also been some investments made in the technology sector in 2023.

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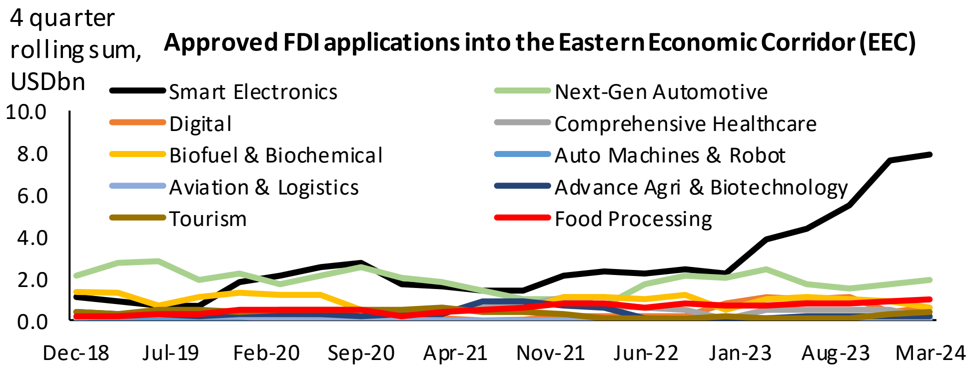
USDmn	Agriculture	Chemicals	Consumer goods	Energy	Finance	Logistics	Metals	Other	Real Estate	Technology	Tourism	Transport	Utilities
2008													
2009					530								
2010									500			170	
2011	100												
2012				100								270	
2013				280									
2014										1000			
2015		220		810								400	
2016	540			110						210		280	
2017			230									170	
2018	470		320									680	
2019				280			130					300	
2020				500								1640	
2021						280		110				480	
2022	210			560								610	
2023										330		1060	

Source: The American Enterprise Institute and The Heritage Foundation; OCBC.

Moreover, Thai authorities are keen to develop the Eastern Economic Corridor (EEC) and recently there has been an increase in FDI applications in the 'smart electronics' and 'next-gen automotive' sectors. FDI from China accounted for 10% of foreign investment into EEC from 1Q18 to 1Q23[59]. From Jan-October 2023, investments from China were ~USD1.3bn, concentrated in the 'automotive and auto parts' as well as 'electrical and electronics' sectors.



Source: CEIC; OCBC.

Vietnam: Registered FDI inflows from Mainland China & HK SAR into Vietnam rose significantly in 2023 and 1Q24. In 2023, FDI inflows from Mainland China & HK SAR stood at USD9.2bn, followed by Singapore (USD6.8bn), Japan (USD6.6bn) and South Korea (USD4.4bn). Year-to-April 2024 investments from Mainland China and HK SAR totalled USD885mn, rising 17.8% YoY compared to the same period last year.

[59] Chinese investment in EV industries helps boost Thailand's economy, says EEC panel ahead, Xinhua News Agency, Belt and Road Portal, 30 May 2023.

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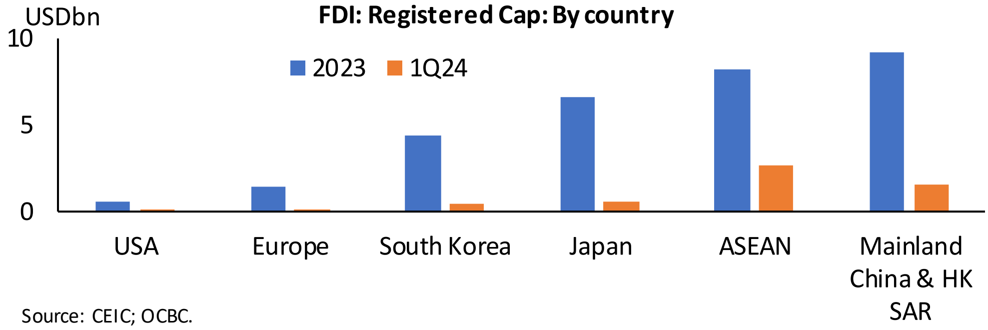

Source: CEIC; OCBC.

Vietnam's Ministry of Planning and Investment (MPI) stated in April 2024, that the authorities are working on two joint high speed rail projects to boost connectivity with China. These projects aim to connect China to Vietnam by 2030. The first project will connect northeastern Haiphong and Quang Ninh to the border with Yunnan province in China. The other is a train line from Hanoi to near Guangxi in southern China.

The nature of Chinese FDI inflows into Vietnam have changed in recent years in a variety of areas, according to MPI[60], with investors expanding into electronics, tire production, textiles and footwear; this is in addition to hotels and restaurants. There has also been some interest in expanding production in the solar panel sector.

Data from the American Enterprise Institute and the Heritage Foundation corroborates this to some extent. China's outward FDI has risen in the consumer goods, energy, metals and transportation sectors. Changes in regulations mandating foreign companies to store user data in Vietnamese territories are encouraging Alibaba to consider establishing a data centre in Vietnam[61]. With Vietnam-China bilateral relations strong, there seems to be a strong interest from both parties on nurturing and developing deeper ties.

USDmn	Agriculture	Chemicals	Consumer goods	Energy	Logistics	Metals	Other	Real Estate	Technology	Transport
2008		900				460				160
2009				1380						1380
2010				3400		340				170
2011				3260				140		280
2012				100		2290				300
2013				870			120		110	140
2014							210			
2015				3070						450
2016			170							
2017				910				460		250
2018				550		1040	360			180
2019	170			650			110		260	
2020				3660	750	130				
2021			210	930						430
2022						190	150		270	140
2023			290	540		390			150	240

Source: The American Enterprise Institute and The Heritage Foundation; OCBC.

[60] Vietnam expects strong wave of Chinese investment, Vietnam+, 18 December 2023.
[61] Alibaba to build data centre in Vietnam, Vietnamnet Global, 2 May 2024.

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Conclusion

FDI inflows from Mainland China and HK SAR into the region are gaining traction, with the manufacturing and certain services receiving the bulk of inflows. The ASEAN-6 region has benefited from a diversification of global and regional supply chain as well as the adoption of 'China+1' strategies.

Moreover, regional authorities remain focused on pursuing domestic reform agendas, raising competitiveness and encouraging domestic investments to complement FDI inflows. That said, a bumpy global growth trajectory, 'high for longer' global interest rate environment, local currency depreciation risks are some near-term risks we continue to monitor.

Thematic Report 7

Hong Kong: What Accounts for Weak Retail Sales?

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- Against the backdrop of higher median household income and a tight labour market, the consumption downgrade was obviously not due to cash constraints, but a case of wilful scaling back of domestic consumption.
- Admittedly, residents' increased spending abroad should have some crowding out effect on their spending in the domestic market. That said, residents' departure and spending abroad in 1Q24 was only marginally higher compared to pre-pandemic levels, and still in line with historical trends.
- Weaker consumption sentiment could be a function of the negative wealth effect, caused by the price corrections in the local housing and equity market over the past few years.

Oddly weak retail sales

Retail sales figures recently underscore some oddities, which we think do not quite add up. Against the backdrop of a surge in tourist arrivals and steady growth in household incomes, the retail market was oddly weak year-to-date, and below pre-pandemic levels.

Total retail sales value declined by 4.7% YoY in the first four months of 2024, and was down by 21.1% compared to the same period in 2019 (***Chart 1***). Many have attributed the weak performance to lower spending by tourists and frequent outbound travels, particularly to the nearby city Shenzhen. This thematic report intends to unveil the mystery behind such a trend and offer some possible explanations.

Reduced tourist spending?

While the recovery of tourist arrivals is on track, it has still lagged regional peers such as Macau and Singapore. In January-April this year, total visitor arrivals returned to 61.4% of the pre-pandemic level, at 14.6 million (***Chart 2***). Yet on a year-to-year basis, visitor arrivals surged by 100% from the low base last year. This should contribute positively to the overall retail sales figure. In fact, weighted per capita spending by visitors rebounded slightly to HK$4,154 in 2023 (HK$3,624 in 2019), but is still below the historical average (***Chart 3***).

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No consumption voucher? Or poor weather?

The government had attributed the weakness in April's retail sales to higher-than-usual rainfall and the end of the Consumption Voucher Scheme. While these claims are all factually correct (rainfall doubled in April this year; ***Chart 4***), retail sales had showed signs of weakness before in early 2024. Retail sales value posted three straight months of decline in February to April this year. Foot traffic was also low during that period, as evidenced by the drop in passenger numbers of mass transit railway (for domestic services, excluding cross-boundary and airport express services) (***Chart 5***).

Cash flow strain?

Number of households reached an all-time-high of 2.73 million in 1Q24. At the same time, median household income of economically active household continued to push higher to HK$39,700 (***Chart 6***). Meanwhile, the labour market remained tight. The consumption downgrade was obviously not due to cash strain, but a case of wilful scaling back of domestic consumption.

Chart 1: Weak retail sales

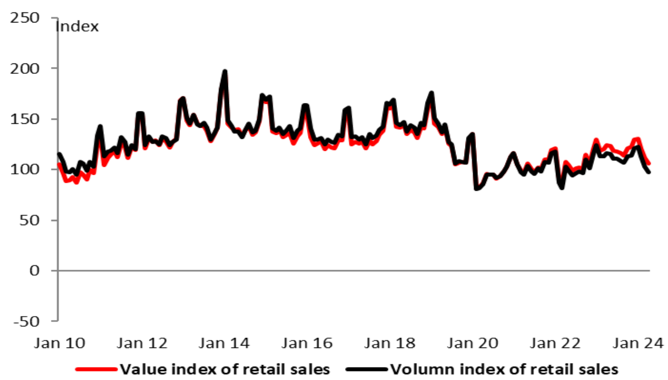


Chart 2: Tourist arrivals back to 61% of pre-Covid level

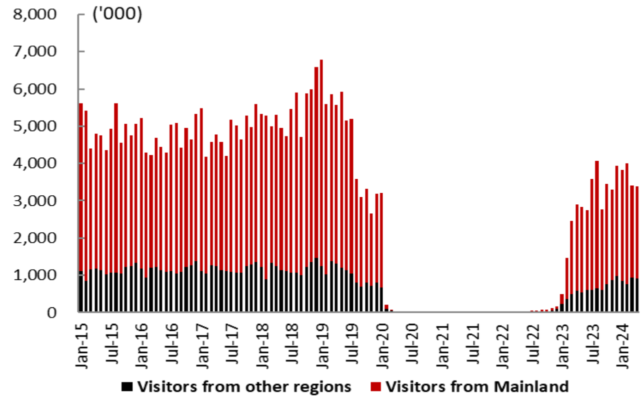


Chart 3: Per capita spending of visitors*

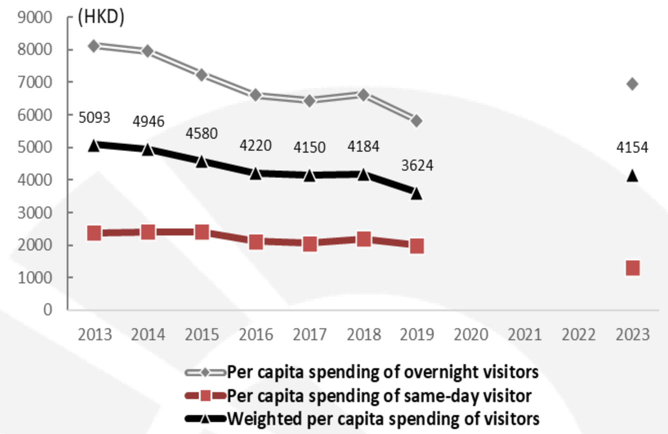


Chart 4: Higher-than-usual rainfall in April

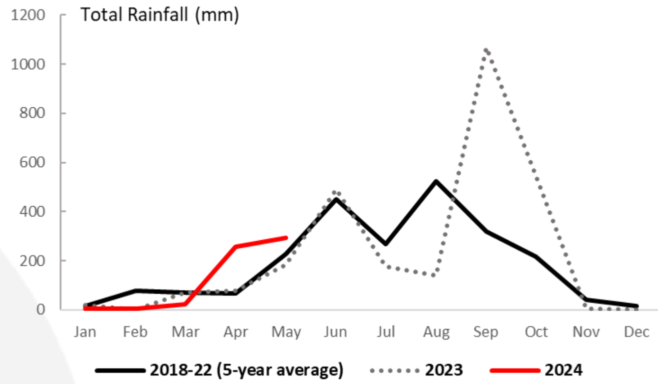


Chart 5: Low railway patronage figure

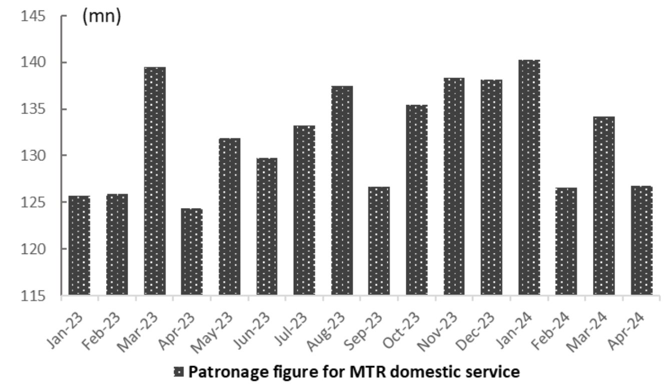
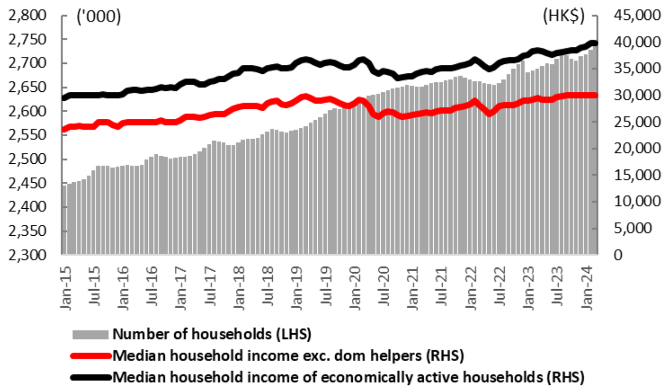


Chart 6: Household income on the rise



Sources: Hong Kong Census and Statistics Department, Hong Kong Observatory, MTR, OCBC
(*) Data not available for 2020 to 2022 when border control was in place.

More outbound travels and spending abroad?

Total consumption expenditure by residents in the domestic market and abroad rose by 1.0% YoY combined in 1Q24. Yet, the component that was included in retail sales figures (residents' expenditure in domestic market alone), rose marginally by 0.2% YoY (***Chart 7***). Admittedly, residents' increased spending abroad (+60.9% YoY in 1Q) should have some crowding out effect on their spending in domestic market.

Hong Kong residents are known to travel to the neighbouring city of Shenzhen during weekends for recreation. This has become more popular lately due to the devaluation in RMB against HKD, a widening the price gap, more efficient immigration clearance and transport facilities. Expenditures have also broadened from the purchase of basic consumer goods to enjoying leisure activities and seeking medical services.

Starting from July last year, eligible Hong Kong private cars could travel between Hong Kong and Guangdong via the Hong Kong-Zhuhai-Macao Bridge under the " Northbound Travel for Hong Kong Vehicles" scheme. The Bridge experienced record-breaking traffic during the last Dragon Boat Festival holiday (8-10 June). Between Saturday (8 June) and Monday (10 June) noon, the bridge witnessed the entry of more than 227,000 passengers and over 42,000 vehicles, highlighting the increased connectivity of the Greater Bay Area.

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Chart 7: Residents' total consumption expenditure

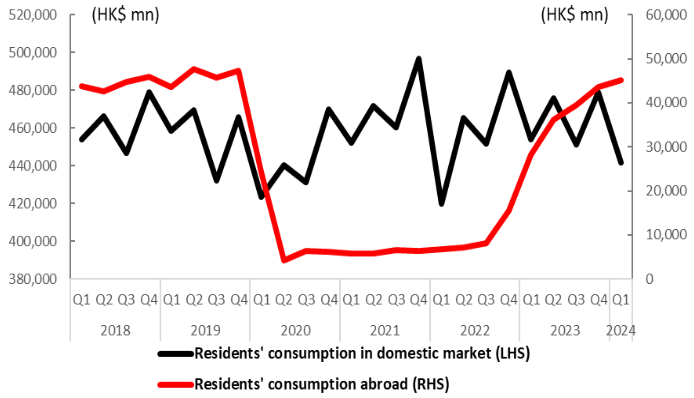
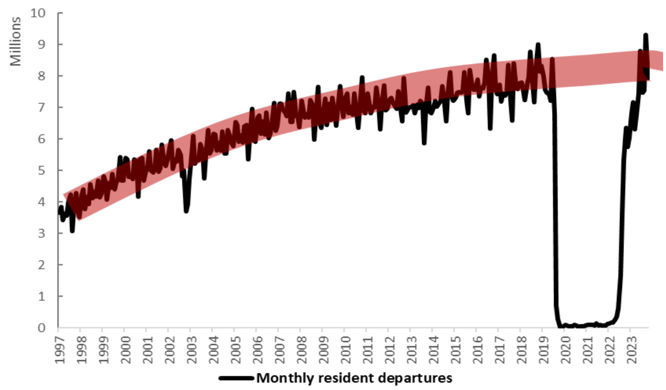


Chart 8: Departure historical trend



Sources: Hong Kong Census and Statistics Department, OCBC

Broader picture points to a reluctance to spend

Residents' more frequent outbound travels and increased spending abroad should only take part of the blame. Residents' departure was only up by 0.3% in the first four months this year, over the same period in 2019 (***Chart 8***). Similarly, the total resident spending abroad in 1Q24 was only 3.6% higher as compared to the pre-pandemic levels. This was still in line with the general historical trend.

Looking at the broader picture, consumption expenditure by residents has been fairly stagnant over the past few years (***Chart 9***), despite continuous growth of household income and number of households. Compared to pre-pandemic levels, total expenditure was still down by 3.0% in 1Q24, while the median monthly income of economically active households exceeded the 2019 level by 7.9%. That leads us to ask an important question – why are residents reluctant to spend despite higher income?

Negative wealth effect?

The weaker consumption sentiment could be a function of the negative wealth effect, caused by the price corrections in the local housing and equity market over the past few years (***Chart 10***). We use the total equity market capitalisation in the Main Board and net housing wealth defined as the average transacted price of private residential properties in past 12 months multiplied with the total private housing stocks (less total outstanding mortgages) as a gauge for household wealth. Our calculations show that the value of household wealth was 33.9% lower at end-April from the recent peak (***Chart 11***). This considerable decline in net wealth has likely depressed household consumption.

Chart 9: Consumption expenditure stagnated

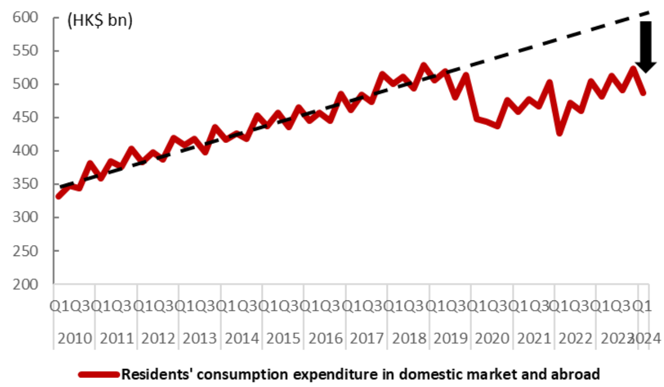


Chart 10: Housing and equity market corrections

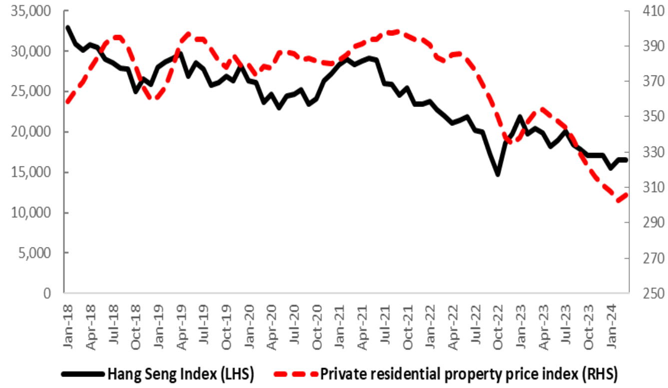


Chart 11: Net wealth fell by more than 30% since peak

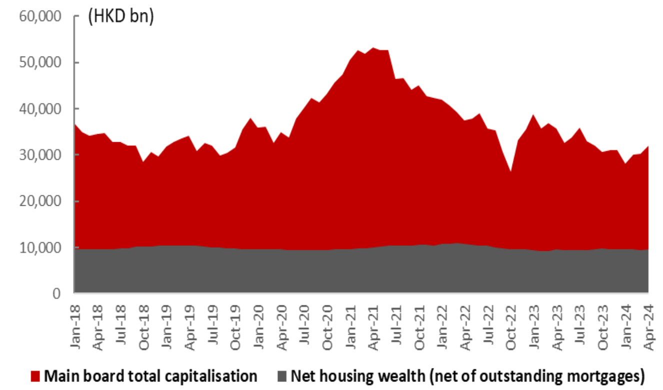
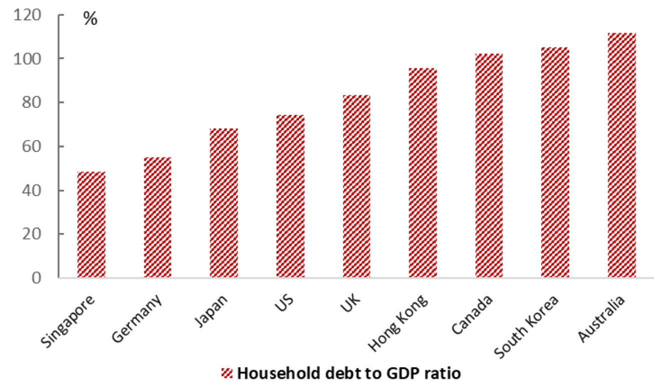


Chart 12: High household debt to GDP ratio



Sources: Bloomberg, Rating and Valuation Department, Census and Statistics Department, Land Registry, IMF, OCBC

High household debt ratio?

The high interest rate environment inflicted significantly more pain on households, as a majority of mortgages are tied to the floating rate. Indeed, 93% of new loans approved in April 2024 were tied to HIBOR. Meanwhile, the household debt to GDP ratio stood at a high level of 92.7% in 2H23 comparing to the world standard (***Chart 12***). Meanwhile, according to survey results, spending on housing accounted for 40% of total household expenditures (***Table 1***), hence increased mortgage payments or a higher debt service burden will reduce residents' expenditure on other goods and services.

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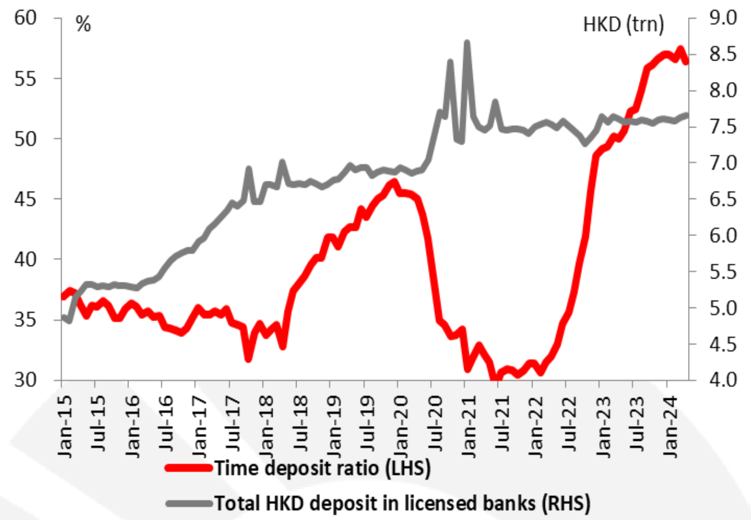
Table 1: Average monthly household expenditure by commodity/service group in 2019/2020

Commodity/service group	Nominal Amount (HK$)	Share to Total (%)
Food	8,107	26.8
Housing	**11,865**	**39.3**
Electricity, gas and water	688	2.3
Alcoholic drinks and tobacco	157	0.5
Clothing and footwear	748	2.5
Durable goods	1,312	4.3
Miscellaneous goods	1,062	3.5
Transport	247	0.8
Miscellaneous services	4,257	14.1
Total	30,230	100

Higher opportunity cost?

Delaying consumption is extremely common in a high interest rate environment. As the time deposit rate hit 5%, savings have become preferred to expenditure. The share of time deposits to total HKD deposit in licensed banks rose from 31.3% at end-2021 to 56.5% as of end-April 2024 (***Chart 13***). Meanwhile, the sales of non-essential items, including "consumer durable" (-12.7% YoY in the first four months this year), "department stores" (-10.8% YoY) and "jewellery, watches and clocks" (-7.8% YoY) all saw notable declines.

Chart 13: High time deposit ratio



Sources: HKMA, OCBC.

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Key Sustainability Trends to Watch

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- Mandatory climate reporting, alongside nature reporting, is becoming mainstream amid greater regulatory push and interest from investors.
- The Voluntary Carbon Market (VCM) is seeing progress in integrity initiatives after recent greenwashing accusations, in efforts to continue delivering high-quality carbon credits to the market.
- Countries are recognising the importance of shifting away from fossil fuels towards renewable energy technologies and low-carbon solutions e.g. hydrogen and carbon capture and storage (CCS).

Introduction

The world has experienced several extreme weather events against the backdrop of the warmest year in recorded history in 2023 and 1H24. Heatwaves and floods were featured in headlines frequently, with spiralling impacts on economies and communities. The UN Climate Change has assessed that the world is not on track to meet the goals of the Paris Agreement, as existing national climate action plans are insufficient to limit global temperature rise to 1.5°C. Stepping into the second half of 2024, this report elaborates on three key sustainability trends to watch in 2024 amidst ongoing economic uncertainty and climate anxiety.

1. Mandatory climate reporting becoming mainstream

Reporting on climate risks and emissions is becoming a norm for many companies, especially when governments are increasingly transitioning from a comply-or-explain basis to mandatory climate reporting. Some investors are calling for mandatory climate reporting on companies' green transition plans to improve transparency and accountability.

Businesses are increasingly seeing climate reporting regulations and supportive capacity building initiatives, including in Singapore and Malaysia. All listed companies in Singapore will be required to make climate-related disclosures from FY25 based on local reporting standards aligned with the International Sustainability Standards Board. These requirements will also apply to large non-listed companies from FY27. To support companies through the changing regulatory landscape, authorities are rolling out a Sustainability Reporting Grant to defray costs associated with the preparation of eligible companies' first sustainability report. In addition, authorities will be launching a programme to support SMEs to develop their first sustainability reports, as well as training programmes to equip the workforce with skills necessary for the transition to a low-carbon future.

As climate reporting becomes mainstream, nature reporting is anticipated to follow a similar trajectory as central banks and financial institutions are increasingly recognising nature loss as an important issue and a systemic risk to financial systems. Adopting standards such as the Task Force on Nature-related Financial Disclosures (TNFD) are also starting to gain positive momentum in the industry.

2. Positive momentum for VCM integrity initiatives

After a few years of exponential growth, the growth of the VCM has slowed recently because of the challenging macroeconomic environment, coupled with growing public scrutiny on the quality of carbon credits amidst greenwashing accusations. Numerous VCM projects were heavily criticised in 2023 for issues pertaining to integrity and credibility, leading to a slump in prices. This was exacerbated by the lack of progress on Article 6 of the Paris Agreement at the UN Climate Change Conference (COP28) in Dubai. Parties could not reach a consensus on both Article 6.2 (guidance on bilateral or multilateral trade of carbon credits) and Article 6.4 (mechanism for trading greenhouse emission reductions), with much of the disagreements surrounding the rules around carbon removals and the issue of transparency over the final text. The lack of progress was a setback for the VCM as the operationalisation of Article 6 could have provided new structure for the global carbon market and increased market demand for carbon credits.

To address market concerns on quality and transparency, there has been progress on new integrity initiatives such as the Integrity Council for Voluntary Carbon Markets (ICVCM) publishing new integrity guidelines for projects with the high-integrity Core Carbon Principles (CCP) labels. The ICVCM has approved five carbon-crediting programs, which have a 98% share of the VCM, to be CCP-eligible i.e. American Carbon Registry, Architecture for REDD+ Transactions, Climate Action Reserve, Gold Standard and Verified Carbon Standard. The volume of CCP-labelled credits is expected to grow steadily this year as the ICVCM Governing Board aims to complete the assessment of the different categories (e.g. improved forest management, sustainable agriculture, renewable energy) by the end of September.

Another integrity initiative is the Climate Action Data (CAD) Trust, a global platform that aims to enhance transparency of carbon credit trading by tracking the full life cycle of carbon credits. It aims to bring on board the large independent registries, as well as national registries over time, so that CAD Trust can aggregate and harmonise the data to prevent double counting. On a national level, the Singapore Government has published the Eligibility List under the International Carbon Credit (ICC) Framework, which sets out the requirements that ICCs must meet for carbon tax-liable companies in Singapore to offset up to 5% of their taxable emissions. Authorities will update the Eligibility List to maintain relevance and uphold high integrity standards based on the latest science-based evidence and market developments. As the VCM remains one of the key decarbonisation strategies to enable companies to offset residual and hard-to-abate emissions, these integrity initiatives help support the delivery of high-quality carbon credits to the market.

3. Shifting away from fossil fuels towards renewables and low-carbon solutions

Countries at COP28 agreed on a historic deal that calls on all nations to 'transition away from fossil fuels in a just, orderly and equitable manner, so as to achieve net-zero by 2050.' While the final text did not indicate tangible targets or actions, some countries are making progress towards the low-carbon transition. The G7 energy ministers have agreed to phase out the use of coal power where the emissions have not been captured by 2035, after the US Environmental Protection Agency outlined a new directive that requires US coal-fired power plants to capture emissions or shut down.

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The transition away from coal will be more challenging for developing economies because of the high reliance on fossil fuels and high costs required for the energy transition. Developing countries may therefore require significant international investment to fund their energy transitions. For example, Indonesia is working on the early retirement of its 660 MW coal-fired power plant as a pilot project for the energy transition, under the Energy Transition Mechanism[62] program of the Asian Development Bank.

As Singapore is an alternative-energy disadvantaged country, the lack of domestic renewable energy resources poses a challenge for its energy transition. With 95% of electricity generated from natural gas, Singapore aims to decarbonise the power sector by importing low-carbon electricity from the region and exploring low-carbon alternatives. The Energy Market Authority has granted Conditional Approval for projects to import low-carbon electricity from neighbouring countries, comprising 2 GW from Indonesia, 1 GW from Cambodia and 1.2 GW from Vietnam. If realised, these projects will tap on a diverse mix of solar energy, hydropower, and wind power to meet Singapore's target of importing 4 GW of low-carbon electricity by 2035. Singapore is also working on ramping up the deployment of renewable energy as well as exploring low-carbon alternatives such as hydrogen, geothermal and carbon capture, utilisation and storage. In efforts to advance CCS as a decarbonisation pathway, Singapore and Indonesia have signed a letter of intent in February 2024 to collaborate on cross-border CCS after Indonesia's presidential regulation to allow cross-border CCS was announced. This can catalyse the deployment of cross-border CCS projects in Southeast Asia and generate new opportunities for both countries in the green economy.

Conclusion

International pressure on countries to transition away from fossil fuels will increase as adverse climate-related impacts on economies and communities become more apparent over time. COP29, set to be held in Azerbaijan in November 2024, is drawing closer. We anticipate COP29 discussions to cover the aforementioned sustainability trends, particularly on operationalising Article 6 and enhancing the integrity of the VCM, as well as financing the global energy transition, especially for developing economies.

[62] The Asian Development Bank launched the Energy Transition Mechanism in 2021, aimed at using concessional and commercial capital to accelerate the retirement or repurposing of fossil fuel power plants and replace them with clean energy alternatives. The program began with three pilot countries i.e. Indonesia, the Philippines, Vietnam, and has since extended to Pakistan and Kazakhstan.

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