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Treading Cautiously into 2024

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I just watched the latest Hunger Games movie "*The Ballard of Songbirds & Snakes*" and the song lyrics "strange things did happen here" continues to echo. 2023 has turned out to be a year of many surprises, starting with the failure of the Silicon Valley Bank which did not lead to any contagion in the US financial markets due to swift action on the part of policymakers, the persistence of the Russia-Ukraine war, as well as the Israel-Hamas conflict more recently. After an aggressive hiking cycle, the Fed has finally paused in its monetary policy tightening cycle, albeit with Fed chair Powell still keeping optionality on the table as the labour market remains robust and inflation while declining is nowhere near its 2% target level. That said, US real rates are already restrictive, hence financial markets have now come round to pricing in around 90-100bps of Fed rate cuts to come in 2024. However, some Asian central banks had to shake off their stasis and hike policy rates recently in order to stave local currency volatility and/or combat resurgent inflation.

Global inflation, however, has mostly trended lower in recent months, even though it is still nowhere near target levels for many major central banks. As policymakers are cognizant about the risks of overtightening monetary policy in the face of a global growth soft patch and potential financial stresses arising from the property market and/or geopolitical tensions, inflation will take longer to return to target levels and likely require periods of sub-par growth to achieve the target. Consequently, the balance between taming inflation while avoiding recession remains on a fine knife edge.

The US, Europe, UK, and Australia are already facing fundamental stresses in the commercial real estate space due to elevated vacancy rates (partly due to a reluctance of workers to return to work in the office), high mortgage rates and a challenging maturity wall that needs to be refinanced in coming months and quarters. Credit conditions tightening is already underway in many developed economies, with bank surveys suggesting that financial institutions are tightening their lending criteria further. Since loan demand has faltered, monetary policy is likely to continue to exert downward pressure on growth and in turn inflationary pressures. Still, the twin bugbears – energy and food prices may continue to be held at ransom by external forces ranging from geopolitical tensions, climate change, idiosyncratic risks (including inward-looking export bans) etc.

Meanwhile, residential property jitters are also dominant in China where oversupply, difficult funding access after several high-yield Chinese developers defaulted, and a lack of confidence on the part of home buyers pose a myriad of challenges. Since a large part of the Chinese economy is tied to the property market, it remains a potential Archilles heel, even though ongoing policy support (including the recent whitelist of some 50 property firms) may keep recovery hopes alive in coming months. Notably, there is now speculation of the state taking an enhanced role to take up more of the excess property stock, in addition to ramping up construction of public housing. More policy stimulus, albeit in drips

and drabs, may keep the time of reckoning (in our terminology cheekily defined as sub-5% GDP growth) at bay for a little while longer, especially since the expanding fiscal deficit allows for a reacceleration of efforts to support struggling local governments.

At this juncture, a global growth slowdown is anticipated for 2024, but the recession risks have ebbed from early 2023. The closer we stand to the peak of the monetary policy rate tightening cycle and the nearer to a potential pivot to an easing cycle at some stage in 2024, the lower the probability of stumbling into a recession due to policy errors. The test of the pudding remains in the scale and depth of the slowdown that may emerge in the US and European economies over the next 12 months – whether it is simply a technical recession with two consecutive quarters of sequential growth moderation or a deeper and more protracted full-year contraction.

On the geopolitical front, the Biden-Xi meeting at the sidelines of the APEC Summit in mid-November fuelled hopes of a thawing in the current era of cool relations, given that the US presidential elections are less than a year away, the dice could still fall either way. More high-level official communications may hopefully point the way to identifying areas of potential cooperation and managing risks. Still, even if their bilateral relationships improve from what is a relatively low base, foreign investors may remain reluctant to view China with rose-tinted glasses in the near-term. Singapore Foreign Affairs Minister Vivian Balakrishnan adeptly characterised it as “sunnier weather amid a poor climate”. Meanwhile, the Russia-Ukraine war drags on, and the US administration’s financial assistance to Ukraine may be running into potential speedbumps. The Israel-Hamas war also posed fresh headwinds given potential contagion to the Middle East region, albeit with recent signs of a temporary ceasefire.

The political calendar year in 2024 will be busy, with Taiwan, Indonesia, India, and the US holding elections just to name a few. While it would be prudent to attach some election risk premiums, especially if drama and uncertainties emerge – the Indonesian presidential election for instance may drag till June 2024 if there is no outright winner in the first round. Taiwan is another place where pre-election developments remain fluid, and the outcome could weigh heavily on cross-straits relationships. Increasingly, our clients have also started to ponder if we will see a Trump redux come November 2024 since some key swing states appear to be swinging his way. Coriolanus Snow aptly hit the nail on the head – “Everything is about winning. If not the games now, then the crowd.” This in turn could have policy implications for US-China trade, investment, and industrial strategies. In this inter-connected world, it is impossible to cut the Gordian knot of politics and economics.

One of the main game-changers in 2023 was that the Bank of Japan (BOJ) adopted a more flexible approach to its 10-year Japanese Government Bond (JGB) yield cap of 1%. The BOJ, which is the most dovish central bank so far, may be inching towards higher conviction levels that the inflation prints it sees is sustainable and that wage growth is real. We believe 2024 may usher in the BOJ’s long-awaited exit from negative interest rates. Notwithstanding policy normalization, yield differentials with the US remains wide by any measure. Moreover, given Japan’s

ageing population dynamic and reluctance to welcome more foreign talent intake, it would be implausible to see Japan swiftly return to its pole position as the apex economy reminiscent of the 1990s.

There is also a limited shelf-life to the high-for-longer rates narrative, which should be conducive to risk sentiment and in turn risk assets come mid-2024. Financial markets are essentially forward-looking and will begin to anticipate the shift from a monetary policy tightening to an easing cycle once the last hike is done. This is likely the case in point now, as illustrated by the rally in both US equities and bonds. With markets priced for perfection, there is little room for manoeuvring. Hence, economic data would have to increasingly tilt south in the coming months to cement the case for rate cuts, barring which there could still be some financial market volatility in 1H24. Nevertheless, our base-case scenario is to lean towards overweight bonds, especially government bonds in this environment of the great monetary policy pivot. There will be a (minority?) camp of bond vigilantes who warn about fiscal laxity especially on the part of the US, which recently saw its sovereign rating outlook downgraded from stable to negative by Moody's. However, we live in a TINA world where "there is no alternative".

Market sentiment will remain understandably cautious – our recent client seminar poll suggested that ~40% of those surveyed believe next year could be more challenging than 2023, with the remainder (50%) somewhat equally split between "more upbeat" and "unchanged", with a minority (~10%) in the "unsure" camp. This underpins the two key risks factors to our fairly benign soft landing (of sorts) scenario for 2024. First, that the Fed is done and will embark on rate cuts come mid-2024, but what if inflation proves more entrenched and there is no material easing in the US labour market conditions? The second key assumption is that the Chinese economy is past the bottom and that the way forward is for a gradual stabilization and improvement, but what if this proves misguided. This implies that while 2024 may see a relatively soft growth landing of sorts, the market headwinds are formidable with so many moving parts which could go wrong.

At this juncture, the DM-EM divide remains clear, but disparate narratives for many EM economies may mean that capital outflows and limited recovery prospects continue to hinder going into 2024. Their growth trajectories have diverged in recent quarters and there may not be a single driver or engine of growth going forward into 2024. That said, the ASEAN economies appear to be more resilient in a world of 'unknown unknowns' given their steady anchor of rising middle class, growing digitalisation and e-commerce potential and sustainability journeys. The improving tide of returning international visitors may put a floor to downside risks to growth but is not a sufficient condition to boost growth back to trend for many ASEAN economies given the current manufacturing, especially electronics, handicaps. The drag from the aggressive DM monetary policy tightening cycle looks to be subsiding, while the manufacturing slump due mainly to the global electronics destocking cycle also may be ending. Industrial output and export data have lately seen some green shoots in the form of trying to form a bottom in recent months, but a meaningful recovery needs to extend into 2024. The external headwinds of 2023 may turn into tailwinds for 2024 if it materialises.

Export-oriented economies like South Korea, Taiwan and Singapore need to see the jumpstart in manufacturing and electronics growth. Otherwise, a modest growth slowdown or rangebound growth prospects in 2024 appears to be the name of the game for many ASEAN economies, amid the persistent soft patch in global trade and tighter global financial conditions. Even the larger more insular economies like Indonesia and India may be sensitised to external economic and geopolitical developments. The main adjustments therefore comes from finding balance in a world of higher global interest rates, softer Chinese growth and heightened geopolitical uncertainties.

Deflationary pressures emanating from China's tepid growth trajectory is a double-edge sword. On one hand, foreign direct investments continue to undertake a China+1 strategy (with China for China, and Outside China for the Rest of the World production). In turn, wealth and portfolio flows are likely to mimic this pattern. On the other hand, China is also increasingly diversifying its outbound investments and portfolio/wealth transfers away from the usual suspects to this part of the globe in search of soft power and more friendly alliances. China's demographics, deleveraging and de-risking pressures will continue to structurally weigh on its medium-term growth prospects but find policy offsets to mitigate downside risks. As a general rule, in an increasingly fractured and polarised world, economic, security, energy/food/supply chain resilience would continue to be prioritized at different levels (country, industry and firm).

For Singapore, 2024 may mark an interesting year of change – GDP growth should improve from a relatively low base, while headline and core inflation subside. Monetary policy will likely take a side seat after the five rapid-fire tightening moves prior to April 2023 while fiscal policy may continue to step up given the needs to provide cost-of-living assistance to lower-and middle-income households as well as embark on new policy initiatives like providing involuntary unemployment assistance to the same said segment of workers as part of the Forward Singapore recommendations. In addition, a leadership transition to the 4G team remains underway.

In summary, there is much to be hopeful for, but also much to be cautious about as we ponder the crystal ball for 2024. After a year of surprises and disappointments in 2023, it would be prudent not to put all your eggs into one basket but stay nimble and alert to the crosscurrents of geopolitics, economics, and markets. Good luck and may the odds be ever in your favour.

GDP Growth Rates

% CHANGE YOY	2022	2023F	2024F	2025F
Global	3.6	3.3	2.8	3.1
US	1.9	2.2	0.3	1.5
Eurozone	3.4	0.5	0.8	1.3
Japan	0.9	2.0	1.0	1.0
United Kingdom	4.5	0.5	0.6	1.2
New Zealand	2.7	1.1	1.0	2.1
Australia	3.7	1.8	1.2	2.0
China	3.0	5.4	5.0	4.6
Hong Kong	-3.5	3.2	2.5	2.2
Taiwan	2.4	1.3	3.5	2.5
India	9.1	7.2	6.3	6.0
Indonesia	5.3	5.0	4.8	5.1
Malaysia	8.7	4.0	4.2	4.5
Philippines	7.6	5.7	6.0	6.0
Singapore	3.6	1.0	2.0	2.7
South Korea	2.6	1.4	2.2	2.3
Thailand	2.6	2.0	2.8	3.3
Vietnam	8.0	4.4	5.2	6.2

Note: *The global forecasts (actuals) are a weighted average of the GDP growth forecasts (actuals) for the countries in the table, weighted against the GDP based on PPP (% share of world). These weights are from the IMF WEO, October 2023. India forecasts are based on the fiscal year.*
Source: Bloomberg, IMF, OCBC Estimates

Inflation Rates

% CHANGE YOY	2022	2023F	2024F	2025F
Global	5.7	3.8	3.0	2.5
US	8.0	4.1	2.6	2.2
Eurozone	8.4	5.6	2.7	2.2
Japan	2.5	3.2	2.2	1.9
United Kingdom	9.1	7.7	3.7	2.1
New Zealand	7.2	5.7	2.7	2.5
Australia	6.6	5.8	3.4	2.8
China	2.0	0.4	2.6	2.4
Hong Kong	1.9	2.0	2.4	2.8
Taiwan	3.0	2.1	1.8	2.2
India	6.7	6.7	5.2	4.3
Indonesia	4.2	3.7	3.1	2.8
Malaysia	3.4	2.7	2.5	2.3
Philippines	5.8	6.1	3.9	3.0
Singapore	6.1	4.8	3.4	2.0
South Korea	5.1	3.7	2.4	2.0
Thailand	6.1	1.3	2.0	2.2
Vietnam	3.2	3.3	4.3	4.0

Note: *The global forecasts (actuals) are a weighted average of the GDP growth forecasts (actuals) for the countries in the table, weighted against the GDP based on PPP (% share of world). These weights are from the IMF WEO, October 2023. India forecasts are based on the fiscal year.*

Source: Bloomberg, IMF, OCBC Estimates

Central Bank Policy Rates

BENCHMARK RATE %	Current	2023F	2024F	2025F
US Fed Funds Rate	5.25-5.50	5.25-5.50	4.25-4.50	3.25-3.50
ECB Deposit Facility Rate	4.00	4.00	3.25	2.25
BOJ Policy Balance Rate	-0.10	-0.10	0.10	0.30
BOE Base Rate	5.25	5.25	4.50	3.50
RBNZ Cash Rate	5.50	5.50	4.75	3.50
RBA Cash Target Rate	4.35	4.35	3.85	3.10
China Loan Prime Rate (1-year)	3.45	3.45	3.45	3.45
CBRC Discount Rate	1.88	1.88	1.63	1.63
Hong Kong Base Rate	5.75	5.75	4.75	3.75
BI 7D Reverse Repo Rate	6.00	6.00	4.75	4.75
BNM Overnight Rate	3.00	3.00	3.00	3.00
BSP Overnight Reverse Repo	6.50	6.50	5.50	5.50
RBI Repurchase Rate	6.50	6.50	5.75	5.75
Singapore SORA	3.60	3.60	3.10	2.80
BOK Target Overnight Call	3.50	3.50	2.75	2.50
BOT Repurchase Rate	2.50	2.50	2.50	2.50

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

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OCBC

China: From Headwinds to Tailwinds

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- It is the end of destocking cycle. Restocking activities will continue to support the growth in the coming quarters while fiscal policy is expected to remain more proactive in 2024.
- We anticipate that both US-China relations and yield differentials could potentially transition from being headwinds to tailwinds in 2024. We expect China to grow by about 5% in 2024.
- On monetary policy, the recent elevated Certificate of Deposit (NCD) yield, coupled with the significant MLF outstanding, implies that there is room for People's Bank of China (PBoC) to consider another cut in its Reserve Requirement Ratio. But it may keep its interest rate unchanged.

The economy exhibited a robust performance in the first three quarters, with a year-over-year growth of 5.2%, surpassing market expectations.

The moderation of economic growth from 6.3% YoY in 2Q24 to 4.9% YoY in 3Q24 can be primarily attributed to the base effect. However, a sequential analysis reveals an encouraging trend, with the economy expanding by a seasonally adjusted 1.3% QoQ, a marked acceleration from the 0.5% growth observed in 2Q23.

This optimistic economic trajectory can be attributable to four factors:

Firstly, the negative impact of net exports on growth was contained at 13% in the initial three quarters of 2023. The resurgence of demand from advanced economies in the latter half of the year ensured that China's goods trade surplus remained substantial.

Secondly, China's industrial activities are picking up. The industry capacity utilization rate climbed by 0.4% to 74.8% in 3Q23. Although it is still below 75.6% in 2022, this upturn signals the end of the active destocking cycle. This aligns with the manufacturing PMI shifting back into expansionary territory (i.e., a reading above 50). We anticipate the restocking will bolster 4Q23 GDP growth.

Thirdly, manufacturing investment remained resilient. High-tech manufacturing investment rose by 11.4% YoY in 1Q-3Q23. Concurrently, investments in computer, communication, and other electronic equipment manufacturing grew by 10.2% YoY.

Lastly, retail sales growth picked up to 5.5% YoY in September, with private consumption contributing 83.2% to growth in 1Q-3Q23.

However, the property sector persists as a significant impediment to growth. Real estate investment contracted by 9.1% in 1Q-3Q23. Despite resilient growth data, there is no sign of a recovery in the property market. 56 of 70 cities registered a decline in the prices of new homes in October. More strikingly, the

market for second-hand homes exhibited widespread depreciation, with 67 cities experiencing a drop in prices. This figure represents an increment of two cities in comparison to the previous month's data. Notably, the number of cities witnessing a reduction in second-hand home prices has escalated to an unprecedented level.

In the latest series of conferences, China has called for equal treatment and reasonable financing access for all real estate enterprises, indicating a more pronounced policy commitment that could lead to improved financing conditions for private real estate firms. Although these improving financing conditions might keep default risks in check, they are not yet sufficient to reverse market sentiment, as pervasive concerns about a downward spiral in property prices continue to deter potential buyers. We will discuss about how China can manage its tail risks in more detail in the thematic piece.

Chart 1: Daily transaction volume remains low

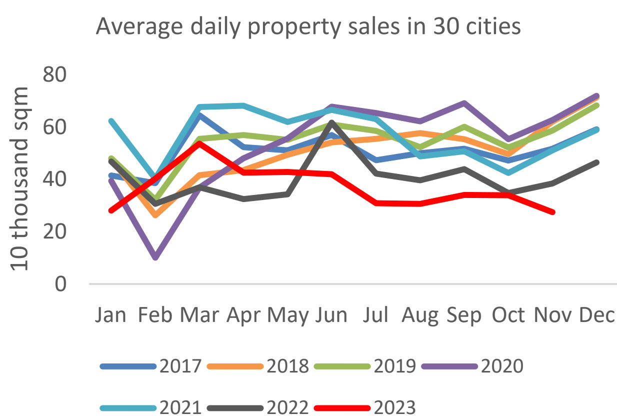
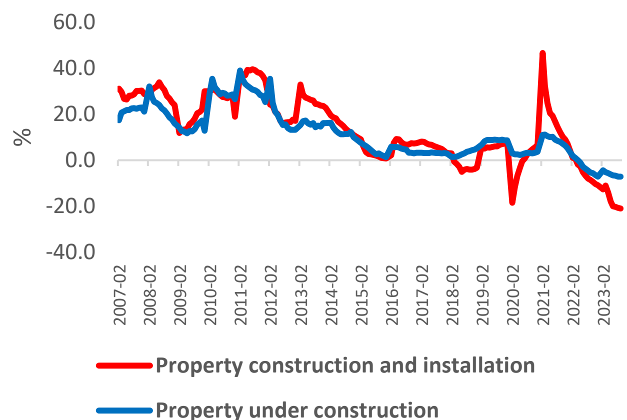


Chart 2: No sign of bottom of property investment



Source: Wind, CEIC, OCBC

End of destocking cycle

Our expectations regarding the bottom of the destocking cycle has been a key factor in preventing us from downgrading the 2023 growth forecast in 3Q23. This assumption has proven to be quite accurate and reliable for us.

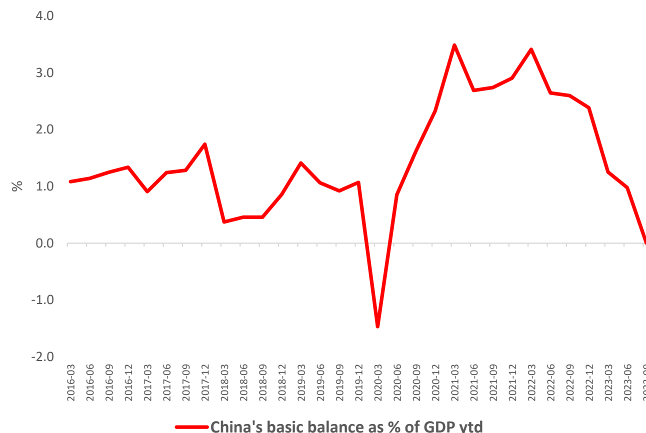
The contraction of industrial profit year to date narrowed further. Profits of large-scale industrial enterprises have shown a turnaround, with profits rising by 7.7% in 3Q23 after contracting for five consecutive quarters. This upturn continued into September, where profits of large-scale industrial enterprises grew by 11.9% YoY, marking the second consecutive month of double-digit growth.

Additionally, the acceleration in finished goods inventory for the second consecutive month to 3.1% in September is a clear sign of restocking. The improvement in the circulation speed of the economy is another positive sign, with the turnover of finished goods inventory decreasing to 20 days in September from 20.3 days in August.

Overall, we expect restocking activities to continue in the coming quarters. As such, we project a reacceleration of economic growth in 4Q23, potentially reaching approximately 5.5%-6%, spurred by a favorable base effect and intensified restocking activities. For the full year 2023, we are comfortable with our forecast at around 5.4%.

Chart 3: emerging sign of restocking activities

Chart 4: Basic balance turned deficit in 3Q



Source: Wind, CEIC, OCBC

More proactive fiscal policy

At the conclusion of the 6th session of 14th National People's Congress (NPC) Standing Committee on 24 October, the NPC approved an additional CNY1trn government bond issuance quota for this year. This decision will widen the 2023 fiscal deficit target to 3.8%, from the previously set target of 3%.

The decision to augment the budget deficit in 4Q23 sent a robust pro-growth signal, especially since the growth target of 5% for this year seems well within reach. We anticipate the growth target for 2024 to hover around 5% with a wider fiscal deficit again in 2024.

Improving US-China relations

The latest APEC meeting in the US showed a marginal improvement of bilateral relations between US and China. China's concerted efforts to normalize bilateral ties with the US are particularly noteworthy. This shift is evident when compared to the Bali meeting in November 2022, which was predominantly focused on foreign affairs. The recent visit saw an expanded Chinese delegation, including heads of key economic decision-making bodies such as the National Development and Reform Commission, the Ministry of Commerce, and the Ministry of Finance, alongside Vice Premier He Lifeng and People's Bank of China Governor Pan Gongsheng pre-APEC meeting. This broad representation underscores the comprehensive nature of the discussions, extending beyond diplomatic courtesies to substantive economic and policy dialogues.

The essence of the recent evolution in China-US relations lies in identifying and capitalizing on areas of potential cooperation, as well as jointly managing risks,

thereby aiming to mitigate prevailing uncertainties. As such, we think going into 2024, despite the possible rising noises about China heading into the November US Presidential election, the US-China relation is likely to turn from a headwind to a tailwind for China's economy.

Key risks to watch

Domestically, it is crucial to closely monitor the risks associated with the property market and local government debt. We will delve into these risks in greater detail in our thematic piece.

Externally, one key factor to watch is the yield differential between the US and China. An interesting development in China's balance of payments is the first quarterly deficit in foreign direct investment, amounting to US$11.8bn, despite the Ministry of Commerce reporting sustained levels of utilized foreign direct investment inflows. This divergence highlights the tangible impact of the yield differential on foreign investment decisions, particularly the accelerated repatriation of retained earnings by foreign corporations.

However, considering our house view that the Fed will cut interest rates from mid-2024, the yield differential between the US and China may narrow, potentially alleviating pressures on Chinese financial assets. A shift in sentiment could be supportive of China's growth.

In conclusion, we anticipate that both US-China relations and yield differentials could potentially transition from being headwinds to tailwinds in 2024. Coupled with the new cycle of restocking, we expect China's growth to remain around 5% in 2024.

Lastly, on monetary policy, the PBoC injected a record CNY1.45trn into the banking system via the medium-term lending facility (MLF) in November. This infusion resulted in a net liquidity injection of CNY600bn, a level not seen since 2017. The scale of this injection suggests a recalibration of immediate policy expectations, particularly regarding the likelihood of a short-term adjustment in the Reserve Requirement Ratio (RRR).

Nevertheless, the recent elevated NCD yield, coupled with the significant MLF outstanding, implies that there is room for China to consider another cut in its Reserve Requirement Ratio. Such a move would align with efforts to alleviate pressures on banks, particularly concerning their shrinking net interest margins.

Hong Kong: Post-Covid Recovery Still an Uphill Battle

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- Tailwinds of reopening are proving difficult to offset the headwinds of elevated interest rate and weak external demand. Added to that, correction in the asset market had a notable dampening effect on consumer sentiment. Taken together, the economic recovery this year is likely modest-to-weak.
- GDP growth averaged 2.8% YoY in 1Q-3Q23. Entering 4Q23, the recovery is set to continue amid sharp revival of inbound tourism, although tighter financial conditions would continue to weigh on growth. We stick to our growth forecast of 3.2% for this year.
- We are of the view that HKD rates are likely to stay elevated until early-2024, before moving lower for the rest of 2024. As and when Fed starts cutting the policy rate, HKD rates should follow the downtrend of USD rates, albeit in a sticky and lagged manner.
- Despite dented sentiment, a sharper correction in the housing market is still not our baseline scenario, given the increased pool of end-users and our downward trajectory forecast of HKD rates in 2024.
- In view of the fading reopening boost and higher base of comparison, economic growth is bound to slow in 2024. Yet, the picture is not all bad, thanks to China's stimulus measures and likely loosening financial condition. Our full year 2024 growth forecast is pitched at 2.5%YoY.

Both Tailwinds and Headwinds Came into Play

Riding on the tailwinds of reopening and a tight labour market, the economy received a strong boost from the rebound in inbound tourism and recovering private consumption in early 2023. However, while economic growth remained underway, momentum faltered as the year progressed. Tailwinds were proving difficult to offset the headwinds of elevated interest rate and weak external demand. In addition, the correction in asset markets had a notable dampening effect on consumer sentiment and posed a persistent drag. Taken together, the economic recovery this year is likely modest-to-weak.

Real GDP growth accelerated to 4.1% YoY in 3Q23 (***Chart 1***), up from 1.5% in 2Q23, due to a favourable base effect. Quarter-on-quarter momentum was weak. On a seasonally adjusted basis, real GDP grew marginally by 0.1% QoQ. In the first three quarters, GDP averaged 2.8% YoY. The government revised down its full-year economic growth forecast to 3.2% (in line with our forecast), from an earlier estimate of a range of 4.0% to 5.0%.

Chart 1: Weakening momentum

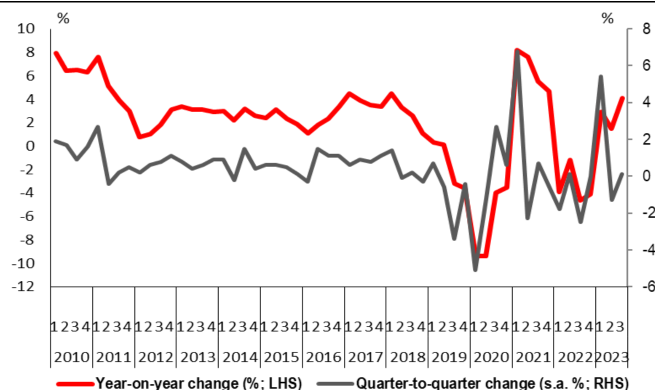
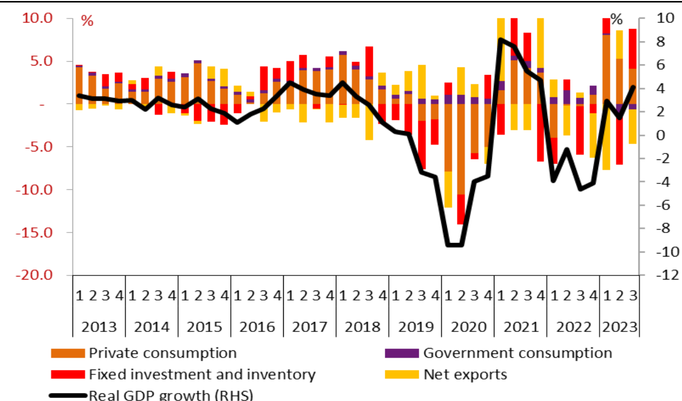


Chart 2: Favourable base effect



Sources: HK Census and Statistics Department, OCBC

Exports of services and private consumption remained to be main growth drivers (***Chart 2***), although the latter continued to lose momentum. Exports of services recorded accelerated growth of 23.9% YoY in 3Q (2Q: +22.8% YoY), while private consumption expenditures expanded at a slower pace of 6.3% YoY (2Q: +7.7% YoY). During the quarter, overall investment also rebounded sharply, due to the low base effect. The gross domestic fixed capital formation rose by 18.4% YoY (2Q: -0.5% YoY). Meanwhile, a major drag on growth stemmed from the sluggish merchandise exports, although the decline narrowed to 8.6% YoY (2Q: -15.1% YoY). Similarly, on the back of scaled back stimulus package, government consumption expenditure dropped by 4.5% YoY (2Q: -9.8% YoY).

Entering 4Q23, the recovery is set to continue amid a sharp revival of inbound tourism, although tighter financial conditions and weak external demand would continue to weigh on growth. We stick to our growth forecast of 3.2% for this year.

Pessimism prevailed and consumption delayed

While a lot of economic data showed growth rates were in positive territory, market confidence weakened by almost all measures. Local headlines were all about the struggling property sector, sluggish stock market, consumption downgrades and sharp pick-up in outbound tours. Facing these growing macroeconomic uncertainties and a high interest rate environment, local residents were increasingly reluctant to spend. Moreover, as the time deposit rates hit 5%, saving increased and spending slowed. The share of time deposits to total HKD deposits in licensed banks rose from 31.3% at end-2021, to 55.8% as of end-September 2023 (***Chart 3***).

Even those consumers willing to spend have apparently taken their expenditures elsewhere, reaping the benefit of a strong HKD. Departures by residents rose to 49 million in the first nine months (***Chart 4***), reaching around 68% of the 2019 level. Consequently, import of services rose 23.9% YoY in 3Q23, to 97.4% of the 2019 level. Such trends also hit the business sectors. Both the overall PMI and diffusion index for SMEs have trended lower since mid-year (***Chart 5***).

Chart 3: More preferred to save than spend

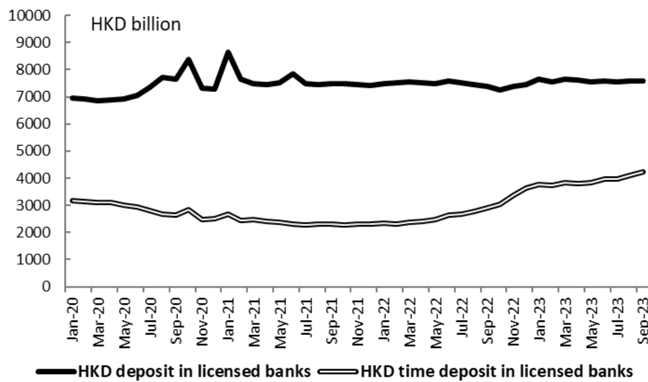


Chart 4: Spending outside of Hong Kong rose

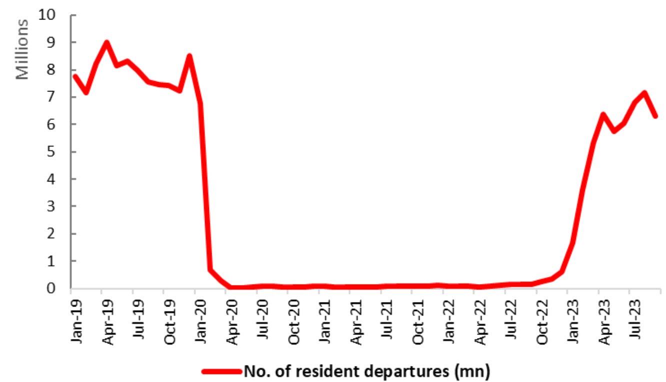


Chart 5: PMI and diffusion index trended lower

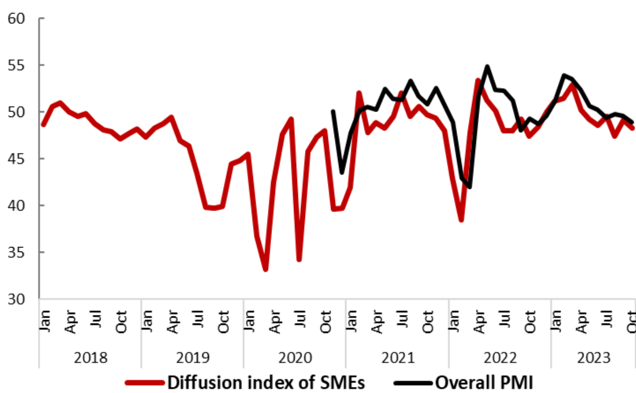
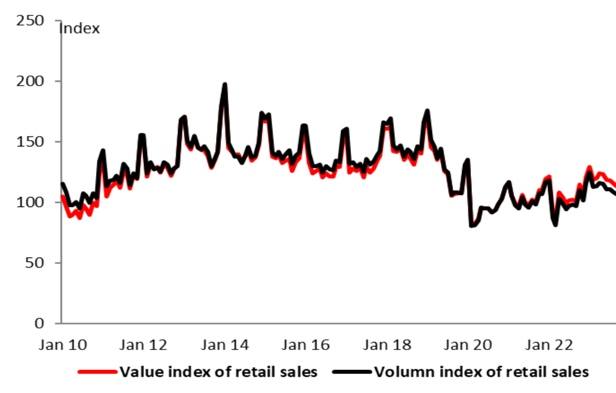


Chart 6: Retail sales losing steam



Sources: HK Census and Statistics Department, HKMA, OCBC

Notwithstanding, retail sales still managed to grow amid a revival of inbound tourism, despite losing some steam lately. The value of retail sales grew by 18.6% YoY in the first nine months of 2023, but was still down by 9.8% as compared to the same period in 2019 (***Chart 6***). Total visitor arrivals rose further alongside the increase in handling capacity, as the constraint in airline capacity and shortage of manpower were largely lifted. The total visitor arrivals reached 23mn in the first nine months this year (***Chart 7***), resuming to around 50% of pre-pandemic levels.

Still weak loan growth

Loan demand remained weak, with major drags coming from demand for loans used outside of Hong Kong, which dropped by 15.6% YoY in September (the largest year-on-year decline since 2016) (***Chart 8***). Given the rate differentials between Hong Kong and Mainland China, loan demand originating from the mainland fell sharply this year. In the meantime, growth in loans used in Hong Kong also slowed markedly (+1.1% YoY in September 2023, the lowest since mid-2022). The slowdown could be attributed to the fall in loans for development and investment on properties, amid the recent correction in the property market (***Chart 9***). Historically, local property-related loan demand (accounting for around half of the total loans and advances used in Hong Kong) were highly sensitive to housing prices.

Chart 7: Returning to around 50% of pre-Covid level

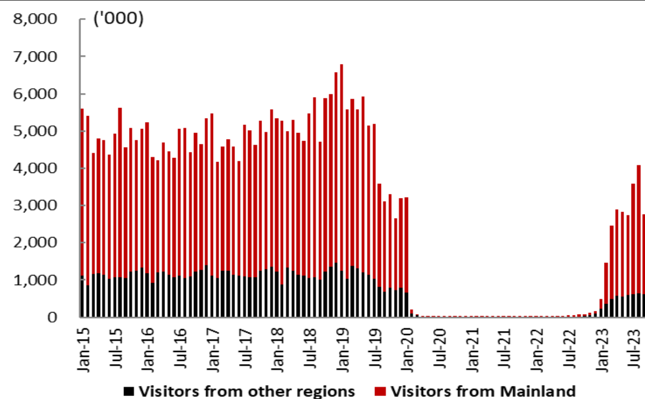


Chart 8: Weak loan demand

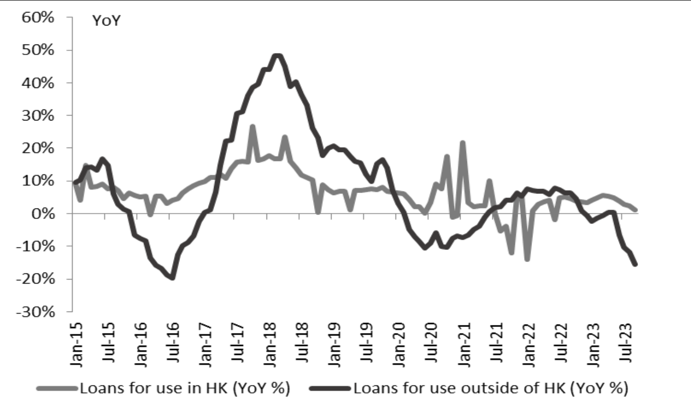


Chart 9: Property related loans fell

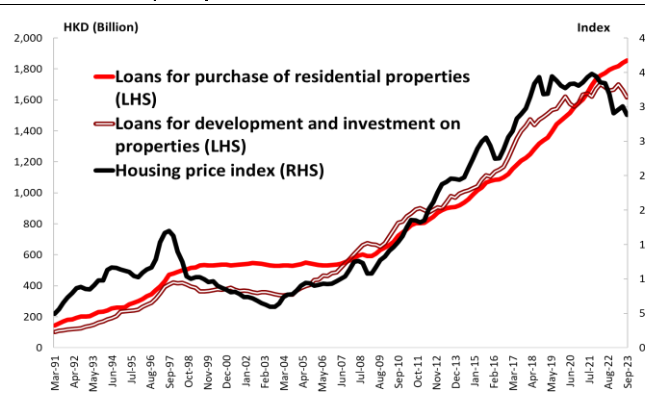
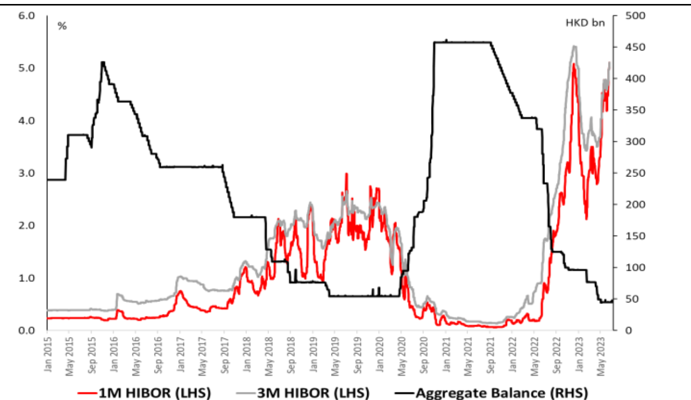


Chart 10: Elevated HKD rates



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

More time needed for headwinds to turn

The high interest rate environment was one of the main drags on growth this year, causing tighter financial conditions and cooling down economic activities across board. On the back of year-end funding needs and generally tight HKD liquidity, 3-month HIBOR rose to 22-year high at 5.59% at one point (***Chart 10***). We are of the view that HKD rates are likely to stay elevated until early-2024, before moving lower for the rest of 2024. Prior to Fed's rate cut, any shift in the inflow-outflow picture (say notable southbound inflows, fund-raising activities, and dividend payout) will likely trigger sharp moves in the HKD rate space, specifically in the front-end. As and when Fed starts cutting the policy rate, HKD rates should follow the downtrend of USD rates, although in a sticky and lagged manner. On HKD prime rate, we expect it to stay put for the rest of 2023, before cutting by 50bps in 2024.

Demographic profile not promising

According to the 2023 mid-year estimate, the population grew by 2.1% YoY to 7.5 million (***Chart 11***), reversing the downward trend since 2019. However, we stay cautious of the fact that the growth was largely contributed by jump in mobile residents (64.2% YoY), while usual residents only recorded marginal increase (+0.8% YoY). The population figure is even less promising when looking at the

demographic profile. The age group that had net increase in population was 65 or above (***Chart 12***), likely suggesting a higher proportion of economically inactive persons. The fall in the population, together with an aging population, can also help to explain the city's challenging post-covid economic recovery.

Labour market stayed tight while labour force grew

Labour markets stayed tight, notwithstanding the sustained growth in labour force. Compared with the recent low in mid-2022, the labour force grew considerably by 84,000 to 3,829,000 in August-October 2023 (***Chart 13***). During that period, the unemployment rate and underemployment rate stayed low at 2.9% and 1.0%, respectively. Amid the ongoing top talent and labour importation schemes, we should see further increases in the labour force and an easing of labour market tightness to a certain extent. That said, we expect the labour market to stay generally strong throughout 2023 and 2024.

Chart 11: Population downtrend reversed

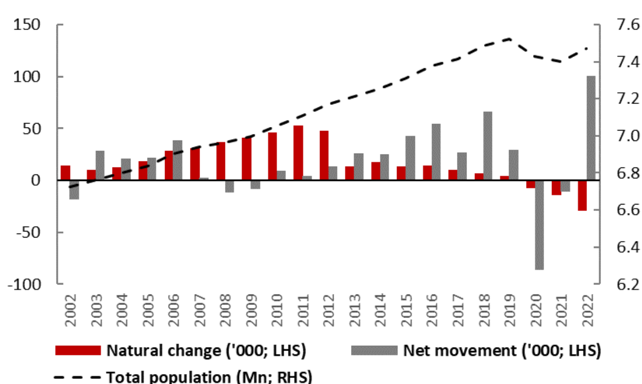


Chart 12: Demographic profile not promising

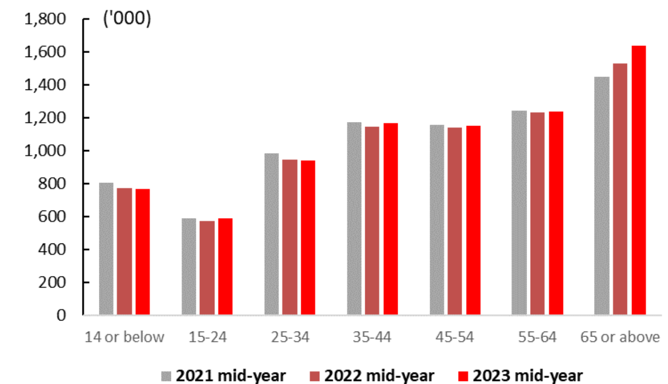


Chart 13: Labour force grew

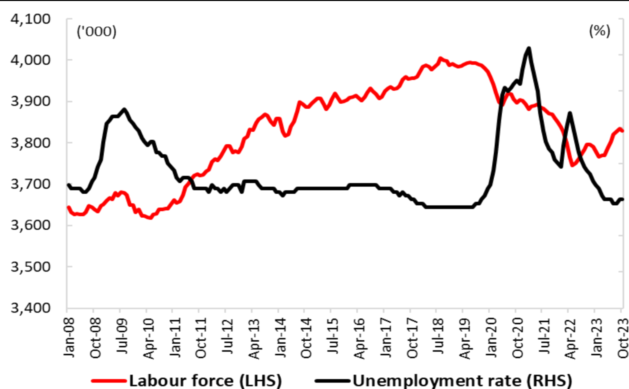
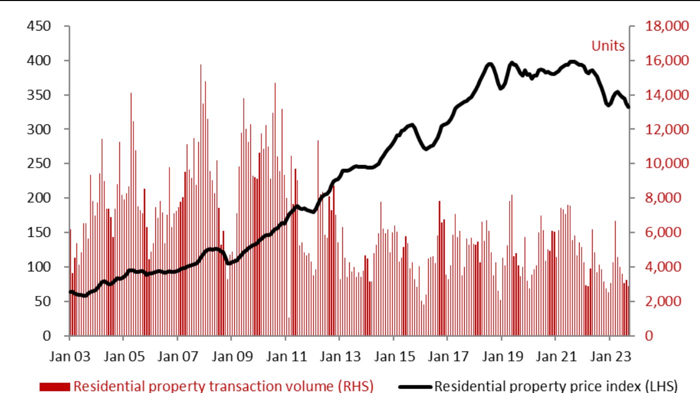


Chart 14: Housing market slowdown



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

Feeling the housing market slowdown chill

As a series of unfavourable developments unfolded since mid-2023, a chill was felt across the housing market**.** First and foremost, commercial banks continued to raise the mortgage rates (both prime rate and new mortgage cap rate). Secondly, developers offered very competitive pricing for new developments amid a robust pipeline of primary projects and inventory backlog. Thirdly, repeatedly failed land

tenders sent a bearish message to the market. Last but not least, the market's call for lifting the "spicy measures" to arrest the housing price decline had only been partly answered. After a brief rebound in the first four months this year, the residential property price dropped again in May and erased all the earlier gains.

Housing price fell by 16.6% against the recent high as of September 2023 (***Chart 14***). Trading activities stayed subdued, with the number of residential property transactions hovering at a low level of 3058 in 3Q23 (down 21.5% YoY). The estimated number of residential mortgage loans in negative equity rose to 11,123 cases at end-September, the highest level this year, collateral damage from the housing market correction. However, we note that it is not a widespread phenomenon. Those negative equity cases were related to bank staff housing loans, which generally have a higher loan-to-value ratio.

Tuning down the "spicy measures"

In the face of slumping housing prices, the government announced what can be called the biggest relaxation of demand-side management measures for the property market on record (***Table 1***), although it still fell short of market expectations. Effective from the date of announcement, the authority would ***1)*** shorten the applicable period of the Special Stamp Duty from three years to two years; ***2)*** halve the tax rates for New Residential Stamp Duty and Buyer's Stamp Duty (from 15% to 7.5%); and ***3)*** put forward a stamp duty suspension arrangement for property buyers in the process of gaining residency via talent schemes.

Table 1: Proposed changes to the demand-side management measures for property market

Property Taxes	***Eligibility***	***Effective since***	***Tax rate***		***Other changes***
			Before	Now	
New Residential Stamp Duty (NRSD)	All property transactions except where the purchaser (a Hong Kong permanent resident) did not own any other residential property in Hong Kong at the time of acquisition	2016	15%	7.5%	
Buyer's Stamp Duty (BSD)	All property transactions except where purchaser is a Hong Kong permanent resident	2012	15%	7.5%	New stamp duty suspension arrangement
Special Stamp Duty (SSD)	All property transactions where property is disposed of by the sellers within 36 months from the date of acquisition	2010	15%	15%	Shorten the applicable period of the SSD to 24 months (two years)

Sources: 2023 Policy Address, HK Rating and Valuation Department, Inland Revenue Department, OCBC

Further sharp price correction not our baseline

Despite dented sentiment, a further sharp correction in the housing market from this point onward is still not our baseline scenario, given the increased pool of end-users and possible downward trajectory of HKD rates in 2024. We continue to see a diverging trend between housing rents and prices in past few months (***Chart***

15), suggesting increased housing demand being redirected to the rental market. The rental index rallied for the eighth consecutive month in September, widening the year-to-date gain to 6.2%. As a result, the rental yield for mass market rose to 2.9% as of September, the highest level since 2016 (***Chart 16***).

Historically, the bottoming out of housing market did not materialise until approximately six months after the last rate hike, which coincidentally was close to the timing of the Fed's first rate cut. The median annualized return of the housing market in the 12 and 24 months following the last Fed rate hike was at 1.9% and 12% respectively. Given our view that the Fed hike in July 2023 was probably the last hike of this hiking cycle, and using history as a guide, we see the Hong Kong property market showing some stabilisation in 1H24. At the same time, rising rental yields and narrower gap with the mortgage rate (which would also fall in 2024 in our view) should lend some support to the housing market. We forecast a 3% decline in housing prices in 2023, and a range of change at -2% to 2% for 2024.

Chart 15: Diverging trend between price and rent

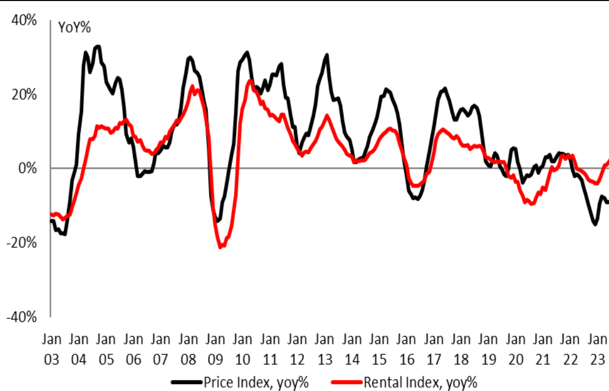
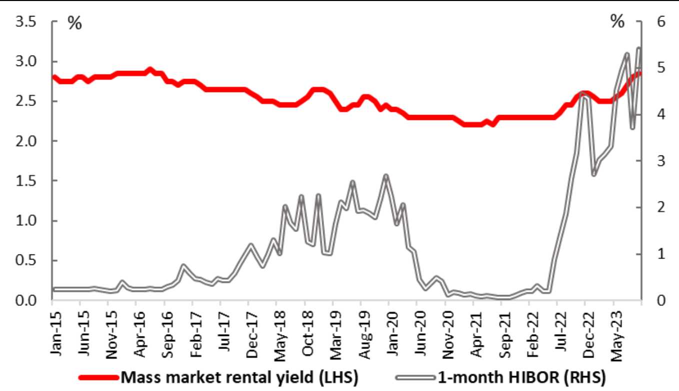


Chart 16: Rental yields narrowing gap with HIBOR



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

Slow recovery in 2024

In view of the fading reopening boost and higher base of comparison, as well as the ongoing headwinds, economic growth is bound to slow in 2024. Yet, the picture is not all bad, thanks to the rollout of China's stimulus measures and likely loosening financial conditions next year. Rate sensitive assets, such as residential properties, should see some stabilisation in prices, if not reverting to an upward trend. At the same time, loan demand will be on stronger footing as HKD rates trend lower and market sentiment improves. Our full year growth forecast for 2024 is pegged at 2.5% YoY. As for labour markets and price pressures, we expect the overall unemployment rate at 2.9%, with average inflation at 2.4% for next year.

India: In the Driver's Seat

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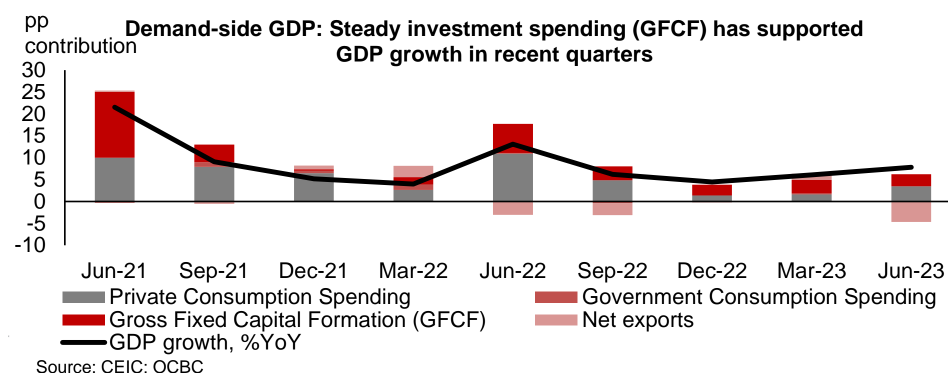
- GDP growth will remain resilient for the remainder of FY23/24 and into FY24/25 supported by solid investments and resilient private consumption expenditures.
- Inflationary pressures will continue to ease in FY24/25, but the downward trajectory will not be straightforward.
- The Reserve Bank of India (RBI) will be patient in terms of cutting interest rates. We forecast a cumulative 75bp in rate cuts for FY24/25, starting in 2Q24.

Investment-led Growth

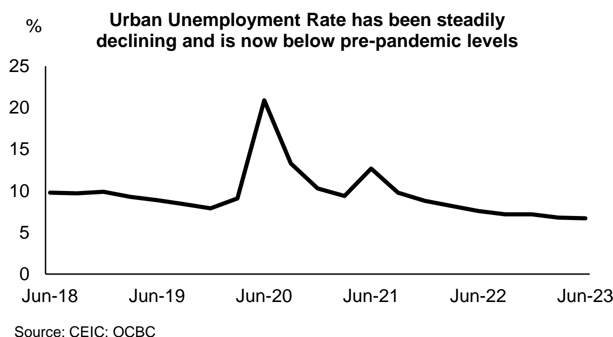
Economic activity has remained strong since the nadir of the pandemic. GDP growth was solid at 7.2% YoY in FY22/23 (i.e., 2Q22 until 1Q23) versus 9.1% in FY21/22. Growth momentum further improved to 7.8% YoY in 2QCY23 (i.e., 1QFY23) driven by domestic final demand. Within this, the main driver was investment spending, which grew at a steady pace of above 8%YoY for five consecutive quarters to 1Q23. This, in our view, reflects consistent public sector infrastructure/capital spending, which has encouraged private sector spending, catalysing a virtuous investment cycle.

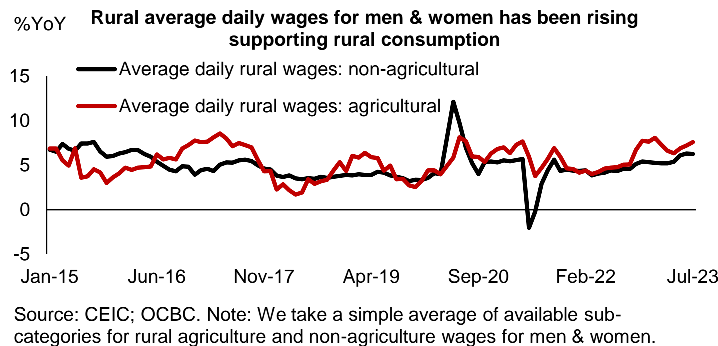


Source: CEIC; OCBC

Resilient investment spending will be the backbone of **strong GDP growth of 6.3% YoY in FY23/24.** Encouragingly, better investment spending continued despite a volatile external backdrop, slower export growth and uncertainties ahead of the April-May 2024 elections (*See Box: India's Busy Political Calendar*). Assuming economic policy continuity following the elections, we expect the share of GFCF (% GDP) to rise in the coming years as the commitments on investment spending from the public and private sectors are met.

Meanwhile, private consumption spending, 58% of GDP and the largest component by share, will remain broadly stable. The urban unemployment rate has been declining steadily while the proportion of employed persons has been rising. This, alongside easing inflationary pressures, will support private consumption expenditures. By contrast, government consumption spending will likely slow in FY23/24, reflecting the fiscal consolidation agenda.

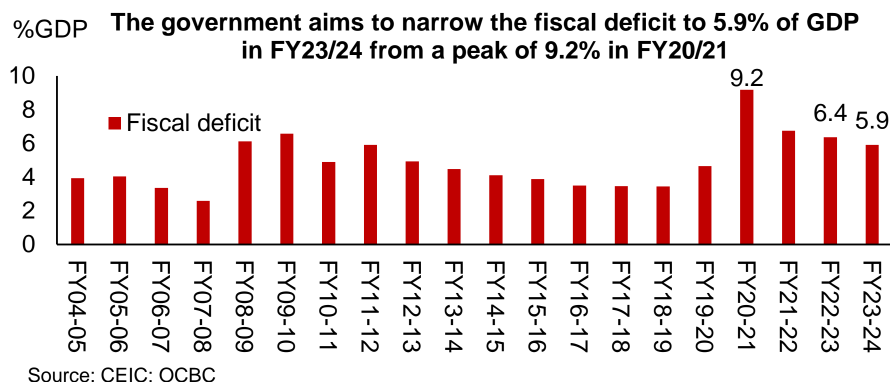




Source: CEIC; OCBC. Note: We take a simple average of available sub-categories for rural agriculture and non-agriculture wages for men & women.

Fiscal Consolidation on Track

The central government fiscal deficit is expected to narrow to 5.9% of GDP in FY23/24 from a revised estimate of 6.4% of GDP in FY22/23, and 9.2% of GDP in FY20/21 during the peak of the pandemic. This is premised on still resilient tax revenue growth of 11.7% YoY in FY23/24 versus 15.4% in FY22/23 and lower expenditure growth.

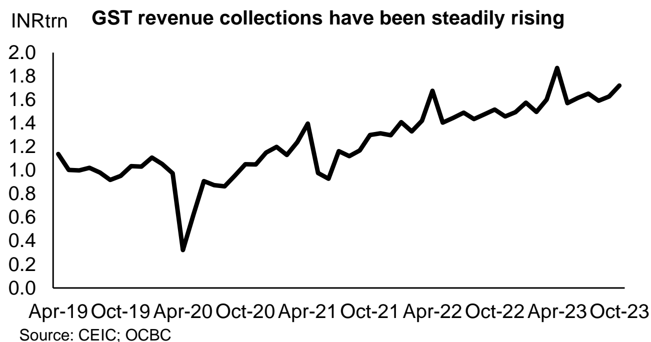


Based on monthly data, tax revenues are on track to achieve the year-end target; collections from April until September 2023 reached 49.8% of the annual FY target. Encouragingly, GST collections (notwithstanding the pandemic period) have been rising consistently since the tax was implemented in July 2017.

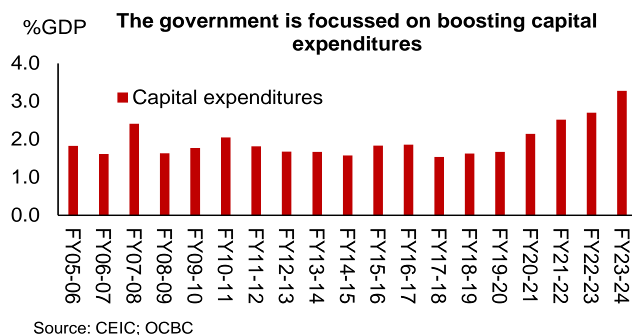
On the expenditure front, the focus remains squarely on boosting capital expenditures. Capital expenditures (as a share of GDP) have been rising consistently and for the coming fiscal year, effective capital expenditures are expected to rise by 30.1% YoY in FY23/24 from 26.1% in FY22/23. Indeed, for the first six months of FY23/24, capex has risen by 43.1% YoY to meet ~67% of the annual budget target. The central government is also providing state governments with incentives to boost capex in the form of long-term interest-free loans and capex-linked additional borrowing provisions.

Current expenditures (aka revenue expenditures) are expected to narrow in FY23/24 as pandemic related spending, namely on subsidies, is unwound. Interest payments, however, will remain elevated rising 14.8% YoY in FY23/24 from 16.8% in FY22/23 reflecting higher interest rates. In terms of financing, central government gross issuances of market borrowings through dated securities were

INR8.88trn from April to September 2023, 57.6% of the full year target. During H2, the Centre's gross market borrowings through dated securities have been planned for INR6.5trn.



Source: CEIC; OCBC



Source: CEIC; OCBC

The upcoming FY24-25 budget in February 2024 will be an interim budget ahead of the April-May elections. The final version of the budget will be announced once the new government is formed[1].

Notwithstanding, the modest pace of fiscal consolidation will keep debt levels elevated. Central government debt is pegged at 57.8% of GDP in FY23/24, with state government debt expected at 27% of GDP in FY23/24. This takes general government debt to 84.8% of GDP, well above pre-pandemic levels of ~70% of GDP.

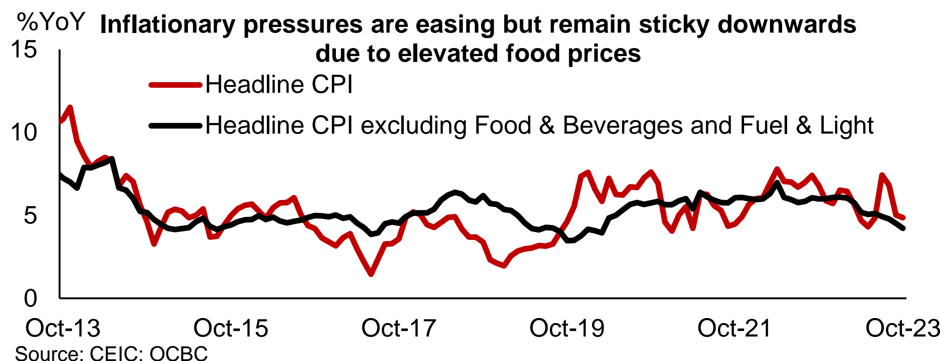
India's high debt levels remain a source of vulnerability as it is not only above pre-pandemic levels but also well above regional peers. Nonetheless, a commitment to quality spending and raising revenues amidst resilient growth will likely keep credit ratings stable over the coming year.

Easing (Even If Sticky) Inflation

Meanwhile, inflationary pressures remained sticky. Much of the stickiness was due to elevated food prices of various items including meats, eggs, vegetables such as tomatoes, cooking oil, and spices. The government adopted numerous measures to mitigate the volatility in food prices including removing/lowering import duties (refined soyabean oil and sunflower oil), restricting exports (rice and onions), increasing supply through calibrated releases (pulses) and open market sales (wheat and rice). This has helped bring down inflation to 4.9% YoY in October 2023 from a peak of 7.4% in July 2023.

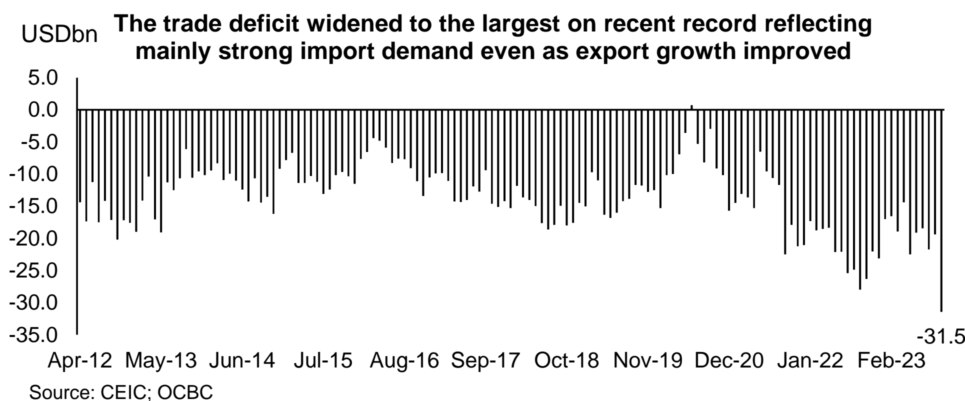
But the downward trajectory will not be straightforward. We expect headline inflation to ease modestly to an average of 5.2% YoY in FY23/24 and 4.3% in FY24/25 from 6.7% in FY22/23. This will bring headline inflation within RBI's 2-6% target range. That said, upside risks to food prices persist from poor weather conditions and El Nino risks, with the crop production subject to heightened uncertainty. Furthermore, core inflationary pressures will persist as domestic demand remains solid.

[1] Following the 2019 elections, the final budget was announced on 5 July.



Trade Balance Stress...

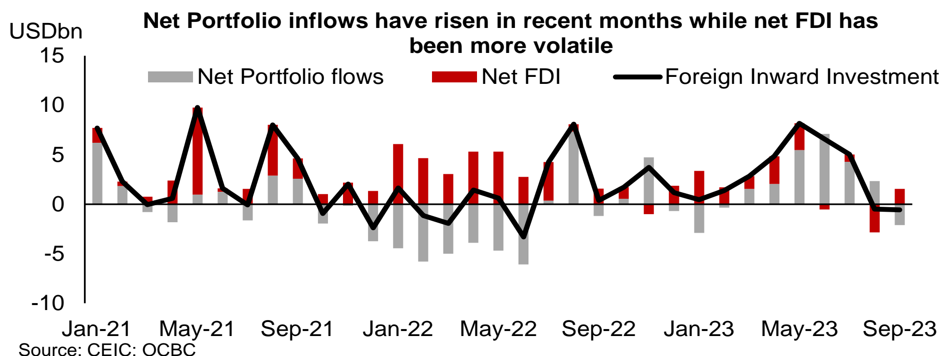
Mirroring the strength in domestic demand, we expect import growth to remain robust, buoying import volumes despite lower prices. Export growth is likely to remain lacklustre given weaker growth in key trading partners including US and Europe. This will keep the trade and current account deficits under pressure. Indeed, the trade deficit widened to US$31.5bn in October 2023, the widest on record reflecting robust import growth more than offsetting better export growth.



The current account deficit, as a result, will likely widen in the coming year. Although the services and secondary income surpluses are likely to improve reflecting higher outsourcing incomes and remittances, respectively, it will unlikely be enough to offset the widening trade deficit. As such, we forecast the current account deficit to widen to 2.2% of GDP in FY23/24 and 2.4% of GDP in FY24/25.

…Offset By Better Capital Flows

Improving capital flows will, to some extent, bolster the overall balance of payments position. Indeed, portfolio inflows rose (on a net basis) from March to August 2023, turning to net outflows only in September. Net FDI inflows were more volatile but are trending upwards. This has helped cushion INR depreciation versus USD.



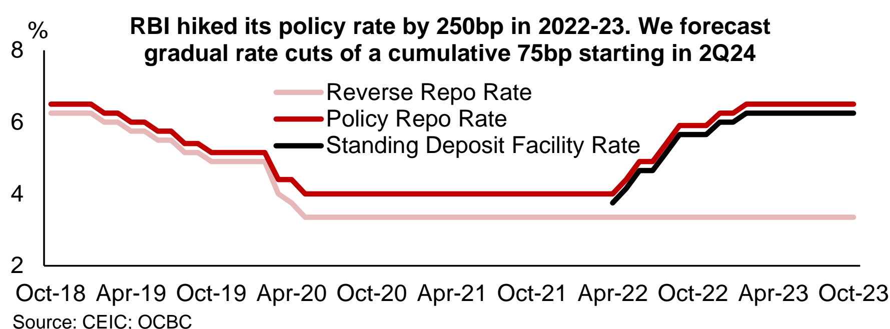
Source: CEIC; OCBC

Reduced volatility in INR was also in part due to RBI actions. RBI has been a net buyer of USD from February 2023 through to July 2023, with net selling taking place in August and September. FX reserves, as result, increased in the start of 2023 and has only recently moderated. Nonetheless, it remains significant at US$590.8bn for the week ending 3 November 2023.

RBI Will Be Patient on Rate Cuts

RBI raised its policy rates by 250bp in the current hiking cycle from May 2022 until February 2023. The repo rate has remained unchanged at 6.50% since February 2023. With inflationary pressures still sticky and growth remaining resilient, we expect a cumulative 75bp in rate cuts from the RBI starting in 2Q24 to coincide with the US Federal Reserve rate cutting cycle (OCBC house view).

Meanwhile, banking system liquidity tightened in September due to seasonal factors including advance tax payments, GST outflows and incremental CRR (i-CRR) prescribed for all scheduled banks in August 2023[2]. While we expect RBI will manage conditions through liquidity operations, prolonged liquidity tightness could raise the probability of a cash reserve ratio (CRR) cut in early 2024.



Source: CEIC: OCBC

[2] Banks were mandated to maintain i-CRR of 10% on incremental deposits from 19 May to 28 July to manage excess liquidity caused by the discontinuation of INR2,000 notes. Tighter liquidity subsequently led the RBI to adjust the i-CRR. RBI released 25% of the I-CRR maintained on September 9 and another 25% on September 23. The remaining 50% of the I-CRR maintained was released on October 7.

BOX: India's Busy Political Calendar

The political calendar for the world's largest democracy is packed with eleven state elections and a General Election from November 2023 until December 2024. In a year of numerous elections, including the US and Indonesia, India's election will stand out for its scale and complexity.

The states elections ahead of Mizoram, Chhattisgarh, Madhya Pradesh, Rajasthan, and Telangana will be held in November 2023. The results will be announced on 3 December 2023. In Chhattisgarh, Madhya Pradesh and Rajasthan, the BJP and Congress will directly take on each other. BJP is in power in Madhya Pradesh while Congress is the incumbent in Rajasthan and Chhattisgarh. Regional parties are in power in the other two states: Bharat Rashtra Samithi (BRS) in Telangana and Mizo National Front in Mizoram.

These state elections will inevitably be seen as litmus test for PM Modi's administration, which has been in power for 9 years, ahead of the April-May 2024 General Elections. The current term of the Lok Sabha (i.e., Lower House) ends on 16 June 2024. The caveat is that state elections have rarely proved an accurate predictor of general election results. In the previous election, the Election Commission announced the election schedule on 10 March 2019 and the elections was conducted in seven phases from 11 April until 19 May 2019.

The members of the Lok Sabha are elected from single-member constituencies using the first-past-the-poll system. Each state based on its population is represented by the proportionate number of seats in the Lok Sabha. For example, Uttar Pradesh, which is the most populous in India, has 80 Lok Sabha seats, followed by Maharashtra with 48 seats. The Northeast states of Sikkim, Mizoram, and Nagaland send one Member of Parliament, along with the Union Territories (apart from Delhi).

There are two main blocs emerging as key contesters: the incumbent National Democratic Alliance (NDA), of which PM Modi's Bhartiya Janata Party (BJP) is the main party. In the 2019 elections, PM Modi's BJP on its own won a majority of seats in the 543 seat Lower House. Contesting the NDA, is the recently banded together opposition of the Indian National Developmental Inclusive Alliance (I.N.D.I.A). This alliance is spearheaded by the Congress Party and inclusive of most key opposition parties to the BJP in the centre and various states (26 parties at most recent count).

Markets may be complacent around the risks of a political change especially since the opposition has doubled down on its efforts to replace the Modi government. That said, there are few polls to indicate which of two alliances is in the lead.

Indonesia: In (Political) Transition

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- We expect GDP growth to slow to 4.8% in 2024 from 5.0% in 2023 as investor sentiments ahead of the 2024 elections turns cautious, commodity tailwinds fade, and fiscal support remains neutral.
- Inflationary pressures will likely remain well contained but external risks including IDR depreciation pressures will keep Bank Indonesia (BI) on hold through 1Q24.
- This will give BI more wiggle room to unwind these hikes in 2024. We forecast a cumulative 125bp in rate cuts, starting in 2Q23 to coincide with US Fed rate cuts.

Resilient Growth in 2023

Economic activity remained resilient in 2023, with GDP growth averaging 5.1% YoY in 1Q-3Q23, versus 5.3% in 2022. This resilience was supported by stable household spending amidst moderating inflation, better-than-expected investment spending as commodity tailwinds sustained to some extent and stable government spending following a period of sharper fiscal consolidation in 2022. These factors will more than offset the weakness on the external front as export and import growth are set to contract sharply in 2023.

Slower Growth in 2024

The growth outlook is less certain for 2024. Not least because of the Presidential election on 14 February, with 3 candidates registered to run for the post. Taken together with fading commodity tailwinds and limited fiscal support for growth, we forecast GDP growth will slow to 4.8% in 2024 from 5.0% in 2023. Indeed, growth momentum has already started slowing. 3Q23 GDP slowed to 4.9% YoY from 5.2% in 2Q23, the first sub-5% growth since the pandemic.

Presidential Candidate	**Anies Baswedan (54)**	**Ganjar Pranowo (54)**	**Prabowo Subianto (72)**
	Former Jakarta Governor	Former Central Java Governor	Defence Minister and Chairman of Gerindra Party
Vice President Candidate	**Muhaimin Iskandar (57)**	**Mahfud MD (66)**	**Gibran Rakabuming Raka (36)**
	Deputy Speaker of the House of Representatives and Chairman of PKB Party	Coordinating Minister for Political, Legal, and Security Affairs	Mayor of Surakarta

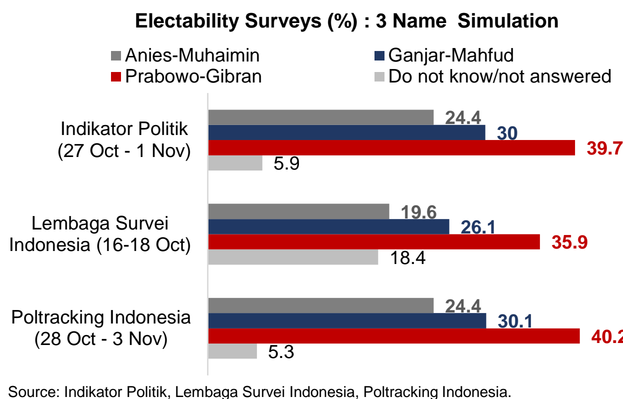
Source: KPU; OCBC. Note: Age of candidates are in brackets

A 3-Way Presidential Race…

The Presidential elections on 14 February 2024 marks a crucial juncture for medium-term development. Economic growth and reform momentum have gained traction under President Jokowi. President Jokowi had also laid out crucial medium-term plans including the development of the new capital city, Nusantara in East Kalimantan, building down-stream capabilities in the mining sector, and

delivering on the Golden Indonesia 2045 Vision[3]. His successor will have to decide on the follow through regarding these plans.

The 14 February elections will be the first time in 3 election cycles (15 years) that 3 candidates will be vying for the post of President. The latest electability surveys suggest that no one candidate will get an outright majority in the first round of the elections on 14 February. This significantly raises the risk that there will be a subsequent run-off on 26 June 2024 and that political uncertainty will extend through 1H24.



Source: Indikator Politik, Lembaga Survei Indonesia, Poltracking Indonesia.

Key Election Timeline	
19 Oct 23 – 25 Oct 23	Presidential Nomination
28 Nov 23 – 10 Feb 24	Election campaign period
14 Feb 24	Voting Day
26 Jun 24	Second round run-off
20 Oct 24	Presidential Oath of Office

… May Support Private Consumption Spending

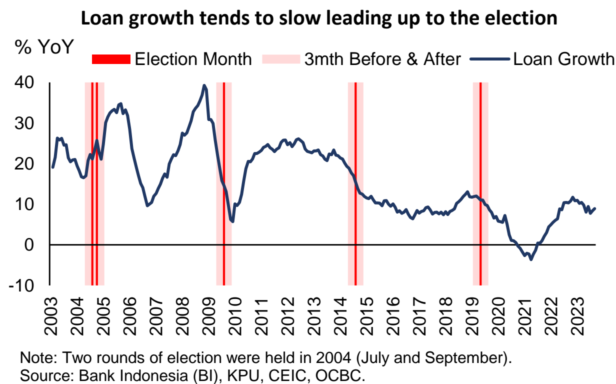
Household consumption, with a share of over 50% of GDP, has been largely stable to modestly higher during past election cycles. We expect the same in 2024. Importantly, labour market fundamentals remain supportive of private spending. The unemployment rate fell to 5.3% in Aug-23 and the government has raised the salaries for civil servants, the national army, and police by 8% next year. In addition, cognisant of rising food prices, the government has provided cash aid worth IDR7.5trn and a free rice distribution programme to help deal with double-digit rice inflation in late 2023.

…But May Weigh on Investments…

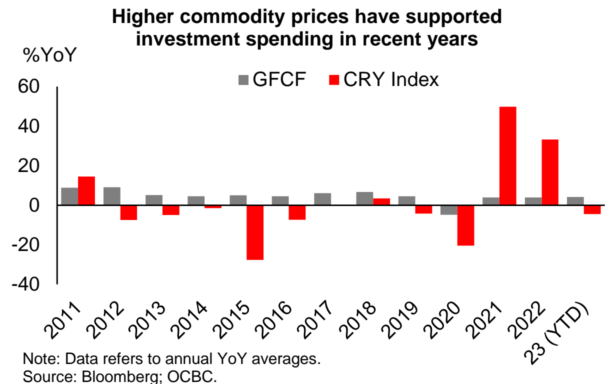
By contrast, historical precedence shows that investment spending and credit growth have tended to slow in past election cycles as investor sentiment turns more cautious. The need to follow through on the medium-term economic plans laid out by President Joko Widodo makes the upcoming elections even more important. Although the formal campaigning period will begin only on 28 November 2023, the three presidential candidates have indicated their willingness to continue President Joko Widodo's down-streaming policies. There is still, however, limited clarity on plans regarding shifting the capital city.

Moreover, there will be a drag from fading commodity tailwinds. Higher commodity prices tend to lift many boats including investment spending, tax revenues and exports. As these commodity price tailwinds fade further into 2024, the drag on these drivers of economic activity will intensify.

[3] Under this Vision, amongst other things, Indonesia will become a developed country by 2045 rising to among the fifth largest economies globally.



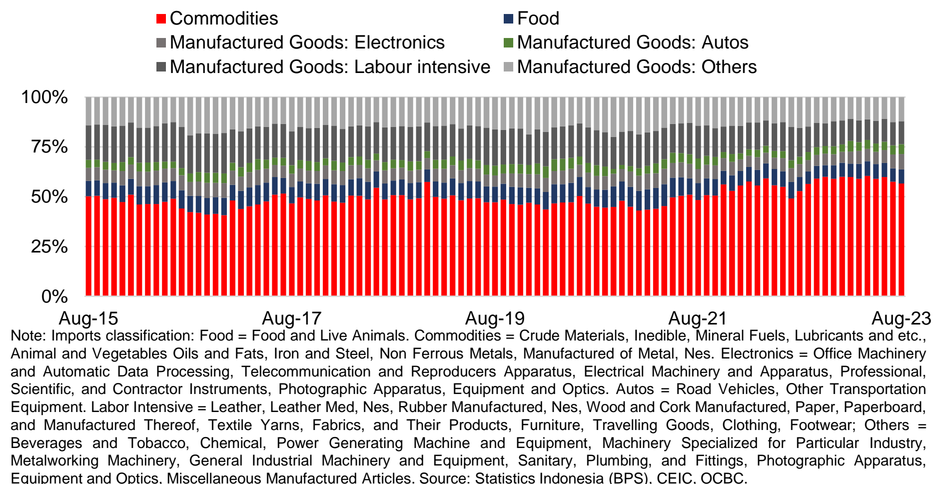
Note: Two rounds of election were held in 2004 (July and September).
Source: Bank Indonesia (BI), KPU, CEIC, OCBC.



Note: Data refers to annual YoY averages.
Source: Bloomberg; OCBC.

No External Respite

Fading commodity prices, particularly for coal and palm oil, will weigh on export growth coupled with slower global growth in key trading partners including China and the US (see China and Global section). The bottoming out in the electronics downcycle will not have a large impact on overall export growth given that the lion's share of exports (57% in 2023 YTD) is commodities.

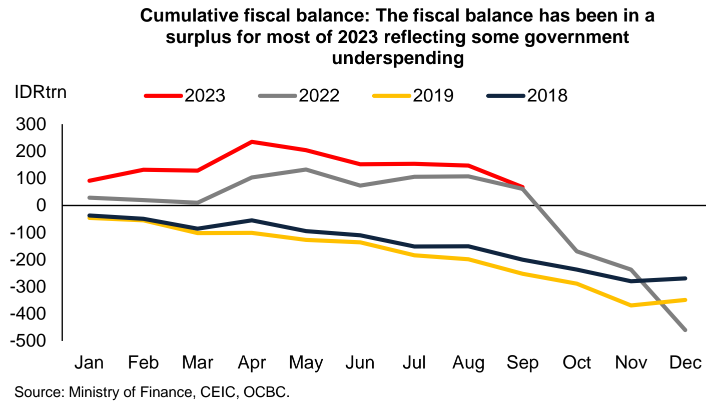


Note: Imports classification: Food = Food and Live Animals. Commodities = Crude Materials, Inedible, Mineral Fuels, Lubricants and etc., Animal and Vegetables Oils and Fats, Iron and Steel, Non Ferrous Metals, Manufactured of Metal, Nes. Electronics = Office Machinery and Automatic Data Processing, Telecommunication and Reproducers Apparatus, Electrical Machinery and Apparatus, Professional, Scientific, and Contractor Instruments, Photographic Apparatus, Equipment and Optics. Autos = Road Vehicles, Other Transportation Equipment. Labor Intensive = Leather, Leather Med, Nes, Rubber Manufactured, Nes, Wood and Cork Manufactured, Paper, Paperboard, and Manufactured Thereof, Textile Yarns, Fabrics, and Their Products, Furniture, Travelling Goods, Clothing, Footwear; Others = Beverages and Tobacco, Chemical, Power Generating Machine and Equipment, Machinery Specialized for Particular Industry, Metalworking Machinery, General Industrial Machinery and Equipment, Sanitary, Plumbing, and Fittings, Photographic Apparatus, Equipment and Optics, Miscellaneous Manufactured Articles. Source: Statistics Indonesia (BPS), CEIC, OCBC.

That said, tourism remains a bright spot. Tourist arrivals have risen by 143% YoY in the first nine months of 2023 to 8.5 million, already surpassing the 5.9 million arrivals recorded in 2022. This is about 53% of 2019 levels, indicating a notable upside potential ahead for export services in 2024.

Fiscal Support to Remain Neutral

Fiscal support to growth will remain neutral. The government has been running a cumulative fiscal surplus until September 2023. Revenue collections remained strong, albeit with growth slowing compared to an elevated base in 2022. Expenditure growth also slowed as subsidy spending was cut back sharply following the sharp rise in 2022.



There is a rising likelihood that the government will undershoot its fiscal deficit of 2.3% of GDP in 2023. Although the fiscal deficit is tracking 2.2% of GDP on a 12-month rolling sum basis until September 2023, expenditure disbursements have been lower compared to past years while revenue collections remain solid. We forecast the deficit to be closer to 2% of GDP for 2023.

This implies a neutral fiscal impulse in 2024 with the fiscal deficit pegged at 2.3% of GDP. The government has forecasted higher revenues and expenditure growth. Revenue growth is expected to rise by 6.3% YoY mainly driven by higher tax revenue (+ 9.0% YoY in 2024). However, this is predicated on a 9.4% rise in Value Added Tax (VAT)[4], which may turn challenging if our forecast of slower economic activity materialises. Meanwhile, non-tax revenue is expected to decline by 4.6% YoY consistent with lower global commodity prices.

[4] We note that the VAT adjustments in 2022 have supported revenue collections, while the simplification of administration tax through the Tax Regulations Harmonization Law (HPP Law) will continue to support revenue collections.

IDR trn	2020	2021	2022	2023 Outlook	2024 Proposed	*%YoY*	2023 Outlook vs 2022	Proposed 2024 vs Outlook 2023
Government Revenue and Grant	**1647.8**	**2011.3**	**2635.8**	**2637.2**	**2802.3**		**0.1**	**6.3**
Domestic Revenue	1629.0	2006.3	2630.1	2634.1	2801.0		0.2	6.3
Tax revenues	1285.1	1547.8	2034.6	2118.3	2309.0		4.1	9.0
Domestic sources	1248.4	1474.1	1943.7	2045.5	2233.0		5.2	9.2
International sources	36.7	73.7	90.9	72.9	74.9		-19.8	2.7
Non-Tax Revenues	343.8	458.5	595.6	515.8	492.0		-13.4	-4.6
Grants	18.8	5.0	5.7	3.1	0.4		-45.6	-86.1
Government Expenditure	**2595.5**	**2786.4**	**3096.3**	**3123.7**	**3325.1**		**0.9**	**6.4**
Central Government	1833.0	2000.7	2280.0	2298.2	2467.5		0.8	7.4
Personnel	380.5	387.8	402.4	432.5	481.4		7.5	11.3
Material	422.3	530.1	426.1	418.2	410.9		-1.9	-1.7
Capital	190.9	239.6	240.6	258.9	244.4		7.6	-5.6
Interest Payment	314.1	343.5	386.3	437.4	497.3		13.2	13.7
Subsidies	196.2	242.1	252.8	271.4	282.7		7.4	4.2
Energy	97.4	140.4	171.9	185.4	185.9		7.9	0.3
Non Energy	98.8	101.7	81.0	86.0	96.9		6.3	12.6
Social Assistance	202.5	173.7	161.5	146.5	152.3		-9.3	4.0
Others	120.0	79.7	404.4	333.4	377.4		-17.5	13.2
Regional Transfer	762.5	785.7	816.2	825.4	857.6		1.1	3.9
Government Deficit or Surplus	**-947.7**	**-775.1**	**-460.4**	**-486.4**	**-522.8**			
%GDP	-6.1	-4.6	-2.4	-2.3	-2.3			

Source: Ministry of Finance, CEIC, OCBC

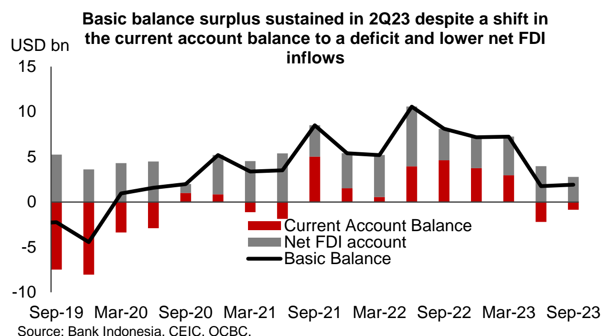
Overall expenditure is expected to increase by 6.4% YoY in 2024 driven by subsidy and social assistance spending (+ 4.1% YoY in 2024) reflecting higher conditional direct cash transfers, basic food distribution, energy subsidies, and micro-credit programmes (KUR). In addition, personnel spending is set to increase by 11.3% YoY in 2024, as salaries for civil servants, the national army, and police increase by 8% next year. Capital expenditures is budgeted to drop 5.6% YoY in 2024 but transfer to regions will pick up next year following a sharp drop in 2023.

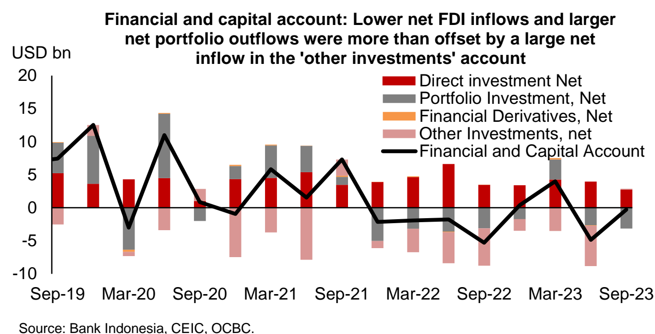
Following sharp consolidation in 2021 and 2022, a more neutral fiscal stance in 2024 remains appropriate. The government will also have some wiggle room to adjust the fiscal spigot wider should economic activity slow more-than-expected.

An Eye on External Vulnerabilities

Even with a more neutral fiscal stance, BI will remain cognisant of external risks. The current account balance will, by our forecasts, shift to a wider deficit of 0.6% of GDP in 2024 from -0.1% in 2023. Weaker exports will continue to put pressure on the trade balance with tourist arrivals providing only a modest offset.

Indeed, the significant narrowing of the trade tipped the current account balance into a deficit in 2Q23. This led to a sharp narrowing in the basic balance (net FDI and current account balance) surplus to 0.5% of GDP in 2Q and 3Q23 from 2.2% of GDP in 1Q23. FDI inflows tend to slow during political election cycles, and this may also be the case for 2024. Indeed, net FDI inflows slowed in 3Q23 with the financial account balance improving mainly due to net 'other investments.'



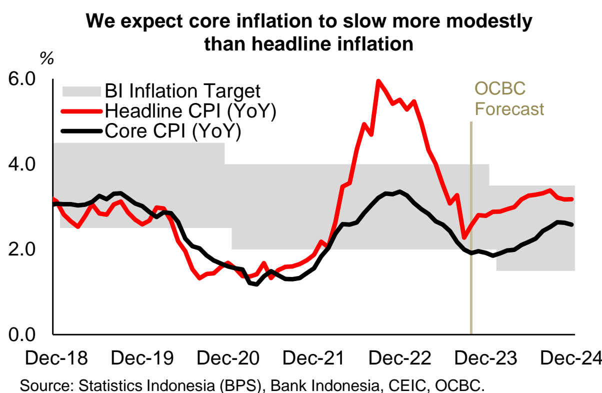


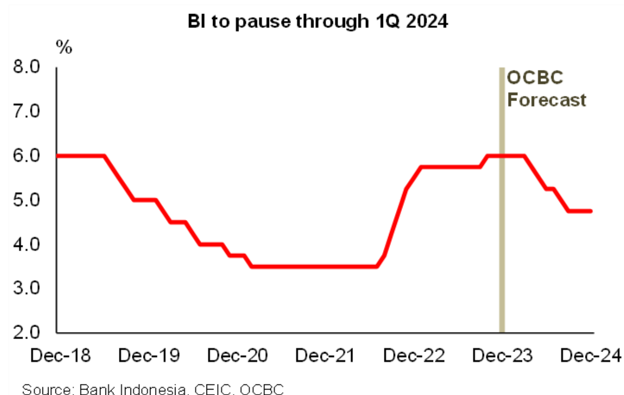
That said, there may be some respite on the external front from impending US Fed rate cuts and relief for the currency (IDR) in 2024. The currency (IDR) has been the worst performing currency in 2H23 (until 18-October) versus USD. To mitigate against IDR depreciation pressures, BI hiked its policy rate by 25bp at its 19 October meeting.

Bank Indonesia in Wait-And-See Mode

Market pricing shows only a small probability that the US Fed will hike its policy rate again in 2023. However, from BI's perspective, it will need to keep monetary policy tight to convincingly mitigate against IDR depreciation pressures and narrow interest rate differentials to the US. We, therefore, expect BI to keep its policy rate unchanged at 6.00% through 1Q24.

Inflationary pressures will remain well contained. While headline inflation has eased perceptibly in 2023, with the sharper drop in September 2023 reflected a normalisation of base effects[5]. Core inflation has been stickier downwards.





Indeed, for 2024, BI revised higher its inflation forecast to 3.2% YoY versus 3.0% previously. This is closer to the upper end of its 1.5-3.5% inflation target range for next year. Our forecast is for headline inflation to ease to 3.7% YoY in 2023 from 4.2% in 2022, before easing further to 3.1% in 2024.

Even so, BI will have room to normalise monetary policy in 2024. Slower growth, moderating inflation, and less pressures from US Fed policies will allow BI to cut its policy rate by a cumulative 125bp in 2024, starting in 2Q24 to coincide with the US Fed lowering its policy rate (in accordance with our house view).

[5] The government raised retail fuel prices by ~33% in September 2022.

Macau: Pre-Covid Growth in Sight

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- Total tourism spending and gross gaming revenue, which represent the total receipt of the two dominant sectors, saw impressive growth in 2023. Meanwhile, various macroeconomic indicators were also on the fast track to return to the pre-pandemic levels. All these point to a stellar year for economic recovery in 2023.
- For 2023, we expect the gross gaming revenue to return to around 65% of the pre-Covid level, while total tourism spending may jump to around 115% of the pre-pandemic level. In view of the stronger-than-expected recovery of tourism and gaming sectors, we expect Macau's full-year growth rate to be as high as 89% YoY this year.
- There is little doubt that Macau will surpass pre-covid levels in 2024, given the current trajectory. Further recovery in gaming and inbound tourism sector should underpin growth. Nonetheless, the full year growth is likely to come down, given the less favourable base effect. We peg the growth rate at 25% in 2024.

Speedy recovery spurred by rebound of tourism and gaming sectors

While most economists had put up rather upbeat forecasts earlier this year, the city's speedy economic recovery still managed to surprise the market to the upside. In the eight-day Golden Week holiday, average daily visitor arrivals into Macau recovered to 83.7% of the level in 2019 (***Chart 1***). Total tourism spending and gross gaming revenue, which represent the total receipt of Macau's two dominant sectors, saw impressive growth during the year, reverting to 99.5% (for the first half of 2023) and 60.2% (for the first ten months) of 2019 levels, respectively (***Chart 2***). Meanwhile, various macroeconomic indicators were also on the fast track to return to pre-pandemic levels. All these are spelling out a stellar year for economic recovery.

Chart 1: Daily visitor arrivals recovered to over 80%

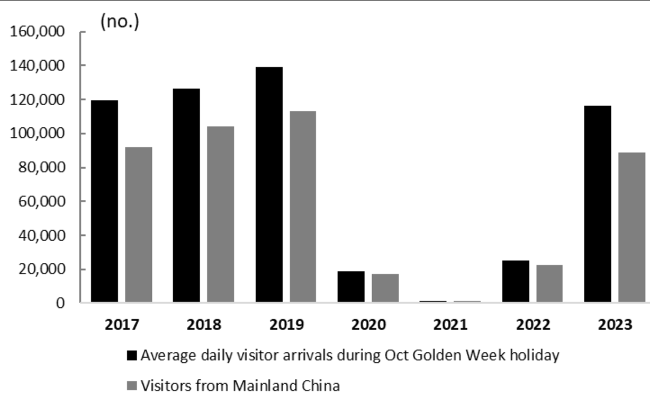
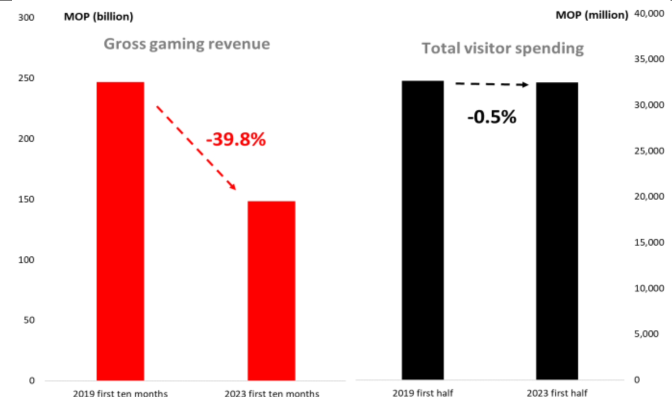


Chart 2: On track to return to pre-pandemic level



Source: DSEC, DICJ, OCBC

Chart 3: Macau's economy

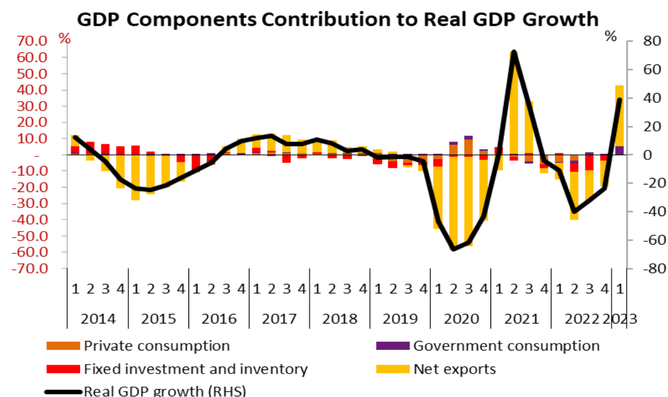
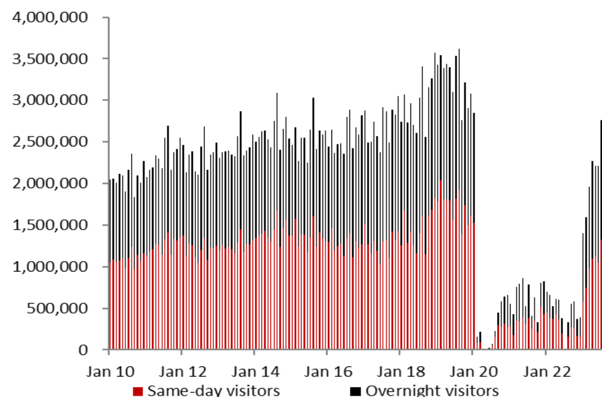


Chart 4: Visitor arrival



Source: DSEC, DICJ, OCBC

Almost doubling the 2022 economic size

In 3Q23, real GDP jumped by 117.5% YoY, led by sharp rebound in the tourism and gaming sectors. In 1H23, GDP grew by 71.5% YoY, recovering to around 71% of the pre-pandemic level in 1H19. Private consumption expenditure reverted to 15.1% YoY growth, on the back of improved economic sentiment and a tight labour market. Gross fixed capital formation also surged by 47.8%, due to solid increase in construction investment. Meanwhile, growth of public consumption expenditure moderated to 3.0% YoY, amid scaled back economic relief measures. Driven by the investment spending, domestic demand expanded by 18.4% YoY.

New appeals and endless shows to bring in more tourists

Splurging on everything from water parks to VR gaming facilities, casino operators are going out of their way to build Macau into a Las Vegas-style entertainment hub with a vast range of non-gaming amenities and entertainment shows for tourists, to fulfil investment pledges under their 10-year gaming concessions. Therefore, in the past few months, new hotels and attractions opened all over town, while firework shows, music festivals, and concerts were lining up. These new appeals and endless shows continued to bring in tourists, even with the pent-up demand partly exhausted and travel sentiment dented by sluggish growth in China.

Total visitor arrivals reached 8.3mn in 3Q23, reverting to around 83.5% of the pre-covid level in 2019 (***Chart 4***). Meanwhile, the total tourism spending recovered to almost pre-covid levels, thanks to the loosened purse strings of tourists. Higher hotel rates and services charges were part of the reasons for the increased spending. Per-capita spending (excluding gaming expenses) of tourists was at MOP2,610 in 2Q23, up by 64.9% compared to that in 2Q19 (***Chart 5***). Tourist Price Index for 3Q23 rose by 2.9% QoQ, largely due to higher hotel room rates. In the periods ahead, we expect the per capita spending for visitors to trend lower, with a larger mix of same-day visitors. Yet, growth in total visitor arrivals should more than make up for the decline in per capita spending.

Chart 5*: Tourism spending

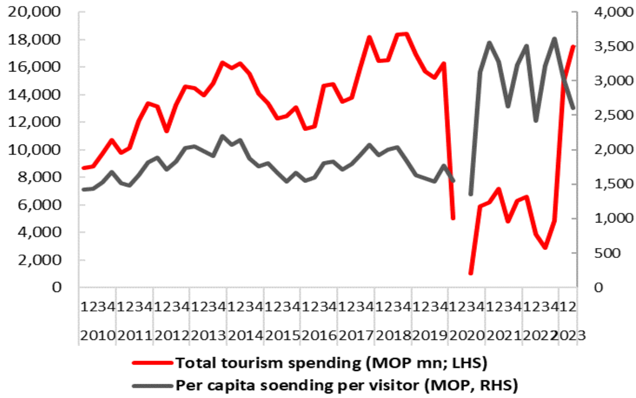
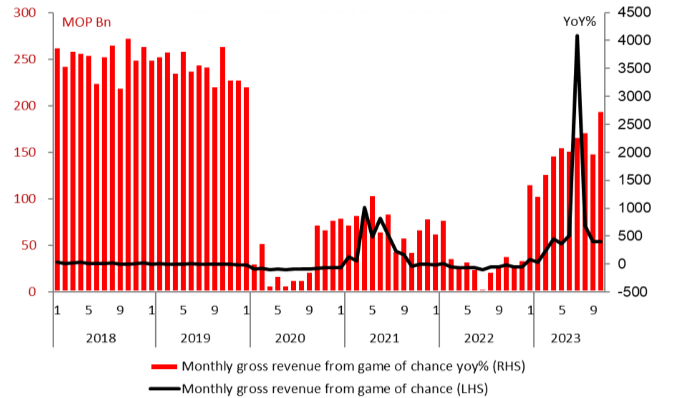


Chart 6: Gross gaming sector



Source: DSEC, DICJ, OCBC
Note (*): The survey data is not available for the second quarter of 2020.

Mass gaming segment leading the recovery story

In the first ten months this year, gross gaming revenue more than tripled over the same period last year, to an average of MOP14.8bn per month (***Chart 6***). In October alone, the gaming revenue returned to 73.7% of 2019 level. The recovery story continued for the mass and premium mass segments, with gross gaming revenue generated from these segments returning to 82.2% of the pre-Covid level (vs. 31.6% YoY in VIP segment). As a result, the share of mass market grew to above 75% again in the 3Q23 (***Chart 7***). Going forward, the casino concessionaires' investment on non-gaming amenities should continue to have positive spill-over on gaming revenues for mass segment, while the same may not be true for the VIP segment under a stringent regulatory setting.

Healthier labour market

The labour market turned much healthier with a larger pool of labour force and a lower unemployment rate, which also bodes well for domestic consumption. In 3Q23, the labour force grew to 378k, 2.3% above the recent low in March-May 2023. Meanwhile, the overall unemployment rate also declined further to 2.4% (***Chart 8***), from the high of 4.1% during the pandemic, though still shy of the 2019 level at 1.7%. In parallel, employment earnings also rose further. The median employment income rose from the low of MOP14,000/month during the pandemic to the record high of MOP18,000/month in 3Q23.

Chart 5*: Mass segment led recovery

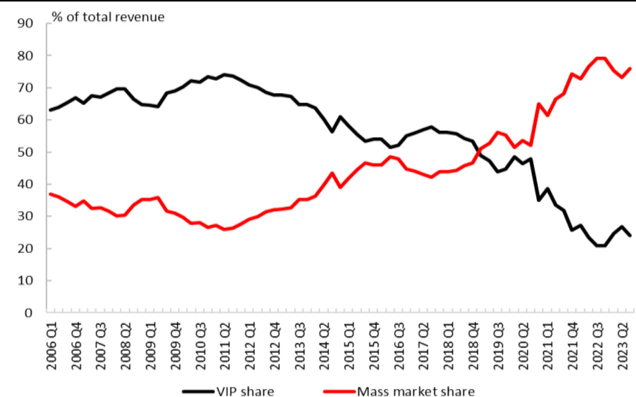
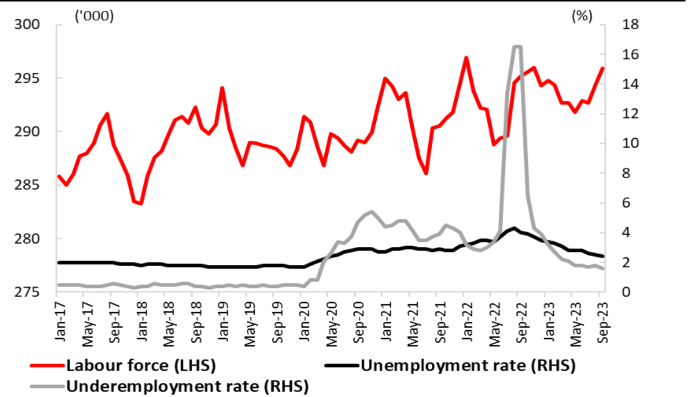


Chart 6: Labour market tightened



Source: DSEC, Macau Labour Affair Bureau, OCBC

Housing market under renewed pressure

Despite the rosy picture painted above, not everything is in a good shape. Take the property market as an example. After seeing a moderate rebound in 1H23, home prices slid again in July and August (***Chart 9***). Yet, compared with the recent low in November 2022- January 2023, housing prices were still up by 1.2%. Meanwhile, trading activities stayed at a subdued level as buyers and sellers remained on the sidelines. Market sentiment was fragile in the face of high mortgage rates and growing uncertainties around the global macroeconomic outlook. Mortgage rates were elevated (***Chart 10***), with 1-month and 3-month MAIBORs climbing to around 5% level, while the prime rate also rose to a high of 6.125% (***Chart 10***).

Chart 9: Housing price slid again

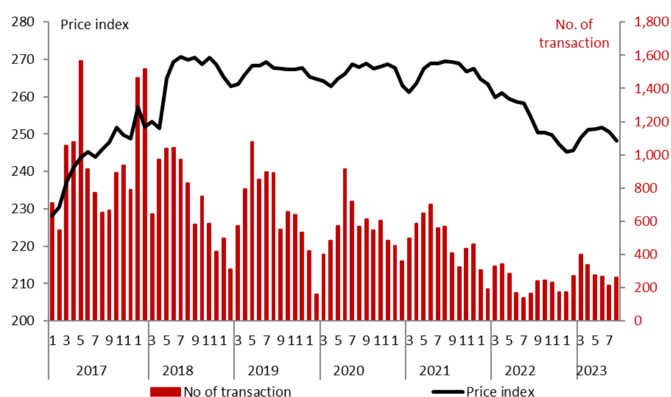
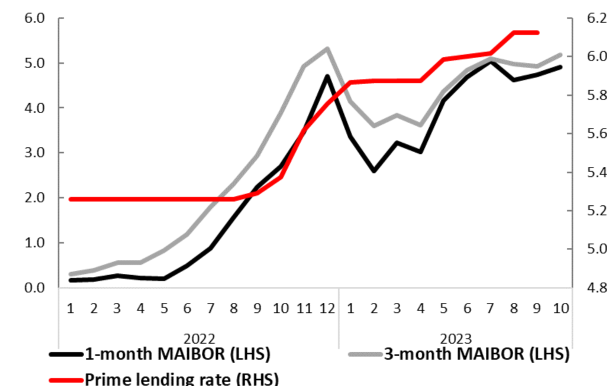


Chart 10: Interest rates elevated



Source: DSEC, Monetary Authority of Macau, OCBC

Inflationary pressure remained moderate

Despite the pickup in economic activities, price pressures remained moderate throughout 2023. For the first nine months, headline inflation averaged at 0.8%YoY (***Chart 11***), as the largest component of CPI "housing and fuels" continued to see YoY declines. Meanwhile, the increase in costs of "food and non-alcoholic beverage" and "miscellaneous goods and services" (with combined weighting of 37.4%) accelerated. We expect the inflation to stay well contained in the near-term, with the housing market undergoing correction.

Turning around the deficit

The government continued to adopt expansionary fiscal policy throughout this year to solidify growth, despite recording a notable fiscal deficit since the onset of pandemic (***Chart 12***). However, the situation is about to change, supported by a surge in gaming taxes. In the first nine months of 2023, the government's current revenue at MOP57.5bn exceeded the expenditure at MOP48.4bn for the first time in four years. Within this, gaming concession revenues reached MOP45.8bn (around 80% of total current revenue).

For 2024 budget, despite the extended cash handout and relief measures, the local government projected a fiscal surplus totalling MOP1.1bn, with public revenue and expenditure estimated at MOP107bn and MOP105.9bn, respectively.

Chart 11: Price pressure remained moderate

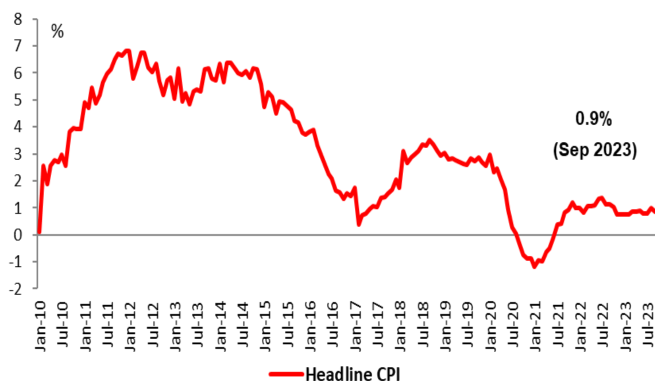
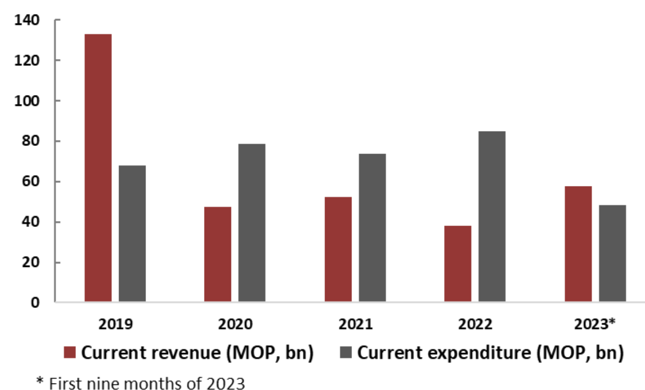


Chart 12: Turning around the fiscal deficit



* First nine months of 2023

Source: DSEC, OCBC

Pre-Covid level in sight

In view of the stronger-than-expected recovery of tourism and gaming sectors, we expect full-year growth rate to be as high as 89% YoY this year, while unemployment rate drops to 2.6%. We also expect total tourism spending (excluding gaming expense) to rise to around 115% of the pre-pandemic level in 2023, while total gross gaming revenue should revert to around 65% of the pre-Covid level. Meanwhile, casino operators and government are investing heavily in non-gaming amenities and city-wide infrastructure.

That said, near term challenges remain as the lack of a qualified workforce and insufficient transport infrastructure put a lid on potential growth. Meanwhile, progress on the economic diversification drive ("1+4 model") had been considerably slow, due to lack of a competitive edge in other industries.

2024 Outlook

There is little doubt, given the current trajectory, that the economy will reclaim the pre-covid level in 2024. The government forecasts gross gaming revenue to reach MOP216bn next year, hence triggering a clause requiring 20% increase in concessionaires' investment commitments (originally at MOP108.7bn for six concessionaires over the course of 10 years). Aside from gaming sector, a further recovery in the inbound tourism sector should continue to underpin growth (increase in visitor arrivals more than offsetting the decline in per capita spending).

Nonetheless, the full year 2024 growth is likely to come down, given the less favourable base effect. All in all, we forecast GDP growth at 25%YoY. The labour market is likely to return to a full employment status, where the unemployment rate will fall back to 1.8%.

OCBC

Malaysia: Navigating Challenges

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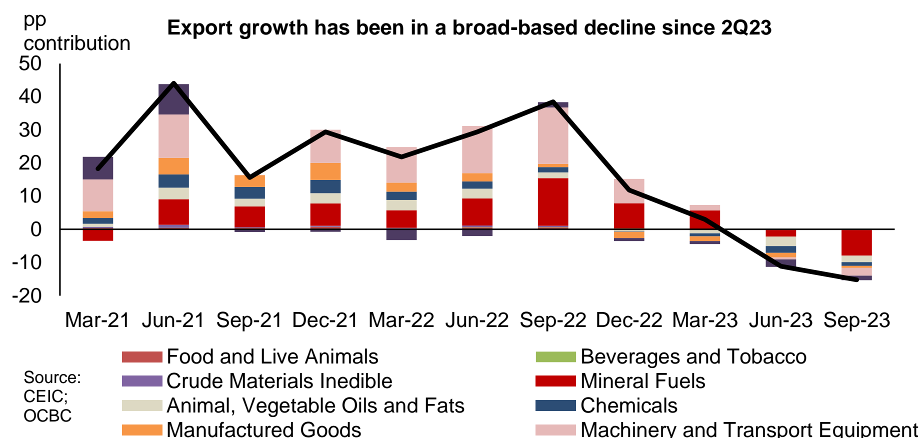
- We expect modestly better growth of 4.2% YoY in 2024 from 4.0% in 2023 buoyed by resilient domestic demand even as headwinds to exports persist.
- The government has introduced numerous medium-term plans aimed at fiscal consolidation, attracting FDIs, enhancing growth and development.
- The inflation outlook depends on the timeline and mechanism of targeted fuel subsidy rationalisation. Notwithstanding, we expect Bank Negara Malaysia (BNM) to keep its policy rate unchanged in 2024.

An Externally Challenging 2023…

GDP slowed to an average of 3.9% YoY in 1Q-3Q23 versus 8.7% in 2022, dragged by a broad-based decline in exports since the start of the year and slowing domestic demand, namely private consumption. Investment and government spending have slowed more modestly.

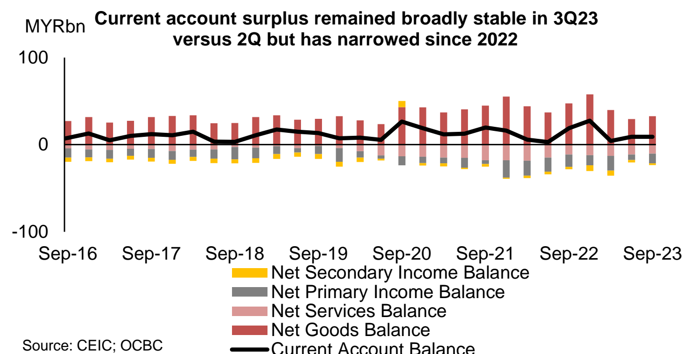


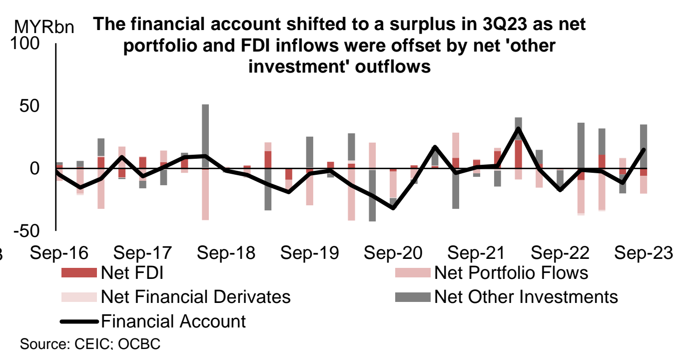
Source: CEIC; OCBC

The bigger challenge was on the external front. Slowing exports have led to narrower trade and current account surpluses. Import growth, mirroring weaker domestic demand conditions, saw a slowdown that was marginally better than exports. Capital outflows have also been volatile with the financial account deficit persisting for five consecutive quarters to 2Q23. The basic balance (net FDI + current account) surplus has also narrowed in 1H23.

The currency, MYR, depreciated ~6% against USD year-to-date as of 23 November 2023, underperforming regional peers. Our FX strategy view is that external factors including higher UST yields driven by the Fed's 'high for longer' narrative, weak sentiment in China (USD/MYR and CSI have a strong correlation) weighed on MYR along with weaker export growth.

The weakness in the currency was explicitly mentioned by BNM in their 9 November policy statement. BNM noted that the currency weakness would not "derail" growth prospects and that it would "continue to manage risks of heightened volatility".





…With More of the Same in 2024

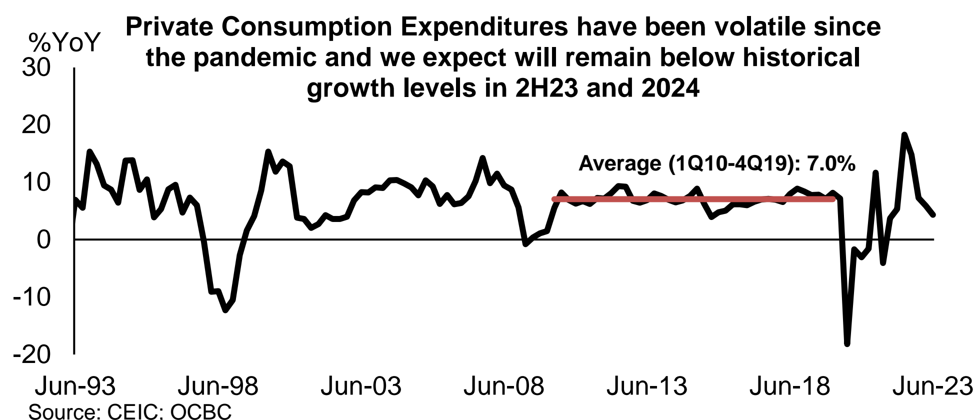
The external backdrop in 2024 is likely to remain as challenging as in 2023. Export demand will be buffeted by numerous factors including slower global growth, fading commodity tailwinds, and persistent geopolitical tensions. The bottoming of the electronics export downcycle may provide much-needed support to exports. To that end, we forecast goods export growth to remain negative at -1.0% YoY in 2024, still better than -13.1% expected in 2023. Resilient tourism inflows in 2024 will provide some support for overall services.

Still Looking for Better 2024 GDP Growth

Despite the weak external backdrop, we forecast marginally higher 2024 GDP growth of 4.2% YoY versus 4.0% in 2023. The support to growth will come mainly from domestic demand factors, namely a stabilisation in private consumption growth and higher investment spending.

#1: Stabilising Private Consumption

Private consumption growth has been volatile since the onset of the pandemic after period of relatively stable growth of 7% (2010-19). Anecdotal evidence suggests that household balance sheets were significantly impacted by the pandemic and that savings were drawn out, with Employee Provident Fund (EPF) savings also being tapped on. As the scars of the pandemic fade into 2024, we expect private consumption growth to normalise, and settle at a lower rate versus pre-pandemic levels.



#2: Clearer Investment Focus…

Investment spending will remain supported by the private and public sectors. With fiscal consolidation underway, capital rather than operational expenditures will remain the priority. The government has listed eleven new infrastructure projects that will be the focus in 2024 and over the medium-term. PM Anwar's government is also keen to attract FDI and enhance development and growth opportunities. The government has set out a strong medium-term development agenda to build on its ambitions.

11 New Transport & Logistic Projects introduced
Pan Borneo Highway Sabah Phase 1B
Penang Light Rail Transit (LRT) Project
expansion of Penang International Airport
redevelopment of Sultan Abdul Aziz Shah Airport, Subang
and the upgrade of the East-West Highway from Gerik, Perak to Jeli, Kelantan
Expansion of Bus Rapid Transit (BRT) and intra-city bus services including in Johor Baru and the Klang Valley
Upgrading the Senai-Desaru Highway
Widening of the North-South Expressway (from Yong Peng to North Senai) in phases
construction of Sarawak-Sabah Link Road II
Upgrading the road from Tanah Rata to Kea Farm, Cameron Highlands
Development of a new port on Carey Island
Source: Mid-term Review of 12MP; OCBC

…Supported by A Solid Medium-Term Agenda

Specifically, PM Anwar's government has launched numerous medium-term plans in 2H23. The 'Madani Economy' was introduced in July 2023 focused on empowering people, building Malaysia as a leader of Asia, and restoring good governance. Subsequent announcements included the National Energy Transition Roadmap (Part I and II), the New Industrial Masterplan 2030, the mid-term review of the 12 Malaysia Plan (MP), the Fiscal Responsibility Act and Government Procurement Act and Budget 2024. The focus of each of these plans is different and is listed below:

1) The National Energy Transition Roadmap details ten flagship catalyst projects and initiatives based on six energy transition levers, emissions reduction pathways, emissions reduction targets, and initiatives needed for the energy transition. Malaysia is highly dependent on coal for power generation, hence a ramp up of cleaner energy sources is required for Malaysia's transition away from coal. The NETR anticipates that Malaysia will require an investment of MYR1.2 – MYR1.3trn by 2050. Significant investments are required to scale up hydrogen and CCUS technologies for commercial use, and for green mobility in the form of increasing domestic EV production capacities and associated EV charging infrastructure.

2) NIMP 2030 is a comprehensive, yet ambitious, blueprint for the industrial sectors. The NIMP is structured under four missions, with four enablers, twenty one strategies and sixty two action plans. Each mission is assigned its own strategies and action plan. The first mission is to advance economic complexity, the second mission is to bolster digitisation, the third mission is to push net zero emissions and the fourth mission is to safeguard economic security and inclusivity. Importantly, NIMP 2030 aims to foster growth in established industries, such as the electronics and palm oil, to move up the value chain.

3) The review of the 12 MP outlines '17 major shifts and 12 major strategies and initiatives' from PM Anwar's administration to lift Malaysia towards a high income economy, build a prosperous society and strengthen governance and sustainability. Some of the major objectives include strengthening governance and institutions, achieving fiscal sustainability, introducing targeted subsidies, and accelerating the implementation of the National Digital Identification.

4) The Fiscal Responsibility and Government Procurement Act set out certain targets aimed at achieving medium-term fiscal sustainability. The fiscal deficit will be lowered to 3% of GDP or less within three to five years, with public debt at 60% of GDP or less and financial guarantees not exceeding 25% of GDP.

5) Budget 2024 took to the first to commit to fiscal consolidation. The fiscal deficit is forecasted to be narrower at 4.3% of GDP from 5.0% in 2023. The consolidation will be driven by resilient tax revenue collections as well as the introduction of targeted fuel subsidies.

#3: Delivering on Focused Fiscal Commitments

While revenue growth is expected at 1.5% YoY in 2024, subsidy and social assistance spending is forecasted to drop by 18%. Achieving this drop in expenditures depends on the mechanism and timeline for implementation of targeted fuel subsidies. This will also be crucial to the government achieving its fiscal deficit target of 4.3% of GDP.

The mechanism and timeline for implementing targeted fuel subsidies is still not officially confirmed. The government has noted, however, that it will depend on the adoption of the PADU database. The aim of the database is to help identify low-income individuals/households and direct welfare assistance to them rather than on blanket subsidies. This government is still building this database and as of November is 72% complete[6], according to the government. It is expected to be operational by early January 2024.

[6] PADU database 72% complete, targeted subsidy will begin with petrol and diesel, mechanism soon – Rafizi, *Paultan.org*, 31 October 2023.

MYRbn	2021	2022	2023RE	%YoY	2024BE	%YoY
Central Govt Revenue	**233.8**	**294.4**	**303.2**	**3.0**	**307.6**	**1.5**
Tax Revenues	**173.7**	**208.8**	**229.0**	**9.7**	**243.6**	**6.4**
Direct Taxes	130.1	164.1	173.0	5.4	185.0	6.9
Indirect Tax	43.6	55.3	56.0	1.3	58.6	4.7
Non-Tax Revenues	51.1	85.6	74.2	-13.3	64.0	-13.8
Central Govt Expenditures	**332.5**	**393.8**	**396.4**	**0.7**	**393.0**	**-0.9**
Current Expenditure	231.5	292.7	300.1	2.5	303.8	1.2
Emoluments	85.9	87.8	91.3	4.0	95.6	4.8
Pension and Gratuities	29.1	31.4	32.1	2.2	32.4	1.1
Debt Service Charges (DS)	38.1	41.3	46.1	11.7	49.8	8.0
Supplies and Services	24.9	34.7	34.0	-2.0	38.0	11.8
Subsidies & Social Assistance	**23.0**	**67.4**	**64.2**	**-4.6**	**52.8**	**-17.9**
Net Development Expenditure	63.3	70.2	96.3	37.2	89.2	-7.4
COVID-19 Fund	37.7	31.0	n.a.		n.a.	
Fiscal balance	-98.8	-99.5	-93.2		-85.4	
% GDP	-6.4	-5.6	-5.0		-4.3	

Source: Ministry of Finance; OCBC

Inflation Outcomes Depended on Fiscal Outcomes

The outcomes around fuel subsidy rationalisation will impact inflation in 2024. The government has estimated a wider inflation forecast range of 2.1-3.6% depending on fuel subsidy reforms. Our forecast at 2.5% is at the lower end of the range but is subject to revision pending further details on fuel subsidy reform.

BNM To Hold Steady

Notwithstanding, we expect BNM to be on prolonged pause through 2024. BNM has rarely reacted to changes in inflation caused by supply shocks such as the food price shocks in 2006-07 or the introduction and subsequent removal of the Goods and Services Tax (GST). BNM may entertain the possibility of further hikes if core inflation rises due to the second-round impact of higher prices.

Stable External Balances

The external environment, however, will turn more conducive for BNM to keep rates on hold. We expect the US Federal Reserve to deliver a 100bp in rate cuts in 2024 allowing for more attractive interest rate differentials to the US. It remains to be seen if this can manifest in higher portfolio inflows, especially given our view of slower global growth in 2024. FDI inflows into select sectors such as electronics manufacturing and electric vehicles may remain resilient as the government continues to promote these sectors under its medium-term plans.

Meanwhile, our forecast is for the current account surplus to be 2.5% of GDP in 2024 versus 2.4% of GDP in 2023 supported by narrower contraction in goods export growth and stable tourism inflows.

Philippines: Consolidation Mode

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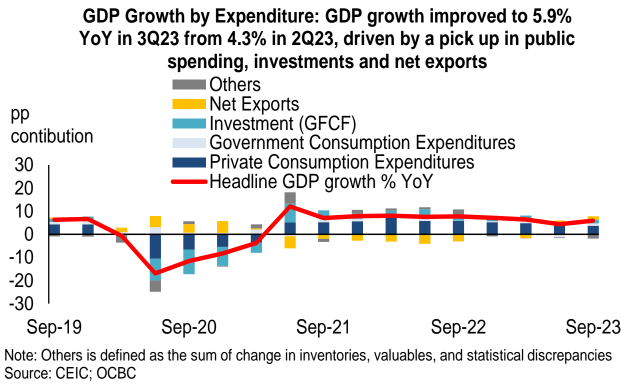
- 2024 will be a year of consolidation following on from a sub-par 2023 in which growth disappointed and inflationary pressures remained elevated.
- We expect 2024 GDP growth to consolidate at 6.0% from 5.7% in 2023 and for headline inflation to ease perceptibly averaging 3.9% in 2024 (2023: 6.1%).
- Bangko Sentral ng Pilipinas (BSP) will likely start cutting rates only in 2Q24 and cut by a cumulative modest 100bp in 2024.

A Sub-Par Weak 2023

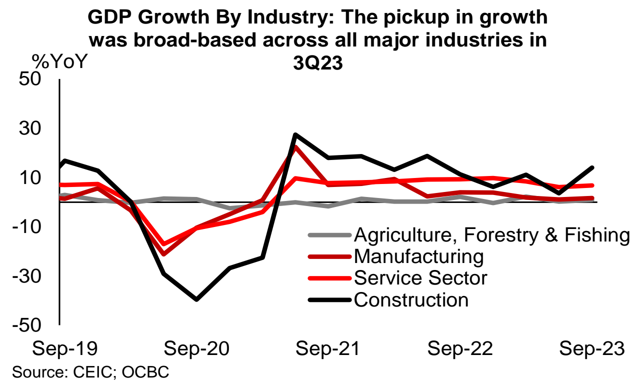
GDP growth slowed to an average of 5.6% YoY in 1Q-3Q23 from 7.6% in 2022 as government underspending, weak external demand, elevated inflationary pressures, and tighter monetary policy conditions proved to be significant drags on growth. Although 3Q GDP growth improved to 5.9% YoY from 4.3% in 2Q23 and we revised higher our full year 2023 GDP growth forecast to 5.7%, the government will still likely miss its 6-7% target.

GDP Growth by Expenditure: GDP growth improved to 5.9% YoY in 3Q23 from 4.3% in 2Q23, driven by a pick up in public spending, investments and net exports



Note: Others is defined as the sum of change in inventories, valuables, and statistical discrepancies
Source: CEIC; OCBC

GDP Growth By Industry: The pickup in growth was broad-based across all major industries in 3Q23

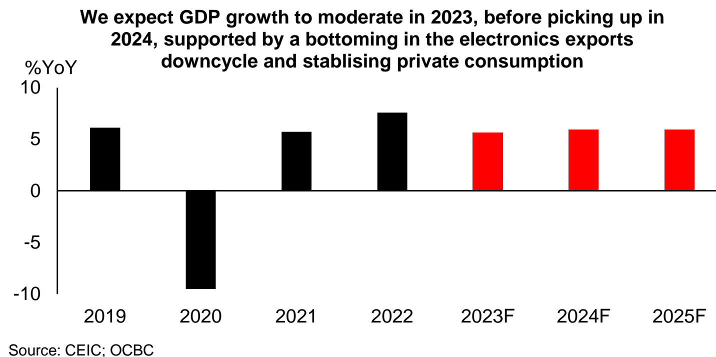


Source: CEIC; OCBC

Dealing With Headwinds into 2024

We forecast marginally higher 2024 GDP growth of 6.0% YoY from 5.7% in 2023 supported by a bottoming in the electronics exports downcycle and stabilising private consumption.

We expect GDP growth to moderate in 2023, before picking up in 2024, supported by a bottoming in the electronics exports downcycle and stablising private consumption

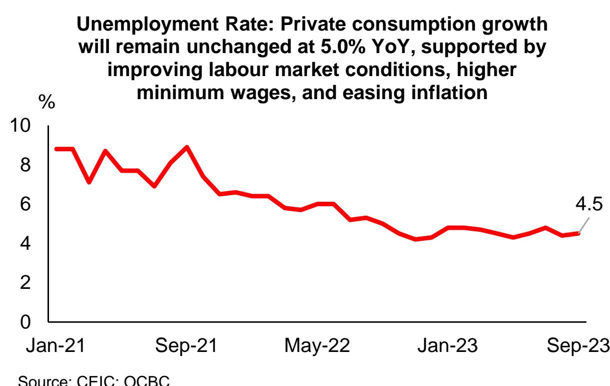


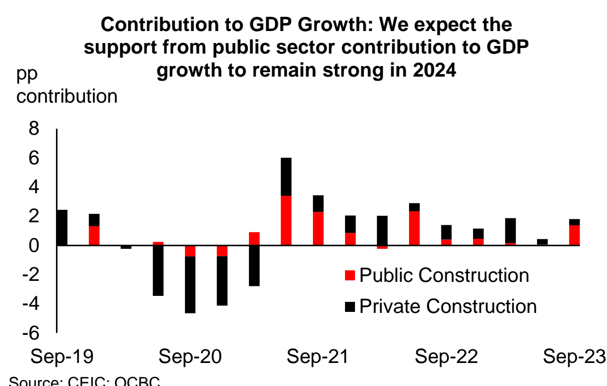
Source: CEIC; OCBC

To be sure, the external backdrop will remain as challenging as in 2023. The potential slowdown in the US economy as well as uncertainties surrounding China's economic recovery will continue to weigh on global growth. However, the bottoming in the global electronics downcycle in 1H23, as per our house view, will help cushion Philippines exports to some extent[7].

This will narrow the contraction in 2024 goods export growth to -0.6% YoY from -5.9% in 2023. Tourism inflows will also further normalise into 2024 as the statistical distortions caused by the pandemic will fade. We expect 2024 services export growth to normalise to 3.4% YoY from 13.7% in 2023.

The offset to still weak (albeit improving) external demand will come from more resilient domestic demand. Private consumption growth will remain unchanged at 5.0% YoY, supported by improving labour market conditions, higher minimum wages, and easing inflation. This will help negate some of the lagged impact of monetary policy tightening at least in 1H24.





Investment spending, by contrast, will likely remain weak in 1H24 before improving in 2H24. Private construction spending has been volatile in 2023 partly reflecting tighter financial conditions – this will extend into 1H24, in our view. BSP will begin easing the policy rate only in 2Q24 (more below). Moreover, with global growth still slowing, private sector firms will likely stay on the sidelines at the start of 2024.

Government spending, which despite the fiscal consolidation agenda, will reflect some catch-up from the underspending in 2023 and the government's focus on pushing infrastructure spending under the "Build, Better More" program. To that end, public investment spending will be supported by projects such as the North-South Commuter Railway System and Metro Manila Subway Project Phase 1[8].

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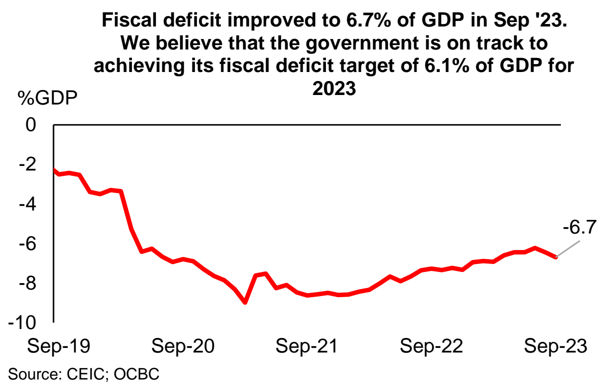
[7] Electronics exports in the Philippines are focussed on components such as microprocessors and CD-ROMs.

[8] A substantial portion of the proposed PHP214.3bn budget of the Department of Transportation for 2024 will be earmarked for the implementation of the Marcos administration's "Build, Better, More" program, according to the Department of Budget and Management. Of the proposed PHP214.3bn, a total of PHP176.4bn would go to the Department of Transportation's Public Sector Infrastructure budget. The infrastructure projects include the North-South Commuter Railway System and the Metro Manila Subway Project Phase I. Big chunk of DOTr's 2024 Budget Allotted for Infra Development, *Philippine News Agency*, 10 August 2023.

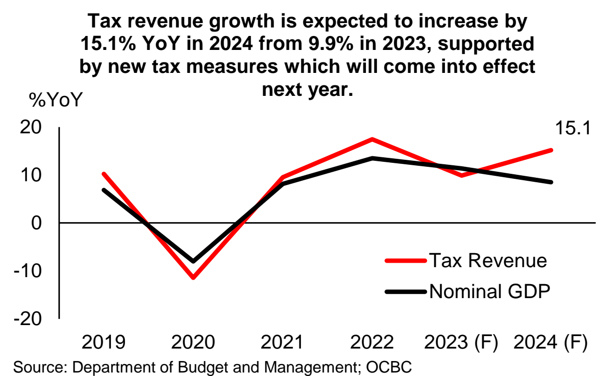
Fiscal Consolidation on Track

The government aims to narrow the 2024 fiscal deficit to 5.1% of GDP in 2024 from 6.1% and 7.3% in 2023 and 2022 respectively. This in line with the Medium-Term Fiscal Framework (MTFF).

The fiscal report card in 2023 has been mixed. On a 12-month rolling sum basis until September 2023, the deficit narrowed to 6.7% of GDP from 7.3% of GDP in 2022. Both revenue and expenditure growth slowed to 6.8% YoY and 4.1% YoY in Jan-Sep '23 compared to 18.0% and 10.4% in 2022, respectively. That said, we still believe that the government is on track to achieving its fiscal deficit target of 6.1% of GDP for 2023.



Source: CEIC; OCBC



Source: Department of Budget and Management; OCBC

The consolidation in the 2024 Budget will be driven by stronger projected revenues as new tax measures come into effect and previous measures continue to bear fruit[9]. Tax revenue growth is expected to increase by 15.1% YoY in 2024 from 9.9% in 2023. The new measures include the imposition of 20% tax on interest income from currency bank deposits, deposit substitutes, trust funds or similar arrangements (Passage of the Passive Income and Financial Intermediary Taxation Bill) and the imposition of VAT on digital service providers, excise taxes on single-use plastics and pre-mixed alcohol.

Summary of Budget

PHP bn	2019	2020		2021		2022		2023		2024	
	Actual	Actual	% YoY	Actual	% YoY	Actual	% YoY	Program	%YoY	Proposed Budget	% YoY
Government Revenue	**3137.5**	**2856.0**	**-9.0**	**3005.5**	**5.2**	**3545.5**	**18.0**	**3729.0**	**5.2**	**4272.6**	**14.6**
Tax Revenue	2827.8	2504.4	-11.4	2742.7	9.5	3220.3	17.4	3537.9	9.9	4073.6	15.1
Bureau of Internal Revenue	2175.5	1951.0	-10.3	2078.1	6.5	2335.7	12.4	2639.2	13.0	3046.8	15.4
Bureau of Customs	630.3	537.7	-14.7	643.6	19.7	862.4	34.0	874.2	1.4	1000.2	14.4
Non Tax Revenues	309.7	351.5	13.5	262.9	-25.2	323.5	23.1	190.6	-41.1	198.5	4.1
Privatization	0.9	0.5	-44.4	0.3	-40.0	1.6	448.7	0.5	-69.6	0.5	0.0
Government Expenditures	**3797.7**	**4227.4**	**11.3**	**4675.6**	**10.6**	**5159.6**	**10.4**	**5228.4**	**1.3**	**5629.4**	**7.7**
Current Operating Expenditures	2741.0	3326.3	21.4	3493.8	5.0	3831.8	9.7	3932.1	2.6	4180.5	6.3
Capital Outlays	1039.8	878.9	-15.5	1163.8	32.4	1300.6	11.8	1267.6	-2.5	1420.2	12.0
Infrastructure & Other Capital Outlays	881.6	681.5	-22.7	895.2	31.4	1015.2	13.4	1036.9	2.1	1176.4	13.5
Net Lending	17.2	22.1	28.5	18.0	-18.6	27.2	51.1	28.7	5.5	28.7	0.0
Fiscal Balance	**-660.2**	**-1371.4**		**-1670.1**		**-1614.1**		**-1499.4**		**-1,356.8**	
% GDP	**-3.4**	**-7.6**		**-8.6**		**-7.3**		**-6.1**		**-5.1**	

Source: Department of Budget and Managment; CEIC; OCBC

The higher projected revenue growth will allow the government to increase its expenditure to support the administration's eight-point socioeconomic agenda,

[9] The government has been bolstering the nations' tax base since 2012 through a series of tax reforms (See Box: Watching Fiscal Reform Momentum).

without needing to compromise the MTFF. Capital outlays and operational expenditures, which are projected to increase by 12.0% YoY and 6.3% YoY in 2024 from -2.5% and 2.6% in 2023, respectively.

Meanwhile, the ratio of outstanding government debt to GDP remained relatively stable at 60.2% of GDP in September 2023 from 60.9% in 2022. Under the MTFF goals, the government aims to bring the debt-to-GDP ratio to less than 60% of GDP by 2025 and further down to 51.1% by 2028. This is highly contingent on the government following through with further fiscal reforms (see Box: Watching Fiscal Reform Momentum)

Year	A Timeline of Fiscal Reforms**	Status
2005	**RA 9334: Sin Tax Law**	Enacted 1 January 2005
	RA 9337: Expanded Value Added Tax (EVAT)	Enacted 1 November 2005
2008	RA 9504: Individual Income Tax Relief	Enacted June 2008
	RA 9511: Imposition of Franchise Tax on Power Transmission	Enacted 1 December 2008
2010	RA 9994: VAT Exemptions of Selected Goods and Services purchased by Seniors	Enacted June 2010
	RA 10001: Restructuring of Documentary Stamp Tax (DST) on Life Insurance Policies and Reduction of Premium Tax on Life insurance policies from 5% to 2%	Enacted February 2010
	RA 10020: Abolition of DST on OFW Remittances	Enacted 8 March 2010
	RA 10026: Income Tax Exemption and Condonation of Unpaid Taxes for Local Water Districts	Enacted 11 March 2010
2013	**RA 10351: Sin Tax Reform Law (indexation)**	Enacted 1 January 2013
2015	**RA 10708: Tax Incentives Management and Transparency Act (TIMTA)***	Enacted 29 December 2015
2018	**RA 10963: CTRP Package 1: Tax Reform for Acceleration and Inclusion (TRAIN)**	Enacted 1 January 2018
2019	**RA 11213: CTRP Package 1B: Tax Amnest Act**	Enacted 14 February 2019
	RA 11346: CTRP Package 2+ Sin Tax Reform: Tobacco Tax Law	Enacted 25 July 2019
2020	**RA 11467: CTRP Package 2+ Sin Tax Reform: Sin Tax Reform on Alcohol and E-cigarette Products**	Enacted 1 January 2020
2021	**RA 11534: CTRP Package 2: CREATE Act**	Enacted 11 April 2021
2023	Budget Modernization Bill (Progressive Budgeting for Better and Modernised Governance Bill)	Pending in Committee
	CTRP Package 3: Real Property Valuation Bill	Pending in Committee
	CTRP Package 4: PIFITA (Passive Income and Financial Taxes Act)	Ongoing Committee hearings
	National Government Rightsizing Program (NGRP)	Ongoing Committee hearings
	Government Financial Institutions Unified Initiatives to Distressed Enterprises for Economic Recovery (GUIDE) Act	Pending in Committee
	Unified System of Separation, Retirement, and Pension	Pending in Committee
	Digital Services Tax Bill	Pending in Committee
	Act Enhancing the Fiscal Regime for the Mining Industry	Pending in Committee

*Note: Enacted in the same year the BIR announced that it had expanded the number of taxpayers who must now use e-filing to pay their taxes. Taxpayers will now have to enroll, file returns, and pay taxes early using the BIR Electronic Filing and Payment (eFPS) System or use electronic

**Note: Grey cells indicates major fiscal reforms

Box: Watching Fiscal Reform Momentum

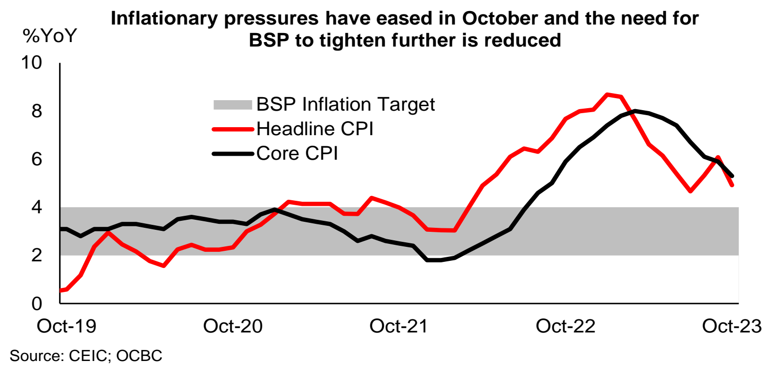
The number and frequency of fiscal reforms have slowed down recently. Numerous and significant tax reforms were passed from 2013 to 2021. Beginning with the Sin Tax reform law (R.A. 10351), a landmark legislation under the then Aquino administration, which aimed to restructure excise taxes on alcohol and tobacco products as well as finance the government's Universal Health Care program. These were then followed through with multiple reforms from 2018 to 2021 under the Duterte administration with the Comprehensive Tax Reform Program or CTRP which has 7 major components. Within that period, 4 of the 7 major components of the CTRP were enacted into law.

Presently, there are important fiscal legislation in the pipeline. Under the Medium-Term Fiscal Framework, measures such as the CTRP 3: Real Property Valuation Bill and the CTRP 4: Passive Income and Financial Taxes Act, are expected to come into effect next year but are either currently pending in the Senate Committee or are undergoing deliberations since the beginning of the year.[10]

A Delay in Inflation Relief…

Inflationary pressures have been extremely sticky. Headline CPI (year-to-October) has averaged 6.4% YoY, well above BSP's 2-4% target range, with core inflation averaging 7.0%. The stickiness in inflationary pressures underscore elevated food, namely higher rice prices in 3Q23, and energy prices which has also translated into second round transportation, restaurants and accommodation costs rising. For 2023, we expect headline CPI to average 6.1% YoY, this implies slower headline CPI in November and December 2023.

[10] S.B. 2386 or Real Property Valuation and Assessment Reform Act is pending in Senate since August 2023; S.B. 1848 or Passive Income and Financial Intermediary Taxation Act is pending in the Senate since February 2023



The moderation in inflationary pressures will continue into 2024. We expect headline inflation to average 3.9% YoY in 2024 from 6.1% in 2023. The government will continue efforts to increase food supplies through higher importation to mitigate food price pressures[11] and a moderation in domestic demand pressures. Our forecast is lower than BSP's (risk-adjusted) forecast of 4.4%[12], but consistent with our relatively modest GDP growth forecast.

Nonetheless, the balance of risks for inflation remains tilted to the upside from higher domestic food prices (driven by the El Nino phenomenon), higher transport charges, higher wage adjustments (which will support private consumption into 2024), and higher electricity rates.

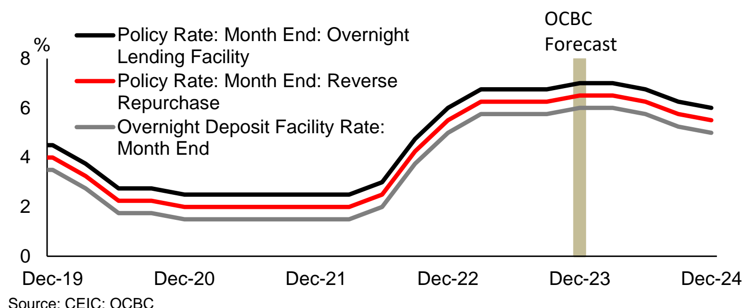
… Which Shifted the Opportunity to Ease Policy Rates to 2H24

BSP raised its policy rate by a cumulative 450bp in policy rate hikes since mid-2022 to mitigate against persistent inflationary pressures. The opportunity to ease policy rates will come only in 2Q24 when the US Fed begins to cut rates (according to our house view) and inflationary pressures start to consistently ease (albeit still higher than BSP's upper target range of 4%).

We expect that the BSP will cuts its policy rate by a cumulative 100bp, taking the policy rate to 5.50% by end-2024. The rate cutting cycle will be more measured in 2024. It could potentially extend into 2025 (not our baseline yet) provided headline inflation returns to BSP's 2-4% target range and economic growth remains resilient.

[11] Philippine President Ferdinand Marcos Jr plans to address a continuing surge in prices of basic commodities in the country by importing more agricultural produce in 2023. Philippines to Import More Agricultural Goods in 2023 to Quell Rising Prices, *The Straits times*, 24 January 2023.

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

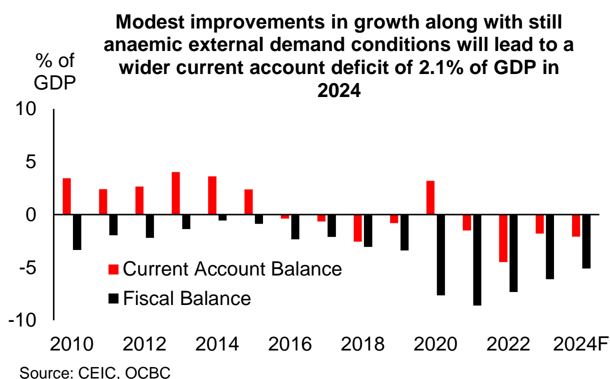


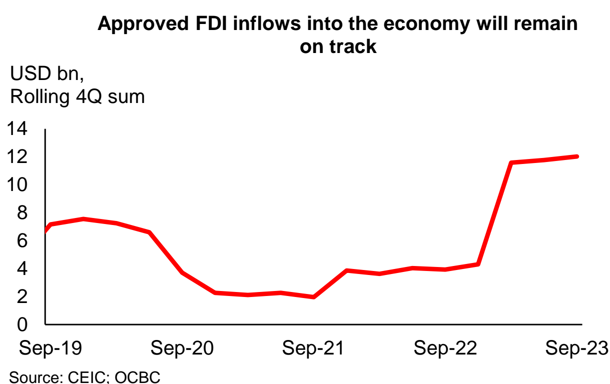
BSP Vigilant of External Vulnerabilities

The BSP will remain vigilant of external pressures in 2024. The modest improvements in growth along with still anaemic external demand conditions will lead to a wider current account deficit of 2.1% of GDP in 2024 from -1.8% in 2023, by our forecasts.

Our forecast is close to BSP's forecast and implies that a twin deficit situation (i.e., current account and fiscal account deficits) will persist. The BSP will remain vigilant of concomitant capital outflow vulnerabilities especially during times of heighted risk aversion. Nonetheless, rate cuts from the US Fed and easing domestic inflation will remain supportive of inflows.

More fundamentally, FDI inflows into the economy will remain on track as the Philippines, along with regional ASEAN economies, are poised to take advantage of shifting global supply chains.





OCBC

Singapore: Time of Transition

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- GDP growth has been subdued in 1Q-3Q23 and full-year growth is estimated at around 1% YoY, before improving to around 2% in 2024. The low 2023 growth base anticipated a global monetary policy pivot to easing starting around mid-2024, the expected stabilisation in the Chinese economy and global semiconductor industry, and the uptick in overseas visitors may usher in improved growth prospects next year.
- Despite a choppy external economic environment, the domestic labour market conditions and household balance sheets remain healthy. Ongoing cost-of-living issues, as reflected in the various enhancements to the Assurance Package, imply a slightly accommodative fiscal policy stance which may culminate in the upcoming Budget 2024 announcement in 1Q24.
- While headline and core inflation have largely eased in line with expectations in 2H23, there are some pricing pressures to keep an eye on – these include the upcoming additional 1%-point hike in the GST, carbon tax increases, etc. MAS is likely to keep the S$NEER policy stance steady at the January 2024 meeting, but we would not rule out a potential easing down the road if core inflation subsides further.

The Singapore economy avoided a technical recession earlier this year, but GDP growth remained muted at 0.7% YoY for the first three quarters of 2023. This is a slowdown from the 3.0% YoY growth registered for the full-year 2022. The main drag was from the manufacturing sector, particularly electronics due to the protracted global semiconductor industry downturn, as well as lacklustre external demand conditions amid rising interest rates, geopolitical tensions, and China's bumpy recovery post-reopening. The construction and services sectors remained resilient, which helped to keep the domestic labour market on a firm footing even as more foreign workers returned.

Economic growth for 2023 is projected to be at the lower half of the 0.5-1.5% forecasts range. While the strength of external demand around the turn of the year remains uncertain, the MAS expects GDP growth to improve gradually in 2H24. This is aligned with our forecast for around 1% YoY GDP growth for 2023 before improving to around 2% YoY (forecast range: 1-3% YoY) for 2024, predicated on some stabilization in the global and Chinese economies, as well as the global chip sector, and major central banks pivoting to an easing cycle starting around mid-2024.

Reflecting the weak external economic environment, industrial production (IP) contracted for the 12th straight month by 2.1% YoY (+10.7% MoM sa). The electronics cluster surprised with 10.2% output growth, aided by the infocomms & consumer electronics (21.6% YoY), semiconductors (13.5% YoY), and other electronics modules & components (4.7%) which offset the weakness in computer peripherals & data storage (-22.7% YoY). We forecast 2023 IP to shrink 4.6% YoY but recover to 2.1% YoY in 2024.

Non-oil domestic exports (NODX) also slumped 15.0% YoY in the first three quarters of 2023. NODX may contract by up to 12.5% YoY for the full-year even if

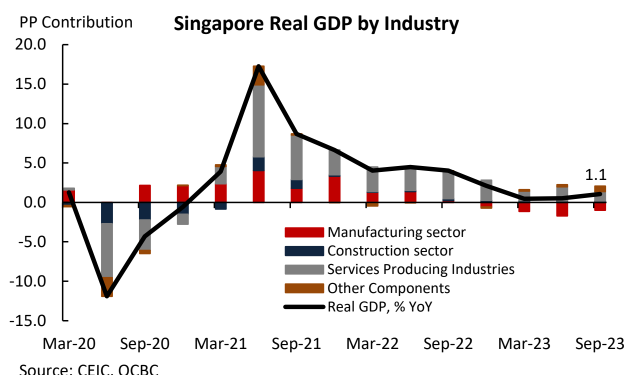
there is a stabilization in the remaining two months of November-December. This would still be the worst annual NODX performance since 2021 (-14.5% YoY), but at least the recent tea leaves suggest that the global electronics cycle may have bottomed and is looking to stabilize in the months ahead.

October NODX fell for the 13th consecutive month, albeit by a smaller-than-expected 3.4% YoY but rebounded 3.4% MoM sa. Notably, electronics exports contracted a narrower 5.6% YoY in October, compared to -11.6% in September, and marked the smallest decline since August 2022 (-4.5% YoY) even though this is still the 15th consecutive month of contraction. Non-electronics exports also eased to a 2.7% YoY decline in October, compared to a 13.7% YoY drop in September, but still marked the 13th straight month of contraction.

Six of the top ten NODX markets continued to underperform in October, led by Taiwan (-43.7% YoY), the US (-13.8%) and South Korea (14.7%). Nonetheless, NODX to China, the EU 27, Thailand, and Hong Kong improved in October, which is better than the three NODX markets (US, Hong Kong, and China) that saw positive growth in September. NODX to China has risen for the second consecutive month by double-digit growth, partly due to the low base a year ago, but nevertheless suggests that the Chinese economy has likely bottomed even though the recovery pace remains uneven. Meanwhile, the abrupt pullback in NODX to the US market in October was mainly due to non-electronics.

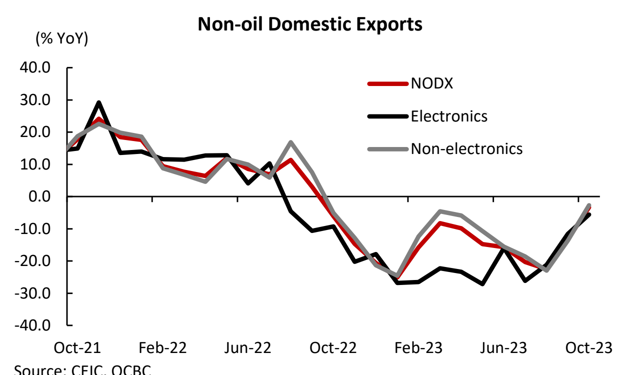
For 2024, NODX growth may rebound to 4-6% YoY, partly due to the low base in 2023 and assuming that the global economy may still see a modest slowdown in some of the major economies like the US and rangebound growth prospects in China, albeit the global electronics industry should be stabilizing after the current de-stocking cycle. However, the NODX growth trajectory may remain soft in 1H24 before accelerating in 2H24, possibly when the global monetary policy easing cycle starts to kick in and in turn support overall risk sentiments and demand conditions.

Chart 1: GDP growth (by sectors)



Source: CEIC, OCBC

Chart 2: NODX slump.



Source: CEIC, OCBC

The business expectations survey for the manufacturing firms suggests an uptick in the next six months outlook, led by the transport engineering industry due to ramp up in maintenance, repair and what was encouraging was the improvement in the electronics industry (+23% mainly due to the semiconductor inventory cycle nearing an end), in addition to the outperforming transport engineering industry.

However, the manufacturing sentiment towards 4Q23 output and employment deteriorated to -10% and -3% respectively, down from +6% and +4% three months ago. This is still very much a mixed bag - likely reflecting global headwinds including the weak recovery in China and ongoing geopolitical tensions, even though 77% of firms surveyed cited no limiting factors affecting export orders.

Similarly, the October manufacturing PMI also improved to 50.2 from 50.1 in September, marking a second consecutive month of an above 50 reading after 6 months in contraction. Improvements in manufacturing were broad-based with only 'supplier deliveries' gauge (49.4 vs. 49.5 in September) showing signs of weakness. The electronics PMI also inched higher from 49.8 to 49.9, nearing the key 50 threshold even though it stayed in contraction territory for the 15th consecutive month. Recent earnings guidance remains soft - STMicroelectronics NV forecasts 4Q revenue below analyst expectations amid weak demand for chips that go into consumer electronics like phones and laptops due to global headwinds, and ditto for Texas Instruments and also ASML Holding NV.

Chart 3: Manufacturing business expectations survey

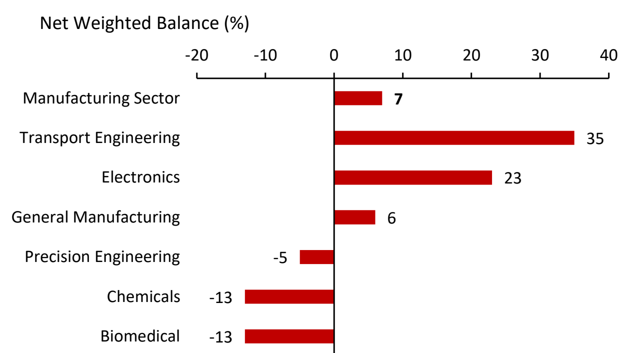
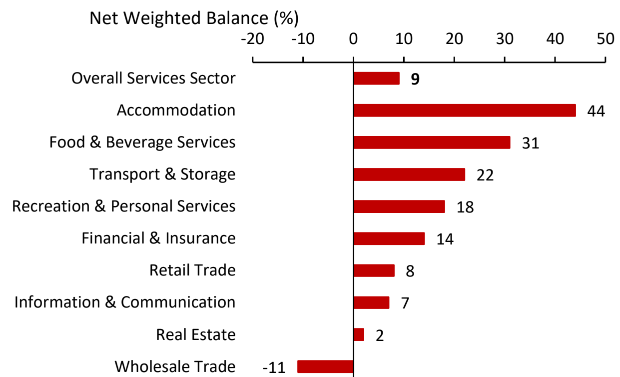
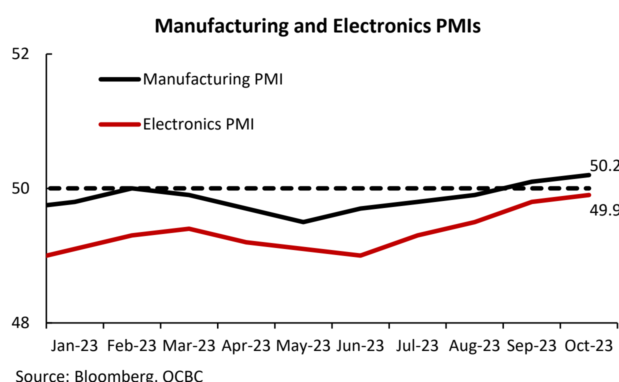


Chart 4: Services business expectations survey.



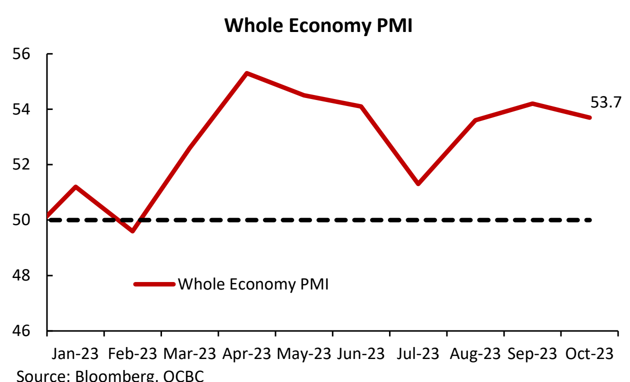
Source: SingStat

Chart 5: Manufacturing and electronics PMIs



Source: Bloomberg, OCBC

Chart 6: Whole Economy PMI



Source: Bloomberg, OCBC

The services sector has improved by leaps and bounds this year. The recent business expectations survey showed that a net 9% of services firms anticipate a better six months ahead. The most upbeat were the accommodation and F&B services industries. The key exception was the wholesale trade industry which reflects soft demand conditions globally and regionally.

The other leading indicator is the whole economy PMI which eased from 54.2 to 53.7 in October, the lowest since August 2023 even though this is the 8th consecutive reading in the expansion territory. Both the new orders and output gauges softened in October, marking the lowest readings since July 2023. This suggests that while private sector growth momentum is supported by new business growth and backlog accumulation, but external demand is weak, especially new export orders which fell at the sharpest pace since Covid. From the cost perspective, higher input prices accelerated even though wage inflation eased. This was coupled with a worsening of supply constraints leading to longer lead times, and Singaporean private sector firms also raised their prices to consumers at a faster pace. Therefore, inflationary pressures are intensifying, which may not be welcome news to policymakers.

Zooming in on the tourism sector, there has been a pickup in momentum through the course of this year – visitor arrivals amounted to 11.26 million for the first ten months of 2023, averaging 1.12 million per month. This is equivalent to 70.7% of 2019 (pre-Covid) levels, which is an improvement from the 58.5% (6.3 million) seen in 2022 and should sustain in in the coming months as well. As it is, both leisure and business travel activities have picked up speed. During the recent Formula One (F1) event, hotels enjoyed high occupancy rates and higher room rates. Anecdotally, more large-scale meetings, incentives, conferences, and exhibitions (MICE) activities at venues like Marina Bay Sands also have resumed.

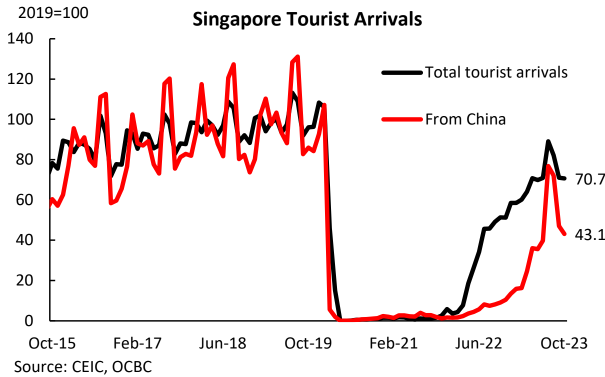
This means that Singapore Tourism Board's (STB) 2023 visitor arrival forecast of 12-14 million is clearly within reach, even though October numbers of 1,125,948 showed a small stepdown from September's 1,130,757. Top contributors of visitor arrivals were Indonesia (180,881), followed by China (122,764) and India (122,764). STB also tipped 2023 tourism receipts at $18-21 billion. The influx of concerts by Blackpink, Taylor Swift and Coldplay have also put Singapore on the global entertainment stage. As such, a full tourism recovery may be within reach in 2024.

This could be good news for job opportunities for skilled professionals in various tourism-related industries and services, ranging from event planning, hospitality management, customer service, sustainable tourism, urban wellness amongst others. In fact, the latest business expectations survey for services firms showed that a net weighted +9% of firms are bullish about the next six months' outlook (back to 4Q22 levels), and 10% expect better operating revenue and 12% tip improved employment conditions in 4Q23. Notably, accommodation, retail trade, professional services, and F&B services are more upbeat, especially ahead of the upcoming festive season given the expected pickup of international visitors towards the year-end.

However, this has not been reflected in the retail sales which disappointed by shrinking 1.6% MoM sa in September after two months of sequential on-month growth. The main drag was from motor vehicle sales which shrank 7.7% MoM sa, marking the largest sequential decline in September. Compared to a year ago, retail sales rose at a tepid 0.6% YoY, which is also a sharp slowdown from the revised August reading of 4.2% YoY and marked the slowest on-year growth pace since January 2023. For the first nine months of 2023, retail sales expanded 2.9% YoY but may slow to ~1.5% YoY in 4Q23 (partly due to high base a year ago) to

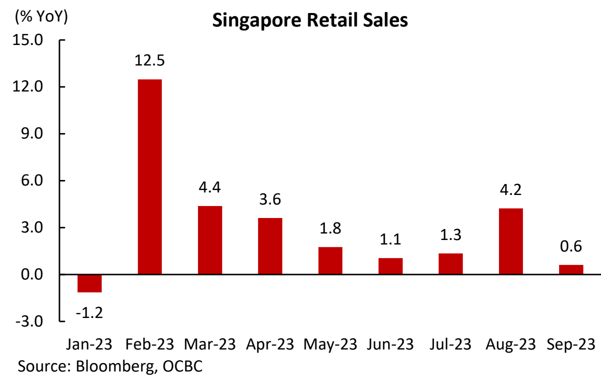
bring full-year retail sales growth to 2.7% YoY. That said, 2024 retail sales should accelerate to ~4% YoY as international visitor arrivals and GDP growth improve.

Chart 7: Visitor Arrivals



Source: CEIC, OCBC

Chart 8: Retail sales.



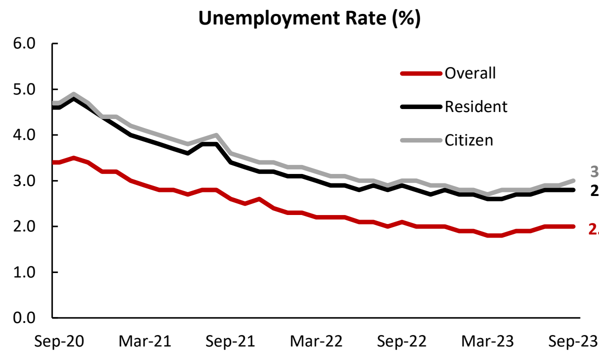
Source: Bloomberg, OCBC

Singapore's labour market has been on a roll since the re-opening of borders back in 2022, as employment (excluding MDW) jumped 227.8k (2021: 41.4k, 2020: -166.6k). However, the labour market conditions have started to evolve in 2023 - total employment rose 24K in 3Q23 (2Q23: 24.3k and 1Q23: 33k), but retrenchments also rose 4.1K (highest since 4Q20: 5.6k). The majority of retrenchments came from the 'Wholesale Trade' sector where the business reorganization or restructuring was cited as the main reason for retrenchments. For the first three quarters of 2023, retrenchments totaled 11.1k, which is higher than the 6.4k and 8.0k seen in 2022 and 2021 respectively, suggesting rising worker churn.

The overall, resident and citizen unemployment rates, which peaked at 3.4%, 4.6% and 4.7% respectively in September 2020, stood at 2.0%, 2.8% and 3.0% in September 2023. The latter is marginally higher than the recent low in 1Q23 at 1.8%, 2.6% and 2.7% respectively, suggesting there is some cooling in the domestic labour market. Looking at the breakdown, employment growth was driven by the financial services, professional services, and health & social services for resident workers, while retail trade, F&B services, administrative & support services, and construction saw employment increases for non-resident workers.

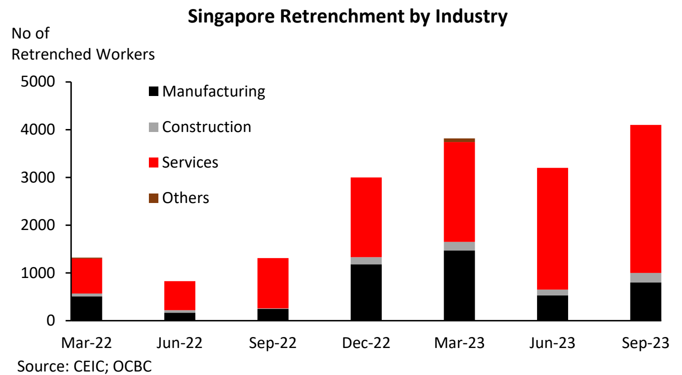
Looking ahead, the proportion of firms that indicated an intention to hire in 4Q fell from 58.2% to 42.8%, while that those intending to raise wages also fell from 28% to 18%. The Ministry of Manpower's (MOM) view is that while unemployment rates remain low due to continued labour market tightness; the unemployment rate has been on a slow uptrend and may rise further. That said, we do not anticipate widespread retrenchments as business sentiments are cautiously improving and barring any downside surprises, firms may be reluctant to embark on layoffs unless the industry conditions have deteriorated substantially. The improvement in the tourism and hospitality sectors may also be supportive of near-term employment conditions and offset some of the soft patch in manufacturing and/or wholesale trade.

Chart 9: Overall, resident & citizen unemployment rates



Source: MOM, OCBC

Chart 10: Retrenchments by industry.



Source: CEIC; OCBC

On the inflation front, core CPI picked up to 3.3% YoY. Compared to September, core CPI rose 0.4% MoM nsa, lifted by slightly higher costs of food, clothing & footwear, healthcare, and recreation & culture. Headline CPI accelerated to 4.7% YoY (0.2% MoM nsa) in October, up from 4.1% YoY (0.5% MoM nsa) in September, as record COE premiums and higher petrol prices drove private transport prices up 11.7% YoY (September: 8.5%) and offset lower inflation in food, retail & other goods, and accommodation prices. Accommodation inflation eased marginally from 4.3% to 4.2% YoY as housing rents rose at a slower pace. Meanwhile, food inflation also moderated from 4.3% to 4.1% YoY amid a slower uptick in non-cooked food and prepared meals. Services inflation picked up to 3.4% YoY in October as holiday expenses picked up. Additionally, tuition & other fees, outpatient and hospital service costs also picked up. Electricity and gas costs rose 1.8% YoY in October, a reversal from a contraction of 1.4% in September, mainly driven by higher electricity & gas tariffs.

Certificates of entitlement (COEs) have garnered significant market attention recently, as they have been on a continuous ascent since late 2018 – early 2020. For instance, category A COE saw a cycle low of S$23,568 in December 2018 to the recent record high of S$106k in mid-October 2023 before retreating to S$95,689 in early November. Similarly, category B COE hit a record high of S$150,001 in mid-October before pulling back to S$110,001 in early November, but this is still triple the S$30,012 seen in March 2020. Hence, bringing forward some future supply did help to curb COE premiums. Similarly, the ramp up in construction of public HDB housing is also expected to contain accommodation inflation going forward. However, the external inflation drivers, namely commodity prices, especially energy prices (given the OPEC+ supply curbs and Israel-Hamas conflict) and food prices (given El Nino, idiosyncratic export bans, and persistent geopolitical tensions) remain in the spotlight, even though the base effects from a year ago remain favorable.

The 3Q23 headline and core CPI stood at 4.1% and 3.4% YoY respectively, and the year-to-date readings to 5.1% and 4.3% accordingly. Taken into perspective, headline CPI clearly peaked at 7.5% YoY in August-September 2022 and may have hit a temporary bottom of 4.0% YoY in August. Core CPI, on the other hand, had peaked at 5.5% YoY in January-February 2023 and is likely to continue to ease to 2.9% YoY in 4Q23, notwithstanding some monthly volatility from electricity & gas prices.

We anticipate 2023 headline and core inflation at 4.8% and 4.1% YoY respectively, before easing to 3.4% and 3.1% YoY in 2024. MAS expects core inflation to reach 2.5-3.5% by year-end citing that although global oil prices have risen rapidly, other upstream price indicators have continued to decline. Moreover, they project core and headline inflation to average around 4% and 5%, respectively. The MAS expects core inflation to edge up in 1Q next year, partly reflecting an increase in the GST. However, they expect core inflation to resume moderating afterwards. For full-year 2024, MAS core inflation is expected to slow to an average 2.5-3.5%, while headline inflation is expected to average 3.0-4.0%.

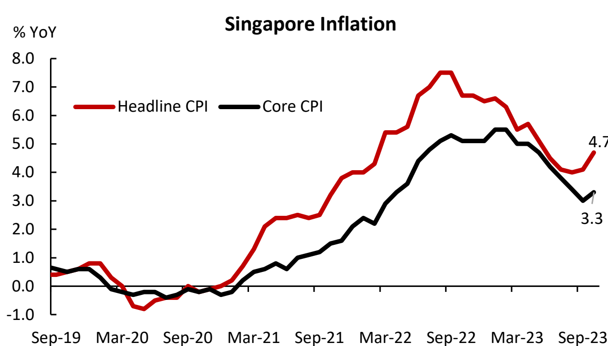
For monetary policy, the MAS had tightened the S$NEER policy five consecutive times before holding at the April and October 2023 policy reviews. Even though MAS kept its monetary policy stance unchanged at the April and October 2023 reviews, the trade-weighted S$NEER continues to trade near the upper end of the band, which should help to continue to contain imported cost pressures in the months and quarters ahead.

MAS also earlier announced a shift from a semi-annual April and October schedule to a quarterly monetary policy frequency from 2024, on a January, March, July, and October schedule, as part of efforts to enhance monetary policy communications. While frequent policy reviews are not necessarily better per se, having more frequent policy reviews would facilitate greater market understanding of its economic assessment and policy trajectory guidance, in addition to having more policy flexibility.

However, should core inflation ease further into 2024 as projected by MAS, then the SGD strength seen for a large part of this year can potentially taper off against some of its major trade partners. Historically, there is a positive correlation between the change in S$NEER and MAS core inflation. If core inflation does ease materially, then there is no need to for the S$NEER policy to be so tight. Other currencies within the trade baskets may have more room to appreciate vs. SGD. To some extent, a 'goldilocks' environment could possibly see low-beta SGD trade on the back foot versus some of the currencies in its trade basket (non-USD).

Looking into our forecast horizon, we still expect a mild downward trajectory for USDSGD, premised on our view for a moderate-to-soft USD outlook, on expectations that Fed is likely at end of its tightening cycle and will embark on a rate cut cycle in 2024, and that China growth will find a bottom in 2H23.

Chart 11: Headline and core CPI



Source: Bloomberg, OCBC

Chart 12: S$NEER

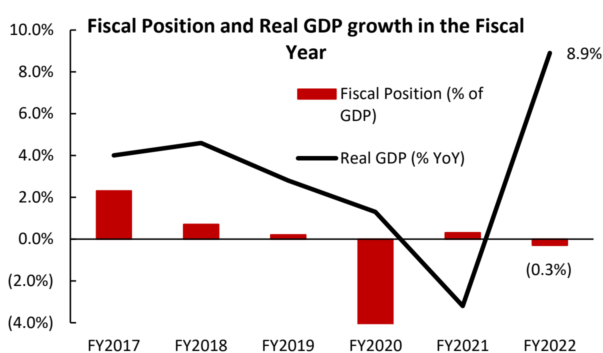
For fiscal policy, DPM and Finance Minister Lawrence Wong announced a SGD1.1 bn Cost-of-Living Support Package for Singaporean households, particularly lower- to middle-income families to help with the rising cost of living. This was in response to unplanned events like recent price increases (including the water hike by 50 cents per cubic m, starting with 20 cents in April 2024 and 30 cents in April 2025), possible disruptions to energy and food supplies and uncertainties in the global economy. The package includes a cash special payment of up to SGD200 for 2.5 million eligible Singaporeans to be disbursed in December, additional SGD200 CDC vouchers for every Singaporean household in 2024, an additional one-off 0.5-month S&CC rebate for 950,000 Singaporean HDB households to be disbursed in January 2024, and additional SGD20 U-Save rebates per quarter starting from January 2024 to December 2025. In addition, the government has also set up a committee against profiteering.

However, businesses were not included in the package as the approach was that businesses must be self-sustaining, and the government cannot permanently subsidize businesses. While there was no need to dip into past reserves for this package and it did not have to file a supplementary supply Bill, Mr. Wong said down the road in Budget 2024, the government will probably have to do a supplementary supply Bill to cover the additional funding.

Moreover, the Forward Singapore report also flagged a new support scheme to help involuntarily unemployed jobseekers in the lower-and middle-income groups, amongst other elements that make up the "Singapore Dream". With the recognition that policymakers have to do more to support Singaporeans and provide assurances during periods of greater disruptions, it would require a lot more resources, but the additional spending is deemed as necessary.

Therefore, Budget 2024 will be key to assess the shift in fiscal policy to implement and execute the roadmap for the 4G team, in what is likely to be a period of leadership transition. PM Lee also said he will hand over the reins by November 2024. As such, 2024 will likely be an important year of transition in both economic terms and also potentially for monetary and fiscal policy.

Chart 13: Fiscal Position and Real GDP growth



Source: MOF, CEIC, OCBC

Chart 14: Cost Increases in 2023 and in 2024

Year	Cost increase
2023	-GST rate change from 7% to 8% effective 1 Jan 2023. -Monthly school fess for non-Singaporean students enrolled in government funded schools will increase, according to the MOE. -On 1 March, food services workers receive 3-year annual pay increase under Progressive Wage Model (PWM). -15 town councils would raise their S&CC over two years, on 1 July 2023 and 1 July 2024. -On 1 July, PWM for the waste management sector receives a S$100 pay hike. -City Energy announced gas tariff for households will increase by 0.23 cent per kWh in 3Q23 -SP Group announced an increase in electricity tariffs by an average of 1.2% in 3Q23. -Beginning 9 October. Rates for standard regular mail will increase to 51 cents from 31 cents, according to SingPost. -From December 2023, public transport fares for adults who pay via card will climb up to 11 cents, according to the Public Transport Council. -Gas tariffs to increase by S$0.51 per kWh and electricity tariff to go up by S$0.98 per kWh in 4Q23
2024	-GST rate change from 8% to 9% effective 1 Jan 2024. -Carbon taxes will be raised to S$25/tCO2e, from S$5/tCO2e -First phase of water price hike of S$0.20 to S$2.94 per cubic meter -15 town councils would raise their S&CC over two years, on 1 July 2023 and 1 July 2024.

Source: MOE, MOM, SP Group, City Energy, PUB, PTC, Various news sources

South Korea: Stable

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Assisted by Kenneth Chong

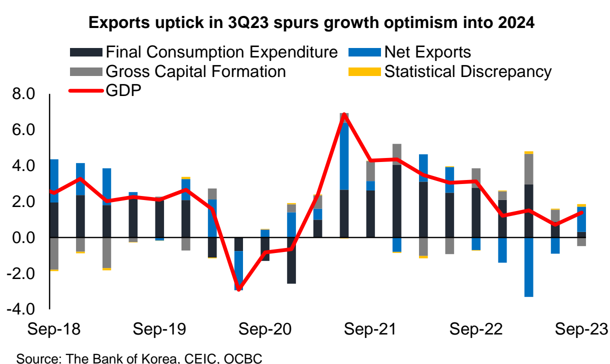
- GDP growth momentum has started to stabilise in 2H23 and will continue in 2024. This hinges on better electronics export growth.
- Inflationary pressures are subsidising, but the risks remain to the upside.
- Notwithstanding, we expect BoK cut its policy rate by a cumulative 75bp in 2024 to 2.75% by end-2024.

Stabilising Growth Momentum…

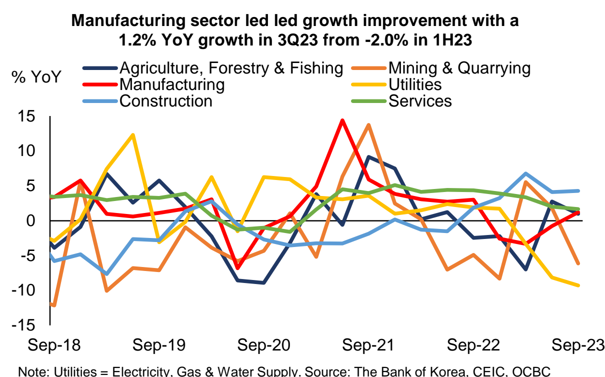
The economy proved to be more resilient than previously expected. After narrowly avoiding a technical recession at the beginning of 2023, economic growth accelerated to 1.4% YoY in 3Q23 from 0.9% in 1H2, bringing the year-to-date growth to 1.1% YoY from 2.6% in 2022.

The recovery was primarily driven by the uptick in goods and services exports (3.2% YoY in 3Q23 from -0.9% in 1H23), which have more than offset the easing in domestic demand (private consumption, government expenditure, and investment).

On the supply side, growth improvement was led by the manufacturing (albeit from a low base) and agriculture sectors, while construction and services sector growth eased. Meanwhile, the mining & quarrying and utilities sectors recorded a contraction in the third quarter.



Source: The Bank of Korea, CEIC, OCBC



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

…To Continue Into 2024

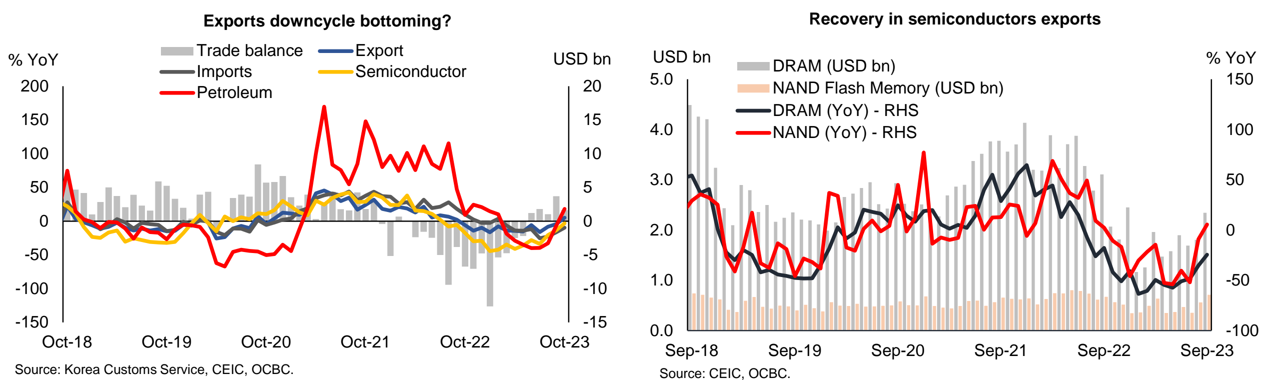
The growth outlook for 2024 will be more of the same, stabilising growth at a low level. BoK forecasts GDP growth of 2.2% YoY in 2024[13], versus 1.4% growth in 2023.

The main driver of the improvement will be a bottoming out of the electronics exports downcycle. Given the crucial role South Korea plays in the global supply chains for semiconductors, this improvement will lift numerous boats. SK Hynix, the world's second-largest memory chipmaker and the third-largest semiconductor company globally, is 'seeing more purchasing demand from

[13] As of August 2023.

customers who are in the final stages of inventory correction,' while Samsung 'expects overall memory demand to improve.'

This aligns with the improvement in NAND flash memory exports, which rose by 5.6% YoY in September, marking the first increase positive print in 12 months. Meanwhile, Dynamic Random Access Memory (DRAM) exports has experienced a significant turnaround from its January bottom. Additionally, as the DRAM market underwent a technological transition toward the next generation of chips, there could be a potential tailwind that boosts DRAM demand in 2024. Given that Samsung and SK Hynix dominate the DRAM market share, their first-mover advantage could set the stage for strength in the recovery of the South Korean semiconductor industry."



On the domestic side, private consumption, which accounts for almost half of the economy, is projected to remain broadly stable at 2.2% in 2024 from 2.0% in 2023 (versus 4.1% in 2022). With inflation stabilising, wage growth on better footing and labour conditions more conducive, household spending will remain supported. But the room to expand rapidly is severely constrained by a higher debt burden, limited pent-up demand (as most of this demand was satisfied in 2022-23) and rising external uncertainties.

Meanwhile, continued fiscal consolidation will be keep government spending in check. Budget 2024 has pegged government spending growth of 2.8% YoY, the smallest annual percentage increase since the country began compiling relevant fiscal data in 2005. The budget reflects a contrast in fiscal approaches between the current sitting President, Yoon Suk Yeol, elected in 2022, and his predecessor, where annual budget growth averaged 8.7% between 2018 and 2022.

Despite moderate expenditure growth, the 2024 fiscal deficit is expected to widen amid weak revenue forecasts. The consolidated fiscal deficit is anticipated to widen to 1.9% of GDP from 0.6% in 2023[14].

The risks to the outlook remain to the downside. Private consumption and investment spending will remain constrained by higher-than-historical interest rates while household debt levels remain elevated. On the external front, the

[14] This equates to a higher fiscal deficit on a managed basis, which excludes social security, from 2.6% of GDP in 2023 to 3.9% in 2024. The government is committed to returning the managed fiscal deficit back to below 3% of GDP in 2025 and over the medium term.

recovery in exports remains precarious, as the global demand is forecasted to slow next year.

Current Account Surplus to Sustain

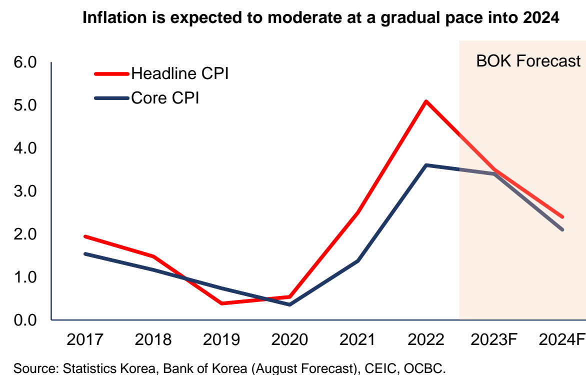
Notwithstanding, we expect the current account surplus remain supported in 2024. The current account was in a surplus for five consecutive months, reaching US$5.4bn in September. This contributes to a cumulative year-to-date surplus of US$16.6bn. this was supported by better tourism activities.

The Bank of Korea foresees a further acceleration in the current account, projecting it to rise to US$46 billion in 2024, compared to the anticipated US$27 billion for the current year.

Watching Inflationary Pressures

Against a backdrop of higher food and energy prices, inflationary pressures have built up in recent months, with headline inflation rising to a six-month high of 3.8% YoY in October 2023. That said, year-to-date inflation remains on a downward trajectory, reaching 3.7% YoY from 5.1% YoY in 2022.

Looking into 2024, headline inflation is likely to ease further to 2.4% from an anticipated 3.7% YoY in 2023 due to normalizing base effects, a forecasted lower oil price in 2024 and a tighter fiscal stance. This is still, however, slightly higher than BoK's 2% target.



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

The balance of risks remains to the upside, especially if geopolitical tensions result in higher energy prices. More notably, excluding food and energy components, core inflation remains sticky, with the year-to-date figure unchanged at 3.6% YoY from 2022.

Rate Cuts on the Cards

The BOK kept its policy rate unchanged for a sixth consecutive meeting in October, leaving its seven-day repurchase rate at 3.50%. our base case is for the policy rate to remain on hold at 3.50% for the remainder of 2023.

For 2024, we expect 75bp in rate cuts from BOK. Indeed, Governor Rhee Chang-Yong mentioned that one member flagged the possibility of lowering interest

rates if required over the next 3 months. This shows a building divergence in BoK MPC views.

KRW: A Bullish Bias

The Korean Won (KRW), being a high-beta currency, can see a potential turnaround though it is highly dependent on when USD inflection is, when UST yields ease lower, and easing of geopolitical tensions. We lean towards a bullish bias on KRW in 1H24, with upbeat China data pointing towards signs of stabilisation of China economy and the Fed being likely done in tightening for current cycle.

OCBC

Taiwan: Embracing A New Growth Chapter

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- We expect exports to recover versus a steep drop in 2023 while domestic demand recovery remains uncertain in 2024. The road ahead remains challenging for as the central bank will have to get the balance right between monetary policy tightness and growth support.
- We expect consumption growth to slow while investment remains subdued as the impact of the "high for longer" rate backdrop continues to feed through onto fundamentals and weighs on sentiment in 2024 despite strong labour market conditions. In addition, the fiscal impulse that helped to fuel the resilience of growth this year will wane in 2024.
- We reiterate our call for the CBC to extend its rate pause at 1.875% through at least 1H24 and begin to cut rates in 3Q24 taking cues from the US Fed, which we believe will start its easing cycle in 2Q24.

Taiwan's 3Q GDP growth was unexpectedly higher at 2.3%, on resilient consumption and strong exports recovery

3Q GDP growth was unexpectedly higher at 2.3%, on resilient consumption and strong exports recovery, accelerating from +1.4% YoY in 2Q. On seasonally adjusted sequential basis, GDP expanded for the second straight quarter by +2.5% QoQ from +1.4% QoQ in 2Q.

While private consumption continues to be the main growth driver, as it rose by +8.9% YoY (+4 ppt to headline growth) in 3Q, driven by strong spending on services such as dining, transportation, accommodation, and tourism, the decline of its contribution to the GDP growth has been in line with our expectations following the extraordinary gains (+ 12.6% YoY, +5.6 ppt in 2Q). Notably, the strong sequential recovery in net export of goods and services recorded an outsized gain of +2.2ppt to the headline growth, after having contributed negatively to the four quarters (-0.5ppt in 2Q and -5.4 ppt in 1Q) as export contraction narrowed noticeably. The higher shipments of semiconductors pointed to further signs that the electronics cycle has bottomed out.

In contrast, there were two main drags on growth in 3Q23. First, the contribution of government spending (+0.7% YoY, +0.1ppt) narrowed significantly in 3Q versus 2Q (+1.61% YoY, +0.21 ppt), given the reduced need for government stimulus. Second, gross capital formation continued to be a drag and the pace of decline worsened to -14.0% YoY (-3.9 ppt) from -13. 4% YoY (--4.0 ppt) in 2Q, likely due to the persistent decline in corporate investment in machinery equipment and a reduction in inventory, which more than offset the improvement in transportation equipment investments.

Overall, GDP growth expanded +0.2% YoY in the 1Q-3Q23, and we now expect moderate growth ahead, with a projected +4.5% YoY growth in 4Q23, reflecting the steady upturn in export recovery and moderate domestic demand. Our latest forecast for the full-year 2023 GDP growth is 1.3% YoY versus 2.4% in 2022.

Chart 1: Taiwan's GDP slightly outperforms in 3Q23, driven by private consumption and net exports

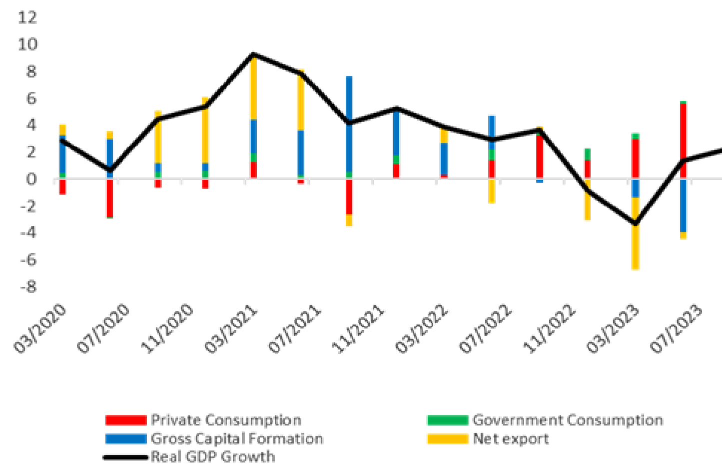


Table 1: Weak investment capped the upside growth (percentage contribution, by expenditure)

Component	2021	2022	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23 (p)		2023F DGBAS	2023F CBC
Domestic Demand	5.24	3.73	3.04	5.58	3.84	2.65	2.47	2.09	0.18		2.89	
-Private Expenditure	-0.35	3.59	0.67	3.14	7.52	3.05	6.4	12.56	8.9		7.94	
-Public Expenditure	3.69	3.44	-0.56	5.99	2.11	6.39	3.84	1.61	0.71		2.53	
-Gross Capital Formuation	17.26	4.11	9.35	9.23	-0.93	-0.06	-4.8	-13.44	-14.04		-4.22	
External Sector												
-Exports	17.27	2.41	8.98	4.78	2.15	-5.73	-11.02	-7.03	-1.05		-1.74	
-Imports	18.06	4.5	8.92	9.81	2.02	-1.6	-4.31	-7.84	-4.87		-0.57	
Real GDP	6.53	2.45	3.87	2.95	3.64	-0.78	-3.31	1.36	2.32		1.61	1.46

Source: DGBAS, OCBC

Embracing a new growth chapter in 2024

The road ahead remains challenging for GDP growth as central banks will have to get the balance right between monetary policy and growth. That said, we expect Taiwan's exports to recover further from a steep drop in 2023. The weakness in manufacturing and investment activities this year can be attributed to a combination of unusual macro headwinds, including a structural rebalancing of spending back from goods to services, the SVB bank crisis, a longer-than-expected inventory correction cycle, as well as a weaker- than- expected rebound in Chinese industrial activities. We expect most of these headwinds to fade in 2024, along with a smaller drag from fiscal and monetary tightening and an increased willingness of the CBC to deliver an insurance cut if growth slows.

To recall, TSMC did officially acknowledge in the mid-2022 that the semiconductor industry had entered an inventory correction cycle, with the management anticipating an overall rebalancing of the industry's inventory by 1H23. Even though the downcycle has lasted longer-than-expected, it is about to turn in 2024, as indicated by TSMC's 3Q23 earnings call. The management indicated that the downcycle is nearing its end, with healthy progression in inventory digestion into 4Q23, and see early signs of demand stabilization in smartphone/servers/and PCs. Furthermore, we are also encouraged by the structural boost of AI-related products given the high demand in advanced packaging associated with the CoWoS (chip on wafer on substrate). Specifically, TSMC is projecting for a nearly 50% Compound Annual Growth Rate (CAGR) in AI revenues (particularly in data centres) over the next 5 years despite the current revenue contribution being only

around 6%. Regarding CoWoS capacity expansion, the management expects its capacity could be at least double in 2024 while revenue growth could be more than double.

While TSMC's management sounded more confident than three months ago regarding the medium-term earning outlook, we still expect the upside revenue for Taiwan' supply chain, including semiconductor foundries and components, to be gradual rather than a strong pick up in 2024. This reflects lags in artificial intelligence application and capacity, geopolitical uncertainty, and the ongoing shifts in supply chain. Altogether, we expect Taiwan's exports could rebound strongly by 5.2% in real terms from an estimated 3.9% contraction in 2023.

Regarding domestic demand, we expect consumption growth to slow while investment remains subdued as the impact of the "high for longer" rate backdrop continues to feed through onto fundamentals and weigh on sentiment in 2024 despite strong labour market conditions. Leading indicators like PMIs and non-manufacturing indexes have taken a recent turn lower amid increasing cyclical and geopolitical risks. In addition, the fiscal impulse that helped to fuel the resilience of growth this year will also decelerate in terms of rate of change.

On the risk outlook, our bear case of a mild global recession and a slower-than-expected growth recovery in China would be a major further blow to the Taiwan economy. We are also mindful of elevated geopolitical uncertainty and key elections in 1H24. At the time of writing, pre-election developments remain fluid as we watch on whether an alliance will be formed. The potential alliance between KMT and TPP is now in doubts as both parties failed to arrive at an agreement on how to interpret on the margin of error from the opinion poll results on Saturday - over which candidate – TPP's Ko or KMT's Hou should lead the campaign as presidential nominee. Both parties are still engaging in talks, but they must firm up on their decision before the 24 November deadline to register their candidacy. The joint bid will be significant if they decided to go ahead to form the alliance. Based on the last polling results from various agencies and media, the combined KMT and TPP votes should well surpass the ruling party DPP's votes. A DPP win may continue to put more strain on cross-straits relations while a TPP-KMT win should bode well for cross-straits relationship and lead to a further unwinding of election risk premium.

On balance, we expect real GDP growth to be 3.5% YoY in 2024 on the back of trade recovery. The balance of risks is to the downside especially if Asian economies are affected by a mild recession in the US and China experiences a debt-deflation trap.

Taiwan

Chart 2: Global semiconductor sales activity in recent months seems to have bottomed and recovered modestly

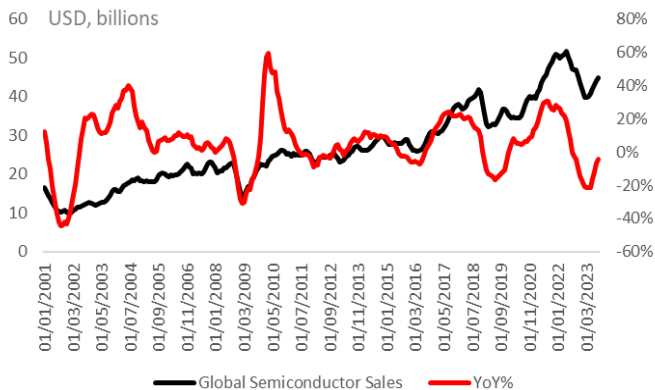


Chart 3: Tech exports have been improving

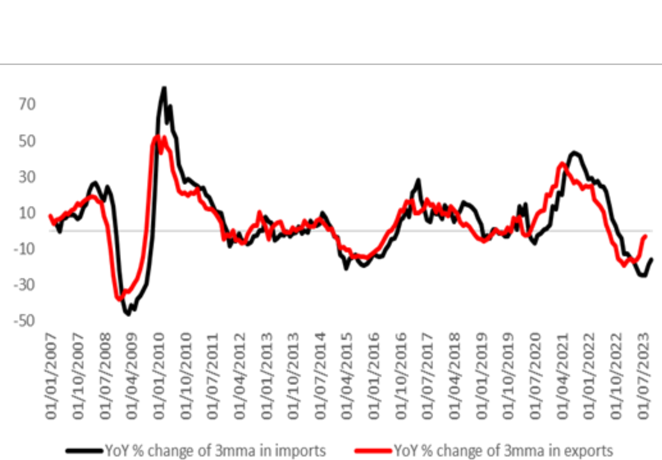


Chart 4: Export orders and key products, YoY%

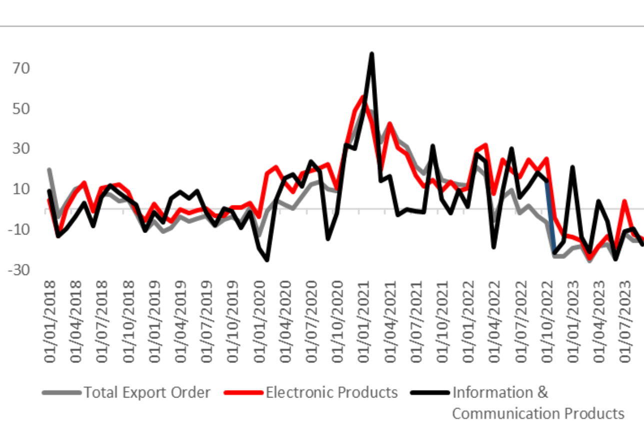
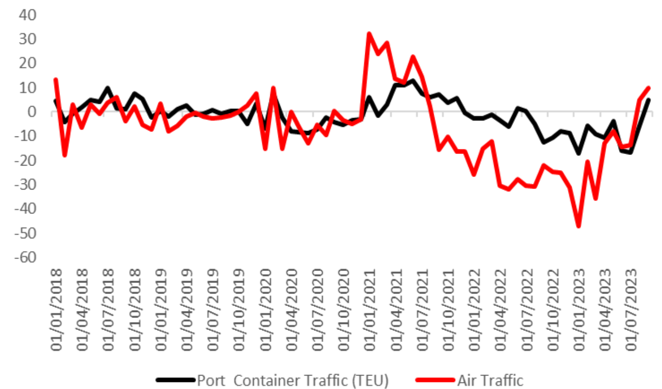


Chart 5: Freight carried, and container traffic are improving



Source: SIA, CEIC, Bloomberg, MoEA, MoF, Ministry of Transportation and Communications, OCBC

CBC to extend rate pause while inflation to trend down

Despite global food and energy prices re-accelerating in the recent months (headline inflation surprisingly rebounded to +3.1% YoY in October from 2.9% in September, the highest level since January), the CBC kept its benchmark rate at 1.875% at its 21 September meeting, marking the second consecutive quarter that it has stayed put, in line with our expectations.

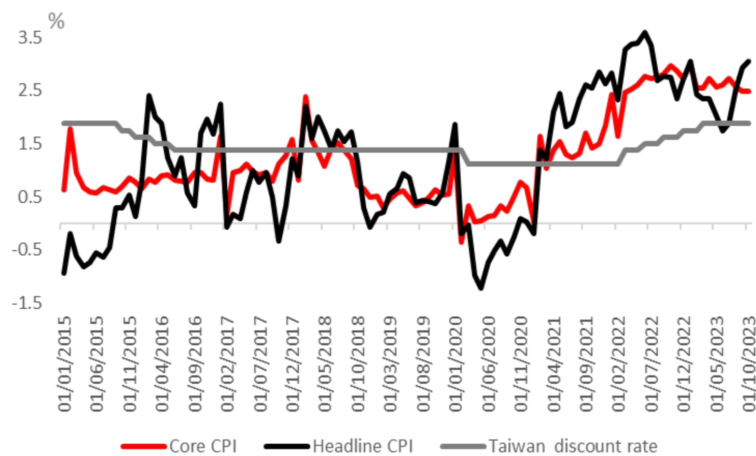
CBC hiked a total of 75bp since 1Q22, as well as two increases of 25bp in the reserve requirement ratio (RRR) of banks in June and September 2022. The central bank also tightened selective credit control measures to curb the excessive flow of capital into the housing market.

While the CBC board members voted unanimously to keep the policy rate unchanged at all meetings, the central bank highlighted that inflation remains the key priority given the volatility shown in global food and commodities prices, while services inflation remains elevated. Indeed, higher October inflation reflected price increases in vegetable and fruit caused by various typhoons, a rise in entertainment service cost, as well as higher oil prices for the month. In the first

tenth months of 2023, the headline inflation rate averaged at 2.4% and the core inflation rate was 2.6%.

Looking ahead, we reiterate our call for the CBC to extend its rate pause at 1.875% through at least the 1H24. We expect CBC will begin to cut its policy rate in 3Q24 taking its cue from the US Fed (our house view is for the Fed to start the easing cycle in 2Q24). This will be supported by a disinflationary trend over the next year, with headline inflation likely to head towards the 2% target by mid-2024 and stay stable below 2% in 2H24. One important point to note is that inflationary pressure has been mainly energy and food price-driven due to import prices and extreme weather events. These factors should moderate further on the back of subdued imported inflation and weakening domestic demand, especially after the Presidential elections in 2024. The next monetary policy meeting will be on 14 December 2023.

Chart 1: CBC likely to stays on hold for a prolonged period



Source: Bloomberg, OCBC

Chart 2: Retail sales growth edged down significantly in Q323 as fiscal support effect faded

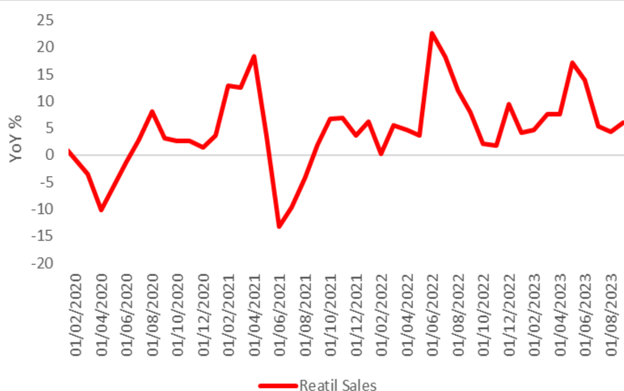


Chart 3: Domestic sales increased moderately in September

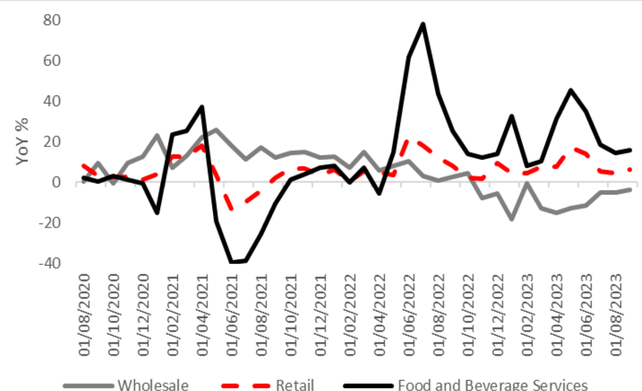


Chart 4： Consumer price index by key product

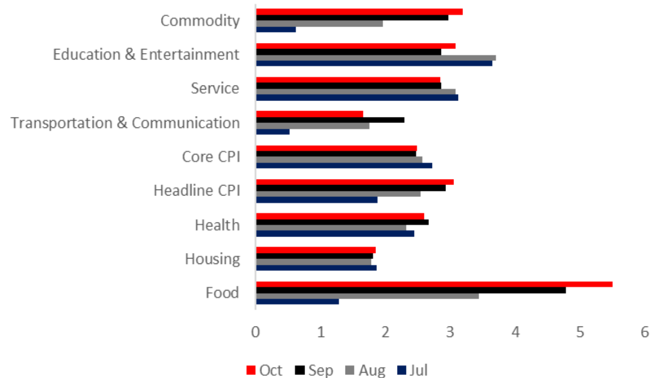
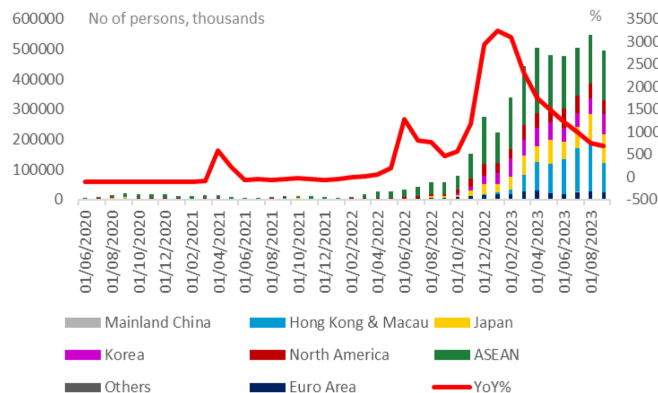


Chart 5： Visitor arrivals by country



Source: National Statistics Bureau, Bloomberg, CEIC, MoEA, Ministry of Transportation and Communications, OCBC

Thailand: Steadying the Ship

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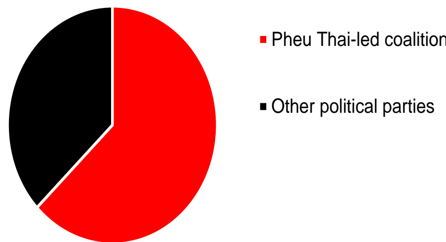
- We expect higher 2024 GDP growth at 2.8% from 2.0% in 2023, supported by fiscal generosity and private consumption.
- Headline CPI is expected to pick up modestly to 2.0% YoY in 2024 (2023: 1.3%) reflecting government support measures.
- With broadly stable growth and inflation, we see little reason for the Bank of Thailand (BOT) to change its policy rate in 2024.

Political Transition Finally Complete

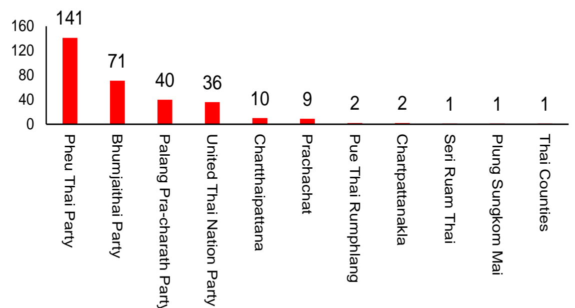
This was a year of political change with a long absence of a formal government between May and August, following the 14 May elections.

Pheu Thai-led coalition involves 11 parties with 314 votes in the Lower House...



Source: Bangkok Post; OCBC

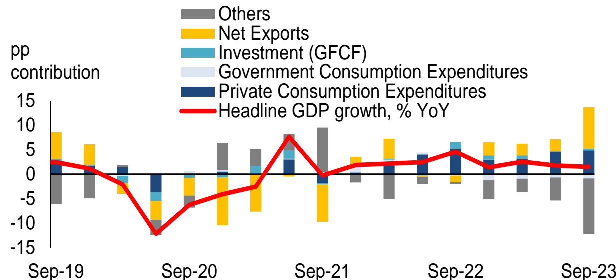
...Some of these parties prior to the May 2023 were on diametrically opposite sides of the political aisle



Source : Bangkok Post, OCBC

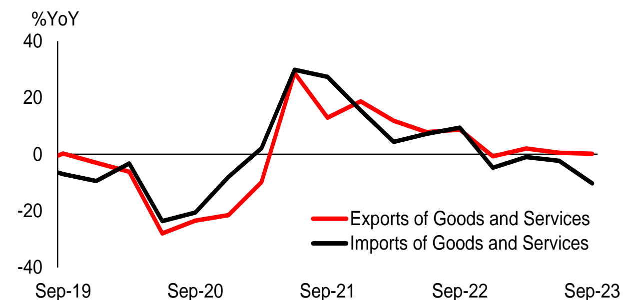
This, along with persistently weak external demand, dragged on GDP growth which slowed to 1.9% in 1Q-3Q23 versus 2.6% in 2022. The uncertainty cleared in August with the appointment of Srettha Thavisin as Prime Minister, with a Pheu Thai coalition holding the majority in the Lower House.

GDP Growth by Expenditure: GDP growth slowed to 1.9% YoY in 1Q-3Q23 from 2.6% in 2022



Note: Others is defined as the sum of change in inventories and statistical discrepancies
Source: CEIC; OCBC

Weak external demand was a drag on GDP growth



Source: CEIC; OCBC

A Pheu Thai Redux

The policies of the incoming government are similar to the previous Pheu Thai government. The focus of policy is on boosting consumption expenditures through cash handouts, subsidising retail fuel/electricity prices, capping retail food prices and higher minimum wages. The willingness to prop up consumption is reflected in larger quasi-fiscal pressures such as higher deficits in the Oil Fund[15] and higher medium-term fiscal deficits.

Measures	Date of Announcement
Diesel excise tax cut: Diesel prices were lowered by ~6% to THB29.94/litre. The cut in excise tax on diesel will be effective from 20 September until end-23.	13-Sep-23
Debt moratoriums for farmers and small businesses for a 3-year period.	13-Sep-23
Visa fee waiver for targeted tourist groups: The government has waived visa requirements for tourists from China and Kazakhstan from 25 September 2023 through to 29 February 2024.	13-Sep-23
Minimum wage increases: Thailand plans to raise the minimum daily wage, capped at below THB400, by the end-2023, according to Labour Minister Phiphat Ratchakitprakarn.	15-Sep-23
Electricity tariff cut: Electricity tariffs were lowered by ~10% to THB3.99. The cut in electricity tariff will be effective from September to December 2023 period.	18-Sep-23
Gasoline excise tax cut: The government has trimmed the excise taxes for gasoline (i.e., a cut to the price of 91-Octane Gasoline by THB2.50/litre) to help ease cost of living. The cut in excise tax will be effective from 07 November, and for the next three months.	31-Oct-23
Visa exemption for targeted tourist groups: The government has exempted visa requirements for tourists from India and Taiwan fom 10 November 2023 through to 10 May 2024.	31-Oct-23
Cash handouts of THB10,000 per person: Approximately 50 million people will benefit from the digital wallet program. To be eligible, an individual should be earning less than THB70,000 per month and has less than THB500,000 in its saving accounts. The cash handout has to be used within six months and cannot be used to purchase tobacco, cannabis and alcohol.	10-Nov-23

Source: Royal Thai Government; National News Bureau of Thailand; Bloomberg; Reuters; OCBC

Fiscal Generosity…

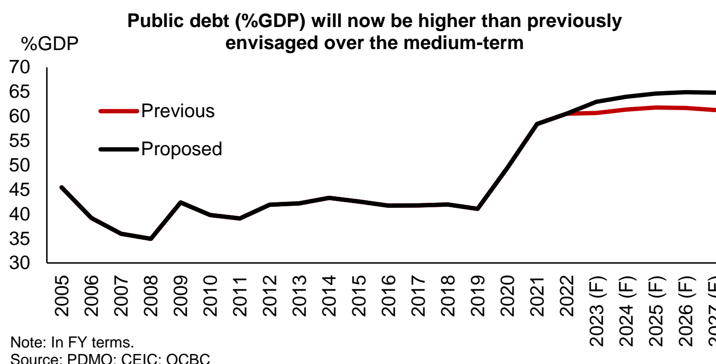
The government has proposed to widen the fiscal deficit to THB693bn (-3.6% of GDP) for FY2024 from the previously approved fiscal deficit of THB593bn (-3.0% of GDP) for FY2024 by the previous administration. Over the medium-term, higher fiscal deficits are intended compared to the previous plan.

THB bn	Actual				Forecasts				
	FY19	FY20	FY21	FY22	FY23	FY24	FY25	FY26	FY27
Net Revenue (proposed)	2540.2	2344.5	2446.6	2551.5	2490.0	2787.0	2899.0	2985.0	3074.0
Total Expenditures (proposed)	3043.2	3168.7	3208.7	3146.2	3185.0	3480.0	3591.0	3706.0	3825.0
Fiscal deficit (proposed)	-503.0	-824.2	-762.0	-594.8	-695.0	-693.0	-692.0	-721.0	-751.0
% GDP	-3.0	-5.2	-4.8	-3.5	-3.7	**-3.6**	**-3.4**	**-3.4**	**-3.4**
Fiscal deficit (previously)						-593.0	-590.0	-615.0	-641.0
%GDP						**-3.0**	**-2.8**	**-2.8**	**-2.8**

Source: Cabinet Meeting Notes; Fiscal Policy Office; OCBC

The FY2024-FY2027 deficit will be pegged at 3.4% of GDP versus 2.8% of GDP, previously. Consequently, the public debt profile will be higher reaching at 64.8% of GDP by FY2027. While this is below the debt ceiling of 70% of GDP, it is still much higher than the pre-pandemic levels.

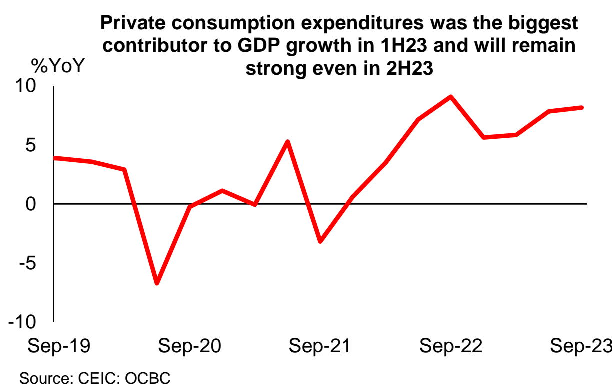
[15] The Oil Fund was established under the "Oil Fuel Fund Act, B.E. 2562 (2019)", in the Oil Fund Office. The objective of the fund is aimed at stabilising domestic oil fuel prices to be in an appropriate level, during events of fuel crisis. The Oil Fund will be operated in accordance with fund management policies prescribed by the National Energy Policy Council.

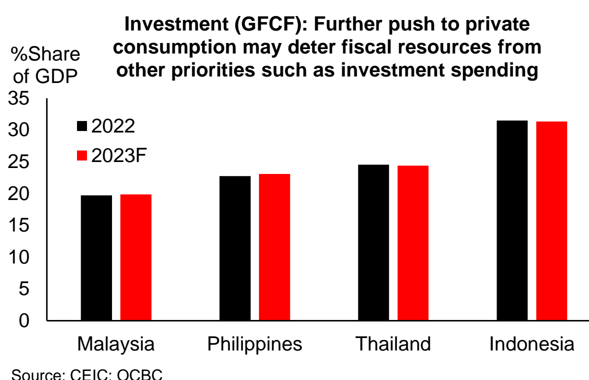


The general government fiscal deficit for FY2023 narrowed to 3.3% of GDP on a 12-month rolling sum basis until September 2023 from 3.5% of GDP for FY2022. This was supported by higher revenue growth of 7.2% YoY with expenditure growth falling to -3.4% YoY from 4.8% and -4.9% in FY2022, respectively.

…Will Keep 2024 Growth Supported

However, this time around it may not be the most appropriate policy direction. Private consumption was the biggest contributor to GDP growth in 1H23 (3.8pp of 2.2% YoY growth) and will remain strong even in 2H23. A further push to private consumption, while good for growth, may deter fiscal resources from other priorities, namely investment spending. Encouragingly, the government is receptive to feedback and has downsized its generous digital wallet scheme[16].





Investment as a share of GDP has been declining for some years now and requires a significant push in order to keep pace with regional peers. Although there have been numerous medium-term infrastructure and other developmental projects in place, the rates of disbursement have been underwhelming.

[16] The government has unveiled a THB500bn cash handout to stimulate the economy through its digital wallet programme. The programme will distribute THB10,000 to ~50 million people and will likely be disbursed by May 2024, according to Prime Minister Srettha Thavisin. The number of eligible individuals is lower than the original proposal of 56 million people (aged 16 years and above). To be eligible, an individual should be earning less than THB70,000 per month and has less than THB500,000 in his saving accounts. Thai PM Srettha Defends Debt Plan for $14 billion Cash Handout, *Bloomberg*, 13 November 2023.

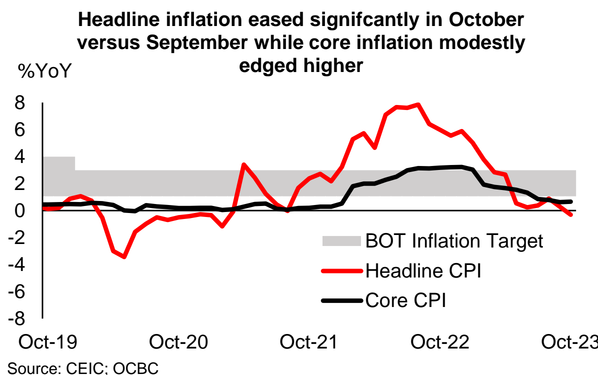
As such, we forecast higher 2024 GDP growth of 2.8% YoY in 2024 from 2.0% in 2023. Private consumption expenditure will remain the biggest contributor to growth, albeit with the pace slowing to 3.6% YoY from 7.0% in 2023. Public sector spending will expand by 5.3% YoY in 2024 from -3.8% in 2023. The pickup in public sector spending will be supported by the current government's stimulus measures.

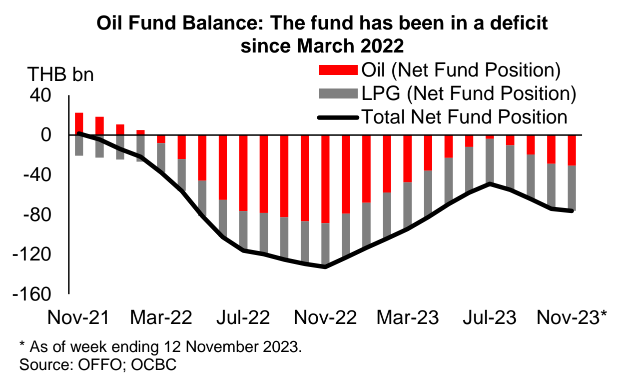
There will be modest gains in investment spending as political uncertainty has cleared. Public investment spending will resume while gains in private sector spending may be dampened by an anaemic external demand backdrop and lower global oil prices (US$80/barrel by our forecasts versus US$84/barrel in 2023).

The external backdrop will remain as challenging in 2024, as it was in 2023. GDP growth in key trading partners such as China, US and Europe are forecast to slow in 2024. There may be some offset as the electronics exports downcycle is expected to bottom in early 2024.

Inflation Will Remain Subsidised

Inflationary pressures have been significantly dampened by the governments' policies to contain the cost of living. The government cut retail diesel and electricity tariffs by ~6% and ~10% in September to below THB30/litre, and THB3.99/unit respectively. This essentially led to negative headline inflation of -0.3% YoY in October from 0.3% in September.





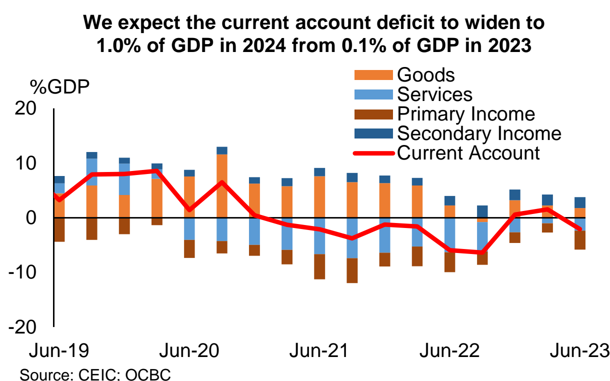
Despite the recent increases in global crude oil prices, the government decided to further trim gasoline excise taxes in November, implying that price pressures will be further eased. As such, we forecast headline CPI to average 1.3% YoY in 2023 from 6.1% in 2022.

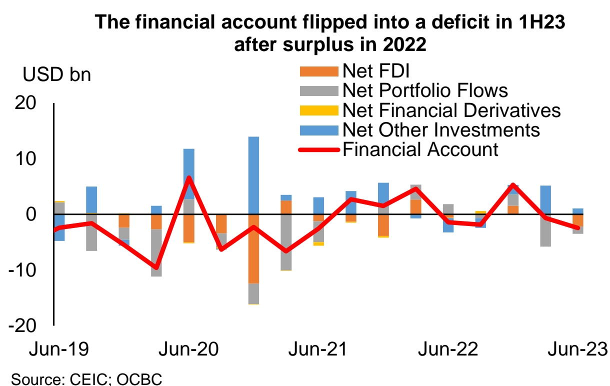
For 2024, headline CPI is expected to pick up modestly to 2.0% YoY. The government's policies including raising minimum wages and boosting private spending via higher cash handouts will be modestly inflationary. Admittedly, the risk is that the government uses further fiscal and quasi-fiscal mechanisms to support prices and lower inflation through 2024.

Current Account Deficit Set to Widen

Meanwhile, we expect the current account deficit to widen to 1.0% of GDP in 2024 from 0.1% of GDP in 2023 (2022: 3.2% of GDP). This reflects weaker goods export growth which more than offset stable tourism inflows.

On the financial account, the combination of domestic (i.e., the delay in government formation) and global factors (i.e., market expectations of a tighter monetary policy stance by the Fed and for longer) led to a substantial outflow of net FDI and net portfolio flows in 1H23, resulting in a financial account deficit of USD3.1bn in 1H23 versus a surplus of USD6.6bn in 2022.



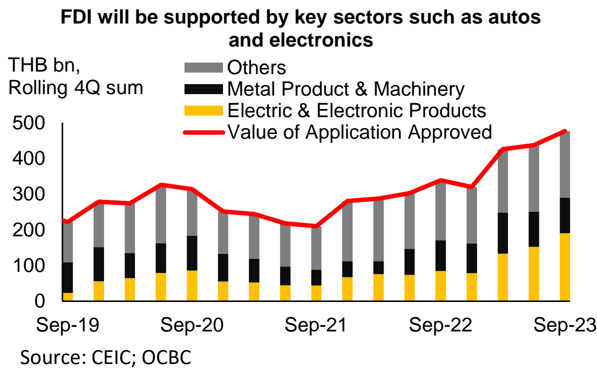


PM Srettha Thavisin is keen to boost FDI into key sectors such as autos and electronics[17]. To that end, he announced that Thailand is expected to receive investments of at least USD5bn from Tesla, Google and Microsoft for EV manufacturing facility and data centres respectively[18]. Boosting FDI inflows and engaging key trading partners to renegotiate Free Trade Agreements (FTAs) are some of the stated priorities of the current administration, which will have medium-term economic benefits.

Meanwhile, tourist arrivals reached 64.1% of 2019 levels in September and 66.7% of the government's target of 30mn arrivals. Although arrivals from China are significantly lower at 34.5% of 2019 levels in September, they are on a modest uptrend[19]. We expect tourist arrivals to remain resilient next year, albeit at similar to 2023 levels. This will provide some support to growth but also the current account balance.

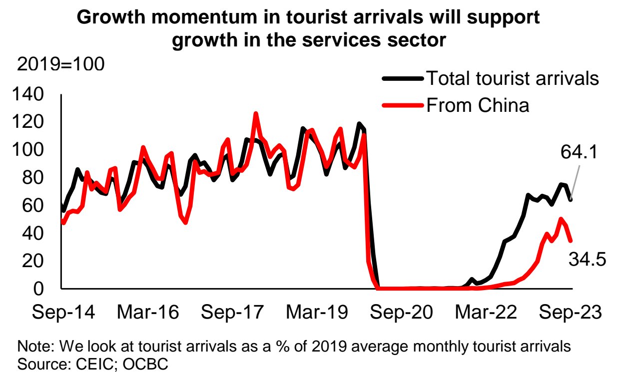
[17] Thailand Board of Investment has a new classification for the different business categories. Hence, we compute "Metal Product & Machinery" using available data. This is an estimated figure using OCBC classification. Under the "Metal Product & Machinery, we sum the "Machinery and Vehicles" and "Metals & Materials" components to derive the proxy.
[18] PM Srettha Thavisin travelled to New York to attend the UN General Assembly where he also held discussions with company executives earlier in the week. He shared that Thailand is expecting to receive an investment of at least US$5bn from Tesla (for an EV Manufacturing facility), Google and Microsoft (for data centres). Thailand Expects Tesla, Google, Microsoft to Invest $5 billion, Prime Ministers Says, *Reuters*, 24 September 2023.
[19] The impact of the fatal shooting on 03 October at Siam Paragon mall in Bangkok seems to be mainly restricted to Bangkok as tourist arrivals into the Phuket and Chiangmai airports continued to pick up in October.

FDI will be supported by key sectors such as autos and electronics



Source: CEIC; OCBC

Growth momentum in tourist arrivals will support growth in the services sector



Note: We look at tourist arrivals as a % of 2019 average monthly tourist arrivals
Source: CEIC; OCBC

Bank Of Thailand on The Sidelines

Given a sanguine growth-inflation mix, we expect Bank of Thailand (BOT) to remain on a prolonged pause through 2024. The BOT appointed Roongrote Rangsiyopash and Santitarn Sathirathai to the Monetary Policy Committee (MPC) on 01 November 2023, and extended the terms of Paiboon Kittisrikangwan and Rapee Sucharitakul by three years. We do not see the change in the composition to the MPC as having major policy implications.

Names	Role in MPC
Sethaput Suthiwartnarueput	Chairman
Alisara Mahasandana	Vice Chairman
Roong Mallikamas	Member
Paiboon Kittisrikangwan	Member
Rapee Sucharitakul	Member
Roongrote Rangsiyopash	Member
Santitarn Sathirathai	Member
Piti Disyatat	Secretary

Note: The Monetary Policy Committee comprises three internal members and four external members.
Source: Bank of Thailand

The main risk to our view is that BOT could turn more cognisant of global growth risks, putting rate cuts back on the table. Interest rate differentials may not seem as unattractive with the US Federal Reserve embarking on its rate cutting cycle (by OCBC forecasts in 2Q23) and regional peers such as the Philippines and Indonesia also lowering rates.

Vietnam: Under Pressure

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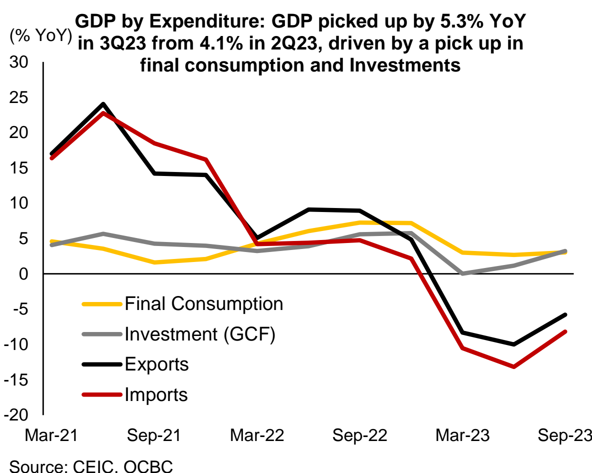
- GDP growth will come in at 4.4% YoY in 2023 (vs. 8.0% in 2022), below the government's full-year target of 6.5% YoY.
- For 2024, we expect modestly better GDP growth of 5.2% YoY supported by resilient travel and tourism activities, better electronics exports, and domestic consumption.
- The State Bank of Vietnam (SBV) has room to cut its policy rate by 50bp in 2024 to support growth amidst well contained inflationary pressures.

Weaker Growth in 2023

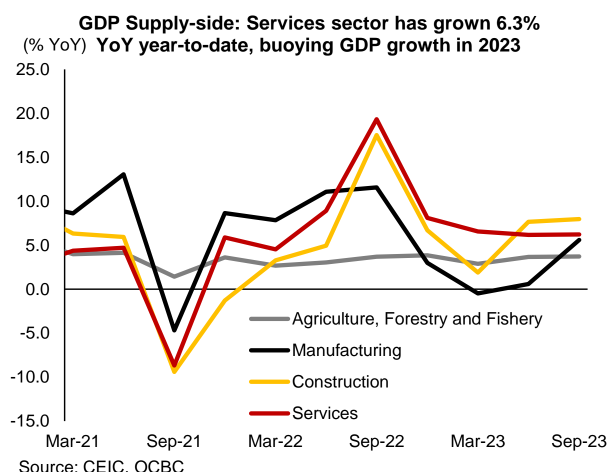
GDP growth will come in below the government's target of 6.5% YoY in 2023 after expanding 8.0% in 2022. GDP growth averaged 4.2% in 1Q-3Q23 and is expected to improve marginally to 5.0% in 4Q23, taking 2023 growth to 4.4%. For 2024, we expect GDP growth of 5.2% YoY.

The drag was mainly from weaker exports and manufacturing, which more than offset improvements in travel and tourism related sectors. Goods exports from Jan-Oct fell to -7.1% YoY while industrial production declined by 12.9% YoY in the same period. Persistently weak demand amid an electronics downcycle and slower growth in key trading partners such as the US, China and the EU weighed on exports and industrial production.

There was some offset from better services sector growth, reflecting a continued recovery in travel and tourism related industries. Services sector GDP grew 6.3% YoY in 1Q-3Q23 driven by 'wholesale & retail trade', 'transportation & storage', and 'accommodation & food'. In early October, the Ministry of Culture, Sports and Tourism proposed to raise Vietnam's tourism target to 12.5 to 13 million international visitors.[20] Tourist arrivals reached close to 10 million in the first ten months of 2023, exceeding its original annual target of 8 million visitors.

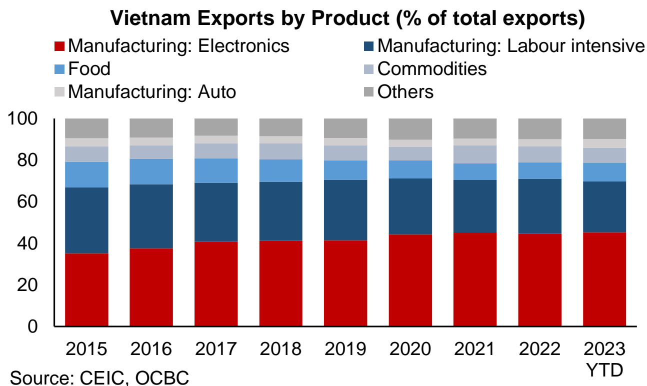


Source: CEIC, OCBC

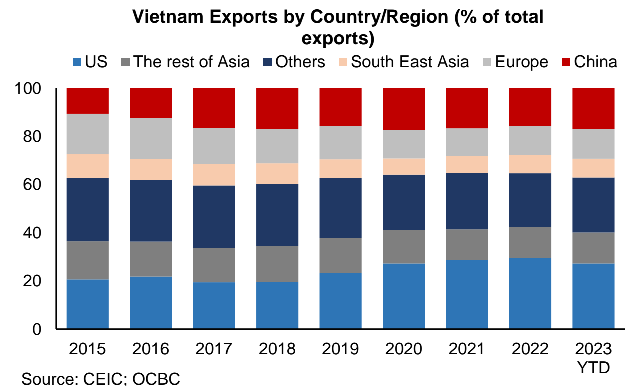


Source: CEIC, OCBC

[20] "The Ministry of Culture, Sports and Tourism will propose that Government raise this year's target to 12.5-13 million tourist arrivals.", Viet Nam News, 2 October 2023



Source: CEIC, OCBC



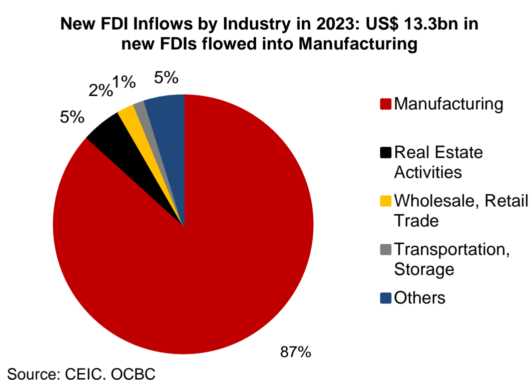
Source: CEIC; OCBC

Some Improvements in 2024

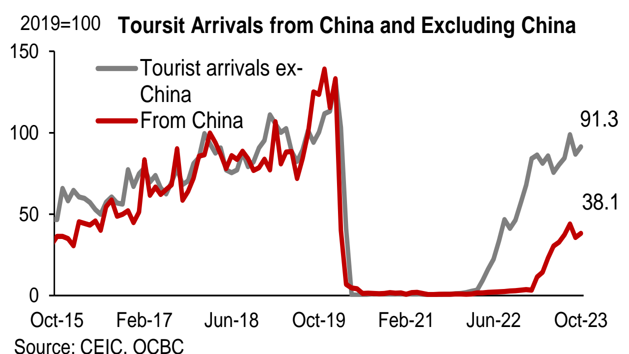
There is room for further improvements in tourism related activities in 2024. Tourist arrivals reached 74% of the 2019 monthly average in October and is expected to pick up further in the coming months. Chinese tourist arrivals are noticeably boosted by the Lunar New Year celebrations. Historically, tourist arrivals from China increase in February by 27% MoM nsa, which coincides with the Lunar New Year festivities, while arrivals ex-China tend to pick up pace in the latter part of the year.[21]

This, however, depends on global growth, which is expected to remain subdued in 2024. On the other hand, signs of a bottoming out in the global electronics downcycle have emerged as electronics exports, which account for more than 40% of total exports, quickened pace to 6.7% YoY in October from its 2023 low of -17.4% YoY in March and marking the second straight month of positive growth. If this persists, it will help drive the growth story next year. Nonetheless, the services sector will be the bright spot but the recent pickup in inflation may weigh on its ability to offset weaknesses from other sectors in the economy.

That said, Vietnam will continue to benefit from the supply-chain recalibration or China+1 strategy as multinational corporations look to diversify amid an uncertain geopolitical landscape. New Foreign Direct Investments (FDI) have risen 54% YoY in the first ten months to US$15.3bn with 87% of the investments going into manufacturing.



Source: CEIC, OCBC



Source: CEIC, OCBC

[21] From 2010 to 2019, Vietnam sees an average 26.8% MoM nsa increase in Chinese tourist arrivals every February while arrivals ex-China pick up pace in the 2H of the year around July onwards by ~9% MoM nsa.

Increased investments will continue to support the local economy including the labour market. The unemployment rate averaged 2.3% from 1Q-3Q23 while average monthly earnings grew 6.1% YoY in the first half of 2023. This will also support personal consumption expenditure (PCE) next year. PCE was volatile in 2023 and pushed the government to lower Value Added Tax (VAT) to 8% from 10% for several goods and services from July 2023 till the end of the year with a good chance of this being extended into 2024.

Additional support to PCE next year will also come from the planned salary reform for the public sector which aims to replace the current salary system. The new salary system will see the monthly base salary for public sector workers increase and serve as the foundation for calculating salaries of different positions along with adjustments to pensions, social insurance, monthly allowances, and preferential allowances for revolution contributions. VND 55.4 trillion has been earmarked in the 2024 government budget for the salary reform which is significantly higher than the previous 2023 plan's VND 12.5 trillion.

This will complement government policies, which are also geared towards supporting growth. Outlined in the 2024 socioeconomic development plan, the budget spending will prioritise key national infrastructure projects while speeding up the allocation and disbursement of public investment capital given that 2024 is the 4th year of the medium-term plan for period 2021-2025.[22]

Summary of Budget

	2021	2022		2023					2024	
(VND billions)	Actual outturn	Actual outturn	(9 months 2022)	Plan 2023	% YoY	(9 months 2023)	% YoY	% of full-year budget	Plan 2024	% YoY
State budget revenues and grants	**1,568,453**	**1,815,470**	**1,327,289**	**1,620,744**	**-10.7**	**1,223,760**	**-7.8**	75.5	**1,700,000**	**4.9**
Taxes and Fees	1,378,716	1,597,192	1,158,286	1,464,276	-8.3	1,145,061	-1.1	78.2		
Capital revenues	186,391	210,142	164,068	150,968	-28.2	78,424	-52.2	51.9		
Grants	3,346	8,136	4,935	5,500	-32.4	275	-94.4	5.0		
Total state expenditures	**1,854,940**	**2,158,100**	**1,086,300**	**2,076,244**	**-3.8**	**1,239,380**	**14.1**	59.7	**2,100,000**	**1.1**
Of which:										
Investment and development expenditures	515,881	638,142	253,148	726,684	13.9	363,311	43.5	50.0		
Current expenditures	1,187,659	1,200,897	833,152	1,291,660	7.6	876,069	5.2	67.8		
Expenditures from higher-than-budgeted revenues										
Contingencies				57,900						
Budget deficit	**286,487**	**342,630**	**-240,989**	**455,500**		**15,620**				
Budget deficit/GDP (%)	3.41%	3.60%		4.42%		0.21%			3.60%	
Principal repayment	**243,027**	**195,076**		**192,713**						

Source: Ministry of Finance, National Assembly adoption of Socioeconomic Development plan for 2024

That said, the government will continue with fiscal consolidation. The fiscal deficit is projected to narrow to 3.6% of GDP from 4.4% in 2023. In the first nine months of the year, total state spending increased 14.1% YoY compared to the same period last year, with spending reaching 59.7% of the target.

The implementation of several fiscal measures such as the reduction in value added tax (VAT) and deferral of taxes and land rent payment for firms and households caused government revenues to contract 7.8% YoY.[23] Note that in the first nine months of 2023, total fiscal stimulus measures were estimated to amount to VND 152.2 trillion in lost revenues to the government.[24] The fiscal

[22] Ministry of Planning and Investment of Vietnam issued Official Dispatch 8542/BKHDT-TH on expected state budget capital investment in 2024.

[23] On 14 April 2023 the government decreed the deferral of taxes and land rent payments in 2023. The new decree ("Decree No. 12") took effect on 14 April 2023 and ends on 31 December 2023. Additionally, the Government reduced the VAT from 10% to 8% for eligible goods and services in its "VAT Reduction Policy", effective from 1 July till 31 December 2023 (Resolution No. 101/2023/QH15).

[24] Ministry of Finance press release (18 October 2023), "VAT proposed to reduce in the first half of 2024"

deficit, therefore, came to 0.21% of GDP from a fiscal surplus of 1.51% of GDP in the first half of 2023.

For 2024, a modest increase in state revenues is projected in line with marginally better economic activity. Despite an estimated reduction in state revenues of VND 25 trillion from the proposed extension of the VAT reduction, the planned implementation of the global minimum corporate tax (GMT) in 2024 will partly offset the lost revenues by VND 14.6 trillion.[25]

Proposed state spending in 2024 is projected to rise by 1.1% YoY with the focus being the spending budget for salary reform. This will be a boon to the services sector as it could help sustain domestic consumption. However, the effects won't be felt until latter half of the year, following the restructuring of the salary regime on 1 July 2024.[26] Nevertheless, we cannot rule out the introduction of additional measures in 2024 especially if growth disappoints.

Inflation to Remain Benign

Although inflationary pressures have picked up since June, driven by higher transportation, food, and housing & construction costs. The subdued growth outlook should keep inflation muted. Year-to-date, inflation has risen 3.2% YoY, which is still well below the central bank's 4.5% target. Core inflation, which excludes food and foodstuff, energy and items administered by the government (e.g., healthcare and education) has risen by 4.4% YoY from Jan-Oct. but has been on a steady decline since the beginning of the year.

% YoY, Drivers of Inflation	Jan-23	Feb-23	Mar-23	Apr-23	May-23	Jun-23	Jul-23	Aug-23	Sep-23	Oct-23
Consumer Price Index	**4.9**	**4.3**	**3.4**	**2.8**	**2.4**	**2.0**	**2.1**	**3.0**	**3.7**	**3.6**
Foods and Foodstuffs	6.1	4.3	4.0	3.6	3.6	3.3	2.6	2.3	2.9	2.8
Beverage and Cigarette	4.4	3.8	3.7	3.6	3.4	3.2	3.0	3.1	3.0	2.8
Garment, Hats and Footwear	2.8	2.6	2.5	2.3	2.2	2.2	2.0	2.0	2.1	2.0
Housing and Construction Materials	6.9	7.9	6.7	5.2	6.4	6.5	6.5	7.1	7.3	6.9
Household Equipments and Appliances	2.9	2.7	2.7	2.3	2.2	2.1	1.9	1.8	1.8	1.7
Health and Personal Care	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.5	0.6	0.5
Transportation	0.1	-0.2	-4.9	-3.9	-8.9	-12.0	-9.3	-0.3	3.2	3.9
Post & Telecommunication	-0.2	-0.3	-0.3	-0.3	-0.5	-0.6	-0.9	-1.1	-1.3	-1.3
Education	11.6	10.4	8.4	6.0	5.7	5.7	5.6	5.0	7.2	7.1
Culture, Sport and Entertainment	5.3	4.7	4.7	3.0	2.5	2.3	1.7	1.3	1.4	1.3
Other Goods and Services	3.5	3.4	3.1	3.3	3.4	3.4	5.9	5.9	5.9	5.9
Core inflation	**5.2**	**5.0**	**4.9**	**4.6**	**4.5**	**4.3**	**4.1**	**4.0**	**3.8**	**3.4**

Source: CEIC, OCBC

The upside risks to inflation should not be discounted. Higher domestic food prices brought about by El Nino, higher transportation costs as a result of volatile global oil prices, and higher salary adjustments from the planned salary reform pose a risk to the inflation trajectory. On balance, inflation will come in at the lower end of the government's 4.0 to 4.5% target in 2024.

[25] The Ministry of Finance estimates that 112 foreign corporations may have to pay additional taxes, helping the budget collect an additional VND 14,600 billion in 2024.

[26] Vietnam Law & Legal Forum: "New salary policy mandates budgetary requirement of nearly VND 500 trillion for 2024-26"

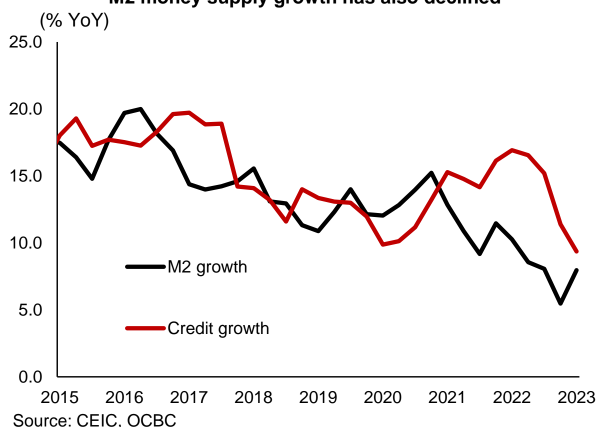
SBV Faces a Double Challenge

The State Bank of Vietnam (SBV) has expressed commitment to pursuing further monetary policy easing to bolster economic growth. However, with the recent uptick in inflation and the near-complete reversal of the 2022 policy tightening, the room for additional easing could be limited. Despite easing its policy rate by 150bps since the beginning of 2023, sentiment has yet to improve amid the ongoing domestic real estate and corporate bond market challenges. As a result, the average credit growth rate has slowed to 10% YoY in Jan-Aug, down from 16% in the same period last year. This falls below the target range of 14-15% set by the SBV for the full year. The challenge going into 2024 for SBV is to encourage lending activities while economic activities remain relatively subdued.

Headline inflation is below the inflation target of 4.5% YoY, indicating that the SBV still has some leeway for inflation to rise. With the cumulative 150bp cut since the start of the year, the SBV still has the potential to cut an additional 50bps to fully reverse the policy tightening in 2022.

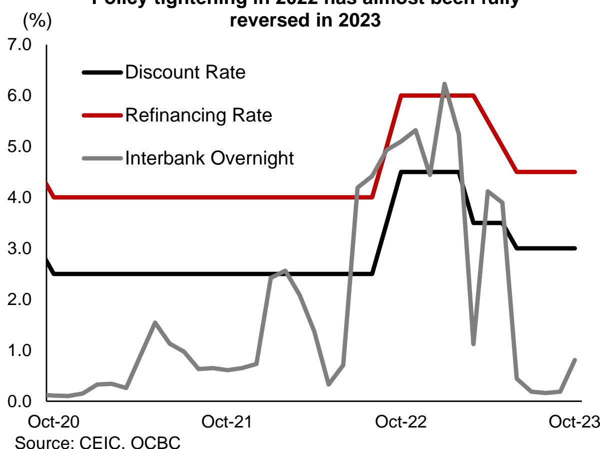
The country's current account surplus along with its trade surplus should provide the SBV flexibility to continue supporting growth. Robust growth in new FDI inflows this year is expected to persist into 2024 as the country benefits from supply chain recalibration. This trend should ultimately support the overall balance of payments.

Credit growth continues to weaken in 2023, while M2 money supply growth has also declined



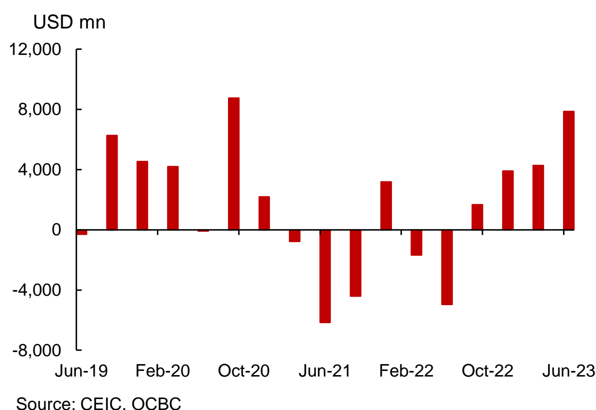
Source: CEIC, OCBC

Policy tightening in 2022 has almost been fully reversed in 2023



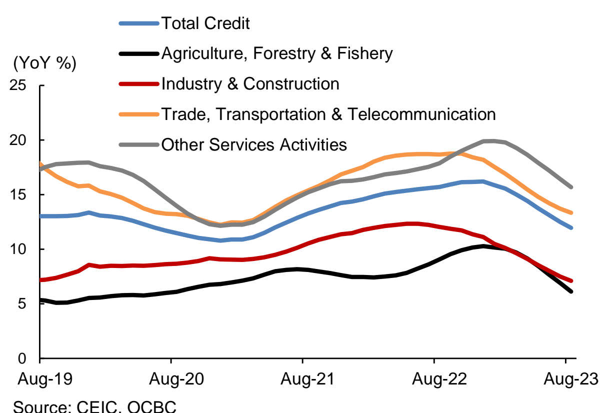
Source: CEIC, OCBC

The current account surplus will provide SBV the ability to continue reversing its policy tightening



Source: CEIC, OCBC

Lending growth has been focused on 'other services activities' (12 month rolling average)



Source: CEIC, OCBC

OCBC

Managing China's Twin Challenges

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- While the management of local government debt risk has been more aggressive, responses to the property market risks have been comparatively reactive.
- One key aspect to monitor is whether China will establish a stabilization fund dedicated to acquiring housing projects from developers.
- Another significant indicator will be whether higher central government (CG) budget deficits persist, which would enable the CG to assume a more active role in leveraging financial resources.

Despite an anticipated recovery in GDP growth rate to 5.4% year-over-year in 2023, market sentiment within the country has remained tepid. Major Chinese equity indices have underperformed their regional counterparts for a second consecutive year, primarily due to investor concerns about risks in the property market and local government debt.

The authorities' approach to these twin challenges has been notably asymmetric. While the management of local government debt risk has been more aggressive, responses to the property market risks have been comparatively reactive. Since the start of the year, China has incrementally relaxed its stringent measures on both the supply and demand sides in the property sector. However, demand continues to be sluggish, as evidenced by further declines in the average daily transaction volume across 30 major cities.

The recent central financial work conference, the first of its kind in six years and attended by all members of the Politburo Standing Committee, signaled a potential shift in policy towards the property sector. The conference called for equal treatment and reasonable financing access for all real estate enterprises. This directive builds upon and reinforces previous guidelines issued by the State Council, indicating a more pronounced commitment that could lead to improved financing conditions for private real estate firms.

Although these improving financing conditions might keep default risks in check, they are not yet sufficient to reverse market sentiment, as pervasive concerns about a downward spiral in property prices continue to deter potential buyers.

Looking ahead to 2024, it is expected that China will implement additional measures to stabilize the housing market. A potential strategy could involve the central government spearheading the establishment of a dedicated housing security fund. This fund would aim to convert existing residential properties, including those embroiled in developer-related risks, into affordable public housing. Such an initiative could simultaneously increase affordable housing supply, alleviate financial pressures on developers, stimulate demand in the real estate market, expedite the clearance of commercial housing inventory, and bolster the resilience of real estate companies.

In contrast to the more cautious approach towards the housing market, China's handling of local government debt has been decidedly more proactive, with two

main strategies: issuing special bonds and increasing the central government's budget deficit.

China's public debt structure is unique. The central government's debt accounts for just over 20% of the total, relatively low compared to other major economies. However, when including both reported and hidden debts of local governments and Local Government Financing Vehicles (LGFVs), the figure approaches nearly 80% of GDP. This places the overall public debt-to-GDP ratio in line with countries like Italy and the UK, albeit lower than Japan and the US.

Chart 1: China's official debt to GDP ratio

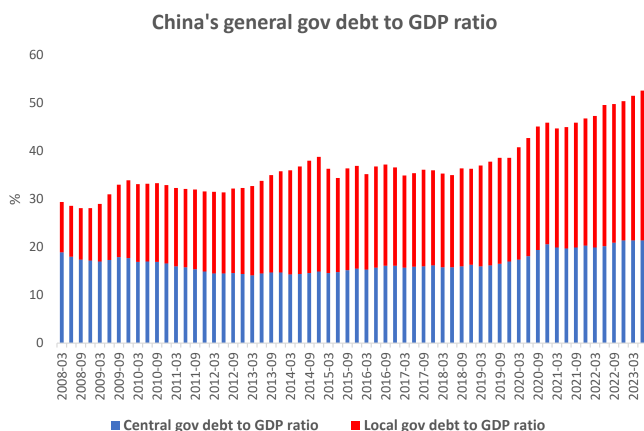
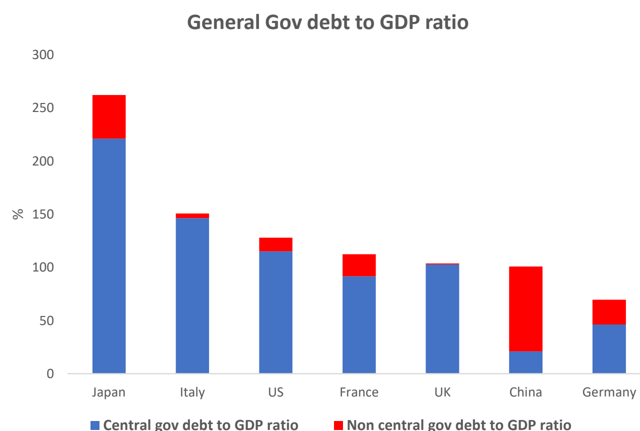


Chart 2: Local gov debt accounted for close to 80% of China's GDP.



Source: Wind, CEIC, OCBC

On an aggregate level, public debt appears manageable. However, the predominantly local nature of the debt has complicated policy transmission from the central to local levels, necessitating immediate remedies.

On a positive note, the authorities have already initiated two measures to address this issue: the issuance of special bonds to offset hidden local corporate debts, and an increase in the budget deficit. These steps indicate a concerted effort to rectify imbalances in the debt structure and enhance the effectiveness of fiscal policy transmission.

At the conclusion of the 6th session of 14th National People's Congress (NPC) Standing Committee on 24 October, the NPC approved an additional CNY1trn government bond issuance quota for this year. This decision will lead to a wider fiscal deficit target of 3.8% for the year, up from the previously set target of 3%.

This marks only the fourth example of an off cycle increase in the fiscal deficit target, and the first time since the Asian financial crisis. Historically, the three prior adjustments, which took place between 1998 and 2000, were set against the backdrop of a bleak economic outlook during the Asian financial crisis. Notably, this is also the first time China has revised its fiscal deficit target in the final quarter of the year.

There are four aspects of this announcement. Firstly, the augmented issuance quota is designated to bolster infrastructure investment in regions affected by

natural calamities in recent years. Secondly, the entire CNY1 trn will be issued in the fourth quarter. Thirdly, the proceeds will be channeled to local governments via transfer payments. Lastly, CNY500bn is slated for allocation this year, with the residual CNY500bnreserved for deployment next year.

The decision to augment the budget deficit in the last quarter of the year sent a robust pro-growth signal, especially since China's growth target of 5% for this year seems well within reach. From this, we see four implications.

Firstly, given that CNY500bn is earmarked for deployment next year, we anticipate China's growth target for 2024 to hover around 5%.

Secondly, the supplementary bond quota might also serve as a mechanism to alleviate the financial strain on local governments. The central government will shoulder the responsibility for both the principal and interest payments of this debt. This will ensure that local governments do not face an increased repayment burden.

Thirdly, the forthcoming issuance of government bonds could exert upward pressure on yields in the short term. This is due to both anticipated supply influx and an optimistic growth outlook.

Lastly, we anticipate the People's Bank of China (PBoC) will intervene to bolster the proactive fiscal stance through a more accommodative monetary policy. This expectation is further reinforced by President Xi's recent visit to the central bank on October 24th. Consequently, we believe there's a heightened likelihood of a Reserve Requirement Ratio (RRR) reduction this quarter.

Looking forward, there is a growing consensus that the fiscal stance will be more expansionary in 2024, potentially setting its fiscal deficit target at around 3.8%. This adjustment would be a strategic move, primarily aimed at addressing the pervasive local government debt issue. Such a policy would signify a continuation and intensification of efforts to stabilize local government finances, underscoring the commitment to maintaining financial stability.

In summary, the authorities' strategic approach to managing its principal financial challenges — notably, the risks associated with the property market and local government debt — is becoming increasingly coherent and transparent. As we progress into 2024, two critical developments merit close observation. One key aspect to monitor is whether the authorities will establish a stabilization fund dedicated to acquiring housing projects from developers. Another significant indicator will be whether there will be a wider central government budget deficit set for next year. A higher deficit would enable the central government to assume a more active role in leveraging financial resources, which could be instrumental in managing local government debts more effectively.

These potential measures could collectively serve as foundational pillars in establishing a safety net for the economy, mitigating the risk of systemic financial disturbances. Such proactive and preventive strategies would be crucial in safeguarding the resilience of the financial system amidst the challenges posed by property market fluctuations and local government debt burdens.

Hong Kong: Growing Fiscal Pressure

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- Fiscal pressure is on the rise after years of maintaining budget deficits. Drained by the counter-cyclical measures introduced during the pandemic, the fiscal balance plummeted to HK$657bn as of end-September 2023, down by two-fifths compared to the pre-covid levels.
- Government revenues have become more volatile and susceptible to the asset market cycle over the years. In the current environment of high interest rates and weak economic momentum, government revenue would inevitably take a major hit, particularly for property related revenues. If the property price correction persists for an extended period, the government's fiscal position would further deteriorate.
- Given the constitutional constraints limit on budget deficits and heightened global uncertainties, we believe the best way out is to improve fiscal prudence. Some of the low-hanging fruits is the cutting back of Covid-era support measures and operating expenses.

Big miss in the fiscal revenue target

The government is under greater fiscal pressure after years of maintaining budget deficits (***Chart 1***). Drained by the counter-cyclical measures introduced during the pandemic, the total fiscal balance plummeted to HK$657bn as of end-September, down by nearly two-fifths compared to pre-covid levels.

The situation has yet to take a turn for the better in the post-covid era. Slumping housing prices, weak land sales (reaching only 18% of annual land sale revenue target of HK$85bn in the first six months of 2023) and shrinking trading volumes in the stock market means that there will inevitably be a big miss in the revenue target this year. According to the Financial Secretary, the fiscal deficit in the current fiscal year is likely to top HK$100bn, almost double the initial estimate at HK$54bn.

Chart 1: Years of fiscal deficits in a row

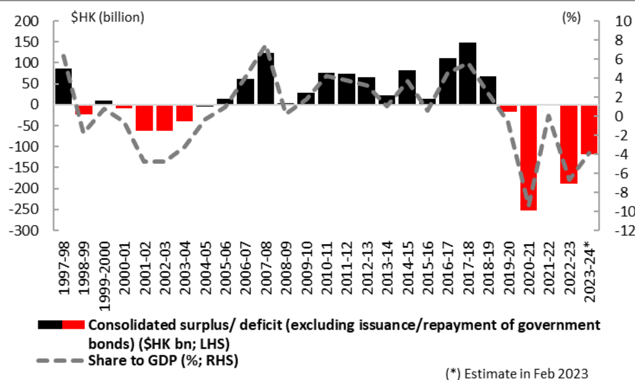
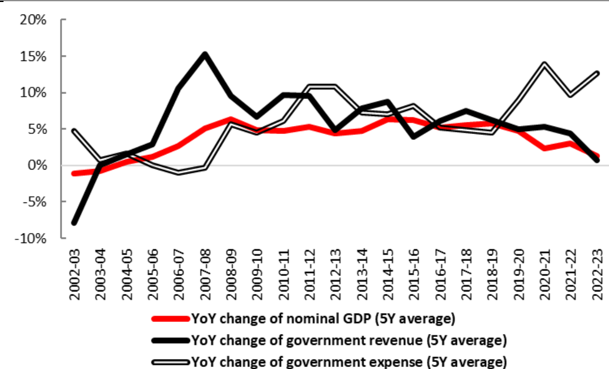


Chart 2: Growth of government revenue/expense



Source: Hong Kong Financial Services and the Treasury Bureau (FSTB), Bloomberg, OCBC

Chart 3: Government's operating revenue/expense

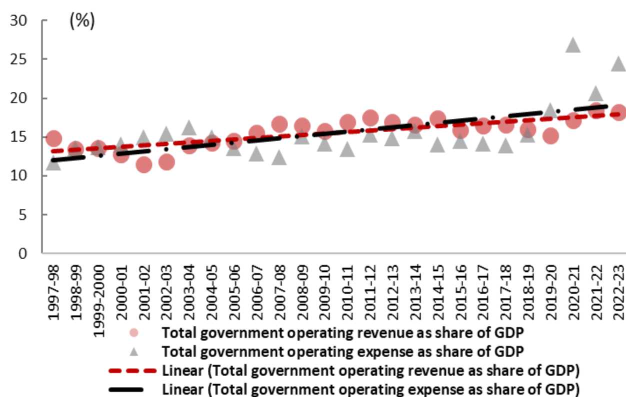
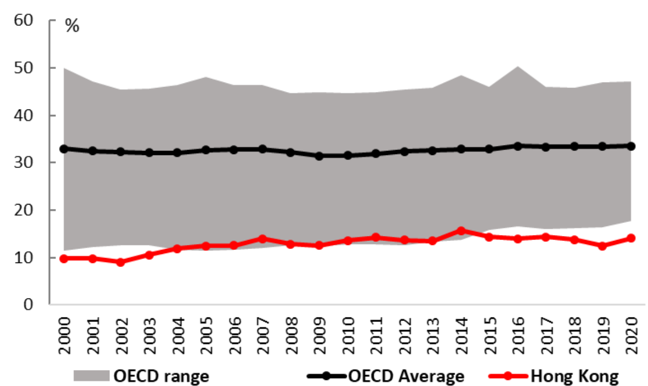


Chart 4: Tax revenue as share of GDP



Source: FSTB, Bloomberg, OCBC

Widening gap fiscal deficit

The fiscal deficit (i.e., gap between the government expense and revenues) had significantly widened. The blame, however, should be not fall entirely on the covid spending. Even prior to the pandemic, from FY1998-99 to FY2018-19, government expenses were expanding at a faster pace of 4.9%YoY, as compared to revenue growth of 3.7%YoY (***Chart 2***). More concerningly, operating expenses (+4.8% p.a.) grew at a faster pace than the operating expense (+3.9% p.a.) during that period (***Chart 3***). These figures suggest that either the government's spending spree was getting out of hand or tax revenue collection capacity of government was limited, or a mix of both.

Limited tax collecting power and narrow tax base

Hong Kong has long been an advocate of "small government", with a low tax rate and narrow tax base by any standard. The government's tax revenue (government revenues collected from taxes on income, profits, goods and services and ownership and transfer of property) as share of GDP averaging at around 12.8% was way below the OCED average at 33.4% in 2019 (***Chart 4***). On the other hand, Hong Kong did not any impose taxes on goods and services, dividend and capital gain, income from overseas sources, as well as value added tax. During FY2014/15-FY2018/2019, major sources of government revenue came from profits tax (27% of total), other incomes (25%), land premium (20%) and stamp duties (14%) (***Chart 5***).

Tax revenue increasingly susceptible to asset market cycle

The growing significance of land premiums, stamp duties and investment income within total government revenue (***Chart 6***) suggests a weakening correlation between revenue and performance of the real economy (***Table 1***). Meanwhile, government revenues have become more volatile and increasingly susceptible to the asset market cycle. In the current environment of high interest rates and weak economic momentum, government revenues would inevitably take a major hit, particularly for stamp duties and land premium which were levied directly on land and property transactions (***Chart 7***). If the property price correction were to persist for an extended period, the government's fiscal position would further deteriorate.

Chart 5: Sources of government revenue FY14-FY18

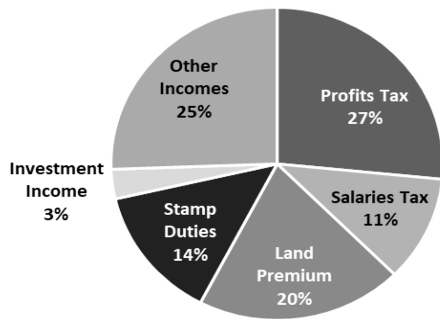


Chart 6: Government revenue by component

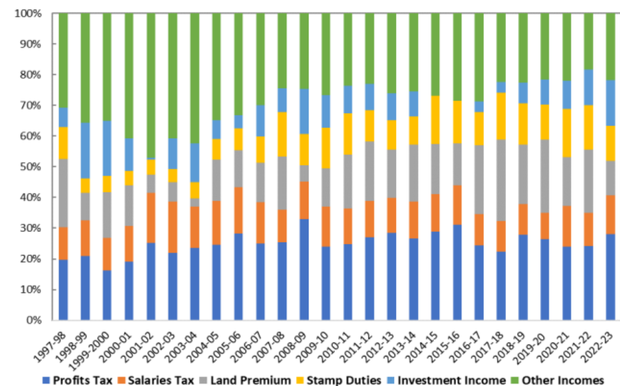
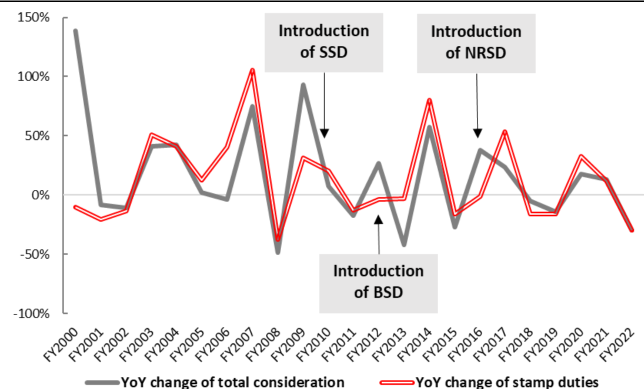


Table 1: Correlation with GDP growth since 1997

	Average correlation with nominal GDP growth since 1997
Profit Tax	0.642
Salaries Tax	-0.066
Land Premium	0.196
Stamp Duties	0.306
Investment Income	-0.011
Other Incomes	0.153
Total revenue	0.514

Chart 7: Year-to-year change of total consideration of property transactions and stamp duties



Source: FSTB, Bloomberg, OCBC

More pain ahead

The slump in trading volumes and the price of stocks and properties alone have already hurt the city's fiscal health. A further cut in stamp duty on stock trading and property transactions would likely exacerbate the short-term pain. In the latest policy address, the government announced what can be called the biggest relaxation of demand-side management measures for property market on record. In addition, to revive sentiment and enhance liquidity in the equity market, stock trading stamp duty would be cut from 0.13% to 0.1%.

In addition, to support the property market, the government will typically refrain from selling more land and control the supply of properties. The government indicated earlier that it would refrain from selling commercial sites, considering the high vacancy rate of office space and tepid performance in the past few years. Combined that with the recent failed land tenders, we are likely to see a big miss in land sales and overall revenue target in periods ahead.

Kicking the can down the road

While there have been active discussions on widening tax base and improving fiscal sustainability for years, not much progress had been made due to several

reasons. First and foremost, the simple and low tax regime is a matter of national pride, and as such the system has broadly worked well. Prior to the pandemic, deficits were only recorded in five out of 22 fiscal years, while the government accrued a sizable fiscal balance (HKD1,120bn at end-2019, around 40% of GDP). Secondly, given the relatively shallow and short-lived economic recessions in the past decades, the city economy has yet to experience prolonged and unnerving fiscal pressures. Hence, the sense of urgency to improve fiscal sustainability was lost along the way and any proposition to increase tax burden was met with strong resistance. Last, but not least, the government has grown complacent with the increase in revenues from stamp duties and land sales, due to the booming property sector.

Practice fiscal prudence and look for low hanging fruits

Budget surpluses are usually a product of a robust economy and fiscal prudence. Given the constitutional constraints limit on budget deficits and the heightened uncertainties in the global macro picture, we believe the only way out is to improve fiscal prudence. One of the low-hanging fruits at this stage is the cutting back of covid-era support measures and other operating expenses. Hence, in the FY2023-24 Budget, salaries tax and profits tax rebates (with a ceiling of HK$6,000, down from that of HK$10,000 previously), and waivers were scaled back.

Meanwhile, a prudent approach should also be taken in undertaking large infrastructure projects in the future. The need for acquiring alternative sources of funding has become more dire now that the government plans to forge ahead with the Northern Metropolis, Kau Yi Chau Artificial Islands and six major infrastructure projects, including three road projects (i.e., Northern Metropolis Highway, Shatin Bypass and TKO-Yau Tong Tunnel) and three railway projects (i.e., Hong Kong-Shenzhen Western Rail Link, Central Rail Link and TKO Line Southern Extension). Currently, the government is looking into bringing in private investors for those infrastructure projects.

ASEAN-4: Assessing Policy Direction

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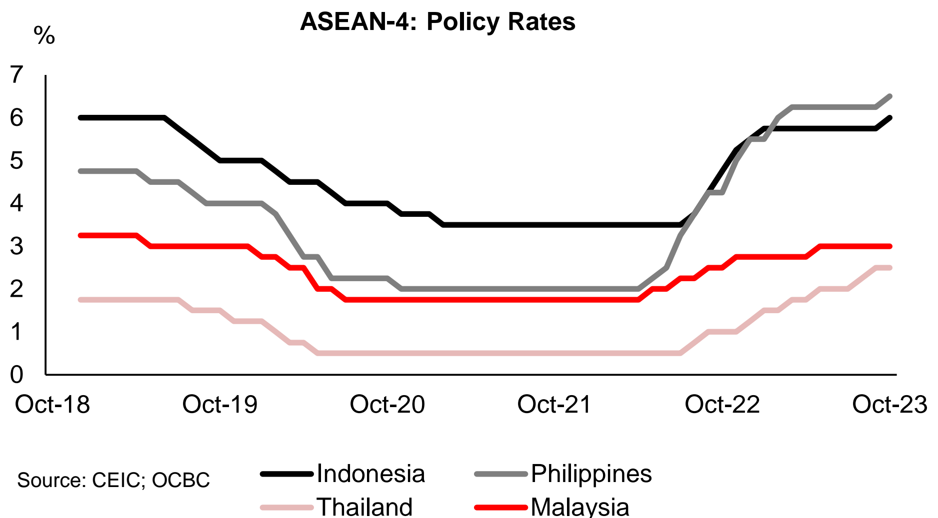
- Fiscal and monetary policy was tighter in 2023 versus 2022 for the ASEAN-4 economies (Indonesia, Malaysia, Philippines, and Thailand).
- Policy direction will become more mixed in 2024. Monetary policy stance will be slightly easier for Indonesia and the Philippines supported by rate cuts while for Malaysia and Thailand, it will remain neutral.
- Fiscal consolidation will continue in 2024 for the Philippines, Malaysia and to a lesser extent, Thailand. Indonesia's fiscal stance will be more neutral.

Policy direction, on the fiscal and monetary fronts, was tighter in 2023 versus 2022 for the ASEAN-4 economies (Indonesia, Malaysia, Philippines, and Thailand). This was hardly a surprise given that fiscal deficits needed to be narrowed as pandemic related support measures was completely wound down and domestic inflationary pressures were brought under control.

There was mixed success in achieving the intended objectives in 2023. The Philippines, for example, is still dealing with elevated inflation while Thailand's new government has proposed more fiscal spending rather than less.

The volatile external backdrop further complicated matters with the US Fed's higher-for-longer interest rate narrative weighing on EM Asia FX with the MYR, THB and IDR bearing the brunt of the impact. Local currency depreciation risks even prompted Bank Indonesia to be reignite its rate hiking cycle on 19 October 2023.



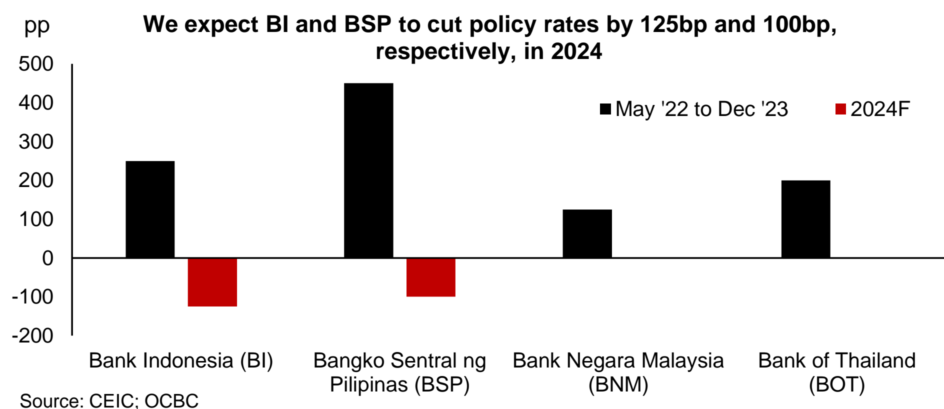
Differentiated Monetary Policy Direction

Central bank reaction functions will remain flexible in 2024 insofar as deliberating the most important policy parameter for domestic policy rates. Although BI, BSP and BOT are explicitly inflation targeting central banks, historical precedence has shown that inflation is not the only criterion. An evolving global backdrop, particularly with unfavourable interest rate differentials exacerbating capital outflow risks, has become a crucial piece of the ASEAN-4 central bank equation.

Our house view is that the US Fed is set to unwind at least some of its tightening next year with a cumulative 100bp in rate cuts starting in 2Q24. This does not necessarily mean that the ASEAN-4 central banks will follow suit. Contrary to mirroring the US Fed rate hiking cycle, where the four central bank hiked rates in more synchronous manner to the US Fed, the path down will be more differentiated.

Of the four central banks in question, we believe BI will be the first central bank to unwind policy rates. The most recent hikes heightened the risk of BI overtightening. Indeed, financial conditions tightened noticeably following BI's surprise 25bp hike on 19 October.

BI will keep its policy rate unchanged at 6.00% in 2023 but will unwind some of the rate hikes as concerns around weaker growth is amplified. We forecast 2024 GDP growth of 4.8% YoY, in contrast to BI's expectation of stronger growth versus 4.5%-5.3% in 2023. Meanwhile, inflationary pressures managed by subsidised retail fuel prices will remain contained allowing further room for policy easing. As such, we forecast a cumulative 125bp in rate cuts in 2024 starting 2Q, taking the policy rate to 4.75%.



For BSP, the rate cuts in 2024 will have to be more measured. We forecast that BSP will cut its policy rate by a cumulative 100bp starting in 2Q24, taking the policy rate to 5.50% by end-2024. The stickiness of inflationary pressures persisted through 2023 and will likely remain high through 2024, despite BSP's aggressive rate hiking cycle of a cumulative 450bp since May 2022. BSP forecasts that headline inflation will average 4.7% next year, well above its 2-4% inflation target range and much higher than our upwardly revised forecast of 3.7%. The rate cutting cycle will extend into 2025 provided headline inflation returns to BSP's 2-4% target range.

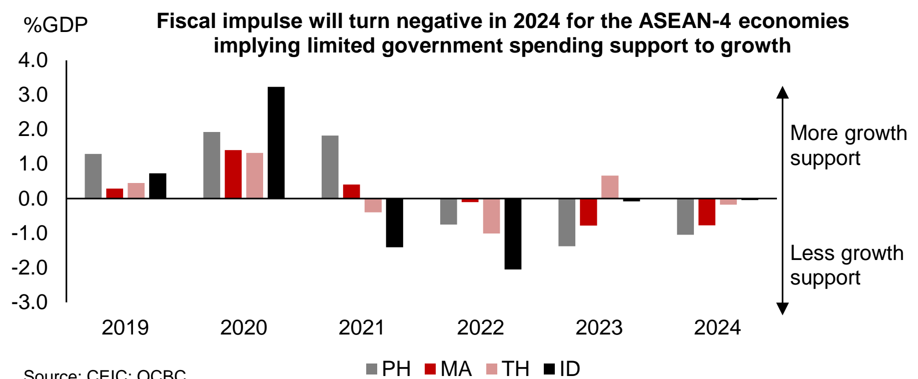
By contrast, we expect BNM and BOT to maintain its benchmark policy rates at current levels. BNM's rate hiking cycle was more gradual compared to regional peers and the US Fed. This means that BNM has less room to unwind rate hikes. Moreover, historical precedence shows that BNM is comfortable maintaining its policy rate for prolonged periods supported by the appropriate growth-inflation mix. BNM held its policy rate at 3.00% from May 2011 until May 2014.

Meanwhile, BOT will keep its policy rate unchanged at 2.50% through 2024. Inflationary pressures will likely rise in 2024 but remain within BOT's 1-3% target range given the low starting point. Higher inflation in 2024 will be driven by government policies including cash handouts and potential minimum wage hikes, in our view.

Limited Fiscal Policy Support to Growth

The ASEAN-4 countries will continue fiscal consolidation in 2024, albeit to differing degrees. This implies that there will be limited fiscal support to growth as the fiscal impulse is expected to be contractionary.

The consolidation trajectory will be the sharpest for the Philippines and the least for Indonesia. Indonesia's achieved significant fiscal consolidation in 2021-22 and brought the fiscal deficit back within its 3% of GDP limit. Malaysia's consolidation hinges on the timely and effective implementation of a targeted fuel subsidy rationalisation plan. Thailand's fiscal stance in FY24 only modestly reverse the extra fiscal support to growth in FY23[27].



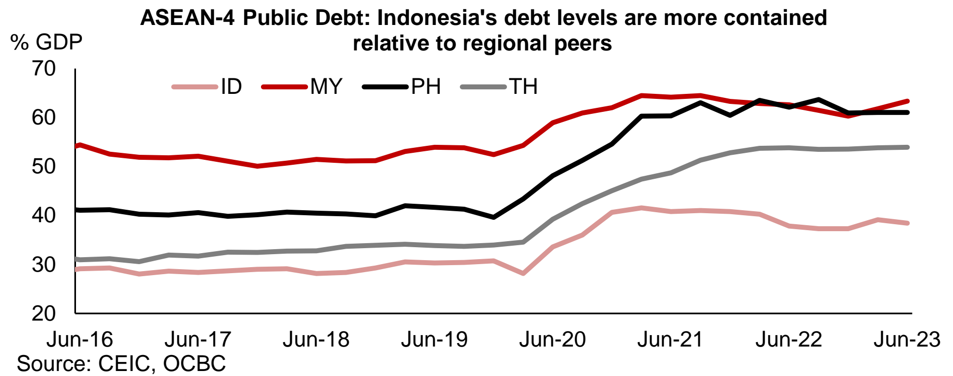
Indonesia: Fiscally Prudent

Indonesia's fiscal stance is likely to remain the neutral over the medium-term as the bulk of fiscal consolidation took place in 2021 and 2022. The windfall revenue gains from higher commodity prices helped narrow the fiscal deficit to below the 3% of GDP threshold.

For 2023, the government is likely to undershoot its fiscal deficit target of 2.3% of GDP (OCBC: 2.0% of GDP) providing some fiscal room to manoeuvre in 2024. The government has pegged the 2024 fiscal deficit at 2.3% of GDP (unchanged from the 2023 'outlook'). Notwithstanding, we expect 2024 GDP growth will slow to 4.8% from 5.0% in 2023 given the lagged impact of monetary policy tightening and dampened investment sentiment due to election cycle.

Given this, there is some room for looser fiscal policies in Indonesia, to support BI's rate cutting cycle. While this is not our baseline, it cannot be ruled out. There is space to widen the deficit by 0.1-0.3% of GDP, if necessary, to 2.5% of GDP. This can be accommodated since public debt (%GDP) is lower compared to regional peers.

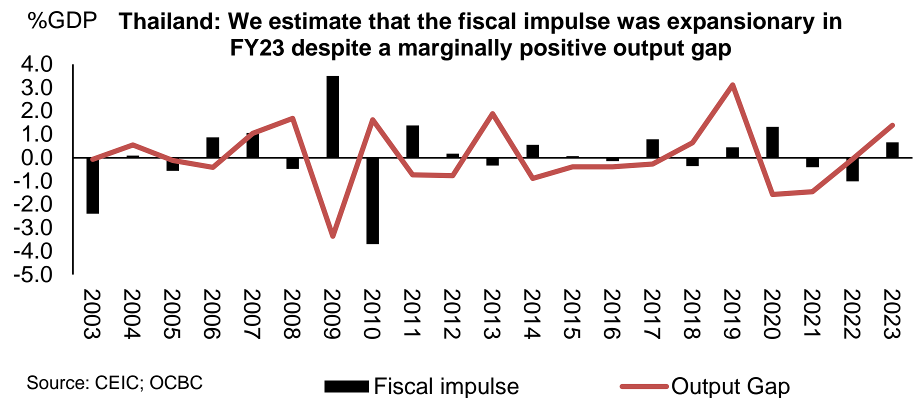
[27] The FY24 is expected to be passed by Parliament and sent for royal endorsement in April 2024.



Source: CEIC, OCBC

Thailand: Only Modest Consolidation

The new government, under PM Srettha Thavisin, promised a host of measures to boost consumption. However, following some criticism, discussions are ongoing to moderate the largesse. Even so, the fiscal impulse, i.e., fiscal support to growth, remained positive in FY23 despite a marginally positive output gap.



Source: CEIC; OCBC

For FY2024, the fiscal stance will only be modestly contractionary. Although the direction is appropriate, the extent of fiscal consolidation is lower compared to regional peers. With BOT likely to remain on hold through 2024, we see the fiscal and monetary policy mix as implying slightly tighter conditions in 2024 compared to 2023.

Malaysia: Relying on Subsidy Rationalisation

By contrast, we expect the fiscal stance in Malaysia to remain contractionary. Malaysia's government, under PM Anwar, has embarked on a fiscal consolidation path. Budget 2024 pegs the fiscal deficit at 4.3% of GDP versus 5.0% in 2023. Achieving this is contingent on the timeline for implementing targeted fuel subsidy rationalisation, given that subsidy and social assistance spending is budgeted to drop 18%. Encouragingly, the government has pressed ahead with new tax measures aimed at broadening the tax base.

Importantly, under the newly enacted 'Public Finance and Fiscal Responsibility Law', the government is committed to lowering the fiscal deficit to 3.0% of GDP or less within three to five years (i.e., latest by 2028) while keeping public debt at 60% of GDP or lower. This means that fiscal support to growth over the medium-term is likely to be limited with growth reliant on other engines for a sustained support.

Philippines: Consolidation Adhering to Medium-Term Plans

Fiscal policy in the Philippines, similar to Malaysia, remains geared towards consolidation. The 2024 fiscal deficit is pegged at 5.1% of GDP versus 6.1% of GDP in 2023, with the consolidation to be driven by higher revenue growth of 12.2% YoY in 2024 from 5.2% in 2023. Expenditures will also continue to rise by 7.7% YoY in 2024 versus 1.3% in 2023 on account of higher capital expenditures.

The Philippines revenue reform agenda has been ongoing for the past decade through the Comprehensive Tax Reform Program (CTRP). The government estimated that these reforms generated PHP202.8bn in additional revenues in 2022[28] while further reforms under the Medium-Term Fiscal Framework (MTFF) will generate PHP145.5bn in revenues from 2024-2028. Specifically in 2024, revenues collections will be supported by the implementation of the Passive Income and Financial Intermediary Taxation Bill (Package 4 of the CTRP), the imposition of VAT on digital services providers and excise taxes on single-use plastics and pre-mixed alcohol.

The room for counter cyclical fiscal policy is the constrained, particularly if the government aims to follow through on its MTFF. Under the MTFF, the government will narrow the deficit to 3% of GDP by 2028 and lower the national government to GDP to less than 60% of GDP by 2025 (2022: 60.9%).

Conclusion

In conclusion, the monetary policy stance will be slightly easier for Indonesia and the Philippines in 2024 supported by rate cuts while for Malaysia and Thailand, it will remain neutral. In terms of fiscal policy, the ASEAN-4 economies will continue with fiscal consolidation, led by the Philippines and Malaysia. Thailand's consolidation trajectory is more modest with Indonesia's stance neutral.

[28] https://www.pna.gov.ph/articles/1202370

GLOBAL MARKETS RESEARCH

Thematic Report 4

De-Dollarization: Slowly but Surely

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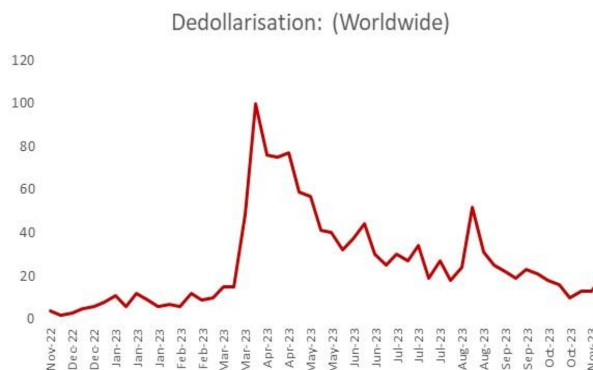
Assisted by Kenneth Chong

- The de-dollarization process picked up pace amidst growing concerns of over-reliance on the US dollar (USD). This year, Argentina, Brazil, and Bolivia started to pay for Chinese imports in Renminbi (RMB) while trade between Malaysia and India can be settled in Indian Rupee (INR). Several countries within the ASEAN bloc have also committed to push for better regional payment connectivity and increase the use of local currency transactions to transition away from established currencies used for trade.
- Notwithstanding, the role of the USD in internationally remains irreplaceable at this point for a lack of alternatives even as the share of USD reserves has been trending down.
- We look at some of the recent de-dollarisation efforts and re-visit the role of the USD in the context of central bank reserves, medium of payment and access to capital markets.

"The greenback's dominance won't last forever because nothing does. But the hype about de-dollarization is much ado about almost nothing. For now, the dollar dominates because there just aren't any good alternatives".

Nobel laureate, Paul Krugman
New York Times, 7 Jul 2023

Google Search Trends for De-dollarisation



Source: Google search trends, OCBC

Shifts Taking Place, Gradually

The topic of de-dollarisation has seen recurring interest from time to time. The most recent catalyst was the financial sanctions levied by the US and western allies on Russia following Russia's invasion of Ukraine in 2022. The western alliance froze nearly half of the central bank's US$630bn in foreign reserves; it also removed major Russian banks from the SWIFT payment network in attempt to cripple the economy. Thereafter, there has been an uptick in efforts globally to create alternatives to the USD -, as a mean of risk management and diversification.

This year there has been a handful of RMB-settled LNG deals, including China's CNOOC and France's Engie, CNOOC and Singapore's Pavilion Energy (Oct 2023), PetroChina and UAE's Adnoc (Apr-2013) as well as between CNOOC and France's Total Energies (Mar-2023).

Most recently, in November 2023, Singapore and Indonesia launched cross-border QR payments. The payment linkage is the first step to foster a wider use of local currencies in bilateral transactions via the local currency transactions (LCT) framework that is expected to be completed in 2024. For Malaysia, direct transfers were enabled between PayNow (SG) and DuitNow (MY), allowing customers of the participating financial institutions to send up to S$1,000 daily. This is a continuation from the previously established NETS-DuitNow QR payment linkage in March 2023. Currently, these initiatives are in-place for individuals and small businesses. This may be a small step but is pivotal in setting the stage towards commercial use as MAS begins a live pilot of wholesale central bank digital currencies (CBDCs) in the coming year.

In September 2023, Indonesia launched a national "de-dollarisation" task force, that is made up of at least 6 ministries. Bank Indonesia and key financial regulators will help facilitate cross-border local currency transactions with regional partners in an attempt to reduce reliance on the USD in ASEAN especially when more than 70% of the exports in the region are invoiced in USD. The move is consistent with the agreement signed by ASEAN members at the 42nd ASEAN Summit (May-2023) to push for better regional payment connectivity and the use of local currency transactions to transition away from established currencies used for trade.

In August 2023, Indonesia, Malaysia, and Thailand inked an MoU for cross border bilateral transactions. This supersedes the MoUs on the local currency settlement framework signed between the 3 central banks in 2015 and 2016. The new framework is expanded to include more transactions beyond trade and direct investments and will be implemented gradually.

Also, in August 2023, BRICS nations extended membership invitations to 6 countries, for the first time since 2010. Notable names include top oil producers: Saudi Arabia, UAE, and Iran. This expansion seeks to further their standings in the world stage to challenge US and Western influence. Though the discussion of a common BRICS currency was not on the agenda, several leaders including Brazil's President Lula and Russian Foreign Minister Sergey Lavrov expressed support for the idea of a common currency among BRIC nations as a means of increasing payment options and reducing their vulnerability to dollar exchange rate fluctuations. BRIC leaders recognise the challenges to creating a common currency. Instead, the focus is on boosting trade in national currencies and providing alternative mechanisms like the BRICS new development Bank (NDB).

In April 2023, it was reported that Argentina aims to pay around US$1.0bn of Chinese imports in RMB instead of USD and thereafter, around US$790mn of monthly imports will be settled in RMB. In Oct 2023, Argentina tapped on its US$18bn RMB swap lines to pay part of the US$2.6bn due to the IMF.

In April 2023, trade between India and Malaysia can be settled in Indian rupee (INR), in addition to the current modes of settlement in other currencies. Trade between the 2 countries was at US$19.4bn in FY2021-22. This initiative by the RBI was aimed at facilitating the growth of global trade and to support the interest of the global trading community in INR.

Earlier this year, China and Brazil reached a deal to use their own respective currencies in trade and financial transactions directly without going through the USD. China-Brazil trade stood at US$171.49bn in 2022. Bolivia also uses the RMB to pay for imports and exports, though the amount was small for a start. Bolivia's Economy Minister Marcelo said that Bolivia conducted financial operations worth about US$38.7mn between May and June 2023. This accounted for about 10% of its foreign trade.

Sufficient to Challenge USD's Dominance?

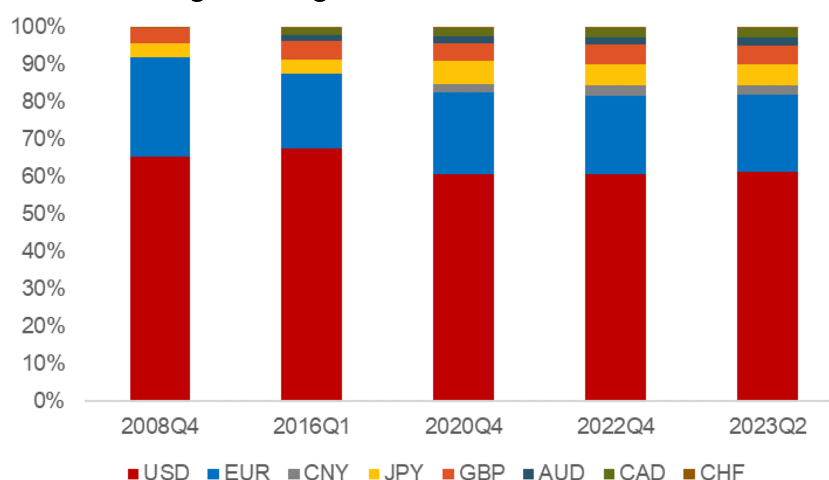
The above-mentioned list is not exhaustive but offers a glimpse into how there is slightly more walk and less talk on the shift to a USD alternative. This raises questions about whether de-dollarisation this time is different in light of a fragmented geopolitical landscape and growing fears of one's foreign reserves/financial resources being potentially held hostage to USD hegemony in an increasingly polarised world.

To answer this, we look at the role of US dollar in the context of 1/ reserve accumulation by central banks; 2/ global trade and invoicing; 3/ international payments; 4/ access to debt markets and role in global financial markets.

1/ Reserve Accumulation

While US dollar's share of global currency reserves has held steady this year at 58.9% in 2Q 2023, the share has been trending down from 72% in 2001.

% Share of Foreign Exchange Reserves



Source: IMF-COFER, OCBC

A working paper published by the IMF[29] highlighted a few key points: 1/ that the decline in dollar share of international reserves since the turn of the century reflects active portfolio diversification by central bank reserve managers. 2/ In particular the decline in USD's share was not accompanied by increase in share of other major FX, such as EUR, JPY, or GBP. 3/ Instead the shift out of USD has been in 2 directions: a quarter into the Chinese renminbi (RMB), and three quarters into the currencies of smaller countries that have played a more limited role as reserve currencies. The paper classified AUD, CAD, RMB, KRW, SGD, and SEK as nontraditional reserve currencies.

Nontraditional currencies in Global FX reserves (End 2020)

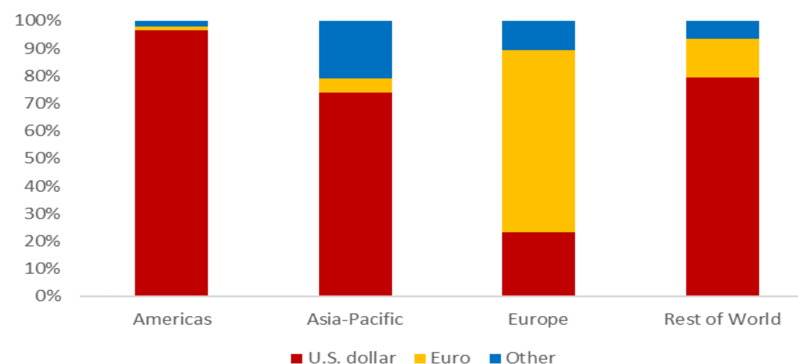
	in bil US$	as % of Total
Total	1070	100%
Australian dollar	217	20%
Canadian dollar	247	23%
Chinese renminbi	272	25%
Swiss franc	21	2%
Other	315	29%
Korean won	81	8%
Swedish krona	63	6%
Singapore dollar	51	5%
Norwegian krone	49	5%
Danish krone	47	4%
New Zealand dollar	12	1%
Hong Kong dollar	11	1%

Note: The size of "other" currencies is estimated based on Arslanalp and Tsuda (2014).
Source: IMF, COFER, CPIS

2/ Global Trade and Invoicing

Despite the US only accounting for 10% of global trade, trade invoices denominated in USD accounts for half of global trade, albeit its share faces a varying contrast depending on regions. In fact, other than Europe, the remainder of world still largely relies on USD for global trade invoicing. According to Boz et al[30], the share of USD in invoicing has varied little over history across different regions.

% Share of Export Invoicing through 1999 to 2019



Source: IMF Direction of Trade; Central Bank of the Republic of China, Federal Reserve, OCBC

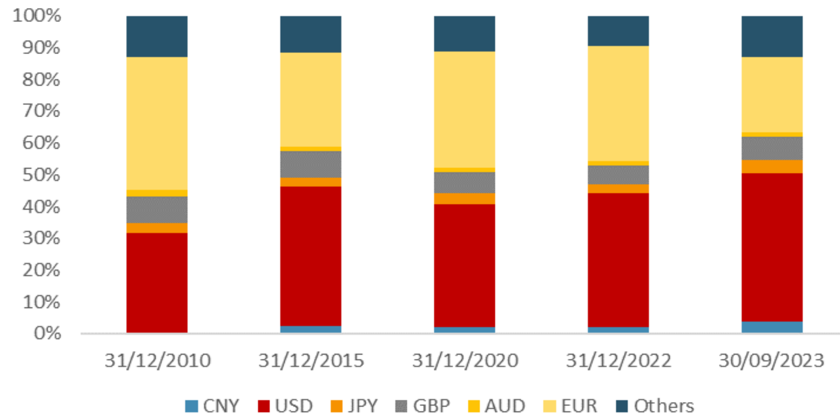
[29] Arslanalp, S., Eichengreen, B.,and Simpson-Bell, C. 2022. The Stealth Erosion of Dollar Dominance: Active Diversifiers and the Rise of Nontraditional Reserve Currencies. IMF WP/22/58, Washington DC: USA

[30] Boz, Emine and Casas, Camila and Georgiadis, Georgios and Gopinath, Gita and Le Mezo, Helena and Mehl, Arnaud and Nguyen, Tra, Patterns in Invoicing Currency in Global Trade (July 1, 2020). IMF Working Paper No. 20/126, Available at SSRN: https://ssrn.com/abstract=3670607

3/ International payments

The dollar continues to play a key role in international payments. Latest data (3Q 2023) from SWIFT showed that 46.6% of transactions were made in USD. Despite the shifting geopolitical landscape in recent times, the USD continued to extend its dominance. In fact, USD's transaction via SWIFT saw a sharp increase from 41.9% to 46.6% during the period from 4Q 2022 to 3Q 2023.

% Share of SWIFT Payments denominated in foreign currency



Source: SWIFT, Bloomberg, OCBC

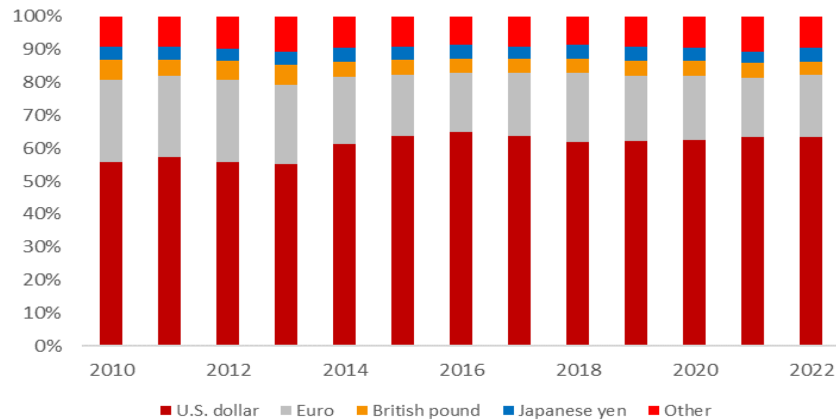
While RMB's share of international payments via SWIFT remains low at 3.71% (3Q 2023), RMB's share has been on the rise from about 1.6% in 2020.

In China's own Cross-Border Interbank Payment System (CIPS), RMB's share of cross border payments and receipts hit a record high of 49% in 2Q 2023, surpassing the USD for the first time. This may bring to question as to whether China's growth in global commerce could make a case for a strong alternative to the USD. However, there remains much to be seen from RMB before the picture clears.

4/ Access to Debt Markets and Role in Financial Markets

The USD has also been the dominant currency in international banking. Bank of International Settlement (BIS) data shows about 60% of foreign currency liabilities remain denominated in US dollars and it has remained largely steady since 2000.

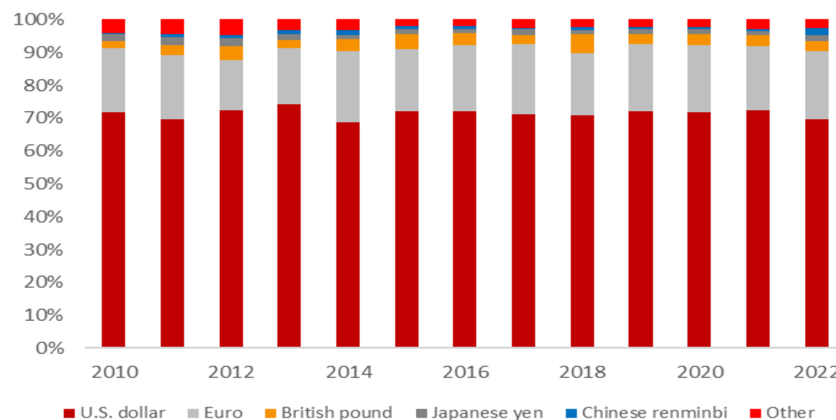
% Share of banking liabilities (deposits) across national borders or denominated in foreign currency



Source: BIS, Fed, OCBC

In the space of foreign currency debt issuance (debt issued in a currency other than home country), the US dollar is also dominant with its share standing steady at around 70% since 2010.

% Share of foreign currency debt issuance

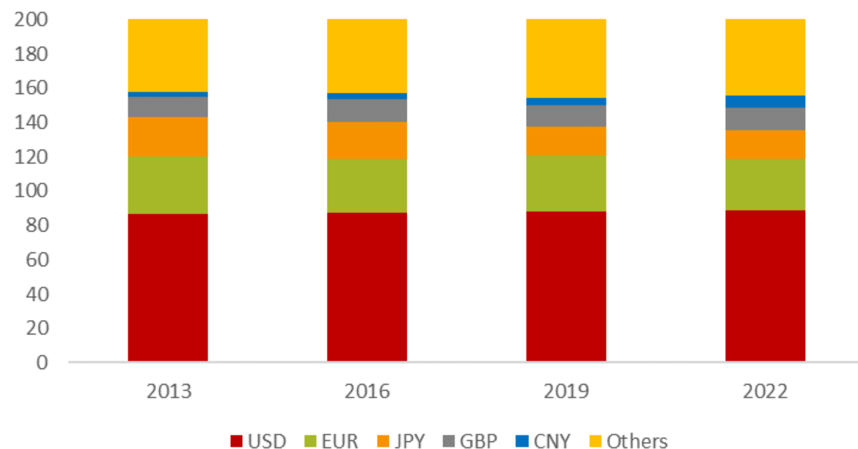


Source: Refinitiv, Fed, OCBC

The FX markets is predominantly concentrated in USD with 88% (2022) of spot, forward and swap markets featuring USD in one leg of the transactions. As a comparison, the EUR, being the second most trade currency, is trailing behind with a rather large margin. CNY in the past decade has begun picking up in FX turnover from <1% in 2010 to 7% in 2023; while this likely corresponded with the slight decline within the other major currencies, the USD's significance within the FX markets is still seemingly unshaken. The USD's role as a vehicle currency for FX transactions has remained steady (not fallen below 87% since 2013).[31]

[31] Based on BIS Triennial OTC derivatives statistics

% Share of FX Turnover by Currency



Source: BIS, OCBC

Conclusion

"So far, the data do not show substantial changes in the use of international currencies. But they do suggest that international currency status should no longer be taken for granted, and that we should be really attentive to the currency in which trade transactions are organized."

Christine Lagarde, President, European Central Bank
At the Council of Foreign Relations, 17 Apr 2023

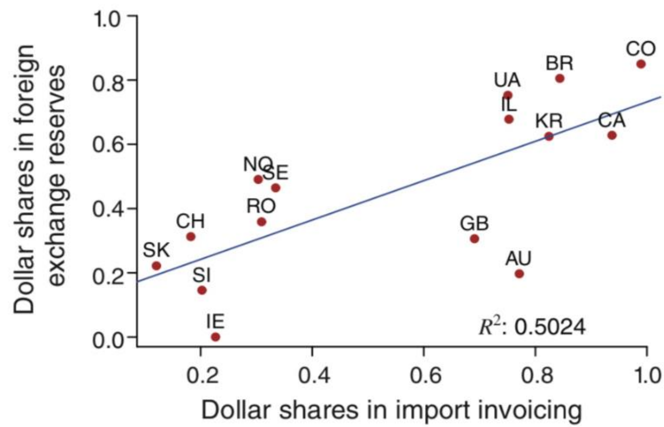
Attempts to reduce reliance on the use of USD for trade settlement is picking up pace but the progress remains slow. The USD share in trade invoicing and payments still makes up the majority (in the range of 40% - 50%) and has been largely stable over the years. While USD's share of reserves has been on a downtrend since 2001 as reserves managers engaged in reserve diversification towards nontraditional reserves, it is also true that the share of USD reserves is still significant (slightly under 60%) and remains a key reserve currency. In the context of global FX markets, international banking and foreign debt issuance, the USD has continued to play a dominant role.

In conclusion, the USD still plays a dominant role in trade & invoicing, international payments, reserves, and access to capital and FX markets as there is a lack of suitable alternatives in the foreseeable future. But this does not hinder the de-dollarisation trend, which may be slow for now. What could be worth keeping a close watch is the relationship between reserve holdings and trade as well as payment alliances, trade invoicing. Efforts to create alternatives to the USD seem to be picking up pace this year. One research[32] documents a significant correlation between a country's trade with China and its holding in RMB as

[32] Barry Eichengreen & Camille Macaire & Arnaud Mehl & Eric Monnet & Alain Naef, 2022. "Is Capital Account Convertibility Required for the Renminbi to Acquire Reserve Currency Status?," Working papers 892, Banque de France.

reserves while another IMF study[33] shows a link between trade invoicing and central bank reserve holdings.

Strong correlation between USD share in import invoicing and USD share in FX reserves



Source: Gita Gopinath & Jeremy C. Stein, 2018

[33] Gita Gopinath & Jeremy C. Stein, 2018. "Trade Invoicing, Bank Funding, and Central Bank Reserve Holdings," AEA Papers and Proceedings, American Economic Association, vol. 108, pages 542-546, May.

Implications of the EU's deforestation-free law for Indonesia

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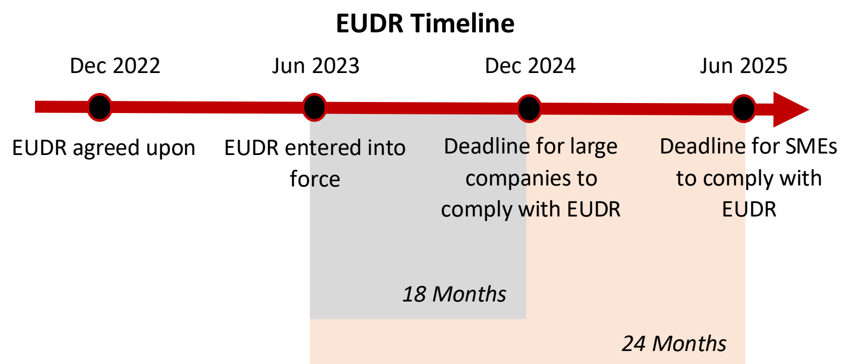
European Union (EU) regulation on deforestation-free products (EUDR)

The EUDR came into force on 29 Jun 2023, that mandates companies placing certain commodities on the EU market to screen their global suppliers through mandatory deforestation and forest degradation due diligence frameworks. A key driver is that the EU is a major consumer of commodities associated with deforestation and forest degradation for agricultural land expansion. The six commodities covered by the regulation are (i) palm oil, (ii) cattle, (iii) soy, (iv) coffee, (v) cocoa and (vi) timber and rubber, as well as derived products such as beef, leather, chocolate, and furniture. The EUDR aims to increase the consumption of deforestation-free products, limit the EU's impact on global deforestation, and reduce EU-driven greenhouse gas emissions and biodiversity loss. Under the EUDR, companies that export or place these commodities on the EU market must prove that the products originated from land that has not been subject to deforestation or forest degradation after 31 Dec 2020. All relevant companies will need to conduct strict due diligence to ensure that the products comply with regulations including those surrounding human rights, or face penalties for non-compliance. There is a transition period of 18 months from 29 Jun 2023 for large companies to comply with the EUDR, while small enterprises will have up to 24 months to adapt.



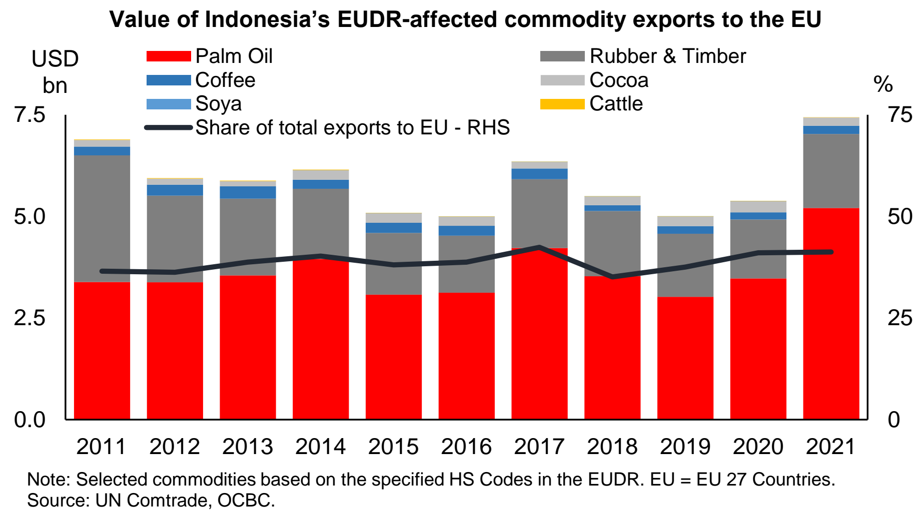
The EU estimates that there will be a reduction of at least 31.9 million metric tons of carbon emissions annually from the EU consumption and production of the targeted commodities, that translates to at least EUR 3.2 billion of economic savings annually.

Value of Indonesia's commodity exports affected by the EUDR

As Indonesia is the world's leading palm oil exporter and a major supplier of rubber, timber, cocoa and coffee products, approximately USD 5.9 billion[34] of Indonesia's annual exports are expected to be affected by the EUDR. While this constitutes only ~2.9% of Indonesia's total global exports, it contributes up to ~40% to the country's total exports to the EU. More importantly, both the

[34] Average value of annual exports of commodities covered by the EUDR to the EU from 2017 to 2021.

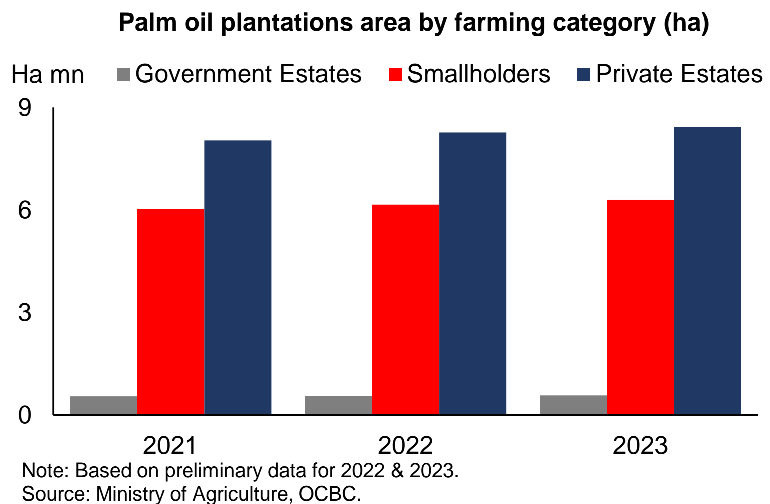
nominal export value and its share of total exports to the EU have been on an upward trend since 2018.



Note: Selected commodities based on the specified HS Codes in the EUDR. EU = EU 27 Countries.
Source: UN Comtrade, OCBC.

Impact on Indonesian palm oil: Increased costs but decreased climate risks

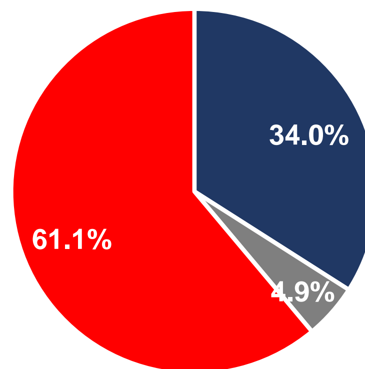
A key driver of deforestation in Indonesia is the large-scale conversion of forests into agricultural land e.g., palm oil. The EUDR is expected to largely affect around 15 – 17 million smallholders and small-scale farmers of palm oil in Indonesia, as they may not have sufficient resources to comply with the regulatory requirements.



Note: Based on preliminary data for 2022 & 2023.
Source: Ministry of Agriculture, OCBC.

Palm oil production by farming category (tons)

■ Smallholders ■ Government Estates ■ Private Estates



Note: Based on preliminary data for 2022 & 2023
Source: Ministry of Agriculture, OCBC.

These smallholders contribute to 34% of palm oil production for domestic and international markets. As a result, the Indonesian government is lobbying for the EU to recognise its locally recognised palm oil sustainability standards, i.e., Indonesian Sustainable Palm Oil (ISPO) certificates and Roundtable on Sustainable Palm Oil (RSPO), for export to the EU market.

However, there are also challenges with integrating smallholders into the sustainability palm oil supply chain, due to barriers such as lack of technical knowledge, limited access to planting materials and financing. There are existing efforts such as the smallholders training programme to support small-scale farmers in gaining access to financing, replacing ageing palms and managing their plantations while meeting certification standards.

The EUDR may spur greater government support for smallholders in capacity building and financing, as well as efforts to build on existing sustainable certification schemes like ISPO and RSPO to meet international regulations. This can increase the implementation of more innovative agriculture technologies for more productive palm oil production and lower the exposure to climate risks with decreased deforestation and forest degradation.

Deforestation risks in other sectors

Apart from palm oil, other monoculture plantations such as timber plantations also contribute to deforestation in Indonesia. Mining activities are also another major driver of deforestation in Indonesia, especially nickel mining as Indonesia has large nickel reserves and is the world's largest nickel producer. With the growing electric vehicles (EVs) sector, the demand for nickel is also expected to increase as nickel is a critical component of EV batteries.

The list of commodities covered under the EUDR is expected to be regularly reviewed and updated while it considers new deforestation drivers and emerging trends. Therefore, it is possible that the scope of commodities may be expanded in the future to include more commodities associated with deforestation such as nickel.

Resistance from commodity-producing countries

Indonesia is amongst several commodity-producing nations that export commodities covered under the EUDR to the EU. 17 countries signed a letter of concern to be involved in the drafting of implementing rules, as there are concerns over many small-scale farmers across Asian, Latin America and Africa who are not able to comply due to high costs and technical complexity. The 17 countries are Argentina, Brazil, Bolivia, Ecuador, Ghana, Guatemala, Honduras, Indonesia, Colombia, Malaysia, Mexico, Nigeria, Ivory Coast, Paraguay, Peru, Thailand, and the Dominican Republic. These discussions will be crucial to trade relations between EU and affected commodity-producing nations.

What's next?

1. **Risk classification of supplying countries**

   The EU will determine levels of low, standard, and high risk for the supplying countries, which are dynamic and can change over time depending on country developments. Countries assessed as low risk will be subject to simplified due diligence processes, while high-risk countries will be subject to more comprehensive checks e.g., satellite images. There are concerns that Indonesia may be labelled as a high-risk country that can lead to greater scrutiny on Indonesia's supply chains and additional regulatory burden.

2. **Increased operational costs to commodity-producing countries and potential delays in trade negotiations**

   Countries exporting the affected commodities to the EU will be faced with increased compliance costs associated with tracing complex supply chains, such as new technologies and administrative processes. They are required to provide documents and certificates of traceability to European partners, which increases long-term operational costs of exporting to the EU. To support compliance to EUDR, the EU may provide financial and technical support to some of the supplying countries.

   The enforcement of the EUDR is expected to slow down the advancement of free trade agreement negotiations between the EU and Indonesia. On 31 May 2023, Indonesia, and Malaysia delayed trade talks with the EU to seek fair treatment for palm oil smallholders that will be greatly affected by the EUDR.

3. **Alternative export markets**

   The EUDR is likely to transform trade and supply chains across commodities associated with deforestation. Companies who cannot comply with the EUDR while keeping their businesses sustainable may seek alternative export markets. Indonesia is considering the diversion of palm oil exports to Africa in place of Europe. This decision will depend on the EU's receptiveness to Indonesia's locally recognised palm oil sustainability standards, as well as supporting smallholders in exporting to the EU.

Coordinating Minister of Maritime and Investment Affairs, Luhut Binsar Pandjaitan, suggested a gradual shift of palm oil exports to Africa, while Eddy Martono, Chairman of Indonesia Palm Oil Association (GAPKI) emphasised the growing opportunities to increase exports to China.

4. Watching developments from the Ad Hoc Joint Task Force

Indonesia, Malaysia, and the EU have agreed to establish an Ad Hoc Joint Task Force (JTF) to address concerns about the EUDR. The Ad Hoc JTF aims to establish dialogue and workstreams related to EUDR implementation through identifying practical solutions and approaches. The Ad Hoc JTF aims to conclude its work by the end of 2024 but may extend if mutually agreed upon. The first meeting took place in Jakarta on 4 Aug 2023, with the next meeting scheduled for end Nov 2023.

The formation of the Ad Hoc JTF is a positive first step towards addressing the structural challenges within the industry, particularly pertaining to the livelihoods of smallholders through the sustainable transition. If executed successfully, the Ad Hoc JTF can lay a strong foundation for Indonesia, Malaysia and the EU in future sustainability policy initiatives and partnerships.

OCBC

Enhancing Malaysia's competitiveness through Bursa Carbon Exchange and upcoming carbon policy

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Role of carbon markets in global decarbonisation

The global carbon market comprises compliance and voluntary carbon markets, which can promote global decarbonisation by complementing other emissions reduction measures. Regulatory bodies drive compliance markets, while voluntary carbon markets (VCMs) enable companies and individuals to voluntarily participate in carbon trading.

The use of voluntary carbon credits has been gaining traction as companies explore various net-zero pathways, although the market is currently hampered by oversupply and greenwashing criticisms questioning the quality of carbon credits. VCMs are a growing market despite uncertainties, with upcoming frameworks and international standards to bolster confidence in the market and ensure high carbon credit quality. The market value of VCMs was valued at ~US$2bn in 2021 and is estimated to grow by at least 5 times to US$10 – 40bn by 2030, according to a report by BCG and Shell[35].

Launch of Malaysia's national VCM

Malaysia launched its VCM called the Bursa Carbon Exchange (BCX), which is the world's first Shariah-compliant carbon exchange in December 2022. It aims to complement existing national efforts to combat climate change, and support Malaysia's ambition to achieve its target of net-zero emissions by 2050.

The launch of the BCX is the first step to broader carbon-related policies in Malaysia such as a carbon tax. Malaysia's New Industrial Master Plan (NIMP) 2030 highlighted plans to develop a carbon tax system and carbon accounting model, to encourage industry players to adopt more sustainable mitigation measures and reduce greenhouse gas (GHG) emissions (*see Global Markets Research report named "Comprehensive & Ambitious Reform Agenda"*).

As the BCX is at its early stages, it may take some time to scale up the supply of carbon credits and streamline the associated administrative processes. To incentivise companies to participate in the BCX as suppliers or buyers, BCX will be waiving its onboarding fee and offering a discount on its trading fee until the end of 2023.

[35] Shell and BCG published a joint report in 2023 on the VCM, specific to 2022 insights and trends. The report highlights market updates, growth possibilities and challenges faced by the market.

Guidance for stakeholders through Malaysia's VCM Handbook

A VCM Handbook, put together by Bursa Malaysia and Green Technology and Climate Change Corporation, was published to provide interested parties with guidance on the VCM mechanism in Malaysia. Other information includes types of eligible projects, VCM project formulation, methodologies, case studies, as well as relevant government incentives.

The focus is on nature-based solutions (NBS) and technology-based solutions (TBS) as the two project types that are allowed to be traded on the BCX currently.

NBS projects comprise two main categories, namely:

(i) **Agriculture, Forestry and Other Land Use (AFOLU)** projects, which Verra's Verified Carbon Standard (VCS) Program[36] categorised into six subtypes:

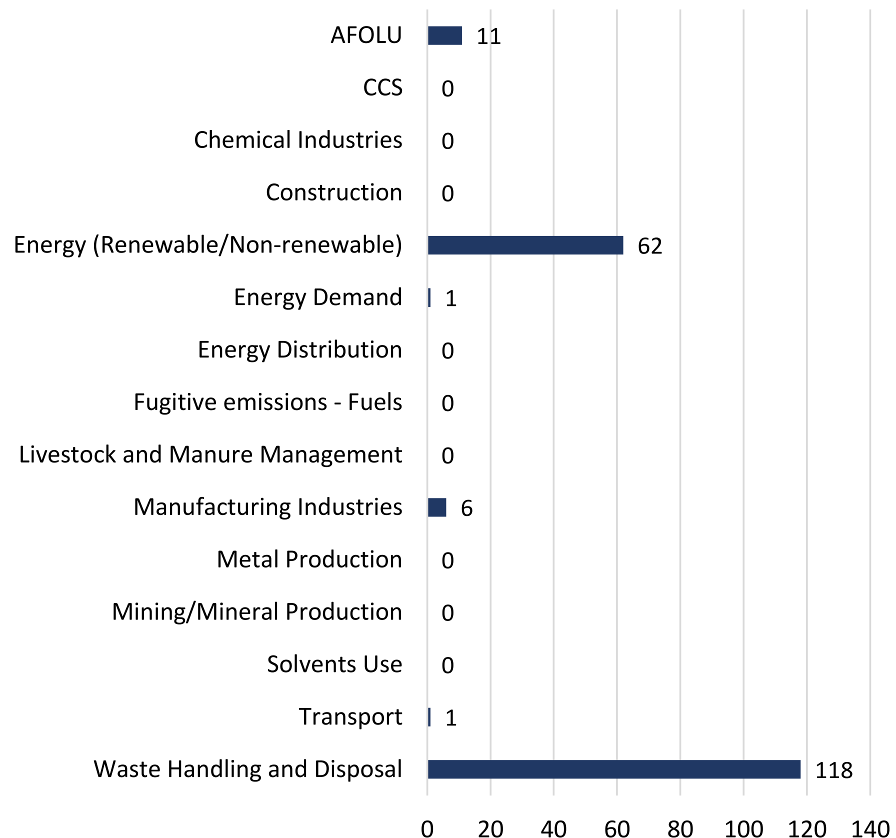
a. Afforestation, Reforestation and Revegetation (ARR);
b. Agricultural Land Management (ALM);
c. Improved Forest Management (IFM);
d. Reduced Emissions from Deforestation and Degradation (REDD);
e. Avoided Conversion of Grasslands and Shrublands (ACoGS); and
f. Wetlands Restoration and Conservation (WRC)

(ii) **Livestock and Manure Management** to achieve reductions in methane emissions produced from livestock enteric fermentation and manure decomposition.

TBS project categories include renewable energy projects and carbon capture and storage (CCS) projects, that many emissions-intensive industries in Asia can explore. This highlights the huge potential for Asia to generate carbon credits through TBS projects. As of 16 May 2023, there were a total of 156 projects registered or requesting for registration in Malaysia (Table 1).

[36] Verra's VCS Program is a global program and standard for GHG emission reduction and removal projects. It aims to enable the successful development of GHG projects and programs for the creation of high-quality GHG credits.

Table 1: Number and type of carbon projects registered or requesting for registration in Malaysia



Note: Some projects fall into multiple sectoral scopes, leading to a total of 199 projects that fall into the sectoral scopes (as of 16 May 2023). Source: Bursa Malaysia Berhad, Malaysia Green Technology and Climate Change Corporation, OCBC

The majority (~76%) of projects in Malaysia fall under waste handling and disposal, followed by energy (renewable/non-renewable) (~40%) and AFOLU projects (7%). An example of an NBS project registered under AFOLU (Improved Forest Management) is the Kuamut Rainforest Conservation Project located in Sabah, estimated to reduce 543,049 tCO_2e of GHG reductions annually. The project aims to protect and restore the rainforest, enhance the livelihoods of communities in the area, and enable biodiversity in the area to thrive.

Enhancing Malaysia's global competitiveness

Developing a robust carbon market can enable Malaysia to enhance its global competitiveness, especially when global policies and regulations are evolving to become increasingly climate aligned. For instance, the European Union's Carbon Border Adjustment Mechanism (CBAM) will impact Malaysia due to considerable exports of products covered under the regulation to the EU e.g., iron, steel, and aluminium. The impact to Malaysia may grow if the scope of products covered under the CBAM expands. Therefore, the launch of the BCX can enable greater climate action and increase Malaysia's competitiveness on an international level.

With plans for the implementation of a carbon tax, it can spur greater sustainability efforts from carbon tax-liable companies if the carbon tax is appropriately priced. This can be an enabler for the transformation of brown sectors to become greener and accelerate the growth of green industries.

What's next?

The BCX is working towards stronger stakeholder participation to build greater carbon credit supply and increase liquidity. There are also product expansion plans to offer renewable energy certificates (RECs) on BCX by 3Q 2024, in response to an increasing number of corporates seeking a platform for RECs transactions. Malaysia, being a country with abundant natural resources, has great potential in creating high-quality carbon credits such as through AFOLU projects. With increasing awareness of VCMs and technical capabilities for project formulation, coupled with government incentives, the number of Malaysia-based projects registered on BCX across both NBS and TBS project types may start to increase.

In Malaysia's journey towards net-zero GHG emissions by 2050, stakeholders can anticipate the implementation of a progressive carbon tax system as part of the country's upcoming carbon policy. Company operations and emissions-reduction measures can better prepare companies for a low-carbon future, especially in anticipation of the carbon tax.

OCBC

Thematic Report 7

RMB Internationalism, Thus Far

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- While China has recently accelerated its push for the internationalization of the renminbi (RMB) due to geopolitical uncertainties, the process has been underway for many years.
- Although the usage of RMB for international investments has remained stagnant, there has been a significant acceleration in the issuance of foreign-issued RMB bonds since 2022. Given the cheaper funding costs versus the heightened US rates, global companies and institutions see the opportunity to raise funds though Panda and Dim Sum Bonds.
- Looking ahead, we believe China has enter the next phase of capital account liberalization after the recent development, especially the sustain growth of the RMB's role as a financing currency. To recall, China has taken a more proactive or structured strategy after the report of the 20th Party Congress published in October 2022 advocated for the "orderly promotion of RMB internationalization", a stance contrasting with the narrative presented in China's "14th Five-Year Plan".

While China has accelerated the push for the internationalization of the renminbi (RMB) due geopolitical uncertainties, the process has been underway for many years. In fact, Chinese policymakers have strategically planned the internationalization of the RMB and set up the CNH market in the late 2010, during the 2010 SDR review. Following the China's efforts to realize the commitment in capital account liberalization, the usage of international renminbi has grown significantly. Additionally, the RMB's inclusion to the SDR currency basket in 2016 and the cross-border utilization of e-CNY have also played pivotal roles in periodically accelerating the process of RMB internationalization.

With the latest trend of countries continuing to diversify away from the US dollar (USD), albeit gradually, RMB internationalization has regained traction globally in 2023. Earlier this year, Argentina and Brazil signed an agreement with China to allow the two countries to trade in local currencies. Meanwhile, on 29th March, a significant milestone was reach when the first ever RMB-settled of liquified natural gas (LNG) deal between China and the UAE was completed. According to the State Administration of Foreign Exchange (SAFE), the yuan also surpassed the US dollar in March 2023 to become the most dominant currency in China's cross-border settlement.

Although the usage of RMB for international investments has remained stagnant, there has been a significant acceleration in the issuance of foreign-issued RMB bonds since 2022. Global companies and institutions have recognized the opportunity to raise funds in China due to the lower funding costs compared to the higher rates in the US. As a result, the issuance of Panda bonds in the first nine months of 2023 surged to CNY 106bn, marking a significant 58.2% increase compared to the same period in 2022.

Looking forward, we believe China has enter the next phase of capital account liberalization, driven by the recent development, especially the sustain growth of the RMB's role as a financing currency. It is worth recalling that China has adopted a more proactive and structured strategy following the report of the 20th Party Congress published in October 2022 that advocated for the "orderly promotion of RMB internationalization", a stance contrasting with the narrative presented in China's "14th Five-Year Plan”.

Chart 1: Since 2010, China has promoted RMB internationalization via various pilot programs. More than 24% of China's goods trades were settled in RMB in 2023

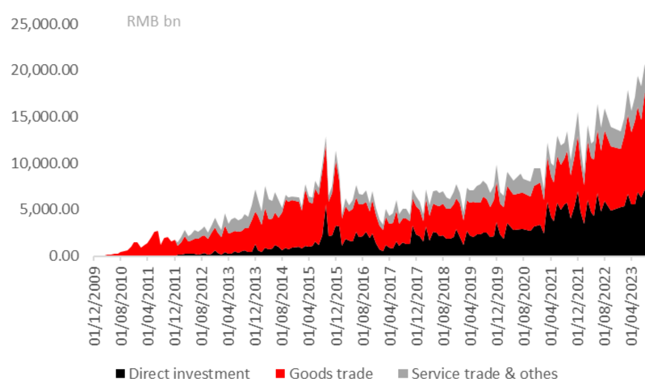


Chart 2: Global companies and institutions have recognized the opportunity to raise funds in China due to the lower funding costs compared to the higher rates in the US

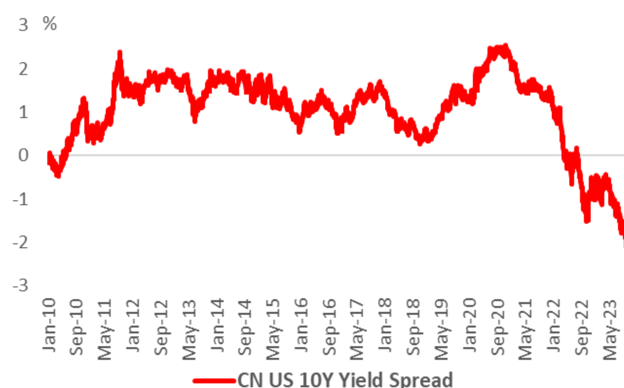


Chart 3: Offshore RMB deposits (in RMB billion)

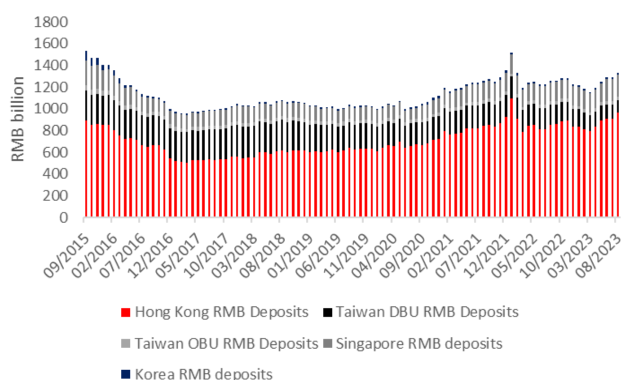
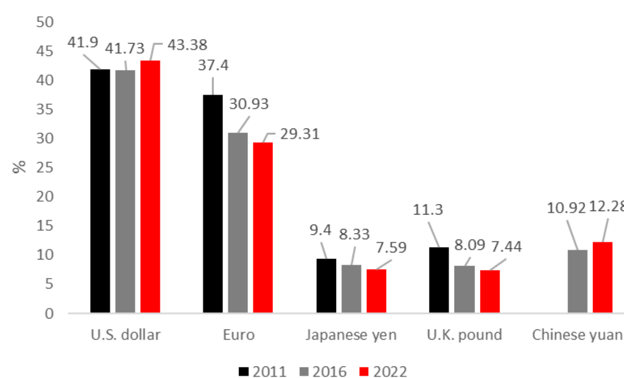


Chart 4: Since Aug 2022, the weight of the RMB in Special Drawing Rights (SDR) has been increased



Source: Bloomberg, CEIC, WIND, IMF, OCBC

Why internationalization?

With no doubt, the dollar's dominance in multilateral trade, foreign exchange transactions, and reserve management has established an asymmetric basis within the international financial system. While this has contributed to enhanced financial efficiency through its strong network effect, it has also come at a cost. The downside of the dollar standard in the international financial system is excessive reliance on the self-discipline of the dollar-issuing country. This reliance necessitates that the United States promptly adjusts the money supply in

response to global demand, which may or may not align with the US domestic business cycle, notably when it deviates from the global backdrop.

The pursuit of RMB internationalization comes naturally as the result of China's economic ascendance. In a remarkable transformation, China has transitioned from a centrally planned economy to a fast-developing nation today. Policymakers see the opening of the capital account as an imperative step to foster the development of financial markets, optimize resource allocation, and diversify private-sector asset portfolio, which gives rise to higher status of the Chinese currency globally. They also expect financial reforms will play a pivotal role in enhancing corporate governance and promoting market-based policy implementation, particularly in the monetary arena.

Since 2010, China has promoted RMB internationalization via various programs. These initiatives include RMB-cross-board trade settlement, offshore-RMB centres, Dim Sum bond market, Stock Connect, Expansion of QFII/QDII, Dual counter model, swap connect, and more. In 2014, the development of the CNH market, which refers to offshore RMB trading, led to a significant increase in USDCNH trading volumes, comparable to that of USDJPY in Asian time zones. Furthermore, as China gradually liberalized its capital account and increased RMB convertibility the capital account, portfolio investment flows have experienced periodic increases. This has been facilitated through private investment and equity/bond investment channels such as QFII/QDII. However, shrinking liquidity pool in the offshore market due to the "811" exchange rate regime reform had led to an increase in depreciation expectations against the US dollar. Consequently, this has led to concerns over capital outflows and a reduced appetite in RMB products after 2015.

While the process of RMB internationalization has slowed after the year of 2015, the growth of international renminbi usage has re-gained momentum following the discussion around "de-dollarization". In 2023, RMB settlements for China's goods trade have risen to 24.4% and service trade payments to 31.6% in the first nine months of 2023, marking increases from 18.2% and 25.7% in 2022, respectively. Furthermore, 65.1% of China's cross border income and transfers are now settled in RMB, a jump from 56.8% in 2022. In addition, the yuan have surpassed the US dollar this year to become the dominant currency in China's cross-border transactions, according to the calculation by SAFE.

2023 year in review

Despite the ongoing geopolitical tensions and economic challenges with structural rebalancing, RMB internationalization have witnessed remarkable developments in 2023 thanks to many structural bullish factors. To best characterize them, we summarize the following and illustrate in detail in the below:

1. **Payment.** While SWIFT data suggests RMB ranks as the fifth most often used currency in global international payments, the share has risen since the beginning of 2023. With Russia, Argentina, and most recently Brazil joining the RMB settlement schemes, the usage of RMB in China's cross- border payments for trade have been fast. According to the PBoC RMB internationalization

report in 2023, RMB settlements for China's goods trade have risen to 24.4%, and service trade payments to 31.6% in the first nine months of 2023, marking increases from 18.2% and 25.7% in 2022, respectively. Similarly, the use of China's self-developed Cross-border Interbank Payment System (CIPS) has regained traction. As of 2Q23, the system processed 29.5 trillion yuan in transactions value during the period, marking an increase of 29.0% compared to the previous year. We believe there are two critical reasons attributed to the rise in RMB cross-border payments: **1)** Following the imposition of intensive sanction on Russia by the US and other developed economies, the RMB has increasingly emerged as an alternative currency for payment, particularly in trade. This appeal is particularly relevant for countries seeking to bypass sanctions related to Russia, which are connected to the US and other G7 currencies. **2)** Amidst rising interest rates, a strong U.S. dollar has become economically more expensive for EM countries, leading to a preference for local currencies settlement rather than the dollar. For instance, Brazil signed an agreement with China on 31 March to facilitate exports and imports using RMB.

In short, if the trend of "de-dollarization" continues to progress, we expect this will promote a wider use of RMB in investment and trade settlement. And over the longer term, the RMB accumulated in overseas market is likely to follow investment opportunities through offshore centres and further opening up of onshore financial markets.

Chart 5: SWIFT use of local currency (% of total)

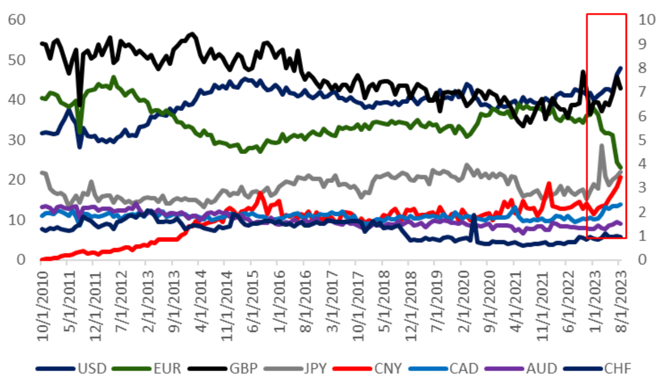


Chart 6: China's CIPS has also regained traction after Russia and Brazil increased the use of RMB

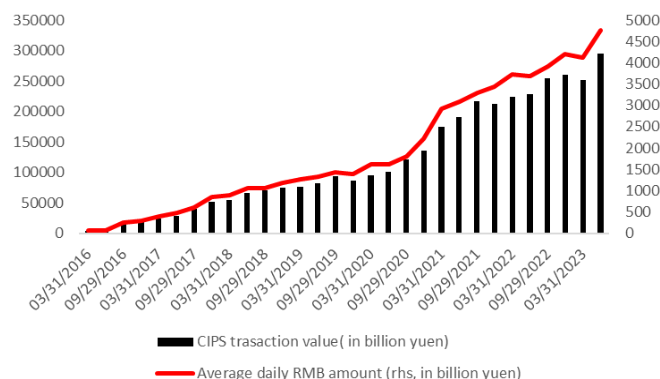


Chart 7: China and Brazil set up a renminbi clearing banks in 2022

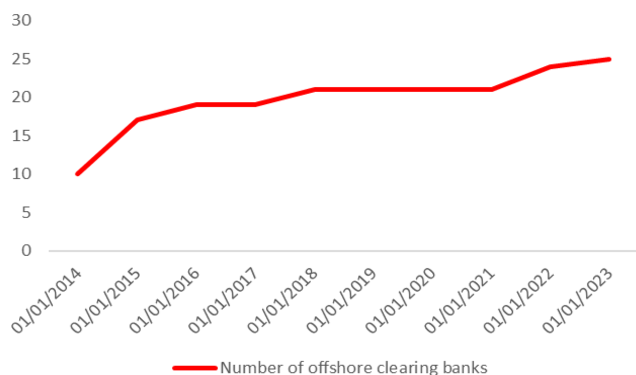


Chart 8: Yuan surpassed the US dollar for the first time this year and became the dominant currency in China's cross-border payments

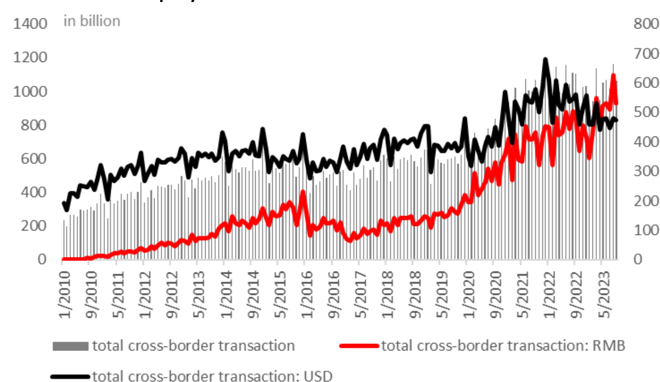


Chart 9: RMB has been increasing their share in Chinese Banks' foreign related payment and receipts on behalf of clients

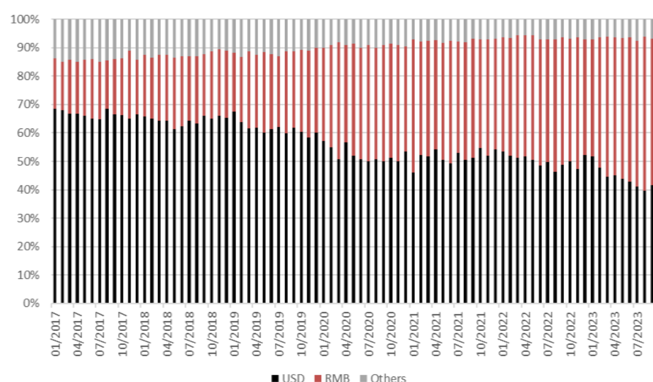
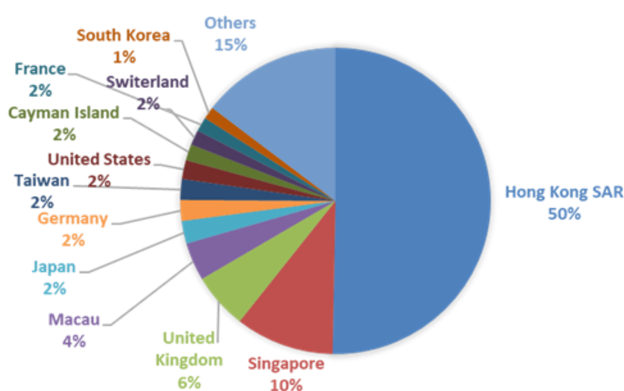


Chart 10: Mainland China and Hong Kong accounted for 50.3% of the total cross-border RMB receipts and payments in 2022



Source: PBoC, SWIFT, CEIC, Bloomberg, and OCBC

2. **Investment.** Despite China's economy exhibited a robust performance with + 4.9% YoY growth in 3Q23, recent data shows a massive selloff in the equity market, given the recent fragility in China's risk sentiment. Our preferred indicator for assessing foreign exchange flows in China, which encompasses banks' net sales of foreign currency on behalf of clients, including both spot and derivatives such as forwards and options, indicated an escalated outflow of US$36.6bn in October, the most substantial since the end of 2016.

On the bond front, foreign participation in China's bond market continues to come down, driven by the unfavourable yield differential. As a result, foreign ownership of China's government bonds has fallen to less than 8%, while domestic bond participation has also seen a decline, reaching to just 2.77% in September.

On the positive note, Hong Kong's role as the key of offshore RMB centre continues to strengthen, highlighted by several key developments: **1)** There has been a pickup in offshore RMB deposits, primarily in Hong Kong, with the total balance of offshore RMB deposits reaching approximately 1.32 trillion yuen as of August 2023. **2)** Apart from offshore deposits, there has also been a surge in Dim

Sum bond issuance since 2022, driven by corporates' greater incentive to use RMB as a funding currency due to lower interest rates. In fact, the total issuance of Dim Sum bonds in Hong Kong doubled to 330 billion yuan in 2022. In the first eight months of this year, the issuance of Dim Sum bond amounted to 343 billion yuan, representing a 62% YoY increase compared to the same period in 2022.

Looking ahead, we remain optimistic about the RMB bond outlook in 2024 despite the share of China government and domestic bonds held by global investors having dropped to the lowest level since 2018. As China continues to initiate financial liberalization reforms, the RMB bond market will continue to emerge as a global asset class for both investors and borrowers to facilitate investment diversification and financing demands worldwide.

Chart 11: RMB's use as investment currency loses traction as China's stock market stumbles and bond yields trending down

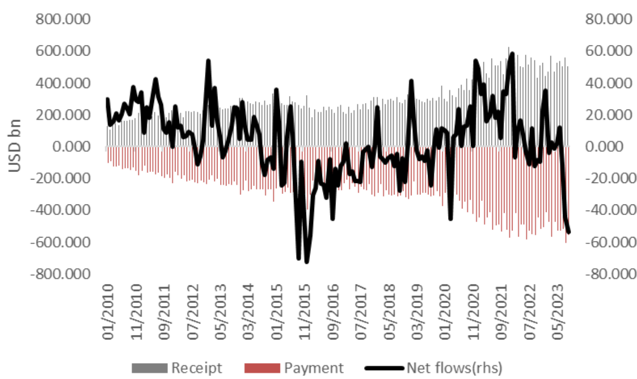


Chart 12: Banks' net sales of foreign currency on behalf of clients- including both spot and derivatives such as forwards and options- indicated an escalated outflow of US$36.8bn

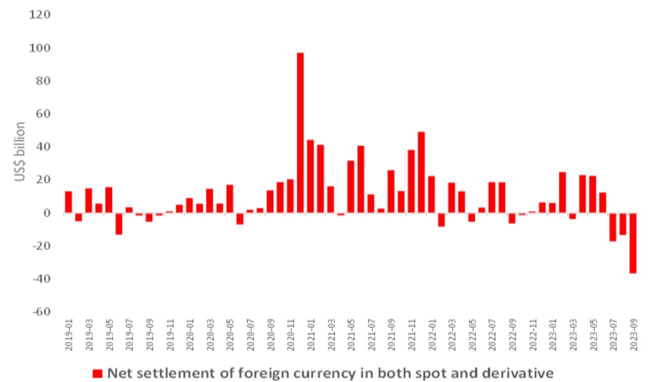


Chart 13: Net monthly purchase of A-share via Stock Connect

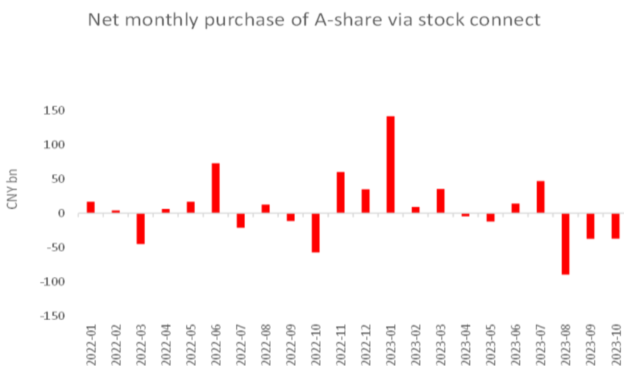


Chart 14: Foreign holding of Chinese equity (in RMB billion)

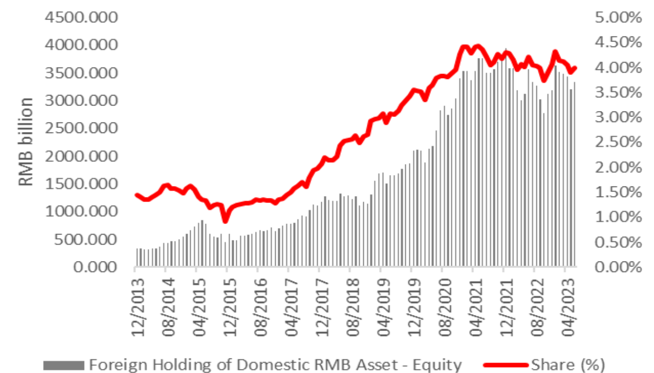


Chart 15: Foreign holding of Chinese domestic bond (in RMB million)

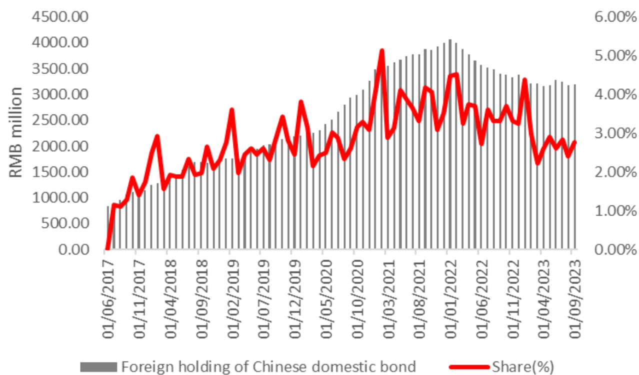


Chart 16: Foreign holding of Chinese government bond (in percentage)

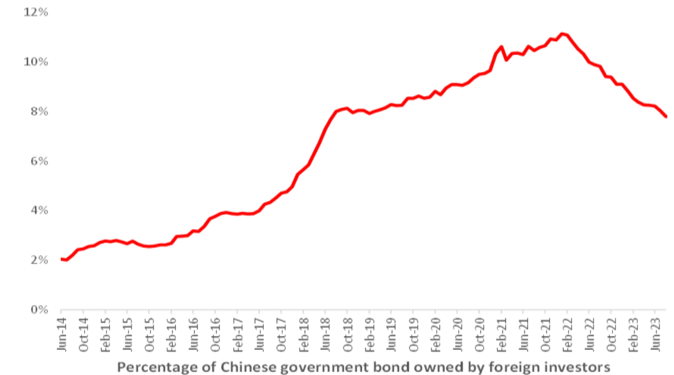


Chart 17: Hong Kong's RMB outstanding bond

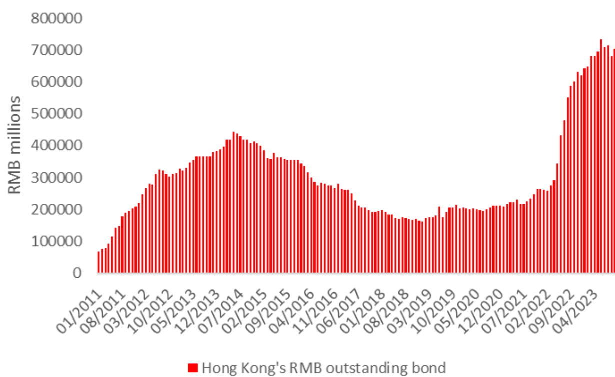


Chart 18: Dim Sum bond issuance momentum remains strong in 2023 for both Chinese and foreign issuers

Source: PBoC, SWIFT, HKMA, CEIC, Bloomberg, and OCBC

3. **Financing.** Foreign-issued RMB bonds have been accelerating since 2022 thanks to its lower funding cost versus the heightened US rates. With USD borrowing costs being higher, many debtors have turned to RMB for financing or refinancing purposes. According to the CEIC database, outstanding overseas RMB loans were 1,206 billion in September, marking a 36.0% increase compared the previous year. Furthermore, data from the SWIFT reveals that by the end of 2022, the RMB's share in global trade finance reached 3.91%, up by 1.9 percentage points (pp) from the previous year, ranking it third globally. By September 2023, this figure climbed to 5.8%, securing the RMB the second spot in global trade finance rankings, a year-on-year increase of 1.6 pp. Additionally, the issuance of Panda bonds surged to CNY 106 billion in the first eight months of 2023, a 58.2% year-on-year increase.

Considering the sustained growth of the RMB's role as a financing currency, we anticipate this will: **1)** Encourage financial institutions to actively participate in RMB cross-border trade financing, overseas loans, and other financing activities **2)** Support a diverse range of high-quality issuers, such as foreign central banks, international development organizations, and multinational corporate groups, to

issue Panda bonds in the domestic market **3)** Back more entities, including policy financial institutions in issuing RMB-denominated securities overseas.

Chart 18: Overseas RMB loans from Chinese financial institutions

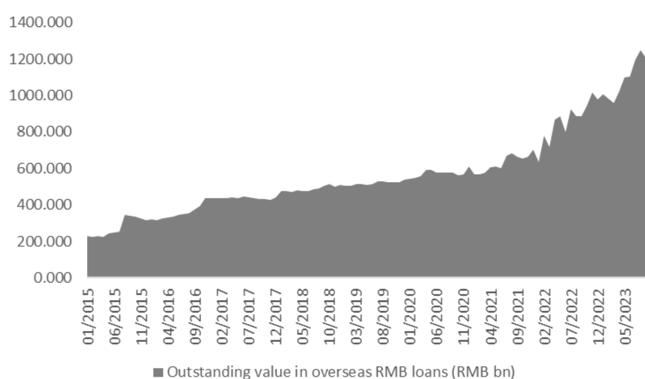


Chart 19: Share of RMB in Global Trade Financing (in %)

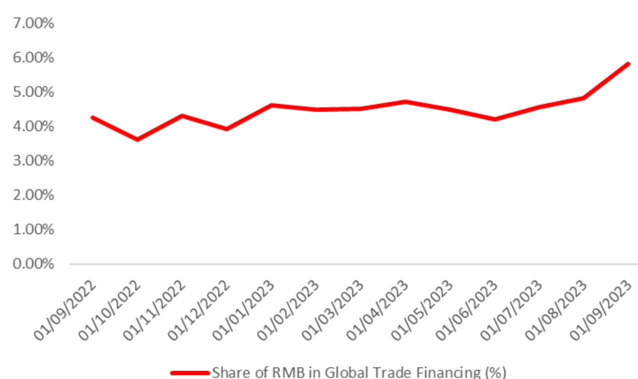


Chart 20: Outstanding bilateral swap lines

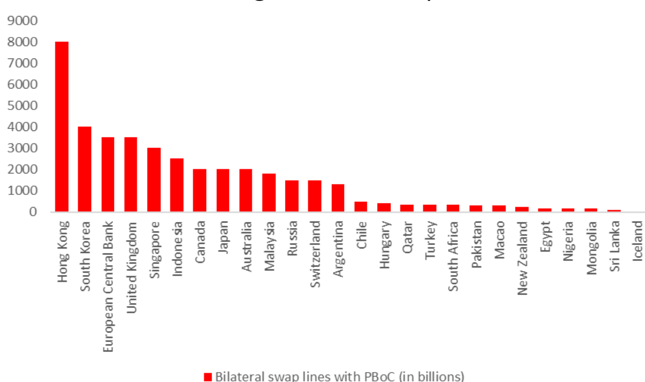
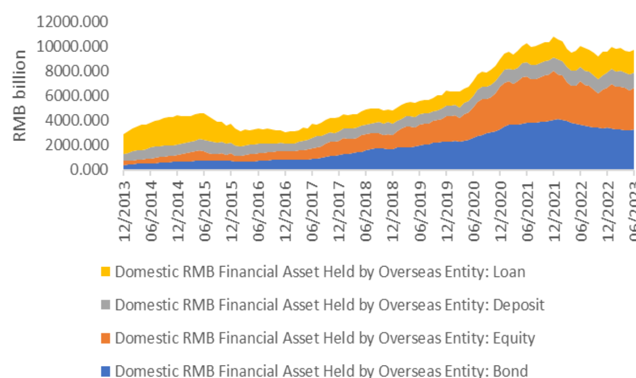


Chart 21: Domestic RMB financial assets held by oversea entities



Source: SWIFT, IMF, WIND, CEIC and OCBC

4. **Reserves.** While the RMB's share remains stable in global central bank's allocated reserve, US dollar's share continues to lose market share. The US dollar's share of global FX reserves has declined from roughly 71% at the beginning of the 21st century to around 58.88% in 2Q23.

Still, it is unlikely that the RMB will soon become the dominant status in global reserve currency despite the decline of the US dollar's market share. Throughout history, the US's economic strength and military power have supported the dollar's supremacy. In the post-World War II era, the United States accounted for 50% of global GDP, a figure that has now diminished to approximately 20-25%. It was a critical turning point in the year of 1971 when President Richard Nixon made a monumental announcement in the suspension of the dollar's convertibility to gold, effectively ending the Bretton Woods system.

The White House dispatched Secretary of State Henry Kissinger to the Middle East to secure a deal with two objectives: **1)** That oil transactions be settled in dollars and **2)** that the dollars flowing to oil producers be deposited in American banks to

buy American bonds. In return, the US agreed to supply Saudi Arabia with military protection and not require the kingdom to democratize. This arrangement also resulted in the creation of petrodollar. Since then, more of the commodities around the world have been settled in US dollars.

In contrast, although the RMB currently holds the position of the world's third-largest trade financing currency and fifth-largest payment currency, the relatively low proportion of RMB used in trade settlements does not fully reflect China's status as the leading trading nation. As such, the RMB remains a small share in reverse of the overall international markets.

Chart 20: Share of USD in global FX reserve declined

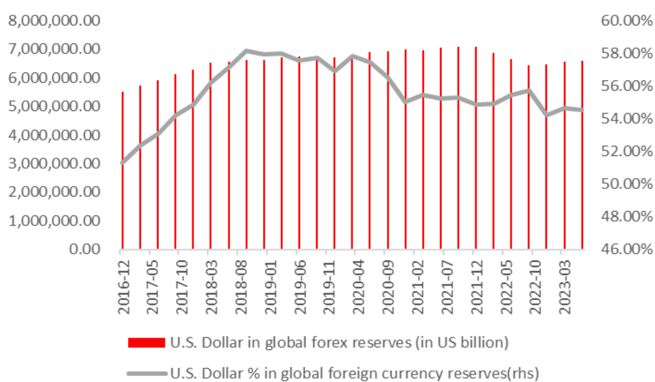
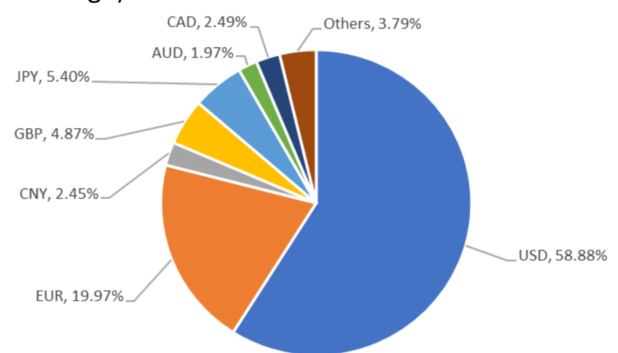


Chart 21: Allocated reserves by currency for Q223 (in percentage)

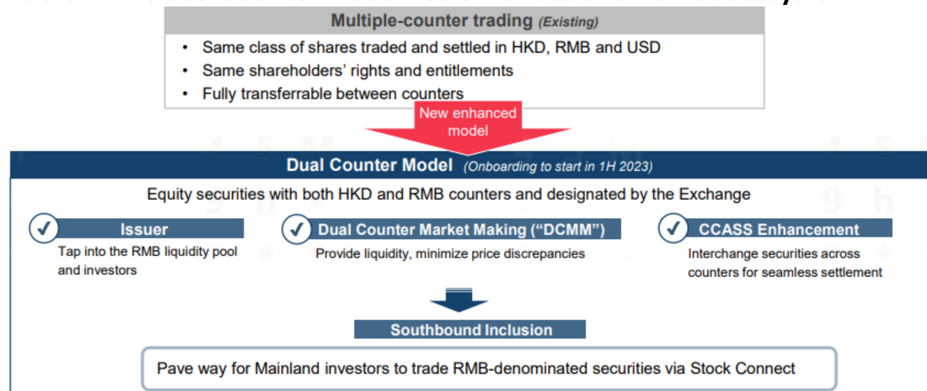


Source: PBoC, IMF, and OCBC

5. **Dual Counter Model.** On 19 June 2023, Hong Kong Exchanges and Clearing Limited (HKEX) officially introduced the "HKD-RMB Dual Counter Model" and the market-making arrangement of dual counter securities. This framework enables investors to trade selected stocks, currently comprising 24 securities, in both HKD and RMB. The list predominantly consists of large-cap stocks with high average daily turnover, primarily from the internet/technology, automotive, and financial sectors.

While a concrete timeline for phase II (potentially expand to southbound investors) has yet to be available, we view the dual counter model as a long-term initiative aimed at attracting a broader range of investors, both retail and institutional. Consequently, we anticipate that the dual counter model will bring: **1)** Higher liquidity and turnover for H-shares **2)** Promotion of RMB internationalization and further enhancing Hong Kong 's status as an international financial centre and offshore market; and **3)** Smaller FX and interest rate risks.

Table 1: The dual counter model has enhanced the market ecosystem

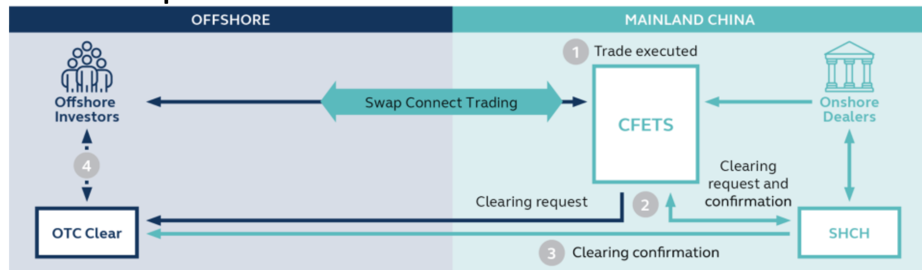


Source: HKEX and OCBC

6. **Swap Connect.** Following the successful launch of mutual market access between China and Hong Kong in equity and bond market, Swap Connect is the latest scheme to deepen the connect channel in the OTC market derivatives space. While the Swap Connect will be only opened for "Northbound Trading" at the initial stage, offshore investors will be the key beneficiary as this could be the solution for overseas institutions to better manage interest rate risks and enrich their toolbox to hedge in onshore IRS market.

With Swap Connect launched in Mid-May, we believe overseas investors may pose a greater influence in the pricing of onshore market, and gradually lead to a tighter the cross-market spread while helping to attract more foreign capital for the China's domestic bond market.

Table 2: Swap Connect



Source: HKEX and OCBC

GLOBAL MARKETS RESEARCH

Thematic Report 8

Commodities: Food Prices Hold the Key

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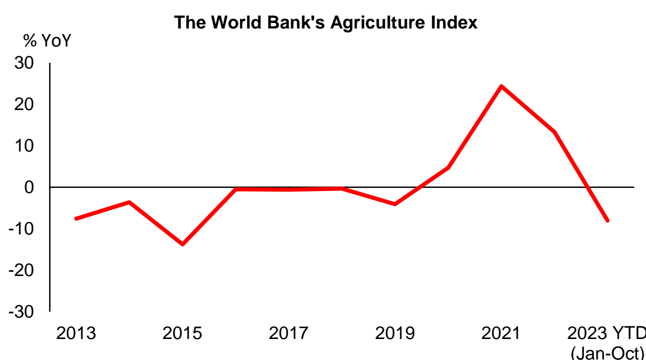
- The sharp rise seen in commodity prices in 2023 reflect a confluence of factors including the ongoing El Niño phenomenon and export restrictions by key exporters of agricultural products.
- In 2024, dryer conditions will affect the production of rice, sugar, Robusta coffee, and palm oil, with the extent of these effects varying per commodity.
- Government policies across key commodity exporters will continue to play an important role in determining food prices.

What happened to food prices in 2023?

Agricultural news has been attracting global headlines following a notable spike in rice and sugar prices since the beginning of 2023. Notwithstanding these few items, the World Bank agricultural commodities index declined 8.0% YoY (Jan-Oct 2023) versus a 16% rise during the same period in 2022.



Source: The World Bank; OCBC

A closer look at key commodities within the index reveals a mixed performance across the board. Year-to-date, the price of rice, sugar, and Robusta coffee surged by 25%, 26%, and 11% YoY, respectively. Meanwhile, wheat, palm oil, and Arabica coffee tumbled by 26%, 33%, and 22%, respectively. The sharp rise in some of these commodities reflect a confluence of factors stemming from extreme weather patterns brought about by the ongoing El Niño phenomenon in addition to export restrictions by key exporters of agricultural products.

Year	Rice, Thai 5%	Rice, Thai 25%	Rice, Thai A.1	Rice, Viet Namese 5%	Wheat, US SRW	Wheat, US HRW	Palm Oil	Coffee, Arabica	Coffee, Robusta	Sugar, world
2018	5.5	6.1	5.6	11.8	14.4	20.5	-14.9	-12.0	-16.0	-21.9
2019	-0.6	0.6	-1.9	-13.4	3.6	-3.9	-5.8	-1.6	-13.2	1.6
2020	18.8	17.4	20.6	21.6	7.8	14.8	25.0	15.4	-6.5	1.1
2021	-7.8	-7.0	-8.1	4.3	23.7	36.1	50.4	35.8	30.7	37.6
2022	-4.7	-4.1	-4.2	-9.4	35.6	36.4	12.9	24.8	15.3	4.7
2023 YTD (Jan-Oct)	24.6	22.1	26.1	25.5	-31.9	-19.3	-33.0	-21.9	10.7	26.4

Source: The World Bank; OCBC

The current El Niño episode, extreme weather patterns, and global warming events are known to adversely affect crop yields and global food security.

Regional forest fires brought on by this year's El Niño dry season have become a common sight, resulting in poor air quality during the late Sep/Early Oct period.[37]

Commodity	Top 10 Producers	% of Global Production	% of Global Export	Trade Policy Tracker (2023)
Rice*	China	28.76%	3.82%	1. Bangladesh ban the exports of 'Rice'. The ban is expected to be lifted at the end of the year (31/12/2023). 2. India ban the exports of 'non-basmati rice' and 'Broken rice'. The ban is expected to be lifted at the end of the year (31/12/2023). 3. India implements export taxes on its rice products (i.e., 'Rice in the Husk (paddy or rough)', 'Husked (brown) rice', 'Semi-milled or wholly milled rice (specifically parboiled rice and basmati rice'). The tax is expected to be lifted at the end of the year (31/12/2023). 4. Myanmar introduces a rice export licensing system for its 'Rice'. The policy is expected to be lifted at the end of the year (31/12/2023). 5. Russia ban the exports of 'Rice' and 'Rice groats'. The ban is expected to be lifted at the end of the year (31/12/2023).
	India	25.48%	33.44%	
	Bangladesh	7.03%	0.02%	
	Indonesia	6.65%	0.00%	
	Vietnam	5.21%	14.52%	
	Thailand	3.76%	15.29%	
	Philippines	2.43%	0.00%	
	Burma	2.32%	3.44%	
	Pakistan	1.74%	9.55%	
	Japan	1.41%	0.23%	
Wheat*	China	17.49%	0.44%	1. Afghanistan ban the exports of 'Wheat'. The ban is expected to be lifted at the end of the year (31/12/2023). 2. Algeria ban the exports of 'Wheat derivatives'. The ban is expected to be lifted at the end of the year (31/12/2023). 3. Belarus introduces export licenses for its 'Wheat'. The policy is expected to be lifted at the end of the year (31/12/2023). 4. India ban the exports of 'Wheat', 'Wheat flour', 'Semolina', 'Maida'. The ban is expected to be lifted at the end of the year (31/12/2023). 5. India introduces export licenses for its 'Wheat flour and related products'. The policy is expected to be lifted at the end of the year (31/12/2023). 6. Kosovo ban the exports of 'Wheat'. The ban is expected to be lifted at the end of the year (31/12/2023). 7. Russia implements export taxes on 'Wheat'. The tax is expected to be lifted at the end of the year (31/12/2023).
	European Union	17.10%	18.18%	
	India	14.49%	0.48%	
	Russia	10.85%	24.24%	
	US	6.29%	9.24%	
	Canada	3.96%	11.15%	
	Pakistan	3.57%	0.24%	
	Australia	3.13%	8.48%	
	Ukraine	2.87%	5.33%	
	Turkey	2.49%	4.12%	
Palm Oil*	Indonesia	59.15%	55.56%	
	Malaysia	23.91%	32.39%	
	Thailand	4.34%	1.33%	
	Colombia	2.39%	1.47%	
	Nigeria	1.89%	0.04%	
	Guatemala	1.16%	1.72%	

[37] With the expected continuation of dry conditions over much of the southern ASEAN region in October 2023, an escalation in the hotspot and smoke haze situation and an increased risk of transboundary smoke haze occurrence in the region can be expected, particularly over fire-prone areas where below-normal rainfall is forecast. The hotspot and smoke haze situation in the region this year is the most intense since 2019, with the combined influence of the current El Niño conditions and the positive Indian Ocean Dipole (IOD). Seasonal Forecast for October – December 2023, *ASEAN Specialised Meteorological Centre*, 03 October 2023

	Papua New Guinea	1.01%	1.57%	
	Cote d'Ivoire	0.76%	0.74%	
	Honduras	0.75%	0.85%	
	Brazil	0.74%	0.02%	
Green Coffee**	Brazil	38.09%	31.04%	
	Vietnam	17.95%	18.82%	
	Colombia	6.65%	8.28%	
	Indonesia	5.56%	4.27%	
	Ethiopia	4.79%	3.30%	
	Uganda	3.93%	4.46%	
	India	3.33%	4.34%	
	Honduras	3.15%	3.56%	
	Peru	2.41%	2.78%	
	Mexico	2.35%	2.09%	
Centrifugal Sugar***	Brazil	22.36%	44.93%	1. Algeria ban the exports of 'Sugar'. The ban is expected to be lifted at the end of the year (31/12/2023). 2. India ban the exports of 'Sugar'. The ban is expected to be lifted at the end of October (31/10/2023). However, it was reported that the ban will be extended beyond the expiry date till further order. 3. Kosovo ban the exports of 'Sugar'. The ban is expected to be lifted at the end of the year (31/12/2023). 4. Lebanon ban the exports of 'Sugar'. The ban is expected to be lifted at the end of the year (31/12/2023). 5. Pakistan ban the exports of 'Sugar'. The ban is expected to be lifted at the end of year (31/12/2023). 6. Thailand introduces export licenses for its 'Sugar'. The policy is expected to be lifted at the end of the year (31/12/2023).
	India	19.16%	9.71%	
	European Union	8.24%	1.26%	
	Thailand	5.96%	16.64%	
	China	5.32%	0.35%	
	United States	4.45%	0.04%	
	Pakistan	3.78%	1.11%	
	Russia	3.37%	0.76%	
	Mexico	3.33%	1.91%	
	Australia	2.34%	4.99%	

Source: US Department of Agriculture (USDA) Estimates; The World Bank; OCBC
Note: USDA's estimates as of *October 2023, **June 2023, ***May 2023

Admittedly, several Asian economies are expecting reduced crop yields this year due to the impacts of the ongoing El Niño phenomenon. Countries such as India, Indonesia, Philippines, Thailand, and Vietnam were reported to be affected following a much drier weather (or weaker rainfall) condition.

These concerns led India to impose an export ban on various agricultural products (i.e., rice, wheat, sugar) to dampen rising domestic prices and ensure sufficient domestic food supplies. The increased protectionism, while justifiable, led to supply shortage concerns for these commodities pushing up global prices.

This has been especially true for rice, where prices jumped in August and September. Thailand and Vietnam, however, used this economic opportunity to

boost its own rice exports. These efforts met with limitations as Thailand, for example, is dealing with drought conditions with the government restricting water usage and encouraging crop diversification away from rice.

Wheat prices, on the other hand, have fallen year-to-date with the soft red winter (SRW) and hard red winter (HRW) variety falling 32% and 19% respectively, despite the lapse in the Black Sea Grain initiative in July. Similarly for palm oil, prices fell sharply following strong production numbers in the current high-output season, despite the ongoing El Niño phenomenon. A build-up in palm oil inventories will weigh against any upward momentum in prices in the near-term.

The divergence in Arabica coffee prices from its Robusta counterpart stems from differing production outlooks for the two coffee beans. Robusta is predominantly grown in Southeast Asia while Arabica in South America. The El Nino phenomenon has been adversely affecting the Southeast Asian region leading to supply concerns for Robusta. This has caused the price of Robusta coffee to climb 11% year-to-date, diverging from Arabica which has fallen 22% year-to-date.

Where will food prices be in 2024?

Weather-related factors are a central point of concern when discussing the outlook for agricultural commodities. As we enter 2024, drier conditions will affect the production of rice, sugar, Robusta coffee, and palm oil, with rice production being particularly sensitive to El Nino[38]. Indeed, the US National Oceanic Atmospheric Administration (NOAA) Climate Prediction Centre announced in their El Niño Advisory on 9 November 2023, that "El Niño is anticipated to continue through the Northern Hemisphere spring (with a 62% chance during April-June 2024)[39].

Food item (YoY % change)	2022	YTD 2023 (Up to Oct-23)	2024 (OCBC Estimates)
Rice	-5.6%	24.6%	2.4% to 5.3% ↑
Wheat, US SRW	35.6%	-31.9%	-2.1% to -6.7% ↓
Wheat, US HRW	36.4%	-19.3%	
Palm Oil	12.9%	-33.0%	-11.7% to - 12% ↓
Coffee, Arabica	24.8%	-21.9%	-1.2% to -5.7% ↓
Coffee, Robusta	15.3%	10.7%	
Sugar, world	4.7%	26.4%	-3.8% to -5.9% ↓
Source: The World Bank; OCBC estimates			

Signs of distress have emerged. Thailand and Vietnam, the next two largest exporters of rice are unable to plug the supply gap from India due to unfavourable weather conditions across the region. Consequently, the U.S. Department of Agriculture (USDA) has revised downwards its 2023/24 outlook for global rice production. Resulting in a projected supply deficit of 4.5 million tonnes as global consumption exceeds production[40]. Given this, rice prices will continue to be elevated well into 2024 as dry weather and the risk of continued export

[38] Rice cultivation is highly water intensive and dependent on good irrigation and rainfall.
[39] The latest reading in the Nino-3.4 index was reported at 1.5. This is a patch smaller than the 1.6 reported in September.
[40] See USDA Economics Research Service: Rice outlook November 2023 (https://www.ers.usda.gov/publications)

restrictions dampen the supply outlook. We expect rice prices to continue its upward trajectory by 2% to 5% in 2024.

Similarly, global palm oil production is set to ease next year as top producers Indonesia and Malaysia face slower production. According to a press release from the Indonesian Palm Oil Association (GAPKI), the dry season will impact production in 2024 where they expect to see a decrease in output if plantations are not well maintained against the effects of El Nino[41]. The USDA Foreign Agricultural Service (FAS) expects the surplus supply of palm oil to narrow to 1.2 million metric tonnes from 2.9 million previously. Despite El Nino related disruptions, we see a downside risk for prices. Limited indications of lower production prospects due to El Nino-related issues, high stockpiles in key producing countries, and sufficient reserves in key importing nations lead us to expect crude palm oil prices to ease from MYR 3,850 per metric tonne in 2023 to MYR 3,400 next year.

For sugar, the impact from El Nino is expected to be minimal with the USDA FAS predicts projecting an increase in sugar production in the next crop year leading to a surplus of 7.8 million metric tonnes. The improvement is driven by Brazil, which accounts for more than a fifth of global sugar production, surpassing that of India (19%) and Thailand (6%) which are presently facing weather-related issues from El Nino. Our baseline forecast is for sugar prices to ease in the range of 4% to 6% in 2024 given a higher production outlook especially as El Nino should let up in the latter part of the year, improving the production outlook for India and Thailand. Near-term upside risk to prices from an extension of export restrictions, however, remain.

Total coffee production is expected to remain stable next year with Arabica production set to increase. Robusta production, on the other hand, is expected to decline due to lower production forecasts for Brazil. Despite dryer conditions in Vietnam, which accounts for more than a third of global Robusta production, the nation is expected to increase its output next year, but not enough to offset losses from Brazil. Overall, a larger surplus of 4.1 million (60 kg bags) in the next crop year is projected by the USDA FAS for coffee as production exceeds demand. Therefore, coffee prices will face downward pressure in 2024 especially as production should pick up in El Nino affected countries (e.g., Vietnam, Indonesia) in the latter half of the year. Our base case is for coffee prices to tumble approximately 1% to 5% in 2024.

Wheat production is expected to decline next year, leading to a supply deficit of over 10.5 million metric tonnes, a reversal from a 5.6 million surplus in the current season. Production from top exporter, Russia, is expected to fall to 90 million metric tonnes from 92 million metric tonnes amid the ongoing conflict in the region. However, despite the fall out of the Black Sea grain initiative between Russia and Ukraine, there is little evidence of major supply disruptions for the commodity (See Box: Black Sea Grain Initiative). As such, we see wheat prices tapering off in the range of 2% to 7% in 2024 as the war premium fully subsides.

[41] Press Release (7 October 2023): Despite El Nino, CPO Production Believed to Rise 5% [in 2023]

That said, we cannot discount the potential risk of an escalation in the conflict leading to upward price movements.

Thousand metric tonnes		2022/2023	2023/2024	% YoY change
Global production	Green Coffee	170,019	174,340	2.5
	Palm oil	77,563	79,464	2.5
	Rice	513,684	517,796	0.8
	Sugar	177,279	187,881	6.0
	Wheat	789,493	781,980	(1.0)
Global consumption	Green Coffee	168,263	170,233	1.2
	Palm oil	74,644	78,283	4.9
	Rice	523,418	522,286	-0.2
	Sugar	176,007	180,045	2.3
	Wheat	783,905	792,536	1.1
Surplus (Deficit)	Green Coffee	1,756	4,107	133.9
	Palm oil	2,919	1,181	(59.5)
	Rice	(9,734)	(4,490)	NA
	Sugar	1,272	7,836	516.0
	Wheat	5,588	(10,556)	NA

Note: Unit of Coffee is in thousand 60kg bags. 2022/2023 refers to calendar year 2023.
Source: USDA Production, Supply, & Distribution database; OCBC

Box: Black Sea Grain Initiative

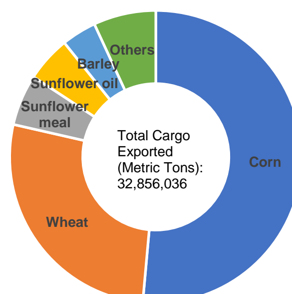
The Black Sea Grain Initiative was a United Nations (UN)-brokered agreement that took place in July 2022 between the UN, Russia, Ukraine, and Turkey to facilitate the safe transportation of grains and foodstuffs from the three Ukrainian ports of Odesa, Chernomorsk and Yuzhny. The agreement came into fruition following a disruption (caused by the Russia-Ukraine War) in the flow of Ukrainian grains and other foodstuffs into the global market.

According to data provided by the UN, more than thirty-two million tonnes of grains and foodstuffs were exported from designated Ukrainian ports and delivered to over forty countries across three continents. To that end, elevated global food prices in 1H22 reversed following the agreement of the initiative. Admittedly, this has helped to tame rising food prices that threatened to set in motion a ‘second wave’ of inflationary pressures.

Nonetheless, the Black Sea Grain Initiative was only valid for a period of 120 days. Despite several rounds of extensions, the initiative ultimately expired in July 2023 as Russia refused to extend the agreement, indicating that promises to free its shipments of agricultural products and fertilisers had not been met. With the initiative having lapsed, this jeopardised a key trade route for the exports and delivery of Ukrainian grains and foodstuffs into the global market before its next harvest. The immediate reaction was an increase in the prices for Wheat and Corn which closed 2.6% and 5.9% higher respectively the next day.

At the time of writing, the Black Sea Grain Initiative has not been revived. Nonetheless, this has not stopped Ukraine from establishing temporary routes along the western coast of the Black Sea for the continued delivery and exports of its grains and foodstuff. Over the last few weeks, ten vessels have successfully completed their journeys to major Ukrainian ports on the Black Sea without incidents. Still, there remain upside risks as Russia has declared that it will regard all cargo ships in the Black Sea heading to Ukraine as potential military targets. The UN remains engaged with Russia in its attempt to revive the Black Sea Grain Initiative and stabilise global grain prices. Admittedly, an agreement by all parties bounded in the previous Initiative looks to be the only way to dampen any upside risk.

Under the Black Sea Initiative, more than 32 million metric tons of food were exported out from designated Ukrainian ports



Source: United Nations; OCBC

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