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Despite mounting headwinds, a global recession does not seem likely
Singapore: In a good place cyclically, but structural challenges lie ahead

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Despite mounting headwinds, a global recession does not seem likely to stifle Asian growth

- **The red-hot jobs market and rising capital goods orders in the US** point to a disconnect between such bottom-up figures and the GDP advance estimates, which might well be resolved when the GDP is revised upwards. Asian exports to the US are likely to be resilient – the PMI survey indicated rising import demand in the US economy.
- **The latest PMI figures point to a sprightly recovery across ASEAN that still has legs** : Domestic demand, powered by the easing of covid-related curbs and the accumulation of excess savings will help offset the likely deceleration in global demand.
- **There are two key risks** 1) China's economic woes that predate Covid-19 and are therefore likely to persist in the medium- and long-term, and 2) mis-calibrated tightening by central banks that slows growth much more than intended.

Singapore: In a good place cyclically, but structural challenges lie ahead

- The latest GDP and labour market data confirm that Singapore's cyclical prospects remain strong. Although external demand is likely to slow, the rebound in sectors badly hit by covid is firming. Foreign investment in manufacturing and the integrated resorts sectors will be robust. The finance sector is benefiting from relocation from Hong Kong.
- But there are three structural challenges that need to be tackled. First, productivity growth has been persistently weak. Second, the large external surpluses reflect excessive savings in the economy. And, third, rising home prices show a disconnect from fundamentals.
- Policy actions to address these weaknesses are yet to be seen, and that is a concern.

What has changed recently:

- **Material deterioration in the region's risk profile:** Against our expectation, US House Speaker Pelosi went ahead with her visit to Taiwan. China's response in the form of massive military exercises around Taiwan crossed several lines not breached before. The result is that Taiwan's sense of insecurity has likely deepened. China's diplomatic reactions have also meant that US-China ties are at their most precarious in decades. China's relations with Japan have also taken a hit.
- **There are nascent indications that inflation in Korea will peak soon**, although this will not deter the BoK from hiking rates later in August, albeit in increments of 25bps instead.
- **Rice production could disappoint in India, necessitating a fresh round of export curbs**. Domestic shortages are unlikely, however, given plentiful stocks which will blunt the likelihood of stirring food prices just as inflation is becoming more sticky and inertial.
- **2Q22 GDP growth surprised positively in Indonesia**, thanks to the tailwind from commodity prices. But with core inflation and the Rupiah under control, there is little to suggest BI will move in August.
- **The Philippines is set for a blockbuster 2Q22**, as our nowcast pegged growth at 8.9%. Lagging indicators such as credit growth and lending standards, point to a buoyant recovery.

Despite mounting headwinds, a global recession does not seem likely to stifle Asian growth

Fears of a global recession have picked up, as rising inflation prompts a harsh policy adjustment by central banks. In our view, a recession this year remains unlikely. But the risks to growth are clearly stacking up, from expeditious monetary tightening to the slowdown in China.

Currently, advanced economies are still posting moderate expansions

- **Underlying economic fundamentals in advanced economies remain largely intact**. Recession fears were amplified after the US economy shrank 0.9% y/y in 2Q22, after it contracting by 1.6% y/y in 1Q22. But the contraction was slight and could potentially be revised upwards by the National Bureau of Economic Research (NBER, the agency which determines whether recessions have occurred). The contraction could also be put down to the large annualised fiscal drag in 1H22, which is expected to ease in the coming quarters as high base effects from massive government stimulus in 1H21 begin to subside.

- **Further, an uptick in factory orders in the US as well as continued tightness in the labour market** suggest that the economy is performing reasonably well currently. New orders for core capital goods in the US rose by 0.7% in Jun 22, up from a 0.5% increase in May 22: this could only have happened if American firms were confident about demand in the future. And similarly, the sizzling pace of job creation could not have occurred unless employers were feeling secure about demand. Non-farm employment grew by 528,000 in July, after expanding 398,000 in June, well above the rate needed to reduce the number of unemployed in the economy. Job openings have also increased at a clip of +6.6% y/y, based on the latest Job Openings and Labour Turnover Survey in Jun 22. These are signals that US businesses are still confident about the outlook and are, if anything, looking to ramp up production levels.

Turning to Purchasing Manager Index (PMI) data for July, the G3 economies were largely still able to achieve moderate expansions in their outputs. But an area of concern is emerging around a slowdown in Eurozone manufacturing. Detailed data on the PMI are in the annex to this article.

- **In Jul 22, the Eurozone manufacturing output contracted for the first time in over 2 years.** After posting 52.1 in Jun 22, July's figure of 49.8 signalled a deterioration of manufacturing conditions. With the exception of input inventories, all the Eurozone's sub-indicators dragged the overall index down. New orders fell sharply, as customer appetites were lowered by rampant inflation and high inventory levels. Buying activity of Eurozone manufacturers also declined for the first time in 2 years, and overall business sentiment turned negative after a long streak of optimism beginning in May 20. With production levels dropping in the major European economies of Germany, France, Italy, and Spain, this could herald the beginning of a steep downturn for manufacturers in the region.

- **Even still, the services PMI figures suggested that the services-dominated advanced economies may have avoided an outright contraction.** Despite falling from the previous

month, services PMI figures for the US, EU, and Japan all stayed expansionary. The index for Japan came in at 50.3 in Jul 22, down from 54.0 in Jun 22, while that for the Eurozone came in at 51.2 in Jul 22, down from 53.0 in Jun 22. As for the US, the ISM services PMI logged a strong 56.2 for Jul 22.

- **Manufacturing output in the US and Japan also expanded in July**. Japan's manufacturing PMI registered 52.1 in Jul 22, while the ISM manufacturing PMI for the US posted 52.8 in the same month. Of note would be the sharp increase in the imports indicator for the ISM index, which rose from 50.7 in Jun 22 to 54.4 in Jul 22. An increased appetite for imports might be a sign that US manufacturers are bringing in more raw materials from abroad in anticipation of an increase in production.

Outside China, emerging Asia remains largely insulated from economic headwinds

As the world grapples with inflation and a widespread weakening of demand, ASEAN manufacturers appear to be remarkably resilient. All 6 of the bloc's economies covered in the data registered PMI figures above 50.0 in Jul 22, indicating that the region's manufacturing sector is still expanding.

- **Thailand and Vietnam saw growth in new export orders for Jul 22,** in contrast to the clear global trend of declining foreign demand. This could be a positive sign that ASEAN's efforts to strengthen intra-bloc trade through initiatives like the Regional Comprehensive Economic Partnership are working. Unsurprisingly, both Thailand and Vietnam recorded expansionary PMI figures in Jul 22 at 52.4 and 51.2 respectively.

- **Total new orders also expanded across the bloc**, with the exception of the Philippines which saw a slight decline. Renewed client confidence was the most cited reason by ASEAN manufacturers for higher order book volumes. Domestic consumer confidence is also strengthening in large regional markets such as Indonesia as the pandemic abates, which helped to push the PMI of ASEAN's biggest economy up from 50.2 in Jun 22 to 51.3 in Jul 22.

- **Singapore's manufacturing sector recorded an impressive PMI reading of 58.0 in Jul 22,** inching up from an already eye catching 57.5 in Jun 22. The strong expansion can be attributed to an uptick in new orders, which occurred at the second-fastest pace on record. New export orders also rose sharply, possibly due to a growth in demand from key external markets like the US.

Global trade may be coming down, but Asia's resilience can be sustained by strengthening domestic demand, as pent-up savings from two years of the COVID-19 pandemic are unleashed in domestic markets.

- **Manufacturing conditions in both Taiwan and Korea deteriorated in July**. Taiwan's PMI fell sharply to 44.6 in Jul 22 following a slightly contractionary 49.8 in Jun 22. Korea's PMI also

entered contractionary territory, dropping from 51.3 in Jun 22 to 49.8 in Jul 22. The two Asian tigers are considered bellwethers of global trade, given the world's reliance on their semiconductors and other tech exports. Manufacturers in both countries witnessed accelerated declines in new export orders, which they attributed to reluctance among clients to build up inventories as international demand dampens due to inflation, the Ukraine war, and a slowdown in China.

- **Services PMI in July point to a recovery in Asia driven by domestic demand**, making up for the slowdown in external demand. Compared to manufactured goods, which are often bound for foreign export markets, most of the output from the services sector is consumed domestically. Services PMI data are thus useful as an inward-looking gauge of the strength of domestic demand. In Jul 22, China, India, and most of the G3 countries saw increases in new orders despite softening export demand, implying a substantial rise in domestic spending fuelled by excess savings that accumulated during the pandemic. Indeed, in countries like Korea, domestic private consumption expenditure as measured by final sales is now pulling up GDP growth for the first time since Jun 21.

- **Further evidence of a pick-up in domestic demand** can be found in India's manufacturing sector, where total new orders grew strongly despite a weak increase in export business. This helped India to post an impressive manufacturing PMI of 56.4 in Jul 22, higher than the already expansionary 53.9 reading it recorded in Jun 22. Output rose at the fastest pace in 8 months, buoyed by India's economic growth as well as a slight easing of inflationary pressures. And there are signs that Indian manufacturers will continue to perform strongly in the coming months: employment increased only marginally despite a sharp uptick in input buying, which points to ample slack in the manufacturing sector.

<u>China's refusal to budge from zero-COVID stance is hurting its economic recovery</u>

- **The outlook for China's manufacturing has turned gloomy.** The official NBS manufacturing PMI showed a contraction underway in Jul 22, with the index at 49.0 after posting 50.2 in Jun 22. The private sector-oriented Caixin manufacturing PMI was also only slightly expansionary at 50.4, down from 51.7 a month earlier. Contractions in the oil, coal, and metal smelting industries weighed heavily on China's manufacturing sector, as worldwide recession fears dampened export demand and led to a fall in new orders. The confidence of Chinese consumers has also been shaken by an ongoing property crisis, as well as worries that COVID-19 lockdowns that crippled Beijing and Shanghai earlier in 2022 could be imposed in other cities like Shenzhen and Tianjin, where virus cases are spiking.

- **That said, China's services sector continued to expand in July.** The services PMI for Jul 22 stood at 55.5, up from 54.6 in Jun 22. Total new orders rose at the fastest pace since Oct 21 despite weakening export work, as domestic demand rebounded strongly following the easing of COVID-19 restrictions in various parts of China. Optimism about supportive state

policies and sustained recovery from the pandemic also led to business sentiment being at its most positive since Nov 21.

Input price inflation and supply chain disruptions remain thorns in the global economy

- **Input lead times continue to lengthen for all but two of the economies covered**, a sign that supply chain disruptions have not yet resolved. From S&P Global reports, many firms complained that vendor performance had been impeded by stock shortages and COVID-19 disruptions as employees fall ill, which increased the time taken for supplies to be delivered. India and Indonesia were the only economies to experience reduced lead times, albeit marginal ones.

- **The majority of economies recorded further increases in input costs in Jul 22,** in both the manufacturing and services sectors. Higher staff expenditures were frequently cited as the main driver of rising input charges, suggesting a tight labour market where firms seeking to ramp up production still struggle to hire. The only country that registered a decline in input charges in Jul 22 was China, where the SOE-dominant NBS data showed a sharp drop in production costs. Even still, small, private Chinese firms experienced a slight uptick in input prices, as indicated by the Caixin index.

- **However, there are signs that inflationary pressures may be easing,** as increases in input costs have decelerated for most of the economies covered. This comes as prices of raw materials and commodities begin to cool somewhat from their peaks in 1H22. Oil prices have come down with an expected fall in global demand, with the Brent crude now trading some 20% lower than its Mar 22 highs.

- **Even so, further tightening of monetary policy is expected**, with central banks set to continue increasing interest rates in the coming months to bring down still-elevated price levels. The US Fed is likely to raise its rates by at least 50 bps at its FOMC meeting in Sep 22 after a 75 bps in Jul 22, while the Bank of England implemented its sharpest rate hike in 27 years on 5 Aug 22 as it increased interest rates by 50 bps to 1.75%. In Southeast Asia, the Bank of Thailand is widely expected to raise rates in its upcoming meeting on 10 Aug 22 as well, having kept them relatively low since May 20 as demand was hit hard by the pandemic.

- **Nevertheless, the build-up of excess savings by consumers during the pandemic will provide a sufficient buffer** and a second wind for economic growth. This is especially the case for Asia, which lagged behind the West in its post-pandemic reopening and are only now just starting to ease virus curbs, which should pave the way for a resurgence in domestic consumption expenditures.

The bottom line: emerging Asian economies are likely to demonstrate significant resilience even as global headwinds grow.

Annex: Summary of PMI measures

	Manufacturing PMI		New Orders	New Export Orders	Employment	Business Expectations
	Headline	Imports				
US (ISM)	52.8 (53.0)	54.4 (50.7)	Down at faster pace	Up at a faster pace	Down, but softer decline than Jun 22	Positive, but less optimistic
US (IHS)	52.2 (52.7)		Down at a faster pace	Down at sharpest rate since May 20	Up, but weakest increase in 6 months	Negative, most pessimistic since Oct 20
EU	49.8 (52.1)		Down sharply	Down, sharper decline than Jun 22	Up, but softest increase in 1.5 years	Negative, pessimistic for first time since May 20
Japan	52.1 (52.7)		Down, sharpest decline since Nov 20	Down modestly, softest decline in 5 months	Up, but slowest increase since Apr 22	Positive, optimism unchanged from Jun 22
China (NBS)	49.0 (50.2)		Down anew	Down at a faster pace	Down, sharper decline than Jun 22	Positive, but less optimistic than Jun 22
China (Caixin)	50.4 (51.7)		Up, but increase was soft	Up marginally	Down for 4th straight month	Positive, but less optimistic than Jun 22
Hong Kong	52.3 (52.4)		Up for 4th straight month	Down for 2nd straight month	Down anew	Positive, optimism returned in Jul 22
	IHS	SIPMM				
Singapore	58.0 (57.5)	50.1 (50.3)	Up strongly, second sharpest increase on record	Up at a faster pace	Down for 2nd straight month	Positive, but significantly less optimistic than Jun 22
Philippines	50.8 (53.8)		Down modestly	Down for 5th straight month, but decline was soft	Up for 3rd straight month	Positive, confidence highest in 7 months though still below average
Taiwan	44.6 (49.8)		Down sharply, steepest decline since May 20	Down sharply, sharpest decline in 2 years	Up marginally, slowest rise in 3 months	Negative, most pessimistic in 2 years
India	56.4 (53.9)		Up strongly, sharpest increase since Nov 21	Up moderately, weakest increase in 4 months	Up marginally	Negative, up slightly from 27-month low in Jun 22
Indonesia	51.3 (50.2)		Up modestly, faster increase than Jun 22	Down, sharpest decline since Aug 21	Up strongly, fastest increase on record	Positive, optimism strengthened
Malaysia	50.6 (50.4)		Up marginally, but strongest increase since Apr 22	Down for first time since Mar 22, sharpest decline in 10 months	Down marginally for 6th straight month	Positive, optimism highest since Feb 22
Thailand	52.4 (50.7)		Up fractionally	Up from Jun 22	Down modestly	Positive, optimism among strongest on record
Vietnam	51.2 (54.0)		Up, but weakest increase since Apr 22	Up solidly	Up solidly, but slower increase than Jun 22	Positive
Korea	49.8 (51.3)		Down for first time in 2 years, but only fractionally	Down, quickest decline in 3 months	Down moderately, but strongest decline in 22 months	Positive, but weakest optimism since Oct 21

Source: IHS Markit, ISM, SIPMM, NBS, Centennial Asia Advisors; Note: Figures in parentheses refer to Jun 22 PMI

	Manufacturing PMI		Input charge	Output charge	Input lead time	Input Inventory	Input buying	Business Expectations
	Headline	Imports						
US (ISM)	52.8 (53.0)	54.4 (50.7)	Up, but increase eased sharply		Up, at record-highs	Up at a faster pace		Positive, but less optimistic
US (IHS)	52.2 (52.7)		Up markedly, but softest increase since Mar 21	Up strongly, but softest increase since Feb 21	Up strongly, but least marked increase since Nov 20	Up fractionally	Up from Jun 22	Pessimistic, expectations lowest since Oct 20
EU	49.8 (52.1)		Up, but slowest increase in 17 months	Up, but slowest increase in 15 months	Up sharply, but slowest increase since Oct 20	Up at faster pace	Down, first decline in 2 years	Negative, pessimistic for first time since May 20
Japan	52.1 (52.7)		Up, 6th sharpest rise ever	Up, but softer rise than June	Up markedly	Up strongly, 2nd sharpest rise ever	Up strongly	Positive, optimism unchanged from June
China (NBS)	49.0 (50.2)		Down sharply	Down, sharper decline than Jun 22	Up fractionally, softer increase than Jun 22	Down at a faster pace	Down anew	Positive, but less optimistic than Jun 22
China (Caixin)	50.4 (51.7)		Up, but slowest rise in 7 months	Down modestly	Up slightly from Jun 22	Up mildly, but rate of increase fastest in 20 months	Up for 2nd straight month	Positive, but less optimistic than Jun 22
Hong Kong	52.3 (52.4)		Up at a faster pace	Up, but softest increase in 5 months	Up for 15th straight month	Up solidly	Up solidly	Positive, optimism returned in Jul 22
Singapore	IHS	SIPMM	Up sharply, pace of increase among highest on record	Up, second sharpest increase on record	Up at a faster pace	Up solidly	Up at a faster pace	Positive, but significantly less optimistic than Jun 22
	58.0 (57.5)	50.1 (50.3)						
Philippines	50.8 (53.8)		Up, sharpest increase in 3 months	Up, third-sharpest increase on record	Up, longest in 4 months	Up, but rate of increase slowest since Oct 21	Up, but only fractionally	Positive, confidence highest in 7 months though still below average
Taiwan	44.6 (49.8)		Up, but slowest increase in 23 months	Up, but slowest increase since Oct 20	Up solidly, but slowest increase in 2 years	Down solidly	Down, sharpest decline since May 20	Negative, most pessimistic in 2 years
India	56.4 (53.9)		Up, but rate of inflation slowest in 11 months	Up softly, slowest increase in 4 months	Down for 2nd straight month, though only marginally	Up, rate of increase among sharpest on record	Up strongly	Negative, up slightly from 27-month low in Jun 22

	Manufacturing PMI	Input charge	Output charge	Input lead time	Input Inventory	Input buying	Business Expectations
Indonesia	51.3 (50.2)	Up markedly, slowest increase in a year	Up, but slowest increase in a year	Down slightly	Down slightly	Up solidly, fastest increase since Jan 22	Positive, optimism strengthened
Malaysia	50.6 (50.4)	Up, but softest increase in 10 months	Up, but softest increase since Feb	Up solidly, but increase was softer than average	Unchanged	Up for first time in 3 months	Positive, optimism highest since Feb 22
Thailand	52.4 (50.7)	Up, sharpest rise ever	Up, 2nd-sharpest rise ever	Up for 3rd straight months	Up modestly	Up solidly	Strongest optimism ever
Vietnam	51.2 (54.0)	Weakest rise since Oct 20, > average	Up modestly	Up, but weakest increase in 22 months	Down, sharpest decline in over a year	Up strongly	Positive
Korea	49.8 (51.3)	Up, softest increase in 4 months	Up, softer rise than June	Up, 2nd softest rise in a year	Up for fourth time in 5 months	Up, highest increase in 3 months	Positive, weakest since Oct 21

Source: IHS Markit, ISM, SIPMM, NBS, Centennial Asia Advisors; Note: Figures in parentheses refer to Jun 22 PMI

	Services PMI		New Orders	New Export Orders	Employment	Input charge	Output charge	Business Expectations
	Headline	Imports						
US (ISM)	56.7 (55.3)	48.0 (46.3)	Up sharply	Up at a faster pace	Down slightly, pace of decline eased	Up sharply, but increase softened from Jun 22		
US (IHS)	47.3 (52.7)		Up anew, but only slightly	Down, second sharpest decline since Dec 20	Up, but at slowest pace since Jan 20	Up markedly, but slowest pace in 5 months	Up strongly, slowest rise since Mar 21	Positive, but weakened to lowest since Sep 20
EU	51.2 (53.0)		Down for first time since Apr 21	Down at sharpest pace since Mar 21	Up, but at softest rate in 5 months	Up, but at a softer pace	Up, but at a softer pace	Positive, but weakened to 21-month low
Japan	50.3 (54.0)		Up marginally, slowest increase in 3 months	Down slightly	Up for 6th straight month	Up markedly at second sharpest pace on record	Up modestly	Positive, eased from Jun 22 but still strong
China (Caixin)	55.5 (54.5)		Up strongly, sharpest increase since Oct 21	Down for 7th straight month	Down modestly	Up moderately, but at a faster pace	Up marginally	Positive, improved to strongest since Nov 21
India	55.5 (59.2)		Up markedly, slowest riseincrease in 4 months	Down markedly, but slowest decline in 6 months	Up fractionally	Up sharply, but slowest increase in 5 months	Up solidly	Negative, largely unchanged

Source: IHS Markit, ISM, SIPMM, NBS, Centennial Asia Advisors; Note: Figures in parentheses refer to Jun 22 PMI

Singapore: In a good place cyclically, but structural challenges lie ahead

As Singapore gets ready to celebrate its 57th year of existence, it is in good shape to weather the near-term challenges that have grown. In the long run, however, there are multiple structural issues that the economy will have to grapple with – such as weak productivity growth, external imbalances, and high and rising real estate prices. Some of these issues were raised by the International Monetary Fund (IMF) in its recently released 2022 Article IV report for Singapore.

1. A bright short-term outlook despite growing headwinds

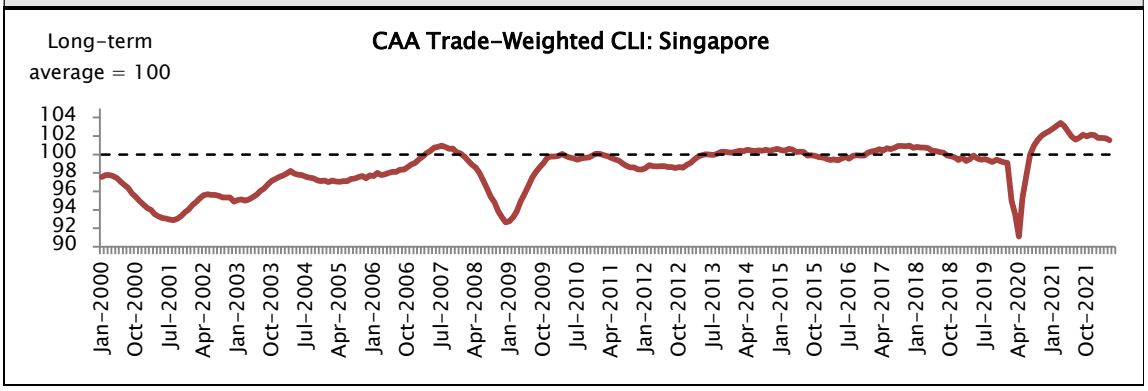
The Singapore economy's strong recovery from the pandemic demonstrates its resilience

After contracting by a sharp 4.1% in 2020, the first year of the pandemic, Singapore's economy rebounded to grow by 7.6% in 2021, driven by a recovery in both domestic demand and net exports. This momentum continued into 2022, as real GDP grew 4.0% y/y in 1Q22 and 4.8% y/y in 2Q22. As a result, overall activity had already exceeded pre-pandemic levels by 3Q21, and with growth likely to be above trend, an output gap (actual output exceeding potential output) of +0.6% of GDP is likely by end-2022.

While headwinds to growth have appeared, the near-term outlook remains bright.

The main headwind for Singapore is a slowdown in external demand. An energy price shock has hurt consumer and investment demand across the globe. Inflation has also accelerated faster than expected, compelling an aggressive monetary policy tightening in advanced economies which will also cool economic activity in Singapore's key markets. Moreover, economic growth in China is slowing. Not surprisingly, sequential growth in the externally oriented sectors of manufacturing and wholesale trade weakened significantly in 2Q22, dragging overall sequential GDP growth down to +0.0% q/q sa in 2Q22.

Chart 1



Sources: OECD, Centennial Asia Advisors

Our CAA Trade-Weighted Composite Leading Index (CLI, in Chart 1 above) also shows weakening external demand for Singapore's exports. This index takes the weighted average of the CLIs of an economy's top export markets. When the index trends downwards, it shows overall economic activity in key export markets slowing down, which translates to weaker external demand for an economy's exports. This is currently the case for Singapore.

Despite growing headwinds, our view is that the Singapore economy will continue to grow strongly in the near-term on account of multiple growth drivers.

- **Post-covid economic reopening will boost output in sectors that are still operating below pre-Covid levels**: For example, the transportation & storage sector has ample room for growth as Changi Airport passenger traffic still stands at 50% of pre-covid levels as of Jul 22. The construction & offshore marine sectors that rely heavily on migrant workers are poised to grow further as non-resident employment remains 10% below pre-covid levels as of 2Q22.

- **The pipeline of investment commitments will keep fixed investment sustained through end-2023**. Since 2020, the Economic Development Board (EDB) has secured a total of SGD29bn in fixed asset investment commitments which are being implemented now. The 900ha land reclamation project off Changi Bay, Marina Bay Sands' SGD4.5bn investment to expand its integrated resort, Genting Singapore's SGD4.5bn investment to revamp Resorts World Sentosa, and the ramping up of government land sales for residential construction will also drive investment growth for the next few years.

- **Tight labour market drives consumption as real wages rise**: Nominal resident wage growth reached +7.8% y/y in 1Q22 and the overall unemployment rate was at a low of 2.1% in 2Q22.

- **Singapore (SG) benefits from activity relocating from Hong Kong (HK)**: Company announcements point to this trend taking place, especially in banking and finance. HSBC is starting its new wealth management unit in Singapore, Societe Generale is temporarily moving at least a dozen of its traders from HK to SG, and the Bank of America is exploring moving part of its HK staff to SG.

- **The finance industry is a bright spot for the economy**: the finance industry is poised to grow strongly with the introduction of the Variable Capital Company (VCC) legal structure. The VCC is a new corporate structure for investment funds that allows for greater flexibility, and it has been attracting streams of wealth managers, family offices, and debut funds to Singapore. From its launch in Jan 2020 up till Jun 21, over 300 VCCs have been incorporated in Singapore.

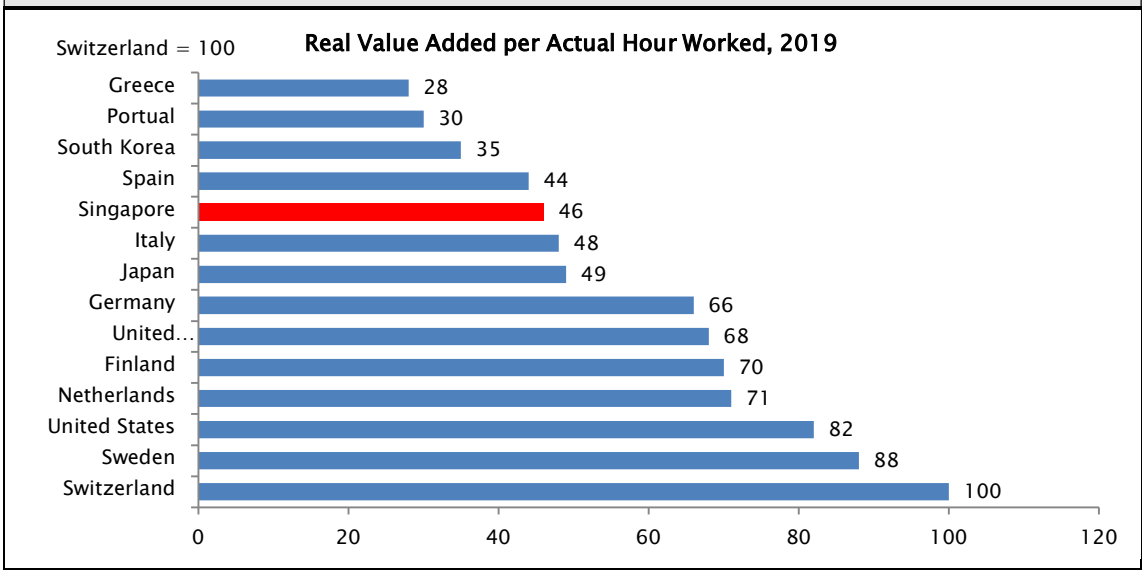
Confident of Singapore's short term growth prospects, we forecast 4.0% GDP growth in 2022 and 3.5% GDP growth in 2023. Despite growing headwinds, Singapore's short term growth outlook remains bright. Consequently, Singapore's larger concerns have to do with its long-term structural challenges.

2. The first structural challenge: a continual struggle with weak productivity

Weak productivity has been a long-standing challenge for Singapore. From 1999-2009, the compounded annual growth rate (CAGR) of real value-added per worker (real VA per worker) was a mere 1.4% per annum. This led the Economic Strategies Committee in 2010 to adopt an ambitious productivity growth target of 2-3% per annum for the period of 2009-2019. A decade later, this ambitious goal seems to have been met. Between 2009 and 2019, real VA per worker grew at a CAGR of 2.4% per annum and real value-added per actual hour worked (real VA per AHW) grew at a CAGR of 2.8%[1]. However, if we dig below the surface, we will find that Singapore continues to have a productivity problem.

First, in terms of absolute levels of productivity, Singapore still lags behind its peers. With the level of productivity in Switzerland as a benchmark, absolute productivity in Singapore as of 2019 is still a mere 46% of that in Switzerland and 36% lower than that of the United States (Chart 2).

Chart 2



Sources: Ministry of Trade and Industry

Second, Singapore still fares poorly in the type of productivity growth that matters more. Productivity growth can be driven in three ways - an increase in the quantity of capital (machinery, equipment, intellectual property, infrastructure) used by each unit of labour for production;

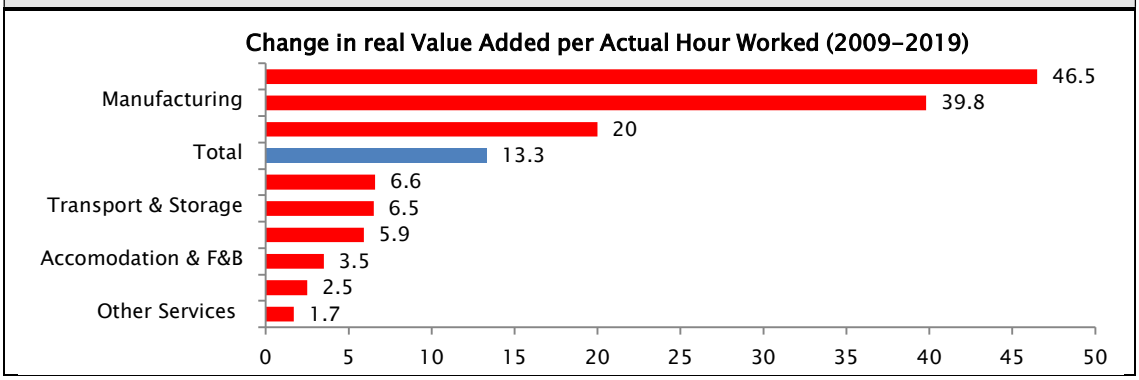
[1] There are two main measures of productivity growth - real value-added per actual hour (real VA per AHW) worked or the real value-added per worker (real VA per worker). Of the two measures, VA per AHW is recognised internationally, including by the International Labour Organisation, to be a better measure of labour productivity because actual hours worked capture the intensity of labour input more accurately. In Singapore's context, this measure has also become more relevant in recent years with the rising share of part-time workers in the economy, and cyclical changes in the number of hours worked by full-time workers. (MTI, 2020).

improvements to labour quality; and improvements to total factor productivity (TFP). TFP refers to intangible factors such as technology, managerial skills, and organisational efficiency. All three drivers of growth are important, but labour quality and TFP matter more for long-run productivity growth. There will come a point in time where additional capital can no longer be accumulated and diminishing marginal returns set in. It is also important that productivity in the economy is being driven by genuine improvements in innovation and efficiency rather than a reliance on capital accumulation.

Singapore has not been faring well in this regard. From 2009 – 2019, capital accumulation was the main driver of productivity growth. While capital accumulation contributed an average of 2.2% to overall productivity growth per annum in the period, labour quality and TFP contributed a mere 0.2% and 0.6% to productivity growth respectively.

Third, productivity gains have been concentrated in a few sectors. Productivity gains have been the sharpest in the finance & insurance, wholesale & retail trade, and manufacturing industries, while the services sectors have fallen behind. Productivity growth is the weakest in the construction, accommodation, and F&B sectors, where large numbers of foreign labour are employed. This means that contrary to what the headline productivity growth figures suggest, a large part of the economy may still be struggling with weak productivity growth (Chart 3).

Chart 3



Sources: CEIC, Centennial Asia Advisors

As digitalisation efforts grow, it will not be difficult for the economy to notch productivity gains through capital deepening and higher technology. While these gains are not to be discredited, what is more important is that labour quality and total factor productivity grows as well. These intangible factors will be the biggest challenge for Singapore in its efforts to raise productivity.

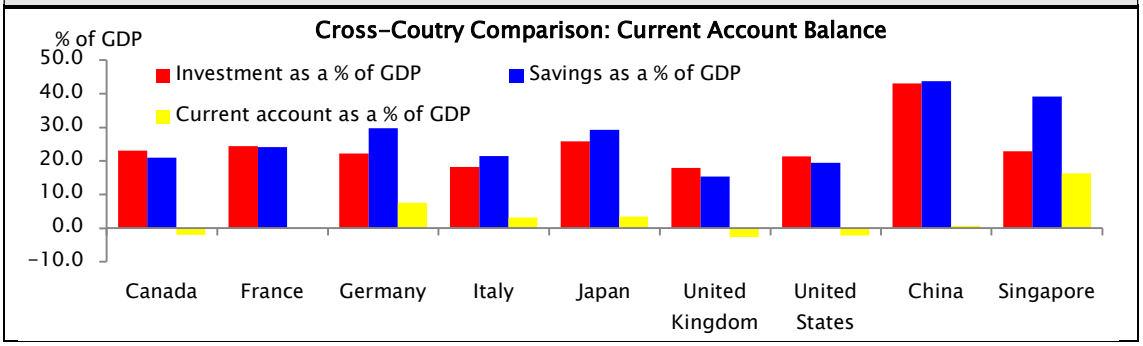
We think that only fundamental changes will be able to bring about material improvements in the level of innovation and efficiency in the economy. For example, a greater degree of competition may have to be introduced to the economy to spur efficiency, but this will require addressing the dominance of GLCs in the economy; there may to be a change in working culture where individuals feel a greater sense of ownership over their work and their company; social safety

nets may have to be strengthened to encourage greater risk-taking; and the educational system may have to be re-looked at. Such changes go beyond policy programmes and grants; they will not be easy and will require an immense exertion of political will.

3. The second structural challenge: imbalances resulting from the current account

The Singapore economy has a second set of structural problems that are revealed by the current account balance. Singapore's current account balance as a percentage of GDP is much higher than that of the G7 economies and China. While the current account balance in those economies hovers between -3 – 8% of GDP, Singapore's current account balance comes in at a whopping 16.3% of GDP in 2019 (Chart 4) (we use 2019 as a guide to do away with distortions from the pandemic). The level of the current account balance is neither objectively good nor bad, but it reveals aspects of the economy that could be either. For Singapore, the current account balance reveals several shortcomings of the economy.

Chart 4



Source: World Economic Outlook Database, Centennial Asia Advisors

First, the economy may be relying too much on external demand to drive growth. This entails an economy that is more vulnerable to global volatilities, the risk of which is even more pronounced now as the possibility of "slowbalisation" surfaces and rising geopolitical tensions threatens global bifurcation.

Second, the economy's external position may be substantially stronger than warranted by fundamentals. This is the case when an undervalued exchange rate boosts the value of the current account balance, and it was suggested by the IMF in its 2022 article IV report for Singapore. The IMF assessed that Singapore's real effective exchange rate was undervalued by 6.8%-14.0% in 2021. This leaves Singapore vulnerable to international accusations of currency manipulation (Singapore remains on the US' currency manipulation watch list as of 2021) and protectionist measures. It could also entail an inefficient allocation of resources, as resources are being channelled to the export sector not because of free market forces but due to a distortion of the exchange rate.

Third, the current account balance reflects an excessive level of savings. Mathematically, the current account balance equals to the difference between the level of savings and investment in the economy. When the current account is in surplus, savings is greater than investment. Vice-versa, when the current account is in deficit, investment is greater than savings. Singapore's sizeable current account surplus is brought about by a much higher level of savings rather than by a lower level of investment. As can be seen from Chart 4, Singapore's investment share of GDP is on par with peer countries while its savings as a % of GDP is significantly higher than peer countries. This level of savings may not be optimal for the economy.

Household savings, corporate savings (profits) and government savings all contribute to the level of savings in Singapore. The Department of Statistics does not provide detailed data for each component, but related statistics point to their magnitude. Household consumption in Singapore accounts for 35% of GDP, as compared 55-70% in other middle- and high-income countries, indicating a high degree of household saving. The profit share of GDP is extremely high by international standards at nearly 50%. The level of "net investment returns contribution" (NIRC) in the annual fiscal budgets suggests a high level of government savings as the NIRC likely only represents a proportion of the investment income earned by the government every year.

We highlight two ways in which the current levels of savings may be suboptimal. First, it may be taking away from domestic demand, rendering the economy more vulnerable to external shocks than it should be. Second, there may be excessive fiscal conservatism, where not enough is being spent on the issues that matter, such as tackling inequality or providing greater social support. Here, it is often argued that Singapore is more efficient in its fiscal spending, where it is able to spend less for better outcomes. Spending in education and healthcare are oft-cited examples. However, data published by the International Labour Organisation begs to differ (Table 1). Singapore falls far behind peer countries in spending on social protection (excluding health). The definition of social protection differs by country, but it generally refers to the redistribution of resources for the following groups of people in society: children, mothers with new-borns, persons with severe disabilities, workers in case of work injury, the unemployed, and older persons. As such, there may be valid reasons to believe that Singapore has accumulated more savings that it needs.

Table 1: Expenditure on social protection (excluding health) as a % of GDP (2020)

Country/Territory	Total Expenditure	Expenditure by demographic group		
		Children	Working-age population	Old age
Singapore	**1.0**	**0.4**	**1.3**	**3.8**
Canada	8.3	2.3	4.5	2.9
France	23.9	2.2	9.6	14.8
Germany	19.4	1.7	9.1	11.3
Italy	20.9	1.0	6.2	16.0
Japan	16.1	1.9	2.9	12.4
United Kingdom	15.1	1.3	7.5	8.4
United States	18.9	0.6	2.6	7.1

Norway	19.1	3.4	13.3	7.3
Denmark	22.2	4.4	15.9	8.3
New Zealand	11.5	2.5	4.2	4.8
High-income countries	16.4	1.2	4.8	8.5

Source: International Labour Organization: World Social Protection Report 2020-22.

4. The third structural challenge: a divergence of housing prices from fundamentals

Housing prices increases have exceeded pre-Covid trends for private residential home prices and rentals as well as resale flat prices (Chart 5). Construction delays for public housing projects pushed first-time home buyers into the resale and private residential property markets. Low real interest rates, strong foreign demand, and an increase in single person households pushed up demand. However, with property ownership rates in Singapore at 90%, much of property demand can be attributed to non-resident demand and resident search for yield activity.

Chart 5

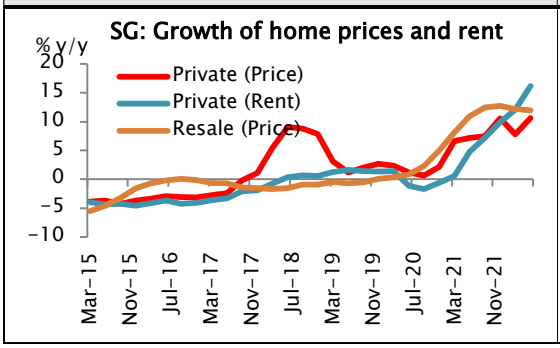
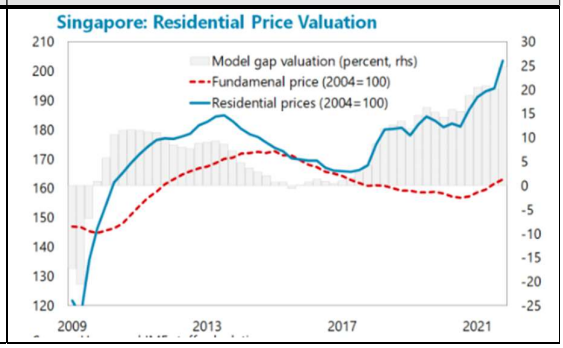


Chart 6



Source: CEIC, IMF 2022 Article IV (Singapore)

High and rising property prices is the third structural issue Singapore will have to grapple with. To quote the IMF, "the private residential housing market runs the risk of diverging further from fundamentals". Chart 6 shows the gap between fundamental and current real estate prices as determined by the IMF. Housing prices out of line with fundamentals threatens sharp price corrections later on. More insidiously, however, real estate price growth that outpaces income growth will sap consumer demand, cause already high household savings to accumulate further, negatively impact fertility rates, and feed into the high-cost structure in Singapore.

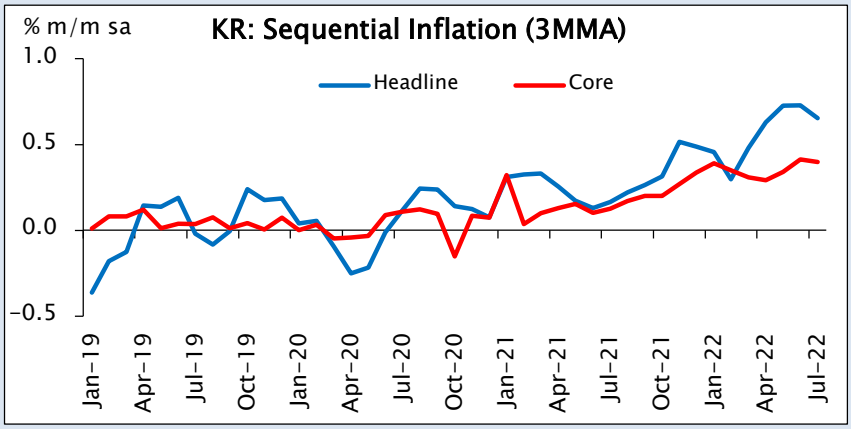
Conclusion

Cyclically, Singapore is in a strong position, it is its structural shortcomings which need policy attention, which seems to be slow in coming. It is important for Singapore to address these issues now, because as the global macroeconomic environment becomes more turbulent, Singapore may no longer be able to rely on the external sector for growth.

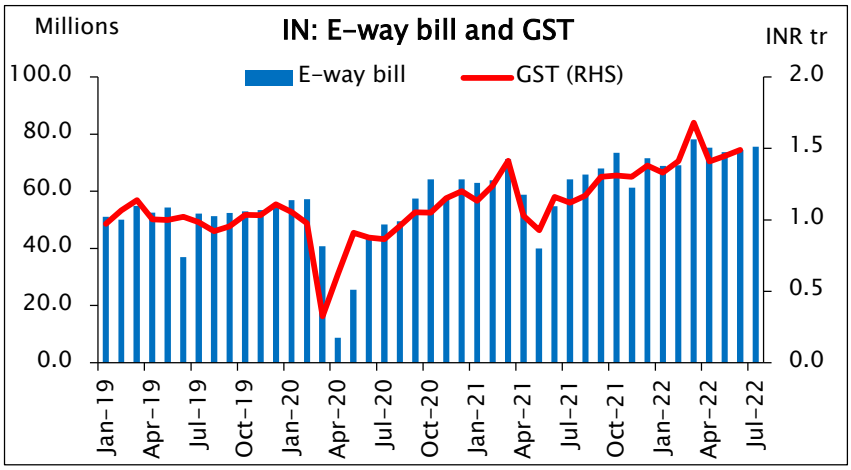
Key Drivers of Asian Economies

Variable	Development/Assessment
Asian economies:	
US-China ties: now what?	We were wrong in our call last week that the visit to Taiwan by US House Speaker Pelosi would not go ahead. Our view now is that the region's risk profile has deteriorated as a result of this visit and China's hyper-active reaction to it in the following ways: <u>The Pelosi visit was long on symbolism but short on substance or strategy</u> ▪ America's Taiwan policy is made by the executive branch, not by Congress. So, Pelosi's strong backing for Taiwan and her assertion in Japan that the US will ensure that China would not isolate Taiwan does not guarantee that the executive branch will carry out Taiwan strategy in line with her assurances. And Taiwan also knows that the US itself does not have the power to prevent China's retaliatory economic, diplomatic and military measures from hurting Taiwan. ▪ Nevertheless, Taiwan's nationalists will be heartened by the visit. China's angry reaction will not deter America or Japan's support for Taiwan in a military emergency – if anything it might strengthen their will to stand up to China. <u>China's retaliation does change the picture in substantive ways</u> ▪ **Taiwan will feel more insecure now:** China has seized on the Pelosi visit to create new realities in the Taiwan theatre of operations. Where before it was careful not to let its military aircraft cross the median line between the mainland and Taiwan island, that line has now been crossed. Similarly, Chinese naval vessels have sailed close to the Taiwan's coast. Chinese missiles were sent flying over Taiwan as well. The nature of China's military drills around Taiwan in the past few days indicated that China was testing out means of blockading Taiwan in future. There is a good likelihood that China will carry out more such military exercises in future, as a way of intimidating Taiwan and stretching its limited military resources. Taiwan is likely to invest more heavily in its defence – the flurry of Chinese intrusions have exposed its shortage of pilots among other failings. ▪ **US-China dialogue and relations set back:** China has called off bilateral talks on military matters and suspended cooperation with the US on matters relating to climate change, repatriation of illegal immigrants, drug trafficking and other crimes. Chinese Foreign Minister Wang Yi walked out of an ASEAN meeting twice, when the US and Japanese foreign ministers were scheduled to speak. The US administration summoned the Chinese Ambassador in the US to criticise China's "over-reaction" as the US described it, only to receive a harsh pushback from China. There is now little possibility that Presidents Biden and Xi will meet in November as we had thought possible last week. The

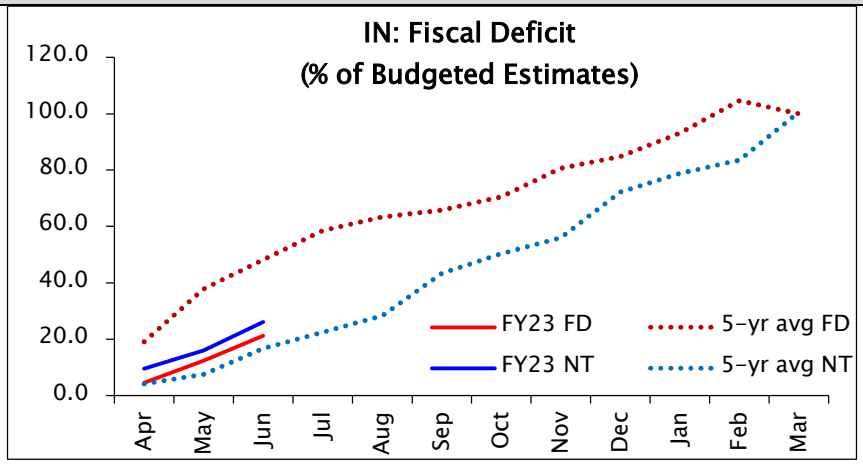
Variable	Development/Assessment
	Chinese response has angered the American political class – Congress may well pass more laws targeting Chinese interests, if only to show China that the US will not be cowed by its show of force. ▪ **China's ties with Japan also hurt:** China has chosen to hit at Japan as well for backing the US, through Japanese Prime Minister Kishida's meeting with Pelosi and Japan's participation in a G7 communique referring to the Taiwan question. Some of the missiles China fired over Taiwan landed in Japan's exclusive economic zone, something which would have alarmed the Japanese. China's Foreign Minister Wang Yi cancelled a scheduled meeting with his Japanese counterpart, Yoshimasa Hayashi, which would have been the first such meeting in two years. At the ASEAN Foreign Ministers Meeting, Wang used harsh words to attack Japan and was reported to have raised his voice when addressing Hayashi. Far from being intimidated by China into being more sensitive to China's wishes in future, these moves are likely to push Japan even more firmly into working closely with the US to protect itself. <u>Big power contestation in the Indo-Pacific region to intensify</u> ▪ With the stakes now higher, the US and China will ramp up their efforts to woo allies in the region. ▪ US Secretary of State Antony Blinken was in the Philippines this past week where he pledged America's commitment to the 1951 Mutual Defense Treaty. After a period of awkwardness under the anti-American President Duterte, the new President, Marcos Jr, appears more open to closer ties with the US. The two countries are even exploring the possibility of conducting joint sea patrols, stepping up mutual training exercises and American assistance in modernizing the Philippines armed forces. ▪ The US will also step up efforts to secure a stronger commitment by India to cooperate in military and strategic affairs. Although India has tried to avoid too close an affiliation with US-backed alliances against China, it is getting more nervous about China. Several rounds of talks have failed to to resolve border frictions which led to the bloody clash in 2020 between soldiers of both sides. In the meantime, China has accelerated construction of military infrastructure, which India has struggled to match. Both countries are also competing for influence in Sri Lanka – a planned visit there by a Chinese naval vessel has aroused Indian suspicions. In other words, we are likely to see an action-reaction cycle of retaliations causing more frictions between the US and China. With military exchanges between the two suspended, there is a higher risk of accidental clashes.

Variable	Development/Assessment
	The countries in the Indo-Pacific region will be wooed as well as pressured by the big powers to take sides.
Asian economies:	
South Korea: Early indications that inflation will peak soon	▪ **Manufacturing PMI showed contraction in July (49.8) (June: 51.3)**. New orders declined for the first time in close to two years as demand was curtailed by supply issues. The contraction in new export orders accelerated to the quickest rate in 3 months, however. Input inflation moderated to a 4-month low, and output charge inflation, while marked, moderated as well. There was moderate job shedding, which was the strongest in 22 months. But, business sentiment is still in the black amid hopes that inflation and supply shortages will ease. ▪ **Export growth picked up in July (+9.4%) (June: +5.2%)**. Autos (+25.3%), petroleum products (+86.5%) and steel products (+5.2%) were the main outperformers, whereas semiconductors (+2.1%), general machineries (-2.9%) and petrochemicals (-1.7%) were the laggards. By destination, exports to Europe (+14.6%) and the US (+14.6%) more than offset the weakness in shipments to China (-2.5%) and Japan (-1.4%). Import growth remains buoyant, however (+21.8%), reflecting domestic demand in fine fettle. The trade deficit almost doubled to USD4.7bn, from USD2.6bn in June. ▪ **Headline inflation edged up to 6.3% y/y in July** (June: +6.0%) <u>but there are signs that the worst may be over, as core inflation was unchanged at +3.9%.</u> Piling upward pressure on prices were food (+8.1%), accommodation (+6.2%), transport (+15.3%) and restaurants (+8.3%) while other components were broadly steady - clothing (+3.2%), household equipment (+5.1%), communication (+1.0%), recreation (+3.1%) and education (+1.5%). Sequentially, headline inflation is up 0.5% m/m sa in July - the slowest in 5 months, with the core figure exhibiting a similar trend (+0.3%) (see Chart below).  Source: CEIC

Variable	Development/Assessment
	Assessment: Nascent indications that peak inflation is in sight ▪ **Headwinds to external demand:** All indications point to slowing external demand, compounded further by China's never-ending struggle to tamp down Covid-19 caseloads as well as the deceleration in the tech sector and semiconductors following two blockbuster years of growth. While import demand in advanced economies have held up, the expeditious pace of monetary tightening in the US and Europe is likely to curtail demand in the foreseeable future. ▪ On the domestic front, the robust labour market – the unemployment rate is inching up in tandem with the labour force participation rate – will underpin wage growth and household spending, although the economy is highly unlikely to continue growing in excess of 3% which is suggestive of excess demand and overheating. <u>We are still cautiously optimistic on the growth in 2H22</u>, particularly as households, aided by a tight labour market, use up their excess savings to sustain spending. ▪ **CPI inflation nears its peak:** The figures for sequential inflation suggest price pressures are close to peaking. Some of the weakness in the global economy, evinced by easing commodity prices, falling freight rates from lower import volumes and the protracted slowdown in China, will percolate through to Korea via the trade channel. ▪ While the rate of growth in prices is slowing, <u>we expect the central bank to err on the side of caution and to hike rates in the August review, albeit in increments of 25bps</u>, as opposed to the unprecedented jumbo 50bps hike in July. Terminal rates are likely to end up at around 2.5%-2.75%, depending on the trajectory of inflation moving into 4Q22.
India: Rice output could disappoint	<u>Activity indicators are sprightly</u> ▪ **Manufacturing PMI surged to 56.4 in July**, an 8-month high (June: 53.9). New orders rose at the fastest rate since Nov 21, but there was a slowdown in export orders, which were up at a moderate pace and the weakest in 4 months. Input cost inflation eased to an 11-month low, as did factory gate inflation to a 4-month low. Job creation was subdued however as 98% of firms opted to leave workforce numbers unchanged. Business sentiment improved from June's 27-month low, but remains muted: 96% of manufacturers expect no change in output. ▪ **Services PMI eased to a still-robust 55.5 in July** (June: 59.2). New orders grew markedly but the rate of growth was the slowest in 4 months amid favourable demand conditions, fervent competition and poor weather. Export sales decreased sharply, albeit at the weakest rate in 6 months. Input cost inflation remains salient, and firms passed on the cost increases to clients, as output charges jumped for the 17th successive month. There was a negligible and fractional increase in services sector

Variable	Development/Assessment
	employment. Business sentiment was subdued, with 94% of firms expecting no change in business activity moving forward. ▪ **GST revenues edged up to a 3-month high in June (INR1.49tr)** (May: INR1.35tr). GST revenues were up 39.5% y/y in 2Q22, accelerating from 1Q22 (+16.8%), boosted by rising prices. But e-way bill generation was also sprightly, coming in at a 4-month high in July (75.6 million) (June: 74.5 million), suggesting the recovery is in good shape.  Source: CEIC <u>Policy tightening by both the RBI and the government continues</u> ▪ **The RBI raised the benchmark rate by 50bps** in the 5th August MPC meeting. Citing the softening oil and vegetable oil prices, and assuming a normal monsoon season, the RBI retained its inflation projection at 6.7% in FY23 but it tweaked its quarterly forecast with 3Q22 at 7.1% (previously 7.4%), 4Q22 at 6.4% (previously 6.2%) and 1Q22 unchanged at 5.8% as it does not expect inflation to fall below 6% before 1Q23. The growth forecast was unchanged at 7.2% for FY23, with 16.2% in 2Q22, 6.2% in 3Q22, 4.1% in 4Q22 and 4.0% at 1Q23. The policy statement was largely hawkish, as the central bank warned of "destabilising inflation expectations" and reiterated the need for more tightening to "contain inflationary pressures". The RBI also implied that policy rates have yet to hit neutral territory, citing its focus on the "withdrawal of accommodation". ▪ **The fiscal deficit came in at 21.2% of Budget Estimates in June** (May: 12.3%). Expenditures stood at 24.0% of BE (May: 14.8%), led by both revenue expenditures (24.2% of BE; May: 15.0%) and capex (23.3%; May: 14.3%). The mop-up in net taxes has been robust (26.1%; BE: 15.9%), thanks to a confluence of the cyclical recovery and higher prices. Both the fiscal deficit and net taxes continue to outperform relative to the 5-year average (see chart below).

Variable	Development/Assessment



Source: CEIC. FD = Fiscal Deficit, NT = Net Taxes.

Normal monsoon rains mask poor spatial distribution

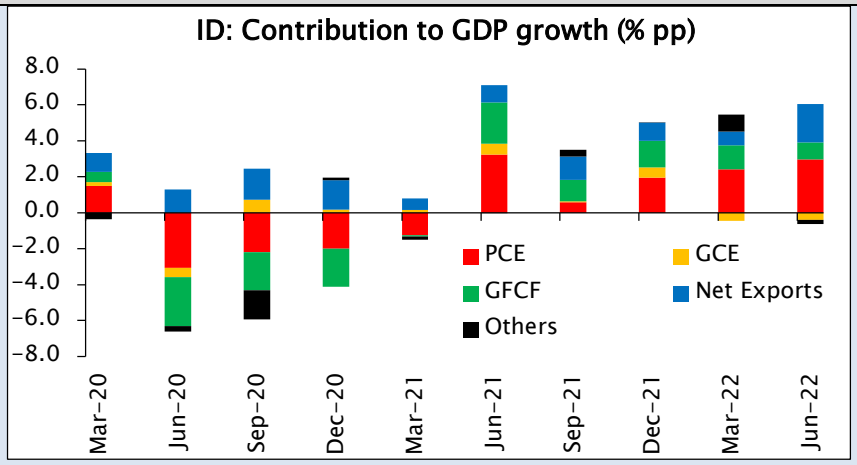
- **Monsoon rains are 21.5% lower than normal in the week ending 3 Aug 22**, ending a 4-week period of excess rains. This brought the cumulative rainfall to 6.2% above normal in the week ending 3 Aug 22, down from 10.4% in the week ending 27 Jul 22.
- **Kharif sowing was down 7.4% y/y as of 5 Aug 22** but this reflects disparate trends. Oilseeds (+0.6%), cotton (+5.3%), sugar cane (+0.1%) and coarse cereals (+3.9%) are now in line with last year's figures, but sowing of rice (-25.3%) and pulses (-2.5%) has surprised lower.

Assessment: Rice production could disappoint but no cause for alarm, yet

- **Rice production to disappoint** as spatial distribution of rains over central and eastern India are not supportive of rice. Key rice-producing areas, such as Bengal (-46.7% as of 3 Aug 22), Uttar Pradesh (-44.6%), Chhattisgarh (-0.7%) and Bihar (-33.8%), have seen poor rains in the monsoon season, which is now ending the last stretch. The risk of export curbs on rice cannot be ruled out at this point, although domestic production and existing stockpiles (July: 31.5 million tonnes against minimum levels of 13.5 million tonnes) should be able to prevent runaway rice prices despite a subpar kharif season. What could upend this baseline scenario is if the authorities extend the food aid scheme, which is set to lapse by September 2022.
- **Rupee weakness to persist**: Preliminary figures point to a record deficit in July, which add to mounting evidence from the macroeconomic fundamentals suggesting persistent Rupee weakness. What will move the needle hinges on capital inflows into both the equity and bond market, which is, in turn, dependent on the prevailing risk appetite in the short-term and the inflows of manufacturing foreign investment in

Variable	Development/Assessment
	the long-term, as well as intervention by the RBI to rebuild its foreign exchange reserves which are down 10% from the peak in Sep 21. ▪ **Bridled spending suggests fiscal deficit may fall below budgeted estimates:** That the fiscal deficit has been restrained despite the expansion of various subsidy schemes such as the food aid program costing an additional INR850bn in outlays and another INR1.1tr in fertilizer subsidy is remarkable. This comes on top of the INR1tr forgone in fuel excise duty following the cuts announced in May 22. It could suggest the authorities are actively constraining spending growth to cushion the hit stemming from higher spending pressures and slightly lower revenues. ▪ In any case, two factors will limit the extent of fiscal slippage – 1) the robust tax mop-up which is in line with the ongoing recovery, although this will slow moving forward and 2) the very conservative nominal GDP growth estimate in Budget FY23 which is clearly an under-estimate, given the current run of CPI inflation averaging 7% in recent months. With nominal GDP growth set to exceed 15% compared to the budget's macro assumption of 11%, this implies the fiscal deficit will widen in absolute terms, but remain at 6.4% of GDP or even lower for FY23. ▪ **Next MPC meeting likely to see a 35bps hike in end-Sep 22**: Inflation shows signs of peaking, going by the manufacturing and services PMI and the June CPI print although it remains sticky in the near-term, as the RBI acknowledged. The hawkish policy statement – aimed at arresting the slide of the Rupee, no less – suggests the central bank will continue to tighten policy further in September, albeit with a 35bps hike instead of the back-to-back jumbo 50bps hike. <u>We retain our expectations for rates to top out at 5.75% in September</u>, particularly as inflation starts to exhibit a downtrend moving forward with all eyes turning to the July inflation print on 12th August.
Indonesia: Nothing to suggest BI will move in Aug 22	▪ **GDP growth surprised on the upside in 2Q22 (+5.4%)**, building on 1Q22's solid expansion (+5.0%). The main drivers of growth were household spending (+5.5%) and net exports – export growth quickened (+19.7%), outpacing import's +12.3% increase. Government spending fell 5.2% y/y as the authorities rein in expenditure in 1H22 to keep the fiscal deficit under wraps. Gross Fixed Capital Formation increased 3.1% y/y, which is the slowest in a year. Residential investments slowed further (+0.9%), offset by machineries (+16.3%) and vehicular investments (+7.0%) known as yellow goods.

Variable	Development/Assessment

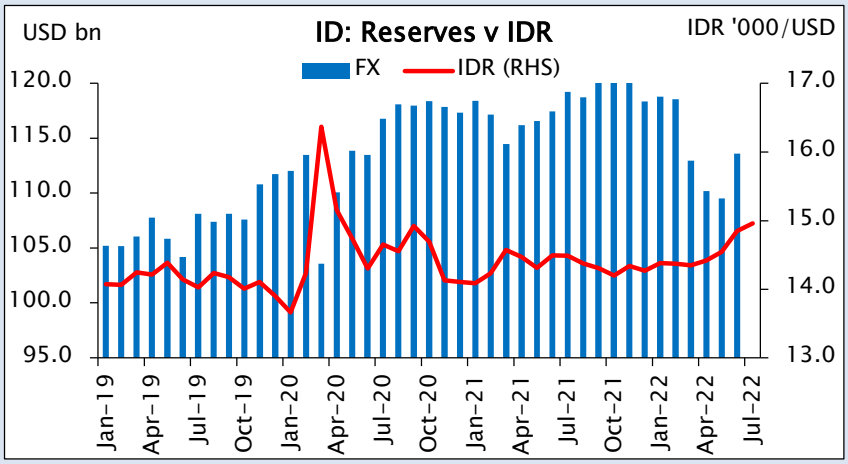


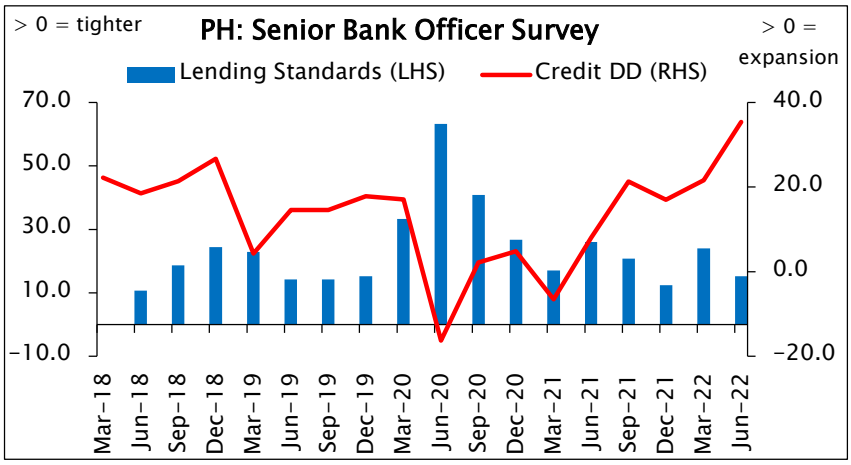
Source: CEIC. Others = inventories + statistical discrepancy

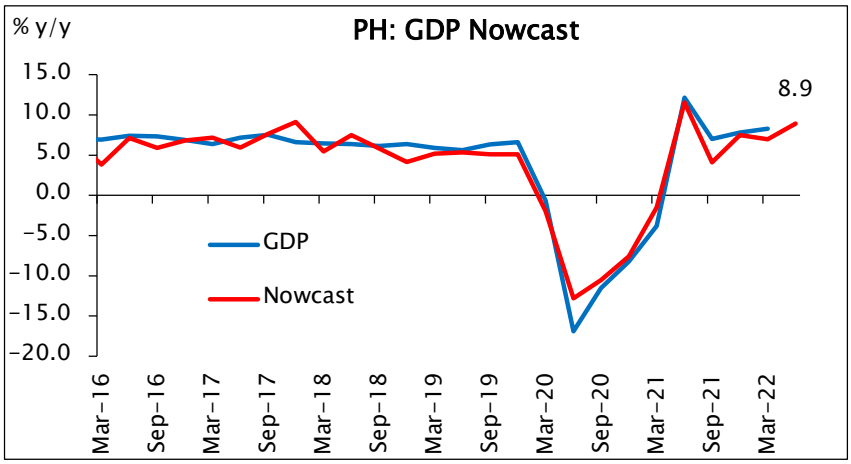
- **Consumer spending contributed 3 percentage points to GDP growth**, followed by net exports (2.1 pp) and investment (0.9 pp). But government spending subtracted 0.4pp from GDP growth (see Chart).
- **Manufacturing PMI climbed to 51.3 in July, a 3-month high (June: 50.2).** Total orders rose modestly, underpinned by domestic demand as foreign business fell sharply at the quickest rate since Aug 21. Employment expanded at the fastest pace on record amid capacity constraints and greater new order inflows. Input cost inflation eased to the slowest since Jun 21, as did output charges which also softened to the slowest in over a year. Business optimism firmed up, supported by expectations of price stability and greater new orders.
- **Headline inflation continued rising in July (+4.9%) (June: +4.3%)**. Food and beverage (+9.4%), accommodation and utilities (+2.6%), transportation (+6.7%), recreation (+2.3%), restaurants (+4.0%), household equipment (+4.9%) and personal care (+4.8%) were the main drivers of headline inflation. Education (+1.0%), info-communication (-0.3%), health (+2.3%) and clothing (+1.5%) were broadly steady. Core inflation also came in at a multi-year high (+2.9%) (June: +2.6%). Sequentially, inflation was unchanged at +0.6% m/m sa in July.

Assessment: Economy in rude health amid conducive external environment

- **Domestic demand needs to do more of the heavy lifting in 2H22** as external demand will probably weaken (see our assessment of the global economy above). Investments in machinery and vehicles – known as yellow goods – has been robust as a result.
- This is also apparent from the PMI figures as well as the sub-components of consumer spending, where restaurants and hotels (+6.6%) remains robust, alongside food and beverage (+4.1%) during the Lebaran festive season. Spending on health (+4.3%) and transport

Variable	Development/Assessment
	(+9.7%) perked up, ostensibly because of the pandemic as well as the fuel subsidies that delinked retail and global fuel prices. We remain upbeat on Indonesia's growth prospects in 2022 as we reiterate the full-year growth forecast of 5.3%. ▪ **Bank Indonesia likely to hold its ground in August:** Despite the uptrend in headline inflation, BI has made it clear that it is core inflation that will move the needle on policy tightening. On this front, there is little to suggest any newfound urgency on the part of BI to move expeditiously – (the next policy review is on 23rd August). Trade data for July and the 2Q22 CA figures will be released two weeks from now in the lead-up to BI's monetary policy meeting, which will provide more clarity on the central bank's reaction function insofar as the Rupiah and external stability is concerned. ▪ For one, liquid FX reserves rebounded in June after falling close to 10% since Jan 22, reflecting in part the plentiful trade surplus in 2Q22. Considering that the Rupiah weakened a tad in recent months before clawing back some of the losses in recent weeks (see chart below, red line), this implies BI is permitting a measured depreciation of the Rupiah in tandem with global trends (specifically a strong Dollar). The upshot is that the hurdle for rate hikes have not been breached just yet and we expect BI to hold rates in August.  Source: CEIC ▪ What could upend this scenario is if BI steps up sales of government securities in the secondary market, which would signal an imminent rate hike if one goes by the hierarchy of BI's policy toolkit. Another of BI's consideration pertains to financial stability, as OJK's loan moratorium scheme will only lapse in 1Q23. This constrains the room for sharp and acute policy tightening by BI for fear of setting off a series of loan defaults just as the budding recovery kicks in. Note that

Variable	Development/Assessment
	Indonesia's excess consumer savings as a share of PCE is almost negligible, at 3.2% as of May 22.
The Philippines: Brace for another blockbuster quarter	▪ **Manufacturing PMI declined to 50.8 in July (June: 53.8), a 6-month low.** New orders fell modestly, in a marked reversal from June's expansion. Export orders also weakened, albeit at the softest pace in the 5-month contractionary streak. Employment crept up for the 3rd successive month while input cost inflation quickened to a 3-month high. Consequently, output prices rose at the third-sharpest rate. Business optimism, while below the historical average, strengthened to a 7-month high, underpinned by expectations of strong demand. ▪ **Headline inflation edged up in July (+6.4%)** (June: +6.1%) Driving the headline figure is food (+7.1%), transport (+18.1%), restaurants (+3.4%), household equipment and utilities (+3.1%) and clothing (+2.5%) while other components were mostly unchanged. Sequentially, headline inflation eased to +0.6% m/m sa, from +1.0% m/m in June. At present, core inflation is still undergoing refinement by the BSP. ▪ **Credit disbursals firmed up in June, rising 12.0% y/y** (May: +10.6%) with growth broad-based across major sectors – wholesale and retail trade (+8.0%), real estate (+18.1%), manufacturing (+17.5%), finance and insurance (+6.3%), construction (+15.0%) and information and communication (+29.7%). Consumer credit also perked up (+10.6%), with credit card (+18.9%) and auto loans leading the way (-0.2%). ▪ **Lending standards eased further in 2Q22 (+15.2)**, albeit after 1Q22's bounce (24.0) (see Chart below, blue bars). The number of financial institutions reporting a tightening of lending standards fell further in 2Q22. Banks are also reporting an increase in consumer loan demand (+35.4%) (1Q22: +21.6%) as the recovery gather steam in 2H22.  Source: CEIC

Variable	Development/Assessment
	Assessment: Brace for a blockbuster 2Q22 ▪ **More evidence of a broadening recovery, led by domestic demand:** The Philippines is set for a blockbuster 2Q22, thanks in large part to election-related spending and the release of pent-up demand. Lagging indicators such as the labour market conditions, credit growth and lending standards point to continued vigour in the Philippine economy, which we expect to persist through 2H22. Our nowcast pegged 2Q22 growth at 8.9% y/y, although our expectation slightly more modest (8.5%-9%). Growth will then moderate slightly in 2H22, but remain robust for the most part as domestic demand does more of the heavy lifting, given the Covid-19 woes plaguing China.  Source: Centennial Asia Advisors ▪ **BSP to stay the course with 25bps hike in September:** Despite the jump in headline inflation, the sequential momentum is clearly cooling, which also reflects the impact of lower oil prices. This rules out another off-cycle adjustment, following the 50bps in an unscheduled monetary board meeting in July. In any case, the BSP will have several more data points to parse before its next policy review on 22nd September, namely 2Q22 GDP growth (due on 9th August and is likely to be strong) and the inflation print for August (6th September). We do expect the BSP to stay the course with a 25bps rate hike in September to rein in the risk of inflation overshoot in 2023.

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	-0.2	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	3.75	53.5
	2023	6.5	4.0	-2.8	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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