

## Monday's The Week Ahead

### Economics

#### Greater China, Korea

- TW:** The final plan for Free Economic Pilot Zones has been approved by the Cabinet in December. Compared to the original proposal, the scope of deregulation in the pilot zones will be expanded to cover more services sectors including education and professional services. Foreign entities will be allowed to set up universities or colleges in collaboration with domestic entities, exempt from the current restrictions on student enrolment, curriculum arrangement, human resources, finance and etc. Meanwhile, foreign investors will also be provided with more freedom in setting up legal, accounting and architectural firms in the pilot zones.

In addition, the concept of promoting international medical services in the zones will be broadened to international health services. International Health Industrial Parks will be established to foster the development of not only medical services, but also biotechnology, pharmaceuticals, health supplements and the related sectors.

The legislation for the FEPZ plan is expected to be completed in mid-2014. The boosting impact on the real economy should remain limited for this year. According to the official estimate, the pilot zones will boost private investment by TWD 21bn in 2014, lift GDP by TWD 30bn (0.2ppt) and create 13,000 new jobs.

The significance is that the revised version of the FEPZ plan adds more focus to deregulation, showing that the authorities are now taking a more serious attitude towards liberalization and internationalization. In the long term, the pilot zones will offer an opportunity for Taiwan to attract FDI into the high value added services sectors, leveraging its advantages in human resources, information technology and geographic location. This should in turn, drive innovation, promote industrial upgrade and help the economy maintain competitiveness and achieve growth potential.

#### Southeast Asia, India

- SG:** Singapore has announced a minimum wages for cleaners. This is the first time the government has announced such measure for any sector. A compulsory licensing scheme leading to mandatory basic wages for cleaners and workers in security sector will be introduced, said Deputy Prime Minister Tharman Shanmugaratnam yesterday. However, he qualified that the moves are targeted approaches to use the industry licensing schemes to raise wages in certain sectors and that it is not a nation-wide minimum wage.

The scheme will make it mandatory for specified sectors to adopt a progressive wage model with basic wage levels set in accordance with the role of the employees, so as to raise wages progressively as workers' productivity improves through skills upgrading and training. All cleaning companies will come under the scheme in September, with the entry-level pay for cleaners set at 1,000 Singapore dollars monthly. This is about 20% higher than the current median basic wage for cleaners. Details for the security sector are still being worked out.

#### US Fed expectations

Implied fed funds rate

	Dec13	Jun14	Dec14
<b>Market</b>			
Current	0.08	0.11	0.19
1wk ago	0.08	0.11	0.17
<b>DBS</b>	0.25	0.25	0.25

Source: Bloomberg fed fund futures

Notes: Given a FF target rate of 0.25%, an implied FF rate of 0.30 is interpreted roughly as the market pricing in a 20% chance of a Fed hike to 0.50% from 0.25% (30 is 1/5th of the distance to 50 from 25). DBS expectations are presented in discrete blocks of 25bps, i.e., the Fed moves or it does not. See also "Policy rate forecasts" below.

- **MY:** Industrial production (Nov13) due today is likely to post an expansion of 2.9% YoY, up from 1.7% in the previous month. A bit of base effect will help to provide some technical lift but generally speaking, demand is picking up, particularly from the external environment.

PMIs of key markets have been inching northward, reflecting the improvement in the global economic conditions. Key electronics leading indicator such as the SEMI book-to-bill ratio has been indicating expansion in the industry while global semiconductor sales have been rising. That said, some seasonal factors such as the lapsing of the Christmas season effect and upcoming Chinese New Year lull, could post some downsides risk to the number.

As it is, export growth announced just yesterday has disappointed. Headline export growth came in below expectation at 6.7% YoY, lower than the consensus forecast of 10.3%. So on this basis, similar downside surprise may surface in the industrial production number today too.

### G3

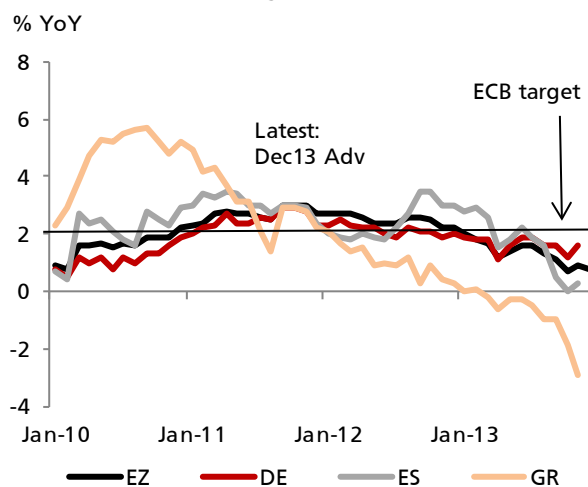
- **EZ:** The advance Dec inflation release presented a fresh headache for the central bank. The ECB Governing Council that meets today is nonetheless expected to leave the main refinancing and deposit facility rates unchanged at 0.25% and 0% respectively. Looking ahead, pressure will build for more policy action to hasten growth and spur spending to arrest the disinflationary trend. As a base case, a rate cut could materialise in 2Q, as the shifts in the US policy bias also exert upside pressure on the Eurozone rates.

The advance estimate of the Dec HICP inflation undershot expectations as headline eased to 0.8% YoY from 0.9% the month before. With this reading, inflation rate averaged 1.3% last year, easing from 2011-12's 2.6% and below the central bank's 2% target.

Equally worrying was the slip in the Dec core measure to 0.7% - a record low for the union and representative of the weak demand quotient. As the accompanying chart shows, inflation rates have been easing across the member countries, with Greece and Cyprus already facing negative headline rates.

ECB President Draghi played down rate cut expectations in comments aired late-Dec, highlighting the slight pickup in growth, favourable externals, modest adjustment in budget deficits, amongst others. That said, worries over deflation will continue to linger, especially as falling prices threaten corporate profits and hinder the sovereigns' ability to lower debt. Hence, even if the central bank sits on its hand at today's meeting, the need to address falling prices will be crucial in the coming months, especially if inflation continues to surprise on the downside. Currency strength, on the back of the policy divergence with the US Fed, is also a negative for the inflation outlook.

**EZ: Inflation below target across the member cts**



## Currencies

- **FX:** There is one thing we need to clarify this morning. The USD and the US 10Y bond yield did not rise on the FOMC minutes for the December 17-18 meeting. The moves higher took place earlier on higher-than-expected US jobs data. Ac-

According to the ADP employment report, America added 238K jobs in December, more than the 200K consensus, while November was revised up to 229K from 215K. Since the start of the week, the bias had been to buy the USD ahead of the US nonfarm payrolls data tomorrow. Between the ADP report and the FOMC minutes, the 10Y yield spiked to a high of 3.00% from 2.95%, and has since edged back to 2.99%.

There was nothing in the FOMC minutes to suggest that the Fed would quicken the pace in which it would taper asset purchases. The broad goal of monetary policy is to wind down QE3 this year before rate hikes can be contemplated in 2015. With USD75 bn of assets to taper and eight FOMC meetings this year, the Fed could continue a steady and measured pace of USD10 bn at each FOMC meeting, except for December. For now, the Phillips curve is not behaving as it should in an improving economic cycle. Inflation is low and not moving higher in spite of the jobs recovery. The Fed's explanation so far had been that while the unemployment rate had fallen from its high, it remained elevated.

While the Fed wants to ensure transparency and increase clarity in its monetary policy setting decisions, it also needs to keep the process flexible. Put simply, there is no pre-set course for the taper. The current "steady, measured" bias can be accelerated or decelerated depending on how employment and inflation evolves, barring any unforeseen shocks like the Eurozone crisis. These are the points that Fed Chairman Ben Bernanke would probably reiterate during his lunch with Senate Democrats today. The US House of Representatives Monetary Policy and Trade Subcommittee will also be holding a hearing on the Fed's QE program today.

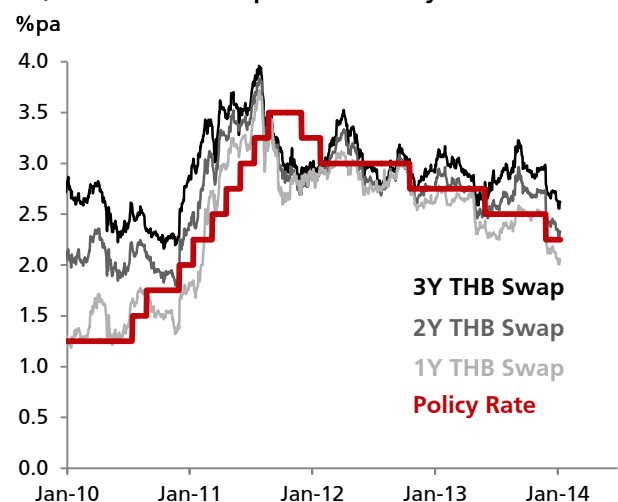
As for currency markets, the USD will probably stay firm ahead of tomorrow's US nonfarm payrolls data. Having discounted a headline print of around 200K, NFP could turn out to be a "buy the rumor, sell the fact" event especially if US long bond yields retreat further. Thereafter, many Fed officials are scheduled to speak over the next week. By and large, most of them are unlikely to deviate from the steady path ahead of the next FOMC meeting on January 28-29.

## Fixed Income

- TH:** The FX-implied 6-month THBFIX (which serves as the floating leg fixing of THB swaps) fell sharply over the past few weeks dragging down front-end THB swap rates in the process. As a result, the 1Y THB swap is now 23bps below the policy rate. Part of the reason for why front-end rates are so low is because political uncertainty has pushed back expectations of rate hikes. With a rally planned on January 13 and elections on February 2, uncertainty is likely to weigh on economic growth. In response, the Bank of Thailand is likely to keep monetary policy accommodative in the immediate few quarters.

The other reason why the 6-month THBFIX is below the policy rate (and the 3-month BI-BOR fixing) is because of the way the THBFIX is computed. As an FX-implied rate, currency dynamics in the forward space has an im-

1Y, 2Y & 3Y THB Swap Rates vs Policy Rate



pact the THBFIX. Historically, whenever there is upward pressure on spot THB/USD, the THB forward points have a tendency to decline (implying less depreciatory pressure on the THB), thereby putting downward pressure on the THBFIX. These conditions have been in play as the THB weakened against the USD on the back of domestic political uncertainties amid worries about Fed tapering. In any case, longer-term expectations have not changed and the 10Y THB swap rate has hovered sideways over the past month. Barring prolonged political turmoil, we expect the spread between the 10Y THB swap and 2Y THB swap to narrow in the coming months.

## Economic calendar

Event	Consensus	Actual	Previous
<b>Jan 6 (Mon)</b>			
TW: CPI (Dec)	0.80% y/y	0.33% y/y	0.67% y/y
EZ: PMI composite (Dec F)	52.1	52.1	52.1
SG: PMI (Dec)	51.0	49.7	50.8
US: ISM non-manufacturing (Dec)	54.7	53.0	53.9
US: factory orders (Nov)	1.7% y/y	1.8% y/y	-0.9% y/y
<b>Jan 7 (Tue)</b>			
PH: CPI (Dec)	3.9% y/y	4.1% y/y	3.3% y/y
TW: trade balance (Dec)	USD 3.6bn	USD 1.4bn	USD 3.5bn
-- exports	0.5% y/y	-1.9% y/y	0.0% y/y
-- imports	2.2% y/y	10.1% y/y	-0.5% y/y
EZ: CPI (Dec)	0.8% y/y	0.8% y/y	0.9% y/y
US: trade balance (Nov)	-USD 40bn	-USD 34.3bn	-USD 40.6bn
<b>Jan 8 (Wed)</b>			
US: MBA mort applications (Jan 3)		2.6% m/m sa	-4.2% m/m sa
US: ADP employment chg (Dec)	200K	238K	229K
<b>Jan 9 (Thu)</b>			
MY: industrial production (Nov)	2.9% y/y		1.7% y/y
EZ: consumer confidence (Dec F)	-13.6		-13.6
US: initial jobless claims (Jan 4)	335K		339k
CN: CPI (Dec)	2.7% y/y		3.0% y/y
<b>Jan 10 (Fri)</b>			
PH: exports (Nov)	11.5% y/y		14.0% y/y
US: nonfarm payrolls (Dec)	195k		203k
US: unemployment rate (Dec)	7.0%		7.0%
CN: M2 (Dec)	13.9% y/y		14.2% y/y
CN: trade balance (Dec)	USD 32.15bn		USD 33.8bn
-- exports	5.0% y/y		12.7% y/y
-- imports	5.0% y/y		5.3% y/y

## Central bank policy calendar

Date	Country	Policy Rate	Current	Consensus	DBS	Actual
<b><u>This week</u></b>						
09-Jan	KR	7 day repo rate	2.50%	2.50%	2.50%	
09-Jan	EZ	7-day refi rate	0.25%	0.25%	0.25%	
09-Jan	ID	o/n reference rate	7.50%	7.50%	7.50%	

### **Next week**

No policy meeting this week

### **Last week**

No policy meeting this week

## GDP & inflation forecasts

	GDP growth, % YoY					CPI inflation, % YoY				
	2010	2011	2012	2013f	2014f	2010	2011	2012	2013f	2014f
US	2.5	1.8	2.8	1.7	2.2	1.6	3.1	2.1	1.5	1.8
Japan	4.7	-0.5	1.4	1.8	1.4	-0.7	-0.3	0.0	0.3	2.4
Eurozone	1.9	1.6	-0.5	-0.5	0.5	1.6	2.7	2.5	1.4	1.3
Indonesia	6.1	6.5	6.2	5.7	6.0	5.1	5.4	4.3	7.0	6.7
Malaysia	7.2	5.1	5.6	4.3	5.2	1.7	3.2	1.7	2.1	3.0
Philippines	7.3	3.6	6.8	7.0	6.5	3.8	4.8	3.1	3.1	4.4
Singapore	14.8	5.2	1.3	3.8	4.0	2.8	5.2	4.6	2.4	3.0
Thailand	7.8	0.1	6.4	3.2	4.5	3.3	3.8	3.0	2.2	3.1
Vietnam	6.8	5.9	5.0	5.3	5.7	9.2	18.6	9.3	6.6	6.8
China	10.3	9.3	7.7	7.6	7.8	3.3	5.4	2.6	3.5	3.5
Hong Kong	7.0	4.9	1.5	2.8	3.0	2.4	5.3	4.1	4.5	4.0
Taiwan	10.8	4.2	1.5	1.9	3.3	1.0	1.4	1.9	0.8	1.1
Korea	6.3	3.7	2.0	2.8	3.5	2.9	4.0	2.2	1.3	2.4
India*	8.4	6.5	5.0	4.8	5.3	9.6	8.9	7.4	6.5	7.0

\* India data & forecasts refer to fiscal years beginning April; inflation is WPI  
Source: CEIC and DBS Research

## Policy & exchange rate forecasts

	Policy interest rates, eop					Exchange rates, eop				
	current	1Q14	2Q14	3Q14	4Q14	current	1Q14	2Q14	3Q14	4Q14
US	0.25	0.25	0.25	0.25	0.25	...	...	...	...	...
Japan	0.10	0.10	0.10	0.10	0.10	104.8	104	105	106	107
Eurozone	0.25	0.25	0.00	0.00	0.00	1.357	1.36	1.37	1.38	1.40
Indonesia	7.50	7.50	7.50	7.50	7.50	12,235	11,500	11,500	11,500	11,500
Malaysia	3.00	3.00	3.00	3.00	3.00	3.28	3.20	3.18	3.17	3.15
Philippines	3.50	3.50	3.50	3.75	4.00	44.7	43.6	43.4	43.2	42.9
Singapore	n.a.	n.a.	n.a.	n.a.	n.a.	1.27	1.23	1.22	1.21	1.20
Thailand	2.25	2.25	2.25	2.50	2.50	33.1	31.6	31.5	31.3	31.2
Vietnam^	7.00	7.00	7.00	7.00	7.00	21,100	21,340	21,380	21,410	21,450
China*	6.00	6.25	6.50	6.50	6.50	6.05	6.06	6.03	6.00	5.97
Hong Kong	n.a.	n.a.	n.a.	n.a.	n.a.	7.75	7.76	7.76	7.76	7.76
Taiwan	1.88	1.88	1.88	1.88	2.00	30.2	29.4	29.3	29.2	29.0
Korea	2.50	2.50	2.50	2.75	3.00	1068	1040	1025	1010	995
India	7.75	8.00	8.00	8.00	8.00	62.1	61.6	62.0	62.3	62.6

^ prime rate; \* 1-yr lending rate

## Market prices

	Policy rate	10Y bond yield		FX		Equities		
	Current (%)	Current (%)	1wk chg (bps)	Current	1wk chg (%)	Index	Current	1wk chg (%)
US	0.25	2.98	-1	81.1	1.2	S&P 500	1,837	-0.6
Japan	0.10	0.71	-3	104.8	0.0	Topix	1,306	2.1
Eurozone	0.25	1.90	-3	1.357	-0.7	Eurostoxx	2,929	0.3
Indonesia	7.50	9.06	49	12235	-0.5	JCI	4,201	-1.7
Malaysia	3.00	4.16	3	3.28	0.1	KLCI	1,831	-1.9
Philippines	3.50	4.28	48	44.7	-0.7	PCI	5,986	1.6
Singapore	Ccy policy	2.53	-3	1.273	-0.5	FSSTI	3,151	-0.5
Thailand	2.25	4.03	14	33.1	-0.3	SET	1,258	-3.2
China	6.00	...	...	6.05	0.1	S'hai Comp	2,044	-
Hong Kong	Ccy policy	2.37	1	7.75	0.0	HSI	22,997	-1.3
Taiwan	1.88	1.68	0	30.2	-1.1	TWSE	8,556	-0.6
Korea	2.50	3.65	6	1069	-1.8	Kospi	1,963	-0.2
India	7.75	8.80	-4	62.1	-0.3	Sensex	20,729	-1.9

Source: Bloomberg

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