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Asia Pacific Executive Brief

May 2016

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Global outlook

A mild 2016 upturn led by the US, Euro area & Asia

Despite financial market volatility, an array of big risks like Brexit (June 23rd) and weak global stock markets, global growth looks set to edge up in 2H'16 with steady or better growth in the US, the Euro area, and most of Asia. However, in emerging markets outside of Asia, growth is expected to remain weak due to a mix of bad politics and weak commodity prices. The net outcome is likely to be little growth in global trade after a very weak start to the year (one important measure, the Shanghai Containerised Freight Index, hit a record low last month from its inception in 1998).

US growth lifts from a weak Q1

… strong housing & a lift in consumer demand

… watch for better corporate capex

After a choppy Q1'16 in the US, early Q2 data points to a steadier growth, with the main concern being weak investment in plant & equipment (growth falling to 0.3%yoy in Q1'16 after slowing to 3.1% in 2015 from 5.8% in 2014). Consumer growth eased to 2.7%yoy in Q1, but the pace should lift to 3% for full 2016, as rising wages and a firm jobs market saw the University of Michigan's preliminary index of consumer sentiment jump to 95.8 in May from 89 in April. Capex on homes is also running strong (up 10.6%yoy in Q1 after 9.4% growth in 2015) and should stay close to 8% this year before easing to 6% in 2017. Sales of existing homes rose 6%yoy in April, while prices rose 6.3%yoy (the 50th straight month of price gains). As the unsold inventory has dropped to 4.7 months, there's considerable pressure for growth in new housing starts. US inflation edged up by 1.1%yoy in April from 0.9% in March on rising fuel prices. With firmer growth ahead, we expect one US Fed rate hike before year-end. That shouldn't interfere with a 2H'16 rise in plant & equipment spending, which will help lift full year GDP growth to 2.6%, with 3% possible in 2017.

A milder Euro zone upturn

… capped by political risk

The Euro zone is six quarters into a mild recovery with Q1'16 growth of 1.5%yoy. The recovery is broad-based, with growth trending up over the last six quarters for consumers, fixed investment, and government demand. New car sales for April were up 8.5%yoy, with the annual rate close to 10m units from a recent low of 8.5m in mid-2013. The zone's residential property prices are also rising by 2%yoy. The weakest aspect is sentiment for both consumers and corporates, and that undoubtedly reflects the uncertain political outlook across the continent. That will likely cap growth around 1.7% in 2016 and 2017.

The challenge of weaker stock markets

The mild global upturn could be challenged by falling stock markets, which face two challenges: the capacity of central banks to boost asset prices by quantitative easing (QE) and negative interest rates is fading; and corporate earnings also have to adjust to weaker growth scenarios and an end to short-term fiddles to boost share prices.

A bit more inflation by end 2016

The world's battle with low inflation/deflation should ease in 2H'16 and give way to mild inflation in 2017. Three factors have driven prices down: supply exceeding demand for many goods, commodities, and some services (like shipping); low food prices (another supply > demand story); and the plunge in oil prices over the last two years. The oil market appears to be rebalancing in 2016 due to supply disruptions in Nigeria and Venezuela, strong global gasoline demand, and fast rising Indian oil demand. We've lifted our 2016 oil price estimate from US$35 to $45, although extra crude supply expected in 2017 suggests limited movement above that next year. That's still enough to nudge world inflation up.

The US$ returns to a rising path

Our forecasts over the last year anticipated a rising US$ (on its trade weighted index) into 2017, mostly due to better growth and higher interest rates in the US. While that trend disappeared in Q1, it is re-asserting itself in Q2, and looks set to continue into 2017.

IMA Asia's forecasts	2013	2014	2015	2016	2017
World – Real GDP growth, %	3.3	3.4	3.1	3.2	3.5
- US	1.5	2.4	2.4	2.6	3.0
- Euro area	-0.3	0.9	1.6	1.5	1.6
- Asia/Pacific (14)	4.5	4.3	4.3	4.2	4.3
- NICs (4)	2.7	3.4	2.1	1.3	1.8
- Developing or "EM" Asia (7)	7.0	6.8	6.6	6.2	6.1
- ASEAN (6)	5.0	4.4	4.4	4.4	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	96	51	45	48
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	0.3	0.6
China	7.7	7.3	6.9	6.5	6.2
Hong Kong	3.1	2.6	2.4	1.3	1.6
Taiwan	2.2	3.9	0.7	0.2	2.0
South Korea	2.9	3.3	2.6	1.7	1.8
Indonesia	5.6	5.0	4.8	5.2	5.8
Malaysia	4.7	6.0	5.0	3.4	3.4
Philippines	7.1	6.2	5.9	6.7	6.0
Singapore	4.7	3.3	2.0	1.8	2.8
Thailand	2.7	0.8	2.8	3.3	4.3
Vietnam	5.4	6.0	6.7	4.8	6.1
India (CY)	6.3	7.0	7.3	6.4	6.6
Australia	2.0	2.6	2.5	1.9	2.1
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	0.1	0.7
China	2.6	2.0	1.4	2.6	3.3
Hong Kong (composite CPI)	4.4	4.4	3.0	2.1	2.2
Taiwan	0.8	1.2	-0.3	1.2	1.3
South Korea	1.3	1.3	0.7	1.2	1.4
Indonesia	6.4	6.4	6.4	4.2	4.7
Malaysia	2.1	3.2	2.1	3.2	2.5
Philippines	3.0	4.1	1.4	1.5	2.4
Singapore	2.4	1.0	-0.5	-0.4	0.6
Thailand	2.2	1.9	-0.9	0.1	1.3
Vietnam	6.6	4.1	0.6	1.8	2.5
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	0.9	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	6.51	6.75
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	1,192	1,175
Indonesia	10,460	11,868	13,389	13,358	13,750
Malaysia	3.15	3.27	3.90	4.07	3.92
Philippines	42.4	44.4	45.5	46.7	46.0
Singapore	1.25	1.27	1.37	1.40	1.43
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	66.8	59.3
Australia	1.03	1.11	1.33	1.38	1.44
New Zealand	1.22	1.20	1.43	1.47	1.41

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

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Regional outlook

Political & policy issues to watch

Asia's new leaders

… Tsai in Taipei

… Duterte in Manila

Asia's relatively new democracies are starting to choose more non-traditional leaders from outside the elites that led government in the first decade or so of democracy. The latest are President Tsai Ing-wen, who was sworn in as Taiwan's first female leader on May 20 and, Rodrigo Duterte, who will be sworn in as the Philippine's next president on June 30. Both won office on a commitment to change policy in ways that prior administrations were unwilling to. While this will cause consternation in some sectors, it's not necessarily bad for markets. PM Modi in India and President Jokowi in Indonesia were outsiders elected some two years ago to deliver change. Both have met stiff resistance, but both continue to be backed by markets who see their reforms as a plus for growth.

Jokowi gains ground in Jakarta

For an outsider, President Joko Widodo ("Jokowi") is proving to be quite adept at winning political battles in Jakarta. While it has been a slow process with occasional setbacks, the first five months on 2016 have seen Jokowi strengthen his position with respect to the legislature (where he is now backed by a majority), his cabinet (by weeding out non-performers), and his party (by proving a better national leader than party head Megawati). That will help him move forward on reforms that should lift long-term growth.

Asia's struggling governments in Korea, Malaysia, & Thailand

Growth is being held back in several countries by governments that are struggling. In Korea, April's elections saw President Park lose control of the legislature, which means she'll achieve little in her final 18 months. In Malaysia, the 1MDB scandal undermines PM Najib's government and worries investors. Thailand's military government is keen to kick-start growth, but is doing little to win the confidence of voters or investors.

RISK – China's new surge in debt

… not yet a crisis but concern is growing

China has embarked on another surge in credit growth that runs contrary to official calls for debt-fuelled growth to stop and for consolidation to start. The scale and speed with which credit is rising worries many analysts, with some estimating that non-performing loans are closer to 20-30% of all loans instead of the sub-2% official level. Given Beijing's control over state-owned lenders and borrowers, where most of the bad debt seems to be, a crisis doesn't appear to be imminent. However, operating conditions are likely to deteriorate this year, with a blow-out in receivables and rising bad debts. The potential for China to topple into a debt crisis is the biggest risk facing Asia.

Outlook for the market

Asia's mixed growth picture

Provided China avoids a debt crisis, developing Asia (China, India, and ASEAN minus Singapore) is set to hold onto 6% growth in 2016 and 2017. However, our country reviews show that this is a mixed picture. In both China and India, core sectors – mostly in manufacturing - have little growth and are struggling with a mix of over-capacity, weak demand, and too much debt. Strong services growth has been critical to keeping both economies growing at 6-7%. Meanwhile, strong growth in Vietnam and the Philippines is being offset by falling growth in Malaysia and Singapore and weak recoveries in Thailand and Indonesia. With global trade falling in early 2016, our forecasts for Asia's big traders (Japan, Taiwan, Korea, HK, and Singapore) have also been trimmed.

El Niño has hurt this time

… but La Nina is due soon

This year's El Niño hit harder than the last few cycles, triggering bad droughts across India, Thailand, Vietnam, the Philippines, and Indonesia (adding to the 2015/16 fires). That cut rural production and trimmed consumer spending in 2015 and 1H'16. A wet La Nina weather cycle will start in the next few months, which should boost production and incomes in 2H'16 and 2017, which is a factor behind our forecast of better growth in 2017.

Looking for opportunities?

Companies looking for strong growth opportunities will continue to find them in the Philippines (provided Duterte proves to be a stable president), Vietnam, and the frontier markets of Laos and Cambodia (both growing at 6-7%). Recovery opportunities look promising in Indonesia and India, as pro-reform political leaders in both gradually gain policy traction against stiff resistance.

Asia's currencies on a rising US$

With the US dollar returning to an appreciation path, currency moves become important. Japan's Yen has climbed over the last year, but should weaken next year provided global risk worries ease. Meanwhile, China's Yuan is likely to drop by 3-4% on the US$ this year and next year. Other Asian currencies that tend to be firm on the US$, mostly on the back of rising current account surpluses, will need to watch they don't rise too fast on the Yuan.

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Japan

Political & policy issues to watch

Abenomics has failed

… not enough reform or fiscal stimulus

Three and a half years after being swept into office on the promise of radical change to revive growth, PM Abe faces a dilemma. Growth has stalled, deflation looks set to return, and offshore corporate earnings are being battered by a rising Yen that defies a move to negative interest rates in January by the Bank of Japan (BOJ). These outcomes reflect problems in two areas: a weak global economy combined with rising fear of global volatility; and Abe's failure to deliver structural reforms and sufficient fiscal stimulus alongside the Bank of Japan's massive monetary easing.

But voters still back PM Abe

… & economic policies now have priority

As PM Abe contemplates how to handle a G7 Summit (May 26-27), mid-year upper house elections, lower house polls by December, and a planned sales tax hike to 10% from 8% next Apri,l two other factors will be important. The first is that he is unlikely to lose office, as popular support for his cabinet is steady at 45%, while opposition parties poll in the single digits. Second, the Kyushu earthquake in April has taken off the table the option of running upper and lower house polls together in summer, as that would be too big a burden for local governments working on quake recovery. That means Abe's push to amend the constitution for a more assertive defence posture, which he tended to give priority over economic policy, is also off the table.

Don't expect big reforms

… but watch for more fiscal stimulus

Ideally what happens next is a big package of structural reforms and a new fiscal stimulus equal to at least 1.5% of GDP. Unfortunately, Abe has never been a brave reformer, so whatever reforms he puts forward won't do much. We do, however, expect a major fiscal stimulus, as despite a mountain of public debt, servicing new debt has no cost (a -0.10% yield for the 10-yr bond). Moreover, global views on central banks monetising government debt are changing. The BOJ already holds some 30% of government debt and could push this to 50% in the next few years. We'd expect Abe to announce a significant fiscal stimulus package on the eve of the G7 summit. Meanwhile, we don't expect the April 2017 sales tax hike to go ahead, and we removed it from our forecast in Q1.

Outlook for the market

Demographics drives growth lower

Demographics has a decisive impact Japan's outlook. Real GDP growth for the last five years averaged 0.5%, half the rate of the prior 20 years. But as the working-age population fell by 1.5%pa, real growth per working age person was 2%pa, which is faster than the US, UK, or Germany on that measure. The BOJ has trimmed its long-term growth forecast to 0.5%pa from 1% made three years ago. In many parts of the economy businesses should plan for flat of falling volumes. Vehicle sales fell 2.4%pa for the decade to 2001 and then dropped a faster 3.3%pa for the decade to 2011. Outbound travellers surged by 4.3%pa for the decade to 2001, but slowed to 0.5%pa for the decade to 2011.

… but stimulus measures should lift growth from 2H'16

Short-term cycles still exist, and from Q4'15 to Q2'16 Japan will likely have little growth, as local demand fails to lift and exports wilt. But if Abe can combine a strong fiscal stimulus from mid-year alongside extra BOJ monetary stimulus, then growth should lift back to a 0.5-1.0%yoy band for 3-6 quarters. Note that if Abe keeps the April 2017 sales tax hike (which we don't expect), growth would jump towards 1.5%yoy in Q4'16 and Q1'17 as companies and households will pull forward purchases from 2017 to avoid the extra tax.

Watch for steps to lift consumer spending

Absent the sales tax hike, real growth in consumer spending could fall for a third straight year in 2016 after average growth of 0.9%pa for the decade to 2013. As Abe will give priority in his stimulus package to reviving consumer demand, we expect consumer growth to lift in late 2016 and reach 0.5-0.7% in 2017. That won't do much for industrial production, which will likely drop 1-2% this year and next, after falling 15% from a 2007 peak as firms continue offshoring production.

Inflation lifts and the Yen falls from 2017

The outlook for inflation and the Yen falls into two parts. Given global risk-off and deflation, it will be hard for Japan to avoid a strong Yen and near zero inflation in 2H'16. Provided the global recovery stabilises in 2017, the BOJ's massive quantitative easing program should nudge inflation above 0.5% for 2017 and weaken the Yen.

	2013	2014	2015	2016	2017
GDP, real growth (2005p), %	1.4	0.0	0.5	0.3	0.6
CPI, year average, %	0.3	2.8	0.8	0.1	0.7
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

Beijing proves it can steady growth

… but not yet that it can drive reform

Since late 2015, Beijing has resolutely focused on reviving growth and restoring a semblance of economic control. By May, both goals had largely been achieved, but only by reviving a high risk strategy based on strong credit growth (15%yoy in Q1). China's leaders have yet to clarify how they'll handle the conflict between adding more fuel to an over-extended credit cycle, and growing risks in financial markets (bad bank debt and bond defaults), in property markets (asset bubbles), and in industry (excess capacity). The policy contradiction is openly debated, yet the gap is widening between calls for reform and the absence of reform in property, financial, and industrial markets.

Despite Xi's rise he can't yet force change

… watch his 2nd 5-year term from 2018

Two scenarios can be outlined through 2017, and what happens in this period will do much to shape the next decade in China. In late 2017, Party leader Xi Jinping is virtually certain to get a second 5-year term (his many other state and military leadership posts would be renewed for similar 5-year terms over the following months). By tradition, he'll also push his supporters into controlling positions across the party and state hierarchies, reducing opposition to his policies. The question is, what does he do before then? He could allow contradictory policies to continue, judging that opponents to reform are currently too strong in provincial governments, state-owned banks, and state-owned enterprises (SOEs). Alternatively, mounting risks could push him into accelerating reform through 2H'16.

Expect more debt to be declared bad

… & receivables to blow out

As mostly happens with scenarios, we'll likely get a bit of both. That means a steady increase in bank recognition of non-performing loans and more bankruptcies, alongside a jump in bond defaults. Pain will be centred in the property and construction sectors, but will spread to related industrial sectors. Small and mid-size firms will be hardest hit, with early signs being an inability to pay their bills. At the same time, big players, particularly SOEs, are likely to be protected by local governments and state-run banks. Growth for them – from housing and infrastructure – should keep the construction sector moving.

Outlook for the market

GDP steadies at 6.5% into 2017

… as strong services growth offsets weak manufacturing

Growth through the rest of this year is likely to stabilise around 6.5%, down from the 6.7%yoy pace reported for Q1'16 and 6.9% for full 2015. Slower real growth in the manufacturing sector, which we put at 4.5% this year from an estimated 6% last year and a 10-year average of 11% to 2014, will be partly offset by slightly firmer construction growth (6% this year from 7% last year and a 13% average for the 10 years to 2014). The main growth driver will remain the services sector, with real growth staying close to the 8% annual rate set for 2012-15. Nominal growth rates will continue to reflect big deflationary pressures in manufacturing, with less than 1%pa growth for 2015-17. By contrast, nominal growth for services should be around 11%pa over 2015-17, as firms lift their prices.

A 1H'16 lift in property & construction

… Beijing aims to push this into 2017

The first four months of 2016 saw a sharp upturn in the property/construction sector, with home sales up 61%yoy, construction starts up 21%yoy, and property investment up 7%yoy. This has revived concerns over property bubbles, leading to some new restrictions in Shanghai and Shenzhen. By contrast, Tier two and lower cities continue to see incentives for home buying in an effort to cut a big housing inventory overhang. This lopsided property market will likely continue into 2020 (and possibly for decades after that, given the inherent attractions of the big coastal cities). We expect the government to restrain the rebound in housing construction over the rest of this year, so that growth is firm without sliding into a boom/bust cycle.

Watch for more inflation and mild Yuan volatility on the US$

Steadier growth, a lift in construction, and rising food and fuel prices should nudge inflation up from 2.3%yoy for April towards 3% by end-2016. Since late 2015, China has pegged the Yuan against a basket of 13 currencies rather than the US$ in an effort to increase flexibility in exchange rate management. One outcome is an unpredictable Yuan on the US$, with rises in February and March followed by a fall in April. Given China's debt problems and the risk of capital outflows, we expect Beijing to steady the currency around its current 6.50 over 2H'16 before allowing another 3-4% fall next year.

	2013	2014	2015	2016	2017
GDP, real growth, %	7.7	7.3	6.9	6.5	6.2
CPI, year average, %	2.6	2.0	1.4	2.6	3.3
PBOC 1-year loan, at Dec., %	6.00	5.60	4.35	4.10	4.10
Yuan to US$1, year average	6.20	6.14	6.23	6.51	6.75

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

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Hong Kong

Political & policy issues to watch

Political environment toxic

… needs a new plan

HK's political environment faces serious challenges. Long-running disagreements between pro-Beijing and pro-Democratic factions over the nature and pace of HK democracy, Chinese encroachment and the number and behaviour of mainland tourists have entrenched both sides' views, with little chance of compromise. This has led to political protests and the stalling of most bills in the Legislative Council (LegCo) – and the situation may worsen. Some protestors have recently turned radical, making demands anathema to Beijing, such as calling for a referendum on HK's independence. But several business and NGO leaders are focussing on ways to diffuse tensions to protect HK's world-class business environment and freedoms – such as the revival of a city government with enough authority to handle day-to-day affairs to keep the city operating effectively.

HK house prices to drop

… but financial system will be ok

HK house prices have fallen 12% from their September peak and will likely drop another 10-20% by end-2017. But unlike many economies, HK will be resilient to the downturn. A large number of cash purchases of houses limits the damage to the financial sector, as property loans made up only 11.3% of banks' assets in mid-2015, well below Singapore's rate (28.2%). The slowdown, however, will hurt the real estate and construction sector.

No recovery in sight for Macau gambling

China's corruption crackdown continues to hurt Macau, with Q1'16 casino revenues 45% below the US$12.7bn level achieved in Q1'14. China is showing no sign of easing restrictions, enforcing a new rule banning 'phone-in' mainland gamblers. While some analysts are suggesting Macau develop as a convention centre (like Las Vegas) to replace gambling receipts, it is unlikely that this would cover revenue losses.

Outlook for the market

China worrying HK

… low growth likely

China's uncertain economic position is adversely affecting HK. Easing Chinese exports are accelerating the decline HK trade growth by 7.5%yoy in Q1'16, from a 3.1% fall in 2015. A 15%yoy drop in Q1 mainland visitor arrivals is hurting the tourism sector and high-end luxury sales. Business sentiment has faltered, with the Nikkei PMI index at 45.3 in April, the 14th straight month it has been below the 50-stable level. These factors will likely keep GDP growth below 2% in 2016 and 2017.

Housing construction has potential

… but not now

HK has a strange residential market, with a limited land supply usually leading to extremely high (if now falling) prices and a large undersupply of affordable housing. Chief Executive CY Leung wanted to boost land sales to allow for the building of cheaper housing, but his plan appears to be unravelling. Falling house prices have left developers with large inventories, making them less interested in buying more land. This will likely reduce private construction investment by 2-3%pa in 2016-17 from a 4.7% rise in 2015.

Export slowdown broad-based

HK's trade slowdown is broad-based. Chinese exports, which make up about half of the total, fell by 9%yoy in Q1'16. Smaller falls were recorded for the US (-8%yoy), ASEAN (-5%yoy) and the EU (-3%yoy). Continuing concerns over the global and the Chinese economy in particular will likely push overall exports down by 6%yoy in 1H'16 and 2-3%yoy in 2H'16, from a 2%yoy drop in 2015. Little trade growth is expected in 2017.

Volatility impacts financial

China volatility is worrying the HK financial industry. Firms are becoming conservative, leading to a 30%ytd to April fall on capital-raising in the HK stock market. Futures and options turnover has fallen by 3%ytd, after a 33% rise in 2015. Weak trading conditions, combined with services offshoring is leading to financial job losses (-1.4%yoy in Feb '16), which will likely continue for the rest of this year.

Easing inflation, US$ link

Falling house prices are expected to reduce inflation from 2.9%yoy in Q1'16 to below 2% by end-2016. The US$-HK$ link will force the HK monetary authorities to match any US Fed interest rate changes.

	2013	2014	2015	2016	2017
GDP, real growth, %	3.1	2.6	2.4	1.3	1.6
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

President Tsai's government faces a slow start

DPP leader Ms Tsai Ing-wen was sworn in as Taiwan's first female president on May 20. For the first time in history, the DPP also controls the legislature, with the newly elected body starting a four-year term in February. Her cabinet, led by Premier Lin Chuan, is noted for inexperience, as there has been only one prior DPP administration (led by Chen Shui-bian over 2000-08, which faced a KMT controlled legislature). Many in the cabinet are academics, and it will take time to learn how to work with ministries that have been led by the KMT for 58 of the last 66 years. That means a slow start to legislation.

Her agenda

… cut China dependence

… phase out nuclear power

… fix pensions

By contrast, geopolitical tussles with China could start soon. In her inaugural speech, President Tsai avoided backing the 1992 "One China" formulation that Beijing demands as a basis for stable political ties (her KMT predecessor, President Ma, happily backed it). Instead, President Tsai emphasized her election campaign pledge to make Taiwan's economy less dependent on China. Taiwan's economy has undoubtedly suffered from hollowing out, as its firms moved production to China over the last 15 years, and it will be interesting to see if Tsai can conjure up a new growth model. Two other big issues in her first four-year term (with a two-term limit) will be replacing nuclear power (6 reactors providing 25% of current baseload, which Tsai has committed to phasing out by 2025, plus two new uncommission reactors) and fixing a weak pension system.

Outlook for the market

Little growth this year

Factory offshoring has not only slowed down growth in exports, manufacturing, and capex but has also hindered consumer growth by delivering real annual wage growth of just 0.3% over the last 15 years (over that period China's manufacturing wage has climbed from 9% of Taiwan's wage to 49%). Given the global slide in demand, a weak China market, and more offshoring, Taiwan's GDP growth will slip towards zero this year before a weak lift in 2017, provided global demand improves.

A weak consumer market

Taiwanese workers had a tough start to 2016, with the slowdown causing firms to cut back working hours. This is worrying households, reducing consumer confidence to a two-year low in April and causing consumers to trim spending. Retail sales growth has eased from 2.1%yoy in January-February to -0.9%yoy in March, with big falls for clothing (-8%yoy) and entertainment (-7%yoy). In real terms, consumer growth will likely be limited to 1.3% in 2016 and 1.7% in 2017 from 2.3% in 2015.

Manufacturing faces more offshoring

Manufacturing continued to suffer in Q1'16 due to a global electronics downturn. Q1'16 saw manufacturing fall 4.1%yoy on the GDP measure with a full year fall of 1-1.5% likely after a milder 0.6% fall in 2015. Manufacturing did get some good news in May, with semi-conductor firm TSMC announcing plans to spend US$4.1bn on more capacity. The bad news is that overall TSMC is gradually shifting its spending to China.

Construction fades

Taiwan house prices in Q1'16 were down 8% from their Q2'14 peak, and will likely continue to fall over the rest of 2016. This has discouraged developers, who have reduced their housing starts by more than 10%yoy for six straight quarters to Q1'16. Construction fell 4.7%yoy in Q1'16, and will likely fall by 2-3%yoy over the rest of the year. Zero growth is expected in 2017.

Low inflation & a steady NT$

Higher food prices pushed seasonally adjusted inflation up by 1.1%yoy in April and a mild rise in global energy costs will likely keep inflation near 1% this year. There is little reason for the central bank to raise or lower the official interest rate from its current 1.5% level. Meanwhile, the NT$ is supported by fast-rising trade and current account surpluses, as imports are falling faster than exports.

	2013	2014	2015	2016	2017
GDP, real growth, %	2.2	3.9	0.7	0.2	2.0
CPI, year average, %	0.8	1.2	-0.3	1.2	1.3
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.

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South Korea

Political & policy issues to watch

Political gridlock for the next 18 months The April legislative elections left a fractured Korean political landscape. President Park Geun-hye's Saenuri party won just 122 seats (down 24) of the 300 total, with her party breaking into pro- and anti-Park factions. Opposition parties won over half of seats, with the largest, Minjoo, taking 123 seats (up 21). Even if she was in a strong position, President Park would have trouble getting bills through the new legislature. But with a popularity rating of 29%, there's little chance of her finding legislative support. That means political gridlock until after the December 2017 presidential election.

The BOK may launch QE Political gridlock is bad news, as the economy has slumped in 2016 to the dismay of the government and central bank. State banks and the shipbuilding sector are in bad shape and may need to be rescued. The Bank of Korea (BOK) is considering quantitative easing (QE) measures to lift domestic demand, although restrictions on the capital account will make implementing QE more difficult than in Japan or the EU.

Getting older fast … means slower growth & higher taxes While growth has slumped, the macro fundamentals are OK at present, with S&P confirming Korea's AA- rating. However, it is worried by long-term issues. Korea's elderly dependency rate (elderly/working age ratio) is forecast to rise from 20% in 2015 to 72% in 2050, lifting the cost of pensions, health, and aged care. The government will need to consider raising taxes or cutting welfare spending to prevent spiralling budget deficits.

Outlook for the market

Growth drops under 2% Korean GDP growth has been stuck in the 2.3-3.3% range for 2012 to 2015, well below the 4.3% rate of 2001-11 and the 4-5% target in government plans. The weak global economy and a gradual slowdown in construction will likely push growth down to 1.5-2.0% for 2016 and 2017.

… with falls in exports & factory production Korean exports fell 12.7%ytd by April after an 8.0% drop in 2015. China (-16%ytd) led the downturn, but there were also declines for Japan (-16%ytd), ASEAN (-6%ytd), and the US (-4%ytd). Of the major markets, only the EU (+6%ytd) and Vietnam (+9%ytd) grew. Some of this reflects a shift in Korea's production chain away from assemblers in China to assembly in Vietnam. The downturn should ease in 2H'16, leaving full year exports down by 6-8% with a return to 0-3% growth next year. Meanwhile, the manufacturing part in the industrial production index (IPI) fell 0.7%yoy in Q1, in line with the 2015 full year fall. We expect the IPI to drop around 0.4% this year before weak growth of 0.2-0.5% next year.

Consumers pull back as wage growth stalls A 12%yoy lift in Q1'16 visitor arrivals helped lift retail sales by 4.0%yoy, up from a 2.2% rise in 2015. However, domestic demand growth is weak, with wage growth and consumer confidence falling. This limited real consumption growth to 2.1%yoy in Q1'16. For 2016 and 2017 real consumer growth is likely to fall below 2% from 2.2% in 2015.

Capex growth will also slow Fixed investment growth is expected to fall from 3.8% last year to about 2% for 2016 and 2017. Rising housing prices lifted construction capex by 9%yoy in Q1'16. However, an expected fall in house prices will feed into weaker residential construction growth over the next 18 months. Corporate plant & equipment spending could fall by 2% this year after a 5.3% rise last year before returning to 2-3% growth in 2017.

Watch for rate cuts, while the Won stays firm With inflation of just 1%yoy in April, the BOK could cut another 50 basis points of its current 1.50% policy interest rate over 2H'16. That would help keep the Won weak, particularly against Japan's Yen. The Won has climbed and fallen on the US$ so far in 2016, and is currently close to its January 1 rate of 1,165. A strong and rising current account surplus will keep the currency firm unless the BOK can figure out how to launch QE.

	2013	2014	2015	2016	2017
GDP growth, %	2.9	3.3	2.6	1.7	1.8
CPI, year average, %	1.3	1.3	0.7	1.2	1.4
BOK Base rate, year-end, %	2.50	2.00	1.50	1.00	1.00
Won to US$1, year average	1,095	1,052	1,133	1,192	1,175

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

President Jokowi wins backing from the legislature

President Joko Widodo ("Jokowi") continues to reshape the national political map in his favour. Golkar, the main opposition party in the "red and white" coalition that has blocked government policy in the legislature, has swung to backing the government. The realignment was highlighted by Jokowi's warm welcome at the Golkar congress in mid-May, which saw long-time presidential contender Aburizal Bakrie step down and Setya Novanto made chairman. Setya's chequered background may hurt Golkar in the 2019 elections, but for now the party hopes that Jokowi will find cabinet seats for several of its leaders in a reshuffle expected in the next few months.

… and boosts his national standing

Skilful cabinet building will also help Jokowi strengthen his position against PDI-P party head Megawati Sukarnoputri, who has often demanded that Jokowi follow her guidance. Jokowi got a further boost from his retrieval of 10 Indonesian crewmen taken captive by a Philippines Islamic militant group last month.

A battle to change to a pro-market bureaucracy

Jokowi's struggle to bring the bureaucracy into line is also edging ahead. The current battle is aimed at breaking the bureaucracy's aversion to imports. Jokowi has made clear he wants food prices to fall ahead of the Islamic fasting month, which starts in early June, bucking the trend of soaring prices of food and other goods that has long been a staple of the Indonesian market. While food imports jumped in Q1'16, it remains to be seen how the bureaucracy will respond over the longer-term. Nevertheless, with agencies such as the business competition watchdog KPPU calling for an end to import quotas for commodities like beef, the idea that imports can be a good thing is gaining credibility.

Outlook for the market

Growth should edge up in 2H'16

… led by fiscal stimulus

GDP growth has bumped along below 5%yoy for four of the five quarters to Q1'16, as the economy has been buffeted by weak commodity prices, drought, and policy uncertainty. Vehicle and motorcycle sales both fell 17% in 2015, although the fall eased in the first four months of this year to 3.3%ytd for vehicles and 6.9%ytd for motorcycles. Corporate demand also fell, with plant & equipment capex down 0.3% in 2015 followed by a 6.8%yoy fall in Q1'16. The government countered that with a 6.4%yoy lift in budget spending in Q1. But as public revenues fell 12.7%yoy in Q1, there is limited room to continue such support (hopes for windfall revenue from a tax amnesty may be disappointed). At best, we expect a slow lift in GDP growth from 2H'16 into 2017.

A mixed consumer market

Consumer spending growth this year could match last years' 5%, which is better than the 4.7% average rate for the decade to 2014. However, there have been big shifts in where consumers spend. F&B has been steadiest, with growth matching the 11%yoy trend rate for the retail sales index. However, clothing is down 15%yoy at April. By contrast, communication sales are up 33%yoy as mobile phone usage jumped.

Hope for a lift in construction

The lift in public spending this year should help the construction sector. Cement consumption growth peaked at 21%yoy in Q4'11 before sliding to a 4%yoy contraction in Q2'15. While consumption rose to 3.8%yoy in Q1'16, local analysts say home sales plunged in Q1'16, and they are calling on the central bank to lower rates (which seems likely) and ease mortgage restrictions.

Inflation eases, allowing rate cuts

… & a steadier Rupiah

While food prices need watching (up 8.9%yoy at April from 7.2% for 2015), overall inflation is easing, with the CPI rise slowing to 3.6%yoy in April. A lift in food imports (see above) and a stable Rupiah should keep inflation in 3-5% band into 2017, allowing the central bank to continue cutting its policy interest rate. Low inflation and a modest but stable trade surplus suggest that the Rupiah should steady in a 13,500-14,000 band on the US$.

	2013	2014	2015	2016	2017
GDP, real growth, %	5.6	5.0	4.8	5.2	5.8
CPI, year average, (2012=100), %	6.4	6.4	6.4	4.2	4.7
Central bank policy rate (O/N rate) at Dec %	7.50	7.75	7.50	6.00	6.00
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

When will voters tire of PM Najib?

A win by Barisan Nasional, the ruling coalition, in the May 7 Sarawak state election has bolstered PM Najib Razak's position, even though the result in this east Malaysian state does not reflect his sliding popularity in peninsula Malaysia. A better guide to Najib's appeal will come from two by-elections in peninsula Malaysia on June 18, triggered by the accidental death of two lawmakers from UMNO, the party that leads the BN coalition.

Pressure for his exit grows as the 2018 poll nears

… & that creates uncertainty

The negative news flow from the troubled 1MDB fund continues. The fund, which is owned by the finance ministry and chaired by Najib, defaulted on a debt repayment last month following a dispute over missing funds with its ex-investment partner IPIC, an Abu Dhabi sovereign wealth fund. Half a dozen investigations by foreign agencies suggest there has been massive corruption involving Najib and his cronies. We think that makes it likely that UMNO will dump him before the 2018 federal election. As politics plays a large part in business in Malaysia, this uncertainty dampens the investment outlook.

A policy reversal on using foreign workers

Malaysia is struggling to fine-tune its policy on foreign workers. In mid-May, the authorities decided to exclude the manufacturing, construction, plantation, and furniture making sectors from a general freeze on hiring foreign workers, due to labour shortages in these sectors. Local workers shun low-paying manual jobs, but are also opposed to the presence of more than three million migrant workers currently in the country.

Outlook for the market

Growth is trending down

GDP growth slowed to 4.2%yoy in Q1'16 on the back to falling exports and weak fixed investment (just 0.1%yoy in Q1 from 3.7% in 2015). Growth would have been softer but for a large inventory bounce and a lift in private consumption (to 5.3%yoy in Q1'16 from 4.5%yoy in 2H'15). The inventory surge likely reflects an unexpected demand collapse, with firms likely to cut production and run down inventory in the next few quarters. Nor is the lift in consumer spending likely to last, as it runs counter to most indicators, such as falling passenger car sales (-22%yoy in Q1'16) and historically low consumer sentiment. Malaysia's financially constrained public and household sectors, together with a sluggish world economy, are set to slow GDP growth to 3.4%yoy in 2016-17 from 5% in 2015.

…as downbeat consumers retreat

Consumers have been unnerved by subsidy cuts, electricity and highway toll price hikes, a cooling housing market, elevated household debt, and a weaker jobs market. We expect private consumption growth to ease to 3-4% in 2016-17 from the 7.4%pa spree of 2003-15, which was fuelled by debt accumulation and government recycling of oil & gas revenues into large pay hikes for civil servants and generous consumer subsidies (now axed).

… and capex activity comes to a halt

For several years, Najib's administration has gambled on a string of big projects to lift growth. That hasn't happened for reasons ranging from weak demand (for housing as much as for oil & gas projects) to risks associated with the 1MDB saga. Fixed investment growth has dropped from 11.3%pa in 2010-13 to 4.2%pa in 2014-15, and is heading to a 1-4% range in 2016-17.

Mild inflation, rate cuts, & a firm M$ as the oil price rises

Cuts to consumer subsidies along with higher electricity and highway tolls saw inflation climb to 3.4%yoy in Q1'16 from 0.7%yoy in Q1'15. It should hover around 2.5-3.0% in 2016-17, which leaves the central bank with room to cut interest rates to support a slowing economy. Since early 2016, the M$ has recovered some of the 32% fall it suffered on the US$ during 2013-15. It is likely to gain more ground into 2017, in line with rising oil prices.

	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	3.2	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	4.07	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

President Duterte

… wait and see for 6-12 months

The election of Rodrigo Duterte as the new president of the Philippines for a single six-year term could see the gains made under President Ninoy Aquino's administration lost. But it won't be clear how much of that risk will become a reality until six to 12 months from now. Key markers to watch include the selection of cabinet secretaries, how Duterte handles the legislature (particularly the senate), and the nature of early stumbles and scandals, which the country's vibrant press will pounce on. Equally, we should watch for positive changes. Duterte capitalised on the fact that the country's rising prosperity failed to help nearly one quarter of Filipinos who live below the poverty line. Fixing that will require careful policies that build on his predecessor's achievements. Duterte doesn't so much have a post-election honeymoon, as a grace period in which to prove himself thanks to a strong sovereign risk rating and considerable impetus behind the current lift in growth.

An opportunity for new policies to fix old problems

As a single-issue candidate (crime and social justice), Duterte will take office on June 30 with few policies. However, he has signalled an interest in lifting foreign investment restrictions in several sectors. He has also talked about a referendum in two years' time for a constitutional change to give more power to the provinces. That could help him end long-running Muslim and communist insurgencies. His track record as a well-regarded mayor of Davao City put him in a unique position to tackle that problem.

VP Robredo as a fall-back

The preliminary victory of Aquino-backed Leni Robredo in the VP race will comfort some in the Manila elite who see her as a viable alternative if Duterte turns into sufficiently bad president that grounds can be mustered for his impeachment.

Outlook for the market

The strongest ASEAN economy

… thanks to local demand

… fuelled by OFW & BPO inflows

Boosted by the start-up of infrastructure projects and a lift in public spending in the lead-up to the May elections, GDP grew by 6.7%yoy in the six months to Q1'16, as domestic demand surged 11.2%yoy. Private consumption growth edged up to 6.8%yoy, while fixed investment soared to 24.9%yoy. That saw imports grow twice as fast as exports (15.6%yoy vs 8.5%yoy), leaving a weaker trade balance that detracted from GDP. Unlike its ASEAN neighbours, exports of commodities and manufactured goods aren't big factors in growth. The big external drivers – remittances from offshore Filipino workers (OFWs) and income from business process outsourcing (BPO) exports – have been immune to the global downturn. Firm domestic activity will continue to drive growth, with GDP set to rise 6.7% in 2016 (up from our prior forecast of 6.3%) and 6% in 2017.

Infrastructure and FDI lift capex growth

The government's strong fiscal position, along with an accelerating public-private partnership (PPP) infrastructure program will continue to drive capex growth. There will be additional help from foreign direct investment (FDI), which climbed to US$5.7bn for each of the last two years (from an average $2.3bn over the prior nine years) and could reach $7bn this year. Capex is set to grow 14% in 2016 and 7% in 2017 from 15.2% in 2015.

A surge in car sales

Private consumption accounts for a large 69% of GDP and is solidly supported by the improving jobs market and OFW remittances (equalling 9% of GDP). Double-digit annual growth of passenger car sales (34.4%pa in 2013-15) reflects the rising prosperity of the local middle class.

Low inflation and a firm Peso

Policy interest rates are likely to remain steady at the current 4% into 2017, as inflation has stayed low (1.1%ytd by April) despite a fast-expanding economy. In line with regional currency trends, the Peso has stabilised at around 46.0-47.7 against the US$ since late last year, after retreating 15.4% over 2013-15. We expect the Peso to stay reactively firm, moving towards the stronger end its current range.

	2013	2014	2015	2016	2017
GDP growth, %	7.1	6.2	5.9	6.7	6.0
CPI, annual average, %	3.0	4.1	1.4	1.5	2.4
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	46.7	46.0

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

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Singapore

Political & policy issues to watch

Singapore's search for higher growth

… if not by migrant workers

… then by a lift in R&D and capex, although that has yet to happen

In its latest review of Singapore's economy, the IMF notes than both structural and cyclical factors are behind a slowdown in growth to 2% in 2015 and 1.8% (the IMF's forecast) in 2016. The structural challenge is a fast-ageing population, while the cyclical challenge is a slump in export growth. Singapore did have a solution to the structural challenge, which was a surge in migrant workers from 2005 to 2011. However, that policy had to be jettisoned, as it was deeply unpopular with voters. In its place, the focus has shifted to driving up productivity with tax and other incentives aimed at encouraging R&D and more capital-intensive production. That policy shift has yet to bear fruit, even though MNCs have opened plenty of impressive R&D centres. Capex on plant and equipment fell 1-2% in each of the last three years, while capex on intellectual property fell an average 6% in each of the last two years, after a brief 35% spike in 2013. We'd guess the problem is twofold. Many local manufacturers aren't interested in higher R&D and capex spending, which suggests some smaller manufacturing firms will exit Singapore in the next few years. A weak global cycle is also deterring such investment.

A mild tourist revival in Q1'16

The post-GFC opening of two large casino/resorts boosted Singapore's tourist arrivals growth to double digits from 2010 to 2013. However, tourist arrivals fell in 2014 and were barely up in 2015, hitting casino profits and forcing one of them, Marina Bay Sands, to seek buyers for its retail business. The casino fortunes may be turning, as tourist arrivals grew 13.8%yoy in Q1'16 suggesting a full year result above the official forecast of 0-3% growth in arrivals in 2016. However, tourist spending may fail to match the arrivals figures. Tourist receipts fell 6.8% in 2015 despite a 0.9% lift in arrivals.

Outlook for the market

Faster growth in 2017 if global conditions improve

GDP growth slowed to 1.8%yoy in each of the three quarters to Q1'16 and we expect it to hover around this pace for the rest of this year with support from government fiscal stimulus in construction. Our 2.8% growth forecast for 2017 is conditional on a stronger world economy, which is the single most important driver of Singapore's business cycle. This is hardly surprising, given the country's extreme exposure to international trade and investment flows.

Expanding public works to offset falling private construction

The government has stepped up its fiscal stimulus to ensure Singapore doesn't slip into a recession. Growth in government consumption spending jumped to 10.7%yoy in 2H'15 from 2.6%yoy in 1H'15. That was followed by an 84%yoy lift of public construction contracts awarded in Q1'16, suggesting that the fiscal expansion is in full swing with the goal of countering weak private building activity (private construction contracts awarded fell 74%yoy over the same period).

Consumers in deleveraging mood

A steep drop in consumer and housing loan growth suggests that households are in a deleveraging mood. A drop in home prices – by some 9% in Q1'16 from a Q3'13 peak – will also have dampened consumer sentiment along with reduced growth in jobs. These headwinds will trim consumer spending growth to around 3%pa in 2016-17 from an unusually strong 4.5% in 2015.

Monetary policy on hold as fiscal expansion takes centre stage

The MAS will likely avoid any major change in monetary policy despite the weak economy and the headline-CPI being in deflation since November 2014. In April, it shifted its monetary policy to neutral (i.e. keeping the S$ flat on an undisclosed basket of currencies) from mildly tight. That should allow the S$ to ease of a rising US$. Given the recently launched fiscal stimulus, the MAS will likely hold back on new monetary stimulus.

	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	-0.4	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	1.40	1.43

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's political strategy

… won't deliver long-term stability

Thailand's military government, in power since a May 2014 coup, is tightening its hold on power, while also attempting to establish a thin civil veneer that engages political parties and curbs demands for democracy. Central to that effort is an August 7 referendum on a new constitution (Thailand's 20th), which is supposed to open the way for elections in 2017. As the new constitution is quite undemocratic, we think it's unlikely to win the support of voters, while political parties have already indicated they'll reject it. Whether the elections will go ahead is unclear. As a result, it remains likely that Thailand faces a confrontation between civilians and the army over the country's political future. While that confrontation doesn't appear imminent, pressure will grow following a transition in the Thai elite.

Pushing for better administration

Unlike most prior military governments, this one has short-term stability. It hasn't split into competing officer cliques and it appears to be acting more or less in alignment with the royal household, a key factor underpinning the current stability. While It has a nasty authoritarian side, it is attempting to deliver better administration. Central to that is the appointment of competent civil servants to run ministries.

Big infrastructure projects to kick-start growth

PM Prayut's government aims to revive growth with a US$83bn infrastructure program, consisting mostly of transport projects. To speed implementation, Article 44 of the interim constitution is being used to bypass procedural obstacles facing rail projects and (possibly) a third runway for Bangkok's main airport. Meanwhile, Thailand and China have reached agreement on a high-speed, dual track railway that in theory will run some 873km from Nong Khai in Thailand's north (where it will connect through Laos to Kunming in China) to Bangkok and then the deep sea port at Laem Chabang. After some debate, Thailand will fund it itself, starting with a 250km section from Bangkok to Nakhon Ratchasima.

Outlook for the market

Public capex drives a mild lift in 2016

… a swing in the stock cycle should boost 2017

Thailand is on track for a mild recovery in 2016, with GDP growth edging up to 3.3% on the back of a 10-12% lift in public investment, a 6% rise in government consumption after 2.2% growth last year, and stronger net exports (a low level export recovery, while imports remain weak). The 2016 headwind is mostly from a big inventory rundown across rural and manufacturing sectors. Private consumption and private capex should both edge up modestly in 2H'16. In 2017, GDP growth should lift above 4% as the inventory cycle swings to rebuilding, and growth improves in private consumer and capex spending. The 2017 headwind will come from weaker net exports, as infrastructure projects suck in capital goods, while export growth remains modest.

Private investors remain wary

The private capex outlook remains weak. Foreign direct investment (FDI) applications fell 90% in 2015, as political risk and weak export demand deterred investors. Housing construction is also set to decline in line with a protracted fall of residential construction permits from their mid-2013 peak.

… & consumers are weighted down with debt

With sentiment weakening in early 2016, consumer growth is likely to stay around last year's 2.1%. Rural and urban households are both struggling with high levels of debt (all household debt is around 86% of GDP). Consumer demand has also been capped by a drought that has hurt rural production, and weak growth in export manufacturing.

Inflation returns and the Baht remains firm

14 months of deflation ended with flat prices in April. Inflation should lift above 1% in 2017 on higher food and fuel prices. That still leaves the Bank of Thailand with room to cut its policy interest rate from a current 1.50% if the big infrastructure projects fail to lift growth. A mixture of deflation, a mildly attractive 1.5% policy rate, and surging trade and current account surpluses, saw the Baht climb from 36.4 to US$1 at the start of 2016 to around 35.7 today. Those same factors should keep it in a 35-37 range through 2017.

	2013	2014	2015	2016	2017
GDP, real growth, %	2.7	0.8	2.8	3.3	4.3
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 change in leadership

… continued backing for pro-market reforms

After a leadership reshuffle in early 2016, Vietnam is led by party General Secretary Nguyen Phu Trong (72), with state President Tran Dai Quang (59) ranked second, and Nguyen Xuan Phuc (61), the new prime minister in charge of economic policy, ranked sixth in the Politburo. Barring ill-health, the two younger leaders could run 10 years (two five-year terms) with party head Trong likely to do just one five-year term. As all three were in prominent roles before the reshuffle, they are expected to continue the market-opening reforms of the prior administration. This will come into focus during a May 20-22 visit by US President Obama, which will aim to boost economic liberalisation, especially via the TPP trade deal (provided it goes ahead).

… bringing in record FDI

Pro-market reforms helped foreign direct investment (FDI) approvals soar 85%ytd by April to US$6.8bn, while realised FDI was up 12%ytd to $4.7bn after hitting a record $14.5bn in 2015. FDI-run factories now account for 70% of exports, up from 24% in 2000. Vietnam also wants to win more foreign portfolio capital for its listed firms, and hopes to have Morgan Stanley upgrade its stock market to “emerging” from “frontier” status. That could help with the slow pace of restructuring of state owned enterprises (SOEs).

Environmental challenges

… are forcing labour out of the rural sector

Public protests over millions of dead fish on beaches will test whether PM Phuc can find a balance between environmental controls and industrialization. Protestors blame a US$10.5bn steel plant operated by an offshoot of Taiwan’s Formosa Plastics, but a direct link has yet to be established. This is bad news for the country’s vibrant tourist industry (a record 7.9m arrivals in 2015), and its large seafood export sector (US$6.7bn in 2015). Meanwhile, the once-fertile Mekong delta is drying up due to severe drought (the worst in ninety years), upstream dams, and salt water penetration. This is forcing big changes in the economy, with employment in agriculture down 6.6% last year.

Outlook for the market

Scope for firm 2016 growth

April’s purchasing managers index (PMI) rose to 52.3 from 50.7 in March on the back of higher new orders, output, employment, and input prices. A 53%yoy rebound in car sales for April also points to better local demand. As exports (up 6.2%ytd by April) have done much better than imports (down 1.4%ytd), the trade balance has swung to surplus, which should lift the GDP growth calculation and keep the Dong firm. Strong capital formation (see below) and 7-9%pa real growth in manufacturing should partly offset agricultural weakness, helping to deliver GDP growth of 4.8% in 2016 and 6.1% in 2017.

Surging capex in manufacturing

… a strong property market

… & changes for infrastructure

Fixed investment is expected to rise by 8-10%pa over 2016-17 from an estimated 11% rise in 2015 as FDI pours into new factories (accounting for about 75% of FDI inflows). A strong recovery in the residential property market is also underway, helped by money from overseas Vietnamese and foreign buyers. There is scope for a lift in infrastructure spending as Vietnam enters the final year of phasing out of low cost ODA loans from the World Bank and other lenders (as Vietnam has been classified as a middle-income country since 2009). While commercial borrowing for infrastructure from mid-2017 will be more expensive, flexibility in sourcing will improve and overall project costs could drop.

Foreign MNCs are riding Vietnam’s consumer boom

Vietnam’s booming retail market is attracting foreign entrants from Korea (Lotte Group, which plans to open 60 supermarkets by 2020) and Thailand (Berli Jucker and the Central Group). Fuelled by rising real wages and an expected 15% jump in remittances from relatives abroad to a record US$14bn this year, consumer spending is expected to sustain growth of 5-6% in 2016-17 from an estimated 5.8% rise in 2015.

Low inflation and a firm Dong

Rising food prices pushed inflation up to 1.9%yoy in April from 0.3%yoy in Q4’15. Inflation is still well below the central bank’s 6.5% policy interest rate and unlikely to prevent interest rate cuts if the economy weakens in the next 12 months. Since 2013, the Dong has been the strongest SE Asian currency on the US$. To keep exports competitive, the authorities may allow the Dong to ease 3-4%pa on the US$.

	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	1.8	2.5
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

PM Modi has to lift growth & deliver more reforms

With the Congress Party blocking most bills in parliament's upper house, including those for a GST, PM Modi's government has to find other ways to deliver change that can lift growth. That is essential in 2016, as India's economy struggles with drought and weak demand in some key sectors. A few useful bills are being enacted, the latest of which is a bankruptcy law that aims to help creditors recover more of their bad debts faster (the current recovery rate is 25% over years. rather than 180 days, which the new law aims for).

Fiscal stimulus helps in 2016

… with critical RBI support

PM Modi's government has a record borrowing program (Rs6tr or US$85bn for the FY from April 1), which could have drained the local money market while forcing up yields. Yet from last December, the RBI has pumped liquidity into the market with a Rs1.1tr bond buying program, while in April it cut its benchmark repurchase rate to a five-year low of 6.50%. That has kept the yield on the government 10-year bond steady around 7.45% and left room for banks and corporates to issue bonds at reasonable yields.

A surge in road building is a good idea

When the private sector isn't investing and parliament's upper house is gridlocked, one of the few things a government can do is spend on roads. Last FY, spending on roads jumped 36% to US$11bn with 3,700km of highway added. This FY, the goal is adding 9,000km of highway. Next FY, the goal is 15,500km, with 11% of the central budget going to roads and railways infrastructure. Accelerated road building likely triggered an 11.4%yoy jump in cement production in Q1'16 after a 1.5% increase in full 2015.

Outlook for the market

GDP growth cools in 2016

… due to drought and weak private capex

Fiscal and monetary stimulus are needed this year, as the economy has slowed more than reflected in India's questionable GDP data (the statistical agency is struggling with the right calibration of a new time series). If we use the new GDP series, then growth will drop towards 6.5% this year from 7.3% last year. On the expenditure side, we expected consumer demand to slow to 5.5% from 6.2% last year with a lift to 6.0% in 2017. Fixed investment growth is likely to stay close to last year's 5.2% in 2016, as extra public capex offsets weak private capex, with a lift to 7-9% in 2017, as private capex climbs on board an expected recovery. On the production side of GDP, we expect services growth to lead at 8-10% for 2016 & 2017 with manufacturing and construction gradually recovering.

Diverging trends for consumers

… rural down

… urban up

India is hopefully in the last months of a crippling drought that has affected 10 of 29 states after two years of below average rainfalls. One result has been rapid divergence between the rural and urban markets. The industrial production index shows a rare year-on-year fall for consumer non-durable goods from the Sept quarter last year to -4%yoy by this year's March quarter, as rural households slashed spending on basics. By contrast, the IPI for consumer durables, which fell from MarQ'13 to MarQ'15, has surged to an average 12%yoy gain for the four quarters to MarQ'16, as urban households benefited from interest rate cuts, along with strong stock market and house price gains. With a better monsoon forecast for 2H'16, we should see the rural market recover from late 2016.

Diverging trend in manufacturing

Manufacturing also splits into two divergent stories. The capital goods sector remains stalled due to debt, red tape, and weak confidence. By contrast, companies are chasing the rise in urban consumer demand, with commercial vehicle sales jumping 19%ytd for the four months to April after 8% growth in 2015 and a 9% fall in 2014.

Mild inflation

… watch for a rising Rupee

India's drought has come at a time of low global food and energy prices, so food prices rose just 6.3%yoy in April, while the CPI edged up by 5.4%yoy. After cutting the RBI policy interest rate from 8% at end 2014 to 6.5% today, there's no room for more rate cuts, with a rate increase likely in 2017 as growth lifts. With the trade deficit stable, and inflation under control, the Rupee could appreciate to below 60 to US$1 in 2017.

Calendar year starting January	2013	2014	2015	2016	2017
GDP (MP, 2011-12), real growth, %	6.3	7.0	7.3	6.4	6.6
Inflation - CPI, %	10.1	6.7	4.9	5.3	5.8
RBI repo rate, December, %	7.75	8.00	6.75	6.50	7.25
Rupee to US$1, year average	58.5	61.0	64.1	66.8	59.3

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

PM Turnbull's July 2 election gamble

Australia will go to the polls on July 2 after PM Malcolm Turnbull called for a double dissolution, the first simultaneous, full election of both houses of parliament in almost 30 years. Two months is a long campaign by Australian standards. Turnbull aims to use that time to boost support for his Coalition government, which has fallen back in opinion polls to level with the opposition Labor Party. The close race suggests that neither of the major parties will win a majority in the Senate, which is currently controlled by micro parties. As winning control of the Senate is the main reason for calling a double dissolution, Turnbull has chosen a high risk political strategy that might cost him government.

Useful fiscal stimulus from a pre-election budget

Treasurer Scott Morrison unveiled an election-geared budget in early May that pinched many Labor policies and does little to end a string of budget deficits. Such a soft, vote winning budget is actually suited to the times, as fiscal stimulus at a time of weak global growth and low public debt (39% of GDP in 2016) is quite appropriate. There is a risk that Australia might lose its AAA rating with S&P, but as many other advanced economies have lost that rating, and interest rates are at record lows, that would have very little impact.

Outlook for the market

Snakes & ladders in the Australian economy

… mining & manufacturing slide

… services firms rise

Australia's economy has distinct winners and losers, reflecting the resources bust and the restructuring required of a small, open economy in a globalised market. Capex for mine and LNG development, which soared from 2002 to 2013, started falling from 2014, and is expected to continue dropping to 2020. By contrast, mine and LNG production is soaring, and those volume increases boost the GDP calculation. However, that won't stop a painful shakeout for resource firms and their engineering and equipment partners. Meanwhile, the manufacturing sector has been hit by a drop in demand for mining plant and the closure of all carmakers by 2017. The counterbalance to these weak or declining sectors is a housing boom and solid services sector growth. Australia has run 97 quarters (from Q1'91) without a recession, but during that period has undergone massive transformations that have decimated some industries while boosting others.

Slower growth in consumer demand

Consumers have done well during this record breaking expansion, with average real growth in spending of 3.3% for the 25 years from 1991 to 2015. Yet growth is likely to be closer to 2% this year and next year from 2.8% for 2015. That reflects a slump in real wage growth from an annual average of 1.7% for 1991-2013 to about zero for 2014-15, with about the same expected for 2016 and 2017. The downturns in mining and manufacturing – both high wage paying areas – clearly hurt. Retail sales growth, which hit a low of 2.5% in 2011 before recovering to 5.3% in 2015, eased to 4.3% in 2015 and will likely stick in a 3-4% band in 2016 and 2017.

Watch for a slide in property prices

… home building eases

A lot depends – for GDP as much as for consumers - on what happens to the property market. Average capital city residential property prices are up 30% from the start of 2012, while Sydney prices have jumped 52%. A downturn has been expected for several years, however interest rate cuts and demand from China have kept prices rising. Housing construction is already easing, with approvals down 9%yoy in Q1'16, after a 14% rise in 2014. Housing approvals will likely remain above 210,000 units in 2016, down from 234,000 units in 2015, but well above the 160,400 units average over 2004-14.

Services is doing well

The services sector is expected to grow by 2.7% in 2016 and 2.9% in 2017, outstripping GDP growth by 0.8pp each year. A weaker A$ has helped tourism, with Q1'16 arrivals up 9%yoy (from a 7.7% rise in 2015). Professional services have also been helped by a weaker A$ and good growth in property and other asset markets.

Little inflation & a stable A$

Inflation was 1.3%yoy in Q1'16, the 6th straight quarter below the Reserve Bank's target 2-3% band. That allowed a policy interest rate cut to 1.75% in May. Even though that's a record low, the government's 10-year bond yield of 2.3% (AAA-rated) remains a standout buy in a world awash with negative yields. That will keep the A$ firm on a rising US$.

Year ending December 31	2013	2014	2015	2016	2017
GDP, real growth, %	2.0	2.6	2.5	1.9	2.1
CPI, year average, %	2.4	2.5	1.5	1.6	2.2
RBA cash rate, year end, %	2.50	2.50	2.00	1.75	1.75
A$1 = US$, year average	1.03	1.11	1.33	1.38	1.44
US$1 = A$, year average	0.97	0.90	0.75	0.72	0.69

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

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New Zealand

Political & policy issues to watch

PM Key's stable government

… has scope for fiscal stimulus

After almost eight years in office (and three election wins), the National Party, led by PM John Key, still leads in public opinion polls with 45.5% support to 41.5% for the Labour/Greens alliance. The budget speech by Finance Minister Bill English at the end of May should see Nationals keep their lead, as the government has room to lift its fiscal stimulus to cushion a softer economy. Gross public debt is just 30% of GDP and the first nine months of the current fiscal year (to March 31) saw a small operating surplus instead of a forecast deficit. Extra spending will likely go on hospitals, schools, and transport infrastructure around Auckland, where demand for more housing has become a hot political issue. However, promised cuts to income tax rate could be delayed. PM Key has one more budget to go before the next election, which must be held by September 2017.

The migration surge continues

… tourism is also at record levels

Behind housing demand in Auckland and concern over foreigners buying homes lies record inward migration, with April the 21st straight monthly record for net inward migration (up by an annual 68,100, or 1.5% of the total population). Kiwis returning from living in Australia made up a quarter of the April inflow. While the surge has peaked, it will provide a major boost to domestic demand for the next year. Tourism is also hitting consecutive monthly records, with an 8% rise in April to 260,000 (including a 40% jump from China).

Limiting foreign home & farm buyers

With house prices soaring, voter concern over foreign purchases of homes and farms is an issue. Key is looking at how to limit foreign house buying, a move that is complicated by equal-treatment clauses in NZ's many free trade agreements. Key has also put into parliament a bill that would amend local laws in line with the Trans Pacific Partnership.

Outlook for the market

Migrants and housing demand offset a dairy bust

Strong growth in inward migration and tourism, and related demand for housing and infrastructure, will keep GDP growth at 2.5-3.0% this year and next, even as dairy exports, NZ's biggest industry, suffer from a prolonged downturn in the global dairy market. The balance of positive and negative forces should see real growth in consumer demand over 2016 and 2017 stay close to the 2.5% reported for 2015. Fixed investment growth, which jumped 10.9% in 2014 at the peak of the housing boom, slowed to 3.1% growth last year, and will likely drop into a 2-3% band for 2016 and 2017.

A prolonged downturn for dairy

Whole milk powder prices, the key variable in payments to dairy farmers, have been stuck below US$3,000 a tonne for the last 21 months. In the 2012 downturn, there were just four months with prices under $3,000, while the 2008-09 downturn saw 13 months. Weaker demand from China and surging output from Europe have prolonged the current downturn.

Mild wage growth

The population surge has meant that despite 2%yoy jobs growth in Q1'16, the unemployment rate rose to 5.7% from 5.4% in Q4'15. Extra labour has kept wage growth in a 2-3%yoy range, which has helped cap inflation.

Housing boom rolls on

House prices reached a record NZ$495,000 in March, with strong housing demand triggering a 22%yoy lift in building consents for Q1'16. That should keep real growth in housing capex for 2016 close to last year's 5% before growth eases in 2017.

Exports earnings remain weak

In NZ$ terms, goods exports have fallen an average 2.5% in each of the last seven quarters, although export volumes (on the GDP measure) have risen by 4.5% a quarter, which has contributed to GDP growth.

A firm NZ$

With inflation of just 0.4%yoy in Q1'16, there is room for the Reserve Bank to cut interest rates in 2H'16. The NZ$ breeched 70 US cents in April for the first time in 10 months, but the uncertain global environment will likely push it below this rate in 2H'16.

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	0.9	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	0.70	0.68	0.71
US$1 = NZ$, year average	1.22	1.20	1.43	1.47	1.41
NZ$1 = A$, year average	1.18	1.09	1.07	1.14	1.06

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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