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The Bank of Tokyo-Mitsubishi UFJ, Ltd.
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Outlook for 2018 ASEAN economy

【Summary】

- ◇ ASEAN economy in 2017 achieved relatively higher growth in recent years. Looking at domestic demand, private consumption remained solid based on stable price, employment and income environment. It was also supported by growth-friendly fiscal and monetary policies. Exports showed high growth mainly in exports within Asia regions and to advanced countries, had a favorable impact on domestic demand through expansion in corporate earnings and household income.
- ◇ In 2018, ASEAN-6 economy is expected to sustain stable growth, close to +5% YoY, backed by firm private consumption and increase in exports. Household income, the basis for private consumption, will not fluctuate greatly considering the current employment and wage development in each country, and inflation rate is also expected to remain stable. The ongoing growth-friendly fiscal policies will support the growth as well.
- ◇ The pace of export expansion will gradually slow down towards 2018 as the cycle of semiconductor demand passes a peak and Chinese economy slows down, however an increasing trend will be maintained on the back of expanding demand from advanced countries.
- ◇ The foreseeable risk could be the external environmental changes such as destabilization of financial markets due to US rate hikes and the increasing geopolitical risks. Though major Asian currencies overall remain stable, the risks of significant fund outflows and sharp currency depreciation will remain. It is advisable to take note of these risks as the currency depreciation often leads to an increase in inflation, makes it difficult to maintain an accommodative monetary policy, and could hinder firm private consumption and business activities.

ASEAN celebrated its 50th anniversary in August, 2017. Having overcome the Asian currency crisis and 2008 financial crisis, the population has grown to 3.5-fold and GDP to 120-fold, made a remarkable development in the last 50 years. Looking back 2017, the economy achieved relatively higher growth in recent years and its financial market remained stable supported by fund inflow from overseas owing to the improved economic fundamentals. The following looks back ASEAN economy in 2017, and outline the outlook of ASEAN economy in 2018 and risks associated with the outlook.

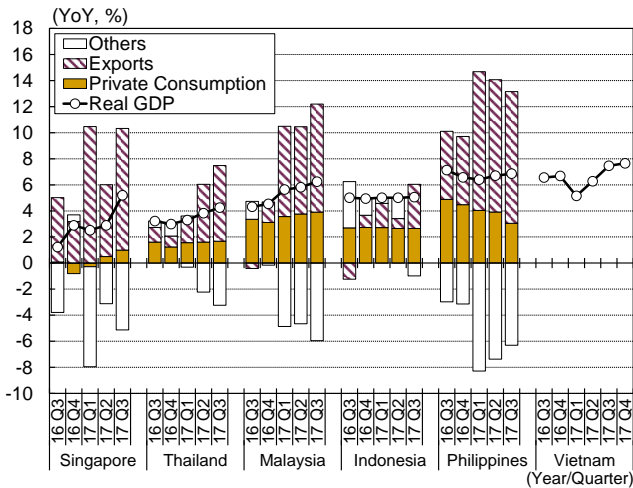
1. 2017 ASEAN economy

ASEAN economy in 2017 remained solid in general, recovering from the slowdown in 2016. Real GDP growth of ASEAN-6 economy (on the average GDP-weighted basis) was +5.0% YoY in 2017, accelerated from +4.5% YoY in 2016, posted almost same level as 2013 (+5.1% YoY). Looking at the recent real GDP growth of main ASEAN countries by expenditure, domestic demand driven by private consumption has been solid and strong exports have been boosting the growth pace (see chart 1).

Private consumption, which is based on stable price, employment and income environment and buoyed by growth-friendly fiscal and monetary policies, supported the economic growth of individual countries. Private consumption in Singapore, which has been the only main ASEAN country with weaker private consumption, recovered in the second half of 2017. Looking at the monthly economic indicators, motor vehicle sales, which is one of the major items of durable goods, kept its increasing trend in main ASEAN countries except for Vietnam where it declined due to conservative buying prior to the elimination of tariffs on imported cars within the region.

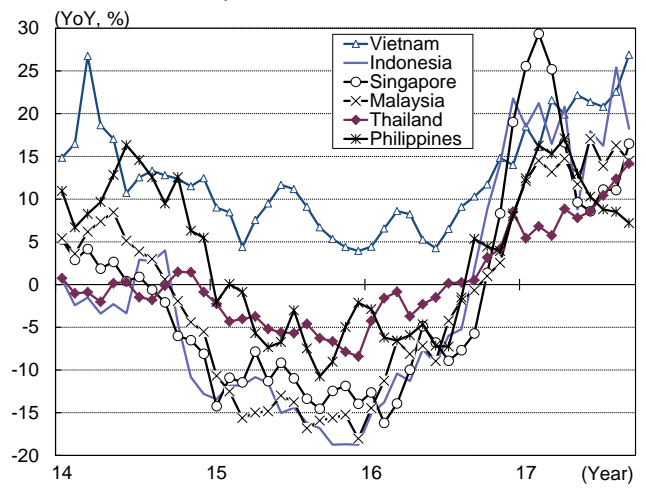
Exports have kept recovery trend since the second half of 2016 and recorded double-digit growth YoY in the first half of 2017 on the whole, although slowed down temporarily towards mid-2017, now accelerated again (see chart 2). Export expansion is boosting growth rate through an improvement in contribution of external demand to GDP and spillover effects to other expenditures. More specifically, export expansion would improve corporate earnings and support private investment as well as reinforce an increase in household income, which could lead to an expansion in private consumption, through wage increase. In fact, not only exports but also economic indicators such as Industrial Production Index and Business Sentiment Index have maintained higher growth or higher level in recent years. Private investment, which has been soft so far, is showing a sign of recovery in Malaysia partially due to favorable market conditions of semiconductors (to be described below), in Singapore where major western semiconductor chip makers have manufacturing base, booming electronics sector is boosting the overall economic growth. Acceleration of growth rate is prominent especially in export-driven economies such as Singapore, Thailand, Malaysia and Vietnam, indicating that strong exports are leading ASEAN economy.

Chart1 : Real GDP of main ASEAN countries



Note: Vietnam does not release the quarterly breakdown by expenditure
Source: Individual country statistics, BTMU Economic Research Office

Chart2 : Exports of main ASEAN countries



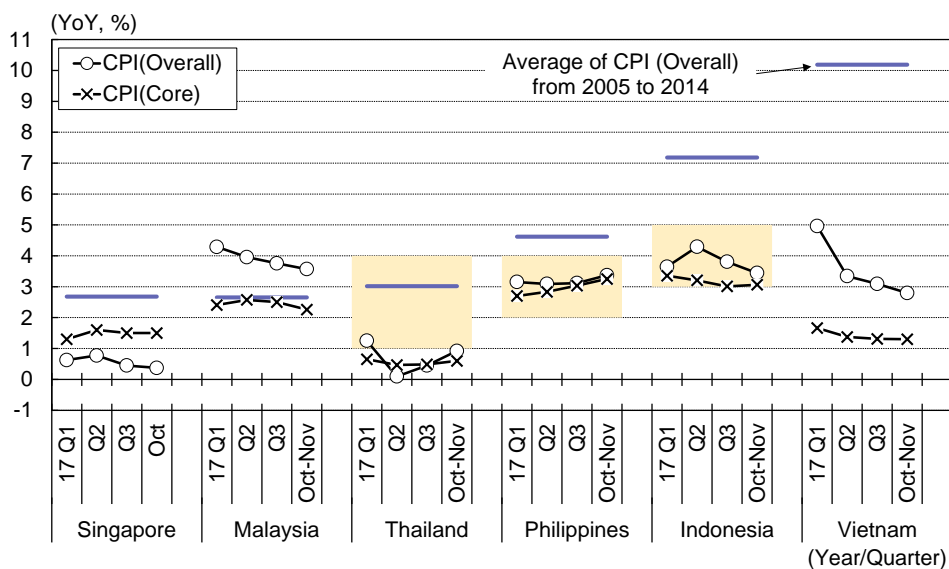
Note: Three-month moving average.
Source: Individual country statistics, BTMU Economic Research Office

2. 2018 ASEAN economy

In 2018, ASEAN-6 economy is expected to sustain stable growth, close to +5% YoY, backed by firm private consumption and increase in exports due to expanding demand from advanced countries.

Observing households' employment and income environment is one of the keys to forecast private consumption, and such environment is not expected to fluctuate greatly considering the current employment and wage developments in individual countries. Employment and wages maintain the increasing trend in main countries, although the employment adjustment is in progress with a shift from manufacturing and construction to services in Singapore. Furthermore, the inflation rates in individual countries remain lower level compared to the past and stayed within or around the central banks' targeted range (see chart 3). Price stability in addition to the continuous improvement of employment and income environment will encourage private consumption to expand steadily to support the economy.

Chart3 : Consumer Price of main ASEAN countries



Note: Shadow areas indicate the targeted inflation range
Source: Individual country statistics, BTMU Economic Research Office

The ongoing growth-friendly fiscal policies will also support domestic demand. Looking at the recent government budgets and fiscal policies of individual countries, they tend to prioritize budget allocation in areas such as lower-income sector, employment and infrastructure investment while paying attention to fiscal discipline (see table 1). The income and employment-conscious fiscal policy will boost private consumption, and expansion of infrastructure investment will, not only encourage domestic public and private investments in the short term, but also stimulate foreign capital inflow in the mid-to-long term through the improvement of business environment. Take note, however, that in order to measure the economic stimulus effect of fiscal policy, not only looking at the budget and policy, but also considering the capacity to implement the budget and its fiscal condition of individual governments is important. For example, in Indonesia, the budget implementation rates had remained 80-90% in the past and they tend to worsen in recent years. In Philippines, future success or failure of the tax reform, which serves as the key to securing funds for infrastructure investment, needs to be monitored.

Table1 : Fiscal Conditions and Policies of main ASEAN countries

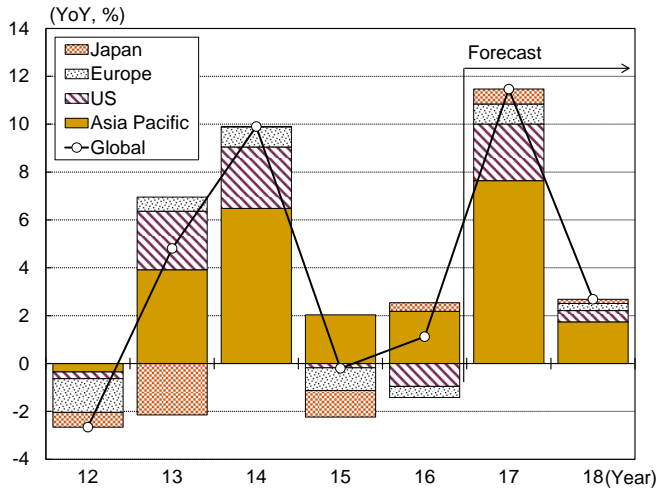
	Fiscal conditions		Recent fiscal policies	
	Fiscal balance % of GDP	Government debts		
Indonesia	-1.0	27.9	FY2018 Budget	Expenditure was increased from FY2017 mainly in areas such as <u>poverty reduction</u> and <u>infrastructure development</u> while aims to <u>reduce fiscal deficit</u> (FY2018 proposed budget was approved in Oct 2017)
Malaysia	-1.3	56.2	FY2018 Budget	Both expenditure and revenue was increased while aiming to <u>reduce fiscal deficit</u> , maintains budget distribution for <u>infrastructure</u> investments such as high-speed railway while it contains <u>income-conscious</u> measures to cut individual income tax as well as to pay extra bonus to civil servants (FY 2018 budget plan was announced in Oct 2017)
Thailand	1.0	42.2	Economic stimulus package Five-year plan	The plans in regards to support measures such as subsidiary using the fund for low-income earner (Pracharat Fund, established in May 2017), <u>infrastructure</u> investments (e.g. Eastern Economic Corridor: EEC) and industrial promotion were announced (in the first half of 2017)
Philippines	1.5	34.6	FY2017 FY2018 Budget	<u>Infrastructure</u> spending budget expanded to 5.4% of GDP in 2017 (compared to 1.8% of GDP in 2010). The government plans to expand it to 6.3% of GDP in FY 2018 and 7.3% of GDP in FY2022
Vietnam	-4.4	60.7	FY2018 Budget	Plans to <u>reduce fiscal deficit</u> , <u>lower poverty/unemployment rates</u> and increase health insured rate (approved in Nov 2017)

Note: Fiscal conditions as of 2016

Source: IMF, media reports, BTMU Economic Research Office

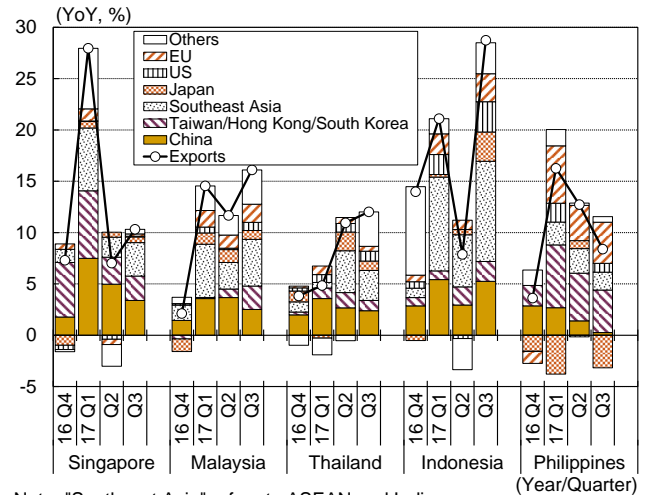
The pace of export expansion will gradually slow down in 2018 as the cycle of semiconductor demand passes a peak and Chinese economy slows down, however an increasing trend will be maintained on the back of expanding demand from advanced countries. For semiconductors, one of the leading export items, 2017 global market recorded high growth of +11.5% YoY mainly buoyed by solid growth in Asia Pacific region and the model change of main smartphones while 2018 growth will not be as high as 2017 due to inventory adjustment, according to World Semiconductor Trade Statistics (WSTS) (see chart 4). The increasing trend in export of semiconductors, however, will be sustained as demand for semiconductors as a base is expected to continue its solid expansion with factors such as progress of Internet of Things (IoT). In fact, a hearing survey of manufacturers in Penang, a major hub of semiconductor manufacturing in Southeast Asia, showed that some manufacturers have positive outlook. Looking at the breakdown by countries, the presence of China cannot be ignored as a major export destination, however a slowdown of Chinese economy in 2018 will be unavoidable while it maintains stable growth, and export to China will also decelerate (see chart 5). Meanwhile, export to advanced countries such as Japan, US and Europe accounts for around 30-50% share of total and economic expansion of such advanced countries will boost the overall exports.

Chart4 : Global Semiconductor Market



Source: World Semiconductor Trade Statistics (WSTS), BTMU Economic Research Office

Chart5 : Exports (by Destinations) of main ASEAN countries

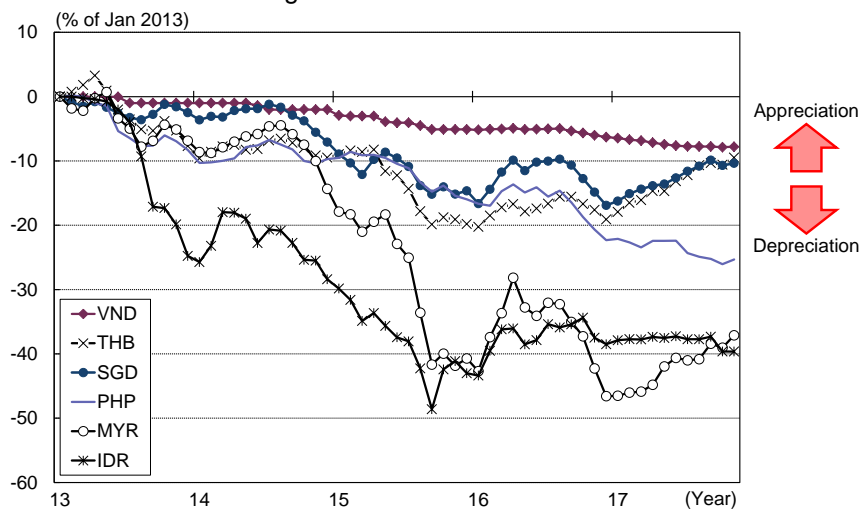


Note: "Southeast Asia" refers to ASEAN and India
Source: Individual country statistics, BTMU Economic Research Office

The foreseeable risk could be the external environmental changes such as destabilization of financial markets due to US rate hikes and the increasing geopolitical risks. Major Asian currencies overall remain stable supported by the expansion of capital inflow from overseas on the back of favorable fundamentals (see chart 6). Major rating agencies in 2017 upgraded ratings of Indonesia and Philippines. Especially Indonesia's credit rating was upgraded to investment grade by all top three rating agencies which attracted the interests mainly from institutional investors. The increasing international confidence to each country will pave the way for more capital inflows from overseas and contribute to currency stability.

However, going forward, gradual but further US rate hikes are expected and the risk of widening the interest rates gap between US and ASEAN countries could lead to significant capital outflows and sharp currency depreciation at any point in time will remain. Although inflation in individual countries remain stable, it is advisable to take note of these risks as the currency depreciation often leads to an increase in inflation, makes it difficult to maintain an accommodative monetary policy, and could hinder firm private consumption and business activities.

Chart6 : Exchange rate to USD of main ASEAN currencies



Source: Individual country statistics, BTMU Economic Research Office

【Reference】 Outlook for South east Asian Economies

	Nominal GDP (USD bn)	Real GDP growth (YoY, %)			CPI growth (YoY, %)			Current Account (USD bn)		
	2016	2016 Results	2017 Outlook	2018 Outlook	2016 Results	2017 Outlook	2018 Outlook	2016 Results	2017 Outlook	2018 Outlook
ASEAN6	2,439	4.5	5.0	4.8	2.0	2.9	3.1	102	105	102
Singapore	297	2.0	3.3	2.5	-0.5	0.8	1.4	57	62	66
Indonesia	932	5.0	5.1	5.2	3.5	3.9	4.2	-17	-17	-18
Malaysia	297	4.2	5.5	5.1	2.1	3.7	2.5	7	8	8
Thailand	407	3.2	3.6	3.5	0.2	0.7	1.4	48	48	42
Philippines	305	6.9	6.6	6.3	1.8	3.2	3.6	-1	0	0
Vietnam	201	6.2	6.7	6.4	2.7	3.9	4.2	8	5	4
India (FY basis)	2,264	7.1	6.6	7.6	4.5	3.2	4.5	-15	-33	-37

Note: Real GDP growth and CPI growth in ASEAN6 are weighted average of Nominal GDP

Source: IMF, Individual country statistics, BTMU Economic Research Office

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