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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 strong finish to 2016

… exports & commodities rose sharply

… alongside strong PMIs

It would be a mistake to attribute this year's better global growth outlook to reflation hopes tied to Donald Trump's win in the US elections, although that clearly boosted US stocks and the dollar. Instead, 2017's improved outlook is anchored in a lift in global growth that started in mid-2016 and both broadened and accelerated in November. It is strikingly apparent in exports reported for the 14 Asia-Pacific markets that we cover, which swung to 5.3%yoy growth in November after falling 4.7%ytd in the first 10 months (US$ basis, see the Regional page). It is also apparent in higher commodity prices (gold bugs will be disappointed with the precious metal's 8%yoy rise for December compared to gains of 95% for iron ore, 74% for zinc, 44% for tin and 20-30% for copper, lead and nickel). Companies also noticed it, with Markit's global purchasing managers' index for December at a 13-month high of 53.4 (based on a two-and-a-half-year high for the manufacturing PMI and the services PMI matching November's 12-month high). Two further points worth noting from Markit's global survey: job creation accelerated to a 19-month high and cost inflation hit a 63-month record (as might be expected given fast rising metal prices).

2017's upside

… the potential for 3.8% growth

… with most markets doing better

How much better might 2017 be? For a start, it's worth noting that 2016 was the worst of 5-straight weak years for the global economy, marked as much by a very poor start as by a very strong finish. In its October update, the IMF cut its 2016 global growth estimate to 3.1%, the weakest pace since the global financial crisis of 2008-09 and well below the 15-year average to 2015 of 3.8%. The average for the five poor years 2012-16 was 3.3%, while the average for the five boom years leading up to the 2008 crisis was 5.1%. 2017 was forecast at 3.4% with 3.6% expected in 2018; essentially a very slow recovery. That forecast will likely be upgraded in April, with nowcast economic models by asset managers such as Fulcrum crunching the latest monthly data to put global growth in December at 4.1%. As Fulcrum and Markit note in their respective analysis, the upturn is apparent across advanced and emerging markets, with notable strength in Europe and recoveries underway in Brazil and Russia. There is now a firm upside risk scenario for 2017 that influences our estimates for likely growth in production, exports, employment, wages, prices, and interest rates. Country managers, who may have noticed a local uptick, might be less aware of the broad base of the upturn and its potential to change the global outlook.

Four risks:

+ a bad Trump

+ a strong US$

+ debt chokes growth

+ EU politics & Italian banks

Given the strength of the 2H'16 upturn, a key question is what might halt it. Four risks stand out. In the US, it would be a bad start for the Trump administration, which undermines confidence in the US and possibly ratchets up global trade tension. Conversely, there's also the risk of a further large rise for the US$ (say by more than 10% in 2017 on its trade weighted index). That would undermine the US recovery (crimping exports and US corporate earnings), while also hurting all foreign entities with US$ debt. That points to a third risk, which is high debt levels across most advanced countries. As a global recovery builds, interest rates and the cost of servicing that debt will rise, potentially offsetting the gains from better demand. Finally, EU risk remains high, from bad election outcomes, which put the future of the Euro and even the EU in question, to an implosion of Italy's high-risk banking sector. So, stronger growth in 2017 isn't in the bag.

Currency swings and a bit more inflation

Apart from stronger growth, companies will need to watch one of the biggest realignments underway, which is the 7% year-average fall for China's Yuan on a rising US$ in 2016 and the possibility of 4-5% falls in the next two years (our forecast). Inflation is also set to rise from very low in 2016 to mild in 2017, as the global oil price settles around US$45-50/bbl.

IMA Asia's forecasts	2014	2015	2016	2017	2018
World – Real GDP growth, %	3.4	3.1	3.1	3.8	4.0
- US	2.4	2.4	1.8	2.9	3.2
- Euro area	0.9	1.6	1.5	1.6	1.7
- Asia/Pacific (14)	4.4	4.4	4.5	4.5	4.3
- NICs (4)	3.4	2.1	2.2	2.1	2.4
- Developing or "EM" Asia (7)	6.8	6.6	6.4	6.2	5.9
- ASEAN (6)	4.4	4.4	4.5	5.0	5.2
World goods & services trade volume, % growth	3.5	2.8	3.1	4.0	4.3
Interest rates, US Fed target rate, year end, %	0.10	0.25	0.50	1.00	2.00
Inflation, CPI, US, year avg., %	1.6	0.1	1.0	2.5	3.5
Inflation, CPI, Euro area, %	0.4	0.1	1.0	1.2	1.4
Crude oil, avg of 3 spot crudes, US$	96	51	45	50	52
US$ / Euro 1, year average rate	1.33	1.11	1.10	1.06	1.02
Yen / US$1, year average rate	106	121	110	123	128

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, %	2014	2015	2016	2017	2018
Japan	0.3	1.2	0.7	1.2	0.7
China	7.3	6.9	6.7	6.2	5.7
Hong Kong	2.7	2.4	1.5	2.0	2.0
Taiwan	4.0	0.7	1.3	2.4	2.4
South Korea	3.3	2.6	2.6	2.0	2.4
Indonesia	5.0	4.8	5.1	5.7	5.9
Malaysia	6.0	5.0	4.0	4.0	3.9
Philippines	6.2	5.9	6.9	6.9	6.8
Singapore	3.3	2.0	1.8	2.6	3.2
Thailand	0.8	2.8	3.2	3.6	3.8
Vietnam	6.0	6.7	6.2	6.5	6.5
India (CY)	7.0	7.2	6.6	7.0	7.5
Australia	2.8	2.4	2.5	2.8	2.8
New Zealand	2.9	3.1	4.2	3.8	3.6

Inflation, CPI year average, %	2014	2015	2016	2017	2018
Japan	2.8	0.8	-0.2	0.7	1.0
China	2.0	1.4	2.0	2.4	3.0
Hong Kong (composite CPI)	4.4	3.0	2.6	2.5	2.2
Taiwan	1.2	-0.3	1.1	1.6	1.3
South Korea	1.3	0.7	1.0	1.8	2.2
Indonesia	6.4	6.4	3.5	3.6	4.5
Malaysia	3.2	2.1	2.1	2.2	2.7
Philippines	4.1	1.4	1.8	3.9	3.8
Singapore	1.0	-0.5	-0.5	0.7	1.2
Thailand	1.9	-0.9	0.1	1.1	2.2
Vietnam	4.1	0.6	2.7	4.6	3.8
India (CY CPI urban non-manual workers)	6.7	4.9	4.9	4.0	4.9
Australia	2.5	1.5	1.3	1.7	2.2
New Zealand	1.2	0.3	0.3	0.8	1.8

Exchange rate to US$1, year avg.	2014	2015	2016	2017	2018
Japan	106	121	110	123	128
China	6.14	6.23	6.71	7.07	7.35
Hong Kong	7.75	7.75	7.76	7.75	7.75
Taiwan	30.3	31.8	32.2	32.4	32.0
South Korea	1,052	1,133	1,160	1,204	1,246
Indonesia	11,868	13,389	13,308	13,825	14,401
Malaysia	3.27	3.90	4.14	4.53	4.51
Philippines	44.4	45.5	47.5	50.8	50.4
Singapore	1.27	1.37	1.38	1.44	1.46
Thailand	32.5	34.2	35.3	36.3	36.6
Vietnam	21,148	21,677	21,932	22,230	22,413
India (FY)	61.0	64.1	67.1	69.5	72.0
Australia	1.11	1.33	1.35	1.30	1.28
New Zealand	1.20	1.43	1.43	1.48	1.47

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

Regional outlook

Political & policy issues to watch

Trade wars

… is it time to rethink global supply chains?

Trump has threatened to impose 35% tariffs on imports from Mexico and 45% tariffs on imports from China while abandoning the 22-year old NAFTA trade deal and ditching the nascent TPP deal. In recent weeks, China has threatened to retaliate in kind. That suggests a significant threat to global supply chains, and serious disruption in both the US and Chinese markets (notably for US firms in the latter). This has quickly become a critical issue for many of our clients, yet none (apart from those twittered by Trump) are about to act, as there's a lot of uncertainty about what Trump will do and how China will respond. Yet, in recent talks with clients there's a growing view that natural hedges to trade nationalism will be part of future Asia business strategies.

Xi's desire for 2017 stability

Despite rising talk of trade wars, it's worth remembering that President Xi Jinping's over-riding goal in 2017 is stability as he approaches a late 2017 transition into his second five-year term as China's paramount leader. Rising nationalism has been a characteristic of his first five-year term, yet Beijing will be wary of allowing an escalation, as nationalism can too easily get out of control, and the Communist Party is always about control.

Nationalism is on the rise

Our Asia Brief reports over the last year have noted a steady rise in nationalism, not only in China but also in Southeast Asia (where Indonesia and Malaysia combined it with a harder Islamic push) and even in Australia. MNCs in Asia will need to adjust to this.

Outlook for the market

GDP

Despite a firm global recovery in 2017, real growth for the A/P 14 is likely to stay at 4.5% in 2017, matching 2016. That highlights the simple point that China is slowing, and its drop from an estimated 6.7% lift last year to around 6.2% this year offsets gains in nine other countries, with two level pegging (Malaysia stuck with a modest 4% and the Philippines still surging at 6.9%). South Korea is in a world of pain and joins China in retreating, as does NZ, which should cool from fast to moderate growth.

A mixed export lift from November

… that should settle into mild growth over 2017-2018

… and broaden

As we worked on this month's Asia Brief it was notable that November's export lift for the region was quite uneven. Indonesia and Australia led with jumps of 20%+yoy thanks to strong commodity prices (see below). Several key export manufacturers delivered double digit growth (Vietnam 16%, Thailand and Taiwan both 12%) while others managed about 8% or better (Japan 9%, HK and Singapore both 8%, Malaysia 7%). Surprisingly, no lift appeared in China (0%) and Korea (3%), although its easier to explain weak growth for India (2%, not much of an exporter) and NZ (3%, dairy prices). Overall, Asia should get a lift in export growth (US$ basis) from an average fall of 0.7%pa for the five years to 2016 to 3-4%pa for the next few years. That's just a third of the 2-decade average of 11% to 2011, so we aren't talking about a return to past trends let alone a boom. However, it will help lift GDP via better growth in export manufacturing and commodities.

The impact of commodity prices

… mostly good for Asia/Pac

On our Global page, we noted the strong rise in hard commodity prices by December (notably iron ore, up 95%yoy, and non-ferrous metals, up 20-40%), which provides a significant boost to the outlooks for Australia and Indonesia. Both countries also gain from a 66% lift in coal prices. Asia also does well on soft commodities, with rubber up 66% (helping Malaysia and Thailand), palm oil up 38% (good for Indonesia and Malaysia), and robusta coffee up 28% (important for Vietnam). Critically, apart from palm oil, key food prices haven't lifted, with Thai rice up just 2%yoy at December, wheat (US HRW) down 25%, and maize down 7%. That helps curb Asia's consumer price inflation. Meanwhile, oil prices, which are always a central concern for Asia given its high dependence on oil imports, look like stabilising. Average crude oil prices were up 44%yoy to US$52.62 for December, but we expect that's close to the top of a $45-55 range that is locked in place by fundamental changes in global oil supply, demand, and storage. Meanwhile, LNG prices have traded their way down from $18/mmbtu a year ago to find a bit of stability around $7.

Asia's currency realignment

Asia's two big currencies—Japan's Yen and China's Yuan—are both in the process of major devaluations on a rising US$ that will have a big impact on export competitiveness across the region. Countries that find themselves dragged up with the greenback will likely suffer. HK stands out due to its US$ peg, but Korea, Taiwan, Thailand, and Vietnam will need to be careful.

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Japan

Political & policy issues to watch

PM Abe's strong position

… he could be PM to 2021

As PM Abe enters a 5th year leading his administration he has four election victories under his belt, large majorities in both houses of parliament, and a cabinet approval rating of 60%, which makes him one of the strongest Japanese leaders in decades. In March, his party, the LDP, will formally vote to extend his term as party president (which expires in September 2018 after two 3-year terms) to include a third term. Provided the economy continues with a mild recovery, we expect Abe to pull the 2018 election forward into autumn of 2017, allowing him to lead government through the 2020 Tokyo Olympics.

Abe moves into step with Trump

… despite losing the TPP

Abe says reviving growth is his main priority this year, but he must also pass legislation to allow the emperor to abdicate (he wants to do so in 2018), and consider if he can push through constitutional reforms for a more assertive military posture. The latter is Abe's pet project, but has so far been opposed by most voters. Yet, in this, Abe is now in step with Trump's unexpected victory in the US. While Trump's rejection of the TPP trade deal is a major blow to Abe's economic reform plan, Abe has done well in immediately meeting with the president-elect and in proposing a second meeting soon.

Little economic reform & no fiscal stimulus

There is little scope for fiscal stimulus, with a minimal 0.8% lift in spending under the initial budget for the fiscal year starting April 1 (if measured from likely final spending in the current FY, then spending growth is likely to drop). Despite a strong political position, Abe continues to shy away from structural reforms to lift growth. Yet Abe and Japan will benefit from a cheaper Yen, which is the biggest change delivered in Abe's first four years.

Outlook for the market

The 2017 outlook is better

… thanks to a much weaker Yen

Since Abe took office in December 2012, the Yen has slid 28% on the US$, including an 11% slide after the US election last November to reach a current 117. The currency slide was followed by a surge in profits for big Japanese firms (almost wholly on their remitted income from offshore operations rather than exports, which remained weak). As a result, the Nikkei 225 stock index is up 87% since Abe took office, including an 11% gain since Trump's election win. Yet apart from providing a brief boost to corporate tax revenues and to corporate investment in commercial real estate, this has had little impact on the economy. That looks set to change in 2017, as global demand recovers after a five-year slump and the BOJ's massive quantitative easing (QE) campaign pushes the Yen lower.

A lift in export manufacturing

Exports jumped 13%yoy in November (US$ terms) following a clear uptrend that emerged last June. That puts exports on track for a 3% lift this year after four years of large falls, with growth of around 2-3% possible in 2018. Higher exports produced a strong 4.6%yoy lift in industrial production for November, which will leave 2016 flat on 2015, but promises 2-3% growth this year and 1-2% in 2018. That should see real growth in plant and capex investment return to 1-2%pa in 2017 and 2018 after falling in three of the last four years.

… should lift workers and consumers in 2017

Consumers should benefit from the recovery in export manufacturing, with the ratio of job offers to applicants reaching 1.41 in November, a level not seen since 1991. While it's too early to expect much of an impact on consumers it's notable that November's 1.7%yoy rise in retail sales was a sharp turnaround from a 1% fall in sales for the year to October. Real growth in consumer demand of 0.3% is estimated for 2016 after falls in 2015 and 2014 (in which the April 2014 sales tax hike played a role). Growth of 0.7-0.8% is likely for the next two years, with 1%pa possible as the 2020 Olympics approach. While car sales jumped 9%yoy in November, 2016 likely finished with a 2% fall after a 15% fall in 2015.

An uncertain Yen outlook

… but we expect a slide

The Yen has the most confused outlook of any of the major currencies, with forecasts from major banks ranging from a sharp rise to 99 to US$1 by year end (JP Morgan) to further depreciation towards 125 (Deutsche Bank). Our own forecast has swung from appreciation (up to the September Brief) to depreciation (from the October Brief onwards). Our current assumption is that continued quantitative easing by the Bank of Japan will see funds flow from Japan to a US reflation story backed by Fed tightening.

	2014	2015	2016	2017	2018
GDP, real growth (2005p), %	0.3	1.2	0.7	1.2	0.7
CPI, year average, %	2.8	0.8	-0.2	0.7	1.0
Overnight call rate, year end, %	0.07	0.04	-0.02	0.02	0.19
Yen to US$1, year average	106	121	110	123	128

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

China

Political & policy issues to watch

Xi's dominance will rise as he gains a 2nd 5-year term

Having used his first five-year term to consolidate his control over the Party, government and the military, Xi Jinping can expect a smooth entry into his second five-year term as party leader this autumn (his government and military posts will renew in early 2018). Xi's supporters are expected to dominate appointments to the 25-member Politburo and its Standing Committee (currently seven members). Xi's rising dominance means that China has swung away from the slow-moving consensus leadership of the last 35 years. Within China that is justified by the need to secure the Party's future, root out corruption, and accelerate reform. This year, the focus will be on stability leading into Xi's second five-year term. From 2018, big and more abrupt policy changes are possible. Containing a slow moving domestic debt crisis and responding to an unpredictable Trump presidency in the US, are expected to be the main policy challenges this year.

Tighter capital controls

… but a surge in outbound FDI should continue

One of the challenges from a mostly containable debt crisis is capital exiting China for safer investment opportunities elsewhere. China has more than sufficient foreign exchange reserves at just over US$3tr (and we'd expect these to drop toward $2.8tr over this year), but it has tightened controls over outflows on the capital account and slowed dividend remittances, which are under the current account and meant to be free of control. This may halt some outbound investment in non-strategic sectors like real estate, entertainment, hotels and hospitality in 2017 after record-high outbound investment (non-financial) of US$161bn in 2016.

Outlook for the market

Growth ebbs in 2017

… as stimulus is trimmed

Brief stimulus measures for residential property and the auto sector should have secured 6.7% GDP growth in 2016, but with renewed property cooling measures this year and a lift in the purchase tax on vehicles to 7.5% from 5%, GDP growth will slow to 6.2% in 2017. Sustaining real growth in consumer spending, which we put at 7.5% last year and 7% this year, will be critical. But as it is just 39% of GDP versus 46% for fixed investment, it's unable to fully offset the impact of an expected cooling in fixed investment growth to 5.9% this year from an estimated 6.3% last year. In short, China remains locked in a slowdown as Beijing seeks to rebalance growth, defuse a domestic debt crisis, avoid a property bubble, and curb environmental degradation. More positively, an end to almost five years of falling producer prices and gradual industry consolidation will help the pricing power of industrial firms, with nominal GDP growth staying around 8%pa in 2017-18.

Stable household consumption

… on less savings and more debt

Quick measures for the consumer sector suggest demand was stable in late 2016, with a 3-month moving average for domestic air travel up 9.5%yoy at November, while growth in rail travel reached 13.5%yoy, the fastest pace in 18 months. Even with wage growth slowing to 7% this year from an estimated 8% in 2016 (and a decade average to 2015 of 13%) we expect real consumer demand to grow by 6.6%pa over 2016-20 from an average of 8.8% in 2011-15, as households trim their savings and take on more debt.

Fixed investment continues to slow

Fixed investment is expected to slow to 5.5%pa over 2016-20 from a decade average of 11% to 2015. In construction, firm infrastructure spending will partially cushion softer residential investment. Plant and equipment capex growth will also be modest due to a realignment from declining capital intensive sectors towards rising new industries like healthcare, consumer electronics, water supply, food processing, and research.

Mild inflation and a 4-6% fall for the Yuan

Even though producer prices have swung from a 5.2% fall in 2015 to a 5.5%yoy surge in December 2016, the feed through into consumer price inflation is expected to be modest and should not trigger a policy rate hike. Last year's 7.1% average fall for the Yuan on the US$ is likely to be followed by a 4-6% fall this year, as Beijing uses a variety of tools to slow the exodus of capital.

	2014	2015	2016	2017	2018
GDP, real growth, %	7.3	6.9	6.7	6.2	5.7
CPI, year average, %	2.0	1.4	2.0	2.4	3.0
PBOC 1-year loan, at Dec., %	5.60	4.35	4.35	4.35	4.35
Yuan to US$1, year average	6.14	6.23	6.71	7.07	7.35

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

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Hong Kong

Political & policy issues to watch

HK's challenge:

… finding a new leader

… and a stable relationship with Beijing

2017 could be a turning point as Hong Kong selects a new Chief Executive (CE) in March to replace the unpopular CY Leung, who will not seek (or be given) a second five-year term when he steps down in June. A central issue is the amount of autonomy allowed under the "1-country, 2-systems" formula, which was agreed with the UK prior to the 1997 handover. Beijing has made clear all CE candidates must be 'trusted', but also has hinted at a willingness to consider moving toward a more democratic election process, but with zero tolerance for a pro-independence camp. That is unlikely to satisfy a growing minority that wants greater "autonomy", which means continued gridlock in the Legislative Council, which has undermined policymaking.

Carrie Lam looks to be an early CE favourite

… but nothing is settled

A lot depends on who Beijing favours in a restricted CE election process that it guides. The first declared candidates are Regina Ip (Executive and Legislative Councillor) and Justice Woo Kwok-king, but neither is likely to get the job. Chief Secretary Carrie Lam appears to be the 'chosen one' by Beijing; she probably will declare this month. Financial Secretary (FS) John Tsang may have more popular backing and could get most pan-Democratic votes in the Election Committee. But Beijing has delayed approving his resignation as FS, which may not be a good sign for him. Other candidates could emerge.

Key issues need addressing in Q1

Two other events to watch are the government's 2017 policy address on January 18 (by a lame duck CE) and the budget speech on February 22 (by an acting Financial Secretary) – representing an outgoing administration, which lowers expectations (if that's possible). They need to address sky-high housing costs, demands of an aging population and developing new sources of growth.

Outlook for the market

A weak 2017 recovery as headwinds continue

A mild trade recovery with stabilizing consumption and investment growth should bring a modest lift in growth in 2017. Dampening the upturn will be currency appreciation, slightly higher interest rates, and Beijing's tighter capital controls, which will curb HK's services sector, property, and the financial sector. Trade is a worry, as companies turn to cheaper mainland ports and airports, and fears of new US import barriers grow. That caps growth for 2016-20 at 2%pa from a decade average of 3.4% to 2015.

Tourism slows, consumers are cautious

HK's large tourism sector faced a 7.8%ytd fall in mainland arrivals by November, mostly due to a strong HK$ and diversification in China's outbound flow. Retail sales were down 9%ytd by October, with luxury goods sales particularly weak. Local consumer spending stayed muted at around 1% real growth in 2016, with 1.7% likely this year and 2% in 2018 (well below the decade average to 2015 of 4.8%pa).

Risk in surging home prices

… construction will stay firm

HK's administration will hope that China's latest capital control measures (see China page) will help cool a residential property market that saw prices rebound in 2H'16 to hit a record-high in November, tripling property prices since the mid-2000s. That's despite a recent doubling in the local stamp duty. The government has raised its home supply target from 18,000 to 20,000 units a year to meet pent-up local demand and a surge of migrant investors from the mainland.

A painfully strong HK$ rises with the greenback

The strong HK$, which is pegged to the US$, means inflation should stay low at around 2% for the next few years. The US$ peg has pulled the HK$ up by 13% on China's Yuan since January 2014, reversing a two-decade slide from 1994. The loss in competitiveness, particularly vis-à-vis China, hurts just about every aspect of HK's economy – which is likely to face a rising US$ and more Yuan depreciation in 2017-18.

	2014	2015	2016	2017	2018
GDP, real growth, %	2.7	2.4	1.5	2.0	2.0
Composite CPI (04/05), year average, %	4.4	3.0	2.6	2.5	2.2
Discount window base rate, % year end	0.50	0.75	1.00	1.50	2.50
HK$ to US$1, year average	7.75	7.75	7.76	7.75	7.75

Sources: 2013-2015 from Censtat, HKMA, and CEIC; 2016-2017 estimates by IMA Asia.

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Taiwan

Political & policy issues to watch

A tough start for President Tsai

Despite sweeping into office last May with an approval rating of 70%, President Tsai has struggled. Her approval rating has slumped to 41%, with her inexperienced administration stumbling, increased tensions with the mainland, and public protests over unpopular pension reforms (see below), a bill to introduce marriage equality, and new labour laws.

… particularly with China

The biggest challenge is souring cross-straits relations. Tsai won office by opposing closer ties to the mainland, and Beijing has retaliated by curbing mainland tourist arrivals, which are down 31% since she took office. Recent direct contact with US President-elect Trump risks triggering further economic retaliation by Beijing.

The quandary of massive reliance on China

Deep economic integration with China has been a central part of Taiwan's industrial model over the last 15 years. China accounts for over one-quarter of Taiwan's exports. Moreover, 57% of export orders are met by overseas factories (up from 13% in 2000), most of which are in China. Over 100,000 Taiwanese companies have operations in China and their deep supply chain linkages through China are vital to survival.

Fixing pensions

President Tsai has set a May deadline for tabling pension reform bills in the legislature. The challenge is big. Currently, civil servants and the military receive very generous

… means higher labour costs and weaker spending by consumers

pensions set at 75-85% of their final pay. Meanwhile, the number of working people per retiree has halved from 13 in 1985 to six in 2015, and is heading to less than two by 2050. The cost of meeting pension obligations is pushing public debt up, with debt ratings agencies warning they'll downgrade Taiwan's bonds. As elsewhere, the only solutions are to reduce pension benefits, lift the retirement age (to 65), and lift savings (meaning higher social security costs for companies and/or reduced spending by consumers).

Outlook for the market

A mild recovery builds in 2017

Taiwan likely had growth of 1.3% in 2016, up from 0.7% in 2015. GDP growth should lift to 2.4% this year as export orders, business confidence, and the semiconductor book-to-bill ratio all indicate a mild upturn. If those positive trends continue, they'd keep growth at 2.4% in 2018. That's still well down on the 3.5%pa pace in the decade to 2015.

Led by exports of electronic goods

Exports jumped by 15.9%yoy (US$ basis) in December—the fastest pace in almost four years. Electronic components drove the upturn with a 24.1%yoy surge. With a firm outlook for global demand for electronic goods, we've lifted our export growth forecast for 2017 to 3.5% (US$ basis) following falls of 3.4% in 2016 and 11.1% in 2015. The export lift drove industrial production up 6.1%yoy in the first five months of 2H'16 after a deep year-long fall. Production of electronic parts and components led, jumping 14.1%yoy for July-Nov 2016 after falling 6%+ over the prior year. We expect industrial production to grow 4-5% this year and 3-4% in 2018 after 1.1% growth in 2016 and a 1.5% fall in 2015.

Weak consumer demand

The export manufacturing lift has yet to feed through to consumers, with consumer confidence at a 39-month low, as jobs growth has stalled below 1%yoy for 14 months and wage growth has dropped to 0.5% for 2016 from 2.5% in 2015. That's likely to cap

… but P&E capex recovers

consumer spending growth at about 2% this year from an expected lift of 2.2% in 2016. Meanwhile, construction capex should remain sluggish this year, with new building permits down 19.6%ytd by November 2016 from a 15.5% fall in full 2015. However, capex on plant & equipment rose 5.9%ytd by Q3'16 and will likely grow 6-7% in both 2016 and 2017.

A firm NT$ rises quickly on China's Yuan

Inflation rose to 1.8%yoy in Q3'16, but given a firm currency and weak local demand it shouldn't go much higher. The NT$ edged down just 1.5% on a rising US$ in 2016, which meant a 5% rise on the Yuan. A similar pattern is likely in 2017, with a mild drop on a rising US$, but a 5-6% lift on a weaker Yuan.

	2014	2015	2016	2017	2018
GDP, real growth, %	4.0	0.7	1.3	2.4	2.4
CPI, year average, %	1.2	-0.3	1.1	1.6	1.3
Official discount rate, year-end, %	1.88	1.63	1.38	1.63	1.63
NT$ to US$1, year average	30.3	31.8	32.2	32.4	32.0

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 to persist for most of 2017

South Korea's political drama, which saw President Park Geun-hye impeached in December, will run well into 2017, resulting in political paralysis and a shakeout of the cosy ties between politicians and big conglomerates, like Samsung, LG, and Hyundai. The Constitutional Court has up to six months to decide on Park's guilt (it may decide much sooner). If she's convicted, elections would follow two months later. Candidates to replace Park include Moon Jae-in of the opposition Democratic party, who leads in the opinion polls, former UN Secretary General Ban Ki-moon, and Lee Jae-myung, an outspoken city major whose popularity reflects rising anti-establishment sentiment. If found innocent, Park would serve out the final months of her single five-year term in 2017, but with no real capacity to govern. Meanwhile, Saenuri, Park's party, has descended into chaos.

Exports hurt by cooling China ties

The next president must deal with cooling China relations, after Park agreed to allow the US to deploy the Terminal High Altitude Area Defence (THAAD) system in South Korea against North Korean missiles. China considers THAAD as a threat, and has responded with a series of non-tariff trade barriers on imports from Korea and limits on mainland tourists (now 47% of all arrivals). That hits a wide range of Korean sales from capital goods (via exports) to cosmetics (to Chinese tourists).

Outlook for the market

Chaotic politics to trim GDP growth in 2017

GDP growth is likely to ease to 2% in 2017 from 2.6% in both 2016 and 2015, and 3.3% in 2014, as political turmoil hurts consumer and business sentiment and freezes public spending initiatives. Korea's manufacturing purchasing managers index (PMI) has stayed below the 50 expansion/contraction threshold for the five months to December, unlike the global PMI, which has posted solid gains in recent months, hitting a 34-month high of 52.7 in December. We expect faster GDP growth of 2.4% in 2018, as the political upheaval subsides and rising global demand lifts exports.

Korean factories move to Vietnam

Korea's export lift in Q4'16 was a bit weaker than that for neighbours like Taiwan and Japan, up just 1.9%yoy. Q4'16 exports were notably weak to both China (-0.9%yoy) and to the USA (-3.1%yoy). In part, that reflects a shifting Korean global supply chain with exports to Vietnam (a favoured production site) surging 34%yoy in Q4'16.

Slower capex

… as construction growth eases

We expect fixed investment growth to slow to 3% in 2017 from an estimated 4.3% in 2016, before edging up to 3.3% in 2018. Strong construction activity (10.6%ytd by Q3'16) partly offset a 3.8%ytd fall in machinery & equipment investment, lifting capex growth to 4.7%ytd. However, recent steep declines in housing transactions and construction permits (by floor area) point to weaker construction growth ahead. Public capex growth is unlikely to revive in 2017, after a slump to 2.3%yoy growth in Q3'16 from a 23%yoy peak in Q1'16.

Consumer sentiment dented

Political uncertainty has unnerved households, pushing the consumer sentiment index down to 94.2 in December, its lowest level since 2009. Local car sales also fell 8.4%yoy in 2H'16, partly reversing a 12.9%yoy increase in 1H'16. Elevated household debt (90% of GDP from 82% in 2014) will hurt consumer spending if Korea's record high house prices start turning down. We expect private consumption growth to ease to 2.5%pa in 2017-18 from an estimated 2.7% in 2016.

Low inflation, flat interest rates, and a weaker Won

Inflation edged up to 1.5%yoy in Q4'16 and is likely to move above 2% by 2018. However, the fragile political situation will prevent the Bank of Korea (BOK) from lifting its policy rate from the current record low of 1.25% before the end of 2017. Delayed monetary tightening should weaken the Won against the US$ by around 3.5%pa in 2017-18, following a 2.5% year-average drop in 2016.

	2014	2015	2016	2017	2018
GDP growth, %	3.3	2.6	2.6	2.0	2.4
CPI, year average, %	1.3	0.7	1.0	1.8	2.2
BOK Base rate, year-end, %	2.00	1.50	1.25	1.25	1.50
Won to US$1, year average	1,052	1,133	1,160	1,204	1,246

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

Gradual political gains for Pres. Jokowi

… despite many challenges

President Joko Widodo ("Jokowi") enters 2017 just over two years into his first five-year term. After struggling to find his footing in national politics, he saw major gains by his 2nd year, as astute manoeuvring won him support in the legislature and two cabinet reshuffles left him with a stronger administration. Those gains are at risk as he enters his 3rd year after the fast rise of hard-line Islam, represented by the Islamic Defenders Front (FPI). Ahead lie local elections in February, including Jakarta's gubernatorial race, the most important poll prior to the 2019 national polls. Tied up in that contest is the blasphemy trial of Jakarta governor, Basuki Tjahaja Purnama ("Ahok", a Christian of Chinese descent). The Jakarta rumour mill suggests a third cabinet reshuffle is also on the way.

Pushing back on Islamic hard-liners

FPI have used mass rallies against Ahok to gain prominence. This included attacks on non-Muslims, particularly Chinese, notably via social media. While FPI claims it is defending Indonesia's founding Pancasila philosophy, it is actually attacking the pluralist spirit of Pancasila and Indonesia's elite, including the moderate Islamic parties that have been central to politics so far. The elite is now pushing back, aiming to curb FPI's leaders and to break a dangerous tendency for some in the elite to pander to or aid FPI as they seek political advantage. Jokowi has shown he is one of Asia's most astute politicians, and containing FPI will be a central challenge for him in 2017.

A broad coalition cabinet mean 2nd best policy

The FPI challenge may well influence a rumoured cabinet reshuffle in early 2017, with ministers from Islamic parties who failed to oppose FPI being sidelined while Gerindra, the leading opposition party, is brought into an ever-broadening coalition government. The political expediency required in such broad coalitions means that some poor-performing ministers and second best policy will prevail. That slows Jokowi's reform drive, and means that MNCs will need to work around policy confusion and anti-market nationalism.

Outlook for the market

Growth lifts into 2017

Stronger commodity prices are set to lift the Indonesian economy in 2017, with cash from exports flowing into stronger consumption and government revenues while also limiting the Rupiah's slide. We've retained last month's 5.7% forecast for 2017, which is above that of most local forecasters (5.0-5.5%), and think 5.5-6.0%pa is likely for the next few years.

As external and local demand both improve

… helped by rising commodity prices

November's 21%yoy surge in exports (US$ basis) was the fastest pace in more than five years, with non-oil and gas sectors leading (agriculture up 25%yoy, manufactured exports up 26%yoy, and mining exports up 50%yoy). Consumer confidence jumped to a two-year high in December, while November's motorcycle sales, an indicator of middle and lower-end consumer demand, saw the first increase in eight months, climbing 6.6%yoy. That suggests purchasing power may finally be on the rise in commodity-driven regional economies after prolonged weakness. Car sales, an indicator of middle and upper-end consumption, surged 15%yoy in November to their highest level since October 2014. Meanwhile, loan growth is also creeping up with November credit expansion at 8.5%yoy from 7.5% in October and 6.5% in September, as corporations start to take on new debt amid a low interest rate environment. October's 3%yoy rise in machinery investment was the strongest lift in two years and suggests real growth in fixed investment will lift from an estimated 4.8% in 2016 to 6-8%pa for the next two years.

Low inflation and a small fall for the Rupiah

Stronger domestic demand should produce a mild lift in inflation over the next two years and require several small rate hikes by Bank Indonesia. After falls in the year average exchange rate to the US$ of about 11% from 2013 to 2015, last year saw the Rupiah recover ground with the year-average rate up 0.6%. Against a rising US$ we expect falls of 3-5% in both 2017 and 2018.

	2014	2015	2016	2017	2018
GDP, real growth, %	5.0	4.8	5.1	5.7	5.9
CPI, year average, (2012=100), %	6.4	6.4	3.5	3.6	4.5
Central bank rate (7-day RR) at Dec %	-	6.25	4.75	5.00	5.50
Rupiah to US$1, year average	11,868	13,389	13,308	13,825	14,401

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

… which PM Najib and UMNO should win

PM Najib Razak's UMNO party has a good chance of winning the next election with a bigger share of seats, despite the reputational damage of the 1MBD scandal. The UMNO-led Barisan National (BN) coalition lost the popular vote in the last 2013 election (49% versus 51% of the opposition), but won a workable parliamentary majority thanks to BN-friendly gerrymandering. Najib is likely to call an early election later this year (one is not required until August 2018), taking advantage of opposition disunity, and the current redrawing of electoral boundaries in ways favourable to UMNO. Najib will also benefit from the government's FY2017 budget, which provides generous cash handouts to rural Malays, UMNO's core constituency. The political impact of the 1MBD scandal has been fading due to news fatigue, and intense government intimidation of critics. This is despite ongoing investigations of 1MDB's international money trail by at least four countries—US, Switzerland, Luxemburg and Singapore—resulting in potentially damaging discloses of corruption at the highest levels of government.

Building ties with China

… should help lift capex

The 1MDB scandal has prompted a shift in policy towards China, as Beijing was quick to bail out 1MDB, and, unlike Western nations, has avoided comment on kleptocracy and human rights. The China relationship was further strengthened with Najib's visit to Beijing last November, which produced 14 business deals involving investments worth M$143.6bn (US$34.3bn). Support from Beijing has surprisingly become a critical factor in Malaysia's economic outlook.

Outlook for the market

Growth cools to 4% on weak confidence

Malaysia finished 2016 on a weak note, with its manufacturing purchasing managers' index (PMI) coming in well below the global PMI (47.1 versus 52.7 in December, with readings below 50 indicating contraction). Moreover, a Financial Times survey found Malaysians the most pessimistic in ASEAN about their country's economic and political prospects. This is in line with the local MIER consumer confidence index, which has been hovering at record-low levels since Q1'15. Constrained household and public finances are limiting the growth of domestic demand, while private investment appetite is held back by political uncertainty and overcapacity in sectors such as real estate and oil & gas. We expect GDP growth to settle at around 4%pa in 2017-18 from 5% in 2015 and 6% in 2014.

Debt-driven consumer spending slows

Cooling employment and housing markets, along with record-high household debt (89% of GDP) are restraining consumer spending. Passenger car sales fell 13.7%ytd by November, while household loan growth has cooled to 9.2%yoy in Q3'16 from a Q4'11 peak of 14.2%yoy. We expect consumer real growth to slow towards 3.7% in 2018 from 4.3% in 2017 and 5.8% in 2016.

Infrastructure cushions weak capex growth elsewhere

Fixed investment is set to grow 3-4%pa in 2017-18 from an estimated 2.7% in 2016, mostly on the back of government sponsored infrastructure projects, often with support from China. Manufacturing capex prospects are weak (US$-based factory investment approvals fell 44%ytd by Q3'16), while housing approvals have been on a steep decline since a 2013 peak.

A weak M$ limits the potential for rate cuts

The recent steep fall of the M$ to 4.49 on the US$, a level last seen during the 1998 Asian financial crisis, will prevent Bank Negara from cutting its policy rate to boost growth. The fall is due to foreign investors exiting M$ government bonds in favour of US assets (foreign ownership of Malaysian government bonds is high, but fell to 48% last November from 52% the prior month). The weak M$ should help lift net exports, but will also push up inflation via higher import prices. The M$ is likely to remain vulnerable to a broad US$ uptrend.

	2014	2015	2016	2017	2018
GDP, real growth, %	6.0	5.0	4.0	4.0	3.9
CPI, year average (2010=100), %	3.2	2.1	2.1	2.2	2.7
Central bank overnight policy rate, Dec, %	3.25	3.25	3.00	3.00	3.50
Ringgit to US$1, year average	3.27	3.90	4.14	4.53	4.51

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

The above forecast is by IMA Asia. Companies seeking local advice and forecasts should contact:

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Philippines

Political & policy issues to watch

Outbursts aside, Duterte pushes ahead with a reform agenda

Despite President Duterte's violent anti-drugs campaign, the downgrading of US ties in favour of stronger China relations, and abrupt policy swings that could put off investors, Duterte still enjoys strong opinion poll support (83%) and the backing of most senators. His authoritarian ways carry risks, ranging from undermining US ties over human rights issues to the loss of support in Congress and on the streets. Yet, domestic opposition is currently limited and lacking in traction, allowing him to ignore criticism and implement his policies. That includes pushing through tax reforms and infrastructure development. Along with his commitment to cutting red tape and improving the delivery of government services that should help sustain 6%+ growth.

The risk of overheating

With GDP poised to grow at a three-year high of 6.9% in 2016 from 5.4%pa in the last decade thanks to a surge in domestic demand, the external position is under increasing pressure and inflation is on the rise. Strong domestic demand has lifted both consumer and capital goods imports and caused the trade deficit to blow out to a record-high US$20bn by October. The current account surplus fell close to an eight-year low of 1% of GDP in Q3'16. While a swing to current account deficits and higher inflation are risks that need watching, a classic emerging market crisis is likely to be avoided thanks to strong inflows from business process outsourcing (BPO) exports, steady offshore Filipino worker (OFW) remittances, strong tourism, and a mild rate tightening cycle in 2017.

Outlook for the market

Strong 6-7% growth for the next few years

Provided overheating is avoided, the Philippines is one of few economies set to sustain 6-7% growth for the next few years, thanks to strong domestic demand backed by favourable demographics and steady growth in BPO and OFW income (collectively worth 15% of GDP). Add to that a strong central bank that should contain rising inflationary pressure (see below) and a capacity for fiscal stimulus, and the result is a resilient economy that should be able to withstand some global shocks and questionable policy swings.

… supported by strong capex growth

Capex has surged since 2015 and likely grew 22-23% in 2016 after growth of 15.2% in 2015. This year should see strong but milder capex growth of about 15%, still well above the 8.3%pa pace of 2010-15. Having likely grown some 15% in 2016, construction is expected to remain robust and grow a further 15% in 2017-18 thanks to an expected lift in public-private partnership (PPP) projects and Duterte's plan to spend US$144bn on infrastructure in 2016-22. Meanwhile, the number of businesses with expansion plans reached a one-year high in December, suggesting good private capex growth in 2017.

… and a strong labour market that drives consumer demand

Consumer spending should grow about 7%pa in 2017-18 from a multi-decade high of over 7%pa in 2016. That strength reflects steady OFW remittances, elevated consumer confidence, and a strong labour market that saw the unemployment rate drop to an eleven-year low of 4.7% in October 2016. As a measure of the strength of consumer demand, imports of consumer electronics and home appliances surged over 46%ytd by October from 19% and 31% respectively in full 2015. Meanwhile, consumer-buying intensions for durable goods are near a seven-year high, while passenger vehicle sales were up a solid 14%ytd by November, from growth of 29% in full 2015.

Inflation heading up as the Peso edges down

Inflation ended 2016 by accelerating to a two-year high of 2.6%yoy. While that's still well within the central bank's 2-4% target range, we expect inflation to breach the central bank's comfort zone by 2H'17. A narrowing current account surplus will continue to put downward pressure on the Peso but a mild rate hike tightening cycle, along with robust BPO and OFW inflows, should keep the Peso in a 50-51 range against the US$ through 2017-18.

	2014	2015	2016	2017	2018
GDP growth, %	6.2	5.9	6.9	6.9	6.8
CPI, annual average, %	4.1	1.4	1.8	3.9	3.8
Central bank reverse rep. rate, year end	4.00	4.00	3.00	4.25	4.50
Peso to US$1, annual average	44.4	45.5	47.5	50.8	50.4

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

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Singapore

Political & policy issues to watch

Political stability backed by voters

Relative to messy politics elsewhere in ASEAN, Singapore should continue to stand out for the stability that has served it well for decades. The People's Action Party has been in power since independence in 1965, and in the 2015 election it lifted its share of the vote to 70% from 60% in the 2011 poll. There is speculation over who will succeed PM Lee Hsien Loong—in power for the last 12 years—after the 2021 elections, particularly as Deputy PM Tharman Shanmugaratnam has said he has no leadership ambitions. Whoever it is, the succession should be smooth with no shift in policy.

The challenge of defining new growth engines

Singapore is grappling with the twin problems of slowing productivity growth (down to about 0.4%pa from an average 3.4%pa in the 35 years to 2010) and a rapid decline of the working-age population typical of other advanced economies. Countering that requires a realignment away from cheap foreign labour and traditional exports and towards greater innovation, digitisation, and services for ageing but affluent consumers. Singapore has a strong track record of skilful economic management and a key report to watch is the Q1'17 release of the government's strategy for the "Future Economy", which will shed light on both policy initiatives and the likely direction of growth. With a strong focus on innovation and a vibrant start-up culture already evident, high value-added manufacturing and services will remain a core part Singapore's economic model.

Outlook for the market

A global trade recovery should lift 2017 growth

GDP growth slowed to seven-year low of 1.8% in 2016, making it the weakest year in the last two decades outside the GFC in 2009, the 2001 tech wreck, and the 1997 Asia Crisis. However, a mild but steady improvement in exports and local demand should help lift GDP growth to 2.6% this year (up from last month's 2.1% forecast). Provided the global economy continues to improve through 2017 and 2018, GDP growth should lift towards a brief peak of 3.2% in 2018, although that is still well down on the 6%pa pace for the 25 years to 2015.

Manufacturing rebounded as 2016 closed

New export orders have improved since February 2016 and reached a 23-month high in December, suggesting good momentum for exporters into 2017. Better export demand has driven a noticeable pick up in industrial production, with growth rising to a 32-month high of 11%yoy in November from 0.6%yoy in 1H'16 and a 5.1% fall in 2015. Looking forward, the broad strength of the global demand upturn in 2H'16 suggests export volume growth on the GDP measure should lift to around 4% this year from an estimated 3% in 2016 and 2.5% in 2015. That should help lift real growth in manufacturing GDP by 3.5-4% in 2017, below the 4.8%pa pace in 1995-15, but up from about 1-1.5% in 2016.

Watch for a mild consumer upturn as headwinds ease

With the resident unemployment rate near a multi-year high (at 2.9%) and the job vacancies to seeker ratio at a six-and-a-half-year low, retail sales (by volume) is in a broad-based downturn, falling 1.8%yoy in October 2016 from a recent high of 7.1%yoy growth in June 2015. Last year, there was little to stimulate consumers, with wage growth stuck at a modest 3-4%, a steady fall in private residential property prices from the start of 2014, low interest rates on bank accounts, and poor earnings on investments. Those headwinds should ease in 2017, allowing real growth in consumer demand to lift a bit above 2% from an estimated 1.8% in 2016, with 2.5% possible in 2018.

… plus a lift in plant & equipment capex

Capex growth has been weak since 2014, and 2016 likely saw a fall in fixed investment of about 1%. As export manufacturing lifts this year, real growth in plant and equipment capex should lift towards 2% after marginal growth in 2016 and contractions over 2013-15. Construction capex should return to weak growth in 2017 after falling for three years.

No need for the S$ to follow the US$ up

Inflation edged up 0.02%yoy in November, ending two years of mild deflation. A weaker currency and a mild demand recovery should nudge inflation towards 1%pa for the next two years. After allowing a 0.5% year average fall on the US$ in 2016, the central bank will likely seek a 3-4% fall on a rising US$ this year to assist with a recovery.

	2014	2015	2016	2017	2018
GDP, real growth, %	3.3	2.0	1.8	2.6	3.2
CPI, year average, %	1.0	-0.5	-0.5	0.7	1.2
3-month interbank interest rate, Dec, %	0.46	1.19	0.95	1.10	1.20
S$ to US$1, year average	1.27	1.37	1.38	1.44	1.46

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

Thailand

Political & policy issues to watch

Muted politics in 2017

… as the army tightens its hold on power

While King Maha Vajiralongkorn's rise to the throne last month removes some uncertainty from Thailand's outlook, it remains unclear whether Thais will accept long-term military rule, which could easily veer from a current stability and growth agenda to autocratic rule that would deter both investors and consumers. However, politics will remain muted this year, as much out of respect to the late King Bhumibol, whose cremation is expected in Q4'17, as due to forceful suppression of debate. General Prayut, who has been in power since the 2014 coup, aims to hold elections under a new constitution in late 2017 or early 2018, which should entrench military government behind a civilian facade.

Big public works continue

Meanwhile, Prayut aims to revive the economy and win popular support with a large infrastructure program led by Deputy PM Somkid Jatusripitak. Some 36 infrastructure projects worth Baht 896bn (US$25bn) are scheduled for 2017, with double tracking of rail lines across the country and expansion of Bangkok's mass rail system dominating.

Foreign investors remain wary

Prayut's government has suppressed opposition, avoided internal divisions, and curbed excessive corruption. Street battles have also stopped and political tension has eased, which has won Prayut support from local firms and temporary acquiescence from most citizens. Yet foreign investors remain cautious, with net foreign direct investment (FDI) collapsing to under US$1bn for the first 10 months of 2016 from $9bn in 2015.

Outlook for the market

Growth edges up in 2017

… as local and export demand lift

Thailand likely finished 2016 with growth of 3.2%, which is faster than in the prior three years and about its average pace for the decade to 2015. Growth should lift to 3.6% in 2017 thanks to infrastructure spending, a stronger consumer sector, a revival in agriculture and better exports. The key variables to watch are the strength of the trade recovery, whether private investment recovers after four weak years, and whether the consumer sector lifts despite a year of mourning for the late King. Our 2017 forecast of 3.6% is above that of most forecasters in Thailand (around 3.2-3.4%). Provided political calm is maintained, growth should lift to 3.8% in 2018.

An easing in headwinds for consumers

Retail sales by value grew 3%ytd by October after being flat in 2015 and falling 6% in 2014. All the growth was in non-durables, up 6%ytd after a 2% dip in 2015, while durables were flat for the first 10 months. Durables were held back by car sales, down 5%ytd at October after a 19% fall in 2015. However, the important 1-ton truck sector was up 4%ytd after an 8% fall in 2015, suggesting better demand from poorer urban and rural households. Wage growth edged up in late 2016, and 2017 and 2018 should see 2.5-3.5% annual pay growth after 2% or less in 2014-15. As the negative impact of drought and a botched first-time car buyers plan (2011-12) fade, real consumer demand growth should come in at 3%pa in 2016-17 with 3.5% possible in 2018 after 2.1% in 2015.

A mild recovery in private capex

… including building and plant investment

Fixed investment has been led by government capex in 2015 and 2016 (up 16% and an estimated 8% respectively) with growth of 4-5%pa likely for the next two years. Private construction capex was flat or contracting in 2014 and 2015 and may have edged up 1-2% last year. We expect a mild lift to 2-4%pa for the next two years. Plant and equipment capex has been flat or contracting for four years, but should lift by 3-4%pa in 2017 and 2018, as factories respond to better local demand and exports. We expect export growth to lift to 4-5%pa for the next two years (US$ basis) after no growth over 2013-16.

Low inflation and a firm Baht

Inflation accelerated to a 25-month high of 1.1%yoy in December. A fast-rising current account surplus (up 42% to US$47bn for the year to November) has limited the Baht's fall on a rising US$ and that pattern looks like continuing through 2017 and 2018.

	2014	2015	2016	2017	2018
GDP, real growth, %	0.8	2.8	3.2	3.6	3.8
CPI (2002 index), year average, %	1.9	-0.9	0.1	1.1	2.2
Central bank, policy rate, year end, %	2.00	1.50	1.50	1.50	2.00
Baht to US$1, year average	32.5	34.2	35.3	36.3	36.6

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

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Vietnam

Political & policy issues to watch

Stable politics and mild reform continue in 2017

Last year's political stability and mild pro-market reform agenda are expected to continue in 2017 and 2018. The prospect of faster reform ended in early 2016 when a bid by PM Nguyen Tan Dung to lead the Communist Party failed, and the conservative Nguyen Phu Trong was reappointment for a second 5-year term. While not halting the reform process, that saw a conservative Party tighten its control over a pro-reform government. The Party has also clamped down quickly on popular protests, which have been triggered in recent years by anti-Chinese sentiment (mid-2014) and environmental scandals (the 2016 "Great Fish Kill" caused by Formosa Plastic's new steel mill). Finally, 2016 also saw tighter controls over foreign direct investment (FDI) projects. Yet that was needed, as there were many moribund proposals from neighbouring countries. Vietnam finished 2016 winning a further US$15.2bn in FDI, about the same as in 2014 and 2015.

Watch for the SOE reform process to lift

… with the help of IPOs

With the Party closely watching, Vietnam's new prime minister, Nguyen Xuan Phuc, has cautiously accelerated slow moving reform of state-owned enterprises (SOEs). A 49% foreign ownership cap appears to have been lifted for listed firms, and the gradual "equitization" of several large SOEs has moved forward, including dairy giant Vinamilk and Vietnam's two largest breweries, Sabeco and Habeco. While this is still an uncertain process, it is enabling foreign players to build minority stakes in some key SOEs. It is also a boost for government finances and for the local stock market, which helps private firms seeking funding via their own IPOs. Some 170 (mostly small) SOEs have been partly privatised since 2015, with a further eleven SOEs slated for equitization in 2017.

Keeping macro risks under control

Vietnam enters 2017 with some success in controlling the three big risks for most fast-growing emerging markets, partly due to reforms put in place after a painful bust in 2012. Inflation, which peaked at 23%yoy in August 2011 after an uncontrolled lending spree is now controlled. Despite a surge in imports, the trade deficit should remain modest and the current account in surplus over 2017-18. Finally, the bank sector is undergoing major reform. While local banks still have some of the lowest ratings in ASEAN, they delivered credit growth of around 18% in 2016, with a similar pace expected this year.

Outlook for the market

Growth lifts to 6.5% in 2017

With a mild region-wide export recovery taking hold, and the agriculture sector set for a modest lift after last year's severe drought, GDP growth is expected to edge towards 6.5% this year and next from a 6.2% lift in 2016. While that's below the government's 6.7% target, it's above the 5.9% average pace set in the five years to 2015. Robust domestic demand should help sustain 6%+ GDP growth through the next decade.

… as exports accelerate

While most of Asia had little export growth over the last few years Vietnam's exports grew 8.7% in 2016, up from 7.9% in 2015. Central to that was a surge in FDI into manufacturing over the last decade, which reached US$9.8bn in 2016. We expect export growth to rise to 9-10% this year, which should lift manufacturing GDP growth by 11%, up from an average 8.7% annual growth rate in the five years to 2015.

… and demand from consumers rises

Vietnam has one of the fastest growing consumer markets in the region. In 2017-18, consumer spending is expected to grow 7-7.5%pa from 5.9%pa in the five years to 2015. Strong income growth (7.9%pa since Q2'12) and buoyant consumer confidence have helped imports of consumer goods more than double since 2009, while passenger vehicle sales are likely to reach over 150,000 units in 2016, up from 78,715 in 2014. Lower registration fees and import taxes should keep car sales strong this year.

Mild inflation and a slow fall for the Dong

Inflationary pressure is mounting, with the CPI up 4.7%yoy in December. Inflation is likely to breach the government's 4% target for 2017, which should force the central bank into a mild rate hike cycle this year. In 2016, the Dong was one the region's firmer currencies through to August. However, it has since weakened due to US$ strength, and is expected to ease by 1-1.5%pa in 2017-18 on the US$, after a 1.2% fall in 2016.

	2014	2015	2016	2017	2018
GDP, real growth, %	6.0	6.7	6.2	6.5	6.5
CPI, yoy, % (2005=100 from 2007)	4.1	0.6	2.7	4.6	3.8
Central bank refinancing rate, year-end, %	6.50	6.50	6.50	7.30	6.80
Dong to US$1, year average	21,148	21,677	21,932	22,230	22,413

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

India

Political & policy issues to watch

Can PM Modi regain ground?

… watch the UP election in Q1

Elections for five states between February 4 and March 8 will give some 160 million voters a chance to indirectly pass judgement on PM Modi's national government. The biggest contest is Uttar Pradesh (UP, 134m voters), where a win for Modi's BJP would help it regain political momentum at the midway point to the 2019 national polls. While Modi's demonetisation on November 8 would have hit rural UP hard, late 2016 opinion polls showed UP voters backing Modi's drive to clamp down on black money.

The 2017 budget

… fiscal reform & tax trimming

Partly with an eye on the state polls, Finance Minister Jaitley has pulled his 2017 budget speech (for the FY starting April 1) forward to February 1. But Jaitley is also interested in fiscal reform, which includes subsuming the Railway Budget into the main budget, ditching an arcane division into plan and non-plan expenditures, and opening the way to fiscal rationalisation. That sets the stage for delivering on a commitment to trim the current corporate tax rate (30%) while ending an array of exemptions. Also, look for whether Jaitley hints at a delay in GST roll out from April 1 towards September.

Demonetisation

… has starved India of cash

By December 19, Indians had deposited 90% of the old 500 and 1,000 Rupee notes (far more than the early expectation of 60%) but only 38% had been replaced by new notes due to delays in printing and distribution. That's left a cap of Rs2,500 (US$37)/day on cash withdrawals at banks and India's few ATMs. As 98% of all household purchases are in cash, that's meant a big squeeze on consumers. While banks are stuffed with cash, growth in loans and overdrafts fell to just 5.5%yoy in December, the slowest pace since 1993 (and well below the low point set in the 2009 global financial crisis), which suggests a big fall in corporate confidence and spending.

Outlook for the market

Growth slipped in Q4'16

… don't expect a 2017 rebound as the GST lies ahead

Demonetisation has particularly hurt India's poorer households and small and medium enterprises. As noted in December's Asia Brief, vehicle sales for November show 3-wheelers (tuk-tuks) falling 22%yoy and 2-wheeler sales down 5%yoy. By contrast, car sales grew 6%yoy and domestic air traveller growth, another indicator for well-off households, remained steady at a high 23%yoy. Our 2016 GDP forecast was cut to 6.6% from 7.1% following demonetisation. That reflects growth to Q3'16 of 7.4%ytd followed by a slip to 4-5%yoy in Q4'16. 2017 growth was also trimmed from 7.8% to 7.0% as we are concerned about cumulative shocks from demonetisation and GST introduction. 2018 should see a return to 7.5% growth as the local economy stabilises post-GST.

Poorer consumers hurt

… with retailers slashing their orders

The consumer sector saw real growth of 7.5%ytd by Q3'16 but we think that slowed to 5-6%yoy in Q4'16. Consumer survey firm Nielsen says that demonetisation led to a much sharper drop in November FMCG sales from October (a festival month) than seen in 2015 (-1.8% in 2016 versus -0.6% in 2015). Meanwhile, retailers made even bigger cuts to their own orders as they scrambled to avoid a stock surge. Given the weak bank loan data for December, we think that retailer caution grew in December. For 2017, we expect consumer real growth to ease to 6.4% from 7.0% in 2016 before a lift to 7.8% in 2018.

Construction also hit

Construction also took a hit, with cement production for November slumping to 0.5%yoy growth from 6.8%ytd for the first 10 months. That will pull real growth in construction down to 2.6% in 2016 from 3.4% in 2015 with a recovery to 4% in 2017 and 7% in 2018.

Cheaper loans and a mild slide for the Rupee

Given the Q4'16 demand slump, December inflation will likely slip to 2-3%yoy from 5.1%ytd for the first 11 months. There's scope for the RBI to cut its policy rate from 6.25% in early 2017 but banks, flush with cash, are at last making bigger rate cuts of 45 to 90 basis points. The Rupee's fall after Trump's election win has been limited to about 2%, producing a 2016 average fall of 4.4% with about 3.5% expected in 2017 and 2018.

Calendar year starting January	2014	2015	2016	2017	2018
GDP (MP, 2011-12), real growth, %	7.0	7.2	6.6	7.0	7.5
Inflation - CPI, %	6.7	4.9	4.9	4.0	4.9
RBI repo rate, December, %	8.00	6.75	6.25	6.00	7.00
Rupee to US$1, year average	61.0	64.1	67.1	69.5	72.0

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

Fragmentation in politics

… slows policy making & points to instability

In common with many other advanced countries, Australia is struggling with rising popular distrust of government and fragmentation of its political landscape. That is despite some 25 years of uninterrupted growth, a recent rebound in resources exports, far less prominent social divisions, a general welcoming attitude to migrants, and general support for free trade. Much of that good economic story was captured in the IMF's latest country review (see below). Despite that, politicians espousing anti-migrant, anti-free trade, and anti-foreign investment positions have been on the rise. The 2018 Queensland state election will show how powerful they've become. At the national level, it has seen the powerful right wing faction in PM Turnbull's conservative Liberal Party threaten to break away and establish a new party. Despite early promise, Turnbull has been ineffective in mastering these trends. As a result, limited progress on policy is likely along with a continuation of the abrupt government changes that characterised the last six years.

Plenty of room but no appetite for fiscal stimulus

In its latest country report on Australia, the IMF praises the seamless transition of the economy from the mining investment boom that ended around 2012, to the current expansion that is driven by a housing boom and the fast-paced services sector. It attributes the smooth transition to the country's flexible foreign exchange rate and appropriately loose monetary policy. Moreover, the IMF believes that Australia has ample room for fiscal expansion, especially for infrastructure development. At 38% of GDP, its budget deficit is way below the OECD average of 115%. Yet such fiscal expansion seems unlikely, as credit rating agencies like S&P (which has Australia's AAA rating on a negative outlook) are much less sanguine about public debt. The right wing of Turnbull's Liberal Party also demands debt reduction, and holding the party together will outweigh any argument for fiscal stimulus.

Outlook for the market

A surge in export earnings lifts 2017 growth prospects

GDP growth dipped to 1.8%yoy in Q3'16 from 2.8%yoy in 1H'16 due to a reduced contribution from net exports, which is likely to have been temporary. Growth likely recovered in Q4'16, putting the full year at 2.5%, with a lift to 2.8% expected in both 2017 and 2018. A range of indicators point to the upturn. The manufacturing and services purchasing managers' indices (PMIs) surged to 55.4 and 57.7 respectively in December (readings above 50 indicate expansion). Much of the lift-off is driven by external demand, as exports surged 23.8%yoy in November (on the US$ measure) from 9.7%yoy in October and 3.1%yoy in Q3'16. Imports increased just 2.8%yoy from 1.2%yoy in October and a 0.3%yoy fall in Q3'16. Moreover, a record 43.94m tonnes of iron ore (Australia's main commodity export) were shipped out of Port Hedland in Western Australia, up 17%yoy in December.

Housing capex is set to cool

… while the fall in mining capex should end in 2018

The end of the mining investment boom more than offset the impact of strong residential investment, pushing overall capex growth into negative territory since 2014. We expect the decline to ease to -1.5% in 2017 from an estimated -5% in 2016, with growth turning mildly positive (up 0.8%) in 2018. Rising commodity prices should help arrest the decline in mining capex, but the growth of housing construction is set to moderate through to 2018 in line with falling housing approvals, which peaked in May 2016. Households have been enjoying record-low interest rates and the wealth effect of the booming housing market, but consumer confidence has been undermined in recent months by slowing employment growth (especially full-time jobs), elevated household debt, and miniscule wage growth. Consumer growth is likely to ease to 2.6% in 2017 from 2.8% in 2016, before edging up to 2.8% 2018.

The A$ rides up on stronger commodity prices

The Reserve Bank of Australia pushed its policy rate to a record low of 1.50% in 2016 from a pre-GFC peak of 7.25% in 2008. Further cuts are unlikely, as inflation is set to pick up from a multiyear low of 1%yoy in Q2'16. The recent lift in commodity prices has helped the A$, which could lift to 0.80 US cents by the end of 2017 from 0.73 currently if iron ore prices continue to strengthen.

Year ending December 31	2014	2015	2016	2017	2018
GDP, real growth, %	2.8	2.4	2.5	2.8	2.8
CPI, year average, %	2.5	1.5	1.3	1.7	2.2
RBA cash rate, year-end, %	2.50	2.00	1.50	1.50	2.00
A$1 = US$, year average	1.11	1.33	1.35	1.30	1.28
US$1 = A$, year average	0.90	0.75	0.74	0.77	0.78

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

New Zealand

Political & policy issues to watch

Nationals set to win 2017 election

… but may have to deal with awkward partners to pass bills

Last month's resignation of the widely popular PM John Key caught many by surprise. Key had been in office since 2008 and resigned despite being in a strong position to win his National party a fourth successive term in government. His successor, Bill English—Key's finance minister for three successive terms—is a well-respected economic manager, but lacks Key's political charisma, which will be put to the test at this year's election, most likely in September. While the latest opinion polls put the Nationals (49.5%) ahead of a potential Labour/Greens coalition (37.5%), English will need to work with minor parties to pass legislation. Key was largely successful in fostering cooperation with the minor parties and independents, helping him to steer the economy through the 2008 global financial crisis, the 2010-11 Christchurch earthquakes, and the collapse in dairy prices (NZ's largest export). Whether an English led government will continue to have the same success is critical for the outlook.

Tax cuts for an election year

… but the overinflated housing market poses risks

English will campaign for the upcoming election with the benefit of a strong economy, a booming labour market (see below), and the promise of personal tax cuts. Tax relief will come thanks to a better-than-expect budget outcome in FY2016. The government returned the budget into a small surplus in 2015-16 from a large 9% of GDP deficit in 2011, the result of the devastating Christchurch earthquake. English's biggest challenge would be to manage NZ's runaway housing market, which saw Auckland home prices nearly double in the last nine years. The housing boom has lifted prices beyond the reach of most first-time homebuyers, and helped inflate household debt to 165% of income in 2016 from 150% in 2013. An abrupt retreat of house prices could damage household and bank balance sheets and slow economic growth.

Outlook for the market

Rapid migrant inflows boost GDP growth

Strong migrant inflows (a record-high 70,400 in the year to November) are boosting demand for housing and consumption and turning NZ into one of the fastest-growing economies in the OECD. GDP growth edged higher to 4.5%yoy in Q3'16 from 4.1%yoy in 1H'16 and 3.1% in full 2015 on the back of strong private consumption (5.4%yoy from 3.6%yoy in 1H'16), and residential construction (14%yoy from 10.7%yoy in 1H'16). These drivers offset the impact of softening non-dwelling capex (1.5%yoy from 4.1%yoy in 1H'16) and falling external demand, with import volumes growing a lot faster than exports (5.4%yoy versus 1.8%yoy in Q3'16). We have lifted our 2016 GDP growth estimate to 4.2% (from 3.4%) and our 2017 forecast to 3.8% (from 3.4%). We expect slower growth of 3.6% for 2018 with rising interest rates expected to cool housing construction (see below).

Housing construction to ease

… but consumer demand should stay firm

A recent decline in housing transactions points to a likely slowdown of residential building consents, the value of which grew 26.8%yoy in October from 19.8%yoy in Q3'16. If non-dwelling activity fails to pick up, total capex growth should ease to around 3.4%pa in 2017-18 from an estimated 5% in 2016. We expect private consumption to grow in line with GDP growth (3.7% in 2018 from 3.9% in 2017 and an estimated 4.3% in 2016), as household finances benefit from the wealth effect of record-high home prices and an increasingly tight labour market. Employment growth surged 6.1%yoy in Q3'16 from 3.2%yoy in 1H'16, with employers reporting widespread skill shortages in Q4'16.

Inflation and interest rates to edge up

With NZ's fast-growing economy running out of spare capacity, inflation and interest rates are set to edge higher in 2017-18 from last year's record lows. Tighter monetary policy by the Reserve Bank of NZ should provide some support to the NZ$, which we expect to trade within a 0.65-0.70 range on the US$ over the next two years.

Calendar years	2014	2015	2016	2017	2018
GDP(Expenditure), real growth, %	2.9	3.1	4.2	3.8	3.6
GDP(Production), real growth, %	3.8	2.4	3.4	3.8	3.6
CPI, year average, %	1.2	0.3	0.3	0.8	1.8
Official cash rate, year end, %	3.50	2.50	1.75	2.00	2.25
NZ$1 = US$, year average	0.83	0.70	0.70	0.68	0.68
US$1 = NZ$, year average	1.20	1.43	1.43	1.48	1.47
NZ$1 = A$, year average	1.09	1.07	1.06	1.14	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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