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This report summarises the current business environment analysis and short-term forecasts of country directors running executive briefing programs across Asia. The Asia Pacific Executive Brief is owned and produced by International Market Assessment Asia Pty Ltd (IMA Asia).

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Global outlook

Trimming the 2016 forecast

… as financial volatility hurts weak countries and industries

The first 15 days of 2016 saw global equities fall 9%, led by an 18% plunge in Shanghai, while Brent oil closed at US$29 a barrel after a rapid slide from $39 a month earlier. Both unexpected developments disconcerted global investors, leading to a string of bearish forecasts (oil at $20 and a global stock market correction of 20%). Along with a string of weak data from the US, Europe, and China, and the IMF cutting its 2016 global growth forecast to 3.4% from 3.6%, the 2016 outlook has dimmed. The question is whether companies should simply trim their own 2016 forecasts or prepare for a major downturn. For most companies the answer will be to follow the IMF in trimming the 2016 forecast. However, this is a lopsided slowdown, with some countries (the more fragile of the emerging markets) and some sectors (commodities, heavy industry, and shipping) being hit harder. 2016 will show which countries and sectors have strong or weak fundamentals, and which are least or most exposed to "risk-off" in global financial markets.

US growth capped at 2.5%

… as factories struggle

… & consumers save more

We've trimmed our US forecast to 2.5% for this year and 2017 from 2.7% and 2.8% previously. The biggest loss in momentum has been in manufacturing, with 2015 growth down at 1.3% from 3.7% in 2014, mostly because exports fell 4% for the year to November due to weak overseas demand and a 16% rise for the US$ on its trade weighted index (it rose by the same amount on the Euro). We expect the US$ rise to slow to around 5% this year, with exports returning to about 2% growth and industrial production growth of 2-3%. The main plus in the US remains the consumer sector (68% of GDP) with estimated real growth of 2.8% in 2015 easing to about 2.5% for the next two years. Consumer optimism is strong in January surveys, with a favourable sentiment on labour demand and wage growth. However, households lifted their savings rate in 2015 and that trend looks set to continue through 2016 and 2017, putting a cap on spending growth. Fixed investment will take a hit from big cuts to the fracking sector, but public spending on infrastructure should lift. There should be enough momentum to justify at least one Fed rate hike in 2016.

A weak but broad Euro area recovery

The IMF nudged its Euro area forecast up to 1.7% in 2016 (from 1.6% forecast last October) but left 2017 at 1.7%. At our Q4'15 forecasting session we reviewed a broad cyclical upturn underway in the Euro area and, although it is weak, it remains on track. Markit's December PMI for manufacturing rose to 53.2, with all countries (including Greece) expanding for the first time since April 2014. Bank loan growth has gradually accelerated since returning to year-on-year growth last March, and unemployment is falling (10.5% in Nov'15 from 11.5% in Nov'14).

EM shakeout

… most EM outside of Asia will struggle

The biggest change in the outlook is for emerging markets (EM) as they struggle with weak commodity prices and capital outflows. The IMF has slashed its forecasts for the Russian-led CIS to zero growth this year and 1.7% next year, while Latin America is now forecast to contract by 0.3% this year before returning to 1.6% growth next year. Sub-Saharan Africa and MENA also had their growth rates cut. By contrast, the IMF left its forecasts unchanged for China (6.3% in 2016 and 6% in 2017) and India (7.5% both years).

The risks and opportunities to manage

The big risks to manage stem mostly from volatile financial flows in 2016 and the hidden linkages or exposures that can emerge. 2015 showed that the high risk areas are where commodity dependence and debt (particularly hard currency) intersect. Asia diverges from other EM regions as the risk can be high at a company level while lower at a country level, and that is expected to opens up interesting acquisition opportunities in 2016.

IMA Asia's forecasts	2013	2014	2015	2016	2017
World – Real GDP growth, %	3.3	3.4	3.1	3.4	3.6
- US	1.5	2.4	2.3	2.5	2.5
- Euro area	-0.3	0.9	1.5	1.7	1.7
- Asia/Pacific (14)	4.5	4.3	4.3	4.4	4.1
- NICs (4)	2.7	3.4	2.2	2.2	2.6
- Developing or "EM" Asia (7)	7.0	6.8	6.6	6.2	5.9
- ASEAN (6)	5.0	4.4	4.3	4.5	4.9
World goods & services trade volume, % growth	3.5	3.3	2.6	3.4	4.1
Interest rates, US Fed target rate, year end, %	0.10	0.10	0.25	0.50	1.00
Inflation, CPI, US, year avg., %	1.5	1.6	0.1	1.2	2.0
Inflation, CPI, Euro area, %	1.3	0.4	0.1	1.0	1.2
Crude oil, avg of 3 spot crudes, US$	105	103	50	40	50
US$ / Euro 1, year average rate	1.33	1.33	1.11	1.05	1.02
Yen / US$1, year average rate	98	106	121	117	114

The Asia/Pacific 14 = the countries on the forecast summary page. NICs are the newly industrialised countries = Korea, Taiwan, HK, Singapore. The ASEAN 6 = Indonesia, Thailand, Malaysia, Philippines, Vietnam, + Singapore. Dev Asia = ASEAN 5 + China and India. IMA Asia forecasts.

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Regional outlook

Summary of forecasts in this month's Asia Brief

GDP (Expenditure), real growth, %	2013	2014	2015	2016	2017
Japan	1.4	0.0	0.6	1.2	0.1
China	7.7	7.3	6.9	6.2	5.7
Hong Kong	3.1	2.5	2.3	2.3	2.4
Taiwan	2.2	3.9	1.1	1.8	2.7
South Korea	2.9	3.3	2.6	2.4	2.7
Indonesia	5.6	5.0	4.7	5.2	6.0
Malaysia	4.7	6.0	4.9	3.4	3.4
Philippines	7.1	6.1	5.8	6.3	5.8
Singapore	4.4	2.9	2.1	1.9	2.8
Thailand	2.8	0.9	2.7	3.4	3.6
Vietnam	5.4	6.0	6.7	6.4	6.3
India (CY)	6.4	7.1	7.2	7.3	7.0
Australia	2.0	2.6	2.2	1.9	2.2
New Zealand	1.7	3.0	3.2	3.2	2.5

Inflation, CPI year average, %	2013	2014	2015	2016	2017
Japan	0.3	2.8	0.8	0.7	1.7
China	2.6	2.0	1.4	1.0	1.0
Hong Kong (composite CPI)	4.4	4.4	2.9	1.4	1.5
Taiwan	0.8	1.2	-0.3	0.4	0.8
South Korea	1.3	1.3	0.7	0.9	1.0
Indonesia	6.4	6.4	6.4	4.1	5.0
Malaysia	2.1	3.2	2.1	1.6	1.9
Philippines	3.0	4.1	1.4	1.6	2.6
Singapore	2.4	1.0	-0.5	-0.2	0.6
Thailand	2.2	1.9	-0.9	0.1	1.3
Vietnam	6.6	4.1	0.6	1.0	1.9
India (CY CPI urban non-manual workers)	10.1	6.7	4.9	5.5	5.5
Australia	2.4	2.5	1.4	1.5	1.8
New Zealand	1.1	1.2	0.6	1.9	2.0

Exchange rate to US$1, year avg.	2013	2014	2015	2016	2017
Japan	98	106	121	117	114
China	6.20	6.14	6.23	6.56	6.84
Hong Kong	7.76	7.75	7.75	7.81	7.81
Taiwan	29.8	30.4	31.9	33.5	32.9
South Korea	1,095	1,052	1,133	1,199	1,195
Indonesia	10,460	11,868	13,389	14,400	15,158
Malaysia	3.15	3.27	3.90	4.43	4.47
Philippines	42.4	44.4	45.5	48.1	48.4
Singapore	1.25	1.27	1.37	1.46	1.48
Thailand	30.7	32.5	34.2	37.3	39.3
Vietnam	20,933	21,148	21,677	22,775	23,528
India (FY)	58.5	61.0	64.1	69.3	70.7
Australia	1.03	1.11	1.33	1.47	1.45
New Zealand	1.22	1.20	1.41	1.51	1.52

Sources: CEIC, central banks, and national statistics offices. Forecasts are by IMA Asia.

Regional outlook

Political & policy issues to watch

China risk rises

… no crisis yet

… but watch out for more volatility

China's financial gyrations in January did little damage to its economy, but they did signal that Beijing is struggling to deliver a transition to a market economy. At the heart of any market economy are efficient systems for setting exchange values and for moving capital from savers to investors. Beijing hasn't achieved that for its stock and foreign exchange markets or, for that matter, in banking. In January, it was clear for the first time that this can roil global markets while also putting Beijing on a collision course with millions of investors in China's rising middle class. Moreover, it also makes it more difficult for Beijing to defuse China's biggest risk – a rapid surge in debt from 180% of GDP to 260%. Beijing has enough money and old-style control to avoid a crisis for several years, but that also means a steady rise in financial volatility and weaker long-term growth for China.

Greater China risk also edges up

The DPP's landside wins in Taiwan's presidential and legislative races in January may be disconcerting for Beijing, but we don't expect Ms Tsai Ing-wen's administration, which takes office in May, to damage ties with China. The bigger risk is that policy-making stalls until her inexperienced administration finds its feet. That is already happening in Hong Kong, where the administration seems incapable of finding an acceptable middle ground between an increasingly autocratic Beijing and a restive HK population.

Watch Malaysia & Australia for cuts to govt spending

Malaysia and Australia have the highest dependence on resources to fund budgets among our 14 countries. The introduction of a goods & services tax (GST) at 6% last April has helped Malaysia, and Australia is debating a lift in its GST rate to 15% from 10%. While neither faces a crisis, both governments will also have to trim their spending in 2016.

Risk hinders deals in Malaysia & Thailand

Political risk remains high in Thailand and Malaysia, as autocratic governments in both countries deter investors and raise questions about participating in big projects. Chinese firms are advancing quickly in both markets in line with Beijing's geopolitical goals. Yet the political risk on such projects is quite high.

Outlook for the market

There's no lift to growth in 2016

… as China slows

… and ASEAN struggles

Our Asia Pacific forecast for 2016 has been cut to 4.4% from 4.6%, which leaves it little different from our estimate of 4.3% for 2015. If there is a difference between the two years it is that the downturn that emerged in the final quarter of 2015, which looks set to carry into 1H'16, should ease in 2H'16. Most of the cut in the region's 2016 growth is due to China's forecast being trimmed to 6.2% from 6.4% last month, with similar sized cuts in the neighbouring markets of HK and Taiwan. By contrast, we've lifted Korea's 2016 forecast to 2.4% from 2.1% last month, as it is proving more resilient in the face of weak global demand than we expected. In Southeast Asia, the main cuts are to Indonesia (to 5.2% from 5.5%) and notably to Malaysia (to 3.4% from 4.2%) as the latter struggles with plunging oil prices and political risk. The ANZ and India forecasts are mostly unchanged.

Nor is there a rebound in 2017

While we expect mildly better growth in 2H'16, we don't see that leading into a region-wide rebound in 2017. Again the primary culprit is China, where we expect growth to drop to 5.8% in 2017 as it confronts domestic challenges. By contrast, nearby markets should get a weak lift on slightly better global growth, while growth for the ASEAN-6 rises to 4.9% from 4.4% in 2016 led by recoveries in Singapore and Indonesia.

But growth stays close to 6% for EM Asia

Despite five straight years of weak global growth, Asia's emerging markets (EM) will hold onto 6.2% growth in 2016 and 5.9% in 2017. Most of that will come from consumers, with China, India, Vietnam and the Philippines all holding onto 6%+ real growth in consumer spending. By contrast, Asia's exports plunged 10% in 2015 (on a US$ basis), putting last year close to the "tech-wreck" drop of 11% in 2001 but not as bad as the 19% fall in 2009. We expect export growth to recover to 1-2% this year and 4-6% in 2017.

While forex risk is mostly contained

In part, EM Asia's better growth reflects lower risk, particularly at a time when capital outflows threaten emerging markets. Sudden falls in foreign exchange reserves can signal trouble. China's 13%yoy fall to US$3.3tr by December stands out. So too does an 18% fall for Malaysia (to $95bn) and a 17% fall for Vietnam (to $31bn). Elsewhere, the position at December is better, with Indonesia down just 5%yoy ($106bn), Thailand flat ($157bn), and India and the Philippines both up 1%yoy (to $350bn and $81bn respectively).

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Japan

Political & policy issues to watch

PM Abe's 2016 policy goals

… inducing big firms to spend their profits on pay rises & capex

… opening up agriculture

PM Abe has two central economic goals in 2016: to encourage large firms to convert record profits and cash holdings into spending on higher wages and domestic investment; and to oversee mild deregulation in agriculture. To get companies to spend more, he has pulled forward a cut in the corporate tax to just under 30% from April 1. Large firms are sitting on record profits and cash piles, and it would help if they lifted their spending. Yet there's little sign of it happening outside of a mini-boom in commercial property in Tokyo. Meanwhile, Abe's deregulation effort will focus on passing bills for the Trans Pacific Partnership (TPP) trade deal. While the opposition DPJ will criticise cuts to protection for farm products under the TPP (for rice, wheat, beef and pork, sugar, and dairy products), we doubt it will get traction, as it championed the trade pact when it was in government. Moreover, with quite a few senior DPJ leaders retiring at this summer's upper house elections, Abe's LDP-led government is under little political pressure, and may even gain an upper house majority in its own right. The prospect of that will help keep New Komeito, its main coalition partner, in line on reform bills.

Abe's "3 new arrows" aim at the demographic challenge

Bills for a small extra-budget for the last few months of the fiscal year (to March) should be approved in January. Some of the extra US$30bn in spending will go to help farmers cope with reduced protection under the TPP. Some money will also go to Abe's new 3-arrow program, which was announced in late 2015 (a call to lift the fertility rate to 1.8%, encouraging women to return to or join the workforce, and funds for elderly care so that workers don't have to retire to look after older family members).

Outlook for the market

Stuck with 0.5% trend growth

… as the population falls

There's little sign of Japan being pushed away from trend growth of 0.5%, either into stronger growth or a recession. The main 2016 event is likely to be a rise in household and corporate spending on investment goods (including housing and cars) in the final months of the year in order to beat a lift in the sales tax to 10% from 8% on April 1, 2017. That simply pulls some of 2017's demand into 2016, so growth in 2017 will slump (a similar pattern occurred when the sales tax rose from 5% in April 2014). Companies should watch to see if Abe cancels or postpones the 2017 sales tax hike.

… that's good compared to others

There's little prospect that Japan can lift trend growth much above 0.5% as the working age population (15-64) is falling at about 1.5% a year. When growth in GDP/working age population is benchmarked against Germany, the UK, France, the US, and Italy, Japan leads for 2000-2010 (at 1.5% pa) and widened its lead for 2010-15 (growing at 2%pa).

Demographic trends drive spending

… alongside sales tax hikes

In such a market it's critical to follow demographic-driven trends as much as sales tax hikes. Households are much older and smaller (many just 1 person), and more women are working (the female labour force participation rate has jumped from 71% in 2011 to 73% at the end of 2015). Such factors help account for a dramatic realignment in retail sales channels, with convenience store sales up 66% from 2000 while department store sales have fallen 31%, chain stores are down 20%, and supermarkets are up just 6%. We expect real growth in consumer demand of about 1.4% this year after an estimated 0.6% growth in 2015 with the pace falling back to about zero for 2017.

Industry gets a small boost from local demand in 2016

Industrial production likely fell 0.8% in 2015. That will be followed by a 1.3% rise in 2016 (as local demand for investment goods jumps at year end) and a fall of about 1% in 2017. We don't expect much of a recovery in exports. The December quarter Tankan survey suggested companies would lift their fixed investment by 10.8% in the FY that ends this March. Yet core machinery orders, which soften in November, suggest that companies are holding back on capex as global markets become uncertain.

The Yen swings to a rising trend on global risk-off

With little sign of inflation moving out of a 0-1% band, the BOJ will continue its quantitative easing program into 2017. While that should put downward pressure on the Yen, the local currency is currently rising due to its safe haven status and a big fall in the trade deficit (as imported energy prices have plunged). That dynamic could continue into 2017.

	2013	2014	2015	2016	2017
GDP, real growth (2005p), %	1.4	0.0	0.6	1.2	0.1
CPI, year average, %	0.3	2.8	0.8	0.7	1.7
Overnight call rate, year end, %	0.07	0.07	0.01	0.01	0.01
Yen to US$1, year average	98	106	121	117	114

Sources: 2012-2014 data from the BOJ and government sources; 2015-2016 estimates by IMA Asia

China

Political & policy issues to watch

It's time to let regulators talk to financial markets

Despite a brief financial crisis in January, there is little sign of disruption to the leadership of President Xi Jinping or to the position of top officials running the economy, the central bank, and financial markets. There is a problem, however, with the lack of communication from such officials, and that shook local investors and global financial markets in January, as it hinted that Beijing had either lost control of the economy or had an unworkable plan. While no communist party likes open commentary by top economic officials, China will have to allow that in 2016 or put at risk its plans for establishing a market economy.

Sub-7% growth won't trigger extra stimulus

… major reforms will roll on, but none will boost growth soon

Prior to the last two quarters, growth had dropped below 7%yoy only twice in the last 20 years, and both times it triggered a major response. In the late 1990s, Beijing unleashed a wave of restructuring that saw some 60,000 firms closed and 40m people let go. Alongside reforms that included WTO entry that set the stage for eight years of 10%+ growth. When growth plunged again in late 2008, Beijing unleashed a Yuan 4tr stimulus, triggering a quick rebound to 10% growth, which helped pull the world out of a slump. Despite the last two quarters of sub-7% growth, there's no hint of Beijing repeating either tactic. Beijing is, however, continuing with big reforms ranging from local government financing to cleaning up shadow banking. While these reforms won't boost short-term growth, they should gradually lower risk and contribute to economic rebalancing.

Purging debt & closing factories has to accelerate in 2016

The January stock and forex market falls are a warning that Beijing shouldn't stall on tackling the bad loans created by a surge in debt from 160% of GDP to 260%. Most bad loans are to state owned enterprise (SOEs), yet SOE restructuring so far has been piecemeal and unconvincing. 2015 also finished with little sign that banks are willing to cut back on the strong loan growth (15%yoy at December) that created the problem.

Outlook for the market

Behind 6.9% growth in 2015

… lie big problems for industry

Real growth fell to a 25-year low of 6.9% in 2015, with industry up 5.9%, construction up 6.8%, and services leading with 8.3% growth. But on the current price measure, industry's growth plunged to just 0.4% from 5% in 2014. That points to collapsing prices and chronic excess capacity, and as China's factory sector is the biggest in the world, that has global implications. Alongside that realisation has come broad acceptance that real growth for the whole economy will continue trending down over the rest of this decade. That still leaves China adding more current US$ GDP to its economy each year (about US$1tr) than the US does (about US$800bn), unless its currency collapses.

2016 starts with strong consumer demand

… with a mild slowdown ahead

The latest surveys suggest that while consumers see a weaker economy, most remain optimistic and are willing to spend. That helped car sales rebound to 17.6%yoy growth in November and 15.4%yoy in December after the tax was halved for cars with engines of 1.6 litres or smaller in October. Q1'16 car sales should be strong, but what happens after that will depend as much on consumer sentiment as the tax cut, which runs to end-2016. Unemployment has to go up (ignore China's fictitious measures), wage growth has to slow, and asset prices face an uncertain future. Despite these challenges, we still expect real consumer demand growth of 6.5% for 2016 and 6% for 2017 from an estimated 7.2% for 2015, which leaves China as the world's strongest consumer market in 2016.

Manufacturing & construction will slow

Slower real growth is expected for the industrial sector (5% in 2016 and 4.5% in 2017 from 5.9% in 2015) and for construction (6% and 5% from 6.8% last year). Big prices falls will cap current growth for industry at 1%pa and at 2-3%pa for construction to 2017.

Little inflation

… with a 4-5% annual Yuan fall

Rising prices for food (up 2.3%) and services (up 2%) kept CPI inflation at 1.4% last year. With growth slowing, the CPI rate will drop to 1% or less for the next few years. That leaves room for 50-100 basis points in rate cuts. To maintain liquidity, the PBOC will likely use new monetary tools and limit cuts to the bank reserve requirement ratio, as that can put the Yuan under pressure. Forex reserves fell 13%yoy to US$3.3tr at December. Some of the capital outflow will have been local firms opting for early retirement of US$ debt. We expect a 4-5% Yuan fall on the US$ in 2016 and in 2017.

	2013	2014	2015	2016	2017
GDP, real growth, %	7.7	7.3	6.9	6.2	5.7
CPI, year average, %	2.6	2.0	1.4	1.0	1.0
PBOC 1-year loan, at Dec., %	6.00	5.60	4.35	3.85	3.35
Yuan to US$1, year average	6.20	6.14	6.23	6.56	6.84

Sources: 2012-14 data from CEIC and government agencies; 2015-16 forecasts by IMA Asia

Hong Kong

Political & policy issues to watch

Leung giving up on moderator role

… Address focus: pleasing Beijing?

Chief Executive CY Leung appears to be facing growing challenges in acting as a moderator between his bosses in Beijing and the HK people. In the CE's policy address in this month, he made scant mention of HKers chief concerns: recent political strife, housing problems and growing income gaps. Instead, he made 48 references to how HK can benefit from Beijing's 'Belt & Road' plan. Leung's apparent Beijing bias has enraged pro-Democracy members of the Legislative Council (LegCo), who are continuing their filibustering. This has delayed many key bills, including copyright and bankruptcy laws. The pro-Democrat vote in the September LegCo elections, including younger candidates associated with last year's Occupy movement, also may get a boost.

HK's small economy leaves it exposed

The IMF's HK Article IV report this month expressed concern with aspects of the SAR's close financial and tourism links to China. These connections are slowing short-term growth, but could boost HK in the longer-term if the mainland undergoes reforms. HK's open economy also leaves it exposed to a slowdown in nearby developing countries. High residential prices remain vulnerable, but a housing shortage makes it hard to predict when the bubble ends.

Macau suffering from HK problems

Macau is also suffering from China's slowdown. In 2015, Chinese tourists fell by 4%, and those who did arrive were more cautious, lowering retail sales receipts by 9% and gaming revenues by 34%. China weakness will likely continue to impact Macau this year.

Outlook for the market

HK also has a 'new normal'

HK, like the mainland, needs to adjust to a new normal of slower growth. The mainland slowdown, rapid population aging, and increased competition from Chinese cities means that GDP growth has slowed from 4%cagr over 1990-2010 to around 2-3%cagr in the mid-2010s. Weak consumer demand, business uncertainty and a lull in public construction will likely keep GDP expansion in the bottom half of this band to 2017. The IMF roughly agrees, forecasting 2.5% growth this year.

Construction in 2016 a bit softer

… to firm in 2017

Construction investment growth will likely ease from 4.0% in 2015 to 2.3% in 2016. Housing will be the stand-out sub-sector. A residential shortage and Leung's housing land plan lifted approvals by 36%ytd to Q3'15, which will support activity in 2016. Commercial construction will slow as some big retailers are looking to decrease their number of stores. LegCo filibustering is holding up funding for the HK-Macau bridge and high-speed rail projects, which will limit public construction. Increased house building is expected to boost construction investment growth to 4% in 2017.

Crucial trade sector under pressure

… weakness to continue

Trade is critical to the HK economy, with 13% of jobs in the trade & wholesale warehousing sector. These employees had a tough 2H'15, with exports down 4%yoy from a flat 1H'15. Key markets, China (-4%yoy), US (-4%yoy) and the EU (-2%yoy) all fell. Weak China demand will likely cut exports by 2%yoy for 1H'16. A gradual recovery is expected to boost growth to 2-3%yoy in 2H'16 and 4-5% in 2017.

Two-tiered retail

HK's retail sector is two-tiered. The domestic tier is lacklustre, with falling consumer sentiment leading to reduced growth for sales of food (5%yoy in the first five months of 2H'15 from 8%yoy in 1H'15) and household goods (-2%yoy from -1%yoy). The tourist sector is even worse; protests and the weak Chinese economy caused mainland tourist numbers to fall year-on-year in July-Nov 2015. This helped slow electronic sales growth to 5%yoy from 14%yoy, and pushed jewellery sales to a 14-15%yoy fall. Both tiers face a weak 1H'16 before demand improves later in the year.

Low inflation, HK$ link to stay

Weak consumer demand will keep inflation below 2%pa throughout 2016 and 2017. The HK monetary authorities will maintain the HK$-US$ link for the forecast period, despite recent pressure on the downside.

	2013	2014	2015	2016	2017
GDP, real growth, %	3.1	2.5	2.3	2.3	2.4
Composite CPI (04/05), year average, %	4.4	4.4	2.9	1.4	1.5
Discount window base rate, % year end	0.50	0.50	0.75	1.00	1.50
HK$ to US$1, year average	7.76	7.75	7.75	7.75	7.75

Sources: 2012-2014 from Censtat, HKMA, and CEIC; 2015-2016 estimates by IMA Asia.

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Taiwan

Political & policy issues to watch

A major political realignment

… as a DPP administration takes over in May

January's elections have brought a major political realignment in Taiwan, with a landside win for the opposition DPP in the presidential race and, for the first time, in the legislative race. A new government led by Ms. Tsai Ying-wen will take office in May. While relations with China defined the elections, her immediate challenges lie in domestic politics. First, her party has little experience in ruling, and the outgoing KMT government is bound to make it difficult for her inexperienced administration to take over the reins of government. Second, Taiwan's legislature is notoriously volatile, and that leaves to door open for rebels in her own party, as well as the KMT, to disrupt government.

Ties with China will cool

Relations with China are set to cool when Tsai's administration takes office. In part, this reflects factions within the DPP that want independence. While Tsai is expected to downplay such demands, she has also committed to introducing a bill that would give the legislature the right to supervise all cross-strait trade agreements. That is bound to slow if not stall any further progress.

A new energy plan is needed soon

The DPP's anti-nuclear policy stance will likely mean that Taiwan will permanently scrap its 98%-built fourth nuclear plant. With some reactors in the three older nuclear plants due to shutdown for operational reasons, the island faces an electricity shortage in the next few years. Tsai will need to come up with a new energy plan quickly so that more gas-powered electricity plants can be built in time to prevent a shortage that could damage the island's export manufacturing sector.

Outlook for the market

Waiting for global demand to lift

With exports accounting for a high 73% of GDP, Taiwan's growth outlook is tied to the global demand outlook. This will keep GDP growth at around 1%pa in 1H'16, similar to the 2015 rate. Increased electronics investment and improving global demand will likely lift growth to 2.7%pa over 2H'16 and 2017.

Offshoring limits the export recovery

Taiwan is also struggling with offshoring of production to countries like China and Vietnam, particularly for electronic goods and components. That puts a cap on any recovery in trade in the next few years. Exports fell 10.6% last year and the 2016 recovery is expected to be limited to about 1% with 4% possible in 2017. Manufacturing output fell 1.4% last year and could contract another 1% this year before lifting to 2-3% growth in 2017.

Consumers pull back

Consumer confidence fell to a 21 month low in November and that will likely keep retail sales growth at 0-1%yoy in 1H'16 from a flat Q4'15. Households will continue to cut back on durable purchases, such as cars (-20%yoy in Q4'15) and home appliances (-1%yoy). Better consumer sentiment from 2H'16 will likely lift retail growth to around 1.5-2.5%.

Construction also faces headwinds

Weak investor sentiment, falling house prices, and a housing oversupply led to a 1% fall in construction in 2015 after a flat 2014. A 23%yoy fall for housing starts for the first five months of 2H'15 points to an even weaker home construction market in 2016. Although commercial building starts were up 7%yoy in the first five months of 2H'15, overall construction growth is expected to fall by 2.5% in 2016.

No inflation and a weaker NT$

Falls in fuel, housing, and clothing costs pushed Taiwan into mild deflation in 2015. While price declines should moderate this year there's little sign of inflation ahead. That leaves the way open for the central bank to cut interest rates to support domestic demand. That, in turn, should help the NT$ drop on a rising US$, providing a bit of support for exporters.

	2013	2014	2015	2016	2017
GDP, real growth, %	2.2	3.9	1.1	1.8	2.7
CPI, year average, %	0.8	1.2	-0.3	0.4	0.8
Official discount rate, year-end, %	1.88	1.88	1.63	1.63	1.88
NT$ to US$1, year average	29.8	30.4	31.9	33.5	32.9

Sources: 2012-2014 government data and CEIC; 2015-2016 forecasts by IMA Asia.

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South Korea

Political & policy issues to watch

President Park is well positioned for her last 2 years

President Park Geun-hye should be dreading the April legislative elections as sliding growth, policy stumbles, and a string of scandals have rocked the first three years of her single 5-year term. Normally, that would have seen her Saenuri party lose control of the National Assembly. Yet the opposition has been riddled with infighting, with the New Politics Alliance for Democracy (NPAD) losing its leader, Moon Jae-in, and splitting into two smaller parties. That leaves the way open for an easy victory for Saenuri, which should make it easier for President Park to maintain policy momentum in her final two years.

Tackling Korea's restrictive laws on labour

A key policy goal in 2016 is relaxing Korea's tight labour laws, which make it hard for companies to fire employees. That has left large firms with an estimated 10% more workers than needed. Park aims to make it easier to fire workers for poor performance and to lower union input on wage negotiations. If the restrictions can be eased, then she'd also like contract workers to be made permanent after four years. Unions oppose most of these changes, and it remains to be seen how much will be passed.

Korea's old growth model needs updating

Park will also have to come up with policies that address fundamental challenges to Korea's traditional growth model, which has relied heavily on export manufacturing. A fast rise in dependence on China as an export market (26% of 2015 exports) exposes Korea directly to China's slumping growth. Meanwhile, growth has collapsed in other emerging markets where Korean exporters have normally done well. On the domestic front, household debt has soared (partly encouraged by poor government policies), while a fast ageing population will limit consumer spending and housing demand.

Outlook for the market

Services growth helps to sustain GDP growth

Korea's GDP grew by 2.6% in 2015. Not a stellar result, but surprisingly good given an 8% fall in exports (US$ basis). Steady services sector growth helped, with a 2.8% rise in 2015 staying within the 2.5-3.5% growth band established over the last five years thanks to 7% growth in financial services. While local demand in areas like construction is expected to cool in 2015, a weak recovery in exports to 0-2% growth in 2016 and 4-6% in 2017 should keep overall GDP growth in a 2-3% band.

Scope for a small lift in export manufacturing

The potential for better exports in 2016 is reflected in volume growth measured on the manufacturing production index. While US$ measured exports fell 8% last year, manufacturing volume lifted by 2% in 2H'15 from 0.7%yoy growth in 1H'15. That helped the local purchasing managers' index rise above the 50-neutral level in December for the first time since February 2015. China's January slump will hurt growth in Q1'16, but manufacturing should achieve 1%yoy growth in 1H'16, before rising to 2-3%pa growth over 2H'16 and 2017. However, this is still well below the 5% rate achieved over 2005-15.

A 2015 surge in home building will ease

Korea's consumers did better than expected in 2015, given the MERS outbreak. Real growth for the year was 2.1% and with steady growth in services and a weak lift in manufacturing the pace should be maintained in 2016. Seoul's housing market improved last year, with prices up 4% (after a 1% rise in 2014) and construction accelerating to 6%yoy growth in 2H'15 from no growth in 1H'15. However, with little population growth, construction growth is expected to slip to 2%yoy in 2H'16 and be flat in 2017.

Low inflation and a weaker Won

Weak demand will likely keep inflation around 1% in 2016 and 2017. This will provide the Bank of Korea with room for a 25bp rate cut in 1H'16, and allow them to keep rates at a record low of 1.25% to end-2017. The Korean Won has eased 20% against the US$ over the past 18 months. The authorities will try to keep the currency weak to help exporters.

	2013	2014	2015	2016	2017
GDP growth, %	2.9	3.3	2.6	2.4	2.7
CPI, year average, %	1.3	1.3	0.7	0.9	1.0
BOK Base rate, year-end, %	2.50	2.00	1.50	1.25	1.50
Won to US$1, year average	1,095	1,052	1,133	1,199	1,195

Sources: 2013-2015 government data (NSO, BOK) and CEIC; 2016-2017 forecasts by IMA Asia.

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Indonesia

Political & policy issues to watch

No change to personal security

The January terrorist attack in Jakarta doesn't mark a shift in the outlook for personal security. If anything, it points to the effectiveness of local anti-terrorist work, and markets seem to have accepted that. The problem needs to be watched, however.

Jokowi gains more control over government

Last August marked a turning point in the year-old presidency of Joko Widodo ("Jokowi"). A cabinet reshuffle signalled a swing to more open, pro-market policies and a commitment to a more accountable, transparent bureaucracy. The policy swing has been helped by a series of reform packages in 2H'15 that cut red tape, and by tougher oversight of an obstructionist bureaucracy by hardnosed insiders like Coordinating Economic Minister Darmin Nasution and Coordinating Maritime Affairs Minister Rizal Ramli.

… and wins more support in parliament

The political environment is also aligning with the president. Last September saw PAN, previously in the opposition Red & White Coalition (KMP), join the Jokowi administration. There are now signs PD and PKS want to support the government, as does Golkar, a leading KMP member and the second biggest party in parliament. That makes another cabinet reshuffle likely in the next month.

A push to jump start public capex in 2016

Central to Jokowi's economic strategy is a big lift in public investment in infrastructure. That failed in 2015 due to legislative and bureaucratic log-jams. It is threatened in 2016 by weak revenues, although the finance ministry started covering the gap with a US$3.5bn bond in December. Some $40bn in bonds are planned for 2016. Meanwhile, ministries are under pressure to start tendering projects in January.

Outlook for the market

A modest upturn in 2016 but watch for downside risk

Indonesia is set for a modest rise in growth in 2016 driven by a lift in infrastructure work, lower fuel prices, interest rate cuts, and some pro-market reforms. Yet there is also the risk of weaker growth, as Indonesia is more exposed than its neighbours to a sharp downturn in China, and to capital flight if panic hits global financial markets.

Good growth in consumer basics masked a collapse elsewhere

… weak areas should recover in 2016

Consumer growth in 2015 was likely a bit weaker than the 5.1% reported for 2014, but it was also very lopsided. Vehicle and motorcycle sales fell 16% and 18% respectively, although the fall eased in Q4 to -9.7%yoy for vehicles and -8.6%yoy for motorcycles. That retail sales as a whole rose 12.9% last year (from 14.5% in 2014) was mostly due to 17.8% growth in food and beverage sales. Reflecting a slide in consumer sentiment in 2015, spending was weak elsewhere, with clothing down 6.9%, entertainment and culture down 5.9%, and household appliances staging a weak recovery to 3.1% after a 4.5% fall in 2014. Surveys show a lift in sentiment at the close of 2015, so the weak areas of spending should swing back into low positive growth in 2016, while the overall level lifts above 5%.

Construction should lift, if macro risk is contained

The construction sector slowed in 2015, with real growth to Q3 at 6.1%ytd from 7% for 2014, while growth in cement consumption, a widely watched indicator, fell to 1% from May from a recent peak of 20%yoy in March 2012. While a modest recovery is likely in 2016, the sector's outlook has the highest exposure to risks such as capital flight.

A fast drop in inflation points to more rate cuts

…though weak, don't bet on a big Rupiah fall

Weak demand and falling fuel prices pulled inflation down to 3.4%yoy in December and allowed Bank Indonesia to cut its policy rate by 25 basis points to 7.25%. Another 75 basis points in rate cuts is likely by Q3'16. The Rupiah has done better than expected in January, shrugging off rate cuts and the terrorist attack. Still, its year average fall for 2015 was 11.4%, not far off the 11.9% fall for 2014. With a slower climb for the US$ expected this year, the 2016 fall could halve to around 5-7%. Despite considerable downside risk, the currency also has a track record of recovering after significant falls.

	2013	2014	2015	2016	2017
GDP, real growth, %	5.6	5.0	4.7	5.2	6.0
CPI, year average, (2007=100), %	6.4	6.4	6.4	4.1	5.0
Central bank policy rate (O/N rate) at Dec %	7.50	7.75	7.50	6.50	6.25
Rupiah to US$1, year average	10,460	11,868	13,389	14,400	15,158

Sources: 2012-2014 government data (BPS, BI) and CEIC; 2015-2016 forecasts by IMA Asia

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Malaysia

Political & policy issues to watch

Political risk remains high

… as PM Najib battles to stay in office

Malaysia could get a new PM in 2016 despite PM Najib Razak tightening his hold over the ruling party and facing down corruption charges with the help of a newly installed Attorney General. There are reports that some senior leaders in UMNO, the ruling party, are seeking a deal on Najib's exit, as they are worried about the damage being done by the 1MDB saga. Yet such a deal might never be struck, as Najib used the December party congress to tighten his control over UMNO, and is now gunning for high profile opponents, such as Mukhriz Mahathir, governor of the state of Kedah and son of his fiercest critic, ex-PM Mahathir Mohamed. Najib also gained some breathing space in late 2015 when China's General Nuclear Power Corp bought US$2.3bn of power assets from 1MDB.

Choosing the next central banker

… a critical April decision

The choice of Malaysia's next central banker when current Bank Negara head Zeti Aziz retires in April will be critical. Her skills and reputation helped stabilise Malaysia's financial system and currency as both came under strain in 2015. Yet Najib would have regarded her as an enemy due to Bank Negara's investigation of breaches of foreign exchange rules by 1MDB and her call for him to clarify the 1MDB situation. If Najib's government replaces her with a pliant central bank governor, the M$ could tumble.

Macro risk rises as the oil price falls

Najib must also contend with collapsing government revenues, some 40% of which come from the oil and gas sector. The government will announce revised budget estimates on January 28, but the bottom line will be that it will have to cut spending at the same time as private demand is sliding, the housing market is dropping, and unemployment is rising. Like other emerging markets, Malaysia is also suffering from capital outflows, with US$7bn leaving its equity and bond markets in 2015. The three main credit rating agencies have Malaysia on a stable outlook in January, but a downgrade is likely in 1H'16.

Outlook for the market

Growth halves in 2016

Malaysia's growth is set to slow to 3.4% for the next few years from an estimated 4.9% in 2015 in the face of heightened political risk, contracting exports and government revenue, a housing downturn, and a pullback in consumer growth. There's little room for fiscal stimulus without triggering one or more credit rating downgrades. Cutting interest rates beyond the 50 basis point reduction we've assumed for 2016 might also undermine the M$, which would hurt firms with offshore debt.

… as a once surging consumer cuts back

Real annual growth in consumer demand was a world-leading 7.5%cagr for 2003-14, as the government recycled surging oil and gas revenues into consumer demand, mostly by a large and generously paid civil service. Household debt also surged to 88% of GDP from 60% in 2008. Both taps have now been firmly turned off just as a 140% jump in house prices over the last decade also appears to be coming to an end. Real growth in consumer demand will drop towards 3.3% for the next few years from an estimated 5.7% in 2015.

Capex growth also slows

… despite mega project plans

Real growth in construction is likely to drop towards 1% this year and 2.5% next year following a 20% fall in the annual rate for new housing approvals by last October. Najib's government had hoped to offset that with a string of mega-projects, but finding private financial support for such projects will be difficult in 2016, unless China decides to step in. Capex spending will also weaken, as state owned oil firm Pertonas cuts capital spending following the plunge in oil prices.

Lots of downside risk for the M$

A sharp drop in growth should cool inflation and allow Bank Negara to cut its policy rate by 50 basis points in 2016. Cutting more than that could undermine the M$, which saw a 16% fall in its year average rate on the US$ in 2015. With heightened political risk, and a collapse in oil prices, the M$ could drop another 10-12% in 2016.

	2013	2014	2015	2016	2017
GDP, real growth, %	4.7	6.0	4.9	3.4	3.4
CPI, year average (2010=100), %	2.1	3.2	2.1	1.6	1.9
Central bank overnight policy rate, Dec, %	3.00	3.25	3.25	2.75	2.75
Ringgit to US$1, year average	3.15	3.27	3.90	4.43	4.47

Sources: 2012-2014 government, Bank Negara, & CEIC; 2015-2016 forecasts by IMA Asia.

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Philippines

Political & policy issues to watch

The May 2016 race for the presidency

… remains wide open

Filipinos will elect a new president on May 9, along with half the senate, all of the lower house of congress, and thousands of local officials. Pricing for sovereign credit default swaps suggests that markets aren't worried about the outcome. This is despite the possibility that the next president, who will take office on June 30, might not continue with President Aquino's reforms. Those reforms helped make the Philippines one of Asia's fastest growing markets. While Aquino has endorsed Interior Secretary Manuel Roxas as the candidate most likely to build on his reforms, he has consistently lagged in opinion polls. The latest survey gives Roxas 21% support, slightly ahead of Davao City Mayor Rodrigo Duterte (20%), but behind Senator Grace Poe (24%), and VP Jejomar Binay, who leads the race with 31%. A lot can change by May, as Poe and Duterte face eligibility challenges, while Binay faces a renewed Senate investigation into corruption allegations.

A catch-up surge in public spending

… triggering a jump in plant & equipment capex

President Aquino is wrapping up his 6-year term with a burst of public sector demand after an anti-corruption campaign stalled spending earlier in his administration and red tape delayed a public private partnership (PPP) program from lifting infrastructure. The GDP measure for real growth in government consumption soared 17.4%yoy in 2H'15, the fastest half year growth in a series that starts in 1982. Investment in plant and equipment also jumped by 30%yoy in 2H'15, which helped lift total fixed investment by 14% last year, pushing its share of GDP above 23% for the first time since the 1997 Asia Crisis. Part of the surge in capex will have been PPP-linked. President Aquino has ordered Congress to accelerate bills that would enshrine in legislation the PPP Center, which oversees the infrastructure program and the procedure for awarding PPP contracts.

Outlook for the market

Growth lifts in 2016 on strong local demand

The 2H'15 surge in capex alongside strong consumer spending propelled Q4'15 growth to 6.3%yoy and lifted full year growth to 5.8%. As these domestic drivers appear to be largely immune to the slump in global demand, and the May elections will be accompanied by strong campaign spending, growth should lift to 6.3% in 2016. That is close to capacity, given decades of weak investment in infrastructure and human capital. This means growth has to slow in 2017, or risk a jump in inflation and a blow-out in the external trade account.

Strong local jobs growth helps lift consumers

Consumption rose faster than GDP at 6.2% in 2015, as household finances were boosted by strong employment growth (unemployment fell to 5.7% in October, the lowest since the early 1980s). This helped offset slower growth in remittances from overseas Filipinos (3.6%ytd by November 2015 from 5.9% in full 2014). A fast-expanding business process outsourcing (BPO) sector contributed to employment and wage growth. The BPO sector expects export revenues to rise 19% to US$25bn in 2016. Such factors should help keep consumer real growth in a 6.0-6.5% range for the next few years.

Strong growth for capex on plant & equipment

By accelerating the PPP program President Aquino has avoided a dip in fixed investment that might have accompanied the elections. That makes the Philippines one of the few countries able to exploit global deflation with an investment boom, which might otherwise have triggered a jump in inflation and interest rates. As 25.4% of companies reported that they are operating at 90-100% capacity in November, up from 12% in 2009, capex growth should stay in an 8-10% range this year, before easing to 6-8% in 2017. Construction is also benefiting, with an 11% rise in cement sales for the year to November.

Little inflation and a weaker Peso

Inflation rebounded to 1.5%yoy in December from a multi-year low of 0.4%yoy in September, but remains well below the central bank's 2-4% target range. That will help it avoid a rate hike, and should allow the Peso to fall 4-6% on a rising US$ in 2016 after a 2.4% year average fall in 2015.

	2013	2014	2015	2016	2017
GDP growth, %	7.1	6.1	5.8	6.3	5.8
CPI, annual average, %	3.0	4.1	1.4	1.6	2.6
Central bank reverse rep. rate, year end	3.50	4.00	4.00	4.00	4.25
Peso to US$1, annual average	42.4	44.4	45.5	48.1	48.4

Sources: 2012-2014 BSP data and CEIC; 2015-2016 forecasts by IMA Asia.

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Singapore

Political & policy issues to watch

Letting growth slide

… as it's hard to counter a global downturn

Despite a faltering global economy in 2015, which saw Singapore's exports plunge 14.5% (US$ terms) while manufacturing output fell 4.9%, the government and the central bank (the MAS) have chosen not to launch a major stimulus. There are three reasons for this. First, there's little sign of distress, with unemployment steady at 2% in Q3, and the advanced estimate for GDP for Q4'15 up 2%yoy on steady services growth. Second, deflating an overheated residential property market has been a major goal for two years, and that has been achieved, with prices down 8.4% from a Q3'13 peak. Finally, there's little that an open economy like Singapore can do to offset a collapse in global demand. However, if unemployment rises quickly in 2016, the government would likely introduce subsidies paid to companies to retain staff, as it did in 2009.

Continuing the move away from cheap foreign workers

At present, policy remains fixed on the long-term goal of promoting industries with higher capital intensity and higher productivity in place of labour-intensive work. Access to cheap foreign labour was cut back in 2015, forcing some manufacturers to move offshore while firms in areas like construction have had to restructure their operations. Many firms aren't happy with the restriction on use of foreign workers, yet the policy is popular with voters as foreign workers were blamed for holding down wages and overcrowding of basic services.

Outlook for the market

Growth dips in 2016 as the downturn widens

The advanced estimate puts GDP growth at 2.1% for 2015. The year finished with steady growth in services (up 3.2%yoy in Q4) and construction (up 2.2%yoy) offsetting a 6%yoy drop in Q4'15 for the GDP measure for manufacturing. A big trade surplus also would have supported growth. In 2016, we expect growth to slip to 1.9%, as manufacturing continues contracting and construction growth slows. Both developments will feed through to weaker consumer demand and slower services growth. A weak recovery to 2.8% is possible in 2017, provided the global economy lifts.

Little if any growth in capex

… except for public works

Most of Singapore's growth for 2006-12 came from an 8.8%pa surge in fixed investment. But with the end of the property boom and a downturn in oil rig work fixed investment fell by 1.9% in 2014 and at best would have been flat in 2015. With construction contracts awarded down 34% for the year to October, the construction component of fixed investment will struggle to stay flat in 2016 even with help from a lift in public works on the MRT network, the sea and air ports, and on public housing (20% more public housing units are planned for 2016). With flat growth in plant & equipment, and in transport equipment, overall capex growth is likely to be limited to 2% for 2016 and 2017.

Consumers pull back

… with signs of stress emerging

Despite a firm jobs market, consumers have been unnerved by a combination of falling home prices and faltering global growth. Households are now deleveraging after a surge in personal debt to 75.6% of GDP in late 2015 from 65.3% in Q1'11. As a result, consumer loan growth dropped to 3%yoy in November from a 20%yoy peak in May 2011. Credit card debt write offs and pawnshop pledges have also risen quickly in 2015. Meanwhile, non-car retail sales fell 1%ytd by November, while growth in outbound travel fell to 1.9% for the year to November from 3% in 2014 and 7.5% in 2013. Real consumption growth is likely to be limited to 2.2% in 2016 and 2.8% in 2017 from an estimated 3.9% in 2015.

Deflation & a steady slide for the S$

The MAS eased monetary policy twice in 2015 by slowing the S$'s rise against a basket of undisclosed currencies (this method works better in a small, wide-open economy than a policy interest rate). That saw the S$ drop 7% on the US$ over 2015. Given mild deflation (the CPI has fallen for 13 straight months and was -0.6%yoy in December) the same settings will continue in 2016, suggesting another 6-7% drop on the US$ in 2016.

	2013	2014	2015	2016	2017
GDP, real growth, %	4.4	2.9	2.1	1.9	2.8
CPI, year average, %	2.4	1.0	-0.5	-0.2	0.6
3 month interbank interest rate, Dec, %	0.40	0.46	1.19	1.42	1.66
S$ to US$1, year average	1.25	1.27	1.37	1.46	1.48

Sources: 2013-2015 government data and CEIC; forecasts for 2016-2017 by IMA Asia

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Thailand

Political & policy issues to watch

Short-term political stability under the army

… but high long-term political risk

General Prayut's junta, which toppled PM Yingluck Shinawatra's elected government in May 2014, will shortly release its second attempt at a new constitution. If voters reject it at a mid-year referendum, the army's ruling council can approve it, opening the way to 2017 elections for a military-guided government. Since 2014, the army's goal has evolved from forcing the populist Shinawatra family from power and overseeing a transition in Thailand's elite to seeking a permanent role in politics. This is stable in the short term, as the army has remained unified and Thais respect their King's backing for Prayut's regime. Long-term stability is unlikely, particularly as the army is struggling to revive growth.

Big economic challenges

… demographic and investment

Low population growth and a weak education system have left a fast-aging and low-productivity workforce. While some of the industrial base has been upgraded (notably automotive), the export sector has relied on 1.3 million registered and 3 million-plus undocumented foreign workers. Alongside low population growth, that has limited growth in the consumer base. Foreign investors have also become cautious, with net foreign direct investment (FDI) inflows slipping under US$4bn in 2014 and (on our estimate) in 2015, after averaging almost $10bn a year over the prior nine years.

Outlook for the market

A mild 2016 recovery, if exports lift

Provided there is a weak export recovery, GDP growth could lift to 3.4% in 2016 and 3.6% in 2017 from an estimated 2.7% in 2015. Local demand is expected to lift as the military pushes its infrastructure program and a weak consumer revival starts. On the export side we're assuming a 4-5% lift in 2016, with 5-7% in 2017 after a 4.5% fall in 2015 (all US$ basis). If exports fail to recover, 2016 GDP growth would stall at 2%.

A 14% fall in manufacturing from 2012

… with a 2% recovery in 2016

An export fall of 4.5% in 2015 is not as bad as Malaysia and Indonesia (both down 14%) but is clearly outpaced by Vietnam (up 8%, and replacing Thailand as the favoured site for low cost export factories). The manufactured component of Thai exports likely fell 4% in 2015, with electronics down 3%, electrical appliances down 2%, and automotive up 3%. As a result, the 2015 fall in industrial output likely matched the 4.6% fall of 2014, making three consecutive annual declines that left the end-2015 index 14% below the 2012 average. A weak export recovery and slightly better local demand should lift manufacturing output by some 2% this year and 4-5% next year.

Weak growth for consumers

… as wage growth stalls

Despite a 14% drop in manufacturing output since 2012, unemployment was just 0.7% at December as foreign workers bore the brunt of the slowdown. However, pay growth in manufacturing slumped to 1.6%yoy by November from 9% in 2013 and 2014. Together with a fast rise in household debt, that saw volume for FMCG fall 2.7%ytd by October (after a 6% drop in 2014) while durable goods (ex-autos) grew just 0.5%ytd (after a 2% fall in 2014). We expect real consumer growth to edge up to 2.3% this year from 1.9% last year with 3% possible in 2017. That's roughly in line with the 2.4%cagr for the decade to 2014.

Capex will have to rely on plans for infrastructure

Growth in private capex will likely be minimal in 2016 given the weak export and consumer demand outlook. The government hopes to offset that with a US$50bn infrastructure plan that includes a 900km rail link between China's Kunming and Bangkok. Rolling out these projects should lift fixed investment growth of 2.1% in 2016 and 3.8% in 2017, after an estimated 2.9% rise in 2015.

A continued, moderate fall for the Baht

With core inflation at 1%yoy, more policy rate cuts lie ahead. Thai industry sees the Baht as far too strong, with year average falls of just 5% in 2014 and in 2015. Yet with the current account surplus surging (as imports have fallen faster than exports) and foreign exchange reserves of US$157bn in December little changed from a year ago, market forces won't push for faster depreciation than some 4-5%pa for 2016 and 2017.

	2013	2014	2015	2016	2017
GDP, real growth, %	2.8	0.9	2.7	3.4	3.6
CPI (2002 index), year average, %	2.2	1.9	-0.9	0.1	1.3
Central bank, policy rate, year end, %	2.25	2.00	1.50	1.25	1.25
Baht to US$1, year average	30.7	32.5	34.2	37.3	39.3

Source: 2013-2015 data from the IMF and CEIC; 2016-2017 forecasts by IMA Asia.

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Vietnam

Political & policy issues to watch

PM Dung's push for the top post fails

… but pro-market reforms should continue

PM Nguyen Tan Dung's hopes for becoming general secretary, Vietnam's top political post, at the Communist Party's 12 Congress in January have fizzled out. Conservatives in the 19-member Politburo distrusted Dung's economic management skills. Rumours of corruption and undue family wealth didn't help. Instead, Dung has been forced to retire and his main rival, 71-year old Nguyen Phu Trong, was re-elected for a second 5-year term as general secretary (given his age he may only serve 1-2 years). Dung's role as PM is likely to be taken by deputy PM Nguyen Xuan Phuc. The failure of the relatively liberal Dung to win the top job shouldn't derail Vietnam's move towards a more open trade and investment environment. But without Dung to champion reform, implementation of trade deals (such as the recently-concluded Trans-Pacific Partnership) and reforms to state owned enterprise (SOE) sector will likely slow. Although Trong is pro-China, Vietnam's tilt towards the West will continue given China's aggressive posture in the South China Sea.

… along with a tilt to the West

The November visit of Chinese President Xi Jinping to Vietnam did little to improve relations between the two countries. On January 19, Vietnam claimed that China had moved an exploration rig into disputed South China Sea waters. Earlier in the month, Vietnam said that China was endangering the safety of civilian flights by running unannounced test flights to a newly constructed artificial island in the South China Sea. However, it's quite unlikely that Hanoi will allow a repeat of 2014's anti-Chinese riots.

Outlook for the market

A rebound in local demand will support 6%+ growth

GDP growth rose to 6.7% in 2015 on the back of strong growth in the manufacturing and construction sectors, up 10.6% and 10.8% respectively, and steady services growth of 6.3%. Last year's rebound reflected a resurgent local economy, as growth in the export sector cooled. That rebalancing has risks, as strong local demand lifted 2015 imports by 11%, just as export growth slowed to 8%. That swung a small 2014 trade surplus to a $4bn deficit, although there's little sign of a blow-out to the US$20bn annual trade deficit of mid-2008. Strong local demand should keep GDP growth above 6% for the next few years, while export growth moderates to 5-6% a year.

Strong growth in FDI

… will drive expansion in export production

Vietnam attracted US$14.5bn of foreign direct investment (FDI) in 2015, 17.4% more than in 2014, of which 70% appears to have gone into greenfield capex for manufacturing. Vietnam is set to be one of the biggest beneficiaries from reduced tariffs imposed by other nations on its exports under the TPP trade deal, and some export production appears to have moved to Vietnam in late 2015 in anticipation of the deal going into effect. FDI will remain a key capex driver in 2016, as some of the US$15.6bn worth of projects approved last year are built. Along with a revival in the housing market, and the broader construction industry, that should sustain fixed investment growth of 9-10% in 2016-17 from an estimated 11% in 2015.

An attractive consumer market

Real growth in consumer demand has recovered from a recent low of 4.1% in 2011 to an estimated 6.3% in 2015, with a 6-7% rate expected for the next few years. Foreign players are now crowding into the consumer market, attracted by a young population (60% are under 35), rising salaries, and strong remittances from overseas relatives (5.2% of GDP). Thailand's Boon Rawd Brewery is the latest entrant, taking a US$1.1bn stake in the beer assets of Vietnam's Masan Group.

Watch for rate cuts to lower the Dong

With inflation falling to 0.6% in 2015, the central bank has ample room to cut its policy interest rate. Given the deteriorating external trade account, rates could be cut by 100 basis points through 2016, with the aim of accelerating the Dong's fall on a rising US$ to 4-6% this year from just 2.4% in 2015 (which made it one of the world's strong currencies).

	2013	2014	2015	2016	2017
GDP, real growth, %	5.4	6.0	6.7	6.4	6.3
CPI, yoy, % (2005=100 from 2007)	6.6	4.1	0.6	1.0	1.9
Central bank refinancing rate, year end, %	7.00	6.50	6.50	5.50	5.50
Dong to US$1, year average	20,933	21,148	21,677	22,775	23,528

Source: 2012-2014 data from the IMF and CEIC; 2015-2016 forecasts by IMA Asia

India

Political & policy issues to watch

India's gridlocked parliament

… leaves the GST at the mercy of Congress Party

Despite a landslide win in the 2014 elections, PM Modi's BJP-led government enters 2016 chastened by 18 months of mostly failed legislative effort and a big loss in the recent Bihar state election. By contrast, the opposition, led by Congress Party, has found that if it is united it can not only block the BJP's legislation in the upper house, where it has a majority, but also beat the BJP and its allies in crucial state polls. This doesn't look good for reform by legislation in the rest of this current parliament. It also puts the Congress-led opposition back in the race for the 2019 elections. As most big reforms require legislation, India will only see a GST this decade if Congress sees it as in its political interest.

Some reforms move ahead

… on FDI caps & bank NPLs

Fortunately, some reforms can be pursued outside of parliament. In recent months restrictions have been cut on foreign direct investment (FDI) in 15 sectors and major public works projects have been accelerated. The Reserve Bank of India (RBI), under Raghuram Rajan, has also launched a drive to force banks to clean up non-performing loans (NPLs) and is putting pressure on them to pass through cuts to the RBI policy rate.

Fiscal stimulus in 2016

… via a public sector pay hike of 23%

Finance Minister Jaitley would like to use the February 29 budget speech to revive capex growth. Yet his scope for fiscal initiatives is limited by the existing budget deficit (about 4% of GDP), weak revenue growth, and a big public sector pay and pension hike from January following a once-in-a-decade pay review. The pay hike for 4.5m central government civil servants averages 23%. As that's a massive hit to the budget (it equals 5.5% of all spending in the current fiscal year), Jaitley will try to delay the increase in allowances (often equal to or bigger than salary). The pay rise flows through to central government pensioners and is mostly followed by India's 29 states.

Outlook for the market

Capable of 7%+ growth in 2016

… thanks to local demand

Provided India has a good monsoon in 2016 after two back-to-back droughts, then it should achieve 7.3% growth in 2016. Almost all of that will come from the consumer sector supported by a rural recovery, a big public sector pay hike, and lower interest rates. Growth could fall towards 6.5% if falling global demand leads to s surging trade deficit due to a combination of weak exports and strong imports driven by local demand. The official GDP measure, which we use, also looks overstated for 2015 by about one percentage point. Industrial production and electricity demand both grew by 4.7%yoy in Q3'15, while and investment spending grew just 5.2%ytd.

Consumers will underpin growth

Consumers will play a key role in sustaining growth in 2016. Vehicle sales signalled the start of an upward trend in Q4'15. Passenger vehicle sales were up 11.2%yoy in Q4'15 from 4.8%ytd growth in the first three quarters. However, two wheeler sales grew just 2.3%yoy in Q4'15 after 0.1%ytd for the first three quarters as farmers struggled after two consecutive droughts. Interest rate cuts and the public sector pay hike should keep real growth in consumer spending close to the 7% estimated for 2015.

Business capex will lag

Two surveys suggest that a corporate recovery is still some way off. December saw Dunn & Bradstreet's business optimism index drop to its lowest level since the 2008 global crisis. Sub-indices pointed to pricing pressure and little interest in hiring. Meanwhile, the industrial outlook survey by the Reserve Bank of India (RBI) shows no lift. Capex growth likely lifted to 5% in 2015 from 3.1% in 2014 and should be close to 7% in 2016.

One more rate cut & a weak rupee

CPI inflation should stay in a 5-6% band in 2016 as lower fuel prices are offset by a big pay hike for public workers. That limits the RBI to one more 25 basis point rate cut in 2016. The Rupee is slipping towards a record low of 69 to US$1, and while it could recover in mid-2016, it will likely weaken in 2017 as India runs higher inflation than its trade partners.

Calendar year starting January	2013	2014	2015	2016	2017
GDP (MP, 2011-12), real growth, %	6.4	7.1	7.2	7.3	7.0
Inflation - CPI, %	10.1	6.7	4.9	5.5	5.5
RBI repo rate, December, %	7.75	8.00	6.75	6.50	6.75
Rupee to US$1, year average	58.5	61.0	64.1	69.3	70.7

Sources: 2013-2015 data from the government (NCI, RBI) and CEIC. 2016-2017 forecasts by IMA Asia with guidance from IMA India.

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Australia

Political & policy issues to watch

The 2016 election

… the Coalition led by Turnbull should win

… but will still face a Senate run by minor parties

Australia's 2016 political year will be divided by a federal election likely to take place in Q3. Opinion polls show a massive realignment in popular support since Malcolm Turnbull deposed Tony Abbott as Liberal leader and thereby as PM last September. Prior to the change, the Liberal-National Coalition government trailed the opposition Labor Party by 45% to 55%. Since the change, the Coalition has led Labor by 55% to 45%. While that puts the Coalition on track to retain control of the lower house, it is unlikely to win control of the Senate in a concurrent half-senate election. Winning support from a handful of independent senators to pass bills will remain a challenge for the government. Turnbull will also have to ensure that Abbott doesn't run a leadership destabilisation campaign from the back benches, as his right-wing supporters are nervous that Turnbull will drop Abbott's policies once he has won his own electoral mandate.

A tough budget ahead as mining revenue drops

… and possibly a GST hike

Turnbull's main economic challenge will be plugging the hole left in government revenue by the collapse of commodity export earnings. In December, the mid-year budget review (for a fiscal year that ends June 30) slashed A$34bn off the revenue forecast due to falling commodity prices. Forecast GDP growth was also cut to 2.5% this FY (previously 2.75%) and to 2.75% for 2016-17 (previously 3.25%). The single biggest fix would be lifting the GST rate from a current 10% to 15% and/or broadening it to cover food (but not health and education). Turnbull wanted the state premiers to back such a move by March, but as that looks unlikely, Treasurer Scott Morrison will have to lead the way in his May budget speech, effectively turning the 2016 election into a vote on a tax rise.

Outlook for the market

Trend growth is slowing from 3% to 2%

Australia is moving to a growth rate that will be considerably less than its traditional 3%. The end of a mining investment boom, weak commodity exports, and the hollowing out of manufacturing all point to slower growth. However, with support from a strong services sector and solid population growth based on a high migrant intake, Australia should achieve 2% trend growth to 2017. That's not bad in today's world.

… services will lead

The services sector had a good 2015, with growth rising from 1.8% in 2014 to 3.2%ytd by Q3'15. The housing boom has pushed up both real estate and financial and insurance services by 5%ytd, and should support these sectors through 2016. Strong visitor growth from China, Korea, and US in 2015 is also expected to bolster tourism.

… while the plunge in exports should bottom

Exports took a hammering in 2015, falling 21%yoy in the first 11 months after a 6% decline in 2014 (US$ basis). Australia's three largest markets, China (-25%yoy), Japan (-31%yoy), and Korea (-27%yoy) all had large declines as volumes and prices fell. While a recovery isn't likely in 2016, the fall should moderate or halt. A mild 3% lift is expected in 2017.

A housing boom is also set to ease

Fixed investment in property has grown at 8%pa thanks to a 2-year old housing boom. Yet, house prices are now falling in Sydney and Melbourne. While that should see developers cut back on new projects in an effort to support prices, the large volume of work underway should deliver 6%yoy growth in 1H'16 and 2-3%yoy in 2H'16 and 2017.

Manufacturing keeps shrinking

Manufacturing will continue shrinking even after 15 straight quarters of negative year-on-year growth. 2016 will see the closure of Australia's car industry (Ford, GM as Holden, and Toyota). Much of a large auto component sector has moved offshore or will move soon (Thailand being a favoured location). Manufacturing plant for the resources sector is also undergoing a big contraction.

Low inflation and downside risk for the A$

Despite a 20% fall in the value of the A$ on the US$ through 2015, inflation has remained well below the Reserve Bank's 2-3% target range. That leaves room for a rate cut if the RBA sees a recession looming. The A$ could well drop towards 50 US cents in 2016, as global markets bet against it as a proxy for a weakening China.

Year ending December 31	2013	2014	2015	2016	2017
GDP, real growth, %	2.0	2.6	2.2	1.9	2.2
CPI, year average, %	2.4	2.5	1.4	1.5	1.8
RBA cash rate, year end, %	2.50	2.50	2.00	2.00	2.25
A$1 = US$, year average	1.03	1.11	1.33	1.47	1.45
US$1 = A$, year average	0.97	0.90	0.75	0.68	0.69

Source: 2013-2015 data from the ABS; 2016-2017 forecasts by IMA Asia

New Zealand

Political & policy issues to watch

A strong PM who could win a 4th term in 2017

… NZ will host the TPP signing

With elections not due until 2017, the biggest 2016 event may well be a decision from PM John Key on whether he'll run for a fourth term. He is the National Party's strongest electoral asset, delivering its three latest election victories as well as a mid-January lead in opinion polls of 47% to 41.5% over the opposition Labour/Green parties. His standing may soon get a further boost, as it has just been announced that NZ will host the signing of the 14-country Trans Pacific Partnership (TPP) in February. While the TPP's economic impact on NZ is small, it will help lock in the country's reputation as a global leader in trade agreements (it launched the TPP several years before the US became involved). That has been essential to NZ's rise as a highly competitive global agribusiness centre.

Risks for NZ's big growth drivers

… dairy

The dairy sector has suffered two awful seasons, with a central bank survey forecasting negative cash flows at 80% of dairy farms in the 2015-16 season. If global dairy prices fail to recover, and farm prices continue falling, then over 40% of dairy farmers would likely default on their loans. This would place significant stress on the banking sector, as dairy farms make up 10% of bank lending.

… & housing

The Reserve Bank is also worried about consumer housing debt. Household debt has reached 160% of disposable household income, and 57% of total bank lending. In the short-term, this poses no risk, as property prices continue to rise and unemployment remains moderate. However, a downturn in economic conditions and house prices would undermine consumer spending and could escalate into a crisis for the banking sector.

Outlook for the market

Steady growth into 2016

… thanks to migrants

The NZ economy did surprisingly well in 2015, notching up its second year of 3% growth thanks to a construction boom and a surge in inward migration. Even exports, which fell in value terms, have risen in volume terms. We've expected growth to drop from 3% for a year, but it hasn't due to the migrant inflow (about 1.3% of the population each year) and the absence of a need for higher interest rates as there was plenty of labour and global deflation held prices down. 2016 could be the same, provided dairy prices lift and natural disasters like drought are avoided. Growth should ease into a 2-3% range in 2017, as the construction boom and migration waves both start to taper.

… that also means a strong consumer sector

Electronic card transactions rose 5.5%yoy in 2H'15, up from 4.3%yoy in 1H'15. Record net migration flows (63,700 persons in the year to November) have supported consumer demand and stopped the labour market tightening, with unemployment around 6% and wage growth held to 2.2%. Consumer growth will likely ease from 2.5%pa in 2015 and 2016 to 2.2% in 2017, as construction sector labour demand slows.

Good growth in parts of services sector

Tourism should continue to benefit from surging visitor arrivals from Asia (+19%yoy in the first five months of 2H'15), and Canada/USA (+10%yoy). Meanwhile, strong housing demand will ensure the financial and real estate services industries maintain 3%pa growth to 2017. Limited government spending will likely keep education, healthcare, and recreation services at or below 1% annual growth.

Strong housing demand in the big cities

Canterbury reconstruction is easing, with housing consents down 10%yoy in the first five months in 2H'15. North island urban centres are now driving demand, with Auckland up 21%yoy and Wellington up 19%yoy thanks to migrant arrivals. That is spilling over into nearby rural regions, with some up more than 50%yoy. This should sustain 4-6%pa dwelling investment growth to mid-2017. Growth will then ease to 2%yoy for 2H'17.

The NZ$ stays down

Negligible inflation allowed the Reserve Bank to cut interest rates by 100bp to 2.5% in 2015, and will likely permit one more 25bp cut in 2016. The NZ$ will likely remain below the 70 US cent level until commodity prices improve.

Calendar years	2013	2014	2015	2016	2017
GDP(Expenditure), real growth, %	1.7	3.0	3.2	3.2	2.5
GDP(Production), real growth, %	2.4	3.7	2.8	2.8	2.5
CPI, year average, %	1.1	1.2	0.6	1.9	2.0
Official cash rate, year end, %	2.50	3.50	2.50	2.25	2.75
NZ$1 = US$, year average	0.82	0.83	0.71	0.66	0.66
US$1 = NZ$, year average	1.22	1.20	1.41	1.51	1.52
NZ$1 = A$, year average	1.18	1.09	1.06	1.06	1.05

Source: 2013-2015 data from Statistics NZ; 2016-2017 forecasts by IMA Asia

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The Asia Pacific Executive Brief is produced by a unique network of in-country experts who run briefing and advisory programs that are designed to help senior executives monitor and anticipate critical business developments through timely insights and analysis. Further information on the markets and the peer group briefing programs is available from the Country Directors listed below.

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