ASEAN ECONOMIC BULLETIN

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Foreign & Commonwealth Office

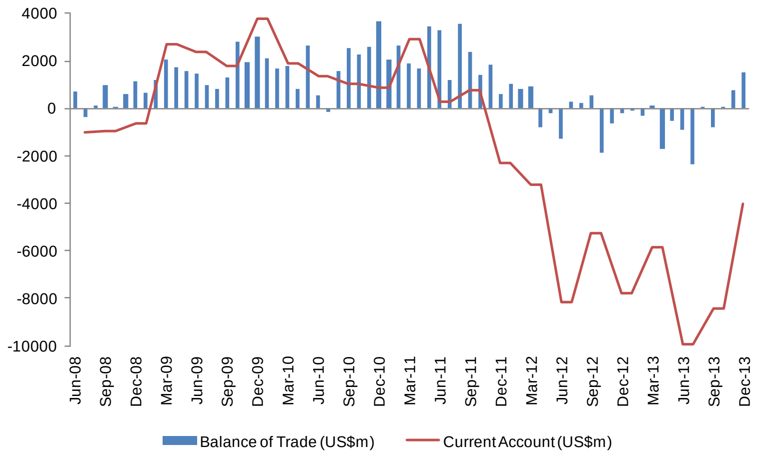
HIGHLIGHTS

- After a volatile second half of 2013, trigged by a record current account deficit, Indonesia's financial markets have been relatively stable so far this year. The current account deficit shrank to 2% of GDP in the final quarter of last year.
- Continued political turmoil in Thailand is hurting the region's second largest economy, which was already slowing before tensions broke out. Analysts fear GDP growth could slip as low as 2-3% this year.
- Singapore's 2014 Budget focused on addressing inequalities through welfare packages, while seeking to boost competitiveness by improving productivity.
- The Vietnamese central bank has cut interest rates again in order to boost growth, which remains below potential. Falling inflation has provided the policy space to loosen monetary policy further.
- Analysis suggests SE Asia may now attract more foreign direct investment (FDI) than mainland China.
- Indonesia's parliament passed a new trade law in February. This gives the government greater control over the setting of import and export restrictions, while allowing the parliament more say on international trade negotiations.
- The UK and Singapore announced the launch of a new bilateral Financial Dialogue and private sector working group on offshore renminbi (RMB).
- The EU and Burma have launched negotiations on an investment protection agreement.
- Vietnam has increased the equity cap on foreign investment in the banking sector from 15% to 20%.

Economic Developments

1. The region's largest economy, Indonesia, had a volatile second half of 2013, trigged by a record 4.4% of GDP current account deficit in the second quarter. But Indonesia's financial markets have been relatively stable so far this year. After falling 20% last year against the dollar, the Rupiah has so far strengthened by around 7% in 2014. Trade surpluses in the final three months of 2013 meant the overall current account deficit shrank to $4 billion, or 2% of GDP, in the final quarter of last year (see Figure 1). The markets largely shrugged off the surprise return to a (goods) trade deficit in January; a sign perhaps that there is now less concern about Indonesia's economic stability. But most analysts believe Indonesia is not out of the woods yet.

Figure 1: Indonesia's Balance of Trade and Current Account (US$m)



Source: Official National Statistics

2. After months of speculation, Indonesia's Democratic Party of Struggle (PDI-P) announced on 14 March the nomination of Jakarta Governor Joko Widodo as their Presidential candidate. Commentators believe the prospect of a closely contested presidential election, with its associated risk of greater uncertainty, is now reduced.

3. The political turmoil in Thailand, the region's second largest economy, is entering its fifth month with uncertainty over whether a properly elected government can be formed soon. This is hurting the economy, which had already been cooling since the summer of 2013 due to weak exports and slowing consumer spending (resulting from the expiration of subsidies and concerns over rising household debt). Analysts fear GDP growth could be just 2-3% this year, following an increase of only 2.9% in 2013 (read more). The Bank of Thailand cut interest rates by a further 0.25 percentage points in March, worried by the drag on growth created by the prolonged political impasse.

4. The Malaysian economy grew by 4.7% in 2013, slower than in the preceding few years. Domestic demand growth was weaker, with both household consumption and business investment cooling. Fiscal consolidation measures are expected to further moderate domestic demand in 2014, due to lower government spending and the impact of subsidy reduction on consumption. But analysts expect exports to play a bigger role in driving growth again due to the improving external conditions and a weaker Ringgit. The economy is expected to grow by 5-5.5% this year.

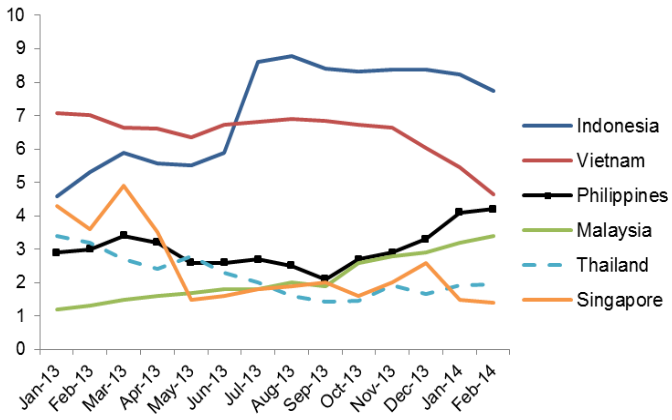
5. Healthy economic growth and a higher than expected budget surplus provided a welcome backdrop for Singapore's 2014 Budget. Delivered by DPM and Finance Minister Tharman Shanmugaratnum on 21 February, the Budget attempted to balance the challenge of addressing inequalities in Singaporean society through welfare packages, while seeking to boost competitiveness by improving productivity and technology adoption (read more). The government has a comfortable fiscal cushion to cover the increased social expenditure in the short term. But government spending is expected to rise rapidly in the next 10-15 years and will need to be funded through new revenue raising measures. This could place further cost pressures on businesses in a country recently assessed as the world's most expensive place for expats to live by the Economist Intelligence Unit (EIU).

6. The Philippines is expected to continue its impressive growth trend in 2014, with the government, multilateral institutions, and banks all projecting 6.5-6.9% GDP growth. But despite strong economic growth the unemployment rate rose to 7.5% in January (compared with 7.1% a year earlier). The government blames Typhoon Haiyan, which wreaked havoc on parts of the Philippines at the end of last year. But the rise in unemployment has renewed calls for reforms that would make growth more inclusive and 'jobs creating', including by addressing significant infrastructure bottlenecks.

7. The Vietnamese central bank cut benchmark interest rates again on 17 March, to encourage greater bank lending and boost economic growth. But high levels of debt in the state-owned banking system remain a drag on the economy. GDP grew by 5.4% in 2013, up slightly from 5.3% the year before but still well below potential. The authorities are targeting 5.8% GDP growth in 2014.

8. Inflation has fallen significantly in Vietnam, dropping to 4.7% in February (on a year-on-year basis, see Figure 2). This was the lowest level in over four years and gave the central bank the policy space to cut interest rates further. Consumer price rises have also decelerated slightly in Indonesia, though remain relatively high. Rising inflation in the Philippines in recent months could be a sign the economy is starting to overheat. But the central bank's decision in February to keep interest rates steady suggests they are not yet worried about inflationary pressure. The cut in fiscal subsidies for fuel was responsible for the recent rise in inflation in Malaysia.

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

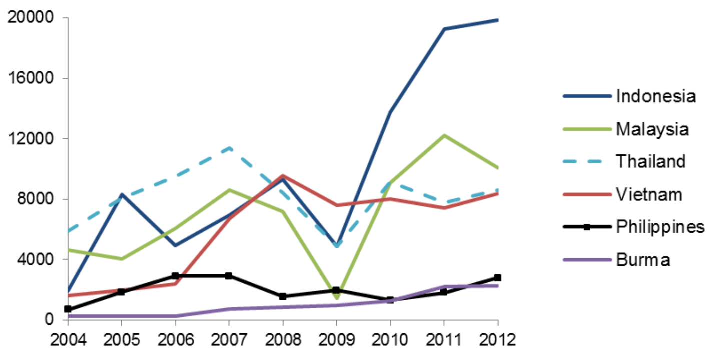


Source: Official National Statistics

9. Recent analysis by Bank of America Merrill Lynch, drawing on national statistics, suggests FDI flows last year into ASEAN's 5 largest economies – Indonesia, Thailand, Malaysia, Singapore, and the Philippines – surpassed mainland China (this comparison excludes FDI into Hong Kong, much of which is aimed at the mainland market). According to the bank, FDI inflows into the ASEAN-5 rose by 7%, to $128 billion, while FDI in China fell slightly, to $124 billion. The data for the different countries are not directly comparable. But if Vietnam, a significant recipient of FDI, and ASEAN's smaller economies are added to the mix it's certainly possible that SE Asia now attracts more FDI than mainland China, highlighting its growing weight in the global economy.

10. A big chunk of total FDI into ASEAN continues to go to Singapore. But FDI into Malaysia, Indonesia, the Philippines and Vietnam has risen considerably in the last couple of years (see Figure 3, which excludes Singapore), attracted by healthy growth prospects and the appeal of some countries as export bases. FDI into Burma is also expected to continue rising rapidly this year. Of the key emerging markets in ASEAN, Vietnam attracts the most FDI relative to the size of its economy - 6% of GDP, compared with just over 2% in Indonesia and 1% in the Philippines.

Figure 3: FDI Flows into ASEAN Economies (US$m)



Source: UNCTAD

11. There are restrictions on foreign investment in some sectors and countries in ASEAN though, and the business environment can be a deterrent in some markets. But despite these concerns, the region's long-term potential – ASEAN could be the world's fourth largest 'single market' by 2030 – is likely to sustain strong FDI inflows. Manufacturing wages are significantly lower in all but the richer members of ASEAN than in China. Japanese FDI has also been diverted from China to SE Asia (read more). The region's relative attractiveness would be further boosted by progress on the ASEAN Economic Community agenda, conclusion of the Trans-Pacific Partnership (TPP, in which Singapore, Malaysia, Vietnam and Brunei are taking part - though this may lead to a diversion of FDI from non-members to members) and a number of bilateral FTAs.

Trade Policy Developments

12. The Indonesian parliament recently passed the country's first comprehensive trade law, replacing the 80-year-old Dutch colonial framework. The new law gives the government greater flexibility to implement export and import restrictions, including the imposition of tariff and non-tariff barriers, to manage domestic supply and prices and to protect national industries. It also gives parliament a greater voice in international trade negotiations. In response to concerns that the new law would undermine Indonesia's WTO commitments, Deputy Trade Minister Bayu

Krisnamurthi, stated "….Indonesia does not fully embrace free trade. What we seek is a balance between market efficiency and the protection of various local stakeholders".

13. The seventh round of EU-Vietnam FTA negotiations took place in Hanoi on 17-21 March. Both sides continued to discuss all chapters of the FTA, with an aim to conclude negotiations by October this year. The political paralysis in Thailand is delaying progress on the EU-Thailand FTA, with only working level technical discussions taking place.

14. The latest round of TPP negotiations were held in Singapore on 22-25 February, the first after the passing of the 'end of 2013' deadline. No substantial agreement was reached with differences remaining on market access issues, sanitary and phytosanitary (SPS), investor protection, and State-Owned Enterprises (SOEs). There is currently no date set for the next round of talks, but reports suggest it may coincide with the APEC Ministerial in May.

Business Environment and Regulatory Developments

15. The UK Chancellor, George Osborne, made his first visit to Singapore in February. DPM and Finance Minister Tharman and the Chancellor jointly announced the launch of a new UK-Singapore Financial Dialogue and private sector working group on offshore RMB, facilitating deeper ties between two of the world's four largest international financial centres and the two largest offshore RMB hubs outside Greater China (read more).

16. Vietnam has loosened foreign equity restrictions in the banking sector slightly. Individual foreign 'strategic' investors are now able to take a 20% equity stake in a Vietnamese bank, up from 15% previously. The authorities hope this will draw more capital into the country's struggling banking sector, although the total share of equity foreign investors are collectively allowed to hold remains unchanged at 30%.

17. The EU and Burma have launched negotiations on an investment protection agreement. The negotiations were announced during EU Trade Commissioner De Gucht's visit to Burma in March. An agreement would provide more protection and certainty for EU investors in Burma and help the frontier emerging market attract more FDI. De Gucht noted "this investment agreement could become an important accelerator for the reform process in Burma".

18. Burma's parliament approved changes to the country's tax laws in March, aimed at improving revenue collection by reducing the incentives for tax evasion, whilst also reducing the tax burden on the lowest earners. The 2014 Union Tax Law includes new tax rates for property purchases, personal income, and corporate earnings (rates vary by sector). Burma's tax take as a percentage of GDP is the lowest in SE Asia.

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