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Global outlook

Brexit means a weaker & more volatile world

The day after Britain voted to leave the EU, some US$2tr was wiped off the value of global stocks, the UK pound plunged, the main parties in Britain fell into disarray, and radical politicians across Europe gained a boost. Such developments hint that weaker growth and rising uncertainty lie ahead. Yet it will be hard to tell the longer term impact of Brexit on the EU or on Britain for weeks if not months. Our working assumption is that it means weaker global growth through 2017, with more volatility and uncertainty. What counts in this less favourable world is the degree of exposure to emerging risks like Brexit (sometimes via poorly understood connections) and resilience.

Forecast cuts by the OECD, IMF, & World Bank

The initial Brexit risk – and possibly the biggest – is a loss of confidence among consumers and businesses. This risk was highlighted by the OECD, the World Bank, and the IMF when all three cut various forecasts in the weeks prior to the June 23 vote. To the extent that Brexit has global contagion risk it is at first via its impact on sentiment rather than via rotten financial markets or rising barriers to trade and investment flows.

… as falling confidence cuts demand growth

In particular, the OECD highlighted the risk of the world falling into a “low-growth trap” with “negative feedback loops” that undermined sentiment that would support private investment. The World Bank cut its 2016 global forecast to 2.4% from a January forecast of 2.9%, while 2017 was cut to 2.8% from 3.1%. Growth in global trade volume was also slashed to 3.1% this year from 3.8% forecast in January, while 2017 drops to 3.9% from 4.3% in January.

We still expect a mild Euro area recovery

At our Q2 forecast updates we outlined the case for a mild global recovery from 2H’16 into 2017. Central to this was a steady lift in year-on-year GDP growth for the Euro area and the USA. In the Euro area, GDP growth has swung from a big fall over 2012 and 2013 to a steady and broad-based rise from the start of 2014 that includes consumer and government consumption as well as capex. Prior to Brexit, that looked set to continue with measures of business and consumer sentiment rising. Post Brexit, sentiment is at risk of waning. Provided the fall is modest, it shouldn’t end the recovery cycle. However, it does justify a cut of 0.3 percentage points (pp) to our Euro area forecasts for both years. We also expect a weaker Euro on the US$, with the 2017 year average now below $1.

While a long US upturn should regain speed in 2H’16

The US expansion is much longer (running for six years from Q1’10) and consistently about a percentage point stronger than Euro area growth, which has led to a much faster fall in unemployment and stronger recoveries in house prices and bank lending. However, Q1’16 saw private investment growth drop to 0.1%yoy with no sign of a recovery in early Q2 data. Adjusting for that takes 0.2pp off 2016 GDP growth, even though we expect a mild capex recovery in 2H’16. While US sentiment is less exposed to the EU’s troubles, we’ve cut our US forecast post Brexit by another 0.2pp in both 2016 and 2017, as a stronger US$ plus a weaker Euro area will weaken US exports. The US$ will also be stronger on its index.

Brexit hurts N Asia and some EM

… SE Asia & India are OK

The rest of the world splits into four groups. Emerging markets (EM) outside of Asia face weaker growth (due to weaker exports) and weaker currencies (due to global risk-off). Asia’s advanced economies (Japan, Korea, Taiwan, HK & Singapore) face weaker growth but steadier or rising currencies (notably for Japan). China’s internal challenges dwarf any Brexit impact, although its central bank may well join other big central banks in easing to help global demand growth. Meanwhile, SE Asia’s EM and India appear distant enough and resilient enough to avoid any significant Brexit impact.

IMA Asia’s forecasts	**2013**	**2014**	**2015**	**2016**	**2017**
World – Real GDP growth, %	3.3	3.4	3.1	2.8	3.0
- US	1.5	2.4	2.4	2.2	2.6
- Euro area	-0.3	0.9	1.6	1.2	1.3
- Asia/Pacific (14)	4.5	4.3	4.3	4.2	4.1
- NICs (4)	2.7	3.4	2.1	1.4	1.9
- Developing or “EM” Asia (7)	7.0	6.8	6.6	6.3	5.9
- 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	0.75
Inflation, CPI, US, year avg., %	1.5	1.6	0.1	1.2	1.5
Inflation, CPI, Euro area, %	1.3	0.4	0.1	1.0	1.2
Crude oil, avg of 3 spot crudes, US$	104	96	51	45	48
US$ / Euro 1, year average rate	1.33	1.33	1.11	1.02	0.96
Yen / US$1, year average rate	98	106	121	105	100

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

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Regional outlook

Summary of forecasts in this month's Asia Brief

GDP (Expenditure), real growth, %	2013	2014	2015	2016	2017
Japan	1.4	0.0	0.6	0.2	0.4
China	7.7	7.3	6.9	6.5	5.6
Hong Kong	3.1	2.7	2.4	1.4	2.4
Taiwan	2.2	3.9	0.6	0.6	2.1
South Korea	2.9	3.3	2.6	1.7	1.8
Indonesia	5.6	5.0	4.8	5.3	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	5.2	6.0
India (CY)	6.3	7.0	7.2	7.0	7.7
Australia	2.0	2.7	2.5	2.5	2.6
New Zealand	1.7	3.0	3.0	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	2.1	2.4
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	2.9	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	0.5	1.5
Vietnam	6.6	4.1	0.6	2.1	2.8
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	105	100
China	6.20	6.14	6.23	6.58	6.78
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	46.6	46.0
Singapore	1.25	1.27	1.37	1.40	1.43
Thailand	30.7	32.5	34.2	35.6	36.3
Vietnam	20,933	21,148	21,677	22,335	23,010
India (FY)	58.5	61.0	64.1	67.5	70.5
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.

Regional outlook

Political & policy issues to watch

Australia's angry voters have their turn on July 2

With political uncertainty up sharply in Europe and rising in the US, its worth asking whether similar trends are spreading in the Asia/Pacific region. That appears to be the case in Australia, where PM Malcolm Turnbull could lose the July 2 election and become the 6th toppled Australian leader in about as many years (with Kevin Rudd accounting for two falls). While Turnbull's immediate problem has been misjudging the opposition Labor Party's scare campaign over Medicare, the underlying issue is growing voter distrust of cynical politics by both major parties (so not too different from trends in the US and EU). That has opened the way for minor parties to capture control of the senate and stall or halt government policy. While some micro parties may disappear on July 2, a new one led by Senator Nick Xenophon looks set to take their place.

… while PM Abe faces anxious voters in Japan

PM Abe in Japan faces a July upper house election in which the surprise may be a poor result for the ruling LDP despite disarray in the opposition. The trigger for this would be rising voter anxiety over the Bank of Japan's move to negative interest rates in February in an effort to kick-start growth (a fear shared with Euro zone voters).

N Asia's policy risk

North Asia faces a big policy challenge as governments in Japan, Korea, Taiwan, and Hong Kong appear to have little understanding of fundamental challenges to traditional growth models. Hollowing out of their economies puts all of them on the path to structurally weaker growth, and in failing to pursue reforms that would ignite new areas of growth they are similar to many Euro area governments.

… & SE Asia's political risk

By contrast, SE Asia benefits from structural changes that are lifting growth (urbanisation, falling dependency levels, rising levels of capex and manufacturing, and rising consumer markets). The region's main challenge is political risk, which could easily spike in Thailand, the Philippines, Cambodia, Myanmar, and Malaysia in the next year.

Outlook for the market

China risk is Asia/Pac's main concern

In our global outlook we nominated exposure/linkages and resilience as the two issues determining growth in the next few years. For Asia/Pacific it is exposure and linkages to China rather than to Brexit that is the dominant concern, although some Brexit impacts are noted below. How close China is to a financial crisis is debatable, but its large fiscal and monetary stimulus in 1H'16 has reduced that risk in 2016. If Beijing is unable to contain risk in the next few years, the collapse in growth would do great damage to the region.

The impact of Brexit & a weaker world

A world of slower growth and rising uncertainty is unkind to North Asia, particularly as its governments are failing to address the challenge of weaker exports via structural reforms. Too often there is a knee-jerk reaction to boost construction in Korea, Japan and HK, although that brings risk of a sharper and more protracted downturn. Singapore's growth falls just as much as that of Korea, HK and Taiwan, yet it has far stronger reforms underway to create new sources of growth. There's not much pressure for Southeast Asia and India to rethink policies, as structural growth drivers still work.

The problem of high debt for consumers

One of the biggest uncertainties in the lower growth world we have entered into is how debt affects debtors. Traditionally, a swing to rising interest rates has been one of the biggest signals to consumers to trim spending and deleverage. Yet interest rates are falling to record lows with little sign of a significant rise ahead. That has left households in countries like Korea, Malaysia, and Australia gorging on debt. We expect this to lead to a gradual but prolonged deleveraging cycle, as the scale rather than the cost of debt forces change.

Asia's better stimulus capacity

In a world that has run out of capacity to stimulate demand, parts of Asia stand out. China has led in 1H'16 with a combined fiscal, monetary, and regulatory stimulus. India, Indonesia, the Philippines, and Thailand also have capacity for stimulus in all three areas. This month's Asia Brief also notes stimulus underway or rising in the Philippines, Thailand, and Singapore.

Asia's hard and volatile currencies

With the exception of the Japanese Yen, we expect most Asian currencies to ease against a broadly rising US dollar by varying degrees, reflecting each country's external position and investor sentiment.

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Japan

Political & policy issues to watch

July 10 polls

… watch for a swing against the LDP

PM Abe's LDP-led coalition should retain control of the Diet's upper house in the July 10 elections. Abe had hoped that a strong win would allow him to call for a referendum on amending the war-renouncing Article 9 of the constitution, but with opinion polls showing 68% of voters opposed to the idea, that has been shelved. Instead, the July vote will, in effect, be a referendum on "Abenomics" – the "3 arrow" economic revival strategy pursued by PM Abe after he won office in 2012. The government doesn't need to call a lower house election until December 2018, although Abe might call one in late 2016 to take advantage of disarray in the opposition. Abe also faces a term limit in late 2018 as LDP president (and thereby as PM), although some think he may try to extend.

Delaying a sales tax hike until late 2019

… as Abe's economic revival plan falters

The government's biggest decision this year has been postponing a hike in the sales tax to 10% from 8% from April 2017 until October 2019. An earlier hike from 5% to 8% in April 2014 pulled forward demand for durable goods and housing by several quarters but also left a year long recession in its wake. If Abenomics had delivered on its goal of a sustained lift in capex and wage growth, then a second sales tax hike may have been possible. Yet with monetary policy (the first of Abe's 3 policy arrows) backfiring, these goals look unreachable. Massive quantitative easing (QE) did help growth from 2013 to 2015 by weakening the Yen. That delivered record profits to big firms on remitted income from overseas operations (it did not, however, boost exports). Yet QE lost traction in 2016, with the Yen climbing relentlessly from January to reach 109 to US$1 in May. Moreover, a move to negative interest rates by the Bank of Japan (BOJ) from February 2016 frightened Japan's consumers rather than encouraging them to spend.

A possible ratings cut ahead

Extra revenue from the sales tax hike was meant to help fix Japan's parlous budget and public debt position. Without that extra revenue, Japan may have its government bonds downgraded this year. But as almost all public debt is locally held, and the BOJ dominates purchases under its QE program, a downgrade will have little impact.

Outlook for the market

Little growth in 2016

… as capex & consumer demand fall

On our customary year-on-year measure, Japan's GDP fell by 0.1%yoy in Q1'16 after four quarters of weak growth. Consumer demand fell 0.4%yoy (its second consecutive fall after two quarters of weak growth) and fixed investment fell 0.5%yoy (the first decline after three quarters of growth). Both declines were partly offset by a small lift in public consumption and net exports even though imports and exports both saw their biggest volume falls in three years. With the sales tax hike being pushed back from next April, it's hard to see what will lift demand in 2H'16, which leaves full 2016 growth at 0.2%, with a lift to 0.4% next year provided global demand edges up.

Consumers pull back as the Yen rises

Abenomics' failure to lift consumer demand is apparent in the 0.3%yoy fall in retail sales in Q1'16, which matched the 2015 full year drop. However, last year's 10% plunge in car sales eased to a 0.5%ytd fall by May. Resident departures for overseas even rose 3%ytd by May after a 4% fall in 2015 and a 3% drop in 2014. But with the Yen climbing towards 100 to US$1 in mid-2016, the one bright spot for households – a lift in income from overseas investments tied to a weaker Yen – has been snuffed out. That leaves a third straight year of falling consumer demand in 2016 with a weak lift towards 0.3% in 2017.

Export volumes and factory output will fall

The 2.5%yoy fall in Q1'16 exports on the GDP volume measure was the biggest in three years. With Brexit likely to weaken European demand over the next year it's hard to see exports lifting until 2017. Industrial production is likely to drop 1.5% this year after a1.2% fall in 2015 with a smaller fall of 0.5-1.0% next year.

The BOJ can't halt the Yen's rise

The BOJ faces a daunting challenge in the wake of Brexit, which has forced the Yen up and the stock market down. That dynamic mightn't change for 6-12 months. It suggests that even a push deeper into negative interest rates won't stop the Yen rising. Our biggest forecast change post-Brexit for Japan is to the Yen, which we now put at 100 to US$ by Q4'16 through to 2017, from a prior forecast of 108 for 2016 and 115 for 2017.

	2013	2014	2015	2016	2017
GDP, real growth (2005p), %	1.4	0.0	0.6	0.2	0.4
CPI, year average, %	0.3	2.8	0.8	0.1	0.7
Overnight call rate, year end, %	0.07	0.07	0.04	-0.02	-0.02
Yen to US$1, year average	98	106	121	105	100

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

China

Political & policy issues to watch

A dominant Xi Jinping

… & a surprising turn to the left

President Xi Jinping, already regarded as China's strongest leader in 25 years, will strengthen his hold over China when he gains a second 5-year term as party head in late 2017. His supporters are already moving into key mid-level government and party posts, and at next year's party congress they should gain a majority in the 25-member politburo and its 7-member standing committee. Xi's rise ends 25 years of factional wrangling that tended to result in consensus leadership. Disconcertingly, Xi has revived aspects of communist ideology in order to gain tighter control over society and the economy.

Focused on a gradual resolution of debt

… & maintaining social stability

As debt risk has risen quickly in the last decade, Beijing's main goal in the next few years will be to resolve a debt crisis without a collapse in growth and a surge in unemployment. To reach that goal it has to ensure growth is strong enough to allow gradual debt restructuring. If achieved, then it's possible that many other goals can be partly achieved, ranging from economic rebalancing to massive reforms of the household registration system and key sectors like financial, healthcare, local government, and state owned enterprises (SOEs). High domestic savings and a closed capital account will help, as will tight control over banks and debtors (mostly SOEs). There are plenty of risks in this strategy, and signs of debt stress will rise quickly in the next year.

Lots of fiscal stimulus over the last year

To keep the economy growing, China will lift its budget deficit to 3% of GDP in 2016 from 2.4% in 2015. The fiscal stimulus is already apparent, as spending grew at 14%ytd by May while revenue growth was a milder 9%. A series of statements in May hinted at a big Rmb4.7 trillion infrastructure investment plan over the next three years for some 300 projects ranging from road and rail links to outlying cities, to airports, waterways, and metro-systems. Some of these projects were likely in the 13th Five Year Plan (2016-20), which was approved in March. Stimulus measures should ease in 2H'16.

Outlook for the market

Achieving 6.5% growth in 2016

… despite a worrying slump in private capex

Beijing should be able to hold GDP growth at 6.5% this year thanks to strong infrastructure investment (up 20%ytd by May from 17% in 2015) and a rebound in property investment (7%ytd from 1% in 2015). That will help offset weak private sector investment, which slowed to 4%ytd by May from 10% in 2015. Fixed investment growth for plant and equipment slumped to 2%ytd by May from 10% last year reflecting weak demand and oversupply in many industrial sectors.

A priority on steady growth in consumer demand

China's growth outlook hinges on the consumer story remaining strong, yet growth could ease. Retail sales grew 10%ytd by May, broadly in-line with 10.7% in 2015. On-line sales continue to do better, with 27.5%ytd growth, easing from 33.3% in 2015. However, we expect wage growth to slow to 5-8% this year and next from 8-11% in recent years. Very low household debt should cushion the pullback, but a lot will depend on maintaining consumer confidence. That puts pressure on the government to take steps to limit unemployment and stabilise property and stock markets. Those measures appear to be working, but they won't stop real consumer growth trending down from a 9% annual pace over the last 25 years to a 5.5%pa pace for 2015-20.

Heavy industry & construction get a brief lift

The May official manufacturing PMI came in at 50.2, the third consecutive expansionary month as large firms benefited from the 1H'16 fiscal stimulus. The construction PMI was particularly strong at 59. Services also did well with a 53.1 PMI for the sector. Smaller firms haven't benefited, however, with the Caixin manufacturing PMI slipping to 49.2.

Monetary stimulus and a weaker Yuan

With fiscal and monetary stimulus measures supporting growth in 2016, inflation will lift towards 3% by end-2016. That isn't enough to reverse the PBOC's monetary easing cycle, which has seen the policy rate fall by 100 basis points over the last year to the current 4.35%. One more rate cut is possible before end-2016 to keep GDP growth at or above 6.5%. Since ending its US$ peg last August, Beijing has gained greater flexibility in currency management. In recent months that has meant a mildly weaker Yuan on a rising US$. We expect that trend to continue into 2017.

	2013	2014	2015	2016	2017
GDP, real growth, %	7.7	7.3	6.9	6.5	5.6
CPI, year average, %	2.6	2.0	1.4	2.1	2.4
PBOC 1-year loan, at Dec., %	6.00	5.60	4.35	3.85	3.85
Yuan to US$1, year average	6.20	6.14	6.23	6.59	6.78

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

Hong Kong

Political & policy issues to watch

A deteriorating political outlook

… hurts one of Asia's great hub cities

HK's political and policy environment is deteriorating. At present, this is mostly an issue for firms reliant on public projects or approvals, as filibustering and a split Legislative Council (Legco) have delayed HK$55bn in funding for some 60 projects. However, with Legco polls looming in September, followed by Beijing's selection of a new Chief Executive in 2017, conflict over HK's future could start to hurt the business environment (e.g. by street protests, good staff migrating, and abrupt moves by an irritated Beijing). Balanced against this, HK's business environment has consistently been ranked among the best in the world. In many areas of finance, HK is Asia's main hub, and it is hard to equal its position as a starting point for China outbound and inbound business.

A clash with Beijing over democracy

Central to the political conflict is a clash between a fragmented but growing band of political players calling for various versions of self-determination for Hong Kong in 2047, when Beijing's promise to keep the SAR's capitalist system and way of life for 50 years may – or may not – expire. Anything implying or even hinting at HK's independence is a non-starter with Beijing, but will be an issue in the Legislative Council elections in September – with some candidates sympathising with this view likely to do well.

PRC firms move into HK

HK needs to reconsider its value proposition, particularly as a currency peg to a rising US$ deters tourists and sees logistics move to cheaper mainland ports and airports. One fast emerging growth engine is the arrival of mainland firms who find HK an ideal base for international operations. Their demand helped to keep the vacancy rate for HK grade A office space at 2% in April, and contributed to a record-US$175bn FDI in HK last year.

Outlook for the market

Scope for a 2017 recovery

As a global business hub on China's southern coast, HK's outlook is largely dependent on better China growth. A mild improvement is expected from 2H'16 despite an array of risks. The government hopes construction, long central to the economy, will lift, as it releases more land for developers. Positive trends in these areas should lift growth back to 2.4% in 2017 from a weak 1.4% this year.

The loss of China tourists

… little growth for consumers

Dragging 2016 growth down is a fall in tourists from China. Retail sales fell 11%ytd by April, with durable goods down 24%ytd and luxury goods down 22%ytd. Mainland arrivals on China's individual travel scheme (who spend more than group travellers) fell by 22%ytd. With local consumer spending flat at best, real growth in consumer spending will likely fall to 1.7% this year from 4.7% in 2015 followed by a lift to 3% next year. Growth in spending on food should remain around 1% while services spending slows towards 1% this year before returning to 2% or better in 2017.

A turnaround for the residential market

… with risks

While HK's residential property sector has cooled, construction starts soared in Q1'16. Residential sales were down 50%ytd at April after a 12% fall in 2015, before May saw the strongest sales in 10 months. Developers are now offering loans of 80%-95% of value without proof of income, something that should worry regulators. Meanwhile, new residential starts soared to 13,300 in Q1'16, as the government's 2016 land release targets 19,000 extra units (from an average of 11,000 over the prior decade). Despite weak civil works, that should lift construction growth towards 5% in 2016 and 2017 from 2% in 2015.

The decline of logistics

Exports were down 5.6%ytd by April after a 1.8% decline in 2015. With nearby mainland ports offering better value, laden containers loaded in HK fell 15%yoy in Q1'16, below the low point set in the GFC.

Little inflation & stuck with a US$ peg

With weakening demand, headline inflation will likely drop from April's 2.6%yoy. The 33-year old HK$ peg to the US$ will be maintained, as its guarantee of stability is valued more than the stress of adjustment for industries like tourism and logistics. The peg requires the policy interest rate to stay 25 basis points above the US Fed's rate.

	2013	2014	2015	2016	2017
GDP, real growth, %	3.1	2.6	2.4	1.4	2.4
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

A slow start likely for Tsai's new government

Taiwan's first female president, DPP leader Tsai Ing-wen, was sworn in for a 4-year term on May 20 after winning 56% of the vote in January's poll. The DPP also won control of the legislature for the first time. Tsai's cabinet includes a lot of academics and lawyers with little experience in government, and it will need time to get to grips with ministries that were run by the KMT for most of the last 66 years.

Critical business ties with China

… no further gains, but also no damage

Geopolitical risk rises a notch with the election of a DPP government, as Tsai has resisted pressure from Beijing to support the 1992 "One China" consensus. How Beijing might retaliate is an issue. Growth in tourist arrivals from the mainland has dropped after a 39% surge in 2014, although the slowdown hit in Q2'15 and appears to have more to do with developments in China. A bigger concern for Taiwan's industrialists would be any hindrance to their cross-straits business operations, as close to 100,000 Taiwanese firms have established mainland operations. So far, there's no sign of disruption, and, as both sides have so much invested in this relationship, trouble should be avoided.

Finding a new growth engine to replace China

… & tackling power & pension challenges

Taiwan does, however, need a new economic plan, as the hollowing out of export manufacturing over the last 15 years has seen household income growth stall even though the island has fostered a vibrant high-tech IT sector. Tsai's predecessor, President Ma, sought stronger growth via tighter commercial ties with China. However, it's unlikely that Tsai's administration will ratify a trade-in-services agreement signed with China in 2013 or complete negotiations on a trade-in-goods deal, as opposing both helped her win government. Instead, Tsai talks of a new southbound policy focused on India and southeast Asia, and of promoting new industries like biotechnology. More pressing issues are a new energy plan, as she has committed to closing down nuclear power by 2025, and coming up with a pension reform plan within a year.

Outlook for the market

Little growth until global demand lifts

Taiwan's export-led economy is in recession, with GDP growth contracting for three straight quarters to Q1'16. Leading indicators such as building permits, the PMI, bank loans, and consumer confidence suggest GDP growth will be limited to 0-1% in 2016, about the same as last year when growth slowed to its weakest reading since 2009. We've lifted our forecast from May, as the 2.2%yoy lift in consumer spending in Q1'16 was stronger than we'd expected. Next year, better global demand should lift growth to 2-3%.

Factories destock

… & consumers slow spending

Offshoring and weak global demand will see manufacturing output drop by 1-1.5% in 2016, following a 0.5% contraction in 2015. Industrial production remains weak and with new orders dropping factories are scaling back production, destocking, and discounting prices. Unemployment stayed near a 23-month high of 4% in May, as growth in manufacturing and services has slumped. That saw consumer confidence hit a 29-month low in May. As a result, consumer demand growth is likely to drop below 2%pa over the next two years, down from 2.8%pa in 2014 and 2015.

Construction activity fades as home prices ease

Home prices have fallen by 7.9% since their mid-2014 peak, and growth is likely to remain weak amid a soft labour market. Growth in building permits fell by 27.3%yoy in the first four months of the year, after a 15% fall in 2015. This will likely see construction spending drop a further 3-4% in 2016, after a 1.3% fall in 2015.

It's hard to get the NT$ down

Little inflation is likely over the next 18 months, allowing the central bank to continue its easing cycle. Unfortunately, that may not do much to lower the NT$ and boost exports, with the current account surplus surging, as the fall in imports outpaces the fall in exports.

	2013	2014	2015	2016	2017
GDP, real growth, %	2.2	3.9	0.6	0.6	2.1
CPI, year average, %	0.8	1.2	-0.3	1.2	1.3
Official discount rate, year-end, %	1.88	1.88	1.63	1.38	1.38
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

Continued legislative grid lock until 2018

Korea faces legislative gridlock until after the December 2017 presidential election following a shock defeat for the ruling Saenuri party in April's legislative elections. It was the worst result for a ruling party in 16 years, with the main opposition Minjoo party gaining a slender one-seat advantage. Meanwhile, the People's party, a 2014 spin off from the Minjoo party, won 38 seats in a clear rebuke of the two major parties at the centre of four years of legislative gridlock. The elections leave a fractured political landscape in which President Park, with an approval rating of just 34%, will find it hard to implement her agenda.

… limiting reforms needed to boost growth

Legislative gridlock is bad news for an economy that has lost momentum. Korea's challenges range from weak exports, high levels of household debt, and rising youth unemployment to a rapidly aging population and weak productivity growth. State banks and the shipbuilding sector are also in bad shape and face a painful period of restructuring.

Outlook for the market

Growth slides on weak local and export demand

Despite frontloading 40% of this year's public spending in Q1'16, GDP growth slipped to 2.8%yoy, after a brief acceleration to 3.1%yoy in Q4'15. With only modest growth in fixed investment and household consumption likely over the next two years, and export prospects still dim, GDP growth is expected to slip under 2% in 2016 and 2017, well below the government's 3.1% target for 2016 and the OECD's 2.8% forecast released in June. Our lower forecast anticipates a sharp stock rundown, which we expect to take about one percentage point off growth this year after adding 0.8pp in 2015.

Construction will cool

… as will capex in equipment

One of the major drivers of the Korean economy over the last year was the construction sector, which grew by 3% in 2015. That growth should continue through 2016 before easing in 2017 as new construction orders, especially private (75% of total), is slowing. Capex elsewhere, notably for plant and equipment, is likely to be tepid, which will limit fixed investment growth to around 2%pa over the next two years, down from 3.5%pa over 2013-15.

Consumers face headwinds

…

Household consumption won't do much to lift GDP growth, as weak wage growth and a drop in consumer confidence dampen prospects. There's little chance of sentiment lifting in the next year as corporate Korea embarks on a wave of restructuring. Unemployment in the 20-29 age group has risen to about 10% this year, a level not seen since the Asia financial crisis. However, there is no sign yet of delayed consumer debt repayment, with "one-day passed due" at historic low levels. Real growth in consumer spending is likely to be around 2%pa over 2016 and 2017, down from a 3.4% rate set in the 2000 decade and ending hopes of a rebound after four weak years to 2015. Retail sales growth cooled to 3.7%yoy in April after reaching a 44-month high of 6.7%yoy last October, despite an excise tax cut for car buying that has been extended to June.

The external environment remains a drag

Exports have fallen for 17 months, the longest decline on record. A 6-8% fall is expected this year after an 8% drop in 2015; at present we expect a weak 2017 recovery to 2-4%. The weak trade performance has hit the industrial sector, with April's 2.9%yoy fall in industrial production the largest in nine months. The latest PMI reading, which was just above 50, points to continued weakness in the manufacturing sector.

…but the BOK has room to cut the policy rate

Consumer price inflation continues to hover around 1%yoy, while producer prices have fallen for the last 22 months. That allowed the Bank of Korea to cut its policy rate to a record low of 1.25% on 9 June. The cut should help weaken the Won, which has already fallen by 6.3% in real effective terms since reaching a seven-year high in April 2015.

	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

An improving political outlook

… as Jokowi wins some battles

A major political realignment in early 2016 should pay off in faster legislation from 2H'16 that will lift growth and might make Indonesia more attractive to foreign investors. The realignment involved fracturing the opposition Red & White coalition, which had dominated parliament since the 2014 elections and weakened President Jokowi's reform agenda. Golkar, the largest opposition party, has now swung firmly behind Jokowi's administration, and will hope to be rewarded with seats in a cabinet reshuffle that should come soon. Golkar's backing has also strengthened Jokowi's position with his own party, PDI-P. That enabled him to sidestep a questionable PDI-P promoted candidate for police chief and secure the promotion of Tito Karnavian, the head of the police anti-terrorism squad.

Watch for a fiscal stimulus despite a higher oil price

With the average price for Indonesian crude at US$36 a barrel in 1H'16, parliament has agreed on a revised budget for FY2016 (to December) with a $40 oil price from an initial estimate of $50. At the same time, the government aims to lift spending and allow a bigger budget deficit at 2.35% of GDP, up from an initial target of 2.15%. Hopes for extra revenue from a tax amnesty bill will likely be disappointed, but the government shouldn't have any problem raising more debt. With parliament now backing spending bills and Jokowi telling regional government to step up spending, the construction and consumer markets should benefit from fiscal stimulus in 2H'16.

Risk - still waiting for that S&P upgrade

At some point in the next year Indonesia should earn an upgrade to investment grade (BBB-) with S&P. On June 1, S&P surprised markets by concluding a review without making the upgrade. When S&P does move, it should trigger a stronger funds inflow which will support the Rupiah and help lower the cost of debt.

Outlook for the market

Watch for a mild lift in growth in 2H'16

Indonesia's growth slipped to 5.1% in Q1'14 and has bumped along at a weak pace since then, with 4.9%yoy for Q1'16. Big ticket consumer purchases have been notably weak, although the 2015 collapse for vehicle sales (-16%) and motorbikes (-18%) eased in the first five months of 2016 to -0.6%ytd for vehicles and -6.0% for motorbikes. For the year to April, industrial production growth slowed to 3.6%ytd from 4.8% for full 2015, while bank loan growth eased to 7.7%yoy from 10.1% for 2015. We expect a mild lift in pace in 2H'16, as the government increases its spending, particularly via regional governments, and the central bank trims interest rates. That should lift full 2016 growth to just over 5%, with close to 6% possible in 2017.

Headwinds for consumers are easing

Indonesian households are quite exposed to marginal shifts in costs and incomes. Negatives in the last 12 months include a drought, low commodity prices, a weaker employment market, and spending delays at regional governments. These have been partially offset by a 13.5% average lift in the minimum wage across all provinces for 2016 and a cut to petrol prices from April 1 to September 30. We expect the negative forces to ease in Q3'16 allowing real consumer growth to edge up to 5.3%yoy by Q4'16 (so around 5% for full 2016) with 5.5% likely in 2017.

Capex and construction should lift

Construction should be a beneficiary of Jokowi's accelerated spending program. 1H'16 was heading in the right direction with cement sales to May up 4.3%ytd after 0.9% growth in full 2015. Regional spending on roads, ports, and power should lead a lift in fixed investment growth to just over 6% this year and 7-8% next year from 5.1% in 2015.

Big interest rate cuts and a stable Rupiah

A big drop in inflation to 3.3%yoy in May allowed the central bank to cut another 25 basis points off its policy rate in mid-June, bring the total 1H'16 cut to 100 basis points. We think there's room for 1-2 more cuts from the current 6.5% this year given low inflation and a stable current account deficit (2.2% of GDP), while keeping the Rupiah stable in 2016.

	2013	2014	2015	2016	2017
GDP, real growth, %	5.6	5.0	4.8	5.3	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

PM Najib uses wedge politics to build support

Strong wins in two by-elections on June 18 have strengthened PM Najib Razak's position by demonstrating his tight hold over UMNO, the ruling party, and highlighting the ineffectiveness of a deeply divided opposition. Najib continued his use of divisive communal tactics in seeking to lock up ethnic Malay votes by agreeing to back the imposition of sharia law in the northern state of Kelantan. That drove a wedge between factions within the Islamic opposition party PAS, even though it also distressed the smaller Chinese and Indian parties that support UMNO.

… but 1MBD hangs over his head

We still doubt that Najib can lead the government into the 2018 elections, as the scandal surrounding the 1MDB state-owned fund that he heads continues to blossom with judicial authorities in the US, Singapore and Switzerland uncovering evidence of massive theft. Even though UMNO is wedded to "money politics", we expect it will want a new leader.

Still fumbling with a highly protected car sector

The government has given Proton, a national carmaker, five years to improve its finances, find a new strategic auto partner, and repay a US$0.4bn soft loan. Proton employs 12,000 workers directly and another 50,000 through local suppliers. Its long-standing problems reflect Malaysia's failed 3-decade effort to create an auto industry behind high tariffs and taxes. Some 563,000 cars were assembled or made in Malaysia last year, of which 98,000 (17%) were Protons. That's down from a 59% share of production in 2001 (210,000 units out of 356,000). Perodua, another local builder tied to Daihatsu, lifted its share of production to 41% in 2015 (229,000 units). Local cars accounted for 95% of the 591,000 passenger vehicle market in 2015, with some major global brands running small assembly operations and consumers paying 70-100% more than in the US.

Outlook for the market

Growth slides to 3-4%

… with little stimulus likely

GDP growth slowed to 4.2%yoy in Q1'16, as both investment and consumer demand eased. Fixed investment was essentially flat after 3.7% growth last year and a 7.1%cagr for the decade to 2014. Real growth for consumer spending eased to 5.3%yoy in Q1'16 from 6% last year and a 7.1%cagr for the decade to 2014 (matching capex). As the export sector offers little hope of growth (export volume fell 0.5%yoy in Q1'16) the question is whether stimulus measures can lift local demand. That looks unlikely, as the government is keen to lower public debt to 55% of GDP from the IMF's estimate of 57% last year. Meanwhile, households are struggling with debt, sliding asset prices, and a weak jobs market (see below). As a result, GDP growth will stay in a 3-4% band to 2017.

Head winds knock fixed investment growth down

The government's US$444bn Economic Transformation investment program has failed to sustain the double-digit capex growth of 2010-12 (12.4%pa). Growth eased to 3.7% in 2015 and is likely to remain in a 1-4% range in 2016 and 2017. The capex slowdown is driven by constrained public finances, political uncertainty arising from the 1MDB saga, and a deflating residential property market. Housing approvals were down 68% in Q1'16 from their Q2'12 peak, while housing starts fell 44% from their Q4'14 high.

Consumers are deleveraging

Online job advertisements were down 18%yoy in April, while car sales fell 20%ytd. Both hint at negative consumer sentiment, as households faced with record high debt (89% of GDP) seek to deleverage. That limits consumer growth to 3-4% in 2016 and 2017.

Small rate cuts and a firmer M$ with oil near US$50

Inflation was up 3.1%ytd by April from 2.1% in full 2015, but we expect it to ease back in 2H'16 and 2017. This should allow Bank Negara to lower interest rates later this year. The M$ has gained some ground after plunging 32% on the US$ between mid-2013 and late-2015. Rising oil prices should help counter the downward pressure on the M$ even as the central bank trims its policy rate.

	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	2.9	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

Markets welcome Pres. Duterte's pro-growth policies

While the stock market and the Peso have risen since Rodrigo Duterte was elected as president in May (he will be inaugurated on June 30), it is too early to tell whether he might help or hinder one of Asia's best performing economies. His promise to continue the pro-growth policies of outgoing president Aquino is a good start. That includes lifting infrastructure spending to 5% of GDP, lifting investment in agriculture, cutting red tape, and slowing population growth with a 3-child policy. He'll push into new territory with a commitment to lower foreign ownership limits and give more power to the provinces. In line with his tough policies as mayor of Davao (1988-2016), he has also said he'll reinstate the death penalty and curb smuggling. Finally, a fall in the budget deficit to 0.9% of GDP in 2015 (with public debt at 36% of GDP) has left him with room to lift spending and cut both the top personal and corporate tax rates to 25% from 32% and 30% respectively.

… but can he stay on top of Manila's politics?

Duterte should initially have little trouble passing bills in congress, as his administration quickly secured a two-thirds majority in the lower house despite his party, PDP-Laban, winning just 1% of the vote and 1% of the seats (Duterte won 39% of the vote in a 3-way presidential race). Yet the fluidity of Filipino politics could also work against Duterte if he stumbles or annoys the powerful families that dominate the country. Duterte's cabinet draws heavily on his team from Davao, and while that may ensure unity, it also casts them as outsiders in Manila's tough political game.

Outlook for the market

Booming domestic spending to drive growth

With the help of a surge in fixed investment and pre-election spending, GDP growth jumped to 6.9%yoy in Q1'16. The 26%yoy lift in fixed investment in Q1'16 reflected strong private investment, as well as steps to correct earlier public underspending. The resulting jump in domestic demand triggered a 16%yoy lift in import volumes and a bigger trade deficit on the GDP measure, which stopped GDP growth from breaking well above 7%yoy for Q1. Domestic spending should remain the main growth driver, but its pace is likely to moderate, with GDP growth easing to 6% in 2017 from an expected 6.7% in 2016.

Cashed up consumers

Consumer growth hit 7%yoy in Q1'16 from 6.3% in 2015, as household finances were boosted by a strong jobs market, a steady inflow of remittances from relatives working abroad (up 4.4%yoy in Q1'16 after 4.6% in full 2015), and fast-rising consumer loans. With these factors expected to persist, consumer growth of 6.5% is likely in 2016 and 2017. Vehicle sales rose 25%ytd by May after 23% growth in 2015 and 30% in 2014.

Strong capex growth should continue

… and that helps industry

The 26%yoy surge in fixed investment in Q1'16 reflected the government speeding up infrastructure work in partnership with private investors. Civil works will continue to drive fixed investment, although private building work is also doing well, with the annual rate by floor area in March some 21% above the 2010 level and almost double the 2005 level. Foreign direct investors have helped, with FDI inflows hitting a record US$5.7bn in each of the last two years. We expect capex growth of 14% in 2016, before easing into a more sustainable 7% in 2017. Strong local demand swung industrial production from a trend decline from 2000 to 2008 (at -2%pa) to a trend rise for 2010-2015 (at 6.4%pa).

Low inflation, an attractive policy rate, & a firm Peso

Inflation rose to 1.6%yoy in May from a 0.4%yoy low in September 2015, but remains below the central bank's 2-4% target range. With little inflation expected the central bank will likely keep it policy interest rate unchanged at the current 4% level well into 2017. That should support the Peso, which is trending towards the stronger side of its recent 46-47 range against the US$, after a 15.4% decline from 2013 to 2015.

	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	46.6	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

Restructuring industry & labour markets

A cutback to migrant worker inflow, a downturn in private construction, and a slump in exports have pushed Singapore's recent growth to less than half its pre-GFC (1975-07) pace of 7.3%pa. This is more of a structural decline than a cyclical downturn. It implies a big restructuring of Singapore's production base, with the government doing little to hold onto labour-intensive production and focusing instead on R&D driven industries. This is occurring alongside a structural lift in labour costs that will gradually end a 2-tier labour force, as migrant workers were holding down pay for low income nationals. The National Wage Council (NWC) supported the lift in wages with its May 31 recommendation for a S$50-75 hike for those on the lowest wages (S$1,100 or less – about 7% of the workforce and mainly outsourced workers). That's the fifth year in a row the NWC has recommended a 5-6% rise, more than double the pace of inflation. The NWC pay rises will help rebuild political support for the government with low wage earners.

More civil works

… as private construction drops

With global growth falling, the government has lifted its fiscal stimulus via a 69%yoy jump in public spending on development projects in Q1'16. That included an 81%yoy spike in capital works on the MRT network, Singapore seaport and Changi airport. The resulting 55%ytd lift in public construction contracts by April helped offset a 61%ytd slump in private contracts awarded over the same period. The net result should be a 2-3% annual lift in construction and works spending in 2016 and 2017, after a 0.8% fall in 2014 and 2015.

Outlook for the market

Growth slips below 2%, with a mild 2017 lift

Weak investment and exports have seen GDP growth stall at about 1.8% over the last year - the slowest pace since the global financial crisis. This cyclical weakness is likely to continue in 2H'16, with growth set to slip below 2015's 2% pace before recovering modestly to 2.5-3.0% in 2017, provided exports lift.

Consumers trim growth in spending

Growth in consumer demand reached a five-year high of 4.5% in 2015, despite a 15% fall in stock prices, an ongoing decline in house prices, and a sharp slowdown in job growth. However, this upturn was driven by a surge in vehicle sales under Singapore's unique certificate of entitlement (COE) system, while retail sales growth ex-cars remained near a seven-year low. With stock and house prices continuing to fall, job growth still weak, consumer loan growth in a steep downturn, and consumer sentiment down, household consumption growth is expected to moderate to 2-3%pa in 2016.

A plunge in exports should ease

… factory output should edge back to growth

… & strong tourist growth

Real export growth in GDP fell to a three-year low of 2.5% in 2015 and is expected to ease to 1-2% in 2016 as export demand remains soft. There's little significant demand in any of the major export markets. Exports to the rest of Asia (75% of total exports) were down 9.7%ytd by May (S$ basis), after a 6% drop in 2015. Meanwhile, exports to the US fell about 1%ytd by May, while exports to the EU were up by just 0.3%ytd, following a 4.3% decline in 2015. While exports in value terms have been weak, last year's 5.2% fall in industrial production eased to a 1%yoy fall in Q1'16. A slight lift in global demand over 2H'16 should allow industrial production to edge towards 1+% growth this year with 3-4% possible next year. Tourism has done well with arrivals up 14.1%ytd to April, from 0.9% growth in 2015 thanks to a 53% jump in Chinese arrivals.

Little inflation & a mild fall on a rising US$

Consumer prices have been stuck in deflation since November 2014 (-1.6%yoy in May) but the MAS is unlikely to make any major adjustments to its neutral monetary policy stance in 2H'16, particularly given the recent increase in government spending. This should keep the S$ largely stable against an undisclosed basket of currencies and easing against an expected rise for the US$.

	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 aims to lift growth & reform Thailand

… yet its goal of staying in power is high risk

Thailand's military government, which seized power in May 2014, is trying to revive growth and to implement reforms that prior elected governments avoided. With some key ministries now run by civil servants rather than party politicians, our clients report faster and more transparent public sector decisions. The main concern in the outlook is that the junta's plans to entrench itself in power for the long-term suggest a clash at some point with civilians. That may not occur until a year or so after a transition at the top of Thai society, which is bound to weaken the junta's legitimacy. Developments to monitor include a referendum on a newly drafted constitution (the country's 20th) on August 7 and promised elections in late 2017. Neither exercise is likely to win public support, leaving an uncertain long-term political outlook to undermine investor sentiment and growth.

A big fiscal stimulus & low macro risk

Some of the junta's efforts to revive growth are working. Its expansionary fiscal policy (an extra US$18bn in spending has been announced since last September) has been welcomed by the IMF in its latest review. The IMF also notes that macro risk is contained by a robust financial system, a large external surplus, and high foreign reserves. However, if the junta is to make changes that will lift long-term growth it will have to tackle issues around a fast-ageing population, an inadequate education system, and weak infrastructure.

An effort to boost private capex with a tax break

While its fiscal stimulus boosted public capex 24%yoy in Q1'16, private capex fell over 2%. In an effort to reverse that decline the government has doubled the tax deduction on capex for new projects that start this year. So far local business sentiment indices show no improvement, with the bank of Thailand's index flat in April (at 49.8) and the Federation of Thai Industries index continuing a trend decline that started in 2010. Net foreign direct investment (FDI) inflows are also stuck at a weak US$5bn for the year to March.

Outlook for the market

Public spending nudges growth up

… exports will help from 2H'16

GDP growth edged up to 3.2%yoy in Q1'16 from 2.8%yoy in 2H'15 thanks to strong government spending and a rise in net exports as the volume of imports fell 5%yoy while export volumes rose by 5%yoy (the strongest lift in three years). A modest revival in private spending in the next few quarters should help lift the 2016 growth rate to 3.3%. Provided the mild trade recovery continues in 2017, GDP growth should lift toward 4.5% with the help of infrastructure projects (see below) and improved agricultural output as the current drought ends.

Capex outside of public works is flat at best

The IMF expects the government's US$83bn in civil works (consisting mostly of transportation projects) to eventually draw in private investment. By contrast, the outlook for buildings is muted, as a rolling annual sum of building permits has been trending down since mid-2013. Investment in plant and equipment, which fell for three straight years to 2015, is likely to be flat at best this year with 2-3% growth next year.

Consumers lift but debt puts a cap on growth

Consumer demand growth was close to 2.5%yoy for the second quarter in a row in Q1, the best performance in three weak years. That's well below an average growth rate of 4.2% for the 2000 decade and its likely to ease in the next few quarters due to debt and slow wage growth. Officially household debt is 86% of GDP but its likely much higher due to widespread loan-shark lending. With consumer confidence at an 8-month low in May, household spending will stay around last year's pace of 2.1% in 2016 and 2017.

A strong Baht with limited scope for rate cuts

Inflation rose to 0.5%yoy in May, ending 15 months of deflation. There's still scope for one interest rate cut to the current central bank policy rate of 1.50% to help a recovery in 2H'16. With the trade and current account balances soaring, a 3-year slide in the Baht halted last October in a 35-36 to US$1 range. Provided political risk is contained, the Baht will likely stay close to that 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	0.5	1.5
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	35.6	36.3

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

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Vietnam

Political & policy issues to watch

Policy continuity under a collective leadership

A smooth leadership reshuffle in January has left a stable but more defuse power structure. Nguyen Phu Trong kept the top spot as the Communist Party's general secretary, while Nguyen Xuan Phuc was promoted to PM, but without the extensive powers of his predecessor, Nguyen Tan Dung. The new leadership is committed to policy continuity in key areas, including opening up to trade and investment and restructuring state-owned enterprises (SOEs). US ties have also improved following President Obama's late May visit, which included lifting an embargo on lethal weapon sales.

Urbanisation to drive housing and metro expansion

Rapid urbanisation will be a key driver of Vietnam's infrastructure sector. Urban dwellers will reach 45% of the total population by 2020 from 33% in 2014, with city dwellers being younger and better paid than those in rural areas. That should boost demand for housing and infrastructure in and around the main cities of Hanoi and HCM City. Both cities are building metro rail systems, although poor funding has slowed progress.

A surging air travel sector

Vietnam has become one of the ten fastest growing aviation markets in the world, with capacity set to double each decade over the next 20 years. Last year saw the number of air travellers climb 13% to 21m while the first five months of 2016 saw a 106%ytd surge. To cope with demand, Hanoi airport has a US$5.5bn expansion plan that will double capacity by 2020, HCM plans a new US$16bn airport that will compete for regional airline hub status with Bangkok and Singapore, and regional airports are being upgraded.

Outlook for the market

Strong growth in 2016 and 2017

… due to the rise of export manufacturing

Manufacturing activity is lifting after a Q1'16 slip in growth on the GDP measure to 8.1%yoy from 11.1%yoy in 2H'15. It's likely to be stronger in Q2 and Q3 as the local purchasing managers' index (PMI) rose to 52.7 in May from 52.3 in April and a 49.4 low in November 2015, boosted by the fastest rise in new orders of the last 12 months. The economy is also getting a lift from a swing to a US$800m trade surplus in the 12-months to May from a US$5.4bn deficit the 12 months to August 2015. Weak agricultural and crude oil output is likely to cap GDP growth at just over 5% in 2016 from to 6.7% rise in 2015. Stronger fixed investment activity should lift growth towards 6% in 2017.

And fast rising consumer demand

… helped by remittances

Consumer demand is set to grow 7-8% in 2016 and 2017 after an 9.3% rise in 2015. Spending is supported by more and better paying urban jobs, better household access to bank credit, and a steady inflow of remittances from Vietnamese working abroad. As the US – where many overseas Vietnamese live - has a strong jobs market, local banks expect a 15% lift in remittances to US$14bn this year. With the interest rate on local US$ bank accounts now at zero, much of the inflow is heading into housing and consumption. Booming car sales (up 36.7%ytd by May, 53.6% in 2015 and 40.4% in 2014) and airline passenger traffic point to rising middle class prosperity, which makes the domestic retail market increasingly attractive to foreign MNCs.

A prominent role for FDI continues

Foreign direct investment (FDI) in greenfield projects will continue to drive capex activity, which we expect to grow 9-10%pa in 2016-17 from 9.3% increases in both 2014 and 2015. FDI pledges soared to US$10bn in January-May, double their year-ago level, with the bulk of funds flowing into the manufacturing sector. After a long delay, foreign-owned factories are starting to develop supply links with local firms. For example, Korea's Samsung has established 11 tier-1 and 52 tier-2 supply links with Vietnamese vendors.

Little inflation and a slightly weaker Dong

Inflation lifted to 2.3%yoy in May from 0.3%yoy in Q4'15, mostly on the back of higher food prices. As the CPI is still well below the central bank's 6.5% policy interest rate, there's ample room for interest rate cuts if needed. But given the pace of demand growth and the risk of overheating, one rate cut at most is likely. While there's no macro threat to the Dong's value at present, we expect depreciation of 3%pa on the US$ in 2016 and 2017 from a 2.4% slide in 2015.

	2013	2014	2015	2016	2017
GDP, real growth, %	5.4	6.0	6.7	5.2	6.0
CPI, yoy, % (2005=100 from 2007)	6.6	4.1	0.6	2.1	2.8
Central bank refinancing rate, year end, %	7.00	6.50	6.50	6.25	6.00
Dong to US$1, year average	20,933	21,148	21,677	22,335	23,010

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

India

Political & policy issues to watch

PM Modi's big step backwards

… sacrificing good monetary policy

PM Modi's decision to give in to a small group of industrialists and to Hindu hardliners in rejecting a second term for central bank head Raghuram Rajan is disappointing. Rajan is one of the world's best central bankers, and he has done much to rid India of high inflation, a falling currency, and a bank sector choked with bad debt. His opponents faulted him for not cutting interest rates fast enough, forcing state owned banks (70% of lending) to clean up bad loans to favoured industrialists (and by implication this also means no more lending at the direction of politicians), and not cheering India's dubious GDP growth rates. Short-term this has little impact, as Rajan's term runs to September and crony capitalists won't be able to roll back his reforms quickly. Long-term it points to a BJP government that puts political and crony interests above securing a stronger growth path for India.

Allowing better access for FDI

In an effort to reassure markets, PM Modi announced a new package of market opening measures that built on last November's package. Full foreign ownership will now be allowed in areas like broadcasting (automatic) and aviation (still requiring approval over 49%). While the package does not make India *"… the most open economy in the world for FDI"* as the government claims, it should help win new foreign direct investment.

The GST saga

… keep an eye on it

PM Modi is working hard to find the numbers in India's upper house to pass a long-delayed GST bill. If it passes, its introduction will be complex and possibly a negative for business and consumer sentiment. The GST rate, which is yet to be set, is likely to be 18% or more and even though many state level taxes will be withdrawn, that will be a tax hike for services firms (now paying 14%) and smaller businesses (some of whom will pay tax for the first time). With different federal and state rates, complexity will be a drag on efficiency.

Outlook for the market

India's 7.9%yoy growth in Q1'16 is overstated

… but growth did lift

… and India is changing

India's new GDP series (2011-12 prices) reported surprisingly strong growth of 7.9%yoy in Q1'16 although traditional measures, like the industrial production index (IPI, up just 0.2%yoy), were weak. Many suspect the new GDP series overstates growth by one to two percentage points. That the statistical discrepancy was a record +5.3% of GDP in Q1'16 suggests problems. However, two other points should be considered. First, some other measures do point to a lift in growth. Motorcycle sales for Q1'16 rose 8%yoy (following five quarters of 0-3%yoy growth), electricity use rose 8.8%yoy (after 4 weaker quarters), and credit growth edged above 10%yoy for the first time in seven quarters. All of these gains are surprising, as India has just weathered two weak monsoons, and in all prior years that would have slashed demand across the economy. Our own Asia CEO Forum survey for Q2'16 also found clients reporting strong sales growth. Second, India is changing, and measures like the IPI and the older GDP time series likely miss new areas of growth, particularly in services. Given the strong Q1'16 result, our full year 2016 forecast lifts to 7% from last month's 6.4% while 2017 rises to 7.7% from 6.6%.

India is due for a cyclical upturn

While structural change is lifting trend growth, India is also due for a cyclical lift based on traditional cyclical drivers, such as a better monsoon (which started mid-June), falling inflation and interest rates (inflation is down from 10.4%yoy in Q4'13 to 5.8% at May while the RBI has cut its policy rate by 150 basis points to 6.50%), and stock rebuilding.

Capex should recover while consumers lead

Cyclical factors should help lift fixed investment, which fell almost 2%yoy in Q1'16 underscoring the fragility of the upturn. Capex growth should lift to 3-5%yoy in 2H'16 and 5-7% in 2017. Consumer demand should lift to 7.8% this year from 7% last year.

Mild inflation & an end to rate cuts

We expect inflation to stay near the top of the RBI's target band of 2-6%. Rising growth will bring an end to the current cycle of rate cuts. Better growth, mild inflation, and capital inflows should limit the rupee to a 3-5% annual fall on the US$ into 2017.

Calendar year starting January	2013	2014	2015	2016	2017
GDP (MP, 2011-12), real growth, %	6.3	7.0	7.2	7.0	7.7
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	67.5	70.5

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 July 2nd election

… watch the senate result

Another change in government is possible at the July 2 election, which would be the 5th change in just over six years. The opposition Labor Party (ALP) needs a 4% swing that would give it the 19 extra seats needed to form a majority. It's unlikely, however, that either of the two major parties will win a majority in the 76-seat senate. Changes to the senate voting system made in March are likely to favour long-time independent Nick Xenophon, who has formed a party, and could carry two to three senators onto the cross benches, which in the current senate number eight. That may make it easier for the next government to negotiate senate support for bills, which have stalled under the current parliament.

Policy impact

… the housing market

… and foreign trade deals

Taxes on corporate profits and real estate separate the two major parties. Turnbull proposes to lower the corporate tax rate from 30% to 25% by 2026-27; Labor only supports a tax cut for small businesses to 27.5%. On real estate – a critical factor in domestic demand growth – Turnbull won't change negative gearing and the capital gains tax discount; Labor wants to limit negative gearing to new homes and reduce the capital gains tax discount from 50% to 25%. On the environment, Turnbull aims to cut emissions by 26% by 2030; Labor would cut emissions by 45%, which includes a 50% renewable energy target. Xenophon might use his swing votes in the senate to push for a repudiation of free trade agreements.

Outlook for the market

Growth sits at 2.5%

… as export volumes lift

… & housing cools

A mix of sound fiscal and monetary policy and big swings in the exchange rate have allowed Australia to ride out a resources bust while racking up 25 years without a recession. On the resources front, commodity prices have fallen about 60% from their 2011 peak, but export volumes have risen 27%, as new super-mines have come on stream, turning a trade deficit of 2.8% of GDP in the national accounts for 2011 to a 1.4% surplus in 2015, which lifts GDP growth. From 2014, the economy also gained from a surge in the east coast housing market and a modest lift in consumer growth. Provided Australia pulls off a soft downturn in its housing market (see below), growth should be sustained near last year's 2.5% through to 2017. Given the strong Q1'16 GDP result (3.1%yoy), we've lifted our forecasts for consumer demand and export volumes while softening the downturn in residential construction.

Steady growth for consumers

… despite a high debt load

While real wage growth is likely to stay at about zero for the next 18 months, employment growth is strong at 1.5-2%pa and unemployment has dropped to 5.7%. That should keep real growth in consumer spending close to last year's 2.8% this year and in 2017. Lost high paid jobs in mining will be partly offset from July 1 by a 2.4% lift in the basic wage covering some 1.8 million low-wage earners. High levels of household debt (125% of GDP) are a risk, but low interest rates have seen interest payments drop to 8.7% of disposable incomes and we don't expect higher interest rates to become a problem anytime soon.

Overall capex continues to fall

National home prices are up 30% since the start of 2012, but there are signs that the market is softening, with growth in prices and dwelling approvals falling in recent quarters. Along with a continued fall in mining and LNG capex, overall fixed investment will likely fall another 2-3%pa in 2016 and 2017, following a 3%pa decline in the previous two years.

Services driving growth

Services activity will stay robust, but as housing cools, services growth is likely to slow somewhat to 2.5-3.0% in the next two years from 3.4% in 2015. Health care, retail trade, and finance and insurance are doing well, while the lower A$ saw tourist arrivals grow by 9%yoy in Q1'16, after a 7.7% rise in 2015. The transition from mining investment to production is in full swing, and growth in mining production surged to 10.6% in Q1'16, up from 4.7% in 2015.

A mildly weaker A$

With inflation slipping to 1.3%yoy in Q1'16, the RBA cut its policy interest rate to a record low of 1.75% in May. That saw the A$ slip to around US$0.72, but downward pressure has abated, with a relatively attractive 2.3% yield on Australian 10-year Government bonds (AAA rated but with a downgrade possible) providing some support.

Year ending December 31	**2013**	**2014**	**2015**	**2016**	**2017**
GDP, real growth, %	2.0	2.7	2.5	2.5	2.6
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

New Zealand

Political & policy issues to watch

Stable leadership under PM Key

After a decade at the helm of the National Party and almost eight years in office, including three election wins, some gloss has come off PM John Key's reign, with his approval rating dipping to 36.7%, the lowest score since he took office in 2008. Yet, Key remains the preferred PM, and his National Party also leads in the party standings, with 47% support (the same as when Key won office) to 42.4% for the Labour/Greens alliance. Should PM Key decide to run in next year's election, he could win his fourth consecutive term, extending a remarkable run of political stability over a period that includes the GFC, Canterbury earthquakes, and a dairy price bust.

Little need for fiscal stimulus

With a strong economy and next year's election on the horizon, Finance Minister English unveiled a conservative eighth budget in May with a 4.6% lift in revenue while spending growth was limited to 2.8%. That should allow a second straight budget surplus after six years of deficits, while net public debt falls to 21% by FY2020 from 25% in FY2015. The budget forecasts 3.5% growth on the GDP expenditure measure in FY2016 (on the more widely watched production measure in NZ, growth is forecast at 2.6%).

Outlook for the market

A resilient economy

Three engines helped NZ achieve 2.5% compound annual growth over the 2010-15 period: its global leadership in dairy exports, a strong construction market, and strong migrant inflows. The dairy engine switched off in 2014, as global prices plunged with the EU ending its cap on dairy production from April 2015. Little improvement is expected in the next two years, and that drags down manufacturing (in which dairy processing is a large component) as well as investment and consumption by a large block of dairy farmers. Fortunately, construction and inward migration remain strong and should continue to support growth through 2017, keeping growth in a 2.5-3.0% band. In its June quarter policy statement, the Reserve Bank of NZ (RBNZ) expects GDP growth (on the expenditure measure) to lift to 3.6% in FY 2016 (to next March) with 3.2% in FY2017 from 3.3% in FY2015.

Steady consumer growth

Despite 2.0% jobs growth over the past year, consumer confidence dipped in Q1'16, as households became more nervous about economic prospects. That saw retail sales growth fall to a 2-year low of 3.3%yoy in Q1'16, down from 4.6% in 2015. However, the counterbalance is elevated home prices and strong stock price growth (up 14.1% since January), which are boosting household wealth. That should keep household consumption growth at 2-3% in 2016 and 2017, about its average pace since 2010.

A strong housing market continues

Record low mortgage rates and an ongoing housing shortage, especially in Auckland, saw house prices rise 10%yoy to a record high in May. A 23%yoy increase in building permits in the year to April suggests housing construction will remain strong in 2016 and 2017, with real growth in housing capex expected to stay around last year's 5% pace.

Dairy exports face weak prices

The export outlook remains weak. The global dairy market remains oversupplied with a surge in output from Europe met with falling demand from China. As a result, the whole milk powder price - the most important determinant of farmer incomes - remains well below recent highs, despite improving since February. Lower dairy prices have dragged the NZ$ lower and this will remain a boon for tourism, with visitor arrivals up 10.8%yoy this year, following a 9.3% increase in 2015.

Room for another rate cut to stop a NZ$ rise

Inflation remains weak and at just 0.4%yoy in Q1'16, the RBNZ has room to cut interest rates further from a record low of 2.25% in 2H'16, notwithstanding strong growth in house prices. A cut could dampen the NZ$, which traded as low as 63.7 U.S. cents in January, but appreciated to 71.2 U.S. cents early June. An uncertain global environment will likely cap further rises in 2016, even as 10-year government bond yields an attractive 2.6%.

Calendar years	2013	2014	2015	2016	2017
GDP(Expenditure), real growth, %	1.7	3.0	3.0	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	1.07	0.98

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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