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US-China-Taiwan: Just how much has political risk changed?
China: economic conditions deteriorate further, policy has to give

Manu Bhaskaran
Nicholas Chia
Celine Tan

US-China-Taiwan: Just how much has political risk changed?

US House Speaker Pelosi's visit has set in train developments that will raise big power frictions structurally, and for a long time.

- However, the US and China will do what is necessary to avoid direct clashes. They may even restart direct talks which China just cancelled. But, tensions will persist as China intensifies its pressures on Taiwan while the US steps up its support for it.
- China's strategy to reunify Taiwan with the mainland was never principally about an invasion. It was always about relentlessly increasing the suffocating pressure of diplomatic, economic and military actions so as to force Taiwan to eventually negotiate with it on Beijing's terms. Pelosi's visit allowed China to double up on this strategy.

China: economic conditions deteriorate further, policy has to give

- There was little good news in the latest batch of Chinese economic data. Domestic demand is weakening again after a brief rebound in June. External demand appears strong on the surface but new export orders are falling, suggesting that exports will lose momentum soon.
- The drags on the economy are now deeply rooted – a contracting real estate sector whose ill-effects are spilling over into consumer despondency, weak investment and credit stresses.
- Policy responses remain inadequate and sometimes contradictory. Policy makers are betting that incremental and cautious measures will allow employment and incomes to stabilise. We suspect that they are too optimistic.

What has changed recently:

- **Inflation has peaked in India**, although subsequent inflation prints will still remain elevated in the near-term. Activity indicators for 2Q22 were flattered by base effects when Covid-19 woes were salient in the year-ago period as we expect 2Q22 GDP growth upwards of 15%.
- **Retail sales and consumer confidence are in healthy spirits in Indonesia**, marked by broad-based strength across all components in the former. All eyes now turn to July's trade data.
- **There is upside risk to our GDP growth forecast for Malaysia** following the breakneck pace of growth in 2Q22. Robust external demand, particularly in the commodity and electronics space, continues to buoy Malaysian exports.
- **Singapore's economy remains in good shape despite the government's cautious tone.** The pipeline of high-value manufacturing investments remains strong while the financial sector will benefit from the inflow of wealth management activities.
- **While the Philippines' 2Q22 GDP print surprised on the downside**, the recovery still has legs. Notably, excess private savings actually increased in the period, suggesting cutbacks to discretionary spending, perhaps because of the spike in Covid-19 caseloads or the high-inflation environment.

US-China-Taiwan: Just how much has political risk changed?

Now that the dust is settling after US House Speaker Nancy Pelosi's visit to Taiwan, we can take stock of the implications by looking at what has changed and the forces for further change that have been strengthened. The net result is that the Taiwan issue will continue to fester, with the Chinese side likely to keep increasing the pressure on all fronts on Taiwan while the US is likely to push back by firming up its support, including military aid, for Taiwan. While this makes for a troubled US-China relationship and while the risk of military confrontation over Taiwan is not zero, military clashes between the US and China over Taiwan remain highly unlikely in the next few years.

1. The risk of war in the near term remains very low and should not be over-stated

The patterns of behaviour exhibited by China and the US suggest that there is no desire for confrontation on either side. While China mounted its largest-scale military exercises around Taiwan, it was careful not to deploy air or naval forces near where American forces were positioned. It did enough to intimidate Taiwan, which it made clear was the main target of its military exercises, not the US. China announced only muted responses against the US such as sanctioning Pelosi and her immediate family, hardly the stuff of war risks. While it cancelled talks with the US on military affairs and climate change, this may not be long-lasting. The US, on its part, was also careful not to aggravate the situation. It even postponed a missile test in the region so as to send a positive signal to China.

> *The message is clear: neither side will intentionally undertake actions that could result in a military clash. An accidental clash is always possible but it is also likely that both sides will take great care to minimise that risk. And if something wayward were to occur they would rapidly act to de-escalate.*

This does not mean everything will be smooth between the two big powers. There is an action-reaction dynamic underway, with each side still testing the other to signal determination not to be cowed by the other. Over the weekend, a five-member US delegation led by Democratic Senator Ed Markey of Massachusetts was in Taiwan, as part of a visit to Asia. Markey chairs the Senate Foreign Relations East Asia, Pacific, and International Cybersecurity Subcommittee and was accompanied by several Congressmen. President Biden's Indo-Pacific coordinator, Kurt Campbell, has also indicated that the US will send aircraft and warships to the Taiwan Strait in the coming weeks to demonstrate its commitment to Taiwan. Campbell also said that the administration would unveil details of a trade pact with Taiwan soon as well. The US, he warned, would also persist with "freedom of navigation" operations in the Taiwan Straits.

All this is will anger but not surprise Beijing which will likely bring forth other measures to signal its displeasure with the US. We believe, however, that after a while, each side would have made its point to the other and the relationship will stabilise. This is what happened in 1990 - after the US imposed sanctions against Beijing in reaction to the Tian An Men suppression, the then

Bush Administration signalled confidentially to China that it sought to renew ties at an appropriate time. Similarly, it happened again in 1997, after the 1996 standoff as well – within a year, President Clinton was in Beijing for a state visit.

Hence the continuing talk of a summit meeting between Presidents Xi Jinping and Joe Biden despite the Chinese cancellation of other talks. Media reports talk of Chinese officials still preparing for Xi to visit Southeast Asia for the APEC and G20 summit meetings in November – with the possibility of an in-person Xi-Biden summit meeting not entirely ruled out yet.

2. The focus of Chinese pressure will be on Taiwan not the US

Having taken advantage of the crisis to shift the military goal posts, China will increase pressure on Taiwan on all fronts.

China has created new and exceedingly uncomfortable military realities for Taiwan

By undertaking unprecedented military actions, China introduced new norms of military conduct which it will repeat around Taiwan.

- Chinese aircraft crossed the median line between the mainland and Taiwan several times, something it had not done before. Chinese navy vessels sailed close to the Taiwan coast as well.

- Chinese military exercises were carried out in six zones surrounding Taiwan – a scale of intimidation China has not carried out before.

- Chinese missiles flew directly over Taiwan during the exercises. China did this before, in 1995-1996, but those earlier missile tests did not cover Taiwan's territorial seas as it did this time.

All this will stretch Taiwan's limited military resources. Note that the Chinese exercises brought home to Taiwan just how short it was on air force pilots, among other things. The Chinese pressure will keep Taiwan on edge continuously and so demoralise the Taiwanese people. Such actions also remind Taiwan's foreign partners of the risks of investing or trading with Taiwan – which could result in supply chain reconfigurations that hurt Taiwan.

China has also hinted at a tougher stance towards Taiwan beyond military pressure

Soon after Pelosi's visit, China released a new white paper on Taiwan. It did not make for pleasant reading for Taiwan:

- The white paper continued to assert Beijing's right to use military force to reunify Taiwan. This is not new but it made that assertion in words that demonstrated its growing confidence

in its military capacity: " Never before have we been so close to, confident in, and capable of achieving the goal of national rejuvenation …"

- While acknowledging that Taiwan and the mainland have "distinct social systems and ideologies", its solution was to offer Taiwan the "One Country, Two Systems" model that was offered to Hong Kong and which has been shredded to pieces following China's imposition of its will on Hong Kong in the past two years. This despite polls showing that 85% of Taiwanese people reject this model.

- The white paper removed one important assurance that was in the 2000 version – that Chinese military forces would not be deployed on Taiwan after reunification. The offer that "any matter is up for negotiation under the one-China principle" also does not appear in the latest version.

In other words, China is telling the Taiwanese people that reunification will happen on China's terms and the Taiwanese would just have to get used to that.

3. What to expect in the near future?

First, China will step up the pressure on Taiwan – and on other countries to isolate Taiwan.

China's strategy towards reunifying with Taiwan was never primarily about invading it – it was about suffocating it gradually until the pressure forces Taiwan's rulers and residents to consider negotiating with China on Chinese terms. The Pelosi visit gave China the excuse to shift the military goal posts in such a way as to strengthen this strategy which will now proceed on a turbo-charged basis. Military exercises around Taiwan will be frequent and persistent – and likely to get bolder in its provocativeness.

Moreover, China will keep pressing other countries to downgrade economic, diplomatic and military ties with Taiwan. China is likely to become less compromising on this issue and exert greater pressure on other countries to help China isolate Taiwan.

An example of how this could unfold is China's demand last week to India that it explicitly reiterate India's One China policy under which India recognises Taiwan as a part of China. But India has steadfastly refused to mention this stance in bilateral documents or in public statements since 2008 as retaliation against China for claiming India's Arunachal Pradesh as Chinese territory and seeming to withdraw recognition of Indian sovereignty over Jammu and Kashmir by changing the way it issued visas to residents of those Indian territories.

Second, the US is likely to cautiously strengthen its economic and military support for Taiwan – and some of these efforts will infuriate China.

The US political elite is broadly agreed on American support for Taiwan. Kurt Campbell's announcement of the furthering of trade ties and the deployment of military assets in the seas around Taiwan is a clear signal of this. The US Congress will keep pushing the envelope as well – thought not always in a coherent way or in coordination with the executive branch. An example is the proposed Taiwan Policy Act which adopts a more aggressive stance of support for Taiwan than previous US policy:

- It seeks to strengthen Taiwan's military capacity, offering it USD4.5 billion in security assistance and giving Taiwan the special status of a "major non-NATO ally" of the US which would enable Taiwan to receive the highest level of American military technology. The bill, as it is currently drafted, would expand the kinds of weapons Taiwan can purchase from the United States, including not just those "of a defensive character," but also "arms conducive to deterring acts of aggression" by China. It would require the US to regularly assess the risk of a Chinese invasion and help train Taiwanese forces for such an attack, mandating the Defense Department to set up a training programme with Taiwan to boost its defences.

- It would establish a sanctions regime to penalize China for any hostile action against Taiwan.

- It would require the US to press multilateral institutions to elevate Taiwan's status or membership in those organisations.

- It would also promote Taiwan's diplomatic standing in Washington D.C., changing the name of Taiwan's representative office there from the Taipei Economic and Cultural Representative Office to the "Taiwan Representative Office."

The bill is likely to be watered down so as to be less provocative of China but it is likely to pass in its broad form.

In summary, over the next two to three years, therefore, we should expect more and more military and other pressure by China on Taiwan while the US works cautiously to buffer Taiwan against these pressures. Both the big powers will take pains to avoid actions that could significantly raise the risk of a direct clash. While the chances of a big power war in the next two to three years is low, it will be a messy period, marked by big power frictions and uncertainties.

The economic consequences will probably include some degree of supply chain reconfiguration away from both China and Taiwan – some of that will be in the form of continued offshoring in low-cost economies such as Vietnam while some of it may be re-shoring of higher value production back to the developed home countries such as the US or Europe or Japan.

China: economic conditions deteriorate further, policy has to give

There was nothing but dismal news in China's latest batch of economic data. The headwinds are intensifying but policy support is not forthcoming in sufficient strength to steady the economy. Unless stimulus measures become more effective, the downward pressures on the economy could worsen sharply. At best, the authorities' piecemeal stimulus efforts will prevent an outright contraction.

1. Demand is in the doldrums, dragging down industrial production

Domestic demand remains weak, dragged down by despondent consumers and businesses which are uncertain about their prospects.

- **Retail sales growth lost momentum, decelerating** to +2.7% y/y growth in Jul 22 from +3.1% y/y in Jun 22. Drilling into the data, it appears that a degree of malaise prevails among consumers, as seen in weak discretionary spending. Stimulus measures are helping – but the boost appears to fade fairly quickly, reflecting downbeat consumers. For example, the government's support measures have boosted consumer discretionary items but as the fading boost to auto sales shows, such stimulus measures do not last long and are struggling to offset the headwinds. The declining real estate sector is feeding into crashing sales of property-related consumer items.

- **Fixed asset investment (FAI) growth decelerated further** to +5.7% y/y YTD in Jul 22, down from +6.1% y/y YTD in Jun 22. Decelerations were reported across the primary, secondary and tertiary industries.

    - Infrastructure stimulus is coming through – infrastructure FAI accelerated to +7.4% y/y YTD in Jul 22 (Jun 22: +7.1% y/y YTD) – but it has not been sufficient to offset the overall decline in fixed asset investment in the economy.
    - But manufacturing investment decelerated, expanding by 9.9%YoY Ytd in July, down from 10.4%YoY in Jan-Jun 22.

- **Real industrial production declined slightly** to +3.8% y/y growth in Jul 22, down from +3.9% y/y in Jun 22. Previously released PMI data pointed to continued weakness in industrial production, as the sub-indexes for employment and new orders fell into the contractionary territory in Jul 22.

External demand is not likely to come to China's aid even though July exports appeared to beat expectations. The strength in exports was probably due to

- **Exports in Jul 22 grew 18% y/y** (Jun 22: +17.9%), faster than the consensus had expected. However, part of this growth probably represented a rebound due to easing supply chain dislocations rather than a genuine surge in underlying demand. An article in Bloomberg

reported on anecdotal evidence of a sharp fall in new export orders. The official PMI sub-index for new export orders fell from 49.5 in June to 47.4, staying below 50 for the 15th consecutive month, not a good sign and suggesting that the anecdotal evidence may represent something real.

- **Imports rose by just 2.3% y/y in Jul 22** (Jun 22: +1.0%). Where import volume data is available, as for commodities such as grain, soybean, crude oil, natural gas and coal, volumes fell in July while the Dollar values increased. That suggests that the rise in imports was at least in part due to the price effect rather than true underlying demand.

- **Trade surplus in Jul 22 reached USD101.3bn,** the largest ever surplus for a month, exceeding June's previous record of USD97.9bn.

2. The reasons for the malaise remain in force

First, the real estate sector remains in a downward spiral:

Property sales by floor area declined further at -23.1% y/y YTD in Jul 22 (Jun 22: -22.2% y/y YTD) and average new home prices declined for the 11th consecutive month at -0.11% m/m in Jul 22 (Jun 22: -0.1% m/m). In turn, developers continue to hold back on further real estate investment. Real estate FAI worsened to -6.4% y/y YTD in Jul 22 (Jun 22: -5.4% y/y YTD) and new construction starts measured by floor area plunged by -36.1% y/y YTD in Jul 22 (Jun 22: -34.4% y/y YTD).

Second, financial stresses are widening, adding to the headwinds.

The contraction in real estate activities is spilling over into large numbers of defaults among property developers. This in turn is hurting weaker banks, especially the village and township banks, some of whom have experienced bank runs in July.

Another sector that is affected by the real estate contraction is the local governments. Their revenue base is excessively dependent on land sales which have collapsed. They are reported to be cutting officials' salaries and reducing spending – at a time when government spending should be supporting demand not detracting from it.

Third, the central government's unrelenting covid-zero policy continues to take a toll.

Despite harsh restrictions, covid infections continue to be higher than the authorities are able to tolerate. On Saturday, 2,467 domestically transmitted cases were reported nationwide with hot spots in Hainan and some of the outlying provinces. The scenes of panic in an Ikea store in Shanghai as screaming shoppers attempted to flee the store when they suspected the authorities were about to lock the shop down in response to a suspected covid case is a reflection of the mood of fear and despondency among consumers, fed up with months of unending and unreasonable lockdowns.

3. **Set against these headwinds, policy support has been weak and not likely to turn things around – for several reasons**

Expansionary monetary policy seems to be losing its efficacy. Despite monetary easing undertaken by the PBOC, new yuan loans plunged to CNY679bn in Jul 22, less than a quarter of Jun 22's amount. Household loans (including mortgages) fell to CNY121.7bn in Jul 22 from CNY848.2bn in Jun 22, while corporate loans slid to CNY287.7bn from CNY2.21tr in Jun 22. This leaves the government more constrained in the policy tools it has at its disposal, further complicating stabilisation efforts.

The monetary easing by the People's Bank of China (PBOC) in response to Jul 22's weak macroeconomic data will not be sufficient to stabilise the economy. On 15 Jul 22, the PBOC lowered the medium-term lending rate by a niggardly 10 bps to 2.75% from 2.85% and cut the 7-day reverse repo rate by 10bps to 2.0% from 2.1%.

Several factors could explain this half-hearted policy response:

First, inflationary pressures are accelerating.

- **Consumer prices rose by 2.7% y/y in for Jul 22** (Jun 22: +2.5%), hitting a 24-month high despite still being below the government's 3% inflation target for the year. Food prices, which increased 6.3% y/y in Jul 22, were the main driver of rising price levels. Excluding food and energy prices, China's core CPI rose 0.8% y/y, decelerating from a 1.0% increase in Jun 22.

- **The producer price index (PPI) rose 4.2% y/y in Jul 22** (Jun 22: +6.1%), marking the ninth consecutive month of slowing inflation. The continued easing of factory gate prices was brought about by a drop in commodity prices, as well as the resolution of supply chain bottlenecks.

- **The People's Bank of China (PBoC) responded to the latest inflation data** in its quarterly monetary policy report on 10 Aug 22, pledging to safeguard the economy against inflation by avoiding excessive monetary stimulus. The central bank warned that structural and imported inflation pressures "may increase in the short-term", but also signalled more flexibility in its credit expansion targets to allow for "reasonable growth of" money supply.

Second, China's anti-corruption campaign continues to terrify officials who approve infrastructure projects and bank credit officers who sign off on loans.

China's anti-corruption watchdog's latest target is the semiconductor sector.

- **The Central Commission for Discipline Inspection (CCDI) has launched investigations against several executives linked to a chip investment fund.** The National Integrated Circuit Industry

Investment Fund, also called the "Big Fund", was set up in 2014 to help China's semiconductor industry pursue self-sufficiency. With the backing of state investors, the Big Fund has raised over USD51bn in its previous funding rounds, and counts chip giants SMIC and Hua Hong Semiconductor among the homegrown champions it has successfully financed.

- **From Jun-Jul 22, at least five executives tied to the Big Fund have come under investigation by the CCDI for fraud.** These include Ding Wenwu, the fund's general manager, as well as high-level managers at SINO IC Capital, which manages the Big Fund's assets. The ramp-up of probes follows the collapse of state-supported semiconductor manufacturer Tsinghua Unigroup, which filed for bankruptcy in Jul 21 after struggling to refinance large debts. Its former head, Zhao Weiguo, was also placed under investigation on 26 Jul 22 for potentially unlawful activities that led to the company's downfall.

Assessment: Forceful stimulus policies are needed to stabilise the economy

The government's bet is that its piecemeal, tightly calibrated stimulus policies will suffice to steady the economy and spur renewed growth, growth that is enough to achieve its now, less ambitious, goal of keeping employment and incomes stable rather than the 5.5% growth target it talked about in March.

Over the past few decades, the authorities have consistently proven their critics wrong, pulling off economic recoveries that many critics had thought impossible. So, it is possible that the policy makers know something that outside we observers, cut off from visiting China to get an on-the-ground feel, are unable to discern.

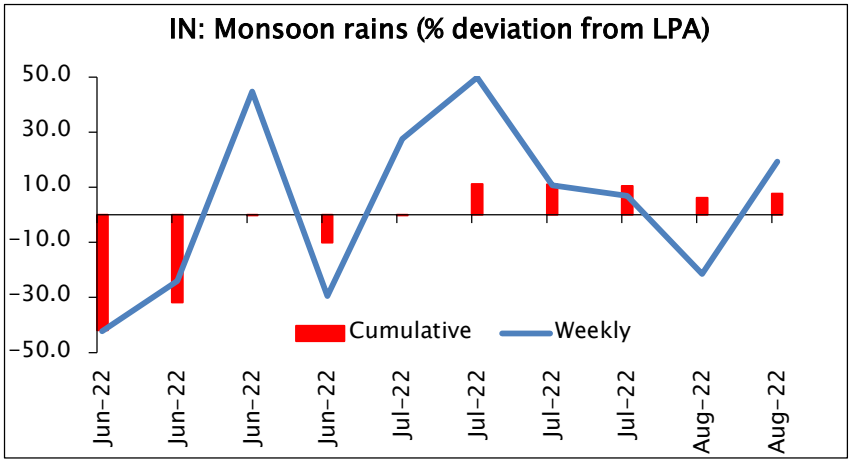
However, our sense is that the authorities, being too wedded to policies dictated by a dominant President Xi Jinping, are not willing to be as flexible and as pragmatic as the previous generation of policy makers. We would also assert that there might be trends depressing consumer and entrepreneur psychology that the policy makers do not fully understand, which makes them underestimate the headwinds – and potentially make policy misjudgements.

In short, our view is that incremental policy measures will proliferate and help to prevent an outright economic contraction. But economic performance will remain mediocre – and that will raise the risk that a weak economy could crystallise the structural problems in the economy such as high debt.

Key Drivers of Asian Economies

Variable	Development/Assessment
Asian economies:	
India: Activity indicators flattered by base effects	Activity indicators flattered by base effects ▪ **Industrial production rose 12.3% y/y in June**, down from +19.6% in the previous month. Mining (+7.5%), manufacturing (+12.5%) and electricity (+16.4%) all decelerated. Electronics (+44.0%) and refined petroleum (+17.6%) were bright spots by virtue of the prevailing external conditions. By goods production, primary (+13.7%), capital (+26.1%), mining (+11.0%) and consumer durables (+23.8%) led the charge, while infrastructure (+8.0%) and consumer non-durables (+2.9%) were more sluggish. ▪ **Export growth slowed abruptly to a standstill in July (+2.1%)** after months of double-digits growth (June: +23.5%). Agri (+20.1%), chemicals (+3.8%), electronics (+46.1%) and petroleum products (+9.2%) were the main drivers, albeit having softened from June while ores (-44.1%), jewellery (-5.2%) and machineries (-2.1%) were in the black. Import growth remains upbeat, however, slowing slightly to +43.6% in July (June: +57.5%). The proxy indicator for capital imports clocked marked growth (+34.1%) which is the fastest in 10 months. The trade deficit broke another record in July (USD30bn) (June: USD26.2bn). ▪ **Passenger vehicle sales grew 19.1% y/y in June**, following May 22's breakneck growth (+185.1%) amid last year's Covid-19 restrictions. Two-wheelers, a barometer for rural demand, jumped 24.0% y/y in June (May: +255.3%). ▪ **Fuel consumption rose 6.1% y/y in July**, which is the slowest pace in 5 months (June: +17.9%). Diesel consumption, a proxy for industrial activity, eased to +8.2% y/y from +23.9% in June. Fuel sales were curtailed by the monsoon rains amid bridled mobility and construction work, compounded further by demand destruction from hefty prices although this is starting to ease. Poor rice output cast a pall over food inflation ▪ **Headline inflation pulled back further in July (+6.7%)** (June: +7.0%). Food inflation eased to a 5-month low (+6.8%), as did personal care (+6.0%), offsetting the uptick in fuel (+11.8%) and clothing (+9.9%). Other components were broadly unchanged - housing (+3.9%), health (+5.4%) and household goods and services (+7.4%). Core inflation also edged down to 5.8% y/y, from +6.0% in June. Sequentially, headline inflation fell for the first time since end-2020 in July (-0.1% m/m sa).

Variable	Development/Assessment
	▪ **Monsoon rains were 19.2% above the long period average (LPA)** in the week ending 10 Aug 22, reversing from last week's 21.5% deficit. Cumulatively, this brought total rainfall to 7.7% above the LPA, from +6.2% in the previous week. Among the 36 meteorological sub-divisions, 24 received at least normal rainfall while the remaining 12 saw deficient rains of varying magnitude.



Source: CEIC

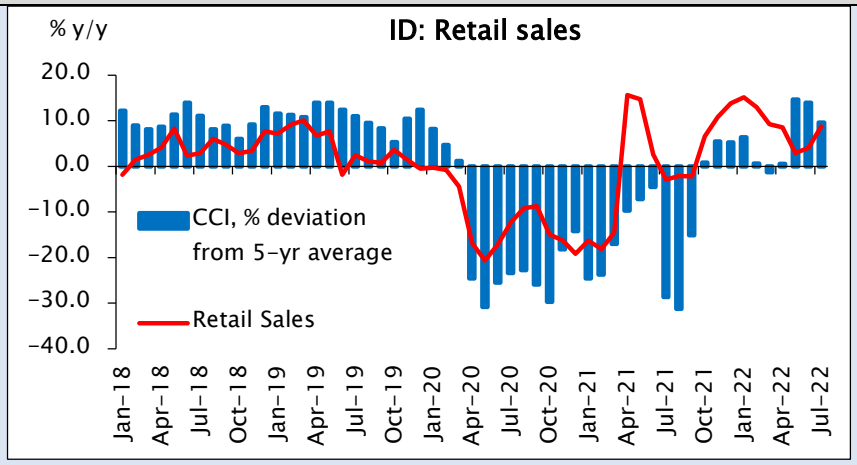
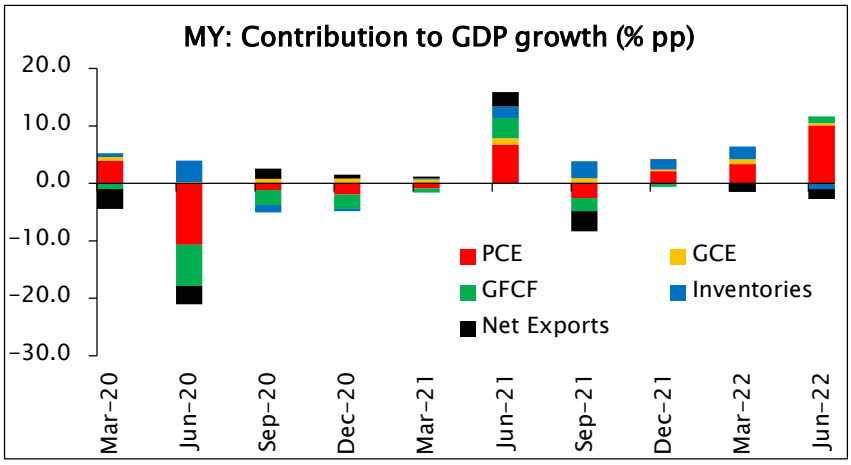
▪ **Kharif sowing is down 11.8% y/y as of 12 Aug 22**. Planting of rice, the main kharif crop, is 33.7% lower y/y, as is pulses (-4.0%), sugar cane (-0.01%) and oilseeds (-0.8%) while coarse cereals (+3.2%) which includes maize and bajra, and cotton (+1.3%) fared better.

Assessment: 2Q22 growth will be flattered by base effects

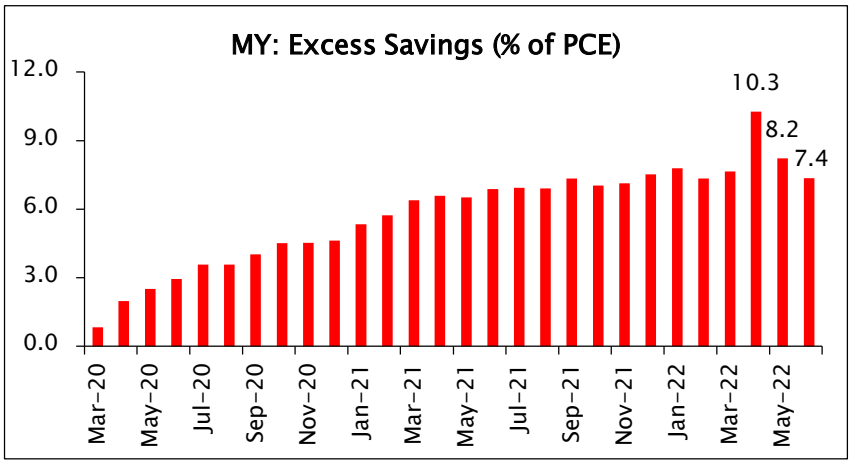
▪ **Activity indicators inflated by last year's base effects**: The seemingly stellar performance of factory output and other activity indicators are a result of Covid-19 woes in the year-ago period when lockdowns chilled economic activity and severely constrained economic growth. As such, 2Q22 GDP growth in excess of 15% y/y appears plausible, merely because of base effects before growth eases to around 5.5% thereafter. Insofar as growth is concerned, the jury is still out on whether the long-mooted capex upturn by the private sector will materialise and persist moving into 2023. We will scrutinise the figures on corporate earnings and private capex once more data is available in due course.

▪ **Inflation has peaked but risks remain salient**: We reiterate our view that inflation has peaked in India, although it will remain above 6% for some time yet. Energy and food prices have moderated of late, which piles on downward pressure on monthly inflation. Meanwhile, the 2Q22 GDP print will be inflated by last year's Covid-19 woes which artificially depressed economic output but the expansion is now into the mid- to

Variable	Development/Assessment
	late-stage of the cycle. In turn, this reduces the propensity for the build-up of excessive, pent-up demand pressures associated with the reopening of economies. ▪ What could upend this hitherto rosy scenario is if there is a further escalation in geopolitical tensions in Europe or Asia, feeding into the risk premium of energy commodities, of which India is a massive net importer. The monsoon season is another wild card, because rice production will fall short of estimates, although this is mitigated by plentiful stocks held by the Food Corporation of India (FCI) and conditioned on the non-renewal of the food aid program once it lapses by Sep 22.
Indonesia: Brisk consumer spending shores up the economy	▪ **Consumer confidence softened further in July (123.2)** (June: 128.2), although it is still above the 100-threshold that separates optimism from pessimism. Both the present sentiment (110.9) and future expectations metrics (135.5) declined in July. ▪ **Retail sales likely expanded at a robust clip in July (+8.7%)** (June: +4.1%), according to preliminary figures from BI. The strength was broad-based across all categories, as spending on food and beverage (+10.1%), car spare parts (+34.6%) and fuels (+66.9%) – all of which are mainstays of consumers – held up. Even spending on clothing (+49.5%), other goods (+31.4%) and recreation (+14.6%) booked solid growth, while the contraction in spending on durables (-7.9%) and stationery (-20.3%) narrowed. **Assessment: Economy remains in fine fettle as all eyes turn to July exports** ▪ Consumer spending continues to perk up briskly in July, suggesting the upturn in 2Q22 is no fluke and will persist moving forward. Our back-of-the-envelope calculation suggests excess household savings have peaked in April (3.6% of PCE) and are starting to trend down (June: 2.9% of PCE). On the flip side, non-financial corporate savings continue to edge up, which may reflect the precautionary motive amid the unfavourable external environment from geopolitical uncertainty and the moderating commodity prices. ▪ Our view is that the services sector that dominate the economy, and domestic demand by extension, will remain the main locomotive in the remainder of 2022 even as all eyes turn to July's trade data which will likely paint a still-rosy picture of exports amid the softening of food and energy commodity prices.

Variable	Development/Assessment
	 Source: CEIC
Malaysia: In rude health	Domestic demand led the charge ▪ **The economy expanded at a rapid clip in 2Q22 (+8.9%)**, with household spending delivering a 10pp boost to headline GDP growth (see Chart below, red bars). Government spending (+2.6%) softened while GFCF grew 5.8% y/y, with residential investments ending a 3-quarter contractionary streak (+3.8%) while equipment and machineries slowed to a 6-quarter low (+9.6%). Sequentially, the economy expanded 3.5% q/q sa in 2Q22, which is just a touch lower than 1Q22's +3.8%.  Source: CEIC ▪ **The volume of services increased 16.7% y/y in 2Q22**, firming up sharply from +7.0% in 1Q22. Distributive trade (+22.3%) and transport and storage (+16.4%) led the charge, while business services (+7.7%) and other services (+18.6%) expanded at a more moderate pace. Services production rose 7.1% q/q sa in 2Q22, firming up from +6.6% in 1Q22.

Variable	Development/Assessment
	▪ **Distributive trade surged 44.0% y/y in June** (May: +19.6%). Wholesale (+19.3%) and retail trade (+38.4%) were robust, and buttressed by food and beverage (+21.5%), household equipment (+28.5%) and recreational spending (+27.0%). ▪ **Construction work done grew 6.1% y/y in 2Q22,** with the private sector leading the charge (+14.8%). With the exception of civil engineering projects (-4.4%), both residential (+7.9%) and commercial projects (+18.1%) and special trades (+11.9%) were all in the black. ▪ **The unemployment rate edged down further to 3.6% in June** (May: 3.8%), converging on the pre-crisis low. The labour force participation rate held steady at 69.5% which remains a record-high since the inception of the series, although this may also reflect the growing class of the precariat from the rising cost-of-living that outpaced nominal wage growth. …even as external conditions remain supportive, for now ▪ **Factory output jumped 12.1% y/y in June** (May: +4.1%) and is set for further upside surprise in 3Q22 amid favourable base effects. Mining (+2.1%) was relatively weak, while manufacturing (+14.5%) and electricity (+14.1%) climbed on the back of the year-ago contraction. The electronics sector (+16.9) continue to outperform, as did the machineries (+89.9%), basic and fabricated metal (+25.1%). On a monthly basis, IIP rebounded sharply in June (+8.4%) following May's contraction (-2.9%). ▪ **Manufacturing sales quickened further in June (+23.4%)** (May: +15.7%), which chimes with the upbeat manufacturing value-add from IIP. Every component logged double-digits growth, led by transport equipment (+47.5%), non-metallic minerals and basic metals (+43.2%), electronics (+25.4%) and petroleum and chemicals (+18.8%). **Assessment: Risks to growth are well-contained** ▪ The breakneck pace of growth underpins the resilience of the Malaysian economy as domestic demand kicks into high gear and more than made up for the near-term headwinds emanating from the external sector. Excess household savings may have peaked at 10.3% of PCE in April, but they remain elevated and are at levels (~7%) last seen around the entirety of 2021, offering a solid buffer against any talk of a protracted slowdown. ▪ We retain our growth forecast of 6% for 2022, although several headwinds to growth from the external sector are emerging, mainly from a confluence of softening commodity prices, tightening of global financial conditions and negative spillovers from China's harsh and

Variable	Development/Assessment
	unrelenting adherence to the zero-Covid approach. That said, we are confident of the resilient Malaysian economy weathering through these storms as domestic demand does most of the heavy lifting going forward.  Source: CEIC
Singapore: economic outlook dampens	<u>2Q22 GDP growth remained creditable</u> ▪ **GDP grew 4.4% y/y in 2Q22** (1Q22: +3.8%), lower than the 4.8% y/y growth estimated by the Ministry of Trade and Industry (MTI) in its advanced estimates. On a seasonally adjusted basis, the economy contracted by 0.2% q/q in 2Q22, down from a 0.8% q/q increase in 1Q22. ▪ **The manufacturing sector logged an expansion of 5.7% y/y** (1Q22: +5.5%). Growth in the quarter was supported by strength in transport engineering, general manufacturing, and electronics, although the biomedical and chemical clusters saw their outputs shrink. Seasonally adjusted, the manufacturing sector grew 0.4% q/q, reversing a 1.7% contraction in 1Q22. ▪ **The finance and insurance sector grew moderately by 1.6% y/y** (1Q22: +3.7%). or 2.3% m/m. On a seasonally adjusted basis, the sector expanded marginally by 0.4% q/q, up from a 0.4% contraction in 1Q22. Growth was supported by an uptick in payment processing activities, but was held back by weaker sales in the insurance and banking segments. <u>The government is sounding a note of caution</u> ▪ **In response to the latest figures, MTI narrowed its 2022 growth forecast.** Where it had previously expected GDP growth between 3.0 to 5.0%, MTI has now shaved the upside and predicts growth between 3.0 to 4.0%, citing weakened demand from export markets like China as

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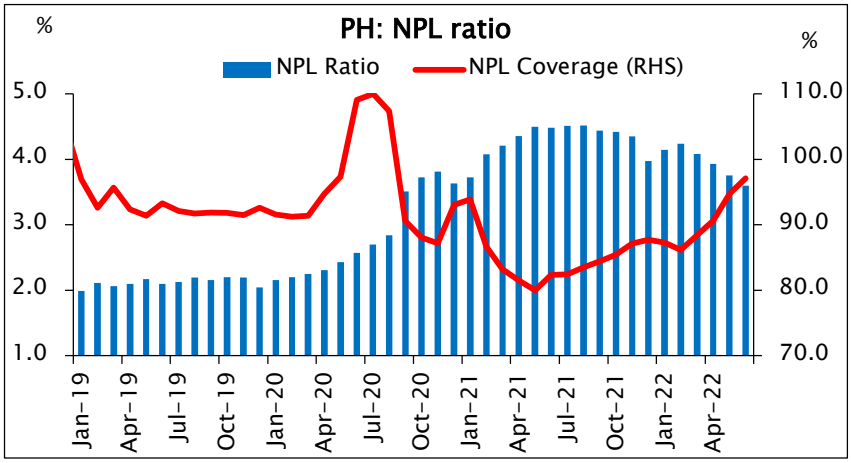
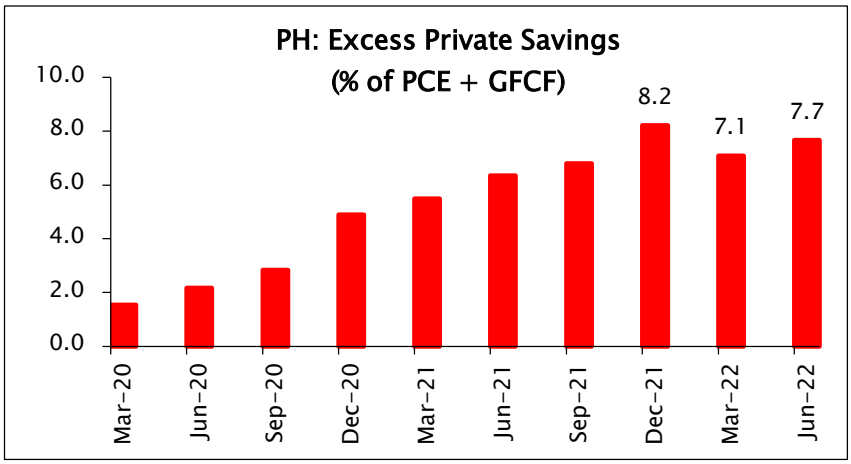
	well as downside risks from the escalation of geopolitical conflicts, including the Russia-Ukraine war. ▪ Prime Minister Lee also struck a somewhat downbeat note in his National Day speech to the nation. A storm was gathering in the geo-political environment while the economic outlook had turned cloudy despite the nation's rebound from the pandemic. He saw inflationary pressures remaining problematic for a while as well. **Assessment: we remain confident in a relatively resilient economy** Despite the government's downbeat message, we think the economy will maintain reasonably firm growth in line with its potential or slightly higher: ▪ The opening of the borders is helping tourism. Passenger throughput at Changi Airport reached 2.9 million in June, compared with 5.8 million in June 2019, reflecting a massive turnaround since the government eased covid restrictions earlier in the year. ▪ The pipeline of investments that will expand the economy is continuing to be highly impressive. Fixed Asset Investments (FAI) and Total Business Expenditure (TBE) amounted to $6.3 billion and $2.1 billion respectively in 2Q22 – with many new investments in the high-value areas that will power Singapore's growth in the medium term. ▪ The finance sector should regain momentum from its modest showing in the second quarter as the new activities spurred by the government's innovative ideas to attract wealth management to Singapore bear fruit. The number of family offices in Singapore is reported to have doubled this year. Moreover, Singapore's variable capital company structure is attracting large numbers of investment funds who find this new corporate entity enticing. 590 Variable Capital Companies have been set up since the entity was launched. ▪ Finally, Singapore's hinterland – Malaysia and Indonesia – are enjoying strong rebounds as discussed above. This is why Singapore's re-exports have accelerated sharply in the second quarter, boosting the entrepot sector.
The Philippines: Growth story still on track	<u>GDP growth surprised on the downside but growth story remains intact</u> ▪ **GDP growth slowed unexpectedly to 7.4% y/y in 2Q22** (1Q22: +8.2%). Household spending rose 8.6% y/y, aided by a strong showing by GFCF (+13.2%) and government spending (+11.1%). Construction (+15.7%) and durable equipment investments (+11.7%) firmed up. By sector, the all-important services sector clocked growth of 9.1% y/y, which is the fastest in a year, underpinned by retail trade (+9.7%) and accommodation and food services (+29.9%) amid the easing of Covid-19 restrictions. Sequentially, the economy contracted 0.1% q/q sa, ending a 7-quarter expansionary streak (1Q22: +1.5%).

Variable	Development/Assessment
	▪ **Philippine exports eked out a 1.0% y/y growth in June**, down sharply from +6.4% in May. Electronic exports – the mainstay of outbound shipments – booked the first contraction (-5.2%) since Aug 20. This also shows up in exports by destination – shipments to China (-18.8%), Hong Kong (-9.0%) and the US (-3.9%) are all in the red, albeit for differing reasons with Covid-zero being one of them. Import demand (+26.0%) remains buoyant, however, reflecting firm economic conditions at home. Consumer (+30.2%) imports strengthened materially, followed by intermediates (+14.0%) and capital imports (+2.9%). The trade deficit widened to a record in June (USD5.8bn) (May: USD5.6bn). ▪ **Industrial production growth is stabilising in June (+9.8%)** following March's triple-digits growth (May: +8.0%). Driving the upturn is food (+17.2%), electronics (+14.0%), transport equipment (+12.5%) and textiles (+30.1%). Conversely, apparel (-3.8%), leather products (-0.5%) and electrical equipment (-12.6%) were a drag on the headline figure. <u>Lagging indicators paint a still-sanguine picture of the economy</u> ▪ **Labour market conditions continue to improve**, characterised by a rising labour force participation rate in June (64.8%). The unemployment rate held steady at 6.0% as the ranks of discouraged workers shrank and more job-seekers entered the labour market. The rate of underemployment has also fallen to a 1-year low (12.6%). ▪ **The NPL ratio continues its descent**, falling to 3.6% in June – the lowest since mid-2020 – from 3.7% in the previous month. The ratio for Past Due loans also edged down to 4.2% (May: 4.4%) while the NPL coverage ratio, which accounts for loss provisioning by banks, rose to 97.1% from 94.8% in the same period.  Source: CEIC **Assessment: Don't write off the Philippines yet**

Variable	Development/Assessment
	▪ **Growth rebound still has legs:** The 2Q22 GDP print surprised lower vis-à-vis our nowcast of 8.9%, and despite last year's unfavourable base effects – the economy clocked growth rates in excess of 10% in the year-ago period in 2Q21 – the sequential slowdown does raise some concerns over the state of the recovery. Nevertheless, all indications suggest the economic momentum will continue moving into 2H22, albeit at a more moderate pace. Lagging indicators from the labour market and credit ▪ We should also point out that the stock of excess *private* savings (savings and deposits data by firms and households are aggregated in the Philippines, unlike say in Indonesia or Malaysia) actually went up 0.6 percentage points in 2Q22, which could imply some belt tightening efforts by the private sector alongside cuts to discretionary spending, either because of rising Covid-19 caseloads or the high-inflation climate. This also means that the private sector is still sitting on a still-sizeable buffer of excess savings that can be deployed to gin up the economy in 2H22. In any case, we hew to our growth forecast of 6.5% for full-year 2022, as we remain confident in the Philippine economy's growth prospects.  Source: CEIC ▪ **Robust GDP print gives BSP the go-ahead for further policy tightening:** The still-upbeat GDP print should give the BSP confidence to continue monetary policy tightening necessary to ensure inflation expectations are well-anchored. While food and fuel prices are coming down on a monthly basis and sequential inflation points to a moderation on the horizon, the BSP will be particularly wary of being caught flat-footed a la the US Federal Reserve. ▪ As such, the August review will see a 50bps hike, as the BSP has telegraphed previously, followed by two more 25bps back-to-back

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	hikes in Sep 22 and Nov 22, lifting the terminal rate to 4.25% (previously 3.75%). The BSP could countenance rate cuts in 2H23 once inflation slows materially and growth runs into more headwinds, although there is considerable uncertainty over how economic conditions will evolve in the 12-month ahead period.

CAA Latest table of forecasts

	Year	Growth (%)	Inflation (%)	Current Account (% of GDP)	Policy rate (%)	Currency (vs USD)
China	2021	8.1	0.9	2.8	2.95	6.36
	2022	3.2	1.9	2.2	2.75	6.80
	2023	5.4	2.0	1.4	2.75	6.60
India	FY22	8.7	5.3	-1.0	4.00	74.5
	FY23	7.0	6.3	-3.2	5.75	76.5
	FY24	6.8	5.8	-2.8	5.00	76.0
Indonesia	2021	3.7	1.6	0.3	3.50	14,300
	2022	5.3	3.8	-0.8	4.00	14,200
	2023	5.5	3.3	-1.5	4.50	14,000
Korea	2021	4.0	2.5	5.0	1.00	1,188
	2022	2.5	5.0	3.9	2.75	1,250
	2023	2.0	3.5	3.5	2.25	1,200
Taiwan	2021	6.1	2.0	15.0	1.125	27.5
	2022	4.0	3.0	15.3	1.75	27.0
	2023	3.0	2.0	15.3	2.25	27.0
Hong Kong	2021	6.4	1.6	5.9	-	7.80
	2022	0.5	4.0	5.0	-	7.80
	2023	3.5	3.0	0.7	-	7.80
Singapore	2021	7.6	2.3	18.1	-	1.40
	2022	4.0	5.5	17.5	-	1.28
	2023	3.5	1.9	17.5	-	1.28
Malaysia	2021	3.1	2.5	3.5	1.75	4.18
	2022	6.0	3.0	3.9	2.75	4.20
	2023	5.6	2.5	3.8	3.25	4.10
Philippines	2021	5.6	4.4	-1.8	2.00	50.9
	2022	6.8	5.0	-3.0	4.25 (3.75)	53.5
	2023	6.5	4.0	-2.8	4.00 (3.50)	51.0
Thailand	2021	1.6	1.2	-2.2	0.50	33.3
	2022	3.5	6.0	0.5	0.75	35.0
	2023	4.5	2.5	4.2	1.25	33.0
Vietnam	2021	3.0	2.5	-1.1	4.00	23,300
	2022	6.5	4.0	1.5	4.00	23,050
	2023	6.0	3.0	2.0	4.00	22,500

Source: Centennial Asia Advisors. Forecasts for India are on the basis of the fiscal year ending March. Figures in parentheses refer to previous forecast. Figures in red indicate a downgrade; green signal an upgrade.

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