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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 synchronised upturn

… driven by better balance sheets

… means a sustainable recovery

Many indicators, from trade data to purchasing managers' indices (PMIs), suggest that the global economy entered a broad upturn in Q4'16 that has continued into Q1'17. If it runs through mid-2017, it will be the best upturn since global growth slumped five years ago, in 2012. In judging its sustainability, two factors are important. First, the upturn is largely synchronised across advanced and emerging markets (EM). One of the pluses for EMs has been the surge in commodity prices, which is helping lift regions like Southeast Asia. A second plus for sustainability is the source of demand, which is coming from across the main sectors (household, corporate, and government) in each economy. That reflects a modest repair of balance sheets in each sector, and better quality balance sheets usually mean stronger demand. Both factors suggest that the upturn should run through 2018.

But an inventory rebuilding spurt will fade by Q2

… and growth will plateau in 2018

Two other aspects of the upturn are worth noting. First, the recent surge in exports for Asia likely reflects inventory rebuilding by importers after five years in which inventories were run down in the face of weak demand. That catch-up surge should moderate from Q2'17. Second, unlike most recoveries in the four decades to 2007, this one will plateau or cool in 2018 with GDP growing around 4%, rather than accelerating to 4.5-5.5%. Global demand is still dominated by advanced economies, which are older (more inclined to save then spend), carrying higher debt (in an environment of rising interest rates), and faced with restructuring. China's demand for hard commodities is also set to cool in 2018.

Better resilience to most risks

Better balance sheets and a synchronised recovery lift resilience in the global economy, and it is the level of resilience that is almost always the key consideration in evaluating risks to growth. Improved resilience should overcome many of the risks apparent on the front pages of newspapers today.

The risks to watch

… policy un-certainty brings down capex

However, two sets of risks could knock over the recovery. The first is uncertainty over policy, which could see firms and some households hold back on spending, particularly investment decisions. In the US, there is uncertainty about the corporate tax rate, the cost of imports (and protection from imports), and support for local production and exports. Alongside that, there is uncertainty in healthcare and support for infrastructure, both large sectors of the economy. In the 28-member EU, which had 18 states growing at 2% or better by Q3'16 (thus, a broad recovery), there is uncertainty about fragmentation, as nationalists across the continent attempt to replicate BREXIT.

… a sharp rise in US interest rates

The second risk is a sharp rise in interest rates, which could hurt firms and households that have loaded up on debt over five years of ultra-low interest rates. While this is the traditional brake that limits most upturns, there is uncertainty about the inflation outlook. Our view is that inflation has already risen faster than markets expected (at 2% for the Euro area it is at the inflation ceiling targeted by the ECB), and will continue a steady rise through 2018. Key drivers will be strong growth in commodity prices and wage-push inflation in the US construction sector (if the Trump administration manages to launch its infrastructure program). However, with considerable excess capacity in many industrial sectors, we don't expect advanced country inflation to get above 5%.

That means a rising US$

The US Fed's policy rate will need to reach at least 3% in 2018 to keep a lid on inflation, with the pace of rate rises quickening in 2018 from an expected three hikes in 2017. That puts the US$ on track for a 2-4% rise against its trade weighted index.

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	2.6	1.6	2.4	2.8
- Euro area	0.9	1.6	1.7	1.7	1.6
- Asia/Pacific (14)	4.4	4.4	4.6	4.6	4.4
- NICs (4)	3.4	2.1	2.3	2.2	2.5
- Developing or "EM" Asia (7)	6.8	6.6	6.5	6.2	6.0
- ASEAN (6)	4.4	4.4	4.5	4.8	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	0.50	0.75	1.50	3.00
Inflation, CPI, US, year avg., %	1.6	0.1	1.3	2.5	3.5
Inflation, CPI, Euro area, %	0.4	0.0	0.3	1.1	1.3
Crude oil, avg of 3 spot crudes, US$	96	51	43	50	52
US$ / Euro 1, year average rate	1.33	1.11	1.11	1.07	1.05
Yen / US$1, year average rate	106	121	109	113	119

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

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Regional outlook

Summary of forecasts in this month's Asia Brief

GDP (Expenditure), real growth, %	2014	2015	2016	2017	2018
Japan	0.3	1.2	1.0	1.3	0.9
China	7.3	6.9	6.7	6.3	5.8
Hong Kong	2.8	2.4	1.9	2.4	2.4
Taiwan	4.0	0.7	1.5	2.4	2.5
South Korea	3.3	2.6	2.7	2.0	2.4
Indonesia	5.0	4.9	4.9	5.4	6.1
Malaysia	6.0	5.0	4.2	4.0	4.0
Philippines	6.2	5.9	6.8	6.5	6.4
Singapore	3.6	1.9	2.0	2.7	3.2
Thailand	0.9	2.9	3.2	3.7	4.1
Vietnam	6.0	6.7	6.2	6.5	6.5
India (CY)	6.8	7.4	7.4	6.8	7.2
Australia	2.8	2.4	2.5	3.0	2.8
New Zealand	2.9	3.1	4.0	3.5	3.4

Inflation, CPI year average, %	2014	2015	2016	2017	2018
Japan	2.8	0.8	-0.2	0.4	0.6
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	1.4	1.8	1.6
South Korea	1.3	0.7	1.0	2.3	2.5
Indonesia	6.4	6.4	3.5	4.0	4.9
Malaysia	3.2	2.1	2.1	3.0	3.5
Philippines	4.1	1.4	1.8	4.1	5.0
Singapore	1.0	-0.5	-0.5	1.0	1.5
Thailand	1.9	-0.9	0.2	2.1	3.2
Vietnam	4.1	0.6	2.7	5.0	4.4
India (CY CPI urban non-manual workers)	6.7	4.9	5.0	4.0	5.1
Australia	2.5	1.5	1.3	1.8	2.3
New Zealand	1.2	0.3	0.7	1.6	2.1

Exchange rate to US$1, year avg.	2014	2015	2016	2017	2018
Japan	106	121	109	113	119
China	6.16	6.28	6.64	6.96	7.04
Hong Kong	7.75	7.75	7.76	7.75	7.75
Taiwan	30.3	31.8	32.2	30.4	30.5
South Korea	1,053	1,131	1,160	1,179	1,199
Indonesia	11,868	13,389	13,308	13,536	13,825
Malaysia	3.27	3.90	4.14	4.53	4.53
Philippines	44.4	45.5	47.5	50.9	51.7
Singapore	1.27	1.37	1.38	1.42	1.45
Thailand	32.5	34.2	35.3	34.4	34.9
Vietnam	21,148	21,677	21,932	22,425	22,858
India (FY)	61.0	64.1	67.2	69.5	72.0
Australia	1.11	1.33	1.35	1.36	1.44
New Zealand	1.20	1.43	1.43	1.47	1.53

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

Regional outlook

Political & policy issues to watch

China's drive to realign Asia's allegiance

… as the US retreats

… and North Korea risk rises

Geopolitical risk has sprung into prominence in Asia thanks to three developments. The first is China's drive to realign the allegiance of neighbouring states from South Korea in the north, through ASEAN in the south, to the stans to China's west. Little has been achieved so far in North Asia, although China hopes that a swing to a left-leaning government in South Korea's May 9th election will help. In ASEAN, China has been remarkably effective in buying support in Laos, Cambodia, the Philippines, and Malaysia. Still up for play are Thailand, which may tap China for help with a major infrastructure program, and Singapore, which will need to tone down its muted calls for ASEAN coordination. The second development has been an abrupt swing to transactional geopolitics by the Trump administration, which undermines the "Pax Americana" across Asia of the prior five decades. Finally, after 20 years of trying, North Korea has a deliverable nuclear threat that reaches Japan, and may soon reach the US.

MNCs in Asia will need to take care

MNCs with prominent positions across Asia will need to pay close attention. Apart from potential disruptions to supply lines and marketing campaigns, they may be pressured, like Lotte from Korea, into taking sides on China's realignment push. Stepped up government affairs work and a broadly defined localisation agenda may help. North Korea is a different challenge. Ultimately, China will decide what happens, but with an unpredictable leader in Pyongyang, political change under way in South Korea, and a new leader in the US, the risk level rises several notches over the next few months.

A better outlook for Thailand

Our political risk grading for Thailand has improved to moderate with a stable outlook, as the military government led by PM Prayut has developed a workable political formula for the country that promises long-term stability. In addition, the Eastern Economic Corridor (EEC) looks like a good revitalisation plan for Thailand's industrial sector.

… and for Malaysia

Malaysia's political risk grading has also improved to moderate with a stable outlook, as the 1MDB scandal that threatened PM Najib, as well as local banks and major projects, has subsided, partly thanks to financial support from China and Saudi Arabia.

Outlook for the market

Asia's export led recovery

… good, but not what is used to be

… except for Australia's latest resource boom

Given a broad global recovery, Asia's exporters of manufactured goods and commodities are doing well. Exports for prominent factory economies in north Asia (Korea, Taiwan, and Japan) and in Southeast Asia (Vietnam, Malaysia, Thailand, and Singapore) are all set to rise by 5-8% this year (US$ terms). While that's better than average growth of around 1% over the last five years, it is half the 10-20%pa pace set for 30 years prior to 2007. Interestingly, China's exports for the four months to February fell 2.5%yoy, suggesting that a lot of light export manufacturing may have offshored to south and southeast Asia. Big commodity exporters have done even better, with Indonesia's export earnings for the four months to February up 19%yoy while Australia's exports for the four months to January soared 31%yoy. Australia is close to a mini resource boom, which is lifting growth (and the A$) just as east coast consumers pull back.

Consumers will be central to growth

While better than the last five years, the mild export lift in 2017 provides a barely perceptible rise in our regional growth forecast to 4.6% for 2017 from last month's 4.5% forecast (the rise is more noticeable from our forecast of 4.2% made last August). With a few exceptions (Vietnam for manufactured goods and Australia for commodities), Asia's GDP growth no longer swings on trade demand. In our country assessments from China to India, the most important determinant of growth is now consumer demand.

Lagging and uncertain capex

Fixed investment is the wild card for Asia, and how that goes largely depends of policy. India's outlook is undermined by very weak growth in fixed investment, as non-performing loans choke its banks. That must be PM Modi's next priority. Governments in Vietnam and the Philippines have got the right policies, so capex is soaring. But, Thailand, Malaysia, and Indonesia are struggling.

Not following the US$ up – except for the A$

With the US$ set to rise by 2-4% a year on its trade weighted index, most Asian currencies will fall by 2-4% on a rising US$. Critically, we expect China's Yuan to drop 1-2% from Dec 2016 to Dec 2017 (and about the same over 2018) on the US$ after a 5.4% year-average fall in 2016. The A$ is an exception, as it finds support from booming mining exports.

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Japan

Political & policy issues to watch

PM Abe

… a strong leader

… who could hold office until 2021

PM Abe dominates Japanese politics, and that looks set to continue. More than four years after winning the December 2012 election, opinion poll support for his cabinet stands at 60%+, while the main opposition party is stuck at 8%. Within the ruling LDP he is also dominant, with the factional jockeying that long plagued the party subsiding for now. In March, the LDP will amend its rules to allow Abe's term as party president (and thereby as PM) to run for three consecutive three-year terms instead of the current two-term limit. That opens the way for him to lead Japan to September 2021 (a period including the 2020 Tokyo Olympics). Rather than fast-approaching a term-limit, Abe likely sees himself as approaching the mid-way point in his nine-year term as Japan's leader.

But Abe has done little to reform Japan

… so, growth remains weak

The press speculates that Abe may pull the 2018 elections forward to 2017. His decision will depend on continued popular support, whether the LDP-led coalition looks capable of retaining its super-majority, and the challenges facing key legislation. The big issues are labour market reform (the absence of which has contributed to a slide in consumer demand), pension reform (also a factor in weak consumer demand and massive public debt), and power sector reform (as restarting most of the 40+ nuclear stations that once delivered 20%+ of electricity looks unlikely). So far, Abe has avoided any serious work in these areas, focusing instead on re-igniting growth via fiscal and monetary stimulus, with the latter leading to a weak Yen. Only the weak Yen has helped growth by boosting profits at large corporates and, more recently, supporting an export revival.

Handling Trump

… & avoiding a return to Super 301

Abe has excelled at quickly getting on the right side of US President Donald Trump. That may help Japan avoid a repeat of the "super 301" trade sanctions applied by the US at times between 1989 and 1994 (such unilateral sanctions were dropped after the WTO came into being; but as Trump distains the WTO, he may return to bilateral action). Toyota and Soft Bank also moved fast to announce big US investment commitments.

Outlook for the market

A broad lift in growth in Q4'16

… should carry through 2017 into 2018

Japan finished 2016 with a firm lift in growth to 1.6%yoy in Q4'16 from 0.8%ytd for the first three quarters thanks to a broad upturn that included consumers (to 1%yoy in Q4'16 from 0.2%ytd for Q1-Q3'16), fixed investment (to 2.1%yoy from 0.6%ytd), and export volumes (to 4.8%yoy from 0.1%ytd). Better global demand suggests that export volumes should grow about 1.6% both this year and in 2018 from 1.2% in 2016. That should nudge up capex and salary growth, contributing to slightly better consumer spending (see below). The next sales tax hike (to 10% from 8%) has been put back to October 2019, and that may pull forward some spending into Q1-Q3 2019, if it goes ahead. Abe would hope that the 2020 Tokyo Olympics will fill the gap in 2020 demand. Our 2017 GDP forecast rises to 1.3% (previously 1.2%) and 2018 lifts to 0.9% (from 0.7%).

Exports are helping after 5 weak years

Japan's exporters benefited from the broad global recovery in late 2016, with total exports up 8.9%yoy in Q4'16 from 1.3%ytd growth in the first three quarters (on US$ values). The upturn is apparent in exports to the US, China, and ASEAN, while exports to the EU cooled slightly but were still up 5.1%yoy in Q4'16. Exports should lift about 5% this year and 2% next year after an average annual fall of 4.6% over the prior five years. That should lift industrial production by 2% this year and 1% in 2018 after five years of no growth.

A small lift in consumer demand is likely

Consumers should get a mild boost, as the lift in exports nudges up incomes (mostly by more overtime hours, as pay growth will stick around last year's 0.9%). But with inflation turning mildly positive, real growth in consumer spending should lift to 0.9% this year and 0.6% in 2018 from 0.4% last year. The annual rate for housing starts rose 6.4%yoy to 967,413 units in Q4'16 and might reach the 1m level in 2017, a rate last seen in 2009 (and still well below the 1.4m annual average from 1980-2000, as the population shrinks).

Low inflation and a weak Yen

Inflation edged up 0.2%yoy in Q4'16, ending two quarters of deflation, and looks set to rise to around 0.5% through 2017 and 2018. That won't be enough to shift the Bank of Japan away from monetary easing, and as rates rise in the US that should mean a weaker Yen.

	2014	2015	2016	2017	2018
GDP, real growth (2005p), %	0.3	1.2	1.0	1.3	0.9
CPI, year average, %	2.8	0.8	-0.2	0.4	0.6
Overnight call rate, year end, %	0.07	0.04	-0.06	-0.06	-0.06
Yen to US$1, year average	106	121	109	113	119

Sources: 2013-2015 data from the BOJ and government sources; 2017-2018 estimates by IMA Asia

China

Political & policy issues to watch

President Xi stays on track for a 2nd 5-year term

… with even more power than in his 1st term

As Party head Xi Jinping nears the end of his first five-year term, the National People's Congress (NPC) has reconfirmed his dominance as "core leader" over the party, the government, and the military (the latter putting loyalty to Xi over loyalty to Party for the first time). Xi is set to get a second term at the 19th Party Congress this autumn, and his team should dominate in appointments to most key posts and party forums. The plus from such unusual dominance may be that Xi will push ahead with stalled reforms in 2018. But it also means his views will dominate, and that includes greater Party control over the market, and a renewed priority for state owned enterprises (SOEs). Industry and foreign policy have also become more nationalistic under Xi. After some three decades of consensus leadership, this also suggests the potential for abrupt policy shifts ahead.

Targeting slower growth

… and slow reform

In the government's work report at the NPC, Beijing eased the 2017 growth target to "around" 6.5% from last year's 6.5-7.0%, while the credit (M2) growth target was inched down to 12% from 13%. Slower growth will be accepted, provided unemployment doesn't rise. Beijing also recommitted to supply-side reforms (very gradual in practice) and SOE reform (barely happening). Stepped up spending on infrastructure will continue.

Outlook for the market

Over-reliance on debt & public capex for growth

Beijing aggressively lifted public capex last year to underpin growth. That helped construction (and also global commodity prices), but came at the expense of a continued fast rise in debt. Beijing has enough financial resources to continue such stimulus through the end of the decade in the hope that private demand takes over. While consumer demand is growing as fast as might be expected, private capex has slowed. We expect that trend to see growth slow to 6.3% in 2017 and 5.5%pa over 2017-21.

Fundamental change in the trade account

… as China's export surge cools

On a six-month rolling sum basis to February, imports were up 8%yoy but exports slid 5%yoy, hinting at a shift in external trade. Strong imports growth points to firm local demand (and surging commodity prices). Weak exports are harder to explain, as the Yuan fell over 6% on the US$ in 2016, and North Asian neighbours saw strong export rebounds in Q4'16. It may reflect some off-shoring of labour-intensive manufacturing. It also suggests that a surging trade surplus has moved to a long-term decline. We expect export growth of 5-7% this year and in 2018 from falls of 7.7% last year and 2.9% in 2015.

Consumers underpin growth

… with a shift to services

The urban household expenditure survey showed overall spending (in current prices) up 7.9% last year, a bit faster than 2015's 7.1% rise. Spending on medical goods and services led at 13% growth, with education, culture and recreation up 11%, transport and telecoms up 10%, residence up 8%, food & beverage up 6%, and clothing lagging at 2%. We estimate real consumer spending grew 7.4% in 2016, down from 7.9% in 2015. Growth is likely to slow to 6.3% this year and 5.8% next year, as wage growth slows.

A big slowdown in private capex

… offset partly by SOEs

Xi's preference for SOEs is partly reflected by a 19% jump in 2016 in SOE fixed asset investment (FAI, a slightly different measure from "fixed investment" in other countries). As SOEs account for 19% of all FAI, that helped cushion slower growth of 9.8% in private firm FAI (down from 13.9% in 2015 and a 34% average pace over the prior decade; accounting for 32% of all FAI in 2016). Beijing talks about easing barriers to private investment in the next year to revive growth in private FAI. Our estimate for real growth in total fixed investment is 5.9% this year and 5.5% in 2018, from 6.3% last year.

Low inflation

… and a slower fall for the Yuan

Despite producer prices jumping 7.8%yoy in February, consumer price growth unexpectedly fell to 0.8% from 2.0-2.5% over the four prior months. We expect a return to 2.0-3.0% over the next two years, as higher producer prices partly push through into consumer prices. Meanwhile, the Yuan's 6%+ fall over 2015 and 2016 on the US$ is expected to ease to 1-2% falls in 2017 and 2018, as Beijing stems capital outflows.

	2014	2015	2016	2017	2018
GDP, real growth, %	7.3	6.9	6.7	6.3	5.8
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	6.16	6.28	6.64	6.96	7.04

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

Carrie Lam is set to become HK's next leader

… but political divisions will remain

Given Beijing's clear backing and her 580 nominations from the 1,194-strong election committee, Carrie Lam's victory in the looming Chief Executive election looks assured. However, with no nominations from the pan-democrat camp, Ms Lam will be poorly positioned to bridge the political divide that has bedevilled HK politics in recent years and has blocked or slowed most bills in the Legislative Council. John Tsang, the ex-Financial Secretary, is the only candidate who received nominations from both pan-democrats and pro-establishment camps, but China's leaders have signalled their lack of trust in him.

A small fiscal boost in HK

… but a bigger one from China

With GDP growth slowing to 1.9% last year, the government announced a stimulatory budget for FY2017/18 that aims to raise growth back to 2-3% over the next few years. Key measures include a cut of up to HK$20,000 (US$2,580) in personal income tax and a 39% jump in public capital works. Yet, with the budget surplus set to grow, many in HK believe the budget will do little to lift the economy or tackle key social and business challenges, such as very high operating costs that can more than offset low tax rates. HK will benefit more from stimulus measures in China in 2017 (see below).

Outlook for the market

A mild 2017 recovery

… as global demand lifts

Following a dip in growth to 1.9% in 2016, HK should benefit from a rise in global demand and sustained growth in China, where an increase in stimulus measures in 2H'16 should provide a strong boost to the economy in 1H'17. Both developments are likely to lift trade, logistics, and financial and business services in Hong Kong, taking 2017 growth to a modest 2.4% (still below the decade average to 2016 of 2.9%). The medium-term outlook is less certain given the rise in global trade protectionism, the uncertain impact of rising US interest rates, and political risk in Europe.

The challenge from falling mainland tourists

HK's large tourism sector, a key driver of retail trade, needs a better 2017. Mainland tourist arrivals fell 6.7% to 43m last year, which dragged total arrivals down 4.5% to 57m. That saw retail sales fall 8% by value with the index sub-sector for watches, jewellery and luxury items plunging 17%. Clearly, mainland visitors are also spending much less, with the US$-peg for the HK$ helping to keep prices high and making HK a less attractive shopping destination. One outcome has been considerable distress and turnover in the city's large luxury retail sector.

… and subdued local consumers

Local consumer demand growth slumped to 1.6% last year from 4.8% in 2015 (and a decade average to 2015 of 4.8%), but should recover with growth of 2.5% in 2017 and 2018. Households are struggling with soaring property prices and a slide of median monthly earnings (with bonus) growth to 3.6% last year from 7.8% in 2015.

A weak recovery in capex, led by housing

Despite the FY2017/18 budget's boost for public capex, public works are likely to be delayed by legislative gridlock. Private construction should lift in response to an ambitious target to increase home supply by 40% over 2017-21 from the prior five years. The net result should be a recovery in total capex growth to 3-4%pa over 2017-18 from 1.3%pa in the last three years.

Following the US$ and US rates up

A strong US$, to which the local currency will remain linked, and moderate economic growth should cap HK inflation at 2.5% this year. Helping curb inflation—and also cool parts of the economy—should be weaker capital inflows, particularly from China, and higher interest rates, as the US$ peg requires the local policy interest rate to shadow the US Fed's rising policy rate.

	2014	2015	2016	2017	2018
GDP, real growth, %	2.8	2.4	1.9	2.4	2.4
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	1.75	3.75
HK$ to US$1, year average	7.75	7.75	7.76	7.75	7.75

Sources: 2013-2015 from Censtat, HKMA, and CEIC; 2016-2018 estimates by IMA Asia.

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Taiwan

Political & policy issues to watch

Tough policy challenges

… see support for Pres. Tsai ebb

It has been a difficult start to office for President Tsai Ing-wen, who became Taiwan's first female president following a decisive victory for her independence-leaning Democratic Progressive Party (DPP) at last year's election. Despite sweeping into office with the opposition KMT party in disarray, a number of issues ranging from labour market and pension reforms to marriage equality, saw her approval rating slump as low as 33.8% in January. While it has since recovered to 41.5%, it is well below her 70% opinion poll support when she took office last May, with confidence in her inexperienced administration's ability to solve major issues (see below) still low.

Geopolitical risk with China

… a concern for electronics

One of Tsai's biggest challenges is souring cross-straits relations, as she opposes closer ties to the mainland. That threatens vital supply chain linkages for Taiwan's manufacturing sector (and the global electronics market), with China accounting for over 25% of Taiwan's exports. So far, Beijing has applied soft pressure; for example, curbing mainland tourist inflows to Taiwan by 29% since Tsai took office. Taiwan's manufacturers fear that rising geopolitical tension in North Asia could trigger a harsher response from Beijing.

Messy new labour laws

… annoy both firms and unions

Meanwhile, new labour laws, affecting some 8.6mn workers, have cut the workweek to five days, lengthened annual leave, limited monthly overtime, and increased overtime and public holiday pay. Over half of Taiwanese do not support the changes, while labour intensive businesses face a messy adjustment process with many reporting increased costs. Pension reform to curb the cost of generous public pensions and to ease the strain on public finances is also a divisive issue. Pension reform is due to be tabled in the DPP-dominated legislature this May.

Outlook for the market

Rising global demand lifts Taiwan in 2017

Taiwan's economy is on a mild recovery path, with GDP growth edging up to 1.5% in 2016 from a six-year low of 0.7% in 2015. The prospect of better growth this year hinges on the emergence of a stronger labour market and a revival of private capex growth. Another key development to watch is the duration of the export recovery, with the recent and broad-based global industrial upturn suggesting sustained momentum in 2017. We expect firmer global demand to lift GDP growth towards 2.0-2.5% in 2017 and 2018, in line with the government's forecast but below the 3.5%pa pace of 2005-15.

Electronics surge

Export volumes on the GDP measure surged 8%yoy in Q4'16, making it the best quarter in almost six years. That flowed through to 6.2%yoy real growth in manufacturing in Q4'16, with the production of electronic parts & components soaring 14.2% from a 1.6%yoy fall in 1H'16. Provided the NT$ doesn't jump in value (see below), export growth could top 10% (US$ terms) this year after falling 13% over 2014-16, with 8% possible in 2018.

Weak consumer demand

… but capex is lifting

Weak consumer confidence, little wage and employment growth, a 6% fall in home prices, and a two-year slide in stock prices, saw consumer demand growth slow to a four-year low of 2.1% last year, with a similar pace likely in 2017. Meanwhile, capex growth gathered momentum in 2H'16 and should firm in 2017, as infrastructure (including energy) development is at the top of Tsai's economic revival efforts. That should see capex grow 3-5% in 2017 and 2018 from a 2.7% lift last year.

Risk from a firm NT$

Despite rising to an 11-month high of 2.3%yoy in January, weak local demand and a firm NT$ should keep year-average inflation at 1.5-2.0% this year from 1.4% in 2016. The NT$ fell 1.5% on a rising US$ last year. That meant a 4% lift on China's Yuan, which hurts Taiwan's export competitiveness. The NT$ has risen 1.1% on the US$ this year, and should firm to 30-31 in 2017, with a lift to 4.3-4.6 on the Yuan also possible this year.

	2014	2015	2016	2017	2018
GDP, real growth, %	4.0	0.7	1.5	2.4	2.5
CPI, year average, %	1.2	-0.3	1.4	1.8	1.6
Official discount rate, year-end, %	1.88	1.63	1.38	1.38	1.38
NT$ to US$1, year average	30.3	31.8	32.2	30.4	30.5

Sources: 2013-2015 government data and CEIC; 2017-2018 forecasts by IMA Asia.

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South Korea

Political & policy issues to watch

Pres. Park is toppled

… as Koreans tire of a corrupt elite

Korea's political crisis has built since last April, when the ruling Saenuri party was unexpectedly beaten in legislative elections. It peaked on March 10, with a court confirmation of parliament's impeachment of President Park Geun-hye over an influence-peddling scandal. Koreans will go to the polls on or before May 9 to elect a new president. Tied into the scandal is Samsung's vice-chairman, Lee Jae-yong, who is under investigation for a US$37m payment to entities linked to a friend of President Park, likely in return for government support for a contentious merger of two Samsung affiliates that helped secure his control over the whole group at the expense of other shareholders.

The left is set to lead government

… taking a harder line on business & the chaebol

Park's toppling will swing Korean politics to the left, bringing regulatory challenges for companies and geopolitical challenges for the US. Moon Jae-in of the Democratic Party leads the presidential race with a 33% approval rating, followed by Ahn Hee-jung, governor of South Chungcheong province, with 22% support. If elected, Moon is expected to adopt a friendlier attitude towards North Korea, and will try to diffuse an escalating conflict with China over the deployment of the US-operated THAAD antiballistic missile system in Korea. That could see ties with the US cool, which risks triggering an uncertain response from President Trump. Moon will also try to reduce the dominance of the family-run chaebols with a focus on the big four: Samsung, LG, Hyundai, and SK.

Outlook for the market

Weak sentiment limits growth prospects

A swift rise in trade flows hints at a strong start to 2017 for Korea. Exports for the first two months grew 15.7%yoy from 1.8%yoy in Q4'16, while imports surged 21.5%yoy from 4.1%yoy. The trade lift has yet to flow to other indicators, with the February purchasing managers index (PMI) for manufacturing stuck below the 50 expansion/contraction level due to weak output, new orders, and employment. Despite the strong trade start, we are cautious about growth this year, as household finances look fragile, consumer and business sentiment is weak, and a two-year surge in construction growth is set to cool. We maintain our GDP growth forecast at 2% for 2017 and 2.4% for 2018 from 2.7% in 2016.

Financially constrained consumers

Consumers face record-high household debt (90% of GDP in 2016 from 62% in 2005), a weak job market (employment growth halved to 1.2% in 2016 from 2.1% in 2014), and slowing pay growth (3.4%yoy in Q4'16 from 5.3%yoy in Q1'16). These headwinds, along with political turmoil, saw consumption growth slow to 1.6%yoy in Q4'16 from 2.7%ytd for Q1-Q3'16. We expect consumer demand to grow 2.2% in 2017 and 2.5% in 2018 from 2.4% in 2016.

Capex growth to ease

…as construction moves to a lower gear

Fixed investment growth lifted to 5.3% last year thanks to an 11% jump in construction capex (real growth for construction GDP also rose 11%). However, weak forward-looking indicators, such as construction permits (-18.3%yoy in 2H'16 from peak growth of 48.7%yoy in Q4'15), suggest that construction growth will slow to 6-7% this year and less than 4% next year, which will see total fixed investment growth slip towards 4% this year and 3% in 2018. Plant and equipment capex fell 2.4% last year, and with exports likely to lift 8-10% this year and about 5% next year after a 13.5% fall over 2014-16, a lift of 2-3% is likely this year and next.

Rising inflation to force interest rate hikes

With producer prices rebounding from a fall of 4.4%yoy in Q4'15 to a rise of 0.8%yoy in Q4'16 (and a 3.8%yoy rise in January), consumer prices are on an uptrend that will take them from 1% last year to 2.3% this year and towards 3% next year. The Bank of Korea will try to stick with its current record low policy rate of 1.25% to support local demand but may need to edge up rates this year and next year. That should help limit the Won's year average slide on the US$ to around 1.5% in 2017 and 2018 from 2.5% in 2016.

	2014	2015	2016	2017	2018
GDP growth, %	3.3	2.6	2.7	2.0	2.4
CPI, year average, %	1.3	0.7	1.0	2.3	2.5
BOK Base rate, year-end, %	2.00	1.50	1.25	1.75	2.25
Won to US$1, year average	1,053	1,131	1,160	1,179	1,199

Sources: 2013-2016 government data (NSO, BOK) and CEIC; 2017-2018 forecasts by IMA Asia.

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Indonesia

Political & policy issues to watch

The race to be Jakarta's next governor

… a microcosm for national politics

Political debate is running hot in Jakarta, as the second-round vote for the city's next governor approaches on April 19. The contest between incumbent Basuki Tjahaja Purnama ("Ahok") and former education minister Anies Baswedan has a multi-layered complexity. At one level, it is a forerunner of the 2019 national race in which Prabowo Subianto (who lost in 2014, and who backs Anies for governor) will square off against President Joko Widodo ("Jokowi", who backs Ahok, his deputy when he ran Jakarta). Jokowi and Ahok stand for good governance and reform; Prabowo, a controversial ex-army general, prefers a return to traditional politics. At another level, the race has been used as a platform by militant Islam, which has held mass rallies to attack Ahok (a Chinese Christian) for blasphemy. Ahok is under trial on this charge. Anies is favoured to win, but if Ahok avoids a conviction and pulls off a victory, it will be a boost for Jokowi and reform.

Rising resource nationalism

… the battle with Freeport

… can Jokowi halt the trend?

A dispute between US miner Freeport and the government over the Grasberg mine has seen output slashed by Indonesia's largest exporter and taxpayer. The government is attempting forced nationalisation under new rules, which contravene a 1991 contract with Freeport that runs to 2021. Support for resource nationalism is so strong that it's hard to see the government backing down, even though it could lose under international arbitration. Moreover, surging exports and revenues from other commodities strengthen the government's position. This could drag on for years, harming Indonesia's reputation as a destination for foreign investors. That makes it a key test of Jokowi's administration.

Outlook for the market

Growth lifts in 2017

… as consumer demand & exports lift

After four years of growth stuck close to 5%, the pace should lift to 5.4% this year and could exceed 6% in 2018. Most of the upturn will come from recovering consumption and exports. The weak area is likely to remain fixed investment, reflecting a difficult investment environment beset by red tape, rising nationalism, and political and policy uncertainties. The upside potential lies in President Jokowi improving the investment environment, which might trigger a long-delayed return to an investment grade rating from S&P.

Exports boosted by earnings from coal and palm oil

Over the five months to February, Indonesian exports have risen by 16%yoy (US$ basis) after a fall of 9% in the first nine months of 2016 and a 15% fall in full 2015. Most of the turnaround in Q4'16 was due to a 29%yoy jump in coal exports and a 32%yoy jump in palm oil. Apart from lifting GDP, better exports cut the current account deficit to US$16bn in 2016, its lowest level in five years. That will take some pressure off the Rupiah.

Watch for a gradual lift in consumer demand

Real growth in consumer spending of 5% last year was in line with the prior two years. The pace should lift to 5.8% this year and could reach 6% in 2018. The 9% fall in motorcycle sales last year, which reflected drought and weaker employment conditions, appears to be easing, with a smaller 1.4%yoy drop for the first two months of 2017. Households face a smaller lift in the minimum wage this year (7.3% from 13.5% in 2016), but consumer sentiment is improving and growth in bank lending to individuals bottomed last August at 7.3%yoy, with a rise to 9.3%yoy by January.

… but a weaker lift in capex

Fixed investment growth remained stuck at a weak 4.5% last year from an average 4.6% for the prior three years. Plant and equipment capex has been notably weak, falling an average 2% for each of the last four years. A commodity price recovery plus better vehicle sales should lift total capex growth to 5.4% this year, and just over 6% in 2018.

Moderate inflation and a weak Rupiah

An end to drought should help keep food prices stable this year and limit inflation. Bank Indonesia will need to keep its policy rate at least 150 basis points above inflation to curb the Rupiah's year-average fall on a rising US$ to about 2% in 2017 and 2018.

	2014	2015	2016	2017	2018
GDP, real growth, %	5.0	4.9	4.9	5.4	6.1
CPI, year average, (2012=100), %	6.4	6.4	3.5	4.0	4.9
Central bank rate (7-day RR) at Dec %	-	6.25	4.75	5.25	6.50
Rupiah to US$1, year average	11,868	13,389	13,308	13,536	13,825

Sources: 2013-2015 government data (BPS, BI) and CEIC; 2017-2018 forecasts by IMA Asia

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Malaysia

Political & policy issues to watch

PM Najib recovers

… as the 1MDB scandal fades

… & UMNO reasserts its formula

PM Najib Razak is preparing for a snap election later this year, even though one is not due until August 2018. Emboldened by the failure of the opposition to capitalise on the long-running 1MDB scandal, Najib expects his UMNO-led coalition to perform better than in the 2013 election, when it lost the popular vote, but won a parliamentary majority thanks to gerrymandering. The unravelling of the opposition coalition, which includes disparate members such as the DAP (a party representing the local Chinese community), PAS (a hard-line Islamic party), and PPMB (a new party formed by ex-PM Mahathir), accelerated after the imprisonment of the opposition's de-facto leader, Anwar Ibrahim, in 2014.

Watch for big projects to move ahead

… thanks to funds from China and Saudi Arabia

In 2010, a year after he took office, PM Najib launched an economic transformation program to run to 2020 with an array of major projects requiring some US$444bn in investment, nearly all from the private sector. The 1MDB scandal, a collapse in oil and gas revenues, and declining foreign investor interest in emerging markets hamstrung the plan. In the latest setback, the US$100bn Forest City residential development in Johor, focused almost entirely on mainland Chinese looking for overseas property, has stalled after China clamped down on forex outflows. Yet, a revival in big project capex is likely. Over the last year, Chinese state-owned firms have helped 1MDB deleverage by buying a string of its assets. China will also help fund and develop several major rail projects. Meanwhile, Saudi Aramco has just announced it will pay US$7bn for a 50% state in the RAPID refinery and petrochemical project under development by state oil company Petronas. That should help Petronas reverse a major cut in capex spending announced in 2016.

Outlook for the market

Growth of 4%

… as local demand cools while exports lift

GDP growth eased to 4.2% in 2016 from 5% in 2015 and 6% in 2014, despite a 6.1% rise in private consumption, which accounts for 53% of total demand. Strong consumer demand wasn't enough to offset slower growth in public consumption (up 1% in 2016 from 4.4% in 2015) or in fixed investment (2.7% in 2016 from 3.7% in 2015). We expect GDP growth to settle at around 4%pa in 2017-18 on the back of softer household consumption, a quickening of capex activity, and firmer export growth.

Infrastructure spending to lift capex activity

Housing approvals have been falling since 2013, and manufacturing investment approvals fell 28.5% (in US$ value) in 2016. However, government-sponsored infrastructure projects, with newly acquired Chinese participation (see above), will take up some of the slack. The projects consists of multiple transport and prestige real estate developments, and help lift total capex growth to 3.5%pa in 2017-18 from 2.7% in 2016.

Consumer demand growth hits the wall

Private consumption growth eased to a still-impressive 6%pa over the last two years after surging by 7.5%pa over 2003-14. This year, we expect real growth to drop to 4.5%, as households confront headwinds that include record-high debt (89% of GDP from 60% in 2008), a cooling housing market, weaker job prospects, and rising living costs. These trends look set to continue into 2018, cutting consumer real growth to 3.7% next year.

A weaker M$ as rate hikes are delayed

As consumer demand weakens, Bank Negara (BN), Malaysia's central bank, will be loath to lift its policy rate from a current 3% despite the real policy rate turning negative as CPI inflation reached 3.2%yoy in January. Surging producer price inflation to 10.2%yoy in January suggests that CPI inflation will push into a 3-4% band by 2018. With at most one rate hike this year, the M$ will be exposed to a narrowing interest rate differential to US rates, and the year-average exchange rate to the US$ will drop by 6-8%. BN will have to raise rates faster in 2018, which should halt the M$'s slide.

	2014	2015	2016	2017	2018
GDP, real growth, %	6.0	5.0	4.2	4.0	4.0
CPI, year average (2010=100), %	3.2	2.1	2.1	3.0	3.5
Central bank overnight policy rate, Dec, %	3.25	3.25	3.00	3.25	4.00
Ringgit to US$1, year average	3.27	3.90	4.14	4.53	4.53

Sources: 2013-2015 government, Bank Negara, & CEIC; 2017-2018 forecasts by IMA Asia.

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Philippines

Political & policy issues to watch

A difficult but powerful president

Eight months into his single 6-year term, President Duterte remains best known for his violent anti-drugs campaign, which has seen some 7,000 people killed. While foreigners are appalled, it is supported by most Filipinos (Duterte's approval rating remains at 83%), and the few local politicians and organisations opposing it have gained little traction. Duterte also has one of the strongest positions in Congress in decades, with his PDP-Laban led coalition commanding a supermajority. Potential support in the 24-seat Senate improved at the end of February, with opposition Liberal Party senators being stripped of their roles as committee chairs. However, senators rarely vote along party lines, so we've yet to see whether this will help end the logjam facing legislation since Duterte took office.

The need to break a legislative logjam

… big tax reforms are waiting

Central to speeding up legislation is passing a law to reinstitute the death penalty. It was the first bill put forward by Duterte, and it is holding back major economic bills. The lower house has just approved it, so the senate will now debate it. Waiting behind it is the first of four tax reform bills, which would cut the top personal tax rate to 25% from 32% while raising the threshold, and increasing taxes on fuel and vehicles. Following bills would cut the corporate tax rate to 25% from 30%, broaden VAT, lower inheritance tax, and lift taxes on cigarettes, alcohol, and (possibly) sugary drinks. The extra revenue would help cover a promised P8.2trn (US$160bn) infrastructure program to 2022. Without the tax reform, Duterte's infrastructure plan will struggle, and the country's credit rating might be at risk.

Undermining mining

The Philippines is in the process of closing its mining industry following decades of bad management, an abrupt swing to rigid environmentalism, and an ill-informed belief in downstream processing. The outcome will partly depend on whether Regina Lopez, an environmentalist who has ordered the closure of 23 mines, suspended five more, and cancelled planning for another 75, remains in her position as environment secretary.

Outlook for the market

Robust 6-7% growth for the next few years

Provided overheating is avoided (see below) and tax reforms are passed, the Philippines should remain one of Asia's standout growth stories, with favourable demographics, steady growth in BPO and OFW income, and a big lift in infrastructure development likely to deliver 6-7% growth for the next few years. While that's lower than the government's 7-8% target, it's well above the two-decade average pace of 4.8%.

Bright capex prospects

Domestic demand surged by a multi-decade high of 10.2% last year from an 8.4% lift in 2015. That was led by a 23.5% spike in capex from a 15.2% lift in 2015, which saw capital goods imports surge 40% in 2016 from 21% growth in 2015. The number of businesses with expansion plans has risen to a nine-year high, suggesting capex growth of about 15% this year, well above the 8.3%pa pace of 2010-15.

… and a strong consumer market

Consumer spending grew a multi-decade high 6.9% in 2016 with a similar pace likely for the next two years, thanks to buoyant consumer confidence, steady OFW remittances, strong employment growth and low unemployment, which fell to at an eleven-year low of 4.7% in its latest reading. A 14.4% lift in passenger car sales saw a record-high 133,000 units sold last year after 26%+ annual growth over 2013-15. Meanwhile, demand for durable goods should stay firm, with purchase intensions close to a seven-year high.

Watch for rate hikes to curb inflation & a softer Peso

Inflation is on the rise, and should breach the central bank's 4% upper limit in 2H'17, with 5% likely in early 2018. While few in the local market expect it, we think a string of rate hikes will be needed. Those rate hikes, along with steady offshore income from OFW and BPO remittances, should limit the Peso's slide on a climbing US$ to about 6.6% this year (most of which has happened) and 1-2% next year.

	2014	2015	2016	2017	2018
GDP growth, %	6.2	5.9	6.8	6.5	6.4
CPI, annual average, %	4.1	1.4	1.8	4.1	5.0
Central bank reverse rep. rate, year end	4.00	4.00	3.00	4.25	5.25
Peso to US$1, annual average	44.4	45.5	47.5	50.9	51.7

Sources: 2013-2015 BSP data and CEIC; 2017-2018 forecasts by IMA Asia.

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Singapore

Political & policy issues to watch

Global challenges to policy

… halve GDP growth

Almost all governments have been challenged by global economic conditions and a swing in voter mood over the last five years and Singapore is no exception. The city's unique industrial/economic model, with a large forward planning component, is under challenge from five years of weak global trade, a crash in the oil exploration sector, a suppressed global financial system struggling to restructure, and demands from citizens that large-scale use of foreign workers be stopped. Such challenges were not anticipated, so the city has entered a transition period marked by a halving in growth to 2-3%, and a bumpy ride for many companies. Some recent policies have worked well (deflating a housing bubble, an excellent business environment with affordable rentals, rising industries like healthcare, aerospace, and integrated resorts), but they haven't fully offset the challenges.

Big changes to labour policy

… forcing firms to adjust

Labour issues lie at the centre of tension between voters, the PAP, and companies. Voters want "core" Singaporeans (i.e. citizens) to get priority in the job market. Policy has adjusted to that demand, even though that can clash with Singapore's ambition to be a global services and technology hub. Mid to low-end work in construction, manufacturing, and services is under pressure to move to higher automation or exit.

A reduced growth target & a search for new drivers

… with a bit of fiscal stimulus

In contrast to the big fiscal stimulus over 2007-09, the government is handling the latest challenges by tweaking its budget and focusing on a handful of strategies to support growth over the next decade (with a target set at 2-3%pa growth, well down from the 5.1% average for the two decades to 2016). Public spending for FY2017 (starting April 1) is expected to lift by 5.2% (from 4.4% in the current FY). As revenue growth is expected to slow to just 1.1% (from 5.9%), we estimate the basic budget deficit will lift to around 2% of GDP from 1.4% likely this FY (investment returns more than cover that basic deficit). Key measures include deferring a hike in the foreign worker levy in the marine and process sectors, and pulling some future infrastructure work into 2017.

Outlook for the market

A mild lift in 2017 growth

Growth has been stuck close to 2% for the last two years, which feels uncomfortably weak to many firms. The big question in the outlook is the extent to which export manufacturing and trade related industries—two of Singapore's traditional engines—are about to fire up. Non-oil domestic exports jumped 11%yoy for the three months to January after falling 5.6%ytd for the 10 months to last October, while the industrial production index soared 11.5%yoy in Q4'16 after falling 1% over the year to Q3'16. We've been cautious in lifting forecasts for these indictors, as we think the current surge is driven by global inventory rebuilding that will cool from 2H'17. Our 2.7% GDP forecast for 2017 is up from 2.6% last month, while 2018's 3.2% is unchanged.

… led by export manufacturing

We expect export volume growth to recover to around 4% this year and next year from 1.6% last year and a two-decade average of 6.7% to 2016. That should be enough to lift manufacturing GDP real growth close to 6% this year and 3% next year from 3.6% in 2016 (almost all in Q4'16 with an 11.5%yoy jump after just 1%ytd for the first three quarters) and a two-decade average of 5.3%. Industrial production should lift by about the same.

Services should also recover

… helping consumers

A key question is what the export manufacturing recovery does to services (67% of GDP compared to 17% for manufacturing). Services grew just 1% last year, but should return to around 3% growth this year and 4% next year from a two-decade average of 5.5%. Better employment and pay, mostly in the services sector, should help real growth in consumer spending recover to 2% this year and 2.4% next year after slumping to 0.6% in 2016.

Modest inflation and a weaker S$

Inflation picked up to a 28-month high of 0.6%yoy in January and with firmer domestic demand and rising commodity prices, will likely move up to 1.5% in 2018. As the MAS, Singapore's central bank, guides the currency on an unspecified basket of currencies to manage inflation, it will likely follow a firmer path as the economy recovers. Against a rising US$, that will limit the S$ fall of around 2-3% this year and next year.

	2014	2015	2016	2017	2018
GDP, real growth, %	3.6	1.9	2.0	2.7	3.2
CPI, year average, %	1.0	-0.5	-0.5	1.0	1.5
3-month interbank interest rate, Dec, %	0.46	1.19	0.97	1.10	1.20
S$ to US$1, year average	1.27	1.37	1.38	1.42	1.45

Sources: 2013-2015 government data and CEIC; forecasts for 2017-2018 by IMA Asia

Thailand

Political & policy issues to watch

Politics to stay subdued

… while a new political structure emerges

Thai politics should remain muted this year, as much out of respect for the late King, who is due to be cremated in Q4'17, as due to the suppression of political debate. Meanwhile, PM Prayut's rural development programs, better administration (with an effort to curb corruption), and a push to lift growth have won his coup-imposed administration some acceptance. A February poll by the National Institute of Development Administration shows 35% rating Prayut's performance as very good and 48% rating it as good, while 82% rated him as working for the country. That suggest he'll get a favourable result in the 2018 election, with a civilian but military-guided government, which he might lead, taking office. While well short of democracy, that may bring stability.

Big infrastructure plans

… aiming to become ASEAN's factory hub

Prayut has a more developed policy agenda than prior governments. His strategy hinges on the success of a Bt1.8trn (US$51bn or 13% of GDP) infrastructure program that runs to 2022. The central project is the Eastern Economic Corridor (EEC), which aims to become ASEAN's high-tech industrial hub. Legislation will let foreigners own land and provide an array of tax incentives. Infrastructure work will start this year, but most of the scheme won't start until 2018. If successful, the EEC could lift Thailand up the value-added chain, revitalising growth in exports, manufacturing, GDP, and household incomes.

How this is paid for will be critical in 2017

Stepped up spending on infrastructure under Prayut saw public fixed investment in construction jump 51% in real terms over the last two years, while the government's fiscal reserve fell 85%, which prompted concern about the government going bust. We think the reserve is still adequate, with the bigger issue being how the market is tapped for private funds to support projects. Central to this will be the launch of a Thailand Future Fund this year. Prior funds to tap public savings for infrastructure have done well. But given the scale proposed, funding will also be needed from the budget, investors, and contractors.

Outlook for the market

A steady 2017 recovery, with upside potential

A decade of turmoil that culminated in the May 2014 coup saw growth drop to 0.9% in that year. Since then, growth has edged up, as a drop in political instability has allowed a muted recovery that reached 3.2% last year. The key question is how much upside there might be if exports do better than expected, the EEC gains traction, and politics remains stable through a 2018 election. We think the outlook is improving, and we've nudged up our 2017 forecast to 3.7% (last month 3.6%) while 2018 lifts to 4.1% (prior 3.8%).

Steady consumer growth

Steady consumer demand growth at close to 3% over the last five quarters has been central to Thailand's return to stable growth. While FMCG sales returned to 3-6% growth over 2015 and 2016, surveys show consumers remain cautious about buying cars and homes, with sales for both dropping last year. We see no reason for consumer growth to fall below 3% in in the next two years, with upside potential in 2018.

While exports and private capex lift

Better global demand should lift exports by 6-8%pa (US$ basis) in 2017 and 2018 after an average fall of 0.6%pa over the prior five years. That should help lift manufacturing to about 4% real growth this year and next year after four straight years averaging 1.2%pa. Sluggish private capex growth and a slowdown in public investment saw overall capex growth slow to 2.8% last year from 4.4% in 2015. While residential construction looks like remaining muted, plant and equipment spending by industry and a gradual lift in infrastructure should help drive 3-5%pa capex growth in the next two years.

Inflation heads up & the Baht's rise should reverse

Thailand's surging current account surplus due to a large fall in imports helped the Baht outperform SE Asian currencies against a rising US$. That helped cap inflation. But as the US Fed lifts its rates through 2017, we expect the Baht to start losing ground, and by 2018 to fall by at least 2% year average on the US$. Inflation should rise faster in 2018.

	2014	2015	2016	2017	2018
GDP, real growth, %	0.9	2.9	3.2	3.7	4.1
CPI (2002 index), year average, %	1.9	-0.9	0.2	2.1	3.2
Central bank, policy rate, year end, %	2.00	1.50	1.50	2.00	3.00
Baht to US$1, year average	32.5	34.2	35.3	34.4	34.9

Source: 2013-2015 data from the IMF and CEIC; 2016-2018 forecasts by IMA Asia.

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Vietnam

Political & policy issues to watch

Stable politics underpins mild reform

Vietnam managed a stable leadership reshuffle last year, with conservative Communist Party head Nguyen Phu Trong gaining a second five-year term. A new PM, Nguyen Xuan Phuc, has continued the government's commitment to trade and investment-friendly policies, as well as reforms to the bank system and state-owned enterprises (SOEs).

… with gradual openings for FDI in banks & SOEs

Bank reform is moving slowly, with the sector weakened by unresolved bad loans and low capital buffers. A foreign cap on bank ownership is likely to lift from 30% this year in the hope of attracting new capital and expertise. Meanwhile, SOE reform is edging forward via the "equitization" (a process of cornerstone stakes to leading foreign firms followed by partial domestic floats) of several SOE's, like dairy giant Vinamilk, and Vietnam's two largest breweries, Sabeco and Habeco.

The lost TPP opportunity can be offset

Vietnam stood to be one of the big winners under from the Trans-Pacific Partnership (TPP), which the US has now dumped. Smaller trade deals are in the works, but Vietnam still has a strong tail wind from WTO entry in 2006, and the ensuing relocation of factories from all of North Asia to Vietnam's fast rising industrial sector. It's hard to see President Trump targeting the type of labour-intensive manufacturing that thrives in Vietnam.

Macro risk is contained

… but watch inflation

Vietnam's external accounts improved last year, with the current account surplus lifting to 4-5% of GDP from 0.5% in 2015, and international reserves rising to US$38bn from US$27bn in 2015. Still, a pickup in inflation (see below), which could hurt consumer purchasing power, and a jump in public debt to its mandated cap (65% of GDP), which could limit the government's ability to deliver its development goals, need watching.

Outlook for the market

GDP growth to firm this year

Vietnam's economy should remain a standout performer in coming years. Over half of the population are below the age of 35, while a surging export-manufacturing sector and robust construction activity should continue to underpin economic growth. A severe drought capped GDP growth to 6.2% last year, but as its impact fades and exports firm on the back of the synchronised global growth upturn, GDP should expand 6.5-7.0% in 2017 and 2018, up from the 5.9%pa pace notched in 2010-15.

… led by export manufacturing

Vietnam won a further US$15.2bn in foreign direct investment (FDI) last year in a decade-long foreign investment surge into export manufacturing, which has helped drive a 16%pa export lift since 2006. Last year saw export growth of 9% (US$ basis), with a lift to 13-15% possible in 2017 on the back of firmer global demand. Exports surged 28.6%yoy in February thanks largely to spikes in textiles, footwear, and computer & electronic component demand. The export lift and ongoing industrial capacity expansion should see manufacturing grow 11-13%pa in the next two years from 8.7%pa in 2010-15.

… alongside strong consumer demand

Buoyant consumer confidence, low unemployment, and rising disposable incomes should underpin consumer demand growth of 7-8%pa in 2017 and 2018, a bit above its average pace in the decade to 2015. Passenger vehicle sales increased to 159,000 units in 2016 from 79,000 in 2014, with lower registration fees and import taxes likely to keep sales strong this year. One issue for 2018 is how Vietnam's large vehicle assembly industry will handle a planned removal of all tariff and non-tariff barriers in the automotive sector. Meanwhile, tourist arrivals surged 26% last year to a record-high 10mn, up from 8mn in 2015. More than 70% were from Asia, with over a quarter from China.

Watch for rate hikes to curb inflation

Inflation has risen to around 5%yoy in the last two months, in line with the government's year-average target for 2017. Yet, it's well above the central bank's 4% limit, suggesting the policy rate will have to lift this year. A rising current account surplus kept the Dong's fall on the US$ at 1.2% in 2016, with a further 1.5-2.5% fall likely in 2017 and 2018.

	2014	2015	2016	2017	2018
GDP, real growth, %	6.0	6.7	6.2	6.5	6.5
CPI, year average, %	4.1	0.6	2.7	5.0	4.4
Central bank refinancing rate, year-end, %	6.50	6.50	6.50	7.25	7.25
Dong to US$1, year average	21,148	21,677	21,932	22,425	22,858

Source: 2013-2015 data from the IMF and CEIC; 2017-2018 forecasts by IMA Asia

India

Political & policy issues to watch

A big UP win puts Modi on course for a national win in 2019

… and should help his reform bills win passage

After a landslide win in state elections for Uttar Pradesh (UP), India's most populous state, PM Modi and his BJP-led government are well positioned to win a second five-year term in the 2019 federal election. The UP win also signalled the collapse of Congress Party and its Nehru/Gandhi dynasty, which together had led India for most of the 70 years since independence. It's less clear if the UP win was a decisive vote for reform over the politics of caste and religion, as the BJP has just appointed a Hindu firebrand as UP chief minister. Still, the win should help Modi push reform legislation through the federal parliament's upper house, where his bills have been frustrated by a lack of support. Modi won't gain an immediate upper house majority (UP sends 31 MPs to the 245-seat upper house, but they are appointed for 6-year terms with one third retiring every two years). However, it should help him win over smaller parties that have sided with Congress in blocking legislation.

The GST may start in July

… but watch for implementation risk

All five of the enabling bills for the GST have been approved by the joint federal-state GST Council and will be put into the current parliamentary session attached to "money bills", which can't be rejected by the upper house. Finance Minister Jaitley hopes the new tax system will start in July, and it must start before October, when the states will lose many existing taxes under laws already passed. Most clients we've spoken to think GST introduction will be relatively smooth, but there is scope for considerable turmoil that may affect consumer sentiment and corporate cash flow.

Outlook for the market

Demonetisation

… sorting out what happened

… and the speed of recovery in 2017

India's questionable new GDP series says that consumer demand surged by 10%yoy in Q4'16, when most Indians were unable to buy anything but necessities following demonetisation on November 8. Vehicle sales (by volume) show who suffered most. Hardest hit were 3-wheeler sales (for tuk-tuks, a classic small business), which saw an 8%ytd fall to last October turn into a 30%yoy plunge in the final two months of 2016 and a 25%yoy fall for the first two months of 2017. Two-wheeler sales (a guide for low-income households) swung from 11%ytd growth by last October to a 12%yoy fall for the final two months of 2016, followed by a milder 3%yoy fall for Jan-Feb 2017. Passenger vehicle sales were least affected, with growth easing from 10%ytd by October to 5%yoy growth for Nov-Dec 2016 and then a rebound to 12%yoy growth for Jan-Feb 2017. Commercial vehicle sales, which rose 11%ytd by October, fell 7%yoy in the final two months of 2016, but recovered to 2%yoy growth for Jan-Feb 2017. Poor households and small businesses were hit hardest, with considerably less impact for middle-income households and larger firms. Apart from small businesses, the hit to demand is fading in the current quarter.

7% growth for consumers in 2017

… thanks to a big public sector pay hike and good rains

… but weak capex due to high bank NPLs

India claimed 7% growth in 2016 with the help of a 20%yoy surge in public consumption in Q4'16 and a 10% jump in consumer demand. The jump in government consumption started earlier in 2016, with the phase in of a 14.3% pay hike (plus an array of allowances) under India's once-in-a-decade pay rise for civil servants. That undoubtedly supported recent passenger vehicle sales and should continue to lift consumer demand in 2017. A good monsoon in 2016, after two poor ones, appears to have produced good (possibly record) wheat, rice, and pulse production. Both developments should help sustain real growth in consumer spending near 7% this year. The main weakness in domestic demand lies in fixed investment, which fell 1.5% last year, as bank credit growth slowed to 6.5% under a mountain of non-performing loans. India has no quick fix for this, so fixed investment growth is likely to be limited to 3-5% this year and next. This sets India up for GDP growth to continue at around 7%, mostly thanks to its consumers.

Mild inflation and a 3-4%pa slide for the Rupee

Strong growth in rural production should keep inflation in a 4-5% band. But with an inherently weak currency, the central bank will need to keep its policy rate 1-2 percentage points above inflation to limit the Rupee's fall on a rising US$ to 3-4%pa.

Calendar year starting January	2014	2015	2016	2017	2018
GDP (MP, 2011-12), real growth, %	6.8	7.4	7.4	6.8	7.2
Inflation - CPI, %	6.7	4.9	5.0	4.0	5.1
RBI repo rate, December, %	8.00	6.75	6.25	6.50	7.25
Rupee to US$1, year average	61.0	64.1	67.2	69.5	72.0

Sources: 2013-2015 data from the government (NCI, RBI) and CEIC. 2016-2018 forecasts by IMA Asia with guidance from IMA India.

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Australia

Political & policy issues to watch

The risk of more political instability

… undermining key policies in energy and housing

Policy uncertainty is high in Australia, and the political turmoil that has seen six prime ministers since 2007, when Rudd replaced Howard, shows little sign of ending. That hasn't damaged growth so far, but uncertainty in big policy areas ranging from energy to housing makes corporate planning difficult, and has undermined investment by both the public and private sectors. The current right-of-centre government led PM Malcom Turnbull is struggling, with opinion poll support sliding to 45% while support for the opposition Labor party has shot up to 55%. As Turnbull has a single seat majority, a by-election loss could force an early general election. Turnbull will be equally worried by a leadership challenge within his own Liberal Party from ex-PM Tony Abbott, who leads the party's conservative right wing. Adding to instability is the rising power of minor parties, particularly in the senate, where they control the balance of power. The Labor Party has just stormed to power in the Western Australian state election with a 16% swing that dumped a Liberal government, and captured voter unease over stalled income growth. The next lower house election must be held before May 2019, and Turnbull will be lucky to survive until then.

Luckily, a rise in mining revenues will help cover poor policy

In the rat's nest that passes for politics in Australia today, the one thing going for Turnbull is a new resources boom. Surging iron ore and coal export earnings are lifting corporate profits (at least for miners), GDP growth, the A$, and government revenue. The Liberals want to cut corporate tax to 25% from 30% and to reduce spending to quickly return the budget to surplus. By contrast, the IMF says Australia has relatively low debt and should lift spending on infrastructure. Meanwhile, ratings agency S&P warns that any fiscal easing will put at risk Australia's AAA credit rating. The only way to meet such wildly conflicting priorities is through another resource boom, and a mini one is underway now.

Outlook for the market

Exports will lift growth to 2018

… with a slower rise for local demand

GDP growth rebounded to 2.6%yoy in Q4'16 from an unusually weak 1.9%yoy in Q3'16, bringing the pace for full 2016 to 2.5%, roughly in line with the 2.4% of 2015. Yet growth didn't feel that good for many of our clients, as domestic spending growth has been trailing GDP growth since 2013 at a 1.2% annual pace. The export side of the economy drove growth last year and is set to continue driving growth in 2017 and 2018, thanks to a 68%yoy surge in Australia's coal export price and 90%yoy rise in the iron ore price. That saw export earnings surge 27%yoy in Q4'16 (US$ basis) while imports rose just 3%yoy, due to weak local demand. We expect GDP growth to lift to 2.8-3.0% in 2017-18, as rising net exports should outweigh the impact of relatively sluggish domestic demand. Domestic demand growth should lift to 2% this year and 2.3% next year from 1.6% in 2016.

Steady consumer growth at 2.7%

Private consumption grew at a steady 2.7% in 2015 and 2016, as households gained from a combination of record-high home prices and record-low borrowing costs. That partly offset slower employment and wage growth (0.8%yoy and 1.9%yoy in Q4'16 from 2.7%yoy and 2.2%yoy in Q4'15 respectively). While there is concern about a housing bubble, excessive debt, and rising interest rates, these factors aren't expected to undermine consumer demand in the next two years. The result should be steady real consumer growth around 2.7%pa.

A four year drop in total capex should halt

A steep fall in mining capex from 2013 has been partly offset by fast rising housing capex. The net result was 2.2% annual fall in total fixed investment for the four years to 2016. But with housing approvals falling 14%yoy in Q4'16, residential construction is set to slow. Yet with soaring commodity prices supporting renewed mining capex, the fall in total fixed investment should end this year, with a small lift possible in 2018.

Watch out for a volatile A$

… which could fall fast

Despite soaring commodity prices and a global lift in inflation, Australia's weak domestic demand growth and firm currency held inflation to just 1.5%yoy in Q4'16. With a steady but mild rise in inflation expected, the Reserve Bank of Australia will be slow to lift its policy rate. That means a dramatic narrowing in the gap to US interest rates, which exposes the A$ to considerable downside risk over the next two years. Any slowdown in China's commodity demand could also trigger an abrupt currency drop.

Year ending December 31	2014	2015	2016	2017	2018
GDP, real growth, %	2.8	2.4	2.5	3.0	2.8
CPI, year average, %	2.5	1.5	1.3	1.8	2.3
RBA cash rate, year-end, %	2.50	2.00	1.50	2.00	3.00
A$1 = US$, year average	1.11	1.33	1.35	1.36	1.44
US$1 = A$, year average	0.90	0.75	0.74	0.74	0.70

Source: 2013-2015 data from the ABS; 2016-2018 forecasts by IMA Asia

New Zealand

Political & policy issues to watch

The Nationals are set to win a 4th term in Sept polls

… led by new PM English

On September 23rd, New Zealand's new PM, Bill English, aims to win a fourth consecutive term for his National party. The Nationals will still need the support of minority parties to pass legislation, as did governments led by John Key, English's popular predecessor who stepped down unexpectedly last December. NZ's proportional representation system tends to produce coalition governments, which functioned smoothly under Key, who held office from 2008. English, who was a successful finance minister under Key, should benefit from a strong economy and sound public finances, both of which will allow him to offer personal tax cuts. February opinion polls put his approval rating at 31%, well ahead of NZ First party leader Winston Peters (8%), and Labour party leader Andrew Little (7%). The National party is also ahead with 46%, followed by Labour (30%), and the Greens (11%).

Macro risk is under control

… but watch offshore funding by banks

In February, Fitch affirmed its "AA" credit rating for NZ government debt with a Stable Outlook. The country's strong governance, prudent fiscal management, and flexible exchange rate have reduced the risk from relatively high external debt and persistent current account deficits (moreover, both are typical of a small, but well-run resource based economy with a high migrant intake). The recent lift in dairy prices (up 60% from February 2016 lows) will bring some relief to highly-leveraged farmers, but elevated housing debt (53% of bank lending) needs watching if there's a jump in interest rates and a steep downturn in house prices. As NZ banks rely heavily on offshore financing, they are experiencing higher funding costs due to rising US interest rates, and that may cool the credit-driven element of demand growth in the next two years.

Outlook for the market

Surging local demand lifts GDP

… a mild easing into 2018

In recent years, NZ's economy has been boosted by a self-reinforcing cycle of surging inward migration and rising local demand, particularly for housing. While a boom in housing construction has contributed to employment growth, wage growth has been modest, as the migrant inflow ensured an adequate labour supply. Net inward migration reached a record high of 71,305 in the year to January 2017 (equalling 1.5% of the entire population). As sustaining such high growth without a rise in macro risks is difficult, the government is expected to adopt a more selective approach to migrant intake with greater emphasis on skills. Coupled with an emerging slowdown in housing approvals, we expect GDP growth to ease to 3.4% in 2018 from 3.5% in 2017 and 4.0% in 2016. Domestic demand growth surged 4.2% last year (almost double a 10-year average to 2015 of 2.4%pa) and is expected to cool to 3.5% this year and 3.2% next year.

Strong consumer demand should ease

…& so should surging capex in housing

Private consumption growth hit a multi-year high of 4.2% in 2016 from a 10-year average (to 2015) of 2.5%pa, as consumer demand was lifted by a 4.6% surge in employment over 2016, record-low borrowing costs, and the wealth effect of a 22% lift in average home prices over the three years to January 2017. We expect private consumption to grow 3.9% in 2017 and 3.7% in 2018. An 11% surge in housing construction helped lift fixed investment growth to 5.7% in 2016, as non-residential capex grew at a relatively slow pace of 2.6%. However, the recent fall of housing transactions and the slowdown of residential approvals foreshadow cooler dwelling activity ahead. In the absence of a pickup in non-housing investment, total capex growth is set to ease to around 3.4%pa in 2017 and 2018.

Rising interest rates

… but a weaker NZ$

With inflation edging up to 1.3%yoy, monetary easing by the Reserve Bank of NZ has come to an end. The central bank will likely start lifting its policy interest rate later this year, as inflation will climb above 2% in 2018 even with inward migration helping to curb wage growth, as the economy operates close to capacity. That means a sharp narrowing of the gap to US interest rates, which should see the NZ$ fall on a rising US$ by 2-4%pa.

Calendar years	2014	2015	2016	2017	2018
GDP(Expenditure), real growth, %	2.9	3.1	4.0	3.5	3.4
GDP(Production), real growth, %	3.8	2.4	3.1	3.5	3.4
CPI, year average, %	1.2	0.3	0.7	1.6	2.1
Official cash rate, year end, %	3.50	2.50	1.75	2.25	3.00
NZ$1 = US$, year average	0.83	0.70	0.70	0.68	0.66
US$1 = NZ$, year average	1.20	1.43	1.43	1.47	1.53
NZ$1 = A$, year average	1.09	1.07	1.07	1.08	1.11

Source: 2013-2015 data from Statistics NZ; 2016-2018 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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