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HIGHLIGHTS

- Jakarta Governor Joko Widodo ("Jokowi") was declared the winner of Indonesia's presidential election, which took place on 9 July. The widening of the current account deficit in the second quarter is a reminder of the challenges the new administration will need to grapple with when they take office in October.

- Thailand's economy narrowly avoided slipping into a technical recession in the second quarter. Investment and exports remain weak but rebounding consumer confidence is a positive sign. Economic growth is forecast to remain below potential in 2014, at 1.5-2%. The National Legislative Assembly (NLA) was established by the military junta at the end of July and in August it unanimously approved Army Chief General Prayuth's nomination as Prime Minister.

- Malaysia's economy grew by an impressive 6.4% in the year to the second quarter. Domestic economic restructuring slowed Singapore's economic growth rate to 2.4% in the second quarter. Economic growth in the Philippines slowed to 5.7% in the first quarter (latest official figures), but remains healthy and is expected to strengthen during the rest of 2014. The Vietnamese economy is gradually improving, growing at a rate of 5.3% in the second quarter, but remains below potential.

- Malaysia has taken welcome steps to further liberalise its legal services profession and the Philippines has opened up its retail banking market. Burma is planning to remove a ban on foreign companies participating in trading activities.

- According to the United Nations Conference on Trade and Development (UNCTAD), combined foreign direct investment (FDI) inflows into the 10 ASEAN member states exceeded those into mainland China last year, for the first time.

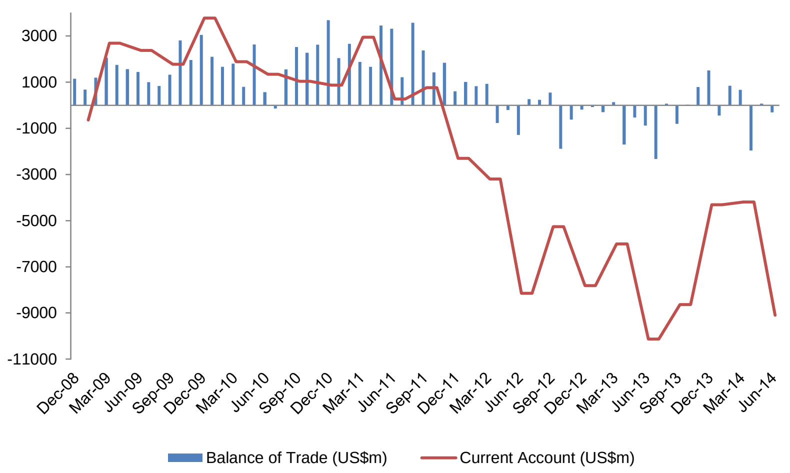
- Singapore has taken further steps to enhance its intellectual property dispute settlement mechanisms.

Economic Developments

1. Jakarta Governor Joko Widodo ("Jokowi") was declared the winner of Indonesia's presidential election, which took place on 9 July. He won by a margin of 6.3 percentage points and any doubt over the succession was removed after the Constitutional Court dismissed his opponent Prabowo Subianto's challenge on 21 August. The President-elect's transition team is up and running but he will not appoint his Cabinet until after formally taking office on 20 October. President-elect Joko Widodo will be the first leader of the world's third largest democracy to come from outside the political and military elite.

2. Recent economic data highlight the challenges facing the new administration. The country's current account deficit expanded to 4.3% of GDP in the second quarter of this year. Cyclical factors - 'Lebaran' festivities, higher dividend payments and income repatriation - usually increase the current account deficit in the second quarter of each year (see Figure 1). But the substantial increase in the deficit came despite an overall cooling of the Indonesian economy, which should have been good news for the current account. GDP grew by 5.1% in the year to the second quarter, the slowest rate since the end of 2009. The government's ban on the export of unprocessed minerals, which was implemented in January, has not helped tackle the current account deficit. The main cause, though, is the persistently large trade deficit in the oil and gas sector, which in turn is exacerbated by fuel price subsidies. Oil imports have continued to rise despite reform of fuel price subsidies in July 2013.

Figure 1: Indonesia's Trade Balance and Current Account Deficit



Source: Bank Indonesia

3. The current account deficit was only marginally smaller than the second quarter of last year (4.4% of GDP), which triggered volatility in the financial markets in the second half of 2013. This time round the markets have been less affected, buoyed by the election of a reform-minded president and possibly focused on other international and domestic developments. But the latest data nonetheless increase the pressure on the new president to tackle the underlying structural causes of the persistent deficit. This includes further reform of fuel subsidies, which are also an enormous drain on the state's finances. Sharp cuts had to be agreed to the 2014 government budget to prevent a breach of the constitutional 3% of GDP deficit limit - due not only to a ballooning fuel subsidy bill but also a declining tax take. These twin challenges, unless addressed, will hamper President-elect Joko Widodo's ambition for structural reform and stronger growth (read more here on Indonesia's structural challenges and risk of the middle income trap).

4. Tackling Indonesia's infrastructure bottlenecks and improving education will be key priorities for the new administration. The President-elect has indicated his other priorities will include streamlining Indonesia's bureaucracy, reducing corruption and improving the business environment. His experience running his own business will be helpful in this regard and his track record as mayor of Solo and governor of Jakarta is encouraging. There is less certainty over whether the new administration will embrace freer trade and take steps to encourage more foreign investment, although President-elect Joko Widodo is expected to take a pragmatic approach to achieving his goal of 7% GDP growth.

5. Three months on from the military coup in Thailand, there are signs that confidence is starting to return to the region's second largest economy. The economy expanded by 0.4% in the year to the second quarter - very weak but at least positive, avoiding a contraction for a second consecutive quarter (which would have meant Thailand was in a technical recession). The key drivers of growth remain weak, particularly investment and exports. But on the positive side, consumer spending rose for the first time in a year. Consumer confidence is at its highest level since last September, after hitting a low in April this year.

6. The official forecast for Thai GDP growth in 2014 is 1.5-2.0%, down from last year's disappointing 2.9% and far below potential. The National Economic and Social Development Board recently highlighted several risks to the Thai economy: slow recovery in the global economy; sluggish recovery in the tourism sector; delayed investment projects and low capacity utilisation; contraction of car sales and production. The central bank consequently decided to keep the benchmark interest rate at 2% in order to spur growth and maintain the stability of the Thai Baht. Inflation remains fairly subdued, giving the central bank the policy space to support growth.

7. The National Legislative Assembly (NLA) was established on 31 July and on 21 August it unanimously approved Army Commander-in-Chief General Prayuth's nomination as Prime Minister (he will formally assume the role once royal assent has been granted). The Cabinet is expected to be formed by mid-September. Analysts believe that once the Cabinet is in place more investment projects will be approved and the junta will announce other policy measures to put the economy on a stronger growth trajectory. The NLA passed the first reading of the 2015 Budget on 18 August. The junta's draft Budget proposes an expansionary fiscal policy to support growth, anticipating a fiscal deficit of nearly 2% of GDP, and predicts economic growth will be 3.5-4.5% next year.

8. The Malaysian economy grew by an impressive 6.4% in the year to the second quarter, making it one of the fastest growing economies in ASEAN. Exports continue to grow strongly and domestic demand also remains relatively robust - although a fall in imports and moderating private consumption suggest the domestic economy may be cooling slightly. As exports become the main driver of growth, the economy will be more exposed to developments in the EU, US, China and Japan in particular. Growth is expected to soften slightly as the year progresses, given the possibility of a further tightening of monetary policy (the central bank raised the benchmark interest rate in July), additional subsidy reductions and lower government spending.

9. Singapore's economy grew by 2.4% in the year to the second quarter. Growth in all sectors slowed from the previous quarter and labour productivity - a key indicator used to measure the success of Singapore's restructuring - declined for the first time in a year. As a result, the outlook for the rest of 2014 looks mixed. Externally-oriented sectors such as wholesale trade and finance are expected to support growth as the global economy improves. But labour-intensive industries such as retail, restaurants and hotels will likely feel the effects of foreign worker restrictions. The official forecast range for GDP growth in 2014 has therefore been narrowed from 2-4% to 2.5-3.5%.

10. The pace of economic growth in the Philippines slowed to 5.7% in the year to the first quarter of 2014 (latest official figures), compared with 6.7% in the previous quarter. Lower government spending was a key factor behind slowing economic growth. The central bank also tightened monetary policy in July, for the first time since 2011, as rising food and energy prices pushed up the overall level of inflation. The crackdown on food smuggling, capacity constraints at Manila’s ports and a ban on trucks during the daytime in the capital have all added to inflationary pressures. The World Bank and the IMF have therefore revised downwards their growth projections for 2014, to 6.4% and 6.3%, respectively. But both the government and independent analysts believe robust consumer spending, an improving manufacturing sector and recovering exports will ensure that economic growth accelerates again - despite the slight tightening of monetary policy. The birth of the country’s 100 millionth citizen in August was a reminder, though, of the need to ensure economic growth creates more jobs. Unemployment has remained stubbornly high in recent years (read more).

11. Vietnam's economy shows modest signs of improvement but growth remains well below potential. GDP grew by 5.3% in the year to the second quarter, compared with 5.1% in the first quarter. In June, the central bank devalued the currency, the Dong, reducing its reference rate by 1%. The move was primarily aimed at spurring faster export growth after some factories were destroyed during anti-China riots in May, triggered by the appearance of a Chinese oil rig in disputed waters in the South China Sea. The authorities are targeting 5.8% growth in 2014 but the World Bank predicts 5.4%. In August, Prime Minister Dung said the country should strive to achieve 6.5-7% growth. But that will require significant reforms to inefficient state-owned enterprises and resolution of bad debts in the banking system. The official estimate of the non-performing loan (NPL) ratio is around 5% but the ratings agency Moody's believes it could be 10-15%. The measures adopted to address these issues have only had a limited impact so far.

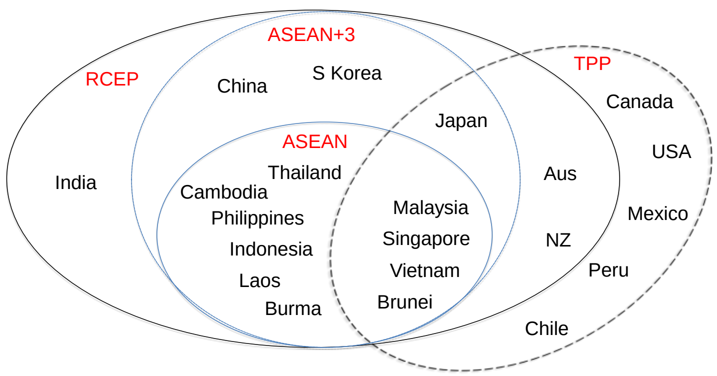
12. Analysts believe the Cambodian government’s projected economic growth rate of 7% in 2014 now looks more difficult to achieve. The nearly year-long political stalemate, unresolved labour issues, political and economic dynamics in Thailand and extreme weather conditions are all taking their toll on growth. Private sector investment fell by 64% in the first half of the year, on the same period in 2013. Tourist numbers are still rising but the growth rate has slowed. Garment and textile exports, which account for almost 80% of Cambodia's total exports, grew by 16.3% in the first half of the year on the same period in 2013, slower than in recent years, and rice exports rose by just 1%.

Trade Policy Developments

13. Negotiations on the EU-Thailand free trade agreement (FTA) are effectively on hold and formal discussions between the EU and Malaysia have not yet resumed. Steady progress continues to be made on the EU-Vietnam FTA, although it remains to be seen if negotiations can be concluded this autumn, as the Vietnamese authorities hope. Ratification and implementation of the EU-Singapore FTA, initialled in September 2013, continues to be delayed by ongoing negotiations on the outstanding investment chapter.

14. The fifth round of negotiations on the Regional Comprehensive Economic Partnership (RCEP) - 'mega trade pact' that includes all 10 members of ASEAN, China, India, Korea, Japan, Australia and New Zealand (but not the US) - took place on 23-27 June in Singapore. Limited progress was reportedly made. Member countries have stated their desire to conclude negotiations by the end of 2015 but observers believe this is increasingly unlikely. The second meeting of RCEP trade ministers is scheduled for late August in Burma and will be an opportunity to assess progress, and perhaps inject momentum into the negotiations. Brunei, Malaysia, Singapore and Vietnam are also taking part in the Trans-Pacific Partnership (TPP), which includes the US but not China (see Figure 2).

Figure 2: ASEAN in the Regional Trade Architecture



15. Malaysia has taken steps to liberalise its legal services profession. Foreign law firms can now operate in Malaysia, either in partnership with a Malaysian law firm or independently as a 'Qualified Foreign Law Firm'. Malaysian law firms can also now employ foreign lawyers if they wish. Under the recently passed amendment to the Legal Profession Act, foreign lawyers advising on non-Malaysian law will be allowed to enter Malaysia for up to 60 days per calendar year, subject to immigration approval.

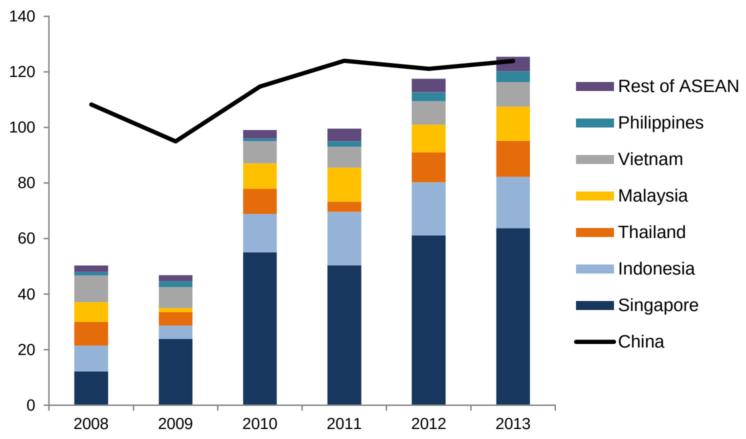
16. Philippine President Aquino signed a bill in July allowing foreign banks, whether already established in the country or not, to buy up to 100% of Philippine banks and open retail branches. Previous banking laws only allowed up to 60% foreign ownership and restricted branch operations.

17. New regulations in Indonesia require all shops to sell 80% local content. The regulations allow for exemptions on premium products and goods that cannot be produced in Indonesia, provided the retailer is able to demonstrate a plan to develop such products domestically in the future. If fully enforced, this could have a significant impact on the retail sector in Indonesia.

Business Environment and Regulatory Developments

18. According to the United Nations Conference on Trade and Development's (UNCTAD) 2014 World Investment Report, foreign direct investment (FDI) flows into ASEAN surpassed those into mainland China in 2013, for the first time. Inflows into the region rose by 7% in 2013, to $125 billion, while inflows into mainland China grew by only 2%, to $124 billion (see Figure 3). ASEAN now collectively attracts 9% of global FDI inflows, up from 4% in 2007. Singapore, ASEAN's financial hub, attracts half of the region's FDI inflows. Indonesia, Thailand and Malaysia are also significant recipients. FDI outflows from the region to other parts of the world increased by 5% last year, to $56 billion, compared to a 15% rise in outward investment from mainland China, to $101 billion.

Figure 3: FDI Inflows into ASEAN and China ($bn)



Source: UNCTAD WIR 2014

19. Burma's Ministry of Commerce is planning to abolish the ban on foreign companies engaging in trading activities. The reform is intended to help boost the country's exports, particularly in the agriculture sector. The authorities also plan to merge separate laws for foreign and domestic investment into a single piece of legislation. The bill is likely to be reviewed in the next session of parliament, with the aim of implementation by early 2015.

20. Singapore has taken further steps to enhance its intellectual property dispute settlement framework. Disputing parties will now be able to choose from a list of patent experts approved by the World Intellectual Property Organisation. The expert agreed upon by both parties will then determine the outcome of the dispute. This new route for resolving disputes offers another time and cost efficient alternative to litigation, and may be particularly beneficial for international parties settling disputes across jurisdictions. Singapore's Parliament has also approved amendments to the Singapore Copyright Act. One of the key changes gives content owners the right to directly seek High Court orders requiring Internet Service Providers (ISPs) to take down websites with infringing content. Copyright owners can now sue ISPs if they do not comply. Previously, content owners were only allowed to request ISPs to block out pirated content on a case-by-case basis.

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