Economics & Strategy Research

DBS Monthly

Waiting for a trade revival

Group Research

April 26, 2019

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- ***Economics: Markets have moved well ahead of the China-US trade deal and an actual revival in global trade. In fact, trade dependent economies continue to face major headwinds with little sign of upside. We examine the macro factors that could support or undermine the markets' fervor.***

- ***Rates: On an FX-hedged basis, our calculations find that 10-year US Treasuries have been expensive relative to Bunds for a long time. Indeed, the cost of hedging has soared so much that for a Euro or Yen-based investor, USTs are presently yielding negatively. We examine the drivers of this phenomenon and market implications***

- ***FX: As growth scares have dissipated and markets rallied, the USD has resumed its strengthening march. Barring shocks to US GDP growth in 1Q19, the DXY should push towards 100 on a weaker euro towards 1.10. Meanwhile, as per our model, the implied USD/SGD policy band has risen to 1.36-1.41 from 1.35-1.40. We see USD/SGD rising to 1.38-1.40 by 3Q19.***

- ***Equities: Following four months of an extraordinary rebound, equities are likely to enter May with elevated uncertainties over the growth outlook and geopolitical risks. The market adage of "Sell in May and go way" may well stack up.***

Have we seen the worst of trade numbers?

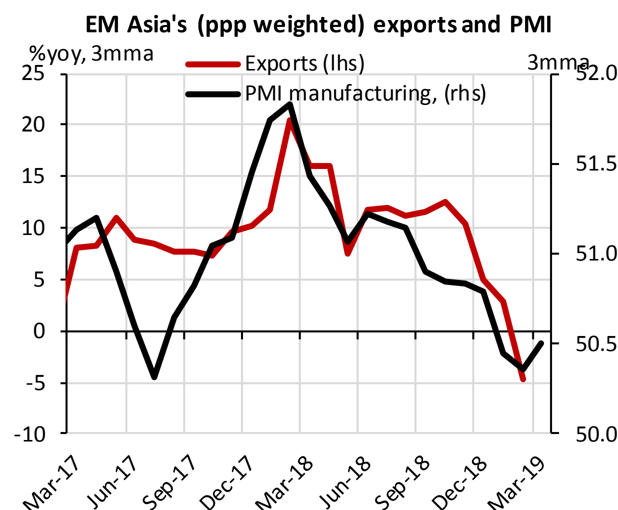
Barring a few exceptions, trade figures remain dismal. On a three-month moving average basis, exports growth in March was not only negative but worsening in Indonesia, Singapore, South Korea, Taiwan, and Thailand. While China surprised with a strong March outturn, thereby taking its corresponding figure to positive territory, it is way too early to call a bottom in regional exports.

Not that weak exports are something to be alarmed about. First, there is a strong base effect at play as exports soared in the first half of last year, perhaps reflecting some advancing of trade ahead of US tariffs on Chinese exports. Also, there have been many instances of negative exports growth in the region (see chart below) during the course of this decade.

Source: CEIC, DBS

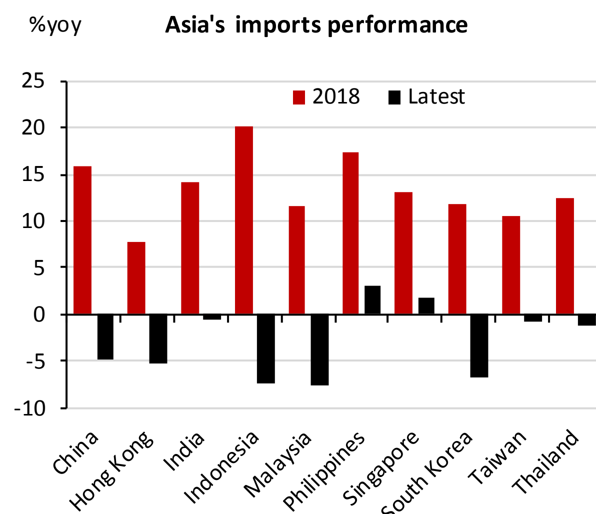
The fact that regional PMIs have arrested their declining trend in the past month is a more promising development, in our view. Considering the strong historical relationship between PMI readings and exports, we reckon that the worst of exports performance may be behind, and once data from April start coming through, a broad-based recovery in exports in Asia may become apparent.

Risks to this cautiously optimistic forecast include: (i) China-US trade talks breaking down; (ii) a major credit event in China or the US hurting global sentiments, and (iii) further economic weakness in Europe. Additionally, the markets' big bet on China stimulus may be only half right: the stimulus, designed to revive domestic demand, may help domestic consumption, but leave investment demand muted, thus disappointing the outlook of auto and machinery exporters like Germany.



Source: CEIC, DBS

The weak import numbers reported by Asian economies so far reflect the other side of the trade coin, in our view. As soon demand from major trading partners pick up, the regional supply chain will receive a shot in the arm, boosting intra-regional trade, leading to import figures perking up as well.



Source: CEIC, DBS. Latest denotes year-to-date yoy growth

We think that the export recovery could well remain tepid and get delayed, prompting some policy action from Asian policy makers. First on this list would be South Korea, in our view. Malaysia could follow next.

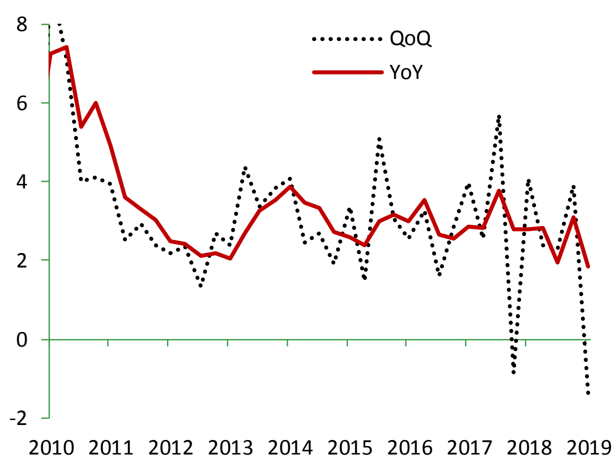
Taimur Baig

South Korea: GDP forecast downgrade

The South Korean economy deteriorated sharply during the beginning quarter of this year. **GDP growth unexpectedly contracted on the QoQ basis, by -1.4% (saar)**. While the contraction came after a strong 3.9% expansion in the previous quarter and could be seen as a technical payback, the average QoQ growth in the past two quarters was also discouraging, at only 1.3%.

On the YoY basis, GDP growth also fell markedly to 1.8% in 1Q19 from 3.1% in 4Q18, the slowest pace seen over almost a decade since 3Q09. This is in fact the first time for the YoY growth to fall below the 2% mark since the end of global financial crisis in 2009.

The main drags in 1Q19 came from exports (-9.9% QoQ saar) and investment (-10.7%), reflecting the rapid weakening of overseas demand and the spillover effects on domestic manufacturing activities.



Chances remain low for the economy to repeat a full-scale recession like in 2008/09. There are some tentative signs showing that 1Q19 is the bottom of the current cycle. For instance, manufacturing PMI has rebounded modestly to 48.8 in Mar19, up from 47.2 in Feb19. Consumer confidence has been rising for four months in a row, from the trough of 95.7 in Nov18 to 99.8 in Mar19. Business sentiment index has also picked up, from 86 (sa) in Feb19 to 94 in Apr19.

But a V-shaped recovery also appears unlikely. The lingering weakness in China's imports, in contrast to the rebound in investment/consumption, suggests that it will take time for Chinese stimulus to start to benefit the neighbouring economies through the trade channel. Domestically, the Korean government has proposed a KRW6.7tn supplementary budget this week to spur the economy. This is estimated to add 0.1ppt to GDP growth this year, still too small to offset the external drags.

In the tech sector, there are supportive factors stemming from Apple's iPhone price cuts, Huawei's launch of new smartphone models, and the initial rollout of 5G networks later this year. But the impact on South Korea could be mixed, given that Korean tech firms supply semiconductors and other upstream components for the American and Chinese counterparts, and at the same time, also compete directly with them in the smartphone and other downstream consumer electronics sectors.

Taking into account that the 1Q results missed expectations by a wide margin and growth will likely stay on a soft patch in the remaining quarters of this year, **we are revising down the full-year 2019 GDP forecast to 2.1%, compared to 2.6% previously.**

Monetary easing becomes likely

The Bank of Korea signalled little intention to ease monetary policy at the April meeting, while lowered the 2019 GDP estimate only slightly to 2.5% from 2.6%. Pressure should mount in the months ahead, as the BOK will be obliged to downgrade growth forecast more significantly at the next economic outlook review in July.

Admittedly, policy constraints will exist. CPI inflation is likely to bottom out from 2Q19 onwards, given the expiration of the US's waivers on Iran sanctions in May and the ongoing rebound in global oil prices. The lingering concerns about financial imbalance issues – household debt overhang and high property prices – would also dissuade the BOK from loosening policy aggressively.

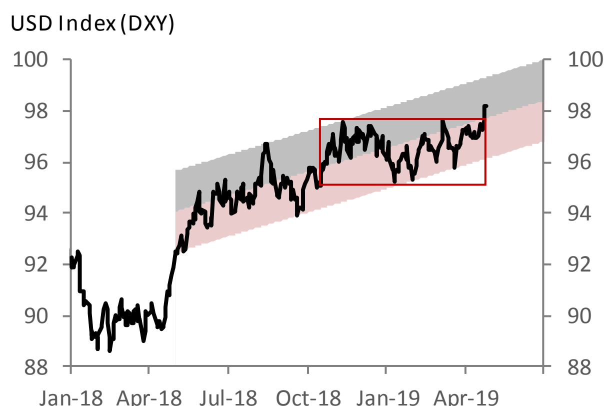
All considered, **we now expect the BOK to cut rates by a modest 25bps at the July meeting.** This will take the benchmark repo rate back to 1.50%, which is equivalent to withdrawing one of the two rate hikes delivered during the 2017-18 policy normalisation process.

Ma Tieying

FX: USD is breaking out on the high side

The USD Index (DXY) has traded above its 95.5-97.5 range of the past six months. The drag from the Fed hike pause was more than offset by the weaknesses in its major components. The euro, which accounted for 57.6% of the DXY, has been bedeviled by persistent downgrades in the Eurozone's outlook. The German government now expects 2019 growth to be as slow as 0.5% in 2012-13, three months after it axed forecast to 1% from 1.8% on US-China trade tensions and Brexit uncertainties. In May, Germany fears that the US may impose auto tariffs, and populist and far-right parties increase their representation at the EU Parliament elections. Barring shocks to US GDP growth in 1Q19, the DXY should push towards 100 on a weaker euro towards 1.10.

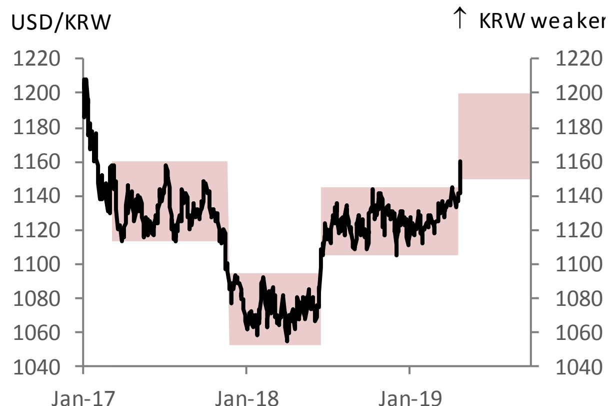
US dollar's appreciation has gained traction



The Malaysian ringgit has entered into a weaker trading range of 4.10-4.15 vs 4.05-4.10 in February-March. Capital outflows fears heightened after the FTSE Russell announced that it is considering removing Malaysia from its World Government Bond Index in September. The Malaysian stock market has not participated in the global and regional stock market rally. The KL Composite Index has, as of April 25, lost 3.2% of its value this year. Despite higher oil prices, Malaysia was the only Asian country that reported negative CPI inflation in January-February. Our economist expects Bank Negara to lower, as early as its next meeting on May 7, its overnight policy rate by 25 bps to 3%. We see USD/MYR pushing higher to 4.20 by 3Q19.

We have downgraded the South Korean won. Real GDP growth slowed more-than-expected to 1.8% YoY in 1Q19 from 3.1% in 4Q18. This was the first time since 3Q09 that growth fell below 2%. Our economist has downgraded this year's growth from 2.6% to 2.1% (its slowest post-crisis growth) and pencilled in a 25 bps rate cut to 1.50% in July 18. The won has, as off April 25, depreciated 3.9% YTD to become the worst perfomer in Asia this year. Having traded above its 1100-1140 range of the past 9 months, we see USD/KRW in a higher 1150-1200 range, and ending the year around 1170 instead of 1140.

South Korean won stepped into a weaker range



We see the Thai baht stepping into a weaker 32.0-32.5 trading range from 31.5-32.0 in March-April and 31.0-31.5 in February. The Bank of Thailand is no longer expecting growth to hold up at/above 4% for a third straight year. It has revised down this year's outlook to 3.8% from 4% on weaker-than-expected exports. Another downgrade is possible if high household debt (3Q18: 77.8% of GDP) and tighter credit conditions hurt consumption. Delays in forming the government after the March 24 elections could also postpone government spending. Election results will not be announced on but after May 9. We are comfortable with our forecast for the baht to reach 33 by end-3Q19.

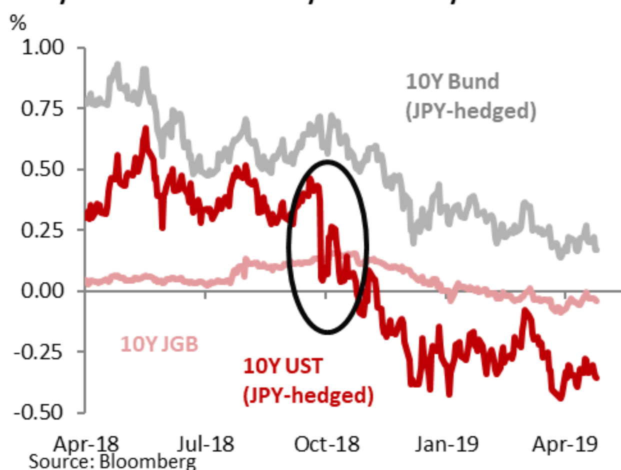
The Singapore dollar has weakened out of its 1.3450-1.3620 range of the past 3-4 months. We still consider the SGD strong relative to fundamentals. The nominal effective exchange rate has been near the ceiling of its policy band. Yet, real GDP growth has fallen four straight quarter to 1.3% YoY in 1Q19, below this year's official 1.5-3.5% growth target. Both CPI and core inflation have remained in the lower half of their (revised down) official forecasts. Not surprisingly, the SGD policy was left unchanged at its review on April 12. Since then, the implied USD/SGD policy band has, according to our model, risen to 1.3580-1.4130 from 1.3495-1.4040. We see USD/SGD rising to 1.38-1.40 by 3Q19.

Philip Wee

Rates: US Treasuries have gotten more expensive

Amid the broad market selloff of 4Q, we saw large moves in relative FX-hedged yields. 10Y UST FX-hedged yields have been trading below Bunds since July 2017 and have usually maintained a spread not more than 25bps. In 4Q, that spread widened to 50-60bps. Against JGBs, in 4Q, UST fx-hedged yields went from trading 40bps above to breaking below JGBs and trading 40bps less.

In 4Q, on a hedged-to-JPY basis, UST yields fell below JGB yields and further away from Bund yields...



Source: Bloomberg

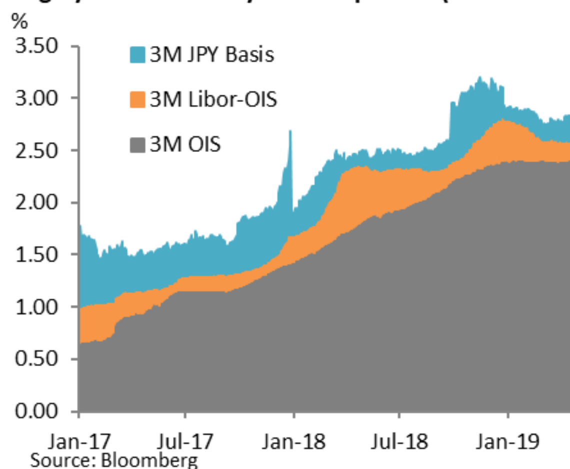
We had expected these moves to reverse in 1Q when risk assets began to recover and risk sentiments improved, but that did not happen. Breaking down the numbers, we see that it is due to equal contributions from narrower UST-Bund/JGB yield differentials and higher hedging costs. Hedging costs rose because of the Fed's December hike and wider Libor-OIS spreads (cross currency bases actually tightened and helped to paritally offset).

USTs may have the highest yields amongst G10 government bonds, but on an FX-hedged basis, things are quite different. For European and Japanese investors, at present, USTs offer 30-50bps less than the bonds of their own government.

Type of investor	UST	Bund	JGB
USD-based	2.52	3.04	2.83
EUR-based	-0.54	-0.01	-0.22
JPY-based	-0.35	0.17	-0.04

We believe many bond investors hedge their bond positions (or at least partially). It is probably tough to predict how much longer can UST FX-hedged yields stay so low relative to Bunds/JGBs. At some point, we should see some convergence. Rising US Treasury issuances, higher US inflation or a Fed re-pivot to hawkish stance could pressure UST yields higher and wider against Bunds/JGBs. We believe lower hedging costs would most likely come from further tightening of cross currency bases. Reason being, we do not expect the Fed to cut rates (ie OIS is not going to fall) and Libor-OIS spreads seem to have limited room to compress further (current levels are already extremely tight at 17bps).

So far, rising cost of fx-hedging UST purchases has largely been driven by OIS component (ie Fed hikes).



Source: Bloomberg

In the immediate term, there are a couple of likely implications in terms of global investor behavior. Yield-sensitive investors could be inclined to buy even more Bunds/JGBs at the expense of USTs (more of such rebalancing flows could help drive the convergence that we discuss above). Some investors could also make bigger reductions to the hedge ratios on their UST purchases to limit hedge costs (inadvertently, this helps to boost the USD).

Duncan Tan

Equities: Buckle your seatbelt!

This month, there was a standoff between the bulls and bears, as **investors were uncomfortable on stock valuations amid bubble talks and scattered signs of "green shoots"**. The US S&P hit another new high this month, but the strong move failed to carry other markets and itself higher, especially with emerging markets having a rough time with currency volatility. **The CBOE S&P Volatility Index (VIX) looks to spike, after hovering below its one-month moving average for some time**.

On the global economic outlook, while most PMIs are improving, only those of US and China managed to stay above 50. The manufacturing PMI in other countries including Japan and Eurozone are still below 50, showing that most economies are still in contraction mode. Early Q1 GDP reports for Singapore and Korea pointed to the worst YoY growth rates since the Global Financial Crisis, with Korea registering negative QoQ growth. 1Q19 looks set to be the weakest in terms of growth, and **recovery in the second half is not guaranteed given unresolved trade issues and if the US economy will be dragged down by the rest of the world**.

Oil price was up 9.6% (Brent) month-to-date, and the US dollar (DXY) jumped to its one-year high. **Emerging market currencies are again stressed by the sharp weakening in the Turkish lira and Argentinian peso**, which sparked off the mini-EM crisis last year. Asian currencies' resilience may be tested next.

Thus, we are likely to enter May with elevated uncertainties over the growth outlook and geopolitical uncertainties. The market adage of "Sell in May and go way" may well stack up.

In Asia, high PE valuation in various markets is our main concern. **We recommend staying defensive on sectors and companies with valuation support and our preferred valuation matrix is dividend yield**. Dividend-paying stocks are also believed to have more resilient earnings with steady business, good capital management policies, and embrace shareholder value creation. Similarly, their share prices should also be less volatile with good support from longer-term investors.

Joanne Goh

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South Korea & Taiwan: Tentative signs of a bottom
India: RBI leaves door open for another neutral cut
No urgency to tighten SGD policy
Another volatile month ahead

Growth, Inflation, Policy Rates & FX forecasts

	GDP growth, % YoY				CPI inflation, % YoY, ave			
	2017	2018e	2019f	2020f	2017	2018e	2019f	2020f
China	6.9	6.6	6.2	6.0	1.6	2.1	2.3	2.3
Hong Kong	3.8	3.3	2.5	2.0	1.5	2.5	2.7	2.5
India*	8.2	7.2	7.0	7.0	4.5	3.6	3.4	3.8
Indonesia	5.1	5.2	5.2	5.1	3.8	3.2	3.6	3.6
Malaysia	5.9	4.7	4.5	4.2	3.8	1.0	1.7	1.6
Philippines**	6.7	6.3	6.5	6.4	2.9	5.2	3.9	3.8
Singapore	3.9	3.2	2.6	2.8	0.6	0.4	1.1	1.5
South Korea	3.1	2.7	2.1	2.4	1.9	1.5	1.1	1.5
Taiwan	3.1	2.6	1.9	1.8	0.6	1.3	0.7	1.0
Thailand	3.3	4.1	3.8	4.0	0.7	1.1	1.0	1.3
Vietnam	6.8	7.1	6.6	6.3	3.5	3.5	3.8	3.4
Eurozone	2.5	1.9	1.2	1.5	1.5	1.8	1.2	1.3
Japan	1.9	0.7	0.7	0.5	0.5	1.0	1.1	1.6
United States***	2.3	2.9	2.5	1.5	2.1	2.4	1.5	1.5

* refers to year ending March ** new CPI series *** eop for CPI inflation

Policy interest rates, eop

	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20
China*	4.35	4.35	4.35	4.35	4.35	4.35	4.35	4.35
India	6.25	5.75	5.75	5.75	5.75	5.75	5.75	5.75
Indonesia	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00
Malaysia	3.25	3.00	3.00	3.00	3.00	3.00	3.00	3.00
Philippines	4.75	4.75	4.75	4.75	4.75	4.75	4.75	4.75
Singapore**	1.95	1.95	1.95	1.95	1.95	1.95	1.95	1.95
South Korea	1.75	1.75	1.50	1.50	1.50	1.50	1.50	1.50
Taiwan	1.38	1.38	1.38	1.38	1.38	1.38	1.38	1.38
Thailand	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75
Vietnam***	6.25	6.25	6.25	6.25	6.00	5.75	5.75	5.75
Eurozone	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Japan	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
United States	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50

* 1-yr lending rate; ** 3M SOR ; *** prime rate

Exchange rates, eop

	Mar 29	Q2 19	Q3 19	Q4 19	Q1 20	Q2 20	Q3 20	Q4 20
USD/CNY	6.71	6.85	7.00	6.95	6.90	6.85	6.80	6.75
USD/HKD	7.85	7.85	7.85	7.84	7.83	7.82	7.81	7.80
USD/INR	69.4	70.0	71.0	71.5	71.0	70.5	70.0	69.5
USD/IDR	14248	14300	14500	14400	14300	14200	14100	14000
USD/MYR	4.08	4.10	4.20	4.25	4.20	4.15	4.10	4.05
USD/PHP	52.7	54.0	55.0	54.5	54.0	53.5	53.0	52.5
USD/SGD	1.36	1.37	1.40	1.39	1.38	1.37	1.36	1.35
USD/KRW	1137	1170	1180	1170	1165	1160	1155	1150
USD/THB	31.7	32.5	33.0	32.8	32.6	32.4	32.2	32.0
USD/VND	23201	23250	23300	23280	23300	23250	23200	23150
AUD/USD	0.71	0.70	0.68	0.68	0.68	0.69	0.70	0.71
EUR/USD	1.12	1.12	1.10	1.11	1.12	1.13	1.14	1.15
USD/JPY	111	113	115	114	113	112	111	110
GBP/USD	1.31	1.30	1.28	1.29	1.30	1.31	1.32	1.33

Australia, Eurozone and United Kingdom are direct quotes

Rates forecasts

		2019				2020			
		Q1	Q2	Q3	**Q4**	Q1	Q2	Q3	**Q4**
US	3m Libor	2.60	2.70	2.70	**2.70**	2.70	2.70	2.70	**2.70**
	2Y	2.26	2.45	2.50	**2.50**	2.50	2.50	2.50	**2.50**
	10Y	2.41	2.55	2.60	**2.65**	2.70	2.70	2.70	**2.70**
	10Y-2Y	15	10	10	**15**	20	20	20	**20**
Japan	3m Tibor	0.07	0.05	0.05	**0.05**	0.05	0.05	0.05	**0.05**
	2Y	-0.17	-0.15	-0.15	**-0.15**	-0.13	-0.10	-0.07	**-0.05**
	10Y	-0.08	0.03	0.05	**0.07**	0.10	0.13	0.15	**0.15**
	10Y-2Y	9	18	20	**22**	23	23	22	**20**
Eurozone	3m Euribor	-0.31	-0.30	-0.30	**-0.30**	-0.30	-0.30	-0.30	**-0.30**
	2Y	-0.60	-0.55	-0.55	**-0.55**	-0.55	-0.55	-0.50	**-0.50**
	10Y	-0.07	0.10	0.10	**0.10**	0.10	0.15	0.20	**0.25**
	10Y-2Y	53	65	65	**65**	65	70	70	**75**
Indonesia	3m Jibor	7.21	7.20	7.20	**7.20**	7.20	7.20	7.20	**7.20**
	2Y	6.78	6.90	6.80	**6.70**	6.70	6.70	6.70	**6.70**
	10Y	7.63	7.70	7.60	**7.50**	7.50	7.50	7.50	**7.50**
	10Y-2Y	86	80	80	**80**	80	80	80	**80**
Malaysia	3m Klibor	3.69	3.44	3.44	**3.44**	3.44	3.44	3.44	**3.44**
	3Y	3.38	3.40	3.40	**3.40**	3.40	3.40	3.40	**3.40**
	10Y	3.77	3.85	3.90	**3.95**	4.00	4.00	4.10	**4.10**
	10Y-3Y	39	45	50	**55**	60	60	70	**70**
Philippines	3m PHP ref rate	5.55	5.55	5.55	**5.55**	5.55	5.55	5.55	**5.55**
	2Y	6.78	5.75	5.75	**5.75**	5.75	5.75	5.75	**5.75**
	10Y	7.66	6.00	6.00	**6.00**	6.00	6.00	6.00	**6.00**
	10Y-2Y	88	25	25	**25**	25	25	25	**25**
Singapore	3m Sibor	1.94	1.95	1.95	**1.95**	1.95	1.95	1.95	**1.95**
	2Y	1.92	2.00	2.00	**2.00**	2.00	2.00	2.00	**2.00**
	10Y	2.07	2.15	2.18	**2.20**	2.20	2.20	2.20	**2.20**
	10Y-2Y	15	15	18	**20**	20	20	20	**20**
Thailand	3m Bibor	1.88	1.85	1.85	**1.85**	1.85	1.85	1.85	**1.85**
	2Y	1.78	1.80	1.80	**1.80**	1.80	1.80	1.80	**1.80**
	10Y	2.43	2.40	2.50	**2.60**	2.60	2.60	2.60	**2.60**
	10Y-2Y	65	60	70	**80**	80	80	80	**80**
China	1 yr Lending rate	4.35	4.35	4.35	**4.35**	4.35	4.35	4.35	**4.35**
	3Y	2.91	2.80	2.80	**2.80**	2.80	2.80	2.80	**2.80**
	10Y	3.36	3.15	3.10	**3.15**	3.20	3.25	3.25	**3.25**
	10Y-3Y	45	35	30	**35**	40	45	45	**45**
Hong Kong	3m Hibor	1.76	2.00	2.00	**2.00**	2.00	2.00	2.00	**2.00**
	2Y	1.45	1.70	1.70	**1.70**	1.70	1.70	1.70	**1.70**
	10Y	1.47	1.85	1.90	**1.95**	2.00	2.00	2.00	**2.00**
	10Y-2Y	2	15	20	**25**	30	30	30	**30**
Korea	3m CD	1.90	1.90	1.76	**1.76**	1.76	1.76	1.76	**1.76**
	3Y	1.69	1.75	1.75	**1.75**	1.75	1.75	1.75	**1.75**
	10Y	1.83	1.95	2.05	**2.05**	2.05	2.05	2.00	**2.00**
	10Y-3Y	14	20	30	**30**	30	30	25	**25**
India	3m Mibor	7.42	7.00	6.90	**6.80**	6.70	6.70	6.70	**6.70**
	2Y	6.88	6.65	6.50	**6.50**	6.50	6.50	6.50	**6.50**
	10Y	7.22	7.40	7.50	**7.50**	7.50	7.50	7.50	**7.50**
	10Y-2Y	34	75	100	**100**	100	100	100	**100**

%, eop, govt bond yield for 2Y and 10Y, spread bps

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Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations)

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