ASEAN ECONOMIC BULLETIN

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HIGHLIGHTS

- SE Asia was one of the fastest growing regions in the world last year. Growth will remain strong in 2014, but events at home and abroad will make for an undercurrent of uncertainty.
- Indonesia, the region's largest economy, continues to grapple with a large current account deficit, which has led to financial market volatility since last summer. Elections this year add to the uncertainty, although Indonesia is likely to remain one of the world's fastest growing emerging markets.
- Political tensions and an election at the beginning of February have further complicated the outlook for the Thai economy. Growth has been slowing since mid-2013 and could dip below 4% this year due to political uncertainty and the delayed launch of its multi-year infrastructure programme.
- The outlook is brighter for Malaysia, Singapore, and the Philippines. Growth is ticking up in Vietnam, though remains below potential. Frontier emerging markets Burma, Cambodia and Laos are likely to maintain their rapid growth rates this year, although political tension in Cambodia is a risk.
- The recovery in the global economy bodes well for export-orientated Singapore and Malaysia in particular. But changes to monetary policy in the West could lead to capital outflows from the region, especially from Indonesia and the Philippines.
- Rising debt levels in households and, to a lesser extent, governments and companies may necessitate some belt tightening this year. But the region is not in the danger zone.
- Negotiations on the Trans-Pacific Partnership (TPP) - which includes Brunei, Vietnam, Singapore, and Malaysia - are expected to conclude this year. The EU-Singapore free trade agreement (FTA) could be ratified this year. Both the EU and Vietnam hope to complete negotiations on their FTA by the end of 2014. EU-Malaysia FTA negotiations could resume soon.
- Indonesia has announced a number of new measures that will impact on the business environment for foreign firms. Vietnam has cut the corporate tax rate from 25% to 22%.

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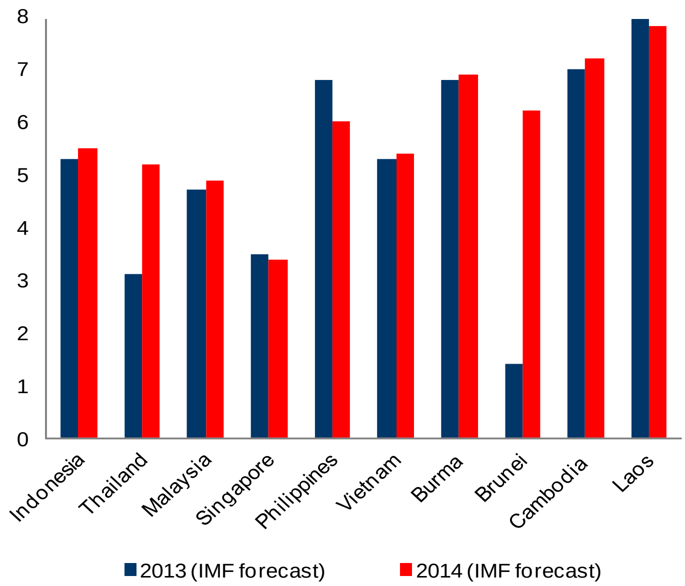
Economic Outlook for 2014

1. SE Asia was one of the fastest growing regions in the world last year. Growth will remain strong in 2014 but it will be a more complicated year. Figure 1 shows the latest IMF growth projections for 2014 for SE Asian countries, and their estimate of GDP growth last year (in descending order of economic size, from left to right). These forecasts from the IMF's World Economic Outlook October 2013 have not yet been updated, so they do not factor in recent developments.

2. Indonesia, the region's largest economy, has suffered financial market volatility since the middle of 2013 thanks to a record current account deficit. The currency fell by around 20% against the US dollar in 2013. But the government reacted swiftly and the deficit is now shrinking, albeit at the expense of some economic growth. Indonesia recorded a trade surplus in October and November 2013 (implying a shrinking overall current account deficit). But question marks remain over implementation of some of the policies, and the elections this year add to the uncertainty. Most analysts believe, though, that Indonesia will safely navigate these challenges and remain a fast (5-6%) growing economy in 2014.

Figure 1: GDP Growth in SE Asia (% change on year earlier)



Source: IMF WEO October 2013

3. The region's second largest economy, Thailand, has slowed more significantly as the domestic demand engine stalled before exports could pick up. Political turmoil in recent months and uncertainty around the election in February complicate the outlook further and may delay the launch of the country's 7-year, Baht2.2 trillion (£40 billion), infrastructure programme. Growth may therefore slip below 4% this year if the new government is not formed promptly.

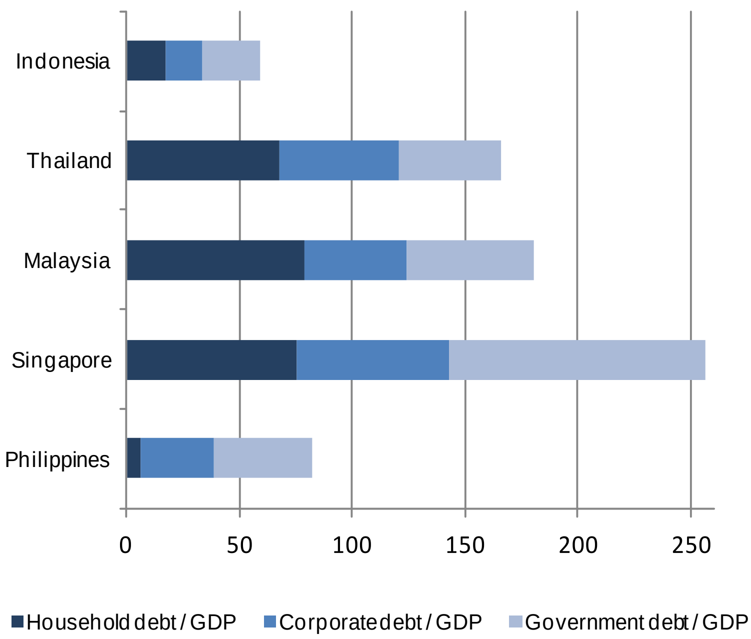
4. The outlook elsewhere is brighter. Malaysia is returning to stronger growth and healthy current account surpluses. The Philippines looks set to remain one of the fastest growing economies in Asia. Growth is ticking up in Vietnam (GDP grew by 5.4% in 2013, up from 5.3% in 2012) though remains below potential. The Vietnamese stock market was one of the best performing in the region last year.

5. The region's wealthiest country and financial hub, Singapore, ended 2013 on a bright note with annual GDP growth of 3.7%. This is a big improvement on the 1.3% growth posted in 2012, and was due to a stronger performance in services and recovery in the manufacturing sector. The outlook for 2014 is positive as growth momentum continues on the back of the global recovery. Most analysts believe growth in Brunei will be broadly similar to 2013 (around 2%), rather than the 6% predicted by the IMF.

6. Frontier emerging markets Burma, Cambodia and Laos look likely to continue growing rapidly this year. Recent economic growth in Burma has been stronger than expected, with predictions of 7.5% GDP growth in financial year 2013/14. The Financial Commission's draft budget for financial year 2014/15 proposes increased budget allocations for health and education, higher salaries for civil servants, and slightly lower defence spending in nominal terms. Other priorities include tackling the budget deficit, which is currently around 5% of GDP, by improving the collection of tax receipts. Political tensions are a risk in Cambodia, with the opposition party still contesting the results of the national elections in July last year. To date the political impasse has not had a significant impact on the economy. But concerns are growing that continued tensions could lead to a significant slowdown in foreign direct investment (FDI) in the short-term. These fears have been exacerbated by strikes by garment workers, which turned violent in January.

7. The big global economic themes in 2014 will have varying implications for SE Asian countries, reflecting the diversity of the region. Recovery in the West bodes well for more export-orientated economies such as Singapore, Malaysia, and Thailand (all else equal). But likely changes to monetary policy in the US, and perhaps Europe, pose risks to economies that have benefited from cheap money in recent years, such as Indonesia, and perhaps the Philippines, who are more vulnerable to significant capital outflows. But the region's financial systems are in much better shape than they were during the Asian financial crisis in 1997/98 and continued monetary easing in Japan will mitigate some of the effects of US tapering.

Figure 2: Total Debt Levels in the ASEAN-5 (as % of GDP)

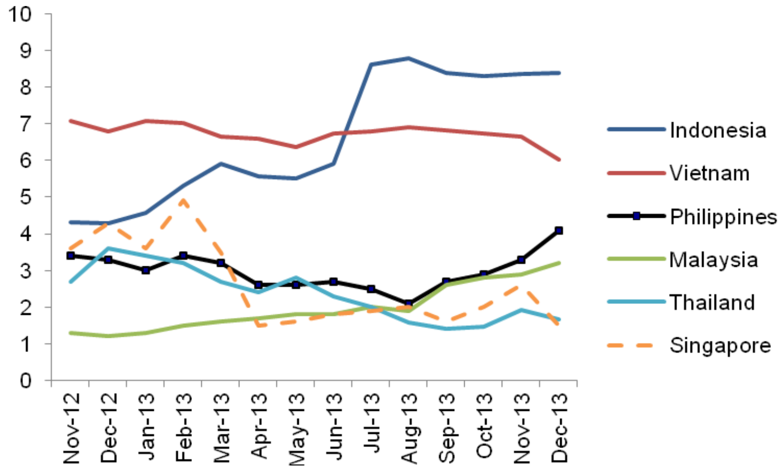


Source: Standard Chartered

8. Another key theme for 2014 is debt. SE Asia's impressive domestic demand growth in the last few years has been partly fuelled by a rapid rise in the debt of households and, to a lesser extent, governments and companies. The region is not in the danger zone. But belts will need to be tightened in Malaysia and Thailand in particular (see Figure 2) – though the pace of accumulation in recent years is arguably more of a concern than the absolute level of debt. On the positive side, the combination of higher debt levels and capital outflows due to US tapering may also force governments in the region to grasp structural reform nettles in 2014. Singapore appears to have a high level of government debt in Figure 2 (around 100% of GDP), but this is misleading as the debt is countered by sizeable assets. But the Monetary Authority of Singapore (MAS) is watching household debt levels closely.

9. The inflation outlook for the major economies in the region is mixed. Consumer price inflation in Indonesia spiked after the reform of fuel prices in the middle of last year but has since stabilised (see Figure 3). Multiple interest rate rises, in response to the (then) widening current account deficit and financial market volatility, should help keep price rises in check. Inflation in Vietnam is high compared with most of its regional peers, but not by recent historical standards for the country and it appears to moving in the right direction. Inflation has accelerated in the Philippines, stoking fears of possible overheating. But at around 4% it still remains manageable for an emerging market.

Figure 3: Headline Inflation Rate in Major SE Asian Economies (% change on year earlier)

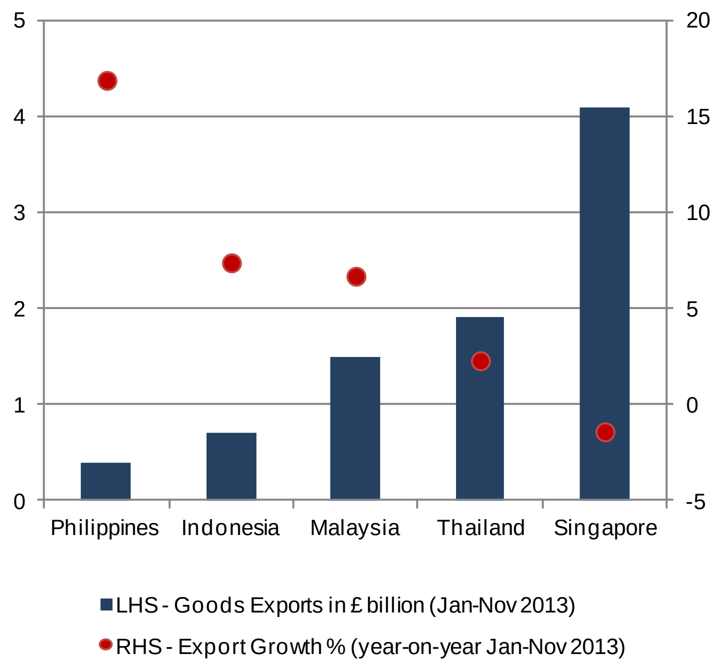


Source: Official national statistics

Trade Policy Developments

10. Weaker economic growth and currency movements may make it harder, but not impossible, to maintain rapid rises in UK exports to Indonesia and Thailand (see Figure 4). Measures to constrain rising debt levels may also temper spending on UK goods and services in several markets. But the bright outlook for most of the region's economies mean SE Asia will continue to punch above its weight in terms of UK exports. Figure 4 shows UK goods export volumes and growth rates (on the same period a year earlier) between January and November 2013. Some of the UK's exports to Singapore will be re-exported elsewhere.

Figure 4: UK Goods Exports to ASEAN-5 Economies



Source: Office of National Statistics

11. The EU will be hoping to make progress on a number of FTA negotiations in the region this year. Hopes remain that the investment chapter of the (already initialled) Singapore FTA will be completed in time for the text to reach the European Parliament before April's recess. Otherwise implementation could be delayed until 2015. Political difficulties will likely delay negotiations on the EU's FTA with Thailand. But there are encouraging signs that negotiations with Malaysia could resume soon, after a long hiatus. There should be continued steady progress on the Vietnam FTA,

where the sixth round of negotiations took place in Brussels on 13-17 January 2014. It was reported that progress was made on all chapters of the proposed FTA, especially on customs and trade facilitation, technical barriers to trade, and competition. The next round of negotiations will be held in Hanoi on 17-21 March 2014, and both sides hope to conclude the deal by October this year. Progress on the proposed EU-Indonesia Comprehensive Economic Partnership Agreement (CEPA) agreement is not expected until after the Indonesian elections.

12. TPP negotiations are expected to conclude this year, which would provide a boost to Vietnam, Brunei, Singapore and Malaysia. Attention will then shift to whether Indonesia, Thailand and the Philippines can be persuaded to get on board. But that is a big ask. The third round of negotiations on the Regional Comprehensive Economic Partnership (RCEP, a proposed trading bloc involving the 10 ASEAN nations and Australia, New Zealand, China, Japan, South Korea and India) were held in Kuala Lumpur, Malaysia, on 20-24 January 2014. Representatives continued discussions in the working groups for goods, services and investment, and established new working groups on competition, intellectual property, economic and technical cooperation, and dispute settlement.

13. Indonesia has recently introduced a number of measures that will impact on trade and investment. The long anticipated ban on the export of unprocessed minerals, which is intended to boost domestic supply, came into effect on 12 January – with some temporary concessions to minimise job losses and potential damage to local economies. Those companies that have already committed to building smelters or that are exporting concentrated minerals, e.g. copper, are allowed to continue exporting, albeit with increased export taxes. Reduced mineral export earnings will not help Indonesia shrink its significant current account deficit.

14. Malaysia recently announced its National Automotive Policy (NAP) 2014, a six year plan for its automotive sector. Highlights of the NAP include a raft of incentives to make Malaysia the ASEAN hub for 'efficient energy vehicles' production, as well as to increase vehicle exports by tenfold and create 150,000 new jobs by 2020. But duties targeting foreign cars and affirmative action policies will remain, which some analysts believe will stifle the sector. Malaysia's car industry faces competition from larger regional vehicle manufacturers Indonesia and Thailand, as well as the complete elimination by 2016 of import duties on Australian and Japanese cars, as agreed in their respective FTAs.

Business Environment and Regulatory Developments

15. The Indonesian Parliament passed a new Industry Law on 19 December 2013, the aim of which is to provide more support and protection to domestic firms, possibly disadvantaging foreign businesses. The new law gives the Minister of Industry powers to impose new standards on goods, require minimum levels of 'local content' and 'national product' (undefined), to ban foreign workers from certain sectors, and impose non-tariff barriers on imported goods. The law is unlikely to come into effect during this Parliament. Meanwhile, the long promised revision to the Negative Investment List, which would relax some restrictions on foreign ownership, has still not been issued.

16. Indonesia's Supreme Court has implemented a new decree allowing intellectual property (IP) cases to be heard in the civil courts (rather than criminal courts), with effect from April 2014. Also in Indonesia, the latest draft of the Copyright Bill sent to Parliament proposes new rules to manage Indonesia's Collective Management Organisations (CMOs, which collect royalty fees from users of copyright works). If the new rules come into effect, some of the CMOs will no longer be permitted to collect royalties, leading to consolidation. The Philippines will set up a new agency, the Bureau of Copyright, in March 2014 to manage CMOs. The move was part of the recent amendment of the Philippines' IP Code. The plan also calls for the Bureau to increase public awareness of the need to protect copyrighted works and encourage innovation.

17. Singapore will implement a new system for patent approvals, moving from 'self-assessment' to 'positive grant'. This change means that Singapore will only grant patent applications which have been examined locally and have fully met the patentability requirements (in the past patent applications were not examined locally). The change, which takes effect from February 2014, will put Singapore on a par with the patent offices of the UK, US, Japan and the European Patent Office. Other amendments to Singapore's Patents Act included a provision for patent applicants to enjoy a default 'extension of time', rather than have to pay for a longer filing period. But there is no minimum time period for granting patent approvals.

18. The Vietnamese authorities cut the standard corporate income tax rate from 25% to 22%, with effect from 1 January 2014, in a move aimed at supporting domestic enterprises and attracting greater foreign investment. After the change, Vietnam's corporate tax rate will be lower than most of its economic peers in the region, including China, Malaysia, Philippines and Indonesia (assuming they don't change their rates). Committed FDI into Vietnam reached $21.6 billion last year ($11.5 billion of which was actually disbursed). Vietnam is one of the key beneficiaries of surging Japanese FDI into SE Asia.

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