Mizuho Asia Quarterly – Q2-Q3 2022

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Asia Quarterly

— Q2-Q3 2022: Compromised & Precarious —

Global economic prospects appear **severely compromised**. Especially **as** the *war in Ukraine,* in exacerbating **inflation** risks, has set **global central banks** on an unnervingly **precarious** tightening **path to achieve a soft** (*enough*) **landing**. Between being overtaken by destabilizing runaway inflation and lurching into policy-induced downturn, the *Fed (and global policy-makers generally) has a very narrow path on which it may avert a recession.*

In particular as **geo-political price shocks**, led by surging energy/food prices, are **notoriously less sensitive to declines in demand**. And **may leave demand compromised instead**. And this is inevitably worsened by **precarious and potentially painful policy trade-offs**.

US rates/yields rising at the fastest pace in decades alongside **daunting USD drainage** under current quantitative tightening (QT) **plans**, set out by **aggressively hawkish Fed**, arguably **threaten to inflict more pain outside of the US**; **especially for** EM (including **EM Asia**).

Not only because the **US economy's stronger starting point** may better withstand headwinds from war and tightening **compared to more uneven and fragile EM Asia recovery**. But crucially also because *EM (Asia) capital outflows risks,* which **feed into and off economic woes**, are *exacerbated by the adverse feedback loop with higher US rates and a stronger USD*.

What's more, **EM Asia's** heightened sensitivity to **geo-political price shocks** (concentrated in food and energy) alongside **binding post-COVID fiscal strains**, means that **policy buffers are compromised**. And the **precarious confluence of risks** warn of *gathering global headwinds could portending a full-fledged storm* if caught dismally wrong-footed.

6th July 2022

Mizuho Bank, Ltd.

Asia & Oceania Treasury Department

Executive Summary

- **US: Elusive peak inflation** has **Fed doubling down with an "unconditional" assault on inflation**. **Ultra aggressive hikes** (June 'Dot Plot' nearly doubling 2022 hikes to 325-350bp) and a **higher bar to dial back**, despite softening growth momentum, **invoke recession fears**.

- **EZ:** The Ukraine **war poses acute stagflation risks**; as energy/food price shocks both **inflame inflation** and **inflict demand destruction**. Acceptable policy *compromise* entails a *precarious* policy tight rope, while *policy is complicated by the need for "anti-fragmentation" safe-guards*.

- **Japan:** In stark contrast to the Fed, **BoJ's trenchant dovish stance is neither compromised** by growing **inflation** discomfort **nor motivated to backstop precarious JPY drop**. Instead, *monetary complement* for fiscal boost *to revive the economy assume policy priority.*

- **China: Top-down assurances of growth stimulus compromised by a legacy of "unforced errors"**; in particular far-reaching drag from a *property sector* (hobbled by liquidity-turned-credit woes) *precariously navigating defaults*. Crucially, if **circular confidence deficit and restrictive lending** result, ***stimulus plans will be undermined by compromised growth multipliers***.

- **India: External fault lines undermine rupee stability** and **amplify headwinds**. Especially as *adverse Oil shocks, inflation woes* and *"twin deficit" deterioration* inflict **disproportionate pain on the informal sector**, associated growth multipliers. and **accentuate RBI dilemma**.

- **Indonesia:** As Fed policy miscalculation (over-tightening) risks mount, Indonesia's **commodity tailwinds offer diminishing cushion**; especially as risk of a downward lurch in commodity prices are compounded by IDR instability risks, aggravated by BI's tightening lags.

- **Korea**: The **BoK's early-mover "Kokomo" hikes squandered by inflation upswing**, underpin **persistent policy trade-offs and softer outlook** as the trade engine is blunted by China risks and Fed headwinds. **Vietnam's** boost from (quasi-)fiscal **price shocks buffer** and **industrial resumption** are **limited by global headwinds**; therefore *growth is set to moderate, not accelerate*.

- **Singapore:** As a **small, open**, **economy**, **defying global headwinds** from an ultra-hawkish Fed is **a tall order**. And **"hot spots"** in the job and property markets accentuate, not diminish risks. Given this the *MAS' sweet spot is to increase the S$NEER slope, not re-center high in October.* **Malaysia's resilience** is admittedly **helped by fiscal space derived from oil revenues**. **But immunity is an illusion** given potential for (trade) headwinds and potential Oil volatility.

- **Thailand's recovery**, while broadening on re-opening, **remains hobbled**; as China's hard-line Zero COVID policy deprive fuller tourism multipliers while geo-political and Fed risks accentuate THB stability risks. **Philippines**: Despite election spending and re-opening boost, food and energy price shocks alongside headwinds from macro-stability risks may impede; even with BSP hikes.

- **Australia:** *China risks* and *Fed headwinds* **render commodity boost hollow**. Moreover, **RBA hawks set to entrench** amid solidifying jobs deepen underlying fissures from elevated mortgage liabilities, implied household balance sheet vulnerabilities and corresponding banking exposures.

- **Asia/AXJ: Mounting stagflation-type pressures** are *aggravated by an exceptionally hawkish Fed amidst geo-political price shocks.* And **AXJ sell-off risks** amid *corresponding capital outflow risks* accentuated by EM Asia' inflation acceleration vis-à-vis US.

AT A GLANCE

Yearly Economic Forecasts

Country	2020			2021			2022		
	GDP YoY	CPI	C/A (% GDP)	GDP YoY	CPI	C/A (% GDP)	GDP YoY	CPI	C/A (% GDP)
United States	**-3.4**	**1.2**	**-2.9**	**5.7**	**4.7**	**-3.5**	**3.7**	**7.7**	**-3.5**
Japan	**-4.5**	**0.0**	**3.0**	**1.6**	**-0.2**	**2.9**	**2.4**	**0.7**	**2.4**
Eurozone	**-6.4**	**0.3**	**1.9**	**5.3**	**2.6**	**2.4**	**2.8**	**5.3**	**1.8**
ASIA (ex-Japan)	**-0.7**	**2.9**	**2.3**	**7.1**	**2.6**	**2.4**	**4.9**	**3.7**	**1.0**
ASEAN-6	**-3.5**	**1.3**	**3.1**	**3.7**	**2.0**	**1.2**	**4.5**	**4.2**	**2.9**
China	2.3	2.5	1.5	8.1	1.3	2.0	4.6	2.3	1.1
India	-7.1 (-7.5)	6.6 (6.2)	0.9	8.3 (8.7)	5.1 (5.5)	-1.6	6.7 (6.9)	7.1 (7.1)	-2.9
Korea	-1.0	0.5	4.6	4.0	2.4	4.9	2.9	5.1	2.2
Singapore	-5.4	-0.2	16.8	7.5	2.7	18.5	3.8	3.8	17.2
Malaysia	-5.6	-1.1	4.2	3.1	2.5	3.5	5.3	2.5	3.9
Indonesia	-2.1	2.0	-0.4	3.7	1.6	0.3	4.2	3.6	4.5
Thailand	-6.1	-0.8	4.2	1.6	1.2	-2.1	3.1	6.7	-0.1
Philippines	-9.5	2.4	3.2	5.7	3.9	-1.8	5.6	5.0	-2.7
Vietnam	2.9	3.2	4.4	2.6	1.8	-0.5	6.1	3.3	-0.1
Australia	-2.4	0.9	2.2	4.8	2.9	3.6	3.7	6.1	1.8

Note: Asia (ex Japan) includes China, India, South Korea, Singapore, Hong Kong, Taiwan, Malaysia, Indonesia, Thailand, Philippines, Vietnam
The current account forecasts for Asia, the GDP, CPI and CA foreasts for G3 are from the IMF (April 2022 WEO edition)

Quarterly Outlook – Growth and Consumer Inflation

Growth Forecasts

GDP Growth Forecasts (% YoY)

Country	2020				2021				2022				2023		2017-19	2020	2021	2022	2023
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Average	(FY20/21)	(FY21/22)	(FY22/23)	(FY23/24)
Australia	1.4	-6.2	-3.7	-1.0	1.4	9.6	3.9	4.2	3.3	3.3	5.6	2.8	2.6	2.5	2.4	-2.4	4.8	3.7	2.7
China	-6.8	3.2	4.9	6.5	18.3	7.9	4.9	4.0	4.8	2.9	5.6	8.5	7.8	6.0	6.5	2.3	8.1	4.6	5.3
India	2.8	-23.82	-6.6	0.7	2.5	20.1	8.4	5.4	4.1	12.9	5.6	5.2	5.1	4.4	5.8	-6.6 (-6.6)	8.3 (8.7)	6.7 (6.9)	5.5 (6.3)
Indonesia	3.0	-5.3	-3.5	-2.2	-0.7	7.1	3.5	5.0	5.0	3.0	4.2	4.6	5.3	5.4	5.1	-2.1	3.7	4.2	5.5
Malaysia	0.7	-17.2	-2.7	-3.4	-0.5	16.1	-4.5	3.6	5.0	3.0	8.1	5.0	5.4	5.1	5.0	-5.6	3.1	5.3	4.8
Philippines	-0.7	-16.9	-11.6	-8.2	-3.8	12.1	7.0	7.8	8.3	4.8	5.3	4.5	7.0	6.2	6.2	-9.5	5.7	5.6	6.5
Singapore	0.0	-13.3	-5.8	-2.4	1.5	15.2	7.1	5.9	3.4	4.3	4.1	3.4	3.3	3.0	3.1	-5.4	7.5	3.8	3.2
Korea	1.4	-2.7	-1.1	-1.4	1.9	6.0	4.0	4.1	3.1	2.8	3.1	2.5	2.6	2.5	2.8	-1.0	4.0	2.9	2.6
Thailand	-2.0	-12.1	-6.4	-4.2	-2.6	7.5	-0.3	1.9	2.2	2.9	4.4	3.1	2.5	4.3	3.5	-6.1	1.6	3.1	3.6
Vietnam	3.7	0.4	2.6	3.8	4.7	6.6	-6.2	5.2	5.0	7.7	11.0	1.4	5.0	5.2	7.1	2.9	2.6	6.1	6.5

Consumer Inflation forecasts

Inflation Forecast (%YoY)

Country	2020				2021				2022				2023		2017-19	2020	2021	2022	2023
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Average	(FY20/21)	(FY21/22)	(FY22/23)	(FY23/24)
Australia	2.2	-0.3	0.7	0.9	1.1	3.8	3.0	3.5	5.1	6.5	6.5	6.4	5.0	4.1	1.8	0.9	2.9	6.1	4.3
China	5.0	2.7	2.3	0.1	0.0	1.1	0.8	1.8	1.1	2.4	2.8	2.7	2.5	2.4	2.2	2.5	1.3	2.3	2.4
India	6.7	6.6	6.9	6.4	4.9	5.6	5.1	5.0	6.3	7.3	7.4	7.2	6.3	5.3	3.9	6.6 (6.2)	5.1 (5.5)	7.1 (7.1)	5.4 (5.3)
Indonesia	2.9	2.3	1.4	1.6	1.4	1.5	1.6	1.8	2.3	3.8	4.2	4.1	3.9	3.1	3.3	2.0	1.6	3.6	3.2
Malaysia	0.9	-2.6	-1.4	-1.5	0.5	4.2	2.1	3.2	2.2	2.7	2.6	2.3	2.0	1.7	1.8	-1.1	2.5	2.5	1.7
Philippines	2.5	1.9	2.3	2.9	4.0	4.0	4.1	3.6	3.4	5.5	5.9	5.3	4.4	2.9	3.8	2.4	3.9	5.0	3.3
Singapore	0.4	-0.7	-0.3	-0.1	0.8	2.3	2.5	3.7	4.6	4.2	3.7	2.8	2.6	2.1	0.5	-0.2	2.7	3.8	2.1
Korea	1.0	0.0	0.7	0.5	1.4	2.5	2.5	3.5	3.8	5.4	6.2	6.1	3.9	3.1	1.3	0.5	2.4	5.1	3.3
Thailand	0.4	-2.7	-0.7	-0.4	-0.5	2.4	0.7	2.4	4.7	6.5	7.6	7.0	4.7	3.8	0.8	-0.8	1.2	6.7	3.6
Vietnam	5.6	2.8	3.2	1.4	0.3	2.7	2.5	1.9	1.9	3.0	3.7	4.5	3.8	3.6	3.3	3.2	1.8	3.3	3.6

Central Bank Policy Outlook

Central Bank Policy Outlook

Country	Central Bank	2020				2021				2022				2023	
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
US	**Fed**	**0.00-0.25%**	**0.00-0.25%**	**0.00-0.25%**	**0.00-0.25%**	**0.00-0.25%**	**0.00-0.25%**	**0.00-0.25%**	**0.00-0.25%**	**0.25-0.50%**	**1.50-1.75%**	**2.75-3.00%**	**3.25-3.50%**	**3.50-3.75%**	**3.74-4.00%**
Australia	**RBA**	0.25%	0.25%	0.25%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.85%	1.85%	2.25%	2.25%	2.25%
China	**PBoC**	4.05%	3.85%	3.85%	3.85%	3.85%	3.85%	3.85%	3.80%	3.70%	3.60%	3.50%	3.50%	3.50%	3.50%
India	**RBI**	4.40%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.90%	5.75%	6.00%	6.00%	6.00%
Indonesia	**BI^**	4.50%	4.00%	4.00%	3.75%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	4.00%	4.25%	4.50%	4.50%
Malaysia	**BNM**	2.50%	2.00%	1.75%	1.75%	1.75%	1.75%	1.75%	1.75%	1.75%	2.00%	2.25%	2.50%	2.50%	2.50%
Philippines	**BSP**	3.25%	2.50%	2.25%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.50%	3.00%	3.25%	3.25%	3.25%
Singapore	**MAS***	Flatten S$NEER & Re-Centre to Prevailing S$NEER (~40-70bps lower)		Status Quo		Status Quo		Restore a "Slight" S$NEER Slope (0.5% per annum)		**Unscheduled "Steeper" Slope to 1.0% p.a.**	**Re-center Mid-Pt Higher & "Slightly" Increase S$NEER Slope (1.5% p.a.)**	"Slightly" Increase to S$NEER Slope (2.0% per annum)		Maintain S$NEER Slope (2.0% per annum)	
Korea	**BoK**	0.75%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.75%	2.25%	2.25%	2.25%	2.25%
Thailand	**BoT**	0.75%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	1.00%	1.25%	1.50%	1.50%
Vietnam	**SBV**	5.00%	4.50%	4.50%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.25%	4.50%	4.50%	4.50%

* The MAS conducts monetary policy via FX. Specifically it adopts a trade-weighted SGD appreciation at "modest and gradual" (estimated to be 2% per annum) pace as default.
^ BI shifted to the 7 Day repurchase rate as the benchmark rate in August 2016. This by default constituted 125 bps reduction from the last policy rate

FX Outlook

FX Forecasts	Sep 22	Dec 22	Mar 23	Jun 23	Sep 23
USD/JPY	133 - 140 (137)	134 - 142 (140)	135 - 143 (138)	134 - 142 (136)	132 - 140 (135)
EUR/USD	1.01 - 1.09 (1.07)	1.06 - 1.11 (1.09)	1.08 - 1.13 (1.11)	1.10 - 1.16 (1.13)	1.12 - 1.18 (1.15)
USD/CNY	6.42 - 6.93 (6.79)	6.38 - 6.86 (6.69)	6.46 - 6.96 (6.62)	6.27 - 6.73 (6.48)	6.18 - 6.64 (6.38)
USD/INR	77.2 - 82.8 (80.5)	76.8 - 81.5 (78.8)	73.4 - 78.5 (76.2)	71.4 - 77.7 (75.3)	70.6 - 76.8 (74.4)
USD/KRW	1250 - 1380 (1310)	1240 - 1380 (1290)	1230 - 1340 (1280)	1220 - 1320 (1270)	1210 - 1330 (1260)
USD/SGD	1.366 - 1.438 (1.408)	1.358 - 1.414 (1.388)	1.340 - 1.421 (1.374)	1.317 - 1.405 (1.354)	1.310 - 1.392 (1.346)
USD/IDR	14810 - 16320 (15200)	14640 - 15570 (15000)	14450 - 15530 (14900)	14180 - 15360 (14650)	13990 - 15200 (14450)
USD/MYR	4.38 - 4.78 (4.47)	4.36 - 4.60 (4.41)	4.09 - 4.50 (4.35)	4.10 - 4.43 (4.29)	4.08 - 4.41 (4.26)
USD/PHP	55.2 - 57.6 (56.3)	54.7 - 57.5 (55.7)	52.7 - 56.6 (55.0)	51.9 - 55.9 (54.3)	51.4 - 55.3 (53.7)
USD/THB	34.8 - 37.3 (36.0)	34.2 - 37.2 (35.2)	32.5 - 36.1 (34.4)	32.3 - 35.4 (34.2)	32.9 - 35.2 (33.8)
USD/VND	23000 - 24300 (23440)	22800 - 23900 (23100)	22800 - 23400 (23000)	22700 - 23300 (22800)	22600 - 23100 (22750)
AUD/USD	0.648 - 0.748 (0.670)	0.665 - 0.755 (0.695)	0.688 - 0.775 (0.742)	0.726 - 0.808 (0.765)	0.737 - 0.811 (0.775)

Note: For FX forecasts, level in parentheses pertains to period end forecasts; and the period's range precedes

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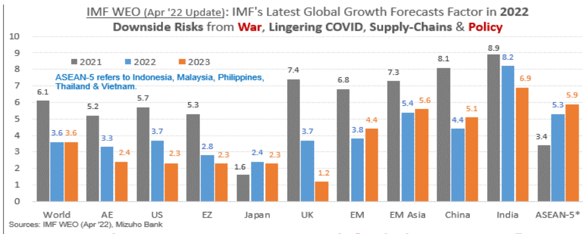
Global Overview: Compromised & Precarious

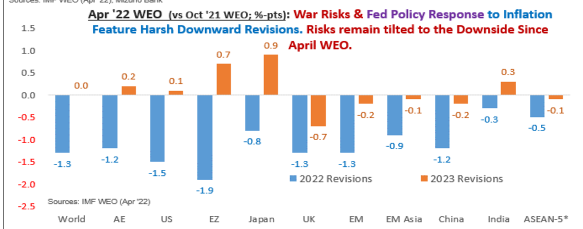
Growth: The **global economic outlook** is **compromised by a conspiracy of** factors; from *war* to uneven COVID exit and attendant *costly policy response* to **resultant inflation**. This is revealed in sweeping downward revisions to growth by the IMF, World Bank and OECD. Fact is, *risks of policy-induced downturn are amplified* as *stagflation-type pressures (see Box 1) sharpen policy trade-off.* In particular, as **Fed-led global hawkish onslaught** trained on inflation, **despite war and wider uncertainties, undermine precarious post-COVID recovery**. So much so that *recession risks cannot be ruled out heading into 2023-24.* Moreover, rolling **disruptions from China's 'Zero COVID' policy** threaten to amplify stagflationary impulses. All said, the ***compromised intersection of macro, geopolitical, and policy risks set a precarious path to avert a hard landing***.

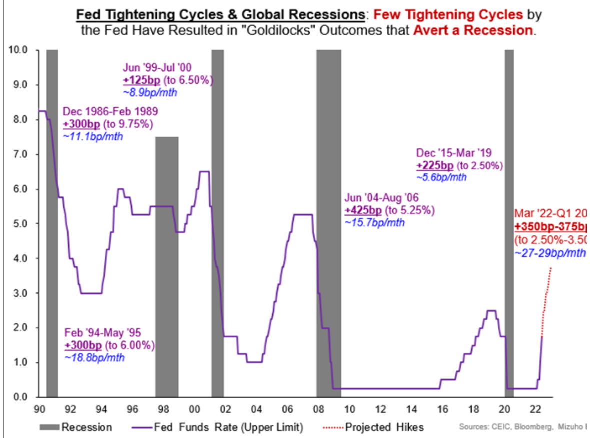
Risks: A **suite of risks** confront and *compromise precarious global recovery*. With the **threat of inflation genie unleashed**, undermining macro-stability, on one hand and **policy-induced recession from resultant hawkish response** overdrive on the other. Consequently, the **path to avert a** *Volcker-esque hard-landing* appears **perilously narrow**. Moreover, **further price and demand shocks from on-going war** in Ukraine (with tail risks of escalation), threaten to **sharpen policy trade-offs** by imposing more acute stagflation-type pressures. Also, **new strains** *(not limited to COVID)* wreaking health and economic havoc remain a threat. Apart from compromised growth and compounded inflation flirting with **stagflation**, **financial turbulence** *provoked by hawkish aggression* is a worry too.

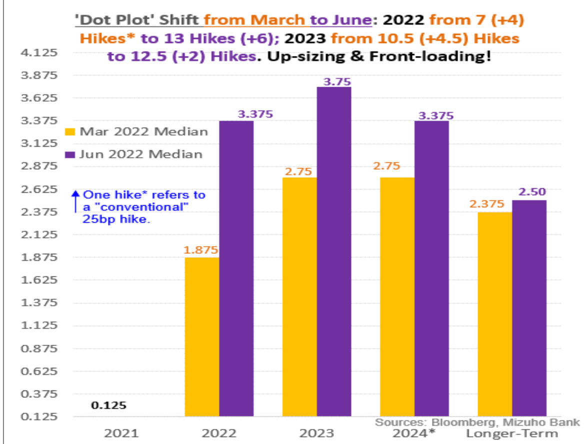
Policy: While **price-stability priorities have supplanted pro-growth accommodation** for most central banks, there are *key differences in approach and aggression.* The **Fed** is positioned as the **alpha hawk**, stepping up with **dramatically upsized hikes upfront** alongside record pace of QT in the offing (initiated at $47.5bn/mth in Jun, set to be doubled to $95bn/mth in Sep). And *"unconditional" assault on inflation* is underscored by front-loaded, **cumulative 350-400bps rate hikes by early-2023**; with hike magnitude of 50-75bp at least through Q3. Until US inflation moderates substantially "*50(bp) is the new 25*". Whereas **ECB's tightening pales in intensity to the Fed's**; and falls far short of the Fed's hawkish ferocity even if "lift-off" from Jul is stepped up in Sep. Even more stark is the **BoJ's trenchant dovish stance**.

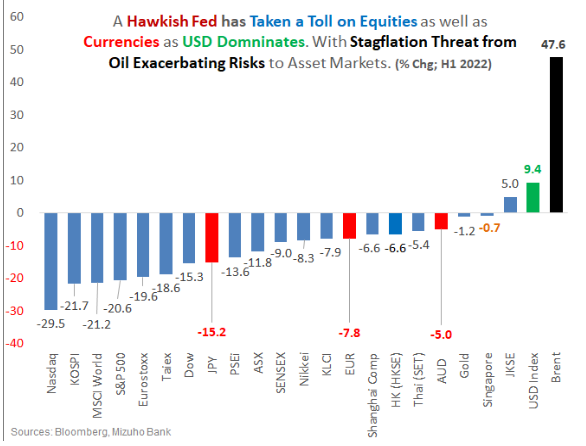
Asset Markets: **Precarious**, **if not turbulent**, is *what asset markets are primed to be;* as a **brutal combination of rapidly rising rates** and **QT** (accentuating risks of liquidity shocks and widens term/credit premium) **deliver blunt force trauma** via sharp corrections in valuation and cashflow squeeze – one feding off the other. Moreover, stagflation threat imposed by war-induced oil price shock. Under these circumstances, **contagion risks lurk** insidiously. Especially vulnerable to more brutal renditions of Fed policy tightening. In which case, the **odds of invoking a quick rebound in markets corresponding to hopes of a soft landing** are **compromised by "tipping risks"** – *that flip inflation risks into recession fears*. In any case, **stark policy divergence** threatens to **accentuate volatility** in the meantime.



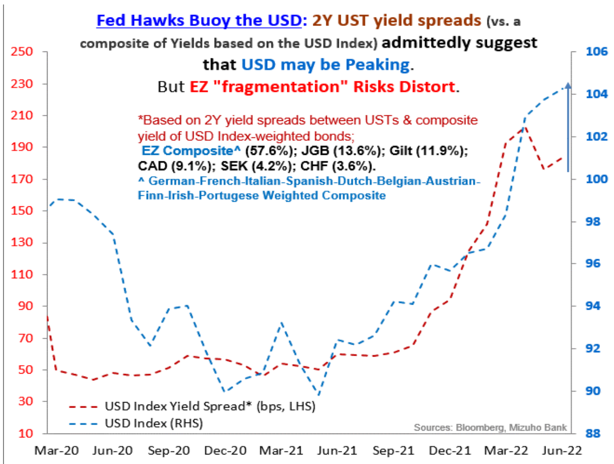




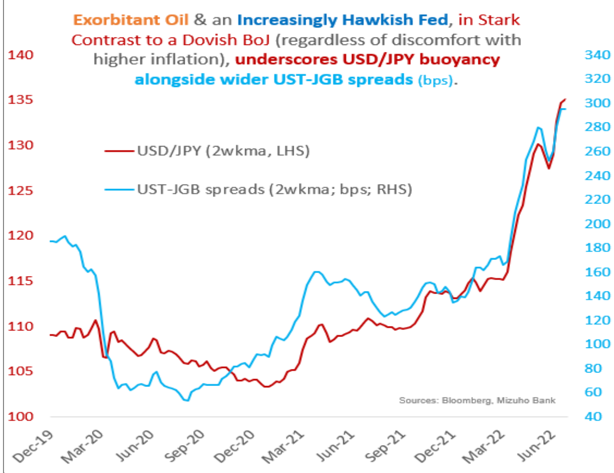




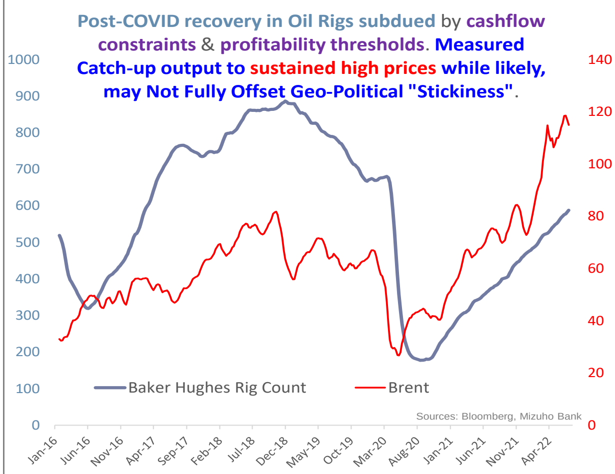
EUR/USD Outlook: EUR bulls may struggle to gain any durable traction near-term as a double-whammy of EUR dampening factors. First, a **fundamentally significant and persistent shortfall in policy tightening vis-à-vis the Fed**. In particular, the Fed's stance is one of upsized rate hikes upfront until "compelling" evidence of inflation cooling, whereas the ECB is inclined to gradual hikes until evidence to step up is presented. Second, **"fragmentation" risks** (peripheral bond yield spreads widening dramatically) **undermine EUR**. Until the ECB is able to deliver a convincing "anti-fragmentation" tool, EUR could struggle to regain traction; especially as Fed hawks sdouble down.



USD/JPY Outlook: The **weak JPY narrative is not about to slip away quietly** in the night in H2. At *least not without bouts of JPY weakness through Q3*, and possibly Q4. And while policy, geo-political and COVID conspire to buoy, USD/JPY. First, **widening Fed-BoJ policy divergence** (with Fed hawks doubling down whilst BoJ doves dig in their heels). USD/JPY looks likely to be buoyed by the consequent *widening of UST-JGB spreads.* Second, **surge in the cost of energy imports** that have *compromised the Current Account (C/A) position*. Third, **Japan's lagged re-opening to tourism** not only dragging the C/A but also investor confidence; with the further compromising the JPY. These forces, and **JPY weakness**, are **only expected to dissipate late-2022/early-2023.**



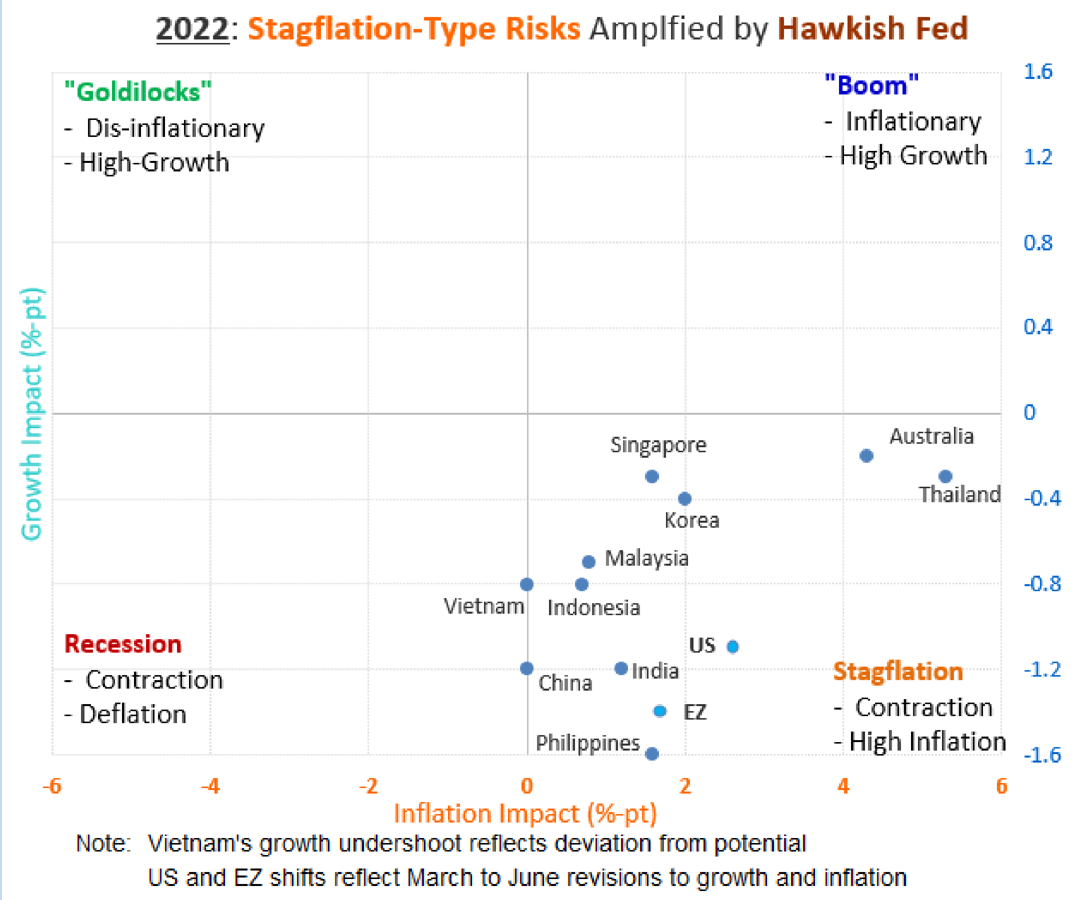
Oil (Brent): Oil is set to be a **binary risk** [See Box 2]; with **very limited middle ground** *between elevated and sticky prices* on one hand and a *recession-fulled collapse on the other*. In turn, this is bound to lead to binary risks around the Fed's response (to oil), with aggressive tightening for the former and capitulation back into accommodation if the latter spooks. Near-term, given *capacity constraints of the OPEC+*, *rolling Russia risks* colliding with *re-opening/global travel demand*, Oil is set to be sticky. So **near-term dips below $100-105 may be rather limited**; *although mounting recession risks could culminate in an an abrupt tip-over to a sharp drop below $70-80 in 2023.*



	Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023
Fed Rate^ (%)	0.25-0.50	1.50-1.75	2.75-3.00	3.25-3.50	3.50-3.75	3.75-4.00
ECB Rate^ (%)	-0.50	-0.50	0.00	0.50	0.75	0.75
BoJ Rate (%)	-0.10	-0.10	-0.10	-0.10	0.00	0.00
EUR/USD*	1.11	1.05	1.07	1.09	1.11	1.13
	1.08- 1.15	1.03 - 1.11	1.01 - 1.09	1.06 - 1.11	1.08 - 1.13	1.10 - 1.16
USD/JPY*	122	136	137	140	138	136
	113 - 126	121 - 137	133-140	134 - 142	135 - 143	134-142
Brent Crude (US$/bbl)	107.9	114.8	108.5	110.0	86.5	76.6
	77.0-140.0	97.0-126.0	88.5-132.8	75.5-118.5	70.5-112.5	62.5-92.5

Note: Values in black are historical whereas those in blue represent forecasts.
* Point forecast is for end-period. Q1 2022 ranges are from Bloomberg and only indicative.
^ Fed rates refer to the Fed Funds Target rate; ECB rates refer to the Deposit facility rate.

Box 1: EM Asia: Stagflation-Type Risks Mount



"It is stupidity rather than courage to refuse to recognize danger when it closes upon you"
– Sherlock Holmes

Stagflation-type risks for EM Asia are magnified not despite, but precisely because, of an aggressively hawkish US Fed; which threatens to impose *disproportionately greater downside growth risks* ***as*** *inflation dampening objectives are fettered* by more **profound**, **pervasive** and **persistent supply-side quirks**.

EM Asia central banks forced to tighten in tandem to deflect macro-stability risks is one more transmission of asymmetric tightening. But not just that. Insofar that inflation is de-sensitized to policy tightening due to supply-side quirks, **demand may be further subdued by compromised affordability**/bottom-line. And it is hard to refute Holmes that it is "stupidity rather than courage" to not recognise clear and present danger.

Fed's Asymmetric Growth-Inflation Dampener: To be sure, **stagflation risks, notably for EM Asia, are amplified by asymmetric growth-inflation impact** from the Fed's tightening. Point being, **the Fed's brutal tightening path imposes sweeping downside risks to precarious, if not fragile, demand recovery**. Even more so as pressures on EM asset markets amid capital outflow risks threaten to exacerbate economic risks via financial channels. **Whereas**, global **inflation risks may be far more unyielding**. Particularly given that *inflation may be de-sensitized to demand drag induced by monetary policy tightening* amid a **perfect storm of supply-side COVID cost-push**, **geo-political price shocks** and **food security risks** (which trigger self-sabotaging exports control/hoarding by food producers and middlemen).

Upshot being, there **are growing risks that weakened link between demand growth and inflation** will result **disproportionately larger negative growth impact**, if not an outright downturn, **without necessarily taming inflation to the same extent**.

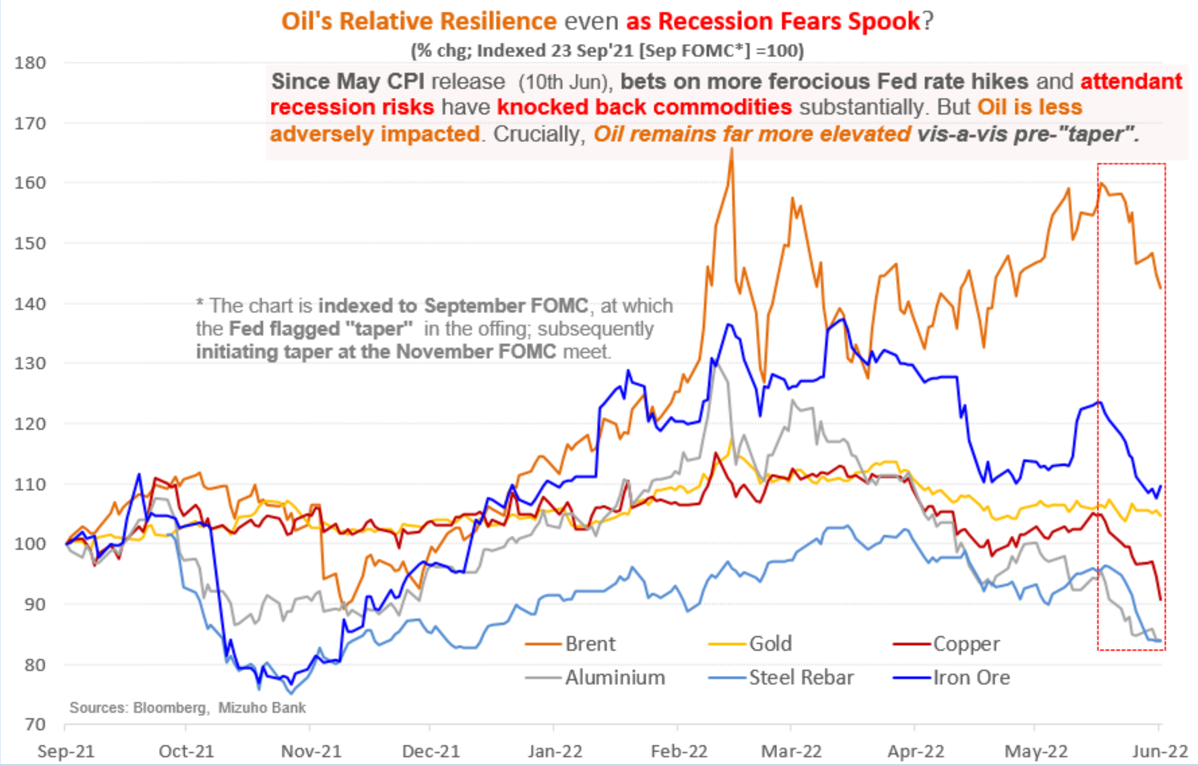
Wars, Fuel & Feed Stagflation Risks: What's more, **war waged on Ukraine by Russia reinforces stagflation risks** as it **simultaneously sets off price shocks** and **hollows demand**. A combination of *displaced activity, uncertainty* and *attendant confidence slippage that stifle growth multipliers* resonate with the **IMF's downgrades to global growth** (-0.8%-pts to 3.6% for 2022) on account of war in its April World Economic Outlook. Yet, the correspondent risk is that of *elevated and sticky inflation, particularly* **driven by energy and food price pressures**.

Insecurities About Food Security: And in EM Asia, troubling **upward pressures in energy and food could turn even more problematic if** worries about **shortages** (amid global geopolitical and farm disruptions) **are exacerbated by exports ban/hoarding** by producers and middlemen. In short, **protectionist reflexes** with regards to food security could **inadvertently amplify stagflation ripples** by **elevating prices and depressing demand** (amid compromised affordability).

Sharp Policy Trade-Offs: Moreover, **sharp policy trade-offs** imposed by an aggressively hawkish Fed also **entrench stagflation-type risks**. Specifically, an *undeniably greater growth sacrifice is required to address inflation risks;* **between forced tightening to avert macro-stability risks** and **maintaining accommodation at pain of capital outflows amid financial shocks**.

Path of Least Pain: The upshot is a **"perfect storm" of cost-push inflation** that is **de-sensitized to monetary tools amid clouds of geo-politics** are **set to inflict pain**; perhaps *disproportionately on EM* (including Asia) as a stronger US accentuating policy divergence amplifies policy trade-offs. Against this backdrop, *EM (Asia) policy-makers may only endeavour to navigate a path of least pain* to avert a deep downturn rather than coming off unscathed.

Box 2: Why Oil is a Binary Risk



"To be a Jedi is to face the truth and choose. Give off light or darkness, Padawan" – Master Yoda

Binary Risk: **Oil is by and large turning out to be a binary risk**. That's to say;

a) **Either elevated and "sticky" oil** prices *due to exceptional supply-side uncertainty imposed by* the *war* in Ukraine **results in more profound and prolonged inflation** that **compels far more aggressive Fed tightening** (and consequent risks) on one hand.

b) ***Or*** on the other, **sharp plunge in Oil prices amid recession fears** (induced by brutal Fed tightening) **exacerbates the downturn**, ultimately **forcing the hawkish Fed to suspend tightening, if not make a violent, bearish swerve**; potentially too late **to avert a hard-landing**.

Dog or Tail?: To this end, determining **whether Oil is the "dog" or the "tail"** is **critical to discern** at a time **when the Fed has "unconditionally" committed to fight inflation**; and is consequently undertaking **tightening** (rate hikes and QT) **with unprecedented ferocity**, thereby ***risking an inadvertent recession***. Specifically, the question of interest is whether **oil is** *the "dog" wagging the inflation "tail"*, consequently is setting Fed up for an aggressive tightening path, **or** *the "tail" wagged sharply lower by recession fear dog*, which inevitably accompanies the Fed's Volcker-esque response to inflation shocks.

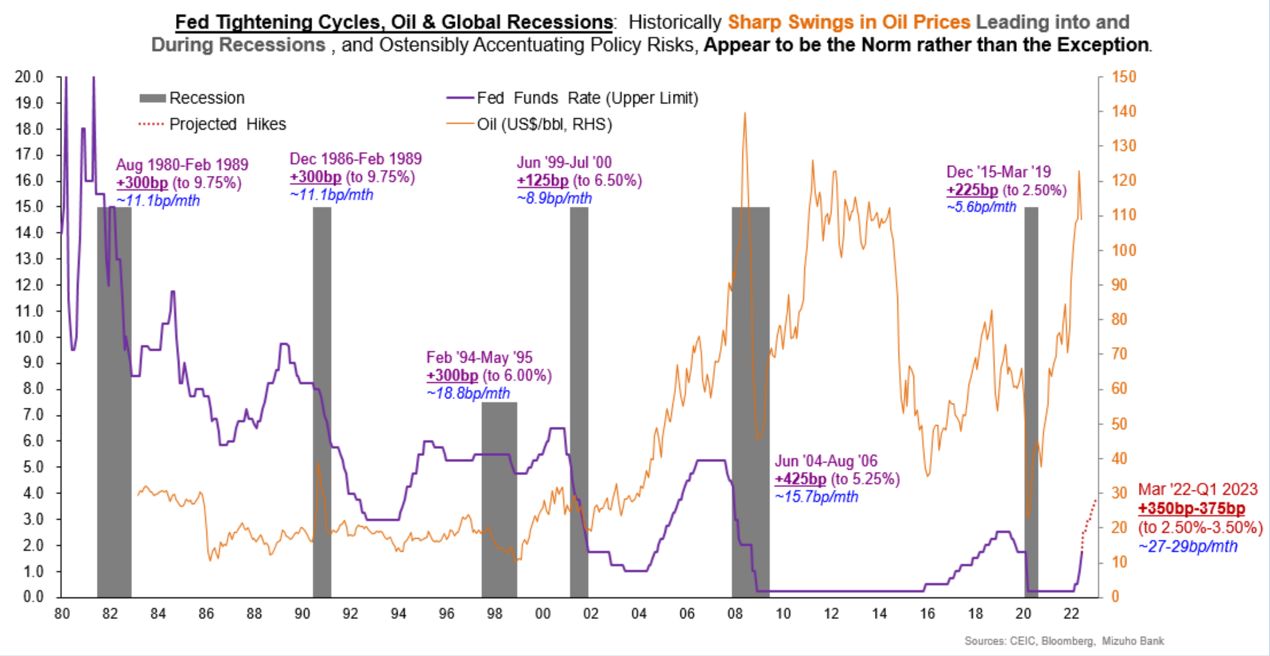
Sticky Oil & Inflation: *For now, it appears that Oil is the dog* given perceptibly, if not **significantly**, "**stickier" Oil prices** (vis-à-vis industrial metals) **on the way down amid recession fears** (See Chart above). This "stickiness" arguably **reflects war**, and attendant **uncertainty, premium**.

Fact is, **despite recent price declines** in response to recession risks, taking directional cues from other commodities, **oil prices are unequivocally and unusually elevated** (up ~42% YTD as well as since the Sep FOMC); **consistent with inflation risks** that feed into the **vehemently hawkish Fed response**.

Tipping Tendencies on a Narrow Path: Crucially, **"tipping tendencies" in Oil**, whereby **sticky Oil prices suddenly collapse** with short notice **renders Oil a binary risk**; liable to lurching from one extreme to another.

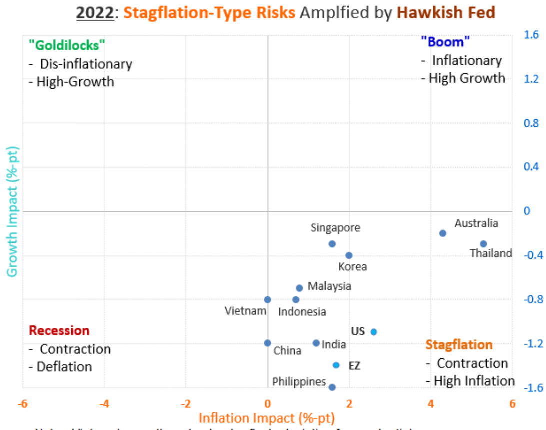
Admittedly, there may be an argument for adjustments in Oil feeding back to inflation and policy response that helps achieve a highly desirable "soft-landing". But **neither historical precedent** (See Chart below) **nor the "reflexive" nature of oil dynamics**, exaggerated in a pro-cyclical manner by financial channels/contagion risks, provide favourable odds for such an ideal outcome.

Instead, **tipping tendencies are consistent with binary risks in Oil** that **simultaneously feed off and into a narrowing path for a soft-landing**. *Echoes of Master Yoda's allusions to the Jedi's choice between two extremes resonate with Oil's binary risks.* **Stagflation-type risks for EM Asia are magnified not despite, but precisely because, of an aggressively hawkish US Fed**; which threatens to impose *disproportionately greater downside growth risks* ***as*** *inflation dampening objectives are fettered* by more **profound**, **pervasive** and **persistent supply-side quirks**.



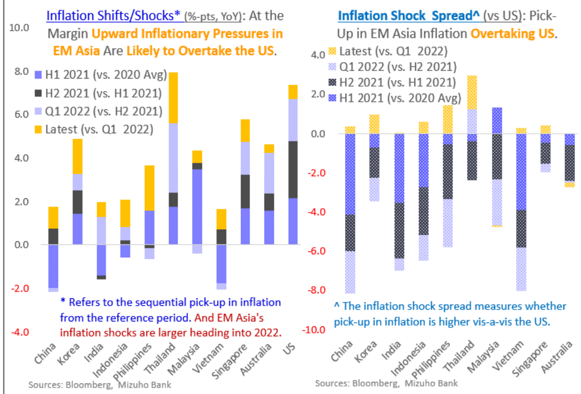
Asia Outlook: Stagflation-type Setback?

Output: Nascent and uneven recovery out of COVID is **threatened** to be **setback** by **stagflation-type pressures**. To be sure, industry has been fairly quick back on its feet, and increasingly supported by normalizing domestic demand amid COVID restrictions eased. But ***two key impediments*** **stifle growth multipliers**. The first is *tourism resumption hampered by conspicuously absent Chinese tourists*. The other, *strained post-COVID fiscal positions* setting back uneven private sector recovery. These impediments **accentuate vulnerabilities to cost shock setback** (as supply disruptions, capacity curtailed and war conspire); ultimately dampening demand. The resultant **stagflation-type setback** is further **aggravated by an aggressively hawkish Fed**.

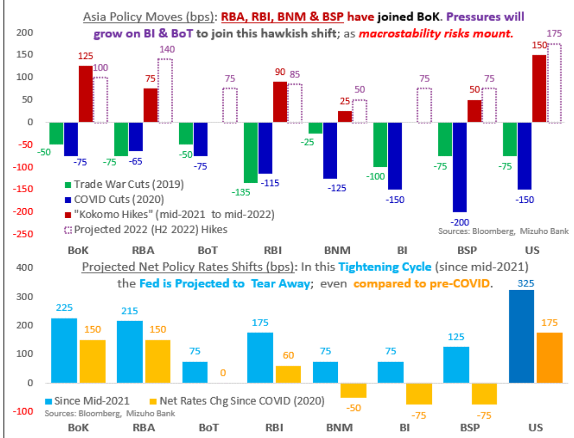


Note: Vietnam's growth undershoot reflects deviation from potential
US and EZ shifts reflect March to June revisions to growth and inflation

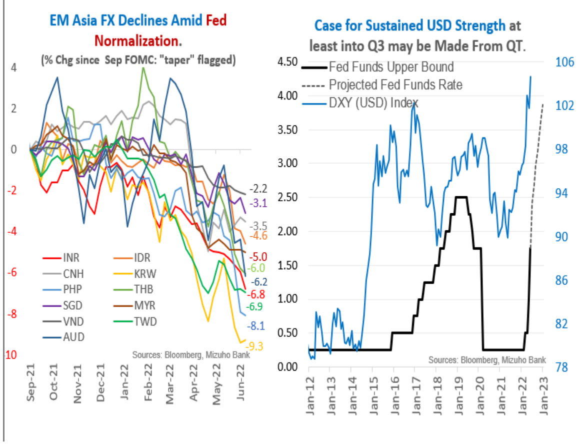
Inflation: "Reversion" of inflation dynamics is the base case; with the nascent **EM Asia's inflation acceleration vis-à-vis the US set to entrench**. This catch up in EM Asia's are driven by two key macro forces. First, the *outsized and stickier inflation pressures from food and energy,* which feature more prominently in EM Asia's consumption basket; thus, affect inflation more profoundly. Second, *strained post-COVID fiscal positions compromising the ability to absorb price shocks* effectively. To be sure, **second-round effects** may **not** be **as dire** given that *demand-pull forces and wage inflation are arguably less acute* than in the US. Nonetheless, the escalation in inflation will be a binding concern.



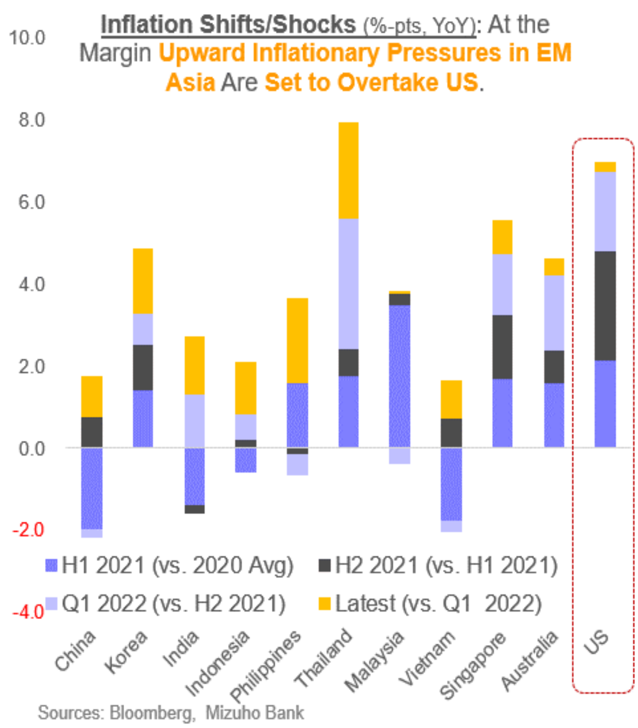
Policy: EM Asia central banks simply **don't have the luxury of discounting cost-push shocks** *despite justifiable context of diminished demand-pull* forces. And **not just because of price shocks to food and energy**, featuring so prominently for consumers, inevitably **leave a profound impact on inflation expectations**. In particular as inflation may continue to accelerate more persistently into H2. Crucially, the **Fed stepping up to an exceptionally aggressive tightening path** (of 325-350bp for 2022) **will force partial catch-up** by EM Asia central banks **as macro-stability risks emerge**. Front-runners such as *BoK and MAS can afford measured tightening.* Whereas *RBI and RBA will have to persist with larger hikes upfront*. **BI and BoT are notably on borrowed time**; and will have to start hiking in Q3.

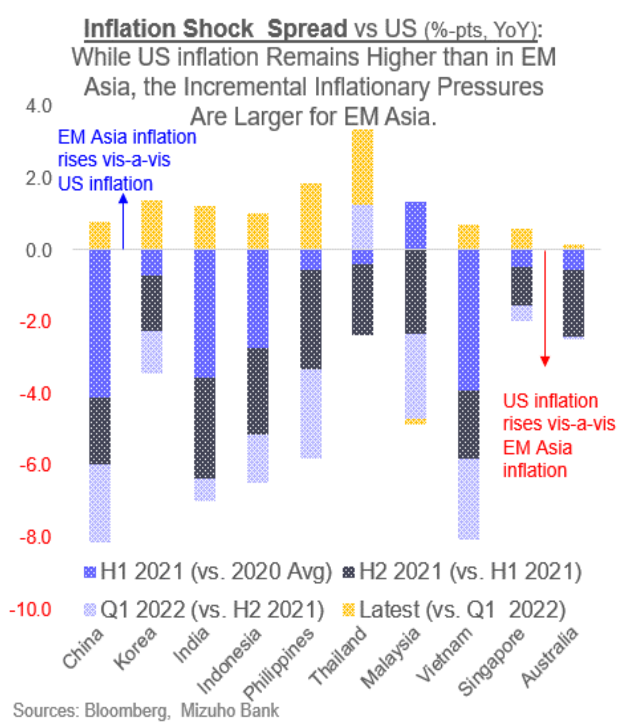


FX: Admittedly, **USD bulls**, **fueled by** a **Fed hawks** and **precautionary USD demand** (amid wider geo-political risks), have extended front-loaded gains. Nonetheless, USD upside is argubaly **not completely exhausted**. Fact is, with in-coming data likely to underpin the hawkish end of Fed hike expectations and the impending doubling of QT (from $47.5bn/mth to $95bn/mth), the **prospects of rising rates** and **shrinking USD supply** (from USD drainage from QT) is likely to buoy the Greenback. What's more, *with inflation in EM Asia set to accelerate faster than in the US, eroding real rates may dampen AXJ.* As such, **downside volatility in AXJ is par for the course in Q3 before tentative stabilization further out**.



Box 3: EM Asia Risks: Inflation Shocks to Overtake?





"I presume nothing"
– Sherlock Holmes

Relief from peaking US inflation may be **compromised by accelerating inflation in EM Asia**. Point being, even as (**US**) **inflation** is undeniably the **dominant driver for markets and policy**, it is **not a one-dimensional risk**. In fact, ironically, **peaking US inflation accentuates**, rather than assuages, **associated macro-stability risks in EM Asia** *in the context of EM Asia's inflation out-run.* As Sherlock Holmes said, "presume nothing".

Admittedly, **peaking US inflation** imaginably provides some **relief from fears of an inadvertent policy-induced hard-landing from Fed oversteer**. But this may be **insufficient to override capital outflow risks** associated with **coincident out-run in EM Asia's inflation** (vis-à-vis the US) **eroding EM Asia's real (excess) returns in EM Asia**.

Especially as uncomfortably elevated, despite peaking, US inflation constraints the Fed's ability to dial back hawkish instinct. And consequent pressures on EM Asia central banks to tighten as macro-stability vulnerabilities mount may compound economic woes while fiscal space for cushion is compromised. In all these inflation shocks narrow the path to averting worse-case outcomes.

EM Asia's Inflation Outrun: **In-coming inflation shocks reveal EM Asia's price pressures accelerating to catch-up with US inflation. More pronounced vulnerabilities to food and energy price shocks**, as a consequence of considerably higher weights for food and energy in the consumption basket, means that the **out-run in EM Asia's inflation looks set to extend and entrench**. Especially as lags in EM Asia's re-opening underpin the *contrast between peaking US inflation and rising EM Asia cost shocks* – which turns up stagflation-type^ pressures in EM Asia.

Resultant Inflation "Inversion Reversion": The resultant **inflection in EM Asia-US inflation spread**, as EM Asia's inflation pick-up overtakes that of the US (as it has almost ubiquitously since Q2, and since Q1 for Thailand; see Charts), is **consistent with our earlier warning* of inflation "inversion reversion"**. Specifically, in reference to *inflation dynamics beginning to reverse out uncharacteristically "inverted" state of higher US inflation vis-à-vis EM Asia.*

Accentuating Hawkish Fed Risks: And **insofar that US inflation**, despite peaking, is **not set to recede convincingly enough for the Fed to renege on its aggressively hawkish stance**, EM Asia's **inflation "inversion reversion" will accentuate capital outflow risks** from an aggressively hawkish Fed. Especially considering the context of stagflation-type pressures, real returns in EM Asia are undermined by a double-whammy of compromised growth and exacerbated cost-shocks.

Necessary, But Insufficient Policy Response: Admittedly, EM Asia central banks have stepped up to the plate in front-loading the removal of accommodation. But the risk is that **sharp policy trade-offs** (between growth and tackling inflation) will **limit options and cushion**. Upshot being, **EM Asia's policy tightening is necessary to insure against worst-case macro-stability threats**, **but insufficient to render the Fed's far more aggressive tightening a glancing blow to financial stability**.

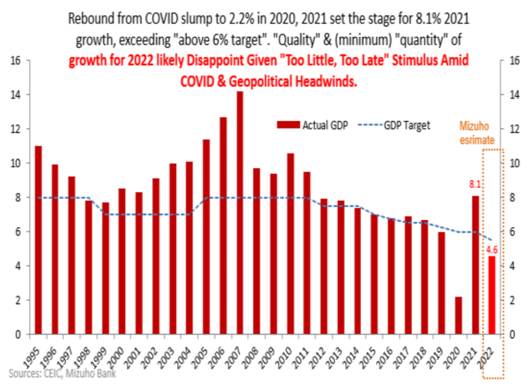
Narrow Path to Avert Worse-Case: What's more, monetary **tightening comes at the expense of growth**, which in turn also compromises growth/returns/stability. Invariably, it is a **narrow path to avert worse case outcomes**; especially **as fiscal space to compensate for monetary policy dilemma is compromised** by *pre-existing COVID strains* now vulnerable to the *risks of negative ratings cycle that tend to accompany rising global/US rates.* With Fed's rate hike strewn with risks from war, China, lingering COVID and a myriad of other moving parts, we can benefit from Sherlock Holmes' wisdom to "*presume nothing*".

^ Please see Mizuho Chart Speak - EM Asia: Stagflation-Type Risks Mount, 1 Jun 2022.
*Please see Mizuho Chart Speak - EM Asia FX: The Inflation 'Inversion Reversion' Risks, 21 Feb 2022.

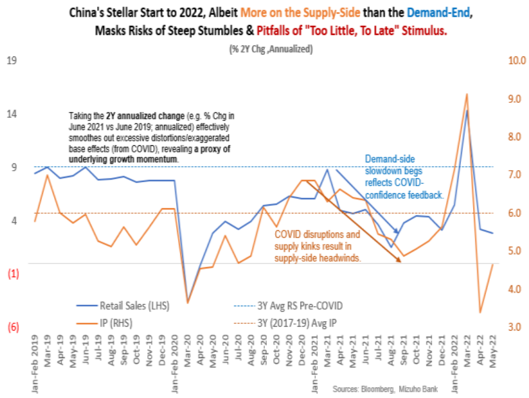
China: Unforced Errors

Growth: "*Saving China from itself*" is a refrain we have alluded to; reflecting primary concerns about self-inflicted headwinds. Moreover, **China is not immune to gathering global headwinds**. *But* much of the **pre-existing weakness in China precede the looming storm**; and mostly self-inflicted. Arguably, **unforced errors** that have incurred huge economic costs for political and social objectives. As such, China is not **only poised to fall well short of the "around 5.5%" growth target** it has set. But even this **"miss" may be overstated by massive public health efforts** at "Zero COVID" policy that add to growth. This, rather than bona fide optimism, is why our 4.6% forecast is more upbeat than the street. So, the underlying **risks are to the downside**.

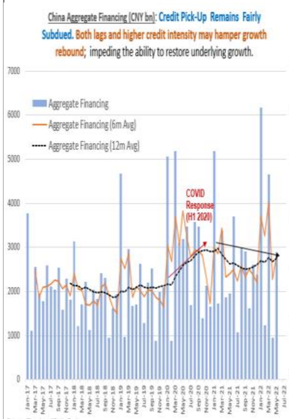
	2005-2011	20102-2014	2015	2016	2017	2018	2019	2020	2021	2022
GDP Target	8.0%	7.5%	"Around 7%"	6.5-7.0%	6.5% or higher"	"Around 6.5%"	6.0-6.5%	6.0-6.5%	Above 6%	"Around 5.5%"

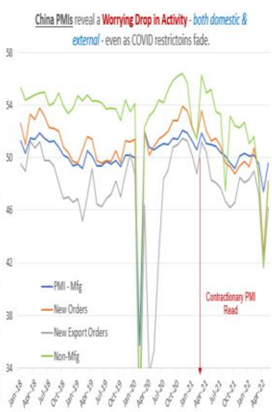


Industry: *Rolling COVID lockdowns* exacerbating the disruptions appears to have **shown up more brutally in domestic services** whereas large manufacturing/exports industries appear to have been quicker to resume activities (albeit in some cases in a "bubble"). As a result, the **recovery looks more to have been a lot bumpier and uneven** than headlines alone might otherwise suggest. But the **bigger worry** is **confidence deficit from persistent property market overhang**; as spillover chills in ancillary sectors and negative wealth effects dampen growth multipliers. As such, reliance on *"infrastructure" stimulus may be a worry, not relief*, if public projects fail to inspire "animal spirits".

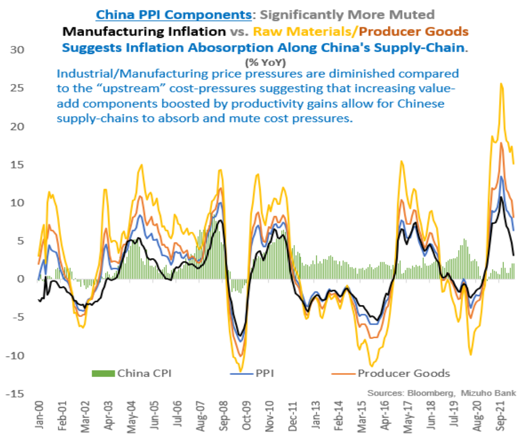


Growth dynamics: The **single biggest risk** taken from a policy standpoint is "*too little too late*" **stimulus** coming off a runway of **brutal liquidity clamp-down in the property sector** (which has already led to some degree of credit restructuring) alongside **regulatory/tech crackdown** that has simultaneously **sapped confidence and triggered pervasive negative ripples** across the economy (given the sheer reach of these sectors). And so, **policy stimulus plans** - monetary or infrastructure - **may be under accounting for compromised growth multipliers**. Upshot is that a lot more may be required by way of reparations/reassurance (fresh stimulus included) to revive underlying growth momentum.

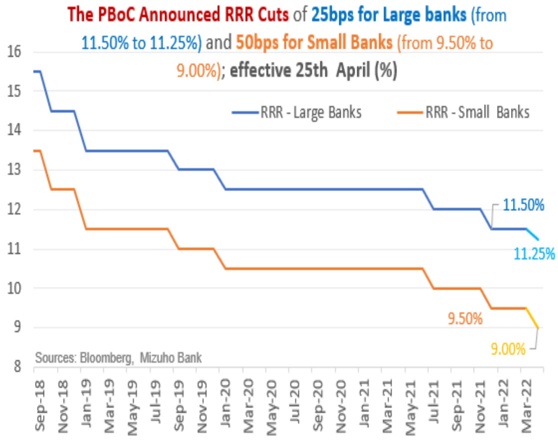




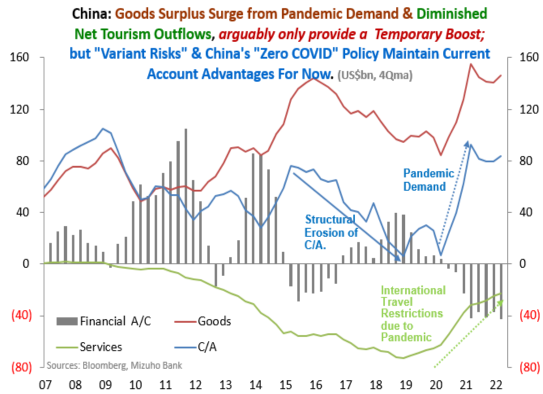
Inflation: In contrast to elsewhere, China's **consumer inflation is not flashing red**; certainly not enough to require that the PBoC backs down from an accommodative policy stance. *However*, this **should not be misconstrued as China being blissfully insulated from global price shocks**. It simply isn't. Instead, the availability of strong *SOEs across industries to impose top down and effective price controls* - the equivalent of quasi fiscal subsidies - helps to anchor CPI far more effectively. As do *diminished vulnerabilities to shipping snarls* thanks to vertical supply chain onshore. What's more, *productivity gains* across China's comprehensive supply chain further *provide scope to dampen price shocks.* In concert, these buffers explain the **disparity between subdued CPI and more elevated PPI**. A disparity which is **likely to be persistent**, **but** comfortingly, **not problematic** for policy.



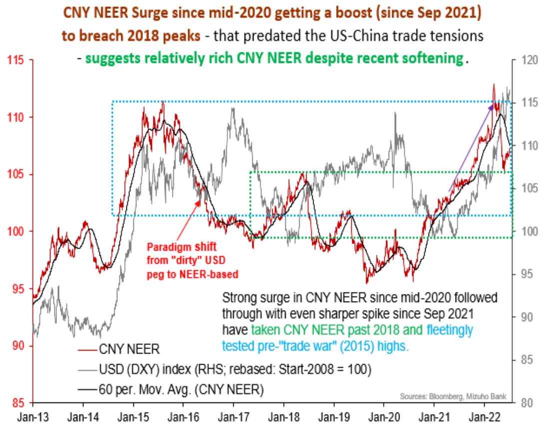
Policy: As such, the **PBoC is well-placed to overlook cost shocks** (which are predominantly absorbed via industrial productivity) to keep its eyes on providing sufficient stimulus for the economy; especially given the shortfall in momentum so far. *Further RRR cuts to buffer risks of adverse liquidity shocks* alongside *credit quotas increments to boost lending* - especially to SMEs to preserve jobs - looks like a matter of timing and preferred policy mix. *CNY and wider asset market stability* may be **additional policy imperatives heading into the Oct/Nov NPC**. That said, efficacy of the suite stimulus depends more on **combination tools** and **execution finesse** rather than showy headline rate cuts.



External Position: : **For all the activity disruptions** from Zero COVID policy, China's **Current Account does not appear to have been adversely impacted**. For one, exports have been fairly resilient give the priority give to large industries in restarting activities. What's more, the continued pent-up global demand re-emerging from COVID has also boosted top line. Meanwhile, despite increased energy and commodity bills, the lockdowns have in some way dampened scope for import surge. Crucially, **extended closed border policy** by China means that the recent (pre-COVID) *potential net travel outflows* (~1.5-2.0% of GDP) continue to be **"dammed" onshore, propping up the C/A**. And this state of affairs may by and large be intact **even if rising energy costs erode the goods surplus at the margin**.



FX: There will be **clear tensions between a rising USD tide** *in the midst of hawkish Fed flex* (at times being contrasted against the PBoC's easing bias) **and the desire for CNY stability**. Especially heading into the NPC in Oct/Nov, where a **critical power transition for President Xi**, is likely to **accentuate the importance of economic** (and by extension, **CNY) stability**. **But** our suspicion is that this *will not invoke a "line in the sand" type of policy,* but rather take into account broader USD trend that prevail. And so, ought to **be consistent with wider CNY NEER stability**, perhaps with a slight upward bias to reflect relative CNY resilience. Which is why it is likely that USD/CNY will see back below 6.50 later in 2022; so long as USD bills begin to mellow gently alongside peak Fed hawks.



	Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023
GDP (% y/y)	4.8%	2.9%	5.6%	8.5%	7.8%	6.0%
CPI (% y/y)	1.1%	2.4%	2.8%	2.7%	2.5%	2.4%
Policy Rate^ (%)	3.70%	3.60%	3.50%	3.50%	3.50%	3.50%
USD/CNY*	6.34	6.69	6.79	6.69	6.62	6.48
	6.30-6.39	6.34 - 6.82	6.42 - 6.93	6.38 - 6.86	6.46 - 6.96	6.27 - 6.73

Note: Values in black are historical whereas those in blue represent forecasts.

* Point forecast is for end-period. Q1 2022 ranges are from Bloomberg and only indicative.

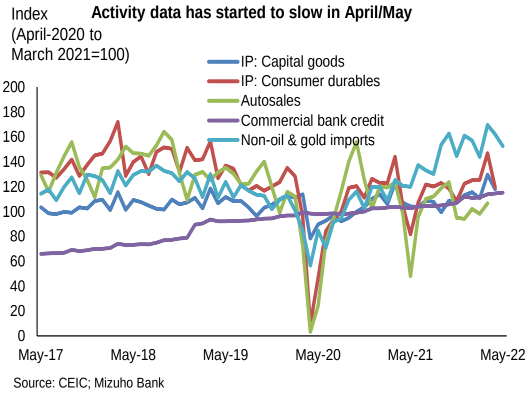
India: Fault Lines Hit Home

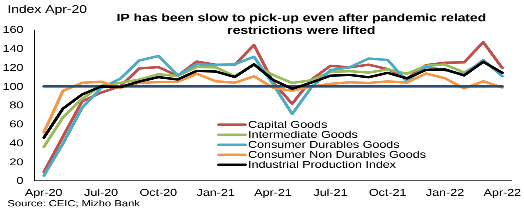
Growth: GDP growth recovered to 8.7% YoY in FY22 from -6.6% in FY21 but there are signs that the growth recovery has started to peter out. For one, activity data is becoming more mixed. The growth recovery in exports, industrial production and auto sales has slowed. Consumer and business confidence have fallen on account of higher inflation and financing costs. Despite this, credit growth has continued to pick-up, reflecting some pent up demand but also some front-loading as domestic interest rates look set to rise. **We expect GDP growth to slow to 6.9% YoY in FY23, below the Reserve Bank of India's (RBI) 7.2%. For FY22, we expect GDP growth of 6.7%.**

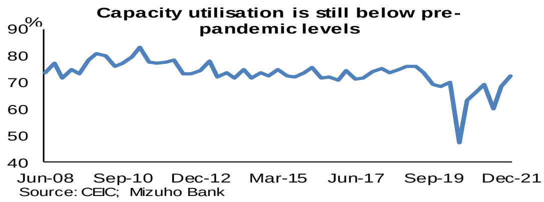
Industry: Industrial production (IP) has remained characteristically volatile. Underlying momentum suggested that IP is weakening in a broad-based manner, with the weakest link being capital goods IP. Capacity utilization, while having picked up, still remains below pre-Covid levels. **Notwithstanding, the outlook for IP for the remainder of FY22 (and possibly FY23) is uninspiring.** The rising cost of inputs and the limited ability to pass-through price pressures will weigh on production targets, corporate profits and in all likelihood, reduce capex allocations.

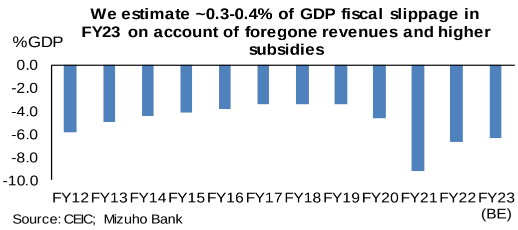
Growth dynamics: **All indicators point to slowing growth but none more than the fiscal tightrope the government is walking.** The budget deficit is pegged at 6.4% of GDP but given the elevated global commodity prices, the associated fuel, food and social assistance costs, and revenue foregone from lower-than-expected economic activity and excise revenue losses, *we estimate the slippage could be 0.3-0.4% of GDP*. This would result in little to no fiscal consolidation compared to a 6.7% of GDP deficit in FY22. The government is reluctant to increase borrowings to compensate for the fiscal slippage **given the signal it sends regarding India's already precarious sovereign ratings position** .

Inflation: As of mid-2022, India's **inflation has far from peaked**. Crucially, the **retreat in May's inflation** (to 7.0% from 7.8% in April) is but **a short-lived distortion of base effects** that understate price pressures. Arguably, the effect of fuel tax cuts probably also has an ephemeral dampening impact. Whereas, **underlying price pressures are likely to be elevated and sticky**. For one, **upside risks to food** are **intact**; especially as higher minimum support prices conspire with a compromised harvest. What's more, **energy inflation is set to remain problematic** as "low hanging" respite from cheaper energy imports are insuffient to deflect wider global energy inflation; especially with an energy crunch adding to pressures. Upshot being, *inflation is likely to get higher, flirting with 8+% before moderating into 2023.*







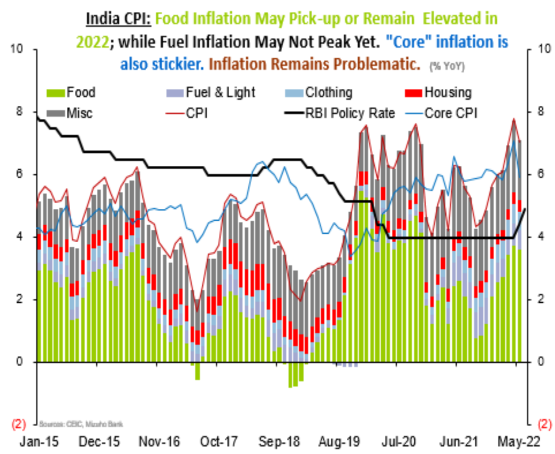


Country	Rating/Outlook	Fitch	S&P	Moody's
India	Rating	BBB-	BBB-	Baa3
	Outlook	Negative	Stable	Negative

Source: Bloomberg; Fitch Ratings, S&P, Moody's, Mizuho Bank. Note: These are Local Currency Long Term ratings

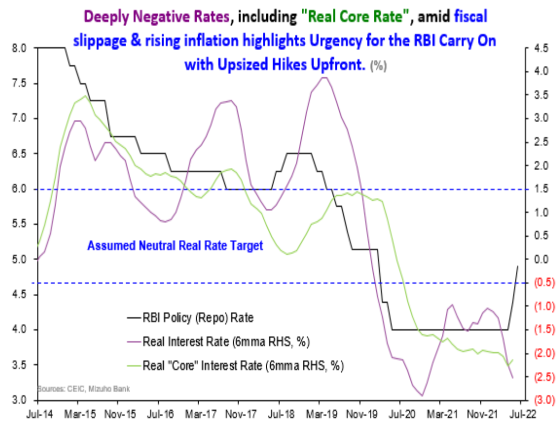
Red highlight denotes a rating/outlook downgrades in the last 12 months; Yellow highlight denotes downgrades in the last 12-24 months

Green highlight denotes rating/outlook upgrades in the last 12 months

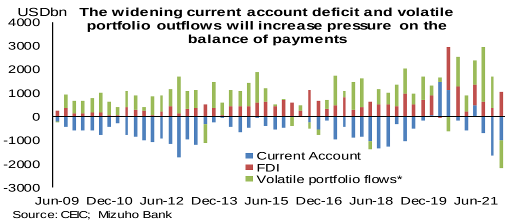


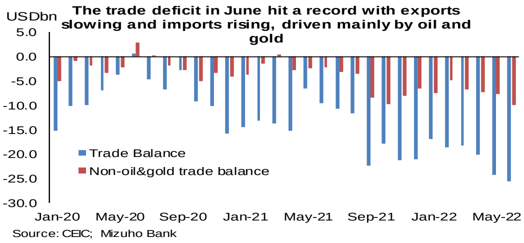
MSMEs: Micro, small and medium-sized enterprises
NBFC: Non-banking financial companies in India, the source of credit surge in the recent past.

Policy: **Distinct hawkish policy inflection by the RBI** – from an *unscheduled 40bp hike in early-May* followed by a *50bp hike at the June meeting* alongside notable abandonment of allusion to "accommodation" – is a **welcome shift in stance** in response to mounting inflation risk. The RBI has revealed **continued tightening bias**, with a preference for *upsized* and *front-loaded rate hikes*. The urgency of which is **validated by the fact that real rates remain deeply negative despite 90bp of hikes May-June**. So, another **110bp hikes in H2 2022** to lift the repo rate to 6.00% is par for the couse. And *MPC view that inflation outrun influences direction, not levels*, of *policy rates* hints at restraint; especially if inflation is seen peaking in 6-12 months. All said, "getting ahead of the curve" remains a key policy priority for now.

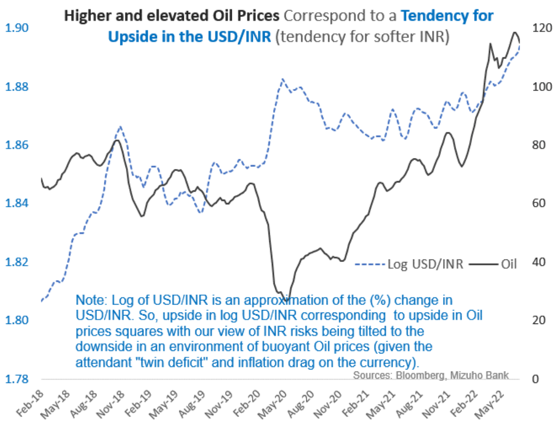


External Position: **The record June trade deficit of USD25.6bn speaks to the stress that the external position is under.** Slowing export growth, not least before the implementation of an export tax on diesel, petroleum and turbine fuel, combined with rising imports mainly of fuel (with gold pulling its weight). **Mirroring the trade deficit, the current account deficit will also widen in Q2 FY22, without consolation of consolidation in the coming quarters**. **Elevated global food prices are also bearing down on India's external position with the wheat embargo** hurting exports and imported food inflation worsening terms of trade. While the balance of payment is less precarious than in 2013, RBI's running down of FX reserves to lean against INR depreciation has hit its limit leading to INR depreciation.





FX: Heading into end-2022, **rupee is by and large likely to be compromised** on account of two things. First, *elevated oil prices*, which suggest that sustained pressures on the Current Account will be a bugbear for the rupee. Second, *higher inflation* that *erode real returns* (from rupee asssets); thereby further undermining INR. To be sure, the **RBI shifting gears to get into serious (hawkish) catch-up mode** – with a front-loaded approach to rate hike – could help provide some **buffer for the rupee**. But this is merely at the margin. Whereas, exceptionally low real (policy) rates alongside "twin deficit" risks rendered more actute by an aggressively hawkish Fed sets the stage for potentially sharp corrections in H2 before gradually regaining ground.



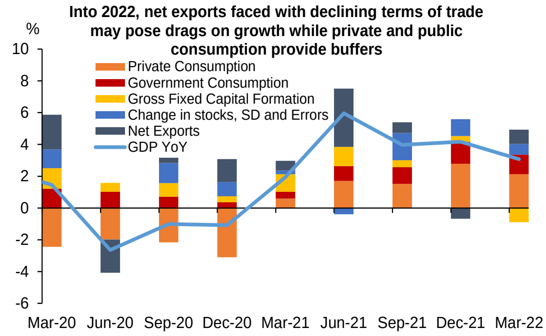
	Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023
GDP (% y/y)	4.1%	12.9%	5.6%	5.2%	5.3%	4.4%
CPI (% y/y)	6.3%	7.3%	7.4%	7.2%	6.3%	5.3%
Policy Rate (%)	4.00%	4.90%	5.75%	6.00%	6.00%	6.00%
USD/INR*	75.8	78.3	80.5	78.8	76.2	75.3
	73.7 – 77.0	75.3 – 79.0	77.2 – 82.8	76.8 – 81.5	73.4 – 78.5	71.4 – 77.7

Note: Values in black are historical whereas those in blue represent forecasts.

* Point forecast is for end-period. Q1 2022 ranges are from Bloomberg and only indicative.

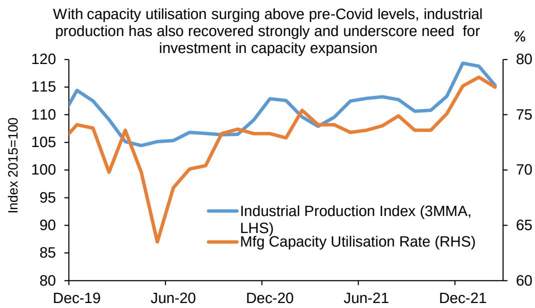
South Korea: Blunted Trade Engines

Growth: With GDP growth coming in at 4% in 2021 and 3.0% YoY in Q1 2022, we continue to expect **growth to soften towards pre-pandemic trend growth to post 2.9% for 2022,** a downward **0.4% point revision** (from our previous forecast) on account of slightly higher than expected 2021 outturn and growing downside risks. Private consumption stemming from pent-up demand alongside **fiscal spending efforts** to repair household balance sheets supported economic growth. Net exports also contributed to GDP growth as electronics demand held up strongly. **Risks from China growth slowdown and declining terms of trade** amid higher import prices from commodities look set to **blunt the external trade growth engine in H2 2022.**



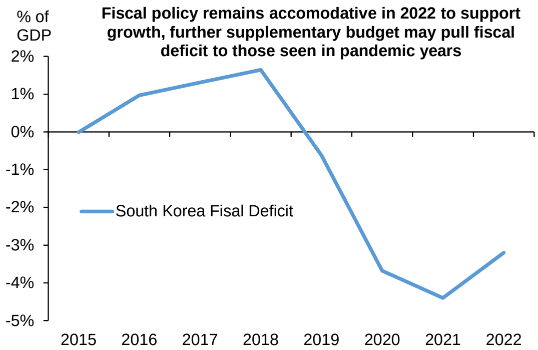
Source: CEIC, Mizuho Bank

Industry: Industrial production has recovered strongly and **manufacturing capacity utilization,** being 5.7% above pre-Covid levels and **at multi-year highs,** tells of the need for substantial investments to expand productive capacity. With FDI pledges and arrivals in 2021 expanding 42% and 58% YoY respectively, **industrial production is expected to continue in a steady and resilient manner** for the rest of this year while the Korean New Deal 2.0 drives economic transformation. Admittedly, higher interest rates may weigh on construction as seen in Q1 22 outturn while geo-political uncertainties restrain private capital expenditure plans.



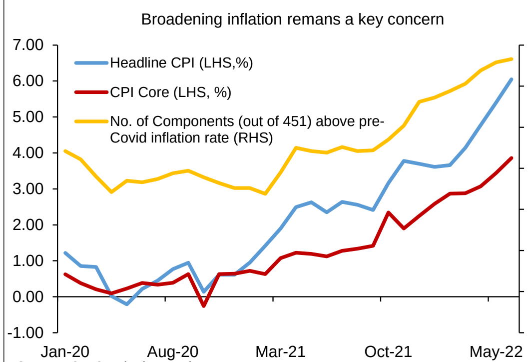
Source: CEIC, Mizuho Bank

Growth dynamics: With the **supplementary budget amounting to more than 3% of GDP passed last month** which culminates in overall 2022 fiscal deficit of 3.3% of GDP, fiscal support remains critical to underpin growth ahead. With a positive output gap, rising costs eroding margins and higher consumer prices may pose impediments to the trajectory ahead. **Supply constraints** from on-going Russia-Ukraine conflict will weigh on imports ranging from fuel and fishery products to metals on both **availability and cost fronts** while **revenue from export of goods such as automobiles** may take a slight dent from the missing Russian market.



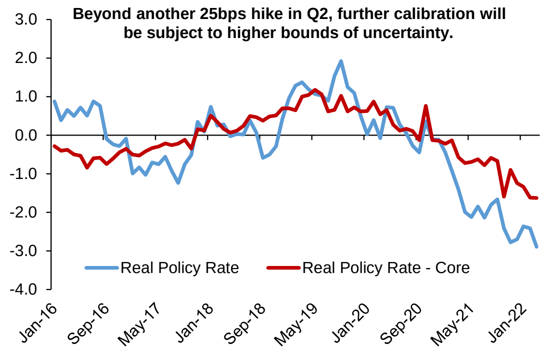
Source: CEIC; Ministry of Economy and Finance; Mizuho Bank

Inflation: With headline CPI and core inflation averaging 5.4% and 3.5% respectively for Q2 2022, both cost push inflation from higher crude oil prices and underlying demand pull pressures from economy growth culminates in a **broadening of price pressures**. Even on an unweighted basis, **73% of components show inflation rates higher than their pre-Covid inflation rates** with evident pickup in services inflation. Fuel tax cuts has so far been deepened and extended multiple times in a bid to prevent further escalation of energy prices. **2022 headline inflation is upgraded to 5.4% from 2.4% at the start of this year underscoring substantial stagflation risks**.



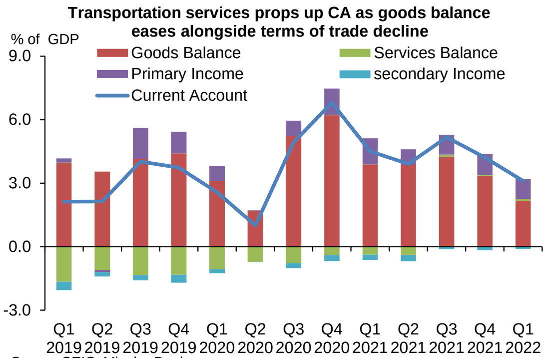
Source: CEIC, Mizuho Bank

Policy: With two steps of 25bps rate increases bringing policy rate to 1.75%, the BoK has sought to anchor **inflation expectations which has edged up in recent months**. Given external Fed headwinds and **still excessively negative real interest rates**, we expect another **50bps of hikes in Q3 to reach 2.25% based on** a delicate balance between nearer term concerns of unprecedented inflationary pressures amid **slowing global growth** and longer term potential growth amid a **silvering population and productivity challenges. However, for the decision between 2 steps of 25bps or a single big step of 50bps, we lean towards the latter as it allows time for policy transmission with a pause from mid-July to October. On the fiscal front,** President Yoon has passed his **additional supplementary budget** which, despite the large sizing at above 3% of GDP, will be largely funded from excess government revenue and consequently, government debt to GDP ratio will be expected to edge up only to 49.7%.



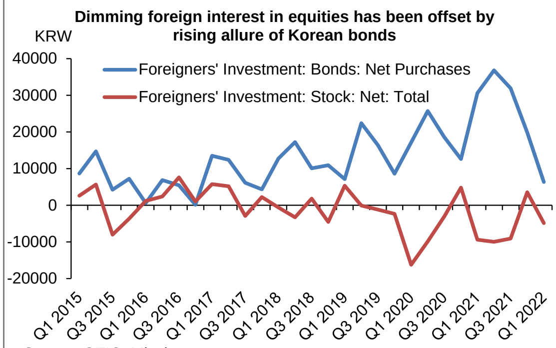
Source: CEIC, Mizuho Bank

External Position: Current account surplus in Q1 dipped to a 3.1% of GDP as the goods balance faltered while the **transport balance through higher freight rates continue to support**. The worrying phenomenon on the trade front is the **declining terms of trade** in which **escalating import prices from surging input prices has begun to chip away at tailwinds from their traditional high tech comparative advantage.** All in, expanding semiconductor and electronics demand will underpin and lean against external cost headwinds resulting in a smaller current account surplus in 2022 towards 2-3% of GDP instead of 4-5% of GDP in 2021.



Source:CEIC, Mizuho Bank

FX: While a further rate increase by the BoK will serve to backstop excessive KRW weakness, deference to the USD remains the base case in Q3 2022. First, evidently **rising inflation will erode real returns** while **policy rate differential will be diminished as the Fed embarks on their hawkish monetary policy tightening**. While current account surplus alongside interest in Korean bonds will drive KRW demand, the accelerating winds of the Fed's quantitative tightening and higher oil prices highlight Korea's **energy reliance, and transmission through the industrial complex will mean that weakness can stem from multiple fronts**.



Source: CEIC, Mizuho

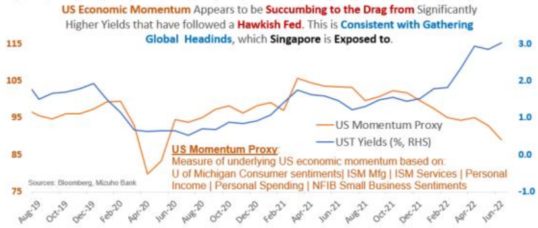
	Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023
GDP (% y/y)	**3.1%**	2.8%	3.1%	2.5%	2.6%	2.5%
CPI (% y/y)	**3.8%**	**5.4%**	6.2%	6.1%	3.9%	3.1%
Policy Rate (%)	**1.25%**	**1.75%**	2.25%	2.25%	2.25%	2.25%
USD/KRW*	**1212**	**1299**	1310	1290	1280	1270
	1185-1244	**1210 - 1304**	1250 - 1380	1240 - 1380	1230 - 1340	1220 – 1320

Note: Values in black are historical whereas those in blue represent forecasts.

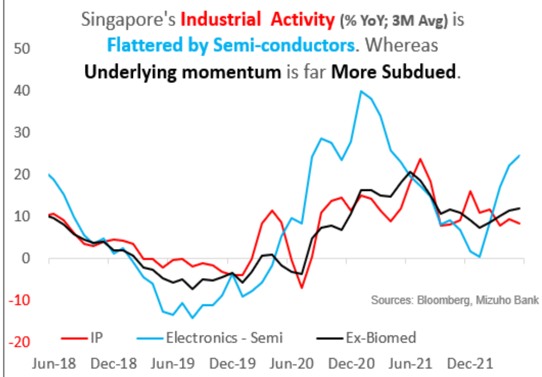
* Point forecast is for end-period. Q1 2022 ranges are from Bloomberg and only indicative.

Singapore: Spring

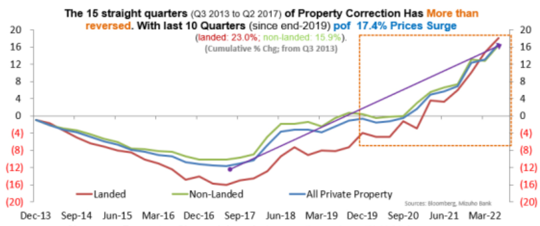
Growth: Admittedly, **H1 2022 growth showed a spring** in the step; as both manufacturing and services picked up with fairly robust momentum. ***But* the forward-looking assessment of "spring"** refers to **Charles Dickens'** "*summer in the light, and winter in the shade*" take on the volatile vagaries of early-Spring. Point being, **despite clear hot spots in the job and property markets**, spilling over as broadening inflation risks (that compound external cost push), the **economy remains vulnerable to chills from global headwinds**. Especially *amid Fed-induced recession risks* and *China uncertainties*. And so, while 2022 may deliver fairly resilient 3.2-4.0% growth, **underlying momentum risks sharp slowdown should global recession risks play out**.

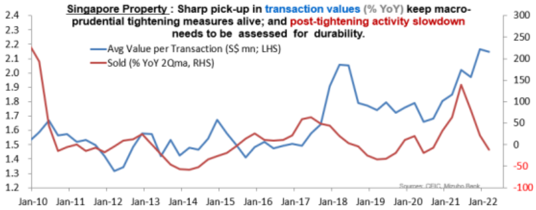


Industry: Even with the distinct moderation in industrial activity growth, the **underlying momentum appears to be flattered** by exceptional strength in semiconductors. To be sure, this burnishes the resilience in industry. But the wider point is that **downside risks may be under-stated** in the current industrial activity headlines for two reasons. One is that the **semiconductor "spring"** may be **masking inherent volatility amid uncertainty** from the on-going war and wider energy shocks; resulting in more volatile Petrochems output. The other, and notably larger risk, is **cost shocks and aggressive Fed tightening may dampen demand further**.

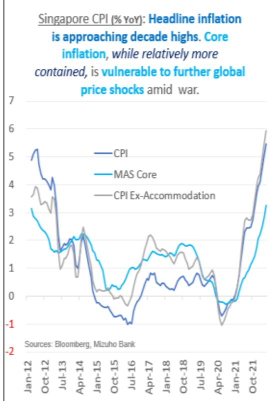


Growth dynamics: A particular **challenge to policy calibration** may be the **dissonance between slowing growth momentum** and a **bubbling hot property market**; creating *tensions between asset market* (stock) *and activity* (flows). And this **disparity may be accentuated** as (as anecdotal evidence of) investor inflows fuelling property demand may be less sensitive to rising global rates, which typically slow overall demand. **If the property market averts lurching over**, *rising property values despite an economic slowdown threaten to exacerbate inequality*. And **if a sharp property market correction is set off**, it may *inadvertently result in a more painful economic hard-landing* – via adverse jobs-housing-banking-wealth feedback loops. **Like a coiled spring, the property market poses latent risks**.

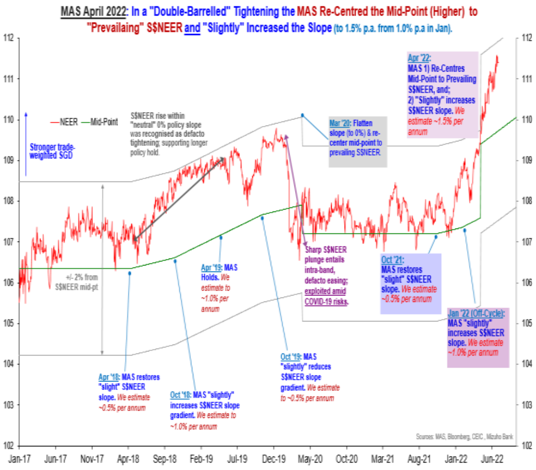




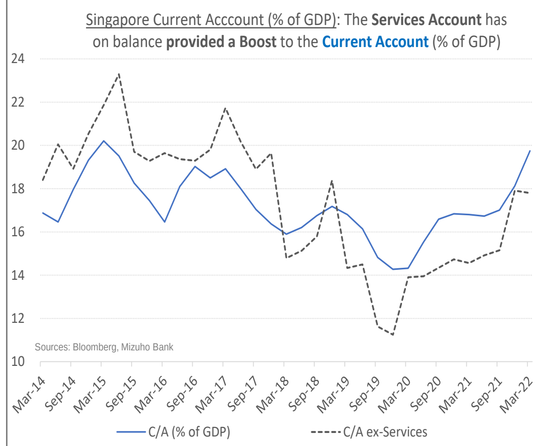
Inflation: More generally, **upside risks to inflation continue to linger** as *lagged and persistent energy inflation impact* (via contract utilities tariffs) conspires with *vulnerability to bouts of food price shocks* amid protectionist tendencies amid global grain shortages due to war and weather. What's more, **with a 2%-pt GST hike start of 2023 flagged**, not only will there be **administrative price pressures** but also the **risk of additional (precautionary) cost buffering** by merchants; which may inadvertently lead to an **additional wave of price impulses**; resulting in more persistent inflationary pressures. A **tight labour market and rising wages** may also **"lean into" these inflationary dynamics**. At the margin, *inflation is set to be stickier* with upside risks. *But not unacceptably unsettling.*



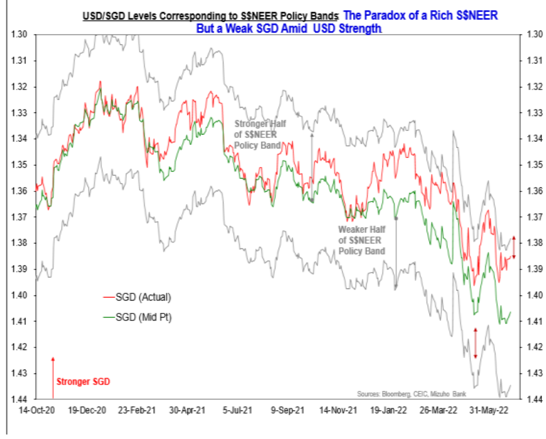
Policy: So, **despite inflation risks** remaining tilted to the upside, accentuated by vulnerability to food and energy price shocks conspiring with a tight labour market, the **MAS is unlikely to deliver another "step appreciation"** (re-centring the S$NEER midpoint higher). Tellingly, the *MAS has rightly said that not all inflation shocks require a monetary response in the context of higher food prices due to supply disruptions*. This **reflects holistic policy approach** that *recognises substitution channels that may be exploited with far greater efficacy*. Crucially, it also alludes to **proportionate and appropriate policy response in view of policy lags and evolving inflation**. With a series of slope steepening and front-loaded "step appreciation", *further slope steepening at the October meeting may be the more appropriate response.* Especially as **mounting global headwinds increase risks of a recession**.



External: The **widening C/A surplus**, getting close to 20% of GDP for Q1 2022 partly **reflects strong goods surplus**. But crucially, a notable **boost from net services** surplus as well. Admittedly, **high oil prices amid wider geo-political cost shocks could begin to chip away** at the C/A surplus in coming quarters. But the *sheer quantum of C/A surplus buffer*, and *outsized trade with respect to the domestic economy* means that **"margins"** will quite comfortably allow for a **C/A surplus** – *albeit potentially diminished* – **to be maintained**. Whereas, actual demand, rather than cost pressures, may be a bigger risk to the C/A surplus. In any case, the **resilient, if not resplendent, C/A position is likely to underpin S$NEER**.



FX: If we are right about the MAS not resorting to another re-centring (higher) of S$NEER mid-point, **scope for pronounced S$NEER outperformance is fairly limited**. Especially *as a rich S$NEER close to the top end of the policy bands limits scope for instantaneous upside;* **but** leaves **room for bouts of under-performance**. Instead, the **steeper slope could accentuate scope for gradual appreciation** bias - but "gradual" is by and large the operative term with regards to relative outperformance of the SGD vis-a-vis trade partner currencies. What that means is that **SGD performance may be reliant on a greater degree to USD trends and turns** alongside relative EUR, CNY and MYR shifts.



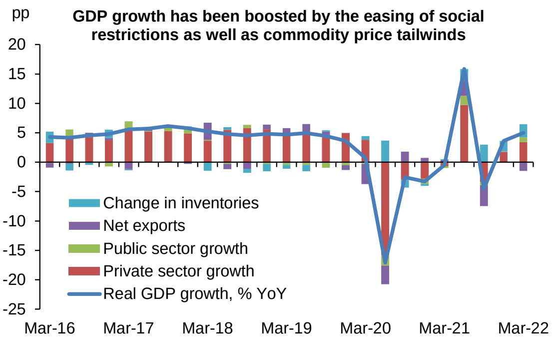
	Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023
GDP (% y/y)	**3.4%**	4.3%	4.1%	3.4%	3.3%	3.0%
CPI (% y/y)	**4.6%**	4.2%	3.7%	2.8%	2.6%	2.1%
FX Policy	**Recenter Mid-Pt Higher & Slightly Increase S$NEER slope (1.5% per annum)**		"Slight" Increase of S$NEER Slope (2.0% per annum)		Maintain S$NEER Slope (2.0% per annum)	
USD/SGD*	**1.35**	**1.39**	1.408	1.388	1.374	1.354
	1.34 - 1.37	**1.35 - 1.40**	1.366 - 1.438	1.358 - 1.414	1.340 - 1.421	1.317 - 1.405

Note: Values in black are historical whereas those in blue represent forecasts.

* Point forecast is for end-period. Q1 2022 ranges are from Bloomberg and only indicative.

Malaysia: Resilient But Not Immune

Growth: The economy grew 3.1% in 2021 after contracting 5.6% in 2020. With Q1 2022 GDP growth at 5%, the recovery in GDP levels is back to pre-covid (2019) levels. **Activity data for April 2022 slowed partly as base effects normalize** (the imposition of stringent social restrictions in Q1 2021 depressed the base for Q1 2022) but also global growth headwinds, from tighter monetary policy, elevated commodity prices, supply-side constraints and domestic labour shortages, take hold. Elevated commodity prices, to some extent, boost growth but the intensity and duration of sticky global commodity prices is fast reaching a point of diminishing returns.

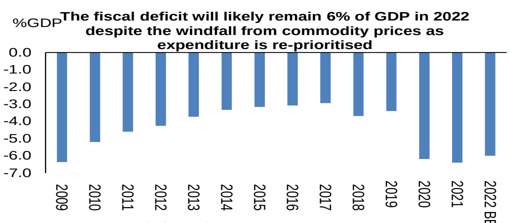


Source: CEIC; Mizuho Bank

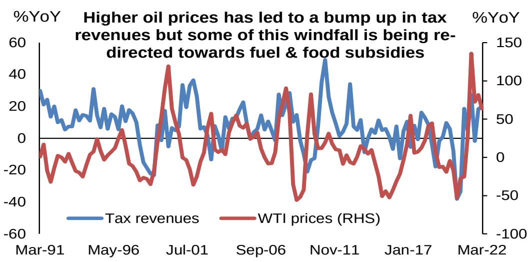
Industry: Industrial production growth remained relatively stable at 4.6% YoY in April from 4.5% in Q1; with anecedotal evidence pointing to higher capacity utilization. In fact, **labour shortages from stringent border restrictions are only gradually easing** – a case in point was Malaysia's labour shortages prevented it from raising palm oil production to take advantage of Indonesia's palm oil embargo. Even so, as global export volumes ease on account of slower demand, Malaysia's exports look set to slow albeit from elevated levels. April/May goods exports growth remained solid at 25.7% YoY from 22.2% in Q1.

Source: CEIC; Mizuho Bank

Growth dynamics: **We have lowered our 2022 GDP growth forecast to 5.3% from 6%.** Even though Malaysia is a net commodity exporter and will benefit on the export and fiscal revenue fronts from higher commodity prices; the offset from weaker global growth and rising inflation is becoming acute. To that end, the economic situation is resilient as it can still rely on commodity price buffers but the economy is not immune to the global growth slowdown and rising 'stagflation' associated trade-offs. **More specifically, higher government revenues associated with rising global commodity prices is being directed to increasing subsidies on retail fuel and food prices**. The government, with effect from 1 June, restricted the exports of chicken to ensure adequate domestic supply; while placing retail price caps on poultry products.

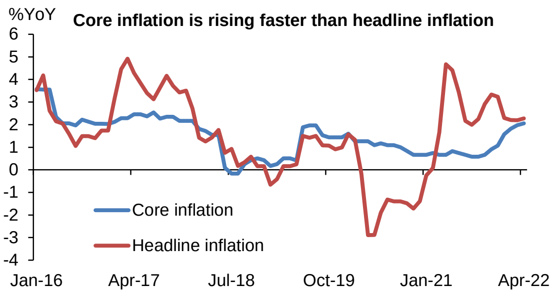


Source: CEIC; MOF; Mizuho Bank



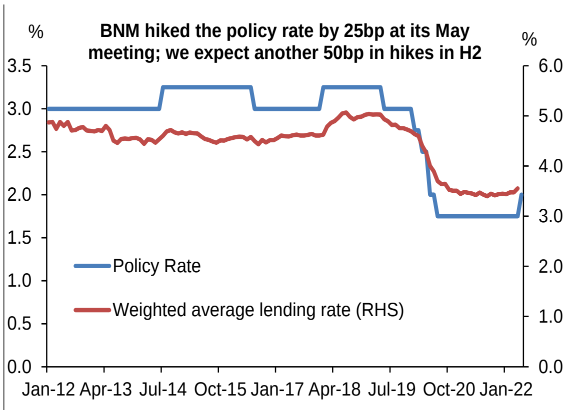
Source: CEIC; Mizuho Bank

Inflation: Even though headline inflation has been kept artificially low through food and fuel subsidies, **core inflation, however, has been rising noticeably** and this is on account of global supply chain constraints pushing up producer prices, tightening labour markets as well as some demand pull-inflation. **The rise in core inflation will likely continue and was in fact cited by Bank Negara Malaysia (BNM) as one of its key reasons to begin normalizing monetary policy.**



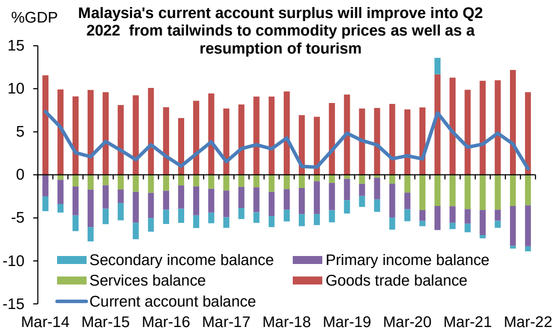
Source:CEIC; Mizuho Bank.

Policy: **BNM initiated the process of policy normalization with a 25bp hike in May 2022** citing a host of factors including rising core inflation and tighter global monetary policy from the aggressive tightening by the US Fed. **We expect BNM's pace of tightening to be more calibrated than some of its regional peers, with a total of 50bp in rate hikes in H2 2022.** Meanwhile, the fiscal policy stance will remain neutral as higher revenues from elevated commodity prices will be largely offset by increased subsidies on food and fuel. **We expect the 2022 budget deficit to remain at 6% of GDP from 6.5% in 2021**; the underlying details however will be different from the budget estimate with subsidies increasing alongside revenues.



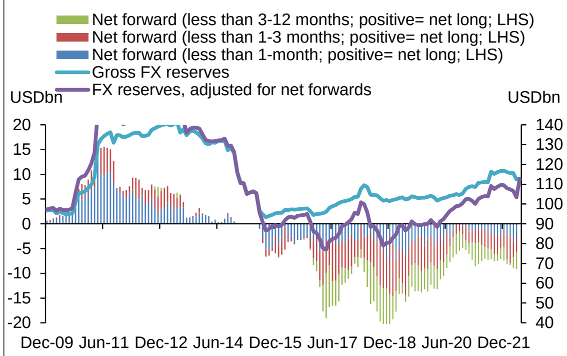
Source: CEIC; Mizuho Bank

External Position: **The current account surplus narrowed to 3.6% of GDP in 2021 from 4.2% in 2022**; with the surplus in Q1 2022 shrinking to 0.7% of GDP. A larger trade surplus was more than offset by a wider deficits on the services, primary and secondary income accounts**.** **For the rest of 2022, we expect the current account surplus to widen driven by a higher trade surplus.** The elevated commodity prices will provide sufficiently high price effects to buffer against lower volumes; also, the gradual resumption of tourism and a re-opening of borders will also help support the services balance surplus. With FDI inflows steady, albeit diminished from pre-Covid levels, the external surplus look well supported.



Source: CEIC; Mizuho Bank

FX: **Against a strong USD backdrop and a 'Kokomo Fed', MYR will continue to depreciate versus USD** before regaining some lost ground in late-Q3 as the monetary policy tightening peaks globally. That said, volatile capital flows and 'home bias' retreats during peaks of risk aversion will put pressure on EM Asia FX, with MYR being no exception. **Indeed, since the start of 2022 BNM's reserves have been drawn down (and net forward positions have risen).** Idiosyncratic domestic factors including resorting to protectionist food policies and political risks could add to MYR headwinds.



Source: CEIC; IMF; Mizuho Bank

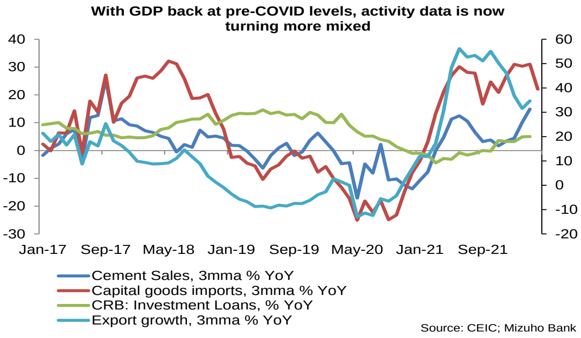
	Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023
GDP (% y/y)	**5.0%**	3.0%	8.1%	5.0%	5.4%	5.1%
CPI (% y/y)	**2.2%**	2.7%	2.6%	2.3%	2.0%	1.7%
Policy Rate (%)	**1.75%**	**2.00%**	2.25%	2.50%	2.50%	2.50%
USD/MYR*	**4.20**	**4.41**	4.47	4.41	4.35	4.29
	4.16 - 4.24	**4.20-4.43**	4.38 -4.78	4.36-4.60	4.09-4.50	4.10-4.43

Note: Values in black are historical whereas those in blue represent forecasts.

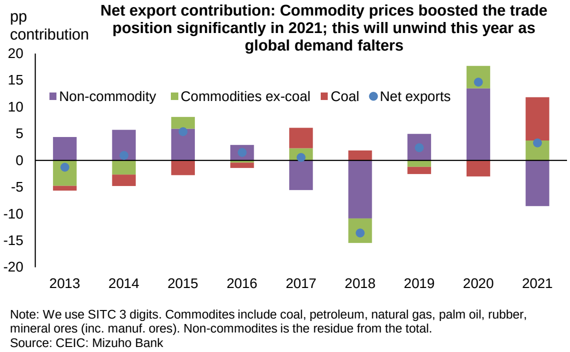
* Point forecast is for end-period. Q1 2022 ranges are from Bloomberg and only indicative.

Indonesia: Tailwinds Eroding, Policy Space Narrowing

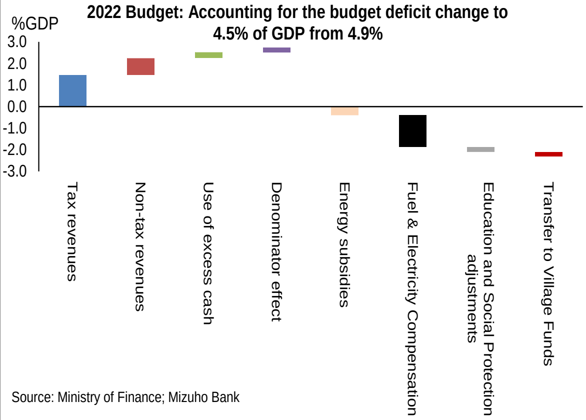
Growth: The economy grew 3.7% in 2021 after contracting by 2.1% in 2020. The recovery was led by domestic and external sectors, with the easing of social restrictions concomitant with higher vaccination rates and commodity price (especially coal) tailwinds kicking in towards end 2021. **The activity data into Q2 has shown a consistency in economic momentum** especially on the private consumption, investment spending and export fronts. Government spending has, unsurprisingly, moderated after ramping up in 2020 and 2021.



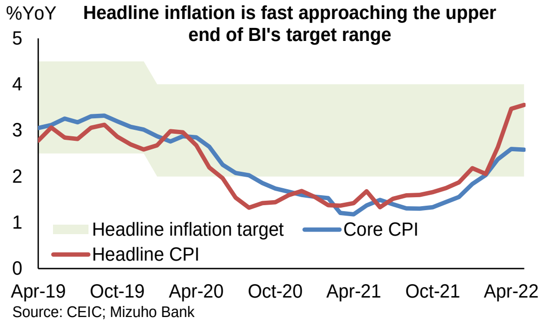
Industry: Despite the headline optics of a sustained trade surplus, details are mixed. Export volumes have turned decisively negative with only price effects holding up overall export growth. Meanwhile, non O&G import volumes remain low, offsetting (for the moment) higher O&G import volumes – pointing to an anaemic domestic demand picture even as oil imports sustain amidst sharply higher global oil prices. **At the margin, it is clear that commodity price tailwinds from coal and palm oil late last year are eroding.** This will put pressure on the nascent economic recovery.



Growth dynamics: **To that end, we have moderated our 2022 GDP growth forecast to 4.2% from 5.0%.** This also reflects tighter monetary policy from Bank Indonesia (BI) this year on account of an expedited US Fed rate hike timeline. To the government's credit, it has maintained fiscal nimbleness: the VAT tax increase was implemented as planned on 1 April and electricity prices for a certain segment increased from 1 July. However, fuel and food subsidies are set to increase, offsetting some of the positive revenue impact. **Even then, the government has narrowed its 2022 fiscal deficit target to 4.5% of GDP from 4.9%,** highlighting the extent of revenue outperformance. Recently, it even suggested that the deficit could be below 4% of GDP. **Notwithstanding, the government decision (briefly) to embargo palm oil exports highlights a penchant towards protectionist policies, which could be self-defeating.**



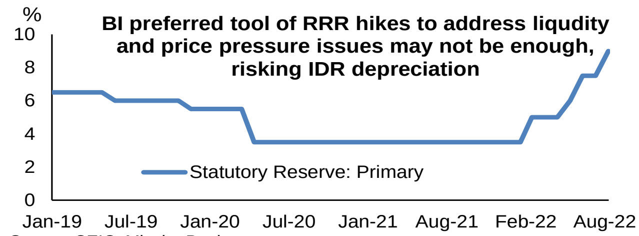
Inflation: Headline inflation jumped to 3.8% YoY in Q2 from 2.3% in Q1 2022. **The trajectory for CPI is upward at least until Q3 as, despite subsidies, there will some pass-through from elevated global food and energy prices;** the economic recovery will also put pressure on core inflation. **Our 2022 average inflation forecast of 3.6% (within BI's 2-4% headline inflation target range) does not vindicate BI of closely watching inflationary pressures.** If anything, it underscores rising price pressures despite efforts to keep retail prices in check as headline inflation will breach the upper 4% band for some months this year.



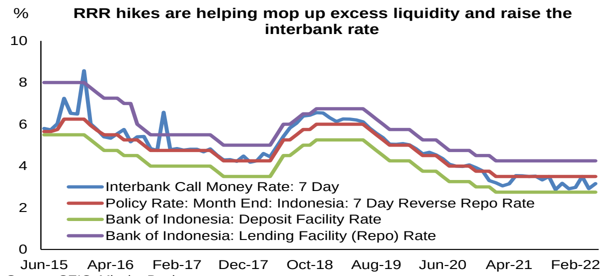
Policy: Rising inflation but more so tighter global liquidity conditions and macro stability (IDR depreciation) risks driven by the US Fed 'super' hiking cycle will push BI to normalize monetary policy sooner than we had initially thought. **We expect BI to start hiking its policy rate in Q3 and deliver a cumulative 75bp this year.** **The upsized Rupiah Reserve Requirement (RRR) hikes** to 9% by September from 6.5% is a part of BI's efforts to normalize loose liquidity conditions in the banking system (interbank rate is at the floor of policy corridor); **but it will not provide a credible substitute for rate hikes. BI risks falling behind the curve as it anchors on non-rate support to keep macro stability and IDR depreciation risks in check.** Failure to pull the trigger on rate hikes will only worsen IDR depreciation risks.

External Position: **The marginal current account surplus of 0.4% of GDP in Q1 2022 may sustain into Q2**, driven by higher commodity prices. But as the price effect fades, and import growth improves more convincingly in H2, the surplus will diminish**. Given the weak global backdrop, attracting FDI inflows to sustain a basic balance surplus may not be possible, making the economy vulnerable to volatile capital outflows.** That said, **outright BoP financing concerns will not emerge. FX reserves are ample and well above 2013's 'taper tantrum' levels to cushion** against some IDR volatility in addition to reduced foreign holdings of government bonds. However, more stable support will be from policy rate hikes.

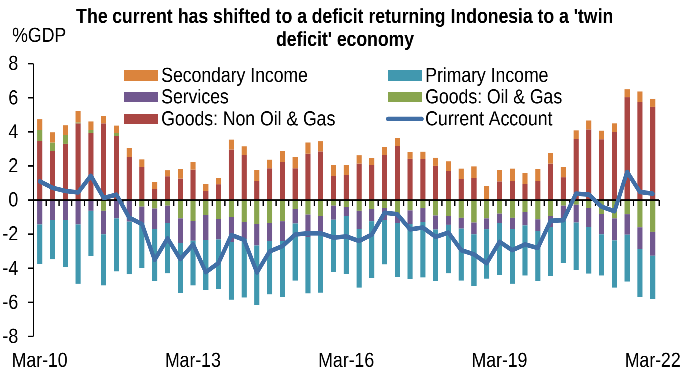
FX: **The strong USD bias against the backdrop of Ukraine-Russia geopolitical tensions as well as the US Fed tightening super cycle will weigh on IDR into Q3**. IDR underpeformance may be exacerbated by BI holding out on rate hikes and worsening the interest rate differentials. Within EM Asia, **IDR remains one of the more vulnerable currencies to volatile sentiment as the 'twin deficits' on the current and fiscal accounts persist.** That said, reduced foreign ownership of government bonds and increased FX reserve buffers will cushion against sharp IDR depreciation.



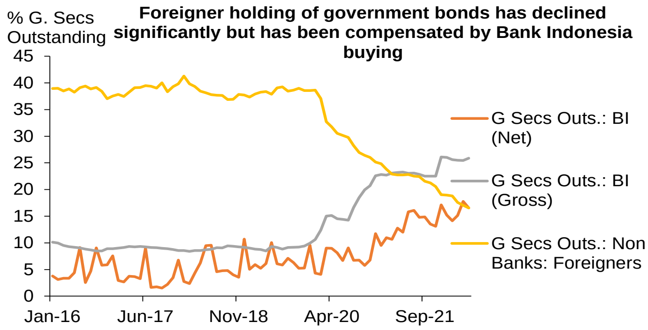
Source: CEIC: Mizuho Bank



Source: CEIC; Mizuho Bank



Source: CEIC; Mizuho Bank



Source: CEIC; Mizuho Bank

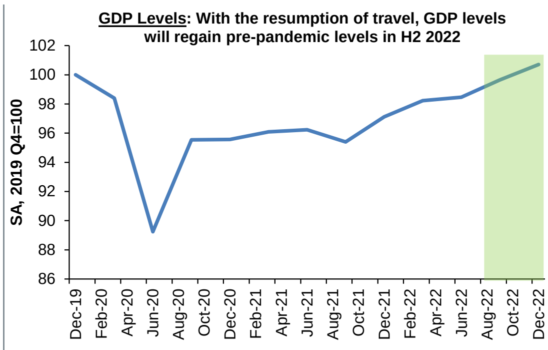
	Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023
GDP (% y/y)	**5.0%**	3.0%	4.2%	4.6%	5.3%	5.4%
CPI (% y/y)	**2.3%**	**3.8%**	4.2%	4.1%	3.9%	3.1%
Policy Rate (%)	**3.50%**	**3.50%**	4.00%	4.25%	4.50%	4.50%
USD/IDR*	**14369**	**14898**	15200	15000	14900	14650
	14253-14420	**14334-14898**	14810-16320	14640-15570	14450-15530	14180-15360

Note: Values in black are historical whereas those in blue represent forecasts.

* Point forecast is for end-period. Q1 2022 ranges are from Bloomberg and only indicative.

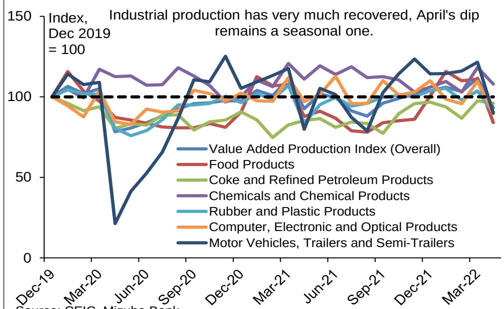
Thailand: Restrained Recovery

Growth: Coming off a low base growth of 1.6% in 2021, we **project GDP growth in 2022 at 3.1% this year (a 0.4% point downgrade from previous forecast),** with momentum of stronger recovery in H2 2022 with the return of Chinese tourists in late-2022. **Fiscal support remains critical** to support household balance sheet amid rising fuel prices through transfers to poorer segments and also through reduction in social security contributions to increase disposable incomes. The reduction in contributions (May-July) also lowers labor costs for employers which will free up cash flows for investments and debt servicing.

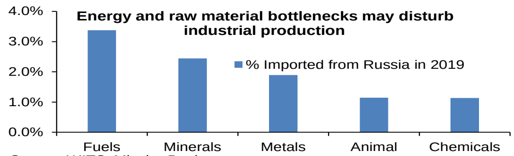


Source: CEIC, Mizuho bank

Industry: Overall industrial sector grew 0.5% YoY in Q1 as contraction in mining and quarrying activities weighed down manufacturing growth of 2% and highlights the resource sector's intensive manpower needs. Industrial production will have **to contend with issues of rising energy costs as well as supply chain bottlenecks of raw materials** (e.g. metals and chemicals) and input shortages arising from the Russia-Ukraine conflict. This translates to **slower production pace further hit by lower profitability**. Investment momentum may also be weighed down by global economic uncertainties.

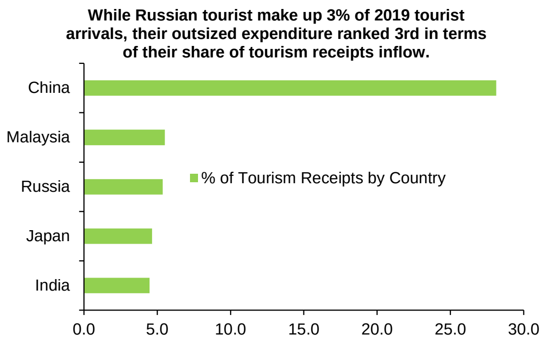


Source: CEIC, Mizuho Bank



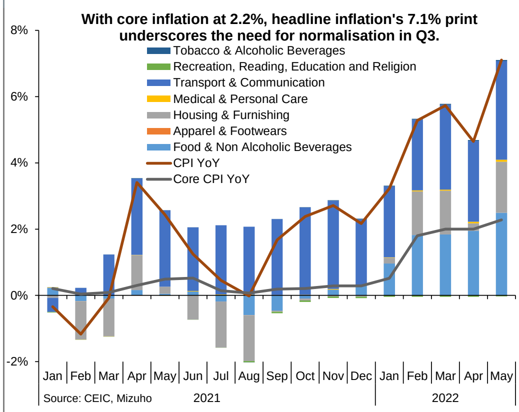
Source: WITS; Mizuho Bank

Growth dynamics: While Q1 growth posted a steady 2.2%, recovery in Q2/Q3 will see services contributing more as tourism enjoys an initial non-linear surge as ASEAN region reopens and Thailand Pass requirements are removed from July. However, **rising fuel prices will erode household budgets and hold back private consumption and restrain growth optimism**. Into H2, a firmer and fuller recovery may only manifest in Q4 as missing Chinese tourist arrivals make up more than 30% of pre-pandemic arrivals. In addition, the high expenditure Russian tourist fraught with payment difficulties and domestic economic woes will also hinder.

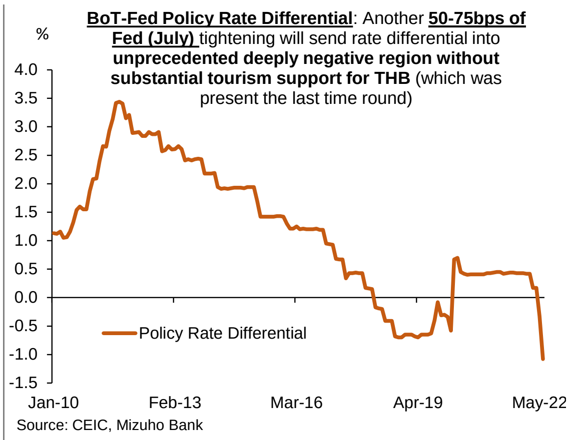


Source: CEIC, Mizuho Bank

Inflation: Global price pressures have intensified and consequently, we have **upgraded our headline inflation forecast to hit 6.7% on average for 2022**. With the oil fund in deep deficit, the diesel price ceiling has been raised in multiple steps from 30 THB to 35 THB (from 14 June) despite a reduction in diesel excise duties. As such, transport cost will remain elevated in the months ahead and spillover to higher business cost. Underlying inflation also show signs of broadening as **more than half of the categories are now displaying inflation rates above pre-pandemic averages** (2017-19), inflation expectations have also risen in recent months as the prevalence of widespread price increases are **entrenched into consumer's psyche.**

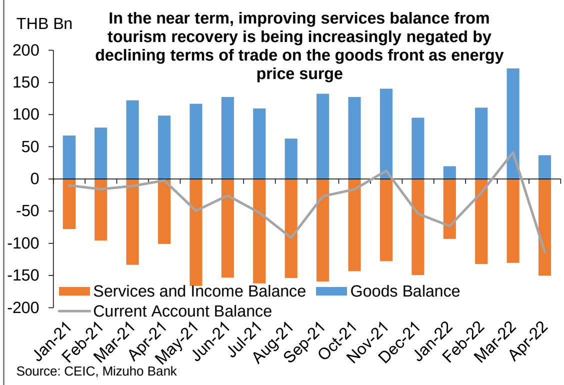


Policy: At their June meeting, the Bank of Thailand (BoT) kept policy rate unchanged at 0.50%. Nonetheless, they have now explicitly recognised "rising demand side inflationary pressures" and the policy statement also alluded to "very accommodative monetary policy will be less needed going forward" which sets the stage for policy normalisation. In consideration of enlarged debt servicing burdens from high levels of household debt, the BoT is likely to avoid a big step hike and **proceed with 25bps calibration. That said, risks of an inter-meeting hike are increasing with the next meeting only in August** amid a depreciating THB which threatens to worsen imported inflation and exacerbate capital outflows in an adverse feedback loop. Fiscal deficit from upcoming FY23 (Oct-22 to Sept 23) looks set to remain at ~3.9% of GDP and support growth. As such, fiscal consolidation back to pre-pandemic trends (around 3% of GDP deficit) remains elusive while public debt climbs.



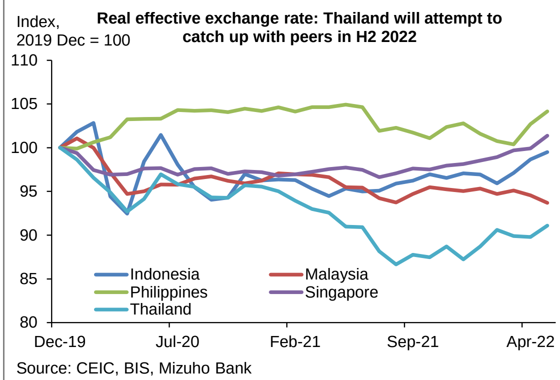
Source: CEIC, Mizuho Bank

External Position: While the **services deficit is set to be reduced** as a result of the tourism recovery, the **untimely surge in crude oil prices will weigh on and dimish the goods balance** and in turn, a **sustainable current account surplus may remain elusive in Q2 and even Q3**. Factoring in a partial resumption of outbound Chinese tourism, we could see some **green shoots of current account surplus in Q4** after the National Party Congress. Meanwhile, political instability may feature in H2 with possible snap elections as ruling coalition shows signs of fractures and consequently dampen foreign investment sentiments.



Source: CEIC, Mizuho Bank

FX: Overall, **the THB will be subjected to bouts of weakness in Q3 2022 before recovery into Q4 2022.** As their twin deficit position is unlikely to recover soon, the THB will continue to face headwinds from rising inflation eroding real asset returns and a widening policy differential. The THB's recovery and catch up with regional peers from their 9% decline in 2021 may be restrained. With expected policy convergence and firmer tourism recovery, the THB may enjoy better **recovery prospects late** in H2, though the magnitude is **doused with sufficient awareness** of the extent of **hawkishness from the Fed** which will **dwarf plausible BoT moves on all counts of magnitude and pace**. Political instability from multiple no-confidence votes may also result in THB volatility.



Source: CEIC, BIS, Mizuho Bank

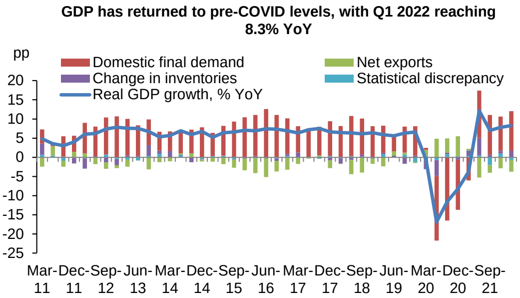
	Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023
GDP (% y/y)	2.2%	2.9%	4.4%	3.1%	2.5%	4.3%
CPI (% y/y)	4.7%	6.5%	7.6%	7.0%	4.7%	3.8%
Policy Rate (%)	0.50%	0.50%	1.00%	1.25%	1.50%	1.50%
USD/THB*	33.2	35.3	36.0	35.2	34.4	34.2
	32.1-33.8	33.3-35.6	34.8-37.3	34.2-37.2	32.5-36.1	32.3-35.4

Note: Values in black are historical whereas those in blue represent forecasts.

* Point forecast is for end-period. Q1 2022 ranges are from Bloomberg and only indicative.

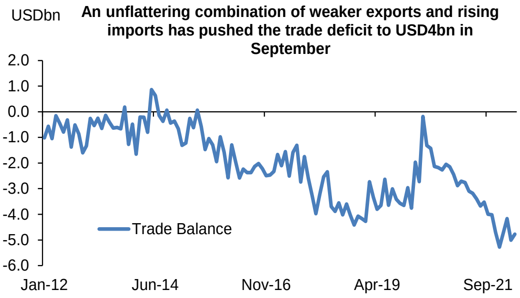
Philippines: Winds Of Change

Growth: **With GDP growth of 8.3% YoY in Q1 2022, GDP levels are now back to pre-COVID levels**. The drivers of growth have been broad-based with an unwinding of social restrictions boosting domestic activity and better global demand boosting exports. **The latter, however, is already set to peter out as headwinds from tighter global monetary policy, rising inflation and binding supply side constraints weigh on exports**. Nonetheless, the domestic economic recovery coupled with a slow, but steady, reopening of tourism activities will keep growth on resilient footing.



Source: CEIC; Mizuho Bank

Industry: Industrial production growth and manufacturing capacity have stabilized, just under pre-Covid levels. **Philippine exports have underperformed regional peers because of more fundamental issues** (focus on products with lower demand, capacity constraints etc.) while import growth has surged, partly on account of higher costs associated with fuel and food imports but also due to domestic demand improvements. **As a result, the trade deficit has widened significantly, with the December 2021 and March 2022 hitting records of USD5.3bn and USD5bn.**



Source: CEIC; Mizuho Bank

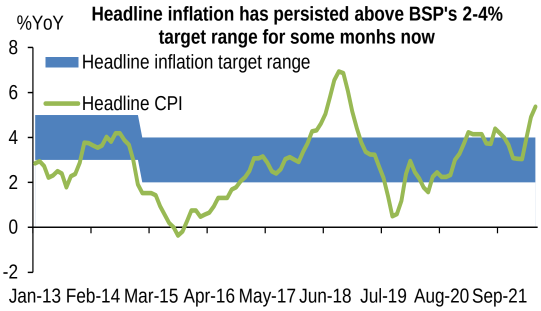
Growth dynamics: **Bongbong Marcos is the President-elect and was sworn in on 30 June. Although the initial market reaction to his victory was negative, subsequent announcements on his cabinet appointments have been positive**. The most revelant posts for economic policy making have been assigned to technocrats, with sound policy making experiencing. This include Diokno as Finance Secretary, Medalla as BSP Governor and Balisacan as NEDA Chief. Furthermore, these individuals have underscored the importance of policy continuity, the focus on fiscal prudence and tighter monetary policy: all the needs of the hour.

*Calculated by Mizuho Bank by adding total votes for candidate and providing a vote share of total.
Source: ABS-CBN News. Note: These are partial, unofficial results aggregates from Comelec data as of 10 10:47am, with 97% of election returns.

Department	Head	Background
Department of Finance	Benjamin Diokno	BSP Governor
Bangko Sentral ng Pilipinas	Felipe Medalla	Member of BSP Board
Department of Budget and Management	Amenah Pangandaman	AG of BSP
National Economic Development Authority	Arsenio Balisacan	Chairperson of the Philippines Competition Commission

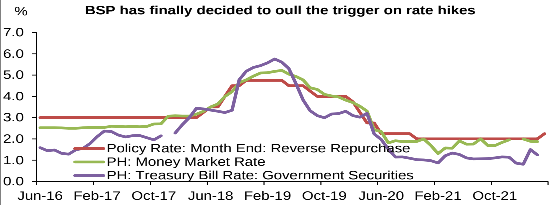
Source: Philippine News Agency, CNN Philippines, Mizuho Bank

Inflation: Headline inflation has been in breach of BSP's 2-4% target range for some months, with the June CPI print hitting 6.1% YoY. Despite the elevated inflation levels, BSP was reluctant to hike rates. However, given the unyielding combination of sticky food and energy prices, rising inflation expectations and rapidly tighter monetary policy prospects, **BSP moved to raise rates in May and June. It has signaled that it is willing to hike by larger magnitudes at subsequent meetings depending on the data.** For now, we expect another 75bp from BSP in 2022, taking the cumulative hikes for the year to 125bp.

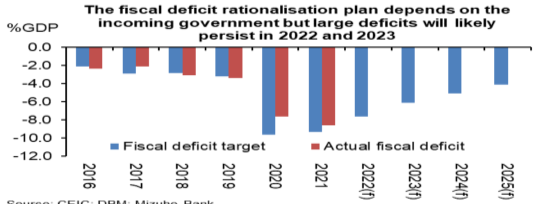


Source: CEIC; Mizuho Bank

Policy: **Although monetary policy is getting tighter, fiscal policy will remain relatively accommodative**. Fiscal consolidation is projected to take place at a moderate pace; **with the fiscal deficit narrowing to 4.1% of GDP by 2025 from a projected 7.6% in 2022 (2021: -9.3% of GDP).** The risk, however, is that the incoming government will reprioritize certain spending. The Marcos administration has been looking to lower the cost of retail fuel prices (i.e. increased subsidy spending) while staying focused on infrastructure spending and revenue reforms. **The incoming administration will present its first budget for the year 2023; this will give us a better gauge of the Marcos administration's priorities.**

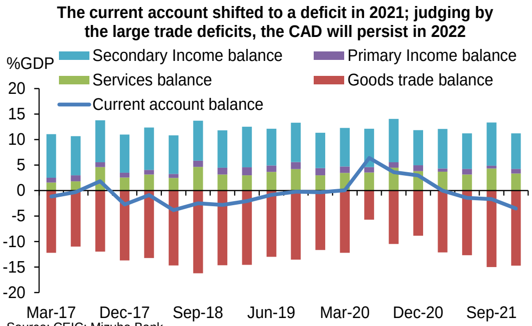


Source: CEIC; Mizuho Bank



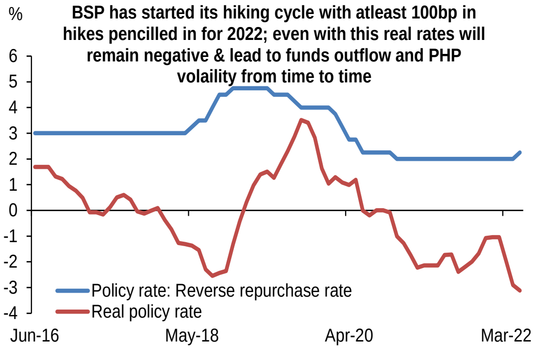
Source: CEIC; DBM; Mizuho Bank

External Position: **The current account shifted to a deficit of 1.8% of GDP in 2021 from a surplus of 3.2% in 2020**. This deficit is likely to persist into 2022 mirroring the trade deficit, which has widened on account of higher oil and non-oil imports. **There will, however, be some offset from tourism opening up and remittance inflows picking up** (following increased deployment as COVID related restrictions ease). But this will not be enough to avoid an outright current account deficit, in our view. As a result, the Philippines will remain a 'twin deficit' economy with deficits on the current and fiscal accounts.



Source: CEIC; Mizuho Bank

FX: As a 'twin deficit' economy heavily reliant on oil and food imports, the Philippines is at a distinct disadvantage which will be reflected onto the PHP. The mitigating factor to adverse PHP depreciation is BSP finally pulling the trigger on rate hikes; **we argued that rate hikes as early Q1 2022 were warranted.** USD strength into Q3 will keep PHP on the backfoot for the quarter, but it will regain some lost ground in Q4. **More fundamentally, macrostability risks from elevated inflation, widening external deficits and elevated public debt can put undue depreciation pressure on PHP; something the authorities will be vigilant about.**



Source: CEIC; Mizuho Bank

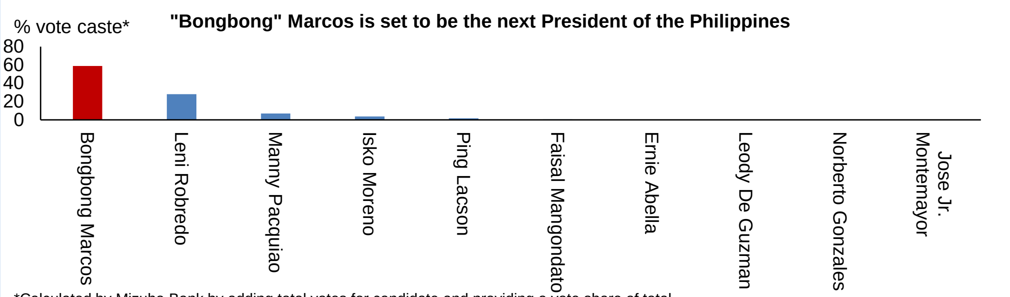
	Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023
GDP (% y/y)	8.3%	4.8%	5.3%	4.5%	7.0%	6.2%
CPI (% y/y)	3.4%	5.5%	5.9%	5.3%	4.4%	2.9%
Policy Rate (%)	2.00%	2.50%	3.00%	3.25%	3.25%	3.25%
USD/PHP*	51.8	55.0	56.3	55.7	55.0	54.3
	50.9-52.5	51.1-55.2	55.2-57.6	54.7-57.5	52.7-56.6	51.9-55.9

Note: Values in black are historical whereas those in blue represent forecasts.

* Point forecast is for end-period. Q1 2022 ranges are from Bloomberg and only indicative.

Box 4: "Bongbong" Marcos Is The New President

"Bongbong" Marcos is the next President of the Philippines. According to the Election Commission (Comelec), Marcos has garnered 58.8% of the total votes cast, blazing ahead of the closest competitor Leni Roberdo, who has 28% of the vote. **Given "Bongbong" Marcos' family lineage and the baggage that it carries, the initial negative market reaction was not surprising.** USD/PHP moved higher while the equity index sold off more than 3%. Following the knee-jerk reaction, however, both FX and equities regained lost ground. Sara Duterte will be the next Vice President. **The new President and Vice President will be sworn in on 30 June.**



*Calculated by Mizuho Bank by adding total votes for candidate and providing a vote share of total.
Source: ABS-CBN News. Note: These are partial, unofficial results aggregates from Comelec data as of 10 May, 10:47am with 97% of election returns.

With the election being fought on emotional grounds, economic policy was largely relegated to the side lines. Our baseline is for policy continuity under a Marcos Presidency as the Philippines economy navigates its way out of the pandemic and into its 'new normal'. As such, we maintain our 2022 GDP growth forecast of 5.6% from 5.7% in 2021.

That said, we list the signposts, which could potentially become red flags, that we will look for with the new administration to assess our view against the baseline. So far, the signs seem in line with our baseline:

Cabinet appointees: **The cabinet appointments so far have been positive.** Appointments of technocrats to post such as Finance Secretary, BSP Governor, Budget Secretary and NEDA Chief is lending credibility to the economic policy making apparatus. Most credible of the recent appointments has been Benjamin Diokno, current BSP Governor, as the new Finance Secretary and Felipe Medalla as new BSP Governor.

Department	Head	Background
Department of Finance	Benjamin Diokno	BSP Governor
Bangko Sentral ng Pilipinas	Felipe Medalla	Member of BSP Board
Department of Budget and Management	Amenah Pangandaman	AG of BSP
National Economic Development Authority	Arsenio Balisacan	Chairperson of the Philippines Competition Commission
Department of Education	Sara Duterte	Vice President
Department of ICT	Ivan John Uy	Chairman for Commission on Information and Communications Technology
Department of Interior and Local Government	Benjamin "Benhur" Abalos Jr.	Chairman of the Metro Manila Development Authority
Department of Justice	Boying Remulla	Legislative Representative
Department of Labor and Employment	Bienvenido "Benny" Laguesma	Labour Secretary under Joseph Estrada
Department of Trade and Industry	Alfredo Pascual	University of Philippines President (2011-2017)
Department of Public Works and Highways	Manuel Bonoan	CEO of SMC Tollways
Department of Social Welfare and Development	Erwin Tulfo	Broadcaster

Source: Philippine News Agency, CNN Philippines, Mizuho Bank

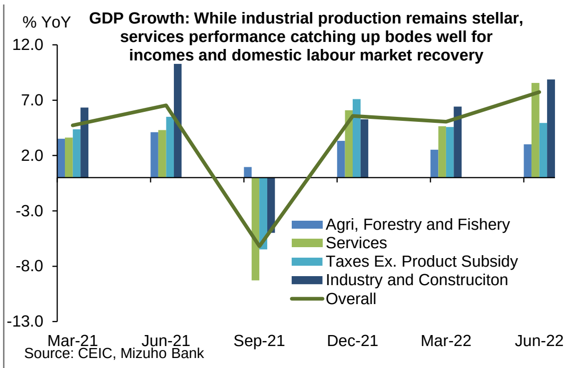
Infrastructure focus: The Marcos-Duterte duo made clear during the campaign trail that it will continue the current administration's **focus on infrastructure development and poverty alleviation, with renewed rigour around MSME development to create new employment opportunities** and ease pandemic related scars. We expect this focus will sustain into the Marcos Presidency**. As agriculture minister, the President himself is looking to focus on this sector. There maybe a risk of populist policies, which is something we will monitor closely.** Recent announcements on the redactment of the rice tarrification law fall into the above category.

Fiscal stance and debt management: The incoming administration's **stance on fiscal consolidation and debt management is unclear** and here we will watch for signposts and red flags in terms of judging the direction of policy. During the Presidential campaign, **Marcos sent mixed signals**: on the one hand, stating that debt levels will need to be brought down given its sharp increase during the pandemic while on the other hand, mentioning the possibility of re-introducing fuel subsidies. **The 2023 Budget, which will be first budget to be presented under the new administration, likely in August, will set the tone in this regard.**

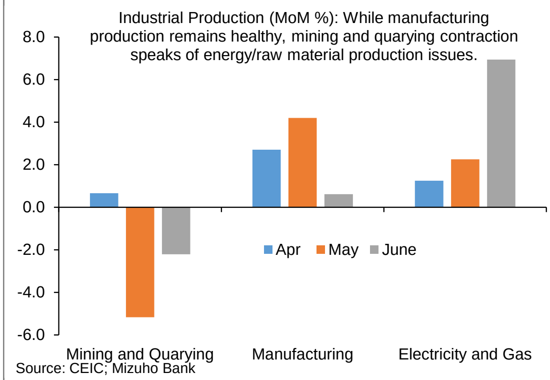
BSP Staying the course: **Even with political change afoot, we expect BSP will not deviate from its stated path of policy normalisation.** BSP started the process of normalising monetary policy by raising the policy rate by 50bp in May/June; we expect another 75bp in hikes in H2. This will take the cumulative hikes for the year to 125bp. We do not expect that the incoming administration will make the monetary policy process political; by contrast, **it would be in the new administrations' interest to maintain central bank independence as it enables better management of currency and macro stability risks.**

Vietnam: Growth Entrenches

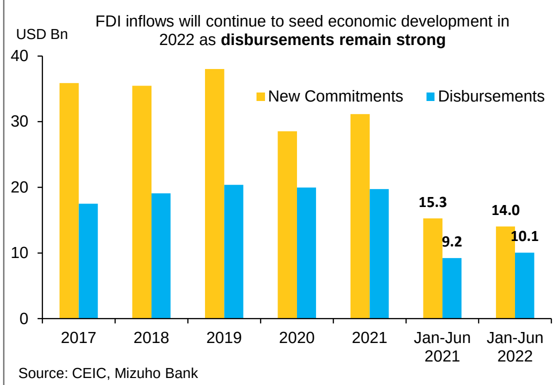
Growth: GDP grew 7.7% YoY in Q2 and the recovery was encouraging on two fronts: i) the level of activity sustaining at higher levels, ii) contribution from both manufacturing and services sectors imply quality growth via higher valued jobs from the former while the latter confers broader labour market pickup. We **maintain our 6% growth projection for 2022 which was already at the lower end of the government's 6.0%-6.5%**, given the Jan-2022 approved fiscal stimulus package (4.2% of GDP) to be disbursed over 2022-23 set to offset demand destruction from higher energy costs.



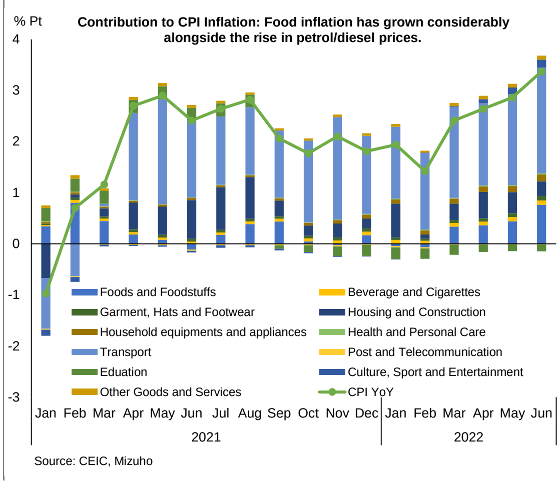
Industry: Within their growing manufacturing complex, energy demand continues to accelerate. However, domestic resource production has yet to keep pace and thereby increasing reliance on imported energy sources. The inconvenient point being that 12% of coal was imported from Russia and are now subject to delays and diminished shipments. Diversification towards Australian and South African coal imply implementation lags between diplomatic cooperation and actual deliveries. However**, authorities will prioritise industrial needs** and prevent stalling of manufacturing operations.



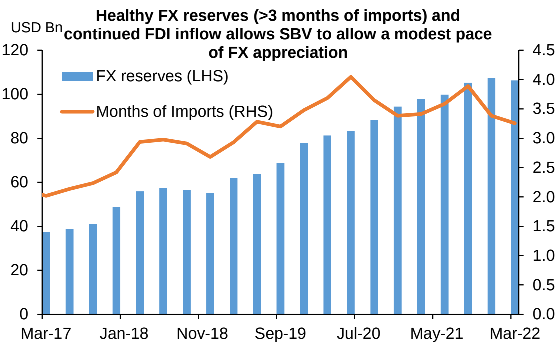
Growth dynamics: While tourism recovery bolsters employment, manufacturing output will continue performing alongside FDI inflows amid resumption of structural trends for supply chain resilience. However, energy shortages will lead to higher cost and chip away at industrial margins and household budgets. As such, growth may be dragged to a slower pace but fiscal policy to reduce taxes such as VAT will alleviate such cost pains. Downside risks may stem from **implementation delays in their economic recovery program** which consist of significant infrastructure projects. In addition, despite Russian tourist having a small 3.5% share, their leadership in terms of expenditure per stay (in 2019) will be missed.



Inflation: Q2 headline inflation at 3% was largely driven by transport cost. The government has displayed **nimbleness to tackle various supply side price pressures** via reduction in VAT, lowering taxes on fuels, usage of petrol stabilization fund and smaller initiatives such as decreasing highway tolls fees. As such, we mildy upgrade our forecast to 3.3% for headline inflation in 2022. On top of energy prices staying elevated and petrol stabilization fund being stretched, **food prices is a key risk considering their one-third weight of CPI which can handily lead headline inflation above 4% target**. In addition, resumption of tourism will boost demand led price pressures in areas such as entertainment and restaurant services.

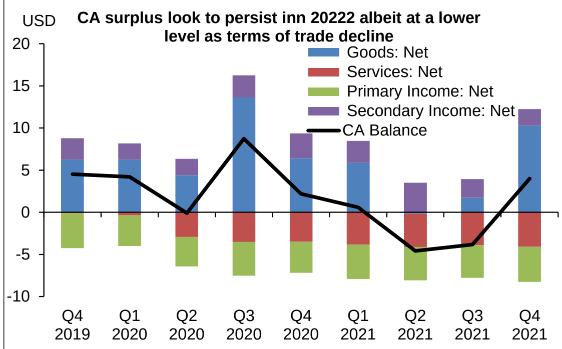


Policy: The SBV will look to successfully maneuver through a bumpy growth path in Q2 to allow healthy green shoots of demand pull inflation. This will put the SBV in a **position to normalize policy in Q3 2022** amid healthy FX reserves which had been utilised as **the SBV sold foreign currencies to meet economic demands and stabilise the VND**. However, the SBV may adopt a cautious stance and delay normalisation to end-2022, **watchful of domestic risk** from a rise in NPL following expiry of loan restructuring schemes in June amid **external risks of China slowdown.** Meanwhile, the SBV will continue implementing loans with subsidized interest rates as part of the economic recovery package to assist in the recovery. **With the need for supportive fiscal policy, their deficit is set to remain above 4% of GDP in 2022.**



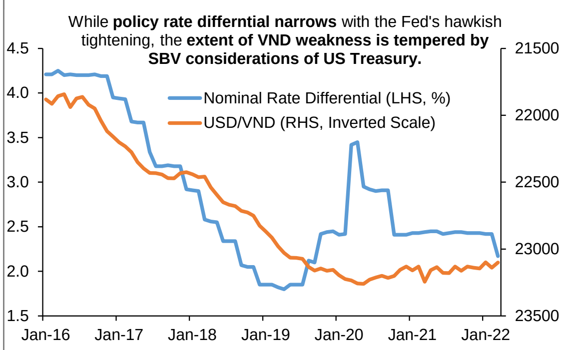
Source: CEIC, Mizuho Bank

External Position: Following the Q3 2021 lockdown, a strong industrial production catch-up in Q4 has led to the **current account position return to a healthy surplus**. The broader ASEAN reopening will reduce the services deficit in Q2 as tourism receipts stream in with tourist arrivals at 12% of 2019 levels in May last month. However, the **higher oil prices will weigh on the goods balance** and reduce the extent of surplus position in 2022. On the capital account front, FDI inflows is projected to remain healthy and support overall BOP while **awaiting stronger tourism resumption in Q4 2022 to firm external resilience.**



Source:CEIC; Mizuho Bank

FX: Following the US Treasury's latest report released this June, Vietnam is no longer on "enhanced bilateral engagement" but will still be on the monitoring list. Nontheless, they will still be keen to avoid excessive net FX purchases and prevent **excessive VND depreciation which will be subject to the Treasury's scrutiny the next time round**. Therefore, we **expect partial seep through of VND weakness in Q2** from energy imports eroding current account surplus and tightening Fed headwinds. A **firmer late Q4 Chinese tourism reopening will backstop a firmer VND recovery**. Underlying trend and structural factors such as their push into various FTAs (RCEP, CPTPP and EU-Vietnam FTA) conspire for medium-term, sustained VND appreciation.



Source: CEIC, Mizuho Bank

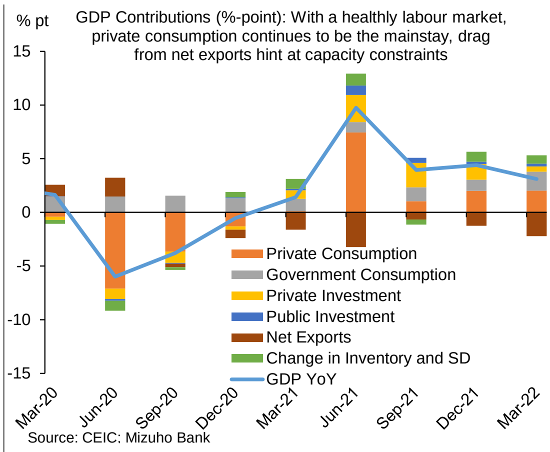
	Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023
GDP (% y/y)	5.0%	7.7%	11.0%	1.4%	5.0%	5.2%
CPI (% y/y)	1.9%	3.0%	3.7%	4.5%	3.8%	3.6%
Policy Rate (%)	4.00%	4.00%	4.25%	4.50%	4.50%	4.50%
USD/VND*	22837	23282	23440	23100	23000	22800
	22627-22910	22842 - 23283	23000 - 24300	22800 - 23900	22800-23400	22700-23300

Note: Values in black are historical whereas those in blue represent forecasts.

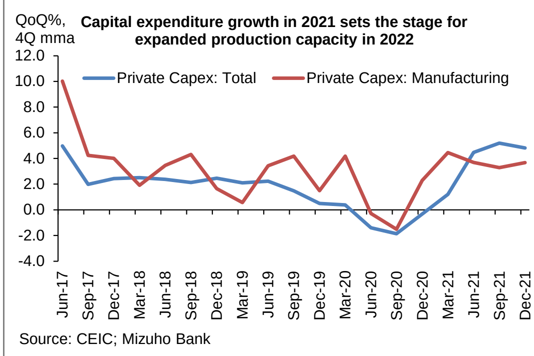
* Point forecast is for end-period. Q1 2022 ranges are from Bloomberg and only indicative.

Australia: Hollow Commodity Boost

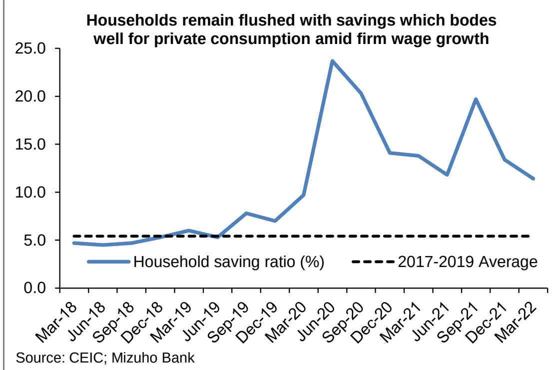
Growth: Q1 2022 GDP grew at 3.3% YoY with private consumption driving two-thirds of growth while public consumption and private investment contributed the rest. Drag from net exports hints at a constrained resource sector unable to expand production to capitalize on high prices. Going forward, with **a tight labour market, private consumption will be well supported.** In addition, **commodity demand** for coal, oil and gas resulting from Russia-Ukraine will **boost net exports if capacity investment picks up**. However, risks from slowing China growth on iron ore output remains relevant. We kept our **estimated full year GDP growth at 3.7%** (RBA: 4.5%) as we account for likely downside bias.



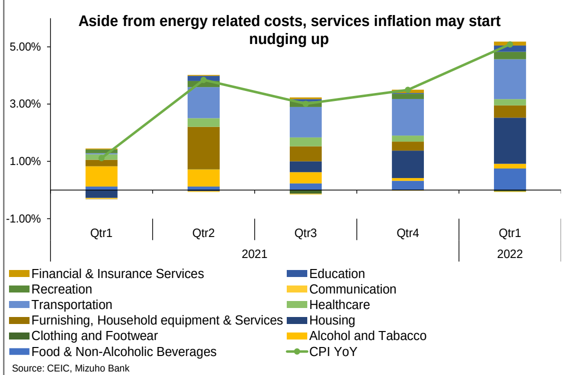
Industry: Overall private capital expenditure growth at 10.7% in 2021 sets the stage for **industrial production to take advantage of the expanded capacity** this year. Building approvals in the first two months of 2022 has grown 3% compared to a year ago which will lead to higher levels of construction activity ahead. The geo-political conflict driven commodity demand will also boost production and investment in the resource sector. The services sector will also look to international reopening to allow for both tourism and education sector resuming pre-pandemic growth.



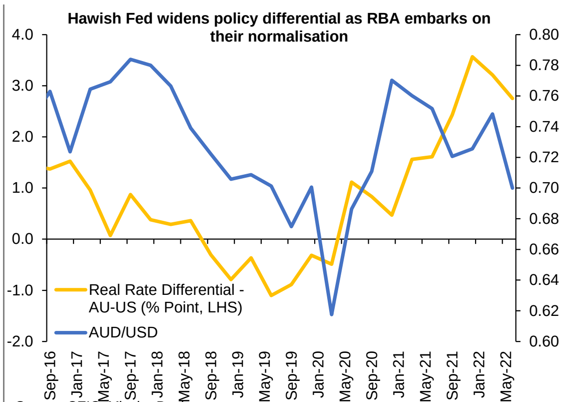
Growth dynamics: With wage growth at 2.4% for Q1 2022 and a raise in the national minimum wage by 5.2% announced in June, the **recovery in private consumption was not entirely driven by depletion of savings** as the household savings-income ratio remains elevated. Looking ahead, private consumption growth looks to remain firm as **employment in terms of both hours and wages continue to rise** and the excess savings will defend against rising energy cost. Commodity terms of trade will lift on the price front while **capacity constraints such as labour shortages** in the mining sector are gradually resolved from mid-2022 to boost volumes.



Inflation: With headline inflation posting 5.1% in Q1 2022, the higher petrol prices is set to **lift headline inflation to challenge 6% in Q2 and Q3**. While the weaker AUD exacerbates imported inflation, the domestic **services inflation** and **wage feedback loops will worsen price pressures in the coming months** as the labor market remaining tight signals a positive output gap. Headline inflation forecast is now upgraded to average 6.1% for the year as transmission from second round effects takes hold with the economic re-opening propping price increases ranging from food to education fees.

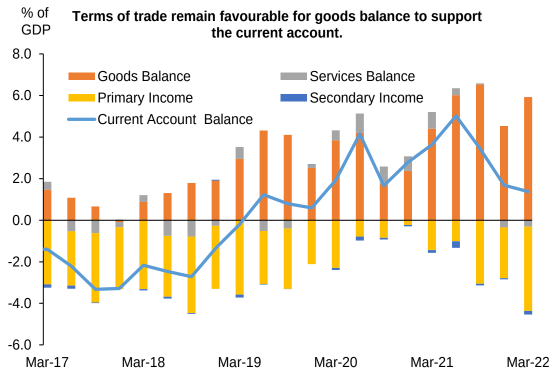


Policy: RBA has embarked on a "Kokomo" move with 75bps of rate hikes in Q2, both their policy calibration in May and June being above market expectations and each move was more surprising (to markets) than the previous (May: 10bps above market expectations; June: 25bps above). Given acceleration of inflation, the RBA's expeditious move is certainly warranted. Recent employment gains also prove supportive of further monetary tightening. We expect more front loading to occur, **with another 50bps of hikes in Q3** after their **50bps move in July.** A more cautious 40bps is expected in Q4 for the cash rate to reach 2.25% as finer calibrated moves will be apt when the RBA grapples with determining the neutral rate while global economic conditions may begin experiencing slowdown effects from earlier policy tightening.



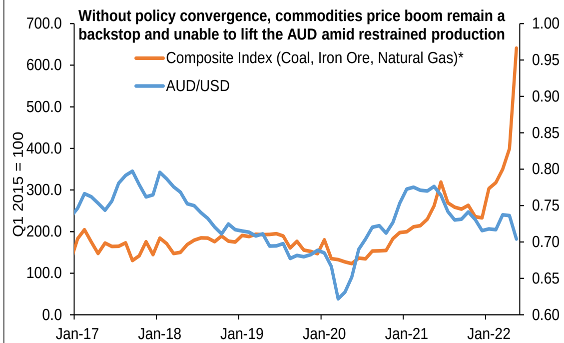
Source: CEIC, Mizuho Bank

External Position: With Russia-Ukraine conflict, the goods balance was injected with **favourable terms of trade** alongside **resilient demand from multiple trade partners** which is set to persist for months ahead and support the goods balance. **Overall current account surplus will likely average 2-4% of GDP.** Global travel re-opening on a firmer footing may see tourism services recover though significant outbound tourism will be expected to drag the services account. With the interim Australia-India FTA signed, Australian exports such as commodities from coal, metal ores to wines will receive preferential treatment ranging from zero to reduced tariffs and diversified export destinations.



Source: CEIC, Mizuho Bank

FX: With commodities turning into a weak backstop amid concerns surrounding China's growth, **AUD weakness from a tightening Fed looks to continue for much of Q3**. Meanwhile, the **RBA's hawkish turn will still be unable to keep pace with the Fed's QT** and rate hikes and as such **AUD boost will be found wanting**. Background downside risks from any escalation of geo-political conflict escalation will further dampen any commodity boost. Global impetus for infrastructure expansion should continue to feed in as a fundamental support for AUD, which at current levels looks undervalued. But a restoration to 80 cents and above in 2023 is pre-conditioned on the abatement of an ultra-hawkish Fed and soft spots in the Chinese economy.



*Index: This index is calculated based on rebasing prices of Coal (32%), Iron ore (42%) and Natural Gas (25%) to 100 based on their respective relative shares of total exports.
Source: CEIC, Bloomberg, Mizuho Bank

	Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023
GDP (% y/y)	3.3%	3.3%	5.6%	2.8%	2.6%	2.5%
CPI (% y/y)	5.1%	6.5%	6.5%	6.4%	5.0%	4.1%
Policy Rate (%)	0.10%	0.85%	1.85%	2.25%	2.25%	2.25%
AUD/USD*	0.748	0.690	0.670	0.695	0.742	0.765
	0.697-0.754	0.682 - 0.767	0.648-0.748	0.665-0.755	0.688-0.775	0.726-0.808

Note: Values in black are historical whereas those in blue represent forecasts.

* Point forecast is for end-period. Q1 2022 ranges are from Bloomberg and only indicative.