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MUFG Bank, Ltd.

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Outlook for 2019 ASEAN economy

【Summary】

- ◇ ASEAN economy in 2018 maintained stable pace of expansion. Looking at domestic demand, private consumption remained firm in general on the back of an improvement in household income environment and the government's fiscal policy. Exports maintained an increasing trend albeit at slower pace.
- ◇ In 2019, ASEAN-6 economy is expected to sustain stable growth, close to +5% YoY, backed by ongoing solid domestic demand particularly in private consumption and export expansion. Household income, the basis for private consumption, will not fluctuate greatly considering the current employment and wage development in individual countries, and ongoing growth-friendly fiscal policies will support the growth as well. The pace of export expansion will gradually slow down partially due to speed adjustment of production activities in manufacturing industry on global basis, however considering that the advanced economies are projected to maintain growth at a pace in line with potential rate, slowdown in manufacturing industry will settle eventually and exports will also keep an increasing trend.
- ◇ Looking at the impact of the US imposing tariffs on Chinese imports on ASEAN economy, a decline in exports to China of parts and materials from ASEAN countries which are to be incorporated in Chinese export products to the US is anticipated in the short term. Meanwhile, in the long term, a rise in costs of Chinese products might encourage the US to switch the source of import from China to ASEAN countries, and furthermore, positive impacts such as shifting investment and production from China to ASEAN countries can also be expected.
- ◇ The foreseeable risk could be destabilization of financial markets, in addition to repercussions of negative impact associated with the escalating US-China trade conflict. While most countries in the region implemented on-and-off rate hikes, policy rates remain accommodative level in real terms in each country. However, if those countries are forced to accelerate the pace of rate hikes in case of financial market turmoil as a result of the intensifying US-China trade conflict, then attention needs to be paid to the negative impacts on domestic demand.

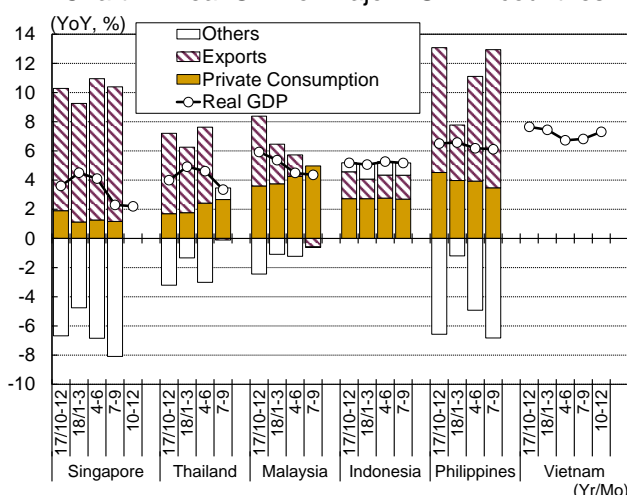
1. 2018 ASEAN economy

ASEAN economy in 2018 maintained stable pace of expansion. Real GDP growth of ASEAN-6 economy (on the average GDP-weighted basis) was +5.0% YoY in 2018. Although slightly decelerated from +5.1% YoY in 2017, the level remained similar to the average of the past decade (+5.0% YoY). Looking at the recent real GDP growth of major ASEAN countries by expenditure, domestic demand driven by private consumption remained solid and exports also maintained an increasing trend in general, boosting growth (see chart 1).

Private consumption remained firm in general on the back of an improvement in household income environment and the government's fiscal policies. In Thailand, minimum wages were raised in 2018 for the second consecutive year. Together with the government's stimulus measures to support farmers and low income earners, private consumption growth on real GDP basis in Jul-Sep last year reached to the highest level in five and a half years.

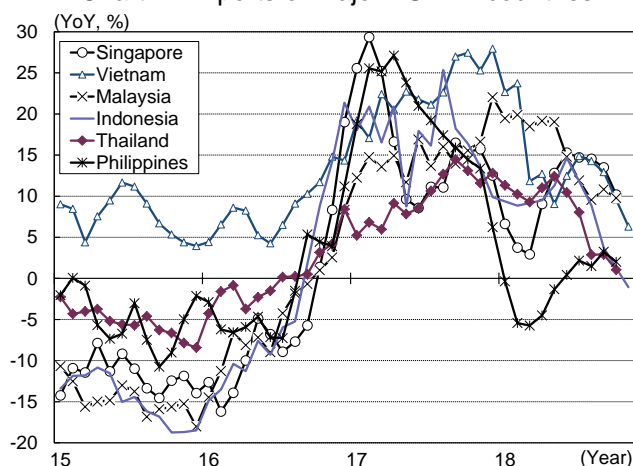
Exports maintained an increasing trend in general albeit at slower pace in 2018 after showing a double digit growth year on year in individual countries in 2017 (see chart 2). In Singapore and Malaysia, major semiconductor manufacturers have production base and exports slowed down mainly in electronic products, which showed strong growth in 2017, on the back of inventory adjustment in semiconductor industry. Meanwhile other items continued solid expansion in general.

Chart1 : Real GDP of major ASEAN countries



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

Chart2 : Exports of major ASEAN countries



Note: Three-month moving average
Source: Individual country statistics, MUFG Bank Economic Research Office

2. 2019 ASEAN economy

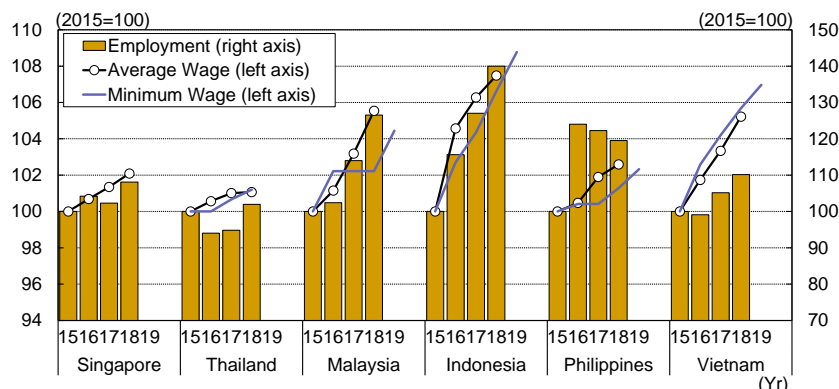
ASEAN-6 economy is expected to sustain stable growth, close to +5% YoY, on the back of solid domestic demand driven by private consumption owing to favorable employment and income environment and growth-friendly fiscal policies and still accommodative monetary policies in real terms, as well as export expansion.

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 an increasing trend in general in major countries (see chart 3). In Singapore and Thailand, the number of employment increased year on year in 2018. In Malaysia, the average wage in manufacturing sector recorded +10.2% YoY in 2018. In Indonesia and Vietnam, the minimum wage will be raised in 2019 in addition to the ongoing increase in average wage. Even in Philippines where the number of employment has been declining (see note 1), an expansion in remittance from overseas workers, who are made up of approximately 10% of

total population, (Overseas Workers Remittances account for approximately 10% of GDP), in addition to an increase in wages appears to be supporting an increase in household income. Considering such ongoing improvement in employment and income environment in individual countries, private consumption is expected to continue solid expansion and supporting the economies in the region.

(Note 1) Nevertheless, productive age population has been increasing and an increasing number of workers in informal sectors and loss of personnel to overseas on the back of a scarcity of job opportunities domestically have been pointed out as issues of the Philippine economy or social problems.

Chart3 : Employment and Average Wage of major ASEAN countries



Note: 1. Reference date of each data is based on the standard of each statistic, and not identical.
 2. Average wage in Malaysia is the one in manufacturing sector. Singapore has no minimum wage system except for some sectors.
 3. Minimum wages in Thailand, Philippines, and Vietnam refer to the ones in Bangkok metropolitan area, Manila metropolitan area, and the urban area respectively.
 Source: Individual country statistics, MUFG Bank Economic Research Office

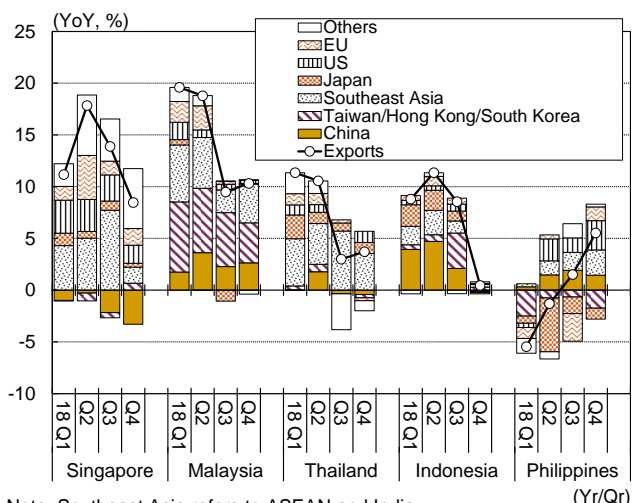
Furthermore, the ongoing growth-friendly fiscal policies will also support domestic demand. Looking at the government budgets and fiscal policies of individual countries, they tend to prioritize budget allocation in areas such as low income sector, employment and infrastructure investment while paying attention to fiscal discipline. In Indonesia, FY2019 budget focuses on social security including subsidies to the poor and rural areas and also includes a budget for disaster restoration. Looking at the recent budget implementation, it tends to accelerate particularly in subsidy area ahead of the upcoming presidential election scheduled in April. Although weak fiscal discipline is a concern, income and employment conscious fiscal policy will boost private consumption, and expansion of infrastructure investment is expected to, 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.

The pace of export expansion will gradually slow down partially due to speed adjustment of production activities in manufacturing industry on global basis, however considering that the advanced economies are projected to maintain growth at a pace in line with potential rate, slowdown in manufacturing industry will settle eventually and exports will also keep an increasing trend. China has a great presence as an export destination (approximately 10% of total exports of individual countries) and export to China slowed down or declined in some countries and items (see chart 4). However, Chinese economy in 2019 is expected to avoid downturn although deceleration of growth is inevitable (see note 2), and export to advanced countries such as Japan, US and Europe accounts for around 30-50% share of total export of individual countries, which is larger than the share of export to China, and economic expansion of such advanced countries will boost the overall exports. For semiconductors, one of the leading export items, global market growth recorded +15.9% YoY in 2018, showing a double digit growth for the second consecutive year according to World Semiconductor Trade Statistics (WSTS). However, WSTS said in its statement that 2019 global market growth is

projected to slow down to +2.6% YoY, not as high as 2018, as “there are many uncertainties in global economy such as the US-China trade conflict”. An 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).

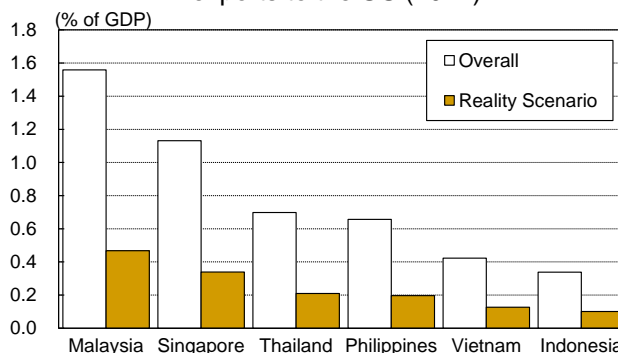
(Note 2) For Chinese economy outlook, please also refer to “The Outlook for Asian & Australian Economies (November 2018)”.

Chart4 : Exports in major ASEAN countries



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

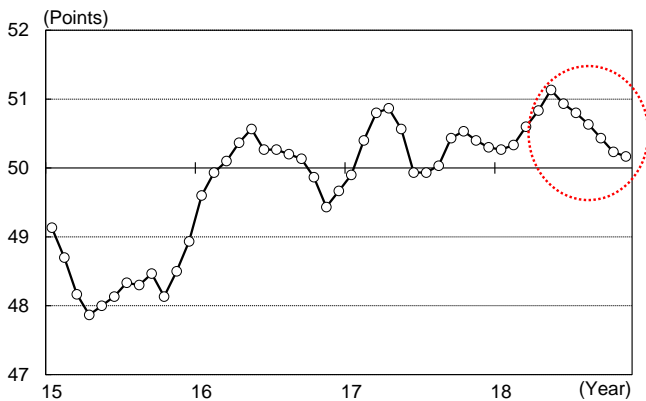
Chart5: The estimated amount of value-added from major ASEAN countries that are included in China's exports to the US (2017)



Note: 1. On the assumption that value-added ratio of China's exports to the US remains unchanged since 2011, estimated each country's amount of value-added of China's exports to the US and calculated its GDP ratio.
2. "Reality scenario" indicates the impact in case China's exports to the US will decrease 30%.
Source: OECD, the US Commerce Department, MUFG Bank Economic Research Office

Looking at the impact of the US imposing tariffs on Chinese imports on ASEAN economy, a decline in exports to China of parts and materials from ASEAN countries which are to be incorporated in Chinese export products to the US is anticipated in the short term. Looking at value added from Asia that is included in Chinese export to the US, the rate is 1-2% of Nominal GDP respectively in Malaysia and Singapore, relatively high in ASEAN countries which means those countries are more likely to be negatively impacted (see chart 5). The recent manufacturing sentiment in the region, which has been softening particularly in export orders when looking by items and in export-driven countries when looking by countries, will bear watching including indirect negative impacts such as postponing investment and hiring (see chart 6).

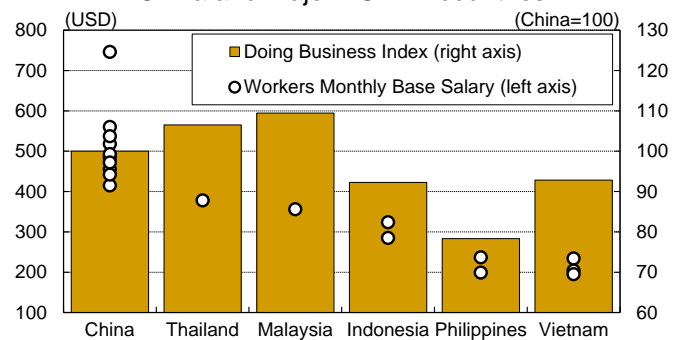
Chart6 : Manufacturing PMI in major ASEAN countries



Note: 1. Purchasing Manager Index (PMI) survey is based on questionnaire responses from purchasing managers in areas such as new orders, production, prices, and employment. A PMI above 50 represents an economic expansion and a PMI reading under 50 represents a contraction.

Source: Markit, MUFG Bank Economic Research Office

Chart7 : Base Salary and Business Environment in China and major ASEAN countries



Note: 1. "Workers Monthly Base Salary (Factory Workers)" is a comparative survey of investment-related costs in major global cities conducted by JETRO with Japanese companies in the period between November 2017 and January 2018.
 2. The World Bank's "Doing Business Index" ranks 190 countries and regions on the ease of doing business in 10 areas such as "Getting electricity", "Dealing with construction permits" and "Resolving insolvency".

Source: JETRO, World Bank, MUFG Bank Economic Research Office

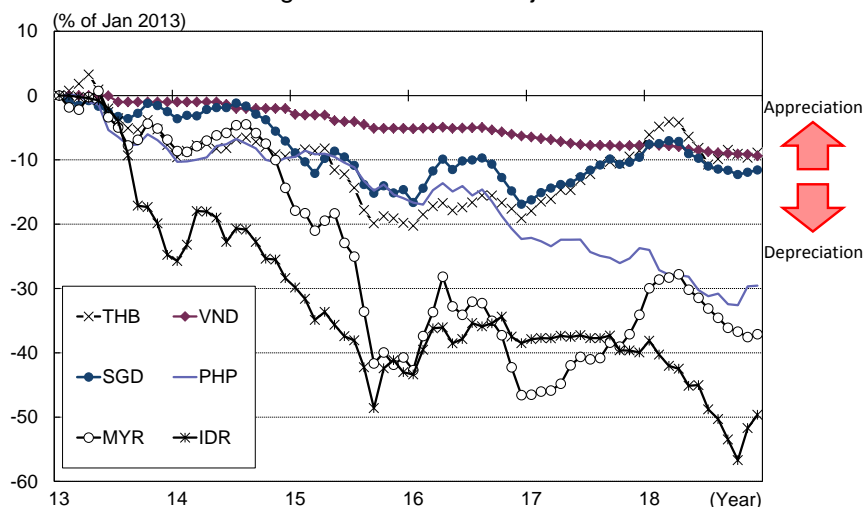
Meanwhile, in the long term, a rise in costs of Chinese products might encourage the US to switch the source of import from China to other Asian countries including ASEAN, and positive impacts such as shifting investment and production from China to ASEAN countries can also be expected. According to Asian Development Bank (ADB) estimate, in case the US-China trade conflict escalates and both countries impose blanket tariffs of 25% on all merchandise imports from the other country, GDP of Asian economies excluding China will be boosted by 0.22% in total as (1) disadvantage from a decline in demand associated with higher import prices of items that are subject to tariffs and a decline in production and exports to China through supply chains (direct and indirect effects) will be outweighed by (2) advantage from import substitution by third countries (trade redirection effect) (see note 3). Comparing workers monthly base salary (factory worker) in individual countries, monthly base salary in major ASEAN countries are lower than ones in major cities in China (see chart 7). Furthermore, according to the World Bank, business environment in major ASEAN countries has been improving owing to various reforms promoted by governments. In the World Bank's Doing Business Index, ASEAN countries in general have higher scores than China especially in areas such as "Dealing with Construction Permits", "Getting Credit", "Paying Taxes" and "Resolving Insolvency". It is likely that companies will accelerate shifting investment and production base to other emerging economies including ASEAN due to business challenges such as an increase in manufacturing cost in China, which has been an issue for some time, and escalating uncertainties associated with the US-China trade conflict.

(Note 3) ADB stresses that it might take more than a year for the estimate to realize.

The foreseeable risk could be destabilization of financial markets, in addition to repercussions of negative impact associated with the escalating US-China trade conflict. In major Asian currencies, a fall in the currencies of Indonesia, Philippines and India is significant amid growing downward pressure to the currencies of emerging countries as a result of intensifying US-China trade conflict and higher US interest rates. The governments and authorities in the region introduced measures to curb trade deficits such as a biofuel mandate to promote the use of fuel blended with domestic palm biodiesel (Indonesia) and also implemented on-and-off rate hikes. While policy rates remain accommodative level in real terms in these countries, if they are forced to accelerate the pace of rate hikes in case of financial market turmoil as a

result of the intensifying US-China trade conflict, then attention needs to be paid to the negative impacts on domestic demand (see chart 8).

Chart8 : Exchange rate to USD of major ASEAN currencies



Source: Individual country statistics, MUFG Bank Economic Research Office

【Reference】 Outlook for ASEAN-6 economies

	Nominal GDP (USD bn)	Real GDP growth (YoY, %)			CPI growth (YoY, %)		
	2017	2017 Results	2018 Outlook	2019 Outlook	2017 Results	2018 Outlook	2019 Outlook
ASEAN6	2,641	5.1	5.0	4.8	2.7	2.5	2.9
Indonesia	1,015	5.1	5.2	5.1	3.8	3.2	3.6
Thailand	455	3.9	4.1	3.8	0.7	1.1	1.5
Singapore	324	3.6	3.3	2.6	0.6	0.5	1.3
Philippines	314	6.7	6.2	6.1	2.9	5.2	4.5
Malaysia	312	5.9	4.8	4.7	3.8	1.3	2.1
Vietnam	220	6.8	7.1	6.5	3.5	3.5	4.1

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

Source: IMF, Individual country statistics, MUFG Bank Economic Research Office

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