17 April 2024

Global Economics & Market Strategy

Looking Past Black Swans – Implications on Growth, Inflation & Rates

- **Global risk appetite will likely remain in risk-on mode, assuming no further escalation of Middle East tensions. We keep our global growth assumptions for a rosier 2024 backdrop.**

- **Geopolitical risks remain to be a black-swan event. In the short term, we advocate some asset allocation into quality assets and safe havens. Any unexpected escalations may threaten our global growth assumptions given downside trade, investment, and tourism risks.**

- **We downgrade our view for the US Fed Funds Rate to see only one cut in 2H24, with the balance of risks observably magnified towards no cuts in 2024. The tensions have reinforced our view for high-for-longer Fed Funds Rate (FFR) in 2024 on the back of higher inflationary pressures.**

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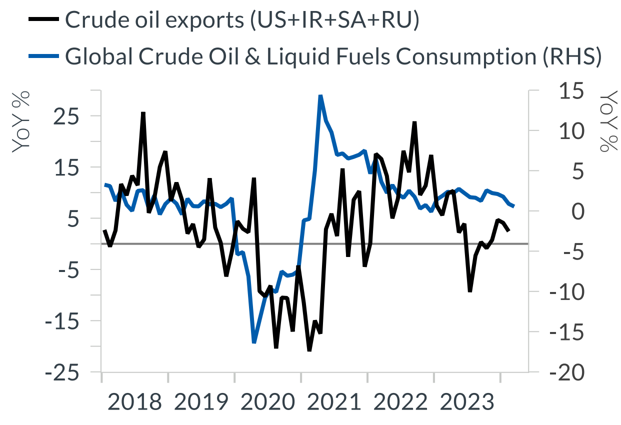
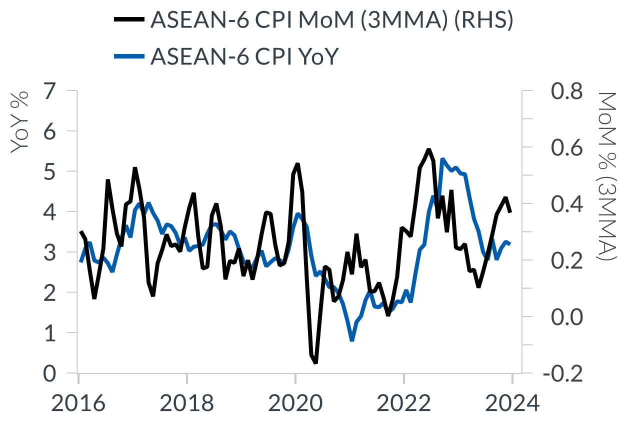
Figure 1: Geopolitical tensions may stress supply chain conditions and lead to higher oil prices…



Source: Macrobond, RHB Economics & Market Strategy,

Figure 2: … where we are already seeing higher ASEAN inflation, and also in the U.S. (see Figure 21)



Source: Macrobond, RHB Economics & Market Strategy

Two Probable Scenarios, With Varying Implications

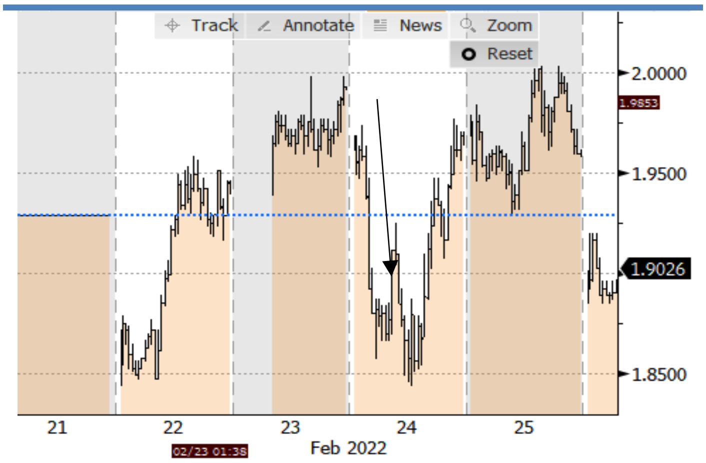
Global risk appetite will likely remain in risk-on mode, assuming no further escalation of Middle East tensions. We continue to adopt an optimistic outlook for the global economy in 2024, whereby we expect a continued economic recovery momentum in key markets such as the U.S., China and selected ASEAN economies. With global economic indicators still signalling a year of growth and optimism, we will keep our global asset allocation strategy as overweight (O.W.) equities, marketweight (M.W.) fixed income, and underweight (U.W.) cash. For 2Q24, we expect a further rally in U.S. equities by 5.0%. Year-to-date market data has remained resilient; U.S. labour, consumer confidence, and manufacturing activities continued to point north, while ASEAN data (Malaysia's industrial production, Singapore's industrial production, retail sales & GDP) and the relative swift post-earthquake recovery of Taiwan's manufacturing space suggest global growth momentum remains on the climb.

The recent escalation in Middle East tensions spells two probable scenarios in the coming months. We think (1) the base case is for tensions to stay isolated within selected members of the Middle East, thus suggesting that the collateral damage may be limited to the broader region and the Group of Seven (G7) members. In the scenario, we discount the possibility of further escalation between Israel and Iran, with both sides taking a defensive (rather than offensive) stance in the current conflict. Evidence suggests the unfolding of our base case – we observe that G7 members have collectively urged restraint in further escalating current tensions, with the United States announcing their decision not to take part in any counter-offensive against Iran. We view the second scenario – (2) further escalation of current tensions – to be a tail-end risk at this point, defined as tensions spreading into the broader Middle East region, especially with Iran facing "an attack of its own"[1], which may be further exacerbated should the G7 region intervenes from a military approach.

Geopolitical risks remain to be black-swan events. In the short term, we advocate some asset allocation into quality assets and safe havens. From an asset allocation perspective, we maintain our O.W. equities, albeit we now favour (O.W.) on quality names (prefer investment grade bonds over high yield) in the fixed income space and U.S. Treasuries in the short term. Across ASEAN, from a government bond perspective, we expect some fund outflows from ASEAN ex-Singapore as geopolitical uncertainties magnify. Separately, we like Singapore government bonds on the back of its investment grade status, reinforced by a relatively stable SGD on the back of potential S$NEER tightening against inflationary pressures.

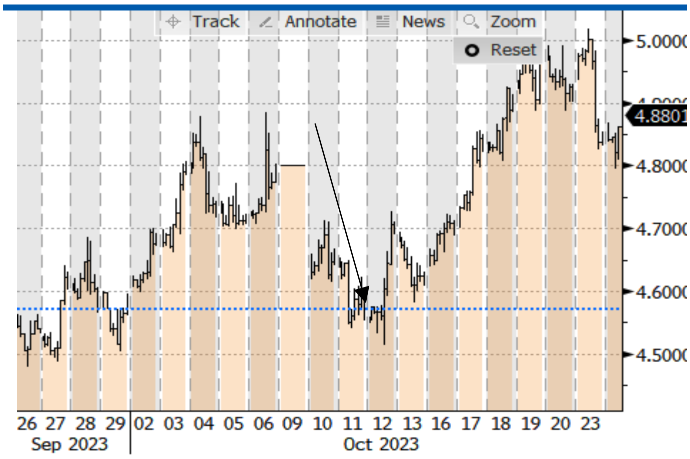
On commodities, we expect higher safe haven demand into gold and elevated crude oil prices as tensions linger. We see upside risks for Brent crude at a high of US$140 per barrel should tensions escalate (note Brent edged towards US$140 per barrel in 2022 during the onset of the Russo-Ukrainian (RU-UK) conflict). With potentially higher energy prices, global inflation pressures will likely stay elevated, thus reinforcing our high-for-longer U.S. rates view in 2024. As such, as long as tensions brew in the backdrop, we expect (1) a short-term decline in UST yields on the back of higher global demand, (2) higher gold prices, and (3) higher crude oil prices.

Figure 3: U.S. 10Y Treasuries fell on the back of safe haven demand...



Source: Bloomberg, RHB Economics & Market Strategy

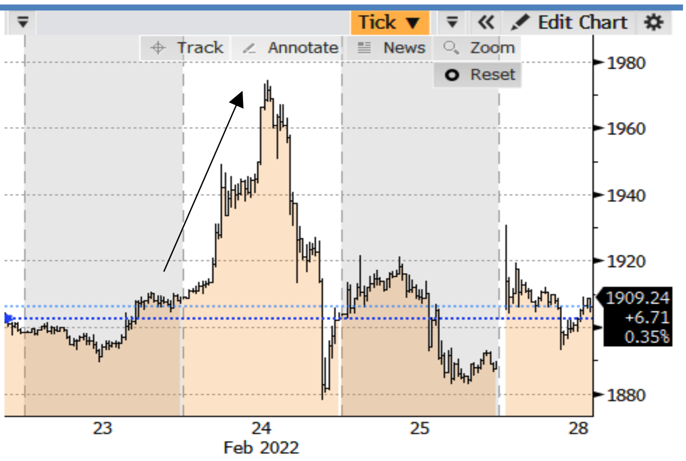
Figure 4: ... on 24 February 2022 (RU-UK) and 7 October 2023 (PL-IS)



Source: Macrobond, RHB Economics & Market Strategy
(RU-UK): Russia-Ukraine
(PL-IS): Palestine-Israel

[1] The Guardian, Jordan faces difficult balancing act amid row over role in downing Iranian drones, 15 April 2024

Figure 5: Gold prices benefited during geopolitical tensions...

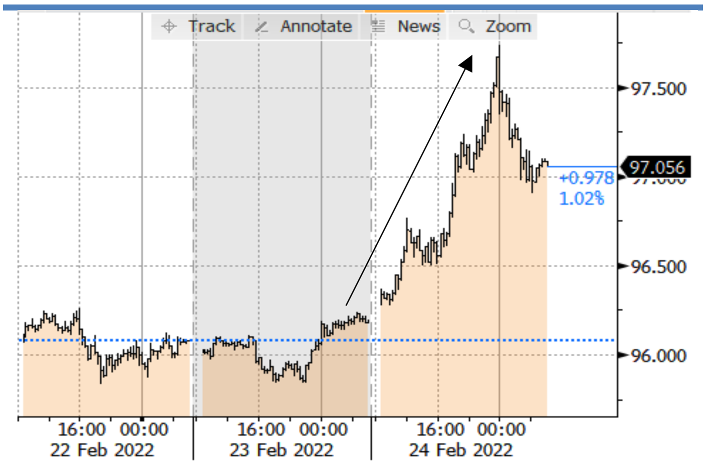


Source: Bloomberg, RHB Economics & Market Strategy

Figure 6: ... on 24 February 2022 (RU-UK) and 7 October 2023 (PL-IS)

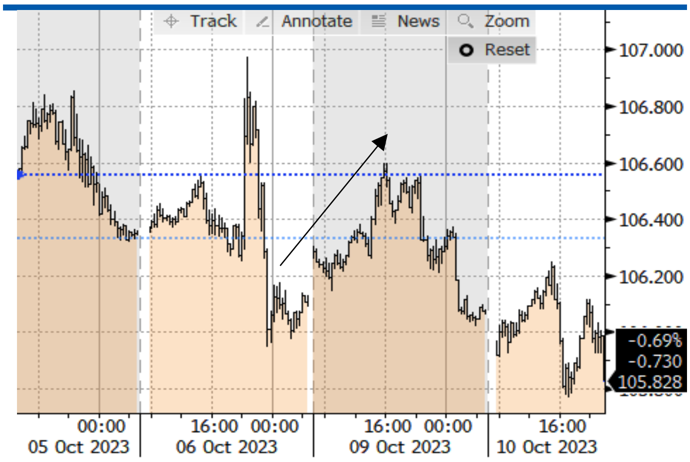
Source: Macrobond, RHB Economics & Market Strategy

Figure 7: DXY also rose on safe haven demand in 24 February 2022 (RU-UK), and 7 October 2023 (PL-IS)...



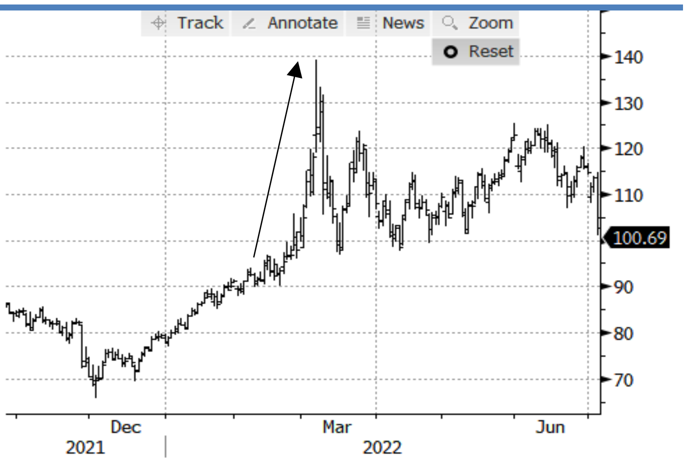
Source: Bloomberg, RHB Economics & Market Strategy

Figure 8: ... albeit in 2023 and into 2024, higher DXY is likely a function of the high-for-longer FFR backdrop



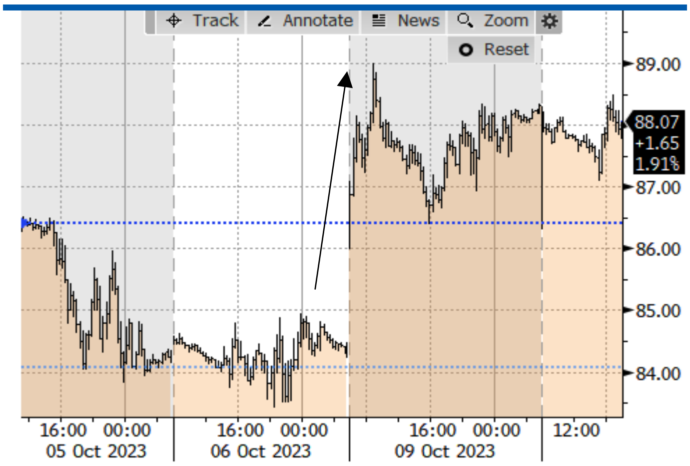
Source: Macrobond, RHB Economics & Market Strategy

Figure 9: Crude oil surged during past geopolitical conflicts...



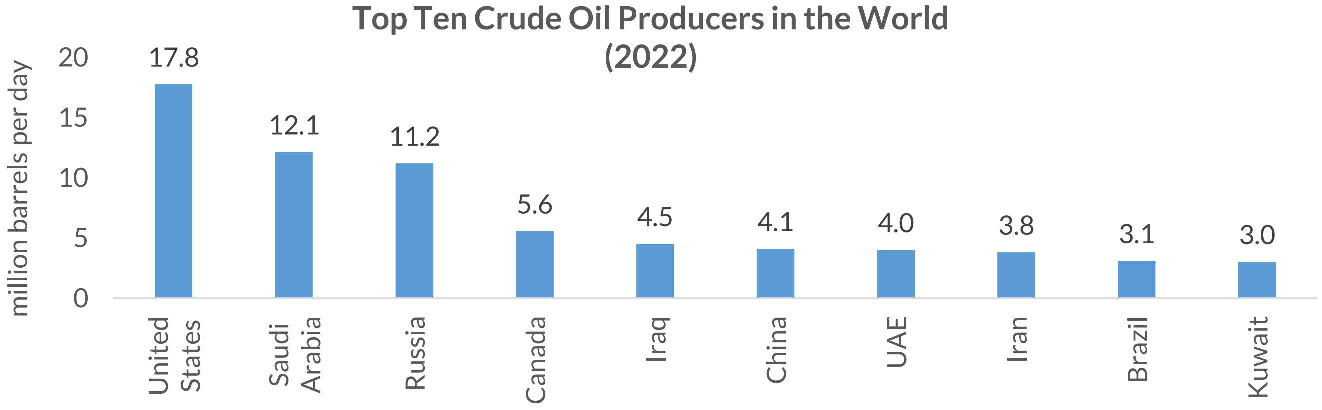
Source: Bloomberg, RHB Economics & Market Strategy

Figure 10: ... on 24 February 2022 (RU-UK) and 7 October 2023 (PL-IS)



Source: Bloomberg, RHB Economics & Market Strategy

Figure 11: Crude oil will be exceptionally interesting with the latest conflict – Iran + Iraq make up over 8.0 mbpd



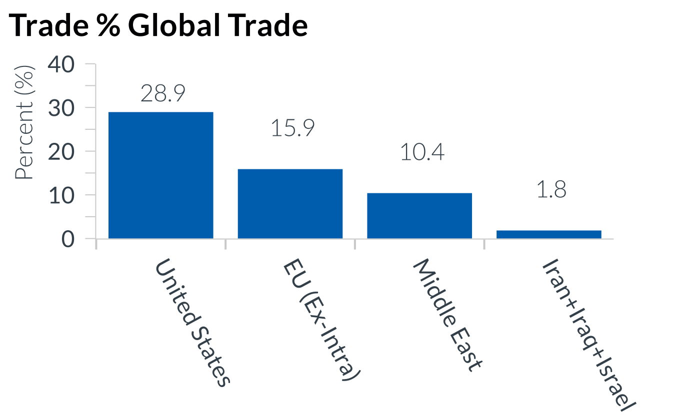
Source: Various newswires, RHB Economics & Market Research

So far, our discussions centred on the absence of further escalation of tensions, whereby we advocated a relatively optimistic and risk-on global appetite. Notwithstanding, we admit that unexpected escalations may threaten our global growth assumptions given downside trade, investment, and tourism risks. Should we assume tensions to intensify into military actions in the broader Middle East and G7 regions, our model shows that over 40% of global GDP and 50% of global trade may be affected. Moreover, about 30% of global investments may also be negatively impacted. In the worst-case scenario, we see five key implications in the global markets:

1. **Global GDP may sink into a recession** should there be protracted military actions by the G7, including collateral damage across the Middle East. Downside risks to global growth will be driven by the decline in global trade activities, higher inflation (and thus, higher cost of funds), lower investment demand and declining tourism activities.
2. **Global trade activities will plummet severely as economic activities in global economic pillars stall.** We note that the U.S. remains the second-largest trading nation, just behind China, with over US$7.0 trillion in total trade in 2022.
3. **Oil prices will surge to as high as US$140 per barrel, if not higher, should supply chain constraints take root.** Iran (and assuming Iraq and Yemen, whereby newswires[2] cited missiles against Israel were being launched) is a significant oil producer. This is coupled with potential supply chain disruption in the Straits of Hormuz, a vital supply route to transport crude oil from the Middle East to the U.S., Japan, China and Western Europe.
4. **U.S. Fed Funds Rate (FFR) will not see any cuts in 2024** on the back of higher inflation and crude oil prices, with the balance of risks tilted towards rate hikes to mitigate higher price pressures. Higher U.S. rates will also translate to elevated global interest rates, with ASEAN central banks likely to hike further in tandem.
5. **U.S. 10Y Treasuries may see a knee-jerk reaction towards its 4.0% handle** as investors flock to safe haven, before heading towards the 5.0% handle, with the USTs and quality fixed income names likely to see higher demand on the back of asset preservation. This is coupled with higher DXY valuation as U.S. rates turn north (see point four above). Gold will likely be a dominant safe haven, with futures likely to trend 20% higher towards US$2,800 per oz.

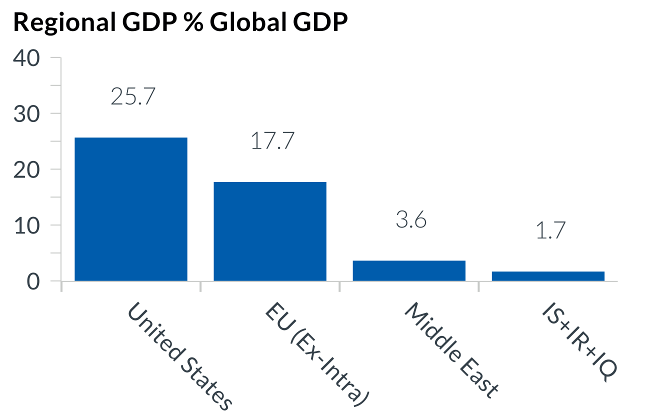
[2] Aljazeera, Iran launches hundreds of missiles, drones in first direct attack on Israel, 14 April 2024

Figure 12: Global trade exposure is limited if its isolated in Israel, Iran and Iraq (IS+IR+IQ)...



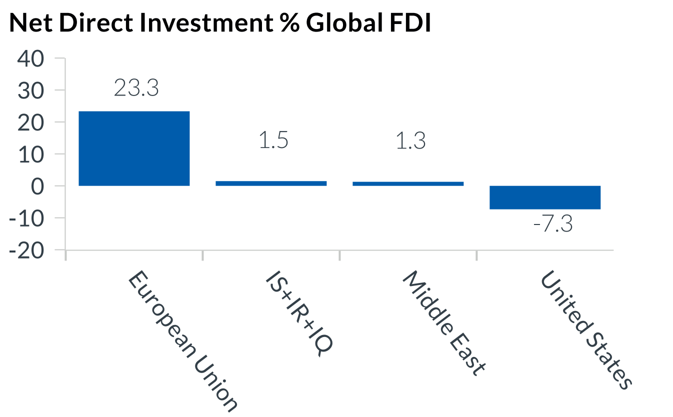
Source: Macrobond, RHB Economics & Market Strategy

Figure 13: ... but an escalation may mean over 40% of Global GDP is affected



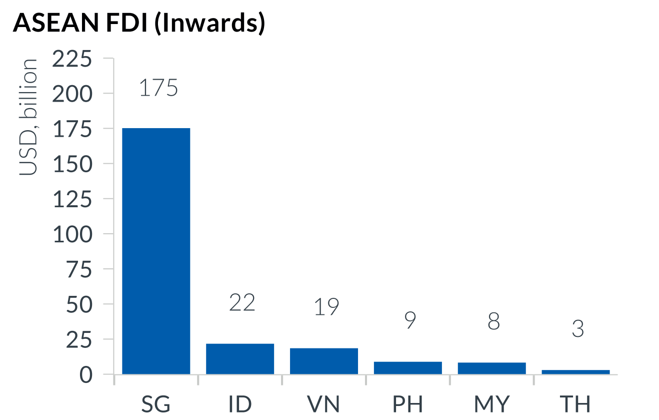
Source: Macrobond, RHB Economics & Market Strategy

Figure 14: Investment from key regions are sizeable, small from the Middle East



Source: Macrobond, RHB Economics & Market Strategy

Figure 15: Across ASEAN, SG has the highest FDI exposure, making it the most vulnerable in the region

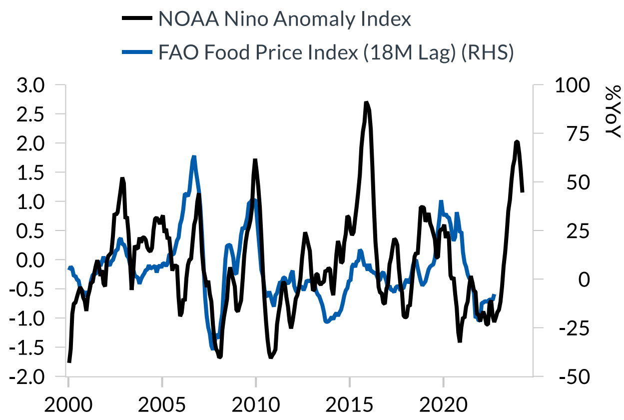


Source: Macrobond, RHB Economics & Market Strategy

We downgrade our view for the U.S. Fed Funds Rate to see only one cut in 2H24, with the balance of risks observably magnified towards no cuts in 2024. The tensions have reinforced our view for a high-for-longer Fed Funds Rate (FFR) due to higher inflationary pressures. Our revision of the U.S. inflation model suggests core PCE inflation will not touch 2.0% by the end of 2024, even on the assumption that month-on-month prints decelerate gradually towards 0.1% subsequently. We keep U.S. full-year headline inflation at 3.0%, with upside risks towards 3.2%, thus suggesting that inflation will continue to persist in the year ahead.

With core PCE inflation likely not touching 2.0% anytime soon, we think that inflation is likely not on the path towards the Fed's goal in 2024. Our model suggests that (1) U.S. core PCE inflation will head towards 3.4% (from the current 2.8%) if MoM % is unchanged at February's 0.3% handle, and (2) should it accelerate to 0.4%, core PCE inflation will head up to 4.2% by year-end. Our view for higher commodity prices into the year, telegraphed as early as 2H23, remains unchanged. As such, global inflation is likely to be persistent, rather than a blip, on the back of (1) energy supply constraints by OPEC+, (2) poor weather conditions given the El Nino conditions, and (3) demand-led prices on the back of our above-consensus GDP forecasts in key markets.

Figure 16: NOAA Nino Index leads FAO Food Index by 18 months



Source: Macrobond, RHB Economics & Market Strategy

Figure 17: Quant analysis shows a high degree of relevancy across periods…

Dependent Variable: FAO Food Prices YoY %
Period: 1996 - 1998 (31 months)

Regression Statistics	
Multiple R	0.7071
R Square	0.5000
Adjusted R Square	0.4827
Standard Error	0.4551
Observations	31

	Coeff	*Std Error*	*t Stat*	*P-value*
Intercept	0.1205	0.0981	1.2281	0.2293
NOAA Nino Index	6.5541	1.2172	5.3846	0.0000

Source: Macrobond, RHB Economics & Market Strategy

Figure 18: … with R-square between 0.5 – 0.8 depending of sample periods…

Dependent Variable: FAO Food Prices YoY %
Period: 2007 - 2009 (20 months)

Regression Statistics	
Multiple R	0.9152
R Square	0.8376
Adjusted R Square	0.8286
Standard Error	0.3721
Observations	20

	Coeff	*Std Error*	*t Stat*	*P-value*
Intercept	-0.7263	0.0852	-8.5224	0.0000
NOAA Nino Index	2.1065	0.2186	9.6363	0.0000

Source: Macrobond, RHB Economics & Market Strategy

Figure 19: … thus suggesting that food prices will rise on the back of adverse weather conditions

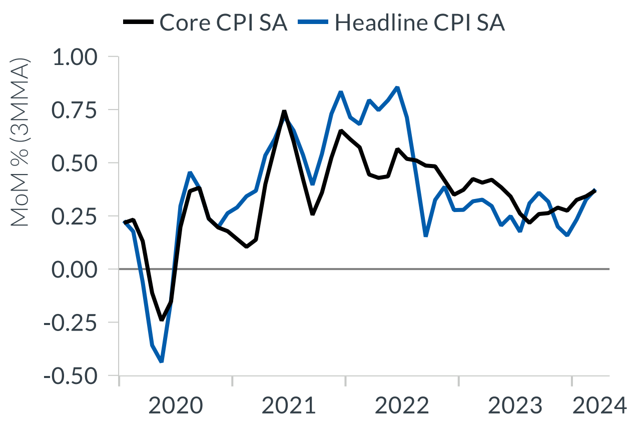
Dependent Variable: FAO Food Prices YoY %
Period: 2011 - 2013 (30 months)

Regression Statistics	
Multiple R	0.8201
R Square	0.6726
Adjusted R Square	0.6609
Standard Error	0.5722
Observations	30

	Coeff	*Std Error*	*t Stat*	*P-value*
Intercept	-0.8480	0.1129	-7.5078	0.0000
NOAA Nino Index	4.3248	0.5702	7.5841	0.0000

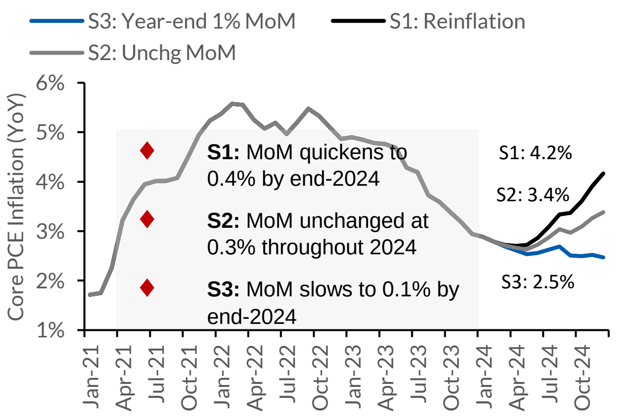
Source: Macrobond, RHB Economics & Market Strategy

Figure 20: U.S. core inflation momentum is elevated, suggesting that it is not on a 2.0% path…



Source: Macrobond, RHB Economics & Market Strategy

Figure 21: … and year-end PCE core inflation will be flat at around 2.5% even if MoM decelerates to 0.1%



Source: Macrobond, RHB Economics & Market Strategy

Figure 22: RHB government bond yield forecasts versus Bloomberg consensus forecasts

RHB Government Bond Yield Forecasts					Bloomberg Consensus				
10YR Government Bond	2Q24	3Q24	4Q24	2025	10YR Government Bond	2Q24	3Q24	4Q24	2025
United States	4.5 - 4.8	4.4 - 4.6	4.1 - 4.3	3.8 - 4.0	United States	4.10	3.96	3.89	3.7 - 3.8
Malaysia	3.90	3.80	3.75	3.65-3.85	Malaysia	3.73	3.68	3.65	3.5 - 3.6
Singapore	3.30	3.10	3.00	2.50-2.70	Singapore	2.70	2.70	2.55	2.7 - 2.9
Indonesia	6.80	6.60	6.40	6.20-6.40	Indonesia	6.63	6.49	6.33	5.9 - 6.2
Thailand	2.70	2.70	2.60	2.45-2.65	Thailand	2.51	2.48	2.51	2.4 - 2.5

Source: Bloomberg, RHB Economics & Market Strategy
Note: Above forecasts are on a quarterly average basis

Figure 23: RHB USD/Asia forecasts versus Bloomberg consensus forecasts

RHB FX Forecasts					Bloomberg Consensus				
G10FX	2Q24	3Q24	4Q24	2025	G10FX	2Q24	3Q24	4Q24	2025
EUR	1.0425	1.0533	1.0751	1.101	EUR	1.0900	1.0900	1.1000	1.1200
JPY	156.68	155.74	153.87	150.21	JPY	148.00	145.00	143.00	135.00
GBP	1.2247	1.2342	1.2532	1.283	GBP	1.2600	1.2700	1.2800	1.3000
AUD	0.6310	0.6370	0.6491	0.665	AUD	0.6600	0.6800	0.6800	0.7000
NZD	0.5786	0.5856	0.5997	0.614	NZD	0.6100	0.6200	0.6300	0.6400
AxJ FX	2Q24	3Q24	4Q24	2025	AxJ FX	2Q24	3Q24	4Q24	2025
CNH	7.3118	7.2572	7.1490	6.9788	CNH	7.2000	7.1500	7.1400	7.0000
IDR	16,423	16,337	16,168	15,783	IDR	15,750	15,500	15,500	14,800
MYR	4.8166	4.7805	4.7088	4.5967	MYR	4.7000	4.6500	4.6000	4.4500
SGD	1.3734	1.3617	1.3386	1.3067	SGD	1.3500	1.3300	1.3300	1.3000
THB	37.59	37.30	36.72	35.84	THB	36.10	35.50	35.10	34.30
VND	25,466	25,446	25,405	24,801	VND	24,750	24,540	24,600	24,350

Source: Bloomberg, RHB Economics & Market Strategy
Note: The above forecasts are on a quarterly average basis

Figure 24: RHB real GDP growth forecasts versus Bloomberg consensus forecasts

RHB Real GDP Growth Forecasts					Bloomberg Consensus				
% YoY	2022	2023	2024F	2025F	% YoY	2022	2023	2024F	2025F
US	1.9	2.5	2.5	2.7	US	1.9	2.5	2.2	1.7
Western Europe	3.5	0.5	1.0	1.5	Western Europe	3.5	0.5	0.7	1.5
Japan	1.0	1.9	1.0	1.2	Japan	1.0	1.9	0.7	1.1
China	3.0	5.2	5.0	5.0	China	3.0	5.2	4.6	4.3
ASEAN					**ASEAN**				
Indonesia	5.3	5.1	5.0	5.3	Indonesia	5.3	5.1	5.0	5.1
Malaysia	8.7	3.7	4.6	4.7	Malaysia	8.7	3.7	4.3	4.5
Singapore	3.9	1.1	2.5	3.0	Singapore	3.9	1.1	2.4	2.6
Thailand	2.5	1.9	3.0	3.0	Thailand	2.5	1.9	2.8	3.4
Vietnam	8.0	5.1	6.0	6.4	Vietnam	8.0	5.1	6.0	6.4

Source: Bloomberg, RHB Economics & Market Strategy

Figure 25: RHB CPI inflation forecasts versus Bloomberg consensus forecasts

RHB CPI Inflation Forecasts					Bloomberg Consensus				
% YoY	2022	2023	2024F	2025F	% YoY	2022	2023	2024F	2025F
US	8.0	4.1	3.0	2.5	US	8.0	4.1	2.9	2.4
Western Europe	8.1	5.7	2.8	2.5	Western Europe	8.1	5.7	2.4	2.1
Japan	2.5	3.3	2.4	1.5	Japan	2.5	3.3	2.3	1.7
China	2.0	0.2	1.5	2.0	China	2.0	0.2	0.8	1.7
ASEAN					ASEAN				
Indonesia	4.2	3.7	3.3	3.0	Indonesia	4.2	3.7	2.9	3.0
Malaysia	3.4	2.5	3.3	2.9	Malaysia	3.4	2.5	2.5	2.4
Singapore	6.1	4.8	3.5	2.5	Singapore	6.1	4.8	3.0	2.0
Thailand	6.1	1.3	1.0	2.5	Thailand	6.1	1.3	1.0	1.7
Vietnam	3.2	3.3 (F)	3.5	3.3	Vietnam	3.2	3.3 (F)	3.5	3.2

Source: Bloomberg, RHB Economics & Market Strategy

Figure 26: RHB policy interest rate forecasts versus Bloomberg consensus forecasts

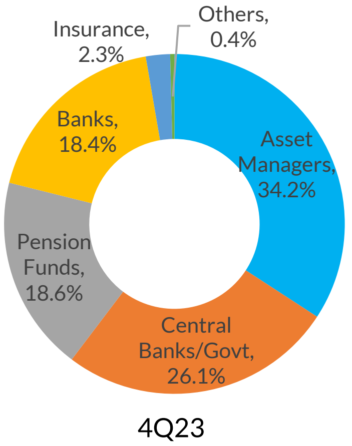
RHB Policy Rate Forecasts					Bloomberg Consensus				
%	2022	2023	2024F	2025F	%	2022	2023	2024F	2025F
US	4.50	5.50	5.0 - 5.25	4.25 - 4.50	US	4.50	5.50	4.65	3.55
Western Europe	2.50	4.50	4.25	3.50	Western Europe	2.60	4.48	3.32	2.57
Japan	0.00	0.00	0.10	0.20	Japan	0.00	0.00	0.20	0.30
China	3.65	3.45	3.00	3.00	China	3.65	3.45	N/A	N/A
ASEAN					**ASEAN**				
Indonesia	5.50	6.00	5.75	5.00	Indonesia	5.50	6.00	5.45	4.85
Malaysia	2.72	3.00	3.00	3.00	Malaysia	2.72	3.00	2.95	2.90
Thailand	1.25	2.50	2.50	2.50	Thailand	1.25	2.50	2.05	1.85
Vietnam	6.00	4.50	4.50	4.25	Vietnam	6.00	4.50	4.50	4.50

Source: Bloomberg, RHB Economics & Market Strategy

Fixed Income: Stay Cautious, But Do Not Expect Severe Sell-off

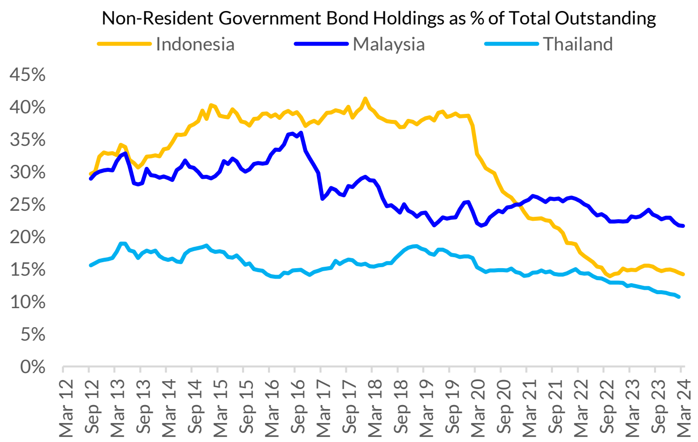
- **Base case**: We expect domestic and foreign investors to stay cautious in the ASEAN fixed income market.
  - **For corporate bonds**, non-residents (NR) have negligible holdings in domestic and regional corporate bonds. As such, we do not anticipate any risks of major sell-offs. Regarding credit risks, domestic bonds and sukuk should remain stable as local currency issuers are domestically focused.
  - **For government bonds**, a historically low NR government bonds holdings (as a percentage of outstanding, Figure 28) in the ASEAN regionally could help blunt any active fund outflows. Also, passive inflows could continue but active managers could avoid allocations to EM given the still highly fluid situation. In addition, the inclusion of Malaysia and Singapore government bonds/sukuk into major global bond benchmarks and its diverse profile of holders (Figure 27) should keep NR holdings sticky. We expect domestic investors to stay cautious but supportive of the market.
  - Retrospectively, the Russia invasion in February 2022 had no impact on MGS/GII yields, as bond yields are guided more by policy rate. For instance, the first FFR hike on 16 March 2022 and the first OPR hike in 10 May 2022 marked the rise in 10YR MGS yields from 1.80% which later peaked at 4.20% in October.
- **Worst case:** Under the worst case scenario, ASEAN yields and bond volatility will rise as the Federal Reserve raises interest rates higher to combat spiralling inflation caused by a long period of elevated oil prices. Under such scenario, investors could take shelter in high grade sovereigns and credits and potentially benefit from a strengthening SGD should MAS decides to tweak its monetary policy to offset the inflationary pressures from high oil prices.
  - **For corporate bonds**, we expect bond yields to rise from a valuation perspective as higher UST yields filter into the ASEAN risk-free rates. NR investors have negligible holdings in domestic and regional corporate bonds, as such, we do not anticipate any risks of sell-offs. However, in terms of credit risks, domestic bonds and sukuk should could see temporal weakness in their operations as global economic uncertainty lingers.
  - **For government bonds**, we expect some upside pressures on ASEAN government yields over the medium-term as global interest rates rise on elevated US and global inflation pressures, attributed to heightened oil prices and supply chain disruptions. As UST yields rise, NR investors could exit local currency government bonds from a relative value perspective, causing short-term volatility. Nevertheless, negative price actions should smooth out as domestic liquidity should be able to pick up the void by NR flows.
  - We expect 2bps movement in MGS/GII for every 10bps change in UST yields. Nevertheless, MGS/GII yields will be anchored by policy rate expectation. Any significant risk-off event could see NR holder disposing MYR20bn to MYR25bn of holdings within a one or two month period, which could raise the 10YR MGS by 70bps to 80bps. These estimations are based on recent risk-off event observations (Covid-19 selloff in Mar-20 and US Election in Nov-16).

Figure 27: Diverse non-resident MGS/GII holders



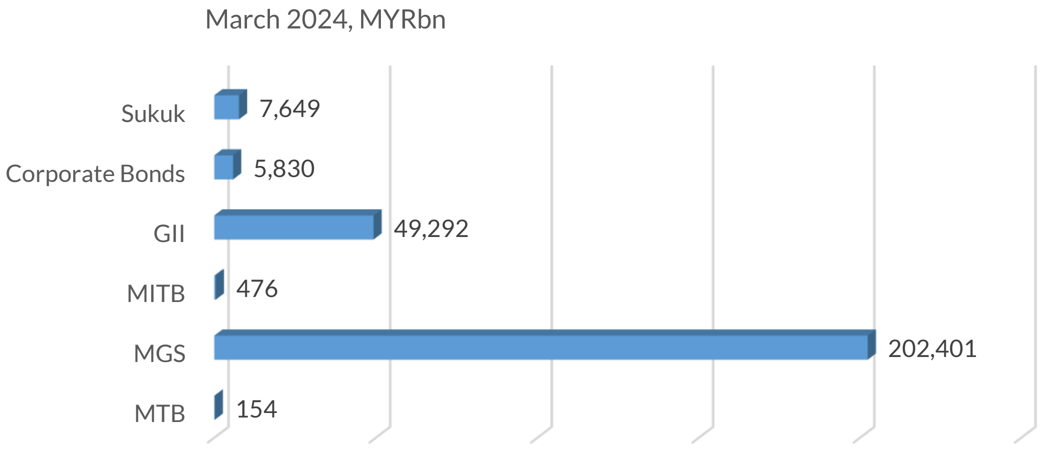
Source: BNM, RHB Economics & Market Strategy.

Figure 28: Current non-resident holdings of ASEAN sovereign bonds are low historically



Source: BNM, Bloomberg, RHB Economics & Market Strategy.

Figure 29: Non-resident holdings as of March 2024, negligible holdings in corporate bonds and sukuk



Source: BNM, RHB Economics & Market Research

Little Impact on Malaysia's Economy, Cautious on MYR

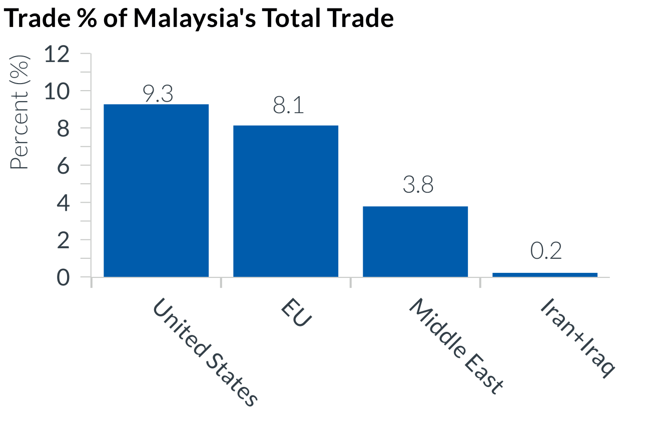
Despite escalating geopolitical tensions in the Middle East, we maintain our GDP growth projection at 4.6% YoY. The direct impact on Malaysia's economic landscape is expected to be limited, as Malaysia's trade and tourism incomes have relatively low exposure to the Middle East economies. For instance, the trade with Iran and Iraq accounts for only 0.2% of total trade, while the tourist arrivals from the aforementioned countries account for 0.3% of total tourist arrivals. Meanwhile, the trade with the Middle East region accounts for 3.8% of total trade, while the Middle East tourist arrivals constitute 1.1% over the past five years.

On the currency front, the MYR weakness against the USD might persist in the near term. MYR might break its interim resistance of 4.8 per USD amid persistence in US-Malaysia interest rate differentials. The greenback is supported by (1) high for longer rates in the U.S. and (2) renewed interest in safe-haven currencies. FFR will likely stay high for longer should the crude oil prices stay elevated at US$95 per barrel with the core PCE inflation remaining sticky.

On the inflationary front, we maintain our headline inflation forecasts for 2024, assuming transport inflation remains manageable. Fuel subsidies are likely to be extended in the event of elevated crude oil prices to cushion the impact of higher transportation costs and subsequent secondary effects. The impact of higher transportation costs on the overall headline inflation momentum could be sizeable as transport inflation accounts for 11% of the total CPI basket, with fuel sub-components alone constituting 6% of the CPI basket. As highlighted in our previous report, the increase in diesel and RON 95 prices is estimated to lift headline CPI by 0.25 – 0.35%, should we assume a mere 5% increase (or RM0.10) in retail prices. Hence, from the balance of risks perspective, there could be possible delays in the fuel subsidy rationalisation especially given the risks of elevated crude oil prices.

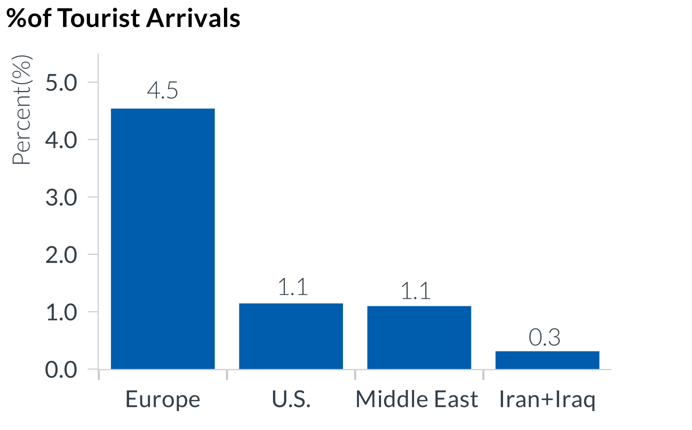
In the worst-case scenario, slower global GDP growth and trade might impact Malaysia's external demand and investment income. As major trade partners of Malaysia, the total trade with the U.S. and E.U. accounts for 9.3% and 8.1% of Malaysia's trade, respectively. Regarding FDI, the FDI net flows from the E.U. constitute a sizeable share of 25% of total FDI, while the U.S. accounts for -7% of total net FDI flows. The impact of tourism incomes is limited as tourist arrivals from Europe account for 4.5% of total arrivals, with the U.S. accounting for another 1.1%. In the light of further escalation of Middle East tensions, the possibility of a knee-jerk reaction from the market might be expected.

Figure 30: Limited exposure to Middle East economies in terms of trade…



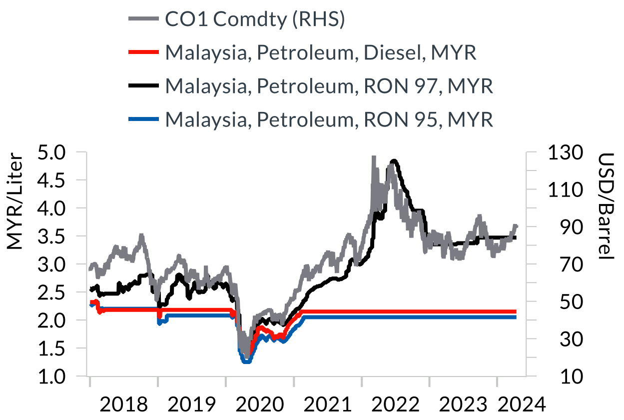
Source: Macrobond, RHB Economics & Market Strategy.

Figure 31: … and tourism exposure



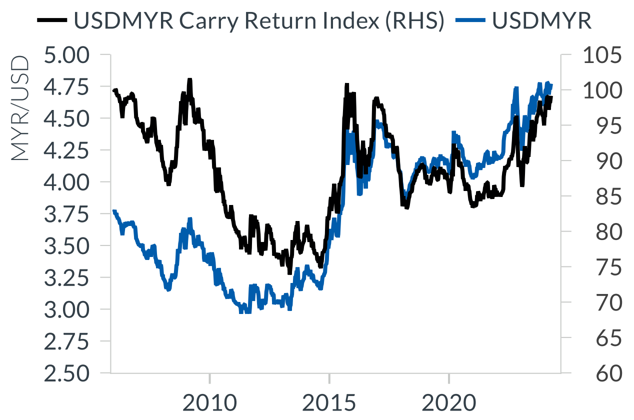
Source: Macrobond, RHB Economics & Market Strategy.

Figure 32: The transport inflation is likely to remain manageable on the extension of fuel subsidies



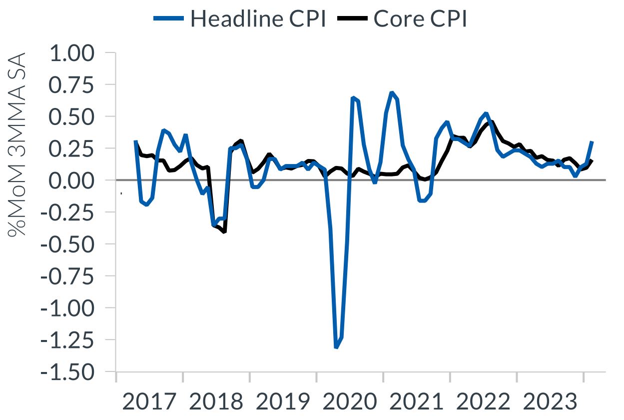
Source: Macrobond, RHB Economics & Market Strategy.

Figure 33: USD carry against MYR remains rich as market price out FFR cuts,



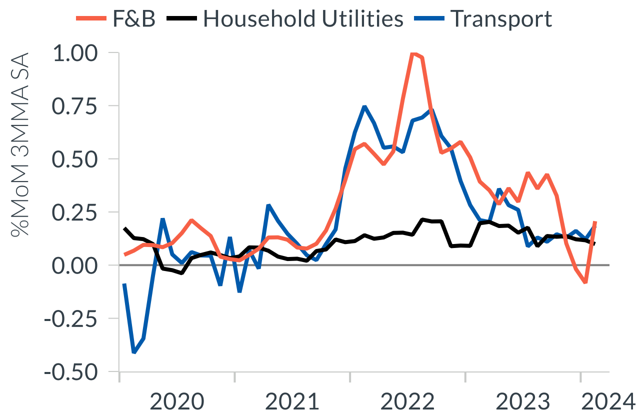
Source: Macrobond, RHB Economics & Market Strategy.

Figure 34: Inflation in Malaysia is already picking up…



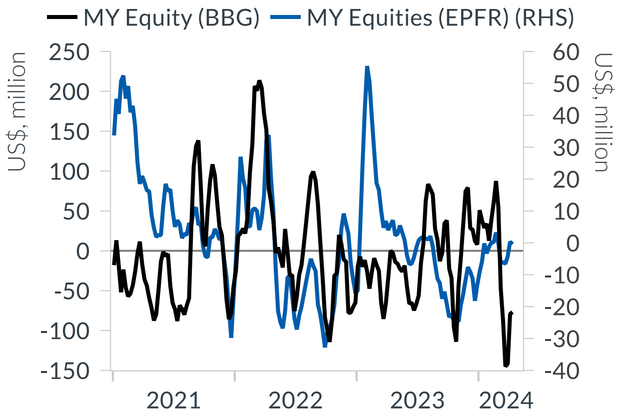
Source: Macrobond, RHB Economics & Market Strategy.

Figure 35: … led by key sectors (Food, TPT)



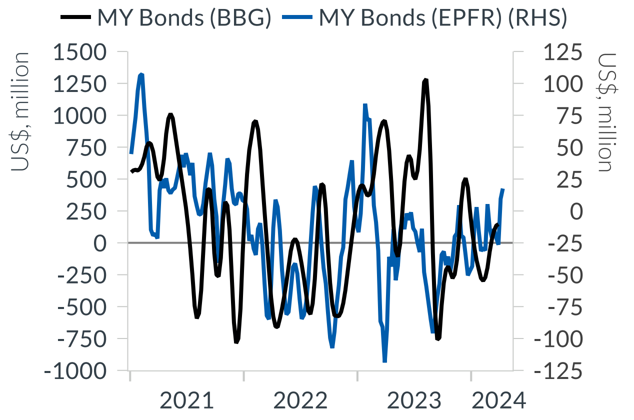
Source: Macrobond, RHB Economics & Market Strategy.

Figure 36: Equity flows have improved in Malaysia…



Source: Macrobond, RHB Economics & Market Strategy.

Figure 37: … ditto for bonds



Source: Macrobond, RHB Economics & Market Strategy.

Indonesia: Limited Direct Impact, But Watch for Capital Outflows

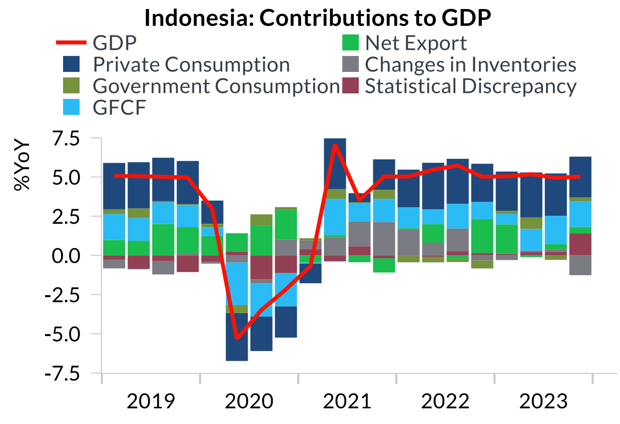
In our base case scenario, we observe a limited direct impact of the Iran-Israel conflict on the Indonesian economy. The economy maintains its resilient growth at 5% for 2024 with robust domestic demand-driven growth. Key drivers such as household consumption continue to drive expansion, shielding it from external geopolitical disturbances. When assessing Indonesia's economic ties with the Middle East, it becomes evident that the nation's exposure remains minimal. Trade volumes, foreign investment inflows, and tourism from the conflicted areas constitute a negligible fraction of Indonesia's overall economic activities. Specifically, the combined trade and investment interactions with Iran, Iraq, and Israel collectively amount to less than 1% of Indonesia's total trade and investment flows.

However, in a worst-case scenario involving a full-scale military conflict, the impacts on Indonesia's economy are expected to be profoundly severe, adversely affecting the foreign exchange rates, inflation, and overall economic growth. Anticipating such a scenario, we foresee the USD/IDR exchange rate depreciating sharply between 16,700 and 17,000. Two primary factors would drive this depreciation. Firstly, we expect a persistent strength in the USD due to heightened U.S. inflation, potentially driven by crude oil prices soaring towards US$140 per barrel. This situation would likely exert pressure on the U.S. Federal Reserve to refrain from or limit interest rate cuts, thereby increasing the positive carry of the USD.

Secondly, investors flocking to safe havens could trigger substantial capital outflows from Indonesia. Consequently, Indonesia's basic balance on currency support could weaken considerably. This weakening would be compounded by slower exports to major markets like the U.S. and E.U. and Indonesia's status as a net energy importer, leading to more significant current account deficits exacerbated by higher crude oil prices. From a financial account perspective, investors are likely to divest from IDR-denominated bonds and redirect their investments towards assets perceived as lower risk, such as the DXY index and gold. Additionally, foreign direct investment activities worldwide are likely to decelerate or halt as risk sentiment heightens in the wake of the conflict. These factors contribute to the anticipated weakening of the currency exchange rate.

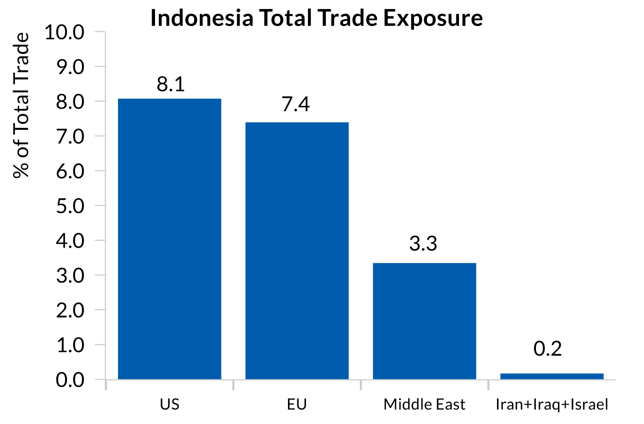
On the inflation front, we expect the impact of the conflict to be relatively limited, primarily due to the provision of fuel subsidies by the government, which has effectively shielded the Indonesian domestic market from the uncertainties in the global market. However, there is a potential risk stemming from the sustainability of government finances. An extended period of higher fuel prices could exacerbate government expenditures. If the government decides to remove or reduce subsidies in response to greater deficits, this could trigger strong inflationary pressures, as seen in October 2022 when subsidies were reduced by raising the ceiling price of retail petrol. Another inflationary risk arises from the disruptions in global supply chains. This could compel manufacturers to seek alternative sources for raw materials and increase the length of shipment routes to avoid conflict regions. Consequently, production costs may rise, potentially leading to price increases that could be passed on to consumers.

Figure 38: Indonesia's GDP growth remains resilient…



Source: Macrobond, RHB Economics & Market Strategy

Figure 39: …given limited exposure from total trade…

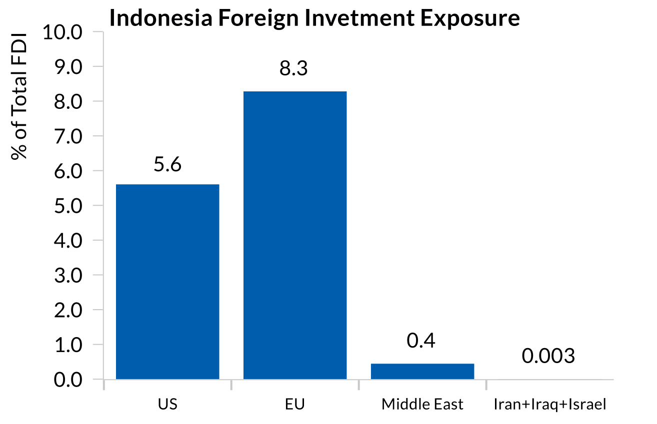


Source: Macrobond, RHB Economics & Market Strategy

Figure 40: ...tourism and...

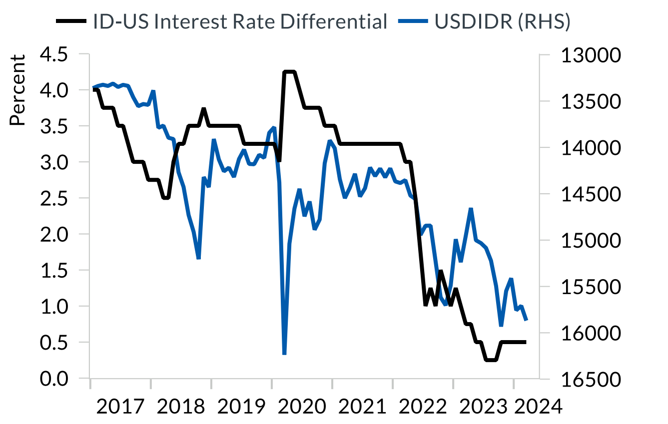
Source: Macrobond, RHB Economics & Market Strategy

Figure 41: ... FDI with the conflicted region...



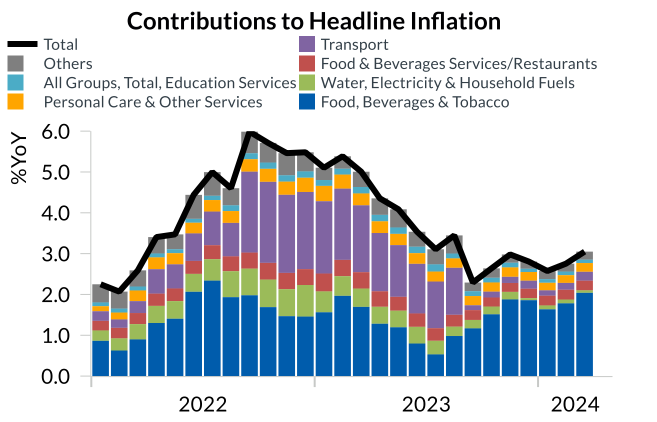
Source: Macrobond, RHB Economics & Market Strategy

Figure 42: ... we expect IDR to depreciate further if the conflict escalates...



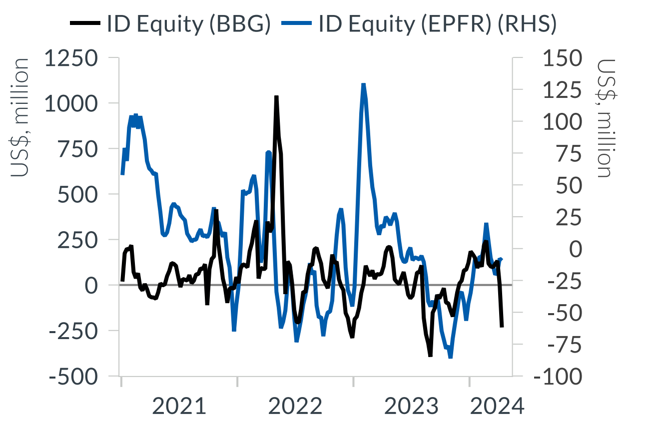
Source: Macrobond, RHB Economics & Market Strategy

Figure 43: ... while inflation trajectory is largely dependent on fiscal policy



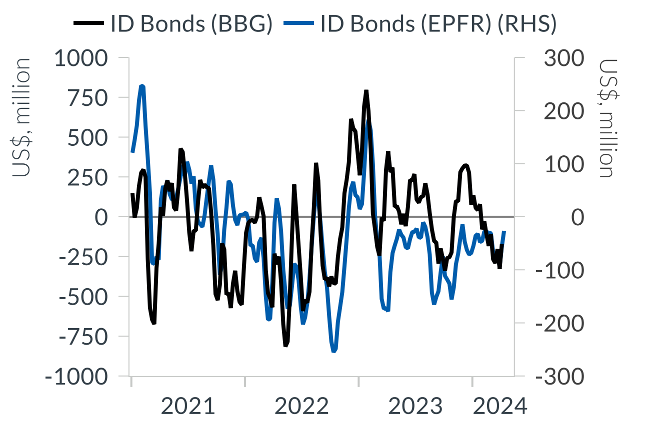
Source: Macrobond, RHB Economics & Market Strategy

Figure 44: Indonesia is already experiencing net equity outflows year-to-date...



Source: Macrobond, RHB Economics & Market Strategy

Figure 45: ... similar to bonds, thus placing downward pressure on the IDR



Source: Macrobond, RHB Economics & Market Strategy

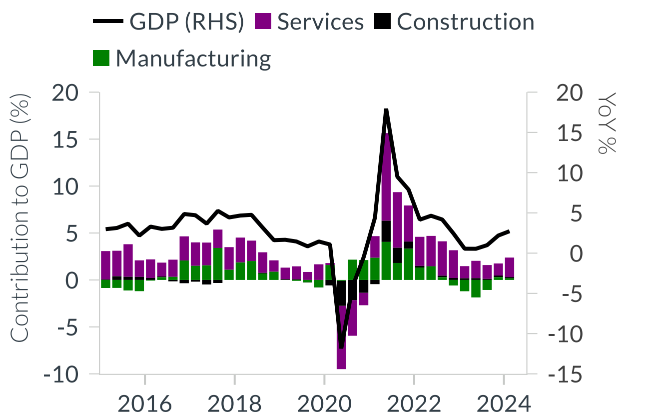
Singapore: Worst Case Will Spell Significant Implications

In our base case scenario, the Iran-Israel conflict has a limited impact on Singapore's economy. We maintain our outlook for a resilient growth of 2.5% in 2024, driven by robust services-producing activities in Singapore. Key drivers like higher tourism influx insulate the economy from external geopolitical conflicts. When looking at Singapore's economic connections with the Middle East, the country has limited trade exposure. While the combined tourism and trade dealings with Iran and Israel amount to less than 0.5% of Singapore's total trade and tourism activities.

As a small, open economy heavily reliant on trade, Singapore might be impacted by the ongoing geopolitical conflicts in the Middle East, especially in trade activities. It can be seen that trade interactions with the Middle East are nearly 5% of Singapore's total trade activities. However, in a worst-case scenario of full-scale military conflict, Singapore's economy could negatively impact inflation and overall economic growth. The disruptions in oil supply from the Middle East region might lead to increased oil prices, impacting production costs and consumer prices. Maritime activities and shipping routes may be affected, impacting Singapore's role as a key shipping hub. The slowdown in the trade environment potentially affects investor confidence, business activities, and government revenue, collectively exerting downward pressure on economic growth. Furthermore, higher import costs and inflationary pressures (assuming the conflict continues to prolong) might impact the economy's trade balance and tamper consumer spending.

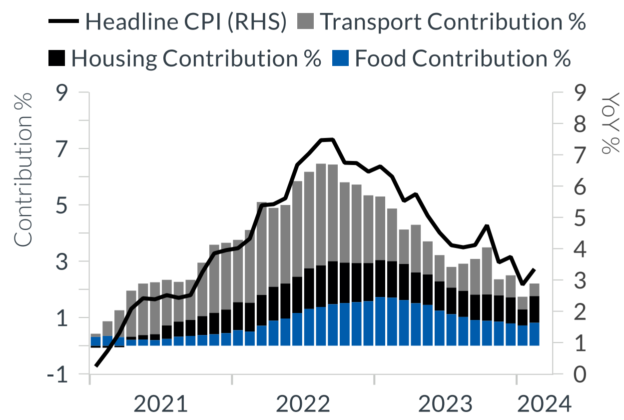
Overall, escalating tensions leading to an Iran attack have significant implications for Singapore's economy. The spike in global oil prices resulting from the conflict threatens to raise energy costs and inflation domestically, prompting a need for strategic energy security measures. Secondly, as a major trading hub, Singapore faces risks of disrupted shipping routes and trade flows, necessitating diversification efforts and supply chain resilience strategies.

Figure 46: Singapore's GDP growth remains resilient…



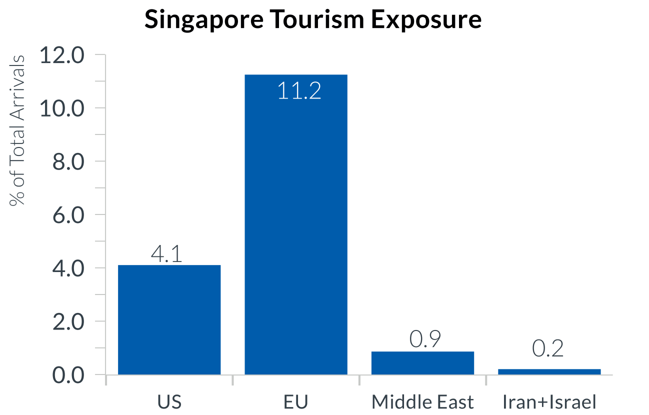
Source: Macrobond, RHB Economics & Market Strategy

Figure 47: …while headline CPI is picking up



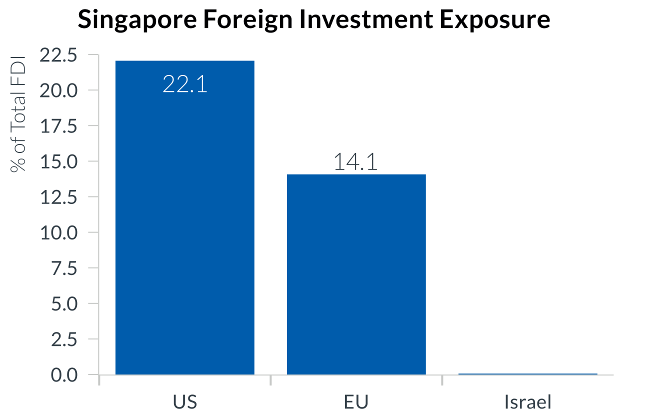
Source: Macrobond, RHB Economics & Market Strategy

Figure 48: Tourism exposure in the Middle East is less than 1%…



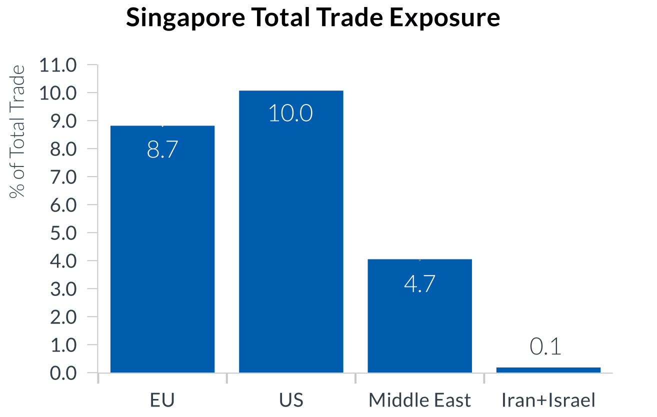
Source: Macrobond, RHB Economics & Market Strategy

Figure 49: …and foreign investment dealings with Israel…



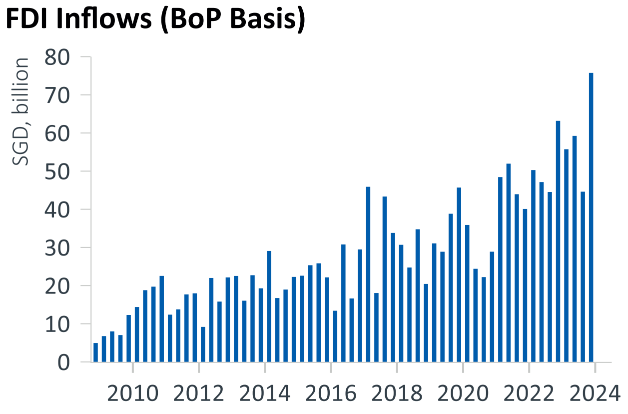
Source: Macrobond, RHB Economics & Market Strategy

Figure 50: Singapore has limited trade exposure with the conflicted region



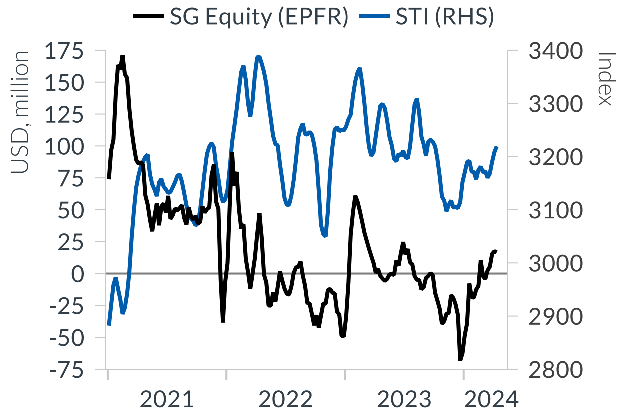
Source: Macrobond, RHB Economics & Market Strategy

Figure 51: SG FDI inflows have grown markedly since 2010, suggesting the importance of future resiliency



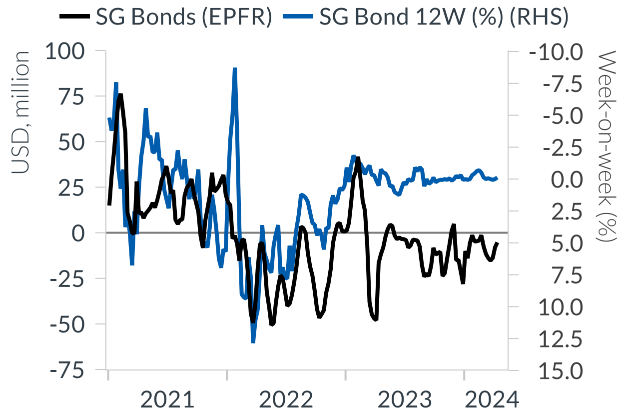
Source: Macrobond, RHB Economics & Market Strategy

Figure 52: SG equity inflows remain strong



Source: Macrobond, RHB Economics & Market Strategy

Figure 53: Bond flows are stable too



Source: Macrobond, RHB Economics & Market Strategy

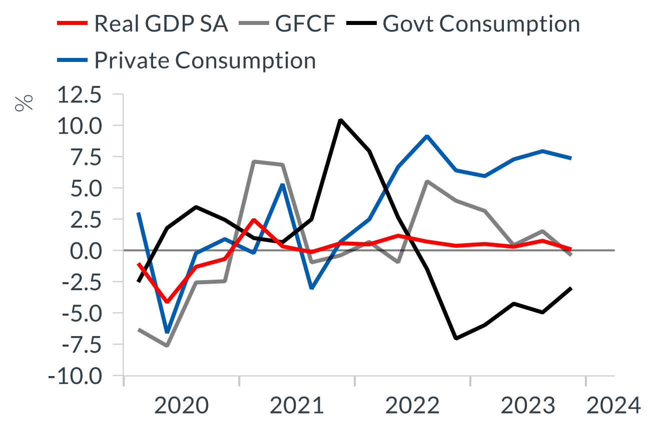
Thailand: Trade and tourism will be severely impacted if…

In our base case scenario, we remain cautious about Thailand's GDP growth in 2024. Led by our proprietary GDP leading index amid Thailand's lacklustre external-facing sectors, we downgrade its GDP forecast to 3.0% in 2024. We have been relatively cautious about the economy's GDP growth in 1Q24, given the private consumption backdrop seen year-to-date and the risk of a material spike in prices given the expiry of the diesel fuel subsidy effective 31 March 2024. The consolation, perhaps, is that the economy has limited exposure in terms of tourism and foreign investment with the Middle East - combined tourism and trade dealings with Iran and Israel amount to merely 2% of Thailand's total trade and tourism.

We expect Thailand's headline CPI to average 1.0% in 2024. Thailand is observing subtle indications of increased prices in crucial sectors. Consumer prices are expected to increase due to higher global oil prices, depreciation of the Thai baht, the low base effect of power costs and strong recovery in tourism activities. As aforementioned, higher inflation is on the cards, especially as subsidies are expected to be phased out later this year, coupled with the present rise in energy prices.

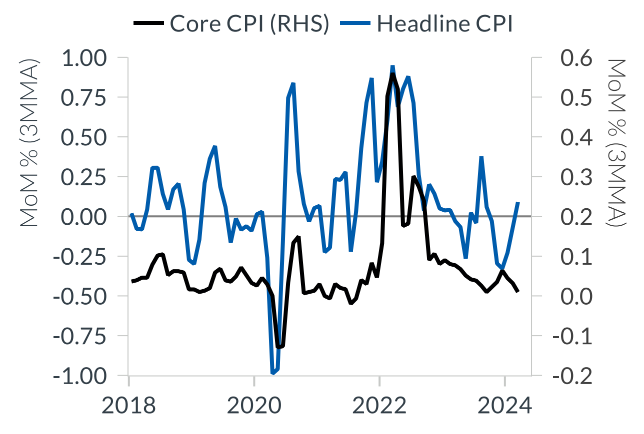
Assuming the conflict in the Middle East escalates and disrupts oil supply routes, it might lead to a sharp increase in crude oil prices. Given that Thailand imports a significant amount of oil, this would directly impact its economy, potentially leading to higher costs across various sectors and affecting the country's GDP. The Middle East conflict's impact on Thailand's GDP growth is significant as trade and tourism from the region contribute 10% to Thailand's total trade and tourism activities. As we expect tourism activities to boost in 2H24, the ongoing conflict might deter tourists from the Middle East and other affected regions from visiting Thailand. This reduction in inbound arrivals eventually impacts tourism demand, leading to lower hospitality-related services and overall consumption.

Figure 54: GDP shows signs of bottoming in 2023…



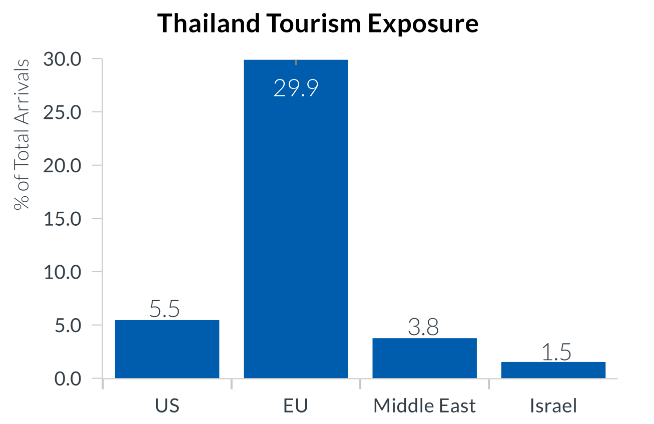
Source: Macrobond, RHB Economics & Market Strategy

Figure 55: … and inflation is expected to rise



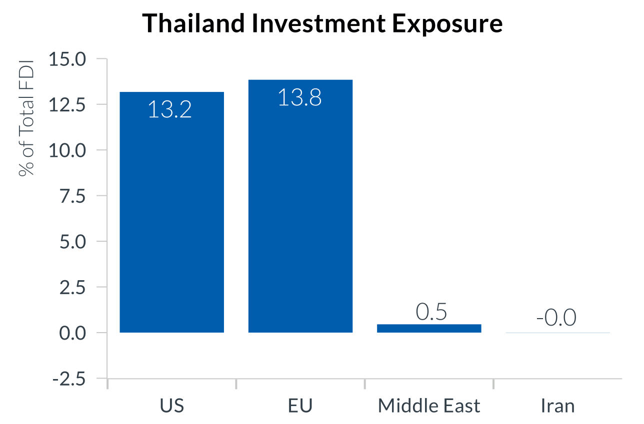
Source: Macrobond, RHB Economics & Market Strategy

Figure 56: Limited tourism impact from the Middle East…



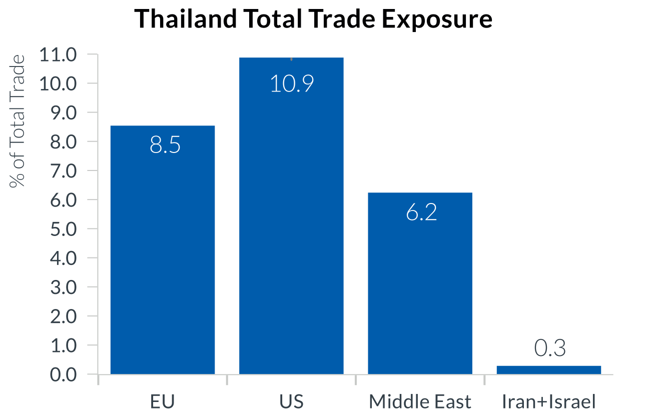
Source: Macrobond, RHB Economics & Market Strategy

Figure 57: … and foreign investment



Source: Macrobond, RHB Economics & Market Strategy

Figure 58: Thailand has significant trade exposure with the Middle East

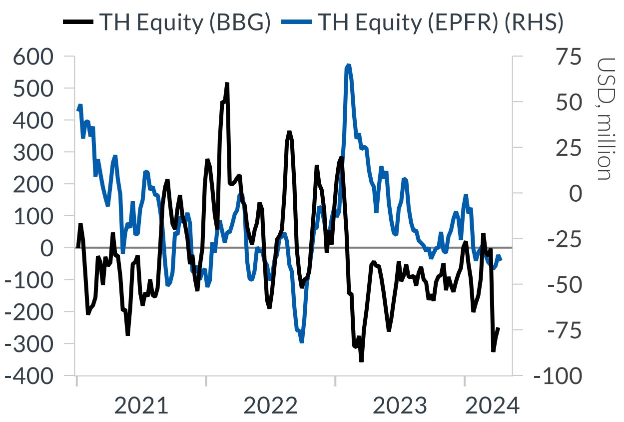


Source: Macrobond, RHB Economics & Market Strategy

Figure 59: Tourism activities might slow down if the geopolitical conflict is prolonged

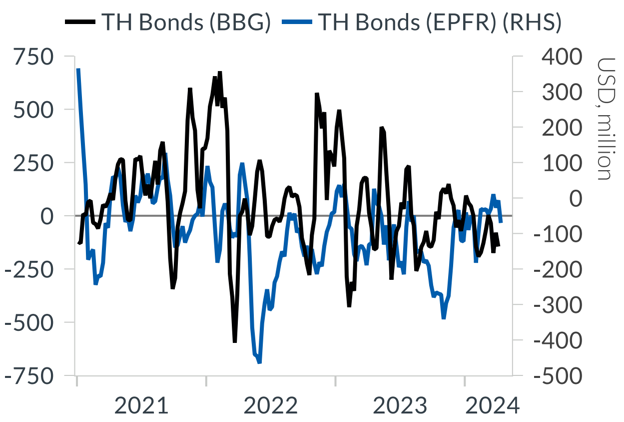
Source: Macrobond, RHB Economics & Market Strategy

Figure 60: Thailand's net equity outflows accelerated as investors take caution on its externally-facing sectors



Source: Macrobond, RHB Economics & Market Strategy

Figure 61: Thailand's net bond flows also saw renewed outflows year-to-date



Source: Macrobond, RHB Economics & Market Strategy

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