Global Macro Department –Vietnam (OVERWEIGHT)

Date: 27th Dec 2020

Analysts

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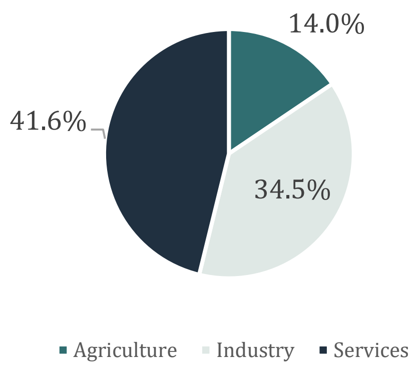
Basic Information

Real GDP (USD)	**200.858B**
M2(USD)	**449.517B**
CPI	**103.11**
PPI	**101.25**
Con. Confidence	**117**
Building Permits	(Text)
Stock Index	(Text)
Currency	(Text)

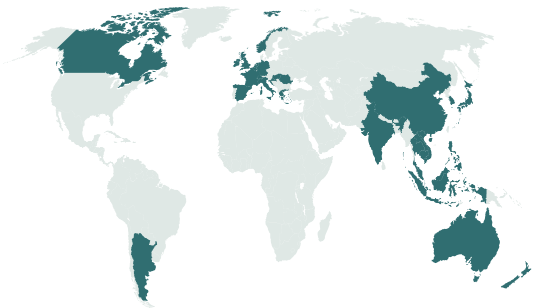
Chart info

Figure 1: Breakdown of Vietnam's Economy (% of GDP 2019)



Source: EIU

Figure 2: Vietnam's current Free Trade Agreements



Source: EIU

Southeast Asia's brightest spot

- Vietnam is currently poised to be the only country in Southeast Asia by the end of 2020 with a positive growth of 2% and the only country in Asia to see positive growth alongside China.
- There is a projected return to pre-crisis growth in 2021 at 6.8%. Vietnam has maintained a roughly consistent 7% annual growth in the past 5 years before 2020.
- Q3 2020 Real GDP jumped 61.72% compared to Q2 2020.
- However, Vietnam relies on trade as a key growth pillar as well, where exports made up close to 100% of its GDP in 2019 and was affected by the global slowdown of trade. This however was mitigated by a positive spillover effect from the U.S.-China trade war.
- This is fuelled by a recovery in key economic sectors such as in manufacturing as well as domestic consumption.
- Vietnam also sees strong political stability, as neighbouring countries such as Thailand and Malaysia see political turmoil with large scale protests in the former and constantly changing alliances in the latter. Vietnam is a one-party state, ruled by the Communist Party of Vietnam (CPV) which determines all major strategic policies. Dissent in the country is strictly controlled, and there is no evidence of large-scale criticism on the party's governance among its citizens. Mainstream media outlets are fully under the control of the CPV.

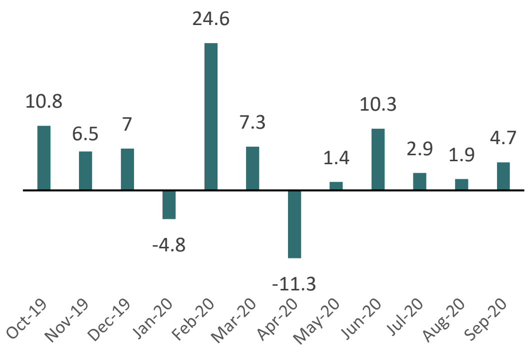
Domestic tourism sees success

- Both foreign and domestic tourism made up 7% of GDP in 2019, far less than neighbouring Thailand. Fall in inbound tourism from the U.S. did not affect Vietnam as much as Thailand.
- Vietnam has been introducing stimulus programmes aimed at reviving domestic tourism. This includes promotions and discounts provided by subsidies from the government up to 70%.
- As of October 2020, Vietnam has been putting in place tourism reopening strategy, through a CNN international advertisement to attract tourists post – COVID. We are not sure if this is an apt period to reopen borders, as countries around the world are still facing second and third virus waves. However, with close to zero local transmission rates in the past few months, Vietnam is poised to be one of the first countries ready to welcome tourists after the pandemic.

Surging manufacturing sector, China Plus One Strategy

- Having similar characteristics of political stability and a socialist-oriented market economy, Vietnam is viewed by many as a "Mini – China".
- Implications of the U.S.-China trade war saw many companies around the world diversifying their supply chain beyond China, accelerating the adoption of "China, Plus One" strategy. Vietnam is high on the shortlist of these companies, with companies such as Hasbro, Apple and Samsung relocating factories.

Figure 3: Vietnam Manufacturing Production Growth % (over the same month previoU.S. year)



Source: Tradingeconomics

- Manufacturing has been Vietnam's key pillar of growth in 2020, where manufacturing rose by 4.6% month on month in September 2020. Manufacturing had made up 16.5% of Vietnam's GDP in 2019. Figure 3 shows Vietnam's growing manufacturing production despite global circumstances.
- Vietnam is one of the world's top exporters for textiles and garments, with the sector accounting for 16% of its GDP, with export revenue in 2019 at USD 39Bn. Top trading partners for the sector include the U.S., Europe and Japan. In 2019, the industry also received USD 1.5Bn in investments, led by Hong Kong, Singapore and South Korea

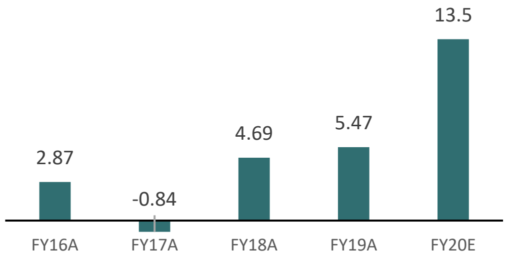
Attracting foreign investment

- In recent years, Vietnam has aggressively sought foreign investment through relaxation of its business environment as well as tax incentives.
- In September 2020, Vietnam introduced a 30% reduction in Corporate Tax Income for 2020, making the incentive available for bU.S.inesses with revenue that does not exceed VND 200Bn (USD 8.8Mn).
- Vietnam also has been expanding its special economic zones (SEZ) to include 18 coastal economic zones and 325 industrial parks. These zones provide their own incentives, from having free trade areas to low personal taxes.
- In addition, Vietnam has also entered into several free trade deals and is poised to capitalise from the recovery of global demand for its exports. These trade deals include the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and EU Vietnam FTA (EVFTA). Vietnam's current free trade agreements can be seen in Figure 2.
- Vietnam has been developing and stepping up LNG imports, and the Institute of Energy of Vietnam is drafting a new master plan to host 22 LNG power plants. This includes a plant by Singapore based Delta Offshore Energy Pte Ltd, and an upcoming plant by U.S. based ExxonMobil. The shift towards LNG power plants is detailed in Macro Theme 2.

Monetary policy in Vietnam

- Three key rates in Vietnam are its discount rate, refinancing rate and open market operations rate.
- Vietnam enacted one round of interest rate cuts after the onset of COVID-19, with refinancing rates cut to 4.0% in end September 2020, with a total cut of 200bps in 2020. The discount rate was cut to 2.5% from 3.0% and the open market operations rate at 2.5% from 3.0%.
- Cap on VND deposit rates was also lowered to 4.0% from 4.5%, and the maximum VND lending interest rate for short term loans lowered to 4.5% from 5.0%.
- The overnight interbank lending rate was also cut to 5.0% from 5.5%.

Figure 4: Vietnam's Trade Balance (USD Billions)



Source: Vietnamnews.vn

Macro Theme 1: Growing trade surplus with the U.S.

Spillover impacts from the U.S. – China trade war

Vietnam has absorbed a lot of companies adopting the "China, Plus One" strategy, where companies diversify their supply chains out of China into Vietnam. Close to 60% of companies in the Asia Pacific were planning to make major changes or completely transform their supply chains in the wake of the trade war. Total trade with the U.S. as of 2020 amounted to USD 80Bn.

Vietnam's trade surplus with the United States had risen 11% from July 2020 to August 2020 to USD 7.6B, representing a 38.9% increase compared to the year before. In 2018, after the start of the trade war, exports to the U.S. had been 125% higher compared to the same period 2017. Vietnam's growing trade surplus can be seen in the Figure 4.

Potential Tariffs and Currency Manipulation Allegations

The U.S. has voiced concerns over this trade surplus where Trump had labelled Vietnam as the "biggest abuser of us all". The Office of the U.S. Trade Representative (USTR) is activating Section 301 of the 1974 Trade Act to launch 2 different trade probes: allegations of currency manipulation by Vietnam and illegal harvesting of timber. This act was also used to launch tariffs against China which had led to the trade war in 2018. Should allegations of currency manipulation continue, the U.S. might launch similar tariffs against Vietnam.

<u>Little evidence of Vietnam's intervention in the currency market</u>

Vietnam need not intervene in the currency market, especially in 2018 during the start of the trade war. Trade tariffs against China had pushed all Asian rates down and reduced appreciative pressures even on Asia's most managed currencies such as the SGD and THB.

The jump in the trade surplus could be seen as mostly from U.S. action. As mentioned, trade tariffs against China had sent companies moving their supply chains to Vietnam.

<u>Concerns among investors and companies</u>

Investors who had relocated supply chains to Vietnam are fearing potential tariffs imposed on exports, where they would have to either relocate factories again or pass costs down to consumers.

<u>Both sides reaffirming ties</u>

In October 2020, the U.S. Secretary of State reaffirmed strong ties between both countries. During the Indo-Pacific business forum held in October 2020, ExxonMobil laid plans to invest USD 5.09Bn into a liquified natural gas power plant in Haiphong, Vietnam. Vietnamese businesses have also committed to purchase USD 500Mn worth of American pork over the next 5 years.

Figure 5: Current and estimated production and imports of LNG (Billions m3 per year)

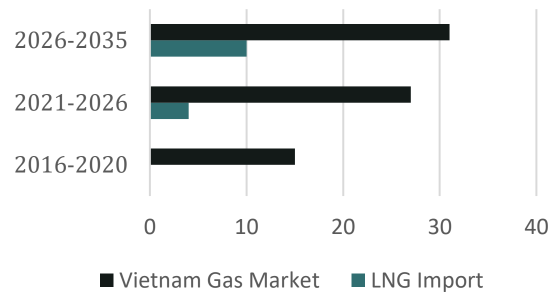
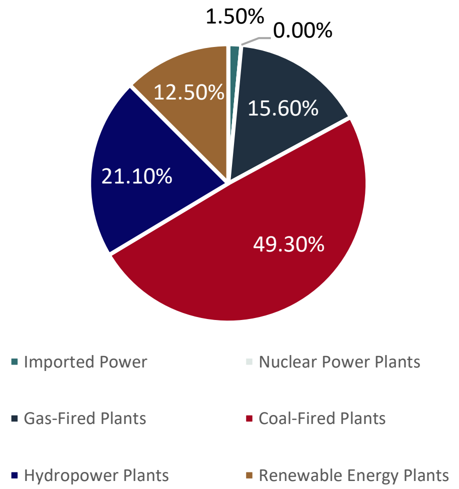


Figure 6: Makeup of estimated 129,500MW of energy requirements



Macro Theme 2: Vietnam's push towards LNG

Vietnam's needs for alternative power

Current domestic situation

Vietnam in 2020 still regularly faces instability in its power grid, caused by power shortages from delayed investments into power projects. Energy security requirements limit the amount of energy imports Vietnam can draw from surrounding countries.

Coal and hydro reserves are also running out, where in 2018, Vietnam had already shut down two out of four turbines due to a lack of coal. Sustainable energy sources through wind turbines and solar generators are limited and dependent on weather conditions. Prior plans to construct nuclear power plants in 2016 were scrapped due to rising costs. As such, LNG projects are critical for Vietnam's energy needs.

This requirement for LNG was highlighted in Resolution 55 posted by the CPV, encouraging investment and development in LNG plants in Vietnam.

Plants in the Pipeline

Vietnam is on track to construct 3 additional LNG terminals – the Thi Vai LNG Terminal, Cai Mep LNG Terminal and Nam Dinh Vu LNG Terminal. Terminals constructed help to facilitate the import of LNG and is a key step in the process of regasification.

There are also currently 7 power plants in the pipeline, and its estimated power capacity by 2030 is shown in Figure 5. Coal-fired plants are expected to be the main contributor to meet Vietnam's energy requirements

Limitations to LNG Investment

Restrictions on foreign ownership

Even though there are no restrictions on foreign ownership relating to the main activities of LNG plant operations, there are restrictions on ancillary services, such as tanker towing. This might discourage further foreign investment.

Moving focus away from high trade balances

The move to LNG was in part precipitated by threats from the Trump Administration to impose tariffs on Vietnam from its ballooning trade deficit, shown in Macro Theme 1. These LNG agreements seek to mitigate potential tariffs by closing and lowering trade surplus while allowing for the Vietnamese government to have a strong relationship with the U.S. market.

NUS INVESTMENT SOCIETY

Global Macro Department – Thailand

Date: 27 Dec 2020

Analysts

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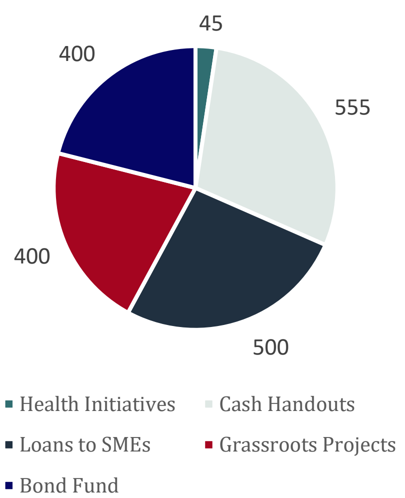
Basic Information

Real GDP(US$)	**543.65B**
M2(US$)	**720.75B**
Core CPI	**102.7**
PPI	**101.5**
PMI	**52**
Building Permits	**4,422**
SET50	**THB798.05**
USD/THB	**30.61**

Chart info

Figure 1: Breakdown of Stimulus Allocation (THB Billions)



Source: Bloomberg

Figure 2: THBUSD 2017 - 2020

Source: Yahoo Finance

Thailand Overview

- Having borne the brunt of COVID-19 with 0 foreign tourists for 6 consecutive months, Thailand is not in good shape, especially as protests and growing political instability threatens to erode efforts towards the revival of its economy.
- Thailand's economic growth is closely related to tourism and manufacturing industry.
- Income from foreign tourists make up 11.3% of GDP
- Strong THB over the past years has hurt the country's exports and tourism sectors which are the key drivers of the Thai economy.

Empty Phuket beaches for the near future

- Thailand's economic growth is closely related to the tourism industry. In late 2019, Thailand was the first country to record a COVID-19 case outside of China, and swiftly took measures to close its borders and impose lockdowns. This was done with the aim to quickly control the domestic spread of the virus to welcome tourists back into the country.
- While the domestic spread of the virus was contained, Thailand could not open up its borders as countries all around the world were afflicted by the virus. The prolonged lockdown of its country had also taken a hit on its supply chains and domestic consumption.
- In October 2020, Thailand has started opening up its borders to 150 Chinese tourists on special tourist visas, which will be followed by waves of tourists from China and Scandinavia as well.
- Chinese tourists are the most significant for Thailand, accounting for 28.1% of tourist receipts.
- A large informal economy revolves around the tourism industry as well, with jobs related to the sector at 1 out of 6.

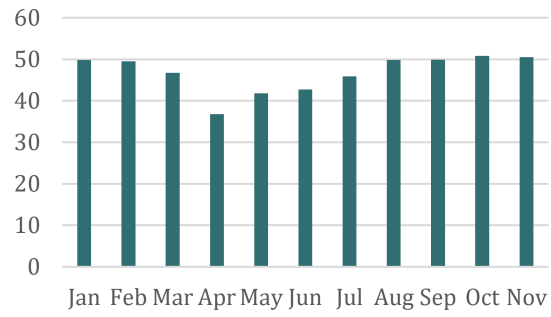
Thai Baht Strength

- The strong Baht strength is attributed to investors seeing Thailand as a safe haven with ample foreign exchange reserves.
- In a bid to ease currency gains for the export-reliant economy, the BoT is pondering a move to ease investment outflows for the individual investor, as well as permitting more sales of foreign financial products. Capital outflow out of Thailand would ease pressure on the Thai currency, aiding the Thai manufacturing and export industry.

Future rate cuts not likely

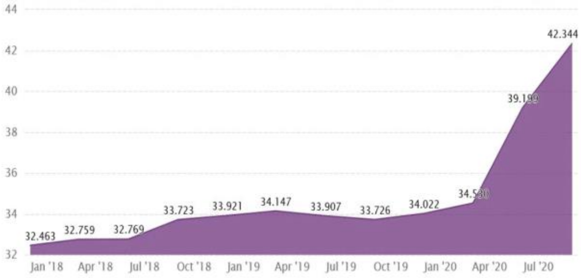
- From the onset of COVID-19, Thailand has made 3 rate cuts, with the latest rate cut leaving its policy rate at 50bps in May 2020
- On 4 October 2020, the BoT laid out plans to ease overseas investment rules to encourage an outflow of the THB, by easing restrictions on Thai citizens to invest overseas as well as requiring pre-trade registration for Thai bonds, to ease interest in Thai dominated bonds.
- Further cutting of policy rates closer to zero not deemed necessary by the BoT for the time being.
- Support for Thai businesses, households and workers might not receive as much help from monetary policies, compared to direct fiscal checks. Domestic consumption is currently viewed as a key factor to replace the fall of tourist dollars

Figure 3: Thailand PMI 2020



Source: Trading Economics

Figure 4: Thailand Government Debt: % of GDP



Source: Thailand Business News

Lots of fiscal ammunition….

- Fiscal stimulus forms a key component of Thailand's measures to support households and businesses amidst COVID-19. As of 20th October 2020, Thailand has issued 4 fiscal packages from May to June, totalling THB2.4T (US$76.7B) or 14.5% of 2019 GDP. Close to half of fiscal packages go towards real spending, such as cash handouts to citizens worth THB620B (US$19.8B), and support for the tourism sector through subsidising hotel rates and F&B businesses. The other half goes towards monetary support through soft loans to businesses at low interest rates, debt moratoriums and debt restructuring plans.
- A tax break was included in Oct 2020, offering taxpayers income tax deductions of up to 30,000 THB for purchasing products with the 7% VAT, costing THB11B in total. The tax break was initiated in a bid to boost domestic consumption, a crucial pillar for growth in the Thai economy for the near future.

….. but bullets not hitting targets

- Current spending of fiscal packages only makes up 1/3 of its THB1.9T stimulus borrowings due to several limitations.
- THB500B allocated towards soft loans for SMEs have faced roadblocks due to lenders' reluctance to extend more loans with fears of growing default rates and NPL portfolios.
- THB400B grassroots investment projects facing difficulties in the identification of appropriate projects.
- Cash transfers delay due to bureaucratic processes and identification of appropriate target groups.

Growing Debt Concerns

- Thailand faces record household debt levels at 84% in the first half of 2019, making up THB16.6T (US$53B), projecting to reach 90% by end 2020. Reports from commercial banks state how close to 6% of borrowers availed of the debt moratorium period have broken off contracts, with this value making up THB100B. A further 4% of borrowers are still facing liquidity problems. Figure 4 shows the Thailand government debt ballooning in 2020.
- The BoT plans to take on a THB1T borrowing plan to finance packages to last Thailand for the next 5 years through government bond issuances and borrowings from the Asian Development Bank (ADB). With this, the national debt to GDP will increase from 48% to 57% of GDP. This touches close to the legal limit of 60% as per the Thai constitution.
- Tax breaks, weaker domestic demand and zero foreign spending have led to government revenues falling 5.8% y.o.y.

Investment of State Enterprises

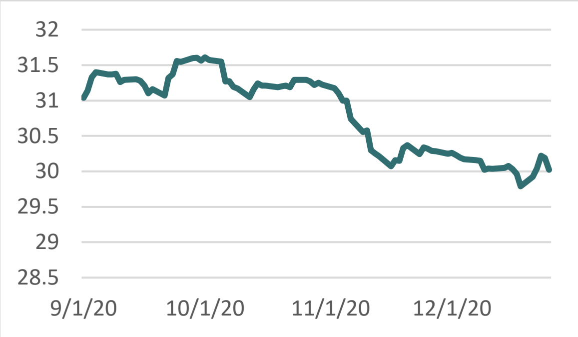
- The government plans to unveil a budget worth THB200B towards investments by state-owned enterprises, with the disbursed investment budget aimed to create 129,083 new jobs.
- The transport and logistics sector is expected to receive the bulk of the funds at THB93.1B, being the most directly impacted industry in the aftermath of COVID-19. This included projects such as The Thai-Sino high-speed rail linking Bangkok and Nong Khai at the Chinese border and an extension of Bangkok's metro and rail systems.

Trade recovery is slow but on track

- Even as Thailand has successfully contained the virus, economies all around the world face resurging viruses, with daily records expected to reach a high as countries move towards winter. The BoT expects a slower recovery in external trade demand with as lockdowns continue to dominate most of the world.
- Thailand's manufacturing has been recovering, with the manufacturing index rising 4.8% month on month in Oct 2020, the 5^{th} consecutive monthly rise in the index. Thailand's manufacturing index is tied heavily to its GDP. Thailand's PMI in 2020 can be seen in Figure 3.
- Thailand in November signed the Regional Comprehensive Economic Partnership trade pact with other countries in Asia and Oceania, which unifies pre-existing bilateral free trade agreements between the ASEAN countries and 5 of its major trading partners. The trade pact was also aimed at drawing economic investments back into Asia on the back of the decline of US influence in the region.

Macro Theme 1: Political Instability in Thailand

Figure 5: USDTHB for Sep-Dec 2020



Source: Yahoo Finance

Shaky politics not new to Thailand

Thailand has been facing one of the worst protests and political instability in years. The country is not new to protests, with the last protests of this scale leading to a coup, replacing previous premier Yingluck Shinawatra with incumbent premier Prayuth Chan-Ocha. The protests had placed considerable strain on an already faltering Thai economy, battered by COVID-19.

On 5 November 2020, it was reported that investor confidence had hit 7 months low on the back of protests concerns, with bearish concerns over its political situation. A survey by the Federation of Thai Capital Market Organisations (FETCO) shows that its confidence index fell to 61.27 to a record low of 56.7 in March.

Impact on Currency

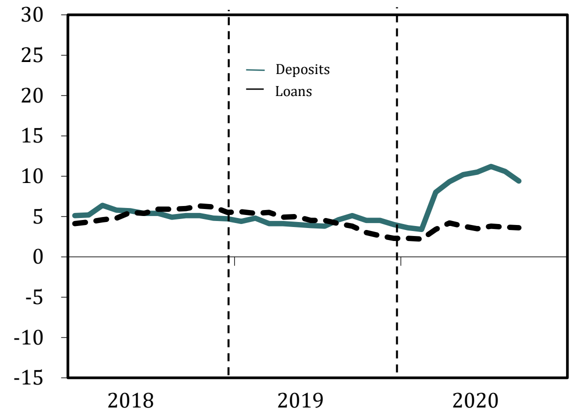
The Thai Baht has come under pressure with the political crisis posing a near term downside risk. This, however, does not seem to be reflected in its currency, where THBUSD has weakened by 1.27% over the past month. In response, the government is even encouraging capital outflows to further dampen the pressure on the Thai Baht through measures announced in 2020. This included free deposit and transfer of funds in foreign currency for Thai citizens, which facilitates overseas investments to cool the Thai market.

Impact on Equities

Thailand's stock market, the SET50 is the region's poorest performer in 2020, at a -29.1% yearly change as of October 2020. This is despite the huge listing of Thai giant Siam Cement Group at US$1.5B, the second largest after Central Retail Group's listing.

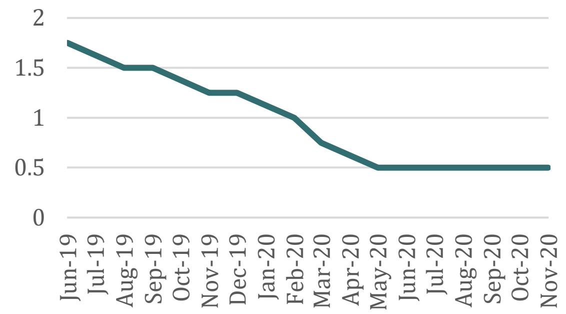
In particular, banking counters are under greater pressure due to a higher rate of non-performing loans, poor economic outlooks and projected lower dividend pay-outs.

Figure 6: Loans and Deposits % Change from the same period the year before



Source: BoT, Dec 2020.

Figure 7: Thailand Policy Rate Movement from meetings (in %)



Macro Theme 2: Low Interest Rate environment

The last rate cut in May 2020 took policy rates to 50bps, after 2 previous rate cuts, from 125bps at the start of 2020.

<u>Toll on Bank Profits</u>

Thai banks are expected to take a hit from low interest rates. Low interest rates have caused narrowing net interest margins (NIMs). 71% of the revenue of banks are from net interest income in the first half of 2020. In addition, a report by Moody's has stated that 70% of banks' assets carry floating rates and will be repriced in January 2020.

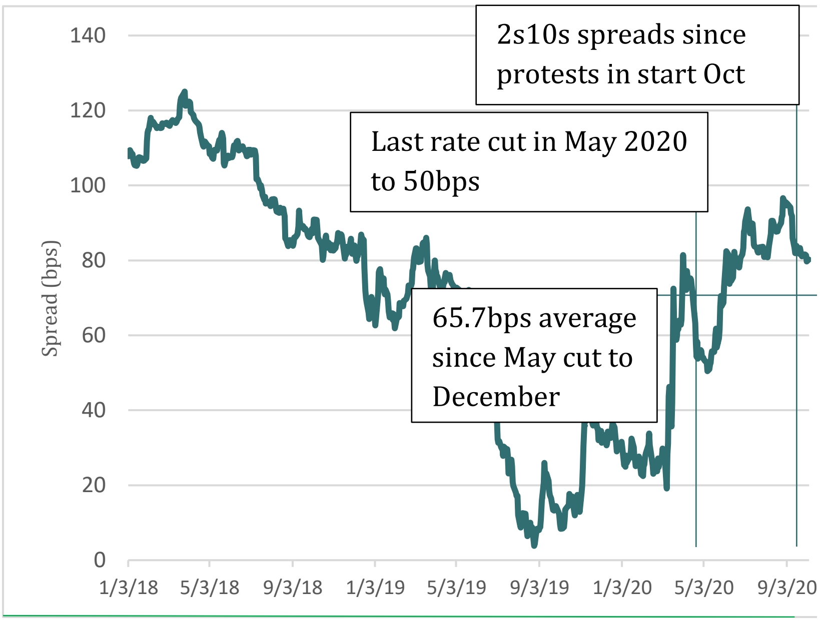
This is exacerbated by slower loan growth, where poor economic conditions from the COVID-19 pandemic and political instability dampen credit demand. Deposits in current and savings accounts are also expected to grow, as risk-averse population stash away fiscal handouts. This is seen in Figure 6, where there is a disconnect between the % change of deposits and loans.

The impact of slower loan growth might run counter to the intended impact of low interest rates encouraging greater loan take-up. On the demand side, poor economic conditions from prolonged lockdowns and delays have dampened and curbed credit demand, while on the supply side banks are tightening credit reviews as credit ratings of borrowers nosedive.

<u>Future Cuts?</u>

As of December 2020, the BoT has made the decision to keep the policy rate at 50 bps. Past interest rate cuts from BoT meetings are shown in Figure 7. This is done to preserve room in monetary policy for potential crises in the future, where the BoT does not wish to move towards negative rates. Fiscal packages through large borrowings dominate the large part of the BoT response with direct support to the economy and workers.

Figure 8: Thailand Government Bonds 2s10s Spread



Source: Yahoo Finance

Figure 9: Recommend short 2y Thais and long 10y Thais

	Interest Rate	Notional	DV01	Spread Ratio
2Y Thai futures (TGB2)	0.62%	THB 1,000,000	THB 190.28	0.188
10y Thai futures (TGB10)	1.375%	THB 1,000,000	THB 1010.5	1.000

Source: Bank of Thailand

Trade Idea: Flattening 2s10s Thailand government bonds. Short 2y Thais and Long 10y Thais

View: Greater uncertainty over current political climate pushes investors into longer-dated bonds.

Rationale:

<u>Greater volatility from political instability</u>

The ongoing protests against Thailand's government have taken a hit on investor expectations. Since the protests started in October, 2s10s spreads have flattened by 5.5 bps as investors look towards long-dated bonds.

Current spread at 75.5 bps is on a high end of recent range after the last rate cut in May, and current political instability is expected to put downward pressure on spreads to beyond the 62.4bps average since the last rate cut.

As indicated in Macro Theme 1, investor confidence as reported by FETCO is at a 7 month low.

<u>No further rate cuts expected in the near future</u>

The front end is currently pinned at 50bps with no further rate cuts expected. Longer ends impacted by macro themes.

Increase in longer borrowing slated for next year with greater supply, putting downward pressures on price.

<u>Poor performing stock market</u>

The SET50, Thailand's primary stock index has been one of the worst performers in the region

Trade structure:

Notional of swaps at the front and back leg must be set such that the DV01s of both legs are neutral. As DV01s of both legs are different, contract sizes have to be tweaked.

We calculated DV01 values for each leg of the futures contract. We will short 5 TGB2 contracts and long 1 TGB10 contract to achieve a neutral DV01 position. We have sized the trade to reflect a DV01 risk of THB 1010.5.

Risks:

<u>Recovery of manufacturing sectors</u>

Announcements of a greater recovery of its manufacturing sectors might strengthen bullish sentiments, pushing spreads to steepen instead.

As of December 2020, there are greater doubts over a fast recovery in 2021 as Thailand battles with the biggest outbreak in 6 months, pushing its 10y yields further lower.

DV01: THB1010.5

Current: 71.4

Take Profit: 65.7bps

Average 2s10s spread at 65.7 bps since the last rate cut in May 2020. Reports of a recovering manufacturing and export sector from August month-on-month has pushed investors' expectations up.

We expect greater political instability to derail investor gains from the past months

Stop Loss: 9.9bps

Sizing a trade with a notional PFE of THB10,000 per contract, with a DV01 of THB1010.5, we will put a stop loss at 9.9 bps steepening from its current 75.5bps.

NUS INVESTMENT SOCIETY

Global Macro Department – India (Overweight)

Date: 21st June 2020

Analysts

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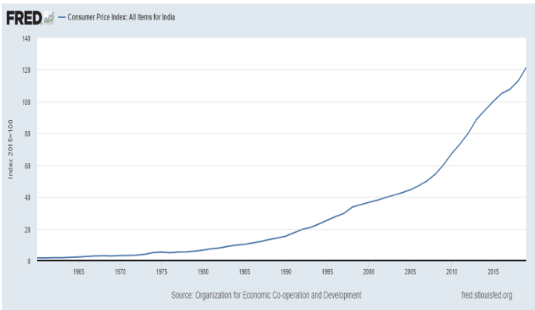
Basic Information

Real GDP(US$ bn)	2,875
CPI	121.4
Unemployment Rate	7%
Trade Surplus (US$ bn)	19.8
Trade Surplus (% of GDP)	3.9%
Interest Rate	4.0%

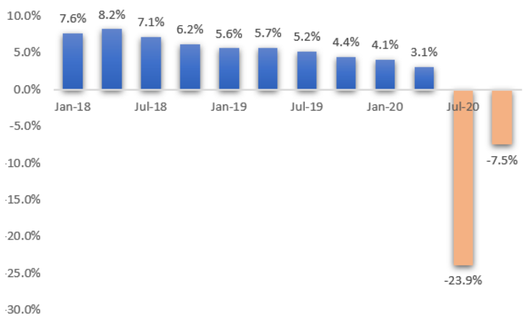
Chart info

Figure 1: India's CPI



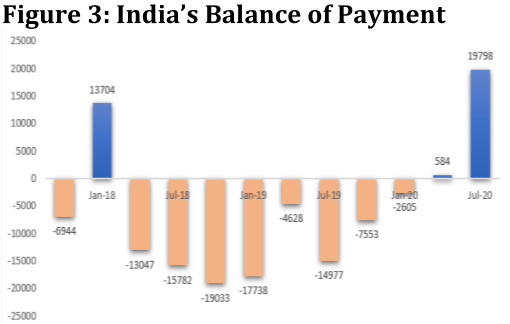
Source: Federal Reserve Bank of St. Louis

Figure 2: India's GDP Growth



Source: Trading Economics

Figure 3: India's Balance of Payment



Source: Trading Economics

Overview of India

- With a population of more than 1.2 billion people, India is one of the world's largest economies. Since the 21st Century, India has made drastic improvements in reducing poverty. As the world's 3rd largest economy in terms of purchasing parity, India possesses a diversified economy, with the majority of growth stemming from the service industry. Key growth drivers for the nation include telecommunications, IT and business process outsourcing (BPO) services. While Covid-19 has severely dampened India's GDP growth, consumption is forecasted to pick up in the near future. This is backed by the Reserve bank of India's RBI's) monetary policy, which maintains a Flexible Inflation Targeting Framework (FITF) that sets inflation targets every 5 years. The FITF has set a Consumer Price Index (CPI) of 4%, with an upper and lower tolerance limit of 6% and 2% respectively. As of December 2020, the RBI has maintained their decision to keep CPI levels at 4% in order to combat import inflation.

Summary of events in the past 6 months

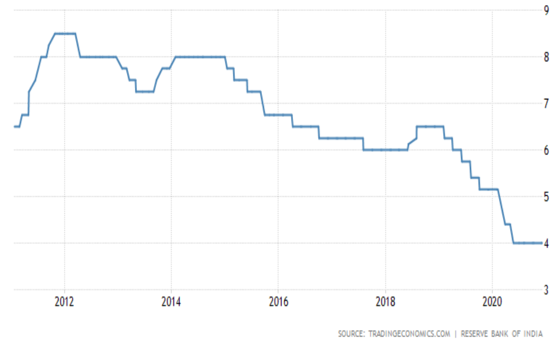
- The Reserve Bank of India (RBI) expects a 7.5% contraction of India's economy for the Fiscal Year (FY) ending in March 2021, an upgrade from their earlier forecast of -9.5% economic growth. This can largely be attributed to expectations of growth in the latter part of the fiscal year, resulting in a V-shaped recovery that reflects a robust improvement in India's economy. Additionally, the RBI has hinted at allowing the rupee to further appreciate in a bid to dampen the impacts of imported inflation. However, as India's economy bounces back from the impact of the pandemic, demand for imported goods, along with consumption, is expected to rise.

- The RBI has stated intentions to maintain a repo rate of 4%. This is coupled with decisions to continue with accommodative monetary policies for as long as necessary. RBI's decision to keep rates unchanged is slated to induce an accommodative environment that supports growth. The "sit-and-wait" approach adopted by the RBI signals a willingness to maintain current levels of liquidity. The potential for improvements in the Indian economy also bodes well for domestic consumption, likely resulting in greater expenditure within the nation as well as increased import consumption.

- Market capitalization of all listed companies in India hit a record ₹161 trillion ($2.11 trillion) in October. This broad-based growth was mirrored in non-index stocks and is indicative of bullish sentiment on Indian equities. Additionally, the London Stock Exchange (LSE) and Indian technology stocks are also in talks with regards to overseas listings. This could potentially lead to increases in valuations and greater access to capital for said firms.

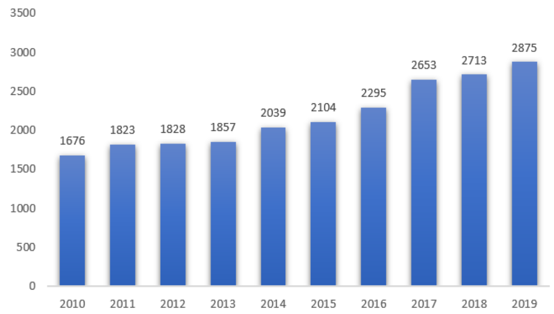
- Despite negative impacts of Covid-19 on India's real economy, the nation's current account recorded an annual surplus in the April-June quarter of 2020, with a $19.8 billion surplus, a stark contrast from the $15 billion deficit recorded in the first quarter of FY2020. However, the current surplus can be attributed not just to reduced imports expenditure, but also a one-third fall in exports. This raises concerns over the state of India's economy, where the nation's current account surplus suggests reduced investments due to weak economic prospects.

Figure 4: India's Interest Rate



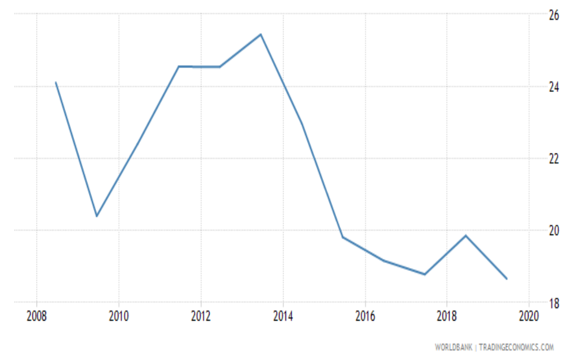
Source: Trading Economics

Figure 5: India's GDP in $US Billions



Source: Trading Economics

Figure 6: India's Exports as % of GDP



Source: Trading Economics

Figure 7: Crude Oil Prices

Source: MacroTrends

Extended Impact of Covid-19

The RBI estimates India's economy will contract less than expected by 7.5% this FY, with expectations of gradual recovery thereafter and risks tilted on the downside. During this period, weak domestic and foreign consumption is likely to result in a continued reduction of Indian imports and exports. Stimulus packages would therefore be key in expediting economy's recovery.

In addition, the uncertainty of the global economy as multiple countries impose fresh lockdowns, as well as the emergence of new Covid strains, raises concerns over the health of India's key trade partners. Consequently, the uncertainty brought about by Covid-19 poses potential problems to India's economy in the form of reduced export revenue, an issue exacerbated by the fact that India exports form 18.66% of their GDP.

The uncertainty projected by the extended impacts of Covid-19 form major roadblocks in India's journey to economic recovery, potentially resulting in greater depreciation of the INR as we venture into 2021.

Worsening Current Account Surplus

In spite of expectations for India to generate a record USD19.8 billion surplus in 2020, the bulk of this surplus can be attributed to a fall in imports rather than increasing exports. As the economy inevitably opens up, the trade deficit is expected to increase again.

Additionally, recent statistics suggest that the future of India's remains uncertain in the long run. Despite the rosy picture of a recovering economy painted by revised quarterly GDP figures, these numbers were derived from corporate accounts, a sector which has performed relatively better compared to their non-corporate counterparts. The micro, small and medium enterprises (MSME) sector in particular, has been particularly hard hit. The nation's stagnating production capacity also raises concerns over the extent of the impact of an extended pandemic.

Consistent High Inflation

Inflation levels within India have consistently ranged between 6 to 7%, with interest rates slipping into the negative zone as the RBI attempts to jumpstart the economy via greater consumer spending. Consequently, the lower returns on investments drives institutional and retail investors alike away from India, resulting in devaluations of the currency and a cheaper INR.

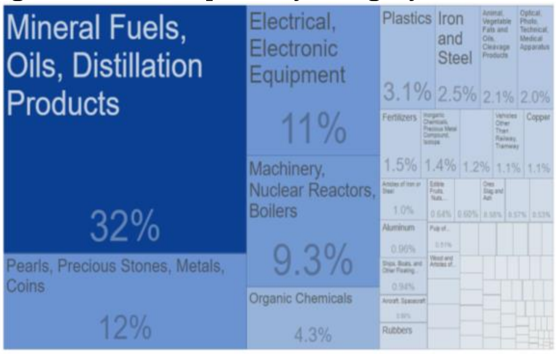
The Indian government is also slated to enact record borrowing in order to combat revenue slumps. This could lead to a surge in India's combined fiscal deficit to more than 10% of GDP. Moreover, since higher inflation rates have a direct impact on the cost of holding cash, the reduced holding of cash and increased inflation levels within India is expected to exacerbate fiscal deficits.

Consequently, the RBI is expected to maintain an active role in keeping borrowing costs in check, which could come in the form of active bond repurchases to prevent significant increases in market interest rates. The increased supply of INR as a result of these active measures will likely lead to further depreciation of the INR.

Unsustainable FDI flows

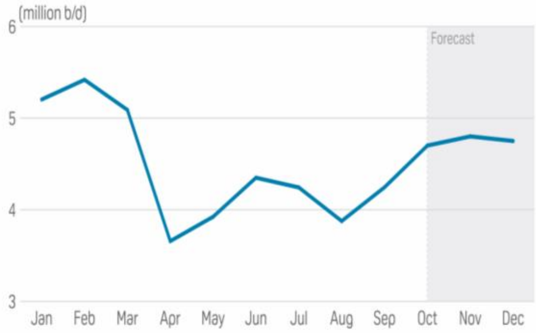
Earlier in the year, market capitalization of all listed companies in India hit a record ₹161 trillion ($2.11 trillion) in October, with the Sensex trading above 41,000 at the time this report was written. This surge in market cap comes after rebounds in several macro indicators and earnings optimism fired up stocks. The Bullish outlook on Indian

Figure 8: India Imports By Category



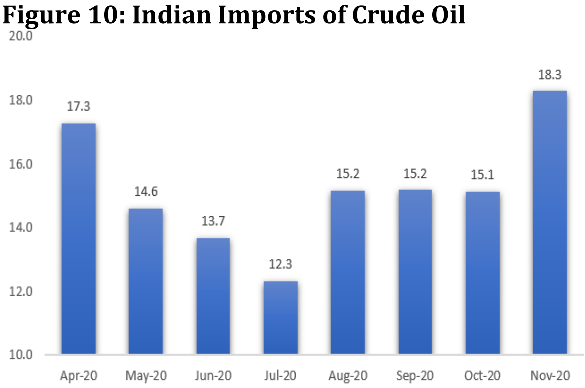
Source: Trading Economics

Figure 9: India's Crude Throughput



Source: S&P Global Platts Analytics

Figure 10: Indian Imports of Crude Oil



Source: Trading Economics

equities follows a good start to the quarterly earnings season led by the IT sector, with Foreign Portfolio Investors (FPIs) making a net investment of $9.3 billion USD in the Indian capital markets.

However, with expectations of improvements to the Covid-19 situation, the recent increased conviction in India's IT sector might suffer from pullbacks in the near term, resulting in greater outflows from India's equity sectors. Moreover, the increase in money inflow occurred largely after the re-rating of India equities by financial institutions, casting doubts on the sustainability of the INR's long term bullish outlook. Furthermore, weakness in the US dollar has also increased the attractiveness of Indian equities, whether such a trend is likely to persist in the future remains to be seen.

Increased Oil Imports

India's oil import bill is also expected to increase as oil prices continue to recover since their pandemic lows. As a major importer of crude oil, India's crude imports account for 32% of overall imports. With expectations of improvements in the Covid-19 situation, India recorded an increase in crude oil imports from 15.14 million tonnes in October 2020 to 18.28 million tonnes in November 2020. The increased demand for crude is attributed to greater demand for diesel and gasoline.

Crude oil prices have traditionally been a huge factor in the movement of INR, where higher Brent prices induce downward pressure on the rupee. This is due to India buying more foreign currencies in order to meet its needs for greater imports. As the price of crude oil continues to recover, India's increased demand of the commodity is expected to further impact the price of the rupee, resulting in greater inflationary effects.

Crude oil prices have been gaining steadily ever since hitting pandemic lows, leading to higher risks of INR depreciation. As crude prices approach $50 a barrel, the increase in oil prices is expected to have a knock-on effect on Indian equities, where increases in crude oil prices lead to higher costs of production and therefore reduced productivity. This in turn causes stock prices to fall, potentially stifling money inflows into India's capital markets. Continued increase in crude prices is therefore expected to result in reduced demand and increased supply of INR, leading to greater downward pressures on the INR.

Figure 13: USDINR Daily Chart

Source: Tradingview

Trade Idea: Long USDINR

Entry: 73.488

Take Profit: 74.490

Stop Loss: 73.070

Risk Reward Ratio: 2.40

Increased Strength of USD

Despite strong dollar selloff in the earlier half of the year, the USD has begun to show signs of strength. This can be attributed to key risks such as the US presidential election coming off, as well as sharp rebounds in US GDP Growth aided by the nation's stimulus packages.

Additionally, the strength of the INR is also expected to weaken venturing into 2021, with expectations for continued depreciation in the mid to long term. Increased import expenditure as the nation gradually opens up to trade is likely to increase downward pressure on the INR.

Furthermore, USDINR is trading well within the lower bands of the upward channel. With expectations of greater import expenditure on the part of India, supply of INR is likely going to continue increasing, leading to downward pressures on INR prices. The expected rally in the strength in USD is also expected to increase the price of USDINR, with the golden cross showing strong bullish momentum. The take profit level is derived from the 0.236 Fibonacci level, while the stop loss is derived from previous support levels.

Ultimately, this is a consensus trade driven by expectations of a stronger dollar coupled with a weakening Rupee. As countries across the globe eventually forge ahead in a post-pandemic world, both currencies are predicted to continue these trends, leading to rising USDINR prices.

NUS INVESTMENT SOCIETY

Global Macro Department –Malaysia (UNDERWEIGHT)

Date: 27th December 2020

Analysts

Ho Yu Ki

Global Macro Analyst

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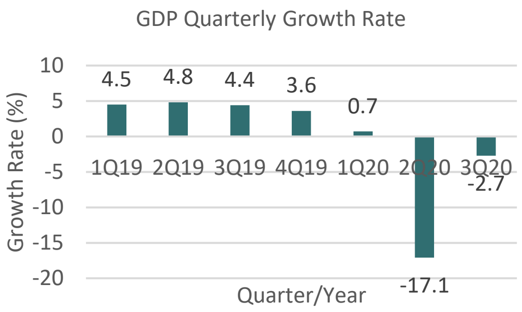
Basic Information

Real GDP(USD)	364 billion
M2(MYR)	2,033,284 million
CPI	120.1
PPI	101.2
Con. Confidence	90
FBM KLCI	1575
USD/MYR	4.059

Chart info

Figure 1: Malaysia GDP Quarterly Growth Rate



Source: Singstat

Overview

We can see some recovery towards the end of 3Q20 with a -2.7% GDP growth rate following 2Q20's unprecedented GDP drop of 17.1%. 3Q20's growth was mainly raised by a rebound in the manufacturing sector which grew 3.3% in the third quarter compared to the previous -18.3% in the second quarter of 2020. Export-orientated industries had a turnaround of 5% (3Q20) compared to -13.5% (2Q20) and this was reflected in a double-digit growth in September. This quarter's growth has also been supported by lower negative growth in other sectors such as industrial production and services (-4% in 3Q20 compared to -16.2% in 2Q20). Meanwhile, merchandise exports dropped more in August indicating a significant fall in shipments for liquified natural gas (LNG), oil and chemical products. Malaysia is the second-largest oil and natural gas producer in Southeast Asia and the second-largest exporter of LNG, being strategically located between important sea routes for energy trade.

In the third quarter, Malaysia has benefited significantly from the surge in palm oil prices which increased by 37.5% and this was mainly due to higher demand from its major trading partners China and India.

On the 23rd of September, the government announced a stimulus of MYR10 billion to further increase economic activity. Unfortunately, Sabah's internal elections which caused another wave of Covid-19 across Malaysia have prompted renewed restrictions in all states but three, which halted activities again in 4Q20.

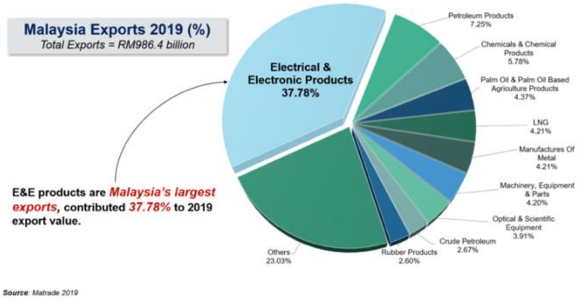
Summary of events in the past 6 months

- **A Resurgence of Covid-19 cases**
  A new wave of the infections emerged in September due to the Sabah state election which stunted economic performance in October and November. This rose up to a record of 1240 on October 26th from just 82 a month before that. The total cases in the same span of time rose over 33,000 from less than 11,000, prompting the government to order a new round of Conditional Movement Control Order (CMCO) to curb the virus transmissions. We expect average inflation to be negative this year, given the substantially lower global oil prices, before prices rise again in 2021.
- **Renewed lockdown measures**
  On the 7th November, the government implemented a CMCO in all states except for three (Kelantan, Pahang and Perlis) due to the increased infections across Malaysia. This is effective until December 6th 2020.
- **Budget 2021**
  The largest Budget yet, of MYR322.5 billion where MYR28 billion was allocated in the form of subsidies

and incentives. This has passed the parliament in mid-December after 3 readings.

- **Political Crisis**
  Prime Minister Muhyiddin was sworn in earlier this March, being the 3rd government in less than 2 years, coming into power after elites in several political parties reconfigured their coalition alliances to remove the previous Prime Minister Mahathir Mohamad and prevented his successor Anwar Ibrahim from assuming the place. The 9-months old government has been facing many difficulties to hold a fragile majority in parliament and public distrust due to the failures of several prime ministers to implement economic reforms.

Figure 2: Malaysia Exports



Source: Matrade 2019

Figure 3: Malaysia Unemployment Rate

Source: Tradingeconomics

<u>**Economic Impact**</u>

Prime Minister Muhyiddin Yassin stated that the economy is losing about MYR2.4 billion daily during the Movement Control Order (MCO), which took place from 18th March 2020 until 12th May 2020 because all business activities were suspended. According to the Ministry of Finance, the GDP is expected to contract by 4.5% in 2020 and grow 6.5% to 7.5% in 2021. The GDP growth forecast is premised on the distribution of the vaccine to the front liners and the vulnerable by 1Q21, continued improvements in exports and increasing momentum of consumption. The implementation and extension of CMCO until the 31st December has also impacted Malaysia's economy severely:

- Broad-based travel restrictions and travel risk aversions have affected all tourism-related sectors.
- Disruptions to the global supply chain impacted production and trade; loses in the Electrical and Electronics (E&E) sector is estimated to be MYR7.28 billion locally while the loss in exports is estimated to be at MYR 29.12 billion. The E&E industry is a significant export contributor contributing more than MYR330 billion annually for the past three years. This is more than the combined exports of oil and gas and palm oil. Malaysia is the world's second largest producer of palm oil after Indonesia.
- Decline in private consumption and investment due to decline in household spending
- According to the Department of Statistics Malaysia (DOSM), 67.8% of a total of 4094 Malaysian companies responded to having no sales or revenue during the MCO period. The main problems were insufficient financial source for salary and rental payment and low customer numbers.
- According to DOSM, unemployment rate is at 4.7% in October. As most of the states were under CMCO in October, industrial and business activities continued their operations under strict standard operating procedures (SOP). It is expected that the rate will be at 4.5% in December as CMCO ends in some states.

Aside from the pandemic, the domestic economy will also be impacted by the fall and volatility of crude oil prices and supply disruption in commodities due to unfavourable weather conditions and reduced operations from MCO.

Figure 4: Malaysia's Political Figures

(from left) Dr Mahathir Mohamad, Malaysian Prime Minister Muhyiddin Yassin and Mr Anwar Ibrahim

Source: Google

A Precarious Political Situation

Since taking power in March after the sudden resignation of previous Prime Minister Mahathir Mohamad, Muhyiddin Yassin, the current Prime Minister, has only proved to have the majority confidence of Parliament a few times while evading similar tests. With no clear outlook of a stable relationship between Malaysia's constitutional bodies in the near future, the political situation will exert a great influence over the economy.

<u>Quick timeline of a series of events:</u>
July: Anwar, the opposition's leader claims to have two thirds of the seats vouching for him

September: Mahathir's no confidence vote towards Muhyiddin; Sabah state election won by Muhyiddin, further solidifying his position

December: Budget 2021 has passed in parliament which put to rest claims by the opposition that Muhyiddin has lost most support from the members of Parliament.

Muhyiddin initially lost some prestige after the King rejected his request to declare a state of emergency to tackle the pandemic, which would have allowed him to pass a budget without approval from lawmakers. We believe that Muhyiddin took this action to maintain power and political stability in anticipation of parliament's vote on his government's budget. The Parliament voting against it would have substantially signified a vote of no-confidence causing government will collapse, leading to a snap election.

Muhyiddin's Bersatu party controls less than 5% of the 222-members parliament, requiring it to carefully navigate its relationships with other parties in the ruling coalition, and opposition. The two most important being the following: First, the leaders of the biggest party in the ruling coalition, United Malays National Organization (UMNO) are full of doubts in their dealings with the government and proposed new terms in black and white and some leaders are leaning towards a new coalition formed by the opposition's leader Anwar Ibrahim. Second, the Democratic Action Party (party with most seats in parliament) who are willing to negotiate with Muhyiddin for now under condition that its 6 fiscal and financial measures were included in Budget 2021. With elections next scheduled for 3Q23, there seems to be no way out of this precarious situation suggesting power struggles like this will continue.

This political uncertainty has definitely taken a toll on Malaysia's financial markets. The Malaysian stock index fell by 0.4% after Muhyiddin's failure to declare a state of emergency. The ringgit fell in October and fell behind most Asian countries which strengthened from the weakened dollar. Global funds have pulled out USD161 million from local shares in October with the benchmark equity index capping its 3rd straight month of losses.

The political landscape seems to be tumultuous in the next decade with Muhyiddin's tenuous hold on power. If power change hands often, it will lead to a questionable policy continuity and stalled reform momentum. This was already seen early this February when the Pakatan Harapan government was deposed after backroom maneuvers sparked by inter-personal and inter-party rivalries within a four-party coalition.

This uncertainty in the interim is a negative investment sentiment, which is inopportune as businesses around the world plan to move part of their operations out of China because they want to diversify and strengthen their supply chains amidst the US-Sino trade war. The chaotic nature of Malaysia politics in such a transitional period (the defeat of a 60-years-old government in 2018) risks a resurgence of corruption, further decreasing investor confidence.

Other factors that weigh down on investor confidence include the putting off of key reforms that can expand growth in Malaysia or things like the Bumiputera policies (privileges that only a certain ethnic group can have) may cause a brain drain, lowering Malaysia's growth prospect. The ringgit will be receptive to all this as it has weakened both after the announcement of resignation of Mahathir and after Anwar's claim of having majority support.

The rising Malaysia's debt level start to be concerning because of the populist approach taken by the government. Increased cash handouts in the next few years will lead to a diminishing fiscal space for future interventions and increase Malaysia's vulnerability to negative economic shocks.

Monetary Policy

Figure 5: Malaysia Interest Rates

Source: Trading Economics

Actual	Previous	Highest	Lowest	Dates	Unit	Frequency
1.75	1.75	3.50	1.75	2004 - 2020	percent	Daily

Globally, economies have started recovery led by manufacturing and exports. Economic activity has gained pace in more advanced and regional economies, with a more pronounced recovery from China. However, resurgences in some major economies have led to the reintroduction of partial lockdowns suggesting that the global economic recovery remains lacklustre in the short term. The overall outlook remains subject to downside risks of rising infections again which can result in weaker market conditions.

Malaysia's central bank, Bank Negara, kept the interest rate unchanged on Nov 2^{nd} at a record-low of 1.75%. It has been cut 125 basis points from earlier this year and they deem this appropriate and accommodative. The latest economic indicators suggest significant improvements in the economy in 3Q20. However, with the resurgence of Covid-19 after the internal elections in Sabah, and the introduction of targeted measures to contain the virus in some states may hurt the economy for 4Q20. Recovery will also be underpinned by the recovery of global demand, policy measures, and production output. Headline inflation is still negative by the end of 2020 due to lower global oil prices.

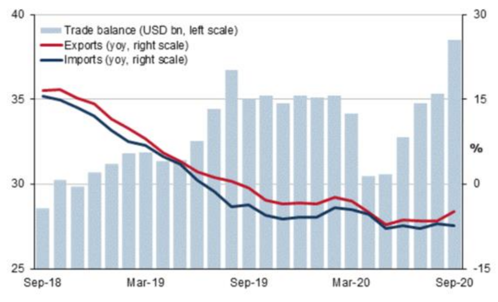
Despite having some downside risks in the 2021 outlook, the announcement of the vaccine being distributed to front liners and the vulnerable by 1Q21 has led us to believe the economic activity is expected to improve and will be underpinned by a recovery in global demand, a turnaround in public and private sector expenditure, supported by monetary and fiscal policies and increased production.

Conversely, Bank Negara remains neutral but is open to lowering interest rates on further downside risks in 2021; the rate cuts will be contingent on the whether there will be more waves of Covid-19 and the renewed restrictions and lockdowns. With the mutant virus on the rise and has spread to the APAC region, there seems to be rising uncertainty due to heightened infectiousness and the possibility that the vaccine may not be effective against it.

The pace of recovery will be uneven across sectors, with some industries remaining below pre-pandemic levels such as the construction industry which is estimated to contract at most 18.7% in 2020 and rebound by at most 13.9% in 2021. The mining and services industry which contracted at 7.8% in 2020, is projected to grow by 4.1% next year. Moreover, we also expect a slower improvement in the labour market due to continued weakness in trade activity. We believe that economic growth in 2021 will be supported by higher production from existing and new facilities, especially from the manufacturing, commodity and E&E sectors.

We trust that the interest rates are unlikely to drop in the near future as it means limited monetary space to be reserved for future economic shocks. Further reducing the interest rate may provoke uncertainty within the public especially after the upturn in 2H20 and recent worrisome rise in infections. Rates will continue to support economic recovery as the more positive outlook is backed by a revival in domestic and global economic activities. However, if there are more incoming waves or mutant viruses, higher geopolitical tensions and continued weak commodity prices may pose some downside risks.

Figure 6: Malaysia Trade Balance



Note: 12-month trade balance in USD billion and annual variation of the 12-month sum of exports and imports.
Source: Department of Statistics Malaysia (DSM) and FocusEconomics calculations.

Source: DSM and FocusEconomics

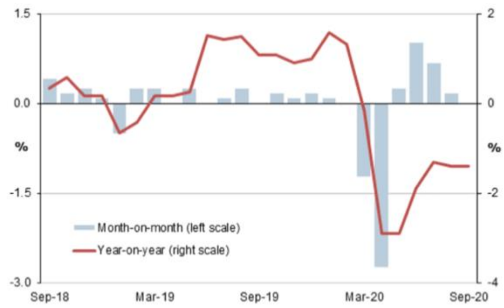
Increase in private consumption

Private consumption fell by 6% during 1H20 due to the implementation of the MCO. However, it has picked up by 2H20 due to stimulus packages such as the moratorium on loan payments, the temporary reduction in the required contribution to the Employees Provident Fund (EPF), discounts on electricity bills and lower interest rates.

Merchandise exports increased by 14.5% YoY in September, rebounding from the 2.9% drop in August. This was the highest since October 2018. Total exports have increased by 13.6%, far exceeding market expectations and overcoming a drop of 2.8% in August. This increase was mainly due to a larger demand for shipments of agricultural goods and manufactured products which highly reflects the higher exports of electronics. Meanwhile, merchandise imports have declined at a slower pace of 2.8% Y.o.Y resulting in trade balance improvement (USD5.3 billion surplus, compared to in September 2019, a surplus of USD2.1 billion).

The announcement of Budget 2021 being the largest budget ever, along with various stimulus packages and resumption of economic activities will hopefully restore some consumer and business confidence going into the new year. We anticipate private consumption to increase by 7% in 2021 from higher disposable incomes as the economy recovers. As Malaysia adapts to accelerated digitalization, the increased accessibility and availability of e-commerce platforms and 5G technology will advance economic activity.

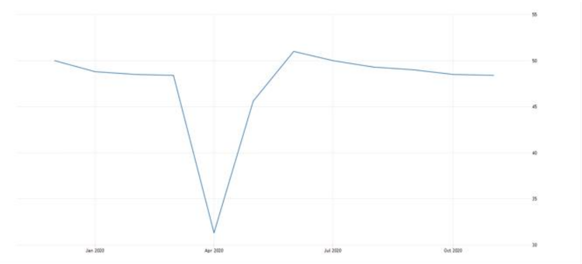
Figure 7: Consumer Price Variation



Note: Year-on-year and month-on-month variation of consumer price index in %.
Source: Department of Statistics Malaysia (DSM).

Source: FocusEconomics

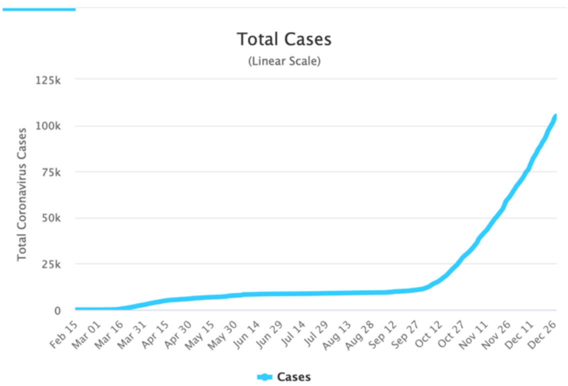
Figure 8: Malaysia PMI



Actual	Previous	Highest	Lowest	Dates	Unit	Frequency
48.40	48.50	52.00	31.30	2015 - 2020	points	Monthly

Source: FocusEconomics

Figure 9: Total Covid-19 cases in Malaysia



Source: IHS Markit

<u>**Consumer prices falling for the 9th month in a row**</u>

The Consumer Price Index (CPI) fell 1.7% YoY in November, falling for the ninth consecutive month and being the steepest since June. The decrease was attributed by prices declining in transport (-11.1% vs -10.2% in October), housing (-3.3% vs -3%), clothing and footwear (-0.5% vs -0.4%) and furnishings (0.1% to -0.1%) which totals up to 45.7% of the total weight.

The annual average variation of consumer prices dropped to -0.5% in September and rose slightly to 0.9% in November. This was due to stagnating prices for transport, communication, clothing and footwear.

This deflation is expected for the rest of 2020 as demand conditions will remain unchanged or drop due to the implementation of the conditional movement control order in 11 out of 14 states in Malaysia. It may start to pick up around February 2021 as the vaccine is rolled out to a part of the population in Malaysia.

<u>**Lower momentum in the manufacturing sector**</u>

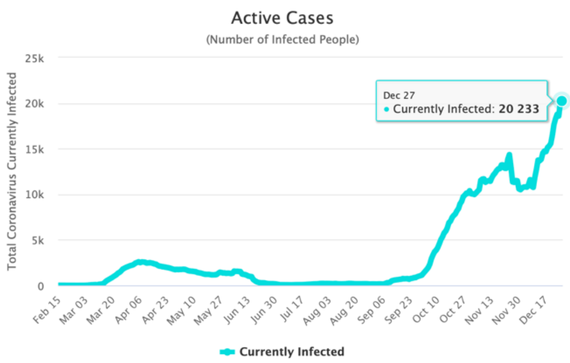
The recovery in the manufacturing sector has lost steam by 3Q20 and continued to do so by 4Q20. Businesses have scaled back production as new orders numbers moderated. The recent resurgence in Covid-19 cases both domestically and in other countries resulted in a decreased demand for Malaysia's manufactured goods and disrupted global supply chains as input delivery has consistently delayed.

The decline in November is the highest since May 2020, holding a PMI of 48.4. The index is now further below the 50 level that separates recovery from deteriorating conditions. This decline was due to little growth in the renewed CMCO and output as Covid-19 infections have been steadily rising and suppressed demand domestically and internationally. Input cost inflation rose in November with a raw materials shortage due to lockdowns in other countries delaying supply hence, pressuring firms to increase selling prices again. Manufacturers have reduced output for the second time since September.

Even though new order volumes moderated by October, the pace of deterioration was remarkably slower compared to April. This was due to the MCO being implemented from mid-March to June, as seen in the large dip in the PMI graph when all business operations were put to a halt. More and extended restrictions or SOPs will lead to a decline in new export orders, which decreased faster than business inflows. The rise in infections in key markets like India was also a contributor to Malaysia's export weakness.

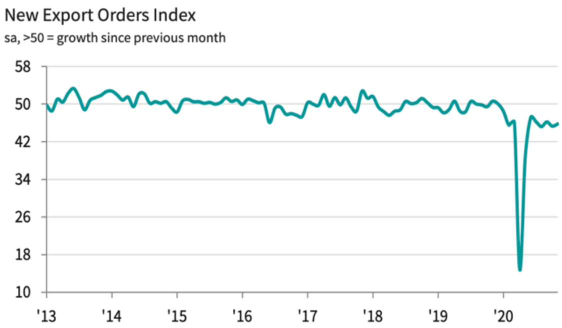
This decline from moderating growth in new orders and output have several implications. For instance, a fall in export sales attributes to lower order book situation so production was scaled back and employment fell. Confidence in the 12-month outlook also dipped as weaker new order inflows show that firms could deplete their stocks of purchases and finished

Figures 10: Total Active Covid-19 cases in



Source: IHS Markit

Figure 11: New Export Orders Index



Source: IHS Markit

goods. According to surveys conducted by IHS Markit PMI, backlogs of work have declined the slowest since June. This is due to firms cutting production in response to subdued demand and suggests that capacity pressure seems to be rising. The raw material shortages have also translated into higher production costs and input cost inflation which were passed down to consumers in the form of higher prices.

Nonetheless, the manufacturing sector is forecasted to rebound by 7% in 2021 driven by the improvement in exports and domestic-orientated industries. The E&E subsector will surge as digital transformation has become part of new business practices. Higher demand for integrated circuits, microchips within the global semiconductor market will further bolster growth. Furthermore, production for chemical and rubber products will increase as demand for disinfectants, sanitisers and glove increases.

Figure 12: SGDMYR Daily Chart

Trade Idea: Long SGDMYR

With the renewed CMCO coming from the third wave of the pandemic and decreased public confidence in the government shows negative sentiment, vs when we see the gradual, positive recovery in Singapore, we believe in that MYR will become weaker in relative to the SGD

Entry: 3.044
Take Profit 1: 3.070
Take Profit 2: 3.090
Stop Loss: 3.03
Risk Reward Ratio: 1:2

The entry should take place when the RSI is above 50 indicating an uptrend, the stochastic is above 20 which is just above the oversold level and where the K line is above the D line and the MACD is more than the 9 days EMA. Currently, all these indicators except for the stochastic point to an uptrend so we will choose to enter at a later date when it becomes close to the oversold region. We estimate this to be at the current resistance around 3.044. We take profit when the RSI is above 70 and the stochastic is in the overbought region. For now, we will set the take profit level at the previous high which is 3.07 and the second take profit level at 3.09. As for stop loss, we will set it at 3.027 at the previous resistance.

<u>Fundamental analysis:</u>

Overall negative sentiments over Malaysia due to resurgence of infections which is contrasted against positive sentiments for Singapore as daily infections have decreased significantly. Malaysia records a fiscal deficit of -6% of GDP with a 60% debt to GDP ratio, an all-time high since 2009 due to additional stimulus packages and lower GDP. Malaysia's growing budget deficit may distort its economic growth which can erode investor's confidence.

Low international reserves relative to SG: Foreign exchange reserves are necessary to withstand the risk of speculative capital flights and arbitrage transactions. Singapore's foreign exchange reserves remain high at USD349.7 bn(Nov 2020) whereas Malaysia's is only at USD100.3 bn (Nov 2020).

Crude oil price: Being a net exporter of petroleum, volatility in crude oil prices affects the ringgit. Crude oil exports account for 7% (2020) of Malaysia's total exports. Lower oil prices have a proportional relationship with the MYR. Oil prices are likely to fluctuate between high USD30s to low USD40s per barrel and have a subdued growth.

Crude palm oil price: Malaysia is the second-largest exporter of crude palm oil in the world with 39% of world palm oil production. It has an inverse relationship to the ringgit; higher palm oil prices lead to a weaker ringgit. The daily price for Crude Palm Oil (CPO) rallies at an 8 year high at RM 3420 per tonne due to concern that labour shortage will hamper output at the same time when dry weather leads to expectations of a fall in soybean crops in South America and the sentiment remains bullish on the expectation of lower stockpile in the country. Sabah is Malaysia's biggest palm producer and output is expected to be lower due to the renewed movement control orders and a labour shortage.

According to the Council of Palm Oil Producing Countries (CPOPC), palm oil prices are expected to continue rising in the first half of 2021 due to tight supply from a La Nina weather pattern. Persistent heavy rainfall in Southeast Asia will mean that supply will remain tight at least for the next 4 to 6 months. Palm oil prices will probably continue to stay high for 1H21 on low soybean crushing in Argentina and rising sunflower oil prices. The implementation of B20 (blending of 20% palm oil and 80% diesel) mandate in Malaysia and B30 mandate in Indonesia will sustain domestic consumption and take in some of the expected supply increase in palm oil. The supply deficit in vegeoils will also lead to CPO prices rising in 2021.

Global Macro Department –Singapore (UNDERWEIGHT)

Date: 27th December 2020

Analysts

Ho Yu Ki

Global Macro Analyst

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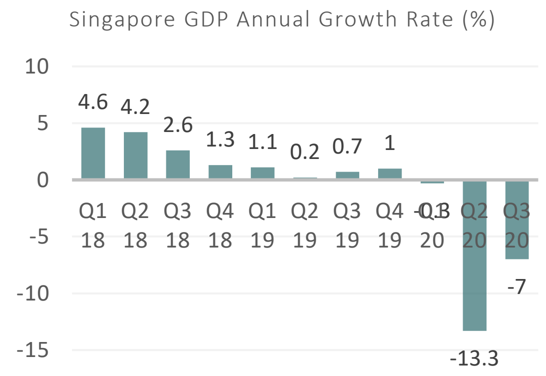
Basic Information

Real GDP(USD) in 2019	372 billion
M2(SGD)	696,016 million
CPI	101.1
PPI	88.788
Con. Confidence	101.8
Building Permits (1Q20)	1997
Straits Times Index	SGD2,842
USD/SGD	1.33

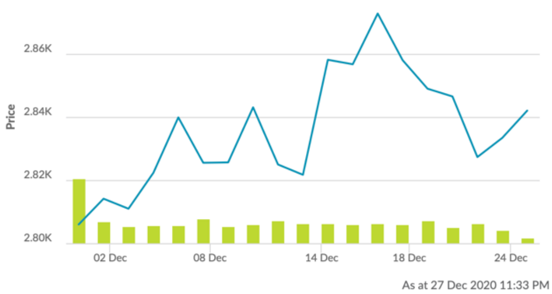
Chart info

Figure 1: Singapore GDP Annual Growth Rate



Source: Tradingeconomics

Figure 2: Straits Times Index



Source: SGX

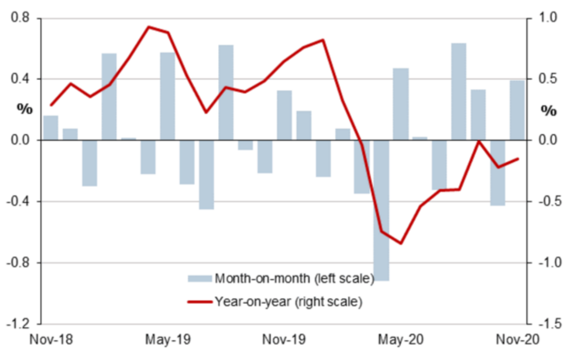
Overview

Singapore's GDP picked up by 3Q20 by 6.3% after the sharp contraction in Q2. However, it will most likely remain modest against a sluggish external environment, persistent weakness in travel-related industries and contact-intensive domestic services that are unlikely to recover to pre-pandemic levels even by the end of 2021. Nevertheless, from more positive sentiments of the pandemic and rollout of the vaccine in 2021, the economy is expected to expand next year and core inflation will remain low at 0 – 1% next year.

In 2020, the Singapore economy is forecasted to contract by 6-6.5%. The negative output gap will narrow as most sectors recuperate back into their pre-pandemic levels in 2021 with the exception of travel services. It is expected that the economy has expanded by 6.3% on a q.o.q basis in 3Q20 after a 13.2% decline in 2Q20. This reflected policy stimulus and an increase in domestic activity as circuit breaker lifted. The most devastatingly hit consumer services and construction sector rebounded, while the manufacturing sector scored positive growth due to the increasing global demand for semiconductors and expansion in petrochemicals output. Furthermore, many of Singapore's major trading partners in Asia have been recovering well by 3Q20 as their economies opening up. However, this will likely to plateau as there has been a resurgence in infections in some countries which resulted in renewed state lockdowns. There are also some downside risks to the progress of recovery from the pandemic, such as the extent of future fiscal support by the government and US-Sino tensions. On the other hand, the ICT and digital financial services have attracted investments and many headquarters of international brands are stationing in Singapore.

Moreover, regions like the US and Eurozone are experiencing a resurgence of infections and a new strain of Covid-19 has appeared in Europe, prompting new lockdowns in London. This mutated virus has now been confirmed in countries like Japan, Korea, Singapore, Hong Kong and Australia, sparking new fears and uncertainty. This will continue to pose a drag on consumer and business sentiments as well as the labour market. Singapore has tightened border controls and placing bans on people arriving from the UK. Weak external demand and ongoing travel restrictions will continue to weigh in on trade and tourism-related sectors. Although sectors such as retail and food have recovered with the economy going into Phase 2 and 3, sales volumes will likely remain on moderate levels due to dampened consumer sentiments and capacity constraints caused by safety measures. There is some positive outlook for the manufacturing sector lead by strong and stable demand for semiconductors of the 5G market, data and cloud services.

Figure 3: Singapore Inflation Chart



Note: Annual and monthly variation of consumer price index in %.

Source: Singstat

In 2Q20, employment registered a sharp decline on a q.o.q basis. The opening up of the economy in Q3 after the circuit breaker should absorb some of the underutilized labour and narrow the negative output gap. Prolonged weakness in the travel industry and labour-intensive production will impact other related industries and thus keep labour demand muted.

The weak external demand for an open economy like Singapore, the decline in tourism, shifts in consumption pattern and excess labour supply in some markets will also reflect a subdued inflation rate.

Figure 4: Estimated Macroeconomic support for real GDP

	2020			2021		
	Fiscal Policy	Monetary Policy	Total	Fiscal Policy	Monetary Policy	Total
Real GDP	+5.6	+1.1	+6.7	+4.8	+0.8	+5.6

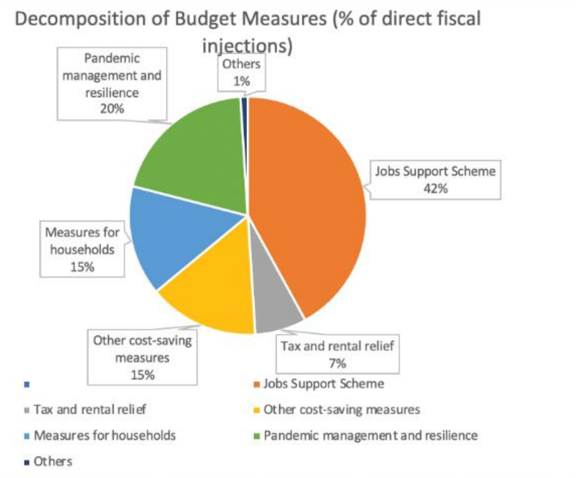
Source: EPG, MAS

Figure 5: Fiscal Outlay 2020 in billions

Name of budget	*Fiscal outlay (including loans and Guarantees)*	*Fiscal Outlay (excluding loans and Guarantees)*
Unity	*6.4*	*6.4*
Resilience	*48.4*	*28.4*
Solidarity	*5.1*	*5.1*
Fortitude	*33.0*	*31.0*
Ministerial Statements	*8.0*	*8.0*

Source: MAS

Figure 6: Decomposition of Budget Measures



Source: MAS

Fiscal Policy

Singapore has offered unprecedented fiscal support to counter the impact of the virus and supported hard-hit sectors like airlines, construction and tourism. Through 4 fiscal support measures (Unity, Resilience, Solidarity, Fortitude) amounted to about SGD100bn – nearly 20% of its GDP. They contain wage subsidies, tax rebates, and rent relief for companies and workers to sustain over a longer period.

Cash handouts to families, additional payment to lower-income families. Support to businesses like wage subsidies, covering rental costs, enhancement of financing schemes and additional aid for self-employed and most impacted industries (aviation, tourism, transpo1rtation). These budgets helped to provide immediate relief to households and firms that had a sharp decline in revenue and income flow and the aim was to prevent firm shutdowns, retrenchment and thus mitigating any damage to the Singapore's productive capacity.

Singapore succeeded in avoiding a breakdown of its supply chains and softening the blow, its definition essential services were broad hence allowing vital players in the manufacturing supply chain to continue operating during its circuit breaker. The Fortitude budget was also extended to sustain fragile recovery after the circuit breaker was lifted, providing extra wage and cost relief.

Towards mid-August to October, in 2 ministerial statements, the government started to allocate resources efficiently such that they scaled down support for industries doing better and channelled more assistance towards those that would not sustain anytime soon. This was apparent when the subsidy under the jobs scheme support (JSS) for biomedical sciences, financial and IT services dropped from 25% to 10% and payouts stopping by the end of the year whereas, in aviation and tourism, they will receive a 50% wage subsidy until March 2021. Moreover, further assistance to boost domestic tourism through SingapoRediscovers Vouchers which will hopefully create a multiplier to boost the economy.

Due to the shift in consumption habits like working from home, using more automated processes, accelerated digitalisation of the economy, there is an urgent need for the government to cushion the foreseen structural friction. The Fortitude Budget helps this by putting more emphasis on medium-term restructuring objectives like helping firms with high growth prospects to further expand and expand its workforce through schemes like the SGUnited Jobs and Skills package and the Jobs Growth Incentive. On December 16th, the Covid-19 Recovery Grant was implemented for low and middle-income workers. It provides support of up to SGD 700 per month for 3 months for those who are impacted by the pandemic while they look for new jobs. These relief measures will help cushion the impact of the pandemic and to an extent, deter longer-term unintended effects of a prolonged recession such as underemployment, weaker wages and career advancements for graduates.

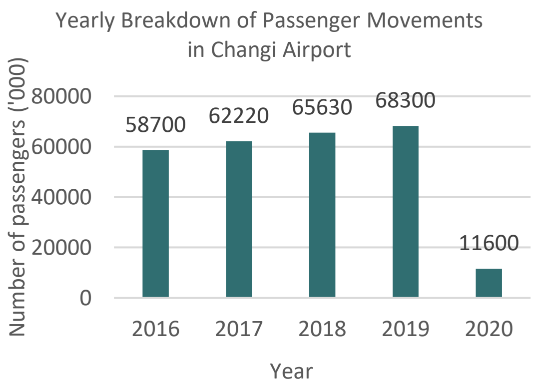
Figure 7: Travel and Tourism sectors as part of Singapore's GDP

Source: Singstat

Figure 8: Exports of Goods and Services

Source: Singstat

Figure 9: Yearly Breakdown of Passenger Movements in Changi Airport



Source: Singstat

Sluggish Growth Of The Travel Sector

Singapore's small and open economy is largely dependent on international trade and tourism and service sectors. Travel and tourism are major industries for Singapore, contributing to 10% of its GDP in 2019 while exports are worth 176% of its GDP. With the unexpected occurrence of the virus, it has severely affected its economy and its openness means Singapore is more exposed to longer-lasting effects of softer trade conditions. This will also drive a structural change because people will start to re-evaluate travelling and have heightened health consciousness hence avoiding crowds. These changes may lead to more remote working options, increased scrutiny over supply chains and increased replacement of business travel with technology use.

As of now, Singapore lags against the global recovery of air transport due to the absence of domestic flights. Despite reciprocal green lanes and travel bubbles are being implemented with several Asian countries and Oceania, the improvement of cross-border travel may be slow from the recurrent waves of infections and renewed lockdown measures in place in different countries at different times. SIA's passenger capacity is expected to only recover up to 15% of its pre-pandemic level by 2020 and less than 50% by March 2021.

Nonetheless, some parts of this sector will be bolstered by domestic tourism with the Singapore Tourism Board (STB) injecting a stimulus of SGD320 million in tourism vouchers in December for Singaporeans to go on a local holiday up until summer of 2021. In a way, this scheme would allow authorities to track how well tour companies and local attractions are doing with Singaporeans and reward them proportionately. It would also partially offset the foregone foreign spending and support the tourism sector that plunged more than 40% this year.

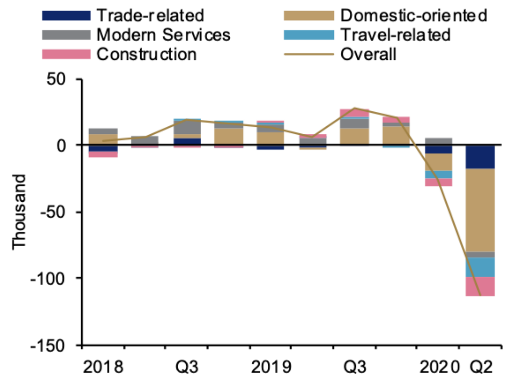
Dislocated Labour Market

Overall employment fell by 113,200 in 2Q20 Q.o.Q in which domestic orientated services accounted for 54% of that loss. Apart from electronics, insurance, IT, and other information services segments, all 25 sub-industries in the labour market recorded job losses.

In the first half of 2020, the loss in employment was 138,400 and foreign work pass holders accounted for 55% of the loss which is higher than their 38% share of the workforce. The sharp decline reflected the cessation of activity in contact-intensive, labour intensive sectors.

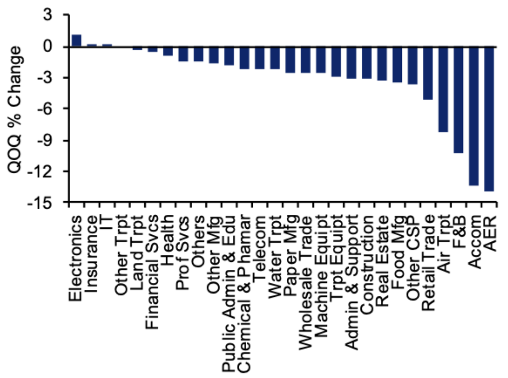
Despite the increased government wage support through the Jobs Support Scheme, the waiver of foreign worker levy and provision of rebates during circuit breaker, most firms that suffered a significant loss in revenue have chosen to lay off their workers, indicating that the marginal productivity of labour is below wage costs even after subsidies.

Figure 10: QoQ Employment Change



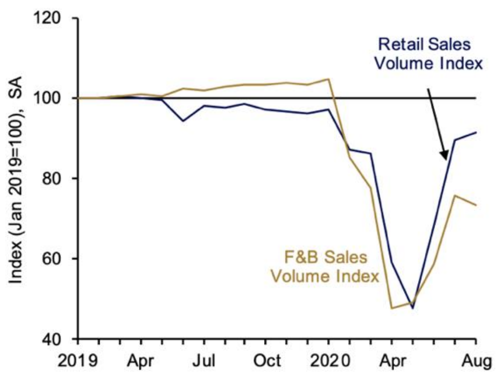
Source: MOM, EPG, MAS

Figure 11: Employment growth in 2Q20



Source: MOM

Figure 12: Retail and F&B Volume Indices



Source: DOS, MAS

<u>Some Spare Labour Capacity Should Be Absorbed Back As The Local Economy Resumes</u>

The low number of retrenchments relative to higher number of temporary reductions of workers suggest that firms are able to call staff and increase activity when operations resume in 3Q20 which will counter some of the labour market weakness.

There has been a sharp rise in consumption activities i.e. F&B, retail, support services. Construction activities, tourism-related sectors are gradually picking up pace in the second half of the year with the easing of safe distancing in October and November so we expect to see some recovery by the end of the year.

The extended credit and fiscal support should continue to support the revenue loss and retrenchment for businesses. The new SGD1 billion Jobs Growth Incentive should also help create new jobs for local workers by co-paying salaries of new hires in growth sectors like IT, biomedical sciences, financial services etc.

Unfortunately, recovery is still looking meek for the labour market. Just the travel sector alone represents 6% of the workforce, which will spill over to other sectors and dampening the entire labour market. Sectors that depend on tourism that are domestic orientated such as taxis are unlikely to pick up in the short term. Labour demand is also subdued due to shifts in consumption patterns. Working from home means less demand for workers in contact services and increased demand in home entertainment will not offset labour intensive services either.

Additionally, structural unemployment can worsen and keep the labour market slack elevated. As a result of the innovation of more automated processes (meaning less need of labour), we can see that this will impact demand for low to mid skill services that require a significant degree of in-person tasks. Even though this also means that new demand is created for modern services which are more prominent in the IT sectors, it will accelerate structural unemployment, slowing reallocation of the labour market.

Figure 13: USDSGD Daily Chart

Source: Tradingview

Trade Idea: Short USDSGD

Entry: 1.330

Take Profit: 1.318

Stop Loss: 1.336 (setting at resistance level)

Risk Reward Ratio: 1:2

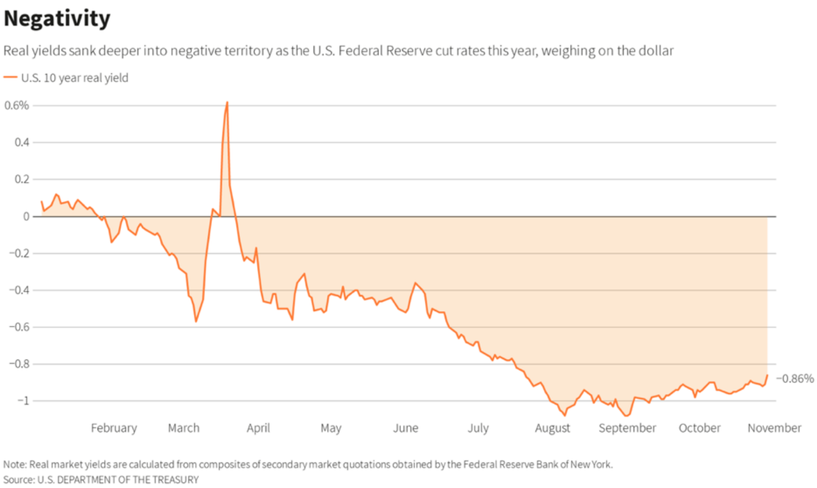
We can see that the market price is below the conversion line and the decreasing conversion line implying short term downward momentum. The baseline predicts for medium-term trends, looking back since October, prices have also been below the baseline underpinned by the decreasing baseline, hence indicating a downward trend. On the other hand, the lagging span shows the bigger picture of the trend; it has been consistently below the price levels since September, meaning the current prices were lower than previously and therefore suggesting a bearish bias. Moreover, the prices have been mainly staying below the Kumo cloud since August and the longer it stays below the cloud, the stronger the downward trend.

Baseline-conversion line crossover with the lagging span and Kumo cloud as a filter

The crossovers between both lines offer a trading opportunity similar to moving average crossovers. We can wait for a stronger strong sell signal when the baseline crosses below the conversion line while the prices and both lines are found under the cloud. This is further encouraged with the downward lagging span to confirm the downward momentum.

Moreover, we can use the RSI to confirm the current trend momentum, the RSI is below the 50% mark so it is going for the downtrend. For short positions, there was a strong downtrend when the price appears below the Kumo cloud and below the conversion and baselines in November. However, this momentum slows when the prices touched the conversion line in early December and is currently below both lines in late December. We should wait for a rebound upside towards the first resistance curve (conversion line) then add more volume on a test of the second resistance (baseline), all under the condition that the RSI stays below the 50% level.

Figure 14: U.S 10 Year Real Yields



Source: Reuters

Fundamental Analysis

The dollar will most likely remain weak post-election. First, the dollar has been weak for most of Trump's presidency due to tax cuts, bigger deficits, interest rate cuts from the Fed that has pushed the greenback lower. There has also been continued negative US real yields. For many years, the yield was attractive due to high interest rates. This yield advantage disappeared when real yields plunged negative in 2020 during the pandemic which diminished the dollar's attractiveness and fuelled rallies in stocks and gold. This negative expected return would make the dollar less attractive to investors.

With Biden winning the presidency, the dollar would not rebound too quickly. The Biden administration means stimulus for consumers and small businesses, especially if democrats gain control of the senate. He may also push for increases in spending on infrastructure and clean energy. This spending could offset government revenue and will weaken the dollar or keep it quite flat. If Biden intends to roll back on some of Trump's tax cuts it would reduce firm and consumer spending and further put downward pressure on the dollar.

If Jerome Powell remains for a second term as Fed Chairman after Feb 2022, we can expect rates to remain lower for longer, further pressing down on the dollar.

Furthermore, a weaker dollar is not entirely bad for American companies as it makes their goods more competitive for foreign markets and boosting the sales and profits for multinational corporations so perhaps it is not in America's best interests to see a stronger dollar.

Currently, the Republicans hold 50 seats in the Senate and the Democrats hold 48. The upcoming Georgia runoff elections will decide whether Republicans hold the majority or there will be an equal split senate. A divided Congress could keep the less market-friendly aspects of Biden's decisions (such as the reversing of Trump's tax cuts, deregulation etc) grounded. In a Biden administration we can expect more friendly, conventional strategies to foreign trade relative to Trump.

Another point to bring is that a senate majority will hold the deciding power to Biden's

Figure 15: USDSGD Chart compared to GMF ETF

Source: Tradingview

agenda. Assuming a blue sweep, additional fiscal stimulus (deficit-financed) up to 2 trillion will be used for more unemployment payments, aid to schools, healthcare, clean energy, and infrastructure. If there is split congress and White House, there will be policy logjams leaving unemployment still high and stimulus measures will be delayed or not set in place. Worst case scenario, referencing back to 2011 from a split congress brought America to the brink of default when the nation lost its AAA credit rating from S&P. If there is a 50:50 tie, then Vice president Kamala Harris will serve as a tie-breaker and this means it will be easier for Democrats to pass bills and legislations.

We expect the SGD to continue advancing against USD in 1Q21 as more capital flows into emerging markets. There seems to be an inverse relationship between the USDSGD pairing and the SPDR S&P Emerging Asia Pacific ETF (GMF). Investors began to invest more onto the latter when the US financial conditions and APAC 2021 conditions improved as shown when the GMF was at its highest. This is when the USDSGD rate was at its lowest since 2018. Some other factors that will keep the USGSGD low in 1Q21: better containment of Covid-19 in the APAC region as vaccines start to get distributed early next year and investors are looking for better yield in a zero interest rate environment away from the US-China trade war.

NUS INVESTMENT SOCIETY

Global Macro Department –Philippines (UNDERWEIGHT)

Date: 27th Dec 2020

Analysts

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Basic Information

Real GDP(US$)	376.80Bn
M2(US$)	264.90Bn
CPI	123.80
PPI	129.60
Con. Confidence	-54.50
Stock Index	PESi
Currency	PHP

Chart info

Overview of Philippines

The Philippines is one of the most dynamic economies in the East Asia Pacific region. With a strong consumer demand supported by a vibrant labour market and robust remittances, it is on track to becoming an upper-middle-income country. However, its growth is now projected to significantly decelerate due to the impact of the Covid-19 pandemic.

Despite a rebound in economic indicators from their April lows, the Philippines economy is expected to remain in recession for the rest of 2020. Double-digit unemployment and new infections kept consumers indoors, dampening consumption and capital formation. Easing of government spending, the main driver of its GDP in 2Q, to protect a widening fiscal deficit serves as a bearish driver to the economy. Overall, the Philippines GDP is expected to continue contracting with the peso likely to remain on an appreciation path as import demand and potential output continue to fade.

Taal volcano eruption

Eruption disturbed the agricultural activities and disrupted tourism activity during its peak season in January. Tourism in the Philippines contributes 10% of GDP resulting in H12020 being worse than expected for the Philippines.

Covid-19

The pandemic dampened capital spending and investments which was expected to drive growth in 2020. Investments are down by 18.3%. Both exports and imports were down by 24.9% and 26.2% respectively. With lockdown introduced early in March, people limit spending with 1Q2020 number standing at a mere 0.2% YoY.

Fiscal Stimulus

The Philippines also adopted fiscal stimulus worth 5.0% to 6.0% of GDP or about USD 23 billion. Thanks to prudent fiscal policy in the past, the debt to GDP ratio stands at 41.5%.

Limited downside risk for the peso

In January 2020 alone, FDI (Foreign Direct Investments) is up by 12.1% YoY, reaching USD 657 million, showing the staunch support for the economy. While the government stated that it adopts a floating approach for its currency management, it did quote a target of around 51. This limits the downside risk for foreign investors in the region, limiting the selloff impact.

Figure 1: Philippines Stock Exchange PESi Index

Source: Trading Economics

The Return of Optimism

The Philippines has seen a good 2H after the pandemic has wreaked havoc on the economy earlier this year. Market sentiment has improved recently after a much-delayed passage of the 2021 budget aimed at supporting an economic recovery. A surge in Philippines stocks was also observed after Philippine Stock Exchange (PSE) unveiled plans to amend its listing rules, aimed at underpinning small company's fund-raising efforts.

Earlier October, a dramatic political standoff between Philippines House Speaker Alan Peter Cayetano and his rival Lord Allan Velasco has almost pushed the passage of Philippines' much-awaited 2021 budget back to November. On 16th October, amid the speakership squabble, the General Appropriations Bill was finally approved with 267 affirmative votes and six negative votes. Markets have drawn relief from this timely passage of the 2021 budget.

<u>Relaxing of PSE listing rules</u>

The recently unveiled plan to revise listing rules with a focus on small companies whose growth has been thrown off course by the pandemic have also had positive impacts on Philippines stocks. Under the plan, PSE would waive the market capitalisation requirement for listings on its mainboard. For the secondary board, a requirement of positive EBITDA in two of the three fiscal years before filing would be dropped and the three-year operating history requirement would be cut to two. Companies that lack the requisite record but have demonstrated potential, particularly tech-based start-ups, could also go public through a sponsor.

The proposed rules would help revitalise the economy, after slipping into its first recession in three decades due to a lengthy lockdown. In addition, it helps to lift the PSE's profile and boost trading liquidity which has been weakened by the pandemic. The reform plan, against the backdrop of an easing in restrictions in capital Manila as infection rate showed signs of slowing, could set Philippine stocks to see their biggest gain since June. The better-than-expected U.S. jobs data and signs of progress on the $2 trillion stimulus deal talks in Washington have supported U.S. equities, which has made broader Asian stocks firmer.

There are, however, some concerns about the plan to relax listing rules. Many are worried that the new rules basically mean selling stocks to Philippine investors who may not have the money nor time to wait for 10 years. This increases the risk for all stakeholders — the company, the investors, and the PSE. Nevertheless, the climb in stocks and Philippine ten-year benchmark bond's yield signals the return of optimism.

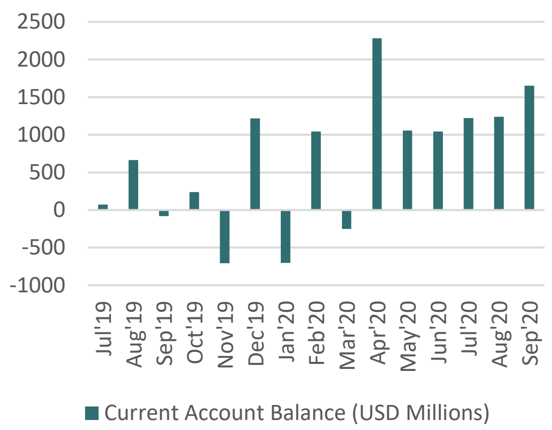
Figure 2: USDPHP

Source: Tradingview

Strong Peso in A Weak Economy

In 1H2020, PHP was propelled to the top of the Asia-Pacific currency leader board due to a widening current account surplus and a narrowing trade gap. It was able to sustain its bullish trend even into August as the pandemic continues to disrupt the global supply chain. In August, export went down 18.6% while imports fell 22.6% due to poor external demand and a weak domestic economy. The pullback in export data can be attributed to a significant drop-off in its mainstay semiconductor sector, while the substantial drop in imports is largely due to contraction of capital equipment, consumer goods and fuel.

Figure 3: Philippines Current Account Balance



Source: Trading Economics

Remittances in contraction

Overseas Filipinos were able to send much-needed funds back home post-lockdowns in their various countries, which has helped to boost remittances back into expansion for June and July. Large-scale repatriation of these overseas Filipinos has also brought lifetime savings to the Philippines. However, by August, remittances have slumped as Filipinos working overseas faced challenging labour markets and have less to send home. Remittance is likely to end the year with continues contractions as rising infections in Europe and the U.S. would mean that overseas labour market will remain gloomy. In addition, the stocks of Overseas Filipinos have fallen after the wide-scale repatriation. This signals that PHP may finally come under some pressure in 1H2021 as import is expected to bounce against the backdrop of a fragile remittances flow.

However, for the rest of 2020, even though remittances are unlikely to deliver the customary boost as Filipinos head into the holiday season, continued narrowing of the trade deficit and slump in imports could compensate. PHP may also benefit from an increase in risk appetite for Asian assets once the U.S. election is out of the way. Overall, the outlook for the PHP is still quite optimistic, and renewed portfolio flows may provide another wave of strength between now and year-end.

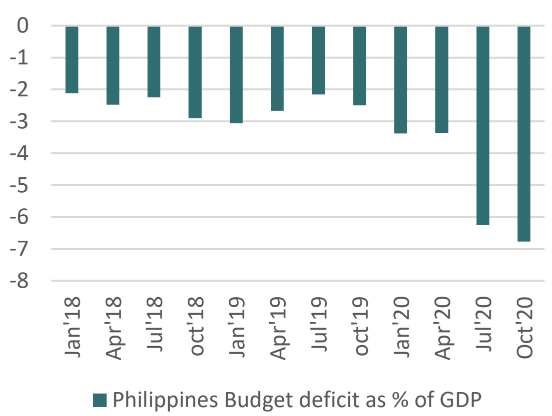
Not so jolly strength

The strong peso foreshadows bad economic outlook as it primary caused by a steep drop in imports that are needed by the Philippines to maintain its growth trajectory.

The economy's high growth rate in recent years rides on the back of a capital formation resurgence and both corporates and households doubled down on investing in the then bright economic future. The resurgence of imports with raw materials and capital machinery have boosted the economy. The falling import demands and consequently U.S. dollars has catapulted the peso to greater heights, but at the expense of the much-acclaimed investment boom in recent years.

A rebound of foreign money hinges on how quick the Philippines economy recovers from the pandemic. Unfortunately, the presence of two major roadblocks, consumption, and investment, means we may not expect a substantial rebound next year as the potential output takes a hit while the peso stands tall.

Figure 4: Philippines Budget deficit as % of GDP



Source: CEIC Data

Deficit VS Stimulus

In Q3 2020, Philippines' budget deficit fell as expenditures dropped. Lower fiscal spending might be a strategy to curb the budget deficit, but a continuous pullback could hinder the economic recovery.

In September, the Philippines posted a budget deficit of PHP138.5Bn, which is 22% smaller than the same period last year. Revenue collections had fallen by 10.2% as the economy slid into recession with customs collections down 14% and internal revenue down 19%. At the same time, after surging in the first half of the year in response to the pandemic, government spending dipped sharply by 15.5%, with authorities choosing to hold off fiscal stimulus to offset the negative fallout from the pandemic. The current deficit is roughly at -6.8% of GDP, which is still substantially away from the gloomy forecast of -9.6% by the finance ministry a few months ago. However, the danger is that the government is barely reaching revenue targets.

With upcoming tax reform measure 'Citira' expected to be "revenue-neutral", which means making and losing tax revenues in equal measure, the Philippines government has little option but to borrow and incur more debt, whether from foreigners or its own people. This borrowing should be of no concern if the country's GDP grows at a suitable rate, which sadly, is not. Philippines' GDP growth has been faltering - from 6.9% in 2016, it was down to 5.9% in 2019. The economy is still growing, but slower and slower

The lack of growth despite more borrowing could be attributed to infrastructure disbursements (part of the deficit explosion last quarter). But the government's flagship infra project called Build, Build, Build is proceeding at a glacial pace. In fact, Duterte's economic managers have had to revise the master list of flagship projects once they realized many projects turned out to be unfeasible. All these means a growing deficit could potentially be devastating for the economy.

With government spending and net exports accounts act as the driving forces of the Philippines GDP in 1H 2020, the expenditure cut could risk destabilising a quick economic recovery. Also, Government officials have repeatedly turned down calls for additional fiscal packages in 2021 and it appears that the economy will not be able to count on government spending to help offset the slowing growth momentum in the coming year.

Slower economic activity will likely mean revenue collection stays sluggish but have generally outpaced projections and targets. After the spate of typhoons to hit the Philippines in November this year, legislators have pushed for a third tranche of fiscal stimulus to offset the negative effects of Covid-19 and damage caused by the storms. Two proposals have surfaced, ranging from PHP400bn to roughly PHP247bn which would help provide a decent jolt to an economy that has flatlined into recession. With government spending likely negative in the last three months of 2020, 4Q GDP will likely post a more severe downturn from the -11.5% 3Q GDP reading. The economy lacks any sort of momentum, with all sectors side-lined by the pandemic and storm damage.

Overall, while dipping expenditures may be a strategy to limit the budget deficit, a sustained cut back in expenditures does not bode well for its GDP outlook in 2021.

Figure 5: USDPHP Daily Chart

Source: Tradingview

Trade Idea: Short USDPHP

Continued narrowing of the trade deficit and slump in imports together with a domestic demand that have yet to reach full recovery will likely to continue supporting the strong PHP. The global growth rebound in the coming year will also boost demand for Filipino workers abroad, with a 4 percent advancement predicted by the central bank after the drop in 2020.

PHP may also benefit from an increase in the risk appetite for Asian assets. PHP bonds, Asia's top performer this year, are expected to remain supported by the central bank's accommodative policy. BSP has said it stands ready to use a full range of tools to boost growth, which bodes well for the PHP.

This, against the backdrop of a weakening USD, which may continue to weaken considering a Fed Fund rate that is expected to remain stable at 0.25 percent for the next couple of months, means further support for PHP. The US Federal Reserve's latest modest average inflation targeting framework will likely keep rates low into 2023. A steeper US yield curve when the US recovery gains traction may, however, bring some volatility.

Technical analysis suggests an entry point at 47.87 where it breaks the support line. Take profit at 45.93 before it reaches the historical support and stop-loss at 48.79 to give a risk-reward ratio of 2.11.

Entry: 47.87

Take Profit: 45.93

Stop Loss: 48.04

Risk Reward Ratio: 2.11

NUS INVESTMENT SOCIETY

Global Macro Department – Indonesia (OVERWEIGHT)

Date: 27th December 2020

Analysts
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Basic Information

Real GDP(US$)	1,120Bn
M2(US$)	461Bn
CPI	104.92
PPI	103.36
Con. Confidence	83.4
Stock Index	JCI
Currency	IDR

Chart info

Overview of Economy

As the biggest economy in Southeast Asia, Indonesia has maintained consistent economic growth prior to the Covid-19 pandemic, which could have qualified the country to reach the upper-middle-income status. However, the pandemic brought unprecedented complications to its economy. In an attempt to revive the economy, the government has carried out quantitative measures through debt monetisation, for the first time in Indonesia's history. The initial success of the move has galvanised the government to pass several new laws including the reform of Bank Indonesia and the Omnibus Law, both aiming to boost the economy. The new law is expected to draw in higher foreign investments and create jobs in Indonesia. While there are some controversies surrounding the new laws, they have good potential to transform Indonesia's economy for the better in the long run. This, against the backdrop of a fall in coronavirus infection rates, could mean a stable road to recovery for Indonesia – albeit a slow one.

Macroeconomic trends have been dominated by the pandemic for the past 6 months.

The outbreak has resulted in a negative net export. It disrupted trade flows worldwide, resulting in slumping commodity prices and demand. Palm oil and coal, two of Indonesia's largest commodity exports, have come under pressure too. With overall uncertainty and poor labour market worldwide, many are cutting spending, resulting in slumping imports.

Weakness in Rupiah amidst Sell-Off

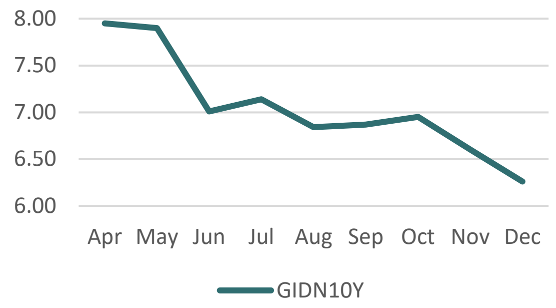
The outbreak has also triggered a sell-off similar to 2018 as investors fled risky emerging markets assets. Once it became clear that the outbreak would have a long-lasting impact, the sell-off was merciless as IDR was one of the biggest losers with a fall in the value of 20% against USD at its peak despite Bank of Indonesia's (BI) continuous market intervention.

Government Policies Amidst the Pandemic

Key measures include slashing the primary benchmark rate, lowering USD reserve ratio and lowering IDR reserve ratio for banks dealing with export-import clients. Indonesia had limited options for further accommodative macroeconomic stance due to IDR's weak position.

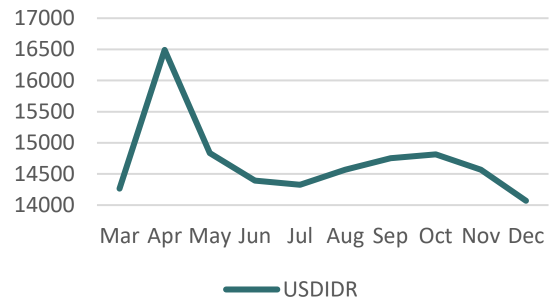
The government relied more on fiscal policies to bolster the economy to help with healthcare costs and financial aid to the vulnerable households and businesses. Aggressive fiscal policy has elevated the debt burden which is worsened by IDR weakness.

Figure 1: Indonesia 10 Year Government Bond Yield



Source: Tradingview

Figure 2: USDIDR exchange rate



Source: Trading Economics

A step back for Bank Indonesia

Bank Indonesia (BI) has won its independence after the Asian financial crisis with the 1999 central bank law. However, it could be losing the hard-won independence as the parliament attempts to cushion the pandemic hit through a reform that expands BI's mandates from currency stability to include job creation and economic growth. The proposed reform, which includes bills such as allowing cabinet ministers to vote at BI's monthly monetary meetings to set interest rates, could severely hinder BI's autonomy, if it goes through.

Indonesia's Quantitative Easing Experiments

This move has come on the back of the "quantitative easing (QE) experiments" that Indonesia has been conducting since June this year. The financial turmoil caused by the pandemic has, for the first time, led to the BI buying government bonds and other assets to help fund economic relief programmes. Due to a large foreign holding of rupiah-dominated government bonds (40% pre-pandemic), the Indonesia economy is very vulnerable to capital outflows and currency depreciation during the crisis, but QE efforts could help to stem the outflow.

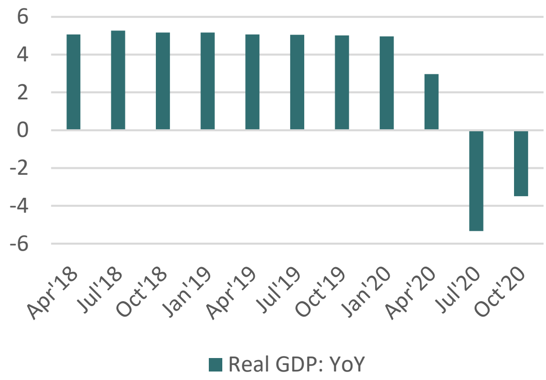
The QE has had some success. Foreign capital inflows totalled IDR 7tn in the first week of June 2020, after suffering IDR 125tn (USD 8.83bn) of capital outflows in the first quarter when the pandemic struck. Emboldened by the success, the parliament has moved forward to propose the reform to place greater political control over BI to help the government generate job and support economic growth. The central bank would be allowed to buy government bonds in the primary market as well as zero-coupon bonds, but it raises the risk of printing money to finance government deficits.

Reform in a very different global context

The reform looks awfully lot like a throwback to the era of former dictator President Suharto, whose government exercised direct control over BI until its economy collapsed in 1998. Many are concerned that this was another attempt by parliament to undermine credible and autonomous institutions. The parliament could have been emboldened by its successful weakening of Indonesia's previously much-lauded anti-corruption commission with the passage of an anti-corruption law last year.

If the majority of the proposed bills do go through, there is likely going to be a fall in investor confidence, which could trigger volatility against the backdrop of a weakening rupiah (against the US dollar) after performing strongly earlier this year. Foreign holdings of rupiah-denominated bonds, which have dropped from about 40 percent pre-pandemic to 27 per cent, are not spared too. This could potentially drive government bond yields higher. But while the suggested reforms seem like a step backwards for BI since the passing of the central bank law in 1999, it is worth noting that they come in a "very different global context" today. Central banks around the globe are generally being asked to do a lot more.

Figure 3: Indonesia GDP Annual Growth Rate



Source: Trading Economics

The Ominous Omnibus

Indonesia's attempt to boost foreign investments did not stop at QE, the government have passed a new law on 5th October 2020 that will revamp a dozen tax and labour market laws in order to counter the economic impact of the pandemic.

The new Omnibus law will see Indonesia's corporate income tax gradually reduced from 22% to 20% by 2022 and domestic dividend will no longer be taxable. More importantly, the new law is expected to draw in foreign investments, particularly the labour-intensive part to create more jobs for the economy.

<u>Killing two birds with one stone</u>

Indonesia's president, Joko Widodo, has made the new law a priority, and for good reasons. He sees the bill as part of his "legacy" to stimulate Indonesia's labour-intensive industries and at the same time, revive an economy that has been severely impacted by the Convid-19 pandemic.

With rich natural resources and a young population, Indonesia should have been one of the top foreign direct investment destinations. However, that has not been the case due to its expensive labour and rigid labour law keeping competitiveness low. The 2003 Labor Law, for example, mandates employers to give severance compensation and service benefits amounting to up to 17 months of salaries, depending on the years of employment. Even employees who are detained as criminal suspects are entitled to allowances for their families, ranging from 25 to 50 percent of the monthly salary for up to six months.

Foreign manufacturers of garments and textiles usually pick other low-cost Southeast Asia countries like Vietnam over Indonesia. Omnibus law could help change regulations and make Indonesia's labour force competitive and attritive to foreign investors. More importantly, reformed regulations could facilitate Indonesia in capitalising on the supply chain reshuffle amid the Sino-US trade tensions.

The reform also gives Indonesia a push on its road back to recovery. The fallout from the Covid-19 pandemic has pushed the economy into a technical recession with two consecutive quarters of contraction. Economic growth fell 5.32% year on year in the second quarter, making it the largest contraction since the Asian Financial Crisis. The new, less stiff labour laws seek to attract foreign investments and help revive the economy.

For a long time, one of the primary obstacles to foreign investments in Indonesia is the Negative Investment List. The list restricts the percentage of foreign ownership within each industry sectors.

The Negative Investment List, which restricts the percentage of foreign ownership within each industry sector, is regarded as one of the primary obstacles to foreign investment in Indonesia. The roll-out of Omnibus Law, however, helps to liberalise all businesses sectors except those that are reserved for the Indonesian government (e.g. weapons manufacture) or prohibited entirely (i.e. production of narcotics; gambling activities); and promises fiscal and non-fiscal incentives for prioritised business sectors.

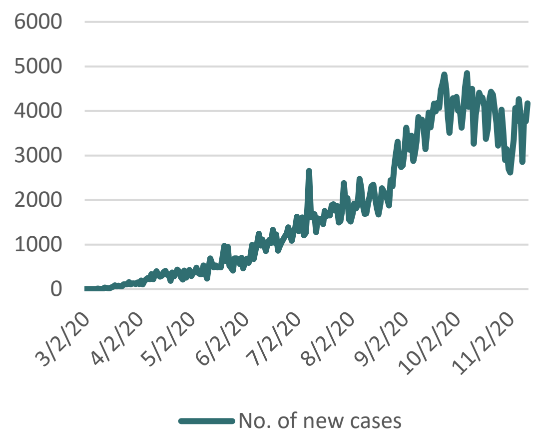
In addition, the law streamlines Indonesia's notoriously convoluted business licensing regime into four risk categories and relaxes licensing requirements for businesses in all but the highest category of risk. These reforms could very well be the push that the bruised Indonesia economy needed.

The Ominous Law

The law, however, has sparked staunch oppositions. Some governors have asked for the law to be revoked while some people have taken to the streets and protested for over three days after the law was passed. This is not surprising given that the law will roll back legal support for excessive overtime, safe working environment as well as fair wages. Severance packages for laid-off workers, which used to be one of the most generous in the world, will also slip and the whole process of the bill's preparation was relatively opaque. Most importantly, the law effectively eliminates the power of labour unions.

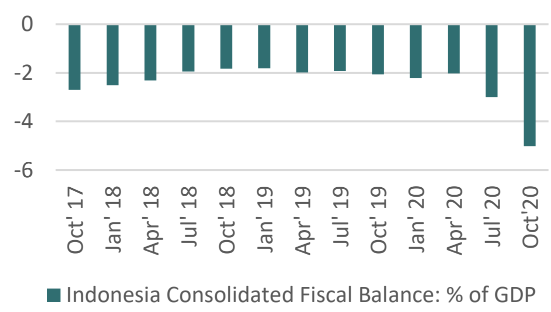
Deregulation of environmental protection (Part of the law) could have severe environmental and labour-related repercussions that bring significant uncertainty. This could greatly impact the attractiveness of the Indonesian markets in general.

Figure 4: No. of New Covid-19 Cases Per Day



Source: Humanitarian Data Exchange

Figure 5: Indonesia Consolidated Fiscal Balance: % of GDP



Source: Indonesian Finance Ministry

The long-awaited plateau

Indonesia has been battling upticks in coronavirus infections even as regional peers appear to have gotten the first wave of infections under control since June. Finally, on 12th October 2020, Jakarta kicked off a two-week "transitional" period of easing the pandemic curbs after the infections seem to have plateaued.

<u>Backed up against the wall</u>

Indonesia had previously re-imposed tougher restrictions measures in mid-September after a spurt in virus infections put stress on its health services. The toughened measures had taken a toll on the economy. It suspended its long-time sentiment anchor of capping the fiscal deficit at 3% of GDP to meet the target of 5.07% of GDP. Furthermore, its backs were against the wall when it comes to stimulus measures. BI has cut policy rate down to 4.0% and was reluctant to trim it further in order to preserve yield differential to help secure foreign fund inflows that will help to finance the increase in the budget deficit. Continuous trimming of the rates would also come with an increased risk in terms of fund flows and exchange rate stability.

A kind inflation trajectory that kept real rates in strong positive terrain this year might provide some room for lower rates, but BI might opt to retain ammunition to defend against downside risks to growth as well as maintain rupiah stability. IDR has once again become the regional underperformer on a year-to-date basis, despite seeing a 1% gain vs the US dollar this month. Rates are likely near the bottom, with only a higher-than-expected growth shock likely to invite authorities' action. Non-rate measures will be the preferred route to support the domestic financial markets.

<u>Baton of policy support passes from monetary to fiscal policy</u>

Indonesia faces tough policy choices amid downside risks that the 2020 YTD fiscal run-rate until July had been slower than recent years. There was some catch-up in August, as total expenditure jumped 86% year-on-year, nearly doubling from July. This increase was concentrated in personnel spending, social assistance, regional transfers/ village funds alongside subsidy payouts. Capital expenditure was scaled back for a second successive month, likely due to reallocations to make way for the support packages to defend against the health crisis.

Stimulus disbursements worth IDR 695trn national economic recovery (PEN) edged to 44% by late-September, with 74% of allocations towards the social safety net completed. This pick-up is encouraging after capacity constraints and beneficiary identification slowed the rollout in the first few months of the year.

<u>Beginning of the easing</u>

Finally, in October 2020, the government started to ease the curbs after a fall in the number of new positive virus testing and a fall in intensive care units occupancy from 83% in September to 67% in October. The plateauing infections are likely going to boost consumer confidence and domestic demand, allowing fiscal mitigation measures to work at its full capacity.

However, any new spurt in economic momentum can only come with a big caveat of unbearable potential pullback again. Hence, while the government has offered some sensible words on how the pace of economic reopening will depend on data, they should view the recent move to allow more sectors to operate once more like a double-edged sword.

Figure 6: USDIDR Daily Chart

Source: Tradingview

Source: Tradingview

Trade Idea: Short USDIDR

The USD60bn repo facility that BI reached with the Fed in early April has fuelled the IDR's 22% appreciation to 13870 in 2Q. Since then, USDIDR has settled into a stable 14000-15000 that most likely will extend to the next couple of months in accordance with past consolidation during the early recovery phase from a global recession.

BI will hold its benchmark interest rate in Q4 at 4% until the end of next year as it focuses on maintaining a stable currency amid the COVID-19 induced uncertainty. This, together with the government's latest effort in job creation through the Omnibus law and a new mandate for BI, could lead to the strengthening of the Indonesia Rupiah.

U.S. Dollars may continue to weaken considering a Fed Fund rate that is expected to remain stable at 0.25 for the next couple of months. The US Federal Reserve's latest modest average inflation targeting framework will likely keep rates low into 2023. A steeper US yield curve when the US recovery gains traction may, however, bring some volatility.

The conducive US environment will likely keep foreign investors' faith in IDR-denominated government bonds which boast the highest yields in Asia. Like equities, these bonds are an important source of support for the IDR as evidenced by the sell-off during the coronavirus outbreak in March and the brief jolt to confidence in 3Q20 from debt monetization and fiscal slippage concerns.

Apart from the fundamentals discussed above which point to bearish USD and bullish IDR, technical analysis suggests a take entry at 14288.5017 where it is likely to break out of a bearish triangle.

Take profit using the Fibonacci extension at 0.618 level and Stop loss using the Fibonacci Retracement at 0.236 level shown in the graph.

Entry: 14288.5017

Take Profit: 13230.7317

Stop Loss: 14593.2830

Risk Reward Ratio: 3.47

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