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

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Global outlook

Once again, hopes for mildly better growth next year

… with more fiscal stimulus & a bit of inflation

2016 is closing with hints of better growth next year, repeating a pattern that has inevitably faded into persistent weak global growth for each of the last five years. The "new normal" of weak global growth has been accompanied by surprisingly weak trade growth and strong deflationary forces that reflect an oversupply of commodities, many manufactured goods, and some services (like shipping). Yet 2017 is likely to differ in several important ways. First, governments in the West are beginning to understand that monetary stimulus is exhausted and fiscal stimulus has to lift. Such stimulus should gain extra impetus if it occurs alongside a weak cyclical upturn, which seems to be underway in the U.S. and EU (see below). Second, mild inflation is set to return as the fall in oil and other commodity prices is replaced with stable or marginally firmer prices. At the same time, there is so much excess capacity that there's little risk of an inflation spike. Finally, the U.S. Fed should succeed in a slow lift in its policy rate without undermining an extended but mild U.S. recovery. That could make 2017 the best of six weak years in a row.

Room for more mild growth in the U.S.

… provided political & stock market risks are skirted

Purchasing managers' indices (PMIs) for U.S. manufacturing and services were up strongly in October, pointing to rising momentum into 2017. U.S. GDP growth also edged up to 1.5%yoy in Q3'16 from 1.3% on Q2'16. Private consumption growth of 2.6%yoy continues to lead GDP growth, while private capex growth remains the economy's weak spot (-0.7%yoy in Q3'16 after a modest 1.5% increase in 1H'16). Despite uninspiring top-line growth, consumer and producer price inflation is edging up (the CPI rose 1.5%yoy in September, the fastest pace since November 2014), and employment growth remains solid (up 1.8%ytd by September). 10-year Treasury bond yields are also turning up in anticipation of a gradual tightening of monetary policy by the Fed, which could unsettle the richly priced U.S. stock market. The outcome of the U.S. presidential election remains a key area of concern for both main street and financial markets.

A strong UK economy

… and a weak lift in EU growth

Expectations of an imminent UK recession following the Brexit win in the June referendum failed to materialise, forcing economists to lift their growth forecasts for this year and next. The economy expanded by a solid 2.3%yoy in Q3'16, much faster than market expectations. The steep fall of the Pound should provide much-need support, as the economy transitions into a post-Brexit environment. In the EU, GDP growth of 1.7%yoy in 1H'16 and 1.9% in full 2015 has not been enough to push the unemployment rate below 10%. However, the ECB's massive monetary expansion may have succeeded in averting deflation, as the region's inflation rate edged up to 0.3%yoy in Q3'16 from -0.1%yoy in Q2'16 and 0.0%yoy in Q1'16. Growth prospects have improved, as the EU composite PMI (manufacturing and services) hit a ten-month high in October 2016.

The EM plunge has bottomed

The collapse in some leading emerging markets (EM) outside of Asia should halt in 2017. Growth in Brazil is likely to recover to 1.2% next year after an expected fall of 3.2% this year and a 3.8% fall in 2014. Meanwhile, Russia may see a return to sub 1% growth next year after three annual contractions, although its government has just slashed spending in next year's budget, as it struggles with weak oil prices.

A mild rise for the US$

Our global currency outlook expects continued mild U.S. growth and a slow lift in U.S. interest rates to keep the US$ on a 2% annual uptrend against its trade weighted index and about the same on the Euro. The main changes to our currency outlook are bigger devaluations for Japan's Yen and China's Yuan (see the country pages).

IMA Asia's forecasts	2013	2014	2015	2016	2017
World – Real GDP growth, %	3.3	3.4	3.1	3.0	3.2
- US	1.5	2.4	2.4	1.9	2.1
- Euro area	-0.3	0.9	1.6	1.2	1.3
- Asia/Pacific (14)	4.5	4.3	4.3	4.5	4.3
- NICs (4)	2.7	3.4	2.1	2.1	2.1
- Developing or "EM" Asia (7)	7.0	6.8	6.6	6.5	6.1
- ASEAN (6)	5.0	4.4	4.4	4.5	4.9
World goods & services trade volume, % growth	3.4	3.5	2.8	3.1	3.8
Interest rates, US Fed target rate, year end, %	0.10	0.10	0.25	0.25	0.50
Inflation, CPI, US, year avg., %	1.5	1.6	0.1	1.0	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	50
US$ / Euro 1, year average rate	1.33	1.33	1.11	1.10	1.08
Yen / US$1, year average rate	98	106	121	108	113

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	0.5	0.6
China	7.7	7.3	6.9	6.6	5.9
Hong Kong	3.1	2.7	2.4	1.3	2.2
Taiwan	2.2	3.9	0.6	1.3	2.1
South Korea	2.9	3.3	2.6	2.6	2.2
Indonesia	5.6	5.0	4.8	5.0	5.7
Malaysia	4.7	6.0	5.0	4.1	4.0
Philippines	7.1	6.2	5.9	6.6	6.8
Singapore	4.7	3.3	2.0	1.6	2.3
Thailand	2.7	0.8	2.8	3.6	3.9
Vietnam	5.4	6.0	6.7	6.0	6.2
India (CY)	6.3	7.0	7.2	7.1	7.8
Australia	2.0	2.7	2.5	2.6	2.6
New Zealand	1.7	3.0	3.0	3.3	3.0

Inflation, CPI year average, %	2013	2014	2015	2016	2017
Japan	0.3	2.8	0.8	-0.3	1.0
China	2.6	2.0	1.4	2.0	1.8
Hong Kong (composite CPI)	4.4	4.4	3.0	2.7	2.4
Taiwan	0.8	1.2	-0.3	1.0	1.3
South Korea	1.3	1.3	0.7	1.0	1.4
Indonesia	6.4	6.4	6.4	3.4	3.3
Malaysia	2.1	3.2	2.1	2.0	2.1
Philippines	3.0	4.1	1.4	1.8	3.7
Singapore	2.4	1.0	-0.5	-0.6	0.6
Thailand	2.2	1.9	-0.9	0.3	1.6
Vietnam	6.6	4.1	0.6	2.3	3.3
India (CY CPI urban non-manual workers)	10.1	6.7	4.9	5.6	5.8
Australia	2.4	2.5	1.5	1.3	1.7
New Zealand	1.1	1.2	0.3	0.3	0.7

Exchange rate to US$1, year avg.	2013	2014	2015	2016	2017
Japan	98	106	121	108	113
China	6.20	6.14	6.23	6.62	6.99
Hong Kong	7.76	7.75	7.75	7.76	7.75
Taiwan	29.7	30.3	31.8	32.1	30.5
South Korea	1,095	1,052	1,133	1,158	1,183
Indonesia	10,460	11,868	13,389	13,283	13,450
Malaysia	3.15	3.27	3.90	4.11	4.24
Philippines	42.4	44.4	45.5	47.3	48.0
Singapore	1.25	1.27	1.37	1.37	1.42
Thailand	30.7	32.5	34.2	35.1	34.5
Vietnam	20,933	21,148	21,677	21,892	22,138
India (FY)	58.5	61.0	64.1	66.8	68.1
Australia	1.03	1.11	1.33	1.34	1.31
New Zealand	1.22	1.20	1.43	1.43	1.46

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

Regional outlook

Political & policy issues to watch

Rising nationalism and autocracy in Asia

… requires better political risk management

A central theme in our Q3 forecast meetings was the need to elevate political risk management in Asia, as the threat to profits and investments appears to be rising, at least for Western firms. Moreover, the type of risk is changing, while some Western firms have become less skilful at political risk work as they focus instead on compliance risk. One of the biggest shifts centres on China's rise under an unusually powerful leader who is using nationalism to break free of the consensus leadership that delivered 35 years of political stability. China is also using its South China Sea claims to force a geopolitical realignment in Asia away from the Pax Americana that shaped trade and investment flows over the last six decades. That's usually a slow process (China has pursued such claims for 40 years) yet the abrupt change in the Philippine's foreign policy under President Duterte shows how fast things can move. Malaysia's scandal-ridden government has also been quick to seek favour with Beijing. Thailand and Vietnam may well follow the realignment, leaving an ASEAN that echoes China's authoritarianism and rising nationalism. Much of this is in line with the presentation by Professor Michael Enright, a member of our Client Advisory Board, at forum sessions in early 2015. Western firms will need to adjust to the shift in tone in both China and ASEAN if they want to ensure long-term success.

Stumbling leaders in Korea, Taiwan, & HK

Korea, Taiwan, and Hong Kong suffer from stumbling governments and rising structural challenges that are hard to solve. This is undermining both short and long-term growth prospects. Poor leadership is part of the problem, but that simply compounds the challenge from declining growth, as populations age and manufacturing offshores.

Power realigns in Thailand

The death of Thailand's King Bhumibol on October 13 after 70 years on the throne marks the start of a one-year period of mourning, along with a major realignment in political authority. Companies will need to get used to working with an authoritarian, army-run government that looks set to deliver on a strong pro-growth agenda.

Outlook for the market

China gets its 6.7% growth in 2016

As 2016 closes several dominant economic trends have clarified. The most important has been China's ability to secure 6.7% growth this year with the help of fiscal, monetary, and regulatory stimulus in the face of a slow rolling debt crisis. However, there's little that Beijing can do to prevent a steady easing in growth over the rest of this decade, even though it should avoid a full-blown debt crisis.

A cyclical upturn in India

… & approaching in Indonesia & Thailand

Second in importance has been India's entry into a cyclical upturn and Indonesia's likely upturn from Q4'16. Good policy from political leaders who have strengthened their political positions this year is partly responsible. But so too is good monetary policy and a global tail wind from cheap oil and cheap money. Thailand's military government has thrown an enormous fiscal stimulus at the country's sluggish economy and should see a modestly positive response from private investors over the next year. The recovery in consumer spending will be muted but not halted by mourning for King Bhumibol.

Scope for Vietnam & the Philippines to sustain 6%+ growth

Vietnam and the Philippines have been growing at close to capacity for the last year but have managed to avoid a blow-out in inflation and their trade accounts, which would have triggered sharp downturns. The drivers of growth for both countries (strong exports of goods or services and rising capex levels) remain quite sound, suggesting both have embarked on unusually long expansions.

Big exchange rate moves

… as China's Yuan slides

… + Japan's Yen may also tumble

We've attempted to clarify two big exchange rate moves in this month's Asia Brief and while markets are uncertain about future directions we've suggested likely scenarios. The biggest and most surprising so far is China's large devaluation, with a 6.5%yoy slide on a rising US$ by late October and an even bigger 8.4% drop on the Yuan's new currency basket since last November. Given the resumption of US$ appreciation and rising export pressure, we've cut our Yuan/US$ forecast to 6.85 and 7.10 by the end of 2016 and 2017 respectively. As many other Asian currencies have had much milder falls on the US$, a major realignment in exchange rate competitiveness is taking place. The second big exchange rate move is for the Yen, as we expect the Bank of Japan's super QE program to gain better traction in 2017, while the U.S. Fed lifts its interest rate. That means a weaker Yen, which we think could fall to 118 to US$1 by the end of 2017. That also means a lift in inflation and in nominal GDP growth in Japan – both goals sought by the government.

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Japan

Political & policy issues to watch

What will PM Abe do with all his power?

With the LDP-led government dominating in July's upper house elections, Japan has an unusually strong government and, in PM Abe, one of the most dominant leaders in the last 50 years. The question is what Abe does with that power. Three areas bear watching: Abe's desire for a stronger military posture; hints that he'll amend his party's constitution to extent his term as LDP head (and thereby as PM) beyond the two 3-year terms that expire in September 2018; and plans to step-up labour market reform by next March. None will be popular, with opinion poll support for the government ebbing but still above 50%.

… a slightly more assertive military position

Japan's military posture was amended in March by legislation that allows members of the Self Defence Force assigned to UN operations to rescue UN staff under attack. The first deployment of troops under that expanded mandate may come this November in the Sudan. Abe has also long wanted to amend the war renouncing articles in Japan's constitution. Although he should now have the Diet numbers to do that, he'll likely first spend his political capital on some difficult economic reforms.

… and mild labour market reform

Foremost among the economic reforms is labour market deregulation, with PM Abe committing to the delivery of a major package next March. Yet it's likely he'll once again fudge the core challenge of ending a dual labour market under which irregular workers are paid 40% less than regular workers, and regular workers have jobs for life with steadily rising pay based on seniority. The dual labour market undermines domestic demand (temporary workers have little capacity for discretionary spending) and stifles innovation (regular workers are paid more for being older not smarter). Abe knows that Japan's salarymen are wedded to this system, and would rebel against any significant change. That leaves monetary policy in the driving seat for big change in Japan (see below).

Outlook for the market

Real growth edges above 0.5%

… helped by another Yen fall in 2017

If the exchange rate stays near its current 105 to US$ rate and PM Abe dodges structural reform, then the long-term trend in Japan's real GDP growth rate is unlikely to lift much above the 0.5%yoy achieved in 1H'16. As Japan returned to mild deflation in 1H'16, nominal GDP growth was just 1.3%yoy in 1H'16. However, in the last few months we've gradually amended our outlook to include a significant Yen devaluation (to 118 by end 2017 – see the last paragraph) and that means higher inflation (1.5%yoy by Q4'17). That will lift the nominal GDP growth rate to 2-3% next year and to 3-4% for 2018-20. As that should encourage a bit more investment and consumption spending, we've lifted our 2017 real GDP growth forecast to 0.6% from 0.3% last month.

Limited gains in a weak consumer market

However, we shouldn't expect a strong lift in consumer spending, as the headwinds in this sector are considerable. A lot will depend on what happens to wages. Employment growth is currently near a 19-year high while the unemployment rate is near a 21-year low, which should boost wage growth. Yet the opposite has happened. Real wages have fallen by 0.9%pa in the last five years, while nominal wages have fallen by 0.4% a year. At best, nominal wage growth may turn slightly positive in 2017. That means that after falls of about 1% in 2014 and 2015, real growth in consumer demand is likely to be flat this year, followed by 0.5% growth in 2017.

Little growth in corporate capex

Excess capacity and weak demand prospects are holding back corporate investment. That saw investment in machinery and equipment (37% of capex) slump 2.3%yoy in 1H'16, from growth of 1.4% in full 2015. We expect capex growth of just 0.2% in 2016 before it slips back towards zero in 2017, after a 0.5%pa fall in the decade to 2015.

As QE steps up watch out for inflation and a weaker Yen

Japan's swing to quantitative easing (QE) under PM Abe saw a dramatic Yen devaluation from 2012 to 2015 followed by unexpected Yen strength in 2016. The BOJ will push harder on QE in the next year, gambling that a lift in the US Fed's policy rate will create the conditions for another sharp Yen devaluation, which will boost inflation and nominal GDP growth and thereby provide the only feasible solution to Japan's mountain of public debt.

	2013	2014	2015	2016	2017
GDP, real growth (2005p), %	1.4	0.0	0.6	0.5	0.6
CPI, year average, %	0.3	2.8	0.8	-0.3	1.0
Overnight call rate, year end, %	0.07	0.07	0.04	-0.02	-0.02
Yen to US$1, year average	98	106	121	108	113

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

China

Political & policy issues to watch

Xi's new "core leader" crown

… raises political & policy risk

In October's 6th party plenum, the Communist Party raised Xi Jinping's political status to "core leader" (Mao Zedong, Deng Xiaoping and Jiang Zemin also held this title). That confirms Xi's undisputed final approval or veto power within the party. Interestingly, collective leadership was also highlighted in a newly approved party code of conduct, possibly to counterbalance Xi's growing dominance. Xi is now in a strong position to push his supporters into key posts at the party congress in late 2017, when he'll undoubtedly get a second five-year term. Whether China is turning away from the consensus leadership that served it well for the last 35 years will depend on Xi's actions over the next year rather than China's political institutions. A dominant leader may be able to push for faster structural reforms, but political stability and policy continuity could suffer.

Time to tame the bubbles

Having secured at least 6.7% growth this year through a big 1H'16 stimulus, Beijing has turned its focus to reining in a property bubble and tackling ballooning corporate debt. The central bank (PBoC) has switched from monetary easing to tighter control over shadow financing along with telling banks to curb excessive mortgage and corporate lending. This will likely continue for several quarters, but will be eased in 2017 to sustain growth.

Outlook for the market

Locking in 6.7% growth in 2016

… & preparing for slower growth ahead

China's "managed" 6.7%ytd growth in Q3'16 would have helped Xi at the 6th plenum, and was thanks to strong growth in infrastructure and property investment, as well as auto sales. These tailwinds offset lacklustre private investment and a shrinking trade surplus. But given recent property tightening measures and a likely end to a tax incentive for car sales in 2017, the stimulus-driven recovery will run out of steam next year. That will see lending growth for housing and corporates continue to slow while GDP growth will ease to 5.9% in 2017 and 4.8% by 2020. The question is whether Beijing will continue to accept this steady deceleration. In recent years, China's leadership has pragmatically accepted the necessity of slower growth, with Xi realigning popular expectations by talking of slower growth as China's "new normal".

Firm household spending

… with more debt offsetting weaker incomes

Despite a 57%yoy surge in lending to households in the first nine months of 2016, household debt levels (equal to 40% of GDP) is much lower than most major economies. Moreover, the aggregate household balance sheet remains strong, with mortgage debt of 23% of GDP set against financial assets equal to 158% of GDP. That will help consumers cope with a slowdown in income growth from 10.3%pa in 2010-15 to 6.6% in 2015-20. Thus, the slowdown in consumer spending should be milder, easing from 8.2% in 2010-15 to 6.4% for 2015-20, as households lift debt and lower savings to sustain spending.

Private capex and exports both slump

Private investment (60% of China's fixed asset investment or FAI) grew just 2.5%ytd by September, down from 10% in full 2015. Measures to cool property investment will keep growth weak, offsetting Beijing's infrastructure investment (up 19.4%ytd by September). The 10%yoy fall in exports in September was surprising, and likely reflects a mix of factors (a structural decline in apparel and footwear exports, rising trade disputes, and factory shutdowns in Zhejiang during G20 meeting). A weaker currency may briefly help a realignment of the export base into higher value added production.

Deflation eases & and Yuan slides

September inflation lifted to 1.9%yoy as typhoons forced up fresh food prices. But the bigger story was a 0.1%yoy rise in the producer price index after 54 months of decline, led by gains for firms in mining and raw materials (reflecting a mix of excess capacity closures, stimulus spending, currency depreciation, and speculative activity). China's exchange rate has also been a surprisingly big story this year, with a 6.5%yoy slide on a rising US$ by late October and an even bigger 8.4% drop on the Yuan's new currency basket since last November. Given the resumption of US$ appreciation and rising export pressure, we've cut our Yuan/US$ forecast to 6.85 and 7.10 by the end of 2016 and 2017 respectively.

	2013	2014	2015	2016	2017
GDP, real growth, %	7.7	7.3	6.9	6.6	5.9
CPI, year average, %	2.6	2.0	1.4	2.0	1.8
PBOC 1-year loan, at Dec., %	6.00	5.60	4.35	4.10	3.60
Yuan to US$1, year average	6.20	6.14	6.23	6.62	6.99

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

Hong Kong

Political & policy issues to watch

Political risk bears watching

… as localists chafe against Beijing's rule

HK's political environment is deteriorating, as the government and Beijing struggle to cope with the rise of newly-elected "localist" legislators. Collectively, a disparate group of 'pan-democrats' won 29 of 70 seats, which leaves them able to block legislation and constitutional reforms. The first test for the CY Leung administration will be whether he wins legal backing to eject at least two victorious localists who purposely disparaged China by spoiling their oath of office. Issues that bear watching include whether Beijing proposes the unpopular CY Leung for a second five-year term in next March's chief executive election; whether Legco finds a way to negotiate passing laws without constant struggle and delays and how the government deals with its Legco opponents.

Core business advantages remain intact

HK's political gridlock has hurt the operating environment by delaying key bills — particularly for public spending on infrastructure — undermining business confidence and threatening an outflow of local talent. At present, the actual impact remains modest and are mostly offset by a low tax rate, strong rule of law, excellent services, and minimal regulation (although high real estate prices are another negative). In the World Bank's latest Ease of Doing Business ranking, HK moved up fourth place worldwide, while expanding its role as a hub for mainland firms heading overseas.

Outlook for the market

HK struggles with the global slow-down

HK is also struggling with headwinds from a slower Chinese economy, persistently weak global trade, currency appreciation and fading competitiveness as a regional hub. Such challenges will offset the gains from a strong property sector and steady local consumption, limiting GDP growth to 2.2% in 2017 and an average of 1.8% for 2017-21, well below the annual average of 3.4% in 2005-15.

Retail sales face a structural decline

… as China's tourists pull back

Retail sales by value fell 10.5%yoy in August, led by a 26%-28% slide in electrical and luxury goods. That followed a 3.4% fall in 2015 that confirmed a persistent downtrend in retailing. The slide reflects a 9.4%ytd fall in mainland tourist arrivals (to 28m) through August, which more than offset a 3.4%ytd gain (to 9m) in arrivals from elsewhere. A stronger HK$ and a maturing Chinese travel market (more interested in experiences than shopping) were factors. Food & beverages spending, which averaged 6% growth in 2014 and 2015, slipped to 2.2%yoy growth for the first eight months, with some support from local consumers. But with pay growth set to slow, real growth in consumer spending will fall to just 0.8% this year and an average of 2.3% for 2017-21 from 4.8%pa in 2005-15.

A risky property boom

… fed by mainland buyers

While a strong HK$ has hurt tourism, it has contributed to a residential property rebound as mainland investors are attracted by capital gains in a US$-linked currency. Local buyers also are being swept along by cheap mortgages and aggressive financing schemes. Property prices have risen 7.8% above their March low with 7,826 homes sold in September, up 84%yoy. The rally could end if Beijing finds a way to plug the capital outflow or lending rates move up after a U.S. Fed rate hike. The government aims for 18,000 new apartments a year over 2016-18, 60% higher than in the last decade.

A weak services sector

The services sector (90% of GDP) is struggling, with weak flows of trade, tourism and capital. Real growth is likely to fall to 1.8% this year and an average 2.6% for 2017-21, from 3.5%pa in 2005-15.

Low inflation and cheap money

Netting off the government's one-off public housing rent relief measure, inflation was 2.3% in September. Inflation should stay at about 2-2.5% in 2017-21, from an average 3.2% in 2005-15. The average cost of funds of banks was unchanged at 0.25% at end-September, enabling banks to offer cheap mortgages to fuel the real estate market.

	2013	2014	2015	2016	2017
GDP, real growth, %	3.1	2.7	2.4	1.3	2.2
Composite CPI (04/05), year average, %	4.4	4.4	3.0	2.7	2.4
Discount window base rate, % year end	0.50	0.50	0.75	0.75	1.00
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 runs into reality

… it's hard to grow away from China

Just months after President Tsai Ing-wen swept into office in May amid high expectations and with an approval rating of 71%, a series of controversies and dip in public confidence over her government's ability to resolve deep-seated problems have seen her approval rating slump to 38%. At the heart of those concerns is Tsai's reluctance to accept the 1992 "One China" consensus, which not only threatens cross-strait tourism (which has contracted since Tsai took office, including a 32%yoy fall in August), but also existing trade and investment linkages with the mainland, especially for the 100,000 or so Taiwanese firms with operations there. Another major issue is Tsai's plans to overhaul a pension system facing bankruptcy from 2020 by cutting generous public pensions, which are three to four times above those in the private sector.

Taiwan struggles with an export decline

… and plans to end nuclear power

President Tsai also presides over an economy struck by both cyclical and structural headwinds. Tsai's plans to boost innovation will take time to work. Meanwhile, her economic pivot away from China threatens an economy struggling with slowing workforce growth, the offshoring of manufacturing, and sluggish productivity growth. While a mild export lift has emerged as 2016 closes, hopes for a long-term export lift from the US-led Trans Pacific Partnership (TPP) trade deal look like being frustrated by failure of the U.S. Congress to approve the deal in its lame-duck session after the November election. The Tsai government's commitment to shut down all nuclear power plants by 2025 in favour of renewable energy also raises questions about Taiwan's power supply.

Outlook for the market

A weak 2017 recovery

Although Taiwan's three-quarter long recession ended in Q2'16, the rebound that typically occurs following a recession will be milder this time, as Taiwan no longer benefits from a favourable global trade environment, which reliably drove its export manufacturing sector for decades. That's likely to keep GDP growth at about 2% next year from an expected 1.3% in 2016 (revised up from a previous forecast of 0.7% on stronger than expected exports in Q3'16), well down on the 3.5%pa pace in the decade to 2015.

… as export growth edges up

Exports emerged from a year-and-half contraction in August and grew 3%yoy in September, albeit still well below the 8.2% annual pace in the decade to 2008. The modest improvement was mainly due to better exports to China and, to a lesser extent, to the U.S. and ASEAN. With growth in export orders near a 16-month high, the modest export upturn should be sustained at least in the near-term. That should help lift real growth for manufacturing to 1.5% next year from about 0.8% this year and a 0.5% fall in 2015.

But consumers remain cautious

… with little growth in capex

With jobs growth falling to 0.5%yoy in the last two months — lows not seen since 2009 — consumer confidence is near a 30-month low, while consumer expectations for durable goods purchases in the next six months are at a 44-month low. Given such weak confidence, real growth in consumer spending should ease to about 2%pa in 2016-17, from 2.8%pa in 2014-15. Meanwhile, the investment outlook is also dim, with real growth expected to slow from 1.2% in 2015 to 0-0.5% this year before improving to just 1-1.5% in 2017. That reflects ongoing weakness in public investment, which has declined 2.5%pa in the last two decades, and sluggish private sector investment growth, which has slowed to just 1.2%pa in the last decade from 5.7%pa in 1996-05.

A surging current account lifts the NT$

Inflation has hovered around 1% this year, with the weak inflationary environment allowing the policy interest rate to be cut four times to 1.375% since last September. In year-average terms, the NT$ is down just 2% from last year, thanks to a surging current account surplus. Provided that continues, the NT$ should trade in a 30-31 range through 2017.

	2013	2014	2015	2016	2017
GDP, real growth, %	2.2	3.9	0.6	1.3	2.1
CPI, year average, %	0.8	1.2	-0.3	1.0	1.3
Official discount rate, year-end, %	1.88	1.88	1.63	1.25	1.13
NT$ to US$1, year average	29.7	30.3	31.8	32.1	30.5

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

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South Korea

Political & policy issues to watch

Lame duck government until 2018

President Park's approval rating has collapsed to 17% after revelations that she allowed a friend to become involved in policy decisions without holding an official position and to use her ties to Park to raise funds from companies. The scandal may force Park to step down before her single five-year term expires in December 2017. Park's presidency was already on the ropes after her ruling Saenuri party suffered an unexpected loss in April's legislative election, with its share of seats at the national assembly falling to 43% from 52%. Without a working majority in parliament, the government has found it hard to respond to multiple challenges, including North Korean belligerence, weak exports, an overheated property market, and a rigid labour market that deters manufacturing.

… and that makes it hard to deliver a fiscal stimulus

There is a growing divergence between the government and the central bank about how to boost Korea's sluggish economy. The finance ministry would like to see further monetary easing by the Bank of Korea (BOK), while the central bank argues for a more aggressive fiscal expansion. Having brought its policy interest rate down to a record low 1.25% in mid-2016, the BOK is concerned about record-high house prices and over-geared households. It argues that there is plenty of scope for fiscal stimulus, as Korea's public debt was just 41.8% of GDP in 2015, well below the OECD average of 115.2%. Growth in public spending has averaged a modest 4.6%pa since 2012, with the budget consistently in surplus on the IMF's calculations.

Outlook for the market

Growth cools as 2016 ends

… on weak exports and de-stocking

Recent headwinds — including the bankruptcy of Hanjin shipping, related problems in the shipbuilding sector, Samsung's Galaxy 7 global recall, and a major strike at Hyundai Motors (Korea's largest automaker) — saw GDP growth slow to 2.7%yoy in Q3'16 from 3%yoy in 1H'16. Domestic demand growth was steady at 3.6%yoy, but the decline in net exports intensified to -13.1%yoy from -10.2%yoy in 1H'16, and destocking continued for a third consecutive quarter. We expect slower domestic demand growth of 2.7% in 2017 from 3% in 2016 and 4.1% in 2015. That will limit GDP growth to 2.2% next year from an estimated 2.6% in 2016.

Falling car sales point to consumer pullback

Private consumption growth eased to 2.6%yoy in Q3'16 from 2.8%yoy in 1H'16, but stayed higher than the 2.2% pace of full 2015. Consumer demand has been supported by double-digit increases in household borrowing (consumer loans up 11.8%yoy and mortgages up 13.1%yoy in September), which helped offset the impact of slowing employment growth (1.2%yoy in Q3'16 from a 3%yoy peak in Q1'14). However, a 10.8%yoy fall in passenger car sales in Q3'16, following increases of 12.9%yoy in 1H'16 and 9.3% in full 2015, points to the beginning of a consumer pullback. This is likely to see real consumer growth ease to 2.2% in 2017 from an expected 2.6% in 2016.

Slower capex growth ahead

Strong construction activity (11.7%yoy growth in Q3'16 from 10.3%yoy in 1H'16) offset the impact of falling machinery & equipment spending (-4.4%yoy from -3.6% in 1H'16), allowing capex to grow much faster than GDP (5.2%yoy from 4.4%yoy in 1H'16). Investment growth is likely to ease to 3% in 2017 from an estimated 4.4% in 2016, as the construction cycle appears to have peaked (housing construction permits and housing starts are falling), public capex growth has eased to 2.2%yoy in Q3'16 from 12.5%yoy in the year to Q1'16, and industrial overcapacity keeps manufacturing capex subdued.

The Won should slip on a rising US$

The Won has climbed 10% on the US$ since January despite weaker growth, record-low interest rates, and inflation hovering below 1%yoy since Q1'15. However, the emerging broad resurgence of the US$ could drive the Won down towards 1,200 from 1,127 currently.

	2013	2014	2015	2016	2017
GDP growth, %	2.9	3.3	2.6	2.6	2.2
CPI, year average, %	1.3	1.3	0.7	1.0	1.4
BOK Base rate, year-end, %	2.50	2.00	1.50	1.25	1.00
Won to US$1, year average	1,095	1,052	1,133	1,158	1,183

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

Indonesia's big 2016 political realignment could soon be tested

President Jokowi's position has improved in 2016 with Golkar, previously a key member of the opposition coalition, changing sides to support him and even nominating him as its candidate for the 2019 election. That alliance may be tested in the next few months as Golkar chair, Setya Novanto, has been caught up in a corruption investigation into the home affairs ministry's problematic electronic ID card project. Novanto has been expanding his influence since his election as Golkar chair in May, becoming one of Jokowi's most powerful allies in supporting the president's reform agenda. If Novanto is found complicit, it will be a major test of Jokowi's commitment to clean government, even though that could threaten his alliance with Golkar and, with it, his reform agenda.

Watch for mining and energy policy to be cleaned up

Mining and energy has dominated the policy agenda in 2H'16. Arcandra Tahar was dumped as minister for the sector just 19 days after he was appointed in the August cabinet reshuffle. In a surprise move he has just been returned as deputy minister, while Ignasius Jonan, who was dumped as transport minister in the August cabinet reshuffle, was brought back as the minister. Their task is to reduce the entrenched corruption in the ministry and to clarify shifting policy on a mineral ore export ban.

A tax amnesty windfall may help public spending & Indonesia's debt rating

Jokowi's tax amnesty program has been a resounding success. The first three months of the nine-month program saw US$277bn in assets declared and Rp97.7 trillion (US$7.5bn) in penalties collected, which should help ease a tight constraint on public spending imposed by Finance Minister Sri Mulyani. By limiting the budget deficit, Mulyani hopes to convince credit rating agency S&P that the government's bonds should be rated investment grade when it next reviews the country in December.

Local election campaigning is underway

Campaigning is underway for next February's elections covering 101 provinces, regencies and cities, with the Home Ministry installing acting governors where incumbents are running for re-election. Campaign spending should provide a slight boost for the economy.

Outlook for the market

Growth dips in Q3'16

… but should lift again from Q4'16

After 5%yoy growth in 1H'16, growth likely slipped under 5%yoy in Q3'16, as credit growth slowed to 6.8%yoy in August from 8.9%yoy in June, while vehicle sales growth slowed to 5.1%yoy in Q3'16 from 8.9% in Q2'16 and motorcycle sales plunged 15.7%yoy in Q3 after a milder 6.7%yoy fall in 1H'16. Other factors behind the slowdown were reduced government spending and tax amnesty payments, as well as stress in the corporate sector, which saw the non-performing loan ratio for banks lift to 3.2% by July from 2.7% a year earlier. Yet the downturn should be brief, with stronger growth expected in Q4'16. We've trimmed our 2016 forecast to 5% (previously 5.3%) while 2017 remains at 5.7%.

Corporate capex should revive

… as interest rates fall

Investment is seeing steady growth, with cement sales up 2.5%yoy in Q3'16 or up 62m tons in the year to September, steadily setting new records. BKPM, the investment board, reports realised domestic investment was up 16%yoy in Q3'16, and 19% in the first nine months of the year from a 15% increase in full 2015. Lower interest rates are helping, with the average corporate lending rate dropping to 9.8% in August from 10.4% a year earlier. We expect capex growth to lift to 6.6% next year from 5.5% this year and 5.1% in 2015.

Low inflation and a briefly firm Rupiah

Inflation fell to 3%yoy in Q3'16 from 7.1% a year earlier, allowing Bank Indonesia to cut its new policy rate to 4.75% on October 20. With inflation likely to stay close to the low end of the central bank's 3-5% target range there's scope for another rate cut in early 2017. While the Rupiah has risen from over 14,000 last December to around 13,000 at present, it's unlikely to have broken its long-term downtrend of 3-5% a year on the US$.

	2013	2014	2015	2016	2017
GDP, real growth, %	5.6	5.0	4.8	5.0	5.7
CPI, year average, (2012=100), %	6.4	6.4	6.4	3.4	3.3
Central bank rate (7-day RR) at Dec %	-	-	6.25	4.75	5.00
Rupiah to US$1, year average	10,460	11,868	13,389	13,283	13,450

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

Watch for an early 2017 election

… as PM Najib seeks to regain momentum

In late October, Malaysia's PM and Finance Minister Najib Razak presented a pre-election budget for FY2017 (starting January), as he contemplates an early election in March 2017 (one is not due until mid-2018). Najib hopes to consolidate his power with a big win for the UMNO party-led Barisan National (BN) coalition, as the opposition remains fragmented and the political impact of the scandal surrounding the 1MDB state-owned investment fund is fading, at least in Malaysia. He aims to regain the two-thirds popular majority that BN lost in the 2013 election, even though favourable gerrymandering helped it secure a comfortable majority in parliament. Recently proposed changes on electoral boundaries by the election commission have tilted the playing field even more in favour of BN, despite strong objections from the opposition.

A modest fiscal stimulus for voters from January

Najib's FY2017 budget raises public spending by 3.4% from a year ago, with increased cash handouts for groups that form UNMO's support base, such as low-income families (about 23% of the population), village heads, Muslim clerics, and the large Malay-dominated civil service (1.6m civil servants or about 11% of the labour force). The impact of the post-2014 fall in oil & gas revenues on public finances was partly offset by the introduction of a 6% goods & services tax (GST) in April 2015, cuts in fuel & food subsidies, and selective reductions in public investment spending. The government aims for a budget deficit of 3% of GDP in FY2017, roughly in line with the 3.1% of FY2016. Given the weak global economy, this is appropriately a slower path towards a balanced budget (in deficit since 1998) than anticipated in the last couple of years.

Outlook for the market

Growth steadies at 4% thanks to local consumption

GDP growth eased to 4.1%yoy in 1H'16 from 5% in 2015 and 6% in 2014, as destocking and falling net exports offset a lift in private and public consumption growth to 5.7%yoy in 1H'16 from 4.2%yoy in 2H'15. Fixed investment growth edged lower to 3.2%yoy in 1H'16 from 3.5%yoy in 2H'15 and 3.9%yoy in 1H'15. We expect GDP growth to stay close to the current 4% pace in both 2016 and 2017, with pre-election government spending helping to partly offset the impact of weak exports and falling residential construction.

… but watch for deleveraging by consumers

Cash handouts to low-income households from January might win a few votes but won't be enough to lift consumption growth back to the 7.5% average pace in the decade to 2014. Private consumption growth eased to 5.8%yoy in 1H'16 from 6% in 2015 and 7.3% in 2013. We expect it to grow at around 4.2-4.6% in 2016 and in 2017. Household debt has surged to a record-high 90% of GDP and consumers are moving into a deleveraging cycle. Personal and housing loan growth has slowed noticeably in the last two years, while passenger car sales were down 16.9%ytd by August from a 0.7% fall in 2015 and a 2.3% increase in 2014.

Public works to support capex activity

A sustained post-2012 fall in housing approvals suggests that fixed investment will not find support from residential construction. However, several large government-sponsored infrastructure projects will continue to support capex activity. These include MRT and LRT lines and the DUKE highway extension around KL, the Pan-Borneo highway in East Malaysia, and the massive KL118 and Kwasa Damansara real estate developments. Most of these projects are well underway, which should help sustain fixed investment growth of 3.5% in 2016 and 4.2% in 2017, compared with a 3.7% increase in 2015.

Room for monetary easing and a soft M$

With inflation at around a modest 2%yoy in 2016-17, Bank Negara's monetary policy is likely to retain an easing bias to support growth. The prospect of lower interest rates should keep the M$ relatively soft at around 4.20-4.27 against the US$, as U.S. interest rates are gradually heading up.

	2013	2014	2015	2016	2017
GDP, real growth, %	4.7	6.0	5.0	4.1	4.0
CPI, year average (2010=100), %	2.1	3.2	2.1	2.0	2.1
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	4.11	4.24

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

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Philippines

Political & policy issues to watch

The pros & cons of Pres. Duterte

… fast policy making

… but surprise policy swings

President Duterte will have little trouble passing bills early in his single six-year term, which should help his administration build on the gains of his predecessor, Benigno Aquino. While his war on drugs is popular, his credibility a year from now will depend on whether he can deliver on broader policy that sustains growth. It's unclear where his pivot to China, built on his angry anti-Americanism, fits in the outlook. It won't be as popular as the drugs war given the strong ties of many Filipinos to the U.S., particularly in the Manila elite. While it has won some early aid for infrastructure from China, there seems to be no economic strategy behind it. The risks are also considerable, ranging from splitting an already weakened ASEAN to becoming a negative for the country's massive business process outsourcing (BPO) business, which focuses on the U.S. market.

A big lift in public spending

… two risks need watching

Duterte's administration has moved quickly to implement other election promises. That includes a big lift in public spending for next year, major tax reforms, and support for his predecessor's infrastructure program (with China now participating). Nine projects worth some US$3.6bn have been recently approved. However, the import-intensive nature of such projects will aggravate a trade deficit that surged to US$16bn by August from $12bn in full 2015. The trade deficit and related inflation concerns are likely to force the central bank into cooling measures in 2017. We'll also need to see if proposed tax reforms will help pay for Duterte's spending plans, as tax evasion is entrenched.

Outlook for the market

Robust growth on strong domestic demand

GDP growth lifted to 7%yoy in Q2'16 thanks to strong local demand, which was supported by BPO income and remittances from offshore Filipino workers (OFW). Add to that a favourable demographic outlook and the government's strong fiscal position, and growth should stay in a 6-7% band for the next few years provided macro risks are contained. Despite some uncertainty about Duterte's policy course, we've lifted our 2017 GDP forecast to 6.8% from 6.3% last month in recognition of strong underlying momentum.

A surge in fixed investment

… driving up construction

A 28%yoy surge in fixed investment in 1H'16 built on 15% growth in 2015 and led the upturn in local demand. Public capex alone jumped 52%yoy in 1H'16. Overall capex growth should moderate to 22% in 2016 and around 11% in 2017, from an average 8.3%pa over 2010-15. Public infrastructure investment is likely to increase 14% next year according to the 2017 budget. Meanwhile, investment approvals were up almost 50% in 1H'16, including a 13.6%yoy increase in residential building permits, suggesting a strong pipeline of construction ahead.

Record low unemployment

… & strong consumer demand

With construction up 12%yoy in 1H'16 and averaging 11% growth over the prior four years, the labour market has tightened and the unemployment rate has fallen to a record low of 5.4% in July in a data series that starts in 1982. Together with a 4.6%ytd lift in OFW remittances (which counters press stories of the impact of Middle East construction layoffs), that has led to buoyant consumer confidence. That helped propel a 27%ytd lift in vehicle sales by September from 23% growth in 2015. Such factors should keep real growth in consumer spending above 7%pa in 2016-17, from 6.3% in 2015.

Watch for higher interest rates

… which will support the Peso

Inflation ticked up to 2.3%yoy in September from a recent low of 0.4%yoy the same time last year. While that's at the low end of the central bank's 2-4% target range, we think concern about an over-heating economy will push rates up quickly next year. The higher interest rates should help the Peso track a rising US$ in a 48-49 range through 2017. Although the currency has dipped in recent weeks, it's too soon to speculate about depreciation due to risk from overheating or President Duterte's antics. BPO and OFW inflows remain a powerful force underpinning the currency.

	2013	2014	2015	2016	2017
GDP growth, %	7.1	6.2	5.9	6.6	6.8
CPI, annual average, %	3.0	4.1	1.4	1.8	3.7
Central bank reverse rep. rate, year end	3.50	4.00	4.00	3.25	4.25
Peso to US$1, annual average	42.4	44.4	45.5	47.3	48.0

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

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Singapore

Political & policy issues to watch

Can Singapore be innovative and creative?

While Singaporeans wonder if their brand of one-party democracy is as suited to fostering growth as it was in the country's first 50 years, no major change is imminent. The People's Action Party (PAP), which has been in power since independence in 1965, will continue to lead government for the foreseeable future. Yet there is concern that PAP dominance is limiting the innovation and creativity that most believe will be crucial to growth in the next few decades. Thus, some small steps are being taken to boost the opposition's ranks (currently just six seats out of 89) in the 2021 election. How this plays out will depend on who follows PM Lee Hsien Loong (64), who has been in power for 12 years. It's unclear when he'll step down, but who follows him is a central issue in the outlook.

Policy set to drive an industrial realignment

… which will force out some industries

Like all other advanced economies, Singapore is struggling with slower productivity growth, a fast-ageing population (compounded by a recent policy swing away from cheap foreign labour), and, more recently, a slump in global trade. Singapore's solution has been to approve integrated gambling resorts in 2010 (lifting tourist arrivals from 10m in 2007 and 2008 to 15m for each of the last three years), push into high-tech (e.g. aerospace) and capital intensive (e.g. petrochemical) manufacturing, and cultivate a handful of new industry clusters, such as biotechnology. At the same time, access to land and cheap foreign labour are being restricted for some long-established but less productive industries to encourage them to leave. One outcome has been a steady fall in manufacturing employment from almost 600,000 in 2008 to just above 500,000 today.

Outlook for the market

Growth slumps as external demand drops

While a lift in government spending helped to deliver 2.1%yoy GDP growth in 1H'16, the pace slipped to just 0.6%yoy in Q3'16 on sliding global trade and a weak residential property market. We've trimmed our 2016 forecast to 1.6% (from 1.8% last month) while 2017 drops to 2.3% (from 2.4%). Although the loss of momentum in Q3 needs watching, we expect a recent and mild lift in exports (see below) to gain traction in 2017. If the trade recovery is stronger that we currently expect, then GDP growth could return to 2.0-2.5% next year. That's still less than half the 6% average rate for the 25 years to 2015.

Unemployment edges up and consumers trim spending

Sluggish growth has started to weigh on the labour market, with the resident unemployment rate edging up to a five-year high of 3% in Q2'16. Meanwhile, job vacancies remain near a low not seen since the end of 2012 and employment growth slipped to 1.3%yoy in 1H'16 from a recent peak of 4%yoy in 1H'13. Notably, the manufacturing industry has shed some 32,000 jobs since the end of 2013. That's likely to dampen consumer confidence and keep a lid on wage growth, which will limit real growth in consumer demand to about 3% in 2016 and 2.5% next year, from 4.5% in 2015.

Housing oversupply limits capex growth

Fixed investment fell 0.6% in 2014 and 1% in 2015 as the economy slowed. No growth is likely this year, with a weak 1.7% lift expected in 2017. A 10%yoy rise in public investment in 1H'16 helped cushion a 3.5%yoy fall in private capex (which accounts for some 80% of total capex). Apart from a weak industrial sector, a large housing oversupply will continue to weigh on residential investment, with housing vacancy rates at a 16-year high in Q2'16 and building approvals near multi-year lows. Although growth is weak, Singapore's fixed investment levels are high, as they equal some 25% of GDP and on a per capita basis were US$13,328 in 2015 compared to $9,392 in the U.S. and $7,039 in Japan.

Scope for a mild export lift

Real exports have staged a modest recovery in recent months, with growth reaching a seven-month high in September from an 81-month low of -11.5%yoy in March. Should that modest improvement continue through 2017, manufacturing output could lift by about 2% in 2017 from an expected 0-0.5% in 2016, still well below the 4.8%pa pace in 1995-15.

Watch for a lower S$ next year

Singapore has been in deflation for almost two years. Persistently weak inflation and global demand could see the Monetary Authority of Singapore move to a mild easing stance next year, which could soften the S$ towards 1.45 on the US$ by Q4'17.

	2013	2014	2015	2016	2017
GDP, real growth, %	4.7	3.3	2.0	1.6	2.3
CPI, year average, %	2.4	1.0	-0.5	-0.6	0.6
3-month interbank interest rate, Dec, %	0.40	0.46	1.19	1.17	1.38
S$ to US$1, year average	1.25	1.27	1.37	1.37	1.42

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

Thailand

Political & policy issues to watch

The King's death

… realigns political authority in Thailand

Thailand has entered a year-long period of mourning following the death of King Bhumibol on October 13 after 70 years on the throne. Even though political debate has been toned down, PM Prayut has moved quickly to consolidate the army's grip on power. He'll likely delay next year's election until 2018, when it is set to deliver a parliament under the firm control of a military nominated senate. In the interim, Prayut's stated goal is to ensure the peaceful coronation of Crown Prince Vajiralongkorn, even though there's some uncertainty about when that may occur. While the royal family is central to Thai society, its future political role is likely to be diminished, as the Prince is an unpopular and difficult character. Conversely, the political power of PM Prayut's government is likely to increase even though it will have lost the legitimising authority provided by King Bhumibol.

Military rule is entrenched

… creating an authoritarian but pro-development environment

Thailand looks like remaining under an army-guided government well into the next decade. The main threat to this scenario is a pro-democracy uprising, as rural Thais (a majority of voters) made clear their dislike of the Bangkok elite in a series of elections from 2000. Curbing that risk will require a mix of country-wide suppression of political activity and big rural development programs. Both strategies will shape the operating environment in Thailand over the next decade. A second risk is of divisions within the military or the wider Bangkok elite. At present, that looks unlikely, as Prayut, and the other generals who back him, appear to be both unified and dominant.

Little change for Thai business

… while Prayut lifts spending on construction

Overall, that leaves an operating environment that won't be much different from the last two years and a moderate political risk rating. It also leaves Thailand's commercial elite largely undisturbed. Businesses tied to the Shinawatra family (ex-PM Thaksin and ex-PM Yingluck) will remain under pressure with a limited future. What happens to the commercial holdings of the royal family (with assets equal to 11% of GDP) is less clear but is unlikely to be contentious for now. Meanwhile, PM Prayut's economic goal is restoring growth with the help of a US$50bn (equal to 13% of GDP) infrastructure program.

Outlook for the market

Public spending drives a mild 2016 upturn

… which will cool a bit for the next year

PM Prayut's fiscal stimulus effort, which saw public spending on construction surge 34% last year and by 16% in 1H'16, helped to lift GDP by 3.4%yoy in 1H'16 from 2.8%yoy in 2H'15. The key question is what impact a year of mourning will have on consumer and business sentiment, both of which have been undermined for a decade by bouts of political instability. In the economy's favour is a military government that has a more developed policy agenda with better implementation than prior governments. Nevertheless, we've trimmed our 2017 forecast to just below 4% from 4.2% on expectations of a weaker recovery in capex and consumer spending.

Watch for a shift in consumer spending

Real growth in consumer demand lifted to 3.8%yoy in Q2'16 and will likely finish 2016 up 2.7% from 2.1% in 2015. We've trimmed our 2017 forecast to 2.4% (it was 2.7%) but the main 2017 development is likely to be a reallocation of spending rather than a fall. Domestic tourism spending may lift as rural Thais visit the capital to pay their respects. Consumption in public will be down but should rise at home. International tourism may dip for a few months after a strong 11.8%ytd rise to August.

Private capex has yet to recover

The main challenge will be private capex. The manufacturing sector is operating well below capacity, along with a 0.7%ytd dip in exports for the first nine months. Construction permits (on an annual rate) are near a five-and-half-year low.

Weak inflation and a firm Baht

With inflation barely above zero, the Bank of Thailand's firm 1.5% policy rate in 2016 has helped the Baht rise 4% on the US$ since January. While inflation will remain low, the central bank could well edge its policy rate up next year to keep the Baht steady.

	2013	2014	2015	2016	2017
GDP, real growth, %	2.7	0.8	2.8	3.6	3.9
CPI (2002 index), year average, %	2.2	1.9	-0.9	0.3	1.6
Central bank, policy rate, year end, %	2.25	2.00	1.50	1.50	2.00
Baht to US$1, year average	30.7	32.5	34.2	35.1	34.5

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 pro-reform leadership

Vietnam's new leadership team, headed by Communist Party General Secretary Nguyen Phu Trong and PM Nguyen Xuan Phuc, presides over an economy that has stabilised since 2013, with inflation under control, the current account in surplus, and a steady Dong. Reforms are also helping the business environment. High on the government's agenda is encouraging more foreign direct investment (FDI), which grew 16% last year to a record $14.5bn. Meanwhile, the restructuring of state owned enterprises (SOEs) is gaining momentum, with the proposed sale of Vinamilk (Vietnam's largest listed company) and Vietnam's two leading beer companies, Saigon and Hanoi Beer.

Strong growth in public spending

… faster sales of SOEs

… & steps to curb surging credit growth

Faster SOE sales come at a time when government finances are stretched after nine years of budget deficits, which lifted public debt close to a mandated cap of 65% of GDP from 48% in 2012. Funds from SOE sales will help pay for the government's development plans while also improving the performance of the corporate sector. That should help with the related, but slow moving, restructuring of local banks, which suffers from high non-performing loans, undercapitalisation, and poor risk management. The State Bank of Vietnam has recently limited the use by banks of short-terms funds for medium- and long-term loans to 40% from 60%, and from next January will lift the credit risk weighting for real estate loans from 150% to 200%. Credit growth's recent peak was 19.6% in mid-2015, with the pace cooling to a still strong 16.7% in August.

Outlook for the market

Strong growth in a classic "take-off" economy

… domestic demand is growing at 7-8%

Vietnam is one of Asia's few economies poised to sustain 6%+ GDP growth in the next few years. Domestic demand is even stronger, rising 9.2% last year (while GDP grew 6.7%) and expected to grow about 8% this year and 7.5% in 2017. The difference between the two growth rates has been caused by a swing in the trade balance measured in GDP from +0.2% of GDP in 2014 to -4.7% last year, with deficits of 3-4% of GDP likely for the next few years. Those trade deficits reflect surging imports of capital and consumer goods. Note that the GDP measure of trade, which shows a deficit, is a volume measure that helps calculate GDP growth; the current price measure for trade in the balance of payments has a healthy surplus of US$3.7bn for the first nine months of 2016. Our forecast of a slip in GDP growth to 6% this year also reflects a severe drought that cut agricultural growth to just 0.7%ytd by Q3'16. As the drought has broken, agriculture growth should return to 2-3% next year, nudging up GDP growth in 2017.

The rise of Vietnam's consumers

We expect consumer spending to grow by 7.5-8% in 2016 before easing to around 7% in 2017, after reaching an eight-year high of 9.3% growth in 2015. That surge is being driven by an emerging middle class, which has been helped by a surge in employment by foreign factories making electrical and electronic goods as well as remittances home by overseas Vietnamese. Retail sales were up 9.7%ytd by September, slightly down from 10.7% in the same period last year, while passenger vehicle sales increased a robust 35%ytd by September, albeit down from growth of 43% in full 2015.

A surge in construction cools

… but export manufacturing remains strong

After a 10.8% surge last year, construction sector growth is expected to ease towards 9% this year. Growth in credit to the construction sector has slowed from an unsustainably high 21.9%yoy last November to 10.7% by August. Meanwhile, lending to manufacturing remains near a 20-month high as the sector's real growth accelerated to 11.4%ytd for the first three quarters of 2016 from 10.6% growth in full 2015. Strong growth in exports of computers and electrical components (up 13.7%ytd by September) is mostly replacing lost exports for other countries like China and South Korea. However, exports of phones and spare parts (about one-fifth of all exports) could plunge with the recall of Samsung's Galaxy Note 7 and the end of its production.

High interest rates help the Dong

With inflation picking up to 3.3%yoy in September, there's little room for cuts to the policy interest rate of 6.5%. Relatively high interest rates and a rising current account surplus should limit the Dong's fall on a rising US$ to about 1% in 2016 and 2017.

	2013	2014	2015	2016	2017
GDP, real growth, %	5.4	6.0	6.7	6.0	6.2
CPI, yoy, % (2005=100 from 2007)	6.6	4.1	0.6	2.3	3.3
Central bank refinancing rate, year end, %	7.00	6.50	6.50	6.50	6.00
Dong to US$1, year average	20,933	21,148	21,677	21,892	22,138

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

India

Political & policy issues to watch

A stronger position for PM Modi and his BJP

… as Congress Party declines

… and the AAP rises

PM Modi's BJP-led government is in a stronger position as it approaches the midway point in its first five-year term thanks to the fragmenting of the Congress Party-led opposition. Congress itself is bedevilled by weak leadership under Rahul Gandhi, while the rest of the opposition divides into strong regional parties that have trouble working together and the rising Aam Aadmi Party (AAP or Common Man's Party, launched in 2012 on an anti-corruption platform and currently in power only in the National Capital Territory of Delhi). Half a dozen state races in 2017 should highlight the shift in momentum. Modi's BJP will try to win UP early in the year and hold onto Gujarat at the end of the year. A UP win would strengthen Modi's bargaining position for passage of bills in India's upper house while setting up a strong position for the 2019 national elections. Meanwhile, the AAP will do its best to win another state, like Punjab, which would underscore its potential to eventually replace Congress as the main national party of opposition to the BJP.

Introduction of a GST next April

… could disrupt the market and business

India's central and state governments are scrambling to prepare for the introduction of a goods & services tax (GST) on April 1, 2017, which will replace an array of state-level taxes that bog down commerce and fragment India into state-based markets. Still to be decided is the rate, with the latest negotiations between the centre and states pointing to multiple rates (around 18%), partly as the Finance Minister has promised the new tax will be revenue neutral and non-inflationary. The GST's great promise lies in reducing tax paper work, lowering a high tax burden on manufacturing, making inter-state commerce easier, and lifting government revenue by including more of the economy in the tax base. Its great risk lies in snow-balling complexity as states demand an array of special deals before approving the GST rates. The complexity of the tax change could significantly disrupt the market and corporate operations in 2017.

Outlook for the market

A mixed recovery is underway

… led by services

… but with capex still weak

While there is reason to doubt India's high growth rate under its new GDP price series (used in our table below), the economy is on an upswing that should deliver growth of 7% or better for the next few years. It is, however, still narrowly based, with fixed investment sliding 2.5%yoy in 1H'16 (we use calendar years), import volumes on the GDP measure falling 3.7%yoy (hinting at weak local demand), and the industrial production index (IPI) gauge for manufacturing falling 0.9%yoy. Oddly, India's new GDP series puts real or volume growth in manufacturing at 9.2%yoy for 1H'16. With the services sector also growing by 9.2%yoy in 1H'16, GDP grew 7.4%yoy as 2.1%yoy growth in agriculture (still 15% of GDP) lowered overall growth. GDP growth should lift towards 8% in 2017 largely due to a recovery in capex growth to 5-7% from an expected fall of 0.8% this year.

Rising demand from India's middle class

Real consumer demand grew 7.5%yoy in 1H'16 on the GDP measure and with two-wheeler sales growth accelerating to 15.1%yoy in Q3 (from 9.7% in 1H'16) and passenger vehicles sales up 18%yoy (from 6.2% in 1H'16) India's middle class is recovering and should keep consumer growth at 7-8% through 2017. However, weak sales growth for FMCG-leaders like Hindustan Lever suggest weak demand from the many low-income households (its sales fell 1% in the September quarter, the first fall in 30 quarters).

… should help manufacturing lift

The lack of investment appetite saw credit growth of just 0.2%yoy for manufacturing and 8%yoy overall in August. However, a recovery may be on the horizon, with the Nikkei manufacturing purchasing managers' index touching a 13-month high of 52.6 in August.

The RBI steadies the rupee

The Reserve Bank of India appears to have increased its currency interventions to steady the Rupee. With inflation dropping to 4.3%yoy in September on the new CPI measure there's scope for 1-2 more rate cuts into 2017. We think improved fiscal and monetary management will slow the Rupee's slide on the US$ to 2% a year.

Calendar year starting January	2013	2014	2015	2016	2017
GDP (MP, 2011-12), real growth, %	6.3	7.0	7.2	7.1	7.8
Inflation - CPI, %	10.1	6.7	4.9	5.6	5.8
RBI repo rate, December, %	7.75	8.00	6.75	6.25	6.00
Rupee to US$1, year average	58.5	61.0	64.1	66.8	68.1

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 fragile hold on government

… raises political risk

Australia's political landscape has fragmented in the last five years with the rise of populist fringe parties and independents who oppose the broad policy agenda of the post-war years. Electoral rules have made it easiest for them to win senate seats, where they've held the balance of power between the major parties and delayed legislation. PM Turnbull's attempt to reduce their power with a double dissolution election in July backfired, leaving them as strong as ever, while inadvertently slashing his government's lower house majority to one seat. This affects the outlook in two ways. First, policy will be slow in coming and subject to extensive modification. Second, Turnbull could easily be forced into an early election.

Pressure for fiscal constraint

A key objective of the government is to end a string of budget deficits from 2008 and preserve its AAA credit rating. The latter is under threat after S&P lowered its outlook for Australia's public debt to negative from stable in the aftermath of the 2016 election. Both the government and the opposition Labor Party aim to return the budget to surplus by 2020. However, this aim could be compromised by Labor's reluctance to cut social spending, and the Liberals' commitment to cut the corporate tax rate to 25% from 30%.

… yet public debt is modest & in high demand

The prospect of a credit rating downgrade has not prevented the government from staging a very successful 30-year bond sale that raised a record A$7.6bn in mid-October. According to IMF estimates, Australia's public debt will hit 40.9% of GDP in 2016 from 20.5% in 2010, before it peaks at 43.5% in 2018. But, even this elevated projection compares favourably with the 115.2% average for OECD member countries in 2015.

Outlook for the market

While GDP looks good at 3.1%

… local demand growth is barely 1%

Australia's top line GDP growth looks better than it feels to many local firms. GDP growth edged up to 3.1%yoy in 1H'16 from 2.4% in full 2015, yet underlying domestic demand growth was much weaker at 1.3%yoy in 1H'16 from 1.1% in full 2015. The gap between the two growth rates is due to a surge in net exports, as import volumes fell 1.6%yoy while export volumes grew 7.2%yoy in 1H'16. Although commodity prices remain weak, there's a surge in shipments underway as super mines and LNG exports gear up. Growth was also skewed on the production side of GDP, with the services sector up 3.4%yoy, construction growing by 2.4%yoy, and manufacturing falling 2.6%yoy. We expect GDP growth to settle at around 2.6%pa over 2016-17, as the growth gap between export and import volumes narrows, while domestic spending growth stays in a slower 1.3-1.7% range.

Watch for over-extended households to deleverage

After dipping to 1.1%yoy in 1H'13, private consumption growth settled at a steady pace of 2.8%yoy in the period to Q2'16. We expect consumption to continue growing at this pace in 2017, as Australia's highly-geared households (record-high debt of 125% of GDP) benefit from a strong housing market and record-low interest rates. At the same time, labour market conditions are worsening, with employment growth easing (0.6%yoy in Q3'16 from 2.9%yoy in Q4'15) and a rapid shift from full-time towards lower paying part-time jobs.

Housing capex up, mining capex down

Despite a housing construction boom, fixed investment has been on a sustained decline since 2013, reflecting the end of a massive mining investment up-cycle. The impact of an 8.3%yoy lift in private dwelling construction was more than offset by an 18.5%yoy plunge in non-dwelling construction, producing a total capex drop of 4.4%yoy in 1H'16. We expect the capex decline to ease to -1.5% in 2017 from -4% in 2016, as the pace of housing expansion softens, while the decline of mining investment slows. Housing approvals are near an all-time high, albeit with its growth easing substantially from a late-2014 peak.

A$ finds support from recovering commodity prices

The prospect of further interest rate cuts from the current 1.5% all-time low has diminished, after inflation edged up to 1.3%yoy in Q3'16 from a 1%yoy multi-year low in Q2'16 and the RBA's newly appointed governor voiced concerns about the impact of excessive monetary easing on asset prices. Aided by a recovery in the terms of trade (the ratio of export-to-import prices), the A$ rose to 0.76 against the US$ from 0.68 in early January. We expect the A$ to trade within 0.75-0.77 on the US$ during the Q4'16-Q4'17 period.

Year ending December 31	**2013**	**2014**	**2015**	**2016**	**2017**
GDP, real growth, %	2.0	2.7	2.5	2.6	2.6
CPI, year average, %	2.4	2.5	1.5	1.3	1.7
RBA cash rate, year end, %	2.50	2.50	2.00	1.50	1.50
A$1 = US$, year average	1.03	1.11	1.33	1.34	1.31
US$1 = A$, year average	0.97	0.90	0.75	0.74	0.76

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

New Zealand

Political & policy issues to watch

PM Key eyes 4th term in 2017

… with the promise of personal tax cuts

PM John Key of the Liberal party has led a minority, but nonetheless effective government since coming to office in 2008. He has a good chance of winning a fourth term in the 2017 election thanks to a strong economy that has paved the way for personal tax cuts next year, as public finances are improving faster than expected. Strong revenue growth lifted the budget's operating surplus to NZ$1.83bn (US$1.3bn) in the year to June 2016. This is a lot higher than official projections of NZ$668m, and last year's surplus of NZ$414m. The favourable budget outcome was mostly due to the economy growing 3.6% in the year to June, compared to the Treasury's forecast of 2.9%. The government has hinted that it will use the budget windfall to lower income tax and repay public debt, which at 24.6% of GDP is one of the lowest in the OECD. The government wants to see it fall to 20% by 2020. A reduced need for public borrowing will also improve the risk profile of NZ banks, which rely heavily on foreign wholesale funding due to the country's structural savings deficit.

The benefits of a slick operating environment

… and trade deals

New Zealand replaced Singapore at the top spot of the Wold Bank's 2017 "Ease of Doing Business" survey released in late October. New Zealand has consistently been close to the top of the survey's rankings thanks to strong property rights, swift enforcement of contracts, and minimum red tape in setting up and operating a business. The only drawback for businesses is the small size of its domestic market (4.7m population), and its distance from export markets. NZ tries to compensate for these disadvantages by being a champion of free-trade agreements, the latest of which is being negotiated with India.

Outlook for the market

Strong growth at 3%+

… driven by record migrant arrivals & a housing boom

The economy is getting a strong lift from rising net immigration, which hit an all-time high of 70,000 in the year to September 2016. Tourist arrivals also posted a record high of 296,710 in September, up 11%yoy. Moreover, household finances are getting a boost from surging home and stock prices (both at record highs), record-low interest rates, and a firmer jobs market. Add booming housing construction and you get GDP growth accelerating to 3.5%yoy in 1H'16 from 3% in full 2015, private consumption up 3.2%yoy from 2.3%, and fixed investment up 5.1%yoy from 2.8%. Last month we lifted our GDP growth forecast to 3.3% for 2016 and 3% for 2017, from 3% and 2.8% respectively. The biggest risk to NZ's sunny economic outlook would be a downturn of the bubbly housing market, which would hurt household and bank balance sheets.

Slower capex growth ahead, as housing cools

An 11.5%yoy surge in housing construction helped lift investment growth to 5%yoy in 1H'16 from 2.8% in full 2015. Building consents surged 37%yoy to a new all-time high in August, but falling housing transactions (-7.6%yoy in Q3'16, after a 9.4%yoy rise in 1H'16) hint at a cooler housing market ahead. We expect capex growth to ease to 2.5% in 2017 from an estimated 4.2% in 2016, as less vibrant residential activity is unlikely to be offset by an upturn in non-residential capex. The latter grew 2.9%yoy in 1H'16 from 2% in full 2015.

Rising income and wealth boost consumer demand

Rising housing wealth (the September median home price was up 47% from September 2009), and rising employment (up 4.5%yoy in Q2'16 from 2%yoy in Q1'16 and 1.4%yoy in 2H'15) helped lift consumption growth to 3.2%yoy in 1H'16 from 2.3% in full 2015. These favourable tailwinds should sustain consumer growth of 3.2% in 2016 and 3% in 2017.

Lower interest rates to soften the NZ$

With near zero inflation (0.2%yoy in Q3'16 from 0.4%yoy in 1H'16) and an undesirably strong NZ$ (up 14.5% to 0.71 on the US$ from an August 2015 low), the RBNZ is inclined to keep lowering its policy interest rate, despite concerns about fuelling asset price inflation. It tries to deal with the latter with credit restrictions on home purchases. If the US$ succeeds in reviving its stalled uptrend, the NZ$ should ease back to 0.67 by end 2017.

Calendar years	2013	2014	2015	2016	2017
GDP(Expenditure), real growth, %	1.7	3.0	3.0	3.3	3.0
GDP(Production), real growth, %	2.4	3.7	2.5	2.3	2.6
CPI, year average, %	1.1	1.2	0.3	0.3	0.7
Official cash rate, year end, %	2.50	3.50	2.50	1.75	1.75
NZ$1 = US$, year average	0.82	0.83	0.70	0.70	0.69
US$1 = NZ$, year average	1.22	1.20	1.43	1.43	1.46
NZ$1 = A$, year average	1.18	1.09	1.07	1.06	1.11

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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