EAST ASIA UPDATES

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Special 2017 Annual Edition

December 2016

Southeast Asia will grow at 4.6 percent

Despite the global volatility and the slowdown in trade, Southeast Asia is expected to grow by 4.6 percent in 2017, which is among the highest growth rates in the world. Asia as a whole is expected to see slower growth of 4 percent in 2017 and 3.5 percent in 2018 as the Chinese economy, which contributes about 45 percent of Asia's GDP, is expected to grow much more slowly, at 6.2 percent in 2017 and 4.2 percent in 2018.

There are three reasons for Southeast Asia's robust growth of 4.6 percent in 2017. First, Southeast Asia's growth is expected to outperform Asia's growth, due in part to strong consumer spending in Indonesia, Thailand, Malaysia, and Viet Nam, which together contributed an annual average 65 percent to consumer spending over the last 2 decades, and the catching up of the less developed countries in Southeast Asia, such as Cambodia, Lao PDR, Myanmar, and Viet Nam. Developed Southeast Asian countries such as Brunei Darussalam and Singapore are also expected to see an increase in growth, albeit by only about 0.5 percent.

The second reason is investment. Although the expectation of an increase in US interest rates by the Fed has dried up liquidity in emerging economies' capital markets, this will not have much of an impact on long-term investment decisions. India, Thailand, and Indonesia are amongst the ones that experienced large net selling in their bond markets. The net selling of foreign investment amounted to US$1.5 billion in bonds and US$1.4 billion in equities during the week after the US election result. Thailand recorded net sales of US$2.3 billion in bonds and US$534.3 million in equity, and Indonesia recorded net sales of US$1 billion in local debt and US$444.2 million in equity (Bloomberg, 22 Nov 2016). Net sales were also recorded in a number of emerging markets. But long-term foreign direct investment (FDI) in Southeast Asian countries is still expected to grow, particularly in consumption goods and electronics. The flow of FDI into this region is largely due to its growing market; the recent opening up to attract more investment particularly in Myanmar, Lao PDR, and Cambodia; the strong commitment of the Indonesian government to shifting its budget allocation towards infrastructure; and the improvement in the region's overall business climate.

Third, the regional comprehensive economic partnership (RCEP), which consists of 16 countries (the 10 ASEAN countries, Australia, China, the Republic of Korea [henceforth, Korea], India, Japan, and New Zealand) to be concluded either at the end of 2017 or in mid-2018 at the earliest, is expected to result in a relocation of production facilities, particularly from China to Southeast Asia. The expectation is based on the fact that there has been an increase of China FDI to ASEAN from 3.5 billion USD in 2010 to 8.2 billion USD in 2015 after the implementation of ASEAN – China Free Trade Agreement. The share of ASEAN's six main trading partners' (Australia, China, India, Japan, Korea, and New Zealand) trade of total world trade increased from 16 percent in 2001 to 25 percent in 2015, largely due to China's increased trade as a result of its export oriented strategy and its accession to the World Trade Organization (WTO) in 2001. While the EU28 is the largest and the US the fourth largest source of FDI, accounting for about 19 percent and 11 percent, respectively, of total FDI in ASEAN from 2005–2015, the 16 RCEP member states contributed 43 percent of total FDI in ASEAN. RCEP could be a good avenue for businesses to enjoy preferential tariff rates and for ASEAN plus its six main trading partners to achieve a certain level of protection for and liberalisation of investment among its members. This is expected to improve the position of Southeast Asian countries as a regional production base in the East Asian region, and increase overall trade and investment activity in the region.

Table 1: GDP Growth

Country/Region	Q4 2016	2016	2017	2018
World	-	2.2	2.5	2.4
United States	1.90	1.6	2.3	2.1
EU28	-	1.8	1.3	1.5
ASEAN				
Southeast Asia Economies	4.3	4.4	4.6	4.2
Brunei Darussalam	-	0.5	1.0	-
Cambodia	-	6.8	7.2	7.5
Indonesia	5.2	5.1	5.0	4.3
Lao PDR	-	7.4	7.6	-
Malaysia	4.1	4.3	4.6	4.0
Myanmar	-	7.9	9.3	8.6
Philippines	6.8	6.4	6.2	5.9
Singapore	1.7	1.3	2.0	1.8
Thailand	2.9	3.0	3.1	2.8
Viet Nam	6.4	6.0	6.6	6.8
Selected ASEAN Trading Partners				
Australia	2.8	2.8	3.0	2.5
China	6.6	6.7	6.2	4.2
India	7.7	7.3	7.0	8.0
Japan	0.7	0.5	0.7	0.4
New Zealand	2.5	3.7	3.3	2.3
Rep. of Korea	2.4	2.8	2.5	2.1

GDP = gross domestic product; EU = European Union;
ASEAN = Association of Southeast Asian Nations; - = not available.
Source: Economist Intelligence Unit; based on December 2016 forecast.

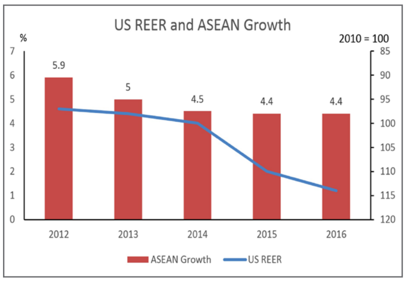
Southeast Asia: Persistent Strength of the United States Dollar Possesses Risks

Despite the strong growth, Southeast Asia should be mindful that the persistent recent strength of the United States (US) dollar vis-à-vis other currencies can have adverse effects on emerging economies, including Southeast Asia, as growth has been subdued since 2013 (figure 1). The effect of US dollar appreciation on Association of Southeast Asian Nations (ASEAN) economies can be assessed through two channels – its effect on commodity prices and its effect on the cost of funds.

First, the US dollar's strength will hamper world demand for commodities as it has been used as the benchmark currency, making commodities more expensive outside the US market. The appreciated dollar will lower commodity prices (figure 2), depress domestic demand as real incomes decline, and real gross domestic product (GDP) growth in commodity exporting countries will decelerate (Druck, Magud, & Mariscal, 2015). Asian economies are vulnerable as commodities account for a significant proportion of their exports, although their exposure differs depending on the significance of exports for the domestic economy.

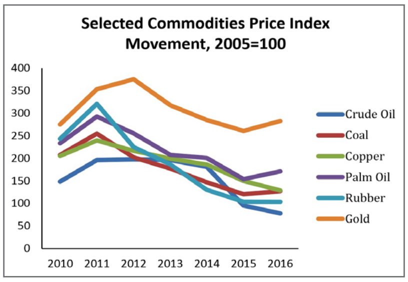
Second, a persistently strong US dollar could disrupt emerging economies, as it is likely to increase the burden on debtors holding US dollar-denominated debt. The transmission of its impact can be traced through two main channels: interest rate hikes and US dollar depreciation. Although there has so far been no visible impact on any of these countries' interest rates (10 year government bonds, money markets, deposits, and lending), there has been a continuous depreciation of Southeast Asian currencies vis-à-vis the US dollar (figure 3). Southeast Asian countries are expected to be more cautious in navigating their economy as the Federal Reserve (Fed) is expected to increase its benchmark rate about three times in 2017 to prevent the US economy from overheating in the coming years.

Figure 1



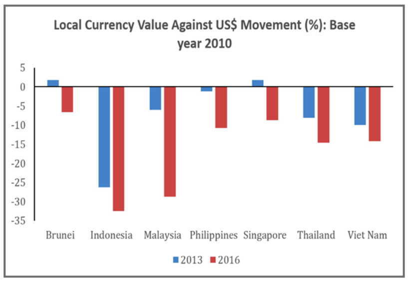
US = United States; ASEAN = Association of Southeast Asian Nations; REER = real effective exchange rate.
Source: CEIC.

Figure 2



Source: International Monetary Fund (IMF).

Figure 3



Note: We used the end-of-period exchange rate against the US dollar for our calculation.
Source: CEIC.

China :Trade and Political Dynamic 2017

China will be amongst the countries most affected if President-elect Trump's America-First Policy is implemented (alongside Canada, Mexico, Japan, and Korea) as it may cause a significant slowdown in trade between the US and China. In 2015, China contributed 21 percent of US goods imports. As the US may implement a number of measures against imports from China, exports of mobile telephones, portable data processing machines, and apparatus for communication in wired or wireless networks could be hit most strongly. The Chinese economy relies heavily on exports, with exports of goods accounting for 35 percent of total GDP in 2015.

India: Narendra Modi's Demonetisation Impact on the Indian Economy

India has a lot of potential to grow; in fact it could be one of the highest-growth countries worldwide despite the expected global volatility in the next 2 years. However, in an attempt to curb India's underground economy, Prime Minister Narenda Modi's administration removed money worth 15.4 trillion rupees (US$220 billion), which equals 86 percent of the total cash value in India, from circulation. This disruption to the money supply will have a significant effect on economic activity as nine out of ten transactions in India are still on a cash basis and the infrastructure of non-cash activity is not well developed, particularly in rural areas. At the same time, India's central bank unexpectedly left its interest rate at 6.25 percent. Based on current estimates, Indian economic growth is expected to decline by 0.6 percent, which would mean a growth rate of 6.7 percent in Financial Year 2016–2017 (FY17).

Korea: President Park's Impeachment and its Impact on the Korean Economy

President Park Geun–hye's authorities as the President of South Korea are suspended as 234 of 300 members of parliament on 8 December 2016 voted to impeach her for the sharing of political information with and the indirect involvement in state affairs of her confidante, Choi Soon–sil, and amidst allegations of corruption. The Korea Stock Exchange KOSPI Index fell from 2,052 on 4 October to 2,031 on 8 December 2016, while the Korean won dropped from 1,102 to 1,158 against the US dollar over the same period. The impeachment vote removed uncertainty over Korea's political situation, as its members of parliament met the demands of political protests since late October 2016. The impact of the President's impeachment on the Korean economy is expected to be limited as there is ample room for fiscal stimulus to mitigate a possible domestic shock. The Korean economy is expected to grow by 2.5 percent in 2017.

References

Druck, P., N. Magud and R. Mariscal (2015), 'Collateral Damage: Dollar Strength and Emerging Markets Growth', IMF Working Paper, Washington, DC: International Monetary Fund.

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