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Global outlook

The world is stuck in low gear

… too much reliance on cheap money

… and not enough reform & fiscal stimulus

The world is on track for a fifth straight year of low growth in 2016, which the IMF puts at 3.2%, roughly in line with last year's 3.1%, but down from its forecast last October of 3.6%. A weak lift in growth to 3.5% is expected in 2017, making a 6th straight year when the global economy has failed to reach a 4%+ rate that was typical of a recovery year over the last four decades. In its April update of the World Economic Outlook (WEO, a semi-annual, 5-year forecast for the global economy), the IMF warns that such prolonged low growth is at risk of becoming entrenched, as too much emphasis is placed on monetary stimulus, which has lost traction, and not enough is being done by fiscal stimulus or reforms to reinvigorate growth. Unfortunately, fiscal stimulus policies are out of fashion in advanced countries even when they have the money. And few, if any, politicians in advanced countries are willing to tackle reforms including trade deals, as angry voters reject the outcome of earlier reforms.

A weak 5-year outlook

… pointing to excess capacity & low inflation

That means the 5-year outlook to 2021 is also subdued, with the high point for a recovery in global growth lowered to 3.9%. In 2011, the WEO had expected almost 5% growth on the 5-year horizon, but it has cut that by about a quarter of a percentage point each year since then. The implication is that over-capacity in commodities and manufacturing is likely to be with us for some time, putting considerable downward pressure on prices. The loss in growth impetus appears to be equally spread between advanced countries, which are struggling with ageing populations and high debt levels, and emerging markets outside of Asia, which are failing to fire-up as hoped for.

Yet there is resilience

… a sustained US recovery

There is, however, a resilience to the new normal of lower global growth, which is apparent in the basic macro data for major economies. While US growth likely slowed to around 2%yoy in 1H'16, unemployment has dropped to 5% and private sector job growth has continued for a record 73 months, with over 14m jobs added. The rebound in home prices and the stock market appear to have survived the US Fed's first small interest rate hike and bank lending growth to consumers and corporates is steady. Public sector demand started growing again in Q4'14 and has steadily accelerated after contracting for 16 straight quarters due to sequestration. A strong US dollar, a modest rise in the consumer savings rate, and fracking cutbacks have taken some of the impetus out of growth, which the IMF now puts at 1.9% this year and 2% next year (our forecast is a bit stronger).

… a broad but weaker Euro area upturn

A low-level recovery also appears to be firmly established in the Euro area, with the IMF expecting growth of 1.5% this year and 1.6% next year. The recovery appears to be broad-based, with Q4'15 seeing capex growth of 1.6%yoy, public consumption growth of 3.4%yoy, and private consumption growth of 1.5%yoy. Meanwhile, industrial production growth averaged 1.6%yoy for the six months to February 2016.

… a strong EM Asia

Along with us, the IMF expects the emerging markets (EM) in Asia to hold onto 6%+ growth for the next two years (its forecast is 6.4% this year and 6.3% next year). Brazil and Russia, which both collapsed last year (-3.8% and -3.7% respectively), are expected to contract again this year before returning to weak growth in 2017. While that will hold back Latin America and the CIS, other EM regions are expected to grow at about 3-4%.

A pause in the US$ rise

As market expectations swing from 3-4 US Fed interest rate hikes this year to just 1-2, the US$ is no longer rising and futures contracts hint that a weaker US$ lies ahead. We expect the US$ to return to a mild upward path later in 2016 before its rise ends in 2017 or 2018.

IMA Asia's forecasts	2013	2014	2015	2016	2017
World – Real GDP growth, %	3.3	3.4	3.1	3.0	3.3
- US	1.5	2.4	2.4	2.3	2.5
- Euro area	-0.3	0.9	1.5	1.7	1.7
- Asia/Pacific (14)	4.5	4.3	4.3	4.2	4.2
- NICs (4)	2.7	3.4	2.1	1.9	2.4
- Developing or "EM" Asia (7)	7.0	6.8	6.6	6.1	5.8
- ASEAN (6)	5.0	4.4	4.4	4.5	5.0
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	108	115

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	0.5	0.6	0.7
China	7.7	7.3	6.9	6.2	5.7
Hong Kong	3.1	2.6	2.4	1.5	2.0
Taiwan	2.2	3.9	0.7	0.8	2.1
South Korea	2.9	3.3	2.6	2.4	2.6
Indonesia	5.6	5.0	4.8	5.7	6.2
Malaysia	4.7	6.0	5.0	3.4	3.4
Philippines	7.1	6.1	5.8	6.3	6.0
Singapore	4.7	3.3	2.0	1.8	2.8
Thailand	2.7	0.8	2.8	3.4	3.6
Vietnam	5.4	6.0	6.7	4.8	6.1
India (CY)	6.3	7.0	7.3	6.6	6.8
Australia	2.0	2.6	2.5	2.1	2.2
New Zealand	1.7	3.0	3.4	2.5	2.8

Inflation, CPI year average, %	2013	2014	2015	2016	2017
Japan	0.3	2.8	0.8	0.6	1.1
China	2.6	2.0	1.4	1.7	1.9
Hong Kong (composite CPI)	4.4	4.4	3.0	2.1	2.2
Taiwan	0.8	1.2	-0.3	1.1	1.8
South Korea	1.3	1.3	0.7	1.2	1.4
Indonesia	6.4	6.4	6.4	4.1	5.2
Malaysia	2.1	3.2	2.1	3.7	2.5
Philippines	3.0	4.1	1.4	1.6	2.5
Singapore	2.4	1.0	-0.5	-0.3	0.5
Thailand	2.2	1.9	-0.9	0.1	1.3
Vietnam	6.6	4.1	0.6	1.4	2.0
India (CY CPI urban non-manual workers)	10.1	6.7	4.9	5.3	5.8
Australia	2.4	2.5	1.5	1.6	2.2
New Zealand	1.1	1.2	0.3	1.1	2.0

Exchange rate to US$1, year avg.	2013	2014	2015	2016	2017
Japan	98	106	121	108	115
China	6.20	6.14	6.23	6.45	6.25
Hong Kong	7.76	7.75	7.75	7.76	7.75
Taiwan	29.8	30.4	31.9	32.9	32.9
South Korea	1,095	1,052	1,133	1,177	1,156
Indonesia	10,460	11,868	13,389	13,358	13,750
Malaysia	3.15	3.27	3.90	4.06	3.92
Philippines	42.4	44.4	45.5	46.3	45.8
Singapore	1.25	1.27	1.37	1.40	1.45
Thailand	30.7	32.5	34.2	35.7	36.6
Vietnam	20,933	21,148	21,677	22,180	23,000
India (FY)	58.5	61.0	64.1	69.3	69.5
Australia	1.03	1.11	1.33	1.29	1.34
New Zealand	1.22	1.20	1.41	1.42	1.35

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

Regional outlook

Political & policy issues to watch

Critical mid-year polls for Japan and Australia

PM Abe in Japan and PM Turnbull in Australia both hope to hold mid-year polls that would recast domestic politics. Abe wants to amend the security clauses in Japan's constitution and Turnbull wants to rid the Australian senate of micro parties who hold bills hostage. Yet opinion polls are swinging against both leaders, and they may face battles simply to hold their positions.

A setback for Park in Korea

Mid-April saw South Korean voters deliver a surprise defeat to the ruling Saenuri party in legislative elections. That leaves President Park as a lame duck leader for her final two years, and derails reforms needed to free up a rigid labour market.

Taiwan's new government from May

For the first time since separating from China in 1949, Taiwan will be under the control of a non-KMT president and a non-KMT legislature when President Tsai Ying-wen is inaugurated on May 20th. While it will take some time for her inexperienced DPP government to find its feet, Tsai's team has policies that should help revive growth. We don't expect significant disruption to ties with China, although Beijing has warned of that.

Less political risk in Thailand

We have modified our view on political risk in Thailand, which we had previously rated as high under the current military government. General Prayut's government looks like being in more stable than expected. Moreover, it is making a major effort to reduce corruption and red tape, while also lifting growth through a big infrastructure program. That may see us lift of Thai growth forecast by mid-2016.

… and shifting political risk in Malaysia

Risk associated with PM Najib's battle to hold onto power in Malaysia is rising, as a steady flow of foreign press revelations make it harder for him to deny involvement in corruption. By contrast, risk associated with 1MDB has been reduced through major asset sales to two Chinese state-owned enterprises. That reduces the risk to a large number of property and banking deals in Malaysia, as well as to some major projects.

Outlook for the market

EM Asia can sustain near 6% growth

We expect China, India, and ASEAN's five main emerging markets (Indonesia, the Philippines, Vietnam, Thailand, and Malaysia) to collectively sustain growth near 6% through 2016 and 2017. While our growth forecasts are a bit weaker than the IMF's, we agree that macro risks are under control and that there are good opportunities for stimulus measures to sustain local demand. A big monetary stimulus is underway in China, while falling inflation in India, the Philippines, Vietnam, and Indonesia have opened the way for central banks to deliver interest rate cuts to support demand. China also leads on fiscal stimulus, with firm spending growth even as revenue growth has slowed. The Philippines, Singapore, and Thailand will all use fiscal stimulus. Even though India aims to cut its budget deficit, there will still be a boost from a big civil servant pay hike this year and extra aid for drought-stricken rural India. The countries facing challenges are Malaysia and Indonesia, as both will have to trim spending because of falling oil prices

Severe drought in due to El Nino

An El Nino weather pattern emerged in 2015 and has brought severe drought to parts of the southern Philippines, Vietnam's Mekong delta, upcountry Thailand, and parts of India. Drought conditions intensified from March 2016, along with very high temperatures. Two more difficult months lie ahead before monsoons and an easing in the El Nino weather pattern bring relief. This is doing considerable damage to rural consumers. Fortunately, global food prices are low, so the impact on inflation is contained.

Asia/Pac currencies gain on the US$ for several quarters

A surprise swing to a weaker US$ in Q1'16 saw the greenback drop about 2.5% on its trade weighted index and against the Euro between December 2015 and March 2016. The realignment on Asia/Pacific currencies varied. Japan's Yen was pushed up most (6.6%), followed by a recovery for the Malaysian Ringgit (up 4.8%) and Indonesia's Rupiah (up 3.8%), followed by rises of 2-3% for Australia, Thailand, Taiwan, and Singapore. The rest of the region's currencies were flat, including China's Yuan, which dropped for several months but then regained ground through March. Several more quarters of a weaker US$ may lie ahead as forex markets watch the US Fed's moves and commentary on rate hikes. Yet by year-end, the US$ should reassert itself on most Asia/Pac currencies, at least for another year.

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Japan

Political & policy issues to watch

A loss of support for PM Abe

… with some tough elections ahead

PM Abe is losing ground after three and a half years of dominating Japanese politics. A by-election in Hokkaido at the end of April will show how voters balance the government's regional revival strategy and Abe's call for a more aggressive defence policy against the failure of Abenomics to help most households. If Abe's LDP party does well in Hokkaido, he'd likely call a lower house poll to coincide with the July upper house poll, hoping that a big win (two thirds or better in both houses) would allow him to initiate a national referendum to revise the war-renouncing constitution. Yet Abe's strategy looks daft, as every opinion poll has shown little public support for a stronger military posture. As a result, we don't expect the LDP to do well in Hokkaido, and Abe will have to drop plans for an early lower house poll in favour of one later in 2016 (it must be by December).

That puts big reforms at risk

As support for Abe and the LDP is wilting, some big reforms are likely to be shelved in the next few months. Prominent among them are the April 2017 lift in the sales tax to 10% from 8%, and ratification of the Trans Pacific Partnership (TPP), which had been scheduled for the current Diet session. That's a shame, as both are needed: the former to cover a growing shortfall in pension funding, and the latter to help Japan open up domestic markets to foreign competition, which would help revitalise growth.

… while courts halt re-starts for nuclear plants

PM Abe's plans to return nuclear power to 20% of electricity capacity in the next few years have stalled as courts are overturning re-start approvals by regulators, leaving just one reactor running. As LNG and coal imports are cheap at present, that's not hurting the trade balance and power price hikes are limited. Yet, ahead lies a massive expense in decommissioning nuclear plants, as well as in building new thermal ones.

Outlook for the market

Two scenarios for Japan

… with and without the 2017 sales tax hike

Japan's immediate outlook faces two challenges. The first is the April 2017 sales tax hike. Like the April 2014 increase (from 5% to 8%), that would likely pull demand forward by two quarters leaving a recession for the following three quarters. The IMF's April 2016 forecast assumes the tax hike goes ahead, so it puts Japan's 2017 growth at -0.1%. Yet we expect Abe to postpone the tax hike as the economy will be too weak and with falling popularity it would be political suicide (polls show most voters oppose it). Without it, growth over the next two years should be steadier and close to the 0.5% trend rate that Japan is capable of given a falling population and a declining manufacturing base.

A strong Yen hurts corporate Japan

The second challenge is a fast-rising Yen, which reached 108 to US$1 in early April from 122 for December 2015. Strong profit growth for corporate Japan on a cheaper Yen helped propel an 80% stock market rally from the end of 2012 to the end of 2015. Take it away, and the biggest gain for corporate Japan from Abenomics vanishes. We have not yet cut our growth forecast because of that, but we may do so in the next few months.

Manufacturing will shrink

In volume terms, export growth slowed from 8.3% growth in 2014 to 2.7% in 2015 and we expect no growth this year followed by 1-2% in 2017. Industrial production fell 0.8% last year after a 2.1% rise in 2014, which put the 2015 index down 15% from its 2007 high point. By February, the index was down 2.6%ytd with a full year fall of over 1% expected. Japan's manufacturers will meet any 2017 lift in global demand from overseas factories.

… the office sector will cool

Private construction was one of the major beneficiaries of rising corporate profits with a 17% rise in office starts in 2015. That kept non-residential construction capex growing at 1.5% in 2014 and 2015. We now expect falls of 0.5% to 1.0% for the next two years.

The risk of a higher Yen

… until 2017

The swing to a negative policy rate in January by the Bank of Japan (BOJ) has not worked as expected, as the Yen has climbed instead of falling, bank profits have been undermined, and pensioners are angry. Yet with BREXIT and other global risks ahead, the Yen could reach 100 by year-end. Provided some form of global normality returns next year, we expect a bit more inflation, a return to a positive BOJ rate, and a weaker Yen.

	2013	2014	2015	2016	2017
GDP, real growth (2005p), %	1.4	0.0	0.5	0.6	0.7
CPI, year average, %	0.3	2.8	0.8	0.6	1.1
Overnight call rate, year end, %	0.07	0.07	0.04	-0.01	0.01
Yen to US$1, year average	98	106	121	108	115

Sources: 2013-2015 data from the BOJ and government sources; 2016-2017 estimates by IMA Asia

China

Political & policy issues to watch

Xi's political goals

… performance legitimacy

… & placing his team

President Xi's goals are to sustain the communist party's performance legitimacy with citizens and to ensure that his supporters rise to power as the 19th party congress in late 2017 approaches. The anti-corruption campaign, launched in 2012, contributes to both goals and shows no sign on ending. It also distracts public attention from China's two big risks - bad debt and massive industrial overcapacity, both of which will force growth down and hurt citizens. Xi will get a second 5-year term in 2017 with considerably enhanced power. At issue is what he will do with that power, as he has moved slowly on reforms.

Slow progress on fixing China's debt crisis

Xi's caution means that plans to reduce debt risk and speed up industrial consolidation are moving slowly. That led S&P to cut its outlook on China's AA- rating from stable to negative in March, although it noted that reforms are moving in the right direction and that China's AA- ratings is well above emerging market peers. Yet, few useful steps have been taken to fix corporate debt and the related implosion of wealth management products.

Some progress on local govt. debt

… lowers risk & boosts financial sector efficiency

Progress is being made on tackling debt run up by local government financing vehicles (LGFV debt equals 38% of GDP). Replacing that debt with municipal bonds, which weren't allowed until 2014, accelerated in 2015 with Rmb3.8tn (US$590bn) issued. Muni bonds typically cost local governments 30 basis points less than LGFV bonds and while the banks lose out on that, they gain on the lower risk rating for muni bonds (20% versus 100% for LGFV bonds), which also qualify for repurchase by the central bank. The process lowers the cost of local government debt, forces greater transparency on how funds are used, helps clear a blockage on bank balance sheets, and creates a deeper capital market. At the 2015 rate, five years will be required to convert some Rmb25tn in LGFV debt.

Outlook for the market

Beijing regains control in Q1

… but the trend to slower growth continues

China's leaders have done enough to stabilise the official growth rate around 6.7%, curb foreign exchange outflows, steady the Yuan, and fend off an array of debt-related risks, at least for this year. The tools used were monetary and fiscal stimulus and a blizzard of directives to all corners of the economy. Official GDP growth, which is more about Beijing's storyline than the economy, will stick in the 6.5-7% range in 2016 and stay above 6.5% to 2020 so that Beijing can deliver on its 13th 5-year plan goals. Actual growth is lower, with our forecast in the table below pointing to a persistent slow down.

Corporate sales growth stalls & profits drop

The scale of the slowdown is hinted in financial data from the National Bureau of Statistics (NBS), which covers 374,359 enterprises (18,373 of which are in the state-owned sector accounting for 21% of sales). Total sales for the first two months of 2016 grew just 1%, about the same as 2015 and down from 7% in 2014 and 11.2% in 2013. Profits for the state-owned sector plunged 14.5% for the first two months (from -22.9% for full 2015) while the non-state sector saw profits edge up to 8.6%yoy from -2.8% for 2015.

Weak growth in industry

… hints of brief stabilisation

Industrial output growth fell to 5.4%ytd for the first two months of 2016, the slowest pace in a data series that starts in 1997 apart from January 2001 (the global IT bust) and two months in 2009 (the global financial crisis). A hint of slightly better times for manufacturing has come in China's two purchasing managers' indices (PMIs). The NBS broke above 50 in March for the first time in eight months while the Caixin manufacturing PMI reached 49.7 with momentum that may carry it above 50 in April for the first time in a year.

Support from consumers

Underpinning 2016 growth are services and consumers. Domestic air travel grew 13.3%ytd for the first two months (up from 7.9%ytd for the year ago period) while light vehicle sales rose 9.8%yoy in March (to 2.06m units). Residential property sales rose 6.9% (by area) last year after a 9.1% fall in 2014, with 3-5% growth likely in 2016.

Low inflation & the Yuan's slide halts

Consumer prices rose 2.3%yoy in March, as pork prices jumped, while producer prices fell 4.3%yoy highlighting massive overcapacity and weak profits in industry. With the weaker US$, the Yuan has climbed back from 6.57 at the start of the year to steady around 6.46.

	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	1.7	1.9
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	6.45	6.25

Sources: 2013-15 data from CEIC and government agencies; 2016-17 forecasts by IMA Asia

Hong Kong

Political & policy issues to watch

Political clashes continue…

… but will they undermine HK's business environment?

… LegCo election could be key

HK's ongoing political clash between pro-Beijing and pro-Democracy factions has so far not significantly influenced the business climate for international companies. Our clients consistently say that while last year's Occupy movement and especially the violence in Mongkok in February cause concern, they remain generally satisfied with HK as a regional HQ location. Positive factors remain, including the rule of law and the free-flow of information. The key question is whether the political climate will worsen, affecting these advantages. Radical and even some "mainstream" pro-Democracy political leaders are making combative statements, including arguing for HK to consider independence – a non-starter with Beijing - when the 50-year "guarantee" of "one country, two systems" could end in 2047. If their candidates perform well in the September Legislative Council elections, it will likely embolden them to start a fresh round of more disruptive protests.

Bills passage remains an issue

In this difficult political environment, the CY Leung administration is struggling to pass bills in the Legislative Council (LegCo). Pro-government legislators used a piece of political trickery to pass funding for the high-speed rail program, but still need support for a range of other bills, including the budget, which should pass, and the transfer of the Western Tunnel to government control. This situation is likely to worsen in the run-up to LegCo elections.

China slowdown worries investors

Moody's March downgrade of Hong Kong's long-term debt outlook from Aa1/stable to Aa1/negative reflects increased investor concern regarding China linkages. The good news is that HK has large fiscal reserves (34% of GDP) that will help protect the economy, and that its banks have limited exposure to the current property downturn.

Outlook for the market

Lowest GDP growth since GFC

HK's GDP is forecast to expand by 1.5% in 2016, its worst result since 2009. Weak China demand is affecting the region's key trade and tourism sectors. Meanwhile, the housing slowdown will lead developers to limit their construction projects. These problems will likely ease slightly in 2017, allowing 2.0% growth. Housing construction will recover as the government boosts land sales, while China demand should stabilise. An ageing population and more competition from Chinese regions will limit HK's economy in the medium term.

Tourism industry hard hit

The tourism industry continues to suffer, with arrivals down 14%ytd to February, after a 3% fall in 2015. Shenzhen visitor restrictions, anti-mainland protests, weak Chinese demand, and relatively high luxury prices are keeping tourists away. These trends will likely cause further shrinkage over 2016. Yet, the recent China vaccination scare could boost medical tourism, as mainlanders take advantage of HK's high quality facilities. But this situation could trigger restrictions on hospital access and a fresh round of anti-China protests.

Tourism retail very weak

… domestic retail roughly flat

The tourism slowdown has hurt the retail sector. Falling tourist demand for jewellery (-24%yoy), electronics (-27%yoy), and clothing (-11%yoy) has lowered total retail sales by 13.6%yoy from a 3.7% fall in 2015. By contrast, domestic demand has remained relatively flat. Solid wage growth has prevented supermarket sales (0.0%yoy) and food staples (+2%yoy) from declining. This two-speed retail sector will persist, unless visitors return in substantial numbers. Consumer GDP growth will likely ease from 4.8% in 2015 to 2-3% in 2016-17.

Services mixed

The services sector performance will be mixed in 2016. Sentiment indicators have remained positive to neutral for finance & insurance and professional services. Import and export trade, lodging, and real estate report negative sentiment. This patchy result will likely limit services GDP growth to 2.0% in 2016 and 2.7% in 2017 from 1.9% in 2015.

Inflation to ease, US$ link here to stay

Rising food prices have pushed the CPI up 2.8%yoy in the first two months of 1H'16 from 2.4%yoy in 2H'15. However, we expect a reduction in housing prices and weak demand will bring down inflation for the rest of the year. The HK$-US$ link will force the monetary authorities to match future US interest rate rises.

	2013	2014	2015	2016	2017
GDP, real growth, %	3.1	2.6	2.4	1.5	2.0
Composite CPI (04/05), year average, %	4.4	4.4	3.0	2.1	2.2
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	7.76	7.75

Sources: 2013-2015 from Censtat, HKMA, and CEIC; 2016-2017 estimates by IMA Asia.

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Taiwan

Political & policy issues to watch

Tsai's government takes shape

… a focus on new industries

… + tricky ties with China

Incoming President Tsai Ying-wen's DPP government is starting to take shape ahead of her May 20th inauguration. She has selected as her premier former Finance Minister Lin Chuan, whose history as an advocate for financial reform should help Taiwan confront its economic and financial challenges. Lin has targeted six areas for economic development: biopharmaceuticals, defence technology, ICT, innovative agriculture, new energy, and high-value petrochemicals. A key issue will be how Taiwan handles China relations. The DPP's draft China trade bill would not allow any further deals with China without a Legislative Yuan vote. This bill, combined with China's icy relationship with the DPP, could halt any further development of trade ties under Tsai's government.

A 2nd offshoring wave

… as China wins a big TSMC plant

Taiwan went through its first wave of factory offshoring in the early 2000s when local companies moved their assembly operations to China. A second wave appears imminent, but this time for high value-added production. While Chinese firms have stepped up attempts to buy into Taiwanese chip builders and designers, the more important move, at least for now, is Beijing's decision to allow world-leading chipmaker TSMC to build a wholly-owned US$3bn factory in Nanjing. It is likely that other Taiwanese hi-tech factories will follow, and that could pose an early test for President Tsai's China policy.

While Hon Hai buys into Japan

Taiwanese firms are also looking to innovation and a broader base for the next wave of growth. Hon Hai's purchase of Sharp allows it to boost its technology base while acquiring a global name. Yet that will do little for production in Taiwan.

Outlook for the market

A weak global chip market will slow 2016

Taiwan's government expects a recovery in Q2'16, with growth forecast to lift to 1%yoy after a 0.6%yoy fall in Q1, leading to full 2016 growth of 1.5%. We are not so optimistic, as the global semiconductor market is not strong (WSTS, the global body for the industry, expects 0.3% growth this year after a flat 2015, with 3.1% forecast for 2017). A mild recovery in 2H'16 will put 2016 GDP growth at 0.8%. We've also trimmed our 2017 forecast to 2.1% to capture some offshoring of production, even though Taiwan should get a boost from a 2017 lift in the next global chip production cycle.

Manufacturing & exports should lift from late 2016

Exports fell 12.5%yoy in the first two months of 2016 from a 10.9% decline in 2015 (US$ basis). China, which makes up about one quarter of exports, led the downturn, falling 17%yoy from a 13% 2015 decline. Exports to the ASEAN-6 and the US both fell 9-10%yoy, while those to Europe were flat. Exports will likely fall by 5%yoy in Q2'16, before returning to 2-3% growth in the rest of 2016 and 2017. Industrial production fell 5.6%yoy in Q4'15 (and by 1.5% for 2015). A similar fall likely occurred in Q1, but by Q4 growth should be positive, putting the 2016 fall at 1% before a lift to 2% growth in 2017.

Housing slides

Taipei home prices in early 2016 were 9% below an April 2015 peak. Stimulus measures could stabilise the housing market for a few months, but we expect prices will fall by a further 5% by mid-2017. A large unsold inventory saw home starts down 21%ytd by February 2016 from a 25% fall in 2015. This will likely push housing investment down 2-3% in 2016 from a 1.4% fall in 2015, before the sector stabilises in 2017.

Services will help growth

The service sector should outgrow GDP by about 0.5pp in 2016 and 2017. Strong visitor arrivals (+14%yoy in Jan-Feb) will boost tourism, while an ageing population will lift the health sector. However, the housing downturn will limit real estate and financial services.

Interest rate cuts & a weak NT$

Faced with little inflation and a weak economy, the central bank cut its policy rate by 12.5bp to 1.5% in March, the third small cut since August. The authorities will favour a weak NT$ to help exporters.

	2013	2014	2015	2016	2017
GDP, real growth, %	2.2	3.9	0.7	0.8	2.1
CPI, year average, %	0.8	1.2	-0.3	1.1	1.8
Official discount rate, year-end, %	1.88	1.88	1.63	1.50	1.50
NT$ to US$1, year average	29.8	30.4	31.9	32.9	32.9

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

The above forecast is by IMA Asia. Companies seeking local advice and forecasts should contact:

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South Korea

Political & policy issues to watch

Park becomes a lame-duck president

A big loss for the ruling Saenuri party in the April legislative elections will bring an end to reform by legislation in the final two years of President Park Geun-hye's single 5-year term. Support for Saenuri collapsed over President Park's hard line on North Korea and her heavy-handed efforts to manage domestic politics, including her own party. While this dramatic political realignment shouldn't hurt Korea's short-term growth, the lack of reform will limit long-term growth prospects.

Stalled reforms limit long-term growth

An ageing population, manufacturing offshoring, and a rigid business structure are limiting long-term GDP growth. Income inequality, which was traditionally low, has also widened quickly since the Asia Crisis in 1997. If Saenuri had done well in the April race, Park hoped to have enough votes for reforms to end a rigid dual labour market, to boost a low female participation rate, or to expand and improve the position of migrant labour.

Facing a tougher China market

Exports to China have been critical for Korea over the last 15 years, rising from 11% of total in 2000 to 26% in 2015. Yet Korean firms report persistent barriers, despite a major effort by President Park to build closer diplomatic ties. In a recent survey, exporters said they face 26 non-tariff barriers in China, against five for Japan and four for Indonesia. Park will have a hard job convincing China to lower barriers while its economy is weak.

Outlook for the market

A consumer recovery should sustain 2016 growth

Korea should do better than Asia's other big export manufacturers in 2016, as its consumer sector recovers from two years of suppressed growth caused by MERS in 2015 and the Sewol ferry tragedy in 2014. Retail sales growth lifted to 4.9%yoy in Q4'15 from 1.3%ytd for the first three quarters of 2015. On the GDP real growth measure we expect consumer demand to grow 2.7% this year and 2.5% next year from 2.2% in 2015 and 1.7% in 2014. That should offset weak exports and keep GDP growth close to the 2015 rate.

… manufacturing will struggle

The manufacturing sector is struggling, with the purchasing managers' index tracking below the 50-stable level for 12 out of the 13 months to March. Weak global demand saw car production drop by 6%yoy in the first two months of 2016 after a flat 2015, while exports of electronics parts and components fell 16.5%ytd by February after 3.3% growth in 2015. After a 0.7% fall last year, industrial production will be flat at best this year with a lift to 2% growth in 2017, provided global demand recovers.

… a hot housing market will slow

After strong residential property price rises in 2015, tighter mortgage rules saw price growth cool in early 2016. Developers are still confident, with housing starts up by 22%ytd by February, matching the 2015 growth rate. But as the annual rate for housing starts is now 65% above the 10-year average, a pullback has to be expected soon. That will limit construction GDP growth to about 2.7% this year from 3% last year with a fall of 2-3% possible in 2017 as the market corrects. Risk of a housing bust needs watching.

Good services growth

Growth in the services sector should ease to around 2.5% this year and 2017 from 2.8% in 2015. Tourism is doing well (with arrivals up 12%ytd by February 2016) while demand for health and social services is growing at double the pace of GDP.

Low rates stay

… & a firm Won

Over the last four years, the Bank of Korea has cut its policy rate from 3.25% to a record low of 1.5%. That hasn't stopped the Won rising from 1170 to 1147 on a weakening US$ over Q1'16. While Korea would like a weaker currency, there is no macro reason for that, so a firm Won will persist while the broad rise of the US$ halts.

	2013	2014	2015	2016	2017
GDP growth, %	2.9	3.3	2.6	2.4	2.6
CPI, year average, %	1.3	1.3	0.7	1.2	1.4
BOK Base rate, year-end, %	2.50	2.00	1.50	1.50	1.50
Won to US$1, year average	1,095	1,052	1,133	1,177	1,156

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

Watch for a 2nd cabinet reshuffle

… as Jokowi's position improves

April opens with a stronger President Joko Widodo ("Jokowi") on the brink of his second cabinet reshuffle as he looks to tap better managers. He is clearly unhappy with some ministers, as well as with the slow pace of reform, which also reflects efforts by mid-level bureaucrats to obstruct policies. That includes delays in releasing a revised negative investment list by the BKPM (Indonesia's investment board), as other government agencies have tried to block industries from being opened up to foreign investors.

The opposition fragments

A second challenge has been an opposition-controlled legislature that blocks many bills. That problem should fade, with the opposition Red & White Coalition (KMP) finding its lead party, Gerindra (led by Prabowo Subianto), under investigation for corruption and its biggest member, Golkar (led by Aburizal Bakrie), recovering from months of internal battles. Smaller parties have started migrating to the government's camp.

Fiscal constraint in 2016

… cuts to cope with cheap oil

Work on revising the 2016 budget has started, as the global oil price is stuck well below the budget's US$50/bbl assumption. The existing budget capped this year's lift in spending at 2.8% after a 5.7% rise in last year's revised budget (and that had been cut from initial plans for a 10.7% rise before the oil price plunged). Under the 2.8% cap of 2016, central government spending was to fall by 4.8% while funds transferred to the regions were to jump 19%. This reflects Jokowi's annoyance with central ministries, which got an 11.4% increase in the 2015 budget, and ended up sitting on unspent funds.

Watch out for aggressive tax collection

Tax collection efforts will also be stepped up. That may be uncomfortable for MNCs, as officials including Finance Minister Bambang Brodjonegoro claim that some 2,000 foreign companies are evading tax payments through transfer pricing and other means. The information ministry has also proposed regulations to force internet firms like Google, Facebook, and Netflix to incorporate locally and pay local taxes.

Outlook for the market

Growth rose at the end of 2015

… as local demand lifted

… helped by better public spending

Despite the challenge of cheaper oil, Indonesia looks set for a mild recovery in 2016 driven by domestic demand with the help of lower inflation and interest rate cuts. Growth in the final quarter of 2015 hinted at the 2016 lift, with GDP up 5%yoy after three straight quarters of 4.7%yoy growth. The late 2015 lift came from a sharp rise in government consumption growth to 7.2%yoy in 2H'15 after a year stuck around 1.0%, plus a lift in fixed investment to 6.9%yoy growth in Q4'15 after six quarters averaging 4.4%. Both gains partly reflect Jokowi's drive to gain control over a slow-moving government. The weak areas in Q4'15 were personal consumption (at 4.9%yoy after three quarters at 5.0%) and exports (down 6.4% in volume after being flat through the first three quarters).

Manufacturing & construction lift in Q1

… and should do better in 2016

2016 has started well with the March purchasing managers index (PMI) rising to 50.6 from 48.7 in the previous month, as better local demand boosted the manufacturing sector. Confirmation of an industrial lift also came from state power utility PLN, which reported a 10.4%yoy rise in electricity sales for February. We have lifted up our industrial production growth forecast to 5% for 2016 and about 6% for 2017 from 4.6% last year. Construction should get a similar lift, with a 4.6%ytd rise in cement sales by February (after 0.9% growth in full 2015) hinting at construction growth of 7-8% in 2016 and 2017 from 6.6% in 2015.

Big rate cuts help local demand

… while the Rupiah rises

With inflation under 5% for the five months to March, Bank Indonesia has made three rate cuts so far this year (to 6.75%) and has room for several more. That the Rupiah climbed 3.5% from last December to March (at 13,193 to the US$) reflects growing confidence in Indonesia and the bizarre global interest rate market. The Rupiah has a track record of 3-6 month rebounds after which it returns to a 3-5% annual fall on the US$.

	2013	2014	2015	2016	2017
GDP, real growth, %	5.6	5.0	4.8	5.7	6.2
CPI, year average, (2012=100), %	6.4	6.4	6.4	4.1	5.2
Central bank policy rate (O/N rate) at Dec %	7.50	7.75	7.50	6.00	6.50
Rupiah to US$1, year average	10,460	11,868	13,389	13,358	13,750

Sources: 2013-2015 government data (BPS, BI) and CEIC; 2016-2017 forecasts by IMA Asia

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Malaysia

Political & policy issues to watch

Political risk

… high for deals with PM Najib

… reduced for 1MDB

Our March review of Malaysian politics found that risk associated with PM Najib Razak's battle to stay in office was rising, while risk associated with 1MDB, the investment vehicle at the centre of the corruption scandal, was falling (ask if you'd like a copy). Specifically, deals done with Najib's administration may be questioned when he leaves office. By contrast, the damage inflicted on Malaysia's commercial scene by 1MDB has been reduced thanks to big assets sales to two Chinese state-owned enterprises (SOEs). Unlike many commentators who argue that Najib's hold on power is secure, we think that a wave of revelations by foreign agencies investigating deals or transactions done with 1MDB will force UMNO, the ruling party, to replace Najib before the 2018 elections.

Watch the Sarawak poll

… & choice of a Bank Negara head

Elections in the key east Malaysian state of Sarawak on May 7 may reveal the damage done to Najib and UMNO by 1MDB. Sarawak's support for UMNO was critical to its narrow win in the 2011 federal election, so any drop in support will worry UMNO. Almost as important will be the nomination of a new head for Bank Negara, the central bank, as the highly-regarded Zeti Aziz steps down at the end of April. Her call for 1MDB to be investigated for breaking central bank rules has been ignored by Najib's government.

A big Q1 rebound for the M$

… yet risks lie ahead

The 1MDB saga did not prevent a rebound in the M$ and capital inflows in Q1. Reuters reports the best quarter for the M$ in 43 years (up 10% after an 18.5% fall in 2015) and that Q1 bond inflows were bigger than the entire 2015 outflow. Yet vulnerabilities remain as external accounts take a hammering from low oil prices, and households and corporates cope with a big jump in debt (to 89% and 70% of GDP respectively).

Outlook for the market

Growth slows in 2016 as oil income and exports fall

The economy has entered a slower path, with growth expected to ease to 3.4%pa in 2016-17 from 5.5%pa in 2014-15. The household and government sectors will be unable to fully offset the impact of sluggish global demand on the economy, as they both face spending constraints. Falling oil prices in 2015 forced the government to trim its FY2016 budget (40% of public revenue comes from the oil & gas taxes and dividends), while national oil company Petronas aims to cut capital and operating spending by 20% in 2016, as part of an M$50bn expenditure reduction out to 2019.

Consumers are pulling back

Consumers are facing uncomfortably high debt, reduced employment opportunities, and an emerging housing correction. Their predicament has been reflected in the MIER consumer sentiment index hitting a record low in Q4'15, and rapidly falling passenger car sales (-17.6%yoy in January-February after a 0.4%yoy rise in 2H'15). With the government no longer able to boost household purchasing power with recycling of oil revenues, private consumption growth is set to subside to 3.3%pa in 2016-17 from 7%+pa in 2003-14.

Transport projects to sustain capex activity

Falling approvals for manufacturing investment and housing construction point to slower capex growth. However, ongoing work on large transport projects, such as the LRT & MRT in greater Kuala Lumpur, and the Pan-Borneo Highway in East Malaysia should be able to sustain fixed investment growth of 2.3% in 2016 and 3.8% in 2017.

Interest rate cuts ahead

… and a return to a weaker M$

Subsidy cuts, along with higher electricity and highway toll prices lifted inflation to 4.2%yoy in February from zero in February 2015. Inflation should average 3.7% in 2016 before easing to 2.5% in 2017. Inflation considerations will not prevent interest rate cuts to counter slowing growth. Unless global oil prices move up sharply, the M$ is likely to give up some of its Q1 rebound through Q2 and Q3 as global risks rise and the US$ returns to an upswing. Provided political risk eases by end-2016, the M$ could regain ground in 2017.

	2013	2014	2015	2016	2017
GDP, real growth, %	4.7	6.0	5.0	3.4	3.4
CPI, year average (2010=100), %	2.1	3.2	2.1	3.7	2.5
Central bank overnight policy rate, Dec, %	3.00	3.25	3.25	3.00	2.75
Ringgit to US$1, year average	3.15	3.27	3.90	4.06	3.92

Sources: 2013-2015 government, Bank Negara, & CEIC; 2016-2017 forecasts by IMA Asia..

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Philippines

Political & policy issues to watch

A wide open race for the presidency

Opinion poll ratings for the leading presidential candidates keep changing in the run up to the May 2016 election. The latest puts Davao City mayor Rodrigo Duterte in the lead for the first time with 27%, followed by independent senator Gloria Poe with 23%. Poe recently won a legal challenge regarding her eligibility, but the issue of her Philippine residency could re-emerge if she wins office. Vice President Binay was third with 20%, while former interior minister Manuel Roxas came behind with 18%. Roxas, who has been consistently trailing in the polls, is backed by President Aquino as the candidate most likely to continue his growth-enhancing reforms. Bongbong Marcos, son of former dictator Ferdinand Marcos, leads the opinion polls in the VP race (which is not a combined ticket with the presidential race) with 26%. Besides electing a new president for a single six-year term in May, Filipinos will also be voting for some 300 lawmakers in the two-chamber parliament and 18,000 local government officials.

Financial markets aren't worried by political risk

… a strong sovereign credit rating

The recent firmness of Philippine bonds, stocks, and the Peso suggest that investors are unconcerned about the risk of a new president derailing President Aquino reforms, which helped lift the country's growth and win an investment-grade credit rating for its sovereign debt. Investors take the view that a less reformist president will not damage the solid fundamentals and growth momentum of the economy. In early April, Fitch affirmed its "BBB" credit rating with a "Positive Outlook" on the back of strong external and public finances. Fitch notes that the country is a net external creditor (in contrast to its median "BBB" peers, which are net debtors), with public debt falling to 36% of GDP in 2015 from 43% in 2010. It also highlights the resilience of the local banking sector, its strong liquidity and early implementation of the Basel III minimum capital standards.

Outlook for the market

Local demand drives growth

… helped by a rebound in public spending

Unlike most of its ASEAN neighbours, domestic activity rather than goods exports is the main driver of the Philippine economy. This has been reflected in the contrasting performance of falling US$-based exports (-4.2%yoy) and surging manufacturing output (up 21.5%yoy) in the first two months of Q1'16. The domestic economy is currently getting a boost from election-related spending, including President Aquino's 30%+ fiscal expansion, which aims to correct unintended underspending in 2015. Strong domestic momentum should lift GDP growth to 6.3% in 2016 and 6.0% in 2017 from 5.8% in 2015.

A big pipeline of infrastructure projects

The government's public private partnership (PPP) infrastructure program will remain the main driver of capex expansion in the coming years. The authorities are currently seeking bids for US$6.5bn worth of mostly transportation projects, which will be handed over to the next administration. Additional support will come from foreign direct investment (FDI), approvals of which surged 27% to US$5.3bn in 2015. Capex expanded 14% in 2015 and should continue to grow faster than GDP at around 9% in 2016 and 7% in 2017.

Cashed up households

Consumer growth is set to rise to 6.3% in 2016 and 6.4% in 2017 from 6.2% in 2015. Upbeat consumer sentiment and double-digit growth of passenger car sales do not reflect the slowdown of remittances sent home by Filipinos working overseas (4.6%yoy in 2015 the slowest since 2002). A firm jobs market (record low unemployment of 5.6% in late 2015) with better paying jobs in the booming BPO sector are lifting household finances.

Low inflation, steady interest rates and a firm Peso

With inflation well-behaved (1.1%yoy CPI in Q1'16 from 1.4% in full 2015) and fiscal policy on an expansionary mode, the central bank is likely to keep its policy interest rate at the current 4% level well into 2017. In line with regional trends, the Peso gained 4.4% on the US$ since mid-January, partly reversing its 15.4% decline of 2013-2015. With the post-2013 US$ upswing starting to fade, the Peso is likely to stay moderately firm in 2016-17.

	2013	2014	2015	2016	2017
GDP growth, %	7.1	6.1	5.8	6.3	6.0
CPI, annual average, %	3.0	4.1	1.4	1.6	2.5
Central bank reverse rep. rate, year end	3.50	4.00	4.00	4.00	4.00
Peso to US$1, annual average	42.4	44.4	45.5	46.3	45.8

Sources: 2013-2015 BSP data and CEIC; 2016-2017 forecasts by IMA Asia.

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Singapore

Political & policy issues to watch

A steady fiscal stimulus from 2H'15

Faced with a weak global economy, the government has lifted its fiscal stimulus since mid-2015. Public consumption rose 10.7%yoy in 2H'15, while public capex grew 6.6%yoy, helping to cushion a 2.9%yoy fall in private capex. The budget for FY2017 (starting April 1) will continue the stimulus with a 7.3% rise in spending. Some of the extra spending will help the offshore marine sector (with a production index down 18% last year followed by a 26%ytd fall in the first two months of 2016) adjust to an awful global outlook, while S$770m is allocated to wage subsides aimed at preventing job losses.

Local banks face some bad debts

While Singapore's government has a rock solid AAA rating, several of its big banks will face modest challenges in the extended global downturn. Moody's has just lowered its credit outlook for DBS, OCBC, and UOB as they need to lift their provisions for rising bad loans, notably to the battered oil & gas service sector and a deflating property market.

The government prefers affordable property

Private home prices are now down 9.1% from a Q3'13 peak, with bigger falls reported for top-end property. Despite lobbying by developers, the government is refusing to reverse the higher stamp duties and credit restrictions that triggered the downturn. They take the view that lower home prices are desirable, even though Singapore's home prices and price-to-income ratios are not excessive global standards.

Outlook for the market

Another slow year in 2016

Our forecast of 1.8% growth this year and 2.8% next year is in line with the government's latest forecast of 1-3% growth. This year is unlikely to be much different from last year, with weak export volume growth, a small slip in consumer demand growth, and slightly better capex growth. The 2017 upturn is dependent on a recovery in global demand, to which Singapore's economy is very sensitive.

No consumer growth

… apart from a jump in car sales

Last year saw a surprisingly strong rise in consumer demand, with real growth of 4.5% on the GDP measure. Most of the growth was due to a doubling in new car registrations to 57,589 units as COE prices plunged. Take vehicles out of retail sales and growth of 4.4% last year (in current prices) turns into a drop of 1.2%. We don't expect retail sales growth (ex-cars) to do much better this year, while the GDP measure cools to about 3% for the next few years. In GDP, car sales are partly counted as personal consumption and partly as household fixed investment. Another measure of consumer demand is outbound travel, which rose 2.5% last year, down from average growth of 5.7% over the prior 10 years.

PRC arrivals keep tourism positive

Tourist arrivals were basically flat last year (up 0.9% to 15.2m) but that was thanks to a 22% jump in arrivals from China to 2.1m. The January occupancy rate was 84%, in line with the average since 2010, although the average room rate has softened a little lately.

A lift in public works

Fixed investment should edge back to weak growth (1-3%) for the next two years as public works lifts projects like the MRT network, the Singapore seaport, and Changi airport. Public construction contracts awarded jumped 146%yoy for the three months to January, which helped offset a 71% fall in private contracts.

Watch for the MAS to reverse the S$'s climb

The MAS just announced a monetary easing by shifting the pace of S$ appreciation against an undisclosed basket of currencies to zero from mildly positive. A policy of modest and gradual S$ appreciation had been in place since April 2010. The S$ has gained 6% on a US$ since early January, as the latter retreated against most currencies on the back of reduced expectations for US interest rate hikes. Concern over the impact of a relatively firm S$ on inflation (negative in the last 15 months), exports and tourism should lead to further easing of monetary policy latter this year.

	2013	2014	2015	2016	2017
GDP, real growth, %	4.7	3.3	2.0	1.8	2.8
CPI, year average, %	2.4	1.0	-0.5	-0.3	0.5
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	1.40	1.45

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

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Thailand

Political & policy issues to watch

The military aims to stay in charge

… even after elections

The military junta that seized power in the May 2014 coup is expected to stay in control of Thailand for several years, and possibly through the end of the decade. Even if an elected government emerges under a new constitution (Thailand's 20th), scheduled for a referendum on August 7, it would have very limited power, with greater authority resting in a military-appointed senate and a variety of other unelected bodies. If the constitution is rejected in August, a new draft (the 3rd since the 2014 coup and likely to be almost as undemocratic) will be developed and may be enacted without a public referendum.

A focus on big infrastructure projects to lift growth

Having entrenched its position, PM Prayut's government is putting more effort into reviving Thailand's economy through increased public investment, cutting red tape, and curbing corruption. The centrepiece of its initiatives is a US$50bn transport infrastructure program, which includes a US$5bn, 250km high-speed railway line connecting China's Kunming to Bangkok through Laos. There is additional fiscal support for the housing market (US$2bn) and several large support programs for farmers, who are struggling with severe drought and very low global rice and rubber prices.

… although the rail link to China may be delayed

The Kunming-to-Bangkok railway project is facing delays, as the two governments disagree over its cost estimates and financing. Having found China's funding proposals unattractive, Thailand will seek alternative financing arrangements. This will not be much of a problem, as the Thai banking system is awash with funds. Bank deposits have been growing much faster than loans since 2014, reflecting households' efforts to reduce their elevated debt, and companies' reduced funding needs as they operate well below capacity.

Outlook for the market

A weak and narrow recovery in 2015

… that slowly broadens in 2016

The economy is slowly recovering from a politics-inflicted downturn in 2014. At present, the upturn is narrowly-based, relying mostly on a 34% jump in government spending on construction in 2015 and a lift in net exports, as import volumes fell while export volume growth was mildly positive. Net exports in US$ terms also jumped on the trade account, which led to a big current account surplus and a firm Baht (down just 5% last year on a surging US$). Of course, strong net exports due to falling imports simply highlights weak local demand. 2016 should see the recovery broaden into consumer demand, stronger capex outside of infrastructure, and better growth in industry. But there are considerable headwinds apart from the drought, including high debt levels in rural and urban households, and caution among foreign investors in dealing with the military government.

A limited upturn for consumers

Record high household debt (71% of GDP) and slow wage growth (1.5% last year after two years above 9%) limit the recovery in consumer spending. The rebound in consumer confidence following the 2014 coup has faded, while credit growth to individuals has been retreating (6.5%yoy in February from 20.7%yoy in March 2013). Such factors limit the lift in consumer demand to 2.3% in 2016 and 3.0% in 2017 from 2.1% in 2015.

… and also for manufactures

Thailand's big manufacturing sector (28% of GDP in 2015) should see growth edge up to 2.2% this year from 0.9% last year and -0.2% in 2014. After barely positive export growth for the last two years, 2016 should see a lift to 2-3% growth with above 4% possible in 2017. Outside of infrastructure, demand from construction is likely to remain weak in 2016 as neither local household or business investors seem confident.

More rate cuts and a briefly stable Baht

With deflation of 0.5%yoy in Q1'16 there is room for the Bank of Thailand (BOT) to cut its policy rate in 2016 to help revive growth. In line with regional trends, the Baht rose on the US$ in Q1'16 and it may be stable for several quarters. Once the US$ regains an upward trend, which is likely by late 2016, the Baht should return to 2-4% fall in 2017.

	2013	2014	2015	2016	2017
GDP, real growth, %	2.7	0.8	2.8	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	35.7	36.6

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

A stable collectivist leadership

The re-election of Nguyen Phu Trong as Communist Party general secretary in January (regarded as the most powerful post in Vietnam's collectivist leadership) won't affect the outlook. We had thought that Nguyen Tan Dung, a strong reformer who was prime minister, would get the top post. He failed, and has just been replaced as PM by his deputy, Nguyen Xuan Phuc. Trong, now in his second 5-year term as party general secretary, and Phuc, as the new PM, represent continuity rather than faster change.

SOE restructuring edges ahead

… potentially ASEAN's biggest IPO pipeline

A core issue in Vietnam's reform process is the future of state-owned enterprises (SOEs). Some 30-50 SOEs could try IPOs this year as part of a privatisation process that has drawn little foreign interest, as the stakes on offer have been low (often around 3%). As Q2 is when SOEs usually outline their IPO plans, the amount on offer will be closely watched. On the distant horizon is a commitment under the Trans Pacific Partnership trade deal (if members, including the US, ever ratify it) that lifts the foreign ownership cap in a Vietnamese company to 65% from the current 49%. So far in 2016, Vietnam has raised more funds via IPOs than any of its ASEAN neighbours.

Curbing another real estate surge

The central bank will tighten home loan curbs after a 26% rise in real estate credit in 2015 as it is keen to avoid a repeat of the 2011-12 property bust. Other factors lifting real estate have been US$12bn in remittances from overseas Vietnamese in 2015 and reduced restrictions on housing investment by foreign investors. House prices are back near their pre-2011 peak, while property deals soared 75% last year in Hanoi and HCM City.

Outlook for the market

Growth drops in Q1'16

… due to weak exports & severe drought

Vietnam's economy cooled in Q1'16 with GDP growth slowing to 5.6%yoy from 7.1%yoy in Q4'15. Manufacturing slowed to 8.1%yoy from 11.7%yoy, construction to 11.2%yoy from 13.9%yoy, and farm output fell 1.1%yoy from a 3.2%yoy rise. Slower Q1 growth saw imports fall 5.1%yoy (US$-basis), the first quarterly fall since the 2008/09 global financial crisis (GFC). In part, the economy is being buffeted by weaker global demand, with Q1 export growth dropping to 3.9%yoy, also the slowest pace since the GFC. Farmers in the Mekong delta are also facing severe drought. River levels are dropping to record lows and salt water intrusion is damaging crops. Even growth in vehicle sales, which soared 54% last year, slowed to 29%ytd for the first two months of 2016.

Little recovery until year end

The combination of weak export demand and drought will pull growth down to 4-5%yoy for the next few quarters before an easing in the El Nino (forecast for mid-year) should see agriculture and GDP lift in Q4'16. Export growth is likely to slow to 4-5% this year and 5-6% next year from 7.9% last year and 13.7% in 2014. Growth of 10-15%pa is likely for exports of electronic and electrical goods based on new capacity but traditional exports like clothing and footwear will be weak, and agricultural exports will fall. Real growth for manufacturing will likely dip to 6-7% this year from 10.6% last year, with most of the support coming from construction demand for products like cement and steel.

Consumers get support from overseas funds

Consumer demand will do better than might be expected thanks to large remittances from overseas family members and strong wage growth in recent years. Still, the drought will hurt, cutting real consumer growth to 5% this year from an estimated 5.8% in 2015.

Infrastructure faces weak public funding

While residential construction has boomed, infrastructure faces public spending cuts as the government grapples with falling revenues from oil production and extra spending on anti-drought measures. Public debt edged up to 62.2% of GDP at the end of 2015, closer to the 65% cap set by the national assembly.

Room for interest rate cuts and a weaker Dong

With inflation dropping to 1.3%yoy in Q1'16 the central bank has plenty of room to cut interest rates to support local demand this year. Lower rates should also weaken the Dong and help exports. The Dong was steady through Q1'16 at 21,900 to US$1, but should return to a 3-4% annual fall on the US$ from 2H'16.

	2013	2014	2015	2016	2017
GDP, real growth, %	5.4	6.0	6.7	4.8	6.1
CPI, yoy, % (2005=100 from 2007)	6.6	4.1	0.6	1.4	2.0
Central bank refinancing rate, year end, %	7.00	6.50	6.50	6.00	6.00
Dong to US$1, year average	20,933	21,148	21,677	22,180	23,000

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

India

Political & policy issues to watch

The legislative path to reform is mostly blocked

There is no chance that PM Modi's government will gain the support of India's upper house to pass much of his reform legislation in the remainder of his current term to 2019. The opposition Congress Party, which controls the upper house with its allies, is a shambles, but its best shot of winning in 2019 is to prove the government is worse. The opposition has the wind in its sails following victories in several key state polls, with more likely in 2016. That also reflects the ruling BJP's weak strategy for state polls, which has focused too much on PM Modi and failed to adjust to local political realities. Congress Party's block on bills may well prevent introduction of a GST during the current parliament.

But a few key bills are passed

… opening up online welfare

Despite the bleak legislative outlook a few laws are being enacted. One allows the direct payment of subsidies and benefits to a recipient's bank account, thanks to the rapid spread of India's unique identification scheme (the Aadhar Bill, 2016). Apart from saving up to 1.5% of GDP, it could help transform the lower end of the consumer market. A second law sets up national and state real estate regulators, along with codes of conduct and protection for home buyers. That could boost property markets across the country, provided vested property interests, often tied to local politicians, can be nudged aside.

Plus steps to fix banks and boost infrastructure

Reform by the administrative channel is also possible, and that includes an array of finance sector reforms being pursued by the Reserve Bank of India (RBI) under Raghuram Rajah. The latest of these will help banks strengthen their woeful balance sheets by valuing fixed assets at market prices rather than book prices. Meanwhile, the government's latest budget contains a 22% lift in infrastructure spending along with steps to improve public-private partnerships (PPP). Both are vital to India's growth.

Outlook for the market

7%+ official growth; actual growth is slower

India's official GDP growth rate is set to chug along around 7% for the next few years (the IMF's April 2016 forecast is 7.5% in both 2016 and 2017). Yet the official data seems to overstate growth by 1-2 percentage points. Notably, Q4'15 saw manufacturing growth on the industrial production index (IPI) fall to 1%yoy, while manufacturing in GDP surged 12.6%yoy. Some divergence is normal, but it is very rare on such a scale.

A recovery in manufacturing after 3 bad years

The IPI is a traditional measure for growth in India, and by that measure manufacturing grew 3.3% in 2015 from under 1.0% for three years in a row as an over-leveraged manufacturing sector faced weak demand and had trouble borrowing. While growth fell 1.1%yoy in the first two months of 2016, we expect 2016 growth of 4.5% with 5-6% likely in 2017 as a cyclical upturn is assisted by interest rate cuts. The Nikkei/Markit manufacturing PMI for March hit an 8-month high of 52.4 on strong new orders. Meanwhile, the services PMI jumped to 54.3 in March from 51.4 in February 2016.

Urban consumer demand lifts

... but drought hurts rural India

The lift in demand is mostly coming from urban Indian consumers, with passenger vehicle sales surging 11%yoy in Q4'15 before settling back to 5%yoy growth in Q1'16. Urban India should also do well from a 21% pay hike for federal civil servants and pensioners from the 7th Pay Commission (a once-in-a-decade pay adjustment). By contrast, rural India is grappling with the first back-to-back drought in 30 years, and faces two more dry and hot months before the monsoon. That will hurt rural sales until 2H'16.

Moderate inflation

… rate cuts and a steady Rupee

CPI inflation dropped to 4.8%yoy in March. After a 25 basis point cut in its policy rate in early April (to 6.50%) the RBI may be able to make one more rate cut before moving to a mild tightening cycle in 2017 as growth and inflation lift. The drought has arrested the fall of global food prices, triggering a surge in food-price inflation. Like its Asian neighbours, the Rupee has firmed on a weak US$ in early 2016. While we expect stability into 2017 there are downside risks associated with large offshore debt.

Calendar year starting January	2013	2014	2015	2016	2017
GDP (MP, 2011-12), real growth, %	6.3	7.0	7.3	6.6	6.8
Inflation - CPI, %	10.1	6.7	4.9	5.3	5.8
RBI repo rate, December, %	7.75	8.00	6.75	6.25	7.00
Rupee to US$1, year average	58.5	61.0	64.1	69.3	69.5

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

A close 2016 poll

… in July or September

Under Australia's 3-year parliamentary term, PM Malcolm Turnbull must hold an election on or before mid-January 2017. He has threatened to bring it forward to July and dissolve the house and entire senate (instead of half the senate in a normal election) in an effort to wipe out micro parties who hold the balance of power between the two big parties and have blocked key bills. But after a recent swing in opinion polls in favour of the opposition Labor Party, Turnbull may decide to wait until later in 2016; likely around September.

Support for PM Turnbull slides

… over fiscal policy muddle

Turnbull has lost support as he has failed to present new policies after his Liberal Party dumped Tony Abbott as leader (and thereby as PM) last September. Abbott's hard-right views on fiscal policies and lifestyle issues turned off voters, and looked set to hand government back to Labor at the next poll. Yet Turnbull has left Abbott's policies in place, which may have been the price for support from the party's conservative wing, while floating an array of tax reforms, some of which were just as quickly dropped.

Watch for a cautious budget

… reality is a AAA rating, which lifts the A$

The May 3 budget will clarify how far PM Turnbull is willing to go on tax reform. Given the swing in opinion poll support, he will likely opt for small changes. Meanwhile, Fitch has affirmed Australia's AAA rating, stating that government debt (at 34.5% in FY'15) is sustainable, and well below the AAA median (43.6%). Fitch believes that Australia's stability is increasing $A use as a reserve currency, which would gradually lift the currency in the medium term. The main risks to the economy, in our view, are a crisis in China and a sharp retreat from a 3-year housing boom (see below).

Outlook for the market

A soft downturn to 2% in 2016

… supported by services growth

Australia has grown by 2-3%pa for five of the last six years and will likely have at least two more years in this band. This year, growth will be near the bottom of the band, as mining investment and manufacturing decline. Exports, though down massively in value terms, are rising in volume terms, which contributes to real (i.e. volume) GDP growth. Strong visitor arrivals (14%yoy in January) will help the tourist sector, while an east coast housing construction boom looks set to continue, although at a more modest pace.

Consumers likely to trim spending

Consumer growth is expected to ease towards 2.0% in 2016 and 2017 from 2.8% over the last two years. High debt levels and a cooling Sydney housing market will slow growth in spending. However, the labour market remains supportive, with falls in employment in mining and manufacturing being offset by strong services employment growth, leaving unemployment around 6% and wage growth level with inflation at 1-2% a year.

A big drop in manufacturing

Manufacturing output in 2015 was 8% below the 2011 level, with the machinery sector (-13%) hard hit by the end of the mining investment boom. With the remaining carmakers shutting down in 2017, manufacturing will fall by 3-5% in 2016 and 2017.

The mining capex retreat continues

… growth in housing capex slows

Private investment will continue falling over the next two years as mining investment retreats. Private non-housing construction capex (mostly mine-related) fell by 10%pa in 2014 and 2015, and is expected to drop 8-10% in 2016 and 5-7% in 2017. The wild card to watch is housing, as a 3-year surge in home approvals hit an annual peak of 239,000 units last October, almost 50% above its 30-year average of 160,000. The boom could turn into a bust, although at present a slowdown is underway with housing capex growth expected to ease from 8.5%pa for the last two years to 4.5% in 2016 and 2% in 2017.

A 2% policy rate into 2017

… and a short-term lift for the A$

Mild inflation should allow the Reserve Bank to keep its policy rate at a record low of 2% into 2017 before better growth nudges up inflation. The $A has jumped seven US cents since mid-January to US$0.76 as Australia's 1.89% 2-year bond yield look good in a volatile global market with negative yields in much of the OECD (also see Fitch's views about central banks buying the A$ above). The interest rate differential, which is often a factor in A$ movements, looks like driving the short-term value of the A$, as the prospect of more than one US Fed rate hike in 2016 has faded.

Year ending December 31	2013	2014	2015	2016	2017
GDP, real growth, %	2.0	2.6	2.5	2.1	2.2
CPI, year average, %	2.4	2.5	1.5	1.6	2.2
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	1.29	1.34
US$1 = A$, year average	0.97	0.90	0.75	0.78	0.75

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

New Zealand

Political & policy issues to watch

Teflon John looks good for 2017

After a decade in power, and three election wins, PM John Key remains remarkably popular despite the odd gaffe and occasional policy stumbles (his referendum on changing the national flag was rejected in March). His National party leads the Labour/Greens by 46% to 42% in opinion polls and Key will need to decide this year if he will run for a fourth term in the November 2017 election. His popularity and age (54) suggests he might.

Room for a bit of fiscal stimulus

… including 2017 tax cuts

Finance Minister John English will hand down the 2016 Budget in late May. Last October, he announced the first surplus (for FY2014/15) in eight years, meeting on schedule a goal the government has set itself in 2011. While another surplus was targeted for this year, that may be elusive as growth has slowed. At issue this May will be whether English can deliver on promised tax cuts in 2017, while also lifting spending to cushion a slide in GDP growth. Gross public debt was just 30% of GDP in 2015 according to the IMF, so English has room for both. Extra spending would likely go to Auckland urban construction and tourism to ease bottlenecks in these two booming sectors.

Outlook for the market

Growth cools

… but migrants, construction, and tourism all help

NZ grew an impressive 3.4% in 2015 on the GDP expenditure measure as export volumes jumped by 6.7% last year (from 3% in 2014) while imports slowed to 3.7% (from 7.9%). As a result, net real (or volume) exports swung from clipping 1.6 percentage points off GDP growth in 2013 and 2014 to adding 0.7 percentage points last year. By contrast, the value of exports fell 2.2% in NZ$ terms in 2015 as global milk prices plunged. That put the trade deficit over NZ$3bn from $1bn in 2014. The production measure of GDP did a better job of capturing the slowdown, as it dropped to 2.5% in 2015 from 3.7% in 2014. Growth at that more modest pace will likely continue for the next two years supported by a strong construction sector, which is backed up by equally strong net migrant inflows (119,200 people in the past two years – 2.6% of the population). Along with strong visitor arrivals (up 9%yoy for the first two months of 2016), this should keep consumer spending firm.

A 2-speed economy

NZ has split into a two-speed economy. In the fast lane are Canterbury, thanks to earthquake reconstruction, and Auckland, due to strong migration and house building. These regions achieved 7% nominal GDP growth in the year to March 2015. The rest of the country grew at 1%. This split-NZ trend will likely hold through 2016-17.

The housing boom starts to ease

The housing boom has entered its fifth year, with consents up 29%yoy in the first two months of 2016 after a 10% rise in 2015. Auckland, which is 37% of the total, rose by 61%yoy, while the surrounding Waikato, Northland, and Bay of Plenty regions all lifted by 40+%yoy. Home prices have started falling and that should see housing investment growth slow from 5.5%yoy in 1H'16 to 3-4%yoy in 2H'16 and 1H'17, and 2%yoy in 2H'17.

Dairy exports face another weak year

In NZ$ terms, exports face a weak start to 2016, with the global dairy market still struggling with a surge in supply out of Europe and less robust China demand. There are cautious hopes for a better supply/demand balance in late 2016. A 13% slide for the NZ$ (on the US$) in 2015 will help limit import demand and prevent a trade deficit blowout.

A record low policy rate doesn't halt the NZ$'s rise

With the housing market starting to cool, the Reserve Bank (RBNZ) felt it had room to cut interest rates by 25bp in March to a record low of 2.25% in order to support local demand. That hasn't stopped the NZ$ continuing a slow drift up on the US$ that started last September (from a low of $1.58) as the 2-year government bond yielding 2% and the 10-year bond at 2.8% are still attractive to investors with the US Fed pausing its own rate hike. The currency is now at NZ$1.47 to US$1 and likely to continue drifting up into 2017, even though the RBNZ, dairy farmers, and the government oppose that. The challenge for RBNZ will be whether it can take its rate even lower in the next year to halt the NZ$ rise.

Calendar years	2013	2014	2015	2016	2017
GDP(Expenditure), real growth, %	1.7	3.0	3.4	2.5	2.8
GDP(Production), real growth, %	2.4	3.7	2.5	2.3	2.6
CPI, year average, %	1.1	1.2	0.3	1.1	2.0
Official cash rate, year end, %	2.50	3.50	2.50	2.25	2.25
NZ$1 = US$, year average	0.82	0.83	0.71	0.70	0.74
US$1 = NZ$, year average	1.22	1.20	1.41	1.42	1.35
NZ$1 = A$, year average	1.18	1.09	1.06	1.10	1.01

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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