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CONTENTS

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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

A mildly better year in 2017

… but volatility & uncertainty continue

While many want the world economy to lift by 4.5% or more next year, a modest lift to 3.8% growth is more likely. That would be stronger than any of the last five years, and right on the average for the two decades to 2015. For many, that's still uncomfortably slow, as demand won't be strong enough to support strong price growth for commodities and most manufactured goods, or to help heavily indebted countries and companies repair their balance sheets. So, big risks in emerging markets (low commodity prices and large debts for some) and in the Euro area (Italian banks struggling with large non-performing loans and low growth) will remain. The big gains for the global economy at the close of 2016 are in three areas: a promised swing in US fiscal policy to reflation; stabilisation or modestly higher commodity prices; and better growth in emerging markets (EM, note that the MSCI EM equity index has returned 25% since the slump in January 2016). Balanced against the positives are three main risks, with the first two being new: a surge in the US$, which, if it matches 2015's 16% jump, would derail the global recovery; a trade war launched by the Trump administration; and a financial crisis in China (warning signs continue to bubble up). Such risks suggest that volatility and uncertainty will remain prominent for many more years.

US growth will cool for a few quarters

… before steps to lift sentiment kick-in

… while the risk lies in bad trade policy

The latest revision to US GDP shows a steady acceleration from 0.8% annualised growth in Q1, to 1.4% in Q2'16, and 3.5% in Q3'16. The pace is expected to dip in Q4 (leaving a full year growth rate of 1.8%), as November data points to weaker growth in wage and salary income, and in consumer spending in Q4. In addition, there's little sign yet of a recovery in private fixed investment, which fell an annualised 2.9% in Q3'16. The US Fed's cautious 2017 outlook, which hasn't changed much over the last year, is for a modest lift to 2.1% growth in 2017. The key question is how much difference a Trump administration's reflationary policies will make. Even though it's clear that tax cuts and a big infrastructure push won't have an impact until 2018, we expect Trump to give priority to a clutch of immediate steps that would help 2017 growth. The aim will be boosting business and consumer sentiment in order to consolidate growth in consumer and private capex spending. The main risk is that Trump's apparent commitment to a trade battle with China will undermine the very lift in business sentiment he seeks. Given the Fed's cautious growth outlook, we expect just two rate hikes in 2017, with the pace rising to 3-4 hikes in 2018 as wages move up quickly in a tightening labour market.

Bad politics hold back the EU

Unfortunately, there's little sign that European governments are about to embark on reflation. Difficult elections lie ahead in Italy and France, with a strong possibility that the outcomes could lead to further fraying of the EU and a vote in Italy on whether it should leave the Euro. Such risks will undermine business sentiment and investment through 2017.

Oil stays around US$50/bbl

2016 also finishes with Russia and OPEC in apparent agreement on steps to cut oil production and force the oil price up (Nymex crude is currently $52 while Brent is $55). We think $55 is the cap, as at that level US frackers can profitably restart operations. Moreover, near-full inventories, mild oil consumption growth, and cheating on quota by some OPEC members will see the price slide towards a $50 average for 2017.

A realignment of big currencies

In part, this occurred in the weeks after Trump's win pushed the US$ up some 6% on its trade weighted index. That saw falls of 4-8% on the US$ for Japan's Yen, the Euro, and China's Yuan. At present, we expect all three of these major currencies to drop another 4-6% on a rising US$ in 2017, and that will be a major challenge for the Trump administration.

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)	4.7	4.4	4.4	4.5	4.4
- NICs (4)	2.7	3.4	2.1	2.1	2.1
- 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	5.0
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	1.00
Inflation, CPI, US, year avg., %	1.5	1.6	0.1	1.0	2.5
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	110	123

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	2.0	0.3	1.2	0.7	1.2
China	7.7	7.3	6.9	6.6	5.9
Hong Kong	3.1	2.7	2.4	1.4	2.2
Taiwan	2.2	4.0	0.7	1.3	2.1
South Korea	2.9	3.3	2.6	2.6	2.0
Indonesia	5.6	5.0	4.8	5.1	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	6.5
India (CY)	6.3	7.0	7.2	6.6	7.0
Australia	2.1	2.8	2.4	2.5	2.8
New Zealand	1.7	3.0	3.0	3.4	3.4

Inflation, CPI year average, %	2013	2014	2015	2016	2017
Japan	0.3	2.8	0.8	-0.2	1.2
China	2.6	2.0	1.4	2.0	2.3
Hong Kong (composite CPI)	4.4	4.4	3.0	2.9	2.4
Taiwan	0.8	1.2	-0.3	1.0	1.3
South Korea	1.3	1.3	0.7	1.0	1.6
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	5.0	4.0
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	110	123
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	31.9
South Korea	1,095	1,052	1,133	1,164	1,218
Indonesia	10,460	11,868	13,389	13,296	13,825
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	67.1	69.8
Australia	1.03	1.11	1.33	1.35	1.30
New Zealand	1.22	1.20	1.43	1.44	1.51

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

Regional outlook

Political & policy issues to watch

We don't expect a US-China trade war

… but a hike in US tariffs looks likely

In the US elections, Trump suggested he'd impose a 45% tariff on imports from China to return the US to balanced trade. Trump has the right target. Measured from the US side, some three quarters of its trade deficit, which we put at 2.9% of GDP or US$500bn in 2016, is with China. Yet brief analysis suggests that such a big tariff on Chinese imports would do as much damage to US corporates and consumers as to China. The problem isn't new, with the US Treasury tackling the China trade imbalance for a decade under the US-China Strategic Economic Dialogue, one outcome of which was a 16% rise in China's Yuan on the US$ to 2015. But with China's Yuan now locked in a weakening trend on a rising US$ (see our China page), emergency tariffs, which a US president can impose, are back at the top of the list of remedies. The latest trial balloon from the incoming Trump administration is an across-the-board tariff hike of 5-10% without targeting China. If that's the case, there'd be little interest in retaliation from China's side.

PM Modi's stumble in India

PM Modi's surprise demonetisation on November 8 has mostly hurt India's poorer households and the companies that serve them (see our India page). Yet poorer households are the majority of voters, and in elections in Uttar Pradesh (India's largest state by population), which could be held as soon as February, Modi's BJP and its allies could take a drubbing. The demonetisation debacle also saw the BJP lose its hard-won momentum in parliament, and that will delay introduction of the GST.

The rise of Islamic hard-liners and wedge politics in Indonesia

Two big protest rallies by hard-line Islamists in Jakarta over the last two months mark a turning point in Indonesian politics. Yet that may simply be the arrival at the national level of a more forceful, conservative Islam. There's no sign yet that it will push aside a more moderate political status quo. Two developments need watching. The first is how hard-line Islam shifts the debate on specific issues that affect marketing and corporate operations. The second is the rise of communal wedge politics (i.e. racial antagonism for political gain), which appears to be underway on local social media.

What to make of Duterte in Manila?

In December, the Wallace Business Forum, our partners, met with President Duterte for dinner (the swearing on both sides was apparently quite limited). The conclusion reached is that behind his bluster is a determination to quickly end a drugs crisis and to ensure that ordinary Filipinos benefit from economic growth. For business, there was a commitment to reforms to improve the business environment.

Outlook for the market

Growth in most of Asia edges up, except in China

There's little change to our aggregate forecasts for Asia's growth this month (see the table on the Global page), as some cuts to markets like India were offset by better prospects for countries like Japan. Looking into 2017, the aggregate numbers barely move up even though a modest lift in global trade appears to be underway as 2016 closes. That's largely because growth in China, some 47% of regional GDP in 2017, continues to cool.

Watch for a trade recovery to broaden in 2017

Asia's trade recovery isn't working equally well for everyone. November saw Japan and Taiwan both report surprising 12%yoy jumps in exports, while China's exports fell 1.5%yoy and Korea's grew a weak 2.5%. Commodity exporters like Australia (up 9.3%yoy in October) and Indonesia (up 21%yoy in November) are also doing well from better commodity prices. The trade recovery should broaden in 1H'17, helping to sustain or lift GDP growth rates for most of Asia (China and Korea being notable exceptions).

Asia weathers a rising US$

… mostly a plus for exports

… with risks contained

A rising US$ is mostly good news for most of Asia, so long as it doesn't undermine the US recovery or pull Asia currencies up with it. Hong Kong is the only one of the A/P 14 to suffer from the latter problem, as its currency remains firmly pegged to the US$. Unfortunately, that has become one of several factors undermining Hong Kong's value proposition. Another risk to watch in a rising US$ environment is companies caught between US$ loans and income in weaker local currencies. Most Asian corporates have raced to retire US$ loans over the last year, so while a few firms may be hit there's little sign of countries suffering. Finally, the currencies for India and Indonesia can dive against a rising US$, as both have traditionally had difficulty in controlling inflation and current account deficits. Yet, both currencies have given up surprisingly little on a fast-rising US$ in late 2016, underscoring improvements in macro-economic management.

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Japan

Political & policy issues to watch

PM Abe remains dominant

… watch for a snap election in early 2017

PM Abe enters his fifth year in office as one of Japan's most powerful leaders. His Liberal Democratic Party (LDP) not only controls both houses of parliament, but has just amended its constitution to extend his term as party president to nine years from six. That likely leaves Abe as PM through the 2020 Tokyo Olympics to 2021. Meanwhile, the opposition is in disarray. As Abe wants to push through a raft of controversial policies, he might take advantage of that and call a snap lower house election in early 2017. A decision on that may depend on how his approval rating fairs after his visit to Pearl Harbor later this month (the first by a Japanese leader since the attack in 1941).

Plenty of bills are passing, but few big reforms

Underscoring his ascendancy, Abe pushed through a deeply unpopular bill to legalise casinos (as integrated resorts) this month. He'll juggle several equally unpopular bills to strengthen Japan's military posture (his pet project) with his election calculations (see above). There's no sign yet, however, that he'll tackle much needed structural reforms, despite hinting in early June that a dual labour market would be reformed to ensure "same work, same pay". Instead, Abe has urged firms to lift modest wage growth.

Issues to watch

… nuclear power restart

… sales tax hike in Oct 2019

Two other issues need watching. Japan has just restarted its first nuclear reactor under more stringent safety rules, bringing the number in operation to 3 out of 42 and raising nuclear supply to some 6% of electricity demand (down from 20%+ prior to the 2011 Fukushima disaster). It's far from clear whether Abe's plan to return nuclear power to its former prominent position will work given popular opposition. That leaves a big question mark over fiscal stability and corporate operating costs. Second, a hike in the sales tax to 10% from 8% is still legislated (but postponed) to October 2019. A hike to 8% from 5% in April 2014 pushed the economy into a year-long recession.

Outlook for the market

A sudden fall in the Yen boosts growth in 2017

… as does a new calculation of GDP

Japan is a major beneficiary of Trump's US election victory, which triggered a surge in the US$ to 118 to the Yen from 104 before Trump's win. That reflected a dramatic widening in the interest rate differential, which means that for the first time the Bank of Japan's massive quantitative easing program is being helped rather than opposed by global trends. A cheaper Yen not only boosts the export outlook and corporate profits, but also lifts tax revenues and household income (via income from overseas investments). In the last week, the BOJ has upgraded its growth outlook for the first time since May 2015 while the government now forecasts growth of 1.5% for the FY starting April 2017 from 1.3% in the current FY. Our own forecast moves up to 0.7% for calendar 2016 (last month 0.5%) and 1.2% in 2017 (prior 0.7%). Note, that some of the lift in 2016 and 2017, plus a significant boost to growth in earlier years, is due to the latest rebasing of real GDP (to 2011 prices from 2005 prices) and a decision to include spending on R&D and intellectual property in fixed investment, as the US and most other advance countries do.

A better export outlook helps manufacturing

There are winners and losers in Asia's 2H'16 export recovery and Japan appears to be a winner. Exports on the US$ measure grew 1.6%ytd by October before November saw a 13%yoy jump and early reports suggest similar growth in December. We've lifted our export growth forecast to 3% this year and 5-7% next year after a 9.5% fall last year. Manufacturing is also doing better with the IPI measure growing 0.3%yoy in Q3'16 after a two-year fall. We now expect 1% growth in 2017.

Plus, a mild lift for consumers

Consumers rarely get a break in Japan, but November saw a surprising jump in car sales (up 9%yoy) and outbound travel (up 11%yoy), both abnormally high. We expect real growth in consumer spending to lift to 0.7% in 2017 from 0.3% in 2016 and -0.4% in 2015.

The Yen's slide continues through 2017

A weak Yen and firmer oil prices should put inflation, which broke into positive territory in October, on a mild upward path through 2017. The BOJ will be slow to tighten, but by the end of 2017 it should have nudged its policy rate to slightly positive. That leaves a big interest rate differential to the US, and puts the Yen on a downward path to 128 by Q4'17.

	2013	2014	2015	2016	2017
GDP, real growth (2005p), %	2.0	0.3	1.2	0.7	1.2
CPI, year average, %	0.3	2.8	0.8	-0.2	1.2
Overnight call rate, year end, %	0.07	0.07	0.04	-0.02	0.02
Yen to US$1, year average	98	106	121	110	123

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

China

Political & policy issues to watch

China's 2017 political goals

… a carefully staged 2nd term for Xi

… and finding a new balance with the US

2017 will be a big political year for China, with a year-end leadership reshuffle as President Xi strengthens his hold on the party at the 19th Party Congress, while a new geopolitical and commercial balance is sought with the US under President Trump. Virtually all analysis points to a carefully stage-managed transition to Xi's second term. The central developments of his first 5-year term are expected to intensify in his second term: his political dominance along with a powerful reassertion of Party leadership, with key sub-themes being rising nationalism and a revived role for the big, centrally-run state owned enterprises (SOEs). Everyone in China, from party members to foreign MNCs, has been adjusting to these developments for a year or more. Xi also redefined China's foreign policy in his first term, and he is expected to rapidly expand China's overseas commercial and military interests in his second term. The main uncertainties revolve around a Trump-led US that looks set to break with three decades of mostly stable China policy. As stability is paramount for Xi in 2017, we expect Beijing's response to be measured.

Beijing lowers the bar for 2017 growth

Economic guidelines for 2017 were released in early December following a 3-day Central Economic Work Conference for China's top leaders. The document implicitly downplays a 2017 growth target, hinting that slower growth is acceptable. Fiscal policy will still be expansionary, but at a slower pace due to a fast-rising deficit. Steps to curb a property bubble will remain centre stage, as will a cautious clamp down on shadow banking and corporate debt. In short, priority will be given to stability, which inevitably means slower progress on reforms and on closing excess capacity and shutting bankrupt firms.

Outlook for the market

Real growth continues to ebb

… as key drivers fade

… but nominal growth is steady

Two stories will play out at the aggregate GDP level in 2017. First, real growth is set to continue a gradual slowdown that started in 2012. It is a structural rather than cyclical development, with a mild downtrend for the foreseeable future as big underlying drivers go into long-term decline. But even with 4% real growth as China enters the next decade, it will be adding more to global expansion than any other economy. Second, the abnormal fall in current growth below real growth in 2015 on China's production measure for GDP (6.5% current vs 6.9% real) reversed in 2016 (we expect 8% current vs 6.6% real) signalling an easing in deflationary pressure on the production side of the economy. Current growth will likely stay at 8% or better next year even as real growth eases to 5.9%, and that will help return a bit of pricing power to industrial firms.

Firm consumer demand is central to 2017 growth

As wage growth is slowing, households are sustaining their spending by saving less and borrowing more. China's household debt has soared by 25%pa over 2009-2015, mainly driven by a 24%pa surge in mortgage loans and a 53%pa rise in credit card loans from 2009. Despite the fast rise, household debt at 44% of GDP is about half the 80% average for affluent economies. Given China's high family net worth and savings ratio, there's scope for China's household debt to rise towards 70% of GDP in the next decade. That should keep real growth in consumer demand at 6-7%pa through 2020.

A cooling property market

Property cooling measures since October have cut growth in sales by area to 8%yoy in November from 27%yoy for the first 10 months. A revival of property investment (up 6.5%ytd by November) will likely reverse in the coming months, as peak housing demand eases and high inventory levels slow building in lower tier cities.

Muted inflationary pressure

… and a sliding Yuan

Despite producer prices rebounding from -5.9%yoy last December to +3.3% this November, consumer price inflation will remain a mild 2.3% in 2017, as the transmission from China's PPI into CPI inflation has historically been weak. The Yuan is down by 8%yoy against both the US$ and its new basket of trading currencies, giving up one third of a 26% rise (on the US$) from 2005 to 2015. The fundamental drivers to Yuan appreciation (a rising trade surplus, large capital inflows, and ultra-low US interest rates), have all reversed since 2015. We expect the Yuan to reach 7.20 on a rising US$ by the end of 2017, putting the year average rate at 7.06. That's a 6% year average fall that mostly offsets a rising US$; anything faster might trigger US retaliation.

	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	4.35	4.35
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

HK's outlook hinges on the next Chief Executive

Beijing's selection of HK's next Chief Executive (CE) in March 2017 (to take office on July 1) stands out as the key political event of 2017 and potentially a turning point for HK. No candidate is likely to close the widening gap between Beijing's demand for political obedience and a local desire for continued, if not more, autonomy under the "one country, two-systems" formula, which was meant to hold until 2047. But at a minimum, the next CE needs to deliver good administration while not aggravating political tensions. The current CE, CY Leung, failed on both counts, and has just announced that he'll not seek a second 5-year term. If the next CE does no better, consumer and business confidence in HK will suffer, and HK will struggle to revitalise its economy.

… and on finding a new growth engine

HK prospered for some 200 years by being Asia's main business hub and a gateway to China. It still retains most of the advantages that underpinned both roles, including minimal but reliable regulation, excellent services, and low taxes. Yet the world has changed, and both these roles are in decline. Soaring rental costs and a US$-peg for the HK$ haven't helped. HK could transform itself into the leading platform for outbound Chinese firms, and there are signs that is happening as a flood of arriving PRC firms keeps office space tight even as Western firms downsize or move out. Yet HK's administration has trouble articulating that opportunity, focusing policy instead on brief stimulus measures and efforts to curb painfully high apartment prices.

Outlook for the market

A mild lift to 2%+ in 2017

… as exports rise

Despite its political and policy challenges, HK's economy should get a modest lift from a mild trade recovery in 2017 while local demand edges up. A weak trade recovery emerged in Q3'16 with export volumes edging up by 1.1%yoy, the fastest pace in nine quarters, while imports rose by 2.3%yoy, the strongest growth in 11 quarters. We expect the same 1-2% growth rate in volumes to continue in 2017 and 2018 (well below the 5% average for the 20 years to 2015) as China's growth slows, trade shifts to cheaper ports in China, and China's export mix changes. That will likely cap GDP growth at about 1.7%pa over 2016-20 from a 2-decade average to 2015 of 3.5%pa.

Tourism & retail face a further fall in PRC shoppers

HK's tourism and retail sectors are struggling with an 8.2%ytd fall in mainland Chinese arrivals by October after a 3% fall in 2015. Those falls brought an abrupt end to a 21% CAGR in mainland arrivals over the five years to 2014, with the inflow peaking at 47m in 2014 or 78% of all arrivals. Since then, retail sales volumes have steadily dropped and stores catering to PRC shoppers have been forced into discounts that match the Yuan's slide on the US$ or have closed. Non-mainlander arrivals were up 3%ytd by October after a 1% fall last year, but total visitor arrivals will likely fall 1-3% next year after a 4% drop this year. Meanwhile, real growth for local consumer spending will likely slip to around 1% this year after 4.7% last year. A mild lift to 1.5-2.0% is expected in 2017, which is well below the 4.8%pa pace set in the decade to 2015.

Weaker property prices but total starts remain firm

Despite a 13% surge between April and November, we expect HK residential property prices to drop next year, hit by a recent doubling in stamp duty, rising interest rates, adequate supply, and over-stretched valuations. Meanwhile, construction is set to remain firm, with a surge in public housing authorisations over the year to Q3 (tripling to 31,302) offsetting a mild easing in private housing authorisations (down 17%yoy to 20,143).

HK's rates and $ rise with US rates and the US$

With the HK$ pulled up by its US$ peg and weak local demand, inflation should ease in 2017. However, as required by the US$-peg, HK must match rate hikes by the US Fed even though demand is weak. The HK$ has climbed about 6% on China's Yuan in 2016 with a similar rise likely in 2017. That won't help the tourist sector and will put HK service operations at a relatively cost disadvantage in Asia.

	2013	2014	2015	2016	2017
GDP, real growth, %	3.1	2.7	2.4	1.4	2.2
Composite CPI (04/05), year average, %	4.4	4.4	3.0	2.9	2.4
Discount window base rate, % year end	0.50	0.50	0.75	1.00	1.75
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 difficult start to office

Having led the DPP to a landslide victory in January's legislative elections, President Tsai swept into office in May in a commanding position and with an approval rating of 70%. By December, her support had slid to 41% after a slow start by her inexperienced administration, increased tensions with the mainland, and public protests over needed but unpopular pension reforms, a bill to introduce marriage equality, and new labour laws.

Cross-straits tensions likely to rise

Souring cross-straits relations with China will be one of Tsai's biggest tests, as it threatens the core of Taiwan's industrial model (design in Taiwan, build in China). Tsai won office by opposing closer ties to the mainland, and her reluctance to agree to a "One China" consensus has seen Beijing suspend official cross-straits communications and curb mainland tourist arrivals (down 34%yoy since Tsai took office). While Tsai's gamble on a phone call to incoming US President Trump might boost her waning approval rating, it also risks triggering increased economic retaliation by Beijing.

It will be difficult to diversify away from China

President Tsai hopes that her "New Southbound" policy, which aims to foster stronger relations with ASEAN and South Asia, will diversify Taiwan's economic dependence away from China. That will be hard to achieve. Taiwan's industrial integration with China over the last 15 years has transformed the global IT hardware industry, while boosting China's industrialisation and halving Taiwan's export growth (over 55% of export orders received are now met by overseas factories, mostly in China). While a boon for global IT hardware buyers, it has meant much weaker growth for exports, jobs, and taxes in Taiwan and that means weaker spending by consumers, corporates and governments. Tsai is grappling with the right problem, but may have the wrong answer.

Outlook for the market

2017 gets a mild lift as exports recover

With GDP growth rising to 2%yoy in Q3'16, thanks to better local demand and a mild rebound in manufacturing and services, full 2016 growth should be 1-1.5% after a weak 0.7% in 2015. Export growth has gained momentum in recent months, while other indicators, such as building permits, consumer and business confidence, and job growth, point to a mild recovery in 2017. Thus, we expect GDP growth to improve to a little over 2% next year, well down on the 3.5%pa pace notched in 2005-15, but a bit above the government's forecast of 1.9%.

… led by a jump in IT exports

Exports have improved since May, and grew at their fastest pace in almost four years at 13.4%yoy (US$ basis) in November. The surge was driven by a 26.7%yoy jump in electronic components exports, a 16.6%yoy increase in machinery exports, and a 6% rise in information and communication technology exports. Should exports continue to improve, real growth in manufacturing GDP could rise to 3-5% in 2017 from an expected 1.5-2% lift this year, and a 0.5% fall in 2015.

But local demand will remain weak

With consumer confidence at a three-year low and jobs growth in a long-term decline, and lately touching lows not seen since 2009, real growth in consumer spending is likely to slip to around 2%pa over 2016-17 from 3%pa over 2014-15. The outlook for capex is not much brighter, with new building permits down 20%ytd by October from a 15.5% fall in full 2015, and a 3% drop in 2014. We expect capex growth to ease to 1-1.5%pa in 2016-17 from a 1.6% lift in 2015.

Inflation is heading up as the NT$ slips

Inflation has inched up in the last couple of months, touching an eight-month high of 2%yoy in November. The NT$ had risen some 4% against the US$ by September, but has since slid by over 1% on the greenback as the US Fed delivered its December rate hike. With the central bank indicating that it will intervene to stabilise the currency if needed, we expect the NT$ to stay in a 31-33 range through 2017.

	2013	2014	2015	2016	2017
GDP, real growth, %	2.2	4.0	0.7	1.4	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	31.9

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

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South Korea

Political & policy issues to watch

Political turmoil & policy gridlock to continue into 2017

South Korea faces six months or more of political paralysis after the impeachment of President Park Geun-hye over an influence peddling scandal in early December. The Constitutional Court has up to six months to decide her guilt. If convicted, then an election must be held within 60 days (watch April or May); if found innocent, she'd return to office for the last months of her single 5-year term (to February 2018, with a scheduled election in December 2017). Both the public and opposition parties smell blood, and want to topple her government sooner. The loss of a majority in the legislature by Park's Saenuri Party last April looks critical in retrospect, as the opposition-run legislature now aims to frustrate if not topple the interim government led by PM Hwang Kyo-ahn.

Korea's next government will head left

At our Q4 forecast update we discussed the damaging confluence of economic dislocation and soaring public distrust of politics as usual in Seoul. That boosted left-wing opposition parties in the April poll, and the swing in popular mood to the left is set to accelerate as the next presidential poll approaches. Moon Jae-in (former head of the Democratic party who lost to Park in the 2013 election) leads in the opinion polls, followed by the UN Secretary General Ban Ki-moon, and Lee Jae-myung, an outspoken city mayor who captures Koreans' rising distrust of the political and business establishment.

… tough times ahead for the chaebol

The political winds are now firmly against Korea's large conglomerates (the chaebol). Apart from being linked to Park's influence peddling scandal, the public is furious with the offshoring of production, which is seen as contributing to high youth unemployment, heavy job losses in traditional industries, and a squeezed middle class.

Outlook for the market

Slower growth as local demand ebbs

GDP growth will slip to 2% in 2017 from 2.6% in both 2016 and 2015, and 3.3% in 2014. This is despite an expected mild export lift to 2-4% growth (US$ basis) after 7-8%pa falls in 2015 and 2016. The problem is domestic demand, which faces three headwinds: Park's big 1H'16 stimulus is fading and policy making has stalled; household debt has soared and consumers will pull back on debt-fuelled spending; finally, political turmoil means weak business and consumer sentiment. Even the mild export lift is uncertain, with the manufacturing PMI at 48 in November (below the 50 neutral expansion/contraction level), on the back of falling production and new orders.

Consumers pulling back as sentiment slips

Real growth in consumer spending will ease towards 2% in 2017 from an estimated 2.7% in 2016 as employment conditions worsen and households stop piling up debt to support consumption. Car sales fell 10.8%yoy in Q3'16 after a 12.9% increase in 1H'16, while the Bank of Korea's (BOK) consumer sentiment index fell to 95.8 in November, its lowest level since 2009.

… capex growth is also set to slow

Fixed investment growth is set to slow to 3% in 2017 from an estimated 4.4% in 2016 as Park's infrastructure stimulus fades. As a result, real growth in construction (on the GDP measure) will slow to 2-4% next year after a 10-12% surge this year. Construction permits (by floor area) fell sharply in recent months, and so did building commencements. Moreover, public capex real growth slowed to 2.6%yoy in Q3'16 after surging 10.5% for the year to Q2'16, and it may well contract in the coming quarters.

Watch for a weaker Won

Despite inflation edging up to 1.3%yoy in November, rising political uncertainty and weaker domestic activity should prompt the Bank of Korea to keep its policy interest rate at the current record low of 1.25% well into 2017. None of that has helped the Won, which is on track to fall some 2% in December. We expect the Won to fall to 1,233 by Q4'17, as the US$ remains on a broad upswing.

	2013	2014	2015	2016	2017
GDP growth, %	2.9	3.3	2.6	2.6	2.0
CPI, year average, %	1.3	1.3	0.7	1.0	1.6
BOK Base rate, year-end, %	2.50	2.00	1.50	1.25	1.25
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

Hard-line Islam pushes into the political contest

… and is cautiously opposed by the status quo

The blasphemy trial underway for Basuki "Ahok" Tjahaja Purnama, the current Jakarta governor who hopes to recontest his seat in the February 15 election, marks a turning point for politics. Ahok, Indonesia's leading politician of Chinese ancestry, is charged by Islamic radicals associated with the Islam Defenders Front (FPI) with quoting the Koran during an election rally. While Islamic scholars note the charge is trivial if not fallacious, the incident has given FPI an ideal opportunity to whip up two massive protest rallies that have signalled its brand of hard-line Islam is now a force to be reckoned with. The top of Indonesia's political establishment, ranging from leaders of the main Islamic parties to heads of the police and security organisations, have scrambled to present a countervailing force. While Ahok is simply a pawn in this struggle, it will be interesting to see the outcome of his expedited case, as the judiciary is under intense pressure from Islamists to jail him. Indonesia is adept at containing Islamic terrorists, but the fast rise of a populist and (so far) peaceful, hard-line Islamic opposition is a new challenge to the status quo.

Fake news on social media drives communal wedge tactics

Indirectly, the Jakarta gubernatorial race is also the biggest contest prior between Indonesia's most powerful politicians prior to the 2019 elections. Prabowo Subianto of Gerindra, Megawati Sukarnoputri of PDI-P, and President Joko Widodo ("Jokowi") each back contenders, who include Agus Yudhoyono, son of ex-President Yudhoyono. Some of these contenders could well play to, or covertly stir-up, hard-line Islam to gain an advantage. An explosion of anti-Chinese fake news on local social media sites suggests that communal wedge tactics are on the rise, which is dangerous in a country with a long history of pluralism, but which also happens to be the world's largest Muslim country.

Twists & turns in reform policy

Meanwhile, President Jokowi is pushing ahead with his reforms. A 15th package to cut red tape will be released soon, and Jokowi has made clear that if cabinet ministers move slowly on reforms, they risk being dumped in 2017. It looks like the government is also about to partially rollback a ban on the export of unprocessed minerals, as that has exacerbated a slump in exports and government revenue. That will hurt many of the firms, notably from China, that have committed to local smelters.

Outlook for the market

A broad-based lift in growth in Q4'16 after 3 weak years

… helped by near record low inflation

After three years of growth stuck close to 5% or a bit lower, the economy finally appears to have started a broad-based lift. Exports, which fell 8%ytd for the first 10 months rose 21%yoy in November, while imports, which were down 7.5%ytd at October, rose 9.9%yoy in November (all in US$ terms), suggesting better local demand. That seemed to be the case, with vehicle sales lifting from 2.6%ytd by October to 15%yoy in November while motorcycle sales reversed a 9.3%ytd fall in the first 10 months with a 6.6% rise in November. As inflation is stable around 3.5% and the currency has steadied after a small drop on a rising US$ over the last month, Indonesia is set for a mild recovery in 2017. Given the likely strength of Q4, we've nudged our 2016 forecast up to 5.1% (prior 5%) while 2017 remains at 5.7%.

… and a jump in consumer sentiment

Consumer optimism on Bank Indonesia's index jumped by 14%yoy for the three months to November after two years of flatlining or falling. Indonesia's low-income households are very sensitive to inflation, and with this year's 3.4% rate one third of the 20-year average of 10.6% and commodity prices firming, real incomes are rising. We expect real growth for consumers to reach 5.5% in 2017 and 6% in 2018 from 5.1% this year.

Low rates and a mild fall for the Rupiah

Indonesia's foreign exchange stability was reaffirmed in December when Bank Indonesia left its policy rate unchanged at 4.75% and the rupiah remained relatively stable. A small rate rise in 2017 should help limit the currency's fall on a rising US$ to about 4% in 2017.

	2013	2014	2015	2016	2017
GDP, real growth, %	5.6	5.0	4.8	5.1	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	13,296	13,825

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 election in 2017

… as PM Najib fights to escape the 1MDB scandal

PM Najib Razak is likely to pull the scheduled 2018 election forward to 2017, possibly as soon as March. Using the considerable power of incumbency for the ruling UMNO party, which has not lost an election since independence in 1957, he'll aim to steamroll a divided opposition and push the 1MDB scandal, in which he appears deeply implicated, behind him. Yet, his UMNO-led coalition might struggle to win back the popular vote, which it lost in the 2013 election. Voters are suffering from fast rising prices and weaker jobs and income growth. Moreover, Mahathir Mohamed, PM from 1981-2003 and one of Malaysia's most formidable politicians, leads a new opposition party after being forced out of UMNO for challenging Najib on corruption. Najib will fight to retain his position by divisive community tactics (pandering to hard-line Islamists and attacking Malaysians of Chinese descent) as well as by buying the support of UMNO's local chiefs. The election will do little to remove the shadow of corruption that hangs over the government, and which hinders progress on most big projects apart from those that China picks up.

Economic fundamentals are OK

Despite the 1MDB scandal pointing to extensive corruption at the highest levels of government, the economic fundamentals remain quite good. In its latest review, the IMF notes that economic diversification, a flexible exchange rate, deep financial markets, and low public debt have helped sustain average growth of 5% for the decade to 2015. One of the main risks is elevated household debt, and that may lead to weaker consumer demand growth over the next few years as wage growth slows and interest rates rise.

Outlook for the market

GDP growth slips to 4% in 2017

GDP growth eased to 4.1%ytd in the first three quarters of 2016 from 5% in full 2015 and 6% in 2014. We expect growth to settle at 4% in 2017, as domestic spending slows to 4% growth from an estimated 4.7% in 2016 and 5.1% in 2015. Households and the government are facing budgetary constraints, while businesses investment appetite is limited by political uncertainty and excess capacity in several sectors. Weak manufacturing conditions have kept the purchasing managers' index (PMI) below the 50 expansion/construction threshold since early 2015. In November, the PMI fell to 47.1, a five-month low, on the back of falling factory output and new orders.

Consumers are pulling back

Falling passenger car sales and a steep slowdown in personal and housing loan growth suggest that consumers are uncomfortable with excessive household debt (89% of GDP) and concerned about cooler employment and housing markets. We expect private consumption growth to ease to 4.3% in 2017 from an estimated 5.8% in 2016, and a world-beating average of 7.4%pa over 2003-15.

Public works will help offset weak private capex

Public infrastructure (mostly extension of urban railways, highways and prestige real estate projects) will be the main driver of fixed investment activity. We expect it to grow 3.8% in 2017 from an estimated 2.7% in 2016. Public infrastructure development needs to be sufficiently vigorous to offset the impact of weak private capex. Total investment approvals fell 43.7%ytd by Q3'16, with domestic approvals down 58%ytd and foreign approvals down 8.4%ytd. Residential activity will also be weak in line will falling housing approvals.

A struggle to support the M$

Bank Negara was forced to intervene to moderate a steep fall of the M$ to the current 4.48 against the US$ from 3.90 in April this year. A weak M$ helps exports, but a rapid currency decline hurts investor sentiment and can be destabilising. M$ vulnerability should prevent the central bank from easing monetary policy, even though inflation slowed to 1.4%yoy in October from 4.2%yoy in February, and the economy would benefit from lower interest rates.

	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

Behind Duterte's bluster is a drive for change

President Duterte's violent anti-drugs campaign, bursts of anti-Americanism, and a sudden reversal of policy in the South China Sea dispute with China have done little to dent his popularity. Together with the backing of most senators and a super majority in the lower house of Congress, that gives Duterte scope for big and sometimes unexpected policy moves. That appears to be what most Filipinos want, as they seek an end to a surging drug epidemic and sustained improvement in the lives of average Filipinos. Opposition to Duterte is minimal, although VP Lena Robredo has resigned as housing secretary after she was excluded from cabinet meetings following her criticism of drug offensive killings. Relations with the US are also sliding due to the killings, and to Duterte's call for weaker US ties. At present, such opposition has little traction and no impact on political stability, policy, or the economy. Business sentiment also remains strong, as Duterte has made clear his commitment to a strong market economy.

Overheating is a risk in 2017

With GDP growth accelerating to a three-year high of 7%ytd by Q3'16 from 5.4%pa in the last decade, capacity is increasingly strained and inflationary pressure is on the rise. Domestic demand has surged for the last year, lifting consumer and capital goods imports and causing the trade deficit to blow out to a record-high US$20bn by October — some 63% above the previous record set in full 2015. Yet, a classic emerging market crisis due to a big current account deficit and rampant inflation should be avoided, thanks to the US$25bn a year business process outsourcing (BPO) sector, steady offshore Filipino worker (OFW) remittances, strong tourism, and a mild rate tightening cycle through 2017.

Outlook for the market

GDP growth of 6-7% for the next few years

Despite the risk of overheating, the economy benefits from favourable demographics, steady growth in BPO and OFW income, good monetary policy under a strong central bank, and sound government finances with low debt. Those factors bring some stability to the outlook, and should underpin 6-7% growth for the next few years. However, companies will need to watch out for skilled labour shortages, upward pressure on wages, and shortages of key inputs.

Thanks to a surge in capex

Fixed investment surged 25.4%ytd by Q3'16, after a 15% lift in 2015. The increase was driven by a 45% spike in public capex, a 35% jump in plant investment, and a 15% lift in construction capex. Meanwhile, capital goods imports grew 31%yoy in 1H'16, from 21% in full 2015. With business expansion plans at a one-year high and construction permits rising 8.8%ytd by September from a 4% increase in full 2015, capex growth should come in at around 22-24% in full 2016, before easing to a solid 13-14% in 2017, still well above the 8.3%pa pace notched up over 2010-15.

While consumers benefit from a strong jobs market

A 4%ytd lift in OFW remittances by October, buoyant consumer confidence, and a booming labour market that saw the unemployment rate drop to an eleven-year low of 4.7% in October. That should lift real growth in consumer spending to a multi-decade high of over 7%pa in 2016-17, from 6.3% in 2015. That strength is reflected in the surge of consumer electronics and home appliance imports, which have each risen some 48%ytd by September, from 19% and 31% respectively in full 2015. Meanwhile, passenger vehicle sales were up a solid 14%ytd by October, albeit down from 29% growth in full 2015.

A mild lift in interest rates will support the Peso

Inflationary pressure continues to creep up, with the CPI rising by a 21-month high of 2.4%yoy in November. While inflation remains well within the central bank's 2-4% target range, it will likely breach the central bank's comfort zone by end-2017. That's likely to push the policy interest rate up next year, which, along with BPO and OFW inflows, should help the Peso stay in a 50-51 range against a strengthening US$ in 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

Singapore looks good as risk and instability rise across Asia

While our political analysis usually focuses on local developments, the most striking point in Singapore's political outlook is its position relative to the region. Domestic politics elsewhere in ASEAN are becoming unusually messy, making Singapore's orderly calm and safety more valuable. Moreover, Asia's other great hub city, Hong Kong, is struggling with poor politics, a declining value proposition, and soaring operating costs. While Singapore is rightly worried about 1-party democracy stultifying innovation, it is constantly searching for and testing solutions. Moreover, its policy of maintaining adequate supply of commercial and residential property at a reasonable price plus a well-managed exchange rate underpin long-term growth. Key issues to watch are the handover, at some future point, from PM Lee Hsien Loong (64, and in power for the last 12 years) to a successor (we expect that to be smooth) and sometimes tricky relations with neighbours.

Companies should focus on Singapore's changing value proposition

Like other advanced economies, Singapore is struggling with a slowdown in productivity growth (from an average 3.4%pa in the 35 years to 2010 to 0.4%pa in the last five years) and a fast-ageing population. Countering that requires a major overhaul of Singapore's value proposition. Over the last four years, policy has swung away from relying on cheap foreign labour to winnowing out a surprisingly large manufacturing sector (18% of 2016 GDP and with more manufactured exports than giant neighbours such as Indonesia and the Philippines). Capital intensive and high value-added manufacturing will be retained, along with a higher value added services sector. A strong focus on innovation and a start-up culture backed by PE is emerging.

Outlook for the market

Don't expect more than a mild lift in 2017

Real growth of 1.7%ytd by Q3'16 suggests full 2016 growth of just 1.6%, making this year the weakest in the last two decades, bar three crisis years (the 2009 GFC, the 2001 tech wreck, and the 1997 Asia Crisis). 2017 has to be better, but not by much. We expect slightly more than 2% growth thanks to a mild lift in global trade and better capex growth.

… led by better exports

The value of new export orders reached a 22-month high in November suggesting good traction for Singapore's exporters in an emerging but weak global trade recovery. However, export volume growth of about 3% in 2017 and 2018 will be well below the 2-decade average to 2015 of 7%. Manufacturing GDP should rise by a mild 2-2.5% next year from an expected 1-1.5% in 2016, well below the 4.8%pa pace in 1995-15.

… while consumers hold back

Retail sales volume growth remains weak, languishing at 1.7%yoy I October from a recent high of 7.2%yoy in June 2015. The consumer downturn reflects a weak labour market, with the resident unemployment rate near a five-and-a-half-year high and the job vacancy to job seeker ratio down at a six-and-a-half-year low. Meanwhile, manufacturing employment is in a steep downturn, while growth of construction and services employment are both falling. Increasing labour market slack is likely to dampen wage growth and consumer confidence, and suggests consumer demand growth is likely to slip to 2%pa in 2016 and 2017 from 4.5% in 2015 and a decade average to 2015 of 3.5%.

A modest lift in capex ahead

Despite an 11.8%ytd lift in public capex by Q3'16, overall fixed investment slumped 1.6%ytd, as private capex fell 4.9%ytd on continued weakness in construction, machinery & equipment, and intellectual property investment. That's likely to see capex fall by around 1% in full 2016, after a 1% dip last year, and a 2.6% fall in 2014. While better transport, machinery & equipment, and intellectual property capex should help to lift overall fixed investment next year, we expect low business confidence, lower profit expectations, and a large building oversupply to cap 2017 fixed investment growth at about 1.5-2%.

Mild inflation next year and a weaker S$

Deflationary pressure continued to ease in October, with the CPI sliding just 0.1%yoy, up from -1.6%yoy in May. We expect weak inflation to return in 2017. Yet, with growth likely to stay sluggish next year, the central bank is likely to ease monetary policy by allowing the S$ to weaken to about 1.46 on the US$ by end 2017.

	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

Thais welcome a new King

… bringing a year of muted politics

With King Maha Vajiralongkorn's ascension to the throne on December 1st, a layer of political uncertainty in Thailand's outlook has faded. Yet, it remains unclear how Thailand will cope with various tensions caused by growing social divisions and rising military power. The divide between rural Thais (the red shirts) and an urban elite and middle class (the yellow shirts) has been at the centre of Thailand's fractious political landscape for over a decade. While the political contest will be muted until next October out of respect for King Bhumibol (whose cremation in likely in late 2017), these tensions could rise thereafter. The next event to watch is the 2017 (or 2018) election, which the army hopes will replace the interim army-run administration with an elected but army-guided government.

… and time for the army to consolidate its hold on power

General Prayut led the 2014 coup, has headed government since then, and may well lead an elected government after the next poll. The success of his government will depend on three developments. The first is maintaining political stability, which has improved since his 2014 coup ended a decade of political turmoil and street battles. At the same time, the army has also avoided internal divisions and leadership battles. Second, Prayut needs to reduce chronic corruption, deliver a modicum of good government, and improve the livelihood of rural Thais. Reports suggest that some progress is being made in all three areas. Finally, he needs to revive domestic demand, particularly private fixed investment. The jury is still out on this (see below). Our view remains that Prayut will stay in control well into the next decade, and that companies should engage with his government.

Outlook for the market

Better growth is possible next year

… as exports edge up

With GDP up 3.3%ytd by Q3'16, Thailand should grow by 3.2% in full 2016. Next year, growth will hinge on a revival in private investment, how the mourning period affects consumer demand and tourism, and on better growth in exports, tourism, and agriculture. Exports should lift by 3-5% next year (US$ basis) after four years of contracting. On balance, we expect weaker consumer growth to be offset by a resilient tourism sector, better agricultural output, and a mild export recovery. That should lift GDP by about 4% next year, the fastest pace in five years.

A muted recovery in consumer spending

… but watch car sales

Real growth for consumers rose 3.2%ytd by Q3'16 from 2.1% in full 2015 and just 0.6% in 2014. As Thais avoid conspicuous spending over the next year, growth is likely to slip to 2.8% in full 2017 after 3% this year. A recent lift in retail sales was mainly driven by non-durable goods purchases, while durable goods struggled to lift, despite a surge in internet sales. One area that could improve is passenger vehicle sales (down 4.9%ytd by October), which should benefit from the end of a five-year ownership requirement imposed under the 2011-12 first-car buyer's scheme.

The outlook for private capex is still dim

Public investment grew 10%ytd by Q3'16, thanks to a 15%ytd lift in public works following a 34% jump in 2015. Yet private capex rose just 0.6%ytd to Q3'16, with non-dwelling investment sliding 2.9%ytd following a weak 1.3% lift in full 2015. Dwelling investment was up just 0.9%ytd by Q3'16 from a fall of 0.8% in 2015, while equipment capex was flat after falling 0.7% in 2015. Data for new housing construction permits, business sentiment, capacity utilization, and corporate loans all point to continued private capex weakness. Total capex real growth is likely to remain stuck at 2-3% in both 2016 and 2017.

Weak inflationary pressure with a soft Baht

Inflation ticked up to a 23-month high in November, but remains below the Bank of Thailand's 1-4% target range. Prior to Trump's US election win, the Baht had climbed 4% on the US$ from a January low of 36.1. However, it has since softened to 35.6 and should ease through 2017, with the central bank set to keep the policy interest rate at a multi-year low of 1.50% to support an export recovery.

	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 pro-market government

… selling out of SOEs & boosting the equity market

… which helps private firms fund growth

A year after pro-market reformer PM Nguyen Tan Dung was forced to retire following the reappointment of his rival, Nguyen Phu Trong, as Communist Party General Secretary, concerns that Trong's conservative views would slow moves towards a market economy have given way to faster reforms, notably in the selling down (or "equitization") of government stakes in state-owned enterprise (SOEs). Notable recent and pending sales include state equity in dairy firm Vinamilk and in the main brewers for Hanoi and HCM. The process is, however, limited by the small stakes on offer and a reluctance to lift a 49% foreign ownership cap, although that may now be legally possible for many firms. That's hurt some IPOs, yet others, like HCM brewer Sabeco, have soared after listing. Foreign MNCs are also jostling for cornerstone stakes. While messy and slow, progress on SOE equitization is deepening the local equity market, which helps IPOs by private firms, such as VietJet (its recent IPO values it at US$1.2bn, and with 20 Airbus and 100 Boeing planes on order, it will soon be bigger than national flag carrier Vietnam Airlines).

FDI inflows soar

… but watch for overheating in 2017

Stable pro-market leadership and better economic management have helped drive an almost three-fold surge in foreign direct investment (FDI) into export-led manufacturing since 2010. Together with strong domestic demand, which has grown 6.9%pa in the last two decades, that should underpin one of the fastest growing economies in Asia for the next decade. However, two issues typical of a fast-emerging economy - a weak current account (due to high capital and consumer goods imports) and high inflation - need watching, as both could emerge over the coming year.

Outlook for the market

Domestic demand underpins a strong outlook

Growth likely slowed to about 6% in 2016 as a severe drought slashed agriculture output. With recent good rains, a rebound is likely in 2017, and GDP growth might reach the government's 6.7% target, although we think 6.5% is more likely (up from last month's 6% forecast). With a rising middle class set to underpin robust domestic demand for years to come, Vietnam is one of few economies set to sustain 6%+ GDP growth through the next decade. Meanwhile, inflationary pressure has started to pick up and is likely to continue next year, requiring a modest lift in interest rates.

Robust manufacturing growth ahead

… as exports continue to lift

On the back of a record US$16.5bn in manufacturing investment in 2015, up from US$4bn in 2005, Vietnam's export manufacturing sector continues to outperform the rest of the region, with growth accelerating to 13.1%yoy in Q3'16, a pace not seen since Q3'06. It's being helped by strong exports, which are up 7.5%ytd by November from an 8.1% lift in full 2015. Exports of computer and electrical components were up 16.6%ytd by November, while growth in exports of phones and spare parts cooled to 11.1%ytd from 27.8% in full 2015. We expect manufacturing GDP to lift by about 11% in both 2016 and 2017, up from 10.6% in 2015 and an average 8.7%pa in the last five years.

Strong growth in an emerging middle class

… driving a car sales boom

With fast rising incomes and some of the most optimistic consumers in the world, we expect consumer spending to grow a robust 7-7.5%pa real terms in 2016-17, from 5.9%pa in the last five years. As a measure of the growing wealth of Vietnamese consumers, imports of consumer goods have more than doubled since 2009, reaching US$14.4bn last year. Meanwhile, passenger vehicle sales are booming, and should reach over 150,000 unit sales this year, up from 78,715 in 2014. Lower registration fees and vehicle import taxes should keep car sales strong next year.

Inflation keeps rising as the Dong edges down

Inflationary pressure has been mounting since the start of the year, with the CPI rising 4.5%yoy in November. We expect inflationary pressure to stay elevated through 2017, which along with robust credit growth, will likely force the central bank to lift the policy interest rate from 6.5%. The Dong was one the region's firmer currencies through to August, but has since weakened on a fast rising US$. We expect the Dong to ease 1.5-2% in full 2016, before weakening a further 4-5% next year on a rising US$.

	2013	2014	2015	2016	2017
GDP, real growth, %	5.4	6.0	6.7	6.0	6.5
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

Demonetisation has weakened PM Modi

… and will delay GST implementation

PM Modi's surprise demonetisation move on November 8 has substantially changed India's political and policy outlook. Since then, Modi's BJP-led government has lost control of parliament in the face of opposition protests over demonetisation that have halted progress on bills. That includes enabling bills for the GST, which Modi had committed to implementing on April 1, 2017. Finance Minister Jaitley now hints of implementation sometime before September 2017, as that's when a constitutional amendment, which has already passed, will end the ability of states to impose many current taxes. While that should force New Delhi and the states into quick agreement, there's little sign of that happening yet, as arguments escalate over implementation and the complexity of four separate GST rates (from 5-28%). More broadly, the government's constant amendments to the demonetisation program hint at chaotic planning, and that's hurting poorer consumers and small businesses (one newspaper has counted 63 changes in 43 days).

Watch the 2017 budget on Feb 1

… extra funds for the poor

… & also for infrastructure

… while S&P leaves its BBB- rating in place

Having lost control of parliament and endangered the biggest reform in his first term, PM Modi must scramble to prevent a slide in growth and a collapse in support in key state polls, notably UP (India's largest state), which may come as early as February. Presentation of a combined general and railway budget on February 1 will be the first major opportunity to rebuild support. Extra spending will be focused on the poorest households, and, with an eye on the UP elections, that will likely include support for farmers. Poorer households should also benefit from a lift in the minimum taxable income to Rs300,000 (about US$4,425) and a trimming of tax rates at the low end of the scale. Incentives to spur growth in digital transactions and infrastructure are also likely. Data to October suggests the government is on track to meet this year's deficit target of 3.5% of GDP thanks to good tax revenue growth. Despite that, ratings agency S&P indicates it is likely to leave India at BBB-, its lowest investment grade rating, for another two years.

Outlook for the market

Demonetisation hits poorer house-holds hardest

… and those who serve them

… while the middle class are less affected

At our November forecasting sessions, we nominated vehicle sales as the first of the useful pointers to the impact of demonetisation. That is out now, and it makes interesting reading. Total vehicle sales fell 4.2%yoy after growing 8.4% for the year to October. Hardest hit were 3-wheeler sales, down 22%yoy (from an 8% fall in the year to October), as cash-based, tuk-tuk drivers were at the epicentre of demonetisation. 2-wheeler sales swung from 9% growth in the year to October to a 5%yoy fall in November, while commercial vehicles swung from 11% growth to a 7%yoy fall (with smaller trucks being hardest hit). By contrast, passenger vehicle sales grew 5.8%yoy in November, down mildly from 9% growth for the year to October. Broadly, that confirms that low-income households, and the businesses that serve them, were hardest hit. Middle-income India, with access to bank accounts and financing for car purchases, faced mild adjustments. Domestic air passenger growth for November, up 23%yoy, suggests the same, as that was bang in line with average monthly growth of 23% for the year to October.

GDP growth gets trimmed but stays close to 7%

Given the November data, we've stuck with last month's forecast in which growth for 2016 (we use calendar years) was cut to 6.6% from a prior 7.1%. Last month, we also trimmed our 2017 forecast to 7% (prior 7.8%), as we were – and remain - concerned about cumulative disruption from big currency and tax changes.

Low inflation while a firm RBI policy rate limits the rupee's fall

Weak demand following demonetisation pulled November inflation down to 3.6%yoy. Despite that, the Reserve Bank of India (RBI) left its policy rate at 6.25% in December, although we expect a rate cut in early 2017. Meanwhile, commercial banks, flush with liquidity, are under pressure to trim their base rates. Firm interest rates and relatively low offshore debt have helped stabilise the Rupee into December, but we still expect a 4% fall on a rising US$ next year, roughly matching this year's rate of decline.

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	5.0	4.0
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	67.1	69.8

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

Policy making stalls

… as a weak government faces populist challenges

Policy-making in Australia has become difficult as fringe parties and independents have tightened their hold on the balance of power in the senate after the July 2016 elections. Meanwhile, frustration with political gridlock has seen voters deserting both the ruling Liberal-National Coalition and the opposition Labor Party. Nearly a quarter of the primary vote went to minor parties in 2016, compared to 14.5% in 2007 and 10.7% in 1993. As in Europe and the US, fringe parties have jumped on populist issues ranging from migrants to opposition to imports and foreign investment. Recent opinion polls point to large gains for the anti-immigration One Nation party in the next Queensland state elections due by 2018. Similar trends are apparent within the two main parties, and PM Malcolm Turnbull often seems to struggle as much with his own party's right wing, which wants to return ex-PM Tony Abbott to power, as the opposition and minor parties in the senate.

Still AAA rated

… with help from rising commodity prices

All three main credit rating agencies (Moody's, S&P and Fitch) confirmed Australia's AAA rating after the government presented a mid-year fiscal outlook in December that forecast a return to a budget surplus by 2021. Underpinning the budget were quite conservative forecasts for growth in GDP, salaries, corporate profits, and commodity prices. If the recent rebound in iron ore and coking coal prices is sustained, the budget could return to surplus sooner. The main risk worrying the rating agencies is that the senate won't pass budget savings measures. The IMF is more relaxed about the budget deficit in its latest review of Australia, noting that public debt of 38% of GDP in 2015 is well below the OECD average of 115%. It's urged the government to lift public infrastructure spending.

Outlook for the market

Better exports to lift GDP growth in 2017

GDP growth eased to 1.8%yoy in Q3'16 from 2.8%yoy in 1H'16, mostly due to a reduced contribution from net exports and destocking. Domestic demand growth was steady at 1.5%yoy, while private consumption slowed to 2.5%yoy from 3%yoy. The fall in fixed investment eased to -2.5%yoy from -3.6%yoy. GDP has been growing consistently faster than domestic demand since Q1'13, and this is likely to continue into 2017. We expect GDP to grow 2.8% next year from an estimated 2.5% in 2016 with the help of stronger net exports. Meanwhile, domestic demand is expected to rise by 1.7% after a 1.5% rise in 2016.

But consumers will be cautious

Households are benefiting from a booming housing market and record low interest rates, but have accumulated excessive debt (125% of GDP) and face employment uncertainties. Jobs growth eased to 1.5%yoy in Q3'16 from 2.7%yoy in Q4'15, with full-time employment growth turning flat from a peak rise of 2.3%yoy in Q4'15. Retail sales growth slowed to 3.2%yoy in Q3'16 from 5.9%yoy in Q3'14, as consumers are becoming more cautious. Consumption growth is likely to ease to 2.6% in 2017 from an estimated 2.8% in 2016 and 2.7% in 2015.

A 6-year fall in capex is slowing

Fixed investment has been sliding on a year-on-year basis since Q1'13, but the pace of decline eased to -2.5%yoy in Q3'16. The prolonged capex decline reflects the end of Australia's mining investment boom, which was only partly offset by fast-expanding residential construction (up 9.4%ytd by Q3'16 and by 10% in full 2015). The latter is set to moderate, as housing approvals growth eased to 3%yoy in Q3'16 from 24%yoy in Q2'15. However, with the slide in mining investment also easing, we expect the fall in total capex to ease to 1% in 2017 from an estimated 3% fall in 2016.

Rising prices for commodities support the A$

With inflation stabilising at 1.2%yoy in the first three quarters of 2016, the RBA's monetary easing cycle appears to have bottomed, with the policy interest rate at a record low 1.50% since August 2016. The A$ has held up better as the US$ surge in the wake of Trump's US election win, thanks to big gains in commodity prices. If export prices stay on an uptrend, the A$ could move up towards 80 cents on the US$ by end-2017.

Year ending December 31	2013	2014	2015	2016	2017
GDP, real growth, %	2.1	2.8	2.4	2.5	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

PM Key steps down at the top of his game

The resignation of PM John Key in early December was a huge surprise, as his high approval ratings almost guaranteed a fourth term for him and his National party in the upcoming 2017 elections. A November Roy Morgan opinion survey showed 49.5% support for the ruling National party versus 37.5% for a potential Labour/Greens opposition alliance. Key has been in power since 2008, presiding over a steady acceleration in growth thanks to well-targeted reforms. These include a lift of the GST rate to 15% in exchange for steep cuts in personal and company tax rates, extensive welfare reforms, and partial privatisation of state electricity assets. His government skilfully navigated a series of external shocks, such as the 2008-09 global financial crisis, the devastating Christchurch earthquake of 2011, and the steep fall of milk prices (NZ's main export) in 2014.

Bill English takes over

… and can offer tax cuts ahead of the next election

Finance Minister Bill English, who replaced Key as PM, is considered the architect of the government's economic reforms and credited with returning the budget to surplus in 2015 from a large deficit (9% of GDP in 2011) in the wake of the Christchurch earthquake. That required slashing public spending from 39.9% of GDP in 2010 to an estimated 34.5% in 2016. Some saw that as excessive, as NZ's public debt is one of the lowest in the OECD (24.6% of GDP in 2016). However, with support from a surging budget surplus this year, that set the government up to offer personal tax cuts next year. That should help English in the 2017 election contest. His main challenge before then will be corralling a runaway housing boom (Auckland home prices nearly doubled in the last nine years), which has pushed the market beyond the reach of first-home buyers and may well undermine household and bank balance sheets when it deflates.

Outlook for the market

Strong migrant inflows lift growth

Strong fixed investment (mostly housing) and net exports helped lift GDP growth to 3.5%yoy in 1H'16 from 3% in both 2015 and 2014. Surging net migration (a record high 70,400 in the year to November) is boosting demand for consumption and housing, while expanding NZ's growth potential through an increased labour force. Along with booming tourist arrivals (a record high of 3.45m in the year to November), migrant inflows are helping to offset the impact of weak dairy prices in the economy. The continuing strength of migrant arrivals suggests that GDP growth in 2017 should match the 3.4% we expect for 2016. That's faster than our previous 2017 growth forecast of 3.2%.

Consumer growth stays firm

… but capex growth slows

We expect private consumption growth to stay elevated at around 3.3% in 2016 and 2017 from 2.5%pa in 2014 and 2015, boosted by high immigration and a firming labour market. A steep rise of employment growth to 6.1%yoy in Q3'16 from 1.3%yoy in Q4'15 helped push unemployment down to 4.9% from a Q3'12 peak of 6.7%. We expect capex growth to ease to 3% in 2017 from an estimated 4.3% in 2016, as housing construction growth slows to 4.8%yoy from an estimated 9.5% in 2015 (11.5%yoy in H1'16). The housing market may be entering a cooler period, as housing transactions have been falling on a year-on-year basis since July 2016, after their growth peaked at 42%yoy in August 2015.

Monetary easing ends

… & the NZ$ drifts lower

Having cut its policy interest rate to a record low of 1.75% from a recent 2015 peak of 3.5% the RBNZ signalled the end of its monetary easing cycle. The central bank expects inflation to lift towards its 1-3% target range from a multi-year low of 0.3% in 2015-16, as capacity constraints emerge in 2017. The NZ$ fell to 0.69 against the US$ from 0.74 in September, partly reversing a year-long rise from 0.62 in September 2015. We expect it to fall back towards 0.64 on the US$ by Q4'17, as the latter stays on a broad-based uptrend.

Calendar years	2013	2014	2015	2016	2017
GDP(Expenditure), real growth, %	1.7	3.0	3.0	3.4	3.4
GDP(Production), real growth, %	2.3	3.8	2.4	3.2	3.4
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	0.66
US$1 = NZ$, year average	1.22	1.20	1.43	1.44	1.51
NZ$1 = A$, year average	1.18	1.09	1.07	1.06	1.16

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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