



Analyst

Hillary Ho Li Ling

+6565311517

hillaryho@phillip.com.sg

Economic Update

Executive Summary

Singapore: With reference to Budget 2011, we think that there is a general absence of positive catalysts to spur the economy in the short run. In the long run, we do think that companies will be able to benefit from the government's effort in restructuring the economy.

China: Latest economic data suggests activities are slowing down in China. We do expect rates to be raised further as the government takes a serious view towards combating inflation.

United States: We remain positive on the US economy given that bulk of the data coming forth remains encouraging. Risks remain in the housing sector.

Singapore: Going for the long haul - Restructuring the economy

Singapore Budget 2011 was announced on 18 Feb. During the speech, it was established that Singapore has rebounded well from the crisis. The strong growth last year was better than the expectations of the markets and in turn this has led to an improvement in the fiscal position for FY2010. With a stronger footing in the country's fiscal position, the government has announced that it will put back into Past Reserves the \$4.0 billion that were earlier drawn to fund the Jobs Credit Scheme and the Special Risk-Sharing Initiatives under the Resilience Package created during the recent financial crisis.

Through his speech, the country's Finance Minister shared that Budget 2011 has two key objectives. First, grow the incomes of all Singaporean by 30% in real terms over the decade. To achieve this, there is a need to restructure the economy to enhance productivity. Second, measures will be taken to ensure an inclusive society. To achieve the two key objectives, at the corporate level, some of the key initiatives announced include: hike in the foreign worker levy by another \$60-\$200 per worker in the manufacturing, services and construction sectors, an increase in the National Productivity Fund to \$2 billion, higher tax deductions for automation or training under the Productivity and Innovation Credit (PIC) program; and some other measures to encourage the employment of older workers. For households and individuals, they gain in the form of growth dividends ranging from \$100 to \$800, increase in the employer CPF contribution as well as the reduction in personal income tax.

There are a few key thoughts on Budget 2011. In the short run, we do expect companies across the board and especially those in the construction and service industries to experience an increase in wage costs (due to changes in CPF rates and higher foreign workers levies). While that is the case, there will be minimal impact on companies' earnings for the year as they will receive the higher of a 20% corporate income tax rebate (capped at \$10,000) or a one-off SME Cash Grant, amounting to 5% of a company's revenue in YA 2011.

Key thoughts on Budget 2011

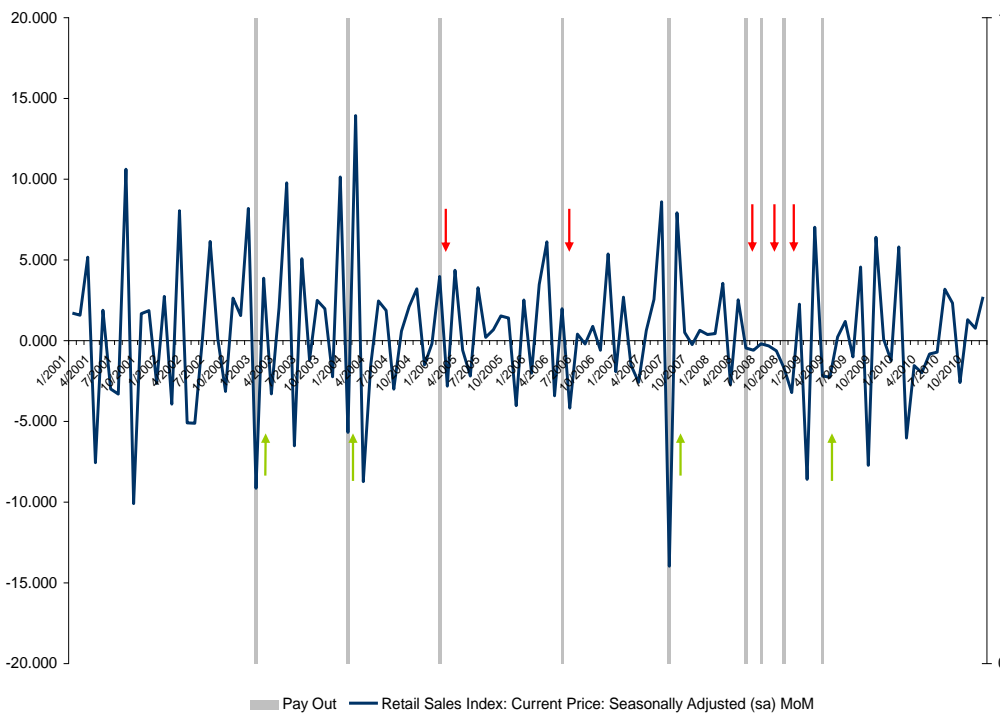
➤ *In the short run, we do expect companies across the board and especially those in the construction and service industries to experience an increase in wage costs.*



While aid is given for the immediate year, we are concerned on the subsequent years. Increase in costs without an equal increase in revenue could cause employers to trim their workforce.

Meanwhile, we do not think that the growth dividend will boost consumption as the funds are likely to be used to combat current inflationary pressures which has risen to 5.5% YoY in January. With reference to past occasions where the government hand out cash, the impact on retail sales has been mixed (figure 1). Hence, it is reasonable to assume that the impact on consumption with the latest payout will be insignificant. Therefore, in the short run, we do think that there is a general absence of positive catalysts from the budget to spur the economy.

Figure 1: Retail Sales & Records of Historical Cash Distribution



Source: CEIC & Singapore Ministry of Finance (Budget Archives), As of Dec 2010

Nonetheless, in the long run, we do think that companies will be able to benefit from the government's effort in restructuring the economy.

- There will be minimal impact on companies' earnings for the year as they will be receiving some form of rebates.
- We are concerned on the subsequent years. Increase in costs without an equal increase in revenue could cause employers to trim their workforce.
- We do not think that the growth dividend will boost consumption as the funds are likely to be used to combat current inflationary pressures.
- In the short run, we do think that there is a general absence of positive catalysts from the budget to spur the economy.
- In the long run, we do think that companies will be able to benefit from the government's effort in restructuring the economy.

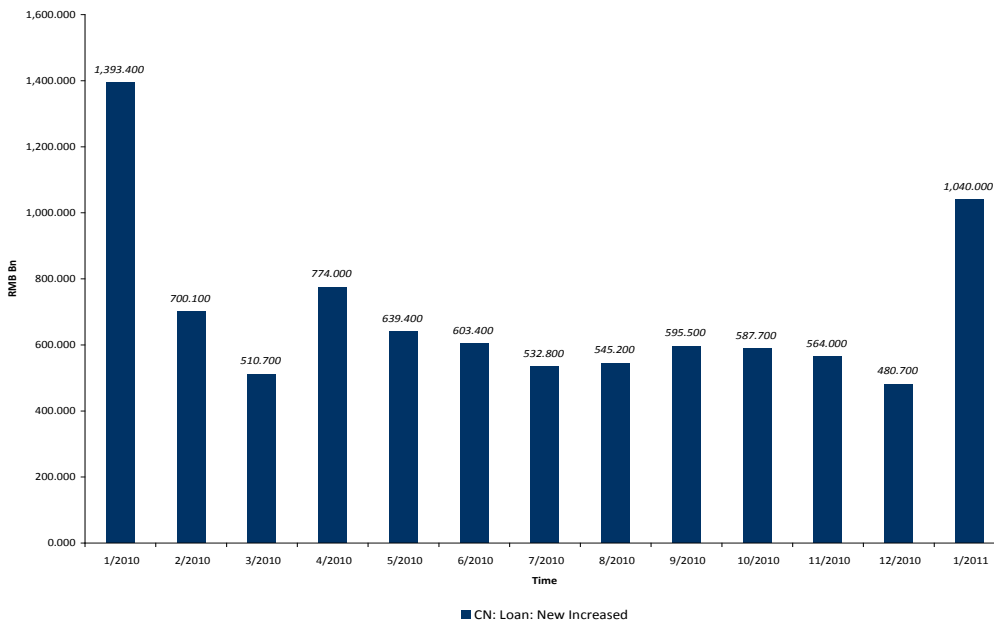


China: Yet Again!

China has tightened again. Barely a month after the last hike in the reserve required ratio (RRR), PBoC announced that it will raise RRR by another 50 bps. With that, major banks will have to set aside 19.5% (from 19%) of their reserves. Meanwhile, the smaller banks are required to set aside 17% of their reserves. This is the second time the RRR has been raised this year and the eighth time since last year.

It is not difficult to comprehend the rationale behind the government’s move. Credit growth remains strong (new loans granted in January came in at RMB1.04 trillion relative to the RMB1.39 trillion loaned out in the same period a year ago), administrative measures and tightening policy moves to clamp down property prices have been met with limited success and inflationary pressures on consumer prices are real. Clamping down inflation is crucial and urgent. Failure to do so could lead to public discontent and affect social stability.

Figure 2: Loan New Increase



Source: CEIC. As of Jan 2011

While the current drivers of inflation are much more global and structural than domestic and cyclical, it is still a monetary phenomenon at the end of the day. When money supply grows faster than the underlying economy can grow through output, inflation results. In the current context, energy and agriculture are leading inflation now as their supplies (output) are relatively inelastic. Supply is further disrupted by a series of bad weather conditions and geopolitical tension. Hence, to combat inflation, it is crucial to ensure that the level of credit growth remains in check and more importantly, that the amount of money in the system be reined in. Therefore, we do expect rates to be raised further; at least to a level where the bank deposit rates rise above the expected inflation rate. People need to be assured that they do not lose money by keeping them in the banks.

Barely a month after the last hike in the reserve required ratio (RRR), PBoC announced that it will raise RRR by another 50 bps.

It is not difficult to comprehend the rationale behind the government’s move. Credit growth remains strong and

inflationary pressures on consumer prices are real.

While the current drivers of inflation are much more global and structural than domestic and cyclical, it is still a monetary phenomenon at the end of the day. Hence, the amount of money in the system must be reined in. Therefore, we do expect rates to be raised further.



PHILLIP SECURITIES PTE LTD

Unit Trust – Economic Update

28 Feb 2011

While growth for the country in 2010 was stronger than expected, with an aggressive and “relentless” effort in tightening its monetary policies, to what extent will the country’s growth for the year be affected?

Looking at retail sales, nominal sales growth rate have been stable around the 18.5% YoY since March 2010. However, the rate of inflation has been steadily increasing during the same period. This suggests that real sales have been decelerating. Meanwhile, car sales were strong towards the end of 2010 as buyers rushed to catch the last opportunity for tax incentives for small cars and subsidies for trade-in, as well as to take advantage of Beijing’s quota policy on car purchases. With the incentive no longer in place, demand is likely to be negatively impacted. Meanwhile, there is also a recent rise in the amount of copper inventories which is a possible indicator pointing to slower Chinese demand. Exports rebounded strongly in January to grow 37.7% from a year ago.

Although the above suggests that the Chinese economy is slowing, by and large, its financial system remains sound. This could partly be attributed to the low interest rates in US, which generates expectations of RMB appreciation and hence prevents capital outflow. The situation could change if inflation becomes a serious contention in the US economy, its monetary policy could reverse quickly.

United States: Fundamentally sound (except the housing sector)

Similar to the month before, economic data from the United States remains positive. Manufacturing continues to expand - the regional Chicago Purchasing Managers' Index rose to 68.8; the highest reading since July 2008. On a national level, the Institute of Supply Management (ISM) Manufacturing Index rose to 60.8 in January, its highest since May 2004. Perhaps even more encouraging, new orders rose to 67.8, the best in seven years, while the employment component posted its highest mark in 38 years. The larger services sector is making solid strides as well, with the ISM Non-Manufacturing Survey rising to 59.4 and its employment increasing to 54.5.

Meanwhile, jobless claims data are indicating meaningful improvement for the labor market. Initial claims for the February 19 week fell 22,000 to 391,000 (prior week revised 3,000 higher to 413,000). The four-week average confirms the improvement, falling a sizable 16,500 to 402,000 for a nearly 30,000 decline from the month-ago level. Continuing claims also fell substantially, down 145,000 in data for the February 12 week to 3.790 million. The four-week average is down 55,000 to 3.893 million for an 87,000 month-to-month improvement.

As always, a concern we have for the US economy is the housing market. Existing home sales rose 2.7 percent in January to a higher-than-expected annual rate of 5.36 million units but the details are not that encouraging. The momentum in sales is coming from cash-rich investors who are scooping up foreclosed properties at bargain prices, not first-time home-buyers who are critical for a housing recovery. The number of first-time buyers fell last month to the lowest percentage in nearly two years, while all-cash deals have doubled and now account for one-third of sales. Meanwhile, the median price fell 5.9 percent to \$158,000 contracting year-on-year by 3.7 percent. Readings for the average price tell the same story, down 5.1 percent to \$206,700 for deepening year-on-year contraction of 2.6 percent. Lower prices would normally be good for first-time home-buyers.

Latest economic data suggests activities are slowing down in China.

Similar to the month before, economic data from the United States remains positive.

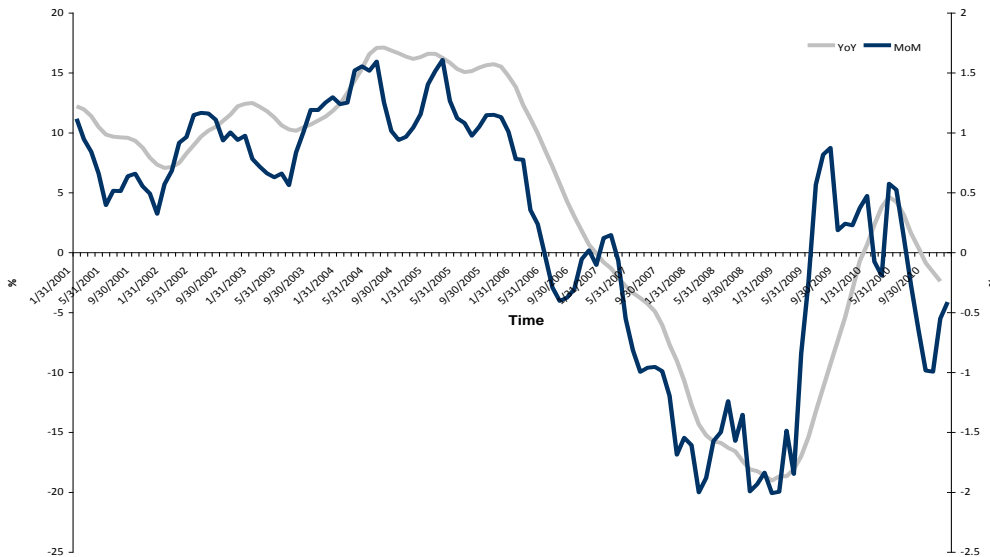
As always, a concern we have for the US economy is the housing market.

Existing home sales rose 2.7 percent in January to a higher-than-expected annual rate of 5.36 million units but the details are not that encouraging.



The fact that they are not coming in reflects unattractive credit conditions. Indeed, tighter lending standards have been adopted since the housing bubble burst. Banks are also requiring buyers to put down a larger down payment.

Figure 3: S&P/Case Shiller Home Price MoM & YoY



Source: Bloomberg. As of Dec 2010

Meanwhile, the general trend of housing prices is still heading south. The S&P / Case – Shiller Home Price Indices declined 0.41% in December from the previous month; amid at a slower pace. YoY, the decline is sharper; the index dipped 2.38% from a year ago.

As mentioned previously, we do not think that prices will be heading south drastically in the interim. With sales having improved towards the end of the year and as the market has not been flooded by the foreclosure supply, prices might be stable in the meantime. However, there remains a possibility that things might reverse in the longer term especially if demand for housing does not pick up.

All in all, we remain positive on the US economy given that bulk of the data coming forth remains encouraging. While risks remain in the housing sector, we think it is probably not a great cause of concern at the moment.

The number of first-time buyers fell last month to the lowest percentage in nearly two years, while all-cash deals have doubled and now account for one-third of sales.

The general trend of housing prices is still heading south. As mentioned previously, we do not think that prices will be heading south drastically in the interim.

We remain positive on the US economy given that bulk of the data coming forth remains encouraging. Risks remain in the housing sector.



PHILLIP SECURITIES PTE LTD

Unit Trust – Economic Update

28 Feb 2011

GENERAL DISCLAIMER

This publication shall not be reproduced in whole or in part, distributed or published by you for any purpose. Phillip Securities Pte Ltd shall not be liable for any direct or consequential loss arising from any use of material contained in this publication.

This publication is solely for general information and should not be construed as an offer or solicitation for the subscription, purchase or sale of the securities, and specifically funds, mentioned herein. It does not have any regard to your specific investment objectives, financial situation and any of your particular needs. Accordingly, no warranty whatsoever is given and no liability whatsoever is accepted for any loss arising whether directly or indirectly as a result of any person or group of persons acting on such information and advice. Unit Trusts distributed by Phillip Securities Pte Ltd are not obligations of, deposits in, or guaranteed by, Phillip Securities Pte Ltd or any of its affiliates. No action should be taken without first viewing the details in a fund's prospectus. A copy of the prospectus can be obtained from Phillip Securities Pte Ltd or online at www.eunitrust.com.sg. Past performance is not necessarily indicative of future returns. Investments in unit trusts are subject to investment risks, including the possible loss of the principal amount invested. Investors should note that the value of the units and income from the fund may rise as well as decline. Investors should also note that there are limitations whenever performance is stated or comparison is made to another unit trust or index for any specific period as no funds or indices are directly comparable.

This publication should not be relied upon as authoritative without further being subject to the recipient's own independent verification and exercise of judgment. The fact that this publication has been made available constitutes neither a recommendation to enter into a particular transaction nor a representation that any investment product described in this material is suitable or appropriate for the recipient. Recipients should be aware that the investment products described in this publication may involve significant risks and may not be suitable for all investors, and that any decision to enter into transactions involving such products should not be made unless all such risks are understood and an independent determination has been made that such transactions would be appropriate. Any discussion of the risks contained herein with respect to any product should not be considered to be a disclosure of all risks or a complete discussion of such risks.

Whilst we have taken all reasonable care to ensure that the information contained in this publication is accurate, we do not guarantee the accuracy or completeness of this publication. Any advice contained in this publication is made only on a general basis and is subject to change without notice. We have not given any consideration to and have not made any investigation of the investment objectives, financial situation or particular needs of any specific person or group of persons as we are not in possession of any such information. You may wish to seek advice from a financial adviser before making a commitment to purchase the investment products mentioned. In the event you choose not to seek advice from a financial adviser, you should consider whether the investment product is suitable for you. Any unit trusts mentioned in this publication is not intended for U.S. citizens.

DISCLOSURE OF INTEREST

Statement pursuant to section 36 of the Financial Advisers Act - Phillip Securities Pte Ltd, its directors and employees may have interest in the securities recommended herein from time to time, and its associates and connected persons may also have positions from time to time. Opinions and views expressed in this report are subject to change without notice.

PhillipCapital is a group of companies who together offer a full range of quality and innovative financial services to retail, corporate and institutional customers. Member companies in Singapore include Phillip Securities Pte Ltd, Phillip Securities Research Pte Ltd, Phillip Financial Pte Ltd, Phillip Futures Pte Ltd, Phillip Trading Pte Ltd, Phillip Capital Management (S) Ltd, CyberQuote Pte Ltd, International Factors (Singapore) Ltd and ECICS Ltd.

Information on any and all independent PhillipCapital members and the respective financial services they offer can be obtained through the following website – www.phillip.com.sg. Members can otherwise be identified by their authorised use of PhillipCapital brand name along with their own name in their documentation and literature.