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Global outlook

The impact of Trump's win in the USA

… a boost for reflation

Donald Trump's win in November's elections sets the US on a more expansionary path, provided he proves to be a capable president who finds a way to work with a Republican Party controlled Congress. Within the blizzard of his contradictory policy statements on how to make America great again, a central theme has been an expansionary fiscal policy that mixes a major infrastructure program with tax cuts and deregulation. In many ways, that has been a move that the IMF has urged on advanced countries that have been struggling with weak growth and deflation. It is also what US Federal Reserve chair Janet Yellen and some other central bank heads have been calling for over the last year if you read between the lines of their commentary. In short, monetary policy based on quantitative easing and zero interest rates may have prevented the world slipping into a global recession, but it had no power on its own to lift growth out of the rut of the new normal.

Building on a firm footing

… low un-employment

… a strong housing market

… & a rising US consumer

Central to the impact of Trump reflation in the US is its starting point. Given the challenges faced, President Obama and Janet Yellen are leaving a remarkably strong economy. The labour market has been returned to near full employment with the unemployment rate halving from a peak of 10% in late 2009 to 5% or less for the 12 months to this October. A strong recovery has also been established in the housing market over the last few years, with new private housing starts more than doubling to an annual rate of 1.3m units in October from around 525,000 units through 2009-10. More importantly, the median house price has climbed to US$314,000 in September from lows around $225,000 in 2009-10, and that puts it above the $263,000 peak of March 2007. With American home owners feeling wealthier and facing stronger wage growth, the giant US consumer market (some 70% of GDP) is on a firm footing.

That means a jump in US wage growth

Into this fully employed market, Trump will inject an extra stimulus centred on a big infrastructure program. The extent to which that is paid for by the public or private sectors can be negotiated with Republicans in Congress, who will want to keep public debt low. Regardless of funding, it will have a strong impact on wage growth, pushing it up from a current 2.3% annual rate to 4-6% within 18 months, which means that a firm consumer sector that has averaged 3%yoy annual growth for the 10 quarters to Q3'16 becomes even stronger. More than any other step that Trump takes, that will deliver on a central commitment to the working and middle class Americans who voted for him.

… with higher interest rates

… a strong US$

… & a 3-4 year US expansion

The Trump bump also means the return of wage-push inflation of around 4-5%pa after a 35-year gap (average manufacturing wages rose 10% in 1982). That will require the US Fed to lift its policy rate into a 4-5% band by 2018, which is much sooner than markets where expecting. That puts the US dollar on a steady upward path that may well return it to a peak on its trade-weighted index last seen in the late 1990s. Broadly, that's not good for the US manufacturing sector. The main risk under this scenario, which is becoming the market consensus (although our version has higher growth for wages, inflation, and the Fed rate than other analysts expect) is that it will need to be funded by more offshore savings, which means larger trade and current account deficits. That's not a risk that blows up into a crisis quickly, so the US could well move into a strong multi-year expansion.

It also means the end of cheap money

A stronger US economy is a plus for the global economy and should have a bigger impact than Trump's anti-trade stand. However, it also means the end of ultra-cheap money, which will hurt some borrowers, benefit savers, and see capital leave riskier emerging markets.

IMA Asia's forecasts	2013	2014	2015	2016	2017
World – Real GDP growth, %	3.3	3.4	3.1	3.1	3.8
- US	1.5	2.4	2.4	1.8	2.9
- Euro area	-0.3	0.9	1.6	1.5	1.6
- Asia/Pacific (14)	4.5	4.3	4.3	4.4	4.3
- NICs (4)	2.7	3.4	2.1	2.1	2.2
- Developing or "EM" Asia (7)	7.0	6.8	6.6	6.4	6.0
- 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	4.0
Interest rates, US Fed target rate, year end, %	0.10	0.10	0.25	0.50	2.50
Inflation, CPI, US, year avg., %	1.5	1.6	0.1	1.0	3.5
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	1.06
Yen / US$1, year average rate	98	106	121	109	119

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	0.7
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	4.0	0.7	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	6.9	6.9
Singapore	4.7	3.3	2.0	1.6	2.1
Thailand	2.7	0.8	2.8	3.2	4.0
Vietnam	5.4	6.0	6.7	6.0	6.2
India (CY)	6.3	7.0	7.2	6.6	7.0
Australia	2.0	2.7	2.5	2.6	2.8
New Zealand	1.7	3.0	3.0	3.4	3.2

Inflation, CPI year average, %	2013	2014	2015	2016	2017
Japan	0.3	2.8	0.8	-0.2	1.0
China	2.6	2.0	1.4	2.0	2.3
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	1.5
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	0.1	1.1
Vietnam	6.6	4.1	0.6	2.6	4.8
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	109	119
China	6.20	6.14	6.23	6.63	7.06
Hong Kong	7.76	7.75	7.75	7.76	7.75
Taiwan	29.7	30.3	31.8	32.2	31.3
South Korea	1,095	1,052	1,133	1,164	1,218
Indonesia	10,460	11,868	13,389	13,371	14,125
Malaysia	3.15	3.27	3.90	4.17	4.49
Philippines	42.4	44.4	45.5	47.5	50.6
Singapore	1.25	1.27	1.37	1.38	1.44
Thailand	30.7	32.5	34.2	35.1	36.5
Vietnam	20,933	21,148	21,677	22,039	23,050
India (FY)	58.5	61.0	64.1	67.6	71.3
Australia	1.03	1.11	1.33	1.35	1.30
New Zealand	1.22	1.20	1.43	1.44	1.49

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

Regional outlook

Political & policy issues to watch

Trump's impact on Asian politics & geopolitics

Trump appears to favour a return to spheres of influence and transactional politics from a more ideologically guided geopolitical framework that has been in place since the Second World War. As US commitment to the older framework was essential to its survival, Trump's potential move has dramatic implications for other countries, and for multinational companies that thrived in a 60-year era of steadily expanding globalisation of world markets (a central tenet of the post-war geopolitical framework, sometimes called the Washington consensus). At the heart of spheres of influence is the view that great powers should be left to sort out developments in smaller neighbouring states. China under President Xi (with its territory grab in the South China Sea) and Russia under President Putin (with its territory grab in Crimea and the Ukraine) have made it abundantly clear that is how they view the new world order, and in Donald Trump they see a kindred spirit.

North Asia will need better relations with China

First and foremost, that is a problem for North Asia, with its US military bases in Korea and Japan and a traditionally solid commitment to Taiwan's defence. That could well mean an escalating arms race in North Asia, and some of that will be apparent. Yet the stronger force is likely to be for North Asia to find a pragmatic accommodation with a rising China in response to a less assertive but still engaged US in North Asia. As geopolitics guides commerce in the long-term, that should underpin rising commercial interconnections.

Southeast Asia's transactional ties to China will grow

Southeast Asia will also need to adjust. That will be easier for President Duterte in the Philippines, PM Najib in Malaysia, and PM Prayut in Thailand, who will welcome less US interest in human rights and theft. Governments in Singapore, Vietnam, and Indonesia will need to make bigger adjustments, but that should be well within the flexible foreign policy boundaries that have long characterised ASEAN geopolitics. More than North Asia, ASEAN has established a stable framework for transactional relations with China that is based on the rise of exports to China (plus some China factories relocating to ASEAN) from a decade ago, through a surge in Chinese tourists from five years ago, to the current rise in China's aid and investment in Southeast Asia.

Outlook for the market

US reflation should be good for Asia

… we may lift our export growth forecast

As a strong US economy has always been good for Asia, the benefits of a Trump reflation in the US should outweigh the risks of rising trade barriers. Trump's construction/ consumer boom should meet the minimum requirements of his supporters, allowing him to find wiggle room in the contradictions between his call for balanced US trade with the rest of the world and a strong US$. We have yet to fully understand the impact of Trump's presidency, as much will remain uncertain about the man and his administration for another six months, but at a minimum we may have to lift our current modest export growth forecasts for East Asia over 2017-20. It is, however, unlikely that we'll return to East Asia's export surge to the US, which characterised 2002-07; but even half of that would be a big step up in Asia's export outlook.

But watch for how Asia handles a rising US$

… China's Yuan will slide 6%pa

Equally important will be how Asia adjusts to a doubling in US interest rates over the next 18 months. That will draw capital out of emerging markets, and even Asia's current account surplus countries like China will struggle with the impact that has on their currencies. China's move to unpeg its currency from the US$ in late 2015 has left it free to slide against the greenback. In that, it will be falling no more than the Euro. Our Yuan forecast has been adjusted to a 6%-year average fall on the US$ in 2017 following a 6.1% fall in 2016. Mostly this is market forces at work, but as the Yuan remains a government-guided currency it is also Beijing's calculation that there's geopolitical risk in allowing markets to force a bigger Yuan fall.

… Indonesia & India face weaker currencies

… & watch for a sharp drop in Japan's Yen

Asia's main "at risk" currencies, India's rupee and Indonesia's rupiah (both countries run persistent current account deficits and so are more exposed to capital flight and associated depreciations) may have faster depreciations than the 5-6% year average falls we currently expect in 2017. So might currencies exposed to bad politics, which is already apparent in the Philippines and Malaysia. But East Asia's traditionally firm currencies in Taiwan, Korea, Thailand, and, more recently, Vietnam, will need to watch that they don't lose competitiveness against a weaker Chinese Yuan. Finally, this month we've strengthened the fall for Japan's Yen as the Bank of Japan's massive QE program finally gains traction in a world with sharply rising US interest rates. That brings a positive shift in our Japan growth outlook on better export growth and rising returns from offshore investments.

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Japan

Political & policy issues to watch

PM Abe eyes off a third-term

PM Shinzo Abe's political dominance was underlined in November when the ruling LDP amended its constitution to allow his term as party president (and thereby as PM) to run nine years instead of ending at six (in 2018). That leaves Abe more room to push his mild economic reform agenda, which includes an October 2019 sales tax hike (to 10% from 8%), and to pass further controversial laws to strengthen Japan's military posture. Abe should also get to preside over the 2020 Tokyo Olympics. More problematic, he may have to preside over the abdication of the emperor, which the emperor raised in July. Abe's extended tenure won't be popular, but set against the national trauma of abdication it may gain voter support. While opposition parties remain in disarray, Abe is loath to sacrifice his popular support.

GDP growth poised for a lift in 2017

… as QE gains traction

We expect GDP growth to lift in 2017, as a massive quantitative easing (QE) program by the Bank of Japan (BOJ) gains better traction after failing to counteract combined global and national deflationary forces since 2013. The combination of stable or slightly rising global energy prices and a reflationary Trump-led US with a faster US Fed rate rise creates a better environment for Japan's QE program to deliver 1-2% inflation (the year to October saw a 0.2% fall) and 1%+ GDP growth (the year to Q3'16 was 0.6%). Most of this will come from a large Yen devaluation (see below). Abe's efforts to lift growth through fiscal stimulus came to little (as there was little public money or borrowing capacity left after funds for post-quake rebuilding ran out in early 2016), as did his efforts to lift wage growth by trimming the corporate tax rate.

Abe likely to side-step core structural challenges

Growth and inflation are secondary issues to the underlying challenges of recasting policy to cope with rapid ageing, population and workforce decline, manufacturing offshoring, and a replacement of nuclear power (previously 20% of operating capacity, but now less than 2%). While Abe has made clear he won't touch big core challenges like labour market reform (ending a two-tier system and seniority pay) he is happy to nibble around the edges. That means some easing of rigid restrictions on using foreign labour, particularly in aged care. Abe had hoped that the US-led Trans Pacific Partnership (TPP) would force Japan's domestic markets to be more open, but the TPP is dead under Trump.

Outlook for the market

A weaker Yen to push growth up in 2017

Our forecast of better growth in 2017 focuses on just three outcomes that flow from a fall in the Yen into a 120-130 range on the US$ in 2017. The first and weakest is a boost to exports from a weaker Yen. Japan's exports were already doing better than those of most Asian neighbours in 2H'16. The bigger impact will be on the Yen income received by both households and corporates from their overseas investments, particularly in the US. Unlike their neighbours, corporates and households in Japan have been wealthy for decades and since the 1990s have increasingly diversified their investments offshore. While our 2016 GDP estimate stays at last month's 0.5% we've lifted 2017 to 0.7% (from 0.6% last month and 0.3% in September) with growth of 1% or better for 2018-20 (previously 0.7%).

Lacklustre wage growth

… but better investment income could lift consumer demand

PM Abe's goal was to increase consumer spending by lifting pay and inflation (which would encourage people to buy before prices went up; deflation does the opposite). However, despite a tightening labour market, wage growth remains modest at best, with nominal wages having declined 0.4%pa in the last five years, and real wages falling 0.9%pa over the same period. That saw household consumption growth slip from just 0.4%yoy in Q2'16 to virtually zero in Q3'16. Yet going forward, we expect the more powerful force to be household investment income (see above), which should drive a mild 0.7% lift in real consumer spending in 2017 from growth of just 0.2% this year and a 1.2% fall in 2015.

Inflation returns next year on a weaker Yen

Little wage growth and a stronger Yen saw disinflationary forces return in March. Headline CPI slipped 0.5%yoy in September and remains well below the BOJ's 2% target. However, a hike in the US policy interest rate should help weaken the Yen towards 119 to the US$ and boost inflation to about 1% in 2017. Since hitting a 33-month high in August, the Yen has already depreciated over 12% towards 114 on the US$ by late-November.

	2013	2014	2015	2016	2017
GDP, real growth (2005p), %	1.4	0.0	0.6	0.5	0.7
CPI, year average, %	0.3	2.8	0.8	-0.2	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	109	119

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

China

Political & policy issues to watch

2016 was a year of big political change in China

… and that will continue in 2017

… leaving Pres. Xi as a dominant leader

2016 was a milestone year for President Xi, as he consolidated his power at both central and local levels, established his "core leader" status, and reset China's reform path. Recent policies on SOE reform, debt restructuring, party governance, and cybersecurity all tightly follow Xi's views. At present, open policy debate within the country's leadership continues, although Xi is in a stronger position to intervene and guide outcomes. In late 2017 and early 2018, Xi will gain a second 5-year term as paramount leader heading the Party, government, and the military. The leadership transition already underway in these three organs means that almost all top leaders in China will be Xi loyalists by 2018. That likely means less debate over issues, and could lead to more abrupt policy moves, along with the potential for poorer decisions. On the plus side, it should also allow Xi to accelerate China's reform program. Broadly, Xi's goals are to strengthen Party rule, as well as central government control over the economy. His views include a dominant position for SOEs and commitment to a two-track economy (market + government guided).

No trade war with the US

… negotiated outcomes will be preferred by both sides

Even though Trump's policies await clarification, relations with China loom large given China's prominent role in the US trade deficit and factory offshoring, both of which Trump has promised to fix. That suggests considerable risk of a trade war alongside battles over the value of China's Yuan. However, we expect both sides to work towards negotiated and acceptable outcomes. While it sounds good on the campaign trail in middle America, Trump would lose more than he gains by hurting US MNCs. Meanwhile, Beijing is a big geopolitical winner under a Trump presidency, so it should be inclined to offer economic concessions, such as buying more from the US (notably agricultural products) and curtailing some of its more egregious supports for exports.

Outlook for the market

The trend to lower growth continues in 2017

In December, Beijing will set out next year's economic strategy and reform plan at the Central Economic Work Conference. A key issue to watch is whether Beijing accepts the necessity of slower GDP growth than the 6.5% implied in the current 5-year plan, alongside the need for faster reforms to reduce macro risks. We expect this year's stimulus-driven recovery to fade in 2017, as incentives in the property and automotive sector are wound back. Strong infrastructure stimulus will be necessary to avoid a collapse in the investment growth. Maintaining a stable jobs market via strong services sector growth is essential, but also possible with slower growth, which we expect to be 5.5%pa over 2015-20.

Stable consumer demand is likely, even as wage growth slows

Despite wage growth dipping to 5% (or 3% in real terms), consumer spending remains relatively stable, as Chinese households are saving less and borrowing more to sustain their spending. New household loans reached Yuan 5tn in the first 10 months of 2016, outpacing new household deposits for the first time since 2007. Over 2011-15, China's credit card, mortgage, and auto loans surged by 40%pa, 19%pa and 18%pa respectively.

Massive capex realignment is underway

China's fixed asset investment (FAI) comprises of industrial (36%), infrastructure (24%), real estate (23%), services (15%), and agricultural (3%) capex. The 6.6%ytd lift in real estate FAI by October will slow a much-needed run down of excess inventory. By contrast, the industrial sector is witnessing a swing from FAI in mining and construction materials to slower growth skewed towards consumer-related and high-tech industries. Overall fixed investment growth will likely ease from 8.2%pa in 2010-15 to 5.5%pa in 2015-20.

A bit more inflation

… and a 6% annual Yuan slide

A rise in inflation to 2.1%yoy in October was mostly food-driven, although services and consumer goods price inflation also saw a lift. We've raised our CPI forecast from 1.8% to 2.3% in 2017 to reflect the cyclical uptick. However, inflation will likely be capped at 3% in the next few years, hinting at neutral monetary policy. The Yuan is on track for a 6.1% year average fall on the US$ this year and a similar decline on the Yuan's new currency basket. Another 3-5% fall is likely in 2017, as the US$ rises and exports require a boost. More capital account tightening measures may be implemented to prevent a massive capital outflow, especially with forex reserves falling towards US$3tr.

	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	2.3
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	6.63	7.06

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

Hong Kong

Political & policy issues to watch

Being tightens its grip on HK

… watch for a spike in protest in Q1'17

Beijing's disqualification of two newly elected Legislative Council (Legco) members for insulting China during their oath-taking has stirred up – rather than quieted down – the "localist" cause. Localists oppose tighter control by China, so Beijing's latest move suggests an escalation in tension as the March 2017 appointment of the next Chief Executive approaches. If Beijing backs a second term for the unpopular incumbent, CY Leung, tension would likely spike into popular unrest in early 2017. Beijing and the Leung administration will hope to regain control of Legco and avoid delays to spending bills that characterised the last few years. That won't be easy, as the pro-China camp still lacks a supermajority in Legco – but could change if more localists are forced to leave Legco and their successors are government-friendly.

HK remains an excellent base

… increasingly for China's outbound firms

Political gridlock is starting to undermine the advantages of HK's traditional "big market, small government" environment by delaying public spending and damaging business confidence. A soaring HK$ (linked to the US$) and some of the most expensive offices and housing in the world add to the problems, at least for Western firms. Yet, the city retains its traditional advantages of minimal regulation, free capital and trade flows, excellent services and low taxes. Mainland firms, both SOEs and private, are moving into HK, as it is proving an ideal base for regional and international operations – which the HK government has promoted. They helped drive FDI to a record-high US$174.9b in 2015. A question is whether HK residents will welcome them in future, given concerns about property prices, parallel goods and political interference.

Outlook for the market

Global slowdown constraints HK's growth

As a global trade and services hub, HK's economy is highly sensitive to global market forces. Our weak outlook on global business in 2017 – despite a resurgent US economy – limits HK's growth to the slow "new normal" of recent years. Legco gridlock doesn't help, as it limits the capacity for extra public spending or deregulation. Such challenges will slow GDP growth to an average of 1.7% for 2016-20 from 3.4%pa in 2005-15.

Retail sales improving

… as Chinese tourists briefly return

The fall in HK's retail sales eased to 4%yoy in September, from a 10%ytd fall over the first eight months. The two-year long fall in retail sales appears to have bottomed, with declines easing in jewellery, watches and consumer durables. The latest iPhone launch and a 7%yoy lift in mainland visitor arrivals during October's Golden Week Holiday (countering a 9%ytd slide in the first eight months) helped. But a stronger HK$ and weak real wage growth will limit the 2017 consumer recovery to 1.7%yoy, after an estimated 0.8% this year. That's well below the 4.8%pa pace for the decade to 2015.

Tough property cooling measures

In an effort to curb surging home prices, the government has doubled the property stamp duty to 15% for second-home buyers and to 30% for foreigners. Along with a weaker Yuan, that should deter mainland buyers. Affordability has also become a big issue with local buyers; growth in the value of outstanding mortgages had slowed to sub-3%yoy, from around 9% for 2015 and 2014. Property construction should remain strong, bolstered by government's proposed home supply target of 93,000 units over the next 3-4 years.

A soft recovery of services in 2017

Despite efforts to revitalise tourism and deepen services ties with China, service sector growth is struggling with weaker flows of goods, capital and people. Services GDP will likely slow from 3.5%pa in 2005-15 to 1.8% this year and 2.6%pa for 2017-21.

Little inflation but risks from the US$ peg

Muted import inflation, softer rental inflation and weak growth should limit inflation to 2-2.5% in 2017. The 32-year old US$ peg will be maintained for stability, but at the cost of lost competitiveness in trade and tourism. A surge in the US$ is a threat for HK, as a falling Yuan will be blow to HK's competitiveness.

	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	1.00	3.00
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's popularity slumps

… as a slow start to office begins to bite

Despite sweeping into office only six months ago, President Tsai's approval rating (41.4%) has quickly sunk below her disapproval rating (42.6%), as a slow start to office is raising concerns over her government's ability to resolve a number of major issues. The first is souring cross-straits relations (see below), which threatens an already fragile economy. The second centres on transforming the export-dependent economy by boosting innovation, which does little to lift near-term growth and will take time to deliver. Other key challenges include overhauling an ailing pension system facing bankruptcy from 2020, and replacing nuclear power (25% of baseload) with less reliable renewable energy by 2025.

Tsai's "One China" stance hits reality

One of the most pressing issues is Tsai's reluctance to accept the 1992 "One China" consensus, which threatens existing trade and investment linkages with the mainland, particularly for the 100,000 or so Taiwanese firms with operations there. More Taiwanese are now in favour of recognising the 1992 consensus than when Tsai took office in May, and it's unclear how long Tsai will be able to withstand pressure from Beijing. Mainland China has already suspended official cross-straits communications, isolated Taiwan from international forums, and curbed Chinese tourist arrivals since May, including a record 44%yoy fall in October. What is clear however is that it's difficult for Taiwan to grow away from China, and how Tsai's "New Southbound" policy plays out is critical for the outlook.

Outlook for the market

A modest recovery in 2017

Having emerged from a three-quarter recession in Q2'16, an improvement in exports and consumer demand saw GDP growth lift further to a one-and-a-half year high of 2%yoy in Q3'16. Still, we expect the rebound to be milder than usual, as the global trade environment is significantly less favourable today than it was in previous years when it reliably drove Taiwan's manufacturing sector. Meanwhile, with consumer demand and capex likely to stay sluggish (see below), GDP growth should improve to just 2% next year from an expected 1.3% in 2016, well down on the 3.5%pa pace in 2005-15.

Export growth edges up again

Exports (US$, seasonally adjusted) continued to improve in October, with growth lifting to a 21-month high of 3.3%yoy, albeit well below the 8.2% annual pace in the decade to 2008. Exports of electronic components were especially strong, rising by 15%yoy, while information and communication technology exports rebounded by 18.7%yoy from barely 1%yoy in the previous two months. By destination, exports to China were particularly strong, growing by 24.1%yoy in October from an average of about 5% in the preceding three months. Should this better export performance sustain through 2017, manufacturing GDP could lift 2% next year from growth of about 1.5% this year and a 0.5% fall in 2015.

Sluggish consumer demand

… with weak capex growth

While modestly better manufacturing prospects could provide a fillip for the 3m or so employed in the sector, broader labour market developments are dim. Jobs growth is in a long-term decline and fell to 0.5%yoy in the last two months — lows not seen since 2009. Consequently, the unemployment rate is up close to 4% and consumer confidence remains near a 30-month low. The weak labour market should see consumer demand growth ease to around 2%pa in 2016-17 from about 3%pa in 2014-15. Meanwhile, weak capex growth looks set to persist in 2016-17, as public investment, which has declined 2.5%pa in the last two decades, and private investment, which has grown 1.3%pa in the last decade, remain sluggish. We expect capex growth to ease to 1-1.5%pa in 2016-17 from 1.6% in 2015.

Inflation edges up as the NT$ strengthens

A weak inflationary environment has seen the policy interest rate cut four times to 1.375% since last September. However, inflation crept up to a six-month high of 1.7%yoy in October. The NT$ has risen some 5.5% against the US$ since January, and by 3.4% on the real effective exchange rate measure, thanks to a rising current account surplus. Provided that continues, we expect the NT$ to stay in a 31-32 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	1.38	1.38
NT$ to US$1, year average	29.7	30.3	31.8	32.2	31.3

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

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South Korea

Political & policy issues to watch

Park's political crisis

… could dominate 2017

… & undermines business activity

Korea's political crisis has intensified, as prosecutors allege that President Park aided a long-time friend in extorting US$66m from major corporations, while also allowing her to receive classified documents and take part in policy decisions without holding an official position. Park's repeated apologies haven't calmed public outrage, with her approval ratings plunging to 4% (and zero % with millennials). Her offer to resign if parliament ensures an orderly power transition has been met by scepticism by the opposition. They view it as a ploy to delay her impeachment, which requires a two-third's majority vote in the 300 seat national assembly. The opposition parties control 159 seats, but several MPs from Park's Saenuri party are likely to vote for her removal. The investigation into the presidential scandal has paralysed the government and unsettled decision making by some of Korea's largest companies, such as Samsung Electronics, Hyundai, and Lotte.

Rising voter anger over economic dislocation

Public anger about the scandal reflects deep-seated concerns about economic issues, such as a rapidly ageing population, investment offshoring, high household debt, and the dominant role of conglomerates in the local economy. Youth unemployment remains stubbornly high (9.3% for 20-29 year olds), while traditional industries like shipping and shipbuilding are going through massive restructuring, with 20,000 job losses in 1H'16. More jobs are set to disappear, as the shipbuilding industry struggles with overcapacity.

Outlook for the market

GDP growth is stuck in a long-term decline

GDP growth has been on a steady decline from 9%pa in 1985-95 to 3%pa in 2012-15, broadly in line with falling population growth and weaker growth in export manufacturing. The trend is set to continue, with growth easing to 2.2% in 2017 from 2.6% in 2015 and (estimated) in 2016. That's despite a strong first three quarters in 2016 thanks to Park's property and construction stimulus measures. That boosted domestic spending by 3.6%ytd by Q3'16 from 2.9% in full 2015, and helped offset weak exports. Exports should do better in 2017 (3-4% growth after a 7% fall in 2016, US$ basis), but the big challenge will be local demand, which is likely to slump due to political uncertainty, industrial restructuring, and a weaker consumer. Our forecast is unchanged from last month, but downside risk is growing for our 2.2% growth forecast for 2017.

A surge in capex fades from Q4'16

Strong construction activity and public investment lifted fixed investment growth to 4.7%ytd by Q3'16 from 3.8% in full 2015. However, both those drivers are set to weaken, as housing permits and housing starts are declining (-31.6%yoy and -13%yoy respectively in Q3'16), while Park's fiscal stimulus has run out of cash. We expect fixed investment growth to ease towards 3% in 2017 from an estimated 4.4% rise in 2016.

Consumers are retreating

Slowing retail sales growth (2.1%yoy in September from 8.6%yoy in June), and falling passenger car sales (-10.8%yoy in Q3'16 from a 12.9%yoy rise in 1H'16) point to softening consumer demand. Consumer spending has been supported by double-digit increases in household borrowing (up 11.4%yoy in October) rather than solid employment gains. Employment growth subsided to 1.1%ytd by October from a high of 2.4%yoy in 1H'14. We expect consumption growth to ease towards 2.2% in 2017 from an estimated 2.6% in 2016.

Watch for a weaker Won

Inflation edged up to 1.3%yoy in October, while the Won was pushed lower to 1,175 from 1,090 in September by a surging US$. The weaker Won supports the BOK's efforts to reflate the economy through a series of interest rate cuts that guided its policy rate to a record low of 1.25% in June this year. We expect a 4-5% fall for the Won on a strong US$ next year, even as large current account surpluses support the Won. But the Won could fall faster if local politics gets messy and the US$ rally accelerates.

	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	1.5
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	1,164	1,218

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

The battle over Ahok's run for governor of Jakarta

… a pivotal point for political Islam

The 2017 Jakarta gubernatorial election, which is the most important political event before the 2019 national election, is turning into a dramatic stand for Islamic hardliners bent on preventing Indonesia's first non-Muslim, Chinese candidate – the popular Tjahaja Basuki Purnama (a.k.a Ahok) – from winning a prominent elected post. Ahok's victory would set a precedent for the kind of pluralistic, democratic Indonesia guaranteed by the constitution. A massive anti-Ahok rally early this month in Jakarta gave the opportunity to radical ISIS-inspired groups to instigate violence in the hope that a Middle East style escalation in religious tension would help them rise to power. However, President Jokowi largely contained the protest with a massive police presence.

A younger Yudhoyono is climbing the political ladder

Other issues are also at play in the Jakarta election. An imminent court ruling is expected on whether Ahok committed blasphemy in referring to the Koran in a recent speech. If he is found not guilty, he can continue to contest the election. An early November SMRC poll put his support at 45% to 22% for Agus Yudhoyono (son of the prior President), with Anies Baswedan at 20%. There is a chance for Agus to quickly take the lead if a court ruling blocks Ahok or anti-Ahok protests escalate and force him to halt his run.

A successful tax amnesty will help ease fiscal constraint

Indonesia's successful tax amnesty program should help government spending from Q4, reversing plans for further austerity measures to fix tax revenue shortfalls due to weaker commodity prices and slower growth. Consumption will also likely see some recovery as individuals and corporations previously preoccupied with tax amnesty-related declarations and payments renew their spending. The final month of 2016 and early 2017 should also see a modest boost from campaign activities ahead of 101 direct local election races (including Jakarta), which will be held simultaneously on 15 February next year.

Outlook for the market

2016 closes on weak local demand

… lower interest rates should help lift growth in 2017

Indonesia finishes 2016 on a subdued note, with GDP growth in Q3'16 slipping to 5%yoy from 5.2% in the prior quarter and a surprisingly big 13%yoy drop in motorcycle sales for the first four months of 2H'16, which suggests problems in small town and rural Indonesia. Leading middle and low-end retailer Matahari Department Store also reported a 22% decline in Q3 same store sales growth. Vehicle sales, which tend to reflect urban consumer sentiment and spending, did better with a 4.6%yoy rise for the same period. In part, we think households are adjusting to much slower wage growth this year, as they have little capacity to sustain spending from savings or increased borrowing. Provided political unrest is avoided (see the above comments on the Jakarta election race), there's scope for interest rate cuts and an easing in fiscal contraction to underpin a mild lift in growth in 2017 towards 5.7% from an estimated 5% this year.

… so should rising export income

… as commodity prices lift

Better export performance will help the 2017 upturn. After a 9.4%ytd fall in export earnings (US$ basis) over the first nine months, October saw a 4.6%yoy lift. No one expects a strong recovery, but a lift to 3-4% growth in 2017 will be in sharp contrast to an average annual fall of over 7% for each of the prior five years. Better commodity prices are a big part of the recovery, with prices for coal and CPO – two of Indonesia's major export commodities – near two-year highs. This should slowly put money in the pockets of outer-island consumers and gradually bolster rural economies after years of underperformance.

Interest rate cuts and a weaker Rupiah

Meanwhile, lower funding costs from BI's policy easing (October saw the central bank cut rates to 4.75%, the sixth cut this year) are also expected to kick in towards year-end and, bolstered by moderate inflation levels (3.3%yoy for October), local consumption should improve. Higher interest rates in the US mean a 4-5%pa fall for the Rupiah.

	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	13,371	14,125

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

An early 2017 election likely

… as PM Najib consolidates his position

Encouraged by ongoing fragmentation of the opposition and the fading local impact of the scandal surrounding the 1MDB state-owned fund, PM Najib Razak is likely to call an early election next March, even though one is not due until August 2018. The October unveiling of a FY2017 budget with lots of handouts for core supporters of the ruling UMNO party (low-income families, the large Malay-dominated civil services, village heads and Muslim clerics), also points to an early poll. So do recent proposals by the electoral commission to redraw electoral boundaries in ways that favour UMNO.

Strengthening China ties

… means fresh money for big projects

Inconvenienced by a US investigation into the 1MDB international money trail, and irritated by western concerns about Malaysian corruption and growing restrictions on civil liberties, Najib is following the lead of Philippine's President Duterte by strengthening ties with China. Chinese state-owned companies stepped in to buy 1MDB assets in 2015, helping the troubled fund repay some of its debt. Moreover, in a recent official visit to China, Malaysian officials and business leaders led by Najib signed 14 deals covering M$144bn (US$34bn) in investments. These include a M$55bn soft loan for the construction of a 600km rail line on the east coast of Peninsula Malaysia. Construction of this five-year rail project is scheduled to start in 2017. Malaysia will also purchase four Chinese naval vessels as part of a naval cooperation agreement.

Outlook for the market

GDP growth slips to 4%

GDP growth slipped to 4.1%ytd for the first three quarters of 2016 from 5% for full 2015, as the pace of domestic demand growth eased to 4.9%ytd from 5.1% in 2015, while export volumes on the GDP measure fell 0.3%ytd in the first three quarters compared to a 0.6% rise in 2015. We've kept our 2016 GDP growth forecast of 4.1% followed by 4% in 2017, with a mild lift in exports helping to offset weaker local demand growth.

Consumers face headwinds

… from debt and weak employment

Private consumption growth lifted to 6.4%yoy in Q3'16 from a recent low of 4.1%yoy in Q3'14. We think the Q3 rate is unsustainable, with consumer growth set to fall back towards 4% in 2017 from an estimated 5.9% in 2016. Malaysian household debt has reached an uncomfortably high 90% of GDP (from 76% in 2011). In addition, the job market is deteriorating (the MIER employment index fell to 63.6 in Q3'16 from 106.0 in Q3'14) and the housing market is cooling. Personal loan growth fell to just 4.6%yoy in Q3'16 from 20%yoy in Q4'11, while the MIER consumer sentiment index has been hovering at multi-year lows since early 2016.

Capex growth to rely on public works

Fixed investment growth slipped to 2%yoy in Q3'16 from 3.1%yoy in 1H'16 and 3.7% in full 2015. We expect growth of 3.8% in 2017 from an estimated 2.8% in 2016, mostly on the back of public infrastructure projects, such as MRT and LRT lines and the DUKE highway extension around KL, along with the massive real estate developments of KL118 and Kwasa Damansara. Infrastructure development should partly offset the impact of reduced residential construction in response to growing housing oversupply and a sustained fall in housing approvals from their 2012 peak.

Risk of a further M$ slide

… limiting more rate cuts

A key challenge in the next year could be more downward pressure on the M$ after a 16% fall in 2015 and sharp drop to 4.41 on the US$ in the week after the US election. Until this week the M$ looked oversold, but Trump's win points to higher US interest rates, which doesn't help the M$. As the US-Malaysian interest rate differential narrows, funds could continue exiting Malaysia for better returns in the US. That suggests a 3-5% annual slide on a firm US$. It will also limit Bank Negara's ability to cut its policy rate from the current 3%, even though inflation fell to 1.3%yoy in Q3'16.

	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	3.00
Ringgit to US$1, year average	3.15	3.27	3.90	4.17	4.49

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

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Philippines

Political & policy issues to watch

Strong support for Pres. Duterte

… despite his controversial policies

With an approval rating of over 80%, President Duterte has little problem in ignoring local and foreign criticism of his violent but popular anti-drugs campaign. It's also given him room for some dramatic policy swings that include downgrading US ties in favour of China and setting aside territorial claims in the South China Sea. Such policies are controversial and have risks, yet whether Filipinos and the Manila elite will back him a year from now will depend on whether he can sustain the current surge in growth. That looks possible, but it will require careful management of an economy that shows signs of overheating.

Duterte's 2017 challenge will be managing surging growth

With growth averaging 6.5% over the last five years (from 4% for the prior two decades), the Philippines economy is straining at capacity. Imports have surged on strong consumer and capex demand, with this year's trade deficit hitting a record US$18bn by September, from US$12bn in full 2015. Inflation, though at a mild 2.3%yoy in October, is heading up, and is expected to breach the central bank's 2-4% target band in late 2017. A traditional emerging market blow out (a big current account deficit and surging inflation, followed by a big devaluation) should be avoided, largely thanks to surging services exports from the business process outsourcing (BPO) sector, which now exceed US$25bn a year. Yet, the central bank will need to start a mild rate tightening cycle in 2017 to cap inflation.

Outlook for the market

GDP growth surges to a three-year high

Q3'16 saw GDP grow at its fastest pace in three years at 7.1%yoy, up from 6.9%yoy in 1H'16. Domestic demand was robust, with consumer spending up 7.3%yoy and fixed investment surging 23.5%yoy. Overall domestic demand surged 10.6%yoy in Q3'16, but a larger net trade deficit meant a lower GDP growth rate. On the back of a strong Q3, we've lifted our 2016 GDP growth forecast to 6.9% from 6.6%. Despite uncertainty about Duterte's policies and overheating, the foundations for 6-7% growth are still strong, thanks to rising BPO exports and offshore Filipino worker (OFW) remittances that are collectively worth 15% of GDP, plus a favourable demographic outlook.

Capex continues to surge

Consistent with the 50%yoy surge in investment approvals and 13.6%yoy rise in residential building permits in 1H'16, fixed investment increased 25.4%ytd by Q3'16, following 15% growth in 2015. Capex was driven by a 45% spike in public capex, 35%yoy jump in equipment and machinery investment, and 15%yoy lift in construction. Still, capex growth has moderated since Q1'16, suggesting growth will come in at around 23-25% in 2016, before easing to 13-14% in 2017, which is still well above the 8.3%pa pace of 2010-15.

Record-low unemployment buoys consumer demand

With the economy running above capacity, the labour market has tightened considerably. The unemployment rate dropped to a record-low 5.4% in July, and along with a 4.8%ytd lift in OFW remittances by September and buoyant consumer confidence, that helped drive a 7.3%ytd lift in consumer demand by Q3'16 and a 14%ytd increase in passenger car sales by October. These favourable conditions should see growth in real consumer spending lift to a multi-decade high of over 7%pa in 2016-17 from 6.3% in 2015.

Interest rate hikes through 2017

… will support the Peso

With inflation edging up to a 19-month high of 2.3%yoy in October, there are signs that inflationary pressure is starting to mount into 2017. While inflation is well within the central bank's 2-4% target range, concerns of overheating are likely to push the policy interest rate up as inflation lifts above the central bank's comfort zone by end-2017. The Peso has weakened of late, however BPO and OFW inflows remain a powerful force underpinning the currency, helping it to stay in a 50-51 range against a strengthening US$ through 2017.

	2013	2014	2015	2016	2017
GDP growth, %	7.1	6.2	5.9	6.9	6.9
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	47.5	50.6

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

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Singapore

Political & policy issues to watch

Focusing on innovation for growth

… does that require political diversity?

While Singapore's brand of one-party democracy has served it well since independence in 1965, there is growing recognition that the current system might not be as suited to fostering growth as it was in the country's first 50 years. The economy now faces both structural and cyclical headwinds, and there is concern that the dominance of the People's Action Party (PAP), which has been in power since 1965, is limiting the innovation and creativity necessary to maintain competitiveness and boost growth in the next few decades. To counter some of those concerns, small steps are being taken to boost the opposition's ranks (currently just six seats out of 89) in the 2021 election. Still, no major change is imminent and the PAP will continue to lead Singapore for the foreseeable future.

Winners & losers as manufacturing restructures

Slower productivity growth, a fast-ageing population that's compounded by a policy swing away from cheap foreign labour, and the recent slump in global trade are forcing a major economic realignment that's creating a distinct set of winners and losers in Singapore. Companies that depend on the global trade cycle or cheap foreign labour as a source of competitive advantage face an increasingly difficult operating environment, while those businesses that focus on innovation, digitisation, technology, and serving ageing and increasingly affluent consumers and tourists face brighter growth prospects.

Outlook for the market

Waiting for exports to lift growth

As one of the most trade dependent economies in the world, Singapore has suffered more than most from the global trade slump. GDP growth has averaged just 1.7%yoy since Q2'15, well down on growth of 6%pa for the 25 years to 2015. While growth dipped to 1.1%yoy in Q3'16, we expect a modest export recovery through 2017. Along with better capex growth, that should help lift GDP a bit above 2% in 2017 from 1.6% this year.

Consumers to trim spending as labour market weakens

With the resident unemployment rate close to a five-year high and job vacancies near a low not seen since the end of 2012, job seekers now outnumber vacancies for the first time since 2012. The weakness is broad-based, with manufacturing employment falling for two-straight years, construction employment slipping 0.4%yoy in Q3'16, and growth of services employment easing to a six-month low. Increasing labour market slack is likely to dampen wage growth and consumer confidence, pointing to real consumer demand growth of about 2%pa in 2016 and 2017, down from 4.5% in 2015.

Subdued confidence limits private capex

Persistently weak investment continues to plague Singapore's economy, as subdued business sentiment, lower profit expectations and weak demand growth continue to prevent a lift in capex. Capex fell 2.6% in 2014 and by 1% in 2015, with a further decline of about 1% likely this year despite a 10%yoy rise in public investment in 1H'16. That's because private capex has fallen 4.9%ytd by Q3'16, with a large housing oversupply and slump in building approvals suggesting the construction sector will remain sluggish. Prospects for 2017 are a bit brighter, as a lift in transport, machinery and equipment, and intellectual property product capex should support modest capex growth of 1.5-2%.

A modest lift for exports

…should help the manufacturing sector

Exports have recovered modestly in recent months, with export orders up at a 21-month high and real export growth improving to 4.2%yoy in Q3'16, from 1.7%yoy in Q2'16 and a fall of 6.6%yoy in Q1'16. Still, real export growth remains below its decade average pace of 6.6%pa, limiting manufacturing GDP growth to just 0.7%ytd by Q3'16, from -5.2% in full 2015. However, provided the current mild export lift continues in 2017, manufacturing output could lift by 2-2.5% next year from about 1% in 2016, albeit well below the 4.8%pa pace set in 1995-15.

Deflation should end and the S$ should soften

Singapore has been in mild deflation for two years on the headline CPI. While weak inflation should return next year, the MAS, Singapore's central bank, is likely to ease monetary policy to help nudge up growth next year by allowing the S$ to weaken to about 1.46 on the US$ by Q4'17.

	2013	2014	2015	2016	2017
GDP, real growth, %	4.7	3.3	2.0	1.6	2.1
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	1.38	1.44

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

Thailand

Political & policy issues to watch

The passing of a great King

… means a quiet year ahead

Thailand is in a year-long period of mourning after the death of King Bhumibol on October 13. King Bhumibol, who was on the throne for 70 years, was in many ways the father of the nation, as well as a powerful moderating force in Thailand's fractious political landscape. Out of respect, the year to next October will be a subdued year for politics and, to an extent, for the economy. The coronation of Crown Prince Vajiralongkorn will take place after October 13, 2017. Meanwhile, the military-run government led by PM Prayut is consolidating its position, and looks set to run Thailand well into the next decade.

The army-run government is firmly in control

… and will stay in control after 2017 elections

PM Prayut indicates that a general election under a new constitution will go ahead as scheduled next year. That will deliver a parliament under the firm control of a military nominated senate. It's unlikely that the 2017 election will see a revival of the decade-long contest between rural/populist Thais (the red shirts) and an urban/elite (the yellow shirts). That contest, and more general political debate, has been suppressed for the moment, while vocal opponents are quickly locked up on dubious charges. Two final problems for prior military governments, rampant corruption and internal divisions, are also mostly contained. Finally, Prayut's administration is attempting to deliver more efficient government, and aims to revive growth after a decade in which political battles and bad policies undermined local demand.

Outlook for the market

A subdued recovery in 2017

… mostly from a weak capex and export lift

… while consumers lag

The central questions in Thailand's outlook are whether Prayut's economic revival strategy is gaining traction, how the mourning period will affect demand, and the extent to which exports might grow in 2017. So far, Prayut's revival strategy, which centres on a 34% jump in real growth for public construction capex in 2015 (with 14% likely in 2016), has helped offset a slump in private demand rather than triggering a rebound. Private capex growth in construction was just 1.5%ytd by Q3'16 from a weak 0.7% for 2015. Meanwhile, consumer demand growth, which rose to 3.2%ytd by Q3'16 from 2.1% for 2015, will be subdued from Q4'16 for a year, as Thais curtail social activities. Finally, exports started a weak recovery in Q3'16, and will likely finish 2016 flat after a 6% fall in 2015 (US$ basis). We expect export growth to lift to 3-5% next year as a US recovery helps restore global demand. Overall, that means subdued, but slightly better domestic demand with a mild export recovery, which should lift GDP by 4% next year from 3.2% this year and 2.8% last year.

Stimulus steps to limit cooling in consumer demand

Real growth in consumer demand is likely to slip under 2.5%yoy in Q4'16, after rising by 3.2%ytd in the first three quarters, its fastest pace in four years. As Thais avoid celebrations and conspicuous spending over the next year, the pace is likely to slip back to 2.8% in 2017. Support for consumer demand should come from lower personal income taxes, an increase in tax exemptions, and the end of the five-year ownership requirement of the first-car buyer scheme, which should lift demand for new cars.

Housing remains weak but factory capex should lift

Prayut's surge in public infrastructure investment lifted real construction growth to 16% last year and an estimated 7% this year with 4-5% likely in 2017. Yet private construction capex has been weak, with 1.4% growth likely this year and 2-3% next year from just 0.7% in 2015. Central to that has been an 8.7% fall in annual new housing construction permits to 204,253 by Q2'16. Fixed investment in plant and equipment looks set to close 2016 flat after a 0.7% fall in 2015, but should lift by 2-4% next year as exports edge up.

Little inflation and a weaker Baht

Given weak demand inflation will remain low. The Baht's 4% climb on the US$ from a January low of 36.1 reversed following Trump's US election win, although it is closing November at a firm 35.5. That's left the Baht steadily climbing on China's weaker Yuan since late 2015, which won't help exporters. But with the central bank avoiding a rate hike to help the economy recover next year, the Baht will likely fall some 4% in 2017.

	2013	2014	2015	2016	2017
GDP, real growth, %	2.7	0.8	2.8	3.2	4.0
CPI (2002 index), year average, %	2.2	1.9	-0.9	0.1	1.1
Central bank, policy rate, year end, %	2.25	2.00	1.50	1.50	1.50
Baht to US$1, year average	30.7	32.5	34.2	35.1	36.5

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 government

… in need of stronger public finances

Better economic management and stable leadership under Communist Party General Secretary Nguyen Phu Trong, who gained a second 5-year term in early 2016, have put the Vietnamese economy on a more solid footing . Pro-growth policies have also helped, with foreign direct investment surging to US$12.7b by October after reaching a record-high $14.5bn last year. Still, the government is not without its challenges. High up on its agenda is the restructuring of moribund state-owned enterprises (SOEs), cleaning up the banking sector that's weighed down by bad debts, and shoring up stretched public finances. Public debt is close to a mandated cap of 65% of GDP and that's limiting the government's ability to meet its development goals.

SOE sales pick up

… providing much-needed funding to the energy sector

This year has seen a flurry of activity in the SOE sector, with sales of the government's stakes in Vinamilk (Vietnam's largest listed company), as well as Vietnam's two leading beer companies, Saigon and Hanoi Beer. The privatisation of SOEs should help improve the performance of the corporate sector and ease strained public finances that have already forced the government to scrap the construction of two nuclear power plants in Ninh Thuan. The plants were to have a capacity of 4,000mw and were anticipated to meet almost 6% of Vietnam's electricity demand by 2030. In their place are plans to build cheaper coal and natural gas power plants with a capacity of 6,000mw by 2030. Yet, even with some US$40bn set to be invested in the electricity sector in 2016-20, an expected shortfall in electricity supply in the near-term is likely to require imported hydro electricity from Laos.

Outlook for the market

Strong growth underpinned by domestic demand

Competitive wages, a young workforce, and stable politics make Vietnam one of the most attractive destinations for factory offshoring from higher-cost North Asia. Add to that robust domestic demand that's being propelled by a fast growing middle-class that demand better products, as well as infrastructure and housing, and Vietnam is one of Asia's few economies that is set to sustain 6%+ GDP growth in the next few years. Domestic demand has risen by 5.2%pa in the last five years and is expected to grow a further 6.5-7% in 2016-17. Together with a mild 3% rebound in the agricultural sector next year and solid export growth, these factors should see GDP lift by 6.1%pa in 2016-17, a bit above its 5.9%pa pace in 2010-15 but less than the government's 6.7% target for 2017.

Consumer demand on solid footing

As one of Asia's major beneficiaries of factory offshoring, employment in the manufacturing industry has surged in recent years, rising from some 5m in 2005 to over 8m by 2015 and now accounting for 15% of the workforce. Along with inward remittances by overseas Vietnamese (US$12.5bn or over 6% of GDP), that's helping to drive the emerging middle class and is expected to support consumer spending growth of 7-7.5%pa in 2016-17, from an eight-year high of 9.3% in full 2015. Retail sales increased 8.8%ytd by October, down from 10% in full 2015. In contrast, passenger vehicle sales increased 35.6%ytd by October, albeit down from growth of 43% in full 2015.

Exports stay resilient

… helping to lift export manufacturing industry

Vietnam's exports have proven to be resilient in 2016 and are up 7.2%ytd by October from an 8.1% rise in full 2015. Exports of computers and electrical components have been especially strong, up 15.6%ytd by October. However, exports of phones and spare parts, which account for about one-fifth of total exports, have eased through the year, with growth slipping to 10.4%ytd by October from 16%ytd to June, as the global recall of Samsung's Galaxy Note 7 starts to bite. Still, the resilience of exports saw manufacturing GDP lift some 11%ytd by Q3'16, with growth of over 11% expected for the full year following a 10.6% lift in 2015.

Dong to weaken on a rising US$

With inflation rising to a 26-month high of 4.1%yoy in October and likely to rise further through 2017, the policy interest rate will likely lift from 6.5% next year. US$ strength saw the Dong slip to 22,700 against the US$ by late November. The Dong is expected to fall about 1.5-2% in 2016, before weakening a further 4-5% next year on a rising US$.

	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	2.6	4.8
Central bank refinancing rate, year end, %	7.00	6.50	6.50	6.50	7.00
Dong to US$1, year average	20,933	21,148	21,677	22,039	23,050

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

India

Political & policy issues to watch

Switching rupee notes to limit the black economy

… a great goal for India

… or an own goal for PM Modi?

PM Modi has staked his political future and the health of the economy on an effort to curtail India's black economy, which estimates put at 10-30% of GDP, although it is telling that only 20m Indians pay income tax and that the ratio of tax revenue to GDP is about half that of countries with better compliance. The November 8 replacement of 500 and 1,000 rupee notes, representing 86% of currency by valuation, is popular with India's middle class and corporates, most of whom are tired of the associated corruption and contortions required in daily life and business. By halving tax revenues, the black economy has also undermined national development and boosted country risk (and thereby the price of capital) through a persistently large public budget deficit. Yet millions of poorer Indians and small businesses may be hurt, and Modi may pay the price for that in next year's state elections.

The black economy will continue

Unfortunately, cancelling India's old high value notes and replacing them with new 500 and 2,000 rupee notes won't do much damage to the black economy. Tax raids find that no more than 5-6% of black wealth is held in cash, with most being in real estate or gold. The largest players also hold most of their wealth offshore. Admittedly, the black money flow will be disrupted in the same way that the whole economy will be disrupted.

Watch out for more disruption from next April's GST launch

While there's speculation about the trigger for currency replacement (mass counterfeiting, upcoming state elections, etc.) the most obvious trigger is the introduction of a GST from April 1 next year. A well-designed GST won't end black transactions, but it will help limit them. Unfortunately, India's GST is becoming complex, with four rates and battles between Delhi and the states on implementation. Muddled GST implementation could slow growth in 2017, and companies will need to watch for associated operating risks.

Outlook for the market

Q4'16 sees an abrupt slowdown

… while Q1'17 gets a small lift

India's economy had entered a mild but traditional recovery in Q3'16 (we use calendar years) with demand lifting as inflation and interest rates dropped. That will reverse in Q4 when damage done by rupee replacement will be strongest, with a portion of consumption and investment deferred for 1-2 quarters. Accordingly, we've cut our Q4'16 growth rate to 4.3%yoy (previously 6.5%) while Q1'17 gets a lift to 6.7%yoy (from 6%). That trims calendar 2016 growth to 6.6% (previously 7.1%); however, 2017 slips to 7% (prior 7.8%), as we are concerned about cumulative disruption from big currency and tax changes.

Consumers focus on essentials until Q1'17

… but growth returns to 7% in 2017

Investment spending by households rose in Q3'16 following interest rate cuts and a better monsoon. Passenger vehicle sales rose 18%yoy after 6%yoy growth in 1H'16, and 2-wheeler sales were up 15%yoy from 10%yoy in 1H'16. Both may plunge in Q4'16, as cash for outright purchases or deposits evaporates. More generally, consumer spending is likely to focus on essentials (about 85% of rural spending and 65% of urban spending) until Q1'17. Real growth in household consumption will likely drop to 5.5% in Q4 from an average 7% over the prior 12 quarters. Low cost FMCG may see little reduction while discretionary items are hit hard. That cuts full year consumer real growth to 6.7% with a mild lift to 7.0% in 2017 with help from deferred 2016 spending.

Investment falls in 2016, with a weak 2017 recovery

Total fixed investment fell 2.5%yoy in 1H'16 after 5.8% growth in full 2015. Given the challenges of rupee replacement, we expect a 1-2% fall this year before 4-6% growth in 2017, provided GST introduction doesn't derail the economy.

Low inflation, rate cuts, & a sliding rupee

Inflation slowed to 4.2%yoy in October, taking pressure off consumers and opening the way for more interest rate cuts. The main risk ahead is the GST, which should be inflation neutral (as other taxes end), but might well lift inflation. The Rupee has slid on the US$ as global capital markets adjust to a Trump presidency. We've lifted our year average fall in 2016 to 5.4% (prior 4.2%) with another 5-6% fall in 2017 (prior 4-5%).

Calendar year starting January	2013	2014	2015	2016	2017
GDP (MP, 2011-12), real growth, %	6.3	7.0	7.2	6.6	7.0
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	67.6	71.3

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

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Australia

Political & policy issues to watch

Government legislative inaction boosts fringe parties

Australia's Liberal-National coalition government finds it increasingly difficult to pass laws through the parliament, after the July 2016 election left it with a one-seat majority in the lower house. Proposed legislation needs to be negotiated with populist fringe parties and independents, and greatly modified, before having a chance to become law. Moreover, the poor outcome of the July election has forced PM Turnbull to maintain the hard-line policies of his unpopular predecessor Tony Abbott. This has led to a steep drop in Turnbull's approval ratings, while government inaction has boosted the appeal of the populist fringe, such as the anti-immigration One Nation party, at the expense of the "two-party" political establishment.

IMF argues for slower return to budget surplus

A key policy objective of both the government and main opposition Labour party is to return the federal budget into surplus by 2020, thus preserving the country's AAA credit rating (S&P put Australia's credit rating on negative watch in July). The budget moved into deficit in 2008, pushing public debt up from 11.7% of GDP to 37.6% in 2015. However, in its latest Article IV report, the IMF cautions against a hasty return to surplus, as the country's public debt remains low relative to that of most OECD countries (average 115.2% of GDP). This provides ample fiscal space for public infrastructure spending. While noting Australia's smooth transition from the end of the mining investment boom with the help of an expanding services sector and a housing construction boom, the IMF recommends that fiscal and monetary policies should remain expansionary in view of historically low inflation, weak wage growth and signs of underemployment.

Help from rising commodity prices

The government's budget repair efforts are getting an unexpected boost from a swift rebound in iron ore and coking coal prices. This helps lift pubic revenue, export values and supports the A$ via an increase in the terms of trade (the ratio of export-to-import prices). Being a commodity currency, the A$ tends to correlate well with the terms of trade.

Outlook for the market

Growth edging up on the back of firm net exports

GDP growth accelerated steadily to 3.1%yoy in 1H'16 from 1.9%yoy in 1H'13 despite much slower expansion in domestic demand (1.3%yoy from 0.2%yoy). This is because weak domestic spending kept import volume growth consistently below that of export volumes, making net exports the main driver of GDP growth. We expect firm net exports, along with some restocking, to continue offsetting the impact of soft domestic demand. This should allow GDP to grow 2.8% in 2017 from an estimated 2.6% in 2016 and 2.5% in 2015.

Consumption growth softening

Private consumption has grown in line with GDP at 2.5%pa since 2013, with household spending supported by increased borrowings, very low interest rates, the wealth effect of rising home prices, and rising employment. However, elevated household debt (125% of GDP), the weakest wage growth on record (1.9%yoy in Q3'16) and an emerging jobs slowdown (0.6%yoy in Q3'16 from a recent high of 2.9%yoy in Q4'15) should restrain consumer growth to 2.7% or below in 2017 from an estimated 2.9% in 2016. The recent slowdown in retail and passenger car sales indicate softening consumer demand.

Capex decline easing

Fixed investment has been declining on a year-on-year basis since Q1'13, as the housing construction boom failed to offset the impact of retreating mining investment. We expect the decline of mining capex to moderate in 2017, but housing activity is also likely to ease, as growth of private housing approvals eased to 3%yoy in Q3'16 from a 28.4%yoy peak in Q1'14. Overall, these factors should ease the decline of total capex to -1.2% in 2017 from an estimated -4% in 2016 and -3.9% in 2015.

Firmer A$ as commodity prices head north

The RBA's policy interest rate has been at a record low of 1.5% since August 2016, but further rate cuts are unlikely, as inflation has started to rise from the 1%yoy multiyear low of Q2'16. The A$ has stabilized within a 0.71-0.78 range against the US$ since May this year, as rising commodity prices offset the impact of a widening interest rate gap in favour of the US$. The prospect of further improvements in Australia's terms of trade could lift the A$ towards 0.80 on the US$ by Q4'17 from the current 0.74 level.

Year ending December 31	2013	2014	2015	2016	2017
GDP, real growth, %	2.0	2.7	2.5	2.6	2.8
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	1.35	1.30
US$1 = A$, year average	0.97	0.90	0.75	0.74	0.77

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

New Zealand

Political & policy issues to watch

A strong, skilful government

A strong economy and the skilful navigation of a series of crises, including the 2008-09 global financial crisis, the devastating Christchurch earthquake in 2011, and the plunge of milk prices (NZ's main commodity export) in 2014, leaves PM John Key in a strong position to win his fourth-consecutive term since 2008 (should he run) in the upcoming 2017 election. Key's approval ratings have been consistently higher than those of the opposition, with an October survey by Roy Morgan putting Key's rating at 48%, compared to 38% for the Labour/Greens opposition alliance.

PM's Key's chances to win 4th term boosted by prospect of tax cuts

In recent years, New Zealand has become one of the OECD's fastest growing economies, helping to attract a record number of migrants, including many New Zealanders returning from stints abroad. Net migrant inflows hit a record high of 70,000 in the year to September 2016. Fast population growth has lifted the country's growth potential, while also boosting local demand for consumption and housing. That's helping to boost public revenues and has paved the way for personal income cuts next year, further strengthening Key's odds at next year's election. The budget's operating surplus hit NZ$1.83bn (US$1.3bn) in the year to June 2016, higher than the officially projected NZ$668m and well above last year's surplus of NZ$414m. Part of the unexpected windfall will be used to repay public debt, which at 24.6% of GDP, is one of the lowest in the OECD.

Outlook for the market

GDP growth to stay above 3%, but watch for housing correction

GDP growth edged up to 3.5%yoy in 1H'16 from 3% in both 2015 and 2014, and 1.7% in 2013. The main growth drivers were fixed investment (up 5.1%yoy from 2.8% in 2015) and net exports (export volume growth stayed ahead of imports with a 3.6%yoy rise, versus 1.1%yoy for the latter). We expect GDP to grow 3.4% in 2016, before growth eases somewhat to 3.2% in 2017, as the housing construction boom that supported capex growth is likely to soften. There is an outside risk of a steep housing correction (the median home price has surged 42% from October 2011), which could damage household and bank balance sheets, as well as undermine GDP growth.

Rising income and housing wealth support consumption

Private consumption growth rose 3.2%yoy in 1H'16 from 2.6% in full 2015, on the back of household wealth gains from record high house prices, historically-low interest rates, fast-rising net migration, and rapid employment growth. Jobs grew 6.1%yoy in Q3'16, the fastest pace since 1991. These factors should allow consumption to grow 3% in 2017 from an estimated 3.3% in 2016 and 2.3% in 2015.

A softer housing market to restrain capex growth

An 11.5%yoy surge in housing construction was the main driver behind the 5.1%yoy capex increase in 1H'16, as non-dwelling investment grew at a modest 2.9%yoy. We expect capex growth to moderate to 2.7% in 2017 from an estimated 4.3% in 2016, as the central bank's recent restrictions on home financing are starting to bite. After peaking at 18.4%yoy in April 2016, residential sales growth dropped 14.2%yoy in October. As a leading indicator of housing activity, declining residential transactions point to slower home price rises in 2017, along with softer construction growth. Non-dwelling investment is unlikely to be strong enough to offset the impact of a softer housing market on overall capex growth.

Interest rate down-cycle ends

… as CPI set to rise with a weaker NZ$

The prospects of further interest rate cuts have diminished considerably after the RBNZ reduced its policy interest rate to an all-time low of 1.75% from 2.00% earlier this month. The central bank expects inflation to rebound from the 0.2%yoy of Q3'16 on the back of strong economic activity, while it remains concerned about the risks of the bubbly housing market. The NZ$ surged unhelpfully to 0.74 on the US$ in September 2016 from 0.62 in September last year, but it has since eased to 0.70. We expect the NZ$ to retreat towards 0.65 by Q4'17, as the US$ has resumed its broad uptrend.

Calendar years	2013	2014	2015	2016	2017
GDP(Expenditure), real growth, %	1.7	3.0	3.0	3.4	3.2
GDP(Production), real growth, %	2.3	3.8	2.4	3.2	3.2
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	0.69	0.67
US$1 = NZ$, year average	1.22	1.20	1.43	1.44	1.49
NZ$1 = A$, year average	1.18	1.09	1.07	1.07	1.15

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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