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Global outlook

Have we underestimated 2017 growth?

... the upside risk in Asia from better exports + better local demand

Each month, we aim to spot the trends that will deliver growth over the next few years. Our concern this month is whether we've under-estimated growth in 2017, as Q2 indicators are running strong. We'll need to keep an eye on the upside risk, and we'll focus on that in next month's Brief. Meanwhile, we'll stick with the two main elements of our commentary over the last few months. The first is our warning that the current surge in Asia's exports will be short-lived. As we talk with our big manufacturing clients, it seems that inventory catch-up is a major driver of better demand after five years in which companies ran low inventories. So, we expect Asia's export growth to drop from 10-12%yoy in 1H'17 to 4-6%yoy in 2H'17, with 4-5% likely in 2018. That's enough to provide a modest kick into Asia's domestic demand cycle via rising industrial production, a mild lift in capex on plant & equipment, and a smaller lift in wages. Our second theme has been that the export lift coincides with modestly better local demand in most countries. While that story differs country by country, it is the combination with modestly better exports that may deliver growth above our forecast.

Plan for a weaker US economy

... and a weaker US\$

In our June forecasting conferences, we outlined the case for a downgrade in the US outlook, which will likely flow through to a weaker US dollar. The US downgrade is built on two related points. First, the current upturn, while moderate in speed, has run two years longer than the six-year average for US expansions. Extending it would require new policy initiatives that would sustain business confidence. Second, it is time to accept that the Trump administration lacks policy, and struggles to work with or guide a Republican congress. The main impact on our US forecast is a swing from expansion to contraction in government consumption and fixed investment. We've also halved forecast growth in private capex, as firms wait for clarity in key areas like tax rates, healthcare costs, foreign trade arrangements, and the many issues tied to energy policy. With weaker growth will come less inflation, and that suggests a lower path for a lift in the US Fed's policy rate (1-2 moves of 25bp a year, instead of 2-3). In this environment, we'll likely find a weaker US stock market, and funds exiting the US in search of growth elsewhere. That's already pushed the Euro up in 1H17, and we expect that trend to continue for several more years.

Better EU growth

... while China delivers 6%+ growth

A key question is what happens to the global upturn if the US economy stumbles. Forty years ago, it was said that if the US sneezes, the rest of the world catches a cold. That's much less so today. Last year, the EU was 88% the size of the US economy, and on our latest forecasts, the EU will match or possibly better US growth for the next two years, while the Euro will outperform the US\$ (see the table below). China demand has also entered the global demand equation, and is expected to deliver 25-30% of the growth in demand each year. We remain confident that China can avoid a crisis and keep growth near 6%.

Stuck with weak inflation

... and cheap money

We are stuck in a world with persistent low inflation, with central banks struggling to reach their inflation targets and the world's workers wondering if the future is nothing but barely noticeable pay rises. A big part of the problem is overcapacity. On one hand, the world is simply too good at producing goods and even commodities like oil today. On the other hand, demand growth isn't what it used to be, as some of the BRICS have stumbled, and advanced countries have suddenly got older. The gig economy is also likely at work, as new low-cost ecommerce channels ratchet down costs to consumers for a widening array of goods and services. There's a matching set of arguments that suggest money will also remain cheap for the rest of our lifetime.

IMA Asia's forecasts

	2014	2015	2016	2017	2018
World – Real GDP growth, %	3.5	3.4	3.1	3.5	3.6
- US	2.4	2.6	1.6	2.0	1.9
- Euro area	1.2	2.4	2.0	2.0	1.9
- Asia/Pacific (14)	4.4	4.4	4.7	4.6	4.5
- NICs (4)	3.5	2.2	2.3	2.8	2.6
- Developing or "EM" Asia (7)	6.8	6.7	6.6	6.3	6.1
- ASEAN (6)	4.4	4.5	4.6	4.9	5.0
World goods & services trade volume, % growth	3.5	2.8	2.3	3.8	4.2
Interest rates, US Fed target rate, year end, %	0.25	0.50	0.75	1.25	1.75
Inflation, CPI, US, year avg., %	1.6	0.1	1.3	2.5	2.2
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	47	40
US\$ / Euro 1, year average rate	1.33	1.11	1.11	1.13	1.15
Yen / US\$1, year average rate	106	121	109	112	109

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	1.1	1.0	1.3	1.2
China	7.3	6.9	6.7	6.6	6.3
Hong Kong	2.8	2.4	1.9	3.2	3.1
Taiwan	4.0	0.7	1.5	2.3	2.1
South Korea	3.3	2.8	2.8	2.9	2.7
Indonesia	5.0	4.9	5.0	5.4	5.4
Malaysia	6.0	5.0	4.2	4.8	4.4
Philippines	6.1	6.1	6.9	6.5	6.4
Singapore	3.6	1.9	2.0	2.7	3.0
Thailand	0.9	2.9	3.2	3.7	4.1
Vietnam	6.0	6.7	6.2	6.1	6.3
India (CY)	7.0	7.5	7.9	6.1	5.8
Australia	2.8	2.4	2.5	2.5	2.6
New Zealand	2.8	3.2	3.6	3.0	3.0

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	2.0	2.5
Hong Kong (composite CPI)	4.5	3.0	2.4	1.5	2.2
Taiwan	1.2	-0.3	1.4	1.3	1.0
South Korea	1.3	0.7	1.0	2.2	2.5
Indonesia	6.4	6.4	3.5	4.3	4.9
Malaysia	3.2	2.1	2.1	3.9	3.6
Philippines	4.1	1.4	1.8	3.5	4.3
Singapore	1.0	-0.5	-0.5	1.1	1.5
Thailand	1.9	-0.9	0.2	0.7	1.4
Vietnam	4.1	0.6	2.7	3.9	4.0
India (CY CPI urban non-manual workers)	6.7	4.9	5.0	3.4	4.6
Australia	2.5	1.5	1.3	2.1	2.3
New Zealand	1.2	0.3	0.6	2.4	3.0

Exchange rate to US\$1, year avg.	2014	2015	2016	2017	2018
Japan	106	121	109	112	109
China	6.16	6.28	6.64	6.90	6.97
Hong Kong	7.75	7.75	7.76	7.83	7.83
Taiwan	30.4	31.9	32.3	30.5	29.6
South Korea	1,053	1,131	1,160	1,124	1,083
Indonesia	11,868	13,389	13,308	13,394	13,750
Malaysia	3.27	3.90	4.14	4.39	4.26
Philippines	44.4	45.5	47.5	49.5	49.7
Singapore	1.27	1.37	1.38	1.39	1.35
Thailand	32.5	34.2	35.3	34.3	32.5
Vietnam	21,148	21,677	21,932	22,496	23,203
India (FY)	61.0	64.1	67.2	64.9	65.5
Australia	1.11	1.33	1.35	1.32	1.29
New Zealand	1.20	1.43	1.43	1.42	1.48

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

Regional outlook

Political & policy issues to watch

Coping with President Xi's China agenda

... will you still belong in China?

The most certain point in Asia's outlook is that all of us will have to cope with a more powerful Xi Jinping when he starts his second five-year term as China's leader after a party leadership reshuffle in late 2017. Previously we've said that there are few clues as to what he will do in his second term. But many pointers have emerged in the last few months, as he has replaced key party and government leaders, cranked up major campaigns, and cracked down on those who've not heeded his guidance, including prominent local firms. Don't mistake this for the muted factional tussle that normally precedes a leadership reshuffle. It's Xi's version of modern China emerging. Figuring out how to work in Xi's China should be a top priority for every firm that wants to do business in China. For example, recent weeks have seen a demand for firms to work within China's new cyber-security and data privacy laws. That could end cross-border data flows, which would force some firms to relocate production, service, support, and management functions for China.

Change underway in HK

We wish Carrie Lam, HK's new chief executive, the best of luck for her five-year term, which starts on July 1. On one level, she'll preside over one of the most difficult periods in HK's political evolution, as it struggles with either maintaining a separate identity or merging into China. History is full of such identity struggles for small parts of larger nations, and they are rarely easy. But on another level, HK is already well into a commercial transformation from being a gateway to China, to being a platform for outbound mainland firms. Its early days in this process, so we'll have to see how it goes.

PM Modi's big gamble in India

July 1 also sees the start of GST in India. There has been impressive confidence in government—and among our clients—that early problems will be resolved during its first year of operation. The creation of a national market and the gain for public finances makes the gamble worth taking. Yet firms should prepare for 12-18 months of disruption.

Leadership battles in Australia

Despite a strong economy that side-stepped the 2008 global financial crisis, many Australians are unhappy with a decade of stalled incomes, worried by too much personal debt, and at risk from a collapse in home prices. As in the UK and USA, that has put Australia's two-party political system under pressure. One outcome has been chronic leadership instability, which has undermined policy making and boosted country risk. In the latest twist, ex-PM Abbott is mounting a campaign to overthrow PM Turnbull.

Outlook for the market

Asia's good starting point for the next 18 months

On our global page, we wondered if we'd underestimated Asia's growth in 2017 as a modest export recovery combines with a mild lift in local demand. You could argue that global conditions have rarely been better for Asia: the cost of oil is relatively low and falling, exports are rising, money is cheap, and portfolio and direct investors are hunting for growth. Yet our regional growth forecasts (on the global page) are barely changed from last month. We have nudged up forecasts for markets such as Hong Kong, while indicating upside potential for other markets like South Korea, particularly if the export recovery is stronger and runs longer than we expect.

Big transitions are underway in China and India

To substantially lift our regional growth forecasts, we'd need to raise the forecasts for India and China, and that's unlikely, as India faces GST challenges and China is locked into a mild but steady cooling. Yet, a prominent feature in both these mega-economies is massive transition, and that also caps growth. For every sector with double digit growth in both countries, there's another sector that has stalled or is collapsing. In Economics 101, such transitions (creative destruction) are essential to sustaining long-term growth.

Asia's firm or rising currencies

... on a weaker US\$

With our US outlook swinging to weaker growth and a falling dollar (on its trade weighted index) we've adjusted our regional currency forecasts, mostly to a rising trend on a weaker greenback. For countries with strong depreciation trends—India, Indonesia, the Philippines, Vietnam—we've cut the depreciation levels. Meanwhile, countries with appreciation trends—such as Korea, Taiwan, Singapore, and Thailand—will likely find their currencies are rising faster than they want. Such trends are driven by macro risks (inflation, current account balances, public debt, forex reserves), purchasing power parities, interest rate differentials, capital flows, and external dependencies. Japan can push against its appreciation tendency by maintaining super QE. China's Yuan may also weaken if President Xi eases capital outflow restrictions in his second five-year term.

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Japan

Political & policy issues to watch

Is PM Abe's dominance fading?

... watch the July 2 Tokyo elections

The July 2nd elections for the Tokyo Assembly could put the first dent in PM Abe's dominance of Japanese politics since he returned to power in 2012. Abe's LDP, which controls both houses in the national Diet, is in danger of losing control of the national capital. His popularity, which has been central to the LDP's electoral success, has fallen after a string of influence-peddling scandals, with opinion polls suggesting that the LDP will be lucky to retain a majority in the city assembly. The Democrat Party (DP), Japan's main opposition party led by Ms Renho, may do even worse, with single digit poll support. Instead, candidates are breaking away from the DP and LDP to run for Tomin First no Kai (Tokyoites First), a fledgling party led by Ms Yuriko Koike, who won last year's Tokyo gubernatorial race. The LDP's long-time coalition partner, Komeito, has also dropped the LDP in favour of Tomin First. Although a modest reformer, PM Abe has brought a useful period of stability to Japanese politics. A loss in Tokyo won't do immediate damage to Abe and the LDP at the national level, as there is no alternative at present, given the DP's weakness. Yet, it will shift calculations on policy and the timing of the next election.

Fiscal and monetary policy settings are a plus for growth

With signs of a mild but sustained economic recovery, the latest IMF review swings from criticising PM Abe's failure to move on reform, to favourable comment on fiscal stimulus efforts. While the debt-laden government doesn't have much money for stimulus, that allows the IMF to argue that the planned hike in the sales tax to 10% from 8% in 2019 should be ditched in favour of smaller increases over a longer time frame to avoid triggering a recession, as the last two tax hikes did. The IMF also urged the Bank of Japan (BOJ) to continue its super quantitative easing (QE) program for as long as possible.

Outlook for the market

Growth lifts above trend

... on better exports and a lift in local demand

Given a falling population, Japan's trend growth rate for the next decade is about 0.5%pa. Yet for the last two years it has risen to 1%pa, and we expect slightly better growth this year (1.3%) and next year (1.2%). The upturn is equally supported by a recovery in export manufacturing after five weak years, and by a lift in domestic demand. Apart from rethinking the 2019 sales tax hike and continuing QE to keep the Yen weak (see above), there's not much more the government or the BOJ has to do. The main risks are a collapse in global demand or another surge in the Yen, and while both are possible, they aren't yet likely.

Watch for a lift in capex

... as firms respond to rising profits

Japan jumped on the current global trade recovery months ahead of the rest of Asia. Exports (in US\$ terms) rose 8.8%yoy in June 2016 and finished the year up 3.2% after four years of falls. By this May, exports were up 9.6%ytd. The export recovery pushed Japan back into a trade surplus after an unusual five straight years of deficits. It has also contributed to record profits at Japanese firms, along with better employment conditions. One outcome, according to a Nikkei survey, is that Japanese companies plan to lift domestic capex by 13.7% this FY (to next March), after four years of single digit growth. Our own estimate of real growth for total (private & public) fixed investment rises to 2.4% this year, and 1.7% next year after average growth of 0.5%pa for the last two years.

A lift in industry boosts hiring & consumer demand

With industrial production up 5.7%yoy in April (and by 4.3%ytd), hiring has stepped up, with a near-record 1.4 job openings for every applicant. A shrinking labour force, which has already seen a surge in participation by women and the over 65s, has contributed to a scramble for workers. While that's not pushed national wage growth above 1%, it has boosted consumer sentiment and spending, with a 9.1%ytd lift in car sales by May.

The Yen edges up on a weaker US\$

We've made a big change to our Yen forecast this month following a swing in our US outlook to a weaker dollar. The Yen has a strong, underlying appreciation tendency, particularly when benchmarked to a weaker US\$. The BOJ's extreme monetary stimulus counters the appreciation tendency, but with a weaker US\$ now expected, we've pulled our Yen year-average forecast for 2018 down to 109 from a prior 119.

	2014	2015	2016	2017	2018
GDP, real growth (2005p), %	0.3	1.1	1.0	1.3	1.2
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	112	109

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

China

Political & policy issues to watch

Paramount Xi

... sweeps supporters into key posts ahead of his 2nd term

Hints of factional manoeuvring always surface prior to a Communist Party leadership reshuffle, which is held every five years. What is different in 2017 is the scale of leadership change already underway, and the intensity of a financial reform drive that is sweeping across the economy. Both suggest that party head Xi Jinping, who is certain to get a second five-year term at the late 2017 party congress, is in an unprecedented position of power. With Beijing's party secretary replaced this month, Xi has put supporters in charge in most key provinces and municipalities, including Beijing, Tianjin, Shanghai, Chongqing, Guangdong, and Xinjiang. Xi's supporters should dominate appointments to the Central Committee, the Politburo and its Standing Committee. What Xi does with his unrivalled and largely unchecked power is the single biggest question for 2018-21.

... & accelerates efforts to curb financial sector risk

Four of China's top five financial regulators were replaced in the last year (the exception is PBOC head Zhou Xiaochuan). Since the start of 2017, they've stepped up efforts to curb financial sector risk, which is the single biggest threat to the economy. On April 26, that campaign jumped into high gear, as Xi instructed them to purge risk arbitrage—essentially the risk of contagion—from the financial system. That has seen the one month Shanghai Interbank Offer rate surge 200 basis points from the start of 2017, putting pressure on city commercial banks. In late June, the crackdown on excessive leverage was extended to four high-profile firms (Dalian Wanda, Fosun, HNA and Anbang – all linked to various party factions). Other firms known for excessive leverage may be called in.

Avoiding a financial crisis

... with a surge in SOE profits

Purging financial sector risk without tanking the economy is difficult. But Beijing has pulled it off so far thanks to a focused stimulus from mid-2016 that led to a 23%ytd surge in industrial profits by May. That included a 53%ytd jump in SOE profits, and as much of the finance sector risk is tied up with lending to SOEs, that ensured they have strong cash flows to meet debt obligations. It will curb financial risk in the short-term, but China is still a long way from putting in place a safe and efficient method for allocating credit.

Outlook for the market

Growth cools in 2H'17

With the large property and auto sectors cooling, a slowdown in industrial restocking, and a retreat in commodity prices (closely linked to industrial profits), GDP growth will slip in 2H'17 from the strong 6.9%yoy reported for Q1'17. Helping to cushion the slowdown will be resilient consumer demand and infrastructure investment, which has become Beijing's favourite stimulus tool. The outcome is expected to be 6.6% growth in 2017 and 6.3% in 2018, with Beijing likely aiming for 6.5% growth in both years.

Stable consumer demand

Real growth in consumer spending should stay above 7%pa over 2017-18, thanks to solid employment growth in services, increased government transfers (e.g. pensions), and strong growth in consumer loans. Three local surveys all show that a rise in consumer confidence in Q1'17 extended into May. While consumer demand should be good, firms will have little pricing power due to the growing intensity of competition.

But capex eases

Growth in fixed asset investment (FAI, which China measures in current prices) rose to 9.2%yoy in Q1'17 from 8.1% in full 2016. But since then the pace has eased to 8.1%yoy in April and 7.8%yoy in May. That easing should continue, as property investment cools and the crackdown on risk arbitrage curbs high-risk investments. Real growth in fixed investment is expected to see a lift to 6.4% this year, which is in line with our estimate for 2016, and a 5.8% rise next year.

Watch for the Yuan to change direction in 2018

Intense competition and lower wage growth will keep inflation around 2%. The Yuan has recently been rising on a weak US\$, but from 2018, we expect Beijing to cautiously ease capital outflow restrictions, setting the Yuan on a mild devaluation path.

	2014	2015	2016	2017	2018
GDP, real growth, %	7.3	6.9	6.7	6.6	6.3
CPI, year average, %	2.0	1.4	2.0	2.0	2.5
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	6.90	6.97

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

CE Carrie Lam starts her five-year term

... can she ease HK into China?

Two decades after regaining Hong Kong, China is keen to reset its relationship with the special administrative region (SAR), and that may well include 'modifying' from the "one country, two systems" formula that was to guide HK for at least 50 years from 1997. President Xi may signal that shift during his HK visit to celebrate the 20th anniversary of the handover, and to officiate at the swearing-in of Chief Executive (CE) Carrie Lam. Xi will also visit two potent and very expensive symbols of HK's growing integration with China, the HK-Zhuhai-Macau bridge and HK-Guangzhou rail link. Carrie Lam's challenge will be converting tighter infrastructure ties into tighter political ties, even though many HKers prefer a smaller Beijing presence.

... and will she push unpopular China integration policies?

While Carrie Lam campaigned on introducing fresh faces to replace the unpopular administration of retiring HK leader CY Leung, the Lam cabinet looks a lot like the last one; it largely combines incumbents and ex-civil servants. Potential new nominees were reluctant to serve or failed to get Beijing's approval. That likely reflects the difficulty that her administration will have in meeting Beijing's requirements and retaining broad local support. Policies that will test her new administration include an imminent decision on locating immigration facilities for the fast rail link, Beijing's apparent desire for another attempt at passing a national security law and reviving national education at HK schools.

Commercial integration is moving fast

Carrie Lam may not have to do much to speed HK's integration with China as that's a process well underway in the market; mainland firms are rapidly building strong positions in HK's property and financial sectors. They are partly filling a gap left by Western firms, some of which find HK expensive and less central to their China/Asia strategies. But HK also is emerging as a base for fast-growing teams that are driving China's outbound firms.

Outlook for the market

A strong Q1

... so, we've lifted our forecast

With an unexpectedly strong jump in HK's growth rate to 4.3%yoy in Q1'17, we've raised our forecast to 3.2% growth this year and 3.1% in 2018, up from 2.9% and 2.8%. Export volumes surged 8%yoy in Q1, and strong growth looks set to continue with a 6% increase for the year, before easing to 3% growth in 2018. An 18%yoy surge in capex for public sector construction pushed total fixed investment growth up 9.6%yoy in Q1.

Consumers recover

... but tourist spending is weak

Consumer demand also improved in Q1'17, rising 3.7%yoy after 1.8% growth in full 2016. So, we've nudged up our forecast, with full year growth now put at close to 3% in both 2017 and 2018, close to the 4.8% average for the decade to 2015. But tourism remains weak, and retail sales growth slumped to 0.3%yoy (in current prices) in April. This has been a story of fewer mainland tourists (down 1.4% for the year to April) spending less (per capita spending by mainland overnight visitors fell 8.2% in 2016).

A dangerously expensive property market

HK's average home price in May jumped by 24%yoy, making the city the most expensive for property in the world – and vulnerable to an array of events that could trigger a tumble. Some price correction is inevitable over 2017-18; at present, we assume mild deflation. Meanwhile, the administration aims to lift private home completions to 20,000+ units a year through to 2018, from 11,000pa over the last decade. This, along with public housing and infrastructure works, should accelerate fixed investment growth to 5-6% in 2017 and 2018, from 2.4%pa in the decade to 2016.

A weak HK\$ for now

Since the start of 2017, the HK\$ has been pushed from 7.75 to 7.80 against the US\$, which is the mid-point of its fixed trading band. If it moves out to 7.83, the HKMA will intervene to tighten liquidity to support the HK\$, which will put pressure on local banks to raise their mortgage rates – something they've been loath to do so far.

	2014	2015	2016	2017	2018
GDP, real growth, %	2.8	2.4	1.9	3.2	3.1
Composite CPI (04/05), year average, %	4.5	3.0	2.4	1.5	2.2
Discount window base rate, % year end	0.50	0.75	1.00	1.50	2.00
HK\$ to US\$1, year average	7.75	7.75	7.76	7.83	7.83

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

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Taiwan

Political & policy issues to watch

Pres. Tsai pushes pension reform through
... but other reforms will wait

President Tsai Ing-Wen, who won the January 2016 election with 56% of the vote, has seen her opinion poll support plunge to 33% in June 2017, as she tackles badly needed but deeply unpopular reforms. However, she's just had her first win, with the passage of legislation that cuts overly-generous pensions for retired civil servants, and lifts the retirement age from 60 in 2021 to 65 in 2026. While further battles are expected over enabling bills, the ruling DPP and the opposition KMT are now turning their attention to local elections due in 2018. That means a string of reforms to support industry restructuring, infrastructure, housing, aged care, and judicial modernisation, will stall.

Beijing still wants Taiwan to step into line

China has been ramping up pressure on Taiwan over President Tsai refusal to accept Beijing's version of a mutually agreed "One China" policy. Panama, one of Taiwan's oldest partners, was recently pressured by Beijing to end its diplomatic ties with Taiwan. Chinese travellers to Taiwan have dropped by 30%yoy in the first five months of 2017, after a 17% fall in 2016. So far, this cross-straits tension hasn't affected some 100,000 Taiwanese firms operating in China. While there's always the fear that Beijing will lean on these firms (as it has leant on Korean firms to pressure Seoul), such a step seems beyond acceptable bounds, as it would shock global markets, and the indirect knock-ons would likely hurt many important Chinese firms.

Outlook for the market

A chip-led export rebound lifts growth

Strong exports due to a rebound in the global semiconductor industry, and a related surge in capex by local chipmakers, should lift real GDP growth from last year's 1.5% to 2.3% in 2017, before growth eases to 2.1% in 2018. At present, we don't see much upside to our forecasts, as we've already incorporated strong trade and capex growth, and they are above the IMF's April forecast of 1.7% in 2017 and 1.9% in 2018.

Trade recovery extends to 2H

The export surge that started in late 2016 appears to have peaked at 27.6%yoy in February (US\$ basis) with the rate easing to 8%yoy in May 2017. In the rest of 2017, we expect the release of new smart phone models to support export growth of 10-12% this year (US\$ terms) and 4-6% in 2018, after an average annual fall of 2.4% over the last five years. Industrial production was up 4.9%ytd for the first five months and should finish 2017 up 5% with growth of 3% in 2018, after average growth of 3.8%pa in 2006-16.

Domestic demand remains soft

Despite the pickup in trade and manufacturing, consumer spending remains soft, due to the years of low wage growth, a high savings ratio, and an outflow of talent (mostly to run offshore factories, notably in China). After 2% growth last year, retail sales fell by 0.1%ytd in the first five months of 2017, while the consumer confidence index has seen a steady fall to 78 in June from a recent high of 93 in 2015. Real growth in consumer spending is likely to stay around last year's soft 2.1% pace, which was down from 2.5%pa in 2011-15.

Little inflation on a firm NT\$

Lower commodity and soft food prices should limit inflation to 1.0-1.5% over 2017 and 2018, which means interest rates will stay low. Massive fund inflows for purchases of Taiwanese tech stocks has helped the NT\$ rise 6%ytd on a weakening US\$ by June. We expect Taiwan's large trade surplus to keep upward pressure on the NT\$ in coming years.

	2014	2015	2016	2017	2018
GDP, real growth, %	4.0	0.7	1.5	2.3	2.1
CPI, year average, %	1.2	-0.3	1.4	1.3	1.0
Official discount rate, year-end, %	1.88	1.63	1.38	1.38	1.38
NT\$ to US\$1, year average	30.4	31.9	32.3	30.5	29.6

Sources: 2013-2015 government data and 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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South Korea

Political & policy issues to watch

President Moon's many challenges President Moon Jae-in, who took office in May, starts his single five-year term with a 79% approval rating. Yet popularity isn't helping him govern, as he has been slow to appoint a cabinet, and his proposals for labour market reform and fiscal stimulus are stalled in parliament, where his Democratic Party controls just 120 of the 299 seats. As the next assembly election is three years away, that could mean a long period of legislative stagnation. Meanwhile, he faces intense pressure from trade unions to fix Korea's dysfunctional labour market, as well as pressure from the US and the EU to remove the country's notorious non-tariff import barriers. Finally, he must also deal with escalating North Korea risk, an unpredictable US president, and a Chinese government annoyed by the installation of a US-operated THAAD antiballistic missile system in Korea. The latter issue has seen Chinese tourist arrivals fall 25.8%ytd by April.

... include rising pressure to end a two-tier labour market In his election campaign, Moon promised to create 810,000 jobs in the public sector over the next five years, upgrade "non-regular" public sector workers to permanent positions, lift the minimum hourly wage 55% by 2020, and shorten the maximum working week to 52 hours from a current 68. About a third of Korea's labour force hold temporary or part-time jobs, with pay rates well below those in permanent jobs. Young and older workers suffer the most, with much weaker income growth. This lifts income inequality and fuels social discontent. The OECD reports that Koreans over 66 are the poorest in that age group among its 30 member countries.

Outlook for the market

Growth edges up ... with upside potential Opposition parties stalling President Moon's stimulus efforts, and particularly his public-sector job-creation package, point to signs of rising economic momentum. That's seen forecasters lift their projections closer to our forecast of 2.9% GDP growth for 2017 and 2.7% for 2018 (unchanged from last month). After slowing to 2.5%yoy in 2H'16, growth edged up to 2.8%yoy in Q1'17 on the back of a 4.5%yoy rise in domestic demand. Domestic demand growth could be even stronger in 2H'17, after a lift in consumer and business sentiment following the May election. In addition, export growth accelerated to 18.7%yoy in April-May (US\$ basis) from 14.7%yoy in Q1'17. We'll watch both trends, as they suggest upside potential for growth in 2017.

A surge in plant & equipment capex ... construction capex cools Fixed investment growth edged up to 9.4%yoy in Q1'17 from 5.2% in full 2016, on the back of a 14.4%yoy surge in spending on machinery & equipment. The latter reversed a 2.3% drop in full 2016 and helped offset the impact of a slight easing in fixed investment spending on construction (9.6%yoy in Q1 from 10.7% in full 2016). Falling building permits point to a further slowing in construction activity. Fixed investment growth is likely to ease to 3.8% in 2018 from an expected 6.5% in 2017, and 5.2% in 2016.

Consumers turn upbeat The consumer confidence index surged to 111.1 in June, which is the highest level since January 2011. That bodes well for household spending. Even if President Moon makes no progress on lifting youth employment and wages, that could push consumer demand up 2.8% in 2017 and 3% in 2018, after averaging 2.2%pa over 2011-16.

Little inflation and a rising Won Persistent slack in the economy, coupled with modest inflation (an average 2%yoy January-May from 1% in full 2016), should allow the Bank of Korea to keep its policy rate at the current all-time-low of 1.25% well into 2018. The Won has gained 5% on a weaker US\$ since the start of 2017. Although it's had a trend depreciation on the US\$ since 1990, its current value is close to implied fair value, and that suggests it will continue to rise on a weaker US\$ through 2018.

	2014	2015	2016	2017	2018
GDP growth, %	3.3	2.8	2.8	2.9	2.7
CPI, year average, %	1.3	0.7	1.0	2.2	2.5
BOK Base rate, year-end, %	2.00	1.50	1.25	1.25	1.75
Won to US\$1, year average	1,053	1,131	1,160	1,124	1,083

Sources: 2013-2015 government data (NSO, BOK) and CEIC; 2017-2018 forecasts by IMA Asia.

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Indonesia

Political & policy issues to watch

After a tough six months, Pres. Jokowi regains ground

... corralling Islamic radicals

... with broad support from the elite

Our political outlook for Indonesia has changed significantly in the last month. The April Jakarta gubernatorial race transformed Indonesian politics by establishing radical Islam as an electoral force, and boosting the prospects of Prabowo Subianto in the 2019 presidential race, when incumbent Joko Widodo (“Jokowi”) will seek a second term. Prabowo’s path to victory in 2019 looked straightforward: keep radical Islamists on the streets, and label President Jokowi as insufficiently Islamic. That promised rising political friction, a distraction from reform, slower growth, and a more difficult environment for foreign firms. Yet, as outlined by CastleAsia in their June Alert, Jokowi, backed by much of the Indonesia elite, has struck back, with a crackdown on radical Islamic leaders and their use of street protests and social media to promote community divisions. The tussle between radical Islamists and leaders of the more moderate community is a recurring theme in Indonesia’s 65-years of independence. Apart from communal wedge tactics relying on radical Islam, Prabowo has little to offer Indonesian voters.

Strong fiscal performance lowers macro risk

...but plenty of problems remain

President Jokowi must also show that he can deliver better growth for all Indonesians and three useful steps have been taken on that path. First, government finances have been put on a firm footing by Finance Minister Sri Mulyani. That included a reasonably effective tax amnesty and realistic budgeting. This, in turn, earned Indonesia a critical sovereign ratings upgrade in May to BBB-, the lowest rung for investment grade debt, by S&P. That will support the Rupiah and lower the cost of debt. Finally, tax revenues jumped 36%ytd for the first four months of 2017. That will help Jokowi push his US\$350bn infrastructure program. While that’s promising, we don’t expect much progress on fixing a poor operating environment characterised by red tape, policy conflicts between ministries, corruption, and the dominance of poorly run state firms in many sectors.

Outlook for the market

Growth edges up

... on strong exports & better local demand

Indonesia exemplifies our regional theme of modestly better exports combining with modestly better domestic demand to produce a mild but steady lift in growth into 2018. After three years of 5% growth, we expect growth to lift to 5.4% for 2017 and 2018, with upside potential to 6% by 2018 if local demand does better than we expect. The main risks are a sharp downturn in China, which would undermine the lift in commodity prices that has lifted export earnings, and a collapse into debilitating political struggles. The latter risk appears under control, as Jokowi’s government has firm support from 70% of legislators, after Golkar, a key party, left Prabowo’s camp to join the coalition government.

A firm lift in capex growth

... and upside potential for consumer demand

By May, Indonesia’s exports (US\$ basis) were up 20%ytd after an average 6.5% annual fall over the prior five years. That saw trade surplus (on a 12-month rolling sum basis) return to a healthy \$12bn by May. Coal and palm oil (up 45%yoy and 62%yoy respectively in Q1’17) led the export lift, and both should help lift capex and consumer spending. Fixed investment will also benefit from Jokowi’s infrastructure push, with cement consumption up 4.1%ytd by May after a 0.5% fall in full 2016. Real growth in fixed investment of 6% is likely this year and in 2018 after four years averaging 4.7%. Consumer demand is improving with motorcycle sales finally positive, up 15%yoy in May after falling 9.7% in the prior four months and falling 8.5% last year. Our forecast of 5% consumer real growth in 2017 and 2018 is in line with the last few years, but has upside potential.

A briefly stronger Rupiah, with milder trend depreciation

After four years of average annual falls of 10% on the US\$ to 2015, the Rupiah has regained ground thanks to reduced macro risks and a swing in the US\$’s own trajectory to depreciation (on its own trade weighted index). The Rupiah’s rise on a weakening US\$ could continue into 2018 before a long-term depreciation tendency reasserts itself. Even then, we expect the trend fall to 2022 to be half the average 5% annual fall of 1990-2016.

	2014	2015	2016	2017	2018
GDP, real growth, %	5.0	4.9	5.0	5.4	5.4
CPI, year average, (2012=100), %	6.4	6.4	3.5	4.3	4.9
Central bank rate (7-day RR) at Dec %	-	6.25	4.75	4.75	5.00
Rupiah to US\$1, year average	11,868	13,389	13,308	13,394	13,750

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

1MDB risk returns to cloud the outlook Unfortunately for PM Najib Razak, 1MDB, although technically dead, has a persistent life normally found only in zombie movies. The fund has been wound up by the Finance Ministry, while China and Saudi Arabia have offered to bail out some of its projects or otherwise bolster government finances. Finally, local news has been disconnected from global reports, and all leaders of UMNO (the ruling party) and a newly installed Attorney General have said nothing was wrong at 1MDB. Yet, the US Department of Justice (DOJ) says US\$4.5bn or more was stolen, and the named offenders and beneficiaries include Najib's wife and Malaysian Official 1 (MO1). There's no effective opposition in parliament to tackle Najib on the issue, yet UMNO's other leaders, though cowered for the moment, might try to topple him to avoid the ignominy of running in the next election behind the biggest thief yet fingered by the US DOJ's kleptocratic unit.

PM Najib hopes a surge in public housing will lift his support PM Najib's preferred scenario is a big win in the 2018 election, which he could pull forward into 2017 if he saw an advantage. In the last election, the government lost the popular vote, but kept a majority of seats. To rebuild popular support, PM Najib has ramped up a government housing program, targeting urban middle-class voters who have drifted away from the government. An ensuing 104%yoy jump in housing approvals for Q1'17 has halted a four-year slide in what had looked like an over-supplied property market.

Can Malaysia turn its protected auto sector into an export earner? With China's Geely buying 49.9% of Proton, a struggling government-owned carmaker, the protected local auto sector enters a new phase of competition. Geely has enough funds, technology, and management skills (as owner of Volvo cars) to suggest it can reverse a steady fall in Proton's local market share to 14% last year. Geely/Proton will now take on local small car builder Perodua (with 40% market share, and linked to Daihatsu) and Toyota (with a 9% share, but doubling its capacity). At issue is whether Malaysia can challenge Thailand for a growing share of ASEAN's production of right-hand drive vehicles.

Outlook for the market

Exports help lift growth Last month, we lifted our GDP growth forecast for Malaysia to 4.8% in 2017 and 4.4% in 2018 (from 4.3% and 4.0% respectively). The lift reflects a better global outlook (crucial to Malaysia's export-driven economy) and an expected rise in public spending ahead of the next election. The main risk in the outlook is another fall of oil prices, as oil & gas deliver some 40% of government revenues.

But watch for weaker spending by consumers Real growth in consumer spending is expected to fall below 5% this year and next year after a 6% rise in 2015 and 2016, and a 7.3%pa surge over 2003-14. Household debt was an uncomfortably high 89% of GDP last year, and consumers have swung to deleveraging. Household credit growth slowed to 5%yoy in April from 12%yoy in April 2014, while consumer sentiment slid in 2016, bringing a 13% fall in car sales.

Capex should lift on infrastructure ... but be wary of building over-supply Capex growth surged to 10%yoy in Q1'17 from 2.2%yoy in 2H'16 on the back of strong machinery & equipment investment. This reflects rising momentum in infrastructure building, which should help lift fixed investment growth to 6.5% in 2017 from 3.1%pa in 2014-15. Capex growth is likely to ease back to 3.6% in 2018, as looming oversupply in the real estate sector will restrain construction activity. Property oversupply is more evident in the office and retail sectors. However, it could get worse in the residential sector if the government proceeds with its plan to build 100,000 low-cost houses by 2020.

The M\$ regains ground The M\$ has risen 4.7% on the US\$ since the start of 2017, following steep declines over 2014-16. The rise could continue on a weaker US\$ into 2018 (even though the 2017 year average falls), with the M\$ marginally gaining whenever the US\$ slips from 2018 onwards.

	2014	2015	2016	2017	2018
GDP, real growth, %	6.0	5.0	4.2	4.8	4.4
CPI, year average (2010=100), %	3.2	2.1	2.1	3.9	3.6
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	4.39	4.26

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

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Philippines

Political & policy issues to watch

Despite concerns & risks, a mostly positive scorecard for Pres. Duterte A pragmatist would say that President Duterte has done well in two out of three areas in his first year, and in the third area time may prove him partly right. First and most importantly, he retains 78% opinion poll support. That ensures he keeps strong majorities in both houses of congress to back his administration's program. Second, the economy continues to do well, with his policies generally contributing to growth. His third area, where he has done less well, is overseas, with dismay at his violent anti-drugs campaign, and concern at his tilt towards China, even though that may prove a smart move in tapping new support for infrastructure. The associated "Duterte risk" is basically about the damage that can be done to markets by an unpredictable leader. That has seen a net outflow of foreign portfolio funds this year, despite strong economic growth and a 13.4%ytd rise in the local stock index. He is on track to complete the next five years of his single six-year term, with his poor health, rather than impeachment, the main risk factor.

Major tax reforms loom
... & are critical to lifting growth Duterte's first big policy test will be winning passage through Congress of the first of four tax reform packages, which seeks to cut the top personal tax rate to 25% from 32% and broaden VAT. The first bill is now sitting in the senate, with senators divided on fuel and vehicle tax increases, and a proposed sugar tax. The administration has launched an all-out lobbying effort to win their support. Extra tax revenue is essential to funding Duterte's US\$160bn infrastructure plan, which is the cornerstone of a revitalisation strategy that aims to ease logistical bottlenecks and lift GDP growth to 7-8%pa (we think 6.5% is more likely).

Managing an overheating economy After four years of growth averaging 6.6%, the economy is in danger of overheating. At the macro level, the immediate danger is the current account balance, which swung to a small deficit in March after 15 years in surplus. Even though a cushion is provided by remittances from offshore Filipino workers (OFW), policy tightening to cool the economy may be needed in late 2017. At the corporate level, companies are likely to struggle with faster wage growth and shortages of critical inputs.

Outlook for the market

On track for 6.5%pa growth to 2022 The Philippines should remain one of Asia's fastest growing economies for the next few years. The key challenge is delivering an economic environment that can tap the fundamental advantage of a young and fast-growing population (102m people in 2016 growing at 1.5%). Healthy streams of income—for the nation and households—from BPO work and OFW remittances have made consumer demand an important growth engine. But the biggest transformation underway has been the surge in fixed investment from 21% of GDP for the two decades to 2015 to 28% in 2016.

... led by strong capex
... and a lift in consumer demand After jumping 23.5% last year, fixed investment real growth should cool to a more sustainable 10-13% for the next few years. A record PHP686bn of investment approvals were made in each of the last two years, with approvals up about 22%yoy in Q1'17, mostly for manufacturing and real estate. Foreign direct investment rose 41% last year to US\$7.9bn, more than double the \$3bn average for the decade to 2015. Meanwhile, April's 5.7% unemployment rate is close to decade lows, and with OFW remittances up 5.1% for the year to April (to US\$27bn) consumer confidence is strong. Real growth in consumer spending should lift to 6-7%pa to 2018, up from 5.1%pa in the decade to 2016.

A weaker Peso nudges up inflation While inflation eased to 3.1%yoy in May, firm local demand should see it approach the upper bound of the central bank's 2-4% target range in 2H'17, prompting a mild rate tightening cycle through 2017-18. Most Asian currencies have risen on the US\$ this year, but a weakening current account has curbed the Peso's rise to just 0.1% by May. A swing to current account deficits should put downward pressure on the Peso in 2017 and 2018.

	2014	2015	2016	2017	2018
GDP growth, %	6.1	6.1	6.9	6.5	6.4
CPI, annual average, %	4.1	1.4	1.8	3.5	4.3
Central bank reverse rep. rate, year end	4.00	4.00	3.00	3.75	4.50
Peso to US\$1, annual average	44.4	45.5	47.5	49.5	49.7

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

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Singapore

Political & policy issues to watch

A more responsive PAP

While it's uncertain who will succeed PM Lee Hsien Loong after the 2021 general election, the People's Action Party (PAP), in power since independence in 1965, should continue leading Singapore for the foreseeable future. In part, that reflects greater responsiveness to popular concerns, ranging from the influx of foreign workers to housing affordability and racial diversity. Meanwhile, the now-public feud in PM Lee's family is unlikely to hurt the PAP, despite concerns that Singapore's brand of one-party democracy may be less suited to fostering growth in the next decade than during the country's first 52 years.

... seeks to develop new sources of growth

Much like other advanced economies, Singapore faces the twin challenges of lifting productivity growth and countering a shrinking working-age population. Labour productivity has fallen 0.7%pa in the last four years. Meanwhile, the working-age population is set to shrink by 2030 in the absence of a reversal of tighter immigration policy, which has seen growth of the non-citizen population slow to 1.8%pa since 2013-14 from 7.8%pa for the two decades to 2009-10. These developments are likely to see trend GDP growth fall towards 2.5%pa in the next decade from about 5%pa in the last 20 years. That's forcing a major realignment of the economy, with the government prioritising innovation and higher value-added manufacturing and services over labour-intensive industries.

Outlook for the market

A mild upturn for 2017 and 2018

After two years of growth at 2%, the pace should tick up to 2.5-3.0% in 2017 and 2018, albeit still well below the 4.7% annual pace of 2006-16. Most of the mild lift will be driven by export growth of 9-11% this year (US\$ basis) and 5-7% next year after an average 4% fall for the five years to 2016. A key issue is whether two big drivers of domestic demand—services and construction—will lift after slumping to real growth of 1% and 0.2% respectively last year. While construction faces challenges, services has shown some signs of improvement, suggesting upside potential for our forecast.

... with a big lift from exports

Last year, Singapore's factories pumped out US\$116bn in non-oil domestic exports (NODX), and what happens to that number is crucial to both short-term growth and long-term restructuring of the economy. Short-term, we expect NODX to lift by 8-10% this year and 6-8% next year after falling 3.3% last year, with an electronics recovery playing a central role. That should help industrial production grow some 5-7% in 2017 and 3-5% next year, from 3.6% in 2016. Yet NODX US\$ earnings have been basically flat since 2006, and the sector faces a shake-out in the next five years with restrictions on access to cheap imported labour and land or factory leases.

... but a weak labour market is hurting consumers

Real growth in consumer spending slipped to 0.6% last year, as falling home prices and a cooler labour market (the ratio of job vacancies to job seekers remains near a seven-year low) hit consumer sentiment. Demand has edged up in Q2'17, with nominal retail sales (excluding motor vehicles) up 5.5%yoy in April (a 61-month high). Consumer real growth should lift by 1.5-2.5% in 2017 and 2018, with 2.5%pa likely to be the new trend level through 2020, well down on the 4.5%pa pace set in the two decades to 2016.

Public works to lift capex

Capex should grow 1-3% in 2017 and 2018, after a 2.5% fall last year, which is down on the 5.4%pa pace for the decade to 2016. Private construction capex fell 10.3% in 2016 after falls of 2% and 4.1% in 2015 and 2014 respectively. Private construction contracts were down 16.3%ytd by April, suggesting another weak year in 2017. Public capex grew a strong 9% last year from 7.4% in 2015, and should remain firm, thanks to public housing works and big projects such as Changi Airport Terminal 5.

Muted inflation on a rising S\$

Inflation ticked up to 1.4%yoy in May from -0.5% in full 2016. Soft wage growth should keep year-average inflation at 1.0-1.5% in 2017 and 2018, enabling the Monetary Authority of Singapore to leave monetary policy—expressed via a managed exchange rate for the S\$—in neutral. As the US\$ has been falling this year, that has translated into a 2.8%ytd rise on the greenback, with further mild gains likely in 2H'17 and 2018.

	2014	2015	2016	2017	2018
GDP, real growth, %	3.6	1.9	2.0	2.7	3.0
CPI, year average, %	1.0	-0.5	-0.5	1.1	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	1.39	1.35

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

Thailand

Political & policy issues to watch

PM Prayut maps out Thailand's future
... late 2018 elections

Thailand's political schedule to late 2018 has been mapped out by PM Prayut, with an extra 20-year policy framework plotted with military rigour. Whether such a 20-year plan will work is debatable, but it shows how the army wants to run the country from 2019. After the army-imposed constitution was promulgated on April 6th, the government has 240 days to draft 10 organic laws, four of which define a new political structure. Once all four are passed, the country has 150 days to hold elections, with late 2018 being the earliest to expect one. The four political laws will aim to exclude from politics ex-PM Thaksin and his supporters, while also ensuring Thaksin's money doesn't enter the political process. It's not pretty, it's not democratic, but it's likely to happen.

And a 20-year policy framework

A National Strategy Act has also just passed, and will lead to the establishment of a committee chaired by Prayut to determine core policies for the next 20 years, which will be broken into five-year plans. Elected governments will be required to follow those policies.

Keep an eye on royal events

Thailand's deep reverence for its royal family means that companies need to incorporate two major royal events into their 2017 schedules. The first will be the cremation of the late King Bhumibol on October 26, with the month leading up to it likely to be especially sensitive for all Thais. A month or so later, the coronation of King Maha Vajiralongkorn will take place. After that, the muted period for Thai politics is over.

Outlook for the market

Growth lifts on better exports & local demand

Our forecast of 3.7% growth this year and 4.1% next year, unchanged from last month, is above the consensus outlook, with the IMF's April forecast putting growth at 3% and 3.3% respectively. In common with the rest of the region, we see Thailand benefiting from a combination of modestly better exports and modestly better local demand. The key risk is that private capex fails to recover, either due to continued political risk or the absence of strong growth opportunities. We are cautiously optimistic in both areas.

The challenge of weak private capex
... will the EEC win private support?

For the 18 years prior to the 1997 Asia Financial Crisis, fixed investment averaged 34% of GDP, with private capex alone accounting for 26%. That built a lot of Thailand. Since that crisis abated in 2000, fixed investment has averaged just 25% of GDP, with private capex at 18%. To revive Thai industry and GDP growth, Prayut needs to lift private capex. There's no sign of that happening yet, with private capex falling in three of the last four years, before dropping 1%yoy in Q1'17. Local firms say they won't invest as there's excess industrial capacity, which is as much a global issue as a Thai one. The government's Eastern Economic Corridor (EEC) aims to tackle that issue, with a combined infrastructure and industrial upgrading plan. Planning is well advanced and construction and early investment should start next year. We expect that to help lift total fixed investment real growth from 2.8% last year to 3.4% this year and above 6% in 2018.

Exports lift manufacturing
... with steady consumer demand

Exports increased 7.2%ytd after an average annual fall of 0.6% over the last five years, thanks to a 13.2%yoy lift in May. We expect export growth of 6-8% this year and 4-6% next year, which should lift manufacturing real growth to 3-4% this year and next year from an average 1.2% over the last four years. Real growth in consumer spending came in at 3.2%yoy in Q1'17, the second strongest performance in 16 quarters. We expect consumer growth to remain steady in 2017 and 2018 at around last year's 3.1% rate given the political and royal events ahead.

A rising Baht & little inflation

A surging trade surplus and a weak US\$ have seen the Baht steadily rise this year. Both trends are likely to sustain a 3-5% lift on the US\$ over 2017 and 2018. A rising Baht helped push inflation down to zero in May, with little inflation likely until 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	0.7	1.4
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	34.3	32.5

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

Political stability and good policies Under PM Nguyen Xuan Phuc—in power since April 2016—Vietnam is on track to move further up the income scale. His priorities include infrastructure, developing Vietnam's tech sector, and restructuring state-owned enterprises (SOE). On the latter, interest this year is focused on the sale of the government's remaining stake in the two dominant breweries, Sabeco and Habeco. While factional tensions in the party surfaced with the recent dismissal of Dinh La Thang (party chief of HCM City, and the first politburo member to fall in 21 years), the tussle is unlikely to undermine policy or progress on reform.

RISK – keep an eye on over-heating
... particularly excessive credit growth PM Phuc hopes to deliver 6.5-7.0% growth to 2020, up from 5.9%pa in the last five years. While economic stability has improved in recent years, the risk in faster growth is a jump in inflation and bad debt, alongside a current account blow out and a sharp drop of the Dong. Foreign reserves, although rising, remain below the three months of imports typically required to ensure exchange rate stability, leaving the Dong exposed to an abrupt fall. Rising debt also needs watching, as public debt has reached its mandated cap of 65% of GDP, which limits the government's ability to support much-needed infrastructure investment. Meanwhile, reliance on rapid credit growth (18% targeted for 2017) could further weaken the banking sector, which is already struggling with bad debts.

Outlook for the market

Bright growth prospects The Vietnamese economy should remain a standout performer in coming years, with a young population, surging export manufacturing, and robust construction activity expected to underpin 6%+ GDP growth to 2022. While growth unexpectedly slipped to 5.1%yoy in Q1'17, it should recover in the rest of the year thanks to strong growth in fixed investment and manufacturing. Next year should see GDP growth of around 6.3% from 6% this year.

A burgeoning export-manufacturing powerhouse Since joining the WTO in 2006, Vietnam has been at the centre of a major realignment of export manufacturing in Southeast Asia. In the space of a decade, its exports have risen from 30% of Thailand's to 82% in 2016. In part, that reflects a surge in foreign direct investment (FDI) into manufacturing, which has averaged some \$10bn a year since 2013. Low wages, a young and large workforce, and political and economic stability should continue to attract FDI. Manufacturing is expected to grow 10-11% in 2017 and 2018, around its average pace in the last two years.

Exports continue to surge in Q2'17 On the back of the synchronised global demand upturn and stronger demand for textiles, footwear, and electronics, exports (US\$ basis) surged 15.2%yoy in Q1'17, from 9.1% in full 2016. Q2'17 looks like being another strong quarter, with exports up an average 23.4%yoy in April-May. Conditions for farmers also appear to be improving, with rice exports surging 19%yoy in April and 81%yoy in May, following six months of declines. Meanwhile, imports surged 25.2%yoy in Q1'17, with purchases of machinery & parts and electronics up 35%yoy and 20%yoy respectively. Critically, Vietnam's export growth is now strong enough to cover the cost of surging imports of capital and consumer goods.

7-8% consumer spending growth With 50% of the population still under the age of 35 by 2025, and urbanisation expected to lift towards 40% by 2025 from 33.6% in 2015, Vietnam's consumer market is supported by favourable demographics. Together with low unemployment, rising disposable incomes, and upbeat consumer confidence, consumer demand should grow 7-8%pa in 2017 and 2018, a bit above its average pace in 2005-15. Passenger vehicle sales almost doubled to 159,000 units in 2016 from 79,000 in 2014, and by May, retail sales were up 12.2%yoy from 8.8% in full 2016.

Inflationary pressure to rise as the Dong softens Despite inflation easing to 3.2%yoy in May, we expect inflationary pressures to pick up in coming months, with average inflation of about 4%pa likely in 2017 and 2018 from 2.7% in 2016. The Dong, having slipped 1.2% on the greenback in 2016, has softened a further 1.1% so far this year. Rising inflationary pressure and weakening external surpluses should continue to put downward pressure on the Dong in 2017 and 2018.

	2014	2015	2016	2017	2018
GDP, real growth, %	6.0	6.7	6.2	6.1	6.3
CPI, yoy, % (2005=100 from 2007)	4.1	0.6	2.7	3.9	4.0
Central bank refinancing rate, year-end, %	6.50	6.50	6.50	6.50	6.50
Dong to US\$1, year average	21,148	21,677	21,932	22,496	23,203

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

India

Political & policy issues to watch

Rising criticism of PM Modi ... mostly valid, but misses India's political realities

On the eve of the keynote reform of his first term, introduction of the GST, PM Modi is drawing criticism for failure in two areas. First, he has done little to fix basic problems (such as rigid labour laws and poor land title – see a useful reform scorecard at [CSIS](#)), and the GST is so complex that its benefits will be minor and its implementation risks are high. Both charges carry weight. The first means that trend growth will be capped at 7%, while GST complexity brings the risk of volatile operating conditions from July 1. Yet, from a long-term investor perspective, Modi has achieved a lot given opposition to reforms in parliament's upper house, and the deals that had to be cut to win GST approval from India's 29 states. So, in evaluating India's potential it means accepting that the political framework limits policy, and thereby caps growth. The second criticism is that Modi is an authoritarian who caters to Hindu chauvinism. That charge also carries weight. Yet, local firms are aware of the associated Modi bandwagon effect, marked by rising adulation in the local media and a blizzard of government PR. The challenge for corporate strategy is picking when to hitch a ride on the bandwagon, and when to get out of its way.

Prepare for 18 months of GST muddle ... with modest gains

So far, 81% of firms registered under the old tax systems have completed GST Network (GSTN) registration, with small and medium firms (SMEs) given leeway to finish registration and to lodge their first returns. Registration for firms not previously covered started on June 25, and will likely take several years. When completed, it will shift the competitive framework in favour of larger firms that have always paid tax. Overall, taxes are expected to fall for manufacturers and rise for services firms. The short-term challenge for all firms will be balancing cash flow and tax obligations.

Steps to halt bad loans that have undermined growth

Apart from GST, a second policy thrust with a big impact in the next year is a government direction to the Reserve Bank of India (RBI) to clear a logjam of bad loans, mostly by state-owned banks, and mostly to a handful of firms, notably in the steel sector. In the first six months, the focus will be on just 12 large bad loans, while banks prepare action plans for another 35-40 accounts. This process looks like working, and should open the way to a gradual revival in bank lending and industrial growth from 2018.

Outlook for the market

Growth eases to 6% for two years ... as headwinds limit growth ... faster growth in services & bits of manufacturing and construction

Our GDP forecasts—6.1% this year and 5.8% next year—are lower than most, as we expect GST problems, a hangover from last November's demonetisation, and weak bank lending to trim growth (the IMF's April forecast puts growth at 7.2% in 2017 rising to 7.8% in 2018). The Q1'17 GDP result (we use calendar year), hints at the contending forces, with manufacturing real growth slumping to 5.3%yoy after two years at 9.8%, while construction fell by 3.7%yoy after two years at 4.2%. Growth in Q1 was supported by a 7.2%yoy lift in services and a strong 5.2%yoy rise for agriculture. Behind the slump in manufacturing and construction lies a lot of diversity, with some clients in both sectors reporting continued strong growth. Increased government infrastructure spending, good demand from India's urban middle class, and good demand from firms without excess debt helped strong performers in these two weak sectors. We expect the Q1 pattern to characterise most of the next two years, with growth rising above 7% from 2019 as manufacturing and construction recover. Near 6% growth is pretty good for India, and the dynamism that supports it is apparent in surging bond issuance, up 14%ytd at May and helping offset a weak 6.3%yoy lift in bank lending to businesses in April.

A briefly stronger Rupee on a weaker US\$

This month, we've amended our Rupee forecast in line with our swing to a sustained weaker US\$ forecast on its trade weighted index. Against a falling US\$, the Rupee has risen 5% so far this year. That could continue into 2018, before the Rupee's fundamental weakness reasserts itself.

<i>Calendar year starting January</i>	2014	2015	2016	2017	2018
GDP (MP, 2011-12), real growth, %	7.0	7.5	7.9	6.1	5.8
Inflation - CPI, %	6.7	4.9	5.0	3.4	4.6
RBI repo rate, December, %	8.00	6.75	6.25	6.25	6.75
Rupee to US\$1, year average	61.0	64.1	67.2	64.9	65.5

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

Snap elections are likely in mid-2018

Despite a three-year term, Australian governments can, and mostly do, call early elections. So, the 2019 election looks like being pulled forward to mid-2018, just two years after the July 2016 election. The aim is to avoid a logjam of fixed-date, state elections in late 2018 and early 2019, and to return to staggered half-senate polls after the 2016 double dissolution. The prospect of an early contest saw PM Malcolm Turnbull's government swing to an expansionary FY2017 budget (starting July 1), with the May budget speech stuffed with big spending initiatives on infrastructure, health, and education. While it was sufficiently prudent to keep Australia's "AAA" credit rating, it failed to lift the government's popularity, with the latest polling putting the opposition Labor party ahead at 53% to 47% on a two-party preferred basis. That's seen ex-PM Tony Abbott, who Turnbull toppled in a party room vote in 2015, step up his campaign to replace Turnbull before the election. Turmoil in leadership for recent Liberal and Labor governments has undermined policy development in major areas, lifting risk for companies and degrading long-term growth.

... and so is more leadership turmoil

A lucky but unhappy country

Despite 26 years of uninterrupted growth (a global record), Australia faces many of the challenges confronting other advanced markets. Employee compensation has fallen to 46% of GDP from a five-decade average of 50% due to record-low wage growth, and rising part-time work. That's contributed to a jump in household debt. Taken in combination, these trends have undermined consumer sentiment and spending, and contributed to rising voter discontent. As elsewhere, the main winner in this transition has been a rise in corporate profits to 25% of GDP from a five-decade average of 20%.

RISK – a housing bubble

The recent downgrade for Australia's largest banks by Moody's highlights the risk from a housing bubble, as 60% of bank loans are for residential property, while consumer debt now equals 189% of disposable income. Any significant rise in borrowing costs or fall in home prices would trigger a big fall in consumer demand. The safer path is for households to gradually deleverage. The numbers don't show that happening yet, but it is likely to start soon, and it will mean a mild but steady suppression of consumer demand.

Outlook for the market

We've cut our forecast as momentum ebbs

A recent recovery in mineral prices hasn't delivered faster growth, with the economy slowing to 1.7%yoy growth in Q1'17 from 2.5% for full 2016. We've cut our GDP growth forecast to 2.5% for 2017 and 2.6% for 2018 (from 3.0% and 2.8% respectively). Commodity prices and export growth have cooled in recent months, while housing construction, a key growth engine in the last few years, is losing steam.

Housing capex is set to fall

Falling mining investment (down 50.6% from a Q4'12 peak) and booming housing construction (up 28% from a Q2'12 trough) have combined to deliver a net 2.2% annual fall in capex over 2013-16. This year, capex growth should return at a weak 1% that lifts towards 2% in 2018, as the decline in mining investment ends, and housing construction turns down. We expect real housing capex to fall 1.7% in 2018, after its growth slows to 0.5% in 2017 from 8%pa over 2014-16. This would be in line with recent declines in dwelling approvals (-12.3%yoy in Q1'17 and -14.3%yoy in Q4'16).

... while the mining capex plunge halts

Consumers grapple with stalled incomes

Consumer demand grew roughly in line with GDP at 2.7%pa over 2014-16, despite weak wage growth (just 2.5%pa in nominal terms), and the rise of lower paying, part-time jobs. To compensate, households borrowed more and the savings ratio fell to 4.7% of income in Q1'17 from 10.1% in Q2'12. We expect consumption to grow at a slightly milder 2.4%pa pace in 2017 and 2018 from 2.6% in 2016.

No rate hike

... and a mostly stable A\$

A cooler housing market and weak wage growth will likely delay an interest rate hike by the RBA well into 2018. This is despite inflation rising to 2.1%yoy in Q1'17. Following a steep fall on the US\$ over 2013-15, the A\$ is now close to its 26-year trend value on the US\$. Without a major event to push it up or down (like a collapse or surge in commodity prices), it is expected to stay in a 0.73-0.78 range on the US\$, even as the US\$ weakens.

Year ending December 31

	2014	2015	2016	2017	2018
GDP, real growth, %	2.8	2.4	2.5	2.5	2.6
CPI, year average, %	2.5	1.5	1.3	2.1	2.3
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	1.32	1.29
US\$1 = A\$, year average	0.90	0.75	0.74	0.76	0.77

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

New Zealand

Political & policy issues to watch

The Nationals aim for a 4th term in the September elections PM Bill English aims to lead the Nationals to a rare fourth straight win in the September 23 elections. He'll be helped by a pro-growth budget for FY2017 (starting July 1) announced by Finance Minister Steven Joyce at the end of May. That saw opinion poll support for the government jump to 49% in June from 45% in May. Meanwhile, support for a potential Labour/Green alliance dropped to 39.5% from 42.5%. While not as popular as his predecessor, John Key, who unexpectedly stepped down last December, English is respected for good fiscal management as finance minister under Key. A surging economy is also in his favour, with buoyant consumer sentiment.

A generous budget that helps consumers & lifts civil works The budget raises the income thresholds at which higher rates of tax kick in, and increases support payments for low and middle-income families. It also lifts infrastructure spending by NZ\$11bn over the next four years, in areas such as roads, rail, prisons, schools, hospitals, and public housing. The aim is to support economic growth and relieve pressure on public services arising from NZ's rapid migrant intake. Net migration hit a record 71,932 in the year to March 2017 from just 2,542 in the year to March 2013. The new arrivals boosted consumption and housing demand, and ensured that adequate labour supply kept a lid on wage growth and inflation. The FY17 budget also pleased credit rating agencies, with Moody's praising NZ's strong public finances and a fall in gross public debt to 28% of GDP by 2018, much lower than the median debt of other Aaa-rated countries.

... yet also pays down public debt

Outlook for the market

Growth sticks at 3% GDP real growth is expected to continue at a firm 3% through to 2018, but with some big swings in underlying drivers. That was apparent in Q1'17, as a surge in import volumes and unexpectedly weak export volumes delivered a weak net trade result, which cut GDP growth to 2%yoy in Q1'17 from 3.6% in full 2016. Imports were strong, as domestic spending jumped 4.8%yoy in Q1 from 4.1% growth in full 2016. Weak export volumes for a second straight quarter is a downside risk we'll need to watch. The Q1 figures also revealed a slowdown in construction, which is likely to continue into 2018. As a result, we've cut our GDP forecast to 3% in both 2017 and 2018 from 3.6% and 3.5% respectively.

... as strong local demand offsets weaker exports

NZ's exuberant consumers Private consumption surged 5%yoy in Q1'17, its fastest pace since 2005. It was boosted by a high migrant intake, a strong labour market (employment rose 5.7%yoy in Q1'17 from 4.6% in full 2016), and a long-overdue, but still modest lift in wage growth to 2.3%yoy in 1Q'17 from 1.8% in full 2016. Record-low borrowing costs and the wealth effect of strong housing and stock markets also helped. We expect real growth in consumer demand of 4.4% in 2017 and 3.6% in 2018 from 4.1% in 2016. However, NZ's elevated of household debt—it hit a record 125% of GDP in Q1'17—needs watching.

... but watch for capex growth to ease

Capex grew 5.4% in Q1'17, roughly in line with its 2016 pace, as a 13.4%yoy surge in plant & equipment spending helped offset the impact of slower construction activity. Housing capex growth eased to 4%yoy in Q1 from 11% in 2016, while non-housing capex fell 0.3%yoy after a 12% lift in 2016. Forward-looking indicators, such as construction permits and housing transactions, are trending down, foreshadowing weaker construction ahead. We expect capex growth to ease to 4.5% in 2017 and 2% in 2018, from 5.5% in 2016.

No rate hike in 2017

Even though inflation rose to 2.2%yoy in Q1'17 from 0.6% in 2016, the RBNZ is comfortable with its current monetary settings. That's good news for households, given the high consumer debt levels. For the last 26 years, the NZ\$ has seen a mild trend rise on the US\$, so even though the interest rate differential is moving against NZ as the US Fed lifts its policy rate, the NZ\$ is expected to remain stable on a US\$ that has entered a weaker phase. That should keep the NZ\$ within its current trading range of 0.64-0.74.

... and a steady NZ\$

Calendar years	2014	2015	2016	2017	2018
GDP(Expenditure), real growth, %	2.8	3.2	3.6	3.0	3.0
GDP(Production), real growth, %	3.8	2.4	3.1	3.1	3.0
CPI, year average, %	1.2	0.3	0.6	2.4	3.0
Official cash rate, year end, %	3.50	2.50	1.75	1.75	2.25
NZ\$1 = US\$, year average	0.83	0.70	0.70	0.71	0.68
US\$1 = NZ\$, year average	1.20	1.43	1.43	1.42	1.48
NZ\$1 = A\$, year average	1.09	1.07	1.07	1.07	1.14

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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