ASEAN ECONOMIC BULLETIN

May 2014

Foreign & Commonwealth Office

HIGHLIGHTS

- ASEAN's second largest economy, Thailand, contracted by 0.6% in the first quarter of this year (on the same period a year earlier) due to prolonged political tensions. Economic growth is forecast to be as low as 1-2% in 2014. The military seized power in a coup on 22 May and it remains to be seen what impact this will have on the economy.

- Indonesia, ASEAN's largest economy, continues to slow as a result of weaker exports and the policies introduced to reduce the country's large, but shrinking, current account deficit. July's presidential election will now be between two coalitions of parties, led by Jakarta Governor Joko Widodo and former Special Forces commander Prabowo Subianto, respectively. This avoids the need for a second round of elections in September, with its associated uncertainty.

- The appearance of a Chinese oil rig in part of the disputed South China Sea in May led to widespread protests in Vietnam, including the destruction of Chinese-owned factories (and those mistaken as Chinese-owned) in the export-orientated industrial heartland in the south. The Vietnamese authorities said they have now stabilised the situation.

- Economic growth figures for the first quarter of this year were better than expected in Malaysia but slightly disappointing in Singapore. The Philippines looks set to remain one of the fastest growing economies in SE Asia in 2014. The "frontier" markets Burma, Cambodia and Laos are all predicted to continue growing by more than 7% in 2014.

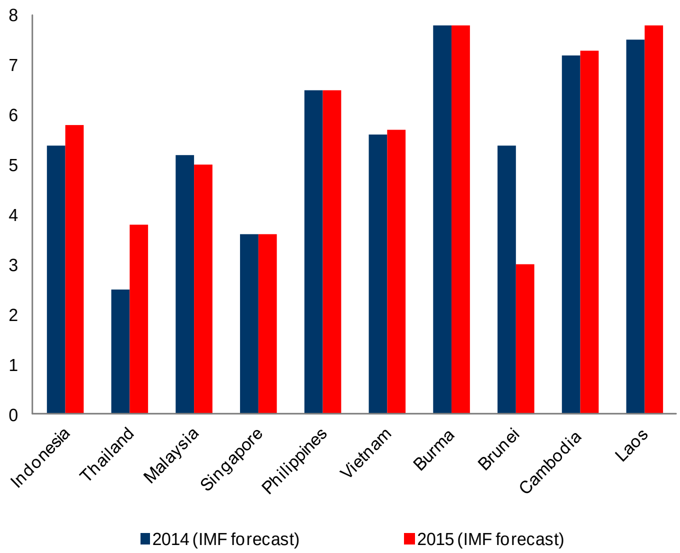
- Trade ministers from the Trans-Pacific Partnership (TPP, "mega trade pact" that includes Brunei, Vietnam, Malaysia, Singapore and the US but not China) member countries met in Singapore in the middle of May. Most of the ministers' public statements after the meeting were relatively upbeat, while recognising significant challenges need to be overcome before negotiations can be concluded.

- Indonesia has issued a revised list of foreign investment restrictions, with limited opening in some sectors but tightening in others.

Economic Developments

1. Political tensions in Thailand since last October have hit the region's second largest economy hard. Thailand's economy shrank by 2.1% in the first quarter of 2014 when compared to the previous quarter, worse than expected, and by 0.6% on the same period last year. Household consumption dropped by 3% (on a year earlier), investment by 9.8% and exports by 0.4%. The state planning agency, the National Economic and Social Development Board (NESDB), lowered Thailand's GDP growth forecast for 2014 from 3-4% to 1.5-2%, below the IMF's revised forecast for this year (see Figure 1, though these were issued in April, before first data quarter were released) and the lowest in the ASEAN region. Some analysts believe the NESDB's figures are still too optimistic. Consumer confidence is reportedly at a 12-year low, tourist numbers are down slightly, public spending has been delayed and the usually robust property sector has started to slow down.

Figure 1: GDP Growth Forecast for ASEAN Economies (% change on year earlier)



Source: IMF WEO April 2014

2. The predictions above were made before the military seized power on 22 May, two days after imposing martial law. The impact of the military coup on currency and stock markets has been relatively limited so far, but economic recovery and investor confidence will depend on how long it takes to put in place a functioning democratic government. The rating agencies Moody's and Fitch have suggested they might downgrade Thailand's sovereign credit rating.

3. Economic growth in the region's largest economy, Indonesia, has also slowed, albeit less dramatically. GDP grew by 5.2% in the first quarter of 2014 (on the same period a year earlier), down from 5.7% growth in the fourth quarter and below expectations. Exports fell slightly in the first quarter, partly as a result of the ban on unprocessed mineral exports that was introduced in January, resulting in a smaller goods trade surplus. But a smaller deficit in services trade and income transfers meant Indonesia's overall current account deficit continued to gradually shrink in the first quarter, to 2% of GDP. Government spending and investment growth have slowed as a result of the measures introduced (which included multiple interest rate rises and reform of fuel prices) to reduce Indonesia's current account deficit, which reached 4.4% of GDP in the middle of last year, sparking financial market volatility. Household consumption, on the other hand, remains resilient and the main driver of the economy. Bank Indonesia, the central bank, forecasts growth of 5.5-5.9% in 2014.

4. Elections this year will have a major impact on the economic outlook. Following April's parliamentary elections, parties have been coalescing around two presidential candidates – Jakarta Governor Joko Widodo ("Jokowi"), whose coalition collectively won 37% of the seats in April's parliamentary elections, and former Special Forces commander Prabowo Subianto, whose coalition won just over half the seats. The narrowing of the field to two presidential candidates means the result will be determined after voting on 9 July, without the need for a second round in September - shortening the period of uncertainty and reducing costs to the public purse. Opinion polls currently suggest Joko Widodo is the favourite to win. Both coalitions are promoting relatively nationalistic economic policies as their campaigning begins. But the new President, whoever wins, is likely to soften the tone when in government.

5. The appearance of a Chinese oil rig in part of the disputed South China Sea in early May led to widespread protests in Vietnam. Riots erupted in industrial zones in the southern provinces, the country's commercial heartland. Mainland Chinese factories were attacked and burned down, as were some Taiwanese firms - mistaken by the rioters as being Mainland Chinese-owned. The Vietnamese authorities say they have now stabilised the situation, conscious of the implications for their foreign investment-driven export industry. According to the World Bank, Vietnam receives the highest amount of foreign direct investment (FDI) in relation to the size of its economy of any SE Asian country (6% of GDP). The bulk of this comes from East Asian investors. The booming export industry is partially compensating for weak domestic demand but Vietnam's growth rate remains below potential due to bad debts in the state-owned banking and corporate sector. Both the IMF and the Asian Development Bank (ADB) predict Vietnam's economy will grow by 5.6% in 2014, up slightly from last year's 5.4%.

6. Malaysia's economy grew by 6.2% in the first quarter of 2014 (on the same period last year), better than expected and up from 5.1% in the final quarter of last year. Household consumption remains a key driver and higher government spending in the first quarter also boosted GDP growth. Net exports also made a positive contribution to growth, due to recovering demand for Malaysian goods in developed economies. Economic growth is expected to be towards the upper end of the central bank's forecast range of 4.5-5.5% this year.

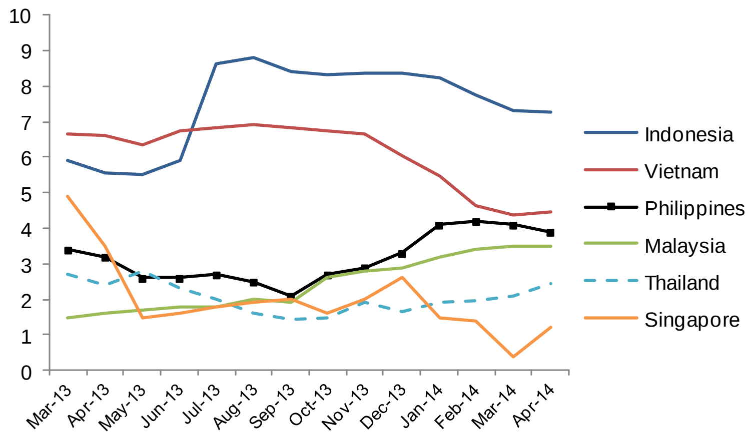
7. Singapore's economy, by far the region's wealthiest, grew by 4.9% in the first quarter (on the same period a year earlier), slightly below expectations due to weaker export figures. The economy only grew by 2.3% in the first quarter when compared with the final quarter of last year. Industrial production is growing very strongly though, driven by the biomedical and transport engineering sectors. GDP growth is expected to pick up over the course of the year, linked to a recovery in the US and Europe, and the official forecast for 2014 remains between 2-4%. House prices, though, are expected to fall by 5-15% in 2014 and continue doing so over the next two years, as strict property cooling measures start to bite.

8. The Philippine economy is expected to continue growing briskly over the course of 2014, with the IMF predicting 6.5% GDP growth and the government targeting 6.5-7.5%. Standard & Poor's (S&P) recently raised the Philippines' long-term sovereign credit rating from BBB- to BBB, firmly within the "investment grade" range. Last October, Moody's became the final of the 3 major rating agencies to upgrade the Philippines to investment grade status. S&P endorsed the fiscal policies pursued by President Aquino's administration, noting that the government's revenue generation, debt management, and governance reforms had been effective. But despite impressive economic growth rates, the country faces stubbornly high unemployment and poverty levels.

9. Both the IMF and the ADB predict Burma will be the fastest growing economy in SE Asia this year, with GDP rising by 7.8%. The ADB points to strong investment and business confidence, resulting from sustained policy reform, as the major driver of growth, supported by healthy commodity exports, tourism and credit growth. The National Budget Law for fiscal year 2014/15 was approved by parliament at the end of March, with the budget deficit predicted to shrink slightly, to 4.5% of GDP. Domestic public debt remains relatively low, at 23% of GDP. The IMF is also bullish about the growth prospects in the other "frontier" markets Laos (7.5% growth this year) and Cambodia (7.2%).

10. Consumer price inflation has continued to moderate in Indonesia (see Figure 2) in response to multiple interest rate rises. Rising inflation in Malaysia, which could be exacerbated by further cuts to energy price subsidies, leads many analysts to predict the central bank will hike interest rates soon. Higher food prices pushed up the inflation rate in the Philippines to just over 4% in April - still within the central bank's target band but rising faster than anticipated. The inflation rate has fallen dramatically in Vietnam over the last 6 months, due to weak domestic demand and stable food and energy prices, enabling the authorities to loosen monetary policy to shore up economic growth.

Figure 2: Headline Inflation Rate in Major SE Asian Economies (% change on year earlier)



Source: Official National Statistics

Trade Policy Developments

11. Indonesia issued the long-trailed third revision to its Negative [foreign] Investment List in early May. This was one of the measures announced last August to reduce Indonesia's large current account deficit. The revision allows slightly more foreign investment in some areas, including raising the foreign equity cap in the pharmaceuticals sector from 75% to 85% (though 100% ownership had been trailed). But this was countered by tightening in some other sectors. Overall, liberalisation was less than foreign businesses had hoped for, but this is perhaps not surprising in this election year.

12. The latest Trans-Pacific Partnership (TPP, "mega trade pact" that includes Singapore, Brunei, Vietnam and Malaysia and the US but not China) ministerial meeting took place in Singapore on 19-20 May, following a gathering of chief negotiators in Vietnam on 12-17 May. The statements made by ministers at the closing press conference were relatively upbeat, suggesting that momentum is returning to the talks after some progress was made towards resolving crucial US-Japan market access differences. But they also recognised that substantial challenges remain and are not committing to any deadline.

13. Political developments in Thailand have stalled progress on the EU-Thai free trade agreement (FTA) and it remains uncertain when the next round of negotiations on the EU-Malaysia FTA will take place. The next round of negotiations on the EU-Vietnam FTA will be in June.

Business Environment and Regulatory Developments

14. Indonesia has announced it will let existing Bilateral Investment Treaties (BIT) lapse as they come up for review and negotiate new agreements "to take account of recent legal changes". The Indonesia Investment Coordinating Board (BKPM) is working on a new standard agreement which is due to be completed by the end of 2014. This is reportedly being driven by concerns about 'investor-state dispute settlement' mechanisms. The UK's BIT is due for renewal in March 2017 and existing investors are protected by a 20-year 'grandfather' clause. Some protection is also provided by the 2007 Capital Investment Law.

15. The Vietnamese authorities have approved plans to partially privatise (or "equitise") one of the country's biggest state-owned enterprises (SOEs), the Vietnam Textiles and Apparels Group (Vinatex). The private sector (local and foreign) will be allowed to buy up to 49% of the company's shares. Vietnam Airlines also plans to sell stock in an initial public offering (IPO) in September, with the private sector allowed to buy up to 25% of the shares. The authorities plan to privatise 531 SOEs by 2015, although some commentators argue that this is ambitious.

16. Media reports highlighted that Singapore has overtaken London to become the second largest offshore renminbi (RMB) centre (after Hong Kong), after a surge in payments in the city state. But according to Standard Chartered's Renminbi Globalisation Index (RGI), which measures all offshore RMB products and services, London remains the second largest centre. The Chancellor, George Osborne, and Singaporean DPM and Finance Minister, Tharman Shanmugaratnam, announced a new UK-Singapore Financial Dialogue and private sector RMB working group when the former visited the city state in February, emphasising that the development of these two financial centres was complementary.

17. Burma's Ministry of Energy announced the awarding of 20 offshore oil and gas blocks in the Bay of Bengal at the end of March. British firms collectively won 8 of the 20 blocks.

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