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**India: Modi's first year – the economy poised to accelerate**

- Cyclical picture is good: strong GDP forecasts, easing inflation, a narrowing current account deficit and rigorous fiscal consolidation make India the IMF's 'bright spot' in Asia.
- Going forward, growth remains sensitive to policy failure. The success of Modi's reforms lies in his ability to implement and pursue them at an equally swift pace and overcome roadblocks a galvanised opposition will hurl.

**Taiwan: Improving relations with China, economy robust despite headwinds**

- KMT chief Eric Chu met Chinese President Xi Jinping last week in the first such high-level meeting in six years. Despite the ruling party's efforts to maintain the momentum of improving relations, the aversion of the Taiwanese electorate to excessively cosy ties with China has grown. The KMT is set to lose the presidency to the opposition DPP's Tsai Ing-wen. However, the DPP has adopted a more pragmatic approach to China.
- The economy has held up well despite weakness in both US and China, registering growth of 3.5% y/y in 2015. Taiwan is expected to outperform its peer in 2015 on the back of robust electronics demand and robust domestic consumption.
- Re-shoring of industrial activity back to Taiwan from China is gaining traction on the back of rising labour costs in China.

**UK elections: the longer term global implications could be unsettling**

- The Conservatives' victory masked a rising tide of English and Scottish nationalism which raises the risk of Scotland leaving the UK and of the UK leaving the European Union.
- The UK is a much diminished world power now, raising questions over its continued heavyweight position in global leadership institutions. Asian nations led by China are sure to demand a new order in which Europe and the UK will lose out.

**Malaysia: political troubles for PM Najib raise risks to TPP**

- Prime Minister Najib's position has weakened further following more allegations which his determined opponents have hurled at him. In these circumstances, it looks increasingly difficult for Najib to overcome domestic opposition to the Trans-Pacific Partnership.

## Key Drivers of Asian Economies

| Variable | Development/Assessment |
|---|---|
| **Global economy a positive for Asia but watch Greek risks** | |
| **US – jobs growth recovered** | Falling unemployment points to Fed normalization sooner than later<br>▪ Non-farm payrolls rose 223,000 in April, following a weak 85,000 in March. The labour force participation rate edged up as well. The unemployment rate fell to 5.4% from 5.5% in March. However, wage growth remained anaemic: average hourly earnings barely rose, up 0.1% in April. |

| Variable | Development/Assessment |
|---|---|
| | ▪ Implications: The jobs report was not strong enough to force an immediate recalibration of market expectations for Fed normalisation. However, the lead indicators – ECRI Weekly Lead Indicator, loosening lending standards pointing to accelerating credit growth, strong PMI services – all suggest an upside to the economy and therefore a growing likelihood of such a recalibration in the coming weeks. |
| **Global economy – Services PMI** | <u>Global services activity bodes well for Asia</u><br>▪ The Global Services PMI stood at a strong 54.9 in Apr 15, down slightly from 55.2 in Mar 15. Services in the US and Eurozone stood at 57.8 and 54.1 respectively. Since services contribute about 80% of their economy, this continued strength is positive for global demand overall.<br>▪ Services PMIs in China and India signalled continued expansion. Japan's services expanded for the first time since Jan 15, with the PMI at 51.3 in Apr 15. |
| **Greece: risk of default?** | <u>Greeks up the ante by reversing reforms demanded by the EU</u><br>▪ The Greek government will rehire thousands of state employees who had been retrenched as part of reforms to Greece's woefully inefficient public sector, effectively rescinding measures that were pre-conditions for EU bailouts. A new system of electronic procurements and public payments to improve transparency as demanded by international lenders were also amended. The Greek government had already offended its creditors last week when it passed a law to reopen the state broadcaster, which had been shut down by the previous pro-EU government as a cost-cutting measure.<br>▪ Implications: The Greek government may well have decided to risk a full-blown crisis rather than bow to its creditors' demands and lose all credibility with voters, hoping that their EU partners will cave in. They may well be under-estimating the patience of Greece's creditors. |
| **Asian political landscape** | |
| **North Asian risks rise** | <u>North Korea new missile raises capacity to threaten US</u><br>▪ North Korean media claimed that the country has successfully tested a submarine-launched missile. This would add considerably to its capacity to threaten the US as well as South Korea and Japan. Even China, North Korea's increasingly unwilling ally will be concerned. |
| **Economic policies in Asia** | |
| **India – Modi's reforms accumulate** | <u>Game changing bills passed into law</u><br>▪ Approval of the 100th constitutional amendment seals the resolution of India's 41-year-old boundary dispute with Bangladesh, boosting ties with neighbours. |

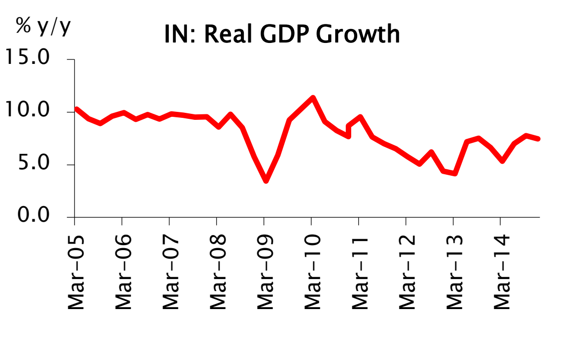
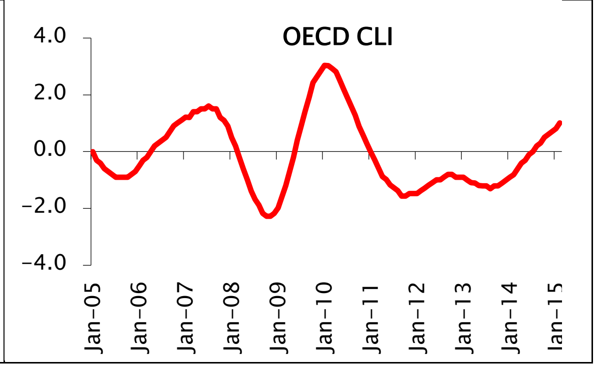
| Variable | Development/Assessment |
|---|---|
| | ▪ Another important legislative landmark was the passing of the GST bill in the Lower House of Parliament, which makes implementation of GST by April 2016 more likely.<br>▪ GST will be a game changer, replacing a vast number of state and central taxes with a single tax, which in effect finally creates a single Indian market 68 years after independence. This will help India achieve scale economies and strengthen supply chains. The overall gains look to bolster India's GDP growth rate by 1.5%. (See below for analysis of Modi's first year in office.) |
| **China – monetary easing** | China's policy makers are worried about growth<br>▪ China's central bank cut its policy rate by 25 basis points (bps) to 5.1%, the third cut in six months. The one-year benchmark deposit rate was also cut by 25 bps to 2.25%, while the deposit-rate ceiling would be widened to 150% of the benchmark from the current 130%. The People's Bank of China explained the move as a response to an economy "still facing relatively big downward pressure".<br>Implications<br>▪ Interest rates do not have a powerful effect on aggregate demand in China. Nevertheless, the rate cuts are important in giving breathing space to highly indebted corporates and local governments. Thus, the main impact of these cuts will be on financial stability rather than growth.<br>▪ With growth trending below policy makers' objectives, more stimulus will be needed such as expanded fiscal spending. |
| **Singapore-Malaysia ties at their best level ever** | High speed train a game changer but details unresolved<br>▪ The annual Singapore-Malaysia leader's summit resulted in both countries agreeing to strengthen economic and security cooperation. The Singapore-Kuala Lumpur high speed rail project was confirmed, which will in effect make the two cities twin cities and release huge synergies benefiting both countries.<br>▪ However, key questions such as the funding model remain unanswered. This makes the project and improvement in bilateral ties very dependent on Malaysian Prime Minister Najib's political position (see below). |
| **Indonesia – Weak economic growth** | President pressed to assert policy leadership as growth weakens<br>▪ Indonesia's economy grew by 4.7% y/y in 2015, its lowest rate since 2009, during the Global Financial Crisis.<br>▪ The sluggish performance has crystallised a growing sense of unease with the direction of economic policy, leading some to call for President Jokowi to replace ministers involved in the economic sector, namely Finance Minister Bambang Brodjonegoro, State-Owned Enterprises Minister Rini Soermarno and Industry Minister |

| Variable | Development/Assessment |
|---|---|
| | Saleh Husin. |

## India: Modi's one year in power – the Indian economy at a glance

As the BJP government of Prime Minister Narendra Modi approaches its first anniversary, we study how the economy has fared under Modi's leadership.

- **Economic growth accelerating towards 8%**: The economy is looking up but the strengthening depends partly on the confidence generated by reforms, making the recovery sensitive to policy failure. Real GDP growth in 4Q14 was 7.45% y/y and is expected to expand by 7.5% this current fiscal year. Institutions like the IMF and World Bank expect this growth to strengthen above 8% by FY2018 starting April 2017. The OECD CLI for India is also trending upwards, reflecting a pick up across several sectors.

| Chart 1 | Chart 2 |
|---|---|
| Growth continues to strengthen... | ...picking up across all sectors |
|  |  |





Source: Calculated by Centennial Asia Advisors using CEIC Database

- **Inflation is decelerating**: CPI inflation has eased significantly, down to 5.17% as of Mar 15 from a high of around 8% in 2014. However, structural issues such as a monsoon-dependent agriculture and relatively low productivity levels remain a risk to inflation. But, Reserve Bank of India Governor Rajan's efforts to bring inflation down to a targeted 4% is supported by Modi and will support structurally higher economic growth over the long-term. Reining in inflation would allow for a stable environment and reduced risks, translating into a lower cost of capital over time, which will boost investment and growth.
- **External resilience has improved**: The current account deficit (CAD) narrowed sharply to 1.6% of GDP in 4Q14 from 2% of GDP in 3Q14, helped by slowing domestic demand and cooling commodity prices. We expect the CAD to narrow to about 0.9% of GDP this year before widening again as domestic demand strengthens. However, lower oil prices and a positive terms of trade for India should help contain the deficit.
- **Fiscal discipline has improved**: Divestments of shares in state-owned companies and better targeted subsidy schemes for food and fuel are helping Modi's government to achieve the 4.1% fiscal deficit target set by the previous government. With more tax reforms and

expenditure management measures on the horizon, further improvements to the fiscal position should help contain excess demand pressures, so contributing to the improvement in inflation and the CAD discussed above. Measures are moving in the right direction to increase public spending to enhance much needed infrastructure in India.

**Chart 3**

**Reduced pressure on inflation…**

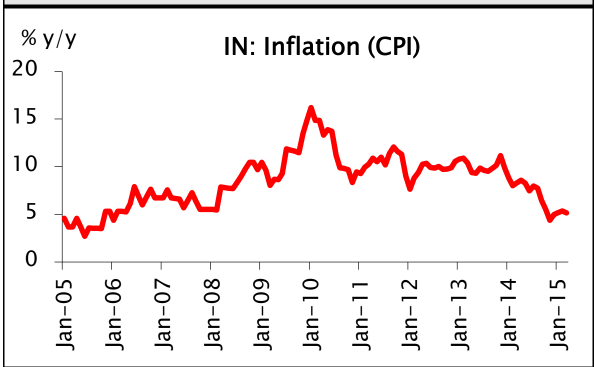
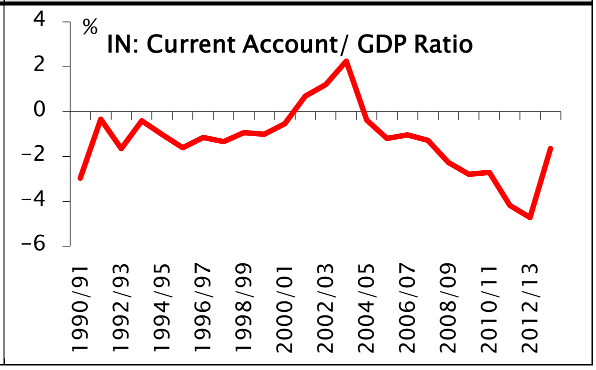



**Chart 4**

**…policies are narrowing deficit**




Source: Calculated by Centennial Asia Advisors using CEIC Database

**Chart 5**

**Sluggish activity seen…**

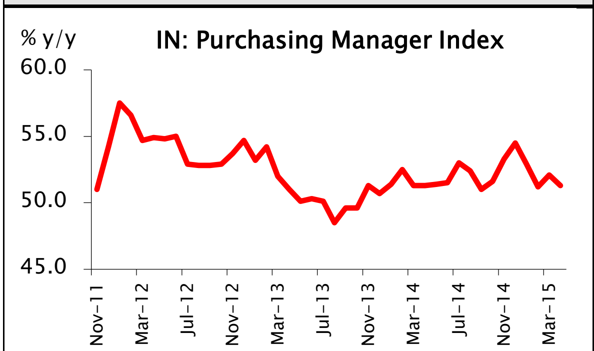
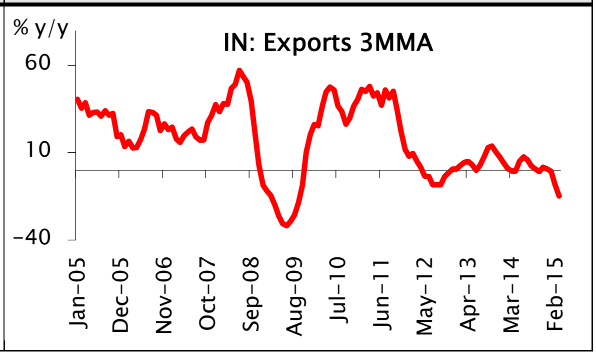



**Chart 6**

**…with exports also sliding**




Source: Calculated by Centennial Asia Advisors using CEIC Database

**However, current conditions remain surprisingly weak**

- **Activity indicators showing weakness**: Despite the hype over the 'Make in India' campaign, manufacturing growth remains desultory, with the Manufacturing PMI falling to 51.3 in Apr 15 from 52.1 in Mar 15. The Services PMI also eased to a low of 52.4 in April from 53.0 in Mar 15. However, with April data showing improving consumer confidence and global conditions and with policy initiatives falling into place, improvements in activity are likely.
- **Exports have been sliding since Sep 14**, with a 21.1% y/y fall in Mar 15 as demand in major markets such as the European Union remained lacklustre. Sustained increases in India's export performance may be difficult in light of the WTO's reduced projections for global trade growth for 2015, down to 3.3% from 4%, especially as India lags behind major regions in terms of share of global exports.

**Assessment: Weaknesses warrant further rate cuts, growth remains sensitive to policy failure…**

- Monetary Policy and the Central Bank's role has been instrumental in bolstering India's positive outlook. Coupled with moderate inflation, easing activity provides more scope and expectations for the Central Bank to cut rates further. With inflation looking increasingly susceptible to disturbances from monsoon volatility, the Central Bank kept the policy repo rate unchanged at 7.5% in April. However with effective interventions, risks to inflation from weather disruptions look to be mitigated. In turn, a delayed rate cut in light of economic risks could prevent India from achieving improved indicative targets.
- Under the Modi government, India has experienced its best legislative record, with improving FDI levels, coal and mining sector reforms and infrastructure improvements amongst others. However growth and further success of the government depends on sustained success with reforms.

Going forward, while Modi has some clear achievements in his first year in office, the real test will come as his efforts to pass the really hard-hitting reforms galvanise the opposition. While growth will improve cyclically, a structural acceleration requires persistence in reforms.

## Taiwan: Improving relations with China, economy robust despite headwinds

In the first meeting between the two parties' leaders in six years, Chinese President Xi Jinping met Kuomintang (KMT) leader Eric Chu in Beijing and discussed greater cooperation and communication. Both sides signalled that they support the "One China" policy, under which Taiwan is deemed Chinese territory but no mention is made as to which government has legitimacy over all of China. Taiwan's once fraught relationship with China is gradually reaching new heights as a result of President Ma Ying-jeou's efforts to foster more cordial cross-straits relations. Economic ties have deepened through a yuan-clearing agreement in 2012 and the Economic Cooperation Framework Agreement (ECFA) in 2010. The thaw in bilateral relations has lifted trade flows to USD130bn in 2014 and boosted tourism from China.

However, notwithstanding Chu's visit to Beijing, the economic synergies Taiwan stands to gain from better integration with China are at risk. Closer economic interaction has perversely aroused concerns among voters who fear competition from China or being overwhelmed by China. Moreover, the prospect of eventual reunification with China is shunned by a broad spectrum of the electorate, especially among younger Taiwanese. Fervent opposition against the China-friendly policies of the KMT has resulted in the Sunflower Movement, supported by the opposition Democratic Progressive Party (DPP), which protested against the opening up of Taiwan's services industries to China. The pushback culminated in the widespread trouncing of the KMT in local elections held in December 2014 which makes its chances in the coming presidential and legislative elections in January 2016 quite poor. The groundswell of support for the DPP in the municipal elections looks to be translated into a large electoral victory by DPP leader Tsai Ing-wen in the presidential election.

The key question is thus how much more pragmatic the DPP leadership is becoming. DPP leaders have moderated their anti-China rhetoric while mid-level DPP leaders have been visiting China. We believe that the DPP does not want to repeat the failures of its previous administration, some of which were due to its then intransigent stance towards China and will adopt a more pragmatic approach to ties with China.

**Taiwan economy remains resilient despite headwinds**

Despite weakness in both the US and Chinese economies, Taiwan is holding up relatively well, registering GDP growth of 3.5% y/y in 1Q15, up from 3.3% y/y in 4Q14 (Table 1). While this is a shade lower than the annual growth of 3.7% in 2014, growth is expected to accelerate going forward. Taiwan is also widely expected to surpass its peers, namely, South Korea, Singapore and Hong Kong, in economic expansion in 2015.

**Table 1: Taiwan's Quarterly GDP Growth**

| % y/y | Jun-13 | Sep-13 | Dec-13 | Mar-14 | Jun-14 | Sep-14 | Dec-14 | Mar-15 |
|---|---|---|---|---|---|---|---|---|
| GDP: 2006p | 2.6 | 1.4 | 3.4 | 3.4 | 3.9 | 4.3 | 3.3 | 3.5 |

Source: Calculated by Centennial Asia Advisors using CEIC Database

- **Manufacturing PMI registered at under 50**, coming in at 49.2 in Apr 15, down from 52.1 in Feb 15 and 51.0 in Mar 15. This reflects the sluggish demand in the world economy as US growth moderates and China rebalances.

Chart 1

Leading indicator languid but positive

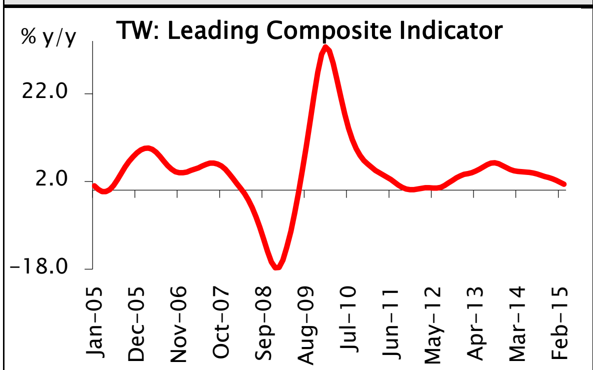
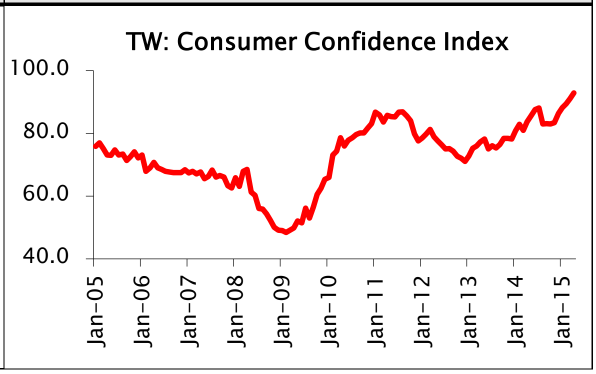



Chart 2

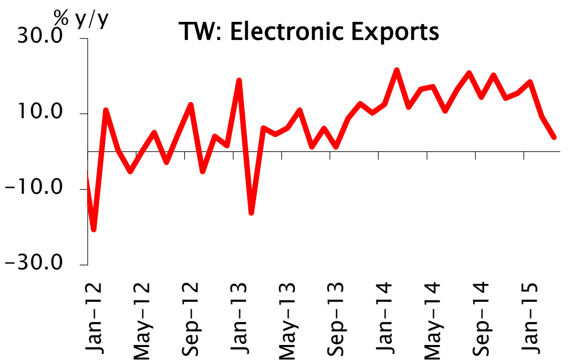
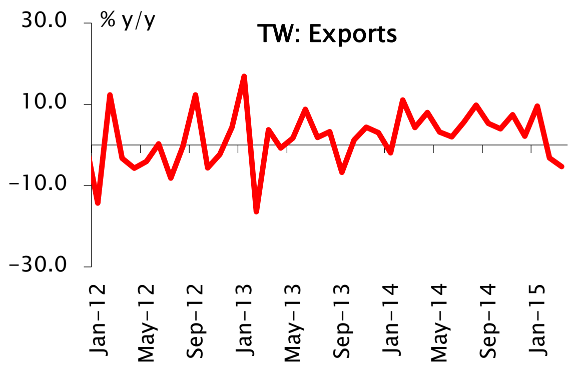
Consumer confidence climbing steadily




Source: Calculated by Centennial Asia Advisors using CEIC Database

- **Depressed oil prices supports domestic demand**: Given that 98% of Taiwan's energy comes from imports, savings from the low oil prices have boosted the real incomes of Taiwanese and bolstered domestic consumption, which has remained robust amid uncertain global economic conditions. The improving job market also provides impetus for greater private consumption of goods and services. This has facilitated Taiwan's shift from an export-oriented economy to one that is increasingly fuelled by consumption.
- **Electronics exports show outperformance**: The global demand for IT products continues to support the electronics sector in Taiwan, especially in smartphone components.

- **Exports have fallen** due to the falling prices of crude oil affecting the exports of petroleum-related industries.

| Chart 3 | Chart 4 |
|---|---|
| Electronic exports remain in positive territory... | ...but exports have fallen |
|  |  |





Source: Calculated by Centennial Asia Advisors using CEIC Database

**Assessment: Re-shoring gathering pace, a new driver of growth in Taiwan**

An increasing number of companies are shifting operations back to Taiwan. Given that China's labour costs are rising rapidly, especially along the coastal cities, there is scope for Taiwan to attract companies looking to continue manufacturing high-value products in the region. Furthermore, given that legal institutions are robust in Taiwan, along with an efficient regulatory climate and stable political environment, Taiwan presents an enticing proposition for companies to relocate their production lines.

Already, a number of Taiwanese companies have shifted their factories back home. These companies include Foxconn, Taiwan Quanta Computer Corp., Innolux Corporation, ASE Kaohsiung, Largan Precision Co. and Eminent, among others.

## UK elections: global implications of rising risk of British exit from EU and Scottish separation

- Prime Minister David Cameron's Conservatives won a small majority of 6 with 331 seats in the 650 seat parliament. The rising nationalist tide in Scotland and England squeezed the Labour and Liberal Democrat parties, with the Scottish Nationalist Party (SNP) winning 56 out of 59 seats. The Conservatives benefited from tactical voting in their favour by English voters who feared Labour would depend on the SNP for a majority. English nationalism remains a force too: while the anti-EU UKIP won just 1 seat, it secured 12.6% of the vote.

**Near term continuity**

- George Osborne remains as Chancellor of the Exchequer and de facto deputy to Cameron, while other senior ministers retained their posts, suggesting continued but moderate fiscal tightening and reforms to improve public services. Osborne will also take charge of negotiations with the EU over British membership.

**Long term uncertainty: Current consensus on EU-UK compromise may prove complacent**

- Cameron's strategy is to persuade the EU to make enough concessions so that he can then lead a call for a Yes vote in the referendum on EU membership that he has promised voters by end-2017. The EU values Britain's continued membership but British demands such as restrictions on labour mobility are unacceptable to it. Yet, Cameron's tiny majority exposes him to pressure from his party's right-wing which is strongly anti-European Union. Moreover, the sheer complexity of the negotiations, the electoral calendar in the rest of Europe and resistance within the EU against any change substantial enough to require amendments to the EU treaty mean that the negotiations will be fraught.
- The UK economy has gained immeasurably from EU membership. It is debateable whether the UK can retain these gains should it leave. There is a complacent view that somehow the UK (or a rump-UK if the pro-EU Scots leave) will continue more or less as before, keeping its profitable access to EU markets and its role as the EU's financial capital even if it no longer wishes to be a member of the EU fraternity. More likely, there will be a cost in terms of output lost in the UK economy.

**Long term uncertainty: Scotland likely to leave the UK within the next few years**

- In addition, the SNP's extraordinary showing means that another referendum on Scotland leaving the UK is only a matter of time. There clearly has been a significant mood shift in Scotland with a stronger sense of nationhood. Unless the Cameron government is able to offer the Scots a more enticing deal, the chances are rising that the next referendum will see Scotland leave, putting an end to the UK as we know it.

**Significant global implications of a diminished UK**

- **Likely clamour for new world political order**: The prospect of a much diminished UK is thus real and its implications go well beyond Europe. Already, the UK is playing a much smaller role in world affairs than at any time in the past 300 years. Its heavyweight position in key institutions of global leadership such as the United Nations (permanent member of the UN Security Council with veto powers), IMF, World Bank and others cannot be justified should the UK dissolve and leave the EU. Consequently, there will be a growing clamour for a big shift in global power away from the UK and Europe towards Asia and emerging economies.
- **American interests will also be hurt**: The US will be less able to depend on the UK to support its global projection of power as it has since the end of the Second World War. With the size of the UK army now reduced to 50,000, the UK has little capacity to support Western interests outside Europe.
- **Separatism in other parts of the EU will be encouraged**: If Scotland does indeed separate from the UK, separatists elsewhere in Europe will be encouraged to step up their demands, with the greatest risk being Catalan separatism in Spain.

## Malaysia: Najib under further pressure

- The alleged scandal over 1MDB is undermining support for Prime Minister Najib Razak. In recent days, his deputy, Muhyiddin Yassin has come out with stronger statements that indirectly attack Najib. The revelation that the Muslim pilgrims fund had bought land from 1MDB at what is claimed to be a high price has further disturbed voters as well as the higher echelons of the dominant UMNO party which Najib heads. In recent days, even senior leaders who had held back from criticizing Najib over the scandal, have felt they have to take a more critical stance. Najib's close ally and first cousin, Defence Minister Hishamuddin Hussein and UMNO Youth leader Khairy Jamaluddin are among those who have called for an independent investigation.
- While Najib still commands strong support from more than three-quarters of UMNO's division leaders, the drip-drip of allegations and the determined campaign by former Prime Minister Mahathir to oust him are taking a toll. Najib cannot afford any more scandals or allegations to come out. He will be forced now to adopt a more aggressive posture to contain his political foes.
- Meanwhile, his opponents have pounced on two recent bye-elections to claim that the allegations of scandal were the reason for a poor showing. However, the hard numbers do not support this: In the Rompin constituency, the UMNO candidate retained the seat with only a small fall of 4 percentage points of the votes cast. In opposition-held, Permatang Pauh, UMNO failed to win the seat but reduced the opposition's vote share slightly.

<u>Implications:</u>

- There are three issues hurting Najib's position. The first - allegations of scandal - resonate less with the common man and can possibly be dealt with through some form of financial restructuring. The second, the impact of the GST on living standards is the real reason for the government's rising unpopularity. But this can be dealt with, for example, through expanded welfare spending. It is the third problem which Najib will find harder to deal with, and that is the growing feeling among Malays that Najib's reformist policies undermine the Malays' economic position to the benefit of Chinese businesses and foreign interests.
- This is why one important possible implication of Najib's weakened political position is that Malaysia may well decide not to go ahead with the Trans Pacific Partnership (TPP) agreement. Opposition had been strong to the TPP because of American demands that policies dear to Malaysia (such as affirmative action in favour of the Malays and other indigenous communities and the role of government-linked companies) be watered down. With the current political challenges, Najib is unlikely to have the clout to push through yet another unpopular policy just after the introduction of the GST has upset voters.

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